Daily Comment

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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 17, 2024—9:30 AM EDT] Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 is up 0.7% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.5%. Chinese markets were higher, with the Shanghai Composite up 2.1% from its previous close and the Shenzhen Composite up 3.8%. US equity index futures are signaling a higher open.

With 40 companies having reported so far, S&P 500 earnings for Q1 are running at $53.60 per share, compared to estimates of $54.24, which is up 0.9% from Q1 2023. Of the companies that have reported thus far, 82.5% have exceeded expectations while 12.5% have fallen short of expectations.

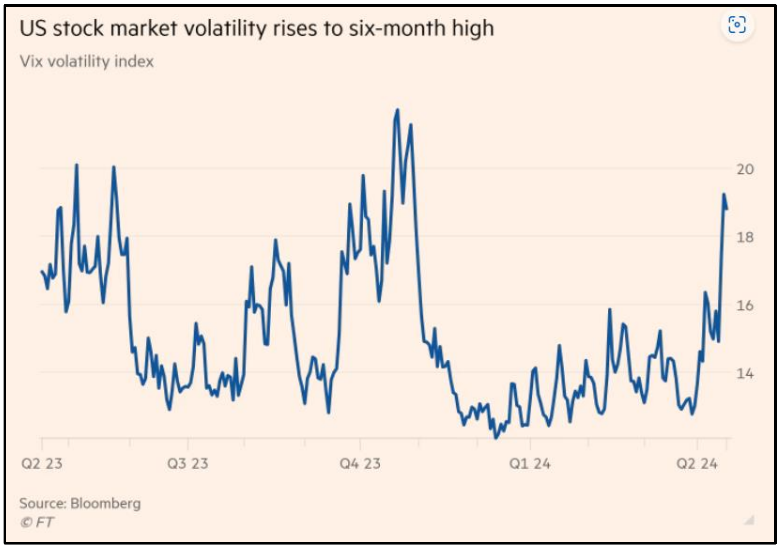
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *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 the latest on the potential for a broader, more intense war in the Middle East. We next review a wide range of other international and US developments with the potential to affect the financial markets today, including downgraded debt rating outlooks for Chinese banks and a statement by Federal Reserve Chair Powell that confirms the central bank is less likely to cut US interest rates in the near term.

Iran-Israel: As the Israeli government continues to consider how and when it will retaliate for Iran's direct missile and drone attack over the weekend, the Iranian government and military are reportedly preparing for an assault. Iranian and Iran-backed Hezbollah militants in Syria are being dispersed, while the Iranian air force is preparing for an attack on Iran itself. The Iranian navy will also escort commercial ships in the Red Sea. The moves illustrate how the war between Israel and Hamas could still broaden and escalate into a disruptive regional conflict.

- US and European officials continue to put strong pressure on Israel not to retaliate or at least to avoid any major retaliation.
- In a sign that the US and European messages may be getting through, the Israeli government has reportedly assured Arab countries in the region that its response to Iran's attack wouldn't endanger their security and would likely be limited in scope.
- Nevertheless, investor concern about a broader war has driven the VIX stock volatility index to its highest level since last October.



Chinese Stock Market Regulation: The China Securities and Regulatory Commission has clarified that its recent rule updates designed to make stocks more inviting for investors won't be applied to smaller companies. The clarification comes after investors raised concerns that the new rules would discourage small companies from listing and force others to abandon their current listing. The CSRC's move is another example of Chinese regulators clamping down on a sector, only to backtrack after going too far or scaring off investors.

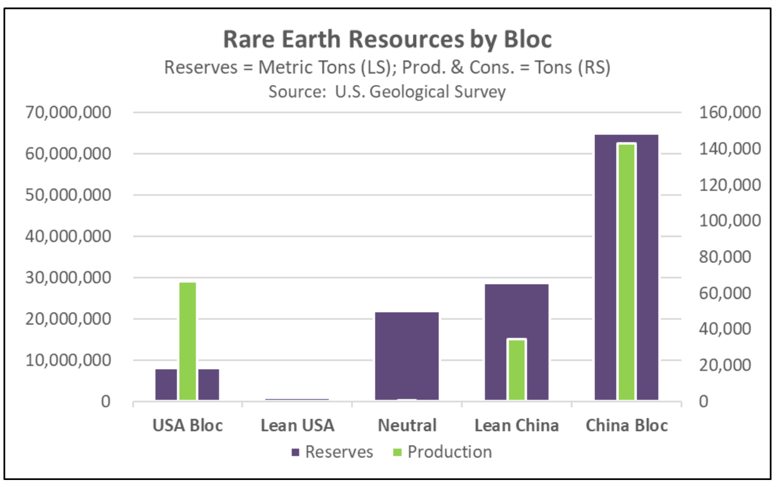
- According to the CSRC, its new policy to flag companies for unsatisfactory dividends will mostly target healthy, profitable firms that pay no dividends at all or relatively small dividends over several years.
- The agency also emphasized that the "special treatment" tag applied to such firms would not necessarily be grounds for delisting.

Chinese Banking Industry: Just days after cutting the outlook for China's sovereign debt rating, Fitch has cut the outlook for China's major state-owned banks from stable to negative, citing China's slowing economic growth and the government's more limited ability to support the institutions as fiscal challenges increase.

United States-China: President Biden today will propose more than tripling a key tariff on imports of Chinese steel and aluminum. The move will lift the tariff to 25% from its current level of 7.5%. Moreover, the higher rate would be in addition to the Trump administration's tariffs of 25% on Chinese steel and 10% on Chinese aluminum, which Biden has kept in place. The resulting total tariffs of 50% on steel and 35% on aluminum are sure to further worsen US-China trade tensions and will probably invite some kind of trade retaliation from Beijing.

United States-Australia: Just weeks after rare-earth mining firms Lynas of Australia and MP Minerals of the US came to an impasse in their merger bid, Australian mining billionaire Gina Rinehart has amassed at least 5% of the shares in each company, raising expectations that she will serve as kingmaker to facilitate the link-up.

- China and its geopolitical bloc currently account for the vast majority of proven reserves, production, and refining capacity for rare earths, which are critical to the more electrified economy of the future.
- The Lynas-MP Minerals merger is seen as one potential way to help boost Western production of rare earths and establish a more secure supply chain for the minerals.



US Monetary Policy: At an event yesterday, Fed Chair Powell gave the strongest hint yet that the central bank expects to hold interest rates "higher for longer" because of continued high consumer price inflation. According to Powell, "Given the strength of the labor market . . . and progress on inflation so far, it's appropriate to allow restrictive policy further time to work and let the data and the evolving outlook guide us." The statement is consistent with our view that investors have been too aggressive in expecting near-term rate cuts.

US Labor Market: The United Auto Workers today will begin a unionization vote at a Volkswagen car plant in Tennessee, marking a key step in the union's effort to organize workers at foreign-owned factories outside the more union-friendly areas in Michigan. Results of the vote are expected by the end of the week. With the vote, the UAW is trying to capitalize on the increased leverage workers have during today's labor shortages and the union's recent success in boosting pay at "Detroit Three" automakers.

US Military: Six months into the federal fiscal year, the Army and Air Force have reported improved recruiting results compared with the previous year. The improvement reflects a number of new programs and policy changes, such as remedial training for low-scoring applicants and relaxed standards for drug use and tattoos. However, the Navy continues to lag its recruiting goals, leaving it undermanned in both at-sea positions and on-land billets.

- After years of falling short of recruiting goals, Army Secretary Christine Wormuth says her service is now about 5,000 contracts ahead of where it was at the same point last year. She also said the Army is on track to meet its goal of 55,000 new recruits for the whole fiscal year, in large part because of a new, 90-day soldier prep course that helps low-scoring applicants meet the Army's academic and fitness standards.
- In the Air Force, recruiting has been strong enough for the service to hike its goal for the year to 27,100, compared with its original goal of 25,900. According to service officials, the improvement mostly reflects easier tattoo rules, bonus increases, and expanded efforts to recruit lawful permanent residents.

US Economic Releases

Home loan demand picked up even as borrowing costs rose last week. Mortgage applications rose 3.3% in the week ending April 12, according to the Mortgage Bankers Association's index. This rise is likely fueled by homebuyers locking in rates before they climb further. While the average 30-year fixed rate did inch up 12 bps to 7.13%, it hasn't deterred potential buyers. The MBA's purchase index surged 5.0% compared to last week, while refinancing activity saw a more modest increase of 0.5%.

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**
16:00	Net Long-Term TIC Flows	m/m	Feb		-$8.8b	**
16:00	Total Net TIC Flows	m/m	Feb		$36.1b	**
Federal Reserve						
EST	**Speaker or Event**	**District or Position**				
14:00	U.S. Federal Reserve Releases Beige Book	Federal Reserve Board				
17:30	Loretta Mester Gives Update on Fed	President of the Federal Reserve Bank of Cleveland				
19:15	Michelle Bowman Speaks at IIF Global Outlook Forum	Member of the Board of Governors				

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	Trade Balance	m/m	Mar	¥366.5b	-¥377.8b	¥345.5b	***	Equity and bond neutral
	Exports	m/m	Mar	7.3%	7.8%	7.0%	*	Equity and bond neutral
	Imports	m/m	Mar	-4.9%	0.5%	-5.1%	*	Equity and bond neutral
Australia	Westpac Leading Index MoM	m/m	Mar	-0.05%	0.06%		**	Equity and bond neutral
New Zealand	CPI	y/y	1Q	4.0%	4.7%	4.0%	**	Equity and bond neutral
	Non Resident Bond Holdings	m/m	Mar	62.9%	62.6%		*	Equity and bond neutral
EUROPE								
Eurozone	CPI	y/y	Mar F	2.4%	2.6%	2.4%	***	Equity and bond neutral
	Core CPI	y/y	Mar F	2.9%	2.9%	2.9%	**	Equity and bond neutral
UK	CPI	y/y	Mar	3.2%	3.4%	3.1%	***	Equity and bond neutral
	Core CPI	y/y	Mar	4.2%	4.5%	4.1%	***	Equity and bond neutral
	Retail Price Index	y/y	Mar	383.00	381.00	382.70	**	Equity and bond neutral
	RPI YoY	y/y	Mar	4.3%	4.5%	4.2%	**	Equity and bond neutral
	House Price Index	y/y	Feb	-0.2%	-1.3%	-0.6%	*	Equity and bond neutral
AMERICAS								
Canada	Housing Starts	m/m	Mar	242.2k	260.0k	243.5k	**	Equity and bond neutral
	CPI NSA	m/m	Mar	0.6%	0.3%	0.7%	**	Equity and bond neutral
	CPI	y/y	Mar	2.90%	2.80%	2.90%	***	Equity and bond neutral
Mexico	International Reserves Weekly	w/w	12-Apr	$217186m	$217299m		*	Equity and bond neutral
Brazil	Economic Activity Index	y/y	Feb	2.59%	3.45%	2.55%	*	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)	558	559	-1	Flat
3-mo T-bill yield (bps)	523	522	1	Up
U.S. Sibor/OIS spread (bps)	533	533	0	Up
U.S. Libor/OIS spread (bps)	534	534	0	Up
10-yr T-note (%)	4.66	4.67	-0.01	Up
Euribor/OIS spread (bps)	390	389	1	Up
Currencies	**Direction**			
Dollar	Flat			Up
Euro	Up			Down
Yen	Flat			Down
Pound	Up			Down
Franc	Up			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.

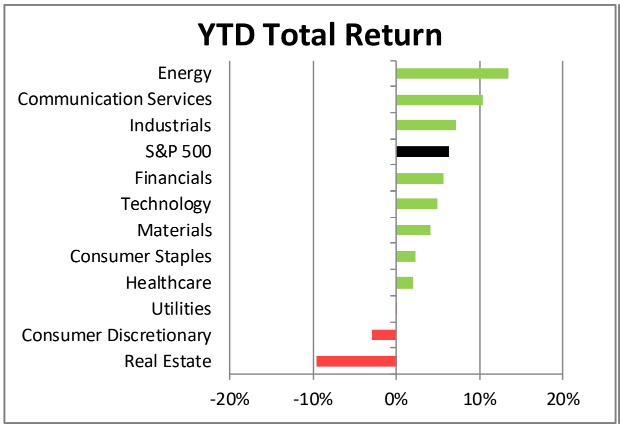
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$89.44	$90.02	-0.64%	
WTI	$84.81	$85.36	-0.64%	
Natural Gas	$1.67	$1.73	-3.46%	
Crack Spread	$30.43	$30.68	-0.82%	
12-mo strip crack	$25.00	$25.36	-1.42%	
Ethanol rack	$1.80	$1.80	-0.02%	
Metals				
Gold	$2,389.34	$2,382.89	0.27%	
Silver	$28.50	$28.11	1.38%	
Copper contract	$436.60	$433.15	0.80%	
Grains				
Corn contract	$443.00	$442.75	0.06%	
Wheat contract	$569.25	$564.75	0.80%	
Soybeans contract	$1,160.00	$1,160.00	0.00%	
Shipping				
Baltic Dry Freight	1,779	1,730	49	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		1.7		
Gasoline (mb)		-1.0		
Distillates (mb)		-0.9		
Refinery run rates (%)		0.6%		
Natural gas (bcf)		53		

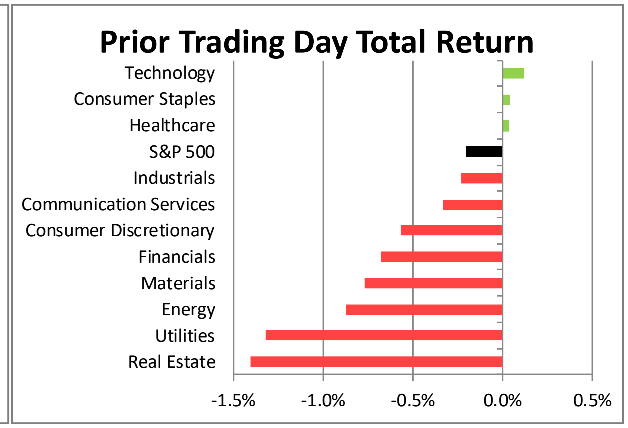
Weather

The 6-10 and 8-14 day forecasts call for warmer-than-normal temperatures spreading eastward across the country from areas west of the Mississippi River, while Southern California is expected to have cooler-than-normal temperatures in the latter half of the two week period. The precipitation outlook forecasts wetter-than-normal conditions for most areas, with normal conditions expected in the eastern third of the country.

Data Section

US Equity Markets – (as of 4/16/2024 close)

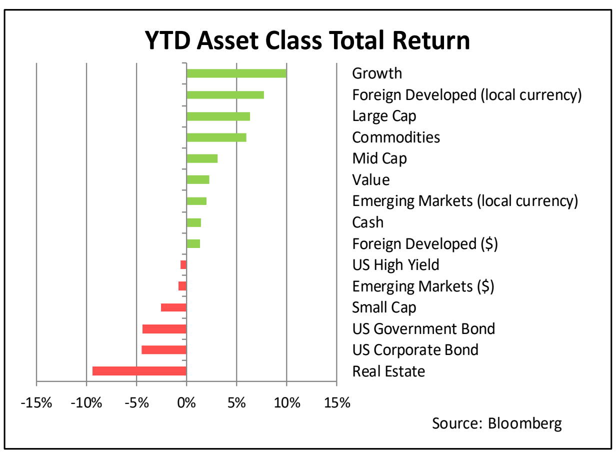




(Source: Bloomberg)

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 4/16/2024 close)

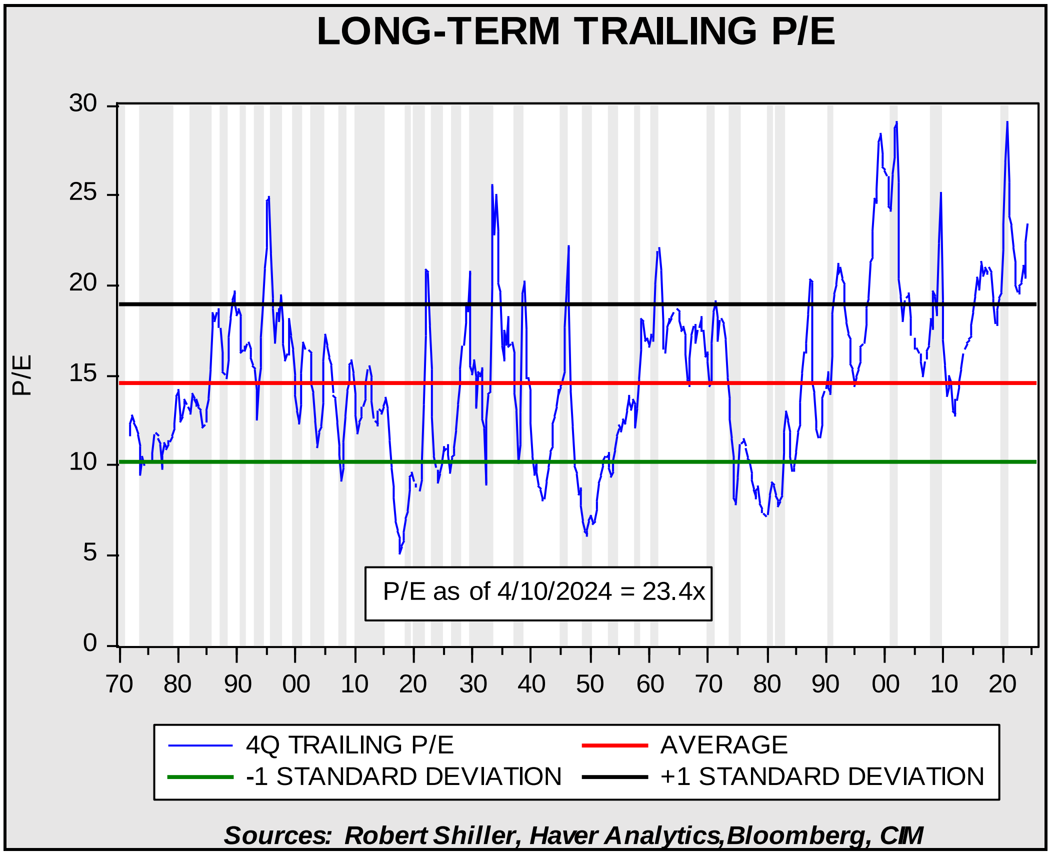


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.