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 25, 2024—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is down 0.8% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.1%. Chinese markets were higher, with the Shanghai Composite up 0.3% from its previous close and the Shenzhen Composite up 0.2%. US equity index futures are signaling a lower open.

With 153 companies having reported so far, S&P 500 earnings for Q1 are running at $54.20 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 15.0% have fallen short of expectations.

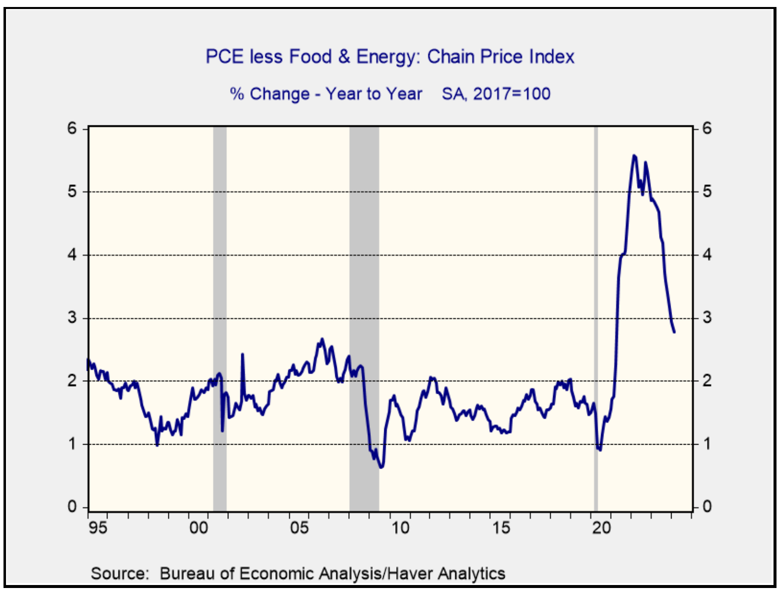
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *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 taking a tumble early in the trading session as Meta's earnings outlook dampens investor optimism. On the sports front, the Miami Heat have tied the series against the Boston Celtics. Today's *Comment* explores why Treasury yields might face continued pressure despite recent strength. We also examine the role of US shale production in tempering oil price surges and analyze the escalating rivalry between the EU and China. As always, we'll wrap up with a summary of important domestic and international data releases.

Appetite for Treasurys? Treasury allure persists despite oversupply fears and Fed unknowns, but its longevity is in question.

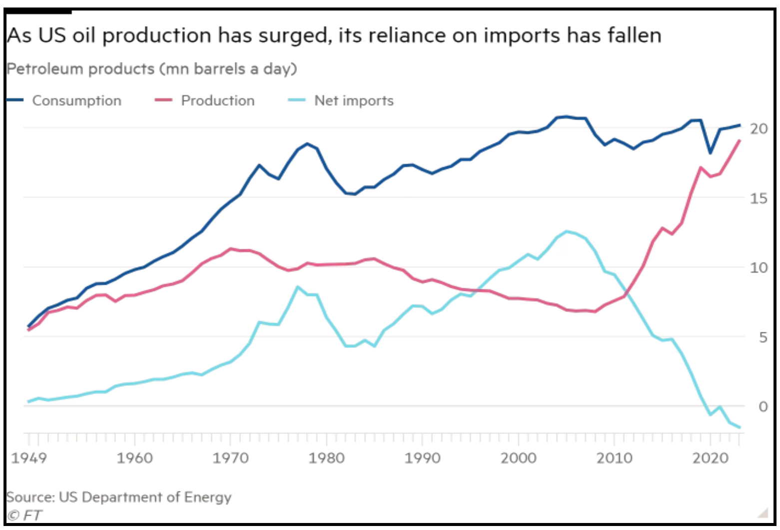
- Demand for U.S. Treasurys held steady even as the government sold a hefty $70 billion in 5-year notes on Wednesday. The auction yield came in at 4.659%, 4 basis points higher than anticipated. This follows strong investor interest in the previous day's record $68 billion auction of 2-year notes, which yielded 4.898%, slightly below pre-auction yields, easing concerns of the yield topping 5.0%. The upcoming auction of 7-year notes on Thursday will be closely watched as a gauge of investor appetite for longer-term Treasurys given the uncertain outlook on interest rates.
- Investor appetite for Treasurys could face headwinds on Friday following the release of the personal consumption expenditure (PCE) price index. This inflation gauge is being closely watched by the Federal Reserve as it guides its interest rate decisions this year. Consensus forecasts predict a deceleration in the core index, from a year-over-year increase of 2.78% in February to 2.66% in the following month. A reading at or below expectations is unlikely to have a strong impact on rate cut expectations, which now show a terminal Fed Funds rate at a target range of 4.50% to 4.75%; however, a higher reading could boost expectations of no rate cuts at all this year.



- Fixed-income securities, particularly those with longer maturities, face heightened volatility for the remainder of the year. Investor uncertainty surrounding factors like policy rate changes, geopolitical conflicts, and widening budget deficits is driving this increased volatility. Intermediate-term bonds offer a potential hedge, balancing interest rate risk and price risk more effectively than bonds on either extreme of the yield curve. However, a hawkish shift in Fed policy expectations could lead to broad-based rate hikes across all maturities. Rising rates could dampen the momentum of already expensive equities, potentially benefiting previously overlooked stocks, especially if corporate earnings disappoint investors.

Swing Producer? US oil production has helped moderate oil prices in the face of geopolitical turmoil, but concerns linger about its long-term ability to continue doing so.

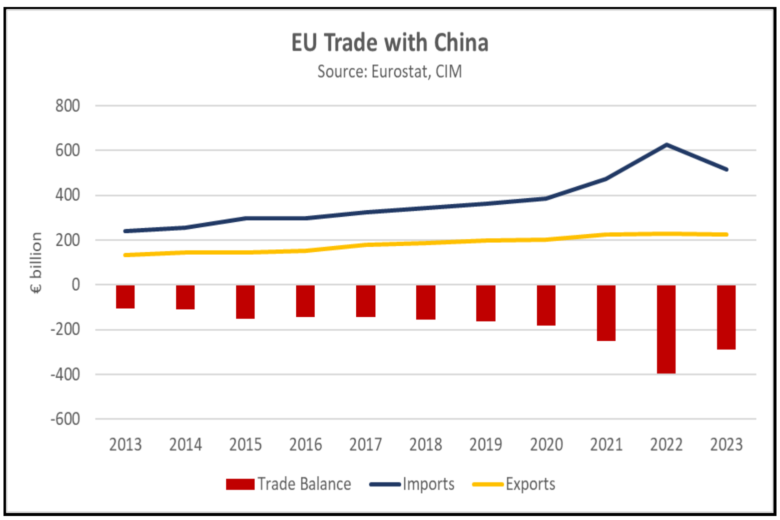
- Fears of a wider Middle Eastern conflict sent Brent crude prices surging past $90 a barrel. However, the oil market quickly rebounded as tensions eased, suggesting short-term resilience. This relative calm has alleviated concerns about supply disruptions, as previously delayed shipments are now reaching their destinations, thus reducing some of the market tightness. Iran's reluctance to close the Strait of Hormuz coupled with U.S. hesitancy to enforce Iranian oil sanctions, suggests that supply will continue to make its way to global markets and could therefore limit the rise in oil prices.
- Soaring 16% this year, Brent crude prices face uncertainty due to continued robust market supply. However, the emergence of US shale production has been a key stabilizing force. This domestic resource has mitigated the impact of rising geopolitical tensions and OPEC production cuts, allowing American consumers to rely more on homegrown oil and reduce dependence on foreign imports. In 2023, the US shattered oil production records thanks to surging shale output, a feat unlikely to be surpassed anytime soon. Meanwhile, US oil consumption has remained relatively flat for the past two decades.



- The recent surge in shale production, though positive, might not be sustainable throughout the decade. A key constraint could be the declining number of operational rigs. Baker Hughes data shows a significant drop of 134 active rigs compared to April of last year, suggesting a potential plateau in production over the next few years. The world may need to turn to other suppliers like Brazil and Guyana to manage oil prices if there is a lull in production. That said, barring major geopolitical disruptions, Brent crude could face resistance around $90 per barrel and potentially dip below $80 by year's end.

EU-China Rivalry: EU regulators are tightening scrutiny of Chinese firms, potentially aligning with the US approach of strategic competition with China.

- EU regulators raided the offices of Chinese security equipment company Nuctech in the Netherlands and Poland on Wednesday. They suspect Nuctech may have benefited from unfair foreign subsidies that distort competition in the market. Nuctech's production of cargo, baggage, and body scanners used at airports and border points also raises concerns about potential national security risks, as the company could conceivably gain access to sensitive data on shipments. This raid follows the EU's recent actions against Chinese companies, including accusations of unfair support for domestic medical device suppliers and an ongoing investigation into electric vehicle exports.
- Brussels' recent assertiveness toward Chinese firms signals a strategic shift in response to the evolving dynamics with the world's second-largest economy. Western concerns about recalibrating the relationship with China fuel heightened vigilance against potential market saturation by Chinese goods, particularly as Beijing seeks an export-driven escape from its economic slowdown. This hawkish shift is further reinforced by the EU's strategic use of trade laws to address security risks posed by some Chinese companies. In 2023, the EU remained the largest importer of Chinese goods, accounting for 20.5% of all imports, while China only accounted for 8.8% of the EU's exports.

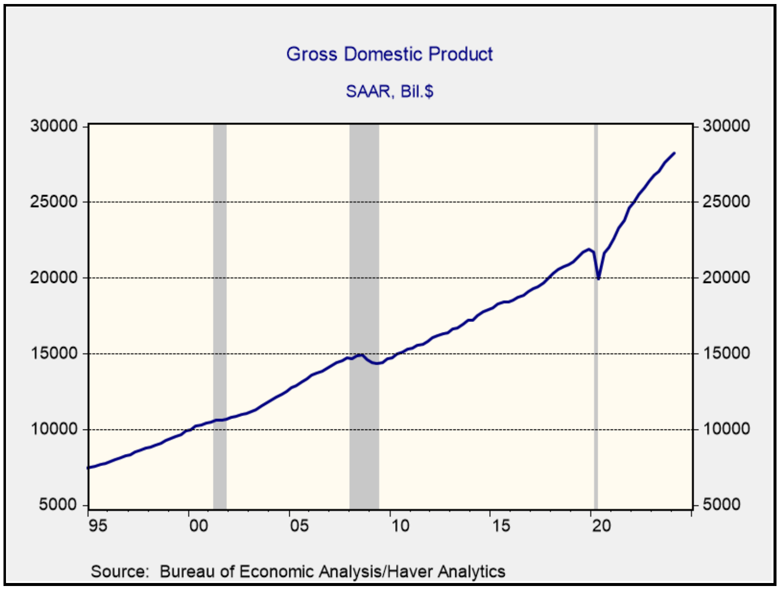


- The escalating tensions between the EU and China highlight Western efforts to counter China's excessive production capacity, aiming to safeguard their domestic manufacturing industries. This trend is likely to persist in the near future, with both upcoming EU parliamentary elections and the US presidential contest potentially favoring candidates who advocate for a firm stance on China. The new protectionist stance will likely complicate efforts of Beijing to bolster its economy and will make deflationary pressure within the country worse. Furthermore, it could potentially complicate efforts to stabilize the yuan (CNY), which has weakened significantly against the dollar.

In Other News: White-collar job growth has stalled in the US recently, with companies focusing on streamlining operations. French President Emmanuel Macron has called for a monetary policy overhaul to allow countries more flexibility to spend on defense. The Scottish government collapsed after a power-sharing agreement crumbled due to ideological differences.

US Economic Releases

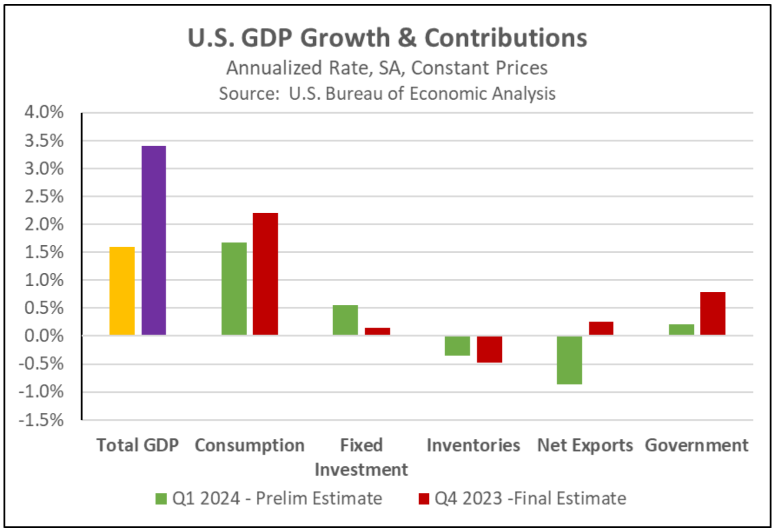
The U.S. economy grew at a slower pace than expected in the first quarter of 2024, expanding at a modest 1.6% annualized rate. This falls short of the consensus forecast of 2.5% growth and marks a significant deceleration from the prior quarter's impressive 3.4% surge. Consumer spending, the key driver of the economy, remained healthy but moderated, rising at a 2.5% annualized rate compared to 3.3% in Q4 2023. Inflation concerns persist, with the GDP price index climbing from 1.6% to 3.1%. The core PCE price index, a key gauge for the Federal Reserve, also rose from 2.0% to 3.7% in the quarter.



This chart illustrates the nominal GDP, currently at $28.2 trillion.

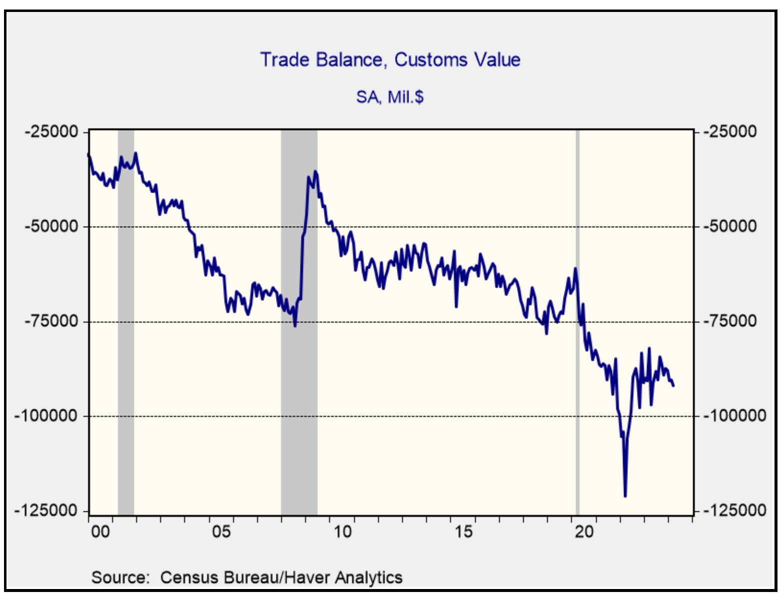
	Q1 2024 - Prelim Estimate	Q4 2023 -Final Estimate	Difference
Total GDP	1.6%	3.4%	-1.8%
Consumption	1.7%	2.2%	-0.5%
Fixed Investment	0.6%	0.2%	0.4%
Inventories	-0.4%	-0.5%	0.1%
Net Exports	-0.9%	0.3%	-1.1%
Government	0.2%	0.8%	-0.6%

The table above shows the contributions chart. Consumption spending and fixed investment were the main drivers of growth in the first quarter, while net exports were a drag.



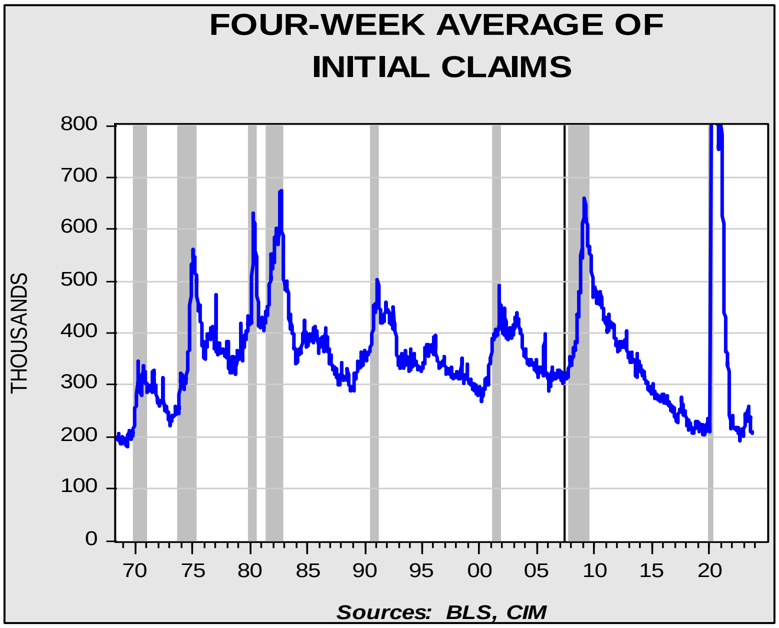
The chart above illustrates the contribution of various sectors to GDP growth. While March's strong retail sales data suggests potential upward revisions to consumer spending, the decline in inventories is likely temporary. In conclusion, despite the slowdown in GDP growth, the underlying economic fundamentals remain relatively strong.

The US goods trade deficit remained unchanged in March at $91.8 billion, exceeding expectations of a slight decline to $91.0 billion. This stability reflects offsetting decreases in both exports and imports, according to preliminary data from the US Commerce Department.



The chart above shows the goods trade balance. Last month, exports fell 3.5% to $169.2 billion, while imports fell 1.7% to $261 billion, in a sign that global and domestic consumption may be showing signs of waning.

Low unemployment benefit claims continue to signal a strong labor market. Initial jobless claims came in at 207k in the week ending April. The reading was below the consensus estimate of 215k and the previous week's reading of 212k.



The chart above shows the four-week moving average of initial jobless claims. Last week, the moving average rose from 210.75k to 212.25k.

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	Pending Home Sales	m/m	Mar	0.4%	1.6%	**
10:00	Pending Home Sales NSA	y/y	Mar	-3.0%	-2.2%	**
11:00	Kansas City Fed Manfacturing Index	m/m	Apr	-5	-7	*
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	Japan Buying Foreign Stocks	w/w	19-Apr	-¥20.9b	¥53.9b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	19-Apr	-¥492.4b	¥1730.7b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	19-Apr	-¥1441.8b	¥51.3b		*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	19-Apr	¥648.1b	-¥1000.1b		*	Equity and bond neutral
	Leading Economic Index	m/m	Feb F	111.8	111.8		**	Equity and bond neutral
	Coincident Index	m/m	Feb F	111.6	110.9		*	Equity and bond neutral
	Nationwide Dept Sales	m/m	Mar	9.90%	14.00%		*	Equity and bond neutral
South Korea	Business Survey - Manufacturing	m/m	May	74	73		**	Equity and bond neutral
	Business Survey - Non-Manufacturing	m/m	May	71	69		*	Equity and bond neutral
	GDP	y/y	1Q A	3.4%	2.2%	2.5%	**	Equity bullish, bond bearish
EUROPE								
Germany	GfK Consumer Confidence	m/m	May	-24.2	-27.3	-26	**	Equity and bond neutral
France	Business Confidence	m/m	Apr	99	100	101	**	Equity and bond neutral
	Manufacturing Confidence	m/m	Apr	100	103	103	*	Equity and bond neutral
Russia	Industrial Production	m/m	Mar	4	8.5	4	***	Equity and bond neutral
AMERICAS								
Canada	Retail Sales	m/m	Feb	-0.1%	-0.3%	0.1%	**	Equity and bond neutral
	Retail Sales Ex-Autos	m/m	Feb	-0.3%	0.4%	0.1%	**	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	Flat
3-mo T-bill yield (bps)	524	527	-3	Up
U.S. Sibor/OIS spread (bps)	532	532	0	Up
U.S. Libor/OIS spread (bps)	534	534	0	Up
10-yr T-note (%)	4.65	4.64	0.01	Up
Euribor/OIS spread (bps)	388	388	0	Down
Currencies	**Direction**			
Dollar	Down			Up
Euro	Up			Down
Yen	Down			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.

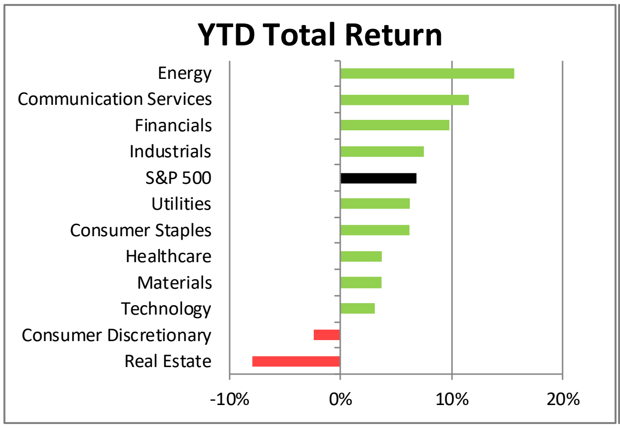
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$88.22	$88.02	0.23%	
WTI	$82.99	$82.81	0.22%	
Natural Gas	$1.67	$1.65	0.85%	
Crack Spread	$29.48	$28.91	1.99%	
12-mo strip crack	$24.61	$24.24	1.51%	
Ethanol rack	$1.84	$1.84	0.01%	
Metals				
Gold	$2,329.99	$2,316.17	0.60%	
Silver	$27.44	$27.16	1.03%	
Copper contract	$456.25	$448.65	1.69%	
Grains				
Corn contract	$449.00	$448.50	0.11%	
Wheat contract	$618.75	$613.00	0.94%	
Soybeans contract	$1,176.00	$1,181.50	-0.47%	
Shipping				
Baltic Dry Freight	1,774	1,804	-30	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-6.4	2.0	-8.4	
Gasoline (mb)	-0.6	-1.4	0.8	
Distillates (mb)	1.6	-1.8	3.36	
Refinery run rates (%)	0.4%	0.5%	-0.1%	
Natural gas (bcf)		83		

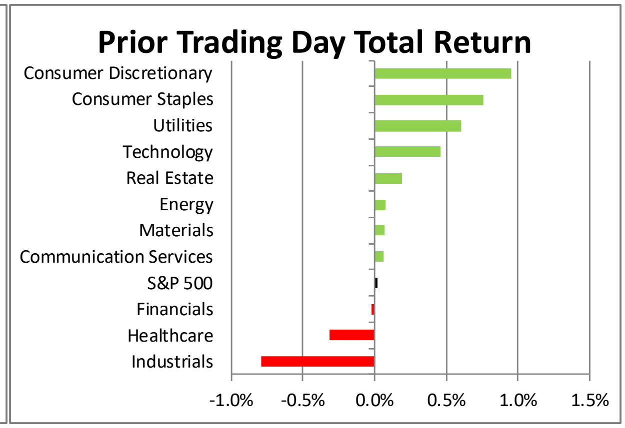
Weather

The 6-10 and 8-14 day forecasts call for warmer-than-normal temperatures across the majority of the country, with the exception of cooler-than-normal temperatures expected in the Pacific Northwest. The current precipitation forecast predicts wetter-than-average conditions across most of the Great Plains and Rocky Mountain regions, with dry conditions expected in the eastern third of the country.

Data Section

US Equity Markets – (as of 4/24/2024 close)

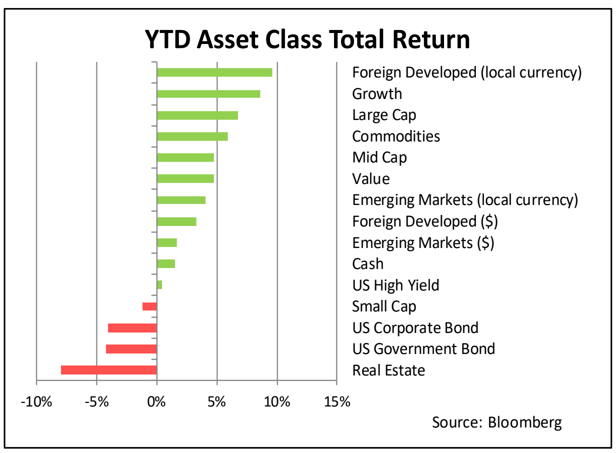




(Source: Bloomberg)

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 4/24/2024 close)

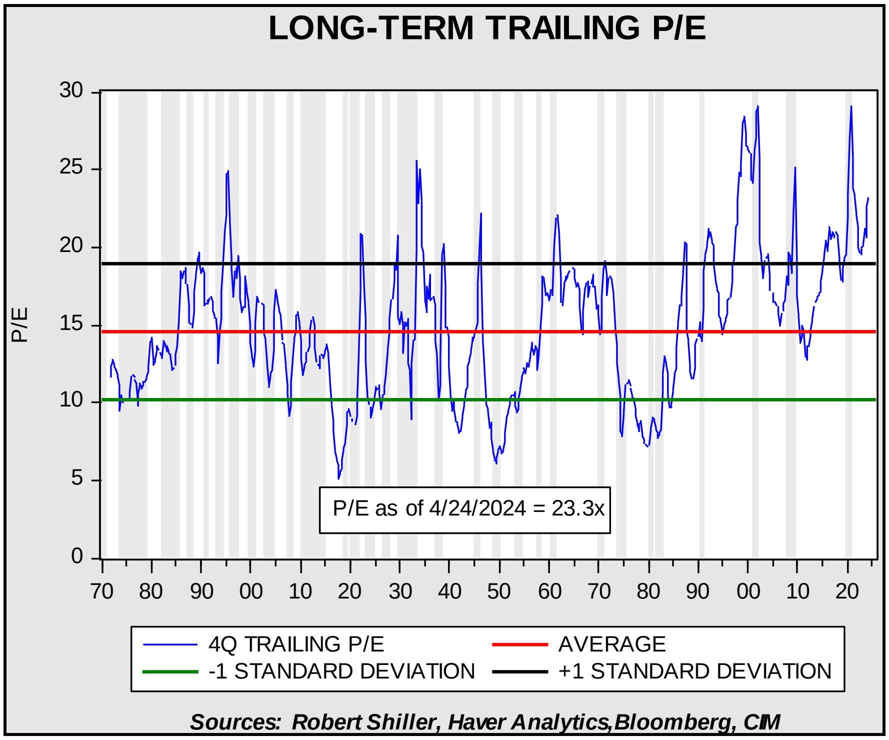


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 25, 2024



Based on our methodology,[1] the current P/E is 23.2x, up 0.2x from our last report. The decrease in the multiple reflects a slight increase in earnings and a 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.

[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.