December 16, 2014

Hi all,

Since launching Fleurus, I have been thinking about writing a monthly newsletter that would discuss markets as well as wealth management issues that may be of interest to you. While I am not completely set on content, the current market environment compels me to share some of my thoughts, before finalizing fully this process. As a result, I am well conscious that this is a rather imperfect product. Nevertheless, I hope that you will find this first attempt useful, as you navigate your portfolio through these volatile times.

"The selling in the market is quite impressive these days and a bit disconcerting, particularly for anyone with a US-centric view. All is going relatively well stateside. The economy continues to mend and most indicators are pointing to a stronger consumer and increasing corporate expenditures in an environment of benign inflation and low interest rates. In that context, one would have, almost legitimately, hoped for new stock market highs before the year-end. For now, we are far from it...

The precipitous drop in the price of oil appears to be causing a major asset reallocation across geographies and asset classes. This is generating significant volatility in the US, as well as a 4% to 5% drop from the major US equity indices since the beginning of the month. In addition, the speed at which this is taking place indicates that this is more than just a simple asset reallocation that might be part of an annual institutional ritual. There is some panic selling coming from some quarters, probably the usual leveraged players, as well as what looks to me to be systematic selling from some very big institutional players. I think that prominent among this lot are the Sovereign Funds that are the most associated with oil - (Norway, Saudi Arabia, Abu Dhabi etc…). I would bet that they are all selling to the tune of hundreds of billions, across asset classes, in order to compensate for the anticipated revenue shortfalls caused by the huge drop in oil prices. This is not deleveraging, this is asset reallocation and liquidation on a massive scale. I do not think it will reach panic level because the US is doing relatively well and the Fed as well as other major players such as the European Central Bank and the Bank of Japan continue to pump serious amount of liquidity in the international financial system.

Yet, from here on, it would only take just one other major unforeseen event, be it a political, economic or natural calamity, to tilt us into less controllable selling. I tend to think that if things remain as they are now and we avoid a more serious correction (which I would say would be another 5% or more drop in equity prices), we might have the beginning of a new order and real opportunities in a variety of asset classes, prominent among them: emerging market equities, bonds and currencies.

If you are happy with your current asset allocation, I do not see a compelling reason to change anything. I would wait to commit more to equities and other asset classes until oil prices have stabilized. That could take a while, several months, perhaps more. If you feel the urge to do something and that your emerging market allocation is hurting too much, sell some. There is probably more bad news coming from this sector. I do not think this is over yet. Do not liquidate your positions though. Nobody knows where this is going to end and you want to stay with some skin in the game, even in a sector that hurts. That way you will know and feel when things turn and be better able to re-commit fast when that happens”.