Current Focus

January 2019

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

- Equity markets fell sharply in December as slowing global growth affected confidence
- Global growth has been slowing since June 2018 but should remain positive for 2019
- The risk of global recession remains small and equity valuations have improved
- 2019 is likely to offer modest positive returns but many tactical opportunities

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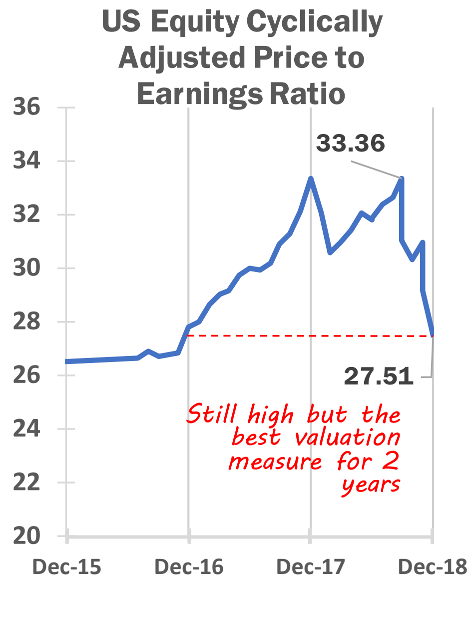
Market Comment

The widely anticipated and hoped-for Santa Rally didn't end up materialising in 2018. In fact if it hadn't been for the post-Christmas bounce of around 6 percent, the US equity market would have been set for its worst December since 1931. Despite the rally the US equity market lost 9% in December and at one point had fallen by over 20% from the all-time high in September. At Rivers, while we did add some risk to portfolios after the initial market fall in October, having cut it significantly in September, we remained underweight risk throughout the final quarter. This protected portfolio values and limited overall losses, as did the positive contributions from many 'Anchor' and 'Diversifier' allocations, but overall losses were difficult to avoid. While it was mainly investor sentiment from the US that changed in December, the origin of that sentiment, slowing global growth, is likely to remain a primary driver for markets in 2019. Looking forward to 2019 as a whole we expect benchmark equity returns to remain modest but positive. In this month's Focus we consider how diversification and successful active management will offer the best opportunities in such an environment.

At the start of 2019 if an analyst were to evaluate the economic fundamentals of the global economy, they would probably summarise by pointing to a robust, but deteriorating, income statement and a worrisome, debt laden, balance sheet. On the positive side, a snap shot of world GDP indicates that the picture is generally good: Unemployment is low, corporate profits are strong, inflation is contained, investment is high, innovation is flourishing and global growth remains strong. The Global economy has been growing at 3.7% a year and while it has slowed to between 3.2-3.5% this is still positive in spite of worries regarding a trade war. The concern that has been apparent for much of 2018 and which increased in the US in December, is that given the debt situation the ability for Central Banks to support a slowing, or stalling, economy may be limited in future. This was however just a sentiment change and there were few indications that such a slowdown is imminent.

Our macro outlook was cautious for much of 2018 as not only were equity valuations high but the trade war was affecting global growth, especially in emerging markets. What was surprising was how the US continued to grow so successfully in spite of the Fed aising rates.



Source: Rivers Capital Management

This was enhanced artificially, as it benefited from the (one-off) stimulus the Trump tax cut provided, but there is no doubt the growth was real. As sentiment out-stripped positive earnings, valuations rose and led us to move portfolios to a very defensive position in September. Sentiment began to change in October and fell sharply in December but interestingly the economic data has not changed materially. Given this, and the fact that valuations are more attractive, if still somewhat high, historically speaking, they are much better than they have been since 2017, and our near term outlook is more positive now than it has been for a while. We remain positive that economic growth can be sustained in the US well into 2019 and given the improved valuations we would rather increase current risk allocations than decrease.

While we remain positive regarding US and other 'Enhancer' Asset returns in 2019, at this point in the market cycle we can expect volatility to remain high and the need for tactical asset adjustment to be maximised. 'Enhancers' are investments selected to increase a portfolio's long term return and are exposed to global equity risk. As the primary driver to the portfolio return and risk, these assets are made up of a diversified selection of global equity, corporate credit and high yield. The primary driver to these assets is US Equities but regional considerations are important. In 2019, as discussed we expect volatility to remain high but also expect the allocation to be higher than in 2018 on average. Brexit considerations, especially regarding sterling value will be a primary consideration throughout 2019. The importance of the 'Anchor' and 'Diversifier' asset classes should also not be underestimated during a period in which effective diversification will be essential.

'Anchors' are investments selected for low risk, low equity market correlation, with capital preservation at their core. These tend to be fixed income orientated but include actively managed truly market neutral strategies (with daily liquidity and no leverage) and exclude corporate and high yield credit. In any defensive environment, as seen in December, we expect government bonds to perform well and we will hold long duration positions opportunistically in what we think will continue to be a period of modestly rising rates.

'Diversifiers' are assets selected specifically for their low correlation to traditional market equity and fixed income risk. In December gold returned to its traditional safe haven status. We expect that to continue in 2019 but we also like uncorrelated thematic investments like global property and other commodity investments. These components are likely to provide some stability and consistency to the portfolio return whatever happens in the more volatile 'Enhancer' assets.

As we start 2019 we expect an opportunity in the coming weeks to increase risk further, to the strategic neutral position. The recent market lows are likely to be challenged at some point and a tactical opportunity to allocate at attractive levels will help portfolios achieve long term objectives.

Market Returns (£) - 31st Dec 2018	1 Month	3 Month	6 Month	YTD	1 Year	S/I*
Anchors						
Cash + 1%	0.2%	0.5%	0.9%	1.7%	1.7%	3.9%
Inflation Linked UK Bonds	2.6%	2.0%	0.8%	-0.4%	-0.4%	9.6%
Gilts	2.4%	2.1%	0.3%	0.5%	0.5%	1.3%
Global Government Bonds (hedged)	1.4%	1.9%	1.1%	1.1%	1.1%	-0.9%
Enhancers						
Global Corporate Bonds (hedged)	1.0%	-0.4%	0.0%	-2.7%	-2.7%	1.1%
Global High Yield (hedged)	-1.0%	-3.6%	-1.8%	-4.5%	-4.5%	8.5%
Emerging Market Bonds (hedged)	1.7%	4.9%	4.8%	-0.1%	-0.1%	10.5%
FTSE 350 TR Index	-3.8%	-10.3%	-11.0%	-9.5%	-9.5%	14.3%
FTSE UK All-Small Cap	-3.7%	-10.3%	-10.5%	-9.4%	-9.4%	25.5%
Global Equity (MSCI)	-7.4%	-11.4%	-5.8%	-3.0%	-3.0%	25.3%
European Equity (MSCI)	-4.4%	-10.4%	-8.5%	-9.5%	-9.5%	18.1%
US Equity (S&P)	-8.9%	-11.6%	-3.7%	1.0%	1.0%	29.9%
Japan Equity (Topix)	-7.1%	-12.9%	-8.9%	-8.6%	-8.6%	23.8%
Pacific Ex Japan Equity (MSCI)	-2.8%	-7.7%	-7.9%	-9.9%	-9.9%	31.5%
Emerging Market Equity (MSCI)	-2.5%	-5.3%	-5.1%	-9.3%	-9.3%	28.6%
Chinese Equity (Hang Sang)	-2.4%	-4.6%	-5.5%	-5.1%	-5.1%	40.5%
Indian Equity (Nifty)	-0.1%	5.9%	3.8%	1.6%	1.6%	37.3%
Diversifiers						
Commodity Index	-6.7%	-7.2%	-8.0%	-5.7%	-5.7%	-6.5%
Gold	4.9%	9.8%	5.6%	3.2%	3.2%	-0.3%
Silver	9.7%	7.9%	-0.9%	-4.6%	-4.6%	-15.3%
Brent Oil	-8.6%	-32.4%	-29.1%	-14.6%	-14.6%	13.3%
UK Property	-0.2%	0.2%	0.9%	3.7%	3.7%	12.5%
Global Property Shares	-3.5%	-9.3%	-13.9%	-13.0%	-13.0%	3.4%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*-0.4%*	*-1.4%*	*-1.3%*	*-1.4%*	*-1.4%*	7.7%
Rivers Cautious Portfolio	*-1.9%*	*-3.4%*	*-2.3%*	*-2.0%*	*-2.0%*	12.8%
Rivers Balanced Portfolio	*-2.6%*	*-4.3%*	*-2.9%*	*-1.8%*	*-1.8%*	16.6%
Rivers Adventurous Portfolio	*-3.2%*	*-4.7%*	*-3.4%*	*-2.3%*	*-2.3%*	18.1%
Rivers Aggressive Portfolio	*-4.1%*	*-6.7%*	*-5.2%*	*-4.2%*	*-4.2%*	21.4%
Rivers Cautious Income Portfolio	*-2.2%*	*-3.5%*	*-3.1%*	*-3.2%*	*-3.2%*	4.8%
Rivers Balanced Income Portfolio	*-2.3%*	*-4.2%*	*-4.0%*	*-3.3%*	*-3.3%*	10.2%

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