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HEIJIN CAPITAL BI-WEEKLY INVESTMENT COMMENTARY

November 17th – December 1st, 2019

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Commentary Overview

Market Snapshot

INDEX	CLOSE	2 WEEKS	YTD
Dow Jones Industrial Average	28,051	+0.05%	+20.15%
S&P 500 Index	3,141	+0.61%	+25.14%
NASDAQ	8,665	+1.35%	+30.00%
10-yr Treasury Yield	1.78%	-0.1%	-0.9%
Oil ($/bbl)	$55.42	-3.5%	22.0%
Bonds	$112.96	+0.4%	8.6%

*bonds are represented by the iShares Core U.S. Aggregate Bond ETF (NYSEARCA:AGG)

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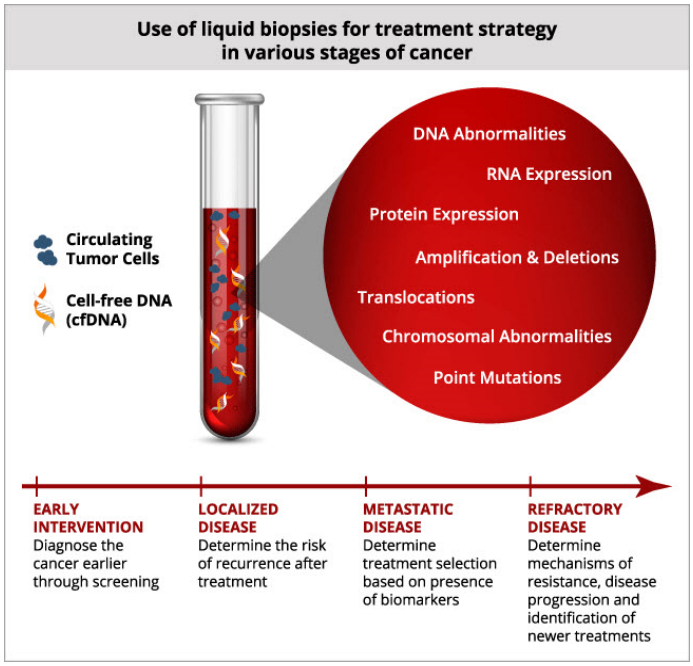
Market Outlook & Strategy
Global Macro
Are Liquid Biopsies The Future?

A biopsy has been standard medical practice since its first use in 1875 by Russian Doctor, M. M. Rudnev. A biopsy is a medical practice of removing a sample of the flesh or organ tissue sample to be examined under the microscope, where abnormal cells may be identified, which can help to diagnose a specific condition. If a condition has already been diagnosed, a biopsy can also be used to assess its severity (such as the degree of inflammation) and grade (such as the aggressiveness of cancer). This information can be very useful when deciding on the most appropriate treatment and assessing how well a person responds to a particular type of treatment. Unfortunately, it has, on the whole, gone mostly unchanged since Rudnev. It's worrying that such a common and useful medical procedure has not experienced the same modernisation that so many other medical treatments have in recent years. This is where a liquid biopsy steps in, liquid biopsy extracts cancer cells from a simple blood sample and has the potential to revolutionize cancer treatment by non-invasively monitoring cancer cells. For patients who previously received a cancer diagnosis, liquid biopsy refers to the use of a bio-fluid sample, such as blood, cerebrospinal fluid, or urine to detect and analyze biological markers to evaluate disease and determine cancer treatment options. This contrasts with a tissue biopsy, in which a small portion of a patient's tumour is removed and analyzed for cancer biomarkers.



Liquid biopsies are typically conducted with blood as the sample type and are used to identify cancer biomarkers in circulating tumour DNA (ctDNA) or on circulating tumour cells (CTCs), which are the most commonly evaluated indicators or drivers of cancer development. Doctors may use liquid biopsies to help design cancer treatment plans, to evaluate how well treatment is working, or to determine if a prior cancer condition has recurred. The ability to take multiple samples of blood may help doctors understand what kind of molecular changes are taking place over time in a

patient's tumour. This technology has proven to be much more effective and detects worsening of a disease condition even before a CT scan. As seen in figure 1.

The companies that Heijin feels is providing the best potential growth in this flourishing sub-category of the healthcare market is **Biocep (NASDAQ: BIOC)**. Biocept is a leading commercial provider of liquid biopsy testing services designed to enable oncologists to rapidly detect and monitor cancer biomarkers from a simple blood sample. Through their Target Selector liquid biopsy, Biocept's focuses on cancer biomarkers that are clinically actionable based on clinical treatment guidelines listed by the National Comprehensive Cancer Network (NCCN). BIOC's revenue growth is vastly outperforming the markets average of 7.4% by 50.2%. Impressively over the past 5 years Biocep has worked diligently to reduce their debt to equity ratio from 147% to 1.7%, a truly remarkable improvement.

Another exciting company (and our personal favorite) is **Guardant Health (NASDAQ: GH),** who are a leading precision oncology company dedicated to helping conquer cancer through our proprietary blood tests, vast data sets, and advanced analytics. The debt free company is currently gaining a brillant following and is moving strength to strength with an enviable product pipeline. Guardant has a potential market of about $6 billion per year, thus this years revenue of just over $200 million is merely a drop in the ocean, especially when one considers their growing pipeline of new products. Furthermore, Guardant not only specialise in biopsies for prevention and early detection, but their LUNAR-1 program also seeks to provide a definitive test for residual disease detection and recurrence, moving beyond the limitations of today's methods. The company estimates a potential $15 billion market for LUNAR-1. The solid management team Guardant has in place is a key driver for the stock, as their global aspirations and vertical growth throughout the sector, (Pre-diagnosis, diagnosis, recurrent tumour detection) has solidified their place in the market. This in addition to revenue growth of 137.1% in the past year. In addition to an improvement in gross margins to 70%, has resulted in projections that Guardant could climb to a $130 in the next twelve months, indicating a potential upside of over 62%. It is clear that liquid biopsies are the noninvasive future of biopsies and the aforementioned companies are more than likely the front runners in this sector.

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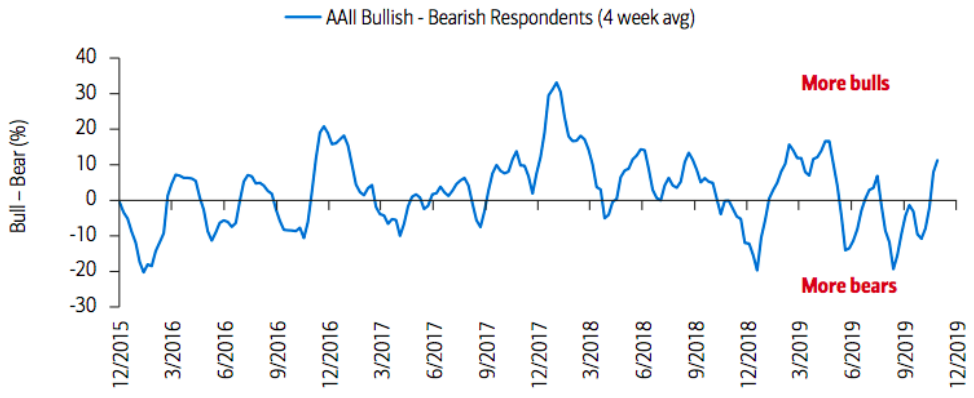
Global Macro
Is Volatility Going to Edge up Anytime Soon?

We've been looking closely at how markets have behaved across the world in response to economic and non-economic events over the past few months, and overall the only significant mispricing we see as of now is in the anticipated volatility levels.

The CBOE Volatility Index that tracks the level of volatility in the markets has been pushed below 15 ever since mid-October. Even though there has been some reassuring economic data in the past month in various regions - matters are far from perfect in today's global economy and financial markets. It seems as though investors are beginning to dismiss the "end of cycle" fears, embracing the opinion that the inverted yield curve "is different this time", and are beginning to like this "hated bull market" we've been in for a decade. This sudden change in sentiment is peculiar as in the end the central banks have all in synchronisation cut rates as if we were entering an economic downturn. Thus, the questions we have to ask ourselves are: have we avoided a recession for now? Or are we as per usual going to try to justify why things are different this time and fall into the same traps?

Heijin's flagship fund, the Vulture Fund, operates a global macro strategy and we do not shy away from executing trades that serve as a general hedge to our portfolio. In a world where investors complain about the opportunity cost of hedging or the pure cost of it, we try to embrace the mispricing in markets this attitude causes. We tend to initiate efficient hedges whereby they are also favourable risk/reward trades that can help us de-risk whilst at the same time generating uncorrelated returns. Thus, in the end, we minimise the opportunity cost as much as possible for our investors and performing when everyone goes running for the exits.

Exhibit 6: Sentiment Has Recently Turned Higher Amongst Individual Investors.



Source: American Association of Individual Investors, Chief Investment Office. Data as of November 14, 2019.

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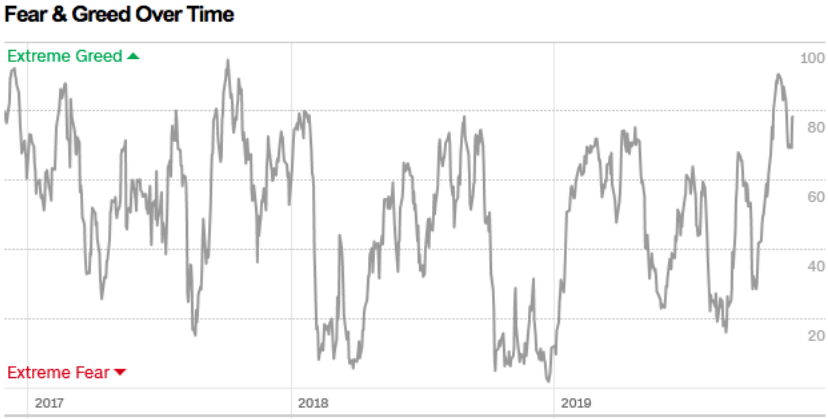
We rarely initiate hedges with the CBOE Volatility Index ("VIX"), but when we do it is only due to the favourable risk/reward potential that appears in extreme cases, i.e. one of the reasons as to why the last time we traded the VIX was in 2017 when we ended up generating 20:1 returns. It is all about being patient and never rushing into plays or forcefully trying to find ideas as this ends up having psychological effects and puts the investor at risk of a having a "confirmation bias" attitude.

One way to move forward with this is by allocating equally into a batch of call options over several months that have a similar strike price. Back in 2017, we were incredibly bearish on markets and there was a worrying amount of 'excess' in capital markets, which is why we opted for $25 strike call options or above. This turned into an immensely profitable trade due to the tiny margin of players in the markets that were taking into account the risk of a severe correction or just a "black swan" event. Despite today's more positive sentiment, investors are hedging more than they did before, which is also why some trading divisions at banks are preferring a more "insecure" environment like today rather than a fully positive market. This makes options on the VIX slightly more costly which is not necessarily an issue for us if it is well executed.



In our view, allocating into calls expiring in January, February, and March is prudent but at least reduces the risk of not having a significant "black swan" event or severe correction in the short-run. But in the upcoming months, there are several economic and non-economic events that could have dire effects on markets such as US elections, UK elections, Middle East tensions, a domino effect on capital markets due to the currently crumbling Chinese debt markets, and etc. Even though market events have 1-2 week impacts on volatility levels usually (unless its an extended period of chaos - e.g. 2008) we remain confident in the fact that the option prices have been so suppressed that losses are minimal. And this coupled with efficient risk management can turn a hedge into something beneficial for the portfolio.

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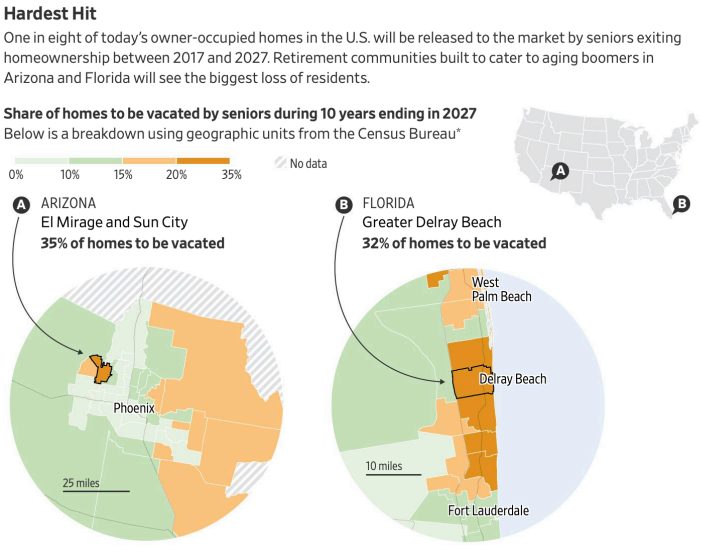
Real Estate

Baby Boomers Are Leaving Behind a $70 Trillion Problem

Baby Boomers make up approximately 30% of the U.S. population and control over 80% of personal financial assets. At the same time, they are starting to retire at an ever-increasing rate. This age cohort started turning 70 in 2019, and from now until 2030, it is estimated that close to 10,000 boomers will retire, every single day, in the U.S. alone. Moreover, a report by Capgemini, a leading French consulting firm, revealed high-net-worth individuals' (HNWI) wealth had grown by 10.6% in 2017—the second-fastest year of wealth growth for the group since 2011. Overall, the firm estimates this group of investors (HNW boomers) has amassed $70 trillion in wealth. Real estate increased to the third-largest asset class for HNWI's, accounting for 16.8% of HNWI assets, or over $1.3 trillion in commercial real estate. If real estate is in a family's portfolio, it is often part of a generational trust fund that is passed down from their grandparents or parents, many of whom started investing in real estate in the early 1950s and 1960s and later. The Boomers that were buying, trading, or investing in commercial property from roughly the 1980s to 2000 are now in control of this massive wealth.



Around nine million homes are presumed to hit the market between 2017 and 2027 as baby boomers begin to age out of their homes, citing new data from Zillow. That amounts to one out of every eight owner-occupied homes in the U.S. The problem with this is that many of these homes are in places that don't appeal to Millennials *or* Gen X. Places such as Arizona or Florida, which are seen as traditional retirement communities, as well as "Rust Belt" cities with declining populations. More often than not, Millenials and Gen X are moving into larger cities and are looking for accommodation in the form of apartments rather than the more traditional multi-family home. In other words, Gen Xers and Millennials would rather be in cities or suburbs in major metropolitan areas that offer reliable Wi-Fi, good public transportation (Millennial car use is also on the decline), and plenty of shops and restaurants within walking distance. What is more interesting is that this is generally true no matter the income level. Even millennial millionaires are choosing non-traditional luxury

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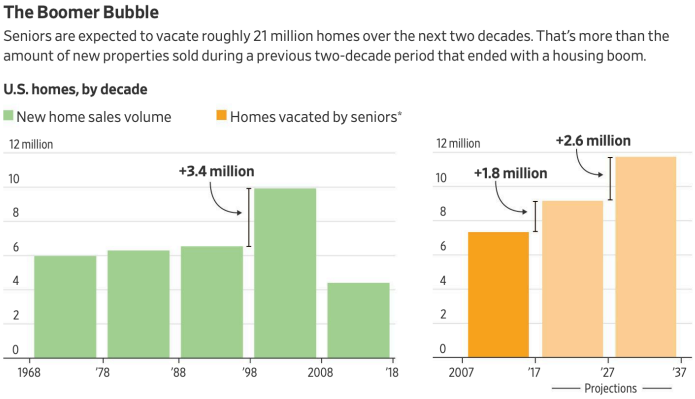
neighbourhoods close to the action, near people, shops, fitness, facilities, and cafés, according to new data released from a Coldwell Banker, a leading US RE agency.

By 2037, one-quarter of the U.S. for-sale housing stock, or roughly 21 million homes, will be vacated by seniors. That is more than twice the number of new properties built during a 10-year period that spanned the last housing bubble.

Some analysts say that they are not worried about a housing bust on the scale of the 2008 crash that decimated communities across the Sunbelt and Southeast. They argue that this time, the wave of available homes will hit the market more slowly. In the Phoenix area, for example, more than 131,000 units will be vacated by baby boomers during the decade ending in 2027, according to Zillow. That is roughly equal to the number of additional new homes sold in Phoenix over a much shorter period at the height of the last housing bubble from 2004 to 2007, according to CoreLogic Inc.



Regardless of whether they can afford it, younger generations might not find boomers' homes to their taste. Millennials don't want the large, elaborate houses baby boomers built 15 years ago in the Sunbelt states. Millennials tend to prefer smaller homes and are replacing traditional crown moldings and ornate details for clean lines and open floor plans. And some millennials who can afford to buy homes prefer to rent instead of buying because they don't want to deal with the hidden costs of homeownership. Younger generations are ultimately realizing that, for them, a house may not be the investment it's made out to be.

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Investment Analysis

Orsted: Blowing Money Into the Wind

1D - Macro Drivers

Promoting policies to limit CO2 emissions has never been a favorite of politicians, given that it usually puts pressure on the economy without imminent return and increases energy prices for consumers. However, the change of generations and increased environmental awareness during the last couple of years made promoting green policies increasingly popular. Europe has this week declared a “climate and environmental emergency” and urged all EU members to commit to net-zero greenhouse gas emissions by 2050. Moreover, Ursula von der Leyen takes on office today and she promised to deliver the details of a "European Green Deal" within 100 years.

Obviously, we have experience with the EU's non-binding commitments and their varying implementation based on economic factors; however, it demonstrates the trend and more importantly from an investor's perspective, it suggests that more money will flow into renewables in the near-term future.

The only major macro threat to renewable energy in Europe is lower investment from governments due to an economic slowdown. However, although economic slowdown seems likely that unlikely in the near-term future, it is unlikely that EU governments will cut their investments into renewable energy because this is one of the last economic sectors where the EU can still consider itself one of the leaders. This implies that if there is a major slowdown, given that the EU has not a lot of room for monetary expansion, there will be a fiscal stimulus that will flow into domestic sectors such as renewables.

2D - Sector Drivers

A big reason why the EU is one of the leaders in renewable energy is that the EU is the leader in wind energy. Yes, it is true that China generates more wind energy than Europe, but 3 of the 5 largest wind turbine manufacturers are European, including the two leaders Vestas and Siemens. Given the higher likelihood of investments by the EU and its members into the wind rather than other renewables because the money is more likely to remain in the region is one reason why the European wind sector might flourish in the near-term future.

The second and less speculative reason is that wind energy is simply more efficient. Actually, not really because water energy is more efficient; however, the problem with hydroelectric plants is that in many places it is already exploited to full capacity and the other problem is that they cannot be built everywhere. So basically the race is between solar and electric energy. While an average wind turbine produces about 3MW (3.6MW off-shore, 2.5-3MW on-shore), an average 37m2 solar farm produces 5kW (0.005MW). Although it might be sensible to use solar panels to gain personal energetical independence --not everyone can build a personal wind turbine in their backyard-- it is unlikely that the green revolution will happen using solar panels.

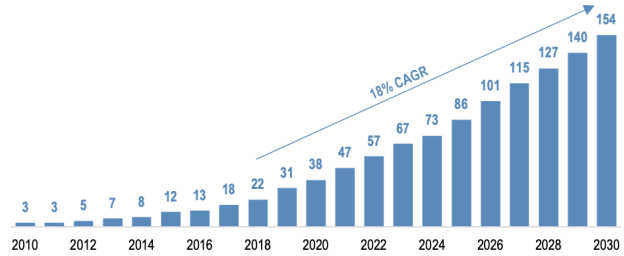
Lastly, EU countries are trying to shut down their coal plants and nuclear reactors, while EVs will significantly increase energy consumption, which will lead to higher electricity prices and

incentivize electricity producers to invest. Moreover, wind energy price is decreasing steadily due to better turbine designs, which will further promote wind energy.

3G - Company Drivers

Ørsted (CPH: ORSTED) is a Danish energy company and the global leader in offshore wind energy production. Ørsted was until 2017 named DONG Energy (Dansk Olie og Naturgas), but after the company divested its entire oil and gas business, it thought a name change would be appropriate. The Danish energy company is the owner of the largest offshore wind energy plant in the world, namely Walney Extension, and is currently building an even bigger 1.2GW plant, named Hornsea One. In 2018, Ørsted produced 5.6GW offshore wind energy (30% of global market share), with 4.3GW to be constructed by 2022 and an additional 5GW pending approval for 2025. The management's goal is producing 15GW by 2025, an equivalent of about 15 nuclear reactors.

Figure 4: Cumulative installed and forecast wind capacity (Global) (GW)



Source: Bloomberg New Energy Finance

After management revised its predicted near-term output last quarter, Ørsted's stock price dropped by up to 15% and is currently trading at an 8% discount from its peak in September. We believe this discount is unjustified at the moment, given that the long-term outlook of energy production remained unchanged and the recent progress towards renewable energy in the EU. Moreover, the current relieves in the markets from the fears of a recession in the summer lead investors to exit the stock, which is known as a safe haven due to its constant cash flows. However, if the economic data continues to suggest problems in the global economy, investors will probably increase their holdings in Ørsted again.

The fear bears of renewable energy stocks had for years that sharp bidding between renewable energy producers will bite into their margins has not substantiated so far and probably won't in the future, since demand is growing faster than supply. Moreover, Ørsted has the benefit of being a large player in a market with competitive entry requirements, which will shield the competition.

Risks

One of the major risks for Ørsted is rising interest rates, given that it is a capital intensive business. At the moment, there is no reason to believe that interest rates will deteriorate significantly in the foreseeable future.

Another potential risk is currency Risk, given that Ørsted has some operations offshore and sources parts of its plants offshore. However, this risk is also limited due to Ørsted's limited exposure to currencies other than DKK and EUR.

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Conclusion

Heijin Capital thinks markets have overreacted to the markets sell-off after the correction of predicted output for the short-term future of Ørsted. Moreover, we are very bullish wind energy in Europe and believe that recent policy movements in Europe are not reflected in Ørsted's stock price. The uncertainties about the future of the global economy make also promote investments into Ørsted, given that it is considered a safe heaven stock due to its constant revenue. Interestingly, Ørsted's return of 148% since its IPO in mid-2016 has made it a very profitable safe heaven stock so far, although we do not expect returns of this extreme magnitude in the next few years.

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