INVESTMENT MANAGEMENT

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 12, 2024—9:30 AM EDT] Global equity markets are generally lower 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 down 1.4%. Chinese markets were lower, with the Shanghai Composite down 0.5% from its previous close and the Shenzhen Composite down 0.8%. US equity index futures are signaling a lower 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"

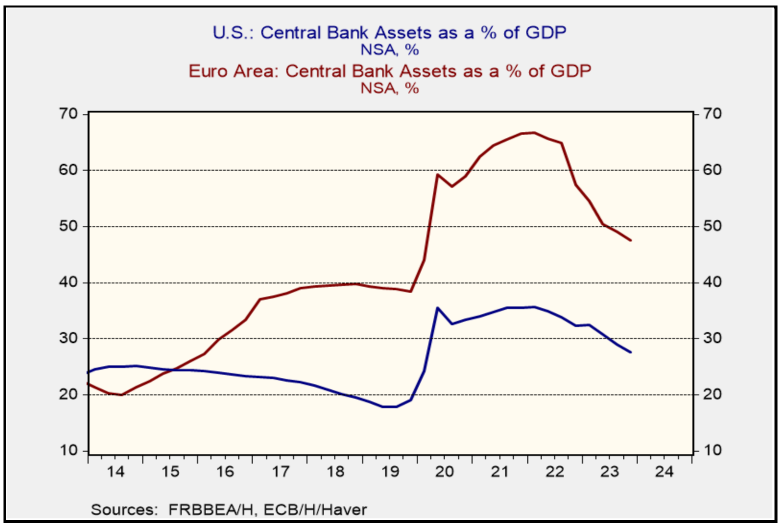
Good morning! Equities are off to a slow start today as investors await key bank earnings reports. In a separate development, NFL fans are buzzing after quarterback Tom Brady hinted at a possible return. Today's *Comment* examines the contrasting monetary policies of the ECB and the Fed, explores the reasons behind gold's recent surge in investor interest, and analyzes the potential impact of South Korea's parliamentary elections on its stock market. As always, we conclude with a summary of key domestic and international data releases.

Taking Different Paths: The ECB and the Federal Reserve are diverging on monetary policy, with both looking to loosen restrictions without abandoning their goals.

- The FOMC minutes unveiled on Wednesday provide valuable insights into the Federal Reserve's strategy for balance sheet reduction. FOMC policymakers have signaled an openness to initiating this process, with a primary focus on scaling back the pace of US

Treasury roll-off while maintaining mortgage-backed securities unchanged. While a specific start date isn't confirmed, May or June are possible targets. Chair Powell stressed a gradual approach to control the process. This aims to reduce reserves from "abundant" to an as yet to be defined "ample" level, with the hopes of preventing disruptions similar to the 2019 short-term funding market issues.

- The European Central Bank (ECB) is taking a contrasting approach. The ECB is maintaining its current pace of balance sheet reduction, continuing to unwind its asset purchase program, and stopping the reinvestment of bonds from its pandemic program by year-end. This last step will significantly accelerate the shrinking of the ECB's balance sheet. This faster drawdown aims to both limit new money entering the financial system and counteract any stimulus from potential future rate cuts, aligning with the ECB's mission of ensuring the return of price stability within the market.

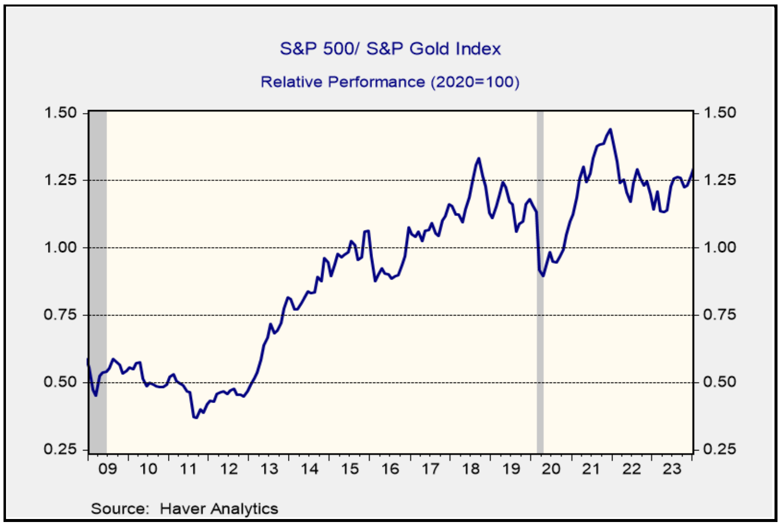


- The central banks are taking different approaches to monetary policy based on their economic concerns. The Fed's measured pace of balance sheet reduction suggests a focus on preventing financial instability, possibly due to rising liquidity concerns. In contrast, the ECB's preference for rate cuts suggests policymakers are worried about rising defaults, hoping lower rates will allow businesses to refinance debt more easily. That said, these adjustments by central banks may not signal a return to loose monetary policy, but rather a moderation of previous tightening measures. Investors should therefore remain cautious about excessive risk-taking.

Gold Bugs in Charge: The bullion has surged in recent months as central banks have looked to acquire the metal as a hedge against the dollar.

- Several factors are driving the gold surge, including heightened demand from central banks in emerging economies, such as China, that are seeking alternatives to the dollar. Investors are also increasingly drawn to safe havens due to rising geopolitical risks and uncertainty surrounding Fed policy rates, which could erode the value of US Treasurys. Additionally, consumers are actively seeking alternative assets to safeguard their savings amid sustained inflationary pressures. As a result, gold has been a star performer in 2024, outperforming the S&P 500 with a year-to-date return of 16.0% compared to 9.6%.

- Traditionally, gold and stocks have moved in opposite directions during uncertain times. But over the past five years, a surprising trend has emerged of a strong positive correlation, with both assets rising in tandem. The five-year moving correlation has jumped to +0.84, significantly above its historical norm of +0.22. This breakdown of the usual inverse relationship suggests a more complex market environment. While economic optimism typically fuels stock prices, with investors betting on growing companies, rising gold prices might indicate underlying anxieties about the high valuation of tech companies.



- A key factor influencing gold's price momentum hinges on the Federal Reserve's ability to achieve a soft landing – controlling inflation without stalling economic growth. Recent comments from Boston Fed President Susan Collins and Fed Governor John Williams suggest policymakers are cautious about cutting rates given the current elevated inflation levels. If policymakers continue to hold rates higher than the market is expecting, it may encourage more investors to purchase gold in order to hedge against a possible hard landing or an unexpected acceleration in inflation.

Yoon in Trouble: South Korea's parliamentary election results dealt a severe blow to the ruling Conservative party, raising doubts about its ability to hold the government together.

- In Wednesday's parliamentary elections, the liberal opposition in South Korea achieved a resounding victory, securing 175 out of 300 seats in parliament. Although the opposition fell short of the 200 seats required for a supermajority, its win holds significant implications. This strong opposition suggests that President Yoon Suk Yeol will need help enacting his agenda. He may be forced to compromise with the opposing side, which could significantly weaken his proposals. Following the crushing defeat, the prime minister and other senior officials tendered their resignations, which paves the way for the president to reshuffle his cabinet in response to the election results.

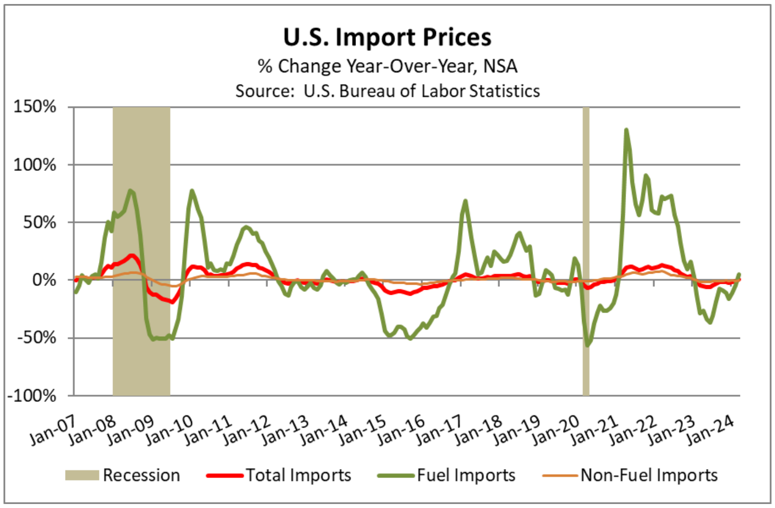
- The election outcome raises questions about the planned reforms designed to enhance the appeal of South Korean equities. President Yoon had pledged to eliminate the planned capital gains taxes on financial investment income before the election. He also proposed a program to address the issue of Korean companies trading at lower valuations relative to their global peers, a phenomenon known as the Korea discount. Despite some hope that the reforms would survive in a weakened form, the uncertainty surrounding their implementation is likely weighing on investors and contributing to today's decline in the KOSPI.

- South Korea's recent political situation exemplifies the challenges in making its equities more attractive. However, the country's booming semiconductor industry, especially with its strengthened ties to the US, Japan, and Taiwan for chip security, offers a potential bright spot for investors seeking exposure beyond a weakening China. Investor confidence hinges on lawmakers' ability to encourage companies to prioritize shareholder value alongside other considerations during decision-making. Unfortunately, the recent parliamentary shift makes achieving this reform more difficult, potentially dampening hopes for a rally similar to the one experienced by the Japanese stock market in recent years.

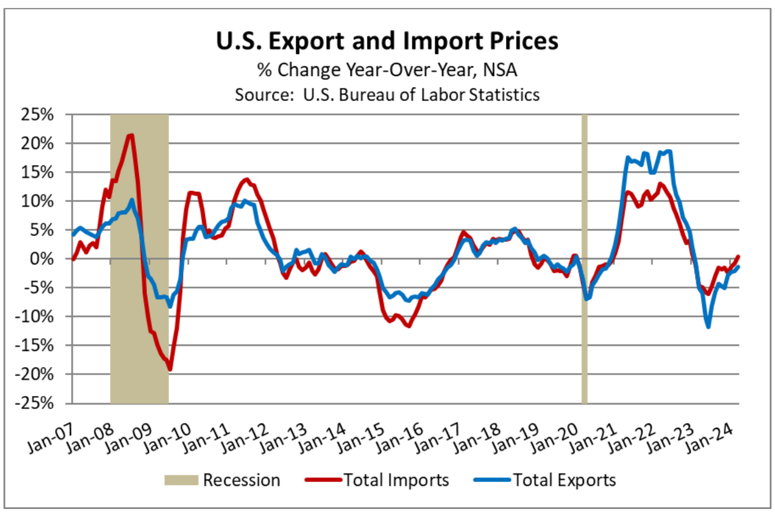
In Other News: Iran has signaled a limited response to Israel, easing fears of wider conflict in the Middle East. China's exports fell more than expected in March, raising concerns about its economic slowdown. Meanwhile, former Fed Chair Bernanke unveiled revamped economic models for the BOE in a sign that central bankers are adapting to a changing world.

US Economic Releases

March ***import prices*** were up 0.4% from the previous month, slightly worse than expectations that they would match the 0.3% rise in February. Of course, import prices are often driven by volatility in the petroleum fuels category. March ***import prices excluding fuels*** were unchanged, which was better than expectations that they would rise 0.1% just as they did in the previous month. Overall import prices in March were up just 0.4% year-over-year, while import prices excluding fuels were essentially unchanged. The chart below shows the year-over-year change in import prices since just before the Great Financial Crisis.



According to the report, ***export prices*** in March were down 1.4% from one year earlier, mostly reflecting a big drop in prices received for agriculture exports. Comparing the annual change in export prices versus import prices provides a sense of the US "terms of trade," or the relative advantage or disadvantage the country is facing because of trends in international trade prices. The chart below compares the year-over-year change in US export and import prices since just before the GFC.



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	U. of Michigan Consumer Sentiment	m/m	Apr P	79.0	79.4	***
10:00	U. of Michigan Current Conditions	m/m	Apr P	81.9	82.5	**
10:00	U. of Michigan Future Expectations	m/m	Apr P	78.0	77.4	**
10:00	U. of Michigan 1-Year Inflation Expectation	m/m	Apr P	2.9%	2.9%	*
10:00	U. of Michigan 5-10 Year Inflation Expectation	m/m	Apr P	2.8%	2.8%	*
Federal Reserve						
EST	**Speaker or Event**	**District or Position**				
9:00	Susan Collins is interviewed on Bloomberg Television	President of the Federal Reserve Bank of Boston				
13:00	Jeff Schmid Gives Speech on Economic Outlook	President of the Federal Reserve Bank of Kansas City				
14:30	Raphael Bostic Gives Speech on Housing	President of the Federal Reserve Bank of Atlanta				
15:30	Mary Daly Participates in Fireside Chat	President of the Federal Reserve Bank of San Francisco				

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	Industrial Production	y/y	Feb F	-3.9%	-3.4%		***	Equity and bond neutral
	Capacity Utilization	m/m	Feb	-0.5%	-7.9%		***	Equity and bond neutral
New Zealand	BusinessNZ Manufacturing PMI	m/m	Mar	47.1	49.1		***	Equity and bond neutral
	Food Prices	m/m	Mar	-0.5%	-0.6%		***	Equity and bond neutral
South Korea	Unemployment Rate	m/m	Mar	2.8%	2.6%	2.8%	**	Equity and bond neutral
China	New Yuan Loans CNY YTD	m/m	Mar	9460.0b	6370.0b		**	Equity and bond neutral
	Money Supply M2	y/y	Mar	8.3%	8.7%	8.7%	***	Equity and bond neutral
	Money Supply M1	y/y	Mar	1.1%	1.2%	1.5%	*	Equity and bond neutral
	Money Supply M0	y/y	Mar	11.0%	12.5%		*	Equity and bond neutral
China	Trade Balance	m/m	Mar	$58.55b	$75.31b	$69.10b	***	Equity and bond neutral
	Exports	y/y	Mar	-7.5%	5.6%	-1.9%	**	Equity and bond neutral
	Imports	y/y	Mar	-1.9%	-8.2%	1.0%	**	Equity and bond neutral
EUROPE								
Germany	CPI	y/y	Mar F	2.2%	2.2%	2.2%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Mar F	2.3%	2.3%	2.3%	**	Equity and bond neutral
France	CPI	y/y	Mar F	2.3%	2.3%	2.3%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Mar F	2.4%	2.4%	2.4%	**	Equity and bond neutral
	CPI Ex-Tobacco Index	y/y	Mar	118.4	118.15	118.4	*	Equity and bond neutral
Italy	Industrial Sales WDA	y/y	Jan	-3.6%	-0.7%		*	Equity and bond neutral
UK	Industrial Production	y/y	Feb	1.4%	0.3%	0.6%	***	Equity bullish, bond bearish
	Manufacturing Production	y/y	Feb	2.7%	1.5%	2.1%	**	Equity bullish, bond bearish
	Visible Trade Balance	m/m	Feb	-£14212m	-£14907m	-£14500m	**	Equity and bond neutral
	Trade Balance	m/m	Feb	-£2291m	-£2205m	-£2950m	**	Equity and bond neutral
Russia	Trade Balance	m/m	Feb	7.7b	6.8b		**	Equity and bond neutral
	Exports	m/m	Feb	30.3b	28.0b		*	Equity and bond neutral
	Imports	m/m	Feb	22.6b	21.3b		*	Equity and bond neutral
	Current Account Balance	q/q	1Q P	22000m	11500m	14700m	**	Equity and bond neutral
	Gold and Forex Reserves	m/m	5-Apr	$598.3b	$589.4b		***	Equity and bond neutral
	Money Supply, Narrow Definition	w/w	5-Apr	18.12t	18.06t		*	Equity and bond neutral
AMERICAS								
Brazil	IBGE Services Volume	y/y	Feb	2.5%	4.0%	5.0%	*	Equity bearish, bond bullish

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	557	-1	Down
3-mo T-bill yield (bps)	523	524	-1	Up
U.S. Sibor/OIS spread (bps)	532	533	-1	Up
U.S. Libor/OIS spread (bps)	533	534	-1	Up
10-yr T-note (%)	4.52	4.59	-0.07	Up
Euribor/OIS spread (bps)	391	391	0	Down
Currencies	**Direction**			
Dollar	Up			Up
Euro	Down			Down
Yen	Up			Down
Pound	Down			Down
Franc	Down			Down
Central Bank Action	**Current**	**Prior**	**Expected**	
Bank of Korea Base Rate	3.500%	3.500%	3.500%	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.

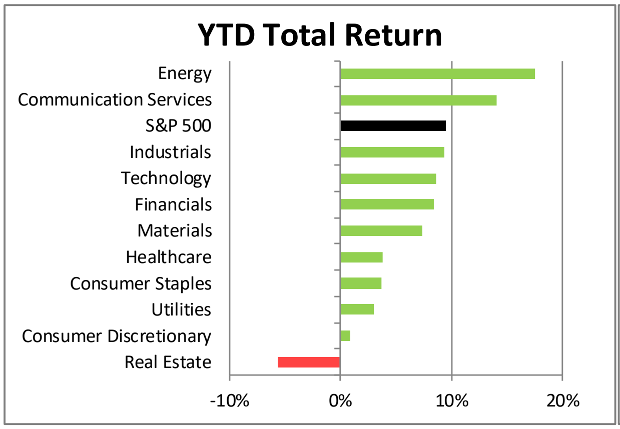
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$90.79	$89.74	1.17%	
WTI	$86.15	$85.02	1.33%	
Natural Gas	$1.77	$1.76	0.51%	
Crack Spread	$30.54	$29.83	2.39%	
12-mo strip crack	$25.37	$25.01	1.47%	
Ethanol rack	$1.79	$1.81	-0.81%	
Metals				
Gold	$2,393.21	$2,372.52	0.87%	
Silver	$28.99	$28.44	1.92%	
Copper contract	$433.40	$425.30	1.90%	
Grains				
Corn contract	$441.25	$441.00	0.06%	
Wheat contract	$566.00	$566.25	-0.04%	
Soybeans contract	$1,174.25	$1,172.50	0.15%	
Shipping				
Baltic Dry Freight	1,690	1,587	103	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	5.8	0.8	5.0	
Gasoline (mb)	0.7	-2.3	3.0	
Distillates (mb)	1.7	-1.4	3.04	
Refinery run rates (%)	-0.3%	0.6%	-0.9%	
Natural gas (bcf)	24	13	11	

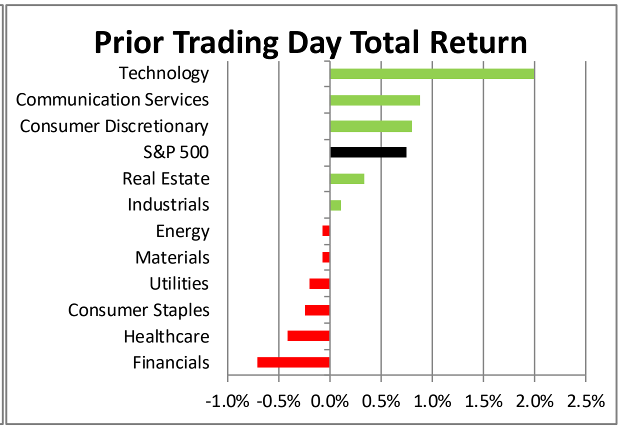
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures in California and from the Great Plains eastward, with cooler-than-normal temperatures in the northern Rocky Mountains and Great Plains. The forecasts call for wetter-than-normal conditions in the southern Great Plains and the Mississippi Valley region, with dry conditions only in the Far West.

Data Section

US Equity Markets – (as of 4/11/2024 close)

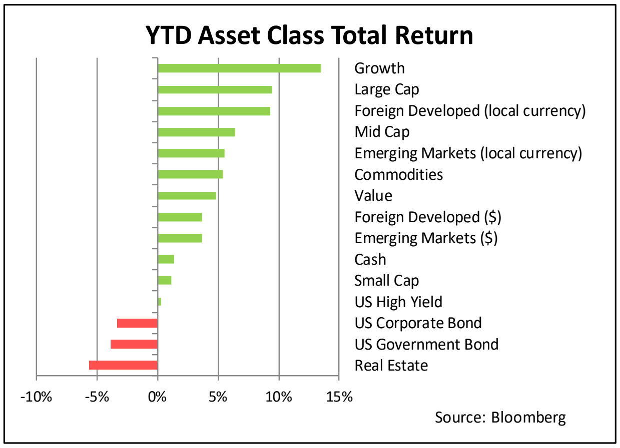




(Source: Bloomberg)

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 4/11/2024 close)

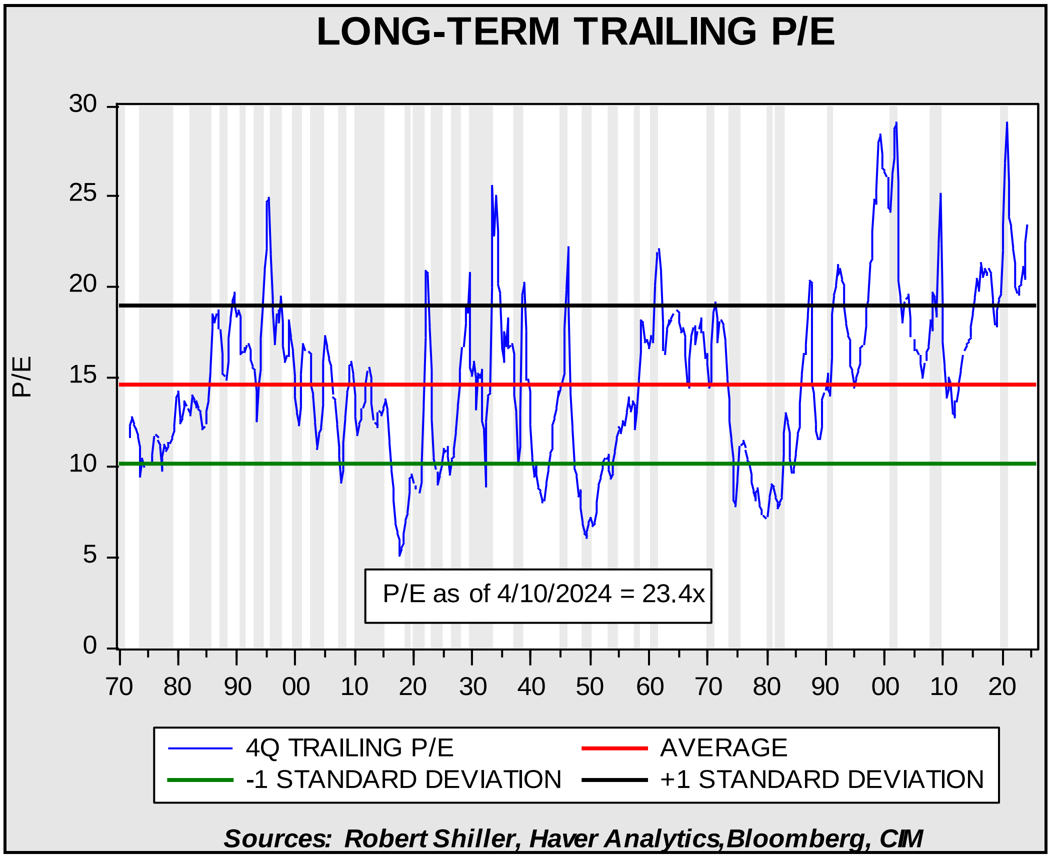


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 11, 2024



Based on our methodology,[1] the current P/E is 23.4x, down 0.2x from our last report. The decline in the multiple reflects a decrease in the stock price index and a slight 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.

[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.