KTS CAPITAL MANAGEMENT

KTS weekly update Nr. 14

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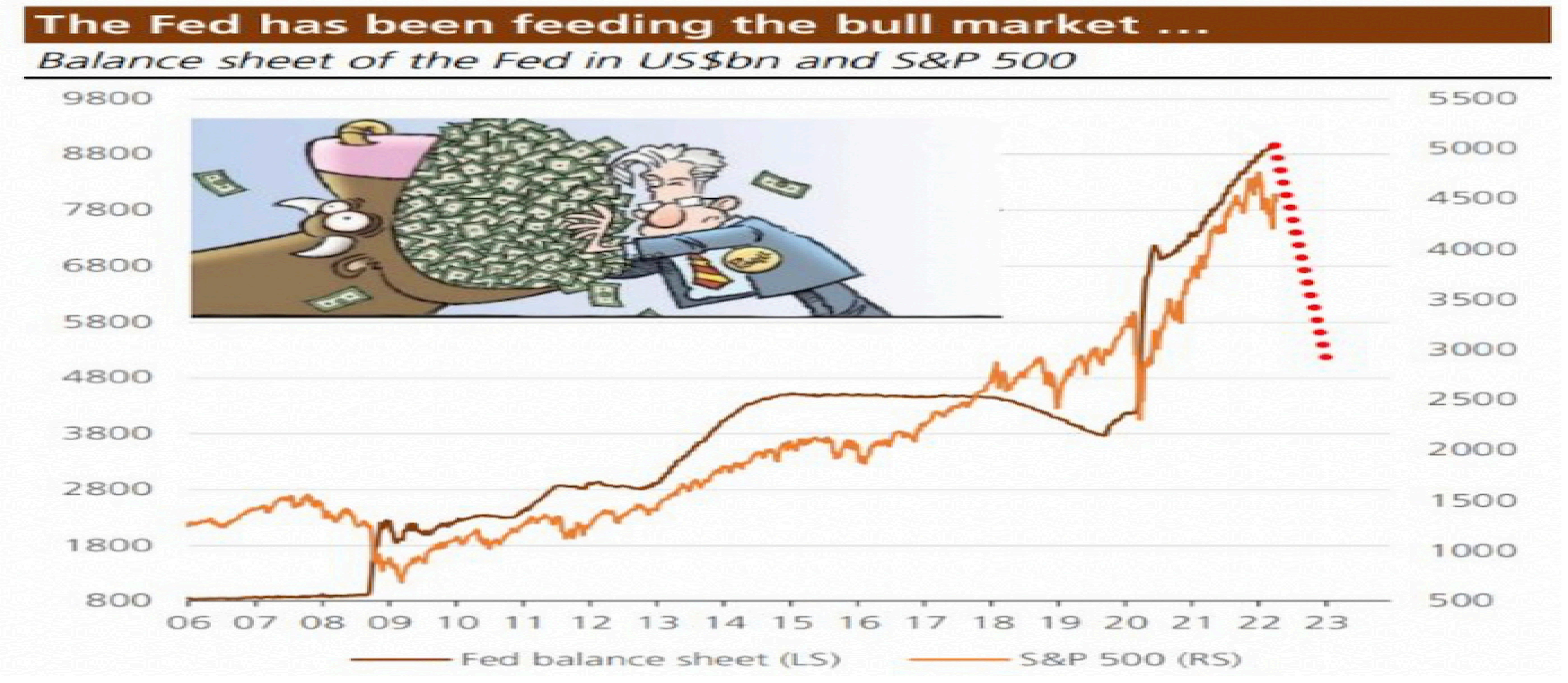
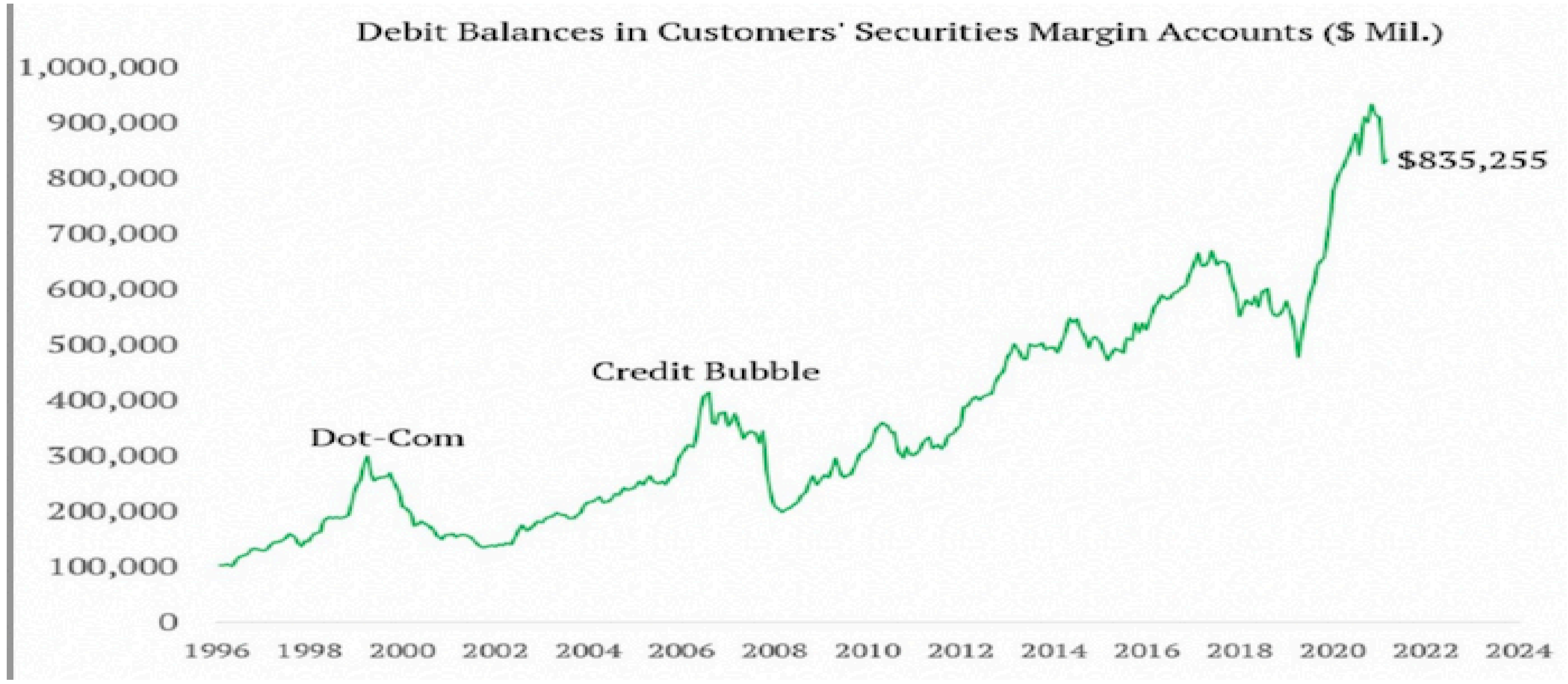
FED QT (quantitative tightening) and market's leverage

- Market participants are worrying on the equity market's upside potential while the FED is starting the QT program, arguing that the bull market has being fueled by the huge injection of liquidity (left hand chart).
- In addition, the investment community also argue that the leverage is still at highs and could be a real danger if equity markets would strongly correct due to persistent high inflation fears, prolonged Ukraine's war, hawkish FED, etc.
- Finally, economists like Mr. Yardeni think that if the FED really wants to decrease the inflation at 2%, analyzing the history, it would be possible only with a recession.
- We understand the worries and honestly speaking we do not have the "crystal ball to read the future", but we genuinely believe that we are in a new cycle and mega trends are going to support equity markets. Nevertheless, **KTS also thinks that there are too many unpredictable uncertainties and therefore we are also focussing on hedge strategies.**



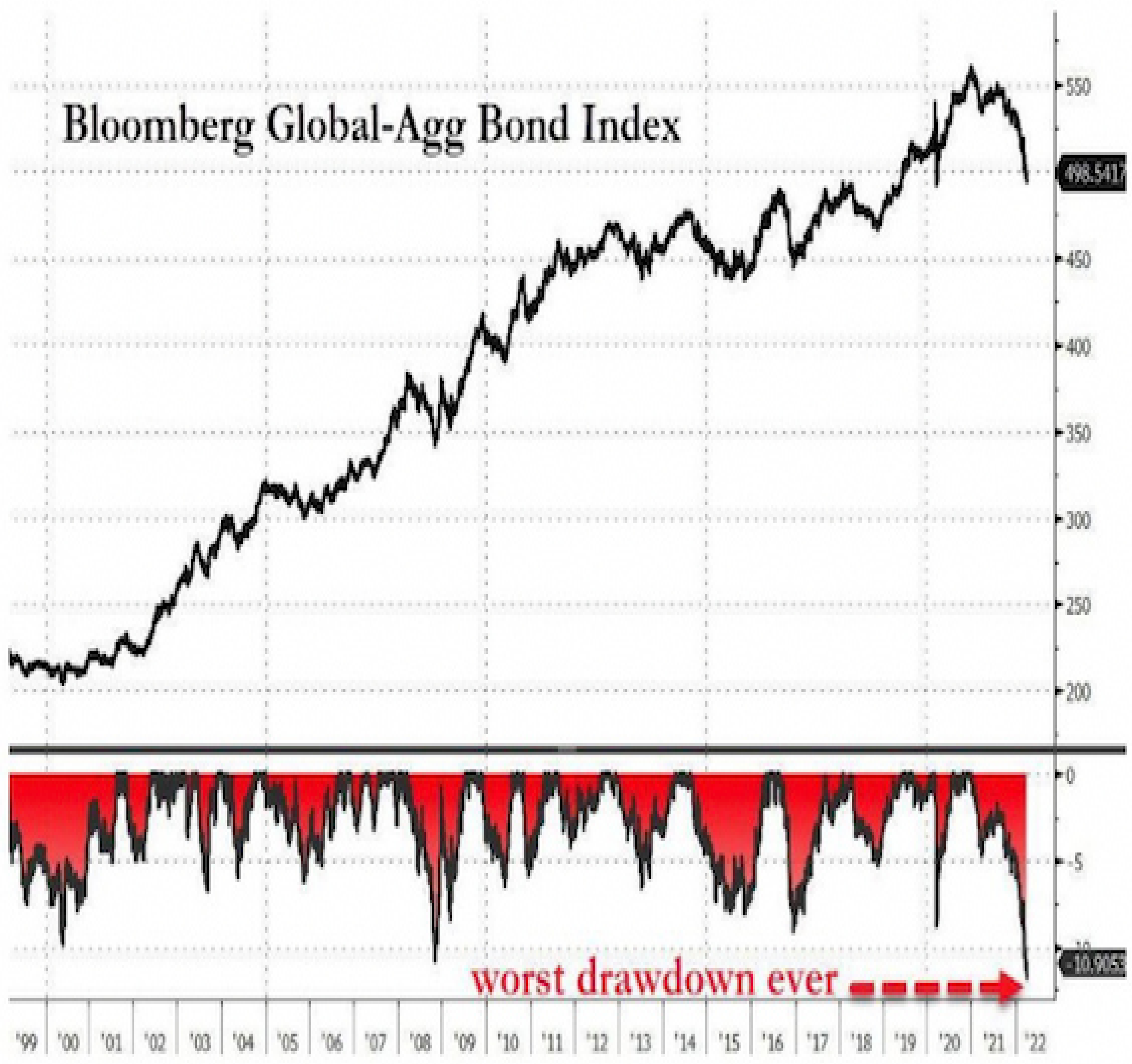
Source: Mr. Dr. Thorsten Polleit, via Refinitiv



Source: FINRA, via Mr. Monchau

Global bond market just suffered its greatest drawdown on record

- We would like to mention, that KTS was arguing since years now that it does not make any sense for clients to invest in developed market bonds. The risk of rising interest rates vs real yields is just not worth the investment. Even if KTS still thinks that long term interest rates will most probably stay lower for longer, having developed countries with high debt, KTS was reducing the fixed income risk, by investing into alternative fixed income strategies with low duration and better risk profile.
- Bond's performance is suffering since 2020 now, but KTS' fixed income strategies could avoid very well the substantial drawdown and continue to reach constant positive yields.
- Some market participants, by analyzing the correlation of the FED's balance sheet vs. the bond benchmark, are arguing that the QE of the FED was fulling the bull market of bonds, rather than equity markets. **We think that equity markets are being strongly supported by increasing earning of companies, and also by substantial share buyback programs and dividend increases.**



Source: zerohedge/Syz group

Bullwhip effect

- The majority of the investment community is focussed on actual high inflation' numbers and fears a hawkish tone of the FED with further interest rate increasings in the next meetings. In addition, investors fear the consequences of the 0 Covid policy in China, foreseeing supply disruptions, which are going to be translated into even higher inflation. We can sense that the actual equity market volatility is driven from such fears.
- We were reading a highly interesting article in the blog freightwaves.com explaining the supply chain "bullwhip effect", which supposed to be predictable and expected. Such article reconnect to statements made by the CIO of Credit Suisse and Flossbach at the end of 2021, where investors could sense an inflated demand in goods, in order to get the needed quantity. When orders did not arrive as planned, retails and companies ordered more. This mechanism could lead to an unprecedented levels of production, which is also translated into an inventory's increase.
- But earlier this year, consumers pulled back, meanwhile production was keeping on, piling up warehouse inventories. Now consumers have shifted away from consuming physical products and have started to consume services and the writer asserts that because of the rapid inflation, inventories appear artificially higher and the numbers have been deflated by the consumer price index (CPI), concluding that, inflation has been stripped out to reflect the true growth in inventory volume and not just the price.
- The study is based on the trucking and freight demand, which has recently slowed. The same effect is to be seen in the used car market, which was responsible for 40% of the inflation rate last year.
- Also lumber prices are coming down. The real estate market is cooling down, having mortgage rates increasing.
- **Therefore the conclusion is, with things normalizing and inflation cooling down, this should be good news for the FED, the global economy and equity markets.**

Next generation of Fintechs

- As our clients know, we are invested in the next generation of the green transition via the Croatian private company Rimac, and also in the next 5G, telecom and health digitalization mega trends, via our Swisscom venture capital engagement.
- But we are also invested in the next generation of banking and according to the webpage of one of our investment, Twig (www.twigcard.com, which is the fastest growing fintech in Europe), the app is a bank of things and the next generation banking, empowering the circular economy, leading the Web 3.0 green payment infrastructure. **The app has been awarded from “the independent” as top 5 financial app to save the planet.**
- TC TechCrunch comments on the app: Twig enables users to “tokenize” real-world assets and make them tradable in seconds. As our clients can remember our research on Decentralized finance (DeFi) and metaverse (KTS weekly report nr. 35, on the 1st October 2021), we were explaining that blockchain technologies will be able to rationalize banking processes, enabling the increase in efficiency and a substantial reduction of costs. Twig is the perfect example.
- We are trilled to be part of the new “Revolut” . Most probably is Twig going to be valued at USD 1 billion in the coming round and it would become a new unicorn. Such valuation would clearly catapult the valuation of our position to at least 5x, which is still in our portfolio at cost price. Once again, **we have a tremendous hidden upside potential in our flagship fund of fund Optima dynamic** and is going to be materialized in the next months, step by step. The next substantial increase going to be the re-valuation of our position in the company Rimac, around April-Mai 2022.
- The other 2 most important apps, in which KTS is also invested, are the German company Grover (www.grover.com) and the Italian start up Scalapay (www.scalapay.com), which are based on the model “buy now, pay later” (BNPL). Both companies are also new unicorns, experiencing a tremendous growth and still having substantial potential, being in the right mega trends.

General news

- Macron is leading over LePen 29% vs 23% and therefore he is likely to win a second mandate. This should be a good news for Europe and European equity markets.
- Finland, and apparently also Sweden, are thinking about the membership of Nato. This would definitely add tensions to the already very fragile situation at the border with Russia, in addition to the fact that the only real solution on the table to dissolve the conflict between Ukraine and Russia, would have being a neutral Ukraine. Market participants were comparing such solution to Finland, but now having Finns thinking to join the Nato, it is difficult to predict, if something is going to change also on peace talks?! Latest comments of Mr. Putin are clearly stating, that “peace talks are at dead end”.
- In addition, we are unfortunately reading, that Russia intended to drastically intensify the battle in Ukraine, planning new attacks. Meanwhile Western countries are heavily supplying Ukraine with billions of dollars worth of weapons.
- Interesting, we are also reading a new discussion amongst investors, that defense and armament producers should be newly consider as ESG stocks, because any country has the right to defense itself. It is quite a U-turn in the discussion compared to a few months ago. KTS is invested in attractive mega trends, therefore we believe, we do not need to consider an investment into the defense sector.
- It is really annoying to read that the conflict between Russia and Ukraine is not cooling down, on the contrary. Analyzing the low equity market’s volatility, we start to sense, that even if the situation is dramatic, market participants start to accept a prolonged outcome as new normal.

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