FLEURUS INVESTMENT ADVISORY

August 4, 2018

Overview

US equities rallied broadly in July with the S&P's 500 up 3.72% and the Russell 2000 (Small caps) up 1.74%, respectively. Internationally and in spite of the on-going trade rhetoric, the picture improved. The Epac BMI (developed markets) was up 1.86% while emerging market equities jumped from 1.68% to 3.34% (MSCI EM and MSCI Frontier 100 respectively).

In the US, the positive performance was not without some sectorial differentiation. As shown below:

The blue line represents the S&P's 500 **Growth Index** in July. It was up 1.36%. The Orange line represents the broader S&P's 500. It was up 3.60% over the same period. Growth stocks were penalized in the waning days of the month as a result of the earnings disappointment at Facebook. I do not expect this performance disparity to endure much.

In the US fixed income markets, the picture was mixed. The long bond lost 1.42% while the High Yield sector and intermediate corporate bonds rose 1.1% and .85% respectively.

In July, our client portfolios rose from .89% to 1.39%. This compares to a monthly performance of 1.88% for a purely US-centric portfolio consisting of 50% SPY (S&P's 500 ETF) and 50% BIV (US bond aggregate proxy). On a year to date (YTD) basis our portfolios are up .15% to 1.77%, net of fees. This compares to a yearly performance of 2.05% for our benchmark.

As a reminder, our allocations to equities currently vary from a minimum of 30% to a maximum of 60%, depending on each client's risk profile.

Market developments

International markets performed well in July, after suffering three months of negative returns due to a rising USD, continuing trade disputes and a rising interest rate environment in the US.

European equities, in USD terms, were up more than 3% in July, helped by soothing words coming from the White House on trade relations with the EU and prospects of a measured pace of interest increases coming from the Federal Reserve.

Last month I mentioned that commodity prices could hardly continue to go down while oil prices were going up. This month, the situation became a bit more coherent with both oil prices and other commodity prices going down between 2% and 3%. I am not sure what to make of this. Commodity prices are down 2% so far this year (Dow Jones Commodity Index), in spite of a sharp move up in oil prices.

Is that a sign of weakening global economic growth or just the effect of a rising USD? This is worth paying attention to going forward. For now, I believe this may just be "noise" and that the global economy is still on track to deliver a decent 3% to 4% growth rate in 2018.

If that is to be, perhaps the gap in performance between US equities (blue line below), European equities (orange line) and Japanese equities (red line) will finally shrink. Over the past three months this gap has grown to about 9% between US and European equities and to about 7% between US equities and Japanese equities, as shown below:

I am anticipating a reversal in favor of international equities as trade tensions ease and the pace of interest rate hikes does not surprise us between now and the end of the year.

Tilts and Allocations

Last month I indicated that *"…in the next few weeks I will take advantage of any significant rebound in emerging equity prices to further reduce our allocation to the sector. The determination of the Fed in pushing rates up, possibly twice more in 2018, makes this decision all the easier to reach".*

This is what I did during the first part of July, after some sectors of the emerging equities markets had bounced back off their June lows. In so doing, I have reduced our equity allocations across all portfolios anywhere from 2% to 4%.

Given the conflicted and often puzzling political and economic signals coming from the US and overseas, a smaller allocation to equities appears warranted at this stage. While US earnings have been good so far, rising interest rates mechanically make current valuations harder to justify. Earnings will have to continue to grow relatively fast for equity valuations to remain even and not drop while interest rate rise. I am in the camp of those who think that prudence is justified and that a smaller exposure to equities is justified. If I end-up temporarily underperforming our benchmark, so be it.

Looking ahead, I expect the short downdraft experienced by US growth stocks to reverse. I also expect non-US equities to recoup more of their recent losses. They have started that recovery during the second part of July. I am banking on more of the same in the few coming weeks.

As a result, I do not intend to change our portfolio allocations in any significant ways. Both from an overall risk standpoint and from a sectorial allocation standpoint, I am satisfied with our current positioning.

Concluding remarks

I was in France over the last two weeks of July. The heat there was above average. Close to 100 degrees Fahrenheit throughout the country! One day, as I was sipping a rosé, I came across a newspaper article that mentioned that squadrons of French and Italian firefighters were being dispatched to Sweden to help that country deal with widespread forest fires. Swedes have never experienced such calamities, on such an extensive scale before, and are apparently ill-equipped to deal with them…If climate change is fake news, go tell the Swedes.

There are many complicated issues facing us globally, nationally and personally, at any given point in time. It is easy to be a bit overwhelmed at times. So here is my concluding point for this newsletter: August is a good time to reflect on things, read books, stay cool with your feet in the water, sip a rosé (or two) and forget about the rest for a little while. I wish all of you have a chance to do so this month.

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

Cordially,

Jeff de Valdivia