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Investment Letter No 2
Week 5
2019

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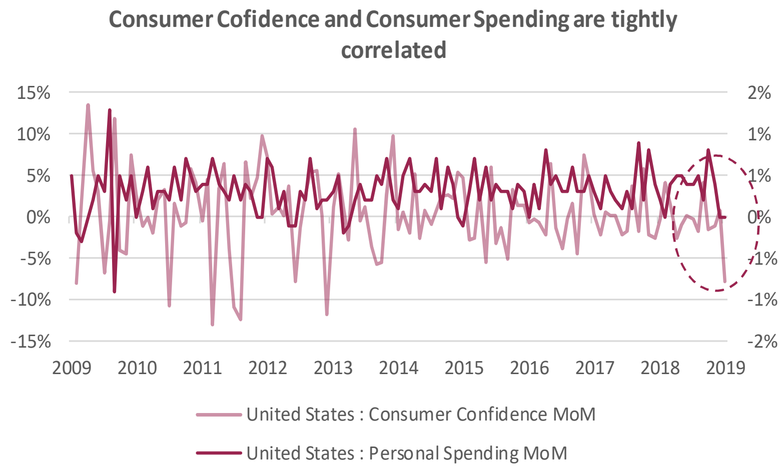
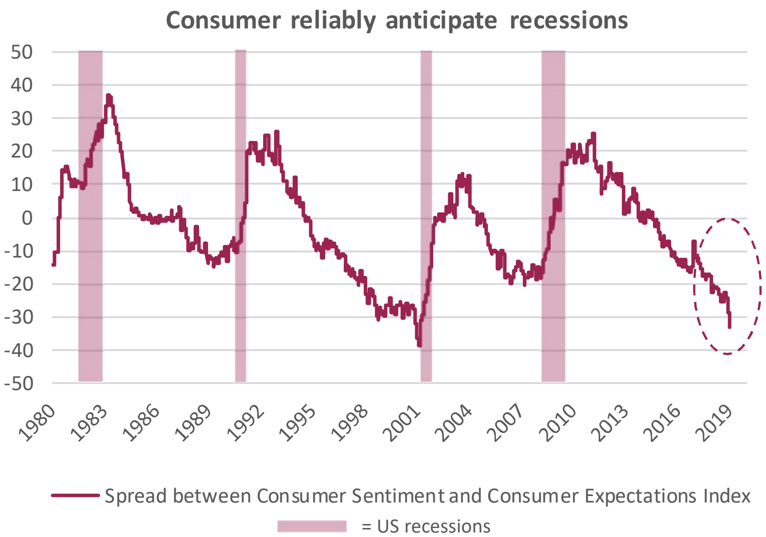
What consumers tell about recession probabilities

After the one-off effect of the US tax cuts in 2018 ran out and after a series of deteriorating macro economic data, it has become sort of **consensus that the US economy is about to slow**. Even the FED is now alerted and suddenly put its hiking path on hold (confusingly by saying that apart from that, all was well). During times, virtually all sell side strategist eagerly tell their clients that yes, growth is slowing but no, there is no change a **recession** will hit, **we ask ourselves** if not maybe markets **underestimate that possibility**. To get a good sense about the state of the US economy, one should just look at how US consumers do since according to the *U.S. Bureau of Economic Analysis*, approx. 68% of the U.S. economy is made up by consumer spending. **Consumer Confidence** as measured by the *University of Michigan* dropped from 100 to 90 points in January and the *Conference Board's Consumer Expectations Index* **crashed** the most over the last 3 months since 2007. While **consumer confidence indices** are admittedly much more volatile than **real consumer spending activities**, they are nonetheless **tightly correlated** (*see graph on the upper right*). As *DoubleLine Capital* points out, the **spread between current consumer sentiment vs. future consumer expectations** (as measured by the relevant indices from the Conference Board) just **posted one of the poorest readings ever**. In the past, this was an **unduly sign of an imminent recession**. I other words, consumers feel allright today but are heavily worried about the upcoming future. Who is to blame them, when in a country in which many literally live from one pay cheque to the next, the government via a self-inflicted shut down defers pay cheques of hundred of thousand of its staff by a months ore more? Be it as it may, **we see the risk of an US recession as far bigger than the market might currently imply**.





Source: University of Michigan; U.S. Bureau of Economic Analysis; Heckyl; DoubleLine Capital; The Conference Board; Bloomberg

Our Tactical Asset Allocation (6months horizon)

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EQUITIES –> REMAIN UNDERWEIGHT

- Admittedly, the **January-recovery in equities** looks impressive and **we would not have expected to run it that far**. Various intermediate technical resistance levels have been cleared, not last thanks to the sudden U-turn of the FED. 2018 earnings reports from some of the large bellwether (tech) companies have also helped. Hopes for a deal in both, the **US-Sino trade** war (remember, the truce will expire on 1st of March) as well as an (intermediate) ending of the US **government shutdown** (the current deal only to last until 15th of February) proved to be a good catalyst. We remind our readers that for both issues, the proverbial **can was just kicked down the road and nothing is truly resolved for now**. Anyhow, **expect the current positive sentiment to prevail for at least until mid of February** until reality might set in again.
- Rather than to the overall direction of the equity markets, the **FED's change of strategy has implications on what sectors and countries should be preferred**. The more dovish language implies a **weaker dollar** for the months to come (since rate hike expectations are dialled back) which again gives an edge to US large caps with large proportions of their sales in overseas markets but is less goof for the European stock indices which large weightings of export oriented companies. Thus, **expect the US equity's outperformance to continue**. The sudden renaissance of the low rates narrative **bodes also well for growth stocks** whose investment rationale is built on lower discount rates.

CASH –> REMAIN OVERWEIGHT

- The FED's implicit reference to a potential slowing of its balance sheet reduction and "other policy tool" (QE4?) will drag the USD lower for the months to come. **Expect EURUSD to reach up to 1,17**, a level at which we would happily convert EURs back into higher yielding USD.
- Furthermore, **lower rates for longer and a weaker US Dollar are the perfect catalysts for gold**. Next stop on the way up is 1350 USD per ounce.
- During times where a 12months US Treasury Bill yields, 2,45% **cash is a very viable investment alternative**.

Our Tactical Asset Allocation (6months horizon)

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BONDS –> REMAIN NEUTRAL

- The **FEDs U-turn in its rhetoric** (so far this is only lip service to the market since no action has been taken**) does indeed not rise the probability of higher short term rates.** Anyhow, **we remain of the opinion that the risk is to the upside** as the market does not price in any rate hike for 2019 any more. We don't think they'll hike because of a overly strong economy but rather because of continued wage growth leading and an extremely tight labour market, which unlike the growth rate of the US economy is indeed part of the FEDs official mandate.
- That all said, it's not the time for floating rate bond investment any more (we have closed our positions already). Whether there is a rate hike in 2019 or not, **what we got as message from the FED is that long term rates won't rise at all**. We are therefore required to add duration to our portfolios which on average are still pretty short on duration.
- Credit wise, **credit spreads are historically low** and that during times of record high leverage and an average credit quality which is poorer then ever, Investors should clearly **avoid lower credit quality** which does only compensate them by a proverbial few basis points but pose a risk of a significant spread widening. If lower credit exposure, then only in the 1-3 year timeframe which you may hold until maturity.
- **Emerging Market Debt in USD looks more compelling to us**, both in relative and absolute terms. The worst seems to be behind us as fundamental economic data are less bad as feared (for now) and a more dovish FED is fuel for its bond prices.

ALTERNATIVES –> REMAIN OVERWEIGHT

- For the sake of boring our dear reader, we repeat our mantra that it is now more than ever a must to remain overweight on assets whose return is decoupled from traditional assets such as equities and bonds.

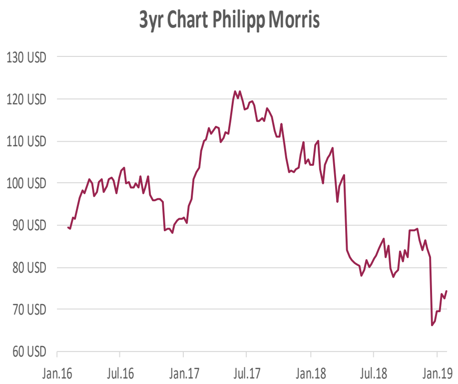
House View: our Preferences on one Slide

Asset Class	We Like	We Don't Like
Equities	*Area*: **Diversification among US, EU & EM** *Sectors*: **Pharma, Consumer Defensives, Utilities** *Style:* ~~**Value**~~**, Growth (with Quality)**	*Area*: **China** *Sectors:* **Telecom, Energy** *Style:* **High growth *without* quality**
Bonds	*Duration:* **Medium term duration** up to **7** years *Area:* **US;** ***selected*** **Emerging Markets** *Credit:* **low grade IG**	*Duration*: ~~**Ultra long duration** beyond~~ **10** years Area: **China** *Credit:* **EU & US High Yield**
FX & Commo-dities	*FX Majors:* ~~**USD**~~**, JPY** *Commodities:* **Gold**	*FX Majors:* **GBP** *FX Minors:* **NOK** *Commodities:* **Base Metals**
Alternatives	*Alternatives:* **Gigant Option Based Equity Growth Strategy; strategies with uncorrelated payoffs to equity & bond market direction**	

mangenta = recent changes

Added to our US Equity Portfolio: Philip Morris

Sector:	Consumer Defensives
Risk Type:	**Conservative**
Market Cap:	115.67bn USD
Dividend:	4.67%
1Yr-Return:	+7%



Company Description: Philip Morris International (PMI) is a global tobacco manufacturer with 6 of the world's top 15 international brands, including Marlboro, the number one cigarette brand worldwide by volume. Until 28 March 2008, PMI was a wholly-owned subsidiary of Altria Group Inc. Since then, PMI has been independent, and it is listed on the NYSE. In 2017, PMI held around 27% of the total international cigarette market excluding China. PMI's sales exposure in 2017 was 29% to the EU, 9% to Eastern Europe, 14% to Middle East & Africa, 15% to South & Southeast Asia, 22% to East Asia & Australia, and 10% to Latin America and Canada.

Investment Rational:

- Thanks to the **trend for non-combustible cigarette products**, the tobacco industry is anything but dead. PM is now offering iQOS, its tobacco heating system, which heats tobacco up to 350°C without combustion, fire, ash or smoke in 43 markets. In most of them, it is **growing fast and gaining market share**. According to PM, more than 5mio smokers have already switched to iQOS. If granted approval by the US Food and Drug Administration, PM will license it to Altria. Anyhow, iQOS is also the source of the share price weakness over the last 18months since growth was slower than initially expected, particularly in the important Japanese market. However, the company addressed the issue and **improved iQOS devices lately**.
- Going forward, a combination of improved iQOS devices combined with the **strong pricing power of its well established brands** in the traditional tobacco business should lead to higher growth in the high-single to low double digit area. A weaker USD will also help (thus making overseas earnings appear bigger in USD).
- Despite some of the highest dividend yields in the sector, strong cash flows and attractive margins, PM trades on **undemanding valuation** compared to the rest of the Consumer Defensives Sector.
- At this point in the economic cycle, having exposure to less cyclically geared Consumer Defensives stocks is a must for broader equity portfolios.

Risk associated:
As always with investments in the tobacco sector, any eventual tightening of regulatory condition poses the nr. 1 risk. Philip Morris is due to report its 2018 results on 7th of February.

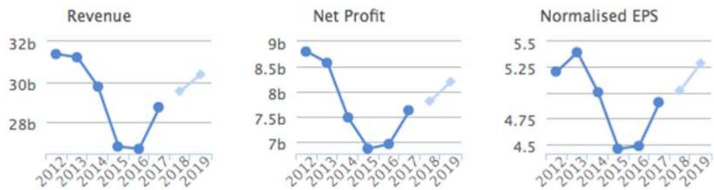
Quality Measures:

		vs. Industry	vs. Market
Return on Capital	50.4 %		
Return on Equity	n/a %		
Operating Margin	39.4 %		

Growth Measures:

12m Forecast Rolling		vs. Industry	vs. Market
PE Ratio (f)	14.1		
PEG Ratio (f)	2.80		
EPS Growth (f)	5.30 %		

Historical Revenue & Profit Evolution:



Source: www.stockopedia.com; FIS Market MAP; all numbers as of 30th of January

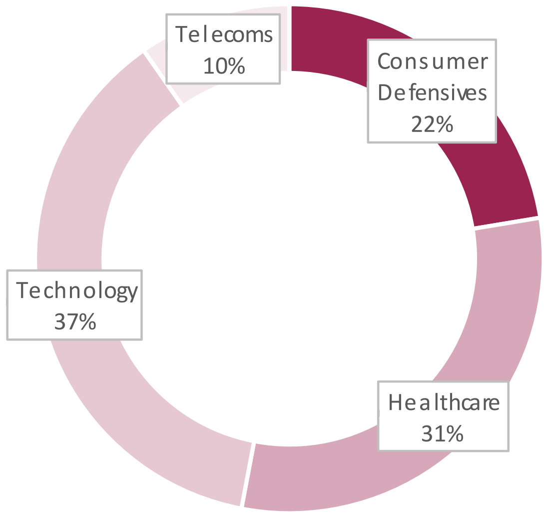
Overview US Equity Model Portfolio

Performance Overview	2019	2018	2017	ITD *)
Gigant US Equity Model Portfolio	**+6.39%**	**-1.24%**	**+17.56%**	**+23.52%**
S&P 500	+7.87%	-6.24%	+19.4%	+20.78%
Dow Jones	+7.17%	-5.63%	+25.1%	+26.50%
Nasdaq 100	+9.11%	-1.04%	+27.1%	+42.01%

Current Situation:	
Current Value:	1'235'213 USD
Start Value:	1'000'000 USD
Realized Gains:	+203'708 USD
Unrealized Gains:	-5'193 USD
Cash:	466'815 USD (38%)
Equities:	768'398 USD (62%)

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 31th of Jan; *) 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 -18,60%	Philipp Morris 3,01%
Health Care	Merck 26,40%	Intuitive Surgical 33,30%
Financials		
Technology	Alphabet 7,57%	YY -28,70%
Telecom	AT&& -17,00%	Soft Bank -6,55%
Utilities		
Real Estate		

stocks we hold but don't buy any more

stocks we still buy

performance = price return

computed by stockopedia.com; all data as of 31th of Jan

Changes to our USD Bond Portfolio:
SELL Veon 2019 to BUY Hong Kong & China Gas Perpetual NC5

VEON

5.2% VEON 13.02.2019

Rating:	BB
Selling Price:	99.99%
Hold. Period:	**730 days**
Tot. Return	**7.38%**

Rationale of Disposal: This bond is about to mature on 13th of February 2019.

About the Issuer: VEON, formerly known as Vimpelcom, is one of the largest integrated telecommunications services providers in the world, serving over 235mn customers in 13 countries. VEON provides voice, fixed broadband, data and digital services. The company is one of three leading operators in Russia and the largest mobile operator in Ukraine. VEON operates in Italy via a 50-50 joint venture with Hutchinson group. Telenor owns 19.7% stake, with Letter One (beneficially owned by Russian businessmen) holding a 47.9%-stake.

煤氣 Towngas

4.75% Towngas Subordinated Perpetual Non-Call 5Y

Rating:	A3 / A-
Buy Price:	100%
Yield to Call:	**4.75%**
Duration:	**15.5**
Min. Size:	200'000 USD

Investment Rationale: This bond is a subordinated bond with infinite maturity. The issuer has the right to call this bond every 5 years from issuance. If not, the coupon is reset at a higher spread. For these type of bonds, the yield is usually calculated under the assumption that the issuer will effectively use his option to call it. Within the framework of our USD Model Portfolio, we are very short on duration and can thus afford some extension. We buy this bond out of issuance.

About the Issuer: Hong Kong & China Gas ("Towngas") is a gas utility business focusing on gas distribution in Hong Kong and China. It owns a 62% stake in Towngas China, which also operates gas distribution businesses in China, servicing primarily residential, industrial and commercial and vehicle users. The company has diversified its businesses upstream to include coal-to-methanol, coalbed methane, aviation fuel storage, and oil projects in Thailand. Founded in 1862, it one of the oldest, publicly listed companies in Hong Kong. 40% of its shares are held by Henderson Land, a leading property developer in Hong Kong and mainland China.

*) 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

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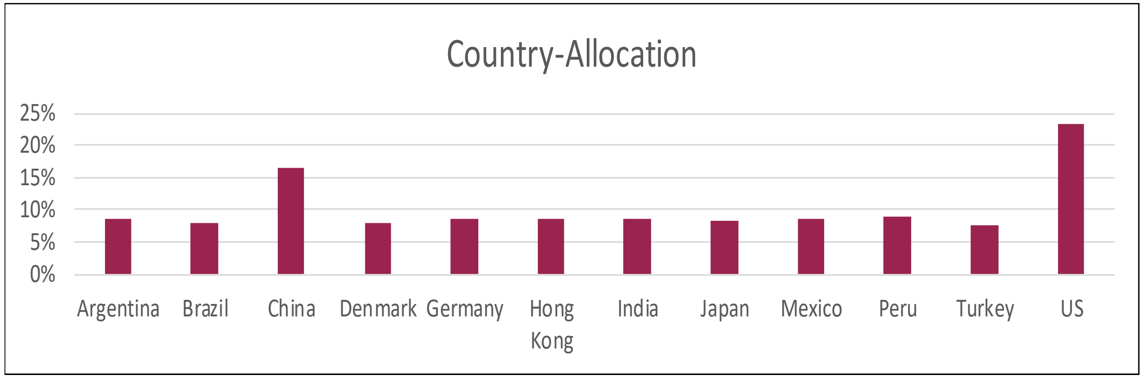
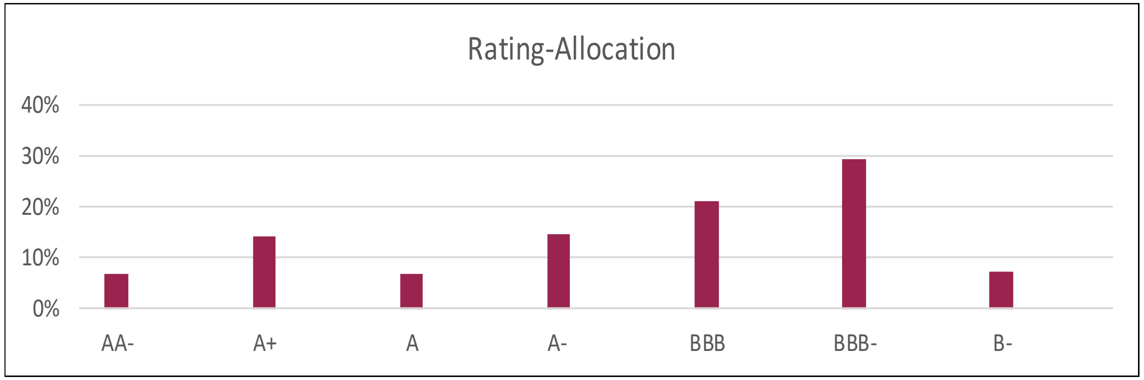
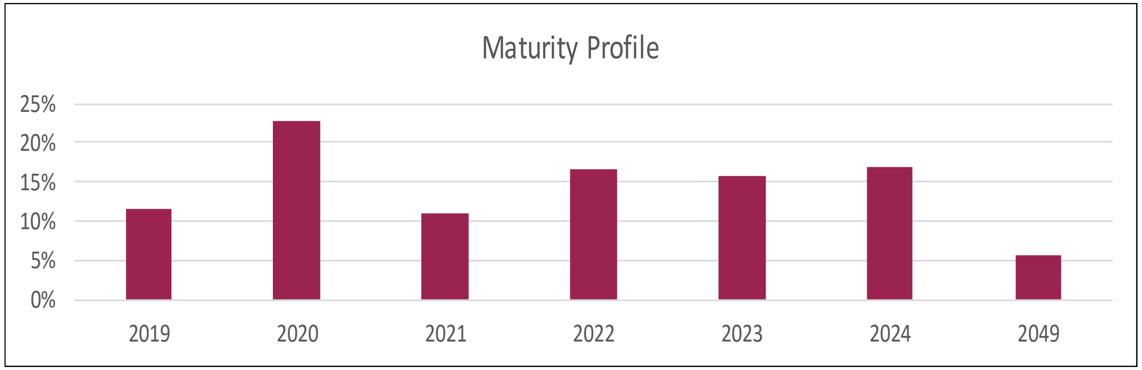
Performance Overview	YTD	2018	2017
Gigant USD Bond Model Portfolio	**+1.53%**	**+1.00%**	**+4.70%**
Bloomberg Barclays US Aggregate Index	+1.07%	+0.01%	+1.17%
Bloomberg Barclays EM USD Aggregate Index	+0.65%	-2.46%	+6.87%

Current Situation:	
Weighted average YTM:	4,07%
Weighted average Duration:	3,4







Source of data: FIS Market Map; own calculation; all data as of 31th of Jan

Constituents USD Bond Model Portfolio

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	Coupon	Bond Instruments	Maturity	Rating	Country	Industry	YTM	Duration	Bid-Price	minimum size	Allocation
	5,750%	BUENOS AIRES, PROVINCE OF	15.06.2019	B-	Argentina	Municipality	5,03%	0,3	100,25	150.000 USD	6,41%
	4,125%	SEMICONDUCTOR MANUFACTURING INTERNATIONAL CORPO	07.10.2019	BBB-	China	Electrical & Electronic	3,87%	0,6	100,07	200.000 USD	6,39%
	4,950%	BARRICK (PD) AUSTRALIA FINANCE PTY LTD	15.01.2020	BBB-	Canada	Mining & Refining	2,98%	0,9	101,78	2.000 USD	6,61%
	4,375%	AFRICA FINANCE CORPN	29.04.2020	A3		Supranational Agency	4,17%	1,2	100,07	200.000 USD	6,39%
	4,000%	VOLKSWAGEN INTERNATIONAL FINANCE N.V.	12.08.2020	A3	Germany	Automobile Manufacturers	3,17%	1,4	100,75	100.000 USD	6,47%
	2,343%	FORD MOTOR CREDIT COMPANY LLC	02.11.2020	BBB	US	Finance & Investment	4,37%	1,6	96,19	200.000 USD	5,90%
	2,362%	CENTRAL NIPPON EXPRESSWAY COMPANY LIMITED	28.05.2021	A1	Japan	Railways & Transportation	3,30%	2,2	97,80	200.000 USD	6,10%
	1,949%	CITIGROUP INC	02.08.2021	BBB+	US	Banking & Finance	1,43%	2,4	0,00	200.000 USD	0,00%
	2,125%	CORPORACION ANDINA DE FOMENTO (CAF)	27.09.2021	AA-		Supranational Agency	3,13%	2,5	97,43	1.000 USD	6,05%
	2,750%	STATE GRID OVERSEAS INVESTMENT (2016) LIMITED	04.05.2022	A+	China	Utilities	3,35%	3,0	97,84	200.000 USD	6,10%
	2,500%	PHILIP MORRIS INTERNATIONAL INC.	22.08.2022	A	US	Tobacco	3,16%	3,3	95,88	1.000 USD	5,86%
	5,000%	BBVA BANCO CONTINENTAL	26.08.2022	BBB	Peru	Finance & Investment	3,98%	3,2	102,00	200.000 USD	6,63%
	3,100%	GENERAL ELECTRIC CAPITAL CORPN	09.01.2023	A	US	Finance & Investment	4,00%	3,5	0,00	200.000 USD	0,00%
	3,500%	BRASKEM AMERICA FINANCE COMPANY	10.01.2023	BBB-	Brazil	Chemicals	4,37%	3,5	96,57	200.000 USD	5,95%
	3,375%	EMC CORPN	01.06.2023	BB-	US	Electrical & Electronic	4,77%	3,8	0,00	200.000 USD	0,00%
	3,875%	DANSKE BANK A/S	12.09.2023	A-	Denmark	Banking & Finance	4,52%	4,0	0,00	2.000 USD	0,00%
	4,750%	**INDIAN OIL CORPN LTD**	**16.01.2024**	**A-**	**India**	**Oil & Petroleum**	**4,28%**	**4,2**	101,14	**200.000 USD**	**6,52%**
	5,250%	**ALFA, S.A.B. DE C.V.**	**25.03.2024**	**BBB-**	**Mexico**	**Industrial (General)**	**4,85%**	**4,3**	101,31	**200.000 USD**	**6,54%**
	4,215%	COCA COLA ICECEK URETIM AS	19.09.2024	BBB	Turkey	Food Manufacturing	5,24%	4,8	94,58	2.000 USD	5,70%
***)**	**4,750%**	**TOWNGAS FINANCE LTD**	**12.08.2049**	**A-**	**Hong Kong**	**Utilities**	**4,75%**	**15,5**	100,00	**200.000 USD**	**6,38%**

Source: FIS MarketMap; all data as of 31th of Jan

mangenta = recent changes

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

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