FLEURUS INVESTMENT ADVISORY

February 7, 2017

Overview

In January the S&P's 500 total return index rose 1.90%, the Russell Mid-Cap index was up 2.15% and the Small Cap Russell 2000 rose a more sedate .39%. US bonds were generally unchanged, although the High Yield sector registered yet another positive performance of close to 1%.

International developed equity markets were up a solid 3.16% (S&Ps' EPAC BMI), helped by a slumping USD. The USD loss of momentum in January propelled emerging markets forward 5.47% (MSCI EM) and 7.74% (MSCI Frontier 100). For those of you who are keen observers of markets and what pundits say about them, 2017 was supposed to be the year where you did not want to be investing in emerging markets. The year is young, but so far this is yet another market prediction that is proving spectacularly wrong.

The chart below shows the advance of EEM, the ETF that tracks the MSCI Emerging Market Index.

The vertical line marks the time of the US presidential elections. After losing close to 10% over a period of two weeks around that time and touching those lows again after the FED's decision to hike interest rates by .25% in mid-December, the momentum seems to be positive for emerging markets again and supported by technical indicators.

In January our client portfolios rose between 1.36% and 2.52%. This compares to a monthly performance of 1.06% 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

The year has started positively for equity markets but somewhat wearily. By January 2 the USD rally that paralleled the rise of the US equity markets and followed the US presidential elections stopped and started to reverse. USDU, an ETF that tracks the performance of the USD against a basket of major currencies was down 2.17% by January 31 as shown below. The vertical line marks the beginning of 2017.

Several factors caused this reversal, chief among them the contradictory statements emanating from the new US administration on a variety of subjects. On the one hand the Trump cabinet does not want a strong USD since it could cause the growth of the US economy to slow rather than accelerate. On the other hand its bellicose attitude, on trade issues in particular, can cause jitters and contribute to reinforcing the haven currency status of the USD.

How the USD behaves going forward will continue to have a significant impact on equities here and abroad.

It is hard to figure out where things are going out from here. Valuations are high, historically. Interest rates remain very low with little chance of staying at those levels much longer. The FED is expected to hike twice in 2017. On the positive side, earnings are up, so far +7.5% for the fourth quarter of 2016 vs. 2015 and the announced economic policies of the new administration are generally supportive of equities.

What the market has perhaps not yet fully priced is the reduction in global and US growth that will undoubtedly come from the restrictions on international trade if the belligerent trade posturing of the new administration morphs into tariffs and other barriers to trade.

Tilts and allocations

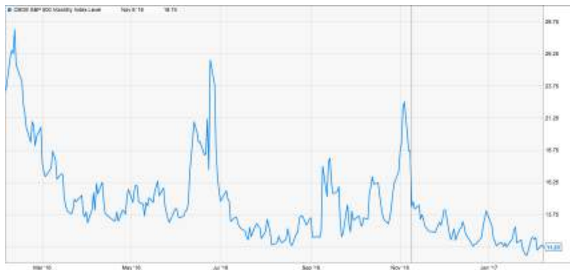
In January we maintained our allocations to international stocks in general and emerging markets in particular. This largely explains our outperformance this month. We remained exposed to European markets in spite of the political uncertainty there. EZU, our choice ETF for this sector of the market, was up 2.1% in January. ECON, our ETF for emerging markets, rose 5.06%.

Overall, we have kept our allocations to equities unchanged and have moderately increased our exposure to commodities. This has paid off with FTGC up 1.37% this past month.

Concluding remarks

The erratic behavior of the new US cabinet may or may not be deliberate. In any event, it has not increased the volatility of the equity market(s), on the contrary. This is surprising.

Below is the chart of the VIX, the volatility index for the S&P's 500.



The vertical line marks the time of the US elections.
The VIX is hovering at a historically low level. We are not sure what to make of this. Does the VIX tell us that the unpredictability of the new administration is irrelevant to equities, as long as it delivers on tax cuts and de-regulation? If so, how about factoring in geopolitical risk?

We have recently read an interesting article about the current level of volatility. It concludes with the idea that it is down because sub-sectors of the equity markets are de-correlating. In other words, the many parts of the equity markets are now moving in different directions (de-correlating) therefore dampening the overall volatility of the market. If that is the case, this volatility puzzle may come with a silver lining.

Looking ahead, with the heightened level of economic and political uncertainty that envelops us and other parts of the world, I plan to maintain a relatively defensive position over the next few weeks and until the horizon clears.

Please feel free to send me your comments or questions.
Cordially.

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