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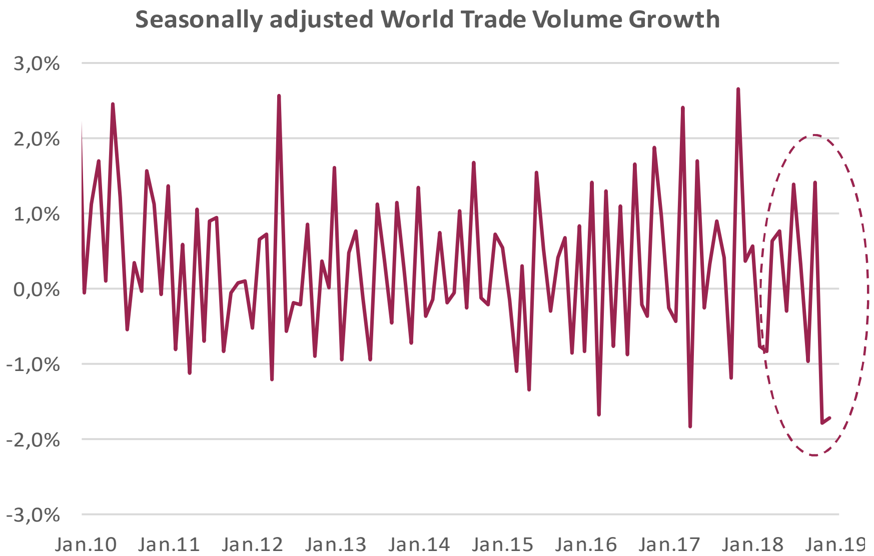
Investment Letter No 5
Week 11
2019

Table of Content

What exactly is the equity market celebrating? (1/2)

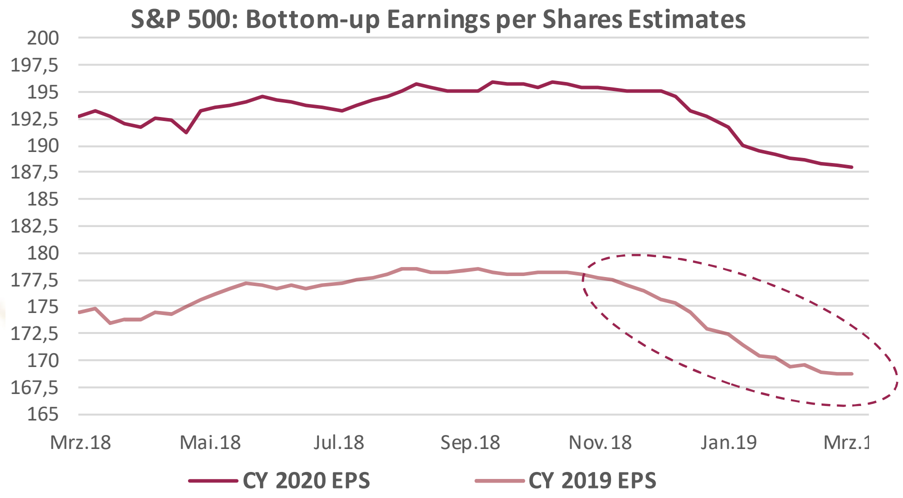
The first quarter of 2019 is almost over and **global equity markets** have **posted impressive year-to-date returns** of approx. +12% Admittedly, we at Gigant have grossly underestimated the potential of this recovery from the Q4 18 plunge to which we did not give meaningful credit at the start of the year. As a matter of fact, we held an "underweight"-rating on equities (the same which prevented us from large losses in Q4 2018). Leaving euphoria aside, it should be noted that so far**, all globally important equity indices still note well below the former highs from late Q3 2018** which does therefore by definition not constitute a fresh uptrend *(see for example upper chart on the right).* Going forward, the all important question is whether there is a catalyst which can drive the market to fresh highs which in some indices are just a few %-points away. To cut it short: we strongly doubt! Rather, we believe that the **current level is a highly unattractive point for fresh equity investments for the months to come**. Over the recent weeks and months, we have repeatedly argued that the **global macro economic environment is deteriorating rapidly** (*see for instance Investment Letter 3, page 3; IL 2, page 2 or IL 20 2018, page 4-5*). At this point, we thus just point to the deteriorating growth rate in world trade (*see lower chart on the right*) which used to be a reliable early indicator for periods of market stress. Despite the macro economic challenges, there is still a change that corporate earnings do well but that is not what market consensus data are telling us. According to them, **earnings estimates have also cooled off meaningfully** *(see upper chart on page 4).* Speaking about earnings estimates, we already hinted at the fact that estimates for H2 19 earnings imply a (too) steep recovery after H1 will likely see negative growth rates *(see Investment Letter 3, page 4).*

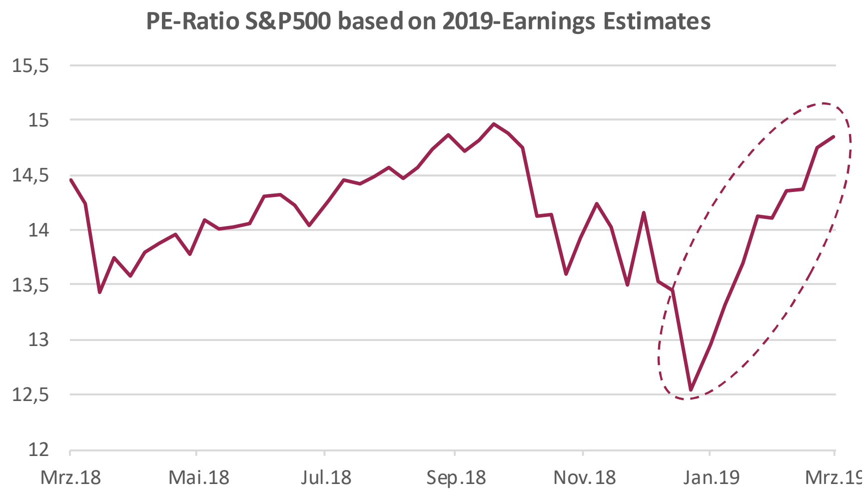


Source: FIS Market Map; CPB Netherlands Bureau for Economic Policy Analysis

What exactly is the equity market celebrating? (2/2)

As a side effect of rising prices and falling earnings, the **stock market valuation has risen to the previous highs**. But **why paying the same high earnings multiple for lower growth?** As it can't be fundamentals nor valuation which are driving equity prices, it must come to other elements which are less easily to quantify. Ranking high must be the **markets belief that some sort of agreement in the Sino US-Trade war will be met** shortly. Anecdotally, the US governments ongoing optimistic language must have raised expectations to the moon already. But as we have detailed on *page 4 of Investment Letter 4*, the Chinese trade surplus with the US is so massively wide that there is no change to cover it with some government induced change of suppliers. And yes, the **FEDs' dramatic u-turn in their rate-setting strategy announced in early February is highly supportive for equity markets** (the notorious FED-Put being still alive!). Anyhow, at the time of writing, odds for a rate hike in 2019 as derived from FED Fund Futures are as low as never before this year implying that **this new policy is now well priced in**. Instead, **we at Gigant are of the impression that it was mainly hope which was driving equity prices so far this year.** No doubt, underweighted investors which are forced to buy into the market the more the market rises may keep this rally alive for quite some time. This can last for days, weeks or even months. Anyhow, if history is any guide, markets will be at some point need to deal with real fundamental data and they unanimously point southwards. In that sense, **don't let greed overcome you but stay rationale!**





Source: FactSet

Our Tactical Asset Allocation (6months horizon)

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EQUITIES –> REMAIN UNDERWEIGHT

- The all time highs reached in late Q3 2018 are only a few % points away. **On the back of deteriorating macro economic data 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

- During times where a 12months US Treasury Bill yields, 2,40% **cash is a very viable investment alternative**.

BONDS –> REMAIN NEUTRAL

- **Credit spreads have tightened substantially in Q1** despite 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.
- **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

- As the mantra of lower rates for longer is more actual than ever before, remaining overweight on assets whose return is decoupled from traditional assets such as equities and bonds is a must.

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 Year Low Strike Reverse Convertible on a basket of fallen angels (1/2)

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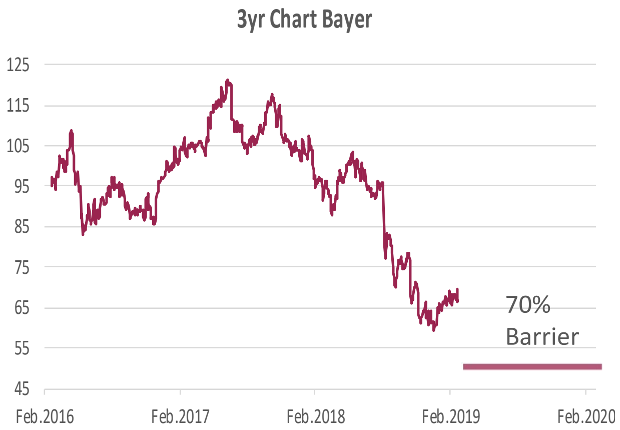
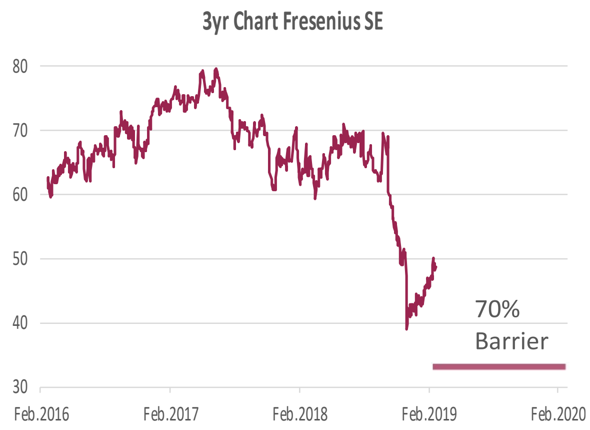
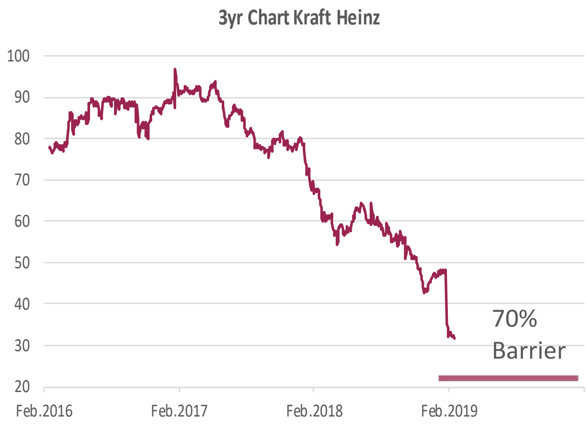
Investment Rationale:
The selected stocks have a proven business model with a sound score in various quality criteria while generating solid cash flows. Due to various special items (see next page), their stock prices haver corrected by a large part in the most recent past. **We are of the opinion that 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 6% p.a. The invested amount is fully repaid if none of the stocks within the basket trades < 70% 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 70% 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 -30% of today's value at maturity date. However, the investor will then buy this share at a price which is 30% cheaper than today.
- The selected stocks are **Bayer, Fresenius SE** and **Kraft Heinz** (see next page for details).

Source: FIS Market Map

Product of the Week: 1 Year Low Strike Reverse Convertible on a basket of fallen angels (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.

In terms of sales, Kraft-Heinz which has more than 25 brands in its portfolio is the fifth largest food and beverage company worldwide. It is the result of the 2013 merger of Kraft Foods Group, Inc. and H.J. Heinz Co. which was backed with financial help from Berkshire Hathaway, the investment holding of Warren Buffet. The combined company generated industry-leading profit margins shortly after the merger, mainly thanks to very aggressive cost cutting which sent the stock to fresh higs in 2017. But since then, the stock has lost about 2/3rd whipping out about 75bn USD in market cap! On Feb 21 2019, an earnings report contained a slew of bad news including a 15,4bn USD write down on the value of some key brands which led to a slid of -27% on a single day. In retrospective, cutting costs and leveraging the balance sheet proved to be a poor strategy during times of quickly changing consumer habits and weaker pricing power. Anyhow, a lot of bad news seems to be priced in already since Kraft Heinz today trades on the cheapest earnings multiple out of 74 companies in the US Food and Tobacco Industry.

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.

Overview US Equity Model Portfolio

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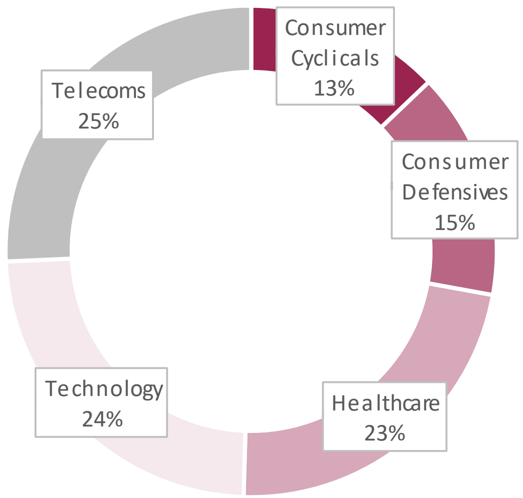
Performance Overview	2019	2018	2017	ITD *)
Gigant US Equity Model Portfolio	**+11.64%**	**-1.24%**	**+17.56%**	**+29.63%**
S&P 500	+12.03%	-6.24%	+19.4%	+25.44%
Dow Jones	+10.21%	-5.63%	+25.1%	+30.09%
Nasdaq 100	+14.42%	-1.04%	+27.1%	+48.92%

Current Situation:	
Current Value:	1'296'294 USD
Start Value:	1'000'000 USD
Realized Gains:	+235'710 USD
Unrealized Gains:	+23'356 USD
Cash:	496'812 USD (38%)
Equities:	799'481 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 14th of March; *) 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	**Walt Disney Company** 1,45%	
Consumer Defensives	**CVS Health** -30,60%	**Philipp Morris** 20,60%
Health Care	**Merck** 38,40%	
Financials		
Technology	**Alphabet** 14,20%	**YY** -18,80%
Telecom	**AT&T** -16,40%	**Soft Bank** 15,60%
Utilities		
Real Estate		

stocks we hold but don't buy any more (Merck, Soft Bank)

stocks we still buy

performance = price returns excluding dividends

computed by stockopedia.com; all data as of 14th of March

Changes to our USD Bond Portfolio:
SELL EMC 2023 to BUY GAP 2021

3.375% EMC Corp 01.06.2023

Rating:	BB-
Selling Price:	96.25%
Hold. Period:	**238 days**
Tot. Return	**5.21%**

Rationale of Disposal: The +2.98% price gain vs our purchase price back in July 2018 does only tell have of the story. During the massive credit spread widening of Q4 18, our holding was substantially down (only to make up for this in the subsequent spread tightening of Q1 19 again). Since we consider the level of credit spreads as rather tight and expect wider spreads going forward, we want to avoid another roller-coaster move of one of our most exposed read weaker quality-holdings. We therefore use the favorable price level to dispose our EMC-position.

About the Issuer: In 2016, Dell Inc. acquired listed EMC in a cash-and-stock deal valued at $67 billion, which has been considered the largest-ever acquisition in the technology sector. Today, the combined Dell EMC sells data storage, information security, virtualization analytics, cloud computing and other products and services that enable organizations to store, manage, protect, and analyze data. 98% of shares in Dell EMC are owned by Michael Dell, founder of Dell Computers.

5.95% Gap Inc. 12.04.2021

Rating:	BB+/Baa2
Buy Price:	104.1%
YTM:	**3.86%**
Duration:	**1.89**
Min. Size:	2’000 USD

Investment Rationale: Gap’s credit quality is only marginally better than that of EMC. Anyhow, due to the much shorter lifetime which is only about half that from EMC, the effect of an eventual further spread tightening should be much more muted than with the EMC-bond which we have switched out of.

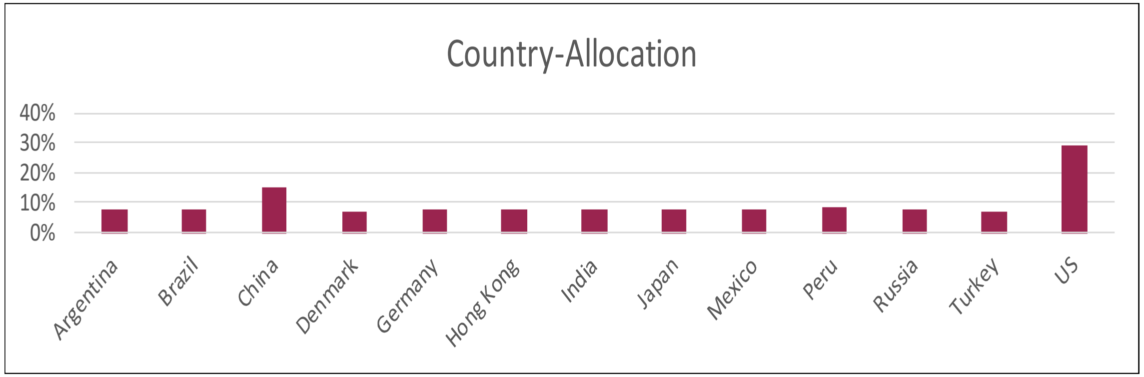
About the Issuer: Gap is a specialty retailer that operates through retail stores and e-commerce, selling casual apparel, accessories and personal care products for men, women, and children under the Gap, Old Navy, Banana Republic, Athleta and Intermix brand names. Its shares are listed on the New York Stock Exchange. Gap announced plans to separate into two independent publicly traded companies: Old Navy and a yet-to-be-named company (“ NewCo”), which will consist mainly of the Gap brand, Athleta, Banana Republic, and Intermix.

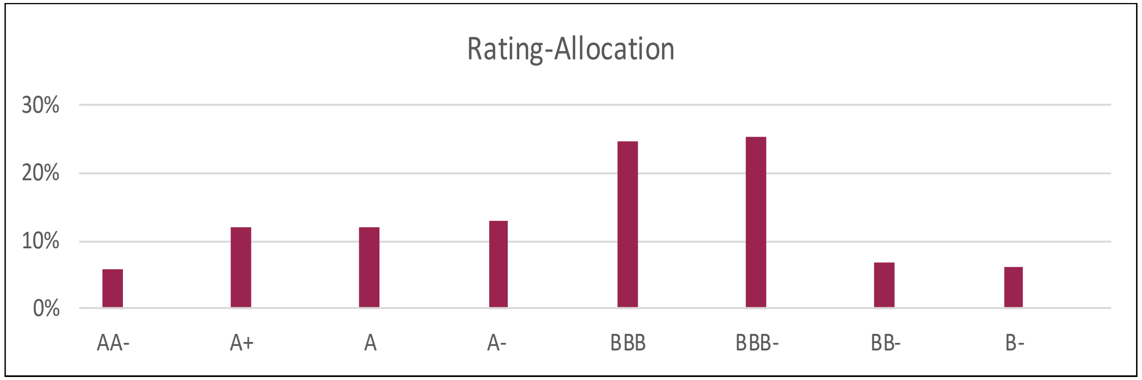
*) non-annualized total return including coupon payments, changes in accrued interest and price changes; all price data from FIS Market Map

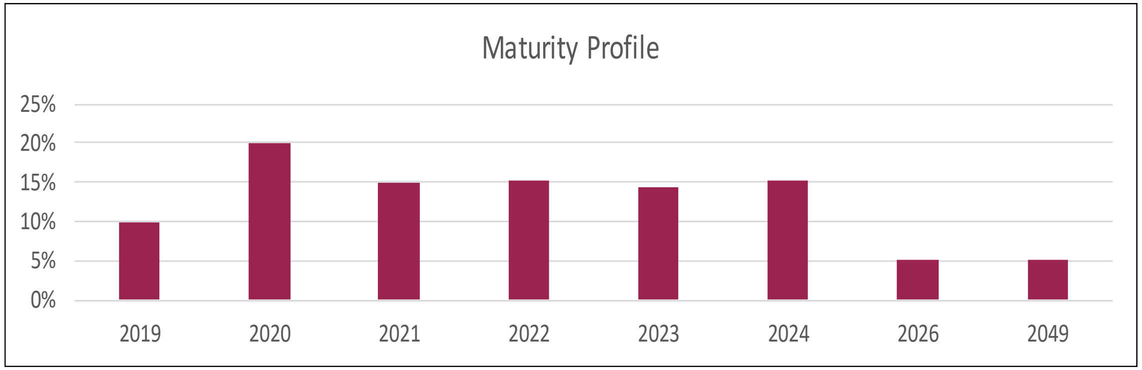
Overview USD Bond Model Portfolio

Performance Overview	YTD	2018	2017
Gigant USD Bond Model Portfolio	**+2.35%**	**+1.00%**	**+4.70%**
Bloomberg Barclays US Aggregate Index	+1.55%	+0.01%	+1.17%
Bloomberg Barclays EM USD Aggregate Index	+1.75%	-2.46%	+6.87%

Current Situation:	
Weighted average YTM:	3.88%
Weighted average Duration:	3.3







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

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	5,21%	0,2	100,12	150.000 USD	5,00%
	4,125%	SEMICONDUCTOR MANUFACTURING INTERNATIONAL CORPO	07.10.2019	BBB-	China	Electrical & Electronic	3,83%	0,5	100,16	200.000 USD	5,00%
	4,950%	BARRICK (PD) AUSTRALIA FINANCE PTY LTD	15.01.2020	BBB-	Canada	Mining & Refining	2,81%	0,8	101,73	2.000 USD	5,16%
	4,375%	AFRICA FINANCE CORPN	29.04.2020	A3		Supranational Agency	3,87%	1,0	100,54	200.000 USD	5,04%
	4,000%	VOLKSWAGEN INTERNATIONAL FINANCE N.V.	12.08.2020	A3	Germany	Automobile Manufacturers	2,58%	1,3	101,93	100.000 USD	5,18%
	2,343%	FORD MOTOR CREDIT COMPANY LLC	02.11.2020	BBB	US	Finance & Investment	4,03%	1,5	97,39	200.000 USD	4,73%
	5,950%	**GAP INC**	**12.04.2021**	**BB-**	**US**	**Supermarkets & Stores**	**3,90%**	**1,9**	104,03	**200.000 USD**	**5,40%**
	2,362%	CENTRAL NIPPON EXPRESSWAY COMPANY LIMITED	28.05.2021	A1	Japan	Railways & Transportation	3,18%	2,1	98,28	200.000 USD	4,82%
	2,125%	CORPORACION ANDINA DE FOMENTO (CAF)	27.09.2021	AA-		Supranational Agency	3,15%	2,4	97,52	1.000 USD	4,74%
	2,750%	STATE GRID OVERSEAS INVESTMENT (2016) LIMITED	04.05.2022	A+	China	Utilities	3,23%	2,9	98,59	200.000 USD	4,85%
	2,500%	PHILIP MORRIS INTERNATIONAL INC.	22.08.2022	A	US	Tobacco	2,97%	3,2	98,49	1.000 USD	4,84%
	5,000%	BBVA BANCO CONTINENTAL	26.08.2022	BBB	Peru	Finance & Investment	3,60%	3,0	104,50	200.000 USD	5,45%
	3,100%	GENERAL ELECTRIC CAPITAL CORPN	09.01.2023	A	US	Finance & Investment	3,63%	3,5	98,12	200.000 USD	4,80%
	3,500%	BRASKEM AMERICA FINANCE COMPANY	10.01.2023	BBB-	Brazil	Chemicals	4,07%	3,4	98,00	200.000 USD	4,79%
	3,875%	DANSKE BANK A/S	12.09.2023	A-	Denmark	Banking & Finance	4,52%	3,9	97,43	2.000 USD	4,73%
	4,750%	INDIAN OIL CORPN LTD	16.01.2024	A-	India	Oil & Petroleum	3,98%	4,1	103,35	200.000 USD	5,33%
	5,250%	**ALFA, S.A.B. DE C.V.**	**25.03.2024**	**BBB-**	**Mexico**	**Industrial (General)**	**4,39%**	**4,3**	103,85	**200.000 USD**	**5,38%**
	4,215%	COCA COLA ICECEK URETIM AS	19.09.2024	BBB	Turkey	Food Manufacturing	5,13%	4,7	95,65	2.000 USD	4,56%
	5,150%	**GAZPROM OJSC**	**11.02.2026**	**BBB**	**Russia**	**Oil & Petroleum**	**4,99%**	**5,5**	100,95	**200.000 USD**	**5,08%**
*)	4,750%	TOWNGAS FINANCE LTD	12.08.2049	A-	Hong Kong	Utilities	4,66%	15,5	101,50	200.000 USD	5,14%

Source: FIS MarketMap; all data as of 15th of March mangenta = recent changes *) = Perpetual Bond with next call date on 31th of Jan 2024

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