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 26, 2024—9:30 AM EDT] Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 is up 0.8% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.6%. Chinese markets were higher, with the Shanghai Composite up 1.2% from its previous close and the Shenzhen Composite up 1.3%. US equity index futures are signaling a higher open.

With 215 companies having reported so far, S&P 500 earnings for Q1 are running at $55.60 per share, compared to estimates of $54.24, which is up 0.9% from Q1 2023. Of the companies that have reported thus far, 81.9% have exceeded expectations while 15.8% have fallen short of expectations.

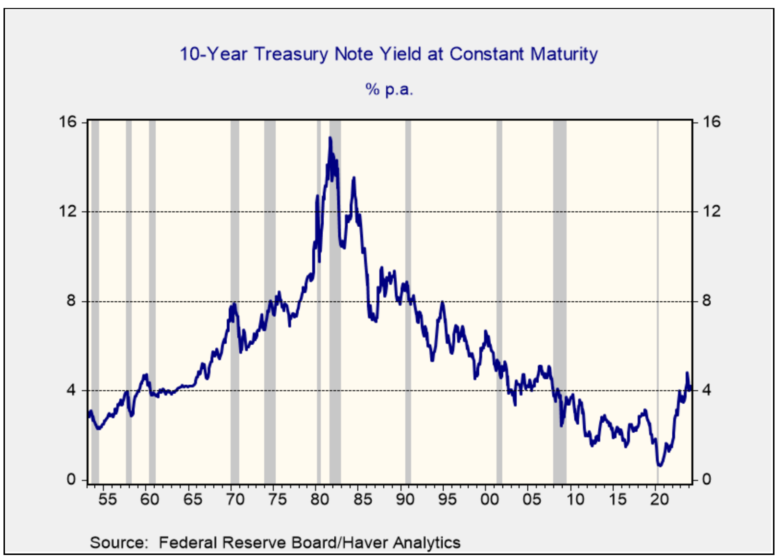
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *Bi-Weekly Geopolitical Report* (4/22/2024) (with associated podcast): "The Changing Face of War"
- ***Asset Allocation Quarterly – Q2 2024*** **(4/25/2024): Discussion of our asset allocation process, Q2 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)
- **Business Cycle Report (4/25/24)**

Good morning! Equities are off to a slow start today as inflation concerns linger for investors. But on a brighter note, the Florida Panthers are surging ahead with a commanding 3-0 series lead over the Tampa Bay Lightning. Today's *Comment* explores the importance of central bank independence, analyzes investor anxieties surrounding the latest economic growth data, and delves into the reasoning behind Argentina's recent surge in attention. As always, we conclude with a summary of key domestic and international economic releases.

Fed Independence Under Attack: Some speculate that if former President Donald Trump is reelected, he might seek to exert greater influence over the Federal Reserve.

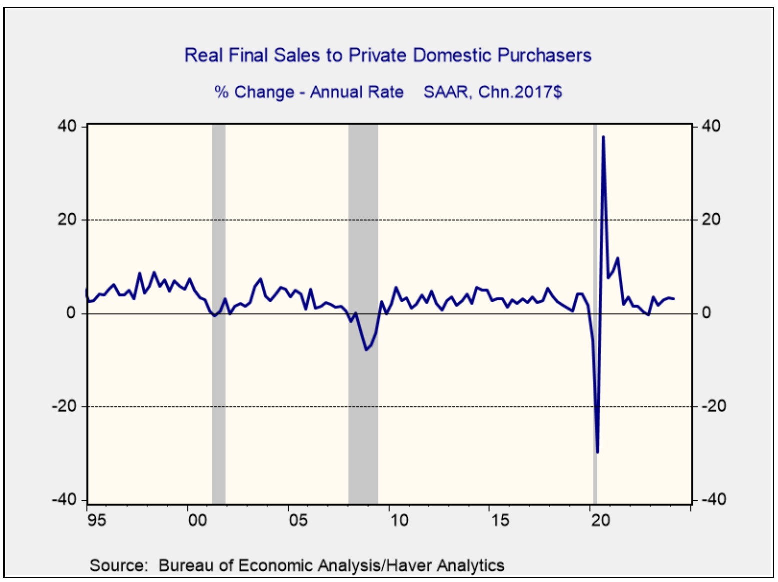
- A proposal is gaining traction among allies of the former president that could weaken the Federal Reserve's independence. According to the *Wall Street Journal*, a group of former officials and supporters drafted a 10-page document advocating for increased presidential influence on the Fed. The proposal reportedly requires the Fed to consult the president before making rate decisions and empowers the Treasury Department to act as a check on the Fed's authority. Additionally, it would seek a way to help push Fed Chair Jerome Powell out of power before the end of his term in 2026.
- The Federal Reserve's independence has been a cornerstone of price and currency stability since the collapse of the Bretton Woods system. This was particularly evident in the late 1970s when then-Fed Chair Paul Volcker's decisive action to raise interest rates, despite short-term economic pain, reassured markets of the US's commitment to tackling inflation. This bold move restored credibility to the dollar, making US Treasury securities more attractive to foreign investors and fueling a subsequent bond bull market over the next three decades.



- While former President Trump's responsiveness to market fluctuations should temper fears of aggressive action to weaken Fed independence, the very discussion raises concerns. Investor and central bank confidence in the Fed's autonomy is crucial. A loss of faith could trigger a flight from Treasurys, a favoring of hard assets like gold, and a push toward a bear scenario with rising yields for the bond market, similar to periods of high government spending in the post-WWII era. This could likely have spillover effects into equities as investors may be less comfortable investing in risky assets. Investors should continue to monitor this situation closely.

Worse Fears: The Gross Domestic Product (GDP) report didn't give investors anything to smile about as it showed the economy was slowing, and inflation was accelerating.

- The US economy grew at a sluggish 1.6% annualized rate in the first quarter of 2024, falling short of analysts' predictions of 3.4% and the prior quarter's 2.5% growth. This weaker-than-anticipated report was primarily driven by a slowdown in consumer spending, which dipped from 3.3% to 2.5%. While some investors might see this as a positive sign indicating a potential cool-down in the economy, a key inflation measure — the core PCE price index — painted a contrasting picture. This index rose from 2.0% to 3.7% in the first quarter, suggesting inflationary pressures are actually intensifying.
- Slowing growth coupled with persistent service sector inflation raises the specter of a stagnant economy with high prices. The surge in price pressures was driven by increases in services, particularly shelter and financial services, which have risen at an annualized rate of 5.7% and 15.9% in the first quarter, respectively. The massive acceleration sent shockwaves through markets, with the S&P 500 dropping 0.5% on the day and the 10-year Treasury yield rising 5 basis points. Investors are now re-evaluating their expectations, with some abandoning hopes for rate cuts and a growing number pricing in the possibility of another rate hike later this year.



- Despite a disappointing Q1 2024 GDP report, a bright spot emerged. Final sales to private domestic purchasers, a key metric of core economic activity, remained stable at an annualized growth rate exceeding 3%. This excludes factors like inventories, net exports, and government spending, suggesting businesses and consumers are still on solid ground. However, the PCE Price Index's jump highlights ongoing inflationary pressures driven by the tight labor market. The next quarter's GDP report could see a rebound, but inflationary concerns remain.

The Argentine Paradox: Argentina's new market-friendly policies, which were praised by investors, have sparked protests from some citizens, echoing a recurring pattern in the country's history.

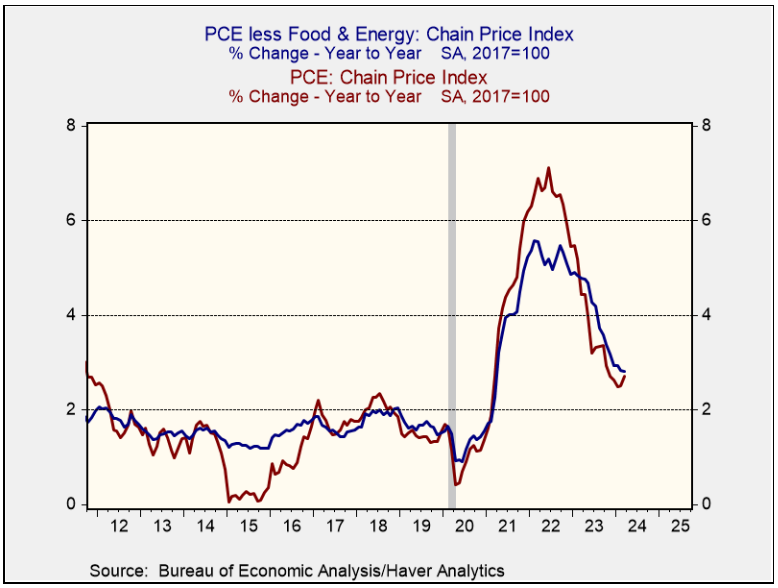
- President Javier Milei is facing mounting pressures following his pledge to curb public spending in Argentina. Thousands of protestors voiced their opposition to the government's decision to forgo increased education spending, even though inflation has increased 80% over the last year. This demonstration serves as the first major test of Argentina's willingness to accept austerity measures to rein in the ballooning budget deficit following Milei's election victory in December. He is expected to implement a series of potentially unpopular measures, including a 50% devaluation of the Argentine peso (ARS), cuts to energy and transportation subsidies, and closures of government buildings.
- Despite the social unrest, investors have started to take Argentina seriously again. Over the last three months, Argentina's parallel currency has outperformed its peers surging 25%, despite the ARS being down nearly 10% on the year in what is known as the blue-chip swap. The strong currency performance has also helped boost returns for foreign investors as the Argentine stock market has emerged as one of the best performing in the world this year, up 26.7%, driven primarily by the energy and financial sectors.

- Although economic changes are likely something to cheer about, it is important to remember that investors have been down this road before in Argentina. The country has often gone through waves of leaders that favor market-friendly policies only to have them thrown out of office and replaced with leaders that favor social goals instead. This pattern has led to significant fluctuations in the stock market, creating an environment where investors should view Argentina more as a trade opportunity rather than a stable long-term investment.

In Other News: Strong earnings reports from multiple tech companies, coupled with a surprise dividend from Alphabet, have fueled optimism that the tech sector remains a favorite among investors. The US is ramping up pressure on allies to tighten restrictions on semiconductor exports to China, aiming to hinder its technological progress in strategic sectors.

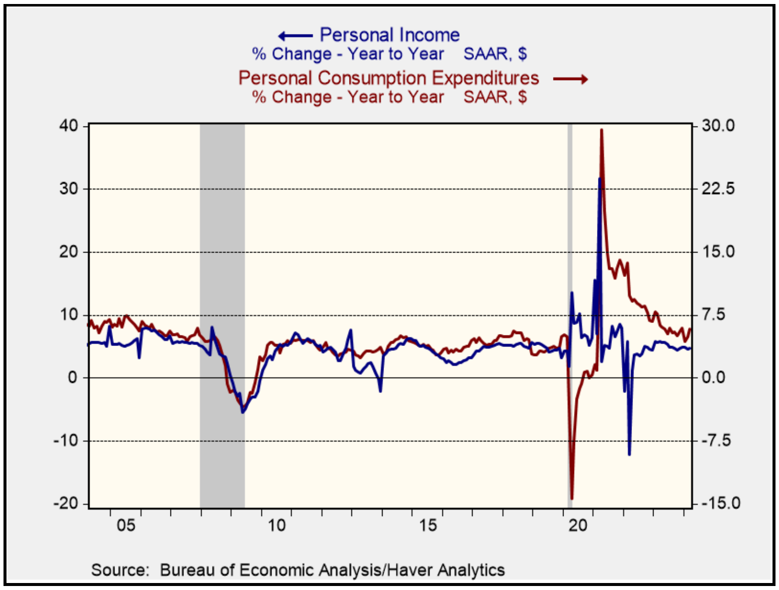
US Economic Releases

Inflationary pressures rose in March, but largely matched market forecasts. According to the Bureau of Economic Analysis, the overall Personal Consumption Expenditures (PCE) Price Index rose 0.3%, in line with consensus forecasts. Excluding volatile food and energy prices, core PCE inflation rose 0.3%, meeting expectations.



The chart above shows the year-over-year change in the core and headline PCE Price Index. Headline inflation rose slightly in March to 2.7%, up from 2.5% in February. Core inflation, which excludes volatile food and energy prices, held steady at 2.8%. While this is a positive sign for price stability, the lack of a decline in core inflation suggests it may be challenging for the Fed to achieve its 2% target in the near future.

Separately, stronger wages continue to boost higher spending. In March, personal consumption rose 0.8% from the prior month, above estimates of 0.6%. Personal income increased 0.5% from the prior month, in line with market expectations.



The chart above shows the annual change in both personal income and personal spending. While personal income has grown by 4.7% compared to last year, personal spending has risen even faster at 5.8%. This suggests a potential increase in consumer demand.

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	U. of Michigan Consumer Sentiment	m/m	Apr F	77.9	77.9	***
10:00	U. of Michigan Current Conditions	m/m	Apr F		79.3	**
10:00	U. of Michigan Future Expectations	m/m	Apr F		77.0	**
10:00	U. of Michigan 1-Year Inflation Expectation	m/m	Apr F		3.1%	*
10:00	U. of Michigan 5-10 Year Inflation Expectation	m/m	Apr F	3.0%	3.0%	*
11:00	Kansas City Fed ManfServices Activity	m/m	Apr		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	Tokyo CPI	y/y	Apr	1.8%	2.6%	2.5%	**	Equity bullish, bond bearish
	Tokyo CPI Ex-Fresh Food	y/y	Apr	1.6%	2.4%	2.2%	***	Equity bullish, bond bearish
	Tokyo CPI Ex-Fresh Food & Energy	y/y	Apr	1.8%	2.9%	2.7%	*	Equity bullish, bond bearish
Australia	PPI	y/y	1Q	4.3%	4.1%		**	Equity and bond neutral
New Zealand	ANZ Consumer Confidence MoM	m/m	Apr	-5.0	-8.6		*	Equity bullish, bond bearish
	ANZ Consumer Confidence Index	m/m	Apr	82.1	86.4		*	Equity and bond neutral
EUROPE								
Eurozone	M3 Money Supply	y/y	Mar	0.9%	0.4%	0.6%	***	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
France	Consumer Confidence	m/m	Apr	90.0	91.0	92.0	**	Equity and bond neutral
UK	GfK Consumer Confidence	m/m	Apr	-19	-21	-20	**	Equity and bond neutral
Russia	Money Supply, Narrow Definition	w/w	19-Apr	18.26t	18.21t		*	Equity and bond neutral
Russia	Gold and Forex Reserves	m/m	19-Apr	603.2b	$600.7b		***	Equity and bond neutral
AMERICAS								
Mexico	Unemployment Rate NSA	m/m	Mar	2.28%	2.45%	5.54%	***	Equity bullish, bond bearish
	Trade Balance	m/m	Mar	2098.1m	-584.7m	450.0m	**	Equity and bond neutral
	Imports	y/y	Mar	48654m	51306m		*	Equity and bond neutral
	Exports	y/y	Mar	50752m	50721m		*	Equity and bond neutral
Brazil	IBGE Inflation IPCA - 15	y/y	Apr	3.8%	4.1%	3.9%	*	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	559	0	Flat
3-mo T-bill yield (bps)	523	525	-2	Up
U.S. Sibor/OIS spread (bps)	533	533	0	Up
U.S. Libor/OIS spread (bps)	534	535	-1	Up
10-yr T-note (%)	4.69	4.70	-0.01	Up
Euribor/OIS spread (bps)	386	388	-2	Down
Currencies	Direction			
Dollar	Up			Up
Euro	Down			Down
Yen	Down			Down
Pound	Flat			Down
Franc	Flat			Down
Central Bank Action	Current	Prior	Expected	
BOJ Target Rate (Upper Bound)	0.100%	0.100%	0.100%	On Forecast
BOJ Target Rate (Lower Bound)	0.000%	0.000%	0.000%	On Forecast
Bank of Russia Key Rate	16.000%	16.000%	16.000%	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.

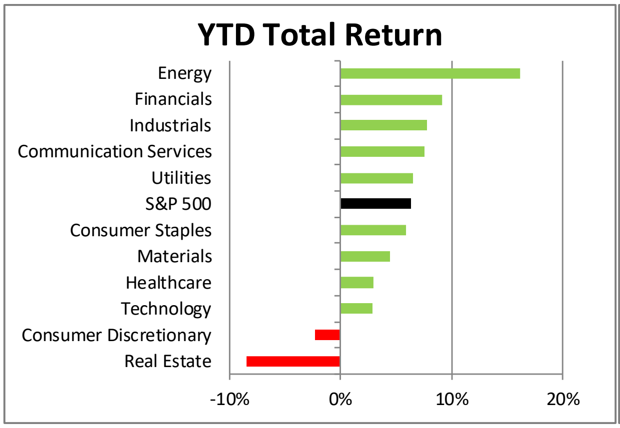
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$89.47	$89.01	0.52%	
WTI	$84.04	$83.57	0.56%	
Natural Gas	$1.56	$1.64	-4.58%	Supply Optimism
Crack Spread	$28.98	$29.00	-0.10%	
12-mo strip crack	$24.34	$24.42	-0.32%	
Ethanol rack	$1.84	$1.84	0.04%	
Metals				
Gold	$2,343.94	$2,332.46	0.49%	
Silver	$27.54	$27.43	0.40%	
Copper contract	$459.20	$453.85	1.18%	
Grains				
Corn contract	$451.00	$452.00	-0.22%	
Wheat contract	$618.00	$620.50	-0.40%	
Soybeans contract	$1,174.00	$1,179.75	-0.49%	
Shipping				
Baltic Dry Freight	1,743	1,774	-31	
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)	92	84	8	

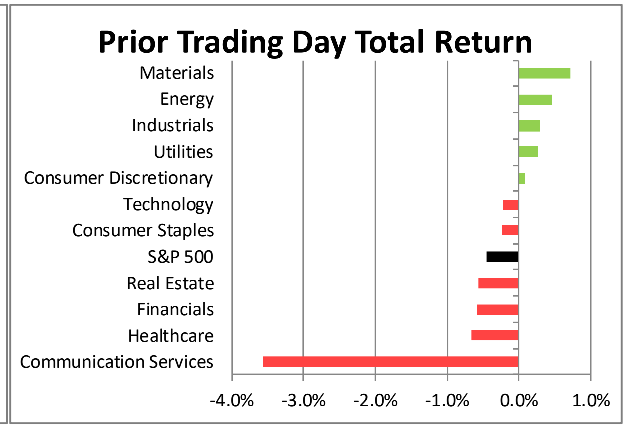
Weather

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 4/25/2024 close)

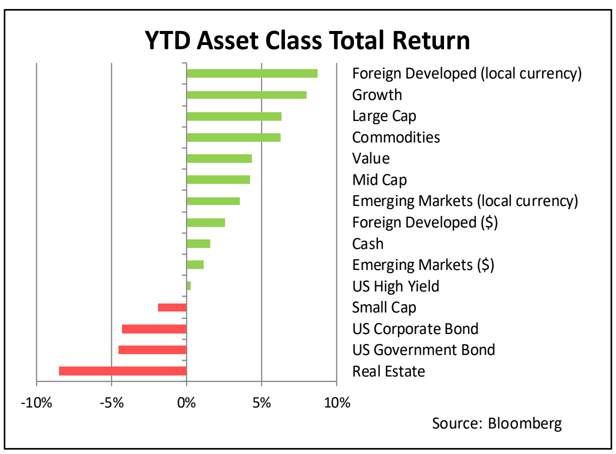




(Source: Bloomberg)

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 4/25/2024 close)

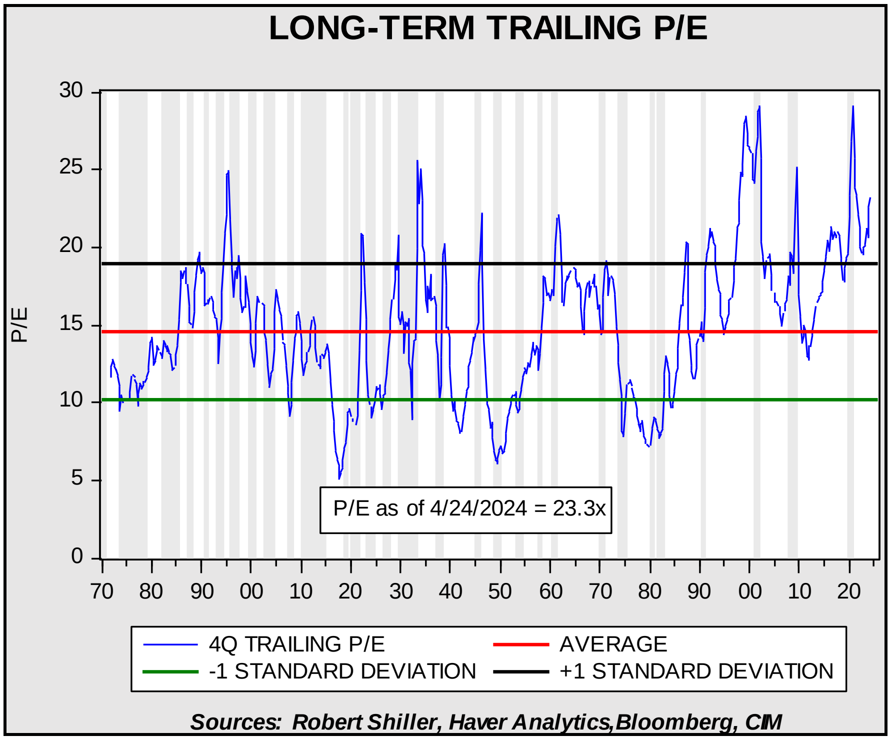


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.