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Investment Letter No 11
Week 32
2019

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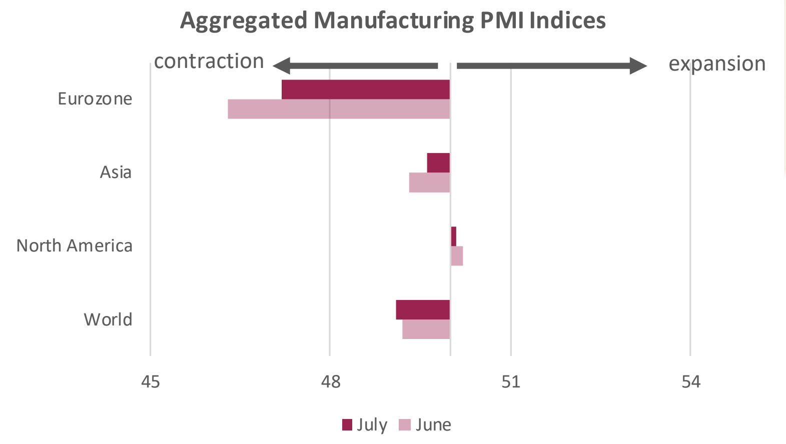
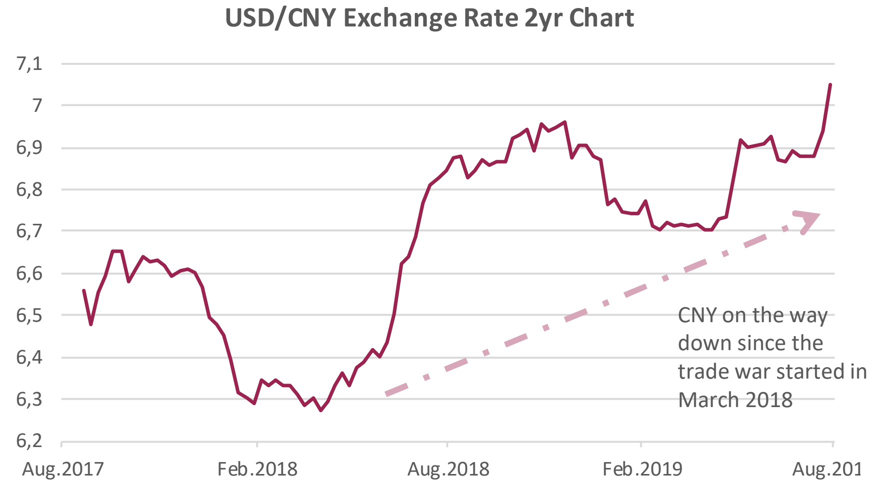
Downgrading Equities to Underweight

In our latest Investment Letter approx. 1 months ago, when the **S&P 500 benchmark-index** was trading at 2987, we rhetorically asked, if we have reached the top of the current bull market? At some point earlier this week, the index has lost about -100 points or less than **-4%.** That for itself is neither great nor a tragedy. So **what to do with that?** If there was one strategy which best characterised the bull market of the last 10 years, then it was **"buy the dip"** referring to purchasing stocks following a decline in price. "Buying the dip" worked extraordinarily well over those years as the market was, overall, supported by solid economic fundamental and low interest rates. According to this narrative, **many might be tempted to buy the current dip again.** While one should be extremely careful with proclaiming an early end of an era (they often last longer than one might expect), wee see evidence that indeed, this time might be different. Accordingly, **we don't buy this dip but rather use intermediate recoveries in order to cut** (our already low) exposure to equities.



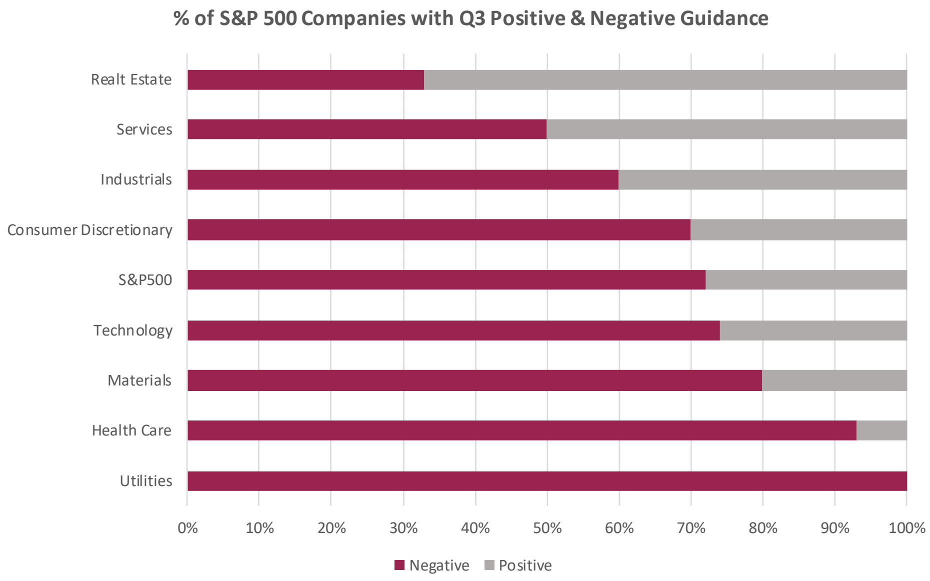
Source: Markit; FIS Market Map

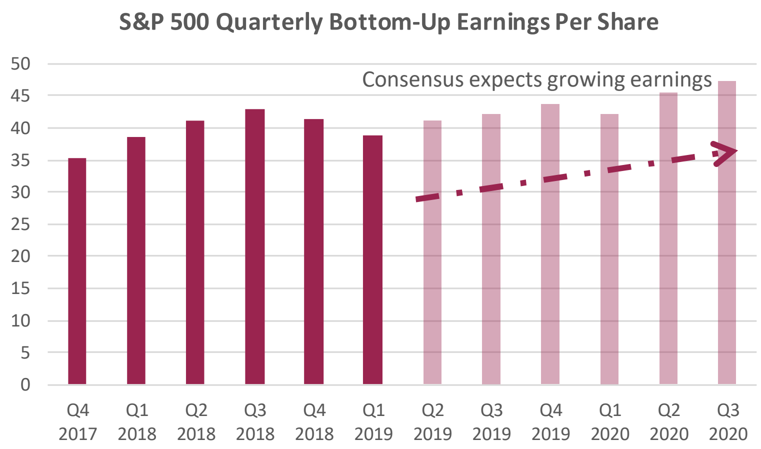


We have extensively covered the fact that **macro economic momentum is dramatically fading** in the most recent past *(see vicarious graph on the right)* which was implicitly confirmed by the FED's most recent "insurance rate cut" for which it blamed macro economic troubles overseas. Trying to **overcome the negative implications** of the **ongoing trade war by easier financial conditions** is an idea which we basically have sympathy for. Anyhow, only 24 hours after the first FED rate cut in a decade, **it became apparent to anybody that this won't work as Trump (voluntarily) further escalated the trade war** by announcing fresh tariffs and officially labelling China as "currency manipulator". The Yuan is indeed heading south vs the USD since the start of the trade war *(see chart above).* **In doing so, Trump hopes to pressure the FED to further ease rates, which in his eyes will secure his re-election** in late 2020.

Downgrading Equities to Underweight

While some analysts argue that fresh tariffs will only be put in place in about 1 months time and that there would be enough time for a settlement, we continue to be of the opinion that **a) there won't be a quick fix** to a conflict which only turned harsher and harsher over the last 12 months and **b) that the economic damage, is already caused**. True, until now, economic data only point to slowing growth and not an outright recession for now, but with the most recent escalation of both, Trade war and Brexit, **we think it is only a question of time until growth finally stalls**. As one can see from the graph on the right, **almost 3 out of 4** of those **S&P 500 companies** which publish an earnings guidance **do expect lower earnings for Q3**, despite the fact that **Q2 earnings growth** for all S&P 500 companies was already **-2.7%.** In other words, the so-called "earnings recession" is almost here already.





No doubt, **central Banks around the globe will do their best to support growth by further cutting rates**. Only over the last week, central banks from Australia, India, Thailand, Malaysia, Philippines to the US and New Zealand cut their benchmark interest rates. However, **we suspect that monetary policy will quickly face its limits when it comes to supporting economic growth** as long as politics are in combat mode. While bond markets are already price in lower rates for a long period of time, the **expected earnings growth looks to high** in our eyes *(see chart on the right).* From a risk/reward-point of view, downgrading equities as a precautionary measure seems only natural to us.

Source: FactSet; Bloomberg; FIS Market Map

Our Tactical Asset Allocation (6months horizon)

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EQUITIES –> DOWNGRADE TO UNDERWEIGHT

- As explained on page 3-4, we downgrade our equity exposure from "neutral" to "underweight". We are **not pretending that a sell-off is imminent** but the **current risk/reward-ratio** at the rather high equity market valuation (which is, on the top, still based on too high earnings growth) **is poor**. We therefore **prefer to play save**, not last duet to the strong performance of equity markets this year. As we have had a pretty good hand in our stock selection so far this year, we are in a comfortable situation where we do not need to chase performance.
- As our **sector exposure is already very defensive** (preference for pharma, consumer defensives, utilities and technology) with extremely little cyclical exposure, we do not see a reason to make adaptions to our sector exposure for now.
- For now, **we do not make any changes to our geographic equity preferences**. The US equity market with its large exposure of international technology companies and a relatively resilient home economy is to be preferred over more cyclically and trade exposed areas such as Europe or Asia.

CASH –> REMAIN NEUTRAL

- **Boring but save & stable**. With stocks still not far from record highs and after one of the strongest quarters for bonds in a decade, holding cash for some time is by no means wrong. Admittedly, the return of cash is extremely low but **preserving buying power** might not be a bad idea **if at a later stage, fresh opportunities will arise** (be that through lower equity prices or higher corporate bond yields with the later caused by rising credit spreads). Not convinced? Berkshire Hathaway, the highly successful investment company run by Warren Buffet just announced that they are sitting on a record high amount of 122bn USD in cash- and are happy with it.

Our Tactical Asset Allocation (6months horizon)

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BONDS –> REMAIN NEUTRAL

- In our last investment letter, we argued that *"(…) the market might have gotten a bit ahead of itself"* when it comes to the magnitude of FED rate cuts. That proofed to be right so far as the FED did only cut by -25bps in late July and signalled that this was a "mid cycle adjustment" rather than the beginning of a fresh easing cycle. However, with Trump about to fully escalate the trade war in order to get his long expected rate cuts, there is, in our eyes, **no other way for the FED to cut as** much as both, **markets and Trump ask for** in order to avoid a recession. **For yields, there is therefore virtually no floor** and the low-rates environment continues to support bond prices.
- That all said, **be careful with credit spreads** whose widening we have expected for quite some time (it did not arrive so far) but it might now be just around the corner! Therefore, **buy / hold corporate bonds with relatively solid credit fundamentals**. Long duration bonds shall only be held when offering superior credit quality!
- Demand for "carry trades" which are *"en vogue"* during period of low rates, Emerging Market bonds have proved relatively resilient of late, despite a strong US-Dollar and an escalating trade war. We suspect this is unlikely to change which is why we **continue to prominently hold EM bonds** which fulfil the above mentioned criterias: sound credit quality and not too long duration.
- We continue to **avoid riskier buckets of the bond market such as High Yield, Senior Loans or Convertible Bonds.**

ALTERNATIVES –> REMAIN OVERWEIGHT

- Lower rates for longer is the guiding principle (again): and thus the hunt for yield in alternative assets is on an will again lead to higher prices in this asset class.
- We have advocated exposure to gold for some time and **we continue to believe that over the medium term (i.e. > 12months time), gold will shine further**. Anyhow, one shall note that gold has rallied >20% year to date, posting a +100 USD move per ounce in just a few weeks time. **At present, gold is heavily overbought which is why additional purchases should be put on hold for now**. For any long holdings: no need to take profit unless you are a truly short term trader.

House View: our Preferences on one Slide

Asset Class	We Like	We Don't Like
Equities	*Area*: **Diversification among US, EM** *Sectors*: **Pharma, Consumer Defensives, Utilities, Technology** *Style:* **Growth (with Quality)**	*Area*: **China; UK, Switzerland** *Sectors:* **Telecom** *Style:* **High growth *without* quality**
Bonds	*Duration:* **Medium term duration** up to **7** years. *Area:* **US; *selected* Emerging Markets** *Credit:* **low grade IG**	*Duration*: **below 2 years** *Area*: **China** *Credit:* **EU & US High Yield; Senior Loans; Convertible Bonds**
FX & Commo-dities	*FX Majors:* **~~USD~~; JPY, CHF** *Commodities:* **Gold**	*FX Majors:* **GBP; ~~CAD~~** *FX Minors:* **TRY** *Commodities:* **Base Metals**
Alternatives	*Alternatives:* **Gigant Option Based Equity Growth Strategy; strategies with uncorrelated payoffs to equity & bond market direction**	

mangenta = recent changes

Removed from our Model Portfolio: SolarEdge Tech.

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solaredge

Sector:	Energy
Risk Type:	**Adventurous**
Market Cap:	2bn USD
Holding Period:	**106 days**
Total Return:	**+85.8%**

Chart Solar Edge Stock during Holding Period

Company Description:

SolarEdge Technologies Inc (SEDG) designs and sells solar power optimizers and inverters for residential and small-scale solar power plants. SEDG outsources manufacturing of its products to third parties. The company's product differs from traditional solar inverter designs in that individual solar module power optimizers provide module level monitoring and power balancing, maximizing total system output under a variety of conditions. Users can thus replace multiple separate management devices ranging from storage (battery, backup and energy control) into one device. Since beginning of shipment in 2010, SEDG has shipped over 10,6 Gigawatt of optimized inverter systems and its products have been installed in solar PV systems in 133 countries.

Rationale of Disposal:

- On 6th of August, SolarEdge Technologies reported a quarterly revenue growth of +43% YoY to a fresh company record of 243mio USD, beating both, consensus as well as its own forecast (which by the way the company has already raised just 3months ago). The company did not only see strong customer demand from Europe and Brazil but also good demand for non-solar products such as lithium-ion batteries and energy storage systems, a development which we forecasted in our buy-recommendation back in April 2019.
- While sales growth looks strong and margins are even slightly up to 36,9% from 34.3%, we now suspect that the planned investments in future capacity increases are likely to weight on the company's margins for the foreseeable future.
- After an absolutely astonishing run in which **shares of SolarEdge Tech were up +85% in just a bit more than 3 months time** (they were up +20% alone following the day of the earnings release), the stock is no longer cheap and **all good news seem to be priced in**. We thus want to realize our tremendous profits.

Quality Measures:

		vs. Industry	vs. Market
Return on Capital	14.2%		
Return on Equity	17.0%		
Operating Margin	11.98%		

Growth Measures:

12m Forecast Rolling		vs. Industry	vs. Market
PE Ratio (f)	23.1		
PEG Ratio (f)	1.5		
EPS Growth (f)	17.8%		

Historical Revenue & Profit Evolution:

Source: www.stockopedia.com; FIS Market MAP; all numbers as of 8th of August 2019

Overview US Equity Model Portfolio

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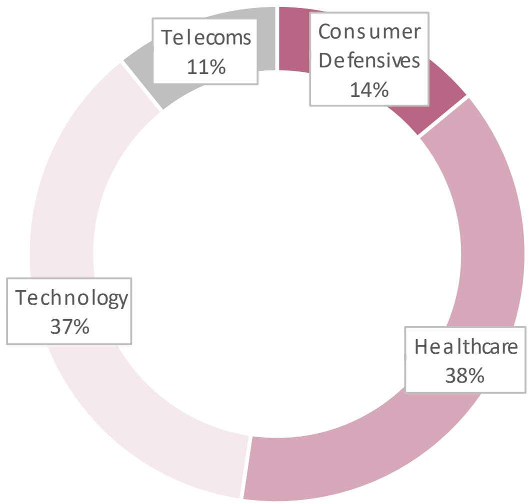
Performance Overview	2019	2018	2017	ITD *)
Gigant US Equity Model Portfolio	**+22.99%**	**-1.24%**	**+17.56%**	**+42.79%**
S&P 500	+17.2%	-6.24%	+19.4%	+31.23%
Dow Jones	+13.08%	-5.63%	+25.1%	+33.48%
Nasdaq 100	+22.04%	-1.04%	+27.1%	+58.83%

Current Situation:	
Current Value:	1'427'941 USD
Start Value:	1'000'000 USD
Realized Gains:	+368'721 USD
Unrealized Gains:	+44'021 USD
Cash:	636'662 USD (45%)
Equities:	791'2879 USD (55%)

Evolution of 1Mio USD invested into the Gigant US Equity Model Portfolio since inception:

Current Sector Allocation:



computed by stockopedia.com; all data as of 8th of August; *) inception date = 31th of Dec 2016

Constituents of our US Equity Model Portfolio

GICS Sector	Stocks & Performance		
Energy			
Basic Materials			
Industrials			
Consumer Discretionary			
Consumer Defensives	**CVS Health** -26,70%	**Philipp Morris** 10,70%	**Intuitive Surgical** 9.48%
Health Care	**Merck** 43.90%		
Financials			
Technology	**Alphabet** 16,10%	**Microsoft** 16,40%	**YY** -43,20%
Telecom	**AT&T** -4,66%		
Utilities			
Real Estate			

performance = price returns excluding dividends

computed by stockopedia.com; all data as of 9th of August

Overview USD Bond Model Portfolio

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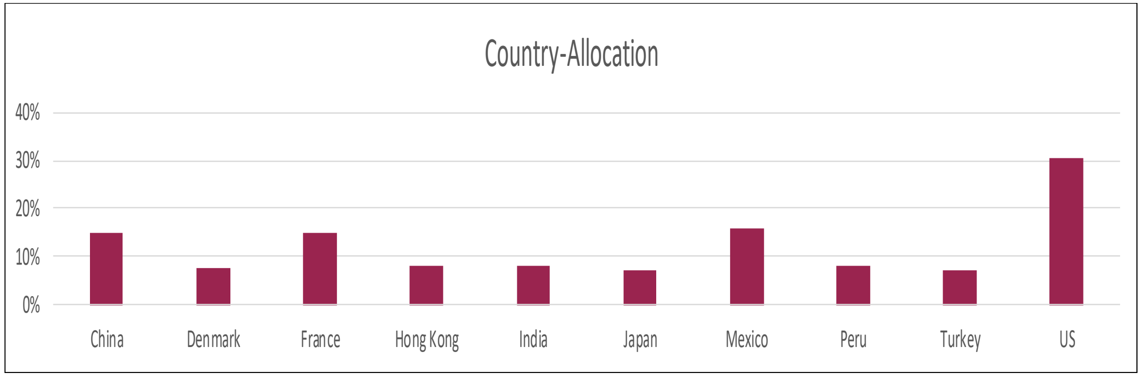
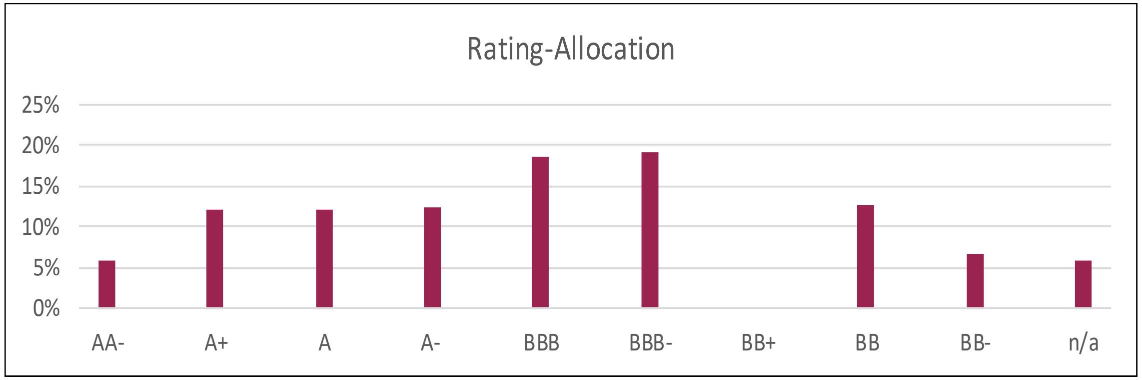
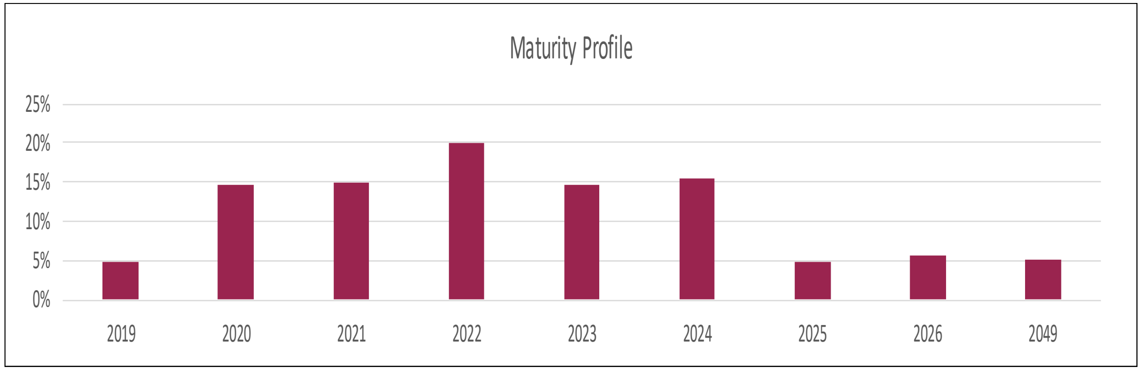
Performance Overview	YTD	2018	2017
Gigant USD Bond Model Portfolio	**+5.27%**	**+1.00%**	**+4.70%**
Bloomberg Barclays US Aggregate Index	+7.85%	+0.01%	+1.17%
Bloomberg Barclays EM USD Aggregate Index	+8.31%	-2.46%	+6.87%

Current Situation:	
Weighted average YTM:	3.22%
Weighted average Duration:	3.4







Source of data: FIS Market Map; own calculation; all data as of 9th of August

Constituents USD Bond Model Portfolio

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	Coupon	Bond Instruments	Maturity	Rating	Country	Industry	YTM	Duration	Bid-Price	minimum size	Allocation
	4,125%	SEMICONDUCTOR MANUFACTURING INTERNATIONAL CORPO	07.10.2019	BBB-	China	Electrical & Electronic	2,82%	0,1	100,20	200.000 USD	4,78%
	4,950%	BARRICK (PD) AUSTRALIA FINANCE PTY LTD	15.01.2020	BBB-	Canada	Mining & Refining	2,39%	0,4	101,07	2.000 USD	4,86%
	4,375%	AFRICA FINANCE CORPN	29.04.2020	A3		Supranational Agency	3,48%	0,7	100,62	200.000 USD	4,82%
	2,343%	FORD MOTOR CREDIT COMPANY LLC	02.11.2020	BBB	US	Finance & Investment	2,57%	1,2	99,73	200.000 USD	4,74%
	5,950%	GAP INC	12.04.2021	BB-	US	Supermarkets & Stores	3,16%	1,5	104,49	200.000 USD	5,20%
	2,362%	CENTRAL NIPPON EXPRESSWAY COMPANY LIMITED	28.05.2021	A1	Japan	Railways & Transportation	2,28%	1,7	100,15	200.000 USD	4,78%
	2,125%	CORPORACION ANDINA DE FOMENTO (CAF)	27.09.2021	AA-		Supranational Agency	2,27%	2,0	99,69	1.000 USD	4,73%
	5,375%	VOLCAN COMPANIA MINERA S.A.A.	02.02.2022	BB	Peru	Mining & Refining	3,73%	2,2	103,84	200.000 USD	5,13%
	5,375%	**PETROLEOS MEXICANOS (PEMEX)**	**13.03.2022**	**BB**	**Mexico**	**Oil & Petroleum**	**4,53%**	**2,3**	102,03	**200.000 USD**	**4,96%**
	2,750%	STATE GRID OVERSEAS INVESTMENT (2016) LIMITED	04.05.2022	A+	China	Utilities	2,45%	2,6	100,78	200.000 USD	4,84%
	2,500%	PHILIP MORRIS INTERNATIONAL INC.	22.08.2022	A	US	Tobacco	2,17%	2,9	100,96	1.000 USD	4,85%
	3,100%	GENERAL ELECTRIC CAPITAL CORPN	09.01.2023	A	US	Finance & Investment	2,55%	3,1	101,79	200.000 USD	4,93%
	5,250%	**LOUIS DREYFUS COMPANY B.V.**	**13.06.2023**	**n/a**	**France**	**Commodity Trading**	**4,80%**	**3,3**	101,55	**200.000 USD**	**4,91%**
	3,875%	DANSKE BANK A/S	12.09.2023	A-	Denmark	Banking & Finance	2,96%	3,7	103,49	2.000 USD	5,10%
	4,750%	INDIAN OIL CORPN LTD	16.01.2024	A-	India	Oil & Petroleum	3,07%	3,9	106,92	200.000 USD	5,44%
	5,250%	ALFA, S.A.B. DE C.V.	25.03.2024	BBB-	Mexico	Industrial (General)	3,33%	4,0	108,15	200.000 USD	5,57%
	4,215%	COCA COLA ICECEK URETIM AS	19.09.2024	BBB	Turkey	Food Manufacturing	4,63%	4,4	98,15	2.000 USD	4,59%
	3,375%	BNP PARIBAS	09.01.2025	A-	France	Banking & Finance	2,73%	4,8	103,20	200.000 USD	5,07%
	5,150%	GAZPROM OJSC	11.02.2026	BBB	Russia	Oil & Petroleum	3,86%	5,3	107,38	200.000 USD	5,49%
*)	4,750%	TOWNGAS FINANCE LTD	12.08.2049	A-	Hong Kong	Utilities	4,48%	15,6	104,47	200.000 USD	5,20%

Source: FIS MarketMap; all data as of 9th of August

mangenta = recent changes

*) = Perpetual Bond with next call date on 31th of Jan 2024

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SWISS CONSULTING

Please contact:

Phone: +41 44 493 90 90
Fax: +41 44 493 90 11
Email: info@gigant-swiss.ch

Gigant Swiss Consulting AG
Bodmerstrasse 9
CH-8002 Zurich

www.gigant-swiss.ch
info@gigant-swiss.ch

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