KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 12

The 18th of March 2022

FOMC decision and general market sentiment

- The March FOMC decision came as expected with only a 25bp rate hike and equity markets reacted positively. **Most of investors are of the opinion, the market's rebound is more a short squeeze due to the sum of events: dovish FED, hopes for a truce in the Ukraine and Chinese authorities trying to stop the bleeding in their local stock markets.**
- Important also to be noticed, that last week, the **index of non profitable tech stocks also strongly rebounded** and market participants are wondering, if the worse is over for the sector, having basically corrected 80% from the highs, back in Feb 2021.
- The FED wants to further hike to a total of 175bp, which is in the range of expectations, but we believe the equity market's reaction was positive more due to the statement of FOMC, which sees as likely additional upward pressure on inflation and weigh on economic activity from the invasion of Ukraine by Russia and therefore are not going for dramatic change of policy, even if inflation is temporarily very high. Logically also the ECB and Bank of England are on the same page as the FED, giving also dovish outlooks.
- Mr. Powell sees the probability of a recession over the next years as not very high and recent US economic numbers are confirming, for the moment, a resilient growth and strong employment. But we will analyze in the next slides, the risks for a weaker economy are there, for this reason, investors should not be overly optimistic.
- **Investors must be aware, that in any cases, interest rates are going to be lower than inflation and therefore we are still in an environment of negative yields, where only real assets are going to increase in value.**
- Therefore, KTS is not trading short term, because there are too many unpredictable uncertainties but we stay invested in our long term theme like the "green & sustainable" transition, Robotic, Artificial Intelligence, Blockchain Technology, Fintech, etc.

FOMC decision and general market sentiment

- Mr. Yardeni is arguing once again, **equity markets do not have the "FED put" anymore, but instead can count on the "CFO put", mainly shares buyback programs and M&A activities, due to the huge amount of liquidity on the account of major companies.** Media are reporting that share buyback programs are the highest levels ever and therefore supporting equity markets. As KTS always argued, those programs are the **natural hedge of equity markets and historically are responsible for 40% of the performance, especially by blue chips.**
- **The confirmation of the "CFO put" is also the strong inflows into high free cash flow yielders. An indicator is the ETF COWZ US: US cash cows 100 ETF, which is at all time high.** KTS is not invested to this specific etf, but we know, via our best-in-class funds, that we are exposured in high FCF generating companies.
- According to Mr. Timmer, chief strategist at Fidelity, equity markets are facing strong headwinds like rate hikes, inflation and geopolitical tensions, but there is also reasons for optimism, **having earning' expectations still at +9% for 2022** even after substantial downgrades. This should give an additional floor to equity markets.
- We are reading in media, that the governor of Ukraine's Central Bank told at an interview with BBC, **frozen Russian assets should be used to rebuild Ukraine after the war.** Apparently we are talking about USD 300 bio. We welcome such a step.
- A reason to worry again about **supply disruption are the actual lockdowns in China**. Companies like Foxconn (Iphone supplier) and VW closed down manufactures. 17 million people and a port that accounts fro 25% of exports are in lockdown in Shenzhen! We can not understand, how Chinese authorities are stubbornly following a 0 covid policy, when other countries abandoned it and the situation is under control.

What happened after the first FED rate hike?

- Historical statistics show that market were turning positive 12 months after the first rate hike of the FED.
- Normally the FED increase interest rates in an environment of strong economic growth and therefore equity markets are supported from rising company' earnings.
- This time the situation is different, having geopolitical tensions causing high inflation due to higher energy and commodity' prices. Market participants are arguing, the rate hike is not influencing oil or commodity prices.
- But analyzing next slides, we can notice how financial conditions are already distressed and are going to cause a reduction of commodity prices on the second half of 2022, helping the process of normalization.

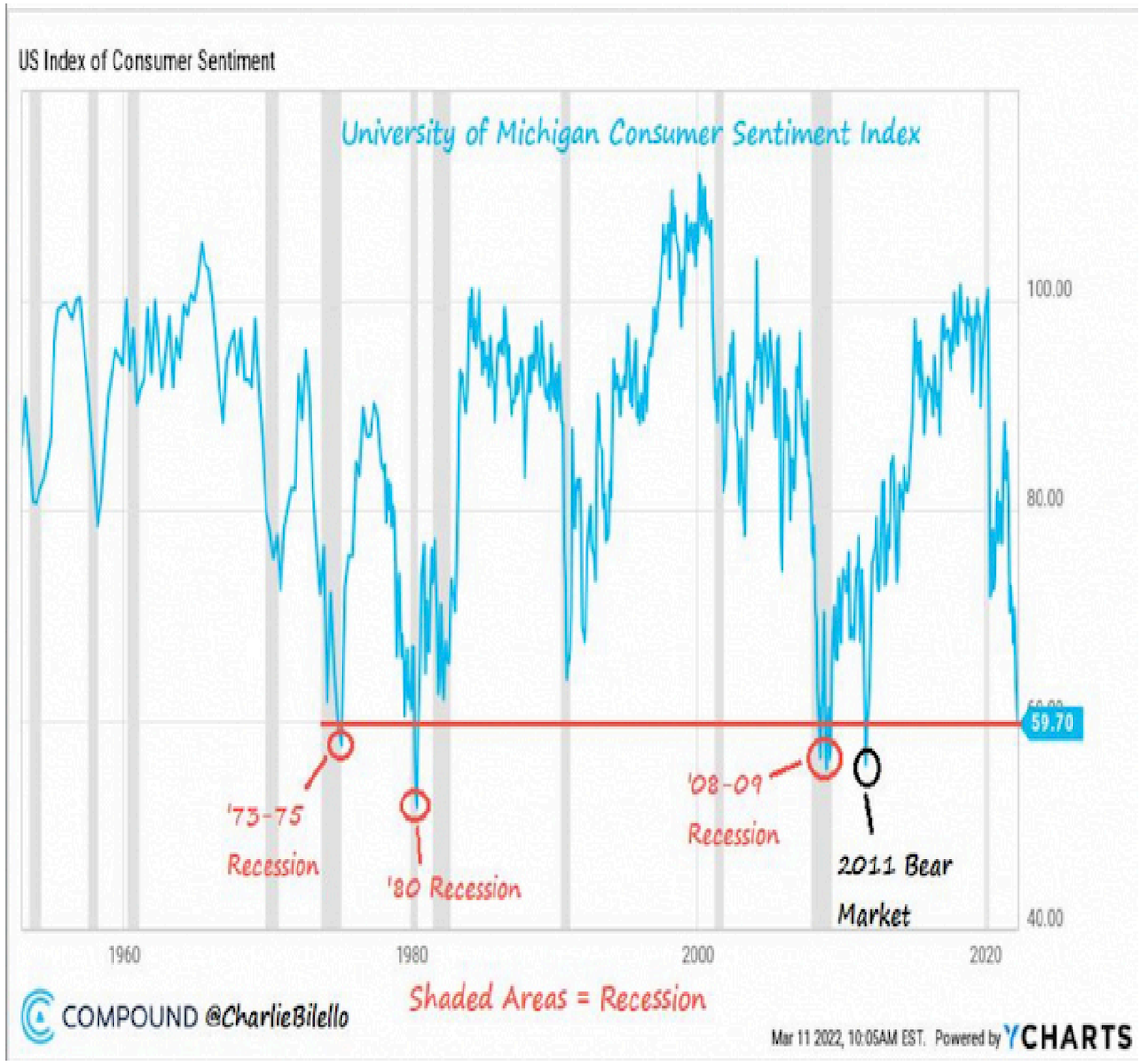
Date of First Hike	Next 3 Months	Next 6 Months	Next 12 Months
8/8/83	2.0%	-0.7%	2.1%
4/1/87	19.1	20.9	1.5
5/11/88	3.4	8.6	20.7
2/4/94	-5.9	-2.5	2.4
3/25/97	13.6	20.6	39.6
6/30/99	-7.6	6.6	6.0
6/30/04	-2.3	6.4	5.2
12/16/15	-1.1	0.1	9.1
Average	2.7	7.5	10.8
Median	0.5	6.5	5.6
% Positive	50.0	75.0	100.0

Source: LPL Research, Bloomberg

Source: Syz Group / Bloomberg

US consumer spending: USD 3’000 less to be spent on consumer goods

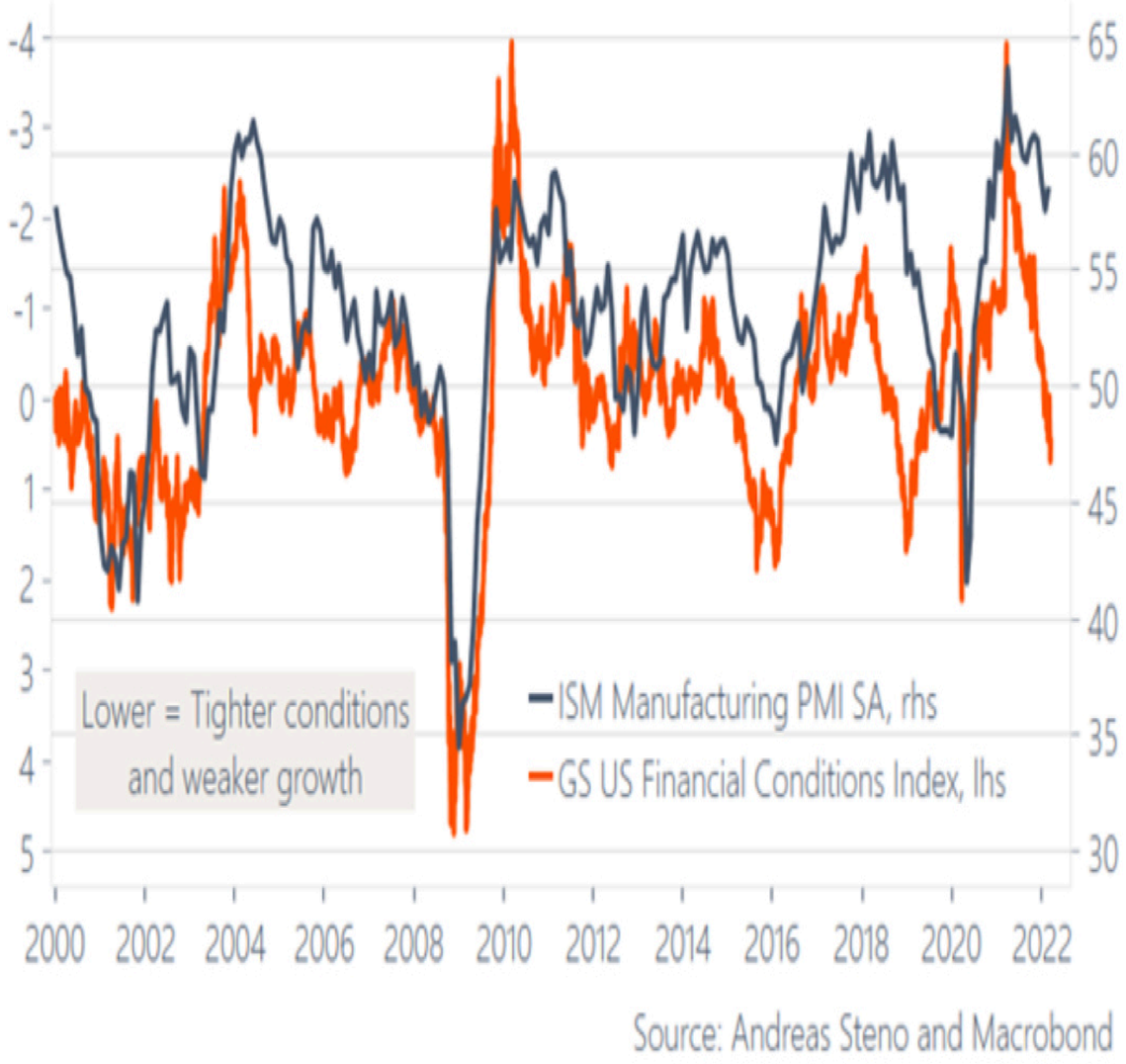
- The US consumer sentiment index is at depressed levels, obviously because of the even higher inflation after the Russia-Ukraine crisis, mainly due to the rising oil price.
- The right hand chart, courtesy Mr. Dae won Yoon, shows that historically, when the US consumer sentiment index is that low, the **economy entered into recession.**
- Last week we have analyzed, that **nowadays the global economy is much less dependent on oil** than during the oil crisis of the 70’ and Russian oil supply is “only” 11% of the global production. Therefore the actual oil price’s crisis should be less acute. **Statistics show, that the energy and food spending has basically halved since the 1970’s.**
- Nevertheless, according to Mr. Yardeni’s research, the average American household spent USD 3’100 on gasoline during December 2021, with the recent increase of 59% , the impact on US consumer is substantial. Mr. Yardeni is also estimating additional USD 1’000 more for food, due to the high inflation. **In total USD 3’000 less to spend on other consumer goods!**



US consumer Sentiment Index predicts recession

Manufacturing PMIs will drop below 50 soon

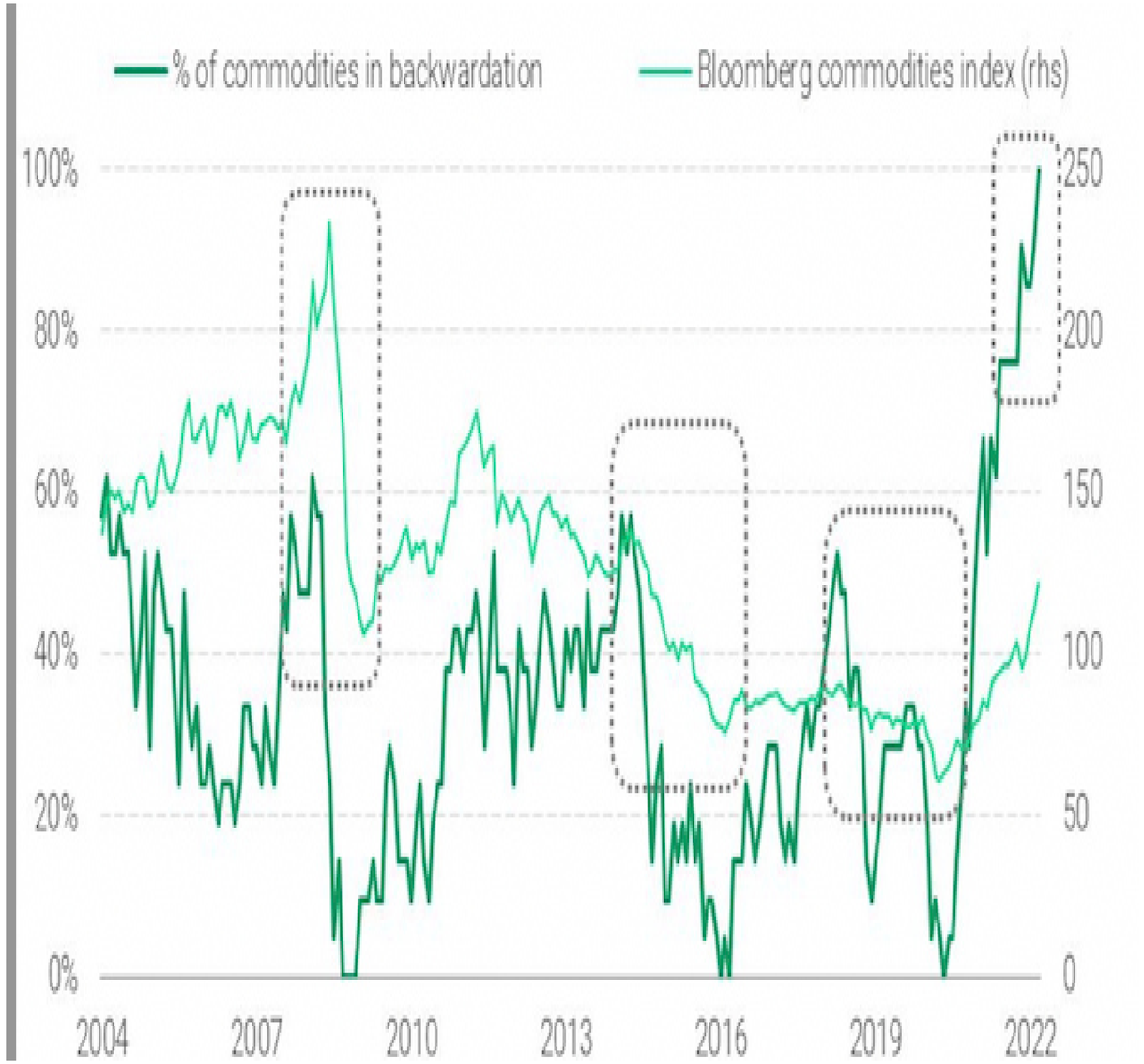
- The right hand side chart, courtesy Mr. Andreas Steno, shows how financial conditions have already tightened enough to bring **about a mild manufacturing recession globally,** which also means that the **demand side of the commodity/energy equation will likely start softening very soon.**
- In addition, we are going to experience a weakening credit cycle and **therefore long bond yields going to fall in H2 2022**, instead to further increase, as most market participants are expecting.
- Finally, Mr. Steno Larsen **expect inflation to stabilize around 2%** over the medium term, given current financial conditions according to the correlations of the past 20-25 years. Therefore there is no need for the FED to tighten more than what is already priced in to forward markets for 2022/2023. The conclusions is: **WE MAY HAVE HIT PEAK HAWKISHNESS BY NOW.**
- For this reason, Mr. Steno Larsen is reducing his exposure into energy and commodities. KTS is not going to sell yet.



Source: Andreas Steno and Macrobond

Commodities in backwardation

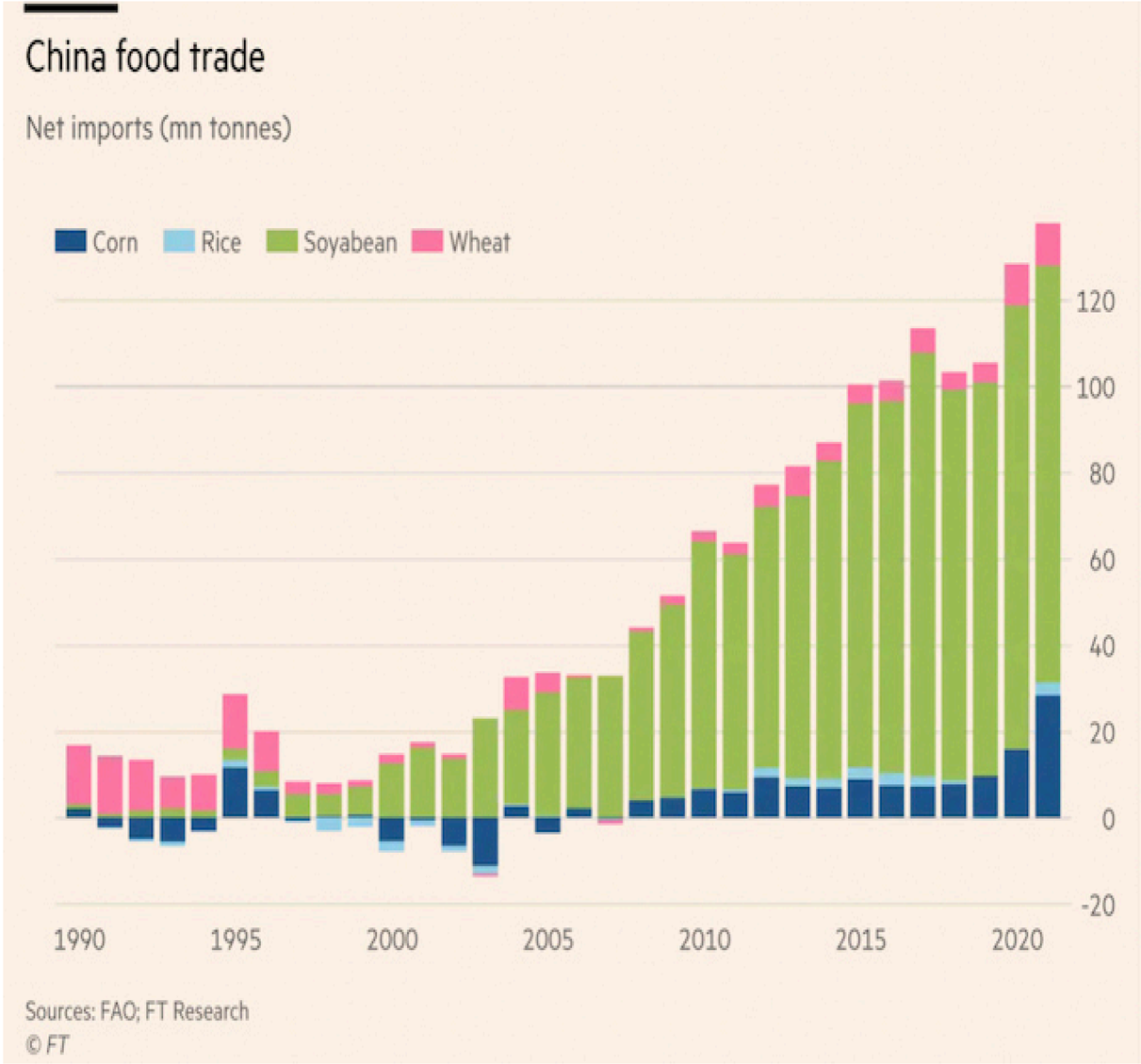
- **The chart on the right hand side, courtesy Mr. Ansidei, shows how in the past, a peak backwardation was always followed by negative returns and therefore the rally in commodities is not sustainable.**
- This chart is confirming the theory of Mr. Steno Larsen. KTS is invested mostly in **special metals, copper or silver which are the pillars for the "green revolution"** and therefore we are not going to reduce our exposure.



Source: Mr. Ansidei

China is the world's largest agricultural importer

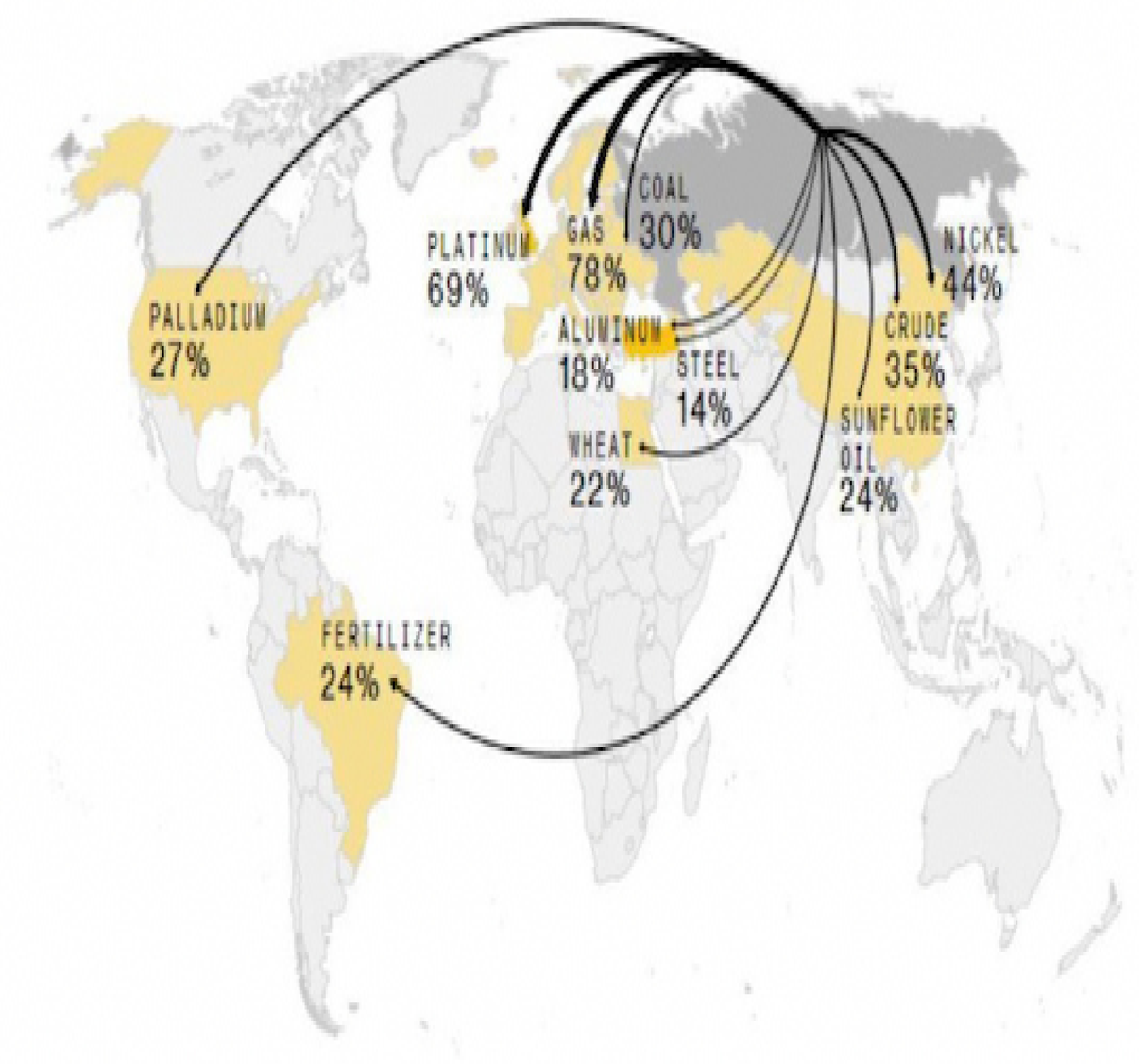
- China is going to be, on one hand, in a better position than the West, by buying discounted commodities from Russia, but it will also faced a food inflation crisis.
- In fact, during 2021, China imported a record 28 million tons of Ukrainian corn, which is more than double the previous year's 11million.
- US is in a better position than Europe, but having also China facing a possible food crisis, like also North Africa, we are of the opinion, that there are strong arguments to have **all parties' best interests, to reach an agreement on the Russia-Ukraine crisis a soon as possible. There is not only a winner in this crisis.**



Source: FT, via Syz group

Russian commodities exports

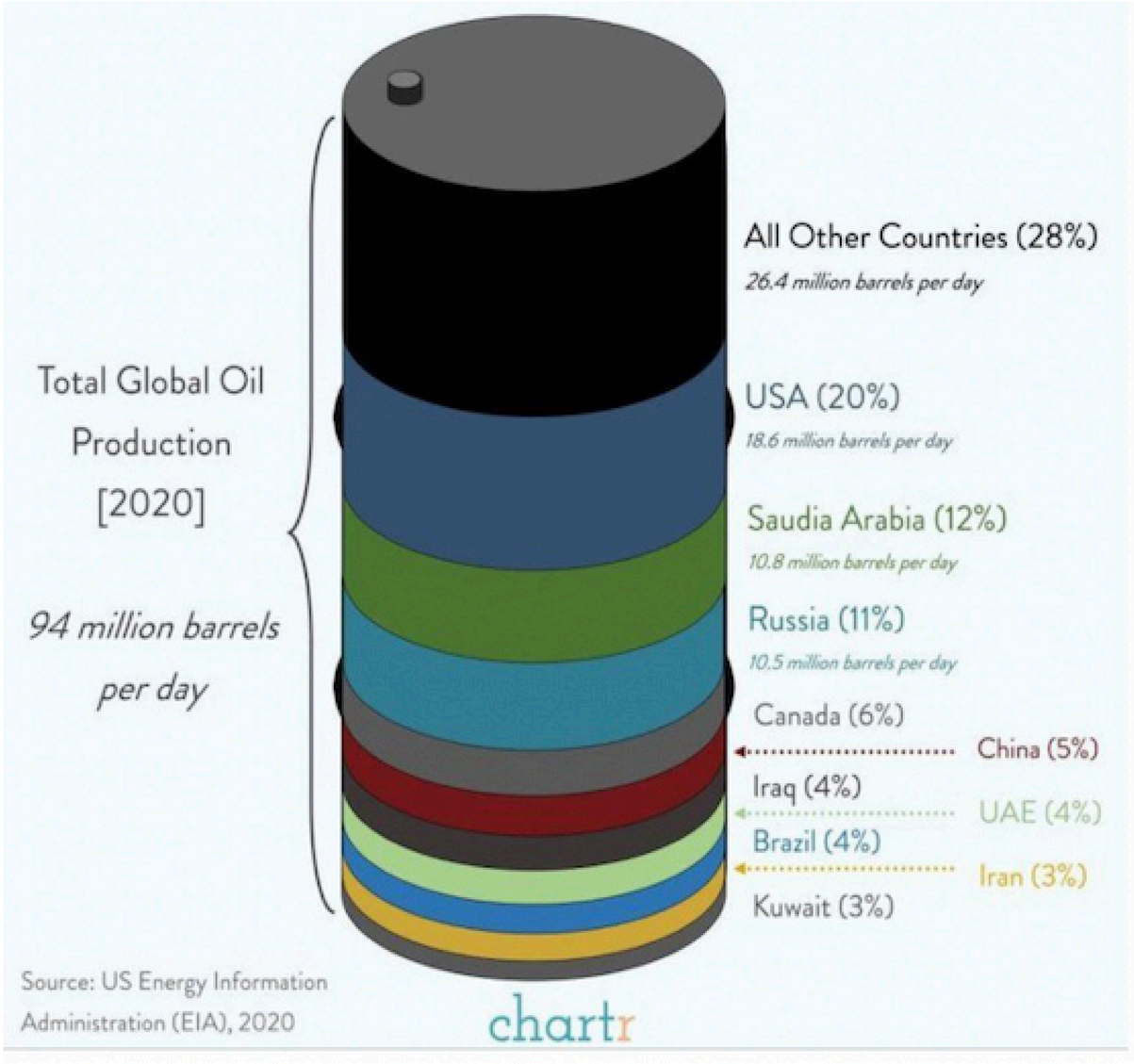
- Interesting chart showing the breakdown of different commodities exported by Russia and the countries that rely on them.
- 24% of fertilizer to Brazil, which is the world leader in Soybean production
- As recently explained, short term the major dilemma is the African dependence on wheat from Russia and Ukraine. Countries like Somalia, Benin, Egypt, Sudan, Congo, Senegal, Tanzania, Rwanda, Madagascar, Burkina Faso, Gambia, Libya, Tunisia, Uganda, Burundi, Namibia, Mauritania, Kenya are strongly depending on Russian and Ukrainian wheat.



Source: Syz group

Global oil supply by country

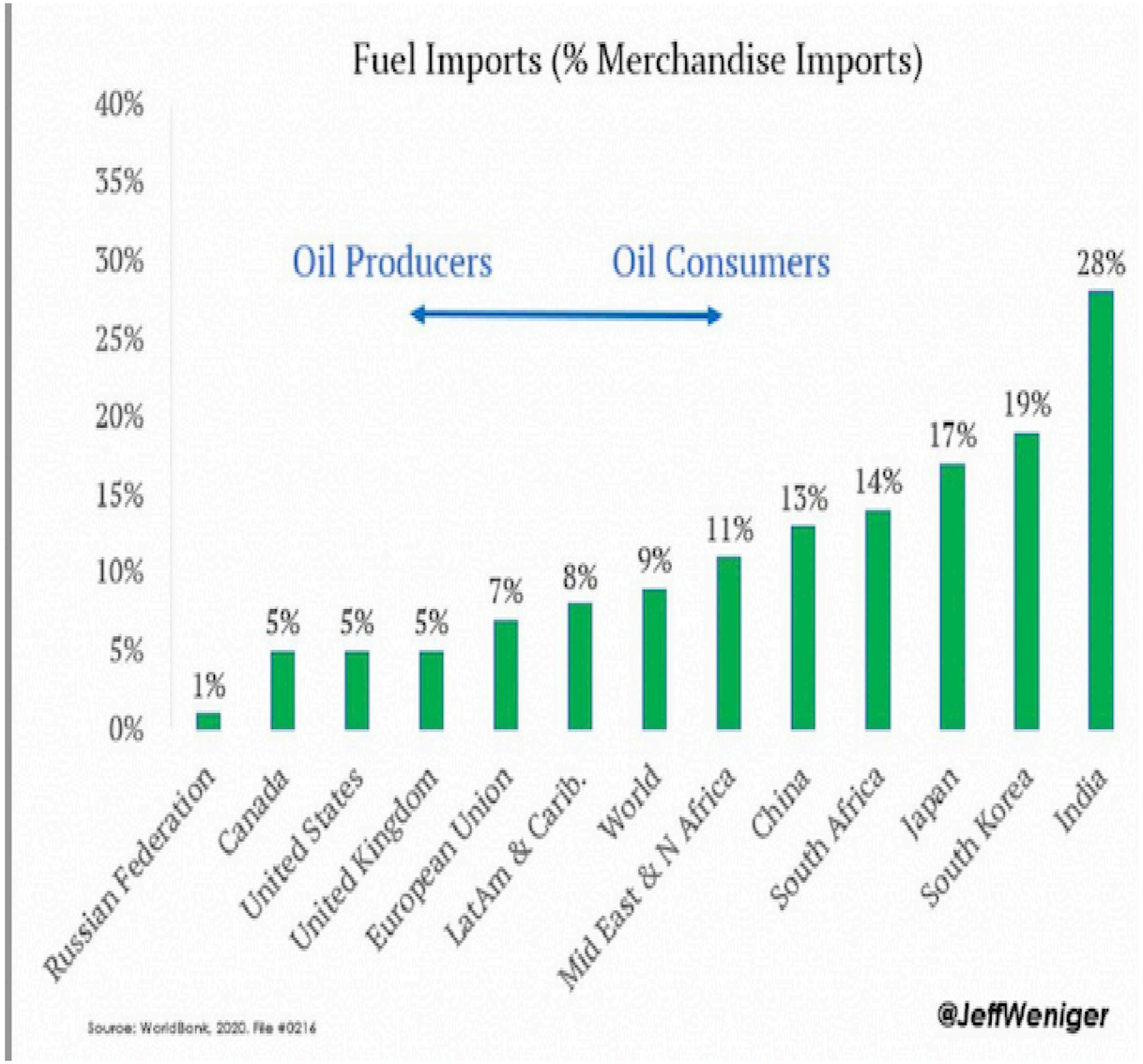
- The right hand side chart, courtesy Mr. Monchau of Syz Group, shows the global oil supply by county.
- **USA is responsible for 20% of the total global oil production** (year 2020), followed by Saudi Arabia (12%), Russia 11%, Canada 6%, China 5%, Iraq 4%, UAE 4%, Brazil 4%, Iran 3% and finally Kuwait 3%. The rest of the world is 28%
- As we have analyzed last week, oil reserve's distribution is different, with Venezuela leading with 17.5% of global worldwide reserves (303.8 Gbbl - billion barrels), Saudi Arabia 17.2%, Canada 9.7%, Iran 9%, Iraq 8.4% and Russia 6.2%
- As we can notice on the next slide, the most sanctioned countries are Russia and Iran. Negotiations in Vienna between US and Iran were paused on March 11th, because apparently **Iran wants Russia on the table and Mr. Sergei Lavrov, Russia's foreign minister, demanded that any new deal also include sanctions exemptions for his country.**
- So many factors are inter-connected, that all the parties need now to really start to talk seriously at the table!



Source: Syz group

Oil dependence

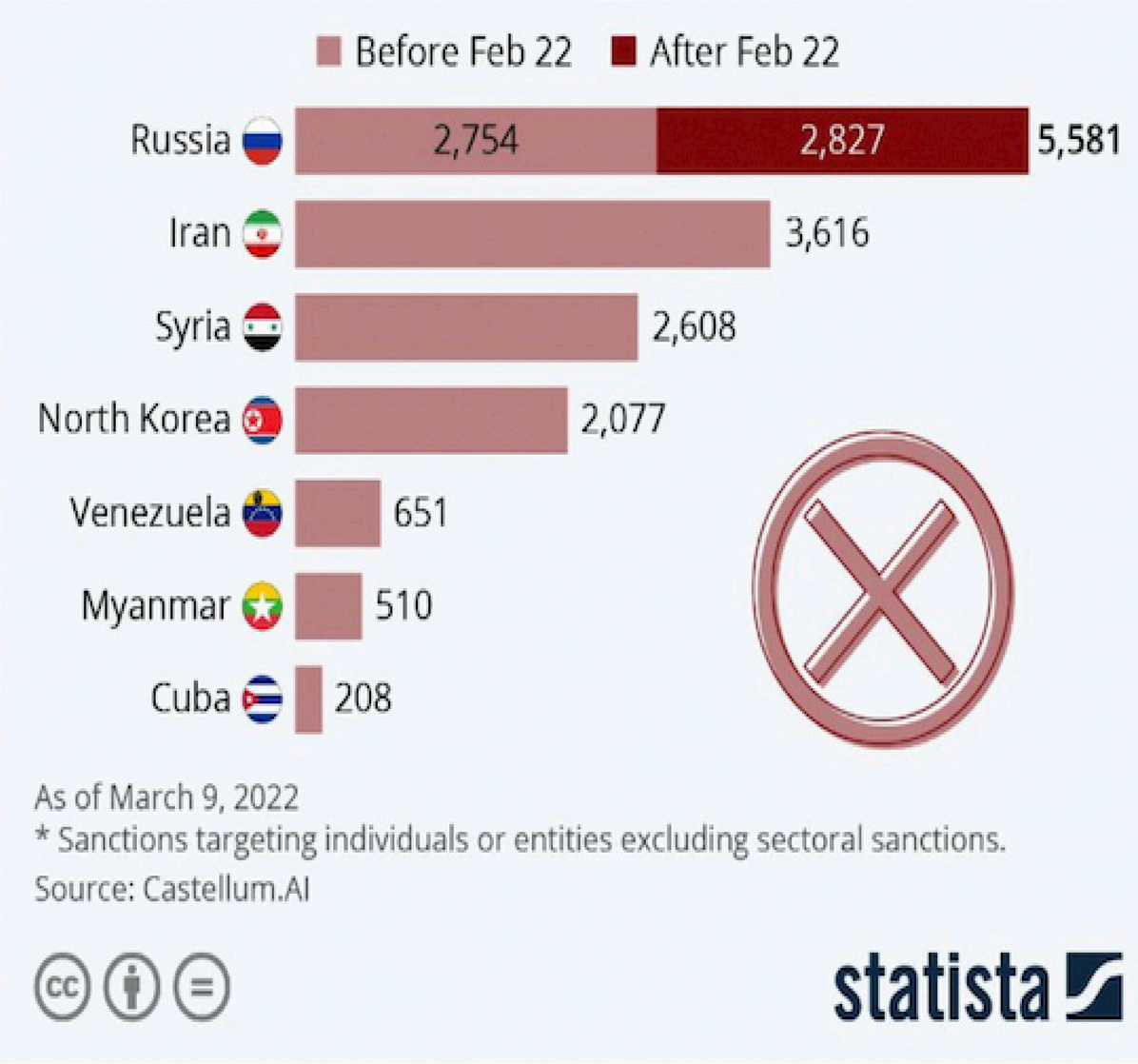
- **India, South Korea and Japan economies are the most exposed to any oil' price spikes.**
- It is not a coincidence, that **India is working on a Ruppee-Ruble settlement mechanism, eyeing cheap Russian oil.**
- Also **Saudi Arabia is in active talks with Beijing to price some of its oil sales to China in Yuan.**
- **70% of all the USD 100 bills are outside US, mostly because of the importance of Petro Dollar.**
- As we argued recently, a long term repercussion of the Ukraine-Russia crisis is the **break of the Eurodollar market hegemony (**see also slide 11).
- The process is actually starting much faster than the investor community was expecting.



Source: Syz group / Jeff Weniger

World's most-sanctioned countries

- Russia is the most sanctioned country and economists are expecting a **reduction of 15% of the Russian GDP** due to the crisis, which is in our eyes quite optimistic, if we take into consideration, that all Western companies exited Russia and the Chinese are not supporting at any prices. In the contrary, China is buying Russian oil and commodities, but at a substantial discount (oil around 30% discount).
- Important to notice on this chart, that China is not on the list. On one hand we are surprised, on the other hand is positive, because it means, **China** is definitely not interested to have more sanctions and therefore **is going to pressure Russia** to find an agreement on the Ukraine crisis.
- It is to be seeing, if US will let the PboC (Chinese central bank) buying Russian commodities with substantial discount, or new sanctions are issued also against China? We know, **China was the only country, which could keep undisturbed buying Venezuelan oil over all those years. Will also be the case with Russian oil?**



Source: Syz group

Bretton Woods III

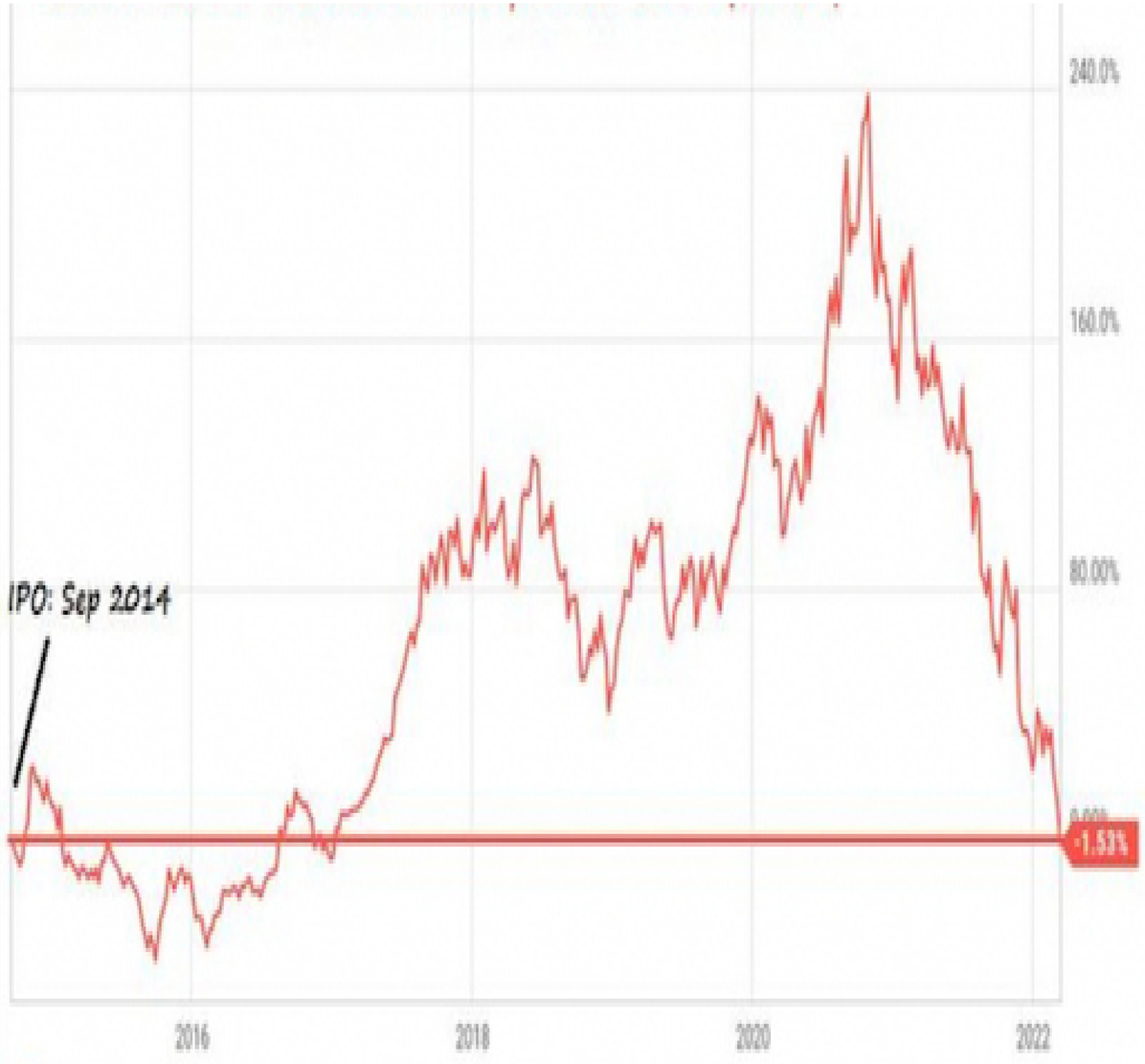
- Credit Suisse issued an interesting report entitled " the Bretton Woods III" arguing, that no one worldwide except the PBoC (Chinese central bank) can buy Russian commodities, profiting from the actual discount to spot prices.
- Theoretically the Chinese could sell US T-Bills in order to fund the leasing and filling of vessels with Russian commodities and because of the **attractive prices, the PBoC can control the Chinese inflation.**
- The longer term consequences would be **commodity shortages for the West,** which is translated into **economy recession, due to higher inflation and higher yields.**
- In addition, it is **negative for Treasury yields and the USD** on the longer term**.**
- The analyst of Credit Suisse sees also the possibility of QE printing renminbi in order to buy Russian commodities and the birth of the **Eurorenminbi** market, which would be the **first step to break the hegemony of the Eurodollar market.** This is also meaning inflationary environment for the West and less demand for long-term Treasuries.
- The conclusion of the research is, **inflation for the West** and this crisis is not like anything we have seen since President Nixon took the USD off gold in 1971, the end of the era of commodity-based money. When this crisis and war is over, the **USD should be much weaker** and, on the flipside, the renminbi much stronger, backed by a basket of commodities.
- **Therefore, from the Bretton Woods era backed by gold bullion, to Bretton Woods II backed by inside money (Treasuries with un-hedgeable confiscation risks), to Bretton Woods III backed by outside money (gold bullion and other commodities).**
- **The analyst conclude, that Bitcoin (if it still exists then) will probably also benefit from all this.**

Drinking less, drinking better

- Our best-in-class global equity selection fund Lindsell Train issued an interesting research on global changes in alcohol consumption and consumer habits.
- Basically market participants can sense a permanent **generational shifts**, where the influence of younger, more **health-conscious consumer are less likely to drink to excess** is instrumental in changing broader societal behaviors, as well as the never before seen availability of information about brands driving an increased emphasis on being selective and prioritizing provenance, heritage and authenticity when choosing what and how much to consume.
- In the **UK alone, alcohol consumption per adult dropped 10% between 1990 and 2017** and in the **USA, 2019 polling showed that 40% of drinking-age adults drink less than they did 5 years ago**. Apparently Covid shutdowns only seem to have accelerated these trends. KTS is honestly positive surprised.
- On the global basis, the picture is somewhat different: **total alcohol consumed per year increased 70% b**etween 1990 and 2017, driven exclusively by low and middle-income countries including **Vietnam, India and China.** In most cases, the alcohol consumed in such countries skews heavily to local beverages and brands.
- Lindsell Train invest in smaller, but higher priced and faster growing segment of “international branded spirits” , so-called **“premium spirits”**. Such trend will be supported from the generational shift towards consumers, which are going to drink less, but better quality. A example is the growth of premium Tequila and the portfolio position’s **Diageo** is profiting in this segment. The French company **Remy Cointreau** is an additional example, which can still profit of the **tremendous growth in China.**
- Finally the fund manager mentions the **trend of “low and no” alcohol beverage**, which are still a very small percentage of the total beverage alcohol, but is increasing substantially in recent years.

Alibaba

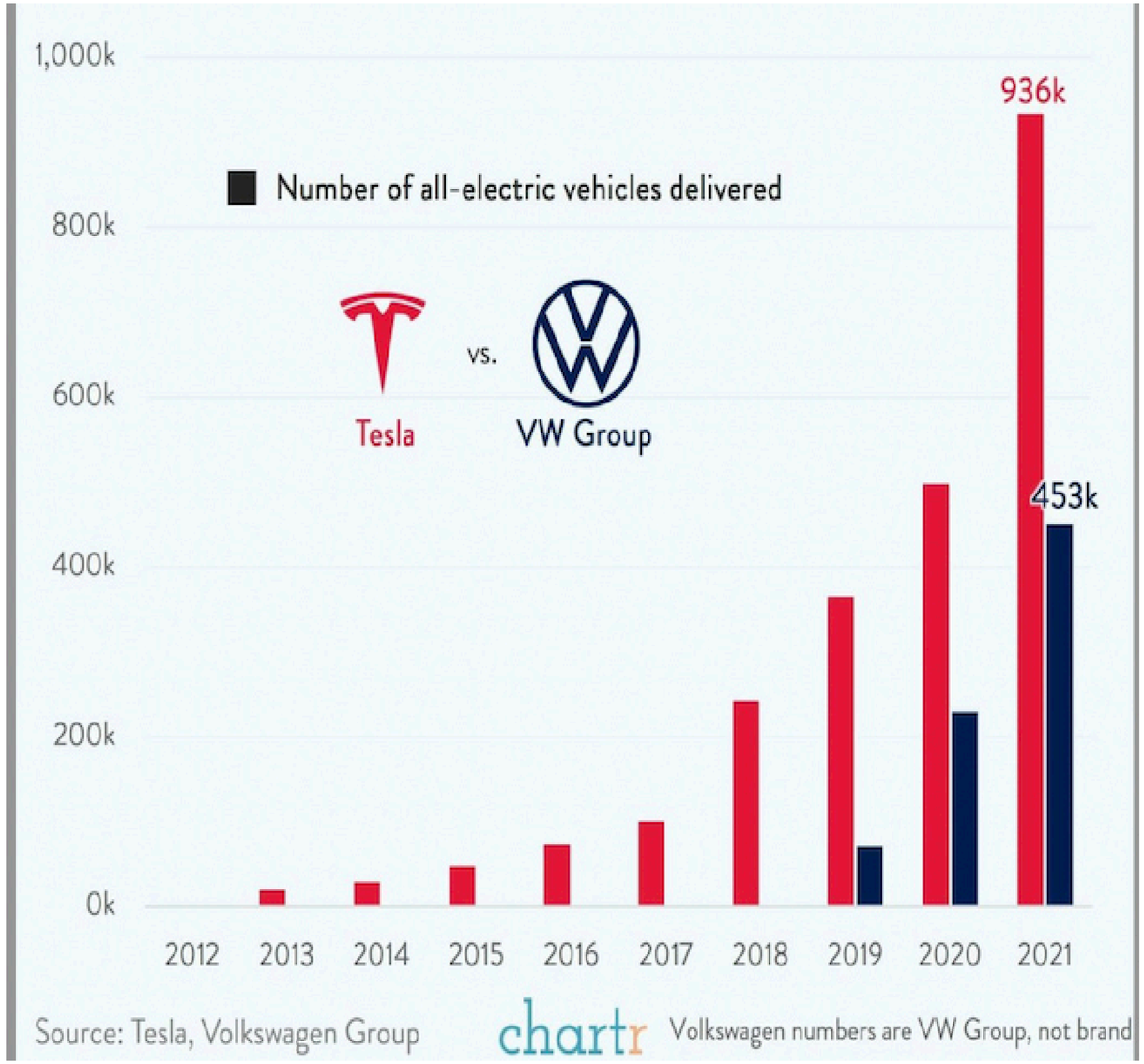
- **Alibaba returned to the IPO's level of September 2014**, correcting 70% from its highs.
- Meanwhile revenues have increase 1'400% , from USD 8.6 billion to USD 129 billion.
- Multiples used to be **24x sales, felt to 1.9x no**wadays and for this reason some market participants are arguing, Alibaba could be **one of the cheapest company in the world.**
- As the fund manager of the emerging market fund Stonehorn, Mr. Sam LeCornu, argues, **Chinese equities are extremely cheap and decoupled from fundamentals.**
- Market participants are arguing that the last "wash out" was mainly caused from the execution of stop losses on HSCEI-linked autocallable structures and **it was basically the capitulation day. The worse should be behind us.**
- Apparently Chinese authorities are also actively engaged with the SEC on solving the dilemma of access to audits of Chinese companies quoted in USA, avoiding the risk of a delisting.



Source: Syz group, via Charliebilello

VW groups is 12-15 months behind Tesla on EV deliveries

- According to market participants, it is impressive the speed at which VW have managed to gain traction in the electric vehicle market.
- This are actually good news for our investment into the Croatian private company Rimac, which is profiting of this trend, having Porsche as biggest shareholder and having VW integrating the brand Bugatti under the Rimac holding.



Source: James Eagle

Russian outstanding debt

- Russian bonds strongly rebounded last week, because interest rates have being paid, avoiding for the moment a default.
- JPMorgan was able to process the payment to Citigroup from interest payments due on dollar bonds held by the Russian government. The question is, how the Russian government will be able to satisfy next interest payments.
- On the right hand chart we can notice the exposure by country on the outstanding Russian debt.

Picture Title

Diamonds

- 1 carat fine diamonds are up 50% and market participants are arguing, diamonds are still the easier way to move large amounts of wealth without confiscation fears?

Source: Syz group / zerohedge

General news

- Fantastic 2min on oil supply: and the winner is?
- https://www.linkedin.com/posts/activity-6907534207346954241-XCGa?utm_source=linkedin_share&utm_medium=ios_app
- Market participants are arguing, that the actual ratio gold to silver is diverging from the supply dynamics. At the moment, an investor can buy with one ounce of gold, around 77 ounces of silver. Mr. Jeff Weniger argues, the price ratio diverges from the supply dynamics, **having for instance each year only 8 ounces of silver mined for every 1 ounce of gold. In the earth itself, silver is 19 times more abundant than gold, so why the market is paying 77.3x?**

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