Current Focus

June 2019

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

INTELLIGENT INTUITIVE INVESTING

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Summary

- Concerns over trade affected equities during May and impacted global bond yields
- Fixed Income markets are forecasting rate cuts and global slowdown
- Rate cuts in the US are possible but nominal rates are already very low
- A defensive allocation is justified but we remain ready to act should valuations improve further

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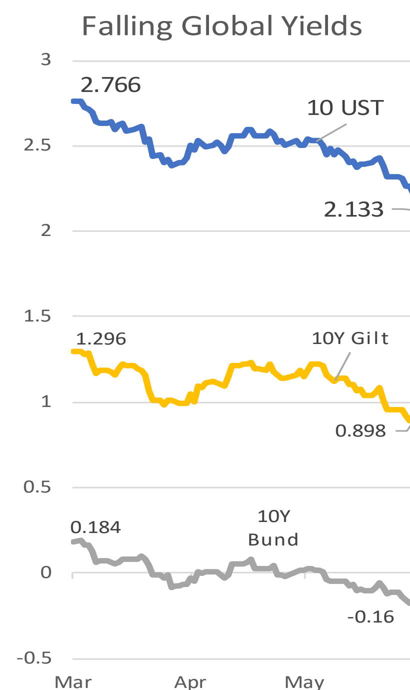
Market Comment

While the on-going trade dispute with China, and more recently Mexico, has affected equity valuations the impact has so far been modest. This is especially the case considering the high valuations prevailing in many sectors and equity indices that remain significantly above where they started the year. What is most interesting is how modest any equity moves have been when compared to the moves and recessionary warning signs that have been coming from the bond market in recent weeks. To put this in context the US Equity market remains within 5% of its all-time high while the Bond market has moved significantly in the last month and now appears to be pricing in a major economic slowdown. It seems almost impossible that both can be correct although in these unprecedented times few things should still surprise us. In this month's Current Focus we will look at the recent fall in bond yields, in the US and elsewhere, and explain why this should concern investors and does concern us. We will consider if rate cuts, now expected in the US, or further Central Bank intervention will be sufficient to sustain economic growth despite the looming issues regarding trade, Brexit, European stagnation and a possible Chinese slowdown.

Since the start of 2019 bond yields have been falling almost everywhere most notably in Japan, Britain, Australia, Germany and the United States. By the end of May, long-term yields on government bonds around the world were at their lowest levels in recent years and in some cases, like Germany, the lowest they have ever been. This tumble in long-term bond yields is especially unnerving because, in the US, it has pushed long-term yields even lower than short-term yields – as low as 2% when overnight interest rates are at 2.5%. Towards the end of May, the 10 year US Treasury interest rate fell below the 3 month benchmark rate for the first time since 2008. This event grabbed a number of headlines as every previous time this has happened in the last 60 years the US has experienced an economic recession within 2 years. Given that the US is currently growing at 3.1% this would be quite a reversal and is indicative of the effects of the trade war. The impact to global trade sufficient to cause a recession in the US would be significant particularly as Europe and Japan appear to be stagnating already and any trade war is expected to hit China worst of all. In addition to the fixed income warning signs coming from yields there have been similar negative signals from inflation and corporate credit markets. In a



Source: Investing.com

possible foreshadowing of falling demand and in spite of near record employment US inflation expectations, expressed through the inflation-linked bond market, are down and are now grounded below the Federal Reserve 2% target going forward. Finally looking briefly at the corporate sector, credit spreads remain low from a historical perspective but rose in May as investors have grown worried about the impact of trade tensions on corporate profits. The US bond markets are consistent in their message that an economic slowdown is expected

The warning signs coming from the US Bond market are also consistent with the red flags we see in Europe, Japan and the UK where yields have fallen significantly. It is perhaps even more concerning for Europe and Japan as both the ECB and Japanese Central Bank are still using 'unconventional' monetary stimulus tools – essentially Quantitative Easing - at unprecedented levels. Those Central Banks had been hoping, by now, to be in a position to decrease, not increase, the size of their balance sheets following the path the US Federal Reserve started over two years ago. In the US (and to a tiny extent the UK, although we still have Brexit to deal with) there is at least some room to cut rates in the traditional sense before zero

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rates and QE become necessary once again. Federal Reserve Chairmen Powell was clear in a speech in Chicago on June 4th that he is prepared to act and at least he has the enviable position of not already being at the ELB (effective lower bound) he has been so clear to articulate recently. What is worrying to us is that it is this possibility, or now expectation, of rate cuts, which has sustained the equity markets at their current levels. It is hard to imagine, if recession is not avoided, that investors will be rushing to embrace risky equities if they think a recessionary wave is threatening to overtake the economy, even if interest rates are coming down, but this does appear to be the overriding driver of markets.

Interest rate cuts may, for the US, soften the slowdown but ultimately after what has been the longest period of positive growth since the second world war, however fabricated, perhaps a slowdown is inevitable. Whether this can be delayed or prevented by further inflating central bank balance sheets is debatable. Also debatable is the sense of starting or escalating a trade war when economic growth appears so vulnerable, but that is not for us to say. Given that fixed income investors tend to have a far better track record when it comes to economic forecasting than anybody else, what we will say is that we intend to continue the defensive position we adopted across the portfolios in early March. That said, should valuations improve further we will not delay or amend our intension to increase risk from our current underweight position. After all, if the last 10 years have shown us anything it is, to *never* fight the Fed!

Market Returns (£) - 31st May 2019	1 Month	3 Month	6 Month	YTD	1 Year	S/I*
Anchors						
Cash + 1%	0.2%	0.5%	0.9%	0.8%	1.8%	4.6%
Inflation Linked UK Bonds	4.4%	8.4%	7.2%	5.7%	7.6%	12.8%
Gilts	2.9%	4.7%	7.3%	4.8%	4.4%	6.1%
Global Government Bonds (hedged)	1.5%	2.9%	4.8%	3.4%	4.7%	2.4%
Enhancers						
Global Corporate Bonds (hedged)	0.9%	3.5%	6.6%	5.6%	5.1%	6.7%
Global High Yield (hedged)	-1.1%	0.3%	4.7%	5.8%	3.2%	14.7%
Emerging Market Bonds (hedged)	3.9%	4.5%	6.2%	4.5%	7.2%	15.5%
FTSE 350 TR Index	-3.1%	2.2%	4.9%	9.0%	-3.2%	24.6%
FTSE UK All-Small Cap	-1.6%	2.7%	4.1%	8.1%	-3.7%	35.7%
Global Equity (MSCI)	-2.5%	4.3%	3.8%	10.9%	6.4%	38.9%
European Equity (MSCI)	-2.0%	4.1%	5.7%	9.8%	1.3%	29.6%
US Equity (S&P)	-3.2%	4.7%	1.7%	11.6%	8.9%	44.9%
Japan Equity (Topix)	-1.4%	2.9%	-2.7%	4.8%	-6.4%	29.8%
Pacific Ex Japan Equity (MSCI)	-6.4%	-1.7%	1.5%	4.4%	-8.2%	37.3%
Emerging Market Equity (MSCI)	-4.1%	0.8%	2.3%	5.2%	-3.8%	35.3%
Chinese Equity (Hang Sang)	-5.2%	0.5%	4.1%	6.6%	-3.1%	49.9%
Indian Equity (Nifty)	3.7%	16.2%	8.8%	9.1%	12.8%	43.6%
Diversifiers						
Commodity Index	-0.1%	1.4%	-3.6%	3.4%	-7.5%	-3.3%
Gold	5.2%	4.8%	8.0%	2.9%	5.5%	2.6%
Silver	0.8%	-1.7%	3.7%	-5.5%	-7.4%	-19.9%
Brent Oil	-7.9%	3.8%	16.5%	22.5%	-8.1%	38.8%
UK Property	0.1%	0.4%	0.4%	0.7%	1.8%	13.1%
Global Property Shares	-3.1%	-2.1%	5.0%	8.8%	-5.8%	12.6%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*0.8%*	*1.9%*	*2.5%*	*2.9%*	*1.0%*	10.8%
Rivers Cautious Portfolio	*0.4%*	*2.8%*	*3.1%*	*5.1%*	*2.2%*	18.5%
Rivers Balanced Portfolio	*-0.2%*	*2.8%*	*3.2%*	*6.0%*	*2.6%*	23.6%
Rivers Adventurous Portfolio	*-0.3%*	*3.0%*	*3.3%*	*6.7%*	*2.8%*	26.0%
Rivers Aggressive Portfolio	*-1.3%*	*2.9%*	*2.9%*	*7.4%*	*1.6%*	30.4%
Rivers Cautious Income Portfolio	*-0.1%*	*2.1%*	*3.1%*	*5.4%*	*2.1%*	10.4%
Rivers Balanced Income Portfolio	*-0.4%*	*2.5%*	*3.5%*	*5.9%*	*1.5%*	16.7%

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

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