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HEIJIN CAPITAL BI-WEEKLY INVESTMENT COMMENTARY

September 8th – September 22nd, 2019

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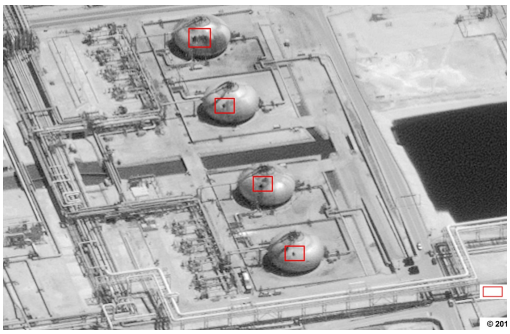
STRATEGIC INSIGHTS

Executive Summary

→ General Market Notes:

Equity markets stayed fairly flat in the past two weeks, apart from the turbulence caused by the commodity markets with the drone attacks that hit Saudi Aramco's Abqaiq facility. The attacks propelled WTI Crude Oil up as much as 19% at the open. Despite Saudi Aramco having almost half of their production offline, their 50m barrels in reserves coupled with President Trump's note on using the U.S.'s reserves made WTI Crude Oil give back more than half the gains the day the next day. Saudi Aramco admitted they underestimated the time it would take to repair all the damage but they stated production levels would be back to normal by the end of the month. However, Yemen's Houthis statement on "stopping any future attacks" should not be reassuring as their unpredictability may cause much more significant turmoil in the Middle East (for instance they recently suggested they had found spots to attack in the UAE, mostly in Abu Dhabi). On another note, the FED once again cut rates by 25bps, which we at Heijin believe to be a mistake as the U.S. is putting itself in a very weak position when the global economy will worsen in the future.



INDEX	CLOSE	2 WEEKS	YTD
Dow Jones Industrial Average	26,935	+0.37%	+15.37%
S&P 500 Index	2,992	+0.46%	+19.20%
NASDAQ	8,118	+0.37%	+21.78%
10-yr Treasury Yield	1.72%	+0.16%	-0.96%
Oil ($/bbl)	$58.09	+3.1%	27.9%
Bonds	$112.92	-0.7%	8.1%

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

Market Outlook & Strategy

Global Macro

Hong Kong, Trade Wars and Global Economy

The current tensions between the US and China is first clash of the titans since the cold war. The tensions have been long anticipated by economists, since history taught us that frictions are inevitable when new superpowers threaten the status quo of the existing superpowers. We understand that you have probably already read tens, maybe hundreds of articles about the current trade wars, so we are not trying to annoy you with the usual bipolar discussion; however, with this article we want to look at the current macroeconomic situation from a new standpoint.

Hong Kong

The semi autonomous region is currently at the center between authoritarianism and democracy, (kind of) communism and capitalism, eastern and western world. Hong Kong is currently the most important city in the world in terms of global political and economic development. Fortunately, two team members of ours can report first hand what is going on in the city in south-east China.

The first idea people have when they hear Hong Kong are the protests that are now going into their fourth month. The protests are an analogy of the clash of generations that are currently happening all around the world on topics such as climate change, Brexit, lgbtq+, progressivism (US), etc. On one side there is the pro-China camp, which is primarily supported by the wealthier and older part of society who are averse to reforms and confrontations with China, since they could lose their privileges in society. On the other side there is the pro-democracy camp mostly composed by the poorer and younger part of society who fears for their future if Beijing gains more influence in Hong Kong.

The protests in Hong Kong are an important macroeconomic event, since they helped to bring Hong Kong to the brink of a recession. The former British colony's economy was already under pressure before the protests due to the trade tensions between the US and China; however, the demonstrations leveraged the effect of the trade wars by severely impacting tourism and the real estate market in the region. Indeed, probably every executive of a major company in Hong Kong has had a least one conference cancelled or moved to another country due to public unrest.

From a quantitative perspective, we have observed that the private sector PMI has dropped from 48 in May to 41 in August, which marks a decline of almost 15% and a 10 year low annual GDP growth has fallen from 4.8% 1Q18 to 0.5% 2Q19 mostly due to trade wars and protest. Overall sentiment for the economy, retail sales, investment and trade are all negative. To put it simply, pretty much everything from retail sales to visitor arrivals to investments are currently experiencing negative growth.

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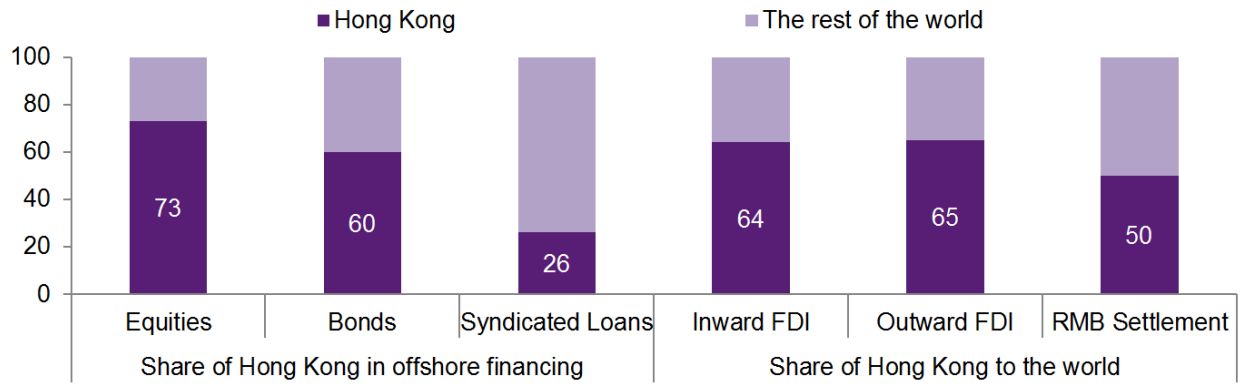
Especially worrying about the situation in Hong Kong is the property market. For 30 years home prices in Hong Kong have risen pretty much without interruption, becoming a bedrock for the economy in Hong Kong and the most valuable asset for many households. Nevertheless, the current economic outlook and protests have created a negative sentiment for Hong Kong real estate and an increasingly positive sentiment for overseas properties. This development could lead to a sharp correction in the HK property market and damage its economy severely.

Chart 2
Hong Kong's Financial Relevance to Mainland China (2010-2018)



N.B. Non-listed bonds are excluded from calculation. OFDI data as of 2010-2017. RMB settlement data as of 2018.
Source: Natixis, Bloomberg, People's Bank of China, China Ministry of Commerce

China

You might wonder why an autonomous region with 7,5 million people is so important to the world. As laid out in the introduction, the answer is Hong Kong's role as the gateway between the second biggest economy in the world and the rest of the world. Hong Kong and it's Hong Kong Dollar are ideal for both, investors and debtors. Investors favor the US Dollar pegged HK Dollar over the Renminbi because it eliminates the currency risk and uncertainty around the Renminbi. On the other side, receiving funding through the Hong Kong Dollar is an acceptable compromise for Beijing, since it makes them more independent from the US and its dollar.

For instance, China receives roughly a third of its equity financing through Hong Kong. Especially China's finance and real estate sector is heavily depended on Hong Kong. A recession in Hong Kong would severely impair China's foreign financing ability and could therefore put even more pressure on China's economy. Moreover, the finance sector of China is heavily interlinked with Hong Kong's banking sector, whereby Chinese banks are holding roughly a third of China's total bank assets. Similarly to how the problems in the banking sector in the US swapped across the globe during the great recession, problems in Hong Kong's banking sector could easily swap over to the mainland.

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Asia

ASEAN countries should thank Trump, since he reshuffled the cards in the global economy. For decades, China has almost been a synonym for offshore manufacturing. Moving the parts of the value chain to China has fueled an unprecedented economic growth that has basically brought an entire country out of poverty within one generation. However, increasing wealth of China has lead to higher manufacturing costs and thus made it less attractive for offshore manufacturing. Nonetheless, most companies still kept their production line in China due to the high costs of moving an existing supply chain and the accommodating legislation of Peking.

The escalation of the trade wars has lead companies to realize that they cannot solely rely on China for their supply chain and created an incentive to move to other countries. In 2018 Foreign Direct Investments (FDI) into ASEAN countries have surpassed FDIs into China, which demonstrates that companies are trying to find alternatives to China.

The biggest benefactor of companies moving their supply chain outside of China is India. It is true, there are many ASEA countries that offer cheaper labour or better conditions; however, all these countries are too small to absorb the workload that could move out of China. Only India has enough workforce and resources that it could sustain if more and more companies move out of China to find a new manufacturing country.

World

One of the major effects of the trade war is China's shift away from the US and towards Europe. Chinese M&A activity in the US has suffered over the past years while it recorded steady gains in Europe. Moreover, China's central government is using its Belt & Road Initiative to make more and more Eurpea countries dependent. At the moment of writing, large numbers of eastern European countries as well as Portugal and Italy have committed to the BRI

Heijin's Take

Hong Kong is currently at the center of major economic and political events that influence the future of the entire world. Moreover, the semi-autonomous region is at the brink of a recession due to the effects of trade wars and public unrest. Due to its fiscal surplus, Hong Kong's government could relatively easily stimulate the economy and thereby prevent or decrease the size of a potential recession; however, the government seems to be reluctant to make use of its power. Our analysis of the situation suggests that if the Hong Kong government fails to take appropriate fiscal measures to accommodate growth, it could be a serious threat to China's economic growth and the world economy.

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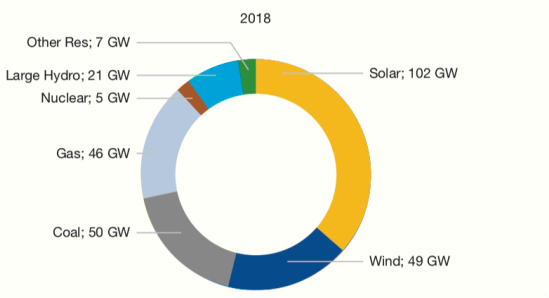
Investment Analysis

A Review Of The Global Solar Market

In 2018, solar took a small break from the enormous growth rates seen in previous years. Although the solar market grew moderately (by only 4%), it was enough to outdo any other power generation technology again last year. More solar PVs (photovoltaics) were deployed than all fossil fuels and nuclear together. Solar also added more capacity than all renewables combined—including hydropower—and had twice as much installed than wind power.

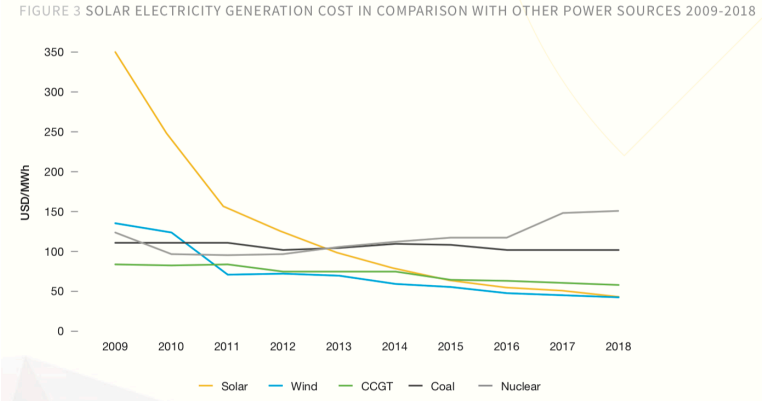
Relatively, solar's share reached 36% of all newly added power capacities in 2018, compared to 38% the year before. While impressive at first sight, the 'stagnation' in both solar and wind growth in 2018 meant that renewable capacities only contributed 63% to total power additions. When looking at the share of total installed power generation capacities, renewables contributed 33% in 2018, and 26% in terms of power output. All solar PV power plants together produced only 2.2% of the world's electricity output. This shows that despite solar's recent dominating role in annual power generation additions, there's vast untapped potential for both solar and its renewable peers. The reason for a preference for solar over other technologies has been, among other reasons, its steep cost reduction curve (see chart below) – which is continuing to decrease. Today, generation costs for solar power are significantly lower than for new nuclear and coal plants, but usually also below gas, and in the range of wind (depending on the region they may be even lower). In 2018, tenders and PPAs (power purchase agreements) showed several instances of bids, awards, and contracts with solar power prices in the 2 US cents/kWh range.

FIGURE 1 NET POWER GENERATING CAPACITY ADDED IN 2018 BY MAIN TECHNOLOGY



In general, prices for solar power are much higher in developing countries than in economies with stable policy conditions and high credit ratings. However, with support from international lenders, such as development financing institutions, project risks can be considerably reduced in

FIGURE 3 SOLAR ELECTRICITY GENERATION COST IN COMPARISON WITH OTHER POWER SOURCES 2009-2018



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developing countries. In Egypt, for example, in 2018, a 200 MW solar tender from the Egyptian Electricity Transmission Company received the best offers from international developers in the 2 US cent range – at 2.8 US cents per kWh. This solar project is backed by the European Bank for Reconstruction and Development (EBRD). The Scaling Solar Programme of the World Bank Group, which is probably the largest solar scheme of this kind, is supporting solar deployment in African countries, Ethiopia, Madagascar, Senegal and Zambia, and in its latest tenders, has led to awards in the low 4 US cent/kWh range - which is definitely a good starting point.

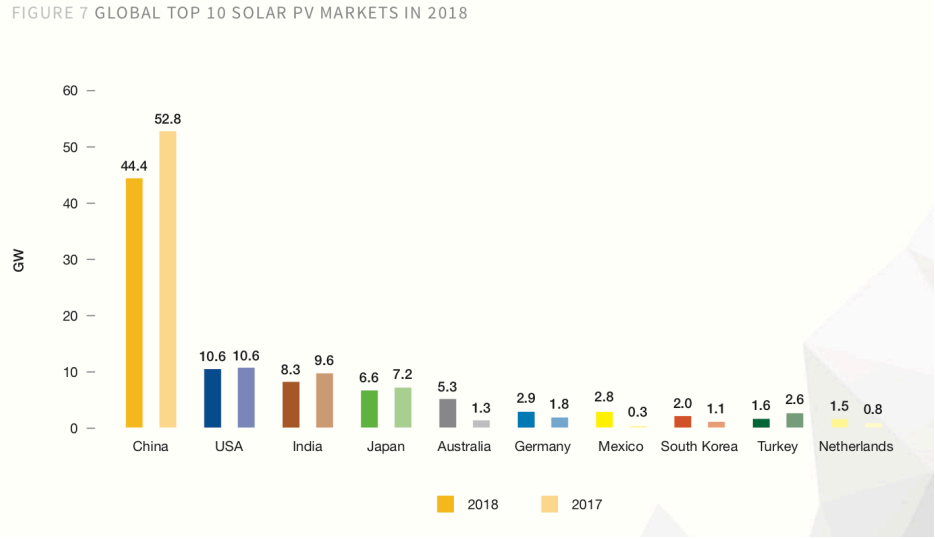
Global Solar Markets

Although annual solar demand in China declined for the first time since 2014, it continued to dominate the solar world in 2018. China installed 44.4 GW: a year-on-year decrease of 16% from the record additions of 52.8 GW and 53% growth in 2017, and installations of 34.5 GW in 2016 (128% growth). Still, this means China added over four times more solar than the second-largest market in the world, and more than the remaining top 10 combined.

The United States' solar market remained stable at 10.6 GW. That made the country the world's second-largest solar market again in 2018. Utility scales solar continued to dominate US solar, being responsible for over half of new installations in 2018.

India did not move up to second place in 2018 after it secured rank 3 in 2017. After installing only 8.3 GW, down 16% from 9.6 GW in 2017, India maintained third place. There were multiple reasons for the market contraction – a new goods and services tax, a lengthy discussion on safeguard duties, and implementation of other protective measures, including attempts to combine multi-gigawatt power plant tenders with the creation of local integrated module manufacturing facilities, and to top it off, issues with missing transmission lines.

FIGURE 7 GLOBAL TOP 10 SOLAR PV MARKETS IN 2018



Investment Analysis

Catching Alteryx On The Dip

Alteryx is in the business of data analytics and has been creating revolutionizing solutions in the space ever since the company was founded in 1997. Their IPO in 2017 was a massive success, and today their stock is up >620%. This is not surprising since it was one of the first companies in this space before the theme of "Big Data" really became big business. And the potential Alteryx has is enormous, as everyday consumers and corporations generate an additional **2.5 quintillion bytes** of data on a **daily** basis. Just to put this into perspective, over the past two years alone 90% of the data in the world was created. Furthermore, we are just barely touching the beginning of the age of the "Internet of things" (IoT), which in other words for Alteryx means its best years are in the future and certainly not behind them yet.

According to Alteryx, **6 billion hours per year** are spent working in **spreadsheets**, 26 hours per week are wasted working in spreadsheets, and 8 hours per week are wasted on conducting the same data tasks. This translates into companies wasting >$60bn every year on paying analysts to do repetitive manual work in spreadsheets.

All in all, the analytics platform (product) offered by Alteryx drastically reduces the amount of time spent on analysing data as it unifies the analytics process into one single platform, instead of having various inputs, tools, and outputs to control. Their platform is great for companies as it can be code-free and/or code-friendly, which are crucial attributes in the industry of data analytics since some companies hold in-house coders but some lack expertise. In the code-free space, they have a data & analytics workbench with >250 tools, various preconfigured statistical & predictive models, and visualytics to see results along the way. The key to their business model is the simplicity of their product since the world of Big Data and data science can easily become incredibly complex for companies collecting data everywhere. Additionally, in their code-friendly space, companies can incorporate more complex analytics models, create more synergy between data scientists & analysts, and lastly can be used with multiple coding languages.

In terms of the market potential for Alteryx, the future is bright! The worldwide analytics and business intelligence market is valued at >$28bn and the worldwide big data and analytics software market are valued at >$49bn (including the former). And on top of that, in the market of spreadsheet analytics & data prep, there are 47mm users, which translates into approximately $24bn annually.

Additionally, the customer base that Alteryx has built over the past few years is staggering in terms of the quality of their clients. They currently have more than 33% of the Global 2000 brands as clients, including household names such as Airbus, HSBC, Nike, Kraft Heinz, Netflix, Amazon,

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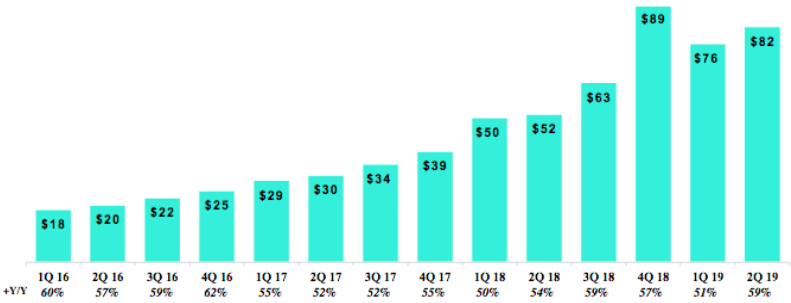
IKEA and many more. And their customer base is continuously growing and currently stands at 5,278 (Q3 2019), an astonishing 34% YoY growth. Moreover, Alteryx intelligently landed consulting firms such as Bain & Company, BCG, and Accenture which are all recommending Alteryx to their respective clients - an exemplary way of leveraging their customer base by making their current clients reverse the deal-flow for them.

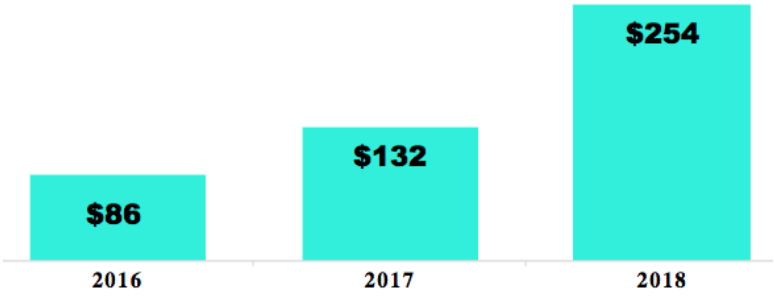
Lastly, financially-speaking, Alteryx is on track for an even better year than 2018 where they booked $28m in net income, which had not occurred for a while (net losses in prior years).

Overall, Alteryx is a great company that just recently experienced a dip in its share price and is thus trading at an attractive valuation. Despite all this negativity in the markets and a worsening economic backdrop, this industry will not stop growing anytime soon and with all these leading companies depending on Alteryx's services we do not see much reason to worry.

Quarterly Revenue [1, 5]



Annual Revenue [1]



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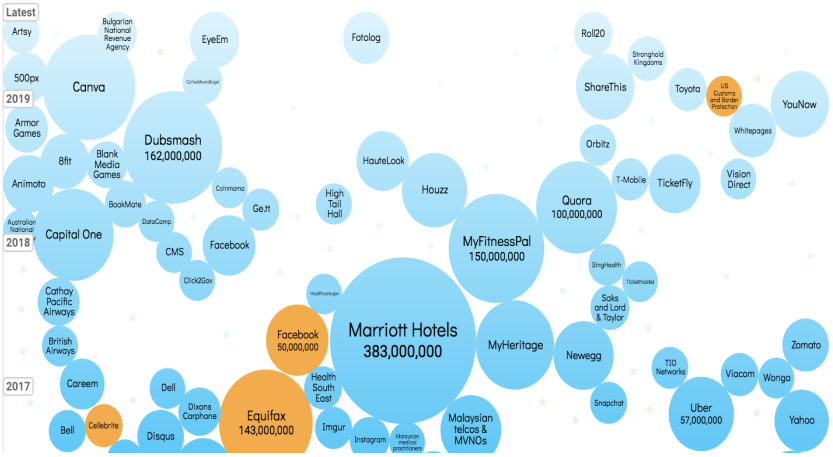
Investment Analysis

Does (Cyber) Crime Pay?

$600 billion, almost 1% of the worlds FDP, that's how much cybercrime costs the globe each year. It is a truly astonishing amount, however, as the digital age we now find ourselves in becomes even more 'digital', this figure is destined to rise. It is not just the direct financial cost of cybercrime that affects businesses, more importantly, it is the loss of confidence and reputation that is the real silent killer. As the Dutch proverb goes, " trust arrives on foot, but leaves on horseback."It is not just small "Mom and Pop" firms that are the victims of cybercrime. As shown by the infographic, many household names such as Twitter, Facebook and Capital One have had devastating data breaches within the past 2 years. These are the companies who, if anyone, should have the highest tier protection.



In Capital One's data breach, users banking information, transaction history, balances, address and credit scores were taken. This is not an anomaly but a worrying trend , and as hackers get more efficient and sophisticated, so must the security software.

Heijin believes that the cybersecurity sector is a brilliant choice for a secure, 'all-weather' portfolio. As, in addition to the sectors growing importance in the global economy, the industry's general business model is incredibly stable. Most cybersecurity products are not single purchase software, they are subscription-based purchases in which the customer pays monthly with the option to upgrade once the 'new generation' software is related onto the market, much like a mobile phone contract. This provides a regular and reliable revenue stream which is extremely predictable and reliable, hence greatly helping subdue much of the potential volatility.

One of the most promising stocks is Palo Alto Networks(NYSE: PANW). Palo Alto Networks is an American multinational cybersecurity company with headquarters in Santa Clara, California.

Its core products are a platform that includes advanced firewalls and cloud-based offerings that extend those firewalls to cover other aspects of security. The company has taken a hit in the past year however it maintains a stellar balance sheet and boast high growth potential. Moreover, the stock is currently trading at 26.4% discount to its fair value of $288.96. Furthermore, Palo Alto Networks has more than enough cash reserves to meet both its short and long term commitments, with assets at 2.6x debt. Heijin believes that Palo Alto would be a great addition to any portfolio.

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