Current Focus

December 2023

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

- Investment sentiment changed dramatically in early November
- Inflation falls have increased confidence that interest rates will be cut in early 2024
- A 'soft-landing' is now broadly expected and fully reflected in asset prices
- Real risks of recession or reflation are not reflected in market prices
- Having increased risk early in November a more cautious allocation may soon be appropriate

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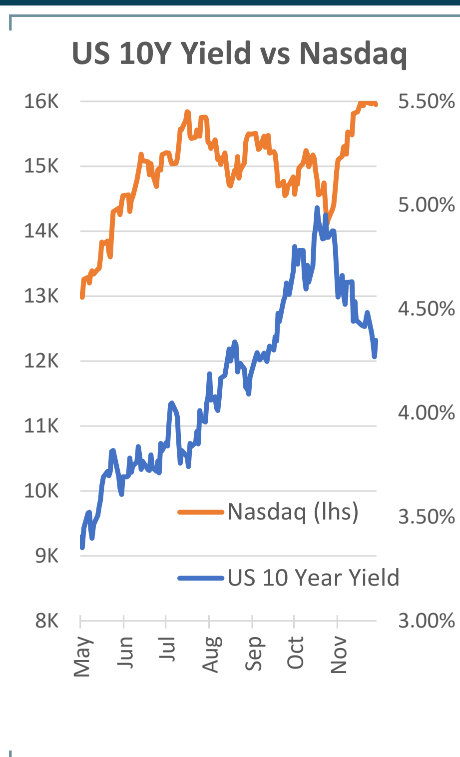
Market Comment

Since November 1st, when the Rivers portfolios increased risk, equity markets have rallied materially. This is good news, but with the rally being so strong – led again primarily by technology – we have started to question how sustainable it is earlier than we had initially forecast. Following three negative months for global equities, when concern over high interest rates dominated the news, there has been a quick and almost complete reversal during November. Over one month, sentiment has changed significantly from moderately cautious to now almost universally optimistic. We had expected some change, if only due to seasonality, but have been surprised by the extent of it. Following the most recent reversal, markets appear to be expecting no recession, the eradication of inflation, rate cuts and growth during 2024. We would be delighted if this turns out to be true, but expect to be, at least in some way, disappointed. For the last Focus of 2023 we look at what may have caused this change in sentiment and why, with such a positive expectation for markets, we retain a cautious outlook for 2024. We consider the main risks for investors and where we think opportunities in better value assets can be found.

Late last year a 2023 recession was the consensus, with the financial media continually alluding to it. That meant we entered the year with many companies defensively positioned and a deeply inverted yield curve. This in itself compressed long-term borrowing costs and helped to delay the forecast recession. Fears that 'something will break' came true in March when a few mid-sized US regional Banks, with concentrated exposure to technology, went bust. The injection of liquidity made to offset the risk from this, combined with the extremely rapid expansion of Artificial Intelligence undoubtedly prevented recession in the US at the time. With liquidity abundant and aided by a massive expansion of fiscal deficits (across the world), asset prices began to recover from the first quarter. While Central Banks were attempting to tighten monetary conditions, governments were almost explicitly working at providing support to offset that. By the end of the second quarter, the recession had not happened and was no longer expected. In the UK, growth slowed but remained positive while in the US, if anything, growth accelerated.

With recession averted, markets appeared to alternate between expecting sustained robust growth, which was bad, and a 'soft



Source: tradingeconomics.com

landing', which was good. From an investment perspective robust growth was unintuitively 'bad' as it meant inflation would be prolonged, alongside higher interest rates. A soft landing was 'good' as it led to falling inflation and a return to lower interest rates. The previous fears of recession, or something (else) breaking, appeared to disappear. After three months of this uncertainty, where inflation seemed to remain high and the expectation of rate cuts extended to 2025, there was an apparent shift at the end of October. With inflation data in the US, EU and UK coming in below expectations and Central Banks no longer raising rates the soft landing narrative again firmly took hold.

Since then, equity markets have rallied strongly. Led by the 'Magnificent Seven' enormous technology companies that dominate the US market, many indices have reached highs for the year. For technology in the US, all-time highs have offset all losses from early 2022, a time when interest rates were nearly zero. This rally has been supported by almost all participants. Essentially analysis of bond markets, equity markets, economists and financial media show them all now expecting a soft landing in 2024, the only notable exception are Central Bankers who have at least attempted to dampen enthusiasm.

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RIVERS CAPITAL MANAGEMENT

Already, the 'soft-landing' scenario is the strong consensus baked in to market prices today.

By definition, the perfect disinflationary 'soft-landing' would see inflation converging below 2.5% and earnings growing around their long-term average of 7% per year in 2024. If anything, expectations are for inflation to fall more (to around 2%) and earnings to grow faster (around 10%). There would be no substantial rise in unemployment and interest rates would begin to fall before any of corporate bankruptcy or mortgage defaults rose or fiscal constraints saw austerity return. This is a perfect outcome for all, but with it already reflected in prices, the risk for it being wrong outweighs the reward for it being correct.

If inflation doesn't fall, maybe because low unemployment continues to apply inflationary pressures, or the recent fall in energy prices is reversed, Central Banks are less likely to lower interest rates. If that happens, given the wall of refinancing for private and corporate debt, defaults will likely increase. That may kill off inflation but could cause a recession. We may see it offset by fiscal intervention. but that is not certain even in an election year. Other scenarios are possible on the upside (in terms of growth) or the downside (particularly given global geopolitical risks), that could upset the soft landing narrative that is so widely accepted and priced in.

With a perfect scenario reflected in many equity valuations, we see risks asymmetrically skewed. As mentioned previously, the portfolios we manage increased risk exposure at the start of November. At the time we expected that allocation to be reviewed in the new year. That is likely to be brought forward somewhat as we would prefer to increase the relative allocation to Diversifiers and Anchors over Enhancers sooner. This will tactically reduce portfolio risk into what we expect to be another volatile year in 2024.

Market Returns (£) - 30th Nov 2023	1 Month	3 Months	YTD	1 Year	3 Years	5 Years
Anchors						
Cash	0.5%	1.4%	4.3%	4.6%	5.6%	6.9%
Inflation Linked UK Bonds	3.8%	-1.3%	-5.9%	-10.7%	-35.6%	-22.2%
Gilts	3.1%	1.6%	-2.1%	-6.4%	-29.4%	-17.0%
Global Government Bonds (hedged)	2.9%	0.6%	2.9%	1.1%	-10.8%	-0.3%
Enhancers						
Global Corporate Bonds (hedged)	4.5%	1.3%	4.1%	3.3%	-12.3%	4.6%
Global High Yield (hedged)	4.5%	2.4%	8.5%	8.4%	-0.9%	11.4%
Emerging Market Bonds (hedged)	-0.3%	1.6%	0.0%	1.6%	0.7%	9.1%
FTSE 100 TR Index	2.3%	0.9%	3.9%	2.4%	33.1%	29.1%
FTSE All-Share	3.0%	0.6%	3.3%	1.8%	27.3%	26.8%
Global Equity (MSCI)	4.8%	1.7%	12.1%	6.3%	29.3%	62.1%
European Equity (MSCI)	5.3%	1.7%	8.7%	7.7%	22.1%	37.9%
US Equity (S&P)	4.5%	1.7%	14.3%	6.6%	37.5%	77.1%
Japan Equity (Topix)	3.5%	1.2%	8.6%	8.0%	6.6%	21.7%
Pacific Ex Japan Equity (MSCI)	2.6%	-0.9%	-4.5%	-4.6%	-19.0%	6.3%
Emerging Market Equity (MSCI)	3.5%	1.2%	0.4%	-2.0%	-6.8%	13.2%
Chinese Equity (Hang Sang)	-4.1%	-6.1%	-13.2%	-10.6%	-25.4%	-23.5%
Indian Equity (Nifty)	2.3%	5.3%	6.2%	-0.6%	50.9%	62.5%
Diversifiers						
Commodity Index	-6.3%	-2.6%	-10.1%	-13.2%	54.6%	36.7%
Gold	-1.7%	5.1%	6.0%	9.3%	19.0%	59.7%
Silver	6.1%	3.4%	0.5%	10.2%	17.4%	70.5%
Brent Oil	-6.3%	-2.6%	-10.1%	-13.2%	54.6%	36.7%
UK Property	-0.1%	-0.4%	-0.1%	-2.8%	3.7%	1.7%
Global Property Shares	12.6%	5.2%	0.8%	0.4%	-8.1%	-6.2%
Rivers Model Portfolios						
Rivers Preservation Portfolio	1.0%	2.0%	4.6%	3.9%	0.4%	8.7%
Rivers Cautious Portfolio	1.5%	1.3%	4.6%	3.5%	4.4%	18.7%
Rivers Balanced Portfolio	1.7%	1.6%	4.7%	3.5%	6.2%	24.4%
Rivers Adventurous Portfolio	2.6%	0.8%	3.3%	1.9%	6.2%	27.7%
Rivers Aggressive Portfolio	2.7%	0.7%	2.2%	0.9%	7.4%	29.5%
Rivers Cautious Income Portfolio	2.1%	0.7%	1.2%	0.1%	-3.2%	4.2%
Rivers Balanced Income Portfolio	2.2%	0.5%	0.7%	-0.5%	0.3%	9.6%

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

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