KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 43

The 28th of October 2022

Macro - signs of FED pivot and US Treasury department interventions

- Last Friday we experienced a substantial short covering, based on a leak of the newspaper Wall Street journal on the FED, set to raise rates by 0.75% in November but **debating the size of future hikes.**
- A reaction of such a magnitude shows how market participants are positioned in an extremely conservative way and shorting equity markets, but do not feel comfortable anymore. In addition this is a proof that, to have a technical rebound, we do not need central banks to start reducing interest rates, but slow down the speed of further increases.
- As explained last week, we believe the FED, and central banks in general are aware that we are already on the **edge of a global collapse** and therefore need to pause in order to reduce panic, but especially, give time to pension plans to somehow orderly re-balance asset allocation. Also Mr. Michael Burry warns of a sever market turmoil arguing the fragile balance on the Treasury markets.
- We also believe that the US Treasury department is also going to intervene soon, perhaps before US election. Mr. Ippoliti argues in his blog, that the US Treasury can use also the tool **SLR (supplementary leverage ratio)** in addition to the buy back program of US treasury bills. The SLR is the ratio of equity capital vs unweighted assets is **3 to 5% depending of the financial institution.**
- In order to increase liquidity in US treasury bills, which are counted under the asset class “unweighted assets”, the US Treasury can reduce the SLR ratio in order to allow banks to hold more Treasury, or at least hold the current amount of US Treasury and not be forced to sell.
- Most probably it will be a combination of both tools, but the most important fact is, the **US Treasury department is going to increase the liquidity of US Treasury bills and therefore stop the current selling pressure on the market.**

Macro - Signs of global central banks' pivot

- Those are short term solutions. What is the long term solution? **The reduction of debt, which is possible only via financial repression (see our latest 2 weekly reports).**
- Also the Senate Banking Committe Chair, Mr. Sherrod Brown, urged the Fed Chair Powell to be careful about tightening monetary policy enough to cause job losses. His words: "it is your job to combat inflation, but at the same time, you must not lose sight of your responsibility to ensure that we have full employment. We must avoid having our short-term advances and strong labour market overwhelmed by the consequences of aggressive monetary actions to crease inflation, especially when the FED's actions do not address its main drivers".
- Meanwhile the **Bank of Canada is the first central bank hiking less than consensus forecasts (50bps vs 75 bps expected).** Even the bearish expert Mr. El-Erian is asserting that Canada's policy decision is reinforcing the notion of a generalized central bank "pivot" in advanced countries. For **equity markets now "pivot" is already enough, less hiking than previously planned.** Mr. Peccatiello argues in his latest blog, that the **private debt in Canada is higher than in Japan at the peak of the real estate bubble** (chart not included). Therefore central banks finally realized the **inherent fragilities of the financial system** and do not want to be responsible for the total collapse.
- We will see in the slides about Europe, also the **ECB had a "less aggressive tone" on the 27th October** and the **Australian central bank changed tone, having the domestic housing market in trouble.**
- Mr. Jain also mentioned in his latest blog, that many more central banks are at pivot point: Brazil, Mexico, Japan, Korea.

Macro - Signs of FED pivot, real estate high valuations

- According to Zerohedge (Bloomberg's data), **financial conditions are at their tightest (on a month-end basis) since July 2009** and the last 12 months have seen an almost unprecedented tightening of financial conditions. In addition, according to the chart of Mr. Frederick Ducrozet, **central banks' QE portfolios are experiencing an actual USD 6.7 trillion losses in public and corporate debt.**
- Therefore, the massive loss of asset valuations is not only a problem for pension plans and investors in general, but also for central banks themselves.
- We also came across a chart of **400 years history on real house prices vs rents in Amsterdam** and rents stayed quite stable, but **real estate prices went up fivefold** (chart not included), which is not sustainable.
- The argument is, of course, that the real estate bubble is going to burst. We are aware of such risk and UBS has just issued a research, where prices in **Toronto are at bubble risk, followed by Frankfurt, Zurich, Munich, HK, Vancouver, Amsterdam, Tel Aviv, Tokyo, Miami**. Meanwhile, **UBS ranked Warsaw, Dubai, Sao Paulo and Milan as fair valued**.
- But knowing that **pension funds are also the most important owners of real estate**, we think that it is an additional reason, why central banks can not keep such hard path on monetary policy.
- Not only the **bond market is on a fragile balance, but also real estate,** as we can see more information in the next slides.

Macro Europe

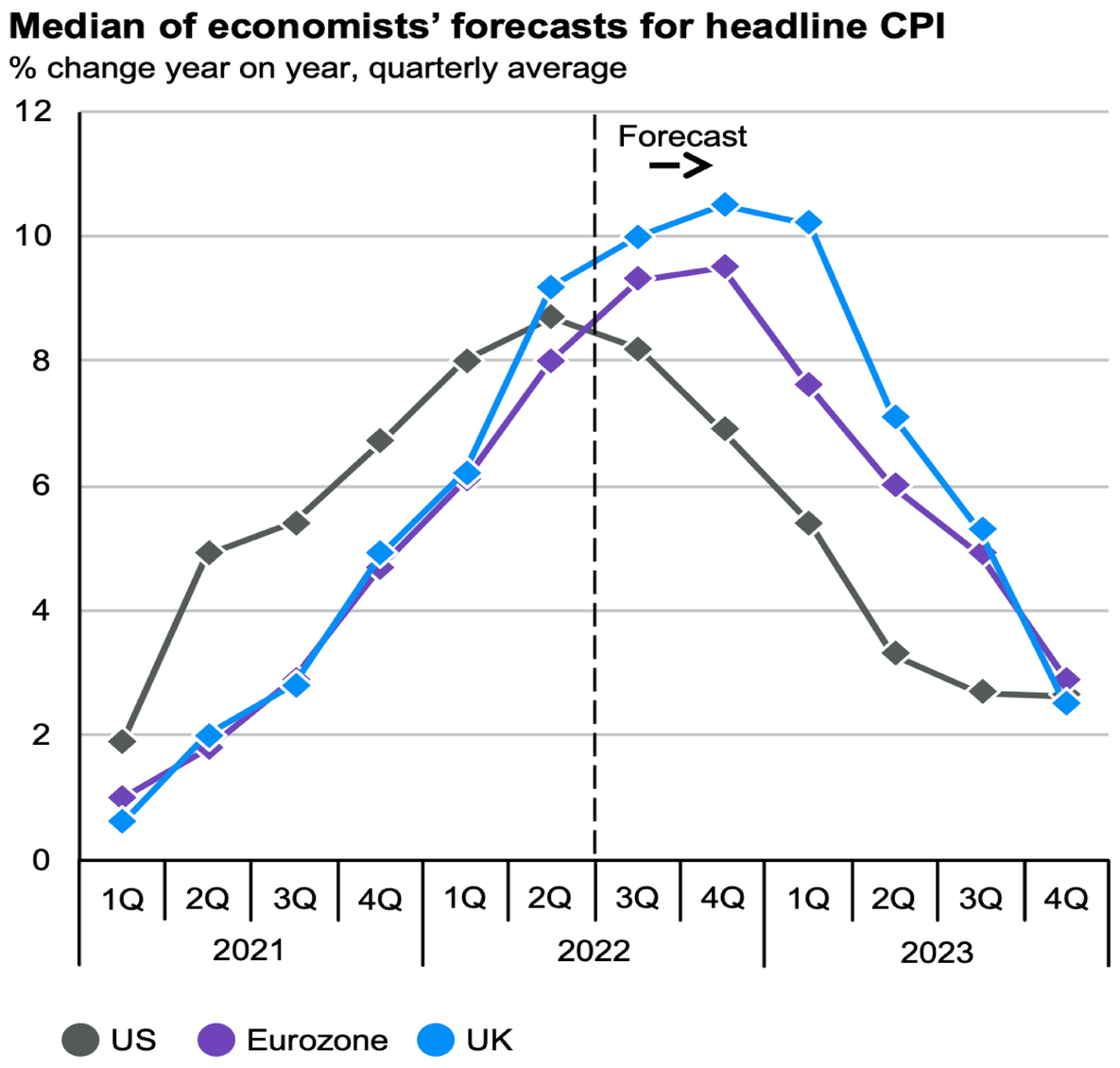
- **European natural gas price is now -95% in just few weeks,** the spot price in EUR is now by 16 EUR, meanwhile the ICE Endex Dutch TTG Gas spot price EUR/Mwh is turning even negative, as Mr. Larsen was predicting last week. That is incredible; who could have predicted such a development two months ago?
- **JPM increased GDP growth to +1.3% from -1.8% for Europe**. Some market participants are in fact expecting that Europe is not going to fall into a recession because of such dramatic change in energy prices.
- But Mr. **Larsen has a different opinion**, showing that **forward European energy pricing for this winter (chart not included) still looks quite terrible**.
- In addition, analyzing the historical relationship between **IFO expectations and the German GDP (chart not included), the recession is coming also to Germany.**
- European equity markets reacted positively on the ECB dovish tone, therefore, even if fundamentals look really weak, for a short term technical rebound, it is enough, that central banks reduce the speed of rate hikes and stay in a “standby mood”. In the contrary, how long it will take to restore the damage to economic growth from the central bank’s shift in monetary policy, it is another question. By analyzing the charts in the next slides, it will take some time.

Macro Europe - ECB less aggressive tone, also at pivot point

- The ECB hiked rates 0.75 bps as expected, but **equity markets perception was a less aggressive ECB on future hikes** and therefore also the ECB realized, they can not “push” it too hard.
- Also the ECB is between a rock and a hard place, having slow growth and high inflation and the whole Europe facing recession. Market participants also argue that recently the ECB got also political pressure, especially from Italy’s PM Meloni and France’s President Macron, who have started to openly complain about rate hikes being unnecessarily aggressive.
- Ms. Christine Lagarde told to the press: “we have made substantial progress in removing monetary policy accommodation, and we have to recognize there are clear signs of an economic slowdown in the Eurozone”. **These are very good news for equity markets, could help to set a bottom, despite very weak fundamentals!?** The shift to dovish monetary policy should able to stabilize liquidity and reduce panic amongst company’s CEOs.
- The ECB was not mentioning anything about the QT, but KTS was always arguing, especially after what happened in the UK, that central banks must guarantee liquidity, in order to avoid a completely collapse of the global financial system. **So all in all, the perception was a less aggressive tone about the path of future rate hikes and the ECB softened its language.**
- The ECB also changed the remuneration **mechanism for TLTROs,** and therefore the cheap funding mechanism that allowed European banks to borrow roughly EUR 2 trillion at very advantageous rates during the pandemic is over. The idea of the ECB is to incentivize banks to repay those TLTRO loans as soon as possible, hence shrinking the ECB balance sheet and at the same time easing some of the collateral scarcity in Europe. **Reducing the TLTROs allow the ECB to gain more time on the QT and give more time to Italy and Greece.**
- **Now is the turn of the FED on the 2nd of November.**

Median of economists' forecasts for headline CPI

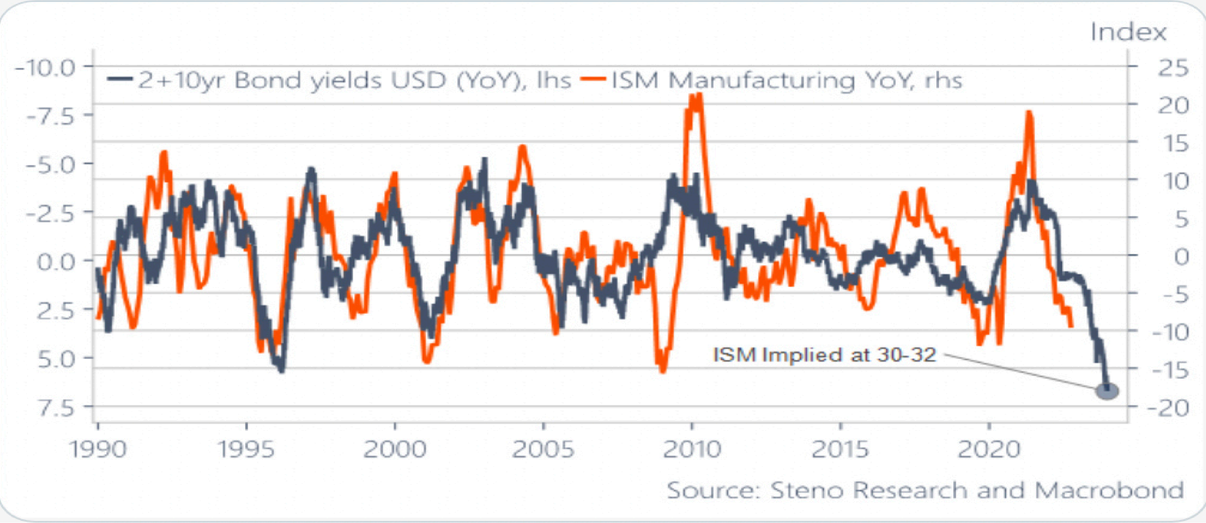
- As we can notice in the right-hand chart, **expectations are for an inflation at 2% at the end of 2023, but the real correction starts only in Q1 2023.**
- On JPM research, the **US ISM manufacturing new orders, US Leading economic index and US leading credit index are falling into elevated recession risk, meanwhile US ISM non-manufacturing still stable.**
- According to the latest research of Mr. Peccatiello, **fixed income markets are expecting the sharpest drop in inflation** ever since 2008 great financial crisis, which is around -8% and in line with the median calculated from JPM.



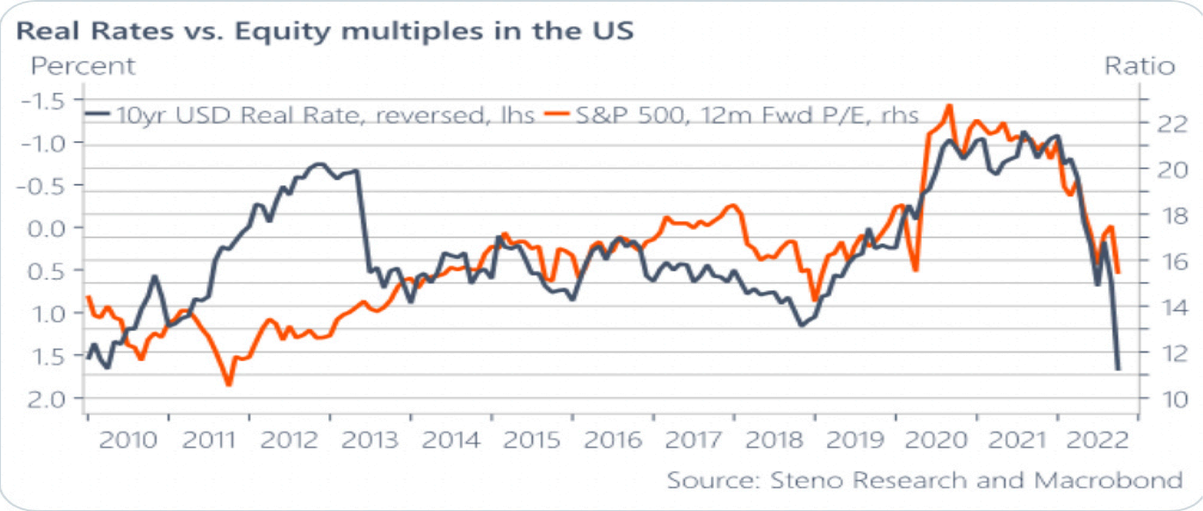
Source: JPMorgan

Fundamentals - global economy will fall into recession

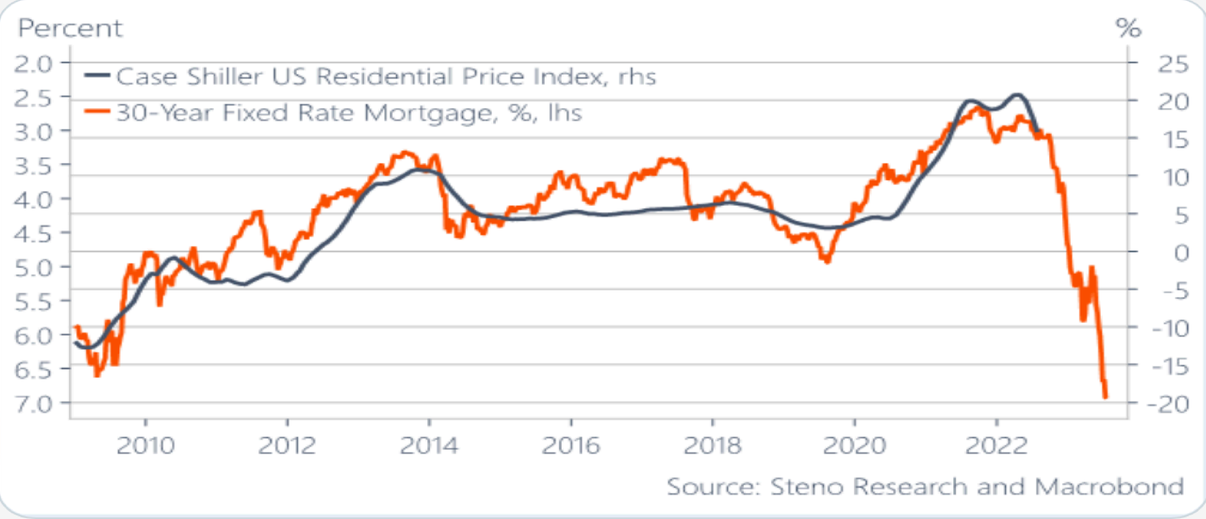
- We include a few charts from the blog of Mr. Steno Larsen, which are pointing out, that with the strong and fast increase of interest rates, the global economy is going to fall into a deep recession. For this reason, in any technical rebound of equity markets, we have to evaluate, where to take some profit.
- According to his database, unemployment is going to be over 7% in 9months, inflation will fall, but EPS falling and therefore the **S&P 500 Index should trade a 2'700 points = an additional -30% from today's level, which equals 11x P/E**



Largest move in the yield curve since the mid-1980= ISM at 30 in Q4 2023



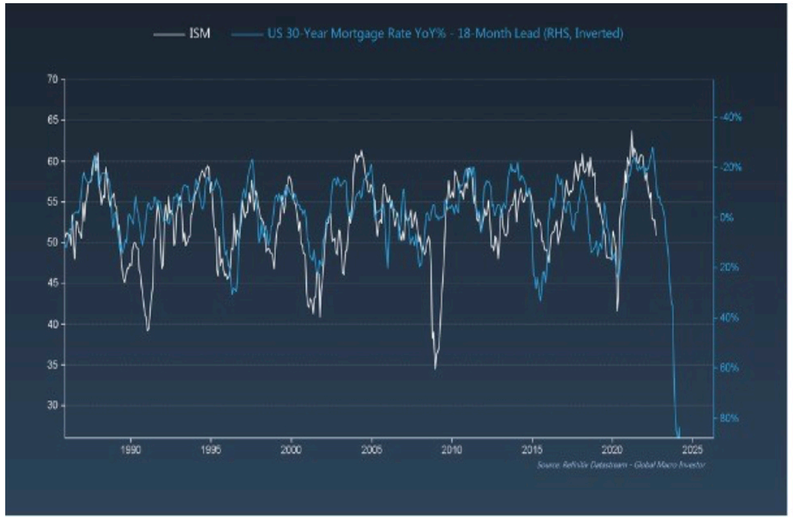
Worst move in 10yr real rate = forward P/Es should trade around 11=2700S&P



Not only -30% in S&P500, but 20% drawdown in residential prices in 12months

Fundamentals - global economy will fall into recession

- We add some other charts of the blog of Mr. Raoul Pal, which indicates according to historical correlations, that the **worst could be not over yet.**
- As we know, the **NAHB Housing Index, homebuilder sentiment, collapsed,** due to high mortgage rates, therefore we have the lowest mortgage application since September 2010 (see our last weekly report). **House affordability is the worst since 1974.** According to historical data (chart 1 from the left), the **homebuilder sentiment will fall further**, off the chart and historically unprecedented, almost terrifying according Mr. Raoul Pal. Chart 2: **ISM vs US 30y mortgage rates**: the current correction of the ISM is nothing to the historical correlation. Finally, the **monthly supply of new homes recently rose to 10.4 months, levels historically consistent with recession** and the highest level since the GFC in 2008 according data of Mr. Pal. There is simply no demand at the moment. Therefore chart 3, the real risk is that **house prices can fall around 10% into early 2023.**



NAHB vs US 30y mortgage rates: correction ahead

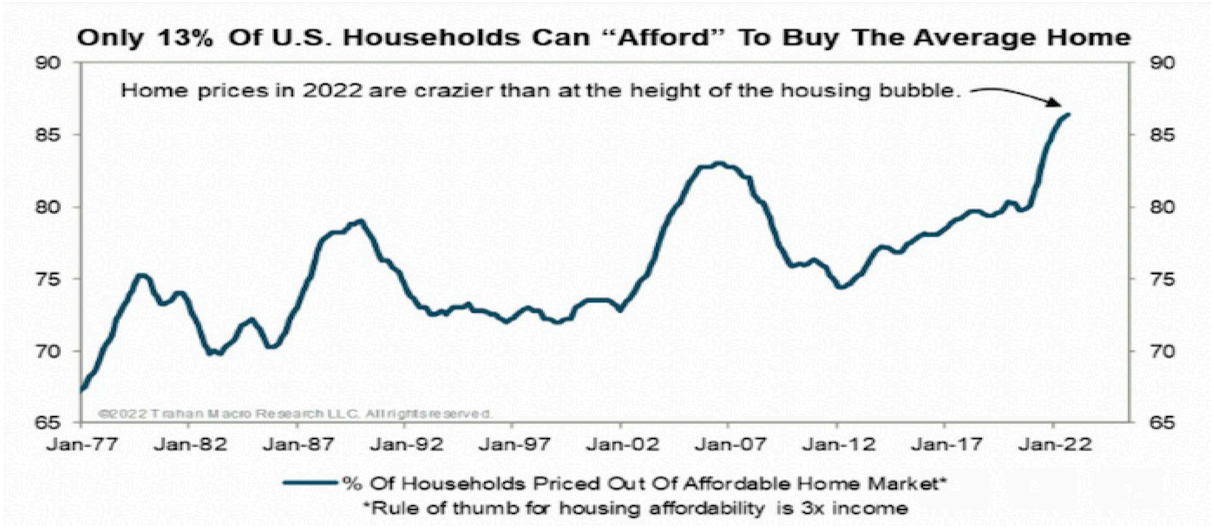
ISM vs US 30y mortgage rates: ISM more correction

US house prices can fall other 10% in early 2023

Fundamentals - global economy will fall into recession

- We include additional charts on fundamental data. The **Richmond Manufacturing expected new orders has just collapsed** to historical lows, lower than GFC 2008 and pandemic 2020. This is quite shocking, if we take into account that currently, we do not have a breakdown of any system, but we all have realized that we are on the edge of the collapse and we are holding on a very fragile balance. **To avoid a recession, we need the FED and policy makers to finally do a U-turn.**
- On the right-hand side chart we can notice, how only **13% of US households can afford to buy the average home** and is the lowest percentage ever. The statistic is based on the rule that one should not buy a house worth more than 3x their income. This chart shows historically, that the relationship between home prices relative to income are more stretched today than on the height of the housing bubble in 2006. Mr. Trahan also adds, that the trend is increasing since 1980, which was the structural peak in interest rates, therefore, **low rates, allowed families to own homes beyond affordability over a 40-year period of time.**

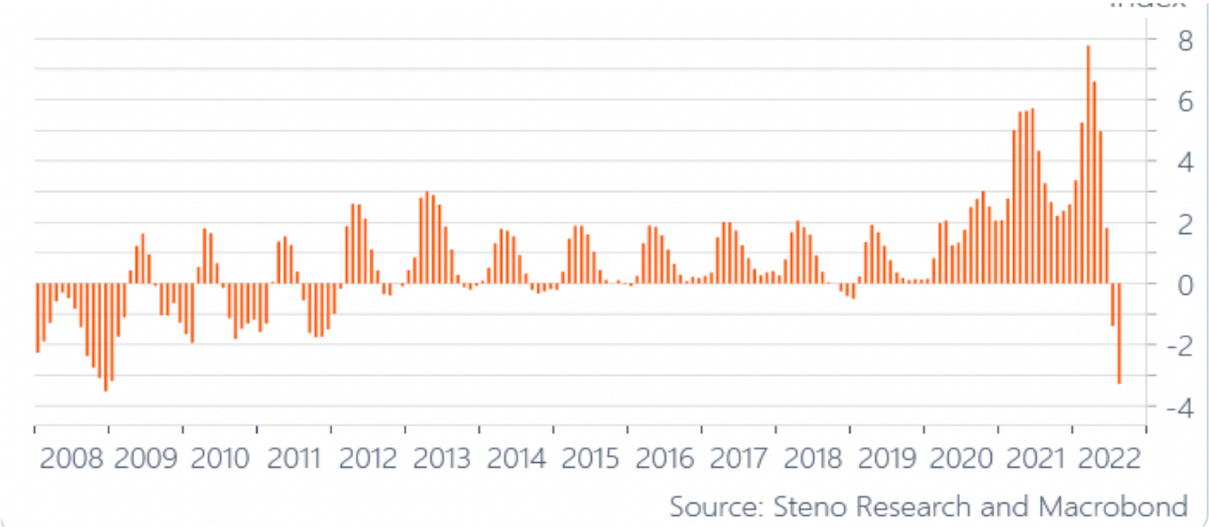
Source: Crescat



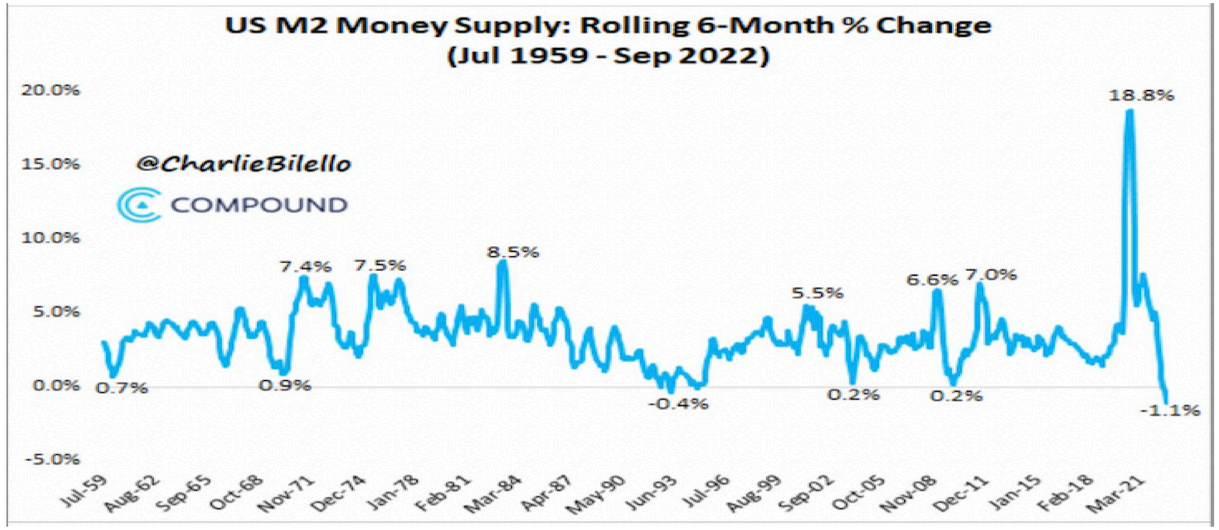
Source: Mr. Trahan

Fundamentals - global economy will fall into recession

- On the left-hand chart we can notice, how the **USA residential price Index also start to fall on official statistics.** Prices were down -3.3% in August, and we know, September and October are also down. This should slowly but surely help the US CPI index, but as we have seen in the previous slides, the issue on US housing is getting much bigger and worse, than most of market participants were expecting.
- We fully agree with market participants, arguing that stock markets tend to bottom before the economy does and as argued in the past, the first real trigger is going to be the **FED's pivot and more dovish tone on monetary policy.**
- A more dovish FED should **help also to slowdown the collapse in M2 money supply,** which with a decrease of -1.1% over the last 6 months has just experienced the largest decline over a 6-month period on record (US M2 data goes back to the late 50s).
- Mr. Peccatiello (via Mr. Patrick Perret-Green) posted, the M2 money supply just had the **sharpest drop in 40 years.**



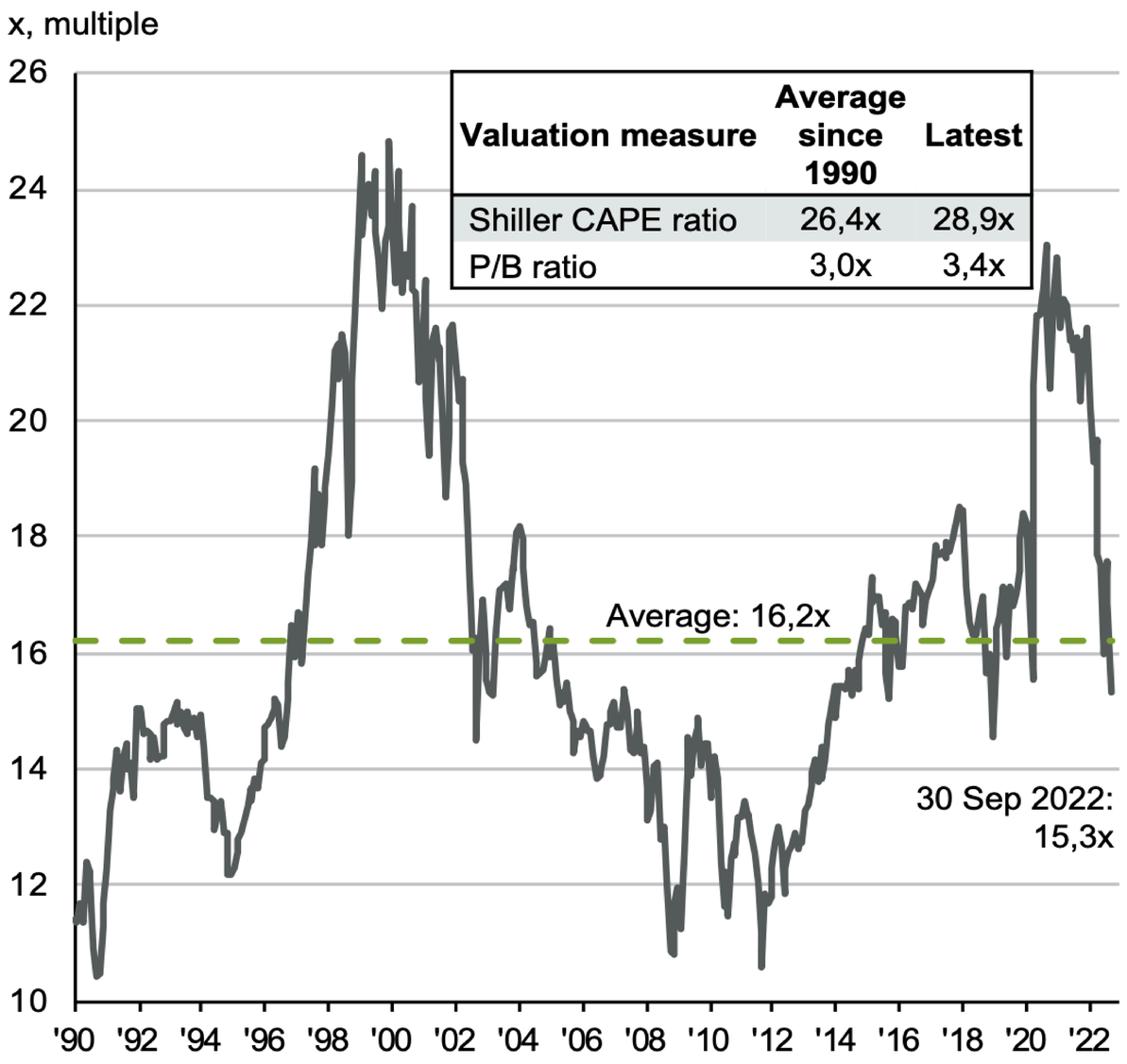
USA residential price index fell -3.3% in August 2022, more to come



M2 money supply at lowest (Source Mr. Budelmann/CharlieBilello)

S&P forward P/E ratio

- We understand the historical correlation of Mr. Larsen and his conclusion, P/Es should fall to 11x and as we can see in the right-hand chart, **we are today at 15.3x**, but we have some considerations:
- The IT sector has a 18.5x forward P/E at the moment, but if we take into account that **most of major companies are net cash,** most probably, the P/E is lower than 15x and therefore lower than the historical average.
- **We have recently seen, that the S&P 500 Index excluded IT is around 10x forward P/E already.**
- **Energy is 7.7x** and this is the reason, why we want to stay invested.
- Financials are 10.8x, Materials 12.4x
- Health care, industrials are at 15x
- Meanwhile Consumer staples at 18.6x, consumer discretionary 22.5x and utilities 17.9x : those are expensive.
- **MSCI Europe forward P/E ratio is 10.4x with Energy at 4.5x**

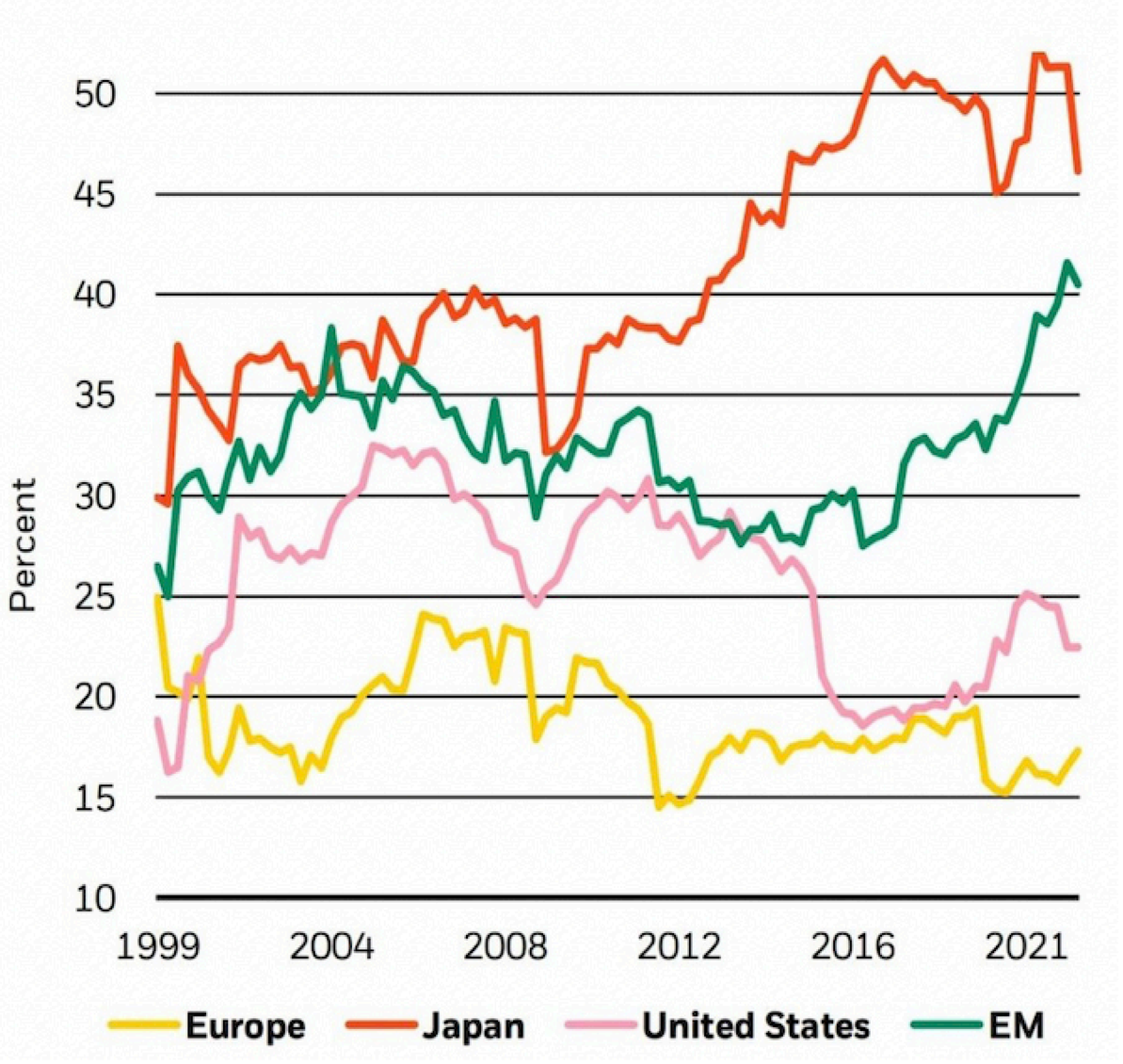


Valuation measure	Average since 1990	Latest
Shiller CAPE ratio	26,4x	28,9x
P/B ratio	3,0x	3,4x

Picture Title

Companies with net cash on the balance sheet

- On the right-hand chart we can analyze the percentage of companies net cash from 1999 to 2021.
- In Japan we have the highest percentage with basically the half of MSCI Japan being net cash.
- MSCI emerging markets had a tremendous rebound from 2016, and nowadays over 40% of companies included in the MSCI emmas index is net cash, showing once again, how solid are many emerging markets, not only private companies, but also governments.
- Europe at the lowest percentage is not as a surprise, being mostly old economy and heavy industry.
- The surprise is US, being the percentage lower than before 2012, but FAANGS actually have currently the highest cash level ever, so the total US percentage fell due to other sectors. After Q3 results, probably we have to slowly exclude Meta, which going to burn USD 100 bn in 2023.



Source: Blackrock

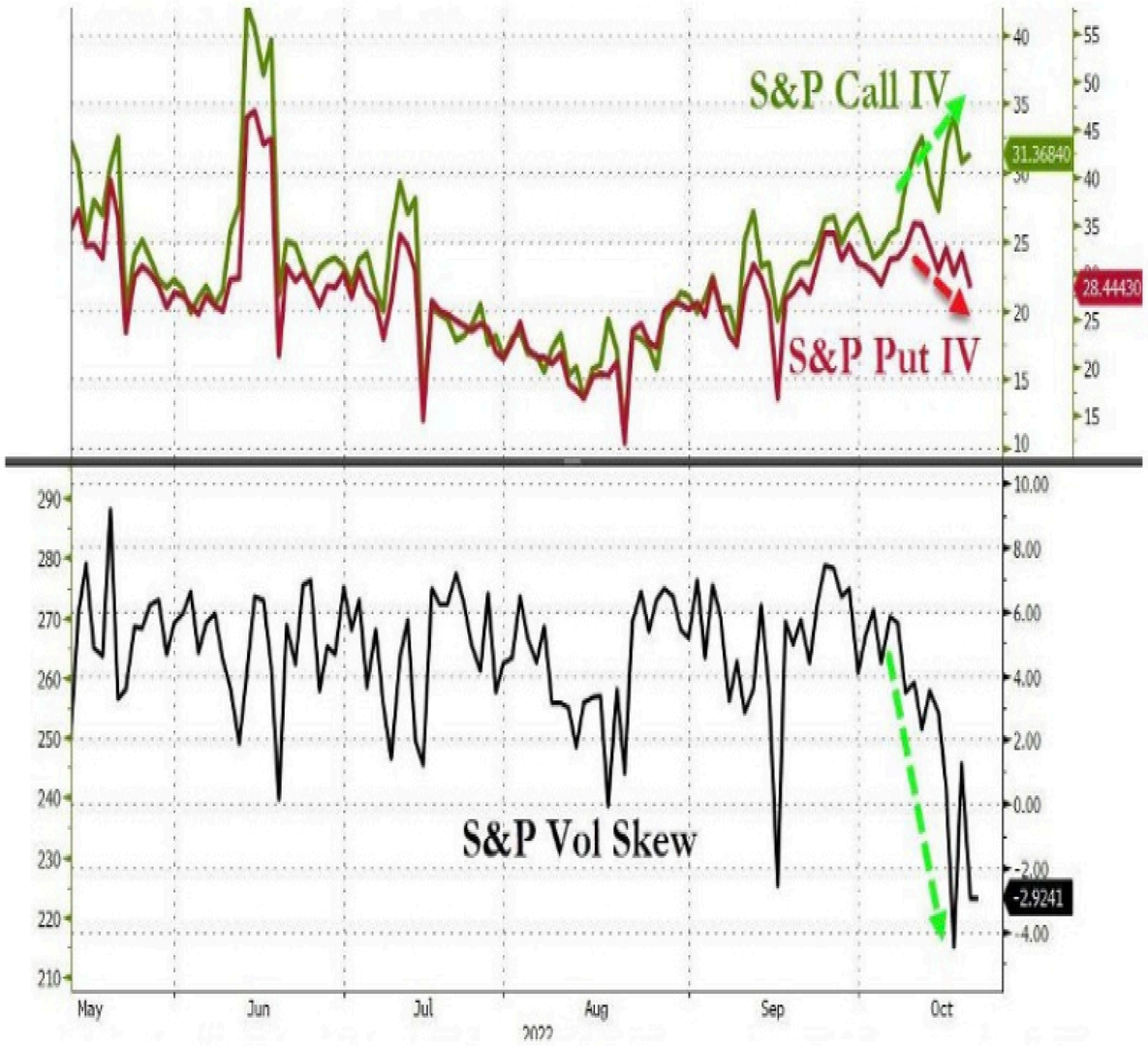
Interventions

- On the Friday 21st October 2022 we could notice **strong reversals in the USDJPY, but also emerging markets and other currencies.** Japan intervened in the foreign exchange.
- Also equity markets had a positive intra-day reversal on the news that the **FED is going to discuss already in November a possible slowdown in the increase of interest rates.**
- Nevertheless, in order to create liquidity, the US Treasury department will have to step into the market with bond buy back programs.
- **US corporate bonds, US Treasuries, EMMAS currencies and bonds, the ARKK US ETF, Chinese equities, GBP and EUR are all below the COVID March 2020 lows!**
- Emerging market sovereign debt is back to GFC 2008 levels and in KTS' opinion too cheap and market participants are arguing, CDS in emerging markets are now finally improving.
- With the BoJ intervention on the JPY last Friday, gold actually experienced the best day since the start of October.

Biggest intervention so far on USDJPY

Extreme Skew

- According to some market participants, the equity market rebound could be caused from investors being short, buying call options on the S&P 500 Index to hedge themselves.
- The volatility skew is at extreme levels. As a consequence of forced call buying, SPX upside calls have never been more expensive in terms of volatility, **according to the SPX 3 months call volatility skew ratio.**
- In addition, earnings reports are in most of the cases more resilient than expectations. In fact, according to the study of Bianco Research, the **guidance Index (net % of companies raising or lowering guidance) is positive, despite the overall weak economic growth.** But as we have seen last week, the historical correlation between the **US Philly Fed and S&P 500 operating EPS is actually pointing out much lower EPS going forward** (chart Macrobond and Nordea).
- Finally, the FED might moderate the pace of interest rate hikes already in the next meeting in November, in order to reduce the illiquidity in US T-Bills.



Source: Syz group

Strong technicals pointing out a bottom

- Mr. Rowles published an interesting chart entitling it: “last seen 6 years ago”
- We can notice a strong double bottom. Also the blog weekly Chartstorm confirms the **positive RSI divergence on the weekly S&P500 Index’s Chart**. This positive divergence is unfortunately still not confirmed by the **A/D line, which is still below the low of June.**
- The rebound of the S&P 500 coincides also with the **50% Fibonacci retracement** (3’505 points) from the lows in March 2020 to the highs in July 2022 and of course the **200d moving average at 3’606 points.**
- Goldman Sachs argues, the **pain trade is to the upside**, as Santa comes to town. On Friday USD 1.8 trillion worth of options roll, put love is gone, therefore gamma selling. Mutual Funds were the largest sellers last week, and corporate **buyback machine will start after the 31st of October,** with most earning reports. In addition to best seasonal period + mid-term election year, highest cash levels since 2011.

Source: Mr. Rowles

Technical analysis

- GS also argues, this year there is **no pressure from tax loss selling**, having the unprecedented and absolutely historic wealth loss in 2022 with over USD 30 Trillion USD YTD vs -28 Trillion in 2008.
- GS also show again the chart, showing the longest **number of consecutive weeks with a negative sentiment indicator: 33 weeks,** compared to 32 weeks in March 2016, less than 30 in 2011 and 25 in 2018.
- As we all know, **Turkey is experiencing one of the highest inflation rate worldwide; what went unnoticed is that the Turkish equity market substantially outperformed the MSCI emerging markets and MSCI World in USD in the last 3 years** and during 2022 experienced a significant rebound. **This is a proof that equity is an hedge vs inflation.**

Main quarterly results - FAANGS

- It is happened, what most of market participants were expecting. The final capitulation is by the FAANGS. In fact, the reaction of investors on the results with -20% for many of the majors, was the missing piece of the puzzle. Results were weak, but not disastrous, perhaps excluding Meta, and we do not have to forget, **big companies can start buying their own shares back, 48h after earnings are released**. We expect a bottom at this levels combined with the fact that central banks are at a pivot point. After such correction, slowly but surely, the P/E of the IT sector is falling to the level, experts were expecting.
- From the beginning of the year, **growth stocks had the biggest EPS downgrade vs other sectors and lost USD 4.7 trillion in value** from peak market cap. META lost 74.6% (!) , Tesla 46% , Amazon 50% , Alphabet 39% , Microsoft 35% and Apple 22%
- Alphabet profitability was below expectations, but revenues higher. Next to the difficult macroeconomic environment, USD strength weighed on the results.
- Google's chief business officer, said, that financial services companies, including in crypto, pulled back on search spending in the third quarter. All in all the business of Google is solid and with USD 16.1bn FCF in Q3 2022 and USD 100bn in net cash on the balance sheet (9% of market cap), Alphabet will buy back shares.
- Microsoft was also solid, but cloud growth momentum slowing. Investors are pointing out, that Microsoft has USD 20 billion less revenues than GOOGL, but **reached a higher net profit and net profit margin.** According to Mr. Costa, Microsoft valuation based on FCF yield is historically too expensive (chart not included).
- Apple surprisingly beats on revenue and earnings, however was short expectations on revenue on iPhone business and services, but the USD was the main headwind. The stock price reacted positively.

Main quarterly results - Amazon

- Amazon also disappointed on its AWS cloud unit and gave disappointing forecast for its fourth quarter, expecting a weak Christmas season, as everyone actually.
- But Mr. Choraria argues, investors oversaw **Amazon advertising business, the "hidden jewel"** of the company, generating a record USD 35.8 bn in net sales in the last 12 months and growing +30% in Q3 2022.
- This growth is incredible compared to Meta's negative growth and google youTube's negative revenue growth last quarter. Such business is bigger in revenues than companies like Visa, Nvidia, Mastercard, Salesforce, Paypal, Netflix, Starbucks, Uber, etc.

Main quarterly results - META

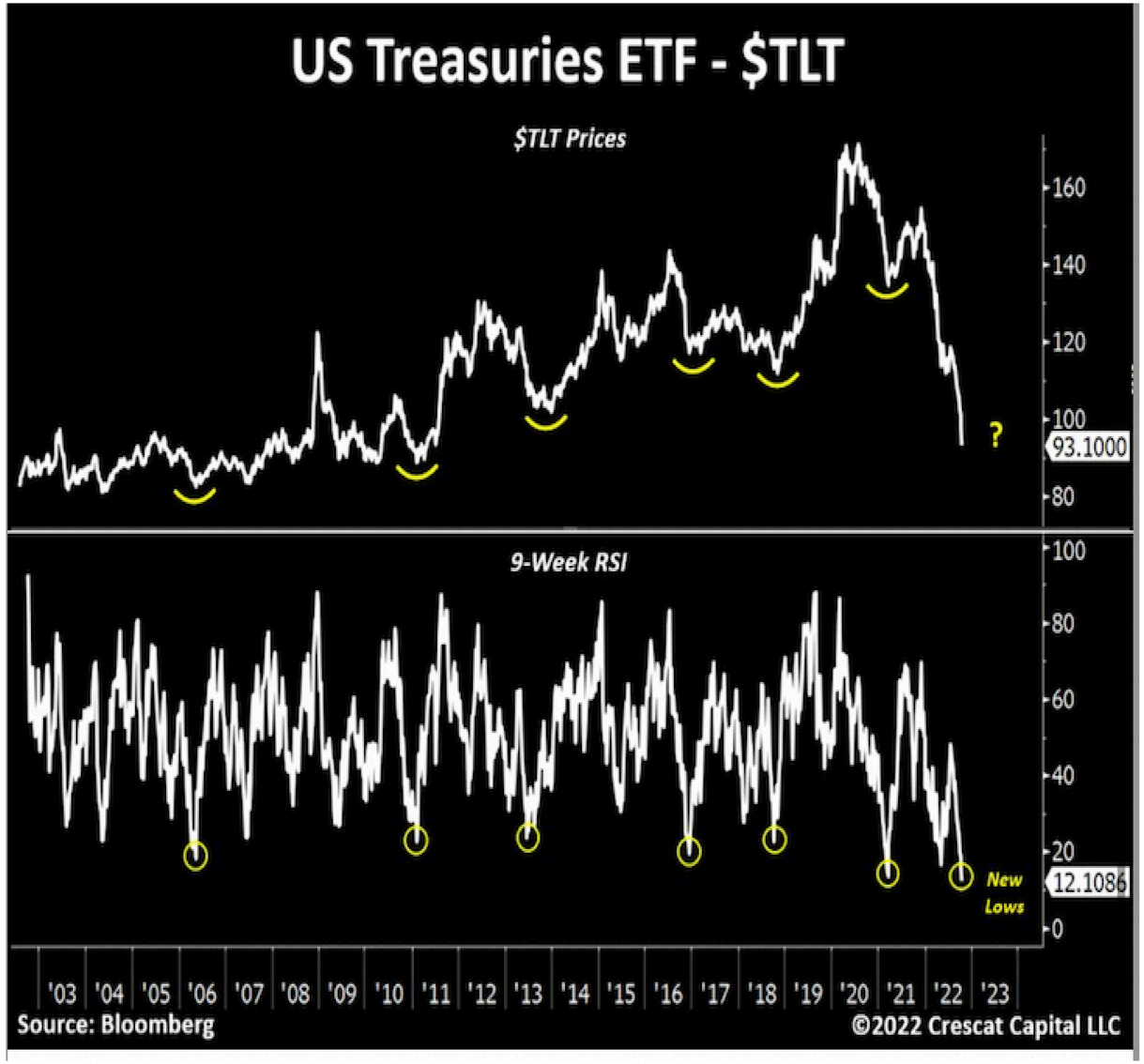
- Meta disappointed and is forecasting a weak holiday quarter. The stock collapsed over 20% on concerns over the future.
- In fact, capex increased to USD 23 billion this year and project higher costs for 2023 in order to develop Metaverse (from USD 85 bn in 2022 to USD 101bn in 2023).
- Most probably market participants were expecting a reduction of staff, but Meta will keep headcount flat through the end of 2023.
- Therefore **Meta has revenues falling 4% , but costs up 19% (added 19k employees) . Users are flat, but average ads price -18% y/y. Profits were declining -36% in Q2 2022 and -52% in Q3 2022.**
- And investors fears, investments into Metaverse are going to cause only losses and no growth.
- It is a long term project and investors fear, it will take long to see any profits from such segment. Currently, reality labs operating loss is USD -12.7bn with only Usd 2.3 bn revenue in the last 12 months and 2023 total expenses are going to be USD 100bn.
- In addition Meta **bought back over USD 48 billion in shares with an average of USD 300.**
- **The P/E is falling under 10x (included net USD 40 billion net cash = 12% of market cap therefore excluding net cash is even cheaper),** therefore we could assert, **META is now a value stock.** But investors have now a company, which is going to have negative FCF in 2023 for the first time and burning USD 100bn in cash for Metaverse. The **net cash halved already since 2021** and therefore Meta is now a **very capital intensive company with lower ROIC going forward.**
- On the short term, we expect the company to start again the share buyback program in order to support the stock.
- We believe, selling put with a volatility higher than 65% is the most attractive strategy for this stock. We should have a short term bottom a this levels, but as Mr. Choraria argues in his blog, Apple and Microsoft spend less on capex and have less competition.

Main quarterly results - old economy beats FAANGS

- Credit cards Visa, Mastercard and American express continues to do well.
- Even if Samsung reported a 31% drop in Q3 profits, the stock price stayed stable. Samsung said, despite the headwinds, **demand for semiconductors may recover later next year as new data centers and computers require more memory.**
- Coca-cola could surprise positively, but Heineken missed estimates and gave a cautious outlook due to weak macroeconomic.
- Caterpillar could surprise with much better results than expectations, profiting from from strong global demand, mostly from mining, oil and gas but also construction.
- All in all, we sense, results were solid. Companies spur the economic slowdown, but the sentiment on earnings was by far too pessimistic. The main dilemma is, analyzing fundamentals, the global economic should experience further slow downs. **The positive trigger is global central banks start to change monetary policy and could alleviate such negative trend.**

Technical analysis - TLT US never been this oversold on a 9 week RSI

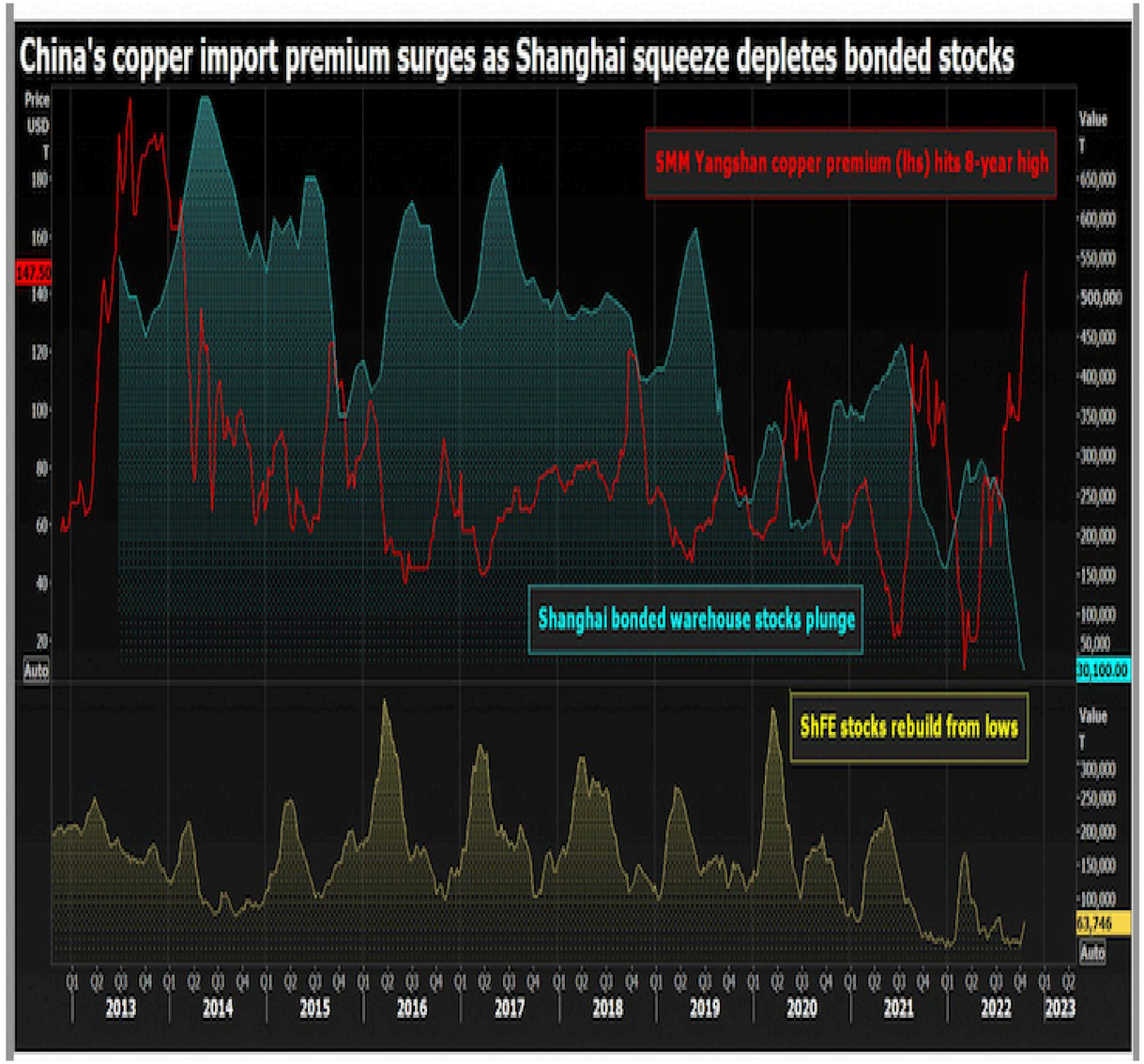
- On the right-hand chart, courtesy Mr. Costa, we can analyze, how the etf TLT US (US Treasuries 20y) has never been oversold like today.
- Even the forever bearish investor Mr. Costa says, probably US Treasuries are due for a bounce.
- We also believe, everything is pointing out for at least a technical bounce, not only in the equity market, but also for bonds and therefore **KTS increased positions into MAN high yields and European CLOs.**



Source: Crescat Capital

LME copper inventories at extreme lows

- On the right-hand chart, courtesy Mr. Wendt, we can notice, how LMC copper inventories have fallen by 64% over the past 5 years from a peak of around 390k tonnes to 139k tonnes currently.
- Over the past week alone, the amount of available copper in the LME's warehouse network has halved, with 48% of current stocks are awaiting physical load-out, leaving just 72'950 of live stocks.
- Mr. Wendt rightly asserts, this is happening, despite the darkening outlook for demand.
- The driving force appears to be China, where a squeeze on the Shanghai Futures Exchange (ShFE) has generated a scramble for metal.
- In the chart we can analyze, copper stocks in Shanghai have fallen from a high of 700k tonnes to 25k tonnes currently.
- **KTS is exposed to copper via our best-in-class fund Bakersteel Electrum and Nevada copper.**



Source: Mr. Wendt / Andy Home, Reuters)

General news - possible U-turn of Democrats on Ukraine

- A possible positive news, if the House would be controlled by Republican, they would not support the US military aid to Ukraine anymore. Apparently Mr. Kevin McCarthy told in a interview with the online-portal Punchbowl News, “I think people are gonna be sitting in a recession and they’re not going to write a blank check to Ukraine”.
- We are also reading, that thirty U.S. Congressional Democrats are urging President Biden to shift his strategy in Ukraine towards pursuing a negotiated settlement. “Given the destruction created by this war for Ukraine and the world, as well as the risk of catastrophic escalation, we also believe in the interests of Ukraine, the United States, and the world to avoid a prolonged conflict”. “For this reason, we urge you to pair the military and economic support the United States has provided to Ukraine with a proactive diplomatic push, rebuilding efforts to seek a realistic framework for a ceasefire”. **KTS would call it a sign of policy makers pivot, trying to help the FED.**
- It is too early to base scenarios on the end of the Ukraine’s conflict, but we have early positive signs, policy makers sense the escalation, especially in the global financial system and start the U-turn.
- This should be positive overall for equity markets, should help inflation to stop increasing, therefore put the FED in a more comfortable zone and yields should fall, therefore bond value increase and pension funds would have some “oxygen”.
- The oil price should initially fall, but we do not have to forget, that US has to rebuilt oil reserves and as soon as the oil price would fall under 70 USD, there is a strong support. We would expect oil companies to perform well up to the end of the year, being the best performers and in the season of “US tax selling”, asset managers need to add positions on the good performers and sell the worst one.

General news - Putin on nuclear arms use

- We are reading the headline of Mr. Putin stressing out, that Moscow “never said anything proactively about the possible use of nuclear weapons”. He adds, “we only hinted in response to those statements that the Western leaders have made”

General news

- **Gold reached** a negative YTD performance in USD, but **positive in GBP and EUR**. In addition, comparing the performance vs **TIP US, gold was holding very well actually**. In fact, the historical correlation with the TIP US was very strong, but this year fortunately not. In addition Mr. Costa rightly observes, that the Treasury Inflation-protected securities were supposed to do what their actual name says, but did not.
- Nowadays most Private Bankers are proposing hedge funds as only place for diversification. But according to a recent research of Bloomberg, **55% or hedge funds experienced YTD negative performances over 10% and 20% of them have performances from 0% to -10%. Only 20% of the HF reached positive return**. We would argue, as explained last week, those HF with positive performances are tail risk funds, which could perform well this year, but still have annualized negative performance from 2011 or longer. We also agree that the best diversification in the portfolio is reached only among different strategies rather than different weighting of asset classes. But you need a good database and knowledge to know which strategies are working and which ones are not. KTS believes to have an excellent network over our 30 years' business experience.
- **Germany's government approves marijuana legalization plan,** but the reform still depends on the European Union sign-off. Basically, the whole world is going in the direction of legalization and we would like to remind that three weeks ago (weekly nr. 40 on the 7th October 2022), Biden pardoned thousands convicted of marijuana possession and initiated practically the decriminalization of marijuana in the country. KTS has a small exposure in the company **Cronos Group (CRON US), of which Altria owns 45% .**

Chinese Party congress

- On the Chinese Party Congress, actually no surprise on the re-election of Mr. President Xi Jinping, but we all saw the video, of the former Chinese leader Hu Jintao, who was escorted awkwardly out to the Party Congress on Saturday.
- Market participants also argues, Mr. Xi Jinping forced the retirement of we--known leaders with previous good relationships with the West and therefore foresee a deterioration in the US-China political relationship.
- It is not up to KTS to talk politic; everyone can make up his mind, but **we slowly tend to agree with our best-in-class Flossbach's manager, that if a person wants to invest with ethics and sustainability,** it is difficult to find the right reasons to invest in the Chinese market, other than, it is **very cheap valued** (never being so cheap and the MSCI China is trading at 8.6x, Hang Send Tech Index even lower at 6.5x).
- Investors want enough risk premium in order to discount the substantial political risk.
- Now **Mr. Xi is in full control of China** and in his **speech, it was all about security,** rather than economy. This fact, worry international investors even more, having Mr. Xi now focusing more on security issues rather on the economy, which is not in the best shape already.
- We have to admit, that when a country is in the hand of a single person, of course it is all about security, in order to repress the opposition, and it can not end up well. Anyone has read enough history books, to guess, what could happen and we do not have to go too far in the past, the **24th February 2022 is the sign of what could happen to Taiwan.**
- Again, it is not about politic, but now **we have to take into account the higher risk on the dilemma of Taiwan on a longer investment horizon.**

Chinese Party congress

- In fact, once again, the Party Congress opposed to Taiwan's independence in addition to to Mr. Xi defending China's crackdown in Hong Kong. Mr. Alessandro Fugnoli stressed out in his last blog, that it is quite clear, Mr. Xi wants to be remembered, like the Chinese President, who solved the Taiwan's dilemma, as he did for Hong Kong. Again, Mr. Xi argued, this issue can not be passed to the next generation.
- Mr. Fulco argues in his blog, if the **pro-independence DPP wins Taiwan's 2024 presidential election (January), something could happen with China, which also speculate, the US would not get involved in most scenarios.**
- Mr. Fugnoli also assets, as the manager of Flossbach also mentioned, that Germany has much more to lose than US, if geopolitical tensions West - China would escalate and the repercussions are of course much worse, than the rupture with Russia.
- The equity market in Hong Kong corrected 5% on Monday the 24th of October due to fears that Mr. Xi Jinping fortifies his power. Equity markets are obviously expecting more regulations, more lockdowns, more nationalization and more tensions with the West.
- On the short term perhaps the market overreact, but on the longer term, KTS does not feel comfortable with the fortified position of Mr. Xi Jinping.

Chinese Party congress

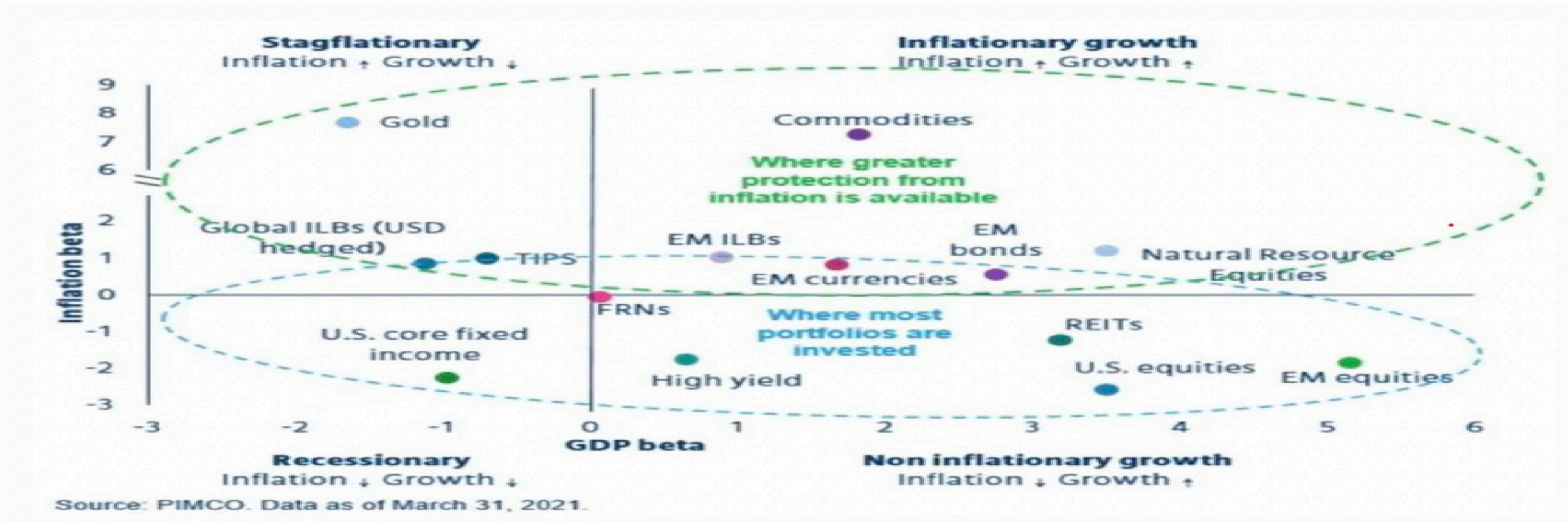
- Meanwhile on Monday the 3Q GDP Chinese numbers came with 3.9% beating expectations of 3.3%, but market participants are asking how the GDP can grow, with property investments, sales and new home prices in a bad shape.
- Analyzing GDP numbers, retail sales growth was 2.5% yoy in September, therefore lower than estimates, but would not be a wonder, due to lockdowns. Also real estate investment continued to register a double-digit decline. Market participants can still not assess the consequences of the housing crash on the USD 55 trillion China banking sector.
- As we know, analyzing our best-in-class emerging market funds, they reduced since long time the exposure in China and are more exposed in India and increased other countries, like Vietnam.

NFT ticketing and secondary market

- Reading that Nike is approaching USD 200 mio in sales generated from NFTs and half of this revenues is from the secondary market, basically as royalties generated as a commission for the resale of these NFTs .
- KTS was also exploring some investments opportunities into NFT ticketing, but it is still difficult to find the right counterparty, where we feel comfortable it is going to be the winning company in the space.
- The segment is highly interesting and is also going to be the future, especially for the re-sale of tickets, where artists at the moment can not share the profit of tickets sold at higher prices in the secondary market.
- With the NFT technology, it would be possible, and for this reason we believe, the market will develop further.

Asset classes vs inflation

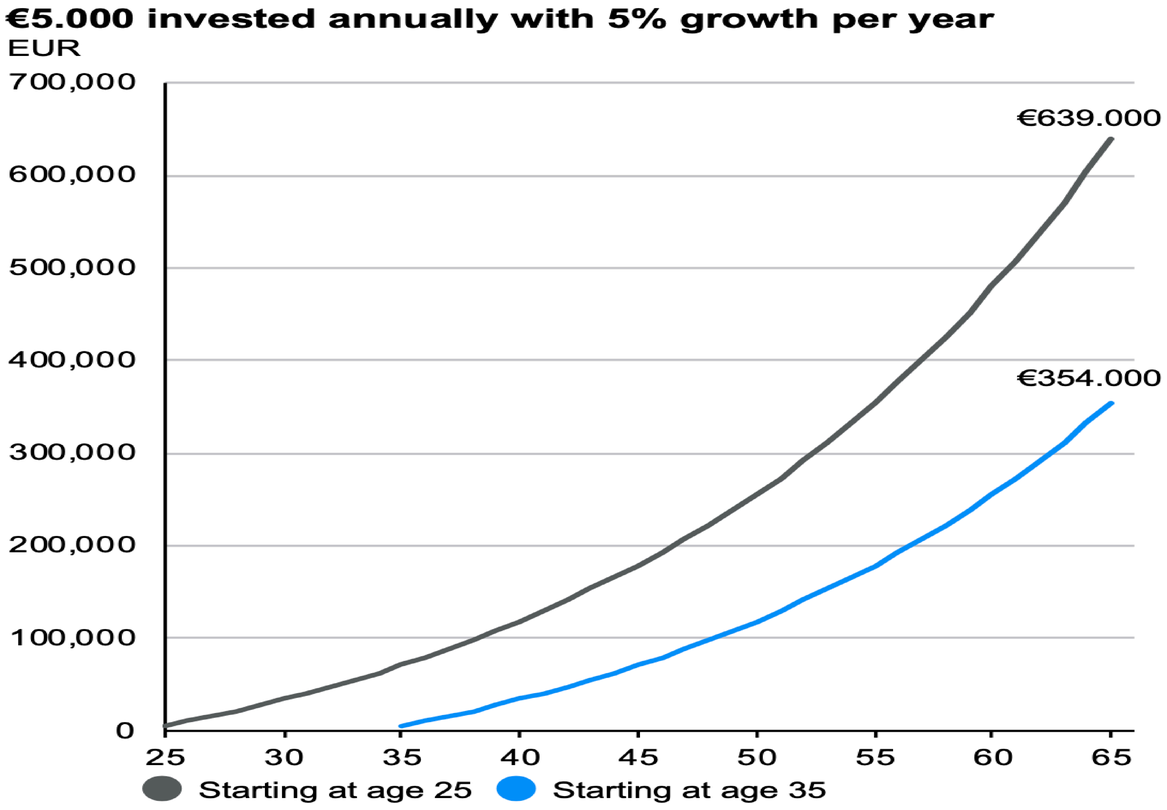
- The below chart shows the correlation between asset classes and inflationary environment.
- We are going to enter a period of **inflation and lower growth, gold should profit from such environment.** This is also in line with the assertions of Ms. Patterson, CIO at Bridgewater (see our weekly report nr. 38 on the 23rd September 2022).
- Flossbach also just issued a blog, in GO(L)D we trust and comes to the same conclusion.

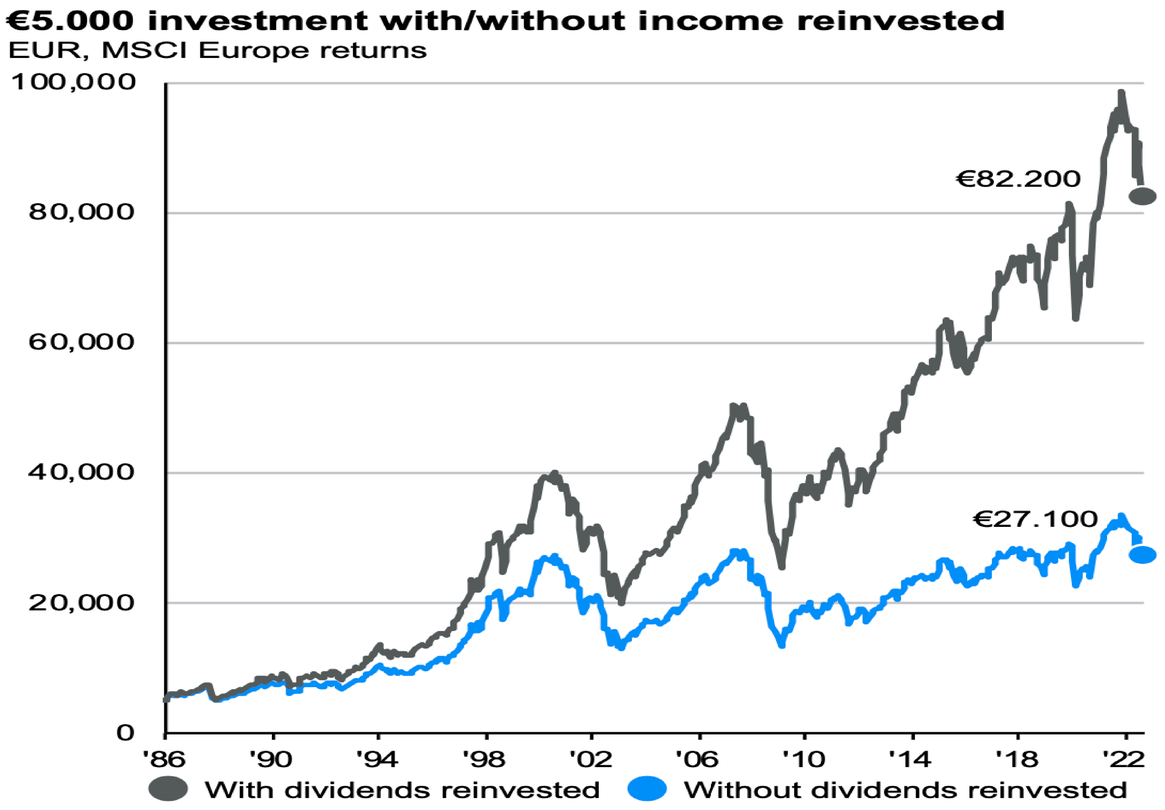


Source: Pimo via Syz group

The effect of compounding

- We are including some interesting slides of the JPM's outlooks.
- In critical moment like nowadays, we do not have to forget to limit the drawdown, but we also have to keep in mind the **effect of compounding.**

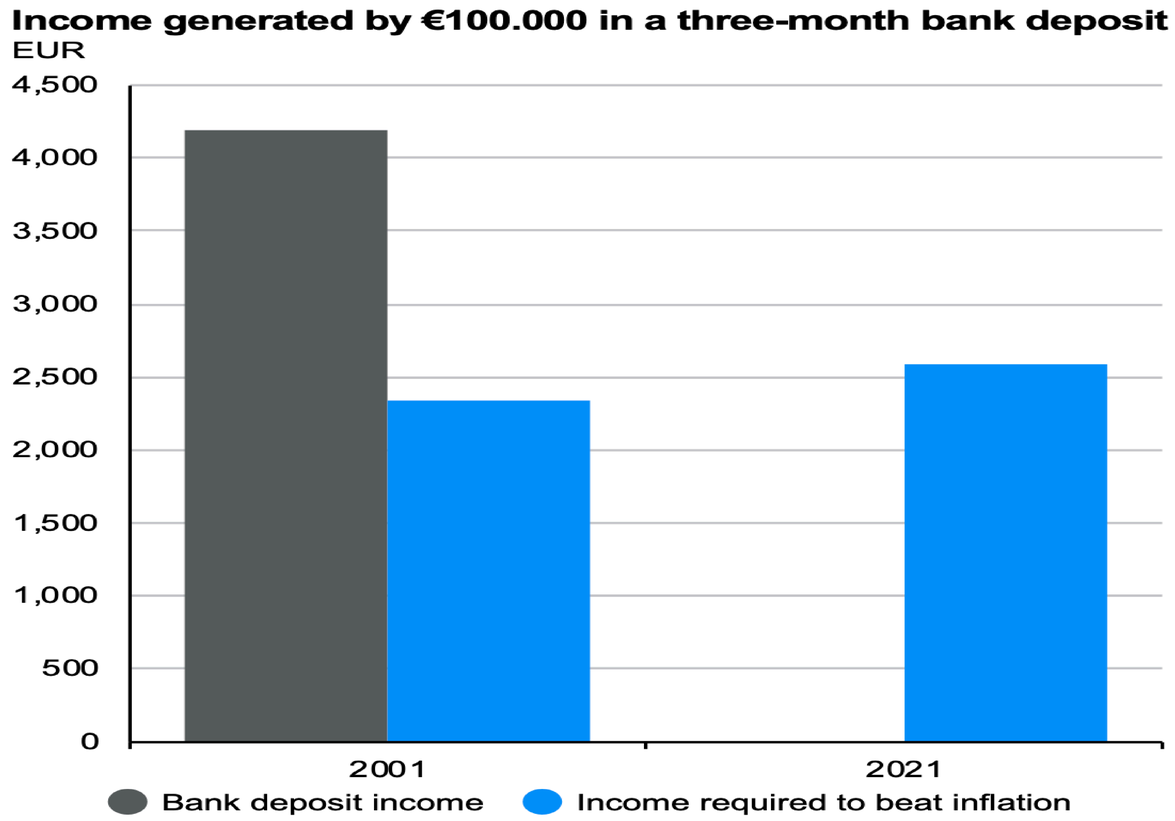


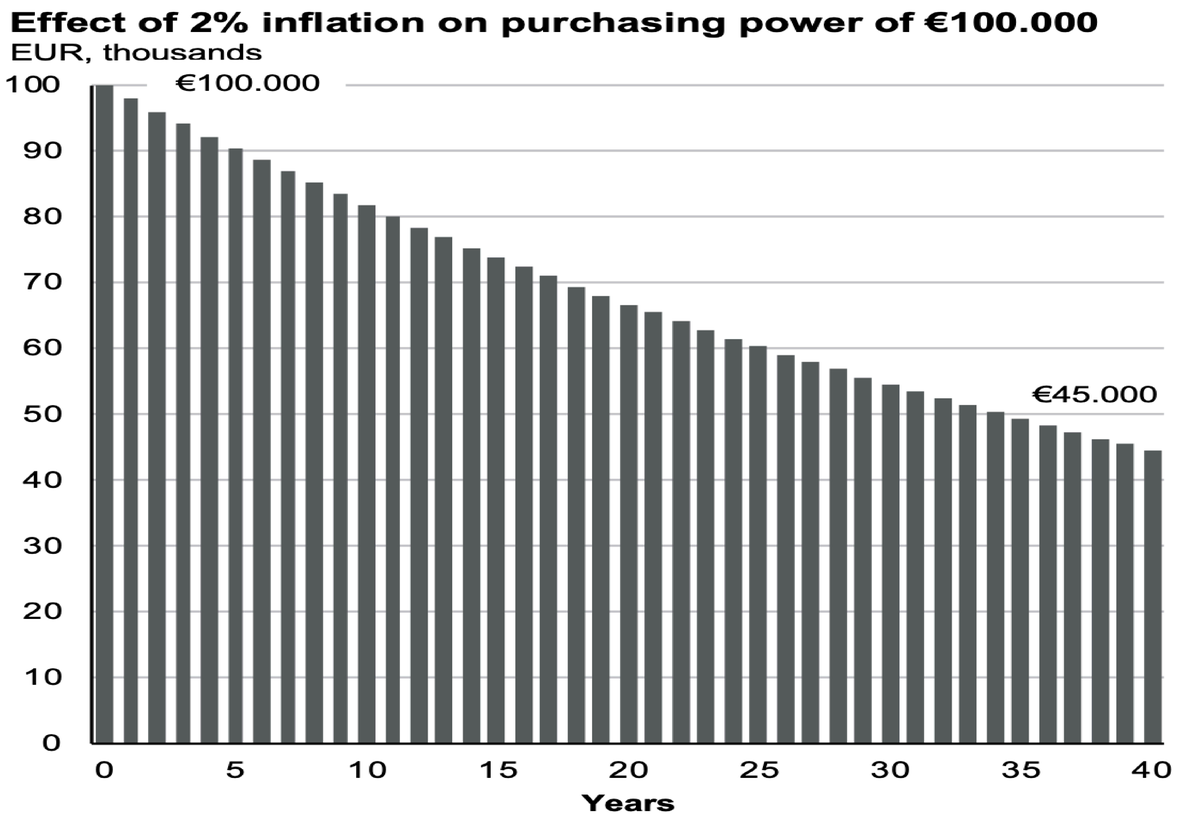


Source: JPM

Effect of 2% inflation on purchasing power

- JPM makes the calculation on the cash investments, but this numbers are giving the idea of the effect on our pension funds, which is also invested with negative real yields and therefore also losing purchasing power.



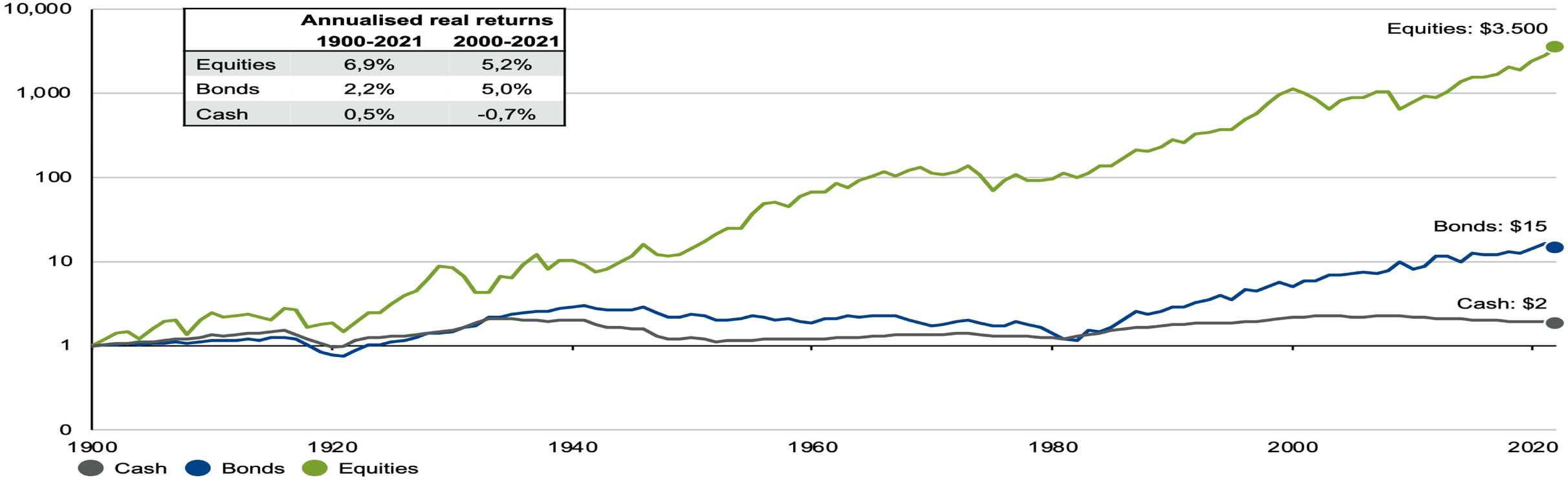


JPM

Long-term asset returns

- **Since 1900, the performance of equities is 6.9% annualized real returns vs 2.2% of bonds.**
- Since year 2000, the performance of equities is 5.2% for equity vs 5% of bonds
- Cash from year 2000 has a -0.7% real returns.

Total return of $1 in real terms
USD, log scale for total returns



	Annualised real returns	
	1900-2021	2000-2021
Equities	6,9%	5,2%
Bonds	2,2%	5,0%
Cash	0,5%	-0,7%

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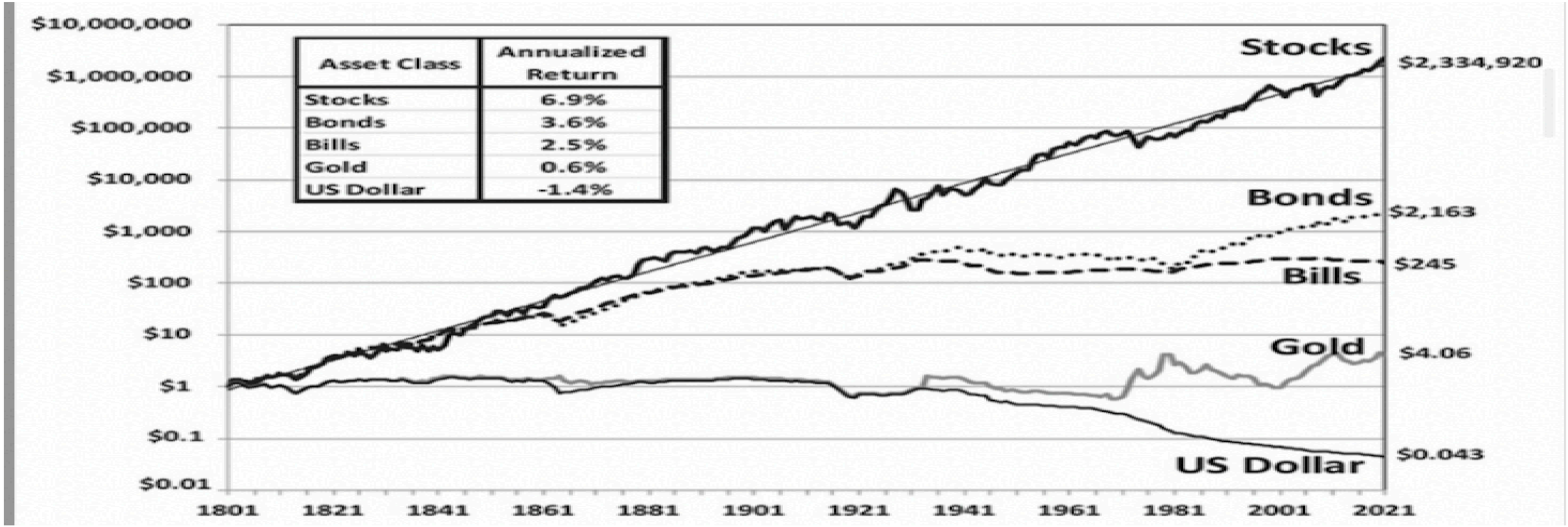
Long-term asset returns

- We include a similar chart like JPM, but courtesy dividend growth (via Syz group Ms. Noel), where we can analyze, that over longer term, stocks reached a better annualized performance than other asset classes. This comparison is from 1801, so it is not really the best comparison to use, but give the idea over long term trends.

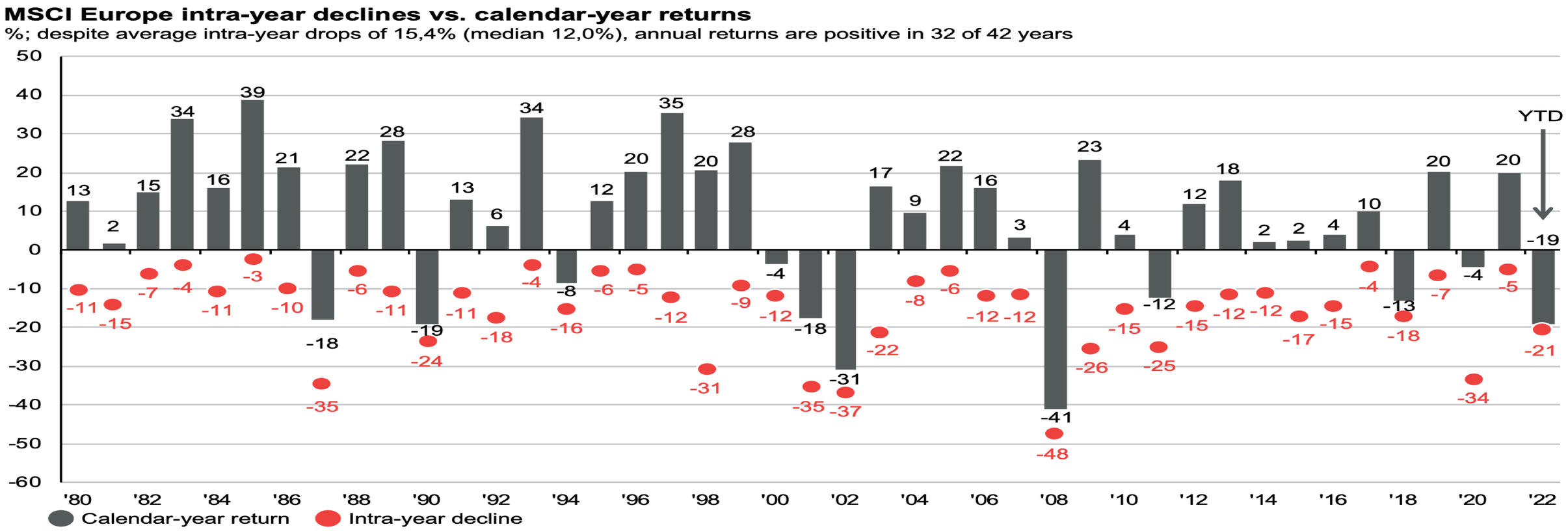


Asset Class	Annualized Return
Stocks	6.9%
Bonds	3.6%
Bills	2.5%
Gold	0.6%
US Dollar	-1.4%

Picture Title

Annual returns and intra-year declines

- This chart give an idea of the magnitude of the -21% YTD's move compared to historical performances.



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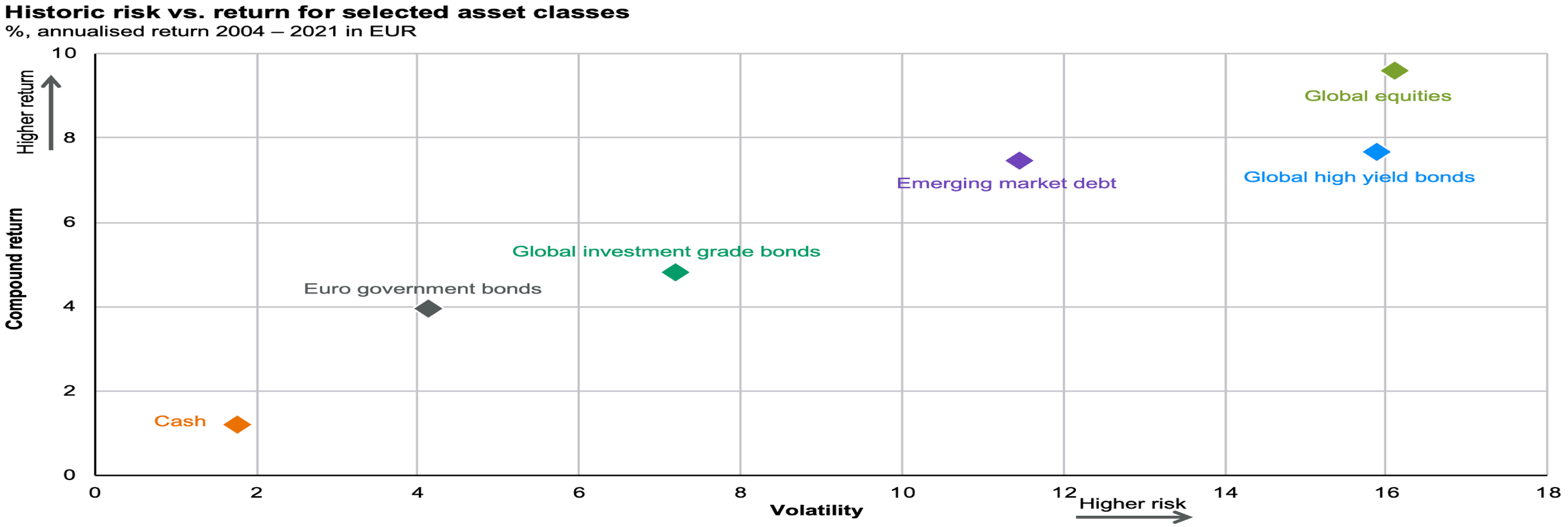
Efficient frontier

- On the below chart we can notice, that with global equities, the average in the last 17 years is a return around 10% with a volatility of 16%.
- Emerging market debt has the same return as global high yield bonds, but with much lower volatility, being emerging market countries and companies in a much better financial shape.



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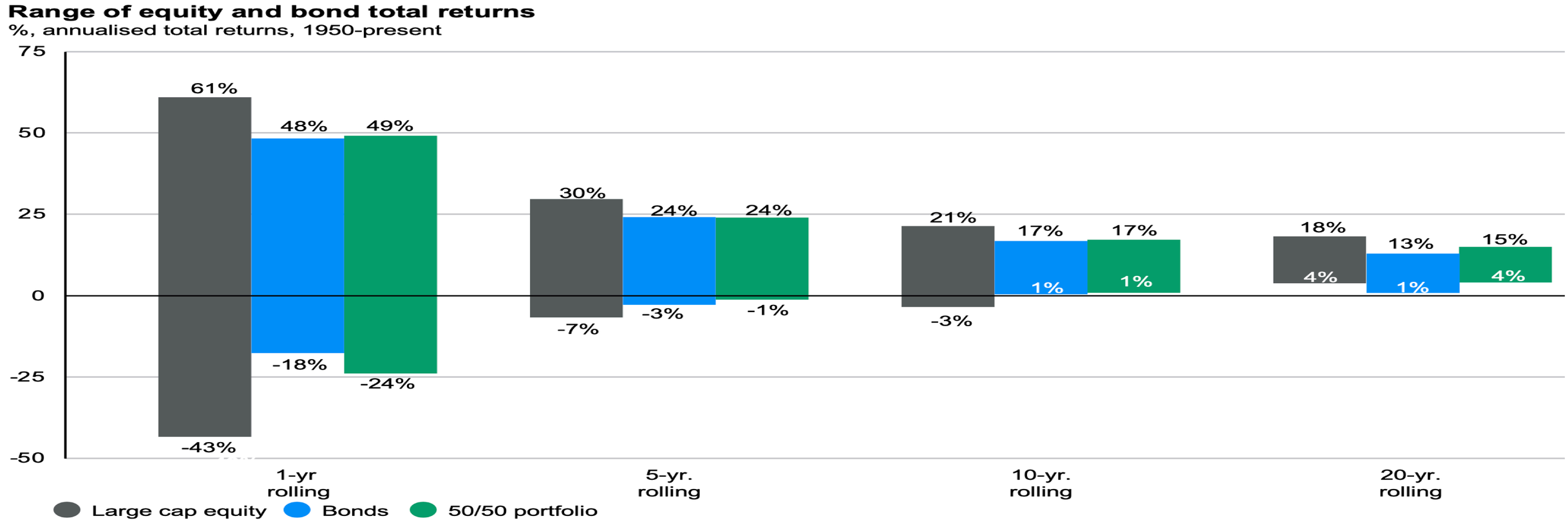
US asset returns by holding period

• As explained in the past, the longer the holding period, the lower the volatility.



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