HESIOD FINANCIAL

Hesiod Financial, LLC
Monthly Report

September 2019

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Monthly Overview

Highlights

- 9/1/2019: As announced, the US began implementing tariffs on more than $125 billion worth of Chinese imports. Beijing, in turn, began imposing additional tariffs on $75 billion worth of goods. This includes a 5% tariff on US crude oil.
- 9/11/2019: Trump agreed to delay increasing tariffs on $250 billion worth of Chinese imports from October 1 to October 15 as a “gesture of good will”.
- 9/18/2019: The Federal Reserve decided to cut interest rates by 0.25%, its second cut since late July. A growing number of Fed officials expect one more cut this year based on economic projections.
- The Conference Board’s *Consumer Confidence Index* for September is expected to fall to 133 from 135.1 in August.
- The market for Repurchase Agreement experienced an unexpected rate spike in late September, causing the Federal Reserve to inject over $300 billion into the financial system over several days to relieve funding pressure in money markets.
- The unemployment rate declined from 3.7% in August to 3.5% in September.
- Total nonfarm payroll employment increased by 136,000 in September. Job growth has averaged 161,000 each month thus far in 2019, compared to an average monthly gain of 223,000 in 2018.
- Pro-democracy protests in Hong Kong have continued throughout September, drawing the attention of organizations like the NBA and companies like Apple and Activision Blizzard. The protests have been ongoing since March 31, 2019 and will seemingly continue into the indefinite future.

Market Sentiment

The yields on the 10- and 30-year bonds are near their year-to-date lows. The 10 and 30 year are trading at 1.52% and 2.02% respectively. The beginning of the month was filled with revitalized trade talks; the month ends with the trade talks continuing to have no end in sight. The market appeared to be spooked by multiple whistleblowers stating that President Trump asked Ukrainian official to investigate presidential candidate Joe Biden's son. And, while the S&P500 still returned positive returns for the month, the end of the month was plagued with increased tensions in Hong Kong between the police and protestors that have had a modest effect on the U.S. equity markets.

Sector Outlooks

Communication Services / Information Technology (CSIT)

The CS/IT sector performed in line with the S&P 500 Index for the month of September. We closed our Zuora position, but have maintained our holdings of Palo Alto Networks, as well as in the iPay ETF. Due to uncertainties in the trade war, the sector has remained fairly bearish, opting to hold cash, rather than increase our exposure to the high market volatility that arises from Presidential tweets. The U.S. and China are set to meet for negotiations halfway through October, but the lack of compromise on both sides leads us to be pessimistic for the possibility of a trade resolution.

For Q3 of 2019, the technology sector saw only a 3% growth, compared to the 5.6% growth seen during Q2. Slowing sector growth, paired with the current trade war and global economic slowdown, reasserts our bearish position. As we enter the next month, our sector will explore countercyclical investments with a specific catalyst for growth in an effort to finish out the year ahead of the rest of the market.

Materials / Energy / Industrials (MEI)

This month has been a turbulent ride for oil traders as Iranian tensions have hampered any ability to predict short-term oil prices. However, Hesiod stands very firmly in its belief in the medium and long-term outlooks for oil. After two weeks, Saudi oil output seems to have steadied with US and Russian crude reserves carrying most of the demand since then. We believe that a full-blown conflict with Iran is unlikely given the improbable domestic support in the US; more likely, the US administration will seek additional sanctions against key Iranian leadership. Therefore, crude supply will not be realistically impacted; however, we will see an increased risk premium for mid-stream activities in the region. In the medium-term this risk-premium will drive crude prices up an additional 5-8%. In the long-term, we foresee this risk-premium holding steady until new developments in the Middle East, but the largest driver crude prices will be in the US, as drilling companies face increasing pressure from their own boards to cap production.

Aerospace and defense continues to be a key industry that we’re tracking. Boeing seems to grab the majority of the headlines though we still lack any key developments in the Boeing 737 Max debacle. Underlying this drama, key industry dynamics in the future of aviation drives the long-term outlook for both Boeing, Airbus, and all its downstream manufacturers. Currently, it appears that the 737 Max will be back in the air in most countries and airlines by Q1 2020, where we will see airlines as the earliest benefactors. Airlines like Southwest and American will be the largest benefactors as they hold the largest US fleets of the Max – though American Airlines will face jet fuel pricing headwinds into the foreseeable future. As the MAX proves its safety, Boeing orders will increase and potentially reclaiming market share ceded to Airbus in the past two quarters. Finally, downstream OEM’s will be the last to recover as they face the lowest margins and a more reactionary supply chain. Other interesting movements to consider is Gold. As Hesiod still firmly holds a bearish view on the overall state of the US economy, we think the devaluation of Gold this month as an overreaction by the market that certainly should be taken advantage of in the long run. With a FED continuously lowering rates, the best place to park your money may just be in Gold.

Consumer Goods & Healthcare (CGH)

The CGH group did not open any new positions in the month of September due to consumer uncertainty and the continued performance of prior positions. In October, the CGH group hopes to focus on adding new healthcare positions. We are hesitant to add new consumer positions to prevent overexposure to a cyclical industry in the face of a recession. As expected from trade wars and political turmoil, the consumer confidence index has fallen slightly since August. The CGH group has a negative outlook for consumer sector equities in October as the trade war between the US and China continues and indicators point towards a coming recession.

The Healthcare sector shows potential for the coming months as it is more immune to macroeconomic cycles than the consumer sector. Political talk about Medicare-for-all and lower drug prices continue, and we can expect volatility depending on the likelihood of nomination for certain Democratic candidates. Between candidates like Bernie Sanders and Elizabeth Warren, pharmaceutical companies, health insurers, and firms that manage hospitals could be in trouble. Because Hesiod operates on a shorter-term basis, we have not decided to concern ourselves with possible political troubles yet. In the coming months, we expect healthcare equities to be volatile but still open for opportunities.

REITs / FIG (REIT)

The REIT/FIG group closed its PLD position for a 13.82% return over a little less than 4 months. EQIX is now the REIT/FIG sector's only holding, with it being up around 18% since opening the position. The Q3 2019 earnings come out for EQIX on October 30th, 2019.

September was a good month for REITs, as investors are seeking yield in this increasingly low yield and interest rate environment. REITs act as a fixed income source because of their legally required high dividend payouts. Investors have been flocking to these fixed income sources and this is why REITs have seen, and will continue to see, good capital gains. We see this sector continuing to outperform the broader market until the end of the year.

Since the financial crisis, financial company's net income has been increasingly reliant on interest income. However, companies that rely on interest income have their margins being squeezed by this low interest rate environment and central bank easing. The Fed has also had to jump in to secure the overnight repo market, where lending rates between banks have been shooting up for “technical” reasons. Pundits believe that this is just an end of the quarter phenomenon that is a result of the Fed’s rate cut along with the need for cash to satisfy capital requirements set in place after the financial crisis. However, this trouble with the repo market is ominous and should not be taken lightly. When banks will actually need funding during a potential economic downturn in the near future, the repo market troubles, recently, have shown that they might not have access to this much needed cash. It is our view that this sector will underperform the market in the next six months to a year.

Foreign Exchange (FX)

USD: Earlier this month, the Fed cut rates by 25bps, and calls for impeachment of President Trump have sowed uncertainty in the markets. USD fundamentals are not too strong, with manufacturing down significantly and consumer spending slowing, but unemployment is still quite low. On the other hand, global growth has slowed, which will likely increase demand for the USD. Overall, we forecast a slight appreciation in the USD.

GBP: Many investors are wary of the October 31st deadline for a Brexit negotiation, which means the implied volatility of the Pound has risen. The British GDP report showed a 0.2% decline, and the PMI report showed overall contractions in manufacturing and other sectors. We predict a depreciation of GBP.
Monthly change: 1.21→1.23.

EUR: The Eurozone continues to struggle in manufacturing, as a result of weak global conditions and the U.S-China trade war. President Trump also announced new tariffs on European companies across many sectors. Finally, if the U.K. leaves Brexit without a deal, the EU economy will also be affected and this could hurt sentiment towards the euro. Therefore, we forecast a depreciation of the euro.
Monthly change: 1.10 → 1.10.

INR: We expect the INR to depreciate, based on its weak fundamentals. The Reserve Bank of India cut rates by 25bp on October 4th, following disappointing reports in growth and inflation. India's GDP growth fell for the fifth quarter in a row in Q2, the weakest performance since 2013. Private consumption, corporate investments and exports are all seeing slowdowns. Analysts expect another rate cut in December.
Monthly change: 0.14 → 0.14.

FX Asia: Asian currency outlooks appear similar to last month, because the Trump trade war is still pushing on, with no sign of an imminent deal. We expect most Asian currencies to decline relative to the USD. China, in particular, has seen its Yuan depreciate recently, and many expect its decline to at least in the short term. Long term sentiment is more divided.
Monthly change: 0.14 → 0.14.

Trading Desk (Kratos)

Our bearish positions on the European and Hong Kong economies remain open. With German manufacturing much weaker than expected, our position realized positive gains this month. And, with Hong Kong riot police using "emergency power" for the first time in half a century, Kratos' Hong Kong position continued to realize gains. Kratos' current view is that while the S&P500 is trading near all-time highs, we are still due for a mid-sized pullback by the middle of 2020, starting with Europe

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Portfolio Analysis

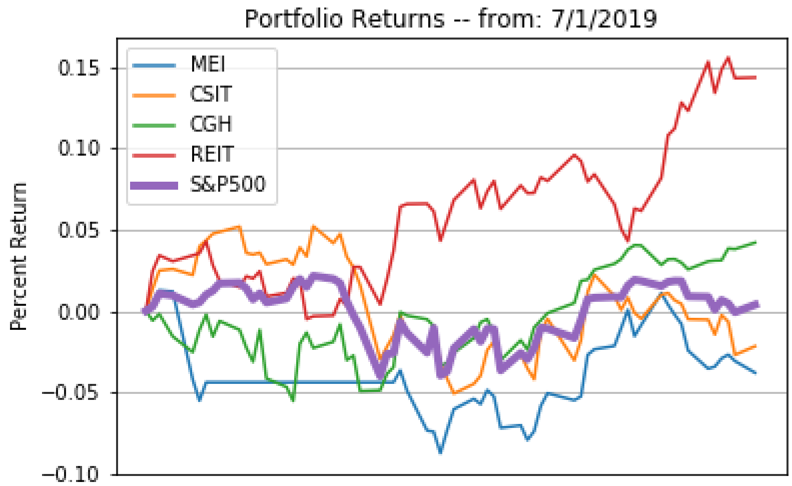
Performance

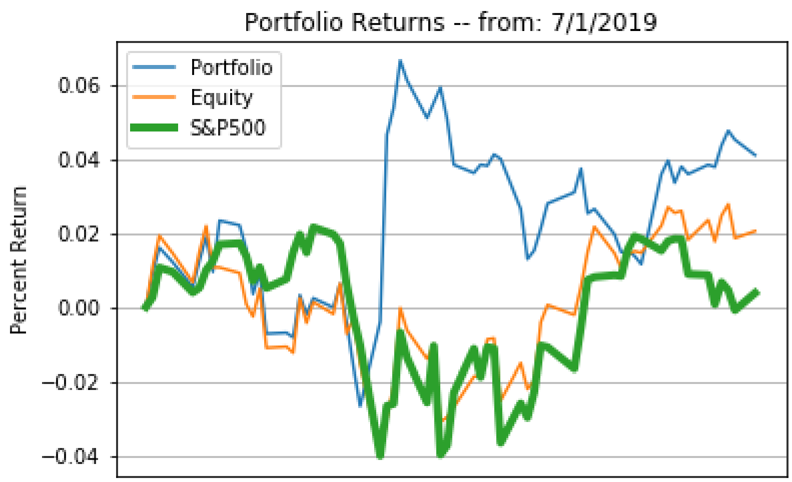
	Monthly (%)	Since 7/1/2019	YTD (%)
Hesiod Financial	-0.31%	2.98%	-2.99%
S&P 500 Index	-1.67%	0.38%	16.90%

Key Statistics

	September 2019	August 2019
Sharpe Ratio	-1.06	-0.88
Standard Deviation of Monthly Returns	4.60%	4.93%
Weighted Avg. Beta	0.83	0.80
Weighted Avg. Market Cap	64 B	67 B
Weighted Avg. P/E	56.38	38.72
Gross Exposure	75.88%	87.77%

Return Visualizations





Commentary Credits

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