MONOGRAM

NEWSLETTER ***The US is 'Not out of the Game'***

April 2017

The Fund returned -0.27% in March, bringing the year-to-date return to +3.96%. In a tempered month, Global Equity markets (ACWI) rose 1.3%, Developed ex-US (EAFE) Equity was up 3.2%, US Equity (S&P) up 0.20%, while US Investment Grade Bonds and High Yield Debt were down a modest -0.2% and Gold -0.9%.

Since the beginning of April, we have seen a dramatic about turn in US political economy on a number of fronts and these may prove to be as influential as any other macro developments which may occur in 2017.

Within one week Mr Trump, the arch political isolationist, economic nationalist, and aggressive trade re-negotiator, has turned 180 degrees with military action in Syria and the belated (but not too late) recognition that China's days as a currency manipulator are long gone. Indeed, it is becoming widely acknowledged that China's job creating investment in the US is rapidly growing (up 3-fold over 2015-6) due to simple economics: wage costs grew 15% in China last year, will continue to do so, and lead to greater relocation of economic activity.

As a further indication that volte-face is becoming the norm, Mr Trump is increasingly making less aggressive noises regarding Janet Yellen's reappointment for another term at the Fed. We think this action would be reassuring for markets in general and suggests that the pressure to politicise the central bank will recede.

It is said that 'the Donald' is most influenced by the last person he spoke to: this is the Random Walk applied to a rather broader canvas than simply asset prices and, indeed, to a rather more important context than just financial markets. But given that the US Economic Surprise index of Bloomberg and Morgan Stanley is currently running at a record high, a little bit of unexpected continuity may indeed be the most pleasant of all surprises!

In other words, we may have more continuation of both politics and economic policy than we expected a few months ago, and markets like less uncertainty.

March began with a slump in equity performance in anticipation of Janet Yellen's rate announcement. When it duly arrived and the Fed raised the US base rate by 25bps (now at 1%), the market revived only to slide once again and close down on the day. The theme which continued for the remainder of March as the Trump "reflation trade" (which relied on a boost in growth and a faster rise in US interest rates) reverted to intense selling after his Healthcare bill failed to gather support amongst his own party, casting further doubt on Trump's ability to implement the much-anticipated stimulus package.

This failure is a clear example of less change than expected by the market.

Normalisation is far from normal.

There has been much discussion about the pace of normalisation in rates: raise too quickly and risk compromising growth, yet, go too slowly and invite the threat of runaway inflation, though the evidence for the latter is still tenuous. Wages are rising faster in a number of countries but are still modest by historical standards, while employment is strong. If the trick with managing unemployment is to keep it low enough to fuel growth, but, just above the inflection point at which it sparks inflation, then things are indeed going to plan.

But what is this inflection point? First-of-all, employment (as mentioned in our last Newsletter) appears to have no direct causal relationship with inflation contrary to undergraduate economics. Modern day research, as reflected by the likes of Justin Wolfers[1] in the *New York Times*, has a more substantiated finding, positing:

[1] Professor of Economic and public policy at the University of Michigan, Ref: Why You Should Be More Optimistic About Wage Growth. Link: https://www.nytimes.com/2015/01/10/upshot/why-you-should-be-more-optimistic-about-wage-growth.html?_r=2

> "It is only when nominal wage growth exceeds the sum of inflation (~2%) and productivity growth (~1.5%) that the Fed needs to be concerned. . ."

With this in hand, we ought to remind ourselves of the policies that Trump upheld in the lead up to his Presidential victory: jobs, infrastructure spending, reforming corporate tax and reducing regulation.

Broadly speaking all of these are designed to improve productivity (supply-side) performance. Cutting regulations and reducing/reforming corporate taxes are intended to revive business investment and thus improve the economy's long-run growth potential. While there remains uncertainty over the scale and timing of the fiscal stimulus, the fact remains that it will aid productivity in the face of widespread concern over a global productivity crisis[2]. Hence, the criticism the administration faces when intent on stimulating growth to boost demand is somewhat unfounded against this back-drop.

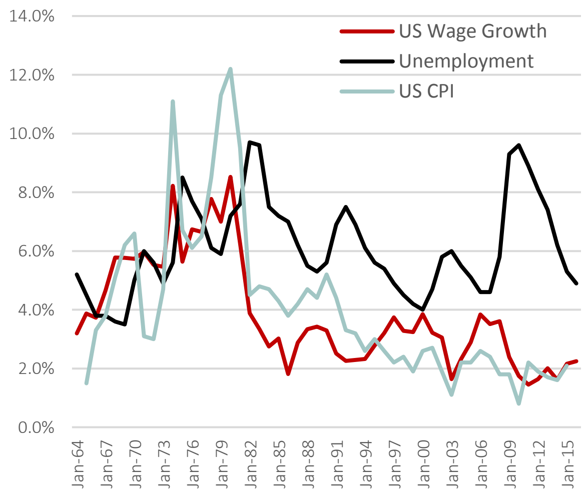
Yes, inflation is on the rise but it is too soon and limited in nature to pose an imminent threat. We will conclude this topic with two points; firstly, Chart 1 depicts how the US Civilian Labour force participation rate has deteriorated over the past decade, while the change in the demographic composition, i.e. the proportion of the workforce that has retired, only accounts for a modest change (~1% of the labour force; *US Census Bureau*). Secondly, in the past 30 years (as of the early 80s) the Fed has done a pretty good job at maintaining inflation at a respectable level – refer to Chart 2 – with much of the 90s experiencing lower unemployment coupled with rising wages (all be it modest) and lower inflation.

In summary, with spare capacity recently revised upwards in the economy, good Central Bank governance and a stimulus package that addresses both sides of the chain (supply and demand) we are hopeful on both the inflation and growth fronts, and not just in the US. Europe is looking much healthier, as are Emerging Markets.

In fact, the only cloud on the horizon is the optimistic global forecast for GDP growth put out by the IMF – with their track record in this space we should be very concerned!

Chart 1. A Decade of Declining Participation.

Chart 2. Recent history of Good Governance.



Position and outlook.

For the month of April our indicators favour US Equity, Developed ex-US (EAFE) Equity, US High Yield, US Investment Grade Bonds and Gold.

Despite our optimistic tone and being fully invested in our portfolio, we remain acutely aware that valuations for risk assets globally are at historically high levels, monetary policies are still in untested waters, and geopolitical challenges are unlikely to disappear in the foreseeable future. As always, we will be watching closely and respond accordingly as events unfold."

[2] Ref. Lagarde's IMF speech: "How to reinvigorate productivity growth, 3rd April 2017. http://www.imf.org/en/News/Articles/2017/04/03/sp040317-reinvigorating-productivity-growth

About MONOGRAM

MONOGRAM Capital Management is an investment boutique founded in 2014 and headquartered in London. 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 available on request.

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