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Investment Letter No 12
Week 35
2019

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Yield Cockpit

Overview current effective yields in USD *)

	current	2months ago
2 Year US Treasury	**1.50%**	**1.74%**
5 Year US Treasury	**1.37%**	**1.77%**
10 Year US Treasury	**1.47%**	**2.00%**
3-5 Year IG Corp Bonds	**2.39%**	**2.79%**
7-10 Year IG Corp Bonds	**2.84%**	**3.06%**
15+ Year IG Corp Bonds	**3.56%**	**4.19%**
High Yield BB-rated	**3.87%**	**4.38%**
High Yield B-rated	**5.96%**	**6.48%**
EM IG Corporate Bonds	**4.32%**	**4.51%**
EM Sovereign Bonds	**5.41%**	**5.72%**

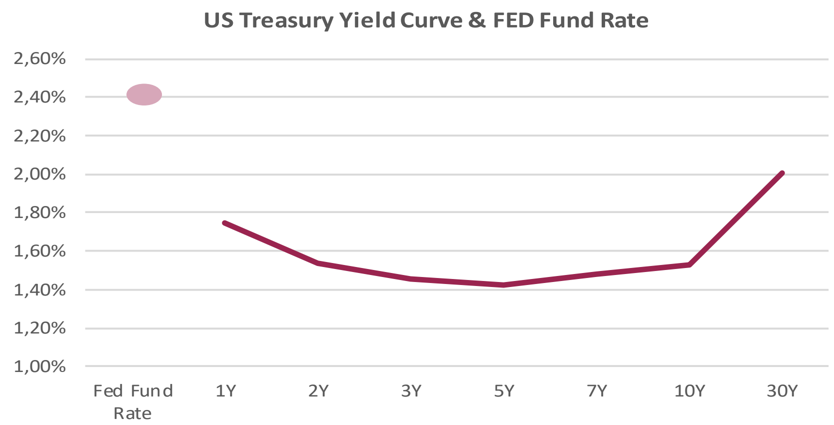
Spreads & Inflation

FED Funds Rate	2,40%	2,50%
TED-Spread	0,17%	0,27%
10yr–2yr Treasury Spread	-0.03%	0,29%
5yr Breakeven Inflation	1,36%	1,53%
10yr Breakeven Inflation	1,59%	1,67%

*) derived from relevant BofA Merrill Lynch effective yield indices
mangenta = Gigant Swiss preferences

What to take note of:

- **We have warned** well in the past **about an upcoming inversion of the US-yield curve** (i.e. longer term yields being below short term yields) and the predictive power of this phenomenon on future economic growth. At the time of writing, every single point on the yield curve, including the 30y Treasury yield, is now below the Fed Funds rate *(see graph below)*. So, going forward, what are the implications for USD-bond investors now the inversion has become reality?
- The rather obvious consequence is that **the market these days does not compensate investors for holding longer term bonds** (which are associated with higher uncertainties and thus, during normal times, higher yields) over short term debt. While it is true that longer term bonds have benefitted most of the most recent collapse in yields, one would need to have the view that longer terms rates would reach even lower in order to generate a return which is above that of short term bond. That, however, is NOT our main scenario.
- Currently, **the highest rates are to be earned in cash** (i.e. 3 months bills). The question remains if rates go down much further, whether this strategy would result in lower future returns (as investors need to re-invest every 3 months)? We think no as the market prices more than -1% of additional FED cuts which we consider too pessimistic. Subsequently, if the FED cuts less than 4 times over the next 12 months, then the return of rolling 3-months investments is likely to beat that of a fixed 1yr investment.

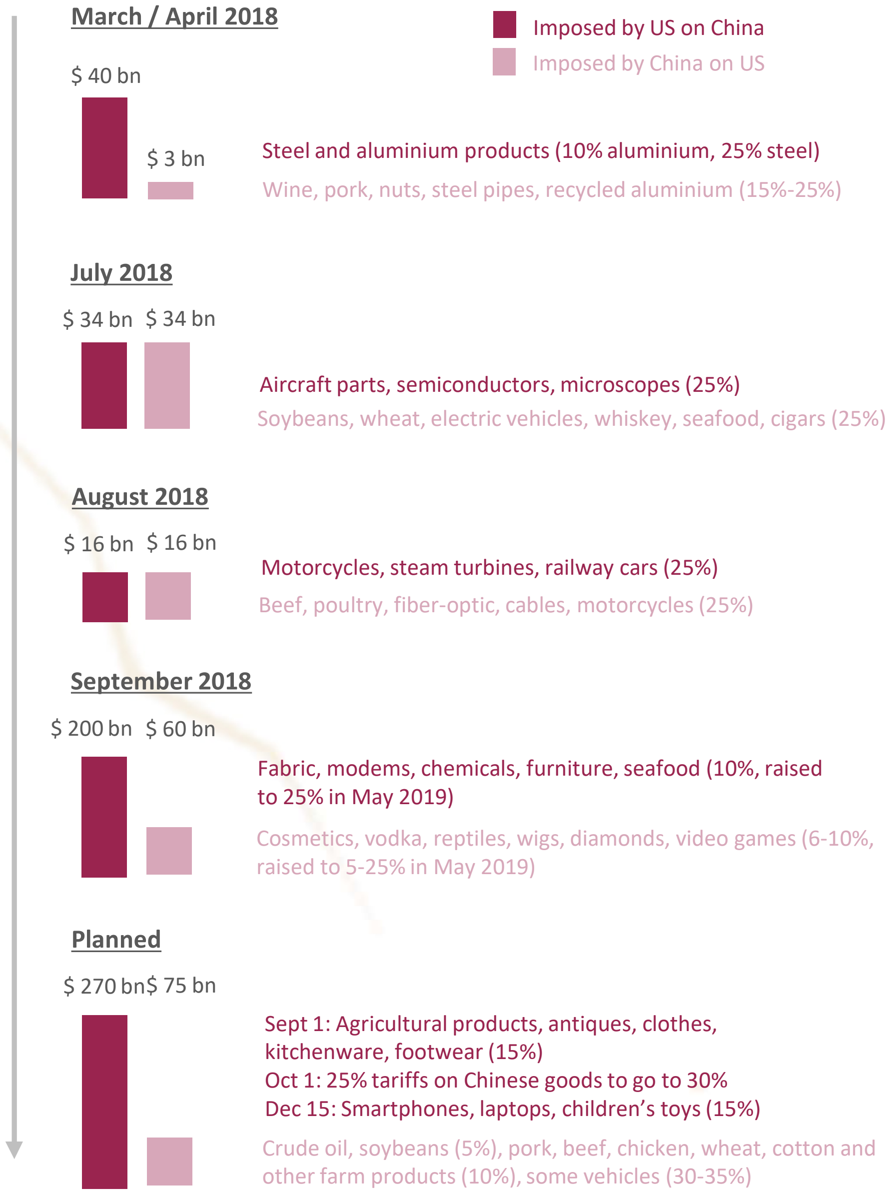


Source: BofA Merrill Lynch Indices retrieved from Federal Reserve Bank of St.Louis; Bloomberg Barclays Index Data; all data as of 30th of August

Trade war escalates- will the FED come to rescue? (1/2)

We have not only **warned about an escalation** of the ongoing **trade war** but also wondered about the fact that many investment professionals (without being truly able to offer thorough arguments other than Trump-tweets) maintained a scenario in which the conflict would not escalate any further. Then came August during which the **US** first **announced fresh tariffs** for September (but straight after postponed most of them to December). That prompted a devaluation of the Chinse yuan which again the US labelled "currency manipulation". Late last week, the **Chinese** then **retaliated** with fresh tariffs. The only who seemed surprised was Trump which on the very same evening announced to raise existing tariffs by another 5% - **if that is not an escalation!**

That all said, risk assets (unlike the rates market) haver proved remarkably resilient until now with the US stock market just about -4% from all time highs reached earlier this summer. As one can see from deteriorating Purchasing Manager Indices, the **trade war** has mostly **affected the manufacturing-** but also the agricultural **sector.** Anyhow, the US economy is largely driven by **consumer spending** (approx. 70% of GDP) which **has proved relatively resilient** until now. As the overview on the right suggest, the **newest round of tariffs** on Chinese goods **will now affect a variety of consumer goods**. *J.P. Morgan* now estimates the average American household will be down -1'000 USD per year due to tariffs. Furthermore, they point to the fact that unlike the agricultural sector which is receiving subsidies from the government to offset some of the tariffs, there is **no easy way of compensating consumers**.

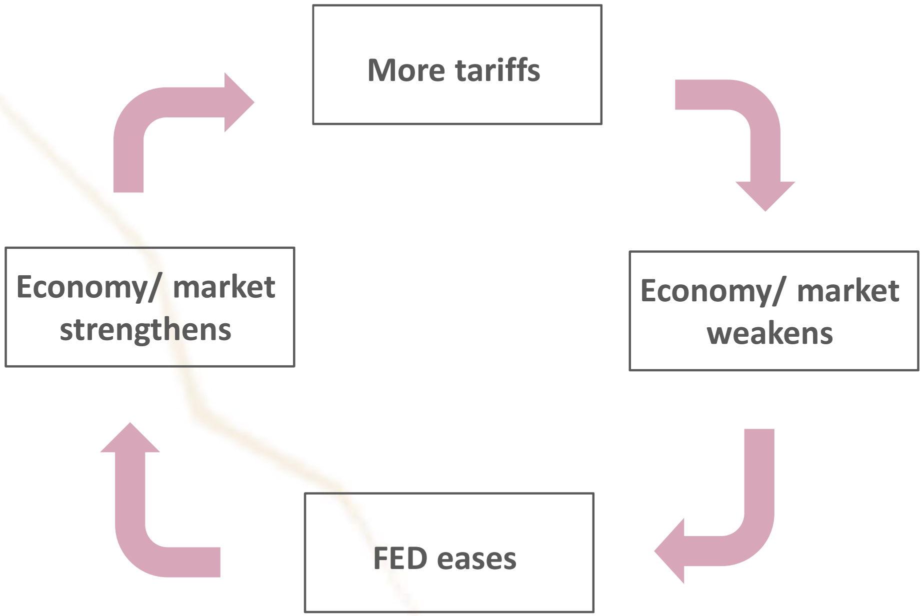


Source: Office of the US Trade Representative; Bloomberg

Trade war escalates- will the FED come to rescue? (2/2)

One of the reason why markets proved relatively resilient is the **hope for further FED rate cuts** to prevent trade-ward induced economic weakness (*see also page 3 for details about the extent of expected rate cuts).* By blaming the global economy for the FEDs' rate cut on 31th of July, the FED's chair Jay Powell has indeed trapped himself as he **implicitly backed any further escalation in the trade war as reason for more rate cuts.** Therefore, it shall not be considered a coincidence that Trump, which is desperately pressing the FED for further rate cuts ahead of election year, escalated the trade war just days after Powell's announcement. So all is well and the **market can just not fall as the FED-put is well in place?** If you are in that camp, the consider the comment from former FED New York President Bill Dudley saying "*this manufactured disaster-in-the-making presents the Federal Reserve with a dilemma: should it mitigate the damage by providing offsetting stimulus, or* ***refuse to play along****?*". His advice: "*If the ultimate goal is a healthy economy, the FED should seriously consider the latter approach*". It must be said that Bill Dudley is not a member of the FED any more but his statement is a good reminder that one shall not take *"eternal"* FED cuts for granted. After all, it is **still corporate earnings which drive the equity market** over the medium- to long-term and there, things do not look all too good. According to a survey conducted by the *Wall Street Journal*, 80% of US corporates interviewed, believe that the trade war is negatively impacting their business activities…

Is there an adverse feedback loop between the FED and US-trade policy?



Source: BofA Merill Lynch Global Research

Our Tactical Asset Allocation (6months horizon)

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EQUITIES –> REMAIN UNDERWEIGHT

- We have downgraded our equity exposure from "neutral" to "underweight" in early August. Conversely, we are not pretending that a sell-off is imminent but the **current risk-reward ratio** at current high equity market valuation **is rather poor.** Major equity indices have performed between 15-20% year-to-date and thus, rather than chasing the last few basis points of potential return, **we prefer to lock in parts of the accumulated gains**.
- 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, consumer focused domestic economy **is to be preferred** over more cyclically and global-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**. As we detailed on page 3, holding cash in form of short term fiduciary deposits or Treasury-Bills might even be more attractive than buying longer term bonds. An as a side effect, **keeping cash leaves investors with enough dry powder for eventual future opportunities** (wherever they might arise). One of the most renowned investors of our time, Warren Buffet's Berkshire Hathaway is doing exactly this- they are sitting on a record high cash pile worth 122bn USD of cash- and are happy with it.

Our Tactical Asset Allocation (6months horizon)

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BONDS –> REMAIN NEUTRAL

- As we have highlighted on page 3, the way for USD-rates is down- no doubt. Anyhow, we continue to **believe the market is too optimistic in terms of the magnitude of the expected FED rate cuts**. On the back of escalating trade frictions and much lower inflation expectations, the long end of the curve has lost dramatically- since November 2018, the US 10yr yield has more than halved. We do not pretend that a turnaround in yield will start shortly but it seems evident that the "easy money" has been made for now. Holding on to longer duration bonds (whose yield is lower than that of short term bonds) implies betting on even lower long term rates. Unlike in equity markets, the **damage from trade frictions on the global economy is already priced in longer term rates which is why we see no need to invest in overly long duration bonds** any more.
- Instead, **be careful with credit spreads!** With increased market volatility over the past weeks, they have already risen a bit, although this effect was offset by lower rates. Anyhow, **corporate leverage is at all time high** and thus an eventual sharp global economic downturn would send spreads substantially higher. True, high earnings margins and low rates have supported low spreads for now but we are of the opinion that the current credit spreads do offer a poor risk reward-ration. We rather buy / hold corporate bonds with relatively solid credit fundamentals.
- We are of the opinion that demand for "carry trades" which are "en vogue" during period of low rates will continue to keep **demand for Emerging Market Bonds high**, no matter that the US-Dollar remains notoriously strong and an escalating trade war weighting on macro economic growth dynamics.
- We continue to avoid riskier buckets of the bond market such as High Yield, Senior Loans or Convertible Bonds.

ALTERNATIVES –> REMAIN OVERWEIGHT

- 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 +250 USD move per ounce over the last 3 months. 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

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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, Energy** *Style:* **High growth *without* quality**
Bonds	*Duration:* **Short ~~Medium~~ term duration** up to **5** years. *Area:* **US; *selected* Emerging Markets** *Credit:* **low grade IG**	*Duration*: **~~below 2 years~~; >5 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** *FX Minors:* **TRY** *Commodities:* **Base Metals, Crude Oil**
Alternatives	*Alternatives:* **Gigant Option Based Equity Growth Strategy; strategies with uncorrelated payoffs to equity & bond market direction**	

mangenta = recent changes

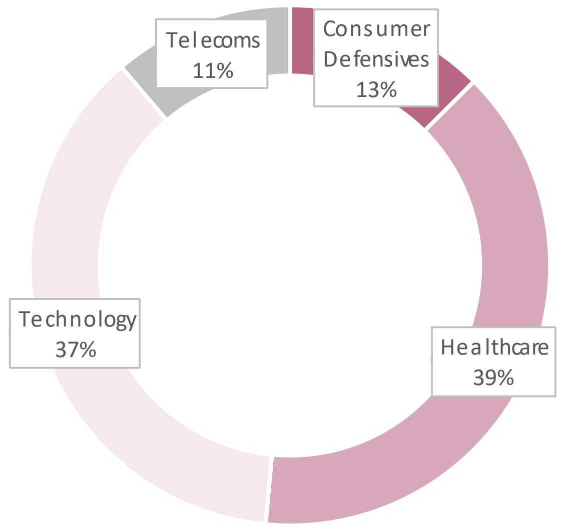
Overview US Equity Model Portfolio

Performance Overview	2019	2018	2017	ITD *)
Gigant US Equity Model Portfolio	**+22.03%**	**-1.24%**	**+17.56%**	**+41.68%**
S&P 500	+18.89%	-6.24%	+19.4%	+33.12%
Dow Jones	+15.16%	-5.63%	+25.1%	+35.93%
Nasdaq 100	+23.99%	-1.04%	+27.1%	+61.38%

Current Situation:	
Current Value:	1’416’841 USD
Start Value:	1’000’000 USD
Realized Gains:	+368’722 USD
Unrealized Gains:	+48’119 USD
Cash:	636’662 USD (45%)
Equities:	780’179 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 29th of August; *) inception date = 31th of Dec 2016

Constituents of our US Equity Model Portfolio

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GICS Sector	Stocks & Performance		
Energy			
Basic Materials			
Industrials			
Consumer Discretionary			
Consumer Defensives	**CVS Health** -25,30%	**Philipp Morris** -2,36%	**Intuitive Surgical** 7,11%
Health Care	**Merck** 47,30%		
Financials			
Technology	**Alphabet** 14,90%	**Microsoft** 15,70%	**YY** -42,50%
Telecom	**AT&T** -2,98%		
Utilities			
Real Estate			

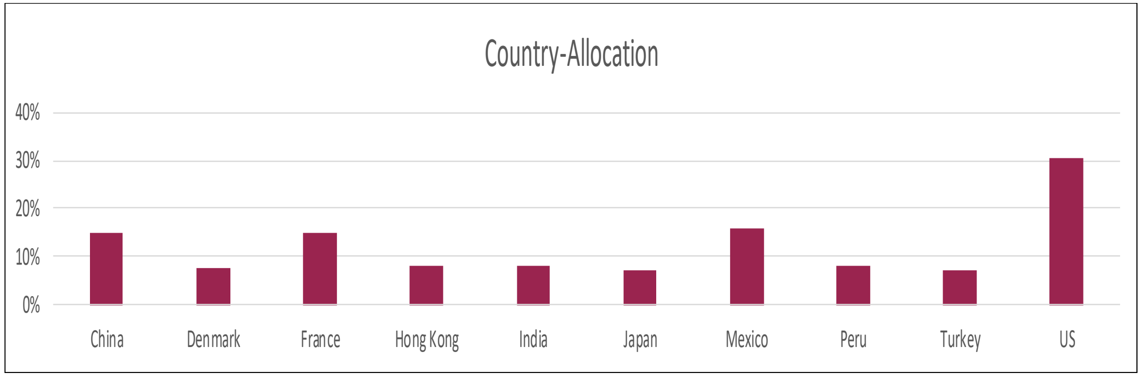
performance = price returns excluding dividends

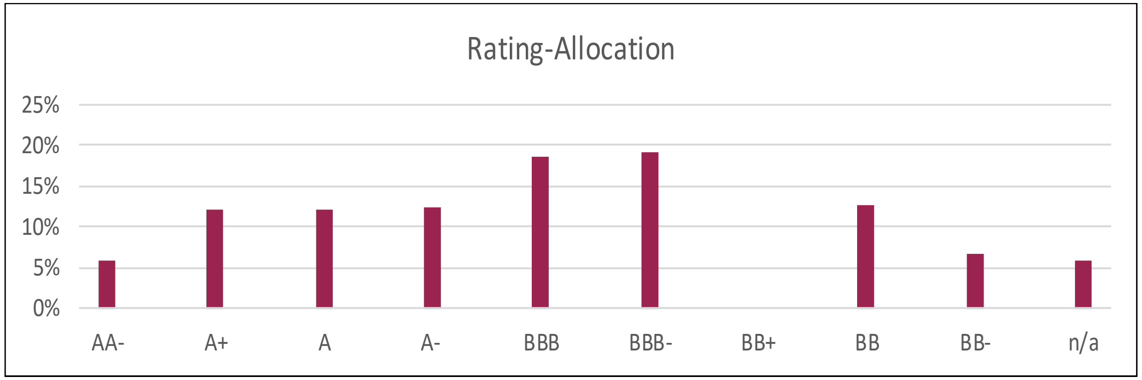
computed by stockopedia.com; all data as of 29th of August

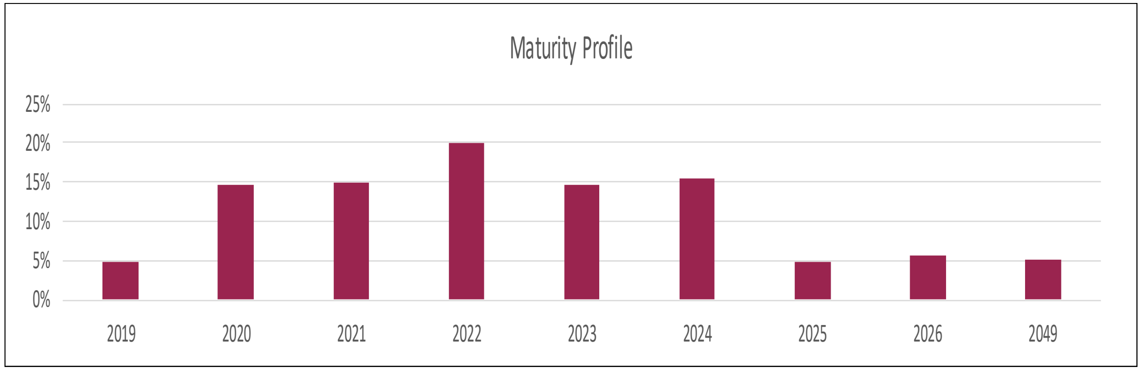
Overview USD Bond Model Portfolio

Performance Overview	YTD	2018	2017
Gigant USD Bond Model Portfolio	**+5.44%**	**+1.00%**	**+4.70%**
Bloomberg Barclays US Aggregate Index	+9.03%	+0.01%	+1.17%
Bloomberg Barclays EM USD Aggregate Index	+10.7%	-2.46%	+6.87%

Current Situation:	
Weighted average YTM:	3.15%
Weighted average Duration:	3.3







Source of data: FIS Market Map; own calculation; all data as of 30th of August

Constituents USD Bond Model Portfolio

	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	3,08%	0,1	100,10	200.000 USD	4,76%
	4,950%	BARRICK (PD) AUSTRALIA FINANCE PTY LTD	15.01.2020	BBB-	Canada	Mining & Refining	2,00%	0,4	101,07	2.000 USD	4,85%
	4,375%	AFRICA FINANCE CORPN	29.04.2020	A3		Supranational Agency	2,60%	0,6	101,15	200.000 USD	4,86%
	2,343%	FORD MOTOR CREDIT COMPANY LLC	02.11.2020	BBB	US	Finance & Investment	2,63%	1,1	99,68	200.000 USD	4,72%
	5,950%	GAP INC	12.04.2021	BB-	US	Supermarkets & Stores	3,18%	1,5	104,32	200.000 USD	5,17%
	2,362%	CENTRAL NIPPON EXPRESSWAY COMPANY LIMITED	28.05.2021	A1	Japan	Railways & Transportation	2,20%	1,7	100,27	200.000 USD	4,78%
	2,125%	CORPORACION ANDINA DE FOMENTO (CAF)	27.09.2021	AA-		Supranational Agency	2,24%	2,0	99,77	1.000 USD	4,73%
	5,375%	VOLCAN COMPANIA MINERA S.A.A.	02.02.2022	BB	Peru	Mining & Refining	3,78%	2,2	103,65	200.000 USD	5,11%
	5,375%	**PETROLEOS MEXICANOS (PEMEX)**	**13.03.2022**	**BB**	**Mexico**	**Oil & Petroleum**	**4,42%**	**2,3**	102,27	**200.000 USD**	**4,97%**
	2,750%	STATE GRID OVERSEAS INVESTMENT (2016) LIMITED	04.05.2022	A+	China	Utilities	2,34%	2,5	101,05	200.000 USD	4,85%
	2,500%	PHILIP MORRIS INTERNATIONAL INC.	22.08.2022	A	US	Tobacco	2,12%	2,8	101,09	1.000 USD	4,86%
	3,100%	GENERAL ELECTRIC CAPITAL CORPN	09.01.2023	A	US	Finance & Investment	2,97%	3,1	100,42	200.000 USD	4,79%
	5,250%	**LOUIS DREYFUS COMPANY B.V.**	**13.06.2023**	**n/a**	**France**	**Commodity Trading**	**4,86%**	**3,3**	101,31	**200.000 USD**	**4,88%**
	3,875%	DANSKE BANK A/S	12.09.2023	A-	Denmark	Banking & Finance	2,88%	3,7	103,78	2.000 USD	5,12%
	4,750%	INDIAN OIL CORPN LTD	16.01.2024	A-	India	Oil & Petroleum	2,91%	3,8	107,48	200.000 USD	5,49%
	5,250%	ALFA, S.A.B. DE C.V.	25.03.2024	BBB-	Mexico	Industrial (General)	3,33%	4,0	108,08	200.000 USD	5,55%
	4,215%	COCA COLA ICECEK URETIM AS	19.09.2024	BBB	Turkey	Food Manufacturing	4,68%	4,4	97,94	2.000 USD	4,56%
	3,375%	BNP PARIBAS	09.01.2025	A-	France	Banking & Finance	2,62%	4,8	103,74	200.000 USD	5,12%
	5,150%	GAZPROM OJSC	11.02.2026	BBB	Russia	Oil & Petroleum	3,60%	5,3	108,85	200.000 USD	5,63%
*)	4,750%	TOWNGAS FINANCE LTD	12.08.2049	A-	Hong Kong	Utilities	4,47%	15,6	104,55	200.000 USD	5,20%

Source: FIS MarketMap; all data as of 30th of August   mangenta = recent changes   *) = Perpetual Bond with next call date on 31th of Jan 2024

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