



HEIJIN CAPITAL BI-WEEKLY INVESTMENT COMMENTARY

August 26th 2018 – September 9th 2018

Global Portfolio Holdings Weekly

Executive Summary

- **We are starting to see some euphoria in some areas again.** Amazon becomes the second company to hit a \$1 trillion market capitalization. Currently it trades at a P/E of 180, which is concerning even though this is of course considered the “growth” stock of the past decade. Heijin Capital believes that with Apple and Amazon both hitting \$1 trillion in market capitalization has put investors in more euphoric moods, which resulted in a more than 1% swing in the S&P 500 this week. With this in mind, we are considering purchasing deep-out-of-the-money put options on both Amazon and Apple as we have come to the conclusion that a lot of retail tech investors out there are currently living with horse blinders. This may cause them to be oblivious or not concerned about whether a company, such as Amazon could actually majorly increase their profits over time and not point at “investing” for limited EPS in proportion to revenues.
- **The market is moving into an environment of sustained volatility after countless years in the “quiet zone”.** The VIX (CBOE Volatility Index) jumped to \$15 this week, and stayed above \$10.9-11 over the past 6 months. This is in comparison to the extremely low levels of volatility in 2017 where the VIX remained at \$9 for extended periods of time. With various events such as: the Brexit negotiations still in play, Greece negotiations, the Argentinian crisis, the Venezuelan crisis, and rising defaults in the Chinese debt markets, there has been a higher level of volatility across most markets. This translates into larger swings for most corporations that depend on a healthy global economy, and may cause severe deeps as seen this week with the semiconductors industry. Of course, this generates greater opportunities for us. At Heijin Capital we prefer allocating capital post extreme events where irrational market action has occurred or such. This has also put hedge fund managers back into the arena of hedging after frighteningly long periods of allocating little to no capital to reduce portfolio risks, according to Goldman Sachs (e.g. George Soros holding \$626 million worth of SPY (S&P 500 ETF) put options).

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Market Summary & Strategy

Emerging-Market Slump

General summary:

Emerging markets fell to a 2 week low this Wednesday, as investors panicked due to the current pressure on currencies in developing markets, as well as the recent surge in the US dollar. The benchmark, MSCI International Emerging Markets index, was marked 0.66% lower by mid-day in Europe and trading at 1,040.17 points, the lowest level since August 23, while India's Sensex index was seen 0.4% to the downside, extending its five-day slide to 2.3%. Analysts from JPMorgan suggest that while investors have largely cut back on their local-currency bond holdings in emerging markets, there's potential for further downside in stocks and fixed income denominated in US dollars and other developed-country currencies such as the Euro or CAD.



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FX Markets:

Argentina's peso has been one of the worst hit currencies, suffering a loss of over 50% this year alone, and slumping a further 2% yesterday as President Mauricio Macri discussed to minimise government spending and secure \$50 billion in new support loans from the IMF. The Turkish Lira has fallen over 40% against the dollar so far this year, stabilizing at around 6.68 in early trading this week. However, pressure remains amid a diplomatic altercation with the U.S. over the release of evangelical pastor Andrew Brunson (whom Turkish officials have accused of being involved in a 2016 coup attempt) and the rising level of inflation in the \$800 billion economy. The South African rand has also been affected, falling to a one-year low of 15.7 against the US dollar as GDP data confirmed the economy entered recession in the Q2, a move that could trigger a change in the country's investment grade rating from Moody's Investors Service.

Oil Markets:

Global oil prices continue to stabilise near the \$80 a barrel mark, with Brent contracts trading at \$77 in early European dealing this week, putting further pressure on economies that heavily rely on imported crude. The broader concerns over growth, provoked by the US - China trade dispute, have investors questioning crude oil demand (although prices have been supported by the approaching US sanctions on the sale of Iranian crude oil, which come into force in November). Moreover, a recent report from Reuters that suggests Saudi Arabia wants to keep a price range between \$70 - \$80 a barrel over the near term to soften the blow of scrapping the planned IPO of Saudi Aramco.



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Stock Recommendation: FLOW TRADERS (EPA:FLOW)

A Microeconomic Analysis

Flow Traders is a technology-enabled liquidity provider for ETFs (exchange traded products) on a global scale. ETP's are a type of security that are priced so that the value follows other assets, such as commodities, indices, and stock prices. Flow Traders have offices in Amsterdam (headquarters), New York, and Singapore, currently an office is being completed in Hong Kong too. Importantly, Flow Traders expansion into China is awaiting the completion of the Hong Kong office to be used as a base of operations. Flow Traders acts as a market maker and thus provides liquidity 24 hours a day in over 5,000 ETP listings worldwide. FT conducted its IPO in 2015 on the Amsterdam stock market.

Flow Traders main form of generating revenue is quoting bid and ask prices onto assets and adding an underlying margin, or commission. As a result, as the spread on bid and ask prices increases, the margins do too, and company revenues follow. When volatility is low, spreads tighten, revenue falls and the bottom-line of the company suffers. Therefore, market makers perform the worst in low volatility markets, very similarly to today's markets.



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Investment Case

A recovery in volatility is our main thesis for Flow Traders as it is what will drive the stock price up to reach our target price of 45\$. As revenues are dependent on volatility, once it returns in the market, bottom line performance will sharply increase. As it is fundamental to economics that markets are cyclical, we believe that it is only a matter of time until volatility returns and Flow Traders breaks out. As an example we can compare the performance of the S&P 500 and EPA:FLOW stocks between January and February. In January the S&P 500 yielded 475 basis points and Flow Traders 260 basis points comparatively, in February S&P 500 lost 389.7 basis points but Flow Traders gained 6,706 basis points. Essentially, Flow Traders manages to be deeply inversely exposed when the markets are down, and inversely underexposed when the markets are up, demonstrating a positive relationship with the VIX.

Financial health and dividend payments are another. FT's cash and other short term assets cover long and short term commitments. Dividends were estimated at 6.3% last year, which is in the top 25% of dividend payers in Holland. Dividends payout to shareholders was at 56% last year. These factors all indicate a healthy company with a strong dividend history.

Competitively Flow Traders is also in a very strong position. This is because it is the only pure play market maker for ETP's.

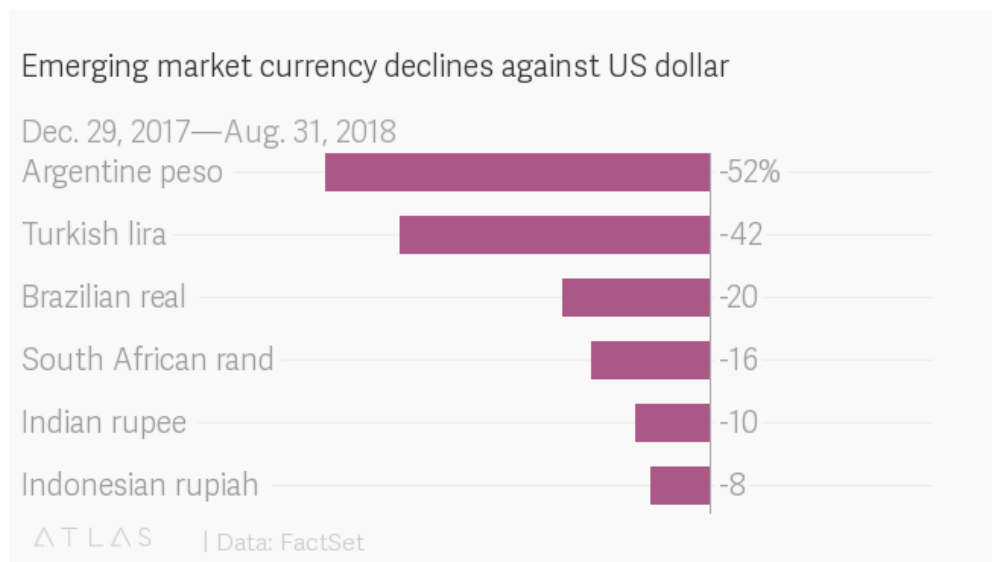
Risk Assessment

Due to its dependence on volatility for generating revenue growth, if volatility remains forever depressed, stock performance will not increase, and the stock will continue to depreciate.

In addition, recessions often influence investors to invest out of funds and certain derivatives into naked equity positions, such as bonds. Following the 2008 mortgage crisis investors preferred to know what their portfolio held as positions. As a result, a recession could cause a decrease in demand for ETP's.

Do troubled waters lie ahead for the global economy?

An atrocious year for the lira, slumping over 40%, a debt crisis in Argentina, resulting in austerity and being saved by the IMF with early release from a 50bn dollar loan. These once flourishing emerging economies are now at serious risk of sparking contagion, potentially spreading economic discontent into the European and American markets. The liras slump against the dollar has exacerbated the already threatening amount of corporate debt in Turkey, leading to skyrocket costs of paying the dollar loans. This is a pressing matter for European Banks such as BNP Paribas and the Spanish bank BBVA, who owns a 49.9% stake in Turkish bank Garanti, which in a worst case scenario, a crash could wipe 12% of BBVA's total group equity. Moreover, Unicredit, Italy's largest bank, owns around 40% of Yapi Kredi. The plethora of banks with serious exposure in Turkey (over \$160BN loaned) , means that a crash in turkey could trigger a domino effect in the European markets. Such is the concern, that the ECB has begun investigating the risk that the liras weakness , and thus the relative increasing in the cost of debt repayments. There is a serious risk that a crisis in turkey could begin contagion , beginning with the Italian economy. A weak bond market, stagnating economy and poor productivity means that Italy is overwhelmingly unprepared to deal with a crisis, and what's more, there is a large amount of foreign exposure to the Italian bond market, with French banks holding 44.27 billion Euros in bonds and Spanish banks holding upwards of 28 billion euros of sovereign debt. The amount of co dependence of these countries and banks, means that the current global economy, is a house of cards, with Turkey, perhaps, being the metaphorical gust of wind to bring the global bond market down.



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Thank you for your understanding,
Heijin Capital Management

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