KTS CAPITAL MANAGEMENT

INVESTMENT HORIZON 2023

The 9th of January 2023

Investment Outlook 2023 – "Commonly known common sense"

2022 was in so many ways an incredibly challenging year for Capital Markets. It was **the worst year for bonds in 322 years of history** and for a balanced portfolio over 100-year history (see weekly Nr. 40, 41, 42 of the year 2022).
Gilt bonds of the UK government fell 57% with extreme volatility during the shortest-serving UK PM, Ms Liz Truss (60 days).
The volatility of Gilt bonds, which was higher than most emerging market countries showed how **the environment of a "risk-free" asset dramatically changed** and most probably also university books, and the calculation of the efficient frontier, need to be re-written, and the model portfolio theory is not modern anymore.
This is, unfortunately, not as funny as it sounds, because the global Asset Management universe is still based on such theory models, and people have started realizing that the theory can no longer be applied to reach a portfolio stability and reduce volatility. In hindsight, it probably never did, but we all lived the illusion of having a tool to work with.
Therefore, KTS must be aware that the fundamental way to invest, especially for professional investors, has substantially changed, and we must analyze and ponder on the outcome of such a shift. One most certain outcome is the questionable use of VaR models, as we will read later.

The reason for such dramatic performance in 2022 was the collapse of the fixed-income universe due to the increase of interest rates and high inflation caused by a combination of the normalization process after Covid19 lockdowns and the Ukrainian conflict.

KTS was able to avoid such dramatic drawdown in the fixed income part of the portfolio, having worked over the past six years on alternative fixed income strategies instead of classic plain vanilla bonds, which had negative yields and therefore could not stabilize the portfolio any longer as in the past, and therefore not able to reduce the portfolio's volatility.

The flagship fund Optima constant yield could reach a positive performance also during 2022 as per every past year; meanwhile, all the bond portfolios experienced around a -20% performance. 2021 and 2020 were already weak years for bonds, but nothing as dramatic as what happened in 2022.

The correction on the bond market was so violent that bonds **reached three standard deviations** from the historical average, this is the reason why KTS decided in October 2022 to start investing again in the asset class via the best-in-class fund **Man High yield** (top 1% percentile in Bloomberg) and European **CLOs (also equity and mezzanine)**, via the French manager Cartesia, which has a 30 years proven and solid record of accomplishment.
At KTS we have invested in highly liquid fixed income investments in order to give us flexibility should the environment suddenly change. Currently we think that yields will fall in line with falling inflation, and in case of a recession, central banks will have to drastically cut rates again, which is positive for bonds.
Of course, in a recession environment, many companies will experience weakening balance sheets and cash management, with eventually many cases of default. For this reason, KTS decided to avoid selecting direct bonds but let the selection of sectors and companies to experienced fund managers through our cooperation with many funds in the Fixed Income realm.
The above scenario, would have been the perfect environment to invest in CoCo, however, due to the need of deep technical knowledge of the asset class, and the lack of support from a reliable partner, we decided not investing in it, contrarily to most players in the market; and this turned out to be a positive decision.
In such a difficult environment, we feel comfortable having a diversification set by experienced fund managers.
To digress to the fixed income as an asset class, KTS, as the clients which have been following us for a while know, has been advocating strongly that with the current market's conditions, constantly increasing correlation amongst asset classes and

2022: Worst in 100y history for balanced portfolio

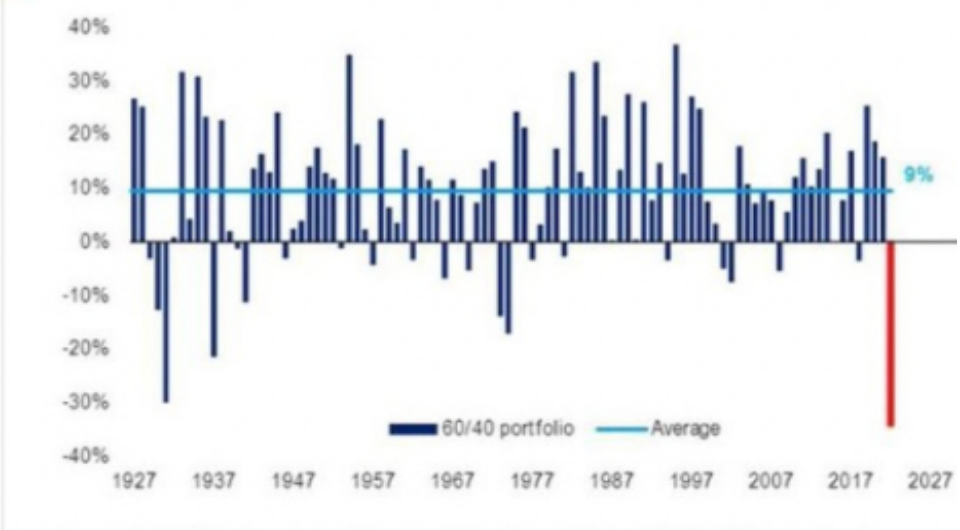
deep negative yields, especially real yields, bonds were becoming an equally volatile risky asset in the portfolio.
In addition, KTS was foreseeing the **risk of all the VaR (value at risk) strategies** being forced to sell and reduce the portfolio's risk in case a scenario as 2022 would happen.
Our external risk management system was a tremendous help in such stress test scenarios.

To conclude with the Fixed Income nightmare of 2022, we can add that the entire world was unaware of the worst thinkable risk taking: **pension funds were leveraging** (apparently 5x!) their bond portfolio to reach higher yields and this was happening in an environment of constantly falling yields (see weekly 40 and 41 in 2022). This was extremely shocking for us, because pension funds were supposed to have reliable risk management systems (internal and external), and history already showed on multiple occasions what could potentially happen when a portfolio is managed with excessive leverage. Any serious risk management system should have shown such risk in any stress test scenarios, as our external model does (margin calls etc.).

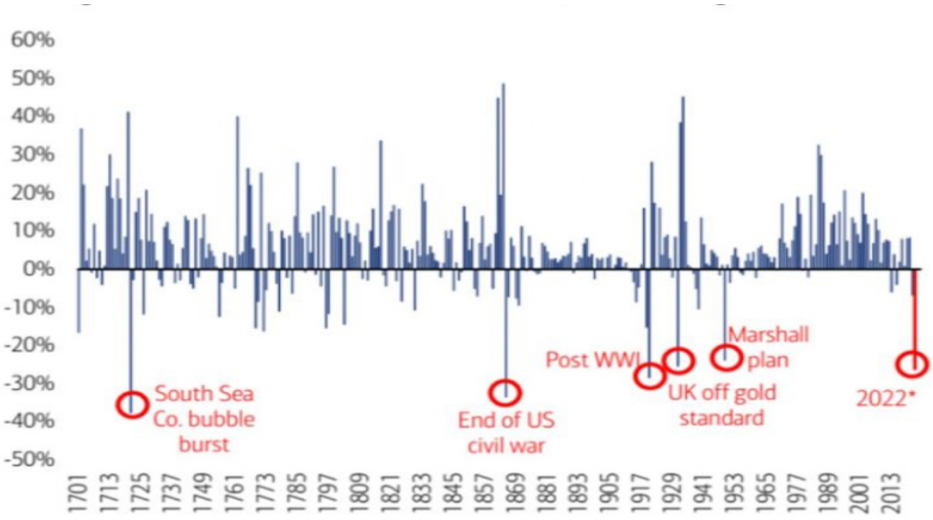
What has happened in the U.K. in the pension fund realm, was nothing but another indication that the whole world is basically managing assets in a similar way (and this is confirmed by the sudden illiquidity of US-T bills during October 2022), and it further shows **how fragile the global financial system is;** nothing but a show or as described today as "fugazi". We seem to be in the hands of managers which are basically "**recklessly playing around**" with our money (retirement money!). KTS must consider such reality in our investment process and realize that there are more hidden risks than we thought, therefore always taking into account hedging strategies.
After 2022, our respect for global managers fell to the lowest level in our entire career.
We cannot claim absolute knowledge and do not claim to be the best asset manager in the world but, once again, KTS has applied a commonsense approach, and in a financial world full of greed, 2022 showed once again that this is the only viable way of approaching financial markets and overall investments. Speaking of greed and irresponsibility, we could add few other scandals in the year 2022, as the default of the crypto platform FTX, which unleashed a number of other defaults (Genesis, BlockFi, etc). The magnitude of the FTX bankruptcy, which was valued USD 32 billion, definitely put in the shade past financial debacles like Enron and Worldcom (2001 - 2002), Lehman Brothers and Madoff (2008). We should also mention the stablecoins Terra Luna's default and the case of the Swiss Bank Credit Suisse.
2022 has taught us, once again, that **we must always prepare for the worst while keeping a positive and constructing attitude.**

Our argument has historically been that people are more exposed to bonds than they think, being invested into pension funds, which are invested over 60% in fixed income and around 30% in real estate.
But for this reason, KTS has always integrated from day one, the risk profile into any investment decision in order to help our clients' awareness of the overall asset allocation of their wealth (see weekly 22, asset allocation and holy grain by Mr Ray Dalio and determination of risk tolerance with the client).

We would like to mention again that Western governments are also "playing" around with our retirement wealth.
In fact, as always argued, **the only way out of the global high indebtedness is financial repression**, which means a reduction of the global debt vs GDP (not in absolute value, but in percentage) by having higher inflation and economic growth in the next years (see weekly 23 – debt repayment via implicit default, and interview with Mr Russell Napier: Financial repression 30th of October 2022).
This means, for the normal citizen, **a heavy purchasing power loss** over the next years and in **a magnitude with an estimate -25%**, being the rosier picture. But with a negative real yield of 8%, like in 2022, the burden could even be higher over a longer period of time.
In addition, one should consider the evolving demographics, **Generation X and Z are going to inherit the highest wealth ever** in history, and policymakers know this very well.



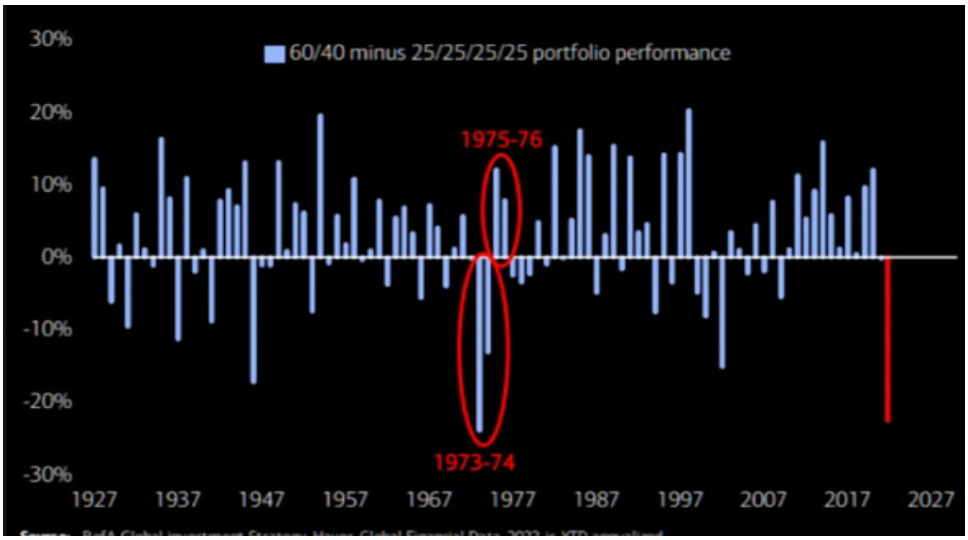
Worst YTD return in 100 years. Source: BofA Global Investment Strategy.



Gov. Bonds ann. 4th worst year. Source: BofA Global Investment Strategy.

For this reason, they are targeting higher inheritance taxes and, of course, want people to work longer because of the increasing life expectation and a burden for the health system, which is increasing in line with the ageing of the population, especially in Western countries, but also across other nations such as China, Japan, etc.
For many wealthy families, the country of residence, going forward, will be a crucial element to be integrated into any financial planning exercise.
Furthermore, the establishment of a solid structure governing wealth planning goals, should help in optimizing wealth for future generations.
This is, of course, the precious value added of our family office, which has been specializing over the years in offering optimized Wealth Planning solutions for its clients over a number of international locations and helping clients to shift wealth to new generations.
(see weekly 34 in 2022: best countries for a comfortable retirement & weekly 43: valuation real estate worldwide, UBS research Toronto, Frankfurt, Zurich, Munich, HK, Vancouver, Amsterdam Tel Aviv, Tokyo, Miami at bubble risk, but Dubai, Sao Paolo and Milan fair valuation).

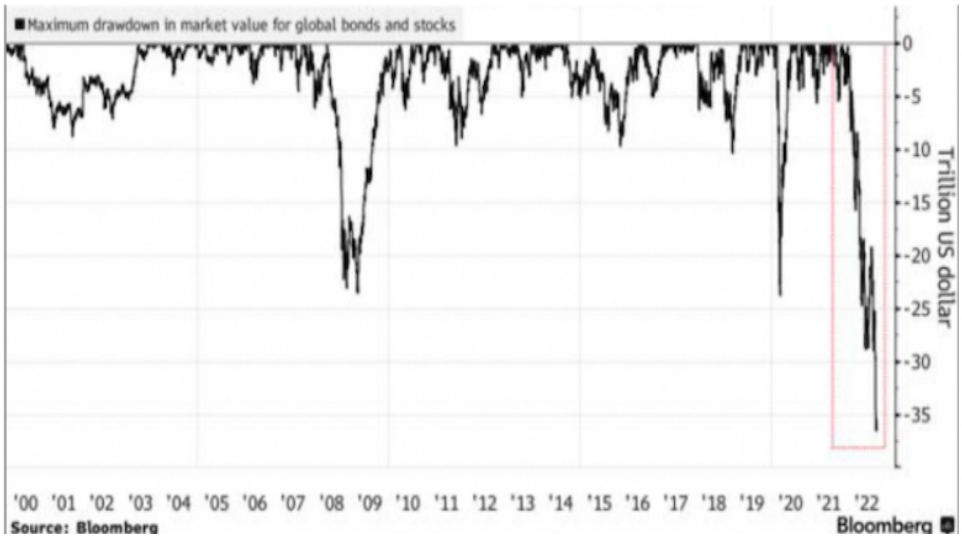
Back to our analysis of the year 2022, we actually started the year in an alarming state, with media publishing on a **daily basis new Covid-19 cases, creating unnecessary panic**. In fact, when digging deep into the situation, it emerged that, on the weekly nr. 1, basically, only 1% of the cases needed serious hospital assistance.
Fortunately, it turned out quite quickly (a reality well known by journalists, which apparently were not allowed to give further information, being blocked by the government) that half of the new hospitalized cases had no symptoms but were at the hospital for other reasons and, when tested, turned out being positive.
A classic case of panic News with the hope of increasing audiences' approval but also creating unnecessary stress to markets and society overall.
Without mentioning the **initial panic on the Omicron variant**, with policymakers spreading unfounded information that the new variant was more lethal, but it turned out it was not; on the contrary, the Omicron variant was the ticket out of the pandemic, with natural occurring infections spreading at a faster pace, but with a less "aggressive" virus.
Finally, governments understood that the only way out would have been to stop spreading panic, and this is what happened, allowing the start of a very fast normalization process, which is also the main reason for the higher inflation we currently have.
Luckily, even if China was stubbornly sticking to the zero Covid policy, no more major supply disruptions have been caused, which is the reason for the current falling inflation, together with the bullwhip effect (see weekly nr. 26 and 39).
This is also something to bear in mind: KTS was able to keep "cool" and never descend into a state of panic, as was the sentiment and mode in January 2022. Once again, the analysis of multiple but reliable sources helped achieving a better view of the general situation and to distance ourselves from the mainstream, helping us to hold back emotions and to keep rationality at crucial times.
As you know, **building up wealth in the longer term, the difference is exactly the right behavior in such dramatic times, limiting the drawdown and catching the upside again**.



2022 comparable to 1973/74. Source: BofA Global Investment Strategy.

As our clients well know, from 100% to 50%, the loss is -50%, but the other way around, to be back to 100%, we need an upside of 100%.
We would like to point out that, as of jet, we still have not seen a clear, detailed, open and fundamental analysis from governments assessing what went right or wrong during the pandemic, which is, of course, an enormous disappointment, and questions the veracity of the general understanding of what really unfolded during the pandemic.
Once again, it is only up to us to make such an analysis in the best way, to draw conclusions, while forming an opinion of how generally similar things have unfolded and how much of what went on behind the scenes has eventually been revealed.
It is now a commonly understood fact that **history never repeats itself, but it does often rhyme, as the American writer Mark Twain once said**.

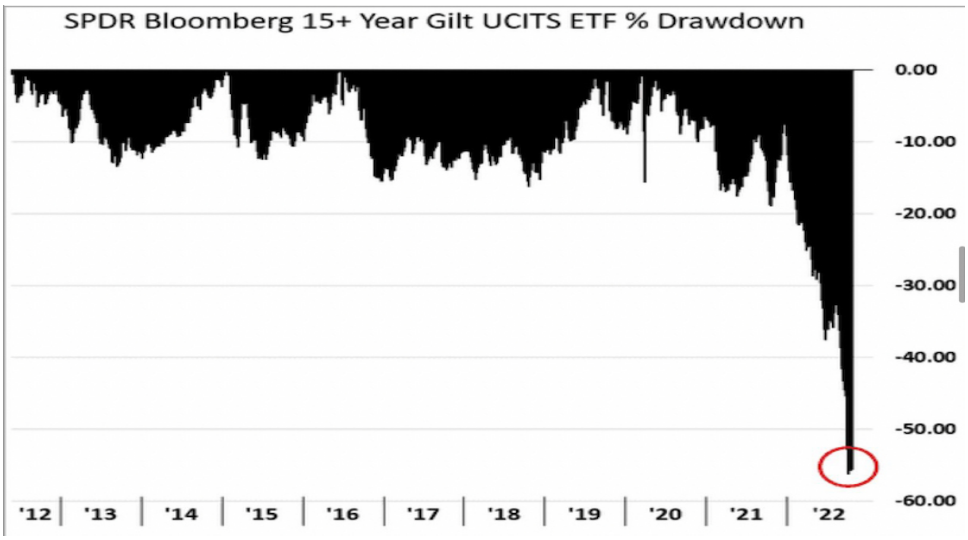
KTS could proudly limit most of the major dramatic debacles and further nefarious consequences which have



2022, largest wealth destruction in the history: over USD 35 trillion.

wiped out many more seasoned players in the market.
As it has happened so many times in the past, it is first followed by a substantial correction and finally the default of the weakest, or in the case of such dramatic bear markets, the default of most players, with only the few that were strong (and nimble enough) able to survive.
Frauds and scandals were quite the theme in 2022, highlighting how the system is still, despite all technological developments, fueled by greed and based way too much on ethical principles.

This was the turn of the crypto segment during 2022, and it started with the default of Terra and Luna, followed in November by the dramatic default of FTX, one of the biggest trading platforms, where any professional investor in the space had an account or investment exposure.
Big staples names such as Bitcoin and Ethereum corrected from highs of over 80%, but all the altcoins, which either defaulted or lost over 90% in value.
We never were too keen on Crypto, not for lack of interest, but simply for lack of understanding the dynamics behind it, and we could avoid losing money in this realm. We have simply let the "experts" give us an exposure through the Arbitrage Fund mentioned above, and being out of the space since February 2021, we could even reach a positive return with the crypto arbitrage fund, which we access through a partnership with Fasanara, based in London.
Further dreadful news came about in 2022 with the drawdown that happened in the venture capital and private equity space.
KTS could reach a tremendous profit with the private company Rimac Automobili (meanwhile, similar SPACs as for Lucid, Rivian lost 90% of their value since going public in 2021) and could profit from the actual attractive valuations in the segment, having Swisscom VC II still investing in highly attractive startups.
The Fasanara VC fintech never had an increase in valuation, having the portfolio at cost price; therefore, it was not forced to correct down valuations during 2022 like most VC funds.
As Benchmark, we analyze the global VC fund Tiger global, which corrected over 60% in 2022, without mentioning Softbank, Sequoia and many other dramatic losses.
Fasanara VC 2 Fund is still 3x over the book value, and during 2023 the NAV should increase to such a level, based on the audited NAV report. All the financing rounds of Grover, Scalapay and Twig are official information, therefore we know exactly the value of our investments.

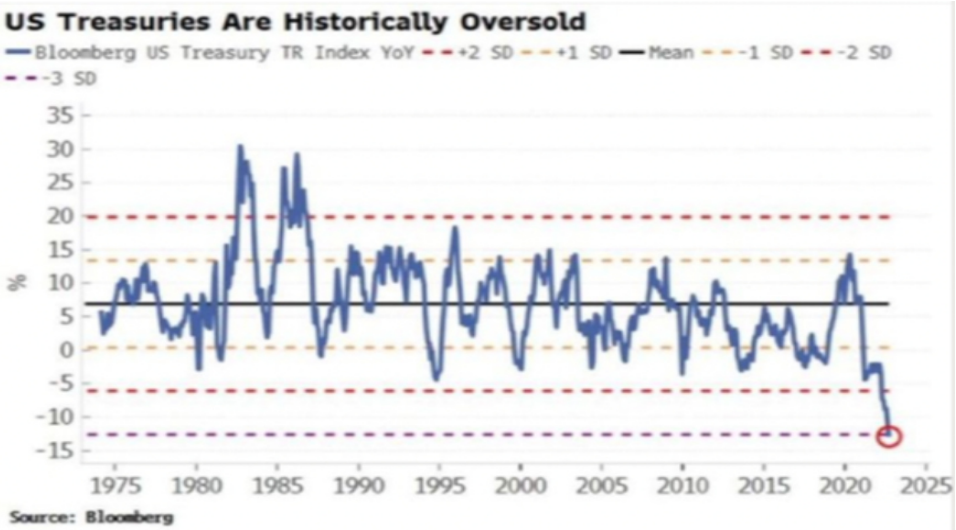


Most dramatic drawdown of long-term UK Gilts in history

As previously argued back in February 2021, the valuation of "meme" or non-profitable companies was insane and needed to fall to reality.
During 2022 this was emphasized in a dramatic way, even for major tech companies like Netflix, Paypal, Docusign, etc., which lost over 80% from the highs.
We started accumulating "beaten" stocks back in June, perhaps a bit too early in some cases, especially via our short put strategy, which was, unfortunately, more volatile than expected, and we were not able to reach the expected return, even if equity markets were offering many attractive opportunities.

However, we were able to start investing in **tech companies with positive free cash flow, leading technology, and a growing business model: therefore, we have patience, and we can wait.**
Such innovations are going to profit from megatrends and therefore survive any recession and most probably consolidate further their leadership position, having weaker companies running out of business or being acquired from such leaders during any recession period at distressed valuation.

KTS is also actively trading around a 15-20% position in QQQ US with strict stop losses and targets in order to catch any upside potential but not risk a major drawdown if the global economy falls into a major recession, which is unfortunately still not fully discounted from equity markets yet.
We are still depending on the pivot point of the FED, and this is not enough for KTS to feel "comfortable", especially after central banks fully underestimated high inflation, which was clearly to be expected after historical huge liquidity injections from their side and a normalization process after over two years of lockdowns, which never happened before in history.



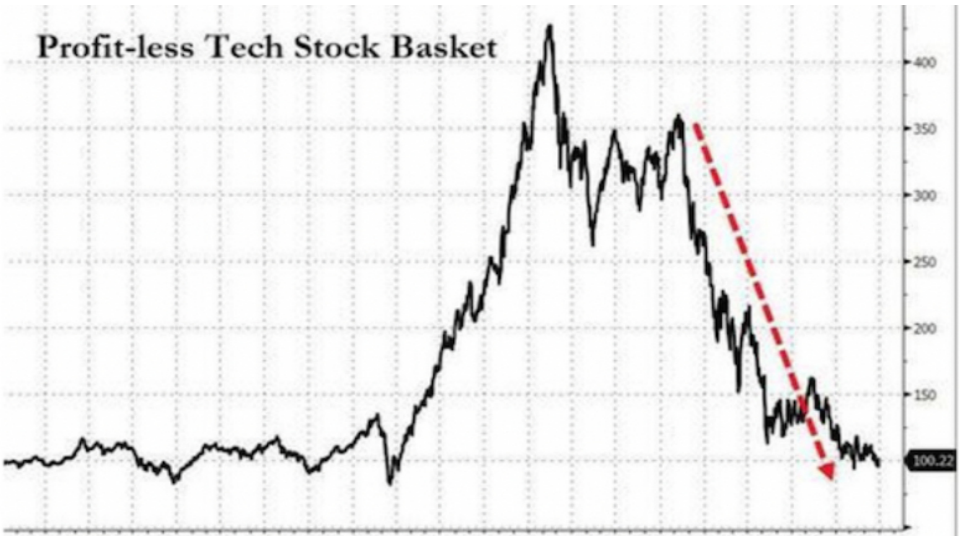
US Treasuries most oversold than 2 standard deviation in 47 years' history

Our flagship balanced fund Optima dynamic could profit from the diversification out of strategies rather than asset classes and had a substantial outperformance vs peer during the whole 2022.
We are talking of a 10% or higher outperformance against major funds, which actually is a tremendous achievement which underscores years of experience building fund management operations!
This, without mentioning the outperformance to the classical 60/40 portfolio benchmark, which was over -20%.

Outperformance which has been reached with the combination of long puts, cash/trading, right investments and, especially, by also investing in uncorrelated strategies.
Or course, the best contributors were the revaluation of Rimac Automobili and our energy investment. In addition to trading into gold/specialty metals and the QQQ US.

On the other hand, the biggest disappointment for 2022 was the investment in our volatility model, which did not help us limiting our drawdown; on the contrary, any long volatility investment during 2022 basically costed performance.
2022 was the first time in history where the scenario in which the S&P 500 index lost over 25% but VIX volatility stayed under 35%.
There is always a first time, and if our clients can remember, during our last outlook 2022, we were arguing that our funds based on volatility models were the best in our fund universe, but that at the time, it would have been irresponsible to further increase the allocation.
In order to reach a balanced and optimized diversification, we were of the idea that human beings still need to "calibrate" a portfolio and foresee through common sense what could go wrong.
A machine learning model does not have such qualities, being focused only on the past, or on future assumptions based on Macro data. Honestly speaking, in our 30 years of career, we have seen only a very few macro managers having the right assumptions all the time. One of them is MAN and we were able there to re-connect to our best-in-class fund Man AHL trend / TargetRisk, which coincidentally always argued, most economists are wrong on macro expectations…

We are still invested in volatility strategies, based on the following assumptions:



Non-profit tech stocks

Firstly, the manager of the funds is constantly improving their model and integrating new parts, which increases the quality of the model but not totally changing the root. In our experience, changing the base of the model completely is normally the beginning of the end of a successful manager or strategy. Without mentioning all the managers showing track records, which are not live in Bloomberg and therefore not credible.
Also, the domicile of the fund is for KTS, a crucial point of decision for investment.
We understand, Cayman and Bahamas are the most flexible jurisdictions, and some strategies need full flexibility in order to work at their best, which is not given by SICAV or Luxembourg structures.
But once again, it is not a coincidence that the biggest fraud and default in 2022, namely FTX crypto platform and all their subsidiaries or Hedge Funds, were based in the Bahamas. Unfortunately, such jurisdictions are more black boxes and many also with very weak audit; therefore, it is a standard rule by KTS to avoid such structures, and also U.S. limited partnerships, which were also the source of many unfortunate defaults in the last few years.

Secondly, we strongly believe **2022 was dominated by the known unknown**, meaning market participants were somehow expecting a war in Ukraine and were slowly selling before the event. In fact, during the invasion on the 24th of February 2022, the equity market was not collapsing but experienced an intra-day reverse and almost closed in positive.
Thereafter, investors reacted to the increasing inflation and started positioning themselves extremely conservatively, speculating on the downside, reaching negative sentiment and putting themselves in conservative positionings never seen before in history.
In KTS's opinion, the VIX index spikes only in a sudden event, where investors panic, not knowing the outcome and therefore selling

The subprime crisis and all cryptos losses are nothing compared to FAANGS

positions in order to be defensive and wait for more clarity.
This was not the case in 2022, and therefore KTS thinks that we do not have to question the volatility model yet.
We base the above also on the fact that we had already a "wiff" of 2022 back the way, in Q4 2018.

An additional observation on hedging, is the worthless value added of put options in 2022 (see weekly 32). In fact, during 2022, being hedged 100% via puts would not have helped at all; on the contrary, it was a cost, and therefore market participants are questioning put options as the best hedge strategy if it does not work in a year when equity markets were correcting over 25%, when should put options be a valuable alternative? Another anomaly brought about in this past year, but KTS always argued that the optimized way to invest a portion of capital into put options is the timing, by buying in the highs of equity markets, when volatility is low and not constantly roll-over the position.

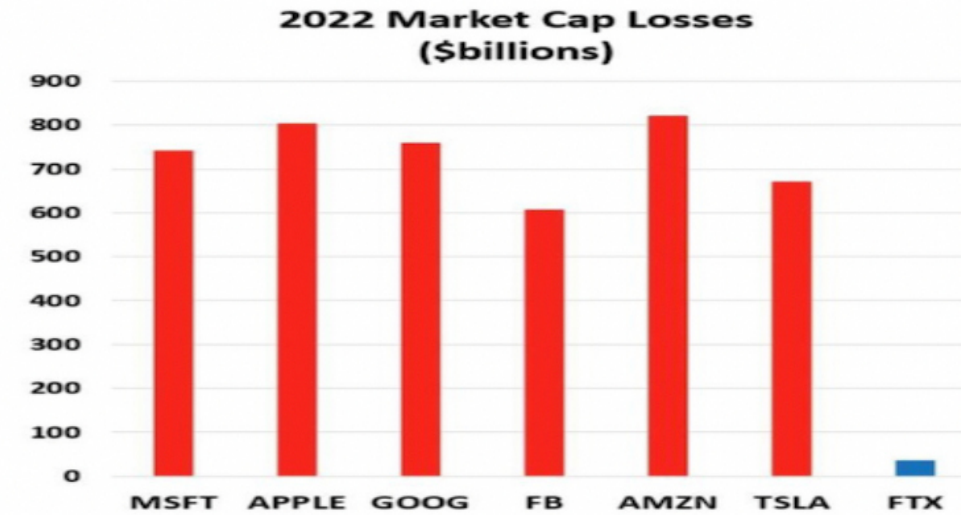
Again, as per our volatility models, in order to have the VIX spike, which means higher volatility, which is translated into a higher value of put options, we need to have a sudden event which would spread panic, and it was not the case in 2022.

We would like to remind you that from January 2022 in the U.S., an investor must pay higher profit taxes on equity capital gains and therefore, we believe that the highest put volume ever in history was caused by investors buying put options rather than selling positions.

The positive side of buying put options as protection of the portfolio is the fact that any write-down on puts' losses can be compensated with eventual profits.

During 2022 we took the opportunity to get rid of some disappointing strategies, which performed below our expectations and were supposed to help during the drawdown of equity markets. We cannot accept strategies which are underperforming during a bull market and during a market's correction are not delivering the expected return or at least strongly limiting the downside risk.
On the contrary, we noticed that many asset managers, not knowing what to propose as an investment during 2022 because most asset classes were correcting, started proposing investments into hedge funds and macro strategies, which were unloved over a longer period of time, especially in bull markets.
It is our assumption that most of the hedge funds, which were positive in 2022, were most probably "tail risk" funds, and such funds are going to underperform during positive equity markets. We do not feel it is the right moment to invest in such space. As a matter of investment philosophy, you might recall that KTS has been working during the last ten years on diversification amongst different strategies and not asset classes because we always argued that correlation was the highest historically, and therefore we could increase our expertise and database in the field.

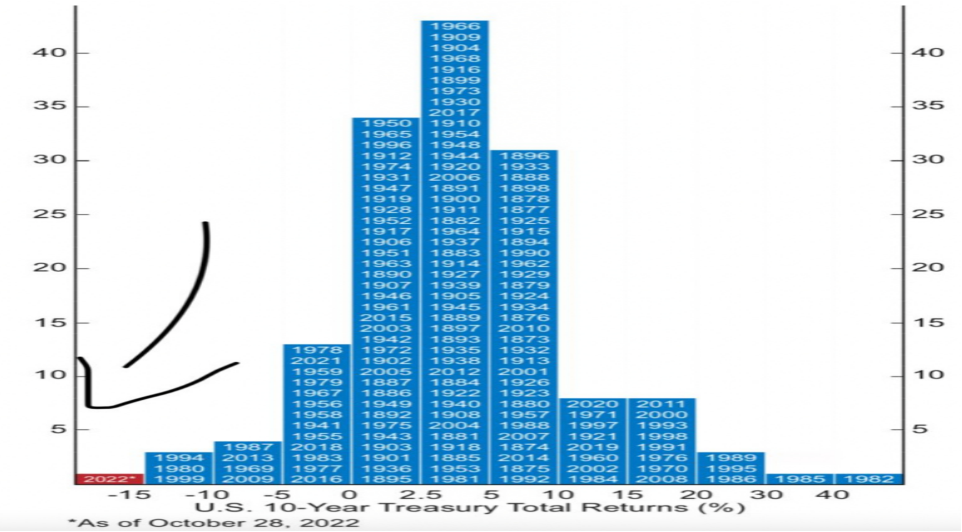
For the moment, we feel more comfortable applying **disciplined trading with the passive ETF QQQ US**, which is a better option than many actively managed funds. In fact, the base conviction of KTS is that the IT sector is going to rebound due to a re-rating, but we need to have a strict stop loss in case the global recession would turn out deeper than expected.



And the USD 32 bn biggest fraud ever, FTX, is peanuts vs FAANGS losses

Meanwhile, if the Nasdaq Index experienced spikes or opens with gaps, we realized that some intraday trading is bringing considerable value-added rather than staying passive.
In addition, when put options are too expensive, but equity markets experience a breakdown, **we prefer to go short the index as a partial pair trade with our long-term long positions**.

KTS strongly believes that **the falling inflation, also combined with the economy in a possible recession, is going to be the pivot point for the FED** and, therefore, yields are going to fall more than market expectations, which is, as said, positive for bonds, and we also believe that the IT sector will experience a re-rating and a positive performance.
As recently argued, we believe the FED has already overtightened and, during 2023, is going to reduce interest rates faster than investors think.
What we also had to learn during 2022 is the fact that the FED is basing its internal analysis on data, which is



2023: the year of bonds

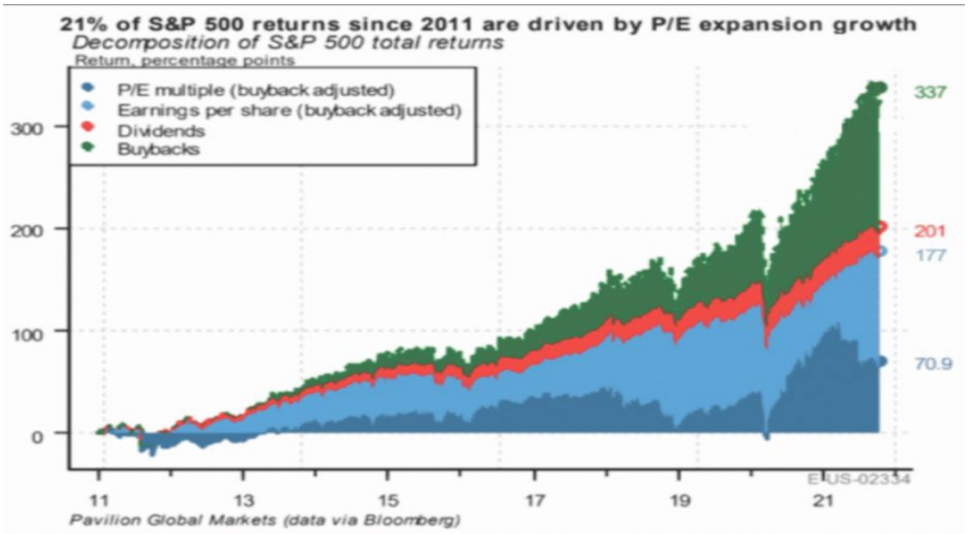
reacting too late on the inflation (see weekly 37-40: weekly 37 - Owner rent (OER), shelter and labor wage / weekly 38 - Bridgewater explain 60% of the US CPI is too late).

Finally, given all the above, a question raises spontaneously: **if traditional hedge strategies and the diversification amongst traditional asset classes are not giving the desired result, an investor has the right to ask, what is the best diversification model going forward?**

KTS would assert that 2020 and 2022 showed how equity markets are trying to discount future events much faster and more dramatically.
The tremendous equity market rebound in the second half of 2020 was an example of how investors were way too optimistic about economic development. Of course, it was a combination of the huge liquidity injection by central banks, which translated into the significant increase of **money supply M2**, and with smart and home working, people had time, probably too much time, and money to trade.
We all also have realized that equity markets are increasing due to **earnings growth (30%), shares buyback programs (40%), re-rating (27%)** and dividends, but at the end of the day, the **M2 money supply was the most important driver for all risky asset classes**, especially for highly speculative segments like cryptos, NFTs, "meme" and non-profitable stocks, SPACs, etc. without mentioning watches, old-timer vehicles or art.

Last year, after the equity market's highs in February and the insane valuations in certain segments, we all were asking how sustainable such tenacious trend would be.
We have to admit that the magnitude of the fall during 2022 also surprised us all, and we went from both extremes in no time, which is unique actually, but further analyzing the charts of the **correlation between the money supply M2 and equity & bonds markets (see weekly 36 and also weekly 44 in 2022),** the reason of the incredible increase, followed by the dramatic fall is quite clear.

One factor can be traced in the fact that also retail investors can now trade in real-time, which was not the case in the year 2000 and year 2008 when an order from a client needed to go through many steps in a bank or a broker before being executed.
The fact that **retail investors can buy and sell in real-time and with leverage,** combined with the emotional shift of the human being, the so-called **"behavior of financial" increased, in our opinion, the extreme positioning on both bearish and bullish sentiments.**



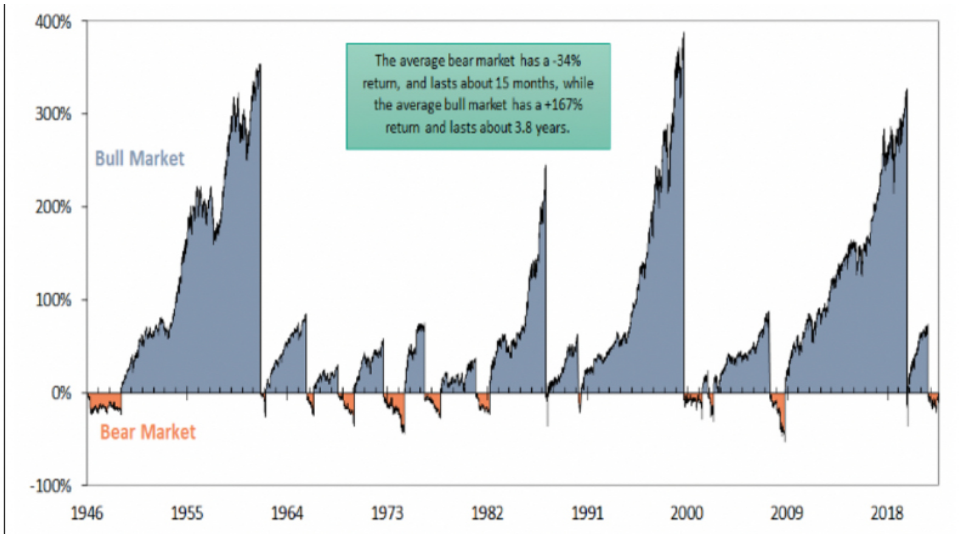
Share buyback program impact on the S&P 500 Index's performance

One further reason is that we cannot discount that machine learning it's able to provoke a trend. As explained in our weekly report, but also in the book by Michael Lewis "Flash boys", artificial intelligence models analyze the order book in-depth and understand if volumes are on the buy or sell side; thereafter, the model starts to input orders in such a millisecond and provoke the price to move in the wished direction, putting retail investors under pressure, which are consequently increasing or decreasing order limits.

In conclusion, we genuinely believe that an **optimized diversification it's Investments into megatrends, which are going to profit from the new geopolitical and the dramatic rupture between the West and the "nonaligned bloc".**

But KTS is timely integrating investments in PUT options when the price is attractive or increasing liquidity based on technical analysis in order to reduce volatility and limit the drawdown.
In addition, as we have always done in the past, to keep a healthy portfolio's diversification, KTS also allocate capital into uncorrelated strategies.

It is very important to mention that our **core asset allocation into mega trends stays always invested** because, as we have seen in multiple charts, it is almost impossible to time the market, at least with the whole wealth, and the risk over a longer period of time is to underperform equity markets if an investor stays too long invested in cash (see long term compounded effect weekly report nr. 43 on the 28th of October 2022 also in slide 33 why you should invest early in life).
In this respect, it would be pertinent now to mention the statement of the manager of our best-in-class fund, Flossbach, whereby equity is a hedge

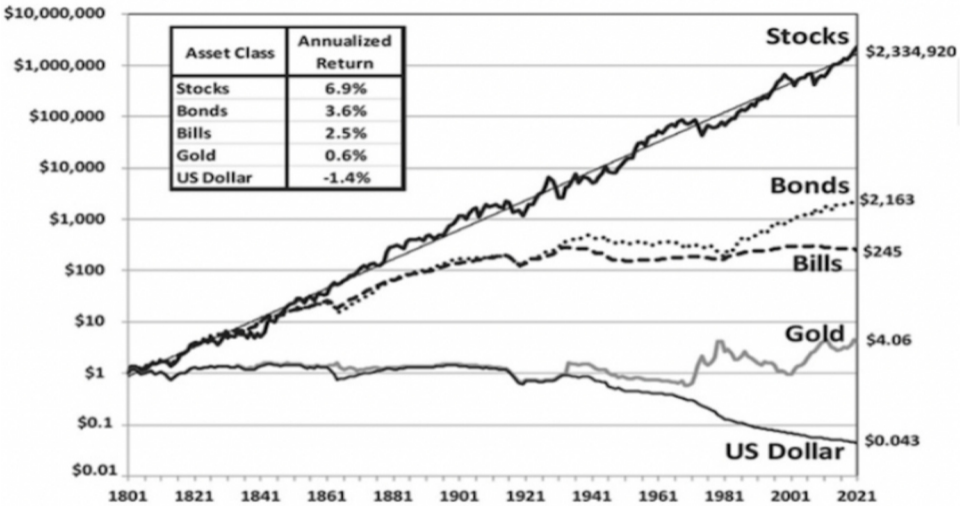


Every bear market has ended and has led to a longer bull market

to negative real yields (see weekly 12), and, to emphasize this point, for example Turkey it's the best performer in equity for 2022, with one of the highest inflation in the world, is the proof, that equity it is a hedge against inflation indeed.
Also, on our weekly nr. 9 in 2022, we can analyze the chart with all the possible reasons to sell from 1950 but, nonetheless and despite all reasons to sell well documented, equity markets only moved one way.
An historical example of that was the story of an important client of us, who sadly passed away and was a mentor for KTS, and who survived the second world war and its predecessor environment, always explained to us that during the dramatic devaluation of the Weimar Mark and the Weimar Republic in pre-war Germany, only gold, equities and real estate were real helpers in keeping his family's wealth intact.

Our ultimate aim would be timing our satellite and special investment allocation in order to generate value-added and profit from short-term market opportunities.
It sounds easy but, as most investment strategies, it presents its problems, and the emotional part of each human being conduces all of us to perpetuate the same mistakes again and again (see our weekly nr. 9, after the invasion of Ukraine, political could be a reason to derail the investment process because of personal political beliefs) and we need to apply a high level of discipline if we are to avoid the dangers stated above.

We tend to agree with many market participants that **from 1964 to 1982, the Dow Jones was 18 years flat**, and therefore we need to be more active and dynamic if such a scenario was to presents itself again. Consequently, we believe that we need to be more active with our satellite asset allocation.
However, as argued in our past 2 outlooks, KTS genuinely believes that **we are in the midst of an innovation decade, with many mega trends in different sectors and we feel comfortable with our investments into the green transition, Fintech revolution, digitalization, automatization, robotization, etc.** (see weekly 35: the world needs a super grid, weekly 26 -on electric cars / megatrend e-mobility, specialty metals, recycling metals, fintech as replacement Swift system and decentralization in a world in de-globalization, weekly 29 - Ethereum new technology, 99% less energy consumption, but more centralized and therefore criticized, weekly 25 - Bitcoin uses 50x less energy than

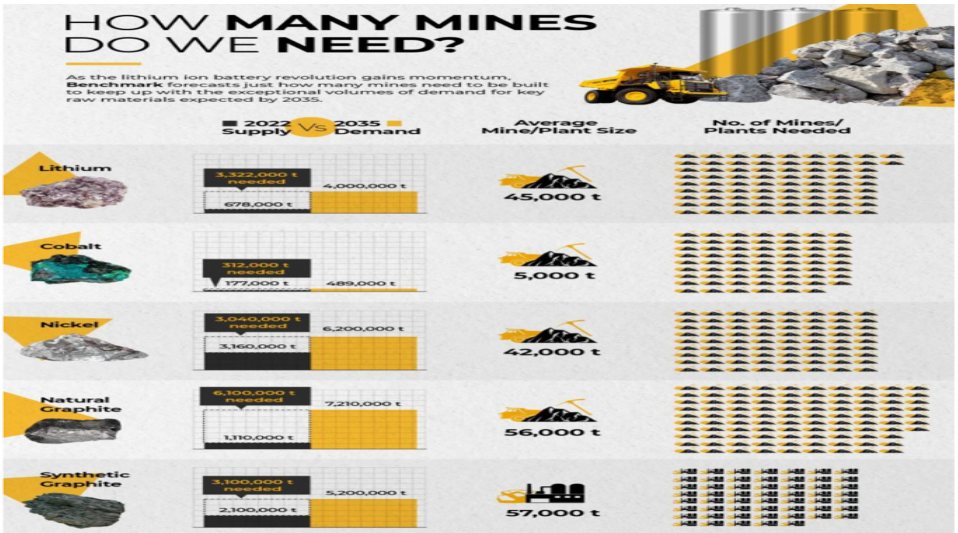


Long term compound effect

traditional banks, weekly 33 - V2G vehicle to grid new technology and major companies into blockchain technology as base for future app and payment systems, weekly 4: Web 3.0 - KTS is invested into Fintechs with Fasanara VC, weekly 21 & 25: Digital health, KTS is invested with Swisscom V.C., weekly 4: Rimac-Bugatti and P3).

The **energy independence, especially for Europe** (see weekly nr. 40, a deep rupture between Europe and Russia and weekly 34 & 36 European energy crisis), is going to set in motion a bull market in many other segments, such as **commodities, specialty metals, precious metals, etc. and from such trends, some emerging markets are also going to profit.**
Many **emerging market countries have a more solid financial situation than Western countries, without mentioning the young, dynamic, and growing population** and therefore increasing middle class, which is translated into higher consumption, that feeds into our consumer based global economic system.
It is worth noticing though, that after 2050, China is not going to be the most populated country in the world, but India will be and is going to be, followed by Nigeria, China, U.S. and Pakistan (see weekly 17 in 2022).

The general agreement, which we also embrace, does explain such a demographic trend with the simple fact that societies which are getting wealthier over time have fewer children. The common understanding is that being the society busy working and enjoying wealth by travelling or with hobbies, there's a lower drive to creating big families.
It is commonly known that in the past, families were large as they supplied for all that governments could not provide and guaranteed care in the later years for the elderly.
However, as societies develop, people have pension funds and, therefore, fewer financial worries than in underdeveloped countries. It is not a coincidence that "old" established

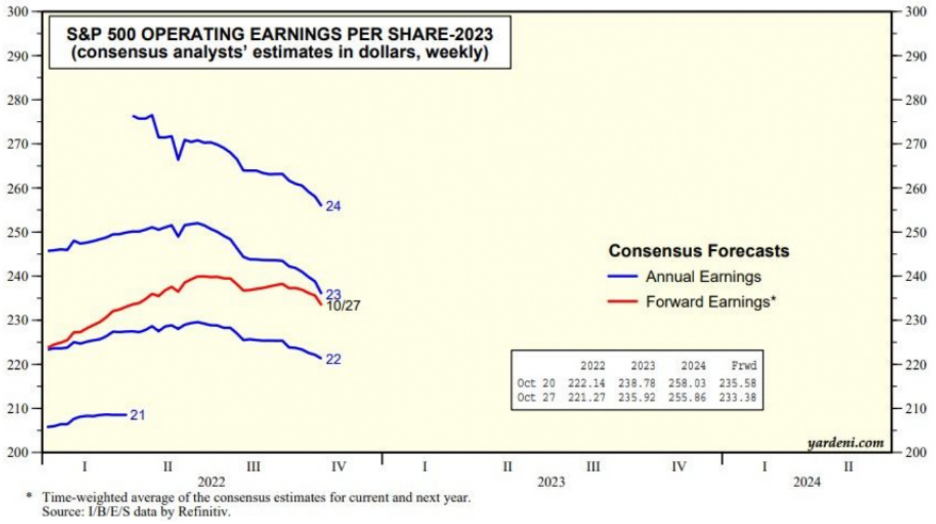


How many mines do we need?

economies such Germany and Italy have now more pets than children, whilst a country like Turkey has 50% of the population under 25 years of age!

There are also some negatives to take into account while discussing possible future outcomes and here we have to mention also all the **geopolitical risks in the future**, which need to be kept in mind in our investment process.
As we have seen in multiple analyses, especially in our weekly nr. 35 (the economic war, research of Mr Zoltan Pozsar of Credit Suisse), the invasion of Ukraine caused a **deep philosophical split in the world.**
Analyzing the world map of BRIC countries or trading partners with China, we, unfortunately, have to realize that over **50% of the worldwide population and an even larger portion of commodities is with a block of non-aligned nations under the guidance of China.**
This is a tremendous dilemma, especially for Europe, which desperately needs to reach as soon as possible an **energy independence** and is considering keeping a neutral stand between the U.S. and the countries mentioned above as the U.S. has its own agenda but is less energy dependent than Europe.
UK having historically an important issue with energy supply, is a good example of the positive trend of green transition and today wind power contributes around 30% of the UK's total electricity generation having the biggest offshore parks worldwide.

2022 was the first time after the cold war where the world had to seriously come to terms with a nuclear scenario. Nuclear weapons could be deployed from both sides, something unthinkable since the end of the Cold War. The MAD peace (Mutual atomic deterrence) which a famous spy of the cold war, Ms Melita Norwood, started by delivering classified information on the Western atomic program to the Russians in the 1940s and 50s, with the noble thinking that if both sides have the technology, no one would use it, seemed now to have come to a brutal end with the Ukrainian War.
We believe 2022 was the proof that nuclear weapons cannot be deployed; otherwise, we would come to an end of the world. However emotional statements can cause tremendous emotional shifts in people and, therefore, also in the sentiments in equity markets.
We were seriously concerned back in March and April 2022 on Mr. Putin deploying nuclear weapons.
It is clear now that it is not the case but it is clear to KTS that military spending worldwide is increasing and therefore,

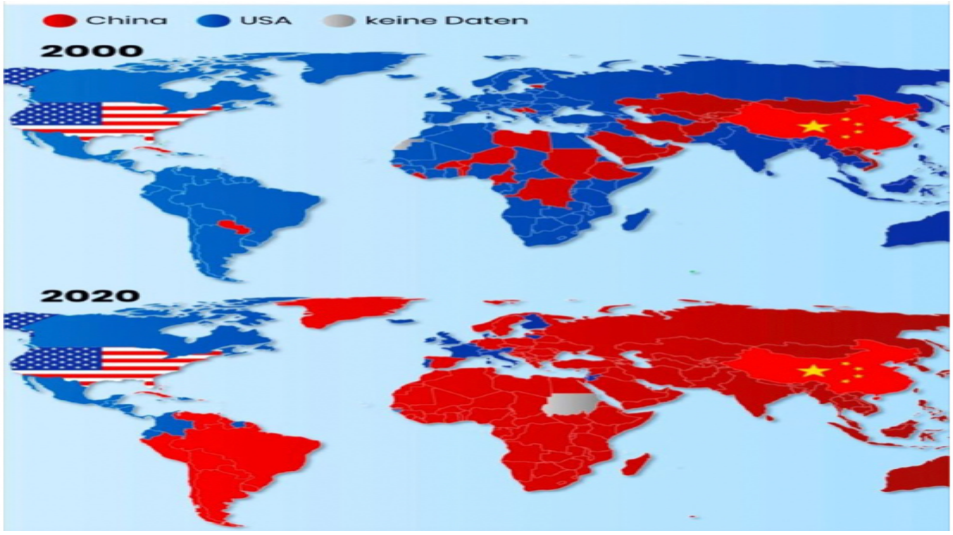


With a P/E multiple of 18x, the S&P 500 Index's target would be 4'248 points

by consequence, it's a sector which is also going to experience a megatrend. But in this case, KTS prefers not investing in the sector, based on ESG rules, but it is also not in our ethic, especially having clients and friends all over the world.

China also represents a potential point of instability in the Geopolitical megatrends! As we know, Mr Xi Jinping cemented his position. During his speech at the 20th National Congress in October 2022; the Chinese President had a focus on security rather than economic growth, which showed Taiwan is going to be the dilemma and the risk could increase dramatically in 2024 if the opposition would win Presidential election in Taiwan (see weekly nr. 43, the Chinese party congress did not recognize Taiwan's independence and therefore, if the Independence party - DPP9 - would win the presidential election in 2024, we should expect an increase in the intensity of geopolitical tensions between China and Taiwan).

Mr Xi stressed once again the Taiwan dilemma cannot be brought to the next generation, and with basically the opposition repressed in China, Mr Xi can allow himself almost everything.
Unfortunately, history already showed enough of what is going to happen when a single personality has power over the whole country, especially if the country has the highest population worldwide and especially with declining public consensus and declining economic hegemony.
Given the above, we prefer to focus our investment opportunities on other countries in the region (see Vietnam and India's highest growth, political stability, and new production for West weekly 42).
Countries like India and Vietnam also have an additional attractive side compared to Western countries. In fact, if we analyze the long-term GDP growth of a country, it is the result of population growth + productivity growth. Western countries have a falling population and productivity. So, governments compensated with higher debt, which can only be reduced with

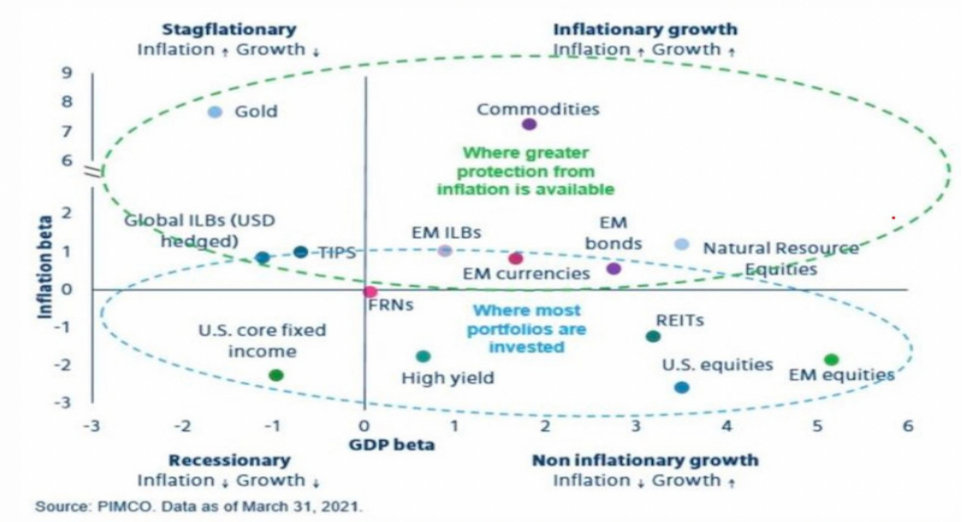


Countries, whose largest trading Partner is USA (in blue) and China (in red)

economic growth and inflation (financial repression), which is also translated into the loss of purchasing power for normal people over a longer period. Therefore, the optimized diversification is not only amongst strategies but also into investment in countries with a growing and young population and therefore also increasing productivity, as said, like Vietnam and India will ultimately pay off.

The real **dilemma of Taiwan is the supremacy in the semiconductor industry**, which is the pillar of any technology worldwide and the Taiwanese company **TSMC produces basically 80% of all the high-quality semiconductors worldwide.**
The U.S. Army, for example, is deeply dependent on all the high-end semiconductors of TSMC. China does not necessarily need to invade Taiwan in order to cause dramatic supply disruption in the semiconduction sector (see weekly nr. 31 – Taiwan strait risk of blockade).

But this is unfortunately not the only risk coming from China. The CIO of the Swiss Bank, Lombard Odier, is rightly arguing that **China could be the next Japan, which is entering a structural slowdown driven by the "3 Ds": debt on property, de-globalization and demographics.** China Housing is actually the most important sector in the world (source 2018 China Urban household wealth health report), followed by U.S. Housing and Japan Housing.
In the midst of all the geopolitical tensions and the deep rupture between the West and the "non aligned bloc", where one main goal of the **BRIC is to dethrone the U.S. dollar dominance in the global system and stop the USD hegemony, we believe Gold is the only international currency,** which is going to profit from such environment. In fact, central banks are still increasing gold reserves, and the Chinese, and not only them, must diversify out of the USD since it's hard to think of an alternative to gold (see weekly nr. 24 and 44 in 2022: record central bank buying lifts global gold demand). In November 2022, we also realized that the US CPI number triggered a spike in Gold due to the expectations of lower FED rate hikes and lower USD.
In addition, we are reading plans for a new BRIC currency, with the ultimate goal of being the new reserve currency. It appears clear such a new currency is going to be backed by gold reserves. As we know, Russia, China and India, which are all massive hordes of gold, don't believe in FIAT currencies.



Best asset classes in case of a stagflationary environment: Gold

Considering all this, in the next decade, we have the belief that the USD is going to weaken.

According to historical data, Gold should profit in the stagflation like (higher inflation but lower economic growth) period. The manager of our best-in-class fund Flossbach is supporting this thesis, but also well-respected asset managers like Bridgewater (see weekly report nr. 38 on the 23rd of September 2022, interview of Ms Patterson, CIO at Bridgewater / see also weekly nr 43 the chart on slide nr. 31).
Finally, to further emphasize this theory, one should take into account that the Indian population is holding more gold, 25k tons, than the top central banks worldwide (see weekly nr. 45).

Many market participants see as main risk for 2023, an increasing inflation, due to the re-opening of China. In fact, investors believe that the oil price is under USD 100, only because China was partially in lock downs. In addition, being China 50% of the demand of the main commodities, the investor community expect higher commodities prices with the end of the Chinese 0 Covid policy.
KTS believes that there is a potential risk of higher prices, but it will be compensated with lower inflation due to disappearing supply disruption, but most especially, with the lower OER and labor wage, which are contributing 60% of the U.S. CPI. Therefore, we would not expect too high pressure from China finally getting out of the extreme and draconian 0 Covid policy measures.

Finally, it's worth spending a few words on **ESG**, which has been an industry wise a pillar of investment decisions and which seems to be in the future a major component of investment choice for the consumer, but which is still not perfectly designed and defined.
As mentioned, Banks are trying to distinguish themselves from peers, offering different portfolio statements with ESG-rating.

M2, global money supply is the fuel of risky assets

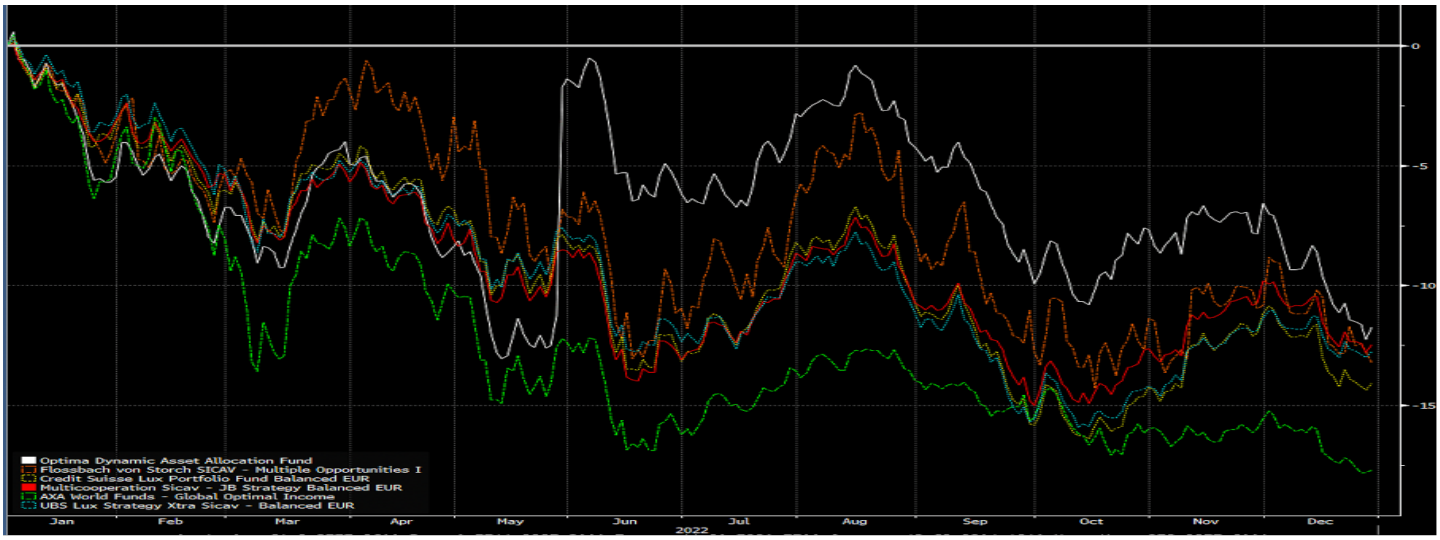


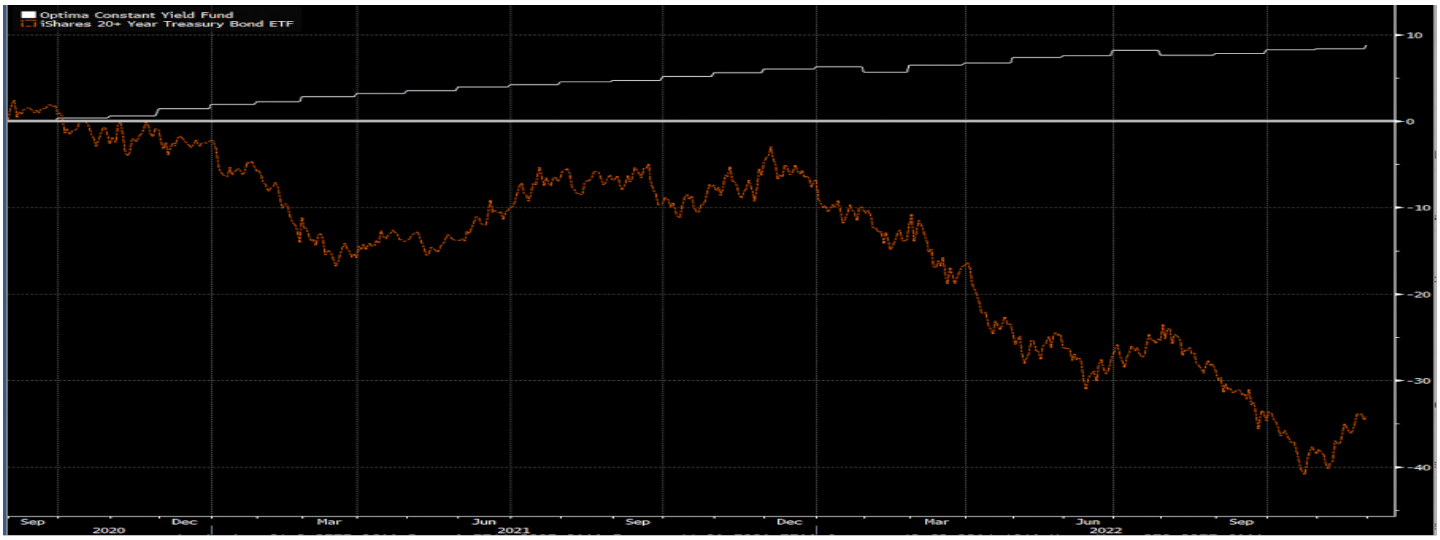
Chart OPTIMA DYNAMIC vs PEERs

Unfortunately, such systems are still far from being perfect, and we see ourselves forced calculating the ESG exposure manually in order to show to our clients and families there has been a tremendous effort, since day one actually, from our side in building a sustainable portfolio, but systems and investments a disposition are still not perfect.

We believe, once again, that common sense is the best solution in such a transitional phase (see weekly 30, 35 & 44).

KTS is working with all our counterparties in order to improve further such ESG-rating statements, and we are confident that in the next years, we will reach the wished sustainable portfolio with also the right statements for analysis. We have to admit that KTS is trying to anticipate the trend, but the infrastructure and systems at disposal are still by far not ready to accomplish our final ESG target.

Of course, the effort in constantly improving our systems is increasing our annual cost base. KTS has always focused on being cost-efficient, but it is clear we are also not immune to the substantial increase over the past years of the overall infrastructure.



Optima constant yield vs TLT US

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