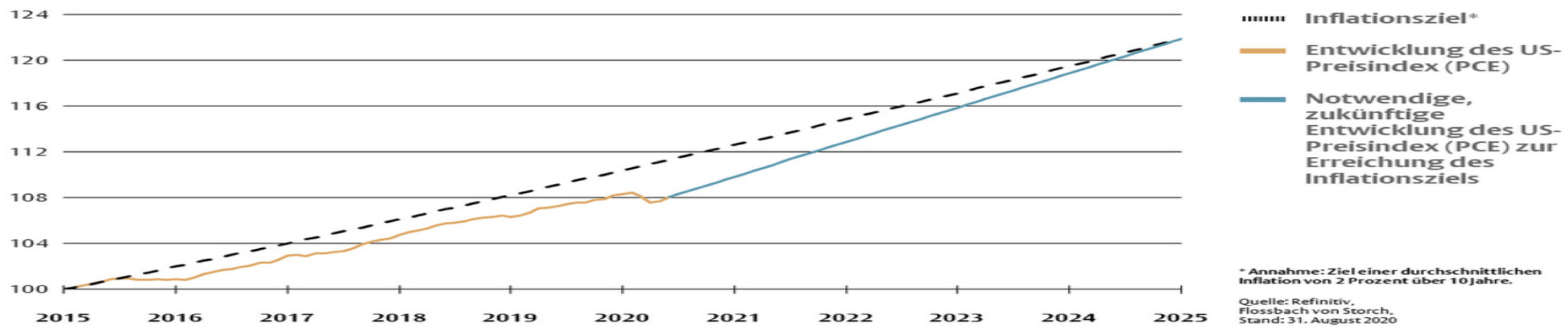
KTS
CAPITAL
MANAGEMENT

COVID-19 update Nr. 20

The 7th of September 2020

Outlook of our “best-in-class” Fund Flossbach

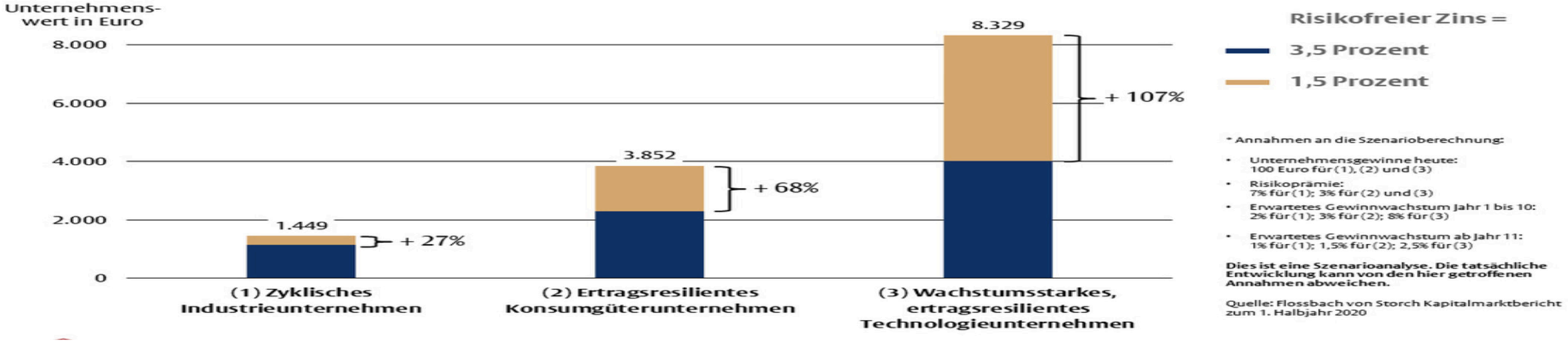
- Analyzing FED’s speech, Flossbach argues that interest rates are going to stay low for longer, debt is probably going to increase and FED can still buy more T-Bill (at the moment owns 21% of the total issued debt, meanwhile Bank of Japan 44%).
- Investors lost credibility in the financial system, especially in western countries, where the population is getting older and the dilemma is, who and how is going to pay back the huge amount of outstanding debt.
- The only way to reduce such debt is inflation (combined with economic growth), for this reason the FED is going to allow higher inflation in the near future, in order to get back to the long term 2% inflation target/line (see attached chart).
- **Conclusion: just stay long growth, technology stocks and gold. USA technology / Nasdaq are going to stay the leaders worldwide. Europe still needs to catch up in technological innovation.**



Long term 2% p.a. Inflation: we need higher inflation rates in order to get back to the “wished” long term trend

Flossbach: why growth stocks have higher upside potential?

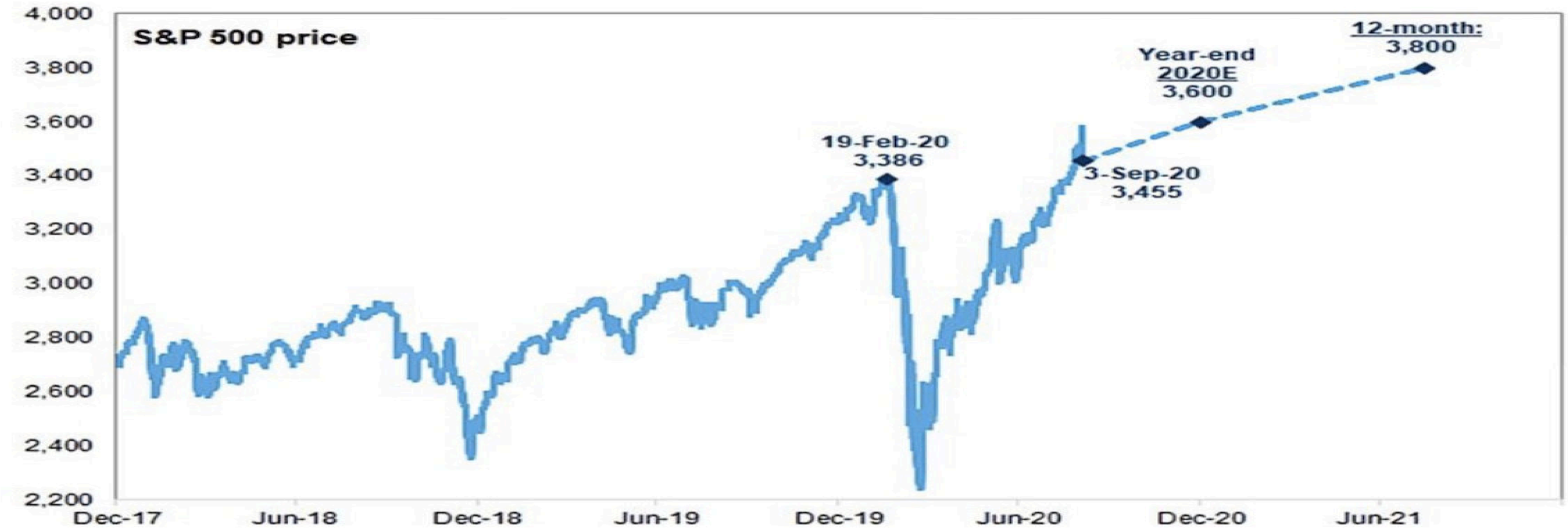
- We are showing again the chart of the upside potential of growth stocks vs consumer discretionary and cyclical stocks: when analysts update lower interest rates in DFC models (lower WACC), the upside potential is an additional 107% from today's valuations.
- Canaccord's global strategist (Mr Tony Dwyer) is also arguing the same fundamental factors and as **conclusion he is withdrawing any S&P 500 Index targets, because there is no way to know how high valuations can go, however he expects some short term market pullbacks over coming months like the fall of 2009.**



Growth stocks have the highest long term upside potential in a low interest rates environment

Goldman Sachs

- Goldman Sachs is increasing S&P 500 Index target to 3’600 points for the end 2020 and 3’800 as a new 12 months target.
- Back on the 7 May 2020, GS had a year’s end target of 3’000 points and was expecting a market correction to 2’400. This shows once again, how it is impossible to predict markets and market participants are not earning any money investing based on market expectation. **We prefer to “calibrate” our risk in the portfolio rather to invest based on market expectations.**



Goldman Sachs’ new S&P 500 Index targets

BUT the real short term dilemma in FAANGMT

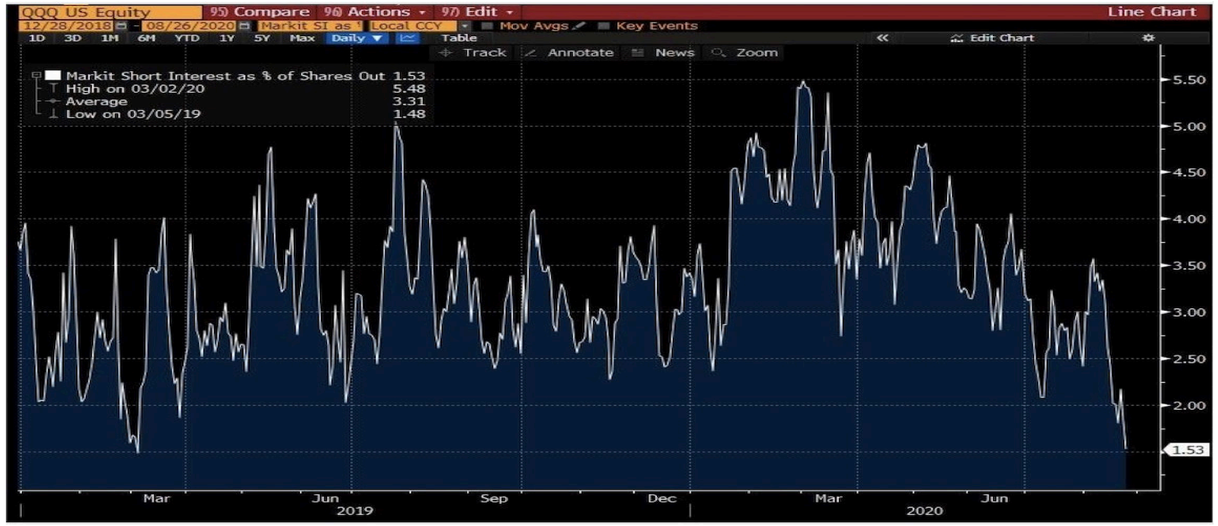
- KTS argued for some time now, **rallies in FAANGMT** (FB, AMZN, AAPL, NFLX, GOOG, MSFT, TSLA) **is not supported by fundamentals** (Apple's FCF is not increasing and according to Mistral Asset Management, Mr. Francesco Magistra, Tesla is currently trading at 1291 years worth of trailing 12-month earnings!).
- For KTS it was difficult to analyze and "figure out" the power behind such impressive move. On one hand we know, investors are buying passive ETFs and Market Makers can replicate the Nasdaq index with basically 5 stocks; on the other hand we know FAANGMT are also at the top of ESG lists. In addition Central Banks are buying equities (Swiss National Bank now owns over USD 120 billion in US stocks!), but we could still not explain the magnitude of the rally during August 2020, especially for stocks like Tesla and Apple.
- We also **observed the huge volume increase in call options**, especially in **FAANGMT**, which never being that high and compared to the rest of the market the volume in notional was **more than 3 times** (around USD 200 bio notional for FAANGMT vs USD 60-70 bio for rest of the market).
- The huge amount in call options and the "dry" market of market makers or Hedge Funds as counter party (selling calls) caused a dramatic increase in volatility even with markets at highs. Market Makers want higher implied volatility for the risk and having the underlying constantly increasing, market makers need to increase delta, to cover open positions on their books.
- We could actually explain those factors, but we could never answer to the question, who are the market participants willing to pay 50% to 70% volatility for call options at market's heights? With which intentions? Especially when stocks are far from fundamentals? And not being invested with equity but via call options? For us this does not make any sense.

BUT the real short term dilemma in FAANGMT (part II)

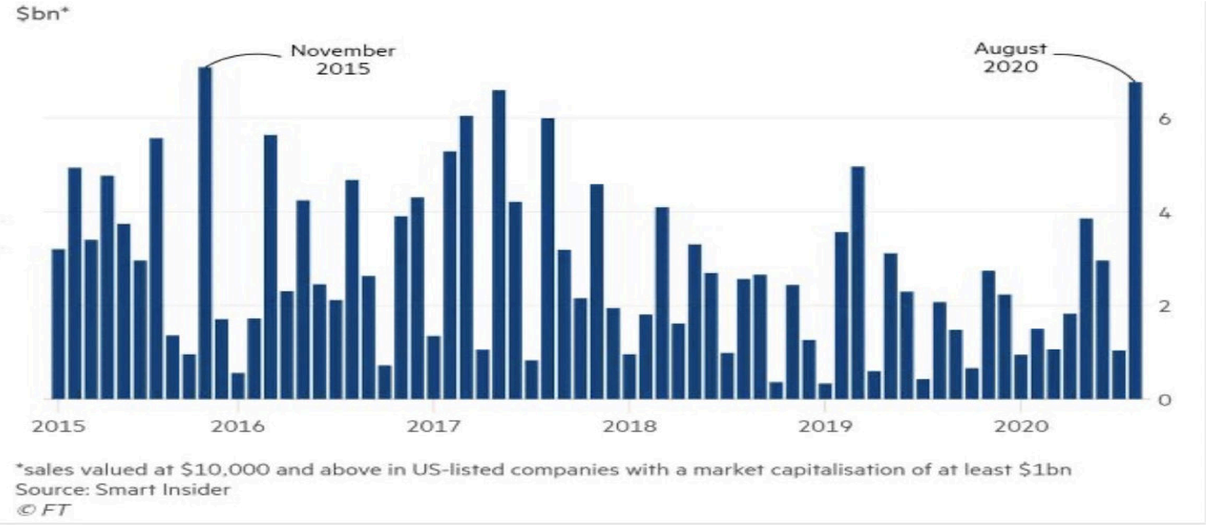
- After the news in FT “SoftBank unmasked as “Nasdaq whale” that stoked tech rally, for us now the whole picture start making sense. It looks like, SoftBank bought billions of dollars worth of US equity derivatives and apparently could be the trigger of the huge rally, having market makers covering delta and being forced to buy equity in the market. This makes more sense than to believe private investors via Robinhood could influence the market with such magnitude. Apparently SoftBank bought options but also stock on the market to provoke the rally. Actually a simple **“ daylight front running”...**
- It is also difficult for us to think that SoftBank alone could “move” the market with such magnitude (it looks like SoftBank is sitting on a unrealized profit of 4 Bio USD and Goldman Sachs reported back in July an “historic inversion”, where for the first time ever, the average daily value of options traded has exceeded shares) but everyone believes, it could definitely trigger the “buying mania”. It looks like, SoftBank was also started the impressive Wirecard’s rally and from July 2020 they applied the same strategy by FANNGMT.
- **After THE GAMMA SQUEEZE the risk of GAMMA CRASH?**
- **CONCLUSION:** the article in FT and the situation with SoftBank give some clarification of what is really going on in the market. Because KTS argued since Mid of August, that FAANGMT stocks are far from fundamentals we started to hedge our net equity exposure via short futures on the S&P500 Index and increasing our liquidity. BUT knowing now that the recent rally is more a kind of dangerous innovative “Ponzi system”, we are going to calculate our exposure in FAANGMT stocks and switch our hedge. Back in March 2020 we proposed to buy QQQ, **we are now actually advise against investing in Nasdaq, especially FAANGMT for the short term**, until the time long call positions will go back to normal.

Low short interest, but record-high insider selling

- In addition to the high volume in call options, the QQQ Nasdaq ETF short interest is at the lowest since March 2019 and we are experiencing record-high insiders selling at market highs.
- For example, Apple's CEO Tim Cook, sold shares for a counter value of 131.8 mio USD.



QQQ Nasdaq ETF lowest short interest



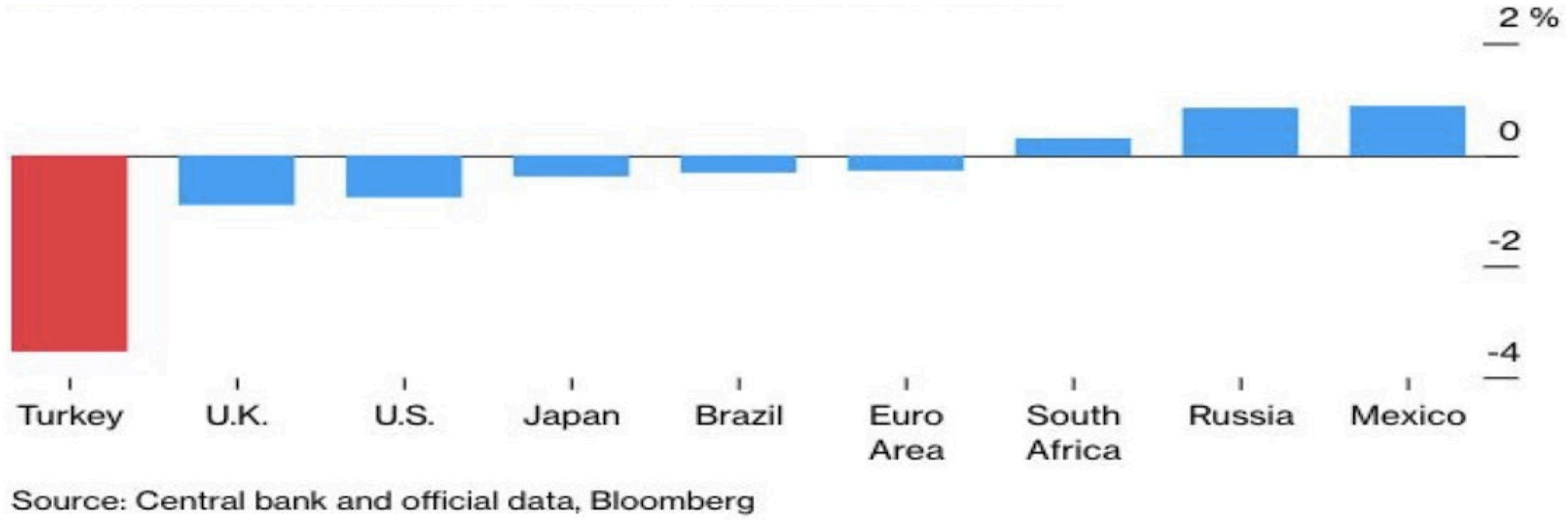
US Insiders selling as high as November 2015

General news

- It is important to remind, that even if Biden would win US elections, the increase of the corporate tax rate from 21% to 28% **would require to be approved in the Senate.** Last statistics show that the **Republicans are going to have 51% of the Senate** (source www.predicit.org), after an impressive rally (from 40%) during August 2020.
- **Historical data shows that the strongest returns have occurred with a Democrats in the White House and either Republicans in control or divided control of Congress** (Source Bob Brinker).
- **Therefore nowadays projections are showing a comfortable US election result for equity markets!**

Worldwide real interest rates

- Turkey has the highest negative real interest rates, because of high inflation: -4% , followed by UK, US, Japan and Brazil.



Deep negative real interest rates

Italian Government debt

- According to the statistics of Mr Gaetano Evangelista (AGE Italia) in Italy during the last 13 years 1 mio VAT numbers had to close down and only during last 5 months 150k self-employed workers have “disappeared”.
- There are no signs of improvement and the real dilemma is: having lower income from taxes, how the Italian Government wants to reduce and pay back its debt? At the moment ECB is filling the gap!
- Many start ups and new technology companies can offer their services from anywhere, therefore an important analysis would be, to understand how many of those self-employed workers were forced to close down their businesses because of financial problems or because of dislocation in countries with better fiscal conditions!? We think that the dramatic reduction of self-employed workers is a mix of both factors!

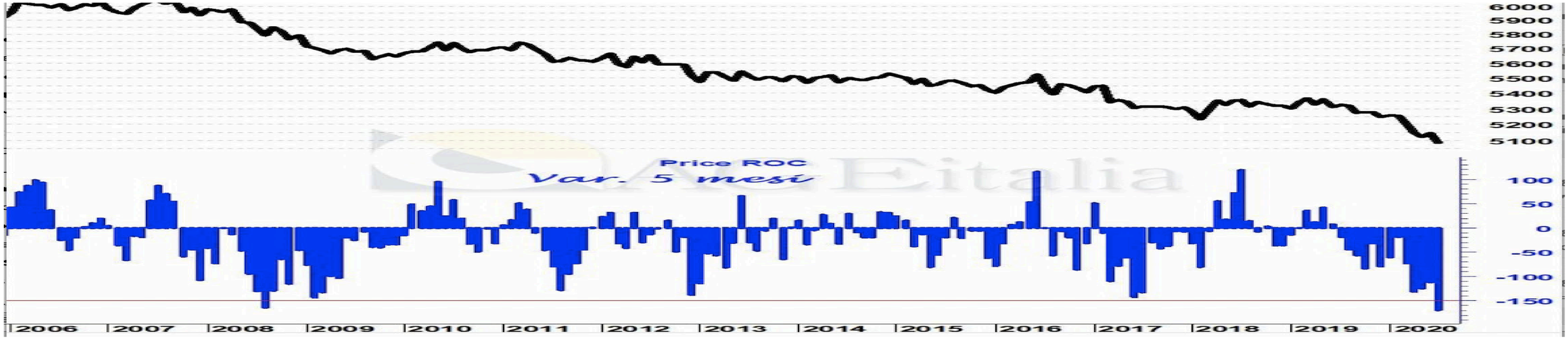


Chart of Italian self-employed workers

Russell Napier “the solid ground”

- Russell Napier’s newsletter confirms our worries on a long term horizon, where the value of fiat money and pension plans, with an inflation of over 2% to 4% and negative real interest rates, will decrease dramatically the purchase power and the majority of the population is going to pay hard consequences. The conclusion of Russell Napier: Gold remains the major beneficiary of this reflation. Herewith we show the most important paragraph:

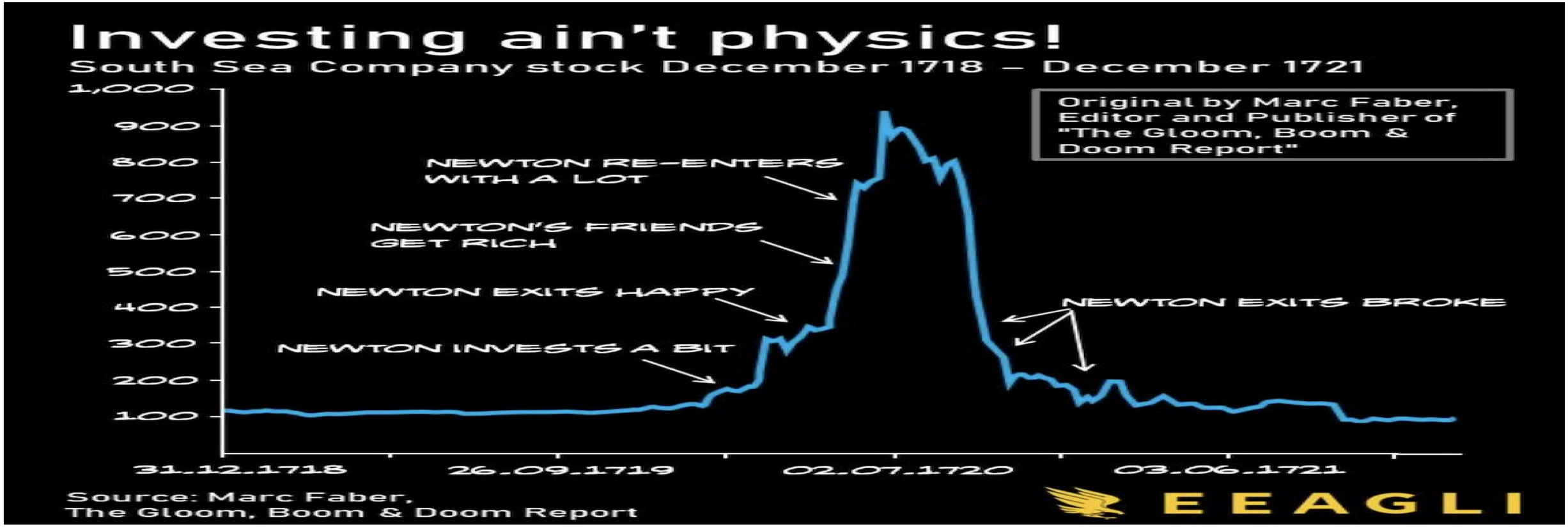
Currently governments and central bankers are perusing the stable to estimate which horse will pull the government debt burden through the long financial repression and keep those interest rates low as inflation rises. That is **you** they are inspecting. When the time comes to enforce Cap Day, you will be told to pull that burden. As the representative of a regulated savings institution, you control the savings that can buy government debt and free the central bank from the destructive task of expanding its balance sheet into an era of rising inflation.

Forcing you to buy government debt at yields below inflation creates no additional money to add to the inflationary fire. With you financing the government, this leaves the government more free to generate the flow of credit through the banking system to those who will likely vote for the government. That credit and money creation policy, combined with measures to restrict the growth in non-bank debt, creates what some call a ‘beautiful deleveraging’ and others refer to as theft. It is of course beautiful for some - debtors - but your analyst would be amazed if it was beautiful for savers.

Most important paragraph of Russel Napier “the solid ground”.

Physicist Isaac Newton lost with investments

- Even the famous physicist Newton lost with the famous stock market bubble of the stock South Sea Company.
- https://www.businessinsider.com/isaac-newton-lost-a-fortune-on-englands-hottest-stock-2016-1?r=US&IR=T



Picture Title

New contrarian indicator?

- To start well our week, we post something a bit funny: 1 hour after President Trump made the tweet, the market collapsed...

Trump Tweet

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