Current Focus

August 2019

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

RIVERS CAPITAL MANAGEMENT

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Summary

- Portfolio returns remain strong driven by expectation of central bank intervention
- Global slowdown continues and unlikely to be reversed by immediate rate cuts
- US and other equity indices vulnerable from slowing corporate investment
- Rivers portfolios positioned to opportunistically add risk at more attractive valuations

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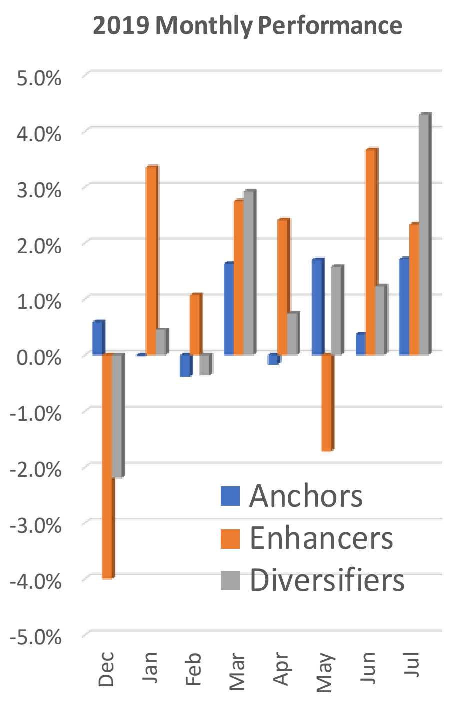
Market Comment

During July many markets continued to behave as if whatever slowdown had occurred to global growth would be easily offset by monetary easing. This is a view that began during the market recovery earlier this year when the US Federal Reserve called time on monetary tightening. The view became more dominant in recent months as the easing rhetoric, from many Central Banks, increased. As we wrote last month, we don't think Central Banks have either the ability or the wherewithal to completely counter the ongoing global slowdown. Central banks around the world are likely to loosen further, keeping sovereign yields very low. We doubt, however, that will bring about a clear economic improvement as quickly as investors hope. In this month's Focus we look specifically at our outlook for asset classes for the rest of 2019 and how we think the strong returns we have enjoyed year to date can best be sustained.

The global slowdown, which started last year, probably has further to go with world GDP growth set to slow later this year to around its weakest pace since 2009. Since the first quarter, when growth was slightly stronger than expected, the world economy has lost further momentum. Global industrial production has continued to weaken as the US manufacturing sector indicated its slowest overall expansion since the height of the financial crisis. Outside the US the boost from stimulus measures in China has largely petered out, while German industry has remained weak. The near-term outlook for investment growth is poor. While financial conditions have loosened since the start of 2019, bank lending and business surveys reveal that firms' appetites to invest has waned from what were already relatively low levels.

With investment intentions unlikely to recover soon it is difficult to justify the current elevated levels seen in many equity indices. The recent escalation of the trade war between the US and China will not improve matters. President Trump announced that the US is to impose a 10% tariff on the $300bn of imports from China not already subject to tariffs this year and raise that to 25% in 2020. China plans to retaliate with tariff hikes on US exports and extend restrictions to other goods. This will affect global GDP as well directly impacting consumption – it is no wonder President Trump is applying pressure on the Federal Reserve to lower interest rates further.



Source: River Capitla Management

Looking at asset classes specifically, at Rivers we categorise them into 'Anchors', which provide predictable but low returns; 'Enhancers', which target higher returns, tend to be equity related and high risk; and Diversifiers, which avoid medium term exposure to equity or interest rate risks. So far this year all three asset types have provided positive performance, particularly in the first quarter. The expectation of lower interest rates, and increased monetary stimulus, has also been to boost all three asset types especially Enhancers. Anchors rose as interest rate yields have fallen, and Diversifiers as Precious Metals, Global Property and other Uncorrelated assets such as insurance have gained. This in part explains why year to date Cautious portfolios, with less Enhancer exposure, seem to have done nearly as well as Aggressive ones, with more, and better on a risk adjusted basis.

We expect the trade war and the relative ineffectiveness of monetary easing on corporate profits, to impact Enhancers over the coming months. We see this, at least in the short term, as a buying opportunity and would advise switching Anchor allocation to Enhancer allocation if more attractive valuations become available. We expect any corrections to be led by US Equities but also to affect other developed and emerging markets as sentiment falls. We do not expect the slowdown to lead to a full-blown recession, at least not this year, so see it as an opportunity to decrease Anchors and increase Enhancers from our current defensive allocation.

We do not expect Anchor assets, significantly driven by interest rates, to lose value but with Gilt yields having already fallen by more than would have been anticipated, the likelihood of further gains is small. Gilts have been supported by safe-haven flows, as the chances of a no-deal Brexit have risen and fears over the health of the UK economy have grown. Brexit fears over no-deal have also devalued the pound and increased the return, in sterling terms, of all foreign denominated assets. Regarding Brexit, if the UK leaves without a deal, we anticipate that the BoE will cut interest rates and that the pound will weaken further but with 10 year yields already as low at 0.5% further significant falls are unlikely. In any case, for what it is worth, our expectation is that Brexit gets delayed again, or a deal is reached, and no-deal is avoided, in which case Gilt yields and sterling will rebound.

Ultimately portfolio returns will be primarily driven by global factors. The portfolios are cautiously positioned for what we expect will be a challenging investment period ahead. This cautious position, however, provides the opportunity to increase risk more easily when valuations get more attractive.

Market Returns (£) - 31st July 2019	1 Month	3 Month	YTD	1 Year	3 Year	S/I*
Anchors						
Cash + 1%	0.2%	0.5%	1.1%	1.8%	4.8%	5.0%
Inflation Linked UK Bonds	4.1%	9.3%	10.6%	11.5%	16.1%	18.1%
Gilts	2.2%	5.4%	7.2%	7.9%	6.4%	8.6%
Global Government Bonds (hedged)	0.7%	3.4%	5.3%	6.8%	4.1%	4.4%
Enhancers						
Global Corporate Bonds (hedged)	0.8%	3.7%	8.5%	7.9%	7.9%	9.7%
Global High Yield (hedged)	0.7%	2.3%	9.4%	5.8%	15.8%	18.7%
Emerging Market Bonds (hedged)	5.1%	14.0%	14.6%	16.4%	25.1%	26.7%
FTSE 350 TR Index	2.1%	2.7%	15.5%	1.4%	27.0%	32.0%
FTSE UK All-Small Cap	-0.1%	-1.2%	8.6%	-3.0%	27.4%	36.3%
Global Equity (MSCI)	4.5%	7.5%	22.3%	11.0%	46.0%	53.2%
European Equity (MSCI)	2.0%	5.7%	18.4%	4.1%	33.4%	39.8%
US Equity (S&P)	5.4%	8.1%	24.7%	15.0%	55.1%	61.9%
Japan Equity (Topix)	4.1%	5.2%	11.9%	1.0%	29.4%	38.5%
Pacific Ex Japan Equity (MSCI)	2.5%	2.1%	13.9%	4.0%	42.0%	49.8%
Emerging Market Equity (MSCI)	2.7%	3.6%	13.6%	4.8%	38.2%	46.1%
Chinese Equity (Hang Sang)	1.4%	1.9%	14.6%	8.1%	51.9%	61.1%
Indian Equity (Nifty)	-1.5%	0.9%	6.2%	2.9%	31.3%	39.7%
Diversifiers						
Commodity Index	3.2%	4.9%	8.5%	1.4%	6.2%	1.5%
Gold	5.0%	18.2%	15.6%	24.2%	11.9%	15.2%
Silver	11.4%	16.7%	9.4%	11.9%	-15.7%	-7.3%
Brent Oil	0.6%	-5.5%	25.7%	-6.9%	65.3%	42.4%
UK Property	0.0%	0.0%	0.7%	0.9%	16.8%	13.1%
Global Property Shares	-2.7%	-5.4%	6.2%	-8.0%	4.4%	9.8%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*1.0%*	*2.6%*	*4.8%*	*3.0%*	*11.0%*	12.8%
Rivers Cautious Portfolio	*2.0%*	*4.2%*	*9.1%*	*5.2%*	*19.4%*	23.0%
Rivers Balanced Portfolio	*2.1%*	*4.4%*	*10.9%*	*6.0%*	*24.3%*	29.2%
Rivers Adventurous Portfolio	*2.2%*	*4.8%*	*12.1%*	*6.4%*	*26.7%*	32.3%
Rivers Aggressive Portfolio	*2.7%*	*5.4%*	*14.7%*	*6.4%*	*32.7%*	39.2%
Rivers Cautious Income Portfolio	*1.2%*	*2.6%*	*8.3%*	*3.8%*	*10.9%*	13.4%
Rivers Balanced Income Portfolio	*1.5%*	*3.1%*	*9.6%*	*3.9%*	*17.0%*	20.7%

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