KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 11

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U.S. Program to cut 50% carbon emissions by 2030

- The Biden administration announced an ambitious goal to cut 50% of carbon emissions by 2030. Such a goal is highly questionable for many reasons, as recently discussed (dramatic increase of energy demand due to cloud computing, machine learning, 5G, etc.). The clear positive side of the news is that the whole world is following the same path. Therefore, we will experience a dramatic increase in infrastructure spending (from the governments' side) and capex (from industries) and also an increase in R&D spending, reflected in technological innovation.
- The U.S. also announced plans to deploy 30 GW of offshore wind energy by 2030. JPMorgan advises to continue investing in "Green" stocks.
- KTS strategy is to invest with the right renewable experts to catch the upside of this greener transitional phase.
- The USD 1.9 trillion COVID bill was just the beginning. According to Citigroup, there will be an additional estimated USD 3+ trillion program that combines an infrastructure bill with a green-energy bill. College education and universal kindergarten, child-care and health-care reforms will follow in the second part of the plan
- President Biden was explicit in his determination that the US will close its infrastructure-spending gap with China. "Rebuilding infrastructure, both physical and technological so that we can compete and create significant numbers of really good-paying jobs". President Biden is trying to avoid the mistake many believe Obama made, which was allowing fiscal policy to be tight in the early stage of the last recovery.
- **BUT taxation is one obvious means to pay** for Biden's New Deal. On the table are new tax ideas, like paying for roads, carbon tax, and increases in existing tax rates (raising corporate tax rate from 21% to 25% or even 28%).

Cargo ship “Ever Given” blocking the Suez Canal

- As of 29th March 2021 it is confirmed that the Suez Canal is at last free. An unusually high tide made the job easier for engineers.
- Herewith, we show our analysis of the event. Hopefully, such events are not going to be repeated, but the world has to realize, once again, that so called “black swans” (black swan theory of Nassim Taleb) can be anywhere and appear at any time.
- Market participants were analyzing the possibility of market disruptions as a result of the massive cargo ship completely blocking the Suez Canal. The Suez Canal represents 12% of the world’s shipping traffic.
- Media were talking about USD 400 Mio hourly costs (USD 10 bn daily) lost to the worldwide economy because of the blockage causing a tailback of hundreds of vessels (200). Such vessels were on standby for the decision of a re-route (in case the cargo would have needed to upload) or only to wait a few more days.
- Following discussions with our senior oil trader and also expert in shipping/cargos, we came to the following conclusions:
    - **It is not true that the blockade was causing such huge costs.** The numbers represented only the value in goods, which will experience a delayed delivery; therefore, not a real loss.
    - Apparently, the **main insurance provider responsible** for shipping through the Suez’s Canal is the **UK company Lloyds Insurance**. Any insurance policy for such shipping transport, has normally up to 1 week flexibility, therefore, no penalties can be claimed. Investors could not short the stock, being a private company.
    - The route of most Saudi Arabia’s oil tankers for the U.S. Market is via the Suez Canal onto Gibraltar. Therefore, **brent oil price (eventually also crude) could have spiked on the upside,** had the blockage lasted any longer.
    - Russian oil companies like **Rosneft and Lukoil should have** profited from re-route of Saudi oil and the oil price’s spike.

Cargo ship "Ever Given" blocking the Suez Canal

- It looks like the cause of the accident was human and not, as initially supposed, caused by a severe sandstorm.
- Apparently, according to most media, the vessel executed confusing maneuvers before getting the green light to enter the canal. In our opinion, this fact should not have influenced the actual passage through the canal, because port procedure is supposed to have command over the captain. Therefore, the event should not be a "Captain Schettino, the revenge!" chapter.
- The dilemma, whether a human failure or a natural event, is crucial to the insurance liability covering the cargo. In the case of a confirmed human failure, **the owner of the vessel "Ever Given", the Japanese company Shoei Kisen Kaisha, would be solely accountable for most of the damages?!**
- Market participants do not have the possibility to short the company Shoei Kisen Kaisha as it is privately held.

To summarize; the world has to realize, once again, that the supply chain is tense and the increase of such tensions can be raised by reasons other than U.S. sanctions.

In our analysis, **if the blockade had been prolonged (to upload the cargo would have taken months)**, the following possible interesting trades could have come into play:

- Be long oil (CRUD LN ETF) or Russian oil giants like Rosneft and Lukoil
- Be short the re-insurance company but, in this case, it would not have been possible to short Llyods Insurance
- Be short the mother company of the vessel "Ever Given" but, also in this case, that would not have been possible either.
- Other market disruptions (LNG market, cereal or metals) were insignificant.

Market’s new highs hand in hand with new leverage highs

- Very interesting chart from Mr. Brian Wälchli, where we can observe the market’s price development vs leverage.
- Today’s highs go hand in hand with new record levels of leverage. Historically, this has never been a healthy situation. Historically such situations were also combined with low liquidity levels by either retail or institutional investors. That is not the case nowadays.
- According to Mr. Christophe Barraud and latest BEA data, U.S. Savings also hit a new high to USD 1.755 trn, or 8.2% of nominal GDP.
- Taking into consideration that central banks have injected almost 3 times more capital than in the GFC (global financial crisis) 2008, we would tend to believe that markets still have potential. Nevertheless, the forced liquidation of the hedge fund Archegos, because of excessive leverage, throws serious questions about current risk management policy, not only by hedge funds, but banks especially.

Mr. Christophe Barraud/ BEA

Archegos Hedge Fund

- Market participants observed how U.S. blue chips like ViacomCBS, Discovery or Chinese blue chips (Baidu, Tencent, Vipshop) and Chinese education stocks plunged last week.
- The dramatic and flash correction was caused by the forced liquidation of the hedge fund Archegos (margin calls) and primary brokers (Goldman Sachs, Nomura and Credit Suisse) experienced massive losses. Apparently, USD 2 bn for Nomura and up to USD 4-5 bn for Credit Suisse (we are not sure, if Credit Suisse still has positions open).
- **Credit Suisse could face serious capital issues** still having pending the Greensill scandal and not being able to recover its total USD 10 bn exposure. Most probably, Credit Suisse will need to increase equity capital. It is not going to be easy to convince investors that the bank has a solid risk management system, neither is it mastering governance and compliance! It could be also the moment when, finally, UBS and Credit Suisse merge? Back in July 1997, SBG had to take over SBV. We are closely monitoring the situation, but we do not yet feel comfortable enough to sell puts and we are definitely not buying the stock.
- Because of recent events, like the GME saga, various short covering squeezes and the highest level of leverage ever, an investor can start to ask which other funds have such dangerous investment positioning? Was Archegos a single case?
- KTS strongly focuses on understanding the risk management policy of funds and is double checking its due diligence findings with other external counter parties. Like, for example, the fund specialist Prima Capital in Geneva, which has over 30 years experience in fund selection.
- **A crucial part of KTS' due diligence is the quality of management.** We all agree that any human being has the right of a second chance. But the failure of Archegos, given the manager Bill Hwang had already been charged in the past with insider trading, is the sad confirmation that such people are hardly going to change and are unlikely to learn from their own mistakes.

Archegos Hedge Fund

- The fund Archegos systematically built huge positions in single companies, in addition to using incredible leverage (apparently up to 10 times?). UCITS Lux structures actually help to avoid this type of risk. Many market participants do not like UCITS structures, because their exposure restrictions limit the upside but, on the other hand, they do reduce the risk of default.
- Our best in class fund Alkeon,for example, is a UCITS structure and has a solid risk management system. The biggest position in the fund has a weighting of 4% and most of the top positions are around 3% . In addition, the manager has to be able to sell the entire position with 1/4 of volume in one day. On the short side of the portfolio, the risk management system forces the manager to close any short position by 1/3 every 20% increase. Contrary to other strategies where adding further short positions, if the stock price is again the manager views, but fundamentals are unaltered.
- We are convinced that such an event is a one-off for the moment. The manager systematically invested via CFDs (contracts-for-difference) and derivatives in order to avoid disclosing positions above the 5% threshold limit and taking advantage of the resulting huge leverage. Analyzing the market dynamic during GME’s short squeezes, where other HFs were forced to reduce dramatically their own short positions, last week`s global markets remained positive. Therefore, we are not expecting further HF dislocation any time soon.
- The **real dilemma will be the longer term impact**: for example, are regulators going to change the disclosure requirements for certain derivative instruments, thus causing deleveraging? And do prime brokers need to tighten their supervision of leveraged holdings? In combination with the slide nr. 4, could this be a reason for any future market correction? We are going to monitor closely for further developments, especially because most HFs employ leverage (Citadel 8.1x leverage, Millennium 6.6x leverage!). At the moment, it is too early to draw any conclusion and markets are still not showing signs of tension.

Archegos Hedge Fund

- Our fund Fasanara, whose model is based on the chaos theory, is not invested in any long equity and has a small short position. Normally, this would be a sign for us to be cautious, but other volatility strategies are still not yet long volatility. Therefore, we do not have a strong enough conviction that a market correction is imminent .
- The HF Archegos also had a considerable position in the Chinese education stock GSX Techedu Inc and back in August 2020 we received research claiming that the stock was a fraud (https://grizzlyreports.com/Research/GSX-New.pdf). Probably market participants knew about the concentration risk of the HF Archegos?
- We sense that there are still insiders using privileged information, but the ways it can be used have changed. Nowadays, platforms like Reddit are the latest instruments to accumulate information. Rather than in the past via rumors in newspapers (with new regulations a journalist must communicate the source of his information in the case of being asked by the authorities). The recent short covering squeezes in Gamestop & other stocks are additional examples of how powerful players can injure important professional players. It is clear to us that such powerful moves were not only caused by a person using the Reddit platform and the focus of their trading was followed by an army of retail investors.
- Taking in consideration that we are in an environment of high leverage, we would not be surprised if, in the future, there will be other victims in addition to the HF Archegos. KTS mades sure not to have any concentration risk in our investment universe.

US Mint has sold out

- The US Mint has sold out of basic 2 ounce silver pieces and you cannot order one for future delivery. The premium is now 192% above the price traded at Wall Street. (Source Flowbank/Golden Coast Consultants also confirmed by theguardian.com).
- Again news of a **very tight silver market,** but the spot price is still following the gold price downwards, because of increasing real yields.
- How long is this situation going to last? Apart from the strong fundamentals for the silver price, the real trigger for more silver price upside potential would be a technical breakout above the resistance at 30 USD.
- If such breakout occurs, investors should definitely be long silver.

General news

- The leading Swiss economic indicators experienced a new high since 2011- reaching 117.8 points vs 104.3.
- The improvement in the reading underscores vaccine optimism and the positive outlook towards second quarter 2021.
- We are quite surprised at such optimism with the rest of Europe still in lock down. But, it does make sense to expect a normalization around third quarter of this year. Access to a vaccination is progressing everywhere with some governments, like Denmark, being more flexible than others and ready to re-open as soon as all citizens over 50 have been vaccinated.

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