KTS CAPITAL MANAGEMENT

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Share buyback programs

- KTS has always argued that share buyback programs are the natural hedge for markets.
- Analyzing the chart below by Mr. Jurrien Timmer, head of global macro at Fidelity, we can observe that, since 2009 GFC lows, USD 7.2 trillion has been spent on share buyback programs and USD 9.3 trillion were M&A activities; IPOs were USD 2.2 trillion.
- Therefore, we can assert that such programs are a strong support for markets and are going to stay the same going forward.

USD 2.2 trillion of supply from IPOs and secondaries was offset by USD 7.2 trillion of buyback and USD 9.3 trillion M&A activity: 8:1 demand/supply ratio

Situation of the US workforce

• According to the chart by Mr. Jurrien Timmer, in the US there are 8 million unemployed people, but 11 million job openings. Thus, we have a gap of 4 million, which can basically only be filled by immigration!? And the other question is that many people in US are re-assessing their work/life balance? Before we experience a recession, or the FED seriously considers a significant increase in interest rates, we need full employment, which is going to be translated into higher consumption, therefore higher growth.

4 million gap between job openings and unemployed

Precious metals and speciality metals

- We attended again the webinar of our best in class fund Bakersteel. The outlook and positive arguments are still the same, how could they not be? Subsequently, the undervaluation of the sector vs general equities has become even more attractive.
- The precious metal sector has also hit extreme lows relative to broader commodity prices. Meanwhile, miners continue to dramatically improve their margins, increase dividends and massively improve ESG. Such improvements should be rewarded by the investment community with higher multiples, translated into higher share prices, even if the underlying price of precious metals remains stable at current levels.
- Also, our best in class fund Flossbach is arguing that fossil fuel prices are going to stay higher for longer than the investment community thinks, because the green transition is going to take much longer than expected. In addition, Flossbach's manager holds a 15% long term position in gold.
- According to Bakersteel's manager, the scale of CAPEX needed for the green revolution is huge and is going to exceed USD 1 Trillion.
- Therefore, the manager believes in the new commodity super cycle and that commodity miners remain undervalued, despite the recent strong performance.
- Demand from solar PV could equal or exceed the silver volumes previously used in the photographic film industry, supporting further the silver price. According to the fund manager Otavio Costa (Crescat), silver miners' ETFs just had their capitulation phase experiencing the worst quarterly outflows ever. Almost 3 times as much as the market experienced during the pandemic crash. Consequently, silver miners have become insanely attractive as deep value opportunities.

Precious metals and speciality metals

- In addition, copper (for electrification, renewables), aluminum (solar components) and battery related lithium, cobalt, nickel and rare earths are all in undersupply.
- For sustainability, metal recycling is going to be an important supply source to help reduce air pollution and avoid environmental damage. Back in 1980, when about 1.8Moz of PGMs (platinum, palladium, rhodium) were used globally in auto catalysts, none of these materials came from recycled material. Due to tighter emissions standards by 2020, circa 12Moz were required by the auto industry, of which, circa 50% from recycling.The percentage of recycled material will keep increasing over the coming years.
- According to Mr. Mattia Cremonini, the simple one factor model of the gold price, based on the real 10y yield from 1985 explains, with a R2 of 76% (it means the statistical significance is well confirmed), that the price of gold today should be USD 3’300. Mr. Cremonini concludes his research by asserting that, given the impossibility of real yields to rise due to the enormous debt level, the gold price should likely explode on the upside in the coming years as, currently, it is tremendously undervalued.
- We were also analyzing an interesting chart of Incrementum, whereby gold physical deliveries have gone through the roof during the pandemic.
- We feel very comfortable with our investments in Baker still Electrum and precious metals, though we are not rebalancing the position.

Highlights from Flossbach's seminar

- As mentioned last week in our report, we attended a seminar of our best in class fund. We would like to mention a few highlights:
  - As usual the manager believes in lower interest rates for longer and that we should keep focusing on longer term fundamentals and not on short term volatility. Investors should invest in real assets and equities. The ideal asset allocation should be 15% in bonds, 15% in precious metals, mainly gold and finally 70% in equities.
  - Equity is as cheap as 20 years ago and is the most attractive asset class. The massive increase in equity prices is supported by increasing earnings. The US market is not expensive vs Europe, because US indexes include more technology companies with higher growth profiles, which is translated into higher future cash flows and on a DFC (discounted cash flow) model the NPV (net present value) of the companies is higher. Europe still has too many “old economy” industries with lower growth and higher CAPEX. Switzerland is somewhere in the middle, but has plenty of attractive worldwide leaders with higher quality in the small & mid caps segment. Though, the SMI Index has increased 50% more than the Eurostoxx, but earnings were the same. Therefore, Flossbach's manager is arguing that the Swiss SMI Index is actually too expensive.
  - We show again the simulation of the fair value of the S&P 500 Index, because this number has to be kept in mind by investors, especially in the case of a market correction or, even more so, in a panic situation! With a long term interest rates of 1.5% (and not 3% like analysts are still using), 4% annual growth for at least the next 10 years, the WACC for discounting future cash flows should be 5.5% instead of 7%. The risk premium should be around 4% but ,actually, if an investor believes in lower interest rates for longer, should be even lower, which is going to be translated in a higher values for equity. As long as the dividend yield is around 4% higher than bond yields on an annual basis, and because in our basis scenario interest rates are going to stay low for longer, a 4% risk premium for equity is actually too high.

Highlights from Flossbach's seminar

- With those parameters, the **FAIR VALUE OF THE S&P 500 INDEX IS 6'050 POINTS. THEREFORE, a 38% UPSIDE POTENTIAL FROM CURRENT LEVELS.**
- The manager of Flossbach believes fossil prices are going to stay higher for longer, given the green transition will take longer than most market participants are expecting.
- **ESG: the manager agues that ESG is misunderstood as only renewable. Flossbach always had the primary focus on the G: governance**, arguing, for example, how the deficit of pension plans on the balance sheets of many European companies endanger sustainability for younger generations.
- The manager cited that the fundamentals for sustainability have roots already in the 18th century with Mr. Carl von Carlowitz, who at that time was trying to save forests from deforestation for future generations. Flossbach's manager argues that long term sustainability success is only possible if social and ecologic responsibilities are included, which has always been the key in their investment process.
- The manager mentioned the example of Tesla vs VW. The MSCI ESG rating, which is used for all passive investments in renewables is for Tesla 71 points vs 0 for VW. On www.sustainalytics.com VW scores 10 points vs 24 of Tesla. And finally, the active manager RobecoSAM rates VW 79 points vs 18 for Tesla. Flossbach's manager thinks that active managers can still add value for investors. KTS also shares this opinion.

Japan under PM Kishida

- Mr. Fumio Kishida is the 100th Prime Minister of Japan. He is viewed as safe and stable. This, and the economic fundamentals, should further support Japanese equities going forward.
- During his campaign speeches it appeared that Mr. Kishida is favorable towards reopening the economy for co-existence with Covid19.
- In addition, Mr. Kishida supports the use of nuclear power in achieving decarbonization. He also advocates a digital garden-city nation concept and will offer support by increasing budgets related to digital infrastructure construction in regional areas, including prompt deployment of 5G capabilities.
- Market participants expect a large scale supplementary budget, which should support the Japanese economic recovery in 2022.
- KTS is not specifically investing in the Japanese market and analyzing our in depth asset allocation, we are marginally invested.

Chinese reforms

- The emerging market fund Stonehorn Global Partners held an interesting webinar on new regulations in China.
- The manager believes that Chinese authorities are not doing anything different than western governments, despite western media have commented negatively on such interventions.
- Chinese authorities aim to reach several goals with these new regulations, mainly fair competition (via anti-trust regulations), social well-being reforms for better labour protection and work conditions for gig workers (delivery people and similar workforces), data protection (the same as any other governments are doing arguing to protect vulnerable national security, especially USA), And, finally, with the project `common prosperity`, the government wants to reduce wealth inequality within the country.
- The manager also listed a comparison of western equivalent regulations, for example:
  - The Chinese guidelines on strengthening labour relations for gig-workers (July & August 2021) is equivalent to the US labour secretary supporting classifying gig workers as employees April 29, 2021).
  - Or, data privacy and security guidelines, for example against DIDI US (May 4, 2021), is equivalent to the Federal Trade Commission fining Facebook USD 5 billion due to data privacy violations in July 12, 2021.
  - Tightening in the Chinese housing market in order to solve affordability issues for average families in China (2021) is comparable to the US also having the same dilemma, whereby 20% of Americans are not able to pay the current month's bill in full and 40% of American adults are not able to gather USD 400 in case of emergency. US Stimulus packages were supporting the lower class of Americans.

Chinese reforms

- Guidelines on fair competition by large Chinese companies are also comparable to the digital services act and digital markets act of the EU to force tech giants to take responsibility for the content on their platforms and ensure fairer market competition. This is without speaking of all the recent claims made by US regulators concerning tech giants position of monopoly and competitive unfairness.
- Finally, China implemented a personal information protection law, largely inspired by the EU’s GDPR (November 2021). The office of the Australian Information Commissioner (OAIC) also announced a new submission to the Australian government to revamp the privacy act 1988, also inspired by the EU’s GDPR.

Swedish concept of investing in start ups

- A very interesting Swedish fund structure, like the concept www.spiltan.se and others, should be the model worldwide in order to support internal economies and start ups. Investments made by professionals, and not by governments, are much more efficient and, therefore, the money is deployed more wisely and efficiently. Instead of the well known corrupt practice of investing capital with the friend of the friend. At the end of the day capital is lost having landed in the wrong pockets.
- The key of such success is the structure of the fund: top Swedish wealthy families initially invest in the structure, but are not allowed to redeem. In order to sell their participation, the family has to find a new investor, which will buy at NAV. Therefore, the capital is always going to stay in the fund and the fund manager is able to focus totally on long term investments and apply proper due diligences on projects, without the pressure of distressed exits due to high redemptions. The major dilemma for venture capital investments is the behavior during periods of market panic, when most investors want to redeem investments at the same time. Just when the fund needs more capital in order to guarantee sustainability. Real wealth has historically being built profiting from market' distressed situations.
- Nordics are always a few steps ahead in innovation. We would also expect more effort in Switzerland in such a direction, but most probably politics, as always, will be the biggest obstacle to surmount. Our Biotech expert, Ms. Dr. Myoung-Ok Kwon has recently become partner of Swisscom Ventures in charge of Digital Health. We congratulate her on her promotion. We are sure her knowledge and, most importantly, her work ethic is going to be a tremendous value added for Swiss start ups.
- In Switzerland we also have interesting structures like the highly professional VC structure www.redalpine.com. But the main dilemma is always the same; such plans normally have a 5 years horizon. Therefore, the manager needs to have an exit strategy. In the case of market panic, investors are focussed on the redemption of the capital, not on deploying more capital.

General news

- Multiple steps have being taken to solve the dilemma Evergrande. A China state-owned enterprise moved to buying a 20% stake in a regional bank from Evergrande. In addition, the shares of Evergrande are suspended for a pending “major transaction”. Apparently, the rival property company, Hopson Development, is planning to buy a 51% stake in Evergrande’s property management unit for more than USD 5 billion.
- China also started an initiative the so called Healthy China 2030, where the government aims to invest 16 trillion yuan into the health-care market and biotech firms with higher long-term growth. New official guidance on cancer drugs’ discovery and development could have a positive long-term impact on China’s pharma industry. JD Health, Alibaba Health and Good Doctor should benefit from China’s online-pharmacy growth over the next years, as restrictions on web-based sales of prescription drugs are gradually relaxed. As we can observe, the Chinese government is trying to support many different sectors and switching the focus away from infrastructure and housing. As explained recently, there are still opportunities in the market, but we need to be invested alongside experts, who have local managers that understand where the emerging profitable trends are to be found. For this reason we feel comfortable to be invested in our best in class fund for emerging markets Aubrey.
- Markets stabilized after the news of a Covid19 oral pill produced by US pharmaceutical company Merck, which helps to cut the risk of death or hospitalization by half. The oral medication against Covid has been given FDA emergency approval and market participants are confident of a further speed up towards normalization.

General news

- Interesting "research" on Tesla, which predicts a difficult future ahead:

  https://youtube.com/watch?v=VV9ofSn3LzE&feature=share

- Analysts start having a better idea on lock down repercussions for Q3 and Q4 2021. Nike issued a profit warning on result ending August 2021, but the worst has yet to come, having had Vietnam in lock down during Q3 (-80 to 90% of the normal production level) and re-starting slowly production capacity (actual 30% with forecasts of 100% in the next 2-3 months). The Christmas season is going to be most probably a disappointment. Companies like Nike, Adidas and also ON, are between 20 to 30% lower from highs and therefore we would assert that the market is discounting such foreseeable profit warnings, but is this discount enough? It is a question KTS is not able to answer and therefore we are not fully invested. We have also not the intention to do so on the short term.
- The US senate has voted along party lines yesterday to raise the borrowing limit well into December with Democrats striking a short-term agreement with Republican counterparts that halted a default. Though, the deal will see the borrowing limit raised to $480 billion an amount the Treasury said is needed to meet the United States' cash needs until the last month of the year. Therefore the show is going on, the US senate is just winning some more time. The market reacted positively on the news.
- President Putin announced to be willing to help stabilizing the natural gas prices by increasing volumes from Gazprom to Europe. Mr. Putin added that European authorities made a mistake in shifting from long-term contracts usually preferred by the Russian to short-term sales! After such assessment, our perception is, the spike of natural gas prices is another "political game" and is going to be resolved on the short term, most probably having European countries signing again longer term contracts.

Crypto currency news

- Bitcoin price rallied over 55k USD following positive news comments by the FED Chairman Jerome Powell. He announced that US has no intention of following China in banning cryptocurrencies and SEC chairman, Mr. Gensler, added that US will not go with a China style ban. In addition, US based futures backed Bitcoin ETF could be launched already in October.
- It is also quite surprising that the family office of the “old school” investor George Soros announced it was also invested in cryptocurrencies, saying that the asset class has officially gone “mainstream”.
- All this positive news provoked a short squeeze of bitcoin’s price, most probably because market participants were still short following the Chinese ban.

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