FLEURUS INVESTMENT ADVISORY

April 4, 2017

Overview

In March the S&P's 500 total return index rose a meager .12%, the Russell Mid-Cap index was marginally down by -.15% and the Small Cap Russell 2000 rose .13%. This relatively flat performance masks a rather more contrasted picture, as shown in the chart below:

The vertical line marks the closing price of the S&P's 500 total return index at the end of February. The index stayed about level from March 1 to March 15 when the FED announced their .25% rate increase. It then proceeded to drift down and accelerate downward (red rectangles) on the eve of the failure of the "repeal and replace" healthcare bill. The market then proceeded to bounce back off its low right on its 50-day moving average (blue line), as if on cue. This is an encouraging sign and a short-term bullish signal.

During the month, international and emerging markets rose about 2.25%. The S&P's EPAC BMI (international developed markets) was up 2.21% and the MSCI EM (emerging markets) finished up 2.35%. Both were supported by a weakening USD (down 1.27% using USDU).

In March our client portfolios rose between .89% and 1.50%. YTD these accounts are up between 4.20% and 5.37%. This compares to monthly and YTD performances of .06% and 3.50% respectively for a purely US-centric portfolio consisting of 50% SPY (ETF for the S&P's 500) and 50% BIV (US bond aggregate ETF proxy), over the same period.

As a reminder, our allocation to equities currently varies from a minimum of 30% to a maximum of 60%, depending on the risk profile of each client.

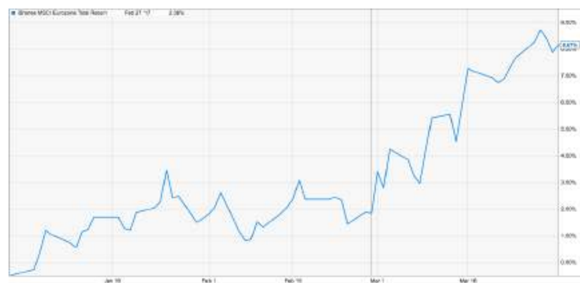
Market developments

US equities markets paused in March. While the FED's rate hike decision was a non-event, the failure of the republican majority in Congress to coalesce around a new bill to replace the ACA provided some turbulences. There were surprisingly short-lived, as shown on the previous chart.

What seems to matter more to the market is tax reform. As long as some form of tax reduction is in the offing for corporations and individuals, current equity valuations seem to be sustainable; or so appears to say Mr. Market. I am not fully convinced.

The market rally since November 8 has been justified or explained by the anticipated pro-market reforms of the new administration. Most central to this economic agenda is tax reform. If the new majority in Congress cannot agree on a common approach to health reform, there is a good probability that they will have some difficulty agreeing on tax reform. If only from that angle, the next few months may be turbulent for US equity markets.

Elsewhere in equity land, the most interesting action took place in Europe. Eurozone markets rose sharply in March. EZU, the Eurozone ETF, was up 6.18%, as shown below:



First, the Dutch elections showed that the populist and anti-European parties there did not have the support that had been assumed. The new Dutch government will be led by the same conservative and pro-European coalition.

Second, the latest polls indicate that the French electorate favors a center right or a center left president over Marine Le Pen and her anti-European agenda. Markets liked all of it.

Tilts and allocations

In March we increased our exposure to Eurozone markets. Specifically, we bought more EWQ and EWG, the ETFs that track the performance of the French and German equity markets, respectively.

The first ETF was up 6.42% and the second 4.47% during the month. Together with a strong showing in emerging markets, our increasing tilt towards international equities paid off. Note that we have not increased our overall allocation to equities. It remains unchanged. We have simply reduced our US equity positions in favor of European equities.

At this juncture, we see no reason to change our stance. As indicated in previous newsletters, current market valuations are more favorable to non-US equities. In addition, an improving global economic environment provides further support for a larger international exposure. While things can turn quickly and become unfavorable in this sector with a rising USD, we see limited downside for now. The new administration will do its best to prevent a significant USD move upward as it would work against its current trade objectives.

We conclude this section with the table below. It lists the annual returns of the US (S&P 500), developed international (EPAC BMI) and emerging (MSCI EM) equities markets, respectively, over different periods, as of the end of February:

	S&P 500	EPAC BMI	Emerging MSCI EM
1-year	25.05%	13.53%	29.44%
3-year	10.25%	-0.77%	-0.63%
5-year	14.80%	6.43%	0.68%
10 year	7.53%	1.59%	0.45%

Only in the past year have international equities market started to catch up with the performance of the S&P's 500.

If we take the past three years to illustrate this, international markets have lagged the US market by close to 11% each year. The gap is wider with emerging markets at the 5-year mark. There it is above 14% annually! Even at the 10-year mark, the outperformance of the US market remains significant. It is unlikely to persist much longer. If it were to persist, it would basically mean that the US economy would grow faster than the rest of the world by 6% annually.

While I can't predict when this performance gap will be filled, it will eventually be, even if partially. One can reasonably argue that this process has started in 2016. As I have previously indicated, mean-reversion is a strong market force that a prudent investor is wise to acknowledge. I certainly do.

Concluding remarks

The first quarter earnings results will not be become public before the end of April. Until then, politics and oil politics, in particular, may provide fodder for market actions.

For those investors who diversify their portfolios internationally, the most important event in the short term is the French presidential elections. It will take place in two rounds on April 23, and May 7. Should Marine Le Pen, of the National Front, gain the French presidency, the chance of the European Union remaining in its current form would be diminished. The impact for equity markets in Europe could be drastic. I remember though that the same had been said about Brexit and basically nothing happened.

The difference this time is that this would be Brexit PLUS possibly pulling Germany's major European partner out of the Euro. The blow to the successful economic and geopolitical experiment that has been the European Union could be so severe as to eventually become terminal.

Another important source of market volatility in the near term is possibly going to come from the oil markets and whether Opec manages to keep its arrangement to limit production for a bit longer past the current June expiration. That will affect the USD and vice versa. Both will affect market flows...

Finally, politics in the US remain worrisome, whatever one's political inclinations. The uninterrupted flow of "issues" afflicting or facing the new administration has not had a negative market impact so far. It would be unwise to bet on that remaining the case forever. At some point, investors will expect results or consider rolling back the gains of the "Trump Trade".

Please feel free to call me with questions.

Best regards.