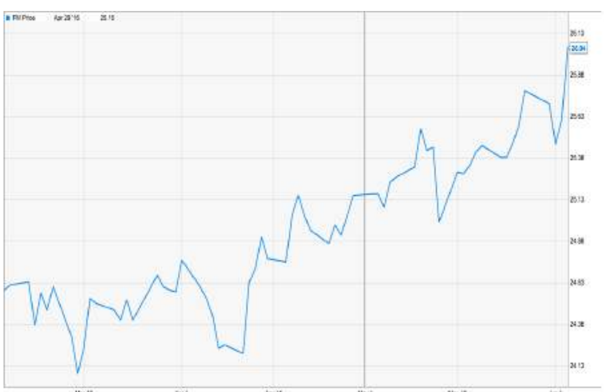
FLEURUS INVESTMENT ADVISORY

June 4, 2016

Overview

In May, the S&P's 500 total return index rose 1.79 % while the small cap Russell 2000 gained 2.25%. This compares to losses of -1.34% for international developed markets (EPAC BMI index) and of -3.73% for emerging markets overall (MSCI EM Index). The discrepancy between US and international markets resulted principally from the sharp appreciation of the USD against most currencies. It put a downward pressure on non-USD assets and particularly emerging market equities. Interestingly enough, while a strong USD is generally accompanied by declining commodity prices, this did not happen in May. The DJCI was essentially flat during the month. Also noteworthy is the performance of Frontier Markets, a subsector of the emerging markets. They managed to gain a little over 2.19% as illustrated below:



This could be indicative of the fact that the negative and up to now fairly strong correlation between the USD and commodities and emerging markets may be weakening. The implications could be positive for those investors with broad geographical diversification.

Our four model portfolios rose from .62% to 1.85% during the month. Year to date (YTD) they are up from 1.82% to 4.22% net of fees. This compares to a performance of 3.22% 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

The chart below compares the performance of USL (blue line), an ETF that is designed to replicate the performance of oil prices, and that of USDU (orange line), an ETF that tracks the performance of the USD against major currencies. The period illustrated is from May 3 to June 3.

Clearly, the rise of the USD in May (over 3% as measured by USDU) did not prevent oil prices from shooting up close to 9%. In addition, we mentioned earlier that the strong USD did not prevent some emerging markets indices from rising significantly also.

Why does this matter? Well, it could give the Federal Reserve more room to manoeuver. Clearly, if the USD goes up because markets anticipate an increase in the general level of interest rates AND this does not automatically send the rest of the world equity markets careening downward, the Fed will have one less problem to worry about.

In the context of relatively good economic numbers in May, this is not without consequences and increases the odds of a rate increase pretty soon. My guess is that the Fed will move in July, unless our British friends decide to leave the EU. The vote will take place on June 23.

The weak unemployment number released yesterday for the month of May adds to the odds of a delay in the Fed's decision. In my estimate however, it will take a series of poor economic data releases, not just one, to derail a rate rise or two before the year-end.

Tilts and Allocations

In May we continued to reduce our USD long positions by selling most of our USDU investments. We think that the USD will not materially increase from here on, unless a major economic or geopolitical event causes investors to seek the refuge of US shores.

We maintained our long position in the Russell Small Cap index (using VTWO) after concluding, at the end of March, that the performance gap with the S&P's 500 was particularly wide and likely to shrink. It has done well for us over the past two months. The Russell Small Cap Index bounced up 3.84% since compared to 2.29% for the S&P's 500 over the same period. Since this spread tends to be highly volatile, we most likely will reduce our small cap position shortly.

We sold some of our holdings in the financial sector after they had risen 30% from their February nadir. Should they reverse the price action of this past Friday session where the sector dropped close to 3%, we will close these positions in June or July.

Finally, We continued to invest in FTGC, an ETF with 54% exposure to the agricultural sector. As I indicated in my previous newsletter, the historic price decline of the commodities sector over the past few years may be over with and we continued to gain exposure to the sector, using strict asset allocation parameters that fit each of our client's risk appetite.

Conclusion

US equity market investors are cautious, even pessimistic. Outflows from equities into bonds continue. The US economy is growing slowly. Corporate earnings are declining. Plenty of industries are experiencing significant drops in revenues. Internationally, China remains a bubble-in-the-making concern and European growth a perennial disappointment.

If you are a habitual reader of this newsletter you are familiar with the chart above. It represents the price action of the S&P's 500 over the past year. The yellow line is that of the 200-day moving average and the blue one that of the 400-day moving average. When the yellow line crosses the blue line, in a downward fashion, as it did around March history tells us that bad things are more likely to happen than not. That chart remains ominous and it will take another few months for the 200-day moving average to catch up to the blue line, if all goes well! There are clearly plenty of reasons to be cautious and to believe that a market correction might be around the corner.

Yet painful and major corrections tend to occur when most investors are optimistic and pouring into equities. We are not there! I do not see euphoria around me. Perversely, I find myself oddly upbeat. Perhaps because this is a market that offers opportunities, particularly on the international side and in many industrial sectors that have been battered. Additionally, the Fed's attempt at normalizing its monetary policy is commendable. There will be volatility around each of their meetings/decisions but the path they have set is the correct one.

The next twelve months are likely to be bumpy. Perhaps bumpier than the past twelve months and the ride was not that smooth!

That said with meaningful liquidity in all portfolios, we remain ready for whatever the market has in store.

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

Thank you for your trust and best regards.