KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 23

The 10th of June 2022

Macro news

- The US labor market is still robust and for this reason, market participants are not expecting a dovish FED. Expectations are a FED's hike of 50 basis points by June and July meetings and a pause in September. As far we understood, Mr. Powell indicated that the FED does not expect to hike by 75 basis points at future meetings.
- The dilemma is, if we analyze the situation of the tourism, traveling and gastronomy sectors, nothing positive will come in the next months on the inflation side. This year everyone wants finally to go on holiday, but airlines, restaurants, hotels, etc do not have enough workforce, creating a bottleneck in the sector and of course, the businesses which still have available place, can increase prices substantially. In addition to the fact that the oil price is breaking the resistance of 120 USD.
- On the other hand, the **bullwhip effect (weekly report nr. 15 on the 15th April 2022)** is happening. The company Target corp, lowered guidance on management of excess inventory. Because of supply bottleneck, last year all supermarket chains ordered more goods as needed and now, having high inventories and consumers shifting focus on food/beverage, household and essentials and beauty, supermarket chains need to substantially discount "unwanted" goods in their inventory. This should help to have a deflationary environment for many goods in the next months and should help to neutralize some price increase.
- As mentioned in the past, in order to "avoid" a recession in the US, it is important, that the US real estate market stays robust. According to a statistic of Bloomberg, courtesy Mr. Freeman, we are in the **midst of the worst housing demand in 40 years,** which collapsed in the last 2 months. At the end of the day, people decided to wait with the purchase of a house, due to increasing pricing, also of materials and higher interest rates. According to the blog or Mr. Yardeni, the housing market is falling into a recession, but **consumers continue to spend, though they have to borrow more to do so. Americans are basically continuing to increase their credit balances at a rapid pace as one way to deal with rampant inflation.**

Macro news

- This is quite of a dangerous “cocktail” and is not very promising. In fact, if the real estate prices would start to fall, bank would stop to lend? But the magazine The Economist is rightly arguing that is not comparable to the year 2000 or 2008, because this time bank balance sheets are strong and the FED is not in the same situation as in the 1980s where inflation was 5% over 7 years.
- Also reading that the World bank fears a 1970s of global stagflation is a bit shocking for us, because the situation nowadays is quite different and actually not comparable. As explained in the past, at present time our dependency to oil is not comparable to the 1970 (see weekly report nr. 12 on the 25th March 2022) in addition, as also the CIO of Credit Suisse pointed out, companies earning were falling and unemployment increasing, which is not the scenario we currently have. Mr. Schellekens, advisor at the World Bank Group, also argues that compared to the 1970s, today we have stronger balance sheets of major financial institutions, economies are more flexible and monetary policy frameworks are more credible.
- **If global economies would in fact fall into recession, also EPS are going to fall further,** which at the moment were very stable, and analysts would have to cut further estimates and according to statistics, valuations are still not discounting a recession (see weekly report nr. 12 on the 25th March 2022), therefore in this case, the risk of further equity market corrections could be real. As we can analyze in the next slide, according to the manager of Alkeon, the tech sector is at extreme attractive valuations.
- **KTS’s solution for the moment, not being able to buy back puts, being to expensive, is to have a stop loss on our trading positions.** We moved the stop loss for our QQQ US trade to the consolidation range up to 300 USD and therefore today we are selling the position. We feel comfortable to have again at least a 10-15% cash position, even if **many technical analysts are arguing, that internal equity market’s breadth is strong and actually expect further upside potential.**

Macro news

- The ECB is ending the net asset purchases as of July 1st , but in the contrary of FED, it is still investing the remain committed to reinvest the cash maturing from the 5 trillion EUR worth of public and private debt on its balance sheet. The ECB will also raise interest rates 25bps next month. ECB expects to raise again in September perhaps additional 50bps. The ECB also cuts the growth outlook for 2022 to 2.8% from 3.7% and 2.1% from 2.8% for 2023. European equity markets reacted negatively, but the negative move was quite contained, most probably because the ECO let open next moves, depending on the future development of the European economy and therefore could be also not too hawkish.
- According to the newspaper Financial Times, the **ECB is planning to ward off bond market stress**, **basically supporting the bond market of peripheral countries like Italy, Spain or Greece**, having their spreads increasing due to higher rates and market participants worrying again about the high indebtedness. We believe, the reinvestment of cash maturities will be more focus on peripheral debt.

Valuation of the tech sector

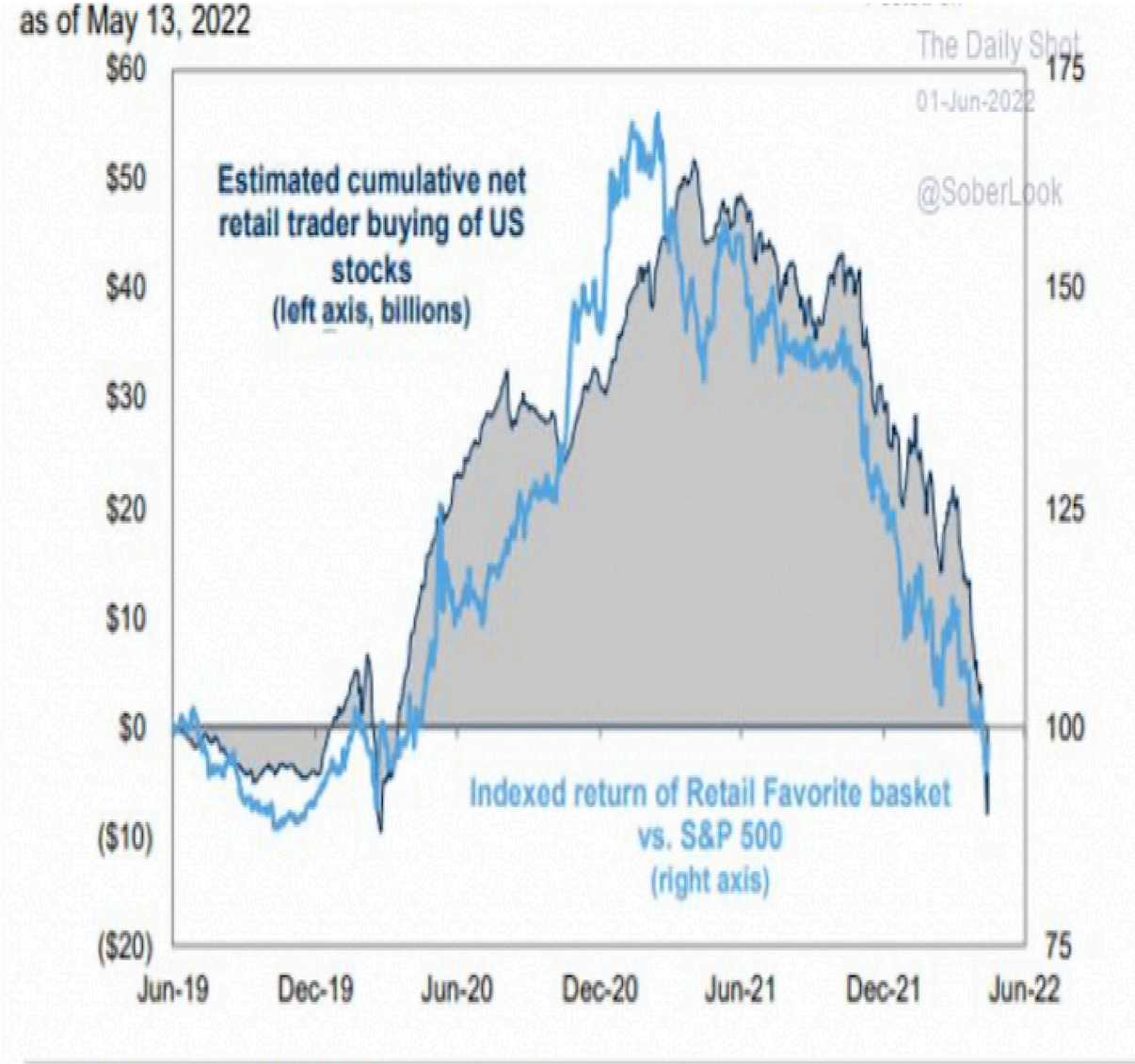
- We had an interesting conversation with our best-in-class L/S fund Alkeon, which is explaining to us, that according to Merrill Lynch statistics, **the percentage of stocks in bear market (>20% off 12-month high) include 81% of Nasdaq stocks and 56% of S&P 500 Index. Tech stocks have sold off -23% YTD, despite an increase in forward earnings of 9.2%. 72% of those stocks have an improvement in earnings projections and price contraction.**
- This is the confirmation that such **extreme stock price behavior is "masked" by the index performance!** Now is the time for stock pickers to buy quality companies with strong growth at attractive prices and it does not matter what happens in the short term, long term investors are going to reach nice performances. In fact, Alkeon's target of many companies in the portfolio is over 100% upside potential. Therefore we stay invested in the fund Alkeon, which should finally perform above average in a rebound of the equity market, but we go again in "barbell strategy", holding 10-15% in cash for trading.
- **Basically, Alkeon believes this is purely a technical correction on growth names as fundamentals have remained strong and asserts that high-quality compounders are being sold indiscriminately and harshly.**
- **The re-rating of the 75 fastest growing companies in the US, which began almost 3 years ago, has now come full circle, with the relative performance against the market 20% below to pre-pandemic levels. Such situation happened only in the year 2008 and Q4 2018.**
- We are reading other statistics, courtesy Bloomberg/AdaptFirst Investments, showing that only 30% of the S&P 500 stocks are down 30% from their highs and therefore comparing to the year 2000 and 2008, still nothing happened. We tend to believe more the research of Merrill Lynch, also from what KTS is seeing on daily business, we have the feeling, the correction in the market is much more dramatic than analyzing only the performance of the Index.

Technical analysis

- **According to a statistic of Mr. Rowles, insider buying in Nasdaq 100 is as high as in 2012, which is quite a strong contrarian bullish signal.**
- **Julius Bär technical analyst is basically advising clients to buy the S&P 500 Index,** having short-term breadth improvement, which opens the way for recovery and to **sell gold and silver**, arguing, they are breaking key support levels and long-term momentum peak. It is quite a strong assessment, if we take into consideration that many other market participants are still seeing a substantial correction in the equity market, as for example the JPMorgan's CEO, Mr. Jamie Dimon, who is expecting an economic "hurricane" coming because of rising interest rates and elevated commodity prices. Mr. Elon Musk is planning to lay off 10% of workforce, because he is expecting harder times. KTS is narrowly monitoring economic developments and **we were increasing our stop loss from 280 to 300 USD for the QQQ US, therefore today we are going to sell.** In addition, we are not reinvesting the 1/3 cash in the Biotech basket from the sale of TPTX US. Finally, we have around 15% overall cash at disposal for trading and we are going to jointly monitor with our external technical analyst, when is again the proper time to try a trading with high conviction. Entering the weakest period of the year and with the risk of Q2 result disappointments, it is better to be invested with a barbell strategy, holding also cash, because we can not buyback a put option position. An example is the stock DOCU US, which is now on our watchlist, after we experienced, that our best-in-class fund Flossbach bought a position and being today -23% pre-market, we are evaluating the possibility to sell put options.
- Gold for us is a long term investment and we are not basing ourselves only on technicals. We would rebalance our gold position at any upside spike, but unfortunately it has not happened yet. But we are also holding 10% cash for trading.
- Next week we are going to listen to the webinar of Flossbach, which is also increasingly worry about the high inflation.

US retail investors have sold all the equity purchases made over the last 2y

- Retail investors were heavily investing during the pandemic, especially having received nice “checks” from the government and being home with “too much time at disposal”.
- According to the right-hand chart, **US retail investors have sold all the equity purchases made over the past 2 years.**
- Market participants think that if the pain continues for investors, which are still long, retails wont come back to the market for years.
- KTS believes that this is what already happened with the majority of SPACs, dubious cryptocurrency projects, NFTs and finally “meme” and non profit tech companies. All those stocks experienced substantial corrections, even over 90% and basically we can assert, **the same year 2000 Dot-com bubble bust’s phenomenon already happened during the equity correction in 2022!** Therefore, most of unexperienced US retail investors, already burned their fingers. But too many market participants are not differentiating the actual correction between stocks and still analyze only the index.



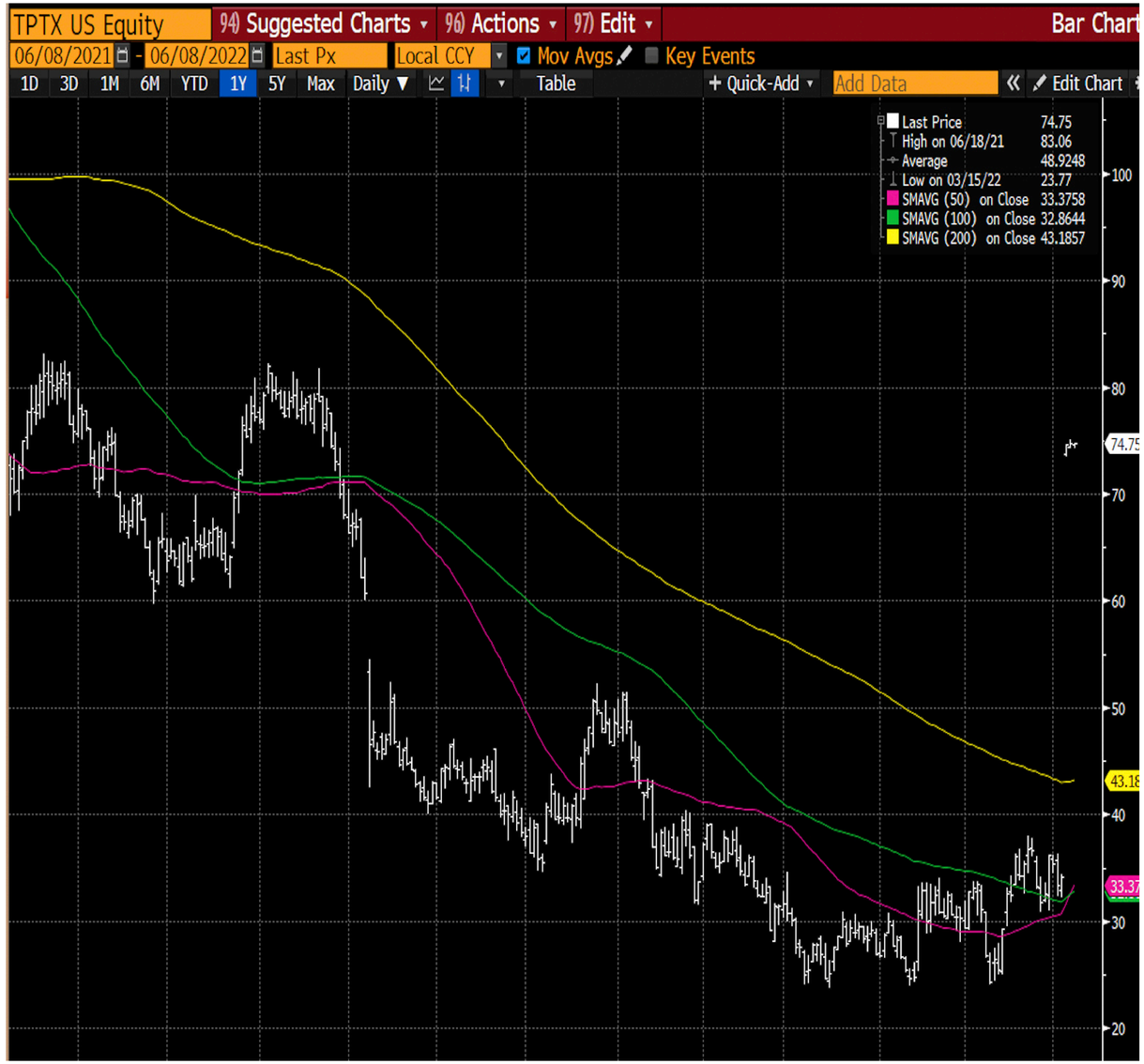
Source: Goldman Sachs via Dr. Jindal

Goldman Sachs negative on specialty metals

- We were reading a research of Goldman Sachs, basically asserting that the battery metals bull market has peaked.
- We promptly had a conversation with our best in class fund Bakersteel Electrum and the manager agrees in many points of GS, but has the opinion that there are still good opportunities.
- The fund Bakersteel Electrum is not investing directly in commodities, but in mining companies, which have **mostly long-term supply contracts and are not based on spot price**. Discussion with insiders of electro mobility are actually expecting a shortage of fundamental metals for electro batteries in the next years. Therefore, KTS would rather listen to the insiders than GS analysts. But of course, on the short term it could be, the sector is losing some steam?
- The manager of Baskersteel is focused on fully integrated producers that can expand into this market and are first or second quartile producers. **Examples are SQM, Albemarle, Mineral Resources and AMG**
- **Bakersteel Electrum is also invested 1/3 into precious metals** and having governments increasing stimulus packages also into **solar panels, this should also support, at least on the long term, the price of silver.**

KTS special situations: TPTX US

- At the beginning of May 2022, we analyzed with our external biotech expert, Ms. Myoung-Ok Kwon (Fund manager of our best-in-class Biotech fund PMG Biotech and partner of Swisscom Ventures), where we should allocate our liquidity in attractive biotech companies, in addition to our investment into the PMG Biotech fund. We unanimously decided, that the company **TPTX US (Turning point Therapeutics)** had the best risk-reward profile on the short and medium term.
- The company has just being bought from Bristol Myers Squibb at USD 76 per share helping tremendously the depressed performance of our biotech investment with a rebound of +33%
- Such event is the proof, that our external joint ventures are an important long term value added to our investment process and investment strategy and give us confidence, that KTS can offer an above average performance with the help of our external experts. In the past, Ms. Myoung-Ok Kwon also helped KTS' clients in taking difficult decisions by special biotech transactions or special positions in the portfolio.



TPTX US: Turning point Therapeutics: M&A a 76 USD per share

KTS special situations: GEVO US

- Meanwhile the company GEVO US could not report any final agreement with Chevron by the 31st of May 2022, but executed a capital increase of 150 mio USD instead (USD 4.5 per share + 1 warrants for free). For KTS a final JV with Chevron was the confirmation, that major oil companies are not in possess of the technology, at least for the SAF, and need JVs with start ups like GEVO, in order to “catch up” with the renewable trend and the substantial pressure of governments.
- On the Firechat interview, the CEO of Gevo, Mr. Patrick Gruber, insisted, that Gevo has even more substantial contracts in the pipeline. For KTS it is clearly a disappointment and we have already experienced in the past enough companies promising but not delivering.
- For the moment, Gevo has over USD 600 mio in cash, which should be enough to build up at least the Net zero 1 project (cost around USD 1 bio) with a planned annual EBITDA of 150-180 mio USD in the next couple of years. Gevo has also a tremendous pipeline of “pay or take” contracts from airlines and Trafigura, which are going to guarantee substantial revenues for at least the next 10 to 15 years, but as we know, especially for the SAF, Airlines are going to constantly increase the use of renewable jet fuel, due to regulatory pressures. **EU plans a percentage of SAF used in air transport of 2% by 2025, 5% by 2030, to 63% in 2050.**
- Therefore the price of USD 3 is extremely attractive, but as long as the company is not able to finalize a JV with a major player like Chevron or ADM, KTS will try to trade the stock, instead of only stay invested (buy&hold).
- Over 55% of Gevo’ shareholders are “passive green” ETFs like PBW US, therefore Gevo is strongly correlated to the renewable sector. Concluding, we decided to keep trading Gevo, being correlated to the renewable sector, trading at net cash and having the company still in discussions with multiple major players in the energy sector for possible JVs, therefore there is still the realistic possibility, something major could happen.

KTS special situations: NCU CN

- The company had to announce, that the production of the mine Pumpkin Hollow will be weaker than forecasted in the second quarter as miners encountered an “unidentified weak rock structure” blocking ramp development until it is reinforced.
- Having rising costs from such special rock structure, the company is planning to cut costs elsewhere.
- **Meanwhile the work on accessing the east north zone of the mine, which holds higher grade ores, is expected to be complete by month’s end.**
- Pala Investment in Zug agreed to provide again an additional USD 20 million in funding through a promissory note, though draws on the financing are subject to exchange approval and “the company reaching satisfactory arrangements with certain creditors and vendors”.
- Of course the company had to warn, that there is no assurance, that the full amount of the funding can be draw and therefore may not be able to continue to carry on business.
- We think that the 3 major shareholders invested substantial capitals over years and the market capitalization is well below the total amount invested, but the project has substantial resources and is the only permitted project in North America (for the new mine). Therefore we can not image the mine to go into Chapter 11. If KTS would be in the position of the 3 major shareholders, would rather think to leave or sell the project to a bigger mine, in order to avoid a total lost and perhaps agree in some royalty fees base on the production. This is the most logical option we can see. KTS is not adding positions yet.
- KTS is very frustrated with the price’s development, but we were actually buying at attractive levels, at least compared to the major shareholders. **We hope in better news in the next couple of months from the east north zone of the mine.**

General news

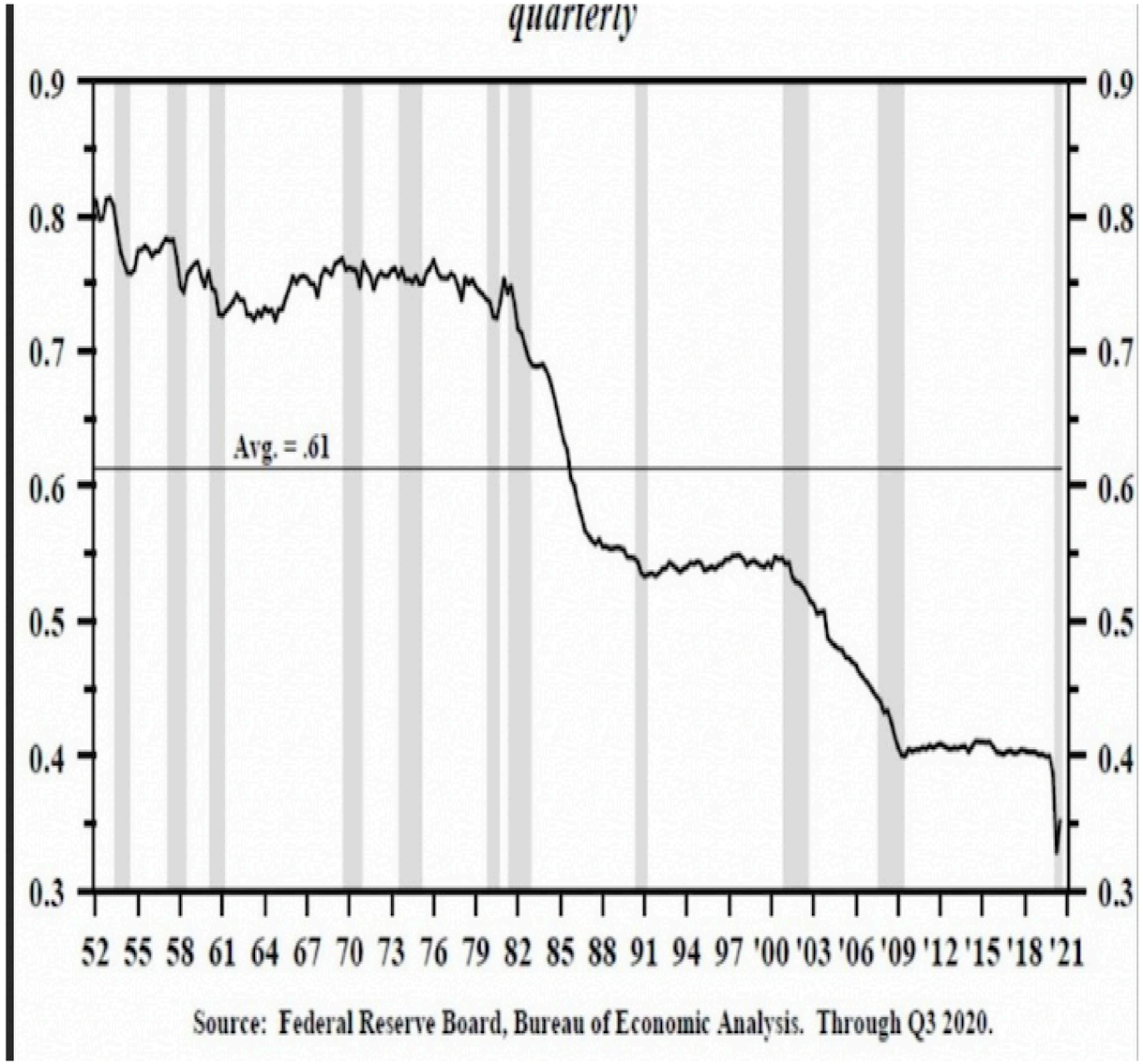
- An interesting article in the magazine The Economist argues that US retails are shifting spending from goods back to services, reversing a pandemic-era trend and this switch should help to ease pressure on global supply chains and lower inflation. Of course the process has been slow and uneven. Mr. Yardeni was always arguing that this shift should happen. KTS is going to analyze again, if some passive ETFs are attractive to invest in. There are multiple ETFs: JETS US (airlines), PEJ US (dynamic leisure, mostly hotels), AWAY US (travel sector), CRUZ US (hotel, airline and cruise), but as mentioned in page 2, many companies are still facing challenges.

General news China/Asia

- Apparently there are positive development between Chinese regulators and the company Didi Global Inc in addition to Chinese regulators approving more video games for this year. The **Chinese tech index experienced a nice rally** and analyzing the long term chart, the segment is bottoming up. In addition we are reading, that the iShares MSCI China ETF (MCHI US) experienced strong inflows in the past days and analysts of JPMorgan and Bank of America are turning optimistic on beaten-down Chinese stocks.
- In addition, China is easing covid-lockdowns and China's exports jumped 16.9% in May, compared with a year ago. Analysts expectations were for only an increase of 8%.
- Finally, apparently China has set up a team to review IPO and listing plan.
- The manager of Alkeon was arguing in our conversation, that being China still strongly depending on manufacturing and therefore not having the possibility to shift "work from home", it should be understandable, why Chinese authorities had such strict covid regulations.
- KTS feels comfortable with the rebound of the Chinese equity market having a small exposure into the **ETF EMQQ LN**, though, with the high conviction we had recently, we did not have to courage to double up our position at attractive prices. Now we just stay invested with the initial position. Meanwhile, our best-in-class fund Alkeon has also an exposure of 6.5% in Chinese E-commerce stocks like **JD.com and Alibaba**. Also our emerging market funds Aubrey and Stonehorn Asia equity have exposure in China.

Debt repayment via implicit default

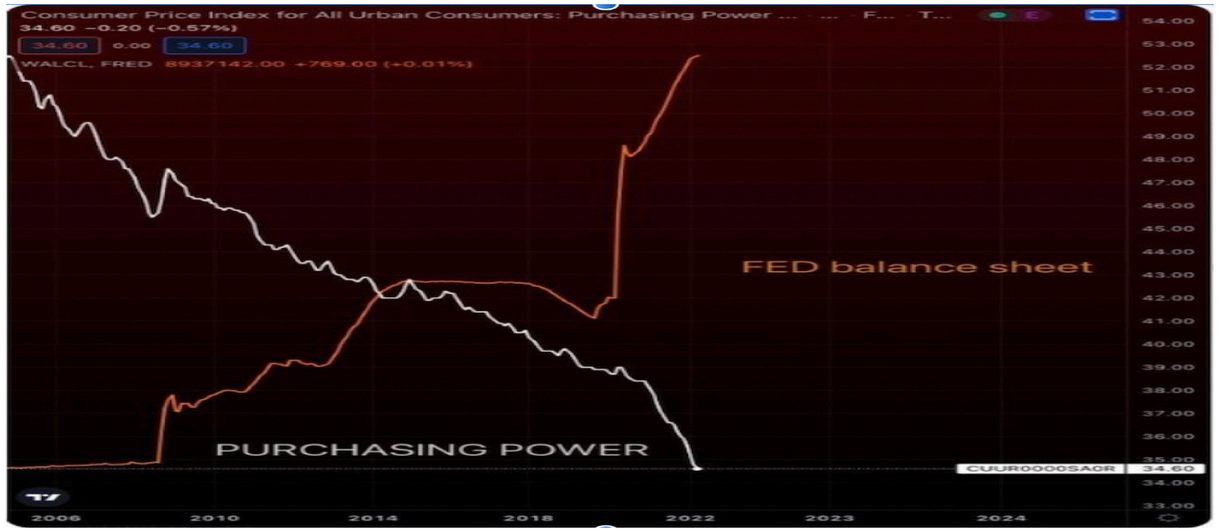
- As always argued in the past, central banks of developed countries are **planning to reduce the substantial indebtedness only via inflation and economic growth**. According to the analysis of Carmen Reinhart & Kenneth Roghoff (via Mr. Rowles), this way to pay the debt off is so called implicit default. The other 2 ways would be to repay the debt (where governments would get the money?) or to simply default.
- According to the research, at present times we have a **USD 0.35 growth for each new dollar in debt**. For this reason the research demonstrated that in the modern era, **developed nations prefer implicit default** and was also clearly articulated the point of no return.
- For this reason, we should not be surprised, that central banks do not have any interest to **have inflation lower than nominal rates, as always explained.**
- **For this reason, real yield in a portfolio can only derive from hard assets and not normal fixed income.**



Diminishing return from US debt (source Mr. Rowles / Carmen Reinhart)

US consumers purchasing power

- Re-connecting to page 10 and the strategy of global central banks, especially by developed countries, we would like to remind our investor, **the trend of consumers purchasing power**, **which is dramatically falling and the only way to compensate such phenomenon is to be invested into real assets.**
- We are also attaching a chart, courtesy mr. Costa of Crescat Capital, arguing that **gold is holding quite strongly vs the substantial correction in the bond market.**

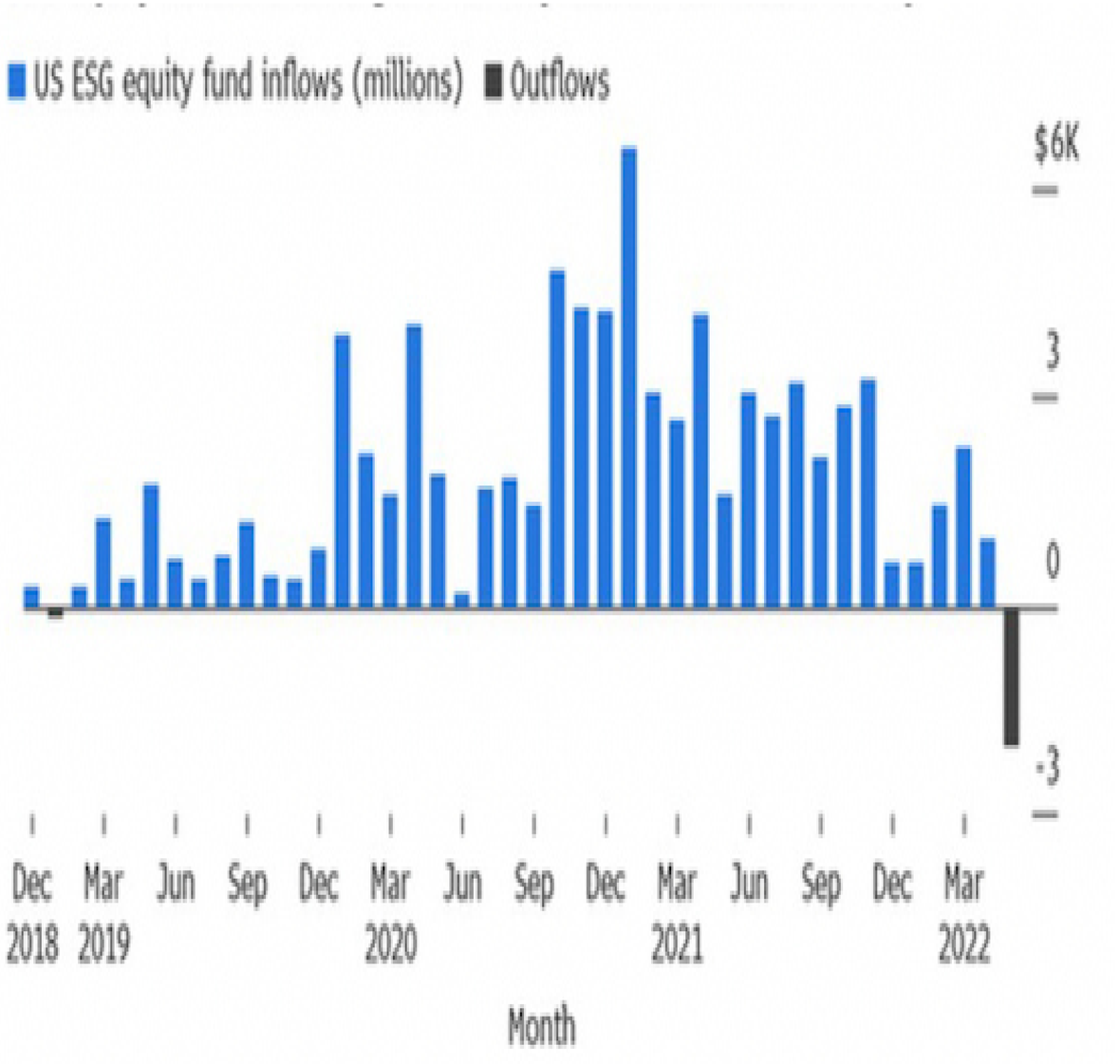


Source: Alessio, via Mr. Charles-Henry Monchau, CIO of Syz group

Gold holding well vs the bloodbath in global sovereign bonds

Outflow ESG funds

- After multiple scandals and many disappointments, investors started selling, most probably passive, ESG funds.
- As always explained, ESG criteria need to be implemented in the investment process of active asset managers, but does not have to be the only reason of investing.
- For this reason, KTS makes sure, that we are invested in active best-in-class funds, which are also focusing on ESG, but not only.
- **The renewable sector is still very attractive and has strong momentum having the Biden's administration and China increasing efforts to support solar, wind and hydrogen energy sources. In addition to Europe to ban new fossil-fuel cars from 2035.**
- KTS feels comfortable with the investments into the space and also silver should profit long term from the increasing investments into the solar industry.



Substantial outflows from ESG funds (Bloomberg/Syz group)

Energy sector comparison

- We find interesting the blog of Mr. Fulop, arguing that NVDA (Nvidia) and Exxon (XOM US) have both USD 440 bn market capitalization, but **Exxon is trading at 15 P/E and reach USD 87 bn revenue**, meanwhile Nvidia P/E 50 and USD 9 bn and that it is understandable, **Mr. Buffet moved USD 40 bn into oil in the last 90 days.**
- This is the reason, why even if our investment into energy is YTD over +50%, **we are not selling**, being the sector still very attractive and having oil companies **drastically improving their ESG rating** (Standard and Poor recently included 15 energy companies in the S&P ESG index and excluded Tesla!).
- According to long term statistics, courtesy Bloomberg/Syz group, the energy sector is still trading at **price-earnings ratio 6.4x**, vs 8.5 times at the beginning of the year. This means, even if the sector is the best performing YTD, earnings increased more than the share price and **valuations are as cheap as in year 2008.**
- Analysts are still busy in boosting their earnings forecasts and the oil price is breaking out the 120 USD resistance.

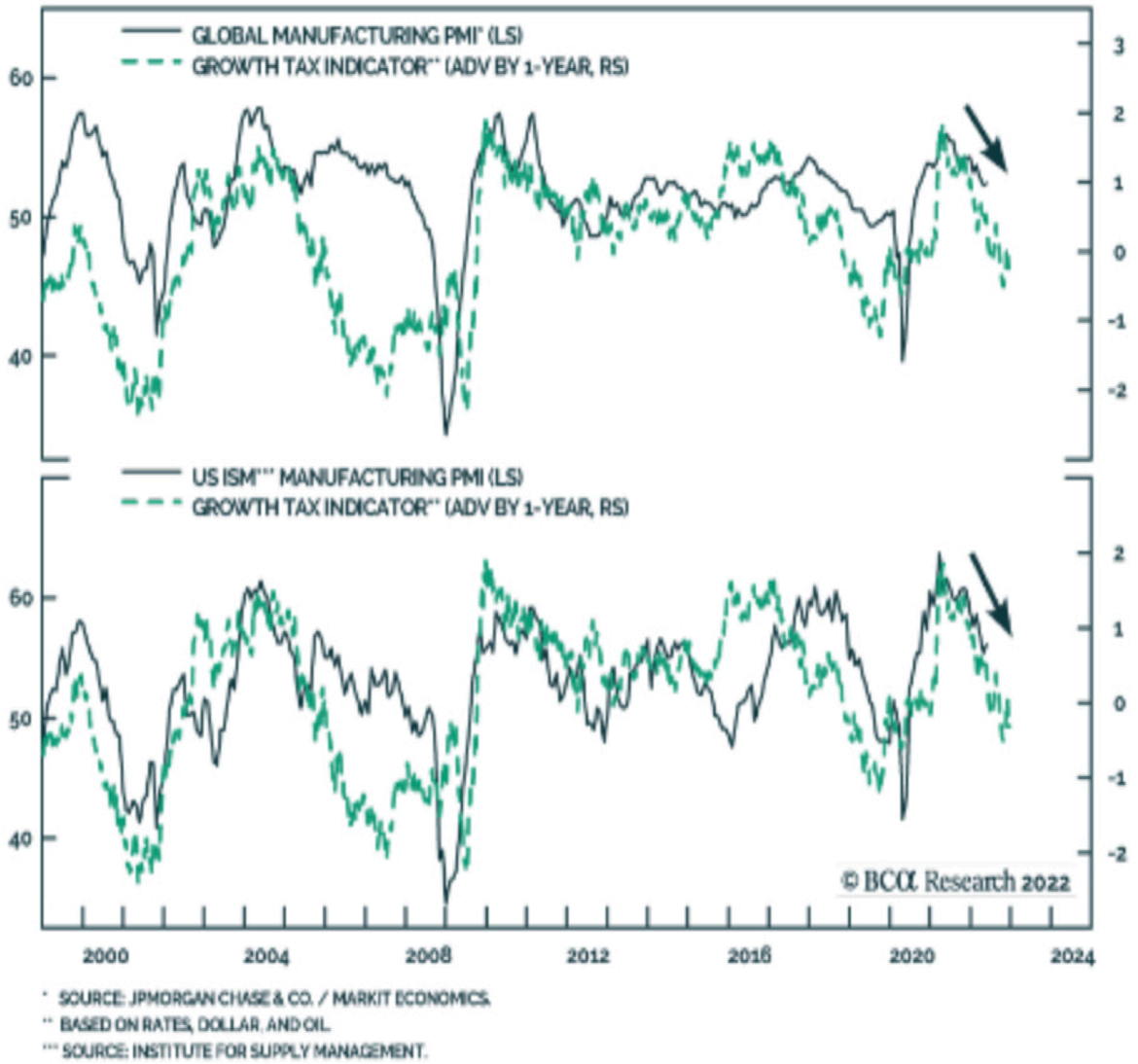
Economist' predictions

- Analyzing the past and according to the experience of KTS, we tend to assert, economists are changing predictions, when events happened and therefore too late.
- Also according to statistics of Man AHL, **economist' predictions are mostly wrong** and therefore the macro model of the absolute return fund AHL Megatrend and AHL Trendrisk are based, quite successfully, on diversification, active risk management ("calibration of volatility") and systematic investing adapting to the rapidly changing of market conditions. The system is not based on any predictions, as many other systematic models.
- When equity markets are correcting, too many investors are focussing on the downgrade of economists, most of the time creating unnecessary panic. Also the World Bank just slashed global growth forecast and warns of 1970s-style stagflation.
- We would like to post a blog of Mr. Bangemann, showing how on the front page of the newspaper Financial Time, journalists can be so contradictorily (unconsciously?).

Source: Financial Time

BCA's growth tax indicator

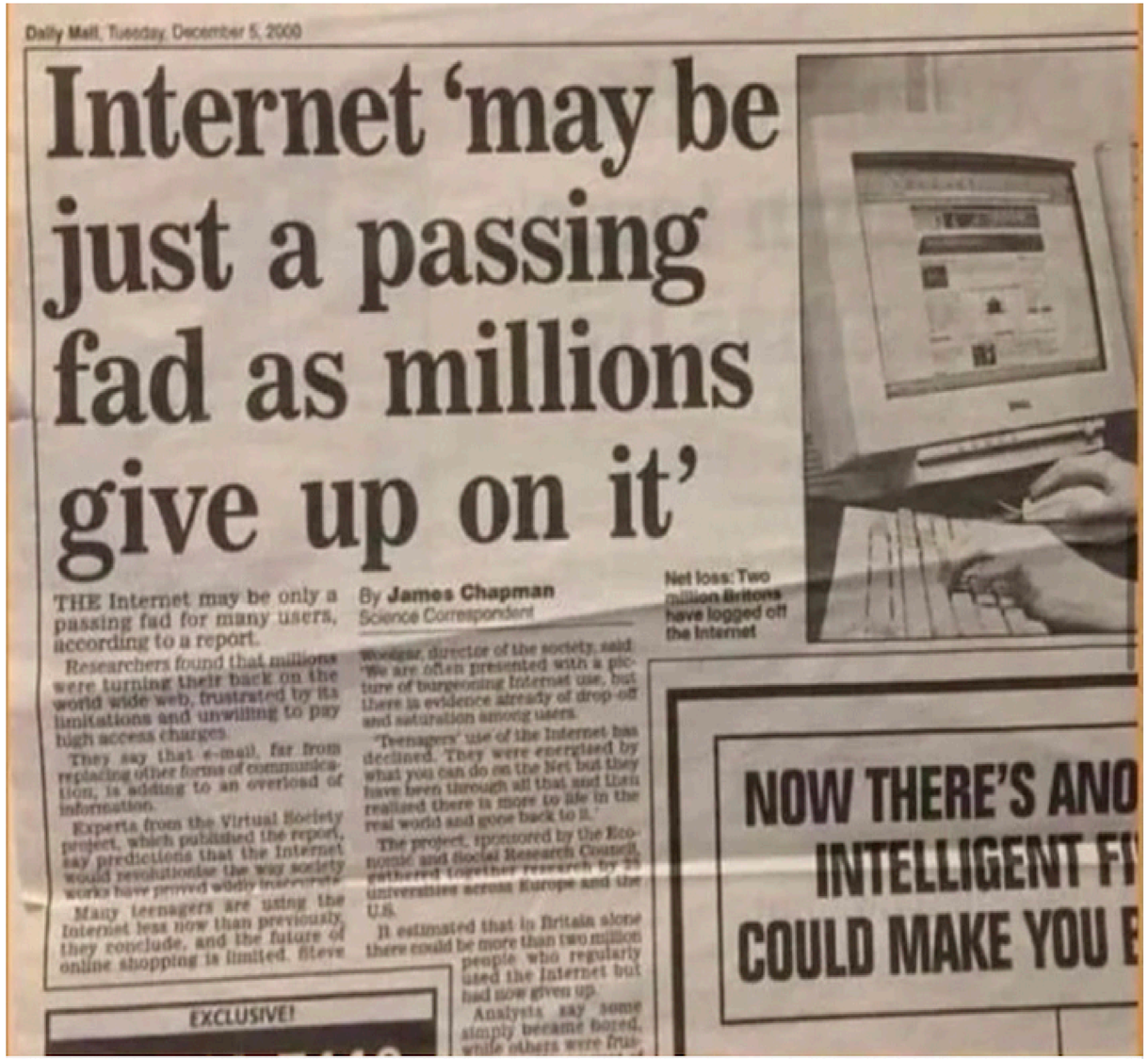
- As confirmation of page 11, we would like to mention the comment of BCA research, which is also pointing out, their growth tax indicator continues to send a negative signal for the economic growth outlook.
- The indicator typically provides an advanced signal on the outlook for economic activity and the trajectory of the Eurozone and the global manufacturing PMIs are consistent with this signal as both have been trending down since the start of the year. Even if the ISM Manufacturing unexpectedly increased, the growth tax indicator is warning that there is further downside ahead.
- **BUT,** economists have been downgrading their 2022 and 2023 forecasts for economic growth to reflect headwinds from rising interest rates, higher energy prices, and a stronger dollar. Meanwhile, the **YTD equity selloff suggests, that the bad news is already discounted**. The global macroeconomic situation is likely to improve in the second half of the year, as Chinese activity improves and inflationary pressures moderate.



Source BCA: went overweight equity 2 weeks ago

Blockchain technology

- As always argued, when there is **momentum in a sector, there is a substantial risk of fraud**. It has always being that way and even in a over-regulated financial market like the current one, we have seen, it is still possible for dubious people to set up frauds. We refer to dubious SPACS as also unfortunately many crypto projects. As always explained, the only way to avoid such worthless investments is experience and prevention, but mostly, **"fight back" emotions focusing only on the upside potential and to avoid the real risk.**
- But, this does not mean, that the whole sector is worthless. We still believe that the blockchain technology is a pillar for future Fintech's innovation and those companies, which have a solid business model going to survive, as Amazon and Yahoo did back in year 2000. **We are happy with our VC investments.**
- Therefore we like the blog of Mr. Chia Hock Lai, arguing that people only associate blockchain with cryptocurrencies speculation and illicit financing, just like those who only associate early days internet with porn and online gambling.



Daily Mail, Tuesday, December 5, 2000

Internet 'may be just a passing fad as millions give up on it'

By James Chapman
Science Correspondent

THE Internet may be only a passing fad for many users, according to a report.

Researchers found that millions were turning their back on the world wide web, frustrated by its limitations and unwilling to pay high access charges.

They say that e-mail, far from replacing other forms of communication, is adding to an overload of information.

Experts from the Virtual Society project, which published the report, say predictions that the Internet would revolutionise the way society works have proved wildly inaccurate.

Many teenagers are using the Internet less now than previously, they conclude, and the future of online shopping is limited. Steve Woolgar, director of the society, said: "We are often presented with a picture of burgeoning Internet use, but there is evidence already of drop-off and saturation among users.

"Teenagers' use of the Internet has declined. They were energised by what you can do on the Net but they have been through all that and then realised there is more to life in the real world and gone back to it."

The project, sponsored by the Economic and Social Research Council, gathered together research by 24 universities across Europe and the U.S.

It estimated that in Britain alone there could be more than two million people who regularly used the Internet but had now given up.

Analysts say some simply became bored, while others were frus-

Net loss: Two million Britons have logged off the Internet

EXCLUSIVE!

NOW THERE'S ANO
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December 5, 2000

SPAC bubble

- The latest research of the Syz group is entitled **"The SPAC bubble is bursting"**, mentioning the ETF SPAK US, or single names like Electric Last Mile Solutions (-94%), Canoo (-84%), etc.
- As recently mentioned, we think that the "speculation bubble" into SPACs, Cryptos, NFTs, meme, "Reddit stocks", non profit companies and all the "dubious projects" **has already bursted with the same magnitude as the Tech bubble in year 2000.** As our clients remember, KTS was warning back in February 2021, that valuations of such investment vehicles were unsustainable and sooner than later investors would have to "come back to reality". It happened faster than we though.
- We are also arguing that, when market participants are only analyzing the Nasdaq Index chart expecting further corrections, but not also focusing on the internal breadth of the Index, is a weak analysis.
- We would like to remind to our clients, that **40% of the performance during the last 10 years by major tech players is to be attributed to substantial share buyback programs.**
- Therefore KTS believes that **stock selection** is now the key of reaching above average performance, on the contrary to the year 2020 or 2021, where investors were better off with the FAANGS.

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