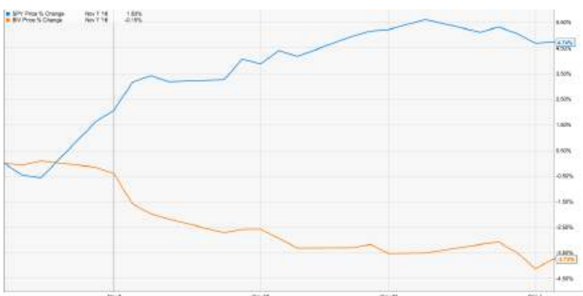
December 4, 2016

Overview

In November the S&P's 500 total return index rose 3.70%, the Russell Mid-Cap index a larger 5.30% and the Small Cap Russell 2000 an eye-popping 11.15%. These sharp advances mirrored a historic rout in the US bond market with the Barclays Long Bond index down 7.71%, intermediate US bonds down by 3.50% and the usually steady S&P's muni index down another 3.62%, capping cumulative losses in this sector of about 4.75 % over the past three months.
These market developments are well illustrated in the following one-month chart with SPY (the S&P's 500 ETF), in blue, and BIV (US intermediate bond ETF), in orange: The vertical line marks the time of the US elections. SPY rose to 3.68% by the end of November, while BIV sunk



3.50%. The US bond market rout contributed to a sharp increase in the value of the USD against most currencies. This in turn caused international equity markets to swoon. Developed markets went down by 2.35% (S&Ps' EPAC BMI) and emerging markets by a greater 4.60% (MSCI EM index). In a nutshell, investors were punished for holding intermediate and long-term bonds as well as for being internationally diversified. Teasing out of these trends those that will persist from the transient ones will be the focus of our research in the next few weeks, resulting in our 2017 expected return analysis and new asset allocation recommendations.

In November our client portfolios dropped between .12% and 1.00%. Year to date (YTD) our internationally diversified portfolios are up from 2.90% to 5.40%, net of fees. This compares to YTD performance of 4.15% 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.

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.

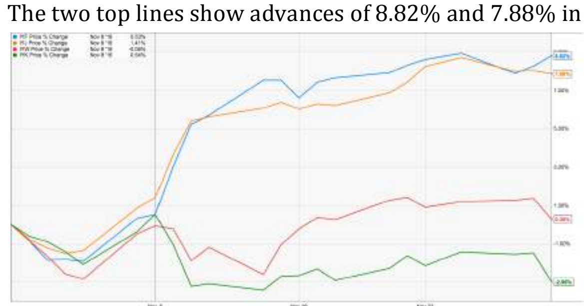
Market developments

What a month! None of the market assessments and predictions anticipated a post-election market reaction of this sort.

The bond rout was avoidable and, for the most part, we avoided it. The election was the catalyst for a much anticipated steepening of the yield curve. Its timing was surprising but the prudent investor should have long reduced exposure to long duration bonds.

What was much more surprising was the rotation out of the technology sector and growth companies in general in favor of "old industrials", financials and small companies. Consequently, the US equity indices' advance was far from even and if your portfolio does not reflect the euphoria that they advertise, the following chart may explain why:

The two top lines show advances of 8.82% and 7.88% in



November for the financial and US industrial sectors respectively. The two lines at the bottom (red and green) reflect the monthly performances of the technology and consumer good sectors respectively at .30% and -2.96%.

The rationale for some of these rotations is straightforward: A Trump administration is expected to reduce the regulatory burden on banks, therefore helping all financials. It is expected to inject $1 trillion into infrastructure projects therefore helping the industrial sector. It is expected to provide fiscal stimulus and create large deficits, therefore pushing interest rates up and creating more headwinds for the Utility and Reits sectors.

However, the drop in the technology sector is less easily explained and may be more transitory. It looks to me more like a case of investors deciding to take profits in a sector that has enjoyed a nice and long out-performance in the recent past.

Fairfield, CT (203) 919-4980 www.fleurus-ia.com

Tilts and allocations

November was a painful month for us. Our emerging market and other international allocations cost us. These allocations are the main reason for our negative performance during the period. In addition, in order to reduce risk shortly before the election, we shrunk our US small cap allocation. This made sense at the time but prevented us from enjoying more fully their whopping 11% ascent in November.

Although completely unanticipated in the magnitude of the shifts, the month of November followed a scenario that is not completely new in some respect: US interest rates up, USD up, emerging market down, international equities down. What is possibly different this time is the persistence of the trends. That will depend largely on inflationary expectations, the new Administration's ability to get its fiscal stimulus in place and the head winds it is likely to face internationally. Since we are not yet in a position to form a firm opinion on these points, we have refrained from dramatic reallocations during the month.

We have reduced slightly our emerging market allocations. For now, we have maintained our short and intermediate bond allocations and have kept our US equity allocation to growth companies unchanged. Finally, we have reduced our allocation to the Eurozone in favor of our Japanese equity allocation, ahead of the Italian referendum.

There is a good chance that some of these sectors will come back in December or January, unless the Fed's mid-December decision comes together with a significantly more hawkish tone. This in turn would support the USD and create headwinds for international equities.

Looking ahead, we will do a bit of tax-related selling in December in order to keep our client portfolios as close to neutral as possible without compromising their overall asset allocation. We will also be looking for signs of sustainability of the current post-opec rally in the energy sector.

Conclusion

As is our custom, the month of December is the month when we conduct our annual expected return analysis. This work informs our asset allocation for the coming year.

The exercise this time is particularly difficult with a return to supply side economics by the new administration. Will the ensuing budget deficit translate into persistent or transient growth acceleration? This will affect corporate earnings and valuations. How far and fast will interest rates rise? This will affect our bond allocation as well as equity valuations. What about the effects of a more confrontational administration on international trade? This will affect corporate earnings.

All these are difficult questions to answer that require a good dose of humility. There are so many things that we do not know and cannot know, yet. We will nevertheless endeavor to provide sensible answers to all of them while keeping in mind the famous aphorism attributed to Yogi Berra: "It is hard to make predictions, especially about the future".

On this lighter note, thank you for your interest and trust. We wish you a peaceful and productive year-end.