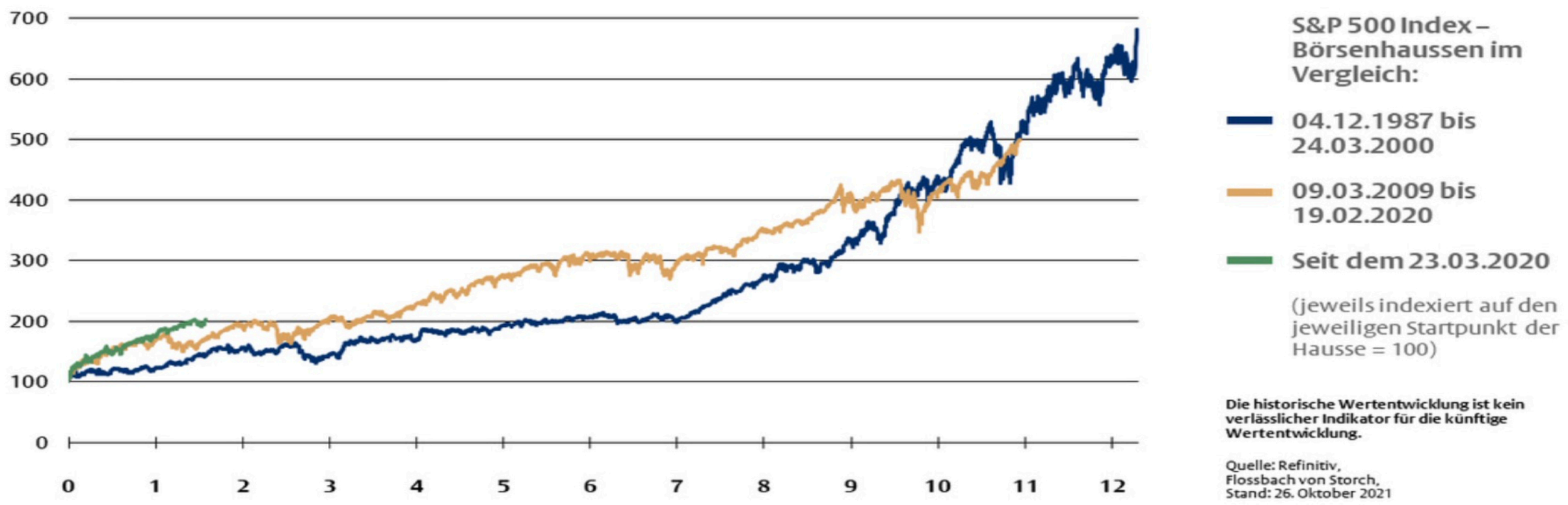
KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 40

The 5th of November 2021

LENGTH OF A BULL MARKET

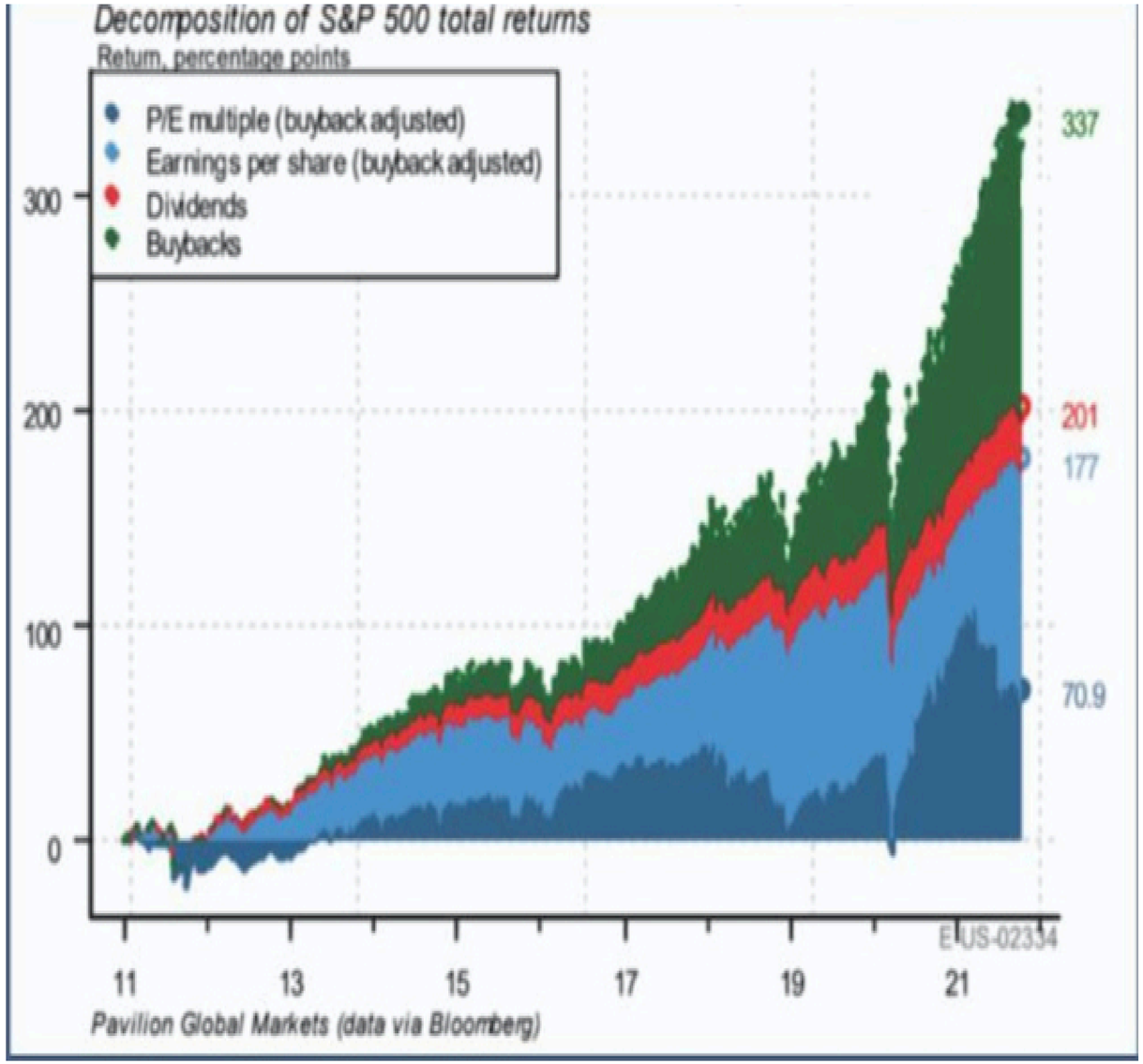
• During the webinar of our best in class funds Flossbach, the manager showed the length of historic bull markets, which also coincides with technological cycles. The green line represents the current cycle and the chart strongly suggests that future upside potential is substantial, as is the **duration, which could be over 12 years**. Market corrections are to be expected, but we have to keep focused on the bigger picture. Also, as Ms. Cathie Wood rightly argues, we are in the midst of an innovative cycle with a lot of mega trends.



Source: Flossbach

The power of share buyback programs

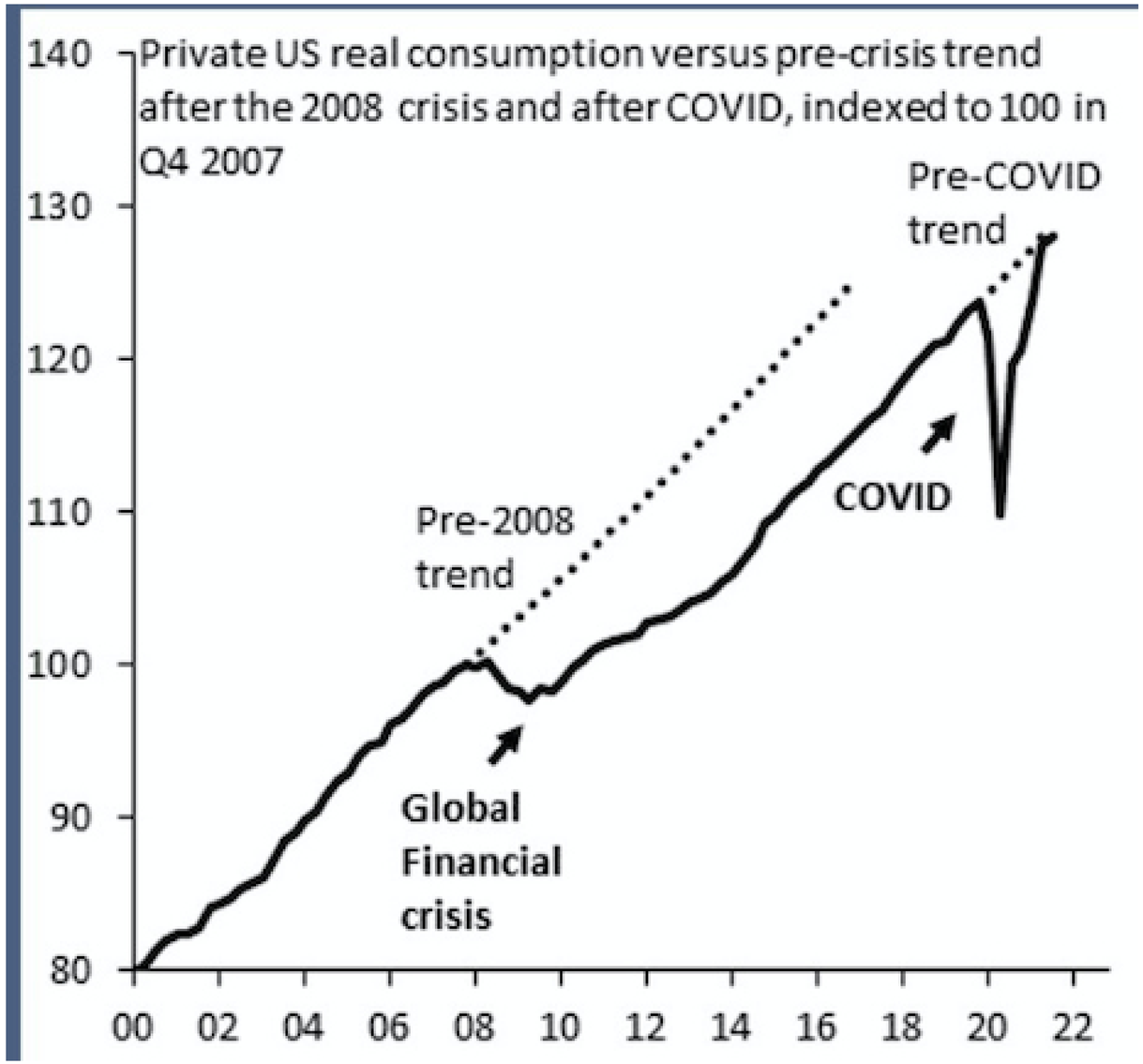
- It is always important to remember the power of share buyback programs, which accounted for more than 40% of the S&P 500 returns over the past decade. As KTS has always argued, share buyback programs are the natural hedge of equity markets and in any market correction companies have the "fire power" to buy in depth; the lower the stock price, the more is purchased.
- The chart, courtesy Mr. Charles-Henry Monchau, CIO of Syz Group, shows clearly the impact stock buybacks have had on the S&P 500 Index over the last decade:
  - 21% coming from multiple expansion
  - 31.4% from earnings
  - 7.1% from dividends
  - **40.5% from share buybacks. Apple reduced by over 37.3% of its shares outstanding during last 10 years.**
  - In our last weekly report we noted that companies were now out of the blackout period and could begin their buyback programs, again supporting the year end equity rally.



Source: pavilion Global Markets, Bloomberg / Syz Group

Real consumer spending in the US

- The chart, courtesy of Mr. Charles-Henry Monchau, shows perfectly how the Covid19 post-pandemic policy stimulus helped real consumer spending return to its pre-Covid trend in less than one year. Unlike during the GFC in 2008, when central banks and government interventions were insufficient and slow.
- We can also observe that, since 2008, the trend maintained an upward path for an additional 12 years.
- KTS genuinely believes that we are at the start of a new economic cycle, which is going to have more upside triggers in the following years. This economic cycle will be supported, on the one hand, by policy makers and government stimulus and, on the other hand, from further normalization processes and, therefore, more entertainment and travel spending. As well as from green transition and, finally, from all the tremendous innovative mega trends, which are going to be with us in the coming decade.



Source: Syz Group

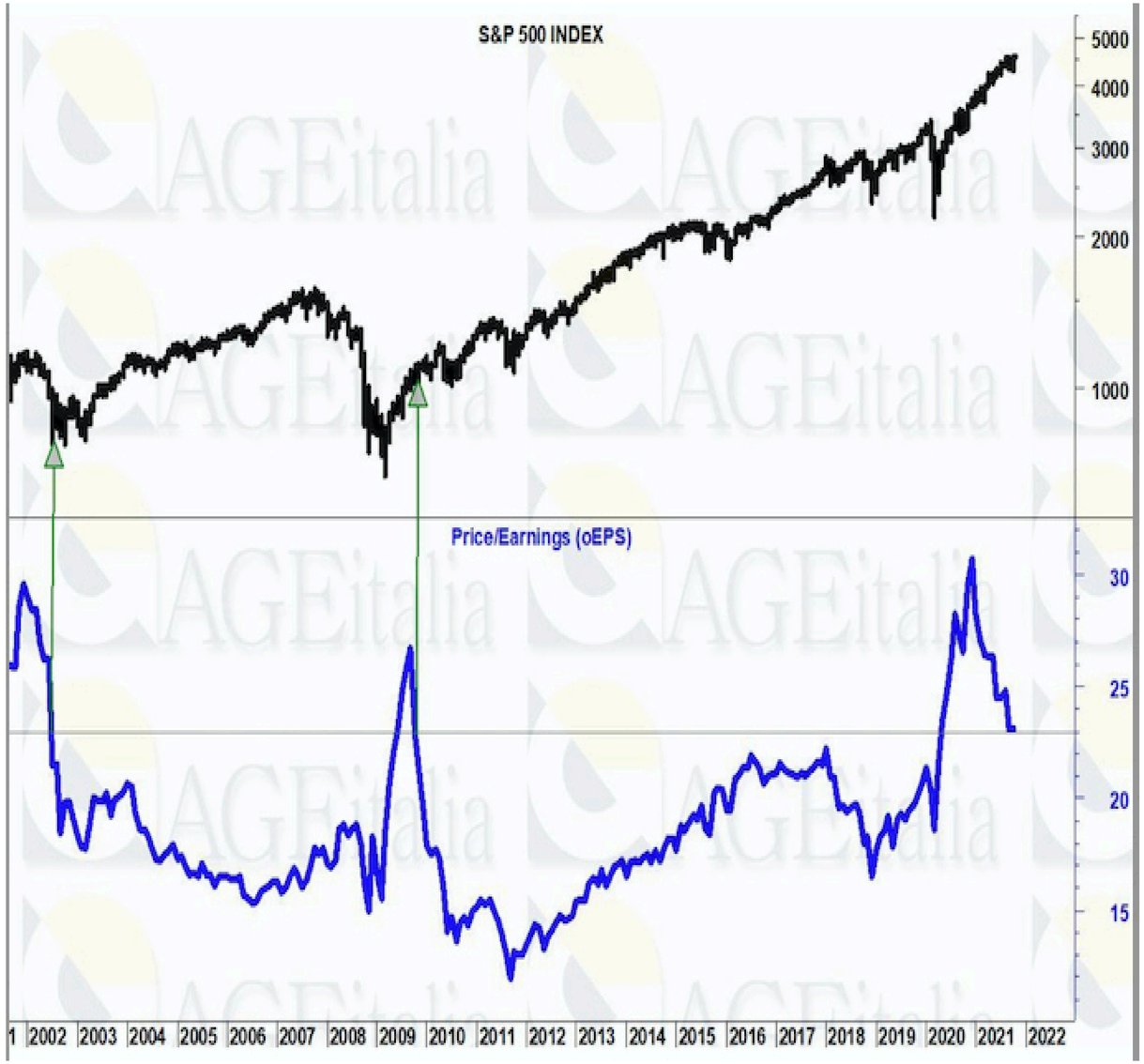
Definition of inflation by US Treasury Secretary Janet Yellen

- Mr. Charles-Henry Monchau, CIO of Syz Group, rightly observes the comments of US Treasury Secretary Janet Yellen and, basically, says how she is re-writing the books that refer to the economy's mechanisms.
- Back in March 2021, Ms. Yellen held the opinion that inflation was manageable, changing that opinion in May to "temporary inflation", then in June increased the outlook to "3%" and in October to "higher for next several months"
- Most interesting was the final assessment this week: Treasury Secretary Janet Yellen predicted that President Biden's USD 1.75 trillion social spending and climate change package will help drive prices lower and get Americans back to work.
- Basically, saying that more fiscal spending is the way to drive inflation lower, which would be a very controversial concept!

  But, KTS`s point of view is very simple: policy makers are changing the projected outcomes, based on their needs.
- As always argued, governments and central banks are going to change their arguments aimed at keeping interest rates low and expansionary monetary policy in place as long as possible in order to achieve negative real yields for longer, with the final aim of technically reducing debt vs GDP, without reducing the debts absolute value.

Valuation

- We read from several sources that equity markets are at bubble levels and valuations are too high vs historical statistic data.
- Our best in class fund Flossbach is one of the few market participants taking into consideration multiple factors and concluding that valuations are not high, definitely not at bubble levels. And that further upside potential for equity markets, of at least +40% from current levels, is possible.
- We came across an additional interesting chart, whereby Mr. Gaetano Evangelista (AGE Italy) is showing that P/E fell from 31x at the end of 2020 to 23x today. Because, of course, earnings have increased. The only 2 times this happened in the past the S&P 500 Index appreciated further, actually by a lot.
- Mr. Yardeni also argues that earnings have increased substantially and confirms a S&P500 target of 4’800 at year’s end, 5’200 in 2022 and 5’800 in 2023. Meanwhile, Flossbach, and also other market participants, like Mr. Jurrien Timmer, see the 10-year yield capped at current levels.



July 2020 and October 2009: in both cases, the S&P500 Index increased

Shipping

- We have recently seen that shipping prices are starting to fall, hopefully indicating that the peak is behind us. The index Baltic Exchange Dry also fell sharply by 28% from its peak in October.
- The ports of Los Angels and Long Beach are working 24h trying to slowly reduce the waiting time. Transport companies are trying to solve delivery problems on multiple levels. For example: using other ports, like in the Caribbean or empty containers being transported via land/trucks.
- The Christmas season is still in danger, but probably not as dramatically as many market participants believe. We are reading that the company Amazon is advising clients to order at least 4 weeks earlier than normal. We would argue that most of people are used to ordering Christmas presents around the middle of November!? So people should start already now.....!?
- The CEO of ABB argues that customers can choose different ports apart from the main ones, and he personally believes that **the situation is going to normalize around Q2 2022.**
- Shipping and semiconductor bottlenecks are still a dilemma, but with Asia slowly, but surely, coming out of lock downs the supply situation should now normalize. During the actual results season, companies surprised and beat analysts' estimates, but we do not expect a repeat of that for Q4 2021 results, which are going to be announced during Q1 2022. It has to be seen if market participants are going to focus forwards to more normalization, therefore, 2023 earnings; or react to the weaker Q4 2021 results?
- We feel comfortable that equity markets are going to look forward. Therefore, we are confident that markets are going to increase further, especially after "digesting" the over reaction to FED tapering fears and seeing yields stabilizing. But, we would feel better still to add some downside protection to our portfolio. **Therefore, we are going to analyze the purchase of puts around the middle of December, especially because the VIX Index is again at lowest levels.**

General news

- Positive developments in Italy are supporting the EU, but the political discussions in Poland about whether to leave Europe surprises us. Poland has received more than USD 225 billion from other EU members and, with public support for staying in the union at almost 90% (according to opinion polls and the newspaper “The New York Times”), we would argue that it does not make any sense for Poland, especially economically, to leave the EU. We quote the end of an article from the online magazine “The New York Times”: there is no other option for us except Europe, said one voter. The only alternative to Brussels is Moscow. And we already know what that would be like.
- With only the children and young amongst the populations in the West yet to be vaccinated it is now finally arriving for them, as it was supposed to: Pfizer vaccine is also recommended for children in the U.S. We do not want to discuss politics, but we know that kids and youngsters are not dying of Covid19. Therefore, we would argue that it is unnecessary to vaccinate children, especially now, when people “at risk” are mostly vaccinated, at least in developed countries.
- UK surprised markets on its spending outlook for the coming years. Most market participants were expecting greater fiscal discipline, but, instead, the planned budget will increase wages, cut taxes for low income households and **pump investment into public services- GBP 75 billion over 5-6 years**. Also, the UK Central Bank is planning to repay debt with the inflation erosion of 3% p.a. and economic growth, as most global central banks and governments are also planning to do.
- According to The New York Times, Merck granted a royalty-free license for its promising Covid-19 antiviral pill to a U.N. backed nonprofit organization aiming at selling the drug cheaper to 105 emerging market countries.
- ECB president Ms. Lagarde reiterated that the central bank is not in a hurry to tighten fiscal policy and that inflation remains transitory for now. Therefore, rates will remain unchanged at around 0% . Good for equity markets and European economies.

General news

- The combined revenue of the 4 largest US companies hit a record of USD 1.24 trillion over the last 12 months: Amazon USD 458 billion, followed by Apple USD 366 billion, Google USD 239 bio and Microsoft with USD 176 bio. Microsoft is still growing 22% in revenues and profit grew 48% (USD 20 bio only in Q3 2021), showing how tech giants can grow like a start up. Of course, as a an article in the magazine “The Economist” argues, technology giants profited from the pandemic; “stay at home” became the new reality. But, in the future, there is going to be more competition from smaller players. KTS has enough exposure to the major tech giants, having all KTS’s best in class funds forced to be invested either in these companies directly or via S&P 500 Futures. As argued in the past, we do not want to influence the selection of stocks. We believe managers of our best in class funds will do so better than KTS. But, we would like to reduce the overall risk, especially with these markets now at new highs and low (cheap) VIX levels, by trying to re-calibrate the exposure via a purchase of PUT options.

General news in Asia

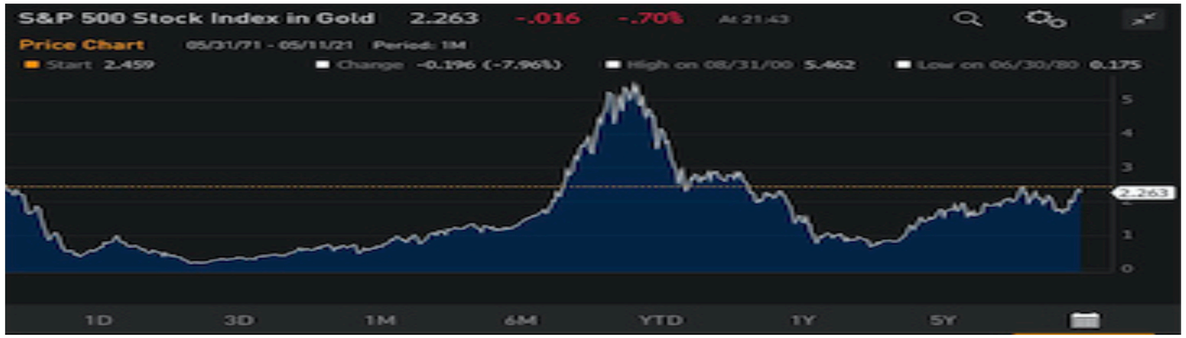
- The Vietnamese Index is also experiencing new highs, whilst, on the contrary, most emerging market indexes are still suffering. KTS's position in the Vietnamese market has been a real "booster" for our discretionary mandates this year, as it was last year. But the most beautiful part of the show, has yet to come. **The Vietnamese government has just announced a new USD 40 billion stimulus package is underway, which is about 15% of the GDP. Therefore, this index's breakout has power and should trigger further substantial upside.**
- Chinese coal futures declined more than 50% over a week after the authorities verbal crackdown saying prices have further to fall, in an attempt to ease the energy crunch. Meanwhile, Chinese stocks have underperformed the world index for 9 months in a row now. This is the longest losing stretch since HSCEI Index data going back to 1993. As a contrarian point of view, this is a buy signal.
- After the campaign by authorities to reduce the burden of homework and after-school tuition for Chinese kids, there is a boom in sport activities and art clubs.

Gold over 50 years

- We were reading again the discussion amongst market participants comparing the absolute value of gold`s apparent underperforming the S&P 500 Index, but not on the net price appreciation
- Back in the 17th weekly report (14.5.2021) discussing purchase power, Mr Peccatiello showed the illusional growth value of the S&P 500 Index, but at the end of the day over a 50 year time horizon, the performance is basically the same, even more, **nowadays it looks like gold is slightly outperforming.**
- Gold is a hedge against inflation over a generational span, not just over months or years. KTS doubts that crypto currencies are going to replace it, having central banks adding up gold positions, not cryptos. In addition, 50% of the world`s gold supply is taken up for consumption (jewelry and technology). Therefore, the assessment of many market commentators that gold is useless is also wrong. Jewelry is not just bought for “pleasure” but also in most cases as a store of value!

S&P 500 Index measured in gold

- Mr Peccatiello shows exactly the right long term comparison, which is mostly forgotten by today`s investors, because we are talking about a 50 year period. That is over two generations and younger investors are not aware of such a `time` phenomenon.
- The chart below shows the development of the S&P 500 Index vs gold: after 50 years the performance is 0% ! In 1971 U.S. left the gold standard and started freely the creation of new USD (as any other country) and the result is: illusional growth!

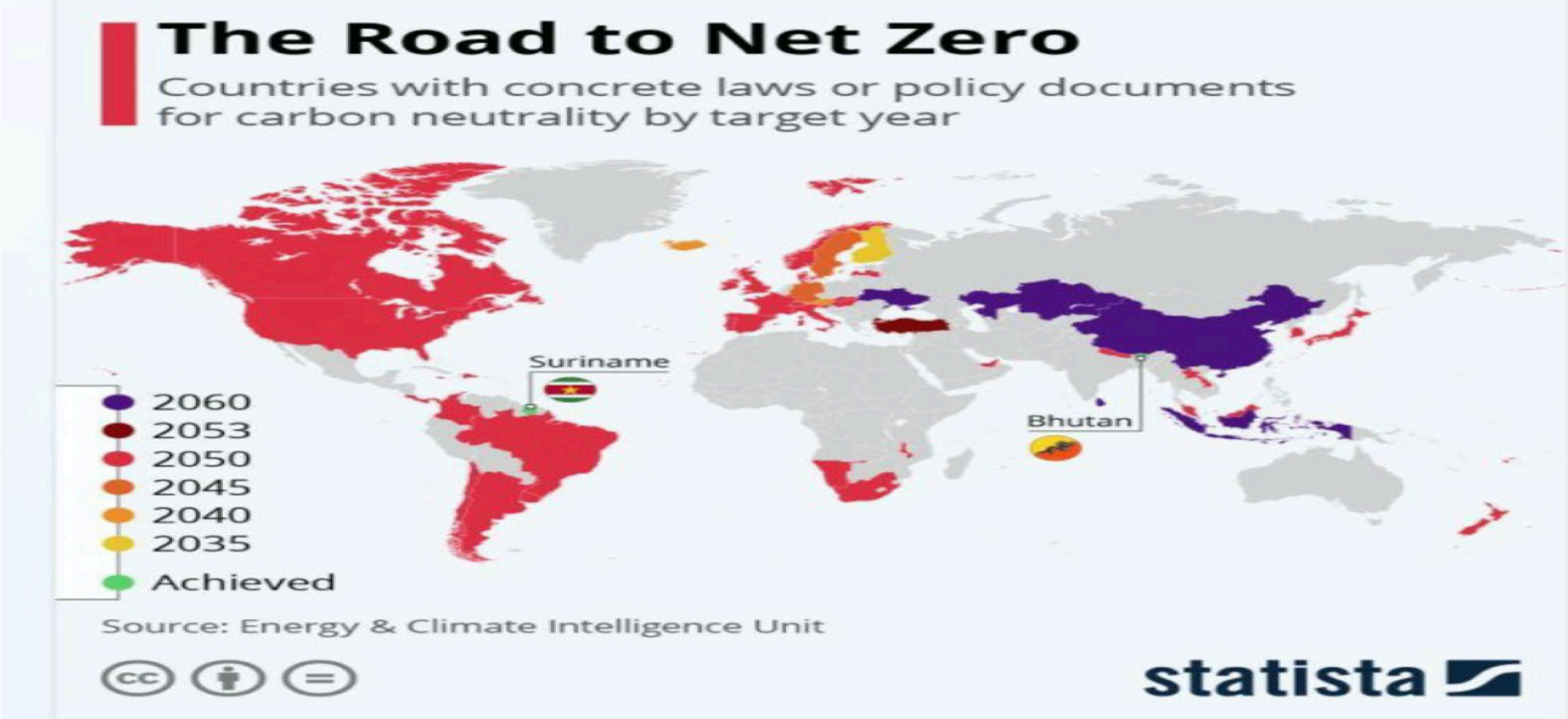


Source: Alfonso Peccatiello, head fixed income ING

Our slide back on the 17.5.2021: purchase power weekly update

Gold outperformance vs US equity (Mattia Cremonini/Viterra)

Countries with concrete laws or plans for carbon neutrality



Still a lot to do.....

Facebook new name Meta, indicating the new vision: Metaverse

- As everyone knows, Facebook changed its name into Meta, which is a symbol of change and a powerful message to the vision and future of the company. As recently explained, Meta is owner of the brand Oculus and, in differentiation to other tech giants like Google or Apple, the company Meta had already recognized that the metaverse virtual world is the world's future and is powerfully undermining it.
- **Oculus alone reached a share of 75% of XR (virtual reality) headset shipments in Q1 2021**, up from 34% one year earlier, proof of a powerful trend and basically asserting that there is no real competitor.
- Reading an article in the magazine "The Economist" concluding that rebranding cannot fix underlying issues with a product or service, we believe that market participants got the Facebook's rebranding wrong.
- Virtual reality is real and is happening. We post a link to a good article from the magazine "Vanityfair", which gives an idea of Meta`s vision for the future and, all of a sudden, a lot more starts to make sense:

https://www-vanityfair-com.cdn.ampproject.org/c/s/www.vanityfair.com/news/2021/10/the-metaverse-is-about-to-change-everything/amp

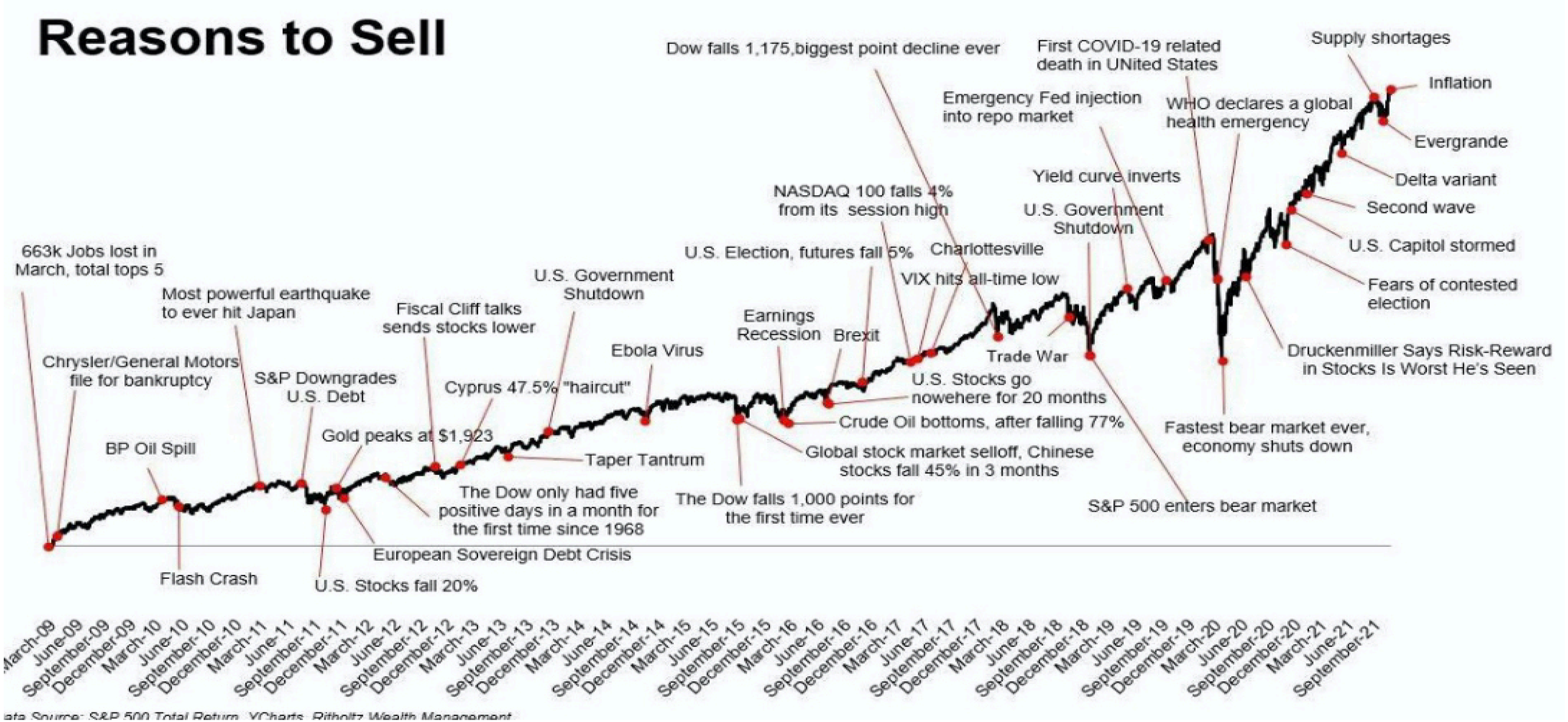
- We also post the first of a series of 9 articles on metaverse from matthewball, which is really well written and gives an idea of past developments to make us better understand where metaverse technology stands in the innovation cycle.

https://www.matthewball.vc/all/forwardtothemetaverseprimer

Meta - Metaverse

- Market participants are starting to wonder if the company Meta is too early in taking such a step. KTS would argue that, compared to the introduction of the World Wide Web, where everything was new, people were understandably skeptical on the technology and the possible changes, as internet companies were, at that time, start ups only burning cash. Nowadays, it is different and tech giants have enough liquidity to invest in the trend, without putting themselves in financial danger; on the contrary, they are diversifying away from old and maturing trends.
- The Netflix series “The Billion Dollar Code” gives a good idea of the sentiment at the time and how hard it was to persuade investors.
- We would also add that the first metaverse virtual world called Second Life, launched back in 2003 (who still remembers it?), was most probably too early. But taking into account the graphic definition of Oculus nowadays, KTS has the feeling that today is the right timing. Therefore, the company Meta is taking the right diversification step, and the risks are not comparable to the introduction of WWW, back in the 90’s- today, tech giants are generating tremendous amounts of cash flow. As mentioned, it could not be a better timing to “move away” from the maturing trend of social media, which is in the middle of political as also social discussion and it is going to experience other growth challenges in the future.

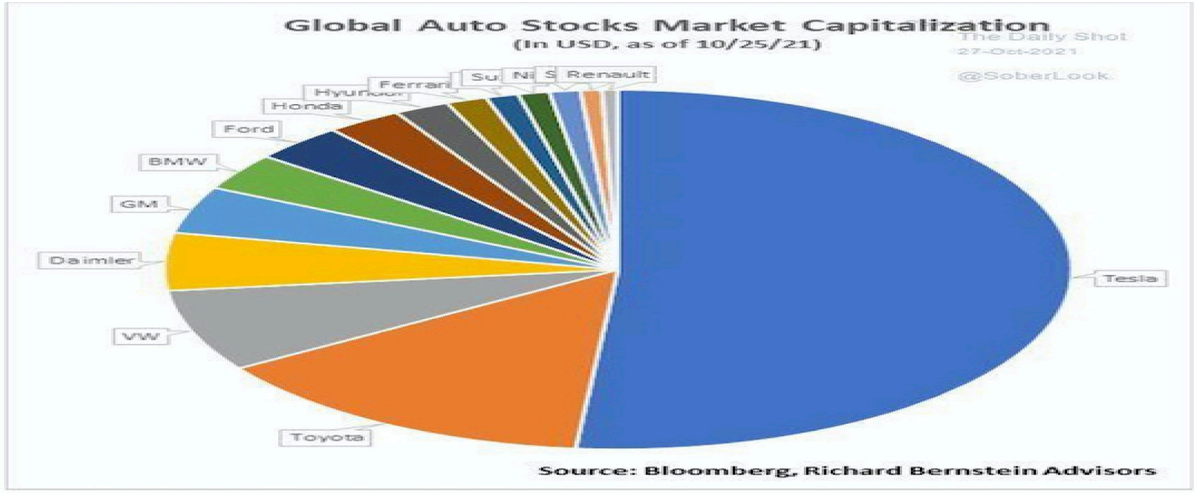
All reasons to sell from 2009



Markets are at new highs, it sounds for most clients self-evident to have being fully invested in equity: really?

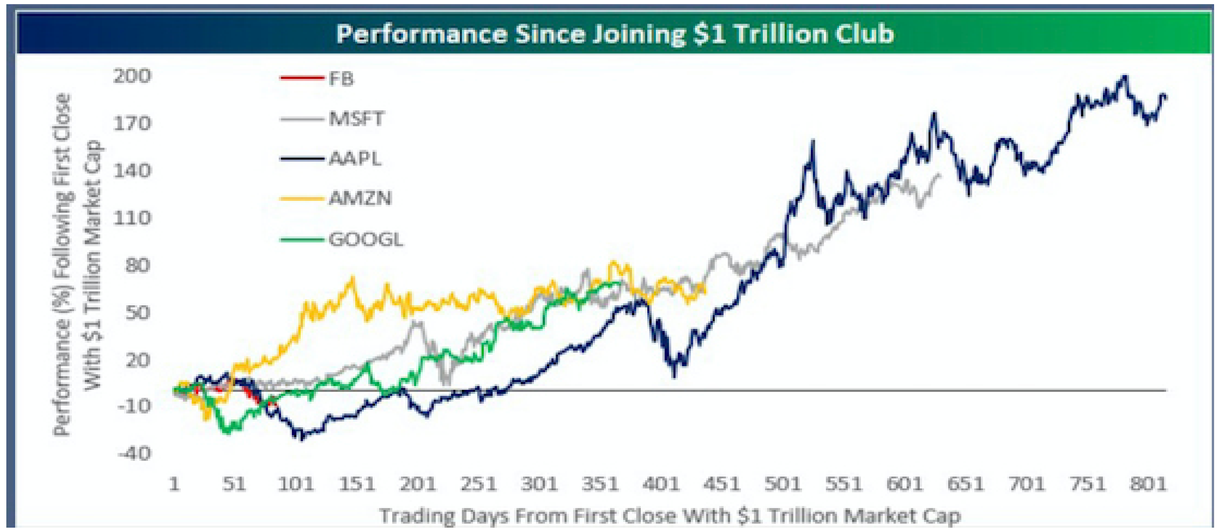
Tesla at USD 1 trillion

- The debate about Tesla always presents one of the most controversial of dilemmas: is Tesla a clear short or a high conviction buy long idea? In this case, it is really hard to have a clear opinion and only time will tell. We would remind our clients that, back in April 2020, in the midst of the pandemic, macro models were giving Tesla a maximum 4 months' life, because market participants were expecting the closure of Tesla's factories for many months, which fortunately never happened.
- Meanwhile, we share 2 charts: on one side the typical graph, where we see that Tesla alone has the same market cap as all the major car producers worldwide combined. A fact which sounds really insane; in addition to the fact that Tesla trades at 27x sales. Tesla joined the "club" of the USD 1 trillion companies and, as we can observe on the 2nd chart, the up trend can easily continue.
- Finally, it took 18 yrs for Tesla to reach USD 1 trillion market cap compared to 21 yrs for Google, followed by 24yrs Amazon, 42yrs Apple and 44yrs for Microsoft. In the last 2 weeks alone, Tesla`s market cap increased around USD 300 billion.



Source: Bloomberg, Richard Bernstein Advisors

Tesla market cap is as high as the rest of worldwide car producers



Still tremendous upside for Tesla ahead?

Crypto currencies news

- For KTS it is always difficult to know how much our clients would like to know about specific subjects. We know that many of you are trading intensively crypto currencies and the investments are a good portion of your portfolio. Others are also passionate about the technology and want to learn more.
- Our best in class fund Fasanara publishes directly onto their webpage many interesting articles on crypto currencies and Fintechs. Anybody can access freely and read directly these publications. Here are the links to the latest updates from Fasanara:

https://www-fasanara-com.cdn.ampproject.org/c/s/www.fasanara.com/amp/web3-0-creates-value-for-users-regulators-target-de-fi-tax-in-fintech-other-news

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