Current Focus

March 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

- The portfolios reduced risk exposure after the recent rally in equities
- The Fed is likely to pause rate rises but not cut rates until the US economy slows
- The US-China trade war may also pause but protectionism is expected to increase
- Valuations are high and not justified given slowing global growth
- The portfolios are not overly exposed to any potential Brexit outcome

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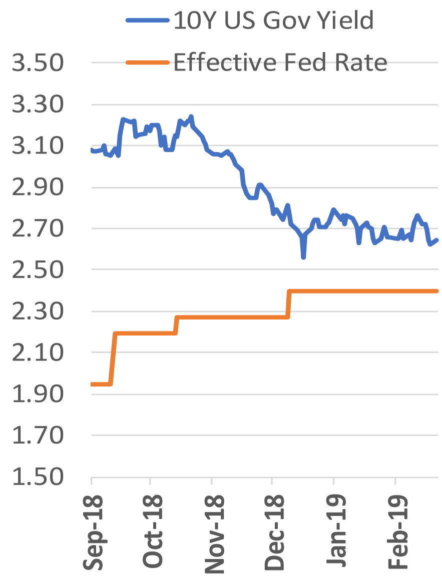
Market Comment

In the last week of February, we tactically rebalanced the portfolios we manage by reducing Enhancer asset exposure in favour of more predictable lower return Anchor assets. By Enhancer assets we mean equity but, we specifically also include high yield fixed income and other credit related funds which are correlated to equity. After adding risk in November and December, which helped the portfolios benefit from the positive returns at the start of this year, our medium-term evaluation of the market is now as cautious as it was in September last year. An apparent reversal in Federal Reserve policy and the hope of a sensible resolution to the US-China trade war has been a positive catalyst since December but these together, do not justify the recent escalation in valuations. Our broad macro outlook, has been, and remains neutral but on a valuation basis we think a cautious allocation is prudent right now.

Brexit uncertainty was not the main consideration which has led to our current investment caution. In fact the counterbalance effect of the value of sterling makes Brexit, given the global allocation and perspective of the portfolios, less of a factor. The discount now available in UK markets, due to investors reluctance to hold UK assets in the run-up to Brexit, makes many UK assets realatively attractive almost irrespective of how Brexit is resolved. From a global investment perspective, however, Brexit is not the most concerning issue.

The market rally since December has been fuelled by two main factors. The most important is the recent communication from the Fed, expressing a more patient “wait-and-see” approach in implementing further rate hikes. Many investors appear to have interpreted this development as though the Fed had reversed its position and more quantitative easing was imminent. There is little evidence that this is the case. Given that in 2018 the consensus was that the Fed had lagged the market and needed to raise interest rates quickly, while also reducing its balance sheet, the fact that the market is now relying on a complete reversal of that is, at best, optimistic. There is little doubt that the market volatility, and perhaps pressure from President Trump – who is keen to keep the economy growing until his attempt at a second Presidential run in 2020 – did affect the outlook from the Federal Reserve. However, to interpret a ‘wait-and-see’ approach as a reversal of the long standing



Source: Federal Reserve

plan is, in our view, a triumph of hope over experience. The fact that the Fed appear unable to raise rates to what they consider a ‘neutral’ level should be a concern. Looking at the 10 year yield, as shown above, it has fallen significantly in the last 6 months; this has continued into 2019. This is partly due to changing expectations regarding rates but such a fall has, historically, been an indication of slowing growth and pessimism from fixed income investors, this is clearly contrary to the sentiments of equity investors. The fact that the Fed are alone in having raised rates at all, other than a 0.25% raise by the Bank of England, and with global growth already slowing, should be a warning in itself.

The second factor supporting the global equity reversal is the hope of a resolution in the US-China trade dispute. While it is likely, after a difficult 2018, that both sides would prefer to concede rather than escalate the disagreement in 2019, we expect any resolution will only be temporary. China’s transition from Emerging State to Global Superpower is inevitable and whatever measures the US uses to combat this are unlikely to succeed. The most obvious example of this was seen recently in the issue surrounding Huawai’s 5G technology. Despite having no comparable technology available, US officials have spent recent months imploring their allies not to allow Huawei to run their equipment on new 5G networks, arguing that this would be an intolerable security risk. Several key US allies, including Japan and Australia, have already taken the American line on Huawei, but others, such as Britain, are still evaluating it. If the British allow Huawei in, they have been told that they will be taking a security risk that could damage their precious intelligence-sharing arrangements with the US, but if they block Huawei, British hopes for a post-Brexit surge in trade and investment from China will be at risk. This all feels more like the Cold War between the US and the Soviets than a traditional trade war and is unlikely to go away soon whatever 'deal' President Trump claims he will make. The reality here is that protectionism, be it from the US, the EU, or from China, is likely to increase in coming years, not fall.

In contrast to the consensus on a more accommodative Federal Reserve, and a resolution to the US-China trade war, we think there are some risks that both factors actually become worse rather than better, especially if inflation from rising wages does occur. Add to this the risk of an unattractive Brexit scenario and deteriorating, not improving, trade relations, and many assets look unattractive at current valuations. At least in the short term we prefer to hold a lower than strategic allocation to Enhancers and a higher allocation to Anchor Assets. Diversifier assets, those with relative low correlation to interest rate and equity risk, should perform relatively well, while also lowering portfolio volatility. Our current objective is to preserve capital in order to increase risk and exposure at times when valuations become more attractive. We expect such an opportunity to occur in the coming months. Should valuations continue to rise the current allocation will ensure target returns continue to be met.

Market Returns (£) - 28th Feb 2019	1 Month	3 Month	6 Month	YTD	1 Year	S/I*
Anchors						
Cash + 1%	0.1%	0.5%	0.9%	0.3%	1.8%	4.2%
Inflation Linked UK Bonds	-1.5%	-1.2%	-2.1%	-2.5%	1.7%	4.1%
Gilts	-1.0%	2.5%	0.6%	0.1%	2.6%	1.4%
Global Government Bonds (hedged)	-0.1%	1.9%	1.9%	0.5%	2.4%	-0.4%
Enhancers						
Global Corporate Bonds (hedged)	0.3%	3.0%	1.2%	2.0%	1.2%	3.2%
Global High Yield (hedged)	1.4%	4.4%	3.0%	5.5%	1.5%	14.4%
Emerging Market Bonds (hedged)	-2.4%	1.6%	7.4%	0.0%	-2.0%	10.5%
FTSE 350 TR Index	2.3%	2.6%	-3.6%	6.6%	1.8%	21.9%
FTSE UK All-Small Cap	1.2%	1.4%	-5.7%	5.2%	-1.7%	32.1%
Global Equity (MSCI)	1.9%	-1.6%	-5.5%	6.3%	4.0%	33.2%
European Equity (MSCI)	2.0%	0.8%	-5.3%	5.5%	-2.3%	24.5%
US Equity (S&P)	2.0%	-2.9%	-5.6%	6.6%	7.8%	38.5%
Japan Equity (Topix)	-0.8%	-5.4%	-8.9%	1.8%	-7.7%	26.1%
Pacific Ex Japan Equity (MSCI)	1.2%	3.2%	-2.7%	6.2%	-5.2%	39.7%
Emerging Market Equity (MSCI)	-0.9%	1.8%	-2.0%	4.4%	-6.7%	34.3%
Chinese Equity (Hang Sang)	1.5%	3.6%	1.3%	6.1%	-0.7%	49.1%
Indian Equity (Nifty)	2.3%	-3.1%	-6.3%	-3.0%	2.6%	33.1%
Diversifiers						
Commodity Index	-0.1%	-4.9%	-3.9%	2.0%	-2.3%	-4.6%
Gold	-1.6%	3.1%	6.8%	-1.8%	2.7%	-2.1%
Silver	-4.2%	5.5%	4.6%	-3.9%	-2.2%	-18.6%
Brent Oil	4.9%	7.8%	-16.9%	18.0%	4.1%	33.7%
UK Property	-0.1%	0.0%	0.5%	0.3%	3.1%	12.7%
Global Property Shares	2.1%	7.2%	-1.7%	11.1%	4.8%	14.9%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*0.2%*	*0.6%*	*-0.7%*	*1.0%*	*-0.1%*	8.8%
Rivers Cautious Portfolio	*0.6%*	*0.3%*	*-1.7%*	*2.3%*	*1.0%*	15.4%
Rivers Balanced Portfolio	*0.8%*	*0.4%*	*-2.2%*	*3.1%*	*2.3%*	20.2%
Rivers Adventurous Portfolio	*1.0%*	*0.3%*	*-2.4%*	*3.6%*	*2.5%*	22.3%
Rivers Aggressive Portfolio	*1.0%*	*0.0%*	*-3.8%*	*4.3%*	*1.6%*	26.7%
Rivers Cautious Income Portfolio	*0.6%*	*1.0%*	*-0.8%*	*3.2%*	*1.6%*	8.1%
Rivers Balanced Income Portfolio	*0.7%*	*1.0%*	*-1.4%*	*3.4%*	*1.6%*	13.9%

Source: Financial Express in GBP (unhedged unless stated) as at 28th February 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.