Komodo SRS

9th January 2025

2025 Scenario Mapping

The Year Ahead

Black Komodo Investments FZE
Specialist Research Service

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SRS Snapshot

Macro	Micro*	Positioning*
• Top-down macro views backed by bottom-up research • Understand the Manipulator not the Manipulated • The interplay between Geopolitics and Macro Policies	• Individual Assets and Sectorial Analysis • Bottom-up research backed fundamental analysis • Technical Analysis on market dynamics and effects	• Asset allocation breakup • Macro and Micro effects on current market trends and how that affects your portfolios

* Available through our subscription service

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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

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SRS Focus

- USA:
  - Fed Pause
    - To brace or not to brace?
  - Inflation
    - Will it reverse?
  - Geopolitics

- India

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SRS Focus

USA

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SRS Focus

- Fed Pause

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What is a Fed pause?

- The Fed pause is when the Fed ends its loosening cycle and pauses the rate cuts, there are several reasons and milestones the economy must see before the Fed begins this process.
- The milestones are inflation reaching a sustainable stagnant level, unemployment staying stable around its long term average and the economy growing at a rate acceptable to the Fed.
- The Fed must pause the cutting cycle in order to minimize the risk of an inflationary spike, however, the pause itself could cause inflation to spike and create what we call runaway inflation.

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Will the pause happen?

- The Fed needs to gauge if the economy can run on its own and at what levels will the economy be running sustainably enough in order for the Fed to reduce its manipulation of rates.

- The economy has particular inflation and interest rate criteria by which it can maintain its growth level without the detrimental effects to the firms and people within the economy, these are the following:
  - Inflation at 2%-3%
  - Interest rates at 3%-4%

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Broad Overview

- Higher growth with high rates and controlled inflation is how we see the year playing out since we see demand and earnings growth improving as production grows and consumption stays consistent and firms improve in efficiency
- We have two major concerns and see them playing a large part in setting the stage for the year ahead:
  - Tariffs
    - Trade policies which will directly impact global production and supply chains and the severity will have a direct impact on inflation
  - Inflation reversal
    - Inflation is at a controllable and sustainable level, however monetary policy changes can cause inflation to spike leading to a reversal in policies affecting capital flows globally and within the economy as well

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Where are we now?

We have been here before:
1940s,1950s, 1970s, 1980s, 2022

14.00%
20.00%
9.00%
12.00%
15.00%
9.00%
2.7%
NOV 2024
Long term average = 3.5%

18
12
6
0
-6
-12

1930 1940 1950 1960 1970 1980 1990 2000 2010 2020

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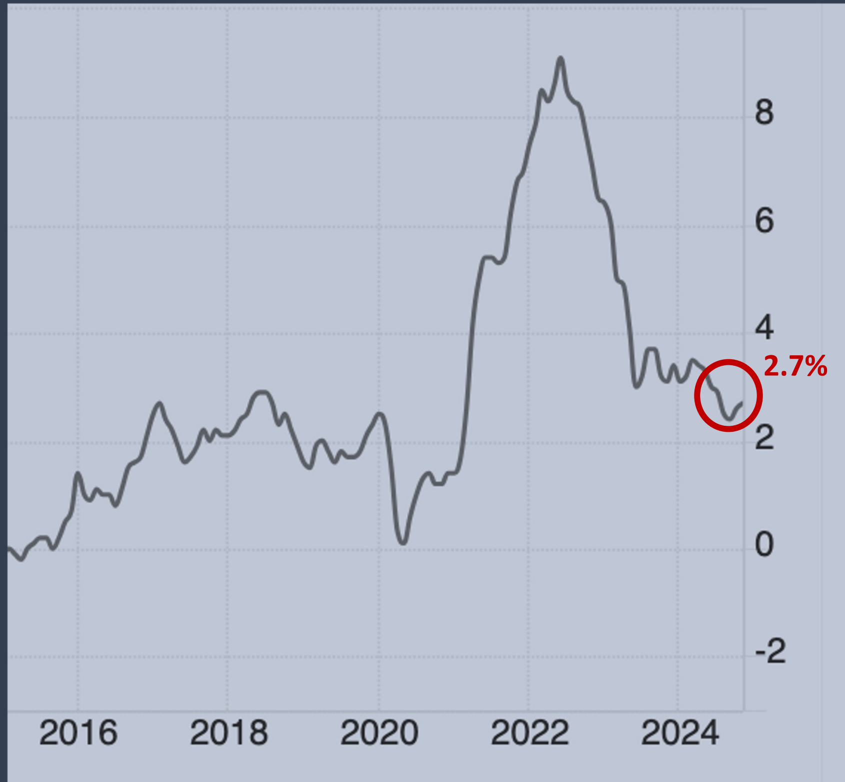
Where are we now?



One of our greatest concerns for 2025 and beyond is an inflationary spike, which could lead to a significant shift in the monetary policy where it goes from a loosening policy to a pause, back to a tightening policy.

This could not only derail the economy from its growth trajectory, but it could additionally impact consumption and production cycles negatively as rates will remain higher and may revert to higher levels, putting monetary pressure on individuals as well as corporations

This has happened before and it is up to the Fed to tame inflation and adjust their monetary policies accordingly, a policy error at this stage could be detrimental. The first half of 2025 will be riddled with VUCA which will make the markets a very tough terrain to navigate.

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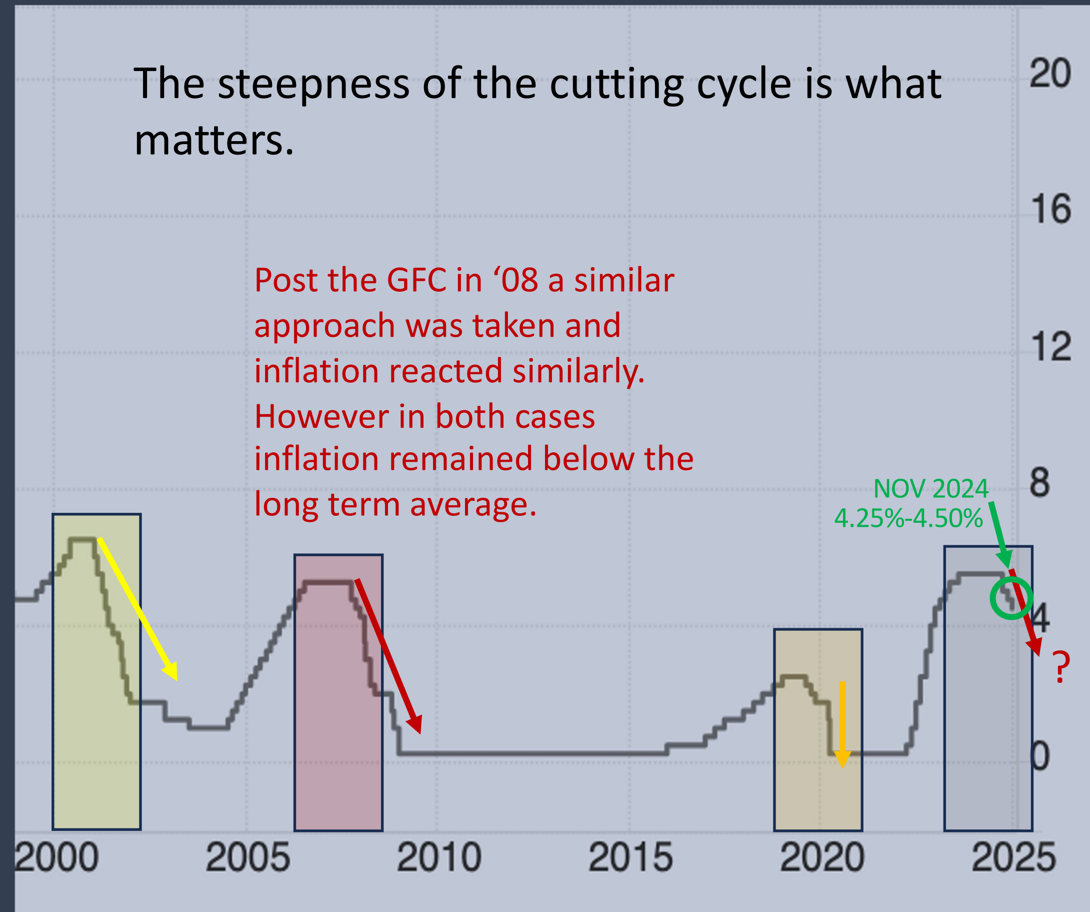
Fed Funds Cycle

Post the dot-com bubble, the Fed cut rates gradually to allow capital to gradually enter the economy, post the pause. Due to the economic conditions in ‘02,’03 and ’04 as asset price deflated rapidly post the crash and capital was removed from the market, inflation fell rapidly and bottomed out post the pause and proceeded to rise back up as the Fed gradually eased their rates.



In 2021 the rate cutting cycle was abrupt and rapid due to the pandemic disrupting supply chains globally causing inflation to spike immensely.

It remains to be seen how the Fed plans to tackle inflation through their monetary policy in 2025 and beyond, bringing rates closer to a more sustainable level of around 3%, with a pause or a more gradual approach. The Fed needs to avoid the mistake of pausing/cutting rates too aggressively or too softly in order to balance the production growth as well as consumption in the economy.

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What does this mean?

- This means we are currently at a point in the economic cycle where inflation is stabilizing, however rising slightly as the reduction in rates has let some capital back into the economy which has caused a slight rise in inflation.

- The Fed has a very important decision to make where it needs to be able to manage the inflationary rise and the financial pressure of the rates on corporates and people alike. It is a fine line for the Fed to walk across.

- We are at a stable yet fragile moment in economic history which needs very gentle care to be able to continue in a sustainable manner.

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What do the numbers tell us? – Fulcrum

- Inflation is at 2.7% which the Fed is still working on to bring down closer to the 2% level and keep it there while reducing their rate manipulation to reach an equilibrium between rates, inflation as well as economic growth in the nation (currently well above estimates at 2.8% growth)
- Unemployment is sticky at 4.1% and stabilizing as job openings are back to rising which job applications are increasing as well, pushing down on the unemployment numbers, keeping them around their long term average
- Rates have been brought down to 4.25%-4.50%, which need to lower to around the mid 3% range to be sustainable
- Consumer spending is stagnant and gradually plateauing as rates are taking their toll but in a slightly elevated plateau as inflation has significantly fallen as well as rates, allowing people to consume less restrictively
- Wage growth for 2024 has been at 5.6% which is higher than inflation and has slightly come down to 4.3%, still higher than inflation, allowing people to have a higher disposable income, once again helping keep the barrier for consumption open

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To Brace or Not to Brace

- The soft landing has taken place, the question is, is the runway leading to a cliff or has it landed on the right track heading to its hangar?
- The Fed pause is inevitable, when and how hard the brakes are applied is what's in focus now!
- Another indicator to keep an eye on is the credit card debt and consumption, as rates remain at higher levels, this could lead to higher number of delinquencies and defaults which could begin a problematic cycle for the nation regarding demand side growth as consumption begins to trail off

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Scenario Mapping

- Scenario 1: The Fed stays on their cutting cycle at 25bps per month
  - Rates are brought down aggressively from 4.25%-4.50% to the 4.0%-4.25% by the first quarter and then around the 3.75%-4.00% by the second quarter and then paused.
  - This would lead to an intense impulse of capital being injected into the economy, which will cause a sudden spike in inflation.
  - This inflationary spike would lead to a reduction in consumption, which will reduce demand and hence effect supply and production of goods and services, leading to a slow down in growth and throwing the economy off its growth trajectory and into a downward spiral.
  - Additionally the spike in inflation would cause a need to hike rates once again leading to a forced delayed recessionary environment due to leveraged growth, bursting so called inflated bubbles and stalling growth as we have seen before, in ‘08, ‘00, ‘75, ‘76 and other recessionary years.

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Scenario Mapping

- Scenario 2: The Fed reduces the magnitude of the cuts but keeps them every month, pausing when necessary
  - Rates are brought down gradually every month and the economy is tested through small injections of capital as the financial strain on corporations and individuals alike reduces and borrowing is made easier.
  - The inflationary reaction will be tested and needed to be seen, the range of inflationary growth will have to be managed between 2%-3% and maintained at those levels.
  - Firms and individuals will be able to adjust to the new capital environment easier, gradually adjusting their borrowing and spending cycles, allowing room for growth as demand gradually rises with consumption and production grows to fill the gap.
  - This is the preferred scenario, to bring rates down from their level of 4.25%-4.50% to the mid 3% range over the course of the year gradually while keeping a watch on inflation and other parameters such as unemployment.

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Scenario Mapping

- Scenario 3: The Fed pauses and makes intermittent cuts, every couple of months or once a quarter
  - Rates are brought down gradually, allowing capital to slowly seep into the economy and giving the economy time to adjust, keeping inflation controlled within an acceptable range.
  - The markets will react erratically as they digest the pauses and how they coincide with previous rate pauses made by the Fed. Algorithms that make up a large part of the market may spark panic sales, leading to spiking of the volatility in the market
  - However this will lead to more opportunity for the prudent investor looking out for the long term as markets digest the changes and react accordingly over time, based on the growth of earnings over the course of the year.
  - This along with the second scenario are the two preferred scenarios to bring rates down gradually while keeping inflation from spiking uncontrollably.

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SRS Focus

- Inflation

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Will it reverse?

- The first quarter as always is one which sets the tone for the year ahead. Inflation reached the lows of 2.4% in October of 2024 and then proceeded to rise to the current levels of 2.7%.
- Oil being suppressed at the lowest levels it has been over the past 3 years has helped keep inflation levels lower, however, with oil potentially spiking to the higher end of its range bound level and the aggressive start to the cutting cycle and consumption continuing at a healthy pace in the US inflation could spike upwards again, leading to a dangerous change in the monetary policy.
- However, if earnings reports are able to show positive growth, wage growth rising higher, unemployment remaining stable and inflation remaining within the low 2%-3% range, the Fed will have to adjust its target as the economy to remain healthy at this size may need a higher stable inflationary range and not the 2% quoted by the Fed.

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SRS Focus

- Geopolitics

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Where are we now?

- The elections have ended and for the most part the changes in government or the chosen leaders have been the same or positive for the countries
- The new President of the free world comes with his pros as well as his problematic points which are yet to be addressed. Yes there will be an improvement in business environments in the US with improved efficiency as well as clear direction for corporations over the next 4 years, however regarding the supply side and global collaborations the greatest concern would ofcourse be the tariff and trade positions he is willing to take, which could disrupt global supply and demand cycles and create a trade war similar to 2018, which would also be inflationarily concerning.
- The global wars that were started two years ago will be brought into this year once again, however, with the change in Presidency of the free world and their geopolitical position could end the wars, if not at least put a pause on them potentially.
- India and China continue to fight for the EM bucket exposure in terms of an investment allocation as well as the ambiguity around China's resurgence which we see playing a major part in 2026 and how that affects India's position in terms of being a manufacturing hub that it had started positioning itself for and how that affects its new growth trajectory.

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Consulting History- Cautionary Tales

- 2018 - Trump Trade Wars began with China leading to intense battle of tariffs which slowed down trade globally, with President Trump back on the helm, there could be a similar situation arising.

- The tariffs are the major concerning point of the new presidency which could affect global trade and lead to an unideal economic situation as the monetary policy would have to shift as it did before to help manage the other economic indicators causing potentially lower earnings growth and barriers for impacting the production cycle leading to potentially lower growth for the nation.

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Where do we go from here?

- The Fed decisions and managing rate cut expectations will be center stage once again until inflation is stable around an acceptable range and the rates have come down to a sustainable level.
- Earnings reports and other economic data prints will be kept an eye on. Strong earnings reports will give important insight into the coming data prints and how they will effect the growth of the country. We see earnings through to Q2 being positive as consumption will be stable and slightly elevated but finding an equilibrium and plateauing close to the second half of the year.
- We see the innovation cycle still persisting and further bolstering the strong growth of the markets as well as the economy as the margin expansions of business from the use of new technology and AI are taken into account when re-evaluating firms.
- However, we see tariffs and trade environments being affected heavily by policy changes of the new regime, which depending on how tough they are or what agreements are reached between the two major parties could be detrimental to the economy and markets as a whole, impacting both supply and demand for major technological production or help boost the growth of the nation and reduce reliance on problematic economies and strengthen relations with new nations.

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Where do we go from here?

- If tariffs are re-evaluated and narrowed to a specific range of goods, there will be minimum impact on the supply chain and production cycle of the economy, hence a minimum inflationary impact.

- If the Fed cuts rates by 50bps for the first half, bringing rates lower gradually while tariffs aren't as excessive as expected we don't see inflation reversing course above the long term average rather staying within the acceptable range.

- If earnings reports are strong, production efficiencies improve and demand doesn't falter, with consumption remaining robust, we see short term stress in the market and a more volatile year but we see the market improving and the economy as well as the markets continuing on their growth trajectories.

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INDIA

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SRS Focus

- Froth or Coffee?

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Where are we now?

- India is in a tricky spot, where inflation is stagnant over 5%, hence rates are sticky at their high levels of over 6%. Both of these factors are adding financial pressures on firms as well as individuals alike.
- Consumption in the country has reduced, for example with automobile purchases down significantly as well as other sectors being impacted negatively, hence demand has fallen, causing EPS growth of firms to drop, therefore production falling causing a slowdown in the growth of the nation as well.
- RBI has re-evaluated the growth of the nation from over 8% to the low 6%, which is a significant reduction.
- All these factors play a part in the country being viewed as overvalued and frothy since the fundamental metrics and financials do not live up to the enthusiastic hype built around the country. However, there are specific pockets in the country that we see will carry the country forward and have been a backbone of production for the nation, where the coffee is truly visible beyond the froth.

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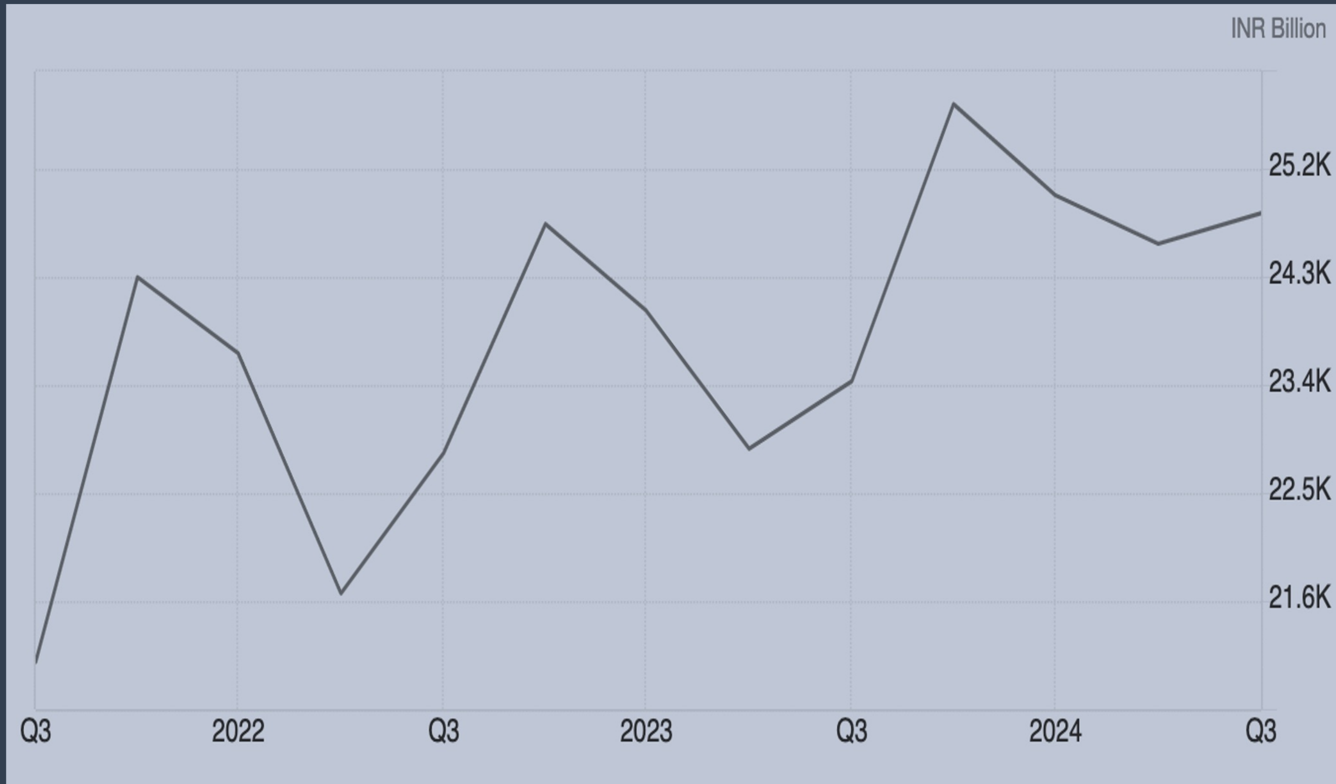
Where are we now?



India is a consumption fueled nation and as both rates and inflation play a part in adding financial stress to the economy, to both individuals and corporations, growth has reduced subsequently.

General consumption in India has dropped leading to lower demand, hence lower EPS growth for firms and a lower revision in growth estimates for the nation.

However, we do see a repeating cycle for consumption in the nation, therefore as inflation is managed and the rates are managed by the RBI we see a pick up in consumption and hence growth over the coming quarters.

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Where do we go from here?

- India as a country will have a short/medium term slowdown both in consumption and production due to the capital pressures on the individuals regarding the high rates they are required to pay as well as the firms that have to pay high rates on their corporate loans.
- Since competition from China is rising once again and EPS numbers for firms are already dropping, the market will also face short/medium term struggle to fundamentally and financially prove the already very high levels of multiples that the firms are trading at on the market.
- We see this as being a wait and watch moment for India as the earnings reports and budget announcement should help provide better insights into the economic health of the country as well as firms within it. Once the budget as well as monetary policy changes take place to correct the policy error done late in 2024, we see there being improved capital flows to India as room to grow remains significant in India over the long run post these medium term demand and supply side bumps.
- However India clearly holds the dominating position in certain industries that push growth for the country and always have which we see as staying the same and growing even greater over the year.

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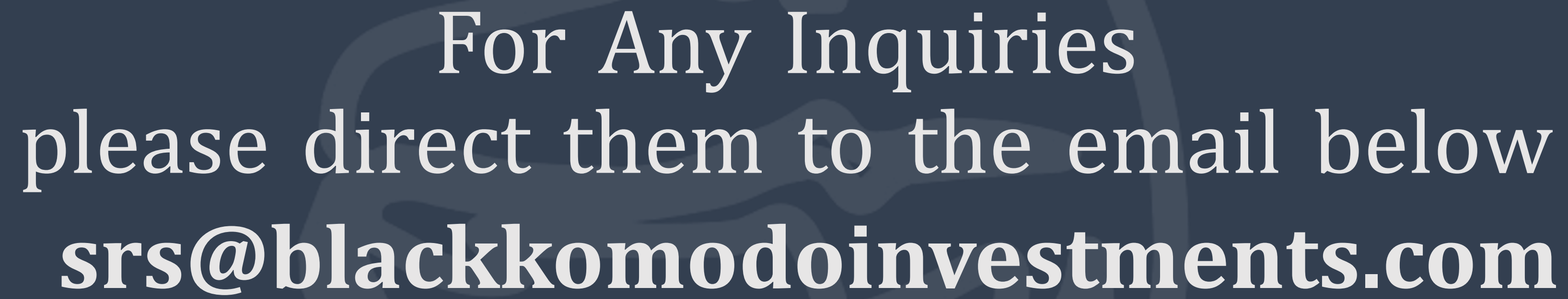

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