KTS CAPITAL MANAGEMENT

KTS weekly update Nr. 20

The 11th of June 2021

Will the FED start tapering?

- The economist Mr. Alfonso Peccatiello has a more technical, but, nonetheless brillant, explanation as to why the FED is not yet ready to introduce tapering.
- Mr. Paccatiello has analyzed the U-6 unemployment rate category, rather than the headline rate.
- The U-6 rate represents the percentage of the labor force that is unemployed, underemployed, or feels discouraged from seeking a job. The U-6 rate is over 10% and not 6%, as provided by the headline rate. The availability of labor is important input for the long-term real growth rate of an economy. With labor supply growth still negative and productivity stagnant, the natural rate of interest (inflation-adjusted consistent with the full use of economic resources and steady inflation) in the US is around 0%.
- The only solution in such a situation is further negative real interest rates, and not higher real interest rates! **Therefore, the FED will need to still buy bonds (= further QE, not tapering, which would increase rates), though at a slower pace.**

Negative real interst rates (source: Mr. Alfonso Peccatiello)

Increasing EPS is the next driver for the upside of markets

- As we explained in our previous update, companies EPS are increasing; and, even should the market rally, P/E`s remain at the same level as last year. Therefore, the market's current rally is supported by strong fundamentals.
- With the ongoing presence of global fiscal stimulus set to continue, we believe that EPS are going to increase further. Providing additional support to the markets.

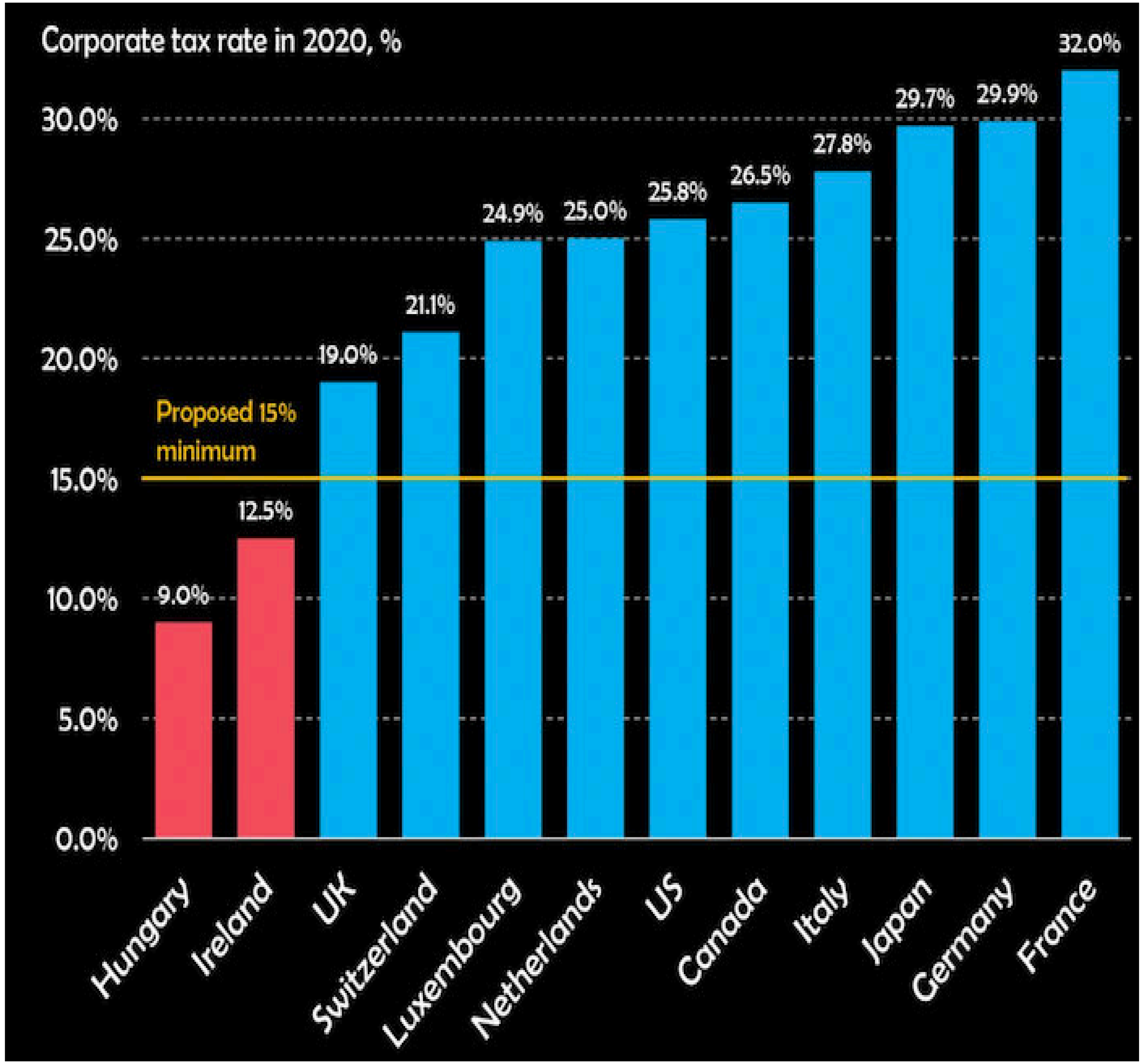
Market's rally is supported by EPS' increase: in 2010 after a small correction, market rallied further (source Mr. Jurrien Timmer, Global Macro at Fidelity Inv)

Morgan Stanley’s fundamental and technical models

- Fundamental analysts at Morgan Stanley have been turning increasingly bearish on stocks in the past months.
- According to the chief equity strategist Mr. Michael Wilson, the overall market is vulnerable to a 15% correction over the next 6 months.
- This week, Morgan Stanley’s technical analyst team announced that, for only the fifth time in over 30 years, all 5 market timing indicators were giving a simultaneous sell signal!
- As explained in our past reports, it appears that respected institutions are now increasingly cautious on global equity markets. Therefore, we expect to see more sellers than buyers gradually appearing in the market. On the other hand, the institutions that are turning bearish are expecting a correction in the order of 10-15% and not for a collapse of markets. Consequently, if the markets do not correct, we anticipate a FOMO rally later in the summer. We are also taking into account that equity purchases in the U.S. *after January 2022* will be subject to higher capital gain taxes. Therefore, underinvested market participants are probably still likely to increase equity positions before year’s end.
- As our best in class fund Flossbach always argues, it is important that investors have a longer term view on markets. For this reason we are not reducing our equity exposure substantially in the light of such strong fundamentals supporting markets for the new cycle / paradigm. Nevertheless, we hold some liquidity (15% to 20%) on the account to invest opportunistically, in addition to a position in put options with maturity September 2021, providing a hedge against any hidden risk, which could trigger a stronger market correction than foreseen.

G-7 countries back a minimum global tax of 15%

- G-7 countries agreed to back a minimum global tax of 15% for corporations.
- As we already analyzed in the 18th weekly update edition (21st May 2021), most of the tech giants are already paying an average of 12.5% in taxes. Therefore, the increase to 15% is actually not such a bad news.
- FAANGS will experience a negative impact on EPS, but not as much as some market participants feared, especially because many multinational companies are paying on average over 20% (Nestle, Siemens, Samsung, Toyota Motor, etc.).
- Only countries like Hungary or Ireland are under the threshold of 15%!



Corporate tax rate in 2020 % (source EEAGLI / Mr. James Eagle)

Financial behavior

- An anonymous market participant was able to quantify the impact of Elon Musk's tweets in the Bitcoin space: apparently, over 1 mio people suffered as their holdings were liquidated in the correction and, basically, lost their entire savings.
- We could only guess at the magnitude of losses incurred, but now we start to have some concrete statistics. The magnitude is comparable to the equity crash back in the year 2000! And these retail investors will not be back in the market any time soon.
- Of course, many market participants are asking why retail investors are investing all their savings in such volatile crypto markets. The answer is much simplier than anyone would expect: **greed makes people blind.**
- Historically, it has happened many times before. Even if many Hollywood movies have already shown us many true stories and events ("Boiler Room" year 2000, "Wolf of Wall Street" 2013, "Gold" with Matthew McConaughey 2016 to mention a few examples), human emotions (greed) is the real cause of irrational investment behavior (so called "financial behavior").
- Unfortunately, this is unlikely to change in the future. We will always have new younger investors entering the market. As long as the younger generation invests savings they have earned themselves it can be an healthy learning process. But the problem arises when younger investors invest inherited wealth and underestimate the downside risk of investing.
- **KTS is the trusted partner for families & entrepreneurs. We have the fundamental and crucial mission to ensure a smooth transfer of wealth to the next generation.**

General news

- Typically, when an institution finds itself in a bad place the situation deteriorates before stabilizing and eventually improving. Credit Suisse now has a redemption issue with the hedge fund Renaissance Alternative Access Fonds placed by its mandates and clients. As mentioned in our past weekly reports, the well known HF Renaissance experienced a disastrous performance in 2020 made worse by heavy redemptions. Apparently, the HF now has liquidity issues to satisfy such heavy outflows.
- Central banks added another 69 tons of gold to their reserves in April 2021! This is a strong signal and we are guessing these buyers are mostly the Russian and Chinese central banks, which are diversifying heavily from the USD and are definitely not diversifying via cryptos (see also following slides “USD losing the role of global reserve currency”).
- Quality has its price, but a company like Hermes is trading at 63.5x P/E for 2021, 55.5x for 2022 with FCF yield of 2% and a dividend yield of just 0.7%! In our opinion, there are more attractive alternatives in the market right now.
- We are reading that the stock AMC US is heavily weighted in 2 ETFs : PEJ US (USD 1.6 bio AuM, position AMC US 3.25% weight) and SFYF US (USD 22 mio AuM, position AMC US 19.33%). Investors should analyze in depth passive investments, before investing.

USD losing the role as global reserve currency

- As mentioned in the past, we observe how global investors, institutions and governments are diversifying away from the USD. As the economist Mr. Day Dalio (founder of Bridgewater Associates) and HF legend Mr. Stanley Druckenmiller mentioned in the press, the USD is going to lose its status of leading global reserve currency. They see the Renminbi increasing to a global marketshare of 10 to 15% as a global reserve currency.
- Nowadays, the Renminbi does not even represent 2% of global marketshare. Meanwhile, the USD currently represents 59% (down from 71% in 1999), EUR 21% (18% in 1999), YEN 6% (unchanged from 1999) and GBP 4.7% (was 2.7% in 1999).
- Last week we saw that the Russian wealth fund sold all its USD based investments for Yuan, Gold, EUR, JPY, etc.
- Market participants are starting to notice that tensions between USA and China are also translating into long term strategic changes amongst global governments and institutions. Remimbi`s recent strength is also something that is no longer going unnoticed. Such a development is likely to eventually cause higher inflation for USA. In such a tense geopolitical environment China, Russia and other countries, in conflict with USA, can no longer depend on the USD and will be obliged to diversify further.
- In the eyes of many market participants, the best asset class emerging from such diversification is gold, rather than other currencies. Most, of which, share similarly weak fundamentals.
- Investors should not forget that China is invested and continues to invest heavily in continents like Africa, and also in the South Asia region (Pakistan, Bangladesh for example). Therefore, the Chinese government has much more influence in such regions than the USA. This influence will also be translated into the use of more Renminbi over the long term. The free trade agreement between the Asia-Pacific nations, in which the US is not a member, but China is, will increase Chinese influence further still.

USD losing the role as global reserve currency

USD dominance from Bretton Woods 1944 - 77 years / Source: The big picture (Mark Dittli) / JPMorgan

Bitcoin technical analysis

- Bitcoin is falling out of a consolidation triangle and the market experienced its biggest outflow in the past 7 months. There now exists a high risk that the Bitcoin price is going to fall further, especially in the event that the support level of 30k be broken.
- The next important support would be 18'300 (last Fibonacci), which is also the medium term upside trendline. Any new long trades should be made at those levels, or in the case Bitcoin breaks above USD 39'466 (upper level of the consolidation triangle)

Breakdown from the triangle consolidation

Bitcoin news

- The Bitcoin price positively reacted to the announcement that El Salvador, is going to adopt it as legal tender. El Salvador is the first country in the world to approve Bitcoin as legal tender. The designation allows bitcoin to be used to buy goods, pay taxes and bank loans and would give access to many citizens, which nowadays do not have any access, to financial services.
- Worldwide there are many emerging market countries, in which the majority of the population owns a mobile phone, but does not owns a bank account. Bitcoin, blockchain technology and crypto currencies are definitily going to improve the lifestyle in emerging markets, there is no doubt.
- Bitcoin's price also positively reacted to the announcement of The Basel committee on Banking supervision, which sets international banking standards, which recommended capital requirements for holding bitcoin. The risk weight proposed is 1'250% for bitcoin, ether and all other cryptocurrencies. It means that a bank would be required to hold capital equivalent to the face value of the bitcoin expsoure. Actually, this news would be negative, because it is highly questionable, if banks really want to reserve capital for the exposure in cryptocurrencies, but market participants think that such news is a proof of cryptocurrencies beginning to make their way into the traditional financial ecosystem and it is normal to expect various regulatory bodies to begin to set regulatory initiatives to protect savers and investors.
- On the other hand, the U.S. Treasury secretary Janet Yellen keeps her strong tone against cryptos, claiming that, cryptocurrencies pose challenges related to financing terrorist organizations and insisted that, the Treasury department is taking actions to prevent organizations from receiving funds in this way. A good example of such success is the recent seizure from the U.S. Department of Justice of USD 2.3 mio, which apparently were paid to the ransomware extortionists Darkside, when the Colonial Pipeline was targeted from a hack attack.

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