DECEMBER 2016

Agincourt Capital Management, LLC

INVESTMENT UPDATE

Dear President-Elect Trump,

First, many congratulations for defying all the pundits and winning the election. Everybody—well, almost everybody—loves an underdog story, and you certainly shocked the world with your come-from-behind victory.

Now, of course, the hard work begins as you formulate your strategic vision, rank your priorities, and assemble a team that can execute the plan. We know you must have all the free (and not-so-free) advice you can probably handle, but we figured "what the heck, we've got a few ideas of our own," and since you're one of our elected officials, and this being a representative republic, and all…well, we just couldn't resist putting in our two cents. Besides, we've got a particularly important point of view: as bond investors, we (along with a few hundred other firms) have the final say-so as to how your policies play out in the US bond market. You'll know pretty quickly how your policies are working just by looking at what interest rates are doing.

So, in no particular order, here's our holiday wish list:

1. Think long-term. We understand that there will be a significant push for you to hurry up and get your agenda moving, but in doing so, please take the time to analyze the long-term implications of your policies. As one example, infrastructure spending, which is a big part of your agenda, has the potential to kick-start the US economy into a higher gear. That's a good thing—we haven't had annual GDP growth in excess of 2% since we emerged from the financial crisis.

Direct investment in the US economy provides long-term positives for our country (while also boosting employment in manufacturing and construction jobs in the short and intermediate-term). But traditional government-sponsored infrastructure spending is not revenue-neutral, and will add to the US' debt burden. As we all know, this burden will be passed on to the next generation unless we somehow find the revenue to offset the cost to the Treasury. *Barron's* wrote a front-page article earlier this month urging you to re-deploy the Build America Bond program, which was used with some success after the financial crisis. In this program, infrastructure projects are funded by the issuance of bonds which, in turn, are paid off over time by the revenues generated by the project. In this way, money collected by toll roads and airports (just to use two examples) is used to pay off the bond holders. And while some will correctly point out that these fees and tolls are taxes to the users of the facilities, who better to pay for the improvements than those who derive utility from them?

2. Along with the first point, we encourage you to think about the demographics in the US in the decades ahead. Like all developed economies, our society is getting older—people are living longer and we are having fewer children. This is going to place a growing burden on future generations to fund the cost of a larger group of retirees and beneficiaries. We need policies, set at the top, that encourage savings and investment so that productivity will flourish. Our aging population—and those of our major trading partners—is a major underlying cause of slowing economic growth and low interest rates, which in turn have forced central banks around the world to come up with ways to boost growth, spur inflation and get interest rates up.

A long-term solution to the problems of slow growth and low interest rates is to implement policies that support families and encourage child-bearing. Denmark has seen a big boost in birth rates by subsidizing day care for young families and offering generous time off for new parents, incentivizing dual-income families to have children. There are big differences between the US and Denmark; we will have to figure out what programs will work best for us. And while there are costs to these programs, their benefits have the potential to help fund our future growth. Meanwhile, we'd all do well to keep in mind that the newest arrivals to our shores are also the most prolific when it comes to having children. Because of our immigrant population, the US is the only developed country in the world with a fertility rate over 2.0 (the minimum rate to keep the population growing, net of immigrants).

3. Make America's Tax Policy Great Again. You want to lower tax rates across the board; we're all in favor of lower taxes—that's axiomatic. But perhaps a more realistic goal would be "truthful" taxes. The US corporate tax rate is the highest in the world, and lowering the rate so that companies don't engage in financial gymnastics to avoid paying taxes to the US Treasury is a good idea. But we know that most major corporations (and many small ones, too) don't pay the 35% corporate tax rate, as (by revenue) less than 1/3 of US companies are set up

as corporations; the rest pay "pass-through" income taxes as S-corps, LLPs, etc. And there are plenty of loopholes which bring the effective tax rate down, no matter what the corporate tax structure is. The one that seems particularly egregious and hits closest to home is the special treatment afforded (i.e., bought by lobbyists) to private equity firms, which are in a similar business as Agincourt, but which pay a tax rate roughly half of what we pay. These loopholes need to be eliminated. We're in favor of similar reforms for personal taxes—lower rates, but very few deductions, so that the effective rate is nearly equivalent to the actual rate that people pay. As mentioned above, we need to generate a certain amount of tax revenue (a little more than 20% of GDP, currently) to pay for federal programs and services, and the costs of those services are almost certain to grow in the years ahead. Let's make certain we pay our bills on time, and not stick them with the next generation.

4. Support the Federal Reserve. As you are aware, the Fed operates independently from the three main branches of the Federal government. Importantly, the Fed has reporting requirements to Congress, and its Governors are appointed by the executive branch, but its day-to-day decision-making and regulatory functions are essentially free from the political process. We think the Fed's independence is critical—neither party should "own" the Federal Reserve. Let's move on from the accusations of political compliance within the Fed; that was campaign rhetoric. With the election settled, it's time to let the Fed do its thing. With two current vacancies to fill and with Fed Chair Janet Yellen's term coming up in a little more than a year, your administration will have the opportunity to change the leadership of the Fed. We would encourage you to find Governors (and perhaps, a new Chair) who will stay outside the political fray and remain independent in the pursuit of the best long-term policies for the US economy and its financial system.

5. Don't gut Dodd-Frank. Yes, the financial regulatory regime in the US has probably gone too far in the aftermath of the financial crisis, with thousands of new hoops for everyone employed in the industry to jump through (including Agincourt!). But we would encourage you to, while paring back on the most ticky-tacky rules, keep in place the regulations that protect our broader financial system. This would include regulations that keep banks from using customer deposits to buy the riskiest financial instruments or to use those deposits to "trade their own book." We favor stringent capital controls for large banks that have, under the worst scenarios, the wherewithal to bring our economy to its knees. And we believe that consumers should be protected from fraudulent and misleading lending and investment practices that threaten household savings. We don't expect to see you getting into the minutia of how Dodd-Frank is implemented, but you have an important role to play in setting the tone for how Main Street and Wall Street will serve—and hopefully, benefit—each other over the next few years.

6. Keep your eye on the bond market. This one might be a little self-serving, but the reality is that the bond market will give you a pretty good idea about how your policies are going over with investors. Since the election, benchmark US Treasury rates have risen, depending on maturity, by 25 to 70 basis points (0.25% to 0.70%). There's valuable information embedded in that data. With long rates moving up more than those of shorter-maturity bonds, investors are showing some unease about the impact of your policies on inflation. Inflation is to bond investors what Kryptonite is to Superman—it saps the value of future cash flows; when inflation rises significantly (think 1975-85) the prices of long-maturity bonds get crushed. Meanwhile, since the election, the prices of corporate bonds have held up relatively well, indicating that the credit markets (like the stock markets) are looking favorably at the prospects of fiscal stimulus and deregulation on corporate profitability. In the coming months, the markets will continue to adjust as expectations for which policies get enacted or rejected align with reality. You, too, will be able to gauge your own policies' effectiveness over time by how bond prices behave.

7. Forget about tariffs and protectionism. We like your fighting spirit, and agree that certain countries don't exactly share our love of free trade, but putting up broad trade barriers is not the solution. For better or worse, the US is the world's largest economy, and starting a trade war risks widespread retaliatory protectionist barriers being erected around the globe. While it's true that the US would be better off than China (and other countries whose entire economies are dependent on exports) if we put in place broad protections for domestic producers, we'd be risking a domino effect and global economic—and political—destabilization. It would be far more effective to play "small ball" with individual industries where governments are clearly subsidizing their domestic producers; there are plenty of those to choose from. We only ask that you choose well, and do so sparingly.

So, that's our year-end wish list, offered in the spirit of the holidays. You've got our support as you take on what must be the toughest job in the world, and our very best wishes in shouldering your new responsibilities. Maybe you can even find a way to bring us all a little closer together in the next few years—perhaps an impossible task, but in this holiday season, we have nothing but hope for the future and love in our hearts.

Happy Holidays,

Your Friends at Agincourt Capital Management