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 4, 2024—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is up 0.1% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.5%. 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 higher open.

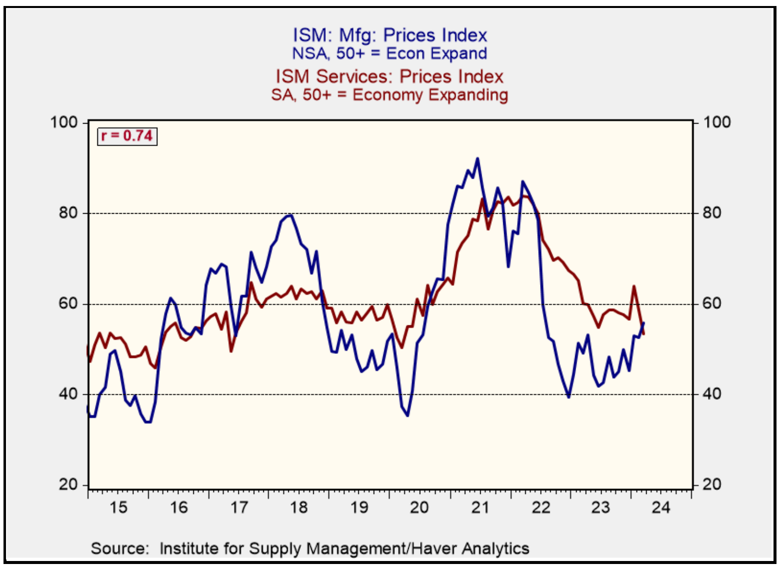
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *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"

Good morning! Equities are off to a great start after initial jobless claims data came in higher than anticipated. In sports news, the St. Louis Cardinals, considered by many to be World Series contenders, kick off their home opener today. Today's *Comment* explores three key market concerns: the impact of future policy rate uncertainty on market jitters, how the AI rally might diverge from the dotcom bubble, and whether Swiss inflation data offers clues about global inflation trends. As usual, our report includes a summary of domestic and international data releases.

Shifting Sands: The Fed's uncertainty about inflation's trajectory is muddying the policy path, prompting markets to reassess their interest rate forecasts.

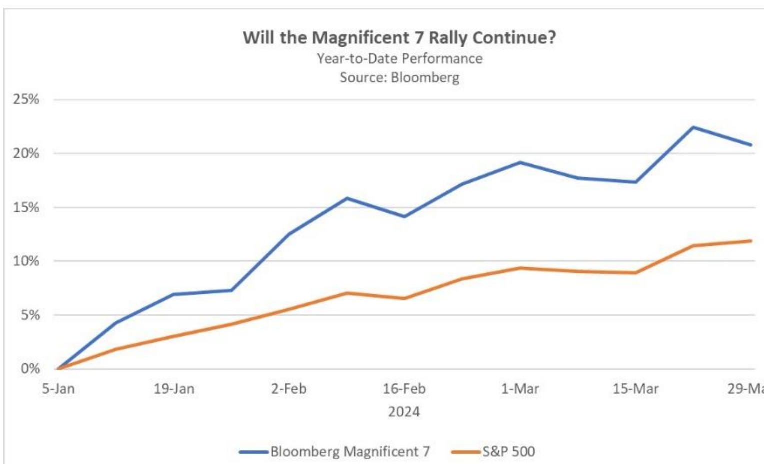
- Fed Chair Jerome Powell reiterated the importance of patience in considering rate cuts for the Federal Reserve. Speaking at a panel discussion at Stanford University, Powell highlighted the significant influence of supply-side factors in curbing inflation since the onset of the pandemic. While he avoided giving a specific rate forecast, he indicated the latest data hasn't "materially changed" the Fed's view on inflation. This aligns with San Francisco Fed President Mary Daly, who still favors three rate cuts this year. In contrast, Raphael Bostic has reduced his forecast from two cuts to one.
- Conflicting economic data is further muddying the Federal Reserve's decision on interest rates. The Institute for Supply Management's (ISM) latest manufacturing PMI shows prices paid have surged to their highest levels since 2022, indicating persistent inflation. However, the non-manufacturing PMI shows service sector prices at a four-year low, suggesting a potential easing of price pressures in that sector. This surge in manufacturing prices likely reflects rising commodity costs, while the low service-sector prices could signal easing wage pressures, which aligns with the decline in the non-manufacturing employment component. The negative response to manufacturing data and positive reception of service data highlights the market's current volatility.



- The ISM report, though not directly influencing policymakers, exposes the market's hair-trigger sensitivity to economic data, as evidenced by contrasting reactions. Uncertainty regarding rate cuts will hang in the air until the Fed's June meeting, where their updated economic projections will shed light on their path forward. Committee members, especially the hawkish ones, are paying attention to payroll data. A significant drop in March or April jobs could trigger a dovish pivot towards rate cuts this summer. Conversely, persistently strong job reports could lead to a reduction, or even a complete halt, in planned rate cuts for the year.

Tech Moves: Soaring valuations prompt tech companies to seek new income sources to satisfy their investors.

- Tech giants like Google are exploring premium features on select products behind paywalls, creating new revenue streams. This could fund continued development of these enhancements while maintaining their free, ad-supported core offerings. Meanwhile, Apple's foray into home robotics signals a potential pivot away from their electric vehicle project. These moves, though not finalized, highlight the growing pressure on tech companies, particularly the Magnificent Seven (M7), to diversify income and justify high valuations in a changing market. The recent drop in Tesla stock following weak deliveries exemplifies how investor sentiment can quickly turn after negative news.
- The recent surge in the M7's stock prices evokes comparisons to the dotcom boom of the late 1990s. However, a crucial distinction lies in the companies' financial health. The dotcom bubble was fueled by speculation on unprofitable startups with minimal revenue and high debt. In stark contrast, the M7 are established powerhouses generating substantial profits. Their impressive free cash flow of $309.2 billion in 2023, a staggering $100 billion increase year-over-year, demonstrates their financial strength. This massive cash cushion positions them as far more resilient than the fragile dotcom companies, providing a buffer during periods of economic uncertainty.

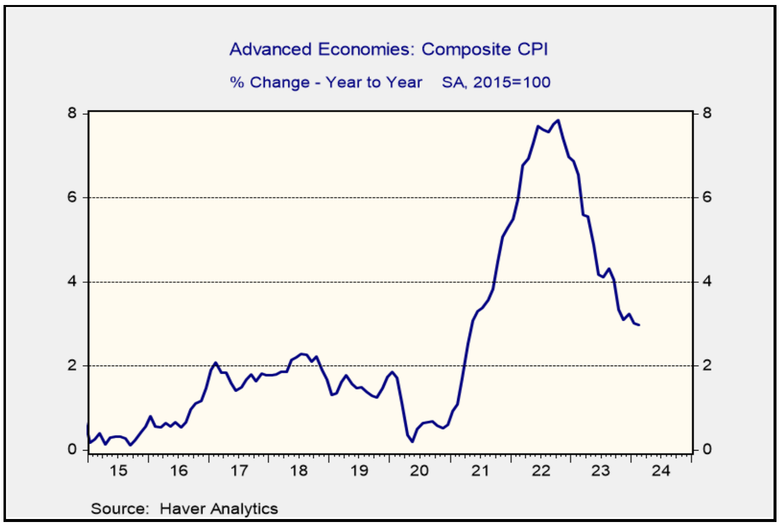


- While there's confidence that the large-cap rally will spread to other sectors, the M7's future path remains uncertain. The upcoming Q1 2024 earnings season will be critical, potentially shaping the rally's direction as it reveals these mega-caps' abilities to maintain profitability. However, unlike the dotcom bubble, the size and scale of the M7 provide a buffer. Even if the AI boom weakens, these companies have the resources to explore alternative revenue streams, fostering a more resilient position. This doesn't necessarily guarantee a complete avoidance of a correction, but investors should be prepared for a more measured market response compared to the dramatic downturns of the dotcom era.

The Swiss's Dovish Surprise: March's lower-than-anticipated inflation data supports the central bank's decision and raises the possibility of additional stimulus measures.

- Swiss consumer prices have risen just 1% since March 2023, falling short of expectations for a 1.3% increase. This comes on the heels of the Swiss National Bank's (SNB) decision in March to cut borrowing costs, marking the first such move by a G-10 central bank since November 2020. The SNB's pivot aimed to curb the Swiss franc's appreciation against the dollar. A recent study suggests the SNB would require an additional $30 billion alongside a commitment to keeping interest rates low for the next three years to prevent a mere 1.1% appreciation of the Swiss franc's real effective exchange rate.

- Although a single month's data shouldn't be over-emphasized, recent CPI figures offer early signs of potential global inflation moderation. For instance, preliminary data from the eurozone shows core inflation dipping below 3.0% for the first time since March 2022. Similarly, both Japan and Canada have experienced a notable slowdown in inflation over the past several months. If this trend continues throughout the developed world, it is possible that the central banks will likely follow through on plans to reduce their policy rates this year.

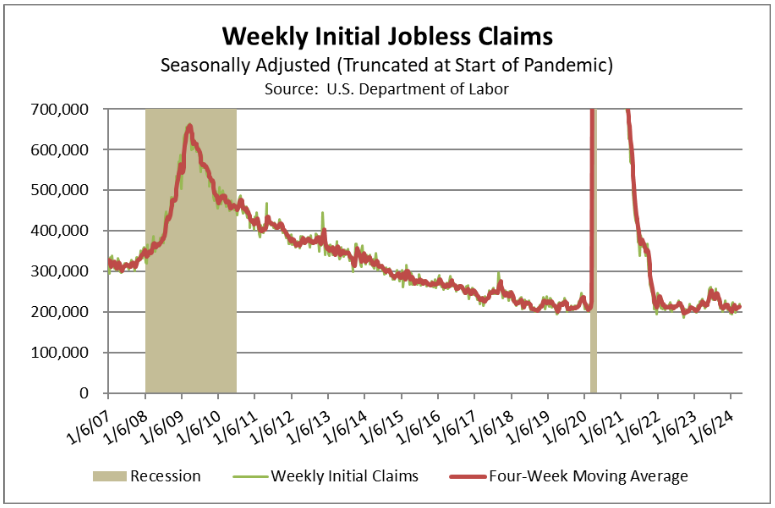


- Slower economic growth in some countries is tempering inflation, but rising commodity prices threaten this progress. The robust US economy, with strong wage growth and a tight labor market, might prompt the Federal Reserve to maintain its current stance before easing monetary policy. This could lead to a stronger dollar as the interest rate differential between the US and other countries widens. Consequently, import-dependent nations may face challenges due to higher costs for dollar-denominated goods. This divergence in monetary policy could dampen global interest rate reductions, potentially falling short of market expectations.

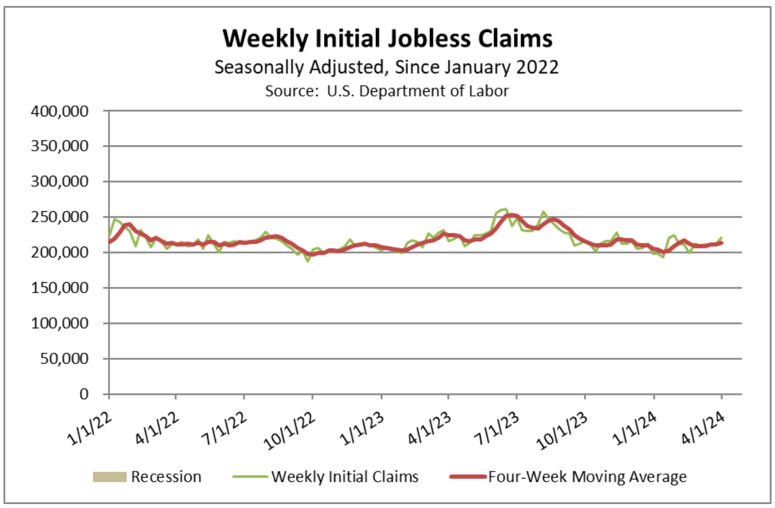
Other News: Germany is undertaking military reforms in response to a perceived increase in global hostility. An Israeli cabinet member's call for early elections highlights the current political instability in Israel.

US Economic Releases

In the week ended March 30, ***initial claims for unemployment benefits*** rose to a seasonally adjusted 221,000, well above both the expected level of 214,000 and the previous week's revised level of 212,000. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, rose to 214,250. Meanwhile, in the week ended March 23, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) fell to 1.791 million, below the anticipated reading of 1.811 million and the prior week's revised reading of 1.810 million. The chart below shows how initial jobless claims have fluctuated since just before the Great Financial Crisis. The chart is truncated through much of the pandemic period because of the extremely high level of claims at that time.



To provide more detail on recent trends, the chart below shows how initial jobless claims have changed just since the beginning of 2022.



In a separate report today, the February ***trade balance*** showed a seasonally adjusted deficit of $68.9 billion, worse than expectations that the balance would match January's revised shortfall of $67.6 billion. According to the data, total ***exports*** rose 2.3%, while ***imports*** rose 2.2%. Compared with the same month one year earlier, exports in February were up 4.1%, while imports were up 2.8%. The chart below shows the monthly value of U.S. exports and imports since just before the Great Financial Crisis.

The table below lists the economic releases and/or Fed events scheduled for the rest of the day.

Economic Releases		
	No economic releases for the rest of today	
Federal Reserve		
EST	**Speaker or Event**	**District or Position**
10:00	Patrick Harker Participates in Fireside Chat	President of the Federal Reserve Bank of Philadelphia
12:15	Thomas Barkin Speaks on Economic Outlook	President of the Federal Reserve Bank of Richmond
12:45	Austan Goolsbee Participates in Moderated Q&A	President of the Federal Reserve Bank of Chicago
14:00	Loretta Mester Gives Remarks on Economic Outlook	President of the Federal Reserve Bank of Cleveland
14:00	Neel Kashkari Discusses US Economy	President of the Federal Reserve Bank of Minneapolis
19:20	Alberto Musalem Gives Introductory Remarks	President of the Federal Reserve Bank of St. Louis
19:30	Adriana Kugler Speaks on Enriching Data	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	Foreign Buying Japan Stocks	w/w	29-Mar	-¥441.3b	-¥889.6b		*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	29-Mar	-¥1660.5b	¥764.6b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	29-Mar	¥842.2b	-¥3892.5b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	29-Mar	-¥233.6b	¥82.1b		*	Equity and bond neutral
Australia	Building Approvals	m/m	Feb	-1.9%	-2.5%	3.0%	***	Equity bearish, bond bullish
New Zealand	Building Permits	m/m	Feb	14.9%	-8.6%		**	Equity bullish, bond bearish
	ANZ Commodity Price	m/m	Mar	-1.30%	3.60%		**	Equity and bond neutral
India	HSBC India PMI Composite	m/m	Mar F	61.8	61.3		**	Equity and bond neutral
	HSBC India PMI Services	m/m	Mar F	61.2	60.3		**	Equity and bond neutral
EUROPE								
Eurozone	HCOB Eurozone Services PMI	m/m	Mar F	51.5	51.1	51.1	**	Equity and bond neutral
	HCOB Eurozone Composite PMI	m/m	Mar F	50.3	49.9	49.9	*	Equity and bond neutral
	PPI	y/y	Feb	-8.3%	-8.0%	-8.6%	*	Equity and bond neutral
Germany	HCOB Germany Services PMI	m/m	Mar F	50.1	49.8	49.8	**	Equity and bond neutral
	HCOB Germany Composite PMI	m/m	Mar F	47.7	47.4	47.4	**	Equity and bond neutral
France	HCOB France Composite PMI	m/m	Mar F	48.3	47.7	47.7	**	Equity and bond neutral
	HCOB France Services PMI	m/m	Mar F	48.3	47.8	47.8	**	Equity and bond neutral
Italy	HCOB Italy Composite PMI	m/m	Mar	53.5	51.1	52.0	**	Equity bullish, bond bearish
	HCOB Italy Services PMI	m/m	Mar	54.6	52.2	53.1	**	Equity bullish, bond bearish
UK	New Car Registrations	y/y	Mar	10.4%	14.0%		*	Equity and bond neutral
	S&P Global UK Services PMI	m/m	Mar F	53.1	53.4	53.4	**	Equity and bond neutral
	S&P Global UK Composite PMI	m/m	Mar F	52.8	52.9	52.9	**	Equity and bond neutral
Switzerland	CPI	y/y	Mar	1.0%	1.2%	1.3%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Mar	1.1%	1.2%	1.4%	*	Equity and bond neutral
	Core CPI	y/y	Mar	1.0%	1.1%	1.2%	*	Equity and bond neutral
Russia	Retail Sales	m/m	Feb	12.3%	9.1%	9.2%	**	Equity bullish, bond bearish
	Unemployment Rate	m/m	Feb	2.8%	2.9%	2.9%	***	Equity and bond neutral
AMERICAS								
Canada	S&P Global Canada Composite PMI	m/m	Mar	47.0	47.1		*	Equity and bond neutral
	S&P Global Canada Services PMI	m/m	Mar	46.4	46.6		*	Equity and bond neutral
Brazil	S&P Global Canada Composite PMI	m/m	Mar	55.1	55.1		*	Equity and bond neutral
	S&P Global Canada Services PMI	m/m	Mar	54.8	54.6		*	Equity and bond neutral
	Current Account Balance	m/m	Feb	-$4373m	-$5100m	-$3500m	**	Equity and bond neutral
	Foreign Direct Investment	m/m	Feb	$5012m	$8741m	$6600m	**	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)	557	556	1	Down
3-mo T-bill yield (bps)	520	521	-1	Up
U.S. Sibor/OIS spread (bps)	530	531	-1	Down
U.S. Libor/OIS spread (bps)	531	532	-1	Down
10-yr T-note (%)	4.36	4.35	0.01	Up
Euribor/OIS spread (bps)	386	388	-2	Down
Currencies	**Direction**			
Dollar	Down			Up
Euro	Up			Down
Yen	Flat			Down
Pound	Flat			Down
Franc	Down			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.

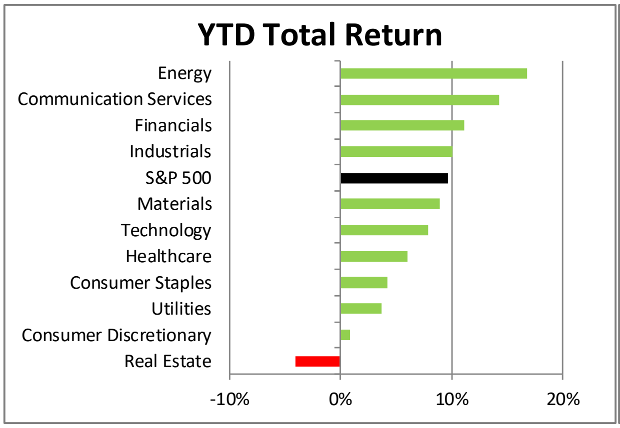
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$89.36	$89.35	0.01%	
WTI	$85.45	$85.43	0.02%	
Natural Gas	$1.84	$1.84	-0.22%	
Crack Spread	$30.01	$30.04	-0.10%	
12-mo strip crack	$25.25	$25.44	-0.74%	
Ethanol rack	$1.77	$1.77	-0.05%	
Metals				
Gold	$2,292.87	$2,300.00	-0.31%	
Silver	$27.00	$27.18	-0.67%	
Copper contract	$424.70	$419.40	1.26%	
Grains				
Corn contract	$433.00	$431.75	0.29%	
Wheat contract	$557.25	$556.00	0.22%	
Soybeans contract	$1,184.25	$1,182.25	0.17%	
Shipping				
Baltic Dry Freight	1,711	1,714	-3	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	3.2	-1.0	4.2	
Gasoline (mb)	-4.3	0.1	-4.4	
Distillates (mb)	-1.27	-1.00	-0.27	
Refinery run rates (%)	-0.1%	0.3%	-0.4%	
Natural gas (bcf)		-42		

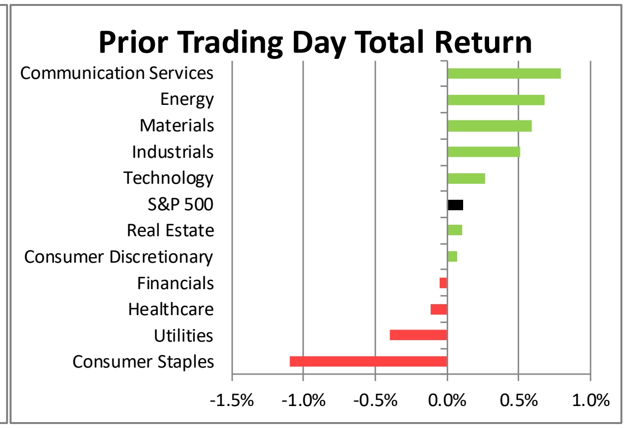
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures everywhere except the southern Great Plains, with cooler-than-normal temperatures only in southern Texas. The forecasts call for wetter-than-normal conditions in the southern Great Plains and east of the Mississippi River, with dry conditions in the northern Rocky Mountains.

Data Section

US Equity Markets – (as of 4/3/2024 close)

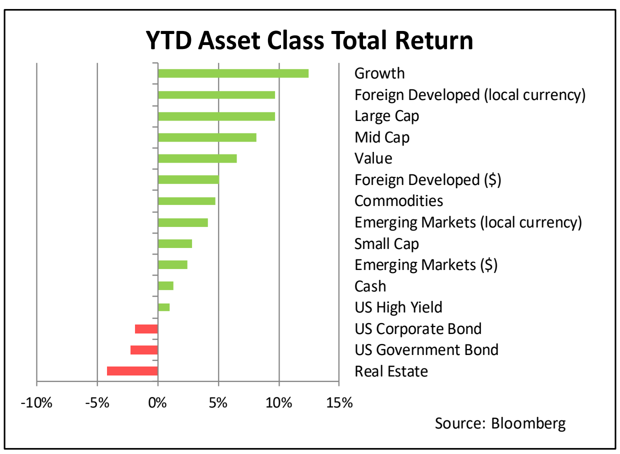




(Source: Bloomberg)

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 4/3/2024 close)

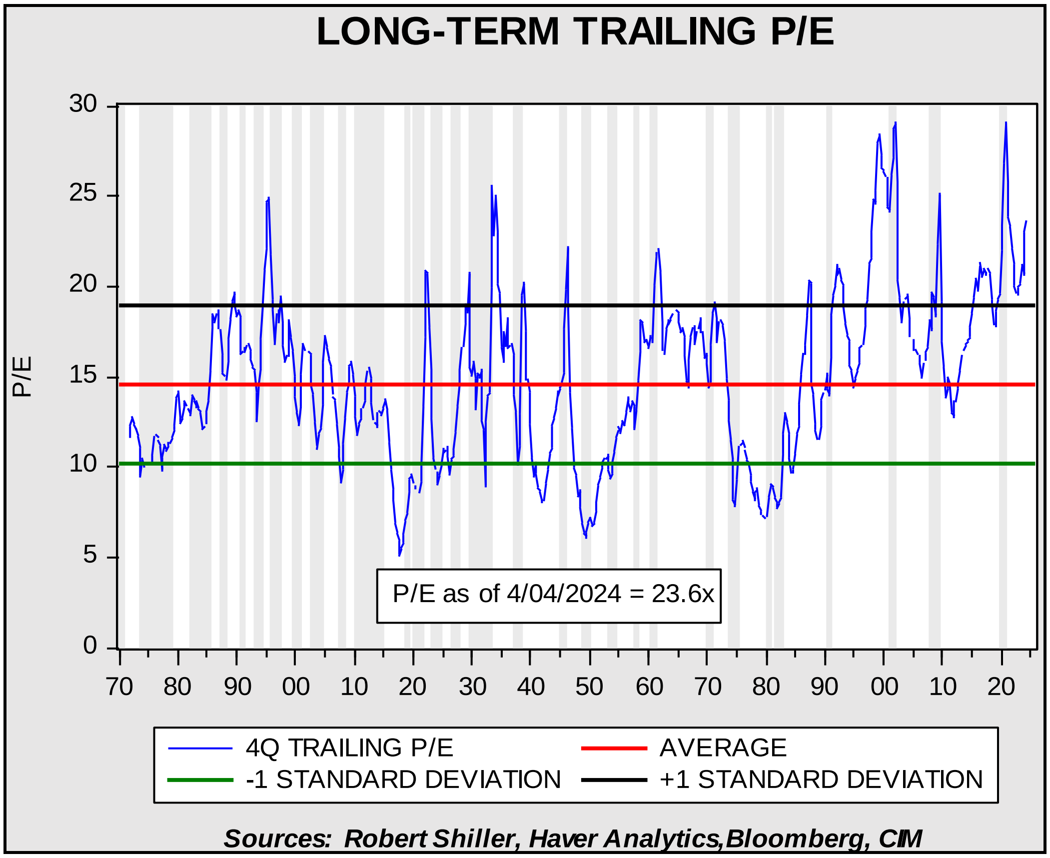


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 4, 2024



Based on our methodology,[1] the current P/E is 23.6x, up 0.5x from our last report. The improvement in the multiple reflects an increase in the stock price index due to a change in quarter, outweighing the increase 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.

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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.