KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 46

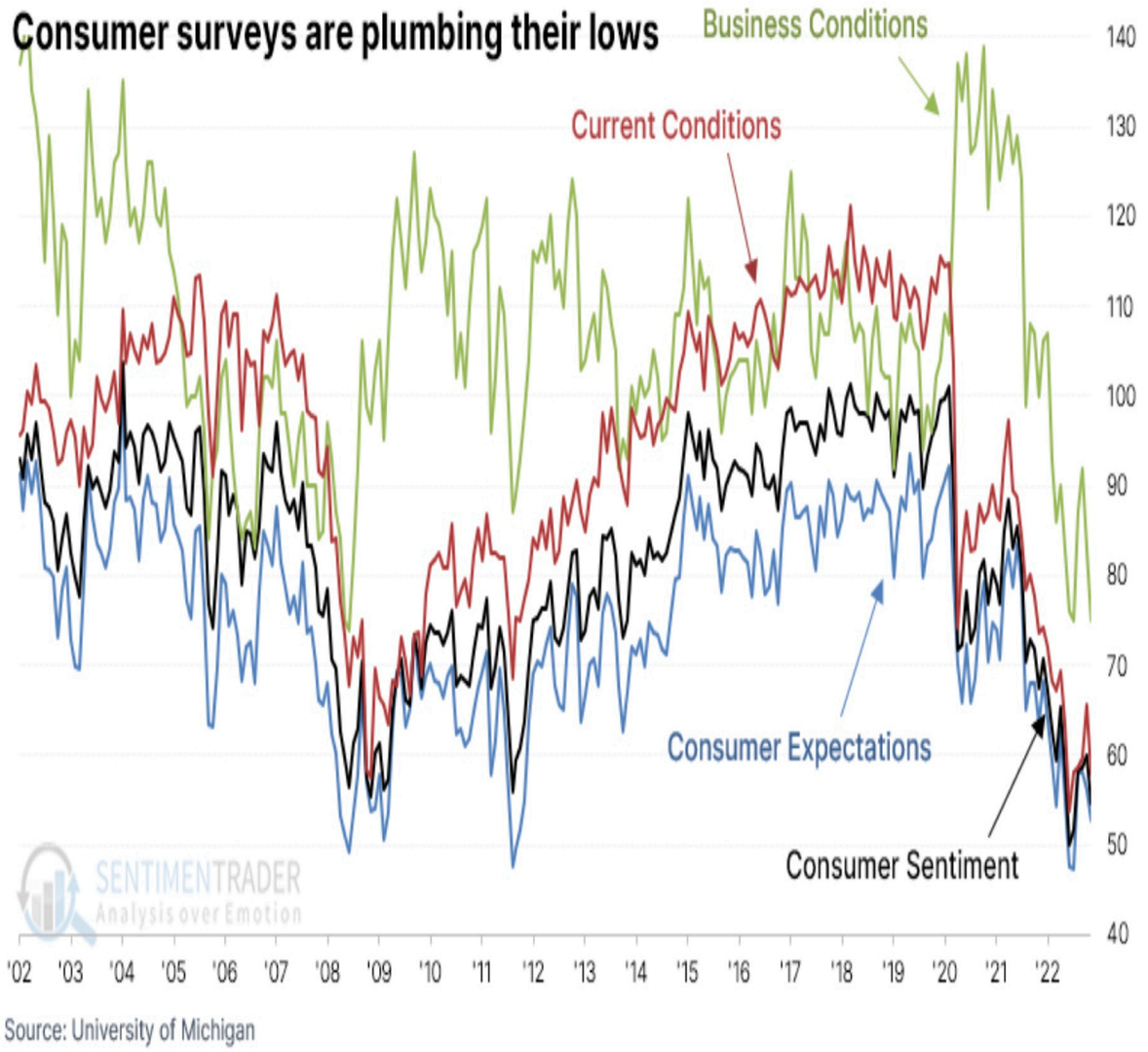
The 18th of November 2022

Macro

- After the impressive equity market's rebound last week, we started reading **upgrades on equities from professional investors,** which should create new demand for equity and probably further short squeezes.
- After the **OPEC revised the demand down,** the WTI dropped almost 3%, helping easing pressure on inflation.
- Meanwhile **US PPI came logically also lower than expected**, as the recent KTS's analysis was forecasting.

Sentiments near the lowest levels in more than 40 years

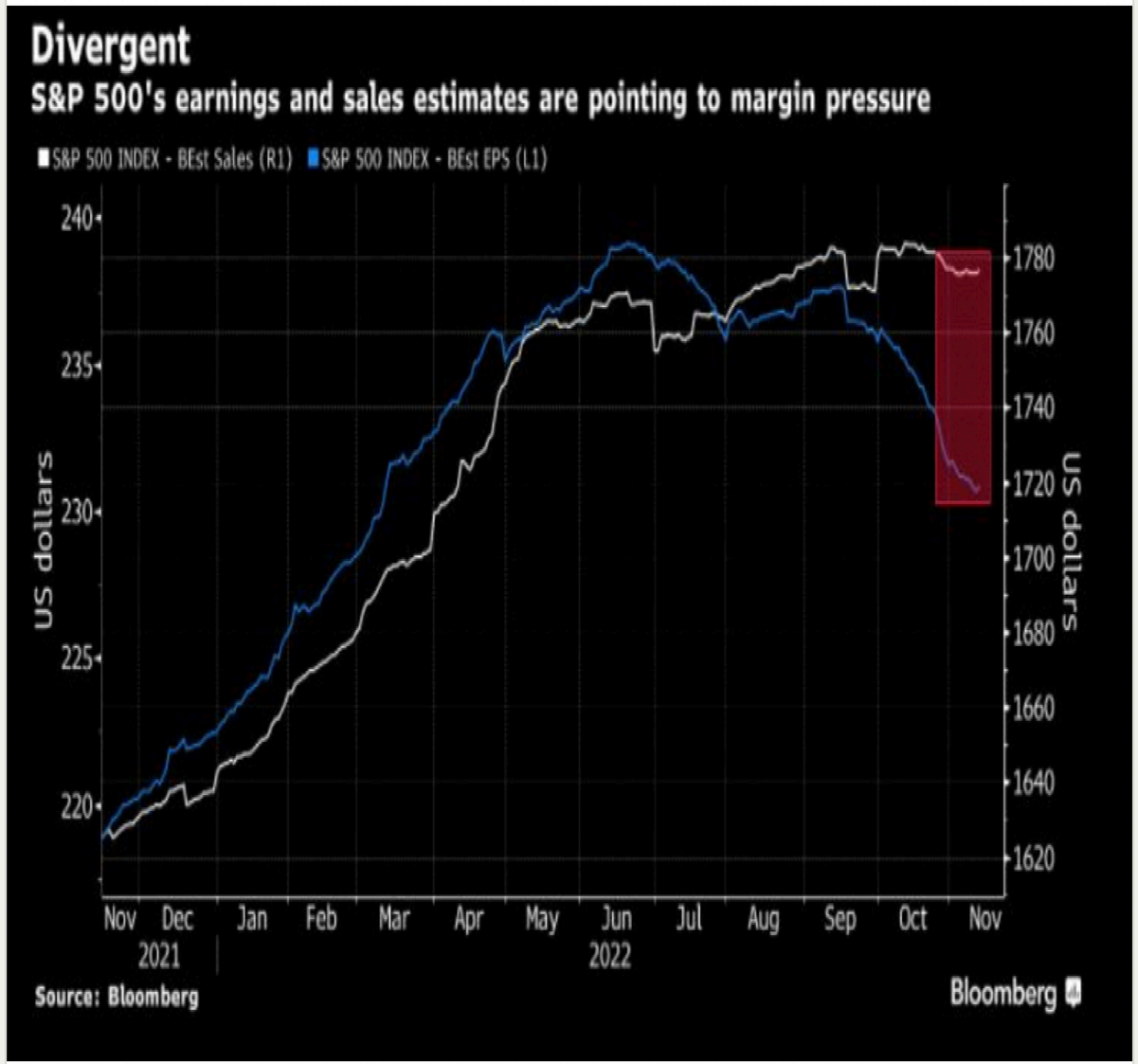
- The latest round of surveys on American consumers by the University of Michigan showed more deterioration.
- Consumers are discouraged about their current condition and outlook for the future.
- Sentiment and current conditions are focused on now, meanwhile expectations and business conditions are more forward-looking and their are all at the lowest levels in more than 40 years.
- **We have the worst consumer sentiment ever, since the start of the statistic back in the 1978.**
- **Analyzing historical data, such depressed sentiment preceded good gains in Tech, Small-caps and value, therefore such sentiment indicator has to be looked at contrarian bullish.**



Source: Kingworldnews, University of Michigan, Sentimentrader

Divergence between sales and earnings

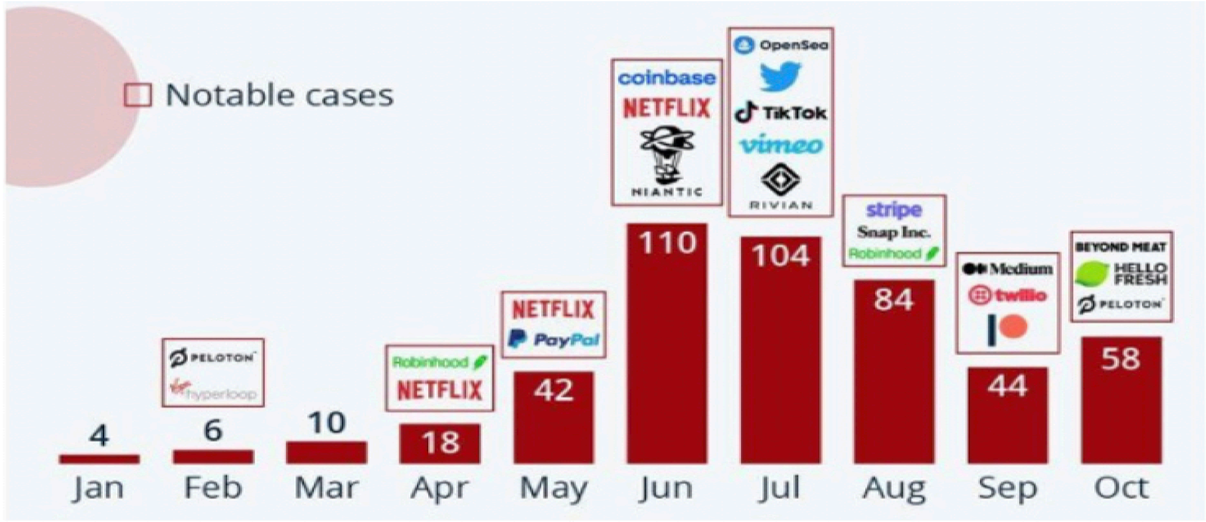
- On the right-hand chart, courtesy Mr. Barraud, we can analyze how the **divergence between the S&P 500 index sales and earnings estimates has widened during Q3 earnings season**, signaling possible margin pressure in the near future.
- We would like to mention (see next slide) that many companies **started major layoffs, especially in the IT sector,** in order to reduce costs and therefore maintain the same profitability.
- The IT sector experienced a boom during the pandemic and most companies were constantly hiring. Now we have seen, that the IT sector has basically 0% growth, therefore the only way to improve profitability is cost cutting, especially the labour cost, and this is happening.
- **This mass layoffs in the last several weeks are clearly anticipating lower labor data in the near future and in combination with further lower US CPI, the FED will be soon at a pivot point.** This is going to be very positive for equity markets. The google search for layoffs is again at record highs, like back in GFC 2008, 2016 and much higher than 2020.



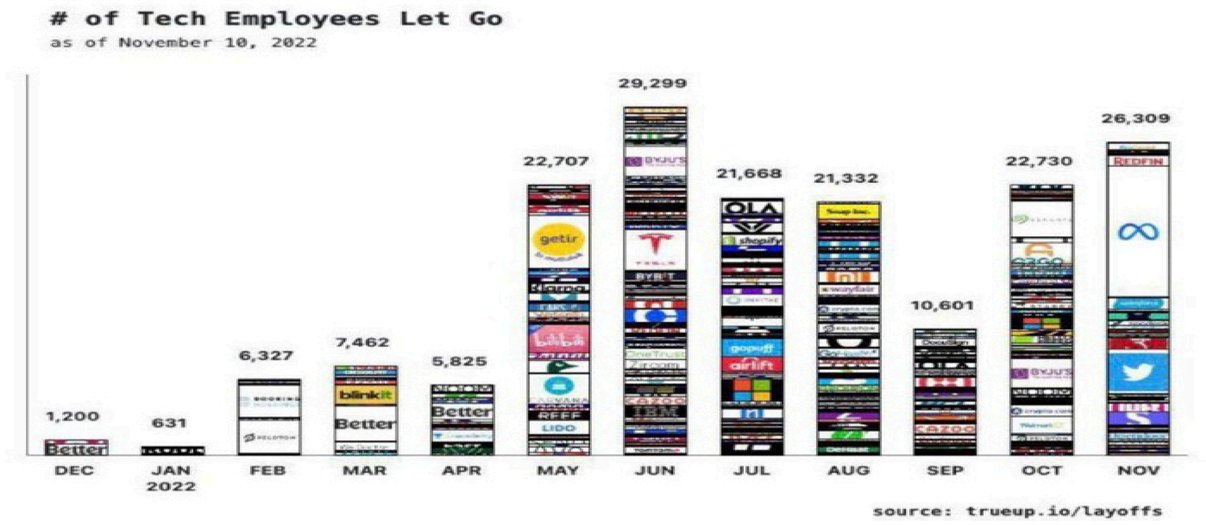
Margin pressure? Companies are already reacting

Mass tech layoff wave rises again

- As recently argued, US labor market is still strong and therefore market participants are arguing, that labor inflation is still a big burden for the FED. Fed Governor Mr. Waller is still arguing in his latest interview, more reports are needed to turn dovish.
- But analyzing latest news, **layoffs from major companies are substantial** and therefore soon, labor market numbers are going to fall substantially, which should be a massive positive trigger for equity markets, but especially for the pivot point of the FED.
- The global economy needs the FED to slowdown substantially the pace of rate hikes, in order to avoid a general collapse, which would be on the other hand very negative for equity markets, which are still not discounting such scenario.
- Bond markets should profit in any scenario from now on. Because in any case, yields are going to fall, which is positive for bonds. Of course, during a recession, defaults are going to increase and therefore, it is important to be invested via solid fund managers.



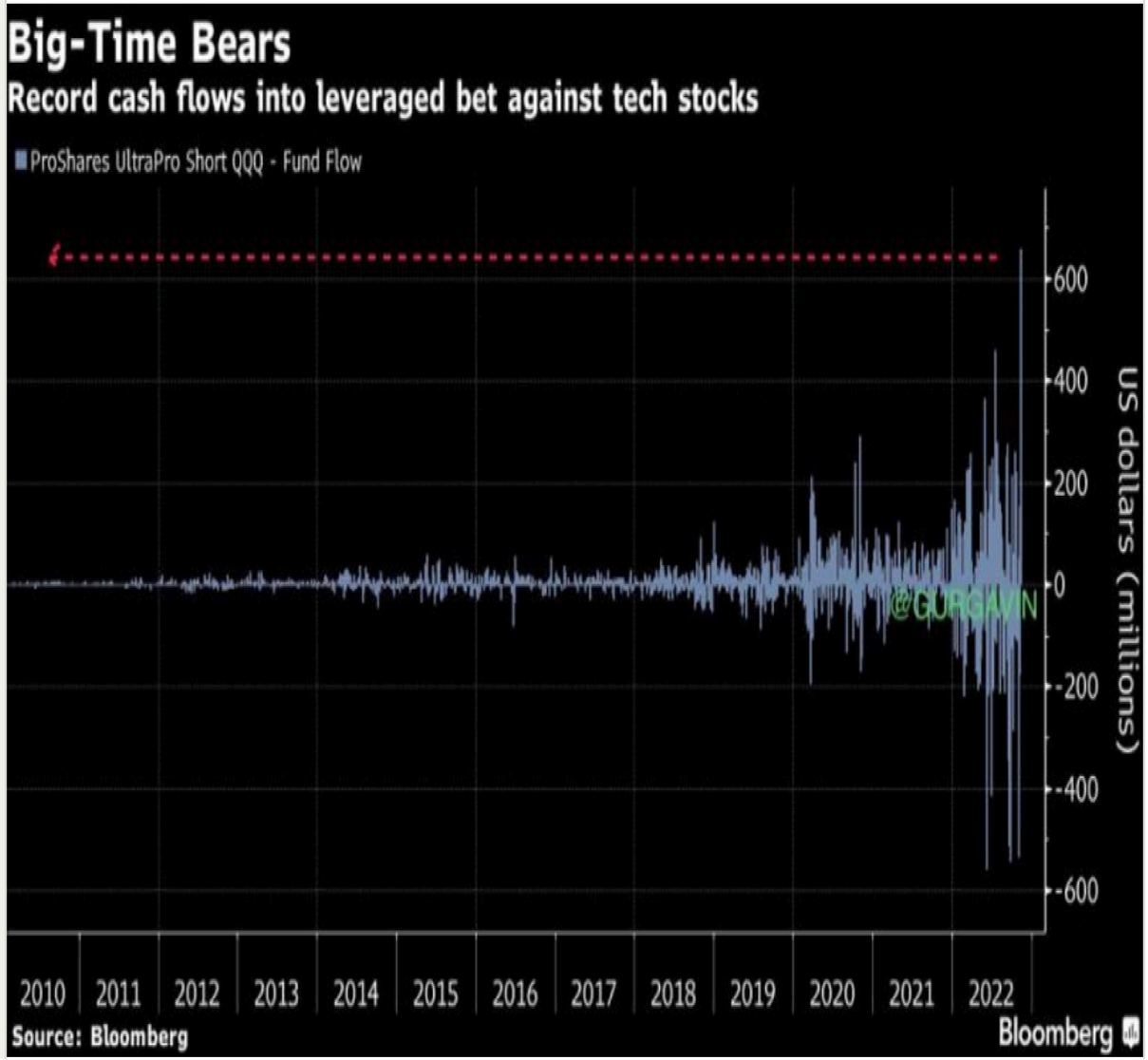
Source: Statista / Syz group



Source: trueup.io / Syz group

Record cash flows into leveraged bet against tech stocks

- Last Friday, after the amazing rally on Thursday, **the short QQQ experienced the biggest inflows ever.**
- Apparently, there are still a lot of investors, who are believing, we are in another bear market rally.
- We are amazed by the huge volumes and daily new records on both side, bearish and also bullish.
- We tend to believe that **the pain is more on the upside,** if more positive news are coming, but it is incredible that the substantial volume is still betting against the IT sector.
- **This in combination with the fact that AAII sentiment poll is negative since 31 straight weeks. Going back to 1987, the record for most persistent bearishness was 34 weeks (from Feb to Oct 2020). As Mr. Monchau asserts, from a contrarian perspective, this is a bullish sign.**
- Most of professional investors are still waiting for stronger fundamentals, but the risk is very high that equity markets are going to strongly rebound before fundamentals improve.



Source: Bloomberg via Mr. Rowles

It is another bear market rally, or not?

- Bank Vontobel is arguing that this time it could be the start of a new trend, having fundamentals changed from July-August's rally.
- First of all, we have more evidence now than back in July, that **inflation peaked.** In addition, we have seen, China is trying to normalize and also **global supply chains is normalizing. There is no more bottleneck in supply.** Even Mr. Peccatiello, who is extremely negative on equity markets, after the publication of the US CPI last week, started arguing that **we are going to reach inflation under 2% before year's end 2023.** Taking into consideration that equity markets are anticipating, 2023 should be a good year for equities.
- For US durable goods inflation: **inventories peaked in 2022** and are **down for the first time since 2020.** Therefore companies are selling inventories at a discount and we are in **deflation for durable goods.** Also for cars, especially used cars, October was -10% and it was just the start of the negative trend for longer, which means disinflation.
- Q3 earnings are showing that companies can deal with inflation. Many market participants are expecting further dramatic cuts in earnings, but up to now, results are resilient, because companies either can pass the price increase to clients, or are cutting costs.
- Also Bank Vontobel is arguing, that the Put/call ratio is at historical peak levels, in combination with strongest intraday reversal ever in the S&P 500 Index and the CEO confidence & investor sentiment is still at historical low levels.
- Being at the end of the year, and therefore there absence of catalysts on the corporate front short term. Next catalyst are at the end of January-March 2023. **But all eyes are on the US CPI data in December.**
- **The CIO of Bank Vontobel argues, we have the FED' hawkishness behind us and technically this rally might well have longer legs than what seen this summer.**

It is another bear market rally, or not?

- According to the survey of BofA, **51% of professional investors are still overweighting cash,** while equities is the biggest underweight at net 34% . Risk appetite improved compared to the October survey, with investors reducing their cash holdings while increasing equity and bond exposure. The survey is quite in line with the still very depressed sentiment.
- One big challenge in the market is still the poor liquidity on the US Treasury bond market, as also per article in Financial Times on the 16th November 2022. **Liquidity has deteriorated at the same levels like in March 2020 or back to GFC 2008** and therefore global financial market are still trading at a very fragile balance.

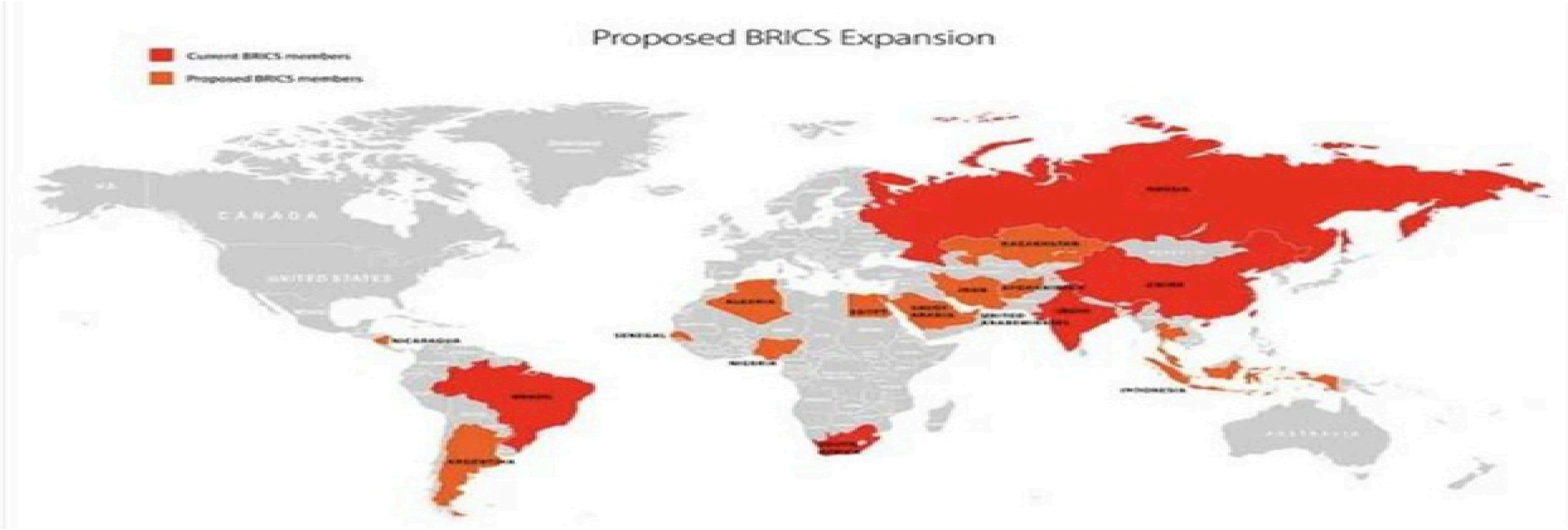
Technical analysis

- On the short term, the 200d moving average is going to be the major resistance for equity markets.
- **As long the S&P 500 Index is not going to break out the level of 4’330 points, from a technical point of view, we are still in a bear market rally.**
- The German Dax index is even more overbought on the short term.

Major resistance: 200d moving average

BRICS

- According to wall street Silver, 12 new countries want to join the BRICs. If all are accepted, **BRIC will have 50% of the world population, but more worrisome is the fact, that the share of commodities such as oil, gas, metals, etc. is even larger.**
- U.S. has its own agenda, but also more natural resources than Europe. Therefore **Europe needs to better plan future geopolitical relationships in order to reach the wished green transition and energy independency.**



Source: Wall Street Silver / Syz group

The ECT pact - 1994 Energy Charter Treaty

- With Germany pulling out of the fossil fuel treaty, the 1994 energy charter treaty, and Europe's largest economy (France, the Netherlands, Spain and Poland) following, energy companies are not in the position anymore to sue governments over energy policy changes that could hurt their investments, as it is happening in Holland, with the German utility company RWE has used the ECT to start a legal action against the Dutch government, alleging that the policy failed to allow adequate time and resources to transition away from coal.
- The German economy Ministry argues, that the decision to withdraw from the ECT was part of the country's commitment to "consistently aligning our trade policy with climate protection" and it is an important signal to the United nations climate change Conference, COP27, underway in Egypt (article on the amp-dw-com).
- In our opinion, such decision to pull out of the ECT is a step forward to force the private global economy to move on the right direction on the green transition.
- **Companies need to increase capex in order to react new CO2 reduction targets and capex means investment into the economy. Such investments should help increasing energy production and therefore on the longer run, have lower energy prices, which is translated into lower inflation.**

General news

- At the end of the day, **Democrats winning in Nevada, means keeping the control of the Senate.**
- Warren Buffett's Berkshire Hathaway took a stake of about USD 5 billion in **Taiwan Semiconductor Manufacturing.** As recently argued by KTS, TSMC had a major correction due to geopolitical tensions, but the stock is trading at a very attractive level.

General news Asia / China

- China is **launching plans to rescue its property sector.** The 16-point plan aims at boosting the real estate market and various measures range from addressing developers' liquidity crisis to loosening down-payment requirements for homebuyers.
- Market participants are rightly arguing that **Chinese real estate companies are actually up 55% during November,** helping the sentiment of the Chinese equity market.
- An additional positive news for the moment from the region, is the announcement of **Mr. Biden after meeting Mr. Xi Jinping, he thinks, China had no imminent plans to invade Taiwan.**
- Finally, during the meeting at the G20, US president **Mr. Biden and China's president Mr. Xi Jinping agreed to renew climate talks,** ending months of silence due to geopolitical tension. According to many journalist, this is a major breakthrough, having the countries stopped talking climate after the visit of Ms. Pelosi in Taiwan. Mr. Biden went further by saying, the 2 countries make an effort to "manage our differences".

The collapse of FTX, crypto arbitrage

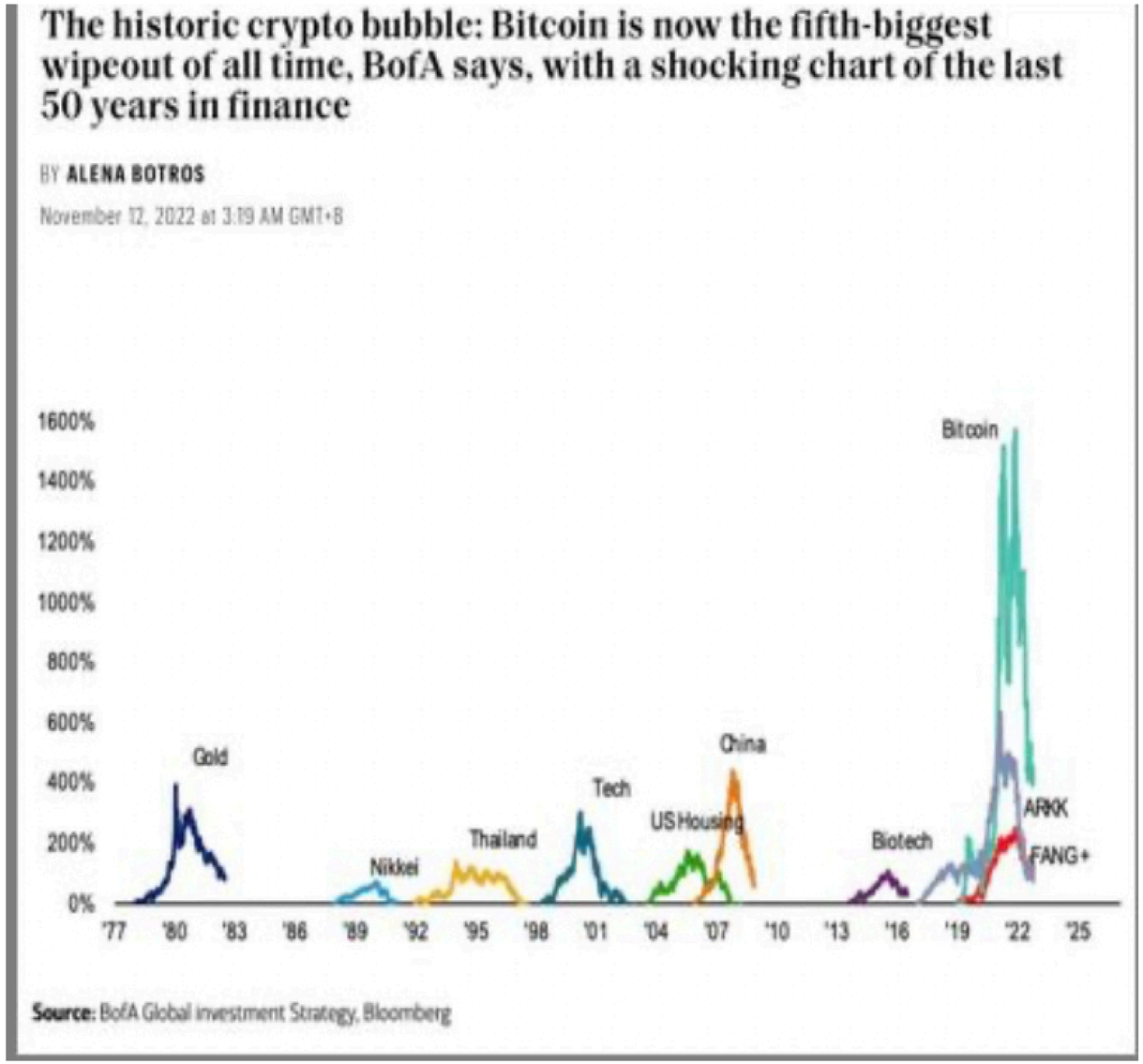
- As explained last week, the bankruptcy of FTX created a real turmoil in the crypto segment, when the sector was still healing the wounds of the Luna/Terra's disaster.
- Asides from the fact that being one of the biggest crypto trading platform, **basically any institutional investor had positions on FTX and it is still a question, how liabilities and client's positions are going to be settled,** the other very worrisome part of the story is the fact, that most of international professional investors were invested into FTX and having Mr. Sam Bankman-Fried abusing of client's wealth in order to mis-conduct its own trading (via the hedge fund Alameda), is the biggest backlash for the sector, especially having Mr. SBF as an ambassador for a better transparency in the crypto environment. It sounds like the exact scheme as Mr. Madoff, at the time chairman of the Nasdaq stock exchange.
- From the Ontario Teachers Pension, to the Singapore Temasek, VC funds like Sequoia, BlackRock, Softbank and of course Tigerglobal were invested into the platform and at the last round with Temasek, Paradigm, Ontario Teachers, NEA and IVP, FTX **was valued USD 32 billion.**
- Being the second largest crypto trading platform by transaction volume, also **Fasanara crypto arbitrage had exposure on the platform.** The sum of long positions and lending is net in favor of Fasanara, but the manager obviously still does not know, how it will be settled. KTS is up +65% since investing into the Fasanara crypto arbitrage and +3% YTD, therefore we can absorb this minor set back. Taking into consideration that counter party risk was known since the beginning of the investment as the major risk of the strategy, we think that, analyzing what happened in the segment during 2022 and 2021, Fasanara managed almost impeccable the "bloodbath" of the sector. For this reason, we stay invested.

The collapse of FTX, crypto arbitrage

- After what happened with FTX, investors will embrace regulations and also the SEC's investigation. The debacle of FTX is the final proof that financial sectors must be strictly regulated, because greed reigns over ethics. Or a better way to explain, the basic problem is: greed and a monetary system that's based on fundamentally flawed and unsustainable principles (Ms. Kiritsi Linkedin).
- Meanwhile the famous American writer, Mr. Michael Lewis, was 6 months with Mr. Sam Bankman-Fried and he is going to write a book. We are all very excited on the publishing.

Bitcoin is now the fifth-biggest wipeout of all time

- We are posting this chart, not for the joy of the losses of other investors, but to emphasize once again, on the way up, it always looks like, the sky is the limit, but at the end of the day, any trend falls back to reality sooner or later.
- KTS could profit from the tremendous crypto trend up to February 2021. We sold too early, but a very important client of us, once told us, **his best trades were, when he had the feeling, he sold too early.**
- As the American writer once said, “history never repeats itself, but it does often rhyme”. This chart is the proof.
- Without mentioning that, Bitcoin and Ethereum are serious technologies and part of blockchain, which is going to change the world. Meanwhile, like in any hypes, a lot of money is being lost, especially from retail clients but not only, in multiple frauds with the ultimate shock FTX, which apparently had to be foreseen, having a lot of alarming signals, but even the most well known international professional investors did not want to be aware of.



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