KTS
CAPITAL
MANAGEMENT

KTS weekly report nr. 4

The 27th of January 2023

The FED start recognising, the real dilemma in the labor market

- We are reading with pleasure that, last Thursday, the FED vice chair, Mr. Lael Brainard, admitted that higher interest rates will not help restoring the missing labor supply, and added that the 1970's - style wage/price spiral was unlikely, given the differences in the factors that pushed up wages at that time compared to now.
- Mr. Ron Insana, in an interview with CNBC, says that the solution for the **tight labor market is more workers**, and actually KTS was arguing the same since some time now. Besides the fact that the US are destined to a falling population if immigration is not increasing, **labor markets are not tight because of an overheating economy,** yet, instead, because of a shortage of labor force and, as said, only recently the Federal Reserve has official grudgingly acknowledged it. KTS would add "better later than never" and better now, because if the FED would increase rates too much, the repercussion would have been a deep recession for the wrong cause.
- Also FED's Chairman, Jerome Powell, recently noted that about **half-million people who tragically died of Covid** were among the working age population, adding that there are roughly **3.5 million Americans missing from the labor force.**
- As we know, **2 million left the work force for early retirement, and another 1 million came from a decline in immigration** and that previously mentioned surge in Covid-related deaths.
- An additional data, which KTS guessed but was never confirmed, is that **2 to 4 mln Americans are dealing with so-called long-Covid**, which may be keeping them from being up to the task of gaining full-time employment.
- Finally **2 mln women,** who left the workplace to oversee pandemic-related distance learning that was required of their children, may not have fully returned to work, owing to the high cost of childcare.

The FED start recognising, the real dilemma in the labor market

- Mr. Ron Insana on the interview with CNBC added that, looking forward, with the absence of any immediate return of those workers, labor markets are bound to remain tight and **higher interest rates from the FED will do nothing to restore the missing supply of labor.** KTS is greatly pleased to read such sentence.
- We would like to add the conclusion of the article, where Mr. Insana says that destroying the village to save it, a vestigial war strategy, is effectively the way these economists are calling for. By raising the unemployment rate, currently employed workers will lose their jobs at decent wages, only to come back, after a recession, to the same jobs at lower wages. Mr. Insana ends like this: **"That is about as misguided a policy prescription I have ever heard of in 39 years of covering economics".** KTS is so pleased to read such hard, direct, but right comments.
- Goldman Sachs says that **immigration is slowly rebounding**, but is not growing quickly enough to restore equilibrium in the US labor market.
- In addition, the **US birth rate has fallen to 1.6 children born per family.** The necessary population replacement rate requires that every new family formed needs to produce **just over 2 children to simply maintain the population**, and that, simply put, is just not happening. This is happening not only in the USA, but also in Europe and other wealthy countries. As we know, in Germany and Italy, we have birth rate of 1.53 respectively 1.24 and the ratio of pets is higher than the children per family.
- The journalist of CNBC asserts that **higher immigration would means: labor force growth + productivity growth = economic growth**. This should not be a political issue, even though, more than social security and medicare funding, immigration has now become the third rail of American political agenda.
- **The Fed can't print people, nor can solve this problem.**

FED

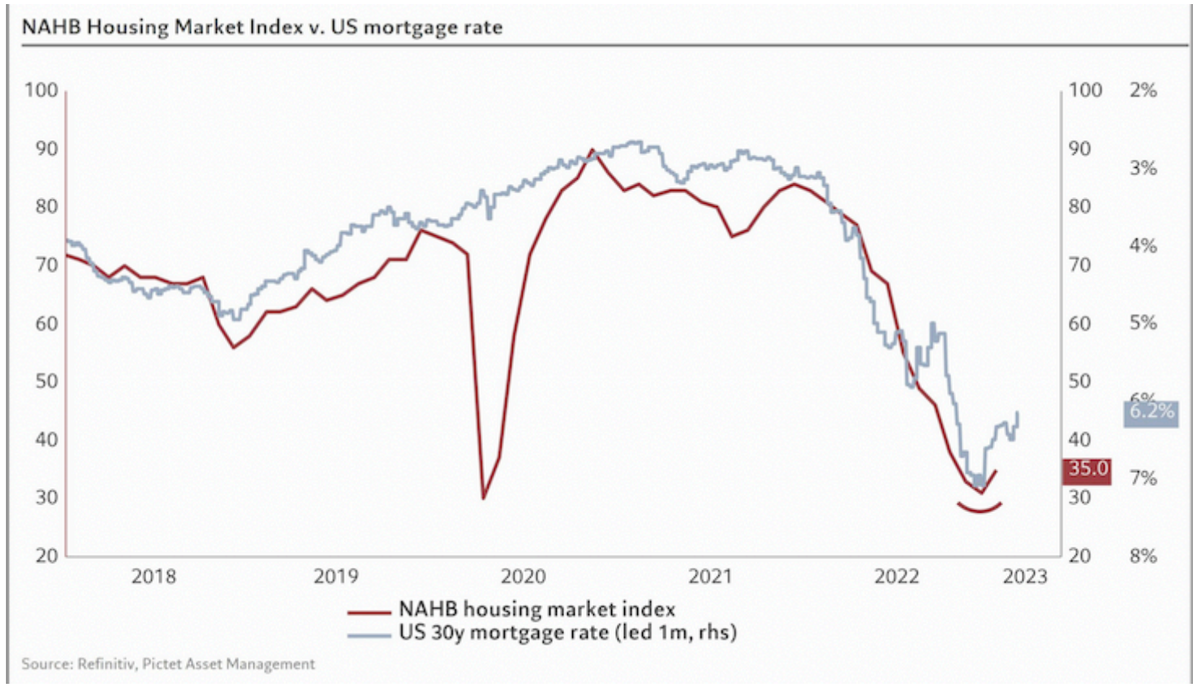
- Market participants are arguing that, sooner than later, the **FED will revise the range of acceptable inflation from 2% to most probably 3% or even 4%**. But it is clear to anyone, that before the FED is going to take such step, they want to see the inflation under 2%, which according to our reliable analysis, should happen in less than 6 months.

Labor market

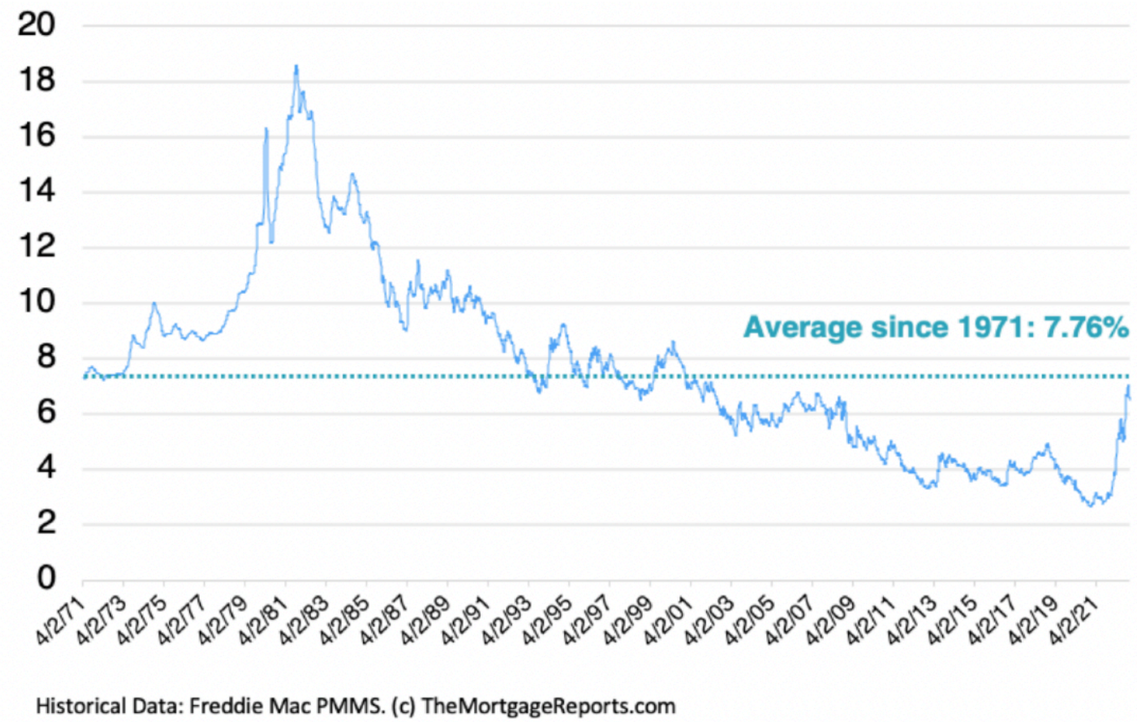
- Meanwhile also Google announced a cut of 12k jobs, and also their global workforce by 6%. After Microsoft, Meta, Amazon, Twitter and Tesla, now we have also Alphabet Inc. Microsoft is cutting workforce, but is also investing USD 10 bn into OpenAI, which would mean, creation of new jobs. Therefore, a workforce of specialists, which are anyway an issue in the U.S. (50% of open jobs are specialists and high end), should always find a job in USA.
- Analysing a statistic, courtesy Mr. Larsen (chart not included), during December 2022 in the technology sector the job market experienced a lay-off of 14’382 people, followed by the Financial with 6’116, Insurance 1’961, Pharmaceutical 1’200, etc. Meanwhile health care added 9’411, Energy 7’000, Automotive 5’557, industrial goods 4’000, construction 3’500, transportation 2’851 and government 2’400.

Possible stabilisation of US housing market

- While the majority of the investment community is still focused on the price's drop of real estate and high mortgage's rates, we have first signs of a possible stabilisation.
- On the left-hand chart we can notice how the NAHB housing market index is trying to rebound. It is not a coincidence: this rebound is due to the **biggest collapse in mortgage rates, which fell by 1%** in 3 months.
- This is one of the best economic news for the start of the year, because most investors are still expecting a major collapse of the real estate market, with the risk of a major "armageddon" on the whole financial system, as in GFC 2008. For this reason, many professional investors are still conservatively invested.
- As we can notice in the right-hand chart, the historical average of the 30y US mortgage rate is 7.76% and, as recently explained, most of US citizens renewed their mortgage at 2.5 to 3% in February 2021.



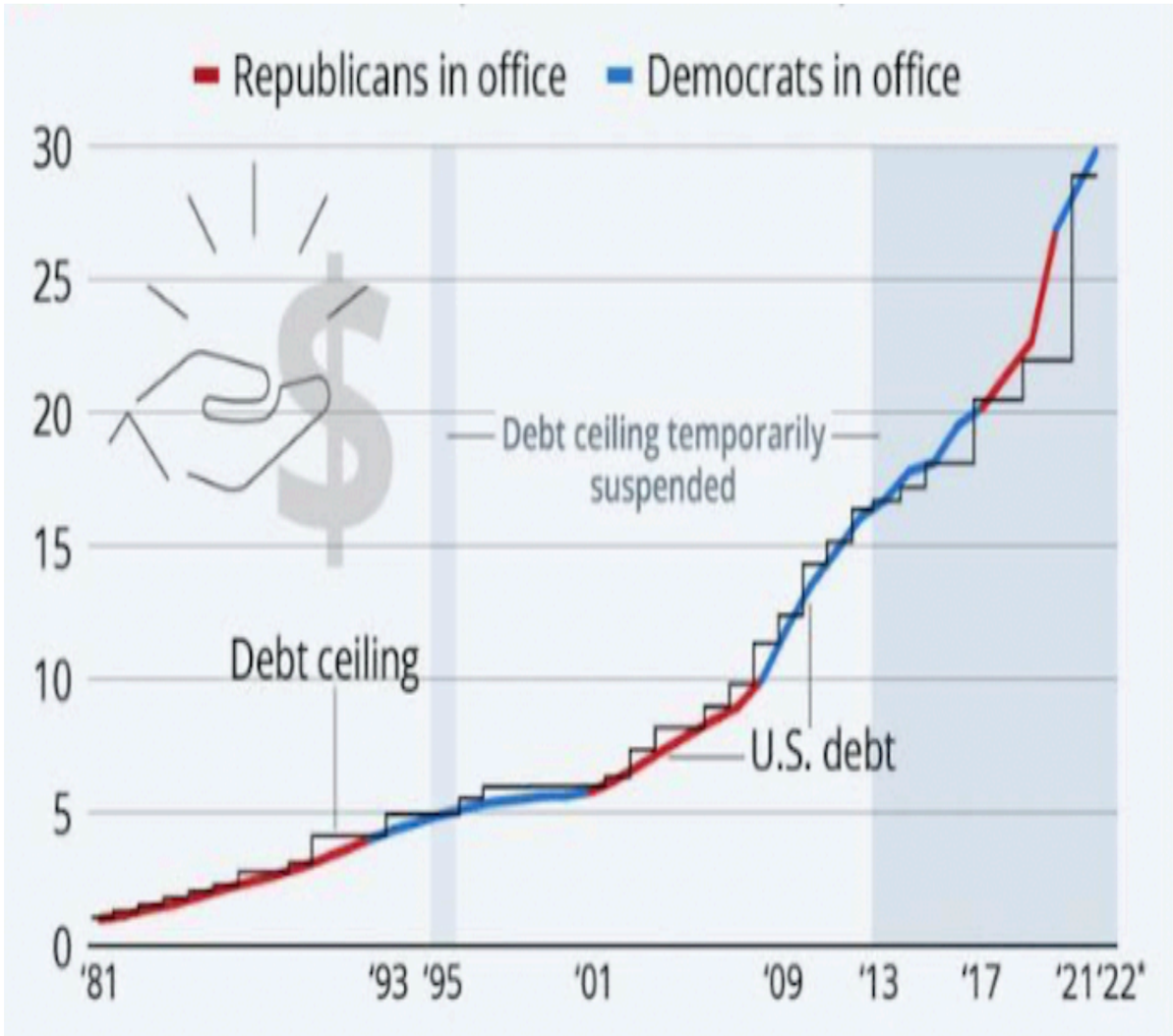
Stabilisation in the US housing market? (Source Pictet)



Historical 30-year mortgage rates from 1971-2022: 7.76% (Source Freddie)

U.S. debt rises irrespective of who is in the White House

- Having the Republicans pressuring Democrats for the increase of the Debt ceiling, the right-hand chart shows, how **it does not matter who is in office; in US the gross federal debt always increases.** For this reason, as any year, both parties will find at the end a solution and increase debt.
- Lombar Odier explains that US's debt ceiling is a political "fight" that will be resolved before any damage to the country financial credibility, but we do not have to forget **2011, where the same issue triggered America's only credit rating cut (from AAA to AA+).**
- As we can notice in the right-hand chart, the US debt ceiling has more than doubled in the last decade and last raise by USD 2.5 trillion to USD 31.4 trillion was on the 16th December 2021.
- As said in our last weekly report, the **extraordinary measures of the Treasury will be exhausted before early June 2023.**
- Meanwhile the pressure on the USD should persist.



Source: statista

Money supply at new highs: bullish for risky assets up to March 2023

- As Mr. Larsen was arguing in December 2022, money supply was increasing and it will continue through January 2023, due to China's re-opening and US debt ceiling extraordinary measures.
- On the chart of the money supply indicator, we can notice that, in fact, money supply substantially increased in the last few months, which is positive for risky assets.
- How long it will hold? According to Mr. Larsen, who was the first economist in our network pointing out such effect, it could last to February/March 2023?
- But he now argues, according to commentaries of Mr. Christopher Waller from the FOMC, that with the balance sheet policy of the FED, the QT process needs to slow or halt, if the amount of **USD reserves is equal to 10-11% of US GDP**, which is around USD 2.5 trillion. We are currently > USD 3 trillion, so for USD 600bn less, **QT would end in 34-40 weeks**. Basically Mr. Larsen sees the **S&P 500 Index start correcting from April 2023 to 3'250 somewhere in January 2024.**

Money supply at new highs due to China's re-opening

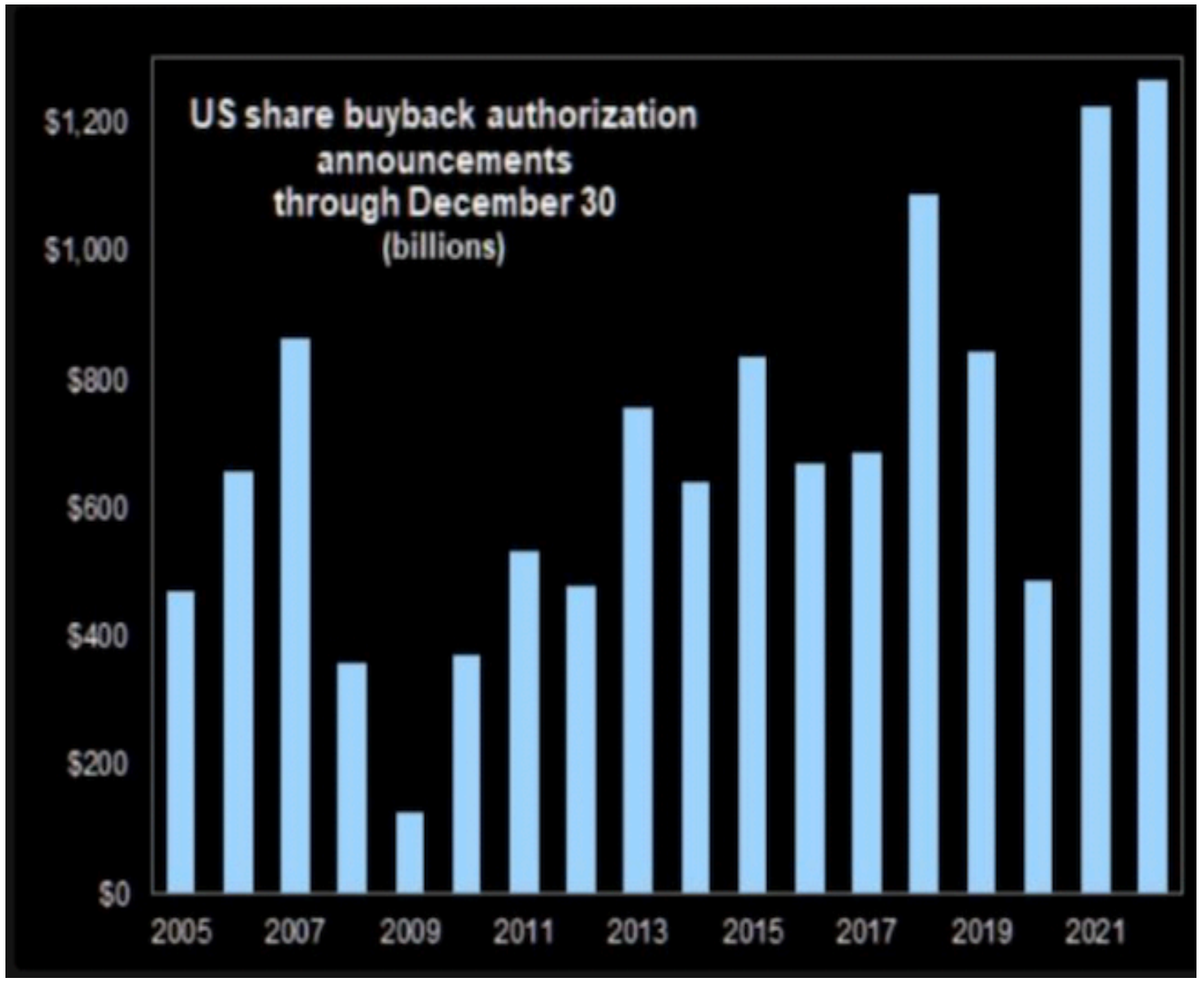
JB: Nasdaq 100 upgraded to bullish

- According to the technical analysis of the Swiss Private Bank Julius Bär, the **improvement in breadth** suggests a healthy development and therefore is upgrading the index to bullish, even if it is still struggling below its 40-week moving average (MAV), because the average stock of the Nasdaq 100 is already trading above its 40-week MAV, and the reading is the highest it has been since January 2022.
- He foresees the break of the 40-week MAV in the coming weeks and for this reason he is upgrading the Index.
- Mr. Pocinci concludes, it will be critical to see, if the beaten down FAAMNG stocks, can follow Netflix's lead and resume their long recovery from oversold readings. MSFT intraday rebound was impressive.
- KTS would add, as argued in our last report, that the base of earnings is deeply depressed; only mediocre results should already help for a positive development in addition to the rising money supply, which is supporting risky assets on the short term.

Source: Mr. Mensur Pocinci, Head of technical analysis of JB

From the 27th of January buyback programs are back

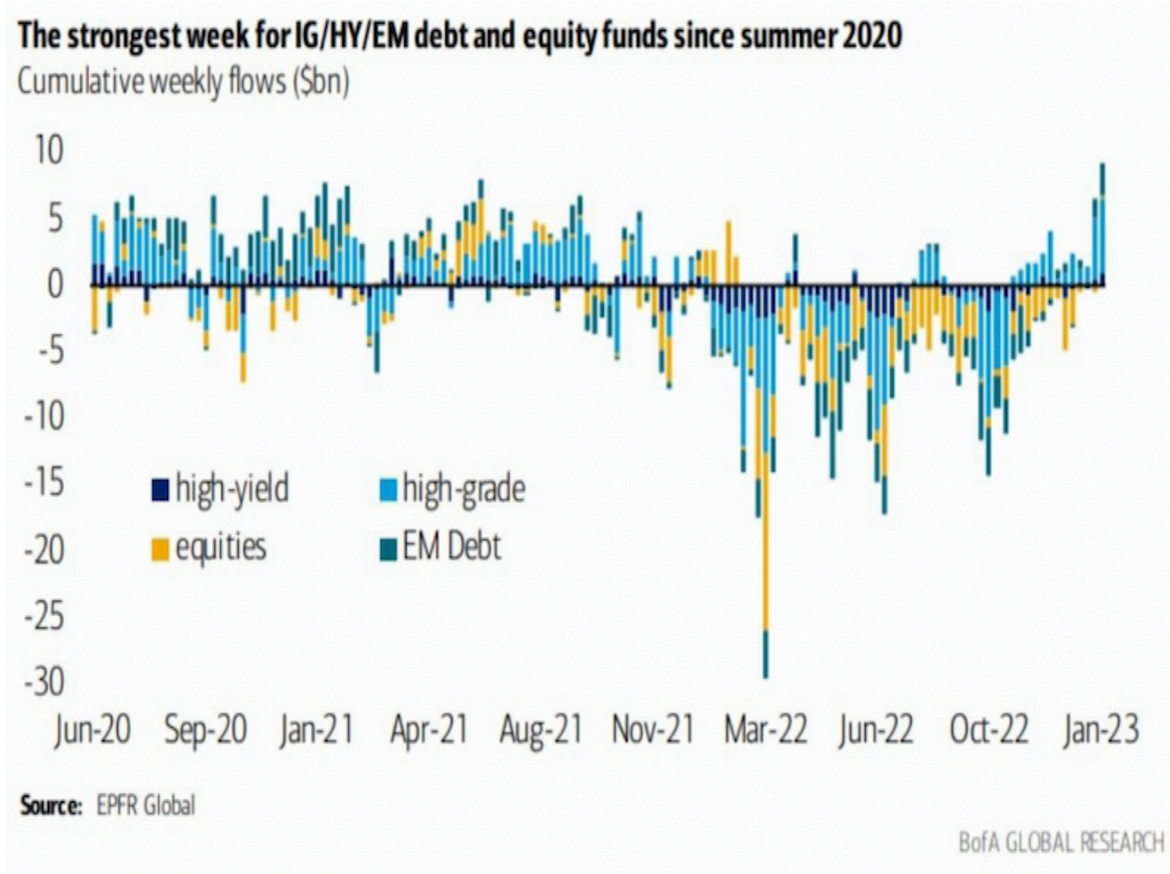
- As we know, companies had a blackout period before the result season, and therefore from the middle of December 2022, companies were not buying back shares in the market.
- This is going to change on the **27th of January** according to Mr. Alessio Urban of Goldman Sachs and therefore such purchases should support equity markets.
- This is happening in a time where the sentiment is still depressed and bearish. In fact, according to Mr. Roberts, the 4-week moving average of the National Association of Investment mangers is still at 48.16, which is bearish (chart of SimpleVisor not included). The low 25.04 in October coincided with the lows of equity markets.
- The intra-day reverse of Microsoft on the 25th of January 2023 was quite impressive. On that day, the entire market had an impressive intra-day reverse, which is sign of strength and should be the base for further upside potential.



Source: GS via Syz Group

With weak USD, money supply rising: the world is in “RISK ON”

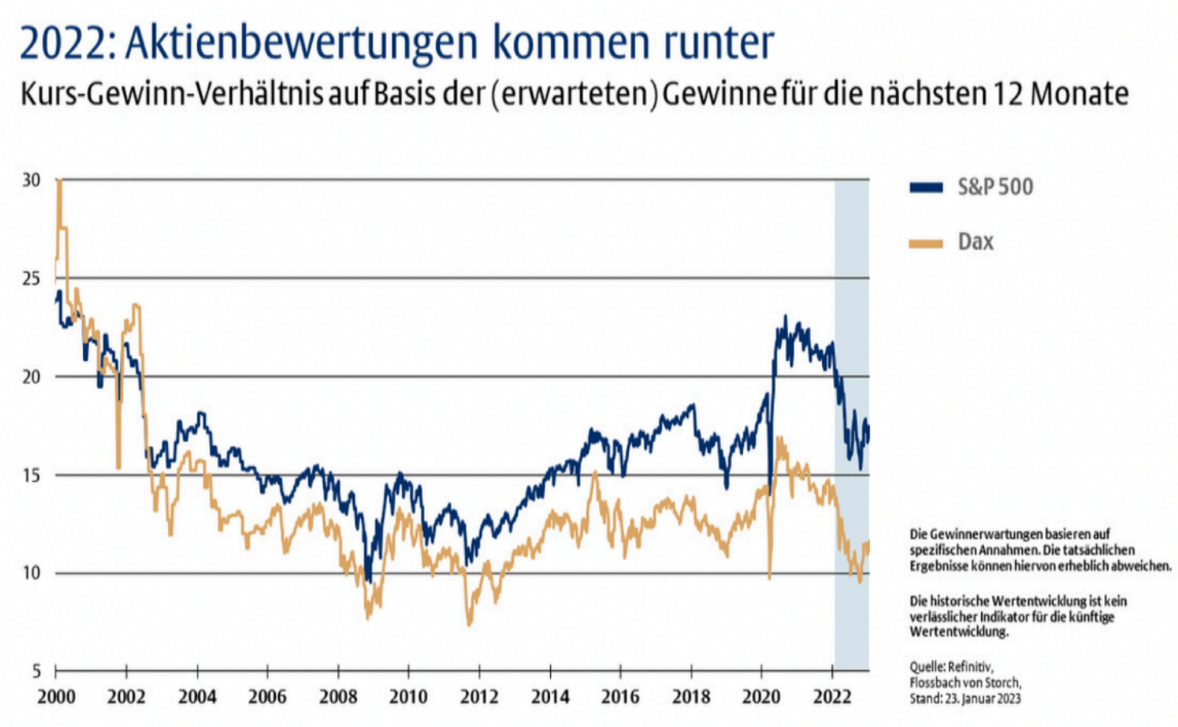
- We would like to include the following chart, only to show that after the dramatic outflows from bonds, high yields, equity and emerging markets in 2022 (highest ever), during 2023 we have the opposite move with the same magnitude.



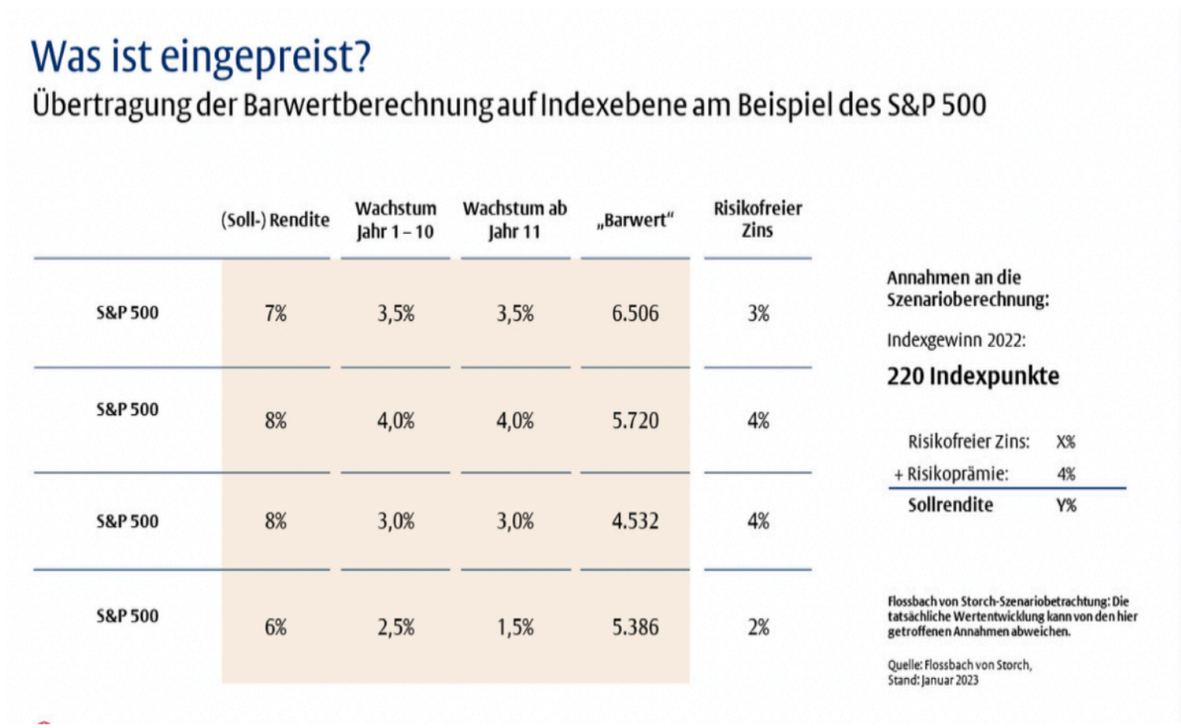
Source: Bank of America

According to Flossbach equities are not expensive

- According to the manager of our best-in-class balanced fund: “Flossbach multiple opportunities”, even if rates are going to stay at current higher levels for longer, equities are not expensive.
- The argument is also that, historically, revenues and earnings of companies could profit from inflation and after WWII, **earnings of S&P 500 companies doubled every 10 years**. In the 70’ US company’s earnings increased in line with inflation (chart not included).
- Below the calculation of Flossbach. **Taking into consideration a 10 years earnings’ growth, even with higher interest rates, the upside potential of the S&P 500 index is still very attractive. For this reason, the manager still keeps a weighting of around 2/3 in equities in addition to 15% in gold.**
- It also argues that **as long we have negative real yields, it is positive for high indebted countries.**



P/E back at level of 2004



	(Soll-) Rendite	Wachstum Jahr 1 – 10	Wachstum ab Jahr 11	„Barwert“	Risikofreier Zins
S&P 500	7%	3,5%	3,5%	6.506	3%
S&P 500	8%	4,0%	4,0%	5.720	4%
S&P 500	8%	3,0%	3,0%	4.532	4%
S&P 500	6%	2,5%	1,5%	5.386	2%

Taking into account earnings’ growth, with higher interest, still upside potential

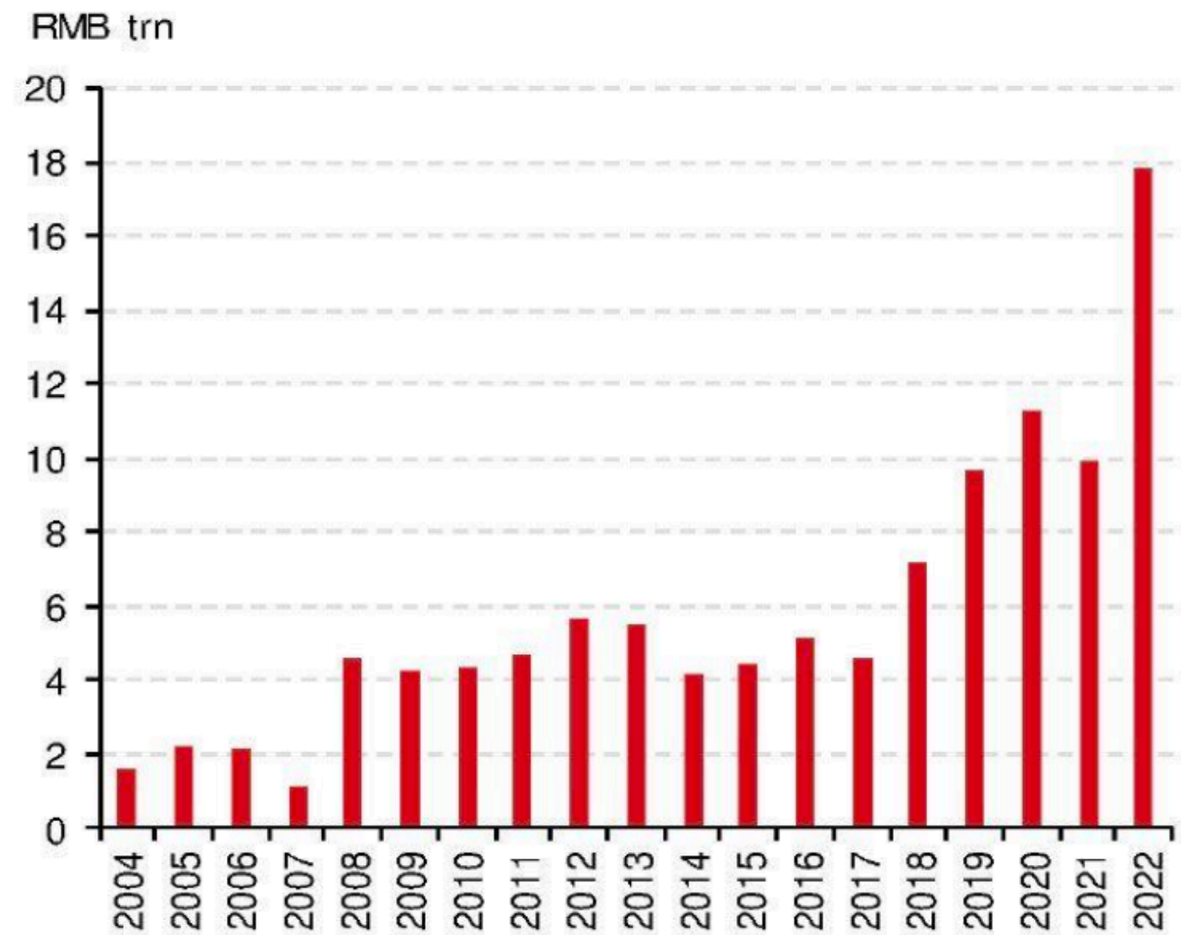
Macro

- Reading that **U.S. is considering to help Ukraine to target Crimea,** unfortunately we have to be aware of a new escalation of the Ukraine-Russia conflict, in a time where almost everyone is convinced that the conflict is going to end sometime this year. For the moment we are reading the mainstream as anyone else, but this is **an additional reason to keep our stop losses** and in case of an escalation, we are also going to add put options as a hedge. If the U.S. is going to assist Ukraine to attack Crimea, it would be quite a strong declaration of war, which most probably no one would like to hear…
- Also KKR blocked all the redemptions of the REIT fund after, few weeks ago, Blackstone decided to do the same. The asset managers are trying to slow down the "bleeding" in the sector.
- But on the other hand, **US mortgage rates fell over 1% during the last 3 months, which was the biggest fall in history, comparable with GFC in 2008** (chart not included of Mr. Evangelista). This should help the US housing sector to stabilise, where currently the annual mortgage cost as a percentage of household income is 45%, the highest in decades (chart not included of Freddie Mac via Syz Group).
- But also the manager of the Doubleline fund confirmed in their outlook for 2023, **that most of existing mortgages in the USA have been renewed in February 2021 at the lowest interest rates ever (between 2.5% to 3%),** and also Flossbach and Credit Suisse argued, back in 2022, and therefore only new buyers would have to pay higher interest rates, and for this reason, almost no one is currently buying and U.S. citizens are waiting for rates to fall further.
- **Oil and gas companies are currently, by far, paying their highest dividend yield in history** of the data (according to the chart of Mr. Costa via Syz group not included). Chevron pledges to buy back shares for an additional USD 75 bn. This supports our investment in the sector.

China re-opening: Chinese are travelling and have savings

- Last week we have analysed how US citizens have their credit card debt at the highest levels ever, but savings rates at the lowest level. Rising interest rates are also hitting consumers on the credit card debt.
- But on the other side, China's re-opening is boosting Chinese and global economic growth, and more importantly, **Chinese citizens have substantial excess in savings waiting to be spent, in China but also abroad.** The dilemma is going to be, whether the inflation is going to derail and put pressure again on global central banks.
- **KTS will have to monitor, if the Chinese demand in commodities, oil, consumer goods, is not going to derail inflation again.**
- Meanwhile, according to the aviation industry Cirium, Chinese domestic air travel in January is 10% above its pre-pandemic January 2019 level.

Fig. 2: Net increase in China's household saving deposits



Source: CEIC and Nomura Global Economics.

General news

- The strategy of OpenAI was typical: first you show the product for free and and spreads it over social media as fast as possible and at the end, you introduce monthly fees: ChatGPT has started proposing to a sample of users USD 42/month.
- Many market participants are talking about the huge profit of USD 22 billion (USD 16 bn net after costs) of Citadel. Citadel is quite an exception, because according to statistics of LCH, hedge funds lost more than USD 200 billion in 2022 and, as an example, the top HF Tiger Global lost USD 18 bn, more than half of their assets under management. Citadel is marketing themselves as macro hedge fund, but we would like to remind the book “Flash crash” of the writer Liam Vaughan, where it is explained how a fund like Citadel is making money with their models: basically they are provoking or influencing price spikes on the upside or downside by analysing the size and volume of existing orders, therefore a sort of front running, which apparently is legal, because authorities believe that such funds and strategies are creating liquidity in the market, especially in panic moments, where human investors would not buy or sell, but machines and AI models would stay in the market. The book “Flash crash” is a good read and eye opening in many senses.
- The **top battery maker Amperex Technology concluded a deal with Bolivia, that allows the Chinese firm to tap the world’s largest lithium resources to secure supplies.** We start seeing action in the sector, and this should support our investments such as Bakersteel Electrum, but also smaller special situations like Nevada copper, ZincX, Largo, etc.

Finfluencer

- We post a sarcastic picture on the phenomenon, but the issue is much more dramatic.
- We already discussed how **Gen Z look for financial advice through social media platforms.**
- Unfortunately, as KTS always argues, most of such trading gurus are either unserious or, even worse, a fraud.
- According to World economic Forum, the market is estimated at USD 104 billion.
- Finally we are reading on mainstream, like the Swiss newspaper NZZ (Neue Zürcher Zeitung), that journalists are questioning the reliability and seriousness of such sources, and in France, Germany and Australia, authorities have started investigating such influencers.
- According to Finma, in Switzerland such influencers must respect rules for financial marketing to the public, but we all know that it is not the case.
- KTS is fully regulated under FINMA and has a FIDLEG license (out of only 500 Swiss companies)

Trading gurus on social media (Source: Mr. Kavrak)

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