Daily Comment

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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 15, 2024—9:30 AM EDT] Global equity markets are generally higher this morning. In Europe, the Euro Stoxx 50 is up 1.1% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.3%. Chinese markets were mixed, with the Shanghai Composite up 0.3% from its previous close and the Shenzhen Composite down 0.8%. US equity index futures are signaling a higher open.

With 30 companies having reported so far, S&P 500 earnings for Q1 are running at $53.50 per share, compared to estimates of $54.24, which is up 0.9% from Q1 2023. Of the companies that have reported thus far, 86.7% have exceeded expectations while 10.0% have fallen short of expectations.

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* (4/15/2024) (with associated podcast): "The Incremental Uranium Demand for Weapons"**
- *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 an update on the Iran-Israel situation, where investors are expecting tensions to cool, but we think risks remain elevated. We next review a wide range of other international and US developments with the potential to affect the financial markets today, including new provocative naval actions by China against the Philippines and a discussion of the US Treasury's disappointing bond auctions last week.

Iran-Israel: As widely expected, Iran launched a strike against Israel over the weekend in retaliation for Tel Aviv's recent attack on Iranian diplomatic facilities in Syria, which killed several high-level Iranian military leaders. So far, it appears Iran has launched over 300 ballistic missiles, cruise missiles, and drones at Israel, mostly from Iranian territory. The Israeli military claims 99% of those attacks were intercepted before they could cause any damage, but the world now braces for a potential Israeli strike directly on Iran that could spark a wider conflict.

- Since Israel avoided any significant damage from the strikes, President Biden has reportedly urged Prime Minister Netanyahu to hold his fire. However, we suspect that Netanyahu's domestic political environment will prompt him to retaliate in some way.
- If Netanyahu does decide to retaliate, a key question is how far he will go. One potential avenue would be to launch a go-for-broke attack to eliminate Iran's nuclear weapons arsenal — something hardline Israeli officials have long wanted to do. Such a strike would almost certainly invite a strong response from Iran, as well.
- Of course, Netanyahu could also show restraint and decide on only a limited response or reserve the right to respond sometime in the future. Indeed, market action today suggests that is what investors are expecting. For example, near Brent crude oil futures are currently trading down 0.9% to $89.64, near their lowest level of the last week. Gold prices are steady at $2,373.40 per ounce.
- Despite today's apparent expectation for a quick cooling of tensions, we suspect that the Israel-Hamas conflict could still be on the brink of widening and intensifying, as many have feared over the last six months. The situation will likely remain a risk for global financial markets in the near term.

China-Philippines: As a reminder that the Middle East isn't the only place where a major war could start, the Chinese coast guard has blocked a Philippine maritime research vessel and its coast guard escort as they were about to cross the "nine dash line," which marks China's expansive, unrecognized claim to virtually all of the South China Sea. The incident happened just 35 miles from the Philippine coast in waters recognized by international law as part of the country's exclusive economic zone.

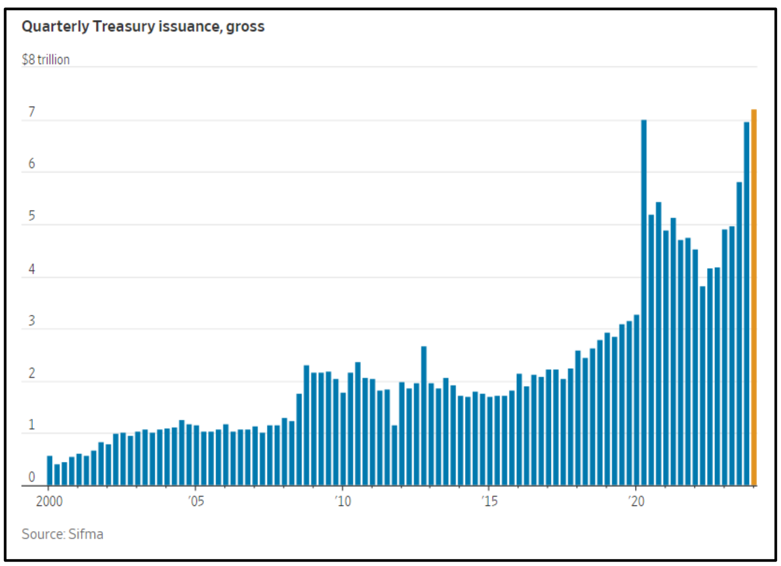
- This occurred just days after President Biden reiterated the US's commitment to defend the Philippines under the two countries' mutual defense treaty.
- As we have noted previously, the US-Philippine defense treaty means today's escalating Chinese-Philippine tensions are probably even more dangerous than China's ongoing military provocations against Taiwan. If Chinese forces directly attack Philippine vessels, the US could be obligated to intervene and come into direct conflict with China.

China: The People's Bank of China today held its key interest rates steady, with its one-year medium-term lending facility at 2.5%. However, it also drained liquidity from the financial system. The moves suggest that, on balance, Chinese monetary policy will be steady in the near term as the economy continues to face strong structural headwinds but is also showing signs of a near-term improvement.

North Atlantic Treaty Organization-France: Reflecting how the growing threat from Russia has spurred Europeans to take stronger defense measures, France will put an aircraft carrier and its strike group under NATO command for the first time ever in a naval exercise next week in the Mediterranean Sea. Besides the *Charles de Gaulle* carrier, the French strike group will include two frigates and a nuclear attack submarine, augmented by US, Spanish, Portuguese, Italian, and Greek navy ships.

United States-United Kingdom-Russia: The US and UK on Friday said they will ban Russian aluminum, nickel, and copper from Western metals exchanges in a further retaliation for the Kremlin's invasion of Ukraine. Since the Russian metals can still be off-exchange, there will be no immediate impact on actual supply and demand. However, the move has raised concern about further restrictions in the future. Prices for the metals are therefore trading higher so far this morning. For example, near copper futures are currently up 1.6% to $4.3236 per pound.

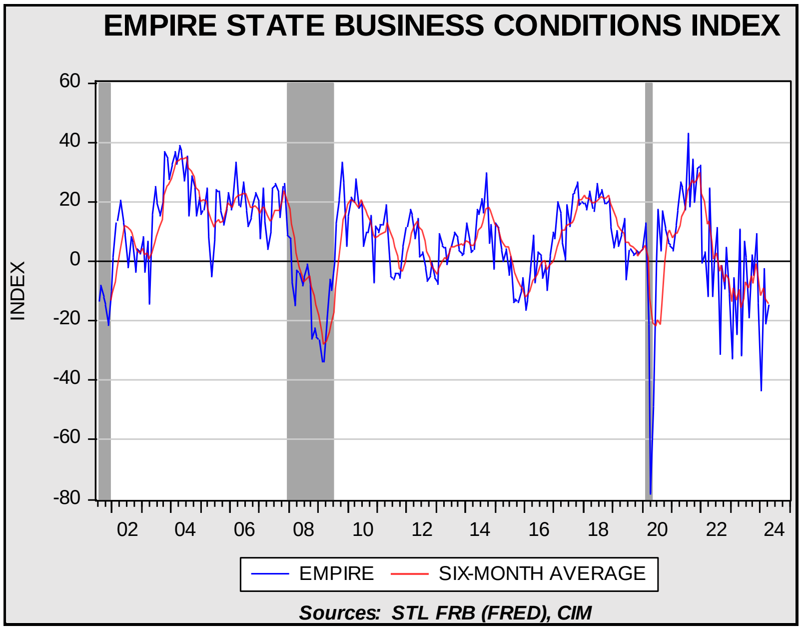
US Bond Market: Although last week's unsettling report on continued consumer price inflation was probably the key reason that bond yields rose, it's important to remember that Treasury auctions also suffered from weak demand. That's raising the prospect that the government may be hitting its limit in terms of investor demand for new Treasury obligations. That would be a negative development because the Treasury plans to sell another extraordinary volume of $386 billion in bonds next month.



US Industrial Policy: The Commerce Department today said Samsung Electronics will be granted up to $6.4 billion to help the company build a major semiconductor manufacturing facility outside Austin, Texas. The company will also be eligible for billions of dollars in loans. The funding is part of the CHIPS and Science Act of 2022, which aims to boost production of advanced computer chips in the US and cut the country's reliance on suppliers abroad, especially those in China and East Asia.

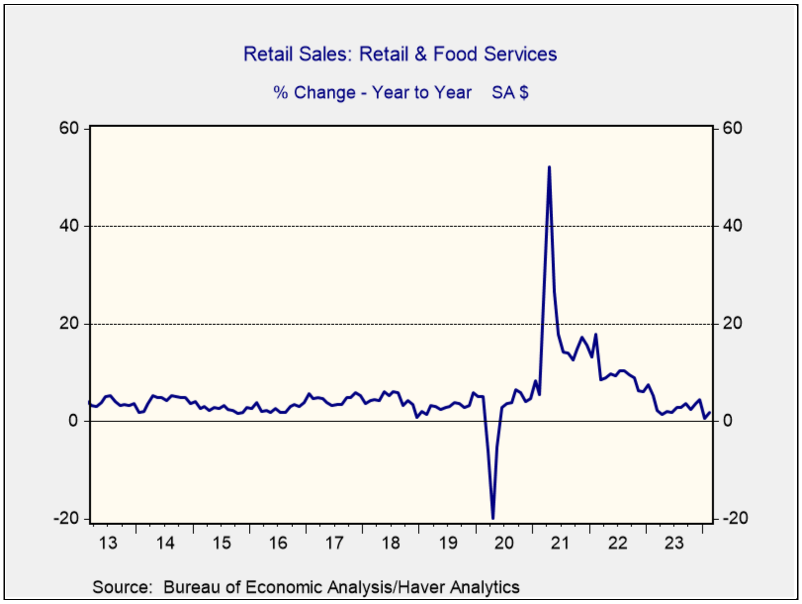
US Economic Releases

Manufacturing in New York State weakened sharply compared to forecasts. The New York Empire Manufacturing Index plunged to -14.3, significantly lower than analysts' expectations of -5.2. Prices paid for materials also rose, with the index reaching 33.7, indicating rising input costs.



The chart above shows the Empire Manufacturing Index along with its six-month moving average. In April, the moving average fell from -12.83 to -14.45.

US retail sales rose above consensus forecasts last month, indicating continued consumer strength. Retail purchase values increased by 0.7% in March, exceeding expectations of 0.4% growth. This follows an upward revision to February's increase of 0.9%. Excluding automobiles, retail sales climbed 1.1% from the previous month. Core retail sales, which exclude both gas and autos, also rose 1.0% during the same period. The retail sales control group, excluding autos, gas, and building materials, saw a 1.1% increase.



The chart above shows the annual change in retail sales. The value of retail purchases is up 1.86% from the previous year.

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	Business Inventories	m/m	Feb	0.4	0.0	*
10:00	NAHB Housing Market Index	m/m	Apr	51.0	51.0	*

Federal Reserve		
EST	**Speaker or Event**	**District or Position**
20:00	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	Core Machine Orders	y/y	Feb	-1.80%	-10.90%	-6.00%	***	Equity bullish, bond bearish
India	CPI	y/y	Apr	4.9%	5.1%	4.9%	***	Equity and bond neutral
	Industrial Production	y/y	Mar	5.7%	4.1%	6.0%	***	Equity and bond neutral
India	Trade Balance	m/m	Mar	-$15598m	-$18710m	-$18402m	*	Equity and bond neutral
	Exports	y/y	Mar	-0.7%	11.9%		**	Equity and bond neutral
	Imports	y/y	Mar	-6.0%	12.2%		**	Equity and bond neutral
	Wholesale Prices	y/y	Mar	0.6%	0.5%	0.6%	**	Equity and bond neutral
EUROPE								
Eurozone	Industrial Production WDA	y/y	Feb	-6.4%	-6.6%	-5.5%	**	Equity bearish, bond bullish
Switzerland	Producer & Import Prices	y/y	Mar	-2.1%	-2.0%		**	Equity and bond neutral
	Domestic Sight Deposits CHF	w/w	12-Apr	469.4b	452.1b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	12-Apr	477.9b	460.9b		*	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)	559	559	0	Up
3-mo T-bill yield (bps)	523	524	-1	Up
U.S. Sibor/OIS spread (bps)	533	532	1	Up
U.S. Libor/OIS spread (bps)	534	533	1	Up
10-yr T-note (%)	4.58	4.52	0.06	Up
Euribor/OIS spread (bps)	392	391	1	Down
Currencies	**Direction**			
Dollar	Down			Up
Euro	Up			Down
Yen	Down			Down
Pound	Up			Down
Franc	Up			Down
Central Bank Action	**Current**	**Prior**	**Expected**	
PBOC 1-Year Med-Term Lending Facility	2.500%	2.500%	2.500%	On Forecast
PBOC 1-Year Med-Term Lending (Bil.)	100.0b	387.0b	170.0b	Below 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.

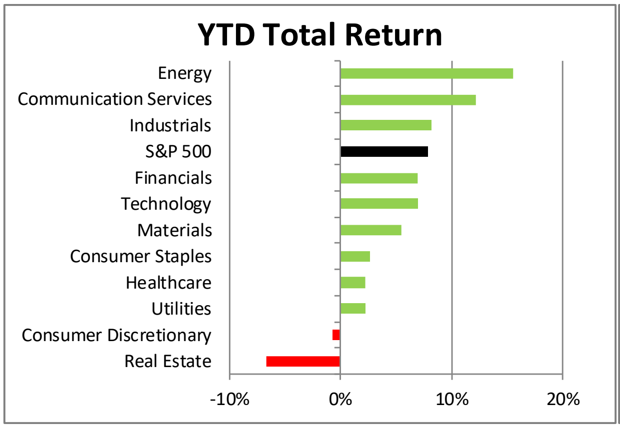
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$89.76	$90.45	-0.76%	
WTI	$84.96	$85.66	-0.82%	
Natural Gas	$1.75	$1.77	-1.24%	
Crack Spread	$30.58	$30.39	0.62%	
12-mo strip crack	$25.30	$25.33	-0.11%	
Ethanol rack	$1.79	$1.80	-0.07%	
Metals				
Gold	$2,357.91	$2,344.37	0.58%	
Silver	$28.59	$27.88	2.57%	
Copper contract	$432.50	$425.85	1.56%	
Grains				
Corn contract	$445.00	$447.25	-0.50%	
Wheat contract	$563.25	$570.75	-1.31%	
Soybeans contract	$1,183.50	$1,186.75	-0.27%	
Shipping				
Baltic Dry Freight	1,729	1,690	39	

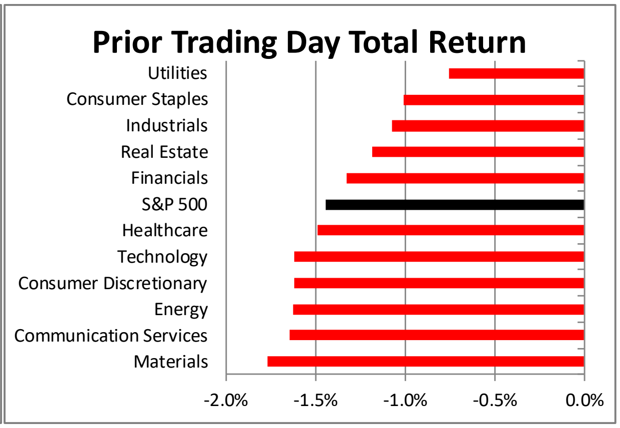
Weather

The 6-10 and 8-14 day forecasts predict warmer-than-normal temperatures in the Pacific region. These temperatures are expected to move eastward across the rest of the country. Meanwhile, cooler-than-normal temperatures are expected in the Mid-Atlantic region. The precipitation outlook forecasts wetter-than-normal conditions in the South to spread into states west of the Ohio River. Conversely, dry conditions are expected in the New England region.

Data Section

US Equity Markets – (as of 4/12/2024 close)

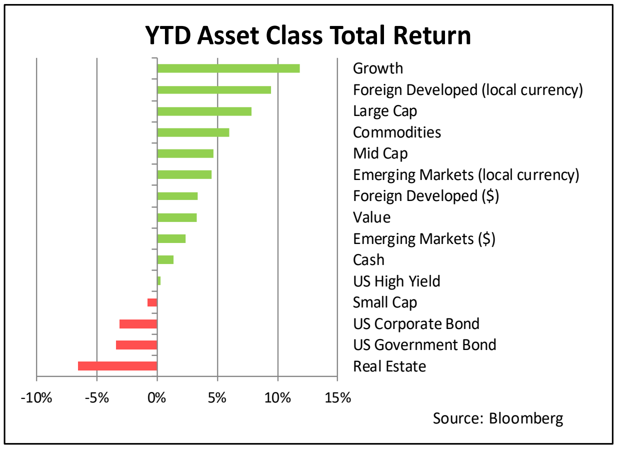




(Source: Bloomberg)

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 4/12/2024 close)

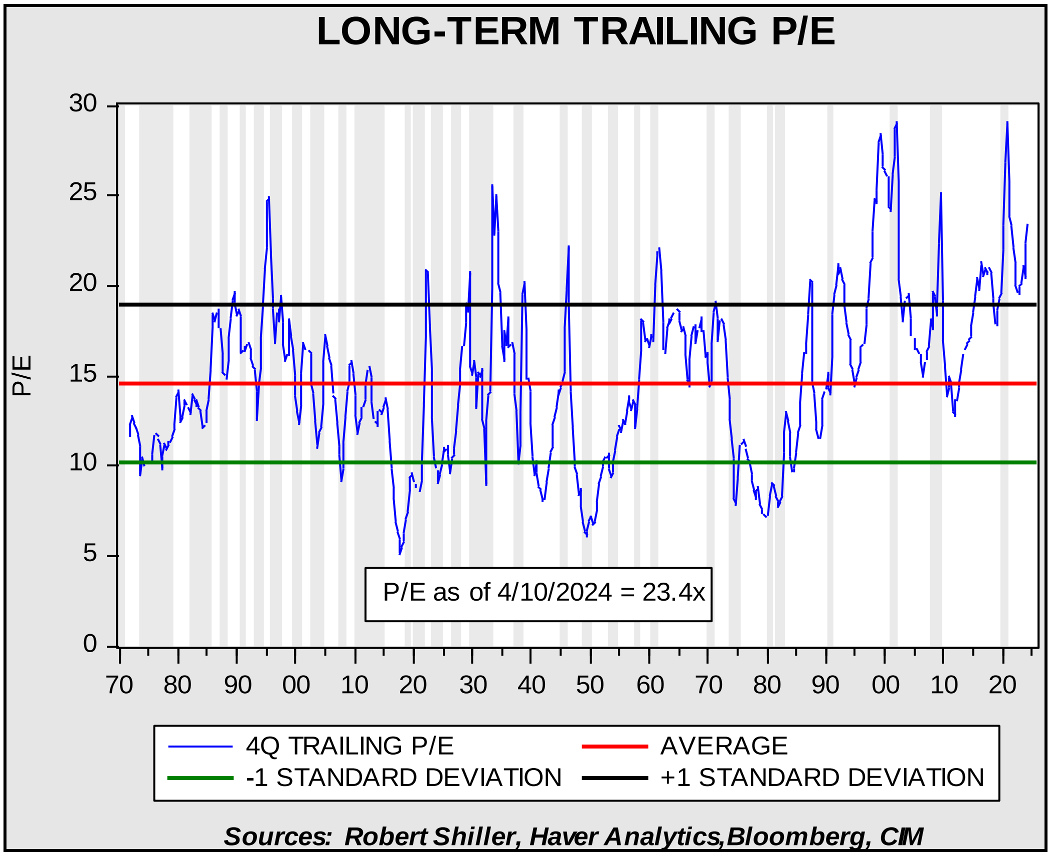


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.