

HEIJIN CAPITAL BI-WEEKLY INVESTMENT COMMENTARY

January 27th – February 10th 2019

Global Portfolio Holdings Weekly

Executive Summary

→ WTI Crude Oil & Brent Crude Oil slid down as concerns over slowing global economic growth grew. WTI Crude Oil fell from \$54.5/bbl to \$52.72/bbl. Baker Hughes reported an increase in active O&G rigs this past week (+7 oil rigs, -3 gas rigs). Venezuela is tightening supplies and now PDVSA does not even produce 1m/bpd. On top of that, Saudi Arabia's January production declined by 400k/bpd in comparison to December 2018 levels. Moreover, Libya's NOC cannot restart the El Sharara Oil field without security being restored (a field that made 300k/bpd).

→ Dallas Fed President Robert Kaplan issued concerns about the global economy and how the slowdown could spillover into the U.S. Kaplan also stated that the U.S. should stop stimulating its economy. And the BoFÉ said that the U.K. is about the face the weakest economic growth in the past decade.

→ Both the S&P500 and the DJIA ended the week flat (slightly into positive territory), but with increased intra-day volatility. The CBOE Volatility Index (VIX) rose as much as 16.8% from its low during the week.

INDEX	CLOSE	WEEK	YTD
Dow Jones Industrial Average	25,106	0.2%	7.6%
S&P 500 Index	2,708	0.0%	8.0%
NASDAQ	7,298	0.5%	10.0%
MSCI EAFE*	1,823	-0.4%	6.0%
10-yr Treasury Yield	2.63%	-0.05%	-0.05%
Oil (\$/bbl)	\$52.73	-4.6%	16.1%
Bonds	\$107.34	0.3%	1.1%

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Review of our recent Asset Allocation from Past Commentaries + Internal Pitches:

We decided to track back our Asset Allocation picks from past commentaries as well as a couple of our internal pitches that we also decided to reveal in order to be fully transparent. Please note that these are taken from the date of the commentary or internal pitch to the current price and thus performance may lack since there is no trade execution specifics (unless noted). The Heijin Capital Team wants to display unconditional performance from what we researched and published in our commentaries that are available to anyone since our first at the beginning of August 2018.

Type	Equity / Ticker	Date of Pitch	Entry Price	Current Price	P/L
LONG	Celgene Corp / NASDAQ:CELG (Internal Pitch)	02/07/2018	79.51	87.91	10.56%
SHORT	USD/RUB	12/08/2018	67.82	65.46	3.48%
LONG	Reliance Industries / NSE:RELIANCE	26/08/2018	1,291.50	1,277.80	-1.06%
LONG	Global X Lithium & Battery ETF / NYSEARCA: LIT	26/08/2018	32.50	28.34	-12.80%
LONG	Neste Oyj / HEL:NESTE	26/08/2018	74.76	86.48	15.68%
LONG	Petrobras / NYSE:PBR	23/09/2018	11.39	15.69	37.75%
LONG	Micron Technology / NASDAQ:MU	23/09/2018	45.16	38.58	-14.57%
LONG	Diageo Plc / LON:DGE	06/10/2018	2,694.50	2,982.00	10.67%
SHORT	Amazon Inc / NASDAQ: AMZN	07/10/2018	1,864.42	1,588.22	14.81%
SHORT	Apple Inc / NASDAQ:AAPL	07/10/2018	223.77	170.41	23.85%
SHORT	Netflix Inc / NASDAQ:NFLX (Properly Executed)	07/10/2018	349.10	261.43	25.11%
LONG	Nokia Oyj / NYSE:NOK	21/10/2018	5.63	6.16	9.41%
LONG	Telefonaktiebolaget LM Ericsson / NASDAQ:ERIC	21/10/2018	9.30	8.90	-4.30%
SHORT	JCPenney Inc / NYSE:JCP	21/10/2018	1.51	1.27	15.89%
LONG	Advanced Oncotherapy Plc / LON:AVO	04/11/2018	41.50	38.00	-8.43%
LONG	Cosan Ltd / NYSE: CZZ (Internal Pitch)	06/11/2018	8.72	10.95	25.57%
LONG	Dollar Tree Ltd / NYSE:DLTR (Internal Pitch)	08/11/2018	87.85	97.65	11.16%
LONG	ProShares Ultra Yen/ NYSEARCA: YCL (Prop. Executed)	17/11/2018	54.63	58.98	7.96%
LONG	Kosmos Energy / NYSE:KOS	30/11/2018	5.38	5.11	-5.02%
LONG	Samkrp Pistons & Rings LTD / BOM:520075	16/12/2018	197.40	170.10	-13.83%
LONG	HDFC Bank Limited / NSE:HDFCBANK	16/12/2018	2,130.20	2,117.00	-0.62%
LONG	Telefonica Brasil / NYSE:VIV	16/12/2018	12.10	12.76	5.45%
LONG	EOG Resources Inc / NYSE:EOG	13/01/2019	98.51	92.50	-6.10%
LONG	Hermes International SCA / EPA:RMS	27/01/2019	504.00	528.00	4.76%

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Market Summary & Strategy

FX Markets

Is the US Dollar Completely Immune to Global Markets?

Over the last three years, the United States government has made three significant errors. In late 2017, Congress cut taxes just as the US economy attained full employment. Later, in April 2018, the Federal Reserve turned hawkish as it mistook the temporary growth caused by the tax cut for more-meaningful higher trend growth when in reality, those numbers were not backed by any substantial evidence. Finally, President Donald Trump abandoned America's longstanding commitment to free trade by imposing a broad range of tariffs on Chinese imports in mid-2018.

What stumped us was that the US Dollar continued to grow year on year, merely ignoring these events. If any other country had done the same thing, it would have been severely punished in not only currency markets, but in both equity and debt markets, facing the consequences of being downgraded by US credit rating agencies. So what's going on? Does the US dollar have complete immunity to global markets and the decisions made by its country's leaders?

The answer lies in the dollar's status as the world's leading global reserve currency. Such a status is similar to insurance — it guarantees access to finance in bad times. The US can access finance even when it causes crises (like we saw in 2008-09), moreover, it also determines the size of its own insurance payout by setting the number of Treasuries it issues. Financial regulations contribute to the dollar's special status. Furthermore, US government bonds are assigned a 0 percent risk rating under Basel III because they are considered risk free. Rating agencies do their bit by assigning higher grades to the US bonds than to bonds in less indebted, faster growth countries without reserve currency status. To finish it off: central banks peg more than 60 percent of the world's \$11tn of forex reserves exclusively to the dollar. This struggle may extend into the medium term as well. Foreign investors accumulated large dollar positions during the era of easy money to participate in the US stock market rally. These positions will now unwind, as risk and uncertainty increases. The US economy has recovered to the point where costs are eating into US company earnings. Higher company costs erode the reach for further capital gains, especially in the context of stagnant productivity, which can be associated with US companies buying back shares in preference to investing back into their businesses.

This causes a chain reaction which spreads deeper into the equity and debt markets of the United States. Without prospect for significant capital gains, total return in the US stock market will therefore mostly derive from dividend yield, which is many times lower than the yield available on, say, bonds in higher yield markets, such as EM. The unwind of dollar longs will eventually subside, but only after US companies have restored a competitive edge, which will most likely happen when the US dollar is 20-30% lower than what it is today.

Decelerating U.S. growth and the Fed removing its reference to further gradual interest rate increases last week are underpinning Morgan Stanley's base case for the dollar weakening beyond consensus projections.

The bank sees the potential for even larger downside moves linked to how investors handle hedging. A FX strategist from Morgan Stanley backed this up by claiming: "For investors outside the U.S., this cost of hedging U.S. assets back into local currency has almost never been higher." Foreign investors were seen selling U.S. equities while domestic funds were selling overseas bonds according to the latest U.S. capital flow data for November.

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Reached Its Peak
Morgan Stanley think the major dollar peak is now in

■ US trade weighted broad dollar



At Heijin Capital, we believe that the US Dollar is under no threat from the Euro or the Renminbi (CNY) as both the Eurozone and China are both struggling with deeply rooted geopolitical tensions. Yet, the dollar looks most likely to lose ground against smaller developed market currencies and emerging market currencies. If the US slowdown is gentle, EM currencies will outperform higher beta developed currencies, such as the Canadian and Australian dollars and the Norwegian krone. If the US slowdown becomes more intense, there may be more near-term support for the Swiss franc, Japanese yen, and maybe even gold.

We have identified this opportunity and have begun to allocate accordingly. We are increasing our exposure in the Japanese Yen and are exploring options on going short on the USD.

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Investment Analysis

Can Huya & Iqiyi become tech giants in the volatile Chinese market?

Over the past year the CSI 300 Index (Shanghai & Shenzhen Index) has dropped 16.5% and was down over 23% just before New Years. The takeaway from our analysis conducted in the past few commentaries on the Chinese market and it's economy is that the CSI 300 Index or China's equity market in general should drop much further this year. This is due to a slowdown in economic growth (still dishonest growth reported), leveraged loans risk, real estate market pullback, and the overall shadow + general banking system's systemic risk.



Despite all this data and noise it is vital to stay rational and calm to ensure returns. Due to our bearish outlook on China we decided to look in the other direction and try to find ways to allocate into assets that may actually profit from all this negativity no matter what the economy may be doing. In other words, we quickly concluded that we had to find non-cyclical assets that could be growing in the double digits when everything turned sour. Typically, non-cyclical assets are used in a defensive manner as they tend to operate in less-elastic demand markets, pay stable dividends, and have a stable amount of growth. Usually these assets have big moats and provide goods that qualify more as needs than wants. E.g., utilities, healthcare, essential consumer products, beverages, consumer food and more. The issue with these industries is that they tend to heavily underperform in bull markets and only a handful are actually able to retain stability in a crisis. We actually looked into the performance of hundreds of US equities in the past crises and the only company that actually saw it's share price appreciate, stay flat, or lose the least was Walmart Inc (NYSE:WMT). Thus, on the most part a crisis will take everything down by at least 15% - broadly speaking.

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On top of that, it is very improbable to time the markets properly. But, the markets give away a lot of information that may serve useful to adjust one's risk appetite and the type of financial instruments one is invested in. We already know that China is on a downtrend as we speak, but no one knows how long it will last or how much lower it will go. Thus, the Heijin Capital Team thought it best to perhaps mix the holdings up with the companies that are most likely to thrive despite all the grim background that affects the businesses reliant on the export-import levels and more.

More than 6 months ago we found Huya Inc and Iqiyi Inc, both fairly recent IPOs in the tech sector with astonishing growth figures. And both exclusively offering their services in China. At the time we thought it was best to wait out on the sidelines as the CSI 300 slid down rapidly, and to only get in if there was more stability or if the market participants had become more rational. But we've now decided to step-in soon since after all these assets are now grossly undervalued and are poised to turn into multi-baggers given the services they offer.

Brief look into Huya Inc - ADR / NYSE:HUYA:

- Huya is the No.1 game live streaming platform in China.
- Huya has the largest and most active game live streaming community in terms of average MAUs, and average daily time spent on mobile app per mobile active user in the fourth quarter of 2016 and 2017, and the largest number of active broadcasters in 2016 and 2017, according to the Frost & Sullivan Report.
- As the pioneer and market leader, Huya is well positioned to expand further in the rapidly growing game live streaming market in China.
- Huya cooperates with e-sports event organizers, as well as major game developers and publishers, and have developed e-sports live streaming as the most popular content genre on their platform.
- As of December 31, 2016 and 2017, Huya's live streaming content covered over 2,100 and 2,600 different games, respectively, including mobile, PC and console games.
- Building on their success in game live streaming, they have also extended our content to other entertainment genres, such as talent shows, anime and outdoor activities.
- In the fourth quarter of 2017, Huya's community had over 38.8 million average mobile MAUs, an increase of 47.6% from the same period of 2016.

Brief look into Iqiyi Inc / NASDAQ:IQ:

- Market leading online entertainment service in China.
- Iqiyi's Platform features highly popular original content, as well as a comprehensive selection of professionally-produced and partner-generated content. Through their curated premium content, they attract a massive user base with tremendous user engagement, and generate significant monetization opportunities.
- One of the largest internet companies in China in terms of user base. They have successfully built iQIYI into a widely-recognized brand among users, content partners and advertisers, and have redefined online entertainment in China.

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- The largest internet video streaming service in China in terms of user time spent and average total MAUs in 2017, according to iResearch. Through their license partner, they also operate the largest smart TV video streaming service in China as measured by monthly active devices in December 2017, according to the iResearch Report. For the three months ended December 31, 2017, they had approximately 421.3 million average mobile MAUs and approximately 126.0 million average mobile DAUs, while their average PC MAUs and average PC DAUs reached 424.1 million and 53.7 million, respectively.
- Significant synergies with their parent company Baidu, Inc., or Baidu. Baidu has provided them with technology, infrastructure and financial support.

It is clear from these brief summaries that both Huya and Iqiyi operate in incredibly high growth industries and are without a doubt leaders. On top of that, both are backed by Chinese tech giants being Tencent for Huya and Baidu for Iqiyi. This bolsters the amount of support they receive whether financially or technologically and it is in the interest of these giants that they grow (less competition with the big players). Some may argue that it would be wiser to allocate to the tech giants instead of smaller underdogs, but our thesis establishes a view that since the tech giants are so diversified they will tend to fall more with the general market. Whereas when playing with the singles (Huya and Iqiyi) that are focused, it increases the probability that the movement of the share price is more linked to the company itself and less so with the general market or sector.

We are prepared to allocate to Huya and Iqiyi because their services are not a huge financial strain/burden and are mostly on a subscription basis. Therefore, the immense Chinese middle class and upper class are beginning to use these services that in the Western world would be Electronic Arts Inc (EA) and Netflix. But, due to China's protectionist stance and communist ideology in government, the Western counterparts are banned to do business in China - providing an incredible opportunity for Chinese start-ups to gain market share. In essence, Huya will become the EA of China, and Iqiyi the Netflix of China if all goes well.

Moreover, the entertainment services they offer tend to be much less affected by economic downturns since they are such a small portion of people's respective incomes on the most part. If we were to take ourselves back into 2008 would you stop playing games (under the condition that you previously played) on Steam, playing FIFA by EA, using Netflix, using HBO, using Hulu or the equivalent? For most of the population a recession would not mean cancelling the \$7.99/month Netflix subscription for example. And that is what we are betting on with Huya and Iqiyi. From our analysis the user base of Huya and Iqiyi should grow as the Chinese start upgrading their lifestyles and start using services commonly used across the world on a daily or weekly basis. Lastly, Huya is 61% lower than the high it hit in June, and Iqiyi is 53% lower than the high it hit in June - with these discounts it is hard to ignore these underdogs even in this market.

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Commodities

Graphene - The material for space elevators and bendable displays

Graphene is a form of carbon firstly observed in 1962, but rediscovered, isolated and characterized in 2004 by Andre Geim and Konstantin Novoselov, which earned them the Nobel Prize in Physics in 2010. From a chemical point of view, Graphene is single, two-dimensional layer of carbon atoms arranged in a hexagonal lattice (honeycomb structure). Although Graphene was just discovered in 2004, most people were unknowingly already in touch with it a lot earlier, namely when they touched pencil powder, since the core of pencils contains normally graphite. Graphite, which appears in nature and might be more familiar to people, consists of multiple layers of graphene. Indeed, the simplest form of isolating graphene is by gently tearing down one layer of atoms from a graphite block with special tape. Obviously, the single layer of carbon atoms will not be visible to the naked eye, but a microscope is needed to identify the graphene.

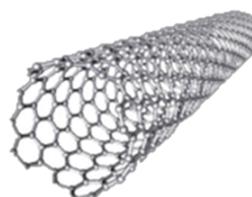
What makes graphene so special?

At this point you are probably wondering why you are reading about graphene in our investment commentary, but this is just another proof of the extensive research that needs to be done when researching equities. The reason why Heijin is reporting about graphene is because it has the potential to disrupt our society similar to the way oil or steel have done before.

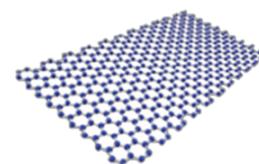
- **Electrical conductivity:** Graphene's conductivity can theoretically be up to 4,500 times better copper and its resistivity is lower than silver, otherwise known as the material with the lowest resistivity.
- **Thermal conductivity:** The thermal conductivity of graphene at room temperature is one of the best ever observed.
- **Melting point:** According to scientists, the melting point of graphene lies between 4,000K and 6000K. (The surface of the sun has an effective temperature of 5,777K)
- **Transparency:** One graphene layer absorbs around 2% of the light, which makes it practically transparent. However, when putting multiple layers of graphene it loses its transparency, because each layer absorbs more and more light.
- **Tensile strength:** Graphene's has an ultimate tensile strength of 130 GPa, whereas steel as "just" a tensile strength of 400 MPa, which is 0.3% the one of graphene. However, graphene has just roughly 25% of the fracture toughness of steel, which makes it relatively sensitive.
- **Elasticity:** Graphene has a very strong elasticity, which allows it to return to its original form even after strong deformations.

Carbon nanotubes

Carbon nanotubes (CNTs) are cylindrical nanostructures made of graphene. In other words, it can be imagined as taking one-layer graphene and roll it to a tube. Generally, there exists two different types of CNTs: single-walled and multi-walled CNTs. Single-walled CNTs consist of one single layer of graphene rolled into the shape of a tube. On the other side, multi-walled CNTs consists of multiple, concentric layers of graphene rolled into the shape of a tube. Since most one is just the wrapped-up form of the other, both, CNTs and Graphene have very similar properties and can be used in conjunction.



Carbon nanotube (CNT)



Graphene

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Applications of graphene

The enormous potential applications of graphene is what makes this material so special. Although not realistic, it is the first material that could theoretically be used to build a space elevator. More realistic applications are:

- **Bendable displays:** Researchers in South Korea were already able to integrate graphene electrodes into OLED display panels and thereby making the panels bendable. The thin yet robust properties of graphene makes it possible to create displays that can adapt to different shapes, which would take the development of portable smart devices onto a new level with smartphones that bend around the arm and displays that are integrated into clothing
- **Transparent displays:** Another achievement that can be attributed to South Korean researchers of the Electronics and Telecommunications Research Institute are invisible displays build with graphene and OLED technology. The commercialization of this technology could allow to turn every window into a display and create smart contact lenses as in science fiction movies.
- **Sensors :** A graphene sensor is so sensitive that it can detect even one single molecule .This means that warnings for deadly gases, such as carbon monoxide, can be triggered well before the “average” sensor can. Whatsmore, due to the multifunctional nature of the graphene, you could have different sheets detecting different things , such as gases , pressure and electricity in one sensor.
- **Medical use:** Biocompatibility means graphene is safe for brain electrodes.as well as its durable and lightweight nature lend itself perfecting in the production of prosthetics.
- **Membranes:** Graphene oxide membranes are capable of forming a perfect barrier across both liquids and gases. This means that it is able to extract a pollutant from a liquid to an almost perfect level. This puts a very real possibility that we will be able to give the whole world clean drinking water.
- **Graphene supercapacitors:** Graphene enables the production of supercapacitors, which can be a light, long-lasting, fast-charging and environmental friendly alternative to traditional batteries. This could solve the biggest problem of electric cars and make green energy more efficient by enabling the storage of unused energy from the electricity grid.

Restrictions of graphene

Despite graphene seeming to be the cure for many of our issues, the major drawback is price. Currently it is extremely expensive to manufacture, with a gram of research grade graphene costing almost 100\$; thus at this moment in time, despite its obvious potential, it is currently nowhere near becoming an economically viable option. Moreover, the major issue for graphene is the difficulty in mass production at competitive prices. However, many research departments are currently on the verge of a break through. Heijin believes that in several years, bulk graphene prices may drop below that of silicon, enabling graphene to enter all markets now dominated by silicon, such as computing, chip manufacturing, sensors, solar cells, etc.

Conclusion

Heijin Capital firmly believes in the enormous potential of graphene and its future disruption of our daily lives. Thus, we keep track of the biggest players in the graphene and CNT industry, since we predict profitable investment opportunities in the upcoming years. Nonetheless, we are aware that there are big difficulties with the production of graphene at industrial levels and at an adequate high quality which might make some of the potential applications practically unfeasible.

Global Macro

Is it time to take a chance on the gaming industry?

The gambling industry has been dealt a bad hand in the past year. In the UK Fixed odds betting terminals, which allowed players to insert a credit/debit card and play, with payouts set according to fixed odds on the simulated outcomes of games such as roulette and poker. Had their maximum slashed from £100 to £2, and a limit on the number of said terminals that could be in any one store was set. This set many gambling stocks into freefall, as their once most profitable form of betting had now been dramatically cut. This has led to a massive decline in high street betting shops and a lot of the industries profits. Furthermore, this month about of equine flu had devastated horse betting, with racing meets being cancelled across the UK. However, despite the recent bad luck, the gaming industry is looking extremely positive for the next year, especially with many British firms setting their sights in the US market.

US gaming laws are both restrictive and confusing, especially surrounding the trouble of cross-state betting and recent changes in legislation. Betting has had a rollercoaster ride in the states over the past year. In May of last year the PASP act, which defined the perimeters of the legality of professional and amateur sports betting, was deemed unconstitutional. This allowed states to set their own laws on sports betting, which led to further issues regarding cross-state gambling and the wire act. Heijin believes that in the coming months, that the draw billions of dollars in tax revenue will be too much for states to resist, leading more states into legalizing sports betting soon. Many bookmakers are treating this a lot like the gold rush experienced when Marijuana was legalised, hoping to cash out on this newly legalised enterprise. The biggest potential player, in our view, is William Hill (WHM). William Hill has recently signed a partnership with US gaming giant Eldorado. Eldorado received a 20% equity stake in William Hill US as well as 13.4 million ordinary shares. This will allow the firms to take up a substantial proportion of the sports betting market and give them the capacity to quickly move in and take advantage when states begin to legalise sports betting. Moreover, William Hill stock is trading at a discount, due to much of the current issues surrounding equine flu and changing game laws in the UK. However in the long term, William Hill is a market leader, that is well placed to take advantage of the potential in sports betting in the US, and also has a brilliant dividend yield of 7.35%. This is a long term choice, however, within the next 2 to 3 years, Heijin expects brilliant growth from William Hill.

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