FLEURUS INVESTMENT ADVISORY

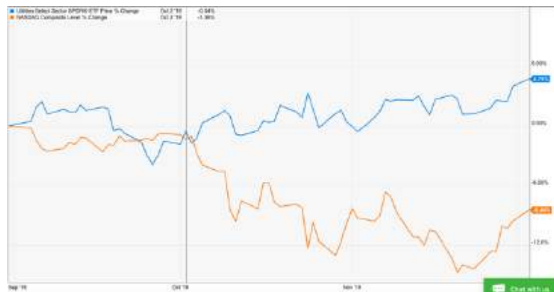
December 4, 2018

Overview

The S&Ps' 500 rose 2.04% in November while the Nasdaq Composite added a comparatively meager .49% and the Russell 2000 (US Small Caps) went up 1.59%.
Internationally, the S&P EPAC BMI (developed markets) was flat at .01% while emerging equities were up 4.06% (MSCI EM) and 2.09% (Frontier 100 Index).

The US Mid-term elections provided an early support to US equities in an otherwise volatile month. Overall though, the market tone remained anxious throughout and defensive sectors such as Utilities performed well. Internationally, the US Dollar stabilized which gave emerging markets equities a chance to bounce back nicely.

Below is the chart of XLU (the Utilities ETF) over the past three months (blue) vs. the Nasdaq Composite index (orange). It illustrates the shift away from the technology sector in favor of one of the more defensive sectors of the US equities market.

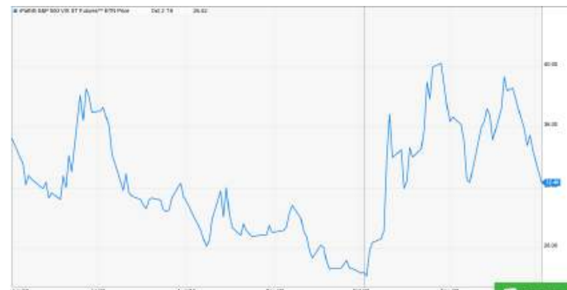


The US bond market was mixed in November again with the long bond rising 1.88% as well as the municipal bond market (up 1.06%) while corporate bonds and the high yield sector dropped -.16% and -.86%, in another sign of investors' concern about the strength of the economy and the high level of financial leverage sustaining it.

In November, our fully deployed client portfolios were up from .63% to 1.55%. This compares to a monthly performance of 1.18% 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 down 1.85% to 4.05%, net of fees. This compares to a yearly performance of 1.25% for our benchmark. As a reminder, our allocations to equities currently vary from a minimum of 30% to a maximum of 70%, depending on each client's risk profile.

Market developments

An electoral result in the US that seemed to please investors early in November, combined with an apparently less hawkish Federal Reserve helped stabilize equity markets in November after a bruising month of October. Volatility remained high nevertheless with the VIX hovering at the high end of its six-month range, as illustrated below. The vertical bar marks the beginning of the October correction.



With the continued slump in oil price (illustrated in the chart below) and the resulting concerns that this raises about the strength of the global economy, it is a bit of a miracle that markets were able to muster gains this month.

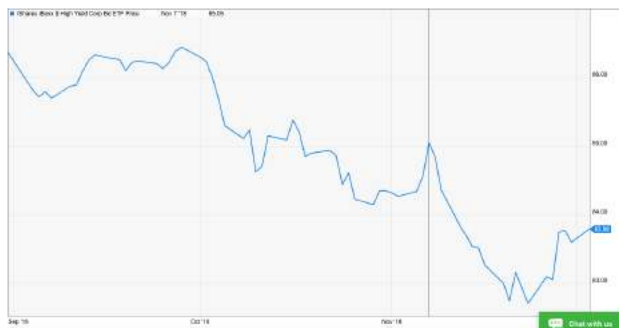
Looking ahead, the recent G 20 meeting seems to have given the markets a respite with the trade talks between the US and China taking a less confrontational turn. That said, nothing was clearly agreed other than to avoid an immediate escalation. Nevertheless, I will take that for now together with the soothing words of Chairman Powell.

This combination of factors appears to have quieted markets for now. Perhaps we will enjoy as a result a good month of December and finish 2018 on a positive note.

Tilts and Allocations

In early November I decided to start reducing all of our high yield bond exposures. All portfolios saw their high-yield corporate bonds exposures reduced by 25% to 33% as of November 9.

My rationale for starting this process was simple: Investors are reducing exposures globally. They have done so with international developed and emerging markets equities starting in May and June, then by moving on to US technology stocks in early October. I thought therefore that It was only a matter of time before a similar adjustment would take place in the riskiest parts of the bond market. This is what happened most notably shortly after the US mid-term elections, as illustrated below:



The vertical bar marks November 6, the day of the elections. The high yield correction that ensued was significant enough. Only the soothing words of the Fed's Chairman combined with the rather robust revised third quarter GDP numbers helped stem the losses and start a recovery.

Elsewhere in our portfolios I started selling other corporate bond holdings to reduce capital gain taxes whenever possible. I will probably continue this "tax selling" process whenever possible and warranted between now and year-end.

With respect to the scrutiny under which I have put our investment in BUFTX, the growth US equities fund that underperformed in October, I am glad to report that it seems to be holding its own for now. BUFTX was up 2.37% in November and nicely above the Nasdaq composite (.49%) and the S&P's 500 (2.04%). I have therefore refrained from reducing further this investment. I will keep on monitoring it daily and will decide at the end of December whether a further reduction and/or replacement is warranted.

Currently, most portfolios are at the low end of their equities allocation, with significant investments in utilities. I believe that this rather conservative positioning is warranted given the high level of economic uncertainty and heightened market volatility.

Concluding remarks

There has been a truce but not a resolution yet on the global trade front. The pace of interest rate increases in the US remains unclear. The US economy appears to be giving signs of slowing while the global economy has already slowed. The political environment in the US and globally remains unsteady with clear flashing points in Europe (Italy, Brexit). Meanwhile, autocrats around the world seem to have a relatively good time, slapping high fives as Vladimir Putin and Mohammed Bin Salman did at the recent G 20 gathering. There is much to mull over as 2018 wanes.

What are the implications for market returns in 2019? The odds are that we will have another trying yea. It is unlikely that US equity markets will remain the sole providers of positive returns globally. But does this mean that international markets will recover from their 2018 swoon or that US equity markets will join their international brethren and correct further? Volatility will continue to rise, that is more than likely, but will the pace of interest rate increases quicken or slow here and globally? I do not know. Yet all those questions need to be addressed in order to construct a reasonable (investment) battle plan for the New Year.

Over the next few weeks I will go through my annual Equity Risk Premium (ERP) calculations and in so doing will attempt to answer some of the above-mentioned questions. While this is a process and only that, it is a valuable one that generally yields one or two insights or investment ideas. I will likely have a few to share with you in my next newsletter.

In the meantime, enjoy the end of the year, your family and your friends.

Thank you for your continued trust.

Cordially,

Jeff de Valdivia