KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 8

The 25th of February 2022

Geopolitical tensions

- KTS could follow the logic of Mr. Putin on the move to recognize Donbass regions' autonomy (Donetsk and Lugansk) and sending the troops to "guarantee peace" and "protect" the regions from a "genocide". Up to Wednesday, the 23th February 2022, the conclusion of our analysis was that such geopolitical tensions at the border would have being enough, to stop for the time being any inclusion of Ukraine into the NATO or EU and both sides would be temporary "happy". After the 24th February, everything has gotten much more complicated even "ugly" and now it is for KTS too difficult to take clear investment decisions on the short term.
- Before we start to go into a detailed analysis, we would like to attach the follow links, which gives a good summary, of what possibly is going on in the "head" of Mr. Putin:
- **https://youtube.com/watch?v=LJNtfyq3TDE&feature=share**
- Summarizing the video, apparently Mr. **Putin really believes, Ukraine and Russia belong to each other** and therefore we could partially explain the Russian invasion aiming to change the actual Ukrainian government into a more pro-Russia one.
- In the next slides, we would like to list facts, which are of essential importance to us in order to execute a details investment analysis and take at least some longer term decisions.
- We do not want to get into politics and we would like to underline, that we are not for or against any sides of the story. We are trying to take decisions on a most possible neutral way. It is for us of vital importance to keep a strong discipline in such short term events and we have to keep also the focus on the longer term vision. As you know, **discipline leads to habits, habits lead to consistency and finally consistency leads to growth**! We are honest with you, we will also await the monthly investment webinar of our best-in-class fund Flossbach, which in all these years, has been our best source to step aside from short term emotions and focus on the longer vision. First commentaries from Flossbach's manager are on the same line like KTS.

Geopolitical tensions: short term repercussions

- We are currently in Moscow and we had an intensive conversation with our expert for Russia, Mr. Vincenzo Trani, who could highlight many aspects from the Russian side, which are not really explained in the press. As always, there are two sides of a medal and it is of vital importance to understand both sides, in order to have a clearer idea, though not the magic formula, because at the end of the day, we can make assumptions, but we are honestly in the hands of the common sense of policymakers.
- As mentioned recently, the whole world was "crying wolf" for so long, that **investors were preparing themselves for a war.** Therefore, as we have recently analyzed, investors started to short the equity market, accumulate cash and inflows in bonds are again very high, even if 2 weeks ago bond markets were worrying about the FED increasing interest rates too fast.
- Other investors were buying expensive put options as protection and finally, the market sentiment is basically more depressed than at the Covid19 pandemic. **According to prime brokerage reports, market sentiment has rarely been worse!**
- Initially the equity market's reaction on the February 22nd showed that market participants were mostly prepared for such smaller scale events and apart from the Russian equity and bond markets, which strongly corrected, the rest of the world had an acceptable negative reaction. But after the attack on the 24th February the whole world has to hope that common sense prevails over insanity.
- **The intraday equity market reaction on 24.2.2022 shows (Nasdaq Index closing at +3.34%, meanwhile the DAX index was at -5% during the day), that apparently the investor community still believes, common sense will prevail.** We are trying to illustrate in the next slides, that both sides have too much to lose and after the first "arm wrestling", the world need a serious diplomatic conversation. Before the attack, all leaders announced to be willing to keep diplomatic discussions. Thereafter everyone is at the moment focused on sanctions, but hopefully soon the focus is back to diplomacy.

Geopolitical tensions: short term repercussions

- Initially, we were actually convinced that the new instability in the region caused by Mr. Putin was enough to stop the process of Ukraine's inclusion into NATO, at least on the short and medium term. Such feeling was also confirmed from the Ukrainian President, Mr. Zelensky, who begun to emphasize that joining the NATO was a "dream" rather than a near-term prospect and the German's new Chancellor, Mr. Olaf Scholz was also confirming such statement. Finally, we would argue, the first round of imposed sanctions were not really breakthrough.
- In addition, such instability also caused the evacuation of foreign companies and capitals/investments, leaving Ukraine begging business leaders to return. Actually we have to admit, the western encourage Ukraine to "stand up" against Russia and the country should follow the path of independence, but as soon Ukraine needs help, the western basically left. Such military invasion crippled Ukraine economically and now the country can find financial accommodation only in Moscow. We were also reading, that apparently many Ukrainian member of parliament left the country before the attack and Mr. President Zelensky is calling them back!
- Up to the 22nd of February, most of market participants were comparing the actual situation, namely the recognition of Donbass regions' autonomy, with **Georgia on the 8.8.2008**, where Russia recognized the independence of Abkhazia and South Ossetia from Georgia and launched an invasion of Georgia calling it "peace enforcement" operation. Also on the **3.8.2014 we had Russian troops invading Ukraine** to support pro-Russia separatists annexing Crimea.
- In addition, several charts on **Vietnam, Gulf, Afghanistan, Iraq war show**, that after such event, equity markets rebounded and therefore it would have been a buying opportunity, because markets corrected before the event and rebounded according to the motto "sell the rumors and buy on the fact".

Geopolitical tensions: short term repercussions

- BUT at this point of time if policymakers and Mr. Putin are not starting to dialogue with the common sense and let the situation escalate, it is too difficult to predict the damage to global economic growth and therefore further correction to equity markets. In fact, new sanctions are going to hurt Russia, but probably not as strong as the western believes and with higher commodity prices, especially for oil and gas, Putin is profiting even more of the situation. **The massive attack of Mr. Putin can resist according to military experts only 3-4 days** and the target was to abate the key Ukrainian military forces. In the next 3-4 days, Mr. Putin must force Europe to look for a diplomatic dialogue. Apparently if sanctions are only on the 2 main State Russian Banks, namely Sberbank and VTB, but obviously not on the energy sector, of which Europe is strongly depending; Russia is not really suffering.
- In fact, the **most important trading partner for Russia is China**, which is not going to sanction Russia and both countries have alternatives to the SWIFT payment system, also because sanctions are already existing since 2014. On the other hand, as we are going to notice in the next slides, the future higher inflation going to damage the western more, than the investment community is expecting. Therefore again, our conclusion is, a diplomatic solution is the only option for both sides!
- **Diplomatic solutions are actually realistic** and in our humble opinion, also in discussion with experts and by reading media, we would argue, that **Ukraine should declare themselves neutral,** as Finland, to find the compromise with NATO, which of course can not sign, to stop expanding further. And **Germany must sign a long term contract for the Nord stream 2 pipeline** in order to stabilize the gas' supply and the interest of Ukraine with Russia, to have stable gas prices and reduce the seasonal volatility because of the warm weather. Analyzing the real start of the "saga", we have to admit, that Russia was not happy with the change of European counterparts, to sign short term gas contracts in order to reduce the price. Finally the Donbass regions are the "industrial heart" (see slides 15 and 16) of Russia and if independence is recognized, Mr. Putin should be "happy".

Geopolitical tensions: short term repercussions

- But unfortunately are only KTS suppositions and diplomacy takes time. Therefore, we have to go through again all our positions in the next couple of days and decided, if there are risks we prefer to reduce on the short term, having anyway in our portfolio some market neutral investments with a tremendous upside potential.
- We would like to mention again, that we own in our portfolios some unicorns like Scalapay, Grover and Twig, which are valued 3 to 5 times higher than the cost price we still have in the portfolio, therefore we have some “hidden” performance reserves. The same is for our private equity investment Rimac automobili.
- We would like to analyze deeper several short term factors, whereby it is in the interest of both sides, to still find a diplomatic solution as soon as possible:
  - on one side, **Biden approval rating fell from 56% in January 2021 to 42%** now and US mid election are in November. Market participants are attributing such fall to the high inflation rate and therefore, it is of trivial importance, that the oil price is going to fall in the next months, having the **FED “tied hands”**. Of course US is trying to reach an agreement with Iran, but we have noticed on the day 24.2.2022, the oil price spike during such geopolitical tensions.
  - Meanwhile **Germany suspended the Nord stream 2 gas pipeline, but as we have mentioned last week, they are not in the position to do so,** because energy experts are arguing, **US in not going to be able to deliver the needed LNG gas quantity** in such a short term, in addition to the fact, that apparently Europe does not have enough LNG terminals (Italy owns only one!) to absorb such quantity. Therefore even if Katar would help, Europe just does not have the infrastructure to distribute such quantity of LNG gas. Analyzing the Russian gas transit through Ukraine, the quantity even jumped, that means, Russia is not shutting down gas delivery to Europe, even more, there is an increase. Most probably Russia want to profit from the higher price.

Geopolitical tensions: short term repercussions

- Ms. Ursula von der Leyen, President of the European Commission, is arguing in her latest announcement, that EU is planning to diversify suppliers and sources to make the EU more energy independent. Ms. Von der Leyen is probably right on the longer term, but we doubt the plan can work on the short term. The natural gas prices was surprisingly stable in Europe, most probably due to the warmer winter, but on the 24th of February the price spiked +40% and now Europe is again in a huge dilemma, but most especially under time pressure. **For Germany natural gas is the only realistic short term "green" alternative** to nuclear power. We would like to remind that Germany is shutting down all nuclear power plans (2 done so far over a total of 4), contrarily to France, US, China and many others, which are actually increasing production. With a strong "green" party in Germany, reopening nuclear power plans is out of discussion.
- Now we would like to analyze the possible short term positive "triggers" for equity markets:
- We would expect **central banks to change the tone to "dovish" again,** because geopolitical tensions are already making investors, consumers and companies nervous enough, but most especially, **increasing interest rates is not going to help to make the oil price falling!** If we **analyze FED rate's increase expectations for March, apparently market participant' forecasts are only for a move of 25 bpi. 2 weeks ago, it was still 50 bpi.**
- The **Russian equity market is trading at 4 P/E !** After the attack, some banks reduced Russian bond' collateral value to 0% and triggered margin call forced sales! **If we were the Russian National Bank, we would actually buy the equity market at such valuations** and especially having the strongest forex reserves in the Russian history, because of higher profits due to higher energy prices, the Russian National Bank could afford to do so. Again, this is most probably an additional reason, Mr. Putin feel so strong and who knows, part of the plan?

Geopolitical tensions: short term repercussions

- With **AAII bull minus bear index scoring below -20 suggests**, there are far too many bears relative to bulls. But the ARMS Index is still not at extreme levels, as also the VIX, to call the final bottom. As we have seeing, the intraday reversal of the 24.2.2022 could be a sign of market's strength, but also an attempt to hold the lows of the 24.1.2022 "capitulation day" , therefore the technical structure of the market is still not strong enough, to assume, we are in a clear rebound and we have bottomed.
- What is the conclusion of KTS on the short term:
  - We see the possibility of **positive triggers** from the political side and any announcement of a diplomatic dialogue in such a depressed market sentiment and heavily shorted market, can caused at least a short term rebound. In such rebound, we are going to analyze, if we have positions to sell, especially the good purchases back on the 24th of January.
  - We are not going to trade gold, we are **staying long gold,** even of course, positive news are going to have a negative effect on the gold price. We really like the breakout of the resistance of USD 1'919 and as we always argued, gold miners a trading at very attractive valuations. In addition, analyzing recent results, gold miners are massively increasing earnings and started to increase dividend and share buyback programs. For us the gold exposure is the cheapest hedge in the portfolio.
  - In fact, put options are just too expensive and at the moment, we are not shorting futures. The main idea would be to keep our long side of the portfolio and hedge a portion by shorting Futures on equity index in a possible market rebound.
- **Our beta**, especially in our flagship balanced investment vehicle, is around **0.6x** but we are invested in different best-in-class funds, which also have a dynamic asset allocation approach and therefore we can also rely on the professionalism of such managers for an optimized asset allocation timing and the selection of stocks, which are less affected by such events.

Geopolitical tensions: short term repercussions

- Our long term argument has always been that it is very difficult to time the market and according to several research on the longer term, timing “costs” only performance. For this reason, KTS invested substantial capital and knowledge in order to find asset managers, which implement strategy’ hedges aiming at limiting the drawdown risk. We are going to talk to our best-in-class managers, in order to define our net equity exposure after the Russian attack to Ukraine of the 24th of February. Preliminary conversations confirm, that some managers reduced already the equity exposure before the attack.
- The volatility models Z22 and ABR were finally right on the last volatility’ spike, after 3 false VIX Index ‘ breaks YTD. Unfortunately it was still not the case of our fund Alkeon.
- The biotech sector was performing poorly, but we believe, every positions in our portfolio have triggers from the different phase of the product pipeline’s development and therefore it is right to assert, their performance can deviate from market’s development. Our M&A strategy is holding relatively well, but we are not adding positions yet.
- Finally, we would like to mention again, that we are also invested in attractive long term market neutral investment vehicles, like venture capital funds, the Croatian private company Rimac, the crypto arbitrage fund and the QUANT model, which not only did not “suffer” from the event, in the contrary, we have “hidden” performance reserves.
- On the positive side, our investments into the energy sector, since 2 years now, and the funds Bakersteel Electrum/precious metals, could contribute YTD positively to our performance. We would like to remind our clients, that at the time when we started to invest in such investment vehicles, the majority of market participants were not believing in such sectors, on the contrary, were given them as “hopeless”. We hold on the investments.

Geopolitical tensions: long term repercussions

- On the longer term, it is clear to all of us, that we are newly **in the midst of a modern version of "cold war",** on one side the western, on the other side "the communist block" Russia/China.
- This time, the huge difference is that asides from the fact that we are most probably experiencing a sort of "egomania" of a few leaders (to stay diplomatic in the description), the influence of China over the world is definitely much higher. In fact, as we have seen on the slides of our last weekly report, **China basically "controls" the majority of the African continent** and having Americans leaving Afghanistan, the **Chinese government started newly infrastructure projects also in the Far Eastern region**, like Pakistan, Bangladesh, etc.
- As we have seen for some African countries, the Chinese government started with friendly financing structures, but in reality, **Chinese authorities** knew already from the beginning of the trade, that the specific country would never be able to repay such debt and therefore as debt defaulted, China has the right to **keep strategic ports, airports, lands,** etc.
- At the end of the day, the whole world does not want to be submitted to one single "superpower". Having the "communistic block" owning the majority of strategic commodities, resources and also technology, we understand the reaction of US, Europe and UK after the Russian attack of Ukraine. The slides 15 and 16 should help to understand about the huge Ukrainian resources.
- **Such strong imbalance could effectively jeopardize any technological trend or innovation, especially the electro mobility.** For this reason, we stay invested in the special metal segment with our best-in-class fund Bakersteel Electrum and we are also invested into the junior copper mine Nevada Copper. In addition also the "green" project GEVO US is profiting from higher oil prices and global imbalance, because western companies are going to implement SAF technology as diversification to the oil and jet fuel, in addition to their prior mission to reduce CO2 emissions.

Geopolitical tensions: long term repercussions

- China/Russia, including all their “satellites” are getting more independent from the USD and the trading with the western, therefore from the aged global SWIFT payment system. Such independence is only possible with the implementation of blockchain technologies, which are the pillar of the wished decentralization. We are reading headlines, that Mr. Putin is asking the Russian central bank to agree on cryptos. But in order to use such new payment systems based on blockchains, the world need new Fintech companies, further digitalization in the telecom segment, faster cloud system, faster semiconductors, etc. For this reason, we feel comfortable with our exposure into VC structures on Fintech and telecom and into asset managers investing in growth stocks.
- **China and Russia have already diversified their financial reserves out of USD into gold, EUR, JPY,** but most importantly, reduced massively the purchase of US T-Bills. One trivial difference between the JPY and the USD currency is that, the JPY is still bought from market participants as “safe haven” even if Japan has the highest indebtedness worldwide. But, if such important trading partners like Russia/China, included all their “satellites” as the African continent and the Far East, are going to buy less and less USD over time, who is going to cover for the huge pile of the US debt?
- **For this reason, once again, we believe the USD is structurally weak on the long term and even if we are not hedged at the moment, we have a stop loss by around 1.15 against the EUR.** On the short term, the mechanism by “risk off mood” investor buy the USD and sell Emerging market currencies, is still working. It happened again with the dramatic devaluation of the Russian Ruble during the invasion of Ukraine. But planning with an investment horizon of 10 years, we are not convinced, that such mechanism is going to hold.

Geopolitical tensions: long term repercussions

- Therefore, **KTS is constantly reducing the USD exposure.** Unfortunately for the moment, the gold and gold miners exposure is still in USD, as also the majority of the Biotech sector and the Emerging market exposure, included Vietnam. In principle, the gold price and local emerging market currencies are normally inverse correlated to the USD, therefore is not a real exposure USD exposure.
- During last years, we could also improve massively our currency exposure, by consolidating our best-in-class funds and fixed income strategies in different currencies into the Optima funds, strongly **optimizing the cost of our currency hedges.**
- A structurally weak USD combined with a very fragile global financial system, **strongly support the long case of gold** as diversification in our portfolios. During the event of Russia attacking Ukraine, surprisingly rypto currencies were not reacting positively like gold.
- We reconnect on the conclusion at our short term horizon, by mentioning again, that **we are still genuinely believing to be in the midst of a decade of innovation and multiple technological trends** and therefore equity markets still have a tremendous long term upside potential.

Geopolitical tensions: long term repercussions

- In order to stay invested aiming to catch such upside potential, but in the meantime to stabilize our portfolios from short term volatility caused from geopolitical events like Ukraine, **we keep the focus mainly into asset managers or investment strategies, which are helping us to limit market' drawdowns.** As the ABR manager of NY explains, everyone is a long term investors, as long volatility hits.
- In addition, asset managers like Flossbach or Alkeon have a team of over 50 analysts and therefore we rely on the professionalism of such asset managers for the selection of the right long term stocks.
- We would like to remind to our clients, that unfortunately, there are still many open geopolitical issues, like Taiwan and Hong Kong to mention a few (see in our outlook 2022 the list of potential risks).
- As explained in our outlook 2022, our core asset allocation aims at "catching" a good upside potential and limiting market drawdowns. This is especially very important for the fixed income part of the portfolio, which is supposed to generate an annual absolute performance and stabilize our portfolios, but plain vanilla bonds (especially of developed countries) are not offering such protection anymore, due to the newly high correlation to other asset classes, not being able to generate attractive yields in the current negative real yield's environment.
- On the other hand, we **believe to be invested into "satellites",** which have a tremendous upside potential on a longer term horizon and which are also less influenced from the short term volatility. We feel comfortable with the weighting of such positions in the portfolio related to the substantial upside potential vs their illiquidity.

Geopolitical tensions: long term repercussions

- We would like to add an interesting link on the longer term war between the US and China/Russia:
- **https://laductrading.com/russia-isnt-attacking-ukraine-they-and-china-are-attacking-the-us/**

- We also would like to conclude by saying that, at the end of the day, it is of vital importance for the world and humanity, that 2 strong “blocks” are against each others, rather than only one “superpower”. Of course, the humanity wishes more diplomacy, but history has proven enough to us, that unfortunately a world with no geopolitical tensions is a wishful dream. On this perspective, we would like to remind the great movie and true story of Ms. Melita Norwood, a British secretary who spied for the Soviets. Her strong an genuine conviction was, if both sides would possess the nuclear technology, no one would use it. At the end of the day it actually worked. Analyzing our long term repercussions we are coming to a conclusion that, seeing the irreversible trend of the run to be the worldwide superpower at any costs of humanity and in some cases also for “ego”, we should probably all wish, that the world have at least two sides of equal strength, in order to avoid any dramatic worldwide event.
- We still believe in common sense, but we are aware of the “hidden forces” behind the scenes.
- For anyone interested, the move is called “Red Joan” with the actress Sophie Cookson.

We are also adding the full text of the declaration of war of Mr. Putin:

https://www.spectator.co.uk/article/full-text-putin-s-declaration-of-war-on-ukraine

Statistic on Ukraine

- Most probably, Mr. Putin also knows that:
  - Ukraine is the 1st in Europe in proven recoverable reserves of uranium ores.
  - Is the 2nd in Europe and the 10th in the world in titanium ore reserves.
  - The 2nd in the world in explored reserves of manganese ores (2.3billion tons, or 12% of the world's reserves).
  - The 2nd largest iron ore reserves in the world (30 billion tons) as also the 2nd in mercury ore reserves.
  - The 3rd in Europe (13th place in the world) in shale gas reserves (22 trillion cubic meters).
  - 4th in the world by the total value of natural resources and 7th worldwide in coal reserves (33.9 billion tons).
  - But Ukraine is known most especially as agricultural country and has always being the pillar for Russia. Is in fact the 1st in Europe in arable land area and 3rd worldwide by the area of black soil (25% of world's volume).
  - Is the 1st in the world in exports of sunflower and sunflower oil and 2nd worldwide in barley production and 4th in barley exports.
  - 3rd largest producer and 4th largest exporter of corn in the world as also 4th largest producer of potatoes worldwide, 5th largest rye producer worldwide and also for bee production (75k tons).
  - 8th rank in wheat exports, 9th in production of chicken eggs, finally 16th in cheese exports.
  - In addition as an industrialized country: 1st in Europe in ammonia production and added to Russia, 2/3 of ammonium nitrate world's supply. 2nd in Europe's and 4th largest natural gas pipeline system in the world (142.5 bln cubic meters of gas throughput capacity in the EU).
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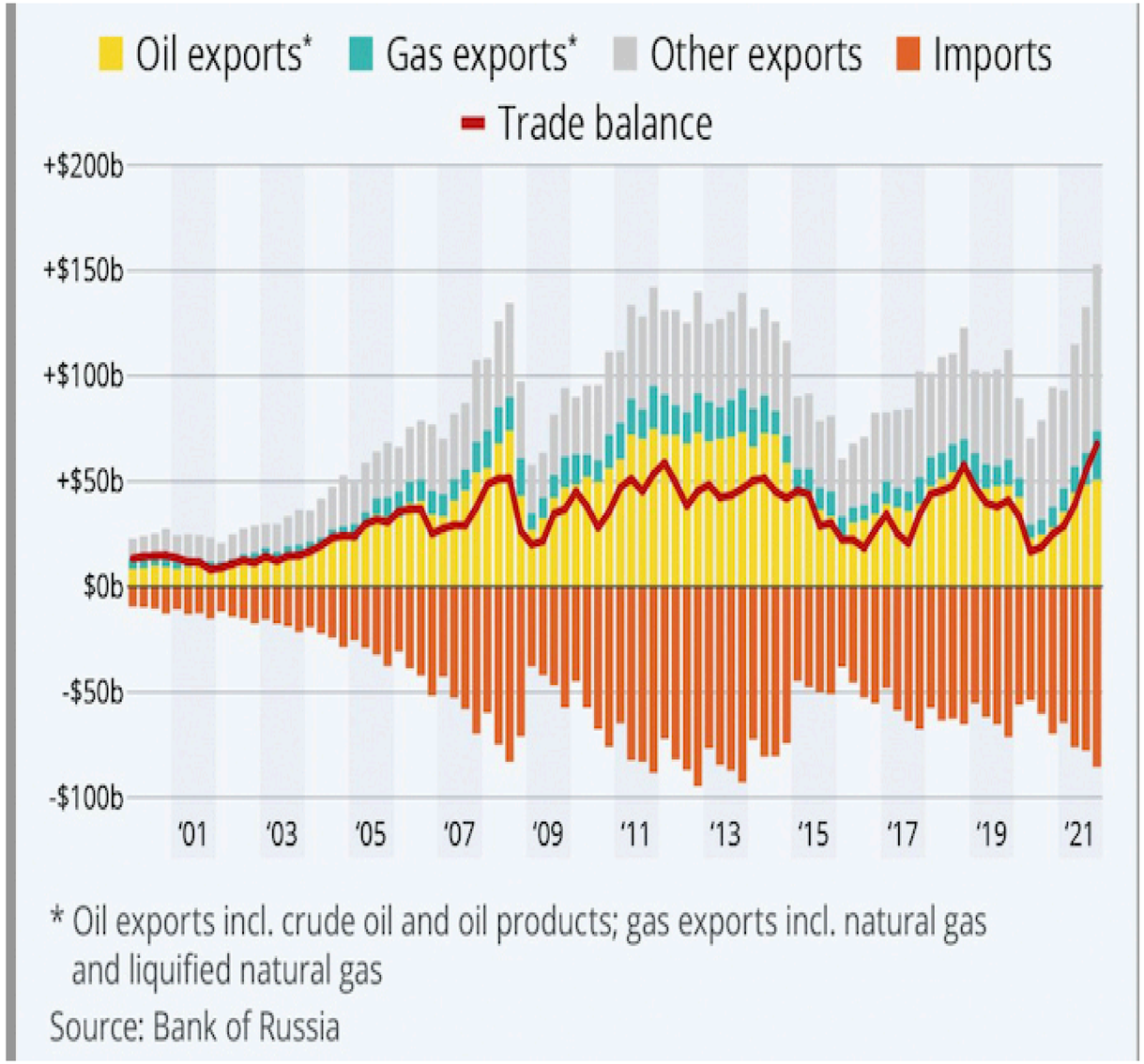
Statistic on Ukraine

- 3rd largest in Europe and 8th largest in the world in installed capacity of nuclear power plants
- 3rd in Europe and 11th in the world in rail network length
- 3rd worldwide (after the US and France) in production of locators and locating equipment, and 3rd largest iron exporter in the world.
- 4th largest exporter of turbines for nuclear power plants in the world, as also 4th largest manufacturer of rocket launchers, 4th in clay exports, 4th in titanium exports.
- Finally, 8th place worldwide in exports of ores and concentrates, 9th worldwide in exports of defense industry products and 10th largest steel producer in the world (32.4 million tons).
- KTS would assert that it is quite amazing the “power” and resources of such a country compared to the average wealth for a single citizens.
- Source: Ms. Lidia Monroe

Improving Russian trade surplus and the MIR Russian payment system

- With energy prices increasing, the Russian trade surplus is also increasing, with FX reserves at new highs at USD 640 bn.
- ON Q4 2021, Russia' merchandise trade surplus climbed to a record high of USD 67.6 billion, despite the fact that country's imports also reached the highest level since 2013.
- Russia is a major supplier of oil and gas to the European Union, but also commodity supplier to China.
- We would also like to mention something that we were not aware of: as a response of US sanctions back in 2014, Russia created their own payment system (MIR) in order to be independent from the SWIFT global payment system.
- The system was created in 2015, after Russian citizens were not able to use Visa and MasterCard anymore. Half of the Russian population is using now the MIR payment system and the Russian government is using the system for all the assistance programs of the government to Russian citizens.
- Most probably for this reason, Mr. Putin is feeling strong.



Source: Bank of Russia, via Statista / Bank Syz

Which are the most important trading partners for Russia

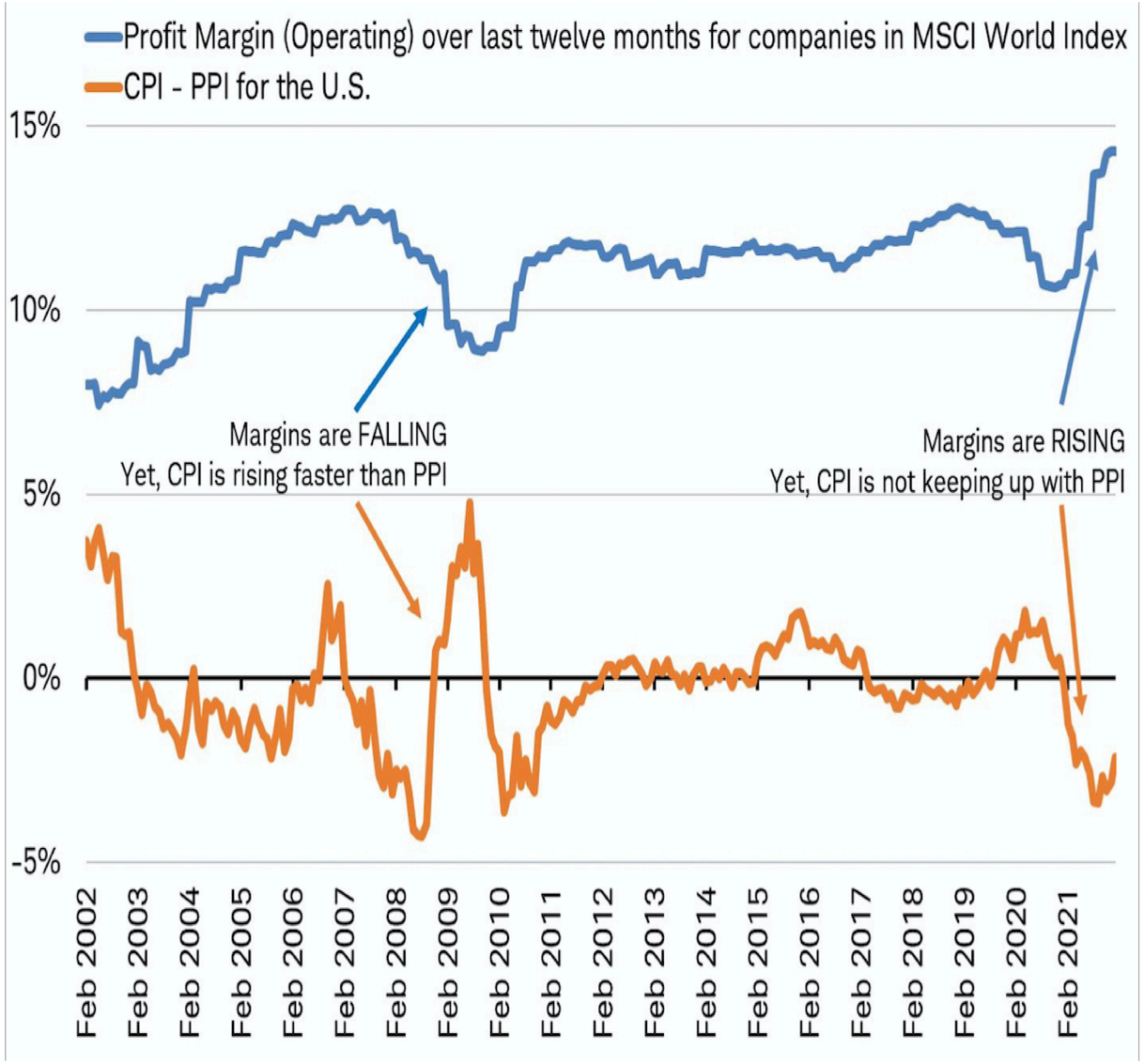
- China with a trade turnover of USD 112.4 billion
- Germany with USD 46.1 billion
- Netherlands: USD 37 billion
- US with USD 28.8 billion
- Turkey: USD 25.7 billion

Sectorial distribution of Russian exports:

- Energy: 53.8%
- Metals: 11.2%
- Chemical products: 7.6%
- Agricultural exports: 7.2% BUT according to the journalist James Forsyth (of the UK magazine, The spectator) **Russia provides roughly 2/3 of the ammonium nitrate world's supply and we have seeing on slide 12, Ukraine is the exporter nr 1 to Europe.** Such statistic are also confirmed in google. NOW Mr. **Putin has already suspended the export of such ammonium nitrate and therefore western countries will experience a further increase of food' prices**, being ammonium nitrate the most important component for fertilizer. **Biden warned already US voters, that imposing sanctions on Russia won't be cost-free for America.** Again a reason more for both parties to sit on the table and talk all over again! And also Biden is running out of time, with already a high domestic inflation and low approval rates!
- **Mr. Draghi announced that sanctions against Russia should not involve any business correlated with gas!**

PPI rising more than CPI

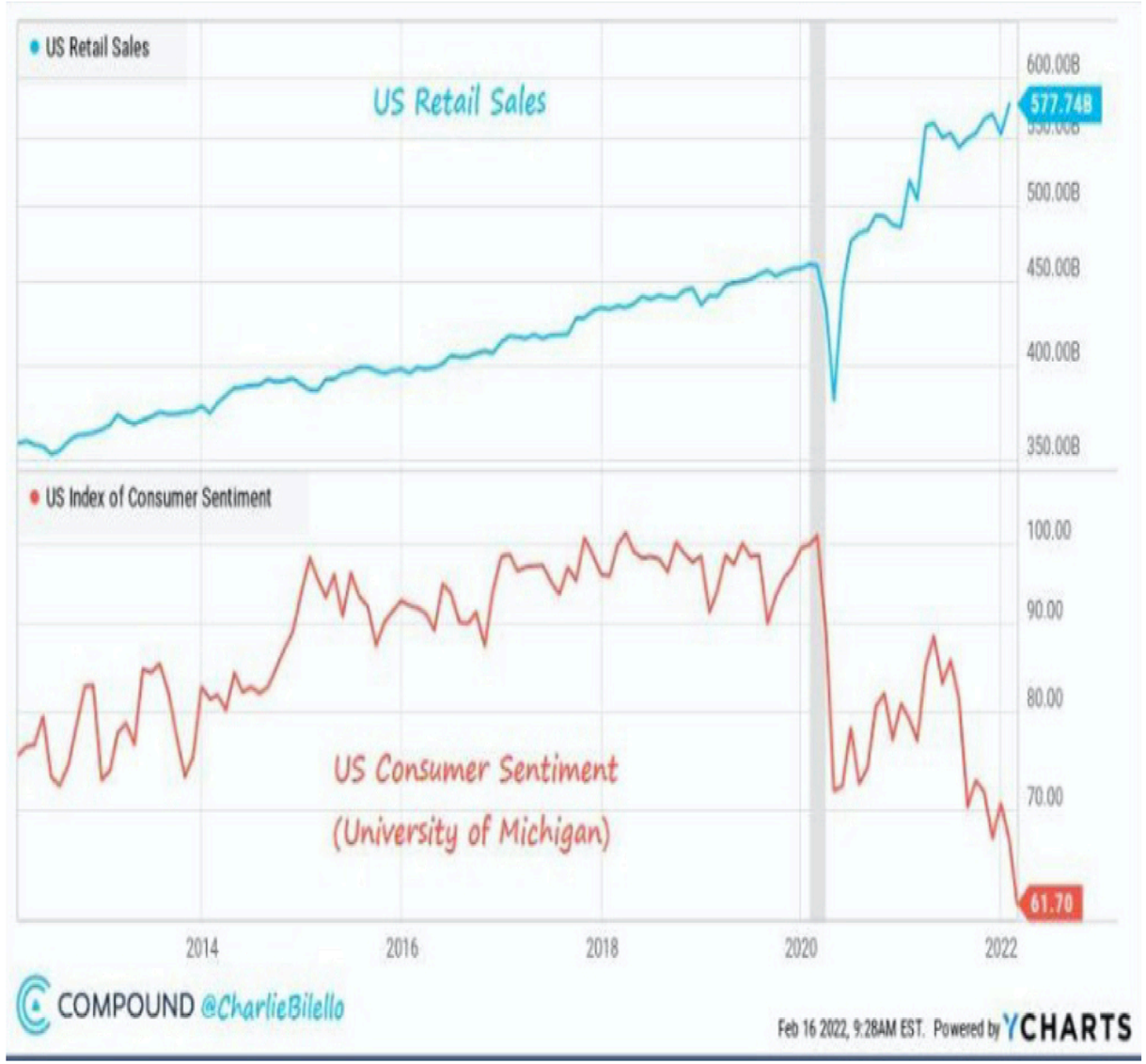
- Mister Jeffrey Kleintop, chief global Investment strategist at Charles Schwab, is showing an interesting chart. We can notice that the **CPI (consumer price index) is rising stronger than the PPI (producer prices Index).**
- This basically means, that companies can actually pass on all cost increases, basically caused by inflation or the increase of labor wages.
- This means, company's margins are actually increasing and not falling, the key amongst negative arguments for a correction of equity markets in 2022 by many market participants.
- KTS still believes that as long companies have increasing earnings and can also increase labor wages, we should have the optimal long term environment for a sustainable economic growth. Unfortunately not all the companies are able to pass on such cost increase and with Ukraine tensions, not all sectors are "untouched". We rely on the selection of our best-in-class managers on the right selection for the companies, which are less affected from such geopolitical tensions.



Source Charles Schwab: PPI rising more than CPI, good for companies

US retail sales at new highs

- Consumer sentiment is actually at the lowest level over a decade.
- US consumers are not happy about rising prices, but they are still spending. We are stubbornly believing that inflation had its peak and is going to fall. We would like to remind that basically **1/3 of past inflation's increase was due to the tremendous spike of over 40% in used cars' prices; the second biggest contributors were oil and gas prices**. As we can read on slide 20, we believe that **US is going to reach an agreement with Iran. Biden's approval fell strongly because of the high inflation** and therefore the Democrat are taking any initiative in order to reduce inflation before US mid election in November.
- In addition, we are reading that **Australia employment fully rebounded from both Covid waves** and we are at new highs, showing that the economy is already stronger than pre covid. This is good news, especially because Australia had quite strong look down policy. Finally normalization is coming everywhere and China is also going to follow.



Source: Charlibilello, via Bank Syz

Emerging market debt

- The broker Lazard issued an interesting research re-confirming our arguments about the attractiveness of **Emerging Market debts and the asset class can still add attractive yields and diversification to the portfolio.** We feel comfortable with our exposure into our best in class Emerging market debt funds.
- Basically the main takeaway points of the research are:
  - EM corporate debt is more attractive after the recent correction, but did not “sacrifice” the credit quality. The default ratio are aligned to the global high yield market, which is falling as we have seen in our recent weekly update (research of www.spglobal.com). In addition, recovery rates are slightly higher.
  - EM corporates have consistently delivered returns in the 4-6% range
  - EM corporates have outperformed sovereign EMD markets over a longer period of time
  - Superior risk adjusted returns vs other credit asset classes. **EM corporates have basically an higher sharpe ratio.**
  - EM corporate are a better protection from rising rates, obviously having higher yields than oder credit asset classes.
  - Statistic data show EM corporate as asset class also give a better diversification to the portfolio.
  - As KTS always argued, to invest in such “exotic” markets, it is better via experts, rather than direct bond investments. Lazard confirm the high inefficient market and therefore the higher alpha generation opportunity, but the investor need local experts, which are executing the proper due diligence, in order to invest in solid companies.
  - Last but not least, fundamentals in emerging markets are solid and more attractive than developed markets, arguments, which KTS fully agree and aligned with our economic outlook.

Chinese equity

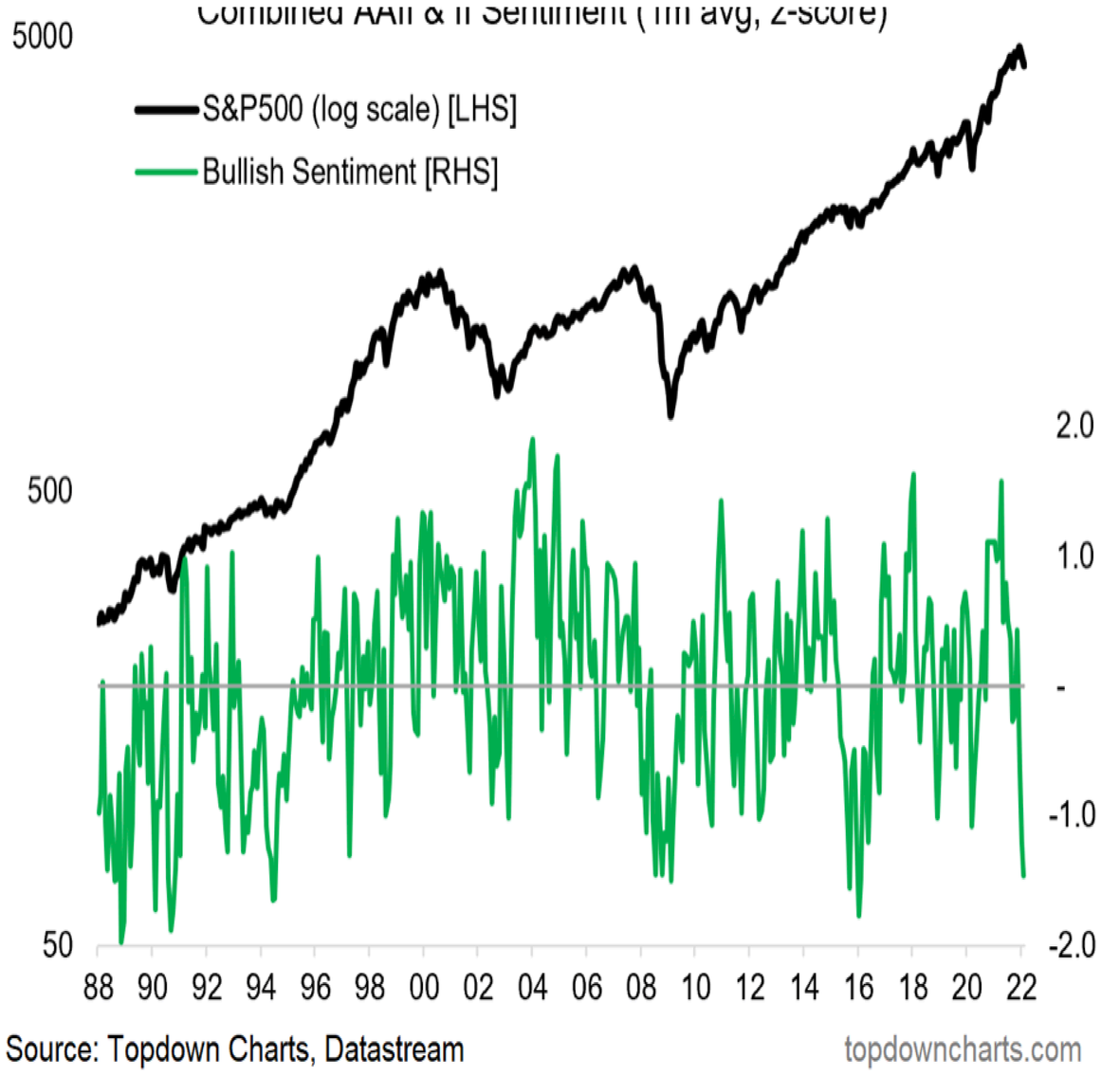
- **Citigroup CIO is going to overweight Chinese equities as counterpoint to US fed policy.**
- According to Citi, China's approach is to ease after macro-economic and regulatory tightening steps in 2021.
- For Citi, China presents another way to diversify portfolios. Domestic credit conditions are starting to improve since October 2021 in addition to a more favorable inflation picture.
- Foreign investors have noted the improvement in Chinese credit and inflows into Chinese ETFs have risen by USD 30 bn over the last 8 weeks following China's central Economic Work conference in December 2021.
- Of course Citigroup is also arguing that valuations are very attractive.
- Unfortunately, also the rebound of the Chinese equity market is most probably going to experience higher volatility on short term events. We are reading again, that Chinese authorities told the nation's biggest state-owned firms and banks to **start a fresh round of checks on their financial exposure and other links to Ant Group co.**! KTS was actually convinced that such scrutiny on tech giants would be over, at least for a while, but apparently it is not. Of course valuations are attractive, but as long as Chinese authorities keeps such unpleasant path, investors are going to expect a higher premium than the rest of the world!
- We invested with a good entry point during the Chinese equity market correction in H2 2021 and our exposure is still minimal compared to the overall asset allocation, therefore we feel comfortable with our investment, tough we were hoping in a faster market's recovery. At the beginning of this year, we also added a position into the equity fund Stonehorn Asia, which has an overweight in China. We are still holding on into half position of the ETF EMQQ LN (better globally diversify than KWEB LN).

Oil price

- According to media, the **US is doing substantial progress during negotiations in Vienna to save the Iran nuclear deal** and Iran shows seriousness on the matter.
- The oil futures felt USD 2 on the news.
- An interim deal could potentially **increase exports by 700k / 800'000 barrels a day (b/d)** according to experts, as we have already mentioned recently. But according to Iranians, announcement done back in November 2021, Iran is set to boost its crude oil **capacity to 4 million b/d by March 2022**, returning to levels not seen since before the US withdrew from the nuclear deal and re-imposed sanctions on the country's crude sales in 2018. Iran would need USD 90 billion investment for the expansion.
- Again, it is not a coincidence that US suddenly has all the interest to finalize such an agreement. Democrats desperately need to improve approval rates having US mid term elections in November, therefore the pressure to reduce inflation number as soon as possible is enormous. We know that more than the half of high inflation numbers are due to the higher energy costs and therefore, a lower oil price or at least not higher, is going to have more comfortable inflation number, which would allow the FED to be more dovish.

Bullish sentiment extreme depressed

- We have already mentioned multiple times recently, that the market sentiment is at extreme depressed levels.
- But we would like to include the right hand chart, which shows very depressed levels, like during 2008 or 2016.
- Last week we also mentioned that for the first time after 2008, the asset allocation into technology fell to the lowest level since 2006 and the investment community is now net underweight technology.
- In a period of high inflation and increasing interest rates, the financial sector is rising, and also energy and commodities. The latter are trading at the lowest valuation ever and some market participant is arguing that it is the "one in a hundred year" buying opportunity!



Very depressed market sentiment

A one in a hundred year opportunity

- **As mentioned, the valuation of energy and metals companies relative to the S&P 500 Index is at lowest levels ever, therefore we can assert that the energy and commodity sectors have deep value.**
- The fact that the technology sector is now net underweight and energy and commodity stocks rallies 10-15% YTD, meanwhile "stay at home hypes stocks" are experiencing a dramatic correction, means, the trend has further room to go.
- We feel comfortable with the positions Bakersteel electrum and precious metals, the value fund Classic global and also our oil expert Renaud. We are not rotating extremely our asset allocation, because it is too difficult to "catch" the right short term timing. We keep our longer term vision and we think that it is also important to be invested into the innovation space like electric motion (via Rimac), Fintech (Fasanara VC), 5G and digital health (Swisscom VC) and Alpora innovation. But also growth is important and we are invested into the Alkeon, 2xidea funds, the Biotech basket, etc.

Source: Callum Thomas

General news

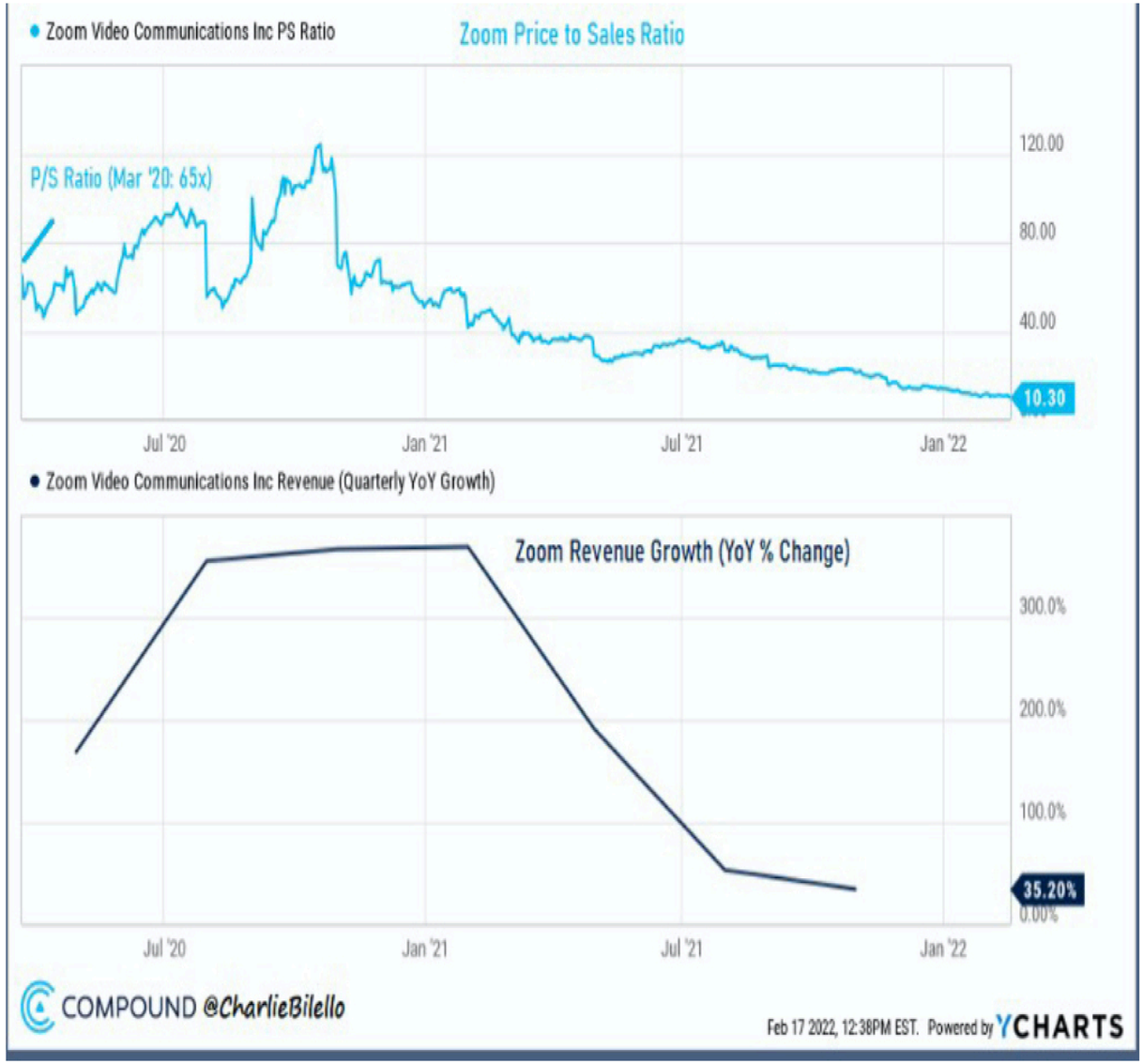
- After the **FED committee, market participants thinks that the tone was again dovish,** having officials showing concerns about the risks of tightening financial conditions too quickly. Once again, the stance of the FED is confirming our long term arguments; the FED is not in the position to take too dramatic steps. As mentioned, the new interest rate hike' expectations are now at 25 bpi instead of 50 bpi.
- **The Los Angeles, average days at anchor & berth is falling back to normal levels and therefore we can assert, that the supply chain crisis is over!**
- The major gold miner **Barrick Gold could double earnings during 2021.** This is the final proof of our arguments: as long the gold price is stable, gold miners are a real "cash cow" and as announced from Barrick, the **company is going to finally increase dividend by 11% in addition to USD 1 bio share buyback.** The confirmation is also coming from the **highest inflows into the GDX, gold miner's ETF, YTD. The magnitude of the inflows is comparable to the beginning of the 2020 rally.**
- We are reading in the magazine Forbes, that Belgium is joining the club of **country offering a 4-day workweek for thousands of federal civil servants (65'000)**. Also Scotland has previously launched an experimental trial of 4-day workweek, whereby workers will have their hours reduced by 20%, but won't suffer any loss in compensation. The program will be funded by the SNP (Scottish National Party) with a GBP 10 million fund. Spain, Japan, Iceland and UAE also have already implemented similar experimental plans. All federal government entities of UAE were the first to implement such plans.

General news

- In our emerging market investment vehicle, we are trying to be invested into experts and therefore we are avoiding single “bets”.
- But we were analyzing the **chart of the correlation between the commodity index and the Brazilian ETF (EWZ)** and we could assert that the Brazilian equity market is currently fully undervalued compared to historical data. The reason is the persistence political instability, but as contrarian point of view, it could be an interesting buying, especially, because commodities have just started a long term bull cycle.

Hype stocks

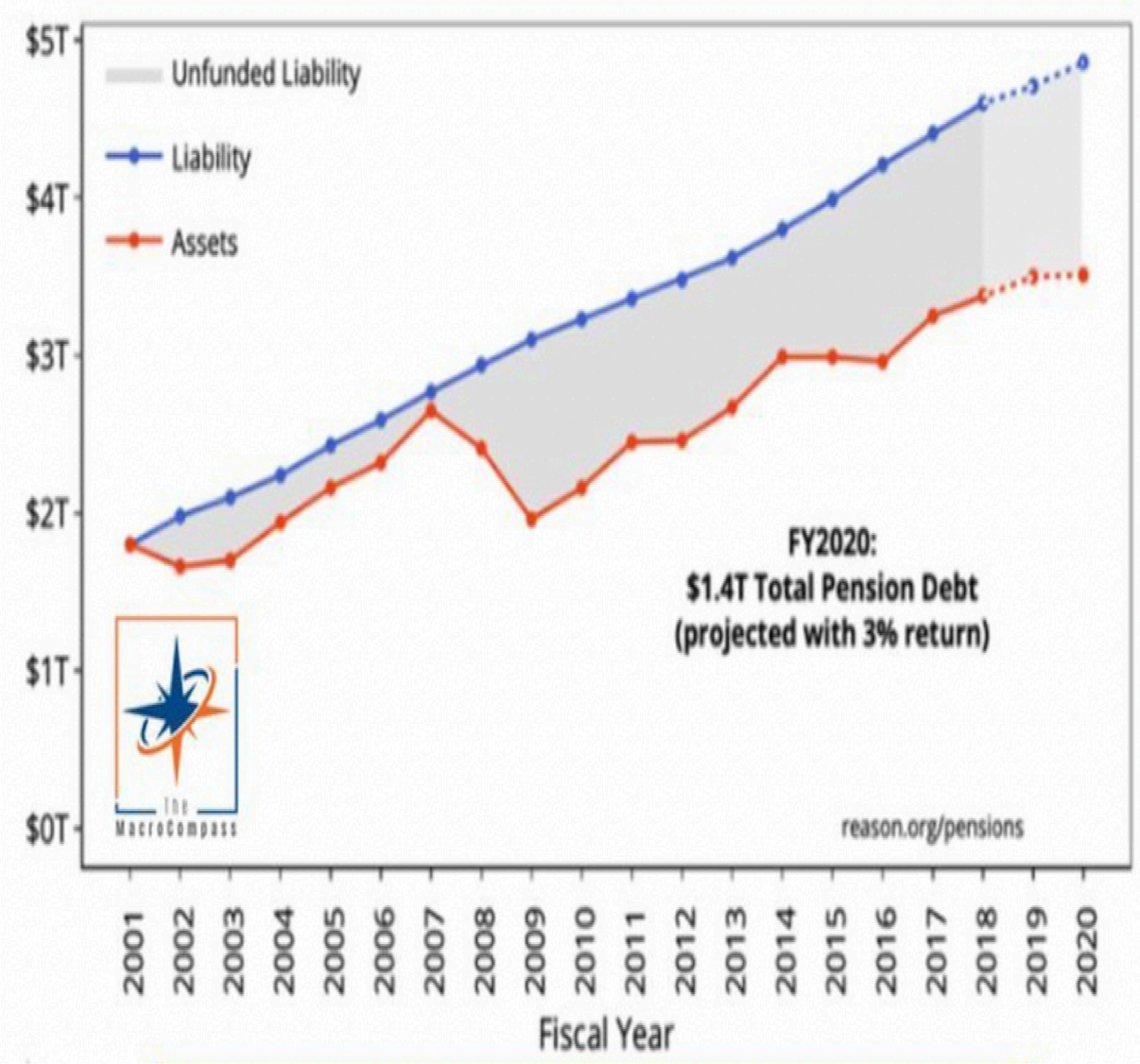
- Back in February KTS argued that too many “hype stocks” like stay at home, green, etc. were trading at insane valuations and most probably would had to fall back to reality.
- Zoom was a typical example of such hype, which back in October 2020 investors were ready to pay over 100x sales.
- **Today Zoom trades at 10x sales and it is still too expensive actually.**
- KTS was not investing in such hypes, though having such strong conviction, we were also not shorting.



Source: CharlieBilello, via Bank Syz

The dilemma of our pension plans

- As our clients know, the biggest long term worry of KTS is the repercussion of negative yields on our pension plans.
- People understanding financials know, the purchasing power of our pension is going to dramatically lose in value over time and therefore, our pension retribution will basically not be substantial enough in order to guarantee our lifestyle in the future.
- On the book “The ascent of money”, the writer Mr. Ferguson confirms in his introduction, that in the US and UK, more than half of citizens basically had learned “not too much” or nothing at all about financial issues at school! Therefore the writer assert that there is a public ignorance around money.
- But finally we have a chart, which shows how dramatic is the the real situation: **USD 1.4 trillion of pension payments can’t be met only in US, and we do not want to know, how high is globally.**



According to Mr. Peccatiello our pension will pretty much suck

The dilemma of our pension plans

- Mr. Peccatiello goes further and tries to figure out possible solutions:
  - Higher interest rates: it is not possible, having governments too indebted and basically no government can afford to pay higher interest rates.
  - Cut pensions: politically and socially unacceptable and no politician will volunteer for this as he won't be re-elected.
  - Generate higher yields, which basically it is possible only with more illiquid, high risk asset classes in order to reach a 7% real returns on a yearly basis
- As recently mentioned in our weekly nr 6 of last week, policymakers are working on finer solutions, but at the end of the day, is not for the "joy" of the workforce. In fact, **discussions are for example for increasing retirement age** (apparently Denmark even to 74 years, Italy and Iceland 71, Holland 69). We expect also possible cap on the public pension plans, where it does not matter, how much a citizen was paying over his life, he will have a maximum cap on the pensions.
- But bottom line we align ourselves to the manager of **Flossbach: the manager of a pension plan needs to reach yields over 7%** pa. in order to guarantee the right sustainability of the structure. **The only liquid asset class, which can realistically reach such performances is equity.**

Cases of fraud in Italy - the real solution is blockchain

- Last year we mentioned, that Italy under the leadership of Mr. Mario Draghi, will most probably experience less corruption and stimulus packages are going to be invested in the right way, finally stimulating the real economy and not the “wrong pockets”.
- Unfortunately we have to read in media, that the “super-bonus 100”, EUR 4.4 bn as Covid19 package to support the restructuring of older building with the goal to increase energy efficiency has been abused by most companies and the mafia could use such program to wash money.
- The main problem was, such payments have been made directly to companies and not building companies by every invoice at completed job, therefore, the money has just been “cashed out” with not real service performed.
- We have to admit, that also in Switzerland we had cases of fraud in such Covid19 payments back in 2020, but definitely not in such magnitude like in Italy.
- The only solution to abolish such risk of fraud, is to automatize the system of such payments in order to have the right control. **The only way to reach such automatization is via blockchain technology, most probably Ethereum.**
- This is an additional reason, why we believe the blockchain technology is going to be the pillar for the future. We explained other reason in our KTS weekly nr. 35 last year (1st October 2021).

General news on cryptos

- In the midst of the geopolitical “saga”, Ukraine passes the bill legalizing cryptocurrency.
- Apparently the virtual assets market in Ukraine has a significant turnover, but we are not surprised, because Ukrainain belong to the most skilled software programmers worldwide!
- Ukrainian authorities are convinced, that legalizing crypto exchanges and cryptocurrencies could protect the assets of Urakinian citizens from possible abuses or fraud.

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