Current Focus

September 2023

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

Rivers Capital Management

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

Summary

- Economic growth in the US is slowing but not as quickly as expected
- The impact from higher US interest rates has been offset by significant fiscal support
- The longer duration of debt accrued in the recent past has delayed credit tightening
- US government deficits are now similar to the peak of the financial crisis
- If high rates are sustained to combat inflation a more pronounced slowdown is likely

Contacts

Richard Bonnor-Moris
rbm@riverscm.com

Eduardo Tomacelli
etomacelli@riverscm.com

Najib El-Rayyes
ner@riverscm.com

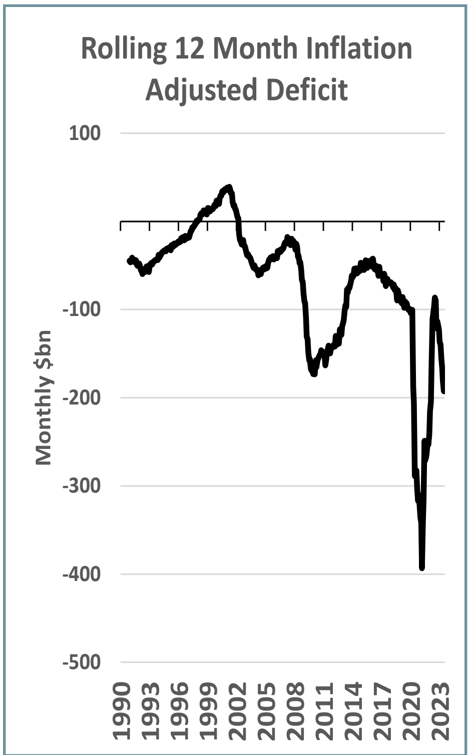
Market Comment

In 2023 global economic growth has slowed and corporate earnings have fallen. This was expected. If anything, given the extent to which interest rates have increased, this slowdown has been surprisingly modest. Growth, particularly in the US has been resilient despite rising interest rates. This has been explained in some way by the rise in artificial intelligence (AI) and its perceived boost to productivity. We think that it may have helped (it certainly boosted a small number of stock valuations) but does not explain why, in the US, spending remains high and unemployment historically low given what is a much tighter monetary policy backdrop. The reason for this sustained growth, and the Focus this month, is that the impact of monetary policy has been slow and essentially offset by increased US government deficit spending.

As of August 2023 the broad measure of US real economic growth is running at around 0% on a 6-month annualized basis. Private sector hiring trends have slowed, including job openings and payrolls and core inflation is falling. Inflation is even expected to hit its 2% target in 2024. Slowing but still positive growth, alongside inflation falling towards its target, is the definition of a 'soft' landing. It is broadly what most investors are now expecting. We are not so sure, as explained below, but there is no denying how robust the economy has been. Given the magnitude of interest rate increases in the US in the last 12 months and the clear fall in credit creation we, and others, were expecting a much more severe economic slowdown at the start of 2023 as was reflected in asset prices. The A.I. 'revolution' and a return to growth in China (not looking that strong now as it happens) do explain some of the rebound in asset prices but not really the broad economic resilience.

That economic resilience can be explained, in a significant way, by looking a fiscal spending. So far 2023 has been an example of the importance of the time-sensitivity of money creation. Simply put, money can be created and destroyed fast and slow. Fiscal deficit is fast money creation, credit tightening is slow money destruction.

Since October 2022, US fiscal deficit spending has increased remarkably, especially for this point of the economic cycle. Examples include the Chips Act (to support the construction of chip manufacturing plants in the US), the Inflation Reduction Act (a pipeline of infrastructure spending), a boost to Social Security payments, delays in kicking off student loans repayments and more. The graph shows the inflation-adjusted monthly (smoothed) fiscal deficit spending for the US. In 'normal' times, the US prints about $40-50 bn of fiscal deficits per month. At the peak of the 2008-2009 crisis, the US did about $100-120 bn of monthly fiscal deficits. After a brief return to 'normal' in mid-2022, in 2023 the US has been a running a looser fiscal stance than during the financial crisis of 2008/9.



Source: tradingeconomics.com

When you increase social security spending or cut taxes, the private sector gets an immediate boost. This means more disposable income right here right now, with no immediate strings attached - fast money creation. In contrast to this, when it comes to levering up through aggressive mortgage activity or loans/credit, the private sector is slow to react. Mortgages and commercial debt are usually at a fixed rate. They take time to roll over but given the near zero recent rates, this rollover time has been historically long. In 2020/21, corporates and households took advantage of historically low interest rates to borrow and lock-in their cheap funding for a long period of time. The duration of high-yield debt hit a high during 2021.

The result has been that fast money creation through fiscal spending has shielded the US economy from the slow money destruction through credit tightening. Government debt has increased rapidly but given the US Dollar's position as the global reserve currency, this has not diminished demand for Treasuries. Last year's crisis caused by unfunded tax cuts in the UK illustrates the advantage the US holds in that respect.

The question now is whether the combination of Monetary tightening and Fiscal loosening is going to work. Is inflation going to continue down to target, thereby allowing interest rate cuts, thereby causing economic growth, increased tax receipts and deficit reduction? This seems like an overly optimistic view to us. With wage growth still high and unemployment low, it is hard to imagine core inflation reaching its target without more pain. If rates do stay at this elevated level, economic growth is likely to slow further and tax receipts fall. If this scenario coincides with the delayed increase in credit tightening, then a soft landing is less likely. Current expectations and therefore many asset prices are not reflecting this risk adequately and with that in mind we prefer to remain cautious.

The Rivers portfolios are positioned at risk level 2, out of 7 (4 is neutral) to reflect this outlook. The economic headwinds ahead, and subsequent risk of a more significant slowdown, are not reflect in the price of many assets. Added to that the return now available for low risk assets allows us to be cautious and await more attractive opportunities to add to risk in the future.

Market Returns (£) - 31st August 2023	1 Month	3 Months	YTD	1 Year	3 Years	5 Years
Anchors						
Cash	0.5%	1.3%	2.9%	3.8%	4.2%	5.6%
Inflation Linked UK Bonds	-1.4%	1.3%	-4.7%	-17.0%	-33.2%	-22.4%
Gilts	-0.5%	-0.2%	-3.6%	-10.3%	-30.1%	-19.9%
Global Government Bonds (hedged)	-0.1%	-0.5%	2.3%	-0.9%	-10.7%	-0.9%
Enhancers						
Global Corporate Bonds (hedged)	-0.4%	0.3%	2.7%	0.5%	-11.6%	1.4%
Global High Yield (hedged)	-0.2%	3.6%	6.0%	6.9%	-0.4%	7.4%
Emerging Market Bonds (hedged)	-0.5%	-1.1%	-1.7%	-4.0%	3.4%	13.5%
FTSE 100 TR Index	-2.5%	1.2%	3.0%	6.2%	39.5%	21.2%
FTSE All-Share	-2.5%	1.1%	2.7%	5.2%	35.0%	18.4%
Global Equity (MSCI)	-0.9%	4.7%	10.2%	6.2%	34.6%	53.0%
European Equity (MSCI)	-2.5%	1.6%	6.9%	12.9%	28.3%	27.4%
US Equity (S&P)	-0.1%	5.8%	12.3%	5.9%	40.7%	69.3%
Japan Equity (Topix)	-1.9%	1.4%	5.8%	4.8%	16.3%	14.7%
Pacific Ex Japan Equity (MSCI)	-5.9%	-0.9%	-3.6%	-9.1%	-10.4%	1.1%
Emerging Market Equity (MSCI)	-4.7%	1.2%	-0.8%	-7.0%	1.3%	7.7%
Chinese Equity (Hang Sang)	-7.3%	0.4%	-7.5%	-12.2%	-16.2%	-20.4%
Indian Equity (Nifty)	-0.4%	3.5%	0.8%	-7.0%	58.8%	46.6%
Diversifiers						
Commodity Index	0.8%	7.3%	-7.7%	-16.1%	61.5%	41.8%
Gold	-0.2%	-3.6%	0.9%	3.7%	1.8%	57.4%
Silver	-0.2%	1.8%	-2.8%	27.2%	-10.5%	63.6%
Brent Oil	0.8%	7.3%	-7.7%	-16.1%	61.5%	41.8%
UK Property	0.1%	0.1%	0.4%	-12.7%	4.9%	2.7%
Global Property Shares	-2.8%	-3.0%	-4.2%	-17.4%	-9.5%	-18.2%
Rivers Model Portfolios						
Rivers Preservation Portfolio	0.5%	1.1%	2.6%	1.3%	-0.2%	5.2%
Rivers Cautious Portfolio	-0.2%	2.5%	3.2%	2.0%	5.4%	14.9%
Rivers Balanced Portfolio	-0.1%	2.4%	3.1%	2.1%	8.2%	19.2%
Rivers Adventurous Portfolio	-0.6%	2.4%	2.5%	1.6%	9.8%	23.2%
Rivers Aggressive Portfolio	-0.9%	2.6%	1.5%	1.0%	12.2%	23.8%
Rivers Cautious Income Portfolio	-0.5%	-0.2%	0.5%	-2.8%	-0.5%	1.6%
Rivers Balanced Income Portfolio	-0.9%	-0.2%	0.2%	-2.6%	4.1%	6.4%

Source: Financial Express in GBP (unhedged unless stated) as at 31st August 2023. *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.