Current Focus

February 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

- In January most assets reversed a significant proportion of 2018 losses
- The reversal was based more on changing sentiment than any fundamental data
- Risk of global recession in 2019 is low but market volatility is likely to increase
- The outlook remains cautious but we expect further opportunities to add risk

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Market Comment

Following 2018, when almost all assets lost value, many having set all-time highs earlier in the year and January 2019, which saw almost all asset values rise, investors must be getting used to increasing volatility. By altering the Rivers risk allocation throughout 2018 between a 'very cautious' risk level 2, a 'moderately cautious' risk level 3 and a 'strategic neutral' risk level 4 client capital was reasonably well protected. In fact, at the end of 2018 we were rare across the industry by being more positive, in terms of outlook, than we had been at the end of 2017, but only by being relatively less cautious. With many markets now nearly 10% above the lows seen in December it is time to reflect on whether this recovery is likely to be sustained and what level of risk we think appropriate, relative to strategic neutral, going forward. Our Focus this month is on risk and tactical management in what we expect is unlikely to be a strong year for overall returns from here on. First it is interesting to briefly consider the market context which led to the market correction we have seen. From there we summarise what has changed, if anything and what this means for our tactical positioning going forward.

The equity market rally that appeared to end in 2018 really started when Donald Trump was elected US President. Or at least the final stage of it started then after the market correction in January 2016. Despite Trump dubiously taking credit for this rally, what he did do was ensure the fiscal stimulus, through US corporate tax cuts, which caused the economic growth rate to accelerate, increased buy-backs and inflated valuations. Whatever the cause, by late 2017 we had a globally coordinated bull market, with surplus liquidity leading to a few giant market capitalisation stocks and historically high valuations.

What was particularly unusual about the market during this time was how many investors felt trapped in equities, despite high valuations, simply because of the extreme unattractiveness of the main alternative investment – government bonds. The US Federal Reserve decided to end its Quantitative Easing (QE) programme in 2017, as the strong economy was leading to full employment and the risk of overheating, and started a gradual program of interest rate increases. In 2018 the European Central Bank stopped QE and there are signs that the Bank of Japan would be ending its own

Global Markets	2018	January
Anchors		
Gilts	0.6%	1.1%
Gbl Gov Bonds(hdgd)	1.1%	0.7%
Enhancers		
High Yield (hedged)	-4.5%	4.0%
EM Bonds (hedged)	-6.0%	5.8%
FTSE All-Share	-9.5%	4.2%
FTSE UK Sm Cap	-9.4%	4.0%
Global Equity Local	-7.4%	7.2%
Europe Equity Local	-10.2%	5.7%
US Equity (USD)	-4.9%	8.0%
Japan Equity (JPY)	-16.0%	4.9%
Pac Ex-Jap Eq (Local)	-13.7%	8.1%
EM Equity (USD)	-10.1%	7.2%
Indian Equities (INR)	4.6%	-0.2%
Diversifiers		
Commodity (USD)	-11.3%	5.5%
Gold (USD)	-2.8%	3.1%
Brent Oil (USD)	-20.2%	17.2%
UK Property	3.5%	0.4%

Source: Bloomberg

soon, though neither ever looked very close to raising rates. In the past, with strong global growth, Central Banks would be raising rates and certainly not providing free liquidity, but this time things are different. Many, including Trump, blame the Federal Reserve who, encouraged by the strong economy, stuck to its rate hiking agenda. At least now they have some room for manoeuvre if recession does hit, unlike almost every other developed economy.

The President also started a trade war, as part of his promise to put America first again, and placed tariff barriers on many items that were imported into the USA. This hit some emerging markets very hard and they immediately went into severe bear market trends. China was similarly hit but it is huge and in the long run can fight back. The main impetus for China is no longer to export cheap products to the West but rather to grow their own domestic economy. Essentially it was this fight and the Federal Reserve rate hikes and ensuing inverted yield curve that led to the breakdown of the bull market almost everywhere.

We think equity markets are unlikely to return to their highs any time soon. Many indicators show that economic growth is nearing a peak in the US, is stagnating in Europe and Japan, slowing in China and extremely uncertain in the UK. This also led to the market correction in December and has not changed. The rally in January started from a clearly 'oversold' position but has been extended due to the renewed doveishness of the Federal Reserve and a hope that a trade agreement is reached between President Trump and Chinese President Xi Jinping when they meet in February.

In terms of the 'Fed-Put' the Fed has indicated that it may now be 'on pause' and will act on 'the data'. Many at the economic forum in Davos suggested that the US economy could well take a turn for the worse in 2019 and force the Fed to ease rates again, but if that is the case, corporate earnings growth will almost certainly stall or fall. Ending the trade war and coming up with a deal that may help the President run for a second term is possible, but we would prefer to see an actual change in policy rather than rumours of it. The best we can hope for is a deal that produces a settlement for now, and we think the recovery in January prices much of this in.

The investment process at Rivers has always been primarily driven by valuations and risk. Currently risk is elevated but at times, such as at the end of December, valuations in spite of the risks are attractive. Given this balance we think our current position of moderately cautious risk level 3 is appropriate. Looking forward, if valuations continue to rise, without any material change in economic data or news, we will lower risk and protect the year to date gains. That said we continue to expect the opportunity to raise risk, at much more attractive valuations in the coming months.

Market Returns (£) - 31st Jan 2019	1 Month	3 Month	6 Month	YTD	1 Year	S/I*
Anchors						
Cash + 1%	0.2%	0.5%	0.9%	0.2%	1.8%	4.0%
Inflation Linked UK Bonds	-1.1%	-0.5%	-0.3%	-1.1%	4.7%	5.6%
Gilts	1.1%	2.2%	1.7%	1.1%	3.9%	2.4%
Global Government Bonds (hedged)	0.7%	2.6%	2.0%	0.7%	2.5%	-0.3%
Enhancers						
Global Corporate Bonds (hedged)	1.8%	2.4%	1.2%	1.8%	-0.2%	2.9%
Global High Yield (hedged)	4.0%	1.9%	0.6%	4.0%	-1.0%	12.9%
Emerging Market Bonds (hedged)	2.4%	6.4%	4.0%	2.4%	2.6%	13.2%
FTSE 350 TR Index	4.2%	-1.4%	-8.5%	4.2%	-3.8%	19.1%
FTSE UK All-Small Cap	4.0%	-0.4%	-7.1%	4.0%	-5.8%	30.5%
Global Equity (MSCI)	4.4%	-2.2%	-5.3%	4.4%	1.0%	30.7%
European Equity (MSCI)	3.4%	-1.8%	-9.1%	3.4%	-6.8%	22.1%
US Equity (S&P)	4.5%	-2.8%	-3.6%	4.5%	5.0%	35.8%
Japan Equity (Topix)	2.7%	-3.9%	-7.3%	2.7%	-5.4%	27.1%
Pacific Ex Japan Equity (MSCI)	5.0%	7.0%	-4.2%	5.0%	-7.9%	38.0%
Emerging Market Equity (MSCI)	5.3%	7.1%	-2.9%	5.3%	-7.3%	35.4%
Chinese Equity (Hang Sang)	4.5%	8.7%	-1.5%	4.5%	-5.2%	46.8%
Indian Equity (Nifty)	-5.2%	5.5%	-7.9%	-5.2%	-3.7%	30.2%
Diversifiers						
Commodity Index	2.1%	-5.2%	-4.6%	2.1%	-0.8%	-4.5%
Gold	-0.2%	5.5%	7.3%	-0.2%	5.9%	-0.5%
Silver	0.3%	9.0%	2.7%	0.3%	-0.1%	-15.0%
Brent Oil	12.6%	-20.1%	-16.6%	12.6%	-2.6%	27.5%
UK Property	0.5%	0.2%	0.8%	0.5%	3.5%	12.9%
Global Property Shares	8.8%	0.2%	-5.7%	8.8%	-2.6%	12.6%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*0.8%*	*-0.3%*	*-0.9%*	*0.8%*	*-0.6%*	*8.5%*
Rivers Cautious Portfolio	*1.6%*	*-0.5%*	*-1.9%*	*1.6%*	*-0.3%*	*14.7%*
Rivers Balanced Portfolio	*2.3%*	*0.1%*	*-2.2%*	*2.3%*	*0.5%*	*19.3%*
Rivers Adventurous Portfolio	*2.6%*	*0.2%*	*-2.6%*	*2.6%*	*0.4%*	*21.2%*
Rivers Aggressive Portfolio	*3.3%*	*0.5%*	*-4.2%*	*3.3%*	*-1.0%*	*25.4%*
Rivers Cautious Income Portfolio	*2.5%*	*0.1%*	*-1.7%*	*2.5%*	*-0.2%*	*7.4%*
Rivers Balanced Income Portfolio	*2.7%*	*0.2%*	*-2.6%*	*2.7%*	*-0.4%*	*13.1%*

Source: Financial Express in GBP (unhedged unless stated) as at 31st January 2019. *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.