FLEURUS INVESTMENT ADVISORY

July 5, 2016

Overview

In June, the S&P's 500 total return index rose .26 % while the small cap Russell 2000 dropped by .05%. This compares to losses of 7.38 % for international developed markets (EPAC BMI index), gains of 4% for emerging markets overall (MSCI EM Index), losses of close to 5% for frontier markets and gains of close to 5% for commodities (DJCI) and bonds (US long bond). These contrasted performances highlight the uncertainty caused by the Brexit vote, on June 23, and investors' somewhat discriminating responses to it.

Since this vote, the British pound has dropped by more than 10% against the USD, bond yields have come further down across most markets and investor sentiment has worsened. Below is a graph of the S&P's 500 Total Return that illustrates the volatility of this equity index around the time of the Brexit vote (vertical line):

The blue line represents the 200-day moving average of the index. As an aside, it is interesting to note that the index bounced back on this line to erase most of its previous losses. Another reason for investors to pay attention to charts and statistics!

After rising by one to two percent before the Brexit vote, our four model portfolios gave up all or most of their gains to finish the month basically unchanged. Our performances fluctuated from -.25% to +.59% across portfolios. The higher the bond allocation, the better the performance.

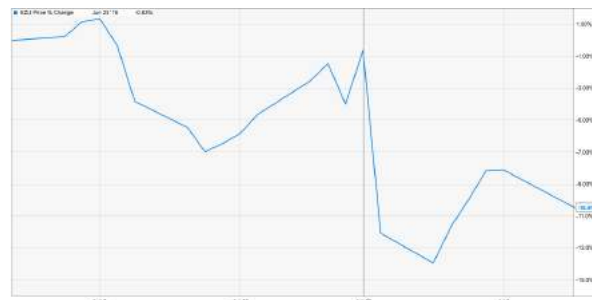
Year to date (YTD) our diversified portfolios are up from 2.25% to 4.30% net of fees. This compares to a performance of 4.33% for a purely US-centric portfolio consisting of 50% SPY (ETF for the S&P's 500) and 50% BIV (US bond aggregate ETF proxy), over the same period.

Market developments

What a mess! By choosing to exit the EU the UK has started its own constitutional crisis, contributed to more political turmoil in Europe, weakened its economy and played into the hands of Vladimir Putin, a man not well known for his attachment to democratic principles. Interestingly and sadly, the main actors of this drama: David Cameron, Michael Farage and Boris Johnson, have all decided to leave the scene of the fire that they started. Might this be a lesson that would-be political arsonists of all hues and geographies will ponder? I am not holding my breath!

From a money management standpoint, this mess has caused increased volatility in most markets, significant re-allocations between and within asset classes and pushed interest rates further down in a classic "risk-off" investor response. To illustrate this below are a few telling charts. First, the price pattern of VBLTX, a Vanguard ETF that replicates the performance of a portfolio of Long Term US treasuries:

That ETF was up 4.5% in June. The vertical line is set on June 23, the day of the vote. Second, the price pattern for EZU, an ETF that replicates the performance of major European equities (non-UK):



That ETF was down close to 10% in June.

Even more interesting are the price patterns of two ETFs within the same asset category (Reits-Real estate Investment Trusts). VGSIX (first chart), the US Reit was up 6.00% in June while its European equivalent, IFEU, was down 11%.

A 17% performance discrepancy between two broadly diversified investment vehicles, within the same asset class, is a rather unusual occurrence. Perhaps offering an investment opportunity to the bold investor!

Tilts and Allocations

Before the June 23 date we limited our investing activity to increasing our small commodity exposures across portfolios and refrained from other significant investment decisions ahead of the British vote.

When the shocking results became available, we decided to wait and see if the initial negative market reaction had more than passing momentum. The significant market recovery since then has comforted us in our decision. We have refrained from any investment activity since while remaining fully aware that new investment opportunities might arise and could cause us to change our stance. So far, nothing obvious has come to our attention. That said, the pain among financials in Europe is bleeding over in the US and may prompt us to allocate more, selectively, to the sector, should this trend gather momentum.

Conclusion

So far the response of the US equities markets to the situation in Europe has been levelheaded and , as a consequence, somewhat comforting. The next few weeks will tell us whether this market is likely to grudgingly move forward or test is lows once again. The unemployment report, at the end of this week, followed by the opening of earnings season by mid-July will provide significant signposts.

On the one hand, investor sentiment remains negative, which tends to be a positive for the market. On the other, earnings growth remains challenging, domestic political turmoil high and geopolitical stress, ever-present.

In this investment environment, less is better! My advice to most investors is to refrain from investment decisions unless they are guided by cool-headed evaluation and market expertise. In other words, this is not a market that is likely to reward the occasional investor.

As usual, please feel free to reach out to me with any questions.

Thank you for your trust and best regards.