NEWSLETTER

Market timing, so tempting… yet…

April 2018

Market overview.

The MONOGRAM fund returned -0.9% in March, bringing the 2018 year-to-date (YTD) return to -0.7% compared to -2.6% (YTD) observed on the Societe Generale Cross Asset Trend Following Index (SGIXTFXA).

In March Global Developed Equities (MSCI World Index) were down -3.0%, Non-US Developed Equities (MSCI EAFE Index) down -1.0% with the decline led by France, Germany, Japan and the UK. Emerging Market Equities were also down -3.0%, while, US Investment Grade Bonds gained 0.7% coupled with a modest gain in physical gold of 0.2%.

Global financial markets posted declines in March, causing most markets to close Q1 in negative territory, as talk of a trade war, pressured technology stocks and Fed policy drove markets downwards.

Although the focus may well have been on Facebook and other technology companies that would be vulnerable to greater regulatory scrutiny, there were other bearish forces that contributed to the falls. The market sell-off was broad-based and no region was spared.

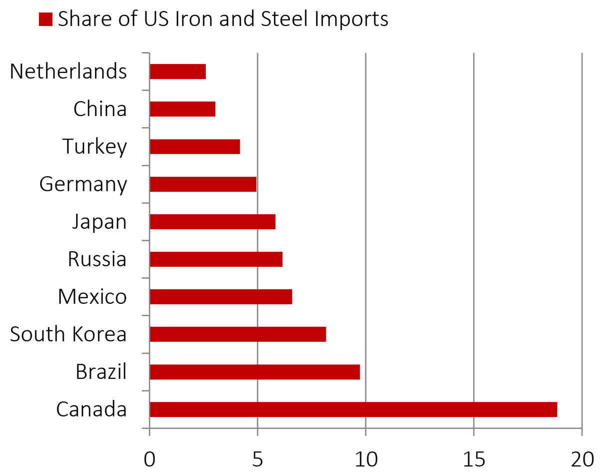
Amidst the pressure on technology stocks, and with the Cambridge Analytica scandal creating public policy waves, we saw the Fed as being modestly hawkish on March 21st and continuing its theme of raising rates by a further 25bps to 1.75%.

Talking trade war, more huff than puff.

On March 8th the US President imposed a 25% tariff on steel while also placing a 10% duty on foreign aluminium. While initially exempting only Mexico and Canada from the duties, later in the month the exemptions were extended to the EU, Argentina, Brazil and South Korea. This left less than a third of US steel imports being subjected to tariffs and significantly lowered the potential global economic impact of the tariffs, as well as, the potential help they might provide to the domestic steel industry in the US.

Extract 1: Canadian Steel Dominates. Share of US Iron and Steel Imports

The US gets almost a fifth of its steel and iron imports from Canada, a country that will be exempted from the new tariffs announced by the Trump administration.



Source: Calculated from World Integrated Trading System

Backtracking on the initial announcement, on March 22nd, the Trump administration announced revised measures targeting tariffs of up to $60bn on Chinese imports while also imposing measures to limit Chinese investment in the US in retaliation for years of alleged intellectual property theft. Markets slumped on the day with the Dow Jones, S&P 500 and Nasdaq each falling in excess of 2%. With China, in return, retaliating by imposing tariffs on 106 products imported from the US the continued rumbling around tariffs and trade wars has a bearish bias, as does the general tone in the geopolitical arena. Yet, the immediate impact on global economics has so far remained relatively muted.

Market timing, so tempting… yet…

As we close Q1, the ongoing market volatility shows little sign of abating, with the S&P 500 continuing to experience extraordinary intra-day movements into early April. Should this not be expected after such a formidable, record-breaking bull market? And should not portfolios be finally repositioned accordingly?

It is a feature of all serious, publicly scrutinised financial market research that the tactical prediction of asset returns is a fool's gold. Thus, we do not advocate switching asset classes based on the predictive power of absolute or relative valuation measures: rather we rely on the track record of momentum investing with its strong, extensively tested and researched results across countries, asset classes and data periods.

Following directly on and re-emphasising the key message from last month's newsletter, intra-month volatility will often be dominated by mean reversion with little real 'net' direction. Hence the temptation to double-guess these higher frequency movements will often simply burn up transaction costs, leading to poor risk-adjusted returns, as the CTA industry so often finds to its cost.

If market-timing is difficult at the best of times, what about its potential during the current extraordinary period? All eras are unique in their own way, which is, of course, a good reason why historical data is often a poor guide to the future. What's more, the current era seems to be characterised by a degree of economic illiteracy of the main decision-maker(s) unseen in modern times, and so market-timing following common logic is even less likely to work today!

This market environment requires our rigorous, rule-driven investing strategy – now more than ever before. We continue to take succour in diversifying across asset classes and being willing to de-risk our portfolio by moving into cash and protect wealth when appropriate, i.e. only when our rigid rules suggest so.

Less cushioning ahead.

Moving ahead, the potential for turbulence may be more pronounced as corporate share buybacks are expected to ease off, following a likely record in February which helped save the day as the volatility blow-up impacted markets. Companies enter their closed periods when they are not allowed to buy back their own shares around the release of their quarterly results. Without this extra line of support, the immediate case for more volatility remains entirely plausible.

We have long argued against market-timing and return predictability and at no time does it seem more relevant than now, with widespread agreement (rare amongst economists!) that the causes of US trade deficits will not be rectified by tariffs on China, and quite bizarrely, that applying further tariffs on Chinese imports will be quantitatively insignificant!

If the US insists on even bigger fiscal deficits to support Mr Trump's economic agenda, then the trade deficit will not shrink.

It's called **ARITHMETIC**!

Portfolio positioning.

For the month of April our indicators favour equities in the US, Japan, Emerging Asia and Latin America, as well as US Investment Grade Bonds, US High Yield Bonds, and Gold.

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.

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