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Investment Letter No 14
Week 42
2019

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Earnings are unlikely to push the market higher

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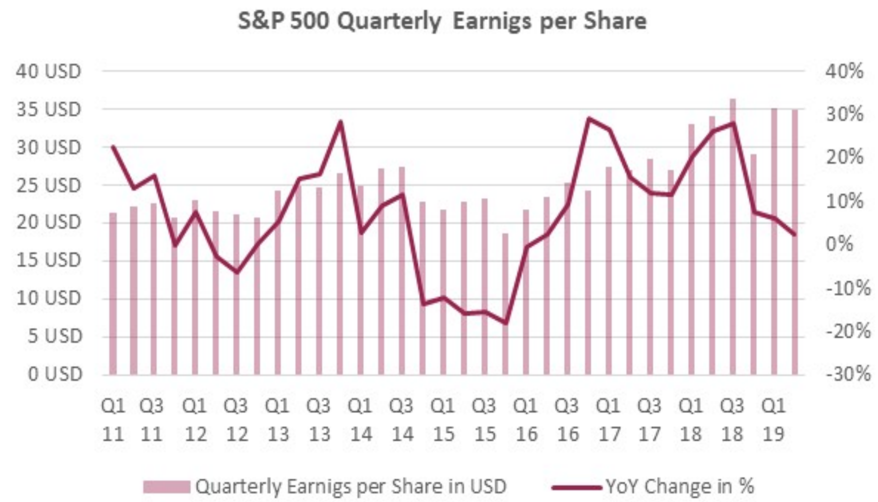
Despite a setback in early October, major equity benchmarks are virtually unchanged compared to when we published our latest investment letter about a month ago. Back then, we argued that in US stock indices face a wall of resistance levels which might be very tricky to overcome. To our surprise, the **news flow over the last weeks was highly positive**. Among the triggers were the ECB's announcement of more "Quantitative Easing", the FED s newly initiated 60bn USD of monthly treasury purchases (which for some technical reason, they don't label "Quantitative Easing"), a set of economic data which is improving on a comparative basis and how could we forget, Trump's *"fantastic"* trade-deal. A wave of **fresh liquidity** combined with **ample central bank support** and at least the **prospect for no additional tariffs** in the trade war altogether sound like **a wish list** for **equity bulls**. But the again, it was **not enough to overcome the all-important resistance levels** which we have highlighted above. In reverse, it seems **hard to imagine what more it actually needs that the wall of resistance can be overcome**. One element could be corporate earnings, which at least back in the old days when central bank intervention was an exception and not a standard, were THE single most important driver of equity prices. The Q3 earnings season has just kicked off this week and it is way to early to draw a meaningful conclusion out of the few data available. Anyhow, **earnings expectations** for Q3 19 **project a negative earnings growth of -4%** YoY which if proofed correct would lead to a so-called "earnings recession". By the way, the last one in late 2015 did result in an an ugly start for stocks in 2016. Going forward, **earnings expectations for the full year of 2020** currently come in at about **+10%.** Admittedly, this number was as high as +20% in early 2019 but during times where the yield curve signals almost 0% growth for the years to come, an aggregated corporate earnings growth of +10% looks ambitious to us, instead **leaving room for disappointments.** What makes us sceptical at present is the fact that earnings growth over the last quarters **would have already been negative had it not been driven by the one-time effect of the tax reform**. As a matter of fact, the average tax rate for S&P 500 companies decrease from 28% to just 19% in 2018. These, dear readers, are not ingredients of a healthy stock market.



Source: FIS Market Map; Bloomberg

Our Tactical Asset Allocation (6months horizon)

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EQUITIES –> REMAIN UNDERWEIGHT

- Since early August, we hold an "underweight" rating on equities for which we argued that **the current risk-reward ratio is poor** given the deteriorating macro economic environment and the very late stage of the current economic cycle. However, we have also pointed to an outlier scenario in which the looming recession can be avoided (for now), under which we would be required to not only increase our equity allocation but also to rotate in more cyclical sectors and higher beta-stocks. The **trigger for a reshuffling** would be **a decisive break above the 2-year old upwards-trend line,** something major indices have failed to do for the last 20 months.
- As long as we maintain our base case scenario, **we also maintain our defensive sector preferences** (pharma, consumer defensives and technology).
- In terms of individual select stocks, the ongoing Q3 earnings season will give us further indications if we need to make changes to one or the other of our remaining stock holdings. So far, none of our holdings which have reported Q3 earnings, have disappointed the market.

CASH –> REMAIN NEUTRAL

- **Boring but save & stable**. With stocks near record highs and bond yields back down at record low levels, holding cash for some time is by no means wrong. As we elaborated in greater detail in the recent past, **holding cash in form of short term fiduciary deposits or Treasury-Bills is most likely 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).
- Currency-wise, we are finally removing GBP from our "least preferred list". While Brexit remains anything but resolved (at the time of writing), the low 1,20 area of the GBPUSD-exchange rate has proved to be support for several times now. The removal from our "least preferred list" does not imply that we see a lot of upside for sterling but rather that after years of depreciation, further downside is finally limited. Anyhow, no action required for USD-accounts with no GBP-exposure.

Our Tactical Asset Allocation (6months horizon)

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BONDS –> REMAIN NEUTRAL

- After 5 months of outright inversion, the 10yr – 3months **Treasury Yield Spread is on the verge of breaking positive** again. Whether the **yield curve** finally steepens needs to be seen but for the time being it **is flat at best**. For the time being, the message is still that **bond investors are not compensated for holding longer term bonds** over short term debt. You do not even need to believe that the curve will steepen, but for investors with no constraints, binding capital for longer with no extra compensation for it does just not make sense (unless you believe that longer term rates will go further down, which again is not our scenario).
- Corporate leverage is at all time high and thus an eventual sharp global economic downturn would send credit spreads substantially higher- maybe not a risk for tomorrow but the more intermediate future. 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 yield carry** which is usually high during period of low rates will keep **demand for Emerging Market Bonds** high. Additionally, it seems as if the USD is running out of steam for now which would further boost Emerging Market Bonds.
- We continue to avoid large exposure to 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**. Some weeks ago, when gold was approaching the 1’550 USD per ounce-level we also noted, that it could be due for a pause. Now, **around 1’500 USD, those who do not yet have any exposure to gold may well start adding positions**. Around 1’460, there is ample support for the yellow metal.

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, Technology** *Style:* **Growth (with Quality)**	*Area*: **China; UK, Switzerland** *Sectors:* **Telecom, Energy** *Style:* **High growth *without* quality**
Bonds	*Duration:* **Medium term duration** up to **5** years. *Area:* **US; *selected* Emerging Markets** *Credit:* **low grade IG**	*Duration*: **long term duration >10 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

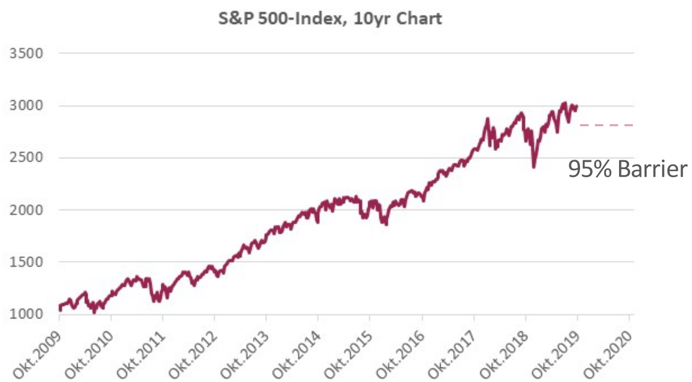
Product of the Week

The Investment Case:

During times of below average bond yields and high equity prices, we constantly browse for alternative sources of income. **Investors which want their capital protected** might **benefit from above average interest** if they **accept a coupon payout which is depending on a set of conditions**. As regular readers will recall, we at Gigant don't see much upside for the stock market but instead have a constructive view on gold. The miss of opportunity in case no coupon is paid is small since interest rates are so low.

How it works:

- **If at maturity in 1 year**, the price of **gold rises above 105**% **and the S&P500-stock index decreases below 95**% from the starting value, the investor will receive **a coupon payment of 5%.** If just one ore none of the two conditions are met at maturity date, no coupon will be paid out.
- The investment has a **capital protection of 100% at maturity** .



Preliminary Product Parameters: *)

Issuer:	Leonteq Securities (BBB+)
Coupon:	5%, paid conditionally if Gold > 105% and S&P500 < 95%
Maturity	1 year
Capital Protection:	100% at maturity
Minimum Investment Size	1'000.- USD

Scenario Analysis at Maturity:

Level of Gold at Maturity:	Level of S&P 500 at Maturity:	Interest Payment:	Capital Redemption
> 105%	< 95%	5%	100%
> 105%	> 95%	0%	100%
< 105%	< 95%	0%	100%
< 105%	> 95%	0%	100%

Source: FIS Market Map *) subject to change depending on market developments

Overview US Equity Model Portfolio

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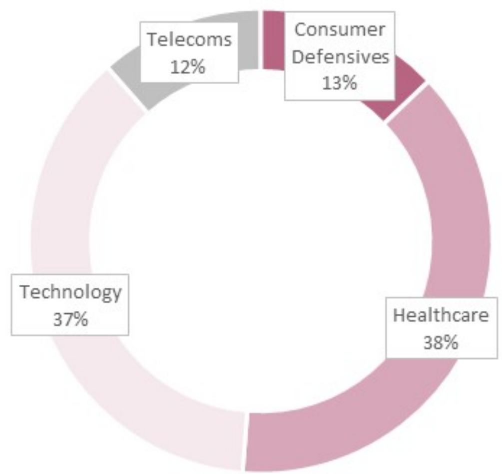
Performance Overview	2019	2018	2017	ITD *)
Gigant US Equity Model Portfolio	**+25.02%**	**-1.24%**	**+17.56%**	**+45.15%**
S&P 500	+19.59%	-6.24%	+19.4%	+33.91%
Dow Jones	+15.85%	-5.63%	+25.1%	+36.75%
Nasdaq 100	+25.47%	-1.04%	+27.1%	+63.30%

Current Situation:	
Current Value:	1'451'530 USD
Start Value:	1'000'000 USD
Realized Gains:	+368'721.5 USD
Dividend Income:	+44'021.23 USD
Unrealized Gains:	+38'786.96 USD
Cash:	636'662 USD (44%)
Equities:	814'868 USD (56%)

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 17th of October; *) inception date = 31th of Dec 2016

Constituents of our US Equity Model Portfolio

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GICS Sector	Stock & Performance		
Energy			
Basic Materials			
Industrials			
Consumer Discretionary			
Consumer Defensives	**CVS Health** -17.50%	**Philipp Morris** 7.21%	**Intuitive Surgical** 11.60%
Health Care	**Merck** 42.30%		
Financials			
Technology	**Alphabet** 20.70%	**Microsoft** 17.00%	**YY** -38.80%
Telecom	**AT&T** 4.36%		
Utilities			
Real Estate			

performance = price return exluding dividends

computed by stockopedia.com; all data as of 17th of October

Changes to our USD Bond Portfolio:
Use expired Semicon.Manufact. 2019 to BUY GTLK 2206

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4.125% Semiconductor Manufacturing Int Corp 07.10.2019

Rating:	BBB-
Redemed at:	100.00%
Hold. Period:	**119 days**
Tot. Return	**+5.63% *)**

Rationale of Disposal: This bond has reached its maturity date and was repaid at 100%

About the Issuer: SMIC is the leading semiconductor foundry service provider in mainland China, providing integrated circuit (IC) foundry and technology services. The state-owned Datang Telecom is SMIC's largests hareholder with a 19.1% stake, followed by China Integrated Circuit Industry Investment Fund (IC Fund) (11.5%), China Investment Corp (8%) and Shanghai Industrial (3.84%). These government related entities held a 42.4% total equity stake in SMIC.

4.949% GTLK Europe Designated Activity Comp 18.02.2026

Rating:	BB+
Buy Price:	100.563%
YTM:	**4.94%**
Duration:	**5.2**
Min. Size:	200'000 USD

Investment Rationale: GTLK's credit rating is among the lowest within our Model Portfolio. However, the amount of issuers with non-investment grade ratings is still below 25%, a degree which we consider appropriate. Anyhow, the implicit government backing undermines our investment case. With the passage of time, we can afford adding another 2026-issue to the portfolio.

About the Issuer: GTLK Europe is an Ireland-based international company, engaged in leasing and trading of a wide range of air and sea vehicles. GTLK Europe is a subsidiary of "State Transport Leasing Company (STLC)" which operates as financial partner for both Russian and foreign investors. STLC is Russia's largest leasing company. The sole shareholder of STLC is the Russian Federation represented by the Ministry of Transport. GTLK Europe hold assets worth 1,8bn USD , among them 50 airplanes and 13 cargo vessels. Among its clients are Easyjet and Sun Express.

*) non-annualized total return including coupon payments, changes in accrued interest and price changes; all price data from FIS Market Map

Changes to our USD Bond Portfolio:
Use early repaid Barrick 2020 to BUY Bank of Sharjah 2024

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BARRICK

4.95% Barrick Australia Finance PTY LTD 15.01.2020

Rating:	BBB-
Redemed at:	101%
Hold. Period:	**926 days**
Tot. Return	**+10.92% *)**

Rationale of Disposal: The issuer early repaid this bond ahead of expiry date.

About the Issuer: Barrick Gold Corporation is the largest gold miner. Barrick operates mines and develops projects in the United States, Canada, South America, Australia, and Africa. Since 2015, the company has reduced its debt by 5bn USD. Five large mines provide over 60% of overall production at a very competitive price and produce over 75% of Free Cash Flow from operations.

بنك الشارقة
Bank of Sharjah

4% Bank of Sharjah Funding LTD 18.09.2024

Rating:	BBB-
Buy Price:	99.33%
YTM:	**4.15%**
Duration:	**4.3**
Min. Size:	200’000 USD

Investment Rationale: Admittedly, with the addition of this security, our portfolio will have a small overhang of 2024-maturities. However, we note that 2025-papers are rare as presently, most new issues have 5 year maturities. We like this security for its above-average yield which is even more attractive when taking into account the relatively solid credit metrics and the government’s stake in the group. From a portfolio point of view, our Model Portfolio does have relatively little exposure to the financial sector so far and also from a regional point of view does this bond help to diversify our holdings.

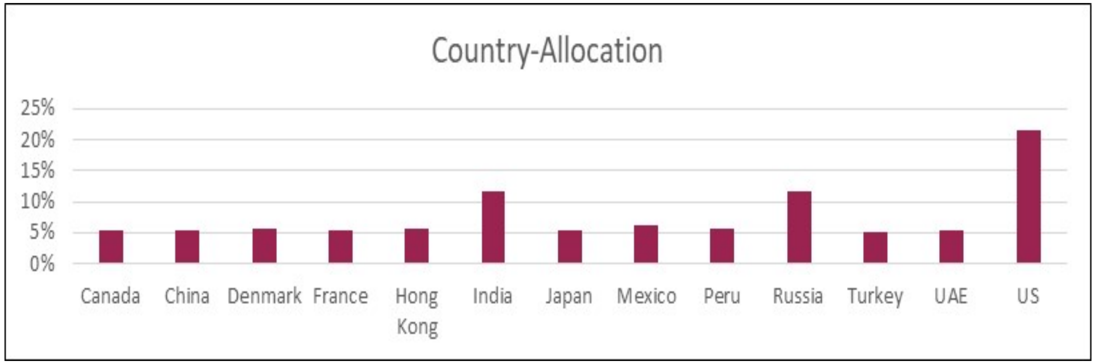
About the Issuer: Bank of Sharjah was established in 1973 as the first commercial bank in Sharjah and the fifth in the UAE. The Emirate of Sharjah is the third largest of the Emirates of the United Arab Emirates. The Bank has a strong presence in the UAE and Lebanon. Ist shares are listed on the Abu Dhabi Securities Exchange. The government of the Emirate of Sharjah holds 17% of the outstanding shares. At the end of 2018, the bank, whose major businesses comprise commercial & personal banking, held assets worth approx. 8bn USD. The bank’s Common Equity Tier 1-Ratio stood at a healthy 13.12%.

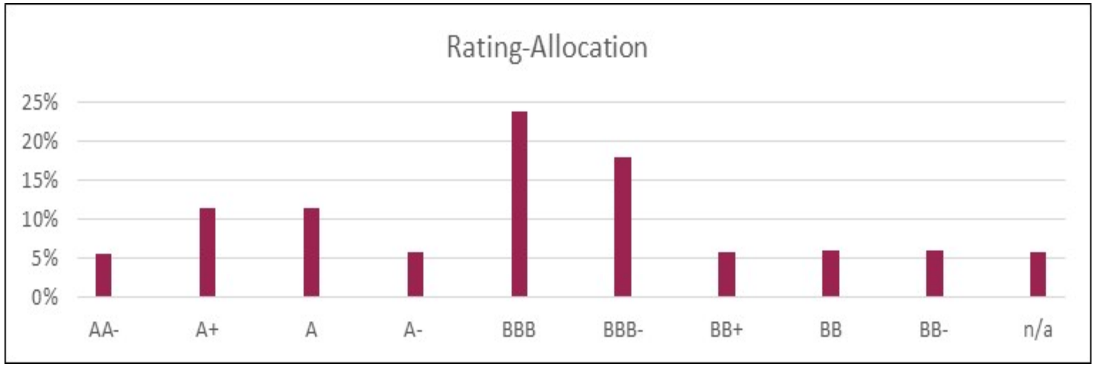
*) non-annualized total return including coupon payments, changes in accrued interest and price changes; all price data from FIS Market Map

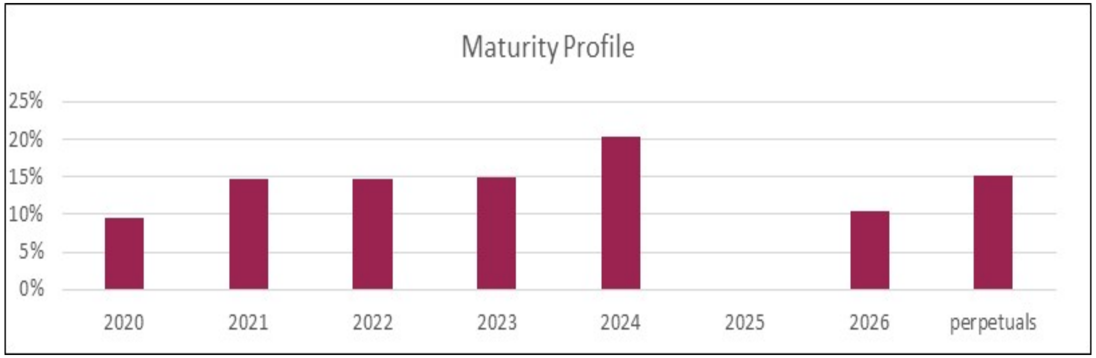
Overview USD Bond Model Portfolio

Performance Overview	YTD	2018	2017
Gigant USD Bond Model Portfolio	**+7.54%**	**+1.00%**	**+4.70%**
Bloomberg Barclays US Aggregate Index	+8.33%	+0.01%	+1.17%
Bloomberg Barclays EM USD Aggregate Index	+8.25%	-2.46%	+6.87%

Current Situation:	
Weighted average YTM:	3.40%
Weighted average Duration:	4.5







Source of data: FIS Market Map; own calculation; all data as of 17th of October

Constituents USD Bond Model Portfolio

	Coupon	Bond Instruments	Maturity	Rating	Country	Industry	YTM	Duration	Bid-Price	minimum size
	4.375%	AFRICA FINANCE CORPN	29.04.2020	A3		Supranational Agency	2.89%	0.5	100.76	200'000 USD
	2.343%	FORD MOTOR CREDIT COMPANY LLC	02.11.2020	BBB	US	Finance & Investment	2.91%	1.0	99.43	200'000 USD
	5.950%	GAP INC	12.04.2021	BB-	US	Supermarkets & Stores	2.84%	1.4	104.48	200'000 USD
	2.362%	CENTRAL NIPPON EXPRESSWAY COMPANY LIMITED	28.05.2021	A1	Japan	Railways & Transportation	2.22%	1.5	100.21	200'000 USD
	2.125%	CORPORACION ANDINA DE FOMENTO (CAF)	27.09.2021	AA-		Supranational Agency	2.07%	1.8	100.10	1'000 USD
	5.375%	VOLCAN COMPANIA MINERA S.A.A.	02.02.2022	BB	Peru	Mining & Refining	3.71%	2.1	103.59	200'000 USD
	2.750%	STATE GRID OVERSEAS INVESTMENT (2016) LIMITED	04.05.2022	A+	China	Utilities	2.39%	2.4	100.88	200'000 USD
	2.500%	PHILIP MORRIS INTERNATIONAL INC.	22.08.2022	A	US	Tobacco	2.26%	2.7	100.66	1'000 USD
	3.100%	GENERAL ELECTRIC CAPITAL CORPN	09.01.2023	A	US	Finance & Investment	2.63%	3.0	101.43	200'000 USD
	5.250%	LOUIS DREYFUS COMPANY B.V.	13.06.2023	n/a	France	Commodity Trading	4.69%	3.2	101.87	200'000 USD
	3.875%	DANSKE BANK A/S	12.09.2023	A-	Denmark	Banking & Finance	2.85%	3.5	103.75	2'000 USD
	4.750%	INDIAN OIL CORPN LTD	16.01.2024	A-	India	Oil & Petroleum	3.06%	3.7	106.65	200'000 USD
	5.250%	ALFA, S.A.B. DE C.V.	25.03.2024	BBB-	Mexico	Industrial (General)	3.29%	3.8	108.00	200'000 USD
	5.375%	GMR HYDERABAD INTERNATIONAL AIRPORT LIMITED	10.04.2024	BBB	India	Services	4.49%	3.8	103.55	200'000 USD
	4.215%	COCA COLA ICECEK URETIM AS	19.09.2024	BBB	Turkey	Food Manufacturing	4.55%	4.2	98.53	2'000 USD
	4.000%	**BOS FUNDING LTD**	**18.09.2024**	**BBB+**	**UAE**	**Banking & Finance**	**3.80%**	**4.3**	**100.90**	**200'000 USD**
	5.150%	GAZPROM OJSC	11.02.2026	BBB	Russia	Oil & Petroleum	3.54%	5.2	109.05	200'000 USD
	4.949%	**GTLK EUROPE DESIGNATED ACTIVITY COMPANY**	**18.02.2026**	**BB+**	**Russia**	**Finance & Investment**	**4.58%**	**5.2**	**102.00**	**200'000 USD**
*)	4.750%	TOWNGAS FINANCE LTD		A-	Hong Kong	Utilities	4.46%	15.6	104.78	200'000 USD
*)	4.800%	BANK OF MONTREAL		BBB-	Canada	Banking & Finance	4.75%	21.1	101.12	200'000 USD

Source: FIS MarketMap; all data as of 18th of October   mangenta = recent changes   *) = Perpetual Bonds with next call date in 2024

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