

SARATOGA CAPITAL MANAGEMENT, LLC

THE ASSET ALLOCATION SPECIALISTS®

10/31/23



ECONOMIC STRENGTH MONITOR™

The Economic Strength Monitor™ (ESM) is a proprietary index produced by Saratoga Capital Management, LLC (SCM). The purpose of the index is to understand, in general terms, the relative strength of the US economy. The index has historically helped us to figure out whether, and to what degree, the Federal Reserve (Fed) is likely to adjust the Federal Funds Rate in the near future. ESM is a here-and-now index, meaning that it is best used to help us understand how “hot” or “cold” the current economy is, as opposed to the direction in which the economy is headed (Saratoga’s Economic Leading Statistics® index helps us with directional forecasting).

ESM includes 14 underlying metrics, such as Housing Starts and New Home Sales, Retail Sales, a number of Manufacturing data points, Consumer Confidence, key pieces of Employment data and others. Index readings begin in January 1960. The index is calculated as a raw number, with a normal range of 0 to 100. Generally speaking, index moves up or down in the 20-30 point range put us on notice that further examination of index trends is necessary and that the Fed may be ready to adjust rates. When combined with SCM’s additional proprietary indices, such as our Economic Leading Statistics® index and our Consumption Modification Index®, ESM may help us to understand if the economy is expanding or contracting, if current economic trends will continue, and what the nature of the economy may mean for various investment strategies or sectors.

THE CURRENT ESM READING

The current ESM reading is 39.29, up from the prior month’s 35.95 reading. Readings in this range generally reflect an economy cool enough for the Fed to remain neutral or loose.

In March 2021, a year removed from the pandemic, ESM began to signal that the economy was running hot enough for the Fed to consider tighter policy. Not only had inflation entered the picture, both the consumer and producer sides of the economy looked healthy. As summer 2021 continued, the economy proved its strength amid a robust labor market. The Fed, seemingly concerned with nipping the post-pandemic economic recovery in the bud, chose not to adjust its loose policy during this period of economic growth, encouraging an inflationary environment. As the Fed finally pivoted in 2022, the economy had been running hot for nine months, artificially spurred on in part by monetary largesse. The Fed’s tighter policy showed up in the macro environment in April 2022, and by May much of the economy had taken a turn for the worse; unfortunately, inflation was still trending higher and, as many economists suggested might happen, the Fed found itself caught between a rock and a hard place. As 2023 matures, the picture has changed for the Fed. The economy has been feeling the impact of tighter policy for over a year. Inflation has fallen far enough from its cycle-high to signal that it is unlikely to peak again in the current cycle, and while the Fed has historically played inflation very cautiously it is unlikely that inflation data alone has convinced the Fed to continue raising rates. Instead, the Fed will likely continue to look at a mixed labor market as justification to remain tight.

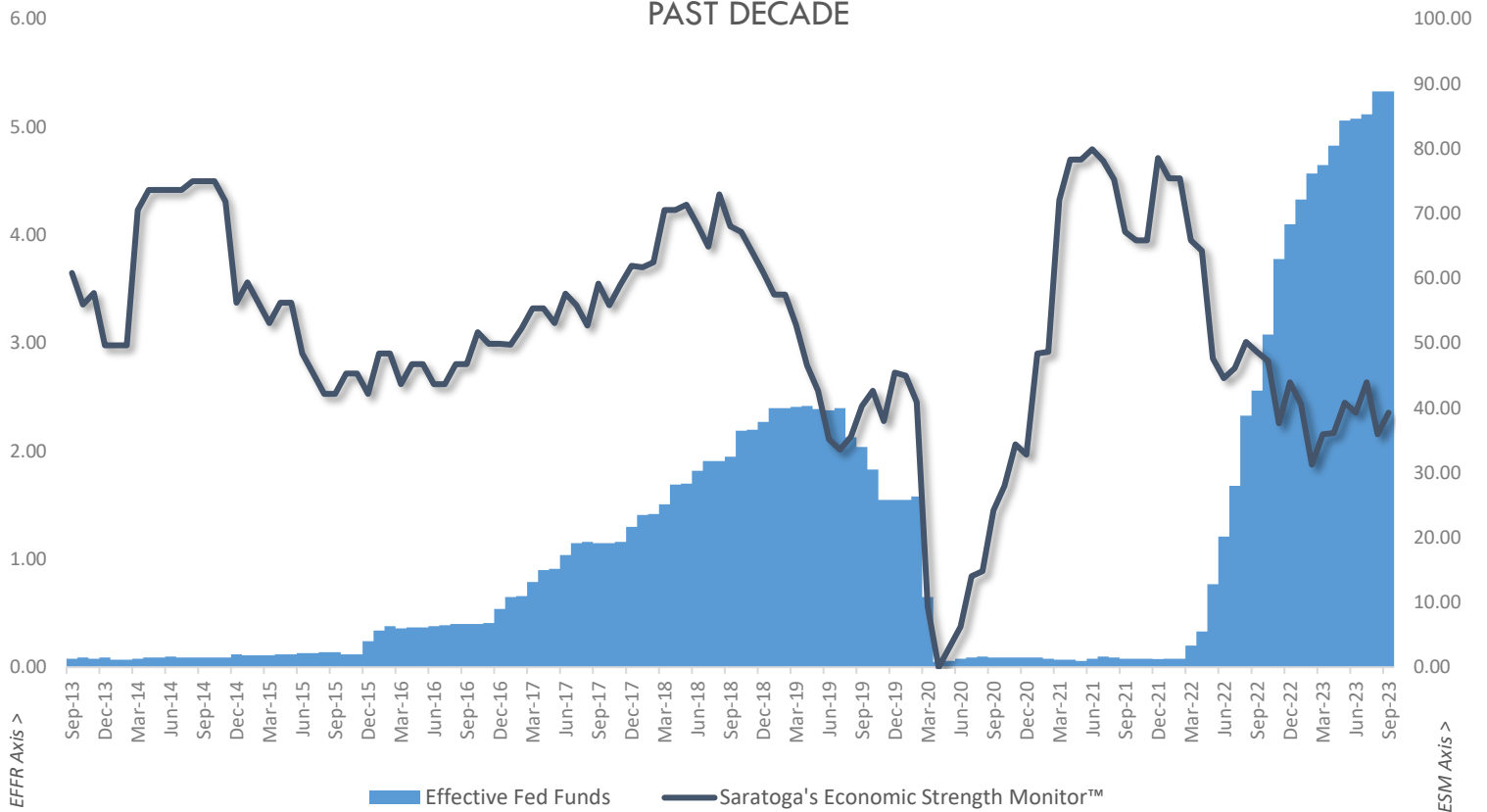
THE CURRENT ESM CHART & COMPONENTS

The charts on the following pages show ESM’s component rankings, as well as ESM tracked against the Effective Federal Funds Rate (EFFR) over two periods. After two years of an EFFR near zero, Fed action finally pushed the EFFR meaningfully upwards in May 2022 and in the ensuing months the Fed encouraged rates higher as fast as they ever have. These large jumps are noticeable, especially in the “Past Decade” chart, on the following page. Rates have now crossed 5.00% for the first time in over fifteen years, and continued to creep upwards for 18 months before stalling out in October’s ESM report.

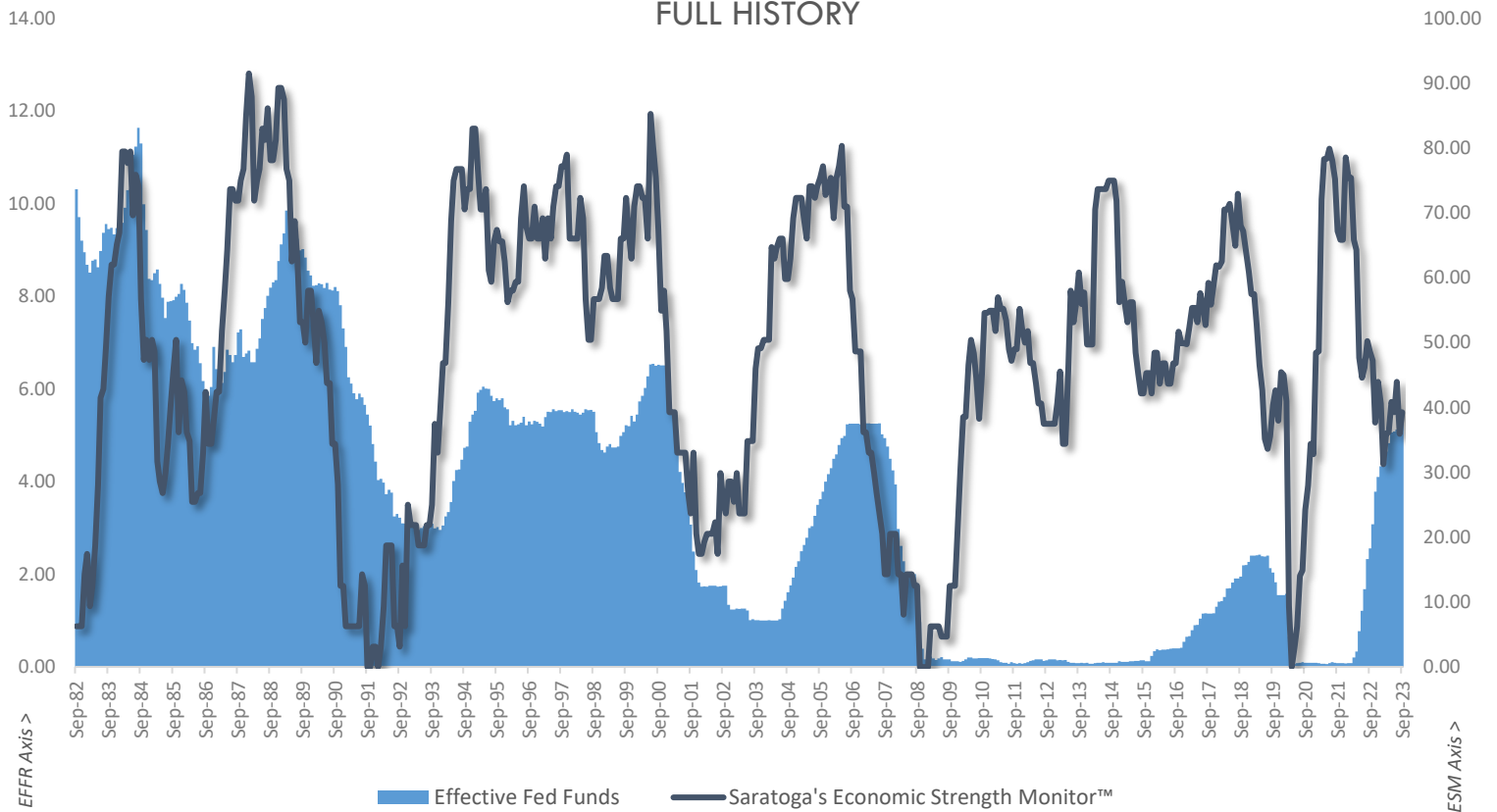
ESM’s underlying components show little justification for the Fed to continue employing tight policy. As labor and housing data has jumped around a bit, ESM has found itself in a relatively tight range somewhat similarly to the early 2010s, though with what feels like much higher stakes. While unemployment is still low, it is also generally a lagging indicator, and certain underlying labor data is in danger of rolling over. Inflation is no longer contributing positively to ESM’s total and most underlying inflation trends are still negative after a year of falling precipitously.

ESM CHARTS

PAST DECADE



FULL HISTORY

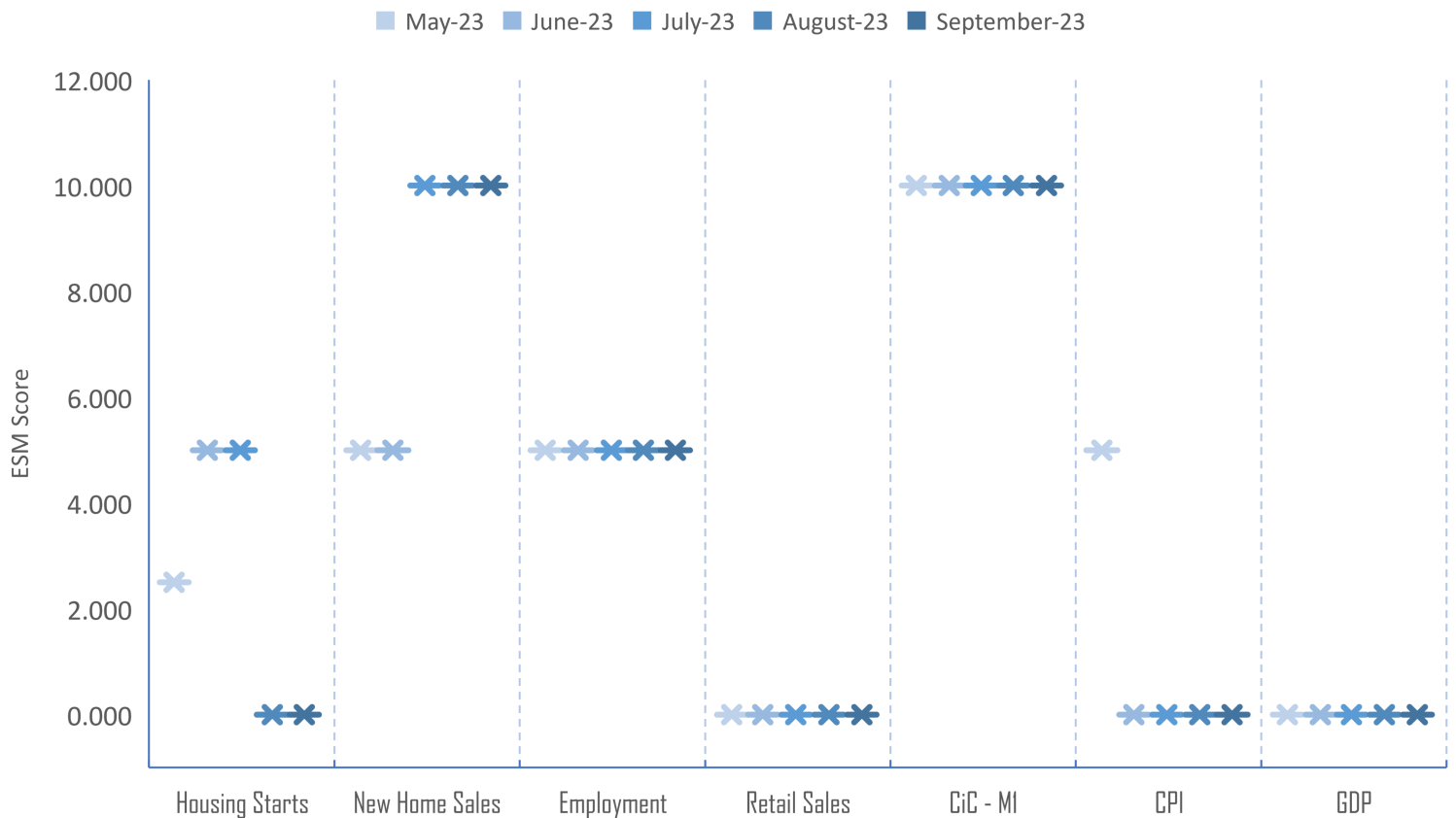
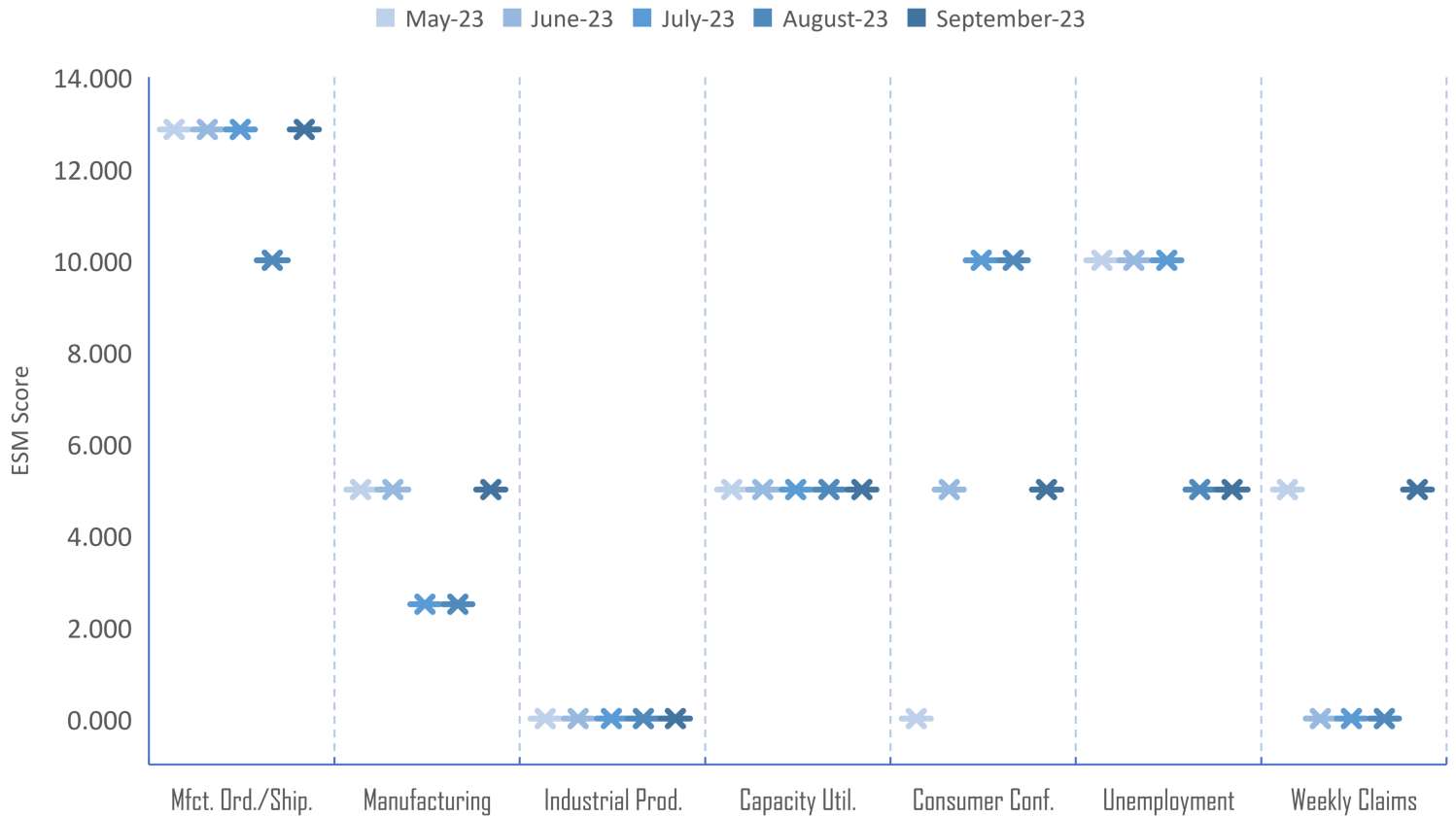


Definitions: The daily Effective Federal Funds Rate (EFFR) is a volume-weighted median of transaction-level data collected from depository institutions in the Report of Selected Money Market Rates (FR 2420) annualized using a 360-day year or bank interest.

The underlying economic data SCM uses within ESM can change rapidly.

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ESM COMPONENTS, PAST 5 MONTHS CHART



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