FLEURUS INVESTMENT ADVISORY

June 4, 2022

Overview

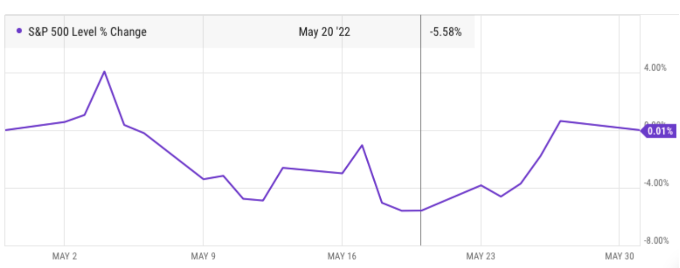
May was another difficult month for equity investors. Equity indices moved up and down often by more than 2% in the course of a day before sometimes reversing in the last minutes of trading. The S&P's 500 finished the month almost unchanged, sprinting up 6% in the last four days of the month after flirting with bear market territory (a bear market starts after an index closes by more than 20% down from its previous peak). The S&P's 500 was up **.18%** in May. The Nasdaq Composite dropped **1.93%** and is now clearly in bear country. It is down **22.53%** for the year, as of May 31.

The Russell 2000 (Small Cap Index) gained a meagre **.08%.** The situation did not turn out much better internationally where the EPAC BM Index remained flat. Emerging markets did a bit better with the MSCI (EM) up **.44%,** helped by a surge in oil prices.

The bond market found its footing after a sharp decline in April. Corporate credit spreads tightened a bit and US corporate bonds managed a **.92%** performance (Bloomberg US corporate Index). The long bond continued to struggle however, losing **1.90%**. Municipal bonds, on the other hand, recouped partially their previous losses with a **1.65%** performance.

This mixed picture overall is emblematic of the struggle that both equity and bond investors are engaged in as they try to assess the impact of the tightening of financial conditions effected by the Federal Reserve (Fed) in its fight against inflation.

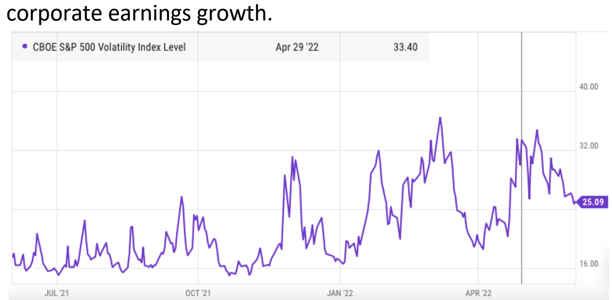
The gyrations of the S&P's 500 during the month of May, below, provide a good illustration of this state of affairs:



In May, our median portfolio lost **.61%.** Over the same period, a portfolio consisting of 50% ACWI (All Country World Index) and 50% AGG (US Bond Aggregate) rose **.61%**. On a YTD basis, our median portfolio has lost **13.06%** vs. **10.81%** for our index. As a reminder, the equity allocation in our clients' portfolios varies currently from 45% to 70%, depending on risk profile.

Market developments

The month of May was one of the most volatile in recent memory. That volatility, illustrated in the chart below (the month of May starts to the right of the vertical line), resulted from the continued ebbing and flowing of economic data leading investors to question the durability of the economic cycle, the persistence of inflation and the sustainability of corporate earnings growth.



In the early part of the month, the Fed raised its key benchmark rate by .50%, as expected. It announced another likely rate hike of the same magnitude in July. This did not spook investors much. What did raise concern was the persistence of inflationary pressures in the economy when the core CPI (excluding food and energy) for April came in at 6.2%. While it showed a slight improvement from the previous annual number of 6.5%, it indicated that bringing it down to 2.5% (the Fed's target level) would take a long while and possibly necessitate a more robust monetary response.

As investors tried to digest this, they divested from their riskier equity positions, selling tech stocks heavily in the process. At one point during the trading session of May 20, this selling pressure brought the S&P's 500 index down 20% from its January 4 peak. Then something interesting happened: The index bounced back a bit to avoid closing down 20% that day. It would have entered "bear market territory" otherwise. It is as if market participants were telling each other: "This can't be…We've got to give this market another chance". That chance came in the following day when President Biden announced a possible and partial lifting of economic sanctions against China, later on when consumption data were released and showed a still healthy US consumer and finally, on May 27, when a key inflation measure (the core PCE) came in smaller than expected.

In combination, these factors caused equities to bounce back up 6% and erase all losses for the month of May. Could this be a harbinger of more market stability in the coming months? It is anyone's guess at this point.

Tilts and Allocations

Early in May, I cut our crypto-currency exposure in half for those portfolios exposed to the sector. GBTC, the bitcoin trust that we use to gain exposure, dropped 22% in May, accelerating a fall that is now close to 63% from its peak at the beginning of November. This is a highly speculative investment and I felt that the small exposure that we had in most portfolios was still too much, particularly in the context of a market that was making new lows on a daily basis.

I have kept our exposure to the sector to 1%. Even at that low level, a price reversal could make a meaningful contribution to performance, should it occur. I want to be ready for that eventuality.

The chart above is that of GBTC. The vertical line marks the peak reached on November 9, 2021. While I cannot discard further losses, this investment is now down to a level that makes a recovery more likely than not, absent an economic recession.

Elsewhere in our portfolio, DLR (the real estate investment trust dedicated to servicing the tech industry) and GT (Good Year Tire) both dropped 3% to 4% in May. I reduced our exposure to GT by about 33% in the early part of the month to further mitigate our downside risk. However, I have kept a meaningful exposure to it. This equity trades at 5 times earnings, an extremely low valuation that in the absence of a coming recession is unjustified.

All together these three investments account for the totality of our under-performance this month. The continued positive contribution of our Air Liquide investment (up 2.78% in May and 2% so far this year) was not enough to compensate for losses elsewhere in the portfolio.

Conclusion

As of this writing, the US Labor Department is about to release the unemployment number for May. If the number is good, in that it shows a sustained hiring trend in the US economy, investors could feel that the Fed will be encouraged to tighten monetary policy further. This could justify more selling of equities. On the other hand, the same robust economic number could be interpreted as meaning that the economy is nowhere near a recession and that this risk is fading, therefore pushing equities up. In other word, a positive number could have two opposite outcomes. And so would a negative number.

In that context, trying to guess and position portfolios accordingly is a fool's errand. At this stage, I remain ultra-cautious and will maintain a minimalist investment approach where less is better until more clarity shines through the current fog of economic and monetary policy uncertainty.

Thank you for your continued trust.

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