Current Focus

November 2017

A monthly market comment from Rivers Capital Management. Views expressed here are subject to change and for professional advisors only

RIVERS CAPITAL MANAGEMENT

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Summary

- Bank of England decision to raise rates adds to challenges already facing the UK
- Modest interest rate change unlikely to boost sterling and weakens growth potential
- UK economic growth remains slow despite robust global recovery
- Rivers portfolios remain underweight risk assets in order to protect long term value

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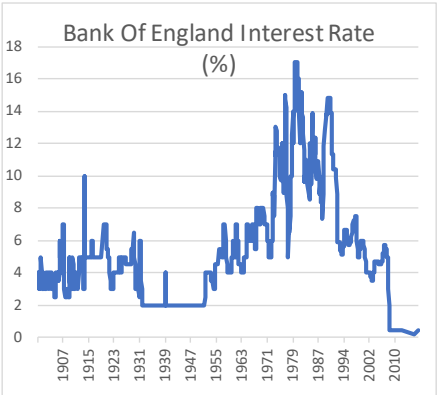
Market Comment

October was another good month for investors. Nearly all developed and emerging market 'Enhancer' assets held within portfolios provided positive performance. The US equity market, led primarily by technology, continued to set new highs despite concerns about valuations. Within 'Anchor' assets, returns were modest, but generally positive while 'Diversifiers', especially energy added value. Investment portfolios generally recovered modest losses from September and benefited from exposure across many different asset classes. Global economic data remained positive boosting investor confidence.

Our concern remains that valuations are extended in both bond and equity assets, which makes risk expensive. Although this could continue for some time it will not last forever and as a result we continue to recommend a cautious stance. That said without an identified catalyst, there is little indication that markets are poised for an imminent correction. From the perspective of global investing that catalyst is unlikely to come solely from the UK, but given recent news flow and what we consider a curious decision by the Bank of England, that is where our Current Focus will be this month.

As readers will be aware, on 2nd November the Bank of England raised the short-term interest rate in the UK for the first time in 10 years. The Bank was keen to message that this was not the start of a cycle of interest rate rises and that the rise was only from the all-time low of 0.25% to the previous all-time low of 0.5%. At best we think the raise will go largely unnoticed and have negligible effect on lending rates but on balance we think this could be a policy error that will further damage the UK economy at a time it is vulnerable despite accelerating global growth. What is already apparent is that it will have very little positive effect for savers or the strength of the pound.

The justification for the interest rate change was given as inflation, which has recently increased to around 3% in the UK, but it is difficult to understand, as a one-off, how this will help. Domestic inflation is high, but it is import costs, and not demand, that has driven prices



Source: Bank of England

higher. Specifically, current inflation has been caused directly by increased import prices because of the devaluation of sterling since the EU referendum result last year. This effect should, and is likely to, be temporary. Provided it does not result in a significant rise in wages, which so far it has not, the objective of the Bank of England could only be to stem further currency depreciation. If that was indeed the objective the resulting depreciation of sterling that followed the announcement cannot have been welcome. Long term currency value is related to economic growth more than anything else and it is difficult to understand how this interest rate change can help that.

Interestingly, the latest evidence suggests that the economy has picked up some pace in the second half of the year, but benefitted only marginally from accelerating global growth. Quarterly GDP growth did edge up from 0.3% in Q2 to 0.4% in Q3, but it hardly appears cause for monetary prudence. October's Markit/CIPS all-sector Purchasing Managers Index (PMI) did point to a further pick-up to about 0.5% in Q4 but this was calculated before the interest rate decision. The reality is that UK GDP growth is positive but remains low. While in the US rates are rising on the back of rising confidence and robust growth, in the UK confidence and productivity are weak and lag much of the world. The lack of wage growth in the face of recent inflation is likely to continue to depress retail sales and any increase to the cost to mortgages will exacerbate this effect. With Brexit the UK faces an issue most of the world does not and the government hardly appears well placed to provide fiscal stimulus to offset any monetary tightening. Governor Carney

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suggested this is time to 'lift a foot off the accelerator'. Within the UK we suggest that this is not the time to do so.

With a global focused economic outlook for investors we have always held a lower than typical strategic exposure to UK assets in the portfolios we manage. The UK stock market is diversified and benefits more than most from global exposure and non-sterling revenue, but our outlook for UK domestic growth has not improved with this interest rate change. One its own the effect on growth is likely to be small added to all the other headwinds currently facing the UK economy it is unwelcomed. Hopefully, as the Bank of England was at pains to explain, this will not materially affect consumer demand, but it is difficult to imagine how this improves any outlook.

We continue to hold an underweight tactical allocation to the UK even within the overall defensive risk underweight we have adopted since the summer. Valuations remain high everywhere, but are relatively more attractive in Europe and Asia. We continue to remain generally underweight risk and overweight passive investments into the last part of 2017, with a view to adding risk at a more attractive valuation at some future point, thereby reducing volatility and enhancing long term returns.

Market Returns (£) - 31st October 2017	1 Month	3 Month	6 Month	YTD	1 Year	S/I*
Anchors						Jun-16
Cash + 1%	0.1%	0.3%	0.7%	1.1%	1.3%	0.5%
Inflation Linked UK Bonds	1.0%	0.2%	-1.1%	-1.7%	-5.0%	9.2%
Gilts	0.3%	-0.4%	-1.7%	0.1%	0.7%	-1.8%
Global Government Bonds (hedged)	0.3%	0.5%	0.5%	0.9%	-0.6%	-1.6%
Enhancers						
Global Corporate Bonds (hedged)	0.5%	0.9%	2.3%	4.2%	2.7%	0.8%
Global High Yield (hedged)	0.6%	1.6%	3.1%	7.3%	8.0%	5.3%
Emerging Market Bonds (hedged)	-2.1%	-2.6%	0.6%	4.0%	-2.5%	12.1%
FTSE 350 TR Index	1.9%	2.8%	5.9%	9.5%	13.1%	8.3%
FTSE UK All-Small Cap	2.3%	3.1%	7.2%	16.4%	21.0%	12.4%
Global Equity (MSCI)	2.9%	3.6%	6.7%	10.0%	12.9%	12.6%
European Equity (MSCI)	1.5%	3.1%	8.0%	14.5%	16.7%	11.8%
US Equity (S&P)	3.4%	3.9%	6.0%	8.3%	13.0%	11.4%
Japan Equity (Topix)	5.5%	6.2%	11.3%	13.3%	10.1%	20.6%
Pacific Ex Japan Equity (MSCI)	5.5%	5.6%	16.2%	28.1%	20.8%	19.2%
Emerging Market Equity (MSCI)	4.6%	4.6%	13.1%	23.1%	16.3%	19.7%
Chinese Equity (Hang Sang)	3.8%	3.9%	15.0%	23.2%	17.0%	21.9%
Indian Equity (Nifty)	7.6%	0.9%	7.5%	23.1%	13.0%	15.7%
Diversifiers						
Commodity Index	2.1%	2.1%	2.5%	-1.6%	1.3%	-4.6%
Gold	0.0%	-0.7%	-2.7%	2.0%	-9.0%	5.1%
Silver	1.2%	-1.5%	-6.2%	-3.8%	-15.1%	4.1%
Brent Oil	7.3%	15.6%	14.9%	0.3%	17.4%	5.1%
UK Property	1.3%	2.2%	3.9%	6.6%	8.1%	-0.5%
Global Property Shares	-0.1%	-1.6%	-2.5%	4.0%	9.9%	-0.2%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*0.7%*	*1.7%*	*1.8%*	*3.2%*	*3.5%*	5.2%
Rivers Cautious Portfolio	*1.3%*	*2.3%*	*2.9%*	*5.6%*	*6.1%*	8.0%
Rivers Balanced Portfolio	*1.7%*	*2.7%*	*3.5%*	*7.0%*	*7.3%*	9.8%
Rivers Adventurous Portfolio	*1.6%*	*2.4%*	*3.2%*	*7.6%*	*8.3%*	10.5%
Rivers Aggressive Portfolio	*2.5%*	*3.2%*	*5.1%*	*11.0%*	*11.9%*	12.0%
Rivers Cautious Income Portfolio	*0.7%*	*0.5%*	*1.3%*	*3.6%*	*3.3%*	4.4%
Rivers Balanced Income Portfolio	*0.9%*	*0.7%*	*2.1%*	*5.6%*	*5.3%*	7.6%

Source: Financial Express in GBP (unhedged unless stated) as at 31st October 2017. *Rivers Portfolios since launch June 30th 2016

Model Performance is indicative only and is net of Rivers Capital Management Charge and Underlying Fund charge but not advisor or platform costs.