MONOGRAM

NEWSLETTER *June 2016*

The Fund returned -1.1% last month, bringing year to date and inception to date returns to -1.9% and -5.7% (with a maximum Drawdown of -8.7%). For the month, the Global Equity Index (in Local Currency terms) returned 1.9%, the US Aggregate Bond Index returned -0.08% and Gold fell 6.0%, the latter a significant contributor the Fund's underperformance. Without wishing to pre-empt our newsletter for July, the Fund has already recovered all, and more, of the May underperformance as Gold and Bonds have rebounded strongly.

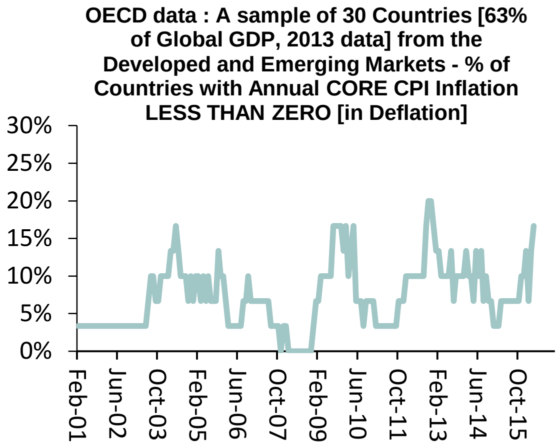
Our readers are well aware of our disdain for QE, a monetary experiment for which there is no theoretical or empirical basis and which, as we have shown in the case of Japan and its fragile banking system, actually exacerbates the strains and stresses in the global economy. An analogy drawn from biology, and the importance of another form of liquidity, "water", illustrates the case quite cogently. Water is essential for life, certainly as we know it on this planet; it functions as a solvent and delivery mechanism for nutrients into the cells that form living bodies. Perhaps less well known is the concept of "water intoxication". Yes, water has a detrimental and extremely harmful effect when over-consumed, much like the impact on the economy of over-indulgence of monetary liquidity. Electrolytes (sodium and potassium, for example), essential for nerve and muscle function and blood pressure regulation are dissolved in water inside cells in your body ("intra-cellular") and in the water outside the cells in your body ("extra-cellular"). When you over-consume water an imbalance is created, extra-cellular water has a lower level of essential solutes relative to intra-cellular water, and water is forced into your body cells to correct the imbalance. Quite obviously, forcing more water into cells causes them to expand, or swell, and that creates serious health issues, particularly in your brain where all sorts of nasty conditions can ensue! Whilst monetary liquidity is essential for the solvency and liquidity of the financial system, and the functioning of credit markets and the efficient utilization of savings, beyond a certain threshold there is a substantial risk of "liquidity intoxication". In our view, that threshold has been reached.

At the point of liquidity intoxication, the distortion to the pricing of risk, and the adverse impact on the balance sheets of banks is such that QE is actually making the situation worse, exacerbating the stresses it seeks to resolve. Beyond the point at which QE alleviates an identifiable and binding constraint, its effect is increasingly detrimental. It defies logic that anyone should argue that a shortage of liquidity imposes such a binding constraint when excess reserves held by Japanese banks (in the current account at the Bank of Japan) amount to Yen 287 trillion (57% of GDP) and reserves held by Euro Area banks in the current account at the ECB amount to Euro 635 billion (6% of GDP). Whilst we have no doubt that Japanese banks are experiencing "liquidity intoxication", as we argued in earlier letters and through our blog, it seems to us that Mario Draghi is turning Japanese and leading the Euro Area down just the same path.

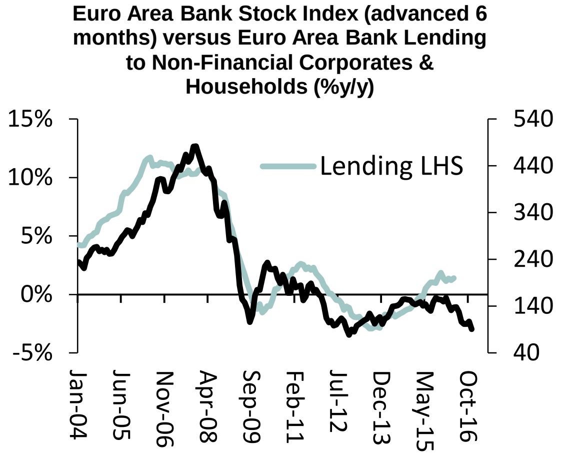
After almost a decade of monetary madness, where the major central banks have expanded their balance sheets by approximately $11 trillion and given us the lowest interest rates in over 4,000 years (yes, four thousand! See "A

History of Interest Rates" by S Homer & R Sylla) and global credit market debt outstanding has trebled to $250 trillion since the turn of the millennium, the median global real GDP growth rate is just 1.9%. What's worse is that the median core inflation rate is just 1.0%, and weakening.

We like to look at the distribution of growth and inflation, as well as their level, to get a cleaner signal, and of the 30 countries we monitor (accounting for 63% of Global GDP), Chart 1 shows a near record 17% of countries are currently in annual core deflation. In fact, a record 47% of those countries have core inflation below 1%. That is, we observe a profile of deflation/disinflation more typical of the depths of recession than the top of the biggest stimulus wave in history. By any measure, liquidity intoxication is evident.



A lack of credit demand in a region in current account (savings) surplus, in a world where investment relative to GDP is at its highest in three decades and capacity still expands, courtesy of China, at a pace in excess of global demand, should not come as a surprise to anyone. In fact, despite, and possibly because of, QE the freefall in European Bank stocks points to a severe credit crunch in the region in the second half, as shown in Chart 2:



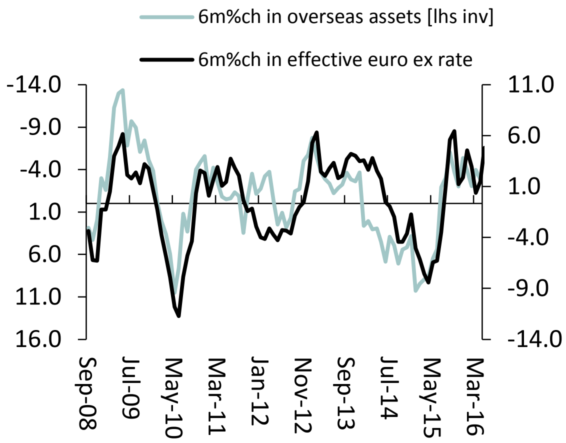
The substitution of cash (with zero or negative yield) for government bonds on bank balance sheets, which in turn have been a substitution for private sector loans, and negative German government bond yields (a weighted average Euro Area government bond yield at just 0.6%, and falling) creates a drag on banks that has no corresponding relief in the form of profitable private sector lending opportunities. Sound familiar? Yes, it's banking "Japanese style". Little wonder Deutsche Bank's stock price is at an all-time low and its credit default swap spread is widening: the ECB is pushing Deutsche Bank into inevitable German government ownership. The asset base of the major financial institutions in the Euro Area is Euro 31.4 trillion, or 3 x GDP, against 1 x GDP in the USA and almost 4 x GDP in China. Quite simply, the Euro Area banking system is far too large, far too leveraged, and struggling for profitability. The last thing it needs is more QE, negative rates and more non-earning cash on balance sheets. We are particularly worried about Deutsche Bank's leverage and that of Southern European banks and their ability to withstand another period of recession, whether brought on by BREXIT or by economic weakness coming out of China and from the USA.

Another parallel with Japan can be seen in the behaviour of the currency as bank stocks have tumbled: the effective Euro exchange rate index is up 6% in the last year as bank stocks have fallen 41%. In the same period, Japanese bank stocks have fallen 44% with the effective

Yen exchange rate index up 12%. Sinking bank stocks, sclerotic growth, disinflationary/deflationary pressure intensifying, negative bond yields (presently in Germany) and appreciating currencies. Oh, and central bankers pinning the problem down to a lack of liquidity. Truly, our grandchildren will look back at us in their history classes and marvel at the lack of wit, ambition and imagination displayed by policymakers at such a telling time. Little wonder that "populism" has found an outlet in the political narrative.

The strength of the Euro can be traced to efforts by Euro Area banks to de-leverage and shore up balance sheets against the ECBs onslaught by liquidating overseas assets (as shown in Chart 3):

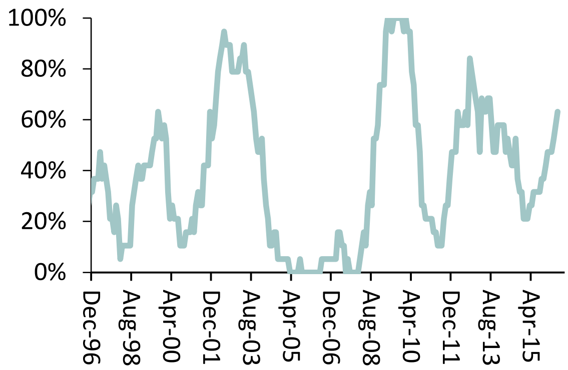
Change in Eurozone MFI Foreign Asset Acquisition [over six months] versus Change in Effective Euro Exchange Rate [over six months]



Gold, unsurprisingly, against this backdrop looks a particularly attractive asset to hold.

In a previous note we showed several charts pointing to a sharp decline in US corporate profitability (the labour share in national income rising from an all-time low as sectoral imbalances adjust and profitability responding predictably to a period of unsustainably high margins) that doesn't bode well for global markets. In Chart 4 we show how this is reflected in the proportion of the individual markets in the MSCI Global Equity Index that have declining earnings per share in the last year. Almost two-thirds of the Global Index components, 15 markets, have declining earnings whilst 19 markets have fallen in price over the last year. With falling prices and falling earnings, equities become a dividend "carry" investment: that is to say, positive returns come from dividends and stock buybacks. Equities are a very poor risk/return trade if all you have to pin your hopes to is a dividend.

23 Markets in the MSCI World Equity Index: % of Markets with Earnings per Share DECLINING Year/Year



Elsewhere, our concerns for China worsen almost weekly and we do not need to go through them again this month, whilst we see a broadening array of negative tail risks: BREXIT, Saudi devaluation risk, Euro Area banks, Japan and Japanese banks, deflationary risks intensifying, US recession risk and US political risk. Heartening then to see George Soros come out of retirement again (he last did so to profit from US mortgage shorts just before the crisis in 2008) and reduce his equity exposure substantially whilst adding Gold and Fixed Income exposure. His reasoning for doing so resonates with our well documented macro view and his positioning looks reassuringly like our own. We remain invested in cash, Gold and Investment Grade Fixed Income, with no equity exposure, with a clear defensive bias. That can, of course, change as and when market sentiment changes, but those tail risks mount and present a formidable headwind, as George would surely agree.

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.

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