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: January 30, 2024—9:30 AM EST] Global equity markets are mostly lower this morning. In Europe, the Euro Stoxx 50 is up 0.4% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.2%. Chinese markets were lower, with the Shanghai Composite down 1.8% from its previous close and the Shenzhen Composite down 2.7%. U.S. equity index futures are signaling a lower open.

With 129 companies having reported so far, S&P 500 earnings for Q4 are running at $55.00 per share, compared to estimates of $55.15, which is up 1.6% from Q3 2023. Of the companies that have reported thus far, 79.1% have exceeded expectations while 17.1% 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* (1/22/2024) (with associated podcast): "How Does Powell Define Restrictive Monetary Policy?"
- *The 2024 Outlook: Slow-Bicycle Economy* (12/18/2023) (with associated *Confluence of Ideas* podcast)
- Business Cycle Report (1/25/2024)

Our *Comment* today opens with a couple of notes on global oil supplies, including reduced capacity investment in Saudi Arabia but a new supply discovery in China. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, such as new data confirming Europe's slow economic growth and a preview of key U.S. monetary and fiscal policy decisions due this week.

Global Oil Industry: In Saudi Arabia, state-owned Saudi Aramco (2223.SR, SAR, 144.40) said it will comply with a request from the energy ministry to suspend a planned investment program that would have expanded its maximum sustainable production capacity from 12 million barrels per day to 13 million bpd by 2027.

- The energy ministry didn't provide an explanation for its move, but other big oil producers in recent years have cut back investment because of profitability concerns and fears of falling future demand associated with the transition to green energy.
- Saudi Arabia and its OPEC+ partners have also been holding down current output in an effort to boost prices amid weakening global demand. Therefore, the energy ministry's decision to limit new capacity investment could aim to help raise concerns about future supplies, thereby helping to boost prices.

China Oil Industry: Officials yesterday announced the discovery of a large new oil field in central Henan province, saying the field could hold up to 732 million barrels of light crude. That volume alone would amount to more than half of China's current annual oil production. The field, therefore, could help replace declining output elsewhere and modestly help reduce China's dependence on foreign energy supplies, although the available volume probably isn't enough to have a significant impact on global prices.

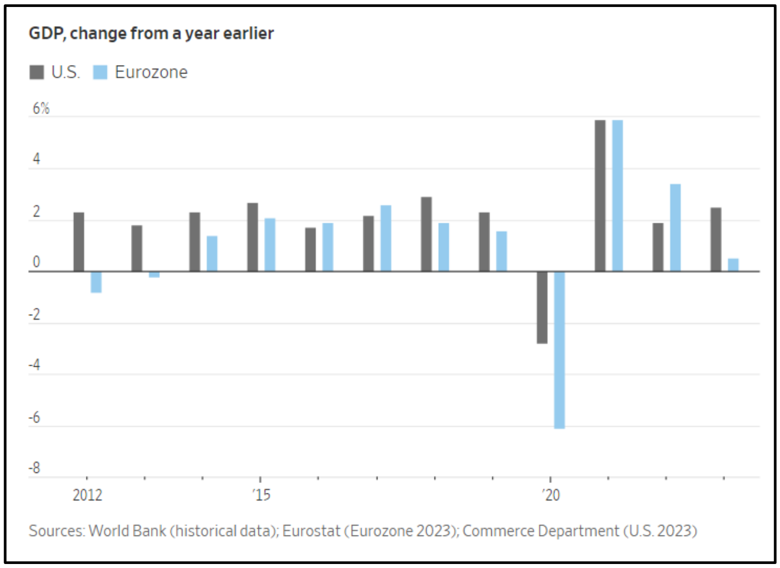
China Stock Market: In yet another move to support China's flagging stock market, the Chinese Securities Regulatory Commission and both major stock markets yesterday said strategic investors would be prohibited from lending out shares for short selling during specific lock-out periods. The modest measure isn't likely to help the stock market very much, but the drumbeat of new efforts to buoy the market show that the government is intent on at least arresting its recent decline.

China Military: The Chinese People's Political Consultative Conference has removed another high-ranking military official associated with missile development, meaning at least 16 such officials are now being investigated or disciplined for corruption or espionage. As we've noted previously, the continued chaos surrounding the People's Liberation Army Rocket Forces has likely unsettled General Secretary Xi, although we don't necessarily subscribe to the theory that it has reduced Xi's willingness to use military force if needed.

EU Regulation: Amazon (AMZN, $161.26) and robotic vacuum maker iRobot (IRBT, $15.50) called off their proposed merger yesterday, largely because of pushback from antitrust regulators in the European Union and the U.K. The deal's scuttling shows how European officials have become much more aggressive than their U.S. counterparts when it comes to ensuring free-market competition and combating market concentration. Going forward, large U.S. firms hoping to combine will probably continue to face high antitrust hurdles in the region.

EU Economic Growth: The EU's gross domestic product in the fourth quarter of 2023 was unchanged after a modest decline in the third quarter. As a result, the region's GDP in all of

2023 was up just 0.5%, much weaker than the U.S.'s growth of 2.5%. The EU economy continues to struggle with elevated interest rates, high energy prices because of Russia's invasion of Ukraine, and now broader supply disruptions because of the conflict in the Middle East. As a result, EU stock values rose much less than U.S. stock values in 2023.

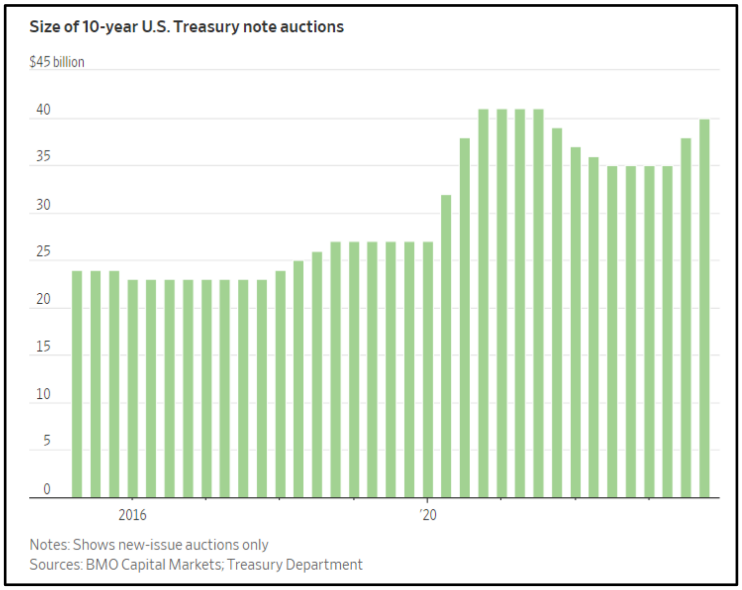


Germany: A panel of outside advisors today issued a report saying the country's constitutional "debt brake" is too rigid and should be broadly reformed to allow for more future-oriented fiscal spending. Implemented in 2016, the rule limits the country's structural budget deficit to 0.35% of GDP, adjusted for the economic cycle. It was suspended at the outset of the COVID-19 pandemic, but it has nevertheless been criticized by left-wing and centrist politicians for slowing growth-enhancing public investment in infrastructure and green technology.

U.S. Monetary Policy: The Fed today begins its latest policy meeting, with its decision due tomorrow at 2:00 PM EST. The policymakers are widely expected to leave the benchmark fed funds interest-rate target unchanged at its current range of 5.25% to 5.50%. We think investors will be focusing on the decision statement and Chair Powell's press conference, either of which could provide clues as to when the Fed will finally start cutting rates and reducing its balance sheet runoff. Many investors expect those moves as early as March, but we continue to think they'll come a bit later than that.

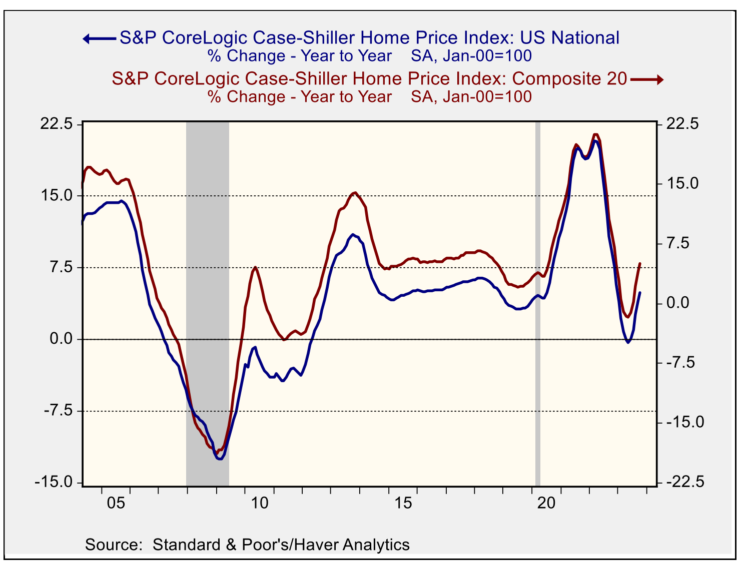
- Separately, Elizabeth Warren and three other Democratic senators wrote a letter to Chair Powell over the weekend urging him to cut the current "astronomical rates" in order to bring down housing costs.
- Without doubt, the policymakers at the Fed are feeling a lot of political pressure to cut rates these days. Importantly, they're likely feeling pressure from the Biden administration and from former President Trump, as well as Warren and her Democratic colleagues. Nevertheless, we still believe Powell will try to delay easing policy a bit longer than investors currently expect in order to be sure inflation pressure is under control.

U.S. Fiscal Policy: The Treasury Department [will release its borrowing plan tomorrow for the coming quarter, including its planned debt issuance by maturity]. The quarterly refunding plan has recently been a market mover, and investors will be watching closely for any major change in the Treasury's issuance of short-term obligations versus longer-term maturities. If the plan shows larger-than-expected issuance of longer-term debt, it will likely drive down Treasury prices, boost yields, and potentially weigh on risk asset values as well.



U.S. Economic Releases

November saw a slowdown in home price growth, with key indices pointing to a moderating market. The S&P CoreLogic Case-Shiller Index, which tracks prices in the top 20 U.S. cities, rose just 0.2% from the previous month, falling short of the 0.5% market expectation. Similarly, national home prices edged up 0.1%. Meanwhile, the Federal Housing Finance Agency Home Price Index rose 0.3% from the previous month, in line with the consensus estimate.



The chart above shows the annual change in the S&P CoreLogic home prices for the country and top-20 cities. National prices are up 5.1% from the prior year, while major cities' home prices are up 5.4%

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
10:00	Conf. Board Consumer Confidence	m/m	Jan	114.0	110.7	***
10:00	Conf. Board Expectations	m/m	Jan		85.6	**
10:00	Conf. Board Present Situation	m/m	Jan		148.5	**
10:00	JOLTS Job Openings	m/m	Dec	8750k	8790k	**
10:30	Dallas Fed Services Activity	m/m	Jan		-8.7	***
Federal Reserve						
No Fed speakers or events for the rest of today						

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	Jobless Rate	m/m	Dec	2.4%	2.5%	2.5%	***	Equity and bond neutral
	Job-To-Applicant Ratio	m/m	Dec	1.3%	1.3%	1.3%	**	Equity and bond neutral
Australia	Retail Sales	m/m	Dec	-2.70%	2.00%	1.60%	***	Equity bearish, bond bullish
South Korea	Discount Store Sales	y/y	Dec	-1.2%	1.3%		*	Equity and bond neutral
	Depart. Store Sales	y/y	Dec	5.9%	6.8%		*	Equity and bond neutral
	Retail Sales	y/y	Dec	7.5%	8.7%		**	Equity and bond neutral
EUROPE								
Eurozone	Consumer Confidence	m/m	Jan F	-16.1	-16.1		**	Equity and bond neutral
	Economic Confidence	m/m	Jan	96.2	96.4	96.3	***	Equity and bond neutral
	Industrial Confidence	m/m	Jan	-9.4	-9.2	-9.6	***	Equity and bond neutral
	Services Confidence	m/m	Jan	8.8	8.4	8.3	**	Equity bullish, bond bearish
	GDP	y/y	4Q A	0.1%	0.0%	0.1%	***	Equity and bond neutral
Germany	GDP WDA	y/y	4Q P	-0.2%	-0.4%	-0.3%	**	Equity and bond neutral
France	GDP	y/y	4Q P	0.7%	0.6%	0.7%	**	Equity and bond neutral
Italy	GDP WDA	y/y	Q2 P	0.5%	0.1%	0.2%	**	Equity and bond neutral
	PPI	y/y	Mar	-20.5%	-16.3%	-16.5%	**	Equity bullish, bond bearish
UK	Mortgage Approvals	m/m	Dec	50.5k	50.1k	49.3k	***	Equity bullish, bond bearish
Switzerland	Real Exports	m/m	Dec	1.1%	1.8%	1.4%	*	Equity and bond neutral
	Real Imports	m/m	Dec	2.3%	1.7%	1.0%	*	Equity bullish, bond bearish
	KOF Leading Indicator	m/m	Dec	101.5	97.8	98.0	**	Equity bullish, bond bearish
AMERICAS								
Mexico	GDP NSA	y/y	4Q P	2.4%	3.3%	3.0%	***	Equity bearish, bond bullish
Brazil	FGV Inflation IGPM	y/y	Jan	-3.32%	-3.18%	-3.16%	***	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)	558	558	0	Down
3-mo T-bill yield (bps)	517	518	-1	Flat
U.S. Sibor/OIS spread (bps)	531	531	0	Down
U.S. Libor/OIS spread (bps)	530	531	-1	Down
10-yr T-note (%)	4.07	4.07	0.00	Flat
Euribor/OIS spread (bps)	391	389	2	Down
Currencies	**Direction**			
Dollar	Down			Down
Euro	Flat			Up
Yen	Flat			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.

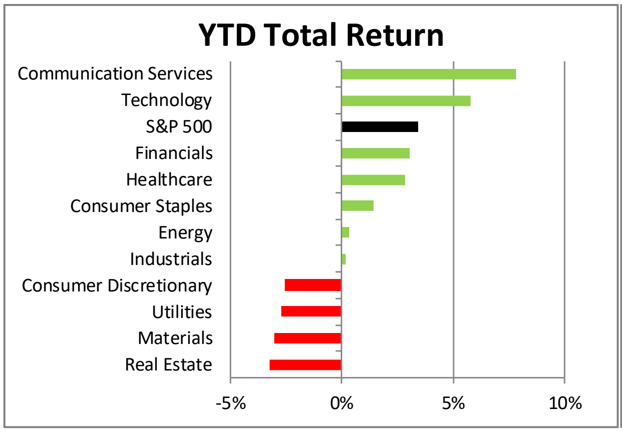
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$81.78	$82.40	-0.75%	
WTI	$76.24	$76.78	-0.70%	
Natural Gas	$2.09	$2.05	1.70%	
Crack Spread	$24.57	$25.81	-4.83%	
12-mo strip crack	$24.29	$24.96	-2.68%	
Ethanol rack	$1.77	$1.76	0.40%	
Metals				
Gold	$2,033.85	$2,033.23	0.03%	
Silver	$23.09	$23.20	-0.50%	
Copper contract	$387.95	$387.90	0.01%	
Grains				
Corn contract	$438.25	$440.25	-0.45%	
Wheat contract	$586.50	$593.50	-1.18%	
Soybeans contract	$1,197.00	$1,194.25	0.23%	
Shipping				
Baltic Dry Freight	1,460	1,518	-58	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-1.4		
Gasoline (mb)		2.0		
Distillates (mb)		1.0		
Refinery run rates (%)		-0.6%		
Natural gas (bcf)		-318		

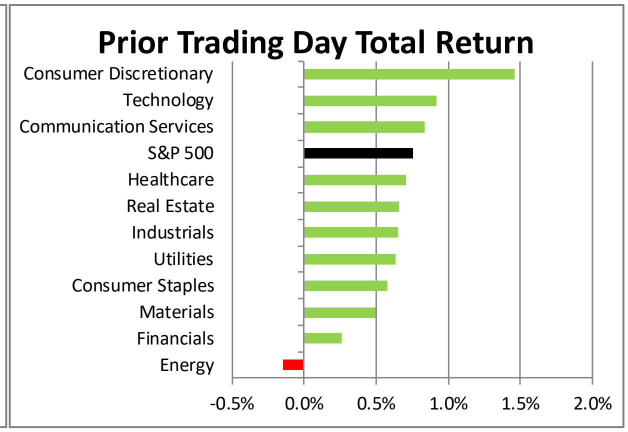
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures in most states east of the Rocky Mountains, with cooler temperatures in the Pacific and Southeast regions. The precipitation outlook calls for wetter-than-normal conditions for most of the country, with dry conditions in the New England region.

Data Section

U.S. Equity Markets – (as of 1/29/2024 close)

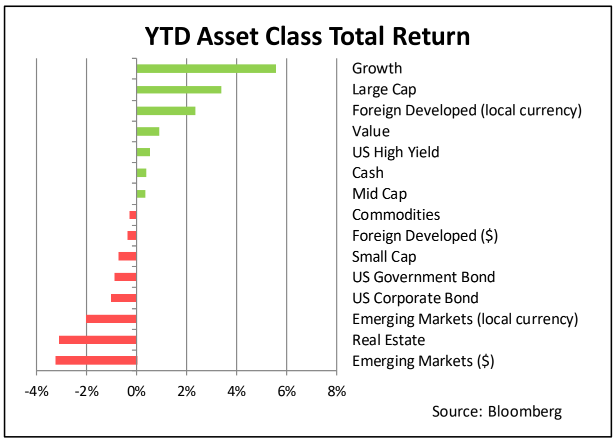




(Source: Bloomberg)

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 1/29/2024 close)

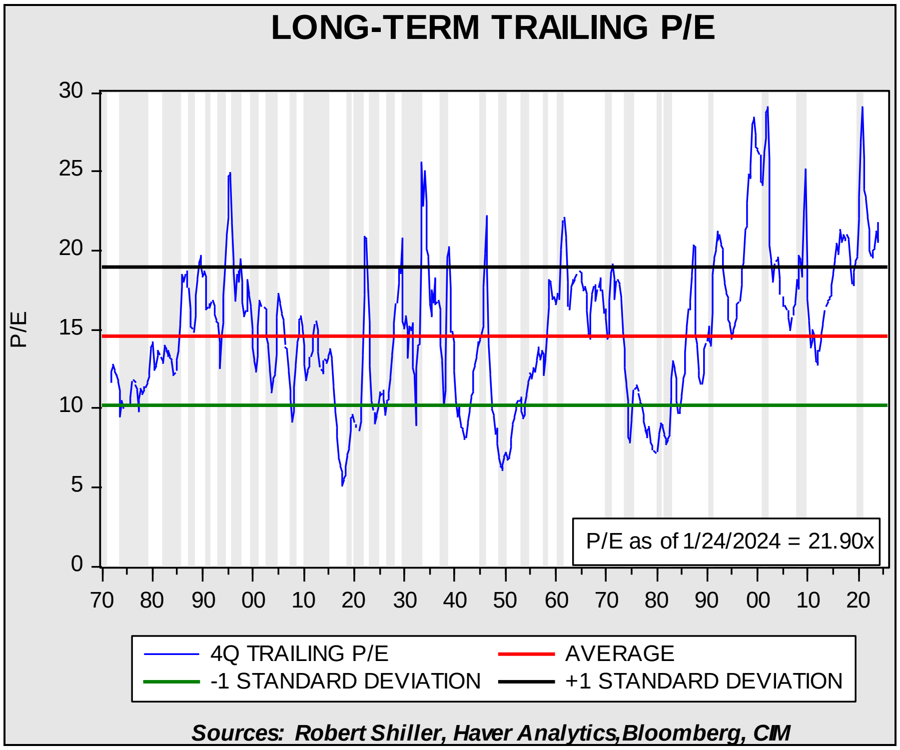


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 25, 2024



Based on our methodology,[1] the current P/E is 21.90x, up 0.12x 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.

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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.