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 27, 2024—9:30 AM EST] Global equity markets are higher 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 up 0.2%. Chinese markets were higher, with the Shanghai Composite up 1.3% from its previous close and the Shenzhen Composites up 2.4%. U.S. equity index futures are signaling a higher open.

With 453 companies having reported so far, S&P 500 earnings for Q4 are running at $57.90 per share compared to estimates of $55.15, which is up 1.6% from Q3 2023. Of the companies that have reported thus far, 76.8% have exceeded expectations, while 17.5% 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*** **(2/26/2024) (with associated podcast): "Posen vs. Pettis"**
- *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* (2/20/2024) (with associated podcast): "Who Wants US Treasurys?"
- *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 an assertion from French President Macron that European leaders have discussed sending Western ground troops to Ukraine to help rebuff Russia's invasion of that country. We next review a range of other international and US developments with the potential to affect the financial markets today, including a disappointing corporate governance reform in South Korea and an important new antitrust lawsuit in the US.

Russia-Ukraine War: As Europe's defense industry struggles to expand output enough to support the rebuilding of the Continent's defenses and help Ukraine fend off Russia's invasion, and as European leaders mull the prospect that the US might renege on its NATO mutual defense obligations, French President Macron said European leaders met yesterday to discuss sending Western troops to help the Ukrainians. Macron said there was no consensus to send troops "in an official manner," but he insisted all options must remain on the table.

- French support for the Ukrainians has so far been more about words than deeds, and Macron has often seemed to put European and French industrial interests ahead of Ukraine's needs. The shift in his rhetoric after yesterday's meeting was therefore notable. Not only did Macron say that defeating Russia is essential to Western Europe's security, but he acquiesced to Europe buying ammunition and equipment outside the region if necessary.
- Macron has long championed the idea that the countries of Western Europe should develop their own independent defense capability. Seeing Europe's faltering defense industrial effort and slow military rebuilding, Macron may have sensed an opportunity for France to take the political lead on the Continent. The proof will be whether France now takes concrete steps to boost the European defense effort and provide more aid to Ukraine.
- In any case, Macron's statement about potentially sending Western troops to Ukraine has already sparked pushback from some corners of Europe, particularly Germany. Today, Germany's Vice-Chancellor Habeck said there was "no chance" that Germany would send ground troops to Ukraine and noted things would be better if France would just send more weapons.

Sweden-North Atlantic Treaty Organization: The Hungarian parliament yesterday gave final approval for Sweden to become the 32nd member of NATO, providing the required unanimous consent of all current members and setting the stage for Sweden to formally join the alliance later this week. The accession of Sweden into NATO is expected to strengthen the alliance's northern flank and help transform the Baltic Sea into a NATO lake. That could help contain any Russian territorial aggression in the area, bolstering both European and US security.

China: It now appears that measures by Chinese authorities have successfully arrested the fall in the renminbi (CNY) this year. The measures, such as delaying short-term interest rate cuts, have put a floor under the currency at around 7.2 per dollar. The currency is still depreciating slowly, but not nearly as fast as in the first three weeks of the year.

Global Corporate Governance: In a survey of business leaders across the Group of 20 major countries, three-quarters of respondents said the pressure to cut carbon emissions and invest in green energy is coming mostly from their own board of directors, rather than from regulators or customers. Some 30% of the business leaders said the board pressure was "extreme," while 47% said the pressure was "significant."

- The survey results suggest the drive to transition to green energy is now deeply embedded in the viewpoint of those top investors, corporate leaders, academics, and former officials who make up so much of today's corporate boards.

- All the same, with many consumers, farmers, and workers now starting to push back against the green-energy drive in many countries, it would appear that corporate directors pushing green policies could eventually face resistance in board elections, potentially creating disruption in some firms' corporate governance.

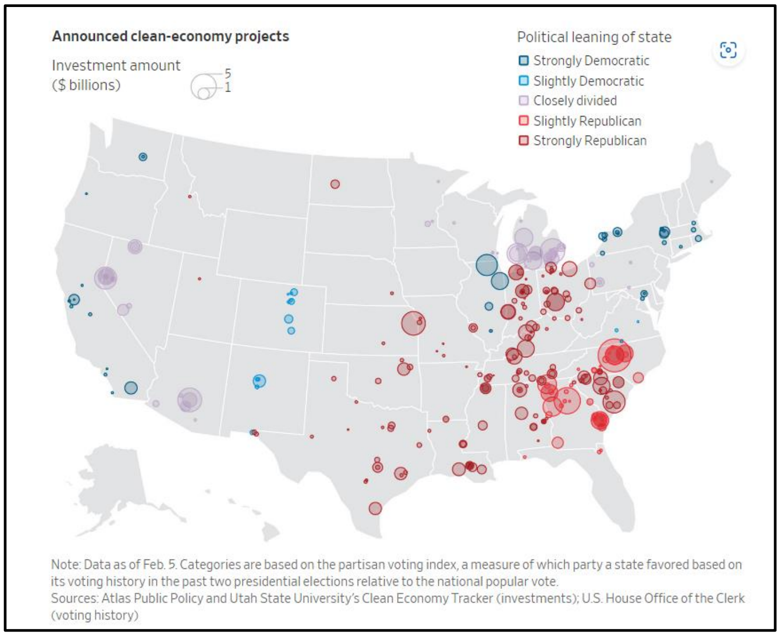
South Korean Corporate Governance: The government has released highlights of its plan to boost Korea's perennially low stock valuations. However, the "Corporate Value Up Program" was quickly panned as too weak, as it relies mostly on naming and shaming companies that don't improve their governance. One key problem is that the plan doesn't include specific incentives for firms to reform their corporate structures to better protect small shareholders vis-á-vis large, controlling shareholders (who are often the company's founding family).

- The Korean program was inspired by Japan's corporate governance reforms under former Prime Minister Abe about a decade ago. Those reforms are considered one reason why Japanese stock values finally began to rally in recent years and finally reached new record highs in recent days, after decades of lethargic performance.
- The government said it plans to release a more detailed version of the plan in June. Nevertheless, disappointment over the initial release helped drive Korean stocks lower yesterday.

UK Antitrust Policy: The Competition and Markets Authority has opened an investigation into possible illegal information sharing among eight British homebuilders. With Britain facing a major housing shortage, homebuilders have come under fire for limiting their development efforts to projects where demand is high enough that they can build on spec and be assured of making high profits. The new probe probably raises the regulatory risk for British homebuilders going forward.

US Antitrust Policy: Yesterday, the Federal Trade Commission sued to block the proposed merger between grocery chains Kroger and Albertsons. According to the FTC, the merger would lead to higher prices for US consumers and lower wages for the firms' workers. The FTC suit reflects the Biden administration's effort to crack down on industry consolidation, but that effort has often run up against the prevailing "Bork Standard," which requires a higher level of consumer harm before a merger can be blocked.

US Industrial Policy: The *Wall Street Journal* carries an article today showing that the boom in US green-energy manufacturing and mining, partially touched off by the Biden administration's industrial policy, is channeling the most investment into Republican-leaning regions of the country. While Biden may be hoping that he'll get credit from the new investment and gain politically in those areas, it seems just as likely that he won't get much credit and will continue to struggle in public opinion polls because of public anger over consumer price inflation.



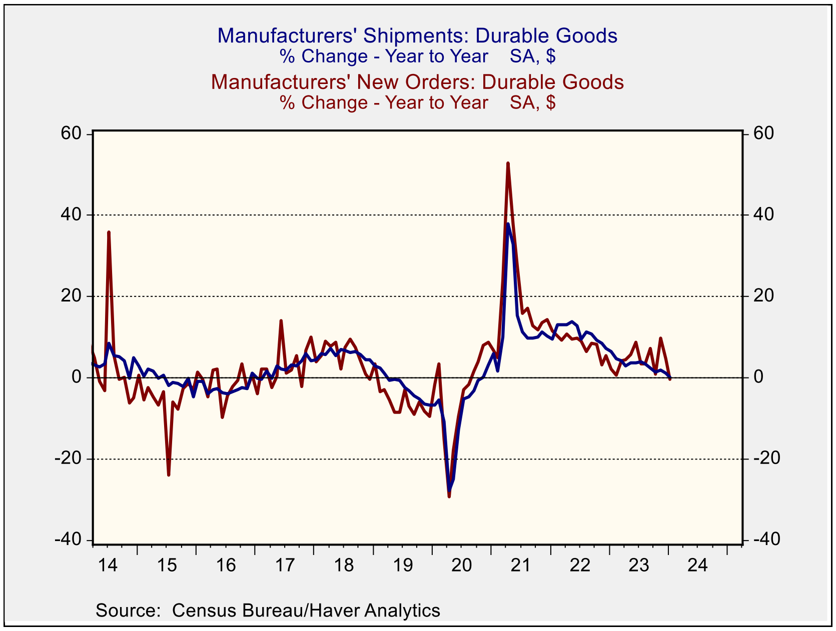
(Source: Wall Street Journal*)*

US Politics: Michigan holds its presidential primary elections today, in which former President Trump is expected to again trounce former UN Ambassador Haley on the Republican side. Nevertheless, Haley remains defiant and has insisted she will stay in the race at least through Super Tuesday next month.

- Both Trump and President Biden face age, popularity, and other issues that could conceivably undercut them or force one or both off the ballot before November.
- Therefore, Haley may be positioning herself to inherit the Republican mantle or even pursue a third-party or independent candidacy.

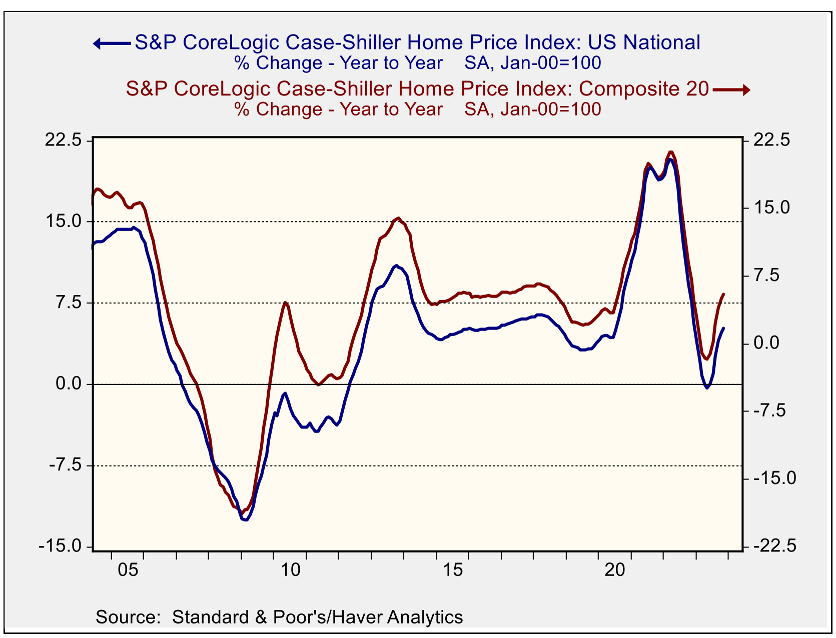
US Economic Releases

New orders for manufactured US durable goods showed signs of weakness in January. The US Census Bureau reported a 6.1% drop in orders last month, exceeding the predicted 5% decline. This decrease was mainly caused by lower demand for vehicles and planes. Excluding transportation, durable goods orders fell 0.3%, worse than the expected 0.2% increase. Nondefense capital goods orders, which is a proxy for business investment, rose modestly by 0.1% in January, while shipments rose 0.8%.



The chart above shows the annual change in durable goods orders and shipments. New orders are relatively unchanged from the previous year, while shipments are down 0.6%.

Despite elevated interest rates, home prices continue to show that demand remains high relative to available supply. According to an index tracked by the Federal Housing Finance Agency, home prices rose 1.5% in the final quarter of the year and 0.1% in the final month. Meanwhile, data privately collected by S&P Global, showed that December home prices increased 0.2% both nationally and in the top 20 cities.



The chart above shows the year-over-year change in the S&P CoreLogic Home Price Index for the country and top-20 cities. Nationally, home prices rose 5.8% from the prior year, while major city home prices rose 6.1%.

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	Richmond Fed Manufact. Index	m/m	Feb	-9	-15	***
10:00	Conf. Board Consumer Confidence	m/m	Feb	115	114.8	*
Federal Reserve						
EST	Speaker or Event	District or Position				
9:05	Michael Barr Speaks on Counterparty Credit Risk	Federal Reserve Board Vice Chair for Supervision				

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	National CPI	y/y	Jan	2.2%	2.6%	1.9%	***	Equity and bond neutral
	National CPI Ex-Fresh Food	y/y	Jan	2.0%	2.3%	1.8%	**	Equity and bond neutral
	National CPI Ex-Fresh Food & Energy	y/y	Jan	3.5%	3.7%	3.3%	*	Equity and bond neutral
South Korea	Depart. Store Sales	y/y	Jan	0.7%	5.9%		*	Equity and bond neutral
	Discount Store Sales	y/y	Jan	-9.2%	-1.2%		*	Equity and bond neutral
	Retail Sales	y/y	Jan	8.2%	7.5%		**	Equity and bond neutral
EUROPE								
Eurozone	M3 Money Supply	y/y	Jan	1.0%	0.1%	0.2%	***	Equity and bond neutral
Germany	GfK Consumer Confidence	m/m	Mar	-29.0	-29.7	-29.6	**	Equity and bond neutral
France	Consumer Confidence	m/m	Feb	89.0	91.0	92.0	**	Equity and bond neutral
AMERICAS								
Mexico	Trade Balance	m/m	Jan	-4314.7m	4242.4m	-2390.0m	**	Equity and bond neutral
Brazil	IBGE Inflation IPCA - 15	y/y	Feb	4.49%	4.47%	4.53%	*	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	Down
3-mo T-bill yield (bps)	519	523	-4	Down
U.S. Sibor/OIS spread (bps)	534	534	0	Down
U.S. Libor/OIS spread (bps)	535	535	0	Down
10-yr T-note (%)	4.27	4.28	-0.01	Down
Euribor/OIS spread (bps)	395	393	2	Up
Currencies	**Direction**			
Dollar	Down			Up
Euro	Up			Down
Yen	Up			Down
Pound	Flat			Up
Franc	Up			Up

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.

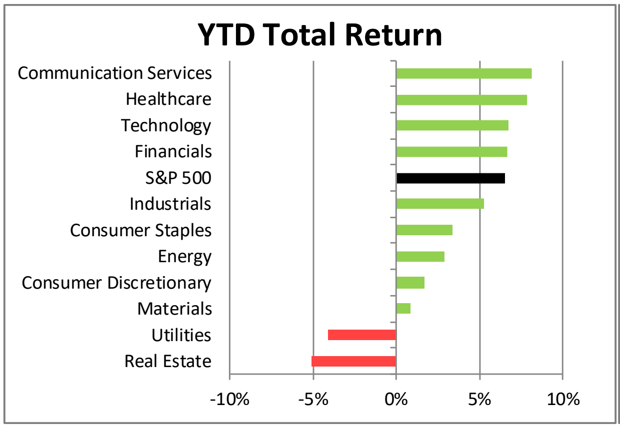
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$82.34	$82.53	-0.23%	
WTI	$77.45	$77.58	-0.17%	
Natural Gas	$1.60	$1.66	-3.62%	
Crack Spread	$32.20	$32.18	0.05%	
12-mo strip crack	$25.29	$25.27	0.07%	
Ethanol rack	$1.63	$1.63	-0.26%	
Metals				
Gold	$2,037.63	$2,031.24	0.31%	
Silver	$22.67	$22.52	0.65%	
Copper contract	$385.50	$383.45	0.53%	
Grains				
Corn contract	$421.50	$421.50	0.00%	
Wheat contract	$573.50	$574.75	-0.22%	
Soybeans contract	$1,155.25	$1,145.25	0.87%	
Shipping				
Baltic Dry Freight	1,871	1,866	5	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		3.7		
Gasoline (mb)		-3.0		
Distillates (mb)		-2.0		
Refinery run rates (%)		0.5%		
Natural gas (bcf)		-59		

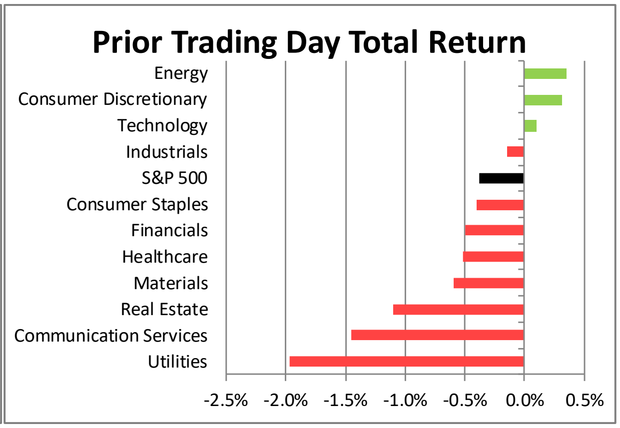
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures east of the Great Plains, with cooler temperatures in the Pacific region. The precipitation outlook calls for wetter-than-normal conditions for most of the country, with dry conditions in the Rocky Mountain region.

Data Section

US Equity Markets – (as of 2/26/2024 close)

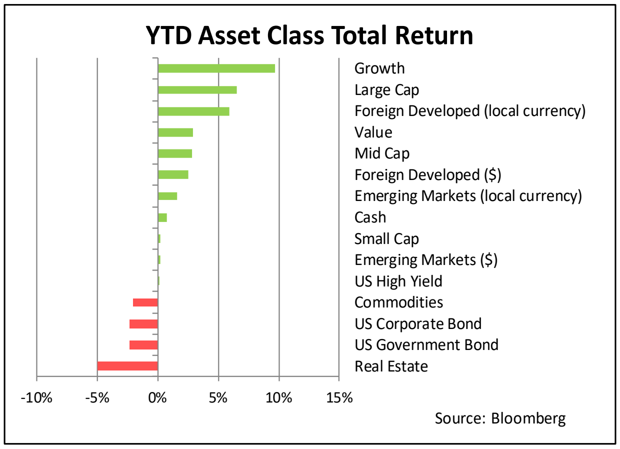




(Source: Bloomberg)

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 2/26/2024 close)

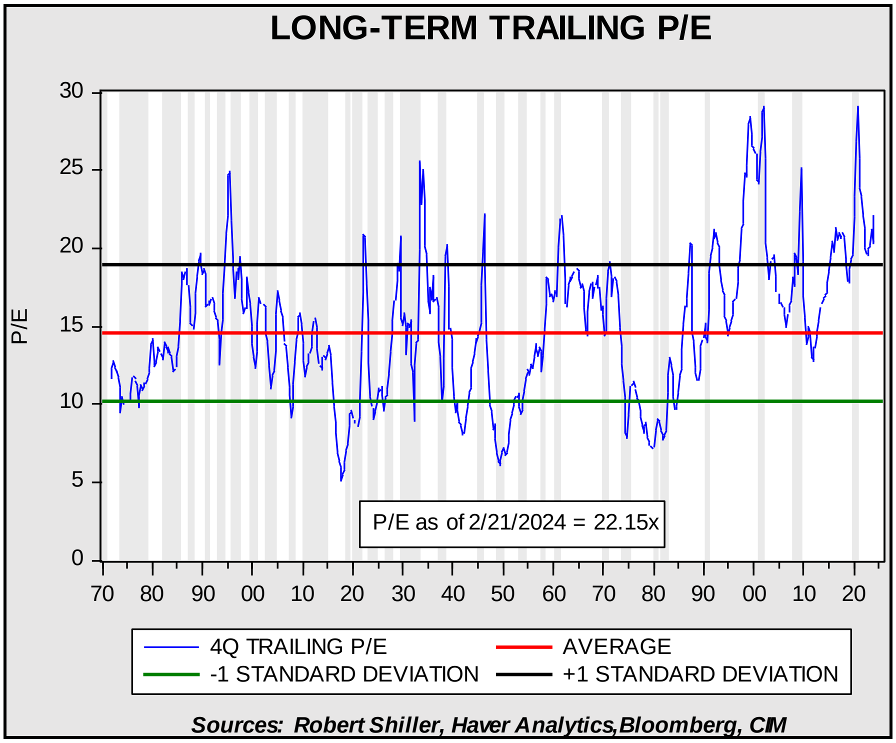


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 22, 2024



Based on our methodology,[1] the current P/E is 22.15x, up 0.05x from our last report. The modest improvement in the multiple reflects a slight increase 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 (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.