KTS
CAPITAL
MANAGEMENT

KTS weekly update Nr. 51

The 23rd of December 2022

Job market

- Mr. Larsen and Mr. Peccatiello argues for some time now, that BLS' job statistics are possibly overstated.
- On the **13th of December the Philadelphia FED issued a research, where basically is asserting, that 1'121'500 new jobs are not existing and only 10'500 new jobs were added during Q2 2022.**
- **Philly FED is apparently based on 11 million of companies, vs the approach of BLS with only 600k companies. Therefore it is right to assert, that the Philly FED's statistic is much more accurate that the BLS.**
- In addition, **Q3 should be even worst, with the worse job market ever and the Philly FED is therefore asserting, we are already in recession, meanwhile the FED stubbornly asserts, that the US economy is still slightly growing.**
- The FED is keeping the hawkish monetary policy, mostly to regain credibility, but by doing so and with fundamentals clearly talking another language, the FED is most probably going to totally lose credibility.
- Meanwhile Mr. Bill Gross warns of chaos ahead for US housing and bond markets if the FED keeps pushing up interest rates.
- What an investor should do? We continue to rely on our multiple sources on fundamentals, but we have to include the technical analysis in our investment process, in order to limit the drawdown, in case the FED is in fact "pushing too hard". Unfortunately, after the latest Powell's speech, we are also not confident anymore, if equity market are going to hold the 200d moving average, which has been the most important technical support for the last 11 years.
- We would add a way to say from one of our long standing client: **You cannot fight a thunderstorm!**
- We are surprised, that no one is talking about this tremendous news and even Mr. Larsen/Peccatiello have not given commentaries, especially being the 2 experts arguing of such possible miscalculation.

BLS overstated over 1’1121’500 new jobs

Early Benchmark Revisions of State Payroll Employment

RESEARCH DEPARTMENT

2022 Q2 Vintage

Release Date:
December 13, 2022

Early Benchmarks for All 50 States and the District of Columbia

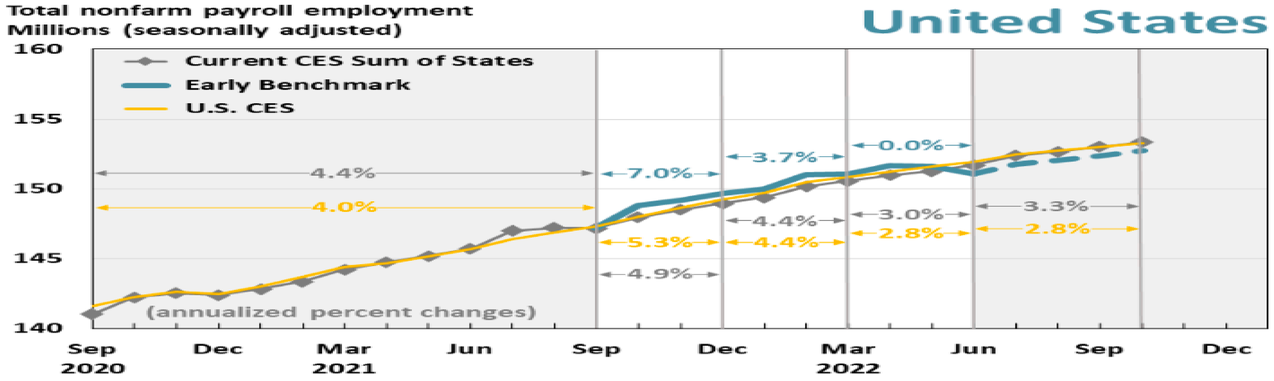
Estimates by the Federal Reserve Bank of Philadelphia indicate that the employment changes from March through June 2022 were significantly different in 33 states and the District of Columbia compared with current state estimates from the Bureau of Labor Statistics’ (BLS) Current Employment Statistics (CES). Early benchmark estimates indicated higher changes in four states, lower changes in 29 states and the District of Columbia, and lesser changes in the remaining 17 states.

Our estimates incorporate more comprehensive, accurate job estimates released by the BLS as part of its Quarterly Census of Employment and Wages (QCEW) program to augment the sample data from the BLS’s CES that are issued monthly on a timely basis. All percentage change calculations are expressed as annualized rates. Read more about our methodology. Learn more about interpreting our early benchmark estimates.

In the aggregate, 10,500 net new jobs were added during the period rather than the 1,121,500 jobs estimated by the sum of the states; the U.S. CES estimated net growth of 1,047,000 jobs for the period.

Payroll jobs in the nation remained essentially flat from March through June 2022 after adjusting for QCEW data:

- Less than the 3.0 percent growth indicated by the sum of the states
- Less than the 2.8 percent growth indicated by the U.S. CES estimates



Over the cumulative three-quarter period ending with this 2022 Q2 vintage — which includes additional QCEW data changes affecting the prior two quarters — payroll jobs in the nation grew 3.5 percent:

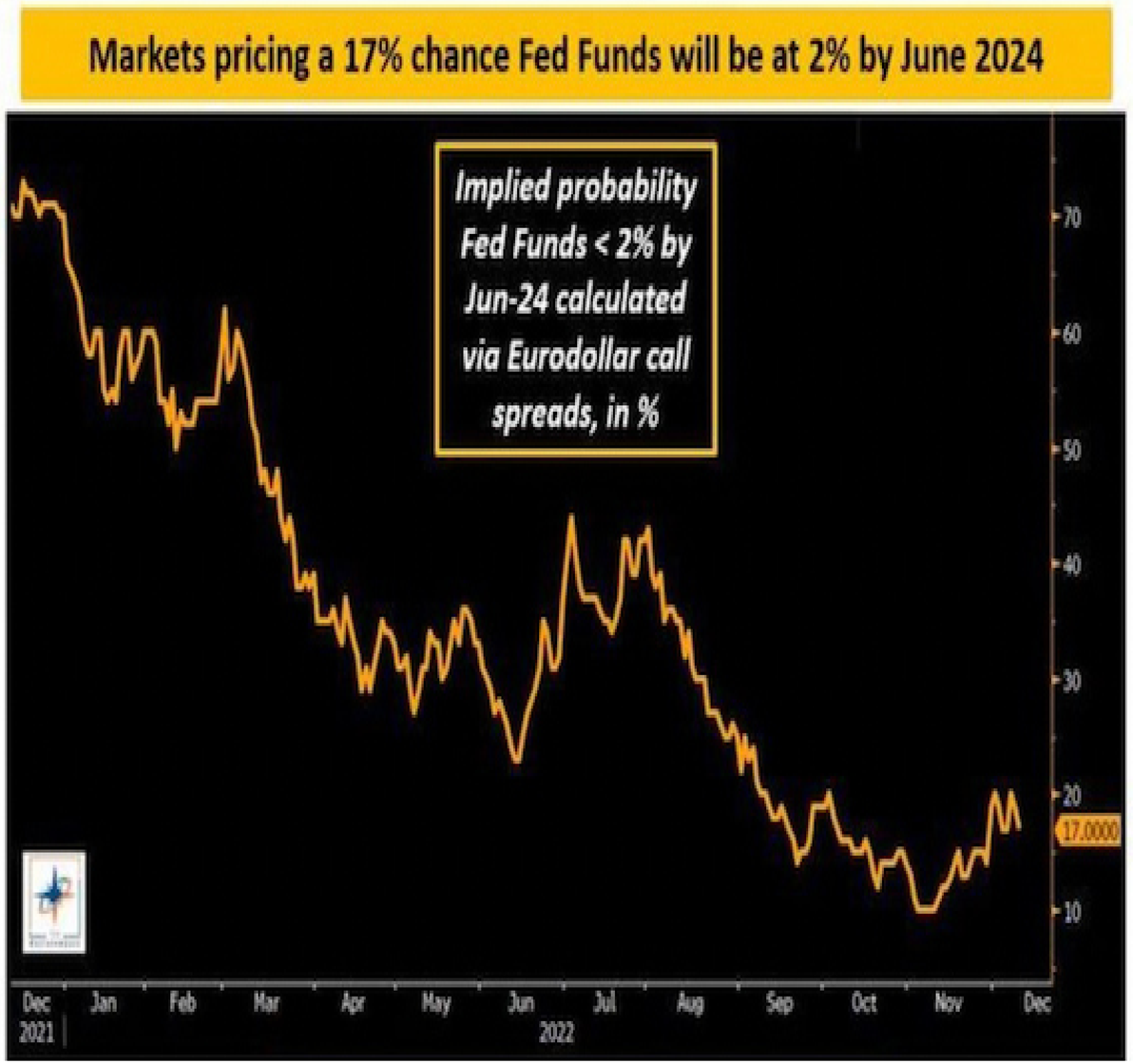
- Less than the 4.1 percent growth based on the sum of the states
- Less than the 4.2 percent growth based on the U.S. CES estimates

Current U.S. CES estimates indicate job growth was 4.0 percent over the 12-month period through September 2021 and 2.8 percent over the four months since June 2022.

Source: Philadelphia FED

What if we would experience a proper recession?

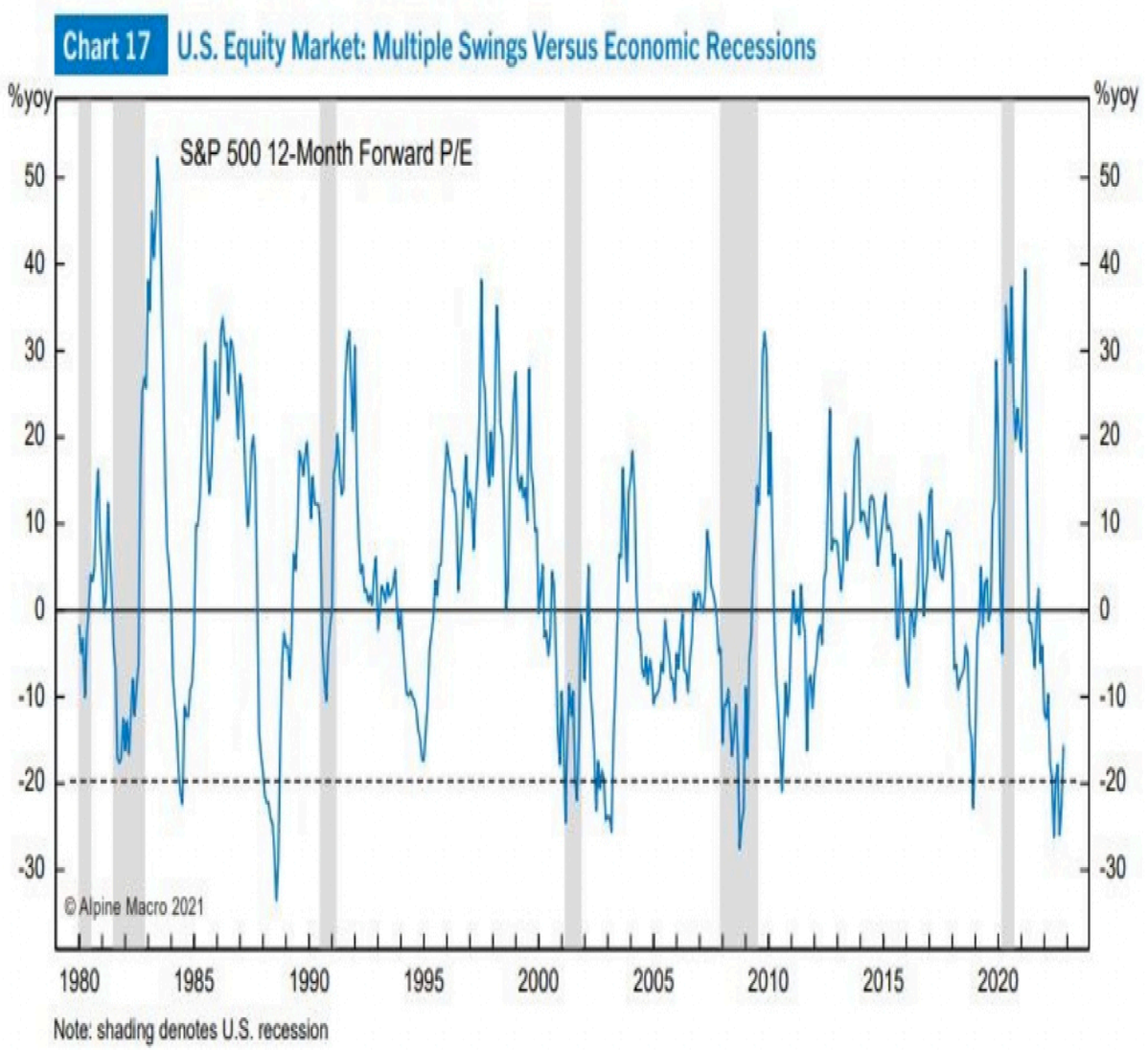
- Mr. Peccatiello argues, that historically the **FED cuts by 300 bps in one year, in case of a proper recession.**
- **Currently, it is still priced by equity markets and bonds as a low probability event.**
- The market implied probability, that the FED cuts from 5% to 2% by June 2024, is currently still below 20%



Source: Mr. Peccatiello

U.S. Stock market discounting a recession?

- In our recent weekly reports we included the charts of Bank Vontobel and Deutsche Bank, showing, that equity markets are bottoming already during a recession and while EPS are still falling.
- We would like to include also the right-hand chart of Alpine macro, which basically shows, that historically, when **stock market fall over 20% and multiples are down 25% , it seems that a recession is priced in.**
- Alpine macro further argues, that **while E (earnings) is falling during a recession, also bond yields are, which is translated into a lower discount rate for DCF valuation model, and therefore the P (price = valuation) should increase.**
- This is quite in line with the arguments of KTS for 2023 and we would like to add, during a recession and falling yields, market participants are starting to discount a future rebound of the economy. For this reason, we are confident, that 2023 is going to be a good year for equities.



Mr. Chen Zhao of Alpine Macro

Macro

- Last week we argued, that the FED and ECB are too hawkish, risking to cause a unnecessary deep recession. We were wondering, if governments are accepting such central bank's behavior or are going to react against it. Promptly, **Italian politicians criticized the ECB's increase in borrowing costs**, pointing to rising tensions between Giorgia Meloni's government and Frankfurt officials.
- December **Philadelphia Index is showing new orders sank further into contraction**, prices moved down, but are still expanding. Delivery times sank, average workweek now firmly in contraction and employment fell to the lowest since June 2020. Everything is actually in line to ease pressure on the FED, but still at level for a soft landing not a hard one, fact which should support equity markets.
- US wage growth is still a **negative real one,** having the inflation higher than the salary increase.
- The US PCE is in line with expectation and unfortunately not lower and for this reason equity markets are still consolidation on a very dangerous level (200d moving average) and do not have many positive triggers for a rebound.
- Also as recently mentioned, in nominal terms, **US retail sales are higher than 2021, but unfortunately in real term are down 1.6%** over the last year and peaked in March 2021.

Macro

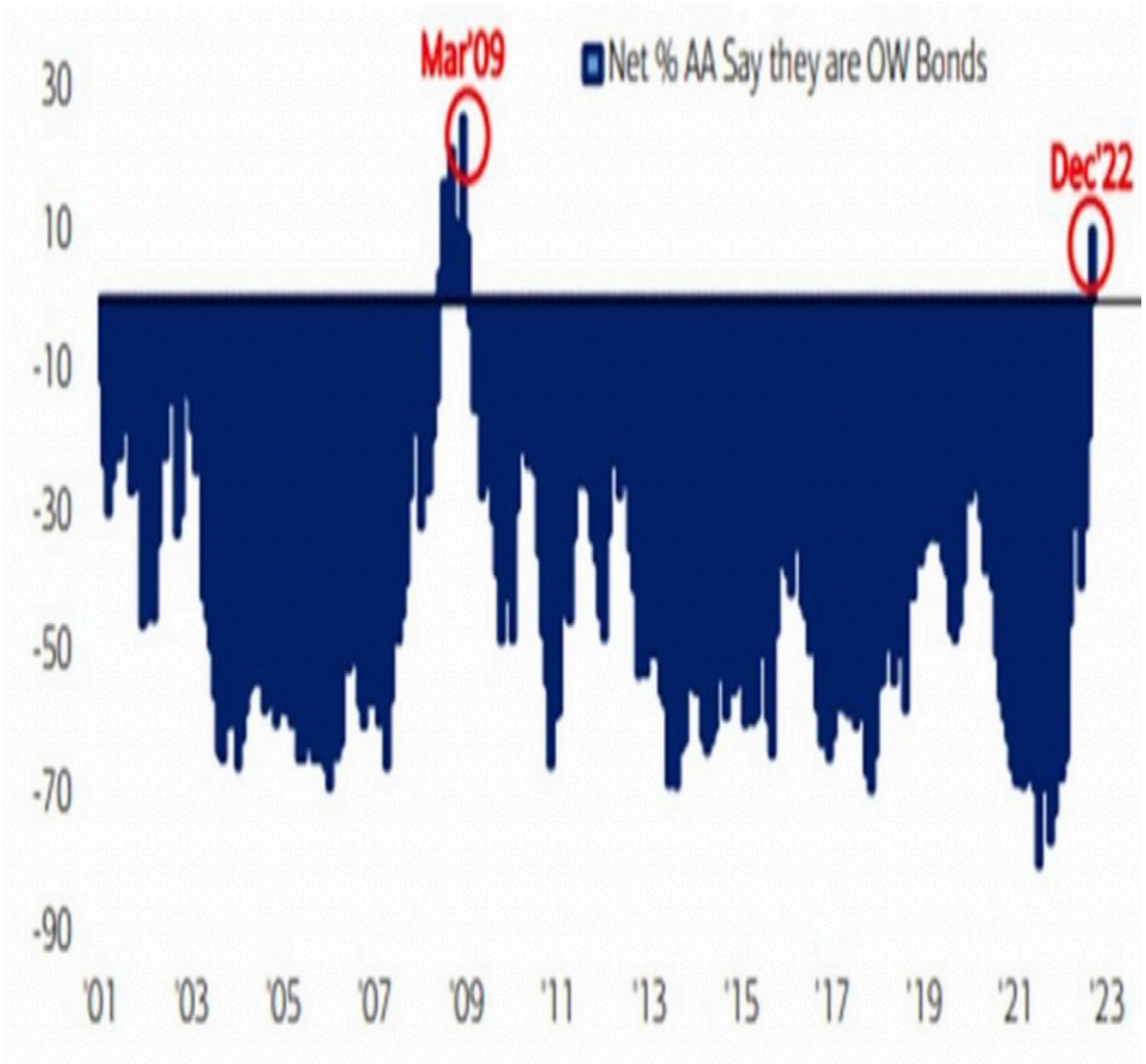
- Meanwhile Mr. Powell says, that his favorite indicator is the **non core service ex housing,** which is correlated to the job market and wage inflation. The FED argues, the labor market is still to strong, but as we have previously analyzed the number of the Philly FED, it is not the case.
- Experts, like Mr. Derek Tang, asserts, that the wage-price spiral is more a fear of the FED, rather than a fact. We tend to agree.
- An additional pressure for equity market was the Bank of Japan, which increased the target of the 10-year yield to +/-0.5% and therefore market participants are speculating, that the BoJ will soon also start to tightening as ECB and the FED. According to Julius Baer, the BoJ is still in coordination with the government, in order to support fiscal stimulus to address higher inflation. Wage negotiations next year remain crucial to decide whether the BoJ will follow other central banks and exit its extraordinarily loose monetary policy stance. KTS believes, the move was done in order to reduce speculation against the JPY. KTS is not invested in Japan and does not intend to do so, even if market participants are arguing, that valuations are very attractive.
- The BoJ's move has also further repercussions on the US Treasury positioning and USD. On the chart of Mr. Ishihara, not included, we could analyze, that the **BoJ is holding only 6% of US Treasuries longer than 2 years, vs 10% in 2020 and 20+% in early 2004**. Who is going to full the missing gap between supply and demand on US T-bill, not having BoJ as a buyer? And not having other countries neither? Only the FED is in the position to do so and therefore it is not possible to apply the QT in 2023.

Macro

- Mr. Mohamed El-Erian is asserting on his blog, that the **main contagion risk for the BoJ's move would be forced sale of credit and other foreign assets by Japanese institutions. For the moment, the move in JGB yields is not large enough as of now to force such sales** and most probably the BoJ is not going to increase interest rates that high to cause such forced sales.
- As we know, the reduction of M2 money supply from the global economy by central banks, caused the highest wealth destruction in the history during 2022. Amazon is the first mega-caps, to see its market cap falling over USD 1 trillion and the **combined drawdowns of all the mega-caps (Apple, Amazon, Google, Microsoft, Meta and Tesla) is over USD 5 trillion.**

Fond manager survey are net overweight bonds for the first time since Apr 09

- We include the chart of BofA, where we can analyze, that **fund managers are again overweight bonds for the first time since April 2009.**
- From a contrarian point of view, it would be a bearish signal, but KTS also believes, yields are again attractive enough, to be invested in the asset class. In addition to the fact, that we are convinced, that yields are going to fall in line with the falling inflation.
- In another chart of BofA (not included) we are also noticing, that investors expect also Stocks, corporate bonds and commodities to be the best performing asset in 2023.



Source: BofA via Syz group

Technical analysis on the Nasdaq 100 Index

- As previously argued, fundamentals would be actually positive for equity markets, having inflation peaked, falling open jobs and a slowdown of the global economy. But unfortunately, **central banks hawkishness is still a significant burden for markets.**
- Only the technical analysis can help us, to recognize the direction of financial markets. Equity market are still consolidating over the lows of the 12th October, which is our stop loss level. Meanwhile the put/call ratio reached again levels never seen before.

The lows of the 12th October is the major support for the Nasdaq 100 Index. Only with a clear breakout of the downtrend channel, we are out of the bear market

Technical analysis on the Nasdaq 100 Index

- If equity markets are not able to rebound from this consolidation base and would break down the lows of October 2022, we will definitely increase liquidity and most probably we will need to go short in order to hedge a part of the long portfolio into mega trends, our core asset allocation, which we are not going to reduce.
- The October's lows coincide with the 200d moving average and next support would only be at 8k points: -20% lower.

50% Fibonacci from 2008 bull market would be at 8'738 points, the uptrend line at around 8k points.

Equity: double-digit losses typically lead to gains

- Mr. Monchau shows 2 interesting charts in his latest research: a possible silver lining after US equity double-digit decline in 2022 is the fact, that historically (since 1936), of **9 prior years with double-digit losses, 7 following year experienced double-digit gains.**
- Since 1928, **only in 4 occasions over 18, the S&P500 Index was followed again by a negative year** (source: both charts Ritholtz Wealth Management via Syz group).

Exhibit 4: Double-Digit Losses Were Typically Followed by Gains

Year	S&P 500 Annual Return	Subsequent Year Return
1937	-34.7%	30.8%
1941	-11.6%	20.1%
1957	-10.7%	43.1%
1966	-10.0%	23.9%
1973	-14.7%	-26.3%
1974	-26.3%	37.1%
2001	-11.9%	-22.1%
2002	-22.1%	28.7%
2008	-37.0%	26.5%
2022 YTD	-15.0%	?
Average		**18.0%**

Over 9 years with double-digit losses, 7 following years were positive

S&P 500 Annual Returns: 1928-2022

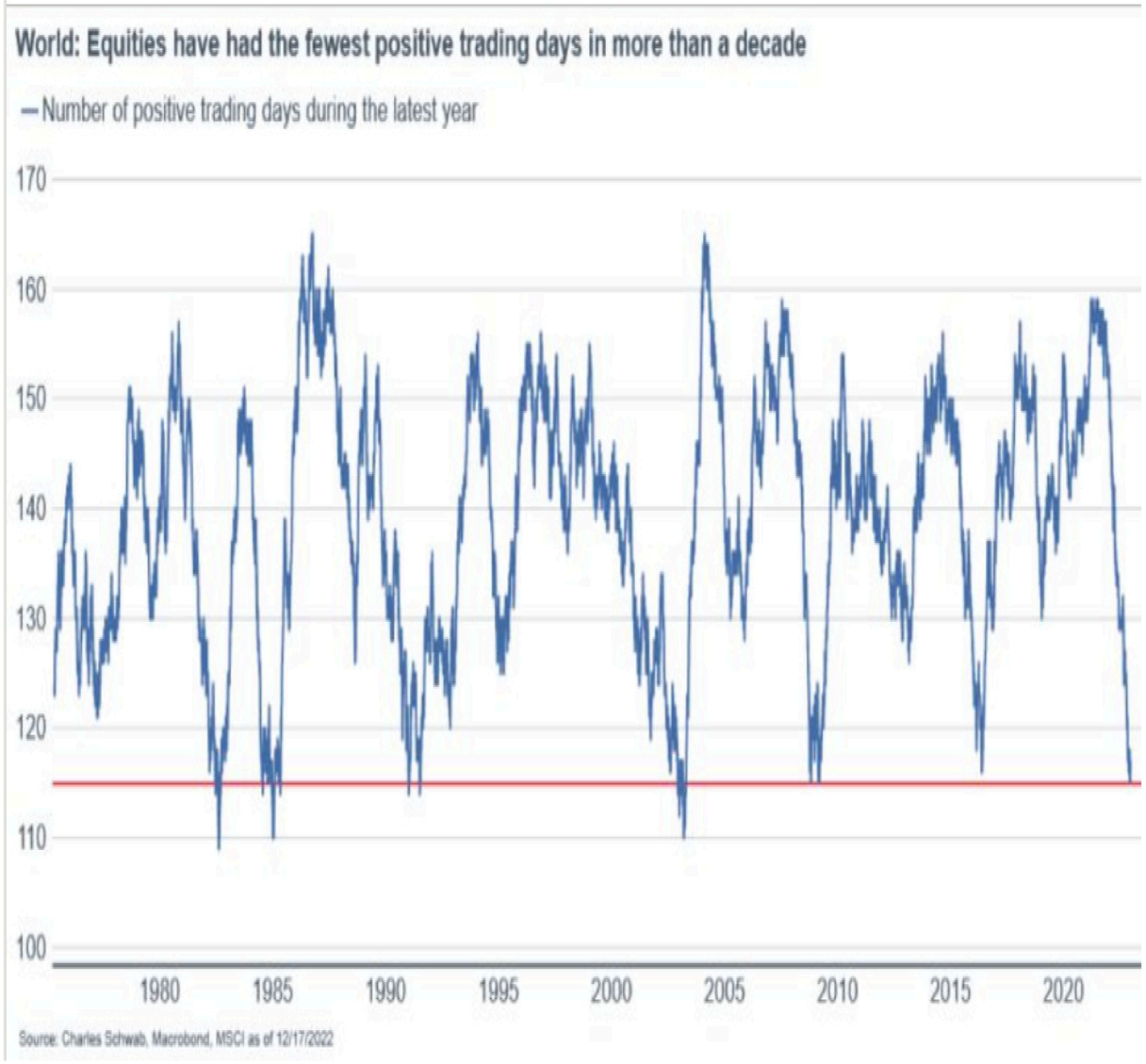
1928	43.81%	1952	18.15%	1976	23.83%	2000	-9.03%
1929	-8.30%	1953	-1.21%	1977	-6.98%	2001	-11.85%
1930	-25.12%	1954	52.56%	1978	6.51%	2002	-21.97%
1931	-43.84%	1955	32.60%	1979	18.52%	2003	28.36%
1932	-8.64%	1956	7.44%	1980	31.74%	2004	10.74%
1933	49.98%	1957	-10.46%	1981	-4.70%	2005	4.83%
1934	-1.19%	1958	43.72%	1982	20.42%	2006	15.61%
1935	46.74%	1959	12.06%	1983	22.34%	2007	5.48%
1936	31.94%	1960	0.34%	1984	6.15%	2008	-36.55%
1937	-35.34%	1961	26.64%	1985	31.24%	2009	25.94%
1938	29.28%	1962	-8.81%	1986	18.49%	2010	14.82%
1939	-1.10%	1963	22.61%	1987	5.81%	2011	2.10%
1940	-10.67%	1964	16.42%	1988	16.54%	2012	15.89%
1941	-12.77%	1965	12.40%	1989	31.48%	2013	32.15%
1942	19.17%	1966	-9.97%	1990	-3.06%	2014	13.52%
1943	25.06%	1967	23.80%	1991	30.23%	2015	1.38%
1944	19.03%	1968	10.81%	1992	7.49%	2016	11.77%
1945	35.82%	1969	-8.24%	1993	9.97%	2017	21.61%
1946	-8.43%	1970	3.56%	1994	1.33%	2018	-4.23%
1947	5.20%	1971	14.22%	1995	37.20%	2019	31.22%
1948	5.70%	1972	18.76%	1996	22.68%	2020	18.01%
1949	18.30%	1973	-14.31%	1997	33.10%	2021	28.47%
1950	30.81%	1974	-25.90%	1998	28.34%	2022	-13.80%
1951	23.68%	1975	37.00%	1999	20.89%		

Source: NYU
2022 Returns as of 12/13/2022

Only 4 over 18 were followed by an additional negative year

The good news is that it has rarely been worse than 2022

- We like the chart of Mr. Kleintop, where we can notice, **that the year 2022 was one of the worst year with positive trading days and the worse in more than a decade.**
- As contrarian indicator, it should be a bullish sign.

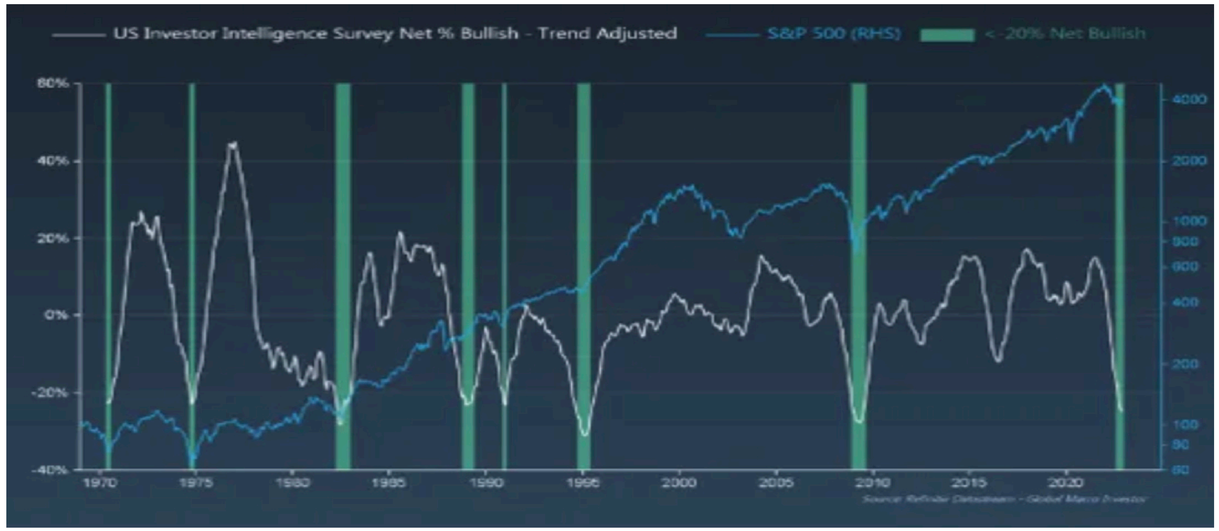


Source: Jeffrey Kleintop

The peak of inflation is historically the start of an equity's rebound

- KTS can not check the calculation of the average trajectory following major peaks in CPI across 12 historical episodes from 1950 done by GMI, but according to them, **the peak of inflation is normally the start of the rebound of equity** (left-hand chart).
- In addition, GMI also brings an interesting chart, showing that the **newsletter writer bullishness has dropped to a point where some of the major market bottoms have been found historically** (right-hand chart).

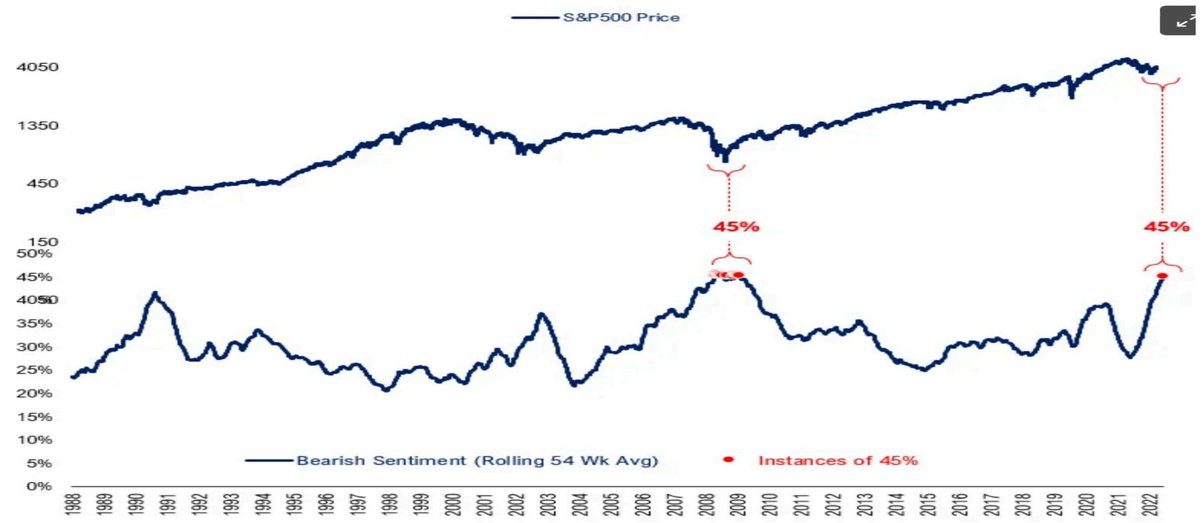
Source: GMI



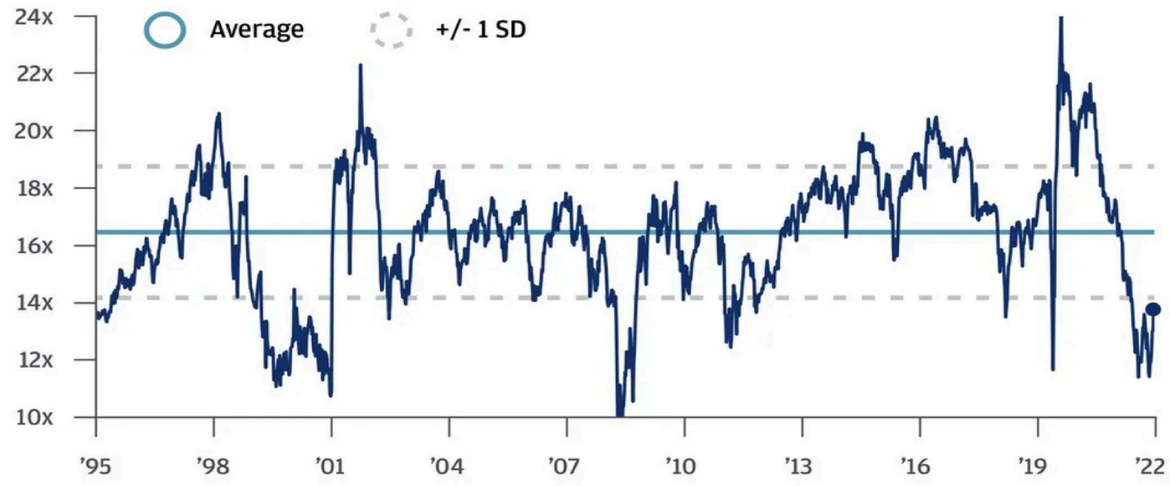
Source: GMI via chartstorm

Extreme bearish sentiment combined with lowest mid caps valuations

- The source @mattcerminaro brings a similar chart, based on individual investor bearishness (different survey AAII): **the bearish sentiment (rolling 54 week average) is at 45%, last time we had the same reading was March 2009 (start of the bull market).**
- Meanwhile the source chartstorm is showing an interesting chart, whereby **mid-cap equity valuations (S&P 400 P/E ratio) is trading at near lowest levels ever.**
- In addition, we are still reading charts arguing, that despite all the bearishness, there is still not an outflow in equity and no sign of capitulation. Also the US household equity allocation in equity remain at near record-highs (50%).
- We would like to re-connect to our chart of last week, where we stubbornly believe, **US retails have not sold positions due to higher tax gain from January 2022,** but on the same time, they were **hedging via put options (highest volume ever).**



Extrem bearishness (source: mattcerminaro)

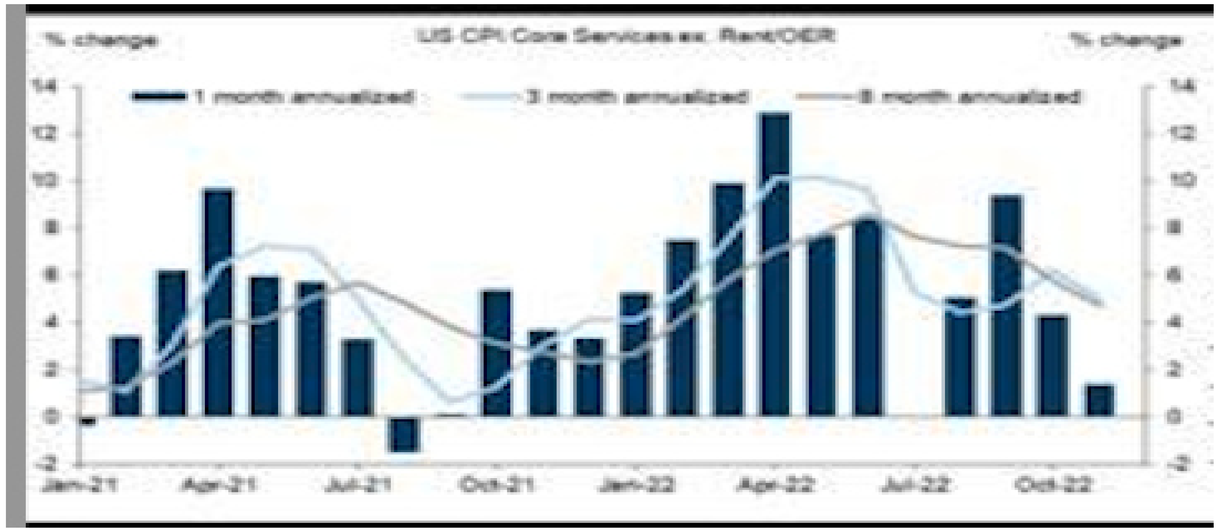


Mid cap equity valuations trading near trough levels (chartstorm)

The CPI is collapsing

- We want to included 3 charts, where we can analyze, that the **CPI inflation with private new rent indices was deflationary in October 2022 and US CPI core services prices collapsed at the end of October.**
- In addition **medical care services prices are in deflationary territory in October 2022.**

Source: Jason Furman



Source: GS

Source GIS

General news

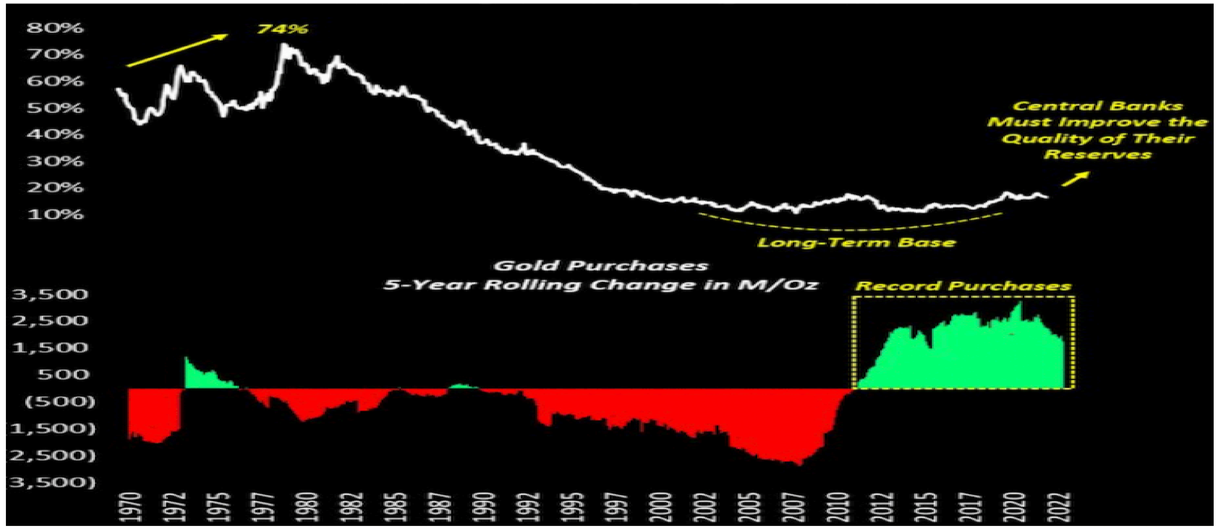
- Apparently on the 16th December 2022, the **White House says it will start refilling strategic petroleum reserve** and the oil price had an intra-day spike. As recently argued, we believe, there are multiple triggers, which should support the oil price and for this reason, we stay invested in the sector, which is trading at the most attractive valuation in the equity asset class, as also materials and gold/silver miners.
- The **SEC is changing regulations on insider selling.** In fact, company directors will need newly to wait at least 90 days between then they schedule a trade and sell their shares. Companies also will have to report on their executives' use of trading plans in quarterly reports.
- **We will see more detail on the slide 19, but the demand for both gold and silver has been exceeding mines and scrap supply for at least 2 years.**
- We are reading in KingWorldNews, that having Putin & top ministers visiting Belarus, meanwhile Mr. Medvedev visiting Xi on Putin's "personal message" in addition to Mr. Zelensky visiting DC and Mr. Putin attending Defence Ministry's board meeting, something major is coming. Of course such blog, which is for gold bulls, is expecting an escalation. KTS has no opinion, but will further search for more explanations. Unfortunately we can not base our investment strategy on guessing, but we are open for inputs, in order to consolidate our geopolitical "puzzle". The Swiss press is also mentioning today, that the Russian Navy and submarines substantially increased activities an are moving direction Ukraine and therefore suspects, something major could happen in the near term.

General news Asia / China

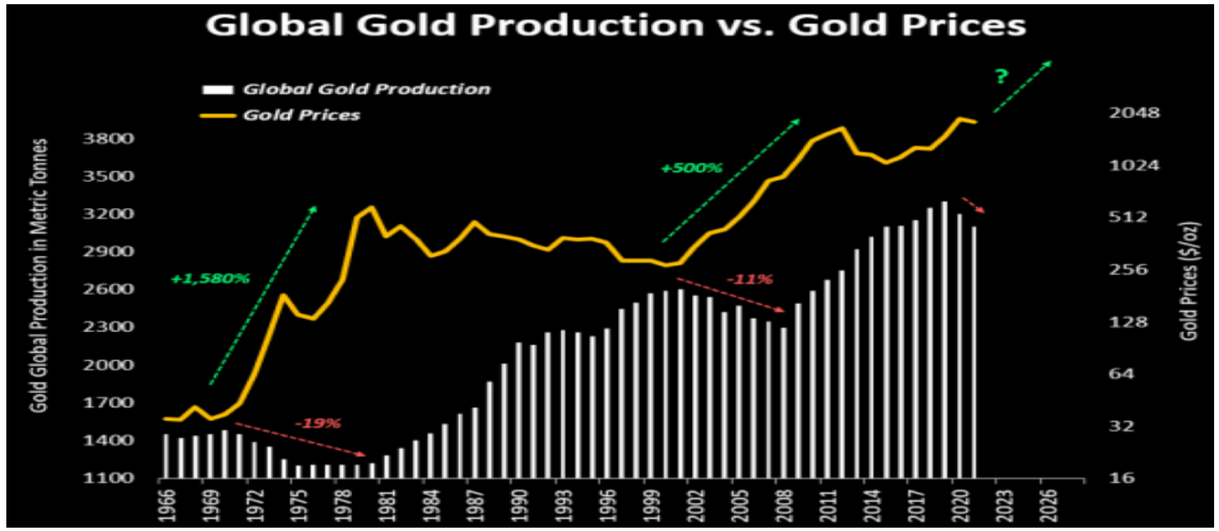
- The newspaper Financial Times had the headline: wealthy nations offer **Vietnam USD 15 billion-plus deal to shift from coal to alternative energy.** This is clearly supporting our investment in the country.
- Similar packages has being done also for Indonesia and South Africa. Apparently it will be more the issue of ESG/green bonds backed by guarantees from IMF, subscribed by big institutional funds.
- Chinese's retail sales fell more than expected, while the industrial production disappointed. But China's top leaders said they will **focus on boosting the economy next year**, hinting at business-friendly policies, further support for the property market while likely scaling back fiscal stimulus. The Chinese government want to revive consumption and support the private sector and the target GDP growth is 5% or higher.

Global central banks accumulation of gold reserves, but production is falling

- KTS has already posted several charts showing, that **central banks are strongly accumulating gold,** in a time where **global gold production is falling** due to overwhelming pressure to adopt the green revolution and therefore declining interest from miners in deploying capital to gold-focused projects and preferring to repay cash flows into dividends or shs buyback programs.
- On the left-hand chart, courtesy Mr. Costa, we can also notice, that **gold holdings as % of foreign reserves** in the **70' gold was representing 74% of total foreign reserves, constantly falling to 10% .**
- We are now experiencing a rebound and Mr. Costa is rightly asserting, that gold is in the early stages of becoming the preferred asset among central banks looking to improve the quality of their international reserves.
- Needless to add, that is very **bullish for precious metals and it could be a new secular mega trend,** in a time where the gold industry is at inflection point, with falling production.



Source: Mr. Costa of Crescat Capital



Source: USGS via Crescat Capital

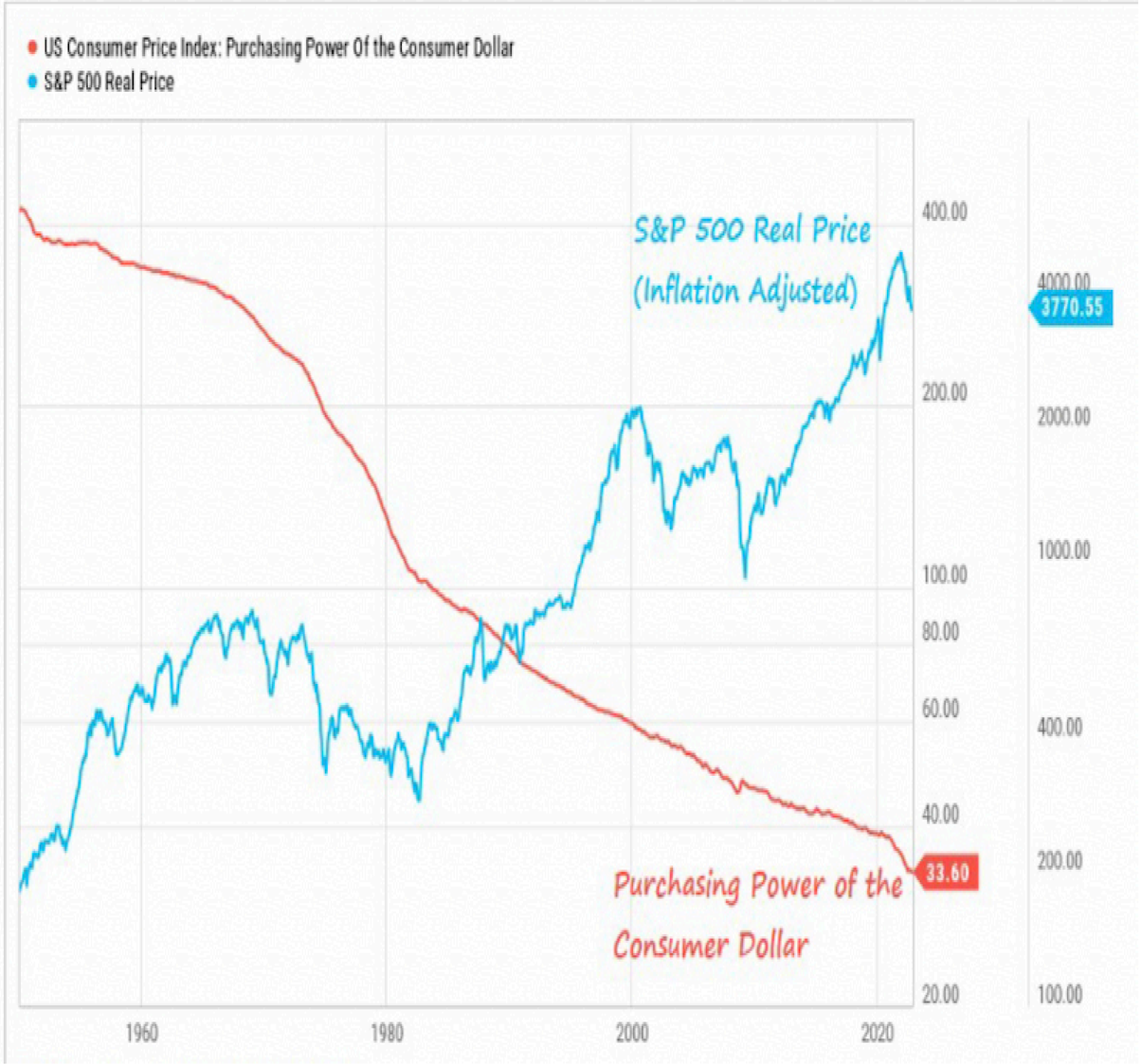
Solar power

- According to a report of the IEA, **solar power is expected to surpass coal in 5 years.**
- IEA adds, renewable energy should become the largest source of electricity generation a soon as 2025, bringing the total capacity to 2’950GW by 2027.
- It will be needed an additional 800GW to reach net zero greenhouse gas emissions by 2050.
- We do not know the reliability of the targets and if it is realistic to reach them in such short timetable. Nevertheless, **it is a great support for our investment into the green transition.**

Source: Financial times

Purchasing power

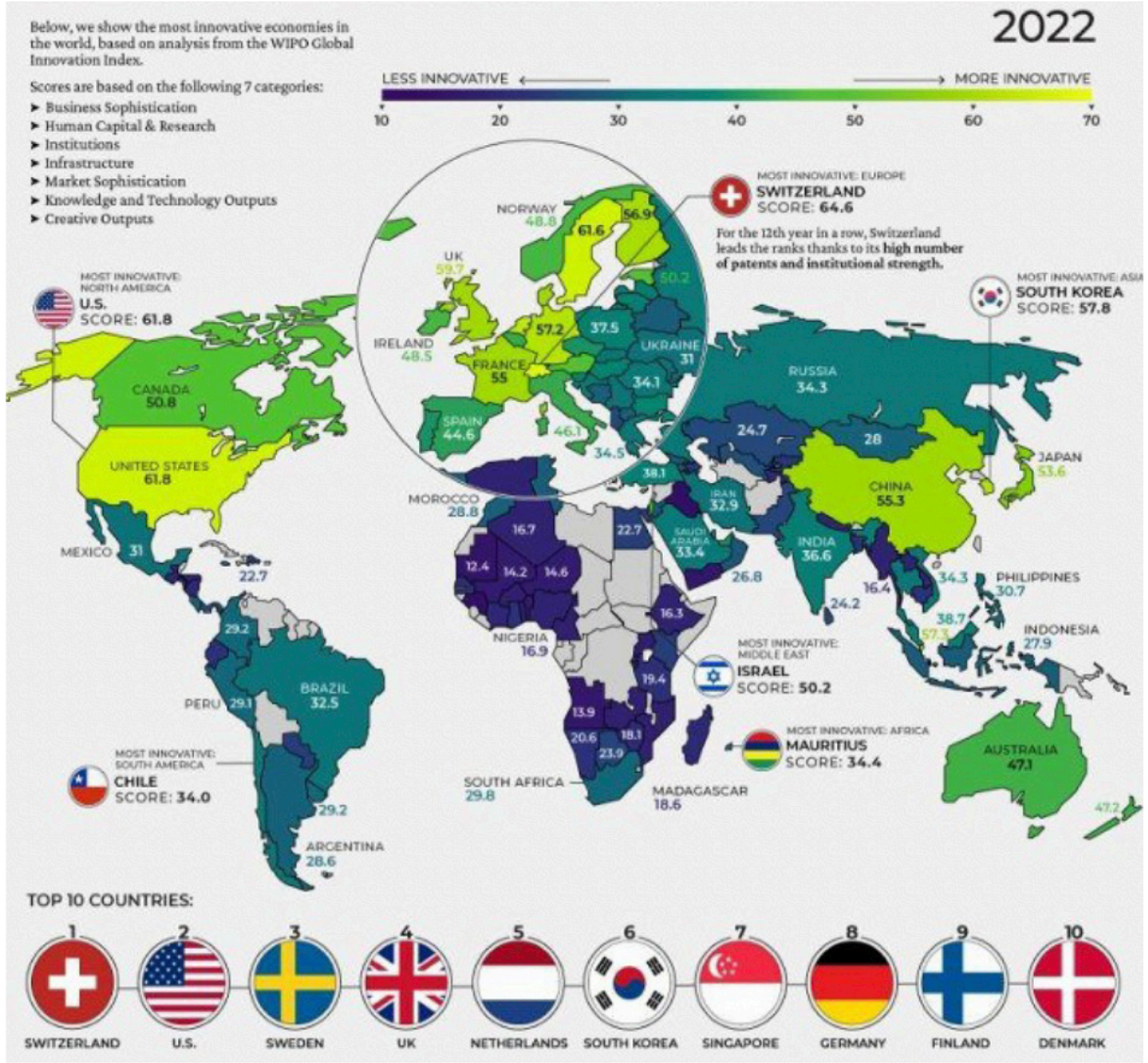
- A picture is worth a thousand words.
- The right-hand chart represents, what KTS is trying to argue over years now, namely, at the end of the day, with financial repression from high indebted countries, the currency's devaluation of states with weak balance sheets, combined with high inflation and economic growth, and finally pension funds, which are not reaching a real yields; the **purchasing power of the middle and lower class is going to dramatically fall over the next decades.**
- With an horizon of over 20 years, the normal citizen he will not be able to afford the same life's standard as today.



Source: CharlieBilello and Charts via Syz group

Global Innovation Index 2022

- We are proudly including the global innovation index for the year 2022, where we can notice, that Switzerland is again the top innovative country worldwide.



Source: The Visual Capitalist via Syz group

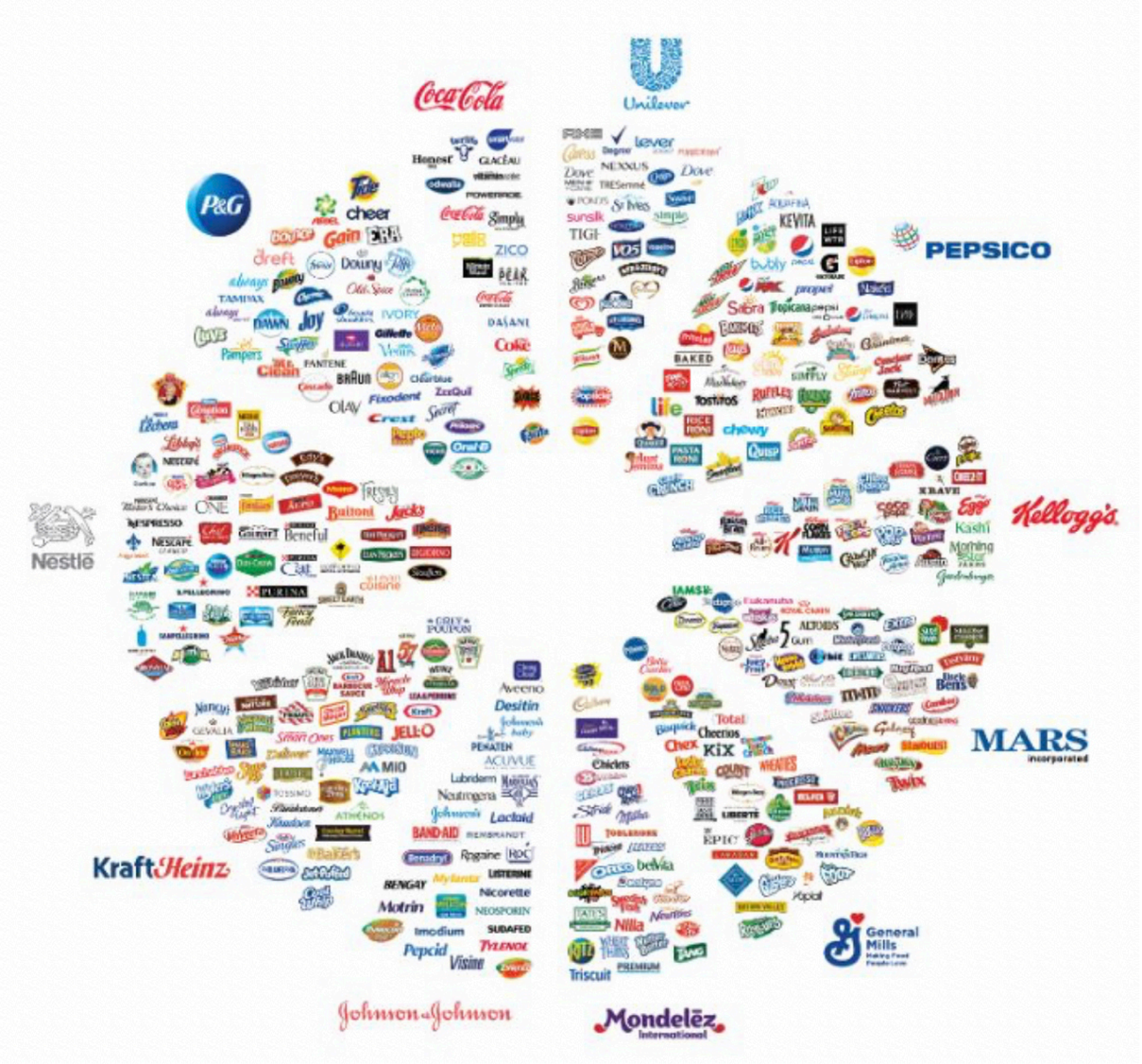
A hierarchy of thinking styles

- Not much to add.

Source: Think again, Adam Grant via Syz group

11 mega-conglomerates and the brands that they own

- We would like to include the following chart, courtesy Ms. Noel of Syz group, which is giving a perfect idea, of the major consumer discretionary's monopoly.
- Those are market leaders with purchasing power. At the moment every professional investor is advising to buy them as defensive stocks for "raining days" , because such companeis have the possibility to increase prices in an inflationary environment and therefore keep a constant profitability.
- But valuations are of course not cheap and as soon equity markets are going to rebound, investors are going to sell, for more attractive investment opportunities.
- Nevertheless, KTS is exposed to the segment, being invested in our best-in-class funds based on the volatility booster, whose portfolio is basically long S&P 500 Futures.



Source: capitaloneshopping via Syz group

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