KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 22

The 18th of June 2021

FOMC meeting

- In the eyes of market participants, the FED is moving towards a more hawkish monetary policy; and certainly appears to be signalling that it will begin to slowly increase interest rates in 2023.
- 10yr US treasury yields increased by 18 bpi. Subsequently, the USD rallied whereas gold and commodities fell. Equity markets reacted neutrally.
- The FED left asset purchases unchanged (USD 120 bio monthly) and that will continue until further substantial improvement in the economy's recovery is evident. As already pointed out many times, the demand for Treasury is falling. Therefore, the FED has to cover the gap. In fact, statistics show that, in the meantime, the net supply of bonds has been relatively flat since March 2021. The Fed has added close to USD 300 bio because of missing external demand from investors, most probably China and Russia. These are all signs that show a clear "point of no return". They also point out weak fundamentals for the USD.
- The 2023 interest hike expected from the FED is forecast to reach levels of 0.6% (from 0.1%). Actual forecasts from market participants exceeded 1%. Therefore, we are surprised by the market's reaction, especially the gold price and the USD. We think that the market has overreacted. In fact, as already explained, the FED needs to employ more hawkish "language" in order to try to dampen the enthusiasm of the investor community, in order to avoid a short term bubble developing in the equity markets. But, in reality, despite the hawkish tone, the move towards higher intertest rates will be managed smoothly; the last thing the FED wants to do is rattle the markets..

FOMC meeting

- Powell is also not in the position to change his monetary policy anytime soon. Biden's administration is in full stimulus and ultra expansive monetary policy mode. The aim is to support the lower classes, who have been particulary hard hit by the pandemic. The Democrat Party is under pressure to not lose their majority in the lower house of Congress next year. Yellen is doing everything possible to reduce unemployment and help minorities. Therefore, if Powell wants to stay in power during FED re-election next year, he needs to stay aligned with the expansive monetary policy of Biden's administration.
- But, of course, if the output gap is to be closed by year's end, providing the economy with full employment by next year, in addition to the fact that we are expecting full normalization by 2022, the real dilemma will hit in 2023/2024. When there will be a realistically high risk of the global economy overheating?!

ECB purchases

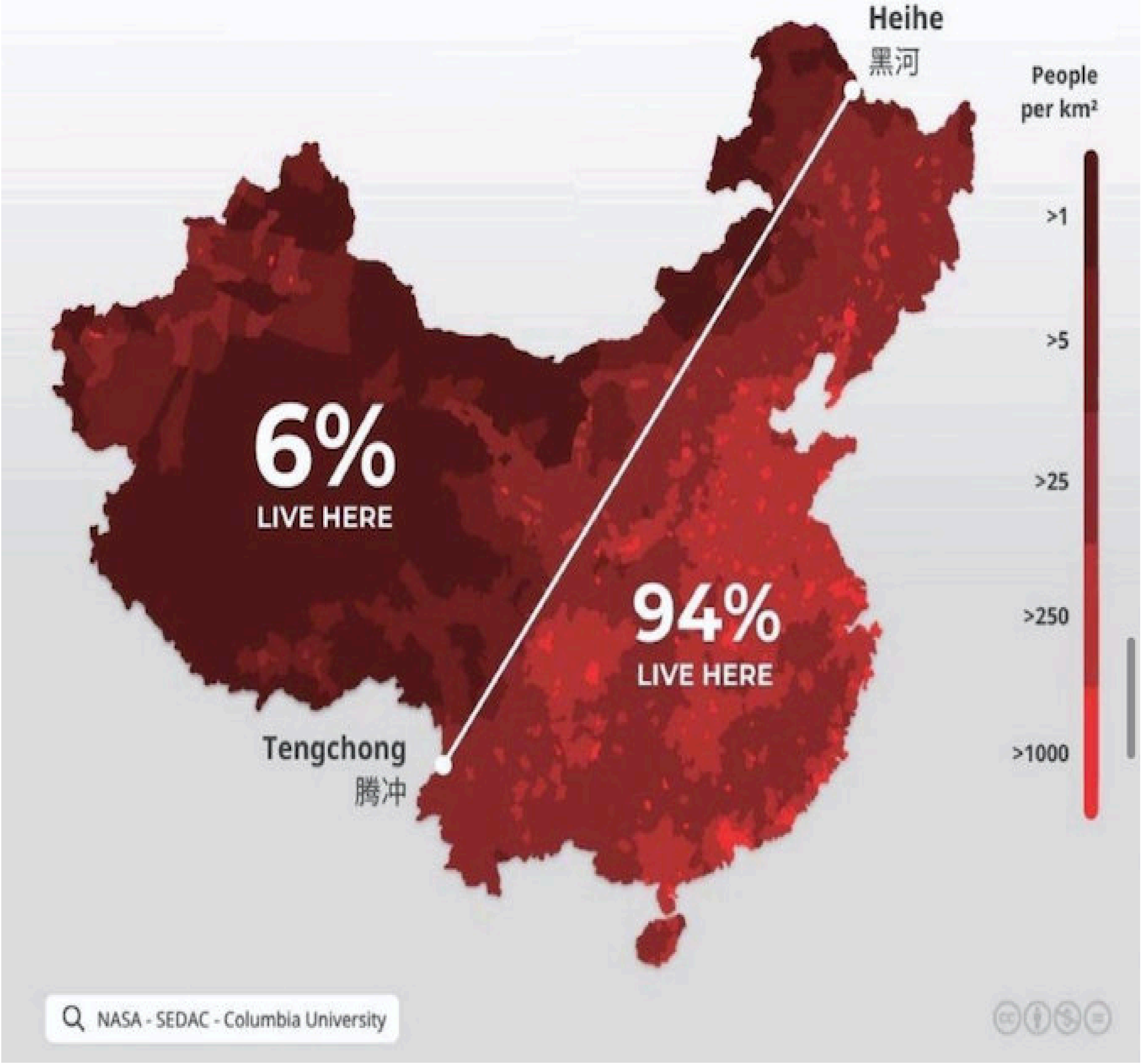
- According to statistics, the ECB is absorbing up to 100% of all government borrowing needs remaining in 2021.
- Mr. Alfonso Peccatiello is asking the right question- why is the ECB is still buying such a quantity of bonds if the economy is now clearly growing as hoped for and that, slowly, the EU population is showing signs of developing immunity.
- The answer is we have reached the point of no return. The economy needs fiscal stimulus and ECB has to keep supporting it.

	Supply left	ECB purchases	%
Germany	121	127.16	105%
France	138	131.56	95%
Italy	158	127.6	81%
Spain	80	86.9	109%
Other govies	79	92	116%
EU and Supras	80	76	95%
Total	656	641	**98%**

Greek 5-year bond yield has just turned negative! (Source Alfonso Peccatiello)

Heihe-Tengchone line

• Very interesting chart from Mr. James Eagle: the imaginary line that divides the surface area of China into roughly two equal parts, but with definitily contrasting population densities.



Population density in China - line Heihe-Tengchong (source Mr. James Eagle)

General news

- EDF is seeking data to review the facts on a report concerning a possible Chinese radiation leak. We still do not know the severity of the matter, but it looks like any leak has been (hopefully) contained. In any case, once more the security and safety of producing nuclear energy is in question. This at a time when the world was gradually re-building confidence in nuclear as a secure and safe power source. We need alternative sources of affordable, clean and sustainable power in the near future. The only real clean and unlimited alternative source of energy would be “fusion power”, as mentioned in our recent weekly update. The university of Lausanne is part of the challenge of providing an alternative energy source.

Bitcoin news

- We are reading between the lines that Elon Musk is trying to restore credibility in Bitcoin by announcing that Tesla will resume accepting Bitcoin payments for its cars. Once, that is, miners of the cryptocurrency can show they are using roughly 50% clean energy. Hedge fund billionaire Paul Tudor Jones has said to go “all in” on the inflation trade, should the FED stay nonchalant about rising prices (he is buying commodities, cryptocurrencies and gold, each representing 5% of his asset allocation).
- The Tanzanian president has urged the central bank to prepare for crypto.
- But, the most important news in the crypto space was definitely announced by the company **Microstrategy.** The company is preparing to buy up to USD 488 mio in Bitcoin with the proceeds of a USD 500 mio bond (sale just completed) and may sell USD 1 billion stock in order to buy even more Bitcoin. We are trying to analyze this news in a very diplomatic way, but we think that this cannot end up well. History has already shown, many times, that such “all-in experiments” end up... very badly. We cannot understand how bondholders can feel comfortable investing in such a strategy. Even though the company has been totally transparent on the use of its fundraise, we would not feel at all comfortable to own such a bond; not to speak of the additional emission of equity intended for buying additional bitcoins! The saddest part of the puzzle is that, most probably, the bondholders will be personal pension plans. Therefore, in case of a total failure the normal citizen will suffer the consequences of this “experiment”. For us, this is a sign of irresponsable behavior. If, for any reason, Bitcoin should collapse a situation like the company Microstrategy would most likely cause a crash in crypto prices. Without mentioning the value of all Bitcoin miners, which, nowadays, are buying to keep the price of Bitcoin at the desired minimum level, due to the high fix costs for mining. We are now starting to feel very uncomfortable about the controversial behaviour amongst crypto market players and for us these are all signs of desperation.

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