FLEURUS INVESTMENT ADVISORY

December 4, 2015

Overview

During the month of November the US equity markets progressed from .30% to 3.25%. The S&P's 500 Total Return Index rose .3%, the Russell Mid Cap Index was up .61% and the Russell 2000 a much sharper 3.25%. International developed markets were down about 1.53% (S&P EPAC BMI) and emerging markets indices down a sharper 4% on average.

Our four target portfolios were flat across the board with our overweight US small cap allocation compensating for losses in our international equity exposures. On a YTD basis, our performances across portfolios range from 1.6% to 2.0%, net of fees. This compares to a 1.75% YTD performance for a portfolio consisting of 50% SPY (S&Ps' 500 Total Return Index ETF) and 50% US bond aggregate.

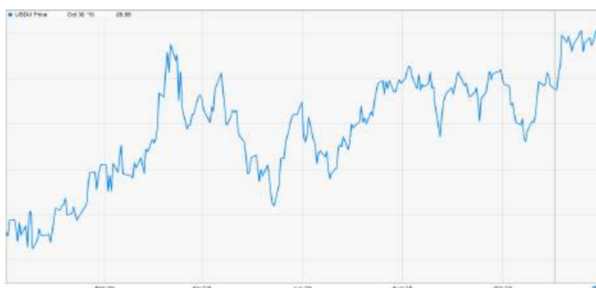
Market developments

November started with a bit of a correction following the strong job number on November 6. US equities had dropped 2% to 3% by November 12.

Then the terrible events in Paris occurred and seemed to mark a turnaround. The chart below shows the monthly performance of the S&P 500 Total Return index in November. The vertical line is set on November 13, the date of the tragedy in Paris.

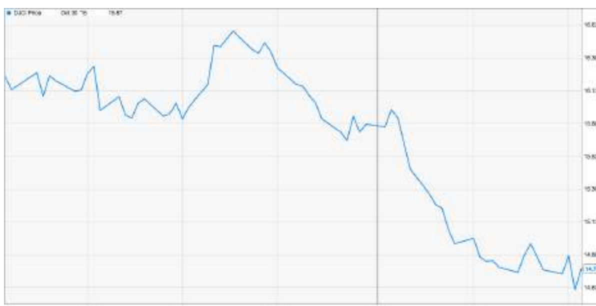
It is often said that markets are driven by sentiment and emotions, at least in the short run. The chart above seems to clearly support this view. The market seems to say, "We shall fight you!".

Also noteworthy in November was the sharp USD rally against most currencies. This move is illustrated in the chart below. It represents the progression of USDU, a fund that we invest in as a currency hedge against our international holdings. The vertical line marks the beginning of November.



The jump in the USD on November 1 and 2 was probably the result of the foreign exchange market anticipating a strong US job market number at the end of that week. This in turn would make the Fed's interest rate decision in favor of a hike on December 16 all the more likely and the attractiveness of the USD, on a relative basis, more compelling.

The sharp move in the value of the USD came together with the usual decline in commodity prices, illustrating their high and inverse correlation, as shown below: This chart is that of the Dow Jones Commodities Index.



The vertical line marks the beginning of November. Note that a chart for emerging market equities in November would show a quasi-identical price action.

USD up, commodities down, emerging markets down. Everyone anticipates it. Everyone positions for it. With less liquidity in most markets, many will get seriously hurt when the trend reverses itself.

Tilts and Allocations

Clearly, volatility has not abated. As I have often written before, it is wise to keep one's investment activities to a minimum when markets behave so unpredictably from one day to the next and when the longer trend remains murky.

In November, we limited our investment activities to increasing moderately our exposure to the Japanese equities market. In spite of the adverse currency effects for a US investor, Japanese equities have performed well in 2015 and we believe that there is more positive to come from the land of the rising sun.

Below is the chart for EWJ, the ETF we use to gain exposures to the Japanese equity sector.

The vertical line indicates the date of our first purchase. The blue line is the 100-day moving average. The period covered is from January 1, 2015.

We have refrained from increasing our European holdings. A complex investment environment that results principally from the diverging policies of the Fed and the ECB is now made almost indecipherable given the political clouds accumulating over the continent.

The price action of EZU, the Eurozone ETF we prefer to use to gain exposure to European equities, seemed to echo our sentiment. The vertical line marks the beginning of November.

Concluding Remarks

Barred an unexpectedly sharp move in either direction in December, most major US equity indices will finish 2015 between -2% and +5% on a total return basis. This is far from the annual average of 7% to 9% that we have been accustomed to over the past two decades.

Here is the astounding annual performance of the S&P's 500 (total return) over the previous 30, 20 and 10 years at the end of November 2015.

- 30-year annual average: 10.81%,
- 20-year annual average: 8.55%,
- 10-year annual average: 7.76%.

I will leave it to economic historians to explain the many reasons behind this amazing run. One thing is certain: It could not have happened without the exceptional drop in the overall level of interest rates since 1985. At that time the 10-year US treasury offered an annual return of 10.62%. In 2015, it will average 2.25%.

Going forward, we can no longer expect a generational decline in interest rates to provide much support to the US and global stock markets.

While there are several other metrics that go into the forecast of expected annual equity returns, none is likely to compensate sufficiently for the loss of support provided by a declining rate environment. Consequently, we should prepare ourselves for (significantly) lower annual equity returns over the next 10 years.

I will elaborate more on this next month, when I discuss my views on the year forward. In the meantime, I wish you all a peaceful and warm year-end holiday season!

Best regards,