Consilience
Asset Management

February 01, 2024

Consilience Market Notes:

A New Bull Market?

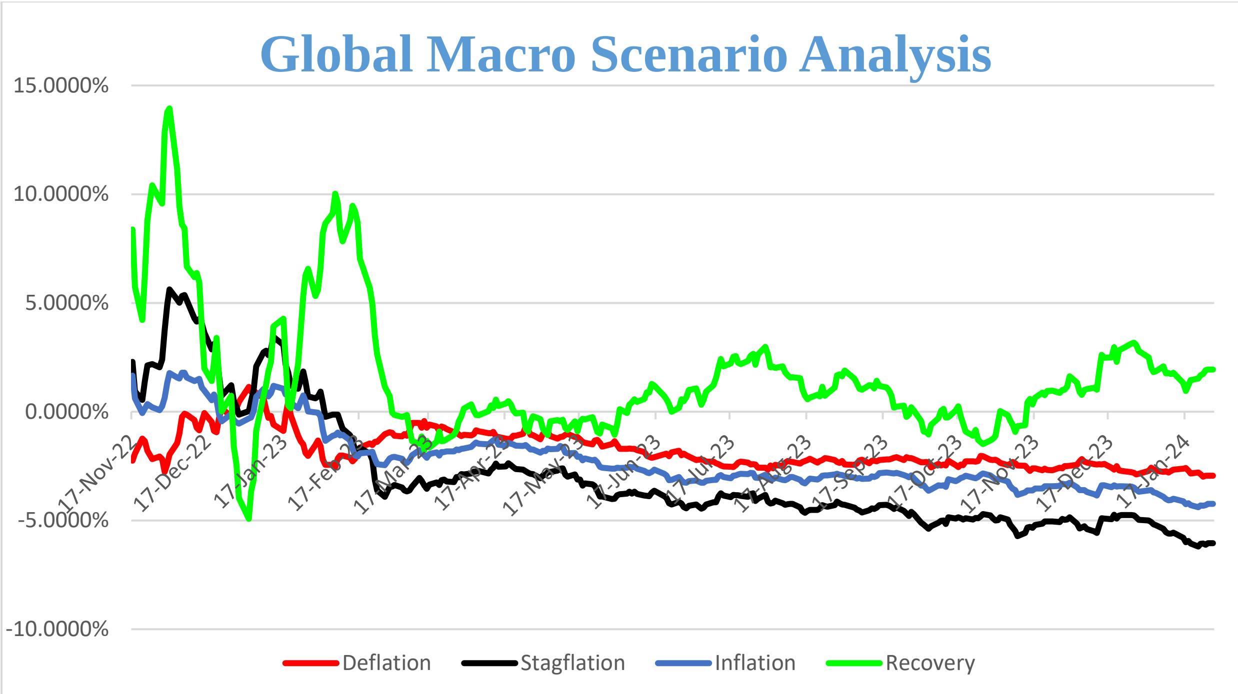
First, an update:

Last year, we at *Consilience Asset Management* added a Macro-Economic component to our *Relative Capital Flow Model**. Using market action, through a process of reverse engineering, we seek to identify which macro-economic climate is being represented in the market at any given time.

This is an important addition to our discipline as central banks across the globe are attempting to unwind decades of monetary expansion. As this unwinding occurs, it could have significant ramifications for the financial market. Thus, there is an increased need to monitor this process and the corresponding macro-economic result.

Below are the ratings of **securities in the five scenarios** that we are monitoring:

Inflation – **Negative,**
Deflation – **Negative,**
Stagflation – **Negative,**
Recovery – **Neutral,**
Financial Crisis – **Negative.**



Source: *Consilience Asset Management*

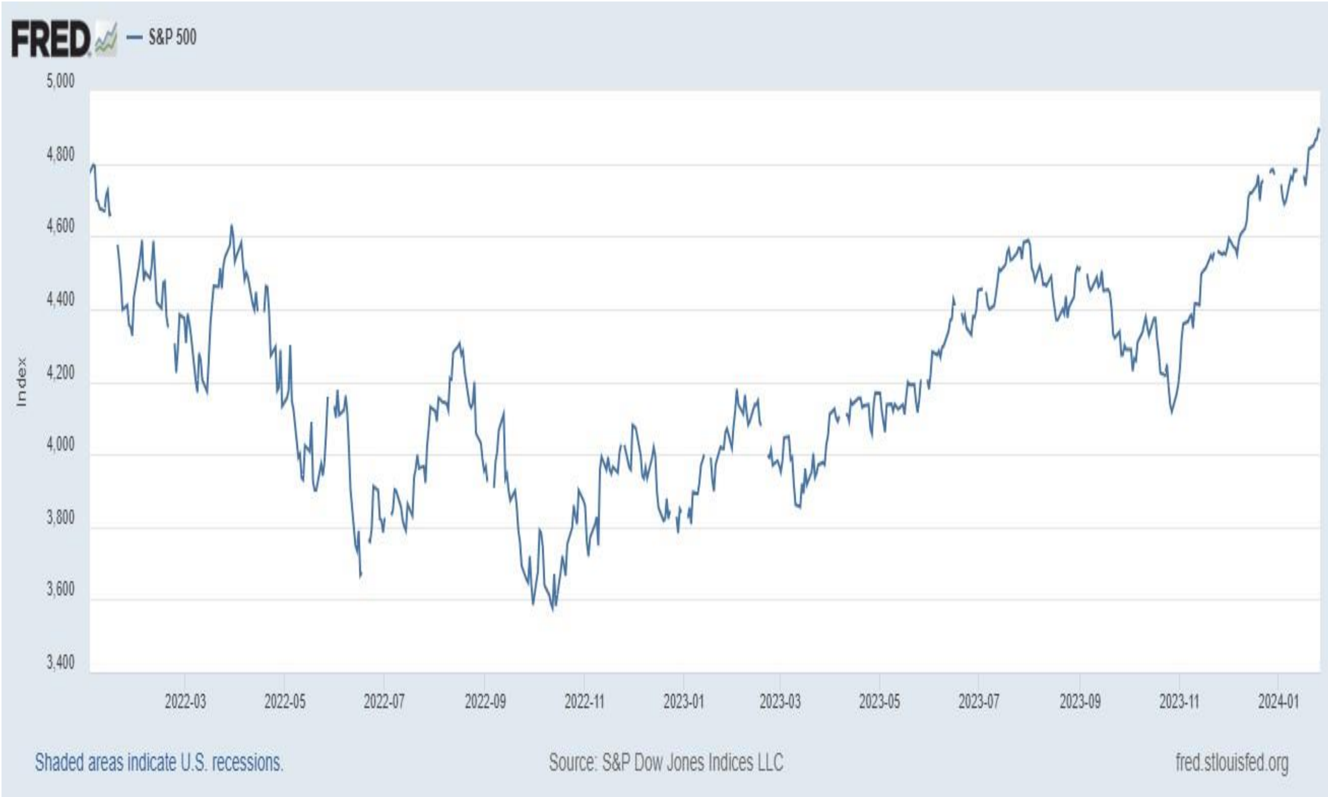
The above scenarios reflect the current *Capital Flow** composite rating of the securities that have historically generated positive returns in the above economic environments.

In addition, our *Global Macro Indicators** are as follows for the seven asset classes we invest in for our clients:

Global Equities – **Neutral,**
Global Bonds – **Neutral,**
Commodities – **Neutral,**
Gold – **Neutral,**
U.S. Dollar – **Neutral,**
Real Estate – **Neutral,**
Cryptocurrencies – **Neutral.**

Now, to this month's report:

It has been over 750 days since the S&P 500 last set an all-time high on January 3, 2022.



Today, many investors believe that both stocks and bonds have moved "too much, too fast" into the start of 2024, with widespread expectations of a "healthy pullback" soon..." or even a resumption of the 2022 “bear market.”

For others, it’s the end of the “bear market” and the beginning of a new “bull market” as the Fed begins a new round of money printing/Quantitative Easing (QE).

In so doing, they will once again provide liquidity to the banking system which would likely provide a favorable backdrop for the stock market.

Note, in Charts 1 & 2 the upward trajectory of both stocks and the Fed’s Balance Sheet (QE) from 2020-2021 as the Fed engaged in a major QE stimulative program during the Covid crisis. This was followed by a downward trajectory in stocks in

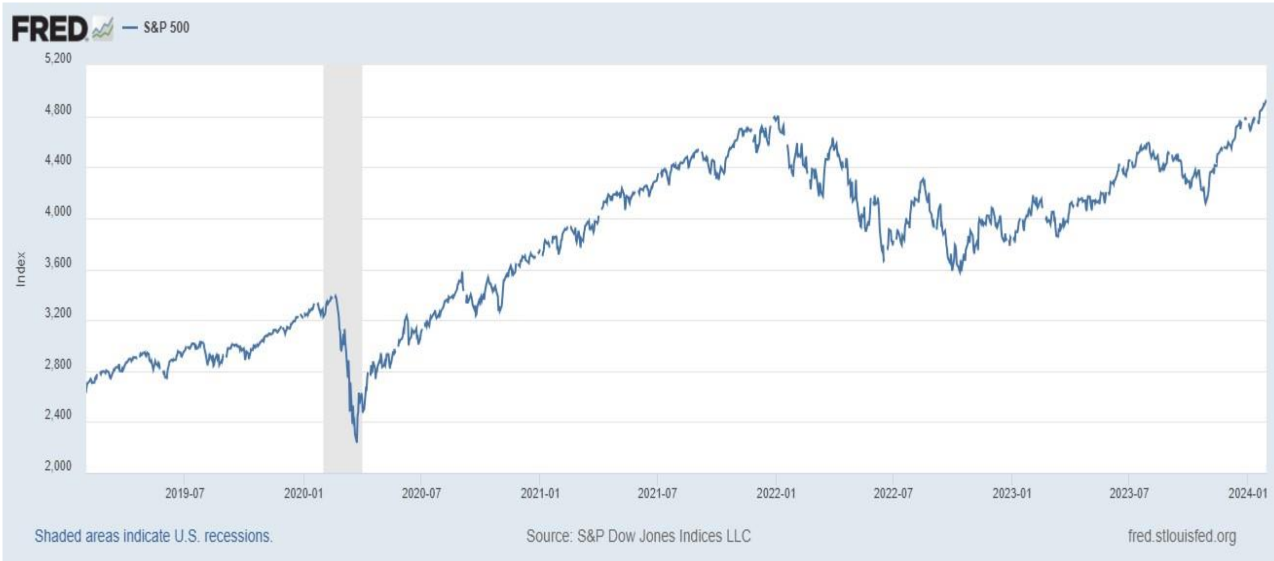
2022 as the Fed reversed course and contracted the money supply through a process called Quantitative Tightening (QT).

Chart 1:

Chart 2:

But then something interesting happened. The Fed continued to contract its balance sheet (QT) as shown in Chart 2, yet stocks resumed their upward trajectory Chart 3.

Chart 3.

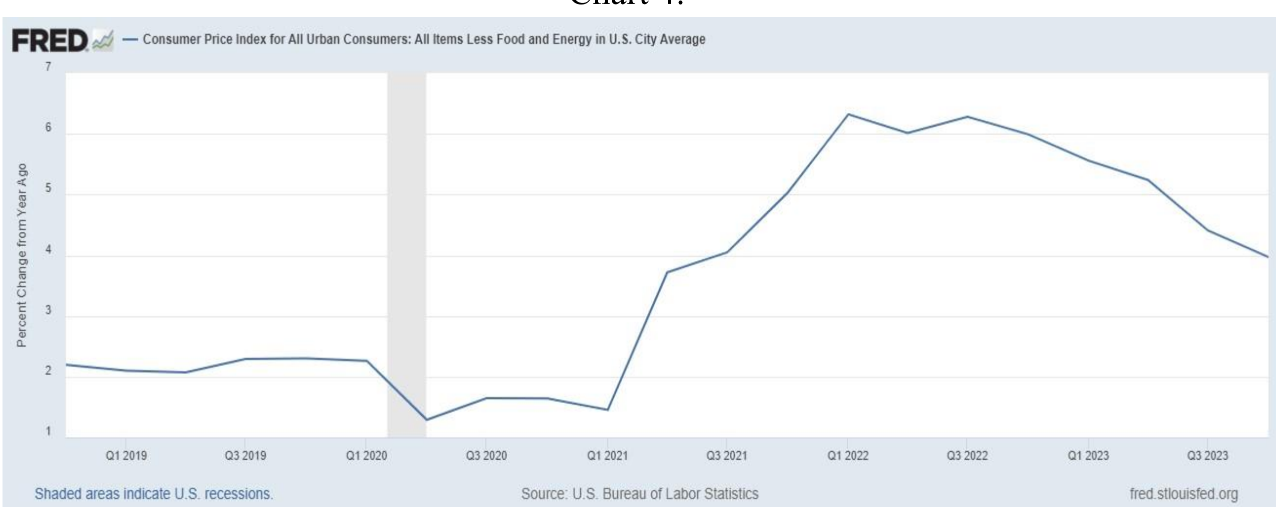


The best explanation for this divergence is that stocks are rising in anticipation of a new round of money printing (QE) this year. This would certainly not be unprecedented in an election year. However, would it be prudent?

Before answering, let's review the reason why the Fed discontinued QE and introduced QT in late 2021. It was an effort to contain inflation. Their thinking was, if they contract the money supply, it will slow the economy and thus reduce inflation.

At first glance, it appears to be working as the Consumer Price Index (CPI) peaked in early 2022 and has been declining as a result of QT.

Chart 4:



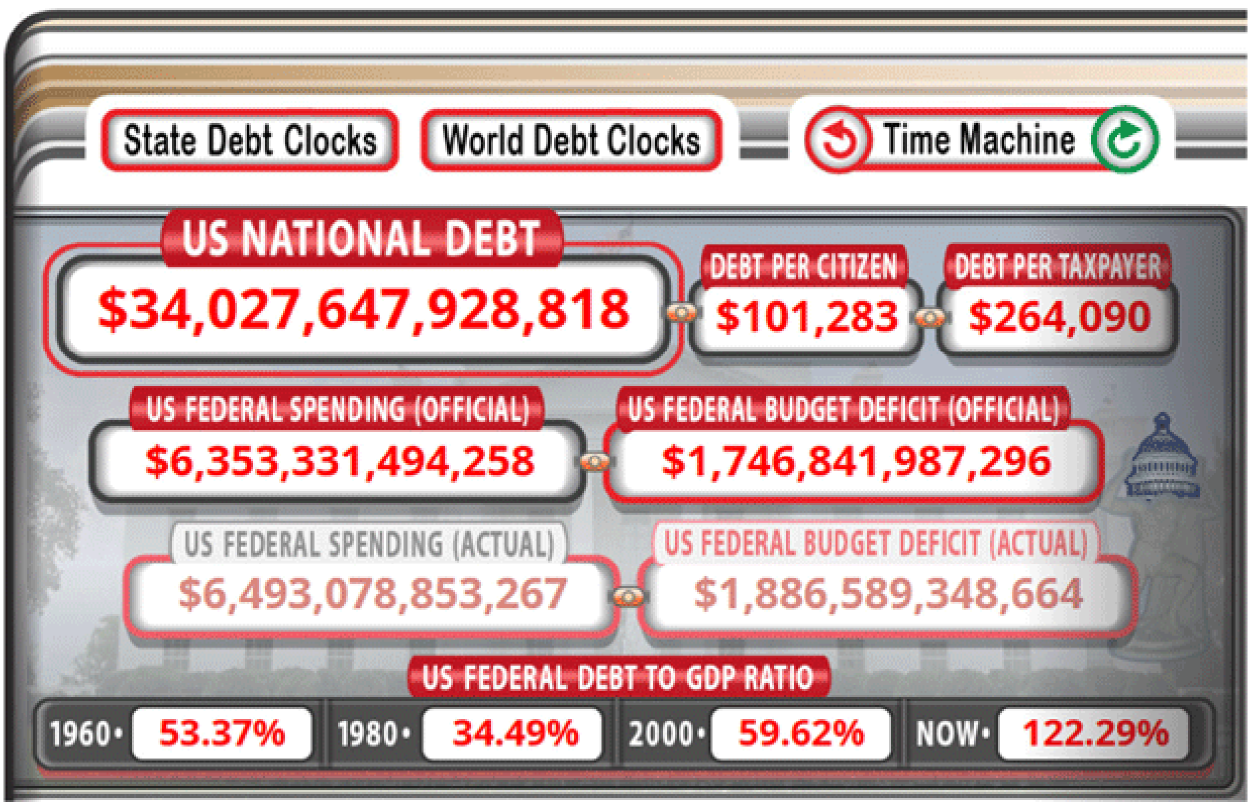
But, with the Fed printing again, will inflation re-emerge and undo all of their QT efforts, requiring a need for a new dose of quantitative tightening in the future?

On top of this risk, are there other factors at play that could prompt them to take such action?

Yes.

Number one is to recognize that monetary stimulus or quantitative easing is code for "money printing." And money printing is accomplished by issuing more debt.

Here's a graphic picture of where this has led us:



Source: USdebtclock.org

Note at the bottom right of the above picture, the US debt-to-GDP is now at 122%. A level above 100% is considered fiscally and economically dangerous.

As discussed in previous *Consilience Market Notes*, such elevated levels can require higher borrowing rates to finance the US's ever-increasing debt. Yes… "ever increasing!"

Last month the U.S. Treasury reported the December budget deficit, which shows the U.S. collected $429 billion through various taxes while total outlays hit $559 billion, adding an additional $130 billion to the national debt.

A second factor that could result in higher inflation can be found in the Red Sea, where the behavior is truly worrying. So far, the markets are overlooking how much worse this can get, how inflationary it could prove to be, and how hard it may be to resolve.

The Strait of Bab al-Mandab is a strait between Yemen on the Arabian Peninsula and Djibouti and Eritrea in the Horn of Africa. It connects the Red Sea to the Gulf of Aden and by extension, the Indian Ocean

This is a vital maritime choke point of immense strategic and economic importance. Approximately 6 million barrels of oil and goods worth around ten billion dollars pass through this narrow waterway every day.

That's about 12% of the world's shipping traffic. Its geographical importance is underlined by its location at the junction of the continents of Asia and Africa, serving as a crucial passage for maritime routes connecting the five continents.

If the Bab al-Mandab were closed to Israeli and their allies' ships, the consequences would be far-reaching, leading to longer delivery times for oil and goods, affecting supply chains and global markets.

The blockade of the Bab al-Mandab Strait and the resulting inflationary pressures and logistical challenges could greatly impact international markets.

In light of these facts, what should an investor do?

The good news is that there are asset classes that can perform favorably under multiple scenarios. Historically stocks do well when rates are declining, and money supply is expanding. Commodities and Gold have performed well when the increased money supply has resulted in inflation and Bonds have performed well during a contracting economy and declining interest rates.

In the meantime, my advice is to pay close attention to our *capital flow* indicators as summarized at the beginning of this report and described below, and as they change, so should the asset allocation of your portfolio.

In our seven asset classes listed, there are both inflation and deflation sensitive options. It is my belief that it would be prudent for investors to allocate a portion of their assets outside the traditional markets of stocks and bonds (paper assets) and into alternative asset classes (hard assets). Some of these are included in our seven assets listed on page 1 of this report.

It is important to note that alternative investments can result in increased portfolio volatility and as with traditional investments like stocks and bonds, are not guaranteed and can decline in value.

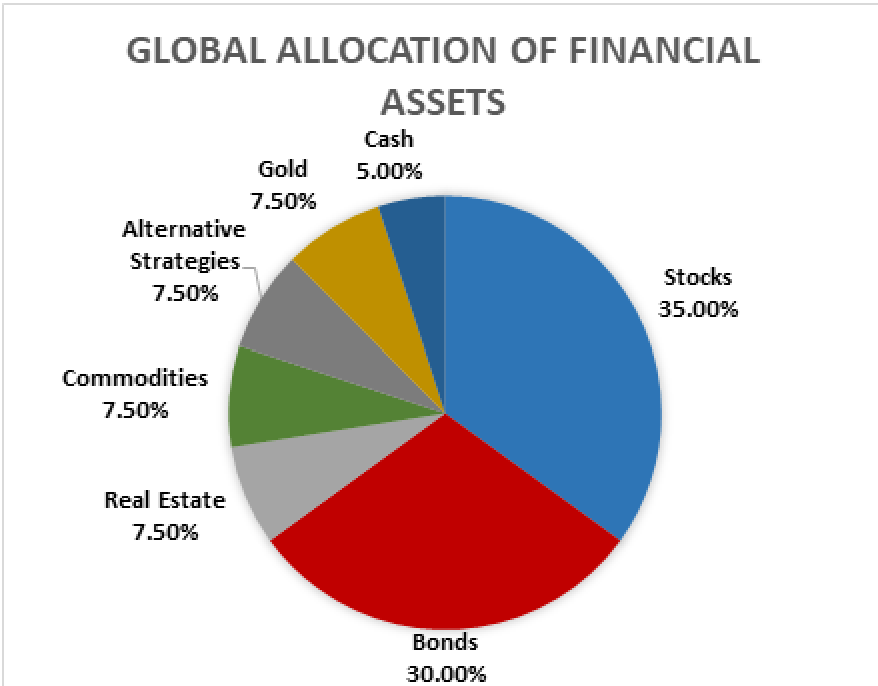
Conclusion: Recognizing that we are in uncharted waters with multiple moving parts, we must admit that there is no way to tell in advance exactly how this will unfold. But in such a transitionary environment, the ability to properly anticipate change is predicated upon a detached analysis of information from multiple sources, applying that information to imagine a plausible world different from today's, understanding how new data points fit (or don't fit) into that world and adjusting accordingly.

Although this will be no easy feat, our answer at *Consilience Asset Management* is to employ a discipline that we believe has the ability to circumvent the effects of these uncertainties and disparities between the above noted risks and actual market action. Ultimately, it will be the forces of supply and demand that will drive prices of financial assets higher or lower, regardless of the fundamental, geopolitical or economic circumstances.

The cornerstone of our process is our *Global Macro Capital Flow Model*.

In this model, we monitor the movement of capital among the approximately $250 trillion of tradable global financial assets. Here, market trends can be identified regardless of their driver; debt, geopolitical, economic, or other…

Below is a picture of the distribution of the world's liquid investment assets as a percent of the $300 trillion total…



Source: BIS, Thompson Reuters, World Bank, World Gold Council, Financial Analysts Journal, (January 2019).

(The performance quoted herein represents past performance. Past performance does not guarantee future results)

By measuring the capital flows of each of these categories relative to the total, both favorable and unfavorable investment trends are identified.

At Consilience Asset Management, we employ this process in deploying client assets.

A more complete description of our model and process can be found on our website:

www.consilienceassetmanagement.com under the tab “Our Process.”

Based on this, the ratings for each of the eight asset classes that we monitor are included each month at the beginning of this report.

We are entering a new phase, as the decade-long bull markets for stocks appear to be winding down. We are cognizant of the new challenges inherent due to the structural changes noted in this report, as they will have a huge impact on the current supply/demand dynamics in the global marketplace.

As such, we realize that these are clearly challenging and unprecedented times and therefore it is important for the astute investor to be nimble and pay close attention!

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*Our Global Macro Tactical Strategy seeks to identify favorable investment opportunities among seven primary asset classes. Capital is rotated to the specific markets in an effort to control risk by underweighting or eliminating exposure to markets that exhibit elevated risk.

*Our Relative Capital Flow Model is the cornerstone of our tactical allocation decisions and is augmented by our Behavior, Economic, Monetary and Stability indicators.

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