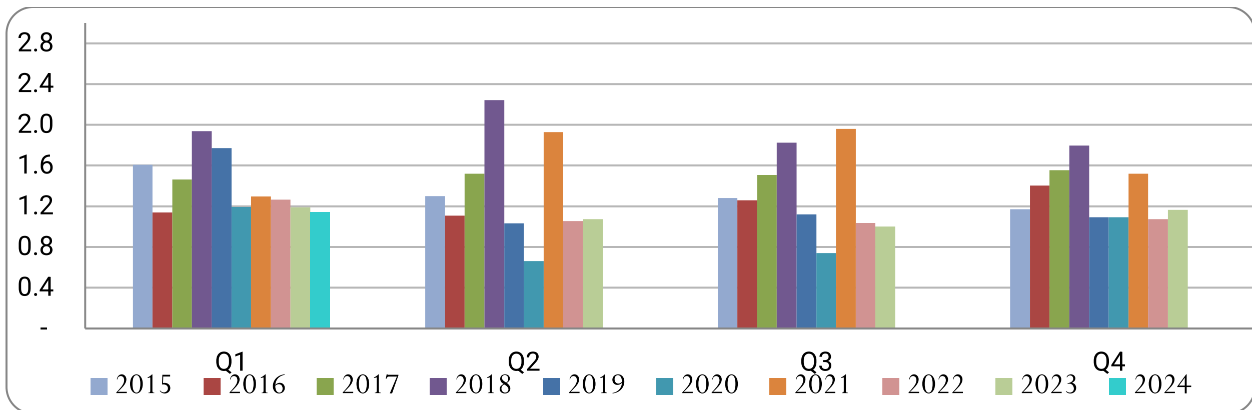
11711 N. College Ave. #200
Carmel, IN 46032
www.thearcherfunds.com

Archer 2024 2nd Quarter Outlook:

"The punishment of wise men who refuse to take part in the affairs of government is to live under the government of unwise men." – Plato

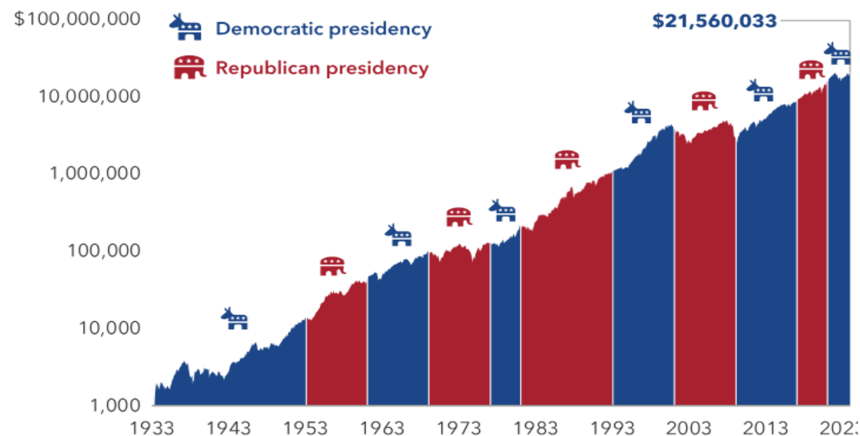
With the S&P 500 gaining 10.16% in the first quarter, the market has shaken off the political doldrums that usually come with a Presidential election year. In the annual newsletter we said for the market to move higher, corporate profits would have to move higher. We also said lower rates should make corporations more profitable as they can borrow for less and save money. However, in the 1st Quarter of 2024, interest rates reversed course from the 4th Quarter trend and moved higher. Even with Treasury yields rising, the stock market has continued its climb in the first quarter of 2024 as the outlook from the Federal Reserve implies at least three rate cuts in the latter half of 2024.

Each week we keep track of companies that report higher profits than in the same quarter the previous year. This has been a very good gauge of the stock market's direction. As you can see in the graph on the following page, the 4th quarter was a 1.16 to 1 ratio, meaning for every 116 companies reporting higher earnings, 100 reported lower earnings. That ratio dropped to 1.14 in the first quarter of 2024. It will be interesting to see if this trend continues in the second and third quarters as those quarterly numbers were much weaker last year. The third quarter of 2023 saw a ratio of nearly 1 to 1 which is not positive for the markets.

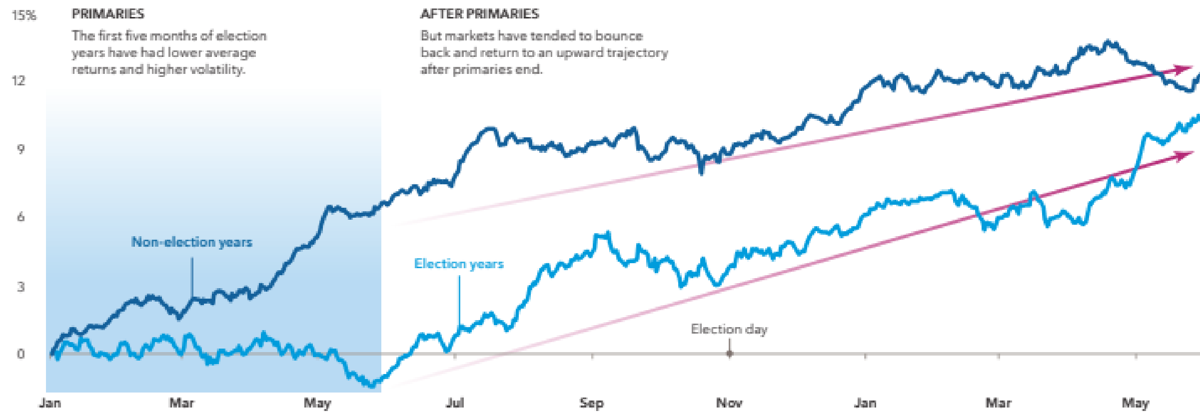


If earnings do decline, the Federal Reserve, who is supposed to be non-partisan, may very well cut interest rates to spur the economy leading up to the November election.

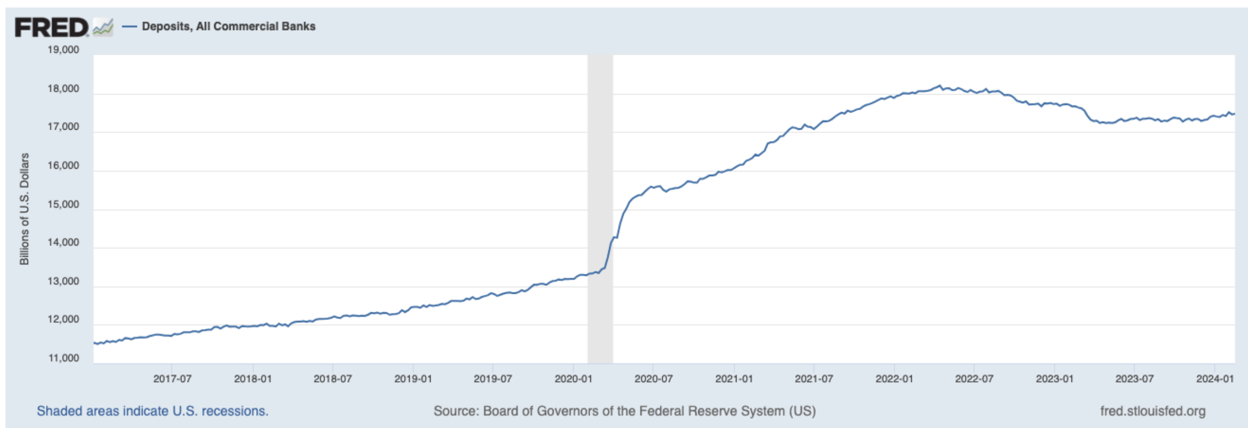
Every four years investor attention turns to Washington as the markets try to digest the uncertainty surrounding the Presidential election. Surprisingly, the market has continued to march on despite the political uncertainty. Much decision making seems to be centered around who investors think will win the election, surmising that if their candidate does not win, it will be the end of time itself. While each party has had difficulty success at different times, the chart below clearly shows that who is in office has had little long-term impact on the markets. We do believe one of the reasons the stock market is moving higher currently is the increase in federal spending. The Federal Reserve is trying to take money out of the system while the politicians are trying to put more back in. That's great if we all have more money. The problem is a socio-economic issue. More money supply usually means higher inflation. That is great for those who own stocks and assets in the long term, but it's not as good for those who make minimum wage or for lower income families. Eventually someone must pay, and it is usually those on a fixed income which creates more disparity among our citizens. The spending has to be reined in.

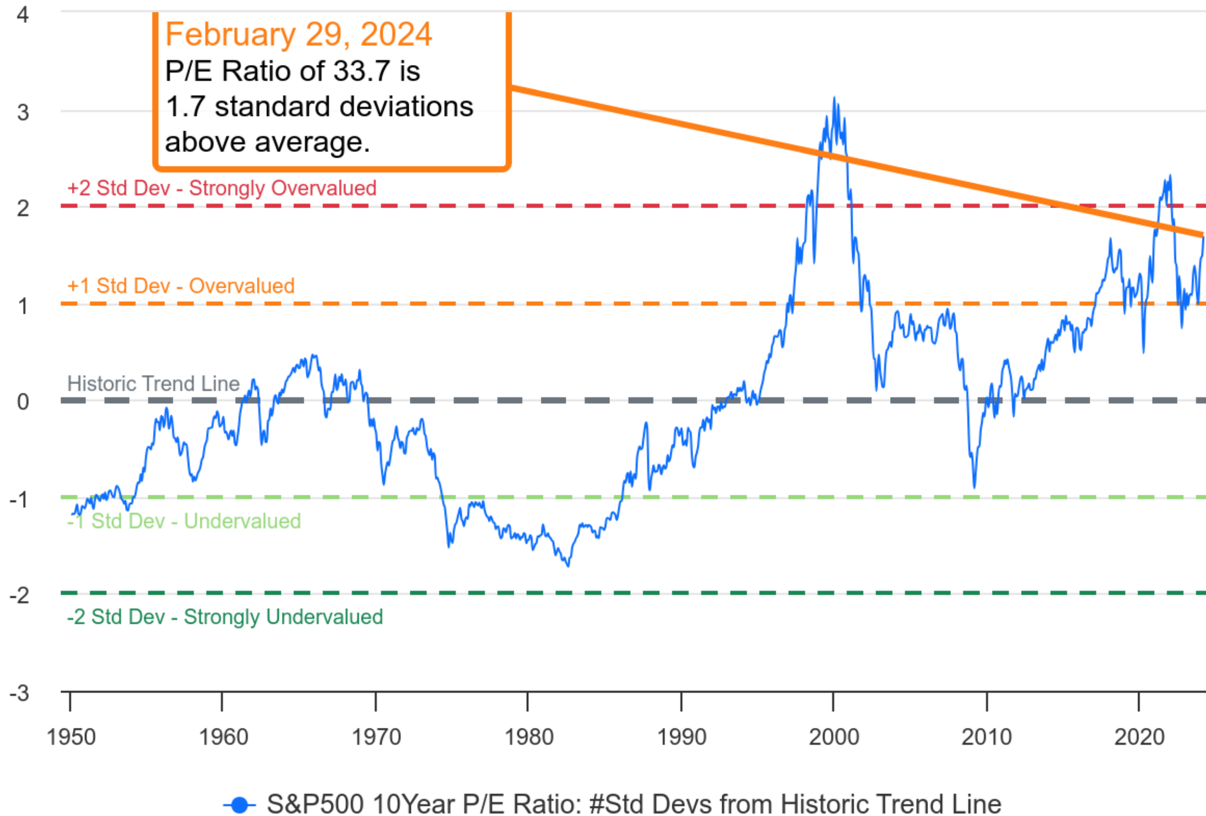


Revisiting the following chart from our last newsletter, we are in the period where the market has been relatively flat during previous election years. This year, the markets have moved ahead with the anticipation of lower rates by the Federal Reserve which may spur more corporate lending and thus higher profits.



The stock market remains overvalued at today's prices. Either interest rates will decline to bring the market closer to fair value, earnings will need to propel forward, or the stock market will lose some of its value. Although we believe the market is extended, the amount of deposits at banks is still extremely elevated. The next chart from the Federal Reserve clearly shows a tremendous increase in buying power of consumers, corporations, and municipalities. This elevated level of deposits is why we not only have inflation, as more dollars are chasing the same amount of goods and services, but also why profits are high and may stay high for some time. The near-term chances of a recession are lower than they might otherwise be, even with an inverted yield curve.





Although the chart above appears to indicate the market is overvalued as it is above the +1 Standard Deviation line, we can see that since 1990 (the last 30 years approx.), the market appears to have an average that trades at the +1 Std Deviation. Some of this can be attributed to the decline in interest rates over the last 30 years. As you can see from the next chart, interest rates declined from nearly 9%, down to .52% near its low. This created immense opportunities for companies to grow their profits and their businesses at much lower rates. Now with the excess printing of cash from the government, rates have reversed course (we use the 10-year Treasury as our example below). This means the financial strength most businesses have enjoyed could subside a bit as they need to borrow new money or retire old debt. When rates rise, we do not see an immediate impact on financial returns as many companies still have bonds with low interest rates and they are in no rush to pay them off early. The market can remain elevated until either money supply drops, interest rates rise too far, or profits subside.

We will be diligent in watching earnings, inflation, and employment. We continue to like the prospects of the stock market over the long term. As we have stated in the past, a recession may be on the horizon at some point, but the timing and depth of a contraction is much less certain. While we have had an inverted yield curve for quite some time, much of this has been forced by the Federal Reserve and not necessarily by market forces as distortions from government spending during covid work through the system. Alternatively, we may continue to see "rolling recessions" in certain sectors or markets as others strengthen. Overall the health of consumers and corporations continues to be very strong.

Regards,

The Archer Team

Past performance is not a guarantee of future results.

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