Current Focus

August 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

- In 2024 portfolios have met targets despite underweighting risk and US tech.
- Global markets have risen due to AI enthusiasm, but valuations remain high.
- Rising volatility, potential US slowdown, and geopolitical risks cloud outlook.
- Unwinding of Yen carry trade signals potential broader economic shift.
- Large Asian holders may reduce US investments, impacting dollar and markets.
- Maintain diversified underweight risk position, favoring UK opportunities.

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Market Comment

As of mid-August, 2024 has been positive for most investors, with all Rivers portfolios having achieved their target returns for both year to date and the past twelve months. Global markets have generally risen despite fluctuating inflation and interest rate speculation, driven primarily by enthusiasm for Artificial Intelligence (AI). While the Rivers Model portfolios have benefited from these trends, we've maintained a diversified approach due to concerns about overvalued assets and the sustainability of economic growth. The fact that the portfolios have met investment targets despite having been tactically underweight risk, with low exposure to the US technology sector, is indicative of the breadth of opportunities that have been available so far in 2024.

The outlook for the rest of this year is mixed. We increasingly prefer UK opportunities but expect to maintain a diversified underweight risk allocation until better opportunities arise, particularly in light of recent market events. Geopolitical risks are escalating globally, and the US, which has led global markets and exhibited strong economic growth until recently, now faces potential slowing growth and the repercussions of shifting macroeconomic trends.

The second half of 2024 has witnessed a noticeable increase in global market volatility. While inflation has decreased sufficiently, enabling central banks to begin lowering interest rates, concerns persist about a US economic slowdown and the risks associated with high valuations in certain equity sectors. One of the notable developments during July was the rapid appreciation of the Japanese Yen, particularly against the US Dollar (up 10% since July 4th). On the surface this looked like a response to the Bank of Japan's decision to raise rates (to 0.25%) but was more likely prompted by fears of a slowing US economy, and falling rates there, than the small increase in Japanese rates. Whatever the cause, the Yen 'carry-trade' appeared to be rapidly reversing. The Yen 'carry- trade' is essentially the ability to borrow capital at low cost, in Yen, and invest that capital in higher yielding assets either inside Japan or, more often, in other regions. The devaluation of the Yen, over recent years, has enhanced the return of the "carry-trade" but increased its risk. Loans taken out in Yen saw costs increase and with Yen appreciation, what was an advantage rapidly became a cost.

Market Volatility: VIX Index

Source: Trading Economics

Whether it was Japanese investors simply repatriating funds or the winding up of Japanese loans there has been a significant increase in demand for the Yen. Japanese equities, dominated by exporters, reacted to the combined forces of currency appreciation and the global economic slowdown. On August 5th the result was the biggest single day loss in the Japanese equity market since the crash of 1987. That reaction looked extreme, and has subsequently been substantially reversed, but is indicative of the risk that has built up across markets recently. This may have been specifically related to the unwinding 'carry-trade' but is related to another imbalance that has been building in recent decades.

For many years, investors from Japan and other Asian economies with trade surpluses have built up large inventories of US assets including Treasuries, Credit and Equities. With higher rates, growing debt but robust growth 'American Exceptionalism' was attractive. Indicators in the last few months show that that trend may be reversing. If it does, the consequences will be significant. The most obvious would be the continued devaluation of the US Dollar. This might be good for US exporters but would increase the risk of inflation returning by increasing the cost of imports. Normally even large-scale sales of US Treasuries and Corporate Credit by foreign investors would easily be absorbed by the vast liquidity in those markets. This has still been the case recently but with the Federal reserve likely to cut rates and encouraging investors to lower risk assets, any upward pressure on yields will have been offset. The alternative, and what may explain some of the volatility in recent weeks, is the sale of US equities by foreign investors. Gains on these are strong, far better than losses embedded in any Treasury or long-duration credit positions. With some corporate earnings reports being negative and a number of economic indicators pointing to a slow-down, foreign investors may be considering US equities as a useful liquidity provider. Given the size of these holdings, current equity valuations and the possibility that such a trend would be self-perpetuating, it needs to be monitored closely. With Asian economies struggling to generate robust growth and their financial systems under pressure, the fact that they are the biggest creditor to the endlessly growing liability from the US should be a concern to all. Even if they do not become net sellers of US assets, a reduction in historic demand has to be expected. This combined with the expected sharp increase in debt issuance by the US will impact markets and limit the Federal Reserve's ability to intervene.

We view this as an asymmetric risk, especially for the coming few months. It may pass, US growth may accelerate again, AI may begin to justify its investment outlay but the chance it does not justifies the possibility of a correction. The opportunity to increase exposure to risk is likely to improve in the coming months. Meanwhile the return on low-risk assets remains attractive given lower UK inflation.

Market Returns (£) - 31st July 2024	1 Month	3 Months	YTD	1 Year	3 Years	5 Years
Anchors						
Cash	0.5%	1.3%	3.1%	5.5%	9.3%	10.1%
Inflation Linked UK Bonds	2.0%	3.7%	-2.3%	1.8%	-35.1%	-29.3%
Gilts	1.9%	4.1%	-1.1%	5.8%	-25.0%	-20.9%
Global Government Bonds (hedged)	1.8%	3.1%	1.5%	5.0%	-6.4%	-2.5%
Enhancers						
Global Corporate Bonds (hedged)	2.1%	4.3%	2.3%	7.1%	-7.6%	1.4%
Global High Yield (hedged)	1.8%	3.6%	5.6%	12.0%	3.7%	12.7%
Emerging Market Bonds (hedged)	0.1%	-0.3%	-0.4%	2.4%	4.4%	-5.2%
FTSE 100 TR Index	2.5%	3.6%	10.6%	13.0%	33.4%	32.8%
FTSE UK All-Small Cap	3.1%	4.4%	10.8%	13.5%	27.1%	32.4%
Global Equity (FSTI)	0.2%	5.7%	12.9%	18.5%	32.0%	68.4%
European Equity (FSTI)	0.5%	2.0%	7.4%	11.0%	19.1%	36.3%
US Equity (S&P)	-0.4%	7.2%	15.5%	21.8%	40.5%	87.1%
Japan Equity (Topix)	0.5%	-0.1%	6.5%	11.4%	18.6%	30.6%
Pacific Ex Japan Equity (FSTI)	-2.9%	1.4%	5.8%	0.4%	-11.7%	3.3%
Emerging Market Equity (FSTI)	-1.3%	2.2%	7.0%	6.5%	-0.4%	12.7%
Chinese Equity (Hang Sang)	-2.7%	-2.0%	4.3%	-9.7%	-19.5%	-29.1%
Indian Equity (Nifty)	2.3%	9.2%	20.6%	35.9%	62.9%	98.1%
Diversifiers						
Commodity Index	-5.6%	-6.3%	0.1%	-5.0%	20.3%	30.7%
Gold	2.5%	3.0%	16.4%	22.7%	43.0%	54.0%
Silver	-3.2%	6.1%	19.4%	15.4%	21.3%	58.8%
Brent Oil	-5.6%	-6.3%	0.1%	-5.0%	20.3%	30.7%
UK Property	0.4%	1.2%	1.5%	0.9%	-1.5%	2.7%
Global Property Shares	3.5%	6.7%	1.1%	13.5%	-17.7%	1.6%
BMi Portfolios						
BMi Low Risk Portfolio	1.0%	2.3%	2.4%	6.4%	2.6%	8.2%
BMi Low to Medium Risk Portfolio	0.6%	1.4%	5.5%	8.9%	7.8%	19.5%
BMi Medium Risk Portfolio	0.5%	1.3%	6.7%	10.8%	9.6%	25.8%
BMi Medium to High Risk Portfolio	0.9%	1.9%	6.8%	11.0%	9.2%	30.2%
BMi High Risk Portfolio	0.9%	1.9%	6.8%	10.6%	8.6%	30.6%
BMi Low to Medium Income Portfolio	1.2%	2.6%	4.5%	7.6%	-0.4%	5.5%
BMi Medium Income Portfolio	1.7%	2.5%	4.9%	7.2%	1.9%	10.2%

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