Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

Looking for something to read? See our Reading List; these books, separated by category, are ones we find interesting and insightful. We will be adding to the list over time.

[Posted: April 10, 2024—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is up 0.8% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.0%. Chinese markets were lower, with the Shanghai Composite down 0.7% from its previous close and the Shenzhen Composite down 1.7%. US equity index futures are signaling a higher open.

The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *Bi-Weekly Geopolitical Report* (4/8/2024) (with associated podcast): "Is Japan Back?"
- *Asset Allocation Quarterly – Q1 2024* (1/26/2024): Discussion of our asset allocation process, Q1 2024 portfolio changes, and our outlook for the markets.
- *Asset Allocation Q1 2024 Rebalance Presentation* (2/5/2024): Video presentation featuring the Asset Allocation Committee as they review the asset allocation strategies, recent portfolio changes, and the current macro environment.
- *Asset Allocation Bi-Weekly* (4/1/2024) (no associated podcast for this report): "Gold, Gold Miners, and Central Banks"
- *The 2024 Outlook: Slow-Bicycle Economy* (12/18/2023) (with associated *Confluence of Ideas* podcast)
- *Confluence of Ideas podcast* (2/13/2024) "Reviewing the Asset Allocation Rebalance: Q1 2024"

Our *Comment* today opens with a major new speech by a top European Union policymaker that calls for greater US-EU coordination to counter China's unfair trade practices — a call that is likely to anger Beijing and fuel greater tensions between the West and China. We next review a wide range of other international and US developments with the potential to affect the financial markets today, including a new downgrade to the outlook for China's credit rating and an Arizona Supreme Court ruling that could have an important impact on the US elections in November.

United States-European Union-China: In a major speech yesterday, European Commission market competition chief Margrethe Vestager called for the US and the EU to team up and present a more systematic, coordinated approach against China's unfair trade practices. To protect their key industries of the future, Vestager outlined a strategy in which the US and EU, working together, could convince the Group of 7 countries to erect trade barriers against subsidized Chinese products being sold in the West at artificially low prices.

- Vestager also announced that the EU is launching an anti-dumping probe into Chinese wind turbines, just as it previously announced an investigation into the likely dumping of low-cost Chinese electric vehicles on the EU market.
- According to Vestager, "We saw the playbook for how China came to dominate the solar panel industry . . . We see this playbook now deployed across all clean tech areas, legacy semiconductors, and beyond, as China doubles down on a supply side support strategy to address its economic downturn."
- The new anti-dumping probe is certain to generate complaints, pushback, and perhaps even retaliation by Beijing. Indeed, some European officials are likely to push back against the probe out of fear that China will retaliate by imposing new restrictions on their trade or investment flows. In the past, those concerns have limited the EU's actions against China. However, faced with yet another onslaught of subsidized Chinese goods, the EU may ultimately impose tougher restrictions this time, as Vestager calls for.
- In any case, Vestager's tough speech is a sign that economic tensions between the West and China aren't going away anytime soon. They actually look set to worsen, since the Chinese government is likely to retaliate in one way or the other and shows no sign of wanting to shift away from its investment/export economic development strategy toward a consumption-led model.

Japan-China: In a new survey by Japanese news firm *Yomiuri Shimbun*, 92% of respondents said China is a threat to Japan's national security, versus 86% who said the same in 2023 and 81% who said so in 2022. The responses help explain Tokyo's enthusiastic support for the US effort to strengthen allied defense efforts against China's increased geopolitical aggressiveness in the Indo-Pacific region. The results also suggest tensions between China and the westernized liberal democracies will continue to increase going forward.

China: Reflecting China's slowing economic growth, slumping property market, and rising fiscal deficit, Fitch today maintained its A+ rating on the country's sovereign debt but cut its outlook from stable to negative. The move follows a similar one by Moody's in December, in which that company maintained its A1 rating on China's long-term debt but also cut its outlook from stable to negative.

- China's burgeoning public sector debt stems mostly from fiscal shortfalls at the provincial and local government levels. The central government has begun to issue its own new debt to rescue some of those lower-level governments, but that is putting new fiscal pressures on Beijing.
- The rising debt challenges compound other structural economic challenges that have come to light in recent years, such as excess industrial capacity, weak consumer demand, poor demographics, decoupling by foreign countries, and the disincentives from the Communist Party's increasing intrusions into the economy.

- Not only are China's debt and other structural economic problems creating headwinds for the country's own economy and financial markets, but they are also holding down growth in some other countries.

Australia: The government said today that it will toughen the country's corporate merger rules amid concerns that increased market concentration is stifling competition and boosting prices. Under the plan, the government will give the Australian Competition and Consumer Commission added powers to scrutinize mergers above certain value and market-share thresholds. The ACCC would also be given authority to stop small serial acquisitions that could reduce competition over time, bringing Australia's rules in line with those of most other developed countries.

Eurozone: Big US money managers are reportedly shifting their bond purchases from US Treasuries to eurozone obligations in hopes that the European Central Bank could begin to cut its benchmark interest rate sooner and faster than the Federal Reserve will cut US rates. The improved outlook for eurozone bonds reflects Europe's much weaker economy and rapidly falling inflation. In contrast, strong economic growth in the US is keeping price pressures high and threatening to delay the Fed's interest-rate cuts.

US Politics: Responding to the US Supreme Court decision in June 2022 that rolled back federal protections for abortion, the Arizona Supreme Court yesterday ruled that a nearly total ban still on the books from Arizona's territorial days must be reinstated. The move follows a recent Florida Supreme Court ruling that also allowed tighter restrictions, even as it approved a referendum on abortion rights in the November election.

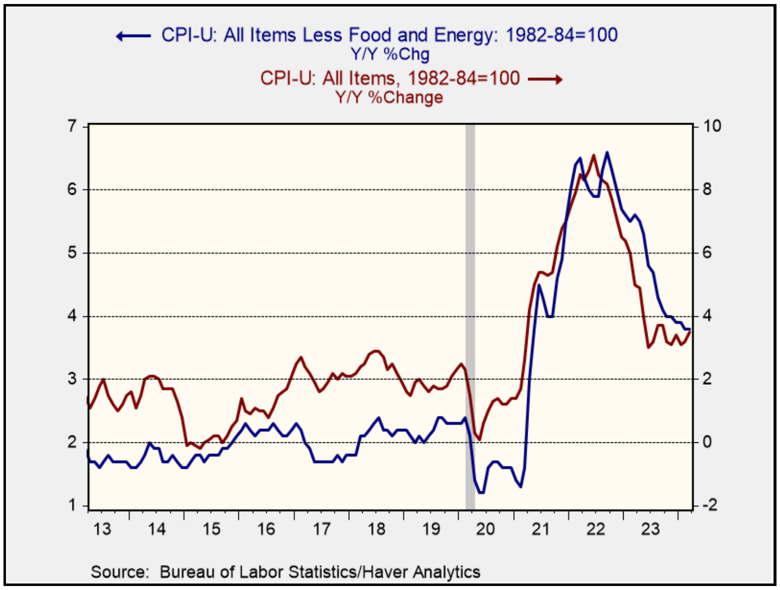
- Although the rulings will have no discernible impact on the US economy or financial markets, they have the potential to affect the upcoming elections.
- Given that Democrats have shown they can exploit the June 2022 ruling that overturned *Roe v. Wade*, the rulings could help the party in Arizona, Florida, and even in other key swing states, despite current polling showing greater support for former President Trump than for President Biden.

US Postal System: The US Postal Service has requested permission to boost the price of a first-class stamp by an additional 5 cents. If approved in the coming weeks by the Postal Regulatory Commission, the cost of a stamp would rise on July 14 to $0.73, up 10.6% from one year earlier.

US Economic Releases

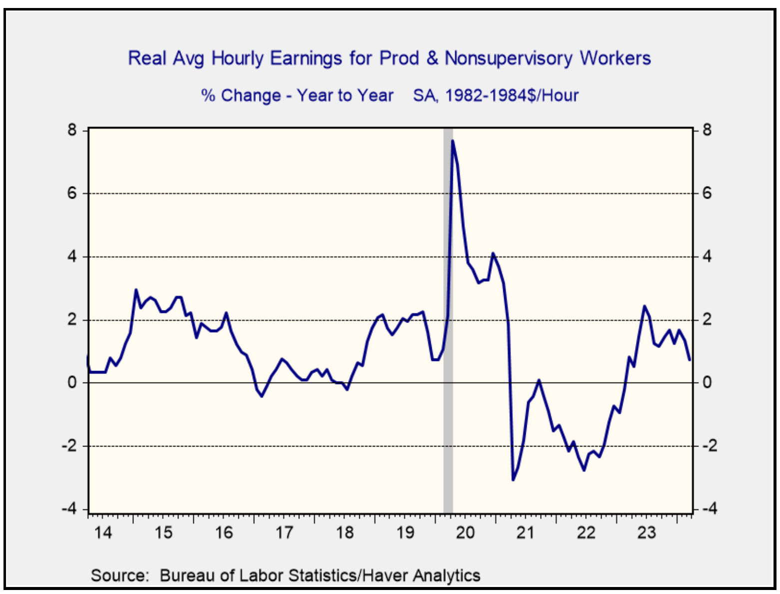
Home loan applications ticked up slightly last week, despite ongoing challenges for buyers due to high borrowing costs. Data from the Mortgage Bankers Association (MBA) shows a 0.1% increase in applications for the week ending April 5. This modest rise was fueled by a 9.9% jump in the refinance index, as existing homeowners sought to secure their current rates before a potential future tightening of financial conditions. However, the average 30-year fixed-mortgage rate edged up 10 basis points to 7.01%, leading to a 4.7% decline in the MBA's purchase index, indicating a pullback among potential homebuyers.

March inflation rose at a faster-than-expected pace, driven primarily by higher shelter and gas prices. The Consumer Price Index (CPI) climbed 0.4% from February, exceeding forecasts of 0.3% and matching the increase seen in the prior month. Core inflation, excluding volatile food and energy prices, also rose 0.4%, surpassing expectations and remaining steady compared to February.



The chart above shows the annual change in core and headline CPI. Last month, headline CPI rose 3.5% from the prior year, while core CPI rose 3.6%. The high reading, particularly the persistence of upward price pressure, is likely to raise concerns at the Fed and impact rate expectations.

Despite the overall inflation stickiness, real wages have shown signs of easing. Last month, average hourly wages rose 1.0% from the prior year, while average weekly wages rose 0.8%.



Real average hourly wages for production and nonsupervisory workers grew at a slower pace in March, rising just 0.73% year-over-year. This is down from a 1.35% increase in February.

The table below lists the economic releases and/or Fed events scheduled for the rest of the day.

Economic Releases						
EST	Indicator			Expected	Prior	Rating
10:00	Wholesale Inventories	m/m	Feb F	0.5%	0.5%	**
10:00	Wholesale Trade Sales	m/m	Feb	0.8%	-1.7%	*
14:00	Monthly Budget Statement	m/m	Mar	-$233.0b	-$378.1b	**
Federal Reserve						
EST	Speaker or Event	District or Position				
8:45	Michelle Bowman Discusses Basel Capital Requirements	Member of the Board of Governors				
12:45	Austan Goolsbee Participates in Panel Discussion	President of the Federal Reserve Bank of Chicago				
14:00	FOMC Meeting Minutes	Federal Reserve Board				

Foreign Economic News

We monitor numerous global economic indicators on a continuous basis. The most significant international news that was released overnight is outlined below. Not all releases are equally significant, thus we have created a star rating to convey to our readers the importance of the various indicators. The rating column below is a three-star scale of importance, with one star being the least important and three stars being the most important. We note that these ratings do change over time as economic circumstances change. Additionally, for ease of reading, we have also color-coded the market impact section, which indicates the effect on the foreign market. Red indicates a concerning development, yellow indicates an emerging trend that we are following closely for possible complications, and green indicates neutral conditions. We will add a paragraph below if any development merits further explanation.

Country	Indicator			Current	Prior	Expected	Rating	Market Impact
ASIA-PACIFIC								
Japan	PPI Services	y/y	Mar	0.8%	0.7%	0.8%	*	Equity and bond neutral
EUROPE								
Italy	Retail Sales	y/y	Feb	2.4%	1.0%		**	Equity and bond neutral
AMERICAS								
Mexico	International Reserves Weekly	w/w	5-Apr	$217299M	$217194m		*	Equity and bond neutral
Brazil	IBGE Inflation IPCA	y/y	Mar	3.90%	4.50%	4.01%	***	Equity and bond neutral

Financial Markets

The table below highlights some of the indicators that we follow daily. Again, the color coding is similar to the foreign news description above. We will add a paragraph below if a certain move merits further explanation.

Fixed Income	Today	Prior	Change	Trend
3-mo Libor yield (bps)	556	556	0	Down
3-mo T-bill yield (bps)	521	521	0	Up
U.S. Sibor/OIS spread (bps)	530	530	0	Down
U.S. Libor/OIS spread (bps)	531	531	0	Down
10-yr T-note (%)	4.34	4.36	-0.02	Down
Euribor/OIS spread (bps)	392	390	2	Down
Currencies	**Direction**			
Dollar	Flat			Up
Euro	Flat			Down
Yen	Flat			Down
Pound	Up			Down
Franc	Flat			Down
Central Bank Action	**Current**	**Prior**	**Expected**	
RBNZ Official Cash Rate	5.500%	5.500%	5.500%	On Forecast

Commodity Markets

The commodity section below shows some of the commodity prices and their change from the prior trading day, with commentary on the cause of the change highlighted in the last column.

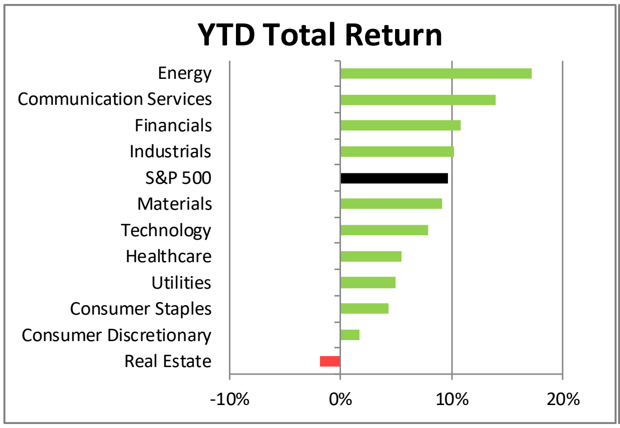
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$90.01	$89.42	0.66%	
WTI	$85.81	$85.23	0.68%	
Natural Gas	$1.94	$1.87	3.58%	
Crack Spread	$29.46	$29.15	1.05%	
12-mo strip crack	$24.95	$24.77	0.74%	
Ethanol rack	$1.84	$1.83	0.16%	
Metals				
Gold	$2,347.71	$2,352.78	-0.22%	
Silver	$28.09	$28.15	-0.22%	
Copper contract	$432.95	$428.55	1.03%	
Grains				
Corn contract	$434.50	$431.25	0.75%	
Wheat contract	$566.00	$557.75	1.48%	
Soybeans contract	$1,178.00	$1,174.50	0.30%	
Shipping				
Baltic Dry Freight	1,570	1,594	-24	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		0.8		
Gasoline (mb)		-2.3		
Distillates (mb)		-1.4		
Refinery run rates (%)		0.6%		
Natural gas (bcf)		15		

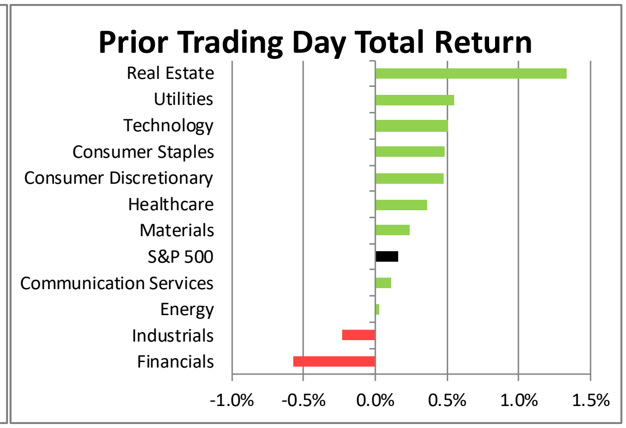
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures for states east of the Rockies, with cooler temps in the northern Pacific. The precipitation outlook calls for wetter-than-normal conditions in most states east of the Great Plains, and drier-than-normal conditions in the Pacific and Southeast regions.

Data Section

US Equity Markets – (as of 4/9/2024 close)

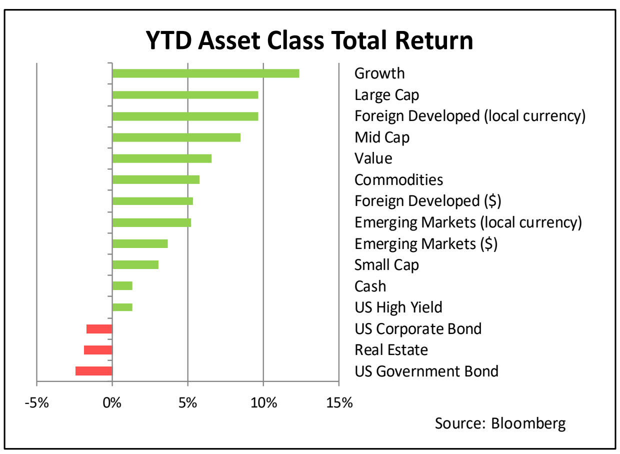




(Source: Bloomberg)

These S&P 500 and sector return charts are designed to provide the reader with an easy overview of the year-to-date and prior trading day total return. Sectors are ranked by total return; green indicating positive and red indicating negative return, along with the overall S&P 500 in black. These charts represent the new sectors following the 2018 sector reconfiguration.

Asset Class Performance – (as of 4/9/2024 close)

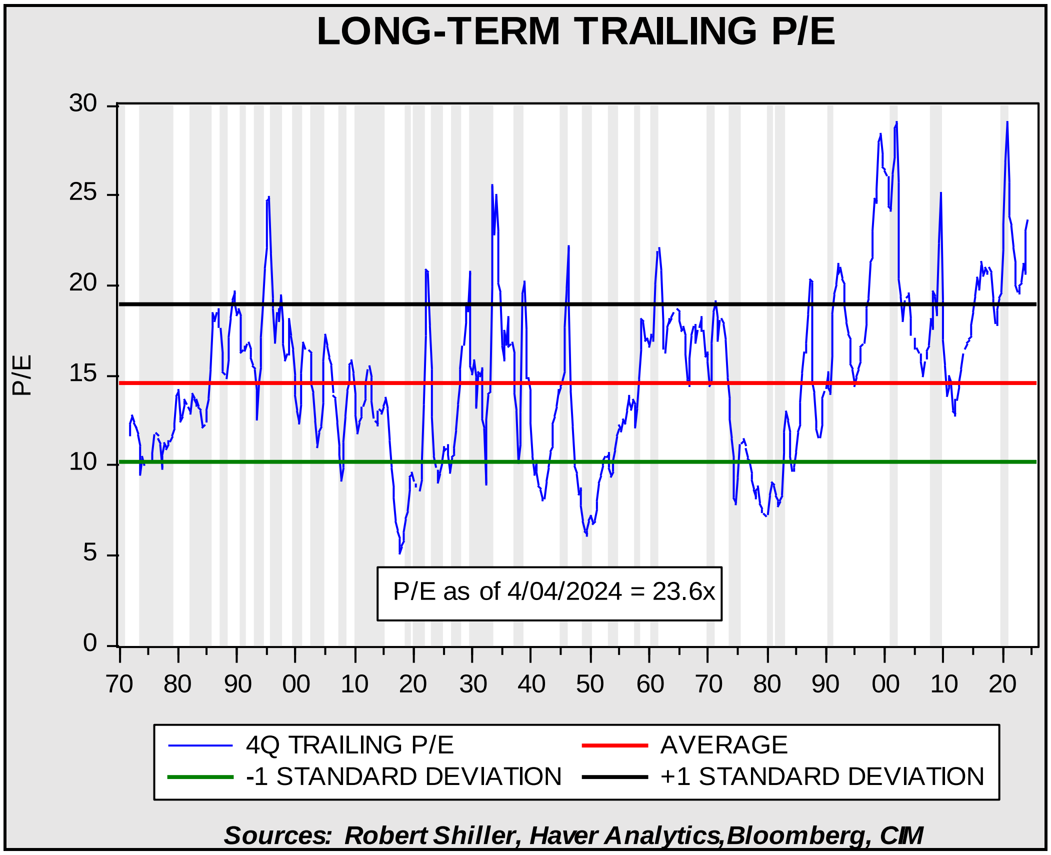


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

Asset classes are defined as follows: Large Cap (S&P 500 Index), Mid Cap (S&P 400 Index), Small Cap (Russell 2000 Index), Foreign Developed (MSCI EAFE (USD and local currency) Index), Real Estate (FTSE NAREIT Index), Emerging Markets (MSCI Emerging Markets (USD and local currency) Index), Cash (iShares Short Treasury Bond ETF), US Corporate Bond (iShares iBoxx $ Investment Grade Corporate Bond ETF), US Government Bond (iShares 7-10 Year Treasury Bond ETF), US High Yield (iShares iBoxx $ High Yield Corporate Bond ETF), Commodities (Bloomberg total return Commodity Index), Value (S&P 500 Value), Growth (S&P 500 Growth).

P/E Update

April 4, 2024



Based on our methodology,[1] the current P/E is 23.6x, up 0.5x from our last report. The improvement in the multiple reflects an increase in the stock price index due to a change in quarter, outweighing the increase in earnings.

This report was prepared by Confluence Investment Management LLC and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward-looking statements expressed are subject to change. This is not a solicitation or an offer to buy or sell any security.

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[1] This chart offers a running snapshot of the S&P 500 P/E in a long-term historical context. We are using a specific measurement process, similar to *Value Line*, which combines earnings estimates and actual data. We use an adjusted operating earnings number going back to 1870 (we adjust as-reported earnings to operating earnings through a regression process until 1988), and actual operating earnings after 1988. For the current quarter, we use the Bloomberg estimates which are updated regularly throughout the quarter; currently, the four-quarter earnings sum includes three actual quarters (Q2, Q3 and Q4) and one estimate (Q1). We take the S&P average for the quarter and divide by the rolling four-quarter sum of earnings to calculate the P/E. This methodology isn't perfect (it will tend to inflate the P/E on a trailing basis and deflate it on a forward basis), but it will also smooth the data and avoid P/E volatility caused by unusual market activity (through the average price process). Why this process? Given the constraints of the long-term data series, this is the best way to create a long-term dataset for P/E ratios.