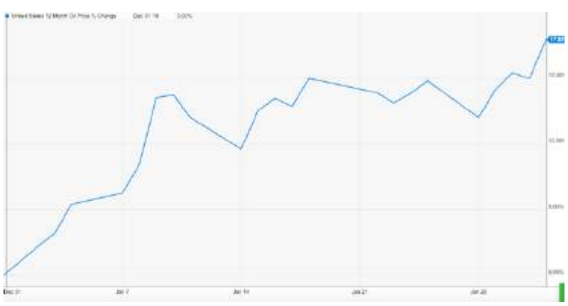
Overview

After four months of violent market movements, any investor could be easily excused for feeling a little lightheaded.

Keeping one's composure has been essential in order to avoid making serious portfolio-damaging mistakes. The unusual and large recent market ups and downs have had the potential to destroy otherwise well-balanced portfolios. Not moving, or not moving much and with clear purpose, was key.

January saw the S&Ps' 500 rise 8.01% after sinking 9.03% in December. The Nasdaq Composite added 9.79% while the Russell 2000 (US Small Caps) rose 11.25%. International equity markets went along for the ride with the the S&P EPAC BMI (developed markets) clocking a 6.83% performance while emerging equities rose 8.71% (MSCI EM) and 5.49% (Frontier 100 Index). Oil and other commodities joined in this general market sigh of relief. Below is a chart of USL, the ETF that I track to keep an eye on oil prices.



This ETF was up 15% in January. Seeming to indicate that, after all, the global economy may not be slowing down as rapidly as previously feared.

The US fixed income markets joined this "kumbaya moment". Corporate and high yield bonds did well too. Intermediate corporate bond indices were up about 2.43% while high yield bonds rose 4.52%.

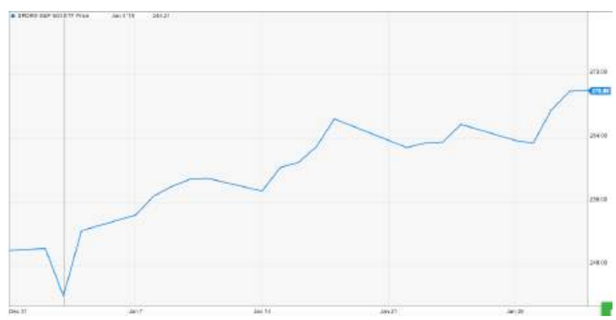
In January, our client portfolios were up from 4.56% to 6.14%. This compares to a monthly performance of 4.81% for a portfolio consisting of 50% ACWI (World Equity Index ETF) and 50% BIV (US bond aggregate proxy). As a reminder, the equity allocation in our clients' portfolios ranges currently from 30% to 60%, depending on their risk profiles.

February 4, 2019

Market development

What caused this sharp market reversal in sentiment and direction? As usual, it is a combination of factors.
First among them was an early indication that the US economy was not on the edge of recession. On January 4, the US Labor Department released an unexpectedly strong employment report (revised downward since). Adding to this good initial momentum, in the middle of the month, were soothing words from the White House regarding the soon-to-come US-China talks on trade and more accommodative musings from the Federal Reserve in the latter part of the month.

Below is the monthly chart for SPY, the S&P's 500 ETF. The vertical bar on the left marks the date of the release of the unemployment number for the month of December.



What followed this positive economic data release was a series of other well-received economic and political announcements, punctuated by generally supportive corporate earnings.

I would not be completely true to myself and to the rest of this readership if I did not mention that the current US Administration appears to be unusually sensitive to the behavior of US equity markets and that this may add, on occasion, an element of unpredictability to already pretty volatile markets.

I have come to think that the Administration and the President in particular may time the release of potentially "market-influencing" pieces of news with a view to muting some market reactions and "encouraging" others. I have reached this conclusion after several incidents and developments: i) the highly unusual release, via tweet on a Thursday evening, a few months ago, of a "likely" positive unemployment number to be released officially the following day, ii) the on-going mention by members of the Administration and the President of "positive" trade talks with China since the beginning of December as the markets were convulsing, iii) the sniping at Jay Powell (Fed chairman) in November and December in order to influence the Fed's hand on monetary policy. I do not think this will have a lasting impact on equity markets. However, it may add to their short-term unpredictability.

Tilts and Allocations

In January, I added to our emerging equity market positions. This decision was motivated by a number of factors; i) the message by the FED that their tightening cycle (the speed and intensity of their interest rate moves) might be slower and shorter than previously indicated, ii) the dampening impact that this would have on the value of the USD vs. other currencies, iii) a particularly supportive technical environment.

Below is the graph of VWO, an all-encompassing emerging market equity ETF.

After a depressing and long downward move of close to 20% in 2018, VWO has established a double bottom (W shaped pattern to the immediate left of the vertical line). This is generally viewed as indicative of a base price from which a security will bounce going forward. It seems to be happening. Together with the macro-news mentioned earlier, I felt that this was a good time to gingerly increase our emerging market exposures. So far, so good.

As you may recall, I have been monitored daily the price of BUFTX since early November. BUFTX is the mid-cap growth equity fund that I use as our principal US equities investment vehicle. I decided to monitor its daily performance then vs. that of the S&P's 500, Nasdaq and Russell 2000 after it had severely underperformed these indices in October, on average by about 3%.

It has since recovered all the ground it had lost and more. Specifically, it has outperformed these indices by 4% to close to 6% since early November. After such a good run and still smarting from the nasty surprise they gave me in October, I decided to reduce some of our exposure to it. I have now replaced half of our investment in BUFTX with PRBLX, a fund with a value orientation. This should give our portfolios more balance and a marginally lower risk profile while keeping us similarly allocated to US equities.

Concluding remarks

The S&P's 500 lost about 13.5% during the last quarter of 2018. It has now recovered about half of that lost ground. If history is any guide, the other half may not be recouped so quickly.

In spite of the political noise that I mentioned earlier in this newsletter, the quality of US economic data will remain the key determinant of how quickly equities fully recover from the late-year correction. The Labor Department employment statistic for January, released this past Friday, was excellent (although this is a number that is subject to substantial revision). Fourth quarter corporate earnings need to continue to come a bit better than expected, as they have so far, for the market to recover its footing and possibly make new highs.

The scheduled China-US trade talk, at the end of February, may help in that respect. However, this is a topic that is subject to political spin and investors will have to discern what is substantively achieved, if anything, from what is announced for the purpose of general consumption.

In this environment, I continue to maintain and to suggest a more-conservative-than-usual investment posture.

Thank you again for your continued trust,

Jeff de Valdivia