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 23, 2024—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is up 1.0% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.4%. Chinese markets were lower, with the Shanghai Composite down 0.7% from its previous close and the Shenzhen Composite down 0.2%. US equity index futures are signaling a higher open.

With 80 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, 81.3% have exceeded expectations while 15.0% have fallen short of expectations.

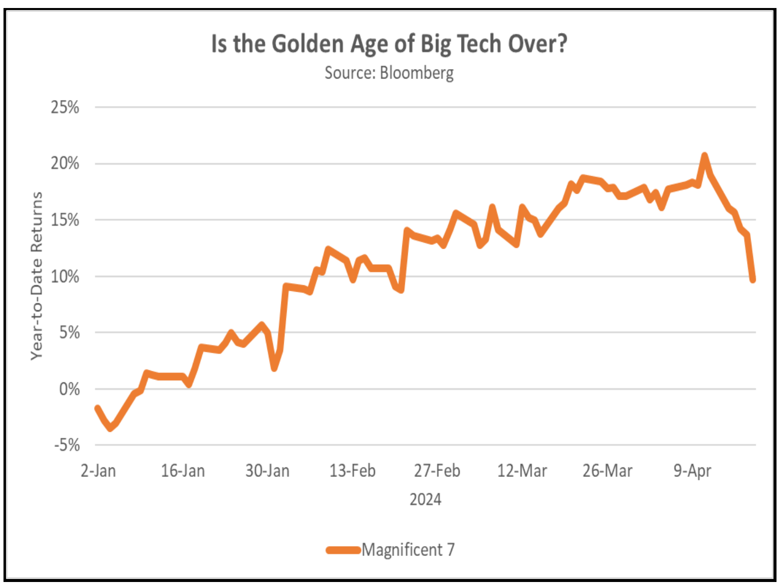
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- ***Bi-Weekly Geopolitical Report* (4/22/2024) (with associated podcast): "The Changing Face of War"**
- *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 strong start as investors await earnings, and the Los Angeles Lakers fell 0-2 against the Denver Nuggets in the NBA playoffs. Today's *Comment* kicks off with an examination of how TikTok is adding yet another layer to the rivalry between the US and China, followed by an exploration of how the conflict between Iran and Israel has highlighted investors' leanings toward safe-haven assets. Additionally, we delve into Brazil's ascent as a geopolitical power. As always, the report wraps up with international and domestic economic releases.

Tech Wars: Facing a potential US ban, TikTok tightens security measures to address concerns, while Beijing simultaneously strengthens its domestic tech industry, potentially hindering American competitors.

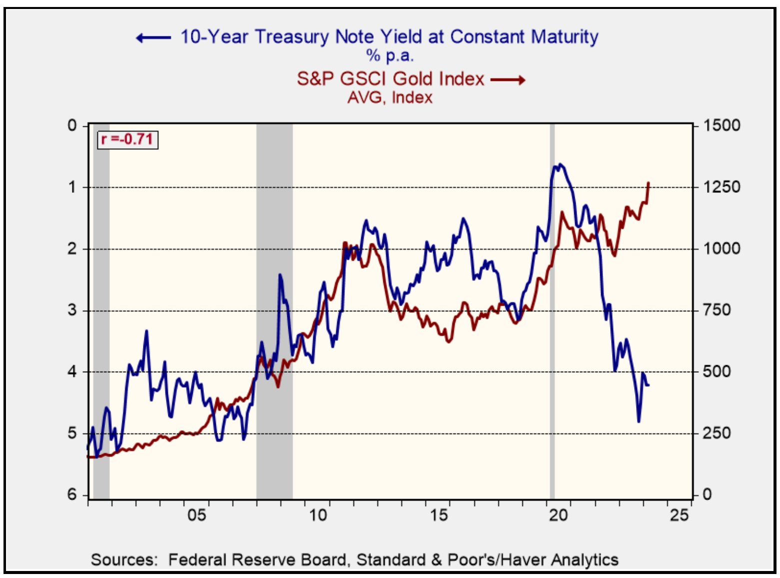
- The Chinese social networking company ByteDance faces hurdles across the West in its fight to maintain access to lucrative markets. On Monday, the company announced it would challenge the legality of a potential ban of its TikTok app by arguing that it would violate free speech principles despite national security concerns. At the same time, the EU has threatened fines and has suspended TikTok's new reward program, where users are paid to watch videos. Regulators fear this could make the app more addictive and may have a negative impact on children. The controversy over TikTok highlights the vulnerability of tech in the growing rivalry between the US and China.
- US tech companies aren't immune to the escalating tensions either. Just days before the proposed TikTok ban made its way through the House of Representatives, Beijing retaliated by forcing Apple's app store to remove Meta apps Threads and WhatsApp. Additionally, China has prioritized strengthening its domestic tech industry by boosting the marketability of its own companies within the country. This strategy has squeezed US tech giants like Tesla and Apple, leading them to lose market share in China, one of their biggest markets. Sales of iPhones in China last quarter were the worst since 2020, and Tesla's price cuts on vehicles threaten to wipe out their operating earnings in the country.



- Regulatory risks stemming from the escalating US-China rivalry remain a major, yet often downplayed, concern for the tech sector. Many US tech companies have a significant presence in China, both in terms of revenue and supply chains. As tensions rise, these firms will likely face headwinds as they adjust to a new, more challenging operating environment. Even industry giants like Nvidia aren't immune. Recent sanctions have complicated its efforts to sell some of its cutting-edge AI chips to China, highlighting the potential for disruption across the tech sector. Despite these challenges, other sectors continue to offer promising opportunities.

Calm Returns: Easing tensions in the Middle East have prompted investors to shift out of safe-haven assets and back into equities.

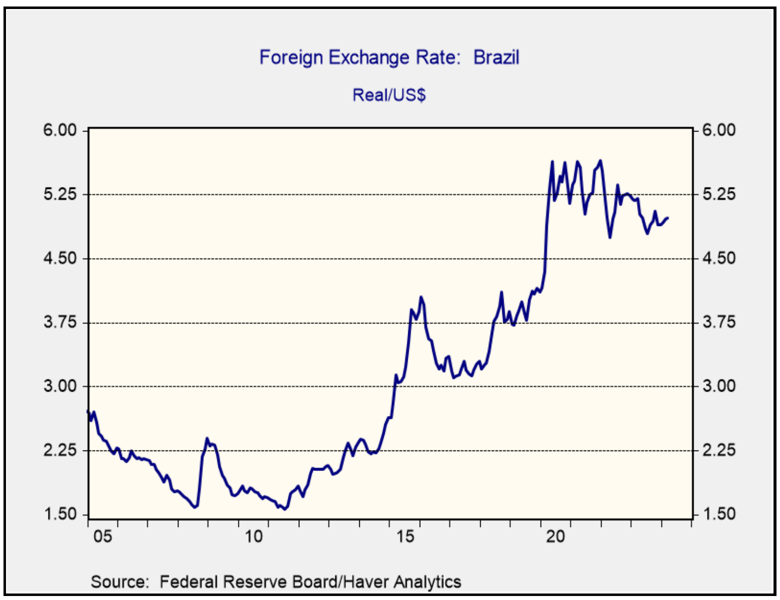
- Israel is shifting its attention from escalating tensions with Iran to addressing the situation with Hamas in Rafah. Israeli Prime Minister Benjamin Netanyahu pledged on Sunday to intensify pressure on Hamas to release the remaining hostages. His remarks follow the Israeli military's decision to temporarily pause operations in Rafah to refocus on the Iranian issue following a scaled-back response on Friday. While the shift signifies an escalation in Gaza, it also signifies a crucial avoidance of the worst-case scenario in a potential broader conflict across the Middle East. As a result, there was an increase in investor risk appetite.
- The recent Iran-Israel conflict has highlighted a discernible shift in investor preference for safe-haven assets. Traditionally, during "flight to safety" episodes, investors gravitate towards bonds and gold, leading to an inverse correlation between Treasury yields and gold prices. However, since 2022, this relationship has become more intricate. Bond yields and gold prices have unexpectedly moved in tandem, a dynamic further reinforced by Monday's news of easing tensions. This was evidenced by a 5-basis point decline in the 10-year Treasury yield and a 2% drop in the gold spot price on the same day.



- Investor anxiety about interest rate risk has likely caused the breakdown in the traditional correlation between bonds and gold. This anxiety stems from the current uncertainty surrounding monetary policy, fueled by the rising US federal deficit. The trend may persist until policymakers offer a clear path toward lower rates, and lawmakers find common ground on controlling government spending. Fed Chair Jerome Powell's comments at the next meeting will be closely watched for any hints of doubt regarding potential rate cuts later this year. Despite the complex market dynamics, gold remains a compelling option for investors seeking a haven during times of uncertainty.

Lula's Dance: Despite Brazil's fiscal struggles, the president persists in promoting the country's image as a global player.

- Brazilian President Lula Da Silva finds himself embroiled in a power struggle with Congress, where lawmakers are poised to advance legislation that would boost spending by around $18.5 billion over the next two years. Additionally, lawmakers stepped in to preserve tax benefits for the events industry, a move that complicates efforts to reduce spending. These developments came soon after the administration watered down its budget target, in order to lower expectations of achieving a 2025 surplus. The country's inability to control its budget has weighed on the currency.
- In contrast to domestic struggles, Lula's foreign policy of engaging with other nations to broaden his country's influence remains effective. Despite strong ties with the United States, the Brazilian president has pursued a closer relationship with China. This month, Lula met with Brazilian beef producers to oversee the first meat shipments under the export deal he struck with China in 2023. This move reflects Lula's strategic vision to position Brazil as a key player in the global food and energy markets, capitalizing on China's desire to diversify its suppliers away from the US.



- While our analysis suggests a tilt towards China, Brazil's economic growth depends on maintaining strong relationships with both the US and China. A rising US dollar could worsen Brazil's existing dollar-denominated debt, particularly as President Lula ramps up social spending. However, China's massive import market offers Brazil's agricultural sector a chance to expand, stimulating the broader economy. Navigating this relationship will require Brazil to demonstrate it is not beholden to Beijing, despite its current focus on the Chinese market. Failure to establish this distance could put Brazil in Washington's crosshairs, particularly as it seeks US assistance with Amazon deforestation.

In Other News: In a troubling sign of Mexico's growing crime issue, masked men held up Claudia Sheinbaum, the frontrunner in the presidential race, along a highway. Russia has threatened to escalate attacks after the US approves a military aid package to Ukraine, signaling a potential shift in the war's trajectory. Lockheed Martin's strong earnings report adds to evidence of rising demand in the US defense industry, likely fueled by growing global tensions.

US Economic Releases

There are no domestic releases prior to the publication of this report.

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**
9:45	S&P Global US Manufacturing PMI	m/m	Apr P	52	44.1	***
9:45	S&P Global US Services PMI	m/m	Apr P	52	44.1	***
9:45	S&P Global US Composite PMI	m/m	Apr P	52.0	45.0	***
10:00	New Home Sales	m/m	Mar	669k	662k	***
10:00	New Home Sales MoM	m/m	Mar	1.1%	-0.3%	**
10:00	Richmond Fed Manufact. Index	m/m	Apr	-8	-11	**
Federal Reserve						
	No Fed speakers or events for the rest of today					

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	Jibun Bank Japan PMI Composite	m/m	Apr P	52.6	51.7		**	Equity and bond neutral
	Jibun Bank Japan PMI Mfg	m/m	Apr P	49.9	48.2		***	Equity and bond neutral
	Jibun Bank Japan PMI Services	m/m	Apr P	54.6	54.1		**	Equity and bond neutral
South Korea	PPI	y/y	Mar	1.6%	1.5%		**	Equity and bond neutral
India	HSBC India PMI Mfg	m/m	Apr P	59.1	59.1		***	Equity and bond neutral
India	HSBC India PMI Composite	m/m	Apr P	62.2	61.8		**	Equity and bond neutral
	HSBC India PMI Services	m/m	Apr P	61.7	61.2		**	Equity and bond neutral
EUROPE								
Eurozone	Consumer Confidence	m/m	Apr P	-17.7	-14.9	-14.5	**	Equity bearish, bond bullish
	HCOB Eurozone Manufacturing PMI	m/m	Apr P	45.6	46.1	46.5	***	Equity and bond neutral
	HCOB Eurozone Services PMI	m/m	Apr P	52.9	51.5	51.8	**	Equity and bond neutral
	HCOB Eurozone Composite PMI	m/m	Apr P	51.4	50.3	50.7	*	Equity and bond neutral
Germany	HCOB Germany Manufacturing PMI	m/m	Apr P	42.2	41.9	42.7	***	Equity and bond neutral
	HCOB Germany Services PMI	m/m	Apr P	53.3	50.1	50.5	**	Equity bullish, bond bearish
	HCOB Germany Composite PMI	m/m	Apr P	50.5	47.7	48.5	**	Equity bullish, bond bearish
France	HCOB France Composite PMI	m/m	Apr P	49.9	48.3	48.8	**	Equity and bond neutral
	HCOB France Manufacturing PMI	m/m	Apr P	44.9	46.2	46.8	***	Equity bearish, bond bullish
	HCOB France Services PMI	m/m	Apr P	50.5	48.3	48.9	**	Equity bullish, bond bearish
UK	Public Finances (PSNCR)	m/m	Mar	20.7b	3.0b	3.2b	*	Equity and bond neutral
	Public Sector Net Borowing	m/m	Mar	11.0b	8.6b	8.8b	*	Equity and bond neutral
	PSNB ex Banking Groups	m/m	Mar	11.9b	9.5b	10.0b	**	Equity and bond neutral
	S&P Global UK Manufacturing PMI	m/m	Apr P	48.7	50.3	50.4	***	Equity bearish, bond bullish
	S&P Global UK Services PMI	m/m	Apr P	54.9	53.1	53.0	**	Equity and bond neutral
	S&P Global UK Composite PMI	m/m	Apr P	54.0	52.8	52.6	**	Equity bullish, bond bearish
AMERICAS								
Canada	Industrial Prices	m/m	Mar	0.8%	1.1%		**	Equity and bond neutral
	Raw Material Prices	m/m	Mar	4.7%	2.1%		*	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	520	0	Up
U.S. Sibor/OIS spread (bps)	533	532	1	Up
U.S. Libor/OIS spread (bps)	534	534	0	Up
10-yr T-note (%)	4.64	4.61	0.03	Down
Euribor/OIS spread (bps)	389	389	0	Down
Currencies	**Direction**			
Dollar	Flat			Up
Euro	Up			Down
Yen	Flat			Down
Pound	Up			Down
Franc	Flat			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.

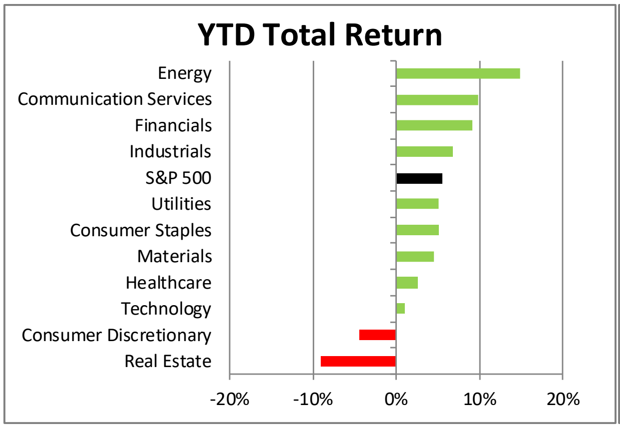
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$86.56	$87.00	-0.51%	
WTI	$81.45	$81.90	-0.55%	
Natural Gas	$1.80	$1.79	0.61%	
Crack Spread	$28.21	$28.12	0.32%	
12-mo strip crack	$23.80	$24.25	-1.84%	
Ethanol rack	$1.83	$1.82	0.42%	
Metals				
Gold	$2,302.51	$2,327.30	-1.07%	
Silver	$26.95	$27.20	-0.90%	
Copper contract	$444.05	$450.60	-1.45%	
Grains				
Corn contract	$449.75	$449.75	0.00%	
Wheat contract	$592.75	$587.50	0.89%	
Soybeans contract	$1,176.25	$1,176.50	-0.02%	
Shipping				
Baltic Dry Freight	1,882	1,919	-37	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		2.0		
Gasoline (mb)		-1.4		
Distillates (mb)		-1.5		
Refinery run rates (%)		0.5%		
Natural gas (bcf)		51		

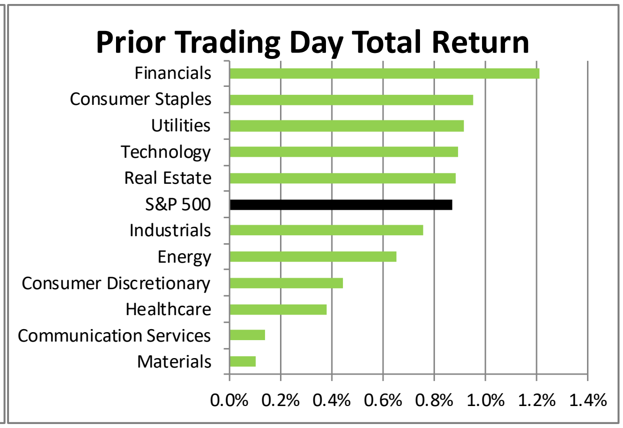
Weather

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 Northern Pacific. The current precipitation forecast predicts wetter-than-average conditions across the Rocky Mountains, Great Plains, and Midwest regions, while the Southeast Coast is expected to experience drier conditions.

Data Section

US Equity Markets – (as of 4/23/2024 close)

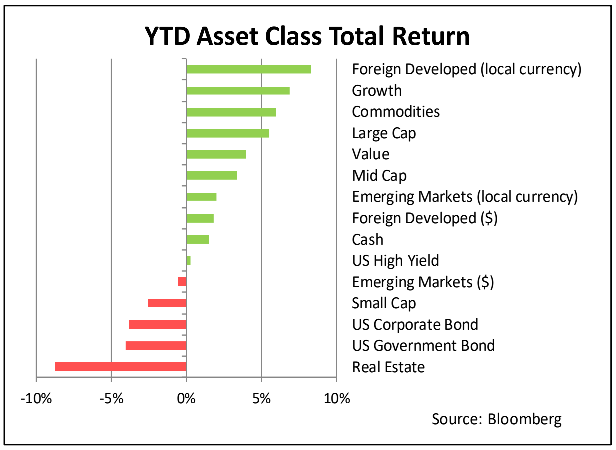




(Source: Bloomberg)

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 4/23/2024 close)

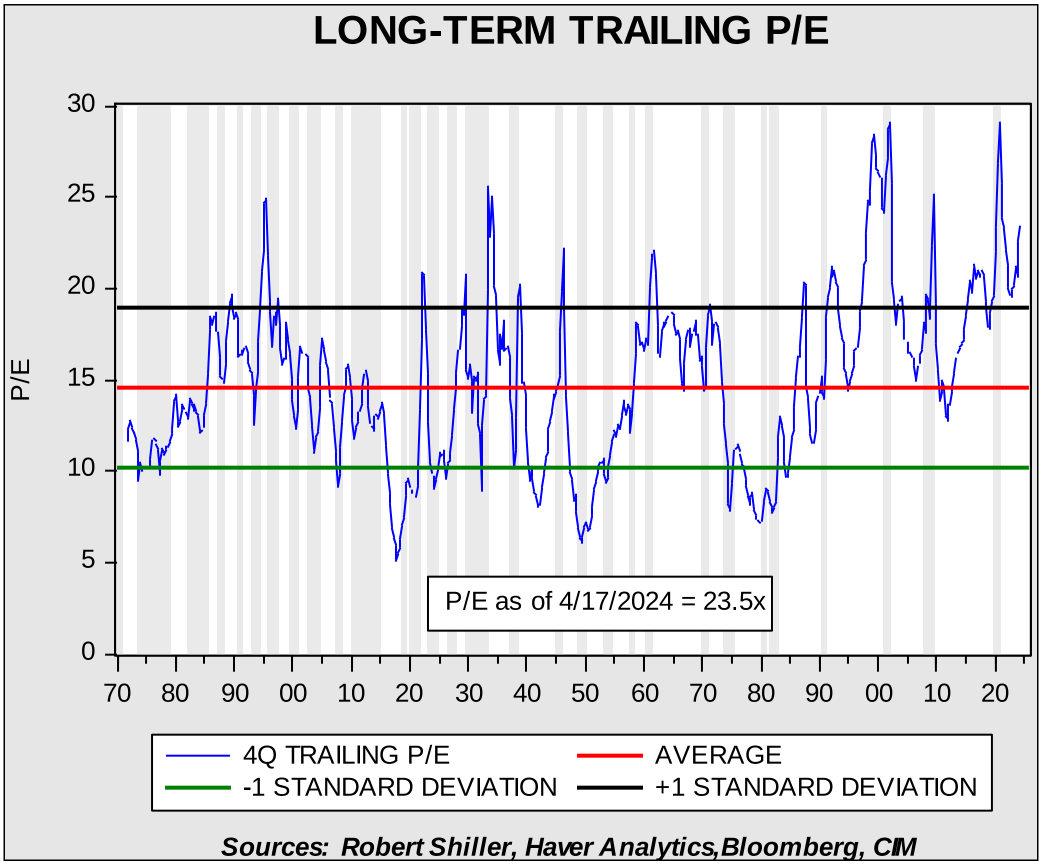


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.