Consilience
Asset Management

March 01, 2024

Consilience Market Notes:

A New Bull Market? (Part 2)

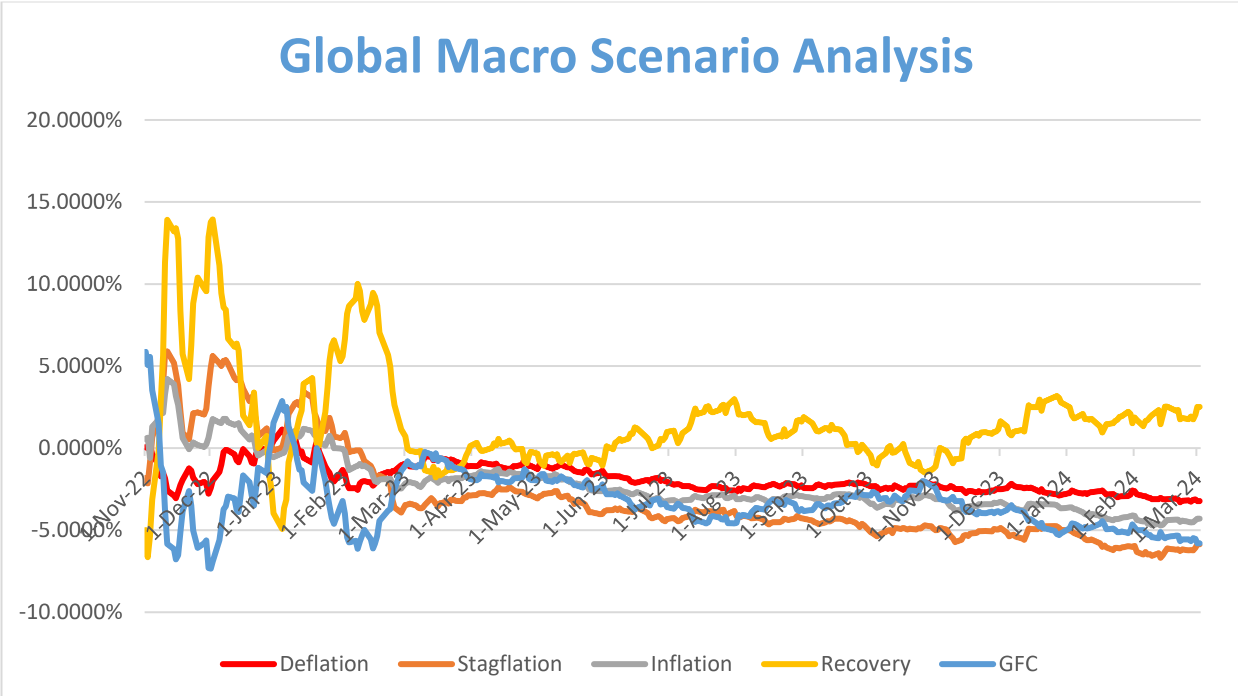
First, an update:

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*

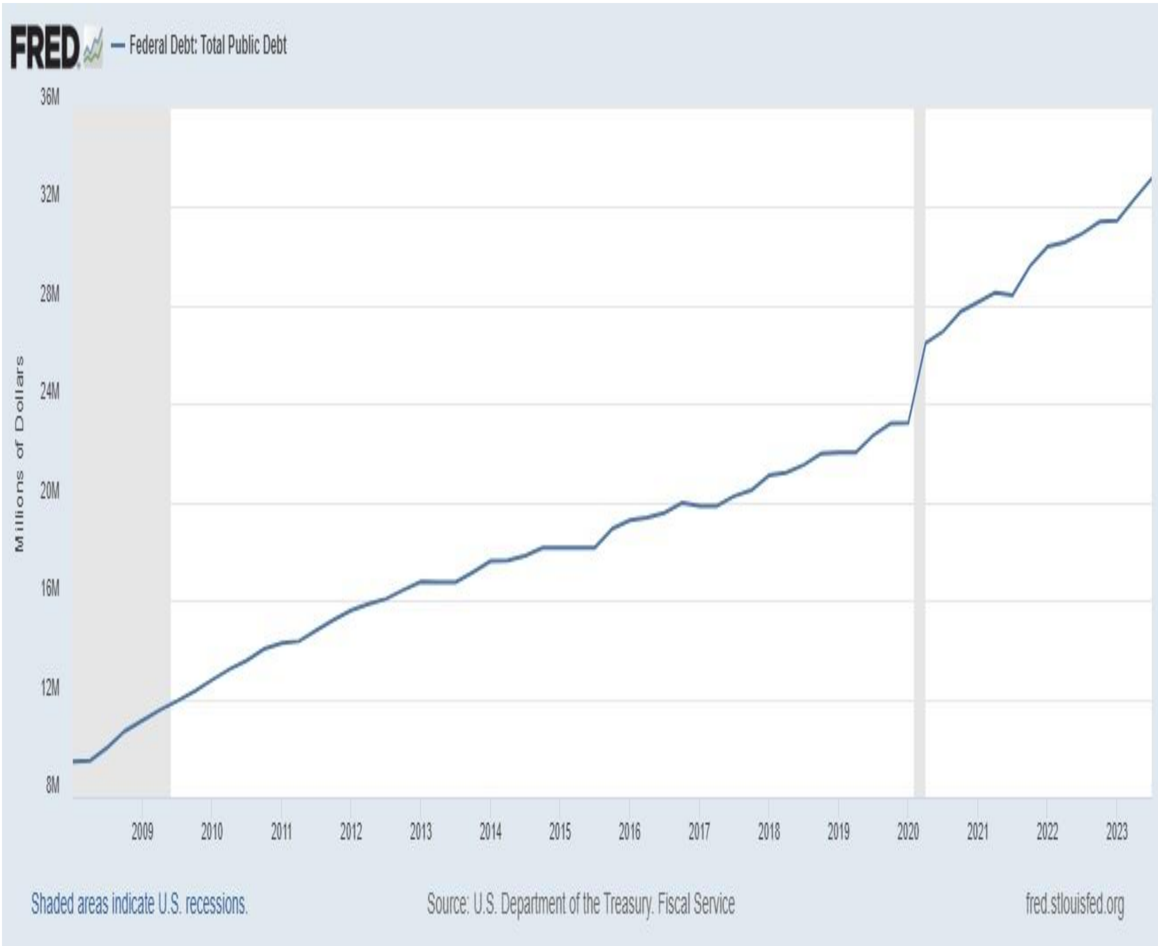
The above scenarios reflect the current *Capital Flow** composite rating of the securities that have historically generated positive returns in the above economic environments.

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

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

Now, to this month's report:

Over the past year, the staggering acceleration in the growth of US debt just hit $34.191 trillion. In just the past three months the US added $1 trillion in new debt!



How will we ever pay back all this debt? There is no easy or painless way this can be done.

If it were you or me, we would immediately reduce spending and pay down our debt.

If the US government attempts to do this, it will result in a significant slowdown in economic growth, possibly a recession or worse.

What do you think the chances are of reducing spending in an election year?

Rather, there is a strong political motivation to engage in a stimulus program of lower interest rates and more money printing. Every administration does this.

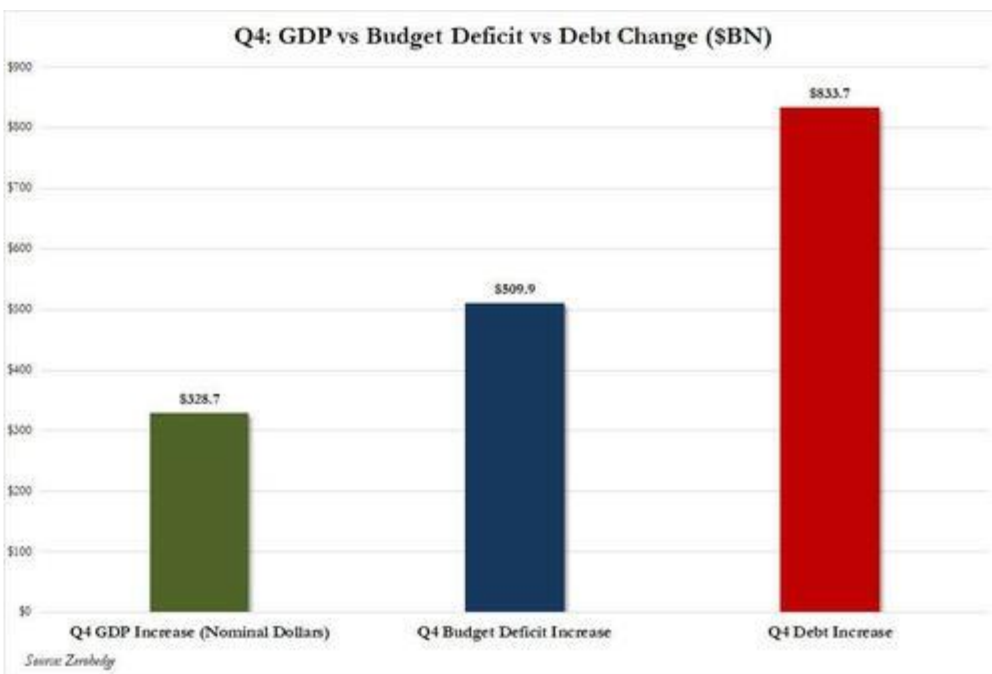
If the Fed's plan is to reduce rates later this year, it is a political strategy and nothing more. It will only result in long-term damage. Such a mix of politics and monetary policy is utterly toxic. And if this year proceeds like it appears to be mapped, we are about to find out just how nefarious this mix is.

But wait… in the fourth quarter US GDP grew at a torrid 3.3% pace, much higher than the consensus estimate of 2.0% and it also came in well above even the highest Wall Street forecast. (source: Federal Reserve and Bank of America)

So, if the economy is experiencing strong economic growth, why the need for new stimulus?

First, let's define what GDP actually is. Contrary to popular belief, GDP is not a measure of economic growth. It is a measure of output.

Whether the GDP growth number was realistic or not is less important than what funded the increase. And it is here that we reveal something shocking: the chart below shows the Q4 change in GDP as well as the corresponding increases in the US budget deficit and the increase in debt.



While Q4 GDP rose by $329 billion to $27.939 trillion, over the same period, the US budget deficit rose by more than 50%, or $510 billion.

The increase in public US debt in the same three-month period was a stunning $834 billion, or 154% more than the increase in GDP.

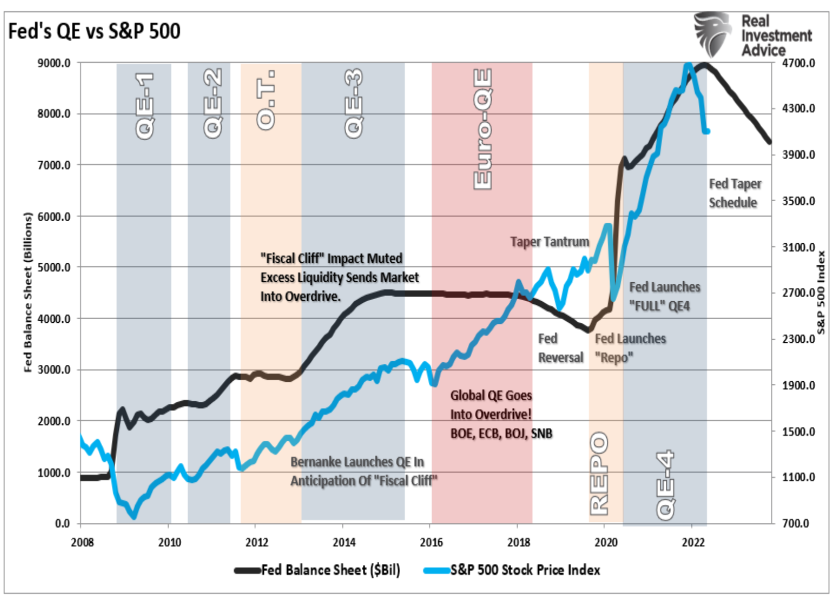
In other words, it took approximately $2.50 in new debt to generate $1 of GDP growth! And yet, this government spending/borrowing is being recorded as productivity and output and interpreted as growth.

Such infusions of cash/debt can make a government look like it is providing greater growth to its economy than it really is, and all too often provide false affirmation of a government's policies.

That's the bad news. The good news, (in the short run at least) is that this increased money creation/debt creates a very fertile environment for the stock market.

Following past crises of the 2000-2003 tech crash, the 2007–2008 banking crisis and the 2020 Covid scare, the Fed engaged in massive stimulus programs, increasing debt and expanding the money supply and the stock market rallied.

Here's a chart I have shown in previous *Consilience Market Notes* to illustrate this point…



Source: Standard and Poor's, St. Louis Fed

Is this what is happening in 2024?

Last week, Fed Governor Christopher Waller quietly dropped quite a bombshell on markets for those who were paying attention when he suggested that the Fed would take steps to lower short-term interest rates. This would be tantamount to engaging in a new round of quantitative easing (QE), the same strategy that drove the markets higher following the crises mentioned above.

This time, it appears to be in response to recent weakness in economic reports which could jeopardize the current administration's reelection hopes in November. This, in spite of the recent misleading stronger than expected GDP report.

As cynical as this sounds, it appears to be driving the markets higher at the expense of the longer-term health of the economy and the stock market.

Why do I say that?

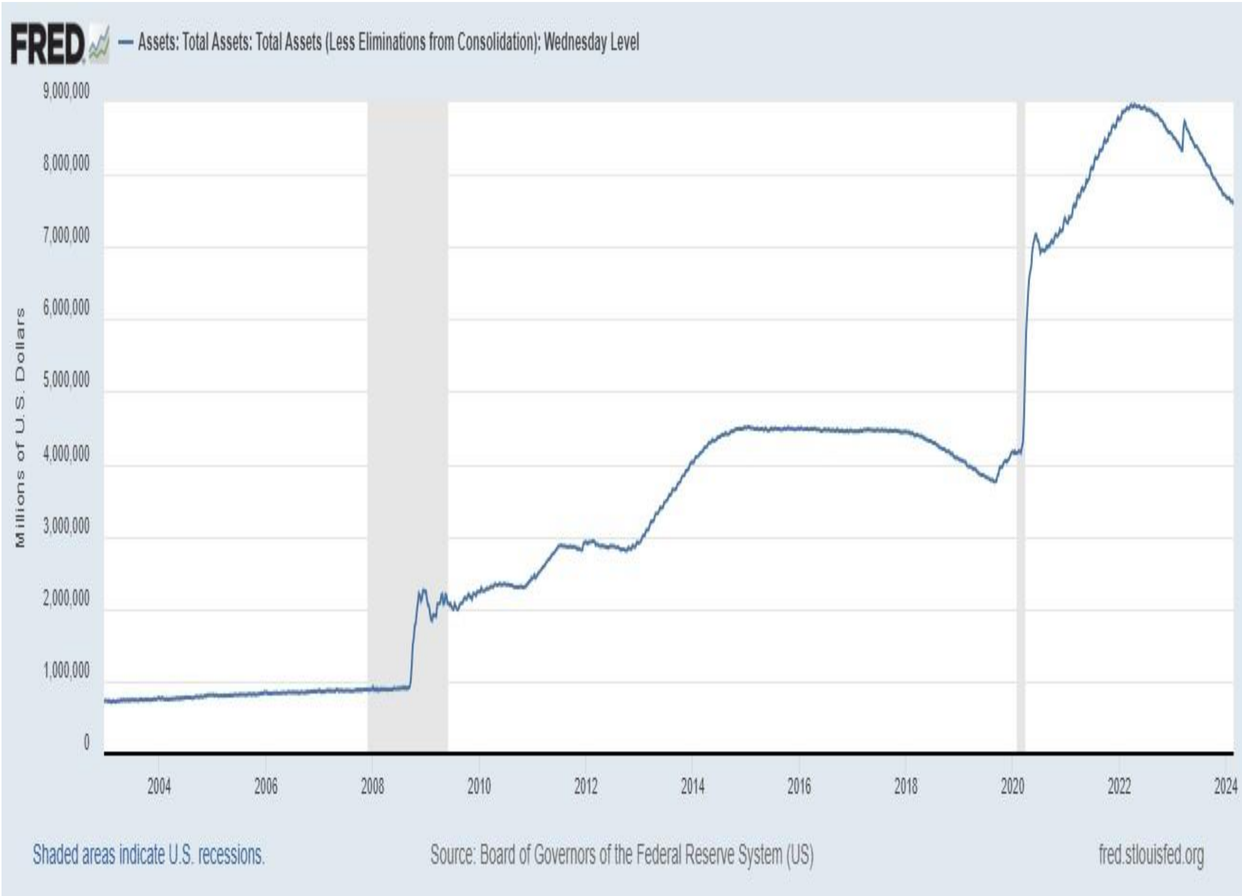
First, it only results in higher deficits and a greater challenge to get our fiscal house in order in the future.

And According to the CBO more than $10 trillion in US government bonds are coming due in 2024. That is more than one-third of US government debt outstanding, and more than one-third of US GDP.

Someone will need to buy/lend this $10 trillion to the U.S. This may be a particular challenge when the biggest holders of US Treasuries, namely foreigners, continue to shrink their share. If there is a shortfall in buyers, it will require even more debt to refinance this debt.

And this, at a time when the St Louis Fed FRED database now admits that total Federal interest payments have surpassed $1 trillion for the first time ever

Here's the Fed balance sheet, the money they created out of thin air and injected into the markets during the past decade...



The second reason for concern is that according to a recent analysis by Bank of America, the S&P 500 is expensive on 20 of the 20 metrics the bank uses based on data going back to 1900.

Based on this, a future bear market would have to fall much further than previous bear markets to bring valuation levels back to reasonable levels.

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.

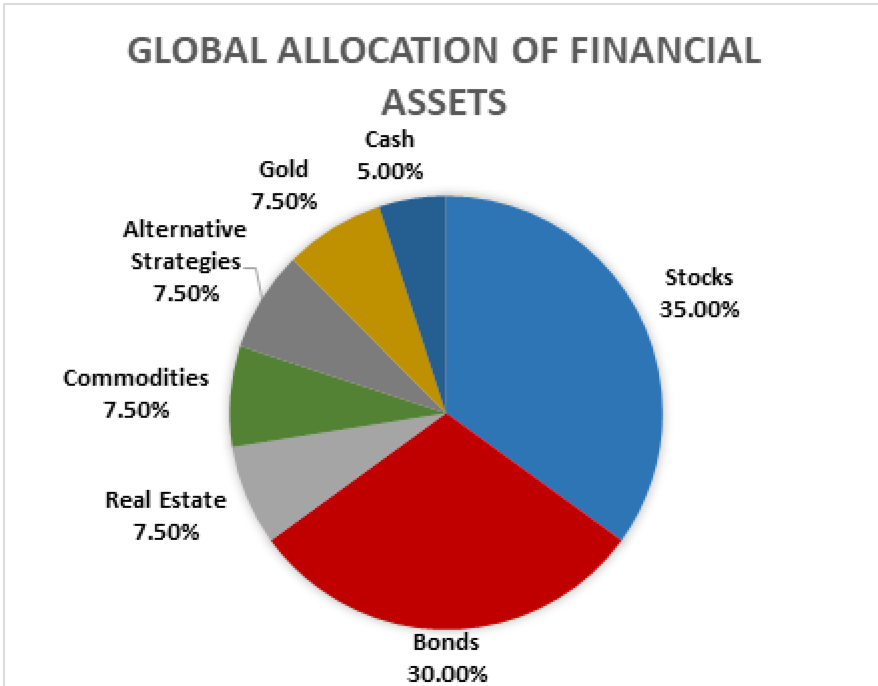
Conclusion: Recognizing that we are in uncharted waters with multiple moving parts, we must admit that there is no way to tell in advance exactly how this will unfold. But in such a transitionary environment, the ability to properly anticipate change is predicated upon a detached analysis of information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

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.