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 3, 2024—9:30 AM EDT] Global equity markets are mostly lower this morning. In Europe, the Euro Stoxx 50 is up 0.4% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.1%. Chinese markets were lower, with the Shanghai Composite down 0.2% from its previous close and the Shenzhen Composite down 0.7%. US equity index futures are signaling a lower open.

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:

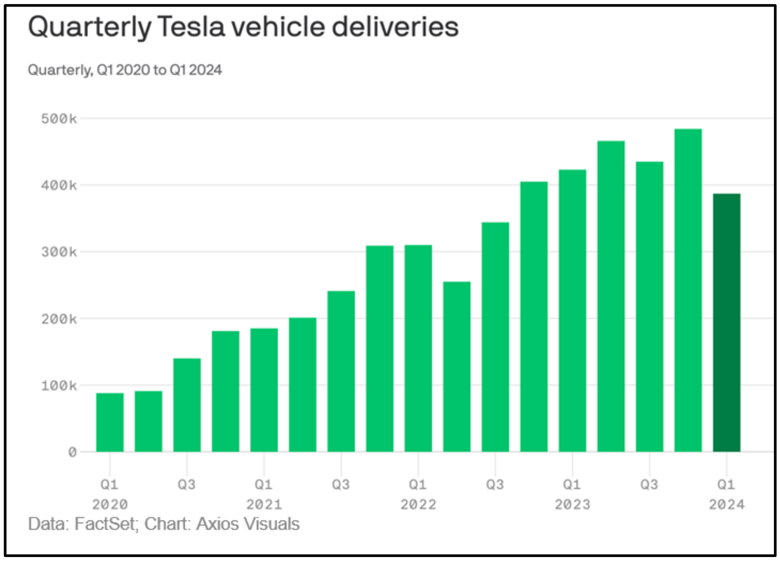
- *Bi-Weekly Geopolitical Report* (3/25/2024) (with associated podcast): "Venezuela Threatens Guyana"
- *Asset Allocation Quarterly – Q1 2024* (1/26/2024): Discussion of our asset allocation process, Q1 2024 portfolio changes, and our outlook for the markets.
- *Asset Allocation Q1 2024 Rebalance Presentation* (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* (4/1/2024) (no associated podcast for this report): "Gold, Gold Miners, and Central Banks"
- *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"

Our *Comment* today opens with new signs that global consumer demand for electric vehicles isn't growing as fast as previously thought, with major implications for the global economy and policymakers. We next review a wide range of other international and US developments with the potential to affect the financial markets today, including news of a major earthquake in Taiwan and the latest statement from a Federal Reserve policymaker pointing to US interest rates remaining "higher for longer."

Global Electric Vehicle Market: Adding to the evidence that global demand for electric vehicles is slowing sharply, EV giant Tesla yesterday stated that its first-quarter deliveries were down much more sharply than expected. The company said it delivered just 386,310 vehicles in

January through March, down 8.5% from the same period one year earlier and far below the anticipated rate of about 457,000.

- Even though top Chinese EV makers reported even steeper delivery declines, leaving Tesla as the world's top seller, the news nevertheless pushed Tesla's stock price 4.9% lower for the day, leaving it down about 33% for the year-to-date.
- If the delivery shortfalls really do reflect a saturated market or waning demand, it suggests there will be an even greater profit bloodbath as China's excess capacity leads it to try to dump even more vehicles on the world market.



Taiwan: An earthquake with a magnitude of 7.4 struck the country's east coast this morning, killing at least nine people and damaging infrastructure and buildings. Of course, a key question for the global economy is the fate of Taiwan Semiconductor Manufacturing Company's fabs on the island, which produce most of the world's advanced computer chips. The firm said damage to its plants has been minimal and workers are already returning to their jobs, but the quake will nevertheless refocus attention on the security of chip supply chains.

European Union-China: Just weeks after signaling the EU wouldn't intervene to help European solar panel makers survive the onslaught of cheap Chinese imports, the European Commission today announced it will investigate whether two Chinese producers are using state subsidies to engage in unfair competition. The probe will utilize a new anti-subsidy law passed by the EU last July. The about-face on solar panels illustrates how political winds are increasingly forcing Western governments to take a tough stand against Chinese military and economic threats.

Eurozone: The March consumer price index was up just 2.4% from the same month one year earlier, coming in a bit better than expected and slowing from the rise of 2.6% in the year to February. The slowdown in inflation mostly stemmed from weaker price growth for food, energy, and other goods, while service inflation remained steady. Despite the sticky service inflation, the figure is likely to increase expectations that the European Central Bank can cut its benchmark interest rate in June.

- With the US's healthy economic growth and sticky overall price inflation increasingly convincing investors that the Fed will move only slowly in cutting its benchmark interest rate, the prospect of near-term rate cuts by the ECB has been weighing on the euro.
- Even though the EUR is slightly higher today, trading at 1.0783 per dollar, it is still down some 2.5% against the greenback for the year-to-date.

US-China Diplomacy: Yesterday, during their first phone call in two years, President Biden and President Xi reportedly had a "candid" and "constructive" conversation about a range of issues between the two countries. However, Xi warned Biden that China "will not sit idly by" if the US continues what he called efforts to suppress Chinese economic and technological development. In turn, Biden said he will keep taking what he called limited steps necessary to ensure US national security.

- While it's probably good that Biden and Xi are talking again, the tit-for-tat exchange on economic and technological relations should serve as a reminder that tensions look set to continue spiraling.
- The US-China relationship continues to show signs of being a "Thucydides Trap," where the reigning hegemon (i.e., the US) faces a rising power (i.e., China). Some foreign affairs scholars, such as Harvard professor Graham Allison, argue that to avoid war in such a situation, the US should accommodate China's rise. However, both Democrats and Republicans in Washington continue to show signs that they're willing to stand up to China in an effort to preserve the US's dominance in geopolitics and the global economy.

US-China Capital Flows: Reflecting the bipartisan effort to rein in China, Democratic and Republican lawmakers in the House of Representatives have introduced a bill that would bar index funds from investing in Chinese companies. According to the bill's sponsors, the proposed No China in Index Funds Act is justified because index funds do not research the firms they hold and therefore can't uncover the unique risks inherent with Chinese companies.

- The bill was introduced by Rep. Brad Sherman, a Democrat from California, and Rep. Victoria Spartz, a Republican from Indiana.
- Sherman and Spartz have also introduced a number of other anti-China bills that would "end tax breaks for Chinese equities, restrict sanctioned Chinese companies' access to US capital markets, increase transparency on risks to American corporations, and reduce exposure to these risks for retail investors and other Americans saving for retirement," according to a statement from the lawmakers.

US Monetary Policy: In a speech yesterday, Cleveland FRB President Mester said the continued fundamental strength in the US economy has convinced her that interest rates will settle at a higher level than she previously thought, even after the Fed finishes its impending rate-cutting cycle. Over the long term, Mester said she now expects the benchmark fed funds rate to settle in a range of 2.5% to 3.0%, rather than the flat 2.5% she assumed previously.

- Mester's view of higher future interest rates is consistent with our view that geopolitical tensions and structural changes in the global economy will lead to increased inflation and interest rates going forward. In our view, inflation and interest rates are also likely to be more volatile.

- Separately, Mester also poured cold water on the idea of any rate cut at the Fed's policymaking meeting in May. She hinted that a cut was still possible at the June meeting, but only if in-coming inflation data clearly supports it.

US Economic Releases

Home loan demand cooled for a third week straight. According to an index tracked by the Mortgage Bankers Association, mortgage applications fell 0.6% in the week ending March 29. The drop in applications is related to elevated borrowing costs keeping potential homebuyers on the sidelines. Last week, the average 30-year fixed-rate mortgage fell 2 bps to 6.93%. As a result, the tracker for purchases was relatively unchanged from the previous week, while the refinance tracker fell 1.6%.

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 Services PMI	m/m	Mar	51.7	51.7	***
9:45	S&P Global US Composiste PMI	m/m	Mar		52.2	***
10:00	ISM Services Index	m/m	Mar	52.8	52.6	***
Federal Reserve						
EST	**Speaker or Event**	**District or Position**				
9:45	Michelle Bowman Speaks on Bank Liquidity, Fed	Member of the Board of Governors				
12:00	Austan Goolsbee Gives Opening Remarks	President of the Federal Reserve Bank of Chicago				
12:10	Jerome Powell Speaks on Economic Outlook	Chairman of the Board of Governors				
13:10	Michael BarrSpeaks on Community Reinvestment Act	U.S. Federal Reserve Vice Chairman for Supervision				
16:30	Adriana Kugler Speaks on Economic, Monetary Policy Outlook	Member of the Board of Governors				

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 Composite PMI	m/m	Mar F	51.7	52.3		*	Equity and bond neutral
	Jibun Bank Services PMI	m/m	Mar F	54.1	54.9		**	Equity and bond neutral
South Korea	Foreign Reserves	m/m	Mar	$419.25b	$415.73b		*	Equity and bond neutral
China	Caixin Composite PMI	m/m	Mar	52.7	52.5		**	Equity and bond neutral
	Caixin Services PMI	m/m	Mar	52.7	52.5	52.5	**	Equity and bond neutral
EUROPE								
Eurozone	CPI	y/y	Mar	2.4%	2.6%	2.5%	***	Equity and bond neutral
	Core CPI	y/y	Mar P	2.9%	3.1%	3.0%	**	Equity and bond neutral
	Unemployment Rate	m/m	Feb	6.5%	6.5%	6.4%	**	Equity and bond neutral
Italy	Unemployment Rate	m/m	Feb	7.5%	7.3%	7.2%	**	Equity and bond neutral
Russia	S&P Global Composite PMI	m/m	Mar	52.7	52.2		**	Equity and bond neutral
	S&P Global Services PMI	m/m	Mar	51.4	51.1	51.5	**	Equity and bond neutral
AMERICAS								
Mexico	International Reserves Weekly	w/w	27-Mar	$217194m	$216903m		*	Equity and bond neutral
	Gross Fixed Investment	y/y	Jan	15.3%	13.4%	17.9%	**	Equity bearish, bond bullish
Brazil	Industrial Production	y/y	Feb	5.0%	3.5%	5.7%	***	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)	556	556	0	Down
3-mo T-bill yield (bps)	521	521	0	Up
U.S. Sibor/OIS spread (bps)	531	531	0	Down
U.S. Libor/OIS spread (bps)	532	531	1	Flat
10-yr T-note (%)	4.37	4.35	0.02	Up
Euribor/OIS spread (bps)	388	389	-1	Down
Currencies	**Direction**			
Dollar	Down			Up
Euro	Up			Down
Yen	Down			Down
Pound	Flat			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.

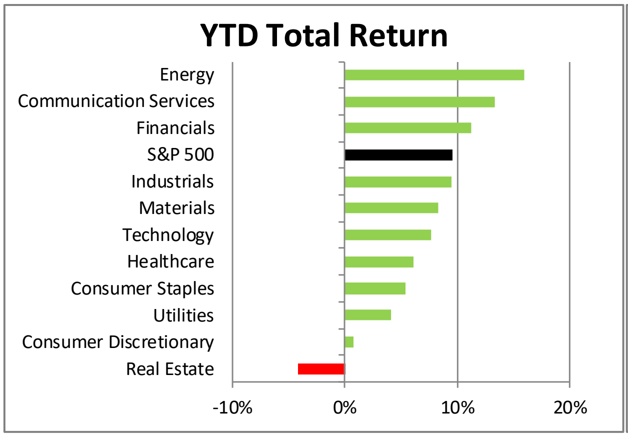
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$89.67	$88.92	0.84%	
WTI	$85.88	$85.15	0.86%	
Natural Gas	$1.87	$1.86	0.21%	
Crack Spread	$30.30	$30.30	-0.01%	
12-mo strip crack	$25.40	$25.49	-0.36%	
Ethanol rack	$1.76	$1.76	-0.06%	
Metals				
Gold	$2,270.21	$2,280.67	-0.46%	
Silver	$26.23	$26.14	0.34%	
Copper contract	$409.00	$407.05	0.48%	
Grains				
Corn contract	$428.50	$426.50	0.47%	
Wheat contract	$550.75	$545.25	1.01%	
Soybeans contract	$1,177.50	$1,174.00	0.30%	
Shipping				
Baltic Dry Freight	1,714	1,821	-107	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-1.0		
Gasoline (mb)		0.1		
Distillates (mb)		-1.00		
Refinery run rates (%)		0.3%		
Natural gas (bcf)		-42		

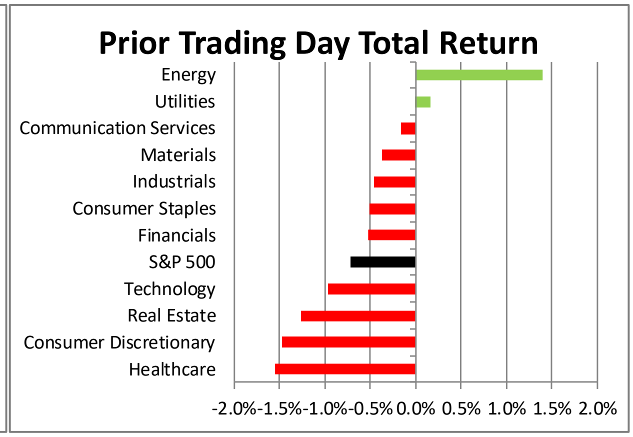
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures throughout most of the country, with cooler temps remaining in the Southwest. The forecasts call for wetter-than-normal conditions in most states east of the Rocky Mountain region, with dry conditions expected in the Northern Pacific.

Data Section

US Equity Markets – (as of 4/2/2024 close)

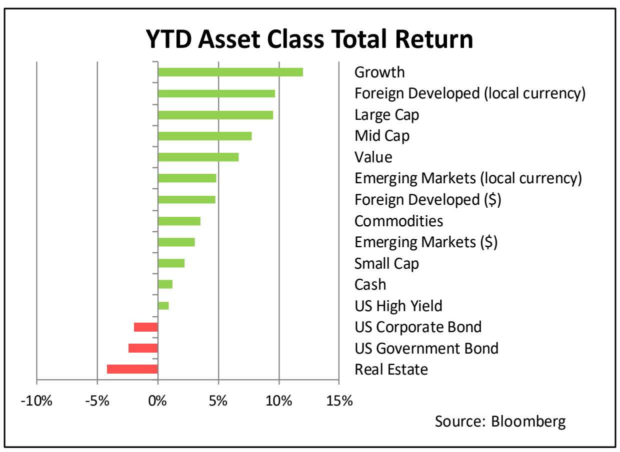




(Source: Bloomberg)

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 4/2/2024 close)

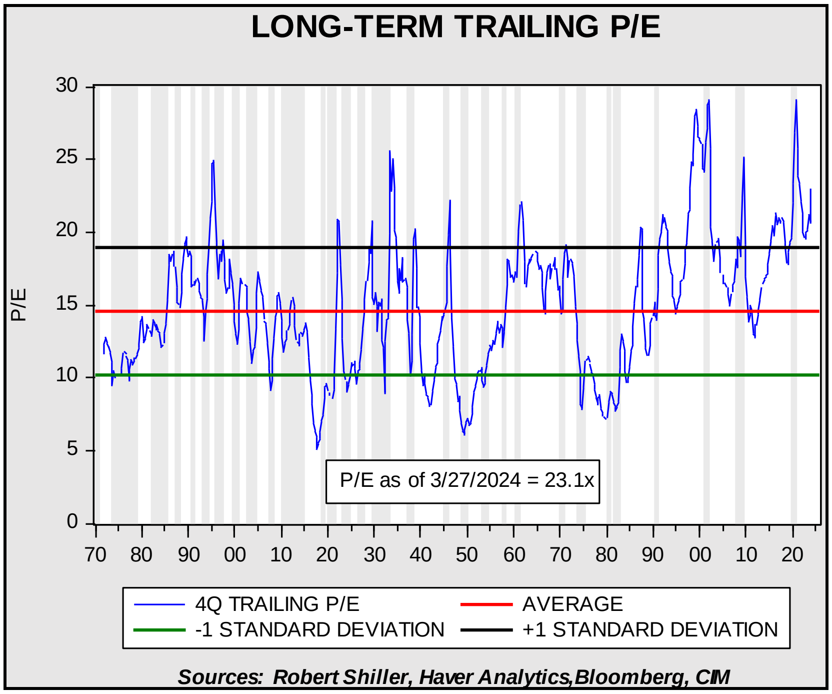


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

March 28, 2024



Based on our methodology,[1] the current P/E is 23.1x, up 0.2x from our last report. The improvement in the multiple reflects an increase in the stock price index, and a decrease in earnings.

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.