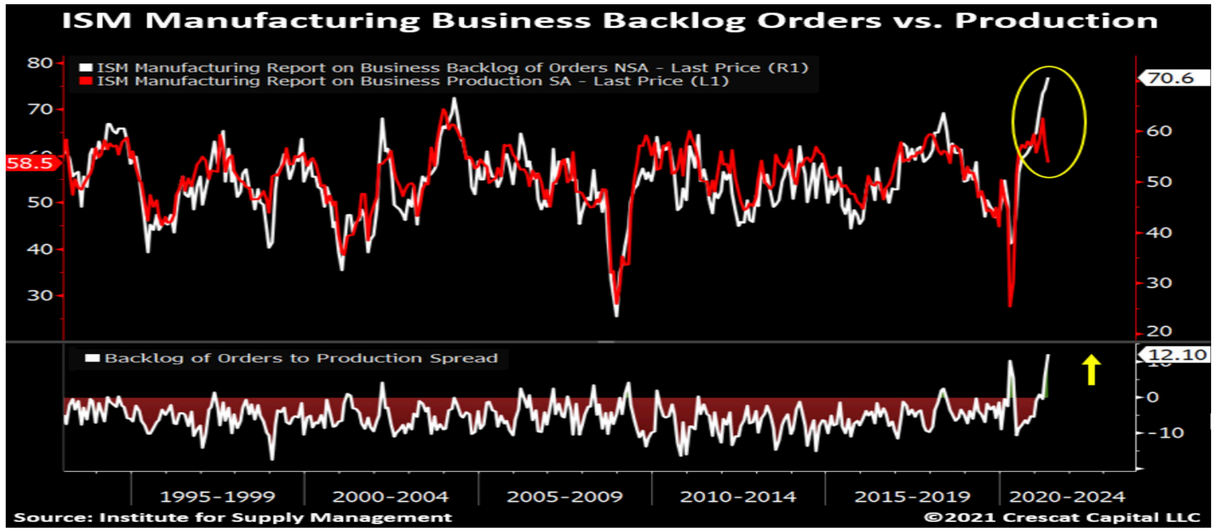
KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 19

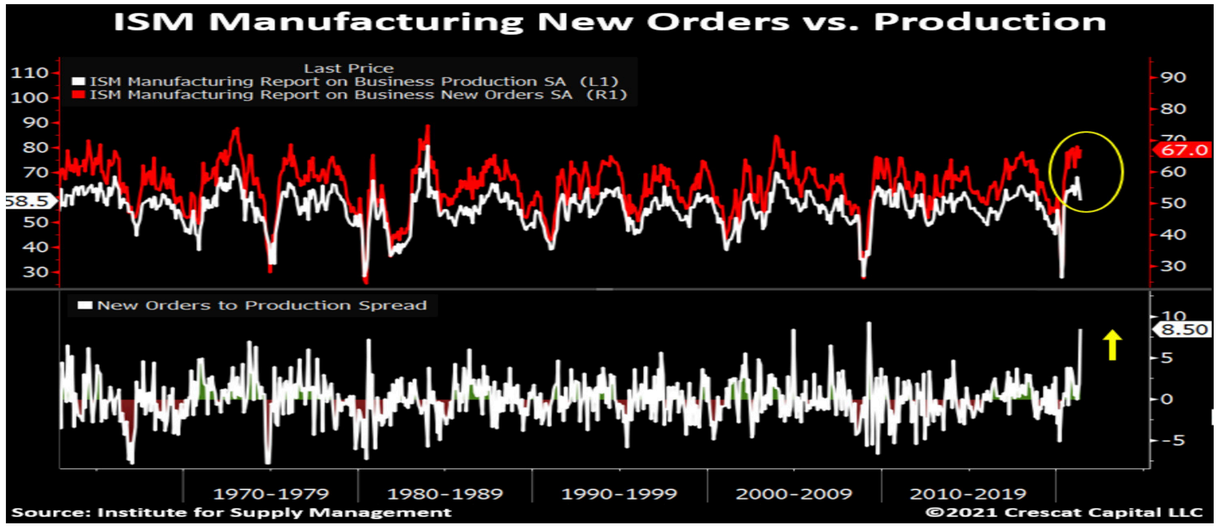
The 6th of June 2021

Largest divergence ever between new orders and production

- Very interesting analysis of ISM manufacturing new orders, business backlog and production from the economist Mr. Otavio Costa (Crescat capital).
- The economy is in full undersupply and inventories are at lowest levels, therefore the economy still have a huge growth potential, even more upside potential for commodities.
- We expect in September 2021 the last payment of the stimulus package and when most of the population at risk is vaccinated, the next "kick" in economy growth.



Huge discrepancy between Business backlog orders and production

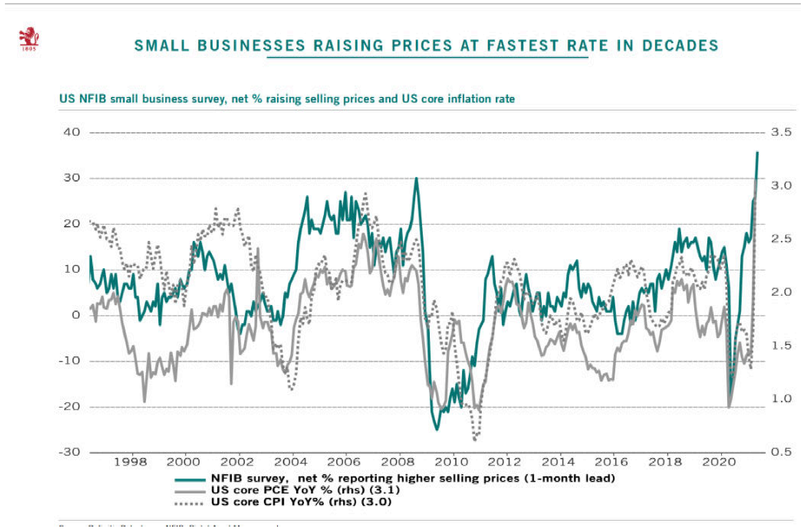


Largest divergence between new orders vs. production

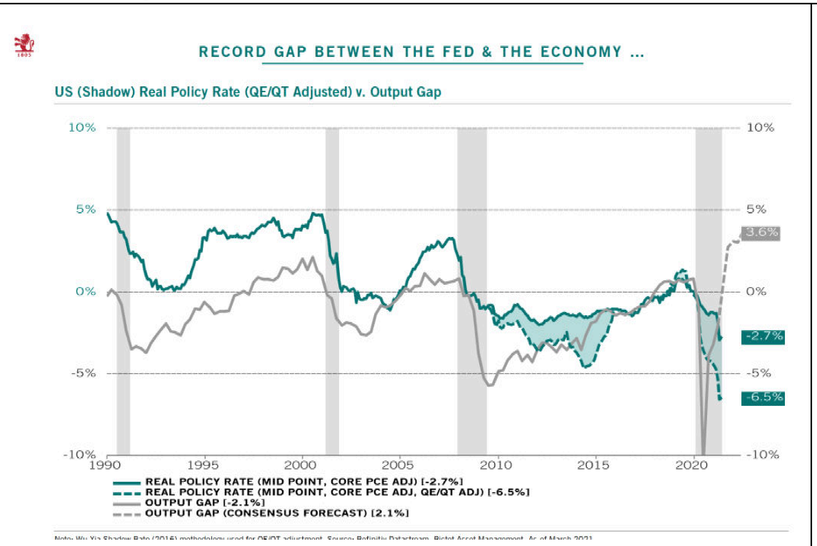
Lowest inventories

Pictet reduce the equity exposure to neutral

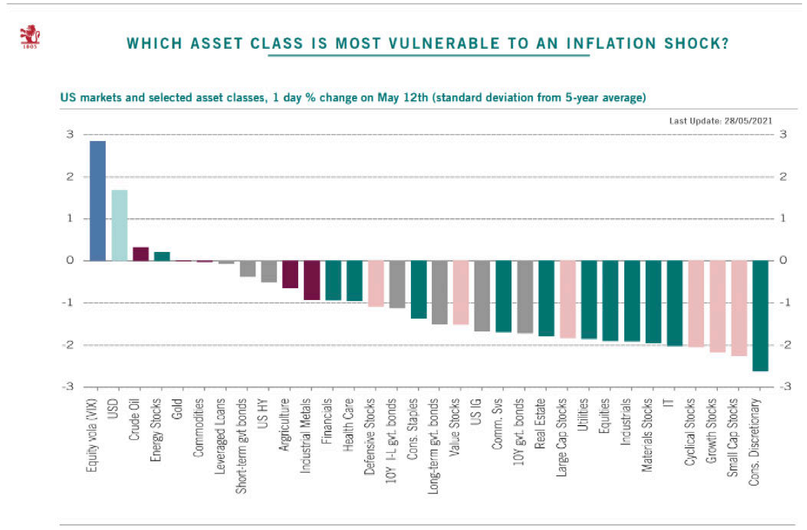
- Pictet has being bullish for quite long time and was one of the first institution to be positive on equity markets after the pandemic.
- The investment commitee of Pictet is worring about a persistent high inflation, which should force the FED to change their dovish monetary policy sooner than market participants are expecting. In case of persistent high inflation, markets should correct and only USD, oil, gold, commodities and energy stocks would experience positive price development.
- We think that the inflation shock is a base effect and has a temporary effect. In September citizens are going to go back to work and supply constraints are going to be contained. Finally developed markets are experiencing real inflation. Central banks fought over years to reach such trend, which is the only way to repay the huge government indebtedness.
- We notice, that more market players have the same worry and therefore, we expect the market's upside potential to be cap for a while. For this reason we are holding some liquidity to be invested in market corrections, if any.



Supply constraints: prices raising too fast



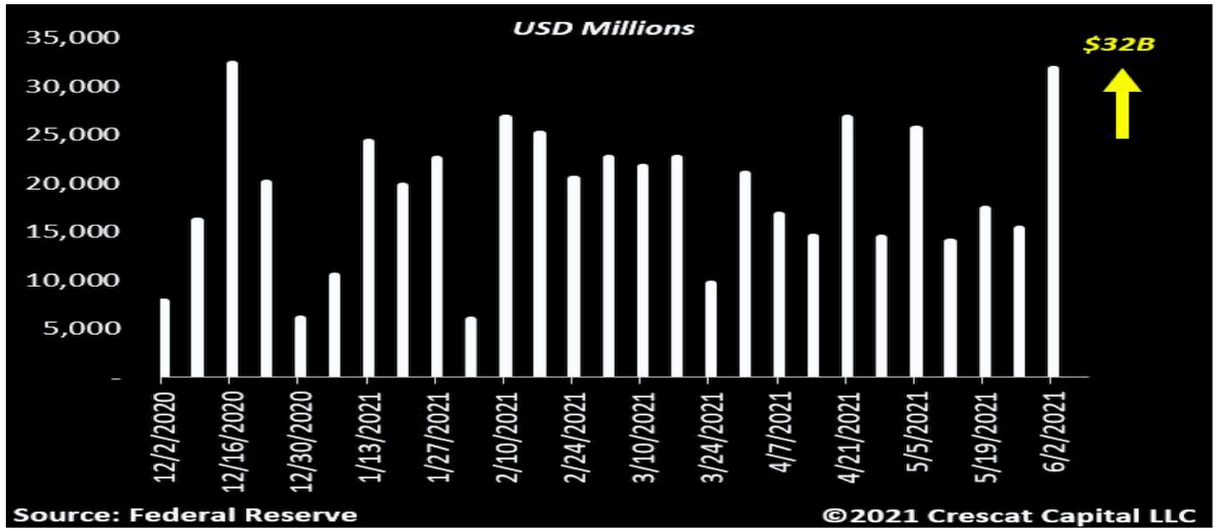
7% negative real rate: too high?



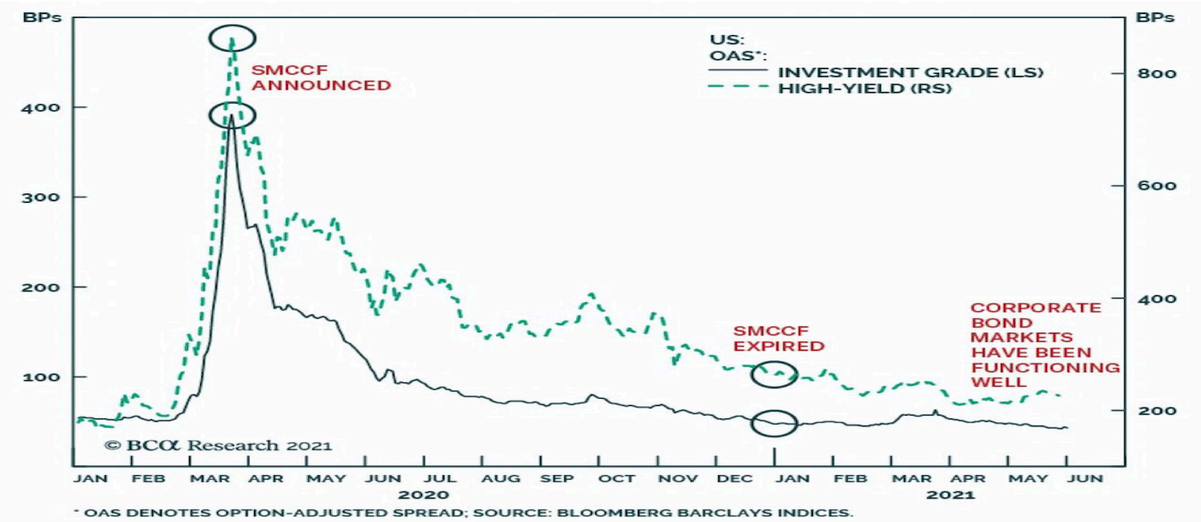
High inflation: good for USD, oil, gold, commodity

The situation of the FED

- We are trying to analyze the situation of the FED and give some answer to the worries of market participants, if the FED needs to change dramatically the monetary policy sooner than later. On the 15/16 june (FOMC) we should have the first answers.
- On the left chart of Crescat Capital we can observe, how the FED just bought the largest quantity in US Treasuries in almost 6 months (USD32 bio in a single week). The right question is, how can the FED start to taper soon, if they still need to intervene into the market with such magnitude?
- On the right side the chart of the FED's SMCCF program. The emergency facility aimed to support market functionality and liquidity. Now the FED can start to sell again corporate bonds into the market, it means, liquidty is back to normality, which is a strong signal. So the FED is unwinding slowly positions, but is NOT tapering! **Therefore we believe that the FED is taking slowly the right steps and is not going to take any drastic move, which could compromise the global economic growth.**



FED's holdings of US Treasury securities (Source FED/Crescat Capital LLC)



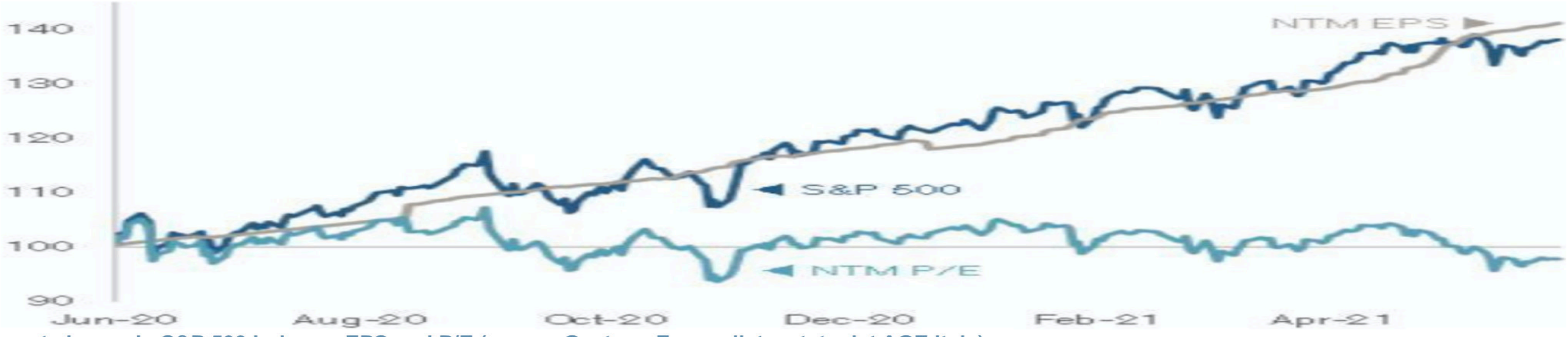
SMCCF (secondary market corporate credit facility) program : source BAC

Inflation analysis from good investment researchs

- We were reading a good market research from some providers with respectable track record and we can summarize as follows:
  - The **Federal Reserve Bank of Cleveland calculated a "median" consumer price index (CPI), which increased year-over-year only to 2.1%**, down from a recent peak of 3% in October 2019. Such trimmed median CPI can provide a better signal of underlying inflation trends than the headline or core CPI!
  - In summer we are going to experience higher inflation due to the extraordinary level of fiscal stimulus since the pandemic has began (estimated USD 5.3 trillion pumped into the economy by direct payments and aid to small businesses), Federal Reserve monetary ease at levels never seen before and the remarkable work of the biotech companies Pfizer/BioNtech, Moderna,etc. with the speed of global vaccination, which offer the best path to a post-pandemic economy growth.
  - The real gross domestic product (GDP) growth should reach at least the 5.5% to 6.5% range this year, this carries with it a demand pressure which contributes to labor supply shortages and manufacturing bottlenecks.
  - The invesment provider see this phase as transitory process as the nation moves through the final stages of this 100-year pandemic. They expect the change in demand that has occurred to cause supply-chain disruptions in the summer season, and therefore the headline CPI and core CPI reading will remain elevated at least until late summer. This coincide with our expectations.
  - Because they expect the inevitable tapering discussion to begin, more volatility in the market is expected, therefore investors should use market' strenghts to reduce equity positions, but rising corporate profit margins are supporting further gradual market's upside (21x P/E). This also coincide with KTS's strategy to keep some liquidity for market's weaknesses.

Are equity really expensive?

- One of the arguments of most market participants (also for Pictet) for reducing the equity exposure, is the high valuation of equity.
- As our best in class fund Flossbach always argued, equities compared to other asset classes, especially vs. bonds, are still very attractive. But the below chart is clearly showing, how from the pandemic, fundamentals are increasing together with the market price, therefore equity valuation (P/E) are at the same level or even lower than June 2020.
- This is very positive for markets actually. Is the proof that markets are not increasing because of multiple expansion, as many market players are arguing, but the increase is supported by fundamentals. Not to forget the increase of companies' share buyback programs and dividend payments, which are a natural hedge for markets.
- For this reason, we understand many market participants are worrying about inflation and we see a cap in the upside potential. We will invest our liquidity in any market's correction, because markets are not expensive and have strong fundamental supports.



Percent change in S&P 500 Index vs EPS and P/E (source Gaetano Evangelista, stategist AGE Italy)

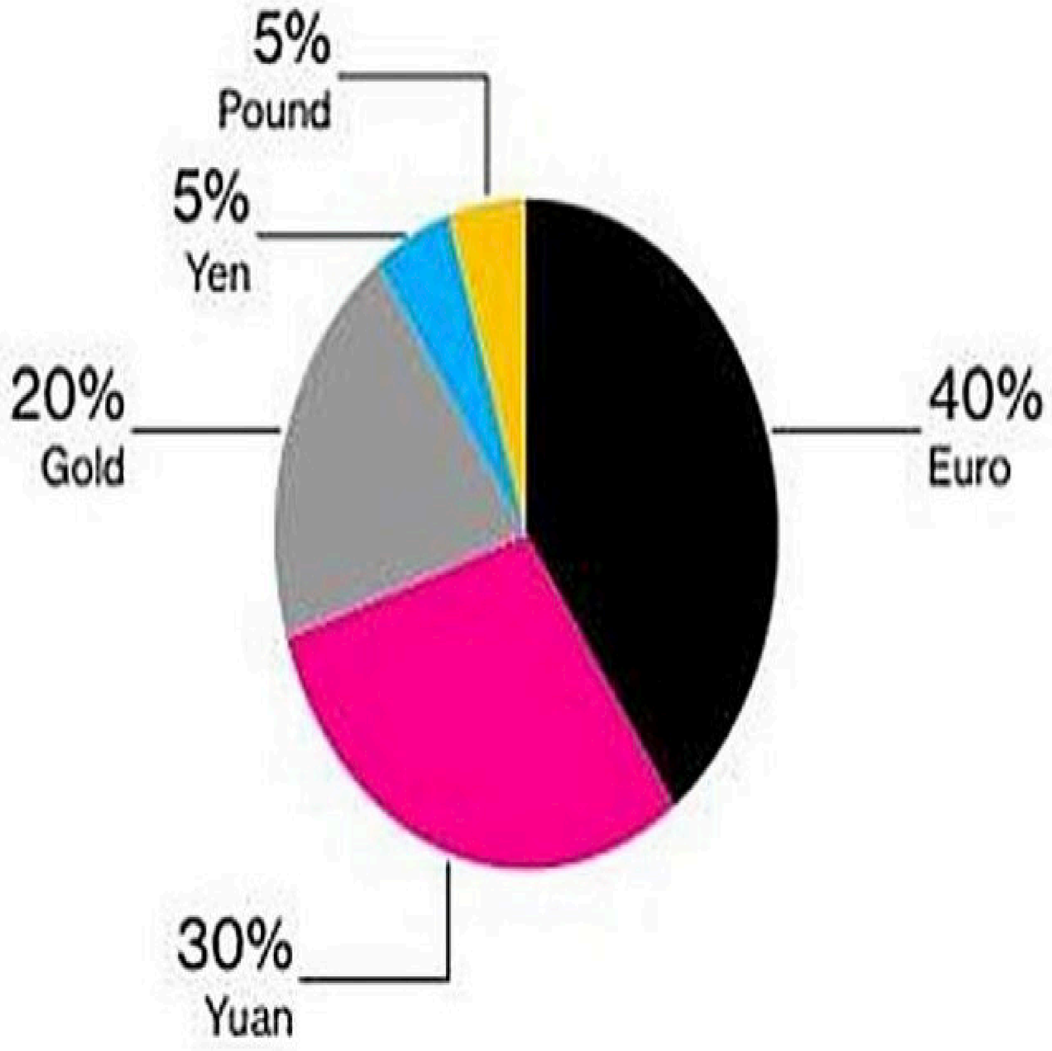
Tesla and the Chinese market

- China is the most important market for electric vehicles. By 2030 sales of EVs are expected to be around 9 mio, which equal an annual growth of 24%.
- The trend is supported by the Chinese government, which wants to reduce dramatically CO2 emissions by 2040. EV sales should increase from a current market share of 8% to 50% by 2035.
- Therefore the Chinese market is the most important market for Tesla, but the U.S. company is experiencing a massive competition and has reputation problem, even if Tesla invested USD 614 mio in a new “Gigafactory” in Shanghai and is helping the Chinese government to build up the recharge network for EVs.
- Market participants are starting to doubt on the potential growth of the company and the stock price is falling under the important 200d support of 600 USD.

China is the most important market for electric vehicles (flowbank/statista)

Russia’s sovereign wealth fund asset allocation

- Russia is sending quite a strong signal to the world.
- The Russia’s sovereign wealth fund has decided to disinvest all of its dollars and dollar-denominated assets in favor of those denominated in euros, yuan and buying precious metals.



Russia disinvest all USD denominated investments (Flowbank/Russia finance)

General news

- According to the magazine Financial Times, **60% of Nestlé' products do not meet "recognised definition of health"** and for some category is not going to change in the future, no matter how much Nestlé is trying to renovate. Apparently this statement was in a presentation circulated among top executives. Water and dairy products scored better (82% of waters and 60% of dairy are meeting the healthy treshold). We do not believe, that by other major producers the situation going to be better. The only solution for the population is to be sensible regarding our nutrition habits and do not expect, that major nutrition producers are adapting the whole pipeline for healthier food. Not to forget, if we are living an unhealthy lifestyle, the pharmaceutical industry is also profiting from such trend.
- Google is opening new offices in Zurich. Google started with 2 people back in 2004 and nowadays has 2000 employees, still growing. This is good news for Switzerland; good reputable international companies like the country for the high quality and not only for tax purpose, therefore the foresee increase of global taxes, especially from U.S. should not particulary touch Switzerland.
- Regulators in UK and EU plan to investigate whether Facebook marketplace and Facebook dating have had an unfair advantage over competitors. Of course Facebook is going to cooperate and is confident to demonstrate that the claims are without merit. Once again a Tech giant is attacked from new antitrust probes. As argued in the past, we will have to live in the future with such attacks, which are going to cap the upside potential of FAANGS. We are still invested in the space, but we are not going to increase our exposure. We see more potential in value, precious metals, commodities and energy.
- Last Sunday, the 30th of May 2021, during the Indianapolis 500 race, about 135k spectators were present at the track for the largest sports event since the start of the pandemic (40% attendance and leaves 100k empty seats). Quite a strong signal of normalisation and one person could wonder, why many people are still not going back to work.....

DISCLAIMER

This report has been prepared by KTS Capital Management AG (“KTS”) / VICTRIX AG (“VICTRIX”) and is intended for information purposes only and does not constitute an offer or an invitation by, or on behalf of, KTS/VICTRIX to make any investments. Opinions and comments reflect the current view of The Investment Team of KTS/VICTRIX and not that one of a third party. We assumes no obligation to ensure that other such publications are brought to the attention of any recipient of this publication. Investments in the asset classes mentioned in this publication may not be suitable for all recipients. This publication has been prepared without taking into account of the objectives, financial situation or needs of any particular investor. Before entering into a transaction, the investor should consider the suitability of the transaction to his individual circumstances and objectives. This publication does not constitute investment, legal, accounting or tax advice or a representation that any investment or strategy is suitable or appropriate for individual circumstances, or otherwise constitutes a personal recommendation for any specific investor. We recommends that investors assess the specific financial risks as well as legal, regulatory, credit, tax and accounting consequences with a professional advisor. The information and data herein are obtained from sources believed to be reliable but no guarantee can be made that the information is accurate or complete.