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: February 16, 2024—9:30 AM EST] Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 is up 0.5% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.7%. Chinese markets were closed for the Chinese Lunar New Year. US equity index futures are signaling a higher open.

With 393 companies having reported so far, S&P 500 earnings for Q4 are running at $57.50 per share compared to estimates of $55.15, which is up 1.6% from Q3 2023. Of the companies that have reported thus far, 78.8% have exceeded expectations, while 15.6% 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* (2/12/2024) (with associated podcast): "Thinking About Deterrence."
- *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* (2/5/2024) (with associated podcast): "US Oil Production at a Record High"
- *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 more news of distorting, state-led policies in China and how they are affecting investors. We next review a range of other international and US developments with the potential to affect the financial markets today, including new moves by Australia to subsidize its nickel miners, indications the European Union is set to subsidize its defense companies, and new research showing US companies still aren't hiring many more applicants without college degrees, despite today's labor shortages.

China: After years of excess investment and debt financing for housing construction, the Chinese Communist Party is reportedly developing a plan for the government to take over swaths of China's residential real estate and convert it to subsidized low-income housing. Such a plan would be in sync with General Secretary Xi's desire for the Communist Party and the government to have more control over the economy, but it's not clear how those entities would get control over the assets currently owned by private developers.

- Separately, investors continue to step back from Chinese assets as they increasingly realize the economic and financial market headwinds arising from Xi's statist policies and other structural challenges.
- All the same, some investors are looking for ways to keep some indirect exposure to China so they can take advantage of any rebound in its economy. New research suggests that one way investors are trying to do that is by buying shares in European luxury goods companies, which get more than one-quarter of their profits from China on average.

India: Despite government efforts to stop them, thousands of farmers continue to march on the capital of New Delhi to demand minimum crop prices and debt service moratoria. The continued protests are increasing the political risk for Prime Minister Modi, who currently leads the opinion polls ahead of the national elections scheduled in the coming weeks.

Australia: The government has formally designated nickel as a "critical" commodity, making the nickel industry eligible for support from a $3.9-billion stimulus fund and for other steps to protect it from the current glut of low-cost Indonesian nickel. Australian nickel miners have also been struggling with the price-deflating impact of softening demand for electric vehicles since nickel is a key component of many EV batteries.

United Kingdom: The Conservative Party of Prime Minister Sunak yesterday lost two parliamentary by-elections. Adding to the pain for the Conservatives, both seats had been considered safe. The results highlight the continuing unpopularity of the Conservatives, who continue to trail the resurgent Labour Party ahead of elections expected this autumn.

European Union: In an interview with the *Financial Times* yesterday, European Commission President von der Leyen threw her support behind the idea of having Brussels subsidize European defense companies to help them boost their productive capacity in the face of rising threats from Russia and beyond. As we've been arguing, increasing geopolitical tensions look set to spark a long-lasting rise in Western defense budgets, creating greater opportunities in Western defense-industry firms, as well as tech or other firms with a lot of defense business.

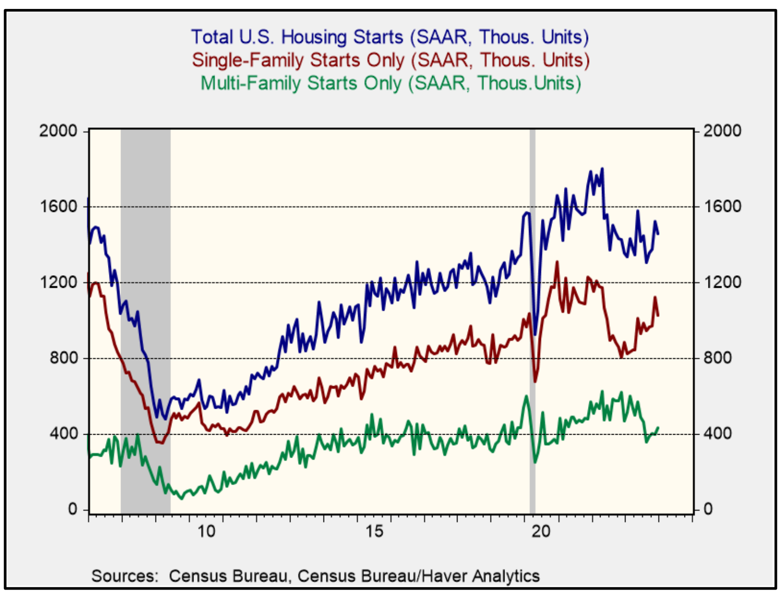
Russia: Officials today said anticorruption campaigner and opposition leader Alexei Navalny died in the Siberian prison where the government of President Putin had been holding him. The authorities claim the cause of death hasn't yet been determined. However, given the convenient timing of Navalny's death, right before Putin faces the next presidential election in mid-March, it would not be surprising if Putin finally decided he couldn't accept the risk of having a gadfly like Navalny around. Navalny's death will likely exacerbate Russian tensions with the West.

United States-Russia: The White House [confirmed yesterday that it has "troubling" intelligence showing that Russia is developing an advanced anti-satellite weapon], as flagged a day earlier in a message to Congress from the chair of the House Intelligence Committee. As we reported in our *Comment* yesterday, the weapon appears to be nuclear in nature, so it could signal that Russia is preparing to break out of an international treaty banning the deployment of nuclear weapons in space. In any case, the new weapon will further raise US-Russian tensions.

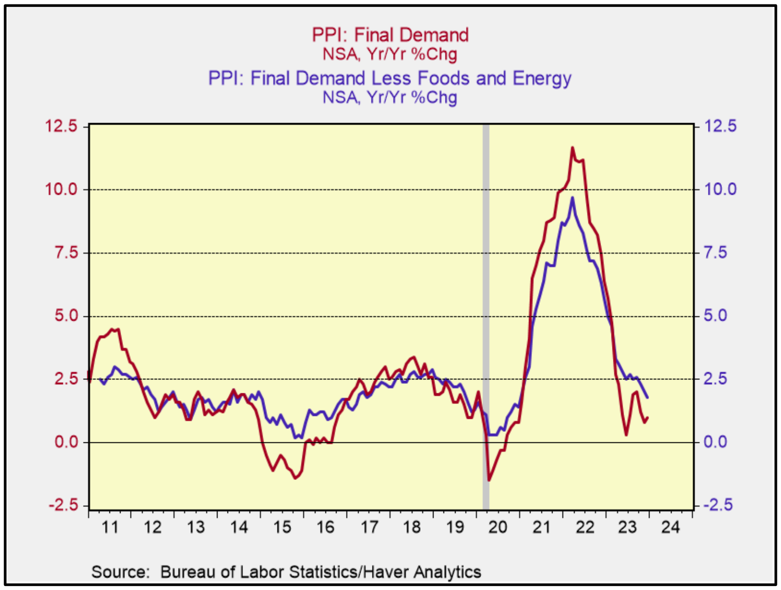
US Labor Market: Despite today's labor shortages and companies' insistence that they are trying to loosen hiring requirements for college degrees, new research [shows that even when those requirements are lifted, companies don't hire many more non-degreed workers]. The research suggests several factors are limiting the progress, from automated screening tools that favor college graduates to the difficulty of changing hiring managers' beliefs about the value of a degree.

US Economic Releases

January ***housing starts*** rose to a seasonally adjusted, annualized rate of 1.331 million units, which was shy of the expected rate of 1.46 million units and the revised prior-month figure of 1.562 million. The rate of housing starts in January declined 14.8% from the rate in the previous month. January ***residential building permits*** also declined to a rate of 1.47 million units, again shy of the anticipated rate of 1.512 million units and the revised 1.493 million in December. This amounts to a 1.5% decline from the previous month. The chart below shows the growth in new home starts by type of property since just before the Great Financial Crisis.



The January ***producer price index (PPI)*** rose by a seasonally adjusted 0.3%, which significantly exceeded the expected 0.1% increase and the revised flat performance in December. Excluding the volatile food and energy components, the January ***"core" PPI*** rose 0.5%, also significantly in excess of its expected 0.1% increase and the previous month's revised decline of 0.1%. The overall PPI in January was up 0.9% from the same month one year earlier, while the core PPI was up 2.0%. The chart below shows the year-over-year change in the PPI and the core PPI over the last decade or so.



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	Feb P	80.0	79.0	***
10:00	U. of Michigan Current Conditions	m/m	Feb P	82.5	81.9	**
10:00	U. of Michigan Future Expectations	m/m	Feb P	77.0	77.1	**
10:00	U. of Michigan 1-Year Inflation Expectation	m/m	Feb P	2.9%	2.9%	*
10:00	U. of Michigan 5-10 Year Inflation Expectation	m/m	Feb P	2.8%	2.9%	*
Federal Reserve						
EST	**Speaker or Event**	**District or Position**				
9:10	Michael Barr Speaks on Bank Supervision	Federal Reserve Board Vice Chair for Supervision				
12:10	Mary Daly Speaks at NABE Conference	President of the Federal Reserve Bank of San Francisco				

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	9-Feb	¥621.3b	¥308.4b	¥308.2b	*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	9-Feb	¥1499.3b	¥456.6b	¥456.7b	*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	9-Feb	¥175.9b	¥394.4b	¥397.7b	*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	9-Feb	¥22.1b	-¥194.7b	-¥194.5b	*	Equity and bond neutral
	Tertiary Industry Index MoM	m/m	Dec	0.7%	-0.7%	-1.4%	**	Equity bullish, bond bearish
New Zealand	BusinessNZ Manufacturing PMI	m/m	Jan	47.3	43.1	43.4	***	Equity bullish, bond bearish
South Korea	Export Price Index	y/y	Jan	3.7%	-2.3%	-2.4%	*	Equity bullish, bond bearish
	Import Price Index	y/y	Jan	0.2%	-4.1%	-4.0%	*	Equity and bond neutral
	Unemployment Rate	m/m	Jan	3.0%	3.3%	3.2%	**	Equity and bond neutral
EUROPE								
France	CPI, EU Harmonized	y/y	Jan F	3.4%	3.4%	3.4%	**	Equity and bond neutral
	CPI	y/y	Jan F	3.1%	3.1%	3.1%	***	Equity and bond neutral
UK	Retail Sales	y/y	Jan	0.7%	-2.4%	-1.6%	***	Equity bullish, bond bearish
	Retail Sales Ex-Auto Fuel	y/y	Jan	0.7%	-2.1%	-1.5%	**	Equity bullish, bond bearish
Switzerland	Industrial Output WDA	y/y	4Q	-0.4%	2.0%	1.8%	*	Equity bearish, bond bullish
Russia	Money Supply, Narrow Definition	w/w	9-Feb	18.02t	18.01t		*	Equity and bond neutral
AMERICAS								
Canada	Housing Starts	m/m	Jan	223.6k%	249.3k	249.0k%	**	Equity and bond neutral
Canada	Manufacturing Sales	m/m	Dec	-0.7%	1.2%	1.5%	**	Equity bearish, bond bullish
Brazil	FGV Inflation IGP-10	y/y	Feb	-0.65%	0.42%	-0.43%	**	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	557	2	Down
3-mo T-bill yield (bps)	520	522	-2	Up
U.S. Sibor/OIS spread (bps)	532	532	0	Down
U.S. Libor/OIS spread (bps)	533	533	0	Down
10-yr T-note (%)	4.27	4.23	0.04	Up
Euribor/OIS spread (bps)	392	392	0	Down
Currencies	**Direction**			
Dollar	Flat			Flat
Euro	Flat			Down
Yen	Down			Up
Pound	Down			Up
Franc	Down			Up
Central Bank Action	**Current**	**Prior**	**Expected**	
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.

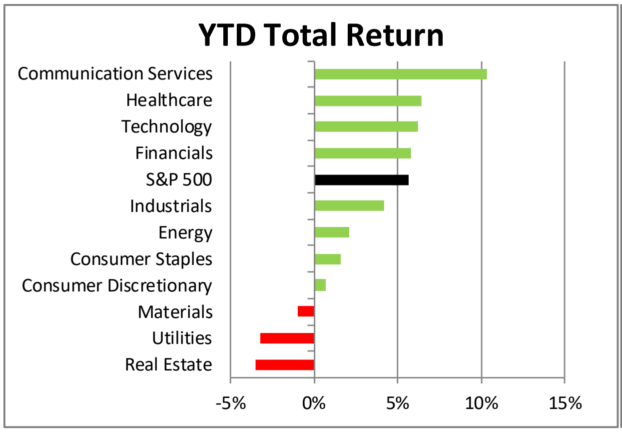
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$82.10	$82.86	-0.92%	
WTI	$77.40	$78.03	-0.81%	
Natural Gas	$1.58	$1.58	0.19%	
Crack Spread	$25.22	$26.08	-3.32%	
12-mo strip crack	$25.41	$25.91	-1.95%	
Ethanol rack	$1.65	$1.66	-0.37%	
Metals				
Gold	$2,006.34	$2,004.40	0.10%	
Silver	$22.98	$22.92	0.25%	
Copper contract	$380.45	$375.80	1.24%	
Grains				
Corn contract	$430.25	$429.75	0.12%	
Wheat contract	$562.00	$567.25	-0.93%	
Soybeans contract	$1,169.00	$1,166.00	0.26%	
Shipping				
Baltic Dry Freight	1,581	1,582	-1	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	12.0	3.4	8.7	
Gasoline (mb)	-3.7	-1.6	-2.1	
Distillates (mb)	-1.9	-1.7	-0.3	
Refinery run rates (%)	-1.8%	0.1%	-1.9%	
Natural gas (bcf)	-49	-66	17	

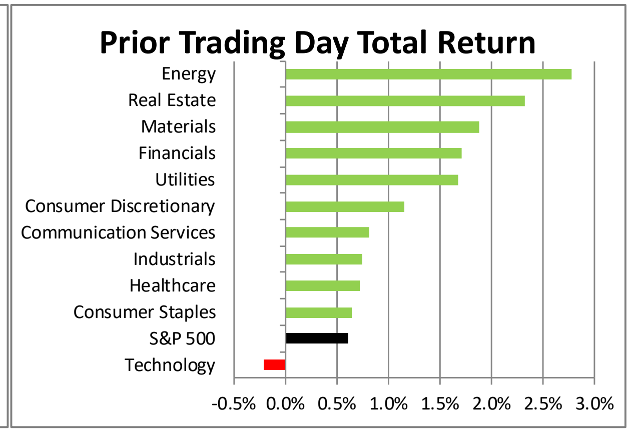
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures from the eastern slopes of the Rocky Mountains to the western slopes of the Appalachians, while there is a chance for unseasonably cool temperatures in southern California and Florida. Meanwhile, New England and the Pacific Northwest should expect wetter-than-normal conditions, while southern Florida and the Texas gulf coast are forecast to have dry weather.

Data Section

US Equity Markets – (as of 2/15/2024 close)

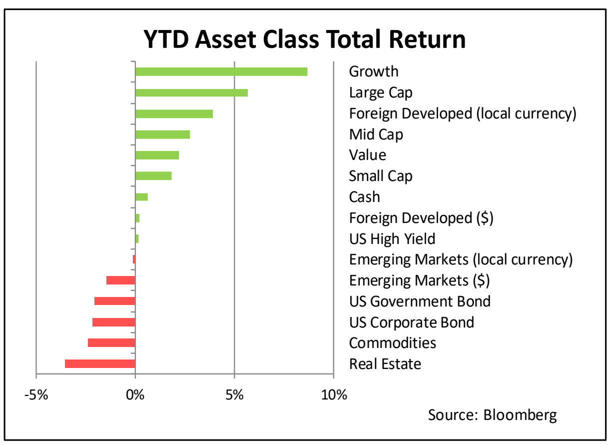




(Source: Bloomberg)

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 2/15/2024 close)

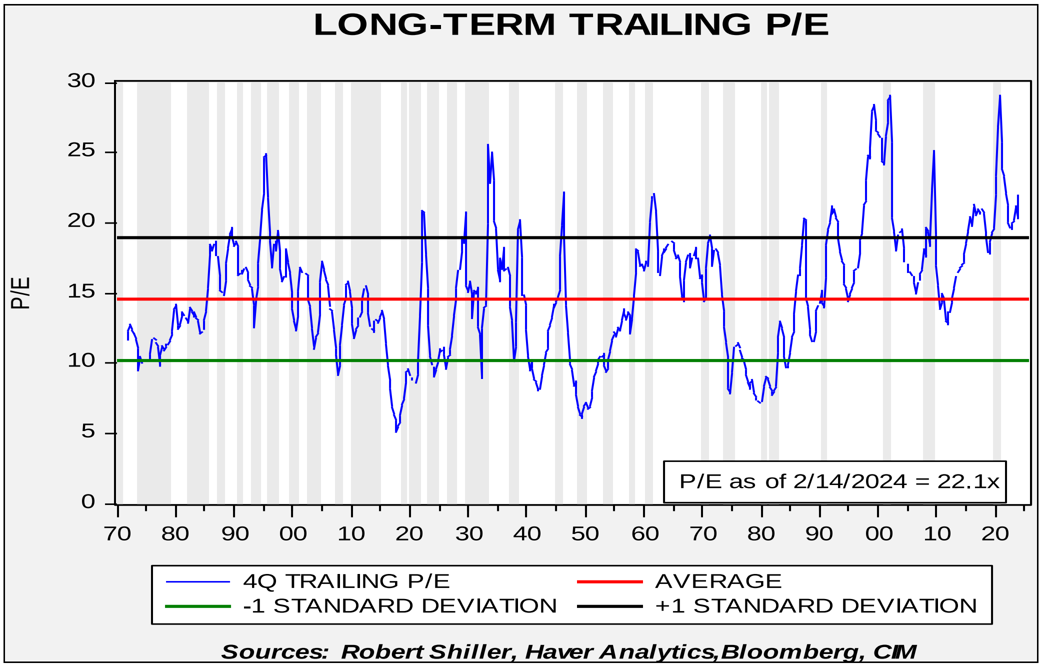


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

February 15, 2024



Based on our methodology,[1] the current P/E is 22.1x, down 0.1x from our last report. The modest decline in the multiple reflects improved 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 (Q1, Q2 and Q3) and one estimate (Q4). 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.