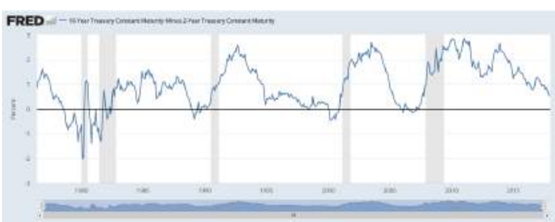
FLEURUS INVESTMENT ADVISORY

January 4, 2018

Overview

In December the S&P's 500 rose 1.11% on a total return basis (dividends included) and the Russell 2000 dropped -.40%. Internationally, the S&P Epac BMI of developed economies rose 1.66% in spite of a lackluster performance from Eurozone equities that struggled under a rising Euro. Finally, Emerging markets had yet another solid month with the MSCI EM up 3.36%. In the Fixed Income (FI) world, US notes and bonds were generally up with positive performances of .10% for short-term treasuries, .91% for US corporate bonds and a more generous 1.72% for the US Long Treasury. Overall, the US long bond managed to gain 8.63% in 2017. Amazing, considering the three Fed rate increases this year. This situation is causing a further tightening of the yield curve and getting us closer to a yield curve inversion, a phenomenon often predictive of recessions.

The chart below represents the difference in yield between the 10-year US Treasury note and the 2-year US Treasury note, since the late seventies.



The grey bars represent recessions. When the yield differential drops to zero (black horizontal line) or becomes negative (below the line), the economy experiences an immediate recession (late 70's and early 80's), or shortly thereafter (all three other recessions).

This yield differential is currently still positive at .52% (extreme right portion of the chart). Further erosion could be a harbinger of trouble ahead. This is an indicator worth watching closely.

In December, our client portfolios rose between .20% and .51%. For 2017, fully deployed client accounts are up between 13.15% and 16.94%. This compares to monthly and yearly performances of .58% and 12.23% respectively 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 periods. 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 month of December was dominated by the ups and down associated with the fate of the new US tax bill. The ultimate success of the GOP in making it the new tax law of the land helped push up US equities another notch in the waning days of the year. As had been the case before, the tax-related rally in US equities benefitted principally the industrial and financial sectors. Tech stocks treaded water most of the month.

US equity gains happened in the context of robust economic data elsewhere in the world, prompting a rally in commodities as well as in emerging market equities.

Overall, 2017 was a great year for investors.

Below is a table of returns for some of the most widely held asset classes:

	Annual Total Return
US Equities	
S&P's 500	21.83%
Russell 2000	14.65%
International Equities	
Developed Economies (S&P EPAC BMI)	24.06%
Emerging Markets (MSCI EM)	34.35%
US Fixed Income	
Short Term US treasuries	0.81%
Long Term US treasuries	8.63%
US Corporates	6.42%
US High Yield	7.50%
US Bond Aggregate	3.54%
Other	
US Reits	4.80%
European Reits	27.85%
Commodities (DJCI)	4.36%

Note that the most spectacular double digits annual returns (emerging markets equities, European reits and international developed markets equities), benefitted from the decline of the US dollar against most currencies in 2017.

On average, the dollar drop in value added about 9% to the annual return of these asset classes. Their performances remain spectacular nonetheless.

Tilts and allocations

Last month I indicated that I intended to start a position in GLD, a large gold ETF. In doing so I wished to add a level of protection to each portfolio in an environment where I perceived risks to be on the rise. I started investing in GLD on December 12.

Below is the chart of GLD. The vertical line indicates the time around our purchase and coincides with two technical signals that triggered our timing. Without boring you with details, let's say that the coincidence of these two signals was strong enough to justify starting a position. And I did.

While technical indicators are not without limitations, I pay close attention to them. In this instance, they gave the right timing signal. The price of GLD has risen 5.5% since our purchase. I intend to add to this position, in the coming weeks.

None of our other positions were modified in December.

Our Euro equities (located in France and Germany primarily) treaded water all month. The strong appreciation of the Euro vs. the USD since early November, of close to 4%, has made it difficult for equities there to perform well, given the importance of the export sectors in both countries. I would expect the Euro rally to moderate in the coming weeks and help support equities. Going forward, I see no need to reduce exposure to European equities yet.

Our emerging market positions, that we had trimmed a bit last month after a breathtaking performance in 2017, continued to do well in December and were up about 2%. We intend to keep them intact for now.

Finally, the US growth equities that we tend to favor in our US equity allocation underperformed their industrial and financial brethren. I did not expect this to last and did nothing as a consequence. Sure enough, as of this writing, the tech sector is once again taking leadership of the US stock market and pushing indices up.

My intention is to keep these investments in place, for now.

Concluding remarks

2017 was a good year for equity investors and particularly for those who were well diversified on an international basis. We are among those and we benefitted nicely, particularly from our allocations to emerging markets and European equities. Thanks to them, our fully deployed client portfolios out-performed their benchmarks by about 1% to 1.5%, net of fees.

While overtaking a benchmark is pleasing, our primary mission is focused on two more important goals:

1) To efficiently harvest the returns that equities, across geographies, often provide,
2) To mitigate the losses that they inflict on occasion.

If we do both, we do well by our clients, no matter what the circumstances.

In 2017 we achieved our first goal and more. We did so without taking significant risks. By most measures, we were rather prudently invested throughout the year. Our equity allocations remain relatively low by industry standards, with a maximum of 60% for the most aggressive portfolio.

Going forward, we will continue to position portfolios to achieve both objectives and with a heightened level of attention given to our second objective. Markets will correct at some point in the future and high on our list is the absolute necessity to avoid catastrophic losses for all of our clients. That means, positioning portfolios prudently ahead of the correction.

With that in mind, I will shortly conduct our annual Equity Risk Premium (ERP) analysis. Its conclusions will determine whether we make significant adjustments to client portfolios or not. As of now, I would be surprised if the analysis were to significantly alter our portfolio allocations. I will keep you posted!

As usual, feel free to contact me with questions or comments.

I wish you all a great 2018!

Best regards.