FLEURUS INVESTMENT ADVISORY

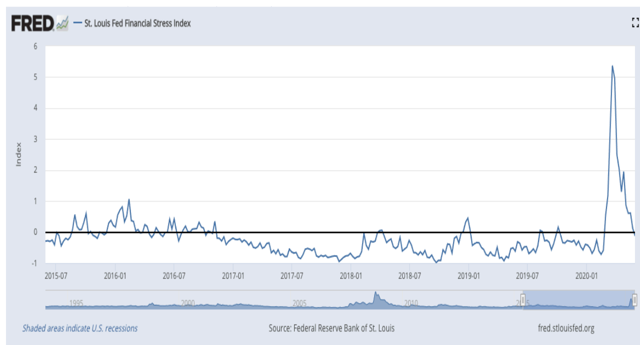
June 4, 2020

Overview

The upward movement in equity markets worldwide continued in May, albeit at a slower pace. The S&P's 500 was up a robust 4.76% while the Nasdaq went up 6.89% and the Russell Small Cap index 6.51%. As of the end of May, US equities had recouped close to 95% of their 2020 losses. The speed at which the correction took place was unprecedented and so has been the rebound.

Internationally, all indices rose but generally less spectacularly than their US counterparts. The S&P's EPAC BMI (developed economies) rose 4.56%. Emerging market indices were up 3.29% (MSCI EM) and 3.97% (MSCI Frontier 100). The USD was down a bit In May, causing some export driven developed economies (Germany, Japan) to finally outperform. The DAX was up 9.37% in May and The TOPIX was up about 7.05%.

Illustrative of this violent back and forth of the past three months below is a chart that shows the level of the financial stress index, as calculated by the St Louis Federal Reserve Bank over the past five years.



From a peak of 5 reached on March 20 (spike on the right), the stress index is now back at or near its five-year average. That largely explains the forceful recovery in US equities of the past two months.

In May our client portfolios gained between 2.58%.and 3.77%. A portfolio consisting of 50% ACWI (World Equity Index ETF) and 50% AGG (US bond aggregate proxy) rose 2.78% during that period. As of May 31, client portfolios are down from 3.28% to 6.82% since January 1, 2020. This compares to a negative performance of 1.65% for our benchmark and of -4.97% for the S&P's 500, over the same period.

As a reminder, the equity allocation in our client's portfolios ranges currently from 30% to 60%, depending on risk profiles.

Market developments

The month started with a fairly lugubrious piece of economic data in the form of the unemployment number for April, printing at an unprecedented 14.7%. Additionally, expectations of a GDP contraction of 45% for the second quarter of 2020 (vs. same period last year) added to the somber market mood.

While largely anticipated, these numbers and forecast caused equities to wobble a bit. Through May 13, US equities were down 3% for the month.

Then the FED's Chairman spoke to Congress of the need for additional fiscal stimulus in fighting the economic contraction. The generally supportive political response he was given contributed to reversing the trend. This was aided by the announcement on May 18 by Moderna (a biotech company) of their progress in finding a vaccine for Covid-19. While the news was encouraging, it was a bit premature. Nevertheless, the announcement was enough to push equities up 3% that day. Announcements of the re-opening of the economies of many states throughout the month helped consolidate the positive market mood for the rest of May.

The absence of hard economic data to support the current market recovery has caused many investors to question its sustainability. While it is impossible to justify it with the most relevant and conventional metric (corporate earnings growth), it is important to keep in mind a few things about the current situation:

1) Equity markets anticipate by six to nine months an observable economic recovery,

2) The Fed and Congress have injected about $6 trillion in the US economy in a two-months period. This is the equivalent of about 25%-30% of GDP. This response dwarfs, in size and speed, anything we have seen before (from the 2008-2009 recession to the Great Depression of the 1930's),

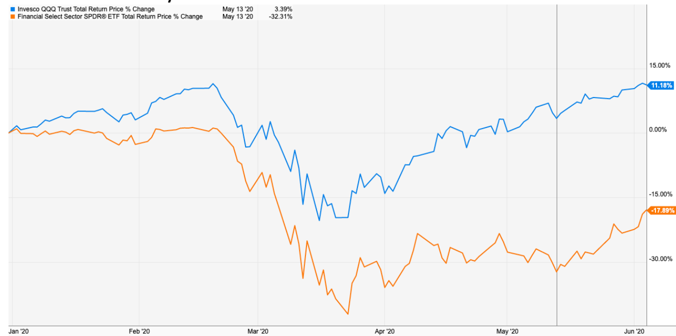
3) A similarly gargantuan response has been given in other developed markets, with Japan's response at close to 46% of their GDP.

With so much liquidity offered to the financial system by monetary authorities and significant buying power provided to consumers, the markets are responding optimistically.

Tilts and Allocations

This has been a difficult year so far for most investors, in spite of the recent and powerful recovery by the main equity indices. In addition to the nerves needed to stay the course (often the best approach in tumultuous times), not getting hurt by the sudden market rotations that have taken place was nearly impossible. Keeping an equity portfolio unscathed in this context is more than a little challenging.

Illustrating one of these points is the chart below that compares QQQ, the ETF that tracks the Nasdaq 100 and XLF, the ETF for the financial industry.



XLF (Orange line) is down 17.90% so far this year and as of this writing. QQQ (Blue line) is up 11.50% over the same period. Note however that since May 13 (vertical line), XLF is up a whopping 21.50% and QQQ up "only" 7.50%. Trying to position a portfolio in anticipation of such moves requires both expertise and luck.

In May, as I tried to discern the likely winners from the losers in a post-Covid 19 world, I started investing in specific stocks in addition to the broad indices and ETF that I usually favor.

I bought SCHW (Charles Schwab and Co.) in the financial sector, DLR (Digital Realty Trust) in the Reits sector and AIQUF (Air Liquide) in the International Developed Equity sector. Each time, I reduced the allocation to the corresponding ETFs (SPY/XLF, XLRE and EWQ respectively), in order to maintain the same general sectorial risk allocation. So far, these investment decisions have paid off.

Hopefully, they continue to outperform and help us recover from our relative underperformance (vs. our benchmark) during the first four months of this year.

Concluding Remarks

If there is a good lesson to draw from the past five months, from an investment point of view, it is that trying to time the market or doing it by default; be it as a consequence of panic or as a result of the latest news headline; leads to losses, sometimes severe losses that can damage a portfolio for a very long time.

For investors who are close to retiring or retiring and who will need their financial assets to support themselves in retirement, crippling losses are more than just paper losses. They can lead to enduring financial trauma that causes permanent underinvesting and underperformance. Fleurus' role as a financial advisor is, first and foremost, to avoid these traumatic and psychologically crippling losses.

I am glad to say that we have been able to do so for all our clients in 2020. The going was tough, particularly at the end of March. However, as of now, our losses are small or manageable (we are up another 2% across most accounts since the end of May).

Accounting for the inevitable bumps along the way, these losses should be erasable by the end of the year or earlier.

Thank you for your continued trust.

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