# 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 6, 2024—9:30 AM EST]** Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 is up 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 2.0%. Chinese markets were higher, with the Shanghai Composite up 3.2% from its previous close and the Shenzhen Composite up 5.1%. U.S. equity index futures are signaling a higher open.

With 238 companies having reported so far, S&P 500 earnings for Q4 are running at $56.70 per share, compared to estimates of $55.15, which is up 1.6% from Q3 2023. Of the companies that have reported thus far, 78.6% have exceeded expectations while 16.0% 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 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): "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 a considerable rebound in the Chinese stock market after the government implemented a number of strong support policies. We next review a range of other international and U.S. developments with the potential to affect the financial markets today, including more signs of pushback against climate stabilization policies in Europe and encouraging forecasts of U.S. consumer price inflation from a key international research group.

**Chinese Stock Market:** The Chinese government today seems to have finally gotten some traction in its effort to boost the country's sliding stock market. Following a series of actions by the stock market regulator, the country's $1.2-trillion sovereign wealth fund, and General Secretary Xi, stock indexes on the mainland and in Hong Kong have jumped sharply today. Nevertheless, it isn't clear whether the upward momentum will continue going forward, especially considering that earlier efforts weren't effective. Included in the moves today:

- The China Securities Regulatory Commission said it will "coordinate and guide various institutional investors" into the stock market to prop up values, including making it easier for the sovereign wealth fund to buy shares;
- The CSRC also advised listed firms to take stronger steps to ensure investor confidence and market stability, including conducting share buybacks, boosting major shareholders' stakes, and declaring regular dividends;
- Following the CSRC's statement, sovereign wealth fund unit Central Huijin Investment said it would buy more exchange-traded funds, expand its holdings, and take steps to ensure "the stable operation of the capital market"; and
- Finally, news reports today say Xi will soon meet with market regulators to discuss market conditions and recent policy moves, indicating he will pressure them to ensure the stock market keeps rebounding.

**Chinese Military:** As a reminder that both geopolitical tensions and economic headwinds have been weighing on Chinese asset values, on Sunday the *New York Times* published a detailed article on China's massive program to expand its strategic nuclear weapons arsenal, which we have described in our past writings. Based on previously unavailable documents, the article shows that General Secretary Xi ordered the expansion just 19 days after assuming power in 2012, saying China needed a major arsenal to truly be a Great Power.

- Now, the article says, Chinese military strategists are looking at how to use the arsenal not only to deter U.S. attacks, but also to bully other nations.
- As more Western policymakers and voters come to realize the aggressiveness of China's military buildup, we think they will demand pushback against Beijing and even stronger efforts to rebuild Western defenses. Tensions between China and the West are therefore likely to keep deteriorating over time.
- We continue to believe that spiraling geopolitical tensions, along with China's own structural economic challenges, will continue to weigh on Chinese assets going forward.

**Australia:** The Reserve Bank of Australia has cut its forecasts for economic growth in 2024 and 2025, citing slower demand growth from China and the impact of its own interest-rate hikes. The central bank now sees Australian gross domestic product rising just 1.4% in 2024, versus its previous forecast of 1.8%. Nevertheless, like many other major central bank chiefs, RBA Governor Michele Bullock is resisting calls for aggressive rate cuts in the near future.

- It's important to remember that central banks outside the U.S. may have even greater incentives to resist near-term rate cuts than the Fed does.
- If the Fed slow-walks its rate cuts as we expect, leaving U.S. rates relatively high, any country whose central bank cuts rates aggressively would risk a sharp depreciation in its currency, potentially fueling a rebound in consumer price inflation.

**European Union:** Faced with massive farmer protests across the EU, the European Commission has scrapped plans to implement a 30% reduction in agricultural greenhouse gas emissions by 2040. Scrapping the planned cut probably reflects EU officials' concern that farmer anger over EU agricultural policies might fuel further political gains for far-right populist parties ahead of the European Parliament elections in June.

**Germany:** Siegfried Russwurm, head of Germany's biggest industry association, has slammed the government's climate policies as "more dogmatic than any other country I know." He especially complained about the government's decision to phase out nuclear energy and coal and switch to renewables, saying the decision has put German firms at a disadvantage to those in other industrialized countries. Russwurm's strong statement is further evidence of growing pushback against climate stabilization policies in Europe.

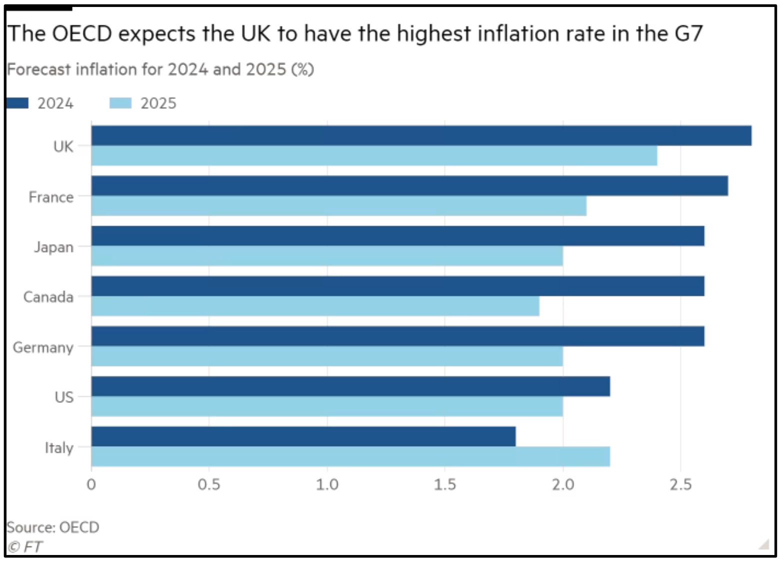
**Turkey:** After the resignation of central bank chief Hafize Gaye Erkan on Friday, President Erdoğan has named Fatih Karahan to be her successor. Karahan is a former economist at the U.S. Federal Reserve, as well as a former deputy governor at Turkey's central bank. Finance Minister Mehmet Şimşek praised Karahan for his experience and knowledge, but his appointment nevertheless may prompt concern that Erdoğan is backing away from the more orthodox economic policies he has pursued since his re-election.

**Mexico:** Ahead of the presidential and legislative elections this summer, President Andrés Manuel López Obrador has proposed almost two dozen major constitutional amendments that would dismantle many of the good-governance and free-market reforms of recent decades. Although the president's Morena Party doesn't currently hold enough seats in Congress to pass the changes, the proposal allows Morena to set the terms of debate for the coming campaign. If Morena wins enough seats, it could then pass the changes later. The proposals include:

- Reducing the size of Congress;
- Directly electing the Supreme Court;
- Dismantling an agency that enforces government transparency;
- Outlawing hydraulic fracturing (fracking) in oil and gas production; and
- Giving workers a pension equal to their final salary.

**U.S. Monetary Policy:** The Organization for Economic Cooperation and Development issued new forecasts showing the U.S. should have the second-lowest rate of consumer price inflation among major developed countries in 2025, at 2.2%, and the lowest rate in 2025, at 2.0%. According to the OECD, the good progress on U.S. inflation could allow the Federal Reserve to start cutting interest rates as early as the second quarter of 2024.

- Nevertheless, we still think investors are expecting the Fed to cut rates more aggressively than it really will. Following Chair Powell's interview over the weekend, in which he basically said the same thing, stock and bond values fell sharply yesterday.
- With the Fed likely to take its time cutting interest rates, and with economic growth relatively weaker in many other large, developed countries, the dollar in recent days has appreciated sharply. The U.S. Dollar Index now stands at its highest level since early December, having risen approximately 4% over the last five weeks.




**U.S. Weather:** Southern California today continues to be battered by torrential rains resulting in extensive flooding, mudslides, disrupted business activity, and property damage. Portions of downtown Los Angeles have already received 9 inches of rain, and outlying areas have received even more, with the downpours expected to continue until Thursday. Besides the potential for a noticeable hit to economic activity in the country's most populous state, we're also watching for any future increases in insurance rates or insurer withdrawals from the market.

## 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 | | |
|---|---|---|
| | No economic releases for the rest of today | |
| **Federal Reserve** | | |
| **EST** | **Speaker or Event** | **District or Position** |
| **12:00** | Loretta Mester Speaks on Economic Outlook | President of the Federal Reserve Bank of Cleveland |
| **13:00** | Neel Kashkari Participates in Moderated Discussion | President of the Federal Reserve Bank of Minneapolis |
| **14:00** | Susan Collins Delivers Opening Remarks at Labor Market Conference | President of the Federal Reserve Bank of Boston |
| **19:00** | Patrick Harker Speaks on Fed's Role in Economy | President of the Federal Reserve Bank of Philadelphia |

## 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** | Labor Cash Earnings YoY | y/y | Dec | 1.0% | 0.2% | 0.7% | ** | Equity and bond neutral |
| | Household Spending YoY | y/y | Dec | -2.5% | -2.9% | -2.0% | * | Equity and bond neutral |
| **EUROPE** | | | | | | | | |
| **Eurozone** | Retail Sales | y/y | Dec | -0.8% | -1.1% | -0.4% | * | Equity and bond neutral |
| **Germany** | Factory Orders WDA | y/y | Dec | 2.7% | -4.4% | -4.7% | *** | Equity bullish, bond bearish |
| | HCOB Germany Construction PMI | m/m | Jan | 36.3 | 37.0 | | * | Equity and bond neutral |
| **Italy** | Consumer Confidence | m/m | Jan | 96.4 | | 95.8 | *** | Equity bullish, bond bearish |
| | Manufacturing Confidence | m/m | Jan | 88.3 | | 87.3 | *** | Equity bullish, bond bearish |
| | Economic Sentiment | m/m | Jan | 98.1 | | 97.3 | ** | Equity bullish, bond bearish |
| **UK** | S&P/CIPS Construction PMI | m/m | Jan | 48.8 | 46.8 | 47.2 | ** | Equity bullish, bond bearish |
| **AMERICAS** | | | | | | | | |
| **Canada** | S&P Global Canada Composite PMI | m/m | Jan | 46.3 | 44.7 | | * | Equity and bond neutral |
| | S&P Global Canada Services PMI | m/m | Jan | 45.8 | 44.6 | | * | Equity and bond neutral |
| **Brazil** | FGV Inflation IGP-DI | y/y | Jan | -3.61% | -3.33% | -3.45% | ** | Equity and bond neutral |
| | Total Outstanding Loans | m/m | Dec | 5783b | 5655b | 5701b | ** | 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)** | 519 | 521 | -2 | Flat |
| **U.S. Sibor/OIS spread (bps)** | 532 | 533 | -1 | Down |
| **U.S. Libor/OIS spread (bps)** | 533 | 533 | 0 | Down |
| **10-yr T-note (%)** | 4.16 | 4.16 | 0.00 | Flat |
| **Euribor/OIS spread (bps)** | 392 | 390 | 2 | Down |
| **Currencies** | **Direction** | | | |
| Dollar | Flat | | | Down |
| Euro | Flat | | | Up |
| Yen | Flat | | | Up |
| Pound | Up | | | Up |
| Franc | Down | | | Up |
| **Central Bank Action** | **Current** | **Prior** | **Expected** | |
| RBA Cash Rate Target | 4.350% | 4.350% | 4.350% | 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.

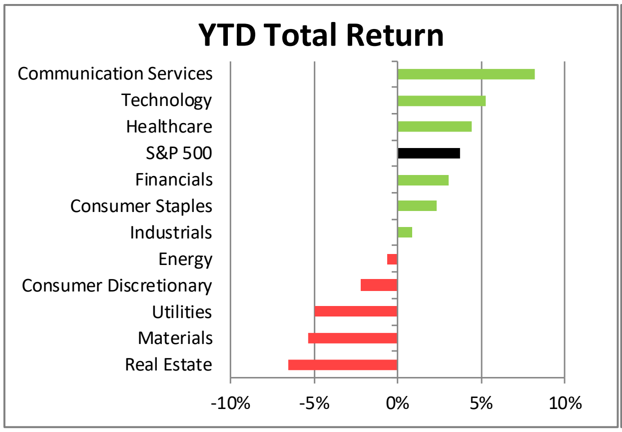
| | Price | Prior | Change | Explanation |
|---|---|---|---|---|
| **Energy Markets** | | | | |
| Brent | $78.62 | $77.99 | 0.81% | |
| WTI | $73.34 | $72.78 | 0.77% | |
| Natural Gas | $2.08 | $2.08 | -0.24% | |
| Crack Spread | $27.44 | $27.25 | 0.73% | |
| 12-mo strip crack | $25.87 | $25.63 | 0.92% | |
| Ethanol rack | $1.73 | $1.73 | -0.23% | |
| **Metals** | | | | |
| Gold | $2,028.15 | $2,025.11 | 0.15% | |
| Silver | $22.34 | $22.35 | -0.06% | |
| Copper contract | $377.70 | $377.15 | 0.15% | |
| **Grains** | | | | |
| Corn contract | $444.00 | $442.75 | 0.28% | |
| Wheat contract | $591.75 | $590.25 | 0.25% | |
| Soybeans contract | $1,201.25 | $1,196.25 | 0.42% | |
| **Shipping** | | | | |
| Baltic Dry Freight | 1,436 | 1,407 | 29 | |
| **DOE Inventory Report** | | | | |
| | **Actual** | **Expected** | **Difference** | |
| Crude (mb) | | 3.0 | | |
| Gasoline (mb) | | 1.5 | | |
| Distillates (mb) | | -2.5 | | |
| Refinery run rates (%) | | 2.0% | | |
| Natural gas (bcf) | | -203 | | |

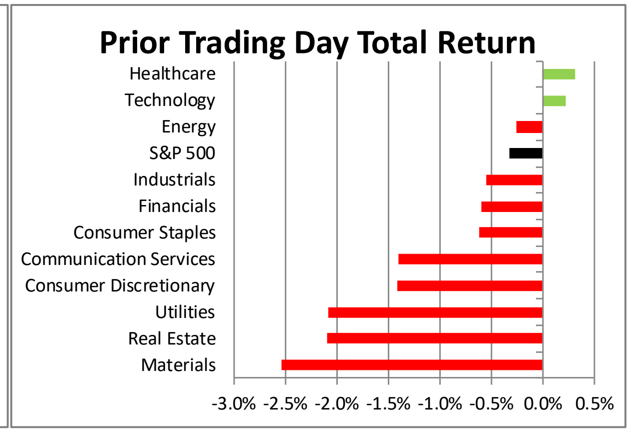
## Weather

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 and East, while warmer-than-average temperatures are anticipated on the West Coast and in the Great Lakes region. 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 2/5/2024 close)

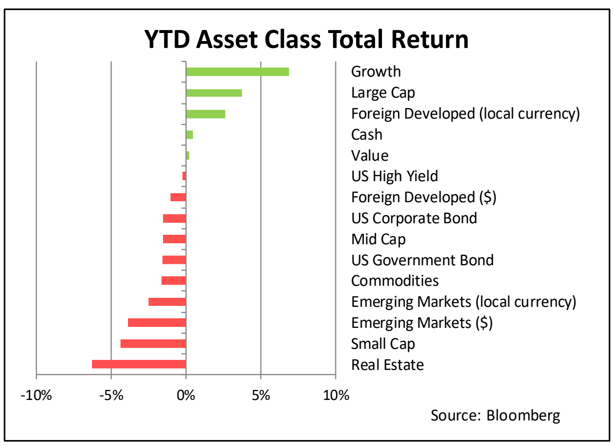



(Source: Bloomberg)

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 2/5/2024 close)

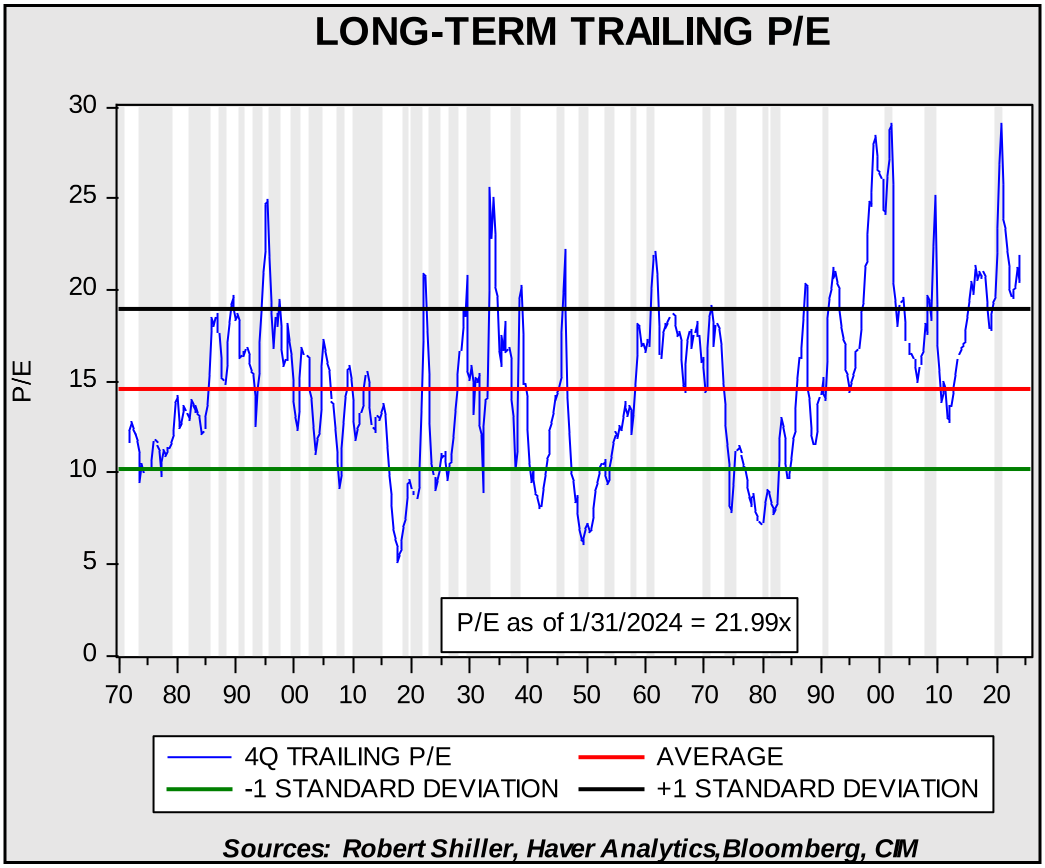



This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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), 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.

*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.