Current Focus

September 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

Market Comment

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Summary

- The Chequers plan will not be supported by parliament even if it is accepted by the EU
- The default No-Deal scenario will also be averted by new legislation
- Brexit uncertainty will continue beyond March 2019
- An extension is prefered to another Referendum or General Election
- The Rivers portfolios will reduce overall risk exposure in the coming weeks

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In the UK the newspaper headlines continued to be dominated by Brexit, and rightly so. Brexit is potentially the biggest constitutional change in the UK for at least a generation. We have avoided any focus on it here because a) it is to do with politics and not investments directly, and b) it is political and should be commented on only from a neutral perspective. However, with just 7 months to go we can resist no longer and the material impact for sterling will affect all investors. This month we focus on the likely outcomes for Brexit and explain why neither Theresa May's 'Chequers' proposal, nor the feared 'No-Deal' scenario, may happen next year. We expect Brexit to be delayed and we think sterling will, eventually, appreciate as a result.

It is now 26 months since the referendum in June 2016 where a small majority of British citizens voted to leave the European Union. In that time parliament has implemented Article 50 of the Lisbon Treaty which gives any EU member state the right to quit unilaterally. Article 50 states that two years after implementation, that member will leave the EU, with or without a trade deal with the other members. It states that it can't be stopped "except by unanimous consent of all member states". That final point is clear and while it sounds daunting there is little doubt that consent would be given should the UK request it. Due to that ambiguity the UK Parliament did add the date, March 29th 2019, to the EU Withdrawal Bill in an attempt to remove any doubt regarding the timing. None of this should be news to anyone, but with less than 7 months to go until that, date it remains unclear exactly what will actually happen on the transition day. With both 'Remoaners' and 'Brexiteers' blaming each other we shall consider the two most publicised outcomes – "Chequers" and "No-Deal" and explain why they are both equally unlikely to happen.

"Chequers" was a three-page government statement regarding a proposed future trading relationship between the EU and the UK. On the face of it, the deal was touted as being agreed to by the whole government with much fanfare, but within a week the Foreign Secretary and the Brexit Minister had resigned and were briefing against it. They, and other Eurosceptic MPs claimed that Chequers was almost worse than remaining and that "No-Deal is better than

the Chequers deal". Since then we have had the intervening parliamentary summer break and scant progress as a result.

Despite all the rhetoric from both sides in this debate, the outcome depends on two realities; the first reality is that any departure from the EU needs to be acceptable to the UK Parliament. Importantly this includes 'No-Deal'. The second reality is that any Deal with the EU regarding departure has to be acceptable both to the EU and to the UK Parliament. It is becoming clear that these two facts will prevent either No-Deal or Chequers ever happening.

The first reality is often understated but it is ultimately a constitutional fact that cannot be ignored. How it plays out will come down to parliamentary arithmetic. The number of MPs who back a no-deal exit from the EU is not nearly enough to stop the legislation that is required to prevent it. When time is running out a law would be needed to prevent the hastily changed EU Withdrawal Bill enacting no-deal. If the Government doesn't do it themselves, the opposition could, through an Opposition Bill, or as they did in November, using the ancient tactic of a 'Humble Address'. Even if the government tried to stop this and enforce a No-Deal (which seems unlikely) it would only need about 20 tory rebels to ensure it passed. This may mean the end of Theresa May as Prime Minister but it would not change the result. With parliamentary approval the consent of the 27 EU member states would be a formality. This would at least provide the opportunity to agree a different deal with the EU, perhaps the much maligned 'Canada Plus plus', but that would be next year's predicament.

We do think more time will be needed though as, looking again at the parliamentary arithmetic, the 'Chequers Deal' won't

get the required MPs support. Even if the current proposal garners the required EU support, which is unlikely, there are already a number of Eurosceptic Conservative members who have said they won't support it. After the probable dilution of that by the EU it seems even more unlikely. The only possibly way to get it through would be with wide opposition support. Given that no self-respecting parliamentarian would support a government so clearly on the ropes, that also seems unlikely.

In order to gain a democratic mandate for 'Chequers', or any other proposal, it is possible that the PM gives in to pressure and offers the 'second referendum' or 'people's vote' on the deal but that seems impossible in the time remaining. The political mess if that referendum were lost would require many more than the 1000 words we have available here. We think an extension from March 2019 seems much more likely.

If we are right and an extension does happen, or even if the possibility of a no-deal is removed, it is likely that sterling will rally significantly. We try to avoid making currency predictions but given valuations around the world, sterling strength would heighten our wish to decrease risk and unhedge Enhancer Exposure. As with many things in Europe it is likely that any Brexit negotiation is taken to, and slightly beyond, the deadline but it seems inconceivable to us that a new deal, or a no-deal, will be accepted within the time. Add to this the fact that the US equity market broke all time records during August, trade wars continue and the stuttering of emerging markets and there are more global reasons why the next rebalance of Rivers portfolios will be to decrease risk. By mid-September we expect to rebalance all discretionary Rivers portfolios from Risk Level 3 (out of 7) to Risk Level 2.

Market Returns (£) - 31st Aug 2018	1 Month	3 Month	6 Month	YTD	1 Year	S/I*
Anchors						
Cash + 1%	0.2%	0.4%	0.9%	1.1%	1.6%	3.2%
Inflation Linked UK Bonds	0.4%	1.4%	3.9%	1.4%	-1.3%	6.3%
Gilts	0.2%	-0.8%	2.0%	0.0%	-0.5%	0.8%
Global Government Bonds (hedged)	0.0%	-0.1%	0.5%	-0.2%	-0.5%	-2.3%
Enhancers						
Global Corporate Bonds (hedged)	0.3%	0.4%	0.0%	-1.9%	-1.3%	1.9%
Global High Yield (hedged)	-1.0%	-0.1%	-1.5%	-2.2%	-1.3%	11.0%
Emerging Market Bonds (hedged)	-5.5%	-4.6%	-8.7%	-7.1%	-11.8%	2.8%
FTSE 350 TR Index	-2.9%	-1.7%	5.7%	0.1%	4.7%	26.4%
FTSE UK All-Small Cap	-0.3%	-0.6%	4.2%	1.1%	5.6%	40.0%
Global Equity (MSCI)	2.2%	6.8%	10.1%	9.1%	12.1%	41.0%
European Equity (MSCI)	-2.1%	2.0%	3.2%	0.8%	1.3%	31.5%
US Equity (S&P)	4.1%	10.2%	14.1%	14.0%	18.0%	46.6%
Japan Equity (Topix)	0.9%	-0.2%	1.3%	2.2%	7.8%	38.4%
Pacific Ex Japan Equity (MSCI)	-0.3%	-3.9%	-2.5%	-1.6%	1.4%	43.6%
Emerging Market Equity (MSCI)	-1.8%	-2.4%	-4.8%	-3.4%	-1.5%	36.9%
Chinese Equity (Hang Sang)	-1.2%	-4.8%	-1.9%	-0.6%	2.0%	47.2%
Indian Equity (Nifty)	0.5%	6.6%	9.5%	5.1%	6.7%	42.1%
Diversifiers						
Commodity Index	-1.9%	-7.7%	-4.9%	-5.0%	-1.0%	-6.1%
Gold	-1.1%	-5.7%	-3.8%	-5.0%	-10.3%	-8.3%
Silver	-6.0%	-10.0%	-6.5%	-12.4%	-18.7%	-22.2%
Brent Oil	5.3%	2.4%	25.3%	21.3%	47.2%	61.0%
UK Property	0.1%	1.0%	2.6%	3.4%	6.2%	12.2%
Global Property Shares	-2.0%	-2.1%	6.6%	-1.7%	5.0%	17.0%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*0.0%*	*-0.2%*	*0.6%*	*0.3%*	*1.1%*	9.6%
Rivers Cautious Portfolio	*0.4%*	*1.2%*	*2.7%*	*2.0%*	*3.4%*	17.3%
Rivers Balanced Portfolio	*0.8%*	*2.1%*	*4.6%*	*3.5%*	*5.5%*	22.9%
Rivers Adventurous Portfolio	*0.8%*	*2.4%*	*5.0%*	*3.7%*	*5.7%*	25.4%
Rivers Aggressive Portfolio	*0.7%*	*2.7%*	*5.6%*	*4.0%*	*6.6%*	31.7%
Rivers Cautious Income Portfolio	*-0.3%*	*0.7%*	*2.4%*	*0.7%*	*0.9%*	9.0%
Rivers Balanced Income Portfolio	*-0.6%*	*0.5%*	*3.1%*	*1.4%*	*2.3%*	15.5%

Source: Financial Express in GBP (unhedged unless stated) as at 31st August 2018. *Rivers Portfolios since launch July 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.