FLEURUS INVESTMENT ADVISORY

August 4, 2016

Overview

In July, the S&P's 500 total return index rose 3.7 % while the small cap Russell 2000 jumped 5.9%. This compares to gains of 5.9% for international developed markets (EPAC BMI index), gains of 5% for emerging markets overall (MSCI EM Index), smaller gains of 2.49% for frontier markets and losses of 5.74 for commodities (DJCI). Fixed income securities were up across maturities and sectors with high yield bonds up 2.62% on average (Bloomberg High Yield Index).

The general uplift was caused by a variety of factors, including favorable geopolitical events following the Brexit vote. I will elaborate on this in our market development section below. For now, here is the shape of the price chart of the S&P's 500 with the two moving averages that I have kept an eye on. The 400-day moving average is in blue and the 200-day moving average is in orange.

Note how the orange line has been "closing in" rapidly on the blue line. In spite of all the political pain of the past few weeks and in spite of the horrendous terrorist events in France and Germany, the market has pushed higher with the 200-day moving average close to crossing on the way up the 400-day moving average. From a technical standpoint, this is a very good sign.

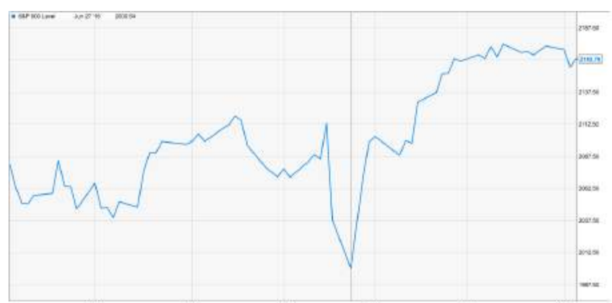
In July our client portfolios rose from 1.75% to 3.40%. Year to date (YTD) our diversified portfolios are up from 4.37% to 6.73%, net of fees. As a reminder, our allocation to equities currently varies from a minimum of 30% to a maximum of 60%, depending on the risk profile of each client.

This compares to a YTD performance of 6.42% 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.

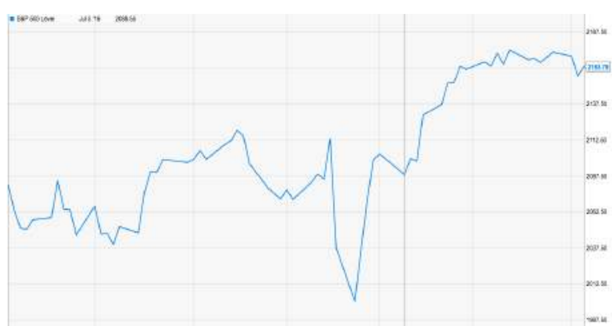
Market developments

From a market perspective, July was a good month for equity investors, worldwide. A set of fortuitous and favorable (mostly political) developments during the first half of the month propped the markets up and supported them throughout the rest of July, in spite of a series of particularly disturbing acts of terrorism in France and Germany.

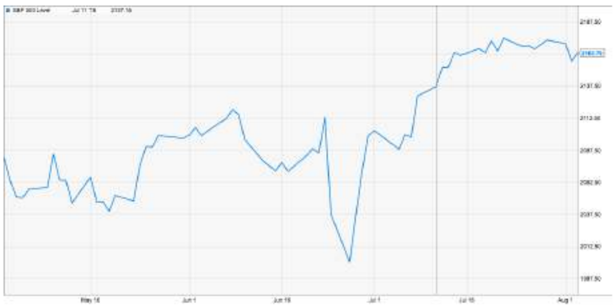
Immediately following the surprising Brexit vote, on Thursday June 23, and on the heels of market drops of 5% to 10% across developed equity markets came the Spanish general election of June 25 and 26. That vote, the results of which came to light on Monday 27, was particularly favorable to the current conservative government and was interpreted by markets, rightly in my view, as a pro-European unity vote. Markets started their rally upwards that very day. See the chart below with the vertical line set on Monday June 27.



Immediately after this bounce came the Fourth of July week and by the end of it (July 6,7,8), surprisingly strong employment numbers in the US. The good employment numbers largely explain another market move up starting around June 5 (vertical line).



Finally, the market pushed further up again starting on July 11 when the Japanese upper house elections brought a more solid majority to Shinzo Abe and when, unexpectedly, Theresa May became PM for Great Britain. See the chart below for details. The vertical line is set on July 11.



So far the international political response to Brexit has caused those electorates that have been called to cast ballots to coalesce around their leaders rather than to seek breaks with the past, however that is defined. This is encouraging. For now and the near future, a break-up of the European Union seems unlikely. That is a good thing for Europe (that includes Great Britain), the US and the rest of the democratic world.

Tilts and Allocations

When market are driven, or largely influenced, by political developments, as was the case over the three weeks following Brexit, investors are generally better served by doing as little as possible. Being patient generally works, in this sphere of human activity as in others.

Except for a few additions to our commodities positions (we like to buy when most people sell) and to our financial sector allocations, we did not take any significant investment initiatives. That has paid off. All our portfolios were significantly up with their European and Japanese holdings in particular bouncing back up a nice 5% on average. We did reduce marginally our European Reits exposure. The negative developments for the real estate market in London, as a result of Brexit, are likely to endure for the medium term and beyond. Most European Reits have a significant exposure to the London market.

Going forward, we are particularly attentive to developments in the oil and commodities sector. The current downdraft may provide additional opportunities.

Conclusion

The US earnings season is coming to a close. Results have not been particularly good. Neither have they been particularly bad, with a few good surprises in the tech sector (Amazon, Google/Alphabet).

On average, second quarter earnings are expected to have decelerated by 3.8%. This is not good but represents a slowdown in the rate of declines. As significantly, analyst expects growth in earnings to resume over the second half of the year. There are good reasons to think that they may be right.

It seems that those companies that are part of the S&P's 500 index are on the cusp of showing some revenue growth for the first time in two years. The healthy job market in the US is starting to translate into more supportive consumption trends. This, in turn, helps support the top line (revenues) of many corporations. If only those same corporations were finally deciding to invest and increase their capital expenditures! Political uncertainty does not make it easier. At some point though, an increase in corporate investments is likely to come to the help of the consumer and to prop up economic growth beyond the pallid .05%-1.5% range where it is currently stuck.

As a consequence of all of this, I am relatively optimistic about the performance of equity markets over the next few months.

There will be volatility on the way to the US presidential election. However, as long as the US consumer continues to show some appetite and employment strong, the rationale for a serious and enduring market correction remains weak. Staying the course seems to be the reasonable option.

As usual, please feel free to reach out to me with any questions.

Thank you for your trust and best regards.