

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 31, 2024—9:30 AM EST] Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 is relatively unchanged from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.3%. Chinese markets were lower, with the Shanghai Composite down 1.5% from its previous close and the Shenzhen Composite down 3.0%. U.S. equity index futures are signaling a lower open.

With 158 companies having reported so far, S&P 500 earnings for Q4 are running at \$55.60 per share, compared to estimates of \$55.15, which is up 1.6% from Q3 2023. Of the companies that have reported thus far, 79.1% have exceeded expectations while 15.8% 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 the latest on the tensions in the Middle East, which still could expand into a broader regional conflict and disrupt key global oil supplies. We next review a wide range of other international and U.S. developments with the potential to affect the financial

markets today, including more indications of weak Chinese economic growth and a preview of key U.S. monetary and fiscal policy announcements due out today.

Israel-Hamas Conflict: Kataib Hezbollah, the Iran-backed militant group thought to be responsible for this week's drone attack on U.S. forces in Jordan that killed three Americans, [said yesterday that it will temporarily halt further attacks on the U.S.](#) Nevertheless, U.S. military officials said the announcement would not stop a planned retaliatory strike against the group, and President Biden said he has already decided how that strike will be carried out.

- Kataib Hezbollah's stand-down could well reflect pressure from Iranian officials, who likely fear a U.S. strike and the prospect that the conflict sparked by the Hamas attacks on Israel on October 7 could expand to a regional war.
- Separately, Israeli forces continue their military operations against Hamas in Gaza; Prime Minister Netanyahu is still considering what kind of government should rule the territory when the fighting is over. Netanyahu remains under pressure from right-wing members of his governing coalition to eventually push Palestinians out of Gaza — a move that would likely be criticized around the world as ethnic cleansing and potentially spark further sympathy attacks by militant groups.
- In sum, the conflict remains a major source of global instability, especially if it widens and more seriously disrupts Middle Eastern energy supplies or Asian-European shipping.

China: The National Bureau of Statistics said its January purchasing managers' index for manufacturing [rose to a seasonally adjusted 49.2](#), improving slightly from the December reading of 49.0. The January PMI for services and construction rose to 50.7 from 50.4. As with most major PMIs, the official Chinese gauge is designed so that readings over 50 indicate expanding activity. At their current levels, the Chinese PMIs reflect the strong headwinds that are holding down growth, especially in manufacturing.

- Separately, the slowdown in Chinese growth continues to manifest itself in falling prices for Chinese real estate and stocks. Naturally, weak pricing in those two areas has forced Chinese investors to scramble for other ways to protect or build wealth.
- Recent reports indicate many Chinese investors have piled into domestic funds that invest in the U.S. or Japan. Those funds have recently provided good returns to the Chinese investors that own them, offsetting their losses from Chinese assets.
- Now, new data from the World Gold Council [shows Chinese investors have also turned to buying gold as a way to protect themselves](#). Along with "blistering" demand from the world's central banks, the WGC says strong Chinese purchases of gold jewelry and investment products were a key factor driving up gold prices in 2023.
- Based on our desire to hedge against today's rising geopolitical risks and take advantage of the rising global demand for gold, [we maintained our positions in the yellow metal across all our asset-allocation portfolios during our adjustments for the first quarter](#).

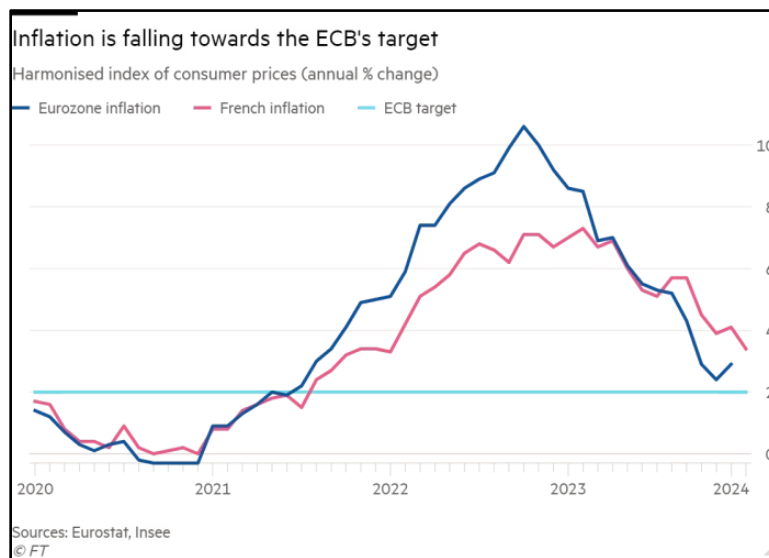
Hong Kong: The municipal government [has released a summary of the new national security law that it intends to add to its mini-constitution this year](#). The proposed law, which is subject to

popular discussion for 30 days, is intended to supplement the national security law imposed by Beijing in 2019. Observers have already raised concerns about its provisions against sedition and the release of state secrets. If passed, the law would likely further discourage foreign investment and travel to Hong Kong.

European Union-Russia: The European Parliament [has launched an investigation into allegations that Latvian lawmaker Tatjana Ždanoka has been spying for Russia for years](#). The allegations were first published in a Russian investigative newspaper. Ždanoka was one of just a dozen or so European Parliament lawmakers who voted against a resolution condemning Russia’s invasion of Ukraine in March 2022.

European Union-Mercosur: French officials yesterday [said the European Commission has stopped negotiating over a free-trade agreement between the EU and Mercosur](#), a trade bloc consisting of Brazil, Argentina, Uruguay, and Paraguay. If true, it appears Brussels has caved to protesting farmers in France and elsewhere in the EU, who fear a surge of cheap South American food imports, despite the promise of greater EU industrial exports. The end of talks over the deal also illustrates how politics has swung against free trade throughout the developed countries.

Eurozone: French consumer prices in January [were up just 3.4% from the same month one year earlier, compared with 4.1% in the year to December](#). The good figures on price inflation have kindled new hopes that the European Central Bank could soon start to cut interest rates. However, in an interview last night, ECB chief Lagarde warned that the monetary policymakers still want to see more data confirming that price pressures are easing. Lagarde specifically cited a need to see easing wage growth.



U.S. Monetary Policy: The Fed [wraps up its latest policy meeting today](#), with its decision due at 2:00 PM EST. The officials [are expected to leave the benchmark fed funds interest-rate target unchanged at its current range of 5.25% to 5.50%](#). Investors will focus 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.

U.S. Fiscal Policy: Today, the Treasury Department [will release its borrowing plan 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. Immigration Politics: After Republicans in Congress pushed President Biden to accept tighter limits on immigration in return for new military aid to Ukraine, former President Trump [has scuttled the deal to avoid giving Biden a win in the run-up to the election in November](#). Meanwhile, Republicans on the House Homeland Security Committee have pushed through a measure calling for the impeachment of Homeland Security Secretary Mayorkas for failing to enforce the national immigration laws and stop the recent surge of illegal border crossings.

- The tussling over border policy signals that immigration reform and border security will be a big part of the presidential campaign leading up to November.
- Given that polling suggests voters are more supportive of the Republicans' tougher restrictions, it's probably no surprise that Biden tacked to the right on border security in his effort to win support for more aid to Ukraine. Now that the Republicans have apparently decided not to accept the win, a key question is whether voters will punish them for playing politics with an issue they previously called essential to national security.

U.S. Defense Industry: As countries around the world work to rebuild their armed forces in response to worsening geopolitical challenges, new data shows U.S. defense companies [recorded \\$81 billion in new foreign military sales in 2023, up 56% from 2022](#). The figures are consistent with our view that increased geopolitical tensions have set the stage for years of increased sales and profits for traditional defense contractors and other industrial or technology firms producing defense-related goods and services.

U.S. Economic Releases

Elevated borrowing costs continue to weigh on housing loan demand. According to an index tracked by the Mortgage Bankers Association (MBA), new applications fell 7.2% in the week ending January 26, after rising 3.7% in the week prior. The drop in loans comes as potential home buyers continue to wait out the market in hopes that lending conditions improve in the coming months. The average 30-year fixed-rate mortgage was unchanged from the previous week at 6.78%. As a result, the MBA tracker for purchases fell 11.4% from the previous week, while the tracker for refinancing rose 1.6%.

The U.S. labor market is exhibiting signs of cooling, with data suggesting weaker job growth and moderation in employment costs. The country added 107k jobs in January, down from the previous increase of 158k and below consensus estimates of 150k. The decline in new hires

suggests that firms may be exercising greater caution amidst escalating economic uncertainty. Likewise, the employment cost index, a gauge of wages and benefits, experienced a modest 0.9% increase in the fourth quarter. The reading was below consensus estimate of 1.0% and was the smallest increase since 2021.



The chart above shows the year-over-year change in both the Employment Cost Index (ECI) and the PCE Core Services Index. In the final quarter of 2023, the ECI rose 4.2% compared to the previous year, while the Core Services Index increased by 3.5%. This strong correlation suggests that as the labor market cools and employment costs decline, core services prices, a key Fed inflation indicator, may also moderate.

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	
9:45	MNI Chicago PMI	m/m	Jan	47.2	46.9	***	
14:00	FOMC Rate Decision (Lower Bound)	w/w	31-Jan	5.50%	5.50%	***	
14:00	FOMC Rate Decision (Upper Bound)	w/w	31-Jan	5.25%	5.25%	***	
14:00	Interest on Reserve Balances Rate	w/w	1-Feb	5.40%	5.40%	**	
Federal Reserve							
EST	Speaker or Event	District or Position					
14:30	Fed Chair Holds Press Conference Following FOMC Meeting	Chairman 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	Retail Sales	y/y	Dec	2.1%	5.3%	5.4%	**	Equity bearish, bond bullish
	Depart. Store & Supermarket Sales	y/y	Dec	2.5%	4.4%	4.2%	*	Equity bearish, bond bullish
	Industrial Production	y/y	Dec P	-0.7%	-1.4%	0.1%	***	Equity bearish, bond bullish
	Consumer Confidence	m/m	Jan	38.0	37.2	37.5	*	Equity and bond neutral
	Housing Starts	y/y	Dec	-4.0%	-8.5%	-6.6%	**	Equity bullish, bond bearish
	Annualized Housing Starts	y/y	Dec	0.814m	0.775m	0.789m	*	Equity and bond neutral
Australia	Private Sector Credit	y/y	Dec	4.8%	4.7%		**	Equity and bond neutral
	CPI	y/y	4Q	4.1%	5.4%	4.3%	**	Equity and bond neutral
	CoreLogic House Px	y/y	Jan	0.4%	0.4%		**	Equity and bond neutral
New Zealand	ANZ Activity Outlook	m/m	Jan	25.6	29.3		**	Equity and bond neutral
	ANZ Business Confidence	m/m	Jan	36.6	33.2		**	Equity and bond neutral
	CoreLogic House Prices	y/y	Jan	-2.7%	-3.3%		*	Equity and bond neutral
South Korea	Industrial Production	y/y	Dec	6.2%	5.3%	5.5%	***	Equity and bond neutral
China	Official Manufacturing PMI	m/m	Jan	49.2	49.0	49.3	***	Equity and bond neutral
	Official Services PMI	m/m	Jan	50.7	50.4	50.6	**	Equity and bond neutral
EUROPE								
Germany	Import Price Index	y/y	Dec	-8.5%	-9.0%	-8.2%	**	Equity and bond neutral
	Retail Sales	y/y	Dec	-4.4%	-2.0%	-1.2%	*	Equity bearish, bond bullish
	Unemployment Change	m/m	Jan	-2.0k	5.0k	2.0k	***	Equity bearish, bond bullish
	Unemployment Claims Rate	m/m	Jan	5.8%	5.9%	5.8%	**	Equity and bond neutral
	CPI	y/y	Jan P	2.9%	3.7%	3.0%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Jan P	3.1%	3.8%	3.0%	**	Equity and bond neutral
France	CPI	y/y	Jan P	3.1%	3.7%	3.3%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Jan P	3.4%	4.1%	3.6%	**	Equity and bond neutral
	PPI	y/y	Dec	-0.9%	0.3%		*	Equity and bond neutral
Italy	Unemployment Rate	m/m	Dec	7.2%	7.5%	7.4%	**	Equity and bond neutral
UK	Nationwide House Px NSA	y/y	Jan	-0.2	-1.8	-0.9	**	Equity bullish, bond bearish
Switzerland	Real Retail Sales	y/y	Dec	-0.8%	0.7%	-1.5%	**	Equity bullish, bond bearish
AMERICAS								
Mexico	International Reserves Weekly	w/w	26-Jan	\$212887m	\$212769m		*	Equity and bond neutral
Brazil	National Unemployment Rate	m/m	Dec	7.4%	7.5%	7.6%	*	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)	557	558	-1	Down
3-mo T-bill yield (bps)	519	520	-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 (%)	4.03	4.03	0.00	Flat
Euribor/OIS spread (bps)	390	391	-1	Down
Currencies	Direction			
Dollar	Up			Down
Euro	Flat			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.

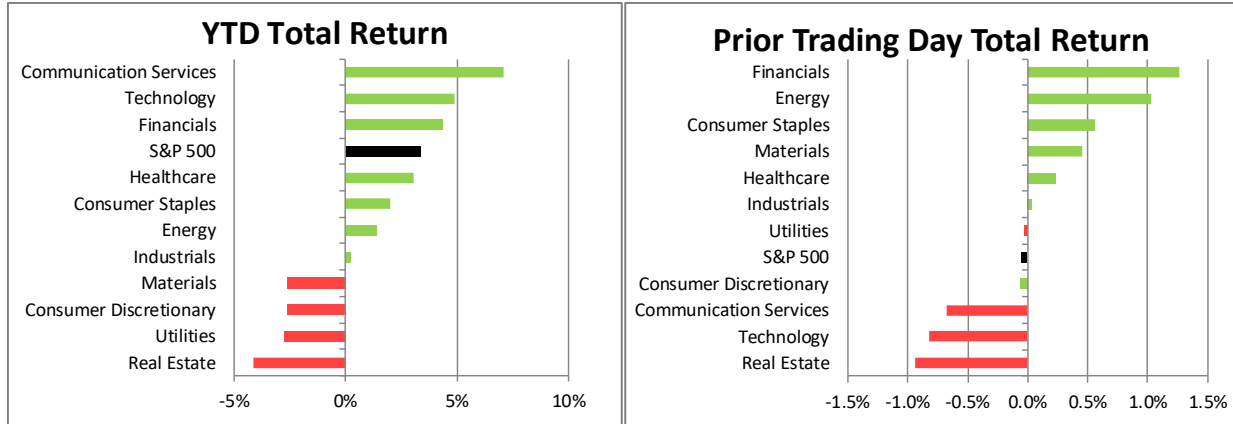
	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$81.97	\$82.87	-1.09%	
WTI	\$76.93	\$77.82	-1.14%	
Natural Gas	\$2.09	\$2.08	0.77%	
Crack Spread	\$25.36	\$25.31	0.17%	
12-mo strip crack	\$24.87	\$24.84	0.14%	
Ethanol rack	\$1.77	\$1.77	0.28%	
Metals				
Gold	\$2,036.67	\$2,037.01	-0.02%	
Silver	\$23.09	\$23.17	-0.37%	
Copper contract	\$390.25	\$391.10	-0.22%	
Grains				
Corn contract	\$446.75	\$447.75	-0.22%	
Wheat contract	\$598.00	\$605.50	-1.24%	
Soybeans contract	\$1,211.50	\$1,218.75	-0.59%	
Shipping				
Baltic Dry Freight	1,397	1,460	-63	
DOE Inventory Report				
	Actual	Expected	Difference	
Crude (mb)		-1.1		
Gasoline (mb)		2.0		
Distillates (mb)		-1.0		
Refinery run rates (%)		1.8%		
Natural gas (bcf)		-201		

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 New England.

Data Section

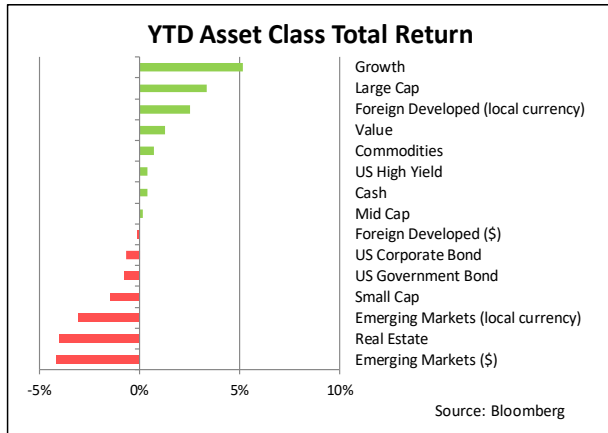
U.S. Equity Markets – (as of 1/30/2024 close)



(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 1/30/2024 close)

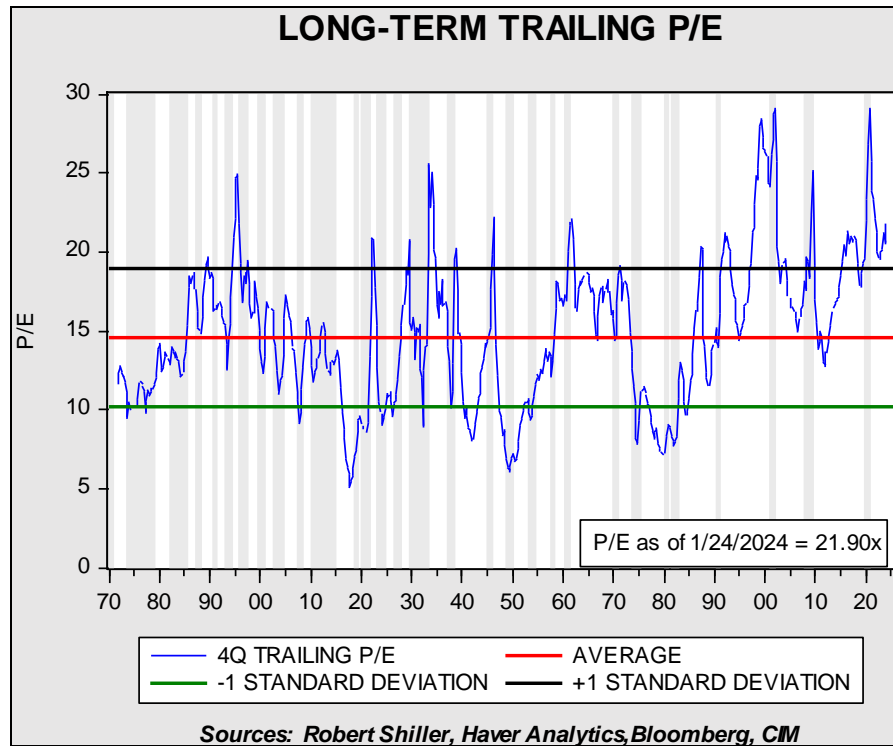


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.

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.