Current Focus

February 2021

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

RIVERS CAPITAL MANAGEMENT

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Summary

- Equity indices continue the positive momentum that has held with March 2020
- Speculation levels, particularly in the US are high backed by excess liquidity and leverage
- The volatility of Gamestop and similar stocks shows high retail investor participation
- With indices priced for 'perfection' the chance of market correction is high
- Gains could continue but offer lower opportunities at higher risks

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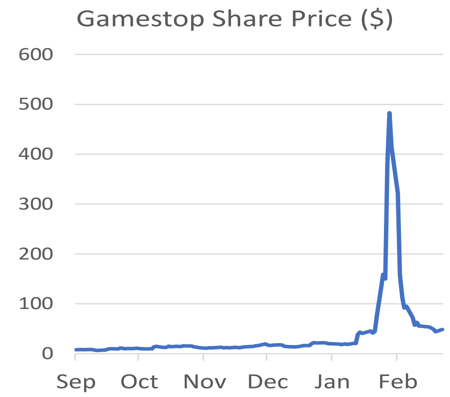
Market Comment

Global equity markets have seen volatility increase recently but have generally continued the rally started from the lows in March 2020. While believing in the opportunity and increasing risk at these lows, we have in recent months, become concerned that some equity valuations have become too high. The market appears to be pricing in continually low interest rates, no inflation and yet a strong economic recovery. This optimistic view is most striking in the valuations seen across many technology stocks and more generally in US equities. The availability of liquidity and low interest rates have been the most obvious drivers of this phenomenon but, more worryingly, so too has been an extreme level of retail investor speculation. For this month's Focus we take a look at this speculation and specifically at the very unusual events that occurred around the stock of a company called GameStop in the last week of January.

GameStop, an ailing bricks-and-mortar US retailer of video games and consoles, is interesting as it was the clearest example of a growing incidence of social media led, speculative, group investor activity in recent months. The company's stock, unloved and loss making, had drifted down from around $50 in 2015 to under $5 in October 2020. This had increased, at low volumes to reach about $20 by the start of 2021 but in the last week of January, after a huge increase in demand for the stock its price rose over 320 percent, meaning that for the month it ended up around 1,700 per cent. This was a speculative bubble. That is, the price departed wildly from the fundamentals. Some investors who got in early and got out early made a lot of money. Just as many people, who got in too late or stayed in too long, lost a lot of money, as, in days, the valuation came back down to earth with a bump.

The GameStop episode became newsworthy, as it tested a common interpretation of the financial markets. It was reported as a David versus Goliath situation where on one side the little guys (mostly amateur traders, mostly young and stuck at home), were able, by coordinating with each other on message boards, such as Reddit's forum "WallStreetBets", to conspire to create the speculative bubble. On the other side, hedge funds - big Wall Street or City traders - would fail in their quiet conspiracy to unfairly bet against vulnerable corporations to drive down prices – known as "going short".



Source: yahoo finance

The question, judged by general media coverage of the issue, seemed to be whether financial markets competitively and efficiently allocate capital via the medium of the stock price, or if instead they are rigged in order to make unseemly profits at the expense of the little guy. Remarkably, the little guys did dominate for a while. Perhaps, at the beginning, they evaluated GameStop as genuinely worth a bit more than the price it was trading at. But then they kept going. They succeeded in creating a speculative bubble even with the hedge funds pushing in the other direction. More often than not, it is the latter that prevail. In this case, the hedge funds appear to have swallowed their losses and to have refrained from taking further short positions.

There is no need to feel sorry for the hedge funds. Their business is risk. They are aware of the wisdom in the dictum, often attributed to Keynes, "The market can stay irrational longer than you can stay solvent." Even after taking their losses, these institutional investors remain wealthy. But the hedge funds in this case are not bad guys. They were doing what they were supposed to do: pushing the price of GameStop toward a level more consistent with economic fundamentals and thereby sending a useful signal for the allocation of capital.

There will be some traders for whom one should feel sorry. Those are the ones who jumped on the GameStop bandwagon, buying after the price had already begun rising, and determinedly stayed in even as the price went down. As a consequence of playing the Reddit game, they probably lost most of the money that they invested - losses that some of them will be ill able to afford. Gamestop now trades at about $45 having peaked at $450. According to some reports the hedge funds 'closed' their short positions at $118 so all the purchases above that price were retail investors buying stock which, according to even the most optimistic analyst, is not worth $25.

Unsurprisingly the regulator is investigating what has happened here. There is no doubt that a 'conspiracy' to manipulate market prices had occurred. The result is likely to be more regulation and further restrictions on commission free trading, especially leveraged positions. To us this is indicative of an unsustainable and rising level of speculation that highlights our current preference for caution. If retail investors, taking no regard for the fundamentals of a stock, are able to generate sufficient demand to manipulate prices, even in the short term, there is probably an excess of liquidity. Further analysis of small sized derivative trading shows that this speculation is not limited to single stocks but is now at levels not seen since the Dot-com boom of 2000. The bias of purchasing calls over puts (betting on market increases over market decreases) is also the highest since 2000.

With speculation this high, we prefer to take a step back which is why we rebalanced recently to lower the portfolios' overall US equity exposure. Our overall risk level remains at 2 (out of 7) but we have increased overall non-US equity exposure where valuations are, on a relative basis, more attractive.

As long term fully diversified investors the short term volatility of individual stocks does not overly concern us. What does concern us is when high levels of speculation move valuations above levels that we think are reasonably sustainable.

Market Returns (£) - 31st Jan 2021	1 Month	3 Month	YTD	1 Year	3 Year	S/I*
Anchors						30/06/2016*
Cash + 1%	0.1%	0.3%	0.5%	1.2%	4.9%	7.2%
Inflation Linked UK Bonds	-3.0%	-2.5%	-4.7%	3.5%	17.8%	25.8%
Gilts	-1.8%	-0.6%	-2.8%	3.1%	17.8%	16.1%
Global Government Bonds (hedged)	-0.6%	-0.4%	-0.8%	2.0%	11.8%	8.7%
Enhancers						
Global Corporate Bonds (hedged)	-0.8%	1.7%	0.9%	4.3%	15.4%	18.9%
Global High Yield (hedged)	-0.1%	6.3%	6.3%	3.9%	10.1%	25.5%
Emerging Market Bonds (hedged)	-1.1%	1.3%	1.7%	-2.2%	6.4%	17.4%
FTSE 350 TR Index	-0.9%	15.9%	12.0%	-8.0%	-2.1%	21.1%
FTSE UK All-Small Cap	0.5%	23.1%	27.8%	8.6%	15.2%	59.6%
Global Equity (FSTI)	-1.4%	9.6%	11.1%	10.8%	31.6%	70.2%
European Equity (FSTI)	-1.9%	14.0%	9.5%	1.6%	7.0%	40.2%
US Equity (S&P)	-1.5%	7.3%	9.2%	12.0%	41.8%	83.4%
Japan Equity (Topix)	0.0%	9.6%	17.7%	8.9%	12.9%	53.5%
Pacific Ex Japan Equity (FSTI)	4.4%	13.4%	20.7%	33.3%	28.4%	92.5%
Emerging Market Equity (FSTI)	2.6%	13.8%	18.6%	22.8%	17.9%	72.3%
Chinese Equity (Hang Sang)	3.4%	10.6%	10.7%	6.7%	-0.5%	54.1%
Indian Equity (Nifty)	-2.8%	10.1%	17.7%	9.2%	12.7%	48.2%
Diversifiers						
Commodity Index	2.2%	5.0%	11.5%	3.0%	-3.5%	-7.2%
Gold	-3.0%	-7.8%	-11.4%	8.8%	36.8%	28.6%
Silver	1.4%	6.6%	4.8%	38.5%	52.7%	29.9%
Brent Oil	2.2%	5.0%	11.5%	3.0%	-3.5%	-7.2%
UK Property	0.6%	1.8%	2.0%	-2.0%	2.6%	12.0%
Global Property Shares	-1.5%	13.0%	6.8%	-14.9%	-3.2%	11.9%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*-0.7%*	*1.3%*	*1.0%*	*2.7%*	*7.1%*	16.9%
Rivers Cautious Portfolio	*-0.8%*	*3.3%*	*3.4%*	*5.9%*	*14.1%*	31.3%
Rivers Balanced Portfolio	*-0.6%*	*5.1%*	*5.5%*	*8.3%*	*19.3%*	41.6%
Rivers Adventurous Portfolio	*-0.5%*	*6.5%*	*7.4%*	*11.5%*	*23.4%*	48.9%
Rivers Aggressive Portfolio	*-0.5%*	*8.1%*	*9.4%*	*10.8%*	*23.1%*	55.9%
Rivers Cautious Income Portfolio	*-0.3%*	*5.3%*	*5.1%*	*1.2%*	*8.1%*	16.3%
Rivers Balanced Income Portfolio	*-0.2%*	*7.1%*	*6.9%*	*2.6%*	*10.2%*	25.1%

Source: Financial Express in GBP (unhedged unless stated) as at 31st January 2021. *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.