FLEURUS INVESTMENT ADVISORY

March 4, 2022

Overview

The beginning of 2022 is proving to be an anxious one for equity investors in the US and across the globe, for a variety of reasons that I will develop later in this newsletter.

In February, the S&Ps' 500 went down **2.99%.** The Nasdaq Composite suffered more, with a loss of **3.35%**. The Russell 2000 (small caps) did marginally better, registering a milder **.72%** loss.
Internationally, developed markets declined, with the S&P Epac BMI down **1.72%** and emerging markets dropping more, with the MSCI Emerging Markets down **2.99%.**

In the US fixed income markets, prices went down and yields up, understandably so, given the Federal Reserve's monetary posture but despite rising tensions in Ukraine throughout the month.

Below is the performance of TLT, the long-term US treasury note ETF, since the beginning of 2022. The vertical line marks the start of the war in Ukraine. Since then, as expected, TLT has recovered some of its losses as a result of the haven status given to long-term US notes in times of turmoil.

Overall, in February, bond losses ranged from a high of **-.49%** in the Municipal sector to a low of **-2%** for intermediate investment grade corporate notes of five to seven-year maturities.

Last month, the performance of our clients' portfolios ranged between losses of **2.33%** and **4.24%.** Over the same period, a portfolio consisting of 50% ACWI (All Country World Index) and 50% AGG (US Bond Aggregate) declined **2.18%**. On a YTD basis, our losses range from **5.89%** to **9.16%** vs. a **5.27%** loss for our index.
I will explain later where our under-performance comes from so far this year.

As a reminder, the equity allocation in our clients' portfolios varies from 45% to 70%, depending on risk profiles.

Market developments

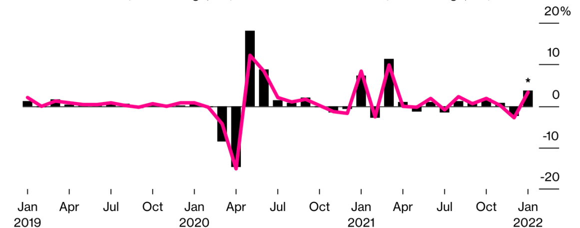
The month of February started well with a stream of positive corporate earnings news. By February 9, 317 firms out of the 500 comprising the S&Ps' 500 index had reported positive earnings that beat expectations, by an average of 6%. Also, the unemployment number for January was particularly strong even if its release was tempered by surging wages (+5.7% over the previous twelve months). Then came another strong economic number in the form of retail data for January that showed a 3.8% increase over the previous month.

For some perspective on the health of the US consumer, see the chart below:

Upside Surprise

U.S. retail-sales measures both increased more than expected in January

■ Total retail sales (MoM change, SA) / Retail sales ex-autos (MoM change, SA)



* Total sales est. = 2% Ex.-autos est. = 1%

Source: U.S. Commerce Department, Bloomberg survey

Those positive economic releases were attenuated by rising inflation that was confirmed at +7.50% from a year earlier. That, in turn, increased the prospects of a stronger monetary response from the Federal Reserve in the form of a deeper and/or longer interest rate tightening cycle. All in all, those contrary forces contributed to the equity market being whipsawed throughout the month and particularly so when the prospect of an invasion of Ukraine by Russia became probable. Since then, market volatility has further increased, and the higher level of uncertainty has caused investors to jettison all sorts of risky assets in favor of gold, long-term bonds or commodities.

In connection with all this turbulence, oil prices are likely to remain high for the foreseeable future given Russia's role as a major world supplier and industrial supply chain disruptions are now likely to last longer.

All of this makes the fight against inflation more complicated and the policy response from the Fed all that more delicate and uncertain.

Tilts and Allocations

Increasing market volatility throughout the month of February caused me to stay on the sidelines for most of it. However, When the Russian state decided to invade Ukraine, I sold the few remaining positions we had in BUFTX. I further reduced a few investments in EWQ (ETF for the French stock market) and in SPY (S&Ps' 500 ETF). These risk reduction moves have caused our equity allocation, irrespective of risk profiles, to drop by a bit more than 10% since the beginning of the year.

Although those decisions have proven timely, they have not prevented us from suffering meaningful losses. The reason behind our under-performance vs. our benchmark so far this year has largely to do with the collapse of Goodyear Tires (GT) shares since February 12 and the lackluster performance of GBTC, our crypto currency investment, as a potential hedge against the types of geopolitical disturbances that we are currently experiencing. The silver lining for this is that there is nothing like a market disruption to see what works and what does not in a portfolio.

So far GBTC has not really worked well for us as a hedge against geopolitical risk or any other type of risk for that matter. That said it has bounced back from its low point in January and gained about 14% in February. It is nevertheless still down 51 % since its apex, on November 10 of last year. I will give this investment more time to work for us and have maintained it in our portfolios for those clients that have indicated a willingness or desire to invest in the space.

As for the performance of GT, it is a bit baffling and at the same revealing of the current market mood. On February 12, GT released its 2021 fourth quarter earnings. The numbers were better than expected and the stock initially went up. However, during the conference call with analysts that accompanied the earnings release the CEO indicated that he was expecting higher "input costs" going forward and that GT intended to concurrently invest aggressively in new manufacturing machinery and facilities in general. Both pieces of news were interpreted as indicative of potentially lower earnings going forward and GT lost 27% of its value by the end of that day. I increased our investment at the low end-of-day price based on what appeared to be a stunning market over-reaction. I have not seen anything since that would cause me to change my decision.

Since then, GT has lost an additional 10% and is now trading at a P/E (price/earnings) ratio of 6. This is an extremely low valuation. Unless the profitability of the firm collapses in the coming quarters, I do not see a good rationale for the current share price and have consequently decided to maintain our investment, however painful it currently is.

Conclusion

The news out of Ukraine is going from bad to worse with no sign of change of direction. Setting aside the human tragedy if one can, a consequence of this state of affair will be to keep equity markets on edge.

A change of tone from Putin is unlikely, from what I have gathered from a variety of knowledgeable sources, including the top echelons of The Economist magazine. Two webcasts from them in the past ten days have given me reasons to think that this situation has all the ingredients to deteriorate further, among them, that of a potentially mentally unstable tyrant surrounded by sycophants.

About the only glimmer of hope that I have on this front is that of a possible "off ramp" for Putin in the form of a peace conference "à la Yalta", after he has seriously damaged Ukraine but before this proud and valiant nation is completely subjugated.

A peace conference of that sort could offer him both the opportunity to claim victory and lend some credibility to the notion that he is a larger-than-life world leader, a recognition that he seems to crave for. The price to pay to arrive at such an end point is hard for me to guess.

Given all these considerations, our current investment posture is at the conservative end of our equity allocation, with ample cash at the ready should the current uncertainty lift.

Thank you for your continued trust.

Jeff de Valdivia, CFA, CFP
Fleurus Investment Advisory, LLC
www.fleurus-ia.com
(203) 919-4980