Current Focus

November 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

- Sterling strength affected returns significantly during October
- Earnings in the US have fallen and are expected to be negative in the final quarter
- Equity indices continue positive trend despite falling revenue and profits
- Defensive portfolio position remains appropriate despite seasonal trends
- High valuations and political risk remain elevated and justify cautious stance

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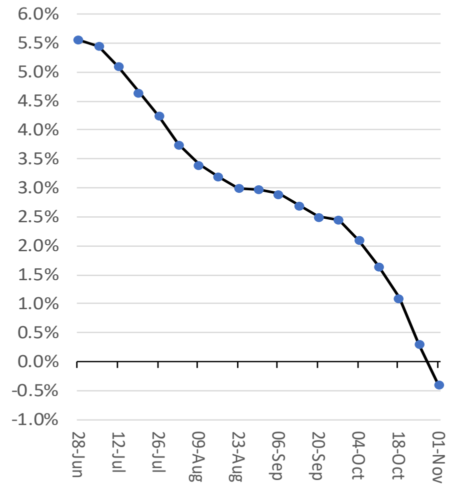
Market Comment

For months in the UK nearly all news flow has been dedicated to Brexit. This has now been overtaken by coverage of the forthcoming UK General Election, which claims to be about more than just Brexit, but is really only about Brexit. How it resolves is impossible to predict so we are not going to try. What we do still think, as we wrote in September 2018, is that Brexit is unlikely to be resolved anytime soon. We will leave such speculation to others though and instead try to Focus on global economic news instead. One of the primary drivers to global economics, and the performance of the portfolios we manage, is US Corporate Earnings. So that is our Focus this month. The third quarter earnings 'season' is in full swing and probably provides more indication as to what to expect for investors in 2020, than the domestic political debate we are likely to be consumed by over the next month or so.

US Corporate earnings have been better than expected, or at least not as bad as expected. The S&P 500, the primary US equity index, hit all-time highs during the first week of November. By the start of November, 71% of the companies in the S&P 500 had reported actual results for Q3 2019. In terms of earnings, the percentage of companies reporting actual EPS above estimates (76%) was above the 5-year average. The blended (combines actual results for companies that have reported and estimated results for companies that have yet to report) earnings decline for the third quarter is -2.7%, which is smaller than the earnings decline of -3.8% that was expected. If -2.7% is the actual decline for the quarter, it will mark the first time the index has reported three straight quarters of year-over-year declines in earnings since Q4 2015 through to Q2 2016. The blended revenue growth rate for the third quarter is 3.1%, which is above the expected revenue growth rate of 2.8%. This is positive but it is worth noting that if 3.1% is the actual growth rate for the quarter, it will mark the lowest revenue growth rate for the index since Q3 2016 (2.7%). So ok, but not record breaking.

With earnings lower, but better than expected, the positive performance of the index was more likely related to the Federal Reserve's expected cut in interest rates. This modest cut, despite the accompanying statement that suggested further cuts would be unlikely, seemed to boost overall

Expected Earnings Growth Rate Q4 2019



Source: Factset

confidence that any economic slowdown will be contained. With the S&P Cape Shiller index now back above 30 (historically very high) we believe our cautious stance in relation to Enhancers remains justified. Looking at the earnings in more detail provides further justification for our caution.

The first factor is the divergence between US domestic earnings and Non-US earnings which point to a much more challenged economic picture outside the US. Companies in the S&P 500 with more international revenue exposure, are reporting a much larger decline in earnings relative to S&P 500 companies with less international revenue exposure. For S&P 500 companies that generate more than 50% of revenue outside the U.S., the blended earnings decline is -7.6%. For S&P 500 companies that generate more than 50% of revenue inside the U.S., the blended earnings decline is -0.1%. The slowdown is more pronounced outside the US with demand falling in Europe and Asia, which will affect US growth.

The second factor is that forward earnings expectations are deteriorating. Expectations for earnings growth for Q4 2019 have been falling over the past few months. On June 30th, the estimated earnings growth rate for Q4 2019 was 5.6%. By September 30th, the estimated earnings growth rate had fallen to 2.4%. As of November 1st, the earnings decline stood at -0.4%. This is a typical pattern (as analysts tend to get more realistic over time) but it is backed up by reports. By November 1st, 64 companies in the S&P 500 index have issued forward EPS guidance for Q4 2019, 45 (70%) have issued negative EPS guidance and 19 have issued positive EPS guidance. This is not a major concern on its own but probably does not justify all time index highs.

In our view, given these factors, equities in the US are more expensive now, on a relative basis, than in other regions. The US economy is still growing, and it is likely President Trump will try and extend this growth into 2020, for his re-election bid, but the concerns we had earlier in the year regarding manufacturing and a global slowdown continue. The US jobs report from October did point to continued job creation, and some signs that a higher proportion of the population are seeking work, but some of the detail showed an economy that is already slowing down. Manufacturing jobs and part time employment were both negative and wage growth slowed despite historically low unemployment.

From a seasonal perspective, equities and therefore Enhancers, tend to perform well during November and December but we are reluctant to increase exposure in the current environment. Given the ongoing political concerns, and the current equity valuations relative to earnings, we expect the portfolios to remain relatively defensively positioned going into December. We are not expecting the volatility seen during the last quarter of 2018, but we do expect an opportunity to increase risk, at more favourable valuation levels, in the future. 2020 holds many uncertainties for investors. Given the continued strong performance of uncorrelated Diversifier asset types we are happy to be patient and to maintain current allocations.

Market Returns (£) - 31st Oct 2019	1 Month	3 Month	YTD	1 Year	3 Year	S/I*
Anchors						30/06/2016*
Cash + 1%	0.2%	0.5%	1.5%	1.8%	4.9%	5.4%
Inflation Linked UK Bonds	-4.5%	-3.7%	6.6%	7.3%	4.2%	13.8%
Gilts	-1.9%	2.3%	9.7%	10.9%	13.1%	11.1%
Global Government Bonds (hedged)	-0.6%	1.2%	6.6%	8.7%	7.4%	5.7%
Enhancers						
Global Corporate Bonds (hedged)	0.3%	1.8%	10.4%	11.1%	10.7%	11.6%
Global High Yield (hedged)	0.3%	-0.7%	8.6%	6.4%	11.9%	17.8%
Emerging Market Bonds (hedged)	-1.7%	-4.3%	9.7%	14.0%	8.1%	21.2%
FTSE 350 TR Index	-1.5%	-2.2%	13.0%	6.9%	19.3%	29.1%
FTSE UK All-Small Cap	0.1%	-0.7%	7.8%	3.3%	20.4%	35.3%
Global Equity (MSCI)	-2.3%	-2.9%	18.7%	11.3%	32.1%	48.7%
European Equity (MSCI)	-1.6%	-2.2%	15.8%	10.0%	22.3%	36.7%
US Equity (S&P)	-2.7%	-3.2%	20.6%	12.2%	40.6%	56.7%
Japan Equity (Topix)	0.0%	2.2%	14.4%	7.1%	17.4%	41.6%
Pacific Ex Japan Equity (MSCI)	-0.4%	-4.1%	9.2%	11.3%	20.5%	43.6%
Emerging Market Equity (MSCI)	-0.8%	-4.4%	8.6%	10.5%	16.8%	39.7%
Chinese Equity (Hang Sang)	-1.6%	-7.6%	6.0%	10.3%	22.2%	48.9%
Indian Equity (Nifty)	-0.7%	-1.2%	4.9%	16.0%	19.6%	38.0%
Diversifiers						
Commodity Index	-2.8%	-4.6%	3.6%	-3.8%	-7.6%	-3.2%
Gold	-1.9%	0.2%	15.8%	22.4%	9.9%	15.4%
Silver	1.4%	3.9%	13.7%	23.5%	-7.5%	-3.7%
Brent Oil	-5.8%	-12.0%	10.6%	-21.5%	19.3%	25.4%
UK Property	0.1%	0.4%	1.0%	0.7%	14.1%	13.5%
Global Property Shares	5.0%	14.9%	22.0%	12.4%	26.4%	26.2%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*-1.0%*	*-0.4%*	*4.3%*	*3.2%*	*6.8%*	12.4%
Rivers Cautious Portfolio	*-1.3%*	*-1.1%*	*7.9%*	*5.7%*	*12.8%*	21.7%
Rivers Balanced Portfolio	*-1.2%*	*-1.1%*	*9.7%*	*7.3%*	*16.5%*	27.8%
Rivers Adventurous Portfolio	*-1.3%*	*-1.4%*	*10.5%*	*7.8%*	*18.0%*	30.5%
Rivers Aggressive Portfolio	*-1.4%*	*-2.3%*	*12.0%*	*9.0%*	*21.4%*	36.0%
Rivers Cautious Income Portfolio	*-0.2%*	*0.1%*	*8.4%*	*5.9%*	*8.8%*	13.6%
Rivers Balanced Income Portfolio	*-0.3%*	*-0.2%*	*9.3%*	*6.7%*	*12.0%*	20.4%

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