



Quarterly Economic Update First Quarter 2024



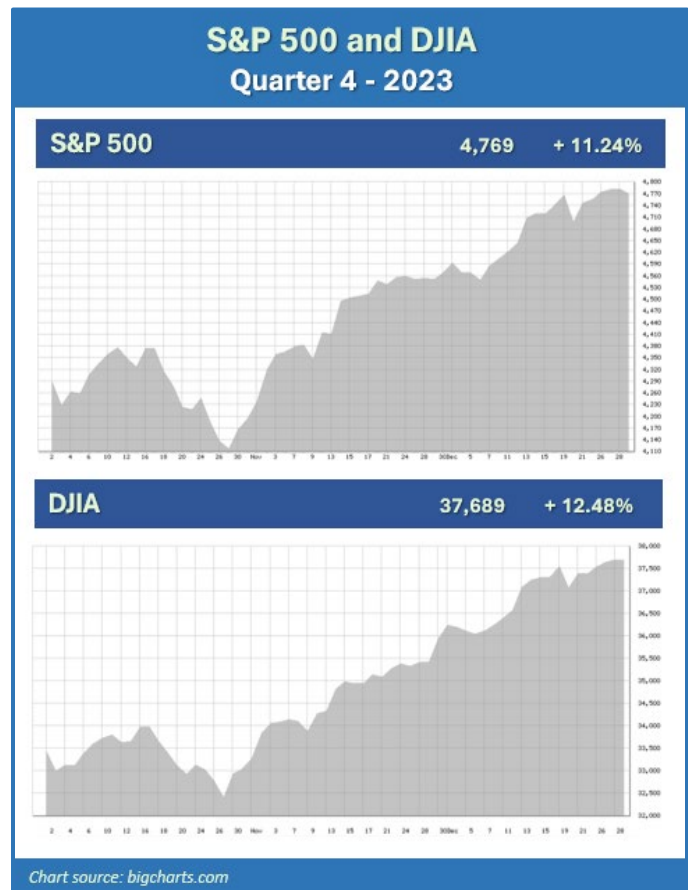
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2023 is in the books and the last quarter left investors looking forward to a bright and happy new year. The economic data in 2023 was better than expected: inflation fell, employment remained resilient, and we didn't end up in recession – in fact, growth was impressively resilient.

It now looks like the elusive economic soft landing may actually have a shot of becoming a reality (*at least, for a time*). Does that mean we can celebrate? Not quite. There is a big difference between achieving a soft landing and maintaining one. The reason is straightforward: When an economy reaches full employment, the central bank needs to calibrate monetary policy almost perfectly to keep it there. If it does not cut rates fast enough, unemployment will increase; if it cuts rates too fast, inflation will rise.

The U.S. consumer demonstrated resilience in 2023. However, excess U.S. household savings may be exhausted at some point this year based on their recent trajectory. That supports the view that the U.S. economy may be on a path to recession so long as monetary policy remains tight. We would likely need to see the Fed and the ECB return interest rates to neutral or even into easy territory for a recession to be avoided this year.

The longer interest rates stay high, the higher the probability of a recession. We acknowledge the possibility that central banks may be able to cut interest rates in time to prevent a recession if inflation decelerates more quickly than is expected. But, to put it simply, investing is a game of odds, and we believe that investors may be putting too much stock in an economic outcome that the Fed has not been able to achieve in over seven decades. Yes, the Fed's strategy has evolved over time and it has more tools in its toolbox now. Hence, this is definitely a bifurcated (*i.e. divided into two branches*) investing environment. We will, of course, stay nimble.



MONEY RATES

(as posted in Barron's 12/25/2023)

	LATEST WEEK	YR AGO
Fed Funds Rate*	5.31%	4.34%
Bank Money Market^z	0.60%	0.25%
12-month Certif^z	1.94%	1.35%

Z – Bankrate.com; * - Average effective offer
(Source: Barron's; bankrate.com)

As your financial professionals, we are committed to keeping you apprised of any changes and activity that could directly affect your unique situation. While 2023 rewarded our focus of being disciplined with our Business Cycle Asset Management strategy, we enter 2024 with our continued mantra of “proceed with caution.” Now is a good time to review your investments and confirm they are still congruent with your time horizon, risk tolerance, and goals.

Inflation & Interest Rates

Inflation pressure continued to ease in the fourth quarter. November’s rate came in at a 3.1% increase compared to a year earlier. While we have seen a significant improvement from the 9.1% peak in June of 2022, there is still a way to go to reach the Fed’s target of 2%.

The November core CPI (which excludes food and energy prices), which is used by many economists as a better indicator of future inflation, was up 4% from the year prior. While this is not the best of news, it is still well below its recent historical peak of 6.6% in September.

As a result of inflation easing and the economy maintaining its strength, the Fed held rates steady at their final meeting of 2023. The Fed had raised interest rates a whopping eleven times since March of 2022, so a three-time consistency of rate stagnancy was well received by investors. Even better news was the minutes shared that the Fed suggested rate cuts in 2024.

Federal Reserve

The positive environment in the 4th quarter was primarily attributed to the Fed signaling a pivot from its aggressive monetary position and indicating that interest rates could be cut several times in 2024.

The Fed left interest rates unmoved in the fourth quarter due to the continued slowdown of inflation. “Inflation has eased from its highs, and this has come without a significant increase in unemployment. That’s very good news,” stated Fed Chair Jerome Powell during a news conference following the December FOMC meeting. Fed officials see core inflation finishing 2023 at 3.2%, and 2.4% in 2024, then to 2.2% in 2025, resting at a final destination of 2% in 2026. (Source: *cnbc.com*, 12/12/23)

KEY TAKEAWAYS

- The Fed has held their federal funds rate range steady at 5.25 – 5.50%, with no changes in the fourth quarter.
- Inflation pressures continue to ease, with November clocking in at a 3.1% increase compared to a year earlier.
- Several key factors, including a presidential election and geopolitical unrest in 2024 could bring uncertainty for investors.
- Active investment management strategies allow investors to be nimble in this bifurcated (*split*) environment.
- Staying the course and maintaining the consistency of a well-devised, long-term financial strategy has historically served investors well.
- ***We are here for you to discuss your unique situation.***

The interest rate hiking cycle currently seems to be coming to an end with the 5.25–5.5% rate as a high point until the Fed potentially commences with an interest rate cut cycle. This can be good news for the investor (*i.e. any easing of the “tight money” stance would be welcome to the stock and bond markets*).

The Fed will cut interest rates meaningfully during the next U.S. recession, as has occurred during every recession in the post war era. However, unless a recession occurs imminently or inflation completely collapses, the Fed is unlikely to cut rates before next summer.

Interest rates and inflation are integral to financial planning so we will continue to keep a close eye on their movements. While the efforts of the Fed’s stringent monetary tightening policies the last few years are now being seen, the Fed still maintains their willingness to raise rates again should inflation reverse direction. Although we cannot predict what the Fed’s next move will be, we will continue to follow key economic indicators for our clients.

Investment Implications

A handful of tech high fliers drove most of the stock market returns in 2023, fueled by AI optimism. We do believe that AI has the potential to be a transformational force for growth across the wider economy, not just in tech. But we also think the market's timeline is unrealistic. In our view, we are more likely three to five years away than the one to two years that we saw priced into a narrow group of companies this year.

The current level of concentration is extreme. The “Magnificent Seven” stocks (Facebook, Apple, Amazon, Netflix, Google, Tesla, Nvidia) accounted for the majority of the gains (*and now account for over 30% of S&P 500 capitalization*). The late-1990s is the only other time in the post-war era that U.S. stocks were this concentrated. This heralds a bit of de-ja-view of prior market melt-up's (*melt-up's occur at the end of bull markets*).

We are not suggesting the stock market must fall from here. A market melt-up by definition is irrational buying devoid of fundamental improvements. AI could be that fundamental improvement but at this point the timing of this impact is highly uncertain.

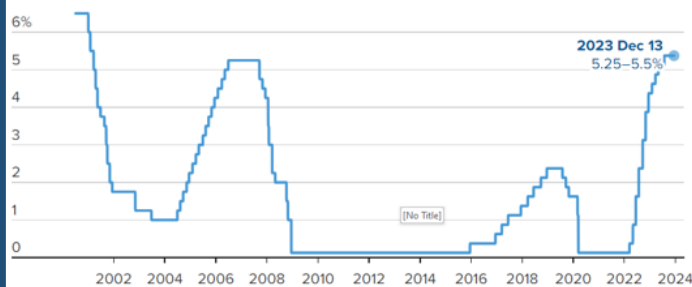
Over 2024, we think the market will be less monolithic, with opportunities spread out more widely. We have been talking recently about the relative underperformance, but real value found today in small caps, mid-caps and internationals. We are also looking to rebuild our bond position as our current position in the Business Cycle clearly favors bonds.

Treasury bonds, municipal bonds, investment grade corporate bonds, REITs and preferred securities may also be opportunities to contribute to the stability and modest growth of any portfolio. In 2023, these were all just a drag on portfolio performance and a source of frustration for all. Should we chuck them? Capitulate and buy the S&P 500? Buy even more Tesla? Of course not. Smart investors remain disciplined, diversified and recognize temporary oversold and overbought extremes for what they are. Fear of missing out can be just as strong as fear associated with losses. Both cause bad behavior, and this is clearly a time to manage emotions.

Investor Outlook

From a big picture perspective, the easy money era that prevailed from 2009-2021 is over. Neither a prolonged zero interest rate policy, nor the sustained use of quantitative easing as a monetary policy tool, are likely to emerge during the next recession.

Federal Funds Target Rate (2002 - December 2023)



Source: Federal Reserve Bank of New York

Note: From December 2008 to present, the chart reflects the midpoint of the Federal Reserve's target range.

Geopolitical unrest is still a major concern with the ongoing Russia-Ukraine war, conflict in the Middle East, and continued tensions with China. Also, the upcoming U.S. presidential election can be one of the major influencers of the market movements in 2024, since a new cabinet could signal major changes to the economy and tax laws. (Source: nytimes.com 12/11/23)

Heading into the new year, we will continue to keep an eye on inflation rates, economic growth data, and monetary policy moves. The coming months bring much uncertainty, and you should not let the recent market surge deflect you from your long-term strategy and goals. The media will be buzzing with daunting, speculative claims and predictions, and confusing information with the upcoming election. We recommend you minimize your viewing of news and social media.

From an investment management perspective, one of Zephyr's main purposes is to keep you as an investor in the game – the “game” is a chance at your best financial future. Emotions always run counter to any strategy that will help you win the game. All through history there has never been a strong emotion credited to good investment decisions. Quite often, good investment decisions are found in investment strategies that are consistent and healthy (*and maybe even a bit boring at times*).

The table is certainly set to benefit investors who have a healthy allocation to active investment strategies such as Business Cycle Asset Management in 2024. The long odds of a soft-landing scenario (*and of the*

Average Quarterly Returns for the S&P 500 (Since 1950)

Average Return	Probability of posting quarterly gain
Q1: 2.1%	63.5%
Q2: 2%	62.2%
Q3: 0.6%	60.8%
Q4: 4.2%	79.5%

Source: FactSet Data; CNBC

economy maintaining a soft landing for long) imply that we will continue to be nimble with portfolio positioning. For now, we will stay tactically in a moderate growth position but, as always, will look for the Business Cycle shifts that will inevitably require a portfolio that looks quite different from the one that worked last year.

2023 rewarded long-term investors and regardless of what 2024 will bring, it is always prudent to make smart money and investment decisions. We believe in proactive preparation and our goal is to provide you with a solid financial strategy that is carefully designed to withstand any market environment. From an investor standpoint, we stand by our belief that investing in equities is best done with a nimble, active management strategy. Heading into a new year, which is also the election year for one of the most raucous races we have seen in recent history, we believe that volatility

could still be prevalent and that investors should be cautionary in any financial decisions. A long-term strategy needs to be a benchmark goal for smart investors.

We always recommend discussing any changes, concerns, or ideas that you may have with us prior to making any financial decisions so we can help you determine your best strategy. There are often other factors to consider, including tax ramifications, increased risk, and time horizon changes when altering anything in your financial plan.

Our goal in 2024 is to exceed our client's expectations. We take pride in offering our clients quality service and are available to review their investments. We are now accepting new clients and would welcome the opportunity to review your situation.

Complimentary Financial Check-up

Our goal this year is to help more people with their financial decisions.

If you are currently not a client of Zephyr Wealth Management, we would like to offer you a complimentary, one-hour, private consultation with one of our professionals at absolutely no cost or obligation to you.

To schedule your financial check-up, please call Cher at (805) 496-6810

"We Cannot Direct the Wind, But We Can Adjust the Sails."

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