

“American Hustle”

Irving Rosenfeld: Did you ever have to find a way to survive and you knew your choices were bad, *but* you had to survive?

— *“American Hustle” (2013)*

Only when I wake up in the morning. Nothing but caper movie quotes today. Seems appropriate.



Doyle Lonnegan: I put it all on Lucky Dan; half a million dollars to win.

Kid Twist: To win? I said *place*! "Place it on Lucky D-" That horse is gonna run second!

Doyle Lonnegan: [There is a pause, and Lonnegan runs horrified to the betting booth] There's been a mistake! Gimme my money back!

— *“The Sting” (1973)*

I suspect there were more than a few Doyle Lonnegan moments in Silicon Valley and the Hamptons last Tuesday night. Here, for example, is Lady Gaga looking particularly distraught, as photographed in her Rolls Royce. No, really.



Wanda: [after Otto breaks in on Wanda and Archie in Archie's flat and hangs him out the window] I was dealing with something delicate, Otto. I'm setting up a guy who's incredibly important to us, who's going to tell me where the loot is and if they're going to come and arrest you. And you come loping in like Rambo without a jockstrap and you dangle him out a fifth-floor window. Now, was that smart? Was it shrewd? Was it good tactics? Or was it stupid?

Otto West: Don't call me stupid.

Wanda: Oh, right! To call you stupid would be an insult to stupid people! I've known sheep that could outwit you. I've worn dresses with higher IQs. But you think you're an intellectual, don't you, ape?

Otto West: Apes don't read philosophy.

Wanda: Yes they do, Otto. They just don't understand it. Now let me correct you on a couple of things, OK? Aristotle was not Belgian. The central message of Buddhism is not "Every man for himself." And the London Underground is not a political movement. Those are all mistakes, Otto. I looked them up.

— *“A Fish Called Wanda” (1988)*

Gonna be lots of Ottos in this administration. I count three in cabinet-level appointments so far.

Lilly Dillon: You're working some angle, and don't tell me you're not because I wrote the book!

Roy Dillon: What about you? You still handling playback money for the mob?

Lilly Dillon: THAT's me. That's who I am. You were never cut out for the rackets, Roy.

Roy Dillon: How come?

Lilly Dillon: You aren't tough enough.

Roy Dillon: Not as tough as you, huh?

Lilly Dillon: Get off the gift, Roy.

Roy Dillon: Why?

Lilly Dillon: You haven't got the stomach for it.



— *"The Grifters" (1990)*

Anjelica Huston's best work. Worth watching just for Bobo and the oranges, hands down one of the most psychologically horrific scenes in American cinema. John Cusack plays Lily's son, and she's right: he doesn't have the stomach for this line of work. Neither do a lot of portfolio managers.

Randolph Duke: Exactly why do you think the price of pork bellies is going to keep going down, William?

Billy Ray Valentine: Okay, pork belly prices have been dropping all morning, which means that everybody is waiting for it to hit rock bottom, so they can buy low. Which means that the people who own the pork belly contracts are saying, "Hey, we're losing all our damn money, and Christmas is around the corner, and I ain't gonna have no money to buy my son the G.I. Joe with the kung fu grip! And my wife ain't gonna f... my wife ain't gonna make love to me if I got no money!" So they're panicking right now, they're screaming "SELL! SELL!" to get out before the price keeps dropping. They're panicking out there right now, I can feel it.

Randolph Duke: [on the ticker machine, the price keeps dropping] He's right, Mortimer! My God, look at it!

— *"Trading Places" (1983)*

Like any good trader, Billy Ray has internalized the Common Knowledge Game.



Louis Winthorpe III: Randolph. Mortimer.

Mortimer Duke: Winthorpe, my boy, what have you got for us?

Louis Winthorpe III: Well, it's that time of the month again. Payroll checks for our employees, which require your signatures. And no forgetting to sign the big ones!

Mortimer Duke: We seem to be paying some of our employees an awful lot of money.

Louis Winthorpe III: [laughs] Can't get around the old minimum wage, Mortimer.

— *"Trading Places" (1983)*

Europeans take racial differences and put them on the dimension of class. Americans take class differences and put them on the dimension of race. Randolph and Mortimer do both.



Angela: She said you were a bad guy. You don't seem like a bad guy.
Roy: That's what makes me good at it.

Roy: For some people, money is ... money is a foreign film without subtitles.

— *“Matchstick Men” (2003)*

Nicolas Cage can act. When he wants to. Ridley Scott can direct. Always. To paraphrase Woody Allen, 90% of alpha is just showing up.

Linus Caldwell: Um, all right, let's go over the list again. Ah, “Swinging Priest”?
Basher Tarr: Not enough people.
Linus Caldwell: “Crazy Larry”?
Turk Malloy: Not enough people.
Linus Caldwell: “Soft Shoulder”?
Basher Tarr: Not enough people.
Linus Caldwell: “Baker's Dozen”?
Basher Tarr: No woman
 [pause]
Basher Tarr: and not enough people.
Turk Malloy: “Hell in a Handbasket”?
Linus Caldwell: [sigh] We can't train a cat that quickly
 [pause]
Linus Caldwell: and...
All: Not enough people.
 — *“Ocean's 12” (2004)*



This is my new go-to line for every business or policy challenge: we can't train a cat that quickly.



Basher Tarr: You don't run the same gag twice ... you run the next gag.
 — *“Ocean's 13” (2007)*

The only question that matters for surviving the next four years: what's the gag they're running on us? What's the narrative they're constructing? Behold Steve Bannon, gag-meister extraordinaire.

Rusty Ryan: Turn the machine off guys.
Turk Malloy: It is off.
Rusty Ryan: Are you kidding?
Turk Malloy: Does it sound like I'm laughing, sweetheart?
 — *“Ocean's 13” (2007)*

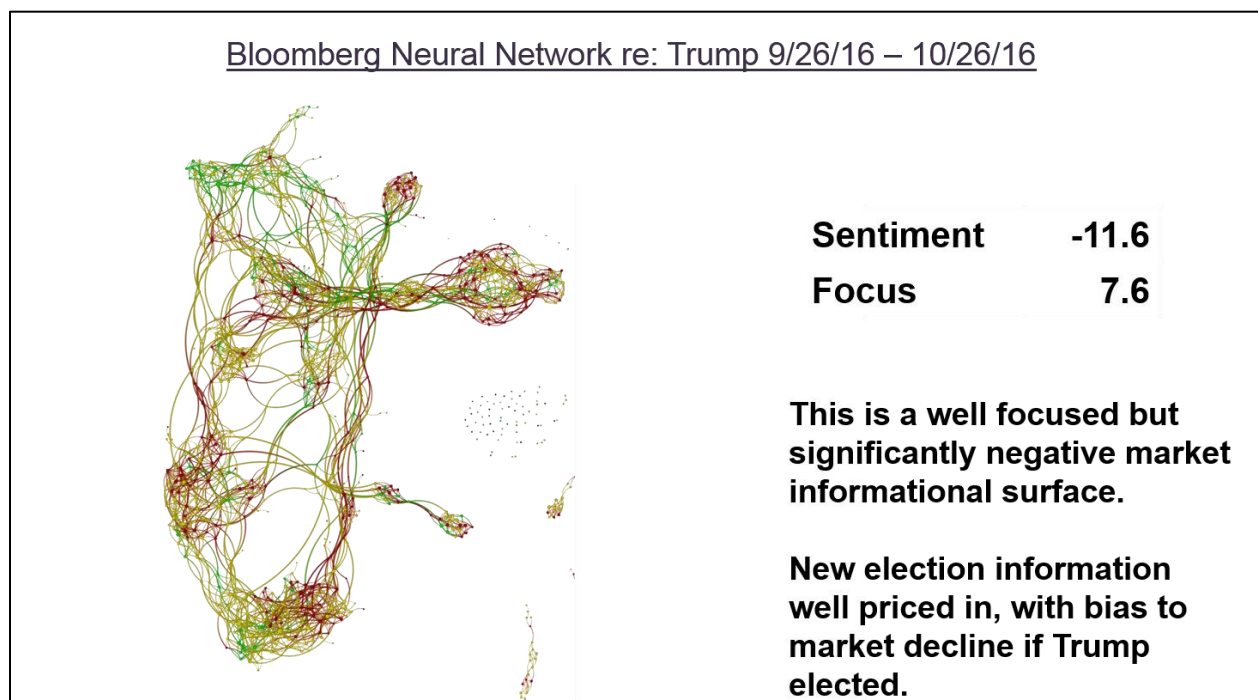
Sometimes when you fire up an earthquake machine, you get a real earthquake.



There are three questions I'd like to answer in this *Epsilon Theory* note: what did the Narrative Machine tell us about the market immediately before and immediately after the November 8 election, what am I preparing for now as an investor, and what am I preparing for now as a citizen? I'm giddy about the first, quietly confident about the second, and pretty darn depressed about the third. Could be worse, I suppose.

On the first question, **the Narrative Machine gave clear, actionable, and non-consensus signals prior to the U.S. election last week.** [For readers who aren't familiar with what I mean by the Narrative Machine, I'll refer you to this note by the same title.](#) In a nutshell, I'm using a [technology called Quid](#) to take Big Data snapshots of large numbers of financial media articles. These snapshots show the connectivity and influence of each article to every other article, constructing a neural network or "star map" of the narratives and meaning clusters that link the articles. By looking at measures of sentiment and connectivity associated with the network, I think that I can get a good sense of market complacency around events like a Trump victory, as well as the likely direction and magnitude of market moves if an event like that comes to pass. Bottom line: I think that the Narrative Machine gives us a good sense of what's priced into markets.

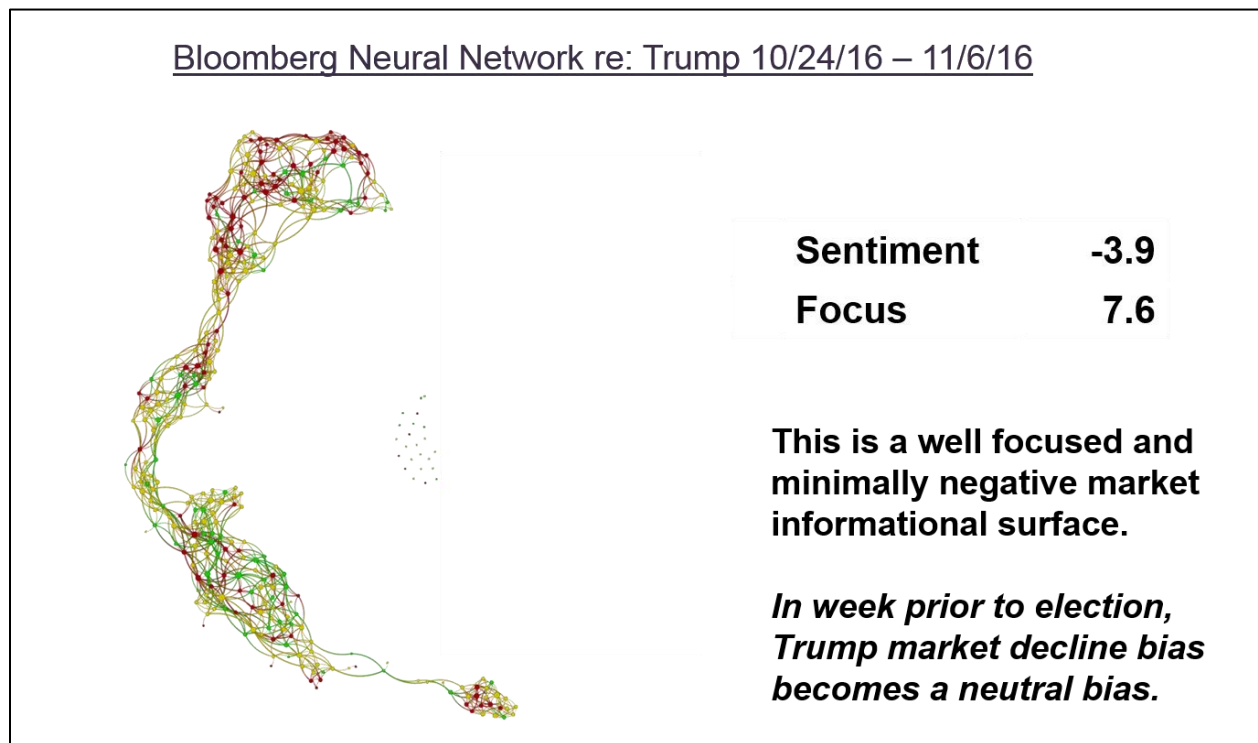
Here's the Quid map of Bloomberg articles talking about Trump in weeks T-5 through T-2.



Source: Quid, Inc. For illustrative purposes only. Quid, Inc. is not an affiliate of Salient. Software used license. Past performance is no guarantee of future results.

The skinny: there was never any complacency in markets about a Trump win. There was negative sentiment, but no complacency. Maybe the Huffington Post thought there was only a 5% chance of a Trump win, but markets were taking it much more seriously than that.

Now here's the Quid map of Bloomberg articles talking about Trump in the week immediately preceding the election.



Source: Quid, Inc. For illustrative purposes only. Quid, Inc. is not an affiliate of Salient. Software used license. Past performance is no guarantee of future results.

Still just as focused (the 7.6 score here is only slightly less attentive and concentrated than the 8.5 score of markets after the Brexit vote), but look at the sentiment score. We've moved from highly negative to only slightly negative. More to the point, it's the change in score that's really important, so this Narrative map is telling us that not only is a Trump victory priced into current market price levels, but if he were to win, the market wouldn't go down much, if at all. That's in sharp contrast to the consensus view (you know who you are), that not only was the market highly complacent about the prospects of a Trump win, but also that a Hillary defeat would be a disaster for markets, with projections for as much as 12% down.

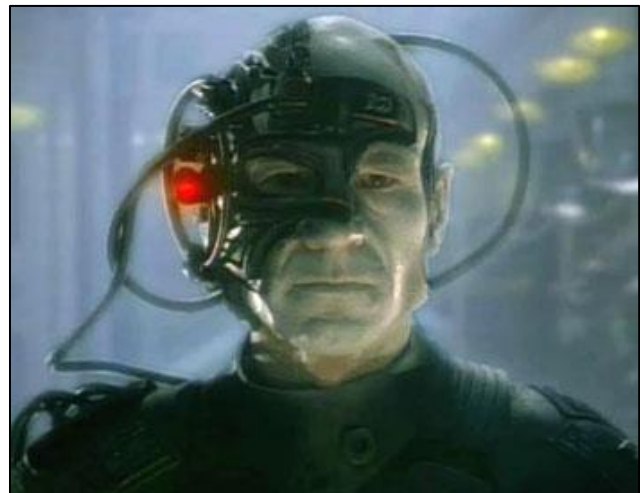
My commitment to the Narrative Machine research project is to make it as public as possible. Mass email is a poor distribution method, so I tweeted about these findings on Monday, November 7 ([@EpsilonTheory](#)) and spoke about them on a Salient-hosted conference call on Tuesday, November 8.

But I'm also managing portfolios for Salient now as part of [the internal reorganization we announced in October](#), so I have a responsibility there, too. Long story short ... follow me on Twitter to stay the most engaged with this project.

So what's next for markets?

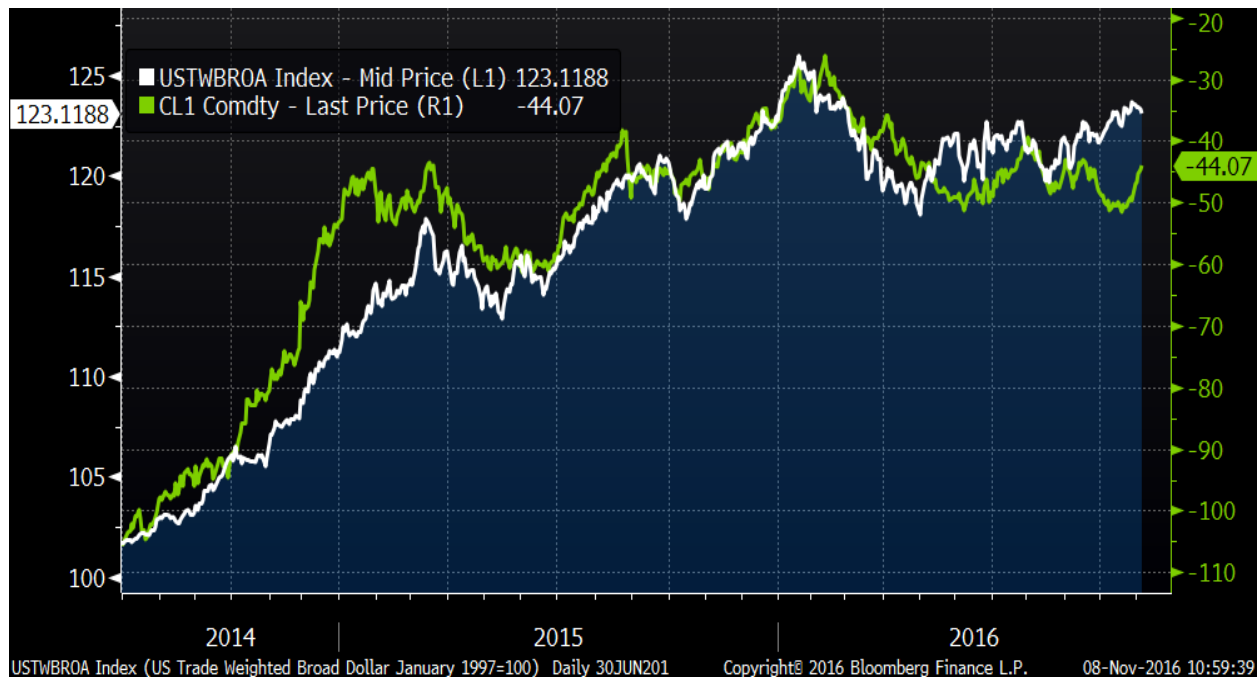
First, the positive market Narrative regarding tax repatriation, regulatory reform, and fiscal stimulus in the form of infrastructure spending is for real. [And by "real", I don't mean that I have any confidence AT ALL that these policies will have any permanent effect or multiplier effect or anything like that on the real economy](#). Sorry. Maybe regulatory reform has a long-lasting impact. Maybe. No, by "real", I mean that this policy "reform" is a highly effective signal in the Common Knowledge Game and that it will make stocks go up regardless of its impact (or not) on the real economy. Ain't that enough? It's enough for me. **The Trump reform and infrastructure Growth Narrative is a tailwind for stocks and a headwind for bonds for the next four years because we want to Believe.** True that.

Second, nothing about the Trump reform and infrastructure Growth Narrative is sufficient, in my view, to undo the overwhelmingly negative constraints that massive global debt places on global growth. [The Silver Age of the Central Banker is still in full force](#), with a shrinking global trade pie and domestic political imperatives that accelerate that decline rather than reverse it. **Competitive monetary policy is the Borg.** First it swallows up currencies, because that's what currencies are — a reflection of your country's monetary policy versus other countries' monetary policies. Then it swallows up commodities — things that don't have their own cash flow dynamics. Then it swallows up entire economies and swaths of the markets that are levered to commodities — emerging markets in general and developed market segments like industrials, energy and transports in particular. Ultimately it all comes down to monetary policy, and its primary reflection in currencies. It's the Borg. Resistance is futile.



Here's an updated chart showing the massive negative correlation between the dollar and oil. This is the trade-weighted broad dollar index in white, as measured by the vertical axis on the left, and this is the

inverted spot price of crude oil in green, as measured by the vertical axis on the right. The chart starts in June 2014, because that's when competitive monetary policy and the Silver Age of the Central Banker begins, when Mario Draghi doubled down on ECB asset purchases and negative interest rates at the same time that Janet Yellen declared her intentions to raise interest rates and forswore more asset purchases.



Source: Bloomberg L.P. as of 11/8/16. For illustrative purposes only.

Yes, you get short-lived divergences in the lockstep negative correlation, first at the end of 2014 when OPEC announces that they're out of the price-fixing game, and then again a month ago when OPEC announces that they're back in the price-fixing game. The joke's on OPEC. And global macro investors who still think that OPEC matters, I suppose, but mostly on OPEC. [The half-life of whatever OPEC does or doesn't do is measured in days ... weeks at most.](#) What is persistent, what is irresistible, what is the Borg in this equation is whether the dollar is going up or down.

The Trump reform and infrastructure Growth Narrative makes the dollar go up. If the Fed raises rates in December the dollar will go up still more. If you get a bad vote in Italy in a few weeks the dollar will go up still more. If you get any sort of geopolitical shock or U.S. domestic political craziness the dollar will go up still more. **Dollar up is bad. Dollar down is good.** I don't know how to say it more plainly than that, and all the Belief in the world about tax reform and repealing Dodd-Frank and all that doesn't change this reality. Maybe you see that and maybe you don't. [I can promise you, though, that China sees it.](#)

So that's where I am as an investor. I'm positive on U.S. equities because we've got a four year tailwind from the Trump reform and infrastructure Growth Narrative. That's not going away no matter what China or Europe does. On the other hand, I'm negative on global risk assets, particularly anything connected to global trade finance, [because we're players in several giant games of Chicken and I think at least one of these is going to break bad](#). But at least I'm looking at the right things (I think), like what's happening to the dollar and to European financial credit spreads, and that's what gives me the hope that I can navigate these risks and these rewards. That and the ability to go short.

So I'm giddy about the potential of the Narrative Machine and I'm hopeful that I can maneuver through the investment storms out there. Why am I so down about American politics?

Well, you gotta admit that this September *Epsilon Theory* note, "[Virtue Signaling, or Why Clinton is in Trouble](#)", has aged pretty well. Turns out that Hillary Clinton was, in fact, the Jay Cutler of this election cycle, a highly talented but highly flawed performer whose team refused to sell out for her. I stand by everything I wrote in this piece — each candidate will be remembered in Common Knowledge as the Yoko Ono of their respective party, breaking up an all-time great band to make an album or two of dubious, to be generous, quality.



And that means I also stand by what I wrote about Donald Trump. I think he breaks us. Why? Because everything is a deal to Trump. Everything is a transaction, from a vote to a policy to a personal relationship. We all know people like this, men who — as the old Wall Street saying goes — would sell their mother for an eighth. Donald Trump transforms positive-sum Cooperative Games into zero-sum Competitive Games. It's his nature ... his great gift as a New York real estate developer, but his fatal flaw as a politician. Is he "a fighter"? Can he "get deals done"? Sure, and there's value in that. **But OUR great gift as Americans is that we are blessed with positive-sum Cooperative Games in the form of limited government and the political culture to maintain those limitations.** Our political culture has been changed by Trump. The teacup has been broken. Can we glue it back? I suppose. But like a broken marriage or a broken partnership it's never the same. It's always a broken teacup.

I'm not saying that this broken political culture is Trump's fault. Like I said, it's his *nature* to transform everything he touches into a competitive strategic interaction. I can't blame him any more than I can blame my Sheltie for barking at the wind. If you don't want barking, don't get a Sheltie. But the FACT is

that we've got a Game Changer for our political culture as president, and there's no walking that back.

Example: look at the prevalent Democratic meme today, that Trump voters were either motivated by racism directly, or that they willfully tolerated a racist candidate ... which is just a paler shade of racism. Okay. I get the argument, although I would ask why Clinton didn't get the support of working class white voters in Wisconsin, Michigan, and Pennsylvania who voted for Obama *twice*. Were they racist all along and just hiding it really well? But leave aside the merits of the argument, because there's no changing anyone's mind these days on the merits of anything (which is kinda my point). My question is a different one. **If you really believe this ... if you believe in your heart of hearts that Trump voters are racists ... where do you go with this? Or rather, what does politics *mean* to you now?** Politics is no longer a "marketplace of ideas" if you think the other side is comprised of bad guys. You're not trying to win them over. You're trying to beat them. Not because you think you're right (although you do), but because you think you *MUST* beat them or else your own survival is at stake. It's not only a zero-sum Competitive Game; it's a zero-sum Competitive Game of self-defense, which means that anything — anything! — goes.

I'm not trying to pick on the Democratic memes (although they're such easy targets). You see exactly the same sort of popular Narratives on the Republican side about Democratic voters. To summarize this vast oeuvre, if you're willing to vote for the evil Hillary and her coven of soul-devouring, child-stealing, gun-confiscating, tax-raising, war-starting warlocks and witches ... well, you must either be a sheep or a thieving Team Elite wannabe. Either way, you're contemptible. Contemptibles and Deplorables, not Democrats and Republicans. My point is that if you believe that the people on the other side of a political argument are not just wrong, but are basically bad people, then the *meaning* you ascribe to politics — your political culture — is entirely different than if you think the other side is comprised of basically good people. You don't cooperate with bad people, and the political institutions you favor if you're surrounded by bad people are very different — and very un-American, in the de Tocqueville-ian sense of that word — than what the Founders came up with.

Look, Trump is no Hitler — [that's Erdogan's shtick](#) — and Trump's preening egomania is actually a good thing because it crowds out ideological fervor. I mean, he's not building a political machine to instantiate His Hugeness in institutional form. But there will be people around him who will try, and unfortunately, if I were a betting man — and I am — I'd bet on them to succeed. The rewards are too great and the technological tools at their disposal are too powerful and the political culture is too conducive to the effort and if it's not them it will be the [Thermidorian political reaction](#) of the Left, and that depresses the bejeezus out of me. True that, too.

But that's the World As It Is, a world of incredible technological promise that thrills the puzzle-solver in me, a world of reasonably interesting market patterns that gives hope to the investor in me, and a world of ascendant soft authoritarians that chastens the small-I liberal in me. I don't think I'm alone. Put it all together, and my attitude is perfectly summed up by the most perfect ending in all of American literature.

So we beat on, boats against the current, borne back ceaselessly into the past.

Onwards. Together. Please.

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