Daily Comment

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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: January 8, 2024—9:30 AM EST] Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 is essentially unchanged from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.9%. Chinese markets were lower, with the Shanghai Composite down 1.4% from its previous close and the Shenzhen Composite down 1.9%. U.S. equity index futures are signaling a lower open.

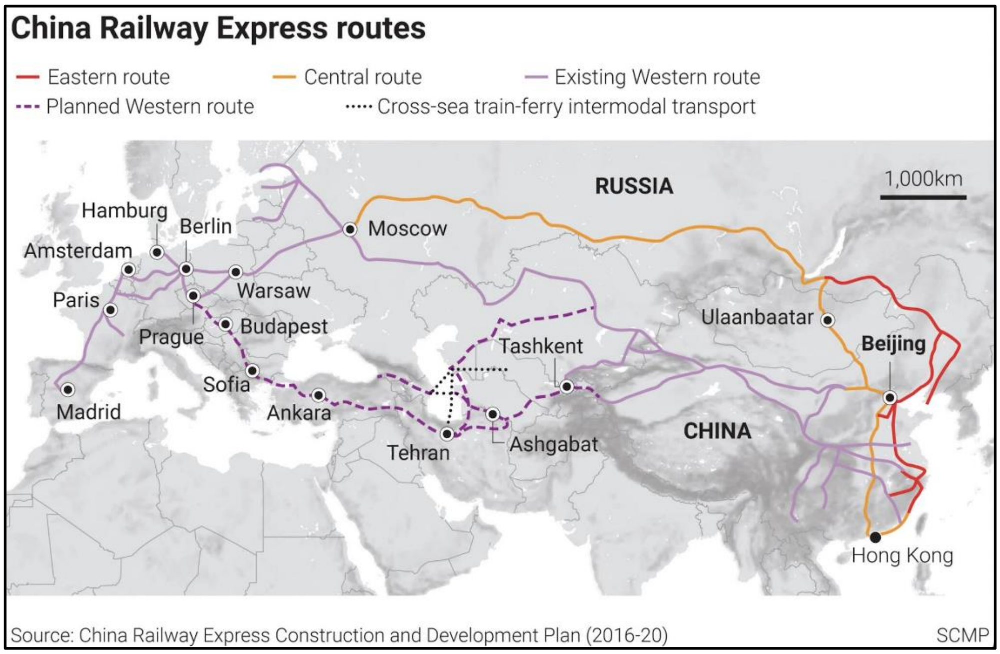
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *Bi-Weekly Geopolitical Report* (12/11/2023) (with associated *Confluence of Ideas* podcast): "The 2024 Geopolitical Outlook"
- *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 – Q4 2023* (10/19/2023): Discussion of our asset allocation process, Q4 2023 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* (12/4/2023) (with associated podcast): "A Pause That Refreshes?"
- *The 2024 Outlook: Slow-Bicycle Economy* (12/18/2023) (with associated *Confluence of Ideas* podcast)

Our *Comment* today opens with a discussion of how the Houthi threat to shipping in the Red Sea is disrupting global supply chains and threatening to push up inflation again. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including a cut in Saudi Arabia's oil export price and a budget agreement in the U.S. Congress that could avert another partial government shutdown or the need for another stopgap funding measure when the current one starts to run out later this month.

Global Supply Chains: As Houthi rebels in Yemen continue to attack commercial shipping in the Red Sea, shippers are increasingly worried that China won't have enough shipping containers for its future exports. When firms carrying goods from China to Europe divert their ships away from the Red Sea and Suez Canal to the longer route around the Cape of Good Hope or shift to the overland China-Europe rail route (see map below), the delivery delay of up to two weeks means the return of half-empty containers to China will also be delayed.

- Any shortage of containers could stymie Chinese exports, further weighing on the country's economic growth. Separately, Chinese electric vehicle makers are struggling to send their EVs to Europe because of an unrelated shortage of car-carrying ships.
- A surge of aggressively priced Chinese exports has been a key reason for the recent decline in consumer price inflation in the U.S. and the rest of the developed countries. Constricted Chinese exports and rising container leasing rates would therefore threaten to boost developed-country inflation again, complicating the major central banks' calculus on when they could start cutting interest rates.



Global Oil Market: Today, Saudi Arabia cut the official selling price for its February oil exports. The cut reflects both rising U.S. oil production and slowing global energy demand because of factors such as China's weak economic growth and high interest rates in many countries.

- We continue to believe that the outlook for oil is bullish over the longer term, but prices are likely to remain under pressure in the short term as global economic growth slows.
- In response to the Saudi price cut, oil prices have fallen approximately 3.3% so far this morning, with Brent currently trading at $76.19 per barrel.

Emerging Market Debt: In a new report, Fitch Ratings warns that higher global temperatures, rising sea levels, and increased flooding could lead to lower credit ratings for developing countries in the Asia-Pacific region that don't adapt. The only country that Fitch identifies as safe is Singapore. The report warns that most other countries in Asia and South Asia will have trouble finding the resources to mitigate the risks.

Japan: Prosecutors have made their first arrests in the illegal political fundraising scandal that's been dogging the administration of Prime Minister Kishida. Those arrested included Yoshitaka Ikeda of the ruling Liberal Democratic Party and one of his aides. Kishida announced that the party has expelled Ikeda, but the scandal nevertheless continues to weigh on the prime minister's approval ratings and threatens his political power.

China: Now that Chinese home prices are no longer providing the strong investment returns that they used to, younger Chinese consumers are reportedly investing more in gold jewelry. Because of their enormous populations, India and China are already the world's top consumers of gold jewelry. If Chinese demand accelerates further, it could conceivably give a further boost to global gold prices, just as recent purchasing by key central banks has done.

United Kingdom-China: The Chinese Ministry of State Security has accused the British secret intelligence service MI6 of recruiting a private-sector consultant from a third country to repeatedly enter the country, collect information, and try to recruit sources of information. The Chinese government has already cracked down on other Western data and due diligence firms, leading to some arrests. The new accusation is likely to further scare off Western professionals and prompt more Western companies to reconsider doing business in China.

United States-China: The top Republican and Democrat on the House Select Committee on the Chinese Communist Party have released a letter they sent to President Biden urging him to take stronger action to stem China's growing dominance in the global market for older, less-advanced semiconductors, rather than just constraining China's access to the most advanced chips, as the administration has already done. The lawmakers warn that the U.S. economy is becoming too dependent on workhorse chips from China.

- As we've discussed in the past, the worsening U.S.-China rivalry is driving a continued fracturing in global supply chains. Government and business leaders are likely to keep driving to cut dependence on critical, high-value goods from China, although many less important, low-value products are likely to continue being sourced from that country.
- The widening scope of the restrictions will continue to be a risk for companies that rely on Chinese inputs or sell to China.

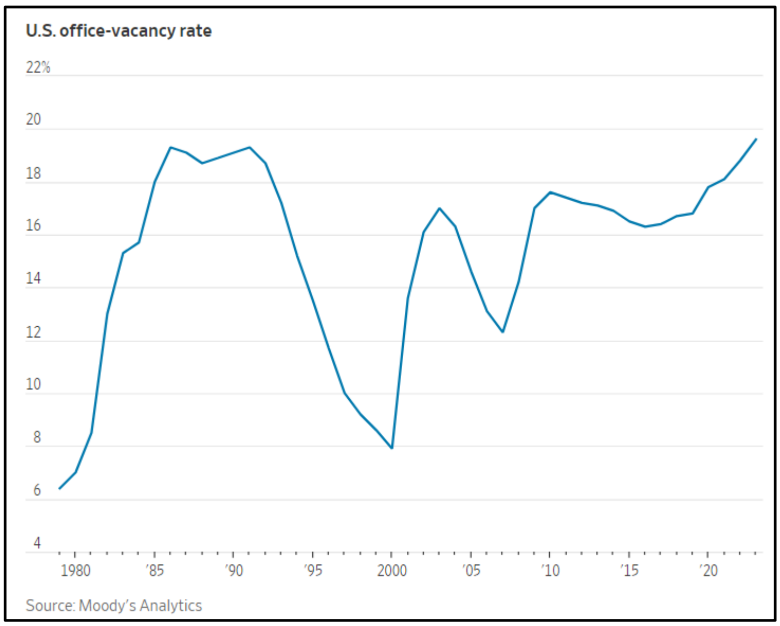
U.S. Military: On Friday, the Pentagon announced that Defense Secretary Austin had been hospitalized in intensive care since New Year's Day to deal with complications from an unspecified elective surgery. However, the incident created a scandal when it emerged that President Biden wasn't informed about Austin's hospitalization for three days, and that key members of Congress weren't informed for four days.

- Deputy Defense Secretary Kathleen Hicks reportedly took on Austin's duties while he was incapacitated, but only via secure communication links from her temporary location in Puerto Rico, rather than returning to Washington.

- The scandal is likely to raise pressure on Austin and lead to increased calls for his replacement. In any case, the scandal has the potential to disrupt the U.S. military's on-going restructuring and adjustments to meet the rising challenge from China.

U.S. Fiscal Policy: Congressional leaders reached a deal yesterday on overall budget spending for the current fiscal year, potentially averting another partial government shutdown or stopgap spending bill when the current stopgap bill starts to run out later this month. The challenge now will be for Congress to pass the many individual appropriation bills that will turn the budget into law. Republican conservatives in particular are expected to oppose the spending total and demand riders that implement their preferred conservative policies.

U.S. Commercial Real Estate Market: New data shows that a record 19.6% of office space in major markets was unleased in the fourth quarter, up from 18.8% one year earlier and slightly above the previous record of 19.3% in 1986 and 1991. The high vacancies reflect both previous overbuilding and the pandemic-inspired "work from home" movement. In any case, high vacancies coupled with high interest rates means the office sector remains an economic risk.



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						
EST	Indicator			Expected	Prior	Rating
15:00	Consumer Credit	m/m	Nov	$9.000b	$5.134b	*
Federal Reserve						
EST	Speaker or Event	District or Position				
12:30	Raphael Bostic Speaks on the Economic Outlook	President of the Federal Reserve Bank of Atlanta				

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								
Australia	Foreign Reserves	m/m	Dec	A$93.9b	A$92.2b		**	Equity and bond neutral
China	Foreign Reserves	m/m	Dec	$3237.9b	$3171.81b	$3198.5b	**	Equity and bond neutral
EUROPE								
Eurozone	Retail Sales	y/y	Nov	-1.1%	-1.2%	-1.5%	*	Equity and bond neutral
	Consumer Confidence	m/m	Dec F	115.0	-15.1		**	Equity and bond neutral
	Economic Confidence	m/m	Dec	96.4	93.8	94.0	***	Equity and bond neutral
	Industrial Confidence	m/m	Dec	-9.2	-9.5	-9.5	***	Equity and bond neutral
	Services Confidence	m/m	Dec	8.4	4.9	5.5	**	Equity bullish, bond bearish
Germany	Factory Orders WDA	y/y	Nov	-4.4%	-7.3%	-3.4%	***	Equity bearish, bond bullish
	Trade Balance	m/m	Nov	20.4b	17.8b	17.7b	**	Equity and bond neutral
	Exports	m/m	Nov	3.7%	-0.2%	-0.4%	*	Equity and bond neutral
	Imports	m/m	Nov	1.9%	-1.2%	-1.1%	*	Equity and bond neutral
Switzerland	CPI	y/y	Dec	1.7%	1.4%	1.6%	***	Equity and bond neutral
	Core CPI	y/y	Dec	1.5%	1.4%	1.4%	*	Equity and bond neutral
	Real Retail Sales	y/y	Nov	0.7%	-0.1%	-0.3%	**	Equity bullish, bond bearish
	Domestic Sight Deposits CHF	w/w	5-Jan	457.1b	453.2b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	5-Jan	468.8b	462.9b		*	Equity and bond neutral
AMERICAS								
Canada	Net Change in Employment	m/m	Dec	0.1k	24.9k	15k	***	Equity and bond neutral
	Unemployment Rate	m/m	Dec	5.8%	5.8%	5.9%	***	Equity and bond neutral
Brazil	Trade Balance	m/m	Dec	$9360m	$8776m	$8766m	**	Equity and bond neutral
	Exports	m/m	Dec	$28839m	$27820m	$27878m	*	Equity and bond neutral
	Imports	m/m	Dec	$19479m	$19044m	$19112m	*	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)	559	559	0	Down
3-mo T-bill yield (bps)	522	522	0	Down
U.S. Sibor/OIS spread (bps)	533	532	1	Down
U.S. Libor/OIS spread (bps)	532	532	0	Down
10-yr T-note (%)	4.05	4.05	0.00	Flat
Euribor/OIS spread (bps)	394	392	2	Down
Currencies	**Direction**			
Dollar	Flat			Down
Euro	Flat			Up
Yen	Up			Up
Pound	Flat			Up
Franc	Flat			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.

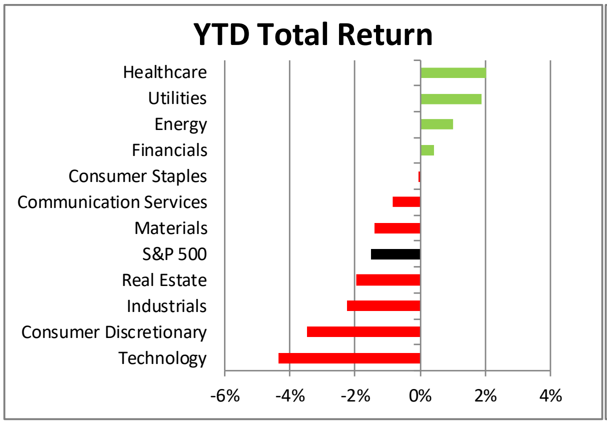
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$76.88	$78.76	-2.39%	
WTI	$71.88	$73.81	-2.61%	
Natural Gas	$2.81	$2.89	-3.04%	
Crack Spread	$21.78	$21.71	0.34%	
12-mo strip crack	$22.67	$22.75	-0.34%	
Ethanol rack	$1.74	$1.74	0.30%	
Metals				
Gold	$2,024.07	$2,045.45	-1.05%	
Silver	$22.92	$23.19	-1.16%	
Copper contract	$380.40	$380.60	-0.05%	
Grains				
Corn contract	$461.25	$460.75	0.11%	
Wheat contract	$604.25	$616.00	-1.91%	
Soybeans contract	$1,251.75	$1,256.25	-0.36%	
Shipping				
Baltic Dry Freight	2,110	2,086	24	

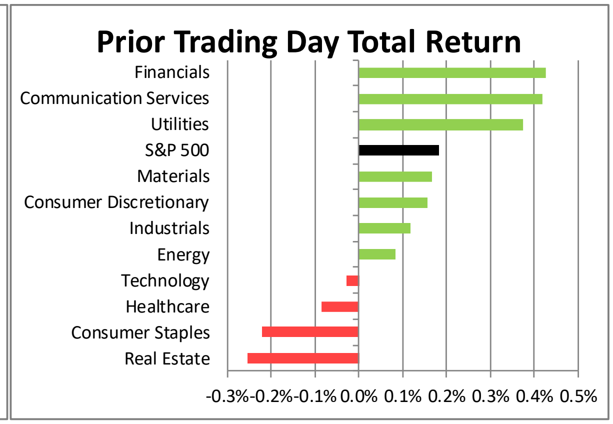
Weather

The 6-10 and 8-14 day forecasts currently call for cooler-than-normal temperatures throughout most of the country, with warmer-than-normal temperatures in the southern Pacific region. The precipitation outlook calls for wetter-than-normal conditions to spread from the Southwest into the Midwest in the latter half of the forecast period.

Data Section

U.S. Equity Markets – (as of 1/5/2024 close)

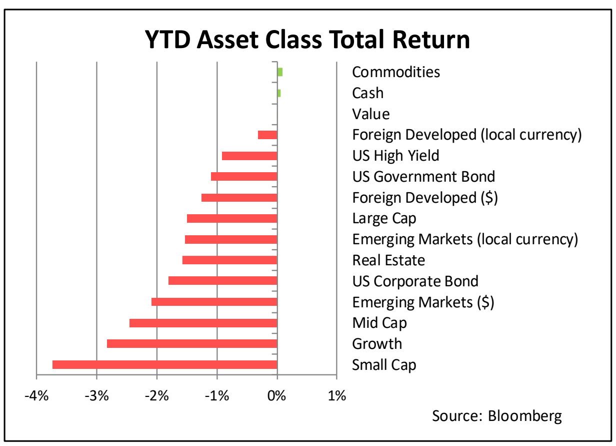




(Source: Bloomberg)

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 1/5/2024 close)

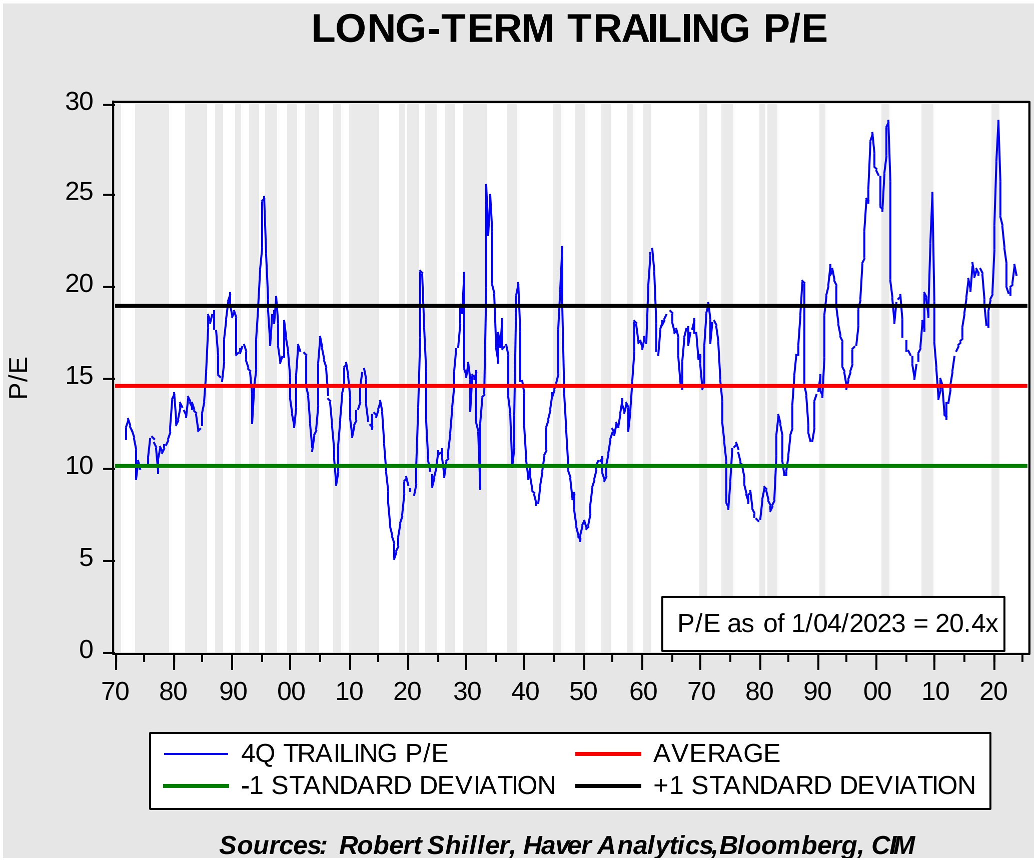


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

January 4, 2024



Based on our methodology,[1] the current P/E is 20.4x, down 0.1x from our last report. A slight increase in earnings weighed on the multiple.

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[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.