FLEURUS INVESTMENT ADVISORY

**December 4, 2021**

## Overview

During November the S&P's 500 went down **.69%** on a total return basis. The Nasdaq Composite managed a small **.33%** gain and the Russell 2000 (small caps) dropped **4.17%.** Internationally, the rapid rise of the USD caused the EPAC BMI index (developed economies) to slip by about **5%** while the MSCI EM (emerging markets) lost **4.08%**.

The chart below illustrates the rapid rise of the USD vs. the € in 2021, the precipitous acceleration in November. It explains In part the resulting poor relative performance of European equity markets, in USD terms, in 2021.

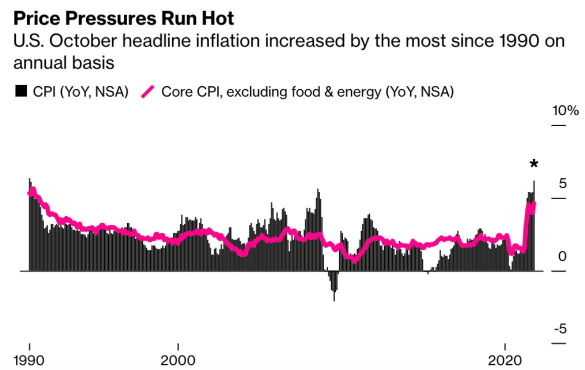

Year-to-Date (YTD) the € has lost 8% against the USD. In November, its loss against the USD amounted to 2%, a sizeable movement for a major currency.

US fixed income markets were mixed last month. The long bond rallied **2.65%** in the waning days of the month as the Omicron scare caused risk aversion to rise and investors to seek refuge in US government bonds. The growing risk aversion mood caused the high yield sector to lose about **.95%**.

Last month, the performance of our clients' portfolios hovered between **.68%** and **-2.04%.** Over the same period, a portfolio consisting of 50% ACWI (All Country World Index) and 50% AGG (US Bond Aggregate) slid **1.10%.** YTD, clients' portfolios are up from **5.70%** to **8.97%,** net of fees. Our benchmark stands at **6.40%** over the same period. The equity allocation in our clients' portfolios ranges currently from 40% to 70%, depending on risk profiles.

## Market developments

November was a rich month when it comes to market moving events. In the early part of the month, the third quarter corporate earnings that were released continued their above trend growth rate in 2021. Corporate America has recovered well from the pandemic shock and equity investors applauded. News on the inflation front was not as supportive for equity markets though, as illustrated in the chart below:




The monthly CPI number, released in early November was at 6.2% for the past twelve months period. Markets wobbled a bit. However, the robust employment data (11/05) and strong retail sales (11/16) provided enough comfort to investors that they had pushed the S&P's 500 up by 2% as of November 24. Investors seemed to reason, justifiably so, that when inflation is largely the result of strong economic growth it is not detrimental to equity performance.

This good investment picture was somewhat spoiled however by the resurgence of another epidemiological emergency in the form of a new Covid variant on November 25. This led investors to assume a more prudent posture. A risk-off mood ensued, causing equity indices to drop from 2% to 5% since, depending on sectors and geographies.

Finally, Jerome Powell's testimony to Congress, on November 30 and December 1, added to the general uncertainty when he declared that inflation was no longer considered to be "transitory". That, in turn is likely to lead to a faster reduction of the FED's bond buying program and, accordingly, move forward the time of their first interest rate increase.

**Tilts and Allocations**

As a result of the contrary signals sent from, on the one hand, rising inflation and the threat of higher interest rates and, on the other, strong corporate earnings and supportive employment and retail data, I did not make any meaningful changes to our portfolios. At 50% to 55% on average, our exposure to equities stands at the lower end of what I consider to be a prudent allocation. Reducing it more, because of current uncertainties, does not appear justified.

In fact, a strong enough case could be made for increasing our equity exposure. While US equity valuations are high when considering major indices, some sectors within them or in other geographies, outside of the US, have already experienced corrections, on an absolute and/or relative basis, and could offer good re-entry points

Here is an example: The chart below compares the relative valuation of European equities to their US brethren. It has not been that low since 2006.


A case could be made for increasing our European equities investments. After all, this sector has already depreciated close to 20% when compared to US equity performance in 2021. The average European stock index, valued in USD, is up about 5% in 2021. The S&Ps' 500 is up about 23%. That is a huge gap that will be filled, eventually.

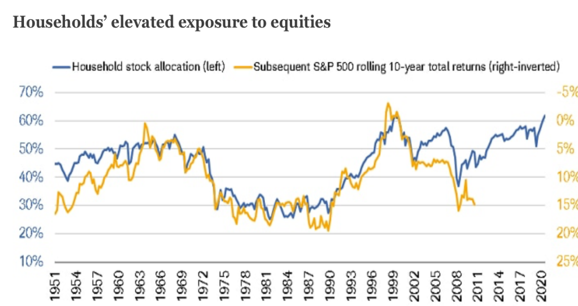
However, and for now, with a rising USD and a faster pick-up in economic growth on this side of the Atlantic, I have decided to stay put and to wait for a "reversal to the mean" in favor of European equities rather that to add to our investments.

**Conclusion**

With strong growth and rising inflation expected to continue in the US for a longer while, a pandemic that does not seem to want to end and high equity valuations, it is hard to commit new cash to equities. Given the strength of the US consumer and of corporate balance sheets, it is equally difficult to reduce equity investments other than very selectively.

However, what every investor should be ready for is lower US equity performance in the coming years.

The chart below compares US household's equity allocation (blue line and left scale) to the 10-year rolling average of the subsequent S&P's 500 performance (yellow line and right inverted scale). It is a bit complicated to interpret but worth the effort.




Counterintuitively, performance (yellow line) increases when the line goes down.

If history is any guide, the yellow line will eventually catch up with the blue line. When it does, 10 years from now, it will have meant that annual equity performance during the 2021-2031 period will have hovered between 0% and 7% at best.

I wish you all a great year-end celebration.

Thank you for your continued trust.

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