FLEURUS INVESTMENT ADVISORY

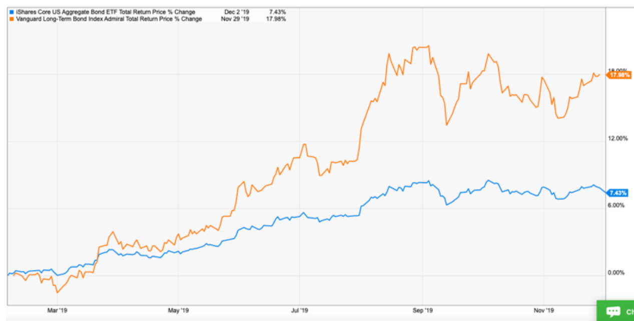
December 4, 2019

Overview

Equities rose once again in November with US equities, in particular, climbing between 3% and 4% overall.

The S&P's 500 gained 3.63% while the US Small Cap index progressed 4.12% and the Nasdaq Composite 4.64%. Internationally, the rising USD made it harder for indices to move up as spectacularly. The S&P EPAC BMI (developed economies index) rose only 1.03%. In Emerging markets performance was more contrasted, with the MSCI EM dropping -.14% while the Frontier 100 Index rose a robust 2.77%.

US Fixed Income markets hovered between slightly positive (High-Yield), and slightly negative (Long Term Governments), with most other sectors remaining within a few basis points of the flat line. The table below illustrates, partially but tellingly, the progression of US fixed income markets in 2019.



The Blue line is that of AGG, the ETF that tracks the performance of the US Fixed Income market as a whole (US Bond Aggregate). It is up 8.51%, as of the end of November. The Orange line is that of VBLAX, the Vanguard fund that attempts to track the performance of the US Long bond. It is up 17.5% over the same period. Most other fixed income sub-sectors have risen between 3% (Ultra Short-Term) and 14% (High-Yield), on a YTD basis.

In November, our client portfolios rose between 1.31% and 2.31%. This compares to a monthly performance of 1.15% for a portfolio consisting of 50% ACWI (World Equity Index ETF) and 50% AGG (US bond aggregate proxy). On a Year-To-Date (YTD) basis, our portfolios are up from 13.75% to 17.03% (net of fees) vs. 15.45% for our benchmark.

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

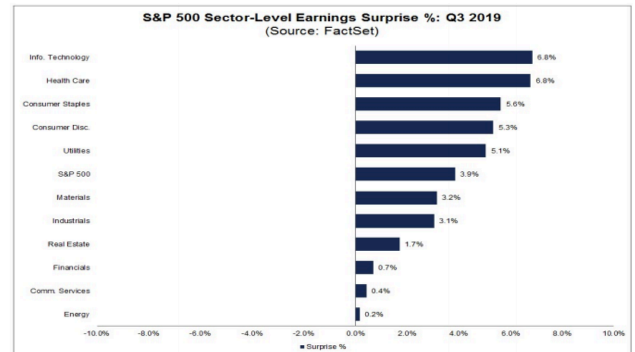
Market developments

The Federal Reserve Bank cut their reference interest rate by another .25% on October 30. This was the third rate cut in four months. On November 1, the job report for the month of October surprised market participants by its strength. Together, both pieces of data set the ground for the spectacular performance of US equities in November.

Adding to this positive tone were third quarter corporate earnings that showed that while slowing down from the high point reached in 2018, their decline was less acute than anticipated. As of the end of November, with 95% of corporate earnings out, 75% of S&Ps' 500 companies have reported positive earning surprises and 60% have reported positive revenue surprises. While earnings for the third quarter were down 2.3% vs. last year's comparable period, that is better than the -4.1% that was expected as late as September 30.

Below is a chart from Facset showing the sectors with the best third quarter earnings performance:

Q3 2019: Scorecard



Over the past three quarters, earnings have nevertheless declined (if less than expected) and valuations, while not extreme remain above average. Currently the forward 12-month P/E ratio (for S&P's 500 stocks) is at 17.5 and above its five-year average of 16.6.

A dose of prudence is warranted. Particularly after a 25%+ performance from the S&P's 500, on a YTD basis.

Tilts and Allocations

The positive market tone in November led me to marginally increase our equity positions. I did so by buying back our short SPY positions when we had one or by selling SH, an ETF that shorts the S&P's 500. We left our Small Cap exposure intact (VTWO). The arbitrage transaction that I initiated in August and September for most accounts (short S&P 500 and long Russel 2000) is now gone. It gained for us between 1% to 3% on average. That was not enough to keep it much longer since there is a cost to holding a short position.

Also, for those portfolios that are not yet fully invested, I added or initiated investments in emerging and developed markets (EWQ,EWG,EWJ).

Finally, my decision to keep intact our investment in BUFTX and PRBLX, the two funds that account for the bulk of our US equities investments, paid off. Both funds recovered some of the ground they lost vs. the S&P's 500 in September and October. They both outperformed this index by .40% and .20% respectively in November.

Overall, these various actions caused our allocation to equities to increase by about two to three percentage points across most portfolios.

So far, 2019 has been a spectacular year for investors. Below is a table that summarizes the performance of a few relevant indices, on a total return basis (with dividend or interest re-invested), as of the end of November:

Index	Ticker	YTD
	Equities	
S&Ps 500 Total Return	S&P's 500	27.63%
Russell 2000 TTR	Small Cap Index	22.01%
Developed International	EPAC BMI	14.31%
Emerging Markets	MSCI EM	10.20%
	Fixed Income	
Ultra Short Term	Less than 1 year	2.30%
US Treasury Long	20 years and more	18.12%
US High Yield	Bloomberg Index	12.08%
Municipal Bonds	S&P SERIES	7.07%

As of the end of November, even a conservative US investor with less than 50% exposure to equities globally, should have enjoyed a double-digit performance in 2019.
However, those of you who read this letter regularly know that I believe strongly in the concept of mean-reversion. With a 27%-28% annual performance so far in 2019, US equity markets are significantly above their long-term annual average of about 10% over the past 35 years (not a paltry average!). It is highly unlikely that 2020 will be as rewarding and we should all reduce significantly our return expectations for the coming year.

Concluding Remarks

The month of December started on a negative note with the Trump Administration slapping tariffs on Brazilian and Argentinian goods, threatening to do the same on French ones and pushing, possibly beyond the Presidential Election, the signing of a trade agreement with China. Markets are a bit unsettled as a result. That said, if recent history is any guide, this should pass rapidly and without long-lasting market consequences.

Finally, while trade negotiations matter, the consumer-driven Christmas shopping season will likely be a more significant factor for US equities over the next three weeks.

Based on early indications, the US consumer seems to feel jolly and ready to buy. This bodes well for the retail sector and the economy at large, pushing farther in the future the risk of a significant slowdown.

As always, please feel free to contact me with your suggestions or questions.

Thank you for your trust.

Jeff de Valdivia, CFA, CFP
Fleurus Investment Advisory, LLC
www.fleurus-ia.com
(203) 919-4980