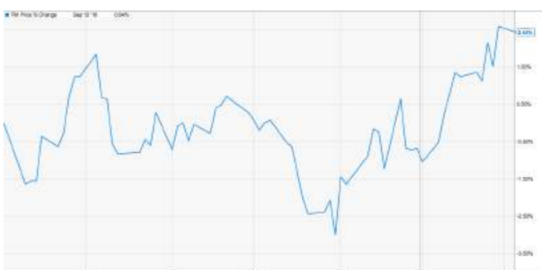
FLEURUS INVESTMENT ADVISORY

October 4, 2016

Overview

In September, the S&P's 500 total return index was flat while the small cap Russell 200 climbed 1.10%. This compares to a positive performance of 1.24% for international developed markets (EPAC BMI index) and 1.28% for emerging markets (MSCI EM). Commodities were up 3.45% as per the Dow Jones Commodities Index. Fixed income securities hovered between slightly negative and slightly positive, with the exception of the US long bond that dropped by 1.74%.

September was a volatile month for US equities but nevertheless ended up flat overall. Positive developments for investors came mostly from international equity markets and commodities. It paid nicely to have a bit of exposure to Frontier Markets. Below is the chart of FM, the ETF we use to gain exposure to the sector.



The vertical line indicates the beginning of September. This ETF was up 5.77% during the month, in good part due to a nice jump in the price of oil. The chart also shows how volatile that investment vehicle can be.

In September our client portfolios rose from .60% to .70%. Year to date (YTD) our internationally diversified portfolios are up from 4.90% to 7.81%, net of fees. This compares to YTD performance of 6.10% 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

As one can tell from the chart below, the S&P's 500 moved quite a bit in September to end up where it had started. SPY, the ETF proxy for the S&P's 500, did not go anywhere, but not before giving investors some excitement.

The heightened volatility started on Friday September 8 with a sharp drop resulting from the Bank of Japan and the ECB hinting at reducing or slowing down their asset purchase programs. Markets recovered partially in the next sessions after digesting the news. The next spike was around September 19 when talks of a possible OPEC agreement on limiting oil production first surfaced. Finally, the zigzagging of the last trading sessions of the month was either a function of the changing market views on the credibility of the OPEC talks and/or rising anxieties about the solvency of Deutsche Bank (DB).

Talking about DB, I do not believe that their difficulties announce another Lehman. As far as I am concerned, their problems have as much to do with a tit for tat between the EU Tax authorities and the US Justice Department (DOJ) as they have to do with real financial stress at the large European bank. "If you (EU) are going to slam Apple Corp. with a $14 billion tax liability, how about we (US Justice Dept.) make DB kneel with the threat of a $14 billion fine for their involvement in the 2008 mortgage debacle". The Apple tax "problem" first surfaced on August 31. It took the DOJ less than ten business days to answer in kind with an equivalent fine for DB. It is hard for me to believe that the two events are unrelated.

As of this writing, the $14 billion DB fine is about to morph into a $5 billion fine. Large but not un-manageable. In the not-too-distant future, I would not be surprised to read that the EU is coming back with a similarly reduced tax liability for Apple Corp. That said, a large European bank "in the ropes" is a cause for concern, if only because of contagion risk. This is worth monitoring attentively.

Tilts and allocations

The increased market volatility in September caused us to trim some of our allocations, particularly to the REITs sector. We raised cash and have kept the product of these sales invested in short term US bonds., ahead o the US presidential elections. We anticipate doing much of the same in October.

Markets do not like uncertainty, or at least they do not like too much of it. When it comes to the US presidential elections, no matter what one's politics, I believe that it is fair to say that Donald Trump is more of an "uncertainty" than Hillary Clinton. Accordingly, I believe it is reasonable and prudent for investors to marginally increase their cash positions ahead of this particularly unusual election.

Coming back to market fundamentals, equity valuations remain elevated. Third quarter earnings will be released within a few trading sessions and, based on analysts' projections, continue to drop on a year-on-year basis.

On the other hand, the economy continues to chug along, employment remains sturdy and wage growth reasonably encouraging. In this ambiguous environment I find the chart below somewhat comforting:

As of Friday September 30, the 200-day moving average of the S&P's 500 (orange line) crossed, on the way up, the 400-day moving average (blue line). This is a bullish signal. If this situation persists for a few trading sessions and more, it will give us another reason to remain optimistic about the next two to three months. As I have written in earlier market newsletters, graphs do not generally give unequivocal buy or sell signals (at least not as far as I am concerned) but they do inform investment decisions.

In the context of a "not-so-bad" market and economic environment, this graph provides another reason to believe that this (very long) bull market is not over yet.

Conclusion

The first nine months of 2016 have been volatile and investors have had many opportunities to lose money, particularly those investors whose emotions wax and wane with the Dow and CNBC's reports. On the other hand, those who have remained calm or blissfully ignorant of markets altogether have been able to enjoy a reasonable return.

Absent a geopolitical event of some magnitude, coupled with a suddenly deteriorating economic environment, equity markets may offer us another 2% to 3% of upside between now and the end of 2016.

I will vote for that!

Thank you for your trust.