KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 18

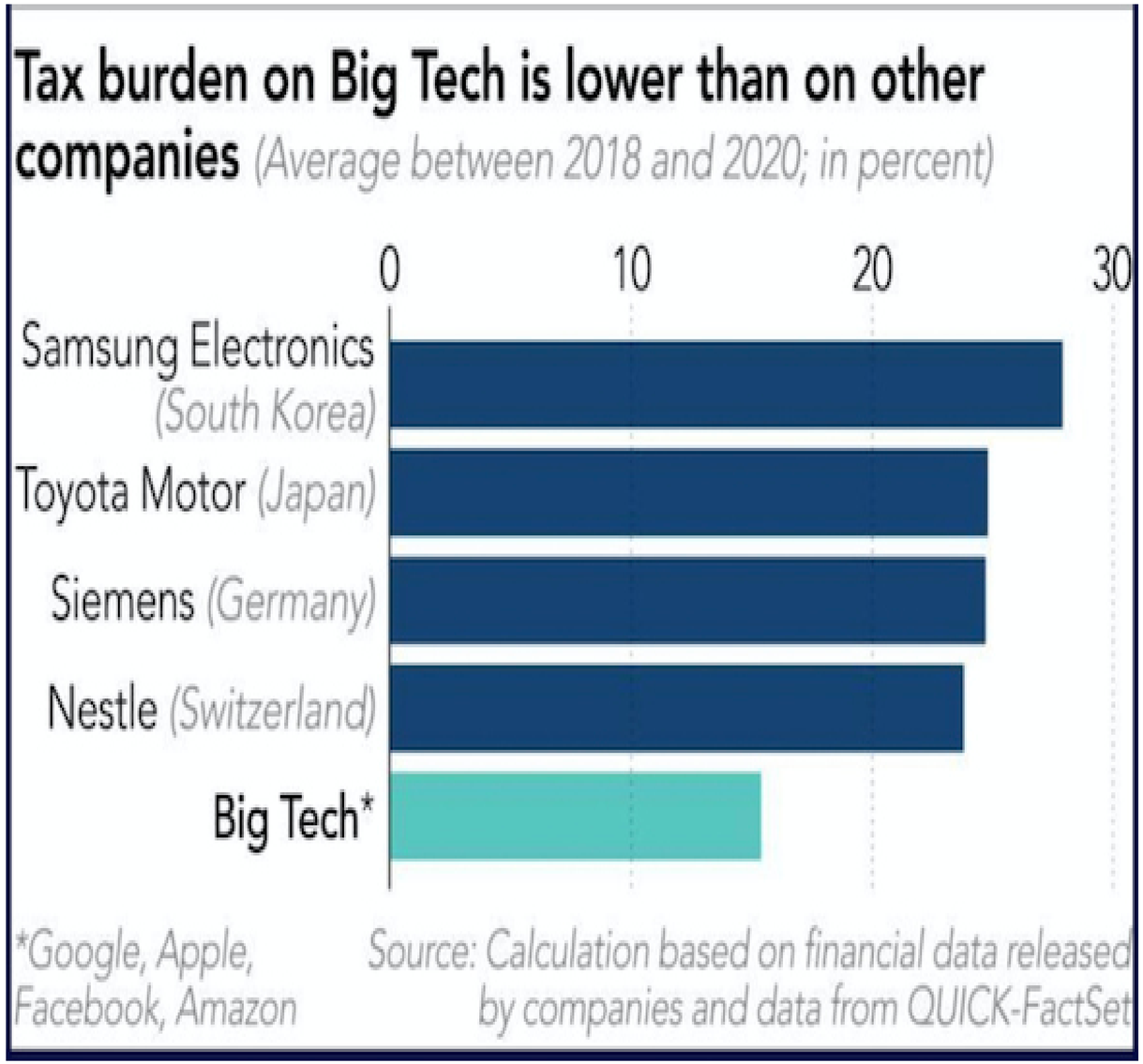
The 21st of May 2021

Inflation

- The economist, Mr. Alessandro Fugnoli (writer of the weekly “il rosso e il nero”), explained in his last report that the hyperinflation phenomenon in Germany started in 1922; and in1925, as a result of final debt’s restructuring, creditors recouped just 2.5% of the initial value, losing basically everything.
- He is also explained that in Turkey (inflation rate 17.1%), the government allows citizens to have an USD account, in order to keep the money in the country. Similarly, in Venezuela the price of real estate transactions is fixed in USD, in order to neutralize the inflation effect of the Venezuelan peso (inflation rate 3’012% !). In Argentina the inflation rate is at 42.6%, Brazil 6.8% , Mexico 6.1% , Russia 5.5% and Saudi Arabia 4.9% . On the contrary, Japan is still suffers from stagflation with inflation at -0.2%. Inflation in Switzerland is 0.3% (but health care costs constantly increase at a higher pace, as does the price of the most important goods), HK 0.5% and Portugal (!!) 0.6%
- But, the most important observation in the report is the fact that if global inflation is over 3%, let`s say even 5%, and in the U.S. from next year capital gain taxes will be 50% a **portfolio needs to return at least 10% p.a. in order to neutralize the inflation impact on wealth**! Analyzing today’s investment vehicles, it is clear to any investor that there are not many asset classes which provide such upside potential! Liquid real assets with such potential are equity, gold and silver, all of which should protect against inflation over the longer term (as suggested in our last report). Of course, real estate and diamonds, though illiquid, should also help to protect wealth against inflation.
- In our opinion, Mr. Fugnoli is absolutely right and we would argue, as we have before, that the application of MMT is helping the economy in the short term. But the longer term (inflationary) impact is that the purchasing power of most of citizens is going to suffer massively (pension plans over 20 years are going to lose around 1/3 of their purchasing power).

Tax treatment of multinationals

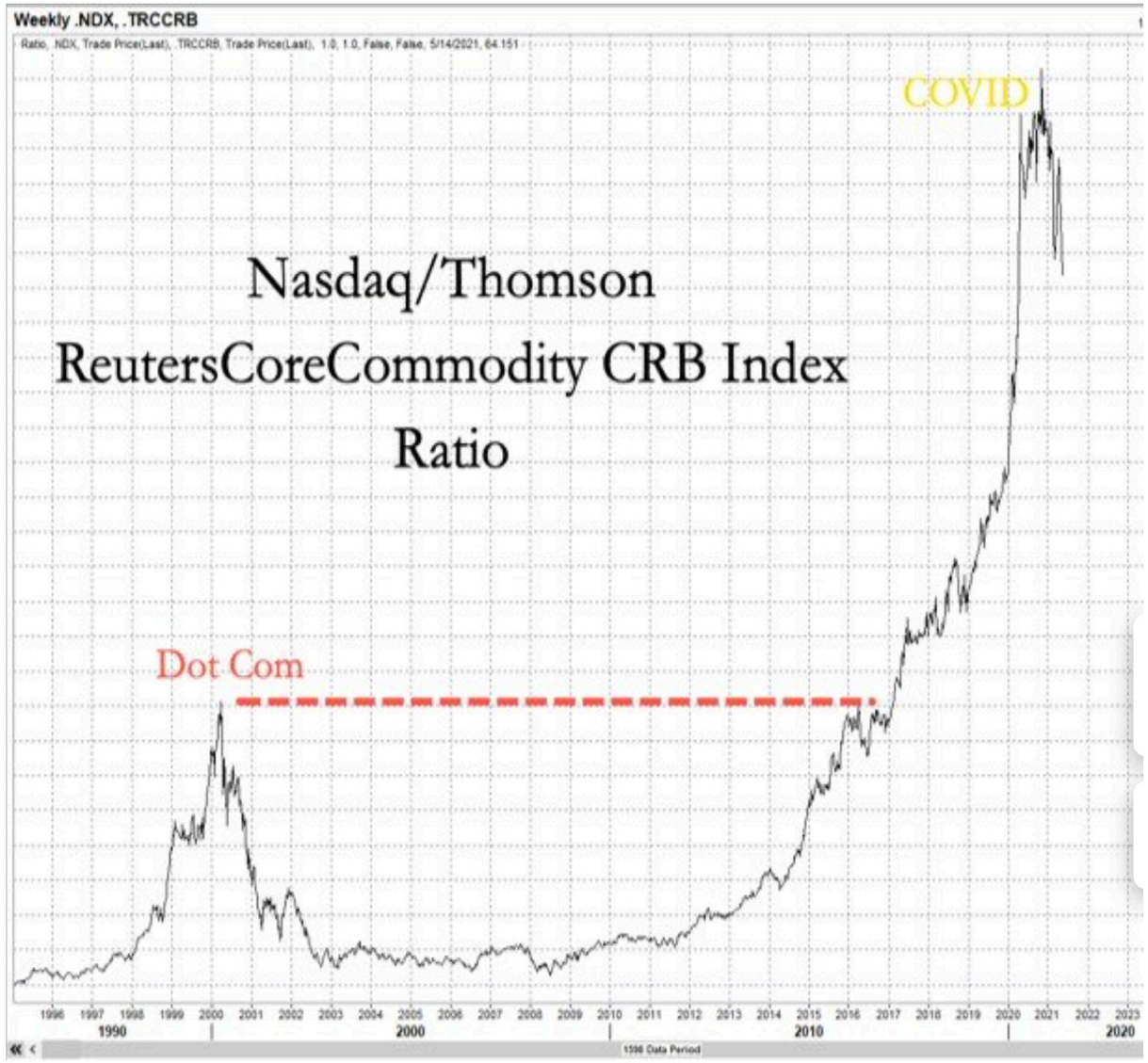
- After the Biden administration proposed an international minimum tax regime (15%?), the debate about multinational tax treatment gained traction worldwide.
- As argued in the past, **FAANGS and big tech giants are going to suffer the biggest negative EPS's impact, which could be reduced by -8% pa.** But, if the minimum tax was only 15%, the impact would probably be less.
- The attached chart shows how big techs are paying on average around 12.5% pa. in taxes vs an average above 20% for traditional big companies.
- The chief strategist David Kostin, of Goldman Sachs, is of the opinion that the S&P 500 Index has little upside potential going forward. One of the main 3 reasons for his opinion is the fact that analysts have still not implemented negative revisions for 2022 EPS due to higher taxes. The other reasons are decelerating US growth (we do not agree, because infrastructure packages are under way and we are in undersupply) and a real rate-driven rise in interest rates.



Source: Flowbank, Quick-factset

Technology against commodities

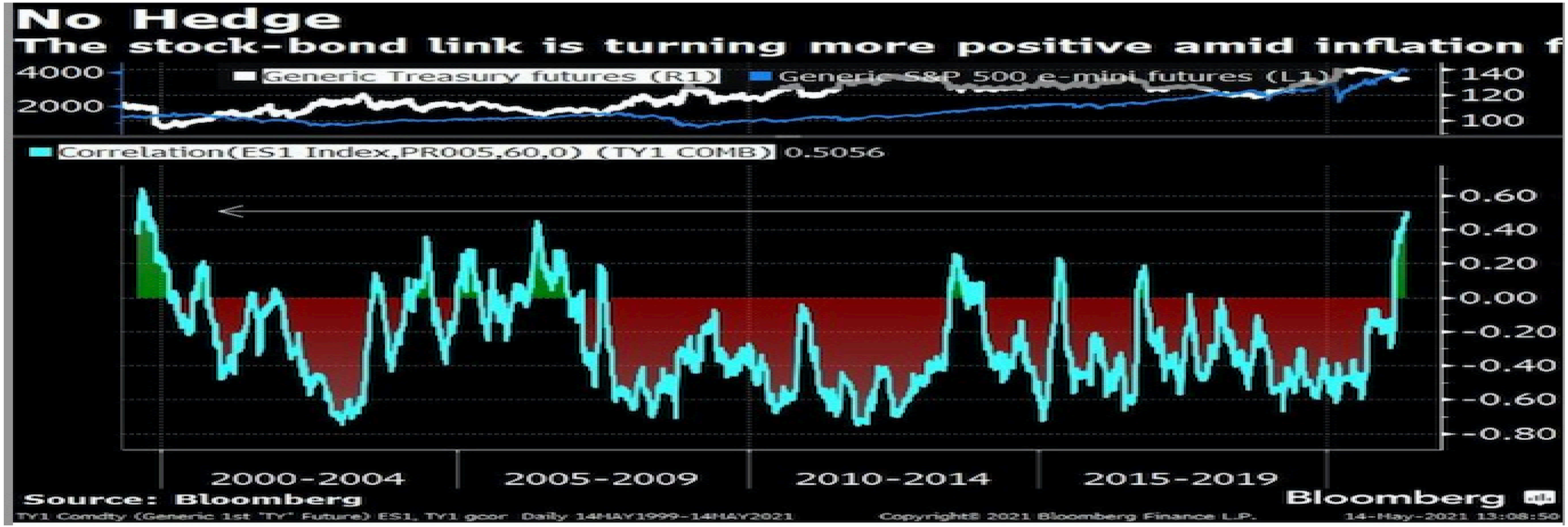
- Interesting chart, whereby market participants believe we could be at the inflection point between Technology vs commodity stocks.
- We believe, with the renewable mega trend, specific companies in the commodity space still have more upside potential than the tech stocks giants. We are invested in some special situations and also in our best in class commoditiy fund Bakersteel Electrum. As well as investing with our energy/ commodity/renewables expert.



Source: Flowbank zerohedge.com

Correlation

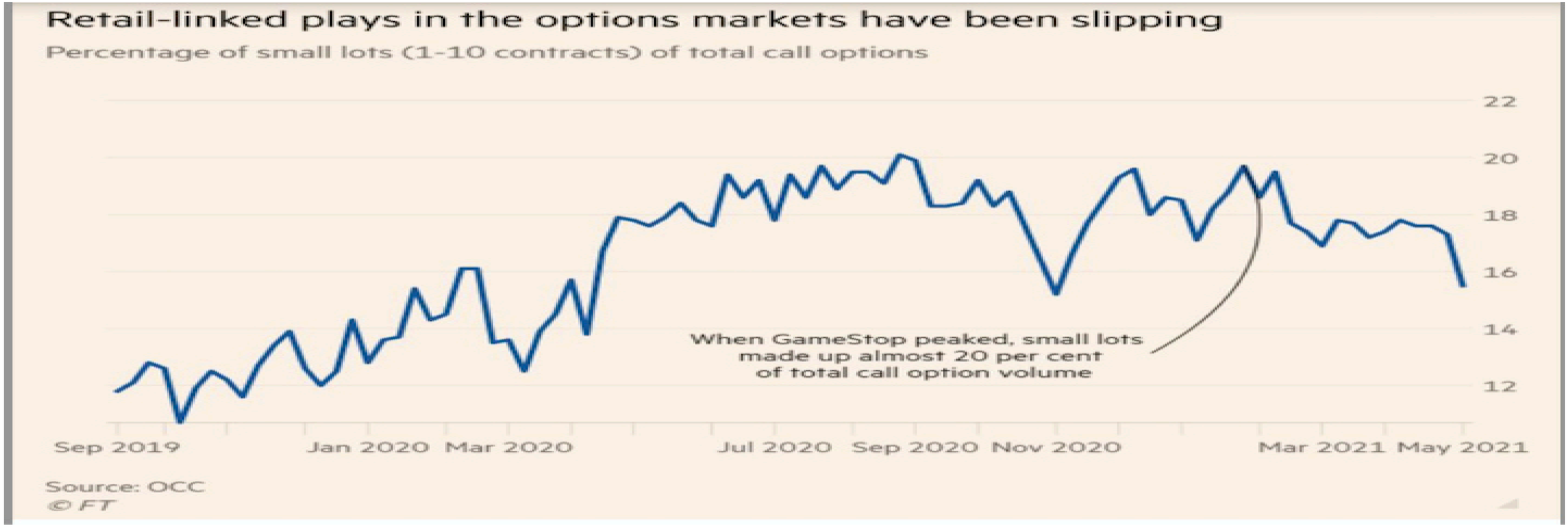
- Mr. Ritesh Jain has produced a very important chart, which is also the basis of the KTS investment philosophy. The correlation between Treasury and S&P 500 index futures is the highest since 1999. We also recently noticed the increase of this correlation, when market participants were fearful about higher inflation, whereby basically equity and bonds moved together.
- **For years now, KTS is systematically diversifying the asset allocation with various strategies, not asset classes.**



Mr Ritesh Jain / Bloomberg

Retail investor

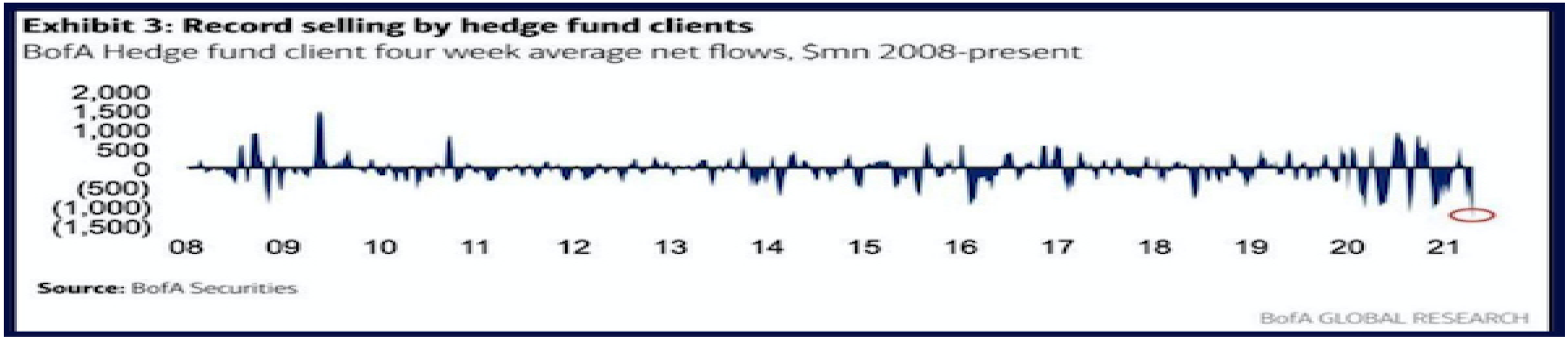
- Our biggest worry for further market strength is the possible decline in trading activity from retail investors, once they have returned to work. The US is enjoying an advanced normalization process and retail trading activities are already back at the levels of November 2020, when the strong market rally started. Main market indexes are actually still at their highs, which is a positive sign. But, on the other hand, hyped renewable stocks have already corrected by 60% on average with SPACs -30% .



Source: Valérie Noèl, Head of Trading at Syz Group / FT, Piper Sandler, OCC

Hedge funds equity exposure

- Hedge funds have recently been reducing their long exposure to equity markets at the fastest pace since 2008, according to BoFA.
- Normally markets tend to follow the “smart money” and this sign should be bearish.
- In our opinion, it is actually very difficult to have a clear idea, because markets are holding well at their highs. Despite retail trading activities now back to normal and heavy equity sales from HF`s. Therefore, we would have expected a stronger market correction, which has not yet happened, or has partially happened in the hyped stocks especially beloved by retail investors.
- Stock markets are in the weakest performance period of the year and even after most of companies had results well over analyst expectations, markets appear to lack the power to rally further. **We are probably going to experience a sideways market for a while. KTS is trying to be opportunistic in some special situation stocks and retains 15 to 20% in cash.**



BoFA, Flowbank

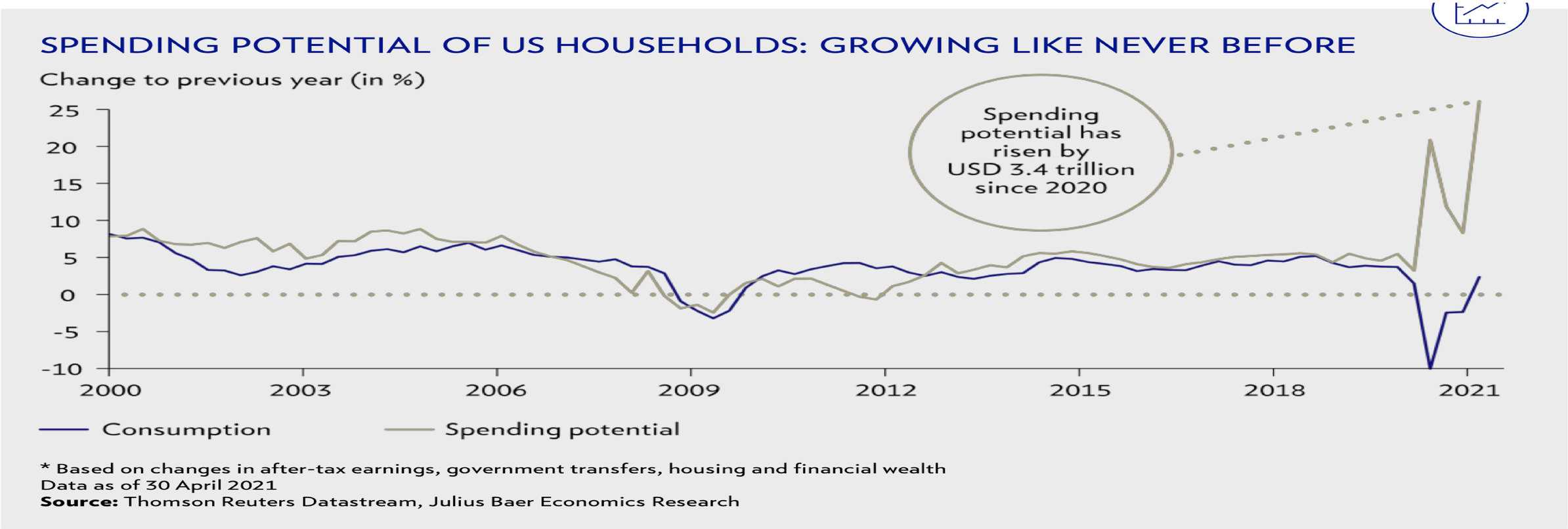
Share buy back programs and dividends

- The chart on the right side shows the increase of cash on the account of S&P 500 companies on a quarterly basis (almost USD 2 trillions).
- US firms have authorized USD 504 bio of share repurchases, according to Goldman Sachs, and many companies have increased dividends dramatically.
- This is the natural hedge of the market, which is forgotten most of the time by the majority of market participants. Such a massive increase in share buybacks is automatically providing a decent level of support to prices. Companies are going to continue to buy back their own shares on any dips.

CASH AND EQUIVALENT holdings among S&P 500 companies (Flowbank)

US households' Savings

- In its latest market outlook, Julius Baer is still bullish on equity markets and still anticipates a strong global economic recovery. They remain focused on sector rotation and ESG. But, especially, they are long small caps, which they feel should profit the most. Consumption is responsible for 70% of their growth and US household spending potential has **risen by USD 3.4 trillion since 2020, meanwhile in 2008/2009 recession, it fell by USD 347billion.**



Source Julius Baer: the total of US personal savings USD 4 trillion, used to be 1 month ago almost USD 5 trillion, is around 20% of the US GDP!

Crypto currencies news

- The Spanish stock exchange is testing its blockchain infrastructure, based on Ethereum technology, to finance small and medium sized enterprises. The main goal of the system is to allow smaller companies to raise capital outside the traditional banking system where, nowadays, it is very difficult to obtain loans. As argued in the past, **Ethereum technology is the base for future innovation** as it helps to simplify and speed transactions and also reduces costs (reducing the endless bureaucracy) by automatizing still rudimentary systems. The big dilemma is to quantify the real value of Ethereum, not whether the technology is going to survive in its development. It does not come as a surprise that bitcoin is losing dominance in the crypto space. Because having various crypto technologies has become an integral part of innovation in different fields.
- The fact that the Chinese government implemented new restrictions related to the crypto market (see slide nr 11) is not helping to estimate an accurate valuation for Ethereum.
- **Grayscale Trust** used to have a 40% premium over the bitcoin price at the end of 2020. Now is at a 20% discount. If an investor compares the performance of Grayscale Trust vs bitcoin's price since December 2020, the underperformance is over 100% . With the new cost advantages of ETF alternatives, market participants are discounting Grayscale's high fees from the price, **therefore the discount is justified and this is not an attractive entry point.** The Swiss provider 21Shares, for example, offers better investment vehicles in the crypto space, in addition to the fact that many Swiss banks do not accept Grayscale Trust in their portfolios, being a trust structure and not an ETF.

Crypto currencies volatility due to tweets

- The tremendous volatility in the crypto space was initially caused by the tweets of Mr. Elon Musk.
- Mr. Elon Musk initially failed to deny that Tesla had sold, or may sell, all its Bitcoin holdings. But, apparently confirmed on the 19th of May that Tesla still owned the initial position of USD 1.5 bio. Analyzing step by step what happened, it is quite clear to us that any move was meticulously calculated with the final goal to enrich himself. It is a shame that such a great visionary is manipulating the market in such manner and with such an egoistic goal. In our eyes, he has definitely lost all his credibility, which is going to have repercussions on the image of Tesla, SpaceX and any other projects that Elon Musk is, or is going to be, involved in.
- In our opinion, bitcoin is developing a long consolidation phase but, it is not yet a safe asset class because of its price volatility caused by some market participants manipulating the market. Cathy Wood also gave an interview confirming the target of bitcoin of 500k USD. From a mathematical point of view, even USD 1 mio target is possible, but the arguments given by such market participants were not convincing in our opinion.
- In our eyes, these market forecasts are not serious, because some influencial investors are abusing of the fact that the crypto market is not regulated. Dogecoin is the example par excellence.
- For this reason again, we are of the opinion that precious metals offer a more preferable long term attraction. Therefore, we expect **gold to shine again. Silver even more so, due to the fundamental support of the renewable mega trend.**
- On the other hand, such volatility and ineffiecincy between crypto trading platforms is offering great arbitrage opportunities to teams with highly specialized infrastructure and skilled staff. We stay invested in our Fasanara Crypto Arbitrage Fund.
- New regulations in the U.S. Is going to be introduced, whereby crypto transfers over USD 10k need to be reported to IRS.

China ban crypto currencies

- It looks like Chinese regulators have tightened restrictions- now banning financial institutions and payment companies (banks and online payment firms) from providing services related to cryptocurrencies. Some bans were already introduced in 2017, but it now it looks like these new regulations make it clear that institutions must not accept virtual currencies, or use them as a means of payment and settlement.
- Nor can institutions provide exchange rate services between cryptos and the yuan or foreign currencies. Authorities added that institutions were prohibited from providing cryptocurrency saving, trust or pledging services and issuing crypto-related financial products. Virtual currencies must not be used as investment targets by trust and fund products.
- Basically, after the introduction of the digital Yuan, we are having the first clear answer as to how the Chinese government is accepting the crypto currencies space and, basically, there is no acceptance. How are other governments going to react?
- We get back to the dilemma we discussed on slide 10. Perhaps there will be no acceptance of crypto as payment service in many countires. But, blockchain technology is developing much further than just being a payment service. There is no doubt that it is the key and the base for the next innovative step in automatization, 5G, robotic, machine communication, smart services, etc. Therefore, blockchain technology is not going to disappear and has a value, but against which intrinsic value is another question.

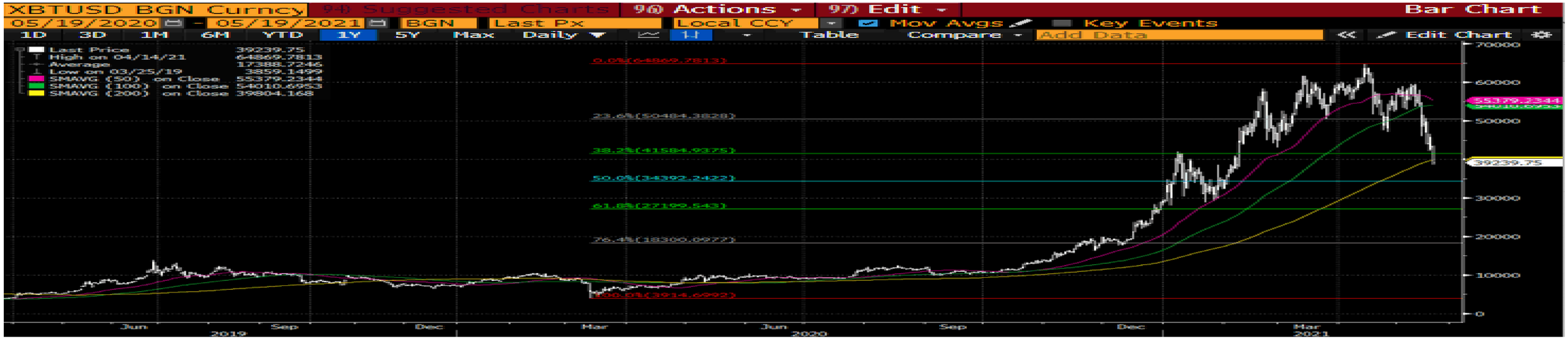
Gold vs Bitcoin

- After Elon Musk's recent comment, we can understand the frustration of investors in the crypto sector. Mr. Elon Musk, in our eyes, abused his credibility to enrich himself. Such activity would not be possible on equity markets, but the crypto space is not under the supervision of the authorities, therefore, everything is allowed.
- The chart on the right side shows the relationship between gold and bitcoin. It looks like we have reached a turning point, people are no longer selling gold for bitcoin, on the contrary.
- The gold price broke out of the 1850 USD downside line. Therefore, we see more upside potential. At the moment we still do not hear many market participants talking about gold. On the contrary, everybody is still talking only about dogecoin, therefore, the gold breakout is still not over crowded and has more upside potential. The gold equity space has the most attractive valuations in the whole equity asset class. We like silver more, it having support from the renewable mega trend, in addition to other fundamentals (money printing, inflation, etc.)

Relationship bitcoin vs Gold since 2018 (source all star charts)

Support level for bitcoin's price

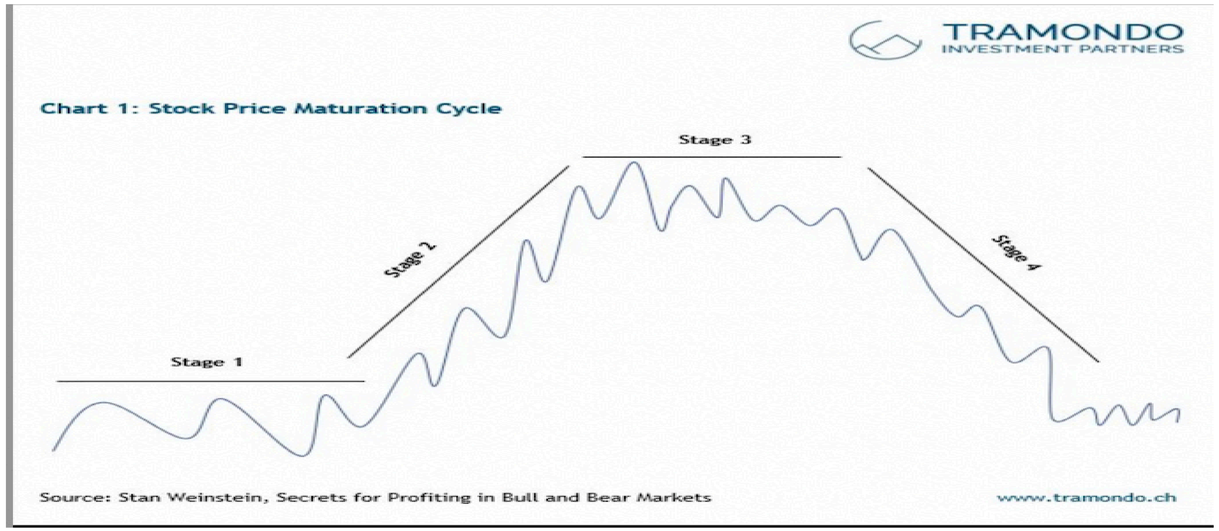
- KTS sold the crypto currency position a while ago and if, initially, it was looking too early, it was a great timing in the end. A wealthy investor explained to us once that his best deals in life were when he thought he sold too early. We are still invested in the crypto arbitrage fund, which is performing very well, plus almost 10% per month, and is market neutral (+3.7% in May so far).
- We are trying to figure out a support level for bitcoin. The first support is actually now at the 200d moving average, followed by the 50% Fibonacci retracement at 34'392. But, as traders use to say, **"never try to catch a falling knife"**. It is better to wait for a solid consolidation, especially because the strong breakout was at 20k USD. Therefore, from a pure technical analysis point of view, this would be the potential final retest of bitcoin. In-between trading is possible, but we feel that this is more of a lottery.
- **Retail investor's wealth has being wiped out by automatic stop losses selling out leveraged positions.** Therefore, their participation has disappered. Long term institutions are accumulating, but we feel that alone is not enough to trigger new highs.



First support for bitcoin 200d, followed by 50% Fibonacci retracement, but the real retest is at 20k USD

Maturation cycle

- The company Tramondo Investment Partners AG explains very clearly in 2 charts the typical phases of hyped stocks. We feel that bitcoin, ARKK US and many other hyped stocks in the renewable sector are in a stock price maturation cycle and ultimately are going to succumb to the reality of lower valuations.
- The first phase is the “basing area”, which was during 2020. It is followed by the “advancing phase” (from November 2020), reaching the top area or unsustainable valuation (February 2021). Finally, the declining phase or capitulation, where we are nowadays.
- If an investor would like to trade in this phase, they should first of all only buy on dips and secondly be very disciplinated with strict stop losses and sell at price targets of +10/15% .

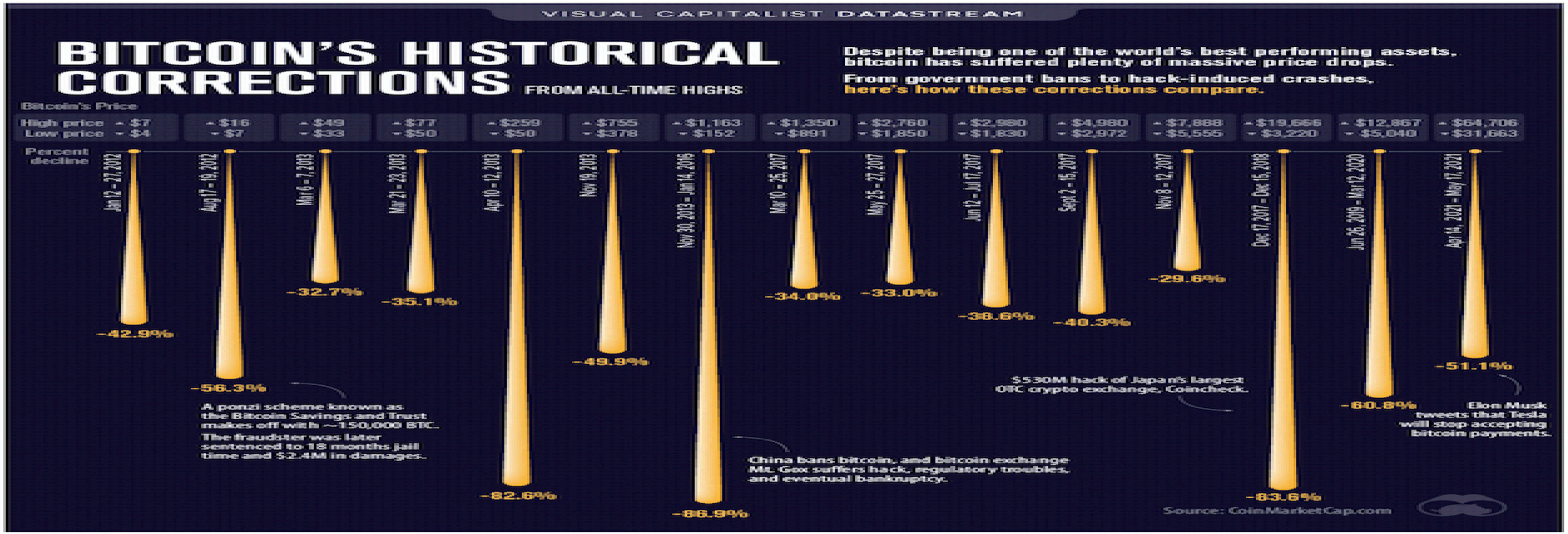


Typical cycle of hype stocks, which end in maturation cycle (source Tramondo

Actual example the stock ARKK US

Bitcoin’s historical corrections

- The bitcoin’s price corrected around 50% from the highs and had a nice rebound around the 50% Fibonacci retracement.
- It could be the first level for trading, but we feel that the price does not have enough triggers for a sustainable rebound.
- During the price action of the 19/20 of May, retail investors have been wiped out, whilst long term institutions accumulated positions, but that does not mean we are experiencing a trend reversal.



Historically, bitcoin also lost more than 50%

Bitcoin's historical corrections

- The additional chart below should help to provide an idea of what followed in the past after such a tremendous correction.
- Basically, from 2016, after bitcoin had corrected with such magnitude, it rebounded; except during year 2018.
- We feel that today`s situation is comparable to the year 2018 The biggest upside move has now been completed and bitcoin is going to build a consolidation base, over time. Retail investors wealth has been wiped out and that demand is not coming back.

After the bitcoin's hype in 2017, the correction at the beginning of 2018 wiped up retail investor's wealth and we experienced a longer consolidation phase

Precious metals Junior miners are attractive

- Very interesting chart from the fund manager Otavio Costa, of macro fund Crescat Capital. We can see that, whilst the precious metal large caps have already reacted to the rebound of the gold price, junior miners have not yet done so.
- Having precious metals and commodities prices rallying again suggests that the sector should now enter the second phase; whereby investors are going to search for attractive mid and small stocks. KTS is already well positioned in the segment.

Junior Miners underperformance vs Newmont Corp (source: Crescat capital)

Electric car's market

- During 2020 in Norway more than half of all cars sold were battery powered electric cars. This is nothing new actually. But, interestingly, Audi's e-tron vehicle is the most sold EV, followed by Tesla. This is the proof that German car quality is still appreciated and sought after and the potential for VW should be enormous, going forward.
- The Chinese electric car producer Nio will also enter the Norwegian market. It is actually not a coincidence that Norway is the first market outside of China to be the fastest growing market for EVs.

General news

- On the 20th of May, U.S. Lawmakers announced their plan to introduce tax credits for lower-carbon, sustainable aviation fuel, which they hope will slash emissions of greenhouse gases from the aviation industry. This is the perfect music for GEVO US.
- From the FOMC's April meeting, Federal Reserve officials stated that improving economic growth could justify a discussion about interest rate policy. Saying that it might be appropriate, at some point, in upcoming meetings, to begin discussing plans for adjusting the pace of asset purchases. We suspect the FED is trying to talk down the market's current euphoria, but we believe we are a long way from this becoming policy. Therefore, we are not worrying about a sudden move against the markets from the FED. The market's reaction to the announcement confirming this viewpoint. In addition, FED is talking about tapering bond purchases not increasing interest rates.

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