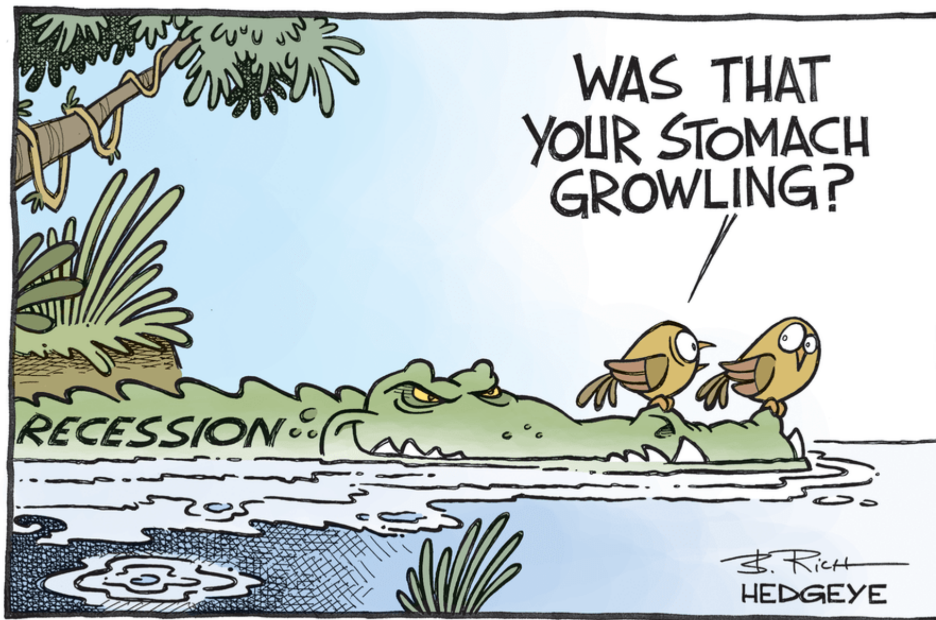
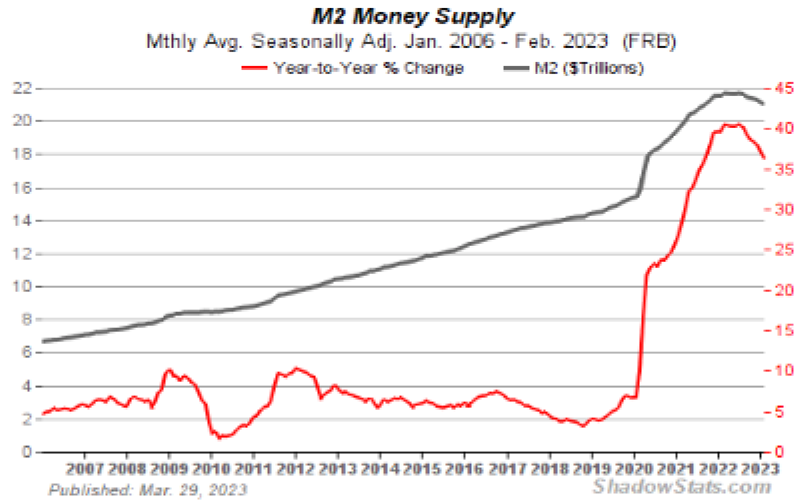
11711 N. College Ave. #200
Carmel, IN 46032
www.thearcherfunds.com

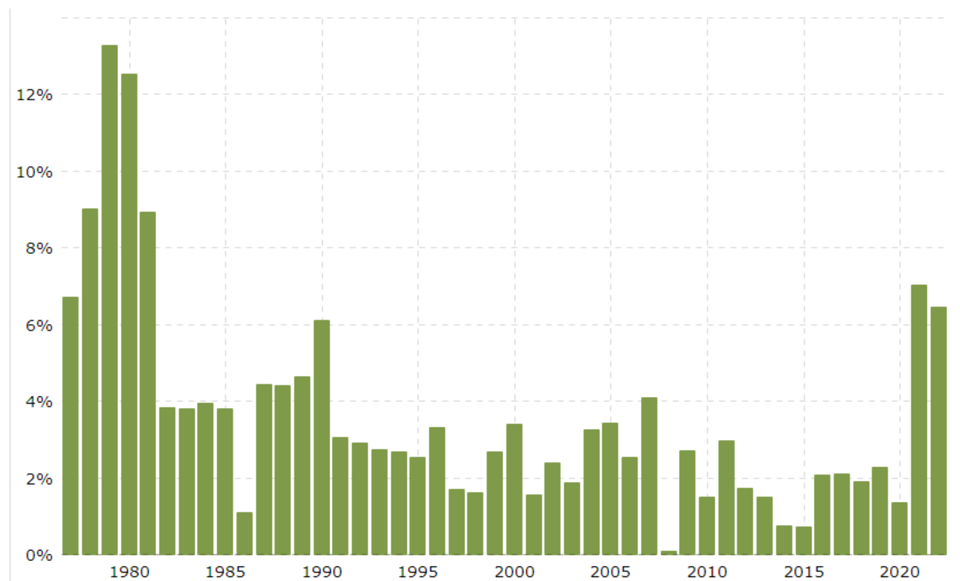
Archer 2023 2nd Quarter Outlook:



Where is the recession? We heard it was coming at the end of 2022 and then early 2023, and now one of the research groups recently reported it would be early 2024. A broken clock is right twice a day. Is a recession coming? The answer is yes, although no one knows exactly when it will happen. There is still significant money in the economic system. When the government creates an alarming amount of money in the system, the only way to get it out is to have the consumer spend their savings or increase their household debt so more payments go to the bank than to current discretionary items. In addition, more dollars chasing the same number of goods can create inflation. We continue to see the past increase in Money Supply spur inflation of all goods and services.



When the ADP payroll report came out on April 5th, as I write this, jobs increased approximately 145,000. The commentator on CNBC said this report was too "hot". Then he went on to state the Federal Reserve will continue to raise rates as long as people are employed at this level. You might be asking, "why in the world are they wanting unemployment to increase." Simple, it will get consumers to use their savings and tighten their belts on spending which will decrease inflation. In the chart below, we can see how inflation has increased, but the latest bar is seen moving down. In the chart above, money supply is starting to decline, more than we have seen in decades. This should push our economy into a standstill or even a decline, thus also reducing inflation. The Federal Reserve does not care how they get the money and inflation under control, but they feel they need to reduce inflation even if it hurts millions of consumers and those employed.



So, the question begs, when will the recession hit? The problem with the Federal Reserve's assumption is two-fold, they are betting on a consumer not spending, and that corporations are willing to lay off workers. Both have been much slower to come to fruition. The chart above shows that inflation is

starting to slow and in fact coming down. Even a call to Captain Obvious said that eventually pushing too much money into the economy too quickly would cause inflation. Now the Fed has to change course.

Let's turn to the consumer for a moment. They are a key piece of the puzzle if we are to see a recession. The need to stop spending and borrowing will usually increase as they work through their savings. We can see from the JP Morgan chart below, the personal saving rate has clearly slowed as a % of disposable income. The amount of revolving debt (think credit cards) the consumer is taking on to make up for the shortfall in spending is rising. At some point one side or the other will call "mercy." When this happens, retail spending should drop, and the corporations will tighten their belts and start laying off workers. The cycle will continue as the consumer spends their savings due to a loss of a job or merely tightening their purse strings.

Consumer saving and borrowing

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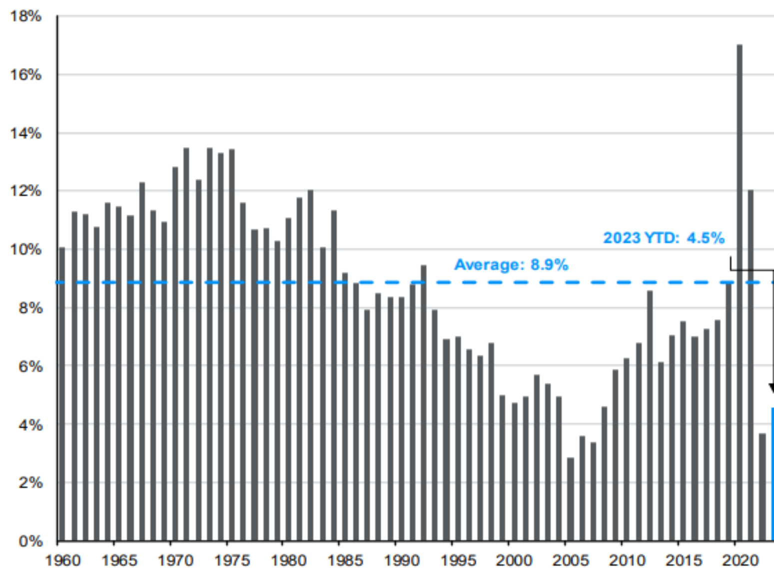
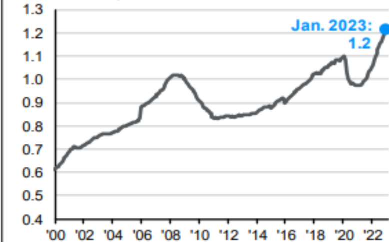
Personal saving rate

Personal savings as a % of disposable personal income, annual



Revolving consumer credit outstanding

USD trillions, SA



Revolving consumer credit outstanding

% of disposable income, SAAR

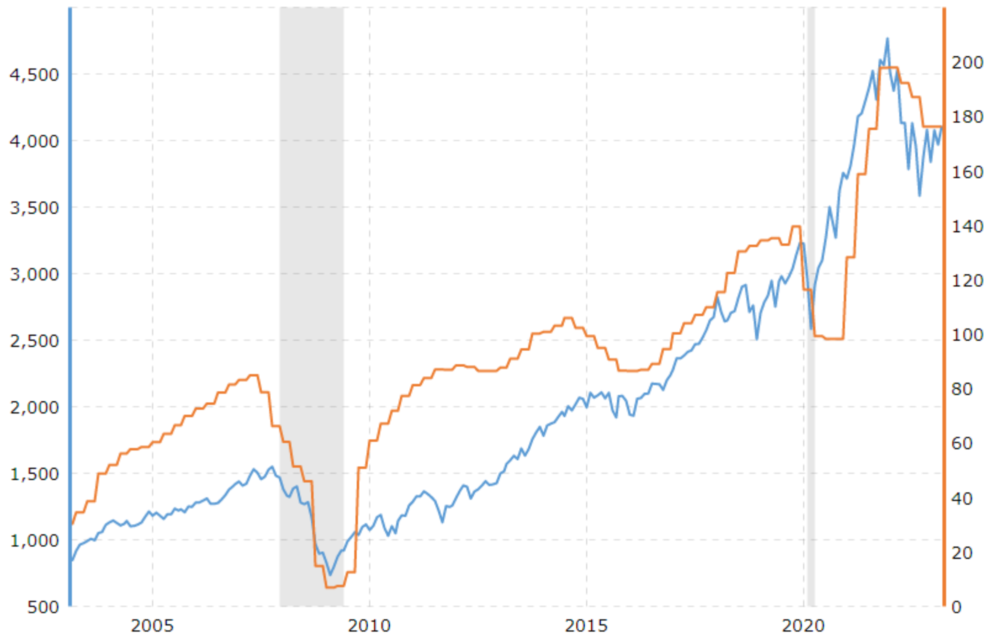
Source: BEA, Federal Reserve, J.P. Morgan Asset Management.
Guide to the Markets – U.S. Data are as of March 31, 2023.

J.P.Morgan

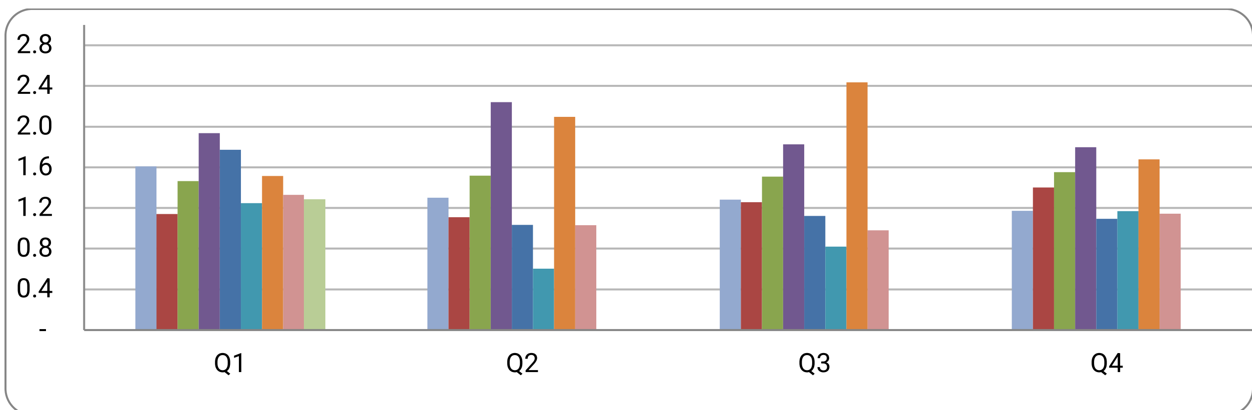
Ultimately, the consumer is in charge, but the Fed is trying to guide the consumer and corporations to tighten. We believe the recession will be muted unless the Federal Reserve raises rates too far and too fast. Why? Look at the previous page on the M2 Money Supply. While it has recently fallen, the rise we have seen from 2020 is still noticeably gargantuan. It will take much longer to work through this excess money. The Fed at some point needs to take a wait and see approach. A soft landing would be best for all parties. Recessions often hurt the middle and lower class to a greater extent than the upper class.

Ok, let's focus next on earnings. Each quarter we discuss earnings and the correlation with the price of the markets (the S&P 500 in this case). The next chart shows where earnings are in the orange and the blue is the price of the S&P 500. This chart from Macrotrends shows there is a clear correlation in the increase in earnings and the S&P 500. In the early 2000's long-term interest rates on a 20 year Treasury

was near 5% compared to the current 3.2% yield. As rates came down, the multiples of earnings of the S&P 500 expanded. Unless we see a further elevation of yields, we expect the price of the S&P 500 to rise and fall with the current earnings.



Currently, the earnings year-over-year are holding up fairly well. As you can see below in Q1, the last green bar indicates the ratio of companies' earnings rising over the same period in the year before are 1.2 companies to 1 declining. Although we would like to see this above 1.3, the earnings are holding relatively steady. We attribute much of this to the Federal Reserve creating a massive amount of money supply. Until these earnings comparisons get significantly weaker and are closer to a one-to-one ratio, or just above it, the earnings recession in our opinion is not coming.



With the uncertainty in the market about earnings, unemployment, inflation, and political risk, we continue to see Value as a better opportunity than growth. Focusing on quality of earnings are also

equally important. Although we did not include a chart this quarter, the disparity between value and growth companies are still too wide with Value lagging in returns.

We will be diligent in watching earnings, inflation, and employment. We like the prospects of the stock market if those numbers are all favorable together. Although there may be a recession at some point on the clock, we expect it to be shallow and create another short-term opportunity to get a discount on stock prices.

Regards,

The Archer Team

Past performance is not a guarantee of future results.

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