KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 42

The 21st of October 2022

US Midterm elections 2022 - Republicans should win back the House

- According to the research of Julius Baer, but also confirmed from multiple sources, Republicans should win back the House of Representatives, but **Democrats should retain the control of the Senate** (270towin.com Democrats will hold 45 seats vs 44 for Republicans).
- According to the newspaper The Guardian, more than half of voters are more motivated to vote than in previous elections, citing abortion has become a crucial motivation for them to vote next month.
- The race to the Senate is very tight and therefore it could be that Republicans could win the House and the Senate, so-called **Republican sweep and this would basically block the Biden's Administration policy** with further stimulus packages.
- JB argues that with approval ratings of the President dropping, this is substantially influencing the election in the House and therefore the probability that Republicans are going to take the House has increased to near certainty.
- Senate elections, on the other hand, tend to be more closely focused on the individual candidates, therefore depends more on general public opinion.
- According to JB, the **impact of election on the US economy is going to be limited.** In case of a Republican sweep, the Republicans can not pass legislature without the approval of the president, a Democrat.
- In case of a split Congress, hardly any proactive policies should be expected considering that a bipartisan consensus is necessary.
- For this reasons, we will have a combination of no additional fiscal policies and no further tax increases. **Finally an unchanged trade policy, limits uncertainties and is likely to be somewhat positive for the overall market.**

US Midterm elections 2022 - overall positive for equity markets

- It is a so-called gridlock scenario, and this should mean, **the strength of the USD should be over and US bonds should increase in price, having the rise of interest rates peaked, not expecting big changes in monetary policy.**
- JB argues, whilst historical data suggests that equity markets tend to welcome a certain form of gridlock in Washington, JB believes this year's midterm elections will not serve as a main market driver in the months ahead.
- **The real trigger is the path of inflation and the FED monetary policy,** as we all clearly understood and therefore, KTS is focusing on inflation, in order to understand when US CPI is going to be significantly lower than expected. As explained in our last weekly reports, we believe that **inflation has already peaked and has fallen already at FED's target;** the only mystification is OER/shelters, which are adapting too slow and weight 31% on the CPI basket, but many market participants agree that rents on new houses are already falling in line with falling housing prices.
- Analyzing historical data on S&P500 Index performances from **November through April in Mid to pre-election years, performances has always being positive with a median of +16% .**
- Also Mr. Yardeni entitled his latest blog "yes, Virginia, there really is a Santa Claus Rally", arguing, that according a post on TheStreet, September is the worst month for stocks, based on a research analyzing historical data since 1950. October has been the 7th worst month for returns, however, returns are substantially better than usual in mid-term election years.

Macro - US Treasury

- Essentially the FED is executing the QT, but the **US government is going to launch a Treasury bond buyback program.**
- In fact, according to headlines of Reuters and Bloomberg, the **U.S. Treasury asks to major banks, if it should buy back Treasury bonds in order to improve liquidity in the USD 24 trillion market.** Liquidity metrics for the US government debt market are approaching crisis levels after a year of steep losses. The Treasury Department has done buybacks in the past, most recently in the 2000 to 2002 period.
- The main issue on the USD liquidity, is the fact that the **global excess of USD liquidity has collapsed** and it is now in worse shape than in 2008 and therefore this is a problem for the global macro financial system.
- With **M2 money supply falling rapidly and, as we have recently seen, correlation between the M2 and risky assets is very high, market participants argue that risky assets can not increase**. But also **cash balances by S&P 500 companies are falling** and according to statistics, it fell 15% y/y in Q2 and still falling in Q3. Therefore also by corporate balances, cash is falling.
- But **debt service coverage ratios are still strong and default levels are still below the long term average,** in US because in Europe (France 9'000 defaults) is increasing, we are still not at alarming levels, though conditions are deteriorating. By US households we have already seen that savings are at lowest levels and inflation is eroding consumption. This was also the argument of the manager of the fixed income MAN high yield fund and therefore, it is now attractive to invest in the segment.
- We were arguing over weeks now that **the FED is keeping a hawkish stance, but fundamentals are deteriorating dramatically,** and therefore, it should be a matter of time, that the FED needs to change tone. The worldwide shift from "risk on" to "risk off" not only in the financial market, but also in the real economy, is so extreme that consequences are not only in the US, but worldwide. If the FED is not doing it, it looks like, the US Treasury department is doing, in order to avoid another UK event.

Macro - US Treasury

- We came across a good example (twitter Ms. Alden) where **Ms. Yellen, US Treasury secretary, said on the 11th October 2022 "I am not seeing anything in markets the causes me to be concerned". One day later (1 day! on the 12th October 2022) she said "I am concerned about the loss of adequate liquidity in Treasuries" and after we read the headline on Reuters, where the Treasury is asking to major US banks, if they should start a Treasury bond buyback program.** Without mentioning the **use of the swap line directly with the Swiss national bank for USD 3.1 billion,** where the SNB was forced to sell passive EFTs (most probably the SPY US) and market participants are guessing that the SNB also provoked the sell off on the 13th October 2022.
- This is the ultimate proof that the FED and US Treasury are not in control of the cascade effect worldwide, and should start realizing, that the damage done is already much bigger than expected. **Therefore we strongly believe, that they want to avoid an "chaos" situation like in the UK?!** It is unfortunately only a guessing, or wishing, but at the end of the day, we are in the hand of policy makers. The fact that the US Treasury department has an open discussion with the major 25 US banks, give us confidence, they are listening to the market, before is going to "crack". This would be the first time, US Treasury department is pro-active and not reactive.
- In fact, market participants are arguing, that the FED and policy makers are only reactive, instead of being pro-active and this with over 400 Ph.D. economists, who represent an exceptionally diverse range of interests and specific areas of expertise in addition to equal number of models. As we were reading in our past weekly reports and we can also read in the next slides, many reliable indicators are pointing out that we are on the edge of a global financial instability, but actually the inflation is still falling significantly and we are wondering, if the FED is also integrating such indicators in their models.

Macro - US Treasury

- Analyzing multiple indicators from multiple reliable sources, KTS believes that **the FED will need to change again monetary policy and if that happens sooner than later, equity markets are going to turn positive.**
- In fact, as recently explained, the "arrow is extremely stretched" on the negative side, so as soon as we will **have positive news from the FED or from fundamentals, a equity market's rebound would most probably cause a delta squeeze,** with PUT options' volumes 3 times higher than call options, without mentioning all the professional investors fully underweighted equity and cash. An initial delta squeeze could be the reason of the strong intra-day rebound on the 13th October 2022.
- Meanwhile some market participants, like Mr. Yardeni, are arguing that equity markets rebound because of Mr. Bullard (President of St. Louis FED) said in an interview, that he favors **"front loading" hikes now and have a wait-and-see stance on 2023.** Basically, the **FED will increase 75bps in November, 75bps in December to a range of 4.5% and then will pause.**
- On the other side, Mr. Kashkari (Minneapolis FED President) still keeps a hawkish tone and argues that the FED needs to push the benchmark rate above 4.75% if underlying inflation does not stop rising. KTS would say, as we have recently seen and we are going to analyze in the next slides, that **inflation should NOT keep rising.**
- In his blog, Mr. Memani has even harder words. Basically he says, "don't listen to Kashkari, as you expect from a political wannabe, he says stuff just to say them. His transition from an uber dove to a chest beating Volckerite is breathtaking". KTS is please to hear, market participants understood, Mr. Kashkari is running somehow his own show.

Macro - US Treasury

- Mr. Memani continues, “pay attention to what Bullard is saying, he was the one pushing for a 75 bps long before everyone else signed for it earlier in the year. The real deal for the current cycle. As said, Mr. Bullard wants to be aggressive with rate hikes up to December, which are expectations anyways, and expects a 2023 to be disinflationary. Basically, the FED is looking to pause in not too distant a future, it wouldn’t be a pivot, but is the next best thing.
- **This would be already a good base, to have market participants relaxing on the FED, which is by the way still not the general consensus, and as we have seen, soon we will have also the official US CPI falling.** And this would be a perfect base to already have many bearish investors, which are totally underweighted, to think over positioning.
- We will see also in the next slides, also in Europe we are reading headlines of high inflation rates in UK, Europe in general, but macro indicators are pointing out, lower inflation soon.
- In addition, we all have read the news, of Ms. Liz Truss resignation. It is incredible the “power” of market on policy nowadays, which is a very positive sign, policy makers will have to “listen” to the market, before taking major steps.
- The major structural negative dilemma at the moment, is the sharply deterioration of liquidity in US bonds, where most probably as we were guessing last week, many pension funds were leverage like in the UK and need to reduce position. The fact, that the US Treasury is reacting very fast, give confident, we will not experience a chaos, how it happened in the UK. Market participants, like Mr. Zhao of Alpine Macro, is rightly asking, if something is about to blow up. We believe, we have the same situation of pension funds like in the UK, also in US and Europe.

Macro - US Treasury

- But, there is also an additional factor: the Bank of Japan. In fact, market participants are pointing out the strong correlation between the US 10 year bond yield and the USDJPY. Having the BoJ doing “whatever it takes” to support the JPY and keep longer term yield low, they are forced to sell huge quantity of US T-Bills. Back on the 22nd of September, we could read the headline in Bloomberg, the BoJ had USD 110 billion at facility, Cash by the FED, before it needs to sell Treasuries. Most probably this facility is gone and the USDJPY is still at 150. In addition, market participants also observe huge sales in US MBS.
- Other market participants are also citing China has to sell US bond holdings in order to support CNY. Basically is happening, what we always argued, the whole world need to sell US T-bonds in order to support their own currencies, in addition to geopolitical tensions between West and the “communist block”.
- As the strategist of BofA, Mr. Mark Cabana & team, is saying, it looks like, the USD 23.7 trillion Treasury market we are on the edge to collapse and this could be the next “black swan”. Reading such headlines, there is no reason to be bullish on anything right now. We are going to closely monitor the situation. Statistically (47 years history), according to the blog of Mr. Jain, the nowadays situation has never seen before and US treasuries are historically oversold at 2 standard deviations. This should give some comfort, but if the issue is structural, the can get worse, before better.
- **Those are additional reasons, why KTS believes, the US Treasury department is obliged to intervene immediately and this would be the short term positive catalyst for equity and bond markets.**
- Unfortunately drying up the liquidity in USD have also repercussions on emerging market debt, which is now back at levels of 2008, even if most of the emerging markets countries are in a better financial shape and definitely in a better shape than many Western countries.

Macro - long term lost of purchasing power

- Reading the blog of Mr. Mohamed El-Erian, arguing that the **inflation, at the end of the day, hits hardest the most vulnerable segments of our society**, we can only agree and it was the argument of KTS in the past several years.
- This regime is not going to stop, because as we have seen, **financial repression (reduction of debt via inflation and economic growth)** is the only way out for governments with high indebtedness.
- Lower incomers will suffer on multiple levels. In fact, higher inflation than the increase of nominal wage growth, means lower purchasing power.
- But the **biggest purchasing power's lost is with our pension funds**, being invested in bonds, which are **reaching annual real negative yields** and therefore over a period of 20 years, the **purchasing power of our future pension distributions is going to be at least 1/3 less value** and lower incomers will not be able to afford the same life quality of today. It is not the case of the "baby boomers". The positive side is, **Generation Z will inherit the biggest wealth ever** and could become the wealthiest generation?! But governments know it and are already planning an increase in heritage taxes. Therefore a residence in the right place is crucial going forward.
- Finally, during 2022 we are experiencing an additional dilemma for pension funds: **the fixed income part of the portfolio has just collapsed and had the worst year ever** (according to a chart of Bianco Research via Mr. Budelmann, with YTD -21.4% it never happens and bond losses of this magnitude were thought to be impossible before this year). Therefore the long term liability of pension funds is getting again wider and, as we have already argued in our past outlooks, the only solution is to work longer and increase taxes in order to close such gap. For this reason, good financial planners have to take into account this pension plan loss of purchasing power, which **can not be influenced and can only be compensated with private investments.**

Macro - optimized asset allocation

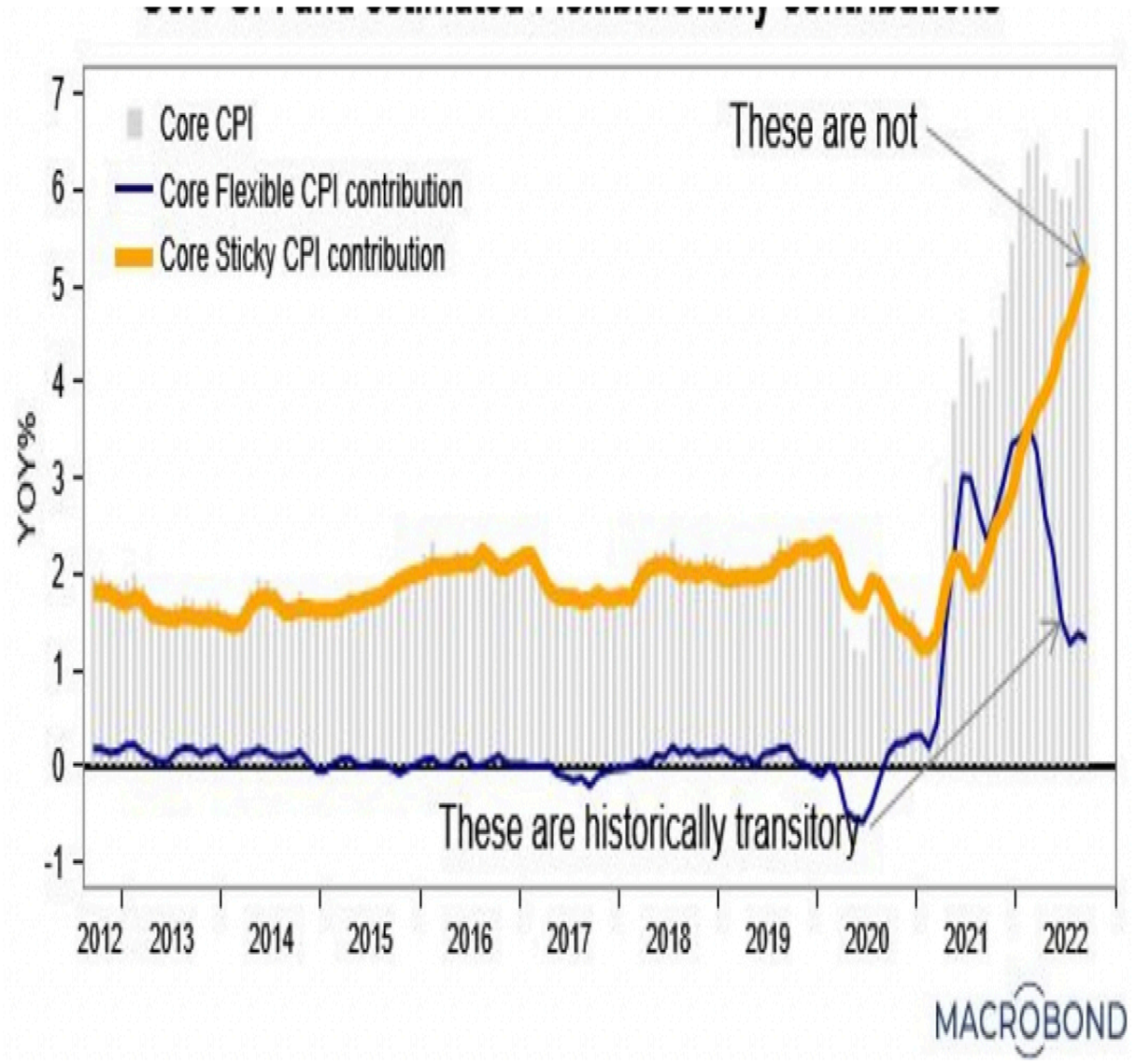
- We are reading an interview in Bloomberg with Mr. Larry Fink, CEO of Blackrock (the biggest asset manager in the world).
- He asserts that if we go back in 1995, the asset allocation for reaching a 7.5% yield p.a. would be 100% in bond. In 2005, it would have been 50% in bonds, 40% in equities and 10% alternatives. 2016: 15% bonds, 60% equities and 25% alternatives.
- Today, to get the same 7.5% yield a portfolio could be 85% bonds and 15% equities and alternatives. He argues that most of their clients, both institutional and retail have been under weighted in fixed income.
- We agree that, after the tremendous correction of the fixed income YTD, it is time to increase exposure in the segment, as KTS recently did in high yield and CLOs. But we can not understand, how Mr. Fink does not mention at all positive and negative yield and even more, it turned out, that in UK, pension funds were leveraged in fixed income, so we are not sure, that institutional clients were under weighted in fixed income, yet the contrary.
- JPM has a good chart on long term performance on equity, bonds or cash, where equities reached an annualized real returns of 6.9% from 1900 to 2021 and 5.2% from 2000 to 2021, meanwhile Bonds 2.2% resp 5% and cash 0.5% resp -0.7% . We will talk more in the next weekly.
- **We believe that the discussion about the asset allocation is a more complex subject, than talking about nominal rates only.**

US CPI - rents are already lower and NAHB housing Market index collapsed

- We are reading in an article of Markets Insider, that Wharton professor, Mr. Jeremy Siegel, says the housing market is distorting high inflation readings, and expects home prices to fall up to 15%.
- He adds that the lagging housing market data is distorting the true rate of inflation, and **if September's CPI report used more current housing data, inflation would have dropped, in fact, housing prices by every indicator are going down, not up, Siegel told to CNBC.**
- Meanwhile the U.S. **NAHB Housing Market Index is plunging to 38, from 46** as mortgage rates continue rising. **Such decline over the last 6 months is comparable to 2006,** which was the start of the housing burst and is matching also the decline during the pandemic (April 2020, chart not included in this report). We have to remember, that during the real estate bubble of 2006, we had high speculation, with people reserving a flat, but not having the money to afford it. Basically, the Global Financial Crisis was initially caused by excess housing demand and amplified by leverage, which is not the case now. Therefore, **nowadays, the decline is not comparable and we are confident that we should not experience the same "meltdown" as in year 2008.**
- **Mortgage demand drops to a 25-year low and hit its lowest level since 1997**, according to the Mortgage Bankers Association, therefore even lower than 2008!
- More dramatically, is actually the speed of the increase of mortgage's costs: basically in 12 months, the costs increased almost 160% , something never seen before (chart of Mr. Trahan, not included).

US CPI - sharp lower rent growth

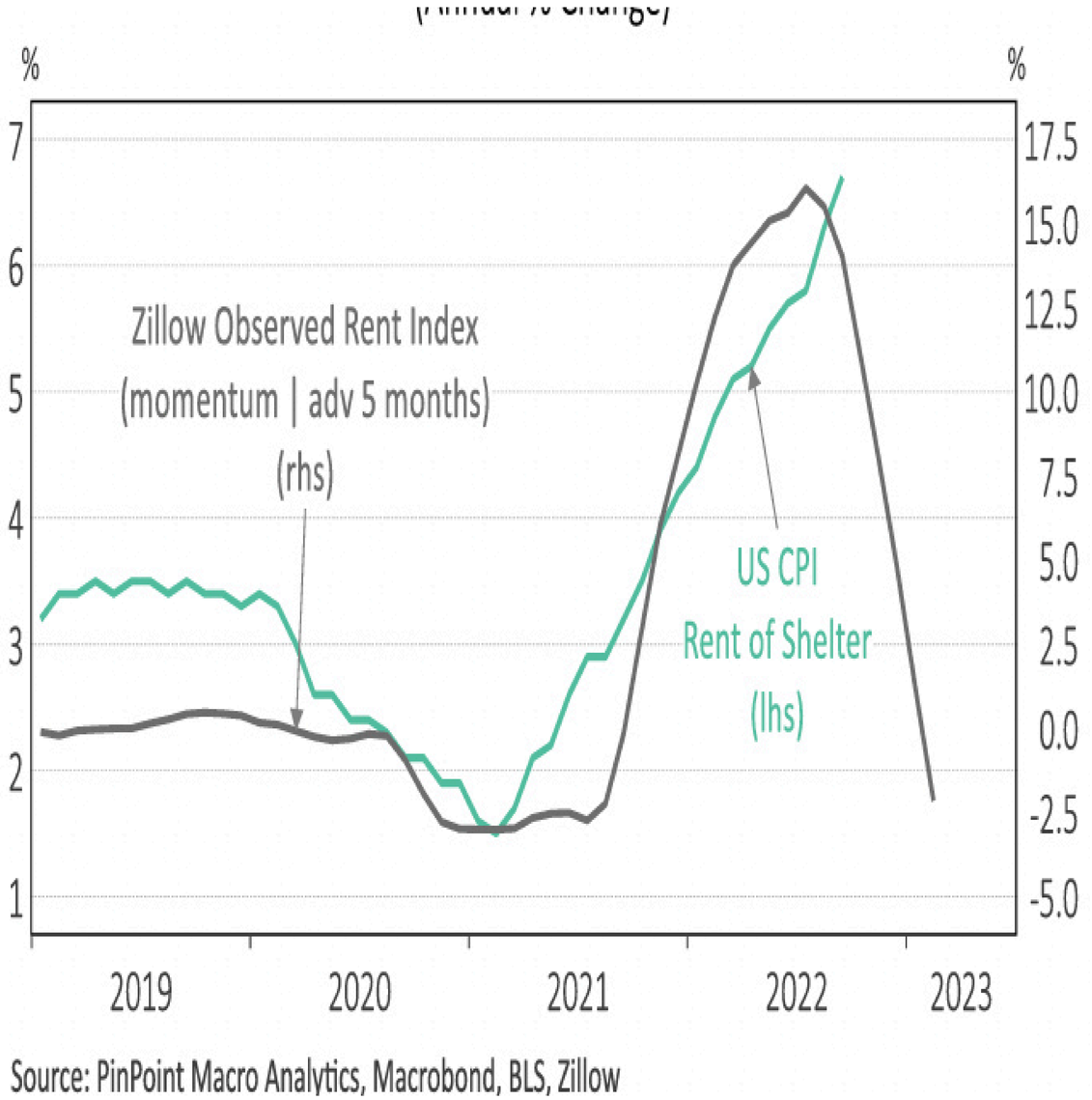
- On the right-hand chart, we can notice how the private sector is already reporting sharp slowdowns in rent growth (blue line).
- If the Bureau of Labor Statistics date would use such private measures of rent for the calculation of the CPI and PCE measures of inflation (orange line), we would have already CPI numbers in September falling lower and therefore would help prevent the FED from over tightening.



Source: Macrobond / Mr. Ishihara

US CPI - new rent are collapsing , as also oil price and Food & food at home

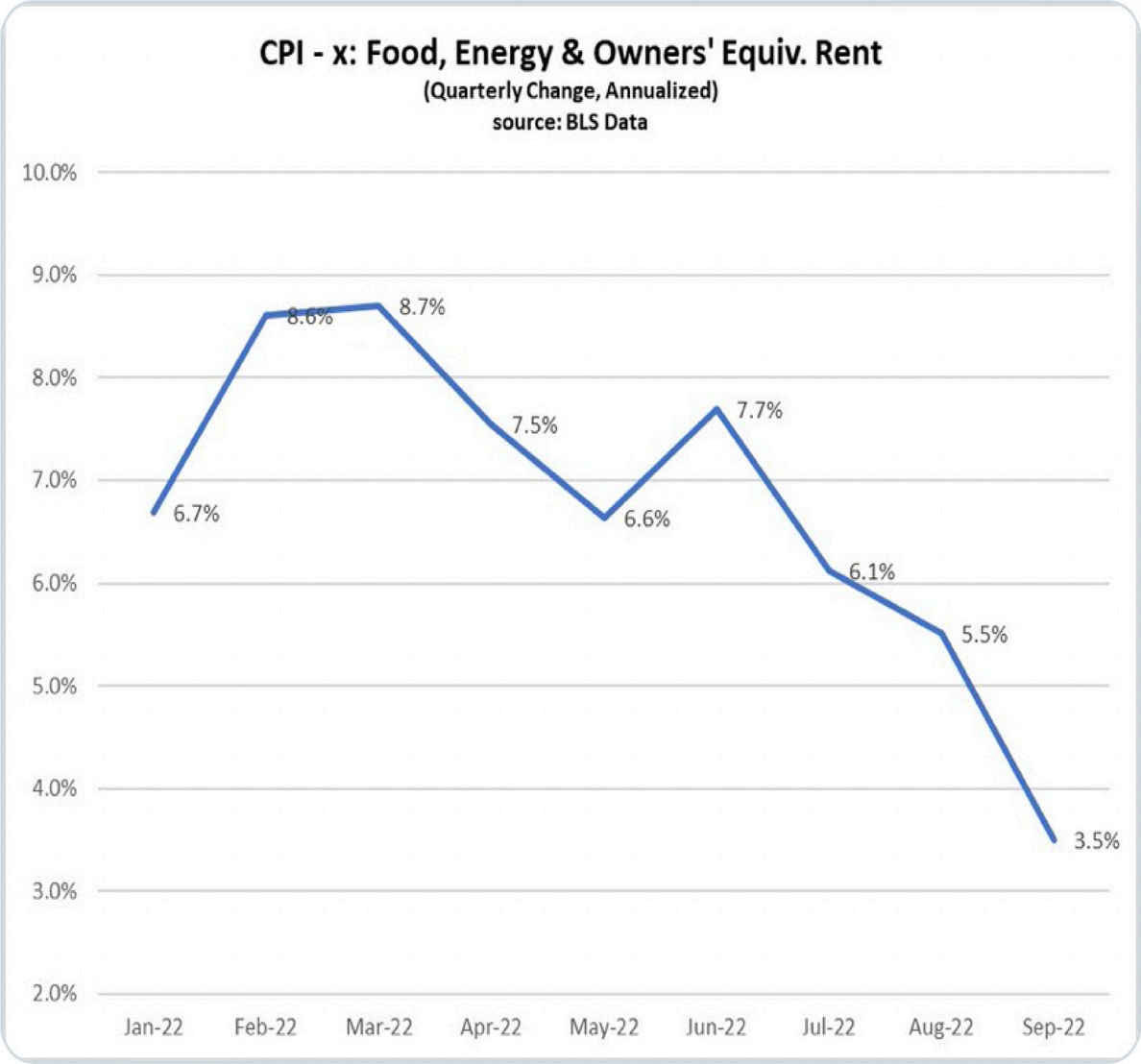
- We are including a better chart of Macrobond showing the Zillow observed rent index over 5 months, and we can notice, how **new rents are collapsing**, meanwhile Rent of shelter is going to be experiencing such move over the next 6-9 months.
- The rent of shelter is running at the moment at 6.7% pa.
- As we know, the major expenditure categories of Housing (3.5% of the CPI index's increase), transport (2.2%), Food&Beverages (1.5%) and Medical care (0.5%) **account for 93% of the CPI growth over the past year.**
- On the **Housing, we have also included household energy costs,** which are growing at 20.8% pa, but analyzing the price of the Brent oil, we are much lower already.
- The same has to be said on the Food and Food at home. The **HWWI Food index (Hamburg Institute of International Economics) global Food Index is also collapsing.**
- Motor fuel and prices of new & used motor vehicles are also falling as seen recently. Also medical costs are slightly lower.



Source: Macrobond, Zillow / research on US CPI in October 2022

US CPI ex food & energy and excluding only OER is at 3.5%

- We included another calculation on US CPI ex food, energy and OER.
- On the right-hand chart we can analyze, CPI is around 3.5% excluding food & energy and only excluding OER (keeping rents). **This is the final proof of the predicted serious deceleration in goods & services CPI.**
- The calculation is on a quarterly change annualized to smooth month-to-month volatility.
- The OER is 23.84% of the CPI index, meanwhile rent are 8.63%. In total, shelter component are 32.47% of the CPI index and as all the experts argue, shelters are a lagging indicator of around 9 to 12 months, due to data construction & methodological weaknesses.
- We are wondering, if the FED 400 Ph. D. economist have such indications in their models.
- Alpine Macro shows a chart (not included), where the numbers of **businesses planning to hike prices are falling rapidly.**



Source: wabuffo via Mr. Barraud

Retail sales are not up 8.2%

- The chart on the right-hand side, courtesy Macrobond/Mr. Ishihara, shows how retail sales adjusted for inflation (taking CPI excluding shelter in order to remove the effects of rent inflation) are even slightly negative. **Therefore, consumers are no spending 8% more than last year, but this is the effect of higher prices.**
- Mr. Hishihara, and also the magazine The Economist, argue that retailers are spending less due to economic slowdown, high gasoline prices, reverse wealth effect (lower stock prices) and other negative fundamentals.

Negative retail sales adjusted inflation (Source Macrobond)

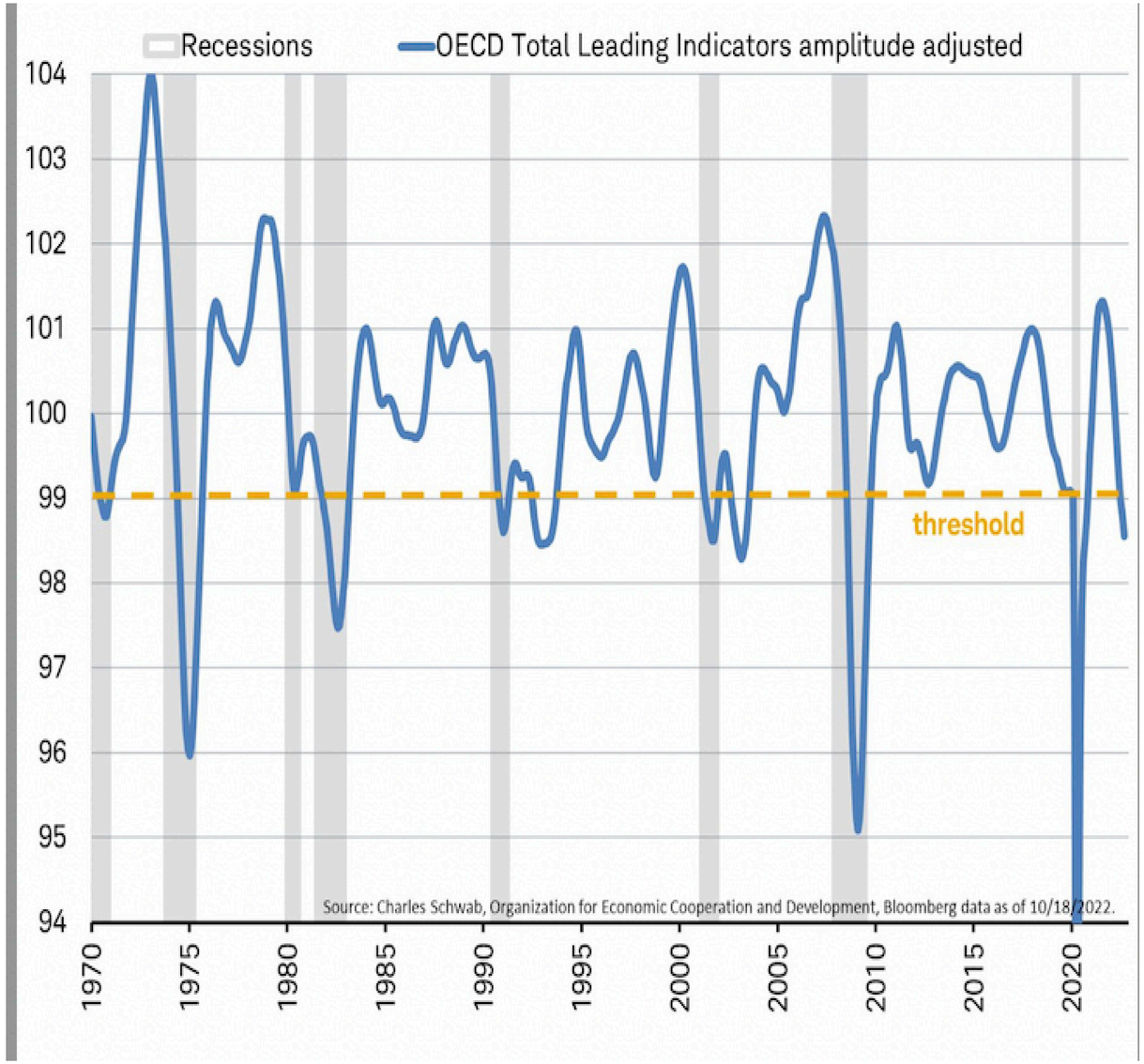
Correlation between freight cost Shanghai to LA vs commodity index

- On the right-hand side chart we can analyze the **historical correlation between the commodity index and freight cost Shanghai to Los Angeles.**
- The freight costs collapsed and according to the historical correlation, commodity too.
- The **Bloomberg commodity weighting is 30% in energy,** where WTI crude oil weights 8%, natural gas 8% and Brent 7%
- **Grains weights 23%** (5% corn, soybeans, wheat, etc)
- Industrial metals 15% (copper 5.4%, Aluminum 4.25%, Zinc 3.19% and Nickel 2.71%)
- Precious metals 20% (15% Gold, 4.75% Silver)
- Softs commodities 7% (sugar, coffee and cotton) and livestock 5.34% (live cattle and lean hods).
- The positive side is, inflation is going to fall further, **the negative side is, economy activities are going to fall like back in the pandemic and this would mean, a stronger recession than market participants are expecting!**

Picture Title

World economy is already in recession

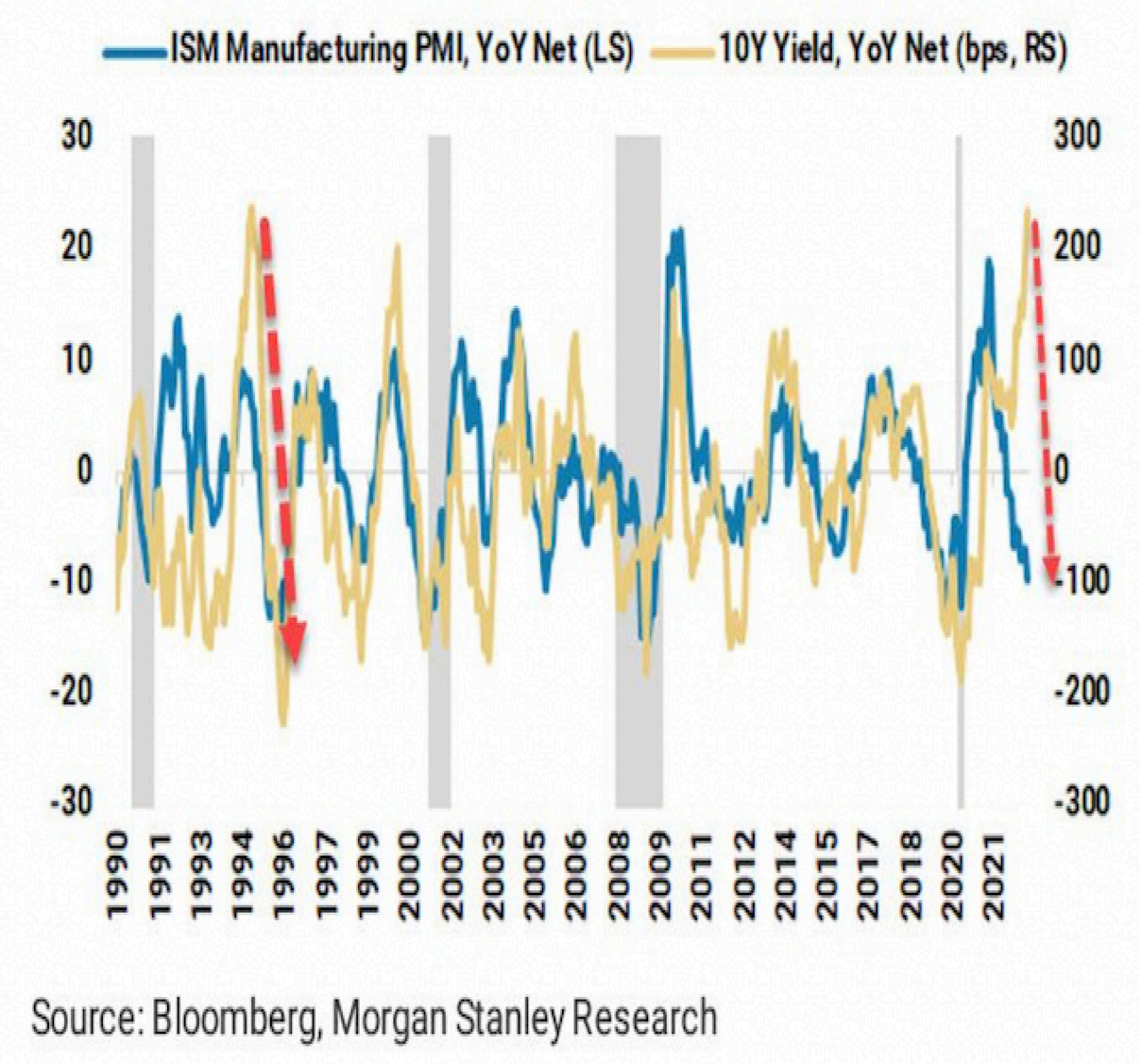
- On the right-hand chart chart, courtesy Mr. Kleintop, we can notice, how the world leading indicator is **falling under 100 and therefore is the start of a global recession**, as in early 2020, in early 2008, early 2001, in late-1990, late 1981, mid-1974 and mid-1970.
- **How deep is going to be the recession? It depends on how long the FED and other central banks are keeping a hawkish monetary policy.**
- In UK we have seen how the whole financial system can collapse in a matter of days, showing, once again, the fragility of the balance we have today. But the resignation of Ms. Liz Truss as U.K. Prime Minister shows, how powerful market moves can be and force policy maker to correction actions.
- **Though, a deep recession is not discounted yet by equity markets.** KTS is aware and has to closely monitor, how we want to protect our asset allocation, having recently increased risky positions.



Source Mr. Kleintop, CIO of Charles Schwab

Divergence US yields from PMIs

- On the right-hand chart, courtesy Morgan Stanley via Mr. Monchau, we can notice that bond yields are diverging from PMI. The last time this happened was 1994 where eventually yields crashed.
- **We expect falling yields from now on and we positioned ourselves investing in high yields and trading the ETF QQQ US.**



Source: Morgan Stanley via Mr. Monchau

Macro - US banks reaching higher profits, shipping no more bottleneck

- US banks are reaching tremendous profits and JPMorgan, for example, even increased guidance for the year. This in a time, where we are talking about a recession. Banks are basically profiting from higher interest rates, where net interest margins are improving. **In addition, having liquidity drying up, Banks are increasing provisions. The dilemma is, with drying liquidity, corporates and consumers will have more difficulties in financing themselves, which means, economy activities will fall further!**
- Mr. Larsen published a chart (not included) of the **outbound tender reject index (OTRI** - a daily index showcasing the percentage of contracted freight that is being rejected by carriers or brokers) showing **how freight prices are collapsing and there is no more supply bottleneck.** In fact, if the index increased, it would mean that the freight market is tightening and there is less available capacity. **This is showing a full normalization after lock downs, especially in China, and inflation should drop very fast in 2023.**
- Also on the blog of Mr. Namouchi, we can analyze the chart of World container Index, USD per 40-foot box (not included in this report), where the **rates from Shanghai to Rotterdam and Shanghai to Los Angeles fell basically back to pre-covid rates.**

No soft landing unless central banks admit to disinflation

- Mr. Steno Larsen last research is showing how inflation is falling sharply, but macro indicators are also pointing out a hard landing. This is also the conclusion of Mr. Peccatiello, good friend of Mr. Larsen.
- Mr. Peccatiello follows his forward-looking indicator, the G5 credit impulse, which is a metric that measures the pace of change in the amount of spendable money owned by the private sectors in the 5 largest economies (chart included in previous weekly reports). The G5 credit impulse collapsed and is pointing out a much lower inflation soon, though also a hard landing. The question is again, how the FED and ECB are going to react fast, in order to slow down such significant deterioration of economic activities?
- Back to the research of Mr. Larsen, he shows, how the FAO Food price index has come down roughly 15% and therefore the US CPI should finally follow.
- As said, US freight rates and international freight rates are collapsing and therefore PCE goods inflation should also follow soon.
- He is asserting something very interesting on the wages and job openings. **Apparently, the number of job openings is in reality much lower than headline number**, due to the work-from-home trend seen through the pandemic, **companies have to post a job opening for the same job in various locations to ensure that the talent pool is exploited, therefore a lot of job openings currently posted, are double-counting.**

No soft landing unless central banks admit to disinflation

- He adds, wages tend to follow openings, therefore, if it is true, there are many double-counting, wages should sharply fall in 2023. In any case, as we have seen, companies are warning to halt recruitment or even layoffs and therefore a sharp increase in unemployment will follow in 2023, consumption will fall, but the economy is heading to recession.
- **Therefore, it is true, inflation will finally fall and the FED pauses, but economy going to fall in recession and therefore EPS going to fall further. For this reason, we are unfortunately still far from being "safe" and if equity markets will have a relief year's end rally, it is not a reason to add positions, but most probably, we will have to evaluate, to take some profit.**

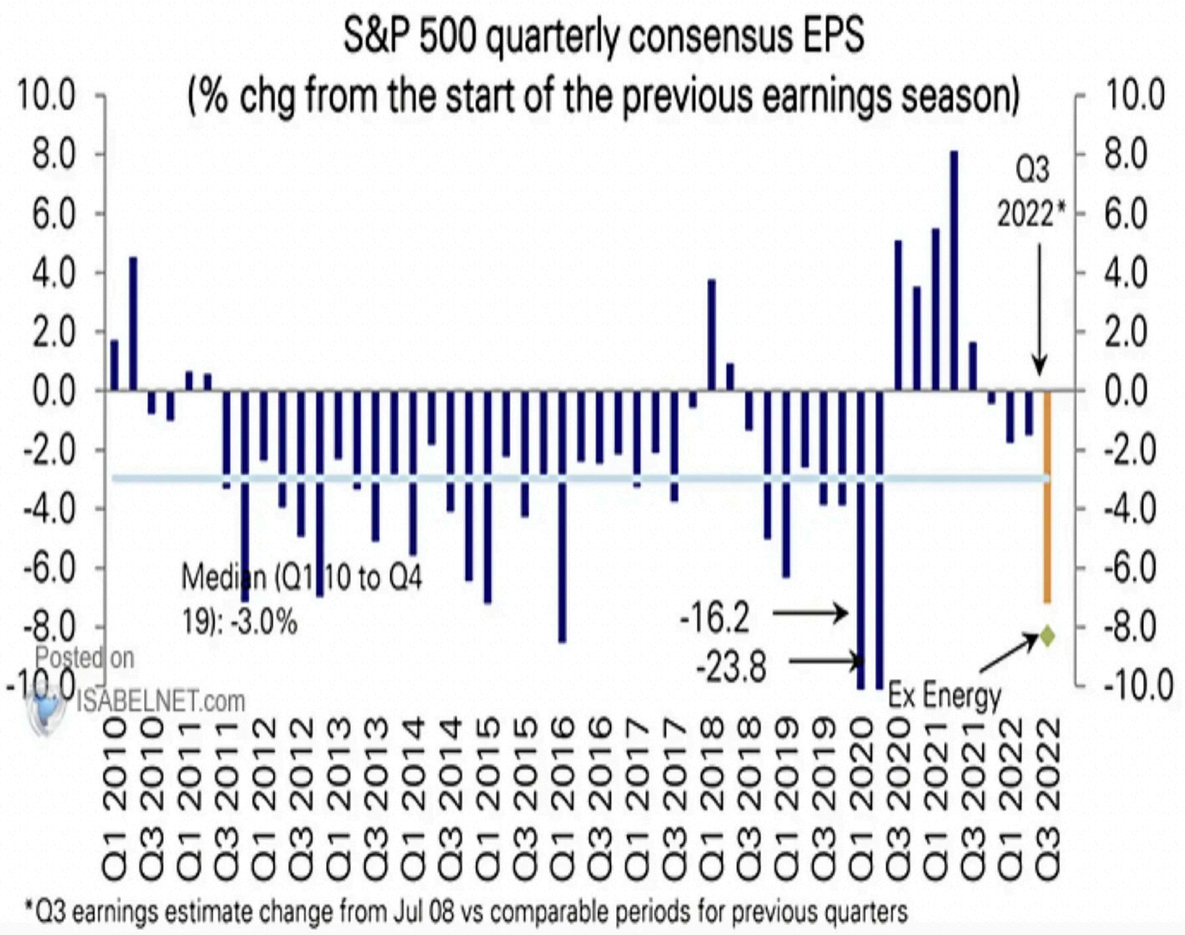
Macro - Europe - much lower consumption of nat gas, LNG ships waiting

- According to the blog of Mr. Hirth, analyzing data of September and October (chart not included of BnetzA DWD BDEW Zeit online), **German citizens saved 20 to 30%+ in gas**, consistently every week; this is a tremendous positive news. In addition it shows that, when the population wants, it can adapt and at a very fast pace. Perhaps after all, it could be the base for a better consumption for the sake of the environment.
- Mr. Larsen also asserts, that **gas prices in Spain are in free fall (chart not included) and there is now a queue of LNG ships waiting to offload LNG outside of Spanish harbors**, as too much gas has arrived. Mr. Larsen even dares to say, that natural gas prices are going to almost 0 before November.
- Meanwhile those are good news, our energy expert argues, that storage are 90% full in Europe, but 40% of what Europe needs for winter. Storage is 50% of total winter demand. In addition, China stopped diversion of cargo to Europe. Therefore, still not time to cheer a success.
- The only real dilemma is the oil price. Market participants are arguing, that US is releasing oil reserves, especially after the OPEC+ cut of 2mio bpd, in order to have a lower oil price before U.S. Midterms election, but having EU restrictions on important and shipping on Russian barrels, from December there is a potential risk of higher oil prices. KTS is keeping the exposure in the oil segment as hedge.
- Next week, market participants are expecting the ECB to increase 75bps, therefore, there should not be bad surprises.

EPS downgrades - last missing piece of the puzzle

- On the right-hand side chart, courtesy Deutsche Bank via Syz group, we can notice the large EPS cut during Q3 estimates, almost with the same magnitude as during the pandemic.
- This was the last missing piece of the puzzle in order to call a at least an intermediary market bottom.
- As we have seen in the previous slides, if economy would fall in a deeper recession, EPS going to fall further.
- In fact, Macrobond and Nordea shows the correlation between the US Philly FED vs S&P 500 operating EPS (chart not included), where basically EPS will have to fall further according to today economic activities.

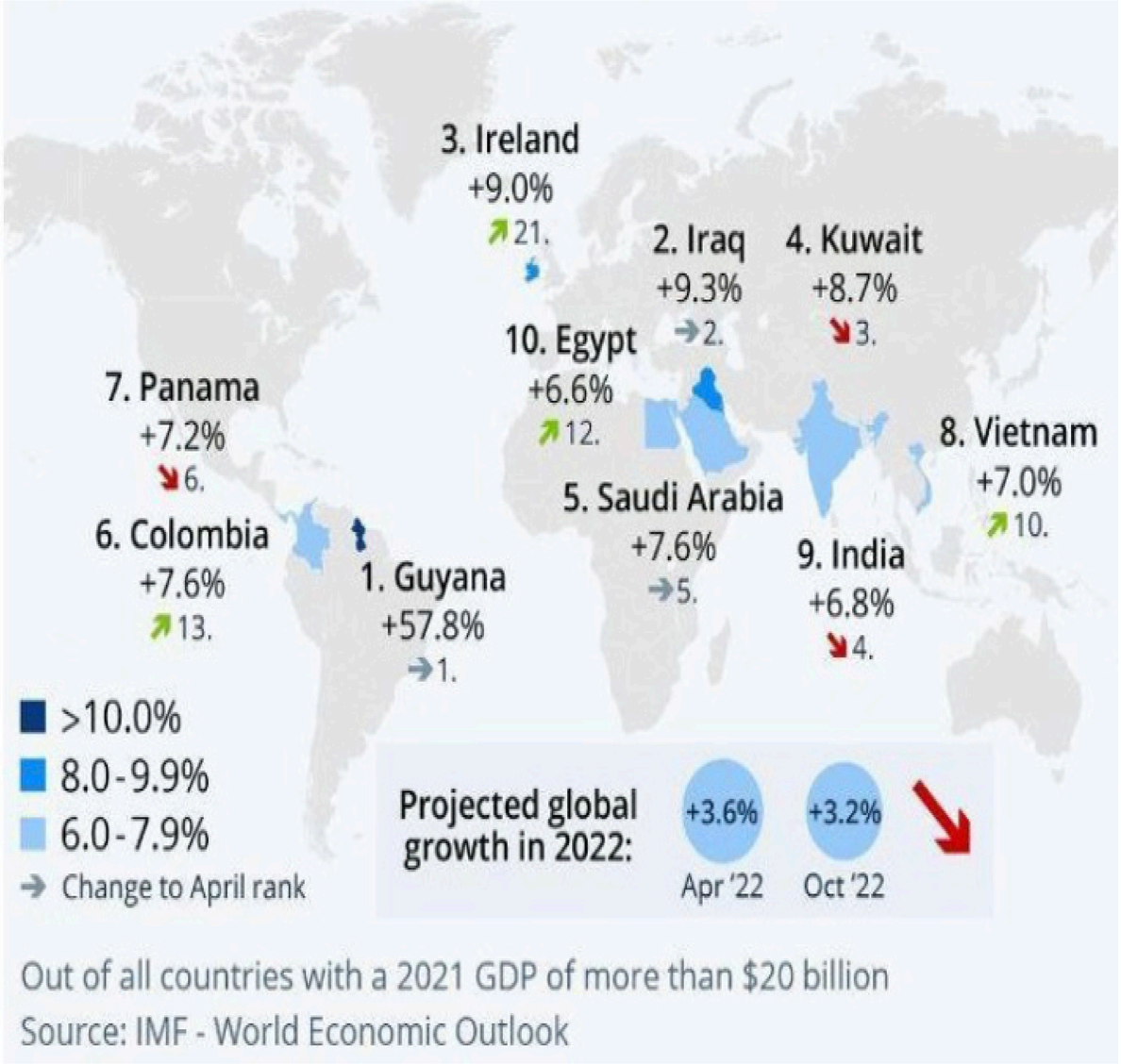
Figure 6: The pre-season cut to Q3 estimates (-7%) is one of the largest outside the pandemic shock



Source: Deutsche Bank / Syz Group

High growth economies - Vietnam and India

- On the right-hand chart we can analyze which countries are growing the most.
- **Vietnam is growing 7% and therefore belongs to the most attractive economies worldwide.**
- Reading mainstream headlines, the IMF cut global GDP growth for the third time this year, from 4.4% to 3.2% growth for 2022 and 2.7% for 2023.
- Therefore Vietnam with a 7% annual growth, very young population, attractive stock valuations and profiting from the production outsourcing from China, is the right place to be invested.
- Unfortunately, the VN Index also recently corrected but we stay invested, because valuations and growth potential are just too attractive to be ignored.
- Another high growth country we are exposed is India, via our best-in-class emerging market funds.

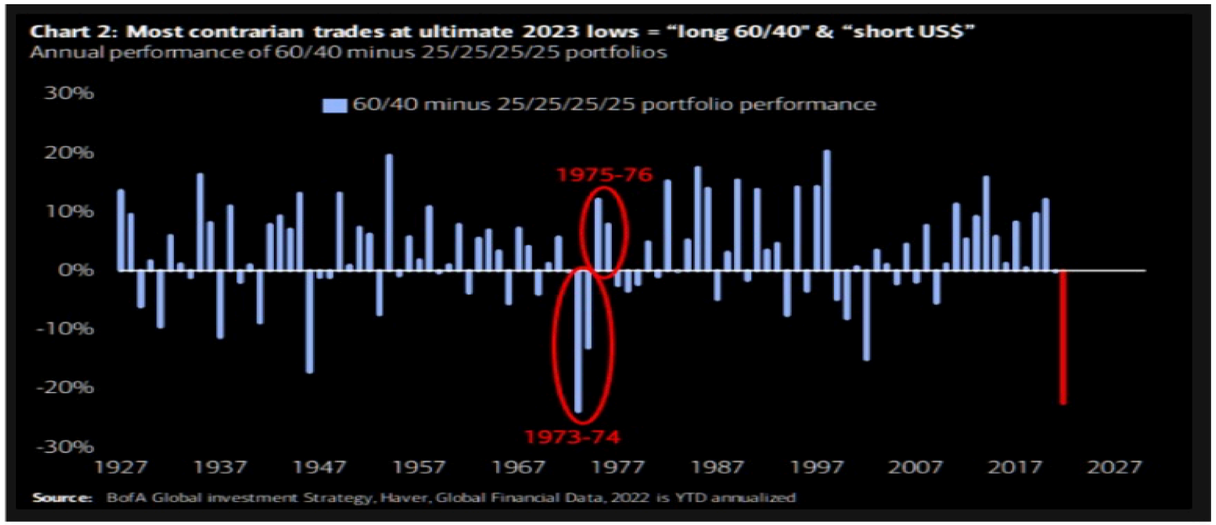


Source: Statista via Syz Group

The worst performance over 100 years for the 60/40 portfolio

- The chart of the BofA on the left-hand side is showing the **YTD annualized performance of the portfolio 60/40 with a -34.4% and therefore even worse than the crash in 1929**. This give an idea of the magnitude of the actual drawdown and, as we know, it can not last forever. Experts says that the biggest mistake done by investors in 2022 was the fixed income part of the portfolio invested into too long bond maturities. **KTS avoided such mistake and was preparing the strategy since 6 years.**
- The BofA's Hartnett shows on the right-hand side chart the **big contrarian trade: long 60/40 portfolio vs short USD** and shows the performance of 1973/74 vs 1975/76. Though, he argues, we are not there yet to call a buying opportunity.
- We like to cite the blog of the Italian journalist, Mr. Gasbarro, who is writing, that it's all already been written and said, **in 1973. At the time the world experienced the Yom Kippur war, the oil increased tenfold in few days and the world seemed on the verge of an unstoppable energy crisis**. KTS is convinced, somewhere soon we will experience a rebound!

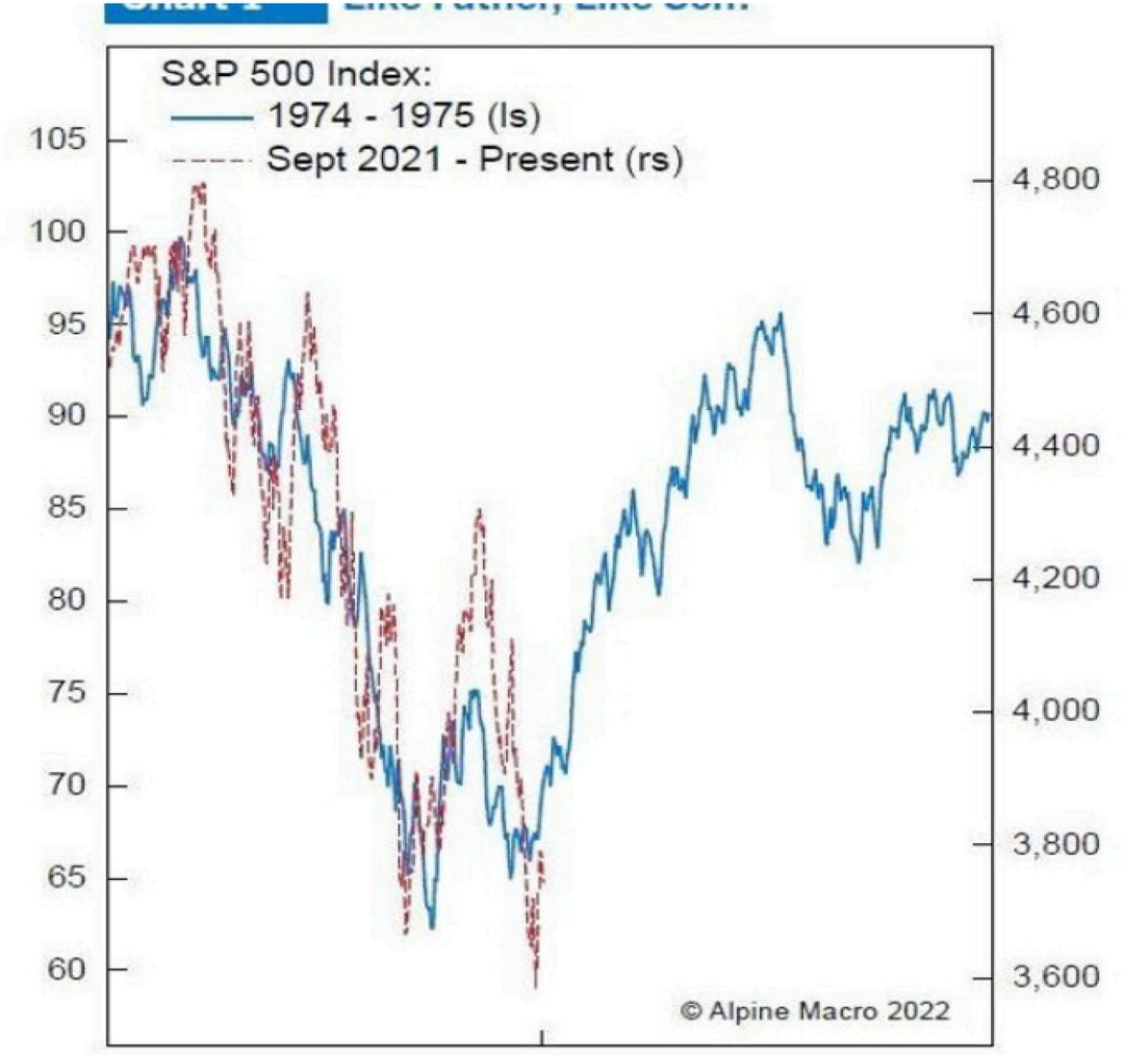
With -34.4% YTD annualized, 2022 is the worst over 100 years history



60/40 long portfolio vs short USD as contrarian trade

Comparison with 1974

- Alpine Macro show a **S&P 500 Index comparison with the years 1974-1975 and ask, if we are in the middle of a sustainable rally or again a dead cat bounce?**
- **Mr. Harnett of BofA is still missing the capitulation in retail or institutional equity flows in order to call a final bottom of equity markets.**
- What is already sure, 2022's bear market has been the largest destruction of wealth in history, in USD terms, and the second largest in GDP terms (2008 was worse, source: Bespoke).
- In fact, **USD 16 trillion loss in value between stock + bonds** vs USD -13 trillion in the pandemic and around USD -10 trillion in 2008. 2000 was -6 trillion.



Alpine Macro : perfect correlation to the rebound in 1974-1975

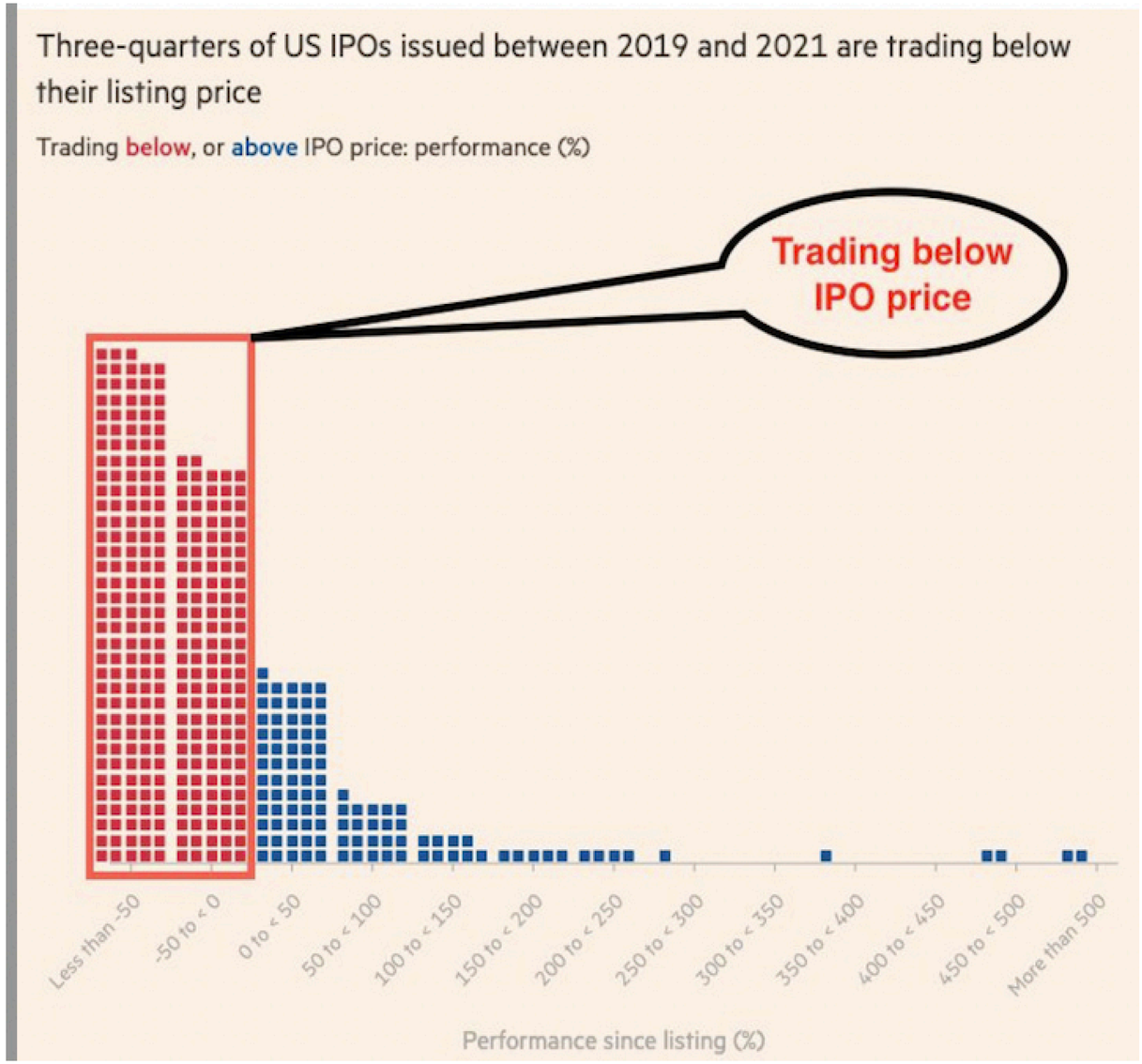
Ark ETF comparison with Nasdaq from 1993 to 2003 - we are hitting the bottom

- On the right-hand side chart, courtesy HolgerZ via Syz Group, we can analyze the parallel between the correction from highs of the Nasdaq Index back in year 2000 with the current ETF ARKK US, which was the high flyer during 2020-2021.
- As we always argued, this is the right comparison, because non profitable companies, as also meme stocks and SPACs, without to mention crypto currencies, already collapsed with the same magnitude as back in year 2000 or 2008.
- We do not believe that the Nasdaq index needs to correct as much, having now major companies with the **highest level ever in cash, being highly profitable and reaching strong cash flows, which was definitely not the case back in year 2000.**
- On the contrary, if we analyze solid tech companies like Netflix, Paypal, DocuSign and many others, we believe, they are extremely cheap and are attractive buying opportunities.
- Therefore, we believe, somewhere soon, equity markets are going to find a bottom.

Picture Title

Over 75% of IPOs between 2019-2021 are under IPO prices

- Another clear indication of the burst of the post-pandemic bubble is the development of IPOs, but also SPACs and crypto currencies, which prices basically collapsed.
- In fact, over 75% of companies that recently went public are now trading below their IPO price.
- But most especially, the magnitude of the correction. Analyzing a few of the most important IPO in the last two years, we can notice that the hype is gone the same way back in the year 2000.
- In fact, Robinhood is -71% , DoorDash -74% and Lyft -84%
- We would like to mention again, that in the contrary to main markets, KTS experienced a tremendous increase in NAV of the private equity Rimac automobili, could profit from the substantial increase during 2021 and +1% YTD of the crypto arbitrage fund, still have hidden performance in the Fintech VC and have the Swisscom VC, which is now slowly investing at very attractive valuations into the VC space.



Source: FT via Mr. Kavrak / Monchau

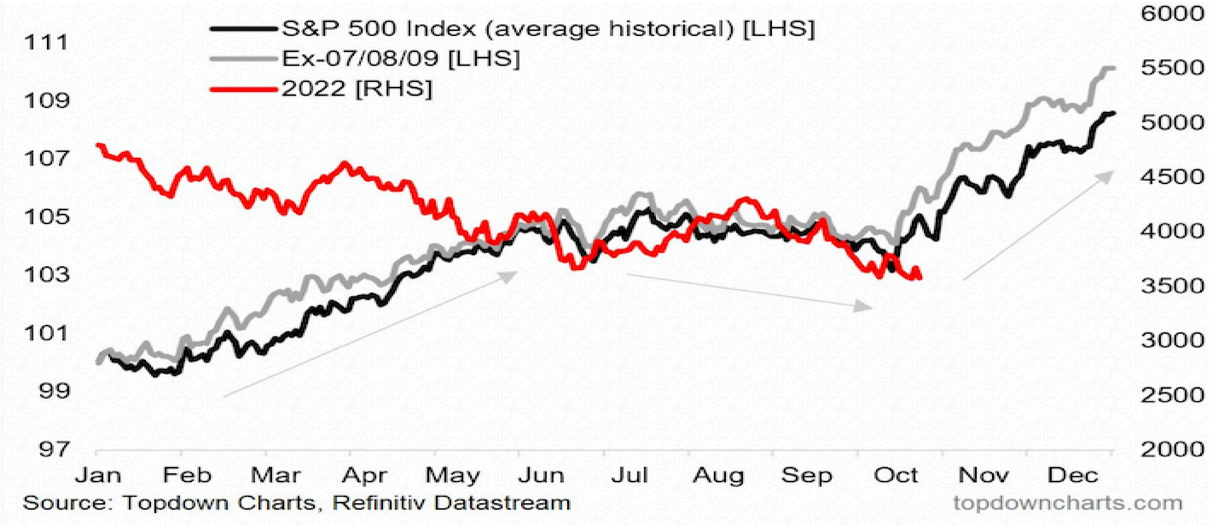
The strong rebound on the 13th October 2022 - is meaningful

- The **intraday reversal of the 13th of October is the 5th largest move in the history of the S&P 500 and the 4th largest for Nasdaq** according to Sentimentrader.
- On the right-hand side chart, courtesy Bespokeinvest, we can notice, going back to 1983 that there were only **9 other days where the S&P 500 Index was down 2% intraday and finished the day up over 2% and 5 of those were in 2008.**
- In 2008, it was not the final bottom, but the majority of such events were marking a bottom and if an **investor has at least 1-2 year horizon, as we have seen in past weekly reports, the performance would be in all the cases positive.**
- Also the volume of options traded on the S&P 500 reached a fresh record high on the 13th October, surpassing 3.8 million options. According to Bloomberg's statistics (not included), this can indicate a bottom is in place. **In addition for the first time, the volume ratio is 3x for puts vs calls.**
- We are still experiencing a high level of Cash and massive underweighting, especially by professional investors.

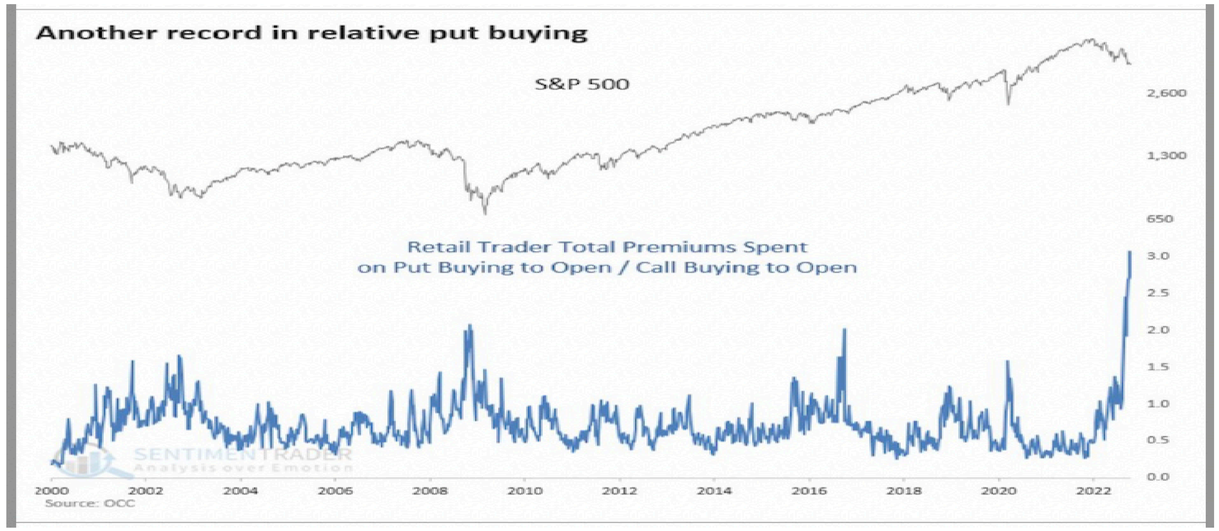
Source: Blog Mr. Barraud / Bespokeinvest

Technical analysis - tremendous put volumes , seasonal strength

- We include again the seasonal chart of the S&P 500 Index (left side), where we can notice, **we are entering the strongest seasonal period for equity markets.** Many market participants are rightly asserting, that this year, equity markets did not follow any usual seasonality trends, nevertheless, it is important to keep in mind, with all professional investors experiencing the worst year ever, most probably everyone is willing to improve performances during Q4.
- We are **entering the Q4 with an extremely bearish sentiment** and the **magnitude of put option volumes is amazing,** never seen before (put ratio exceeded 3x calls). On one hand, we know, due to higher profit taxes, US investors are not selling long positions, but hedging them, nevertheless, such volume are also an extreme gamma exposure, if equity markets would, for any fundamental reason and there would be many of them, rebound, the “arrow is extremely stretched” on the downside, that if market makers **need to reduce delta exposure** only for such put option volumes, they would cause a short squeeze in our opinion.



We are entering the strongest season for equity markets



Tremendous volumes in put options, highest ever (put volume 3x call volume)

Technical analysis - the volatility in sovereign bond market is the worst in 322y

- According to BofA research, the investor community is focused on the drawdown in equity, but what has just happened in the **sovereign bond market is even more extreme. In fact, the correction in 2022 is the 4th worst year in the last 322 years (after 1721, 1865 and 1920).**
- In fact, people are not realizing, **that UK gov bonds, UK GILTs, lost up to 57% in the last 2 weeks.** Even if KTS was always arguing in the last 6 years, that it does not make any sense for a private investor to invest in bonds with negative yields, especially in governments with such high indebtedness, in addition to the fact that we all are not realizing, we are exposed with our private pension fund; **KTS was not expecting such massive volatility, in such short period of time and with the asset class, which per excellence is the safest class and is compared to the "risk free" asset.**
- But it is typical, when things are pushed over years in one direction and finally crack! **We probably have to re-write the books on modern portfolio theory (MPT)**. Again, we would like to emphasize, that KTS was arguing over 6 years, one day something similar could happen, therefore, the fact that our discretionary are not extremely "suffering" from such tremendous drawdown is not luck, but **the result of a thorough analysis.**
- We also would like to add, that this year again, many tail risk funds are proudly showing their positive performance over 70%, but the funds we are monitoring, even if the experienced +91% in 2020 or +69% in 2022, are still -2.81% annualized returns since 2021 and therefore would have reached better performance being 100% long.
- Many market participants are trying to implement now new strategies, arguing the correlation between asset classes is too high and diversification has to be founds elsewhere. KTS was arguing for years now (see our market's outlooks), **that the right diversification must be found among different strategy, rather than different weighting among asset classes.**

Digital payments / cash - the world will not be 100% cashless?

- Last week in Switzerland, the second most important supermarket in the country (COOP) had a technical problem with paying by card and it was possible to buy goods only with cash.
- We are now reading, the **Finnish Head of the Payment systems department and Chief cashier at the Bank of Finland, Mr. Paivi Heikkinen, is advising to all Finnish households, to hold some cash resources available at home** in case disruptions would occur.
- We guess that we are not going to be 100% digital as early as many market participants are predicting. Especially, because Nordic countries are quite advanced in digital payments. In fact, Sweden is basically 90% cashless according to official statistics.

General news - Mr. Thiel pursuing Maltese citizenship

- Reading in the newspaper The New York Times, that Mr. **Thiel, the billionaire and big Republican donor appears to be pursuing Maltese citizenship,** is the final proof, the top wealthy citizen understood the long term repercussion of such high debt policy and the only solution is to run away.
- **We do not have to forget, that the top 1% of Americans by wealth own 53.1% of all stocks in U.S. And the top 10% own almost 89%. On the contrary the bottom 50% own less than 1%** (source: liz ann sonders of federal reserve via Ms. Noel).
- One of the biggest position of our best-in-class precious metal gold fund, AMG Gold Minen & Metalle, Shanta Gold Ltd (SHG LN), has just gotten 3 offers on the same time from 3 different Chinese precious metal companies: Yintai Gold, Shandong and Chaarat. The stock jumped over 40% . This is an example, how the sector is extremely cheap, but with gold holding around 1’600 USD, gold mines are reaching attractive positive cash flows, having drastically reduced costs, especially in exploration, in the past years. If the market does not want to see it, major companies, which start to have substantial amount of cash in the account, will start to buy such attractive opportunities. As we can notice with Shanta Gold, it starts straight away with a “bidding war”.

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