Current Focus

May 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

Rivers Capital Management
27 Gloucester Place
London
W1U 8HU
+44 (0)20 3383 0180
www.riverscm.com

Summary

- Further gains in equity valuations saw new all time highs in the US
- The US-China trade deal remains unresolved and is expected to escalate
- This war is more about identity and global dominance than it is about trade
- The US may try but will be unable to prevent the rising dominance of China
- Portfolios remain defensively positioned going into a challenging summer period

Contacts

Richard Bonnor-Moris
rbm@riverscm.com

Eduardo Tomacelli
etomacelli@riverscm.com

Najib El-Rayyes
ner@riverscm.com

Market Comment

April saw further increases in many equity indices as the economic concerns which dominated investment news at the start of 2019 were forgotten. Those concerns, primarily regarding US interest rates and tensions between the US and China over trade, were largely allayed by hopes of a base rate reversal from the Federal Reserve and a resolution being found between Presidents Trump and Xi respectively. We have said for a few months that a reversal by the Federal Reserve, and not just a pause in rate increase, was unlikely, and in the last week it appears the negotiations between China and the US essentially broke down without agreement. US Equity markets, which had just set all-time highs, were shocked by this development but remain, in our view, relatively expensive. The effect on global trade is unclear but trade wars have never been positive for investors and this one seems now likely to escalate . In this month's focus we look at the background to the latest escalation. We concentrate on the fundamental issues behind the rhetoric, why its escalation was inevitable and why ultimately it will do little to change China's eventual rise to its place as the premier global super power.

The likely failure of the China-US trade negotiations has been forthcoming since a speech made by Vice US President Pence on October 5th last year at the Hudson institute. In that speech Pence removed any doubt on the long-run strategic intentions of the United States. As a matter of choice, he said, the United States will pursue an objective of confrontation rather than co-operation with China going forward. He accused China of a series of sins including "meddling in America's democracy", militarisation of contested areas in the South and East China Sea and China's practice of "debt diplomacy" in developing countries, not to mention repeated reference to Chinese domestic repression of political and civil liberties. Despite all the tweeting rhetoric from President Trump it was not until this speech that the policy was officially confirmed.

Not that China has done anything to calm the hostility. In fact, it is almost ironic that one of the reasons for optimism in recent months has come from Chinese President Xi Jinping's continued request for 'mutual respect'. He has been quoted as asking for maximum co-operation, minimum disagreement and to have 'mutual respect' for each other's core values. This in itself is

Source: istock

a change from the previous (pre-Xi) Chinese policy of co-operation and reverence when it came to the US. Fundamentally the idea that the US, under any president, let alone Trump, would give the Chinese authoritarian administration equal status to the US allies was always going to be unacceptable. The point here is that in the past the US was able to deal with China without giving the regime, essentially the Chinese Communist Party, formal endorsement, and de- facto legitimacy. Insisting that this has changed is an aggressive switch in policy by Xi. As China are effectively insisting on this endorsement it is fair to conclude they are being the aggressor in a war, not of trade, or technology but of identity. They are in effect demanding terms which no President, Republican or Democrat would accept.

All talk of finding agreement and resolution since December have contradicted what is obviously a hostile diplomatic reality. One sign of this hostility was seen when Germany openly considered working on its 5G infrastructure with the Chinese company Huawai in March. In an unveiled threat the US told Berlin to bar Huawei or other Chinese vendors or risk losing access to U.S. intelligence. This threat came in an open letter from U.S. Ambassador Richard Grenell to the country's economics minister and left little room for interpretation by the 4th biggest economy in the world. Countries are going to have to pick sides if this does develop into a new cold war and the option of fence sitting or acting as mediator is unlikely to be available for long, which is why the recent leak from the UK Government was so news worthy.

The fact that Trump doesn't seem to understand the general concept of tariffs (that they are essentially paid for by the consumer of the country imposing them and not by the exporting country) does not help the situation but also doesn't change the fundamental facts. While the US do still hold most of the economic cards, on account of importing many times in value of what they export to China, the impressive economic growth from China will ensure it remains a global economic force, very likely to overtake the US economically within a generation. It is also unlikely the Chinese government under Xi will be backing down. President Xi Jinping currently occupies all three of the preeminent political positions in China. He is almost omnipotent and the constitutional change he enacted last year, which ensures he doesn't need to step down after two terms, makes it very likely he will remain in office until and probably beyond 2025. On the other side the US President may change next year and certainly will in 2024. US politicians are susceptible to electoral pressures and would likely not want to extend the tariff war indefinitely whereas electoral pressure is something that President Xi does not have to concern himself with. Xi's flagship domestic policy, the 'Made in China 2025' policy, may in fact be a beneficiary of the tariffs as its aim is to become less dependent on exports. As Singaporean politician Raymond Lim recently said at a conference regarding the outcome of any US-China trade War "The writing is on the wall, and it is in Chinese Characters", the only question is how best to avoid the cross fire.

Given the current high valuation of global, and especially US, equities the escalation of this risk justifies the cautious stance we have adopted since March. Added to the usual seasonal pressures expected during the summer we do not expect to increase risk unless there is a marked improvement in valuations in the coming weeks

Market Returns (£) - 30th April 2019	1 Month	3 Month	6 Month	YTD	1 Year	S/I*
Anchors						
Cash + 1%	0.2%	0.5%	0.9%	0.6%	1.8%	4.5%
Inflation Linked UK Bonds	0.0%	2.7%	3.2%	1.5%	5.6%	8.4%
Gilts	-1.4%	1.0%	5.7%	2.1%	3.9%	3.4%
Global Government Bonds (hedged)	-0.4%	1.1%	4.1%	1.8%	3.1%	0.9%
Enhancers						
Global Corporate Bonds (hedged)	0.4%	2.7%	3.7%	4.5%	3.2%	5.7%
Global High Yield (hedged)	0.7%	2.7%	2.3%	6.8%	2.5%	15.9%
Emerging Market Bonds (hedged)	0.8%	-0.9%	5.7%	1.5%	-0.4%	12.2%
FTSE 350 TR Index	2.6%	7.9%	-1.7%	12.4%	6.6%	28.5%
FTSE UK All-Small Cap	4.1%	5.7%	-5.3%	9.9%	0.4%	37.9%
Global Equity (MSCI)	4.3%	9.8%	-2.5%	14.6%	12.0%	43.6%
European Equity (MSCI)	4.0%	8.8%	-3.0%	12.5%	3.5%	32.8%
US Equity (S&P)	4.8%	11.2%	-2.0%	16.2%	17.2%	50.9%
Japan Equity (Topix)	1.6%	3.6%	-8.8%	6.3%	-1.8%	31.7%
Pacific Ex Japan Equity (MSCI)	3.4%	7.8%	1.0%	13.1%	0.8%	48.8%
Emerging Market Equity (MSCI)	3.3%	5.4%	1.8%	11.0%	-0.3%	42.7%
Chinese Equity (Hang Sang)	2.3%	7.7%	5.0%	12.5%	7.7%	58.1%
Indian Equity (Nifty)	0.8%	11.2%	10.0%	5.6%	14.9%	38.9%
Diversifiers						
Commodity Index	0.4%	2.2%	-3.6%	4.3%	2.0%	-2.5%
Gold	-0.3%	-1.5%	8.3%	-1.7%	4.6%	-1.9%
Silver	-0.7%	-6.0%	2.5%	-5.7%	-0.8%	-20.1%
Brent Oil	5.9%	17.7%	-15.4%	32.5%	5.3%	50.1%
UK Property	0.3%	0.2%	0.4%	0.7%	2.5%	13.1%
Global Property Shares	1.5%	3.8%	0.9%	13.0%	0.6%	16.8%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*0.0%*	*1.3%*	*1.0%*	*2.1%*	*0.8%*	9.9%
Rivers Cautious Portfolio	*0.9%*	*3.0%*	*2.5%*	*4.6%*	*3.0%*	18.0%
Rivers Balanced Portfolio	*1.2%*	*3.8%*	*3.9%*	*6.3%*	*4.7%*	23.9%
Rivers Adventurous Portfolio	*1.3%*	*4.2%*	*4.4%*	*7.0%*	*5.2%*	26.3%
Rivers Aggressive Portfolio	*2.3%*	*5.4%*	*6.0%*	*8.9%*	*5.4%*	32.2%
Rivers Cautious Income Portfolio	*1.0%*	*2.9%*	*3.0%*	*5.5%*	*2.7%*	10.5%
Rivers Balanced Income Portfolio	*1.5%*	*3.5%*	*3.7%*	*6.3%*	*3.0%*	17.1%

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