Current Focus

December 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

- Progress on Brexit made impossible with Parliamentary arithmetic
- UK direct exposure is low but effect of changing sterling value remains significant
- Global risk remain elevated as UK remains distracted by Brexit
- Rivers Portfolios finish 2018 moderately underweight risk
- We expect more volatility but reasonable opportunity during 2019

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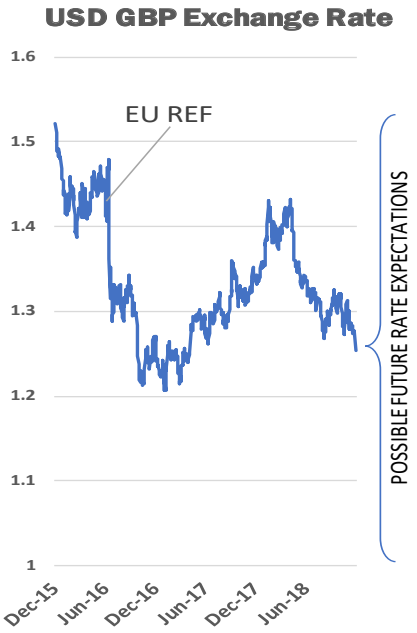
We delayed our final Current Focus article deliberately this month, perhaps naively thinking that awaiting the result of possibly the most critical parliamentary vote this century, was justified. To be honest we hadn't thought Prime Minister May's 'deal' would pass, but had thought our interpretation of the result would be interesting to our clients. It would, at least, have given us a sense of timing for the completion of Brexit. That was clearly too much to ask for. With the unannounced delay and the imminent festive season it now looks likely it will be 2019 before anything is returned for parliamentary approval.

This matters because, even as global investors, the UK is a significant allocation within most of the portfolios we advise on. We have historically ensured our overall UK direct exposure remains below 20% of the overall portfolios (excluding cash). Given the uncertainty regarding Brexit we have further limited UK direct allocations, but given the portfolios are denominated in sterling, the impact on overall portfolio valuation is significant. For non-sterling Enhancer assets we assume long term returns do not require additional currency risk management, but the effect of this on overall returns can be material. Since the referendum of 2016 many global portfolio returns have been boosted by the devaluation of Sterling. This boost has been welcomed, especially as domestic assets have underperformed, but it is a trend that cannot be sustainable. While we are reluctant to protect portfolios in the current environment any reversal (Sterling strength) would impact client portfolios, in sterling terms, significantly

In dollar terms Sterling is currently hovering at an exchange rate somewhere between 1.25 and 1.30. From here the exchange rate is expected to move either sharply down (the amount of dollars a pound buys falls) in the event of a 'no-deal' scenario or sharply up in the even of a 'no Brexit' scenario. Given the pre referendum exchange rate was around 1.5 USD it is not inconceivable that it could return there. The benefits or costs of Brexit will depend on an individual's point of view, like everything regarding Brexit, but its material effect on currency value does make it challenging for those of us trying to manage portfolio risk.

For what it is worth our view on Brexit remains unchanged from September. None



Source: Rivers Capital Management

of the current proposals being offered by Europe have both the support of government and of parliament. Europe may change its stance at the last minute (but given Europe has ruled that the UK can reverse Brexit unilaterally they have rather put that on the UK). We think this stalemate will continue. Theresa May's delay was to avoid an obvious and potentially fatal government defeat, but unless something surprising happens nothing has changed. Whatever is agreed by her or Europe it is unlikely to change the parliamentary arithmetic and ultimately, Brexit negotiations are set for an extension.

What has changed in our view is the likelihood of 'no deal'. If anything, and despite it being the default position, the delay and the amendments to the European Withdrawal bill which were passed on December 6th now make a 'No-Deal' almost impossible. It seems that there is a clear parliamentary, if not cabinet, consensus against allowing the default to occur. If this is true then it leaves only the option of parliament approving a renegotiated 'deal' or parliament appearing to reject the advisory referendum result of 2016. It is difficult to imagine parliament deciding the latter without either a general election or a second referendum to reaffirm public opinion. Support for the so-called People's vote, or second referendum, is

building, and even the general election solution could very well lead to it as it is likely to be put on at least one, and therefore both, major party manifestos. The truth is, however, that unless the result is unambiguously clear, which seems highly unlikely, even this is unlikely to resolve the issue cleanly and it will take time. It is all quite a mess.

Using Donald Rumsfeld elegant categorisation of risks, where we have known knowns; there are things we know we know. In this we have a fact that Brexit will affect sterling. Then, in Rumsfeld terms, we have known unknowns; this, unfortunately is where Brexit is. Looking forward to 2019 we had hoped to be able to promote Brexit to a known known where we could at least understand how the economic impact may be quantified. Alas we cannot and anyone thinking a second referendum will provide clarity has not been paying attention for the last 30 months.

Add this mess to the known unknowns of the escalating world trade war, rising geo-political tensions in the middle east, civil unrest in France and the effects of shrinking central bank balance sheets and it's easier to be more cautious than optimistic for 2019. And that is before considering what unknown unknowns await us. On the other hand with unemployment falling or low nearly everywhere across the world, inflation subdued and corporate optimism high these political unknowns may not necessarily affect investment markets materially.

On balance we expect 2019 to be a challenging year but one offering opportunities for tactical risk management. Given the regional uncertainties we believe a diversified cautious approach will provide the best risk adjusted returns in the long run. We finish a challenging 2018 with a modest risk underweight, having raised risk at the start of November to take advantage of lower equity prices, but expect the opportunity to move to a neutral risk exposure in the new year.

Market Returns (£) - 30th Nov 2018	1 Month	3 Month	6 Month	YTD	1 Year	S/I*
Anchors						
Cash + 1%	0.2%	0.5%	0.9%	1.6%	1.7%	3.7%
Inflation Linked UK Bonds	-0.8%	-1.0%	0.4%	0.4%	1.7%	5.3%
Gilts	-1.3%	-1.9%	-2.7%	-1.9%	-0.3%	-1.1%
Global Government Bonds (hedged)	0.5%	0.0%	-0.1%	-0.2%	-0.3%	-2.3%
Enhancers						
Global Corporate Bonds (hedged)	-0.4%	-1.8%	-1.4%	-3.6%	-3.1%	0.1%
Global High Yield (hedged)	-1.0%	-1.3%	-1.4%	-3.5%	-3.2%	9.6%
Emerging Market Bonds (hedged)	2.2%	5.7%	0.9%	-1.8%	-0.2%	8.7%
FTSE 350 TR Index	-1.7%	-6.1%	-7.7%	-5.9%	-1.4%	18.8%
FTSE UK All-Small Cap	-0.5%	-7.0%	-7.5%	-6.0%	-3.5%	30.3%
Global Equity (MSCI)	1.3%	-4.0%	2.6%	4.8%	6.2%	35.3%
European Equity (MSCI)	-0.7%	-6.1%	-4.2%	-5.3%	-3.7%	23.5%
US Equity (S&P)	2.1%	-2.8%	7.1%	10.8%	12.1%	42.6%
Japan Equity (Topix)	0.8%	-3.7%	-3.8%	-1.6%	-0.6%	33.3%
Pacific Ex Japan Equity (MSCI)	4.9%	-5.8%	-9.5%	-7.2%	-4.9%	35.3%
Emerging Market Equity (MSCI)	4.3%	-3.7%	-6.0%	-7.0%	-3.6%	31.9%
Chinese Equity (Hang Sang)	6.6%	-2.2%	-6.9%	-2.9%	-0.4%	43.9%
Indian Equity (Nifty)	11.3%	-3.3%	3.1%	1.7%	5.8%	37.4%
Diversifiers						
Commodity Index	-0.7%	-1.3%	-8.9%	-6.2%	-3.5%	-7.2%
Gold	0.8%	3.6%	-2.3%	-1.6%	1.1%	-5.0%
Silver	-1.0%	-0.8%	-10.7%	-13.1%	-9.4%	-22.8%
Brent Oil	-21.2%	-21.9%	-20.0%	-5.2%	-1.0%	25.8%
UK Property	0.0%	0.5%	1.4%	3.9%	4.8%	12.7%
Global Property Shares	-4.5%	-8.3%	-10.3%	-9.9%	-2.4%	7.2%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*-0.7%*	*-1.3%*	*-1.5%*	*-1.0%*	*-0.6%*	8.1%
Rivers Cautious Portfolio	*-0.2%*	*-2.0%*	*-0.9%*	*-0.1%*	*0.6%*	15.0%
Rivers Balanced Portfolio	*0.4%*	*-2.7%*	*-0.6%*	*0.8%*	*1.8%*	19.7%
Rivers Adventurous Portfolio	*0.8%*	*-2.7%*	*-0.4%*	*0.9%*	*2.2%*	22.0%
Rivers Aggressive Portfolio	*1.6%*	*-3.8%*	*-1.2%*	*0.0%*	*1.5%*	26.7%
Rivers Cautious Income Portfolio	*-0.2%*	*-1.7%*	*-1.0%*	*-1.0%*	*-0.4%*	7.1%
Rivers Balanced Income Portfolio	*-0.1%*	*-2.4%*	*-1.9%*	*-1.0%*	*-0.2%*	12.8%

Source: Financial Express in GBP (unhedged unless stated) as at 30th November 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.