KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 24

The 17th of June 2022

The FED

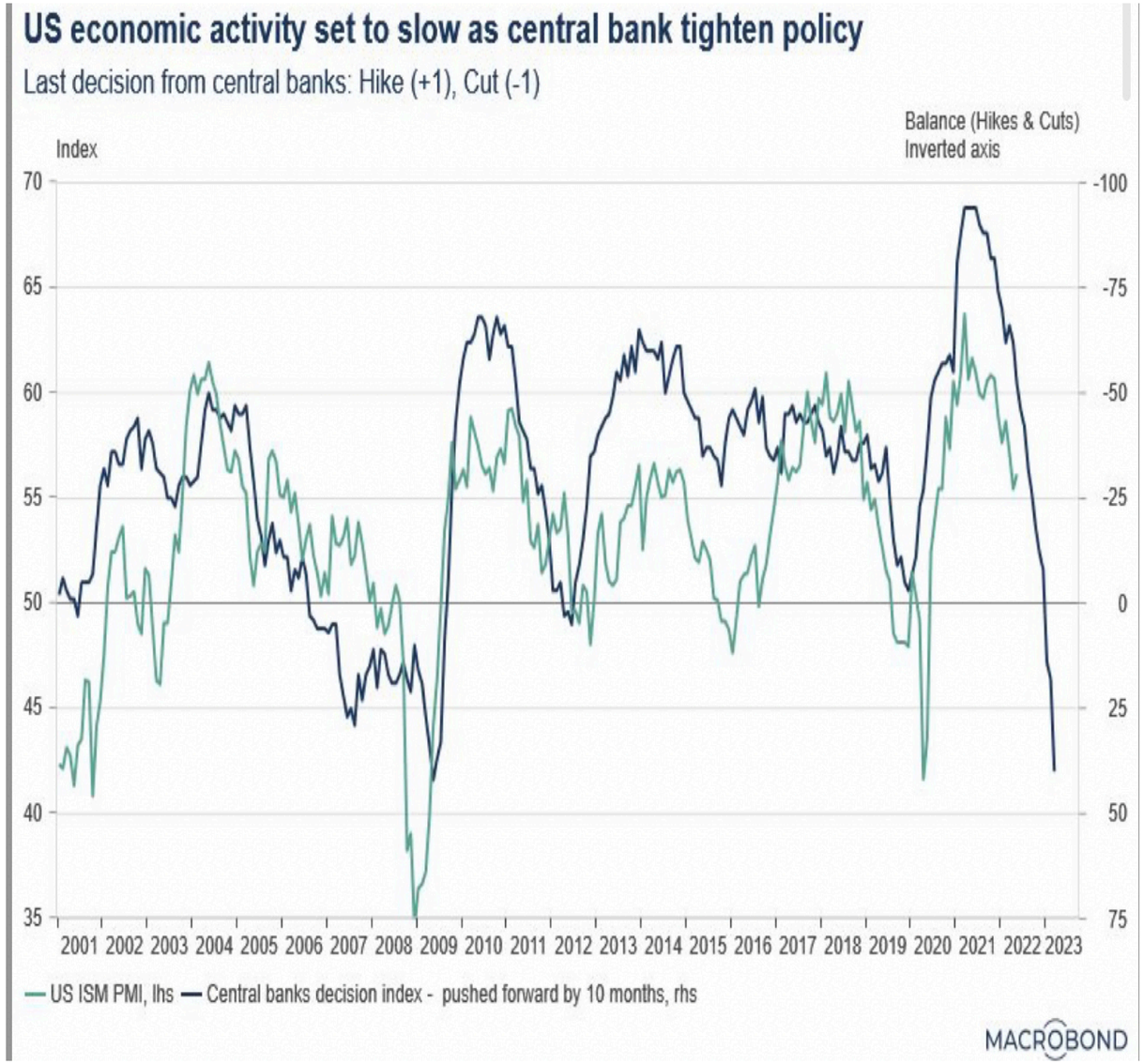
- With the increase by 75 basis points, signaling additional rate hike (target 4-4.25% for mid-2023) and declaring fighting the inflation as the top priority, the FED was as hawkish as it gets. It was expected and the market reacted positively (mostly short covering?), but the day after, all the investors' optimism was gone.
- With increasing interest at this pace, the US real estate and smaller business are going to suffer even more and even the FED is asserting that according to their model we are going to experience a soft landing, it is now for KTS impossible to guess, what is really going to happen.
- **Almost unnoticed are actually the commentaries of Ms. Yellen, saying that the FED does not need to buy equities now, but Congress should reconsider allowing it, arguing that the FED is far more restricted than most other central banks.** In fact, if we analyze the balance sheet of the Swiss National Bank, Japanese central Bank and others, they are acting as hedge funds and were buying substantial amount in equities over the past years. In our eyes, this is another measures to have the FED step into the equity market in moment of panic!
- The Swiss National Bank also had to react and reduced the negative rate from -0.75% to -0.25% and this is the first hike in 15 years.

ECB supports peripherical countries

- As for rumors last week, the ECB set up an emergency meeting and offered some relief by showing flexibility in its reinvestment strategy, **basically giving more room for supporting peripheral countries** already experiencing their spreads under pressure, having investors anticipating higher interest rates and therefore financial issues with the annual budget.
- In fact, countries like Italy, Spain, Greece (apparently Portugal could improve their financial budget) could keep the high budget burden only because of the low interest rate environment.
- The manager of Flossbach is still arguing, that most of Western countries can not sustain higher interest rates for longer, having a tremendous high indebtedness and the move of ECB is the proof, that already now, the “weakest” Western countries have an issue, at least in the eyes of the investor community.
- Therefore high interest rates for a longer period of time is just not sustainable.
- We are also reading, that hedge funds like BlueBay are shorting Japanese bonds until BOJ breaks. We can not have an opinion on the possible success of the strategy, but contrarily to the legendary manager George Soros, who blowed up the Bank of England earning USD 1.1 billion in the 1997, KTS thinks that nowadays the situation is different, because if at the time of Mr. Soros, the issue was only by the Bank of England, today all major central banks worldwide have their interests aligned, mainly, to keep interest rates as low as possible for longer and as we always argued, the very high inflation is a temporary phenomenon and all the governments are using all possible solutions to solve the dilemma as soon as possible.

Correlation US ISM with central banks decision index

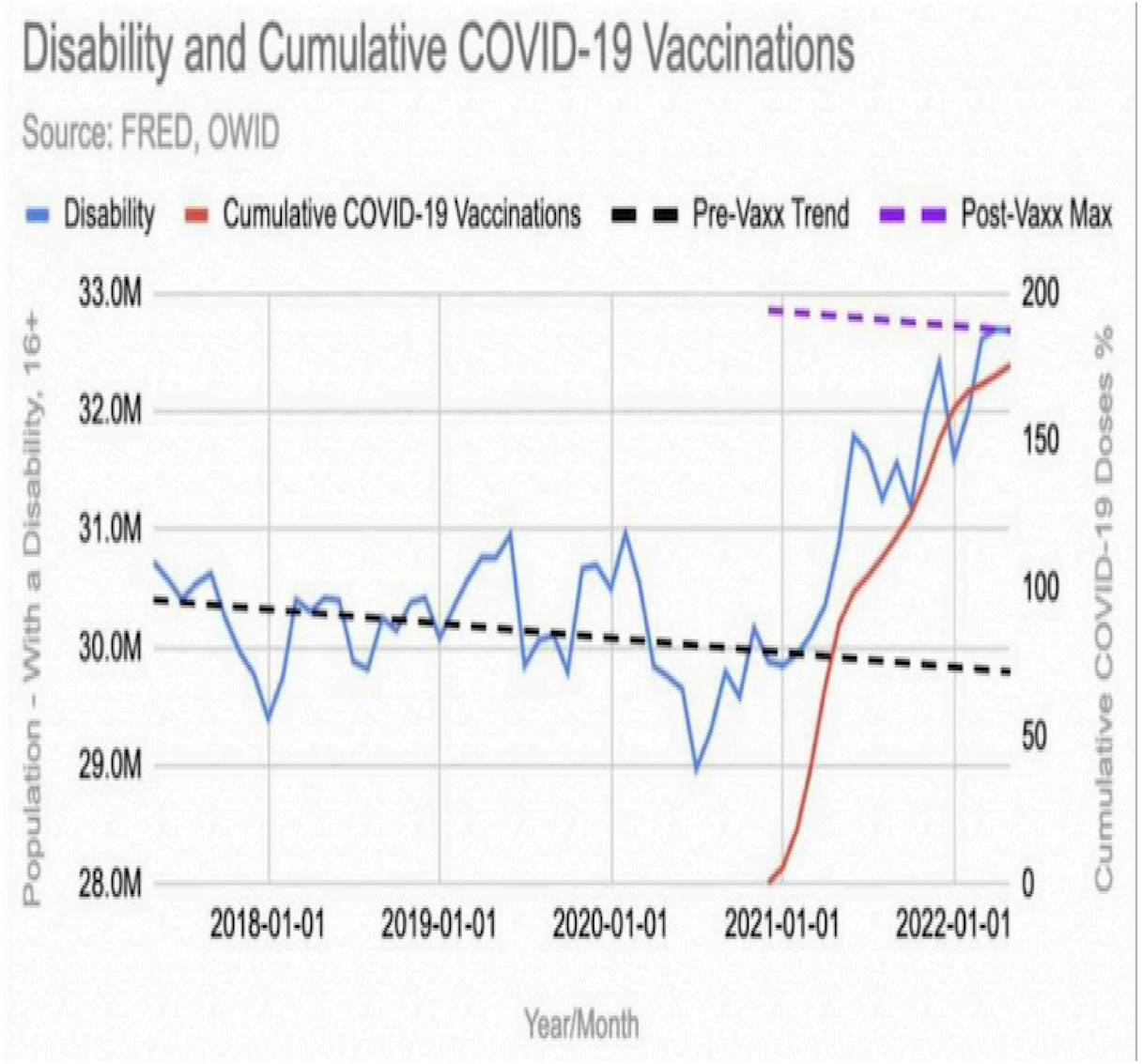
- On our right hand chart, courtesy Macrobond via Syz Group, we can analyze the correlation between the US ISM activity and central bank activities (pushed forward by 10 months)
- According to the research, analyzing historical data, in the near future we are still going to experience a weaker economy.
- Conclusion: unfortunately it is too early to be optimistic on the future development of the US economy, especially after the decisions at the FED meeting.



Source: Macrobond via Syz Group

Working age population is down by 3million people in US

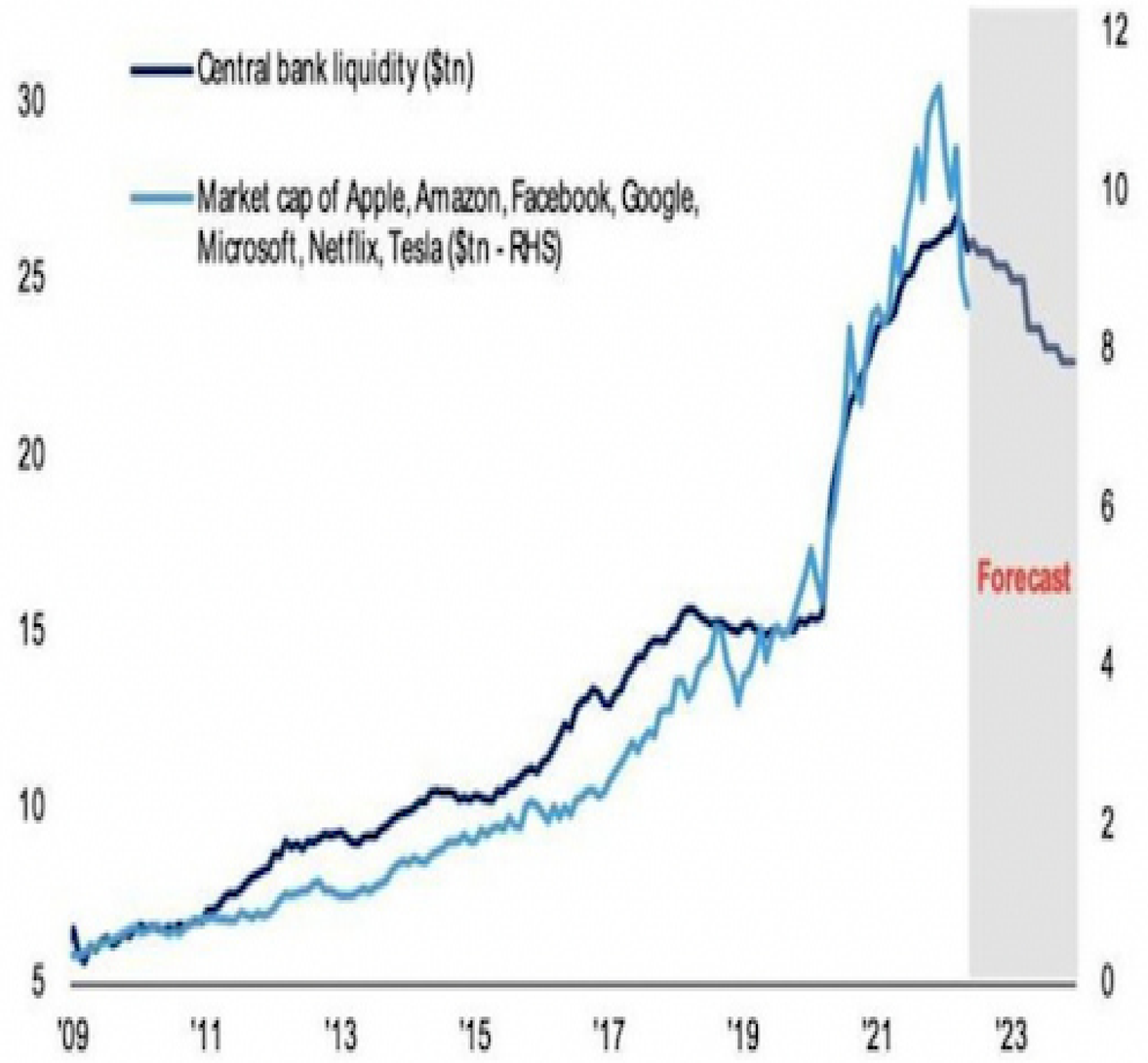
- We like the blog of Mr. Ritesh Jain, arguing that the working population in US is down by 3 million people and this is because of **increasing disability** (see chart on the right-hand side).
- **We agree, that the FED hiking rates is not going to solve this problem.**
- Unfortunately we can not influence politicians or the FED, but we sense, that actually the only real solution at the moment to ease the panic on the inflation, is either to increase oil's production, reduce oil' taxes or finally talk seriously with Russia in order to stop the war (also the journalist Mr. Leopoldo Gasbarro is writing in this direction).
- Anything else is causing unnecessary unrest and derail the normalization process, as also the constant economic growth.
- We are reading that the Biden's administration is trying all possible solutions in order to reduce as fast as possible the high inflation, therefore we would be ready to invest, as soon as we have the right signs, especially from a technical point of view.



Source: FRED, via Mr. Jain

QE correlation with FAANGS

- On the right hand chart, courtesy BofA via Syz Group, we have an indication of the negative influence of the reducing QE from the side of the FED on the FAANGS price development.
- According to the chart, the FAANGS need to correct further?
- But we have seen last week, according the manager of the fund Alkeon, **valuations in the Tech sector are already as depressed, as in year 2000 and 2008 but tech companies are much more sound than at the time! For a long term investor, it really does not matter anymore, if he is buying today or 10% lower.** Historically, with such depressed valuations, the investor over the medium horizon could reach substantial profits.
- On the other hand, we are also reading, that the FED should start the QT (quantitative tightening) yet, but according to latest FED' announcements, instead of sell USD 10 billion in bonds, is still buying USD 10 billion and therefore still practicing the QE not the QT.



Source: BofA via Syz Group

Macro and next buying level

- The CPI data came out slightly worst than expected, 6% versus 5.9% (**bigger contributors are still energy prices, rents and airline costs**, basically due to the reopening effect), and the market corrected almost 3% on the Friday, 10th of June. After the FED meeting, equity markets reacted positively, but the day after all the optimism disappeared.
- It shows, even if the investor sentiment is extremely depressed and, as we have seen last week, valuations are already very attractive, at least for solid companies in the technology sector, that the market breadth is still not strong enough for a sustainable rebound and equity markets remain volatile, especially now entering the weakest seasonal period for equities.
- We are holding on our 10-15% liquidity for better opportunities and as you can analyze in the next slides, we believe an attractive level would be at **3'500 points for the S&P 500 Index, which is the 200d moving average, also coinciding with the 50% Fibonacci retracement and the perfect retest of the breakout back in 2020.**
- **We are closely monitoring, if equity markets are going to experience a capitulation day with a strong intraday reverse and the formation of an hammer formation, like it happened back in May 2022.**

Macro and next buying level

- We would like to remind, that this time labor market is very strong and it is no a coincidence that consumption is still strong. On one side, workforce has confidence of getting a new job and most probably with a raise, on the other hand, there is still USD 1 trillion in excess saving. Therefore, we still believe that the extreme and distressed situation is temporary, and as soon the war ends, or oil's production increases, we could expect a substantial and more stable equity market rebound. We also have to accept, that we are in the midst of the normalization process and this year, for the first time in more than 2 years, everyone, literally everyone wants to go on holiday, causing of course a tremendous bottleneck in the tourism sector and of course higher prices. We would like to mention, that prices on the tourism sector are increasing from depressed levels, having had hotels and airlines to reduce prices during the pandemic. In addition, read that the Swiss airline has a dilemma with its workforce, but mostly due to the fact that unvaccinated people are not allowed to work. Therefore the issue is actually not laying on missing people for the job.
- KTS still believes, that we are in the **midst of an innovation decade, with a "tsunami" of mega trends and technological innovations,** which is going to tremendously support the global economic growth for at least the next decade, hopefully more. Therefore, we do not believe in a more dramatic equity market correction like many economists are expecting, and definitely not the end of the global economic growth. Somehow we sense, too many economists are focusing only on the high level of the inflation, but are not really trying to figure out the whole picture and most importantly, propose the right solutions. We would like also to remind that the lower equity markets are, the higher share buyback programs and M&A acquisitions. In fact this is also a substantial difference from the past crisis, blue chips have tremendous amount of cash, which was not the case in the year 2000, 2008 or during the pandemic, where no one knew, how long the normalization process would take, therefore companies were reluctant in investing the liquidity. We believe, it is not the case nowadays.

Macro and next buying level

- Meanwhile we are waiting for better times at the equity market, our only solution at the moment is to have at least 10-15% in liquidity for trading, because the purchase of put options is too expensive. Analyzing the equity market strong negative reaction in the past days, most probably the buying opportunity is just a matter of days or weeks (entering actually the weakest seasonal period for equity), especially **having the fair value P/E based on the 2-year yield at 14.8x and therefore a fair value for the S&P 500 index a 3'423 points based on fwd EPS of USD 232 (according to statistical data of Mr. Timmer, Fidelity).** Of course, as argued last week, if the economy enter in a deep recession, fwd EPS are not discounting yet such scenario! KTS does not believe in such scenario. Mr. Timmer is also arguing that we entered a period of earnings growth deceleration and P/E ratios compressing and is definitely not supporting an equity bull market.
- Finally, the **market cap of the S&P 500 Index already lost from the peak USD 9.3 trillion** and therefore is almost the biggest drop, after the pandemic in March 2020 (USD 9.8 trio). In 2008 the market cap lost USD 8.1 trillion, but it is not comparable, having had in the past years central banks liquidity injection in trillion of USD.
- **Meanwhile a 60/40 portfolio (60% equity and 40% bond) is YTD -15.7% and analyzing historical data from 1928, this is the third worst result after -27.3% in 1931 and -20.7% in 1937. 2008 was "only" -13.9%,** having had government bonds as hedge of the portfolio, which was not the case in the last 2 years, on the contrary, it was a real negative drag. The negative **performance of bonds YTD is comparable to the same negative magnitude of equity back in year 2001 and 2008 (over -20%)**. We would like to remind to our clients, that KTS is working over years now to exactly avoid such negative contribution in our mandates from the fixed income part of the portfolio, and we can proudly assert, that we are happy with the result during 2021 and YTD 2022 so far.

Macro and next buying level

- Market participants are arguing that having the **30-year mortgage rates up to 6.2%** and therefore double where it was 12 months ago, a collapse of the US real estate market has to be expected. As we have recently analyzed, the US real estate market is already entering a kind of recession, but we think that the FED will not allow a collapse of the US real estate market. Such collapse, would mean a deep recession in the US and the Biden's administration will stand no chance to be re-elected. At the meeting of the FED, the tone was hawkish, but if the situation start to "get out of hand", we are confident that the FED is going to change the tone.
- As a direct consequence of falling US real estate prices is the **U.S. Consumer debt, which is at record high, USD 16 trillion**, and increased substantially on the Q4 2021 (highest increase since 2007, which it is not a coincidence, having real estate prices at highs). As we know, everything is connected and the FED knows it.
- **Canada is also in a similar situation, where according to survey, 1/4 of consumer have the high risk of not afford higher interest rates.** Finally, we can also expect more extreme measures from the side of governments in order to reduce the high inflation, as we can read in the next point.
- We are reading, that the **Biden's administration is "pushing" hard and fast the reduction of tariffs on Chinese goods,** but most importantly **US President Biden is calling US oil refining companies to increase production** to alleviate the burden of higher oil prices on consumers and apparently the **White House is prepared to use all reasonable tools and emergency authorities to increase refinery capacity and output.** As always argued, extreme situations need extreme remedies from the side of the governments.

Macro and next buying level

- Meanwhile, we are reading that part of the Indian's purchased oil from Russia at discount is sold to Europe, of course at spot prices! In Germany, the KfW development bank needs to lend billions to Gazprom Germania. Finally, Europe is buying LNG gas from USA at USD 27, when production costs in US are around 2 USD and deducting transport costs, the net profit for US companies are around 23 USD, when natural gas was costing around 3 USD pre-war. That the other side of European sanctions and we would assert, Europe alone is paying the full price. For this reason, it would be finally time for Europe to look for the right solution and not "running" after desperate solutions.

Technical analysis of S&P 500

- Unfortunately the index break down the important support of 3’800 points. The next strong technical support, which is also supported fundamentally, is at 3’500 points. At this level, we have the 50% Fibonacci’s retracement, a major re-test and the 200d moving average. KTS believes, it is not the same situation, as per the pandemic, 2008 or year 2000, therefore we would expect a rebound by the 200d. As explained, we are waiting for a strong technical signal in order to invest our liquidity.

S&P 500 Index at 3’500 points: Fibonacci 50% retracement, 200d, re-test

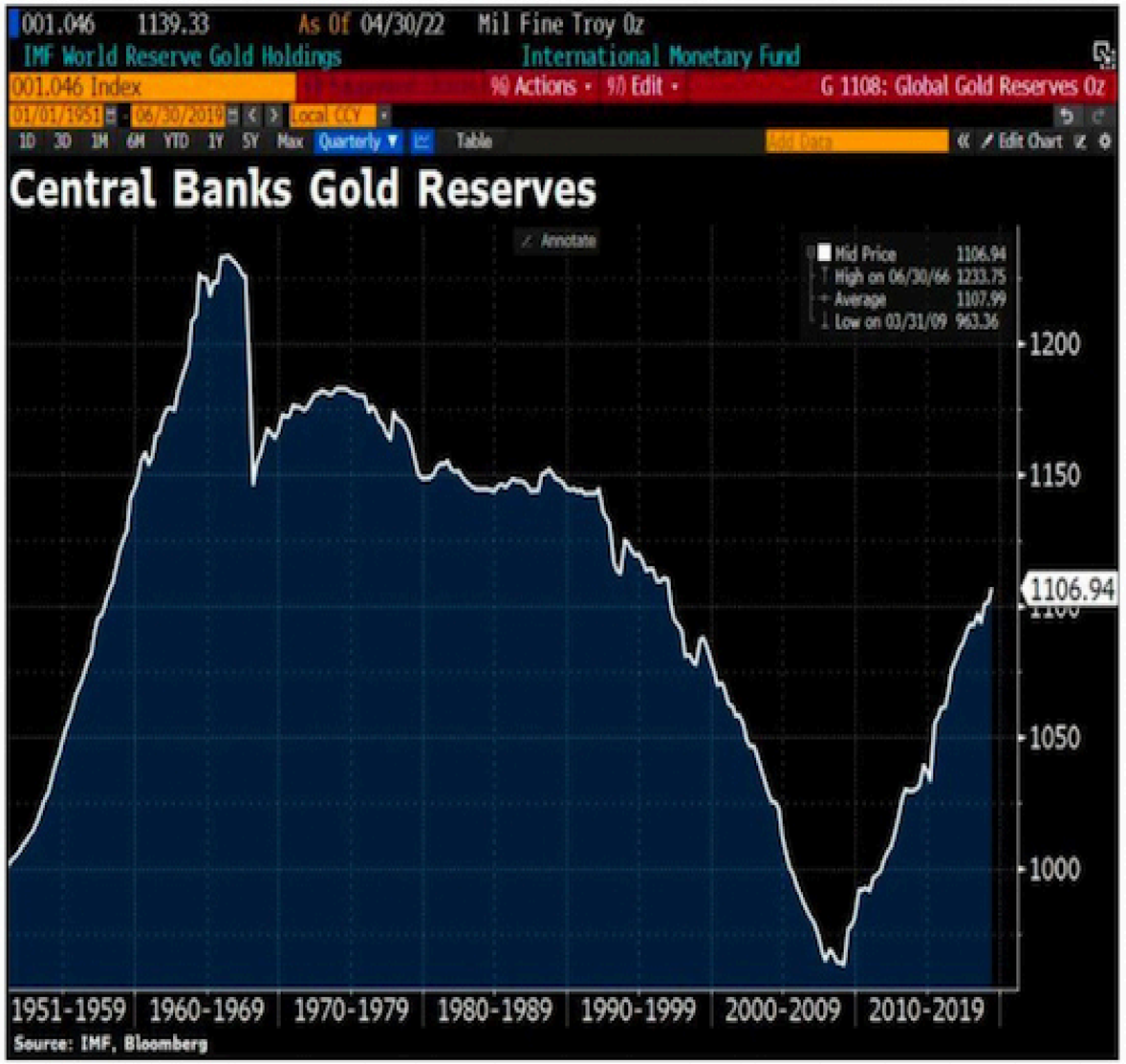
Technical analysis Bitcoin

- The substantial correction of all the crypto currencies is the confirmation, that also this segment was correlated to the QE and not to the fact, that it is a new asset class adding a better diversification to a portfolio, as “digital gold”.
- As our clients know, we are not long cryptos since February 2021 and we are only invested into crypto arbitrage.
- Analyzing the chart of Bitcoin, somewhere by 20’000 USD, it could be a support (200d, uptrend and retest of the major breakout of year 2021). But **reading that the company Microstrategy is in margin call under USD 21k, there is the high risk of further wash out.** KTS always argues, that Microstrategy was “playing” a dangerous game, now we have the final result!
- The actual price move still looks like a “falling knife”, therefore we would wait for a clear intraday reverse, before starting a long position. In addition, we would expect a rebound in the crypto currencies in line with a rebound of equity markets. We all understood now, that everything is highly correlated. KTS is not going to buy crypto currencies.

Bticoin at 20’000 USD: 200d mov av, uptrend line and major retest

Central banks are still increasing Gold's reserve

- According to a chart of Bloomberg, central banks gold reserves are still increasing.
- According to the World Gold Council, Central bank reserves should also increase in the next 12 months.
- **Apparently emerging market central banks prefer to invest into Gold instead of US-T-Bills.**
- As we have recently argued, after the war Ukraine-Russia and US sanctions on Russia, we are going to experience a dramatic long term shift out of USD and US T-Bills into gold and bilateral currency exchanges.
- As we have analyzed last week, **gold price is not increasing, but is quite stable compared to other asset classes** and we would assert, that the recent crypto currencies "bloodbath" also ends the topic of bitcoin being the digital gold.
- Again, that does not mean, the blockchain technology is not the pillar for future innovation, especially for the metaverse, fintech, Web3, etc.



Source: Bloomberg via Syz Group

Rare events

- **Our best-in-class volatility fund ABR Dynamic Fund in New York is noticing that on the 13th of June, SPY (equity), TLT (bond) and GLD (gold) were each down over 2.5% and that has never happened before, based on data back to 1994.**
- The manager, Mr. Taylor Lukof, is not taking any conclusions on this fact, but we would assert, that it is a sign of capitulation and historically, such rare events, are going to be followed by major moves. Many market participants would argue, it is a reason for more dramatic corrections, but KTS still believes the fundamental set up, especially for the labor market, it just too strong for being extreme pessimistic on the global economy. In addition we are reading, **that 3'500 points for the S&P 500 Index should be the level, where the FED would start to be more dovish, at least with the wording, in order to stop the panic.**
- The manager Mr. Lukof also issued a prospect theory, observing, that historically, **by any bear markets with the volatility below 25%, the average upcoming 6-month return of the S&P 500 Index was 10.2% and the best upcoming was +30.4%, while the worst was only -17.5%.** The manager does not make any predictions or have a price target, but note, that the maximum pain can come either with fast losses or fast corrections (like during the pandemic), or from smaller drawn-out losses (like nowadays), **but then the upcoming 6-month S&P 500 return instances may be noteworthy.**
- KTS thinks that such statistical data on the magnitude of the move, are more important than the length of the correction. As explained in the past, the high inflation was caused by energy prices, which derive from the Ukraine-Russia war, and the covid19 normalization effect, but fundamentally the labor market is very strong and innovations are supporting the global economy, therefore it is only a matter of time, and such distressed situation is going to normalize sooner than later. For this reason, KTS believes, that it does not really make much sense to compare the current situation with the year 1970 or other past events. Again, companies also have huge piles of cash, which was not the case in the past crisis.

General news

- We were reading an interesting article of the journalist, Mr. Leopoldo Gasbarro, who is arguing that **investors learn better from mistakes of others**, rather than successes. Mr. Gasbarro finalizes is article asserting that the concentration of risks is the major cause of failures and investors should diversify. KTS is also analyzing failures and successes, but we agree with the **golden rule of investing, that 80% of the investment success derives by avoiding being invested into the worse managers,** which is helping to limit losses and therefore by the rebound of the market, catch up more upside (we would like to remind the research of our best-in-class fund Tramondo on the weekly report nr. 41, the 15th November 2021) and we attach again the links:

https://tramondo.ch/en/publications-en/spotlight-on-drawdown-management/

The most important rule for investment is to cut losses and let profit run and the investor has to keep in mind, from 100 to 50 it is -50%, but from 50 to 100 is +100% .

- Reading that U.S. promised USD 1 billion in military aid to Ukraine, after a commitment of USD 5.6 billion in security assistance since Feb 24, and Germany, Slovakia, Canada, Poland, Netherlands also pledging more artillery, KTS starts losing hope in the war ending soon, which is of course not helping our base scenario in a peace sooner than later and falling oil prices.

Robo-advisor / fraud by banks

- We are reading in CNBC, that **Charles Schwab has to pay USD 187 million for settling SEC charges that it misled robo-advisor clients on fees.**
- As our clients can remember, we were wondering in our **Outlook for the year 2022**, how reliable such robo-advisors are and we were surprised of the tremendous success and momentum. Even more, apparently younger generations trust more robo-advisors than bank relationship managers.
- We can also understand clients to be skeptical on many bank relationship managers, unfortunately a lot went wrong in the past (not only by banks, but also by many asset managers) in addition, a relationship manager by a bank is not flexible anymore like the generation of KTS' partners used to be 20 years ago and therefore the value added is questionable! We are also reading in Swiss media, that a couple, **clients of the Swiss private banking Julius Bär, is claiming the bank for CHF 22 million**, because a relationship manager basically stolen from the account of the client. Incredible, still today we have to read such news.
- We have to admit, that the clients in this case can only blame themselves, having signed a full power of attorney, also for payments and withdraws, which is of course not the case of clients of KTS. In addition, KTS has finally the Swiss FIDLEG license and we are now even more supervised than before, therefore it is like a guarantee, that such a case would not happen in our family office, having all the transactions checked from our external compliance.
- Without going in detail, basically the model of Charles Schwab didn't disclose to clients that funds were allocated in a manner that according to their own internal analysis, it would be less profitable for clients under most market conditions.
- **It is not the first time, that banks are trying to earn hidden fees with algorithms from clients. We re-connect to the book "Flash crash" of Liam Vaughan, or the scandal of forex illegal market-rigging by 5 banks and so on and so on...**

DISCLAIMER

This report has been prepared by KTS Capital Management AG (“KTS”) / VICTRIX AG (“VICTRIX”) and is intended for information purposes only and does not constitute an offer or an invitation by, or on behalf of, KTS/VICTRIX to make any investments. Opinions and comments reflect the current view of The Investment Team of KTS/VICTRIX and not that one of a third party. We assumes no obligation to ensure that other such publications are brought to the attention of any recipient of this publication. Investments in the asset classes mentioned in this publication may not be suitable for all recipients. This publication has been prepared without taking into account of the objectives, financial situation or needs of any particular investor. Before entering into a transaction, the investor should consider the suitability of the transaction to his individual circumstances and objectives. This publication does not constitute investment, legal, accounting or tax advice or a representation that any investment or strategy is suitable or appropriate for individual circumstances, or otherwise constitutes a personal recommendation for any specific investor. We recommends that investors assess the specific financial risks as well as legal, regulatory, credit, tax and accounting consequences with a professional advisor. The information and data herein are obtained from sources believed to be reliable but no guarantee can be made that the information is accurate or complete.