KTS
CAPITAL
MANAGEMENT

# KTS weekly update Nr. 21

The 27th of May 2022

# S&P 500 Index hammer formation

- The strong intra-day reverse on Friday, the 20th of May 2022, formed a very important “hammer formation” at a crucial support for US equity markets. Trader can go long with stop loss the lows of the 20.5.2022.
- In fact, the level of 3’815 points is also the 38.2% Fibonacci retracement, from the lows of March 2020. The perfect support would be the 50% retracement at 3’505 points, level which would also be the re-test of the highs at the beginning of 2020.
- As explained, we closed our put option position and started to buy 1/4 position into the etf QQQ US. We are not going to be too aggressive with the new trade and anyway, if equity markets rebound, we have a few “depressed” positions (Alkeon, 2xidea as also the volatility model funds), which should profit from the market’s bounce.
- In the future, our idea is to have around 10-15% of the portfolio for trading positions, as long as we do not know, if any market rebound is the start of a new bull trend or still a bear market rally.


Important hammer formation on the S&P 500 Index

# Further indications of extreme market's sentiment

- The **Nasdaq's drawdown has now exceeded the Covid19 selloff** and only the Global Financial Crisis decline is larger than the actual correction of -28.6% (pandemic selloff: -27.9%). As recently explained, fundamentally the situation in the year 2008 or 2000 were different and not comparable to today, where we still have a strong labor market.
- According to Bloomberg's statistic (courtesy Syz Group) the **Dow Jones is down 8 straight weeks**, which is the **longest losing-streak since May 1923**! Needless to mention, that any sentiment indicator is still at extreme fear levels (CNN fear and greed, the BofA Bul&bear Indicator, Investors Intelligence Bull/bear ratio), as also the put/call ratio, which approached 0.75x and historically such levels coincide with an equity market rebound.
- In addition to the fact, that also the **S&P 500 Index is into the 7 straight losing weeks, basically at levels of May 1970, March 1980 and March 2001!** All dates coincide with the bottom of equity markets.
- Last week over 8'200 articles were about the "bear market". By quantity, this is the second highest frequency over the last decade. We experienced higher reading only during the Covid19 pandemic in March 2020 with 14k articles.
- According to BofA' statistics, **the tech short is the biggest since 2006**. This is the confirmation of our thoughts during our last weekly report, whereby, investors are starting to short the index and the majority of professional investors have already downgraded equity to at least neutral, if not even underweight. We think, this is quite an "aggressive" bet in such already extreme depressed market environment. Any small positive news on lower inflation rates (as we have analyzed, it is possible to experience soon lower numbers also confirmed from the **manufactures Texas Index)** or the ongoing Ukraine-Russia conflict (both Ukraine and Russia can no longer have their own economy in "free fall" in addition to the fact, that apparently health conditions of Mr. Putin are getting worse day by day), would most probably trigger a strong equity market's rebound if not a short squeeze effect.

# Further indications of extreme market's sentiment

- Meanwhile **major companies have the highest level of cash ever** and can continue to support their substantial share buyback programs or start M&A activities, having plenty of attractive opportunities after the substantial correction in many "meme" stocks and as we have analyzed last week, many tech companies are generating attractive FCF yields and have net cash.
- An actual good example is the attempt of **Broadcom to acquire VMWARE at USD 50 billion**, which is basically the market cap of the company and market participants are expecting an acquisition at least with 50% premium, if the acquisition would have been done 100% in cash. But being cash & shares, market is expecting even a higher premium! As always argued, if investors do not want to see the value in the market, major companies have the money to acquire attractive companies, which are offering long term synergies and therefore from a industrial perspective, the value is even higher.
- As we have recently analyzed, the momentum ETF ARKK US lost all the outperformance reached during the pandemic and after a correction of over 72% from the highs, valuations are now even lower than pre-pandemic. In fact, the **price to sales ratio of the ARK innovation ETF fell to 6.3x,** from the highs 36.1x (February 2021, where KTS was arguing valuations were unsustainable and one day market would have to fall back to reality). During March 2020 lows, the ratio was 8.3x and at the start of the ETF back in November 2017, at 7.8x ! **As per our experience, we would assert that the fair value for growth companies is around 10x price to sales ratio.** Acquisitions are done even at a range between 12 to 15x .
- We are also reading that stocks are already showing dispersion and even if some are still experiencing new lows, **many are making higher lows and therefore market breadth is getting better.** The low of such internal strength was already on the 11th of May 2022. Mr. John Knott concludes on his blog, that **even if stock indices are going lower, correlation was not increasing and for this reason, the VIX is not upticking when markets move lower.**

# Further indications of extreme market's sentiment

- The fact that equity markets **start to have such internal strength** is for KTS the proof, that investors are starting to picking up attractive companies after the substantial market's correction and it was exactly our argument, investors can currently focus and select solid and attractive companies. We believe, we are invested in active fund managers, which are going to select solid companies with still good growth potential.
- Finally we like the blog of Syz group saying: at 4'800 points of the S&P 500 Index, the investor community was arguing, how equity markets can only increase, because of TINA (there is no alternative to equity) and now at 3'800 we are arguing, to do not catch a falling knife. As recently explained, there are enough strong fundamentals, which are still supporting equity markets and therefore we don't think that this is a falling knife.

# Further indications of extreme market's sentiment

- We were not including too many charts, in order to reduce the length of our weekly report, but if our clients are interested in specific graphics, please do not hesitate to contact us.
- But we include this chart, courtesy of Mr. Ansidei, whereby a picture is worth a thousand words. It is incredible, how the mainstream can basically always be wrong again, again and again.
- The cover of the well known financial magazine Barron's is entitled "don't get mauled" . Of course we do not know yet, if the magazine is going to be wrong, but analyzing historical covers, the probability, we are experiencing the lows of equity markets is quite high.
- Meanwhile we spare to our clients all the charts comparing the actual S&P 500 downturn with historical bear markets, basically pointing out, theoretically markets need to correct much more. Many investors posting such charts are always bearish and are not posting any fundamental analysis. For this reason, we do not let us confuse and KTS stays focussed on fundamentals.

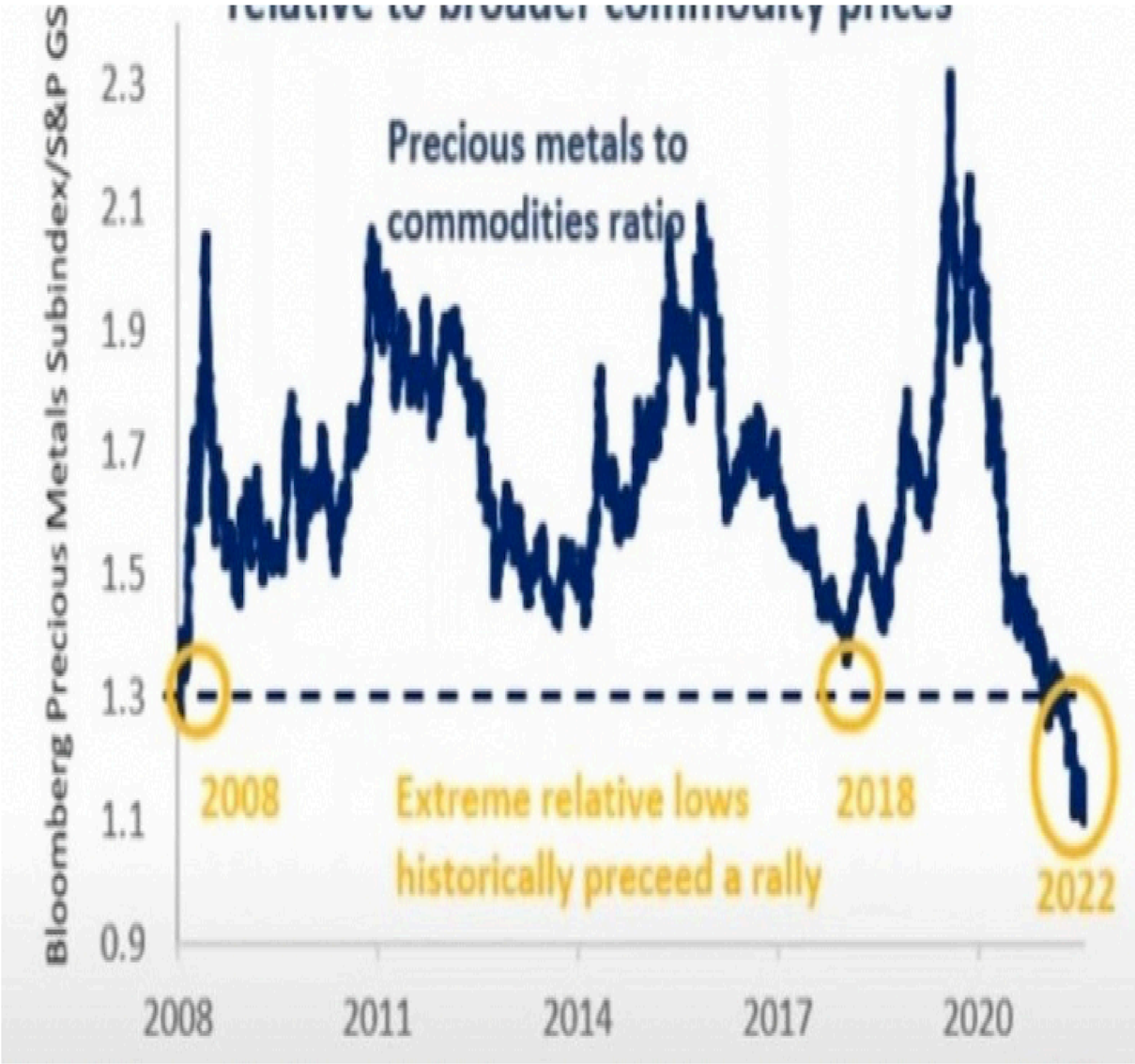

Barron's cover: don't get mauled

# Currencies

- It is quite impressive to read, that the **Russian Ruble soared to its 4 year highs** against the USD and 7 year highs against the EUR. YTD the RUB is +36% .
- Despite the strong Western' sanctions against Russia, such strength is the proof, other countries, like China and India for example, are more powerful than Europe and this is a clear signal also going forward, having the world now definitely split between the Western and the "communist bloc" & "friends" (86 countries worldwide and basically 2/3 of the world's population did not condemn Russia for Ukraine's invasion).
- The **USD has overshot the relative performance of US equities according to historical statistics of BCA Research, but US equity have just experienced the largest outflow in history (USD 90 billion monthly outflow, extreme monthly event never happened before)**. This non correlation between the USD and capital outflows is unsustainable and we would expect the USD to fall soon, because KTS is expecting inflation to fall and therefore market expectations for higher interest rates should vanish. In addition some market participants are attributing the massive outflow to the move of USD/JPY, being the JPY used over years for leverage. Emerging Markets equity and bonds should profit from a falling USD. Gold should also profit from lower interest rate expectations and weaker USD. But as explained, Gold is one of the few alternatives of the worldwide "currency war".
- **For this reason, KTS decided to hedge the USD position in the EUR, CHF and GBP mandates, having the EUR rising over 1.06 against the USD. Our stop loss for the hedge is going to be 1.035 against the EUR,** which was the recent low**.** Our target is over 1.1 EUR/USD.

# Very attractive precious metal sector

- According to historical statistics of our best-in-class fund Bakersteel, **precious metals are at extreme lows relative to the broader commodity prices**.
- In fact, the ratio has just hit the lowest level since the GFC in 2008, and today is even lower than 2018 or 2008, but gold miners never being that solid like nowadays.
- **FCF yields by gold miners is at highest ever** and this time, gold producers are returning capital to shareholders in form of higher dividends or with substantial shs-buyback programs.
- We are also reading from the World gold council, **that the Q1 2022 gold demand was 34% above the Q1 2021**, mostly driven by strong ETF inflows. Strange that with such substantial increase, the price of gold is basically unchanged!




Source: Bakersteel

# Swisscom Ventures investor day

- We were participating to the investor day of our investment Swisscom VC fund and we were impressed of the multiplicity of innovations and promising technologies. In order to invest in the right start ups at such early stadium, long term experience and the right connections are the key and only a worldwide leader like Swisscom possess such qualities, amongst of course the biggest and most famous (mostly closed) VC structures like Sequoia capital, to mention a name.
- Analyzing the portfolio of the previous fund, Swisscom invested into 24 companies, of which 2 had an IPO and 1 was sold.
- Over 4 years, the portfolio experienced a 2.8x increase in value, an equivalent of an annual IRR of 73% .
- Almost the half of the performance is due to one particular successful company, Fireblocks, which is 41% of the NAV. This is the proof, that it is enough to invest in one right start up over 24, in order to basically double the invested amount.
- Swisscom is also able to well diversify the portfolio between sectors and geographically. In some cases, Swisscom is investing in the same people over years, but in different projects. A good example is the actual investment into the Israeli cyber security company, Cato Networks, whom founder and CEO, Mr. Shlomo Kramer, was also the founder of the worldwide leader in cyber security: Check point. Cato is a specialist in cyber security, but in the Cloud, giving to clients simplicity, scalability and flexibility in the very complex Cloud network. Those market players are always a few steps ahead the market and can foresee the needs of new frontiers, anticipating competitors.
- In the case of our Swisscom Venture fund II, the manager is on track to invest as planned, 50% in Switzerland and 50% abroad (1/4 in US, 10% in Israel and the rest is spread all over Europe).

# Swisscom Ventures investor day

- The manager is focused on ESG, digital health, online education, productive and sustainable employment, resilient infrastructure for sustainable industrialization, foster innovation and finally also invests in companies, which promote sustainable use of terrestrial ecosystems.
- In order to give a better idea of the portfolio and the included technologies, we would like to mention few companies:
  - www.anybotics.com: the autonomous robot is helping the oil industry to maximize productivity, eliminate hazards or human error and compensate work-force shortage. In this case, the robot is able to inspect the heat of the pipeline and detect anomalies or dangers.
  - www.catonetworks.com: the company is basically the first world's true SASE platform for cloud. SASE means a dynamic secure access service edge and is the future for cyber security in the Cloud.
  - www.cognism.com: the AI system of the company helps companies to find the ideal customer base, and basically to proactively connect with ideal prospects in order to maximize conversion opportunities.
  - www.neo-medical.com: is the first fully integrated AI-powered augmented reality platform for spinal surgery.
  - www.ecorobotix.com: the technology of the company is enabling smart spraying for ultra-localized treatments of row crops, pastures and lawns allowing to basically use 95% less chemicals (herbicides, pesticides or fertilizers), increase 5% crop yield and reduce by -0.5% global CO2 emissions. The cost saved by farmers in purchasing less chemicals, allow to amortize the initial investment for the machine in less than 2 years!
  - www.preply.com: effective remote language learning with a tutor online.

# General news

- As we have recently analyzed, consumption in US it is still strong. Only the consumer's sentiment is very depressed. Basically people are still spending in an environment of high inflation and the consequence is a lower saving rate, which is according to statistics (source Charlie Bilello/via Syz Group) is at lowest levels since 2013 at 6.2% .
- The unemployment rate in Italy is still around 8.3%. More worrying it would be the youth unemployment rate, measuring job seekers between 15 and 24 years old, which is still at high 24.2%. The European unemployment average rate is around 6.8% respectively 13.9% by youth. Italy is clearly above average and of course a reason to be worried and ask questions. But than we are reading in the magazine financial time, the Italian tourism sector actually needs 387k seasonal workers, of which it is impossible to find 40% of open jobs! During our staying in Italy over summer, we even met Italian students, which are doing 2 shifts during the university's break. This  actually explains a lot in our eyes.

# General news on China / Asia

- According to the source of the People's Bank of China (via Jeff Weniger/Syz group), the Chinese stimulus package in order to **overcome lower growth in 2022 due to Covid lockdown is USD 5.3 trillion**, basically topping the package during the year 2020 and over the budget in 2021. We have not seen anything yet and as soon China is going back to normality, the economic will feel the support of such package.
- China also just announced a tax relief plan of over USD 21 billion, mainly aimed at businesses to offset the heavy impact of coronavirus lockdowns.
- President Biden indicated that US would use military force to defend Taiwan, if it were ever attacked by China.
- Meanwhile the Biden administration is evaluating the possibility to remove some China tariff in order to reduce inflation.
- The CIO of VP Bank is rightly pointing out, that the **Chinese Generation Z (270 million born since the mid-1990)** is the fastest spending growth out of any generation in China, are top buyers of cosmetics and tourism services, and have upended online shopping. Their influence will only grow, with **spending set to rise fourfold to USD 2.4 trillion by 2035** and are going to change the habits of spending, **being more nationalistic than previous generations**. These are not good news for Western companies, but of course good news for local providers. We believe to have a comfortable exposure in the segment with our emerging market investments and active managers are going to closely monitor, which Western companies are going to suffer more from such trend.

# ESG

- During the last 2 years, KTS is investing into attractive traditional energy companies, which are focussing on improving their exposure into alternative energy in order to support the “green transition”. KTS is speculating, that cheap valuations of traditional energy companies are going to increase on better ESG rating after implementation of more alternative energies and reduction of CO2 emissions.
- As most probably everyone was reading last week, **Tesla has being excluded from the S&P ESG Index, but 6 energy companies are newly included.**
- As our best-in-class Fund Flossbach always argued, any active manager has to execute its own homework on ESG, because the S&P ESG’s calculation is not credible enough (see KTS weekly update nr. 36 on the 8th October 2021, page 7, Flossbach’s ESG arguments).
- KTS focused on active managers, which have the expertise to execute the right analysis and even in such difficult investment environment, at least the investments into such “energy green transition companies” paid off.
- As also previously, also the SEC is going to introduce soon new guidelines in order to regulate the fund industry on ESG.

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