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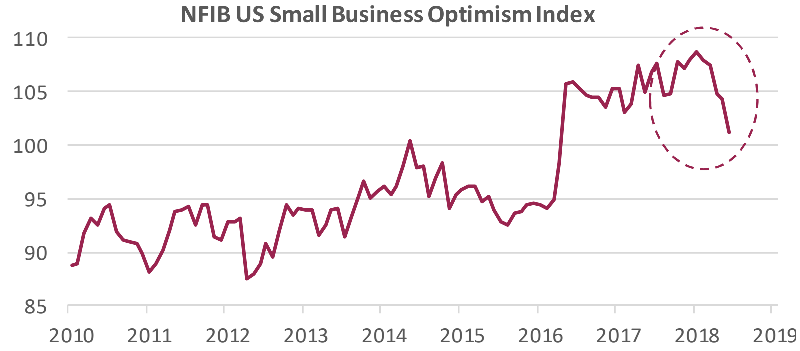
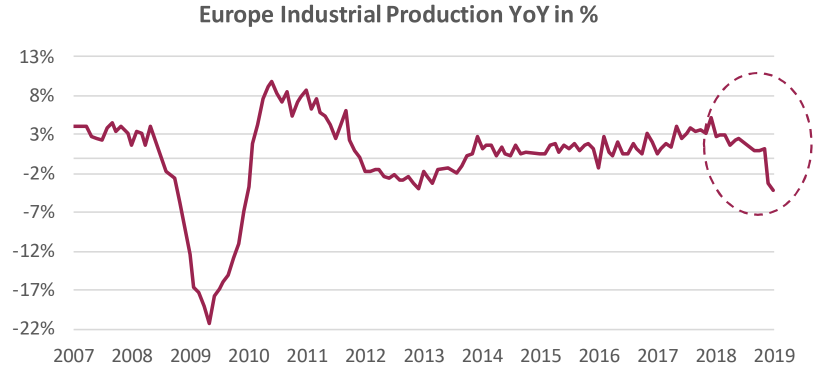
Investment Letter No 3
Week 7
2019

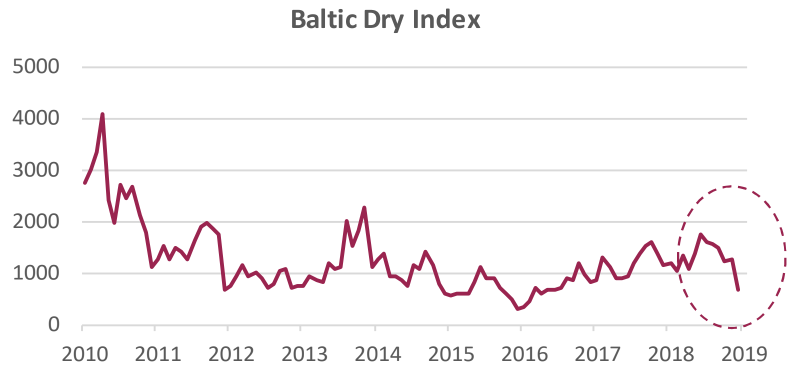
Table of Content

The macro economic outlook is further deteriorating….

In our latest Investment Letter, we discussed the deteriorating US consumer sentiment which in our eyes is a reliable indicator for upcoming economic weakness (*see Investment Letter No 2, page 3)*. In the meantime, the weak sentiment was confirmed by December-**retail sales** which posted its **biggest monthly drop since September 2009**. Likewise, **optimism among small business owners** (as measured by the NFIB Small Business Optimism Index) **posted the lowest reading since Trump's election**. The NFIB Uncertainty Index rose to the fight highest reading in the survey's 45-year history (!). "One thing small businesses make clear to us their dislike for uncertainty, and while they are continuing to create jobs and increase compensation (…), the political climate is affecting how they view the future" commented the President of NFIB. Keep in mind that according to the U.S. Small Business Administration, **small businesses contribute about 46% of the private nonfarm GDP of the US**. Furthermore, confidence of Small Business Owners is highly correlated to GDP Growth. Meanwhile in Europe, Eurostat just reported that the **industrial production in the Eurozone contracted by catastrophic -4.1% in 2018**, a slump higher than that during the European Debt Crisis in 2011/2012. The drop was only worse during the Great Financial Crisis and in the early 90ies. If one needs a prove that protectionist politics do have a harmful impact on global trade, consider the **Baltic Dry Index** which in simple terms represents the cost of renting ocean container ships as an early indicator (the more goods are being made and sold, the higher the demand for fight vessels).





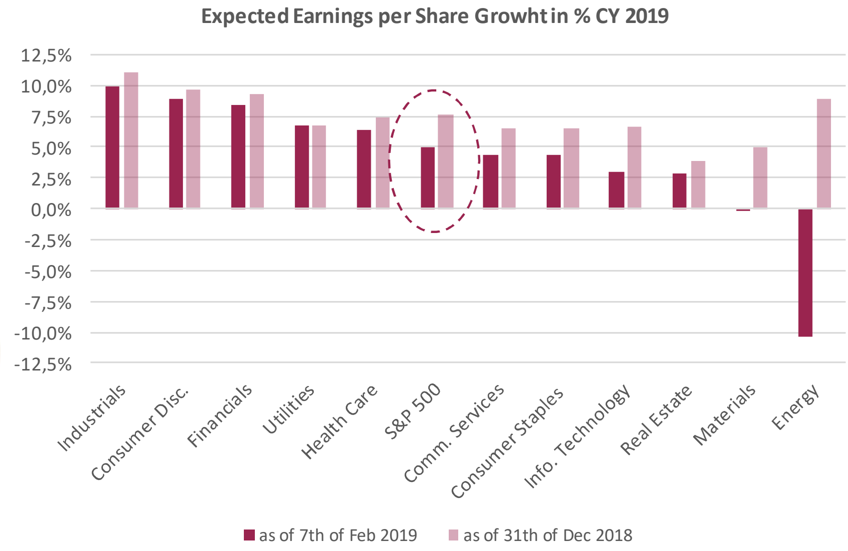


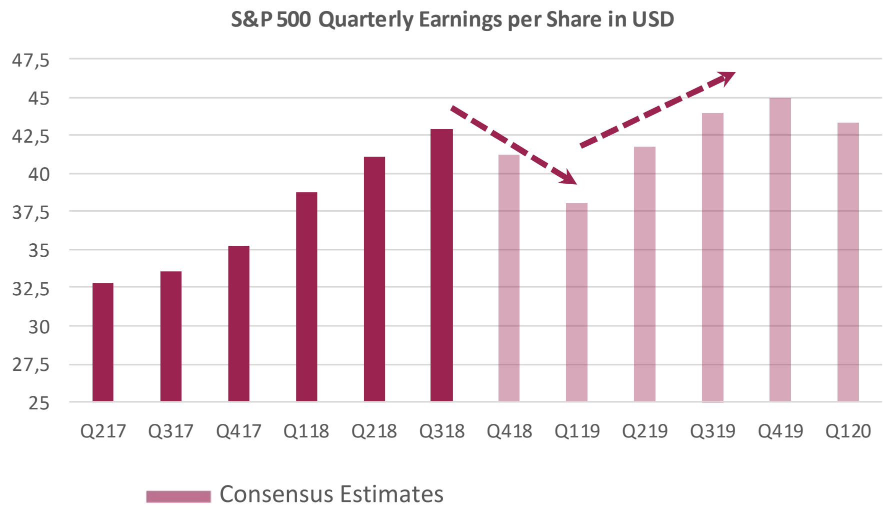
Source: NFIB Research Foundation; U.S. Small Business Administration; Baltic Exchange; Eurostat

…but not reflected in today's share prices

As one can see from the chart underneath on the previous page, the Index just **posted its worst start into a year since 1984**. Admittedly, this index is notoriously volatile and in the past, its explanatory power has been put into question since the supply for container ships is extremely inelastic, but it seems intuitively logic that things go in the wrong direction here. **The problem with all this macro economic cooling-down is that it is not reflected in today's share prices**. Equity Bulls are keen to note that expected Earnings per Share for the aggregated US equity market have retreated quite substantially which in our eyes, is not quite right. What is undoubtedly true is that **Q1 2019 earnings expectations have indeed slumped** quite substantially (from +3,3% at the end of 2018 to -0.8% today). However, the expected earnings growth for the full year 2019 has only retreated from +7,7% at end of 2018 to +5% as of today (see both chart on the right; all data provided by FactSet). The **problem with this projected +5%** earnings per share growth (which by the way is not unusually high in absolute terms when looking at the past) **is that it would need an tremendous recovery in earnings growth for mainly the second half of 2019**. And now that, **in our eyes does just not match with the macro economic warning signs** just described. Bulls are absolutely right in pointing to the fact that economic expansion periods do not die of old age anyhow there is equally no natural law which for quick and sudden recoveries.

Thus, in our eyes, the current growth expectations are exaggerated which is why we conclude that after a +15% rally in US equities, it is not the time to increase allocation to risk assets.





Source: FactSet

Our Tactical Asset Allocation (6months horizon)

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EQUITIES –> REMAIN UNDERWEIGHT

- US equity indices posted double digit gains in just 7 weeks of trading in 2019, a move whose magnitude we grossly underestimated. Anyhow, as we detailed on the previous two pages, the current **macro economic data as well as elevated earnings expectations do not warrant an increase of our equity allocation no matter how tempting the current price action might be**.
- A **final deal** in in the **US-Sino trade war** (remember, the truce will expire on 1st of March after which tariffs on 200bn USD of imported goods would increase from 10% to 25%) **would force us to take more risk** by lifting our equity allocation. Anyhow, an extension of the current truce does not equal a deal! Such an extension may keep hope alive for some time but we still very much doubt there will be a quick fix for a better protection of intellectual property (for which this entire trade war was started).
- 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)

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. As one can see from our latest transactions in our USD Bond Model Portfolio, w**e extended the duration of our portfolio as of late. The absolute level of our duration exposure is still not overly long since the yield curve is historically flat.
- 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.
- We are of the opinion that its **not the time for broad High Yield investments** at spreads have compressed fairly quick after their Q4 2018 blowout. Likewise with our overall credit exposure, High Yield is only investable to us in the very short term where the yield carry will outweigh a potential spread widening.
- **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

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Asset Class	We Like	We Don't Like
Equities	*Area*: **Diversification among US, EU & EM** *Sectors*: **Pharma, Consumer Defensives, Utilities** *Style:* **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**	Area: **China** *Credit:* **EU & US High Yield**
FX & Commo-dities	*FX Majors:* **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

Product of the Week: 1 Yr Reverse Convertible on Gold

Investment Rationale:
We believe the **price of gold** has **good chances to rise** thanks to a less **stronger USD**, a mild inflation and **golds ability to act as a hedge against macro economic risks**. Anyhow, an investment in gold comes at an opportunity costs since holding gold over time does not yield any interest and today, holding USD-cash is a viable alternative (a 1 year US-Treasury Bill pays approx. 2.35%). For those which **share our view that gold can go higher but who would prefer to get a fixed income stream, selling downside-risk of gold might be the strategy of choice**. By doing so, one can collect an interest which beats that of in investment in short dated bonds while taking the risk to buy gold at the current spot price at a given date in the future. Anyhow, there won't be a participation in case gold prices rise.

10yr Chart Troy Ounce of Gold in USD

How it works:

- The investor receives a **fixed & guaranteed coupon of 5% p.a. in USD. The invested amount is fully repaid if the USD-price of a troy ounce gold trades> than 100% of today's level (the so-called "barrier level" which equals approx. USD 1'310 per ounce) <u>at maturity date in 1 years time</u>.** If not, the invested capital will automatically be converted into troy ounces of gold at the barrier level.
- In other words, the **investor will only suffer a capital loss in case gold trades lower than today in 1 years time.** Anyhow, it he may then keep his gold exposure in hope for a later price recovery. During the lifetime of the product, the price of a troy ounce of gold may well trade below the barrier level with no impact on the final redemption.
- A secondary market for trading this product during its lifetime will be provided. However, the quoted price does not include any accrued interest. The value of this product may be below / above the issue price of 100% during its lifetime.

Source: FIS Market Map

Removed from our Model Portfolio: Intuitive Surgical

INTUITIVE SURGICAL®

Sector:	Healthcare Equipment
Risk Type:	**High Flyer**
Market Cap:	61bn USD
Holding Period:	363 days
Total Return:	**+32.84%**

Chart Intuitive Surgical since Purchase

Company Description:
Intuitive Surgical (ISRG) designs, manufactures and markets da Vinci Surgical Systems, and related instruments and accessories. The da Vinci Surgical System translates a surgeon's hand movements, which are performed on instrument controls at a console, into corresponding micro-movements of instruments positioned inside the patient through small incisions or ports.

Rationale of Disposal:

- Our investment in shares of Intuitive Surgical outperformed the Nasdaq-index by an impressive +30% over the holding period of approx. 1 year.
- While ISRG's business continues to experience strong growth (in late January, ISRG reported that shipments of its da Vinci-System surged by +34% in 2018), it seems to us that market expectations have got ahead of itself. In our eyes is that is the sole reason why the company did miss analyst expectations for the last two quarters. After the very impressive stock rally, the shares have gotten extremely expensive, even when compared to the notoriously expensive healthcare equipment industry.
- Subsequently, shares of ISRG have not posted fresh highs since its all-time peak in August 2018. While we continue to see ISRG as a company with a unique position in a secular growth market, we nonetheless prefer to cash in our large paper profits at current levels. We are happy buyers of ISRG-shares again at a more reasonable price again.

Quality Measures:

		vs. Industry	vs. Market
Return on Capital	17.1 %		
Return on Equity	19.7 %		
Operating Margin	32.2 %		

Growth Measures:

12m Forecast Rolling		vs. Industry	vs. Market
PE Ratio (f)	43.6		
PEG Ratio (f)	2.38		
EPS Growth (f)	22.4 %		
Dividend Yield (f)	n/a %		

Historical Revenue & Profit Evolution:

Source: www.stockopedia.com; FIS Market MAP; all numbers as of 14th of February

Overview US Equity Model Portfolio

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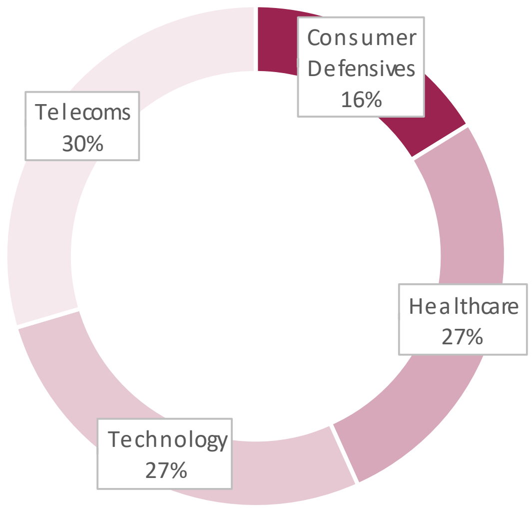
Performance Overview	2019	2018	2017	ITD *)
Gigant US Equity Model Portfolio	**+9.72%**	**-1.24%**	**+17.56%**	**+27.40%**
S&P 500	+9.53%	-6.24%	+19.4%	+22.64%
Dow Jones	+9.05%	-5.63%	+25.1%	+28.72%
Nasdaq 100	+10.94%	-1.04%	+27.1%	+44.39%

Current Situation:	
Current Value:	1’273’963 USD
Start Value:	1’000’000 USD
Realized Gains:	+235’710 USD
Unrealized Gains:	+1’026 USD
Cash:	596’788 USD (47%)
Equities:	677’174 USD (53%)

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 14th of Feb; *) 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 -16,00%	Philipp Morris 9,90%
Health Care	Merck 34,10%	
Financials		
Technology	Alphabet 8,08%	YY -29,30%
Telecom	AT&& -17,80%	Soft Bank 15,20%
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 14th of Feb

Changes to our USD Bond Portfolio:
SELL Citigroup 2021 FRN to BUY Gazprom 2026

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Citigroup 02.08.2021 FRN

Rating:	BBB+
Selling Price:	103.957%
Hold. Period:	**455 days**
Tot. Return	**3.47%**

Rationale of Disposal: This bond pays a floating coupon which move in tandem with the overall level of short term USD interest rates. After the first coupon we received was as low as 2,96% back in February 2018, its payments subsequently rose to as high as 3,92% this months. This floating rate note is the last of its kind in our USD Bond Portfolio since we started to trim exposure to floating rate bonds. More stable rather than rising rates will prevent floating rate bonds from rising any further.

About the Issuer: Citigroup is a global diversified financial services holding company with businesses that provide consumers, corporations, governments, and institutions with a broad range of financial products and services. Citi has approximately 200 million customer ac- counts and does business in more than 160 countries and juris- dictions. Citi has roughly 225,000 full-time employees.

5.15% Gazprom 11.02.2026

Rating:	BBB-
Buy Price:	100%
YTM:	**5.15%**
Duration:	**5.52**
Min. Size:	200'000 USD

Investment Rationale: As one can read in our intermediate bond strategy (*see page 6 for details),* we continue to extend the average duration of our USD Bond Portfolio. In the context of our strategy, we invest into this newly issued bond from Gazprom. After our last Russian holding (Veon) has expired most recently, we restore our Russian country exposure with this purchase.

About the Issuer: Gazprom is the largest vertically-integrated gas company in the world. It is the major supplier of natural gas to Europe with around 30% market share and it has the world's largest natural gas reserves. The Russian government owns an over 50% stake in Gazprom, and exerts significant influence over its operations. The US prohibited the export of goods, services, and technology for exploration and production of Russia's deep water oil, arctic offshore oil or shale oil projects to Gazprom, among other Russian companies.

*) 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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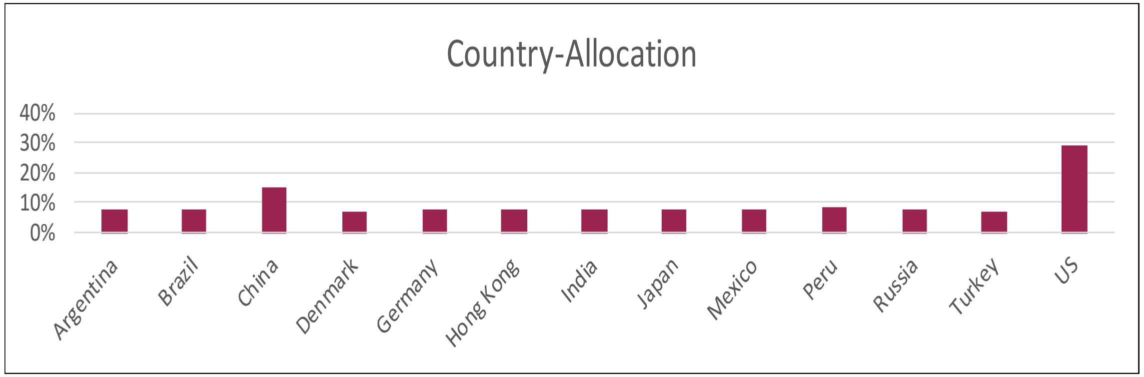
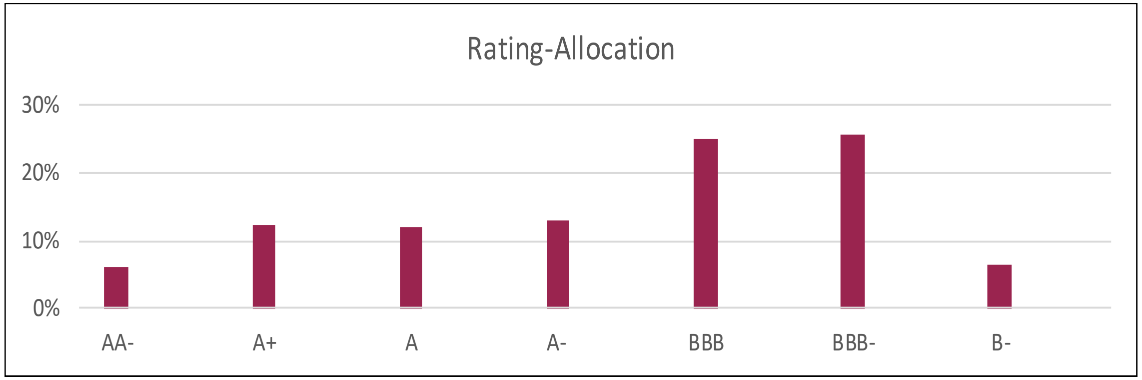
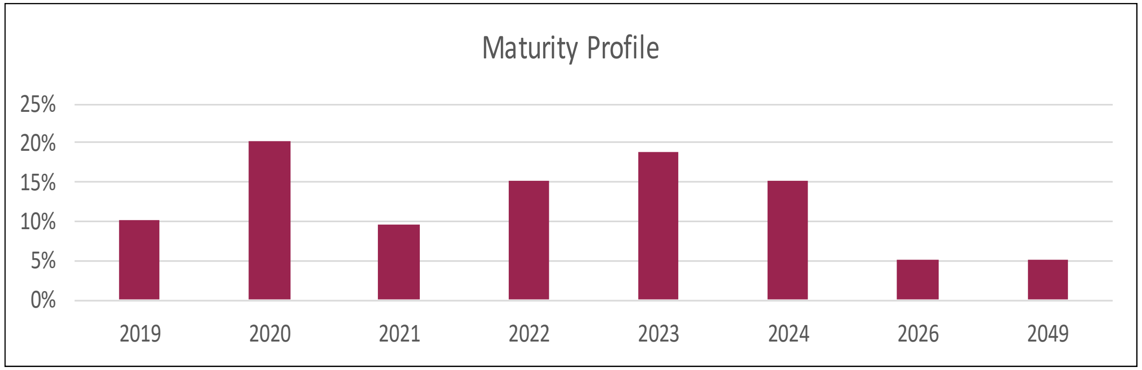
Performance Overview	YTD	2018	2017
Gigant USD Bond Model Portfolio	**+1.80%**	**+1.00%**	**+4.70%**
Bloomberg Barclays US Aggregate Index	+1.12%	+0.01%	+1.17%
Bloomberg Barclays EM USD Aggregate Index	+0.93%	-2.46%	+6.87%

Current Situation:	
Weighted average YTM:	4,04%
Weighted average Duration:	3,4







Source of data: FIS Market Map; own calculation; all data as of 15th of Feb

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	4,44%	0,3	100,13	150.000 USD	5,11%
4,125%	SEMICONDUCTOR MANUFACTURING INTERNATIONAL CORPO	07.10.2019	BBB-	China	Electrical & Electronic	3,95%	0,6	100,04	200.000 USD	5,10%
4,950%	BARRICK (PD) AUSTRALIA FINANCE PTY LTD	15.01.2020	BBB-	Canada	Mining & Refining	2,95%	0,9	101,77	2.000 USD	5,28%
4,375%	AFRICA FINANCE CORPN	29.04.2020	A3		Supranational Agency	3,83%	1,1	100,17	200.000 USD	5,12%
4,000%	VOLKSWAGEN INTERNATIONAL FINANCE N.V.	12.08.2020	A3	Germany	Automobile Manufacturers	3,32%	1,4	100,87	100.000 USD	5,19%
2,343%	FORD MOTOR CREDIT COMPANY LLC	02.11.2020	BBB	US	Finance & Investment	4,08%	1,6	97,17	200.000 USD	4,82%
2,362%	CENTRAL NIPPON EXPRESSWAY COMPANY LIMITED	28.05.2021	A1	Japan	Railways & Transportation	3,30%	2,2	97,76	200.000 USD	4,87%
2,125%	CORPORACION ANDINA DE FOMENTO (CAF)	27.09.2021	AA-		Supranational Agency	3,13%	2,5	97,34	1.000 USD	4,83%
2,750%	STATE GRID OVERSEAS INVESTMENT (2016) LIMITED	04.05.2022	A+	China	Utilities	3,34%	3,0	97,98	200.000 USD	4,90%
2,500%	PHILIP MORRIS INTERNATIONAL INC.	22.08.2022	A	US	Tobacco	3,11%	3,3	97,99	1.000 USD	4,90%
5,000%	BBVA BANCO CONTINENTAL	26.08.2022	BBB	Peru	Finance & Investment	3,81%	3,1	103,85	200.000 USD	5,50%
3,100%	GENERAL ELECTRIC CAPITAL CORPN	09.01.2023	A	US	Finance & Investment	4,00%	3,5	96,78	200.000 USD	4,78%
3,500%	BRASKEM AMERICA FINANCE COMPANY	10.01.2023	BBB-	Brazil	Chemicals	4,10%	3,5	97,67	200.000 USD	4,87%
3,375%	EMC CORPN	01.06.2023	BB-	US	Electrical & Electronic	4,84%	3,8	94,39	200.000 USD	4,54%
3,875%	DANSKE BANK A/S	12.09.2023	A-	Denmark	Banking & Finance	4,73%	4,0	96,51	2.000 USD	4,75%
4,750%	**INDIAN OIL CORPN LTD**	**16.01.2024**	**A-**	**India**	**Oil & Petroleum**	**4,22%**	**4,2**	102,34	**200.000 USD**	**5,34%**
5,250%	**ALFA, S.A.B. DE C.V.**	**25.03.2024**	**BBB-**	**Mexico**	**Industrial (General)**	**4,61%**	**4,3**	102,04	**200.000 USD**	**5,31%**
4,215%	COCA COLA ICECEK URETIM AS	19.09.2024	BBB	Turkey	Food Manufacturing	5,23%	4,7	94,68	2.000 USD	4,57%
5,150%	**GAZPROM OJSC**	**11.02.2026**	**BBB**	**Russia**	**Oil & Petroleum**	**5,25%**	**5,5**	99,55	**200.000 USD**	**5,05%**
4,750%	**TOWNGAS FINANCE LTD**	**12.08.2049**	**A-**	**Hong Kong**	**Utilities**	**4,70%**	**15,4**	100,50	**200.000 USD**	**5,15%**

Source: FIS MarketMap; all data as of 15th of Feb

mangenta = recent changes

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

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