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 5, 2024—9:30 AM EST] Global equity markets are mostly lower this morning. In Europe, the Euro Stoxx 50 is up 0.2% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.4%. Chinese markets were lower, with the Shanghai Composite down 1.0% from its previous close and the Shenzhen Composite down 3.9%. U.S. equity index futures are signaling a lower open.

With 230 companies having reported so far, S&P 500 earnings for Q4 are running at $56.60 per share, compared to estimates of $55.15, which is up 1.6% from Q3 2023. Of the companies that have reported thus far, 78.7% have exceeded expectations while 15.7% 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* (1/29/2024) (with associated podcast): "Introducing the U.S. Space Force"
- *Weekly Energy Update* (12/14/2023): Oil prices have been under pressure as geopolitical risk premium evaporates; COP28 ended with a deal to "shift" from fossil fuels, softer language than the "phase out" comment that was rejected by oil producers. (N.B. The *Weekly Energy Update* will go on indefinite hiatus following this report.)
- *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 Q4 2023 Rebalance Presentation* (10/30/2023): 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): "U.S. Oil Production at a Record High"**
- *The 2024 Outlook: Slow-Bicycle Economy* (12/18/2023) (with associated *Confluence of Ideas* podcast)

Our *Comment* today opens with an artificial-intelligence leader's expectation for a future marked by national AI systems. We next review a range of other international and U.S. developments with the potential to affect the financial markets today, including signs that biotechnology will be

a new source of friction between the U.S. and China and a range of news items related to migration policy in North America.

Global AI Industry: Nelson Huang, chief executive of artificial-intelligence darling Nvidia, said in an interview last Thursday that countries around the world should build their own "sovereign AI infrastructure." According to Huang, a country's data should be considered its own natural resource, so it should be collected, controlled, and refined within the country's borders.

- Of course, Huang could simply be "talking his book," in the sense that building national AI computing systems in each of the more than 200 countries of the world would vastly increase the demand for Nvidia's AI semiconductors.

- On the other hand, his statement also reflects the growing sense that data is extremely valuable, and that it becomes even more valuable when used to train a powerful AI system. Who owns that data and who can capture its value will be increasingly important questions going forward, especially when one country's government or companies try to capture and exploit data from another country.

United States-China: Signaling that biological engineering will be another technology of contention between the U.S. and China, the House Select Committee on the Chinese Communist Party has introduced a bill that would ban any entity receiving federal funds from buying equipment or services from companies in "adversary countries," most notably China. Similar legislation has been introduced in the Senate. The goal of the legislation is to protect the U.S. biotech industry's competitiveness in genomic sequencing, medicine development, and the like.

- One key target of the legislation is Chinese genomic-sequencing giant BGI Group, which has spawned concern because of its global genomic data collection efforts, its obligation under Chinese law to transfer data to the country's government if requested, and its apparent links to the Chinese military.

- As with other advanced technologies such as 5G telecommunications and computer chips, it appears that the U.S.-China rivalry is about to lead to new restrictions in biotech trade, investment, and technology flows. As with those other technologies, the new restrictions will likely have big impacts on Western biotech firms that compete against the Chinese, rely on Chinese equipment or services, or hope to sell to the Chinese market.

- Of course, the U.S. has also clamped down on trade, investment, and technology flows with China in traditional industries as well. After former President Trump imposed punitive 25% tariffs on Chinese steel imports and 10% on Chinese aluminum imports, the Biden administration surprisingly maintained those duties. Over the weekend, Trump said that if he is elected again, he would impose tariffs of more than 60% on imports from China.

Philippines-China: Today's riskiest international dispute may be the overlapping territorial claims of China and the Philippines over certain islands and shoals in the South China Sea. Nevertheless, a Philippine supply ship on Saturday successfully delivered fresh provisions to a grounded Philippine navy ship that serves as an outpost on the Second Thomas Shoal.

Previously, Chinese coast guard and maritime militia vessels had tried to stop such resupply missions by using water cannons against the Philippine vessels or even ramming them.

- China's efforts to stop the resupply missions are dangerous because accidentally sinking a Philippine vessel or killing Philippine sailors could theoretically bring into force the U.S.-Philippine mutual defense treaty, bringing the U.S. into direct confrontation with Chinese forces.

- China's restraint this time around suggests it is looking to cool tensions, in large part because of the severe economic headwinds it is now facing.

China: As Chinese stock values continue to slide amid the geopolitical tensions mentioned above and the country's current economic headwinds, the China Securities Regulatory Commission today vowed that it will implement several measures designed to buoy prices. The proposed measures include cracking down on illegal trading and channeling more medium- and long-term capital into the market. Nevertheless, mainland stock indexes fell sharply again today, bringing their year-over-year losses to more than 20%.

Divergent Paths
One-year index performance

Source: FactSet
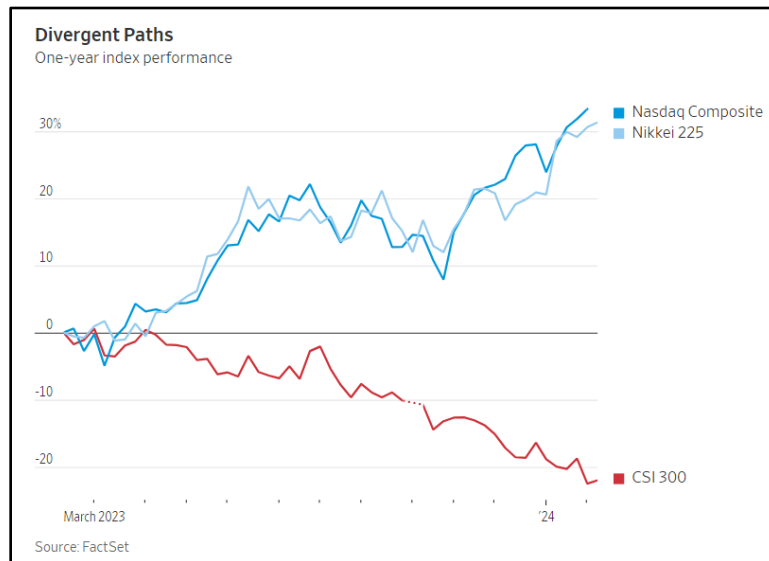
Israel-Hamas Conflict: In the other major conflict that threatens a broader war, the U.S. bombed dozens of sites on Friday run by Iranian and Iran-backed forces in Syria and Iraq, and then continued striking Iran-backed Houthi militant sites in Yemen over the weekend. While the targeted militant groups have themselves conducted dozens of attacks on U.S. ships and troops in sympathy with the Hamas government in Gaza that is now subject to retaliatory strikes by Israel, the attacks are keeping alive the risk that the Israeli-Hamas conflict will expand regionally.

Canada: Reacting to concern that legions of international students are driving up housing costs, Ottawa is imposing a 35% cut in the number of foreign undergraduate students it will grant visas to in 2024 and 2025. The cap, which will not apply to students seeking masters or doctorate degrees, will reduce the number of foreign students in Canada by about 210,000.

El Salvador: Crime fighting President Nayib Bukele handily won re-election yesterday, setting the stage for him to continue aggressively incarcerating criminal gang members and cutting off their ability to communicate with enforcers outside of prison. Bukele's policies have reportedly led to a significant reduction in violent crime and a resurgence of commerce in some areas. That could encourage similar policies elsewhere in the region, reducing the incentive for Central Americans to go to the U.S.

U.S. Immigration Policy: As we flagged in our *Comment* last week, leaders in the Senate yesterday released their big immigration-and-foreign-aid bill that aims to tighten immigration restrictions at the southern border in return for additional military aid to Ukraine and Israel. However, Republicans in the House have already declared the legislation dead on arrival, putting in limbo both new steps to deal with the surge of migrants at the border and additional assistance to Ukraine and Israel.

U.S. Monetary Policy: In a CBS interview yesterday, Federal Reserve Chair Powell said "almost all" of the members of the rate-setting Federal Open Market Committee supported cutting the benchmark fed funds interest rate three times in 2024, for a total cut of 75 basis points. However, he also stressed that economic conditions could lead the policymakers to cut rates more or less than currently planned. In any case, Powell's statement was consistent with our view that bond investors expect more aggressive rate cuts than the Fed is likely to deliver.

U.S. Higher Education: In a post-pandemic first for the Ivy League, Dartmouth University said it will reinstate a requirement that applicants provide SAT or ACT scores starting next year. According to the university, the scores provide the best indication of how students will perform in their freshman year. Currently, providing the scores is optional at the school.

U.S. Economic Releases

There were no economic releases prior to the publication of this report. The table below lists the economic releases and/or Fed events scheduled for the rest of the day.

Economic Releases					Expected	Prior	Rating
EST	**Indicator**				**Expected**	**Prior**	**Rating**
9:45	S&P Global US Services PMI	m/m	Jan F		52.9	52.9	***
9:45	S&P Global US Composite PMI	m/m	Jan F		52.4	52.3	**
10:00	ISM Services Index	m/m	Jan		50.4	50.6	**
10:00	ISM Services Prices Paid	m/m	Jan		56.7	57.4	*
10:00	ISM Services Employment	m/m	Jan		43.8	43.3	**
10:00	ISM Services New Orders	m/m	Jan		53.3	52.8	**
Federal Reserve							
No Fed speakers or events for the rest of today							
EST	**Speaker or Event**	**District or Position**					
10:00	Austan Goolsbee Appears on Bloomberg Television	President of the Federal Reserve Bank of Chicago					
14:00	Raphael Bostic Gives Welcoming Remarks	President of the Federal Reserve Bank of Atlanta					
14:00	Senior Loan Officer Opinion Survey on Bank Lending Practices						

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	Jibun bank Composite PMI	m/m	Jan F	51.5	51.1		*	Equity and bond neutral
	Jibun Bank Services PMI	m/m	Jan F	53.1	52.7		**	Equity and bond neutral
Australia	Melbourne Institute Inflation	m/m	Jan	5%	5.2%		***	Equity and bond neutral
	Trade Balance	m/m	Dec	A$10959m	A$11437m	A$11764m	***	Equity and bond neutral
	Exports	m/m	Dec	1.8%	1.7%		*	Equity and bond neutral
	Imports	m/m	Dec	4.8%	-7.9%	-8.4%	*	Equity bullish, bond bearish
New Zealand	ANZ Commodity Price	m/m	Jan	2.2	2.4		**	Equity and bond neutral
South Korea	Foreign Reserves	y/y	Jan	$415.76b	$420.15b		**	Equity and bond neutral
China	Caixin Composite PMI	m/m	Jan	52.5	52.6		**	Equity and bond neutral
	Caixin Services PMI	m/m	Jan	52.7	52.9	53.0	**	Equity and bond neutral
India	S&P Global Composite PMI	m/m	Jan F	61.2	61.0		**	Equity and bond neutral
	S&P Global Services PMI	m/m	Jan F	61.8	61.2		**	Equity and bond neutral
EUROPE								
Eurozone	HCOB Eurozone Services PMI	m/m	Jan F	48.4	48.4	48.4	**	Equity and bond neutral
	HCOB Eurozone Composite PMI	m/m	Jan F	47.9	47.9	47.9	**	Equity and bond neutral
	PPI	y/y	Dec	-10.6%	-8.8%	-10.5%	*	Equity and bond neutral
Germany	Trade Balance SA	m/m	Dec	22.2b	20.4b	20.8b	*	Equity and bond neutral
	Exports SA MoM	m/m	Dec	-4.6%	3.7%	3.5%	*	Equity bearish, bond bullish
	Imports SA MoM	m/m	Dec	-6.7%	1.9%	1.5%	*	Equity bearish, bond bullish
	HCOB Germany Services PMI	m/m	Jan F	47.7	47.6	47.6	**	Equity and bond neutral
	HCOB Germany Composite PMI	m/m	Jan F	47.0	47.1	47.1	**	Equity and bond neutral
France	HCOB France Services PMI	m/m	Jan F	45.4	45.0	45.0	**	Equity and bond neutral
	HCOB France Composite PMI	m/m	Jan F	44.6	44.2	44.2	**	Equity and bond neutral
Italy	HCOB Italy Composite PMI	m/m	Jan	50.7	48.6	50.0	***	Equity and bond neutral
	HCOB Italy Services PMI	m/m	Jan	51.2	49.8	50.8	***	Equity and bond neutral
UK	New Car Registrations	y/y	Jan	8.2%	9.8%		*	Equity and bond neutral
	Official Reserves Changes	y/y	Jan	-$647m	$1665m		*	Equity and bond neutral
	S&P Global UK Services PMI	y/y	Jan F	54.3	53.8	53.8	**	Equity and bond neutral
	S&P Global UK Composite PMI	m/m	Jan F	52.9	52.5	52.5	**	Equity and bond neutral
Switzerland	Domestic Sight Deposits CHF	w/w	2-Feb	470.5b	463.2b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	2-Feb	481.2b	472.2b		*	Equity and bond neutral
Russia	S&P Global Russia Composite PMI	m/m	Jan	55.1	55.7	53.2	**	Equity bullish, bond bearish
	S&P Global Russia Services PMI	m/m	Jan	55.8	56.2	53.7	**	Equity bullish, bond bearish
AMERICAS								
Brazil	Foreign Direct Investment	m/m	Dec	-$389m	$7780m	$7765m	**	Equity and bond neutral
	S&P Global Brazil Composite PMI	m/m	Jan	53.2	50.0		**	Equity and bond neutral
	S&P Global Brazil Services PMI	m/m	Jan	53.1	50.5		**	Equity and bond neutral

Financial Markets

The table below highlights some of the indicators that we follow on a daily basis. 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)	555	553	2	Down
3-mo T-bill yield (bps)	521	522	-1	Flat
U.S. Sibor/OIS spread (bps)	532	532	0	Down
U.S. Libor/OIS spread (bps)	533	532	1	Down
10-yr T-note (%)	4.12	4.02	0.10	Flat
Euribor/OIS spread (bps)	390	388	2	Down
Currencies	**Direction**			
Dollar	Up			Down
Euro	Down			Up
Yen	Down			Up
Pound	Down			Up
Franc	Down			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.
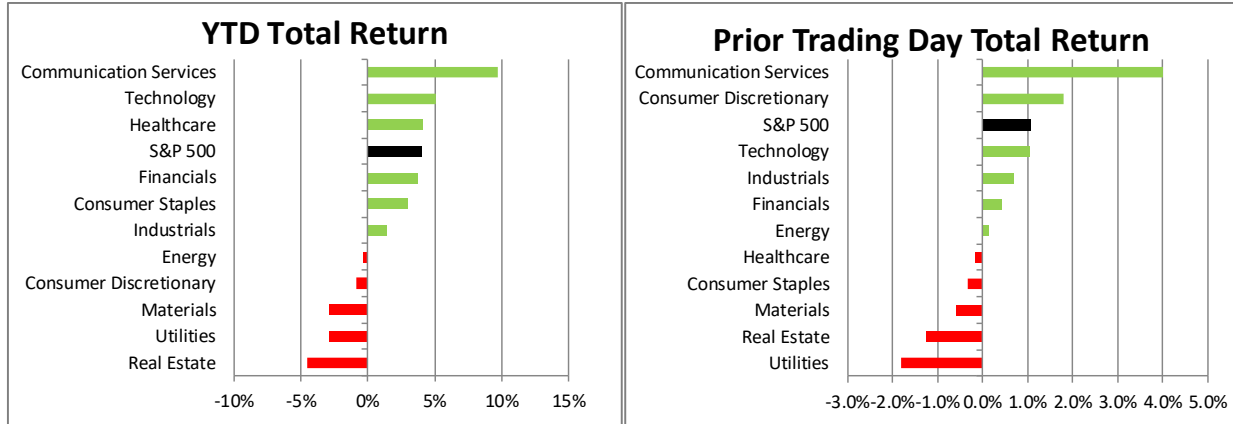
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$77.32	$77.33	-0.01%	
WTI	$72.14	$72.28	-0.19%	
Natural Gas	$2.09	$2.08	0.34%	
Crack Spread	$25.92	$25.07	3.41%	
12-mo strip crack	$24.98	$24.43	2.25%	
Ethanol rack	$1.74	$1.74	-0.33%	
Metals				
Gold	$2,021.61	$2,039.76	-0.89%	
Silver	$22.38	$22.69	-1.37%	
Copper contract	$379.95	$382.15	-0.58%	
Grains				
Corn contract	$440.00	$442.75	-0.62%	
Wheat contract	$592.50	$599.75	-1.21%	
Soybeans contract	$1,182.75	$1,188.50	-0.48%	
Shipping				
Baltic Dry Freight	1,407	1,388	19	

Weather

The 6-10 and 8-14 day forecasts predict a shift in temperatures across the U.S. Cooler-than-normal temperatures are expected to move from the Pacific region into the South, while warmer-than-average temperatures are anticipated on the West Coast and in the Northern states. The precipitation outlook calls for wetter-than-normal conditions to recede to the Southern states, with dry conditions remaining throughout the rest of the country.
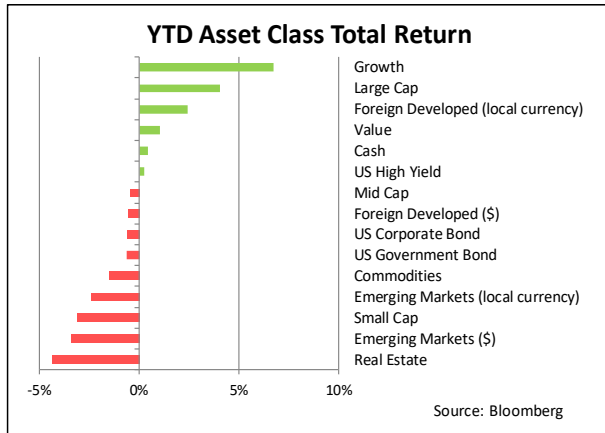
Data Section

U.S. Equity Markets – (as of 2/2/2024 close)

YTD Total Return

Sector	
Communication Services	
Technology	
Healthcare	
S&P 500	
Financials	
Consumer Staples	
Industrials	
Energy	
Consumer Discretionary	
Materials	
Utilities	
Real Estate	

Prior Trading Day Total Return

Sector	
Communication Services	
Consumer Discretionary	
S&P 500	
Technology	
Industrials	
Financials	
Energy	
Healthcare	
Consumer Staples	
Materials	
Real Estate	
Utilities	

(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 2/2/2024 close)

YTD Asset Class Total Return

| Asset Class	
Growth	
Large Cap	
Foreign Developed (local currency)	
Value	
Cash	
US High Yield	
Mid Cap	
Foreign Developed ($)	
US Corporate Bond	
US Government Bond	
Commodities	
Emerging Markets (local currency)	
Small Cap	
Emerging Markets ($)	
Real Estate	

Source: Bloomberg

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), U.S. Corporate Bond (iShares iBoxx $ Investment Grade Corporate Bond ETF), U.S. Government Bond (iShares 7-10 Year Treasury Bond ETF), U.S. 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 1, 2024
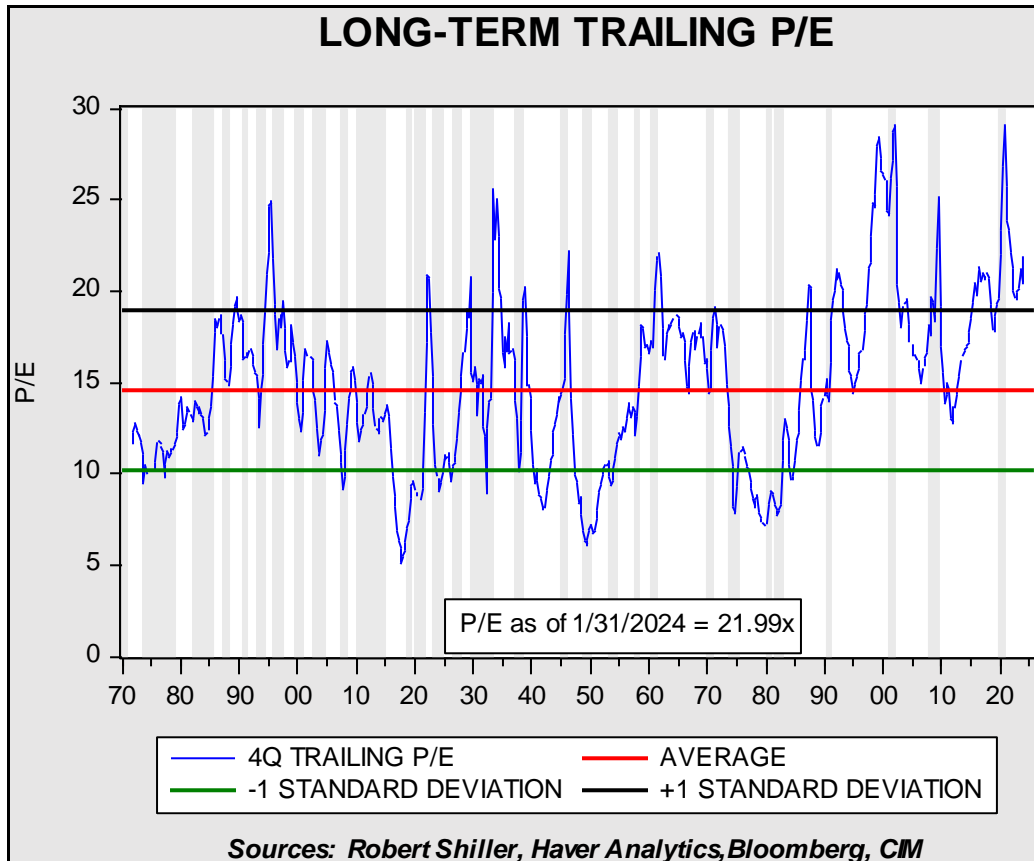
Based on our methodology,[1] the current P/E is 21.99x, up 0.09x from our last report. The rise in the multiple was driven primarily by an increase in the price index.

[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.