Current Focus

June 2022

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

- Interest rates will not return to near zero levels in the foreseeable future
- From an investment perspective the outlook is getting more positive
- Valuation in technology remains high. Valuation in other sectors is now attractive
- A neutral tactical asset allocation is now appropriate for the first time this year
- We see opportunity for tactical investment and still expect positive real returns going forward

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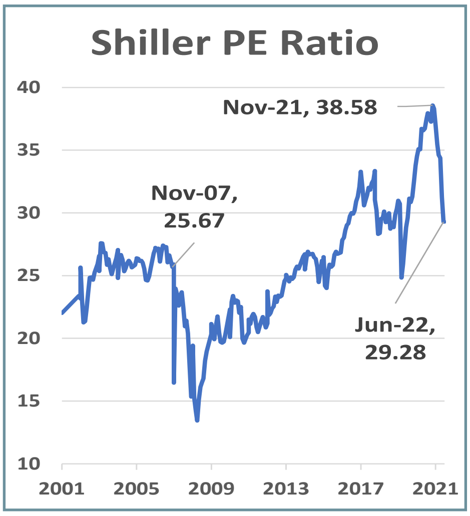
Market Comment

In the last six months the concerns we had regarding inflation and stock valuations have proven to be justified. Whether it is the cost of living, rising interest rates or fears of recession, the financial news is covering little else. From a portfolio management perspective it has been a difficult period, even with an underweight risk tactical allocation there have been few places to hide. As investors adjust for rising interest rate expectations, both fixed income and equity indices have struggled. Even the FTSE 100, which has low technology and high energy and materials sector allocation, has struggled in recent weeks. Diversifiers have helped; commodities in particular, but also absolute return funds and real estate to varying degrees. Overall it has been difficult to protect capital value in a nominal, let alone in an inflation adjusted way, so far in 2022. While from an economic perspective the outlook does not look positive, and the probability of recession is reasonably high, we think the opportunity for investing is now more attractive than it has been for over a year. As the markets have fallen the allocation to risk across the portfolios we manage has reflected this forward looking view. This is consistent with our long term investment strategy, regarding fundamentally improving valuations, particularly in certain sectors. It is also consistent with our tactical view that this period of volatility is not likely to end soon and sensibly adjusting risk exposure will add value to any portfolio.

Our outlook is based on inflation and interest rate risk continuing to dictate investment decisions over the coming months, possibly years. Inflation, which was labelled as 'transitory' throughout 2021, began well before the Russian invasion of Ukraine. It was, however, stoked by it and is now at dangerous levels that will be difficult to control. This is a global inflationary issue but combined with full employment, falling domestic participation and restricted immigration it makes the UK look particularly vulnerable. With quite aggressive interest rate increases already expected in the UK and the US, the main questions for investors are whether enough is being done to dampen demand and if Central Banks, and governments, will accept negative growth, or recession, as a cost worth bearing to defeat inflation.

The rhetoric from the BoE and the Fed suggest that they will, if given the choice,



Source: www.multpl.com
Shiller PE ratio for the S&P 500.
Price earnings ratio is based on average inflation-adjusted earnings from the previous 10 years, known as the Cyclically Adjusted PE Ratio (CAPE Ratio),

do whatever it takes to beat inflation, even forcing a recession if that is required to reduce demand. Many commentators seem less certain and are betting on the monetary 'put' that has supported those equity markets since 2010 – i.e. at some point interest rates will be reversed. This is not the reason for our relatively positive outlook. Whatever path the Central Banks take, we believe the era of minimal, or even negative, interest rates is over for the foreseeable future. In some sectors this is already reflected in valuations but in others, notably technology, it is not. Our medium term view is that as interest rates continue to rise, the capital flow that has for so long been from bonds to equities, may reverse. This will result in a re-assessment of stock valuations, especially in the high multiple technology sector. This will happen even if a recession can be avoided. There are however very significant pockets of value within equity markets which will not be affected by this. The importance of sector allocation has been high, year to date, and will continue. This may be a period, similar to the 2000-2003 period of high active management opportunity. While we think the UK economy is vulnerable to sustained inflation, the make up of the equity index, especially the FTSE 100 is attractive from an investment perspective. The energy and materials bias, and lack of technology, means the index is unlikely to lose much more value. Few regional indices have such an attractive sector allocation given the current market backdrop.

From a tactical perspective the opportunity to add risk now is also attractive. Even if the re-rating we expect does occur it will not be in a straight line. By adding risk after, or during, a correction phase we increase the opportunity of reverting to a more defensive allocation should the market rally without the macro news turning more positive. On the other hand there are numerous reasons why that news may improve. Central Banks could change policy prematurely, as many expect, or inflation indicators moderate more quickly. The first would, we think be another policy error but the second a very positive outcome. Looking, as we have many times in the last few years, at the Cape-Shiller valuation metric, the US equity market has corrected but remains expensive compared to history. This is primarily due to its technology allocation which includes a lower but still significant allocation to the FAANG stocks (Facebook, Apple, Amazon, Netflix and Google). These are great companies but if, as we expect, interest rates settle at a higher long term average than that experienced since 2010, then justifying valuation multiples higher than the return available from US Treasuries is going to be difficult. The Nasdaq has fallen a lot but remains expensive if rates continue to rise and the situation is considered permanent. Ultimately portfolio diversification will be as important as ever.

Positive real return is difficult to achieve in a near double digit inflationary environment but a combination of sector specific equities, fixed income, and diversifiers, unrelated to either, will protect real portfolio value most effectively. With an overall neutral tactical risk allocation and a bias away from technology, as of June 20th, we believe the portfolios are best positioned to reflect the changing environment.

Market Returns (£) - 31st May 2022	1 Month	3 Month	1 Year	3 Year	5 Year	S/I*
Anchors						30/06/2016*
Cash + 1%	0.1%	0.1%	0.1%	0.9%	1.7%	1.9%
Inflation Linked UK Bonds	-8.0%	-16.4%	-13.4%	-8.4%	-0.7%	9.3%
Gilts	-3.1%	-8.1%	-12.0%	-8.3%	-3.8%	-2.7%
Global Government Bonds (hedged)	-0.5%	-4.9%	-6.7%	-2.8%	1.9%	-0.5%
Enhancers						
Global Corporate Bonds (hedged)	0.2%	-6.4%	-9.8%	-0.7%	3.8%	6.0%
Global High Yield (hedged)	-0.4%	-4.7%	-8.7%	1.8%	5.1%	16.8%
Emerging Market Bonds (hedged)	0.5%	1.5%	2.0%	0.4%	4.9%	15.9%
FTSE 100 TR Index	1.1%	3.3%	12.4%	18.4%	22.7%	47.0%
FTSE UK All-Small Cap	-2.0%	-1.6%	-4.9%	31.6%	37.3%	78.5%
Global Equity (MSCI)	-0.3%	0.4%	7.4%	43.0%	62.9%	98.6%
European Equity (MSCI)	0.3%	-0.2%	-0.8%	19.3%	22.0%	54.6%
US Equity (S&P)	-0.3%	0.9%	11.7%	55.5%	86.9%	125.4%
Japan Equity (Topix)	0.8%	-2.7%	-3.0%	13.0%	18.1%	45.2%
Pacific Ex Japan Equity (MSCI)	1.2%	-2.0%	-14.9%	16.3%	22.9%	59.6%
Emerging Market Equity (MSCI)	0.1%	-1.3%	-9.6%	15.8%	23.4%	56.6%
Chinese Equity (Hang Sang)	1.8%	0.9%	-15.9%	-13.2%	0.2%	30.2%
Indian Equity (Nifty)	-6.2%	2.2%	14.3%	32.1%	54.7%	89.6%
Diversifiers						
Commodity Index	1.1%	22.3%	59.6%	72.1%	71.5%	66.3%
Gold	-4.0%	3.1%	8.3%	35.0%	40.1%	38.5%
Silver	-6.3%	-5.4%	-13.6%	40.9%	18.4%	12.9%
Brent Oil	1.1%	22.3%	59.6%	72.1%	71.5%	66.3%
UK Property	0.3%	3.4%	16.6%	18.3%	28.8%	33.8%
Global Property Shares	-5.3%	-3.1%	4.6%	17.7%	18.1%	32.4%
Rivers Model Portfolios						
Rivers Preservation Portfolio	*-0.9%*	*-1.2%*	*-2.0%*	*4.1%*	*7.7%*	15.1%
Rivers Cautious Portfolio	*-0.9%*	*-0.7%*	*-1.0%*	*12.0%*	*18.6%*	32.9%
Rivers Balanced Portfolio	*-1.4%*	*-0.6%*	*-1.2%*	*16.4%*	*25.1%*	43.8%
Rivers Adventurous Portfolio	*-1.3%*	*-0.1%*	*-1.5%*	*20.9%*	*29.8%*	52.4%
Rivers Aggressive Portfolio	*-1.3%*	*0.1%*	*-1.7%*	*23.5%*	*32.6%*	61.2%
Rivers Cautious Income Portfolio	*-0.9%*	*-1.2%*	*-1.9%*	*5.1%*	*7.6%*	16.1%
Rivers Balanced Income Portfolio	*-0.9%*	*0.1%*	*0.1%*	*9.9%*	*14.0%*	28.4%

Source: Financial Express in GBP (unhedged unless stated) as at 31st May 2022. *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.