KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 7

The 18th of February 2022

FED funds future price cuts in 2024

- Mr. Alfonso Peccatiello is showing a very interesting chart, from which we can observe that the market is expecting the FED to cut interest rates already in 2024, based on the fact that the US economy is more and more in debt and demographics are worsening over time.
- The right hand chart is showing the difference between the market implied FED funds in Feb-25 against Feb-24, which is now negative, meaning throughout 2024 the FED is priced to cut rates.
- Basically, the bond market is asserting that the FED is increasing interest rates aggressively in the short term to **1.75% / 2%, but this is the maximum market participants are expecting, which honestly was the pre-pandemic level.**
- Market participants are also arguing again that we have an inverse yield curve and, therefore, we should expect a recession. Again, based on our recent analysis and outlook, we are more optimistic and we are not expecting a recession any time soon.

Source: Alfonso Peccatiello / themacrocompass.substack.com

Global inflation rates are very different

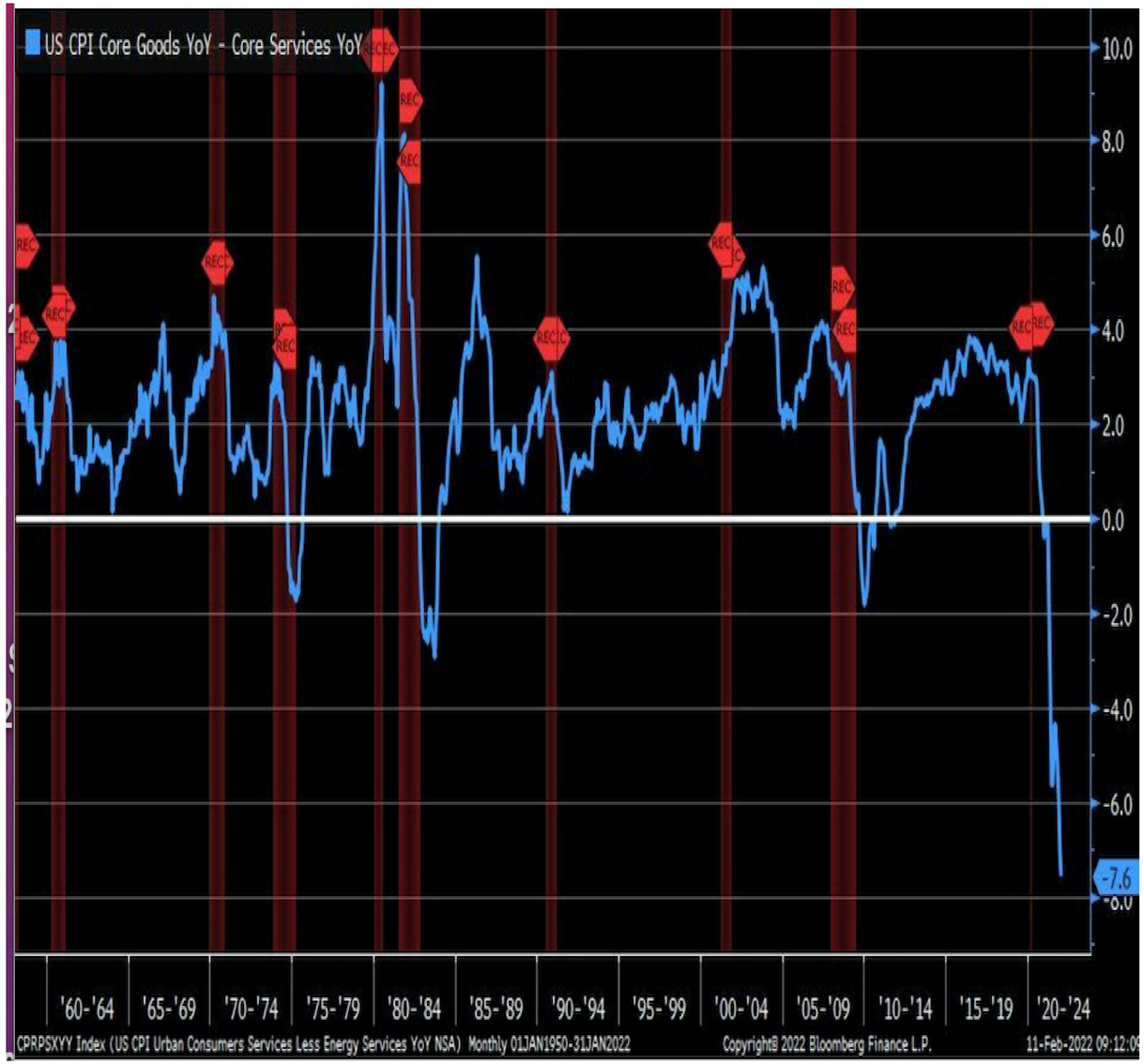
- Market participants are focussing on US inflation and FED's strategy, but inflation rates are very different worldwide and in many countries not at alarming levels, with exceptions in Venezuela, Argentina and Turkey, as we have known for a while now. What is causing such a difference?
- In the US, we noticed how used cars had a tremendous price spike of 40% and we believe that this phenomenon is going to soon be reversed. Also rental cars had a 30% increase.
- In the US, rents have increased 18% and home prices are up 19%.
- In addition, hotel prices increased as much as 37%. Hotel, gastronomy, entertainment experienced very difficult years during the pandemic, it is clear that they need to increase prices in order to cover past losses.
- As we know, for Europe and also the US, natural gas prices increased over 80% and the oil price 66%. Agricultural commodities 25% and Lumber 21%

Country	CPI Inflation (YoY %)
JAPAN	0.8%
SAUDI ARABIA	1.2%
SWITZERLAND	1.5%
CHINA	1.5%
INDONESIA	2.2%
HONG KONG	2.4%
TAIWAN	2.6%
FRANCE	2.9%
PHILIPPINES	3.0%
THAILAND	3.2%
PORTUGAL	3.3%
AUSTRALIA	3.5%
FINLAND	3.5%
SOUTH KOREA	3.6%
SWEDEN	3.9%
SINGAPORE	4.0%
ITALY	4.8%
CANADA	4.8%
GERMANY	4.9%
UK	5.4%
IRELAND	5.5%
INDIA	5.6%
NEW ZEALAND	5.9%
SOUTH AFRICA	5.9%
SPAIN	6.0%
MEXICO	7.1%
US	7.5%
POLAND	8.6%
RUSSIA	8.7%
BRAZIL	10.4%
TURKEY	48.7%
ARGENTINA	50.9%
VENEZUELA	472%

Source: Bank Syz / Charliebilello

Global inflation rates are very different

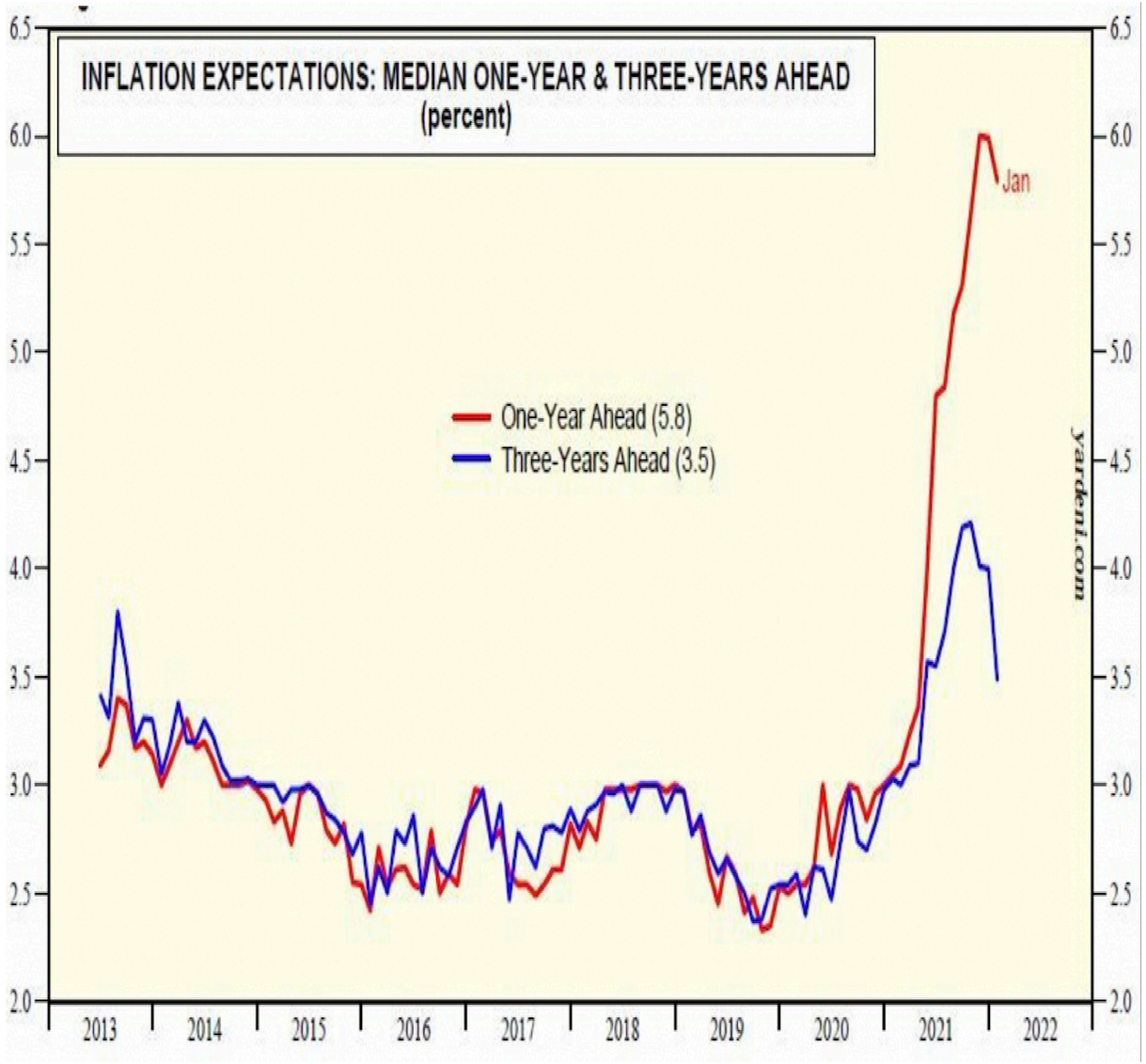
- The major alarming inflationary effect is the constant increase of labour costs, a fact already mentioned by the Classic Global manager and Mr. Yardeni. Recent news, whereby **Amazon had to double the base salary cap to USD 350k from USD 160k** is in one way alarming for shareholders but, of course, good news for consumption, which is 2/3 of US GDP and is going to be translated into higher economic growth. This in addition to the fact that having people feeling comfortable with the job market, is going to be translated in even higher consumption. We have to admit, such salaries are only for qualify workforce.
- **The real dilemma at the moment is energy costs,** which are not coming down due to all the geopolitical tensions. We will talk more about this later.
- The right-hand chart is also interesting, showing that **inflation is mainly coming from services rather than goods**, which would be actually good news.



Inflation rates

Global inflation rates are very different

- Mr Yardeni is worrying about FED moves, inflation and increasing labour costs in the short term. But, he also argues that over the longer-term inflation expectations for the next 12 months are edging down to 5.8%. His biggest dilemma in the short term is guessing the oil price due to political tensions.
- We would also agree with the general consensus that the FED can not undertake dramatic change before the US elections.
- Meanwhile, we have read academic research on demand and supply, arguing that even the FED cuts rate of 175 bps, 30% increase of debt-to-GDP ratio, massive stimulus package as monetary policy, the net GDP increase from pandemic effect, rose from USD 19.2 trn to USD 19.8 trn, therefore only 1.4%. For this reason, market participants do not see further "fire power" from the FED and see a imminent recession. We think it is too early to make such conclusions. We are still in a full normalization process and the world is still in a kind of lockdown "mood", therefore many of such stimulus packages are still not translated into real economy, are still a plan on paper.



Source: Yardeni

Global inflation rates are very different

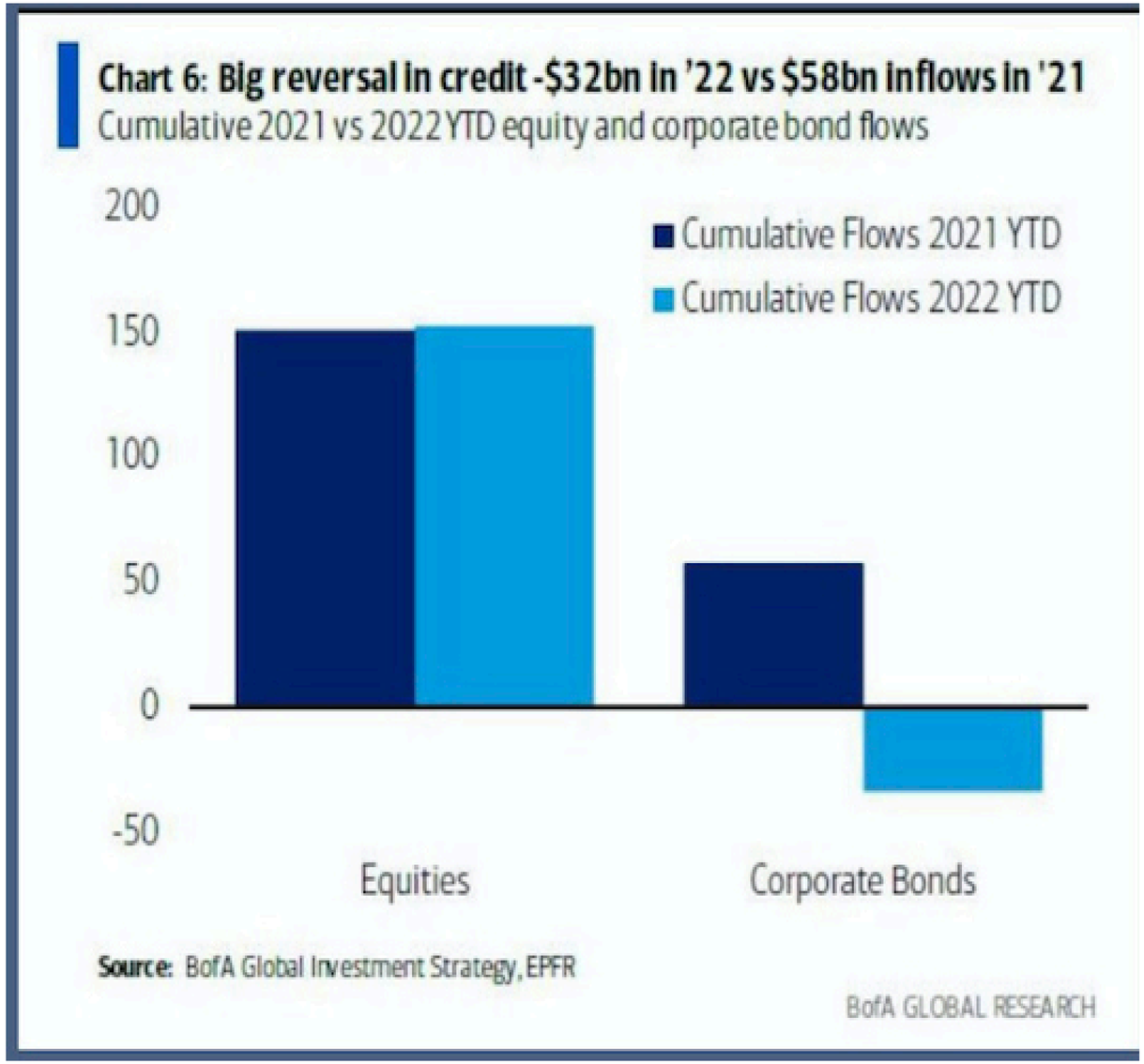
- We do not want to be too exhaustive on inflation numbers, but we want to show how KTS tries to persuade itself that the process of economic growth in the coming years translates into increasing EPS for companies. This can compensate in good “harmony” for increasing inflation numbers and labour costs which, in a strong economic growth environment, can be translated into higher goods’ prices.
- The right-hand statistical table, courtesy of Ms Ludovica Gobbi, shows the S&P’500 Index’s performance in years with high inflation.
- Central banks will have the delicate job of slowly cooling down inflation numbers, without harming economic growth.
- We are confident that central banks are not taking dramatic steps, which could derail the global economic growth. Also, the various geopolitical disputes can not end in wars, which would hurt already depressed Covid19 sentiment of the population and, therefore, harm the approval for policymakers, which is already low due to the pandemic.

Inflation	S&P 500	Year
14.4%	5.2%	1947
13.6%	31.7%	1980
11.3%	18.5%	1979
11.1%	-25.9%	1974
10.9%	19.2%	1942
10.3%	-4.7%	1981
9.1%	37.0%	1975
8.5%	-8.4%	1946
7.9%	23.7%	1951
7.7%	5.7%	1948
7.6%	6.5%	1978
6.5%	-7.0%	1977
6.2%	-14.3%	1973
6.1%	20.4%	1982
6.0%	25.1%	1943
5.8%	3.6%	1970
5.7%	23.8%	1976

Inflation table

Equity inflow YTD

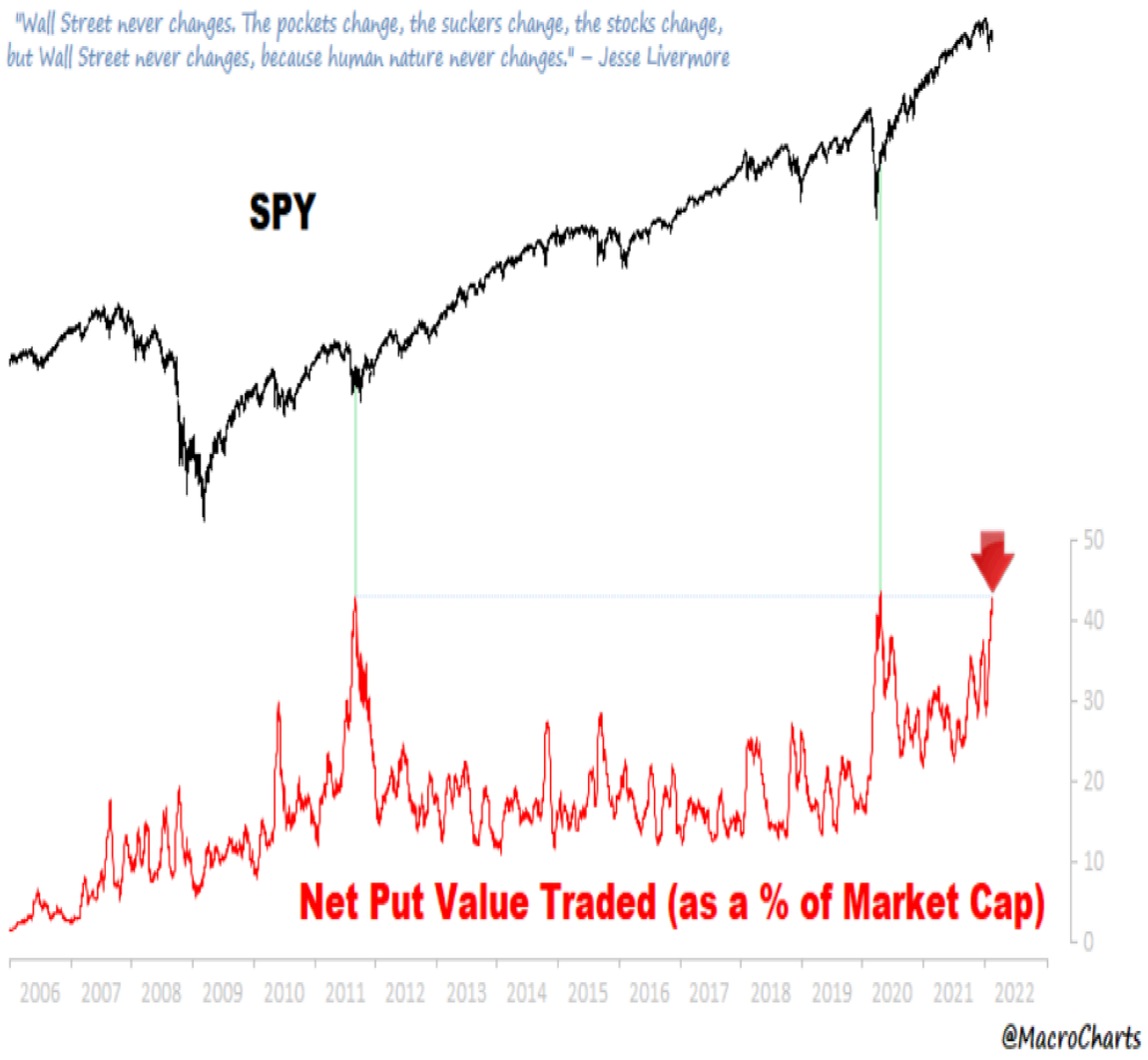
- Strangely enough, experiencing a negative equity YTD performance, the **cumulative equity inflows YTD is USD 153 billion and exceeds the record pace of early-2021 (USD 151 bn)**.
- But, the inflow into bond is negative with USD -32 bn vs USD +58 bn in 2021.
- More interesting is the fact that retail clients invested more in equity than in the year 2021, along with institutional investors. Corporates were adding more purchases than 2021 via higher shares buyback programs.
- Such strong inflows happened even in an environment of very depressed sentiment. The CNN Fear & Greed Index is at fear, though not at extreme fear.
- One possible explanation is the **new volume highs, even higher than 21st January, in the short ETFs with leverage** on the S&P 500 Index. From the beginning of the year 2022, cumulated volumes into such short ETFs are massive.



Source: Bank Syz / BofA

High volume in put options

- The market is starting to discount more and more geopolitical risks.
- Not only is the sentiment very depressed, but the **positioning in PUT options as hedging is at its highest ever, higher than in 2011 and March 2020.** Analyzing the right-hand chart we can notice that normally at such high put volumes, the market bottoms out.
- Market participants are also arguing that in analyzing the performance of the Russian market much is also discounted, **The Russian Index has fallen, even while the oil price is increasing and the gap between the S&P 500 Index and the Russian Index is getting wider and wider.**
- In addition, according to BofA's survey, the **average cash balance amongst investors is again over 5%, which historically is the bottom of the market from which equity markets normally rebound.**
- **According to BofA' statistics, the tech sector has gone from overweight to underweight. The last time was in 2008!**



Total open interest put volume

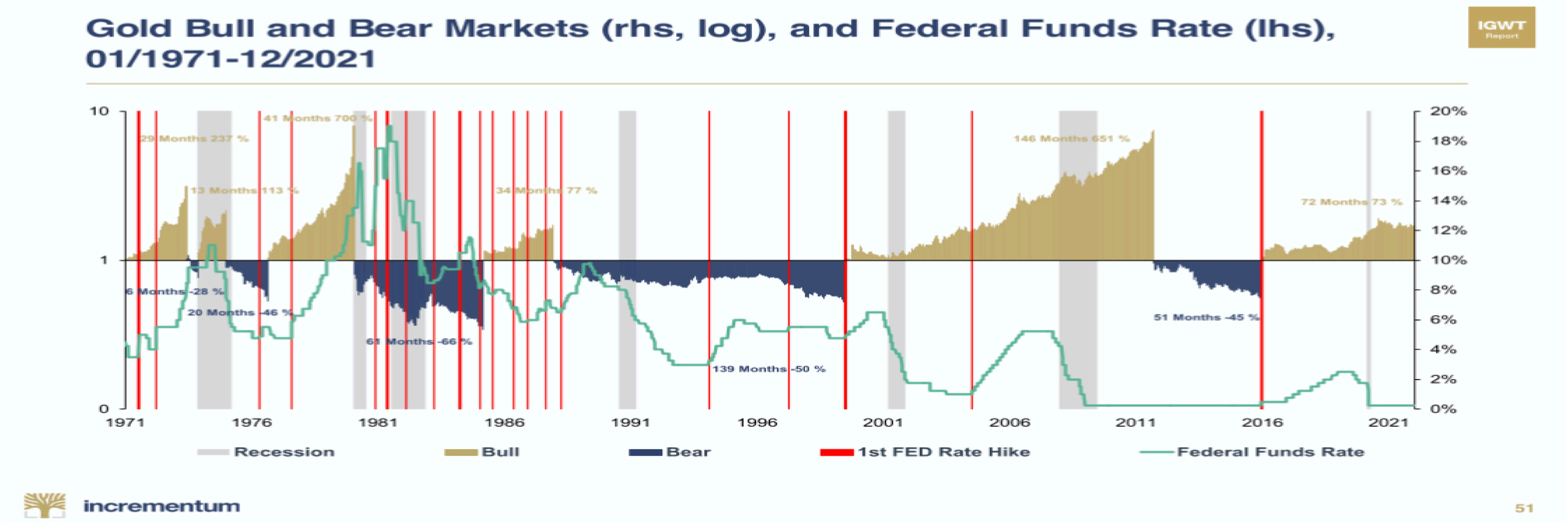
Gold possible breakout

- Due to geopolitical tensions, gold had its **first attempt to break above the resistance at 1’878 USD, reaching 1’900 USD.**
- The possibility of momentum strategies “jumping in” the possible strong breakout could cause a spike in the price of gold and we could see new historical highs. We are riding the wave, as a cost attractive hedge against any geopolitical events, with our gold basket, where, at the beginning of the year, we switched a part of our gold position into more gold miners via the AMG fund.

First resistance 1’878 USD. Gold attempting to break out from the triangle consolidation

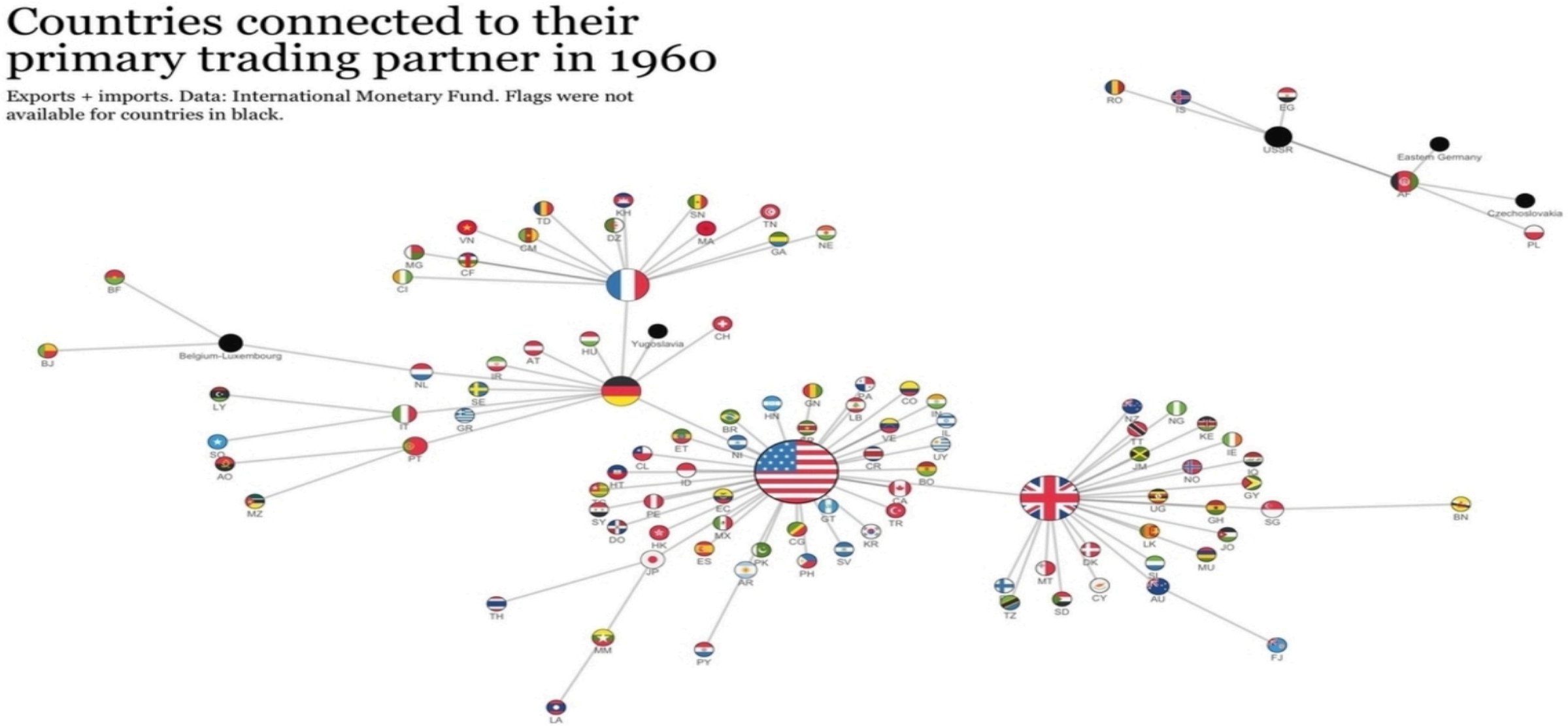
Gold can rally even with the FED rate hikes

- The below chart, courtesy Incrementum, shows historical statistics attesting, that the gold price can also rally during FED rate hikes.



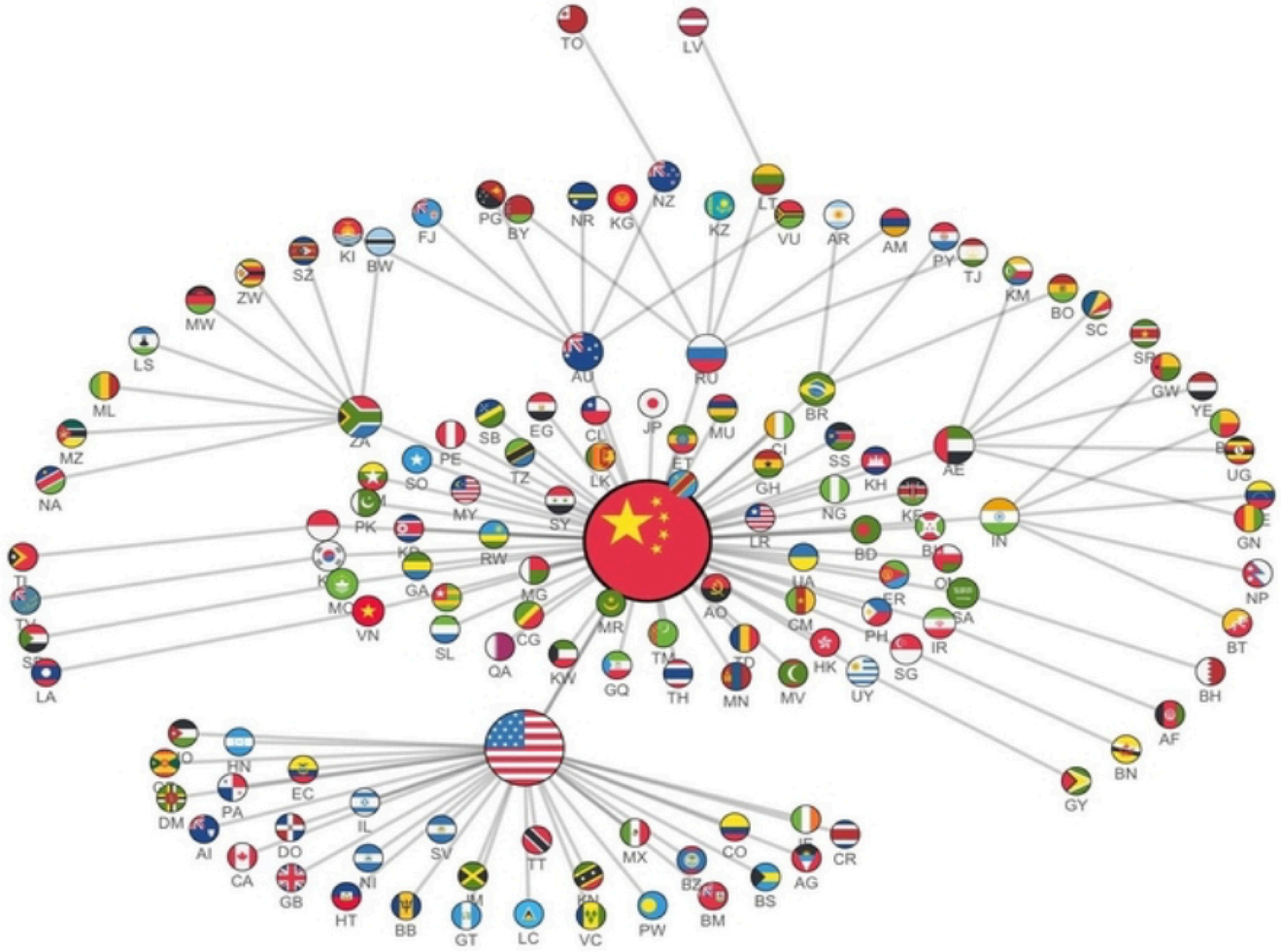
Source Incrementum

Countries largest trading partner (1960-2020)



Back in the 60' US, UK, Germany and France were the most important trading partner worldwide

Countries largest trading partner (1960-2020)



A picture is worth a thousand words! Slowly but surely US sanctions can be really indifferent to China, on the contrary, on the longer run, will hurt the US!

Ukraine

- We do not want to get “lost” in a political discussion, but we would like to list some additional interesting facts:
  - We are reading that the US closed down their embassy in Kiev because they were expecting an immediate Russian attack on the 16th of February (should an attack not be a surprise?!). The Ukrainian President, Mr Zelenskyy, said he was ready to drop any ambition to join NATO, but dismissed it a day later. We liked the “way to say” cited by some market participants: the Americans are crying wolf daily with Russia about to invade Ukraine, to a point where people will be surprised if it does not happen.
  - But, after the meeting of Mr Putin with the German Chancellor, Mr Olaf Scholz, the Russian President announced that Russia had started to pull back troops and that talks with Mr Scholz were businesslike and that US and NATO offer on limits to missile deployments and confidence-building measures could be the basis for further discussions.
  - We believe, that **the impressive Russian maneuvers at the border are allowing Mr Putin to reach his goal, mainly to get the highest attention on the dilemma on an international base**, without needing a war. Mr Putin also knows that the cost of a military attack would be very high with Ukraine having support from the US, Turkey, UK and the Baltics. But the resulting psychological stress and pressure is working in favor of Mr. Putin.
  - Of course, on the other side, as we have seen on slide nr. 12, the major trading partner for Russia is China and the most important export source for Russia is commodities, which are sold entirely, except the gas to Europe, to China, not the US. Therefore, any US/Europe sanctions would have most probably less effect on Russia than the magnitude US and Europe would hope to reach. This is, in our eyes, the most underestimated part of the equation from the Western side and does not allow KTS to have a final opinion, on what is finally going to happen.

Ukraine

- In addition, we had an interesting conversation with our Russian clients, who assert that Russia after past US sanctions closed itself up even more than before and the economy is based largely on local consumption. Russian citizens prefer to have a holiday in Sochi, rather than fly to Europe or other tourist destinations. The European and Swiss real estate markets are also feeling the absence of Russian citizens and prices are falling in specific regions beloved by Russian in the past.
- For Russian companies, in order to gain business in Russia, to build infrastructure for example, they have to re-invest capitals into the Russian economy. This is the reason why Russia could "survive" and then rebound from US sanctions and this shift is not going to change any time soon. A good portion of patriotism is also helping and there is even support for Mr Putin not to reduce his diplomatic expectations.
- We would finally assert, that **the biggest "loser"** of a war in Ukraine is most probably not Russia, as most of the market participants would expect, but **rather Europe**, still having a 40% dependency on Russian energy. It is not a coincidence that the German Chancellor, Mr Scholz, has all the interests to find a diplomatic solution. Even more so, as Germany is in "full green transition mode" and closing all the nuclear power plants, which is not the case of France for example. For the German economy a dramatic increase in energy prices, would be literally a disaster. **Therefore, Europe really needs to find diplomatic independence from the US,** who of course at the end of the day has always everything to gain, if Germany would depend on **US LNG gas, but which honestly cannot deliver!** Or not in the quantity needed in the short term.
- The magazine The Economist also wrote an interesting article on the possibility to have a **neutral Ukraine neutral similar to Finland**, which might be the best way to have a "comfortable bridge" from Western to Eastern. A possibility which really makes sense.

Ukraine

- An interesting article in the Italian newspaper sole24ore of Enrico Verga is arguing, that the real war is in Washington since more than a year, mainly a financial one from Ukrainian lobbies, which of course do not like the **new Nord Stream 2 gas pipeline** from Russia to Germany "cutting off" Ukraine. The article makes sense and the coincidence of such turmoil exactly on the finalization of the Nord Stream 2 gas pipeline is also a confirmation that it could be true. Once again, Germany is the country which has all the interest to solve the dilemma in a diplomatic way.
- Last but not least, our Ukrainian clients explained to us that **Ukrainian citizens believe that the inclusion into Nato would increase the probability of the inclusion into the EU**, in order to benefit from the free movement of workers and the rights of movement and residence for workers. We agree that the EU, especially Italy, Spain, Greece, Portugal and also France, already have enough issues with lower class of workforce and are not in the position to have additional 50 Mio low wage citizens freely moving around Europe. Therefore, an inclusion into the EU, at least short term, is going to be most probably an illusion.
- **We would finally mention some statistics on the ICE Brent COT managed money net long contracts, which are as low as the levels in 2020 and, therefore, the oil price's rally is not supported by investor' inflows into commodity ETFs. In addition, the net positions in oil futures contracts also show a reading of 31% below the level of June 2021 and well below the peak of early 2018. This suggests investors have favored reducing overall positions to protect portfolios as they attribute the current rise to "transitory" supply shocks and geopolitical tensions. This again should favor our base scenario, that inflation numbers are going to fall sooner rather than later and should help equity markets.** The oil price is more supported by the fact, that capex in the sector is depressed and is going to stay depressed, mainly because of the higher ESG standards and therefore the supply is not increasing.

General news

- Meanwhile in Canada, **the Ambassador Bridge could be reopened**, after a blockade of almost a week by truckers protesting Covid vaccine mandates. This is a very good news, as the traffic on the Ambassador Bridge is responsible for over 18% of all US-Canada trade. In addition, the Canadian government invoked emergency powers for the first time in 50 years and the government promised to soon announce financial help for businesses affected by more than 2 weeks of demonstrations.
- An additional, positive news is **China's surprise decision to clear Pfizer coronavirus pill for use**, which should be the final sign that China wants to exit the Covid zero tolerance policy. As the general consensus was arguing before the Olympic games, following the event, China will be forced to open up and start the process of normalization, which has already started quite firmly in the West.
- In addition to the BofA' statistics, the technology sector is for the first time since 2008 fully underweighted by investors. We have the confirmation from the **monthly trend-momentum of the Nasdaq 100 Index, which has turned negative for the first time since early in the pandemic, or about 2 years ago.** Market participants are expecting more volatility ahead, but taking into account that the sentiment is already very depressed, investors are even shorting the market, but earnings are still increasing and a company like **Facebook is trading at 16x P/E, but the growth is still over 30%,** we would not be surprised, that the market is going to move north instead of further south. In addition ,we remind that FAANGS have plenty of cash for share buyback programs but most especially for M&A. The proof is the recent takeover offer of **Cisco for the cloud company Splunk, SPLK US, with no premium! Major technological companies have the money to go around "shopping" at very attractive levels** and with no need to pay a premium, but synergies and monopoly are going to create the value added, which investors cannot or do not want to see.

General news

- We sense that people are not really caring anymore about covid19 and are more relaxed and looking forward to further normalization. Meanwhile, we are reading statistics whereby the **number of new cases in the US (10d moving average in thousands) is strongly falling from a peak of 750k to 145k, the lowest level since just before Thanksgiving of last year.** This should also finally help to ease supply-chain disruptions and therefore again, ease inflation. With more people entering the labor market, it should also easy the upward pressure on wages, which is also going to be translated in lower inflation and lower cost pressure for companies' margin.

Investigation into major banks at Wall Street

- **We are reading that regulators are investigating block trading of major banks on Wall Street. According to the report, investment banks might have tipped off firms ahead of planned sales, mainly hedge-fund clients in advance of large share sales.**
- This definitely does not surprise KTS, on the contrary, back in February last year, with the “meme” stock short squeezes, but especially with the scandal of the HF Archegos, where basically Goldman Sachs with the smallest exposure to Archegos amongst all other investment banks, started the “bloodbath”; with our long term experience as traders, it was absolutely clear for KTS, that the “game” behind the scenes was much bigger with more parties “profiting big” from it. For KTS it was clear, such a move with such magnitude, was definitely not the result of the “fire power” of a few reddit day trader amateurs . As you can remember in our KTS weekly report nr 11 of 2nd April 2021, we argued, that in the past, when media did not have to publish the source of information, such squeezes were structured with first spreading rumors in newspapers and after insiders buying. We argued back in time, the Reddit platform was just the new way to structure insider trading. We let us surprise by the result of the investigation. Such an event is again the proof of greed on Wall Street and investment bankers are always using new ways to enrich themselves in unconventional manners.
- We would like to cite a good paragraph of the book “The ascent of money” by Niall Ferguson, where the writer explains how the CEO’s of the major US banks back in 2007 justified the insane bonus payments to themselves claiming that “the lavish compensation paid to financiers was justified by their exceptional skills, particularly in the realm of risk management”. We all know exactly what happened one year later! And governments had to safe all banks. The writer goes even a step further by explaining that bankers are the cause of poverty rather than prosperity, volatility rather than stability and even stronger assertions.

Green transition

- Good news for nuclear fusion, which could offer a limitless source of clean energy.
- On the 9th of February the Culham's Joint European Torus (JET) facility announced that they had released 59 megajoules of energy, enough to run a 60-watt light bulb for 11 days.
- The technology, based as hydrogen atoms fused together to form helium, which is converted into energy, had the historical dilemma that the process was costing more than the generated energy. Those new successes are giving hopes that the nuclear fusion could be able to change our future, though the path is still long.

General news on cryptos

- According to Glassnode, via Bank Syz, the **Bitcoin hash-rate surged to a new all-time high**. Basically, it means that there is more traffic in the network, which is translated into higher use of power for generating such transactions and, therefore, higher costs supposedly to support a higher price of the bitcoin.
- Market participants are also arguing that it is a good sign, having had the crypto mining suffering the banning in China and the need to transfer mining somewhere else. As we know, the biggest profiteers of the Chinese ban was North America, followed by Kazakstan. Nowadays, the crypto network is supposed to have a higher security and is more resilient to hacker attacks, because they would need to gain over 51% of the network in order to launch an ill-fated attack.

Reflection on the pandemic

- We cannot change the course of the pandemic and we can only hope that governments are going to execute a deep analysis on what went wrong during the pandemic, a fact that we honestly do not think is going to happen, because as we all know, policy makers hate to “lose their face”.
- On the contrary, the discussion on vaccination for children and possible constant vaccinations going forward even at shorter rollover than 1 year time, is worrying us. We sense that, at the end of the day, we are still ignoring the facts and the current solutions are still based on wrong scientific fundamentals, even if after 2 years we have enough data to come to clear and scientific proven conclusions.
- Therefore, we believe that, in order to at least personally develop for future events, we have to try to understand the basis of what really happened during the pandemic. For personal scientific reflections, we believe the following video can help to at least understand facts. Of all the videos or research we were watching or reading, we believe the following presentation is showing in a very easy and structured way all the scientific facts of the Covid19 virus.
- Links:

https://www.youtube.com/watch?v=t6kmm70ji5c

Hillsdale College campus in Washington D.C. , Academy for science and freedom at Hillsdale College, Dr. Jay Bhattacharya of Stanford university, Dr. Martin Kulldorff, Harvard Medical School and the speaker Dr. Scott Atlas of Standford University.

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