Current Focus

September 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

- Equity market rally continued in August led primarily by technology
- US Market high technology weighting accounts for nearly all outperformance
- Comparisons with 200 Dot-Com bubble are valid despite multiples being lower
- Risk of market correction remains high and portfolios are now underweight risk
- Opportunities to increase relative risk are expected in the coming months

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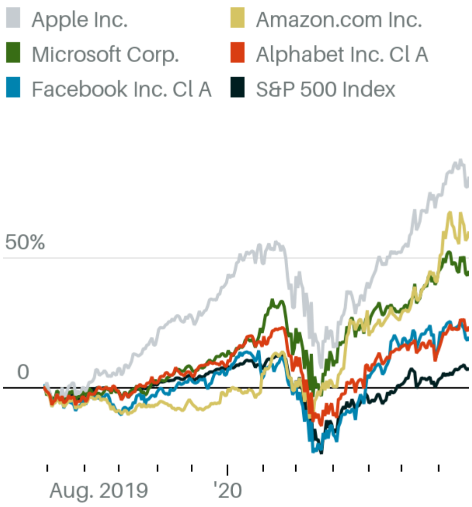
Market Comment

August proved to be another positive month for Enhancer assets, especially equity. While most regional equity indices remain below the highs reached in February, the recovery since March has been unprecedented. The US equity market, led by the technology sector, has set new all-time highs despite the continued economic impact of Covid-19 and a massive increase in unemployment. As investors we added risk, at favourable valuations during the lows of the market in March but have since reverted to a cautious position, as we consider valuations to now be overly optimistic. In this month's Focus we look at the technology sector and the factors that have seen it so significantly outperform in recent months. We look at how the pandemic has accelerated the adoption of many online services but explain why we do not think this makes technology immune from economic reality, and why recent market activity has increased our concern regarding this sector.

There is no doubt that the pandemic has seen changes that have boosted the opportunity for a large part of the technology sector. The first is obvious to those of us that have been working from home and using online connectivity much more than we could have imagined even last year. The previous fears of low productivity and distraction of home working have diminished as many appreciate the efficiency of less travel time and lower costs. Many companies, particularly in financial services, are likely to adopt a permanent increase in employees working from home. This will have consequences for city centre retail, travel and housing but undoubtedly benefits technology. The second is E-commerce, which has also boomed during the pandemic, accelerating its takeover of traditional shopping habits. Amazon seems to be a one stop shop for anything you need, and many things you really don't. Looking forward, artificial intelligence, robotics, electric vehicles and 5G are all themes that are likely to grow exponentially in the future and any companies with exposure to all of these have been popular. This transition has seemed inevitable for some time but the acceleration caused by the pandemic has been momentous.

Big Tech's Big Gains

Past Year Performance



Source: FactSet

The actual monetisation of some of these themes is difficult but the profits and success of many of the incumbents in the technology sector has made them incredibly popular with investors. The availability of fee-free investing in the US, through companies such as Robinhood, has boosted retail investment levels well beyond previous levels and the technology sector has been the undoubted beneficiary of these flows. Analysis of speculative trading indicates a worrying increase in retail investors entering the market using small size Call Options (which offer, for a premium, the right to buy a stock at a stated price). These leveraged positions are over and above the estimated $50 billion of exposure held by the Japanese Softbank, and, if the analysis is correct, create a potential foundation for volatility in the coming months. As a result the valuation of the big five technology stocks, Apple, Amazon, Alphabet, Facebook and Microsoft has grown to 25% of the entire US equity market. Other stocks have proved even more popular. Tesla has grabbed many headlines reaching a capitalisation that exceeded pretty much all other car manufacturers combined.

Many commentators have likened the rally in technology to the dot com boom of the late 1990s when overly optimistic 'day-traders' inflated embryonic technology companies to excessive valuations. We think the comparisons are fair although this time the companies are far from embryonic making up some of the most profitable companies ever. During the dot-com boom, earnings were very low for most technology stocks and multiples were off the charts. This is perhaps true for Tesla today but not at all the case for Apple or Microsoft. Comparing the price earnings multiple of these huge companies to those used in 2000 makes little sense. High multiples can (sometimes reasonably) be expected for companies experiencing exponential growth but the law of diminishing returns makes this level of growth unlikely for any of the big five, even unwise; the profits of these companies have already been raised in congress and could be susceptible to legislation to curtail their growth should it continue.

Technology is a bigger part of the economy now than it has ever been. This is likely to increase for the foreseeable future. It is also likely to grow faster than other parts of the economy, and to be better protected, or even enhanced, from the long term impact of the global pandemic. That said, whether these advantages offset the cost of a slowing global economy and consequent rise in unemployment, is debatable. On a valuation basis we think the advantages of tech are overly reflected in the price of the equities. In some cases these valuations are extreme and at risk of a correction, particularly if made excessive by short-term retail investors. In the portfolios we manage, we have minimal direct technology exposure. We maintain a modest bias towards the US market, which has benefited from the rally but the portfolios remain underweight risk.

Overall the portfolios retain the tactical position at a risk level 2, out of 7. Looking forward we believe the opportunity to increase overall risk at more favourable valuation will come as the economic reality of the pandemic continues.

Market Returns (£) - 31st August 2020	1 Month	3 Month	YTD	1 Year	3 Year	S/I*
Anchors						30/06/2016*
Cash + 1%	0.1%	0.3%	0.9%	1.5%	5.1%	6.7%
Inflation Linked UK Bonds	-4.5%	-3.4%	8.2%	-1.8%	14.2%	26.1%
Gilts	-3.2%	-3.4%	6.6%	2.6%	14.1%	15.6%
Global Government Bonds (hedged)	-1.0%	-0.1%	3.8%	1.4%	10.4%	8.5%
Enhancers						
Global Corporate Bonds (hedged)	-0.8%	3.5%	4.6%	4.1%	12.9%	16.9%
Global High Yield (hedged)	1.4%	7.1%	-0.7%	2.4%	6.4%	19.7%
Emerging Market Bonds (hedged)	-2.2%	-4.8%	-6.6%	-8.2%	-2.8%	12.9%
FTSE 350 TR Index	2.4%	0.1%	-18.7%	-13.0%	-8.4%	10.7%
FTSE UK All-Small Cap	3.7%	6.0%	-12.5%	-2.4%	-2.4%	29.4%
Global Equity (FSTI)	4.6%	6.0%	4.2%	6.7%	28.1%	60.3%
European Equity (FSTI)	1.9%	3.6%	-7.4%	-4.1%	1.2%	30.5%
US Equity (S&P)	5.0%	6.5%	8.2%	11.0%	42.9%	76.5%
Japan Equity (Topix)	5.7%	-2.8%	-4.2%	-0.1%	6.4%	35.6%
Pacific Ex Japan Equity (FSTI)	1.5%	12.4%	7.2%	14.7%	16.5%	61.9%
Emerging Market Equity (FSTI)	0.2%	10.4%	-0.6%	6.5%	7.0%	45.5%
Chinese Equity (Hang Sang)	0.5%	3.2%	-8.8%	-5.6%	-1.7%	40.0%
Indian Equity (Nifty)	1.5%	12.7%	-6.1%	-3.2%	1.3%	27.7%
Diversifiers						
Commodity Index	4.7%	6.6%	-10.0%	-12.4%	-12.4%	-12.9%
Gold	-2.3%	2.7%	25.3%	15.2%	38.9%	41.8%
Silver	14.8%	40.2%	53.4%	34.2%	45.1%	42.3%
Brent Oil	4.7%	6.6%	-10.0%	-12.4%	-12.4%	-12.9%
UK Property	0.0%	-0.4%	-3.7%	-2.9%	4.0%	9.8%
Global Property Shares	0.8%	2.7%	-21.8%	-6.0%	-5.1%	5.7%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*-0.3%*	*1.2%*	*2.7%*	*1.4%*	*6.4%*	15.4%
Rivers Cautious Portfolio	*0.6%*	*2.8%*	*4.3%*	*3.4%*	*12.6%*	27.8%
Rivers Balanced Portfolio	*1.0%*	*4.1%*	*4.6%*	*4.9%*	*16.4%*	35.6%
Rivers Adventurous Portfolio	*1.5%*	*5.5%*	*6.2%*	*6.7%*	*18.6%*	40.7%
Rivers Aggressive Portfolio	*1.9%*	*6.1%*	*3.7%*	*5.8%*	*17.5%*	45.2%
Rivers Cautious Income Portfolio	*0.5%*	*2.7%*	*-3.3%*	*-1.9%*	*2.9%*	11.2%
Rivers Balanced Income Portfolio	*0.9%*	*3.6%*	*-3.7%*	*-1.9%*	*4.4%*	18.0%

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