Current Focus

February 2022

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

- Interest rate increases will be the primary influence on asset prices in 2022
- Most asset classes have seen values fall with technology most affected
- The energy, material and financials within the FTSE100 have boosted its recent return
- While equity valuations have improved they remain high in many sectors
- Bonds are priced for a less optimistic outlook than equities generally
- We expect opportunities to increase equities allocations in the coming months

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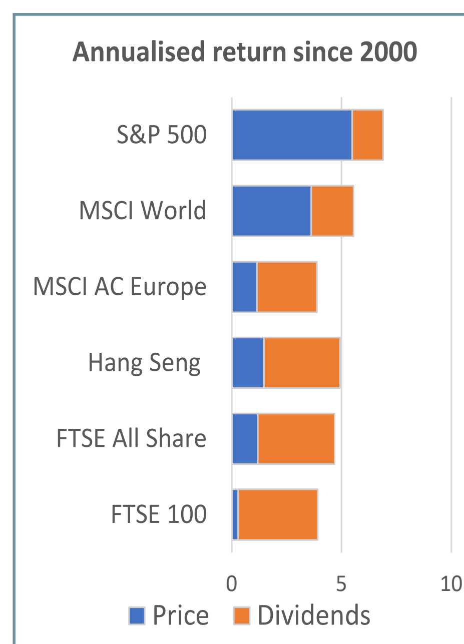
Market Comment

Since December the reality of rising inflation has become the focus of Central Banks. With the Bank of England, Federal Reserve and even the European Central Bank looking to tackle inflation through rate increases this year. This has directly affected benchmark interest rates, particularly on shorter duration debt. During January this finally led to falls in some high valuations across global equity markets. The exception to that has been the UK market, especially the FTSE 100, which has actually seen gains over the same period. Global equities, when measured in sterling terms, lost 4.4% during January. UK Gilts, or government bonds lost a similar 4.1% but the FTSE 100 gained 1.1%. This month we focus on why there is such a difference between the FTSE 100 and other equity markets, whether we expect it to continue and how the factors which have caused this have affected the Rivers portfolios.

The fact is the FTSE 100 UK equity index has, overall, not performed well this century. Even including the last 12 months, during which it has slightly outperformed the Global MSCI index (20.7% vs 19.3% in Sterling) it has been pretty much the worst performer over most periods this century. This is true regardless of whether the time period is since 2000, since the Global Financial Crisis, or since Covid hit the world in February 2020. The main reason for this can be found in the composition of the index; the FTSE 100 has a relatively high concentration in Energy (BP, Shell), Materials (Glencore, Anglo American), Consumer discretionary (BAT, Diageo) and Financials (HSBC, Lloyds) and very low allocation to technology, which apart from the last 3 months, has been the strongest performer since Covid-19. This explains why it doesn't appear much as an allocation within any Environmental, Social or Governance (ESG) focused portfolio – they strictly can't hold much of the above. It also explains why the recent performance has been so good on a relative basis – these are the very sectors that are ideally placed to benefit from interest rate and inflationary issues – and even a possible Ukrainian invasion. This may reflect an overall switch to value or, more likely in our view, just a fall in over-inflated technology stocks, which despite the continued existence of Vodafone play a small part in the index.



Source: FE Analytics - Annualised return since 31/12/1999

Looking forward from here, we do expect the factors which brought about this change to continue. Interest rates are set to rise. Whether it is in the UK, or globally, higher interest rate expectations have been far better priced into fixed income indices than they have into equity indices. Bond traders are notoriously better at discounting the effects of these changes. Despite the recent performance we think this still remains more the case in the US and elsewhere than the UK market, especially the FTSE 100 but we do not expect it to be immune. From a domestic economic perspective, in the UK, the triple risk of rising energy prices, rising tax and interest rates are yet to be reflected fully in equity prices, even within the more domestic focused medium and smaller cap indices. We do continue to see attractive valuations in the large corporates that make up much of the FTSE 100 index. These are relatively well protected from domestic difficulties (global revenue, falling pound etc.) but if there is a more global economic slowdown this will ultimately affect all sectors.

Looking at the Rivers portfolios generally, while the above does make a difference for comparison's sake, it has been a challenging period even though the portfolios have been considerably underweight Enhancers (equity risk). This Enhancer underweight has helped but our bias towards ESG has

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not. The active funds we have preferred have had either an ESG bias or, in the case of the UK, a smaller capitalisation bias. This has added value over the medium to long term but been difficult more recently over the short term. Looking at the Anchor Asset allocation which includes bonds, in this case the bias towards shorter duration and more opportunistic managers has done well – when compared to the All Gilts bond index that is, or even Global Equity, just not compared to the FTSE 100. Finally the Diversifiers we hold (to avoid interest rate and equity risk) such as gold miners and property, even clean energy, were either flat, or down so didn't help much either – again in a global context they did ok, but not compared to the FTSE. These are real assets though so we suspect the price changes have more to do with fund flows than the underlying (the gold price today will certainly have helped).

Our tactical allocation strategy is to add risk tactically and our current allocation is underweight (Risk Level 2 out of 7). At the moment we do still think the UK FTSE is more attractive, from a valuation perspective, than many other regions. This means when we next add risk we will probably favour the UK, although we cannot ignore the domestic situation entirely. We continue to like the valuation in Energy and Materials but must be aware of the ESG implications of such allocations. An inexpensive FTSE tracker fund will probably be our preferred investment but after the recent gains we prefer to remain patient. In the current market it would not be prudent to add more risk as we continue to expect the opportunity do so, at better prices, will come in the coming months. Protecting capital now, while continuing to participate, will add to the benefit of improved valuations in the future.

Market Returns (£) - 31st Jan 2022	1 Month	3 Month	1 Year	3 Year	5 Year	S/I*
Anchors						30/06/2016*
Cash + 1%	0.0%	0.2%	1.0%	4.1%	7.4%	8.3%
Inflation Linked UK Bonds	-2.7%	-2.7%	4.3%	19.0%	22.2%	31.2%
Gilts	-4.1%	-3.8%	-7.5%	4.9%	10.8%	7.4%
Global Government Bonds (hedged)	-1.4%	-1.0%	-2.7%	6.1%	10.0%	5.8%
Enhancers						
Global Corporate Bonds (hedged)	-2.7%	-2.6%	-2.8%	12.4%	16.3%	15.6%
Global High Yield (hedged)	-2.3%	-2.2%	0.0%	11.2%	16.9%	25.5%
Emerging Market Bonds (hedged)	1.4%	2.7%	-0.4%	3.4%	10.2%	17.0%
FTSE 100 TR Index	1.1%	3.6%	20.7%	19.9%	27.7%	41.8%
FTSE UK All-Small Cap	-3.8%	-3.0%	18.0%	44.3%	58.7%	88.3%
Global Equity (MSCI)	-4.4%	-1.3%	19.3%	55.3%	74.7%	103.0%
European Equity (MSCI)	-3.7%	-1.9%	15.2%	32.3%	41.4%	61.4%
US Equity (S&P)	-4.3%	0.4%	25.7%	69.8%	98.2%	130.5%
Japan Equity (Topix)	-4.0%	-4.1%	-0.8%	18.8%	25.6%	49.9%
Pacific Ex Japan Equity (MSCI)	-2.5%	-4.3%	-13.6%	20.5%	41.6%	66.3%
Emerging Market Equity (MSCI)	-1.0%	-2.1%	-5.1%	20.8%	39.7%	63.6%
Chinese Equity (Hang Sang)	2.7%	-4.3%	-12.1%	-7.8%	12.0%	35.4%
Indian Equity (Nifty)	-0.4%	1.4%	30.5%	54.7%	78.9%	93.3%
Diversifiers						
Commodity Index	9.1%	6.0%	37.0%	33.3%	21.2%	27.2%
Gold	-1.0%	2.6%	-1.3%	27.5%	31.3%	26.9%
Silver	-3.2%	-4.7%	-15.5%	29.2%	10.8%	9.8%
Brent Oil	9.1%	6.0%	37.0%	33.3%	21.2%	27.2%
UK Property	1.5%	5.5%	14.6%	13.7%	26.6%	28.3%
Global Property Shares	-4.5%	2.4%	25.1%	24.3%	38.5%	39.9%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*-1.8%*	*-1.5%*	*0.1%*	*7.9%*	*11.1%*	16.8%
Rivers Cautious Portfolio	*-2.3%*	*-1.8%*	*2.5%*	*17.4%*	*23.7%*	34.8%
Rivers Balanced Portfolio	*-3.1%*	*-2.4%*	*3.0%*	*22.2%*	*31.4%*	45.7%
Rivers Adventurous Portfolio	*-4.1%*	*-3.2%*	*3.5%*	*27.1%*	*37.0%*	54.2%
Rivers Aggressive Portfolio	*-4.7%*	*-4.0%*	*4.8%*	*30.3%*	*42.4%*	63.6%
Rivers Cautious Income Portfolio	*-1.7%*	*-1.2%*	*2.3%*	*11.0%*	*14.2%*	19.4%
Rivers Balanced Income Portfolio	*-2.0%*	*-1.2%*	*3.5%*	*14.6%*	*20.0%*	29.9%

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