FLEURUS INVESTMENT ADVISORY

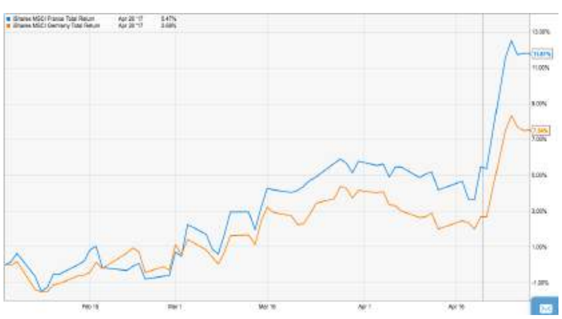
May 2, 2017

Overview

In April both the S&P's 500 total return index and the Russell Mid-Cap index rose by a little over 1%. The Small Cap Russell 2000 caught up a bit with its larger brethren and rose by 2.54%. The Barclays US Bond Aggregate index was up 1% and the Bloomberg High Yield bond index by 1.14%.

Overall, performance was higher internationally with the EPAC BMI index of developed economies rising 2.41% on the back of a strong European finish in France in particular, following the first round of voting in the presidential election there. Emerging markets had another robust performance with the MSCI EM index up 2.20% and 14% Year To Date (YTD)

Below is a chart showing the YTD performances of two ETFs that we use to allocate to French and German equities. We have consistently added to our positions since the beginning of the year on the rationale that those economies were on the mend and that claims of the impending demise of the European Union were exaggerated. The vertical line marks the date of the French vote.



In April, thanks to our international allocation, we outperformed our US benchmark. Our client portfolios rose between 1.30% and 1.80%. YTD these accounts are up between 5.70% and 6.97%. This compares to monthly and YTD performances of 1.15% and 4.61% 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 period.

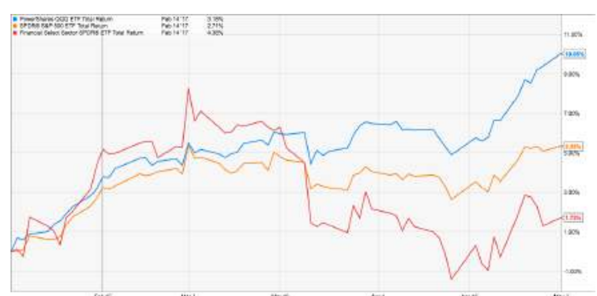
As a reminder, our allocation to equities currently varies from a minimum of 30% to a maximum of 60%, depending on the risk profile of each client.

Market developments

Most of the market action this month was connected to political developments. On April 10, President Trump talked the USD down to support the Administration's trade posture, providing some additional uplift for emerging market equities. A bit surprisingly, the use of military power shortly thereafter and successively in Syria and Afghanistan did not rattle the markets. Neither did the heightened rhetoric with North Korea.

In an unusual turn of event where European developments lead US markets and not the other way around, US equity markets went up about 1% on the news of the result of the French first round of voting. The S&P's 500 ended up the month of April on that higher note.

Other than for the previously mentioned effect of European electoral developments, US equities markets have stayed level for the past two months. However, while index levels have remained generally flat, under the surface, sectors have fared differently, as illustrated in the chart below:



Over the past three months QQQ, the ETF that tracks the Nasdaq Index, is up 10%, the SPY that tracks the performance of the S&P's 500 is up 5% and XLF, the ETF that tracks the performance of the Financial sector a meager 1.73% in comparison. These are significantly different performances. From a sector allocation standpoint, it looks and feels like the market is back to "pre-US presidential elections" conditions.

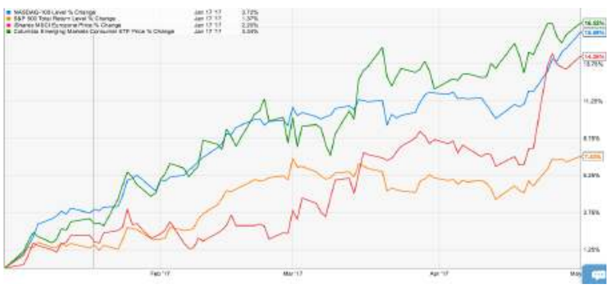
Meanwhile, with 58% of first quarter earnings reported as of April 28, year-over-year earnings growth is 12.5%. If this rate of growth holds, it will be the highest since 2011 and will provide some comfort to those investors, including this one, who remain suspicious of the rationale behind current US stock valuations.

Tilts and allocations

In April we added to our Eurozone equity markets positions. Specifically, we bought more EWQ and EWG, the ETFs that track the performance of the French and German equity markets, respectively. Both markets went up by 5% to 6% during the last days of the month. Another bounce upward of that magnitude is unlikely after the second round on May 7. The anticipation of a Macron victory is high and most probably completely priced in. On the other hand, a surprise Le Pen victory would cause all those gains to be reversed and possibly more.

British betting brokers put the odds of a Le Pen victory at 11/2 (you bet $2 to win $11) and of a Macron victory at 1/9 (you win $1 for betting $9). Let's hope their odds are validated on May 7.

Our outperformance since the beginning of the year is directly tied to two factors: 1) Our international equity allocation, 2) A US equity allocation that tends to be growth and tech oriented. Both sectors (international and US tech) have outperformed major US indices as shown below.



The S&P's 500 Total Return YTD performance is represented by the orange line (up 7.53%). The three other lines are respectively that of the Eurozone ETF EZU (red-up 14.28%), the Nasdaq 100 (blue-up 15.89%) and finally ECON, the emerging market ETF that we favor (green-up 16.52%).

These trends will reverse, at some point. For now we do not see a catalyst for a reversal and we expect more of the same over the next few months. Consequently, we plan to maintain our current international allocation at anywhere from 35% to 45% of our total allocation to equities.

A sudden and significant appreciation of the value of the USD against other major currencies would prompt us to revise our posture. This is not in the interest of the Trump Administration and, barred a military escalation in North Korea or elsewhere, unlikely.

As an aside, our current allocation to international equities is slightly below the weight that non-US equity markets represent in global mark capitalization. On that basis, our allocation should be closer to 50%. In other words, at our current 35%- 45% allocation, we are still "underweight" internationally.

Concluding remarks

So far in the reporting season, first quarter earnings are good. The results of the French election next week are expected to be benign, with a likely Macron victory.

In the US volatility might rise, caused by market impatience with the Trump Administration' difficulty in passing any significant legislation. If this state of affair were to persist, I would expect a slow and possibly painful roll back of market gains rather than a sudden correction.

Overall though, and barred a geopolitical misstep with respect to Iran or North Korea, I do not see much turbulence coming our way.

This worries me a bit!

Please feel free to call me with questions.

Best regards.