

KTS
CAPITAL
MANAGEMENT



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Webinar of our best in class Flossbach Multiple Opportunity Fund

- The manager of the fund Flossbach is assessing the risks of a potential short term correction, but, as usual, keeps the main focus on the longer term picture for the economic environment. The manager has come to the conclusion that investors need not worry about the markets, which, he believes, are not currently in bubble territory. The bull trend will keep going for a while longer and whilst inflation is going to be higher than in the recent past, this will not be a threat to the bull market holding its trend.
- Flossbach also mentions the dramatic reaction and general boycott by Chinese consumers of western textile manufacturers like H&M, Zara, Nike, Adidas and others. The dramatic situation (not really mentioned in western media but a hot topic in local media) was initially caused by the suspension of activities in Xinjiang (80% of Chinese cotton production is coming from this region) from the BCI (Better Cotton Initiative). The decision was prompted by concerns over the prevalence of labour abuses in the region. We mentioned the event earlier, but did not realize that this dilemma could become a game changer. Chinese citizens are going to heavily support Chinese producers at the expense of western manufacturers. For western companies China is the main driver for future growth and, therefore, we could experience negative surprises in future earnings from many western companies. Could this be a reason for market turmoil, because of EPS disappointments, in the near future?
- Flossbach is also analyzing volumes, market strength / breath and technicals. Market volumes are lower than the historical average, therefore there is no sign yet of bubble territory. Analyzing market breath, all the sectors have rallied YTD, therefore investors are diversifying. In addition, our best in class value fund Classic Global (+22% YTD) is arguing that investors are more selective and sees a sector rotation in favor of stocks with more attractive valuations. This is based on statistical data, where the gap between the most expensive 20% stocks with the bottom (value stocks) is lower than 6 months ago.

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- Flossbach also mentions that 90% of the companies included in the S&P 500 are over their 50d moving average. But, contrary to most market participants, they consider that this is not a sign of an overbought market condition, but of the market's strength.
- In fact, analyzing historical data, every time the market has experienced a similar situation (with only 3 exceptions), it was in the middle of a bull market run. As you can observe in the table below, on a 1, 2, 3, 6 and 12 months horizon, historically, the market continued to rally.
- We agree with Flossbach, that the market will continue to rally, but we do see the risk of a short term consolidation first. We noticed that insider selling is at its highest levels and this comes just before the earnings season. In addition, we observed from some historical data and regressions that the upside potential appears very limited with margin debt already at such high levels. KTS keeps around 15% to 20% liquidity and has taken out some PUT options for downside protection.

S&P 500 Wertentwicklung (in%)				
Datum	1 Monat	3 Monate	6 Monate	Jahr
02.06.1991	4,71	5,38	9,07	15,57
30.05.1997	4,60	6,53	12,63	28,59
03.18.1998	3,43	0,19	-3,69	21,28
05.11.1998	3,78	12,19	17,48	20,85
02.05.2003	3,60	6,48	12,97	19,06
12.11.2004	0,32	1,08	-2,54	4,27
29.04.2009	5,21	12,13	19,34	38,13
24.10.2011	-7,37	4,88	8,99	12,67
04.01.2013	3,18	6,38	11,28	24,88
16.03.2016	2,64	2,37	4,86	17,47
15.02.2019	1,69	3,63	4,07	21,78
26.05.2020	3,07	14,69	21,51	?

S&P 500 Wertentwicklung (in%)				
	1 Monat	3 Monate	6 Monate	Jahr
Ø	2,41	6,33	9,67	20,41
Median	3,31	5,88	10,18	20,85
Alle anderen Zeiträume				
Ø	0,76	2,24	4,56	9,34
Median	1,20	2,92	5,34	10,94

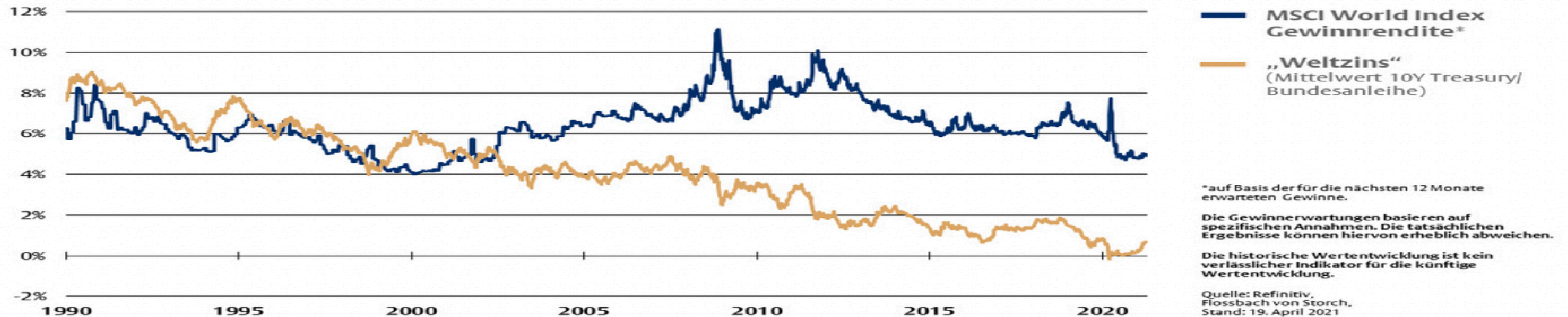
Die historische Wertentwicklung ist kein verlässlicher Indikator für die künftige Wertentwicklung.

Quelle: Bespoke, Flossbach von Storch, Stand: 16. April 2021

Stock exchange performance when 90% of S&P 500 Index companies were over the 50d mov av (source Flossbach)

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- Flossbach also argued that it no longer makes any sense to follow the “Buffett-indicator” (market cap vs total US-GDP), because most US company`s revenues come from outside the US and the cost structure and also margins are totally different than in previous years. We have also argued many times that, nowadays, this Buffett indicator is actually worthless.
- As usual, Flossbach argued that the best indicator to judge valuations is the comparison of EPS vs bond yields. In the chart below we can observe how, during the bubble of year 2000, EPS were lower than bond yields. Today equity, on a absolute basis, is still as attractive as it was 20 years ago. But, on a relative basis, much more attractive because EPS are growing more than bond yields (used to be over 8%, nowadays are at 1%).



On a absolute basis, equity are still attractive, like 20 years ago, but on a relative basis, much more attractive (EPS grew more than bond yields): Flossbach

China and gold

- The Chinese government has given domestic and international banks permission to import large amounts of gold into the country. Apparently, 150 tonnes of gold worth USD 8.5 billion is likely to be shipped in by next month. This could be the real reason for the recent rebound of the gold price. In China the central bank, People's Bank of China (PBOC), controls how much gold enters China through a system of quotas allocated to commercial banks. These usually allow enough metal in to satisfy local demand but can sometimes restrict the flow. Apparently, Chinese demand for gold increased as a result of a fall in prices. Is it possible that what is going on with gold in China today could be linked to the gold-backed yuan-denominated oil futures contract issued back in 2018? These contracts were priced in yuan, but convertible in gold.

General news

- Speaking of the year 2000 bubble- when worthless companies were quoted on the stock exchange for insane valuations, it looks like (via SPAC or VC) we are experiencing the exact same situation nowadays, as also mentioned many times recently. The following example is the valuation of the company New Jersey Deli, which has USD 35k annual revenues and is valued USD 100 mio. The hedge fund manager David Einhorn warned of the danger that he sees for retail investors in the markets today. One of his prime examples was this tiny New Jersey deli with a market capitalization of more than USD 100 mio.
- Beijing displaces New York to become the billionaire's capital, with the highest number of billionaires in 2020 (100 vs 99 in NY).
- KTS always argued that the most alarming signal that markets are near their highs is when your "taxi driver" is advising which stock to buy. The top 2 Apps in the App store are: Robinhood, followed by Coinbase, TikTok, Youtube, Instagram, Slice It All, Snapchat and Facebook. We accept that we are in a new market paradigm, but, nonetheless, those signs are not comforting.
- On the other hand, the economist Mr. Yardeni is arguing that, even if many indicators are flashing that sentiment is way too bullish, we are in a MAMU paradigm: $MMT + TINA = MMT$ (modern monetary theory) and $TINA$ (there is no alternative to stocks = MAMU (the mother of all meltups)). Therefore, now is not the time to worry about whether the current market level is excessive.
- Amazon is going to open its first hair salon in London to test a number of new technologies. Such as augmented reality to show customers what their hair would look like in a different color, for example. The infinity of innovation such technology giants are bringing to us is incredible.
- 68% of US adults are thinking that marijuana should be legalized, reaching a new high and being 20% higher than last decade!

The new SEC chairman

- Mr. Gary Gensler, MIT fintech professor and long time regulator and ex-banker, was appointed SEC chairman by the Senate. Mr. Gary Gensler has a deep knowledge and expertise of financial innovation, both from a technical / technological and regulatory standpoint. Mr. Gensler believes (in his testimony before the House of Representatives in 2019) that projects like Diem (FB crypto asset project) could bring benefits to society, but that its regulation is not yet clear enough. He is also expected to focus on a variety of issues like the GameStop phenomenon, red-hot stock markets or SPAC.
- Market participants understand that with such a nomination the SEC chairman`s role was now intended to shape up the next stage of crypto land and not just to enforce stock market regulation.

Bitcoin news

- Turkey, after banning Paypal in 2016, is also indirectly trying to ban crypto transfers, with the final goal of trying to stop funds escaping the country and hurting the Lira. Technically, bitcoin is not banned, but the new regulation will ban the flow of money from payment companies to crypto exchanges. Users will still be allowed to trade crypto through banks, but in such a way that provides the government more visibility.
- As we can see, more and more governments are trying to gain more control over the crypto currency space and, as we have read in the previous slide, the SEC is now also moving towards regulating the crypto space.
- From the Central Bank of China, there are more signals of willingness to regulate bitcoin as an investment alternative. Li Bo, deputy governor of the People's Bank of China (PBOC), spoke at Boao Forum for Asia citing "we regard bitcoin as a crypto asset. Crypto assets are investment alternatives and they are not a currency per se. The main goal we see for crypto assets is mainly investment alternatives". For years the PBOC has opposed using cryptocurrencies in its economy, citing their illicit uses like money laundering and tax evasion. Chinese regulators banned initial coin offerings (ICOs) in 2017 and imposed a total ban on cryptocurrency trading a year later. According to reports, stablecoins such as Tether have been used on a massive scale in China for money laundering and illegal gambling. Deputy Governor Li added "going forward, any stable coin which has the ambition to become widely accepted payment solution will need very strong regulation, same as for a quasi-bank to serve that kind of function.
- Nowadays, this is the never ending dilemma. How are central banks going to regulate this environment? From the different inputs, it is clear to us that the space is not going to be banned, because central banks have recognized that the blockchain technology is going to be the future. Can authorities and true believers of the blockchain technology find a compromise? What is certain is the fact that volatility is going to stay with us on this journey.

Bitcoin news

- One clear example of how multinationals believe in the future of the blockchain technology is the German Telecom, which is investing heavily in crypto infrastructure. The aim is to link user's phone numbers to the blockchain, in order to simplify access to cryptos, especially in emerging markets.

Tokenized shares

- Binance announced the ability to buy and sell digital tokens on Tesla shares via its crypto asset exchange platform. The token will also allow investors to receive most of the benefits reserved for shareholders, like dividends and transferability.
- We strongly believe that this could be a new era for trading, because with digital tokens on equity the buyer and seller are trading directly. Thus eliminating any counter party risks, and also depositary, custody and bank fees.
- Such trading could also improve liquidity through 24/7 trading. At the moment, this is still not possible, because trading is aligned with Nasdaq's trading hours. In addition, the blockchain technology will automatize settlement, share register, splits, capital increases and dividend payments.
- For the SEC the higher transparency of transactions could be of great interest. In fact, transactions are recorded in real time and are transparent and accessible at all times to regulators.
- Tokenization can also apply to illiquid assets, such as venture capital, private debt, real estate, works of art or collectible cars. Theoretically, this process should decrease massively cases of fraud.
- We also think that banks are interested in automatizing such administrative processes to reduce labor costs. Therefore, they are going to be more and more involved in blockchain innovation and in the tokenization of assets.
- Last year countries like Sweden and Ukraine announced they were in the process of developing a way to register land via blockchain. This kind of process would massively reduce costs of notary, lawyers, etc.

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