7th January 2024

2024 Scenario Mapping

The Year Ahead

Black Komodo Investments Limited.
Specialist Research Service

SRS Snapshot

Macro

- Top-down macro views backed by bottom-up research
- Understand the Manipulator not the Manipulated
- The interplay between Geopolitics and Macro Policies

Micro*

- Individual Assets and Sectorial Analysis
- Bottom-up research backed fundamental analysis
- Technical Analysis on market dynamics and effects

Positioning*

- Asset allocation breakup
- Macro and Micro effects on current market trends and how that affects your portfolios

* Available through service

SRS AOW

- AOW – Art of War:
  - Our approach to market research, using a synergy between a physics inspired bottom up research process and a psychological lens to understand the market makers
  - Look where others aren't
  - Thinking different so we see what others don't in the same data
  - See through the misdirection and misallocation of the market
  - Understand the manipulators of the market:
    - FED
    - Market Movers

SRS Focus

- FED Pivot
  - To brace or not to brace?
- Recession
- Geopolitics

SRS Focus

- FED Pivot

What is a FED pivot?

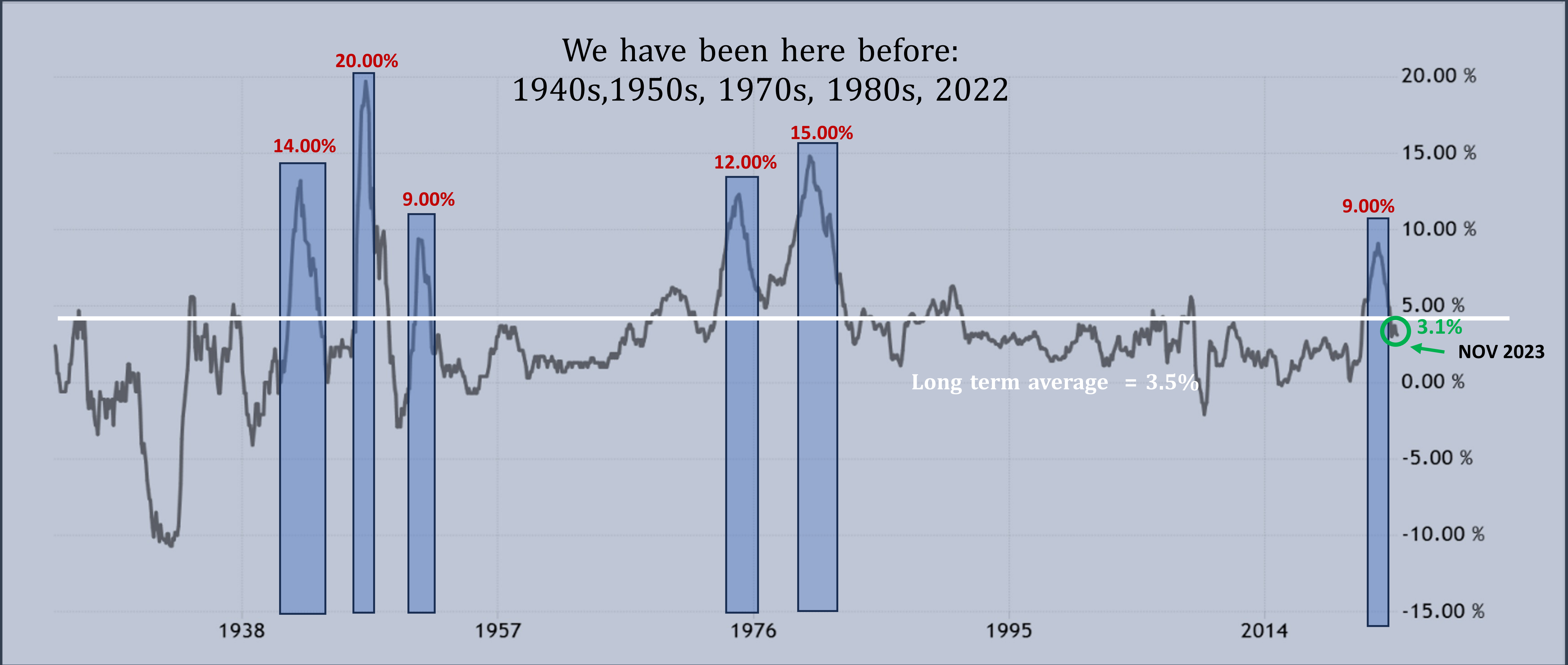
- The FED pivot is when the FED loosens the tightening cycle by reducing the rates which they have hiked.
- Step one is to stop hiking and pause for an extended period of time, which has already happened. The FED has paused for 3 consecutive months.
- Step two is to make the first rate cut and then begin on a cutting cycle.

Will the cuts begin?

- The FED needs to see proof the economy can balance and stabilize itself before beginning the rate cuts.

- The signs for a stabilizing economy in this case is reverting back to "normal" levels for an economy with the events that have preceded are:
  - Inflation close to or below long term average
  - Unemployment stabilizing between 5%-6%
  - Consumer confidence and savings stabilizing

Where are we now?



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What does this mean?

- This means the pauses are warranted responses to test the economy in its ability to self-regulate… it has!
- Its decision time! The FED has to make a decision to begin cutting rates to kickstart the economy and push it into a growth trajectory with lower rates so capital is made easily available to facilitate growth
- This decision will start slow since the economy has proven to be resilient with higher rates and keeping it higher for longer with a light downward push will ease the economy from the recovery cycle to a growth phase.

What do the numbers tell us? – Resilience

- Inflation is at 3.1%
- Unemployment is sticky at 3.7%
- Consumer spending is rising at a gradual and consistent rate
- Wage growth rises by 5.4%, higher than inflation, lifting the consumers out of troubled territory

To Brace or Not to Brace

- The landing gear is out and ready for use. The question is, will it break on impact, or will it be smooth riding?

- A soft landing is in sight, depending on the FED’s moves regarding the interest rate, their timing and magnitude

Scenario Mapping

- Scenario 1: The FED doesn’t cut rates in Q1 and cuts less than expected
  - Rates are left much higher for much longer, this will cause further strain to the economy
  - Suffering firms will suffer even further, there will be distress in the economy
  - Consumers will be tight on consumption
  - This could be detrimental to the economy since it would put undue stress on an economy which has proven to be resilient and self-regulating already
  - This would be a hard landing scenario calling in a recession.

Scenario Mapping

- Scenario 2: The FED cuts rates in Q1 and cuts a minimum of 4 times through the year (100 bps)
  - Rates are brought down gradually, easing the economy back into gear
  - Capital intensive firms will have lower financial stress allowing them to reinvest capital at cheaper levels to continue growing
  - Consumers will consumer more easily as borrowing becomes cheaper
  - This would be beneficial and the desired path for the economy since it alleviate the right amount of stress and allow capital to flow back into the economy at a controlled rate, pushing it up higher
  - This would the preferred soft landing scenario.

Scenario Mapping

- Scenario 3: The FED cuts rates in Q1 and cuts more rates than expected, close to 6 cuts (200+ bps)
  - Rates are brought down rapidly, pushing the economy into rapid growth
  - Firms get a large reduction in financial stress, the distressed environment is completely avoided but lofty valuations are in sight not run by fundamentals
  - Consumption will increase significantly
  - This would would be a runaway scenario since this would push the economy too high too quickly
  - This could lead to a hard landing, bringing the economy into a recessionary environment later in the year due to leveraged growth

SRS Focus

- Recession

Will it happen?

- The first quarter of the year is a confirmatory quarter where valuations are in question, if they can be backed by the financial performance and strengths of the firms and hence the economy as a whole

- If the earnings are strong, demand doesn’t falter and there are no major supply chain disruptions a recession is not in sight

SRS Focus

- Geopolitics

Where are we now?

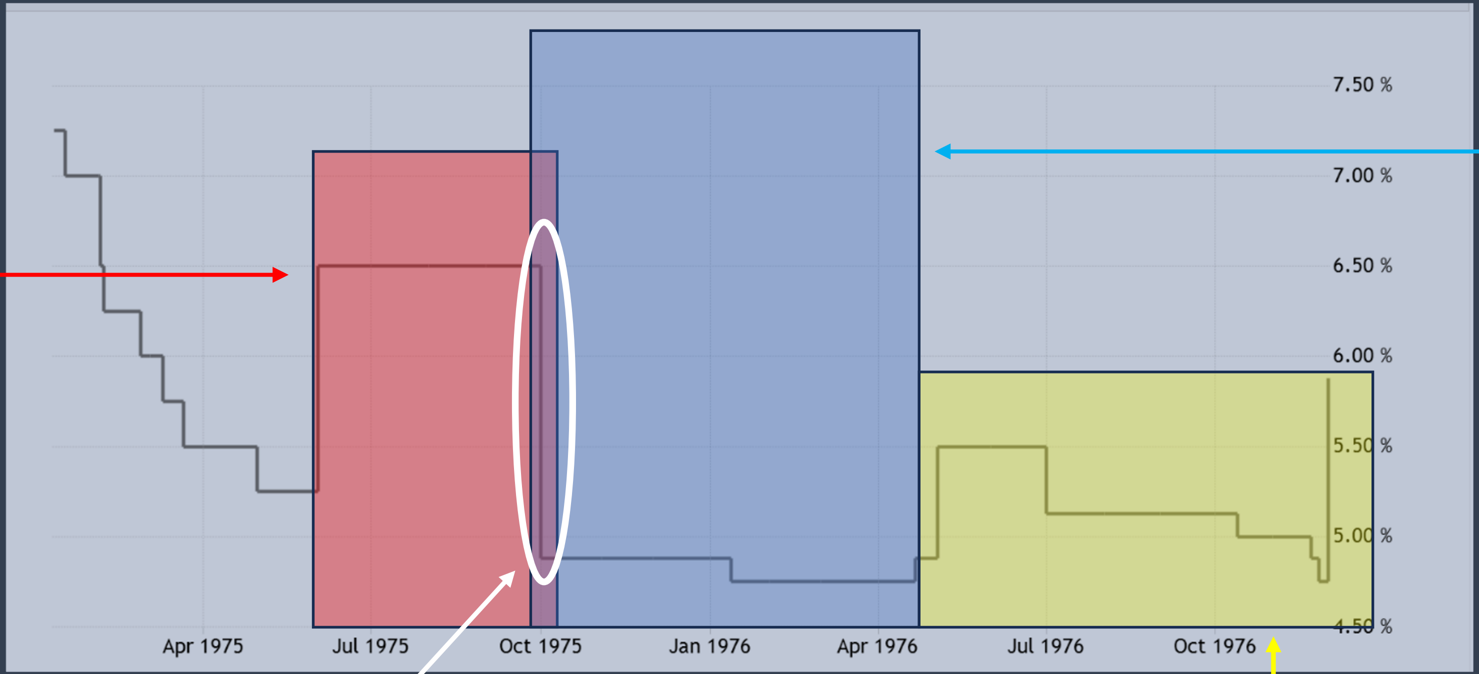
- This is the first-time half of the population will be heading to the ballots to vote
- Depending on the outcomes this could lead to an ambiguous political environment which could have adverse effects on the economy with policy changes
- The wars which started and were brought into last year will continue, however, they will not play a large role globally speaking
- Active international involvement in those wars has diminished, separating them from directly being affected by the conflicts

Consulting History- Cautionary Tales

- 1950s – Post World War, Post Arab-Israeli War, Deflationary Measures and Easing (as you saw in the previous SRS document)
- 1976 – Post-Vietnam War, Deflationary Measures, Lowering Inflation (24.4% to 5.6%)
- 2023-2024 – Wars, High tension, Deflationary Measures Lowering Inflation (9% to 3%)

Fed Funds Cycle

The period of rising FED funds rate between June'75 to October'75. There was a rapid hiking and cutting of rates in this short span of time.



The period of low or falling rate cycle that followed the rapid increase and pausing of rates.

The steep decline in the FED rates

Due to the rapid rise and fall in rates, a more reactive rather than responsive approach to taming inflation and the economy led to further rate hikes through the year and into the year that followed

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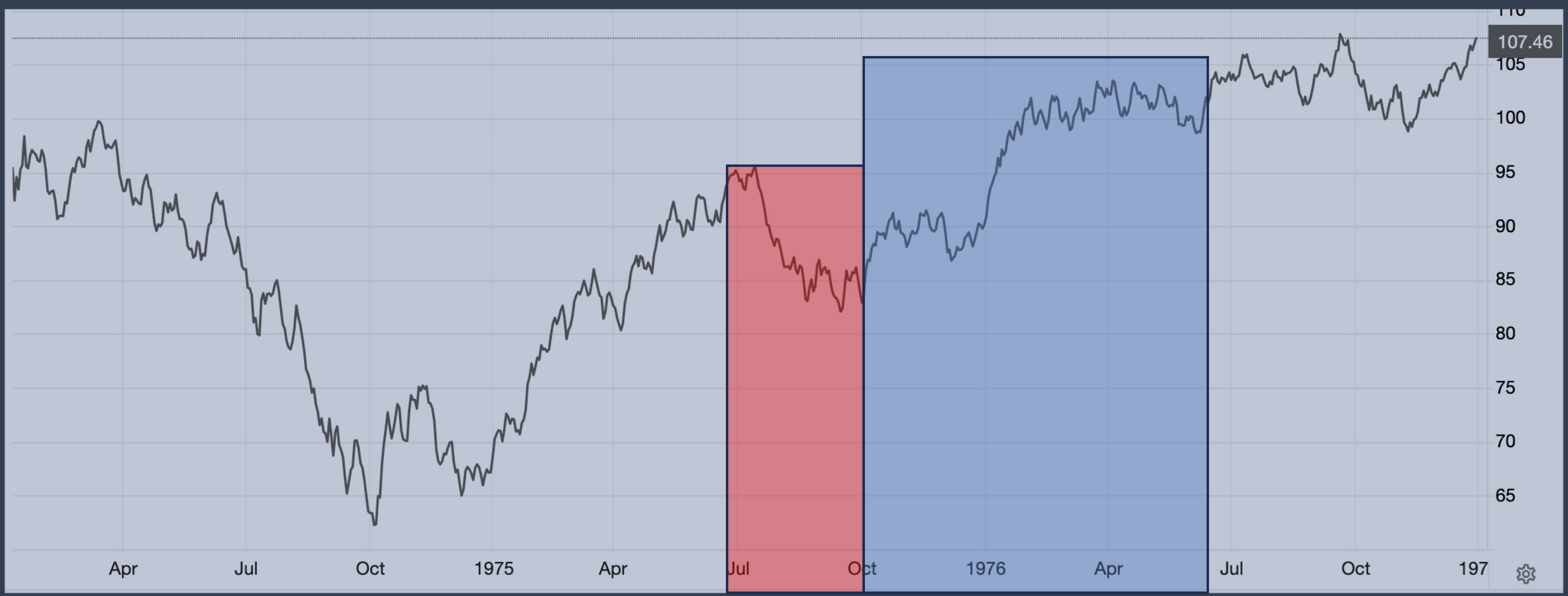
Effects on the market



The rapidly rising fed fund rates during the inflationary environment of the late 1975 market caused the market to fall extensively. The subsequent cutting of the fed fund rates towards the end of the year and into 1976 caused an expansionary effect in the economy and a boost to the market backed by strong earnings and economic data. The volatile movements of the Fed to try and control the inflationary outcome by this knee jerk reaction to it, led to a volatile year going into 1977.

Mistakes made must be avoided

- These are the mistakes the FED must avoid to make when cutting rates and bring them down gradually rather than rapidly.
- The period between 1977-1980 was a hard landing done by controlling the rates, this was however an intentional hard landing.
- This time around with the gradual hikes and the subsequent gradual cuts, the economy can safely avoid a recession and be brought down into a soft landing.

Where do we go from here?

- The environment we have been in over the past year and the one we will be in, in the coming year, the economy has faced before in recent times. The question is will the handling be different ?

- The focus will once again be on earnings growth and increasing unemployment as these will be indicators to show that the economy is resilient and the hiking cycle has come to an end, with a continued downtrend in inflation crossing the long-term average.

- Over the past 11 inflationary crises episodes, seven have been softer rough and one has been soft. The rest have been intentionally hard. This episode can and looks to be another which can be added to the list of soft landings.

For Any Inquiries
please direct them to the email below

srs@blackkomodoinvestments.com