FLEURUS INVESTMENT ADVISORY

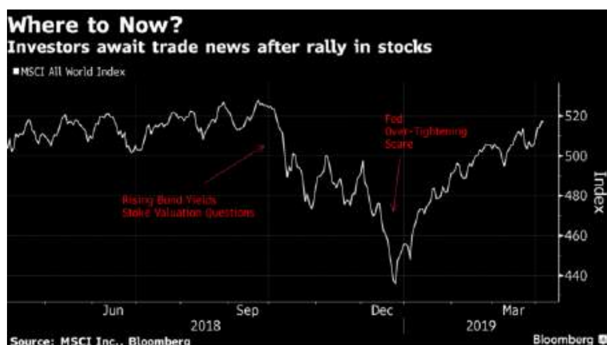
April 4, 2019

Overview

The back and forth between bulls and bears during the month of March saw the bulls finally overcoming their foes in the last third of the month.

The S&P's 500 rose 1.94% in March. The Nasdaq Composite added 2.70% while the Russell 2000 (US Small Caps) surprisingly declined -2.09%.

Internationally, the S&P EPAC BMI (developed markets) was down a tiny -.09%, while emerging markets generally rose. The MSCI EM was up .84% and the Frontier Market index was up 1.35%. These contrasted performances indicate how jittery markets remain after the volatility of the past six months, as illustrated in the chart of the S&Ps' 500, below:



Meanwhile, the US fixed income markets saw the long bond rally an amazing 5.25% in March. The Investment Grade sector did well with a 2.50% performance, while High Yield bonds registered a comparatively muted .94% performance. I will comment later on my interpretation of these contrasted performances, both in the equities and fixed income sectors.

In March, our client portfolios were up from .97% to 1.62%. This compares to a monthly performance of 1.89% for a portfolio consisting of 50% ACWI (World Equity Index ETF) and 50% BIV (US bond aggregate proxy). On a Year-To-Date (YTD) basis, our portfolios are up from 6.91% to 10.28% (net of fees) vs. 8.11% for our benchmark.

As a reminder, the equity allocation in our clients' portfolios ranges currently from 30% to 60%, depending on their risk profiles.

Market developments

During the month signs of economic softness, stateside and globally, alternated with more positive indicators, sending periodically markets up and down. As a result, US equities markets oscillated between small gains and losses throughout most of the month of March before finishing up, on indications of improving trade talks between China and the US.

German and European manufacturing data was generally poor and US manufacturing data was soft, if not poor. On the other hand, retail data was surprisingly good, showing that the US consumer is still keen on eating out (restaurant expenses are generally considered a reliable indicator of consumer health).

With this contrasted environment as background, US investors reduced their risk levels. While remaining invested in US equities, they moved away from Small Caps in favor of Large Caps. This explains the negative performance of the Small Caps sector (down 2.09%) in March, in an otherwise positive month for US equities (S&Ps' 500 up 1.94%). This prudent and careful investment posture materialized in the US fixed Income sector as well. Investment Grade bonds and US treasuries rallied strongly in March but the rally in bonds was much less beneficial to the High Yield sector.

Investors are being quite careful. Not wanting to miss a rally but doing so while reducing their investments in the riskiest parts of the equity and bond sectors. The chart below illustrates this dichotomy, with the S&P's 500 (orange line) and the Russell 2000 (blue line) showing how divergent their respective performances were in March:

That's quite a performance gap in just over one month!

Tilts and Allocations

In March we reduced our exposure to Small Caps, after the serious underperformance the sector generated that month. We reduced our exposure to utilities (XLU), on the assumption that the US economic environment was not as dim as earlier thought. Simultaneously, we increased our exposure to US Large Caps and Growth equities.

We also increased our European exposure moderately, in what is clearly a contrarian move. We invested in EWG, the German equity market ETF. German equities have seriously underperformed other international markets, on the premise that this export-driven economy would greatly suffer from the current trade frictions. It has suffered. I just think that it is overdone.

Below is a chart that compares Japanese and German equities over the past 15 months. Both economies are export-driven. Their equity markets have reacted similarly when confronted with the harsh trade rhetoric of the Trump Administration. EWJ (Japanese equities blue line) is down a little over 7% over that period. EWG (Germany equities orange line) is down close to 16%.

My assumption, in taking a new EWG position, is that German equities will disproportionally benefit from a positive conclusion to the current Sino-US trade frictions.

Concluding remarks

First quarter earnings will be released starting next week. Their quality will greatly influence the behavior of equity markets over the next two months.

Also influencing the markets will be the expected trade agreement between China and the US. The Trump Administration seems to be keen on resolving positively this matter. Indications from the Administration are that an agreement should be attained before the end of the month. Let's hope that its content is acceptable enough and removes one element of uncertainty from the current economic panorama.

As indicated in earlier newsletters, investors should expect increased volatility over the foreseeable future. Economic, political and monetary policy uncertainty should continue to fuel it.

Thank you again for your continued trust.

Jeff de Valdivia