KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 3

The 21st of January 2022

Omicron in Europe and USA in endemic phase, but still zero tolerance in China

- VW announced possible production delays for the Audi Q3 and several versions of the Tayron, because of supply chain bottlenecks in China, due to zero Covid tolerance.
- The world has to hope that China does not keep such a strict policy in place for too long. Many market participants think that China will maintain the policy until the winter olympics, which will take place from the 4th of February to the 20th February.
- Charts show that ships at anchor, or in slow steaming mode, are again increasing from the highs in November of around 80 ships to 105. In June 2021 there were only 9 and during 2020 around 32 ships.
- **Bottlenecks due to Chinese supply chain disruptions are still the major risk for the global economy,** especially due to the high inflation it has caused and, of course, a worsening of the situation would clearly be negative for equity markets. This is the major concern of equity markets at the moment and this fact could explain the market's weaknesses, even if the market's sentiment is already depressed. More than 40% of Nasdaq components are now more than 50% off from the February 2021 highs.
- On the other hand, as we have recently noticed, especially in Europe and USA, governments are now debating whether to change the pandemic status to endemic. And, for example, the **Swiss Minister, Mr. Berset and even Bill gates,** announced officially that **Omicron is comparable to a normal flu for vaccinated people, which is finally great news.**
- **But, should China`s supply chains get hit further, this could turn into a total nightmare. By having increased consumption demand from US and Europe, due to normalization, but no adequate supply out of China.** A situation, which we clearly have to monitor very closely.
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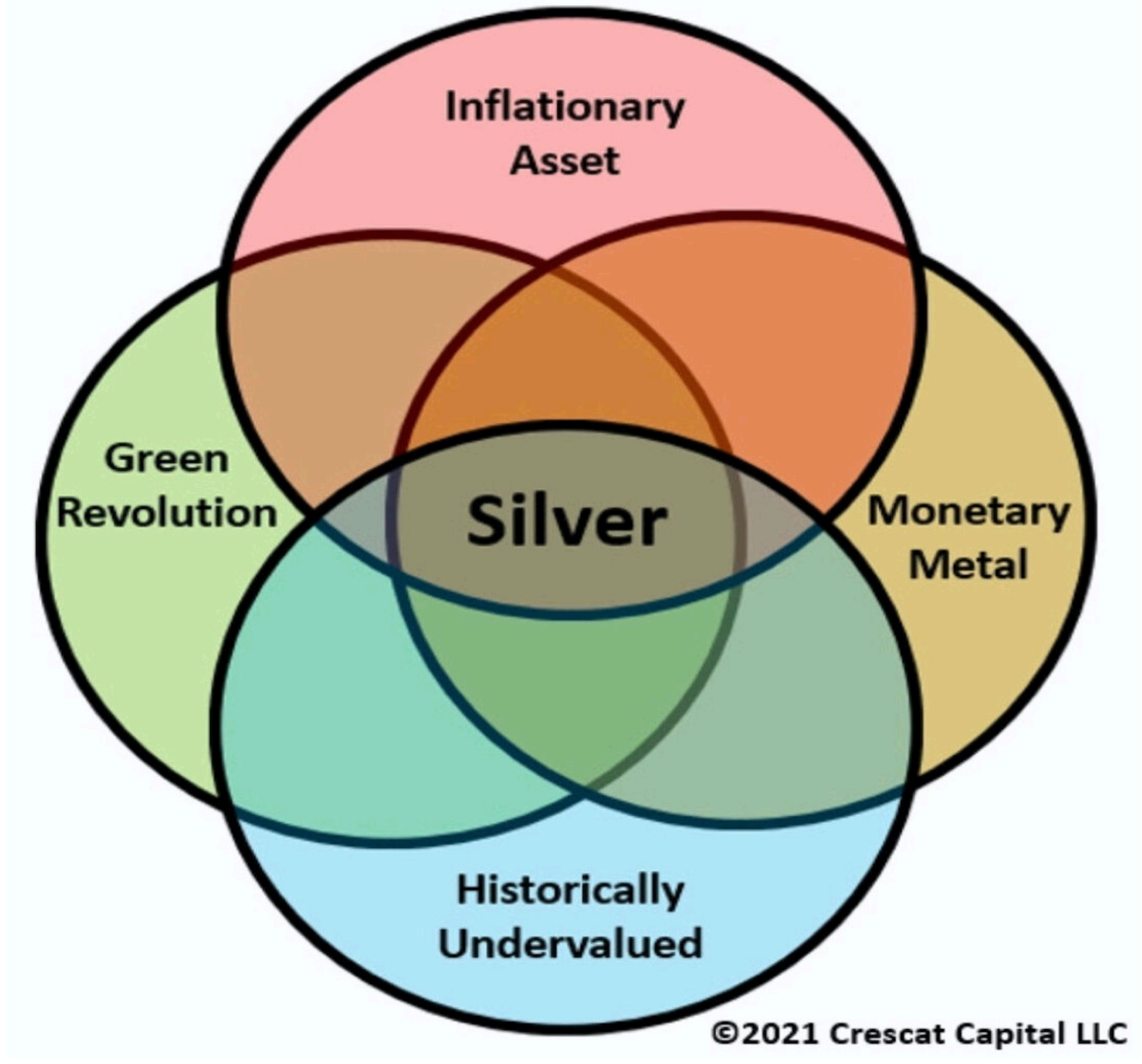
Omicron in Europe and USA in endemic phase, but still 0 tolerance of China

- UK PM Boris Johnson has just announced, that the government will no longer mandate the wearing of face masks and announced the end of all Omicron restrictions in England. Also in Scotland all the Omicron restrictions are going to be lifted next Monday. This is finally a courageous step in the right direction.

Silver

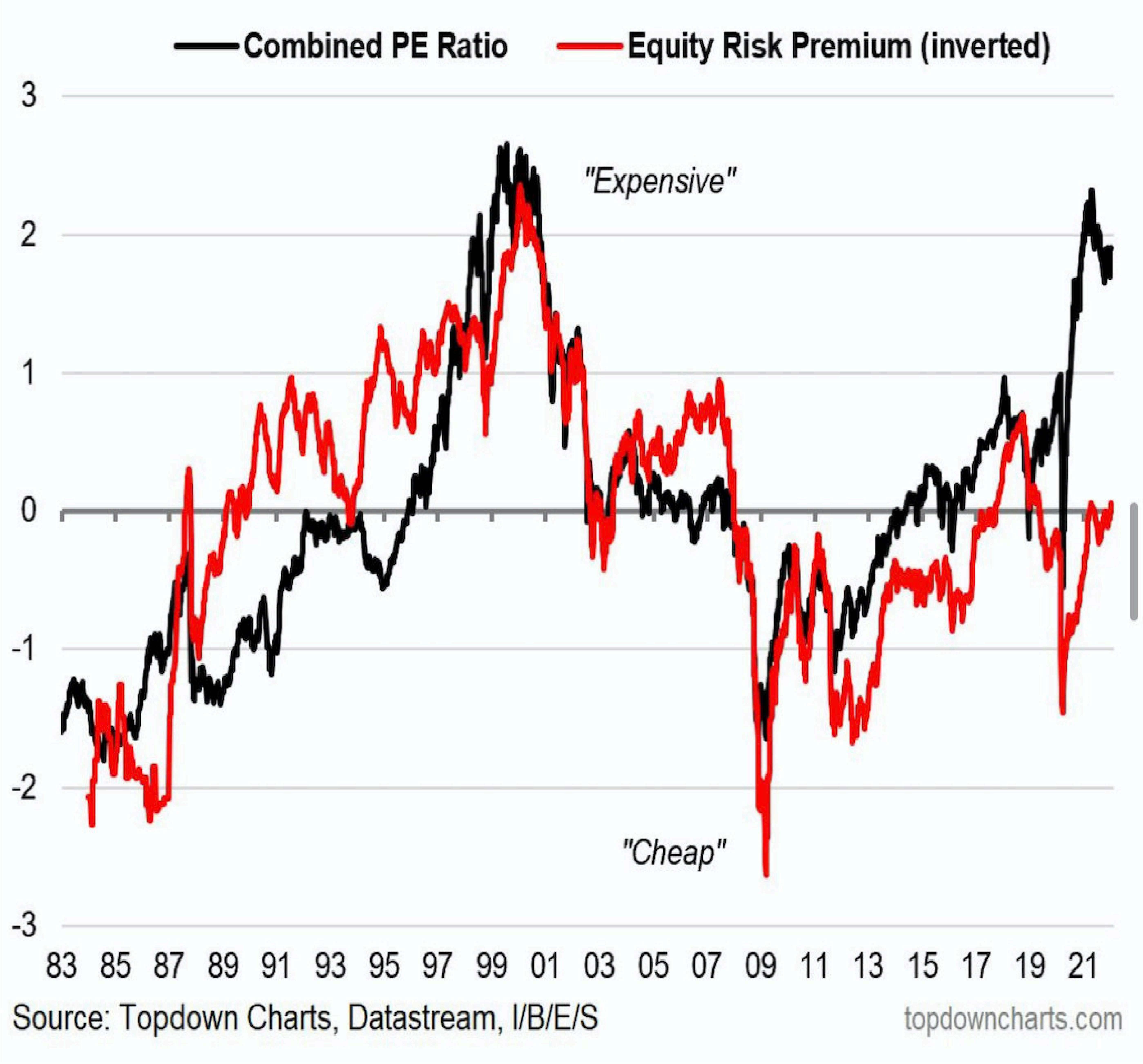
- A good chart is worth a thousand words.
- KTS stays invested in precious metals, especially silver or silver mines like, for example, Hecla mining.



Source: Crescat Capital LLC, Mr. Otavio Costa

US equity valuations

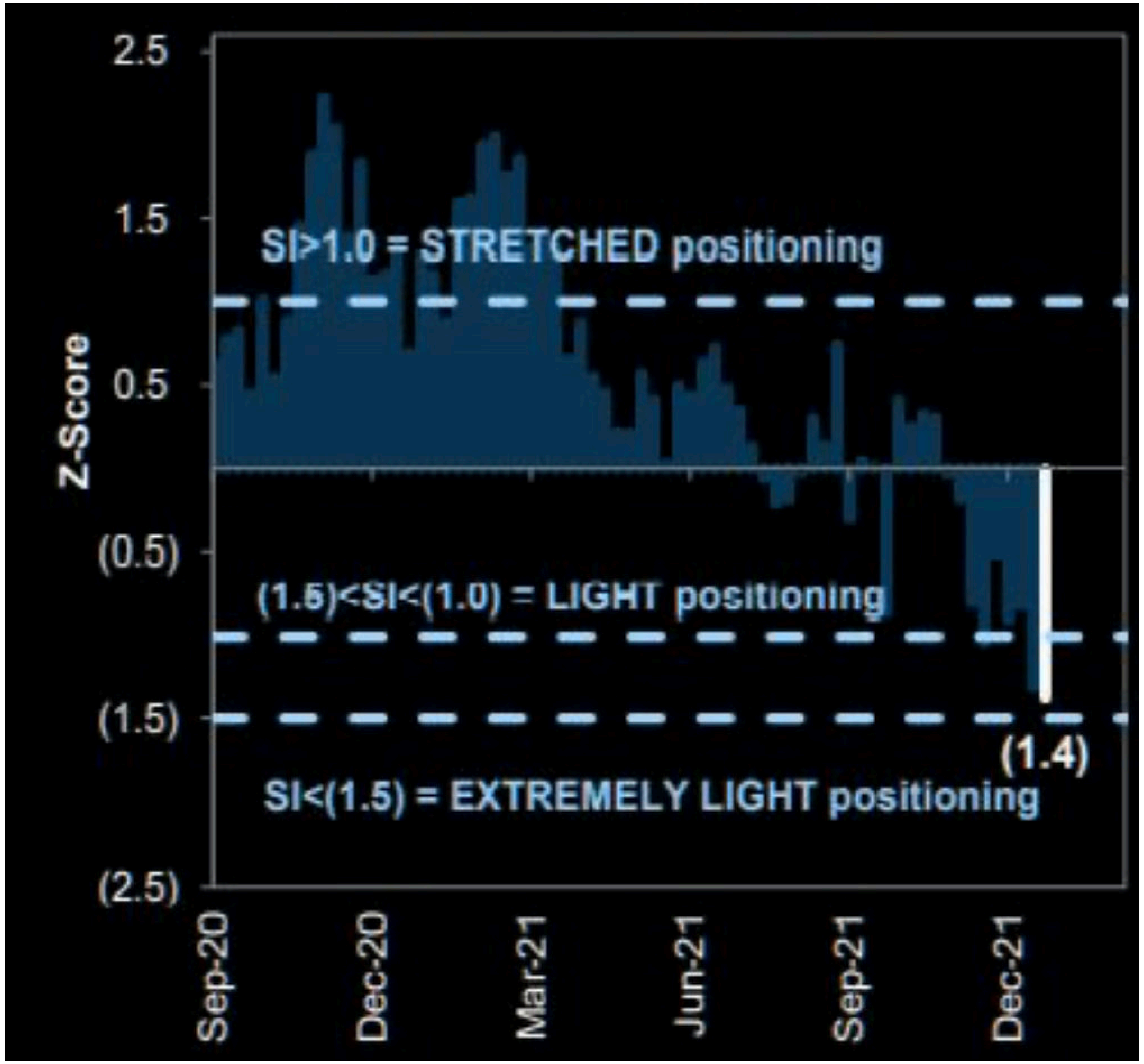
- On the right hand we can analyze a good chart showing relative valuations to bonds. Many market participants are still focused on absolute valuations using indicators like the Warren Buffett indicator or S&P 500 market cap divided by revenues. But, in our opinion, the only real metric to employ nowadays is the relative valuation vs other asset classes.
- Real estate yields, money market rates, liquidity or other asset classes are not in a better position than bonds, therefore, equities are still the most attractive asset class. Even should US short term interest rates increase faster than expected, which is not the base scenario of KTS.
- As argued in the past, and also taking into account the comments of the Chinese President, Mr. Xi Jimping, even longer duration yields need to stay as low as possible. Thereby, further supporting the equity risk premium, which is also supported from still increasing company' earnings, share buyback programs and dividends.



Equity attractive vs bonds

Market sentiment

- According to the Goldman Sachs “sentiment indicator”, which measures stock positioning across retail, institutional, and foreign investors vs the past 12 months, we are still at -1.4, which is an extreme position, in this case extremely light positioning.
- This chart is showing how market sentiment is still very depressed and is confirmed by the fact that over 40% of Nasdaq components are off 50% and more from the February 2021 highs.



Source: GS via Mr. Paolo Calcinari Ansidei

General news

- We are reading from multiple sources that market participants are effectively **switching from growth to value stocks**. We are not undertaking any asset allocation changes, as we feel comfortable with our exposure to the Swiss value fund Global Classic and our energy specialist Renaud. In addition to the sector rotation of the machine learning model of Z22 and the ABR model always being long S&P 500 Index, which is also going to profit, as in 2021, from the positive trend of the energy and financial sector. One question would be a possible reduction of our exposure to the growth fund Alkeon, or Fundana, but we are going to have an intensive conversation with the managers in the next days, in order to take a final decision. We do not want to take a short term step and overreact, because we genuinely believe that we are in a decade of great innovation and interesting new technologies. We have the feeling that by selling the Alkeon fund, we would not have enough exposure to such an important segment of the equity market.
- **Audi announced it would be fully electric by 2033** and expects EV sales to surpass sales of its internal combustion vehicles by 2026. According to an Audi spokesperson, the first pre-production units are already being built and series production is expected for 2023. KTS believes that it is well positioned in the EV trend, being invested in the private Croatian company **Rimac Automobili**, which is also basically part of the VW group, via the participation of Porsche and the integration of the prestigious brand Bugatti under the Rimac Holding. We are also reading in the blog Robb Report that Aston Martin's Valkyrie, which is supposed to be the best car Aston Martin ever built, has a 1k hp with a 6.5-liter V-12, along with a **160 hp Rimac-developed hybrid-electric system!**

General news

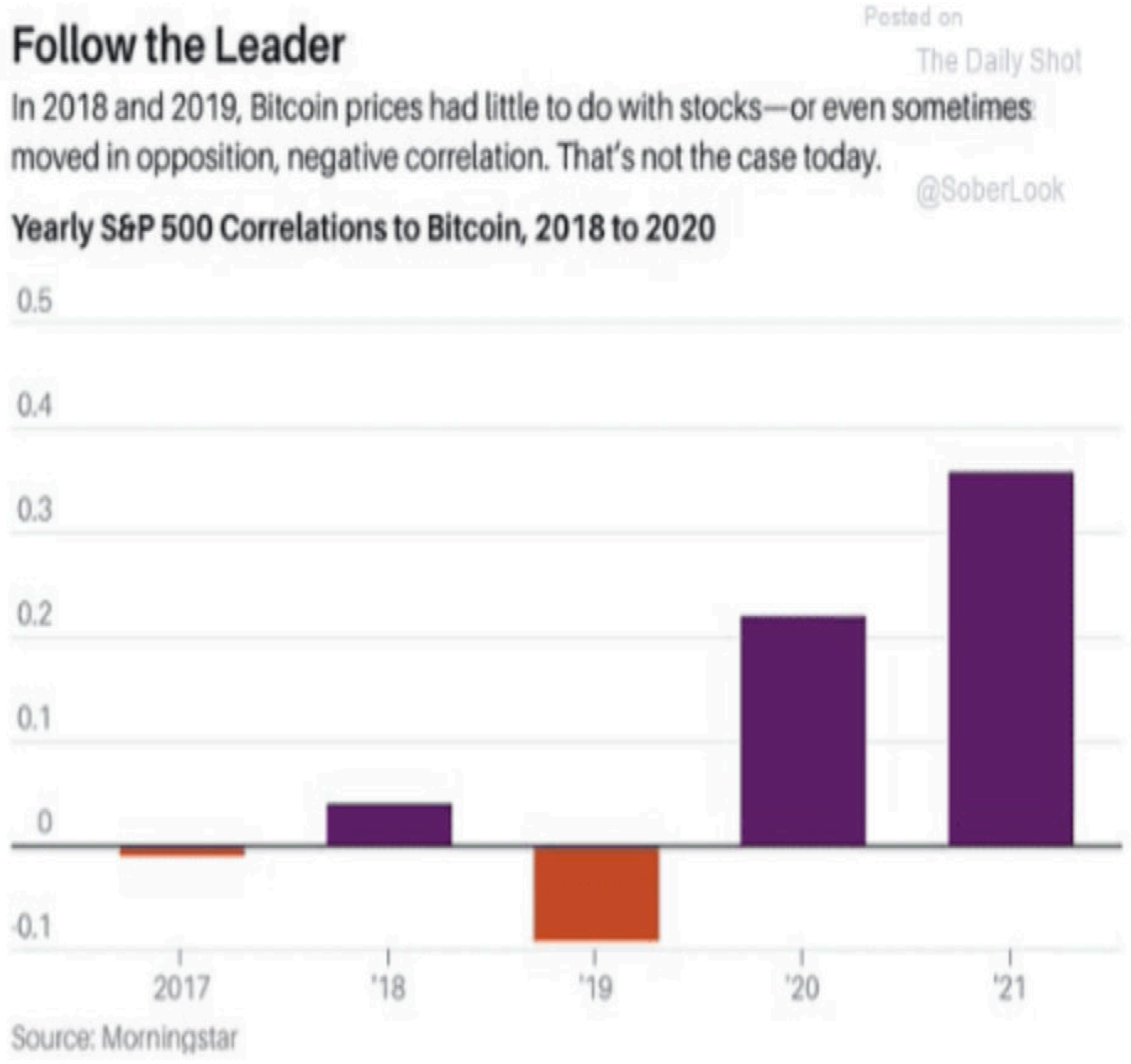
- An additional major risk for equity markets is the tension in Ukraine, especially now that Russia threatens to abandon diplomacy, asserting that the West’s current approach has only led to a “dead end”. We are not going to express ourselves on politics, but this tense situation is most probably not going to be resolved soon and equity markets will live with it for a while and, honestly speaking, we cannot predict the reactions of Russian President Mr. Putin. Even if any conflict was limited to a specific Ukrainian area, the first reaction of equity markets is going to be strongly negative. As Mr. Alessandro Fugnoli rightly argues in his latest research, market participants do not have to underestimate the powerful pressure which **Russia conjunctively with China** have on Ukraine (also Kazakhstan, but no one really cares) and respectively Taiwan, as was the case for Hong Kong.
- The French government confirmed plans to force the company EDF to sell more power at a discount to protect households from surging wholesale electricity prices. The news is ahead of elections, which is a smart move from Mr. President Macron and EDF share slumped on the news.
- The ARK Innovation ETF ended its tremendous outperformance, which peaked February 2021 at basically 500%. This week, its valuation is returning back to reality but, according to market participants, its current valuation is still too expensive.

General news

- Last Monday, Chinese President Xi Jimping warned Fed Chair Jay Powell against hiking interest rates. As the economist Mr. Edward Yardeni is pointing out, China is now highly overdeveloped in real estate and is surpassing Japan as world's largest nursing home having an aging population but a falling birth rate. As well as falling inflation, because of worsening demographics and, basically, desperately needs US consumers as they driver nr. 1 for the Chinese economy. This is a further proof of what KTS was recently arguing, that the FED cannot take any dramatic steps on monetary policy, since the world is too connected and in the same situation.
- The substantial acquisition by Microsoft of USD 69 billion for Activision Blizzard (last acquisition was Linkedin in 2016 for USD 26 billion) is proof of further consolidation in the technology space and how many synergies are still in the markets. According to the magazine The Economist, this acquisition gives Microsoft more of a foothold in the smartphone gaming market, to which it has had little exposure. In addition, it is also a strike against Sony; in fact, if Microsoft controls the rights of the game franchise "Call of Duty", it can decide whether or not to allow the games to appear on Sony's rival PlayStation machine. We expect more of such tactical transactions, especially with many technology companies trading far from February 2021 highs and, therefore, attractive candidates for the major 5, which could enjoy tremendous post pandemic earning growth and are literally "swimming" in cash. In fact based on non-financial companies' cash holdings, we have more than USD 2.15 trillion. Whilst we know USD 1 trillion a year goes for share buyback programs, that leaves the "rest" available for R&D, increasing capex or M&A.

Bitcoin's correlation to the S&P 500 Index

- According to market participants, the correlation between Bitcoin and S&P 500 increased substantially since the start of the pandemic.
- Honestly speaking, we think that such phenomenon is due more to the **correlation of the huge liquidity injected from global central banks in the financial system,** than a change between the direct relationship of S&P 500 and bitcoin.
- With the FED tapering, market participants are expecting market corrections, due to lower liquidity in the market. As argued recently, for equity markets we expect further support from share buybacks and still increasing earnings, though of course less growth than 2021. In the crypto space it is very hard to predict the impact, but we do not have to forget that bitcoin is also an established payment system and comparing valuation to Paypal's traffic, Bitcoin is still cheap. The same for Ethereum blockchains, which is the base for all the smart contracts and fintech technology and is, therefore, also gaining traction from increasing transaction volumes.



Increase of the correlation from 2020 (source Morningstar)

NFTs

- We are reading that **NFT watches**, Rolex for example, can cost more than a real Rolex. Some market participants cannot believe this is real. KTS in internal conversations tends to believe that some NFT insiders in this segment are transacting with such high valuations in order to trigger media interest and, consequently, attract more market participants, who would finally pay such insane valuations for real. Those kinds of transactions are most probably taking place also in other segments, like paintings to mention an example. Honestly, we are most probably still of the old generation but we definitely would prefer to spend 15k USD to buy something real, usable and that you can enjoy every day.....!
- In addition we are all reading on a daily basis, how investors are paying millions of USD for virtual land in the metaverse, mostly in the virtual world called the **Sandbox**. According to media, the most expensive spots are near where lots of users congregate, for instance, someone recently paid USD 450k to be Snoop Dogg's neighbor. Of course specialists like the crypto asset manager Grayscale are estimating that the digital world may grow into a USD 1 trillion business in the near future. KTS would assert, such hype depends on the liquidity injection of central banks and obviously, there is a tremendous amount of money, which people have at disposal and do not have much diversification out of equities. **Such phenomenon is a clear derivation of the high liquidity equation.** Of course KTS is not in the situation to have an opinion or advice over the future development of the segment, but remind us a little bit of the virtual world Second life back in 2003.

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