KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 18

The 6th of May 2022

The FED

- With a hike of 50 basis points and the start of the QT (quantitative tightening) capped at USD 47.5 billion for the first 3 months starting from the 1st of June and growing to USD 95 bn, the news is dovish in the eyes of the investor community and under consensus, especially with Mr. Powell rejecting the idea of even more aggressive actions, like a 75 basis points rate hike. Nota bene the FED's QT plan is to shrink by USD 522.5 bn by year-end but the current size is USD 8.96 trillion, and if the pace is kept constant, in 2023 the amount will be reduced by further USD 1.1 trillion. We would still have around USD 7.5 trillion outstanding!
- In the press conference, Chairman Powell said he still believes in a soft landing thanks to accumulated savings, a stronger balance sheet and a tighter labor market, asserting that the US economy is very strong and well positioned to handle tighter monetary policy, but the inflation is too high.
- We think that the FED is not in the position to take extreme steps, especially because having **China with 400 mio citizens in lockdowns and statistics showing that the world's second largest economy is falling into a recession** (manufacturing and non manufacturing purchasing managers indexes dropped sharply below 50 during March in addition to property market recession), market participants are convinced, that we have not seen the worse part of the supply disruption yet.
- On the other hand, certain investors are arguing, that China' lockdowns have a positive side, in fact, commodities prices are falling and it should help inflation rates to also fall. Pictet Asset managers argue, that most probably the FED reacted too strong on rising rates and in a few months it could be, that interest rates are going to be reduced again. **According to their statistics, the 1 year inflation' expectation is now at 5.4%, but the 5 years is at 3% and in-between around 2.5% !**
- **The Bank Pictet also argues that because of such expectation and having US Treasury drawdowns from all-time highs, it is time to buy long term US bonds.** We tend to agree, the worst part of the bond's drawdown is done.

The FED

- The equity market's reaction on the 4th of May was very positive, basically the **volume of the stocks rallying was 8.8x higher than the stocks falling. Such events happened during market' corrections in Q4 2018 and March 2020**. The most remarkable rally was experienced by the "meme stocks" and highest multiple names, we suppose, **it was more a short-covering movement** rather than new investors buying. In fact, there are just too many uncertainties around, in order to call the 4th of May the bottom of the equity market and the negative market's reaction on the following day is the proof of it. Also **precious metals are now reacting correlated to the FED rate hikes**, rather than any other fundamentals as for example the non-correlation to the USD or geopolitical tensions to mention a few. We are analyzing more in depth in the next slides, where the equity market bottom could be.
- We all have understood, market' reactions are not driven by geopolitical tensions, but rather by the rising of the inflation. Pictet asset managers, and many other market participants, are rightly arguing that, even if the oil price would rise to USD 180 because of the newly introduced European oil bans to Russia, the inflation going forward is **not going to increase more than the actual 7.2%. As we have recently analyzed, also Pictet argues that the consumption's dependency on oil is currently 69% lower than in the 70' and therefore the oil price's increase has a substantial minor impact compared to the 70' .**
- The FED also started monitoring closely the chart of Job openings per unemployed person in the US, which is now at new highs. Basically around 2 million of the US workforce seems to have just left for better jobs and therefore higher salaries, which is translated into **wage inflation,** a subject, which was actually mentioned already by our best - in - class fund Classic global at the end of last year.

The FED

- The most important subject in order to understand, if US is not falling into a recession, is the **behavior of consumers in the housing sector,** which is the most important sector leading the economy's growth in US. As we have seen in our weekly report nr. 6 on the 11th of February 2022, **new households are the pillar for future economic growth in US,** because millennials are starting buying houses and compared to the trend before the GFC in 2008, there is still a substantial upside potential. Having the 30y mortgage rate increasing over 5%, market participants are rightly asking the sustainability of the sector's growth.
- **But Mr. Rich Excell is rightly pointing out, analyzing the housing bubble's collapse in 2006, it was not mortgage rates the main reason of such collapse (used to be much higher than 5%), rather the job market. Housing did not recover until jobs recovered and rates matter marginally. Therefore, having at present time a very strong job market, housing should remain strong, which is translated in orders, profits and employment.** Also the Swiss Bank Pictet is arguing, that the US labour market is very strong and therefore there is not reason to expect a recession in the US yet. **Even though, Pictet is negative on equity, because earning of US companies can not enjoy anymore from tax cuts, interest rate at 0% and globalization.** On the subject globalization, some countries are going to profit from the new trend of independency on technology, chip, innovation, commodities and Europe should growth above average, having governments supporting any sector, which going to help to increase such independency. KTS believes to be well exposure to such innovations, like the private company Rimac, the VC funds Swisscom and Fasanara and the investments in special metals.
- KTS strongly believes that we are still in a strong economic cycle and as soon the short term situation and inflation is going to normalize, equity markets will rally further. But, we are still waiting to see clear indications for a bottom of the equity market, before reinvesting our liquidity and totally close our hedge position.

Next support for equity markets

- We have to differentiate the West from Asia, with the Chinese Index Shanghai Shenzhen CSI 300 trying to bottom since March 2022 and the Chinese central bank increasing measures to support the economy and equity markets, in addition to tech giants substantially increasing share buyback programs and Chinese authorities talking to institutional investors to buy equities and support equity markets.
- US indexes are trying to consolidate at a very important support, the lows of February 2022, and if indexes would break down such levels, next technical, but also fundamental, support is around 15% lower, as indicated in the next slides.
- We also have to differentiate between stocks, because more than **45% of stocks are already down 50% YTD, 22% even 75% and finally 5% are down 90%**. **Last time we had such situation, it was October 2000, October 2002, and November 2008,** where basically equity markets bottomed.
- A comparison of the "momentum ETF ARKK" with the Nasdaq's correction in year 2000, is actually showing the possibility of a strong short term rebound. It is also quite impressive, even if the ETF corrected more than 50% YTD, it could still experience substantial inflows, meanwhile many other sector ETFs experience heavy outflows. This is a proof, that Ms. Cathie Wood is still well respected and almost a cult.
- We think, if equity markets are going to correct further, is going to be the turn of the FAANGS. KTS bought put options few weeks ago in order to hedge exactly the correction of major tech companies, which have not substantially corrected yet, but after some disappointing Q1 results, some are starting to correct, like for example Amazon and Alphabet, to mention few names. Having the major US companies substantially buying back shares, therefore giving a floor, it is always worth to analyze, if volatility levels are attractive enough to sell some put options with the recent correction due to Q1 and outlook disappointments.

Next support for equity markets

- Meanwhile, having the put position tripled, KTS sold 1/3 on the 3rd of May in order to "cash out" the invested capital in the options. This is the perfect example, how KTS optimizes the volatility of our flagship Optima dynamic fund, trying to limit the drawdown.
- Some market participants are arguing, that every time the Nasdaq Index traded below the 100 week moving average, the market bottomed. **This happened 3 times: 2016, 2018 and finally March 2020. We have to admit, as we can notice in the next slides, that the real bottom was at the 200 week moving average, which is still around 14% lower from nowadays levels.** KTS builded up 15% liquidity in the last weeks in order to buy again at such lower levels or at any "capitulation day". **Entering the weak seasonal period of equity markets, it is time to wait and see what is going to happen.**
- Market experts like Mr. Yardeni are arguing, that valuations are starting to discount a recession (Nasdaq 100 Index is trading at 5.9x price to sales from 8.5x and forward P/E of the S&P 500 Index fell from 21.4x to 17.6x), but there is no bottom yet. **The collapse of the S&P 500 forward P/E in April 2022 by 10% is the largest drop since August 1998! Even higher than the GFC in 2008 and the market's correction in early 2000s** (according to Charles Schwab, via Mr. Monchau of Syz group). We think, investors are waiting for the "capitulation day", before increasing again equity positions. Everyone is arguing, the FED can not reduce the high inflation, without having a recession, but the **probability of recession indicator calculated from the yield curve from the Federal Reserve Bank of Cleveland does not foresee any recession any time soon**.

Next support for equity markets

- Finally, forward P/E is falling, but analysts have been raising their estimates for the S&P 500 revenues per share and earnings per share to record highs for both 2022 and 2023. We have do admit, we agree with the observation of our dear friend Mr. Mario Montagnani, Bank Vontobel, asserting that the **upward revisions is basically coming from energy stocks** and a few other sectors linked to commodities, which despite a modest 5% weighting within the S&P 500 Index, had the contribution of 70% of the EPS growth forecasts! Who is going to be right? In any case, valuations are starting to strongly support equity markets and are already starting to discount any disappointments on economic growth during Q2 2022. Some investors start to argue, US bonds are offering an alternative to equity. We do not think so, because even if **nominal interest rates increased, real rates are still negative and therefore equities are the only alternative to reach positive real yields.**
- Meanwhile, the **2-week rolling sum of equity fund flows is at extreme outflows at levels of October 2008 (Post-Lehman), August 2011 (US debt downgrade and EU crisis), March 2020 Pandemic and September 2020.** These are signs of capitulation or we are nearing to it.
- **Warren Buffett announced to have been investing USD 41 billion in stocks during the market's correction** in the first quarter of 2022, after being selling stocks for the past 2 years. Berkshire Hathaway is still holding around USD 100 billion in liquidity to be invested in good market opportunities.
- KTS believes that, if equity markets are going to further correct an additional 15% to strong support levels, it would be a good buy opportunity, because we have the conviction, that this time it is different than during the pandemic's correction, where it was definitely too difficult to analyze, when the world would return to normal. In addition, with such extreme pessimistic sentiment, any positive news on peace talks on the Ukraine-Russia conflict could trigger a substantial rebound of equity markets.

Next support for equity markets

- This time, Western governments will have to realize, that having the global economy in recession because of a **prolonged conflict in Ukraine, will have negative consequences on re-election,** having the public opinion increasing criticism on the behavior of policy makers. US will already have the **Congress elections on November this year** with the high risk of the Republicans to win back the majority! In Germany for example, the population starts to wonder, how a peaceful “green” party could support the delivery of heavy weapons to Ukraine instead of focusing on peace talks. Even the magazine “Der Spiegel” had the front page title “Die Olivgrünen” , basically arguing, that the “green party” wants to increase peace with more weapons, which is not only a contradiction, but is not in line with the promises done during elections: no weapons delivery in war zones!
- Similar criticism is also to be noticed around the globe in many other countries. **Also from most important media around the globe, it is quite clear, that a negotiated peace is the only way to end Russia’s war on Ukraine.**
- Mr. Putin is also not in a better position, having the Russian elite under sanctions. We are reading the constant warnings from the side of Russia on a nuclear WWIII, but we strongly believe, China will not allow such step to Mr. Putin. Of course, unfortunately, it only a guess, more than a prediction. **Actually it does not make any sense to discuss a nuclear WWIII,** because if it would really happen, basically no one is going to survive it and it does not matter anymore if an investor is holding cash, gold or whatever asset class.

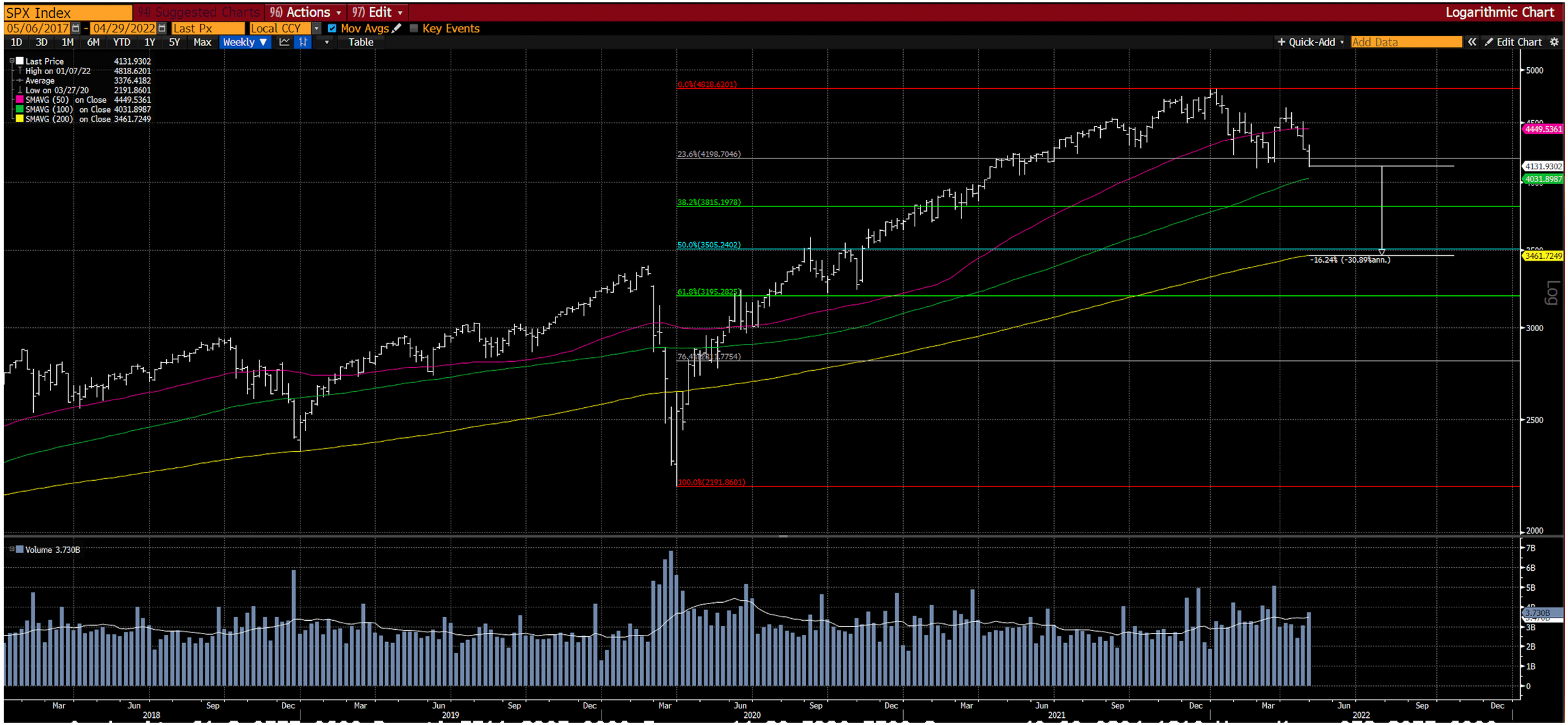
Next support for equity markets

- Most probably also our clients have seen the video of the debate on the main Russian TV channel “Rossiya 1”, whereby is argued, that Russian nuclear rockets (called Sarmat) can reach Berlin in 106 seconds, Paris in 200 seconds and finally London in 202 seconds. In our opinion, the idea of such debate was to show to the whole world, that no one is going to be able to intercept such nuclear rockets. Analyzing different news, **apparently such rockets, as also the submarine Poseidon (also with the most dangerous nuclear weapons) are even not in operation and therefore Mr. Putin would today not even be able to deploy them!**
- We would like to close the subject by mentioning the recent assertion of Ms. Annalena Baerbock, German foreign minister: she doesn’t want to “rule out” a nuclear war with Russia, but she’s relaxed about it. KTS starts to seriously think, if policy makers and media have any idea of the seriousness of the current situation. **Such nuclear rockets have the power of 333 Hiroshima!**
- Some army veteran, but also global media, are arguing, **that it is quite clear, Mr. Putin is sick (cancer?)** and will need soon a surgery, where under the knife, not being in control, there is a chance that he might not wake up and that would be such a convenient relief for a country losing a conventional war and trying to avoid a humiliating catastrophe. Some market participants have the strong conviction, that it is not anymore a question if it is going to happen, rather than it is now only a matter of time. Needless to say, how equity markets are going to react on such a news.
- **For the moment, the investor community is waiting what Mr. Putin is going to plan before or at the 9th of May.**

Next support for equity markets

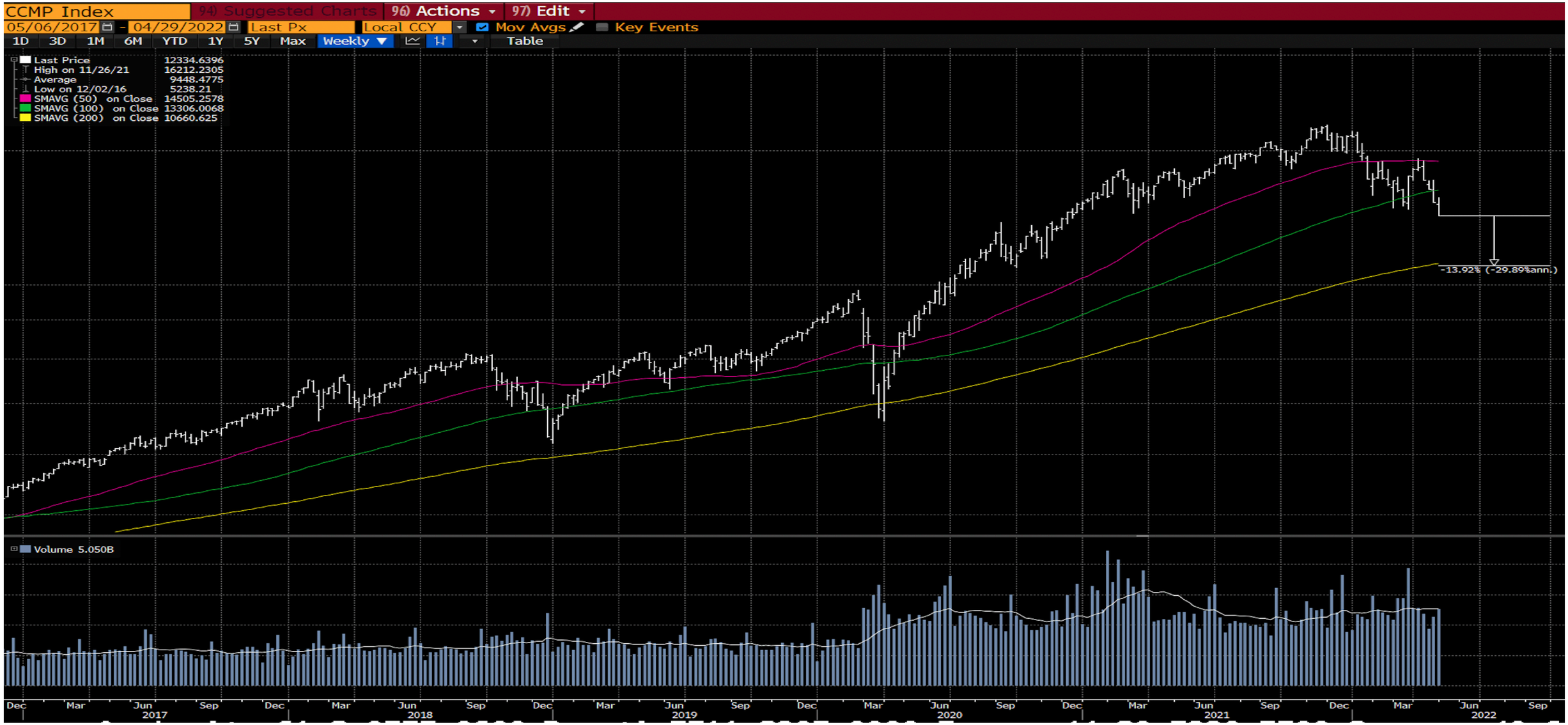
- Finally, China will have to realize, that being basically the only country in the world with a 0 Covid policy, putting the global economy growth in danger, it is time to change strategy. As we have seen on slide nr. 2, the Chinese economy is already in recession in addition to the fact, that 400 mio Chinese citizens are in lockdown. We understand, **Chinese authorities' priority is to vaccinate as many elderly as possible, a generation of people, which strongly believes in the traditional Chinese medicine, rather than pharmaceutical medicaments.** Not an easy task, also for such authoritarian country and we perfectly understand the reason, having KTS full respect of the traditional Chinese medicine.
- For all those reasons, we believe, **if equity markets would have a break down to the 200 weekly moving average, it would be a strong buy opportunity for investors** and KTS is going to invest the liquidity. The **biotech sector** is going to be our first priority, having never been as attractive as today. But also the **ETF QQQ** is going to be on the top of our list, having had technology suffering from higher interest rates. We hope to have indications of a capitulation day in order to decide the purchase with the optimal timing.
- We would also add, Mr. Elon Musk said: buy stock in several companies that make products&services that you believe in. Only sell, if you think their products & services are trending worse. Don't panic when the market does. This will serve you well in the long-term.
- We would argue, KTS is invested in special companies and projects, which are profiting from mega trends like the "green transition", Fintech, digital health and biotech to mention a fews. **Market participants are calling such trends "SHIFT momentum" (Global warming, inflation, shortage, hacking, global pandemic and also war, of which KTS is not invested).** Therefore, we have the patience to stay invested, even during temporary set back.

Next support for the S&P 500, if equity markets would experience a breakdown



During the dramatic correction in Q4 2018 and Covid March 2020, the next S&P500 Index support was the 200w, which is also in this case the 50% Fibonacci

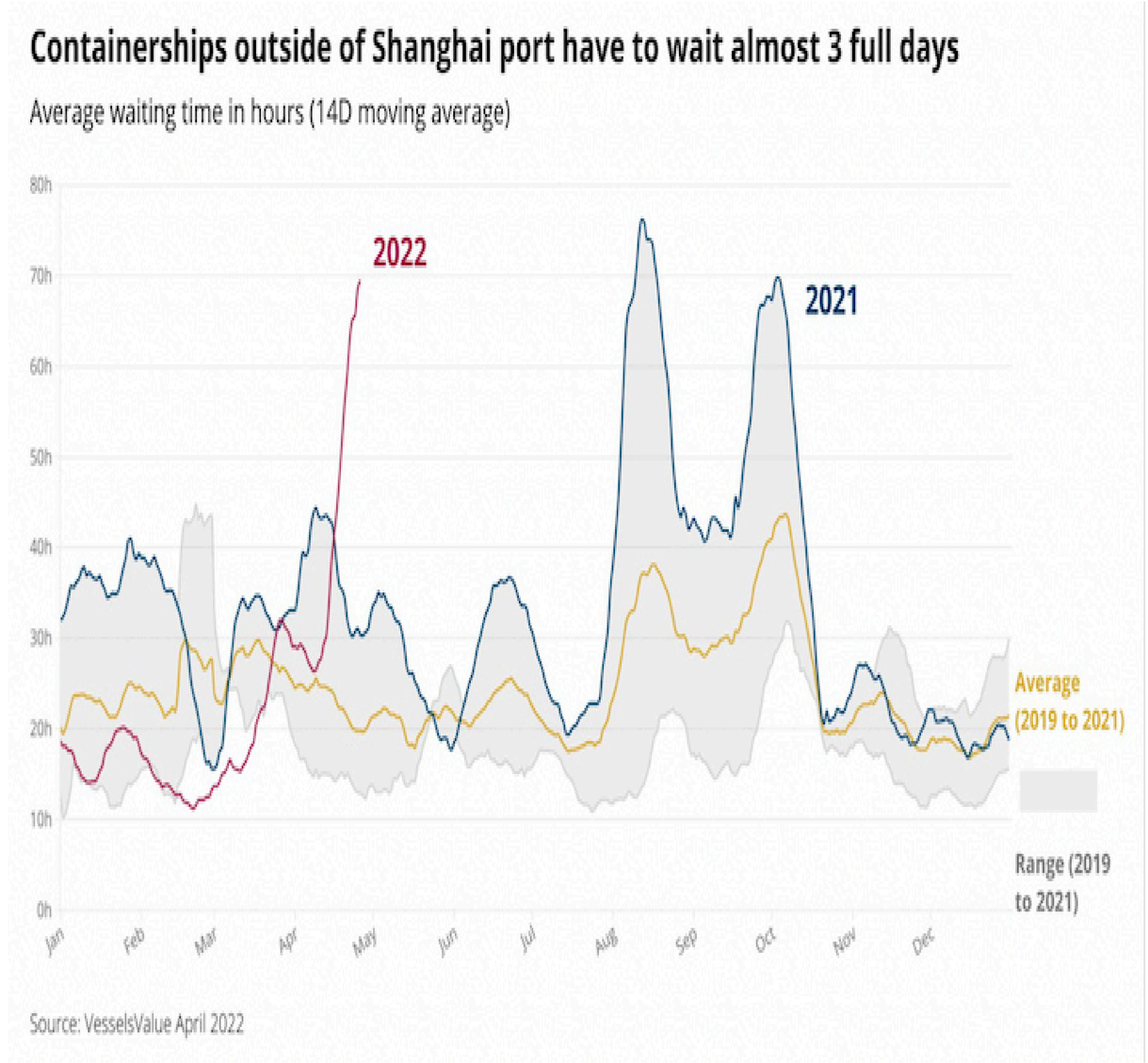
Next support for the Nasdaq Index in case of a breakdown



Also for the Nasdaq Index the next support is around -14% from nowadays' levels a the 200 weekly moving average (similar confirmation also with Ichimoku)

Shipping indicating supply disruption and lower consumption

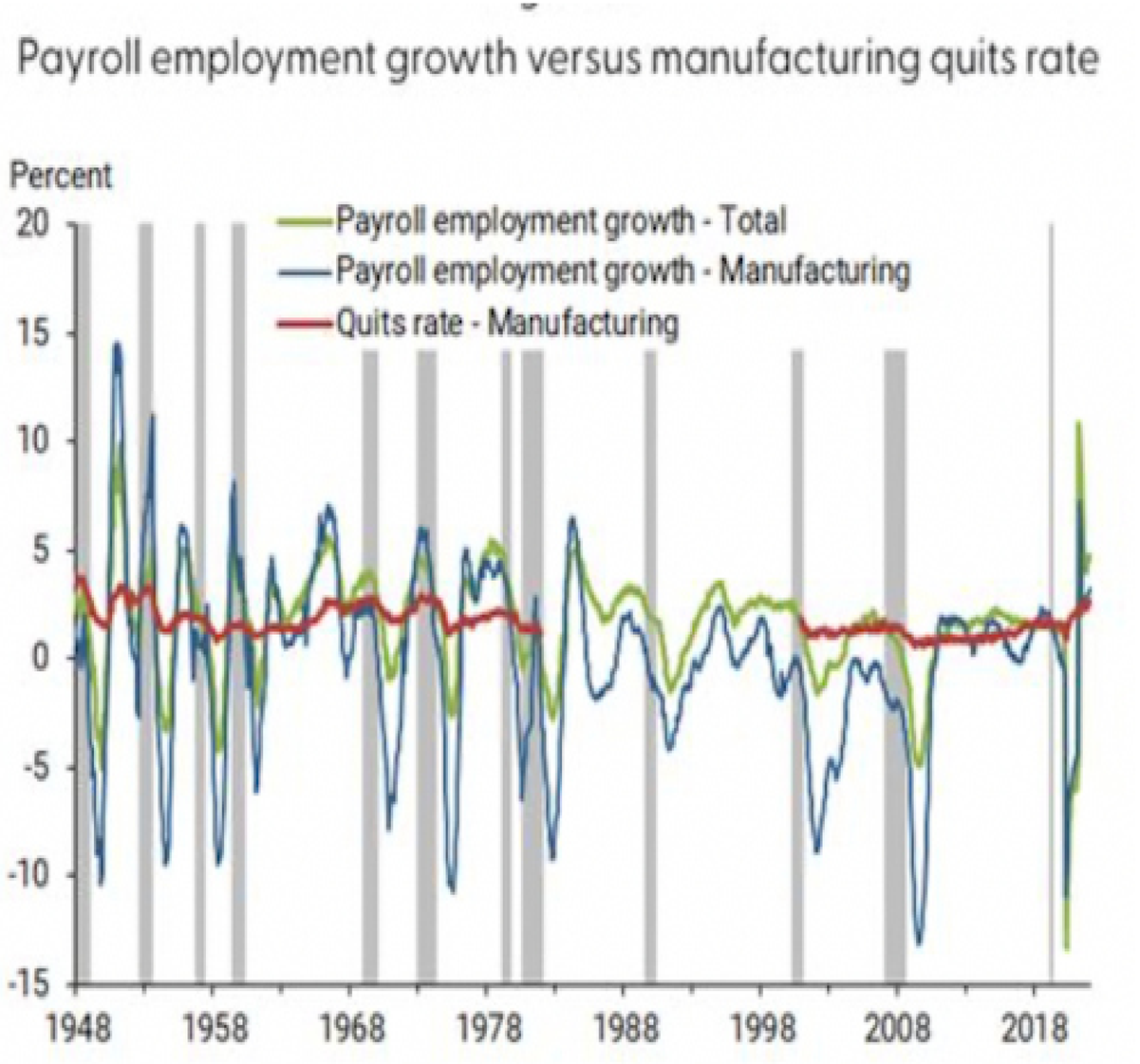
- The right hand chart, courtesy Mr. Steven Desmyter of Man group, is showing how more than 300 ships outside the port of Shanghai are waiting, level slowly comparable to the highs of 2019-2021 average.
- **But shipping cost from LA to Shanghai has actually fallen from around USD 10k per 40ft box in March to around USD 8.7k, despite the supply bottlenecks, indicating the consumer demand is still weakening!** We also would like to mention the Bullwhip effect, mentioned in our weekly report nr. 15 on the 15th April 2022: many companies ordered more goods than needed and inventories are high, therefore now are ordering less. It could be, that this time, Chinese lockdowns are going to hurt the global economy less than many market participants are thinking.
- Also the US ISM (production + new orders) is under 50 a sign of weakening growth, but prices paid are higher, showing, companies are passing the inflation to the final consumer.



jContainerships outside of Shanghai port have to wait almost 3 full days

Scarce labor supply in US

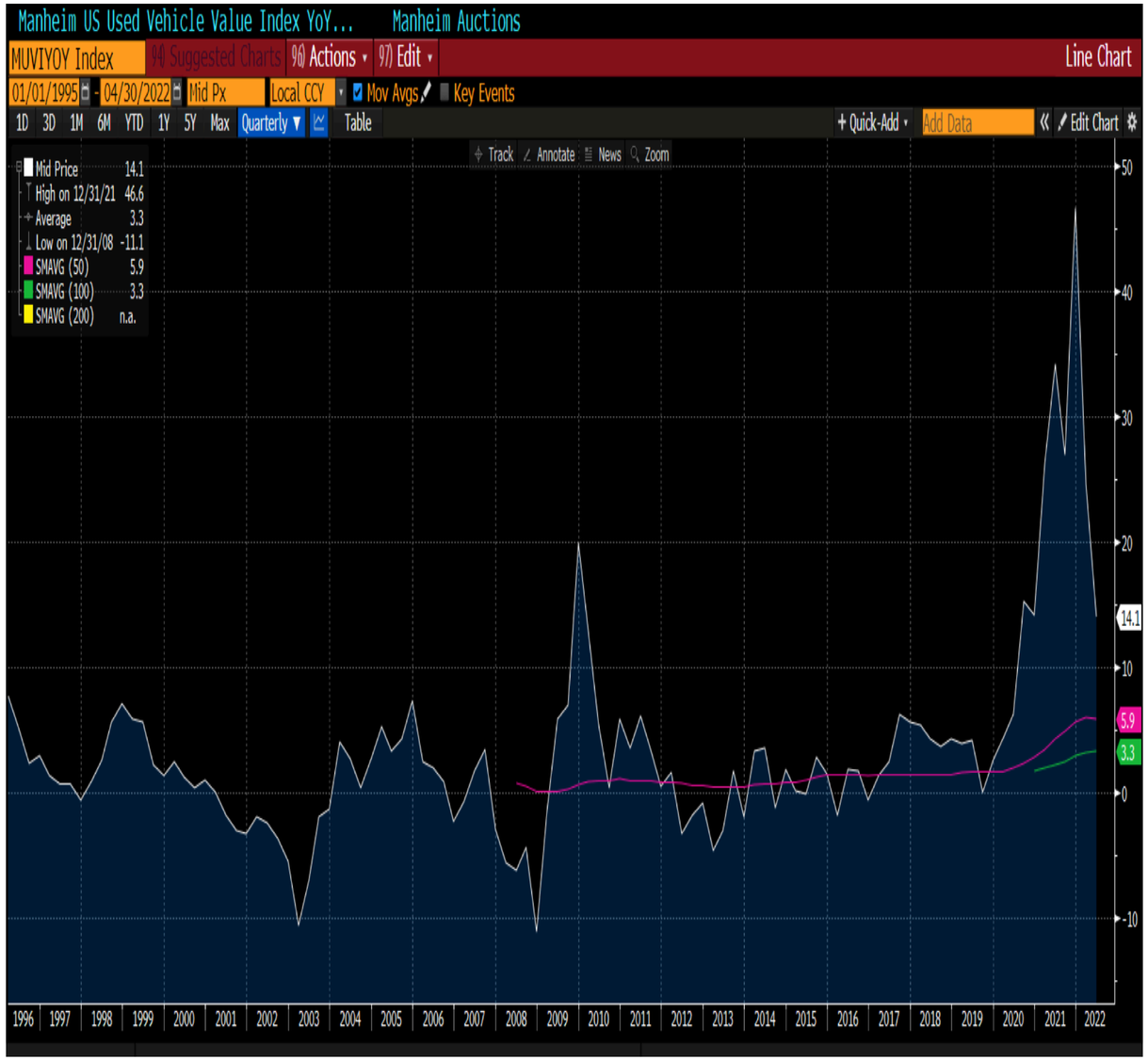
- Market participants are noticing, that the number of jobs currently posted for every person who is “not in the labor force” is at highest level since year 2000: **8.8**
- Therefore, lack of labor supply means higher wage and consequently higher inflation.
- **But The Federal Reserve Bank of San Francisco examined similar fast economic recoveries in history and found out, that today’s quit rates in manufacturing are actually very similar to the previous waves.**
- The chart on the right hand side shows the waves, which coincide with periods when payroll employment grew very fast, both in the manufacturing sector and the total non farm sector.



Source: Mr. Steven Desmyter / Bureau of labor statistics

Inflation

- As argued in our previous slides, it is of vital importance to forecast inflation levels. An important contributor of the past high inflation (40%) was the price of used cars, which skyrocketed, having car manufactures not being able to deliver new models due to the chip bottleneck, but people wanting to buy a car, in order to go back to work without using public transportation. As we can analyze on the right hand side, the Manheim US used vehicle Index is substantially falling, movement, which going to be reflexed in the official statistic in the next weeks, in addition to already lower commodities prices.
- The negative equity market's reaction on the 5th of May was caused by higher inflation number, but this could dramatically change in the next weeks.
- As we have analyzed in the previous slides, even of the oil price would increase further, the base of the increase is not the same as in the past 6 months.
- This could be a trigger for equity market to consolidate on the important support and do not fall lower?



Manheim US used vehicle value index falling substantially

Lowest number of births in China

- According to the National Bureau of Statistics, courtesy Mr. Peccatiello, China just recorded the lowest number of births since the Great Famine. Mr. Yardeni is also negative on China because of such statistic data.
- **After the last decades of tremendous structural and cyclical growth, China is facing a demographics dilemma.**
- During last 40 years, Chinese working age population grew from 600 million to over 1 billion. Those people could actively contribute to the economic growth of the country. But the lagged effect of the 1 child policy and the widespread population aging will take a big toll on the Chinese working-age population over the next decades. As we have analyzed last week and also confirmed by the United Nations, the **Chinese workforce will shrink from over 1 billion to around 700 million by 2065 and therefore the Chinese structural growth rate is going to slow down remarkably.**
- During his speech in July 2021, Mr. Chinese President Xi Jinping announced that China needs to shift the focus to improving the quality and returns of economic growth, to promoting sustained and healthy economic development, and to pursuing genuine rather than inflated GDP growth and achieving high-quality, efficient, and sustainable development. **Basically, from a cheap-labor, export-oriented country to a more domestic-demand centered economy.**
- Most of market participants are rightly worrying about the de-leveraging episodes and of course the process has to be closely monitored.
- But **KTS also has the opinion, that Chinese growth is not only domestic. In fact, China is tremendously expanding in the African continent and now also in the Far East region, therefore the growth is also coming from such expansion.**

Lowest number of births in China

- In addition, the Chinese expansion's plan to other continents or regions is much different than the West. In fact, the Chinese government and companies are offering to their counter party the whole supply chain; from financing, to machinery, the final buyer of the product and finally also Chinese workforce. Analyzing the Chinese expansion in the African continent, the Chinese labor force is not only working, but also living in the new country and therefore, the Chinese population is also substantially growing outside China. We are going to research more on the subject.
- **The Swiss Bank Pictet is arguing that China asset returns were lagging the secular growth and have 50% discount to US equities (our best-in-class fund Alkeon also argue Chinese companies have a higher growth), therefore Chinese equities are attractive and have a substantial risk premium buffer to the tech crackdown with authorities.**

General news

- We are reading with pleasure, that Mr. **Li Ka-shing, Hong Kong business magnate and 30th richest person in the planet with an estimated net wealth of USD 29.4 billion, invests USD 80 billion in Vietnam's infrastructure** and substantially reduced investments in the UK.
- **The Swiss Bank Pictet is expecting a correction of the USD in the next months, when the FED has to start reducing interest rates due to sudden lower inflation and therefore, Emerging Markets equities and bonds should substantially profit from a weaker USD.**
- Futures open interest by Silver are now to the lowest range of last 2 years. Sign of a bottom?
- We are reading that the fund VC Tiger Global Management is -44% YTD. This is exactly what happen with hedge fund managers update valuation of venture capital positions based on internal models and not by the exit of the investment. In our case of Fasanara and Swisscom, the valuation going to be updated only on the exit of the investments, for this reason, we have actually a substantial positive "buffer" at the moment on such positions.
- As predicted from the majority of investors, the E.U. Plans to ban Russian oil. The measure would ban Russian crude oil imports to nearly all the E.U. In the next 6 months, and refined oil products by the end of the year. The E.U. Gets about 27% of its crude oil imports from Russia and a higher share of its oil products. According to the magazine The economist, for the industry-heavy Germany, oil presents a far smaller problem than gas. As explained in the slide nr. 3, according to Pictet because of the lower oil's dependency at present time (69%), the impact of the oil price's increase is substantially lower than in the 70' .

Balanced portfolio

- We would like to stress out again, as already mentioned recently, that the YTD drawdowns in bonds were dramatic and any balanced portfolio worldwide suffered substantial losses from both equities and bonds. For example, the bond ETF Pimco 25y is down 41% from its high, compared to the -13% of the S&P 500 Index. We know, that most of competitors where investing in longer duration, in order to generate higher yields.
- KTS argued since some times now, this scenario could happen, even if we believe long term interest rates are capped, having global government high indebtedness and therefore no one is in the situation to afford higher interest rates.
- For this reasons, KTS focussed into fixed income alternative investment strategies in order to keep the duration as low as possible with a respectable good rating. YTD our fixed income strategy is around +2% compared to an average of -10% to -15% The only negative contributor in our fixed income strategy is the emerging market debt, which suffered substantial drawdown due to the strong USD, but we are also align with the Swiss bank Pictet, as soon the USD going to weaken (it is a matter of time), emerging markets are going to substantially profit. Therefore we stay invested and we are patiently waiting, meanwhile we are “cashing in” a yield of around 4% to 5% pa.

Crypto sentiment

- A picture is worth a thousand words. It is incredible the shift of perception also from professionals. Now investors could argue, when such institutions start to be extremely bullish on something, it is time to sell and be contrarian. KTS does not know, where the price of bitcoin is going to be from now in 10 years, but contrarily to Mr. Warren Buffett, we strongly believe, blockchains are the pillar of innovation for future, faster and cost efficient payment systems.
- Mr. Warren Buffett gave his most expansive explanation for why he doesn't believe in bitcoin, basically asserting, that it is not a productive asset and it doesn't produce anything tangible.
- We think that the blockchain technology is productive and is offering an alternative to the aged Swift payment system and allow to connect "machine to machine" in the future of artificial intelligence.
- The valuation of the crypto currencies can be based for example, on the volume of transactions in different crypto currencies.

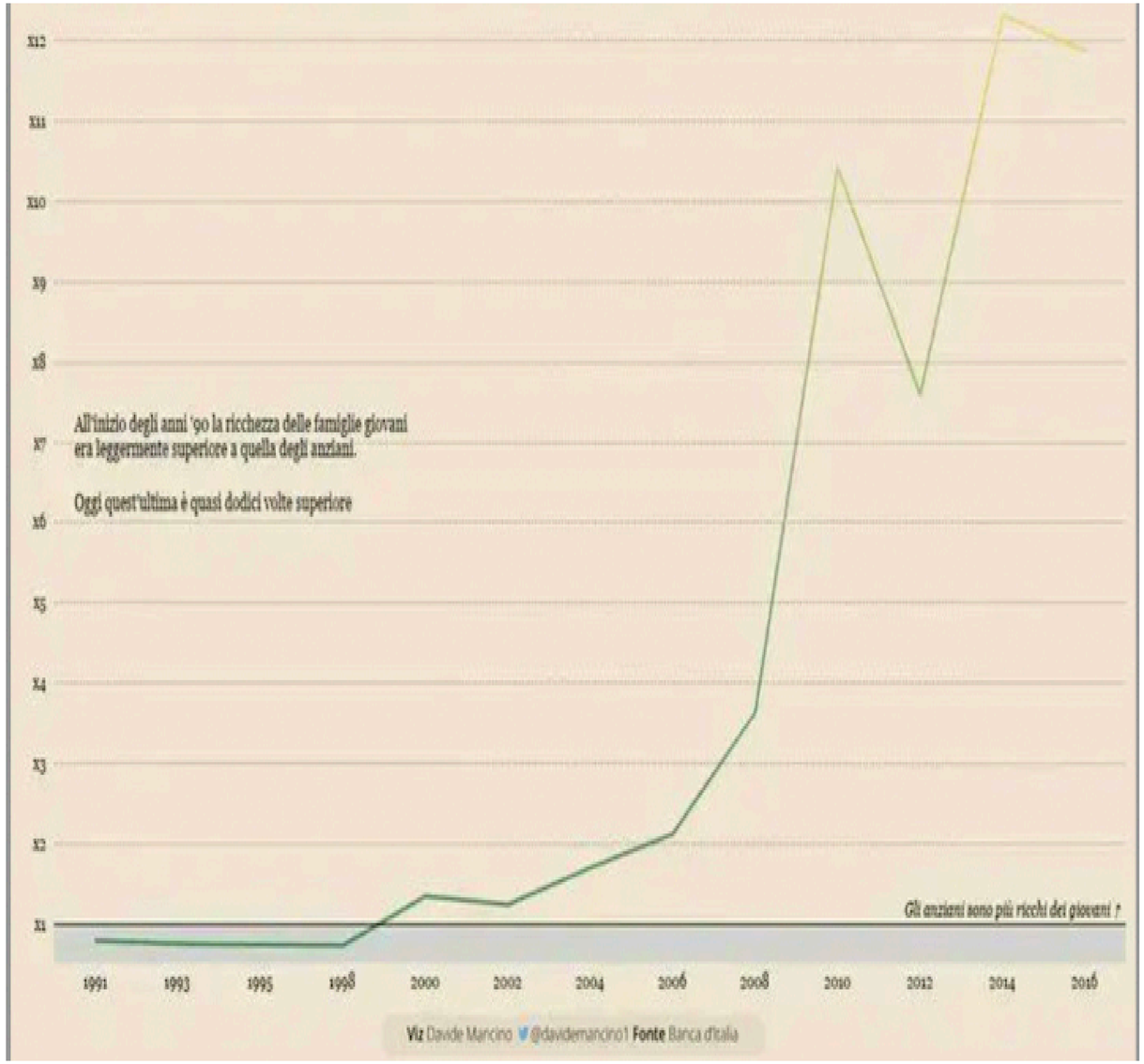
Source: Joaquim Matinero via Syz group

General news on cryptos

- According to a report from NBC News, it states that over 100k Cubans are using bitcoin in response to US sanctions.

Over 65 year old Italian citizens own 12 times more wealth than youths

- The chart on our right hand side, courtesy Bank of Italy via Mr. Marco Brotto, shows how in the 90' the median wealth of younger family was higher than elderly citizens. Nowadays, the wealth of over 65 is 12 times higher.
- In our investment outlook of the year 2020, we explained, how the **new generations are soon going to inherit massive wealth**. According to the magazine "The economist" baby-boomers in US own 63% of the total USD 9.1 trn wealth and the silent generation "only" 20% . In a environment of lower interest rates and younger inheriting such substantial wealth, there are massive influence on consumer behavior. In fact, on the long run, having the value of money devaluating, **younger generations, contrarily to our ancestors, will have to spend the money instead of saving it.**



Source: Bank of Italy via Mr. Marco Brotto

ESG

- We attended at a presentation of the asset management of Swiss Bank Pictet. The manager stressed out, that the bank is focusing on innovation, differentiation and sustainability.
- We liked the argumentations of consistency, whereby responsibility starts with what they do with their own assets. With a strong balance sheet, engaged employees, direct environmental impact, philantrophy and advocacy & partnerships the bank is able to better focus on ESG integration as for example net zero asset manager initiative with a commitment to net zero by 2050 and engagement in climate, water, nutrition and long-term approach.
- We would like to argue, that KTS being born for safeguarding sustainability for the future generations of our families is based from the beginning on ethics, sustainability, engagement, responsibility and innovation in order to update ourselves for the future.
- Finally we would add, that KTS has gotten the FINMA license on such respectable short period of time. This is a proof, that KTS has constantly invested substantial capital and human resources in order to always be updated to the high standards needed to practice our services internationally.

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