



HEIJIN CAPITAL



HEIJIN CAPITAL BI-WEEKLY INVESTMENT COMMENTARY

July 14th – July 28th, 2019

Global Portfolio Holdings Weekly

Executive Summary

→ General Market Notes:

Over the past few weeks the major indices, globally, and most notably in DMs have been incredibly quiet, i.e. could this have been a period of calmness before the storm? Both the S&P 500 and the DJIA have continuously hit record highs and we have not had a significant pullback since May, and this is mostly thanks to the global synchronised “anticipation” of rate cuts. All of a sudden, everything is great! But, if we have to be frank it's really not. The economic backdrop that really determines how well companies perform to a large extent is deteriorating quickly, but the markets keep going up and up and up. The CBOE Volatility Index has not breached \$15 for a while and continuously gets pulled down to the \$12-13 range. Investors are pricing in an outrageously low amount of tail risk. The Heijin Team is bearish on many sectors due to the lack of opportunities they have to grow in relation to how they are valued. For now it seems as though anything that moves attracts more movement as investors are chasing yield - a sort of consortium of mini displacements that are generating tiny bubbles in industries e.g. the majority of recent tech IPOs. But as Livermore stated back in the days, investors do not have to marry the market in one direction - it is vital to remain flexible especially when a market cycle is coming to an end.

INDEX	CLOSE	2 WEEKS	YTD
Dow Jones Industrial Average	27,192	-0.61%	16.47%
S&P 500 Index	3,026	0.38%	20.55%
NASDAQ	8,330	0.87%	24.97%
10-yr Treasury Yield	2.07%	-0.06%	-0.61%
Oil (\$/bbl)	\$56.17	-5.7%	23.7%
Bonds	\$111.23	0.4%	5.9%

*bonds are represented by the iShares Core U.S. Aggregate Bond ETF

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Market Summary & Strategy

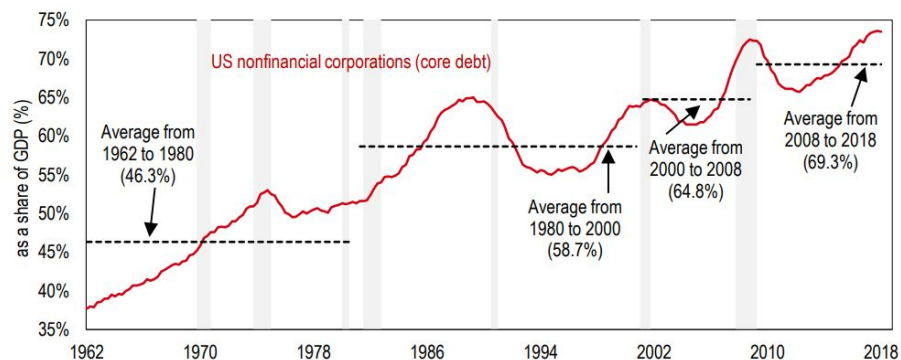
Global Macro

Thoughts On The Fed's Possible Interest Rate Cut

One of the most pressing issues on Wall Street is whether Jerome Powell from the Fed will cut interest rates this week or not. Futures markets are pricing in 100% odds of a quarter-rate cut this week and two more cuts further along this year. The current situation is extremely controversial as the US economy seems to still be in quite good shape: unemployment is at a historical low, annualized GDP growth in the first quarter was 3.1% and personal income growth from January to May was 1.2%.

So why does the Fed want to cut interest rates? The two most prominent arguments for rate cuts are inflation, which was 0.4% below target in the twelve months prior to July, and the global economic slowdown due to trade tensions. From a legal standpoint, the Fed is almost forced to lower interest rates, since it is mandated to "promote maximum employment, stable prices and moderate long-term interest rates". Since the inflation is below target, the Fed is forced to lower interest rates.

Nonetheless, from an economic standpoint it is questionable whether rate cuts are required. The US economy is still strong and corporate debt to GDP is already at an all-time high; lower interest rates would just support a further



Source: HSBC, BIS total credit statistics

deterioration of corporate debt. Moreover, the main reason for the low inflation and the global economic slowdown are the US trade wars. Regardless of whether the trade wars are sensible or not, it is inevitable that if countries begin to slap tariffs on each other the global and domestic economy will slow down. Similarly to how employees on strike have to accept not getting paid when they strike in order to promote their agenda, economic slowdown is the price governments have to pay in order to use tariffs to promote their agenda.

However, by lowering interest rates, the Fed is paying for the trade war with printed money and debt, not the government. Obviously, there is no free lunch and debt needs to be repaid sooner or later. The potential money that is floating in the economy now, in times where it is still strong,

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will have to be repaid at the end of the economic cycle where the economy is anyways already under pressure.

Another interesting aspect of the current potential rate cut is the extend by which it is priced in the markets, which is scary. At this point, with the 100% priced in rate cut the Fed is almost forced to lower interest rates if it wants to avoid a market correction. Cutting rates now would make the Fed's independence from markets and politics questionable.

The Heijin team thinks the Fed should not lower rates this week and allow the trade wars to have their natural effect on the US economy. This is a far more sustainable approach, since it is common sense that trade wars negatively impact economic growth. At the moment, the US economy seems to be able to support some headwind, so why not suffer a bit now instead of getting crushed at the end of the current economic cycle? This does not mean the Fed shouldn't act if things are deteriorating, but at the moment data does not point in this direction. Additionally, not raising rates would be a bold demonstration that it is independent from both politics and market sentiment, but this should obviously not be used as reasoning to not cut rates. However, we do not blame the Fed governors if they cut rates, since they are legally mandated to do so if the inflation target is not met. Moreover, the predicted rate cuts by the ECB and other central banks put even more pressure on the Fed to lower rates in order to keep US products competitive in global markets.

The potential rate cut this week puts the core problem of central banks to light: easy money policies. It seems that after the Great Recession central banks have rediscovered the magic money printing machines do to the economy. We are currently in the longest bull market in history; however, this bull market does not exist because the economy is working extraordinarily well, but because companies have now been floated by easy money for more than 10 years. Sooner or later will be pay day and the global economy will have to return all the printed money. By lowering interest rates, central banks are not saving the economy, but pushing pay day out and increasing the amount we will have to pay back.



Geopolitics & Defense

The Geopolitics Of Outer Space

On the 21st of July 1969, Neil Armstrong and Buzz Aldrin became the first men to set foot on lunar soil. Fifty years later, we have abandoned manned space flight apart from low earth orbit (LEO). There have been several NASA programs aiming to put men once again on the Moon. These programs have not come to fruition. Many in the general public consider that there are better things to do with the money allocated towards these space programs, which have proven themselves to be quite costly. However, nations do not seem to share this opinion and have, on the contrary, been increasingly seeking to extend their presence in space. This creeping trend offers several investment opportunities.

Space is regulated by the so-called “Outer Space Treaty” ratified in 1967. Nations having signed this treaty have agreed that space does not belong to any specific nation and that no nation can claim a celestial body. As such, the American flag on the Moon does not make it American. It also stipulates that no weapon of mass destruction is to be placed in space and that the exploration of the final frontier is to be for the sole benefit of Mankind.

This framework has guided space exploration ever since. Unfortunately, nations such as the United States of America, China and Russia have made clear their determination to defend their interests in space. This was recently seen by Donald Trump’s willingness to create a “Space force” in the United States military and Emmanuel Macron’s re-designation of the *Armée de l’Air* as *Armée de l’Air et de l’Espace*. These interests have not yet taken the form of a militarisation of Space. It has rather been through the acquisition of anti-satellite capabilities and trying to exploit the great potential offered by space mining.

Anti satellite weapons

Anti-satellite (ASAT) weapons have existed since the 1970s but have only recently reached technological and operational maturity. This was most clearly manifested by China’s test launch in 2013 of a SC-19 ASAT missile against one of their own satellite (the FY-1C). This category of weapons includes any weapon designed or having the capability of rendering a satellite dysfunctional, either by blinding it or by simply destroying it.

These missiles have until now only been a credible threat to satellites in LEO (<2000 km). This is set to change as China seems to have tested key components necessary to killing one in geostationary orbit (36000 km). The laws of war being what they are, the US is most probably going to develop its own Exoatmospheric Kill Vehicle (EKV) having at least good intercept capabilities. The interception of a satellite in geostationary orbit is much more difficult because of the large distances and speeds (3.07 km/s) the kill vehicle has to achieve. This can only be done by launching it on a larger rocket, similar to the ones used for commercial launches. These need much more time to prepare for launch and are vulnerable at the launchpad. Launching with a Anti-Ballistic Missile or even a Ballistic Missile does not offer the sufficient range and speed. Furthermore, to counter an incoming threat, a geostationary can be repositioned on a different orbit, forcing the EKV to recalculate an interception solution and spend fuel.

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The development of such technologies will eventually benefit the commercial sector. The question is when this will be the case. It all depends on the willingness of governments to participate in programs where these technologies would be useful.

The manufacturers of such missile are: in Russia the JSC Tactical Missiles Corporation (KTRV) (Russian: АО «Корпорация Тактическое Ракетное Вооружение», КТРВ), in the United States Raytheon and Aerojet, in China it depends of the GAD (General Armaments Department) which directly depends of Chinese state. EU nations have on the other hand demonstrated their common will to not interfere in space affairs by putting forward a draft Code of Conduct for Outer Space Activities preventing the destruction of satellites.

Any attempt to develop a directed energy ASAT weapon has, according to official records, failed. These weapons almost always took the form of a high powered laser shooting beams with the aim to either blind or destroy the satellite, depending on the lasers' power. This is set to change as both the US and China have successfully deployed laser based weapons. The knowledge acquired thanks to such programs will enable these two nations to further their ASAT programs.

As these weapons become more developed, militaries' increasing reliance on certain types of satellites (reconnaissance/intelligence and navigation) will be reconsidered, other technologies being capable of accomplishing these missions (intelligence gathering aircrafts and internal navigation systems). It is therefore likely that sales of these technologies will soar in case of war or as preparation for a major confrontation in between nations.

Space mining

Space mining has long been an element of science fiction. Today it might well become a reality. With diminishing terrestrial resources and the extreme pollution caused by mining, scientists have repeatedly proposed to move Earth' heavy industries from the surface to low earth orbit. This would require the raw material to be brought from outer space rather than the surface. If the raw material were to be brought to the surface, not only would it be incredibly expensive but it would also defeat the purpose of fighting pollution.

Space mining would take two forms: mining asteroids or mining the Moon. Asteroid mining has become increasingly plausible as several missions to asteroids have succeeded, such as the European Rosetta craft landing on the comet 67P/Churyumov–Gerasimenko. Asteroids and comets are both space debris that have agglutinated. While comet are made of dust, ice and organic compounds, asteroids are formed of metals and rocky materials, making asteroids the privileged target for mining. The materials in question are gold, silver and metals from the platinum and iron groups. These are all essential to any industry. Mining these far away objects will at first be prohibitively expensive until companies figure out how to make a profit, hence finding either a way to reduce production cost or the true development of LEO industries. This will take time, probably several decades but experts are optimistic about the endeavour. Several companies are drawing up credible plans for space mining such as Moon Express, Planetary Resources and Deep Space mining. There are too many companies doing so to draw up an exhaustive list. These companies are not yet extracting anything but are developing technologies that are the basis of future operation. The technologies developed for the moment benefit traditional mining companies that come to the new comers for mining innovation.

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The resources in these asteroids are strategic in nature for the different nations involved in the *space mining race* as it has come to be known as. Either these resources threaten the monopoly certain nations have on materials or they offer nations new perspectives for expansion, on Earth or in Space. For example, Luxembourg is very limited in terms of land area and does not have much natural resources but a forerunner in space mining. NASA is currently aiming to visit the asteroid 16 Psyche by 2026. That asteroid alone is estimated to be worth \$700 quintillion (that's 700,000,000,000,000,000,000 USD). However estimates vary because of the lack of precise knowledge on the composition of these asteroids and how bringing back these minerals would affect the price of these commodities down on Earth. For example, if any large amount of gold is to be brought back, it could be a serious blow to the price of gold. Therefore there lies a great importance in the exploration of these resources, which can also be found on the Moon. Its surface contains Iron, Platinum, Gold and certain rare earths. There even is large quantities of Helium 3, an isotope of Helium (of which there only is only kilograms accessible to capture on Earth) that could be used in second generation fusion reactors. It is on the other hand abundantly accessible in the Moon's Regolith. This is an example of how a mineral abundant in Space could be used to address Earth's problems (in this case climate change and the energy crisis) making it the source of tensions between nations.

In short, nations seem to be in a confrontational logic regarding outer space and the resources it holds. These confrontations are led by the US and China, which is coherent with the global geopolitical situation. The immense wealth and opportunities offered by what is up there is of strategic nature for these nations and will continue to fuel confrontations, which are most likely to increase in the years to come. This will in turn create opportunities for companies producing ASAT weapons and mining materials on asteroids or the Moon's surface. Making a profit from space mining may take time but is set to be the case eventually.

Real Estate

The London Commuter Belt, Transport Improvements & The Search For Affordable Housing

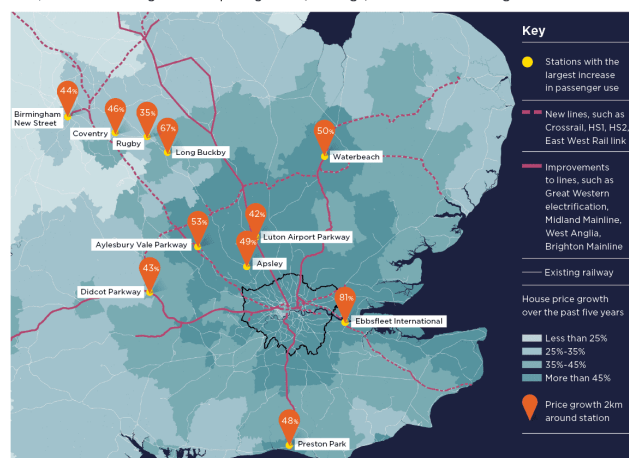
At Heijin Capital we are always striving to deliver strong & steady returns to our investors by positioning ourselves at a truly global level and leaving no opportunity behind. As global economic growth is approaching the late stage of the cycle and the current economic expansion is coming to an end, we are forced to look at other opportunities to protect our assets in the case of a downturn in public markets. We have seen an incredible bull run in the past 10 years and we are estimating that this current bull market may be coming to an end. This is why we are in the process of launching a brand new real-assets oriented fund, primarily focusing on CRE (commercial real estate) and residential opportunities in top EU markets (Germany, Spain, Netherlands, France, Norway & the UK). We will be targeting projects in sectors which have shown huge demand growth in the last couple of years, primarily hospitality, care housing & office space.

Now, moving on to some of the opportunities we have identified in the Greater London Commuter Belt - also known as the Metropolitan London Area. These boundaries are not fixed; they expand as transport options improve and affordable housing moves further away from city centre. The belt currently covers much of the South East region and part of the East of England region, including the home counties of Hertfordshire, Buckinghamshire, Berkshire, Surrey, Kent and Essex, and, by several definitions, Hampshire, West Sussex, East Sussex and Bedfordshire.

Moving onto transportation developments.

Transport has a vital role to play in the delivery of new homes. As people look to move to a new area, a transport hub can fuel residential demand and, consequently, house price growth. Stations that have seen the most substantial increase in passenger use over the last two years are those that have seen larger volumes of new homes delivered. These areas include Aylesbury Vale Parkway and Didcot Parkway, which have been significant hotspots for major real estate development projects over the last five years. Areas such as these have, on average, seen house price growth that is 5%

Stations with the largest increase in passenger use over the past two years are on new or improving lines, and have seen higher house price growth (in orange) than their surrounding local area



Source: Savills Research using Land Registry. Note: Only selected infrastructure improvements shown.

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higher than neighboring regions over the past five years, according to Savills. As people continue to move out of London, improvements to infrastructure can provide an opportunity for developers to take advantage of the demand for new homes in commuter locations.

Over the past two years, stations that saw the most significant increase in passenger use were those located within a 19 to 39-minute journey from a central London terminal. Moreover, these markets have seen the most substantial increase in secondhand sale prices over the past five years: an average of 44% against the average for England and Wales of 20%. Some of the highest increases in passenger use were in lower-value locations in the Home Counties such as Ebbsfleet, Apsley and Luton – areas on the cusp of higher-value ones. As affordability in the capital becomes more stretched, we expect these up-and-coming locations to remain popular with London movers, particularly if they are located on new or improving lines such as HS1 or the Midland mainline.

Beyond The Commuter Belt

Hotspots beyond established London commuter locations have already benefited from infrastructure improvements. The upgrade of Birmingham New Street, for example, has seen a 33% increase in passenger use since 2015, while house prices within 2km of the station have increased by 44% over the past five years.

Ahead of HS2 at Curzon Street station, there has been significant investment in the regeneration of Birmingham city centre. This has fuelled commercial investment from Deutsche Bank and HSBC, and has helped to support residential demand and subsequent house price growth. This demand is also rippling out into markets surrounding Birmingham. Rugby, Coventry and Long Buckby have all seen an increase in commuters of between 18% and 19% while house prices have increased by 35%, 46% and 67% respectively over the past five years. Moreover, migration out of London is at its highest ever level. According to the Office for National Statistics, the number of Londoners in their 30s, leaving the capital has risen by 27% over the past five years. Unsurprisingly, the most popular destinations for these leavers are concentrated around London's commuter belt.

Over the past three years, 14% of all Savills new home buyers across the UK were moving from London, with 39% of them upsizing to a larger property. In this market, space is key. Between 2015 and 2017, the average new build home bought by a Londoner was 14% larger than a home bought by someone moving from elsewhere. With two-thirds of these buyers still working in the capital, new or improving railway lines around London are a key opportunity to deliver new homes where demand is highest. This is especially true if these new homes provide the space secondhand stock traditionally can't.

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Investment Analysis

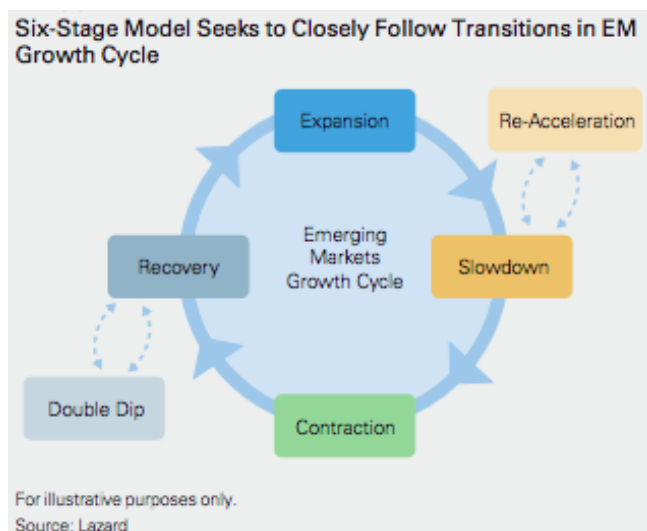
After most investors have steered clear of Argentina, we are now considering a contrarian play on regional banks.

Argentina has suffered heavily over the past few years and the economy is in need of a strong revival. Ever since the election of President Macri in 2015 all of Argentina's economic indicators have gone haywire.

Brief Overview:

- GDP Growth: -5.8% for Q1 2019
- Unemployment: 10.1%
- Inflation: 55%
- Deposit Interest Rate: 59%

It has been incredibly tough for the Argentinians and investors have experienced severe losses after the centre-right policies that President Macri “tried” to implement have not worked out. Thus, most have stepped out of investments that were directly linked to the health of the economy of Argentina. But, the Heijin Team believes there is a turnaround coming and that the worst is behind them.



- Peso +9% since May 2019
- Monthly Inflation down from 4.7% March to 2.7%
- Economic Activity up for the **first time in a year**
- Synchronised improvement in various sectors including farming (+50%), transport, industry, commerce, and construction.

We have been looking into their regional banks as they have been hit extremely hard as their activities are dependent upon the sentiment/confidence and basic economic stability such as the level of inflation. After all, it is understandable that not many businesses or consumers would be willing to borrow at a base rate of 59%, whilst knowing inflation would cripple their ability to cover interest payments and future earnings. The two regional banks we are looking at are Grupo Financiero Galicia S.A. (NASDAQ:GGAL) and Banco Macro S.A. (NYSE:BMA). Both of these regional banks have dropped by 60-70% since their 2017 highs and are finally stabilising.

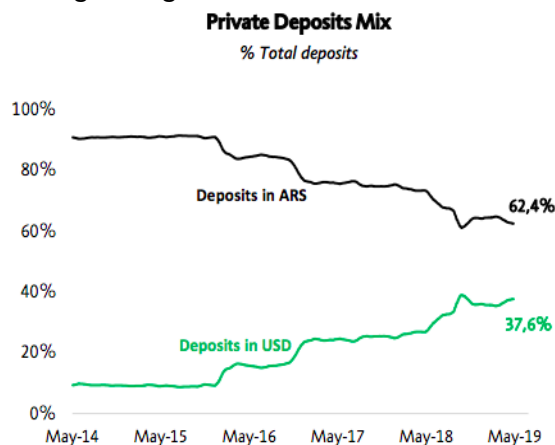
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Driving Factors

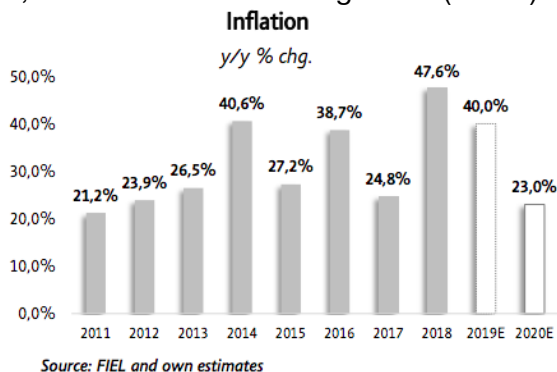
1) U.S. FED Policy

The FED is looking to lower interest rates, which would boost EMs as the USD denominated debt is obviously going to be much cheaper to service. The Argentinian Government will be able to inject more into the real economy instead of constantly losing out to paying back USD debt. This should stabilise economic activity and with growing confidence comes a healthier banking sector. On top of that, the private deposits mix at banks in Argentina was being filled with USD instead of Peso due to the inflation. This hurt the Peso significantly as it was consistently exchanged on the open market for USD. When the Peso gains from a weaker USD due to the FOMC Rate Decision this should reverse the trends and boost the Argentinian economy. Moreover, the Peso is actually what Argentinians use to track their economy as they have become very attached to it over time, thus it could really improve the morale amongst them, which is vital to have a growing economy.



2) Inflation to Stabilise

The level of inflation has already started to fall, which is great news for all the Argentinians. And when the inflation gets more under control, the Central Bank of Argentina (BCRA) can finally begin cutting rates. When rates are lower the lending market should get a big push as businesses and individuals will be willing to take out loans and deposit their earnings in Peso. In addition, lower inflation means higher real wages, which is vital as the big issue is that the population has been crippled due to utility and gas bills that have often more than doubled. These consequences are great for Galicia and Banco Macro.



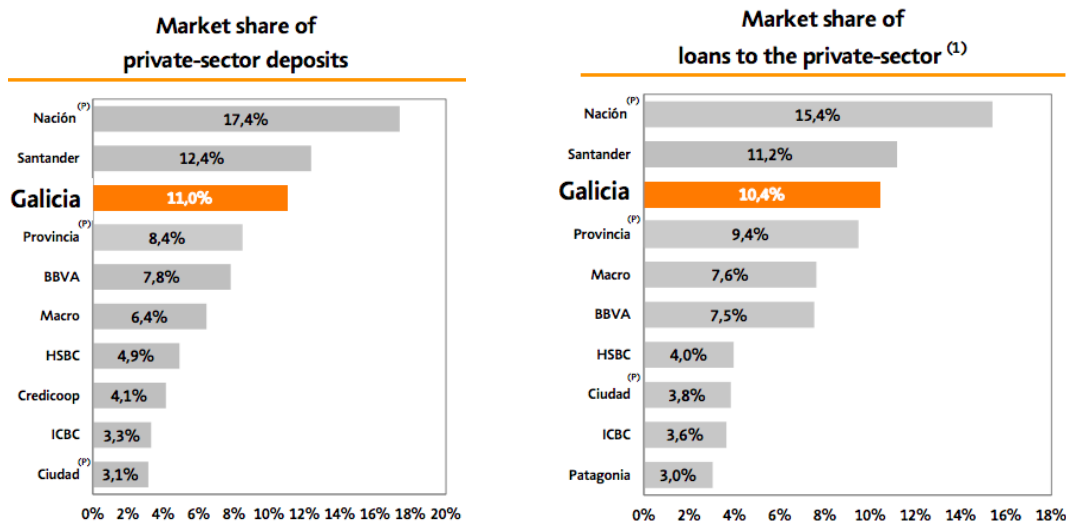
3) Great Valuations & Profitable even in bad times

Both have a Forward P/E <10, and what is most impressive is that they both have profit margins above 25% even during this tough economic period. On top of that, Galicia is a group that has subsidiaries in the insurance, mutual fund, and general asset management business. It is thus very well diversified and all of its subsidiaries are performing strongly. On the other side, Banco Macro has existed since the 1970s, but it has entirely revamped itself - especially its online banking. This makes it better positioned to fight against fintech that are slowly entering South America. By opening a position in both Galicia and Banco Macro it

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could offer a strong risk/reward trade as both are giants in Argentina and will certainly benefit from the economic uptick.



4) A re-election of President Macri in October 2019

In many South American countries, including Argentina, the political leader has a major impact on the country's economy in contrast to the impact leaders in the Western World have. Thus, it is imperative to have a pro-capitalist leader or at least a centre right party to not only attract FDI, but in general to uplift the economy. It is fair to say that we have seen the detrimental effects socialists have on South American nations by looking at Venezuela, Brazil, Argentina and more. For Argentina, the economy will be at stake in October 2019 when President Macri (Republic Proposal Party - right) will try to secure a re-election when facing the other major political opponent, Cristina Fernandez (Citizen's Unity Party - left). From now on for investors its "eyes on polls" as they will be the major determinant of how Argentinian equities move. We see a win for President Macri due to the recent economic improvements, which are making him more favourable in comparison to Fernandez

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Investment Commentary

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