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 9, 2024—9:30 AM EDT] Global equity markets are mostly higher this morning. In Europe, the Euro Stoxx 50 is down 0.5% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.0%. Chinese markets were higher, with the Shanghai Composite up 0.1% from its previous close and the Shenzhen Composite up 0.8%. US equity index futures are signaling a higher open.

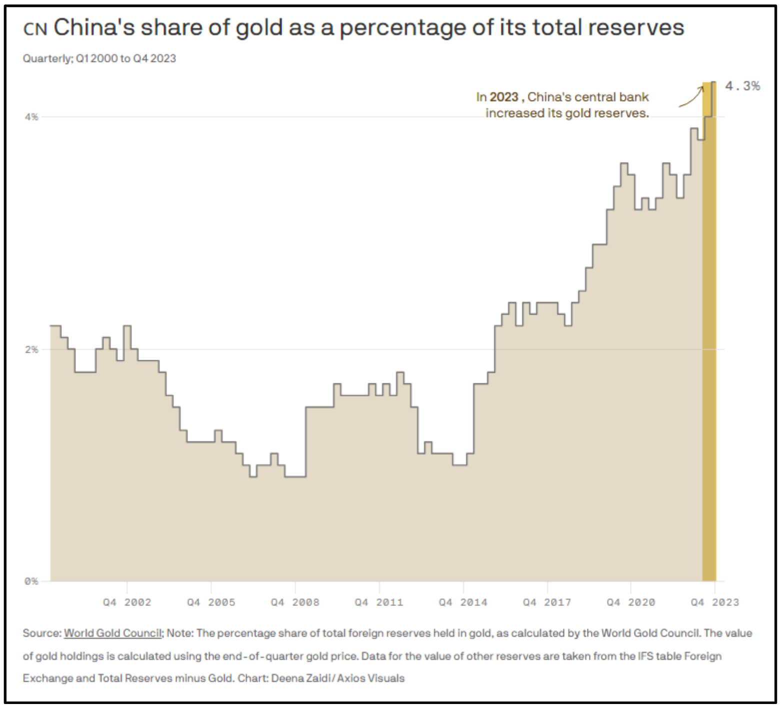
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- ***Bi-Weekly Geopolitical Report* (4/8/2024) (with associated podcast): "Is Japan Back?"**
- *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 some observations on gold prices, which hit a record high yesterday. We next review a wide range of other international and US developments with the potential to affect the financial markets today, including more signs of a Western trade war against China over its dumping of excess production on world markets and another indication that US commercial real estate prospects may be on the verge of improving.

Global Gold Market: Gold prices hit a new all-time record yesterday, closing at $2,357.80 per ounce despite investors' realization that the Federal Reserve isn't likely to cut interest rates as aggressively as previously thought (gold prices have historically been hurt by high real interest rates). In our view, the anomaly reflects a broad commodity rally, geopolitical tensions, and especially strong buying by central banks.

- Gold has long been seen as a “safe haven” asset that can hold its value in the face of currency debasement, rising price inflation, and wars or other geopolitical tensions.
- More recently, it’s become clear that gold is a safe haven even to foreign governments and their central bankers, especially in the rival China-led geopolitical bloc. As those governments and central banks digest how the West has essentially frozen or seized reserves held by countries like Afghanistan, Iran, and Russia, they’ve become much more intent on holding their reserves in hard assets such as the yellow metal.
- The process of central banks shifting their reserve holdings toward gold, silver, or other physical commodities could well continue for some time. Therefore, it’s possible that gold’s current uptrend will continue.



European Union-China: New reports [say waves of imported autos are piling up at European ports](), reflecting not just the onslaught of mostly Chinese-made vehicles but also a shortage of truckers to move them out and a slowdown in demand among European consumers. We think the situation will only make it more likely that the EU will formally impose anti-dumping tariffs or other trade barriers against China once its current investigation of the issue is completed.

European Union-Russia: Yesterday, the European Commission’s top diplomat, Josep Borrell [became the latest high-level European official to warn of an impending war with Russia](). In a speech in Brussels, Borrell warned that “Russia threatens Europe . . . War is certainly looming around us, and a high-intensity, conventional war in Europe is no longer a fantasy.” Consistent with our outlook for bigger military budgets around the world, Borrell urged the creation of a joint EU financing mechanism to boost the bloc’s defense industrial capacity to prepare for war.

Eurozone: The European Central Bank said its first-quarter survey of commercial banks revealed a substantial decline in corporate loan demand. The fall in demand for credit apparently reflects weaker investment plans, so the data may more strongly prompt the central bank to signal the beginning of interest-rate cuts when it holds its policy meeting later this week. At this point, investors largely expect the ECB to start cutting rates in June.

Turkey-Israel: Under domestic political pressure to do more to stop Tel Aviv's war against Hamas in Gaza, the Turkish government today said it will restrict the export of 54 different products to Israel. The restrictions will affect exports ranging from construction machinery and metal products to fuels and oils. The move reflects how Israel's war on Hamas and the resulting civilian casualties are increasingly isolating the country politically and economically, with potentially long-term consequences.

Japan: In testimony before parliament today, Bank of Japan Governor Ueda said the central bank will keep monetary policy accommodative for now, despite its decision to end its negative interest-rate policy last month. Ueda did say that the policymakers might reduce the amount of accommodation if consumer price pressures worsen, but he offered no firm guidance on when interest rates might rise again. The testimony suggests Japanese rates will rise only slowly and remain relatively low for the time being, keeping downward pressure on the yen.

United States-China: In her visit to China this week, Treasury Secretary Yellen has delivered a tough warning that the US will respond if Beijing keeps pushing unwarranted investment that leads to more excess capacity and increased dumping of cheap Chinese goods on the world market. However, Chinese officials have pushed back on the criticism, claiming that excess capacity is normal, and that China is merely trying to develop its economy appropriately.

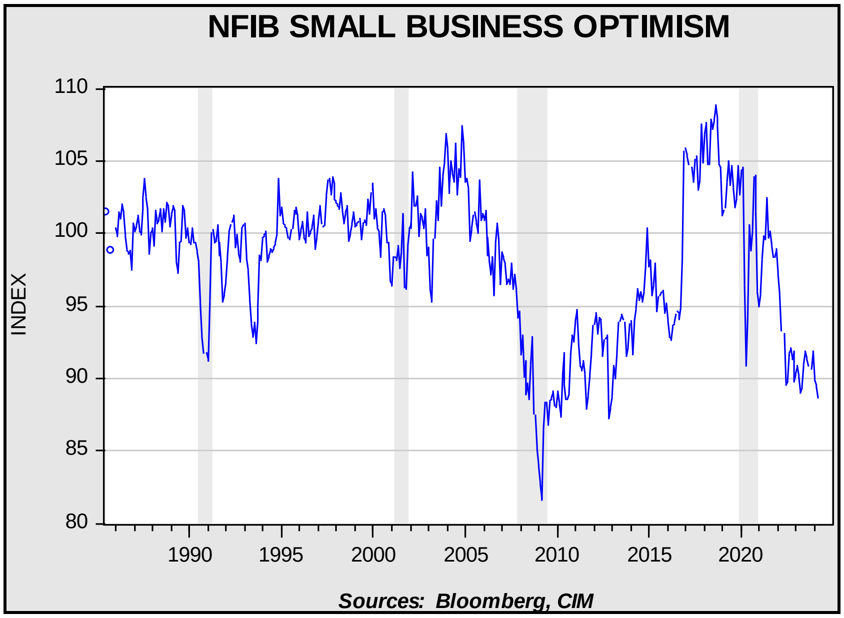
- Yellen's tough message and Beijing's pushback point to further US-China tensions.
- As we have noted many times before, the increasing tensions threaten to catch investors in the crossfire going forward.

US Bond Market: Treasury yields across the maturity spectrum rose to their highest levels since November, with the benchmark 10-year rate closing yesterday at 4.422%. So far this morning, the higher yields appear to be enticing some investors to buy bonds again, pulling yields a bit lower. Nevertheless, as we noted in our *Comment* yesterday, investors are likely to remain skittish about buying fixed income in the face of sticky consumer price inflation and a Federal Reserve that is less likely to cut interest rates than earlier thought.

US Commercial Real Estate Market: Private investing giant Blackstone yesterday said it is buying Apartment Income REIT, known as AIR Communities, which owns 76 upscale apartment communities mostly in coastal markets such as Miami and Boston. The $10-billion buy comes after a period in which Blackstone was being cautious in the face of high interest rates, rising commercial real estate vacancies, and falling building values. The deal, therefore, could signal an upturn in the sector's fortunes and a potential rebound in commercial real estate values.

US Economic Releases

Despite a seemingly healthy economy, small business owners remain cautious about the business climate. The National Federation of Independent Business (NFIB) Small Business Optimism Index dipped from 89.4 to 88.5 in March, falling short of expectations for a modest rise to 89.9.



The chart above shows the NFIB Small Business Optimism Index. This marks the lowest reading in over a decade, with survey respondents citing anxieties about future sales, rising inflation, and difficulty filling open positions.

There are no economic releases or Fed events scheduled for the rest of the day.

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	Machine tool orders	y/y	Mar P	-3.8%	-8.0%		**	Equity and bond neutral
Australia	Westpac Consumer Conf SA	m/m	Apr	-2.4%	-1.8%		**	Equity and bond neutral
	Westpac Consumer Conf Index	m/m	Apr	82.4	84.4		**	Equity and bond neutral
	NAB Business Confidence	m/m	Mar	1	0		**	Equity and bond neutral
	NAB Business Conditions	m/m	Mar	9	10		**	Equity and bond neutral
EUROPE								
France	Current Account Balance	m/m	Feb	-0.5b	-1.0b		*	Equity and bond neutral
	Trade Balance	m/m	Feb	-5244m	-7213m		**	Equity and bond neutral
AMERICAS								
Mexico	CPI	y/y	Mar	4.42%	4.40%	4.50%	***	Equity and bond neutral
	Core CPI	y/y	Mar	4.55%	4.64%	4.63%	**	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)	556	556	0	Down
3-mo T-bill yield (bps)	519	518	1	Up
U.S. Sibor/OIS spread (bps)	531	531	0	Down
U.S. Libor/OIS spread (bps)	532	532	0	Flat
10-yr T-note (%)	4.40	4.42	-0.02	Up
Euribor/OIS spread (bps)	390	389	1	Down
Currencies	**Direction**			
Dollar	Flat			Up
Euro	Flat			Down
Yen	Flat			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.

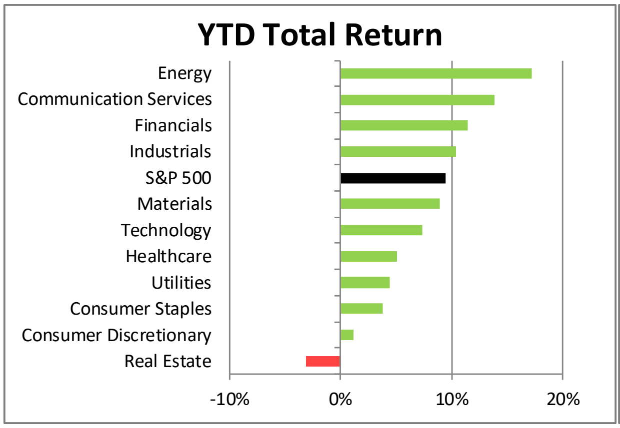
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$90.53	$90.38	0.17%	
WTI	$86.52	$86.43	0.10%	
Natural Gas	$1.89	$1.84	2.22%	
Crack Spread	$28.97	$28.69	0.99%	
12-mo strip crack	$24.91	$24.80	0.45%	
Ethanol rack	$1.83	$1.82	0.60%	
Metals				
Gold	$2,350.62	$2,339.03	0.50%	
Silver	$27.97	$27.85	0.43%	
Copper contract	$429.00	$427.60	0.33%	
Grains				
Corn contract	$434.50	$435.50	-0.23%	
Wheat contract	$559.50	$565.75	-1.10%	
Soybeans contract	$1,177.25	$1,181.50	-0.36%	
Shipping				
Baltic Dry Freight	1,594	1,628	-34	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		1.0		
Gasoline (mb)		-2.5		
Distillates (mb)		-1.43		
Refinery run rates (%)		0.5%		
Natural gas (bcf)		-42		

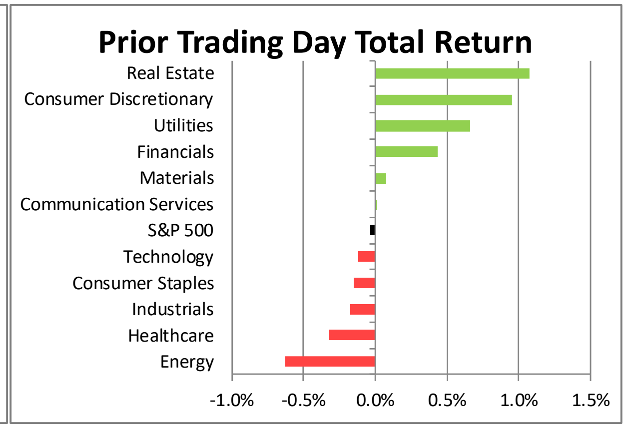
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures for most of the country, with cooler temperatures expected in the Northern Rockies. The precipitation outlook calls for wetter-than-normal conditions in most states east of the Great Plains, and drier-than-normal conditions in the Pacific and Southeast regions.

Data Section

US Equity Markets – (as of 4/8/2024 close)

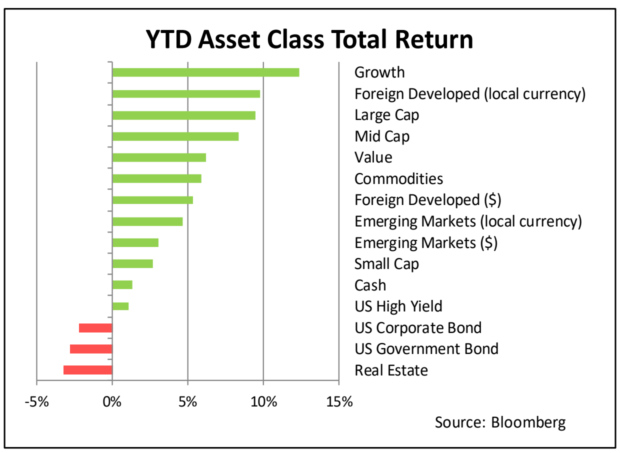




(Source: Bloomberg)

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 4/8/2024 close)

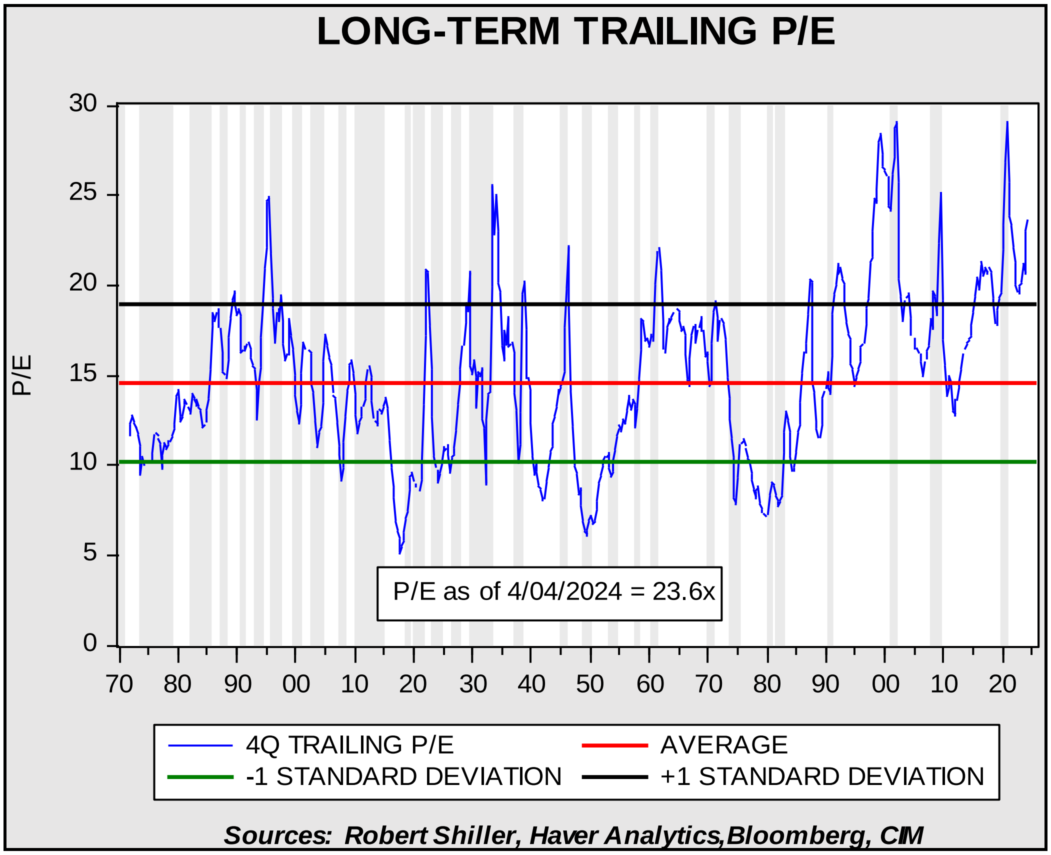


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.