Current Focus

May 2021

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

INTELLIGENT INTUITIVE INVESTING

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Summary

- Portfolios rebalanced to the most defensive relative allocation in April
- Inflation fears and over inflated valuations risk market correction
- Economic growth now almost certain but supply constraints likely to persist
- Rising inflation risks interest rate increases earlier than currently being expected
- Indices may continue rise but risk is high and a correction offering better opportunity is expected

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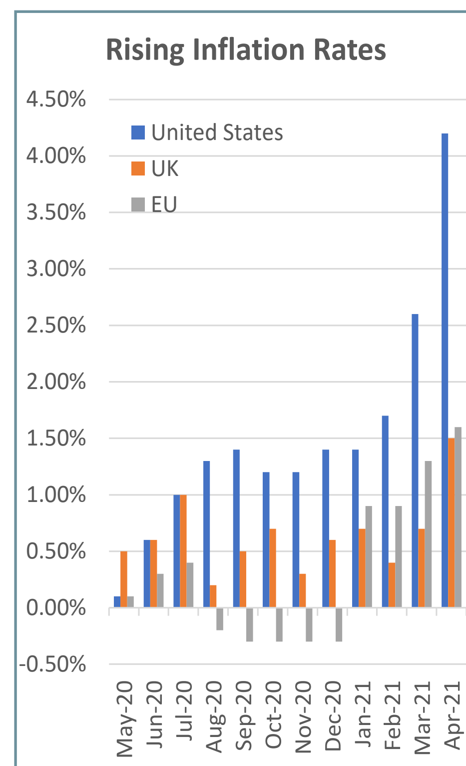
Market Comment

During April, the Rivers managed portfolios were rebalanced to the most defensive position possible for each risk rating. This was done as many equity indices were setting all-time highs, Central Banks were continuing with unprecedented monetary stimulus and governmental fiscal spending was pushing national deficits to record levels. There is cause and effect here. For valuations to be sustained at current levels, or rise further, investors must believe that monetary stimulus and fiscal support will be sustained and that economic growth accelerates rapidly. We think that the likelihood of these three conditions being sustained is not only improbable but impossible. In the simplest terms, economic growth will negate the need for fiscal support and accelerate the need for monetary constraint. The reason for the former is the growing government deficits, the reason for the latter is inflation. Inflation, dampened by globalisation and fiscal austerity is now the biggest risk for investors today. In this update we look at why the already obvious signs of inflation are not transitory, as many Central Banks suggest, and why the pressures it will impose on monetary conditions cannot, sensibly, be ignored for very long.

To start on a positive note we think that economic growth in the coming quarters, in the UK And Globally, will be strong. Pent up consumer demand, a relaxation of lockdown restrictions and generous government support make economic growth in the coming quarters almost certain. The most obvious risk to this may be the re-emergence of the pandemic, for whatever reason, but this is not a major factor in our current cautious outlook. On balance we think despite the risks, economic growth will surprise to the upside. Unemployment will fall rapidly and corporate earnings will grow. We do not think they will grow to the extent being predicted by analysts but not because of a shortage of sales but because of rising costs.

The costs which are most concerning are material input costs and labour costs. As material input costs are determined by commodity prices they have already risen substantially. Be it because of low levels of investment, in the case of oil and traditional energy, or Covid supply constraints, in the case of timber and agricultural products. Nearly all commodities are at all-time highs and producer prices indices have reflected this for a while. Labour costs are arguably less likely to rise because of high levels of



Source: Rivers Capital Management

unemployment. That said, in the US, average hourly earnings shot up 8.2% in April and since June 2020 have an average year on year gain of about 4.8%, currently (just) ahead of inflation. The wage rise in 2020 (in part due to Covid restrictions and some sort of "hazard pay" premium) is probably "transitory," but wage growth is characteristically stubborn. It rarely reverses and if economic growth is strong, as expected, wages are set to increase when activity heightens in the summer. In the UK many pay settlements are closely related to inflation so the problem is self-perpetuating

Last week in the US the effect of overall price rises became clear. The April Consumer Price Index or US CPI rose, on a year-over-year basis, to 4.2%, before seasonal adjustments. This was the biggest increase in monthly CPI since 4.9% in September 2008. A similar effect is likely in the UK this week. With producer prices (PPI) appearing to rise both sides of the Atlantic it is likely this trend will continue for some time.

The fact that inflation cannot be ignored by Central Banks for very long can be seen in its effect on benchmark interest rates already. Despite the Federal Reserve buying $128billion dollars of US debt per month, in an attempt to suppress rates, this month

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the yield on 10 Year Treasuries rose to 1.7%. Historically this is not high but compared to 0.60% last August it is a significant jump, all while interest rates were set to zero and during the most aggressive period of quantitative easing ever. It appears that when there is real inflationary risk, quantitative easing is less successful at reducing Treasury yields. The US 10 Year Treasury rate is the benchmark 'discount level' used for future corporate earnings evaluation, if it were to continue to rise, say above 2%, it would make equity valuations look even more extravagant, and unsustainable than they do already.

With hindsight, the fiscal stimulus provided by President Biden's $2trillion package early this year may be called into question. As it was distributed directly to consumers already looking forward to spending built up savings (as well as some deserving needy), its effect on inflation has been material. The suggested $4trillion to come is at least targeting infrastructure spending so may not increase consumer spending so directly. The Federal Reserve is keen to argue this inflation is transitory, but if economic growth accelerates as they are also predicting, it is difficult to know what, other than higher interest rates, will slow it.

With this pressure on inflation and some compelling evidence that equity values have been inflated by high levels of speculation, we have adjusted the portfolios accordingly. We have reduced equity exposure, especially in the US, where valuations are highest and increased the allocation to assets more likely to offer protection from inflation. While we have attempted to add inflation protecting assets our overall objective has been to lower risk. We do this, as always, with the expectation that risky assets that are available today, will be available in future at lower prices or better valuations. While we wait for that to occur the portfolios should continue to offer positive returns.

Market Returns (£) - 30th Apr 2021	1 Month	3 Month	YTD	1 Year	3 Year	S/I*
Anchors						30/06/2016*
Cash + 1%	0.1%	0.3%	0.4%	1.1%	4.7%	7.5%
Inflation Linked UK Bonds	0.9%	-2.5%	-5.5%	-1.6%	14.6%	22.6%
Gilts	0.5%	-5.3%	-7.0%	-8.1%	10.2%	9.9%
Global Government Bonds (hedged)	0.1%	-2.0%	-2.6%	-2.0%	9.0%	6.5%
Enhancers						
Global Corporate Bonds (hedged)	0.7%	-1.8%	-2.6%	4.7%	15.3%	16.9%
Global High Yield (hedged)	1.5%	1.2%	1.2%	19.3%	13.2%	27.1%
Emerging Market Bonds (hedged)	1.9%	-3.1%	-4.2%	2.7%	3.2%	13.7%
FTSE 350 TR Index	4.3%	10.5%	9.5%	25.0%	6.9%	33.7%
FTSE UK All-Small Cap	5.4%	15.0%	15.6%	56.8%	32.4%	83.6%
Global Equity (FSTI)	4.3%	10.0%	8.4%	32.4%	47.8%	87.2%
European Equity (FSTI)	4.1%	9.3%	7.2%	29.9%	18.9%	53.2%
US Equity (S&P)	4.9%	11.9%	10.3%	32.3%	63.4%	105.3%
Japan Equity (Topix)	-2.1%	0.5%	-1.2%	17.6%	12.9%	51.7%
Pacific Ex Japan Equity (FSTI)	2.5%	-0.3%	4.0%	34.5%	31.5%	91.9%
Emerging Market Equity (FSTI)	2.1%	0.9%	3.5%	35.5%	23.6%	73.8%
Chinese Equity (Hang Sang)	1.1%	1.0%	4.4%	8.1%	3.8%	55.6%
Indian Equity (Nifty)	-1.3%	5.8%	2.8%	37.1%	23.2%	56.7%
Diversifiers						
Commodity Index	7.9%	11.9%	14.3%	35.3%	4.4%	3.9%
Gold	2.7%	-5.4%	-8.3%	-7.7%	27.6%	21.7%
Silver	5.0%	-4.9%	-3.5%	53.4%	48.6%	23.6%
Brent Oil	7.9%	11.9%	14.3%	35.3%	4.4%	3.9%
UK Property	0.5%	1.7%	2.3%	2.6%	2.8%	13.8%
Global Property Shares	6.1%	11.2%	9.5%	21.2%	3.6%	24.4%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*0.6%*	*0.3%*	*-0.5%*	*5.2%*	*7.6%*	17.1%
Rivers Cautious Portfolio	*1.4%*	*1.6%*	*0.7%*	*10.8%*	*16.4%*	33.6%
Rivers Balanced Portfolio	*1.9%*	*2.4%*	*1.7%*	*15.7%*	*22.4%*	44.8%
Rivers Adventurous Portfolio	*2.5%*	*3.4%*	*2.8%*	*20.1%*	*28.2%*	54.1%
Rivers Aggressive Portfolio	*2.5%*	*4.3%*	*3.6%*	*24.2%*	*29.7%*	62.8%
Rivers Cautious Income Portfolio	*1.2%*	*1.1%*	*0.8%*	*10.7%*	*9.4%*	17.9%
Rivers Balanced Income Portfolio	*1.6%*	*1.9%*	*1.8%*	*14.7%*	*12.4%*	27.9%

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

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