KTS CAPITAL MANAGEMENT

KTS Investment Horizon

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EXECUTIVE SUMMARY

- 2018 was one of the worst financial years in history with almost all asset classes retreated.
- We still believe that **the financial market may be driven by central banks' monetary policy and mostly by geopolitical tensions**.
- **Stock markets overall are likely to maintain their volatile temper for 2019**.
- **As for the fixed income**, we feel com fortable with our strategy, which is un correlated to the general interest rate risks and expected to generate higher returns than cash.
- **As for the equity**, we are also confi-dent to reach a portfolio value added via dynamic baskets in themes like gold, biotech stocks and in the emerging markets.
- On a technical point of view, we noticed back in October 2018, that **the Fed was sending a clear signal of a hawkish approach, but at the same time the Fed is also giving a clear support with a more dovish message at the most important support level in the past 7 years, namely was at around 2'350 points of the S&P 500 Index**.
- Therefore, **our investment strategy will consider a stop loss at the low of December 26, 2018 (2'345 points) and we will take a profit when ap proaching the new highs of the market.**

OUTLOOK

2018 can be deemed as one of the worst financial years in history. Even the stock market crash in 2008 driven by the U.S. subprime loan deficiency, which then forced the global economy to fall into a deep recession, could not be comparable. While risky assets such as stocks and low-graded bonds were falling off the cliff, government bonds emerged as the last resort for investors to compensate the huge losses in stocks. In those days, a well-diversified portfolio could come away quite lightly during the 2008 disastrous stock market collapse.

Ten years later, in 2018 this was not the case. As we have argued in our past investment strategy reports, the central banks' unprecedented monetary policy provided the impetus not only for risky assets to rise steadily in value, but also across almost all asset classes. The exception would be gold trading in a sticky range around USD 1'300 per ounce since December 2013.

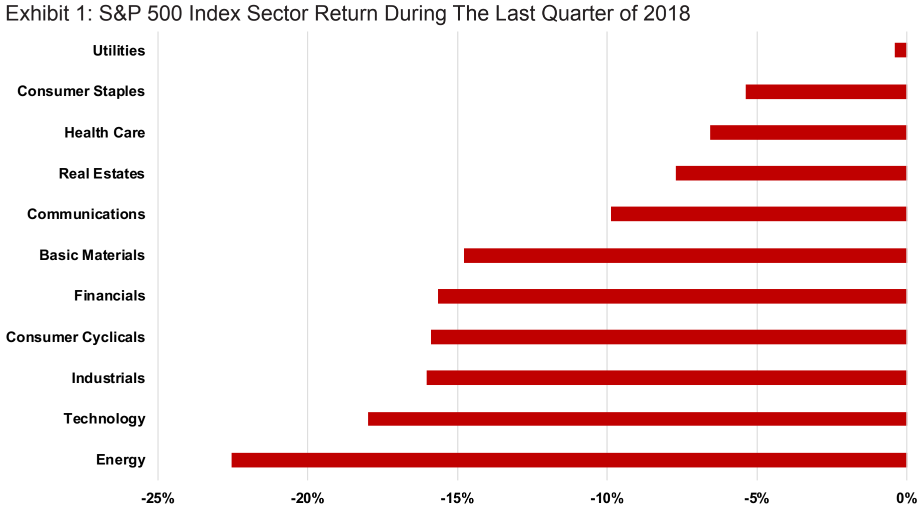
At the beginning of last year, the investment community was still of the unanimous opinion that the global economy was on a good track to recover further; as a result of this, the stock market continued its complacency in the believing that there was only one direction to go.

In February 2018, this belief was proved wrong. **The end of the bull market started during the beginning of 2018 with volatility suddenly spiking by more than 300% and compelled some low volatility funds to surrender.** More than 90% of their fund value was annihilated in just a few days. As we continued into the year, we acknowledged that risk had certainly risen with central banks reversing their stock market approval policy.

With Mr. Trump as the leader of the U.S. eager to gain world power and through his political provocation, concerns about the overall prospect of the economy together with heightening geopolitical tensions had increased.

During the last quarter of 2018, the accumulated agitation in the market translated into reality. **All asset classes performed uniformly bad as they had uniformly risen during quantitative easing. Technology stocks, once led the recovery of the stock market, were particularly punished in the October sell-off, see Exhibit 1**. For example, NVIDIA Corporation, a leader in 3-dimensional graphics processors with a solid business plan to capture the growing gaming industry, lost more

Exhibit 1: S&P 500 Index Sector Return During The Last Quarter of 2018



than 50% of its value during the same period. This demonstrates that investors are highly frightened as risks increased.

As shown in the **Exhibit 2**, **all asset classes, except one, retreated and ended the year in negative territory. Unfortunately, 2018 turned out to be the most difficult and unpredicted market conditions for most money managers.**

As we always argued in the past, we had foreseen a high probability of such a market scenario, therefore our priority in the asset allocation process was to avoid hidden risks.

In fact, our bond allocation turned out to be faultless, reaching a positive performance, while competitors had to struggle with risky structured products like reverse convertibles, as well as having a higher duration or being invested in lower quality bonds.

We had very few exposures in the traditional interest rate sensitive fixed income categories such as government bonds, investment grade bonds, and high yield bonds. As expected, the extremely low interest rate environment eventually started to reverse with central banks around the world reducing their balance sheets. As this happens interest rates will likely rise and bond prices will likely be quite negatively exposed to the rise of interest rates. The only risk that we were conflicted with was the damage of California's "Camp Fire" through our investment in the catastrophic bond (ILS). **On average, our bond investment contributed positively to the performance.**

In addition, **we had an underweight equity space compared to the majority of our competitors. Our alternative strategies in the equity environment, like merger arbitrage, the long/short and dynamic asset allocations proved to be more resilient than traditional markets.** We were unfortunately overly confident via our special investment situations with a low equity exposure. Therefore, we elected that an adjustment should be made and we decided to dramatically reduce these investments and renounce such new investments in the future.

As explained in detail in our outlook for 2019, **we are certainly entering into the last phase of the economic cycle and capital preservation is now more than ever of the utmost importance**.

INVESTMENT STRATEGIES

For 2019 the economic conditions globally continue to be favourable. Inflation remains quiescent and there is no strong reason for central banks to alter the current interest rate levels. The Federal Reserve bank (Fed) is currently the only central bank in the G7 countries to raise interest rates. For this year the Fed is expected to increase rates two times to around 3%, which is still, to some degree, low compared to the historical level. It is also not in the interest of heavily indebted governments to experience a higher cost on their record debts. On the other hand, incoming economic indicators pointed to slightly slowing growth.

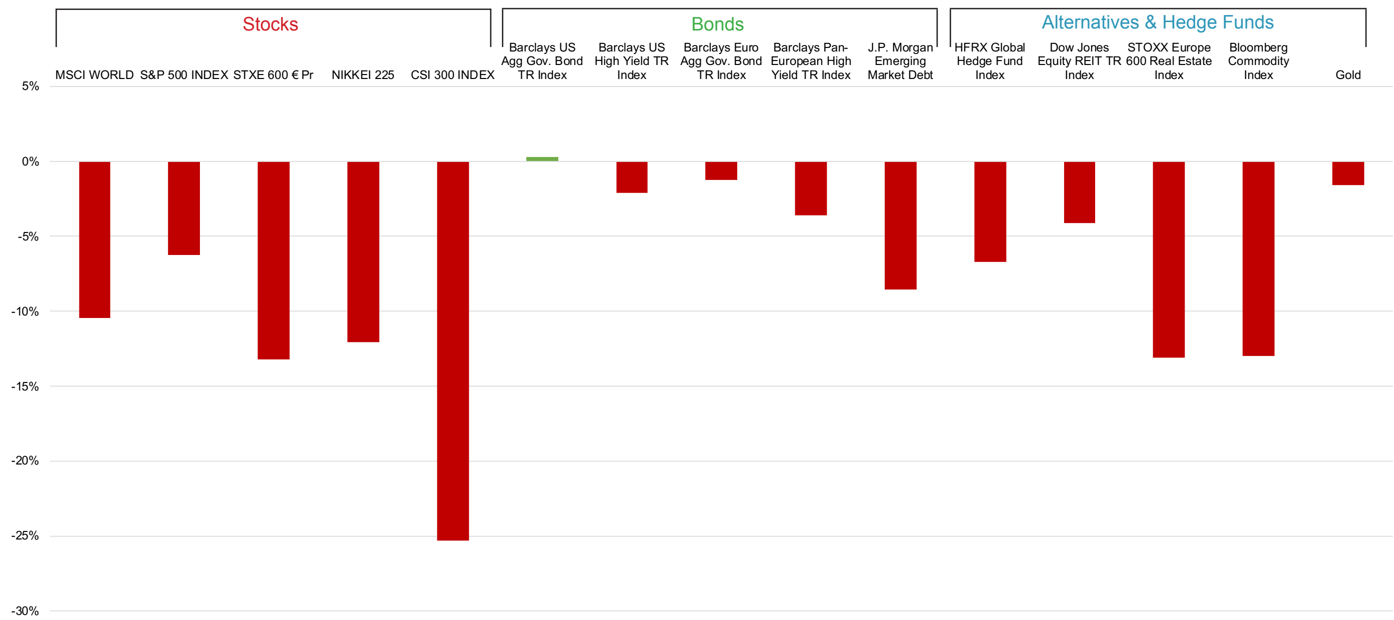
However, **we still believe that the financial market may be driven by central banks' monetary policy and mostly by geopolitical tensions**, such as the Brexit and economic confrontations between major economic powers. Some believe that the world is in a phase of de-globalization, which could have an inverse impact on global economic growth due to new tariffs and agreements.

Considering the above statement stock markets overall are likely to maintain their volatile temper for 2019. We expect the stock markets to be somewhat range traded after a long-run bull market. With the recent stock market correction during October through December 2018 the high valuation of stocks has fairly diminished. **Valuations seem to be moderately above average, and they offer good entry points to increase our below neutral weighting equity exposures at the beginning of 2019.**

As for the fixed income, we feel comfortable with our strategy, which is uncorrelated to the general interest rate risks and expected to generate higher returns than cash. We also notice that spreads in high yields and emerging market debts have widened due to the recent stock market sell-off. **In our opinion, emerging market debts offer an attractive risk-return relationship than corporate high yield**. Selective emerging market countries have even better debt to GDP ratio than most of the western countries, such as the United States and most euro zone countries.

As we anticipate that the fixed income market finds itself in the process of normalization, **financial markets are also likely to be vastly volatile in 2019. As a result of this, we have already optimized our clients' portfolio accordingly to**

Exhibit 2: Almost All Asset Classe Returns Were Negative in 2018



mitigate the downside risk by improving the underlying investment vehicles with an increased number of dynamic managers and investment themes such as the equity long/short, merger arbitrage and dynamic asset allocation funds. With these managers, we believe to have found the optimized strategy for our stock investments in conjunction with a stable balance sheet, high dividend yield, proven management skills and an attractive growth in business.

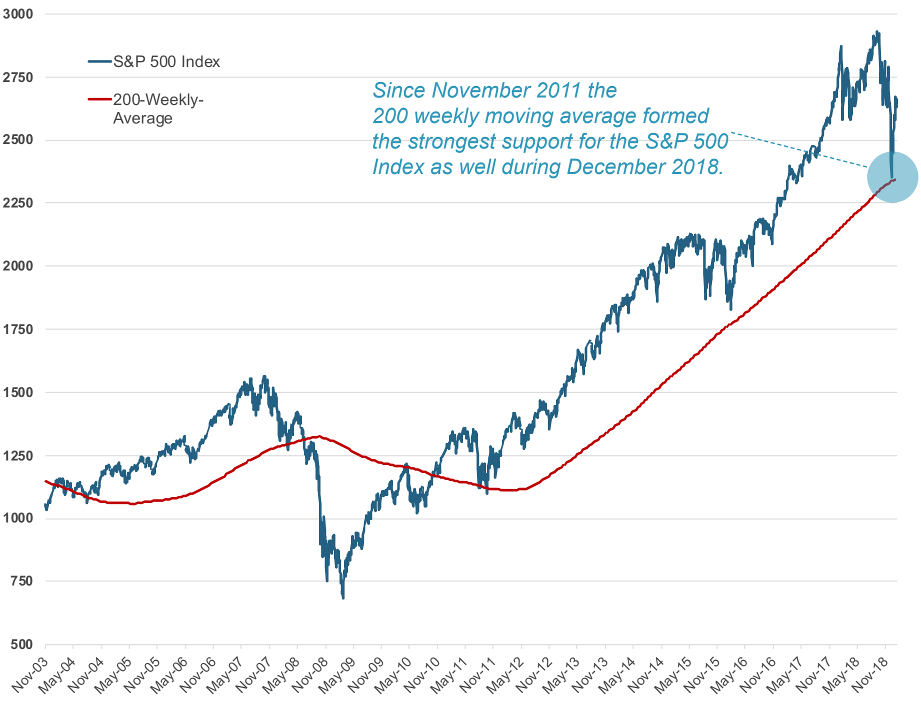
We are also confident to reach a portfolio value added via dynamic baskets in themes like gold, biotech stocks and as previously mentioned, in the emerging markets.

A volatile market like this driven by the angst of investors rather by the fundamental factors, could lead to market corrections in the range of -15%/+15%. In order to generate alpha in this market environment, **we recommend being highly opportunistic and well-diversified**.

On a technical point of view, we noticed back in October 2018, the FED was sending a clear signal to the market (S&P 500 Index around 2'940 points), with a more hawkish approach, that we will not see highs any time soon, but at the same time giving clear support with a more dovish message, moreover that the last most important support in the past 7 years, namely was at the 200 weekly moving average (2'350 points), see Exhibit 3.

Therefore, **our investment strategy will consider a stop loss at the low of December 26, 2018 (2'345 points) and we will take a profit when approaching the new highs of the market.**

Exhibit 3: The 200 Weekly Moving Average as the Long-Term Support



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