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Investment Letter

No 9
September
2020

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Yield Cockpit

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Overview current effective yields in USD *)

	current	1 months ago
3 Months US T-Bills	0.10%	0.10%
2 Year US Treasury	0.13%	0.14%
5 Year US Treasury	0.27%	0.26%
10 Year US Treasury	0.68%	0.65%
3-5 Year IG Corp Bonds	**1.23%**	**1.30%**
7-10 Year IG Corp Bonds	2.00%	2.00%
15+ Year IG Corp Bonds	3.10%	3.06%
High Yield BB-rated	**3.66%**	**3.73%**
High Yield B-rated	5.61%	5.83%
EM Corporate Bonds	**3.42%**	**3.82%**
EM Sovereign Bonds	4.07%	4.45%

Spreads & Inflation

	current	1 months ago
FED Funds Rate	0.05%	0.05%
TED-Spread	0.13%	0.14%
10yr–2yr Treasury Spread	0.56%	0.53%
5yr Breakeven Inflation	1.57%	1.55%
10yr Breakeven Inflation	1.68%	1.68%

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

What to take note of:

- **What if inflation was making a comeback?** Admittedly, betting on higher inflation was the “widow-maker trade” of the last two decades so **we do not even dare to pretend this is finally the start of a fresh wave of inflation**. As a matter of fact, inflation has been running below longer term average for most of the last decades and central banks have failed to spark a rise in prices despite ever looser monetary policy for year. Therefore, the **FED** now **announced to tolerate a modest inflation overshooting over time** in order to compensate for a period of too low inflation. In its last meeting it has increased pressure on politics for a larger fiscal stimulus package. Now, let’s do a quick **scenario analysis**: if **more fiscal stimulus** was to come, then the USD budget deficit further. Now, add a vaccine beeing marketed sooner than expected and you’d have a good **starting point for an increase in inflation**. **If and when** this is going to happen is an **open question** so for now, this is just one of a few potential scenario for us. Anyhow, given the fact **virtually nobody is betting on such a scenario**, it could have **drastic consequences** if it was to unfold, in particular for longer term bonds.
- Whether inflation comes or not, we **stay away from duration > 7 years** as low time premiums do not compensate investors adequately for the risk invovled.

Source: BofA Merrill Lynch Indices retrieved from Federal Reserve Bank of St.Louis; Bloomberg Barclays Index Data; NY FED; all data as of 17th of September

Equities: expensive and crowded as rarely before (1/2)

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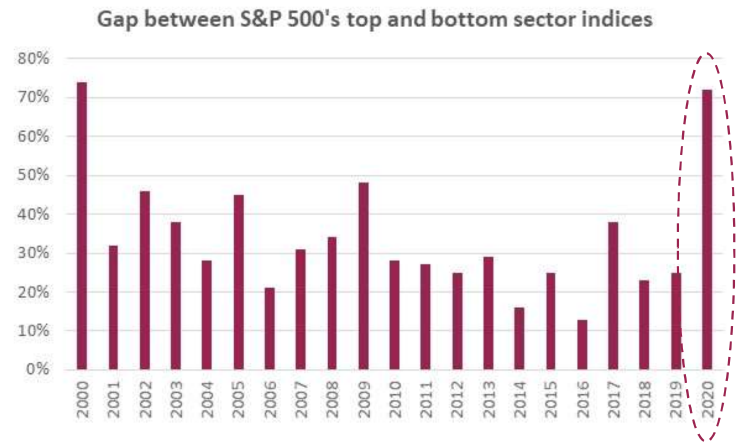
It's been two months since we last wrote in detail about our view on equity markets. Back then we reiterated our *"underweight"* weighting. Admittedly, in the meantime various US equity benchmarks have posted a series of fresh all time highs but as a matter of fact, at the time of writing, the **broad S&P500-index** stands **just fractionally higher than** where it traded **3 months ago**. And even the bellwether technology gauge Nasdaq isn't any higher today then 2 months ago but instead down -10% from the most recent intermediate high reached in early September. Under the surface however, we have seen a **continuation** of the **dispersion between "leading" and "lagging" sectors.** According to Bloomberg, this year's gap between the best and worst-performing sector is unusually wide *(see lower graph on the right).* Given the dramatic boost COVID19 gave to the use of technology but also the impact on consumer behaviour, this development looks intuitively logic. History tells us that during times where entire markets or industries experience a **"re-rating" of their valuation**, **above-average volatility** as we see it now was **the norm**. A look at the most recent Fund Manager Survey by Bank of America might help to display **how crowded the "long technology"-trade** actuality is. In its latest edition, an all-time high of 88% of the questioned 240 fund managers which together oversee some 650bn USD in assets consider "technology stocks" to be the "most crowded" trade in financial markets *(see upper graph on next page).* **Intuitively logic**, if virtually "everybody" is already long an assets, there aren't' any marginal buyers left and hence, **prices** might as well **retreat fairly quick**, as just observed in early September. So whatever the trigger for that sell-off might have been, we conclude that a) **"fear of missing out" is** indeed a strong investing fallacy but **never an investment case** and b) the more the price of an assets is hyped to the sky, the more it may suffer from gravity once normality sets in.

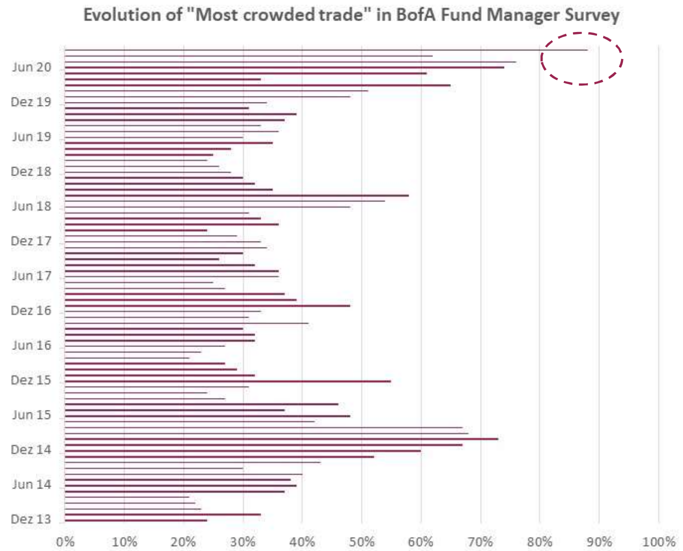


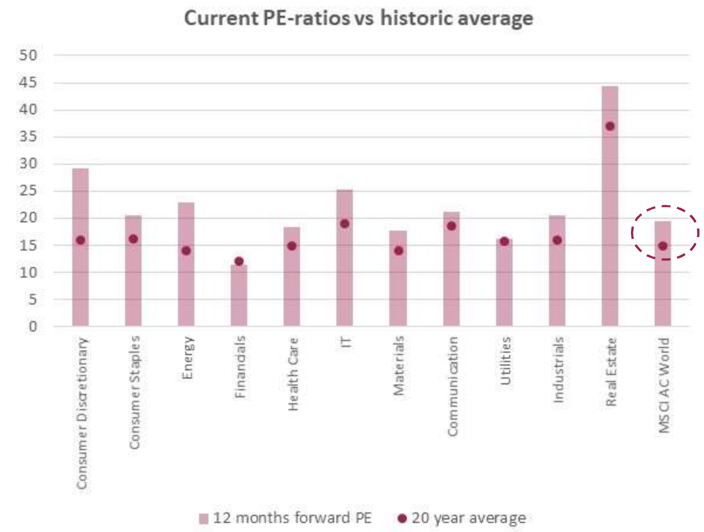
Source: FIS Market Map; Bloomberg

Equities: expensive and crowded as rarely before (2/2)

These days, there are plenty of scary charts being shared in the investment community which display how extremely expensive global stock markets currently are. However, we decided to show a rather muted one since our aim is not to spook investors but rather to inform about the fact that the current rich valuation spans across most market segments. As one can see from the *lower graph on the right,* on a Price/ Earnings-basis for the forthcoming 12 months (based on consensus earnings expectations), the **MSCI All World Index** is currently **about 30% more expensive than its 20-year average!** We admit that **due to the extremely low level of interest rates** around the globe, **somewhat higher valuations are warranted** and we also understand that going forward, earnings might surprise to the upside. However, whichever way you look at it, **markets are priced for perfection** and thus, the **risks are skewed to the downside**. Again, this does by no means the current rally can go any further. As a matter of fact, momentum is sometimes very hard to kill and in our opinion, we will **unlikely see a meaningful regime shift ahead of the US elections** in November. Our strategy of choice for now is neither to leave the market entirely nor to add risk at that point. Instead, we opt to **capitalize on the elevated level of volatility** via the use of structured product *(see also our product of the months on page 9).*

For now, the decade-old ”deflation-trade” (long growth, short value) is still very much in play and there is no need to change course for now. Anyhow, as we just displayed, positioning has rarely been more extreme and therefore, **an eventual reversal of the “deflation-narrative**” *(as explained on page 3)* would not only have devasting consequences on bonds but **also on the preferred type of stocks** in the market and could lead to a sector/style-rotation not seen before. Anyhow, we have to be very clear that so far, the time has not yet come so we just need to keep this potential scenario in mind.





Source: BofA Global Fund Manager Survey; UBS; MSCI

Our Tactical Asset Allocation (6months horizon)

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EQUITIES –> REMAIN UNDERWEIGHT

- The most recent sell-off does not need to bee the start of a new downtrend and neither was the previous "buying panic" the beginning of an ever rising bull market. **Choppy sideways trading might instead prevail** for the months to come.
- Despite ever rising covid19-cases around the world, **consumer spending is picking up again** as lockdown measures continue to be eased globally. In China, the country which is most advanced in its fight against Covid19 just experienced the first monthly rise when compared to the same months of the previous year. We therefore **add "consumer discretionary" at the expense of "consumer staples"** to our most preferred sector list. As long as interest rates stay low (and the FED has just announced it won't raise them until at least 2024), **banks and financials in general are not worth an investment**, no matter how cheap they might look like! Accordingly, we put financial on our least preferred list.
- **Apart from that minor tweak towards more cyclicality, we maintain our** preference for less cyclical sectors such as technology and healthcare. Only Healthcare, the 3rd of our preferred sectors, has stalled over the most recent past but in our eyes, high quality balance sheets and superior cash flow generation makes the sector a "must hold" for the time to come.
- For now, **"growth" remains the leading factor** no matter how expensive it might be vs value. And as long as the low interest-narrative is not to changed, **expect more of the same, i.e. the "momentum"-factor to lead**. Anyhow, as highlighted on *page 3 & 5*, be aware this trend is very mature and any (eventual) rise in inflation expectations might lead to a regime change.

CASH –> REMAIN NEUTRAL

- We have argued for some time to keep some spare cash at hands for the moment opportunities will arise. And as early September proved, **opportunities do appear- sometimes one just needs to be patient until they arrive**. Another learning was that **risks remain high**: during times, virtually all assets are expensive, one may loose more than the loss of opportunity within a short period of time.

Our Tactical Asset Allocation (6months horizon)

BONDS –> REMAIN NEUTRAL

- In case that the US congress would indeed increase fiscal support as requested by the FED, a higher budget deficit should **lead** to a muted **steepening of the US treasury curve** over time which is why we continue to avoid exposure to the long end of the curve (rising yields imply falling bond prices). As we have been saying for some time, the time premium, i.e. the extra yield one can earn for holding longer dated bond over shorter ones is still low which is why think investors are not adequately compensated for the duration risk.
- Instead, we prefer to take "credit risk" **in the form of low investment grade / high non-investment grade corporate bonds** as we expect **credit spreads of that segment to either stay where they are or even tighten further.** To be fair, the big moves in spreads are done and it is hard to imagine how low they can further go but we are of the opinion that the Central Banks "crowding out" in better quality parts of the bond market will keep demand for lower quality high.
- During times where the USD is rather weak, we maintain our overweight rating for **emerging markets.** Keep the **preference for selected Corporates vs. Governments** as the group of the later are facing (even) larger fiscal deficits due to Covid19-combat measures.

ALTERNATIVES –> REMAIN OVERWEIGHT

- Our **long time favourite gold** has been **in consolidation mode** for almost 2 months now. It seems as if the USD 1900.- level per ounce was a solid support. Continue to buy – even more aggressively in case we break below the USD 1900.- level. **Residential property is a good ad-on** during times where low rates keeps demand for stable yields high but make sure your investment vehicle of choice does not hold any commercial real estate (the classic COVID19-victim). The same effects are likely be beneficiary for (listed**) infrastructure investments** which have virtually no exposure to the economic cycle but generate steady cash flows.

House View: our Preferences on one Slide

Asset Class	We Like	We Don't Like
Equities	*Area*: **businesses not affected by COVID19** *Sectors*: **Consumer ~~defensives~~ discretionary, Healthcare, Technology,** *Style:* **Quality, Growth, Momentum**	*Area*: **businesses affected by COVID19** *Sectors:* **Energy, ~~Materials~~, Consumer Cyclicals, Financials** *Style:* **Value ~~traps~~**
Bonds	*Duration:* **Medium term duration** of up to **5** years *Area:* **Emerging Markets corporate debt in hard currency** *Credit:* **high & low grade IG; subordinated debt**	*Duration*: **duration > 7 years** Area: **EU government bonds, EM sovereign in local currency** *Credit:* **High Yield, Senior Loans, Convertible Bonds**
FX & Commo-dities	*FX Majors:* **EUR** *FX Minors:* *Commodities:* **Gold**	*FX Majors:* **GBP** *FX Minors:* **TRY** *Commodities:* **Base Metals, Oil**
Alternatives	*Alternatives:* **relative value strategies, residential real estate, infrastructure**	*Alternatives:* **listed Private Equity**

mangenta = recent changes

Product of the Month: 1yr Low Strike RC on Tech Stocks

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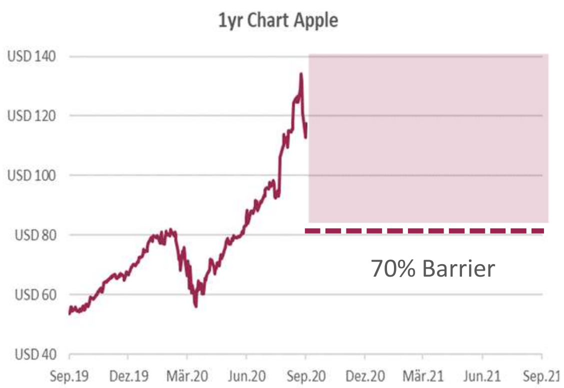
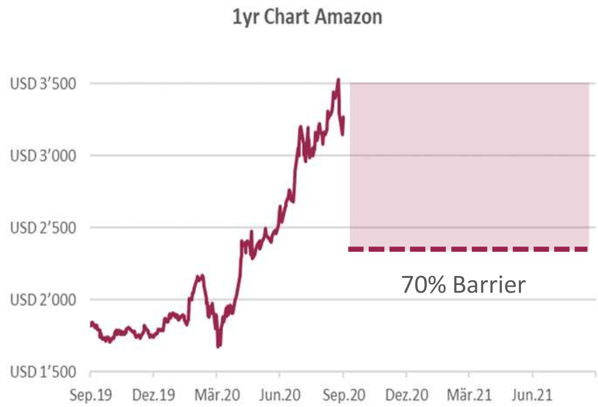
How it works:

- The investor receives a **fixed & guaranteed coupon of 7% p.a. The invested amount is fully repaid if none of the 3 underlying shares trade < 70% of today's level at maturity date in 1 years time.** However, the underlying shares may well trade below the barrier level during the lifetime of the product with no impact on final redemption.
- Accordingly, the investor will only suffer a capital loss in case the worst of the 3 underlying shares losses *more than -30%* from today's value *at maturity date*. In that case, the amount of capital loss at maturity equals the negative performance of the worst performing of the 3 underlying shares over the lifetime of the product. In that case, the investor will be delivered that worst performing stock (which leaves him exposed to future price gains / losses of that security- provided he holds on to it).
- The issuer may early recall the note first after 6 months at 100% provided all 3 underlying shares trade >95% of today's price.
- The selected stocks are **Apple, Amazon & Facebook**





Product Parameters:

Issuer:	Morgan Stanley (Credit Rating: A)	Barrier at Maturity:	70%
Coupon:	7% p.a.; paid monthly (0.584%)	Minimum Investment Size	1'000.- USD
Maturity	1 year	Early Redemption:	monthly, first after 6 months if all 3 underlying stocks > 95%

Source: FIS Market Map

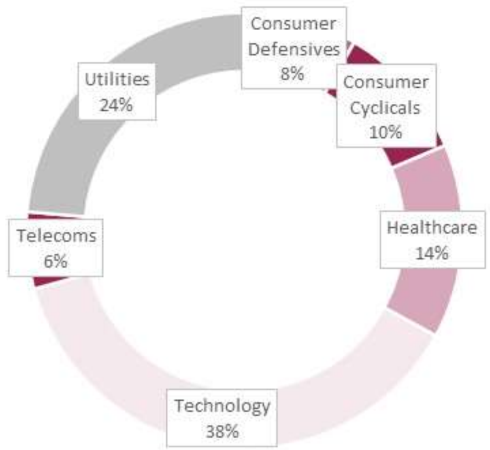
Overview US Equity Model Portfolio

Performance Overview	2020	2019	2018	2017	ITD *)
Gigant US Equity Model Portfolio	**+12,03%**	**+30,56%**	**-1,2%**	**+17,6%**	**+69,82%**
S&P 500	+3,91%	+28,88%	-6,2%	+19,4%	+49,94%
Dow Jones	-2,23%	+22,34%	-5,6%	+25,1%	+41,19%
Nasdaq 100	+26,88%	+37,96%	-1,0%	+27,1%	+127,3%

Current Situation:	
Current Value:	1’698’215 USD
Start Value:	1’000’000 USD
Realized Gains:	+398’982 USD
Unrealized Gains:	+232’239 USD
Dividend Income:	+67’003 USD
Cash:	428’242 USD (25%)
Equities:	1’269’973 USD (67%)

Evolution of 1Mio USD invested into the Gigant US Equity Model Portfolio since inception:

Current Sector Allocation:

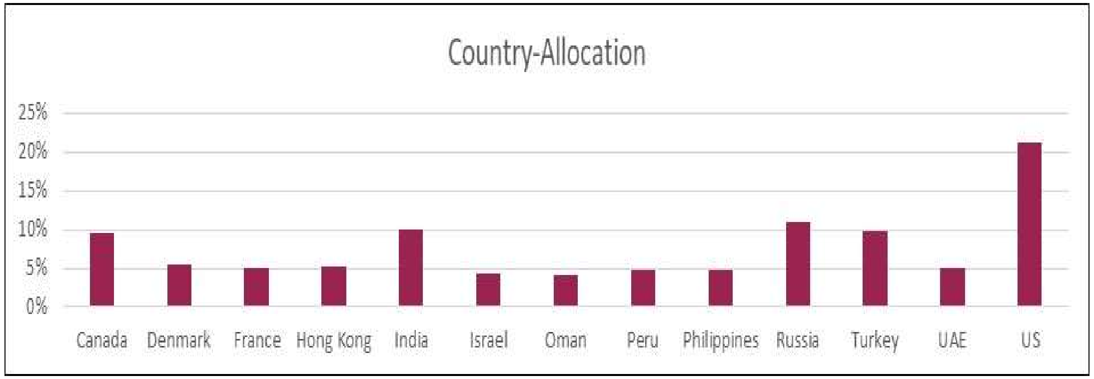


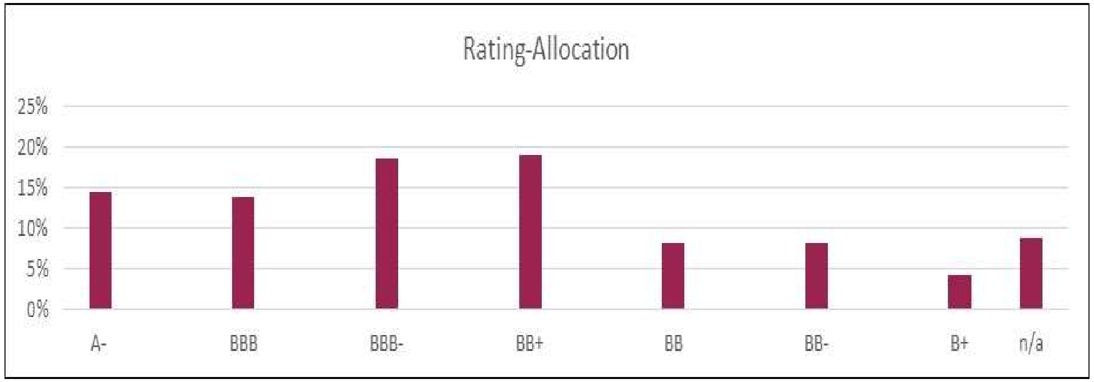
computed by stockopedia.com; all data as of 17th of September; *) inception date = 31th of Dec 2016

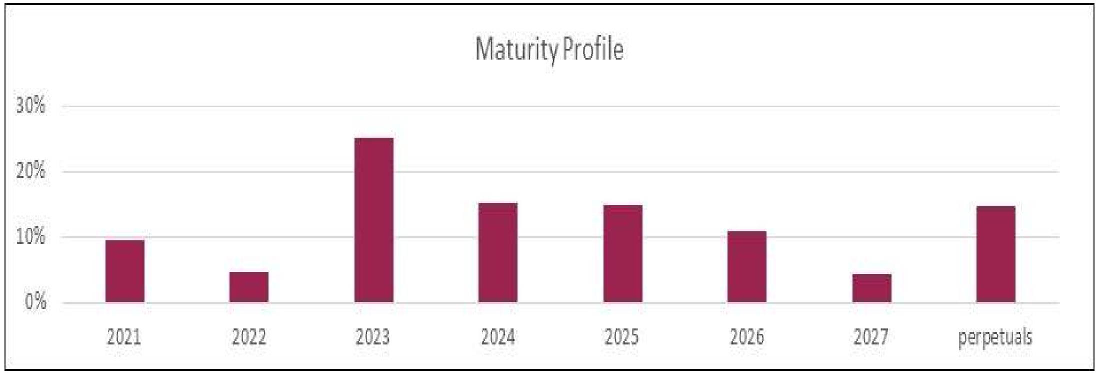
Overview USD Bond Model Portfolio

Performance Overview	YTD	2019	2018	2017
Gigant USD Bond Model Portfolio	**+4,59%**	**+9,5%**	**+1,0%**	**+4,7%**
Bloomberg Barclays US Aggregate Index	**+7,03%**	**+8,7%**	**+0,0%**	**+1,2%**
Bloomberg Barclays EM USD Aggregate Index	**+3,33%**	**+10,1%**	**-2,5%**	**+6,9%**

Current Situation:	
Weighted average YTM:	3,88%
Weighted average Duration:	4,60







Source of data: FIS Market Map; own calculation; all data as of 18th of September

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SWISS CONSULTING

Please contact:

Phone: +41 44 493 90 90
Fax: +41 44 493 90 11
Email: info@gigant-swiss.ch

Gigant Swiss Consulting AG
Bodmerstrasse 9
CH-8002 Zurich

www.gigant-swiss.ch
info@gigant-swiss.ch

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