Current Focus

Sep 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

- BMi portfolios continue to add value whilst maintaining a relative defensive allocation
- The potential bankruptcy of property giant Evergrande in China has impacted markets
- The repercussions to Chinese growth are significant but this is not another Lehman
- This highlights the risk of high valuations, inflation and challenging economic data

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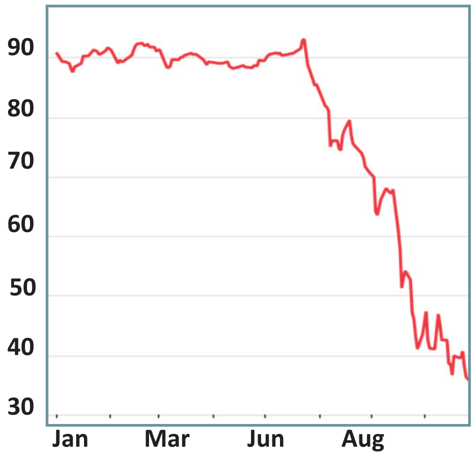
Market Comment

As is often the case during August, equity market liquidity was low and as a result volatility slightly higher. Many in the UK enjoyed their first holiday since Covid began in March 2020, even if it was in the UK, and things appear finally to be returning to normal. Real world news was dominated by the chaos in Afghanistan and whether the increasing cases of Covid were acceptable given the high levels of vaccination. Those investors not on holiday continued to debate whether inflation was transitory and there was some investment market movement during the month but by the end most equity indices were again higher. The MSCI world equity index was higher for the 8th month in a row. Investment-wise August was quiet. Investment wise things usually get more interesting during September. Within the UK, news was dominated by high energy prices and the bizarre possibility of running out of carbon dioxide and as a result, packaged food. These things are undoubtedly relevant but for us the recent events in China have more significance. The Focus this month concentrates on the imminent collapse of Evergrande.

Rarely in the news until just a few weeks ago Evergrande, an enormous and highly indebted Chinese real estate company, is now apparently a threat to global investment markets. It is rumoured, reasonably, that they have essentially built too many homes that they cannot sell. They have run out of cash. The price of Evergrande bonds, in international markets, has plummeted leaving many investors, and a number of banks exposed to enormous losses. Some have likened this to the US Bank Lehman Brothers which collapsed, also in September, 13 years ago leading to a contagion that almost broke the global financial system. While Evergrande is concerning, this comparison is inaccurate. Evergrande's bonds are trading at default-like levels its total obligations and its interconnections are nothing like those of Lehman Brothers. Ultimately Evergrande owes a bit of money to foreign investors and funds (none of which we hold) but the majority is owed to Chinese Banks who are de-facto controlled and for the most part owned by the Chinese government. That does not mean that this will not get ugly, it very well may, just not to the systematic extent of my old employer Lehman. Given the recent other interventions by the Chinese Government, into social media conglomerates and 'education' providers it

Price of 2024 10.5% Evergrande Bond



is not certain that Xi Jinping, the Chinese premier, will even prevent the default – as many have claimed. It is worth mentioning that in 2017 Xi Jinping said "houses are for living in, not for speculation" so it is likely the company and its investors, particularly international ones will be hit, if not entirely wiped out. While this will hit the sector it is extremely unlikely to cause the contagion that spiralled out of control in late 2008. Ultimately, much needed credit will be withheld from Evergrande and other real estate providers only for as long as Beijing wishes.

We do, however, think this maybe a canary in a coal mine situation. Whatever happens, the ballooning Chinese real estate debt market will be hit significantly hit. Evergrande itself employs over 160,000 workers and the real estate industry many more. The direct impact of this to Chinese GDP is unknown but real estate has been its biggest contributor, up to 30%, for many years. The endless, and often unnecessary house building that has boosted GDP will slow significantly. The size and impact of this slowdown is already illustrated by a 60% fall in global iron ore prices since July. Other commodities will also be impacted. Given its size, and contribution to global growth, any slowdown in Chinese growth will impact global demand.

While the Evergrande crisis is not on the scale of 2008 we are, as any regular reader will know, already concerned about global equity valuations. This only adds to that concern. In what we have considered fairly full-priced equity markets since before the summer, this is perhaps the catalyst that may end the seemingly boundless confidence of investors. In April our Risk Committee further reduced the exposure to equites in all the portfolios we manage to the maximum permitted within each portfolio's risk rating. We sought to maximise diversification away from equity risk expecting an opportunity to increase that exposure when it was available at more attractive valuations. Since then, US and Japanese, equities have continued to rise, but on balance equites in Europe and especially the UK have remained relatively subdued.

In addition to the Evergrande situation, in the US and UK we have seen a number of economic reports that have been coming in below economists' expectations. The biggest danger, in our view, remains inflation and whether or not Central Banks continue to argue it is transitory. With wages increasing, job openings remaining higher than unemployment and energy prices continuing to increase it is difficult to argue that zero interest rates and continuing stimulus is justified.

Despite the defensive position held so far this year all portfolios are looking set to exceed target returns and, more importantly, are positioned to protect those returns if the market loses momentum. As we have always said, at Rivers we prefer to buy risk, call that equity or Enhancers, when it is relatively cheap and avoid it when it is relatively expensive. We continue to believe risk is relatively expensive. We think Evergrande, so far, only emphasises that view. If Evergrande proves to be the catalyst that lowers inflated valuations then the portfolios are well positioned to take advantage of that, as they have in all similar situations over the last five years.

Market Returns (£) - 31st August 2021	1 Month	3 Month	YTD	1 Year	3 Year	S/I*
Anchors						30/06/2016*
Cash + 1%	0.1%	0.3%	0.7%	1.1%	4.5%	7.9%
Inflation Linked UK Bonds	0.4%	6.6%	3.6%	6.6%	23.8%	34.4%
Gilts	-0.9%	2.7%	-3.9%	-1.8%	12.6%	13.5%
Global Government Bonds (hedged)	-0.3%	1.6%	-1.0%	-0.1%	10.9%	8.4%
Enhancers						
Global Corporate Bonds (hedged)	-0.3%	2.2%	0.0%	2.6%	17.7%	20.0%
Global High Yield (hedged)	0.8%	1.7%	3.5%	8.6%	17.1%	30.0%
Emerging Market Bonds (hedged)	1.6%	2.9%	-1.6%	3.5%	13.7%	16.9%
FTSE 350 TR Index	2.6%	3.3%	14.3%	26.1%	10.4%	39.6%
FTSE UK All-Small Cap	3.8%	5.5%	24.8%	53.1%	41.5%	98.1%
Global Equity (FSTI)	3.5%	9.4%	17.1%	26.3%	43.5%	102.3%
European Equity (FSTI)	2.7%	5.5%	15.0%	25.9%	25.0%	64.3%
US Equity (S&P)	4.1%	11.1%	20.4%	27.0%	52.9%	124.2%
Japan Equity (Topix)	4.1%	5.0%	2.4%	15.9%	14.3%	57.2%
Pacific Ex Japan Equity (FSTI)	2.1%	-4.6%	-3.0%	10.5%	24.6%	78.9%
Emerging Market Equity (FSTI)	3.7%	-1.0%	2.2%	17.8%	25.3%	71.5%
Chinese Equity (Hang Sang)	0.9%	-7.5%	-3.9%	2.4%	-2.7%	43.3%
Indian Equity (Nifty)	12.1%	14.8%	24.9%	49.0%	37.6%	90.3%
Diversifiers						
Commodity Index	0.7%	6.5%	22.2%	27.5%	11.9%	11.1%
Gold	1.1%	-1.9%	-5.4%	-11.5%	36.8%	25.5%
Silver	-5.3%	-12.0%	-10.2%	-19.2%	47.7%	15.0%
Brent Oil	0.7%	6.5%	22.2%	27.5%	11.9%	11.1%
UK Property	1.0%	3.7%	7.0%	8.4%	6.1%	19.1%
Global Property Shares	4.4%	11.8%	24.6%	33.9%	21.0%	41.5%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*0.2%*	*1.2%*	*1.1%*	*3.2%*	*8.8%*	18.9%
Rivers Cautious Portfolio	*0.8%*	*2.5%*	*3.8%*	*7.6%*	*17.2%*	37.7%
Rivers Balanced Portfolio	*1.2%*	*3.1%*	*5.4%*	*10.8%*	*22.1%*	50.0%
Rivers Adventurous Portfolio	*1.5%*	*3.7%*	*7.0%*	*13.9%*	*27.8%*	60.5%
Rivers Aggressive Portfolio	*2.2%*	*4.5%*	*9.0%*	*17.8%*	*29.9%*	71.2%
Rivers Cautious Income Portfolio	*0.8%*	*2.5%*	*3.7%*	*8.8%*	*11.1%*	21.3%
Rivers Balanced Income Portfolio	*1.1%*	*2.9%*	*5.1%*	*11.6%*	*14.1%*	32.0%

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