Current Focus

March 2021

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

- Consumer confidence is high after falling Covid deaths and vaccine success.
- Lockdown has affect sectors very differently but overall savings rates are high
- The recovery will depend on spending increasing but inflation being avoided
- Rising inflation can not be controlled without rate rises so remains the primary risk
- Equity valuations are generally high so the chance of market correction remains high

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Market Comment

There is a lot to celebrate in the real economy right now. The number of hospitalisations, deaths and new coronavirus cases continues to decline, and the pace of vaccinations has increased to more than 500,000 per day. In the UK, over 27 million doses have been administered so far with 50% of adults having received at least one dose. While few countries have had such success with vaccines, and there has recently been a worrying increase in cases across Europe, as the summer approaches confidence is improving, and it needs to. In addition to the terrible death toll the coronavirus has brought over the last year, the economic damage to countries that have essentially been on 'hold' during lockdown, is immeasurable. The very fact that this self-enforced economic 'hold' can be released makes predicting the economic future today more difficult than ever. For the real economy, and for investment markets, the coming year will provide the answer to the biggest economic experiment of all time. Have the combined forces of fiscal and monetary intervention sustained economic growth while economies have been frozen to protect populations from the coronavirus pandemic?

What is certain, is that the affect of the lockdown has been incredibly uneven. For some businesses it has been catastrophic. Hospitality, travel and consumer discretionary were the most directly affected. Some spending in these sectors has just been delayed, but the majority is lost forever. These sectors have, rightly, received the most government support. Others have seen lower demand, slower turnover and reduced earnings while some significant sectors, including to a large degree financial services, have seen business as usual and little change. Finally, some sectors, DIY. home delivery services and much of technology have seen a record year. Overall, consumer and business spending has fallen materially. Uniquely, because of the enforcement, spending has fallen much further than earnings. Unintentionally, consumer savings have grown substantially. The question for economists now is whether the built up savings, of the many, added to the fiscal support of the government, will sufficiently offset the lost earnings of the unemployed and the damage to the supply chains from a year of being on hold. Anecdotal evidence suggests the pent up demand from individuals for services, holidays and events is high but will that last? To keep it simple we consider two possibly opposing, but in our view equally likely risks to investments as we see economies return to a post pandemic 'normal'. The first, of structural fall in demand in some sectors, the second a material and sustained increase in price inflation.

The first is really the normalisation of certain 'lockdown' behaviour. The pandemic may materially have changed overall preferences and have accelerated more online and less physically 'social' human interaction. This may be extenuated by continued constraints on social distancing, or simply a continued propensity for many to work from home. Surveys point to a significant change in the acceptability of home working and the usefulness of 'zooming' and remote meetings. The first obvious consequence of this will be a permanent fall in business travel and entertainment. The need for carbon neutrality makes this increasingly likely. From a macro perspective this may increase productivity but from a micro perspective it will impact hospitality and travel significantly. With reduced corporate spending the hospitality and travel industries will likely permanently decline. The effect on city centres of increased home working will also be significant and is likely already manifest.

The second risk, and the one currently ascendant for investors, is inflation. The pent up demand and high levels of saving will undoubtedly cause a spike in prices in the short term. When lockdown constraints are relaxed, the demand for events/haircuts/holidays will likely outstrip supply. This will be inflationary but is unlikely to be sustained. The cost of supply, however, as shown in the latest purchasing managers surveys, is increasing. Supply chains have been affected by coronavirus, which is especially true for commodities. One strong signal of investor inflation concern is the 10 year US Treasury yield. It has risen in recent weeks. Despite buying $120billion of treasury bonds every month this yield has risen to around 1.7%. This is still low by historical standard but up from 0.65% last July. This rising yield explains the relative weakness in Gold, the traditional inflation hedge. When the US treasury offers a positive 'real' return then it is preferred to Gold. If the rise in treasury yields is restricted, by a Federal Reserve policy for example, then expect Gold to rally. If inflation does spike, and goes above the US yield then Gold will again be preferred.

Of the two risks described, the Federal Reserve much prefers the first. Supressing rates and stimulating demand has been the Central Bank standard policy since the financial crisis. Since then inflation risk has been very low, apart from a short time in 2010/11 which turned out to be a false alarm. Some economists, including the Nobel prize winning Paul Krugman have suggested that the inflation risk today is similarly false. We are not so sure. The excess demand this time, as a result of savings and the stimulus, will come from median income individuals who tend to spend and not banks determined to correct their balance sheets, as was the case in 2010. What direct effect rising inflation has on stocks is not clear, but if it causes interest rates to rise significantly the damage would be considerable.

For now Central Banks remain very sanguine about inflation despite these warnings. Federal Reserve Chairman Powell indicated recently that the Fed will stand pat with its extraordinary monetary policy accommodation on the basis that any increase in inflation above the Fed's 2% target will be transitory. If inflation does get to that level, I suggest his concern may become more noticeable. In any case inflation may even be positive for stocks in the short term. But with valuations already so high we prefer to hold a more cautious overall asset allocation, with a modest allocation to gold as protection against rising inflation, that is until more attractive opportunities become available.

Market Returns (£) - 28th Feb 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%	4.8%	7.3%
Inflation Linked UK Bonds	-5.1%	-7.6%	-5.4%	-3.7%	11.3%	19.4%
Gilts	-5.9%	-6.0%	-5.5%	-4.3%	10.6%	9.3%
Global Government Bonds (hedged)	-1.8%	-2.3%	-1.7%	-1.3%	9.7%	6.7%
Enhancers						
Global Corporate Bonds (hedged)	-1.4%	-1.8%	0.3%	2.0%	15.0%	17.2%
Global High Yield (hedged)	0.1%	2.0%	5.0%	5.8%	11.5%	25.7%
Emerging Market Bonds (hedged)	-3.9%	-4.2%	0.0%	-5.4%	0.2%	12.9%
FTSE 350 TR Index	1.9%	4.9%	11.5%	2.9%	3.1%	23.4%
FTSE UK All-Small Cap	4.1%	11.4%	28.4%	23.7%	23.7%	66.1%
Global Equity (FSTI)	0.7%	1.1%	7.0%	18.2%	34.0%	71.5%
European Equity (FSTI)	0.6%	1.1%	8.0%	9.4%	10.7%	41.0%
US Equity (S&P)	0.9%	0.8%	4.9%	19.3%	44.1%	85.1%
Japan Equity (Topix)	-0.5%	-0.6%	10.8%	16.5%	10.5%	50.3%
Pacific Ex Japan Equity (FSTI)	-1.0%	7.4%	17.7%	31.0%	29.4%	90.6%
Emerging Market Equity (FSTI)	-1.0%	6.5%	17.1%	24.3%	18.6%	70.5%
Chinese Equity (Hang Sang)	0.6%	5.0%	10.7%	4.8%	3.3%	55.0%
Indian Equity (Nifty)	3.4%	8.1%	19.9%	17.9%	20.9%	53.1%
Diversifiers						
Commodity Index	4.6%	9.5%	11.4%	9.9%	-0.5%	-2.9%
Gold	-8.2%	-7.5%	-16.8%	-2.1%	23.8%	18.0%
Silver	-3.6%	11.6%	-12.0%	42.0%	50.4%	25.2%
Brent Oil	4.6%	9.5%	11.4%	9.9%	-0.5%	-2.9%
UK Property	0.5%	1.8%	2.5%	-1.4%	2.9%	12.6%
Global Property Shares	2.2%	4.5%	8.2%	-4.7%	4.2%	14.3%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*-0.9%*	*-1.0%*	*0.4%*	*2.4%*	*6.4%*	15.8%
Rivers Cautious Portfolio	*-0.5%*	*-0.2%*	*2.2%*	*7.3%*	*14.2%*	30.5%
Rivers Balanced Portfolio	*-0.6%*	*0.3%*	*3.8%*	*11.0%*	*19.6%*	40.6%
Rivers Adventurous Portfolio	*-0.6%*	*0.9%*	*5.1%*	*15.0%*	*23.9%*	47.9%
Rivers Aggressive Portfolio	*-0.2%*	*1.9%*	*7.1%*	*17.1%*	*24.6%*	55.4%
Rivers Cautious Income Portfolio	*-0.9%*	*0.2%*	*3.7%*	*2.6%*	*8.3%*	15.3%
Rivers Balanced Income Portfolio	*-0.6%*	*1.1%*	*5.4%*	*5.2%*	*11.0%*	24.4%

Source: Financial Express in GBP (unhedged unless stated) as at 28th February 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.