SARATOGA CAPITAL MANAGEMENT, LLC

THE ASSET ALLOCATION SPECIALISTS© 3/31/24

MIVI | ABOUT THE ANALYTICAL TOOL

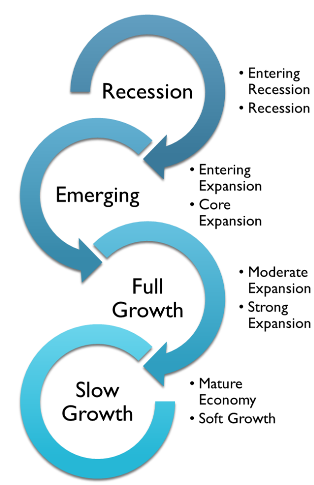
The statistics that comprise MIVI are the foundation of Saratoga Capital Management, LLC's asset allocation research. MIVI is an analytical tool comprised of over 50 macro-economic statistics, and is an acronym for the four main categories these underlying statistics fall into: monetary policy, interest rates, valuations and inflation statistics.

To analyze the capital markets, Saratoga primarily studies the historical and current relationships between economic developments and capital market trends. Our goal is to understand how various asset classes that make up the capital markets (e.g., large capitalization growth, financial services, international equity, etc.) might react in the current economic environment. MIVI helps paint a data-driven picture of current and past economic environments which we can use to shed light on the dynamic between various asset classes. This guides us in our determination for when it is appropriate to adjust our asset allocation strategies. Should the large capitalization growth sector be overweighted versus large capitalization value? Should equity sectors be underweighted versus fixed income sectors, in general? MIVI helps us answer these questions, and more.

GENERAL ECONOMIC OVERVIEW FOR 1Q24

As measured by Real Gross Domestic Product (GDP), the value of the production of goods and services in the United States grew by 3.4% during the fourth quarter of 2023, down from 4.9% during the previous quarter (all quarterly GDP growth rates discussed are seasonally-adjusted annualized rates unless otherwise noted). Within the main components of GDP, consumer spending as measured by Personal Consumption Expenditures (PCE) advanced by 3.3%, while private sector investment as measured by Gross Private Domestic Investment (GPDI) grew 0.7%; a strong three-quarter finish to the year failed to bring private investment positive for 2023, as the figure was dragged down by a -9.0% reading in Q1. Government spending, which accounts for both consumption and gross investment, rose 4.6% for the quarter and 4.1% for the year. Both State & Local and Federal Government spending increased for the sixth consecutive quarter after a run of negative figures in late 2021 and early 2022. While imports were up 2.2% for the quarter, exports were up even more, at 5.1%, driving Net Exports to yet another positive quarter and keeping a streak alive that began in the second quarter of 2022.

SARATOGA ECONOMIC STAGES



As was true in Q3, there was little not to like in Q4's GDP report. While annual growth at 2.5% is somewhat tepid, continued growth on top of persistent inflation is impressive, and the quarter benefited from a broad range of contributors. We mentioned one of the few problems with last quarter's report was continued slow growth in personal consumption of services, however that figure was up a solid 3.4% this quarter. This quarter, we'll nitpick by mentioning weakness in corporate spending on equipment, down for four of the past five quarters, and -0.3% for the annual period. Equipment spending is generally a helpful leading indicator within GDP, and we'd like to see an uptick in what was the hardest-hit major GDP sector during the pandemic.

On the other hand, following three quarters of double-digit growth figures, corporate spending on structures was up yet again, 11.1%, finishing the year 13.2% higher. A sustained boom in spending on Manufacturing facilities led the way again, up a whopping 63.9% for the year, a figure matched only once during GDP's modern recorded history, in 1951. Manufacturing construction has been helped along by three consecutive pieces of federal legislation helping to support surge in computer, electronic, and electrical manufacturing plant buildouts.

Private investment in the residential sector was positive again for the quarter, but couldn't save residential spending from a second straight negative year, down -10.6% for 2023 after a -9.0% 2022. While it wasn't enough to bring spending on residences positive, Single-family structures were once again positive, up 13.7% for the quarter.

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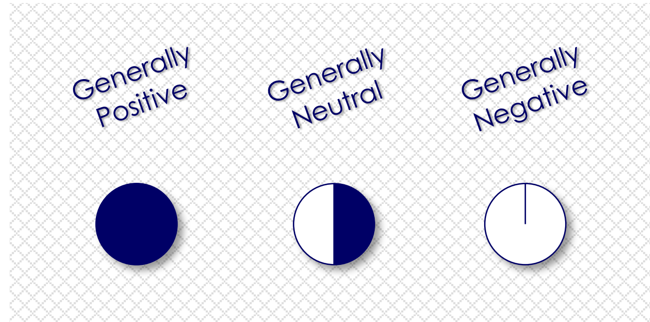
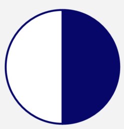


ASSET CLASS IMPACT

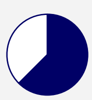
STOCKS



BONDS

SHORTER TERM

LONGER TERM



MONETARY POLICY COMMENTARY & IMPACT

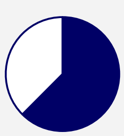
The Federal Reserve is wrapping up its second year of tapering. The Fed balance sheet peaked at roughly $8.96 trillion in April 2022, and has dropped to $7.48t as of March 2024. Notwithstanding a $400 billion uptick in March of 2023, as the collapse of SVB drove banks to take advantage of Fed liquidity programs, the balance sheet has marched steadily downwards for the past two years. The Fed is shedding US Treasury securities at an average of roughly $13b per week over the past year, and Mortgage-backed securities by about $4b per week.

The Fed remains persistent in squeezing the country's money supply from a broad perspective, though there is now certain underlying monetary policy standing as an exception. As of February, the monetary base is up 10.8% year-over-year; we would consider a rate closer to the 7-8% range as neutral, and current monetary base growth is potentially an early sign of the Fed loosening policy. Within the monetary base, balances held by depository institutions with Federal Reserve banks have been the primary driver of growth, up over $550b for the year.

CiC hit a pandemic-high growth rate of 17% y-o-y in 2020; that figure has now dropped to 1.5% y-o-y, far below its modern historical y-o-y growth rate of roughly 6.9%. M2, one of the most widely used monetary figures for measuring liquidity in the economy, is also down massively from its cycle-high 22% y-o-y growth in February 2021 to -1.66% y-o-y currently; like CiC, M2 is also well below its modern historical growth rate of 7.0% y-o-y.

ASSET CLASS IMPACT

STOCKS



BONDS

SHORTER TERM

LONGER TERM

INTEREST RATES COMMENTARY & IMPACT

While it is far from unprecedented for the yield curve to remain inverted for over a year, the yield curve's current inversion is getting long in the tooth. Measuring by the 10yr-1yr Treasury spread, the last time the bond market experienced an inversion over 85 weeks was in the 1970s, when it happened twice. The current 10yr-1yr spread has been negative for 87 straight weeks.

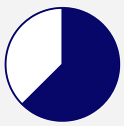
We generally find the 5yr-Fed Funds, 10yr-3yr, and 10yr-1yr spreads to carry the most predictive quality, and while each has normalized meaningfully over the past year, they each remain inverted. After a relatively muted 2023, yields leaked upwards in the first quarter, with 1yr Treasuries gaining 5.12% and 10yr Treasuries gaining 8.85%. This change likely represents multiple dynamics converging: shorter-term treasuries have gained as odds of multiple Fed rate cuts seem to be pushed farther out (though we think this may be a mistake), while longer-term yields are potentially rising as hopes for a soft-landing and continued economic growth solidify (a soft-landing may remain in the cards, but we have doubts about strong near-term economic growth).

Regarding long-term corporate bonds, the quality spread as measured by Moody's-rated Baa bonds minus Aaa bonds is reflecting a similar sentiment as yield spreads. The quality spread has historically been a good predictor of confidence in the corporate bond market and helps us establish a baseline expectation for corporate earnings. The quality spread rose all the way to 1.16 in December 2022, but has moved back to 0.73 as of quarter-end, an improvement we view as positive with regard to future corporate earnings.

EQUITY VALUATIONS COMMENTARY & IMPACT

ASSET CLASS IMPACT

STOCKS



BONDS

N/A

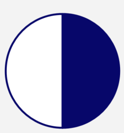
As of March 31, 2024, the S&P 500 index was at 5,254. Our proprietary valuation work suggests a fair value for the S&P 500 at 5,106, factoring in present earnings at a 26 price-to-earnings ratio (P/E). Earnings growth has stabilized for now, and projections expect steady growth; after negative earnings dominated the landscape in 2022, 2023 saw four consecutive quarters of positive earnings growth. We believe PE levels are likely to pull slightly ahead of their modern historical mean of roughly 25, though only slightly so; inflation data continuing to sit below 4% and upward-trending earnings growth has pushed our P/E estimates upward, while intermediate-to-long-term interest rates are still presenting a headwind to valuations.

To create a range of equity market outcomes, we use a valuation system which we refer to as our Proper PE Valuation™ tool. Among other things, this analysis provides us with a set of ranges above and below which we consider the S&P 500 overvalued or undervalued, respectively. Our proprietary valuation work currently sets an appropriate S&P 500 PE from 25 to 28. This produces a fair value range of 5,149 to 5,767 over the next six months. We wrote two quarters ago that earnings growth had been soft, but that much of the underlying macro data reflected the potential for multiple growth; said multiple expansion has since taken hold over the subsequent six-month period. Consequently, we now think multiples are pushing the top of their fair-value range. We are likely in somewhat of a “goldilocks” territory, where equities may be more sensitive to any macro surprises.

INFLATION COMMENTARY & IMPACT

ASSET CLASS IMPACT

STOCKS



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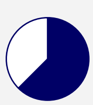

Headline inflation was up during the quarter, with the Consumer Price Index (CPI) coming in hot for February and March m-o-m readings. Interestingly, the Fed’s favored inflation gauge, the PCE Price Index, sits closer to target than CPI, at 2.5% y-o-y as of February. On the producer side of the economy, the Producer Price Index has increased back to 2% y-o-y for the first time since April 2023, though March’s 0.2% m-o-m was cool.

Real wage earnings for full-time workers started an explosive growth trend in 2014, which peaked in the second quarter of 2020. For much of 2022 and early 2023, the trend was reversed, and wage-growth seemed to be dragging inflation down. That dynamic seems to have reversed course once again. A number of our favored wage datapoints are now near or solidly above headline inflation rates, meaning that they could potentially begin pushing inflation back up, as opposed to pulling it down. Production-line workers producing goods, whom we have referenced in a number of our recent reports as Goods Workers, have seen wage gains remain steady, with y-o-y gains of 5.2% as of February, well above 3.5% inflation. Though this figure dropped from last quarter, it remains above its historical mean of 3.7%.

The current inflation environment seems to be causing the Fed considerable consternation; in previous similar economic environments, the Fed has generally been cutting rates and easing monetary policy. And though headline inflation under 4% has often been considered manageable, we believe the current Fed remains somewhat shellshocked by 2021.

__Asset allocation does not assure a profit or guarantee that investors will not incur a loss.__ Information contained herein was obtained from recognized statistical services and other sources believed to be reliable and we therefore cannot make any representation as to its completeness or accuracy. Any statements not of a factual nature constitute only current opinions which are subject to change without notice. Saratoga Capital Management, LLC does not provide investment advice to individual investors.

[1]The S&P 500 is an unmanaged, capitalization-weighted index. It is not possible to invest directly in the S&P 500.

SARATOGA

CAPITAL MANAGEMENT

The Asset Allocation Specialists©

Founded 1994

American Revolutionary War - The Battles of Saratoga, 1777 | *Surrender of General Burgoyne by John Trumbull*

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