Current Focus

December 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

Market Comment

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Summary

- Compared to 2021 expect more investment challenges in 2022
- Inflation will be a significant influence to market returns through Central Bank policy
- Interest rates will rise more quickly early in 2022 but not sufficiently to neutralise structural inflation
- There will be opportunities to increase risk at better valuations early in 2022
- Portfolios finish 2021 relatively protected from interest rate rises and/or equity losses

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Just as we were looking forward to a post-pandemic future, and planning our investment outlook for 2022, the Omicron variant comes along to make it more difficult. Whilst little is yet known of this variant it appears far more transmissible but possibly less severe. That's both good and bad news. As a result we really cannot know the economic impact of Omicron but we are almost certain it will not be as significant as the original pandemic. This is partly because of the excellent vaccines and partly because the world just cannot afford another full lockdown. Our original summary was that 2022 is likely to be a more challenging year for investors than 2021, Omicron just makes that even more likely to be the case. Looking at potential risks for investors next year, the ongoing Covid-19 risk is just one of many. To that you must add higher inflation as a major hurdle; the interest rate uncertainty that inflation brings; the apparent slowing growth in China caused by a defaulting property sector and increasing government control; historically high equity valuations in certain sectors; rising geopolitical tensions between the West and China, not to mention Russia. The list could go on but given that there is not space here to cover anything like all the uncertainties there are. We will, in this final Focus of 2021, concentrate on the factors which most directly affect our investors; inflation and interest rates in the UK and the US and their potential impact on investment portfolios.

Starting with inflation, we expect it to be higher and more persistent than current consensus. Few still argue that the current inflation rate in the UK (5.1% CPI) and the US (6.8% CPI) is simply "transitory" and likely to fade away. There are transitory aspects to it (commodity prices, supply chain issues and others) which may go away (e.g. commodity prices will not continue to rise at previous rates) but the influence on wages and employment costs are already more structural, and likely to persist. The recent rejection of a 4% pay offer from GMB Union members is a clear example. Structural inflation is problematic and unless met by a material increase in productivity can become entrenched and self-generating. It needs ultimately to be controlled by tighter monetary policy.

This is already being communicated by the Bank of England (BoE) and US Federal Reserve (Fed) but does not appear, so far, to be reflected in their actions. While in their respective December meetings, the BoE announced a surprising rate increase, and the Fed decreased its monthly bond purchases, both Central Banks continue to offer extremely accommodative monetary conditions in what appear to be overheating economies. Monetary policy is effective at cutting structural inflation and avoiding the risk of stagflation – a situation where real economic growth (above inflation) appears unachievable. Monetary policy is also effective at stimulating demand when that may be required. The problem is that if rates remain close to zero when an economy booms, rates cannot be reduced sufficiently when a recession occurs. With both the UK and US economies at near full employment (job vacancies higher than unemployment) and pressure on rising wages increasing, it is difficult to understand the stance of the Central Banks given rising inflation. Inflating away massive governmental debt may be one motivation and supporting an extended

Country	November CPI Inflation (YoY %)	October CPI Inflation (YoY %)
Japan	0.1	0.2
Saudi Arabia	1.1	0.8
Switzerland	1.5	1.2
Indonesia	1.8	1.7
China	2.3	1.5
France	2.8	2.6
Italy	3.7	3.0
South Korea	3.7	3.2
Canada	4.7	4.7
Euro Area	4.9	4.1
India	4.9	4.5
United Kingdom	**5.1**	**4.2**
Germany	5.2	4.5
Netherlands	5.2	3.4
South Africa	5.5	5.0
Spain	5.5	5.4
United States	**6.8**	**6.2**
Mexico	7.4	6.2
Russia	8.4	8.1
Brazil	10.7	10.7
Turkey	21.3	19.9
Argentina	51.2	52.1

Source: Tradingeconomics.com

equity bubble may be another, depending on how cynical one wants to be. Whatever that motivation is, we must hope rates are higher before the next inevitable, economic slowdown, or this economic experiment will have failed.

These things are extremely difficult to predict accurately but we suspect continued rising inflation will force both the BoE and the Fed to accelerate their interest rate plans materially in early 2022. This will likely lead to volatility in equity and bond markets correcting some of the extreme valuations and offering an opportunity to increase portfolio risk exposure. Interest rates will not rise materially, we estimate just 0.5% in the UK and up to 1% in the US. This will impact investment markets but should not restrict economic growth. It will however, at least this is our base case, appear to be effective, as inflation rates will fall in the second half of the year, likely supporting equity markets (and benefitting portfolios with increased risk exposure). This fall in inflation however will be the rolling over of the transitory inflationary factors and not the structural factors which will remain. We expect inflation to exceed expectations and remain above 3% on both sides of the Atlantic throughout 2022. Equity earnings will grow but with real yields negative, both for equity and bond investors, the problem will not be fixed. Investment returns will be more dependent on tactical adjustment and diversification as bond yields rise and equity multiples, at best, stop rising. The question regarding inflation will still be whether the Central Banks risk a recession by raising rates more, or risk not having raised rates enough when a recession comes along? Hopefully it will be a question we don't know the answer to this time next year. We wish all of you a happy Christmas and a successful 2022. Thank you for your interest in Rivers.

Market Returns (£) - 30th Nov 2021	1 Month	3 Month	YTD	1 Year	3 Year	S/I*
Anchors						30/06/2016*
Cash + 1%	0.1%	0.3%	1.0%	1.1%	4.3%	8.2%
Inflation Linked UK Bonds	6.1%	6.3%	10.2%	10.7%	33.8%	42.9%
Gilts	3.1%	1.4%	-2.6%	-1.0%	16.4%	15.1%
Global Government Bonds (hedged)	1.1%	-0.3%	-1.2%	-1.1%	10.6%	8.1%
Enhancers						
Global Corporate Bonds (hedged)	0.2%	-0.9%	-0.8%	-0.4%	18.8%	18.9%
Global High Yield (hedged)	-1.5%	-2.7%	0.7%	2.7%	15.4%	26.5%
Emerging Market Bonds (hedged)	2.4%	-0.2%	-1.8%	-1.0%	7.3%	16.7%
FTSE 350 TR Index	-2.2%	-1.3%	12.9%	17.1%	16.1%	37.8%
FTSE UK All-Small Cap	-3.0%	-5.0%	18.5%	26.2%	44.5%	88.3%
Global Equity (FSTI)	1.3%	3.0%	20.7%	22.9%	54.0%	108.5%
European Equity (FSTI)	-2.0%	-1.8%	12.9%	15.7%	30.7%	61.4%
US Equity (S&P)	2.9%	5.3%	26.8%	28.5%	65.6%	136.1%
Japan Equity (Topix)	0.3%	-0.3%	2.1%	3.7%	18.4%	56.7%
Pacific Ex Japan Equity (FSTI)	-0.5%	-3.4%	-6.3%	-2.6%	27.7%	72.8%
Emerging Market Equity (FSTI)	-0.6%	-3.2%	-1.2%	3.6%	25.8%	66.0%
Chinese Equity (Hang Sang)	-4.3%	-5.5%	-9.1%	-8.2%	-5.9%	35.5%
Indian Equity (Nifty)	0.5%	0.7%	25.7%	35.3%	45.7%	91.6%
Diversifiers						
Commodity Index	-4.0%	3.8%	26.9%	30.1%	15.0%	15.3%
Gold	3.1%	1.5%	-3.9%	-0.1%	34.1%	27.4%
Silver	-1.5%	-1.3%	-11.4%	1.1%	46.9%	13.4%
Brent Oil	-4.0%	3.8%	26.9%	30.1%	15.0%	15.3%
UK Property	1.4%	3.5%	10.8%	10.9%	8.8%	23.3%
Global Property Shares	4.5%	0.9%	25.7%	30.5%	33.2%	42.8%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*0.5%*	*0.2%*	*1.4%*	*2.0%*	*10.5%*	19.2%
Rivers Cautious Portfolio	*0.3%*	*0.0%*	*3.8%*	*5.0%*	*19.5%*	37.6%
Rivers Balanced Portfolio	*0.4%*	*-0.2%*	*5.2%*	*6.9%*	*25.1%*	49.8%
Rivers Adventurous Portfolio	*0.3%*	*-0.5%*	*6.5%*	*8.8%*	*30.8%*	59.7%
Rivers Aggressive Portfolio	*0.0%*	*-0.5%*	*8.4%*	*11.4%*	*34.3%*	70.3%
Rivers Cautious Income Portfolio	*0.3%*	*-0.1%*	*3.6%*	*5.0%*	*13.0%*	21.1%
Rivers Balanced Income Portfolio	*0.1%*	*-0.4%*	*4.7%*	*6.5%*	*16.5%*	31.5%

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