Current Focus

Nov 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

- Central Banks maintain low rates despite rising inflation and near full employment
- Equities valuations escalate as nearly all fixed income offer negative real rates of return
- We remain reluctant to do at risk until more attractive valuations become available
- Reducing interest rate risk and adding diversification will protect capital in the short run
- Most portfolios remain on track to meet target returns by year end

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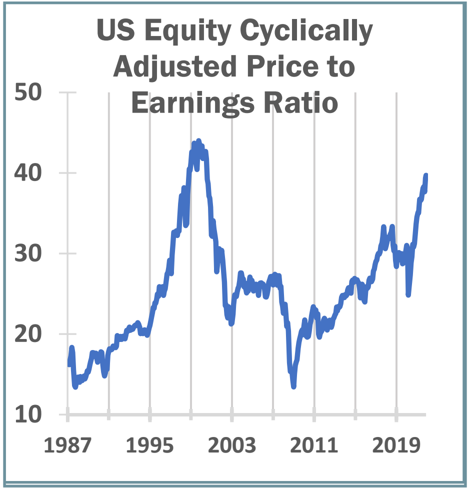
Market Comment

After a relatively calm summer, investment risk as measured by price volatility, increased towards the end of September. This is seasonally often the case, but was enhanced this year by a distinct change in tone by Central Banks. In what appeared to be clear announcements at the time, the Bank of England (BoE), the European Central Bank (ECB) and the Federal Reserve (Fed) all warned of rising inflation risks and their intention to combat those with monetary policy. Benchmark interest rates rose and equity sectors, particularly technology, which have enjoyed the benefit of freely available liquidity, paused.

Having been concerned about extended asset valuations and inflation for some time, we were hopeful that some opportunity to add risk at more reasonable valuations would arise. Subsequent more accommodating announcements from central banks have made that appear less likely. It seems the sustainability of economic growth may have eclipsed concerns about rates of inflation. We think the risks of a policy error by central banks is now higher than it has been since the financial crisis, but equity investors have clearly liked what they have heard. We must accept that our caution, regarding equity valuations, before the summer, was possibly misplaced, or at least it was too early. That said, with portfolio target returns still being met we remain reluctant to add equity risk at current valuation levels. In this month's Focus we look at how we can rebalance the defensively positioned portfolios to protect against inflation, continue to add diversified return and protect clients from what we see as an overextended equity rally.

In early November the BoE's Governor Bailey announced their intention to maintain close to zero interest rates despite rising wage and supply chain price pressures. Almost at the same time Fed Chair Powell announced they would reduce quantitative easing, but diluted previous comments regarding inflation. The quantitative easing being provided, despite inflation, not seen since 1990, remains above any level seen during the Financial Crisis over 10 years ago. With almost every fixed income security now offering negative real returns it is unsurprising that equity indices continue to rise. The domestic inflationary pressures in the UK are obvious with supply chains restricted, job vacancies high and robust demand. Many of these pressures are global and are proving to be more than transitory.



Source: multpl.com

If the primary driver for equity valuations is investor demand and not the underlying economic fundamentals, the possibility of that demand reversing is high. From a tactical perspective the Rivers portfolios have been more defensively positioned for nearly six months as we have waited for better opportunities to increase risk. With equites now even more expensive, and the risk of correction extended, we are prepared to wait for that opportunity. However, the recent fall in benchmark interest rates (following Central Bank comments) does offer some opportunity to rebalance.

That fall, while modest, enables us to reduce portfolio interest rate risk and diversify the portfolios further. Inflation linked bonds, which fell sharply on the initial statements from the BoE in September, have benefited both from falling rates and increased risk of inflation. Breakeven inflation rates (the expectations built into the price of these bonds) have increased but remain exposed to further policy uncertainty. Reducing this exposure, as well as pure interest rate risk within the Anchor assets held, makes sense as the risk of policy changing rapidly increases. Given that many Diversifier asset classes, including commodities and property retain protection from rising inflation, and have added considerable value all year, we see little need to change allocations there. Our main concern now is that the market is either mispricing the extent to which rates can be kept low, because of inflation risk, or overestimating how long strong economic growth can be sustained. It is impossible to time how long, or how far, the equity valuation rally may continue, but at Rivers our strategy is one in which we aim to tactically increase risk when it is less expensive and decrease risk when it is more expensive. This continues to be our strategy. With portfolio target returns still being met we believe investors capital continues to be more safely deployed in Anchor and Diversifier assets than in Enhancers for the time being.

Looking forward, we expect rate rises in both the UK and US during 2022. This is a big change from the 'Lower For Longer' expectation of just a few months ago (when rates were expected not to change until 2024). This change does not currently appear to be reflected in equity, or bond prices. With US inflation now officially above 6% and job vacancies exceeding unemployment, it is difficult to accept that inflation is 'transitory'. The BoE's change in recent months have seen both benchmark rates and sterling's value fall as some commentators suggested a 1970s style stagflation period, where growth remains low yet inflation remains high, was possible. We had thought, in September, that Governor Bailey's statement made this unlikely. His more recent statement increases that risk although we still do not see it as a primary concern.

The UK has some structural employment issues to overcome, many self-inflicted, but from an investment perspective, at least, it looks fairly attractive. Overall we are more optimistic for the UK equity market than many others. Valuations are more attractive, the impact of inflation less damaging to its primary constituents and any further devaluation of the pound positive for much of its corporate earnings. We continue to believe the opportunity to increase risk materially will come even if it is not right now. When that happens our preference remains adding equities with a bias towards UK, European and Emerging equities

Market Returns (£) - 31st Oct 2021	1 Month	3 Month	YTD	1 Year	3 Year	S/I*
Anchors						30/06/2016*
Cash + 1%	0.1%	0.3%	0.9%	1.1%	4.4%	8.1%
Inflation Linked UK Bonds	4.6%	0.7%	3.9%	4.4%	22.0%	34.8%
Gilts	2.3%	-2.5%	-5.5%	-4.4%	11.5%	11.7%
Global Government Bonds (hedged)	-0.3%	-1.7%	-2.3%	-2.1%	9.9%	6.9%
Enhancers						
Global Corporate Bonds (hedged)	-0.1%	-1.3%	-1.0%	1.5%	18.1%	18.7%
Global High Yield (hedged)	-0.5%	-0.5%	2.2%	8.7%	15.9%	28.4%
Emerging Market Bonds (hedged)	-2.3%	-1.0%	-4.1%	-1.7%	7.1%	13.9%
FTSE 350 TR Index	1.9%	3.6%	15.4%	34.9%	16.7%	41.0%
FTSE UK All-Small Cap	-0.2%	1.7%	22.2%	49.7%	48.2%	94.1%
Global Equity (FSTI)	3.9%	5.3%	19.1%	32.5%	54.0%	105.7%
European Equity (FSTI)	2.8%	2.8%	15.2%	33.9%	32.4%	64.6%
US Equity (S&P)	5.2%	6.5%	23.3%	34.2%	64.4%	129.5%
Japan Equity (Topix)	-5.1%	3.5%	1.8%	11.5%	19.1%	56.2%
Pacific Ex Japan Equity (FSTI)	0.0%	-0.9%	-5.8%	2.4%	34.7%	73.7%
Emerging Market Equity (FSTI)	-0.7%	0.9%	-0.6%	10.3%	32.0%	67.0%
Chinese Equity (Hang Sang)	1.7%	-0.3%	-5.0%	1.6%	4.8%	41.5%
Indian Equity (Nifty)	-2.4%	12.3%	25.2%	41.7%	60.3%	90.7%
Diversifiers						
Commodity Index	0.9%	8.9%	32.1%	35.8%	19.3%	20.1%
Gold	-0.1%	-0.4%	-6.8%	-11.4%	31.1%	23.6%
Silver	6.9%	-5.1%	-10.1%	-5.5%	47.7%	15.2%
Brent Oil	0.9%	8.9%	32.1%	35.8%	19.3%	20.1%
UK Property	1.1%	3.0%	9.1%	10.3%	7.7%	21.4%
Global Property Shares	3.6%	0.8%	20.3%	38.1%	21.7%	36.6%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*0.5%*	*0.0%*	*0.9%*	*3.0%*	*9.2%*	18.6%
Rivers Cautious Portfolio	*0.8%*	*0.5%*	*3.5%*	*7.7%*	*19.0%*	37.2%
Rivers Balanced Portfolio	*1.0%*	*0.6%*	*4.8%*	*10.8%*	*25.2%*	49.2%
Rivers Adventurous Portfolio	*1.0%*	*0.8%*	*6.2%*	*13.7%*	*31.5%*	59.3%
Rivers Aggressive Portfolio	*1.1%*	*1.6%*	*8.4%*	*17.8%*	*36.4%*	70.3%
Rivers Cautious Income Portfolio	*0.6%*	*0.4%*	*3.2%*	*9.1%*	*12.4%*	20.7%
Rivers Balanced Income Portfolio	*0.6%*	*0.7%*	*4.6%*	*12.2%*	*16.3%*	31.4%

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