

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 16, 2024—9:30 AM EST] Global equity markets are mostly lower this morning. In Europe, the Euro Stoxx 50 is down 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.9%. Chinese markets were mixed, with the Shanghai Composite up 0.3% from its previous close and the Shenzhen Composite essentially unchanged. 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:

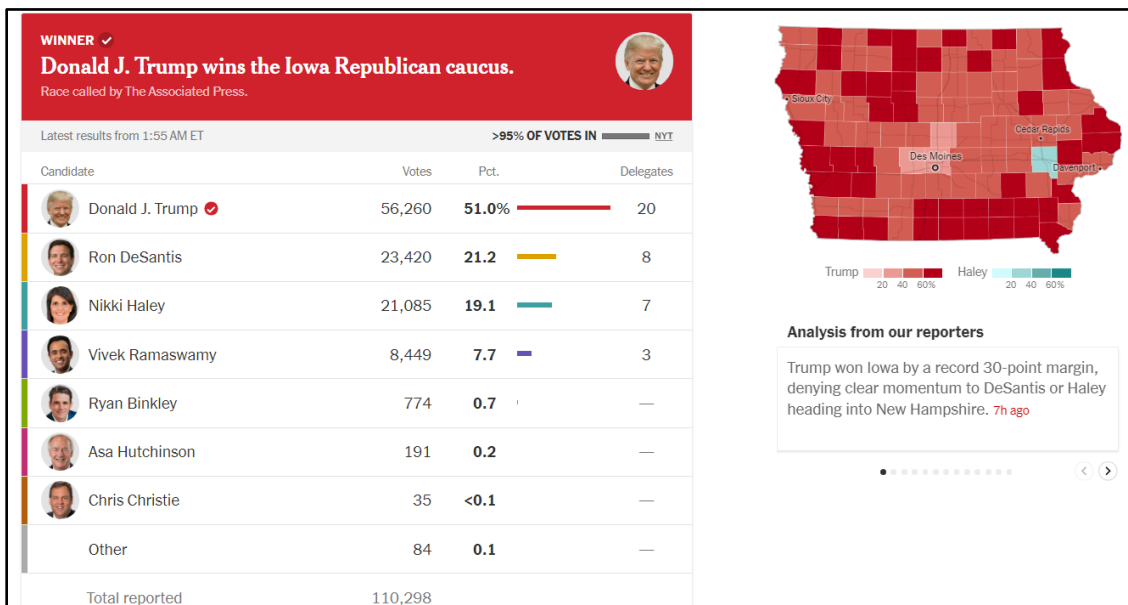
- [Bi-Weekly Geopolitical Report](#) (12/11/2023) (with associated *Confluence of Ideas* [podcast](#)): “The 2024 Geopolitical Outlook”
- [Weekly Energy Update](#) (12/14/2023): Oil prices have been under pressure as geopolitical risk premium evaporates; COP28 ended with a deal to “shift” from fossil 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 some notes on the important voting in Iowa and Taiwan over the last few days. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including further Houthi attacks on commercial ships in the Red Sea and a Federal Reserve policymaker’s warning against cutting interest rates too soon.

U.S. Elections: In the Republican Party’s Iowa caucuses yesterday, former President Trump [overwhelmingly won, as expected](#), with about 51% of the vote. Florida Governor Ron DeSantis came in second with 21%. Former South Carolina Governor Nikki Haley only came in third

with 19%, despite her recent surge in polling support. Entrepreneur Vivek Ramaswamy came in fourth with less than 8% and announced that he will end his long-shot bid for the nomination. Next stop for the remaining candidates is the New Hampshire primary next Tuesday.

- Although Trump’s margin of victory was a record for Iowa, it’s important to keep in mind that the state has had a poor record of choosing the ultimate Republican candidate in recent election cycles. Trump still looks like the likely candidate for the Republicans, but his position at the top of the ticket isn’t yet assured.
- Another thing to keep in mind is that it’s still unclear whether Trump’s candidacy should be treated as that of an incumbent or as an upstart. Over history, the political and financial market dynamics around an election have differed depending on the status of the ultimate winner. For example, if Trump were considered an incumbent, he would have been expected to take nearly all the vote in last night’s balloting.
- In any case, we’ll continue monitoring the election campaigns, with a key focus on the implications for issues such as:
 - U.S. foreign policy, especially the U.S.’s tense relationship with China, the strength of its alliances, and approach to international trade, investment, and migration;
 - Monetary policy, especially the independence of the Fed and likely nominations for key officials;
 - Fiscal policy, including the fate of the Trump tax cuts due to expire in 2025, the outlook for the federal deficit and debt, and spending priorities in the budget; and
 - Regulatory policy, including antitrust policies and the regulation of the energy industry and financial services.



(Source: Wall Street Journal)

Taiwan Elections: In Saturday's election, independence-leaning Vice President Lai Ching-te of the ruling Democratic Progressive Party [won the presidency with 40% of the vote](#). Lai's win will anger Chinese leaders, as it means Taiwan's government will continue to resist near-term reunification with the mainland. Still, Beijing may be partly appeased that the DPP [lost control of the legislature to the China-friendly Kuomintang](#). Thus, the results may be the best possible outcome for peace in the Indo-Pacific and the security of Taiwan's world-leading semiconductor industry, which produces 90% of the world's most advanced computer and cellphone chips.

- Separately, the tiny Pacific Island nation of Nauru (pop. 11,000) yesterday [recognized the People's Republic of China, dumping its diplomatic recognition of Taiwan](#). In response, the Taiwanese foreign ministry accused Nauru of trying to extort large sums of money from Taipei to maintain its recognition of Taiwan.
- As a result, just 12 countries around the world now recognize Taiwan as the official representative of the Chinese nation.

South Korea: Although Taiwan's election outcome probably boosts the near-term security of its chip industry, governments around the world still worry that the U.S.-China rivalry could threaten future semiconductor supplies. Reflecting that concern, the South Korean government yesterday [announced a plan to develop the world's largest semiconductor manufacturing hub by channeling \\$471 billion of private investment into the project over the next 25 years](#).

- Much of the investment will come from the country's premier electronics firms, including Samsung (005930.KS, KRW, 73,900) and SK Hynix (000660.KS, KRW, 134,100).
- As with similar chipmaking plans in the U.S. and other countries, the aim of Seoul's program is to develop its own domestic computer chip supplies.

North Korea-South Korea: North Korean paramount leader Kim Jong Un today [ordered that his country's constitution be changed to remove its language calling for eventual reunification with South Korea](#). Kim also ordered that all government agencies dedicated to reunification be dismantled and that North Koreans should now consider South Koreans to be their principal enemy. The aim of the move is apparently to give North Korea more political leeway for an eventual attack on South Korea, or at least to increase the credibility of threatening such an attack.

Philippines: After a meeting with President Ferdinand Marcos, Jr., yesterday, the chief of the Philippine military [laid out an expansive plan to assert the country's sovereignty over areas also claimed by China](#). The unexpectedly aggressive plan would include purchasing more military ships, radars, and aircraft, as well as building facilities to house troops on up to nine disputed islands. Given the U.S.-Philippine mutual defense treaty, Manila's more assertive stance against China raises the risk of a potential U.S.-China conflict in the future.

China: In a speech to the World Economic Forum in Davos, Switzerland, Premier Li Qiang [said Chinese gross domestic product grew by "an estimated" 5.3% in 2023](#). If confirmed when Beijing releases the official figures, that would mark an acceleration from the weak 3.0% growth in 2022, when the government was still imposing draconian lockdowns to battle the COVID-19

pandemic. Tellingly, Li bragged that the growth in 2023 was achieved without resorting to “massive stimulus,” which suggests investors shouldn’t hope for such policies in 2024.

Japan: As Prime Minister Kishida struggles with abysmally low ratings in opinion polls, compounded by his Liberal Democratic Party’s extensive illegal funding scandal, a recent poll shows that Foreign Minister Yōko Kamikawa [is rising in popularity](#). Indeed, she is increasingly being seen as a viable candidate to replace Kishida, based largely on her reputation as an energetic and courageous leader.

Germany: Data released yesterday showed Germany’s gross domestic product [fell by an inflation-adjusted 0.3% in 2023, making it the worst-performing major country last year](#). The decline reflected headwinds such as high energy costs, elevated inflation rates, and rising interest rates, all of which continue to weigh on Germany — and the broader European economy — so far in 2024.

Middle East Conflicts: Iran [launched a series of ballistic missile strikes this morning against targets in Syria and northern Iraq, including what Iranian officials said was an Israeli “intelligence center.”](#) According to the Iranians, the strikes were in response to recent Israeli attacks that killed an Iranian commander in Syria and members of Tehran-backed militant groups in the region. The strike against the Israeli facility, if true, could dramatically increase the risk of overt fighting between the Israelis and Iran.

- Separately, Iran-backed Houthi rebels in Yemen [fired missiles at both a U.S. Navy ship and a U.S.-owned commercial ship over the long weekend](#), hitting the commercial ship but only causing minimal damage. U.S. military officials said they are expecting more retaliatory attacks from the Houthis and are preparing to launch more punishing airstrikes in response.
- The Iranian and Houthi attacks are keeping alive the risk that the Israeli-Hamas conflict could broaden into a wider regional war that would draw in the U.S.
- A broader war in the region would threaten global trade and oil supplies, boosting prices and threatening to reverse the recent progress in bringing down inflation.

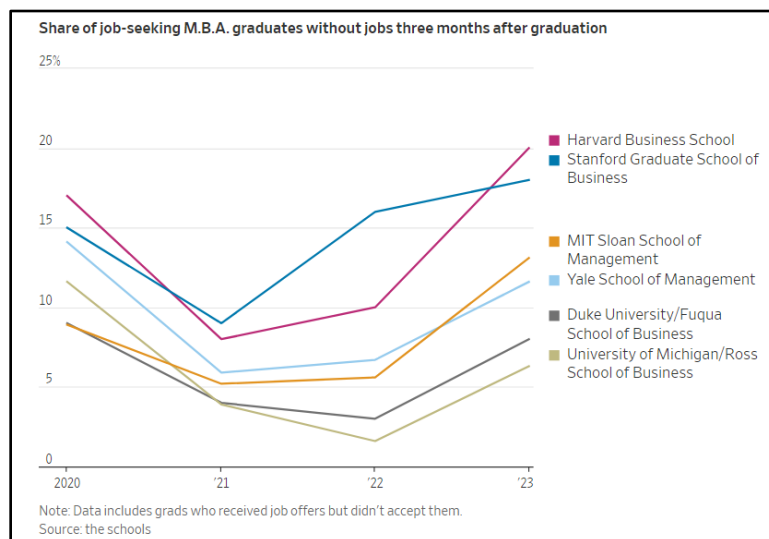
U.S. Monetary Policy: Atlanta FRB President Bostic [warned on Sunday that cutting interest rates too soon could lead to a rebound in consumer price inflation](#). Indeed, Bostic also said that the recent fast progress in bringing down inflation will likely slow going forward. Bostic is a voting member of the policy-setting Federal Open Market Committee this year, so his warnings suggest he may help resist any move by the policymakers to cut rates as quickly as bond investors are expecting.

U.S. Fiscal Policy - Federal: Senate Majority Leader Schumer [has submitted a new stopgap funding bill to keep the federal government open until early March](#), which would give lawmakers more time to agree on the appropriations bills needed to formally fund operations for the rest of the fiscal year. The bill is due to be taken up by the Senate today and would have to pass both houses and be signed into law by Friday to avoid a partial shutdown of the

government, but opposition to the overall funding deal by some Republicans makes it unclear whether that will happen.

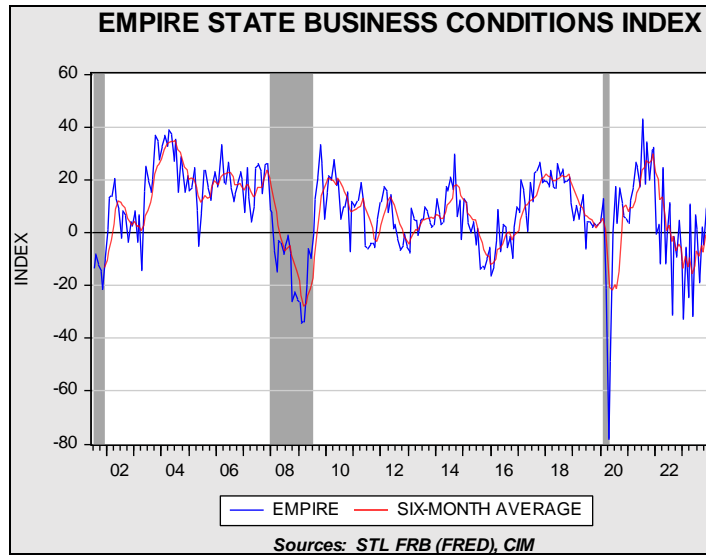
U.S. Fiscal Policy – State & Local: As New York Governor Hochul and New York City Mayor Adams today release their proposed budgets for the coming fiscal year, the plans are expected to encompass the state [sending an additional \\$2 billion to the city to help cover the cost of providing housing, food, medical care, and other services to illegal immigrants sent their by border states](#). City officials expect the cost of caring for the immigrants will total \$10 billion through mid-2025, likely helping create political pressure for tougher border policies.

U.S. Labor Market: Although the overall demand for labor in the U.S. remains strong, data continue to show weak hiring for higher-paid, white collar jobs. The *Wall Street Journal* today [carries an interesting story showing an unexpectedly high rate of joblessness for newly minted MBAs from top schools](#). For example, the report shows that 20% of students who received an MBA from Harvard Business School this spring were still unemployed three months later. Weak demand for white-collar labor could help explain some of the current crosswinds in the job market.



U.S. Economic Releases

Manufacturing activity in the New York State region significantly declined this month, missing expectations by a wide margin. The New York Fed's Empire State Index sank from -14.5 to -43.7, its lowest level since March 2020 and the third worst reading ever recorded. The biggest decline came from new orders, which fell by 38.1 points, and shipments, which dropped by 24.9 points. However, selling prices held relatively steady, which is good for inflation but raises concerns about a potential squeeze on profit margins in the coming months.



The chart above shows the Empire State Manufacturing index along with its six-month moving average. In January, the moving average fell from -4.33 to -11.8. While this drop is significant, it does not show that we are in an economic downturn. That said, this report is a stark reminder that while the broader economy seems resilient, there does seem to be persistent underlying weaknesses that may foreshadow slowing growth in the future.

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
11:00	Chris Waller Speaks on Economic Outlook and Monetary Policy	Member of the Board of Governors

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	PPI	y/y	Dec	0.3	0.3	-0.3	***	Equity bearish, bond bullish
	Money Stock M2	y/y	Dec	2.3%	2.3%		**	Equity and bond neutral
	Money Stock M3	y/y	Dec	1.7%	1.7%		**	Equity and bond neutral
	Machine tool orders	y/y	Dec P	-9.9%	-13.6%		**	Equity and bond neutral
Australia	Westpac Consumer Conf Index	m/m	Jan	82.1	82.1		**	Equity and bond neutral
	Westpac Consumer Conf SA	m/m	Jan	2.7%	2.7%		**	Equity and bond neutral
	Melbourne Institute Inflation	m/m	Dec	5.2	4.4		***	Equity and bond neutral
New Zealand	CoreLogic House Prices	y/y	Dec	-3.3%	-4.5%		*	Equity and bond neutral
South Korea	Export Price Index	y/y	Dec	-2.3%	-2.3%	-7.4%	*	Equity and bond neutral
	Import Price Index	y/y	Dec	-4.1%	-8.5%	-8.8%	*	Equity and bond neutral
India	Trade Balance	m/m	Dec	-\$19.803b	-\$20.580b	-\$20.080b	*	Equity and bond neutral
	Exports	y/y	Dec	1.0%	-2.8%		**	Equity and bond neutral
	Imports	y/y	Dec	-4.8%	-4.3%		**	Equity and bond neutral
	Wholesale Prices	y/y	Dec	0.73%	0.26%	1.22%	**	Equity and bond neutral
EUROPE								
Eurozone	Industrial Production WDA	y/y	Nov	-6.8%	-6.6%	-6.0%	**	Equity bearish, bond bullish
	Trade Balance SA	m/m	Nov	14.8b	10.9b		**	Equity and bond neutral
	ZEW Survey Expectations	m/m	Jan	22.7%	23.0%		**	Equity and bond neutral
Germany	CPI	y/y	Dec F	3.7%	3.7%	3.7%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Dec F	3.8%	3.8%	3.8%	**	Equity and bond neutral
	ZEW Survey Expectations	m/m	Jan	15.2%	12.8%	11.7%	**	Equity and bond neutral
	ZEW Survey Current Situation	m/m	Jan	-77.3	-77.1	-77.0	**	Equity and bond neutral
Italy	CPI, EU Harmonized	y/y	Dec F	0.5%	0.5%	0.5%	***	Equity and bond neutral
UK	Claimant Count Rate	y/y	Dec	4.0%	4.0%		***	Equity and bond neutral
	Jobless Claims Change	y/y	Dec	11.7k	16.0k		***	Equity and bond neutral
	Average Weekly Earnings 3M	y/y	Nov	6.5%	7.2%	6.8%	***	Equity and bond neutral
	Rightmove House Prices	m/m	Jan	-0.7%	-1.1%		**	Equity and bond neutral
Switzerland	Domestic Sight Deposits CHF	w/w	12-Jan	467.8b	457.1b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	12-Jan	476.3b	468.8b		*	Equity and bond neutral
Russia	CPI	m/m	Dec	7.4%	--	7.6%	**	Equity and bond neutral
	CPI Core	m/m	Dec	6.8%	6.4%		*	Equity and bond neutral
	Official Reserve Assets	m/m	Dec	598.6b	592.4b		*	Equity and bond neutral
AMERICAS								
Canada	Housing Starts	m/m	Dec	249.3k%	212.6k	210.9k%	**	Equity bullish, bond bearish

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)	558	558	0	Down
3-mo T-bill yield (bps)	520	521	-1	Flat
U.S. Sibor/OIS spread (bps)	531	530	1	Down
U.S. Libor/OIS spread (bps)	530	530	0	Down
10-yr T-note (%)	4.00	3.94	0.06	Flat
Euribor/OIS spread (bps)	393	393	0	Down
Currencies	Direction			
Dollar	Up			Down
Euro	Down			Up
Yen	Down			Up
Pound	Down			Up
Franc	Down			Up
Central Bank Action	Current	Prior	Expected	
PBOC 1-Year Med-Term Lending Facility	2.500%	2.500%	2.400%	Above Forecast
PBOC 1-Year Med-Term Lending (Bil.)	995.0b	1450.0b	900.0b	Above 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.

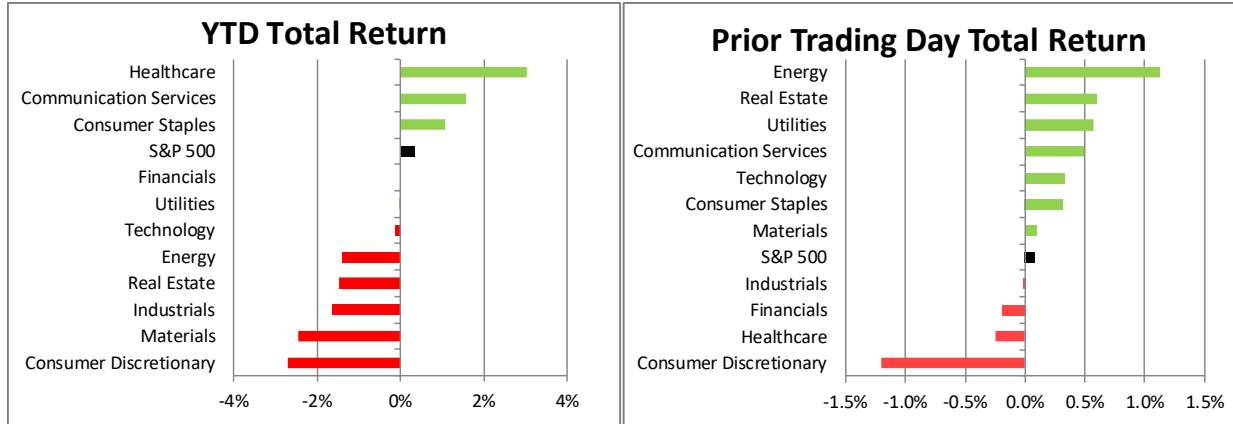
	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$78.81	\$78.15	0.84%	
WTI	\$73.00	\$72.68	0.44%	
Natural Gas	\$3.04	\$3.31	-8.27%	Supply Optimism
Crack Spread	\$25.95	\$24.26	6.95%	
12-mo strip crack	\$25.01	\$23.98	4.30%	
Ethanol rack	\$1.74	\$1.74	0.02%	
Metals				
Gold	\$2,038.60	\$2,056.55	-0.87%	
Silver	\$23.05	\$23.22	-0.74%	
Copper contract	\$377.65	\$374.05	0.96%	
Grains				
Corn contract	\$444.75	\$447.00	-0.50%	
Wheat contract	\$596.75	\$596.00	0.13%	
Soybeans contract	\$1,233.00	\$1,224.25	0.71%	
Shipping				
Baltic Dry Freight	1,360	1,460	-100	

Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures for the entire country. Meanwhile, the precipitation outlook calls for wetter-than-normal conditions in most states, with dry conditions in the Rocky Mountain region.

Data Section

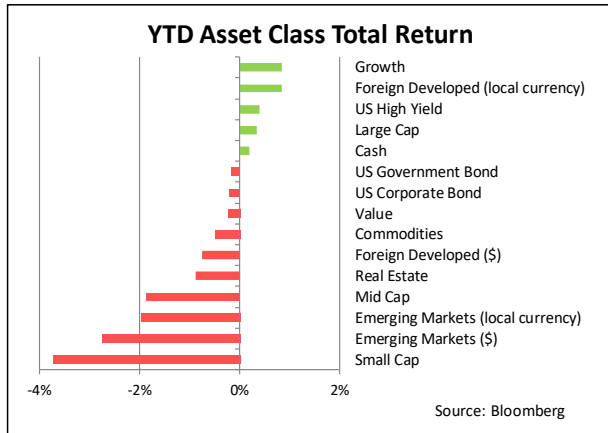
U.S. Equity Markets – (as of 1/12/2024 close)



(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 1/12/2024 close)

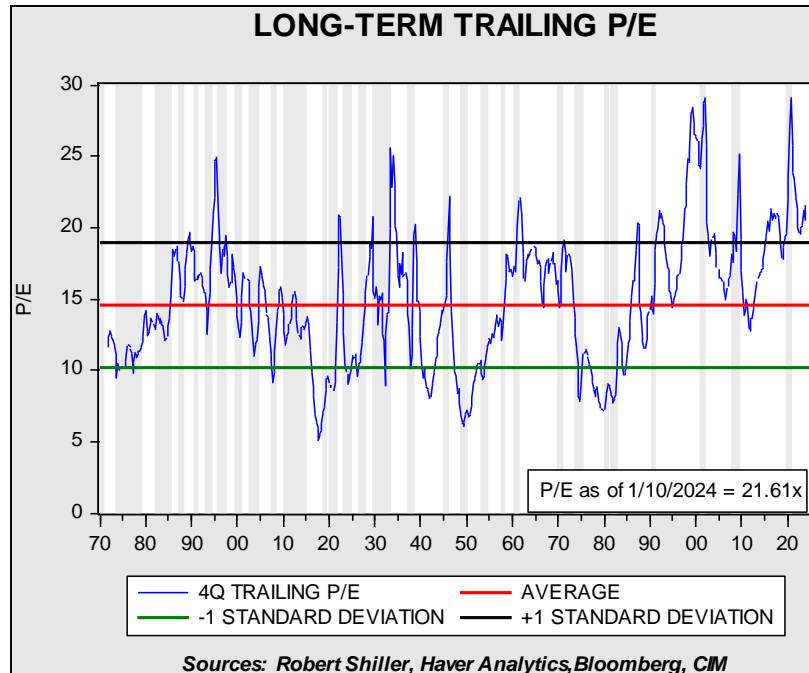


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 11, 2024



Based on our methodology,¹ the current P/E is 21.6x, up 1.2x from our last report. An increase in the price index due to a quarterly adjustment and a slight decline in earnings helped lift the multiple.

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.