

KTS
CAPITAL
MANAGEMENT



COVID - 19 update

The 18th of September 2020

Weighting of China in the Emerging Markets indexes

- According to BofA, China weighting in Emerging Markets increased from almost 0% during year 2000 to **42% in 2020!**



Source: BofA Global Investment Strategy, Datasream, MSCI

China record 42% of EM equity index (source BofA/Toroso Asset Management)

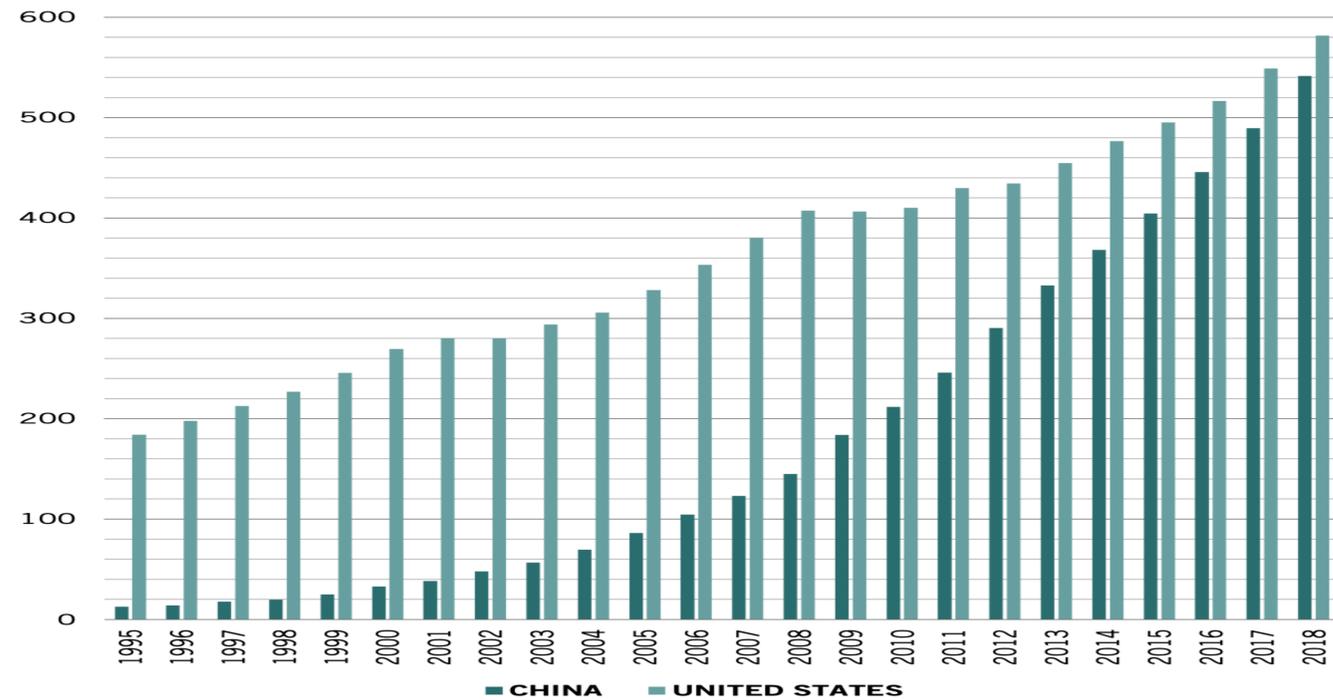
Chinese IT R&D spending

- According to Pictet, China is well positioned to profit from IT innovation and is going to soon overtake the US.
- In addition, China is in better financial conditions than most market participants think, therefore can invest more than the rest of the world.
- **The Chinese Tech Giants still have an huge gap to “catch up” compared to FAANG**



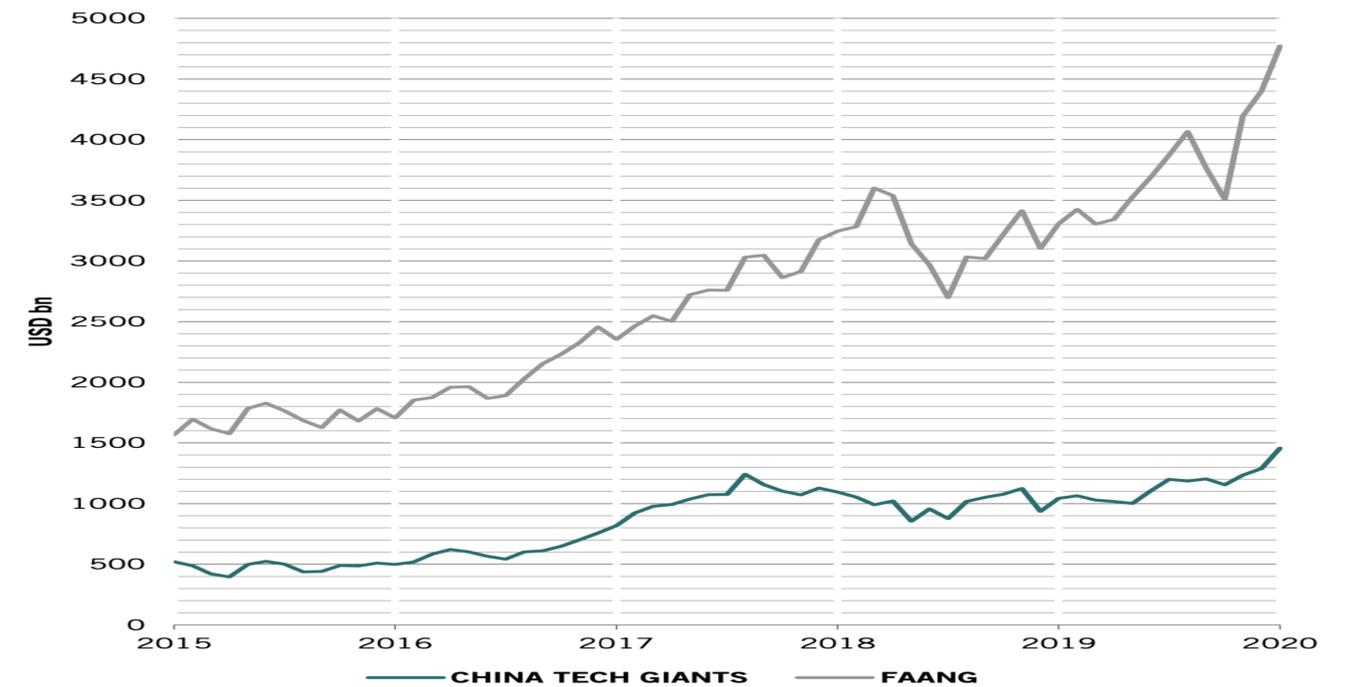
A BRUTAL TECH-RACE IS ON – CHINA HAS THE BEST CARDS TO PLAY IN THE LONG-RUN

Total R&D spending (PPP): China and US



Source: Refinitiv Datastream, OECD, Pictet Asset Management. As of 30 June 2020.

China tech giants* vs. FAANG total market cap (USD, bn)



Source: Refinitiv Datastream, MSCI, Pictet Asset Management. As of 30 June 2020. * Consists of Alibaba, Tencent, Baidu, JD and Meituan (from Sep 18)

Total R&D spending China vs US (source Pictet)

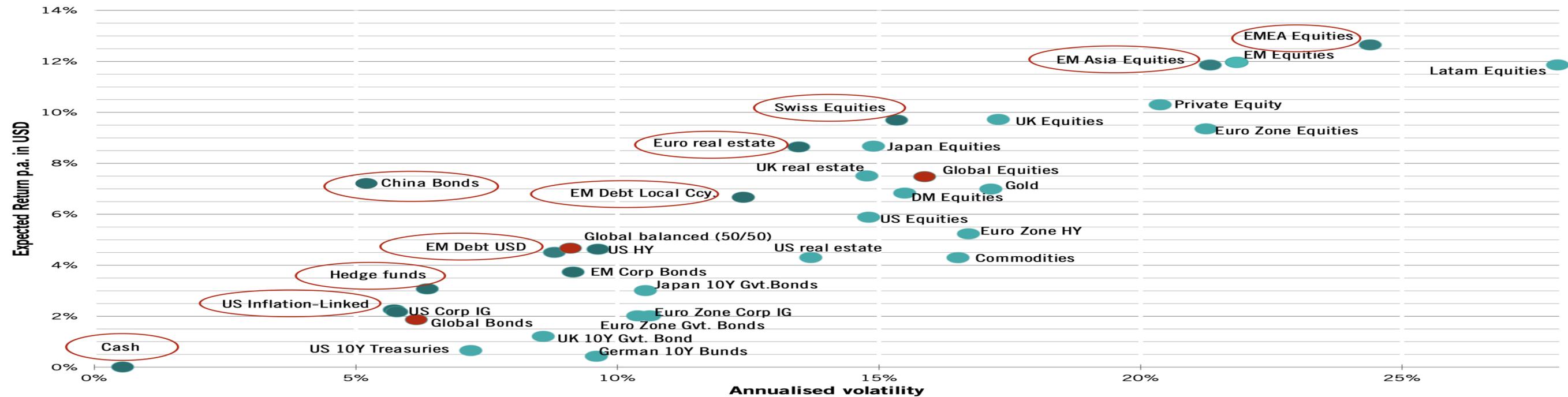
NEW secular efficient frontier

- Chinese Bonds have the best risk/reward profile
- Followed by Emerging Market local Debt, Emerging Market Debt in USD
- On top of the efficient frontier are also Swiss Equities, Emerging Market + Asia Equities
- We are not really sure, if Euro real estate is still so attractive as showed in Pictet's efficient frontier.



OUR EXPECTED "SECULAR EFFICIENT FRONTIER" - JUNE 2020

Expected return p.a. and historical volatility of selected asset classes in USD*



Source: Refinitiv Datastream, Pictet Asset Management. *Volatility is calculated as the standard deviation of monthly returns in USD over the past 15 years. As at 30 June 2020.

NEW secular efficient frontier (source: Pictet)

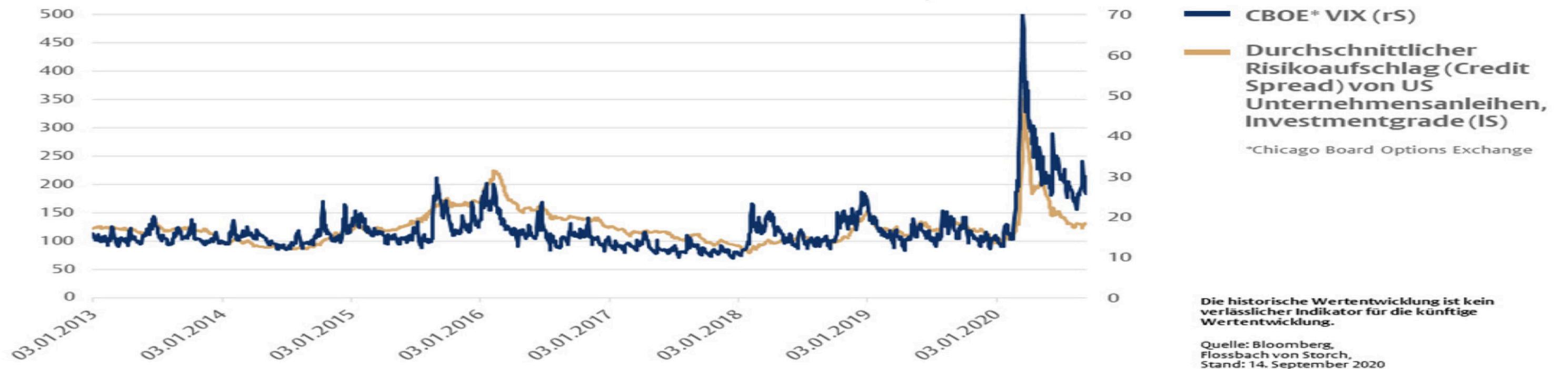
Correlation between equities and bonds

- Flossbach confirms the strong correlation between equities and bonds, therefore bonds are not offering the diversification effect we were used to. For this reason KTS sticks with the belief that the best portfolio's diversification can be reached only via different kind of strategies and not via asset classes.
- Flossbach tries to neutralize the high correlation, switching corporate bonds to Government bonds in period of crisis, like covid.

September 2020

Aktienmarktvolatilität vs Risikoaufschlägen von Anleihen

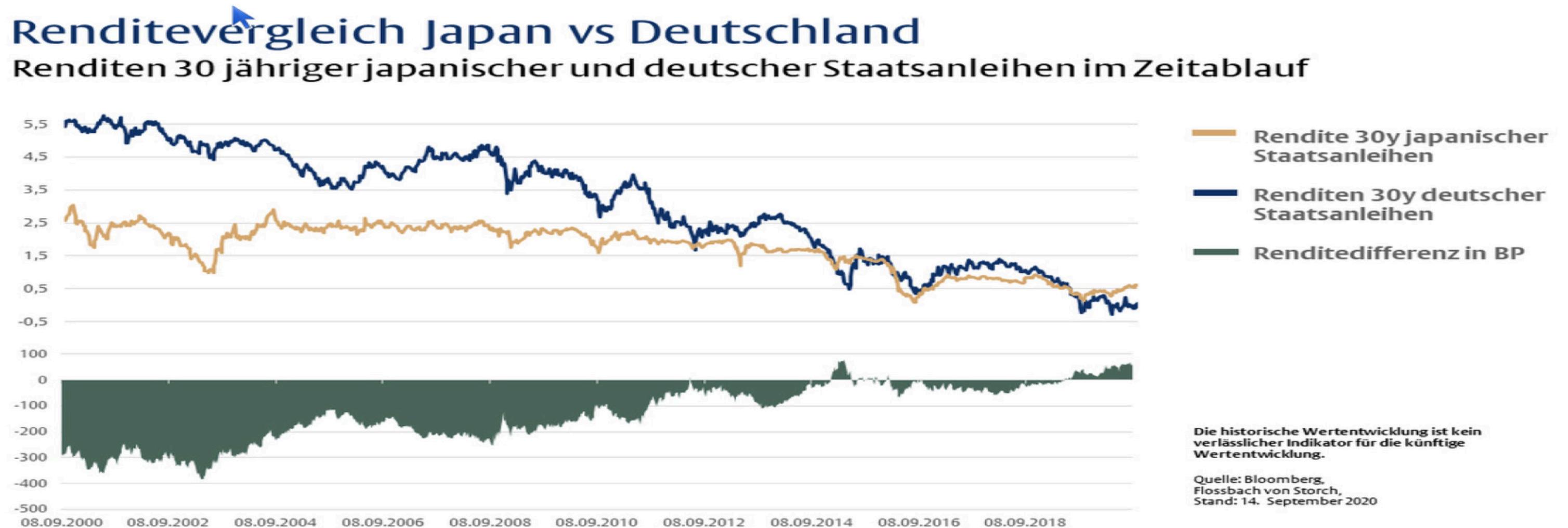
CBOE* Volatility Index (VIX) im Vergleich zu Risikoaufschlägen von US Unternehmensanleihen



High correlation between equities and bonds (source Flossbach)

Japanese Bonds in JPY as perfect hedge against equity markets

- It sounds crazy, but the situation in the fixed income space experienced such a dramatic change, where Japanese Bonds basically the only one in Developed markets together with Italy, are still offering positive real yields! This because the inflation in Japan is basically inexistent. German, European Gov bonds and T-Bills all offer negative yields.
- Flossbach is investing in Japanese Bonds as a perfect hedge against equities markets and started to hedge the USD.



Japan is basically the only country worldwide with positive real yields

Main remarks from Pictet's secular outlook



PAM SECULAR OUTLOOK (2020)

The Global Economy

- **Lukewarm post-Covid recovery**
- High debt, fewer workers, low productivity, state interventionism
- Zombification of business sector
- Focus on national autonomy : more protectionism, re-shoring
- Huge fiscal and monetary stimulus
- Financial Repression & monetization of govt deficit
- Higher precautionary savings rates
- Inflation risks building up
- Wages up, profit margins down
- Higher capital/corporate taxes

Financial Markets

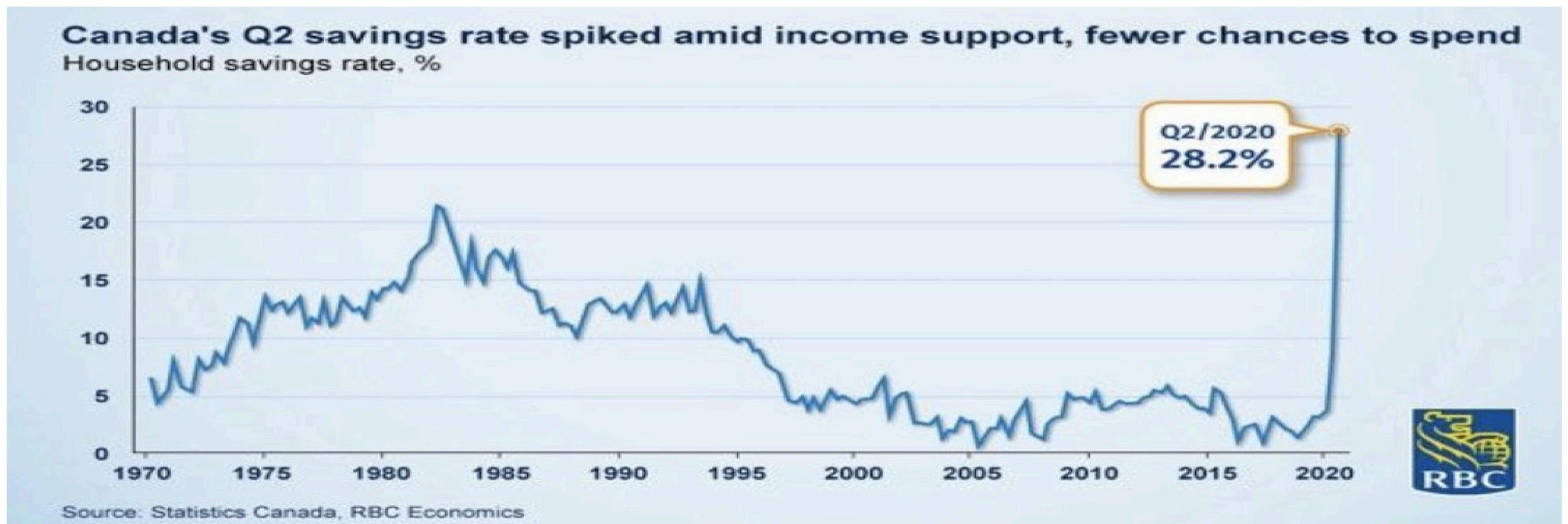
- **Equity (6-7%) and bond (~0%) returns below historical norm**
- Initial valuation unattractive
- Dividends and FX key drivers
- US equities to underperform
- China's assets to re-rate
- Quality growth re-rates further
- No Fed hike, YCC = 1% US BY; US TIPS -1%; Bund 0.4%
- EM local bonds > DM Credit
- USD dollar in secular downtrend (~-10/20% over next 10 years)
- Gold & hedge funds most attractive alternative assets

Investment Strategy

- Trim asset return expectations
- Be ready to take more risk
- Adjust allocation faster within a longer investment horizon
- Focus on secular growth themes
- Best time ever to diversify away from US stocks
- Add to EM and absolute return
- Add to selected "real" assets
- ESG "wall of money"
- **Seek exposure to alpha not beta**

CANADA savings rate

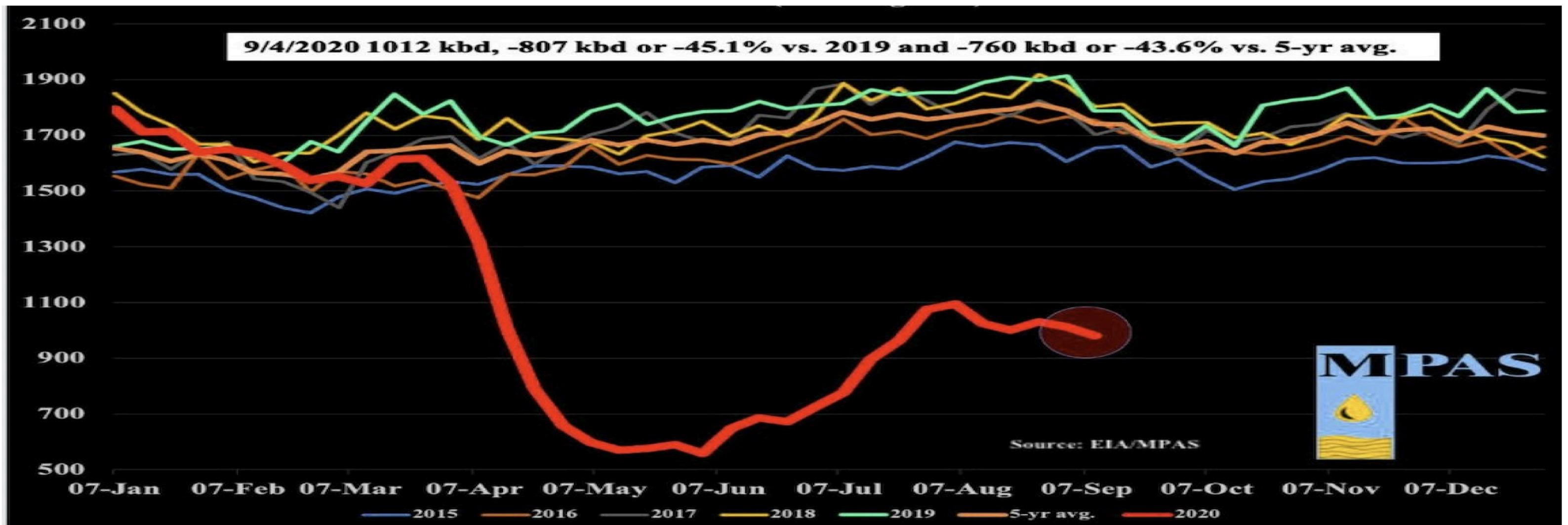
- It is a global phenomenon, savings spike during Covid-19 and later. On one side people could not spend money during the lockdown and later on Government helped the population with stimulus packages and lower taxes.
- There is a lot of dry powder lying in the hands of the global consumer and **one day in 2021 it will start to “kick in” in the economy!**



Canada savings rate (source RBC / Ritesh Jain)

US Jet Fuel Product Supplied

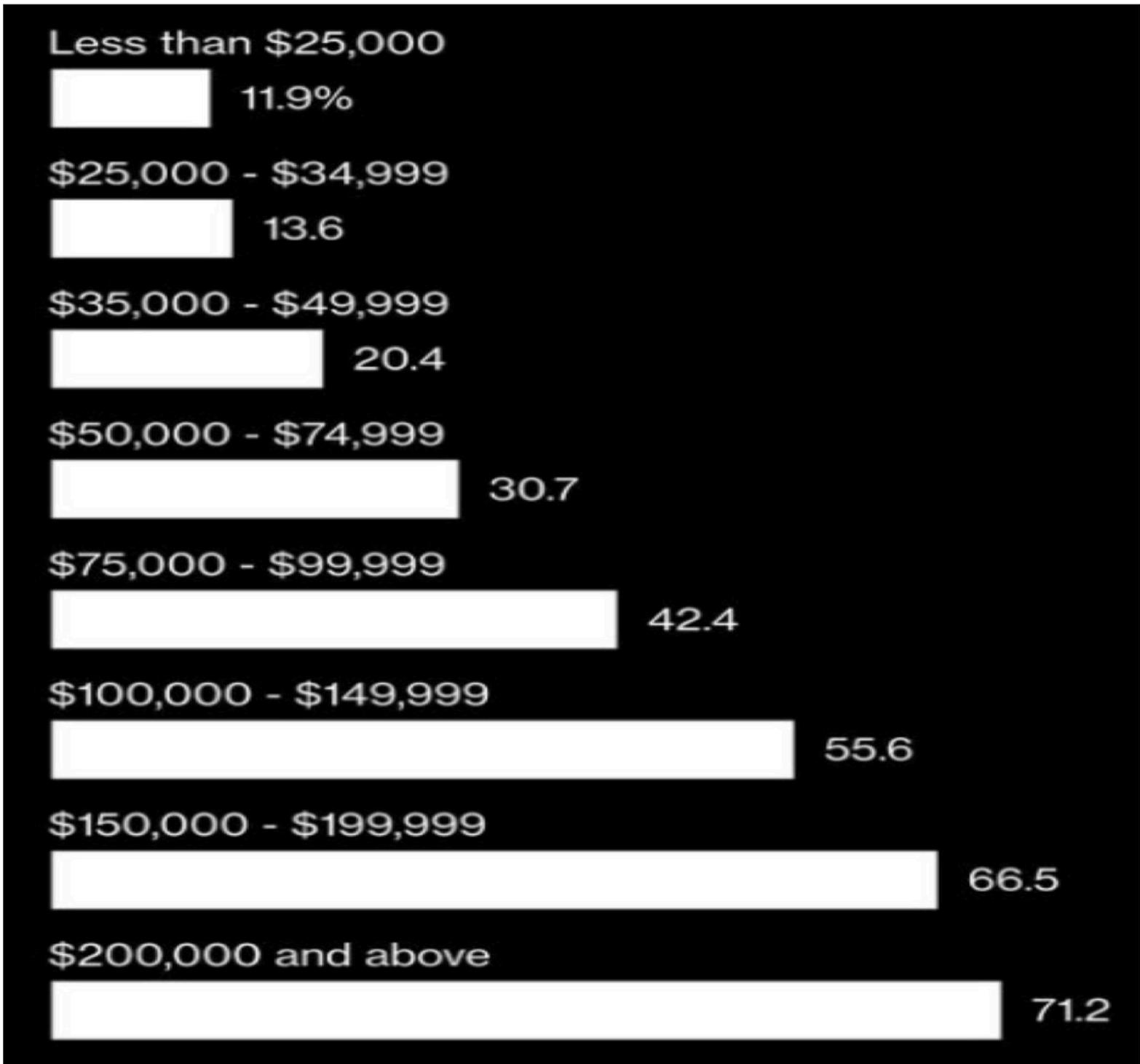
- Analyzing Jet fuel usage data, it looks like, the airline industry is still far from recovering to pre Corona levels.



US Jet Fuel product supplied (source US Energy Information Administration/themarketear/TiloMarotz)

Work at home

- In an interesting chart of The Market Ear, it looks like, that in the USA only high income category can work from home!



Percent teleworking by income category in the USA (MarketEar/Flowbank)

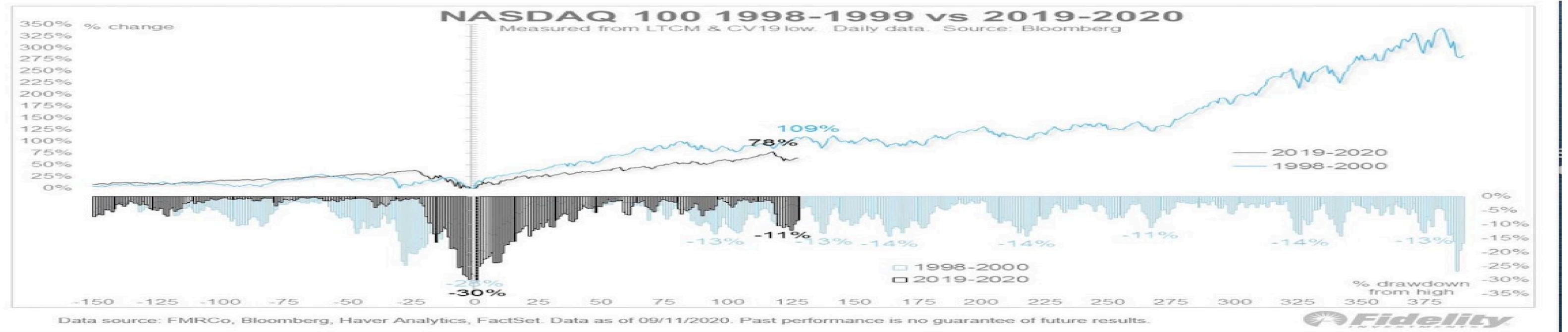
TECH valuations

- Sanford Bernstein compared the Tech stocks in 2020 vs 1999 Dot.com bubble. Despite many worrisome similarities to the tech bubble, such as its overall concentration, share of the market's capitalization, and valuation spreads between the most and least expensive stocks being at historic highs, there are 2 key differences:
 - The magnitude of tech run-up was much more extreme and Valuations today remain notably below 2000 bubble levels.
 - The cap-weighted tech index **traded at 53x earnings in March 2000 vs. 34x today and P/FCF valuations were even more extreme: 118x vs 31x today.** BUT, tech stocks are still trading at their highest levels and it is noted that **tech sector earnings growth (15%) is expected to significantly lag the broader market (31% ex-tech) in 2021.**

Therefore it confirm our assumption, during the next upside, market laggards could outperform.

NASDAQ 100 1998/99 vs 2019/2020

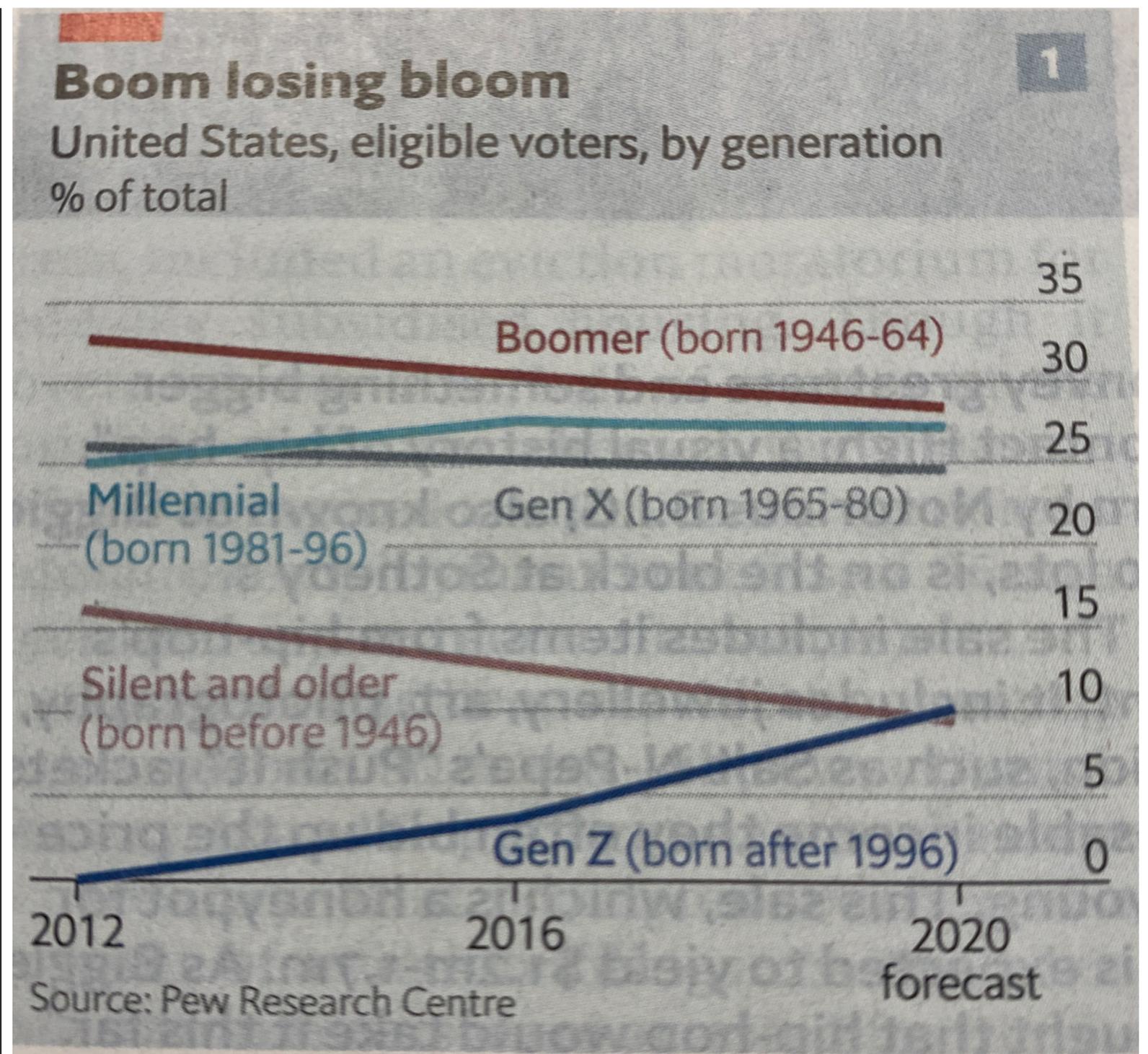
- We normally do not like historical charts' comparisons, because too much depends from the chosen time period and anyone can choose whatever they like, to show whatever they would like (the forever bear investor is showing the comparison with 1929, the bull investor with the year 2000).
- But the comparison of Mr. Jurrien Timmer (Director of Global Macro at Fidelity Investments) from the LTCM bottom in October 1998 to the highs early 2000 with nowadays FANGS development sound reasonable and coincides quite well with the fundamentals analysis of Flossbach, Alkeon and other managers of our best in class funds.
- **The bottom line is: even the market experience corrections of 10-15% do not necessarily mean the end of the upside line and the upside potential coincide with the PE indications of Flossbach & others.**



Comparison NASDAQ from LTCM bottom in October 1998 with FANGs in 2020

The boomers' last stand

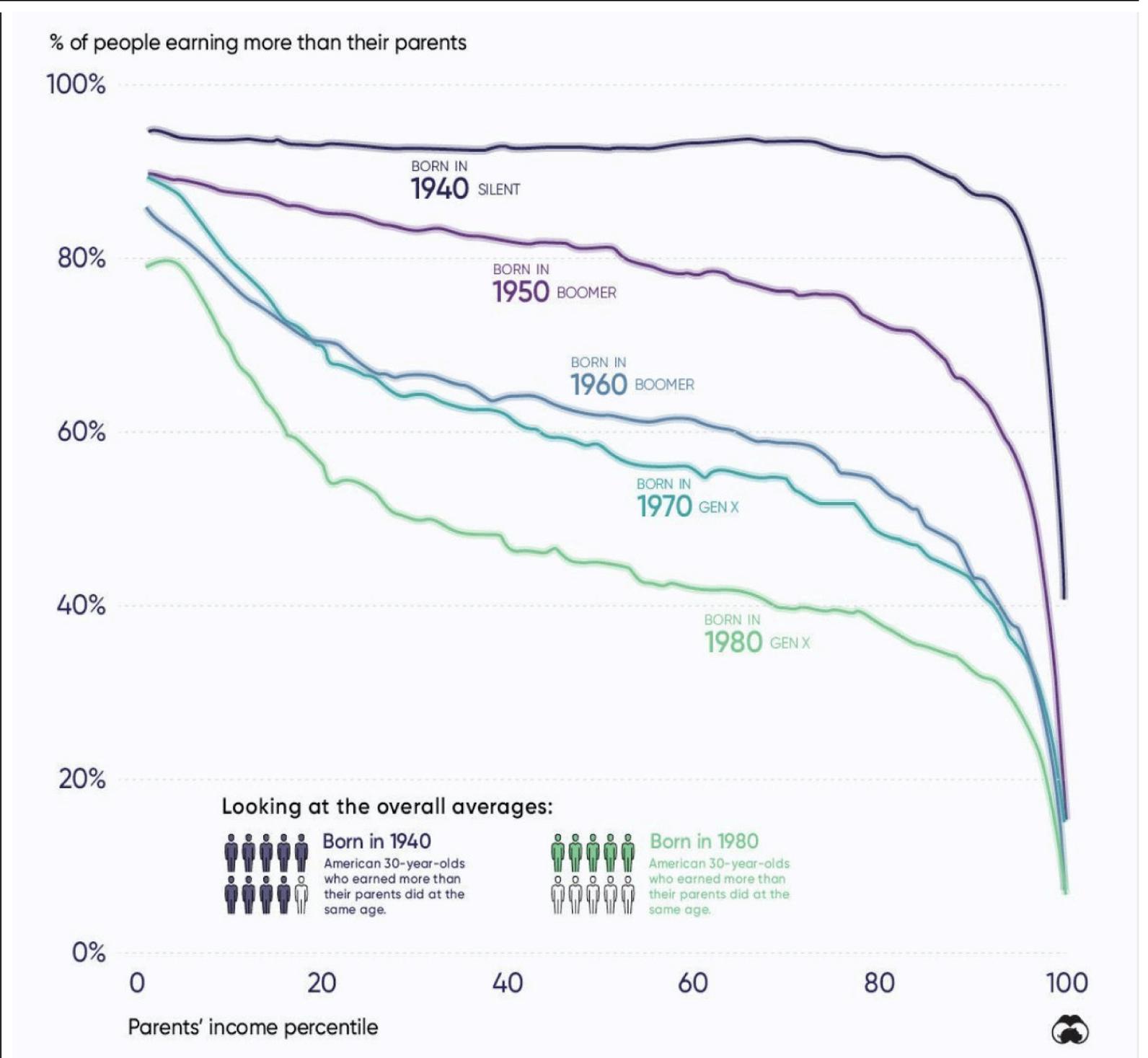
- Interesting chart of the magazine “The Economist”: Baby boomers are still 28-29% of the US eligible voters followed by Millennial (27%) and Generation X (born 1965-80) with 25%.
- Therefore Baby boomers, Gen X and “Silent and older” “still hold” the majority (63%) but probably it will be the last US election with such constellation.
- The Economist is arguing, America is moving from largely white, baby-boomer-dominated politics and culture in the second half of the 20th century to a more racially diverse country fueled by younger generations: millennial, Gen Z-ers and their juniors.



Boomer losing US election power

People earning more than their parents

- A chart of the WEF showing the percentage of people earning more than their parents, clearly indicates, that it is becoming more difficult for new generations to earn more than their parents.
- Almost 90% of people born in 1940 (so called “silent generation”) could earn more than their parents.
- The percentage of Baby boomers (born in the 1950/60) already felt to 80% / 60%
- But by the Generation X percentage felt to a dramatically 40%
- After the financial crisis of 2008, the gap between the top 10% wealthy global population and the middle class increase dramatically, and COVID - 19 could accentuate this gap.
- In addition, as already argued, in the future the gap is going to increase further taking into account negative real interest rates and pension plans. With an horizon of 20 years, retirees of the middle class (if it will still exist!) are going to experience at least 30% less purchase power than today.



People earning more than their parents (source WEF/flowbank)

General news

- Apparently the **Pure Alpha fund of Bridgewater (founder Ray Dalio) is YTD -18.6%** . Since 2012 the fund is underperforming peers and now investors started to redeem. Another legend is not able anymore to outperform the market because of lack of innovation! (Also the Top fund Renaissance Technologies of Jim Simons is around -21% YTD).
- Those news prove once again the importance of the constant monitoring of our best in class Funds, their managers and strategies!
- **Gold miners have the highest Median Free Cash Flow yield since 1996** (Source Bloomberg/Crescat Capital).
- **Spanish Banks are the most exposed to Turkey's Risk** with 60bio USD loans, followed by French Banks with 20bio USD. In fact the stock price of BBVA is crashing together with the Turkish Lira, holding the absolutely biggest foreign Turkish exposure via the Garanti Bank stake.
- **The Federal Trade Commission (FTC) has been investigating Facebook** for more than a year over whether the social media giant has harmed competition. It could file a case by the end of the year, said the person, who was granted anonymity because the inquiry is confidential (source: Bloomberg/Flowbank)
- **Switzerland leading again the Global Innovation Index!** It is the 10th consecutive year! Second on the rankings is Sweden followed by USA. The index looks at a variety of factors, including R&D, ICT, and knowledge and technology outputs.
- NAHB US Housing Market Index is at new highs. We are not sure, after the GFC 2008 crisis, how many investors would bet on that. This is the consequence of low interest rates and it also a sign of inflation. According to Evercore ISI, the sharp rebound of the housing sector is the start of a new era and someone is already calling it “housing's golden age”!

General news

- **The maker of database programs Snowflake** surged 111% on its first day of trading. The IPO price was set at 120 USD per share (discussion started at 75 USD!) and the cloud-computing company which pre IPO was worth around USD 33 Bio, today is worth USD 70 Bio. The company had 248 mio USD revenues during the first half of 2020. Market participants call the valuation exuberance, but taking into account that even Warren Buffett abandoned his customary tech-shyness and bought USD 250 mio worth of Snowflake stock at the IPO and an additional 4.04 mio shares at the debut price (the stake is now worth 1.56bn USD!), it shows, how investors are desperate for sourcing new ways to add performance. Analyzing back other tech IPOs like FB and GOOGL, investors also found at the time, that such valuations were “crazy” and not sustainable, but we have to admit, everyone was wrong. It looks like, the 8-year-old firm Snowflake is revolutionary in its own technology. Therefore, we would not chase to short the stock. The interesting question is how long is the Lock-Up period? We have no reliable information; but it looks like usually the Lock-Up period for Retail investors is 91 days, but the most important is this for institutionals. For example Uber’s stock price, after the Lock-Up period of 6 months, collapsed. Therefore we are going to investigate on this subject, because almost every stock rebound from such Lock-Up period’s correction.
- It looks like **KTS could participate on the hype of SNOW US and FROG US** via our Best in class Fund Alkeon. The fund does not want to be specific on the subject, being invested.
- Here the links of the magazine The economist explaining Snowflake technology:
- https://www.economist.com/business/2020/09/15/why-snowflake-staged-a-record-software-ipo-and-is-now-worth-more-than-70bn?utm_campaign=the-economist-today&utm_medium=newsletter&utm_source=salesforce-marketing-cloud&utm_term=2020-09-15&utm_content=article-link-1&etear=nl_today_1

General News

- A research of Fidelity based on historical data, shows that tax increases may not be the obstacle that many investors expect. Typically, there is sizable federal spending as an offset and the stock market has the potential to see past the tax increases because of so many other economic factors.
- The Swiss media SRF reported, that investors only in Switzerland lost more than 100 mio CHF in frauds. This fact shows once again, how important is a professional due diligence and KTS is trying its best to avoid such frauds! We think that investors underestimate the risk of fraud, mostly because investors are only driven by the desire of high “promised” yields at the lowest possible costs. But investors with a minimum common sense should know, that quality has its price and due diligence processes are costly (traveling, more meetings, information systems, etc), therefore high yields for “free” do not exist!
- Links to the article in SFR news:
 - <https://www.srf.ch/news/wirtschaft/betrug-als-geschaeftsmodell-wenn-das-geld-ploetzlich-weg-ist>
- **The German company Biontech just bought a manufactory from Novartis with the intention to start producing COVID19 doses from October 2020! This would be very positive for equity markets. KTS is still invested in Biontech stock via our Biotech certificate.**
- The tone of the FOMC Press Conference of the 16th September 2020 was very political. The FED of Dallas is known as “anti-Trump” as also those on the “coasts”, meanwhile those of the center USA are more “pro-Trump”. The message was a little bit different than the Jackson Hole speech, but this is purely politic, therefore we stick on the last speech of the FED as reliable long term monetary policy. The bottom line was anyways an expansive monetary policy, which support markets and Trump.

New Technology against COVID-19

- According to WEF, South Korea, but also Singapore, bus stops check your temperature to fight Coronavirus. A thermal scanning camera only allow people with temperatures under 37.5C to enter.
- The city of Seoul has installed 10 of the solar-powered shelters and plan to add 10 more.
- On Buses, UV light sterilizes and cools the air.
- In Asia countries are also massively building up screening technologies.
- Without to get into the discussion of the privacy of any individual, we think the important investments in such infrastructures are going to help in any case to improve hygiene, health and security worldwide. **We are only at the beginning of this specific technological trend, therefore there is still a lot of potential, which should also support the global economic growth.**
- KTS believes to catch the trend via our Emerging market exposure and best in class funds like Alkeon.

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