Current Focus

October 2022

A monthly market comment from Rivers Capital Management. Views expressed here are subject to change and for professional advisors only

Rivers Capital Management

+44 (0)20 3383 0180
www.riverscm.com

Summary

- Political uncertainty in the UK has accelerated an inevitable rise in interest rates
- Interest rates may continue to rise although the chance of a further 'doubling' is very low
- Despite high inflation and expected recession UK asset prices are now attractive
- The balance between equity and bond returns has changed
- Equities with high price multiples remain vulnerable as risk free rates rise
- Portfolios have been rebalanced to add ex-US equities and increase Gilts

Contacts

Richard Bonnor-Moris
rbm@riverscm.com

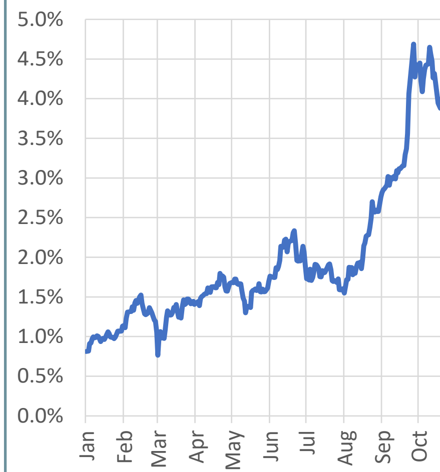
Eduardo Tomacelli
etomacelli@riverscm.com

Najib El-Rayyes
ner@riverscm.com

Market Comment

When financial and political news dominate headlines it is rarely a good time for investors. In the last month, Prime Minister Wilson's adage "a week is a long time in politics" and Thatcher's "you can't buck the market" could not have aligned more perfectly. We will avoid any political comment or predictions, but have been watching the gyrations of Sterling and UK Government Bond (Gilt) yields with some amazement. While the 'intervention' by the Bank of England (in the long dated Gilts) was smaller than feared, it is not something done lightly. That said, if the intervention was done to avoid a crisis, we think it worked. Governor Bailey was keen to stress the intervention was to provide liquidity and not to lower interest rates. It has been ugly but what happened has, perhaps, just accelerated the inevitable. After all, the Bank of England (BoE) was expected to increase interest rates further (to combat inflation) and have been predicting a 2023 recession, in the UK, for months. All that has changed is that the former has been unintentionally accelerated and the attempt to avoid the latter has failed. Looking forward, we will attempt to answer three questions. Will rates continue to rise? Is this a global problem? And has the balance between equities and bonds changed? Relating these to the diversified portfolios we manage, in the 600 words we have left, is a challenge, but is probably easier now than it was at the start of September.

Interest rates relate primarily to future expectations of the BoE's Base Rate (the overnight rate charged for loans). The Base Rate has risen from 0.1% at the start of the year to 2.25% today. It was widely expected to rise to 3.5% by the end of the year and peak at roughly 4.5% during 2023. Market expectations for this peak have not changed much, although the time for it has been brought forward. It is possible the peak in rates may actually have been lowered by recent events, effectively by bringing forward the recession. Longer term rates take into account a myriad of influences on rates such as economic growth and future inflation, and the uncertainty of making long term predictions. Ultimately it is demand and supply. Looking at the yield on a 5 Year Gilt we see it has been rising all year. From 0.7% on January 1st fairly steadily to 2.8% by September 1st. Since then, it hit a peak of 4.7% on September 27th before moderating to just below 4% as the new PM (Rishi Sunak) was appointed. A full 1% of



Source: investing.com

the up move happened in just 3 days, which was a problem. However temporary the peak was, any return around 4% remains more attractive than any return seen since 2008. Given the recent fall in Sterling, this should be even more the case for foreign investors. Should inflation remain high, which is possible if supply side constraints persist, this rate may rise marginally but if a recession happens sooner, it may well decrease as the Base Rate is lowered. Our base case is that the BoE continue raising rates as inflation sustains. That said the possibility of another doubling (as has happened since August 13th) is low. Gilts remain effectively risk free in terms of default so a certain 4% return is attractive, especially or more cautious investors.

Rising interest rates are certainly a global phenomenon, the catalyst of which has been inflation. Inflation was (simplistically and indirectly) started by Covid, enhanced by excess liquidity and essentially doubled by the Russian invasion of Ukraine. The impact on wages, import costs, demographics and deglobalisation have made inflation much more longstanding than previously imagined and will dominate investing for years to come. Belated Base Rate rises were started by the BoE in January but have since been eclipsed by the US Federal Reserve. The US Dollar has strengthened against almost everything as the war in Ukraine continues. All this, however, does not explain away the ominous combination of sharply rising rates and a falling currency that was seen in the UK at the end of September. The cause of that was

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political, but we said earlier that we would not comment on this. What we can say is that as investors, while there remain concerns, these are well compensated for by higher returns.

Finally, yes, this does change the balance between equities and bonds. It removes the TINA (There Is No Alternative) factor for investors looking at equities, if nothing else. The possibility of a positive real return from 'risk free' government debt raises the bar on investing in equity. This may have contributed to, but does not explain the falls in global equities this year. It is a factor worth considering though, especially for equities with high earnings multiples. There are fewer of these stocks now but some remain, especially among US large cap technology stocks.

Equity valuations, right now and in Sterling terms, look better in the UK, in the EU and in Japan than they do generally in the US. Despite, or maybe because of, the recent fall in Sterling, Gilts and UK equities, we have recently increased the relative allocations to all of these within the model portfolios we manage. A recession in the UK is now inevitable, but this is reflected well in asset prices. We have recently increased the Enhancer allocation within the portfolios and reduced the total Anchor allocation. This has been done, while increasing Gilt exposure within the Anchor allocation, by reducing the overweight in absolute return focused Anchor funds. The Diversifier allocation has been sustained with a focus on real assets, energy and insurance. The UKs reputation as a credible and stable G7 economy may have been damaged, but not irreparably.

Market Returns (£) - 30th Sept 2022	1 Month	YTD	1 Year	3 Year	5 Year	S/I*
Anchors						30/06/2016*
Cash	0.1%	0.4%	0.4%	0.9%	2.0%	2.2%
Inflation Linked UK Bonds	-7.4%	-30.3%	-27.0%	-26.5%	-11.2%	-6.0%
Gilts	-8.5%	-26.4%	-24.5%	-27.2%	-16.4%	-17.6%
Global Government Bonds (hedged)	-2.9%	-11.5%	-11.4%	-10.6%	-2.7%	-5.0%
Enhancers						
Global Corporate Bonds (hedged)	-4.8%	-17.5%	-17.6%	-12.0%	-4.9%	-2.1%
Global High Yield (hedged)	-4.8%	-17.3%	-17.7%	-9.6%	-6.1%	6.2%
Emerging Market Bonds (hedged)	0.2%	5.6%	4.4%	-1.2%	9.0%	21.8%
FTSE 100 TR Index	-5.2%	-3.7%	0.9%	3.6%	13.5%	35.1%
FTSE All-Share	-5.9%	-7.9%	-4.0%	2.4%	11.3%	34.3%
Global Equity (MSCI)	-5.5%	-9.5%	-2.9%	26.2%	55.6%	92.1%
European Equity (MSCI)	-4.9%	-15.8%	-11.9%	1.6%	9.8%	41.2%
US Equity (S&P)	-5.4%	-8.0%	1.6%	37.6%	82.0%	121.7%
Japan Equity (Topix)	-5.8%	-9.2%	-13.9%	1.3%	13.3%	41.8%
Pacific Ex Japan Equity (MSCI)	-10.4%	-16.1%	-17.6%	-0.8%	4.9%	43.1%
Emerging Market Equity (MSCI)	-8.0%	-11.6%	-13.2%	3.7%	9.7%	46.0%
Chinese Equity (Hang Sang)	-9.5%	-8.4%	-13.2%	-20.2%	-12.0%	20.8%
Indian Equity (Nifty)	-2.5%	9.5%	8.8%	53.1%	76.4%	112.6%
Diversifiers						
Commodity Index	-4.2%	37.8%	35.0%	61.2%	68.2%	60.7%
Gold	1.2%	10.0%	13.9%	19.8%	47.5%	41.0%
Silver	11.3%	-1.7%	3.4%	17.3%	27.6%	11.5%
Brent Oil	-4.2%	37.8%	35.0%	61.2%	68.2%	60.7%
UK Property	-2.0%	2.2%	7.6%	14.0%	21.7%	29.2%
Global Property Shares	-17.5%	-34.8%	-27.6%	-20.5%	-13.1%	-4.5%
Rivers Model Portfolios						
Rivers Preservation Portfolio	-3.6%	-8.1%	-7.3%	-3.4%	1.5%	9.4%
Rivers Cautious Portfolio	-4.0%	-8.0%	-6.7%	2.8%	12.2%	26.9%
Rivers Balanced Portfolio	-4.4%	-8.7%	-7.1%	6.1%	18.5%	37.3%
Rivers Adventurous Portfolio	-5.0%	-10.0%	-8.2%	9.3%	22.8%	44.7%
Rivers Aggressive Portfolio	-5.3%	-10.9%	-9.2%	10.8%	25.0%	53.0%
Rivers Cautious Income Portfolio	-5.6%	-11.3%	-10.3%	-5.6%	0.5%	7.7%
Rivers Balanced Income Portfolio	-5.5%	-9.8%	-8.4%	-1.3%	6.4%	19.5%

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

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