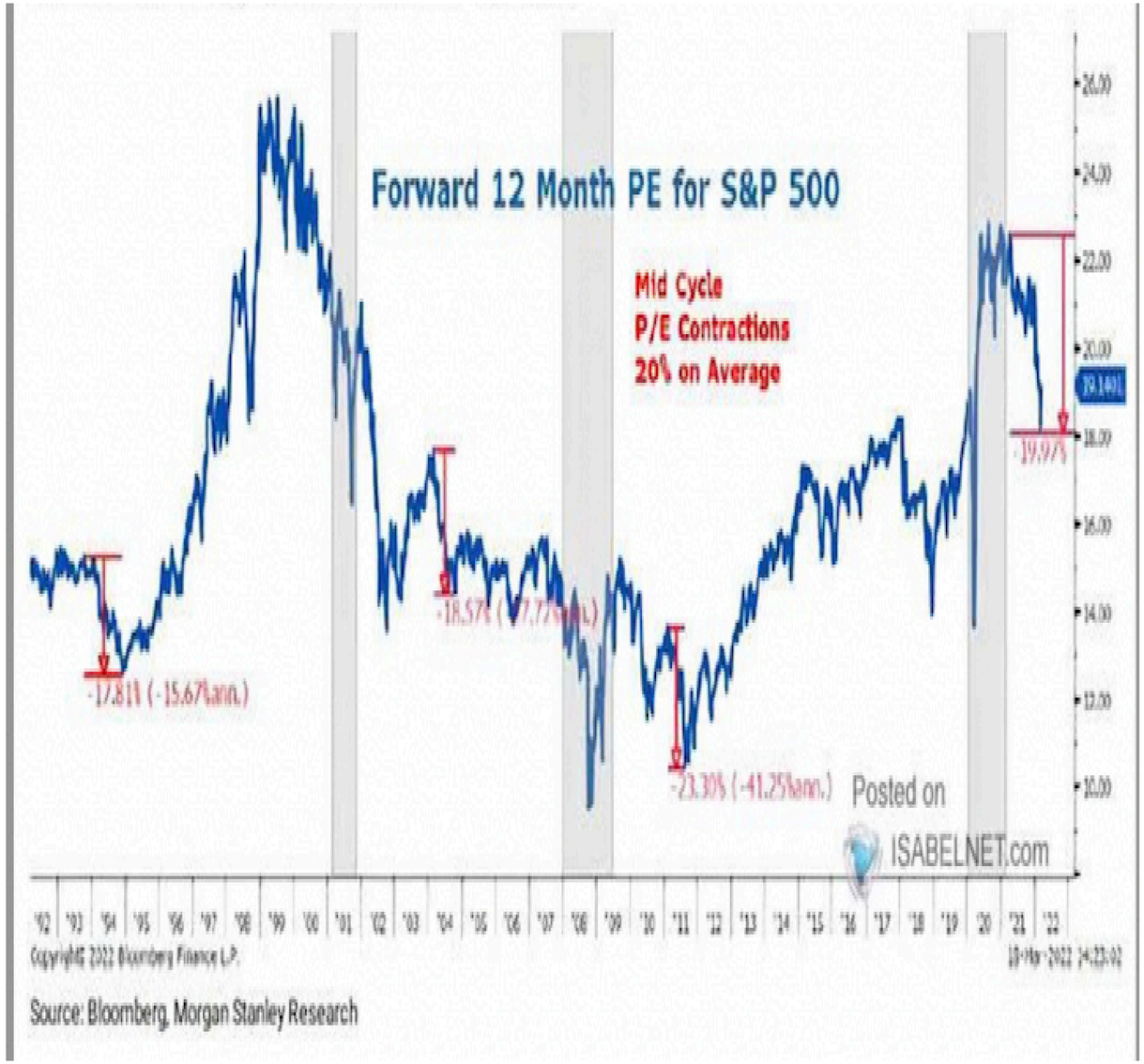
KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 14

The 8th of April 2022

What is the market discounting?

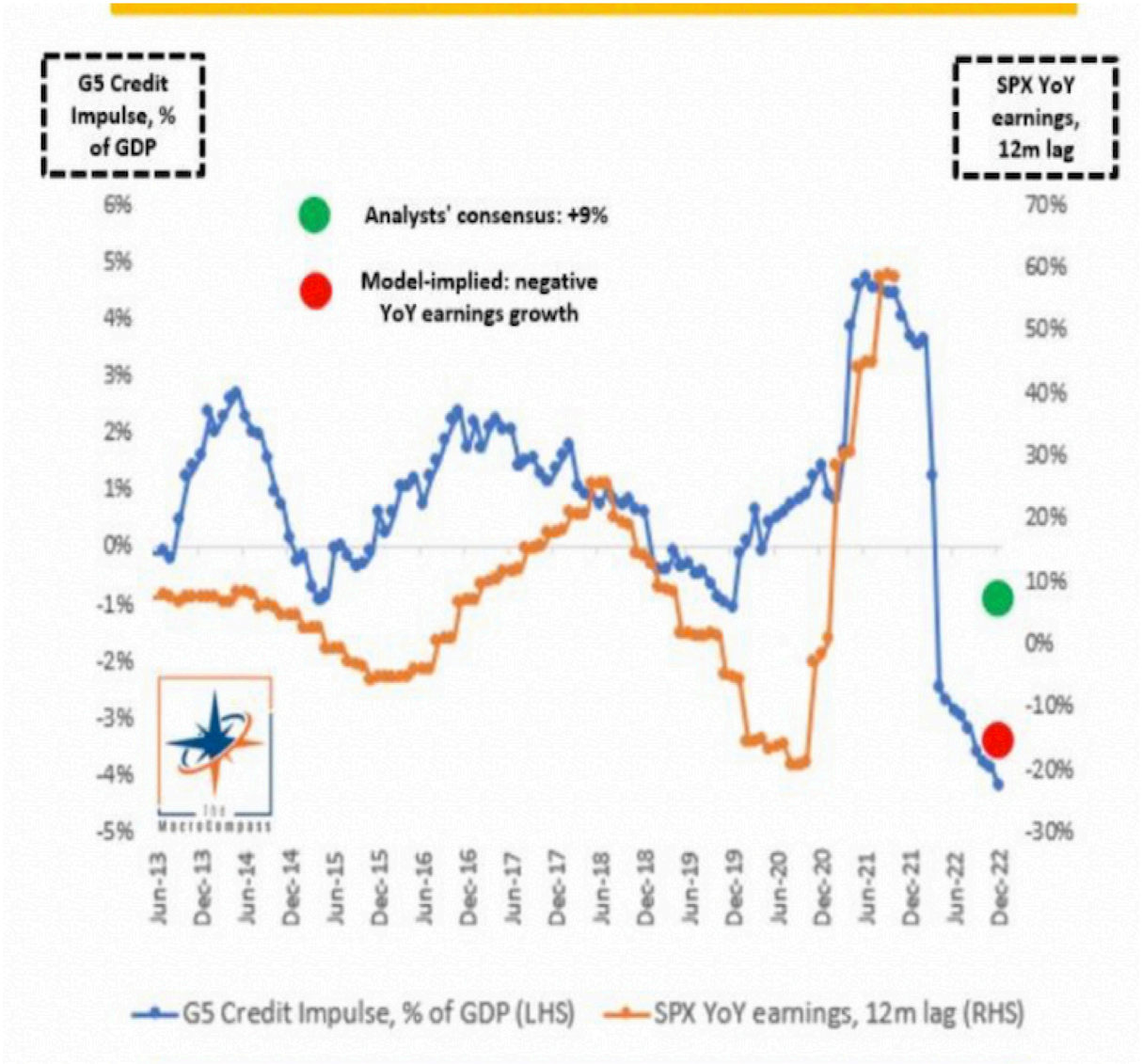
- According to Morgan Stanley the forward 12 months PE for the S&P 500 Index has dropped by 20% from the recent peak.
- The S&P 500 Index was down 14% from the highs and now only 6%, that means, the investor community is expecting a rebound of the economy sooner than later.
- Other market participants are arguing that historically, mid-cycle transitions have seen P/E contractions of 20% and then equity markets have seen a rebound, therefore asserting that the worst is over.
- Mr. Yardeni thinks that lower growth is going to be offset by higher inflation and companies are going to rise prices. For this reason Mr. Yardeni increased the outlook for both revenues and earnings recently, with the conditions that rising costs are offset by price increases and productivity gains. Mr. Yardeni also asserts that industry analysts continue to raise their 2022 and 2023 estimates for both S&P 500 revenues and earnings.
- In our opinion it is too early to be overly optimistic. As argued last week, we stay invested, but we bought 0.5% in put options.



Source: Morgan Stanley Research / via Mr. Mukesh Jindal

Credit impulse: sharpest credit impulse contraction in 10 years

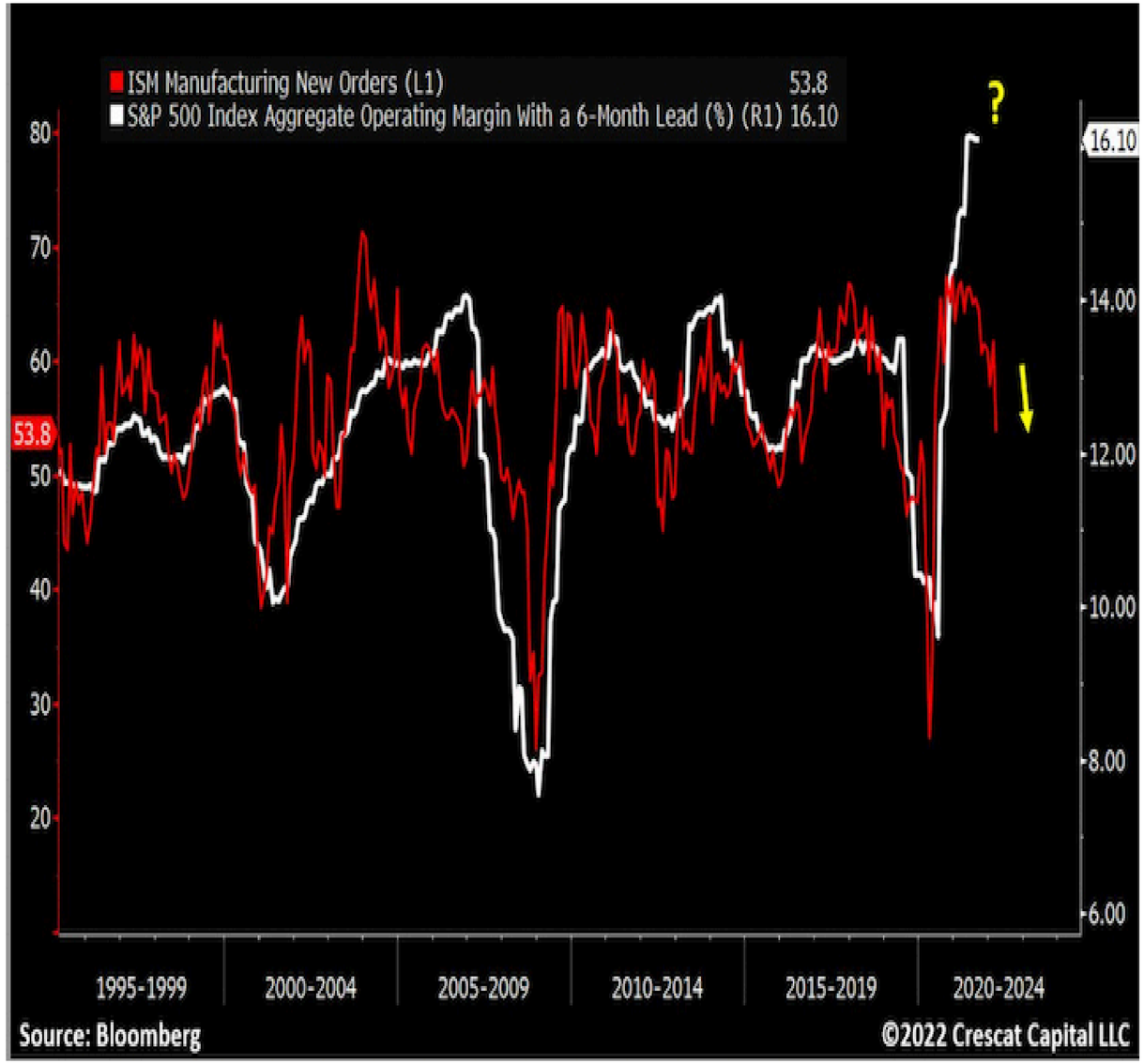
- Mr. Peccatiello argues that the global economy is in the midst of the sharpest credit impulse contraction over the last few decades.
- Basically, the G5 credit impulse as % of GDP (blue line) is forecasting lower S&P 500 YoY earnings growth in the next 12 months, meanwhile general analysts consensus is still at +9% .
- Governments created new spendable money for the private sector via stimulus checks, tax cuts, etc, but commercial banks are creating new spendable money with new loans to the private sector.
- The credit impulse indicator is showing that the flow of credit into the real economy is very slow, which is translated in lower global economy's growth.
- **Mr. Peccatiello is negative on EPS growth and expects further analyst' EPS downgrades,** which would be translated into lower equity markets.



Source: Mr. Alfonso Peccatiello, The Macro Compass

ISM Manufacturing new orders vs corporate margins

- On the right hand chart, courtesy Mr. Otavio Costa, we can notice how the ISM manufacturing new orders index is declining and therefore indicating lower corporate margins in the future.
- There are multiple indicators foreseeing difficult times ahead and therefore KTS is on the sideline for the moment.



Source: Crescat capital LLC

Inverted yield curve

- On the right hand chart we can notice the performance of the S&P 500 Index after the 2-10 year US Treasury yield inversion happened.
- **After a period of 6 and 12 months, most of the times the Index experienced a positive performance.**
- After Federal Reserve Governor Leal Brainard calling curbing inflation pressures and indicating that the FED needs to increase the pace of balance sheet shrinking and interest rates increase, market participants are again nervous on a quicker than expected quantitative tightening, also confirmed on FED speech the 6.4.22.
- Meanwhile, according to Mr. Timmer, Fidelity, the risk free rate in US (10-year) is 2.5%, but the implied equity risk premium (iERP) has collapsed from 3.6% a few week ago to a 2.5%, and therefore the discount rate (WACC) for the DCF model is basically unchanged at 5%, supporting equity markets.
- KTS is not trading on the short term and we are expecting a choppy market up to November's US election. We stay invested in our mega trends, but bought some put options has protection.

Date of yield inversion	1-Month Later	3-Month Later	6-Months Later	12-Months Later
August 1978	-2%	-11%	-6%	3%
September 1980	5%	3%	7%	-4%
December 1988	3%	7%	17%	27%
May 1998	4%	-1%	6%	17%
February 2000	0%	0%	2%	-3%
December 2005	2%	4%	-1%	14%
August 2019	4%	9%	4%	21%
Average	2%	2%	4%	11%

Source: Truist Advisory Services

Source: Flowbank/Truist

Monthly return stats for the S&P 500 1964-2020: April the best month

- Multiple statistics are pointing out that April is historically the best month for the S&P 500 Index in terms of average return and proportion of times positive.
- To be noticed, that 26% of the time also April was negative and the worst drawdown was -9%
- Meanwhile many market participants are arguing that companies are continuously buying back their own shares, which is strongly supporting equity markets. The S&P 500 index has just experienced a **record high USD 403.7 in share buyback programs** (monthly averaging of USD 120 bn). Companies are also increasing dividends and M&A activities picked up.
- According to Mr. Timmer, Fidelity, market's breadth is quite good, having 76% of stocks in the S&P 500 Index trading above their 50-day moving average.
- **KTS is also expecting, like some market participants, a choppy and erratic market activity during the next months, up to November's US election.**

	Avg Return	% Positive	Best	Worst	Std Dev
Jan	1.1%	60%	13%	-9%	5.0%
Feb	0.0%	54%	7%	-11%	3.9%
Mar	0.9%	63%	10%	-13%	3.9%
Apr	1.7%	74%	13%	-9%	3.9%
May	0.2%	58%	9%	-8%	3.7%
Jun	0.2%	58%	7%	-9%	3.3%
Jul	0.6%	51%	9%	-8%	4.1%
Aug	0.1%	56%	12%	-15%	4.8%
Sep	-0.4%	47%	9%	-12%	4.3%
Oct	0.9%	60%	16%	-22%	6.0%
Nov	1.4%	68%	11%	-11%	4.4%
Dec	1.3%	72%	11%	-9%	3.4%

Source: Topdown Charts, Refinitiv topdowncharts.com

Source: Callum Thomas

General news

- According to statistics, the equity exposure of hedge funds is at minimum levels, same like March 2020, which make sense, having too many unpredictable uncertainties.
- **The New York Times reported a study, whereby 30% to 40% of coronavirus deaths in the U.S. have occurred among people with diabetes.**
- China signaled it would increase monetary policy effort in order to combat an escalating covid outbreak, slumping property market and spiking commodity prices. Officials will use monetary policy tools at an “appropriate time” and consider other measures to boost consumption. Chinese authorities want to stabilize the economy, but obviously market participants are questioning how realistic is the target growth of 5.5% for the year.
- On the French election, Mr. President Emmanuel Macron is leading over Ms. Le Pen and therefore we should not experience negative surprises.

General news on cryptos

- The UK government sets out a plan to make a global cryptoasset technology hub. The government aims at recognised stablecoins as a valid form of payment as part of a wider plan to make Britain a global hub for cryptoasset technology and investments. This is quite a U turn, having had FCA quite critical on crypto currencies and clients in UK not being able to buy crypto assets. We believe, also UK has recognized, that the currency world is changing, especially after the world Russia-Ukraine, and the UK government is adapting itself.

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