KTS
CAPITAL
MANAGEMENT

KTS weekly: special U.S. election

The 9th of November 2020

Result U.S. election

- Candidate Mr. Biden has been elected U.S. President.
- However, the Republicans will retain a slim majority in the Senate (52 vs 48 or 51-49 margin, depending on the outcome of Georgia) and the Democrats will keep control of the House. Even if, surprisingly, some seats in Congress were lost. We are going to remind ourselves in the future not to trust pool numbers. We would even dare to say, “electoral maps prepared by the media were unprofessional and probably even manipulated”.

- **The U.S. election outcome is actually positive for equity markets;** the economy is going to receive the much needed liquidity injection to overcome the Covid19 crisis and generate the hoped for inflation. But, it is now unlikely that Mr. Biden will convince Senate Majority Leader McConnell to pass legislation that will include the broad list of tax increases or regulate financial markets and technology giants as feared.

- **Probably by March 2021 (perhaps even before end’s year), a new stimulus package is going to be finalized**. Most probably not at the high end of the forecast range (USD 2.2trn,) but USD 1.5trn, nevertheless. In addition, the Biden administration is planning other packages in education, clean energy, infrastructure, health & caregiving for a total of **USD 5trn over the next 5 years**. **Those packages should generate from 3.5% to a possible 4.2% GDP growth in the U.S.**

Result U.S. election

- Finally, everyone is hoping for a more diplomatic relationship between U.S. and the rest of the world, especially China. On China we do not believe tensions are going to subside, even under a Biden Administration, because both countries are in technological competition, even war (see also our comments under the “5 year plan of China”).
- Reading between the lines; the newly elected U.S. President promised to rejoin the Paris Agreement on his first day in Office, and to holdback the threatened WHO exit. Meanwhile, Germany backed a delay to a USD 4 Bio U.S. tariff strike hoping to renegotiate with the new U.S. Administration.
- We can at least feel that there are good intentions in the air!

Republican candidate Mr. Mitch McConnell

- Mr. Alessandro Fugnoli, Strategist at Kairos, also mentioned an interesting and important outcome from the U.S. Election.
- The Republican Candidate in the Senate, Mr Mitch McConnell was re-elected for the 7th time, and is going to be the fundamental balance between the weak White House and the strong Republican Senate.
- This, at the end of the day, means that, as a Leader of the Senate Majority, he is going to decide about health and tax reforms, on renewable energy and on election of Federal Reserve candidates.
- Mr McConnell had constructive relationship with Bush and Trump, but could also dialogue with Obama. He will, most probably, have a similar relationship with Biden/Harris.
- It looks like with the special situation of Covid19, the U.S. Government will need to create a working bipartisan consensus to apply the crucial measures to successfully support the U.S. Economy and population. Therefore, a diplomatic dialogue instead of radicalisation of the left and the right will be essential.
- It looks like Mr. McConnell going to be the fundamental pillar for such diplomacy.

U.S. Election, impact on sectors

- In line with the general consensus, we agree that under a Biden's Administration the **renewable energy sector and infrastructure will benefit.**

The infrastructure program should also support US cyclicals and midcaps. As mentioned in the past, also **commodities are going to profit from multiple trends**: digitalisation, clean energy and infrastructure programs, in addition to the forecasted weak USD.

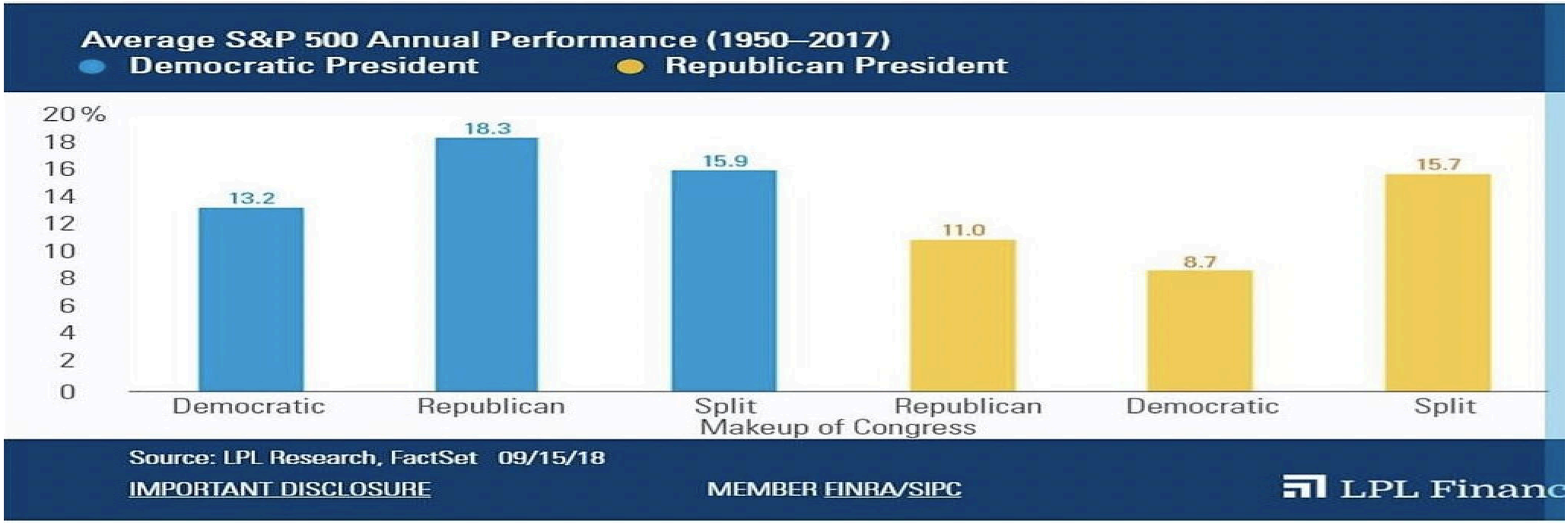
- The market can also relax on technology, as having a Republican Senate will reduce the risk of regulation on big tech. In addition, the technology sector will also profit from the lower probability of corporate tax reform (Technology's EPS would have been the most negatively impacted by as much as 9%). Not to mention 5G infrastructure spending, which is going to support IT services, already profiting from the acceleration in demand due to Covid19. This, in addition to the impact digitalisation has had on our daily lives. On average we spend more than 6 hours a day on the screen and access 8.9 GB average monthly smartphone cellular data, in a world with 3.8 bn smart phone users.
- The consensus is against the oil & gas sector, but investors have to be aware of the fact that a **weaker USD is positive for the oil price**. On top of infrastructure spending, a rebound of the global economy and the eventual resumption of traveling activities will support the oil price even more- resulting in higher EPS, which will lead finally to higher exploration spending in the oil industry.
- We are closely involved with specialists in the oil sector; they are already investing in selected oil companies, which should also profit from the renewable energy trend and will eventually experience a multiple expansion having a better ESG profile (companies like Aker or Subsea for example).
- Sectors like Healthcare, Communication, Financial, Industrials, Materials and Energy would also profit from the lower probability of a tax reforms, where EPS would have being impacted by -8% to respectively -4% .

U.S. Election, impact on markets

- We are of the opinion that markets will continue to focus on the timing and speed of stimulus packages, rather than the economic slowdown in Q4 2020, as a result of recent lockdowns. Hopes of an imminent approval of Covid19 vaccines are also supporting markets.
- Analysts and investors are already focussing on the economy and corporate earnings into 2022 and the S&P 500 Index could potentially trade up to 3’700 points, based on a valuation of 21 times forward 2022 operating earnings in a low interest rate economy.
- Bear in mind that most investment managers are experiencing negative YTD performances. The majority, of which, were awaiting the U.S. election outcome and protecting themselves against the risk of contestations; which should not now materialize. We think **many asset managers will be forced to invest in order to catch any positive performance of markets before year’s end- thus causing a FOMO rally (Fear of Missing Out).**
- Especially, when general consensus is to avoid a conventional 60/40 (60% equity and 40% bonds) portfolio due to negative real rates, and liquidity floats all boats with billions in cash sitting on the sidelines.
- As always argued, under a Biden administration and a further stimulus package, the **USD is going to weaken further. Emerging markets, Gold, Oil and commodities should profit and further rally.**

Split US Government

- **Statistically a split US government is historically much better than a "Democratic Sweep" for the S&P 500 Index.**
- As mentioned previously, the U.S. Election outcome is probably the best for the stock market and is confirmed from historical precedents.



Historical performance of different Governments

KTS investments

KTS reacted to the U.S. Election results and consequently **increased equity exposure.**

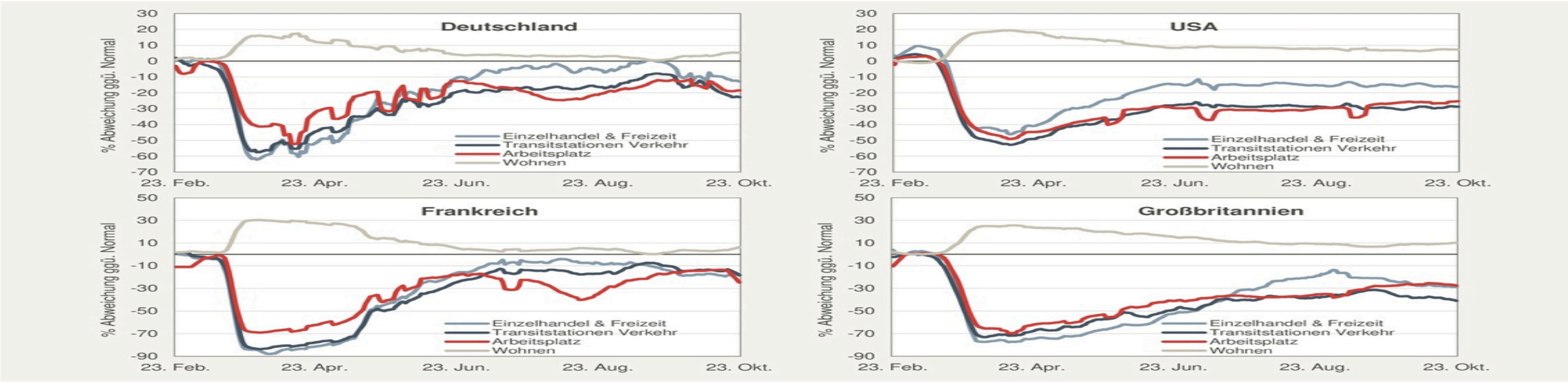
- In the Optima Dynamic FoF the stop loss of our equity hedge (short S&P 500 Index Futures) was executed and the trade closed with a 1% profit. In addition, we reduced liquidity by adding to positions in Z22 Fund, Classic Global Fund, Green Energy L/S basket, Technical Sectors Basket, 2x idea Midcaps Fund, etc. The FoF Optima Dynamic is, therefore, now fully invested.
- We also increased our investments in the Gold and Biotech Baskets
- In the fixed income space, Optima Constant Yield Fund added the European High yield ETF, to be invested but still retaining full flexibility.
- During the last 2 weeks, we also took the opportunity to profit by selling volatility in stocks like SAP, GILD, Bayer.
- Our emerging market and merger & acquisition strategy baskets were already fully invested.

5 year plan of China

- China wants to increase GDP to 100 trillion yuan (USD 14.89 trn) by the end of 2020, internalising economic production and consumption, technological innovation, green development and reducing inequality.
- There are also plans for increased support to Hong Kong in light of recent unrest.
- The plan is a confirmation that China and the West are increasingly moving apart, particularly in the field of technology. The technology war was actually initiated by the Trump administration.
- The China plan is based on “self-reliance”, with the intention to narrow the knowledge gap in technology. After the United States sanctioned the Chinese technology firm Huawei, Beijing recognises new strategies are needed for this new world.
- As a result, China pledges to rapidly increase its research and development budget, to reduce dependency on goods which America sees as pure strategic leverage. We already argued, China has the financial power to invest heavily in R&D, but even more, the country can count on 1.4 billion people and a growing consumer base at home!

Google mobility datas

- Current lockdowns **are not yet negatively influencing economy activity,** as was the case during the first lockdown in March.
- In addition, as mentioned recently, more than 80% of U.S. Companies exceeded analyst's estimates. Surprising both markets and analysts, as to how earnings were so resilient to pandemic events. Therefore, we think that markets are not going to be focused on the economic slow down of Q4 2020, but rather on the stimulus packages in 2021 and timing of vaccinations.



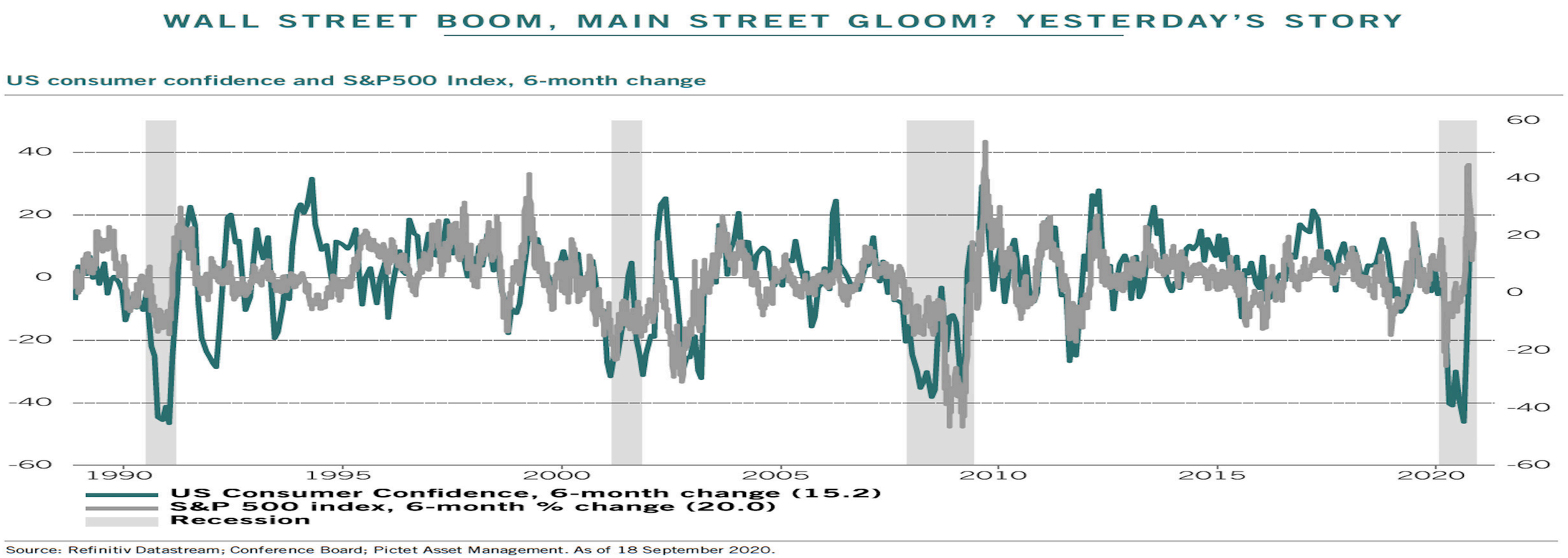
Quelle: Google Mobility Report, Stand 25.10.2020, Zeitraum: 23.02.2020-23.10.2020; die Mobilitätsindizes zeigen die Frequentierungshäufigkeit für bestimmte Kategorien von Aufenthaltsorten relativ zur Referenzperiode 03.01.-06.02.2020 („Normal")

8

Google mobility datas (Oddo/google)

Discrepancies between economy activities and stock exchange

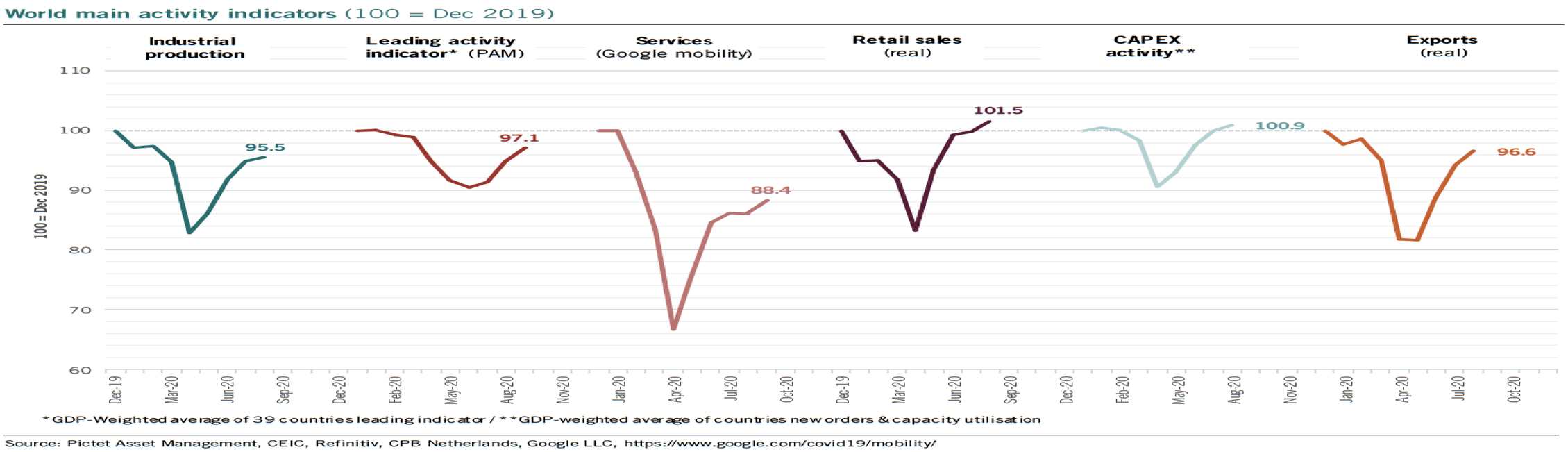
- Pictet points out rightly that after recent Q3 results the economy narrowed the gap of discrepancy between the stock exchange and real economy activities. Economic recovery and companies profitability rebounded more strongly than expected.



US Consumer Confidence vs S&P500 Index

Economic recovery: developed markets

- In developed markets economic recovery is much stronger than expected, especially CAPEX which is over pre-covid19 levels !



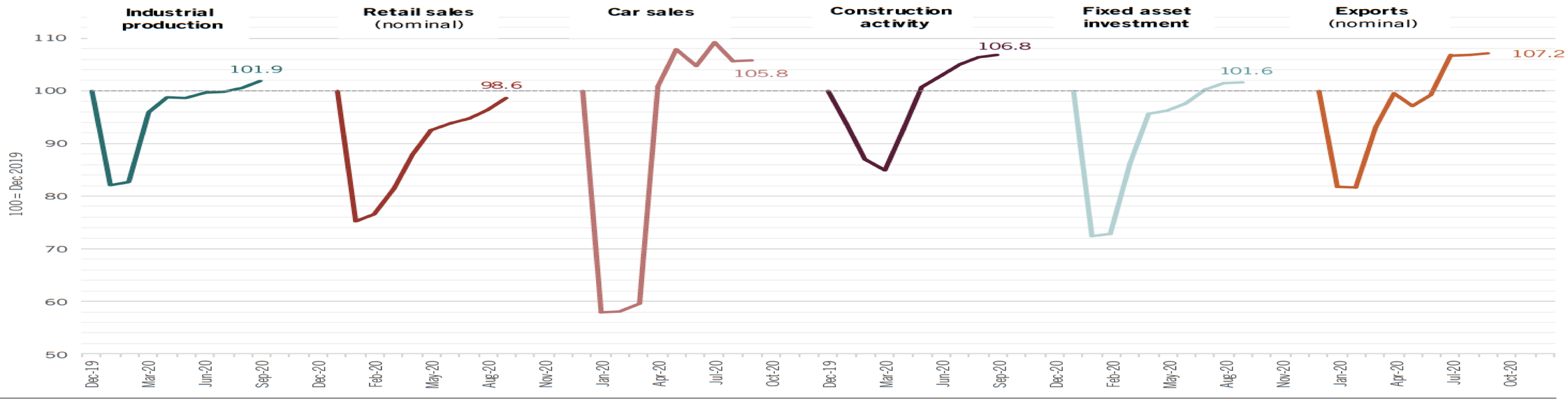
Source Pictet

Economy recovery: China

- China`s recovery levels are higher than pre-Covid19!
- Basically, China overcame the challenges of Covid19 by effectively containing the pandemic. So effectively, that the Chinese Central Bank was not forced to inject tremendous amounts of liquidity, like in other countries!

... WITH CHINA BEING THE BRIGHT SPOT

China main activity indicators (100 = December 2019)

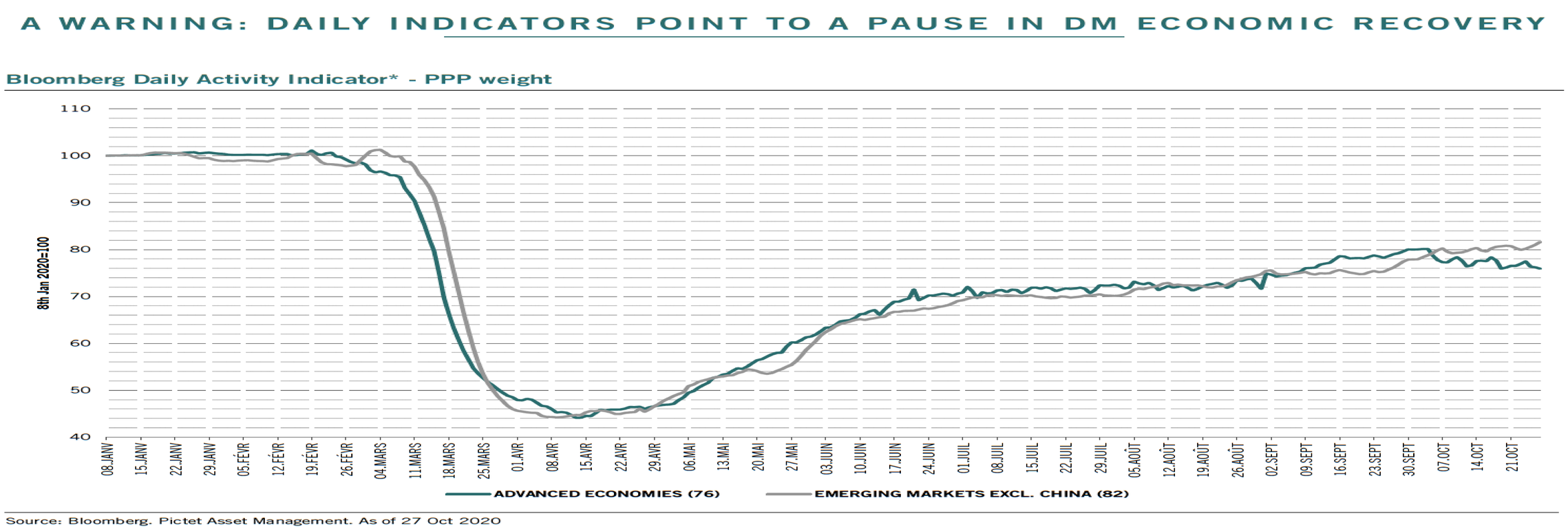


Source: Pictet Asset Management, CEIC, Datastream, Bloomberg.

Source Pictet

Economy recovery: Emerging Markets

- During this covid19 recession, emerging markets unusually performed better than Developed markets.
- As mentioned many times now, emerging markets are at attractive valuations, the cheapest historically.
- Fundamentals are compelling; therefore, emerging market equities and bonds present the most attractive investment opportunities in our investment universe.



Source Pictet

New cases of corona virus

- We are not going to argue, if lockdowns are the right strategy, because the decision has already being made.
- But, we would like to address a better analysis to our clients in order to help take rational investment decisions and not panic.
- Because by analysing the statistics objectively, the actual situation is not as dramatic as the media would have us believe.
- First of all the numbers of new positive people increased dramatically, but we have to differentiate between positive new cases with no symptoms and effectively sick people. Nowadays, countries are testing many more than during the first wave of Covid19 and, in the meantime, we all know of people who tested tested positive, but did not experience any symptoms.
- Therefore, to extrapolate model forecasts with the same fatality percentage, as the first wave, is actually wrong.
- The population in general, but especially the elderly, learned how to live with the new situation. For this reason during the second wave, fatality rates are not increasing, as a percentage of total new cases, on the contrary they are lower (see chart of Pictet). Of course absolute numbers are higher (see chart of Vontobel), but this is the mistake of the media, keeping the wrong focus.

- In our eyes, the exceptional strength of the markets is also due to investors correct statistical analysis, mainly to keep the focus on the percentage of fatalities and not on absolute numbers. In addition to billions of liquidity sitting on the sidelines ready to be invested and the expectation of mass vaccinations in 3 months time.

New cases of corona virus: absolute numbers

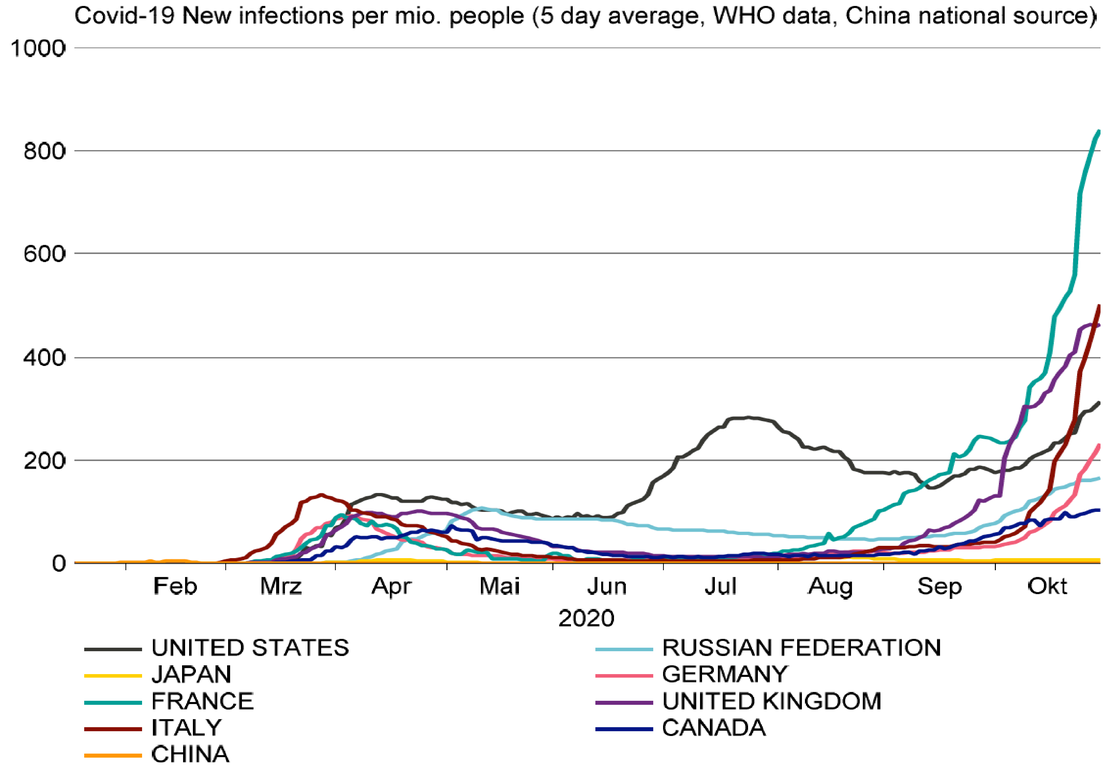
Economics

Covid-19: New cases and infections
Focus Developed Markets (G8 + China)

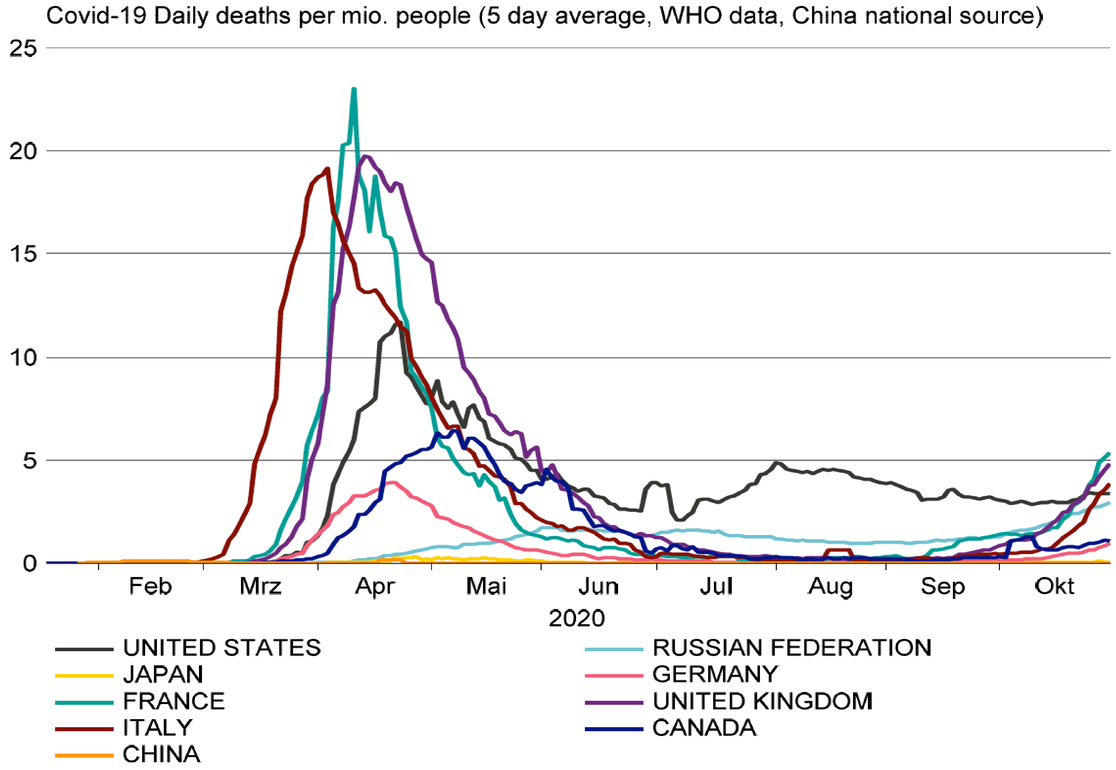
Vontobel

November 2, 2020

DM (G8): Covid-19 infection rates



DM (G8): Fatalities related to Covid-19



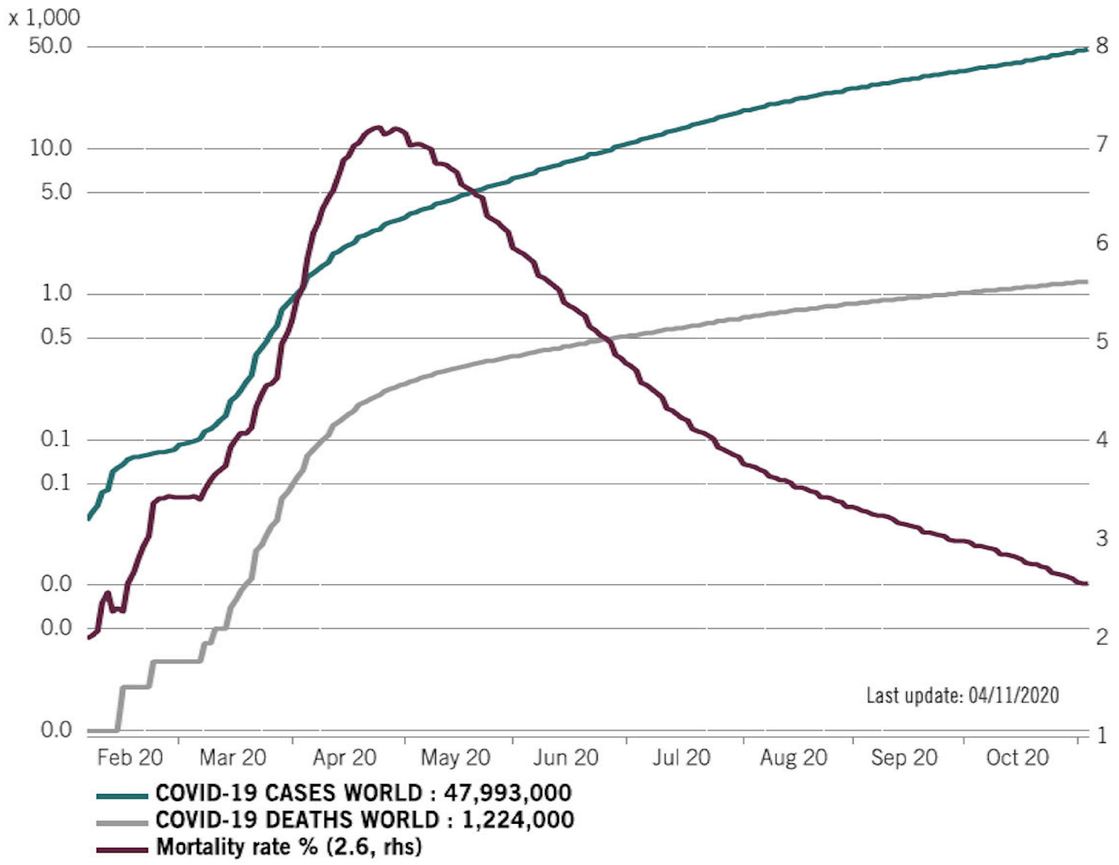
→ Europe is the new global covid-19 hot spot with now also increasing fatalities, also US & Russia show more new cases

New cases in absolute number, not in percentage (source Vontobel)

New cases of corona virus: mortality rate in percentage

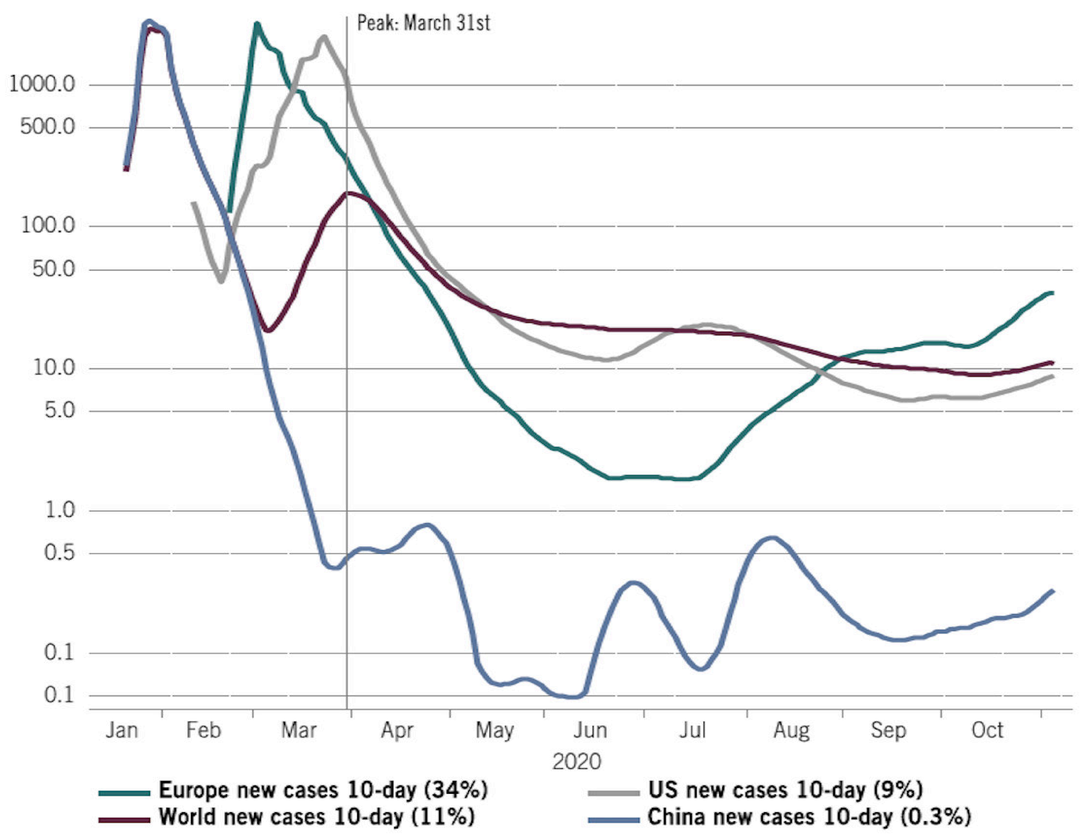
COVID-19: BIG SURGE IN CASES IN EUROPE = LOCKDOWNS

Covid-19: total cases, deaths and mortality rate



Source: Refinitiv Datastream, WHO, Pictet Asset Management

Covid-19: daily new cases, level and % change (10-day average)



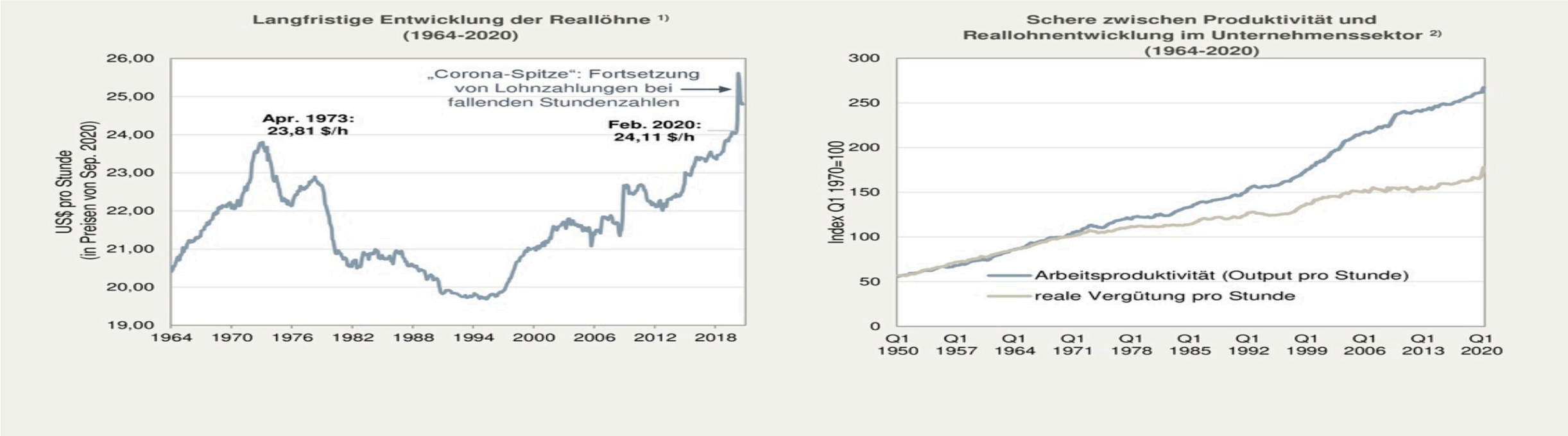
Source: Refinitiv Datastream, WHO, Pictet Asset Management

Mortality rate in percentage (source: Pictet)

Development of real wages

- Stimulus packages are needed to stimulate real wages, which are going to be translated into higher inflation, the final main goal of the FED. Therefore, we are convinced that global policy makers are also going to accept more rounds of liquidity injections.
- As you can observe in the chart below, real wages vs productivity, the U.S. salary development is very weak and has not kept the same pace as productivity. Weak real wages is translated into weak consumption, the main driver of U.S. Economy.

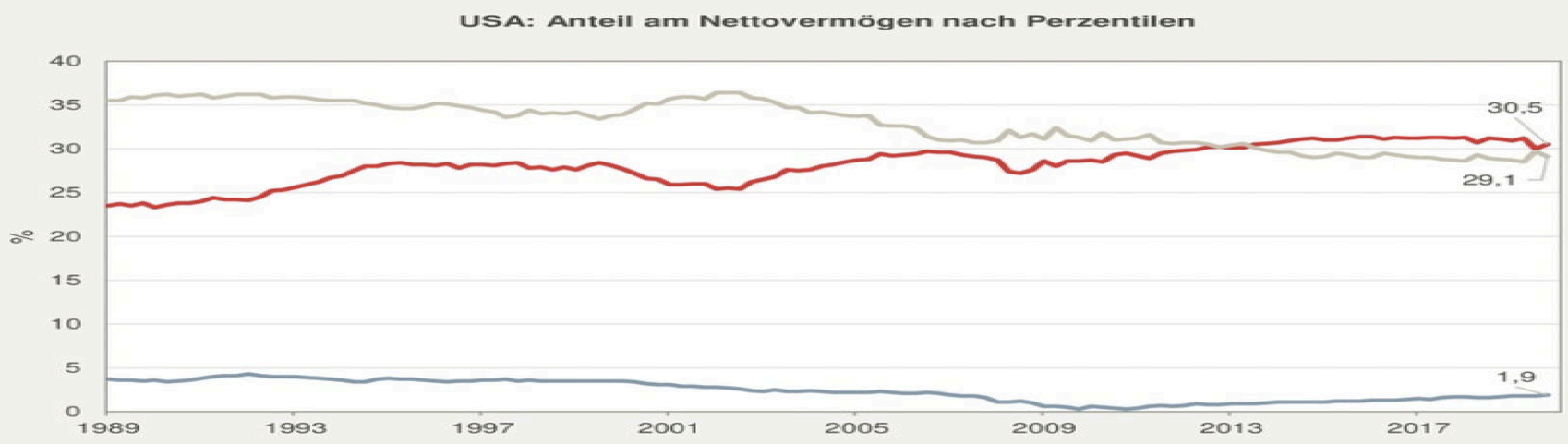
Langfristige Entwicklung der Reallöhne in den USA



Development of real wages vs productivity (Oddo)

Top 10% of wealth

- We all agree, Trump's tax reduction basically favored only the wealthiest citizens. We think that Trump was not re-elected because the majority of the U.S. population is in a seriously distressed financial situation caused by Covid19; meanwhile having the stock market at new highs means the wealth of the top 10% increased further!
- Therefore, Biden's plan to balance wealth distribution, but not drastically like other Democrat candidates were proposing, is the main hope for the majority of US citizens. The majority, of which, does not have even 500 USD of savings.



Zum Vergleich:

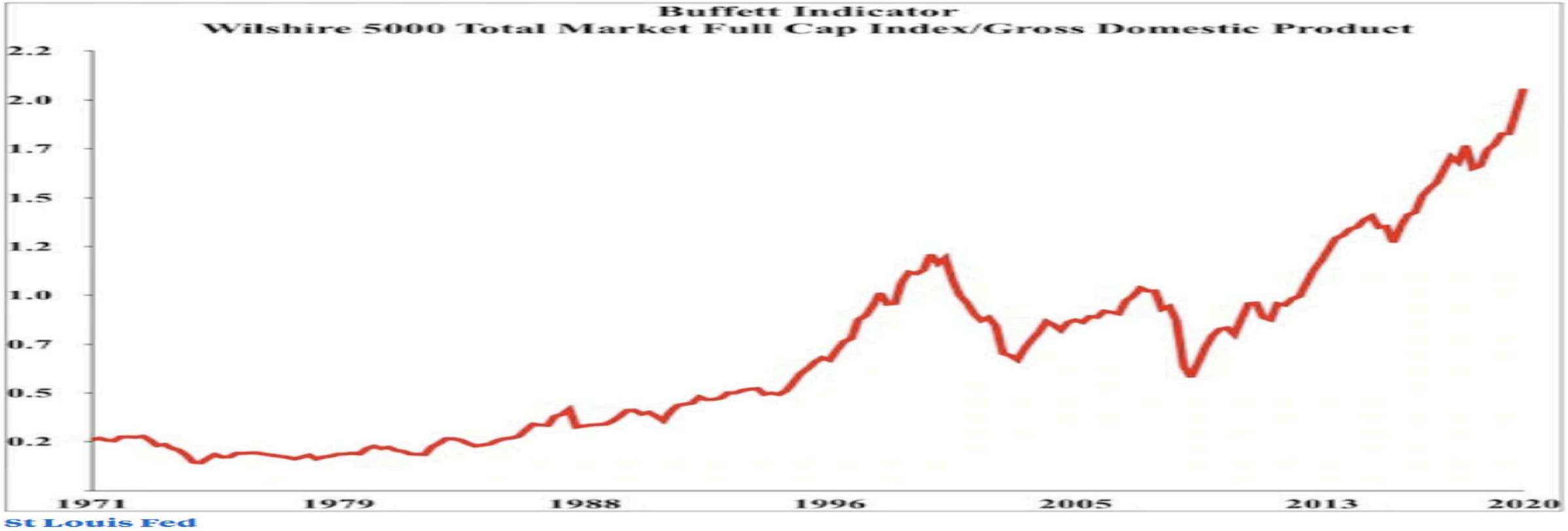
Land	TOP 10 Anteil am Nettovermögen in %
USA	77%
Deutschland	55%
Italien	44%

Quelle: Deutsche Bundesbank

Top 10% of wealth increased post covid19

Warren Buffett's favorite market indicator nears record high

- We are reading again via multiple channels, that investor' eyes are still focused on the Buffett Indicator Wilshire 5000 Total market Full cap Index / GDP.
- As long we still have many investors convinced that stock valuations are expensive, there is plenty of upside potential.
- Any comparisons with historical data are nonsense in the new world of 0%, or even negative interest rates.

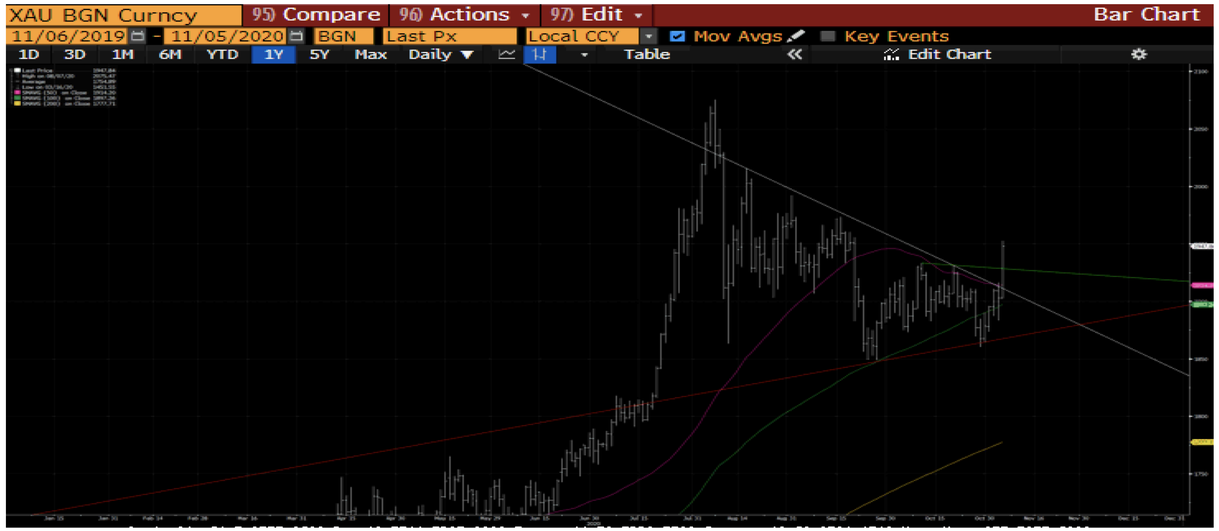


Source St Louis Fed / FlowBank

Breakouts

- FDA is in discussions with the company **Biogen** to approve the Alzheimer drug aducanumab. The stock jumped more than 30% and we took profits in our Biotech Basket.
- **Gold** is finally breaking out from the descending triangle. We are again fully invested in our Gold Basket and our best in class Fund Flossbach holds more than 10% in gold.
- And, finally, also **Bitcoin** has a spectacular breakout of the 14k USD resistance and is on the way to the next one at 20k USD!

Biogen shares jumped more than 30%



Gold breakout

Breakout Bitcoin price

Breakouts

- **Emerging Markets** are also breaking out from a 3 year trading range, after a strong consolidation. Therefore, there is space for further upside potential, supported by forecasted weak USD and strong economic and structural fundamentals. As explained before, general consensus is in favor of emerging markets, based on compelling valuations. According to GMO Asset Allocation Insights, Emmas equities looking amazingly cheap today, just as they did in 1999.
- We hedged the USD in our mandates, because of our fundamental view of a weaker USD going forward and the high risk of a breakout of the EUR at the level **1.2011!**

Solid base of Emerging Markets

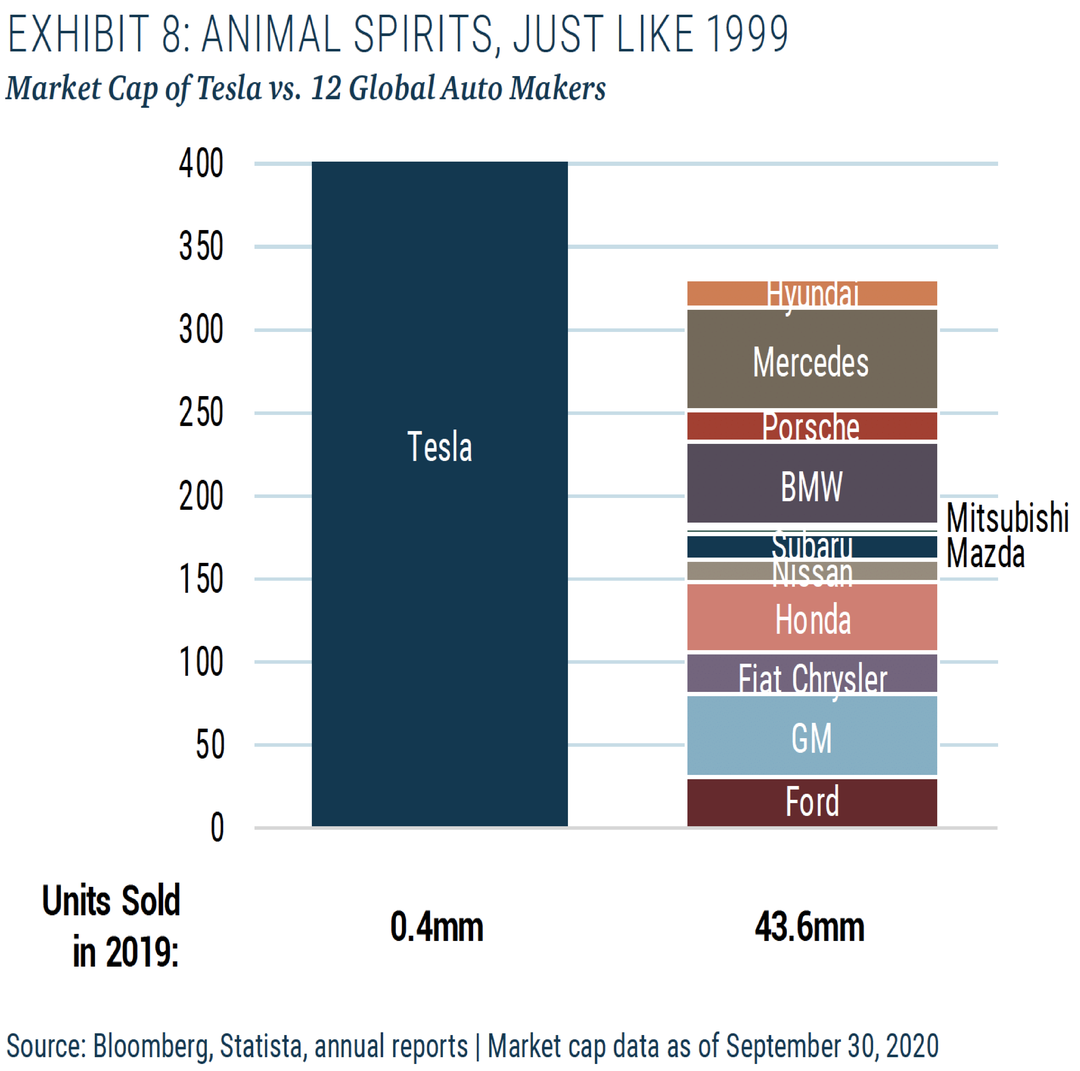
Chart EURUSD

Main takeaway from GMO Asset Allocation Insights November 2020

- Avoid the conventional 60/40 portfolio just like in 1999.
- Today is the perfect time to be unconventional which, by the way, KTS has applied to its asset allocation policy for some time now.
- Emerging Market equities look amazingly cheap today just like 1999. Emerging value stocks and also currencies are the cheapest since 1999.
- U.S. is in a bubble today, just like 1999. Here we basically do not agree. With the 0% interest rate environment, any historical comparisons are actually nonsense, but parameters do have to be adjusted, as our best in class Fund Flossbach is doing.
- As a typical value investor, GMO Asset Allocation is looking stupid today, just like 1999. Overweight in value investing and emerging market equities BUT underweight U.S. Equities just did not work out.
- Value investing is a paradox just like 1999.

Tesla

- This chart of GMO asset allocation is better than 1000 words and possible analysis!
- But, we are not going to short the stock, in the contrary our technical expert in sectors is still long Tesla and Nio.....



Source GMO asset allocation insights

Flossbach von Storch is the best European Asset Manager

- KTS is glad to read, that Flossbach is the best European asset manager.
- Actually, it has not come as a surprise to us, having been invested for almost 10 years now and seeing the outperformance reached constantly every year against competitors for ourselves.
- The best in class fund Flossbach Multiple Opportunities is still our biggest position.
- Links in the media:
- https://m.fondsprofessionell.de/newssingle.php?uid=202140&nt=1

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