Current Focus

April 2024

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

- Strong Q1 masked inflation fears, optimism on rate cuts faded.
- Unexpected inflation surge led to higher bond yields and market volatility.
- Fed rate cuts unlikely, some potential for future US hikes due to high inflation.
- Equity valuations not reflecting potential impact of higher interest rates.
- Underweight risk strategy limited returns from equities but Diversifiers outperformed.
- Expect continued caution with increasing opportunity for future risk increase.

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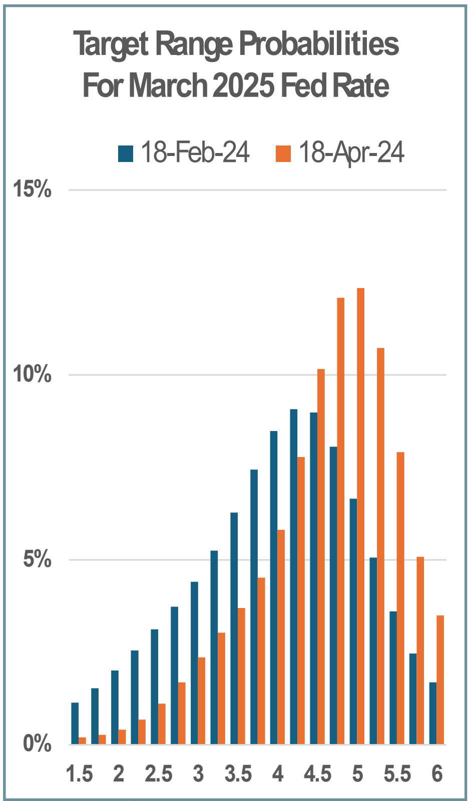
Market Comment

The first quarter of 2024 was positive for most asset classes. with investor sentiment boosted by sustained economic growth and strong reported earnings. The broadly positive economic news has effectively negated growing concerns regarding inflation and its impact on future interest rates. In recent weeks those concerns have risen sharply and momentum in equities, so strong since October last year, has finally slowed. Volatility has returned as uncertainty regarding the future has become dominant. While most commentators remain optimistic over the medium-term, expectations that Central Banks, particularly the US Federal Reserve, will reduce interest rates have changed materially. With interest rates such a primary factor for investors, it has surprised us only in taking so long to have an effect. Since December the expected number of interest rate cuts in the US has fallen from six to seven quarter point cuts, ahead of Central Bank predictions, to the consensus view today of around two cuts. The reason for this change is the slower progress on lowering inflation. In this month's Focus we look at inflation, its various measures, and what bond prices are telling us about current interest rate expectations. While interest rates are expected to remain elevated the high valuations seen in (some) equity sectors are likely to come under more scrutiny.

During the second half of 2023, data suggested a potential disinflationary trend in the U.S. economy. The Federal Open Market Committee (FOMC), focused on these trends, in December highlighted that disinflation was present even within the "Supercore" components of the Core Consumer Price Index (CPI). The Supercore included, according to the FOMC, only the stickiest components of the index (inflation ex food, energy and housing). The message was that with disinflation apparent even there, the battle with inflation was coming to an end and that rate cuts were imminent. The subsequent boost to equity markets as a result was unsurprising.

However, the first quarter of 2024 witnessed a surprising re-acceleration of core and "Supercore" inflation metrics. Markets are not normally lenient on overconfident policy makers, but appeared to allow for a ''statistical aberration'' in January and even "seasonal factors" when February's inflation numbers came out above expectations in March. Positive economic growth, driven by AI – and in large part unfunded government spending



Source: CME Group

– seemed to maintain investor momentum, even in the face of rising political risks from China, Ukraine and the Middle East. It was not until the third 'hot' print for March CPI, which came out this month, that market momentum appeared to stall. Benchmark interest rates shifted significantly, with the move in 5-year yields we saw the day of the CPI release being the second biggest in 10 years, only surpassed by the volatility in bond markets reached during the pandemic.

After that some Fed insiders did suggest that while Supercore remains high it is due in large part to rising Moter Insurance costs and should not be over concerning. While we do await the FOMC preferred Personal Consumption Expenses (PCE) inflation report on April 26th the idea that inflation is finished and rate rises imminent is as rare now as the opposite view was in December. With the annualised last 6 months of Core Inflation data in the US now over 4%, double the 2% target, and the 'Supercore" even higher, by Mid-April FOMC Chairman Powell had to acknowledge that the inflation problem was not going away.

In terms of expectations, we can look at the current probability distribution for future Federal Funds rates to reveal current bond market views. Analysing the chart reveals that there is now a substantial, approximately 25% expectation that the Fed will actually raise rates by April 2025. This expectation was almost non-existent just weeks ago. Second, the expectation of a prolonged period of elevated interest rates, often referred to as a "Higher-for-Longer" environment, has risen to as high as 45%. This implies that the Fed Funds rate could remain at or above 5% for another year. Combined, the average case may remain 1-2 cuts but that distribution is skewed by low probabilities of significant cuts (which would indicate material slowdown/recession). The distribution is now showing there is a higher than 50% probability that rates remain above 5% for the next year. In this case the refinancing costs to corporates, not to mention the US Government will be significant. We would argue this is not accurately reflected in many asset valuations.

Outside the US, the disinflationary trend has been more consistent, which should provide more scope for interest rate reductions, especially in the EU and the UK, but with the resulting change in exchange rates, not to mention the rising political tensions in the Middle East, we are not optimistic. The relative underweight risk positioning, held across the Rivers portfolios since December, has resulted in some underperformance due to being underweight high momentum growth stocks, particularly in the US. This has been offset by the high returns from many Diversifying assets that are held (Gold, energy, insurance) as well as the positive risk-free return that has been available. Looking forward, with high valuations still unattractive in many sectors, we continue to believe an underweight risk allocation is appropriate. We expect the opportunity to increase duration and increase risk to improve in the coming weeks.

Market Returns (£) - 31st March 2024	1 Month	3 Months	YTD	1 Year	3 Years	5 Years
Anchors						
Cash	0.4%	1.3%	1.3%	5.2%	7.4%	8.4%
Inflation Linked UK Bonds	2.6%	-2.1%	-2.1%	-5.4%	-28.3%	-24.9%
Gilts	1.8%	-1.8%	-1.8%	-0.5%	-22.1%	-18.7%
Global Government Bonds (hedged)	0.7%	-0.1%	-0.1%	2.9%	-5.9%	-1.0%
Enhancers						
Global Corporate Bonds (hedged)	1.2%	0.0%	0.0%	5.1%	-6.3%	3.3%
Global High Yield (hedged)	1.6%	2.6%	2.6%	12.6%	3.8%	12.9%
Emerging Market Bonds (hedged)	0.0%	-0.1%	-0.1%	0.7%	7.9%	8.3%
FTSE 100 TR Index	4.9%	4.0%	4.0%	8.4%	32.6%	31.9%
FTSE UK All-Small Cap	4.8%	3.6%	3.6%	8.4%	26.1%	30.3%
Global Equity (FSTI)	3.4%	9.9%	9.9%	22.5%	39.9%	82.4%
European Equity (FSTI)	3.8%	6.2%	6.2%	12.0%	28.0%	47.5%
US Equity (S&P)	3.3%	11.5%	11.5%	26.5%	49.3%	102.8%
Japan Equity (Topix)	3.3%	10.9%	10.9%	21.2%	20.3%	45.3%
Pacific Ex Japan Equity (FSTI)	3.1%	2.4%	2.4%	-3.9%	-19.9%	4.2%
Emerging Market Equity (FSTI)	2.6%	3.3%	3.3%	5.9%	-6.5%	15.1%
Chinese Equity (Hang Sang)	0.8%	-1.9%	-1.9%	-17.2%	-30.2%	-30.4%
Indian Equity (Nifty)	1.0%	7.0%	7.0%	33.9%	54.7%	78.2%
Diversifiers						
Commodity Index	3.5%	3.1%	3.1%	-2.7%	41.9%	40.6%
Gold	8.5%	8.4%	8.4%	9.7%	39.4%	67.9%
Silver	9.5%	4.8%	4.8%	0.6%	9.7%	60.5%
Brent Oil	3.5%	3.1%	3.1%	-2.7%	41.9%	40.6%
UK Property	0.3%	-0.1%	-0.1%	0.4%	1.0%	1.4%
Global Property Shares	8.0%	-2.4%	-2.4%	9.5%	-8.1%	-6.4%
BMi Portfolios						
BMi Low Risk Portfolio	1.3%	0.7%	0.7%	5.0%	2.9%	9.2%
BMi Low to Medium Risk Portfolio	2.8%	3.8%	3.8%	9.1%	9.9%	23.6%
BMi Medium Risk Portfolio	3.3%	4.8%	4.8%	10.2%	12.4%	30.5%
BMi Medium to High Risk Portfolio	3.6%	4.4%	4.4%	9.9%	12.2%	35.2%
BMi High Risk Portfolio	3.9%	4.2%	4.2%	9.5%	11.9%	37.5%
BMi Low to Medium Income Portfolio	1.8%	2.6%	2.6%	5.2%	1.0%	7.4%
BMi Medium Income Portfolio	2.3%	2.2%	2.2%	4.4%	3.2%	12.5%

Source: Financial Express in GBP (unhedged unless stated) as at 31st March 2024. *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.