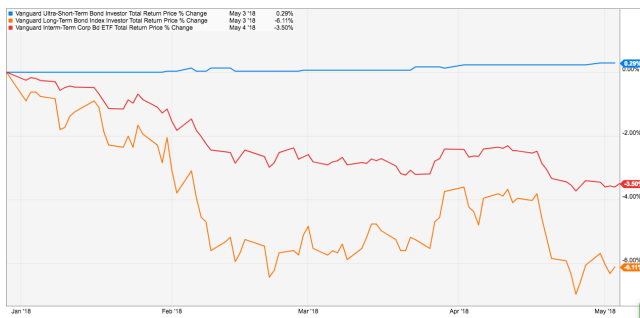




Overview

US equities were marginally higher in April. The S&P's 500 rose .38% while its small cap counterpart, the Russell 2000 rose a more meaningful .86%. Developed markets advanced decisively with the EPAC BMI up 1.72% on the back of strong performances in Europe. Emerging markets retreated .58% (MSCI EM) and Frontier Markets an even more painful 3.88%. The latter suffered from the rising interest rate environment in the US and the support it offers to the greenback. The USD rose about 1.60% against a basket of major currencies in April.

The US fixed income markets saw the long bond retreat by 1.94%, the US 10-year Treasury Note flirt with a 3% yield and the yield curve flatten a little more. Only ultra-short-term securities escaped losses. The chart below shows how various parts of the US fixed income markets have fared since the beginning of the year.



The Blue line shows the performance of VUBFX (up .29% YTD) This Vanguard fund invests in "Ultra Short" securities under one year for the most part. The Red line is that of VCIT, the Vanguard ETF that invests mostly in intermediate corporate bonds with an average maturity of 5 years. It is down 3.50%. As for the Orange line, it is that of VBLTX, the Vanguard fund Invested in long term US treasuries. It is down 6.11% this year. Moving up the maturity curve in the hope of getting paid a little more has been painful. Cash or quasi-cash (investments with less than one year) are the place to go these days. This is likely to remain true for as long as the Federal Reserve pushes interest rates up.

In April, our client portfolios hovered between -.68% and up .08%, net of fees. This compares to a monthly performance of -.25% for a purely US-centric portfolio consisting of 50% SPY (S&P's 500 ETF) and 50% BIV (US bond aggregate proxy), over the same period. On a year to date (YTD) basis our portfolios are down -.65% to up .35%, net of fees. This compares to a performance of -1.65% for our benchmark. As a reminder, our allocations to equities currently vary from a minimum of 40% to a maximum of 60%, depending on the risk profile of each client.

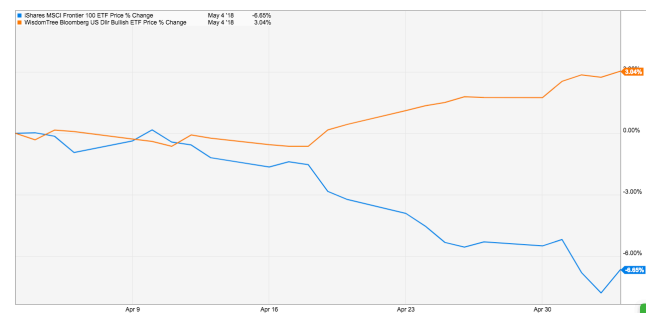
Market developments

US equities have generally moved sideways since early February, caught between the positive force of earnings momentum on the one hand and the negative force of rising interest rates on the other. The chart below is a visual representation of this state of facts. The vertical bar marks the beginning of February.



As interest rates rise, cash and quasi-cash investments become less unattractive and more of an alternative to otherwise pricey equities. That's a strong headwind. At the same time that the market fights this negative force, earnings have increased 24% this past quarter when compared to the same quarter last year. This is a very significant positive for equities. Why is this not translating into more of an uplift for equities? My guess is that, for now, investors treat this earnings uptick as a temporary situation caused by the new tax law. If it were to be sustained over the next quarter (results will start coming in in July), we may enjoy a nice positive bounce over the summer months.

In the meantime, the rising interest rate environment is causing the USD to go up and emerging market equities to suffer. Below is a chart of USDU, an ETF that tracks the value of the USD against that of its major trading partners (orange line) and FM, the ETF that tracks frontier markets (blue line). The negative correlation over the past thirty days is clearly noticeable.



Tilts and allocations

Sometimes, the hardest thing to do when it comes to Investing, is to do nothing. That is precisely what we managed in April. We saw no compelling reasons to alter our investments, other than for minor recalibrations here and there.

As long as the market remains caught in this tug of war where the negative pressure from rising interest rates is essentially counteracted by positive earnings growth a decisive market move in either direction is unlikely.

Of course, things will change eventually.

A spike in inflationary expectations could spook the markets. A slow down in economic activity triggered by negative developments in the current trade talks between the US and China or more geopolitical strife could all contribute to a more pronounced negative turn. For now though, altering our investment posture based on these potential developments would be largely misguided. We maintain substantial reserves of cash and quasi-cash investments to take advantage of a sustained downdraft, should it occur.

Concluding remarks

The P/E ratio for the S&P's 500, based on 12-month forward earnings projections, is 16, as per Factset, the equity research company. This is below the five-year average and above the ten-year. Equities are currently over-priced but not that much. This is encouraging.

Additionally, the positive growth in earnings has been accompanied by significant increases in revenues across most sectors in the S&P's 500. In other words, companies are selling more "stuff" and making more money. So, perhaps the earnings bounce in the first quarter has more staying power than initially thought. If that is the case, we could see a positive momentum reassert itself in the not too distant future.

Except for the potentially disruptive effects caused by the never-ending drama at the White House and/or an abrupt move in interest rate expectations, investors could be positively surprised by the direction of this market going forward. The numbers remain pretty positive and could justify another move upward in the not-too-distant future!

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

Cordially,

Jeff de Valdivia.