



## Overview

In February, the S&P's 500 total return index lost .13%. This compares to -1.87% for international developed markets (EPAC BMI index) and to a largely flat performance across emerging equity markets. Major international equity markets remain in bear territory. The US markets have so far avoided this fate, with the exception of the Small Cap sector that is still down about -21% from its previous top reached in June 2015.

In February our four model portfolios shrunk from -.50% to -.85%. We were hurt by our international diversification, particularly by our allocation to developed markets (Europe and Japan). Year to date (YTD) our portfolios are down from -2.0% to -4.75%. This compares to a performance of -2.0% 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

As of this writing, the overall economic picture remains rather complicated.

On the one hand, recent trading sessions have confirmed a greater appetite for risk taking, across markets. The US High Yield and commodities sectors started stabilizing in January. These trends continued in February. The high yield sector was marginally up (+.4%) while oil prices moved sharply up after touching what looks like a bottom for now at the mid-month mark.

On the other hand, some market indicators remain disturbing to us. The chart below depicts the price action of the S&P 500 index over the past twelve months. The Orange line represents the 200-day moving average (200 MA). The Blue line represents the 400-day moving average (400 MA).



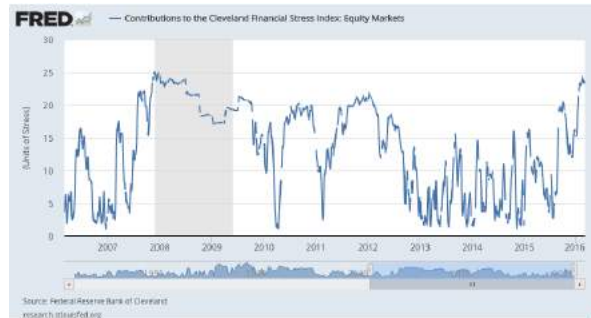
For the first time in close to eight years, the 200 MA has crossed the 400 MA, on the way down. The last time this happened was in mid-2008. When this price pattern develops, technical analysts refer to it as the "death cross". Dramatic enough!



A chart is only that, a chart. It is possible that we are in a period more reminiscent of 2012 when the two lines briefly touched (vertical line). That said, prudence remains the order of the day, all the more as the Fed's overall financial stress indicator, pictured below, does not look particularly encouraging,



and its equity market stress indicator looks really alarming.



## **Tilts and Allocations**

Where does this leave us?

It is impossible to say whether equity markets will correct by another 10% or 20% in the next six months, a scenario that our first two charts support, or whether they will stabilize further as emerging equities, high yield bonds and commodities continue to improve. I give the negative turn of events a subjective 25% probability. Not an insignificant number, but not our base scenario. A volatile and somewhat range-bound market is more likely over the foreseeable future, for a variety of reasons that go from contradictory central bank policies, generally low or stagnating economic growth in various regions of the world, uneasy currency markets, low oil prices, US politics and Brexit, to name a few.

When markets behave as unpredictably as they have recently, we tend to refrain from any significant buying or selling, unless we perceive excess, in one direction or another. We felt the market was overreacting by mid-month when financial stocks declined, sometimes by more than 20%, on renewed fears of asset write-downs (loan losses) and anemic economic growth. We took advantage of this situation and bought a battered brokerage stock we are particularly familiar with. We generally prefer to buy ETFs to single stocks. But unusual circumstances call for flexibility and the decline of the stock of this otherwise good company was too much for us not to try to profit from. It has proven lucrative so far.

Other than for this limited investment action, all our broad sector allocations remain unchanged. We maintain a cautious posture overall, with below average equity exposures and ample amounts of cash or quasi-cash in all our portfolios.

## **Conclusion**

In market parlance, a Black Swan refers to a totally unforeseen event, not factored in probability and risk models, which causes markets to react violently. The event is subsequently rationalized and viewed as predictable, although it was not.

I have the feeling that the current US political climate is so extreme that it may contribute to the development of a black swan. When strident rhetoric, uncivil behavior and generally divisive discourse are added to an already complicated economic environment, the odds of an unpredictable and violent market adjustment increase.

Whether a black swan is in the making or not is difficult to say. What I think it is fair to say is that the next few months have the potential to be particularly bumpy. It is likely that volatility will persist, if not increase, and with it the chances for significant losses and for profitable buying opportunities.

This is a challenging market environment that we are well equipped and positioned to exploit. We look forward to the opportunity of doing so on your behalf.

As always, we encourage you to send us your comments and questions.

Best regards to all.