Market Comment

March 20th 2020

A specific market comment regarding the market impact and expectations from the coronavirus in March 2020

Rivers Capital Management
27 Gloucester Place
London
W1U 8HU
+44 (0)20 3383 0180
www.riverscm.com

Summary

- The Coronavirus virus will dominate news headlines and investment throughout 2020
- Recession is now certain but expect GDP growth and corporate earnings to recover in the next few years
- Credit liquidity remains a significant risk but is improved by government intervention
- The long term impact of the virus is now refected in asset prices which we expect to recover by year end

Contacts

Richard Bonnor-Moris
rbm@riverscm.com

Eduardo Tomacelli
etomacelli@riverscm.com

Najib El-Rayyes
ner@riverscm.com

Market Comment

Its rather incredible that we are only one month from the February 19th all-time high for the US equities. It has been quite a month. It's been quite a virus and quite global response to a virus. No one really saw it coming (apart from Bill Gates – search his TED talk 2015 – incredible). I know many are concerned about how markets have already behaved and how they will going forward so I thought I would, briefly, attempt to explain our current thoughts. I will start by explaining how we came into this period underweight risk, why the portfolios have been rebalanced, twice adding risk, to a neutral risk allocation, why we think that makes sense going forward, and finally why we think this is a temporary dislocation and not a fundamental or systematic collapse. If any further detail is required, please do not hesitate to contact me or any of the Rivers team.

From late 2019 we had developed growing concern over several risk factors regarding global economics and asset market valuations. Political tensions, liquidity within certain sectors and the absolute valuation level of assets worried us. We became wary of the additional risk of the coronavirus at the start of this year but, in fairness, underestimated the extent to which it would impact the global economy. As a result of our general caution, all portfolios were positioned significantly underweight risk, when compared to their strategic asset allocation at the start of the sell off. As the correction in Enhancer assets gained momentum, and it expanded to include many traditional Diversifier and even many Anchor assets, the portfolios were rebalanced to increase risk. The portfolios were rebalanced on February 28th (risk level 2 to 3) and March 12th (risk level 3 to 4) to align with the strategic or neutral asset allocation. This rebalance was done on a relative basis but simply put, involved selling Anchors and buying Enhancer Assets. See the attached table to see the individual asset class and portfolio performances throughout these periods. It has been an unprecedented and unrelenting sell off. The nature and speed of the sell off has exceeded nearly all historical precedents. Its singular and specific cause, at a time when valuations were high, has made it unique in the history of the market.

Looking forward the immediate effects of

the coronavirus on the global economy are becoming increasingly clear and point to a sharp fall in output across the world. Recession is now inevitable. The questions now are how deep is that recession, how far does it extend and what effect will it have on long term global output. Ultimately what is now priced into asset valuations? In our view the most likely outcome is that economies return to the pre-virus economic growth within a couple of years. The global slowdown over the next few months will be unprecedented but provided government intervention is well targeted and lost output is offset, then a long-term recession will be averted. If this is the case, then current valuations in many equity sectors, are more attractive than they have been for some time. Many investors are concerned that the risk of a more extended fall in output and even systematic failure like that narrowly averted in 2008 is possible. We do not think that is likely but the media coverage, and the continued broad selling of assets have so far led us to resist rebalancing to the overweight risk allocation that many metrics now seem to justify.

On balance the most significant area of concern we have now is within credit or corporate debt. The material falls in the oil price, primarily caused by the Russian-Saudi production disagreement but extended by falling demand as a result of the Coronavirus, is the most significant cause. The steady growth in the non-banking credit sectors with stretched valuations was a major concern before the dual shock of the coronavirus pandemic and oil price collapse. By some measures the credit market is already in the early stages of a deepening credit crunch but it is likely, especially with the

Disclaimer: Rivers Capital Management is authorised & regulated by the Financial Conduct Authority (FCA) Reference No. 801238. Its registered offices are at 27 Gloucester Place, W1U 8HU London, United Kingdom. This newsletter is intended only for use by Financial Advisors and not for distribution to retail investors. The Model Portfolio is not suitable for all types of investor and investor accounts may only be attached to it by the instruction of a professional Financial Adviser. Past performance is not necessarily a guide to the future performance. Market movements may cause the value of investments and the income from them to fall as well as rise. Unless otherwise stated, the source of all figures contained herein is Rivers Capital Management. Whilst all reasonable care has been taken in preparing this update, the information contained herein has been obtained from sources that we consider reliable but we do not represent that it is complete or accurate and it should not be relied upon as such.

RIVERS CAPITAL MANAGEMENT

unprecedented liquidity provided recently by the Federal Reserve in the US, that this will be averted. Fundamentally we do not think this will extend to government bonds, even to highly indebted countries, such as Italy, as it did in 2011.

Interestingly the recent fall in haven assets, what we call Anchor and Diversifier assets, has prompted some to argue that a broad systematic failure, even further than the governmental credit crisis of 2011 is possible. The performance table shows that the relative performance of Anchors and Diversifiers, including losses to gold, precious metals and government bonds, over the very recent past suggests there is some support for the systematic failure argument, but we do not think this is credible. The most recent sales of gold and government bonds is more likely due to cash requirements, margin calls and other financial demands than a foreshadowing of financial collapse. The impact of the current crisis is extreme but will be short term. Not as short term as the 1987 crash, which had no long term impact at all, but in our opinion its long-term impact will not exceed the internet doom collapse of 2000, let alone the financial crisis or, as suggested by some commentators, the world wars. It is hard to imagine gold and especially government debt remaining correlated to equities for long if further falls in equities are a result of recession fears, which is deflationary. The recent strength in the US Dollar and weakness in smaller economy exchange rates, not least sterling, is indicative of the ultimate belief in the financial system.

Market Returns (£) - 20th Feb - 20th	20th - 28th Feb	1st -12th Mar	12th-20th Mar	1 month
Risk Level for Portfolios	2	3	4	
Anchors				
Cash + 1%	0.0%	0.1%	0.0%	**0.1%**
Inflation Linked UK Bonds	1.7%	-0.9%	-3.8%	**-3.1%**
Gilts	1.7%	3.2%	-7.4%	**-2.9%**
Global Government Bonds (hedged)	1.3%	0.3%	-2.4%	**-0.9%**
Enhancers				
Global Corporate Bonds (hedged)	0.4%	-3.6%	-8.5%	**-11.4%**
Global High Yield (hedged)	-2.8%	-8.7%	-12.0%	**-21.9%**
Emerging Market Bonds (hedged)	-2.6%	-5.8%	-1.4%	**-9.5%**
FTSE 350 TR Index	-11.2%	-19.9%	-4.6%	**-32.1%**
FTSE UK All-Small Cap	-10.3%	-14.2%	-21.0%	**-39.2%**
Global Equity (MSCI)	-10.7%	-15.4%	2.6%	**-22.5%**
European Equity (MSCI)	-10.4%	-19.5%	1.8%	**-26.6%**
US Equity (S&P)	-11.7%	-14.4%	4.5%	**-21.0%**
Japan Equity (Nikkei)	-5.6%	-8.8%	-7.9%	**-20.7%**
Pacific Ex Japan Equity (MSCI)	-5.6%	-5.7%	-7.3%	**-17.5%**
Emerging Market Equity (MSCI)	-7.4%	-10.5%	-6.6%	**-22.6%**
Chinese Equity (Hang Sang)	-4.4%	-5.1%	-3.6%	**-12.5%**
Indian Equity (Nifty)	-8.0%	-15.0%	-7.8%	**-27.9%**
Diversifiers				
Commodity Index	-6.1%	-5.0%	-0.1%	**-10.9%**
Gold	-2.5%	3.4%	0.1%	**0.9%**
Silver	-9.8%	-0.9%	-18.5%	**-27.1%**
Brent Oil	-6.1%	-5.0%	-0.1%	**-10.9%**
UK Property	-0.3%	-0.4%	-0.6%	**-1.2%**

Source: Financial Express in GBP (unhedged unless stated) as at 20th March 2020.
Performance is indicative only and should not be relied upon to make investment decisions

Disclaimer: Rivers Capital Management is authorised & regulated by the Financial Conduct Authority (FCA) Reference No. 801238. Its registered offices are at 27 Gloucester Place, W1U 8HU London, United Kingdom. This newsletter is intended only for use by Financial Advisors and not for distribution to retail investors. The Model Portfolio is not suitable for all types of investor and investor accounts may only be attached to it by the instruction of a professional Financial Adviser. Past performance is not necessarily a guide to the future performance. Market movements may cause the value of investments and the income from them to fall as well as rise. Unless otherwise stated, the source of all figures contained herein is Rivers Capital Management. Whilst all reasonable care has been taken in preparing this update, the information contained herein has been obtained from sources that we consider reliable but we do not represent that it is complete or accurate and it should not be relied upon as such.