Daily Comment

By Bill O'Grady 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 12, 2019—9:30 AM EDT] Global equity markets are generally mixed this morning. The EuroStoxx 50 is up 0.4% from the last close. In Asia, the MSCI Asia Apex 50 was up 0.3% from the prior close. Chinese markets were mixed, with the Shanghai composite remaining unchanged and the Shenzhen index down 0.1%. U.S. equity index futures are signaling a higher open.

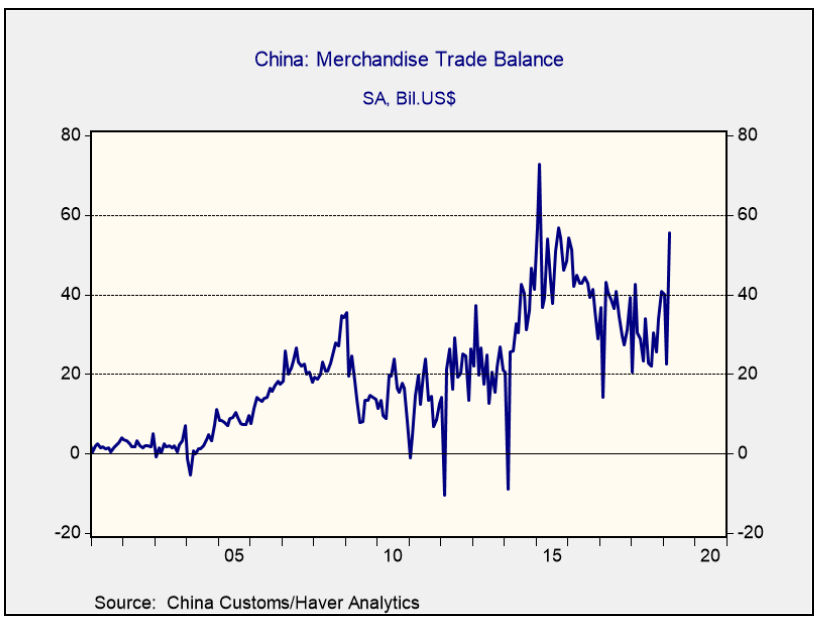
We are seeing a risk-on day. Other than this sentence, there will be no discussion of Brexit today. Here is what we are watching:

Chinese data: Bank loans rose much more than expected, with CNY 1.69 trillion extended compared to expectations of CNY 1.25 trillion. Total financing rose to CNY 2.86 trillion compared to the CNY 1.85 trillion expected. Although the data does suggest that China's announced liquidity expansion is starting to make its way into the economy, it's important to note that recent actions pale in comparison to what we saw in 2009-10.

The yearly growth rate of bank loans in March was 13.7%., up from 13.4% in February. This is welcome growth but not enough to boost global growth.

M2 growth remains sluggish.

Meanwhile, China's trade surplus jumped to $55.6 bn (goods only) as exports rose 5.4% but imports fell 8.1%. The decline in imports is worrisome as this sector is usually sensitive to domestic demand. Still, the rise in the trade surplus will boost China's GDP.



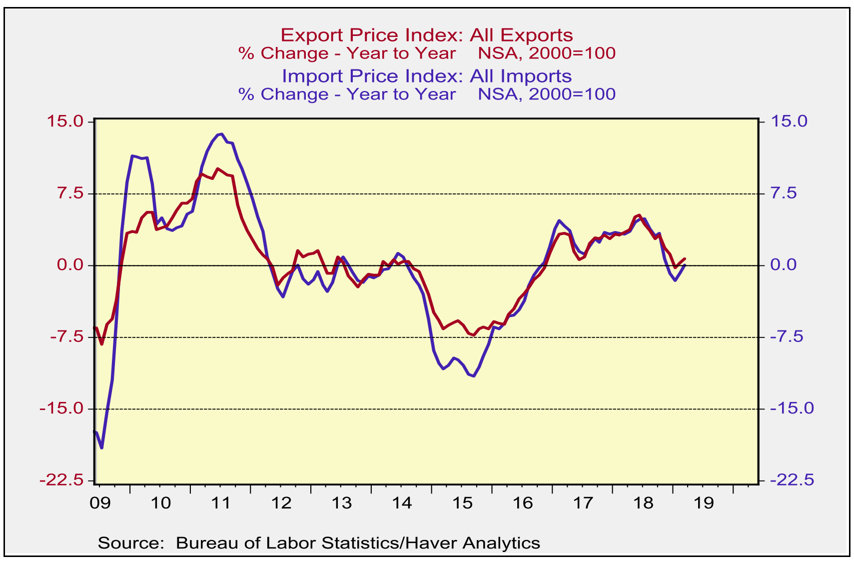
We suspect the lift we are seeing this morning in risk assets is coming from expectations of better growth in China. Although the data is showing some improvement, the growth rates are far from spectacular and the drop in imports is a concern.

Sudan: After ruling (or, perhaps, misruling) Sudan for three decades, President Omar Hassan al-Bashir has been ousted in a military coup[1] after four months of nearly continuous protests. Although al-Bashir was a brutal ruler, his regime remains in place and the ouster probably won't end the protests. Sudan produces around 100 kbpd, but the concern is that if civil order collapses in Sudan then oil from South Sudan (about 200 kbpd) could be affected. Sudan becomes another concern for oil supply, joining Libya and Algeria. Oil prices have bounced this morning.

Cain in trouble: Four Senate Republicans have indicated they won't support Herman Cain for Fed governor.[2] Although this news doesn't bode well for his nomination, it doesn't necessarily kill it either. For this number to sink Cain's chances, all Democrats would have to reject his nomination. That might not happen. Still, if Cain is pulled, we would not be shocked to see Larry Kudlow get the nod, which would put two Trump loyalists on the Fed.

U.S. Economic Releases

The March import price index came in above expectations, rising 0.6% from the prior month compared to the forecast of 0.4%. The prior month's report was revised upward from 0.6% to 1.0%. The import price index excluding petroleum was above expectations, rising 0.2% from the prior month compared to the forecast of 0.0%. The prior month's report was revised upward from 0.1% to 0.2%. The export price index was also above expectations, rising 0.7% from the prior month compared to the forecast gain of 0.2%. The prior month's report was revised upward from 0.6% to 0.7%.



The chart above shows the year-over-year changes in the import price and export price indexes. The import price index fell 0.6% from the prior year, while the export price index rose 0.6%.

[1] https://www.nytimes.com/2019/04/11/world/africa/sudan-omar-hassan-al-bashir.html?emc=edit_MBE_p_20190412&nl=morning-briefing&nlid=5677267tion%3DtopNews&section=topNews&te=1
[2] https://www.washingtonpost.com/powerpost/pelosi-slams-trumps-fed-picks-as-totally-unsuited-unqualified/2019/04/11/8dfebc5c-5c5e-11e9-842d-7d3ed7eb3957_story.html?utm_term=.f3496aa0e38b

The table below lists the economic releases scheduled for the rest of the day.

Economic Releases						
EDT	Indicator			Expected	Prior	Rating
10:00	U. of Michigan Sentiment	m/m	apr	98.2	98.4	**
10:00	U. of Michigan Current Conditions	m/m	apr		113.3	**
10:00	U. of Michigan Expectations	m/m	apr		88.8	**
10:00	U. of Michigan 1 yr Inflation	m/m	apr		2.5%	**
10:00	U. of Michigan 5-10 Yr Inflation	m/m	apr		2.5%	**
Fed speakers or events						
No speakers or events scheduled						

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								
China	Trade Balance	m/m	mar	$32.650 bn	$4.120 bn	$5.700 bn	**	Equity bullish, bond bearish
	New Yuan Loans	y/y	mar	1.690 tn	0.886 bn		**	Equity bullish, bond bearish
New Zealand	REINZ House Sales	m/m	mar	-12.9%	-9.5%		**	Equity and bond bearish
	BusinessNZ Manufacturing PMI	m/m	mar	51.9	53.7		**	Equity and bond neutral
	Card Spending Retail	m/m	mar	-0.3%	0.9%	0.5%	**	Equity and bond bearish
	Card Spending Total	m/m	mar	-0.2%	0.1%		**	Equity and bond neutral
	Net Migration	m/m	feb	6570	6300		**	Equity and bond neutral
EUROPE								
Eurozone	Industrial Production	y/y	feb	-0.3%	-1.1%	-0.9%	***	Equity and bond neutral
Germany	Wholesale Price Index	y/y	mar	1.8%	1.6%		**	Equity and bond neutral
Russia	Money Supply Narrow Def	y/y	apr	10.16 tn	10.10 tn		**	Equity and bond neutral
AMERICAS								
Mexico	Industrial Production	y/y	feb	-0.8%	-0.9%	-0.8%	***	Equity and bond neutral
	Manufacturing Production	y/y	feb	1.1%	1.3%	0.9%	**	Equity bullish, bond bearish
Canada	New Housing Price Index	y/y	feb	0.1%	-0.1%	0.1%	**	Equity and bond neutral

Financial Markets

The table below highlights some of the indicators that we follow on a daily basis. 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.

	Today	Prior	Change	Trend
3-mo Libor yield (bps)	260	258	2	Up
3-mo T-bill yield (bps)	237	238	-1	Neutral
TED spread (bps)	24	21	3	Neutral
U.S. Libor/OIS spread (bps)	241	241	0	Up
10-yr T-note (%)	2.54	2.50	0.04	Neutral
Euribor/OIS spread (bps)	-31	-31	0	Neutral
EUR/USD 3-mo swap (bps)	14	14	0	Down
Currencies	**Direction**			
dollar	down			Neutral
euro	up			Up
yen	down			Neutral
pound	up			Neutral
franc	up			Neutral

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.

	Price	Prior	Change	Explanation
Energy Markets				
Brent	$71.64	$70.83	1.14%	Global Growth Optimism
WTI	$64.46	$63.58	1.38%	
Natural Gas	$2.68	$2.66	0.49%	
Crack Spread	$21.81	$22.30	-2.21%	
12-mo strip crack	$17.99	$18.19	-1.11%	
Ethanol rack	$1.46	$1.46	0.05%	
Metals				
Gold	$1,293.98	$1,292.51	0.11%	
Silver	$15.07	$14.97	0.66%	
Copper contract	$294.65	$288.70	2.06%	
Grains				
Corn contract	$ 369.25	$ 368.75	0.14%	
Wheat contract	$ 467.25	$ 465.50	0.38%	
Soybeans contract	$ 909.75	$ 908.75	0.11%	
Shipping				
Baltic Dry Freight	728	734	-6	
DOE inventory report				
	Actual	**Expected**	**Difference**	
Crude (mb)	7.0	2.5	4.5	
Gasoline (mb)	-7.7	-2.0	-5.7	
Distillates (mb)	-0.1	-1.5	1.4	
Refinery run rates (%)	1.10%	1.00%	0.10%	
Natural gas (bcf)	25.0	33.0	-8.0	

Weather

The 6-10 and 8-14 day forecasts shows cooler temps for most of the country, with warmer temps on the two coasts. Precipitation is expected for most of the country. A major winter storm is dumping prodigious amounts of snow across the northern plains. This will likely delay corn planting and increase flooding in the Midwest and southern river systems.

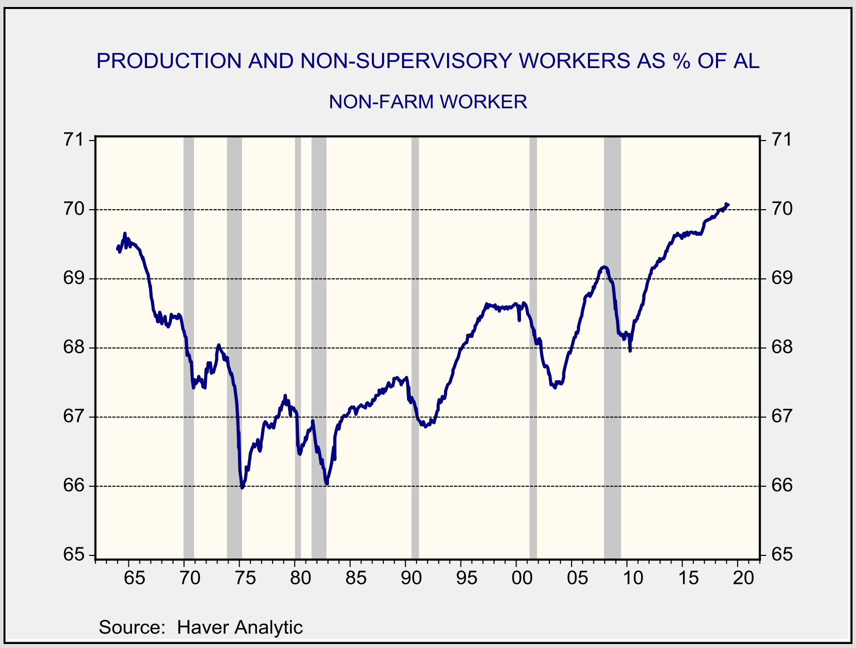
Asset Allocation Weekly

Confluence Investment Management offers various asset allocation products which are managed using "top down," or macro, analysis. We report asset allocation thoughts on a weekly basis, updating this section every Friday.

April 12, 2019

The employment data is closely watched by financial markets; although the data isn't necessarily a leading indicator for the economy, it is probably the most important from a political and social perspective. Weak employment data is a worry for political incumbents and concerning to policymakers. However, beyond the headline data, there are usually interesting trends worth noting. In this week's report, we will examine two trends that have longer term implications.

Career paths were part of corporate culture three decades ago. Large companies often had junior executive programs, where promising young talent was brought to the firm and would follow a rotation of positions in numerous departments before finding a permanent home. In other situations, college graduates would join a company and follow a path of positions of increasing responsibility. However, over the years, outsourcing jobs overseas and increasing industry concentration[3] have probably reduced the number of entry level professional positions in the U.S. This chart shows the percentage of production and non-supervisory workers compared to total non-farm employment.

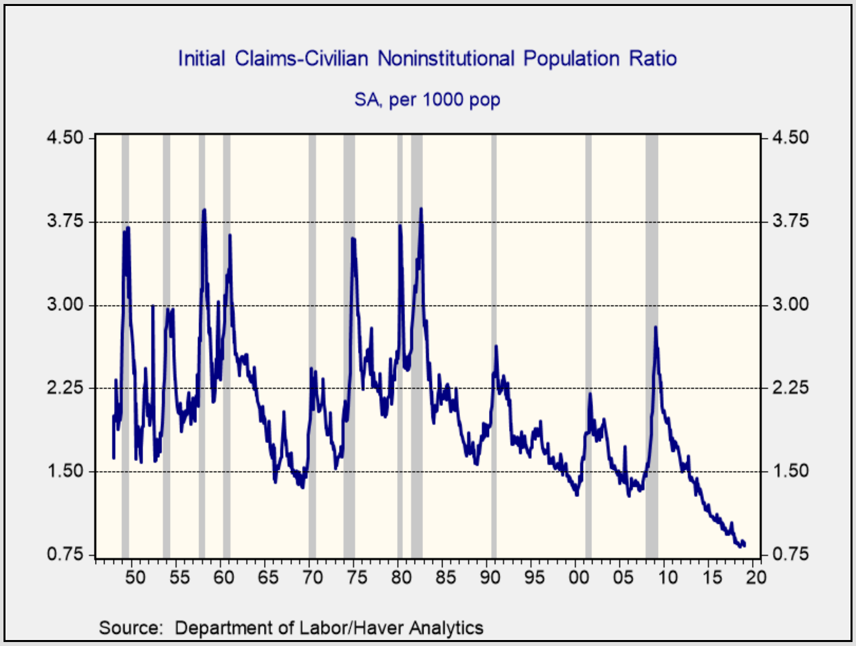


In the 1970s, this percentage declined to a low of 66%. However, since the early 1980s, the percentage has steadily increased in each business cycle. This data suggests that an increasing number of jobs are non-management positions. We suspect that college graduates are being forced to accept non-management positions as fewer of them are available for an increasing

[3] https://finance.eller.arizona.edu/sites/finance/files/grullon_11.4.16.pdf

number of graduates. Such disappointment has the potential to cause social unrest. At the same time, reversing industry concentration would tend to boost the number of management jobs in the economy (every firm needs HR, finance, etc.). Thus, support for anti-trust actions could become more popular.

Second, initial claims, on a weekly basis, fell to 40-year lows recently. However, the weekly data is "noisy" and can be affected by floating holidays and weather. Another way of looking at claims is to scale to the civilian non-institutional population. This data is at historic lows.

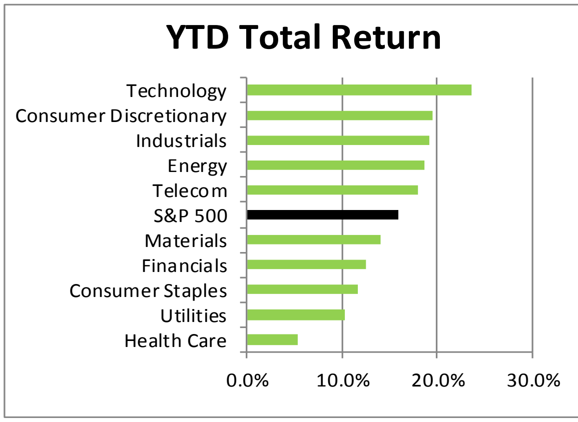


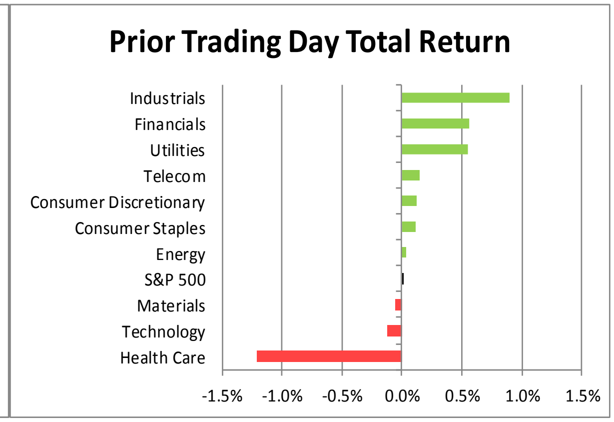
This low level of claims is likely due, in part, to firms holding on to workers because of tight labor conditions. A rising number of retirees will lift the non-working civilian non-institutional population but fewer workers will tend to depress claims. In any case, this level of claims compared to the population is remarkably low and would argue that wages should rise.

Overall, these two charts offer insights into longer term issues in the labor market. They won't have an immediate effect on financial markets, but both signal potential for further disruption.

Data Section

U.S. Equity Markets – (as of 4/11/2019 close)

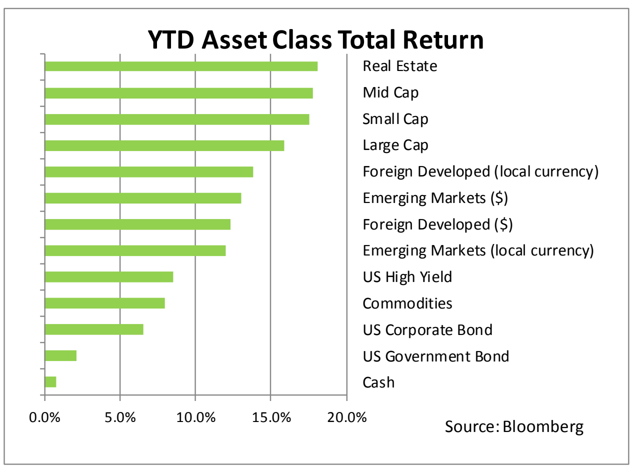




(Source: Bloomberg)

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.

Asset Class Performance – (as of 4/11/2019 close)

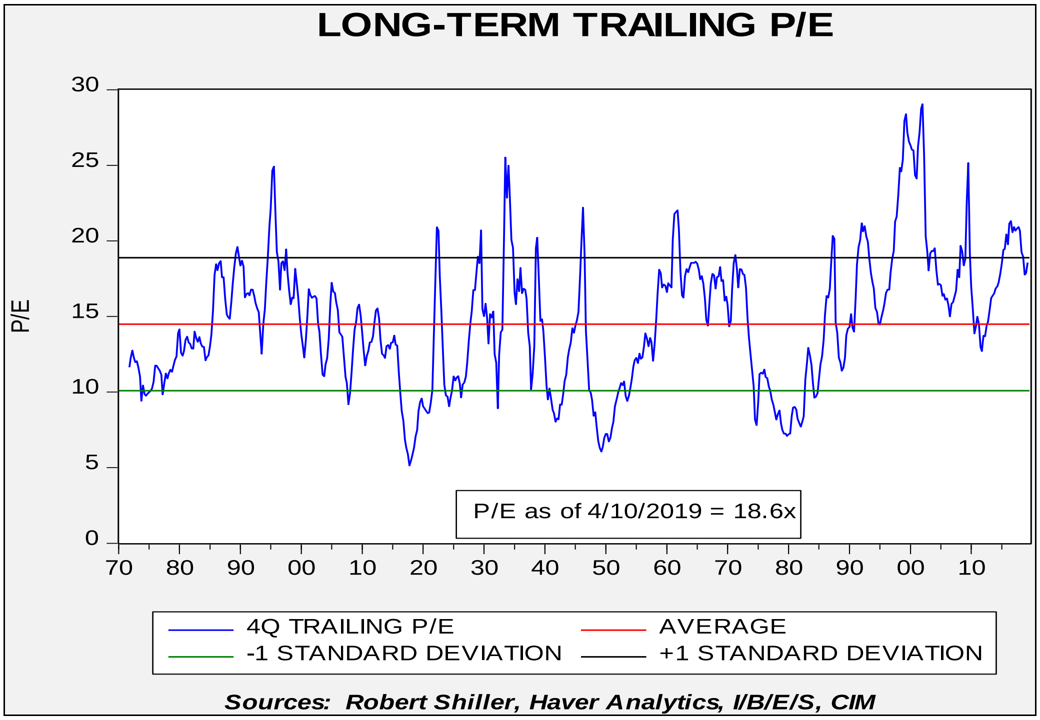


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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), U.S. Corporate Bond (iShares iBoxx $ Investment Grade Corporate Bond ETF), U.S. Government Bond (iShares 7-10 Year Treasury Bond ETF), U.S. High Yield (iShares iBoxx $ High Yield Corporate Bond ETF), Commodities (Bloomberg total return Commodity Index).

P/E Update

April 11, 2019



Based on our methodology,[4] the current P/E is 18.6x, up 0.1x from last week. The increase in the multiple is mostly due to the recent rise in the index.

[4] 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 I/B/E/S estimates which are updated regularly throughout the quarter; currently, the four-quarter earnings sum includes three actual quarters (Q3 and Q4) and two estimates (Q1 and Q2). 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.