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 16, 2024—9:30 AM EDT] Global equity markets are mostly lower this morning. In Europe, the Euro Stoxx 50 is down 0.9% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 2.3%. Chinese markets were lower, with the Shanghai Composite down 1.7% from its previous close and the Shenzhen Composite down 3.8%. Conversely, US equity index futures are signaling a higher open.

With 33 companies having reported so far, S&P 500 earnings for Q1 are running at $53.40 per share, compared to estimates of $54.24, which is up 0.9% from Q1 2023. Of the companies that have reported thus far, 81.8% have exceeded expectations while 12.1% have fallen short of expectations.

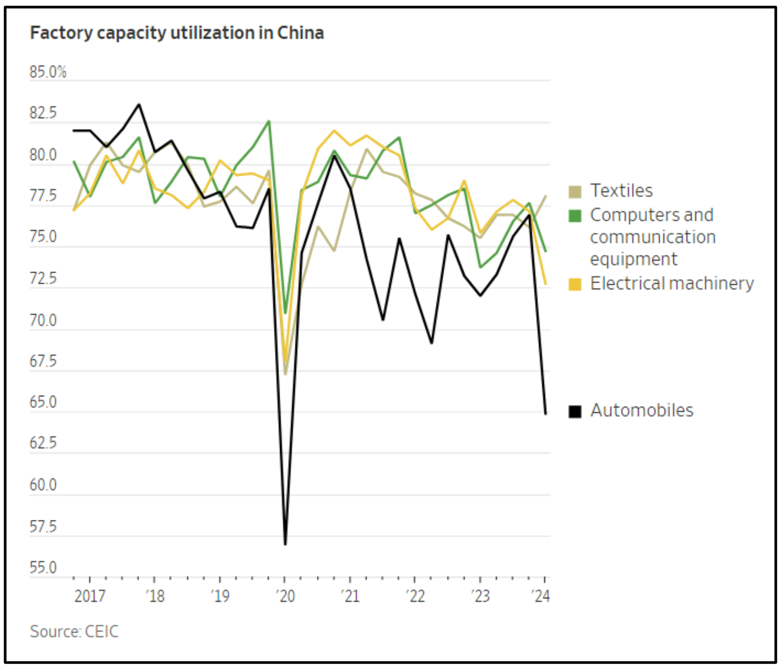
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *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 examination of China's latest economic growth, which will have a big impact on global markets. We next review a wide range of other international and US developments with the potential to affect the financial markets today, including new signs that the Russian military is regaining momentum in its invasion of Ukraine and a major new antitrust suit being prepared in the US.

China: After stripping out price changes, first-quarter gross domestic product was up 5.3% from the same period one year earlier, beating expectations and accelerating slightly from the 5.2% rise in the year ended in the fourth quarter of 2023. However, the country's growth is looking increasingly lopsided. In the year to the first quarter, most of the economic expansion came from corporate investment, industrial production, and exports, while consumer spending and housing investment remained tepid.

- The data is consistent with official plans to encourage massive new investment in higher-technology production, such as electric vehicles, batteries, and solar panels to make up for the weakness in consumption and the steep correction in residential building. The problem is that domestic demand isn't strong enough to absorb all that new production, so Chinese firms are increasingly dumping excess output at fire-sale prices on the world market, further stoking trade frictions.
- So long as the government refuses to stimulate consumption spending or allow another spurt of housing investment, and so long as Western countries keep clamping down on Chinese dumping, the strategy will likely lead to further excess capacity in the economy. Indeed, other data today showed Chinese industrial capacity utilization falling in March to just 73.6%. Excluding the pandemic period, that was the lowest since 2016.



Japan: The yen depreciated further yesterday, closing at 154.37 per dollar, its lowest level since 1990. Given the Japanese government's recent warnings that it will intervene in the currency markets if the currency weakens much further, the likelihood of intervention has probably risen sharply.

- More broadly, last week's unsettling report on US price inflation and yesterday's report of strong US retail sales have pushed foreign stock markets sharply lower today.

- Since the data adds to concerns that the Federal Reserve may be even more reluctant to cut US interest rates, the dollar has surged against a number of currencies and forced foreign investors to consider a prolonged period in which capital will be drawn to the US and out of Europe and Asia.

Iran-Israel: The Israeli war cabinet today continues deliberating whether or how to respond to Iran's big missile and drone attack against Israel over the weekend. As discussed in our *Comment* yesterday, domestic political dynamics are likely to push the Israeli government to launch some kind of response. The key question is how big and destructive such a response could be. A bigger response would raise the risk of a significant expansion of the current war between Israel and Hamas and threaten Middle Eastern energy supplies.

Russia-Ukraine: As warmer weather returns and dries out the ground, making it easier for Russia's armored vehicles to maneuver, the Ukrainian military says Russian forces are now attacking more intensively along the front lines. Kyiv has rushed forces to try to plug the gaps in the line, but residents of front-line cities and towns are fleeing, and it is looking increasingly like the Russians could gain new offensive momentum and re-seize significant territory across Ukraine.

- To the extent that the Russians retake territory in Ukraine, it will have negative security implications for Western Europe. In such a scenario, the Europeans would likely have even more incentive to try to coalesce politically and boost their defense spending.
- If the Russians conquer huge new swaths of Ukrainian territory, it could also have an important political implication in the US, as the Democrats would likely pin the blame on those Republicans who have blocked further US military aid to Kyiv in recent months.

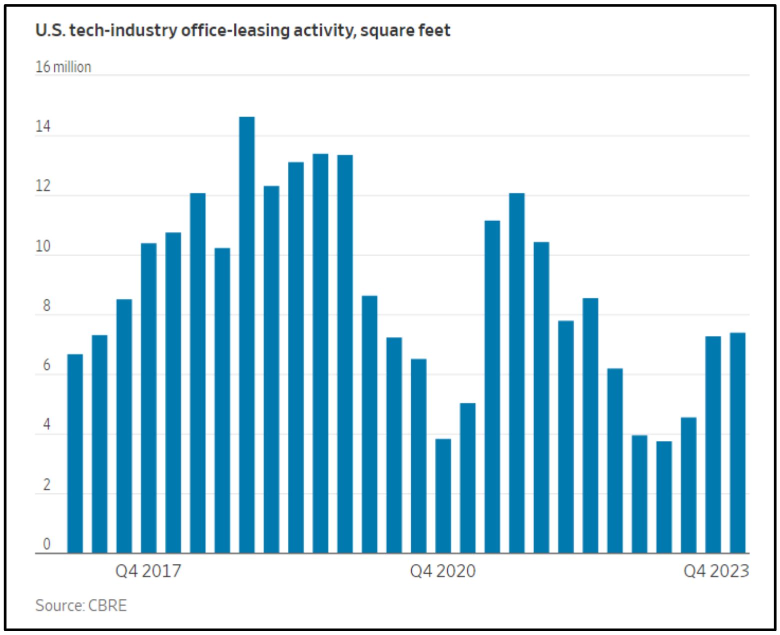
US Antitrust Regulation: The Justice Department is reportedly preparing to file an antitrust suit against concert promoter and ticket vendor Live Nation, alleging it has leveraged its dominance in a way that undermines competition for ticketing live events. The company has long been criticized for exorbitant ticket fees and poor customer service. In any case, the potential suit is another example of the Biden administration's effort to toughen antitrust enforcement, which creates increased regulatory risk for investors.

US Energy Industry: In a little reported development last week, the Biden administration has announced an increase in the royalties paid and bonds posted to drill for oil on federal land. Royalties paid to the government will rise from 12.50% to 16.67%, marking their first increase since 1920. Bonds posted will rise from $10,000 to $150,000, for their first increase since 1960.

- The industry naturally has complained that the moves will weigh on domestic energy exploration and production. However, it's important to remember that only about 10% of US oil output comes from federal land.
- In all likelihood, Biden's move aims to placate supporters on the left wing of the Democratic Party, many of whom have been disappointed by his energy policies.

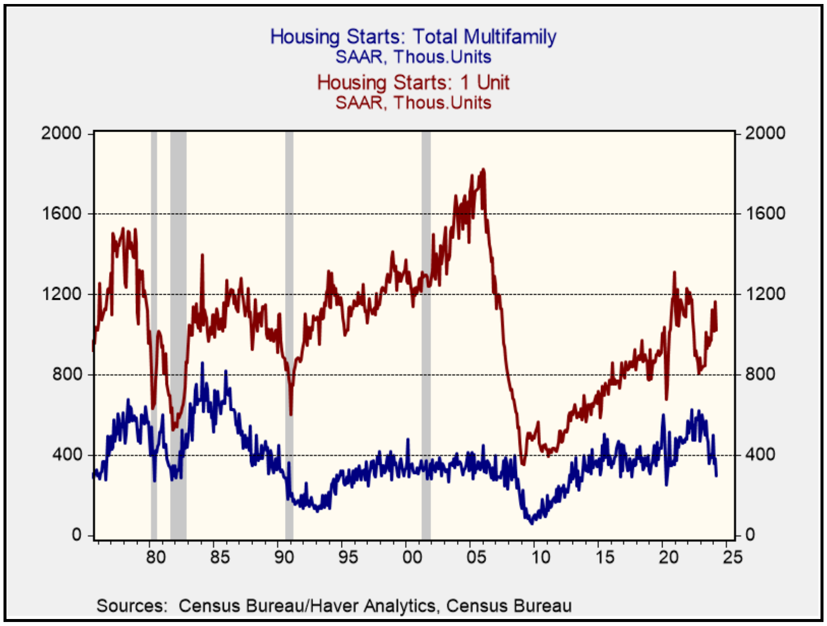
US Electric Vehicle Industry: Premium EV maker Tesla yesterday said it is laying off more than 10% of its workforce to deal with the worldwide slowdown in demand for fully electric cars. In response, Tesla's stock price fell some 5.6%, bringing its year-to-date loss to more than 33.0%. Tesla's layoffs and stock decline illustrate the sharp reversal in fortune for EV makers since last year — a trend that could get even worse as Chinese producers look to dump their excess production on world markets at fire sale prices.

US Commercial Real Estate Industry: New data shows that technology firms have sharply curtailed their purchases and leases of office space in coastal markets, despite strong demand for the companies' products. The drop-off in technology office demand marks yet another blow to the commercial real estate industry. The trend has reportedly boosted sublease listing, driven down lease rates and building values, and hurt office owners.



US Economic Releases

Homebuilding activity dipped last month as rising interest rates dampened builder confidence. The latest data from the Census Bureau reveals housing starts dropped from an annualized rate of 1.549 million to 1.321 million in March. This comes in lower than analyst expectations of 1.48 million. Additionally, building permits, which signal future construction, fell from 1.521 million to 1.349 million.



The chart above shows the level of single and multi-family housing starts. Single family homes rose 0.299 million, while multifamily homes increased by 1.022 million.

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

Economic Releases		
	No economic releases for the rest of today	
Federal Reserve		
EST	**Speaker or Event**	**District or Position**
9:00	Philip Jefferson Speaks at Monetary Policy Forum	Vice-Chair of the Board of Governors
12:30	John Williams Moderates Event w/ François Villeroy de Galhau	President of the Federal Reserve Bank of New York
13:00	Thomas Barkin Speaks on Economic Outlook	President of the Federal Reserve Bank of Richmond
13:15	Jerome Powell Participates in Moderated Q&A	Chairman of the Board of Governors
16:30	Susan Collins Gives Speech on Economy	President of the Federal Reserve Bank of Boston

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								
South Korea	Export Price Index	y/y	Mar	4.5%	2.6%		*	Equity and bond neutral
	Import Price Index	y/y	Mar	-0.4%	-0.2%		*	Equity and bond neutral
China	GDP	y/y	1Q	5.3%	5.2%	4.8%	***	Equity bullish, bond bearish
	Industrial Production	y/y	Mar	4.5	6.0		***	Equity and bond neutral
	Retail Sales	y/y	Mar	3.1%	4.8%		***	Equity and bond neutral
EUROPE								
Eurozone	ZEW Survey Expectations	m/m	Apr	43.9	33.5		**	Equity and bond neutral
	Trade Balance SA	m/m	Feb	17.9b	27.1b	21.8b	**	Equity and bond neutral
Germany	Wholesale Price Index	y/y	Mar	-3.0%	-3.0%		*	Equity and bond neutral
	ZEW Survey Expectations	m/m	Apr	42.9	31.7	35.5	**	Equity bullish, bond bearish
	ZEW Current Situation	m/m	Apr	-79.2	-80.5	-76.0	**	Equity and bond neutral
Italy	CPI, EU Harmonized	y/y	Mar F	1.2%	1.3%	1.3%	***	Equity and bond neutral
UK	Average Weekly Earnings 3M/YoY	y/y	Feb	5.6%	5.6%	5.5%	**	Equity and bond neutral
	ILO Unemployment Rate 3Mths	m/m	Feb	4.2%	4.0%	4.0%	***	Equity and bond neutral
	Claimant Count Rate	m/m	Mar	4.0%	4.0%		***	Equity and bond neutral
	Jobless Claims Change	m/m	Mar	10.9k%	4.1k%		***	Equity and bond neutral
AMERICAS								
Canada	Manufacturing Sales	m/m	Feb	0.7%	0.0%	0.7%	**	Equity and bond neutral
	Wholesale Sales ex Petroleum MoM	m/m	Feb	0.0%	-0.2%	0.8%	**	Equity bearish, bond bullish
Brazil	FGV Inflation IGP-10	m/m	Apr	-0.33%	-0.17%	-0.18%	**	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)	559	559	0	Up
3-mo T-bill yield (bps)	520	519	1	Up
U.S. Sibor/OIS spread (bps)	532	532	0	Up
U.S. Libor/OIS spread (bps)	534	534	0	Up
10-yr T-note (%)	4.64	4.60	0.04	Up
Euribor/OIS spread (bps)	389	392	-3	Down
Currencies	**Direction**			
Dollar	Flat			Up
Euro	Up			Down
Yen	Down			Down
Pound	Flat			Down
Franc	Down			Down

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.

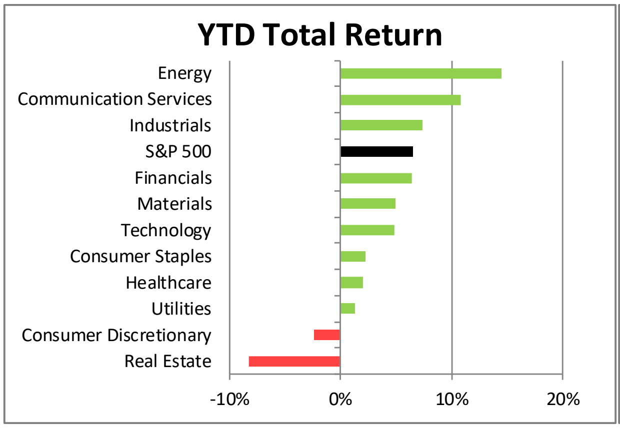
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$89.78	$90.10	-0.36%	
WTI	$85.03	$85.41	-0.44%	
Natural Gas	$1.70	$1.69	0.30%	
Crack Spread	$30.06	$29.72	1.17%	
12-mo strip crack	$24.91	$24.88	0.12%	
Ethanol rack	$1.80	$1.79	0.05%	
Metals				
Gold	$2,373.01	$2,383.34	-0.43%	
Silver	$28.27	$28.87	-2.08%	
Copper contract	$431.70	$437.90	-1.42%	
Grains				
Corn contract	$443.00	$444.25	-0.28%	
Wheat contract	$564.75	$567.50	-0.48%	
Soybeans contract	$1,172.00	$1,172.00	0.00%	
Shipping				
Baltic Dry Freight	1,730	1,729	1	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		1.8		
Gasoline (mb)		-1.0		
Distillates (mb)		-0.3		
Refinery run rates (%)		0.5%		
Natural gas (bcf)		13		

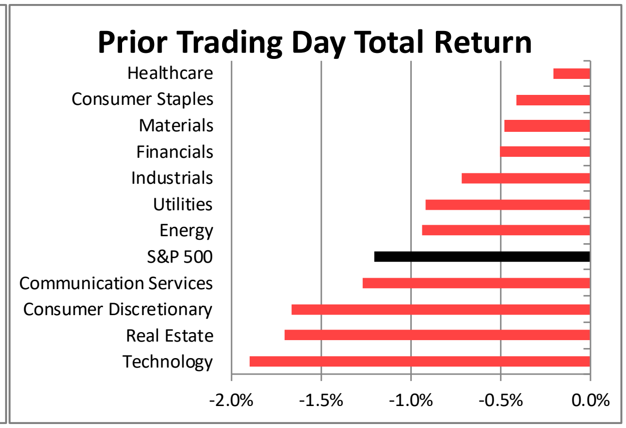
Weather

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 4/15/2024 close)

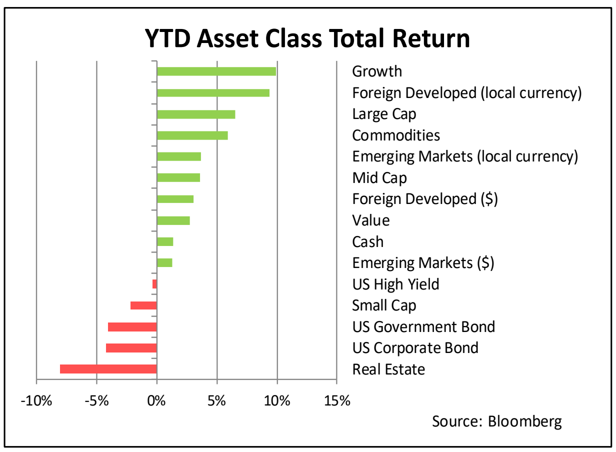




(Source: Bloomberg)

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 4/15/2024 close)

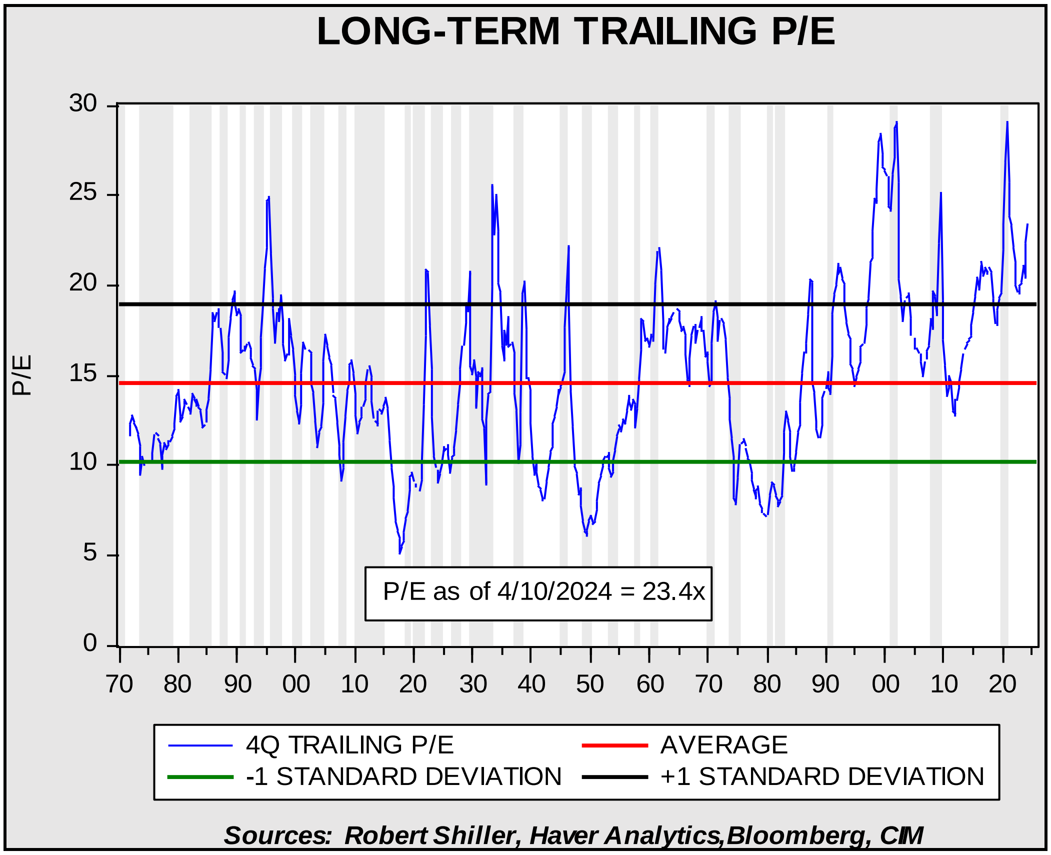


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.

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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.