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Investment Letter No 4
Week 9
2019

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Yield Cockpit

Overview current effective yields in USD *)

	current	2 months ago
2 Year US Treasury	**2,54%**	**2,86%**
5 Year US Treasury	2,45%	2,95%
10 Year US Treasury	2,64%	3,12%
3-5 Year IG Corp Bonds	3,49%	**3,95%**
7-10 Year IG Corp Bonds	4,07%	4,54%
15+ Year IG Corp Bonds	4,70%	5,04%
High Yield BB-rated	4,96%	5,61%
High Yield B-rated	6,85%	7,23%
EM IG Corporate Bonds	**5,00%**	**5,56%**
EM Sovereign Bonds	5,38%	6,00%

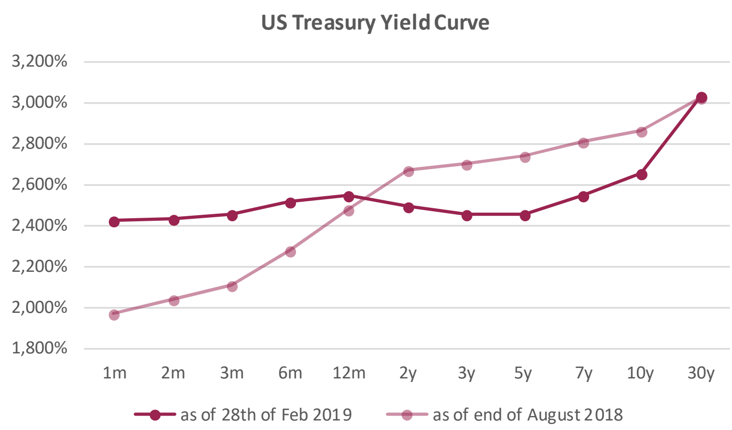
Spreads & Inflation

FED Funds Rate	2,50%	2,25%
TED-Spread	0,26%	0,31%
10yr–2yr Treasury Spread	0,16%	0,26%
5yr Breakeven Inflation	1,82%	1,85%
10yr Breakeven Inflation	1,92%	2,00%

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

What to take note of:

- We first warned of an upcoming US Treasury yield curve inversion in August 2018 *(see Investment Letter No17 2018, page 3 for details)*, which in the past was an unduly warning sign of an upcoming recession**. In the meantime various economic data have indeed deteriorated and economic growth has stalled** (but to be frank: a true recession is still way apart). While equities only sit a few %-points below their record levels set in September 2018 (and are thus not at all afraid of an economic cooling), **the yield curve has indeed flattened further and inverted in parts** *(see graph underneath).*
- Whether that will lead to a recession is not our discussion point this time. At this point, we are rather interested in the **implications for bond investors**: apparently, **holding longer term bonds over short term bonds does not pay** any more (unless one is willing to hold bonds with a maturity> 10 years which hardly any private investor is). As a matter of fact, a 5yr US Treasury Bond (YTM 2,456%) yields less than a 6 months Treasury Bill (2,513%).
- Since we don't believe USD rates will be cut shortly, the so-called "reinvestment risk" (i.e. the risk of not knowing the future yield once an investment needs to be reinvested) seems manageable to us. Accordingly, **staying at the front end of the curve is our strategy of choice**.



Source: BofA Merrill Lynch Indices retrieved from Federal Reserve Bank of St.Louis; Bloomberg Barclays Index Data; all data as of 27th of February

Our Tactical Asset Allocation (6months horizon)

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EQUITIES –> REMAIN UNDERWEIGHT

- In our last edition, we noted that "*a **final deal** in in the **US-Sino trade war would force us to take more risk** by lifting our equity allocation. Anyhow, an extension of the current truce does not equal a deal!*". Et voilà, here is the **extension of the deadline** which **in our eyes is the perfect confirmation that there won't be a quick fix** for a better protection of intellectual property (for which this entire trade war was started). By the way, in 2018 China imported goods worth 123bn USD from the USD but exported goods worth 533bn USD to the them: does really anybody think this massive gap can just be covered by a simple contractual obligation? It should also be noted that if China just buys more US goods, it won't buy them from somebody else…
- While equities indeed proved to be relatively resilient over the last weeks (although with decreasing dynamic), the all time highs reached in late Q3 2018 are only a few % points away. **On the back of deteriorating macro economic data** (since our last publication, for instance Chinese PMI-indices posted readings suggesting contraction and US house priced dropped the most in over a decade) **as well as slower corporate earnings growth we see no reason to believe fresh highs will be reached**. Accordingly, **the current risk-reward ration looks skewed to the downside** for us. Accordingly, we do not lift our equity exposure even if price action might look tempting for now.

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.
- We have been advocating gold for quite some time. The current narrative of lower rates for longer combined with a limited potential for the USD looks like the perfect environment for gold. Anyhow, it should be noted that **gold has risen by more than +13%** (in USD terms) since its lows late September 2018. As we are running into some technical resistance level, **expect some intermediate weakness for the weeks to come** before it might head towards the 1400 USD/per ounce level later during the year.
- 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

- As one can see from our latest transactions in our USD Bond Model Portfolio, **we extended the duration of our bond model portfolio as of late**. As we highlighted on the previous page, the so-called term premium (i.e. the pick up in yield for holding longer dated bonds) is not attractive. The background of our duration extension is thus to make up for a lapse of time (duration diminishes with time) as well as a speculative purpose (we are of the opinion that longer dated rates will move further down). Anyhow, the absolute level of duration is still quite short.
- 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* **quality** 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 continues to 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:* **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 Year Reverse Convertible in USD on a pair of German Quality Stocks (1/2)

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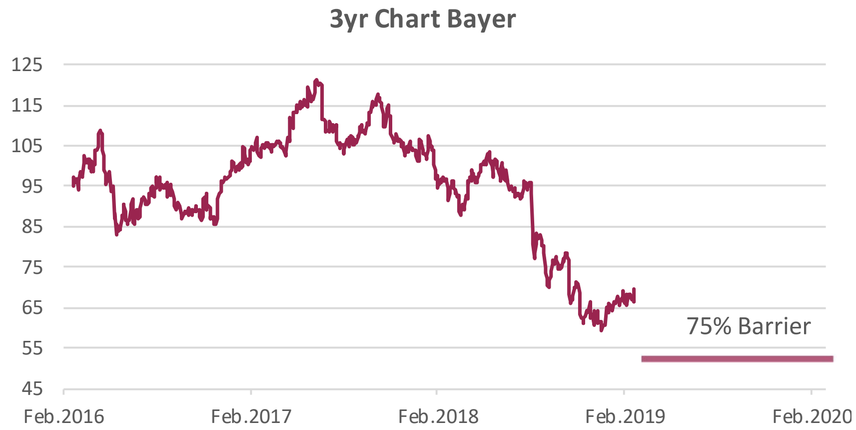
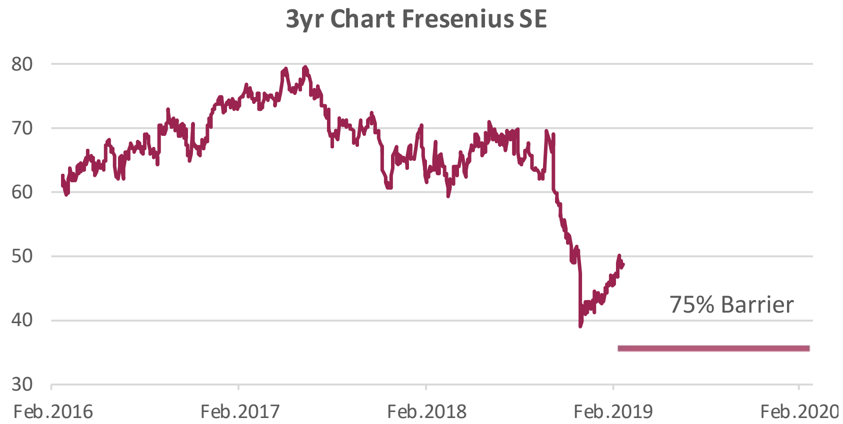
Investment Rationale:
The two selected stocks have a proven business model with a sound score in various quality criteria while generating solid cash flows. Due to various special items (see next page), their stock prices haver corrected by a large part in the most recent past. **We are of the opinion that further downside for the mentioned stocks should be limited given their extremely low valuation and that a lot of bad news is already priced in today's stock price**. Accordingly, capitalizing on those stocks NOT to fall much further (instead of outright buying them) is our strategy of choice.





How it works:

- The investor receives a **fixed & guaranteed coupon of 5.0% p.a. The invested amount is fully repaid if none of the stocks within the basket trades < 75% of today's level <u>at maturity date in 1 years time</u>.** If not, the investor will be required to buy the worst performing share at the barrier level (i.e. at 75% from today's price).
- Accordingly, the investor will only suffer a capital loss in case the worst performing of the two underlying shares looses more than -25% of today's value at maturity date. However, the investor will then buy this share at a price which is 25% cheaper than today.
- The selected stocks are **Bayer and Fresenius SE** (see next page for details).

Source: FIS Market Map

Product of the Week: 1 Year Reverse Convertible in USD on a pair of German Quality Stocks (2/2)

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The selected underlying stocks:

The so-called life science company Bayer, whose roots date back more than 150 years, today consists of 3 business units "pharmaceutical", "consumer health" and "crop science". Among many other products, Bayer is famous for producing "Aspirin" (also known as acetylsalicylic acid) one of the world's best selling pain killers, since the early 20th century. With its purchase of the American agrochemical giant Monsanto back in 2018, Bayer has inherited substantial litigation risks. The main culprit is "Glyphosat", a trademark for a Monsanto-herbicide which allegedly causes cancer. A variety of class action lawsuits are currently pending in which Bayer is threated with high compensation claims. Since its highs in June 2018, Bayer which is a heavyweight in the German 30 DAX Index has lost about half its market capitalization, erasing some 70bn EUR of market cap in just a few months time. Most of the sell-side analysts consider the current cheap valuation (Price Earnings-Ratio of 10x vs sector average at 18,9x) as compelling. According to Bloomberg, out of 32 analysts covering Bayer, 24 recommend to buy, 7 to hold and none to sell the stock. Despite the ongoing claims, it seems as if a lot of bad news is already priced in. Last but not least, it should be noted that Bayer which has an operating margin north of 20%, generated a cash flow yield of approx. 15% in 2018.

Fresenius SE is a diversified healthcare conglomerate. Its business segment Helios operates hospitals in Germany and Spain. Kabi provides infusion and clinical nutrition products, as well as sterile injectable drugs. Fresenius Medical Care in which Fresenius SE holds approx. 30% is separately listed, and provides services and products related to dialysis care. In the most recent past, a series of acquisitions and their implications on the balance sheet of Fresenius SE have resulted in waning patience of investors. Subsequently, shares of Fresenius have lost approx. 40% since its most recent high in April 2018 (the German benchmark index DAX has "only" lost approx. -13% during that time). Over a more medium term time horizon, the recent acquisitions will however lead to a more diversified business model with many potential synergies. According to Bloomberg, out of 26 analysts covering Fresenius, 24 recommend to buy, 9 to hold and none to sell the stock. Likewise with Bayer, it seems as if a lot of bad news is already reflected in todays share price. Last but not least, it should be noted that Fresenius whose operating margin is about 15% generated a cash flow yield of approx. 8% in 2018.

Where your risks are:

- Capital at risk: in case one of the selected stocks trades below the barrier level at maturity, the investor will suffer a loss equivalent to the amount the stock trades below the barrier level.
- A secondary market for trading this product during its lifetime will be provided. However, various factors might impact the prevailing market price during the lifetime of this product. Accordingly, the value of this product may be below / above the issue price of 100% during its lifetime.

Source: FIS Market Map

Added to our US Equity Portfolio: Walt Disney Company

Sector:	Consumer Cyclicals
Risk Type:	**Conservative**
Market Cap:	165bn USD
Dividend:	1.65%
1Yr-Return:	+8%

Company Description: The Walt Disney Company is a diversified media conglomerate operating media networks, theme parks and resorts, film and TV studios and consumer products businesses. Its broadcast network targets upscale women, while its cable networks are focused on kids, family and sports. It is the global leader in theme parks with hotels and cruise lines aimed at families. Its film studio releases family friendly content from four distinct brands. It is the leader in global licensing to support its brands, and has 11 franchises with greater than $1B annual consumer products sales.

Investment Rational:

- Disney's 71bn USD-acquisition of FOX studio assets (20th Century Fox) which is set to close in 2019 will not only dramatically increase Disney's already large content offering but will also raise Disney's stake in Hulu from 30% to 60%. Hulu which is currently offered in the US and Japan is a so-called "over the top media services" which provides subscription based streaming services of its media content (like Netflix). Hulu from which Disney reported a loss of 580mio USD in 2018, currently has 25mio subscribers. It seems highly likely that the remaining co-owners Comcast & AT&T are likely to sell its stake to Disney in order to avoid a conflict of interest with their own streaming business efforts.
- Disney is scheduled to launch its own streaming business called Disney+ in September 2019 to compete with Netflix. It's important to know that Disney announced not to renew its contract with Netflix (which streams Disney's content) by the end of 2019. Disney+ could be jumpstarted by Hulu's existing customer base. With a content offering ranging from Disney Studios, Marvel, Pixar, Lucas Films, ABC Studios, National Geographic, Fox Networks, ESPN and many more, the changes are high Disney can emerge as no1 challenger to Netflix, which so far has dominated the over the top media services market. Thanks to its large content library, Disney is likely to have much lower operating costs, the biggest disadvantage of Netflix.
- Despite a loss of 1bn USD in Hulu and ESPN+ (the newly launched streaming service of ESPN, Disney's live sports broadcasting business), Disney produced an impressive 10bn USD of free cash flow and a net income of 12,6bn USD in 2018. Despite the promising business opportunities in streaming, the current valuation of Disney shares is well below that of the markets average.

Risk associated:
Disney's earnings are particularly sensitive to advertising which again is sensitive to overall macro economic conditions.

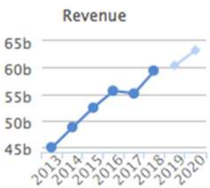
Quality Measures:

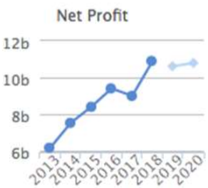
		vs. Industry	vs. Market
Return on Capital	17.5 %		
Return on Equity	23.7 %		
Operating Margin	24.3 %		

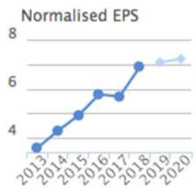
Growth Measures:

12m Forecast Rolling		vs. Industry	vs. Market
PE Ratio (f)	15.6		
PEG Ratio (f)	6.89		
EPS Growth (f)	2.31 %		

Historical Revenue & Profit Evolution:







Source: www.stockopedia.com; FIS Market MAP; all numbers as of 27th of February

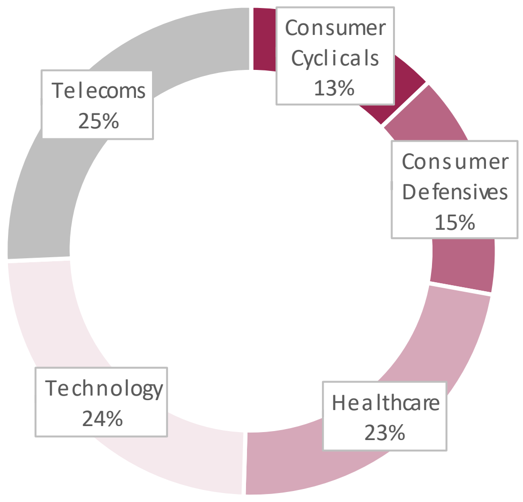
Overview US Equity Model Portfolio

Performance Overview	2019	2018	2017	ITD *)
Gigant US Equity Model Portfolio	**+9.68%**	**-1.24%**	**+17.56%**	**+27.35%**
S&P 500	+11.08%	-6.24%	+19.4%	+24.37%
Dow Jones	+11.1%	-5.63%	+25.1%	+31.14%
Nasdaq 100	+12.13%	-1.04%	+27.1%	+45.93%

Current Situation:	
Current Value:	1’273’478USD
Start Value:	1’000’000 USD
Realized Gains:	+235’710 USD
Unrealized Gains:	+541 USD
Cash:	496’812 USD (39%)
Equities:	776’666 USD (61%)

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 28th 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	**Walt Disney Company** 0,00%	
Consumer Defensives	**CVS Health** -28,20%	**Philipp Morris** 16,70%
Health Care	**Merck** 38,10%	
Financials		
Technology	**Alphabet** 7,91%	**YY** -27,60%
Telecom	**AT&T** -14,10%	**Soft Bank** 10,50%
Utilities		
Real Estate		

stocks we hold but don't buy any more

stocks we still buy

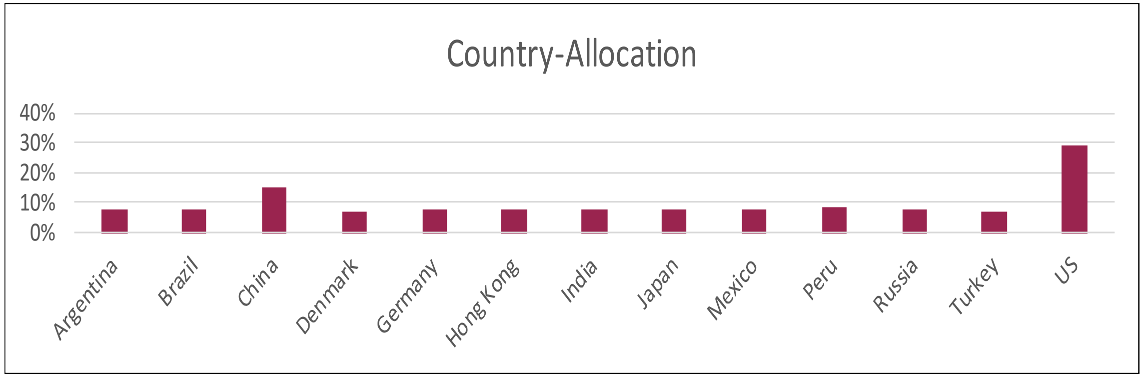
performance = price returns excluding dividends

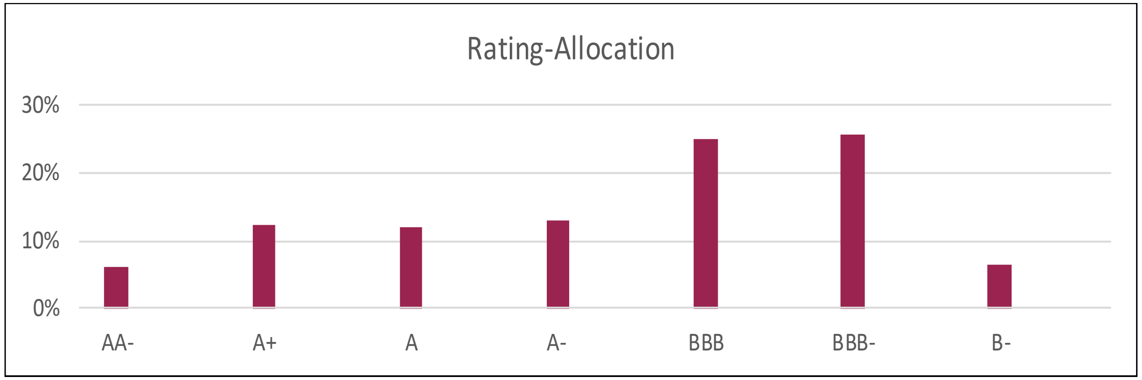
computed by stockopedia.com; all data as of 28th of Feb

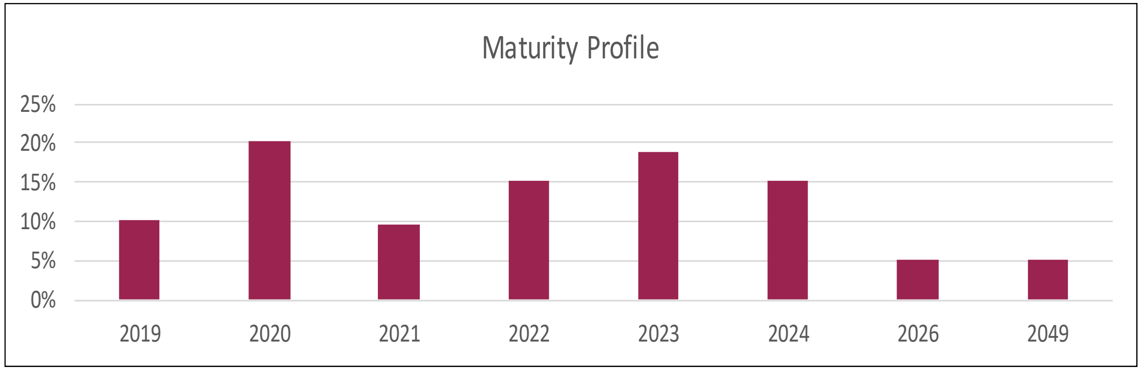
Overview USD Bond Model Portfolio

Performance Overview	YTD	2018	2017
Gigant USD Bond Model Portfolio	**+2.09%**	**+1.00%**	**+4.70%**
Bloomberg Barclays US Aggregate Index	+1.01%	+0.01%	+1.17%
Bloomberg Barclays EM USD Aggregate Index	+1.46%	-2.46%	+6.87%

Current Situation:	
Weighted average YTM:	4,08%
Weighted average Duration:	3,7







Source of data: FIS Market Map; own calculation; all data as of 28th 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	5,39%	0,3	100,09	150.000 USD	5,05%
	4,125%	SEMICONDUCTOR MANUFACTURING INTERNATIONAL CORPO	07.10.2019	BBB-	China	Electrical & Electronic	3,88%	0,6	100,14	200.000 USD	5,06%
	4,950%	BARRICK (PD) AUSTRALIA FINANCE PTY LTD	15.01.2020	BBB-	Canada	Mining & Refining	2,47%	0,8	102,10	2.000 USD	5,26%
	4,375%	AFRICA FINANCE CORPN	29.04.2020	A3		Supranational Agency	3,37%	1,1	101,12	200.000 USD	5,16%
	4,000%	VOLKSWAGEN INTERNATIONAL FINANCE N.V.	12.08.2020	A3	Germany	Automobile Manufacturers	3,03%	1,3	101,36	100.000 USD	5,18%
	2,343%	FORD MOTOR CREDIT COMPANY LLC	02.11.2020	BBB	US	Finance & Investment	3,93%	1,6	97,47	200.000 USD	4,79%
	2,362%	CENTRAL NIPPON EXPRESSWAY COMPANY LIMITED	28.05.2021	A1	Japan	Railways & Transportation	3,33%	2,1	97,95	200.000 USD	4,84%
	2,125%	CORPORACION ANDINA DE FOMENTO (CAF)	27.09.2021	AA-		Supranational Agency	3,22%	2,4	97,34	1.000 USD	4,78%
	2,750%	STATE GRID OVERSEAS INVESTMENT (2016) LIMITED	04.05.2022	A+	China	Utilities	3,28%	2,9	98,42	200.000 USD	4,89%
	2,500%	PHILIP MORRIS INTERNATIONAL INC.	22.08.2022	A	US	Tobacco	3,06%	3,2	98,17	1.000 USD	4,86%
	5,000%	BBVA BANCO CONTINENTAL	26.08.2022	BBB	Peru	Finance & Investment	3,70%	3,1	104,20	200.000 USD	5,48%
	3,100%	GENERAL ELECTRIC CAPITAL CORPN	09.01.2023	A	US	Finance & Investment	3,63%	3,5	98,10	200.000 USD	4,85%
	3,500%	BRASKEM AMERICA FINANCE COMPANY	10.01.2023	BBB-	Brazil	Chemicals	4,00%	3,4	98,24	200.000 USD	4,87%
	3,375%	EMC CORPN	01.06.2023	BB-	US	Electrical & Electronic	4,22%	3,8	96,75	200.000 USD	4,72%
	3,875%	DANSKE BANK A/S	12.09.2023	A-	Denmark	Banking & Finance	4,74%	4,0	96,51	2.000 USD	4,70%
	4,750%	**INDIAN OIL CORPN LTD**	**16.01.2024**	**A-**	**India**	**Oil & Petroleum**	**4,24%**	**4,2**	102,22	**200.000 USD**	**5,27%**
	5,250%	**ALFA, S.A.B. DE C.V.**	**25.03.2024**	**BBB-**	**Mexico**	**Industrial (General)**	**4,38%**	**4,3**	103,89	**200.000 USD**	**5,44%**
	4,215%	COCA COLA ICECEK URETIM AS	19.09.2024	BBB	Turkey	Food Manufacturing	5,13%	4,7	95,65	2.000 USD	4,61%
	5,150%	**GAZPROM OJSC**	**11.02.2026**	**BBB**	**Russia**	**Oil & Petroleum**	**5,13%**	**5,5**	100,10	**200.000 USD**	**5,05%**
***)**	**4,750%**	**TOWNGAS FINANCE LTD**	**12.08.2049**	**A-**	**Hong Kong**	**Utilities**	**4,69%**	**15,5**	101,00	**200.000 USD**	**5,14%**
						weighted average YTM and Duration	***3,94%***	***3,4***			

Source: FIS MarketMap; all data as of 28th of Feb

mangenta = recent changes

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

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