Current Focus

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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

- Lockdown is reducing Covid-19 infection rates at considerable economic cost
- Provided lockdowns are limited we expect the economic cost to be limited
- On a valuation basis equities look attractive froma valuation perspective
- We expect most major economies to recover levels of output within two years

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Market Comment

Looking back at the last two months it is quite breath-taking how quickly events surrounding the Coronavirus have developed. In February we wrote how this was affecting the Chinese economy and how it was not being reflected in asset prices. We were cautious but, considering the subsequent market moves, not nearly cautious enough. The crisis we are experiencing today was unimaginable when the US Equity market set a record high on February 19th. Since then the rapid global spread of what is now known as COVID-19 has led to a global lockdown. A crisis that started in the markets of Wuhan has led to one of the sharpest and unprecedented losses in financial markets. The disaster is unfolding with the almost total blockade of both domestic and foreign consumption, and investment which has resulted in a significant reduction in production capacity. The question for all investors, and our Focus this month, is whether the recession, which is now certain, is temporary or protracted and whether it is even more devastating than the tragic impact of the virus itself. We think the answer is the former and believe that the opportunity for investors remains positive.

First let us consider the current spread of this virus. So far over 70,000 people have died after testing positive for COVID-19. The death toll is still accelerating, having only exceeded 30,000 on March 29th but the status is extremely varied in different regions. An overview of the virus shows its spread is now slowing in Asia, approaching its peak in Europe but still accelerating fast in the US. Different levels of testing and even different classifications of the cause of death make comparisons problematic but some clear patterns are emerging. Measurement of the spread of serious cases shows that the policy of lockdown, does appear to be working. In Italy after two to three weeks of total lockdown the numbers of hospitalisations and deaths appear to have stabilised. The very latest numbers show this also to be the case for Spain. In the UK the numbers are still rising but the lockdown is so far just two weeks old, with most commentators expecting a peak to be reached before Easter. The US now has the most cases globally and is expected to overtake Italy and Spain in terms of fatalities within a week or so. Some tentative signs that in New York the death rate may have peaked very recently are encouraging but it is too early to draw any conclusions. If lockdown does work, then the next question

US Equity Cyclically Adjusted Price to Earnings Ratio

Source: https://www.multpl.com/shiller-pe

will be what happens next? How long does it last and what happens when it is relaxed?

Answers to these questions will define the final economic impact of the virus. It is now a fact that the world is heading for the sharpest and deepest global slowdown since WW2. However, comparisons with other recessions are less meaningful as, unlike all others, this slowdown is self-imposed. There is hope that so long as the lockdown is temporary in the short-term the recovery will be very sharp. This depends on whether the support being offered to businesses and consumers, by government stimulus, will manage to bridge the economic gap caused by the lockdown. If it is, there is scope for a rapid return to previous levels of activity. Once the virus has passed and restrictions are eased, the economy's capacity to produce goods and services should rebound strongly; firms will re-open and people who were temporarily laid off or took unpaid leave will go back to work. Of course, some sectors (airlines, entertainment, restaurants) will have lost business forever but if the substantial government support in the form of loans and grants proves effective, even many of these should survive. People are unlikely to lose their skills during a relatively short period of unemployment and so long as long-term unemployment is avoided corporate earnings will also rebound quickly. Much is made of the incredible spike in unemployment claimants in the US but with unemployment benefit raised to $600 a week for 13 weeks it is not entirely surprising.

Looking more closely at markets we can see that since February, the US, UK and

European indices have lost over 20% in value. In the US this has removed all the gains since 2016 and in the UK the FTSE 100 is at a level not seen since 2012. For valuations in the US we often refer to the CAPE-Schiller multiple. This attempts to illustrate the attractiveness of equities compared to the average earnings of corporations over the last 10 years. This level has fallen from a worryingly high level in February of 31.1 to a more reasonable 23.4 at the beginning of April. We have not seen these levels since the 'taper tantrum' of 2013 when interest rates were expected to rise sharply. It is worth noting that even at this level, valuations do not look 'cheap' on a historical basis (the long-term average is 17) but given the discount rate on future earnings, and our expectations that the fall in earnings is short lived, we consider equities more attractive that we have for some time. Current valuations are pricing in an extended lockdown and a medium-term substantial fall in corporate earnings. We do not think that is likely and expect that the fiscal support will avert that.

Our current outlook is that most economies should ultimately return to the path of output they were on before the crisis. We do not expect the so-called U-shaped recession that some are predicting, with economies bumping along the bottom for a long time. That said we think it is unlikely that either price/earnings multiples or indices reach the highs they saw in February for some time. We expect volatility to remain high and the opportunity for active management to increase. We do not think the impact of the virus on global economics to be as significant as the financial crisis. Nor does it look likely, thankfully, that its death toll will exceed the Asian Flu of 1958 or the Hong Kong Flu of 1968. That said we do expect the impact of Covid-19 to be significant. Long after a vaccine is discovered, and the lethality of the virus significantly mitigated, the legacy of Covid-19 will be its lasting effect on such things as the role of the state and the future of globalisation. These issues will be our focus for future months but in the meantime, we hope all our readers stay well.

Market Returns (£) - 31st Mar 2020	1 Month	3 Month	YTD	1 Year	3 Year	S/I*
Anchors						30/06/2016*
Cash + 1%	0.1%	0.4%	0.4%	1.8%	5.1%	6.2%
Inflation Linked UK Bonds	-0.1%	5.7%	5.7%	8.1%	10.9%	17.2%
Gilts	2.7%	8.1%	8.1%	11.9%	16.9%	17.3%
Global Government Bonds (hedged)	0.2%	3.6%	3.6%	7.0%	11.9%	8.3%
Enhancers						
Global Corporate Bonds (hedged)	-7.4%	-4.8%	-4.8%	1.1%	6.1%	6.4%
Global High Yield (hedged)	-14.6%	-15.9%	-15.9%	-11.9%	-6.9%	1.4%
Emerging Market Bonds (hedged)	-9.0%	-10.2%	-10.2%	-2.4%	-2.6%	8.7%
FTSE 350 TR Index	-14.9%	-25.0%	-25.0%	-18.4%	-12.1%	2.1%
FTSE UK All-Small Cap	-20.9%	-28.2%	-28.2%	-19.9%	-14.5%	6.2%
Global Equity (MSCI)	-10.6%	-15.7%	-15.7%	-5.0%	7.7%	29.7%
European Equity (MSCI)	-12.2%	-19.7%	-19.7%	-11.4%	-6.2%	13.2%
US Equity (S&P)	-9.8%	-14.2%	-14.2%	-2.8%	15.0%	40.0%
Japan Equity (Topix)	-3.4%	-12.0%	-12.0%	-2.9%	2.5%	24.6%
Pacific Ex Japan Equity (MSCI)	-7.9%	-11.3%	-11.3%	-6.9%	6.9%	34.0%
Emerging Market Equity (MSCI)	-12.9%	-18.4%	-18.4%	-13.5%	-4.0%	19.5%
Chinese Equity (Hang Sang)	-6.3%	-9.7%	-9.7%	-10.3%	10.3%	38.7%
Indian Equity (Nifty)	-22.9%	-26.4%	-26.4%	-30.3%	-21.3%	0.1%
Diversifiers						
Commodity Index	-10.2%	-18.1%	-18.1%	-18.4%	-23.0%	-20.7%
Gold	4.8%	11.7%	11.7%	28.5%	26.0%	26.3%
Silver	-11.4%	-15.7%	-15.7%	-2.9%	-24.5%	-21.8%
Brent Oil	-10.2%	-18.1%	-18.1%	-18.4%	-23.0%	-20.7%
UK Property	-1.1%	-1.0%	-1.0%	0.1%	9.9%	12.9%
Global Property Shares	-18.3%	-27.5%	-27.5%	-14.8%	-8.7%	-2.0%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*-5.4%*	*-4.7%*	*-4.7%*	*-2.6%*	*0.1%*	7.0%
Rivers Cautious Portfolio	*-5.9%*	*-6.7%*	*-6.7%*	*-2.3%*	*2.7%*	14.4%
Rivers Balanced Portfolio	*-7.7%*	*-9.7%*	*-9.7%*	*-4.4%*	*2.6%*	17.0%
Rivers Adventurous Portfolio	*-7.4%*	*-10.1%*	*-10.1%*	*-4.5%*	*2.6%*	19.1%
Rivers Aggressive Portfolio	*-9.1%*	*-13.8%*	*-13.8%*	*-6.6%*	*1.0%*	20.7%
Rivers Cautious Income Portfolio	*-10.2%*	*-12.3%*	*-12.3%*	*-7.7%*	*-5.3%*	0.9%
Rivers Balanced Income Portfolio	*-11.2%*	*-14.3%*	*-14.3%*	*-8.9%*	*-5.3%*	5.1%

Source: Financial Express in GBP (unhedged unless stated) as at 31st March 2020. *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.