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: March 12, 2024—9:30 AM EDT] Global equity markets are mostly higher this morning. In Europe, the Euro Stoxx 50 is up 0.2% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.9%. Chinese markets were mixed, with the Shanghai Composite down 0.4% from its previous close and the Shenzhen Composite up 0.8%. US equity index futures are signaling a higher open.

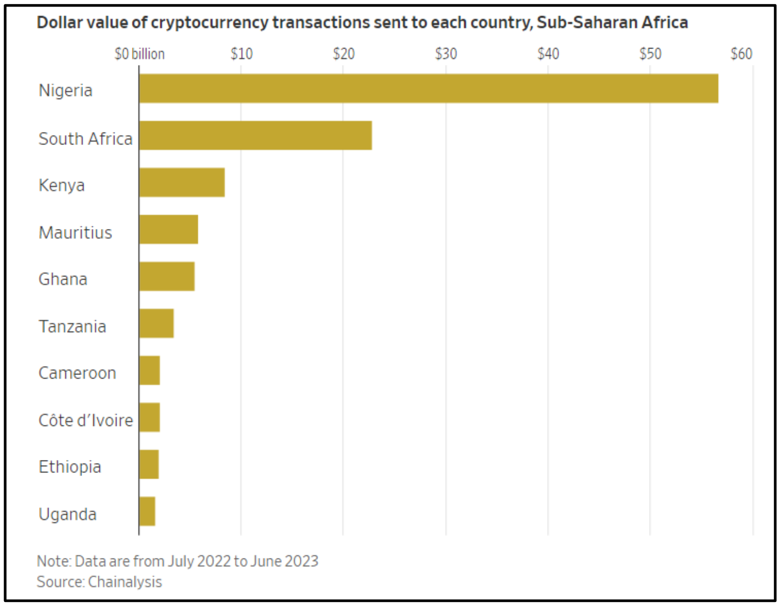
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- ***Bi-Weekly Geopolitical Report* (3/11/2024) (with associated podcast): "Rebirth of US Nuclear Deterrence"**
- *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* (3/4/2024) (with associated podcast): "Uranium Demand, Supply, and Investment Prospects"
- *The 2024 Outlook: Slow-Bicycle Economy* (12/18/2023) (with associated *Confluence of Ideas* podcast)
- *Confluence of Ideas podcast* (2/13/2024) "Reviewing the Asset Allocation Rebalance: Q1 2024"

Our *Comment* today opens with a Nigerian government crackdown on cryptocurrencies and their use to avoid the country's currency controls. We next review a wide range of other international and US developments with the potential to affect the financial markets today, including a worrisome spike in attempted terrorist attacks in Europe and a potential new US probe into unfair Chinese trading practices.

Nigeria-Cryptocurrencies: Highlighting how governments around the world likely see cryptocurrencies as a threat to their sovereignty, Nigerian authorities have detained two high-level employees of crypto exchange operator Binance, apparently for facilitating Nigerian citizens' use of stablecoins to skirt central bank exchange-rate controls.

- Such transactions are a risk to Nigeria's currency controls because cryptocurrencies have become prevalent in the country. Nigeria now has the world's second-highest rate of cryptocurrency adoption, after India. Nigerian cryptocurrency transactions in the year ended June 2023 totaled almost $60 billion.
- The ability of citizens to skirt government financial and currency controls using crypto assets is one reason why countries may increasingly clamp down on their use, as China has already done. As we have written before, many central banks are instead studying the possibility of issuing their own digital currencies.



Argentina: Radical libertarian President Milei is facing a scandal today after opposition Peronist legislators revealed that he signed a decree giving himself a 50% pay raise last month. In response, Milei has fired his labor secretary and argued that he inadvertently signed the decree because it was an automatic inflation adjustment instituted by the previous Peronist government. The scandal could become another headwind for Milei's effort to rein in Argentina's government spending, reduce bureaucracy, spark faster economic growth, and stabilize the currency.

Russia-Ukraine-NATO: Following on French President Macron's statement last month that the North Atlantic Treaty Organization shouldn't rule out sending troops to Ukraine, the Polish foreign minister on Friday told his parliament that it "is not unthinkable" that NATO forces could be deployed there. The statement from the foreign minister, which contradicts the view of Polish Prime Minister Tusk, shows how Russia's new momentum in Ukraine is increasingly scaring Western European leaders and forcing them to consider previously unthinkable actions.

European Union: Authorities in multiple European countries have recently arrested a number of terrorists who were planning attacks on EU soil against Jewish and Israeli-connected targets, apparently in sympathy with Palestinians suffering from the Israel-Hamas war in the Gaza Strip. The terrorists, at least some of whom have posed as refugees, are being directed in part by Iran and its militant Islamist proxies in the Middle East, including Hamas and Hezbollah. The news suggests there is a rising risk of a successful attack that could undermine market confidence.

Israel-Hamas Conflict: In its annual threat assessment report yesterday, the US intelligence community warned that Israeli Prime Minister Netanyahu's grip on power is "in jeopardy" because of the Hamas attacks on Israel last October 7 and the government's continued war against Hamas in Gaza. If that leads to new elections in Israel, the assessment argues that voters could elect a more moderate government than Netanyahu's.

- Separately, Israel and Hezbollah fighters in southern Lebanon have sharply escalated their attacks on each other over the last day. Israel has even launched airstrikes deep into Lebanese territory.
- The intensified fighting in southern Lebanon is a reminder that Israel's fighting with the Palestinians and Iran-backed militant groups still has the potential to spark a broader conflict that could be deeply concerning for financial markets.

China: Moody's has downgraded the debt of Vanke, the China's second-largest real estate developer, to below-investment grade status and warned of further downgrades in the future as the company struggles with declining contracted sales. The downgrade illustrates the ongoing challenges facing the country's enormous real estate sector as the government leans on it to cut excess capacity and debt, which in turn has prompted lower prices and falling demand.

United States-China: In case you thought you could read a *Comment* from us that doesn't include a new US-China friction, think again. The United Steel Workers union will file a petition today with the US Trade Representative alleging that China uses discriminatory practices in shipbuilding and maritime logistics to undermine US producers. The petition will ask the government to launch an investigation into the matter, which could eventually result in further tariffs or other trade barriers against Chinese products or services.

- Ultimately, pushing back against China's dominance in global shipbuilding aims to help revive the once-thriving US shipbuilding industry. That could have important implications for both private industry and the US Navy, which is constrained by limited domestic shipyards. However, any potential revival of the US industry would be a very long-term project.
- In any case, any new investigation into Chinese unfair trading practices or punitive trade barriers would exacerbate the spiraling tensions between the West and China, further fracturing the global economy and presenting risks for investors.

United States-Philippines: As the Biden administration keeps trying to solidify US alliances to protect against Chinese aggression, Commerce Secretary Raimondo has urged US technology firms to at least double their investment in Philippine facilities that handle a key part of the info-tech supply chain: assembling, testing, and packaging computer chips produced in the US or elsewhere. Raimondo's call is an example of US "friend shoring," or trying to shift more of its critical supply chains to friendly countries, both to shore up those allies and boost resilience.

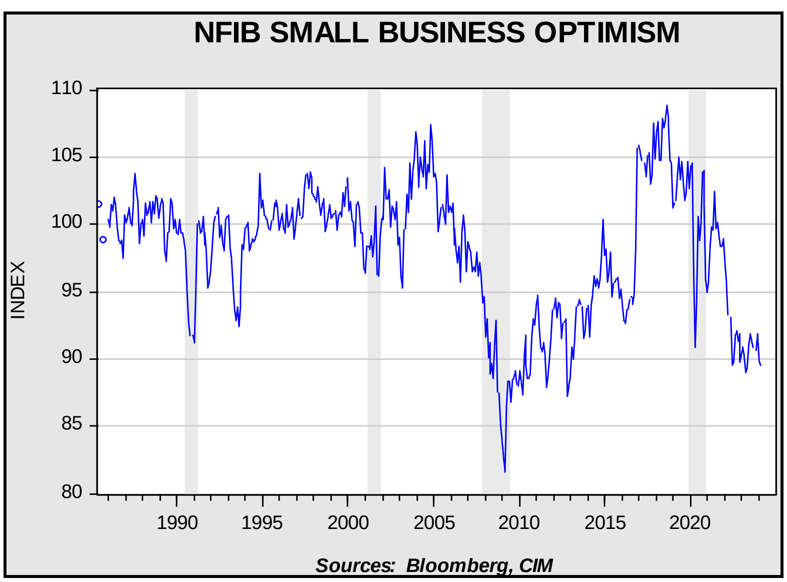
US Fiscal Policy: The Biden administration yesterday [released its proposed federal budget for fiscal year 2025, which starts on October 1]. The [plan] calls for total outlays to rise 4.7% to a total of $7.265 trillion, largely because of Social Security, Medicare, Medicaid, and other entitlements passed by Congress in previous years. The plan calls for receipts to rise 7.9% to $5.485 trillion, reflecting both economic growth and proposed tax increases on higher-income people.

- The deficit of $1.781 trillion would be modestly lower than the estimated $1.859 trillion in FY 2024.
- The plan also calls for a number of sweeteners designed to help the Democratic Party in the November election. For example, it calls for a new mortgage tax credit and subsidy for home sales.
- Nevertheless, because of the fractured Congress, the proposed budget is seen as highly unlikely to pass in anything resembling its current form. Rather, the proposal will serve as a key reference point for Biden's re-election campaign.

US Labor Market: Port operators on the East Coast and Gulf Coast [are starting negotiations with the International Longshoremen's Association for a new, multi-year labor contract] to follow the current one when it expires on September 30. However, the dockworkers are already threatening to strike if they don't get the concessions that they're demanding. If the negotiations fail and a strike occurs, it will likely happen at the peak of the delivery season for holiday imports, potentially causing important disruptions to the economy and pushing prices higher.

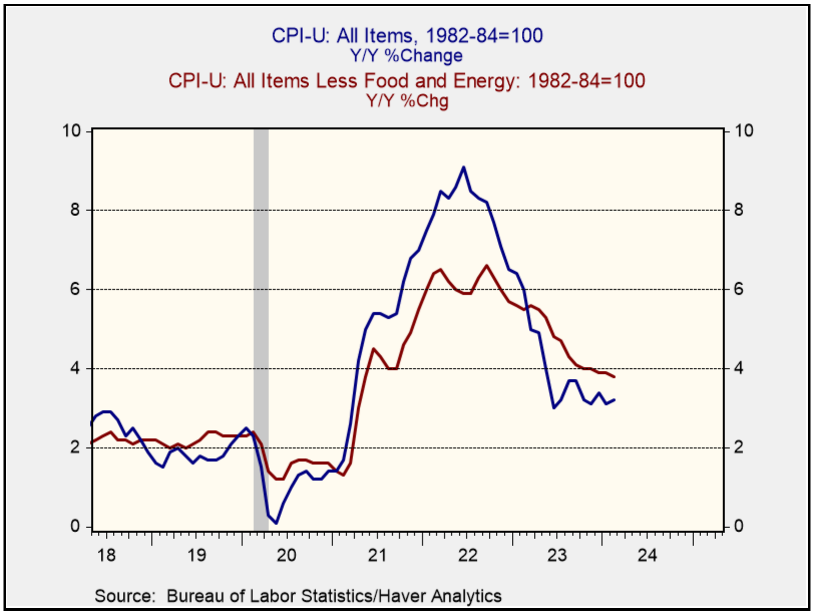
US Economic Releases

Small business confidence plummeted to its lowest point in nine months, reflecting concerns over rising borrowing expenses and a deteriorating economic outlook. The latest figures from the National Federation of Independent Business (NFIB) Small Business Optimism Index reveal a significant dip to 89.4, falling short of the anticipated 90.5.



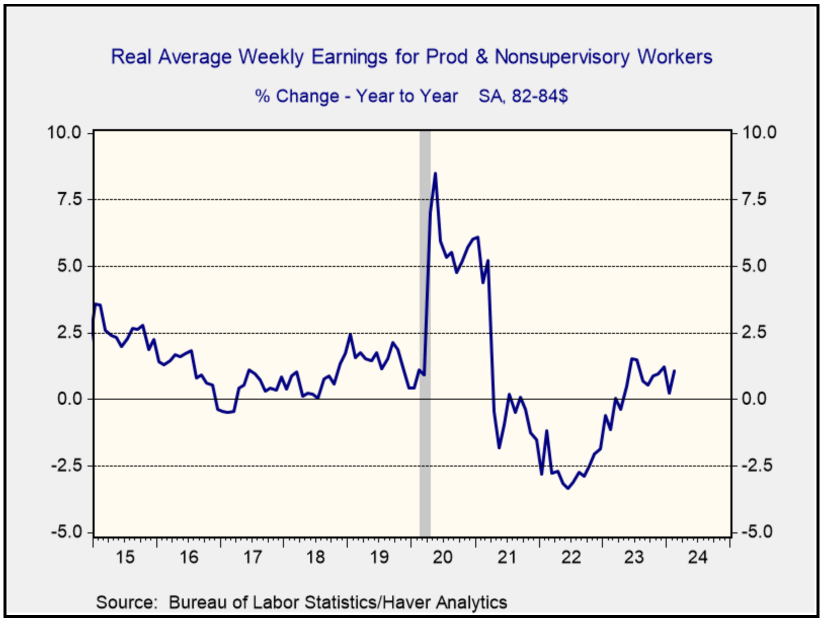
The chart above shows the NFIB Small Business Optimism Index. February witnessed declines across the board, with fewer firms reporting upticks in capital expenditure, intentions to boost inventory, and/or plans for expansions.

February's inflation data showed a slight acceleration. The Consumer Price Index (CPI) rose 0.4% from January, meeting market expectations but exceeding the prior month's increase of 0.3%. Core CPI, which excludes food and energy prices, also rose 0.4%, matching January's increase but slightly above the anticipated 0.3% rise.



The chart above shows that annual headline inflation rose slightly from 3.1% to 3.2%, while core inflation dipped from 3.9% to 3.8%. This modest increase in headline inflation might not be enough to deter policymakers from holding steady in March, but it leaves the possibility open for a summer adjustment.

Real wages, a measure of purchasing power, have shown continued strength. Hourly earnings rose by 1.1% from the prior year, while weekly earnings increased by 0.5% over the same period.



The year-over-year increase in weekly earnings for nonsupervisory workers is around 1.06%, which is roughly in line with the 10-year average. While this suggests some wage growth relative to inflation, it might not be a substantial gain in purchasing power.

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**
14:00	Monthly Budget Statement	m/m	Feb	-$298.5b	-$262.4b	**
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	PPI	y/y	Feb	0.6%	0.2%	0.5%	*	Equity and bond neutral
Australia	NAB Business Conditions	m/m	Feb	10	7		**	Equity bullish, bond bearish
	NAB Business Confidence	m/m	Feb	0.0%	1		**	Equity and bond neutral
India	Industrial Production	y/y	Jan	3.8%	4.2%	4.1%	***	Equity and bond neutral
	CPI	y/y	Feb	5.09%	5.10%	5.04%	***	Equity and bond neutral
EUROPE								
Germany	CPI	y/y	Feb F	2.5%	2.5%	2.5%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Feb F	2.7%	2.7%	2.7%	**	Equity and bond neutral
UK	ILO Unemployment Rate 3Mths	m/m	Jan	3.9%	3.8%	3.8%		Equity and bond neutral
	Claimant Count Rate	m/m	Feb	4.0%	4.0%			Equity and bond neutral
	Jobless Claims Change	m/m	Feb	16.8k	3.1k			Equity bearish, bond bullish
AMERICAS								
Mexico	Industrial Production	y/y	Jan	2.9%	0.0%	2.2%	***	Equity bullish, bond bearish
	Manufacturing Production	y/y	Jan	0.1%	-0.4%	1.1%	*	Equity bearish, bond bullish
Brazil	IBGE Inflation IPCA	y/y	Feb	4.50%	4.51%	4.45%	*	Equity and bond neutral

Financial Markets

The table below highlights some of the indicators that we follow daily. 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)	522	522	0	Up
U.S. Sibor/OIS spread (bps)	533	533	0	Down
U.S. Libor/OIS spread (bps)	533	534	-1	Down
10-yr T-note (%)	4.09	4.10	-0.01	Down
Euribor/OIS spread (bps)	393	394	-1	Down
Currencies	**Direction**			
Dollar	Flat			Down
Euro	Flat			Up
Yen	Down			Down
Pound	Down			Up
Franc	Up			Down

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.

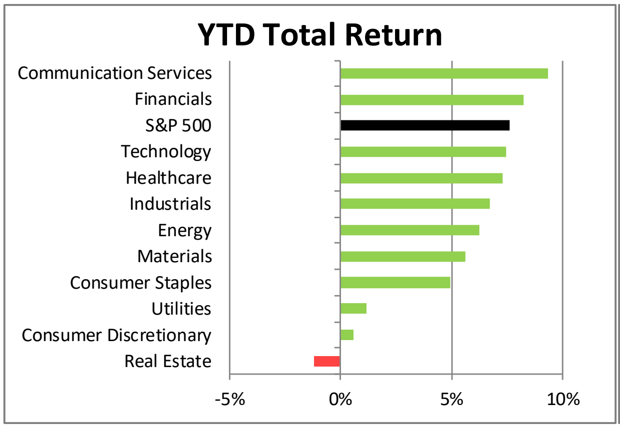
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$82.51	$82.21	0.36%	
WTI	$78.13	$77.93	0.26%	
Natural Gas	$1.81	$1.76	3.01%	
Crack Spread	$31.29	$31.26	0.08%	
12-mo strip crack	$24.76	$24.79	-0.13%	
Ethanol rack	$1.74	$1.74	0.11%	
Metals				
Gold	$2,172.21	$2,182.75	-0.48%	
Silver	$24.39	$24.47	-0.33%	
Copper contract	$393.40	$392.85	0.14%	
Grains				
Corn contract	$438.75	$441.75	-0.68%	
Wheat contract	$541.75	$547.25	-1.01%	
Soybeans contract	$1,178.00	$1,179.25	-0.11%	
Shipping				
Baltic Dry Freight	2,377	2,345	32	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		2.7		
Gasoline (mb)		1.0		
Distillates (mb)		-1.0		
Refinery run rates (%)		0.6%		
Natural gas (bcf)		-37		

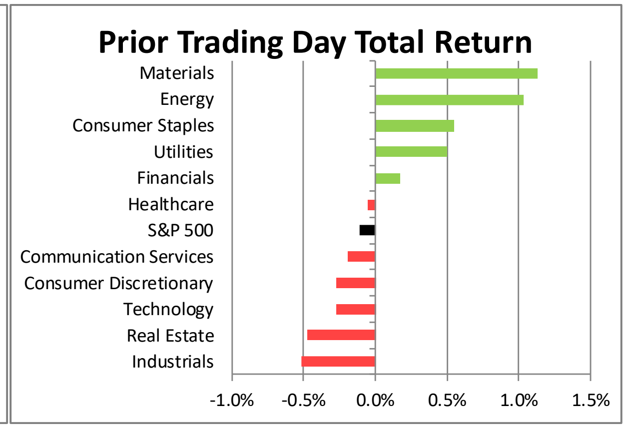
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures in the Pacific region, East Coast, and parts of the Southwest, with cooler-than-normal temperatures for the rest of the country. The precipitation outlook call for wetter-than-normal conditions in the South and the East Coast, with dry conditions in the Far West and Great Plains.

Data Section

US Equity Markets – (as of 3/11/2024 close)

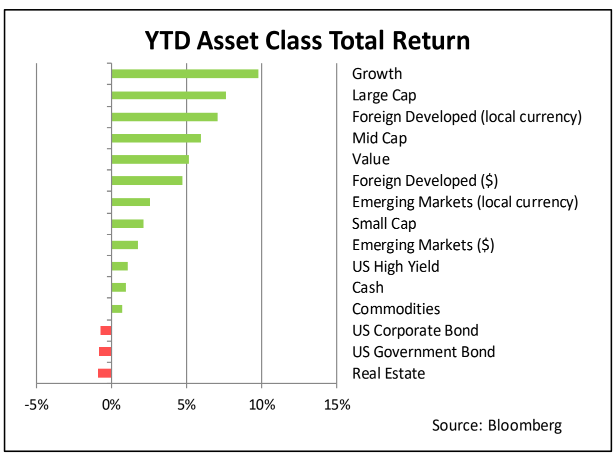




(Source: Bloomberg)

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 3/11/2024 close)

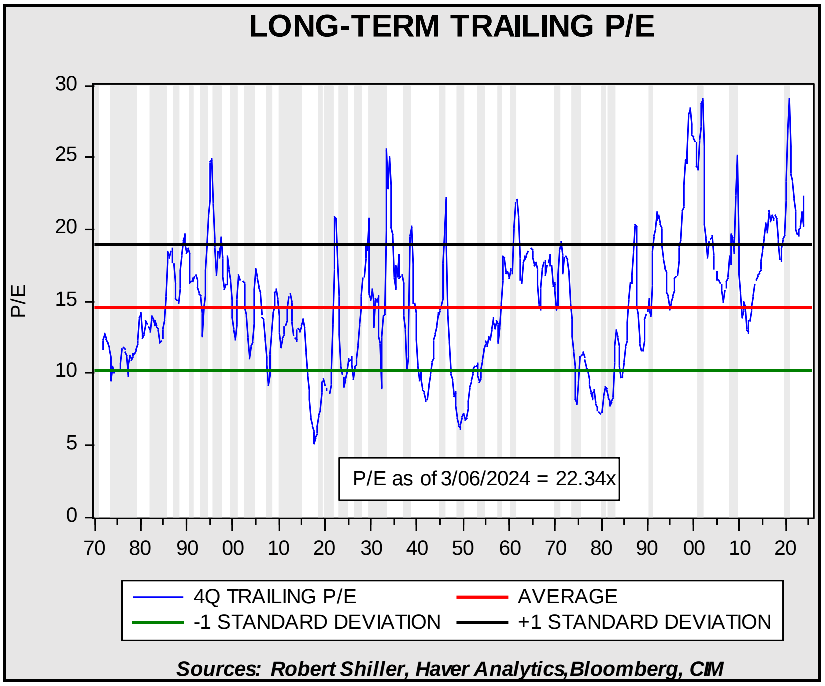


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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), US Corporate Bond (iShares iBoxx $ Investment Grade Corporate Bond ETF), US Government Bond (iShares 7-10 Year Treasury Bond ETF), US 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

March 6, 2024



Based on our methodology,[1] the current P/E is 22.34x, up 0.10x from our last report. The improvement in the multiple reflects an increase in the stock price index, outweighing a modest increase in earnings.

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.