Current Focus

February 2018

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

- A strong start for equities in 2018 masked concerns over rising rates
- Low unemployment and strong global economic growth is expected to continue
- The equity sell off which started in late January offers opportunity to increase risk
- While valuations remain high we do not expect a sustained correction or bear market

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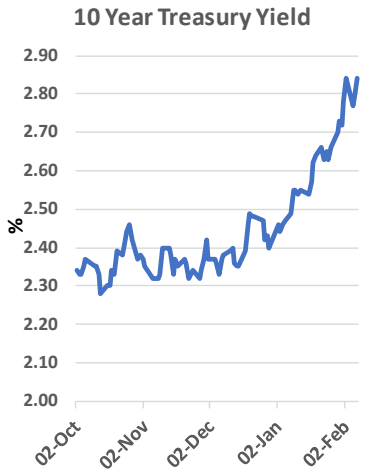
Market Comment

2018 started with new highs in global equity markets and surging investor confidence. The story for investors, and especially sterling denominated investors, was slightly more mixed. And that was before the sell-off that kicked off February. In January global equity markets did see strong gains in local terms but an increase in the value of sterling, especially against the US Dollar, impacted returns and saw domestic UK equity prices retreat. In the last few trading sessions of January and the first few of February a significant shift in mood saw risk assets go into retreat and reverse nearly all gains. In this month's Focus we consider the causes of the sell-off. We also consider whether this is the valuation correction we had been expecting, whether it is a temporary setback in a continuing bull market or whether it is just indicative of underlying issues that are ongoing?

The reason for the sell-off has been attributed to Janet Yellen's comments that "price-earnings ratios are near the high end of their historical ranges." This may have been a catalyst, but we think high valuations, even if acknowledged by the chairman of the Federal Reserve, were not solely responsible. What is, we believe, is the combined concerns of rising rates, rising inflation, government borrowing and rising wages that together eventually stalled a buoyant equity market. These underlying concerns have not been resolved and while some steam has been let off from an overheated market, these issues remain.

The sell-off started in the interest rate markets, resembling a mini-version of the 2013 taper tantrum that followed the announcement by then Chairmen Ben Bernanke that interest rates may, eventually rise. US treasury yields, and UK Gilt yields to some extent, have been moving up since the end of last year due to increasing inflation fears, with the 10-year US yield selling off from 2.4% to reach 2.8% by the end of January. A strong US manufacturing report and another on prices, followed the next day by wage numbers, that were also ahead of consensus, spooked the market. Ultimately the February 1st



Source: US Treasury

intra-day high of 2.88% on the US 10 year, its highest level in 4 years, finally resulted in the fixed income market sell-off spreading to the confident equity market.

Rising long term borrowing rates have the double effect of increasing corporate costs and increasing the discount rate on future earnings. Add to that rising wage expectations and full employment and the only surprise to us is that it took so long. As is so often the case the US equity market was first and sold off aggressively (followed by global indices), as traders feared that higher rates would negatively impact economic growth. The capitulation towards the end of trading on Monday February 5th, which saw the Dow Jones lose over 800 points in a matter of minutes, has been attributed in some quarters to algorithmic trading strategies and commodity trading advisers but, apart from briefly overnight in Asia, the sell-off was reasonably controlled. Volatility rose sharply but from an extremely low, perhaps artificially low, level.

In the day following the sharpest falls for over 2 years the markets rebounded modestly and appeared to settle at about 5% lower than the early January highs, no longer down for the year. In the history of investing this can barely be defined as a correction. The point is though that we see little evidence that the pressures that led to higher yields and a subsequent sell-off are abating. The Central Banks of Europe and Japan

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have begun the process of reducing their aggressive quantitative easing programs so a major anchor on long term yields is being removed. The new Federal Reserve Chairmen, Powell, is set to make his first speech in February but with low unemployment, rising wages and a material fiscal stimulus resulting from tax cuts, it is difficult to imagine him not sticking to Yellen's rate raising intentions. In fact, many would argue that he may have to do more if economic growth continues to accelerate.

What is true is that compared to last month, valuations are now moderately more attractive and the opportunity to decrease our current underweight risk position does appear to be close. In the coming month, and provided some stability can be found, we are likely to see a tactical opportunistic reallocation to equity risk and a further reduction in interest rate exposure. For the time being we expect to remain at least moderately underweight risk. Increased volatility may have made investment more interesting than it has appeared in the last few months. It has certainly made it more challenging.

Market Returns (£) - 31st Jan 2018	1 Month	3 Month	6 Month	YTD	1 Year	S/I*
Anchors						Jun-16
Cash + 1%	0.1%	0.4%	0.7%	0.1%	1.4%	2.2%
Inflation Linked UK Bonds	-3.8%	-2.8%	-2.6%	-3.8%	-3.9%	0.9%
Gilts	-2.2%	-0.4%	-0.8%	-2.2%	1.6%	-1.5%
Global Government Bonds (hedged)	-0.7%	-0.6%	-0.1%	-0.7%	1.1%	-2.7%
Enhancers						
Global Corporate Bonds (hedged)	-0.7%	-0.4%	0.5%	-0.7%	3.8%	3.1%
Global High Yield (hedged)	0.4%	0.3%	1.9%	0.4%	6.2%	14.0%
Emerging Market Bonds (hedged)	-0.3%	0.9%	-1.7%	-0.3%	3.9%	10.3%
FTSE 350 TR Index	-2.1%	0.5%	2.2%	-2.1%	7.0%	17.2%
FTSE UK All-Small Cap	-0.1%	1.3%	3.7%	-0.1%	13.6%	32.7%
Global Equity (MSCI)	0.1%	1.5%	4.6%	0.1%	9.2%	25.9%
European Equity (MSCI)	0.4%	0.1%	2.8%	0.4%	11.6%	26.4%
US Equity (S&P)	0.5%	2.4%	6.0%	0.5%	9.6%	26.5%
Japan Equity (Topix)	-0.8%	1.1%	6.5%	-0.8%	10.1%	30.3%
Pacific Ex Japan Equity (MSCI)	2.7%	3.9%	9.2%	2.7%	24.9%	45.0%
Emerging Market Equity (MSCI)	3.0%	4.7%	9.1%	3.0%	22.1%	41.4%
Chinese Equity (Hang Sang)	4.5%	8.5%	11.4%	4.5%	23.2%	47.5%
Indian Equity (Nifty)	0.0%	1.5%	2.3%	0.0%	21.6%	32.7%
Diversifiers						
Commodity Index	1.8%	4.1%	6.3%	1.8%	2.4%	0.6%
Gold	-2.4%	-1.3%	-2.2%	-2.4%	-1.9%	-4.4%
Silver	-4.3%	-3.6%	-4.8%	-4.3%	-13.1%	-13.0%
Brent Oil	-1.3%	5.6%	22.1%	-1.3%	8.9%	31.0%
UK Property	0.5%	1.5%	3.7%	0.5%	7.7%	9.1%
Global Property Shares	-3.1%	4.6%	1.9%	-3.1%	10.3%	9.5%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*-0.11%*	*0.20%*	*1.87%*	*-0.11%*	*3.58%*	9.11%
Rivers Cautious Portfolio	*-0.01%*	*0.45%*	*2.81%*	*-0.01%*	*5.60%*	15.03%
Rivers Balanced Portfolio	*-0.04%*	*0.78%*	*3.54%*	*-0.04%*	*7.05%*	18.70%
Rivers Adventurous Portfolio	*-0.19%*	*0.81%*	*3.20%*	*-0.19%*	*7.23%*	20.67%
Rivers Aggressive Portfolio	*-0.01%*	*1.09%*	*4.36%*	*-0.01%*	*10.34%*	26.70%
Rivers Cautious Income Portfolio	*-0.51%*	*-0.21%*	*0.30%*	*-0.51%*	*3.04%*	7.64%
Rivers Balanced Income Portfolio	*-0.33%*	*0.21%*	*0.98%*	*-0.33%*	*4.96%*	13.54%

Source: Financial Express in GBP (unhedged unless stated) as at 31st January 2018. *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.