# KTS weekly update Nr. 20

The 20th of May 2022

# Fundamental arguments for a bottom of equity markets

- We are almost only reading, how equity markets are going to further correct and how most of market participants, private banks and asset managers reduced the equity class to neutral, if not even to underweight.
- As we have seen in our recent weekly updates, **equity and bond classes, both experienced one of the most substantial outflows in history and the money is “parked” in cash (confirmed from the BofA statistic, where fund manager survey shows the highest cash levels since September 2001).** An additional historical statistic of Lipper, courtesy Mr. Ansidei, shows that over the past 6 weeks, investors have pulled more than USD 44 billion from equity funds and USD 39 bn out of bond funds. **Such magnitude “double outflows” happened 3 times in the past 20 years**: January 2016, 19 December 2018 and 18 March 2020, basically marking the bottom of equity markets.
- Even if nominal yields on liquidity are higher than a year ago, it is only an optical illusion to generate positive yield with liquidity or short term bonds at 3%, and inflation at 8%, **real yields are still -5%** . Therefore it is wrong to argue, the “TINA” period (there is no alternative) for equity is over, because basically, equity is the only way to realistically reach positive real yields.
- **Also we cannot forget, that an environment of negative yields is perfect for central banks in order to reduce the high government indebtedness, without really paying back debt.**
- We are viewing severals comparison with the Nasdaq correction in year 2000, but all technical comparisons, not fundamental analysis. We would like to stress out again a couple of examples, how in the Nasdaq **currently many stocks have already corrected on average 72%**, as it happened in year 2000, but analyzing the list of such stocks, we must admit, we are in a total different fundamental situation than back in year 2000, where most of technology stocks were cash burning and valuations were based on the number of “click” of users, because companies had basically no revenues.

# Fundamental arguments for a bottom of equity markets

- Today analyzing stocks like **Docusign, Netflix, Wix** and other well known names, all companies have **positive FCF yields, net cash, are still growing, with very attractive business models, and P/E came back to reality. Major tech companies have the highest cash level ever and are able to acquire attractive competitors. All fundamental facts, which were not existing in the year 2000.**
- Also not to forget the **current substantial share buy back programs**, which for a company like Apple for example make up 40% of the performance of last decade.
- Therefore, it is possible to have equity markets correcting further from today's level, but with such depressed sentiment and all investors already underweighted equities and with substantial amount of cash, to have equity markets correct further, we need investors to start to short equity markets and honestly it is quite of a "dangerous bet". According to the historical analysis of Mr. Ansidei, this is exactly what is happening, having the **ratio of leveraged long vs short ETF volumes with growing increase in activity on the short side** (more than 10 times increase compared to the end of 2021) and the bullish speculation basically evaporated.
- We all understood that equity markets are going to further correct, if inflation is further increasing. We have also the FED still very hawkish and causing the heavy correction during the 18th of May (2% inflation target is supposed to be on the medium term, not on the short term!). But to have inflation increasing from the already high base, it will be difficult and analyzing commodity prices, the oil price quite stable at 100-110 USD, used car index falling, etc. the probability to have positive surprises from a falling inflation in the near term are higher, than the opposite.

# Fundamental arguments for a bottom of equity markets

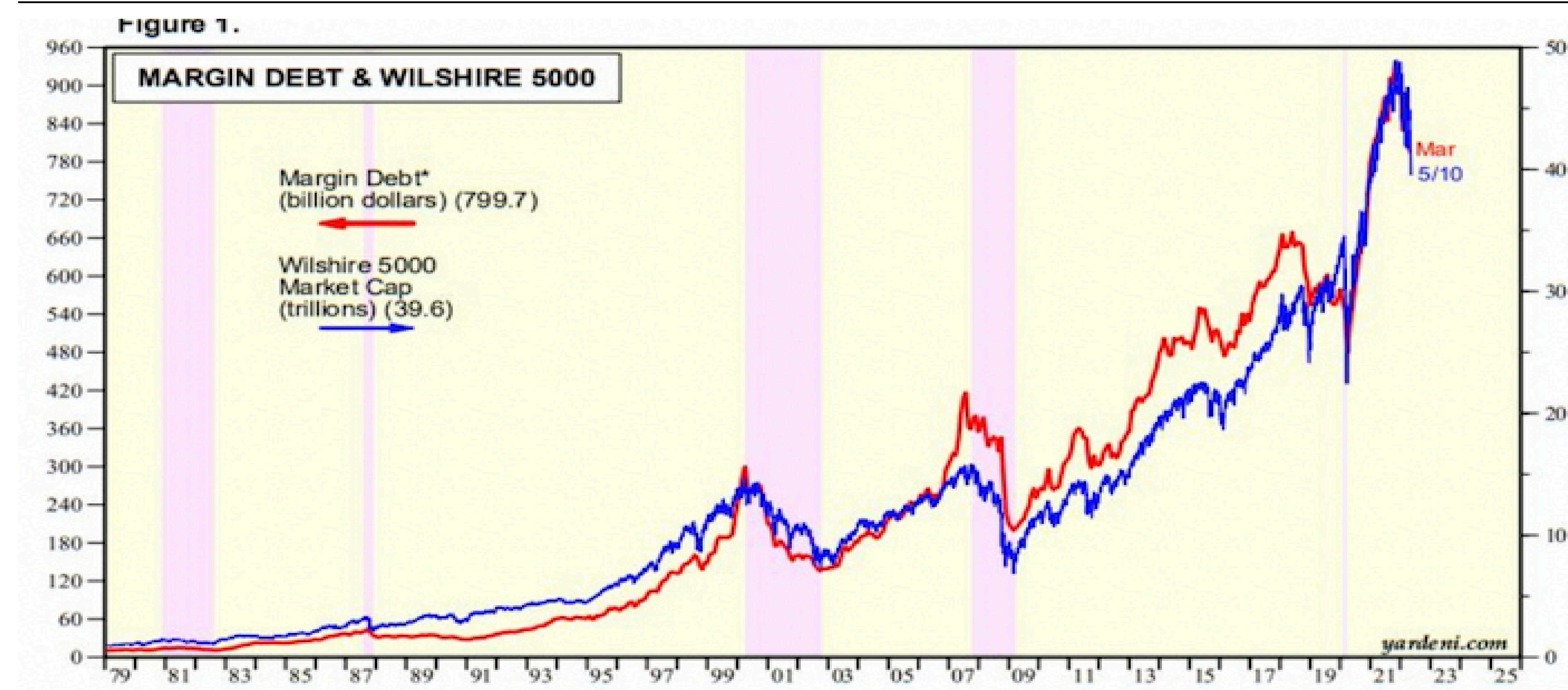
- We all have read the negative news on Walmart and Target, but at the same time we are reading from our best-in-class emerging market fund Aubrey, that **Shanghai has no new covid cases and are planning to resume "normal life" from the 1st of June**. Most of recent supportive measures from the Chinese government to the economy have been recently overlooked and therefore easing lockdowns could be an important catalyst for both economic growth and investor sentiment.
- Finally we would like to mention again, that recessions are caused by higher unemployment, situation, which is currently totally the opposite, having fewer labor force for open jobs. People feel comfortable changing jobs and are receiving salaries' increases. High workers confidence is translated into higher consumption and also a strong purchase of real estate, which is further supporting economy and equity markets. We understand that lower inflation is due only to lower consumption, but as we have previously seen, commodities prices fell and China is reopening, allowing a normalization of the supply chain. Events, which should help for a normalization also in inflation's number?
- The FED is trying to adjust a short term situation, but we do not have to forget, that **we are in the midst of a decade of innovation and technological mega trends.** Therefore investors need again to focus on the medium term and we are confident, that current valuations are attractive for investments in the medium and long term.

# Fundamental arguments for a bottom of equity markets

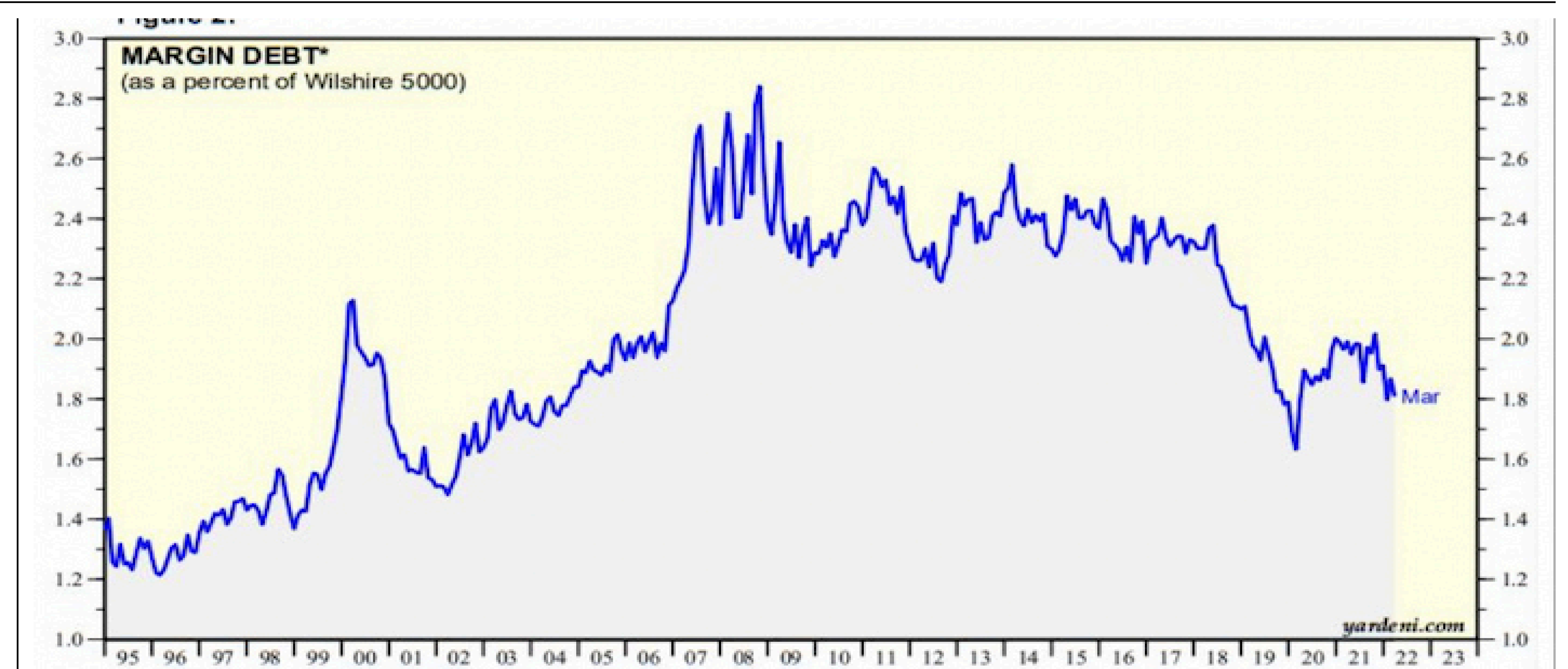
- Finally we would like to indicate that, during the post-pandemic rally, any stock increased massively to insane and unsustainable valuations with no real differentiation between companies. This was due to the massive inflows into passive ETFs.
- Nowadays, after the correction, stock picking is very important, because not all the companies are the same. As we have previously seen, there are now very solid and sound companies, which are trading at attractive valuations, are innovative and still experiencing attractive growth.
- Our typical example is the comparison of the company Gevo to “green” competitors like Fuel cell or Plug: on the rally to 15 USD, Gevo could increase USD 500 mio in “fresh capital” and add several substantial contracts to its pipeline. Nowadays is trading back at 3 USD, basically at net cash, but is a much better and solid company, than when it was trading a 3 USD 1.5 year ago. Meanwhile by Fuel cell or Plug, stocks rallied without any substantial fundamental change in the business model and could “only” profit from the massive inflows into the “green” passive funds. Nowadays are rightly trading back to pre-pandemic levels. We hope that the active selection of the best-in-class fund Alkeon and the active selection of the Z22 fund helps us to reach an above average performance in any rebound of equity markets.
- **For all those reasons, we closed our put option hedge, which added +1.5% positive performance to the Optima dynamic FoF and we started an initial 1/4 position into the etf QQQ US.** Going forward, we are going to keep a dynamic 15% of our portfolio for active trading.

# Margin debt

- The dilemma in exactly knowing, when is the end of an equity market's correction, is to find out, at which levels, margin calls are triggered causing the final "wash out" or "capitulation day". As we have recently seen, margin debts are still quite at high levels and therefore market participants are arguing, the risk of a further correction is still quite high.
- Mr. Yardeni posted an interesting research on his blog, arguing, that the margin debt on the Wilshire 5000 fell to USD 800 billion during March (down from USD 950 billion during January), while the market cap of the Wilshire 5000 Index is USD 39.6 trillion on May 10. **Therefore the margin debt is just 1.8%** and should not be a real dangerous going forward?




Margin debt around USD 800 bn vs SUD 39.6 trillion Wilshire 5000




Margin debt fell from USD 950 bn to USD 800 bn

# EU ban on fossil-fuel cars from 2035

- Eu lawmakers back effective ban on new fossil-fuel (petrol and diesel) cars from 2035.
- The news confirms the mega trend of energy transition and KTS feels comfortable with the investments into the EV transition phase via the Croatian private company Rimac Automobili, which also owns a part of the Project 3 (robotaxi service, driverless vehicle).
- The European Union invested 200 million EUR into the P3 project, which is also under active development for the past several years with KIA Motors (Hyundai) and also have a key partnership with Microsoft. In addition, the Project 3 Mobility is in negotiations with some 20 cities in Europe and the Middle East to enable the robotaxi service, with Zagreb expected to be the first city to offer it in 2024. As recently explained, the total amount of funds that will be invested in the pre-commercial phase of the project is 450 million EUR.
- We are also invested in the producer of electric mini busses EV Dynamic, and several specialty and industrial metal miners in order to exponentially profit from those mega trends, which have definitely being settled in motion and there is no point of return, especially after the conflict Ukraine-Russia, where the all world is now focussed in de-globalization and energy and commodity independency.
- The implementation of the energy transition will be a combination between electric vehicles, hydrogen and also driverless car in the downtown of major cities, therefore optimizing the electricity consumption, one of the real dilemma of such “green transition” in addition to the dependency of specialty and industrial metals.

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