KTS
CAPITAL
MANAGEMENT

COVID-19 analysis

As per 24 March 2020

What markets are discounting, after a correction of 30%

- Markets decline is pricing a 90% probability of a recession.

- Most of analysts are comparing valuation with the year 2008 and see P/E at 14x with EPS for S&P500 Index at 152 USD. Translated to the index S&P 500, the support should be at 2’300 points. KTS is of the opinion, today’s situation is not comparable with 2008. The financial crisis was a failure of the financial system, banks are the heart of the economy and everything was ”frozen”. TODAY THERE IS NO SIGNS OF SYSTEMATIC RISK.

- Some other Macro analysts compare 2020 to 1987. The magnitude of the correction is quite similar (-33%) and the P/E ratio derating also. We tend to agree, therefore in our opinion, the market downside is slowly at is peak (also the VIX Index was over 80%, like the top during 2008). Markets are now trying to stabilize.

Central Banks, Governments and politicians

- Central Banks never reacted as such speed and magnitude. This is very positive and give confidence, as FED mentioned, Central Banks going to do again ”whatever it takes” to keep the financial system efficient and avoid a “frozen” situation like 2008.

- New liquidity ”pumped in the system” is new, fresh money ”out of nothing”. This is a new QE and when (not if!) the US stimulus package is agreed, we can argue, finally the so long discussed helicopter money, or MMT, is injected in the system.

- ON A LONG TERM PERSPECTIVE THIS MEANS INFLATION and actually new highs for markets.

What markets need to turn bullish

- The current correction was unprecedented:
  - in less than 20 days, markets lost more than 30% .
  - During 2018, markets lost 20% in 3 months.
  - By the crisis of 2008/09 -56.8% in 16 months and 2000/03 -49.1% in 29 months.
  - 1987: -33.2% in 2.5 months.

- With such fast and dramatic moves on the downside, there could be also a V surprise on the upside? Investors experienced during 19/20 March 2020 tremendous amount of margin calls, where also Gold and Bonds were sold massively. We could perceive such dramatic days as capitulation day.

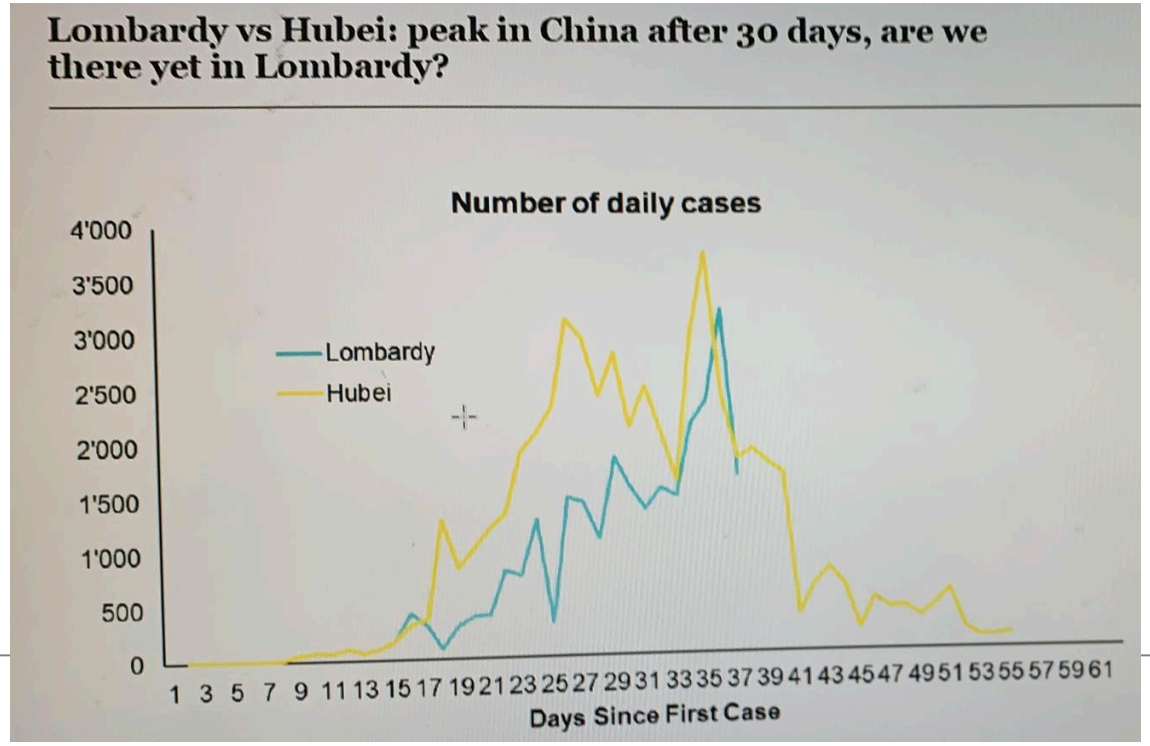
- Analysing our best in class Funds' asset allocation, most of them are hedged for at least half of positions and most of them via Futures, not options. That means, as soon investors are confident, the worst is over, the "first leg up" of markets is only for short covering in the same magnitude as it corrected. We can expect +20% only from short covering, afterwards during Q2 2020 a constant increase, based on the new outlook of companies.

- China, South Korea, Taiwan, most of Asia are over the peak of new cases and monitoring Chinese flight traffic, as also mobile movements, China is back to 77% of its productivity and official forecasts expect 100% by the end of April 2020.

- Eyes are now focussed to Europe and especially USA.

First positive signs in Europe

- Lombardy, the epicentre of the COVID-19 in Europe, had the first drop in new cases.
- It is fair to compare Lombardy with Hubei, where after 35 days the worst was over.
- Hubei has 80’409 accumulated number of cases, over a population of 58.5 million. KTS just take the official numbers and is not in the position to argue the credibility of those numbers. But analysing the mortality rate in Italy, taking into account the older average age of the Italian population, also for KTS, the official Chinese statistic numbers are questionable.



Datas from Vontobel

Worldwide mortality rates and historical events

- Independently from Chinese statistic, it is generally proven, that children are not dying and fatality rate among 40-49 year olds is 0.44% compated to 14.77% for people over 80. Those statistic numbers are confirmed around the world, not only China.
- The infection rate in China with a population of 1.4 billion people is 0.007%
- The number of people every infected person infects, has been lowered to 2-3.
- A seasonal Flu in US infects around 36 to 51 mio people with 22/55k deaths.
- H1N1 in US had total cases of 60.8 mio with 12k deaths. The H1N1 pandemic was overshadowed by the Global Financial Crisis.
- We are also of the opinion, to compare this COVID-19 event with the Spanish flu in 1918 are gross exaggerations.

Therapeutics, Medicaments or vaccines

- Encouraging news from approved medicaments, used to treat malaria, flu, and arthritis; apparently they help to recover faster from COVID-19. Chinese doctors confirm the efficacy. It looks like, AVIGAN medicament is the most efficient. https://www.theguardian.com/world/2020/mar/18/japanese-flu-drug-clearly-effective-in-treating-coronavirus-says-china

- Also encouraging news for vaccines, for which trial tests has already started and first approvals could be at the end of Q3 2020 (CureVac of company Moderna).

- Analysing the speed of approval of FDA for existing medicaments in other fields, we are confident, more positive news from tests going to support markets, especially to "calm down" the hysteria of the population and to come back to normality as soon as possible.

- We do not agree with the argument that people are going to be scared over longer period of time. The best example is 9/11 event: immediately after Sept 11, 2001, Americans were afraid to fly and preferred to drive, which could be a fatal error, because driving poses a greater risk of deadly accidents than flying. BUT time, not even 2 months, has helped some people's fears to fade. The writer Robert Cialdini explain very well in his book "The psychology of Persuasion", how people can forget event quickly.
- We certainly hope that the world will learn something important out of this pandemic event and be more sensitive especially on hygiene. Cleaning your hands all the time is actually not only hygienic, but a sign of respect to others.

Conclusion

- Taking in consideration, that Italy, but also Switzerland/Ticino were the first countries taking drastic lock down measures, eyes should be focus on the impact in those countries first. The encouraging falling numbers of new cases in Lombardy after 30 days, are positive signs, which should helps extrapolate statistic numbers, especially in USA.

- The massive measures of FED, alongside with the soon approved stimulus package in USA, should help markets to stabilize at today' levels, because markets are already discounting a recession. Volatility should fall.

- The investor community is going to first invest in solid companies, which also are less affected of the pandemic event. Those companies should be in the pharmaceutical, Biotech, Food sector.

- Blue chips are going to be the first to increase, because of short covering via Futures.

- It is important to notice, that the correction in Airlines and Tourism sector is stronger than 9/11.

- The oil price tension is a wholly different subject. Russia targets a reduction in production of US shale industry. In addition, lower oil prices affect positively most of consumers. Net oil importers like China, Japan and Europe are going to profit.

Conclusion

- The pandemic event also have winners, especially on the technological side. Home offices, online school, iCloud, automatization in Food distribution (see link on Ocado), etc. We are of the opinion, stock picking is to difficult, but investing in the iShares QQQ US (replicating Nasdaq 100), it is the simple and easiest way to profit of the technological development. In fact analysing market movements during the day 23. March 2020, Nasdaq 100 Index was basically flat, compared to S&P 500 Index, which was heavily negative.

  https://www.theguardian.com/business/2020/mar/19/ocado-online-shopping-expected-to-impose-rationing-on-more-products,

- Selling volatility ii's also the best strategy at the moment. The price of volatility is a mathematical equation and is going to fall down to normalcy. In addition, investors only need a stabilization of markets to reach attractive profits.

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