Current Focus

June 2018

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

RIVERS CAPITAL MANAGEMENT

INTELLIGENT INTUITIVE INVESTING

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Summary

- FTSE returns have been boosted by sterling depreciation
- Interest rate expecations continue to fall for UK due to subdued economic growth
- UK equities now at similar valuations to international alternatives
- Portfolios remain modestly underweight risk going into summer period

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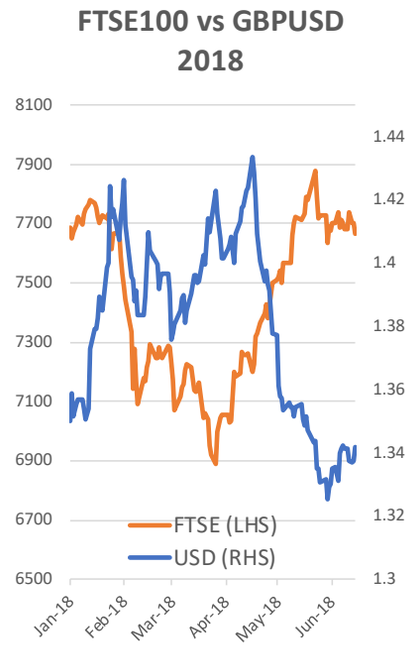
Market Comment

May saw positive returns for most sterling investors as the pound depreciated and the FTSE rallied to near record highs. With the exception of the US, most international equity indices lost value in local terms during June, but the marked depreciation of sterling translated most of these losses to gains for UK investors.

In this month's Focus we look at recent sterling depreciation, the causes for it, it's effect on the UK Equity market and how our expectations for both are likely to affect our tactical asset allocation decisions going forward. We also consider, in light of the increase in risk exposure that we implemented at the end of March, why we think the next tactical adjustment is more likely to reduce risk rather than increase it.

When it comes to investing, it is always easier looking backwards than forwards. Even then it is not always easy to explain why currency exchange rates fluctuate as they do. The recent depreciation of sterling is in part attributed to the expectation of UK interest rates falling, especially against the US Dollar. It may also be related to the general confusion surrounding Brexit and problems further afield in Italy but we think the biggest contributor was conjecture around interest rates. As we discussed last month, between February and the end of April the expectations of a May increase in interest rates from the Bank of England fell markedly. While the market does not yet agree with our prediction of no UK base rate rises at all this year, all forecasts had been revised significantly by the time the Bank of England announced no-change on May 10th.

Given that the main reason for falling UK interest rates expectations is slower economic growth, stagnant real wage growth despite full employment, and an apparently collapsing retail sector it is possibly surprising that over the same period the UK Equity market has rallied to near record highs. The reason can be attributed primarily to exogenous factors, and if anything, confirms the international status of many of the FTSE's constituents. The reality is that the dire state of retail in the UK and the continued shenanigans around the final Brexit deal will likely have a material effect on economic growth in the UK but these are mitigated



Source: RCM

by the fact that 70% of FTSE 100 earnings are coming from abroad coupled with a rising oil price. Global growth remains fairly robust and if earnings are boosted in sterling terms then it will be reflected in the equity value, as it has been so far this year. The real question is whether the equity rally will continue and if it does, will that require further devaluation for sterling?

While we would expect the negative correlation between sterling value and UK equities to continue, we are not foolish enough to make short term currency predictions. Even if interest rates fall there is no certainty the currency will do the same, just a higher probability. Beyond currency factors it is difficult to see how the UK equity market will maintain its outperformance. Our investment approach takes a global focus, so when we added risk at the end of March we thought first that Enhancer assets were generally more attractively priced globally than they had been. We also believed that on a relative basis, the UK market was more attractive than many alternatives. What we can say now is that Enhancers are less attractively priced and that the UK is currently trading at a similar relative valuation to other international indices.

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We do not however believe the changes, either generally or specifically in the UK, are sufficient to warrant a rebalance.

To put this in perspective when we added risk to all portfolios at the end of March we reduced our underweight in risk. In general we added Enhancer assets and decreased the exposure to Anchors across our portfolios. At the time we did not believe that the market was attractive enough, from a valuation perspective, to move to a neutral, let alone an overweight risk position, but it did justify lowering our underweight risk position. The rally that has occurred since the end of March has served to increase valuations, as there have actually been few material changes in earnings or economic indicators. Should valuations increase further we will be minded to reduce overall risk again and move to a more defensive allocation. Similarly should valuations improve, as prices fall or earnings grow, we will likely add further risk and for the first time this year maintain a strategic, or neutral, allocation. High valuations in equities can be sustained for a long period of time but taking into account the elevated level of geo-political risk, especially with regard to trade relations, we prefer to maintain a generally prudent investment approach. This is why we now expect our next rebalance to be risk reducing but we maintain a view that, after some period of correction the opportunity to move to a neutral or overweight allocation will come before the end of the year.

Market Returns (£) - 31st May 2018	1 Month	3 Month	6 Month	YTD	1 Year	S/I*
Anchors						
Cash + 1%	0.1%	0.4%	0.8%	0.7%	1.5%	2.8%
Inflation Linked UK Bonds	2.2%	2.5%	1.3%	0.0%	-0.5%	4.9%
Gilts	1.8%	2.9%	2.5%	0.8%	0.5%	1.6%
Global Government Bonds (hedged)	0.1%	0.6%	-0.1%	-0.1%	0.2%	-2.1%
Enhancers						
Global Corporate Bonds (hedged)	0.2%	-0.4%	-1.7%	-2.2%	-0.5%	1.6%
Global High Yield (hedged)	-1.0%	-1.4%	-1.9%	-2.1%	0.0%	11.1%
Emerging Market Bonds (hedged)	-2.2%	-4.4%	-1.1%	-2.6%	-2.5%	7.7%
FTSE 350 TR Index	2.8%	7.5%	6.8%	1.9%	6.5%	28.6%
FTSE UK All-Small Cap	1.6%	4.8%	4.3%	1.7%	8.3%	40.8%
Global Equity (MSCI)	4.2%	3.1%	3.6%	2.2%	8.2%	32.0%
European Equity (MSCI)	0.0%	1.2%	0.5%	-1.2%	1.8%	28.9%
US Equity (S&P)	5.9%	3.6%	4.6%	3.5%	10.3%	33.1%
Japan Equity (Topix)	2.4%	1.4%	3.3%	2.3%	12.4%	38.6%
Pacific Ex Japan Equity (MSCI)	2.4%	1.5%	5.1%	2.5%	15.1%	49.5%
Emerging Market Equity (MSCI)	-0.2%	-2.4%	2.6%	-1.0%	10.6%	40.3%
Chinese Equity (Hang Sang)	3.1%	3.0%	7.0%	4.4%	19.1%	54.6%
Indian Equity (Nifty)	2.6%	2.7%	2.7%	-1.4%	5.1%	33.3%
Diversifiers						
Commodity Index	1.3%	3.1%	5.9%	2.9%	9.5%	1.8%
Gold	2.1%	2.0%	3.5%	0.7%	-1.6%	-2.7%
Silver	4.0%	3.9%	1.5%	-2.6%	-9.3%	-13.5%
Brent Oil	7.1%	22.4%	23.8%	18.5%	50.6%	57.2%
UK Property	0.3%	1.6%	3.3%	2.4%	7.0%	11.1%
Global Property Shares	-0.5%	8.9%	8.7%	0.4%	6.6%	19.5%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*0.6%*	*0.8%*	*0.9%*	*0.5%*	*2.5%*	9.8%
Rivers Cautious Portfolio	*1.2%*	*1.5%*	*1.5%*	*0.8%*	*3.6%*	16.0%
Rivers Balanced Portfolio	*1.8%*	*2.5%*	*2.5%*	*1.4%*	*4.8%*	20.4%
Rivers Adventurous Portfolio	*2.0%*	*2.6%*	*2.6%*	*1.3%*	*4.3%*	22.5%
Rivers Aggressive Portfolio	*2.3%*	*2.9%*	*2.8%*	*1.2%*	*5.6%*	28.3%
Rivers Cautious Income Portfolio	*0.6%*	*1.6%*	*0.6%*	*0.0%*	*0.3%*	8.2%
Rivers Balanced Income Portfolio	*1.2%*	*2.6%*	*1.7%*	*0.9%*	*2.1%*	14.9%

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