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Hesiod Financial, LLC
Quarterly Report

2nd Quarter 2020

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Note from President

Here at Hesiod Financial, we stand for Equality, Respect, Diversity, and Inclusion.

We have all watched events unfolding in our country over the last month with disbelief. These incidents involving racism, prejudice and divisiveness have been extremely difficult to watch or read about, and it is difficult to find the right words to express our collective response. These tragic stories add to the fact that we're all struggling with the COVID-19 pandemic, which is disproportionately affecting our communities of color.

We are committed to the principles that bring people together, not pull them apart. We stand united with those seeking social justice and equality. In addition to supporting reform efforts individually through our actions and contributions, as a team, we will be donating 20% of every quarter's profits to charities like ACLU, National Bail Out, and Lake Street Council. We will continue to support the fight against systemic racism and senseless violence.

Black Lives Matter.

Victor Xie

Victor Xie
President of Hesiod Financial

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Quarterly Overview

Highlights

- U.S. stock indices recovered quickly this quarter even with high COVID-19 cases and poor economic indicators. S&P 500 rose 20%. Dow Jones increased 18%. Nasdaq surged by 30%.
- As of April 3, 2020, total cases of COVID-19 in the U.S. have risen to approx. 2.57 million. Global cases have climbed past 10 million.
- Many states have entered re-opening phases during this quarter, however, some states such as Texas and Florida are pausing its re-opening process due to the recent up-tick in new cases.

Market Sentiment

The fastest 30% drop in the history of global equities in the first quarter was followed by the largest 50-day advance in market history in the second quarter. The S&P 500 reached back above the 3,100 level on June 3rd and the Nasdaq hit a record high on June 10th. Meanwhile, many investors have started claiming that the markets are detached from fundamentals. We see that markets are priced for an optimistic outcome of no meaningful second wave of infections as lockdowns are lifted. This scenario proves to be much less likely now that U.S. new coronavirus cases hit an all-time high, surging in Florida, Texas, and Arizona. On the other hand, record levels of fiscal stimulus, sustained low interest rates and ongoing low inflation create a supportive environment for risk-asset outperformance.

The approaching U.S. Presidential elections in November is another area of potential volatility. The U.S. Presidential elections will become a bigger focus for markets as the election date nears. Joe Biden plans to at least partially reverse President Donald Trump's 2017 corporate tax cuts. This could deliver a hit to earnings per share in 2021. The other election risk is a re-escalation of the U.S./China trade war. A recovery in the stock market and the economy provide President Trump with his best chance of re-election. We expect he will not endanger this by re-starting trade hostilities.

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Sector Outlooks

Communication Services / Information Technology (CSIT)

The second quarter of 2020 was a stellar one for CS/IT as we significantly outperformed the S&P 500 at +46%. The S&P had it's the best performance for a quarter since 1998, it's growth driven largely by the technology sector. The fact that CS/IT was able to achieve such strong returns is a testament to the hard work and thorough research done by our analysts.

Early in the second quarter, we closed our NVDA position to realize our profits. Their growth was driven by the increased need for data centers. Our investment thesis on AMD was based on consumer trends that showed an increase in consumer spending on mid-range Graphics Processing Units and portable gaming laptops. The scenario soon changed due to COVID-19, causing consumer spending to decrease drastically. AMD's GPU showed little growth at the start of the pandemic, damaging our stake in the company. Ultimately, we decided to close our position for a loss and lowered our price target to $60.

In Q2, the NASDAQ showed a stellar recovery after suffering heavy red candles post COVID-19. We saw this as an opportunity to maximize returns while reducing our risk portfolio by entering into a QQQ position on the thesis that data centers and cloud computing will play a major role in business in the near future.

During the quarter, we were also forced to sell our stake in MOMO for a significant loss. The company's stock price fell heavily due to the crackdown on Chinese companies listed in the stock market and we do not predict their price recovering in the foreseeable future. Our sector entered a position in Stone Co (STNE) due to the increased demand in Brazil for mobile payments driven by people in quarantine. We then promptly closed our position for a profit after their positive earnings report. Our confidence in electronic payments also led us to open a stake in ACI Worldwide. Lastly, our sector opened stakes in Logitech due to their increased focus on gaming and e-sports.

Materials / Energy / Industrials (MEI)

This has been an exciting, albeit rocky, quarter for MEI. We identified two main trends within the MEI sphere that have yielded interesting and highly profitable opportunities. We returned to our tried and true defense thesis in early April during a period of relative consolidation in the markets. Whereas Aerospace and Defense are often spoken in the same breath, the two industries will have wildly different trajectories in the short and medium term.

To briefly break down the aero outlook, we look at OEM's, namely Boeing and Airbus, both as stand-alone companies and as a proxy for their downstream suppliers such as Spirit. Both companies carry excellent, mature programs with 20-30% original margins such as the 737, 787, and A320; they are also weighed down by poorly conceived programs as well such as the 747 and A80. The pandemic has severely restricted the demand for even the successful programs, forcing both companies to pull back production in an effort to preserve cash. The lack of a clear outlook further complicates the Aerospace industry, as "normalcy" has been projected to return anywhere from 2021 to early 2023. For this reason, Hesiod believes any bullish aerospace thesis is not founded on valuations at this point.

Instead, we examine the defense industry on its own, which we see as a niche full of opportunity. We first establish that the defense industry is relatively insulated from the effects of the coronavirus, as the Department of Defense (DoD) will continue to acquire the programs it deems necessary. However, this industry is facing changing tides beyond the Coronavirus. The geopolitical environment today is very different than those of 5-years prior. China has established itself as a strong global contender against the United States, while the US is starting to pull its focus out of the Middle-East. In doing so, the DoD has implicitly changed its strategy in terms of procurement and is redefining the concept of warfare, and defense contractors will need to adjust accordingly to maintain relevance. Most notably, we note the DoD is shifting its priorities towards technology with a focus on procurement. Hesiod has identified certain defense positions that appear to be well positioned for the future while having demonstrated resilience in the short and medium term. Additionally, we took a sizable position in DFEN backed by a valuation thesis that the defense industry was over-discounted in the market crash caused by the Coronavirus.

Aside from the defensive plays, we also successfully capitalized on the bearish sentiment following the March market crash. We decided to scrutinize industrial companies with solid fundamentals and healthy balance sheets so as to identify over-discounted companies. Our careful research convinced us to open positions in Honeywell (HON) and General Electric (GE). The case for HON is that the conglomerate has a diverse set of revenue sources which would lessen its cyclical exposure. Furthermore, their corporate management's foresight in focusing on software-hardware integration and automation endows HON with an attractive Internet of Things (IoT) story. We believed that once the fog of the market-wide panic started to clear up, investors would look back and reinstate their confidence. And as it turned out, the share price indeed went on an impressive rally that rewarded our hunch. Besides HON, we also invested in GE. Because of its significant aerospace exposure, the GE stock had suffered much since the coronavirus lockdown. However, we are bullish on Larry Culp (the CEO who took office in late 2018)'s plan to cut costs and to boost the overall production efficiency. We are confident that investors would soon realize that GE is more prepared to weather the looming recession than they previously thought.

Beyond our two main theses for this quarter, we also identified Stanley Black and Decker (SWK) as an opportune investment. As SWK is generally a consumer brand, the market mistakenly discounted them in accordance with other consumer goods brands. It was quickly evident from both data and management discussions that SWK will not be experiencing similar COVID-19 headwinds as most of its consumer peers, for consumers continued to buy SWK products in an increased wave of DIY home renovations.

Consumer Goods & Healthcare (CGH)

The past quarter has seen a great level of volatility coupled with a strong, but cautious climb back to the top. As COVID-19 related uncertainty persists, the gradual reopening of the economy has fueled optimism for a quicker economic recovery. Consumer staples and healthcare remained in a good position to track the broader economic rebound as a return to a level of normalcy increased demand for consumer goods. In addition, as elective surgeries began to reschedule, demand for healthcare products also increased.

Food and beverage companies have significantly reduced consumption and supply chain disruptions because of the effects of the pandemic. At-home consumption has spiked, but out-of-home consumption has come to a standstill. As regulations lift regarding quarantine, we expect this dichotomy to balance out.

Going into the second quarter, CGH looked to invest in companies that were fundamentally sound before the crisis and positioned to benefit from new trends created by the virus. Seeing Teledoc Health's (TDOC) share price skyrocket due to new demands for medical access without in-person contact, we bought a sizable position of One Medical (ONEM), a primary healthcare company. The company's elevated primary care, option for virtual healthcare, room for growth, and excellent valuation combined for a great buy. Within weeks we hit our price target and sold for a gain. However, we quickly observed that this move was far too short-sighted, and we missed large gains as a result of failing to adjust our price target. Even so, we are happy with our ability to pick great stocks amidst the turbulent crisis.

A number of moves were made towards the end of the quarter. First, we entered a position in Mylan (MYL), a generics and brand-name drug manufacturer. MYL's pipeline, upcoming merger (which should improve their balance sheet), and attractive valuation convinced us that this was an opportunity that we could not miss. We intend to hold at least until their merger with Pfizer's Upjohn, as a much-needed management change in the combined Viatris is likely to improve the company's operations. Finally, we shed part of our position in Invesco S&P 500 Equal Weight Consumer Staples ETF (RHS). Fearing another downturn, we supplemented the position with smaller stakes in QSR and YUMC. These two companies have invested significantly in their delivery technology and other areas that help them adjust to our new reality. Thus, we see them being better equipped in withstanding the remaining COVID-19 headwinds and coming out on top in 2021.

As we finish 2020 and move on to 2021, our sector views the biotechnology industry as a desirable space for investment opportunities. The pandemic has created unprecedented public and political attention on the medical and biotechnology areas. This attention has in turn created substantial demand for the various companies that fall under this heading. As a recent article by Barron's states, "Given the amount of attention paid to COVID-19 treatments and vaccines, it would be easy to assume that all of the good news was already reflected in biotech stocks. That's not quite the case. While they were the stars early in the market's rebound—the iShares Nasdaq Biotechnology exchange-traded fund (ticker: IBB) surged 37% from March 23 through May 11—they have gone nowhere for the past six weeks." While we view there is strong potential in the future for biotechnology, we do not believe this will be seen in all companies. We believe the industry will have strong winners but also strong losers. Choosing the right companies will be key in taking advantage of the strength this overall sector has to offer. This will require close attention to fundamentals as well as larger macroeconomic trends.

Additionally, healthcare has seen drastic changes due to COVID-19, many of which may endure into the near future and fundamentally alter the healthcare landscape. One example is telemedicine, which saw a surge in popularity during the pandemic, and will likely continue to be popular afterwards. The sector will stay on top of these trends and look to capitalize on any changes that occur in the coming months.

REIT / FIG (REIT)

The second quarter of 2020 was good for the REIT/FIG sector as we capitalized off of the overall market rebound from the S&P lows in March that may be indicative of a nascent bull market. We closed our Healthcare Trust of America, Inc. (HTA) position that we entered at the beginning of the quarter. Our thesis was that the revenue of the company will be in large part unaffected by business restrictions and closures due to COVID-19 because of the large and stable financial position of HTA's tenants and the inevitable reopening of business in America that would bring with it the pent-up demand for elective surgeries that are not truly "elective." We were confident that HTA would negotiate fair and favorable agreements with the few tenants that could not pay rent that would not foreclose revenue that was previously expected. The market validated this thesis as we sold our positions toward the end of the quarter.

We exited our position in Digital Realty (DLR) this quarter with a fair profit after being concerned about the near-term upside potential for the company. We thought the company was valued fairly when we sold it and we thought there were more efficient ways to allocate our capital to benefit from an increasingly digitally focused economy. One of those ways we sought to benefit from a more digitally focused economy was through our American Tower Corporation (AMT) position that we entered the previous quarter, as the company manages cell towers. We ultimately made good returns on our investment, but the combined factors of increased uncertainty in AMT's significant exposure to international markets, particularly developing economies, and the increasing national and worldwide attention to 5G technology persuaded us to switch our exposure to Crown Castle International (CCI). CCI has an exclusively domestic focus and we think will benefit more from the T-Mobile-Dish merger and longer-term lease expirations.

We also closed our Taylor Morrison (TMHC) position after the stock was able to rebound from the depths of the market panic in March. We saw increasingly positive home sales numbers throughout the second quarter combined with positive expectations by industry professionals, national steadiness in prices, and even lower mortgage rates as all contributing to the rebound before we sold the position. Overall, we foresee an increase in lenders' selectivity in willing to give out home loans and the short-term seizure of fiscal stimulus into the pockets of Americas as heavy enough short-term headwinds to make us want to exit the home owning industry.

This quarter, we continued to look for positions that would fare well in an economy hampered by the novel coronavirus and looked to capitalize off of macro trends. One of those trends was the increase in interest of people looking to escape crowded and unsanitary urban locations and multifamily complexes combined with a growing work-from-home culture to drive people into many suburban areas in the southern United States around large MSAs. Along with the longer-term secular tailwind of rising home prices, we invested in Invitation Homes (INVH). We also saw the emerging legal market in cannabis as a good area to look for potential investments with short and long-term tailwinds after cannabis dispensaries in the vast majority of states were able to stay open in some capacity during government ordered lockdowns, guaranteeing a more stable revenue stream than most retailers and thus necessitating more product. We also see the plant as recession-proof, much like how alcohol sales were during the 2008 recession. Thus, we invested in Innovative Industrial Properties (IIPR), a multistate operator that engages in triple net leases of industrial facilities for cannabis cultivation. We think the economic impact of the novel coronavirus and the growing consciousness of systematic racism will accelerate legal progress for the cannabis industry.

For our financial positions in the sector, we invested in two companies that we thought would benefit from the increase in distressed assets due to the economic downturn. We invested in Brookfield Asset Management (BAM), as we saw their raising of a large amount of capital as an attractive opportunity to make large returns after the market fully recovers. We made similar conclusions to warrant investing in KKR, Inc. (KKR) as well as their capital markets involvement to yield high returns for companies willing to pay more for debt in a world of scarce capital amongst much demand.

Foreign Exchange (FX)

USD: The USD had a strong showing this quarter, but some worry it may not be able to sustain its momentum. With the stock markets taking a hit, the greenback surged, but stocks are again on the rise, which may reverse the USD's trend. This could be because of the dollar's safe-haven status–when stocks are doing well, investors don't need to keep their money in the safe greenback while equities and other investments might provide higher return. The US interest rate is near-zero, which should indicate low demand for the USD, but all major economies have similar rates – or lower, like the negative rates at the ECB and Japan – so one conclusion could be that USD will retain its safe-haven status. US States have begun to open up, and although scientists say there is still plenty of risk for a second wave, economic activity is starting to heat up. The Dollar Index has also bounced off recent lows, a potentially bullish indicator in the short- to medium-term. The Dollar's performance in the coming months depends much on how the US fares with COVID-19, as well as in comparison to other countries, but overall, we are bullish on the USD.

EUR: Things are looking up for a pandemic stricken Eurozone after their successful lock-down and the Euro showed a great recovery through 2Q20. Europe was affected adversely by COVID-19 due to densely populated urban centers, tourism and open borders. The economic outlook however still remains bleak. The European Commission states that 10% of the GDP and 12% of employment in the Eurozone is directly attributed to the tourism industry. It would not be a stretch to say that we may see a decrease of at least 50% in foreign tourist arrivals to Europe. Europe's powerhouse, Germany, saw an unemployment change of 69K in the month of May compared to 238K in April. German ZEW Economic Sentiment for June was also up by 20% over the previous month. European CPI also steadily increased, as is expected after lock-downs were eased in certain countries. Short term outlook on the European economy and the Euro seems promising and latest numbers have been encouraging. We expect the Euro to hold steady at its current levels.

GBP: GBP steadily lost ground against USD and other major currencies since March, when the UK government carried out an emergency cut to the country's value-added tax, in addition to weak economic forecasts. GBP/USD hit a low of 1.15, with a high of 1.36 near the quarter's beginning and a current price of 1.23. The UK has been hit harder than most countries by COVID-19, and its fundamentals with regards to consumer and business confidence appear fairly weak. The UK's debt at the end of May 2020 was 100.9% of GDP, the first time that debt as a percentage of GDP has exceeded 100% since the financial year ending March 1963, says the ONS. Looking forward, the Pound has already declined a fair amount, but overall, we maintain a bearish outlook on the Pound.

HKD: The USD/HKD rate had a high of 7.7570 and a low of 7.75003 this quarter. The relatively narrow spread is due to the fact that the Hong Kong Monetary Authority has a mandate that focuses primarily on exchange rate stability, a quality necessitated by Hong Kong's entrepôt status. However, in a longer time span the exchange rate has been trending downward YTD. Finally, as China imposes the National Security Law and as the US presidential election comes up, we expect to see greater volatility in the pair.

CAD: We are ending this quarter with approximately a 4.7% appreciation in the CAD/USD currency pair. The appreciation in CAD, particularly against the USD, can be attributed towards better oil prices with WTI oil jumping from US$18/barrel to US$30/barrel in May alone. It has seen gains against the USD for the second consecutive month in May. However, the Loonie faces a range of risk factors that could cause it to go the other way. For instance, an unexpected relapse of the global economy would surely dampen the oil price recovery once again. A Canada-specific shock such as a housing crash/consumer deleveraging would also force the Bank of Canada to ramp up their own Quantitative Easing program. As of now, the central bank has not signaled its willingness to go down that path, but this could quickly change if the economic downturn proves to be slower than expected. One long term thing to keep an eye on will be Canada's chronic current account deficit. Last quarter's C$11bn deficit (roughly 2% of GDP) was the 46th consecutive quarter of deficit. Therefore, continued reliance on foreign capital flows leaves the C$ vulnerable should there be a sudden shift in investor sentiment.

Trading Desk (Kratos)

After our strong performance in Q1, we remained pessimistic on the global markets, predicting that continued COVID-19 outbreaks or a second wave would cause the global markets to fall further or pullback more significantly (as has been the case with many previous recessions). Therefore, we entered long inverse S&P 500 positions and bearish consumer retail positions. However, public markets began rallying — nearly back to pre-coronavirus levels thanks to unprecedented monetary and fascial stimulus — and we lost on both positions. We have tried to manage our flexible, short-term outlook with our fundamentally bearish sentiment on the market. We continue to believe that asset prices are inflated and have not priced in the full effects of the COVID-19 pandemic (as we have not seen Brazil and other developing countries rise toward their first peaks), but we remain patient in executing trades until we see clear signs that the market has reached its top. Overall, while our initial thesis about the pace of recovery was off, we are proud of our quick ability to adapt and execute based off what the market tells us instead of what we believe should happen.

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Portfolio Analysis

Performance

	2nd Quarter (%)	YTD	Since Inception (1/8/2019)
Hesiod Financial	9.55%	16.83%	21.51%
S&P 500 Index	19.95%	-4.84%	20.43%

Key Statistics

	2nd Quarter
Sharpe Ratio	0.50
Average Portfolio Return	3.43%
Risk Free Rate	0.66%
Standard Deviation	5.59%
Weighted Avg. Beta	1.13
Weighted Avg. Market Cap	36 B
Weighted Avg. P/E	50.77
Gross Exposure	66.80%

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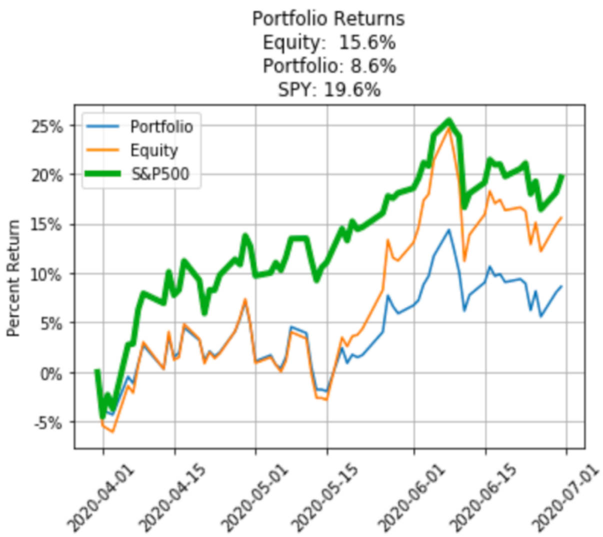
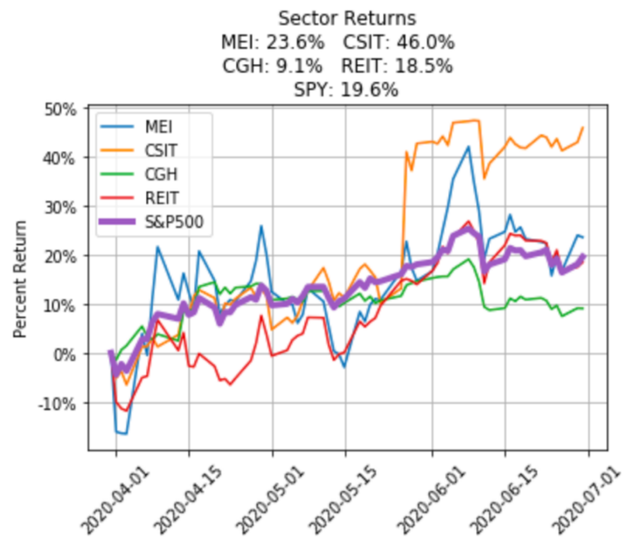
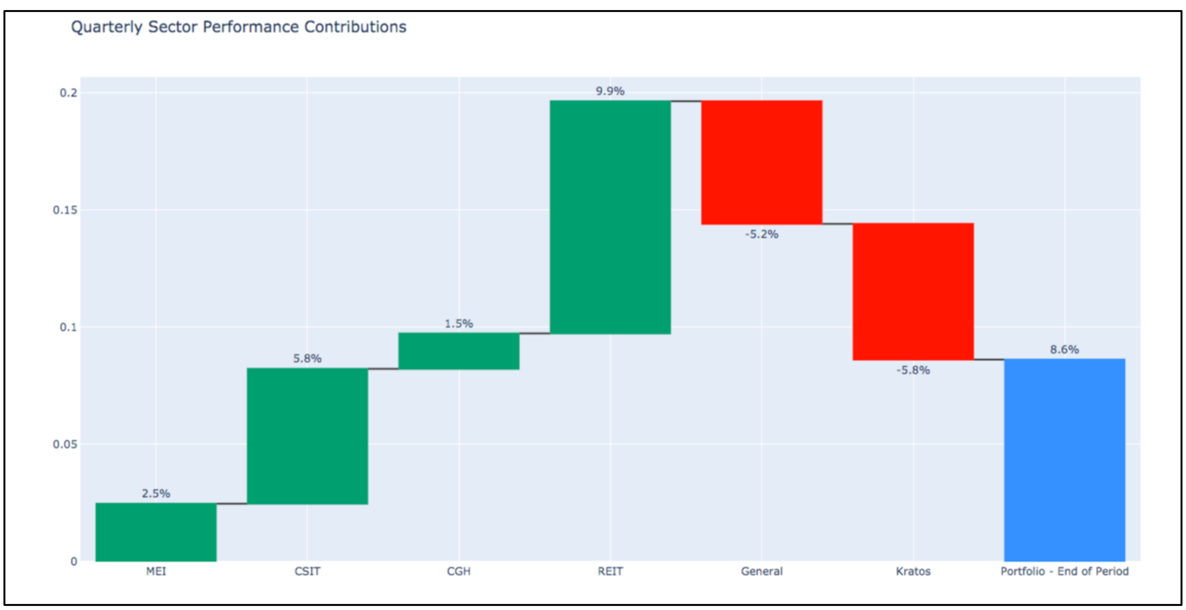
Return Visualizations







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