KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 4

The 28th of January 2022

Market correction, FED tapering, Inflation fears

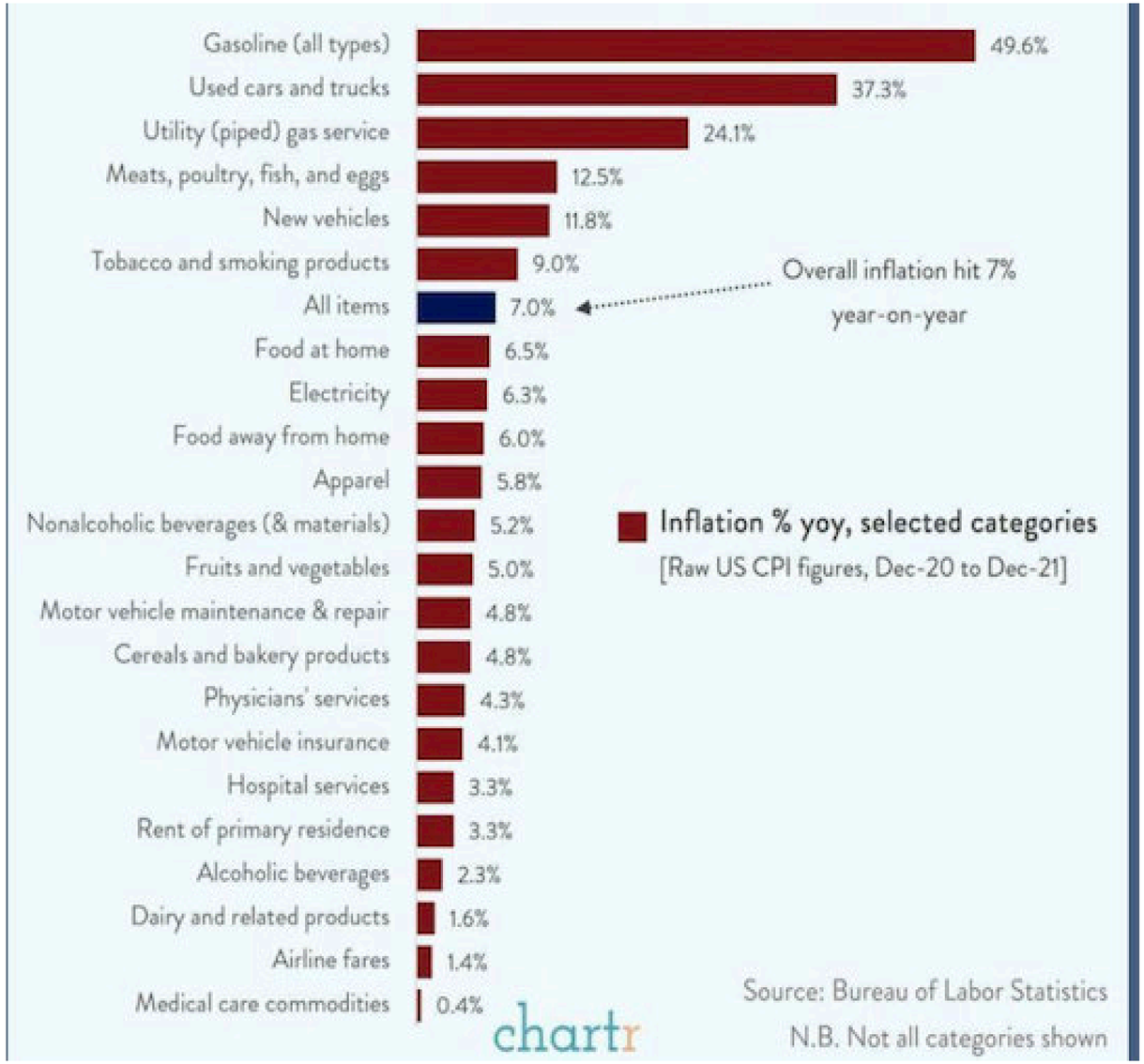
- All in all we would argue that the FED was in-line with the previous statements and is going to start with 25bps increase by March, which was expected (even 50bps were estimated). Tapering will be moderated, but as we always argued, the FED is not in position to take any drastic change. Market participants did not like specific comments of Mr. Powell, especially: “I think there is plenty of room to raise rates without threatening the labor market” or “Asset prices are somewhat elevated” and finally “The FED is willing to move sooner...and perhaps faster”. We think that the FED needs to normalize the monetary policy, as the global economy is also going to, slowly but surely, normalize; but as we are going to see in the next slides, a lot of negativity has being already discounted from equity markets and the market sentiment is partially worse than during the pandemic in March 2020, which says basically everything about the positioning of market participants at the moment.
- The main unanswered dilemma by most market participants is who is going to buy the difference in US Treasury, now that the FED is tapering? If there is no buyer, the yield of the 10-year US government should skyrocket in order to attract new investors. Mr. Yardeni answers the question by asserting that German and Japanese investors are buying US bonds at 2% because their yields remain around zero.
- Nowadays, the question we have to answer is what are the triggers for a market rebound or at least stabilization, having investors worrying about the change in monetary policy of the FED and the persistent high inflation? **With forward earnings continuously rising, and therefore equity valuation getting more attractive**; most probably, future better-than-expected inflation indicators and therefore the FED, as also global central banks, less under pressure, should help to stabilize equity markets. In addition, most market participants are arguing, that basically the Biden Administration put pressure on the FED to reduce the high inflation before the election in November, because obviously voters are quite upset on the recent spike in inflation.

Market correction, FED tapering, Inflation fears

- In the next slide we are analyzing again the major drivers of rising inflation and we sense that, sooner than later, inflation numbers are going to start falling, contrarily to many market participants which are expecting higher inflation over a longer period of time.
- Analyzing credit markets, which are quite relaxed, we would assert that there are no fundamental issues, if not geopolitical tensions like in Ukraine, therefore we would expected the actual equity market correction as temporary and we would expected a rebound.
- For those reasons, KTS is taking the opportunities of this market's correction to increase exposure in some funds, which were on our radar screen, but we were awaiting for the right entry point, which we did not have during year 2021.
- We bought initial positions into the funds Tramondo, Alpora Innovation, Stonehorn Asia and increased the exposure in our ABR volatility model, but this time into the allocation of 75% long volatility and 25% short volatility, profiting from the volatility spike.

What's caused the rise of inflation

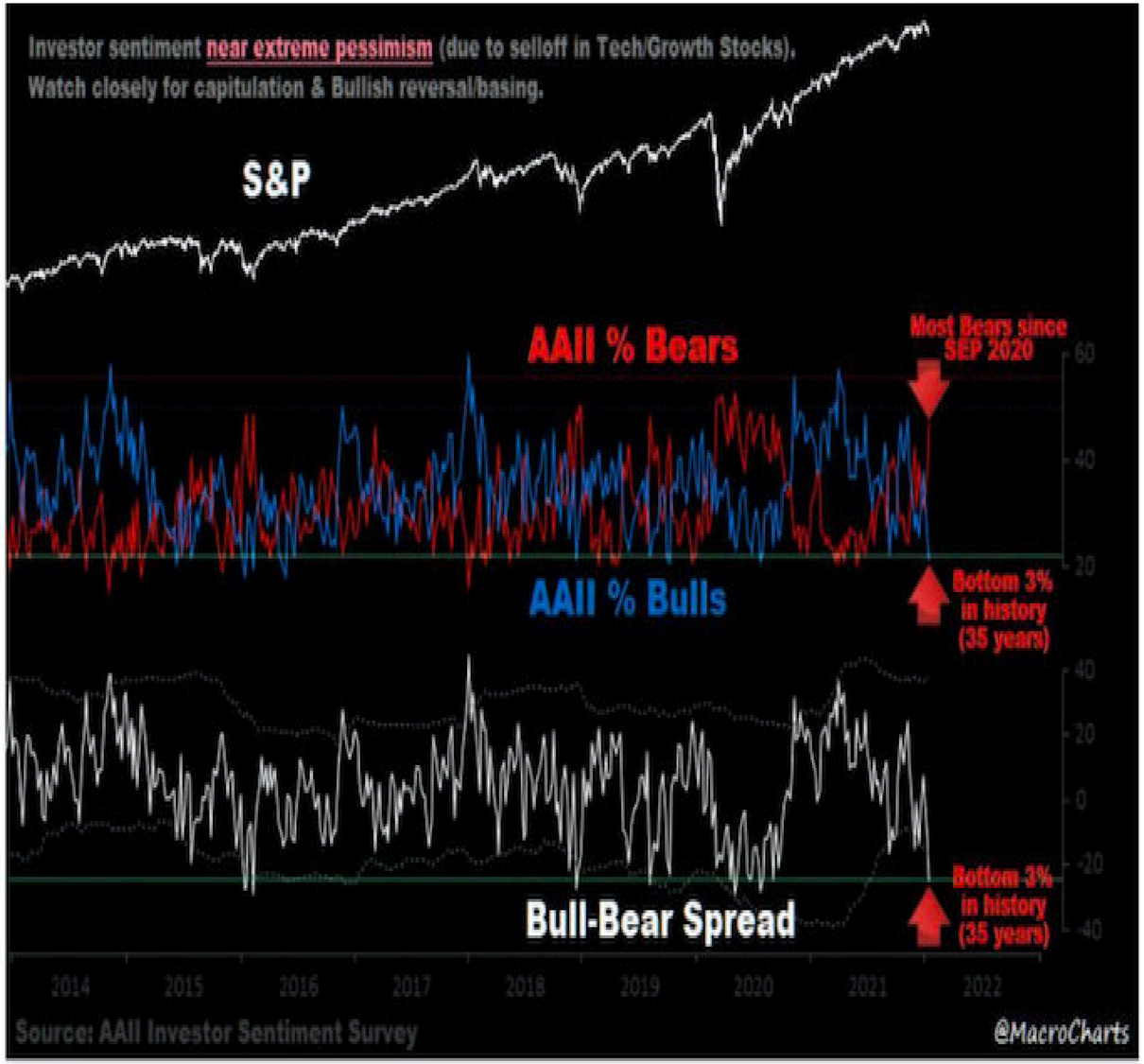
- We add another chart (see also weekly Nr. 46 of 17 December 2021) showing the main drivers of the rising inflation.
- Of course the main factor is gasoline and gas/utility prices, but the second component is used cars.
- The "run" to buy used cars at any prices is most probably the consequence of people feeling safer to drive, instead of using public transportation. Such situation remind us the 9/11 event, when after the attacks, people did not want to fly anymore and the majority of the population was believing that the attacks would change flying habits. Not even 6 months later, airline traffic was again at the same levels than pre-attack. For this reason, we are strongly convinced, that on the second half of 2022 the inflation is going to slowly but surely normalize.
- The increase of food' prices is a consequence of rising transport costs (especially insane shipping prices) and undersupply, due to still various lockdowns. We believe that due to a normalization process, also this price shock is going to be dismissed soon.



Source: chartr

Market sentiment

- As mentioned recently, market sentiment is very depressed and we can analyze on the right side, how the **investor sentiment is the worst since September 2020**. From a contrarian point of view, this is actually bullish.
- Also Mr. Ansidei brought few indicators that show extreme pessimism, but one also very interesting indicator is the sentiment on the average recommended stock market exposure among short-term Nasdaq focused stock market timers / Newletters **(HNNSI indicator, Hulbert Nasdaq newsletter sentiment index), which is worse now than it was in March 2020**, fact which we would assert is incredible and is a sign of extremely aggressive bearish posture, again as contrarian should be a bullish sign.
- Finally Mr. Yardeni mention his favorite technical analyst, Mr. Joe Fashbach, who notes that the CBOE equity put/call ratio rose to 0.82, which is the highest reading since the 2020 pandemic lockdown selloff. Analyzing the chart, such indicator could actually increase to 1.2, so still not at the top.



Source: Bloomberg / Bank Syz

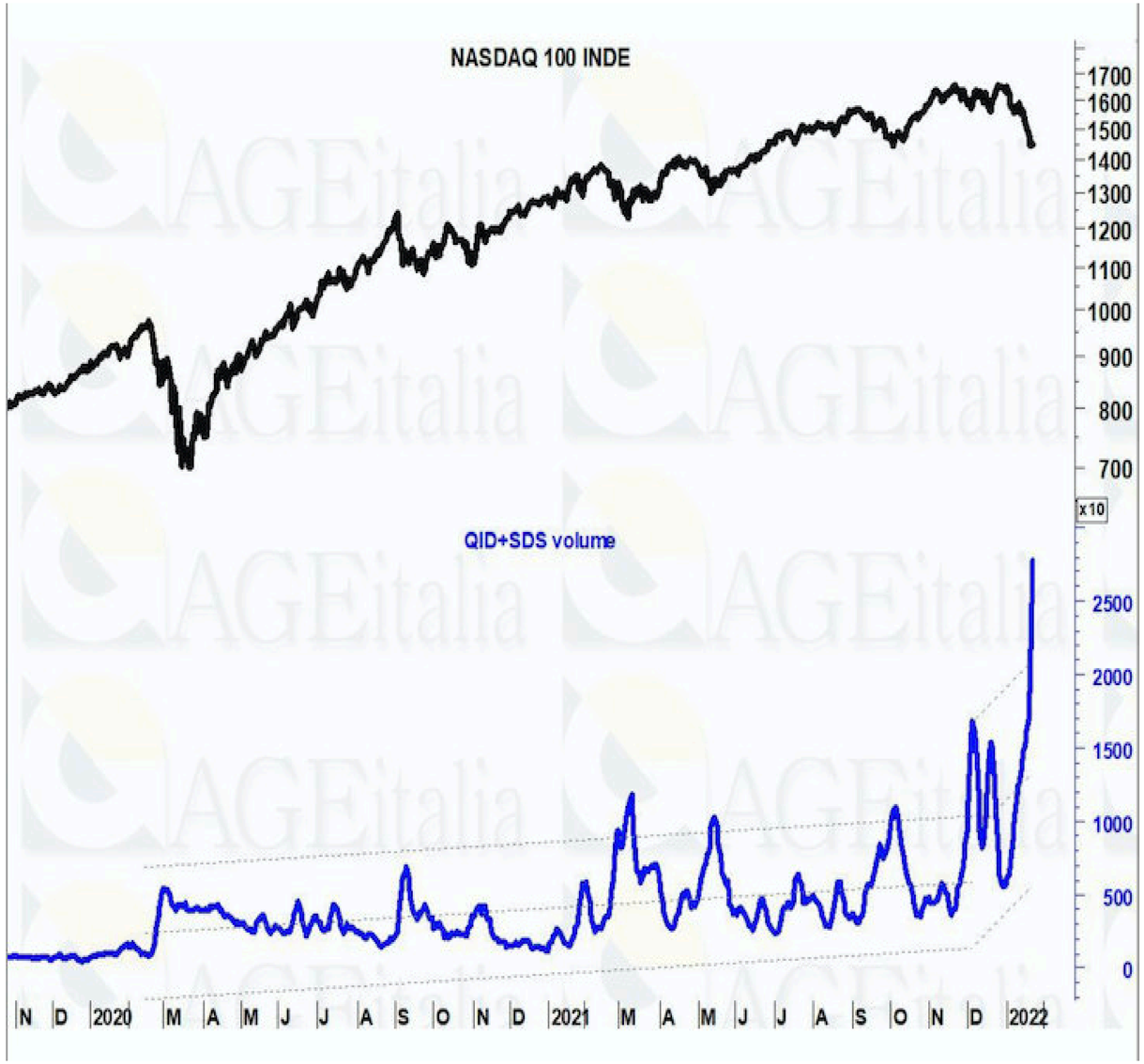
Intra-day reversal by S&P 500 Index (24 January 2022)

- During a heavy market's correction, investors are always looking at possible signs of exhaustion. As described in the previous slide, sentiment is very depressed and during the day 24 January 2022 stock brokers could notice increasing volume of capitulation selling. In fact, at 24.1.2022' lows, January 2022 would have being the worse performance month since the GFC of 2008.
- The substantial intra-day reversal of +4.4% during the 24.1.2022 is a clear sign of stabilization. Statistics of Charlie Bilello are showing, that most of such reversals occurred during bear markets or shortly after bear market lows.
- As recently explained, KTS does not believe equity markets have an imminent risk to enter a bear market, because there are not fundamental signs, which would indicate such risk. Therefore the intra-day reversal of 24.1.2022 is a bullish signal and KTS built up some new positions as mentioned in slide 2.
- The right trading strategy in such events is to go long equity with stop loss the lows of the day 24th January 2022.

Massive intra-day reversal on the 24 January 2022.

Massive inflows into leverage short ETFs on QQQ

- Retail investors or traders bought USD 76.6 million of the Proshares Ultrapro short QQQ etf (ticker SQQQ - three times the inverse performance of QQQ) on the Monday 24th January and a total of USD 121 million in the last 5 days. This volume is the highest in the last 5 years according to Vanda research data. Purchase of put options also had an all-time high.
- The chart on the right hand side shows the volume of the SDS etf (Proshare ultrashort S&P 500) and QID (Proshares ultrashort QQQ etf). We can notice that the volume is basically 5 times higher than during the pandemic in March 2020.
- Market participants are rightly asserting, retail investors changed from buying Game Stop last year, to massively short the market this year, it would explain the massive move during the last 5 days, even having had already a depressed sentiment before the market's correction started and having had professional investors already underweight equity.
- **The risk of a market rebound catching retail investors "on the wrong foot" is getting substantially higher!**

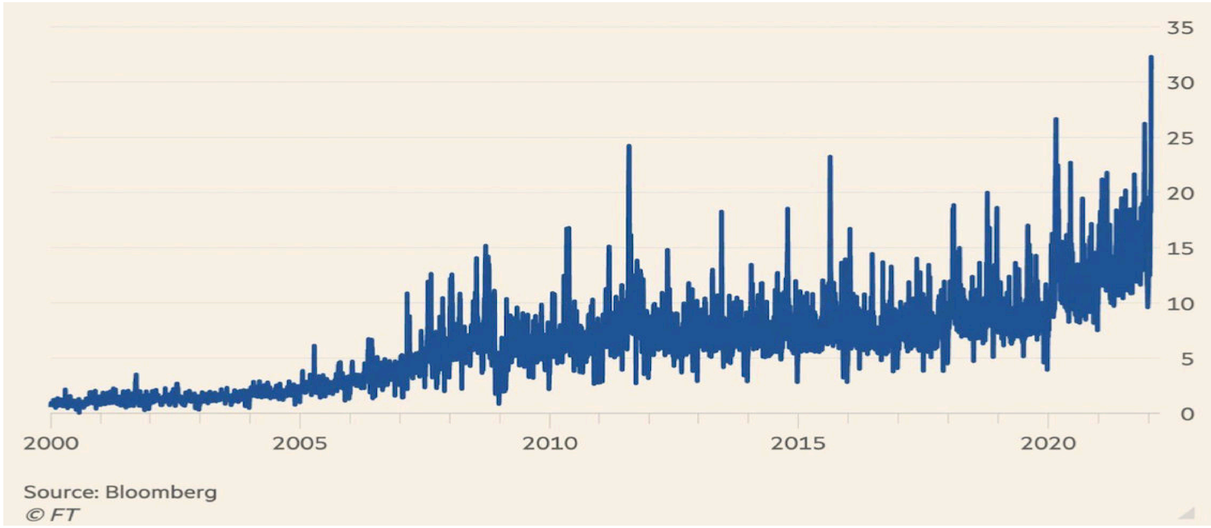


JPMorgan / Bank Syz / Gaetano Evangelista

Capitulation days

- There are enough signals around, showing the intraday move on the 24th January 2022 was a capitulation day and we would like to highlight some:
  - The chart on the left hand side shows the move from new highs to new lows of Nasdaq and only 2 times in the Nasdaq history (1978-2022) such spread happened: March 24, 2020 and January 25, 2022 = it is a clear sign of exhaustive capitulation.
  - Mr. Ansidei also shows the global stocks Fear-Greed index of Bloomberg, which is at lowest level since March 2020.
  - On the right hand side we can notice, how put option volumes are at all-time high and the volume on the 21st to 24th January 2022 surpassed by far the previous record set in February 2020.
  - Mr. Ansidei also published the chart of JPMorgan showing Small-caps P/E valuation near to 20 year lows.

Only 2 times in the Nasdaq history (1978-2022): source Mr. Ansidei



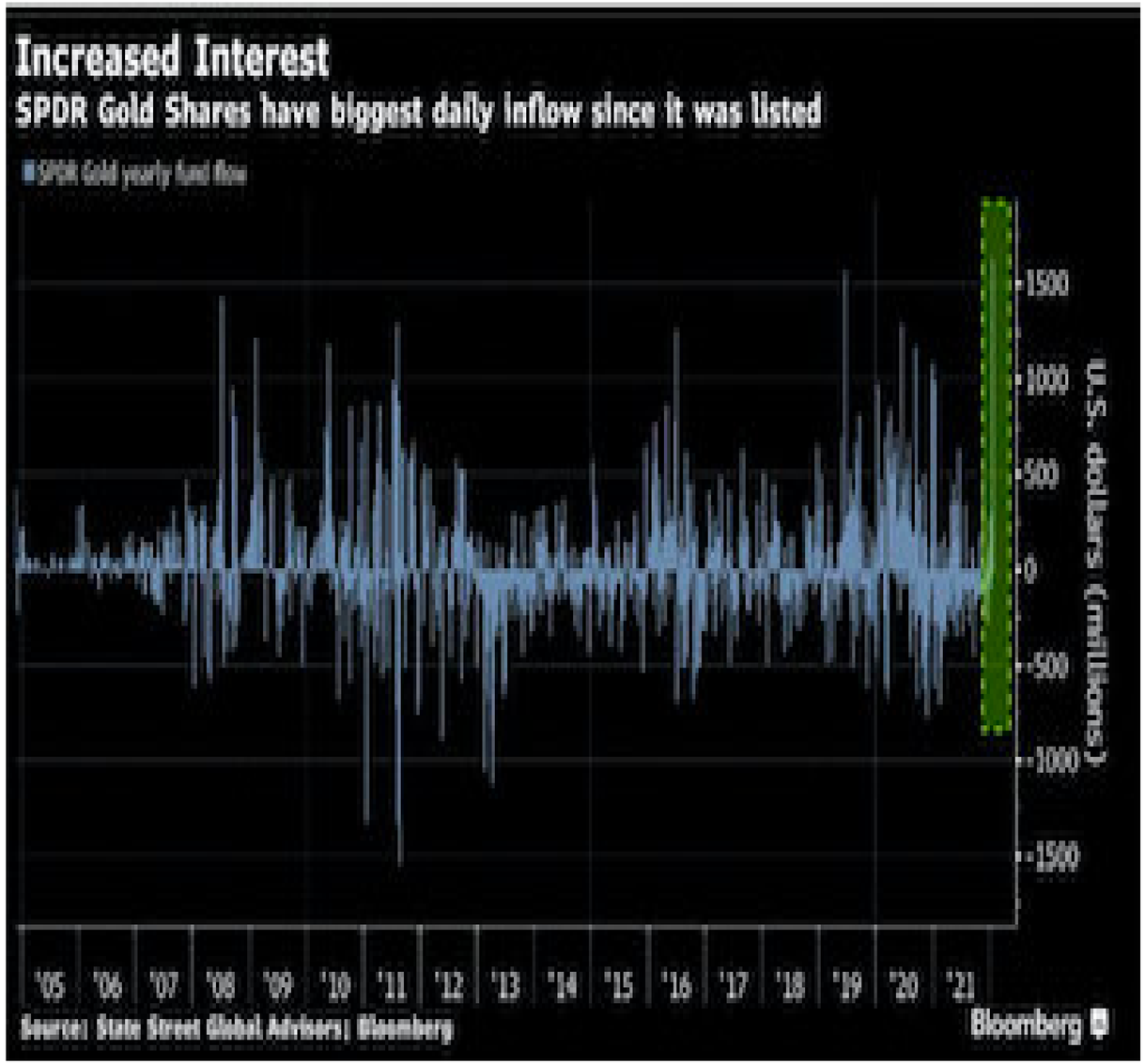
Highest Put option volume ever (source Mr. Ansidei/FT)

Flossbach

- During the webinar of our best-in-class dynamic asset allocation fund Flossbach, we would like to highlight:
  - The investor sentiment between their institutional investors is still at highs, but more because of missing investment alternatives vs equity. In fact, also YTD 2022 the bond's performance is again negative, after being 2021 the worse year for bonds since 1999. This is a proof, that bonds are not helping to stabilize a portfolio anymore, on the contrary, they increase risk.
  - Market participants reacted negatively on the FED turning more hawkish and planning to increase faster interest rates. The manager of Flossbach argued, **if equity markets are going to be too volatile, is going to have negative repercussions on US consumption** and therefore soon the FED is going to find itself "with the back against the wall" and will have to change the monetary policy's tone again. In addition, by analyzing the German energy prices' development, whereby at the end of 2021 prices collapsed, Flossbach is confident that the inflation is going to fall to a 3% level, reducing the pressure on central banks. Also the magazine The Economist is arguing that Europeans are more resilient than in the past on gas prices, having LNG supply from US.
  - **The most important long term chart is the comparison of global equity yields, stable at around 6%, vs the global level of interest rates still around 1%** and therefore, interest rates need to increase substantially in order to have extremely negative consequences on equity markets, or at least on companies with a solid business. It is not the case on high flyers or non profitable companies, whereby, even a marginal increase of interest rates has a substantial effect on "Boom-Bust" stocks, which rallied to insane valuations during the year 2021 and felt back to reality during January 2022. The portfolio of Flossbach includes solid companies, not high flyers, and therefore is not "touched" from such phenomenon.

Inflow into the gold space

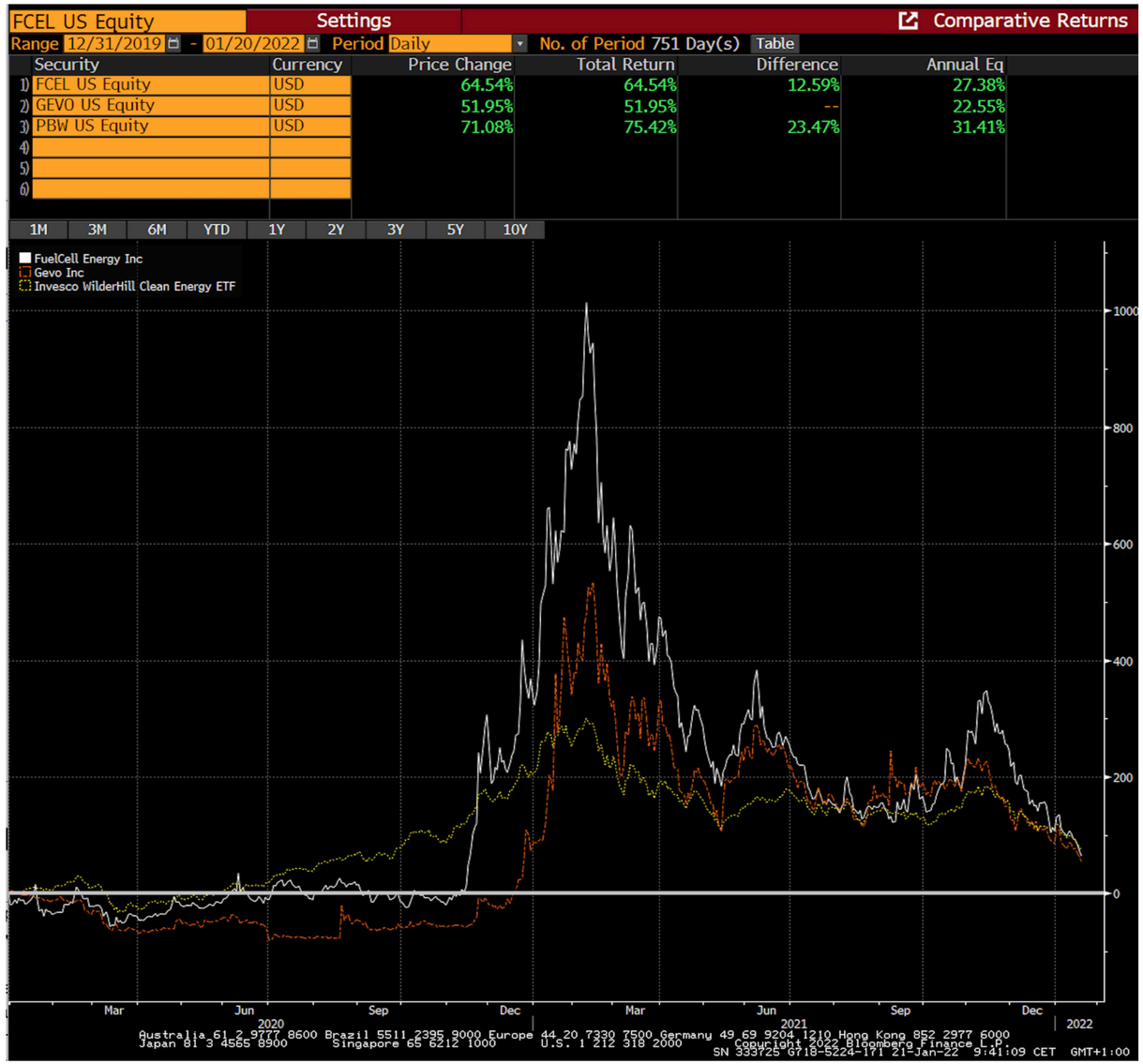
- The gold price was stable before the FED speech, even if real yields increased. There is a sense amongst experts, that gold could again gain attractiveness as stabilizer and diversification of a portfolio.
- In addition the SPDR gold share experienced YTD the biggest net inflow in USD terms since listing in 2004. The net inflow of last week was 27.6 tons.
- As mentioned in our outlook, gold demand from jewelry is very strong and growing, especially out of China and India, therefore the real trigger for a technical break out of the price of gold would come from financial investors. It could be that a breakout of the resistance of 1’880 USD would trigger the purchase from the side of momentum strategies (HFs like AHL Man trend for example) and the move could be strong and fast. We could pass the highs of 2’085 USD and go fast direction 2’500 USD.
- We added to our best-in-class fund Bakersteel Electrum and precious metals, also the active manager AMG Gold Mine fund.



Highest inflow into Gold etfs since 2004

GEVO

- The stock price is experiencing daily new lows and the natural investor's reaction is to explain such weakness by analyzing possible problems on the daily business of the company.
- We analyzed the relationship between Gevo's stock price vs peers, and we can assert that also Gevo, as the whole green and renewable sector is suffering from substantial ETFs outflows, with market participants realizing that some valuations are still unsustainable and some stock prices are still 100% higher than the start of the huge hype back in November 2020.
- But the situation of Gevo is totally different, having had the company increasing substantially the equity capital during the tremendous run up to 15 USD and nowadays the market cap is around USD 600 mio vs USD 560 mio on the bank account of the company. Meanwhile Gevo was adding new incredible JV with Chevron (still a LOI but should be finalized by May 2022), ADM and others. Basically the investor today is paying only the cash on the account and nothing for the USD 600 mio invested in R&D over 11years and the IP valuation of USD 450mio.



Gevo vs. the green etf PBW US and the green company Fuel cell

Rimac has huge ambitions for stand-alone components unit

- Herewith, we are including the links to an interesting interview of the automobile blog autonews with the founder of the Croatian company Rimac, whereby Mr. Mate Rimac asserting, that Rimac automobili is working on projects where they are producing batteries in tens of thousands and hundreds of thousands of units per year for big car companies.
- As we know, **Rimac is already a supplier to Porsche, Hyundai, Kia, Aston Martin and many other prestigious European brands** and will offer engineering, development, high-performance battery systems production, electric drive units and electronic systems.
- We would like to mention the **recent record set with the ultra fast-charging station.** The car achieved an unprecedented average charging power, close to 260kW over a 21-minute session, result, which crushes Lucid Air's amazing fast charging curve. The founder Mate Rimac officially posted, that the Rimac Nevera charges at over 300 kW only because the charger can't deliver more, the car is even ready to accept 500kW, according to the specs.
- As we mentioned, Rimac has more than 1'000 employees, of which 900 are engineers, which means, **Rimac is the heart of R&D and innovation in the space and is already jointly developing new technologies with Porsche and Hyundai/Kia**. For this reason we strongly believe that we are at a "point of no return" for such major car companies, and they need to keep a solid long term relationship with Rimac, but vice versa of course.
- We would like to mention that Renault, Nissan and Mitsubishi want to triple R&D into electric cars, which means to invest up to EUR 20 billion in the next 5 years. The real run to EV started for real and you have to be invested in innovation and technology. For this reason KTS strongly believes to be invested in the right company.

Rimac has huge ambitions for stand-alone components unit

- As we know the company started to build the new EUR 200 mio campus, partially financed from the EIB and Croatian government, but the company is also already trying to buy substantial land surrounding the new campus. The news is quite official, because the founder Mater Rimac had to express officially, that the company is not getting such land for “free”, but is part of bigger plans, also for the Croatian government, finally creating thousand of new jobs and prosperity to the whole country. This basically confirms that the assertions of Mr. Mate Rimac are real and not wishful science fiction.

https://europe.autonews.com/automakers/rimac-has-huge-ambitions-stand-alone-components-unit

- We are reading many research on electric vehicles and basically everyone has the same message; we are in the midst of a technological revolution and the next decade is going to be characterized by the transition into electric vehicles.
- Actually the analyst team of Julius Bär had an interesting observation, mentioning that no one actually thought 10 year ago, that 20% to 25% of new car sales in Europe or China would be electric as early as 2021 and therefore this is a proof, that the transition away from petrol and diesel-powered vehicles is firmly underway.
- JB analysts expect an evolution decade (2020-2030), in which the electrification and plug-in market share is going to increase to 70%, afterwards the revolution phase is going to start, with the autonomous driving share going to “kick in”. This trend is also confirmed from semiconductor experts, whereby autonomous driving is not possible in the near future, not only because of technology development, but because the world is not ready with the supply of chips.
- Meanwhile Tesla just announced exceptional results despite the global chip crisis and supply chain issues, but this is not a surprise, because the company built up a strong relationship in the past with its supply chain! Such positive result is the proof of the strength in the sector.

Innovation

- In order to increase KTS's exposure into innovation via experts, we started investing into the fund **Alpora Innovation Europe** of the **manager Ms. Birgit Heim**, who is well known by KTS and always was on our radar screen. As explained in our recent outlook for 2022, the decade ahead of us will be characterized by innovation and new technological trends and it is of vital importance to be invested into technology leaders in order to catch up the upside of such new technological cycle. As mentioned, KTS is also invested into some VC structures such the Swisscom VC or Fasanara and into the Croatian private equity company Rimac automobili. We believe that also with the investments in the funds 2xIdea, Alkeon and Fundana we are well covering the innovation space. We could profit from the market's correction in order to build up an initial position. More to follow, if equity markets correct more.
- The fund is at the top 1% percentile of Bloomberg and has being recognized from the magazine Forbes as top fund manager in Europe (Links: https://www.forbes.at/artikel/die-besten-fondsmanager-2021.html).
- Our best-in-class fund Fundana was explaining us that the **semiconductor sector is still just at the beginning of the new cycle.** In fact, there is an **explosion in chips' demand** for cloud, 5G but even more for electric vehicles. We are at an inflection point and the demand is going to constantly increase, especially with the future "kick-in" of autonomous cars. Other research are also indicating a booming chip industry, being semiconductors the essential power for modern technologies from electronic devices, the Internet of Things (IOT), artificial intelligence (AI), machine learning, blockchain and finally electric vehicles (EVs). The demand is coming from smartphone, data storage, wired and wireless infrastructure, industrial electronics, automotive, PCs and consumer electronics and the supply chain still needs to catch-up. KTS is not investing in single stocks, being confident, that our best-in-class funds are selecting the right companies to be invested in.

China

- The fund manager Stonehorn explains in his new outlook, how **China is not a black box** as many market participants believe and the manager asserts, that there is a lot of misconceptions among investors about China. KTS started an initial investment into the fund sharing the same views, especially for China.
- We highlight a couple of interesting points:
  - The pollution in Beijing has fallen by more than 60% from 2010.
  - In the west we have short election cycles and political donations undermine the value of official pronouncements and economic planning. China's political system permits a longer-term orientation central to its achievements. In 2016 for example the 5 year plan target was to double the GDP and per-capita income over 2010 levels by 2020. The result is an increase of 142% of the GDP and 131% per capita GDP. The same plan aimed at increasing forest coverage by 23%, a target also reached, and extend the high-speed rail network to 30'000 km, which was surpassed by 2019 with 35'000 km. In 2011 China set a goal to decrease energy consumption per unit of GDP by 16%, which was achieved with a fall of 18%. Of course also the manager express skepticism around official figures, but new airports and rail networks, even cleaner air, are hard to fake and we agree.

China

- **The current 5 year plan (2021-2025)**, as we have seeing last year establishes a **target per capita GDP by 2035 of USD 30k, driven by domestic consumption**. In addition, **half of China's new vehicle fleet will be electric** or fuel-cell powered and the remainder hybrid. Of course, **renewable energy will constitute 1/5 of total energy usage by 2025**, up 30% from the end of 2019. This plan of course is going to help China to be less dependent on oil as energy source, but as we have seen with our energy expert, China is going to compensate the gap in energy source most probably with **nuclear** and Kazakhstan is going to play a major role in that sense, therefore we feel comfortable with the light exposure in the uranium market via our energy expert.
- According to a BBC report, based on **2019 data, China's greenhouse gas emissions exceeded all developed nations combined and 2/3 of China's energy is still sourced from coal**. For this reason, **China plans to achieve carbon neutrality by 2060 by investing in related industries each year an amount greater than Australia's annual GDP, an estimated total investment of USD 76 trillion**. KTS would argue whether with such plan and goals, China could cement an healthy economic growth for the next decades to come and basically substitute the real estate boom. According to the manager of Stonehorn, phasing out coal will lead to massive investments and growth opportunities in solar, wind, hydroelectricity, batteries and electric vehicles.
- The manager also asserts that the regulations that caused such a furore last year, and which ultimately turned the private after-school market into a non-profit sector, first began with The Regulations on the implementation of the non-state education promotion law of 2004.

China

- **Stonehorn's manager is convinced that China will use this transition to move up the value chain and build a larger, richer middle class.**
- The main strategy of Chinese authorities to communicate major changes is to quietly laying the foundation for a proposed change or project by slowly issuing documents and gaining slowly consensus, therefore examining them can also reveal big picture themes and invest consequently.
- The manager asserts that in the west the common prosperity plan was misunderstood as a near-abandonment of capitalism through the elimination of income disparities, but according to Stanhorn by analyzing the speech of Mr. Presiden Xi Jinping, it is rather the plan to **grow the pie and distribute it overall**, than an uniform egalitarianism. Finally the manager asserts that if you want to understand China, you need to understand the culture and the cultural preconceptions. For this reason, KTS prefer to assign investments to experts with local presence, rather than trying to figure out without enough knowledge, what is really going on in the country.
- The manager is writing, that after analyzing the key documents regarding the regulatory environment surrounding Alibaba, having interrogated the source of the documents, followed the breadcrumbs, checked with the right connections and relationships (so called in Chinese "Guanxi") and finally rechecked their thesis, **Stanhorn's manager is confident, that Alibaba is as cheap as Charlie Munger believes**. Alibaba Group is the second top position of the fund with a weighting of 8.2%, after Samsung Electronics (9.5%), followed by SK Hynix (6.4%) and MediaTek Inc (5.5%). Also our best in class Alkeon is starting to rebuild position into Chinese E-commerce, after cutting positions last years. We feel confident, that the manager of Stanhorn has even better long term relationships in China than Alkeon and other providers.

China

- **The final assertion of the fund manager: Hong Kong's Hang Seng Index now trades at around book value and in 14 years of investing in the region, it has never been lower.**
- For China to meet its long term goals, it needs big tech.
- Underinvestment in hydrocarbons continues with new oil and gas discoveries on track to hit a 75-year low and at some point, we will have to question if the current, almost ideological, approach to sustainability is, in fact, sustainable.
- The fund Stanhorn is invested 1/3 into China, followed by 25% into South Korea and 17.7% in Taiwan. Taiwan export orders have risen for 21 straight months, driven by strong demand for technology products. In addition Taiwan's economy is set to receive a substantial boost this year from Taiwan Semiconductor Manufacturing unprecedented spending spree as the chipmaking giant accelerates plans to build more factories. Taiwan's largest company revealed plans earlier this month to spend between USD 40 billion and USD 44 bn this year on new plants to help ease the shortage of semiconductors. That's equivalent to around 5% of Taiwan's USD 760 bn economy. The 2 Taiwanese technology holdings in the portfolio of the fund are on track to double earnings in 2022. According to the manager, on the war on Taiwan rhetoric, China signals to focus rather on domestic issues in the year ahead, rather than taking dramatic steps.

China

- Also India is an important market for Stanhorn, like our best-in-class fund Aubrey, which is still invested 70% in the Indian market. India had the highest GDP growth rate in the region, largely explained by the rebound from the Covid wave that hit the country hard in 2020.
- Indonesia benefited from the commodity boom, meanwhile Thailand suffered from the continued downturn in tourism. Philippines began opening up from previous lockdown.
- Stonehorn portfolio features a large exposure to big technology companies, while the valuation of big tech in China came down substantially towards the end of 2021 and the optimism in US market and the pessimism with China has led to an exaggerated divergence in valuations.
- **In case of the US, the market appraisal of its earnings potential outpaces its growth in earnings power, but the reverse appears to be true in China.**

UBS acquisition of the US robo-advisor platform Wealthfront

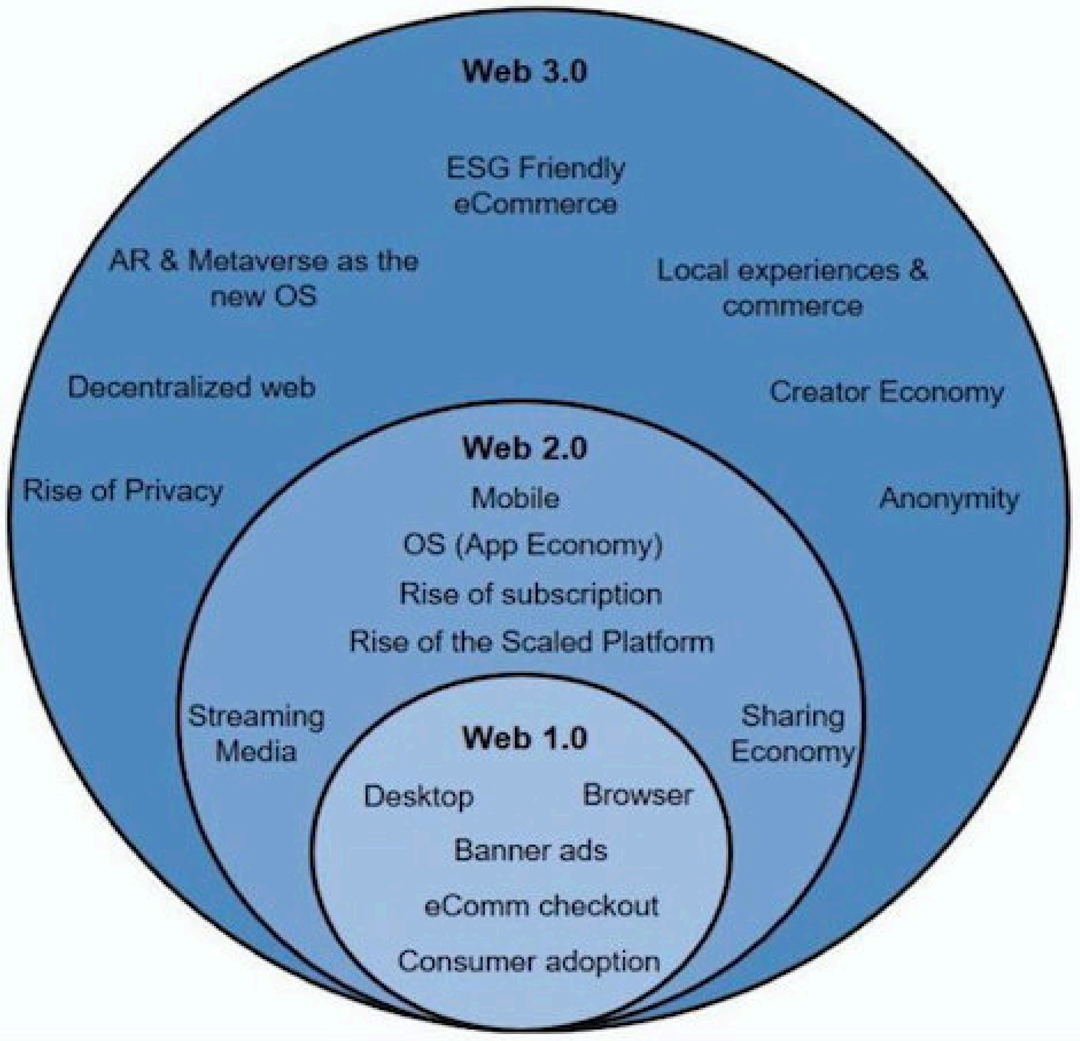
- We are reading, that UBS is acquiring the robo-advisor Wealthfront for USD 1.3 billion. As we have argued in our outlook for the year 2022, we do not see any value added for such service, even if management fees are attractive, because we believe that there are more hidden risks than investment opportunities.
- It is clear to KTS, that UBS aims to fully automatize the portfolio management system in order to further reduce costs. From that perspective, it is strategically a clever move for UBS. In fact, all investment decisions taken by the Bank's investment committee are going to be implemented in all the portfolios fully automated, "cutting out" any human resource from portfolio management to execution traders. About best execution, we advise to read the amazing book **"Flash boys" of Michael Lewis**, because apparently according to our machine learning specialists, which simulated intraday moves and noticed substantial differences between effective execution prices and market prices, in the present state of machine learning and artificial intelligence execution systems, nothing really changed in the execution practice, which would mean that banks are still reaching extra profits in the execution of client' orders or own orders from asset managers. By analyzing the source of profit of the online platform Robinhood, we have the confirmation, that the highest profit is reached, by selling client's data to HFT (high frequency trader) Citadel and others.
- We conclude by asserting that we fully understand the long term strategy of UBS, especially for retail clients, but we think that especially new generations are culturally more interested and educated for investments and therefore there is the need of an open discussion between the manager and the client. For this reason KTS still believes in the personal contact with clients. KTS invested substantial capital in order to improve efficiency into the investment process and implementation and believes to have the optimal structure to contain costs but still have a personal relationship with his clients and families.

General news on cryptos

- The crypto exchange Bitmex is acquiring the German bank Bankhaus von der Heydt in Munich in order to create a regulated crypto powerhouse. Of course the deal is subject to the approval by the BaFin, but if we analyze the Swiss crypto bank SEBA, Zug, which was the first crypto platform with the approval of FINMA, German authorities most probably are going to approve the transaction, because it is in the interest of everyone, to increase the regulatory standard also in the crypto space.

Web 3.0

- On the right hand side we can analyze, how the new internet business will look like.
- We were also reading an interesting article in the magazine The economist, where the journalist asserts, alongside cryptocurrencies such as bitcoin, NFTs are the most visible instantiation of “web3”. VC structures are heavily investing into blockchain in order to build up a better and more decentralised version of the internet. The magazine continues explaining that VC deals in the crypto-sphere reached USD 25 billion during 2021, up from less than USD 5 bn in 2020. The most illustrious VC firm in Silicon Valley, Andreessen Horowitz, was raising a USD 4.5 bn web3-related fund, to add to three existing ones worth a total of USD 3 bn. The conclusion of the article is, web3 is unlikely to displace web2 altogether and the future is going to be a mix of both world.
- KTS feels comfortable with the small VC exposure into the Swisscom VC II and Fasanara.



Source: Company data, Data compiled by Goldman Sachs Global Investment Research

Source: Goldman Sachs via Bank Syz

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