

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 29, 2024—9:30 AM EST]** Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is down 0.1% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.4%. Chinese markets were higher, with the Shanghai Composite up 1.9% from its previous close and the Shenzhen Composites up 3.4%. U.S. equity index futures are signaling a lower open.

With 480 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, 80.7% have exceeded expectations, while 14.6% have fallen short of expectations.

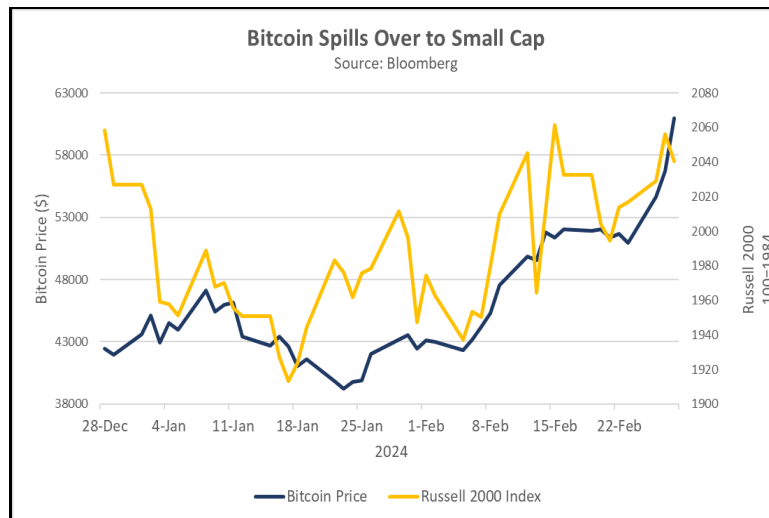
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our [website](#). We highlight recent publications below, with new items of the day emphasized in bold:

- **[Bi-Weekly Geopolitical Report](#)** (2/26/2024) (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 Treasuries?”
- **[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! It’s been a positive start for equities as inflation data meets expectations. Meanwhile, Dallas Mavericks' star Luka Dončić celebrated his 25th birthday with a triple-double. Today’s *Comment* dives into three key topics: the impact of bitcoin on small indexes, the possibility of a June rate cut by the Federal Reserve and European Central Bank, and the ongoing influence of the war in Ukraine on defense and aerospace companies. As always, the report concludes with a summary of international and domestic data releases.

**Crypto Powers Small Cap Growth:** Fueled by bitcoin's rally, the Russell 2000 Index has surged as investors seek growth opportunities beyond the established large-cap tech stocks.

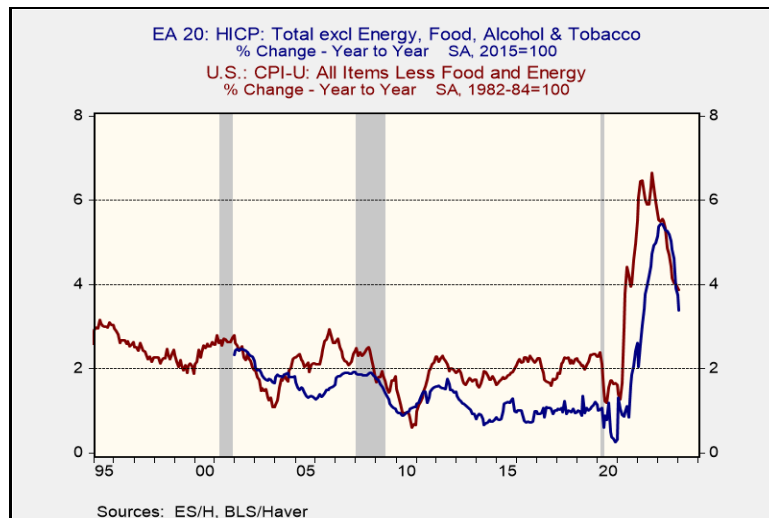
- The combined market cap of cryptocurrency [hit a record of \\$2 trillion](#) earlier this week, fueled by the recent surge in popularity for bitcoin ETFs. Additionally, bitcoin surpassed \$60,000 for the first time since November 2021. This rise [followed the launch of Grayscale Bitcoin Trust last month](#) and was further bolstered by several subsequent ETF launches, which are now attracting record inflows. Retail investors have been the primary driver of this popularity, eager to capitalize on bitcoin's momentum. However, [concerns are rising as early signs suggest leverage may be re-entering the market](#), potentially increasing volatility.
- Bitcoin's surge has boosted small-cap stocks, particularly those with bitcoin exposure like MicroStrategy, Riot Platforms, and Marathon Digital Holdings. This shift may signal that investors are diversifying away from the AI craze that dominated the early part of the year. The Russell 2000 outpaced the S&P 500 over the last week, rising 2.2% compared to 1.7%. However, mirroring its large-cap counterpart, gains remain concentrated in a handful of companies. MicroStrategy fueled much of this growth, rising an impressive 43% and outperforming even media favorite Nvidia, which rose 15% in the same period.



- While current fundamentals raise concerns about the sustainability of this trend, it may reflect a broader shift as the business cycle nears maturity. The Russell 2000's P/E ratio has soared from just above 30 to over 74 in just a week, highlighting the increasingly optimistic (but potentially risky) behavior of investors seeking growth opportunities in small-cap stocks. Historically, late-cycle expansions witness a transition from large-cap value to large-cap growth, followed by a shift into small-cap growth. If this pattern holds, investors' growing risk tolerance could signal the need for portfolio caution. We remain optimistic but maintain vigilance for potential sentiment shifts.

**June a Possibility?** Policymakers in Europe and the US have unequivocally rejected the possibility of an interest rate cut this spring but have signaled the potential for a cut this summer.

- The Federal Open Market Committee (FOMC) signaled that interest rate cuts are likely this year, though the pace of easing will be less aggressive than in previous cycles. While a baseline scenario is three cuts, [New York Fed President John Williams emphasized that economic data will guide the ultimate decision](#). [Atlanta and Boston Fed Presidents Raphael Bostic and Susan Collins also support rate cuts](#), with a potential start as early as June. This hesitancy comes in response to strong employment data and a hot January CPI report, fueling concerns that the Fed's fight against inflation is far from over.
- European policymakers remain committed to using economic data to guide interest rate decisions, but some are signaling a potential rate cut by summer. Members of the European Central Bank's Governing Council, [Gediminas Šimkus](#) and [Peter Kažimír](#), have warned that premature cuts could harm efforts to control inflation and have urged patience. However, Kažimír also expressed concern about Europe's declining competitiveness and suggested that low-interest rates alone may not be enough to avert economic hardship. This concern is underscored by the euro area's narrow avoidance of a technical recession in Q4, where output remained unchanged from the previous quarter. This stagnation may prompt policymakers to consider policy accommodation.



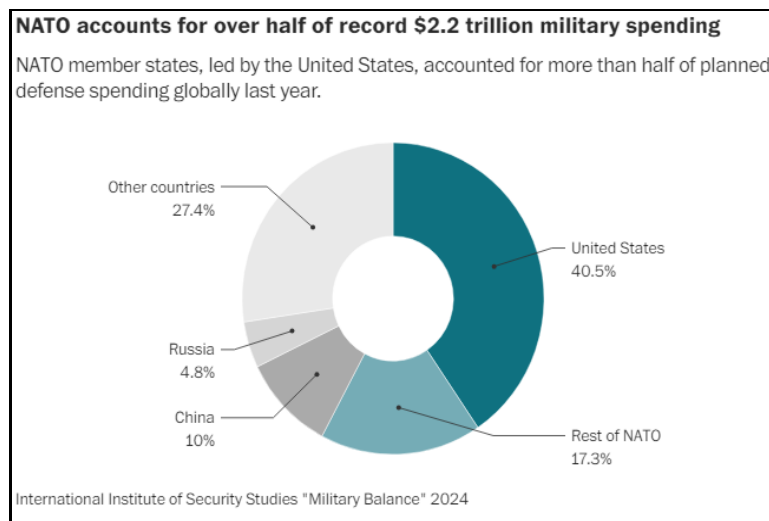
- [Market expectations of a June rate cut seem largely accurate](#); however, the size remains uncertain. US policymakers have expressed concerns about reducing the size of the cut due to persistent economic growth and lingering inflationary pressures. Therefore, while the three cuts outlined in the latest projections are still likely, a smaller, Greenspan-style 50 basis point “maintenance” cut is also a possibility. Europe, on the other hand, may take a slightly more aggressive approach than the US to mitigate a worsening downturn. Consequently, a 100 bps rate reduction before year-end should not be ruled out.

**Ukraine on the Brink?** Russia's perceived military success in Ukraine is raising concerns about the potential for escalation into a wider European conflict.

- Russian President Vladimir Putin issued a stark warning, [cautioning that direct Western intervention in the Ukraine conflict could escalate into a nuclear confrontation](#). His statement follows recent remarks by French President Emmanuel Macron, who

acknowledged discussions within [NATO regarding potential troop deployment to support Ukrainian efforts](#). Despite Western officials firmly rejecting the possibility of direct NATO involvement in the war, Putin's comments suggest that he is taking the perceived threat seriously, especially as [Ukraine struggles to maintain its war efforts amid dwindling resources](#) while it waits for additional aid from the West.

- Putin's menacing rhetoric regarding nuclear warfare has surged in prominence as nations scramble to stymie Russian aggression, particularly in light of its potential spillover beyond Ukraine. Recently, US officials issued cautionary alerts, suggesting Moscow's contemplation of deploying anti-satellite nuclear weaponry within the year. President Biden has conceded that such a [launch wouldn't directly imperil human lives](#); however, security [experts fear that the launch may risk an accidental explosion in space](#). Nevertheless, this development further highlights the intensifying military competition between Western powers and their adversaries, likely contributing to the record-breaking [global military spending witnessed in 2023](#).



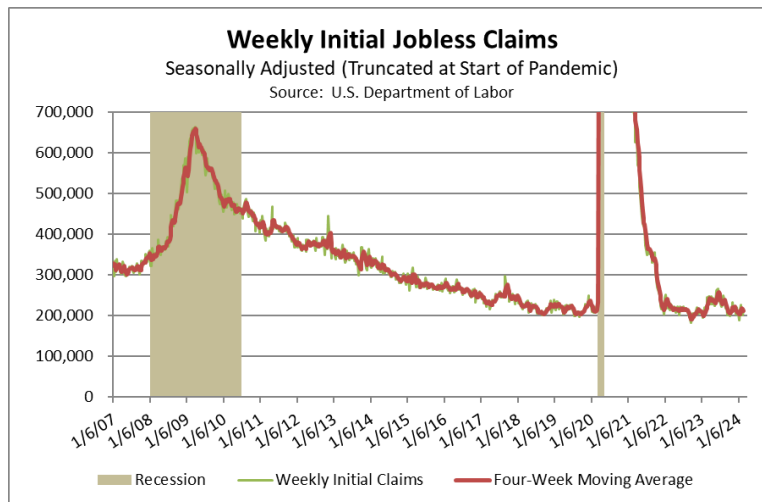
(Source: *Washington Post*)

- Though the threat of nuclear warfare is sadly not new, Putin's repeated threats underscore the increasingly perilous state of global security. Tensions continue to show signs of escalation between the West and its rival. Although a conflict is not imminent, the risk is becoming increasingly elevated. While NATO member states have demonstrated their commitment to developing collective defense capabilities, the specific response of the United States to an attack on its allies remains unclear. That said, the increased military spending should boost revenue for defense and aerospace companies.

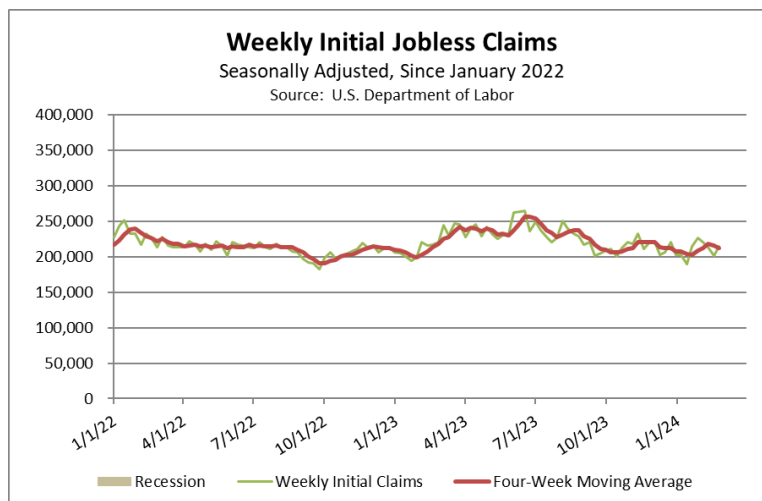
**Other News:** The [House is expected to pass a temporary stopgap bill](#) to avert a government shutdown, highlighting the struggles of a divided Congress to reach consensus on essential legislation. Meanwhile, [the Supreme Court's acceptance of former President Donald Trump's appeal regarding presidential immunity](#), (still likely to lead to an unfavorable ruling) suggests further a delay in a potential trial until after the general election. [Turkish tech stocks have been on a tear this year](#), as investors consider tech stocks in emerging markets.

## US Economic Releases

In the week ended February 24, **initial claims for unemployment benefits** rose to a seasonally adjusted 215,000, above both the expected level of 210,000 and the previous week's revised level of 202,000. Nevertheless, the four-week moving average of initial claims, which helps smooth out some of the volatility in the series, fell to 212,500. Meanwhile, in the week ended February 17, the number of **continuing claims for unemployment benefits** (people continuing to draw benefits) rose to 1.905 million, above the anticipated reading of 1.875 million and the prior week's revised reading of 1.860 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.

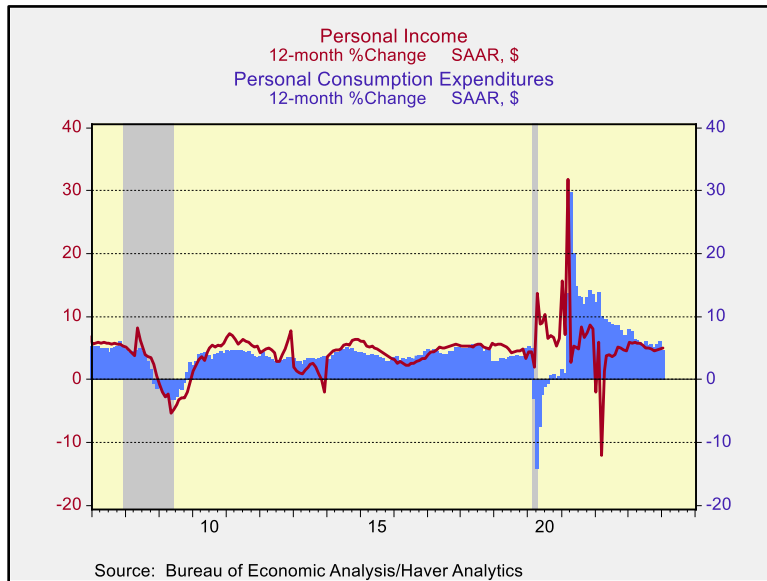


To provide more detail on recent trends, the chart below shows how initial jobless claims have changed just since the beginning of 2022.

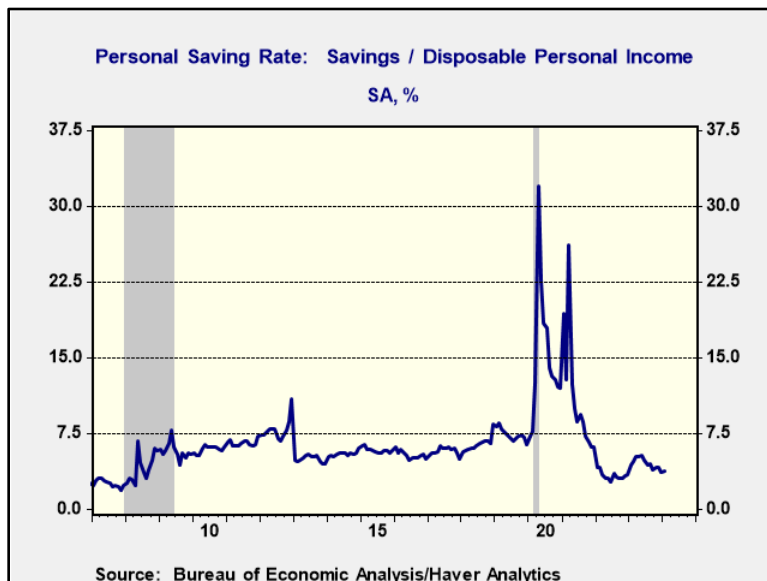


Separately, January **personal income** jumped by a seasonally adjusted 1.0%, more than double the expected rise of 0.4% and more than three times the 0.3% increase in December. Despite the

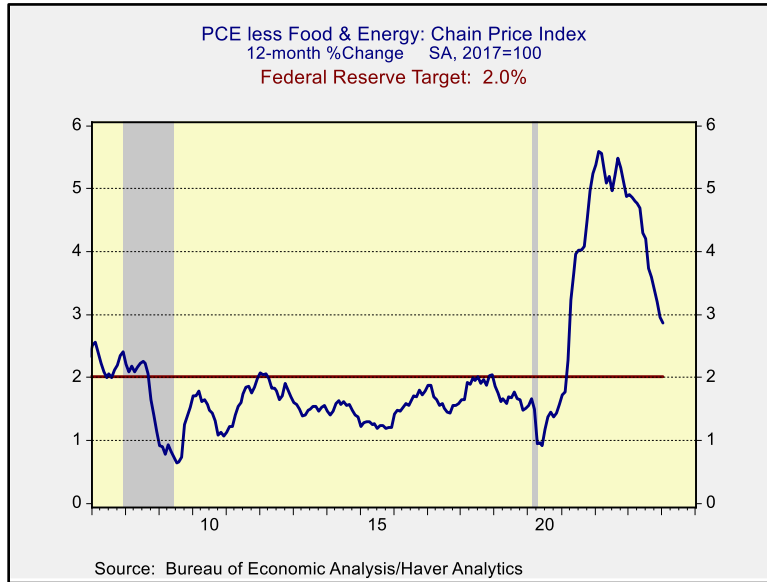
jump in income, however, January *personal consumption expenditures (PCE)* rose just 0.2%, matching expectations but decelerating sharply from the 0.7% gain in December. Personal income in January was up 4.8% from the same month one year earlier, while PCE was up 4.5%. The chart below shows the year-over-year change in personal income and PCE since just before the Great Financial Crisis.



The personal income and spending report also includes a measure of personal saving, defined as disposable (after tax) income less consumption spending on goods and services. With incomes jumping sharply but spending rising more slowly, the January *personal savings rate* rose to a seasonally adjusted 3.8%. The chart below shows how the personal savings rate has fluctuated since just before the GFC.



Finally, the income and spending report includes the Federal Reserve’s preferred measure of consumer price inflation. After stripping out the volatile food and energy components, the January **Core PCE Deflator** was up 2.8% from the same month one year earlier, slowing from the 2.9% rise in the year to December. The chart below shows the year-over-year change in the Core PCE Deflator since just before the GFC.



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	MNI Chicago PMI	m/m	Feb	48	46	***
10:00	Pending Home Sales MoM	m/m	Jan	1.50%	8.30%	**
10:00	Pending Home Sales NSA YoY	m/m	Jan	-4.40%	-1.00%	*
10:00	Kansas City Fed Manf. Activity	m/m	Feb	-2.0	-9.0	*
Federal Reserve						
EST	Speaker or Event	District or Position				
10:50	Raphael Bostic Participates in Fireside Chat	President of Federal Reserve Banks of Atlanta				
11:00	Austan Goolsbee Gives Remarks on Monetary Policy	President of the Federal Reserve Bank of Chicago				
13:15	Loretta Mester Speaks on Financial Stability and Regulation	President of the Federal Reserve Bank of Cleveland				
15:30	Loretta Mester Speaks on to Yahoo Finance	President of the Federal Reserve Bank of Cleveland				
20:10	John Williams Participates in Moderated Discussion	President of the Federal Reserve Bank of New York				

## 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
<b>ASIA-PACIFIC</b>								
<b>Japan</b>	Retail Sales	y/y	Jan	2.3%	2.1%	2.3%	**	Equity and bond neutral
	Depart. Store & Supermarket Sales	y/y	Jan	3.3%	2.5%		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	23-Feb	-¥206.0b	¥382.0b	¥382.5b	*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	23-Feb	-¥257.0b	-¥560.8b	-¥570.9b	*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	23-Feb	-¥19.0b	-¥521.6b	-¥521.1b	*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	23-Feb	¥225.9b	¥359.9b	¥359.7b	*	Equity and bond neutral
	Industrial Production	y/y	Jan P	-1.5%	-1.0%	-1.6%	***	Equity and bond neutral
	Housing Starts	y/y	Jan	-7.5%	-4.0%	-7.8%	**	Equity and bond neutral
	Annualized Housing Starts	y/y	Jan	0.802m%	0.814m	0.810m	*	Equity and bond neutral
<b>Australia</b>	Retail Sales	m/m	Jan	1.10%	-2.70%	-2.10%	***	Equity bullish, bond bearish
	Private Capital Expenditure	y/y	4Q	0.8%	0.6%	0.3%	**	Equity bullish, bond bearish
	Private Sector Credit	y/y	Jan	4.9%	4.8%		**	Equity and bond neutral
<b>New Zealand</b>	ANZ Activity Outlook	m/m	Feb	29.5	25.6		**	Equity and bond neutral
<b>India</b>	GDP	y/y	4Q	8.4%	7.6%	8.1%	*	Equity and bond neutral
<b>EUROPE</b>								
<b>Germany</b>	Retail Sales	y/y	Jan	-1.6%	-1.6%	-3.4%	*	Equity bullish, bond bearish
	Unemployment Change	m/m	Feb	11.0k	-2.0k	1.0k	***	Equity bearish, bond bullish
	Unemployment Claims Rate	m/m	Feb	5.9%	5.8%	5.8%	**	Equity and bond neutral
	CPI	y/y	Feb P	2.5%	2.9%	2.6%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Feb P	2.7%	3.1%	2.7%	**	Equity and bond neutral
<b>France</b>	CPI, EU Harmonized	y/y	Feb P	3.1%	3.4%	3.1%	**	Equity and bond neutral
	CPI	y/y	Feb P	2.9%	3.1%	2.8%	***	Equity and bond neutral
	GDP	y/y	4Q F	0.7%	0.7%	0.7%	**	Equity and bond neutral
	PPI	y/y	Jan	-5.1%	-0.9%	-1.3%	*	Equity bullish, bond bearish
	Consumer Spending	y/y	Jan	-0.7	1.3	1.2	*	Equity bearish, bond bullish
<b>Italy</b>	Industrial Sales WDA	y/y	Dec	-0.1%	-3.4%		*	Equity and bond neutral
<b>UK</b>	Mortgage Approvals	m/m	Jan	55.2k	50.5k	51.5k	**	Equity and bond neutral
<b>Switzerland</b>	KOF Leading Indicator	m/m	Feb	101.6	101.5	102.5	*	Equity and bond neutral
	GDP	y/y	4Q	0.6	0.3	0.4	**	Equity and bond neutral
<b>Russia</b>	Retail Sales	m/m	Jan	9.1%	10.2%	7.0%	**	Equity bullish, bond bearish
	Unemployment Rate	m/m	Jan	2.9%	3.0%	3.0%	***	Equity and bond neutral
	Industrial Production	y/y	Jan	4.6%	2.7%	4.1%	***	Equity and bond neutral
	Gold and Forex Reserves	m/m	23-Feb	\$582.0b	\$573.8b		***	Equity and bond neutral
<b>AMERICAS</b>								
<b>Canada</b>	Current Account Balance	m/m	4Q	-\$1.62b	-\$3.22b	-\$4.74b	*	Equity and bond neutral
<b>Mexico</b>	Unemployment Rate NSA	m/m	Jan	2.85%	2.61%	2.80%	***	Equity and bond neutral
<b>Brazil</b>	National Unemployment Rate	m/m	Jan	7.6%	7.4%	7.8%	*	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)	560	560	0	Down
3-mo T-bill yield (bps)	521	524	-3	Up
U.S. Sibor/OIS spread (bps)	534	534	0	Down
U.S. Libor/OIS spread (bps)	535	534	1	Down
10-yr T-note (%)	4.31	4.26	0.05	Down
Euribor/OIS spread (bps)	394	395	-1	Down
Currencies	Direction			
Dollar	Flat			Up
Euro	Flat			Down
Yen	Up			Down
Pound	Down			Up
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.

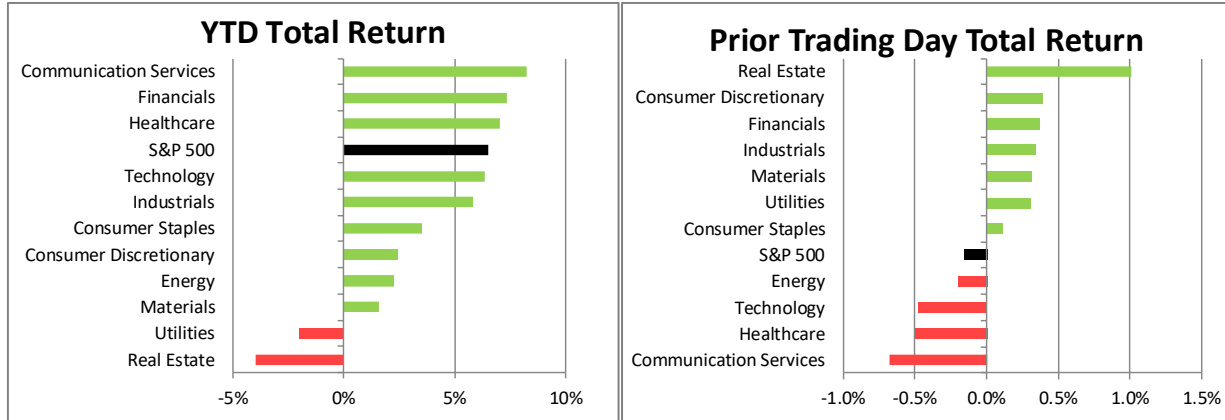
	Price	Prior	Change	Explanation
<b>Energy Markets</b>				
Brent	\$83.58	\$83.68	-0.12%	
WTI	\$78.67	\$78.54	0.17%	
Natural Gas	\$1.89	\$1.89	0.05%	
Crack Spread	\$29.66	\$29.48	0.60%	
12-mo strip crack	\$24.06	\$23.88	0.73%	
Ethanol rack	\$1.61	\$1.61	0.02%	
<b>Metals</b>				
Gold	\$2,029.15	\$2,034.55	-0.27%	
Silver	\$22.34	\$22.46	-0.54%	
Copper contract	\$384.45	\$384.05	0.10%	
<b>Grains</b>				
Corn contract	\$427.00	\$428.50	-0.35%	
Wheat contract	\$573.75	\$574.75	-0.17%	
Soybeans contract	\$1,135.25	\$1,145.25	-0.87%	
<b>Shipping</b>				
Baltic Dry Freight	2,041	1,899	142	
<b>DOE Inventory Report</b>				
	Actual	Expected	Difference	
Crude (mb)	4.2	3.7	0.5	
Gasoline (mb)	-2.8	-2.8	0.0	
Distillates (mb)	-0.5	-2.0	1.5	
Refinery run rates (%)	0.9%	0.5%	0.4%	
Natural gas (bcf)		-86		

## Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures from the Great Plains eastward, with cooler temperatures in the Far West. Meanwhile, the forecasts call for wetter-than-normal conditions in California and the Southwest, the Great Plains, the Mississippi Valley, and the East Coast, with dry conditions in the northern Rocky Mountains.

**Data Section**

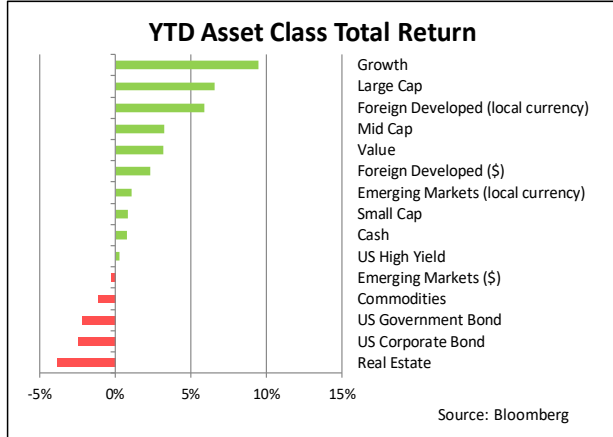
**US Equity Markets – (as of 2/28/2024 close)**



(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 2/28/2024 close)**

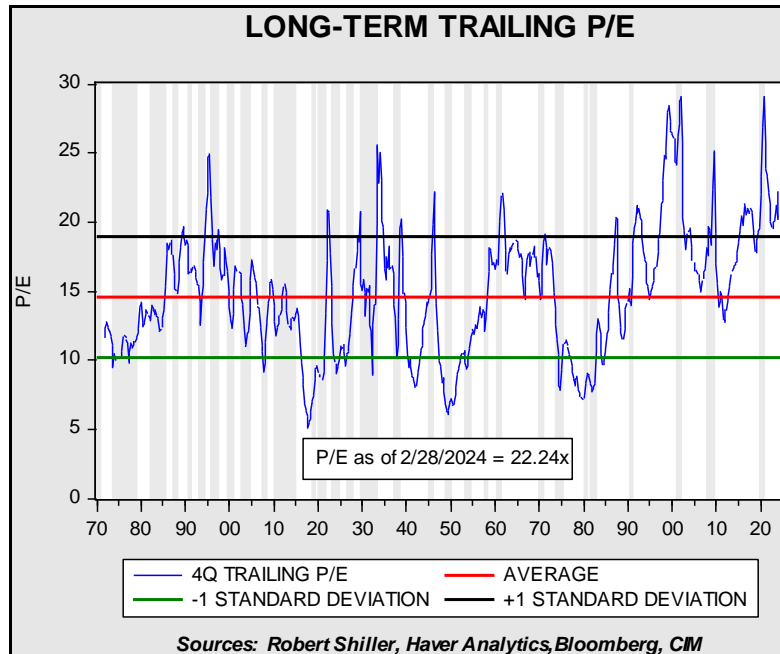


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 29, 2024



Based on our methodology,<sup>1</sup> the current P/E is 22.24x, up 0.09x from our last report. The improvement in the multiple reflects the increase in the stock price index, outweighing modest 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.*

<sup>1</sup> 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.