# Hesiod Financial, LLC
## Monthly Report

August 2019

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## Monthly Overview

### Highlights

- In August, the S&P 500 Index returned -1.67%. The Dow Jones Industrial Average returned -1.72%. The NASDAQ 100 Index returned 3.60%.
- The American manufacturing sector contracted in August, with the Institute for Supply Management's manufacturing index dropping from 51.2 in July to 49.1 in August. Anything below 50 is considered a sign of contraction.
- The Bureau of Labor Statistics reported that employers added a half-million fewer jobs in 2018 and early 2019 than previously reported. The revisions are part of an annual process in which survey-based estimates are reconciled with definitive data from state unemployment insurance records. This means that 2018, considered one of the strongest years of job growth in the decade-long recovery, was weaker than previously believed. After the revision, hiring averaged under 200,000 jobs per month last year, down from the 223,000 initially reported.
- The Trump administration labeled China a currency manipulator in early August, after China allowed the value of its currency to fall. The designation is a symbolic move but dials up pressure in a trade war that has rapidly escalated. A cheaper Chinese currency helps Beijing offset much of the pain of American tariffs, which otherwise would make Chinese goods considerably more expensive in the United States.
- Late August, China imposed $75 billion worth of tariffs on the United States, leading to Trump threatening tariff increase on Chinese goods. Later that day, the State Council approved to reinstate Chinese tariffs on US automotive and auto parts starting December 15, 2019.

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### Market Sentiment

The S&P 500 was range-bound for the month of August. The sideways trading was due to uncertainty regarding trade with China. The 10-Year UST yield is below the 2-Year UST yield, which remains a concern for investors around the world.

## Sector Outlooks

### Communication Services / Information Technology (CSIT)

As we look back on the month of August, as well as the rest of the year, we are very bearish for the outlook of the CS/IT sector. Due to escalations in the trade war between the United States and China, our tech positions were unfortunately impacted heavily. All three of our positions (ZUO, PANW, and IPAY) correlated greatly with the market and suffered heavy losses each time that negative news surfaced. As a result of this, our team has taken action to reduce the size of each of our holdings. We have also been researching companies with less correlation in order to better insulate our sector from future market downturns.

This month we also saw the release of Zuora's Q2 fiscal 2020 earnings. As we expected, ZUO announced improvements in sales tactics, as well as advances in their integrations, elevating both their stock price and our outlook on the company. While we still believe in the future growth of the company, we feel that we must reduce our stake due to how easily their price swings with the trade war.

### Materials / Energy / Industrials (MEI)

This month has hit certain areas of our sector particularly hard. With increasing trade tensions, economic slowdowns in Europe and China, and an ever-looming Brexit, we saw many industrials and commodities take heavy losses. The XLI (SPDR Industrials) has lost ~6% this month with most of the loss coming after the announcement of increasing tariffs against China.

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Similarly, WTI has lowered 5.7% this month following demand concerns, again stemming from trade concerns.

We have focused our efforts this month on the defense sector, which we identify as having taken unnecessary and irrational losses. We follow a traditional defense sector thesis such that defense companies have very little exposure to trade, especially to the likes of China and other superpowers. Instead, defense companies collect their revenues from domestic government contracts with a small percentage from foreign, NATO countries. Following this thesis, we position ourselves more long-term than we are normally accustomed to, but this provides us distinct advantages especially in today's political environment. First, the daily musings of Trump are unlikely to dramatically alter the outlook of our holdings as compared to other sectors. Secondly, a full-fledged trade war is unlikely to severely impact the supply chains of major defense companies as most of their upstream contractors manufacture within US-friendly countries. For these reasons, an undervalued defense companies, such as HII who is trading at 12.9x forward P/E, will be a good bet within the foreseeable future until political tensions settle.

I want to reflect on another sub-sector mentioned last month: gold. Gold has risen ~9% this month, also following the announcement of increased tariffs on China. With lower yields, negative in some parts of the world, bonds are becoming a less attractive haven; this paves the path to GLD as an attractive safe investment as we close out this year. Future drivers of this commodity are:

1. Price of the dollar
2. FED rates
3. Economic outlook tied to Brexit and US-China trade tensions

All three such events serve as catalysts for increasing GLD prices. To attach a timeline to these events, we will look towards the FED to lower rates again (most likely by 25 bps in their Sept. meeting), and Boris Johnson has set the deadline for a Brexit deal to Oct. 31st.Other sectors that particularly interest us is commercial aviation in Boeing. We believe that BA has already been discounted beyond a potential recession following a trade war due to the 737 MAX groundings. Additional tailwinds in the industry of an emerging middle class in developing countries also make this an attractive stock going into 2020.

## Consumer D&S / Healthcare (CGH)

The CGH group slightly outperformed the S&P 500 Index in August. We have opened a large position in retail companies to form our Retail ETF, composed of safe large cap equities. The Consumer Confidence Index has fallen from 135.7 in July to 135.1 in August. Conditions are harsh for Chinese manufacturers as the trade war drags on. Additionally, competition in the retail space remains high. These factors lead to high uncertainty in the coming months, which encouraged us to open our safer large cap retail positions.

The healthcare portion of the CGH group has been inactive in August, opting not to open any new positions. With Healthcare stocks recently on the rise, the CGH group will investigate good opportunities to invest in healthcare companies in the coming weeks. Healthcare companies are still fundamentally strong. Uncertainty remains, but healthcare has fortunately remained out of the political spotlight in August. We hope this trend continues into September.

## REITs / FIG (REIT)

The REIT/FIG sector has been very successful this summer, with the group returning ~8% since July 1st compared to the S&P's ~1% decline. For the month of August, PLD redeemed 1.375% notes due in 2020 and priced €1.8B of guaranteed notes due in 2027, 2031, and 2049. There was no major news on EQIX for the month of August.

The financials sector continues to track the slope of the yield curve, getting a boost when the curve’s inversion has lessened, but struggling when it deepens—as it has done lately. Volatility will likely continue, but with longer-term rates appearing to be capped and the Federal Reserve moving to a more dovish stance, we continue to rate the sector at market perform.

## Foreign Exchange (FX)

USD: The Fed is expected to cut rates again in September, amid still-growing national uncertainty and anxieties from the trade war. Domestic fundamentals are mixed – consumer spending is strong, and wages are growing, but hiring and manufacturing are down. Therefore, we expect the USD to slightly weaken going into 2020.

INR: We expect the rupee to weaken going forward. Recent data shows India’s economy growing at its slowest rate since 2013, and along with its weak manufacturing numbers and bearish stock markets, this points to the Reserve Bank of India cutting rates.

EUR: We also expect the Euro to weaken in the coming months. A rate cut from Draghi remains likely before his departure, as the China-US trade war has taken a toll on eurozone and German exports, and new tariffs between the U.S and China won’t help the situation.

GBP: Some alleviation of Brexit fears – from Parliament taking control of the Brexit agenda and denying PM Johnson’s request for elections before October 31st – means that investor sentiment has risen favorably. Despite lagging fundamentals, we expect the GBP to continue to strengthen, at least in the near term, as the Brexit situation becomes less turbulent and off-putting to investors.

FX Asia: China’s growth has been slowing, causing its PBOC to cut reserve requirements by 50 bps. Additionally, new formal talks have been scheduled for next month to discuss a trade conflict resolution, creating some optimism for China. Therefore, the CNY is expected to strengthen slightly against the USD in the near- to medium-term. For the rest of Asia, the ongoing trade war and lower business confidence is still pushing currencies downward.

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### Trading Desk (Kratos)

The continued inversion of the yield curve and a no-end-in-sight trade war with China, we remain strong in our bearish outlook over the coming year. However, Kratos' positions reflect the understanding that recessions happen many months after the yield curve inversion. We remain bearish on Hong Kong due to heightened tensions between citizens and the government.

## Hesiod Labs (hLabs)

The hLabs team will be taking on a new project this semester. The proposed project is a machine learning application that provides users the ability to interactively visualize data and apply predictive modeling techniques. The application will be written in Python 3.7 as a web-based application built on Django. Data visualization will use the Bokeh library. By having the application be web-based, the application can take advantage of the Bokeh server which allows further functionality, including the following features as listed on the Bokeh website:

- Respond to UI and tool events generated in a browser with computations or queries using the full power of python.
- Automatically push server-side updates to the UI (i.e. widgets or plots in a browser).
- Use periodic, timeout, and asynchronous callbacks to drive streaming updates.

Humans have a strong sense of visual pattern recognition. Thus, visualizing the information in an interactive nature puts the data scientist one step closer to understanding the data of interest. The Bokeh server allows data to be visually selected and used directly for computation. Additionally, most machine learning techniques include at least one "tuning parameter" that affects how the data is "learned." Such tuning could be visualized to aid the user in understanding how the tuning parameters affect model performance.

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## Portfolio Analysis

### Performance

| | Monthly (%) | YTD (%) |
|---|---|---|
| Hesiod Financial | 3.89% | -2.46% |
| S&P 500 Index | -1.67% | 16.90% |

### Key Statistics

| | |
|---|---|
| Sharpe Ratio | -0.88 |
| Standard Deviation of Monthly Returns | 4.93% |
| Weighted Avg. Beta | 0.80 |
| Weighted Avg. Market Cap | 67 B |
| Weighted Avg. P/E | 38.72 |
| Gross Exposure | 87.77% |

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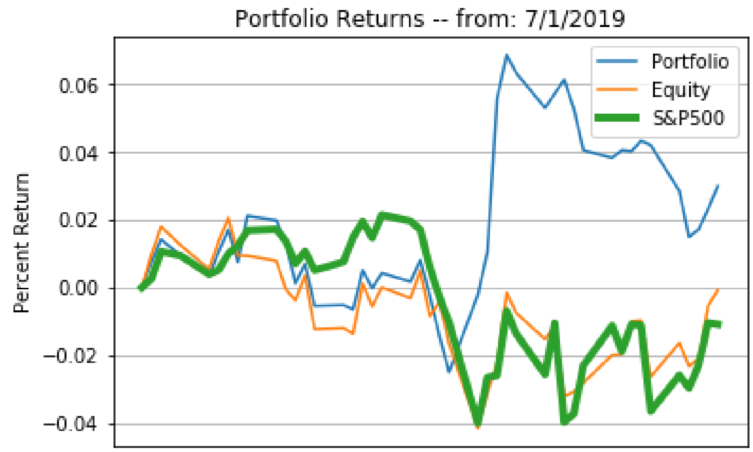
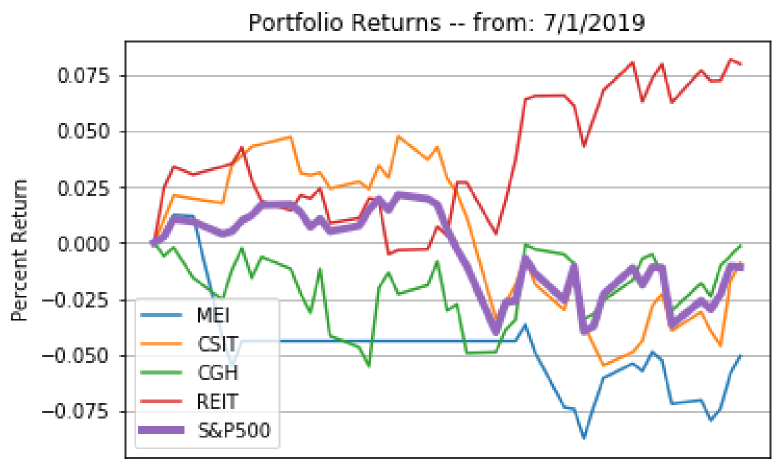
## Return Visualizations




## Commentary Credits

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