MONOGRAM

NEWSLETTER *January 2017*

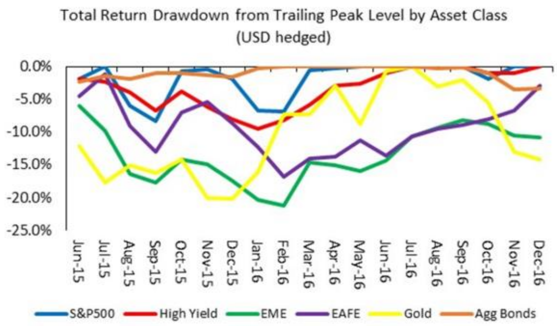
The Fund returned +0.96% in December taking its year-to-date performance to -1.90%.

Review of 2015 and 2016

The chart shows the Total Return Drawdown (from the trailing peak level) for the major asset classes held, or potentially held, in our strategy: Chart 1 starts from mid-2015 and runs through the end of 2016 and illustrates perfectly the source of the lagging performance of our strategy (and, incidentally, also that of many of the systematic strategies we track) in this period: of particular interest is the Drawdown profile for the S&P500.

The S&P500 suffered two sharp drawdowns in this window, 8.4% in September 2015 and 6.9% in February 2016, both followed by relatively rapid recoveries.

Chart 1



The Drawdown of Emerging equities hit 20% in January last year and that of Developed ex-US equities hit 17% in February. Gold hit a 20% Drawdown and High Yield a 9% drawdown also in the early months of last year.

As a matter of interest, at the close of 2016, only the S&P500 and US High Yield, of the assets shown, were not in drawdown at year-end.

As a reminder, our strategy is systematic and based upon slow moving signals, which eradicate the decision-making errors so very well documented in the literature on the psychology of decision making (particularly, but not exclusively, the work of people like Daniel Kahneman and Amos Tversky) and better enable us to extract the signal from the noise of market prices. Based upon extremely well documented measures of both absolute and relative momentum (the former to mitigate much of the cyclical drawdown risk and the latter to enhance returns), our strategy is designed principally to generate returns across the course of a full cycle with substantially less portfolio drawdown. By their nature, the measures we use are relatively slow moving; they must be, in order to determine trend from noise.

This takes us back to Chart 1 and the two instances of US equity market drawdowns in late 2015 and in early 2016. In both cases, and based upon the experience of multiple market cycles in centuries of data, the apparent trend in US equity returns (and by default that of other risky asset classes) turned negative.

As expected, our strategy recommended an exit from the equity market in both instances. However, and here is the key point to note, not all apparent trend changes of course become real trend changes, although the majority do, and the market rebounded very sharply in both instances. Of the 12% total return for US equities in 2016, for example, 7% points of that came in March 2016 alone! You can see that the slide into drawdown was gradual but the recovery steep. So, if you were prudent - based on strongly supportive empirical evidence - and cut risk but did not reinvest very sharply, then your performance suffered. That was the case for our strategy, and for many systematic strategies we monitor. We, and they, paid the price for prudence. Given the slow-moving nature of our signals, we did not re-enter equities meaningfully until later in 2016, by which time the bulk of the return for the year had been recorded.

We would, in similar circumstances, exercise precisely the same prudence.

Besides that central element, our position in Gold cost us later in the year, particularly after the US elections when the US Dollar strengthened: Gold serves as a useful systemic credit hedge in a portfolio and perceptions of credit risk dissipated after the election. Gold fell 8% in November, rising 10% in February, for comparison, and had a positive year but fell modestly from our entry point in the late Spring/early Summer.

Our position in High Yield debt contributed positively to returns, as did our holding of Investment grade bonds.

All in all, it was the loss from our equity position in the early part of the year, which was not subsequently recovered, that dragged on performance.

The Year Ahead

Having reached the end of another eventful year and looking at the state of global markets and economies we can see significant similarities to the beginning of last year especially regarding the key issues in the minds of investors.

Just like this period last year, the Fed has just tightened policy and China is still fighting against the depreciation of their currency. To these two themes, we add the re-emergence of protectionism after the election of Donald Trump as the 45th President of the US, the implications of Brexit for the UK's currency and economic prospects and the state of global economic activity.

Starting with the last theme, 2016 saw a marked rebound in global activity that is expected to continue in 2017. Economists in research departments across investment banks forecast that the global economy will continue to grow at a pace closer to the top end of the range seen over the recent past. The US is leading the pack and expected to grow between 2% and 3%, which is close to its steady state growth rate.

This view links well with the tax reform, fiscal easing and infrastructure spending that the Trump administration has announced that will commence early in their term and will be supportive of growth.

In the EM world, China is expected to achieve its short-term goal of 6.5% growth but this is balanced by the necessity to solve its longer-term structural imbalances, with particular focus on the exceptionally high level of credit growth, and the liquidity problems that this may create in the banking sector. Within EM, we see gradual improvement in the commodity producing economies after the pain they experienced in 2015 and the beginning of 2016 while we do expect a slowdown in India due to the currency reform that the government has decided to embark on.

The two main downside risks to growth prospects for the world economy and EM in particular, are a return to a tighter credit control in China and the intensification of capital outflows as a result of an aggressive tightening in Fed policy and the consequent dollar appreciation.

As far as Brexit is concerned, the commitment of the British government to follow the "hard" path can have an uncertain effect on the country's currency. The picture is muddled even more after the recent decision by the Supreme Court that parliamentary approval should be sought by the government on its strategy for leaving the EU. Some believe that the worst is already priced in and that a recovery is now due on the back of stronger growth and improved labour market conditions.

Others see further depreciation of the GBP as a natural consequence of the harder stance the government has decided to follow in drawing the course of exiting the single market. It is extremely hard to foretell who is right as trying to come up with a valuation for the currency based on fundamentals can lead to a wide margin of error.

Turning to the new US administration and their move towards protectionism, two trade deals have been scrapped (the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership) while a third one (Nafta), will be renegotiated. The short-term objective of boosting employment in less competitive sectors of the US economy will be undoubtedly achieved, creating jobs and higher income in areas where previously it was economically more sensible to use other countries' comparative advantage.

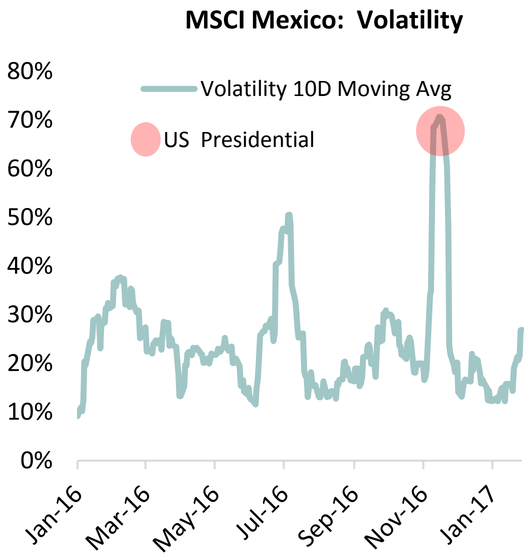
However, this will delay the transfer of resources to sectors where the US does have a comparative advantage and ultimately hamper the path to economic growth. These sectors rely on technology, highly skilled workers and access to materials that can be produced at a lower cost in other countries. The last prerequisite cannot be satisfied under trade wars and if one takes into account the decrease in the demand for American products as a result of counter measures, the long-term prospects for US employment cannot be positive.

The effects of the above themes and especially of the current state of the global economy on investors' portfolios are difficult to assess. The forward-looking nature of financial markets means that the good news regarding the world economic growth has already been priced in and was reflected in the equity rally that occurred during the fourth quarter of 2016.

We have gathered historical valuation data for the US in Chart 2 (on page 4). Here we can see that from a valuation perspective the US market looks very similar to the pre-crisis period, irrespective of the method used. Having reached such valuations levels, small and otherwise insignificant news will have a disproportionate effect on asset prices.

We expect this sensitivity to news to be more pronounced in markets that are most directly affected by the themes we mentioned in our previous analysis. UK-related assets, and predominantly the GBP, will be vulnerable to changes in market perception regarding the course of the exit negotiations. Trade partners of the US and especially those in the EM world, which are financially more fragile, will experience higher levels of volatility in their assets as long as uncertainty over trade relationships hovers over (see Chart 3 on the effects on the Mexican equity market), while small deviations of economic data from expectations pointing to mid-cycle slowdown will lead to swift corrections.

Chart 3



Hence, in our view, risk management and diversification are going to be the main drivers of performance. In particular, managing volatility will be the key issue in both generating returns and preserving capital, and we believe that our asset selection and allocation processes will be effective on both.

Their focus on monitoring both absolute and relative risk-adjusted performance, over sufficiently long periods of time, makes them immune to short-term whipsawing behaviour of asset prices, while rewarding smoother performance. At the same time, we are looking to increase our diversification by expanding our universe of assets.

In the meantime, we remain fully allocated to US equity, driven by robust absolute and relative momentum against the backdrop of elevated valuation, to high yield and, for the time being, to Gold as a crisis hedge.

Chart 2: Valuation metrics, S&P 500

Equity peak	*Worst* P/12m Trailing Reported Earnings (1880-)	P/12m Forward Operating Earnings (1955-)	CAPE (1880-)	P/Peak E (1880-)	NFC Corp Tobin's "Q" (1951-)	MC/GDP (1951-)	*Best* NFC MC/GVA (1951-)	*median*	NFC Credit / GVA (1951-)
Dec-61	98%	91%	96%	100%	100%	100%	95%	98%	80%
Feb-66	81%	57%	98%	95%	96%	88%	82%	88%	68%
Nov-68	88%	40%	98%	97%	100%	100%	100%	98%	99%
Jan-73	87%	94%	90%	96%	69%	55%	59%	87%	86%
Sep-76	76%	0%	60%	57%	17%	10%	15%	17%	75%
Nov-80	14%	12%	41%	35%	20%	19%	22%	20%	61%
Aug-87	98%	93%	93%	100%	61%	57%	58%	93%	100%
Jul-90	75%	56%	88%	82%	45%	26%	31%	56%	100%
Jul-98	100%	100%	100%	100%	96%	98%	98%	100%	94%
Mar-00	99%	98%	100%	99%	100%	100%	100%	100%	99%
Oct-07	86%	78%	95%	90%	72%	93%	95%	90%	99%
Apr-11	65%	48%	90%	78%	87%	87%	91%	87%	86%
current	89%	90%	91%	96%	85%	96%	96%	91%	100%

Source: Datastream

Note: As valuation methods go, on the left (worst) side we see the two metrics that seem most popular with market analysts - despite their having the lowest correlation to forward returns (hence the labelled, worst) - valuation versus the last 12 months of *Reported* and the next 12 months of forecast *Operating* earnings. On the right (best) we show the metrics that have the strongest, most consistent, correlation with forward returns – *Market Capitalization versus GDP* and *versus Gross Value Added* (Revenue). The first thing that stands out is the 2000 bull market peak: on every measure, even the worst ones, the S&P500 was at or very close to its 100th percentile, or record valuation, only the 1961 peak gets anywhere near. The 2007 market peak was very stretched on the better measures and today we see that valuation is exceptionally high, again, on practically every measure of valuation

About MONOGRAM

MONOGRAM Capital Management is an investment boutique founded in 2014 and headquartered in London. The management team has over 55 years of investment management experience, having met and worked together at Goldman Sachs before holding leading investment positions at other institutions.

We take an innovative empirical, evidence-based approach to investing and believe there are fundamental, identifiable, persistent, and exploitable sources of return; risk is the permanent impairment of capital (peak-to-trough drawdown) and not volatility in its various forms.

There are two options for investors to access MONOGRAM's investment strategy. Investors can invest in the Luxembourg Domiciled MONOGRAM Fund or in MONOGRAM's bespoke segregated managed account, provided the investors meet the minimum subscription requirements. Further details are contained in the subscription documents to the fund.

For further information on MONOGRAM or to invest, please contact Milena Ivanova on milena.ivanova@monograminvest.com or +44 (0)7931 776206.