Current Focus

June 2020

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

- The market rally from March lows continued throughout May
- The pandemic appears to be slowing but infections remain high in many areas
- Political risk is high and aggregate demand expected to recover only slowly
- Given elevated risk high valuation in many equities do not appear justified
- Tactical portfolio risk is likely to be reduced in coming weeks

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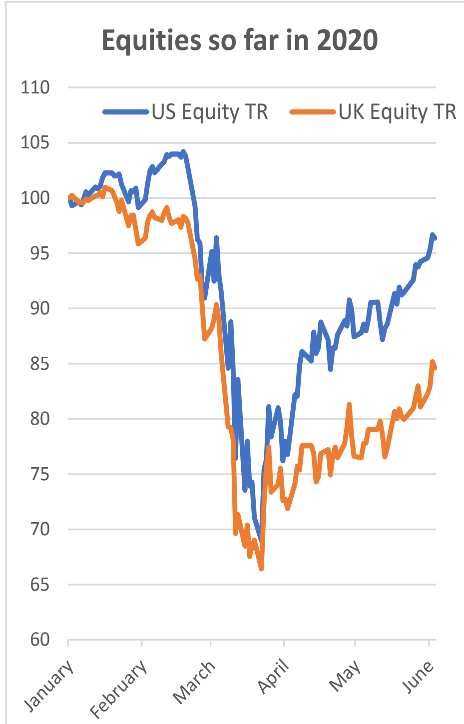
Market Comment

The market recovery from the Coronavirus induced lows of March continues. Lockdown has begun to be relaxed in many countries and investors are becoming increasingly confident that better times lie ahead. Over the last few months we have been relatively positive about the economic outlook beyond the Coronavirus although the speed and strength of the market recovery has recently begun to concern us. In this month's Focus we look broadly at current asset valuations and consider why high economic, political and Coronavirus related risks sway us towards a more cautious stance in the short to medium term.

For some time before Covid-19 impacted global economies, we had warned that we considered valuations in many equity markets to be high. Corporate earnings did increase slightly during 2019 but not nearly as much as equity valuations. These high valuations were, in our view, unsustainable and were ignoring rising political and liquidity risks. The political risks included the US-China trade war, Brexit, the US Election, tensions with Iran and within Opec, among many other issues. Protectionist policies were increasing, and historically they have always hampered international trade. The liquidity risks were less reported but the issue of the US Federal Reserve having to intervene in the essential US monetary markets was a concern. In the last quarter of 2019, the Fed conducted daily operations totalling more than $234 billion in order to reduce market volatility. None of this seemed to dampen market sentiment but it was the reason we started 2020 at a River's Risk level of 2, materially below a market-neutral position, which we consider to be a 4 (out of 7).

From the start of 2020 the escalating Coronavirus threat increased our concern even as equity markets continued to rally. By the time equity markets hit all time highs on February 20th it had become obvious that what looked like a virus that would impact Chinese growth was set to engulf the world. Initially we underestimated the impact. We raised the risk level to 3 but remained underweight on February 28th. On March 12th we increased risk further moving to the strategic neutral risk position (risk level 4) in all portfolios. Our analysis showed that whatever the short-term impact of the virus and the lockdown, the unprecedented governmental and monetary support made equity valuations



Source: FT.com

much more attractive than they had been for some time. In our view the market falls in March, which hit their lows on March 23rd, were a result of panic selling and a need for short term liquidity.

The rally from those lows coincided with gradual slowing of the virus infection rates and, later, the initial easing of lockdown restrictions in many countries. Just as the market had fallen sharply, the V-shaped market recovery continued for most of April despite a historically unprecedented rise in unemployment, a total collapse in productivity and estimates of a 20-40% drop in GDP in many countries. There were signs that the collapse in economic activity, caused by the pandemic, bottomed out in April which was a relief but risk remained high. By the start of June many markets are now less than 10% lower than the start of the year. This has been a positive contribution across all portfolios but in recent weeks has begun to concern us.

The political risks that existed at the start of the year have increased and not been alleviated by greater cohesion sparked by the pandemic solidarity. Despite apparent global collaboration on seeking a vaccine the rhetoric around blame for the virus, and its spread, combined with restrictions on travel will likely last years. The effect of this will impact global trade more significantly than any previously feared tariffs. This may arguably be good for domestic supply chains, not to mention the environment, but it is dependent on sustained aggregate domestic demand. Demand and its recovery is the biggest uncertainty right now. The evidence from China, which is a month or so ahead of the US and Europe in regard to the virus, gives us pause for concern; while manufacturing production has rebounded, retail sales have been much slower to recover. This partly reflects a jump in unemployment, but it also reflects the fact that those workers with a job remain reluctant to spend. The reality is, even if the lockdown was entirely relaxed tomorrow, the propensity for people to spend, even for those who keep their jobs will take a long time to recover. This does not support our initial thoughts that provided the economic fallout can be backstopped by the government then demand will revert to previous levels relatively quickly. We now think that is unlikely.

Comparing our cautious tactical, Risk Level 2, stance in January to our current outlook is interesting. Political risks are now significantly higher, aggregate demand is much lower and the risk to any economic recovery is significant, even if one ignores the chance of the pandemic re-emerging. Liquidity concerns are no longer a problem and monetary policy is likely to encourage speculative investment for some time to come. Bond rates are very close to zero, or below and the provision of corporate liquidity is huge and very inexpensive. Pseudo-government backed corporate leverage, is, in our view, the primary current driver to investment markets. This is problematic if not supported by aggregate demand relatively soon. We do still think that is possible, at least in the medium term, but the risk it is not is high enough for us to take a more cautious stance in the coming weeks and to revert to a Risk level 2 across the portfolio's we manage.

Market Returns (£) - 31st May 2020	1 Month	3 Month	YTD	1 Year	3 Year	S/I*
Anchors						30/06/2016*
Cash + 1%	0.1%	0.4%	0.7%	1.7%	5.1%	6.4%
Inflation Linked UK Bonds	3.4%	3.5%	9.5%	7.6%	15.2%	21.4%
Gilts	-0.4%	4.3%	9.8%	12.4%	17.9%	19.2%
Global Government Bonds (hedged)	-0.3%	0.4%	3.7%	5.9%	11.1%	8.5%
Enhancers						
Global Corporate Bonds (hedged)	0.9%	-2.0%	0.7%	5.5%	10.3%	12.6%
Global High Yield (hedged)	5.0%	-5.8%	-7.2%	-2.5%	0.7%	11.8%
Emerging Market Bonds (hedged)	7.1%	-0.6%	-1.9%	2.7%	7.3%	18.6%
FTSE 350 TR Index	3.4%	-7.8%	-18.8%	-11.2%	-8.5%	10.6%
FTSE UK All-Small Cap	4.3%	-9.1%	-17.5%	-10.0%	-6.1%	22.1%
Global Equity (FSTI)	7.0%	4.2%	-1.6%	8.9%	24.1%	51.3%
European Equity (FSTI)	6.8%	-2.2%	-10.5%	-2.8%	-0.5%	26.0%
US Equity (S&P)	6.8%	6.9%	1.6%	14.4%	37.4%	65.7%
Japan Equity (Topix)	8.2%	8.2%	-1.5%	8.6%	13.5%	39.6%
Pacific Ex Japan Equity (FSTI)	1.0%	-1.0%	-4.6%	4.9%	10.9%	44.1%
Emerging Market Equity (FSTI)	2.8%	-3.9%	-10.0%	-2.5%	4.0%	31.9%
Chinese Equity (Hang Sang)	-5.8%	-8.4%	-11.7%	-9.5%	4.4%	35.6%
Indian Equity (Nifty)	-0.8%	-12.7%	-16.7%	-21.0%	-7.5%	13.4%
Diversifiers						
Commodity Index	6.5%	-7.5%	-15.6%	-15.4%	-15.7%	-18.3%
Gold	4.8%	14.6%	22.1%	34.6%	39.7%	38.1%
Silver	26.1%	15.2%	9.5%	26.8%	6.6%	1.6%
Brent Oil	6.5%	-7.5%	-15.6%	-15.4%	-15.7%	-18.3%
UK Property	-0.6%	-3.4%	-3.4%	-2.6%	6.1%	10.3%
Global Property Shares	0.3%	-14.2%	-23.8%	-8.6%	-8.2%	2.9%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*2.4%*	*0.8%*	*1.6%*	*3.0%*	*6.5%*	14.1%
Rivers Cautious Portfolio	*3.4%*	*2.4%*	*1.6%*	*5.1%*	*11.1%*	24.5%
Rivers Balanced Portfolio	*4.2%*	*2.9%*	*0.6%*	*5.5%*	*13.4%*	30.4%
Rivers Adventurous Portfolio	*4.3%*	*3.9%*	*0.8%*	*6.1%*	*13.8%*	33.6%
Rivers Aggressive Portfolio	*4.7%*	*3.2%*	*-2.2%*	*5.1%*	*12.8%*	37.0%
Rivers Cautious Income Portfolio	*1.9%*	*-3.7%*	*-5.9%*	*-1.9%*	*0.4%*	8.3%
Rivers Balanced Income Portfolio	*2.5%*	*-3.7%*	*-7.0%*	*-2.3%*	*1.2%*	14.0%

Source: Financial Express in GBP (unhedged unless stated) as at 29th May 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.