Archer Investment Corporation
BALANCED INVESTMENT MANAGEMENT

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

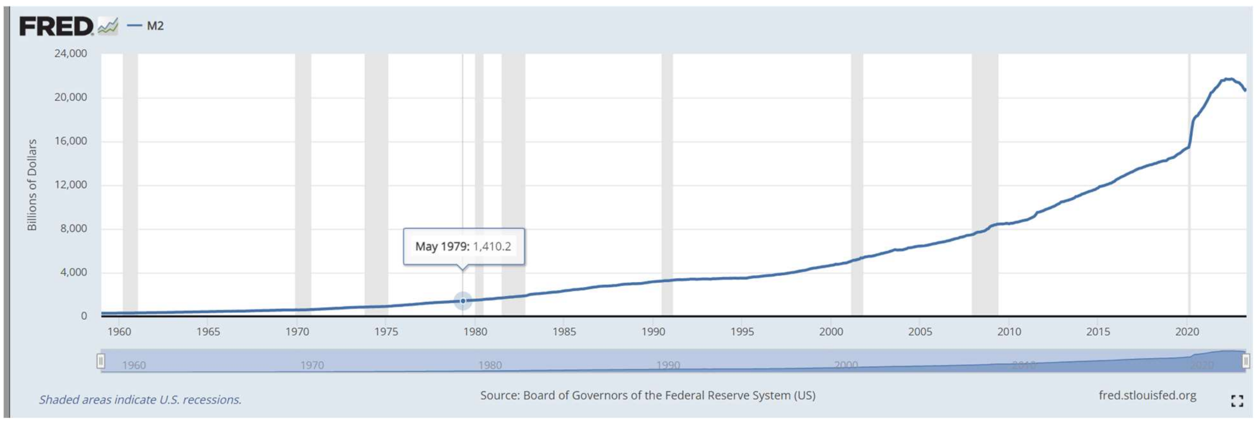
Archer 2023 3rd Quarter Outlook:

As we are sitting in Pensacola at the start of the quarter celebrating the 4th of July and watching the Blue Angels pull off the most unbelievable feats that you only thought were in the movies, it gives us a look into real talent. I am not sure Washington can pull off the same feats when it comes to our economy and inflation. If it were as easy as putting more gas into these jets, then we could all fly one. It is not. They must maneuver, land, takeoff, and focus on the task at hand without interference of public opinion, and who donated to their campaign.

Let's focus our discussion on inflation and earnings. This will dictate where we are headed and in one camp, inflation looks like it is on the right track, while earnings are starting to wane. Where is the recession? We need to understand the basics of inflation and money supply and what it means to our own pocket book. Think of goods to buy as Apples: If we had 10 Apples in the economy and $10 in the economy and this is all we had to spend and buy, then each apple would be worth $1 each in simplest terms.

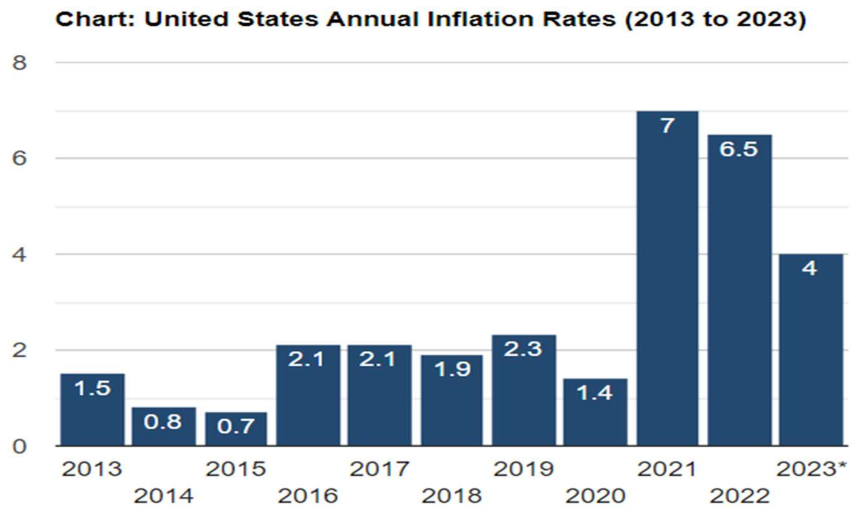
Now the government wants to create $10 more dollars to help the economy, but the same number of apples exist. In perfect terms, the price of each apple will go to $2 each. The first person to buy after the dollars are created may get it for $1.25, and then $1.50, but ultimately the last few people will get it for more than $2. According to Investopedia, M2 is the U.S. Federal Reserve's estimate of the total money supply including all of the cash people have on hand plus all of the money deposited in checking accounts, savings accounts, and other short-term saving vehicles such as certificates of deposit (CDs).

The Federal Reserve shows a graph of M2 as follows. During 2020, 2021, and part of 2022, we had a 33% (according to seeking alpha) increase in M2 (think of printing money and dropping from a plane to all consumers).

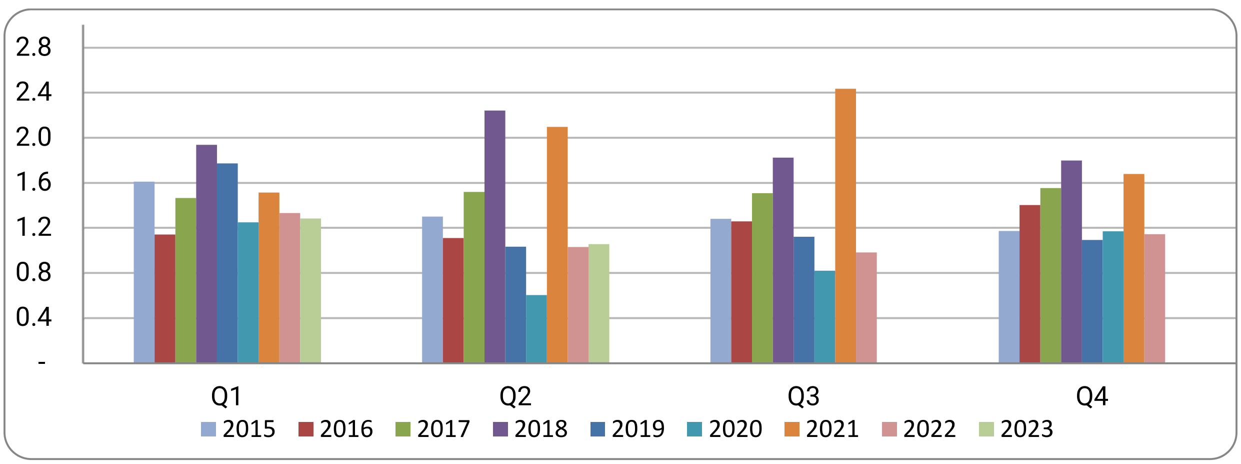


After the 33% increase we had a 4.1% decrease following the highest M2 levels seen in 2022. This decrease in M2 has not happened in nearly 90 years. For inflation to get back to where we were prior to the pandemic, we need M2 to decrease another 7.5%. This would bring inflation back to inflation levels of 2% or less. Although we are on the way and have seen inflation reads lately at 4.05% according to Y charts, we need to see further action by the Federal Reserve. We would like to see them hold off on raising rates again and focus on draining M2, so it slowly works out of the system. Any knee-jerk reaction may send us into that recession the experts have been touting for the last 2 years.

After the following chart on inflation, let's focus on earnings. We need to see earnings increase. As we have stated often, a healthy economy is dependent on increasing earnings in companies and it will ultimately push the stock market higher. There are some forces with AI (artificial intelligence) that will help companies to be more efficient, but in general terms, it will not grow more apples, at least not yet.



Earnings are coming in at less than 1.2 (around 1.06). This means 1.06 companies are reporting higher earnings and 1 company is reporting lower earnings. This is close to dangerous territory if it drops below 1. In fact for a healthy economy we need would like to see it above 1.2. Much of this problem is stemming from raising rates by the Federal Reserve which creates higher borrowing costs for companies at the bank.



It appears we may be close to an earnings recession, but with unemployment still at 3.7%, we are probably not quite ready for an overall economic recession. In fact, although money supply is in decline as we discussed earlier, home builders are still building homes and auto sales appear to be strong as both areas of the economy have pent up demand. It appears there may still be plenty of dollars to be spent in the economy as not all money was spent as the government gave it back to taxpayers. Some saved those dollars and unless we see another 7.5% decline or more in M2, it is likely those dollars will still be in the economy to be spent.

As we stated last quarter, 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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