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 18, 2024—9:30 AM EDT] Global equity markets are generally higher this morning. In Europe, the Euro Stoxx 50 is up 0.4% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.0%. Chinese markets were mixed, with the Shanghai Composite up 0.1% from its previous close and the Shenzhen Composite down 0.1%. US equity index futures are signaling a higher open.

With 54 companies having reported so far, S&P 500 earnings for Q1 are running at $53.70 per share, compared to estimates of $54.24, which is up 0.9% from Q1 2023. Of the companies that have reported thus far, 79.6% have exceeded expectations while 14.8% have fallen short of expectations.

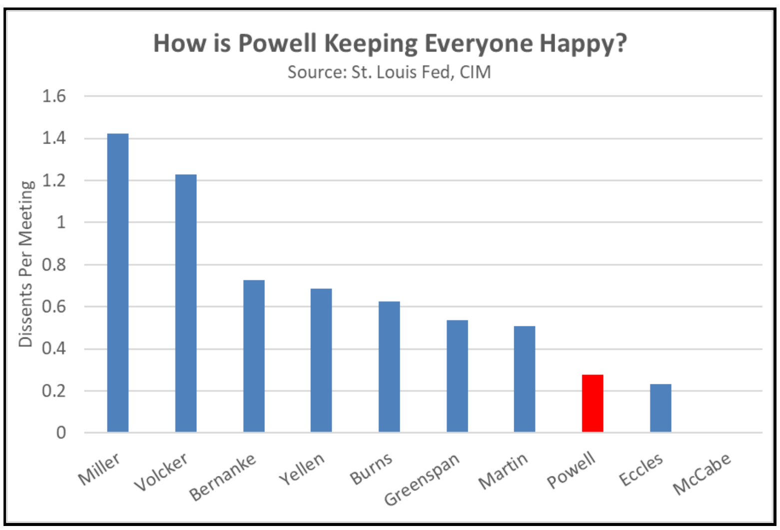
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *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"
- ***Keller Quarterly* (4/18/24)**

Good morning! Equities are surging as investors await another round of earnings reports today. Meanwhile, Real Madrid, after dethroning Champions League champion Manchester City, now gear up for their semi-final clash against Bayern Munich. Today's *Comment* explores how the Federal Reserve's shifting sentiment has impacted market expectations for interest rate cuts, why nuclear power is considered a potential solution to the energy constraints of artificial intelligence, and how the debate over military aid to various countries contributes to global uncertainty.

Powell Pivot: Markets have regained composure following Federal Reserve Chair Jerome Powell's hawkish shift toward a restrictive-for-longer monetary stance.

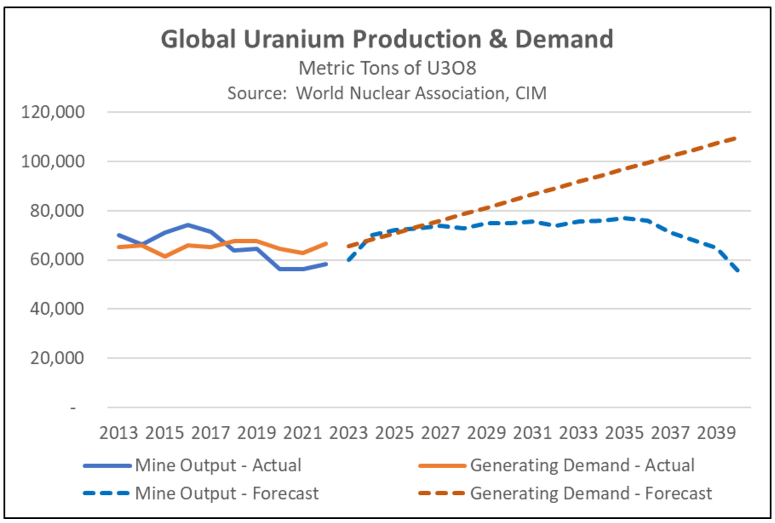
- Investors drove the decline, seeking to capitalize on the highest Treasury yields of the year. The strong demand for the 20-year bond auction, which yielded 4.818% (2 basis points lower than the pre-auction yield), fueled optimism. However, despite exceeding expectations, the auction resulted in the second-highest Treasury yield since the 10-year tenor's reintroduction in 2020. Additionally, the bond yields for the two-year Treasury fell below 5%, while the bond volatility declined after it hit its highest level since January in a sign that investors are still hopeful of rate cuts this year.
- Investor expectations for Federal Reserve interest rate cuts have undergone a dramatic shift in the last several months. Initially, markets anticipated up to seven cuts this year, fueled by the Fed's confidence in controlling inflation and concerns about a slowing job market (evidenced by declining job openings and payroll figures). However, recent data has dashed hopes of an imminent slowdown. Inflation data reveals persistent price pressures, particularly in wage-sensitive sectors. As a result, policymakers have grown reluctant to cut rates anytime soon, as they fear such a move could undermine their credibility in fighting inflation.



- Federal Reserve Chair Jerome Powell's recent shift to a more hawkish stance is likely a reflection of his cautious decision-making approach. Powell prioritizes consensus among policymakers before taking action, which has resulted in one of the lowest dissent rates in Fed history during his tenure. Over the last few weeks, members have offered a range of opinions about the inflation trajectory. Some dismiss the recent data as a blip, while others voice concerns about a new trend of stickiness. However, employment has been an area of agreement. If jobs slow considerably in the coming months, policymakers may be open to a rate cut, but until then, expect "higher for longer" to be a major theme going forward.

AI Energy Problem: The future may belong to artificial intelligence (AI) but addressing its ever-increasing energy demands is a critical challenge.

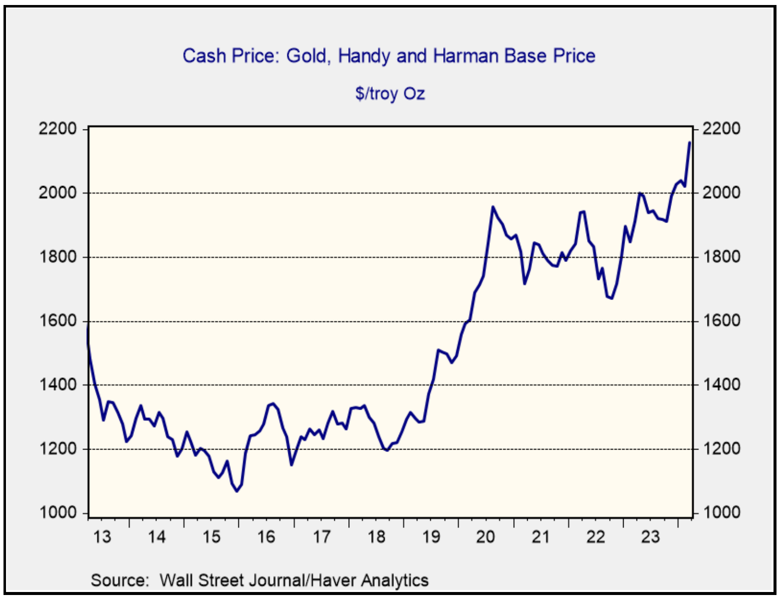
- The AI boom is raising concerns for the overall economy. A representative from UK semiconductor company ARM predicts that AI could consume more electricity than India, the world's most populous country, by 2030. This surge is driven by companies training increasingly complex AI systems with ever-larger datasets. The energy constraint has become a significant roadblock to AI development, potentially surpassing chip shortages as the top concern among tech companies. While these firms have made strides in efficiency with custom chips, these solutions may only offer up to 15% energy savings in data centers.
- Nuclear power is emerging as a promising solution. Energy Secretary Jennifer Granholm recently announced the Department of Energy's support for using small-scale nuclear plants to power AI and data centers. This groundbreaking approach brought together tech giants to explore the deployment of compact, on-site nuclear reactors utilizing nuclear fission. This initiative seamlessly aligns with the Biden administration's focus on modernizing infrastructure, prioritizing a shift towards cleaner energy sources. The forthcoming rejuvenation of the Holtec Palisades facility serves as a testament to this commitment and could herald the resurgence of similar plants nationwide.



- Nuclear energy, currently supplying 20% of the nation's power, is poised for a resurgence as the US divests from fossil fuels. Analysts predict a uranium supply crunch due to surging demand, especially with more countries adopting nuclear power. This scarcity is likely to make uranium a strategic investment, potentially granting uranium companies leverage in pricing. The recent 80% price increase over a year reflects this optimism in the nuclear sector, particularly for miners. This momentum is expected to continue as navigating the regulatory hurdles for uranium production is a slow process for many countries.

Military Aid Dispute: Despite edging closer to approving funding for military efforts abroad, persistent political wrangling among lawmakers raises concerns about future efforts.

- On Wednesday, House Speaker Mike Johnson (R-LA) informed fellow party members of his decision to schedule a crucial vote on foreign aid packages earmarked for Ukraine and Israel, set to take place this Saturday. The announcement comes amid simmering tensions within the leader's own party. Some members are pushing for more funds to address domestic issues like border security, while others are wary of ballooning the deficit. This internal rift makes securing bipartisan support crucial, particularly as pockets of strong opposition have solidified within the party itself.
- While aid can provide much-needed support to these countries, it's unlikely to be a cure-all for the long shadow cast by surging geopolitical tensions. The situation in Ukraine has taken a drastic turn for the worse in recent weeks. Anxieties mount as the country struggles to repel Russian advances due to a critical lack of anti-missile defenses, exemplified by Tuesday's loss of a key power plant. Meanwhile, the specter of wider conflict looms as Israel weighs a response to Iran's weekend attack, with Tehran threatening further escalation in the event of another military strike.

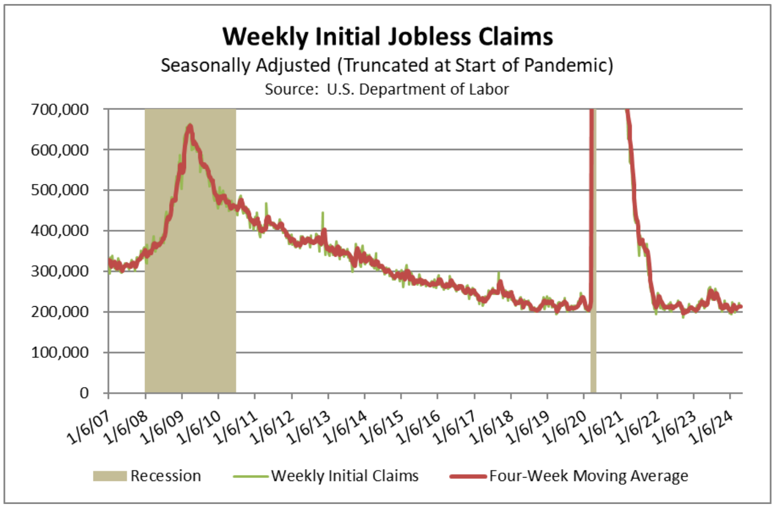


- Escalating geopolitical flashpoints exacerbate global uncertainty, sending investors scrambling for hedges against potential supply chain disruptions in a wider war. This uncertainty fuels a surge in gold prices, as the precious metal reclaims its safe-haven status. The preference for safe-havens is likely to persist, with long-term Treasury yields expected to remain volatile. The US's growing debt burden adds to this volatility, as investors grapple with the government's ability to manage it. Our analysis suggests that growing threats from the Russia-China-Iran alliance will necessitate increased US security spending, further limiting its ability to control spending in the coming years.

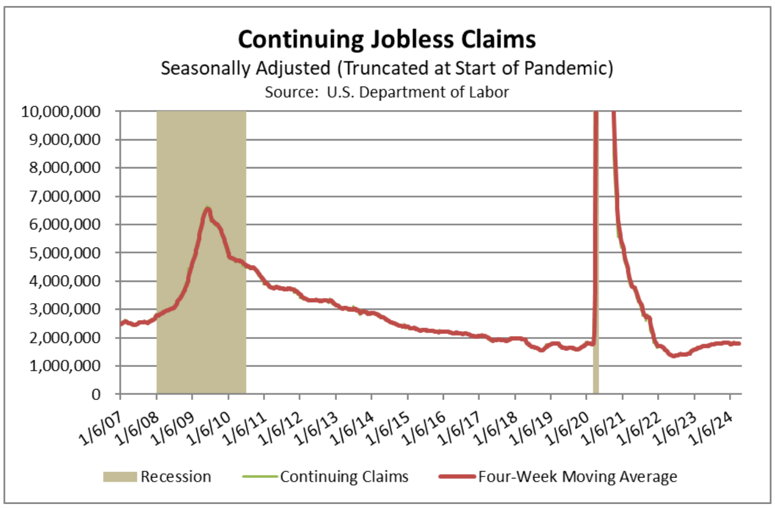
In Other News: A group of conservative economists is advocating for a 17% flat income tax and maintaining the cap on SALT deductions. This plan comes as the presumed Republican presidential nominee is likely to consider ways to reduce taxes. Weight loss drug Ozempic is unexpectedly linked to increased fertility rates in users. This raises concerns about potential unintended consequences of the medication. Japan and Korea [are working with the US to weaken the rise of the dollar.]

US Economic Releases

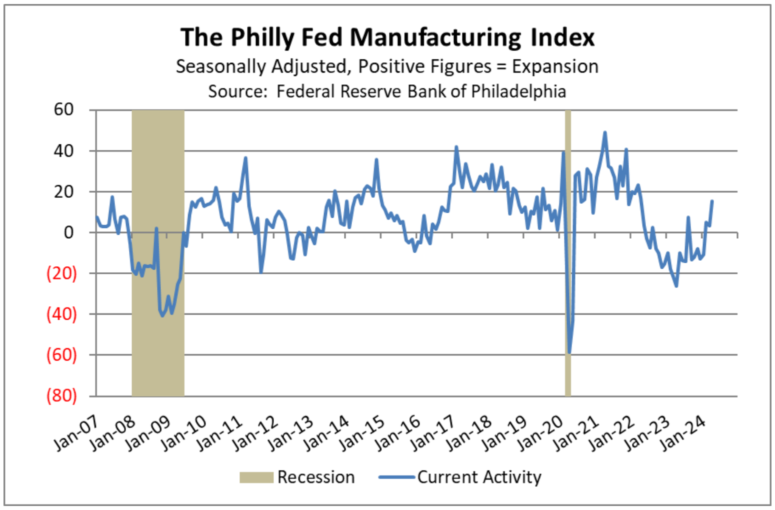
In the week ended April 13, ***initial claims for unemployment benefits*** came in at a seasonally adjusted 212,000, below the expected level of 215,000 but unchanged from the prior week's revised level. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, was unchanged at 214,500. The chart below shows how initial jobless claims have fluctuated since just before the Great Financial Crisis. The chart is truncated through much of the pandemic period because of the extremely high level of claims at that time.



In the week ended April 6, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) edged up to a seasonally adjusted 1.812 million, below the anticipated reading of 1.818 million but slightly above the previous week's revised reading of 1.810 million. The chart below shows how continuing claims have fluctuated since the GFC. It is also truncated during the pandemic period because of the high level of claims at the time.



Separately, the Philadelphia FRB said its April ***Philly Fed Index*** rose to a seasonally adjusted 15.5, well above both the expected level of 2.0 and the March level of 3.2. The index, officially designated as the Philadelphia FRB Manufacturing Activity Index, is designed so that positive readings point to expanding factory activity in the mid-Atlantic region. At its current level, the index suggests mid-Atlantic manufacturing is now surging again after a year and a half of weakness. The chart below shows how the index has fluctuated 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	Existing Home Sales	m/m	Mar	4.20m	4.38m	**
10:00	Leading Economic Indicators	m/m	Mar	-0.1%	0.1%	***
Federal Reserve						
EST	**Speaker or Event**	**District or Position**				
9:05	Michelle Bowman Gives Opening Remarks	Member of the Board of Governors				
9:15	John Williams Participates in Moderated Discussion	President of the Federal Reserve Bank of New York				
9:15	Michelle Bowman Speaks at SIFMA Basel III Endgame Roundtable	Member of the Board of Governors				
11:00	Raphael Bostic Speaks in Fireside Chat on Economy	President of the Federal Reserve Bank of Atlanta				
12:00	Susan Collins Travels to Connecticut	President of the Federal Reserve Bank of Boston				
17:45	Raphael Bostic Chats About Economy, Monetary Policy	President of the Federal Reserve Bank of Atlanta				

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	Japan Buying Foreign Stocks	w/w	12-Apr	-¥293.2b	-¥301.8b		*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	12-Apr	¥347.9b	¥346.4b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	12-Apr	-¥348.9b	-¥349.0b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	12-Apr	¥1764.9b	¥1764.4b		*	Equity and bond neutral
	Tertiary Industry Index	m/m	Feb	-0.5%	0.3%	0.5%	**	Equity bearish, bond bullish
	Tokyo Condominiums for Sale	y/y	Mar	0.50%	-27.60%		*	Equity and bond neutral
	Machine tool orders	y/y	Mar F	-3.8%	-3.8%		**	Equity and bond neutral
Australia	NAB Business Confidence	m/m	1Q	-2.0%	-6		**	Equity and bond neutral
	Participation Rate	m/m	Mar	66.6%	66.7%	66.7%	**	Equity and bond neutral
	Unemployment Rate	m/m	Mar	3.8%	3.7%	3.9%	***	Equity and bond neutral
	Employment Change	m/m	Mar	-6.6k	117.6k	10.0k	***	Equity bearish, bond bullish
EUROPE								
Eurozone	EU27 New Car Registrations	y/y	Mar	-5.2%	10.1%		***	Equity and bond neutral
	ECB Current Account SA	y/y	Feb	29.5b	39.3b		**	Equity and bond neutral
	Construction Output	m/m	Feb	-0.3%	0.8%		**	Equity and bond neutral
Switzerland	Real Exports	m/m	Mar	-1.7%	0.2%		*	Equity and bond neutral
	Real Imports	m/m	Mar	-2.3%	3.6%		*	Equity and bond neutral
Russia	PPI	y/y	Mar	19.1%	19.5%		*	Equity and bond neutral
AMERICAS								
Canada	Int'l Securities Transactions	m/m	Feb	-8.78b	8.88b		*	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	558	1	Up
3-mo T-bill yield (bps)	523	525	-2	Up
U.S. Sibor/OIS spread (bps)	532	533	-1	Up
U.S. Libor/OIS spread (bps)	534	534	0	Up
10-yr T-note (%)	4.58	4.59	-0.01	Down
Euribor/OIS spread (bps)	390	390	0	Down
Currencies	**Direction**			
Dollar	Flat			Up
Euro	Flat			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.

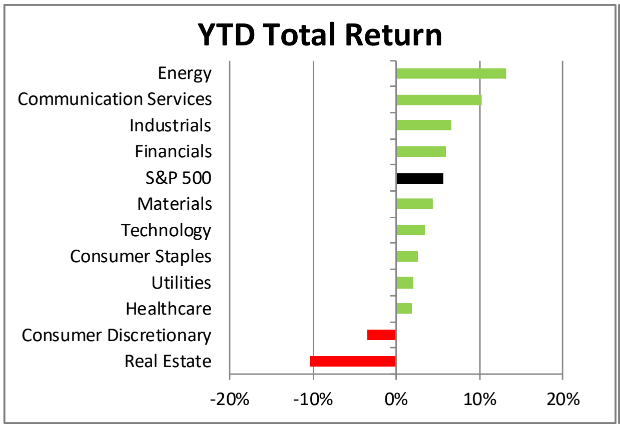
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$86.70	$87.29	-0.68%	
WTI	$82.16	$82.69	-0.64%	
Natural Gas	$1.75	$1.71	2.45%	
Crack Spread	$29.05	$29.74	-2.33%	
12-mo strip crack	$23.87	$24.41	-2.22%	
Ethanol rack	$1.79	$1.79	-0.23%	
Metals				
Gold	$2,382.05	$2,361.02	0.89%	
Silver	$28.44	$28.22	0.76%	
Copper contract	$444.50	$436.35	1.87%	
Grains				
Corn contract	$439.00	$441.00	-0.45%	
Wheat contract	$553.75	$552.25	0.27%	
Soybeans contract	$1,156.50	$1,164.25	-0.67%	
Shipping				
Baltic Dry Freight	1,844	1,779	65	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	2.7	1.7	1.1	
Gasoline (mb)	-1.2	-1.0	-0.2	
Distillates (mb)	-2.8	-0.9	-1.86	
Refinery run rates (%)	-0.2%	0.6%	-0.8%	
Natural gas (bcf)		51		

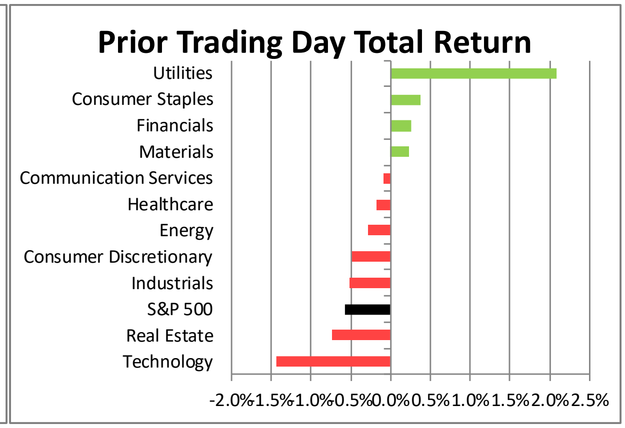
Weather

The 6-10 and 8-14 day forecasts call for warmer-than-normal temperatures from the Rocky Mountain region through the Great Plains and Midwest to the Deep South, with cooler-than-normal temperatures in California and New England. The forecasts call for wetter-than-normal conditions throughout the western two-thirds of the country, with normal conditions expected in the eastern third.

Data Section

US Equity Markets – (as of 4/17/2024 close)

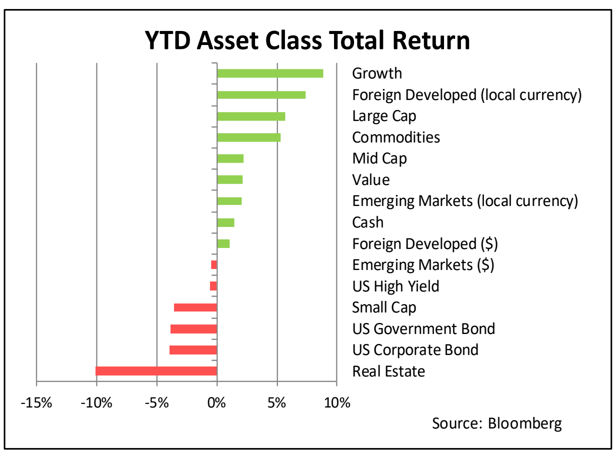




(Source: Bloomberg)

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 4/17/2024 close)

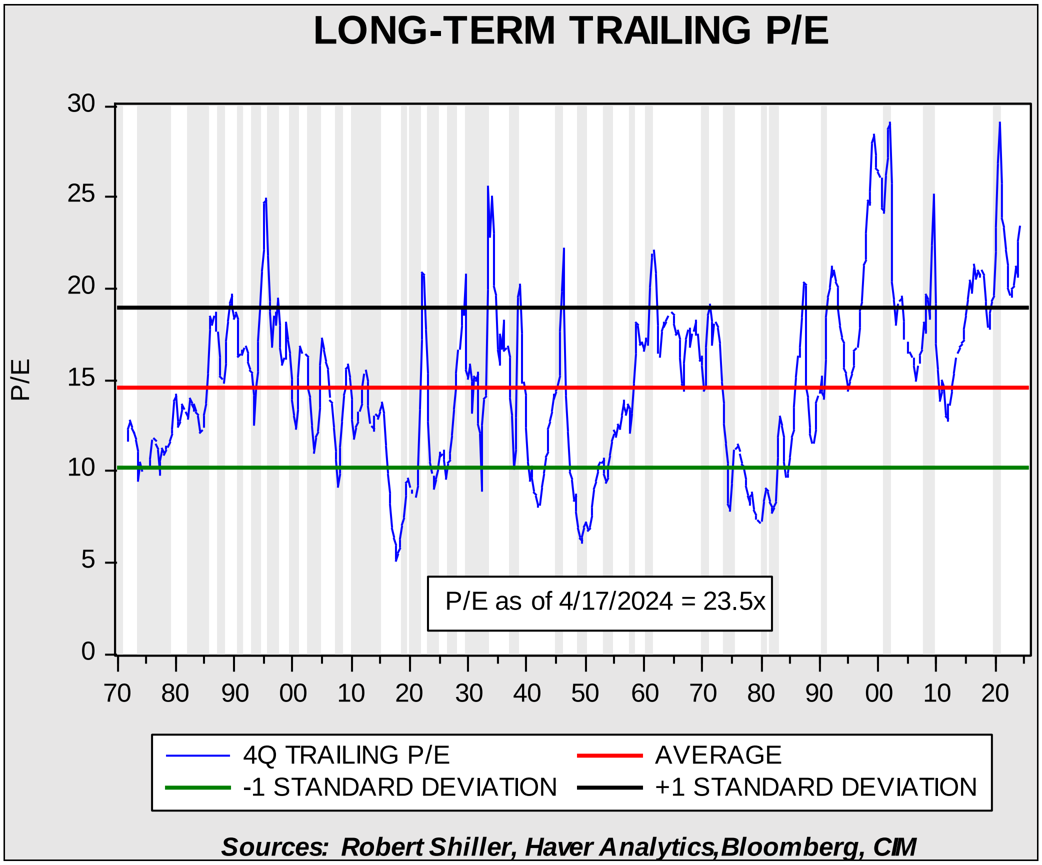


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 18, 2024



Based on our methodology,[1] the current P/E is 23.5x, up 0.1x from our last report. The increase in the multiple reflects a slight decrease in earnings, outweighing the decline in the stock price index.

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.