KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 2

The 14th of January 2022

FOMC minutes

- As highlighted in our last e-mail, equity markets have reacted negatively to the more aggressive plan for monetary policy normalization. The announcement hammered tech stocks, real estate and communication services. Small cap growth stocks also experienced a severe selloff, because higher interest rates will negatively impact their valuations (the discount rate on DCF models would be greater and growth stocks have higher future cash flows to be discounted than the rest of the market). The most common example of a small cap growth stock, which is followed by the majority of investors, is the Ark Innovation ETF of Ms. Cathie Wood, which is now -45% from the highs of February 2021. A comparison with the Nasdaq bubble back in year 2000 is even predicting further negative performance going forward for the Ark Innovation ETF (even an additional -50%). Back in February `21 KTS were rightly arguing that many non profitable companies were experiencing insane valuations and one day such stocks would most probably fall back to reality levels. This process is still ongoing and we would not, therefore, be surprised, if the price of unprofitable companies falls still further. KTS is focusing on companies which have positive fundamentals and we can still calculate a realistic sum of the parts. Our stock picks for 2022 are, for example, GEVO US and NCU CN.
- We would like to remind our clients that the FED is certainly going to increase short term interest rates, but long term rates are going to be "manipulated" at a lower level (expectations are 2% for the 10year US yields). Therefore, we believe that market participants overreacted on the FOMC news. Many market participants are also worrying about the positive correlation between the size of the G3 central bank balance sheets and equity markets. With the FED reducing the size of the balance sheet, there is less liquidity in favor of equity markets. We believe that, if there is less liquidity available, sectors at unsustainable valuations like NFTs, SPACs and some cryptos are going to suffer more than equity markets, which are not expensive and are still supported by growing company earnings.

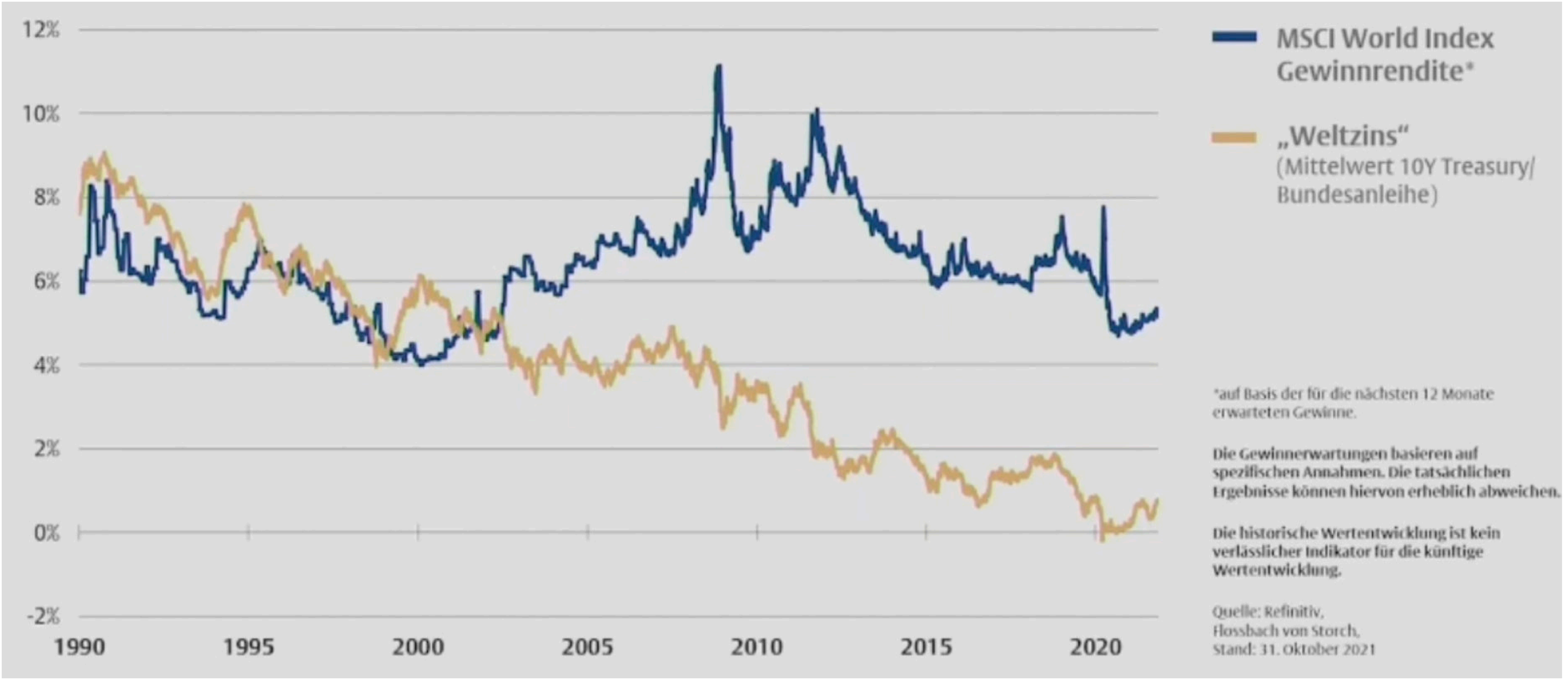
FOMC minutes

- As explained in the past, we are still expecting positive economic growth going forward. In our opinion, the global economy is still supported by huge stimulus packages from governments and multiple innovation trends, which are going to be translated into higher company earnings. This will support equity markets, which still have attractive valuations. Higher company earnings will also support higher share buyback programs and dividends. As well as higher capex and salaries, which will be translated into higher consumption, the major driver of the economy's growth.
- We should not forget that US savers are actually "sitting" on the largest amount of savings ever, and soon people are going to spend more. Hopefully, in the coming months as we are now finally entering the normalization phase of the pandemic. We are expecting, therefore, higher spending in the travel, entertainment, gastronomy and related sectors. This spending should also support the global economy, which will be translated into further positive development of equity markets.
- We were reading an interview with Mr. Jamie Dimon, chairman of JPMorgan Chase, who is confident that U.S. is going to experience the best economic growth in decades, even with the 4 FED rate hikes expected this year. His assessment is based on the robust balance sheets of the American consumer, which has never been in better shape and is now spending 25% more today than pre-Covid. "The debt-service ratio is better than it's been since we've been keeping records for 50 years". Of course, Mr. Dimon concludes the interview with a warning to investors that they are going to experience a "tumultuous year as the FED goes to work", but this is a typical conclusion in order to avoid "losing face" in case things should go wrong, what else.....
- As a precaution, KTS is investing in strategies intended to reduce the volatility of the portfolio, and also focus on limiting the drawdown in the case of market corrections.

Yield differential

- Following the FOMC minutes, many market participants promptly opened the discussion that T.I.N.A (there is no alternative) for equity was no longer going to be the case in the year 2022, due to a rising US 10 year bond yield.
- On the left hand chart, investors are comparing the 10y US yield with the dividend yield of the S&P 500 index, arguing that the 10y yield is now higher.
- **We find that the comparison is not precise**, mainly because most US companies repay investors with share buy back programs and such programs are going to be worth over USD 1 trillion during 2022.
- On the right hand chart, we have included again the chart of our best in class Flossbach, which shows that **the total equity yield of the MSCI World Index is over 6%**. With the inflation now at over 2%, equity is the only realistic alternative for an investor to reach a positive real yield going forward!

US 10y yield vs S&P 500 Dividend yield (source zerohedge/Bank Syz)



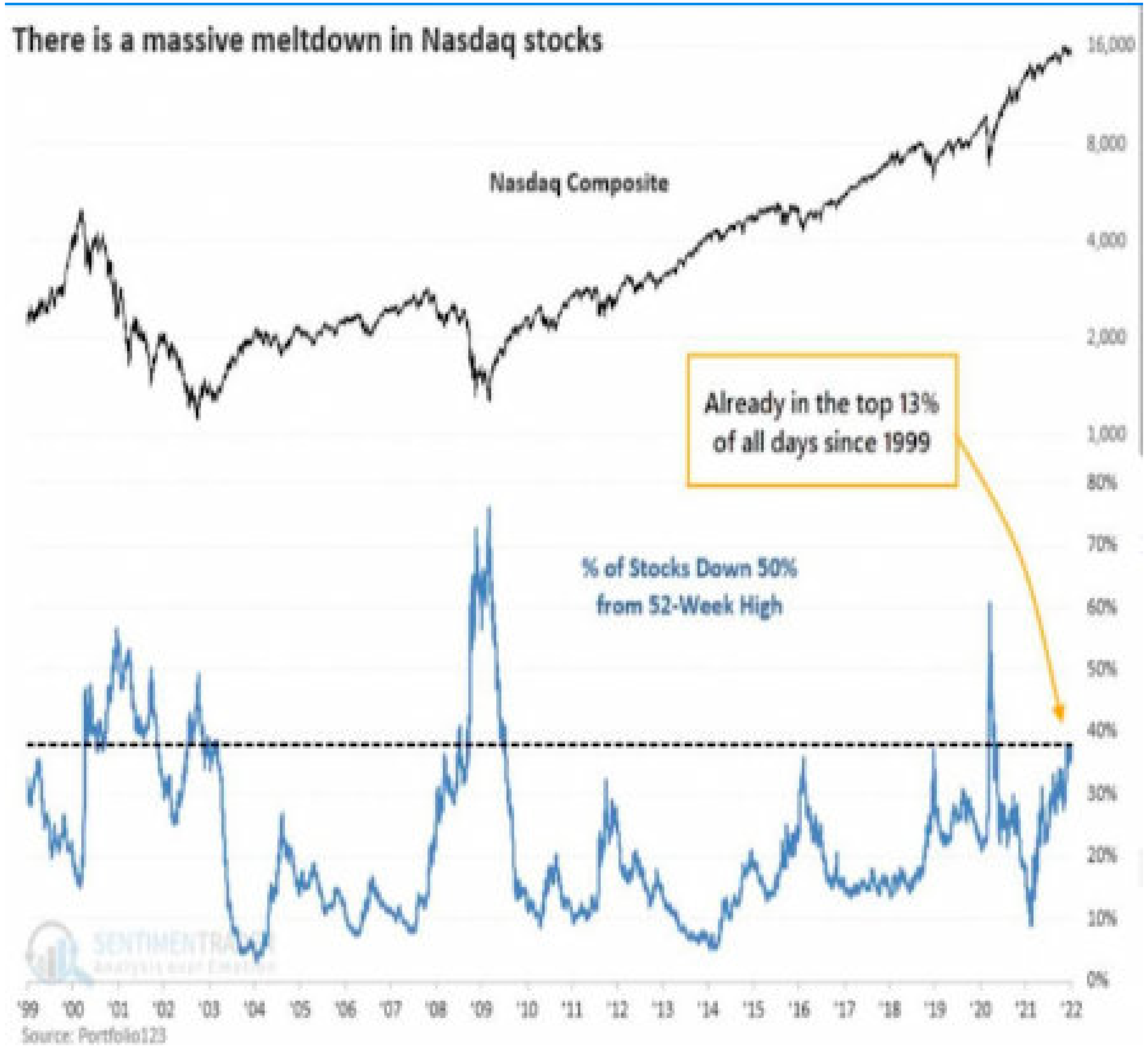
Total equity yield over 6% for MSCI world Index (source Flossbach)

Omicron update

- As mentioned in our last weekly update, **many hospitalized people with the Omicron variant are there for other reasons.** It turns out that in **Switzerland it is half of the cases.** Strangely enough, the “scandal” has been published in the newspaper “Blick”, which was always supporting the Swiss Government during the whole Covid19 “saga”. The timing of such a move is also a “strange” coincidence, as last week the CEO of the newspaper, who was under pressure because internal reports showed that the head of the newspaper was forcing journalists to avoid being “neutral” in Covid19 commentaries. Their policy was , in fact, to support directives from the Swiss government.
- Currently, governments are struggling in the face of further developments and solutions concerning the pandemic. From one side, we watched a TV debate where the Swiss minister was trying to defend WHO regulations. Whereby, any hospitalized person tested Covid positive has to be signaled as positive even if showing no symptoms and hospitalized for other reasons. Which, in our opinion, is not the key point of the discussion. But, on the other hand, we were pleased to read in different media that the Spanish PM, also supported from UK, called for a debate at the European level on treating Covid-19 as endemic. Basically, to switch into a flu-like monitoring system, admitting falling lethality rates for Covid-19.
- On the other hand, the French President, Mr. Macron still has “hard” words against unvaccinated people: he would not “throw them in prison” or “ vaccinate them by force”, but he made it clear that he meant to make their lives harder.

Invisible bear market

- As recently mentioned, even though the Nasdaq and S&P 500 Index are not far from their highs, market breadth is very weak and most index stocks have even reached capitulation levels.
- On the right hand chart, courtesy Bank Syz / Zerohedge, more than 40% of Nasdaq components are down more than 50% from their highs and, therefore, at "capitulation" levels.
- As we know, the main equity indexes are at highs because of the top 5 names all, of which, experienced strong earnings, massive passive investments and strong share buybacks.
- Last week, the Wall Street journal wrote that **85% of active US stock funds underperformed the S&P 500 Index**, which is not a surprise to us because last year a diversified allocation strategy would have not helped performance against the top 5.
- **We believe that 2022 is going to be a year for stock pickers.** KTS expects sector and stock rotation into some laggards of the year 2021. We strongly believe that we are well positioned with our best in class funds Alkeon, Classic Global, 2xIdea, Z22, ABR, etc.



40% of Nasdaq components are down more than 50% from their highs

Kazakhstan

- Russia-allied forces intervened to quell the unrest in Kazakhstan. This followed an outbreak of protests against a surge in fuel prices expanding into an attack on the Kazakh elite. Protesters stormed government buildings, TV stations and hundreds of businesses. According to media, Kazakhstan had been regarded as a pillar of stability in an unstable region, though at the price of a repressive government. We would guess that the root cause of the revolt was the result of years of suffering and repression.
- **Kazakhstan is the second largest producer of uranium worldwide** (15% of world uranium mining production, after Australia with 28%) and is also being a major source of oil, gas and copper. It is clear that Russia is sending troops as peace keepers as they cannot afford to lose their influence in the territory.
- Our energy expert invested in the Uranium ETF and in the company Kazatomprom, whose major shareholder (85% of the company's share capital) is the wholly-owned state company Samruk-Kazyna. Apparently, the Canadian uranium producer Cameco is not a good investment, because the company sold too much production in the past at a lower cost and now has to hedge sales by buying uranium at spot market price. The higher the spot price, the higher the loss for the Canadian company.
- As a special situation, we have a small exposure in the oil producer Caspian Sunrise, symbol Bloomberg CASP LN. The company announced just before the "country turmoil", that they could increase production and would become cash positive. They also expect to pay dividends in the near future. We actually know the company since a long time as back in 2014 it was rumored that the French oil company Totalenergies SE wanted to acquire Caspian Sunrise for over 25 pence a share, because the French refinery was interested in the huge oil and gas reserves of Caspian. Caspian can also now sell 80% of its production outside Kazakhstan at oil market prices. The family Oraziman and friends actually own over 80% of the total share capital and calculating the total that all major shareholders have been buying lately, the total could be even over 100%. Basically, there is no seller.

Kazakhstan

- The country could also profit from China’s crackdown on Bitcoin miners. It is currently the second country for Bitcoin miners (based on hashrate) worldwide with 18.1% share of total power used by computers. US ramped up from 4.1% to 35.4% and Russia from 5.9% to 11.2% .

General news

- Most probably the investor community does not know that the Swiss mid cap Belimo is a leader in heating, ventilation and air conditioning markets providing higher quality solutions. An investor would expect the company to have also the best solution for air filtering, but apparently this is not the case. Two ETH-students, Mr. Pierre Bi and Mr. Constantin Overlack, developed an advanced air filter solution and sold their start up company for USD 72 mio to a US company. The company, whose name is Aeris, is producing 100k filters a year and 15k devices have been delivered to Australia, mainly in the State of New South Wales, where all the school rooms are equipped with the Swiss Aeris technology. An incredible Swiss successful story and we are surprised that the Swiss leader Belimo was not interested in buying such a tremendous start up company. **This is proof of the high quality of Swiss start ups and we believe we can cover the segment efficiently with our investment into the Swisscom VC structure.**
- According to The New York Times, after 7 hours of negotiations between the U.S. and Russia there was no immediate agreement on the tense situation around Ukraine. According to the lead Russian negotiator, it is absolutely mandatory that Ukraine (which was not invited to the talks!) never becomes a NATO member, and he added that Russia had no intention of invading Ukraine.
- According to the asset manager Yourasset AG, **88% of Chinese will invest more into watches** and sales of high-end timepieces are booming. Investors increasingly move from property into watches as a store of value, which is nothing new. Sales of the Swiss watch producers like Swatch or Richemont suffered during the pandemic. Therefore, such news is positive for the sector. We would add that it is also positive new also for precious metals, because high-end watches are normally based on precious metals like gold or silver and diamonds. **57% of gold's demand is coming from jewelry, of which 58% is out of China/India.**

General news for the Asian region

- China called on banks to boost real estate lending in the first quarter and eased a key debt restriction for developers, a sign that authorities are becoming increasingly concerned about industry's liquidity crisis. KTS would add that this is a sign that the "clean up" of unwanted developers is now complete and the government is restoring support to the economy with the real estate "players" aligned with the government's policy and strategy. This is actually positive news for the further development of the Chinese economy and we believe that after a long consolidation phase and the tremendous underperformance of the Chinese market vs developed markets, the Chinese equity market should be ready for a rebound. KTS is invested into the EMQQ LN etf and has indirect exposure via its best in class Aubrey Emerging Market fund and Alkeon.

General news on cryptos

- The biggest Chinese social media and mobile payment app, WeChat, will begin supporting the digital yuan, e-CNY. The People's Bank of China has been working on the project since 2014 and launched its own iPhone and Android app wallet earlier this week, the e-CNY app. WeChat has more than 800 million monthly active users and gives the central bank a real boost.

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