FLEURUS INVESTMENT ADVISORY

July 8, 2017

Overview

In June the S&P's 500 total return index rose by .62% and the Russell Mid-Cap index by 1.00%. The Small Cap Russell 2000 rose a more impressive 3.46% but remains well behind its mid-cap and large-cap counterparts on a Year To Date (YTD) basis, as illustrated in our chart below. The Barclays US Bond Aggregate index was down .10% and the Bloomberg High Yield bond index remained flat for the month.

The chart below compares the performance of the three US equity indices mentioned earlier on a YTD basis.

YTD the performance of the Small cap index stands at 4.99% compared to 9.34% for the S&P's 500 and 7.99% for the Mid-cap index (total return performance numbers). This is another illustration of the tendency of markets, sectors or indices to "mean-revert" or go back towards their long-term averages. The small cap index had sprinted ahead of its larger counterparts just after the presidential election. It is now having a hard time keeping up, as expected.

On the international front, the EPAC BMI index of developed economies dropped a tiny .23% in June while Emerging markets had a good month, in the aggregate, with the MSCI EM index up 1.00%`. That performance was not uniform and some subsectors of the emerging market world remained flat or declined.

In June our client portfolios rose between .15% and .68%. YTD these accounts are up between 6.97% and 9.42%. This compares to monthly and YTD performances of .20% and 6.00% 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

US equity markets were relatively quiet throughout the month. While volatility remained unusually low overall, the first part of the month saw investors taking profits out of technology stocks. This was a short-lived market action. By the end of June, the rotation out of the tech sector seemed to be done with, with large cap technology stocks down only about 5%.

Below is a chart of the price action for four large tech stocks (Amazon, Apple, Google/Alphabet and Netflix) in June.

Amazon (Blue line) was down about 2.8%, Netflix a sharper 8.5% and Apple and Google around the 5% mark. Since the beginning of July they have risen a bit, pointing to the mild nature of this rotation. Investors do not really want to get out of these stocks, no matter what their financial metrics.

The market reacted more robustly to the messages coming out of the central bankers' gathering in Portugal on June 26. Mario Draghi, Head of the European Central Bank, intimated that a gradual reduction of the ECB"s bond purchase program was in the card as a consequence of improving economic conditions throughout Europe. This caused a global bond rout, as illustrated by the chart of the US long bond below:

The vertical line marks June 26. The US long-term bond has lost close to 4% of its value since then. There is probably more to come in the relatively short term.

Tilts and allocations

In June we maintained our Eurozone equity market positions, reduced a bit our technology stock exposure and trimmed our exposure to emerging market equities.

We were not as fast as we could have been in reducing some of these positions. ECON, one of the ETFs that we use to gain exposure to emerging markets dropped 2% during the month. With higher volatility expected on the interest rate front, globally, we intend to reduce exposure to the sector more systematically going forward. We have been rewarded over the past 18 months. Over that period of time our emerging markets investments are up 20% on average. Now may be an opportune time to take some profits.

There is no compelling reason to reduce our European equity allocations. Valuations there remain attractive, compared to US valuations, and pro-market reforms in France have a good chance of becoming law just ahead of the German elections in November. Also, a renewed level of cooperation between France and Germany is contributing to reinvigorating the European Union experiment and to dampening political uncertainties in the process. All of this is good for business and for equities, all the more as European consumers keep on buying.

Finally, interest rates are up. They will continue to go up if economic conditions remain relatively good, as they currently are. Under such conditions, it is only fitting that central banks would send signals to the market about their intentions to reverse the accommodative policies that were implemented in the wake of the 2008 crisis.

What does this mean in plain language? Simply that a new monetary environment is gradually setting in: one where short term rates will rise, where long-bond positions will suffer and where the relative attractiveness of US equities (vs. bonds) will gradually wane.

Some will say that the same things could have been said late last year when the Federal Reserve started raising short term rates and that an investor who would have reduced his/her US equity positions as a consequence would have missed on a 9% performance in 2017 so far.

And, that is correct. However, this does no mean that a wise investor should not reflect on the increasingly palpable reality that a new interest rate regime has started and that adjusting portfolios accordingly or with new urgency is now called for.

Concluding remarks

This newsletter is a few days late. A prolonged European stay kept me away from my desk longer than I had initially anticipated.

My extended sojourn in France leads me to conclude this letter with the following points:

1) Emmanuel Macron is a political phenomenon whose accomplishments over the next few months (or lack thereof) will measurably impact France and its European counterparts,

2) The mood is strikingly up in France and, so it appears, in surrounding countries and....

3) Loire Valley whites can be exquisite. Some of the 2015 Vouvray and Mont Louis are among the best I ever tasted!

Best regards to all.