Consilience
Asset Management

January 01, 2024

Consilience Market Notes:

Recession or Recovery in 2024… a Test of Fed Independence

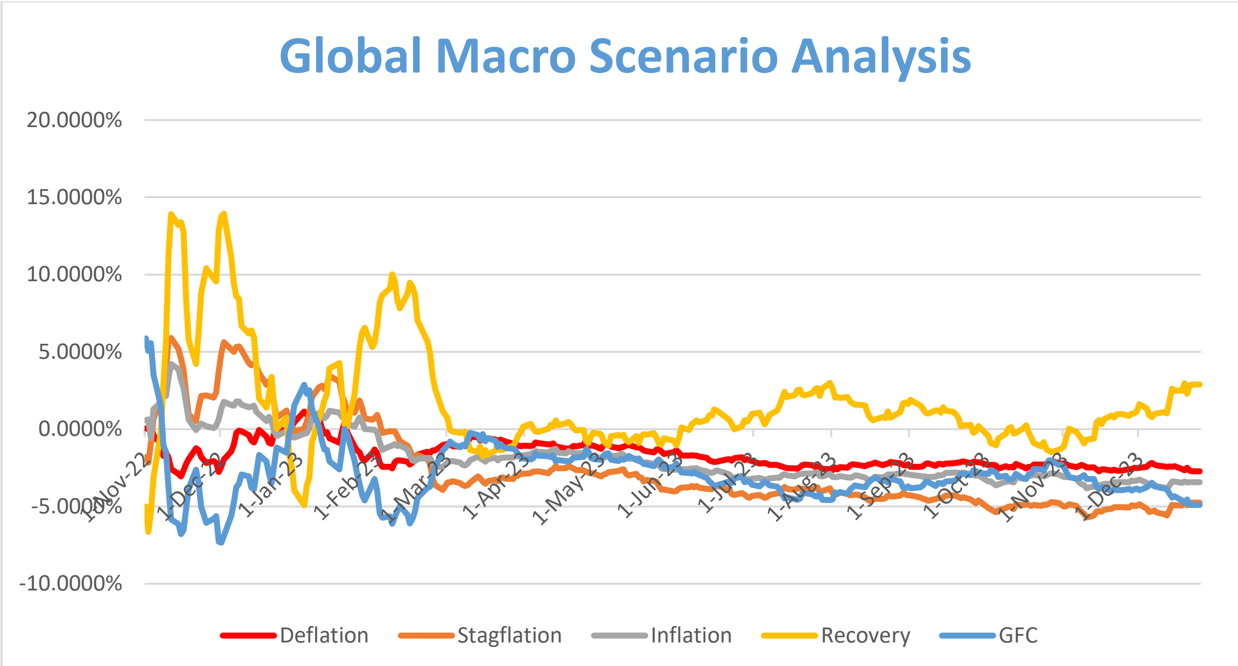
First, an update:

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 – **Neutral,**
Deflation – **Negative,**
Stagflation – **Neutral,**
Recovery – **Positive,**
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 – **Positive,**
Cryptocurrencies – **Neutral.**

Now, to this month's report:

The Fed announced that they are prepared to cut rates in 2024. Hmm, it's an election year and lower rates stimulate the economy and provide liquidity to the financial markets. What timing. But wait, wasn't the Fed's objective to reduce liquidity and maintain high interest rates in an effort to get inflation down to 2%.

There is ample evidence that if the Fed were to keep rates high, the economy would fall into a recession in 2024, which in turn would likely reduce inflation to the Fed's 2% target. But if instead, they reverse course, the economy could strengthen, and stocks could rise. This of course would be a classic "kick the can down the road" maneuver, as inflation would rear its ugly head again 2025.

In this month's report, we'll look at these two scenarios and the likely impact they would have on the financial markets. Using a statistical analysis provided by Orion Risk Intelligence, a portfolio solutions company, we can simulate both of the above scenarios.

I have included 2 attachments: **A Recession Stress Test** and **A Recovery Stress Test**.

In both reports, page 4 provides the details with a description (top left box), an economic and market impact (top right box), and using the statistical calculation called beta, the projected return on each of the 5 ETF asset classes shown at the beginning of our *Consilience Market Notes*.

On page 5 in the recession simulation and pages 5 and 6 in the recovery simulation are some of the best performing ETF markets for each scenario.

No surprise, the results are very different. As no one can tell in advance which of these will play out in 2024, 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.

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.

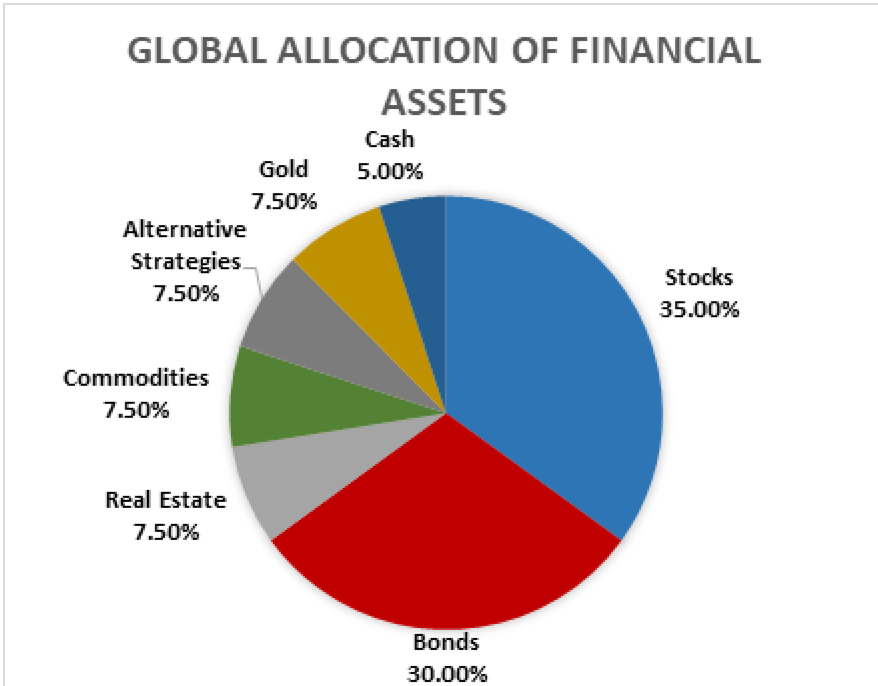
Conclusion: Recognizing that we are in uncharted waters with multiple moving parts, we must admit that there is no way to tell in advance exactly how this will unfold. But in such a transitionary environment, the ability to properly anticipate change is predicated upon a detached analysis of information 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!

Consilience Asset Management
Roger Faulring – Managing Partner/Sr. Portfolio Manager/Investment Strategist
Michelle Malone – President/Investment Advisor
Donna Stone – Managing Partner/Investment Advisor

*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.