NEWSLETTER *August 2016*

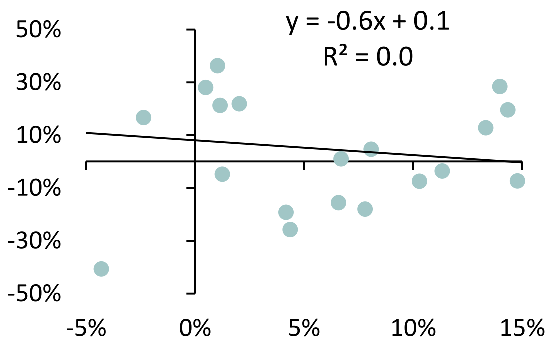
The Fund returned net 0.38% last month, bringing year to date returns to net 0.25%. For the month, the Global Equity Index (in Local Currency terms) returned 4.1%, EAFE (Non-US developed Equities) gained 4.8%, the US Aggregate Bond Index returned 0.5% and Gold gained a further 2.1%. Even Emerging Markets got in on the act, rising 4.3% after a 1.7% gain the previous month: Emerging market equities are now up 14% from February's low, having lost 19% in the prior 10 months. Momentum, a key driver of returns over shorter and intermediate horizons, remains mixed but in many cases improving.

Although Emerging Equity absolute (modestly positive) and relative momentum (firmly negative) remain unfavourable, the material improvement in recent months certainly merits investigation. At the outset, it is worth noting that, of all things, we attach least importance to the absolute and relative economic growth prospects for the Emerging Markets when considering their attractiveness. Almost all arguments in favour of EME seem to be based upon an emerging middle class, faster population growth and faster economic growth.

In short, you have to be where the growth is, and growth isn't, and won't be, in the advanced countries, according to EME cheer leaders. If that's the case, we should see in the historical record a clear and positive link between absolute EM growth and absolute market returns and between relative EM growth and relative returns. Sadly, on closer inspection, neither of those relationships are remotely evident. Whatever drives absolute and relative EME returns, it does not appear to be economic growth!

As we show in Chart 1, there is no relationship between the "growth gap" (Emerging Market GDP growth less Advanced Country GDP growth) and the "return gap" (EME returns less Advanced Market returns):

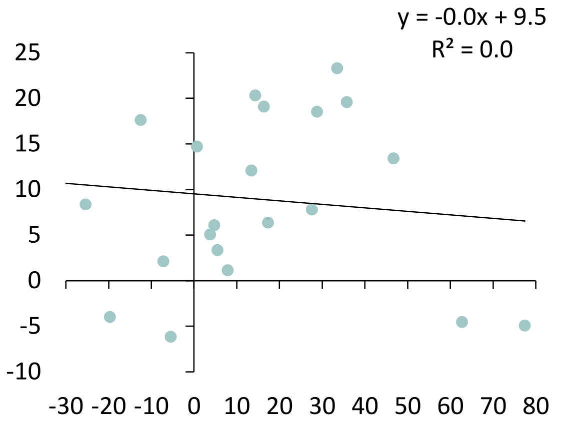
Developing Country Nominal GDP Growth less Advanced Country Nominal GDP Growth (horiz axis) vs MSCI Emerging Market Equity Index Nominal Return less MSCI World Index Nominal Return (Local Currency, vert axis) : 1994-2014



Put simply, just because you expect Emerging Market economies to grow faster than the Advanced economies, do not expect them to produce superior equity market returns.

Just looking at absolute EME returns versus EM GDP growth gives you exactly the same picture, shown in Chart 2:

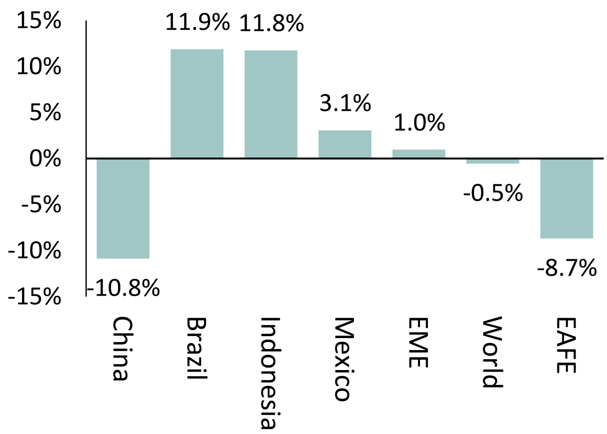
Emerging Country Annual Nominal GDP Growth [% vert axis] vs MSCI Global Emerging Market Equity Index Annual LOCAL Currency Nominal Total Return [%, horiz axis] : 1994 - 2014



Delving into individual countries, you see no positive relationship between GDP growth and equity returns in either China, Brazil, Indonesia, Russia, or India. The reason? Quite simply, economic growth and growth in earnings has to be *financed*. Growth in GDP and earnings that is financed by dilutive share issuance (as is the case most often, heavily, in emerging economies) does not accrue to existing shareholders. Moreover, earnings can be dissipated in wage rises for workers or wasteful empire building by managers long before the long-suffering shareholder even enters the picture. More often than not, shareholders are at the back of the queue when the spoils are shared, which is why corporate governance, corporate financing and shareholder consideration are far more important in emerging markets than crude GDP forecasts, in our view.

Whilst absolute and relative (to the US) momentum are important elements to consider (to manage the severity of EME drawdown risk whilst capturing upside) when looking at EME, and remain unfavourable, as seen in Chart 3, broader factors need to be kept in mind.

Equity Index Momentum (%y/y)



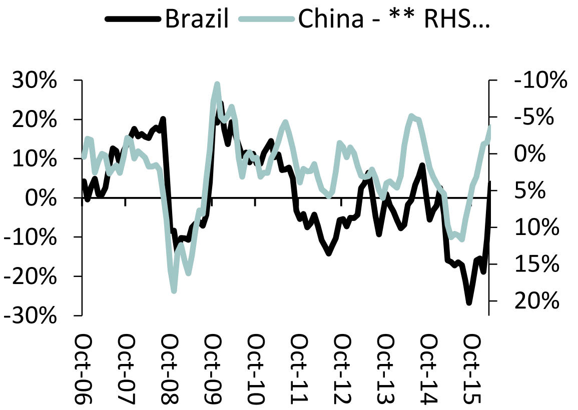
Looking at the historical experience of investors in Emerging Markets, it seems to us that Emerging Markets are most attractive when a defined set of conditions prevail, most noticeably:

- A weak/depressed economy with high nominal and real interest rates, depressed local market sentiment (cognitive dissonance)
- A depressed real exchange rate with improving momentum
- A Current Account surplus, a shock absorber for exogenous factors, a surplus of domestic savings and the accumulation of net foreign assets
- Depressed valuation and positive Implied Risk Premium, strong implied returns. Insurance against high downside beta versus the US market
- Positive market momentum

Looking around the EME world right now, Brazil hits all those targets, with Russia pretty much there as well (subject to property rights/legal concerns) and China isn't even close on most measures.

The importance of China, and the ongoing devaluation of the Yuan, is clearly evident in the relationship between the Yuan and the Brazilian Real, for example (the same applies in Russia), in Chart 4:

Real Effective Exchange Rate (%y/y): China vs Brazil

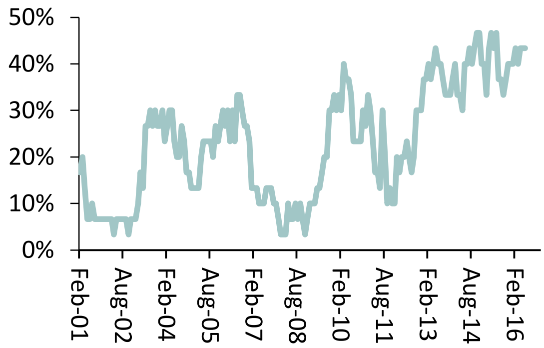


If China continues to let the Yuan slide - and we have no doubt in our minds that it will - then the Brazilian Real (from a material undervaluation) will, along with the Rouble, be a substantial beneficiary, as shown in Chart 4. A weak Yuan implies a stronger Rouble and a stronger Real as the suppliers to the world's largest exporter and marginal price setter benefit from Chinese market share improvement.

All of which brings us on the China where, a year on from a seismic but modest Yuan devaluation and just months on from early 2016 concerns, the Yuan continues to slide, apparently unnoticed or without concern, and underlying pressures continue to worsen. The injection of $1.1 trillion (yes, trillion!) in the first quarter appears to have given some temporary respite for the economy, markets and banks, but aggregate social financing ("lending") slipped away to a two year low in July, net FDI flows are now negative, net capital outflows continue apace and off-balance sheet wealth management products are exploding (approaching the $3 trillion mark). The cracks have been papered-over but they are still there and the Yuan has now fallen 6.8% against the CFETs basket (a 13 country trade basket, 26% USD weighted) this year. The Yuan has fallen 33% against the Yen in the last year and that is crushing Japanese corporate sales and earnings expectations, just as the Bank of Japan talks of the possibility of taking rates further into negative territory and squeezing all remaining life out of the banks. Implied 12-month forward TOPIX index sales growth is negative for the first time since late 2009, just as implied 12-month forward S&P500 sales growth hits a 4-year high and FTSE implied sales growth hits a near 5-year high. Japan remains a place to avoid.

Finally, with a complete absence of global inflation pressures (unsurprising given Chinese Yuan devaluation and gross over capacity), as shown in Chart 5, we continue to expect official rates and bond yields to stay very low for a very long time.

OECD data: A sample of 30 Countries [63% of Global GDP, 2013 data] from the Developed and Emerging Markets - % of Countries with Annual CORE CPI Inflation of LESS THAN 1%



As developed market yields have slid lower, changes to US money market rules (effective from mid-October) have put significant upward pressure on USD Libor (from which almost $28 trillion in debt is priced): US 3 month and 12 month Libor are up 50bp and 75bp respectively in the last year, to the highest level in 7 years. Aside from the material tightening of US policy, mitigating the need for the Fed to act, the increase in hedging costs makes US treasury debt far less attractive to foreign investors and probably goes some way to explaining the relative underperformance of US bonds. If the pressure on Libor dissipates after October we would expect bonds to respond accordingly, otherwise the effect on $28 trillion of debt should, in time, bring yields down as US growth and inflation remain, like that globally, very benign. Of course, persistently low(er) nominal and real rates means persistent pressure on the USD and good support for Gold.

Our Fund, at the end of July, remained cautiously positioned amidst a very challenging environment but, of course, as and when conditions improve we will respond accordingly.

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**.