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 22, 2024—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is up 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.8%. Chinese markets were lower, with the Shanghai Composite down 0.7% from its previous close and the Shenzhen Composite down 0.5%. US equity index futures are signaling a higher open.

With 71 companies having reported so far, S&P 500 earnings for Q1 are running at $53.80 per share, compared to estimates of $54.24, which is up 0.9% from Q1 2023. Of the companies that have reported thus far, 81.7% have exceeded expectations while 14.1% 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"
- *Keller Quarterly* (4/18/24)

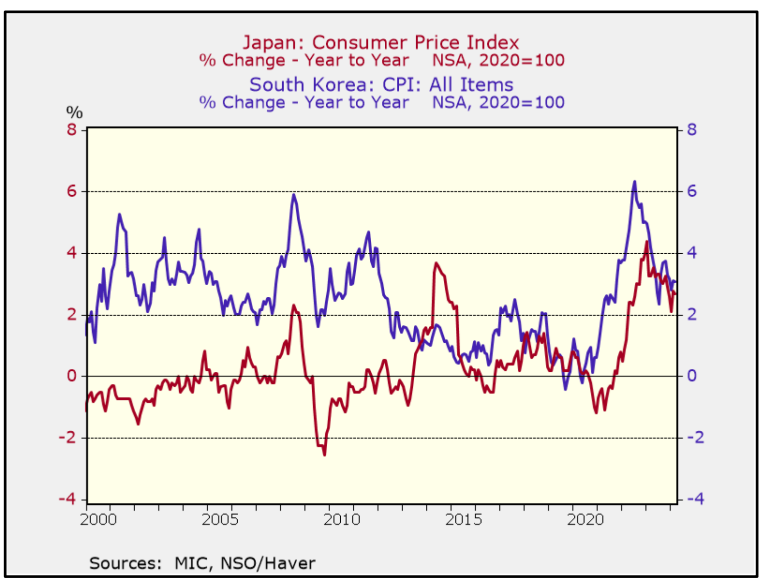
Our *Comment* today opens with a discussion of the big foreign aid bill passed by the House of Representatives over the weekend. We next review a wide range of other international and US developments with the potential to affect the financial markets today, including an analysis of why Japan and South Korea are agitating for a weaker dollar and some observations on where US bond yields go from here.

United States-Ukraine-Israel-China: The House of Representatives [approved a package of bills on Saturday that will provide a total of $95 billion in military and other aid to Ukraine, Israel, and Taiwan], even though a majority of Republicans opposed the $60 billion or so destined to Ukraine to help it fend off Russia's invasion. The Senate is poised to give final legislative approval to the package in the coming days, after which President Biden is expected to sign it into law.

- Here at Confluence, we have long noted how US voters have become increasingly resistant to supporting the country's traditional role as global hegemon, with the enormous fiscal, economic, and social costs. We believe that resistance is a key reason why right-wing populists such as Donald Trump have gained power in recent years.
- Nevertheless, it is not set in stone that US voters will ultimately support a full pullback from US leadership in global affairs. The vote over the weekend is an example of how, when faced with the threat of authoritarian powers abroad, politicians could well line up behind renewed US engagement, higher US defense spending, and a stronger commitment to US military power.

United States-Japan-South Korea: New analysis suggests Friday's joint statement on currency rates by the US, Japan, and South Korea stemmed from Japanese and Korean concerns about consumer price inflation. As strong economic growth and the prospect of continued high interest rates in the US buoy the dollar, the yen (JPY) and won (KRW) have depreciated sharply. In turn, Japanese and Korean purchases of dollar-denominated goods have become more expensive, broadly pushing up price pressures in each country.

- Since the end of 2022, the yen has lost 14.8% of its value versus the greenback. Meanwhile, the Korean currency has weakened 8.3% against the dollar.
- The statement, which acknowledged that Tokyo and Seoul have serious concerns about their currencies, could signal a future coordinated effort to weaken the dollar and allow the yen and won to rise again. At any rate, it suggests the Biden administration has given the two allies a green light to intervene in the currency markets to boost their currencies.



Chinese Monetary Policy: The People's Bank of China today said the country's major banks have kept their prime lending rates unchanged this week, as widely expected after the central bank kept the interest rate on its medium-term lending facility unchanged last week. The banks' one-year prime rate remains at 3.45%, while their five-year rate remains at 3.95%. Because of continued modest economic growth, some economists still expect the PBOC to cut rates further, but policymakers continue to resist broad, aggressive stimulus measures.

Chinese Military: State media on Friday said General Secretary Xi has ordered the biggest reorganization of the People's Liberation Army since 2015. Under the change, the Strategic Support Force will be split up, with its space and cyberspace forces becoming new, standalone services and its remaining elements becoming a new Information Support Force.

- One likely reason for the change is to hasten the development and improve the operational efficiency of China's key space warfare and cyberspace capabilities. If successful, the reorganization could help make those forces even more formidable threats to the US and the rest of its geopolitical bloc.
- Another likely reason for the reorganization is to stamp out corruption. Over the last year, several high-ranking military officials in the sprawling Strategic Rocket Force and defense industry were removed from their posts, apparently for procurement-related corruption that would have made them susceptible to recruitment by foreign intelligence agencies. Breaking up the Strategic Support Force could help increase control over its elements and reduce the opportunity for bribery, graft, espionage, and the like.

Iran-Israel: The Israeli military finally launched its retaliation on Friday for Iran's direct missile and drone attack on Israel on April 13, striking a military base near the central Iranian city of Natanz. Details over the weekend showed the strike apparently used one missile and multiple drones to destroy an Iranian air defense radar near some of Iran's key nuclear program sites. The limited nature of the strike and Iran's muted response suggest the risk of escalation has diminished, but it's clear Israel was signaling it can attack Iran by air if it so chooses in the future.

Canada: Bank of Canada Governor Macklem has given an optimistic assessment that consumer price inflation in Canada is now "closer to normal" and that the March data was a further "step in the right direction." According to the report last week, March consumer prices were up 2.9% from the same month one year earlier. Macklem's statement is being read as further evidence that the central bank will begin cutting interest rates as early as June.

US Bond Market: With the big rise in US bond yields over the last month, which has lifted the yield on the10-year Treasury note to 4.62% so far today, investors are increasingly wondering whether the benchmark yield could re-test the 5.00% level reached last October. Given the strength in US economic growth and sticky consumer price inflation, that's possible. However, we note that Fed policymakers are behaving as if 5.00% is an informal ceiling that, if touched, would spur efforts to try to talk down yields or take other actions to push them lower.

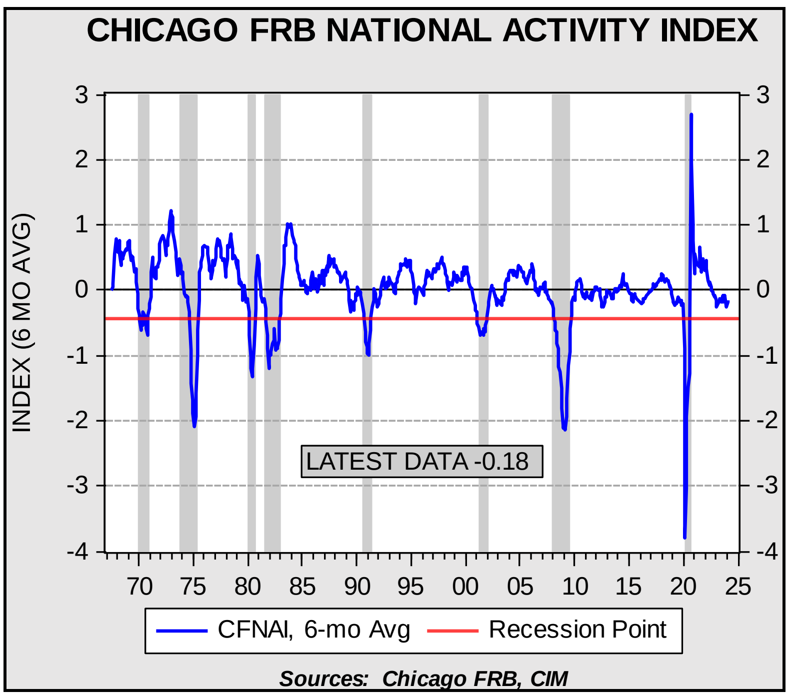
- In other words, if the 10-year Treasury yield hits 5.00%, bond yields may not go much higher in the near term.

- Indeed, that level could potentially be a buying opportunity since Fed policymakers may then push yields lower again.

US Labor Market: The United Auto Workers said late Friday that 73% of the workers at a VW auto factory in Tennessee have voted to join the union, marking the UAW's first success in organizing a non-Detroit Three assembly plant and its first major success in the South. The victory illustrates how labor shortages have boosted popular support for unions to a six-decade high and given workers increased leverage versus employers.

US Economic Releases

U.S. economic activity showed signs of improvement in March. The Chicago Fed National Activity Index (CFNAI) rose to 0.15, up from 0.09. Production indicators were the biggest driver, increasing by 0.11. The sales, orders, and inventories index, however, remained relatively neutral.



The chart above shows the six-month moving average of the Chicago Fed National Activity Index. Last month, the moving average improved from -0.21 to -0.18.

There are no economic releases or Fed events scheduled for the rest of the day.

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
EUROPE								
France	Retail Sales SA	y/y	Mar	0	-2		*	Equity and bond neutral
UK	Rightmove House Prices	y/y	Apr	1.7%	0.8%		**	Equity and bond neutral
Switzerland	M3 Money Supply	y/y	Mar	-1.6%	-2.7%		**	Equity and bond neutral
	Domestic Sight Deposits CHF	w/w	19-Apr	472.9b	469.4b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	19-Apr	481.3b	477.9b		*	Equity and bond neutral
AMERICAS								
Mexico	Economic Activity IGAE	y/y	Feb	4.4%	1.94%	2.70%	**	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)	525	525	0	Up
U.S. Sibor/OIS spread (bps)	532	532	0	Flat
U.S. Libor/OIS spread (bps)	534	534	0	Up
10-yr T-note (%)	4.65	4.62	0.03	Up
Euribor/OIS spread (bps)	389	390	-1	Down
Currencies	**Direction**			
Dollar	Up			Up
Euro	Down			Down
Yen	Flat			Down
Pound	Down			Down
Franc	Down			Down
Central Bank Action	**Current**	**Prior**	**Expected**	
PBOC 1-Year Loan Prime Rate	3.450%	3.450%	3.450%	On Forecast
PBOC 5-Year Loan Prime Rate	3.950%	3.950%	3.950%	On 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.

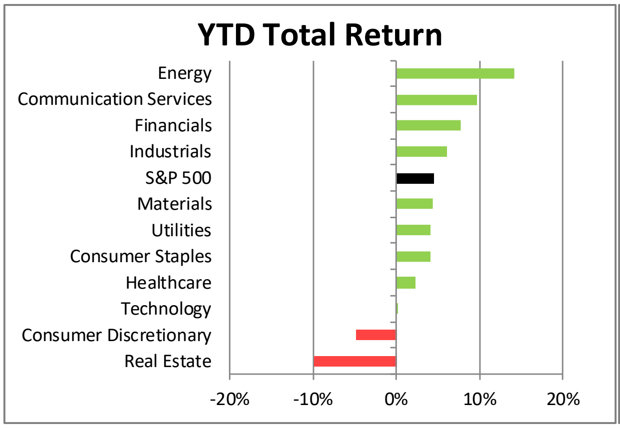
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$86.42	$87.29	-1.00%	
WTI	$83.06	$83.14	-0.10%	
Natural Gas	$1.77	$1.75	0.86%	
Crack Spread	$27.80	$28.30	-1.75%	
12-mo strip crack	$23.97	$24.13	-0.65%	
Ethanol rack	$1.81	$1.80	0.42%	
Metals				
Gold	$2,346.05	$2,391.93	-1.92%	
Silver	$27.48	$28.69	-4.22%	
Copper contract	$452.45	$452.60	-0.03%	
Grains				
Corn contract	$442.25	$443.00	-0.17%	
Wheat contract	$574.50	$566.75	1.37%	
Soybeans contract	$1,161.50	$1,165.75	-0.36%	
Shipping				
Baltic Dry Freight	1,919	1,901	18	

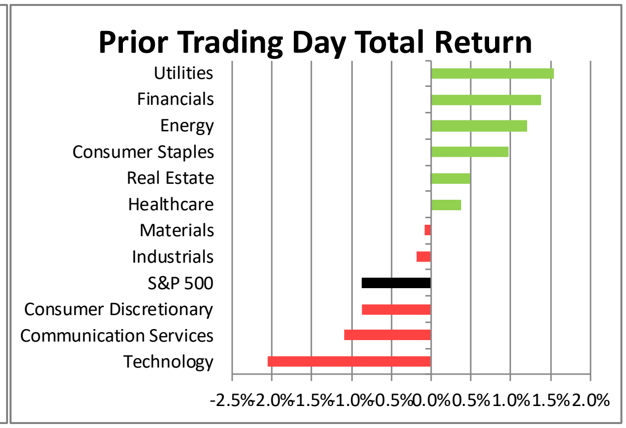
Weather

The 6-10 and 8-14 day forecasts call for warmer-than-normal temperatures west of the Rocky Mountain region, with cooler-than-normal temperatures in the Pacific. The precipitation outlook calls for wetter-than-normal conditions throughout most of the country, with dry conditions expected in New England and California.

Data Section

US Equity Markets – (as of 4/19/2024 close)

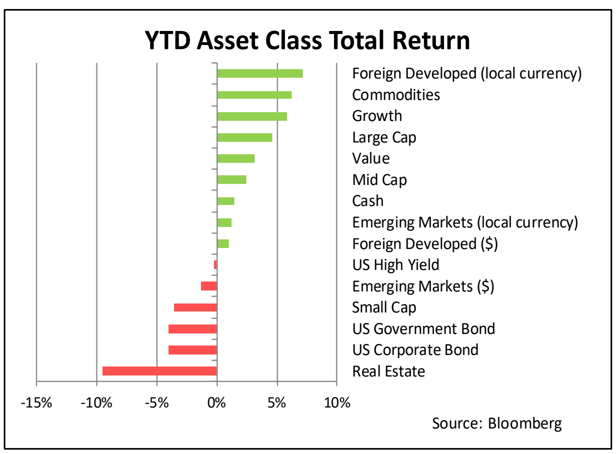




(Source: Bloomberg)

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 4/19/2024 close)

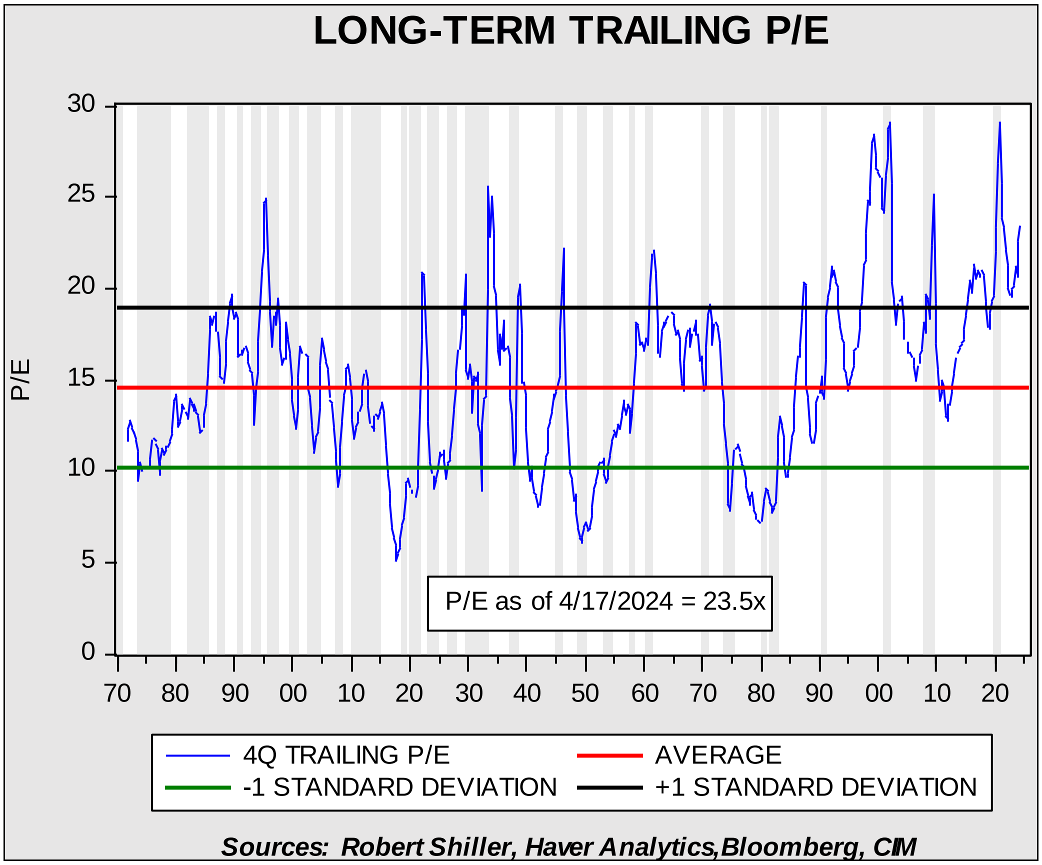


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.