Current Focus

July 2020

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

RIVERS CAPITAL MANAGEMENT

INTELLIGENT INTUITIVE INVESTING

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Summary

- Portfolio Risk was reduced in June to the pre pandemic level held in February
- The economic outlook remains uncertain while valuations appear inflated
- Central bank intervention is welcome but increases systematic risks
- Volatility will continue and offer further opportunity for tactical adjustment

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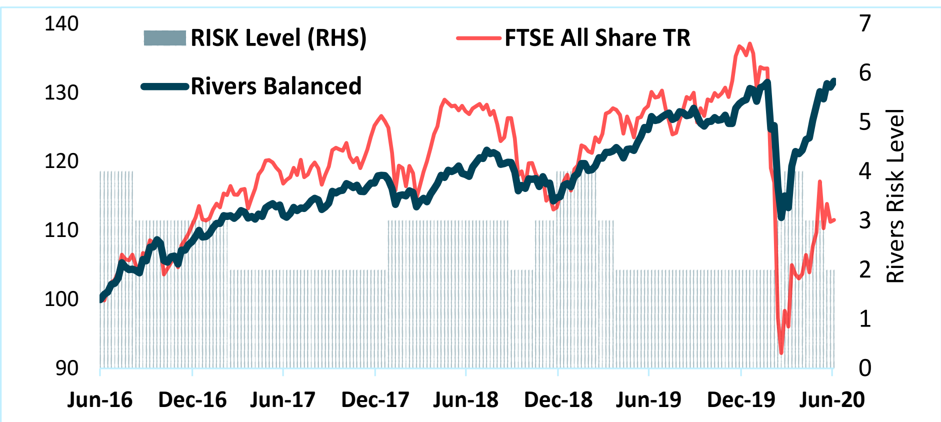
Market Comment

The end of June marked four years since Rivers Capital Management launched its model portfolio service (MPS). Overall markets have been positive, but starting in the wake of the EU Referendum, and now in the midst of Covid-19, there have been some interesting and challenging periods. Despite these challenges, we believe we have achieved many of the objectives we set out at the start. In this month's Focus we look at the tactical changes we have made over the last four years and what we expect in the year to come. We examine why we have tended to be underweight the portfolios' strategic risk allocation and why, with the exception of opportunities such as March, we expect that to continue for at least the next year.

The last four years have been interesting for investors, especially sterling based ones. Since the 2016 referendum the UK's politics, the value of sterling and to a great extent UK Equities have been affected by the ongoing uncertainty of Brexit. From a global perspective UK equities have materially underperformed equities in the US, Europe, Japan and Emerging Markets in both local and sterling terms. While global equity markets have been positive, particularly up until the corona pandemic, they have not enjoyed a Goldilocks period of prosperity. After all in 2016 we had the election of Donald Trump. The President's agenda has been pro business. It has at least lowered the burden of corporate tax, but we have also seen rising protectionism and endless geopolitical tensions. Possibly because of, but probably despite Trump, equities have enjoyed a seemingly endless bull market until early this year. The one difficult period (pre-pandemic) was during the final quarter of 2018, but that did not last long. Economic and corporate earnings growth, sustained by the secret sauce of low interest rates and low tax, remained positive – despite failing to keep up with rising valuations. Similarly steady economic growth did lower unemployment but did not lead to expected wage growth nor inflation. From 2016 the Federal Reserve attempted to raise rates but the risk of a financial market correction prevented the real normalisation of interest rates even in the US. In Japan and Europe, rates have been at or below zero since we started. Given this, we often questioned how far equity valuations could rise, and what central banks and monetary policy could do in the face of economic slowdown, given already low rates.

Six months into 2020 there is no doubt that we now know what central banks are capable of. In fact we know what monetary policy, backed in full by government fiscal policy, can do, not only in the face of an economic slowdown, but to avert economic calamity. Whether the wholesale governmental and monetary response was justified by the Covid-19 pandemic is no longer in question, it undoubtably was. Whether it is successful in averting a spiralling economic downturn only time will tell, but we do hope so. Whether it justifies the valuations now seen in both bond and equity markets is, however, debatable.

Before the pandemic, it was concern over equity valuations that led to the materially underweight risk allocation we held in all portfolios. This position enabled us to add risk with confidence during the crisis when equities appeared oversold and valuations looked much improved.



Source: Rivers Capital Management

While the portfolios have benefited materially from the unprecedented rise in valuations since March we now think these valuations are extended. Most equity indices are still lower than they were in February, but given the significant impact to earnings, valuations now appear higher than they were at the start of the year. Interest rates have fallen and that can in itself justify higher multiples for equities, but the speed of the recovery, in the face of high economic uncertainty, is unjustified in our view.

The message from the central banks and governments, is that they will do "whatever it takes" to counter the current crisis. This has been accepted by investors but the risks of this strategy are high. It is a topic for intense debate whether the Federal Reserve now moves to a policy of direct yield curve control, like Japan, or just sticks to unprecedented buying of corporate or high yield debt. For what it is worth, we think the latter is more likely than the former, but either from the world's dominant reserve currency, would have been unthinkable just ten years ago. Discounting future corporate earnings based on artificial interest rates is fraught with danger.

We have been successful for four years not by trying to second guess central banks, but by adapting the portfolio to the macro opportunity we see in the coming months. With valuations now high and the outlook more uncertain than it has been for some time we are comfortable remaining underweight risk. We expect market volatility to remain elevated for some time and opportunities to add risk, at better valuations to occur more frequently in the coming months. Should markets continue to be inflated artificially we may move to a more defensive allocation but that scenario seems unlikely.

Market Returns (£) - 30th June 2020	1 Month	3 Month	YTD	1 Year	3 Year	S/I*
Anchors						30/06/2016*
Cash + 1%	0.1%	0.4%	0.8%	1.7%	5.1%	6.5%
Inflation Linked UK Bonds	1.4%	7.0%	11.2%	8.7%	18.8%	23.4%
Gilts	-0.6%	2.6%	9.7%	12.0%	20.2%	19.0%
Global Government Bonds (hedged)	0.1%	0.8%	4.0%	4.9%	11.8%	8.7%
Enhancers						
Global Corporate Bonds (hedged)	1.8%	7.7%	2.9%	5.7%	12.8%	15.0%
Global High Yield (hedged)	2.1%	11.8%	-5.3%	-3.1%	2.9%	14.2%
Emerging Market Bonds (hedged)	0.6%	9.8%	-1.4%	-1.1%	7.9%	19.3%
FTSE 350 TR Index	1.5%	9.9%	-17.6%	-13.2%	-4.7%	12.2%
FTSE UK All-Small Cap	3.2%	18.7%	-14.8%	-7.6%	-2.3%	26.0%
Global Equity (FSTI)	2.7%	19.8%	1.0%	5.9%	27.7%	55.3%
European Equity (FSTI)	4.0%	15.8%	-7.0%	-4.4%	5.2%	31.0%
US Equity (S&P)	2.0%	20.8%	3.6%	10.1%	40.2%	69.1%
Japan Equity (Topix)	-0.3%	11.7%	-1.8%	5.6%	12.4%	39.2%
Pacific Ex Japan Equity (FSTI)	8.6%	16.8%	3.6%	7.1%	18.9%	56.4%
Emerging Market Equity (FSTI)	7.4%	18.5%	-3.3%	-0.5%	11.2%	41.6%
Chinese Equity (Hang Sang)	7.5%	5.1%	-5.1%	-8.3%	11.5%	45.7%
Indian Equity (Nifty)	6.9%	21.0%	-11.0%	-14.6%	0.2%	21.2%
Diversifiers						
Commodity Index	2.3%	5.5%	-13.6%	-14.9%	-13.1%	-16.3%
Gold	2.9%	12.5%	25.6%	29.4%	48.4%	42.1%
Silver	-0.2%	29.6%	9.2%	21.7%	12.4%	1.3%
Brent Oil	2.3%	5.5%	-13.6%	-14.9%	-13.1%	-16.3%
UK Property	-0.4%	-2.2%	-3.7%	-2.9%	5.2%	9.9%
Global Property Shares	-0.4%	4.6%	-24.1%	-9.1%	-6.6%	2.6%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*0.9%*	*7.2%*	*2.4%*	*2.9%*	*7.8%*	15.0%
Rivers Cautious Portfolio	*1.7%*	*10.5%*	*3.2%*	*4.8%*	*13.6%*	26.5%
Rivers Balanced Portfolio	*2.4%*	*13.8%*	*2.9%*	*5.3%*	*17.0%*	33.3%
Rivers Adventurous Portfolio	*3.2%*	*15.7%*	*4.0%*	*6.4%*	*18.5%*	37.7%
Rivers Aggressive Portfolio	*3.5%*	*17.4%*	*1.1%*	*4.5%*	*18.0%*	41.6%
Rivers Cautious Income Portfolio	*1.9%*	*9.1%*	*-4.2%*	*-1.7%*	*3.1%*	10.3%
Rivers Balanced Income Portfolio	*2.2%*	*10.7%*	*-5.0%*	*-2.0%*	*4.2%*	16.5%

Source: Financial Express in GBP (unhedged unless stated) as at 30th June 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.