4th June 2024

2024 Scenario Mapping 2

The Year Ahead

Black Komodo Investments Limited.
Specialist Research Service

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 subscription

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

- Update on Year and Overview
  - Inflationary and policy outlook
  - Recession outlook
  - Geopolitical outlook
- Market Movers
  - New Industrial Revolution
  - Everything isn’t cancer!

SRS Focus

- Update on Year and Overview

What has happened so far?

- **Inflation:** Inflation has stagnated and moved down towards 3.0% after the FED paused and maintained its pause for the first half of the year.

- **Recession:** The recessionary scenario that was previously touted by various economists and world leaders has long passed and we are no longer in danger of a recession, since earnings reports have proven the resilience of firms and the reason behind the recession like behavior in the economy is not due to distress rather advancing change within the economy. The new development and advancement in technology has caused the similar response in labor markets as one would get during a crisis.

What has happened so far?

- **Geopolitics:** The Ukraine-Russia war is still ongoing. US-China tensions arise once again, with increased tariffs on AI chips and technology. Tensions in the middle-east stay constant and on going with potential for cease fires arising and dousing just as quick.

- **The market:** The market has continuously created new all time highs, far surpassing its previous all time high. This is due to the consistent strong earnings reports as well as the continued innovation within firms for new products and services as well as their ability to adapt with the new times. However, those who fail to adapt are wiped out with massive haircuts in their valuations.

Where are we now?

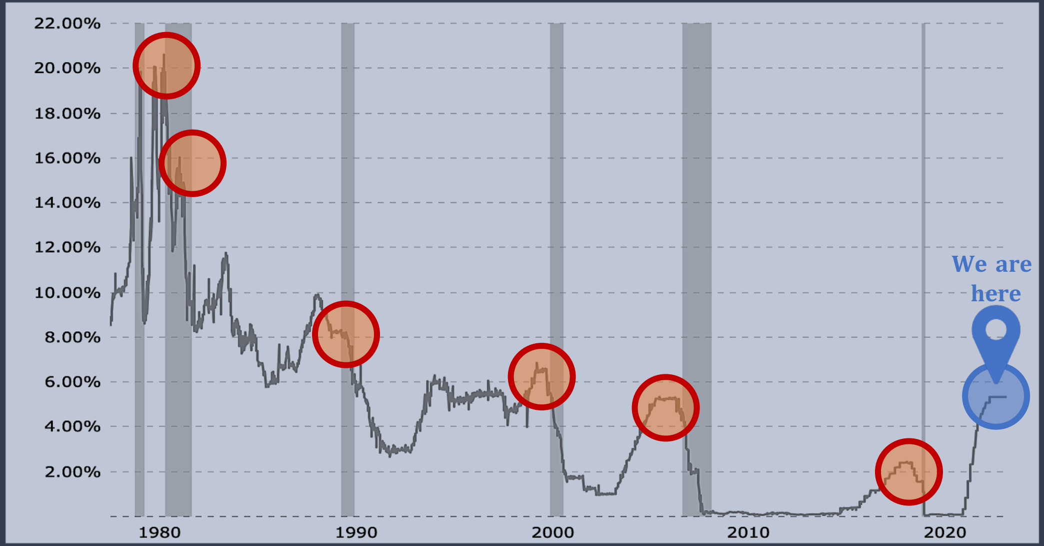
- We are currently at a tipping point. The FED has not cut any rates so far and has maintained they will need to watch inflation in order to make their cutting decisions. However the economy seems to be at a point where higher rates may be detrimental if held for too long.

- This economic landscape has eaten through pandemic level savings and longer rates could be a cause of concern as savings levels reduce, personal loans and credit payments increase with the higher rate environment, which could cause a strain on the consumption and hence demand of the public.

- Earnings still prove to beat expectations as the consumers continue to be resilient against this environment, pushing against the tightness of the economy.

- The markets have broken free from the bearish hold and have entered a bullish landscape, looking for a supporting leg to make the bull market stand firm into the second half and onwards.

Where are we now?



Recessionary led Fed Funds Rate cuts

Historically, the FED has only cut the rates when there has been a recession, leading to a pull back in the markets, not due to the rate cuts but rather due to the recessionary period of time. This can be seen in 2020, 2008, 2000 and 1987. This is because the economy was not able to handle the stress of the higher rates and required a stimulus to regain strength. We are currently in one of the longest pauses in history.

Inflationary Rises during recessionary environments

Historically inflation has been very tricky to manage and taming it has proved to be a task usually resulting in recessionary environments, leading to a major pullback in the economy and disrupting production and curbing consumption. We are currently at a range bound period for inflation, with it being brought down to more manageable levels within a year after the peak.

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Where are we going? – Scenario Mapping

- If the FED continues to pause, this could cause a strain in the economy as consumers begin to pull back due to the rising costs and hence this would hurt the firms, which would then have over production of goods and services leading to missed earnings and reduced profitability, creating a further strain within the economy.

- Scenario 2 of the last update was the one we have witnessed so far and the economy has done well to prove during this litmus test that is can adjust itself and keep inflation on a cooling path downwards towards 2%, however, with a cut, this will mean allowing the tap to flow more freely, which could cause inflation to run hotter than expected, once again causing strain on the government to curb it with a hike, leading to further panic from the public.

- This is the tipping point and the FED must find the sweet spot between keeping the rates high and continuing down this path, since the method is clearly working to keep inflation in check and between pivoting to cutting rates, allowing the economy some more breathing room and re-introducing capital flow into the market.

Where are we going? – Scenario Mapping

- We are leaning towards the scenario where the FED maintains the pause in their hiking/cutting cycle to watch the economy and inflation react to an additional paused month and at the point of inflection, where inflation drops below 3.2% and consumption falls/pauses near 0% growth to begin cutting, reigniting the economy.
- This is akin to letting the plane stall and just as its about to stop completely, switch it back on and level it out.
- We believe this is likely to happen in the second half of the year since earnings are still strong, however some firms in the periphery are seeing their revenue guidance's drop, ever so slightly which could be an indication of a slump in consumption.
- As long as this is paired with a slump in inflation towards the FED target the next 1-3 months (or within the 3rd Quarter) we should see a rate cut.
- Once the cuts begin, this increase in capital and easing borrowing environment will ease the strain on firms as well as the public alike, bringing consumption back and keeping production fueled with cheap capital.

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- Market Movers

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New Industrial Revolution

- The emergence of new technology and the adoption and hence, improvement in efficiency across the board due to this technology is the evidence of a true industrial revolution.
- This changes the landscape of operation for various firms and hence creates an opportunity to create leaner firms, causing a bout of unemployment, leading to higher unemployment numbers.
- This is a double edged sword as it helps in strengthening the bottom line while improving the top line, however, creates concern for the economy.

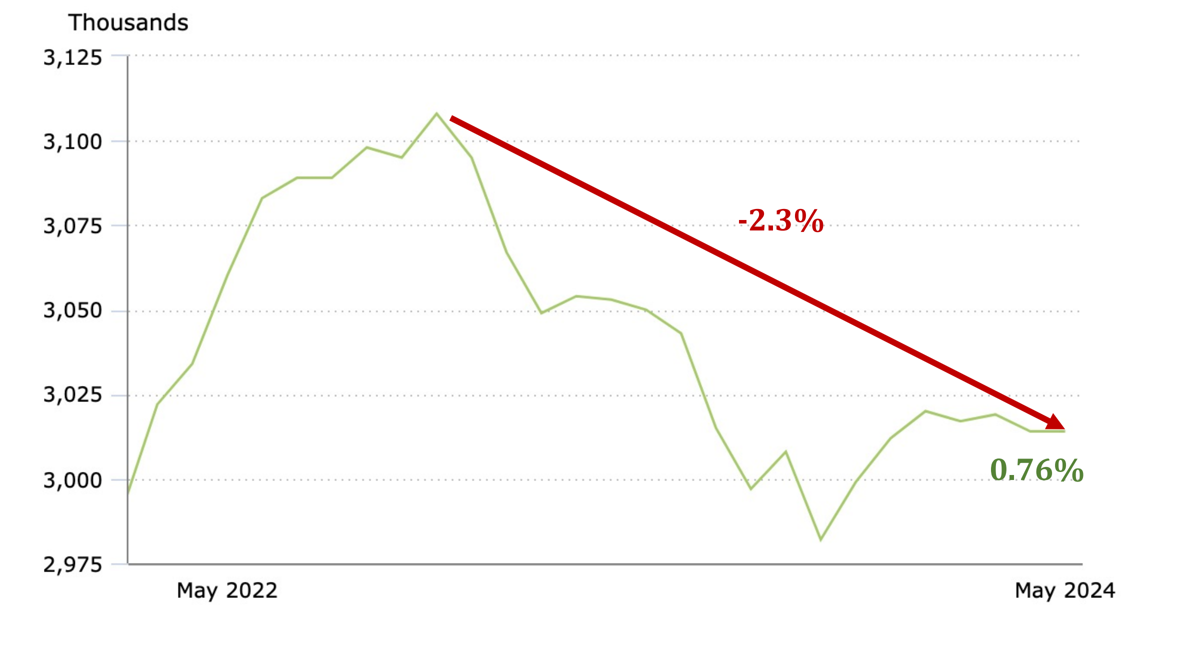
Reallocation of Resources

- An economy is made up of resources and the demand and supply of these resources dictate their allocation.
- Industries are made around those that are required by the economy in those specific periods of time. In other words those in demand by the system not those by the people in the economy.
- When an economy is in their first stage of development they are in need of skills to set up a governing body, to bring order to the chaos. When the economy evolves, usually through an industrial revolution, this reallocates resources in avenues required to further development usually corresponding with the stages of development of the economy. We have reached a point of reallocation.

Reallocation of Resources

- In a more normal environment this would be concerning, however this is the point where the economy requires higher unemployment to normalize to more sustainable levels in terms of interest rates and inflation.
- Additionally it allows the economy to reallocate the resources, including people to areas in need with skills being reappropriated and more focus on other sectors of the economy.
- We have reached a point of innovation in previously heavy employment industries and a saturation of jobs in the same, with a reallocation required for the economy to evolve. Higher unemployment in those areas will allow for talent to adapt and move to areas in need of employment, which hare in a shortage of employees.
- This would allow for lower rates, easing pressures on the various personal and professional loans, reducing loan delinquency rates as well as boosting production with cheaper capital allowing for improved innovation and increased employment in areas of need.

Reallocation of Resources

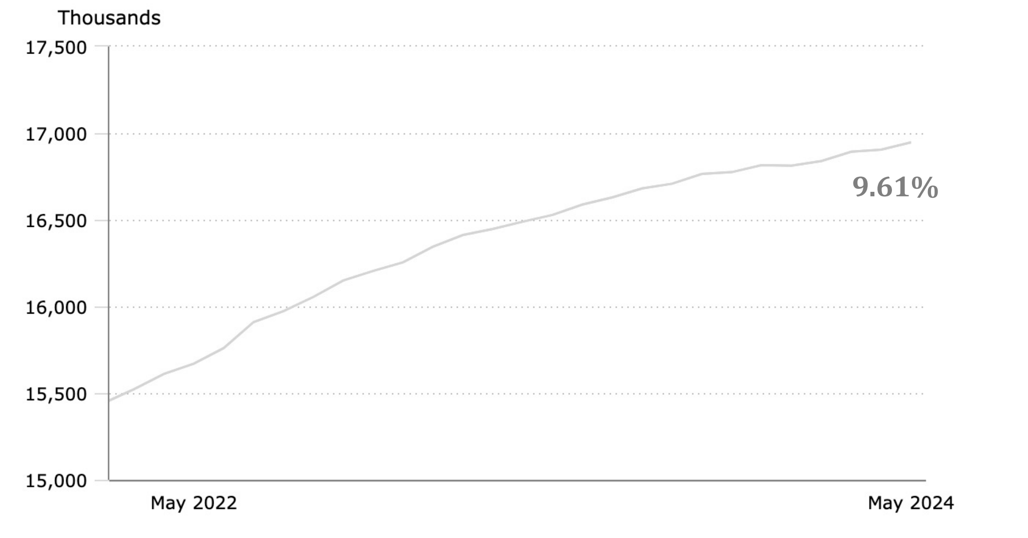


Source: U.S Bureau of Labor Statistics

Information Services Job Data May 2022-2024

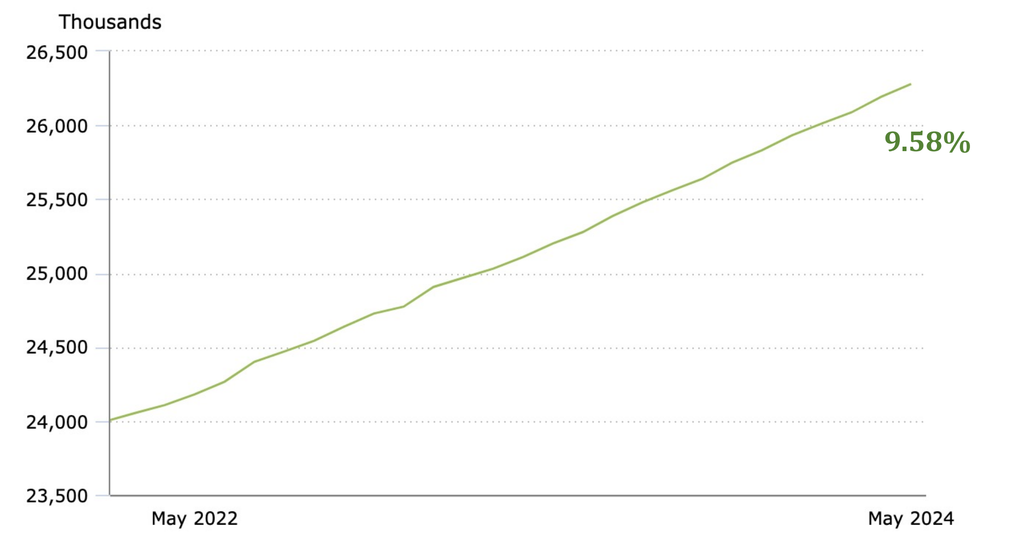
- We have observed a shifting trend in the job growth for various industries.
- There is a reallocation of human resources taking place, with the emergence of the new industrial revolution.
- Just as with all industrial revolutions, the economy adjusts its resources, to service the needs for the economy and optimize the effect of the resources as a whole.
- Therefore certain industries become prominent over certain periods of time and hence investing in those particular industries for that segment of time provides immense opportunities.
- Here we can see a shift in the job growth for information services as AI optimizes and replaces the need for excessive hiring, as the space was previously known for.
- AI makes firms more efficient, which usually results in a smaller hiring class and a cutting of the number of employees as repetitive tasks are automated.
- There have been several major tech firms and other smaller firms that have trimmed 30%-70% of their employees due to the redundancy of their roles using AI.

Reallocation of Resources



Source: U.S Bureau of Labor Statistics

Leisure and Hospitality Jobs Data May 2022-2024

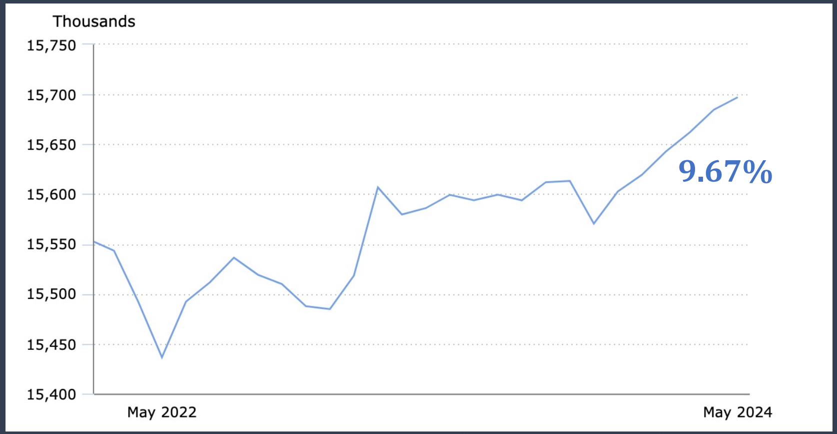


Source: U.S Bureau of Labor Statistics

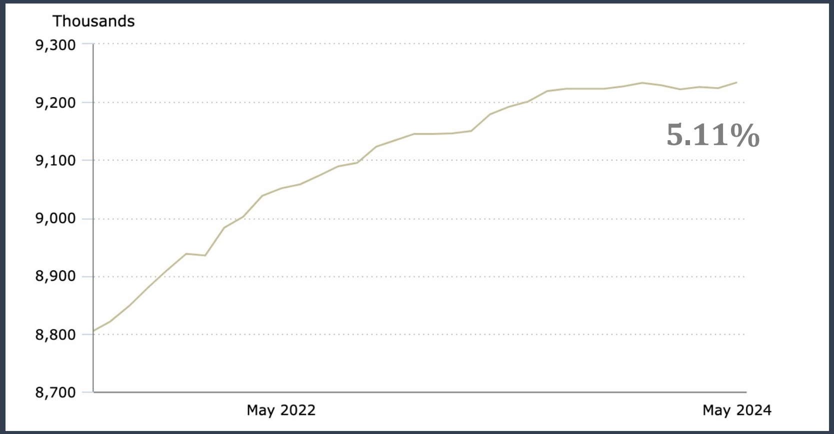
Education and Health Services Jobs Data May 2022-2024

Are there no jobs out there? Not at all. The jobs that are required by the economy to function at its new optimized level are not in the fields that were the most sought after so far, they are in the fields that require the most human capital to advance and develop. These are fields which were neglected for several years with incoming members of the work force, as you can see above, hospitality, healthcare and education are some of the many. Once certain fields such as information technology reach a level of innovation, in this case with AI where it can recursively learn from and correct itself, this gets rid of lower level jobs and only requires the senior most existing employees, leading to major cuts. This will enter into other fields as well as AI and AGI begin being developed and introduced to more labor intensive fields over time. However, for now there has been an increased level of hiring and job openings in those fields. The largest number of job openings in 2023 was in restaurants at various levels and in healthcare, especially with nurses as those are the most short staffed jobs requiring human effort and have not been broken into with complete automation.

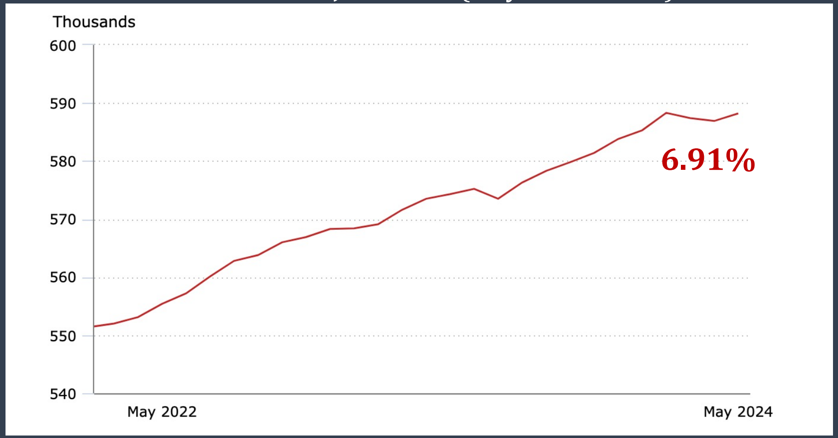
Reallocation of Resources



Retail Trade Jobs Data (May 2022-2024)



Finance Jobs Data (May 2022-2024)



Utilities Jobs Data (May 2022-2024)

Construction Jobs Data (May 2022-2024)

- While technology jobs are slashed and finance jobs plateau, other industries have a consistent growth in hiring.
- There is a potential possibility of a widescale reskilling that will take place as it has several times in the past.
- Where those entering the workforce will not be able to get jobs in the fields they "want" rather in the fields that have availability and those which the economy <u>needs</u>.

Source: U.S Bureau of Labor Statistics

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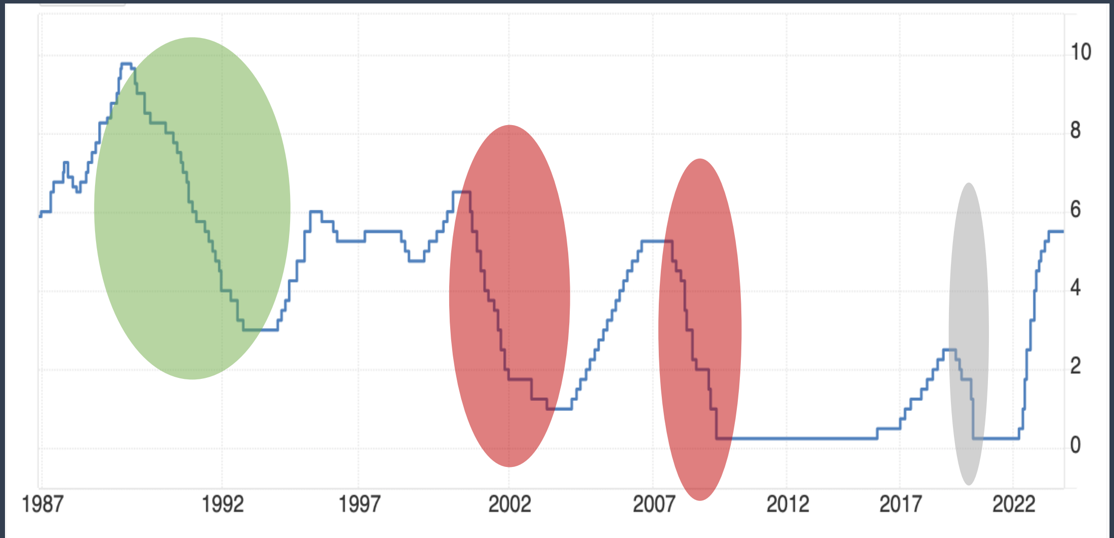
Everything isn’t cancer!

- Symptoms don’t always have the same cause.
- This symptom of high inflation, high rates and a resilient economy has been seen before during the 2000s bubble and before the 2008 financial crisis.
- The underlying causes were valuations running far too hot for the landscape they were in and the root cause was financial distress. In the 2000s the internet firms didn’t live up to the then “hype”, in 2008, the housing crises due to mortgage backed securities being misvalued and over leveraged homes, leading to liquidity of cash that wasn’t really present. That’s cancer!
- This time, however there is no root financial crisis. There was a financial crisis in 2020 with excessive printing of cash at very low rates, which led to the high inflation environment and thus the high rate environment.
- Its not cancer this time. The economy has stayed resilient throughout the high rate environment which it wasn’t able to do previously and hence the cut in rates caused a resurgence of inflation followed by a recession. This time around there has been significant technological advancements creating increased efficiencies allowing for the economy to work under this pressure and for firms to live up to their valuations as well.

Everything isn't cancer!

- The cause has been diagnosed and dealt with, however it is now time to decide how to wean off of the support and revert back to "normal" conditions without the intervention of the FED to hold the economy in place.
- The cause of concern would be the resurgence of inflation post the rate cut.
- To watch for this, the employment figures are a must to keep an eye on. When unemployment reaches over 4%, this would mean there are enough people within the economy who have limited capital, hence consumption will be limited, limiting the potential resurgence of inflation due to excessive spending.
- Due to the advent of AI and the structural changes taking place around most businesses through this new industrial revolution, the above is an achievable target, hence there will be less capital changing hands, causing inflation to cool organically.
- The staggered approach to raising rates must be followed when cutting them, if not even more staggered to allow the economy to adjust as it is happening with more gaps between the cuts in rates.

Everything isn’t cancer!



- When the rates are handled with care and the economy is gradually introduced to lower rates again, hence cheaper capital again, this slows the pace of inflation and reduces the potential for inflation to spike again.
- When the rates have been collapsed aggressively, this has led to capital flooding the markets, causing short term euphoria and long term trouble.
- People begin taking out cheaper capital and spending it in a short span of time, not realizing that this will cause rates to rise again, loan payments to increase and financial crises to emerge.
- Gradual rate decreases give the economy and people a breather from their expenses while keeping the excess spending in check.

The period between 1989-1993 during the cutting cycle of the FED where they took 5 years to cut rates from the extremely high levels of 10% to much lower levels of 2%, the market had one negative year of -7% with every other year growing on an average of 13% with 2 consecutive years of over 25% gain within the year. This is due to the very gradual and staggered approach they took to cutting rates. While between 2000 and 2004, they took a much more aggressive approach, bringing rates down much faster than the economy and market could handle, catalyzed by the panic of the dot com bubble where the hype didn’t last hence the recessionary period followed and the market had performed on average of -9% with two positive years at the end, during the recovery. Additionally, the same goes for the 2007-2009 cutting cycle, where rates were dropped far too aggressively, however this was due to the financial crisis. The years post that for over a decade was the longest 0% rate environment and hence led to the longest bull run of the market. 2019-2020 was an anomaly since it was a health and medical crisis with the pandemic which caused the economy to crash as consumption and production was disrupted for 2 years immediately, leading to an immediate rate cut to 0% to allow it to function, creating the crisis of 2022, which called for a rise in rates.

For Any Inquiries

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