KTS CAPITAL MANAGEMENT

KTS weekly update Nr. 7

The 4th of March 2021

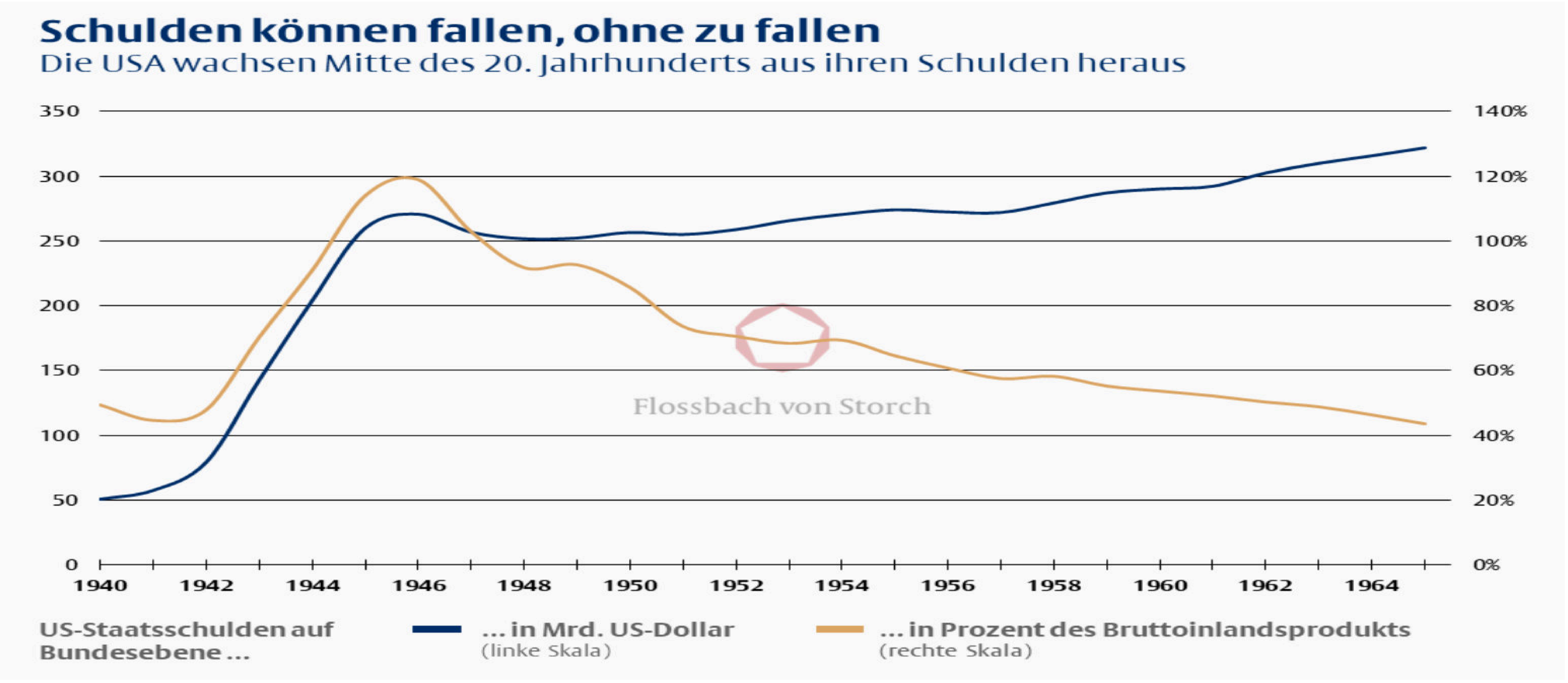
Collapsing Bond market?!

- The bond market recently experienced a strong correction due to higher inflationary expectations. The US 30-year bond total return is YTD -14%, which implies one of the worst corrections since 1974.
- As already explained on many occasions, we retain our long term view, especially after the FED speech of August 2020, that interest rates are going to remain low for longer. Governments intend to reduce their huge indebtedness via higher inflation and higher economic growth combined with lower interest rates (negative real yields). Therefore, we believe that inflation worries are overblown.
- As also explained over the years, KTS reduces duration risk by investing the fixed income part of the portfolio mainly in short term duration factoring or direct lending strategies. Our fixed income allocation is growing constantly on a monthly basis and has not been negatively impacted by recent bond market corrections.

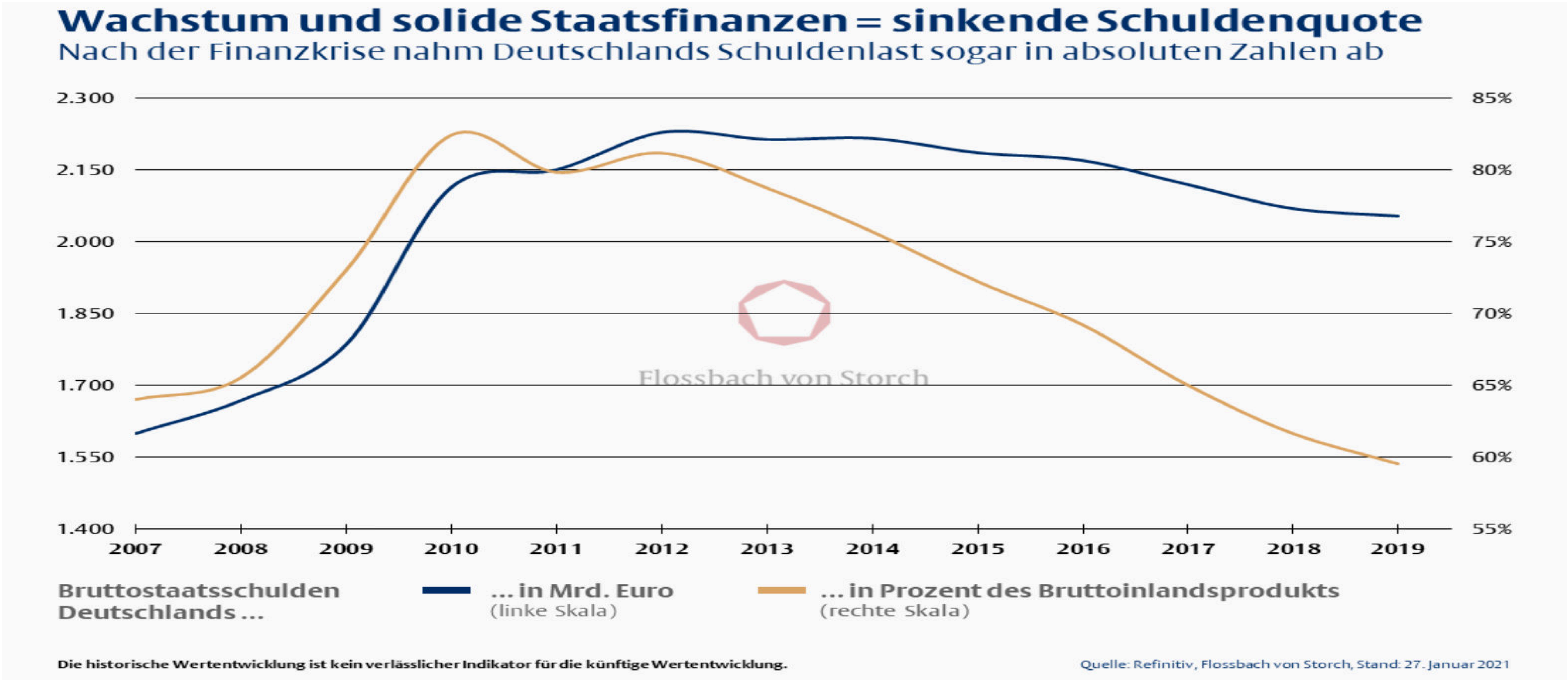
One of the worst bond market corrections since 1974 (source Arbor / Flowbank)

Future repayment of high government’s indebtedness

- Our best in class fund Flossbach recently showed a chart showing the reduction of U.S. Government debt after WW2 with the title:`debt can fall- without falling`.
- In fact, after WW2 the US debt was dramatically reduced as a percentage of GDP (from 120% to 40%) but in absolute terms its volume increased!
- A similar comparison can be made for Germany after the financial crisis of 2008: the debt in percentage to GDP felt from over 80% to lower than 60%, meanwhile the debt in absolute terms stay almost unchanged.



U.S. Government debt reduction after WW2 (source Flossbach)



German government debt after the global financial crisis (source Flossbach)

Around USD 5 tn is still sitting in money market funds in USA

• Post Covid, the invested wealth held in money market funds in the US increased by USD 1 tn. In the past, the yield available used to be up to 4%, but after the FED dramatically decreased interest rates money market funds now yield 0%. This is not going to change anytime soon. 56% of this wealth is owned by US households. What is going to happen to this tremendous amount of money once we return to `normality`.

Source: financialresearch.gov

U.S. savings

- On the other hand, U.S. savings now exceed the longer term average of USD 1.5 tn (USD 2.9 tn totally post covid).
- The “tricky” question is: how much of this capital is already invested in the equity market? Especially penny stocks, IPOs and SPACs? In case of normalization, this excess is going to be spent on consumer items, traveling and entertainment. Does it follow, therefore, that equity markets are going to experience a tremendous outflow!?

Source Bloomberg / Mr Christophe Barraud

Tremendous spike in physical deliveries of gold and silver coins

- Gold and silver have recently experienced a tremendous spike in physical deliveries. The magnitude of the spike has never been seen before!
- Private collectors (and also many young people) are buying based on historical passion. Therefore, they are not going to sell soon.

Source: Garrett Goggin, World Gold Council

Bitcoin's liquidity

- According to the assessment of Glassnode, an analysis firm that tracks blockchain data, there are only 4 mio bitcoin freely circulating right now.
- This is the consequence of institutional and tech companies buying bitcoin with a long term strategic view and, therefore, not selling on short term corrections. According to experts, this could lead to a massive supply squeeze soon...

Source: Coindesk.com / Glassnode

Bitcoin mining earnings

- And we should not forget the revenues of bitcoin miners: latest USD 1.36 bn monthly revenues are the highest ever.

Bitcoin Mining monthly revenues USD: coindesk / Flowbank

Citigroup research on bitcoin: bitcoin is at a tipping point

- Citigroup just issued some interesting research on bitcoin and the main points are:
  - On the question does bitcoin now have mainstream acceptance or is it more of a speculative implosion? Some comforting statistical data is confirming that bitcoin is showing growing levels of adoption:
    - 36% of small-medium business in the U.S. accepted bitcoin in 2020 (impressive number actually and we are also surprised, source: HSB).
    - In addition, USD 536 mio (+55% in 2020) of bitcoin volume traded in South Africa and Nigeria in the month of August 2020 (Source: Reuters).
    - We would argue that the increasing volume in Africa is a clear consequence of U.S. sanctions via the central Swift payment system. But also a new and cheaper way for African citizens working outside the African continent to send money home other than by Western Union. Finally, the fact that for European banks the list of restricted or banned countries with which opening accounts, or processing payment transactions is permissible, is getting longer and longer!
    - Bitcoin OTC trading volumes in early 2020 were USD 20 billion per day (volume of crypto currency transactions is the source of revenue for miners). Source: Hacker Noon
    - USD 500 bn crypto exchange volumes in the first 3 weeks of 2021, twice the volumes of 2017-2018 (source Coindesk).
    - Institutional interest in bitcoin accelerates, especially because of the current low yield environment and inflationary expectations. And, increasingly, the institutional investor view that bitcoin could represent an inflation hedge, portfolio diversifier and a safe haven not currently offered by traditional government bonds.

Citigroup research on bitcoin: bitcoin is at a tipping point

- 1.7 bn adults are unbanked (adults without an account, 2017)
- Bitcoin is more regulated so drastically less used for criminal enterprises. Certainly there are still obstacles to surmount, like capital efficiency, insurance and custody, security and ESG considerations from bitcoin mining. Apparently security issues with cryptocurrency do occur, but when compared to traditional payments it performs better. This is quite surprising, honestly, but we have to admit that there is also still a lot of fraud in the normal payment system!
- The adoption of Paypal, Visa and Mastercard is the recent proof that bitcoin is seen as a payment option and subsequently has moved to the mainstream, especially for millennials.
- As mentioned, the monthly cryptocurrency transfers to and from Africa of under 10k Usd (typically made by individuals and small businesses) jumped more than 55%, according to Chainalysis. With several US sanctions and European bank compliance barriers, bitcoin is the only option with which to pay capital to their native African countries. Africa is not the only continent. US sanction, which strongly influenced also European bank compliance, banned many other countries.
- Crypto-based savings accounts yields 4 to 8% compared to negative interest rates paid on bank accounts.
- Crypto lending and borrowing: those who choose to borrow are able to use their existing bitcoin or other altcoins as collateral to secure loans.
- Digital gold: bitcoin can be mined, has limited supply and, therefore, is a store of value vs the huge growth in U.S. money supply.
- The bitcoin infrastructure is now robust and satisfies, although still not fully, institutional requirements. There are now investment opportunities available to institutional investors, which normally apply a buy & hold strategy reducing further the supply of bitcoin.

Citigroup research on bitcoin: bitcoin is at a tipping point

- Having institutional investors in the space as well as regulatory announcements, will help to provide more certainty to established firms.
- Mapping the future: bitcoin may benefit from the broadening use of blockchain technologies and fiat currency stablecoins create more interoperability between ecosystems.

On general news about bitcoin, we would like to mention the risk of increasing UK's capital gains tax. Which, if so, is also going to have implications for crypto users and miners. The news that Paypal is interested to buy crypto custody firm Curv confirms the seriousness of Paypal building their own crypto platform.

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