

KTS
CAPITAL
MANAGEMENT



KTS weekly update Nr. 22

The 3rd of June 2022

Sign of inflation rate peaking?

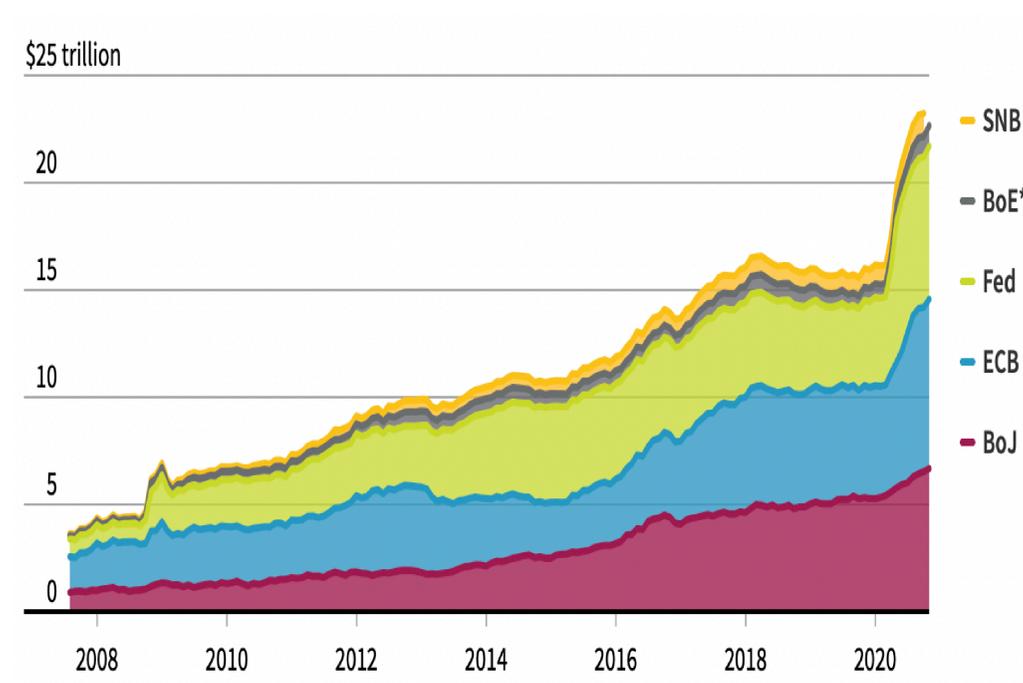
- The strong rebound of equity markets is mainly due to signs of peaking inflation, only in the US, not yet in Europe.
- The **PCE (personal consumption expenditure index)**, FED's preferred measure of inflation, slowed in April from March.
- In addition 5 and 10-year inflation's expectations have declined the most over the past month since the start of the pandemic.
- Other market participants are also arguing that the excess of M2 money stock (advance 9-months), substantially fell and therefore is anticipating that also inflationary pressure should dismiss.
- Non-durable good prices fell in April and therefore this is the first negative m/m negative number since October 2020 and the largest drop since May 2020.
- Reading the analysis of Mr. Yardeni, the improvement in the core PCE inflation rate is attributable to durable goods inflation, especially used car prices (largely expected from KTS as mentioned multiple times in our weekly report). The dilemma is that non-durable goods and services with gasoline and groceries (because of transportation, indirectly dependent to the oil price) are still soaring. Also the rent of shelter index is still increasing. Rent of primary residence or lodging away from home (hotel, etc.). For hotels and the tourism sector it is quite understandable, people want to finally travel again after the pandemic and hotels need to recover substantial losses from lock downs.
- On our weekly report Nr. 15 on the 15th of April 2022 we referred to the **Bullwhip effect** (page 4), where companies ordered more goods than needed due to supply bottleneck and the risk of high inventories. According to a Bloomberg's article, **Walmart, Gap and others have around USD 45 billion in extra goods to sell and will be forced to sell at a discount** in order to substantially reduce inventories. This should also ease the actual inflation's pressure.

Historical charts in relation to the injection of liquidity from central banks

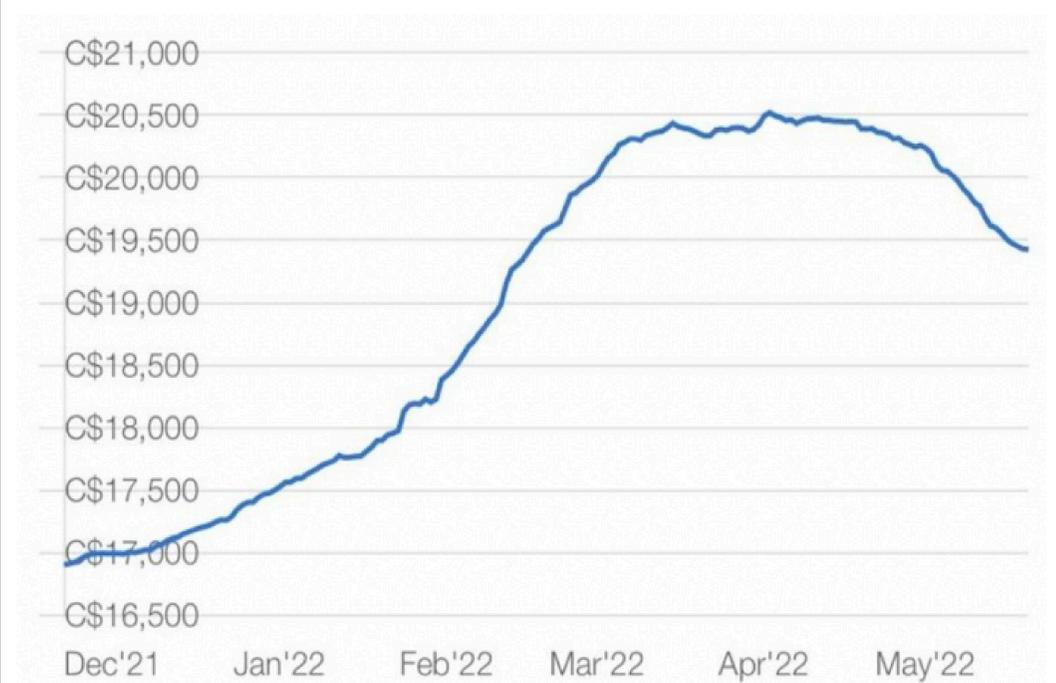
- As recently explained, many investors are predicting further market's correction by only analyzing long term charts.
- In our opinion, there are more components of the puzzle to be taken in consideration, in order to come to any conclusions.
- One key factor is the tremendous injection of central bank's liquidity over past years and therefore any historical comparison has to be neutralized with such element.
- In addition, we think that the tremendous injection of liquidity caused bubbles, but many of them have already burst. We refer to **SPACs for example, where many are now warning, they may go bust** and most of the 2020 and 2021 emissions are substantially lower than IPO's price. As always explained, most of such SPACs had unsustainable valuations.
- Another indicators of the end of exuberance is the Rolex market index or "meme" stocks, which are substantially falling.



More correction ahead?



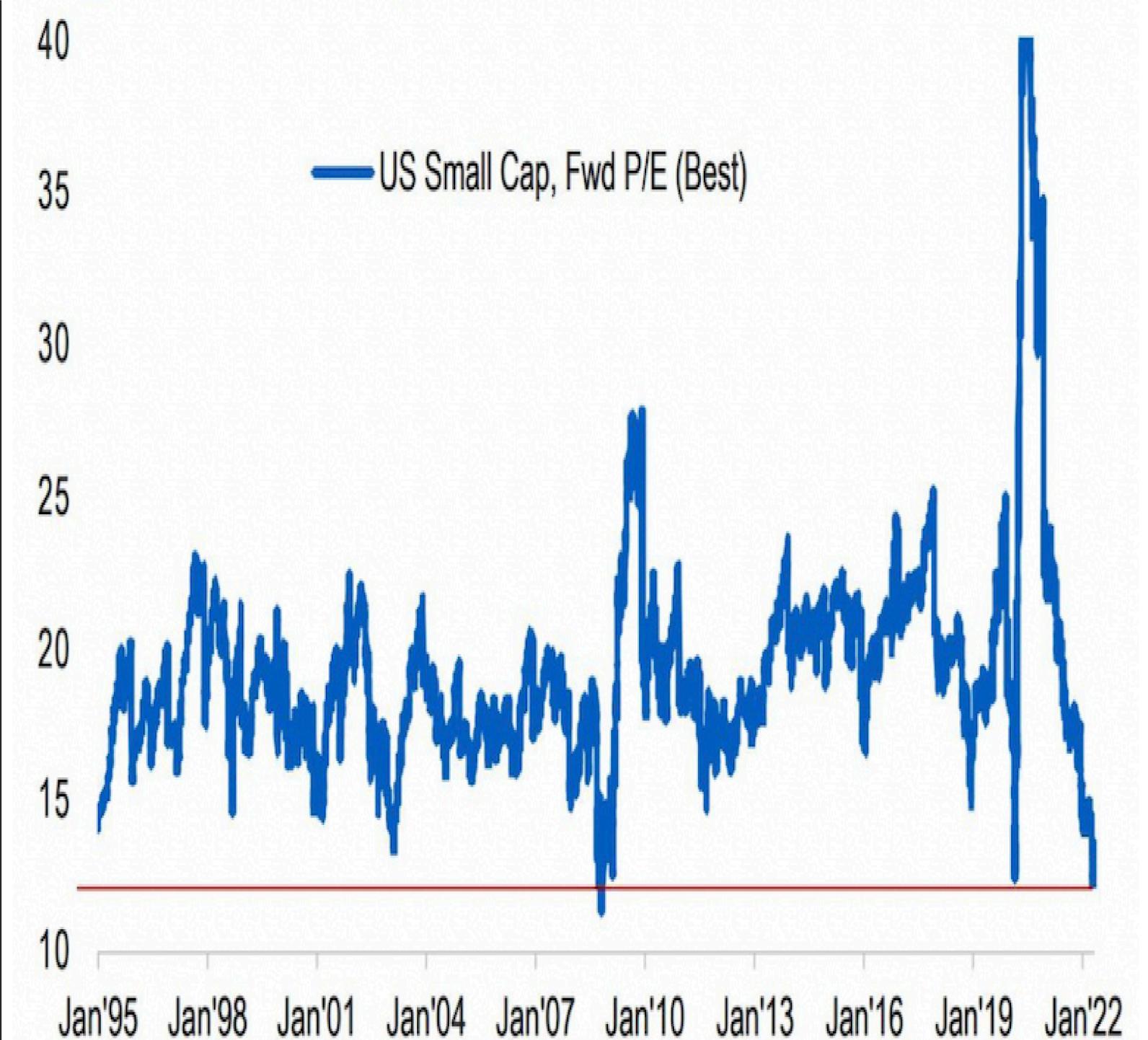
Total central bank balance sheets



Rolex market index starts to fall

Exuberance in the market?

- As explained previously, KTS thinks that too many market participants are expecting further market corrections, but are not analyzing the discrepancies in the market itself. Most of investors are only looking at the chart technically, with no real fundamental analysis.
- Actually, many bubbles already rightly burst, as “meme” stocks, not profitable companies, dubious SPACs with insane valuations, dubious crypto projects, etc.
- But also solid companies corrected along equity markets and are now trading at attractive valuations.
- An example is on the right-hand side chart, where we can notice, that US small caps are as attractive as in 2008.
- As recently argued, also the Biotech sector is very attractive and many companies are trading under cash levels.
- Therefore, it is very important to be invested in active managers, which are selecting oversold, but solid stocks with still prosperous growth.



Small cap valuation at GFC lows (Source Syz group/wallstreetjesus)

3 days in a row with +80% upside volume

• According to the blogs of Mr. Rowles and Mr. Evangelista, the last time equity markets had a 3 days on a row 80% + upside volume were (2 days 90% and 4 days over 5 = very strong setup):

- **The 5th October 2011 , 12th February 2016 , 24th March 2020**

Basically in all 3 cases, the bottom of the equity market was confirmed and moved meaningfully higher (we checked).

• As recently analyzed, there are also several other signals pointing out that we should experience a bottom. We agree, there are still too many fundamental uncertainties to call a final bottom. But we would like to re-connect to the legendary investor Sir John Templeton' famous maxim: **“Bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria.**

• On the right-hand side chart, courtesy Mr. Callum Thomas, we can analyze the performance of equity markets after a >6% weekly gains of the S&P 500 Index, which are mostly positive.

Big Weekly Gains Tend To Mark The Start To More Strength

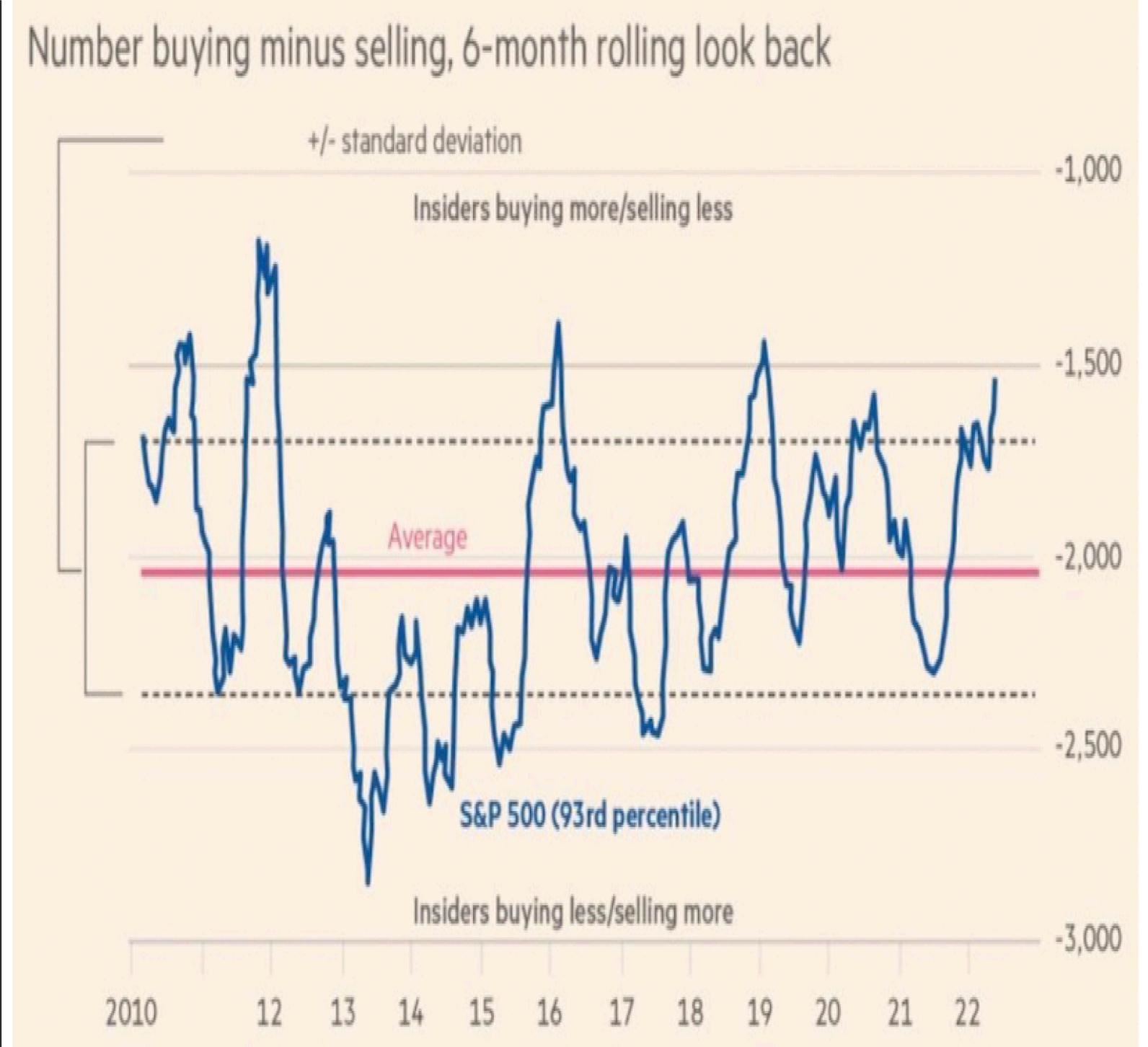
>6.0% Weekly Gains For The S&P 500 Index (1950 - Current)

Date	Weekly Gain	S&P 500 Index Returns After Six Week		
		3 Months	6 Months	12 Months
6/7/1974	6.0%	-22.8%	-28.5%	-0.1%
9/20/1974	7.6%	-3.6%	18.9%	22.4%
10/11/1974	14.1%	1.6%	20.3%	24.0%
11/14/1980	6.2%	-6.8%	-3.4%	-11.3%
8/20/1982	8.8%	22.4%	30.5%	44.7%
10/8/1982	7.4%	10.8%	16.6%	29.9%
11/5/1982	6.3%	2.8%	16.8%	15.0%
8/3/1984	7.4%	3.2%	10.0%	17.9%
5/2/1997	6.2%	16.5%	11.2%	38.0%
10/16/1998	7.3%	18.5%	23.6%	18.7%
6/2/2000	7.2%	2.7%	-11.0%	-14.2%
9/28/2001	7.8%	11.5%	9.2%	-21.7%
3/21/2003	7.5%	11.2%	15.7%	22.3%
10/31/2008	10.5%	-13.4%	-6.7%	7.7%
11/28/2008	12.0%	-22.3%	5.4%	22.2%
1/2/2009	6.8%	-9.6%	-3.6%	21.6%
3/13/2009	10.7%	25.1%	37.8%	52.1%
3/27/2009	6.2%	12.6%	28.0%	43.8%
7/17/2009	7.0%	16.6%	20.8%	13.9%
12/2/2011	7.4%	8.0%	3.3%	13.3%
3/27/2020	10.3%	18.4%	30.5%	56.3%
4/9/2020	12.1%	14.2%	22.2%	48.0%
11/6/2020	7.3%	11.4%	19.7%	34.0%
3/18/2022	6.2%	?	?	?
5/27/2022	6.6%	?	?	?
Average		5.6%	12.5%	21.7%
Median		10.8%	16.6%	22.2%
Higher		17	18	19
Count		23	23	23
% Higher		73.9%	78.3%	82.6%

S&P 500 Index performance after >6% weekly gains.

Net insider buying

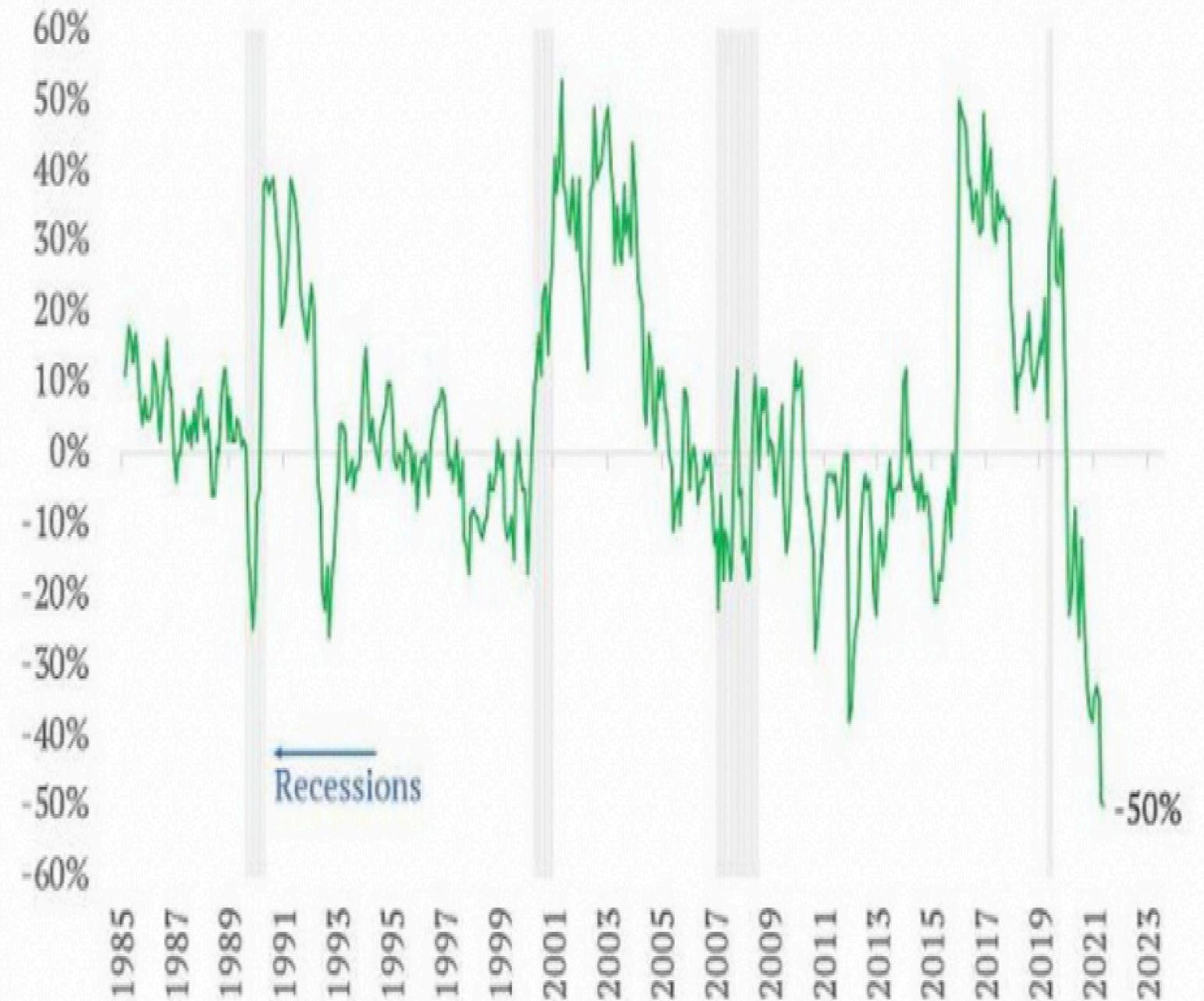
- According to Mr. Ansidei, the long positions in S&P 500 Futures of asset managers is the one of the lowest since 2006. Historically equity markets rebounded when the indicator touched such levels.
- Meanwhile insiders are buying shares of their own company as much as in March 2020.
- The 2 indicators are strongly in contrast to each other, but we would tend to believe more in the manager of a company than professional fund managers.



Source: JPMorgan equity macro research, Bloomberg via Mr. Ansidei

Macro data

- The NFIB survey: % expecting improve economy minus % expecting deteriorating economy is at new record lows, since 1985.
- **Analyzing the lows of such survey vs the Small caps Index Russell 2000, such index is more as a contrarian indicator!**
- We recently argued, that as long the US labor market is strong, also the US real estate market is going to be resilient and therefore we should not expect a recession in the US. Latest **homebuyer sentiment survey collapsed and unsold inventory of new houses increased to highest levels since 2008**, putting in question, if the US real estate is going to really be immune from FED hawkish strategy?
- Also the **index of imported containers to Shanghai still increasing** and market participants are expecting delivery delays in the months to come.
- Unfortunately, as argued, it is still **too early to be overly bullish** and therefore we will have to trade the market's rebound and not only stay long.



Source: National Federation of Independent Business (NFIB), as of April 2022. File #0272

NFIB survey: %expecting improved - deteriorating economy: Jeff Weniger

When and how might the war in Ukraine end

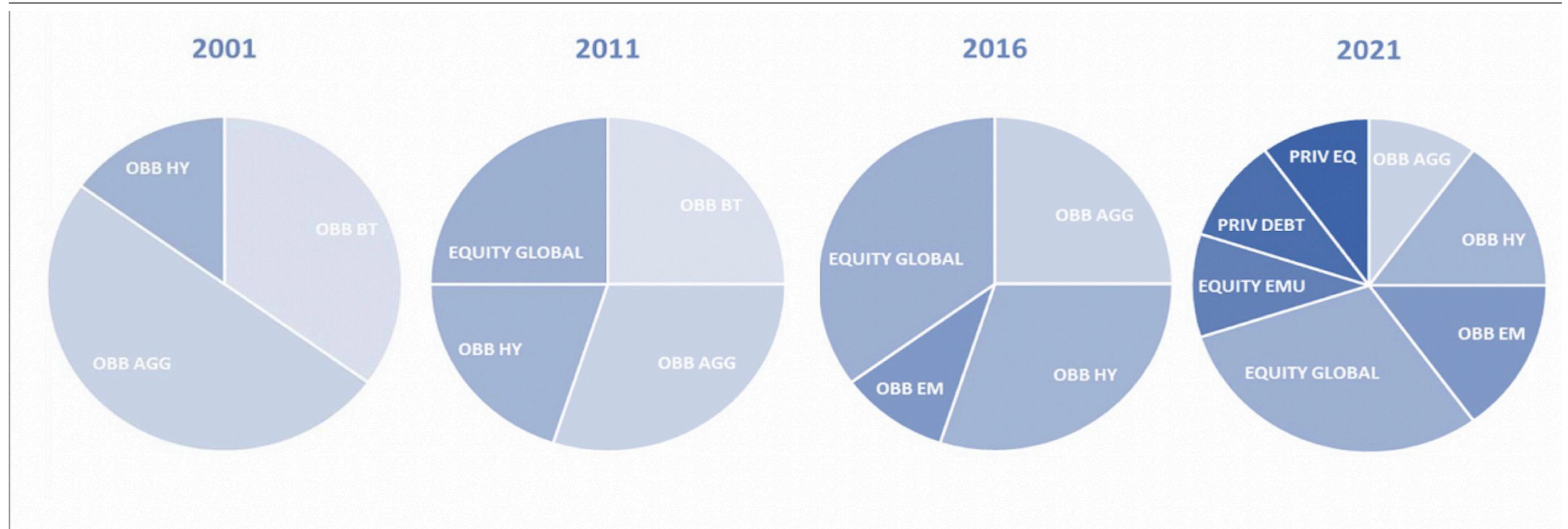
- We are reading an interesting article in the magazine “The Economist”, whereby is explained, that the war can end only through negotiations.
- Apparently the West lets Ukraine decide, when to stop fighting and on what terms.
- We like to read, that Germany is calling for ceasefire. Italy is circulating a four-track plan for a political settlement and France is touching the right point, future peace deal must be without “humiliation” for Russia. Mr. Macron is also rightly pointing out, that Europe will need to find a way of living with Russia.
- The position of USA is still not clear, but the journalist re-connect to the comments of the America’s defense secretary, where after visiting Kyiv last month, he was saying the West should help Ukraine to “win” and “weaken” Russia. But 3 weeks later he is calling for an “immediate ceasefire” following a phone call with his Russian counterpart, Mr. Sergei Shoigu. Apparently the Pentagon insists, there is no change of policy. On the WEF, the ex US foreign minister Mr. Henry Kissinger was even talking more directly and proposing Ukraine to lose the Donbas, in order to reach peace talks and warned Europe, to do not humiliate Russia, in order to keep stability in Europe.
- The article concludes that, Ukraine complains European countries silently want Ukraine to capitulate and USA is not delivering the wished weapons, on the contrary, US is not going to send long-range weapons, which could reach Russia!
- Meanwhile, the end of the war depends in large part on Russia, which is in no hurry for a ceasefire and is determined to conquer all of the Donbas in the east, if not even more land in the west. Finally, the paradox is that both sides still believe they can win! We would argue, the longer the conflict, the higher the humanity and economic suffering, which is unsustainable for both sides and in our eyes, policy makers need soon to face reality! Hopefully still in the next months.

One-off tax on oil&gas

- The oil price has broke the resistance of USD 117 due to European bans of Russian oil, but we are reading positive news of government reducing taxes on fuel in order to support consumption. Such measures should help to reduce further inflation rise in Europe, which increases to 8.1% from 7.4% in April. Market's expectations were 7.7%, **but the inflation rate ex-energy and food, which is the most-watched by the European Central Bank, is at 4.4%, from 3.9%**. We would guess, the main increase is also in traveling. **Saudi also announced to be ready to increase production.**
- **UK is planning one-off tax on oil and gas giants** to ease the pain of soaring household energy bills.
- We are talking about a 25% tax rate on the profits of oil and gas companies. The income of such taxes would be distributed to 8 million of the lowest income households with a one-off cost-of-living payment of GBP 650, already in July and a second payment in autumn.
- In addition, 8 million retired people will receive an extra winter fuel payment of GBP 300 and a one-off disability cost-of-living payment of GBP 150.
- At the moment, the share price of oil giants like BP or Shell did not have a negative reaction on the news.
- On one hand, those are good news for consumption, on the other hand, it is questionable, if with such State's direct intervention on profits of private companies, can still allow to say that we live in free capitalism?
- **Germany decided to cut tax on fuel for 3 months by 30 euro cents for gasoline and 14 cents for diesel.** This measure will cost to the German taxpayers almost EUR 7.6 billion, but is a needed step in order to restore confidence.
- **Even if oil is breaking out, many market participants think that the sector is overbought.**

Nowadays asset allocation aims at reaching a 4% yield per annum

- On the chart below, courtesy Azimut, we can analyze the asset allocation development over time in order to reach a yield 4% p.a.
- Analyzing the asset allocation of KTS, we would assert that we are also invested with similar weighting.
- Instead of high yield bonds, we still prefer factoring or direct lending. We are not investing in private debt, because most of the funds are closed to a 5y period. We hold very attractive private equities and VCs and also are invested into Emerging markets.



Source: Azimut

The “holy grail” by Mr. Ray Dalio and determination of risk tolerance

- In order to explain the asset allocation on page nr. 9 and how at the end of the day, KTS decides the weighting of different asset classes or strategies; the best way is to re-connect to the video of Mr. Ray Dalio: **the holy grail: the power of diversification, the power of portfolio construction.** (<https://www.youtube.com/watch?v=Nu4lHaSh7D4&t=10s>)
- As explained in the past years, KTS thinks that having the highest correlation ever between traditional asset classes because of the new low interest rate environment and the actual central bank policy, diversification in a portfolio can only be reached by adding **different strategies and not by weighting differently traditional asset classes.**
- For this reason, KTS has focussed, over 12 years, in strategies which would help reducing the correlation between investments in the portfolio and consequently reducing the volatility. **We reached such optimization with the help of our external risk manager** and multiple portfolio’ simulations over years. Of course, we are constantly monitoring new strategies. In fact, such optimization is never final and need to be constantly monitored.
- KTS always was of the opinion that in the future, bonds would not be able to help hedging the portfolio, having interest rates too low. For this reason, KTS was focusing over years in alternative fixed income strategies. The years 2021 and 2022 paid off such effort, having traditional portfolios under pressure from any asset classes and the investors could not “hide” itself anywhere. It is not the case of KTS, which **could reach positive performances YTD even in such difficult environment.** Not to mention, that many private equity and crypto projects went bankruptcy during 2022, in a much bigger magnitude than the pandemic crisis in 2020/2021! **Also to note, that many of the founders of such projects, which are worthless for investors, could put aside privately substantial capitals and the prosecution can not touch them!** As always explained to our clients, the only solution is prevention and it is only possible with years of experience.

The “holy grail” by Mr. Ray Dalio and determination of risk tolerance

- Analyzing our present portfolio, we tend to agree with Mr. Ray Dalio, that **15 to 20 uncorrelated investments are the key for the best diversification’s optimization.**
- In order to complete our answer to our clients, prompting asking in such distressed market environment, how to invest in order to limit drawdowns, we need to add, that **not only an optimization of the diversification in the portfolio is the long term key for better performance, there is also an additional pillar in our investment decision process with our clients, which is of course also an integral part of the KTS risk management process (with help of our external expert): the investment profile of our client.** In fact, before even starting to invest, we help our client to understand risk tolerance. We are also constantly monitoring the profile with our client over time, in order to update new financial or family’ situations.
- Such profile is of vital importance, **to determinate the risk tolerance** of our clients and help **preventing panic** in such distressed market environment. In fact, if an investor is not well prepared before a substantial market drawdown, there is the high risk of selling assets at distressed price, instead of having the right mindset for adding positions at attractive prices and think long term.

Optima dynamic FoF

- We would like to mention, that our flagship fund Optima Dynamic is basically flat for the year, clearly outperforming all the competitors, included our best-in-class fund Flossbach Multiple opportunities.
- As you clearly can analyze in the chart below, the Optima dynamic fund (white line) could substantially limit the drawdown during the pandemic and participate to the upside. Since 2020 we are outperforming Flossbach by +4.44% and AXA by 14.8%!



Optima dynamic FoF since January 2020

Rimac - Bugatti

- Finally the Round Series D is closed. Rimac group could raise EUR 500 million with Softbank, Goldman Sachs and the existing shareholders (Porsche, Hyundai, Camel Group, Investindustrial, NAD and of course KTS via the 1741 E-motion fund).
- As explained, after the integration of Bugatti into the Rimac group, the German VW/Porsche group showed to the investment community that there is no point of return and the electric mobility innovation is going to be developed by the Rimac group.
- In addition Rimac group holds also a substantial participation into the “Project 3 mobility” , robotaxi / driverless car , which is fully supported by the EU (EUR 200mio) and is going to be the future of mobility in most of downtown of the major cities worldwide. Zagreb as pilot project is going to be live in 2024. Robotaxis are a reality and are going to be on the street much earlier than we all think. It is important to mention, that Robotaxis are not in competition with public transportation, but is a further measure of governments to reduce traffic in the cities, in order to optimize electricity’s consumption and offer higher quality transportation in the city (especially for business people).
- Link to the official announcement:
 - <https://www.rimac-automobili.com/media/press-releases/rimac-group-raises-eur-500-million-in-series-d-investment-round-led-by-softbank-vision-fund-2-and-goldman-sachs-asset-management-investing-alongside-existing-shareholders/>
- The valuation is also not a secret anymore, as explained in the Financial Time’s article: **EUR 2.2 billion, in a time where most of EV companies lost 50 to 90% of their value!**
- https://www.ft.com/content/af424b80-3e41-4a96-8c43-af40b5015b47?fbclid=IwAR0pcefWhjacAxdXFvzVfCOd9b--_h6RwVdmzY_jul9b4IMfKoKSOEtX4RY

General news

- We are reading rumors of Mr. Putin planning to appoint his daughter, Ms. Katerina Tichonowa, as leader of his party in order to have a successor in case he is not able to be president due to his heavy sickness? (2-3 years to live due to cancer?!).
- We would like to mention, that by watching the Champion league final in Paris with 60k to 75k fans, of which apparently 60k Liverpool supporters travelled extra from UK to Paris, we can definitely assert, the world is back to normality and humanity won the “war” again the covid-virus. Only China needs to change the zero-covid policy...

General news on China / Asia

- Journalists around the globe think that because of the damages due to the zero-covid policy, **Mr. Xi will have challenges for the third term at the party's 20th congress in the second half of this year**. Apparently there are divisions at the party high-level and there is strong opposition to Mr. Xi's career plans. In our eyes, it is difficult to speculate, if the news is negative or positive for the country and the global economy, because we have to admit, that Mr. Xi introduced a kind of dictatorial system in China, which is in the eyes of many market participants not a promising prosperous future for China. But the dilemma is, it needs to be seen, if any successor would improve the central system and offer more democracy?
- Meanwhile China announced further stimulus: halving of purchase tax on passenger vehicles that are below 2.0 litres and below the price of CNY 300k, which covers roughly 80% of vehicles sales in China. In addition to further supportive policies on renewables like solar installation.

General news on cryptos

- We are reading, that despite the large drawdown in the crypto market, the top crypto fund of the manager Mr. Andreessen Horowitz could increase Usd 4.5 billion to be invested into Web3 (USD 1.5 bn) or tradition startup investments. This is the proof, that blockchain is the pillar for further development into fintechs, NFTs, etc.

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