# 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 19, 2024—9:30 AM EDT]** Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 is down 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 2.7%. Chinese markets were lower, with the Shanghai Composite down 0.3% from its previous close and the Shenzhen Composite down 0.7%. US equity index futures are signaling a lower open.

With 65 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, 81.5% have exceeded expectations while 13.8% have fallen short of expectations.

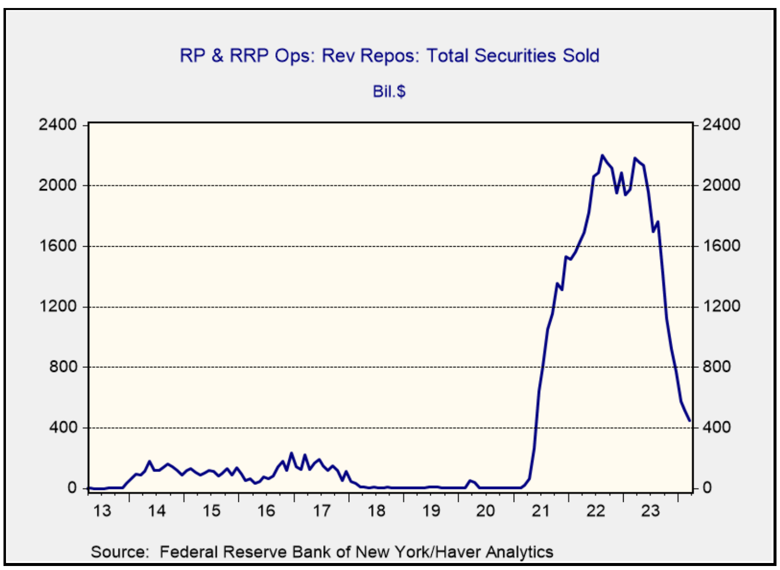
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *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 off to a great start following optimism that tensions in the Middle East might be easing. On the lighter side, NHL fans rejoice — the playoffs begin this Sunday! Today's *Comment* examines the potential effects of rising interest rates on repo markets, explores signs of a slowdown in semiconductor demand, and discusses the growing anxiety among central banks outside the US regarding the resurgent strength of the dollar. As usual, our report concludes with a summary of domestic and international data releases.

**Another Repo-calypse?** The recent rise in Treasury yields has led to concerns about a squeeze in the short-term lending market.

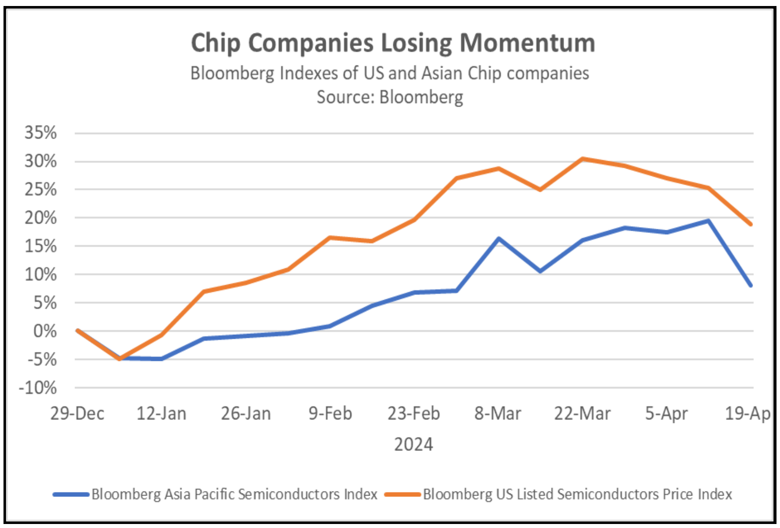
- Recent hawkish comments from Federal Reserve officials have driven yields upwards on the 10-year US Treasury bond. While New York Fed President John Williams signaled a cautious approach by suggesting rate cuts are improbable in the near term, he didn't entirely rule out the possibility of future hikes. Atlanta Fed President Raphael Bostic later offered a contrasting view, indicating that a rate cut in the final quarter is still a possibility. These remarks have further bolstered the market's perception that interest rates may stay elevated for a longer period than previously expected.
- The recent rise in interest rates has sparked concerns about a potential yield curve steepening, which could lead to funding stress. Higher interest rates incentivize investors to shift their funds towards higher-yielding, safer assets, such as the short-term Treasurys the government is issuing to meet its funding needs. This shift has consequently absorbed much of the excess liquidity, leading to a decline in the use of the reverse repo (RRP) facility, which has fallen to its lowest level since 2021, and is currently at $433 billion. Moreover, a sustained decline in RRP usage could lead to an excess reserve problem, potentially posing systemic risks in the financial system.




- The 2019 repo crisis serves as a stark reminder that disruptions in the short-term wholesale market can be a warning sign of an impending recession, even though they don't directly cause one. Notably, each of the last four recessions was preceded by such disruptions. As the usage of the RRP continues to decline, we could see an increase in bond volatility. This, in turn, could raise the likelihood of a market correction. At this time there is no evidence of any sign of trouble, but investors could seek protection in commodities if conditions worsen unexpectedly.

**Chip Hype Fades:** Semiconductor stocks are slumping amid growing concerns about future demand, particularly for consumer goods.

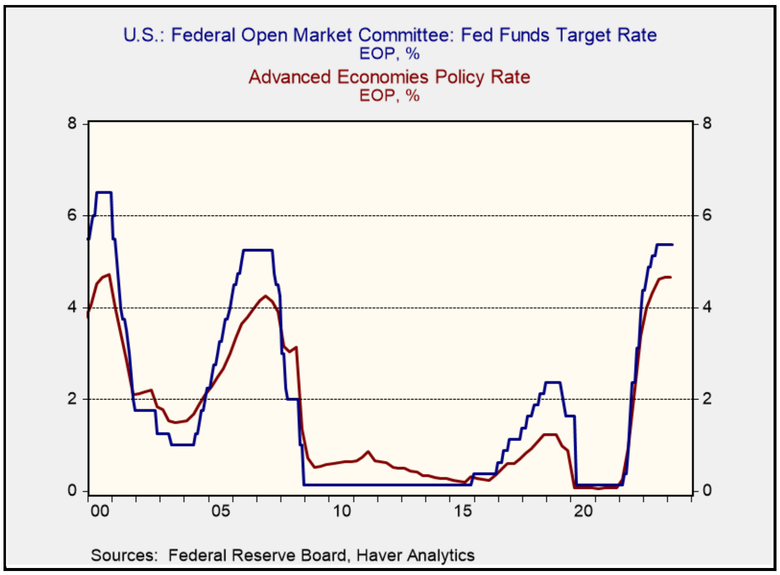
- On Thursday, Taiwan Semiconductor Manufacturing Company (TSMC) the world's largest chipmaker, cut its 2024 chip market outlook due to a slowdown in the purchasing of smartphones and PCs. Excluding memory chips, they now expect the semiconductor market to grow around 10% this year. This revision highlights a widening gap between chipmakers supplying consumer electronics and those focused on AI-related services. The decline in Apple's consumer products, exemplified by weak iPhone sales in China, contrasts sharply with Microsoft's projected strong revenue growth in cloud computing, which fuels its AI efforts. This trend highlights the growing divide between hardware-focused companies and those leveraging cloud services for AI.
- The uncertain macroeconomic and geopolitical climate is likely to exacerbate the weakness in chip demand. While the US has shown some resilience this year, the global outlook remains precarious. The European Union and UK are struggling to stimulate economic growth, and China's slowdown continues to be a drag on the world's economy. This will likely disproportionately impact chip companies compared to other sectors due to their greater reliance on global markets. This lack of optimism is likely why Dutch chip equipment maker ASML posted lower-than-expected orders, as chipmakers are hesitant to ramp up production.




- TSMC's earnings report underscores the waning enthusiasm for tech stocks in this volatile market. Rising interest rates, driven by the Fed's tighter monetary policy, are prompting investors to seek alternative assets with higher yields than US Treasurys. This shift could trigger a sell-off in AI-related companies like Nvidia, particularly if earnings disappoint. Investors are increasingly questioning the sustainability of the AI boom. Even the "Magnificent Seven" tech giants, which started the year strong, may be forced to relinquish some of those gains in the coming weeks. Nevertheless, this doesn't negate the potential value proposition of stocks beyond the traditional tech players.

**The Super Greenback:** Fueled by hawkish rhetoric from Federal Reserve officials and robust US economic growth, the dollar's surge against its peers has sparked international concern.

- The Bloomberg Dollar Spot Index has climbed to its highest level since October 2023, putting pressure on economies reliant on dollar-denominated imports. South Korea and Japan recently met with the US to address the issue. Their worries stem from currency depreciation, with the yen (JPY) trading around 154 per dollar and the won (KRW) nearing 1400 per dollar earlier this week. Both countries fear a stronger dollar could exacerbate inflationary pressures. While no immediate policy coordination was agreed upon, the group has committed to "close consultation."
- A strengthening dollar is prompting central banks to reassess their policies. The People's Bank of China has threatened currency intervention to deter speculative bets against the yuan (CNY). The Bank of Japan is also considering intervention and a potential interest rate hike later this year to curb the yen's depreciation. In Europe, the European Central Bank (ECB), which previously anticipated a rate cut in June, may be forced to reconsider its dovish stance. Similarly, Sweden's Riksbank has hinted that its potential rate cut in May might be jeopardized.




- The strong dollar and tightening global monetary policy have become key drivers of international markets in 2024, creating headwinds for many countries. While the global economic climate remains improved compared to last year, the outlook has somewhat dimmed. Interest rates are likely to stay higher than initially anticipated, potentially weighing on international equities, especially if the Fed maintains its hawkish stance. However, central bank interventions could mitigate some of these challenges by injecting more liquidity into the market, potentially offering some resistance to the dollar's appreciation and supporting foreign equities.

**In Other News:** Israel launched a limited counterstrike against Iran on Friday. Tehran downplayed the retaliation, calling it insufficient, but the measured response may help prevent further escalation. The US Congress is nearing a vote on approving aid for allies, including Ukraine and Israel. In a separate development, Apple removed WhatsApp and Threads from its

App Store in China due to pressure from Beijing. These issues highlight the growing geopolitical tension in the world.

### US Economic Releases

No major US economic reports have been released so far this morning. 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** |
| **10:30** | Austan Goolsbee Participates in Q&A | President of the Federal Reserve Bank of Chicago |
| **16:00** | Fed Releases Financial Stability Report | Federal Reserve Board |

### 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** | National CPI | y/y | Mar | 2.7% | 2.8% | 2.8% | *** | Equity and bond neutral |
| | National CPI Ex-Fresh Food | y/y | Mar | 2.6% | 2.8% | 2.7% | ** | Equity and bond neutral |
| | National CPI Ex-Fresh Food & Energy | y/y | Mar | 2.9% | 3.2% | 3.0% | * | Equity and bond neutral |
| **EUROPE** | | | | | | | | |
| **Germany** | PPI | y/y | Mar | -2.9% | -4.1% | -3.3% | ** | Equity and bond neutral |
| **UK** | Retail Sales | y/y | Mar | 0.8% | -0.3% | 1.0% | *** | Equity and bond neutral |
| | Retail Sales Ex-Auto Fuel | y/y | Mar | 0.4% | -0.4% | 1.0% | ** | Equity and bond neutral |
| **Russia** | Gold and Forex Reserves | m/m | 12-Apr | $600.7b | $598.3b | | *** | Equity bearish, bond bullish |
| | Money Supply, Narrow Definition | w/w | 12-Apr | 18.21t | 18.12t | | * | Equity and bond neutral |
| **AMERICAS** | | | | | | | | |
| **Mexico** | Retail Sales | y/y | Feb | 3.0% | -0.8% | 1.6% | *** | Equity bullish, bond bearish |

### 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 | 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 (%)** | 4.61 | 4.63 | -0.02 | Up |
| **Euribor/OIS spread (bps)** | 390 | 390 | 0 | Down |
| **Currencies** | **Direction** | | | |
| Dollar | Flat | | | Up |
| Euro | Flat | | | Down |
| Yen | Flat | | | Down |
| Pound | Flat | | | 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.

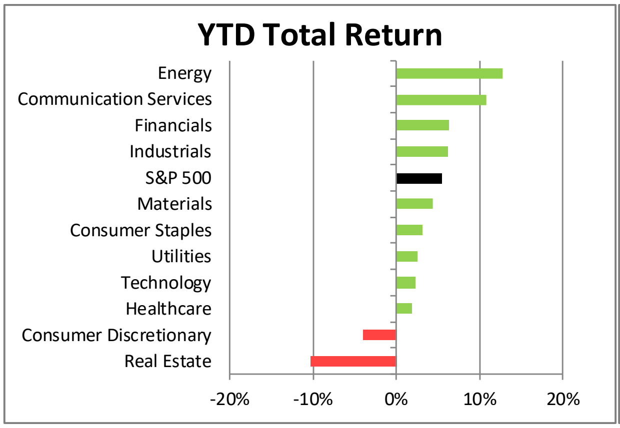
| DOE Inventory Report | Price | Prior | Change | Explanation |
|---|---|---|---|---|
| **Energy Markets** | | | | |
| Brent | $86.67 | $87.11 | -0.51% | |
| WTI | $82.33 | $82.73 | -0.48% | |
| Natural Gas | $1.75 | $1.76 | -0.40% | |
| Crack Spread | $28.51 | $28.68 | -0.59% | |
| 12-mo strip crack | $23.75 | $23.89 | -0.60% | |
| Ethanol rack | $1.79 | $1.79 | -0.13% | |
| **Metals** | | | | |
| Gold | $2,377.43 | $2,379.04 | -0.07% | |
| Silver | $28.21 | $28.24 | -0.12% | |
| Copper contract | $450.30 | $446.60 | 0.83% | |
| **Grains** | | | | |
| Corn contract | $439.50 | $436.25 | 0.74% | |
| Wheat contract | $558.75 | $553.00 | 1.04% | |
| Soybeans contract | $1,151.00 | $1,149.00 | 0.17% | |
| **Shipping** | | | | |
| Baltic Dry Freight | 1,901 | 1,844 | 57 | |
| **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) | 50 | 51 | -1 | |

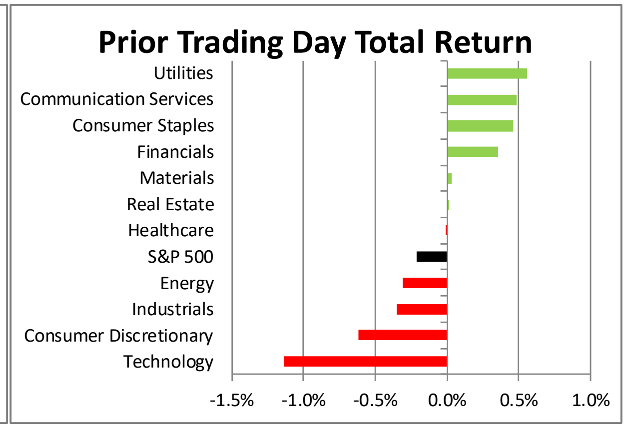
## Weather

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 from the West Coast to the Appalachian Mountains, with normal conditions expected along the East Coast.

## Data Section

**US Equity Markets** – (as of 4/18/2024 close)

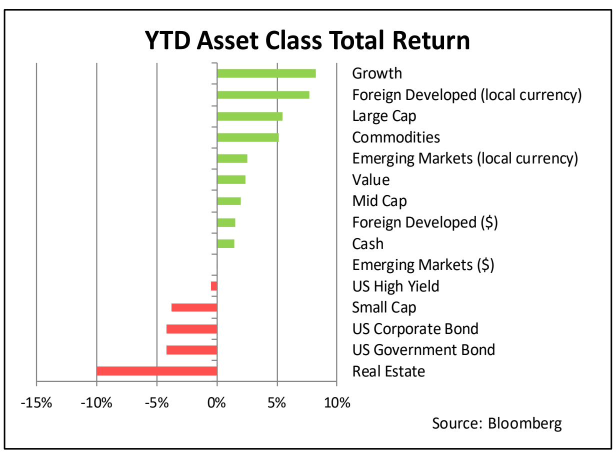



(Source: Bloomberg)

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 4/18/2024 close)

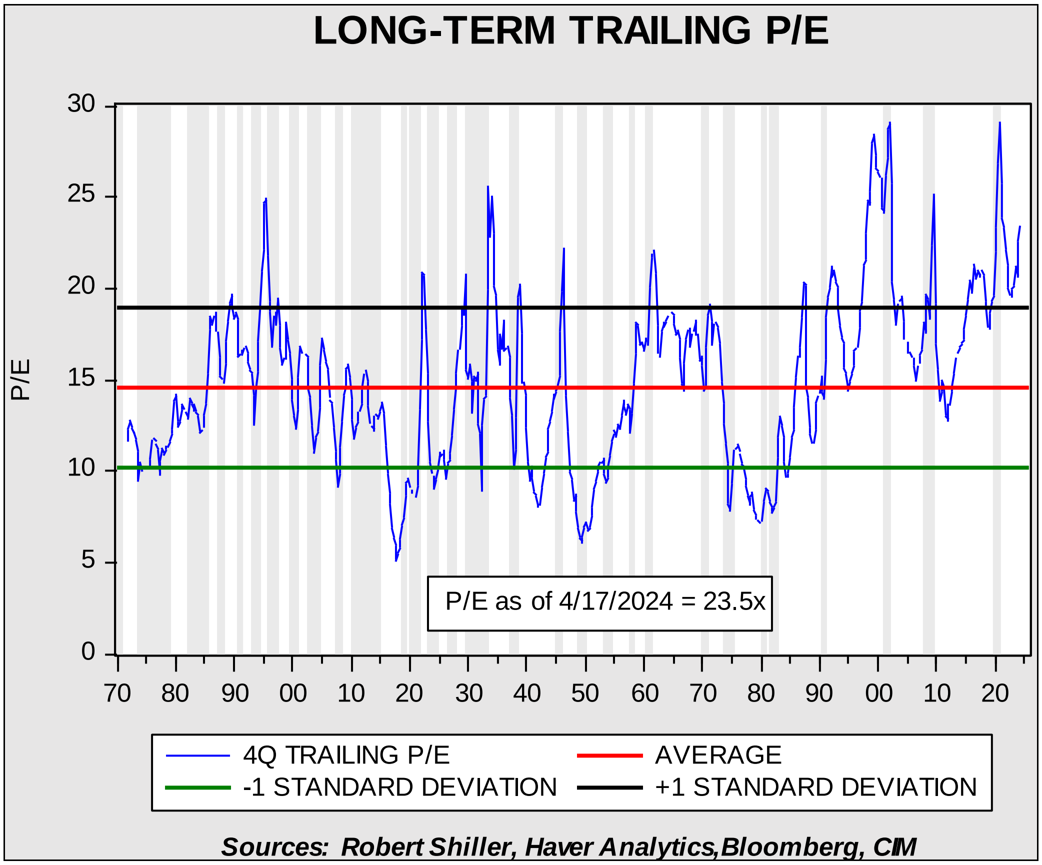



This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.