KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 46

The 17th of December 2021

Omicron: more cases but less deaths

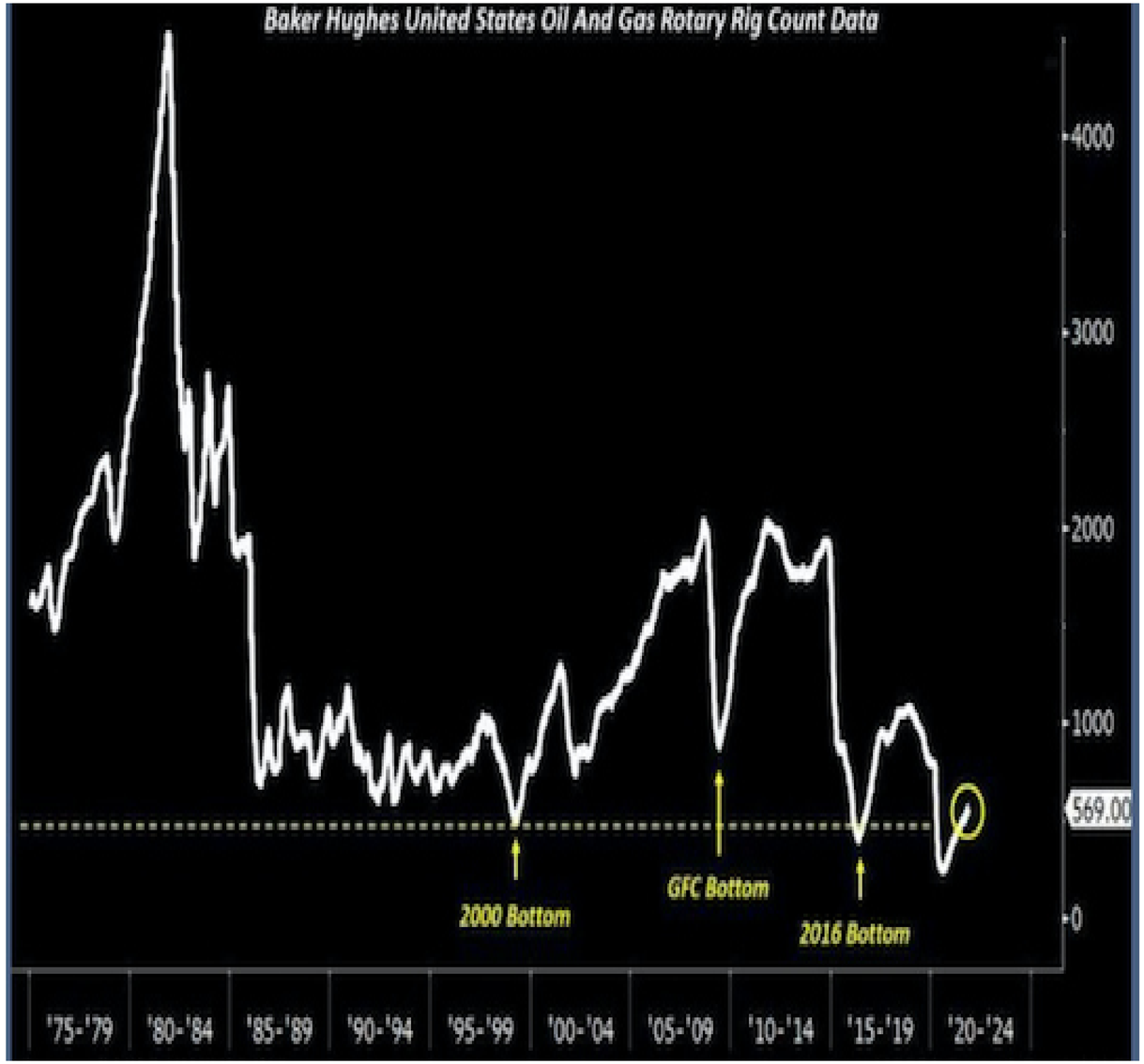
- Last week we mentioned a comment made by Mr. Alessandro Fugnoli, who said that **Omicron was, basically, 4 times more contagious than the Delta variant, but 1/4 less lethal.** The final statement was that the world could achieve global immunity with a bit of coughing! We were pleased to read similar commentaries in the media, where scientists expressed optimism that Omicron is the beginning of the end of the pandemic.
- The chart on the right side, courtesy of Deutsche Bank/Bank Syz, shows how Omicron is spreading more than previous variants but deaths are much lower, confirming the lower severity.
- According to The New York Times, the Omicron variant is spreading at a fast pace in UK, but statistics are not showing equivalent hospitalizations and death rates. The UK government urges people to get the vaccine boosters. Even if Parliament had voted for the "plan B" on health-protection measures against the Omicron variant, Mr. Boris Johnson is still facing a lot of challenges because of recent scandals. He is losing support in Parliament and putting at risk planned reforms.

Source: Deutsche Bank, Bloomberg Finance LP, JHU

Source: Deutsche Bank / Bank Syz

Oil and gas rig count

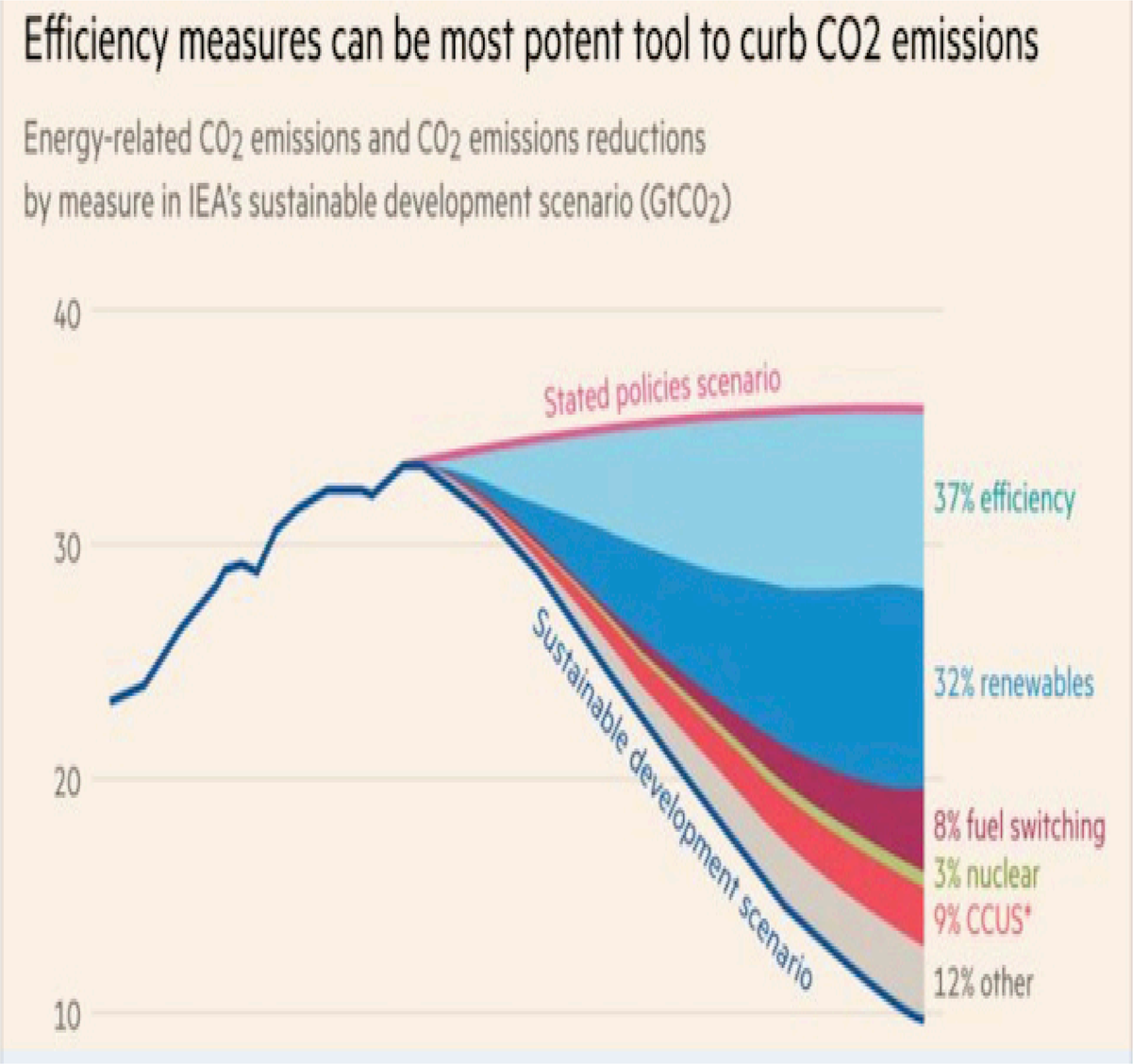
- Even though the oil price has rebounded strongly during 2021, the oil and gas rig count is still lower than it was at other major bottoms for energy commodities.
- This is most probably as a consequence of ESG policies and, in addition, many energy companies are focusing on capital discipline and investor returns rather than expanding supply. This is actually a strong bullish fundamental for the oil price, going forward.
- Forecast for 2022 is slightly increased from an average of 472 in 2021 (actual 569) to 599, but still far from over 1000.



US oil and gas rotary rig count (Baker Hughes USA): source Crescat/Bank Syz

Energy efficiency

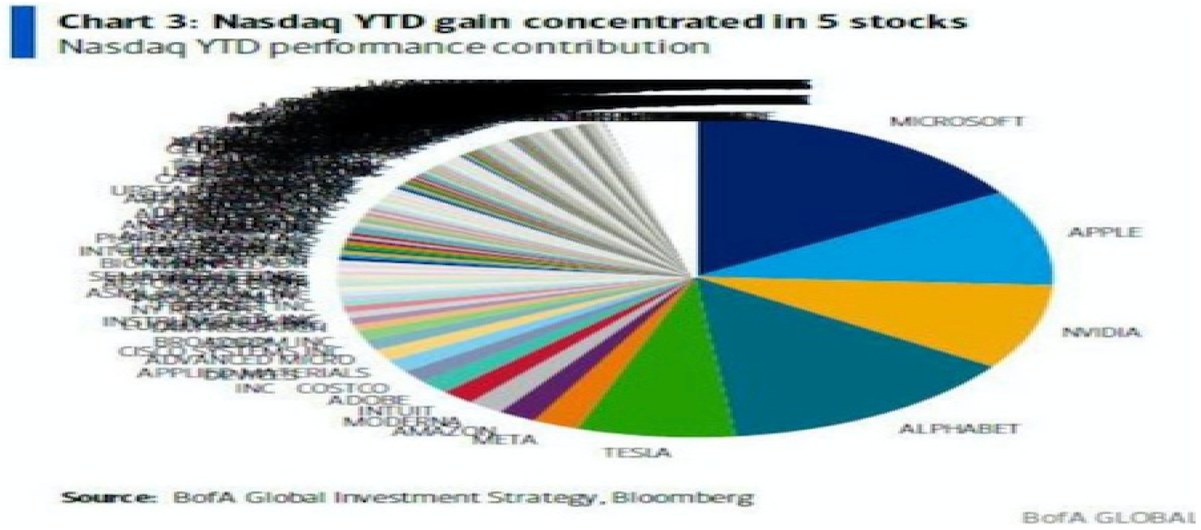
- A very interesting article produced by The Financial Times shows **how powerful efficiency measures can be.**
- A detailed report published by the International Energy Agency last month suggests that the aggregate impact of maximizing energy efficiency schemes in the coming decades would make more impact than either: the deployment of renewable energy, the use of low-carbon nuclear power generation, the development of carbon capture and storage, or the implementation of any emission-cutting tactic.
- KTS has always been aware of such potential and has been monitoring the fund **Carnot Efficient Energy for some years.** The manager focuses on companies whose mission is to improve energy efficiency. The fund achieved some outperformance, but nothing extraordinary. In addition, it is a 100% equity fund with no downside protection. We are going to again consider a possible investment and we will "calibrate" the downside risk with the purchase of put options.



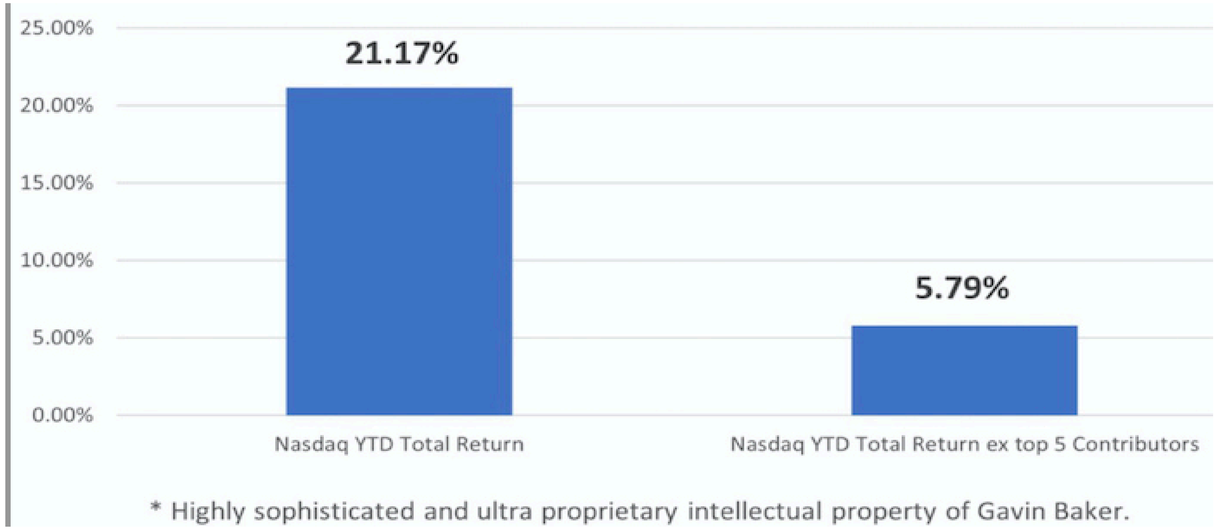
Energy efficiency has the highest potential of CO2 emissions reductions

Nasdaq weak breadth

- Market participants mainly focus on the index's overall performance, but most investors are forgetting that the main contributors to **2021's great results were, basically, the top 5 companies (Microsoft, Apple, Nvidia, Alphabet and Tesla).**
- If we calculated the YTD performance of the Nasdaq index ex top 5, the result would be only +5.79%
- Of course, increased earnings and growth supported the stock price increase of the top 5. But, the higher performance vs. the rest of the market is also due to passive investment volumes and substantial share buyback programs.
- If we analyze the performance of some "meme" stocks like GameStop (-64% from 52-week high), Beyondmeat (-71% from 52-week high), Virgin Galactic (-76%) or Tilray (-87%) we see how the high flyers of the beginning 2021 have had a "very hard landing" back to reality levels. The likelihood of this happening was argued by KTS back in our weekly report of February 2021.



YTD gain of top 5 of Nasdaq Index



Nasdaq YTD total return vs Nasdaq Index ex top 5 contributors

FED

- The tone of the FED press release is a little more hawkish than the previous announcements suggested, but market participants were fearing an even harder line, therefore equity markets and also precious metals reacted positively. Certain market participants are surprised about how well the market “digested the hawkish shift”. KTS actually expected this reaction, because equity markets have already discounted the FED reducing QE asset purchases and hiking interest rates 3 times next year.
- Mr. Powell cited that jobs growth was solid and economic growth remained very strong, despite Omicron.
- The FED adds that inflation has certainly risen and it is now important for investors to analyze any further developments in the inflation rate. An analysis that we assess in the next slide. The main conclusion is that **KTS believes we already reached a peak in inflation’s in 2021; in 2022 the rate of inflation is going to fall and normalize.**

Detail analysis on CPI heat map for US prices

- Comparing US consumer prices to a year ago, we know that the core CPI increased by 4.9% YoY and it is now at the highest level since 1982.
- Many market participants are expecting higher inflation over a longer period of time. KTS expects a moderation sometime next year, because we think that, having suffered over 1.5 years of lock down, it is normal to have a sharp price uplift in the short term.
- If we analyze in more detail the CPI heat map, we notice that the main increase during 2021 was energy up by 33.29%, used cars and trucks up by 31.44%, new vehicles 11.11% and lodging away from home with 22.16%. We understand that hotels need to increase prices in order to compensate for past losses, but we would clearly expect a normalization in used cars and energy.
- Food increased by +6.4%, apparel +5%, transportation +3.9%, Meat/fish/egg +12.8%. All such increases are a consequence of higher transportation costs and supply bottlenecks, which should normalize during 2022.

Oct-21 weight	Component	Nov-21	Oct-21	Sep-21	Aug-21	Jul-21	Jun-21	May-21	Apr-21	Mar-21	Feb-21	Jan-21	Dec-20
100.0	**Headline CPI**	**6.81%**	**6.22%**	**5.39%**	**5.25%**	**5.37%**	**5.39%**	**4.99%**	**4.16%**	**2.62%**	**1.68%**	**1.40%**	**1.36%**
	2yr annualized rate	3.97%	3.69%	3.37%	3.25%	3.14%	3.00%	2.55%	2.23%	2.07%	1.99%	1.92%	1.78%
14.0	Food	6.11%	5.33%	4.59%	3.74%	3.45%	2.39%	2.15%	2.37%	3.47%	3.62%	3.78%	3.93%
7.5	Energy	33.29%	29.97%	24.83%	24.97%	23.85%	24.48%	28.55%	25.14%	13.17%	2.36%	-3.65%	-6.96%
78.5	**Core CPI**	**4.93%**	**4.56%**	**4.03%**	**4.00%**	**4.27%**	**4.47%**	**3.80%**	**2.96%**	**1.65%**	**1.28%**	**1.41%**	**1.62%**
	2yr annualized rate	3.29%	3.10%	2.87%	2.83%	2.89%	2.82%	2.51%	2.20%	1.87%	1.82%	1.83%	1.92%
3.8	Household Furnishings and Supplies	6.00%	6.11%	4.76%	3.26%	3.02%	3.36%	3.69%	3.15%	2.83%	2.26%	2.44%	2.94%
2.7	Apparel	4.96%	4.32%	3.39%	4.21%	4.21%	4.87%	5.56%	1.91%	-2.48%	-3.57%	-2.54%	-3.93%
7.9	Motor Vehicles & Parts	19.17%	16.47%	14.95%	17.21%	19.82%	20.29%	13.32%	9.24%	4.46%	4.18%	4.60%	4.95%
3.9	New Vehicles	11.11%	9.85%	8.74%	7.62%	6.36%	5.26%	3.34%	1.96%	1.49%	1.16%	1.44%	1.96%
3.4	Used Cars and Trucks	31.44%	26.45%	24.41%	31.90%	41.65%	45.24%	29.74%	20.97%	9.37%	9.29%	9.99%	10.04%
1.5	Medical Care Commodities	0.18%	-0.36%	-1.62%	-2.52%	-2.10%	-2.23%	-1.85%	-1.73%	-2.44%	-2.55%	-2.27%	-2.48%
2.0	Recreation Commodities	3.95%	3.98%	3.48%	3.29%	3.17%	3.23%	3.54%	2.86%	0.76%	0.26%	-0.20%	-0.24%
0.5	Education and Communication Commodities	0.94%	2.53%	2.58%	-0.46%	-0.18%	-1.15%	-1.43%	-2.21%	-4.93%	-2.74%	-1.90%	-2.49%
1.0	Alcoholic Beverages	1.91%	2.24%	2.81%	2.58%	2.44%	1.89%	1.55%	1.89%	1.95%	2.03%	2.43%	2.79%
1.5	Other Goods	4.31%	4.46%	3.39%	3.40%	2.67%	2.54%	2.53%	2.32%	1.89%	2.05%	2.24%	1.84%
32.4	Shelter	3.84%	3.48%	3.16%	2.84%	2.83%	2.58%	2.21%	2.11%	1.70%	1.47%	1.62%	1.84%
23.5	Owners' Equivalent Rent of Residences	3.53%	3.13%	2.89%	2.55%	2.43%	2.34%	2.11%	2.04%	2.01%	2.03%	2.01%	2.17%
7.6	Rent of Primary Residence	3.05%	2.70%	2.43%	2.12%	1.91%	1.92%	1.82%	1.80%	1.83%	1.96%	2.05%	2.28%
1.0	Lodging Away From Home	22.16%	22.25%	17.54%	17.43%	21.47%	15.08%	9.00%	7.37%	-6.41%	-14.94%	-11.40%	-9.52%
1.1	Water & Sewer & Trash Collection Services	3.49%	3.73%	3.73%	3.48%	3.69%	3.57%	3.44%	3.55%	3.53%	3.61%	3.57%	3.59%
0.9	Household Operations	8.44%	6.85%	6.63%	7.28%	6.99%	7.16%	8.26%	4.92%	4.34%	4.32%	4.73%	4.12%
7.0	Medical Care Services	2.08%	1.68%	0.89%	1.01%	0.82%	1.02%	1.52%	2.16%	2.71%	3.02%	2.91%	2.75%
5.0	Transportation Services	3.86%	4.50%	4.39%	4.57%	6.38%	10.40%	11.18%	5.62%	-1.64%	-4.37%	-4.06%	-3.47%
0.6	Airline Fares	-3.67%	-4.63%	0.79%	6.71%	18.96%	24.56%	24.08%	9.64%	-15.07%	-25.62%	-21.31%	-18.26%
3.7	Recreation Services	2.80%	3.78%	3.48%	3.48%	3.72%	1.90%	0.62%	1.76%	1.23%	1.06%	0.30%	1.58%
6.0	Education and Communication Services	1.72%	1.71%	1.66%	1.33%	1.24%	2.36%	2.19%	2.02%	2.04%	2.11%	2.04%	2.32%
1.6	Other Personal Services	4.50%	4.05%	3.45%	3.59%	3.08%	2.48%	2.78%	3.01%	2.87%	2.18%	1.99%	2.90%

US inflation, CPI heat map for US prices compared to 1 year ago: source BofA

Core CPI rose at 4.9%, the highest level since 1991: zerohedge / Bank Syz

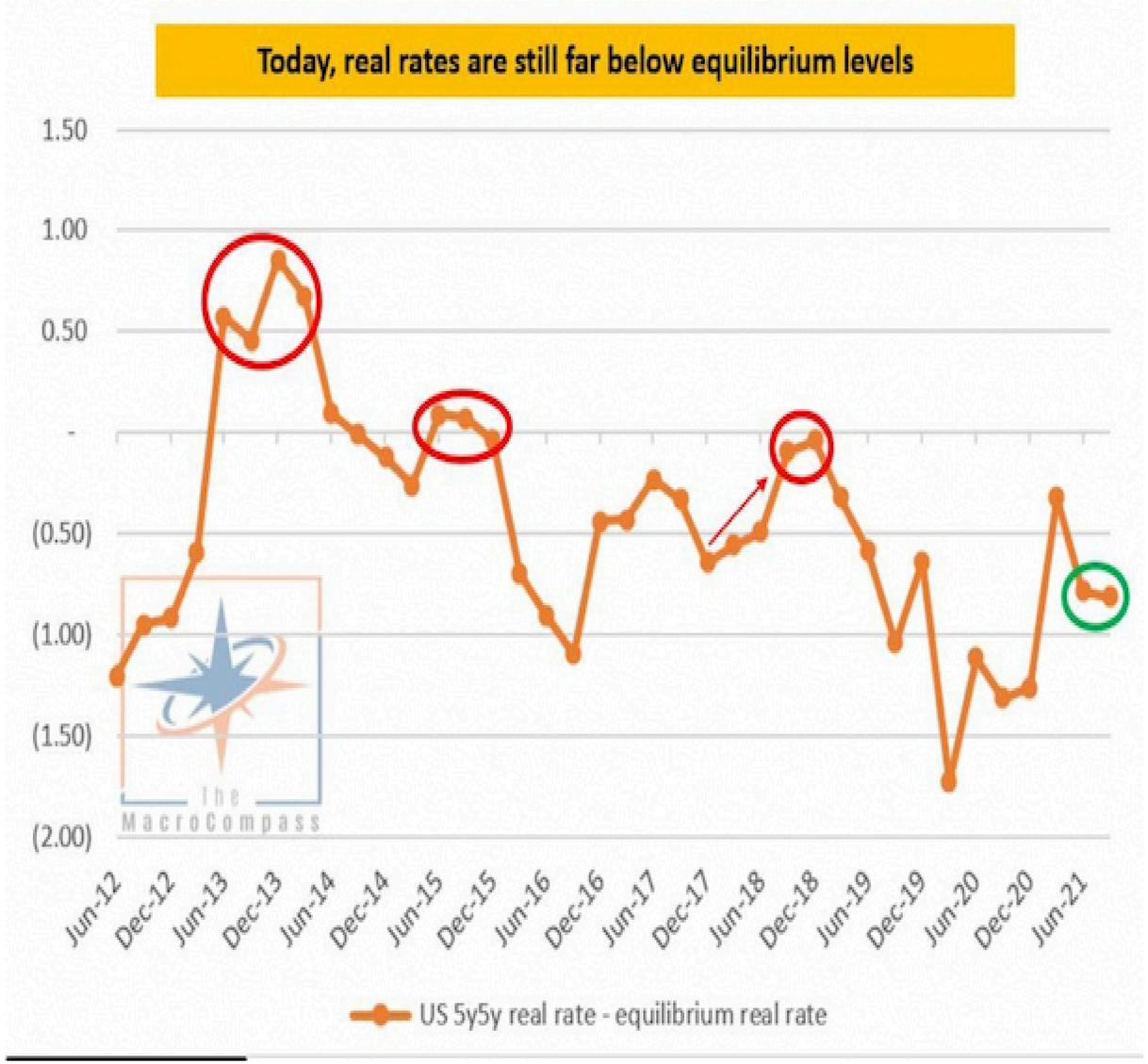
Inflation expectations peaked?

- As previously explained, the economy has just experienced the highest increase in the CPI level in the last 40 years.
- A detailed analysis of the CPI components suggests that the main drivers of higher inflation should fall in the future.
- **The market's confirmation is coming from inflation expectations over 10-years, which fell last week, showing a peak in the inflation.** This should also be translated into lower yields for long term bonds and should be supportive for the gold price?!
- We have read many comments about how inflation is going to stay persistently high. But none of the comments offered a detailed and serious analysis as to why it should be that way. In our opinion, by analyzing the CPI heat map, we are convinced that extreme contributors to sharply higher inflation during 2021 are not going to be persistently high in the future, on the contrary, they should fall strongly.

Peak in inflation? Source: Bloomberg / Bank Syz

Inflation-adjusted interest rates

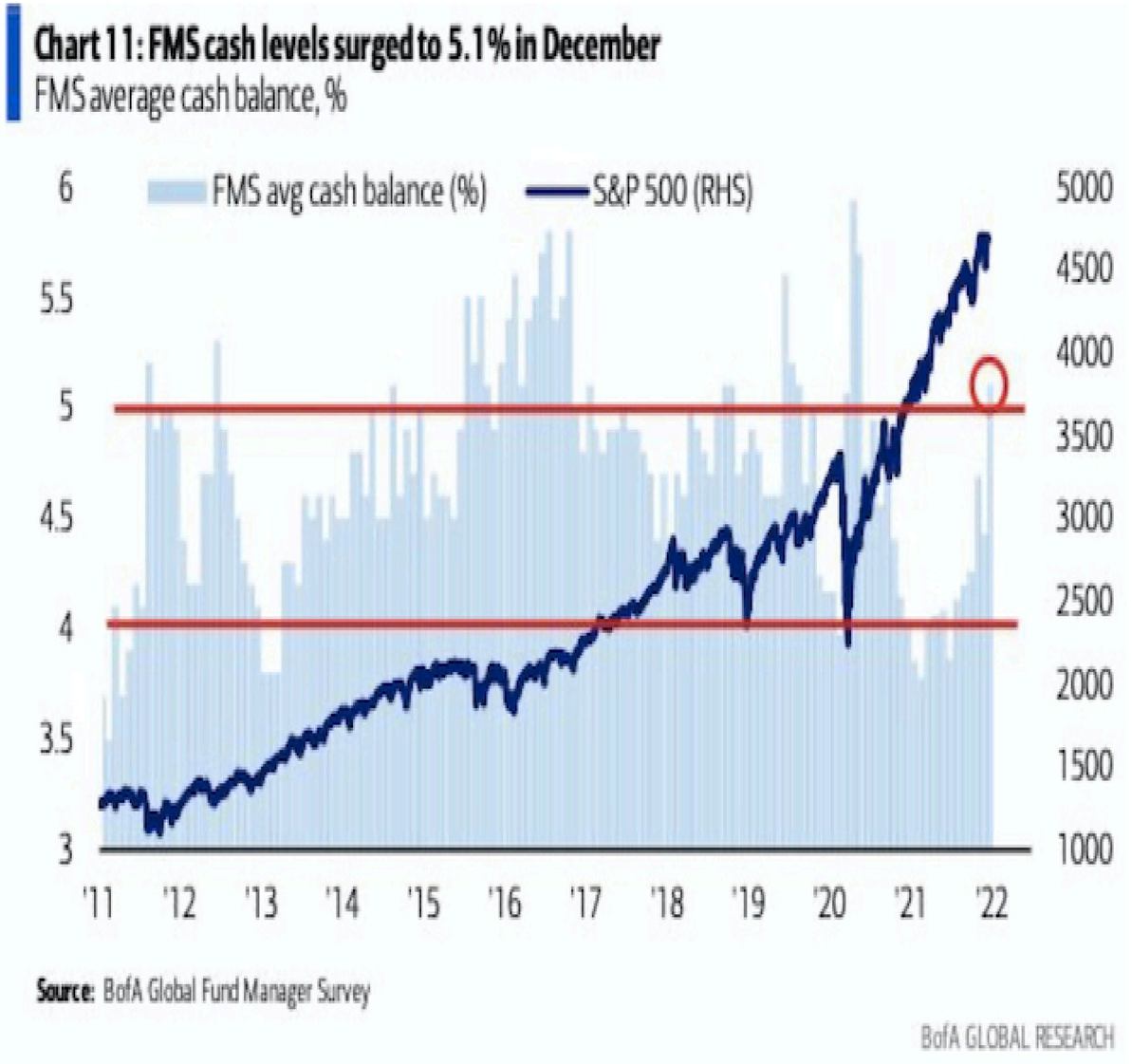
- Mr. Alfonso Peccatiello is rightly explaining that those market participants who are predicting an imminent stock market crash are missing the key point of low interest rates.
- **Inflation-adjusted interest rates are still way below the estimated equilibrium levels.** This means that, as long as real yields stay low or negative, it punishes savers and investors by rewarding very little (or even inflicting negative returns) on savings and risk-free investments.
- In addition, it helps borrowers to significantly reduce their real debt servicing costs, as debts are inflated away while nominal interest rates remain low. Borrowers with the same real income are now able to afford more leverage. This is exactly KTS's argument, which aligns to our best in class fund Flossbach`s observations about how governments want to reduce their high indebtedness.
- As long as earnings and nominal economic activity delivers, very low risk-free real interest rates will help drive portfolio inflows into assets and encourage higher valuations.



US real yields are 100 bps below estimated equilibrium levels

Market sentiment

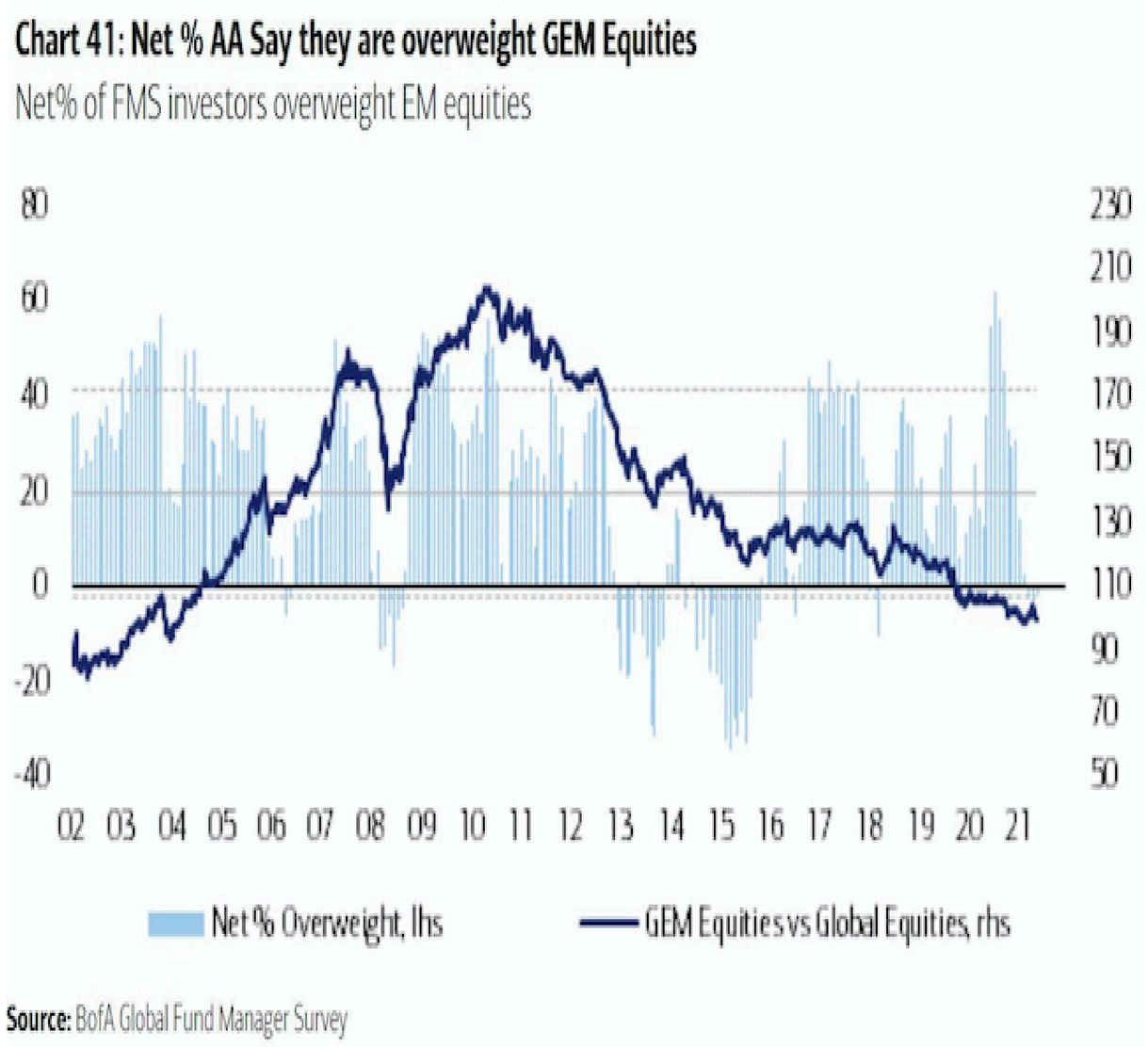
- According to BofA survey, **asset managers increased their liquidity levels to 5.1%**, which is quite of a high level and a contrarian indicator for bullish equity markets. Asset managers are more prudent now than at the beginning of 2021.
- The CNN fear and greed index is around 26, which means extreme fears. This is an additional bullish indicator, showing that market sentiment is extremely depressed at the moment.
- The sentiment indicator of Goldman Sachs, which is focussed on the equity weighting of retail investors, just fell to -1, which is the most extreme `bearish` positioning since March 2020. This was the month of the market's sharp downward correction, due to the arrival of the Covid19 pandemic.
- In addition, we just experienced a substantial correction in many stocks due to the US tax selling window. As we analyzed in the previous slide, most of the market performance YTD is due to the top 5 companies in the US index. The rest of the market has experienced poor performance due to dramatic corrections, we would even assert capitulation.



High level of liquidity from the side of professional asset managers

Emerging market sentiment depressed

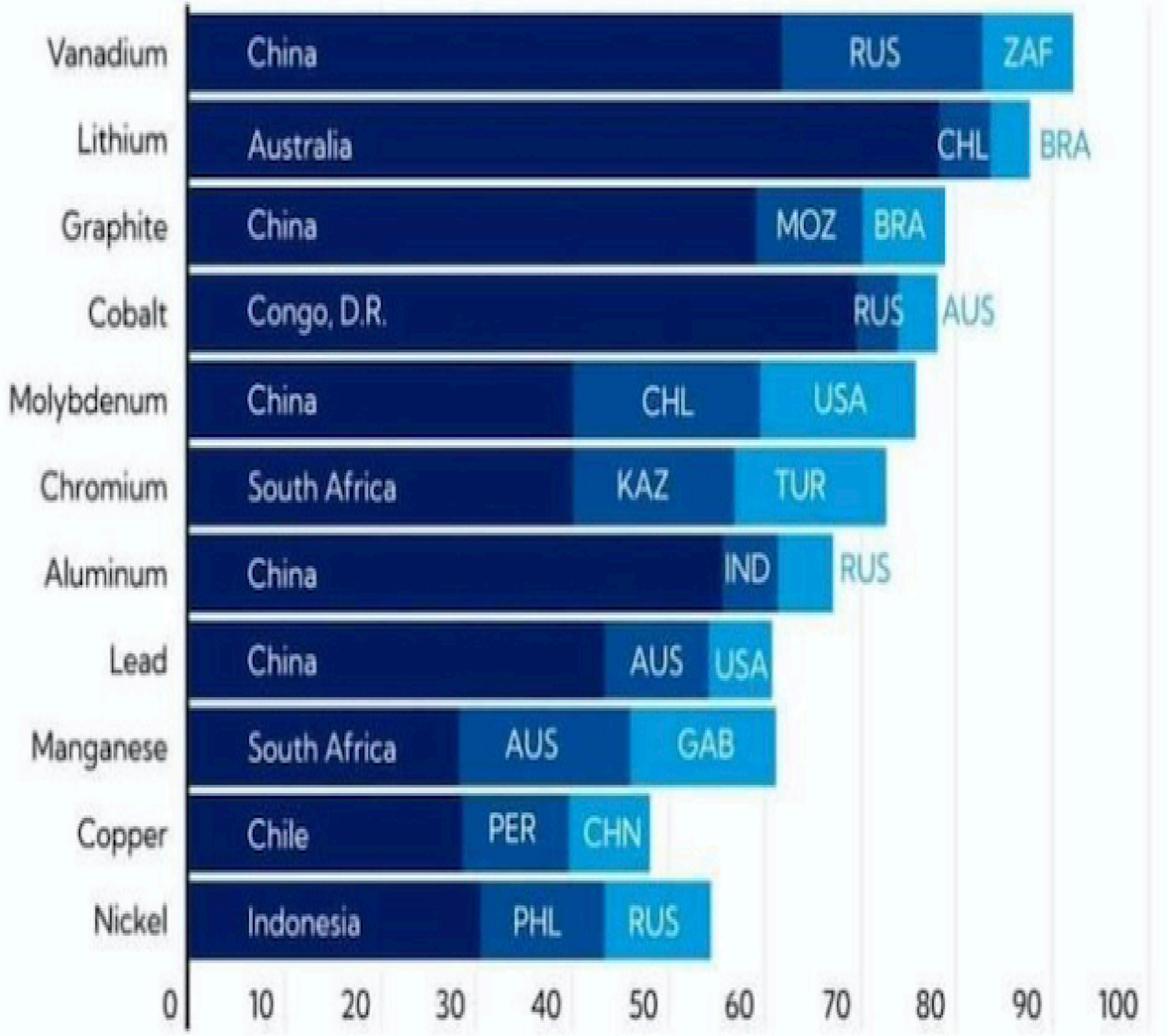
- The weighting of asset managers in **emerging markets is heavily underweight**, from overweight at the beginning of 2021. Basically, from being a favorite allocation at the beginning of the year with bullish/overweight weighting to forgotten today (net bearish now). This is an additional contrarian indicator.
- KTS is still invested into emerging markets debt, Vietnam (via our expert Marco Martinelli), India (via our best in class emerging market fund Aubrey) and China (half position into the ETF: EMQQ LN).



Source: Paolo Calcinari Ansidei / BofA

Biggest producers of crucial metals for the green energy transaction

- Interesting chart, courtesy of IMF / Bank Syz, showing the regions that supply several key metals that are crucial to the green energy transition.
- We notice there is a strong concentration in a handful of countries, like China, Australia, Congo and South Africa.
- KTS is invested in the best in class fund Bakersteel Electrum, in order to gain exposure in this space. Recently we invested in the ex management of the acquired company Galaxy Resources (acquired by Orocobre, a company in which KTS used to be invested directly), which has just launched a USD 350 mio SPAC, in order to acquire mines outside China.



Key metal for the "green" transition: concentration in a handful of countries

Fintech

- **According to the research of Fasanara, cashless opens Fintech lending door.**
- KTS actually agrees because, as we know, different cultures are still using traditional lending systems with cash. Pooling a bigger amount amongst friends and lending out smaller amounts at horrendous interest rates.
- With new limitations on cash, this traditional system is slowly but surely disappearing. Therefore, people are looking for alternatives. Fintechs are cost efficient and can execute accurate analysis by checking social media and algorithms of machine learning/ AI (artificial intelligence), so are able to execute accurate analysis on the single person.
- In addition, in countries like UK, algorithms can also analyze bank accounts and extrapolate delays in payment, negative balances, debt, etc.
- Therefore, Fintechs also have the possibility to lend capital to “lower quality” borrowers with a good default rates and attractive margins.
- This reality is also confirmed by our experts in factoring and direct lending.
- This is one of the reasons why we strongly believe in a prosperous future for Fintechs. Bank and insurance systems are reputed to be too aged to efficiently enter such markets. On the contrary, we have daily conversations with bankers explaining to us how banks are restructuring and laying off people in order to reach higher profits, but their IT systems are aged and less people are not able to keep pace with the work and pressure. They are experiencing more and more cases of “burn out”. It is definitely not a sustainable situation and we are already experiencing, over years, banks which prefer to invest in specialized Fintechs or hedge funds at 3-4% yields. Which is better than raising equity to invest internally to upgrade infrastructure and human resources.

Swisscom Ventures Digital Transformation Fund (DTF) II

- KTS is going to invest in the venture capital structure of the Swiss telecom company Swisscom, having an exclusive entry opportunity, due to Ms. Myoung-Ok Kwon becoming a new partner and Head of Healthcare investments. The Swisscom management has a solid and proven track record since 2007.
- The Swisscom VC has a substantial advantage vs. normal venture capital fund structures: no management fees (usually 2%) and 25% carried interest, which starts to be debited only when investors have achieved a 1x return. Over longer time periods financial advantages are well over 25%, and it is possible to invest more from day 1.
- The first venture capital fund today includes 6 unlisted start ups, which have a valuation above 1 billion (AKA Unicorns) with additional 7 IPO candidates within 2-3 years.
- Strong differentiation from standard VC structures. In fact, Swisscom is not only investing in a start-ups, but is doing so from the position of an insider in the telecom sector, bringing with it a deep knowledge of technological trends and innovations. Swisscom is also a client of startups and, in some cases, a reseller of their products, services and commercial channels. Swisscom is also recognized as a worldwide leader in technological innovation in ICT (Information and Communications Technology), and has had offices in Silicon Valley since 1998. They are, therefore, on the pulse of start-up flows. In fact, the key for VC investments is to have local specialists.
- Swisscom is co-invested in the fund with a 25% stake (CHF 75m). The remaining 75% is represented mainly by institutional investors or pension funds. Total size of the fund: CHF 300m with a time horizon of 10 years. The capital is going to be deployed over a period of 5 years rather than all at once, which again gives financial advantages.

Swisscom Ventures Digital Transformation Fund (DTF) II

- Swisscom is co-investing with the worlds' leading tech VCs.
- Geographically, Swisscom is going to invest 50% in Switzerland and 50% internationally. There exists high conviction in the higher quality of Swiss ventures (the ETH in Zurich is the 8th best university in the world, Lausanne the 14th); the Swiss VC market is not mature and is under researched compared to US and Europe. 88% of the Swiss investments in VC fund structures is invested abroad (only 12% in Switzerland), but 80% of the money invested in Swiss VCs comes from international investors!
- The Swiss telecom environment is also supported by fiscal stimulus from the Swiss government into telecom infrastructure, aimed at achieving a faster broadband connection for Swiss citizens throughout the country by 2024 . The Swiss government still holds 51% of Swisscom, therefore the company has an important role as a Swiss brand.
- Swisscom is playing a very important role in building a trusted and solid digital asset ecosystem.

New Zealand and the tobacco industry

- As we all know, New Zealand, like Scandinavia, is always 2 steps ahead in innovation and open for big changes.
- **New Zealand is going to ban smoking for the next generation in a bid to outlaw the habit by 2025. I**n other words, it means people currently aged 14 and under will never be able to legally purchase tobacco.
- Reading through the lines, it looks like the new legislation is focusing only on nicotine and the media are arguing that smoking has already been widely replaced by vaping among teenagers in New Zealand. In addition, vaping is attracting many young people who would never have taken up smoking, according to surveying of 19k high school students.
- KTS is actually not invested directly and, as far we know, neither indirectly in tobacco companies and we do not intend to invest in the future. But, we should also emphasize that the tobacco industry has acknowledged the current political pressure and taken a lot of innovative steps aiming at change. The fact that the main industry growth comes from the new vaping trend shows that the tobacco industry is trying to become “healthier”.

General news

- According to The New York Times, the highly anticipated study of **Pfizers Covid pill confirmed that it helps stave off severe illness** and, in addition, laboratory experiments indicated that the drug would attack a key protein in the Omicron variant. The pill reduced the risk of hospitalization and death by 88%, when given within 5 days of the onset of symptoms to unvaccinated people at high risk of severe Covid.
- Apparently, the Biden administration is considering imposing tougher sanctions on China's largest chipmaker, according to people familiar with the situation, building on an effort to limit China`s access to advanced US technology. US has a new government, but the strategy stays the same and it looks like political tensions between the 2 countries are not "cooling down".

General news on crypto currencies

- **90% of all bitcoin has been mined,** according to data from blockchain tracker Blockchain.com. This means, 18.89 million bitcoins, out of a maximum of 21 million, are now on the open market.
- This is a milestone reached after 12 years since the first bitcoins were mined on the 9th January 2009. **The remaining supply is not expected to be mined until February 2140**, based on network activity estimates and Bitcoin's halving schedules.

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