Current Focus

April 2019

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

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Summary

- Despite Brexit uncertainty Q1 2019 has been positive for investors
- Brexit uncertainty will continue as parliament fails to agree any way forward
- Global growth continues to slow and will not be materially offset by US rate cuts
- Valuations are high and not justified given political risk and slowing growth

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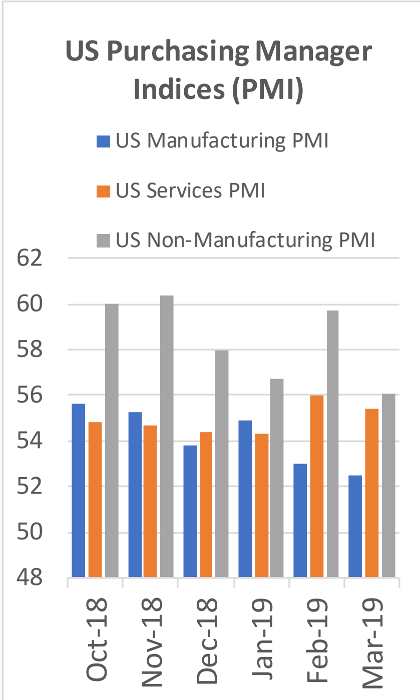
Market Comment

News headlines in the UK, during the first quarter of 2019, have been entirely dominated by Brexit. This has been so draining that many will be forgiven for having not noticed that it has been a very positive period for investors. Nearly all the portfolios we manage have recovered any losses they suffered during the turbulent final quarter of 2018 and now stand at all-time highs. This has not been the case for all market indices, but it has, nevertheless, been a strong period of recovery. If anything, this perhaps emphasises why our portfolios maintain a global perspective. Our focus this month will be on the sustainability of this recovery, but I feel it would be remiss for us not to mention our thoughts on Brexit at this time.

In September 2018 Rivers published a Current Focus looking specifically at Brexit. Few of the thoughts we had then have changed. It was obvious then that Parliamentary arithmetic made it almost impossible for either Theresa May's Deal or No-Deal to pass before March 29th this year. What was less obvious was that it would take until after March 29th for either Theresa May, or many in Parliament, to acknowledge this reality. As I type this in early April some apparently still haven't. It seems likely now that No-Deal is no longer at all likely and that any Deal that is agreed will be significantly 'softer' than many had hoped for, or feared, until very recently. Whether the UK leaves the EU at all, must now be in question, but what isn't is that the EU debate is likely to dominate UK politics for the foreseeable future. A depressing reality for sure, so let us return to global investing.

Global Equity, as measured by the MSCI World Index is, in sterling terms, up over 10% year to date. The strongest developed market has been the United States (10.9%) but European (8.2%), Asian (9.4%) and UK equities (9.5%) have not been far behind. Emerging Market equities (7.4%) have lagged this year, but if we look back 6 months, and include the losses in Q4 18, only Emerging Market equities are positive. All developed market equity indices, despite an impressive V shaped recovery in the last 3 months, are still lower now than they were at the end of September 2018, although not by very much. Given this reversal we would have expected to see some similar reversal in indicative economic data, or at least earnings. In reality we have not. Beyond the hopes of continued low interest rates and a possible resolution of the US-China trade dispute there have been



Source: Markit

few positive quantifiable changes to back up the equity advance.

Looking at the US, the primary indicators for growth – unemployment, wage growth, confidence – are all positive, and have been throughout this period. After 9 years of nearly continuous growth this is not surprising, but it is not the end of the story. If we look at the Purchasing Manager Indices (PMI), of Construction, Services and Manufacturing, which are a good forward-looking indicator of GDP growth, all have fallen from highs over the last few months. All three do remain over the threshold of 50 – indicative that growth will be positive and that recession is not imminent - but, given current stock market valuations the fact that they are deteriorating should be a concern. This and the fact that orders for Durable Goods, another key economic indicator, have slowed has not dented investor optimism. This is unusual.

The market appears to have adopted the mindset that 'bad-news-is-good-news'. The 'bad-news-is-good-news' argument goes that if economic indicators are *bad* it is likely to bring forward interest rate decreases, or even lead to Quantitative Easing (QE), so is therefore overall *good*. This oxymoronic argument took hold after the financial crisis where it appeared that when economic news was bad the Federal Reserve, under then Chairman

Ben Bernanke, would almost endlessly lower rates or increase QE to combat it. Whatever merit QE has economically it was extremely good for inflating asset prices in Wall Street by increasing liquidity. For two reasons we are not sure this makes sense currently. First the economic indicators (of Main street) are not at all bad, in fact wages are rising fast and unemployment is at a 50-year low. Second the Fed has only stated it is 'on-hold' and current Chairman Jerome Powell, a quite different Chairman to Bernanke, believes that the current rate of interest rates is already low, and his preference is to raise, not cut, rates.

With valuations, as judged by the Cape Shiller price earnings ratio, now as high as they were in September 2018 the fact that PMI surveys and Durable Goods order are falling, even if from elevated levels, is a real concern. There is little justification that these factors will be offset entirely by the Federal Reserve. Even if a trade resolution is found between the US and China in the coming weeks, we do not expect it to materially affect global growth, which continues to slow. The increase in Chinese PMI reported at the start of April is positive but was mostly the result of fiscal stimulus on new domestic infrastructure projects, not a recovery from external demand. In fact, the sharp fall in German factory orders released on April 4th is probably a more reliable indicator of global demand. If Global demand continues to fall current equity valuations make them vulnerable to any fall in earnings.

High valuations and questions about global growth are enough to justify the cautious stance we have across portfolios. Political uncertainty over Brexit and US-Chinese trade discussions only help to affirm this position. We expect opportunities to increase risk at more favourable valuations in the coming months.

Market Returns (£) - 31st March 2019	1 Month	3 Month	6 Month	YTD	1 Year	S/I*
Anchors						
Cash + 1%	0.2%	0.5%	0.9%	0.5%	1.8%	4.3%
Inflation Linked UK Bonds	4.2%	1.6%	3.2%	1.6%	5.6%	8.4%
Gilts	3.4%	3.5%	5.7%	3.5%	3.9%	4.8%
Global Government Bonds (hedged)	1.6%	2.2%	4.1%	2.2%	3.1%	1.2%
Enhancers						
Global Corporate Bonds (hedged)	2.1%	4.1%	3.7%	4.1%	3.2%	5.3%
Global High Yield (hedged)	0.6%	6.1%	2.3%	6.1%	2.5%	15.1%
Emerging Market Bonds (hedged)	0.7%	0.7%	5.7%	0.7%	-0.4%	11.3%
FTSE 350 TR Index	2.7%	9.5%	-1.7%	9.5%	6.6%	25.2%
FTSE UK All-Small Cap	0.4%	5.6%	-5.3%	5.6%	0.4%	32.5%
Global Equity (MSCI)	3.4%	9.9%	-2.5%	9.9%	12.0%	37.7%
European Equity (MSCI)	2.6%	8.2%	-3.0%	8.2%	3.5%	27.8%
US Equity (S&P)	4.0%	10.9%	-2.0%	10.9%	17.2%	44.0%
Japan Equity (Topix)	2.8%	4.6%	-8.8%	4.6%	-1.8%	29.6%
Pacific Ex Japan Equity (MSCI)	3.0%	9.4%	1.0%	9.4%	0.8%	43.9%
Emerging Market Equity (MSCI)	2.9%	7.4%	1.8%	7.4%	-0.3%	38.2%
Chinese Equity (Hang Sang)	3.7%	10.0%	5.0%	10.0%	7.7%	54.6%
Indian Equity (Nifty)	N/A	-3.0%	2.6%	-3.0%	8.9%	33.1%
Diversifiers						
Commodity Index	1.9%	3.9%	-3.6%	3.9%	2.0%	-2.8%
Gold	0.4%	-1.4%	8.3%	-1.4%	4.6%	-1.7%
Silver	-1.2%	-5.0%	2.5%	-5.0%	-0.8%	-19.5%
Brent Oil	6.0%	25.1%	-15.4%	25.1%	5.3%	41.7%
UK Property	0.1%	0.4%	0.4%	0.4%	2.5%	12.8%
Global Property Shares	0.2%	11.3%	0.9%	11.3%	0.6%	15.1%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*1.1%*	*2.1%*	*0.6%*	*2.1%*	*1.2%*	9.9%
Rivers Cautious Portfolio	*1.5%*	*3.8%*	*0.2%*	*3.8%*	*3.4%*	17.0%
Rivers Balanced Portfolio	*1.8%*	*5.0%*	*0.5%*	*5.0%*	*5.5%*	22.4%
Rivers Adventurous Portfolio	*1.9%*	*5.6%*	*0.6%*	*5.6%*	*6.0%*	24.7%
Rivers Aggressive Portfolio	*2.0%*	*6.4%*	*-0.7%*	*6.4%*	*6.0%*	29.2%
Rivers Cautious Income Portfolio	*1.1%*	*4.3%*	*0.7%*	*4.3%*	*3.4%*	9.3%
Rivers Balanced Income Portfolio	*1.1%*	*4.6%*	*0.2%*	*4.6%*	*3.9%*	15.2%

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