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 14, 2024—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is up 0.5% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.2%. Chinese markets were lower, with the Shanghai Composite down 0.2% from its previous close and the Shenzhen Composite down 0.6%. US equity index futures are signaling a higher open.

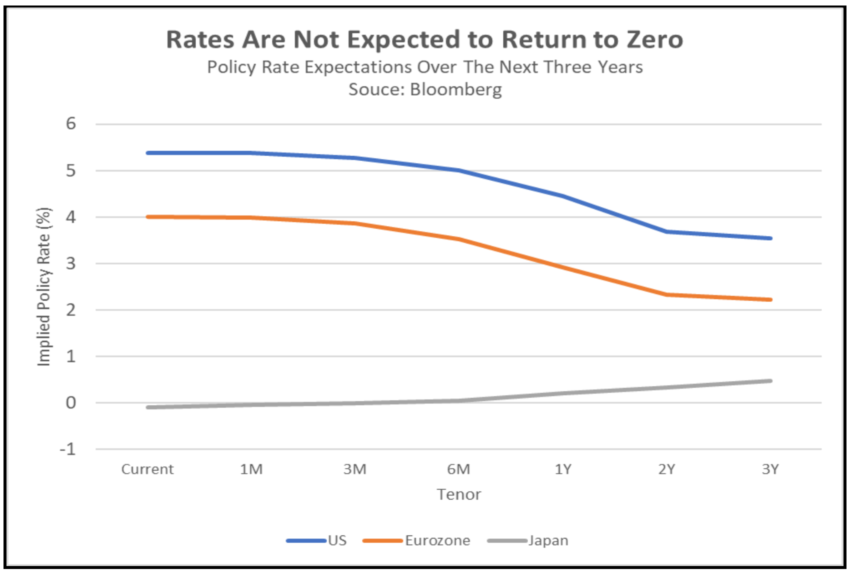
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *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"

Good morning! Equities have pared early gains due to stronger-than-expected PPI data and subpar retail sales figures. Meanwhile, Purdue, UConn, Houston, and Tennessee were able to secure top seeds for the NCAA Tournament. Today's *Comment* dives into our thoughts on central banks moving away from ultra-accommodative policy, the potential for broader social media scrutiny beyond TikTok, and how the IEA's reversal on its oil demand forecast reinforces our concerns about future inflation volatility. As always, we'll wrap up with a summary of key international and domestic data.

The Next Monetary Regime: The European Central Bank and the Federal Reserve have signaled potential rate cuts, but this easing cycle could be unlike past ones.

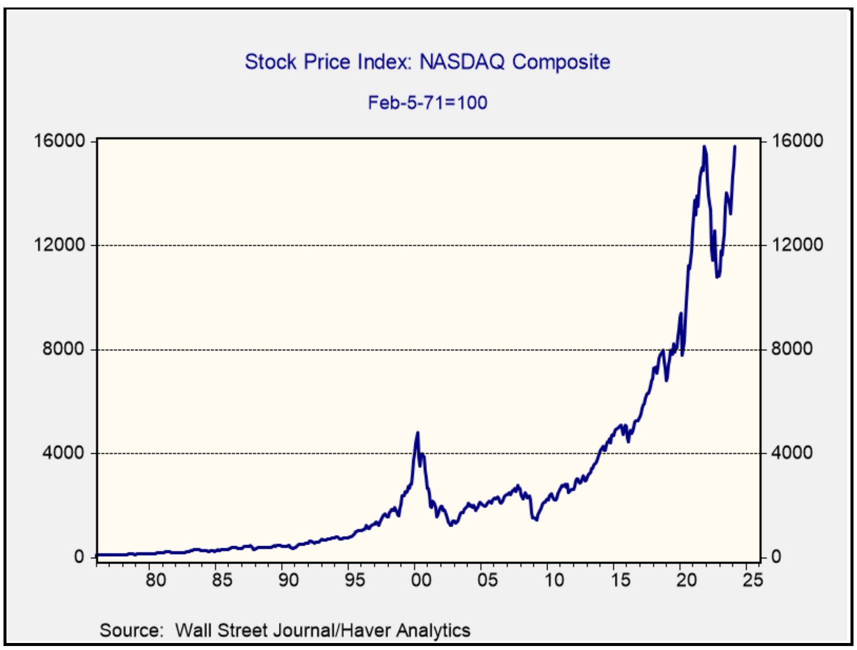
- The European Central Bank (ECB) is poised to implement changes to its operational framework, granting lenders greater autonomy in managing liquidity within the financial system. This shift aims to gradually wean banks off their reliance on the ECB for cash and foster a more self-sufficient approach to liquidity distribution. Interestingly, the Federal Reserve may be following a similar path. The Fed's recent closure of its Bank Term Funding Program and its encouragement for banks to utilize the discount window suggest a potential move toward a less interventionist approach to liquidity management.
- These central bank adjustments signal a potential departure from pre-pandemic monetary policy norms, which could include a more cautious approach to future interest rate cuts. The White House's recent inclusion of higher interest rate expectations in its forecasts further reinforces this shift. The strategy to uphold elevated peaks and troughs in interest rates is driven by the imperative need to preserve central bank agility in striking a delicate equilibrium between sustaining price stability and fostering optimal employment levels. The overarching objective is to mitigate the likelihood of exhausting all available monetary instruments once the economy succumbs to recessionary pressures.



- The evolving approach to monetary policy signals a potential paradigm shift for investors. With the era of near or below zero interest rates likely coming to a close, investors will need to adapt their strategies. While central banks may not entirely abandon this tool, their use of it is expected to be more measured moving forward. This shift in preference suggests a new normal for interest rates — they will likely settle at higher points across the yield curve compared to what we've witnessed over the past decade and a half. This is likely to remain true not just for the US but for most other developed economies as well.

Election Meddling: With presumptive presidential nominees likely secured by both major parties, lawmakers are shifting their focus to the growing influence of social media, particularly in the age of advancing artificial intelligence.

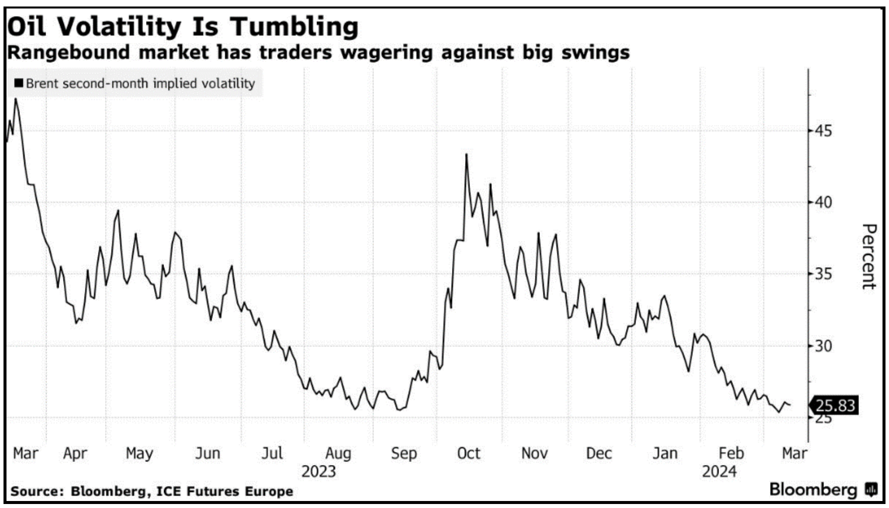
- A bipartisan effort in the House recently passed a bill that could see TikTok banned in the US. The legislation requires the app's Chinese owner, ByteDance, to sever ties with the platform or face a potential shutdown in the US. Citing national security concerns, lawmakers worry about the app's ability to be used for propaganda or voter manipulation. President Biden reportedly supports the bill, but its fate now rests with the Senate. However, Senate Majority Leader Chuck Schumer hasn't scheduled a vote yet, as concerns about potential free speech limitations and government overreach are expected to be debated.
- While TikTok faces intense scrutiny for potential national security risks, other platforms haven't escaped criticism. Former President Donald Trump has repeatedly labeled Facebook "the enemy of the people," alleging bias against conservative voices. On the other hand, New York Rep Alexandria Ocasio-Cortez (D-NY) described the decision of X, formerly known as Twitter, to alter its algorithm to promote or suppress free speech as a form of election interference. The potential of AI-generated deepfakes to spread disinformation on social media platforms is likely to put more pressure on lawmakers to rein in Big Tech.



- The growing pushback against tech giants is likely to extend beyond this year's election cycle. Countries are grappling with the immense power wielded by these companies, and Europe has already implemented a regulatory framework to rein them in. US regulators are also taking a more aggressive stance. However, despite their high stock prices, this increasing regulatory scrutiny highlights the importance of diversification in investment portfolios, given the potential risks associated with tech's high valuations.

Crude Oil Concerns: A brighter economic outlook in the US is raising concerns that crude oil demand will be significantly higher than the initial projections for 2024.

- The International Energy Agency (IEA) adjusted its oil forecast, predicting a shift from a surplus to a deficit due to reduced OPEC supply and robust US economic growth. This adjustment reflects the IEA's expectation that OPEC will likely maintain production cuts throughout the year, even though the group previously aimed for these cuts to last only until mid-2024. The agency further amplified its oil demand forecast, raising its projection by 50% compared to its June 2023 estimate. This significant upward revision reflects an anticipated increase in bunker fuel consumption due to shipping route adjustments to bypass Red Sea conflict zones.
- The revised economic outlook is likely to further exacerbate the upward pressure on Brent crude prices, which have already surged 11% this year. Continued oil price hikes could significantly impact inflation. This connection is evident in the latest CPI report, where the increases in energy price heavily influenced the overall reading. Notably, even non-energy sectors like airline fares have experienced a recent surge, rising 15.2% at an annualized rate over the past three months. Rising price pressures could prompt the Fed to delay cutting interest rates to ensure that it doesn't lead to a reacceleration of inflation.

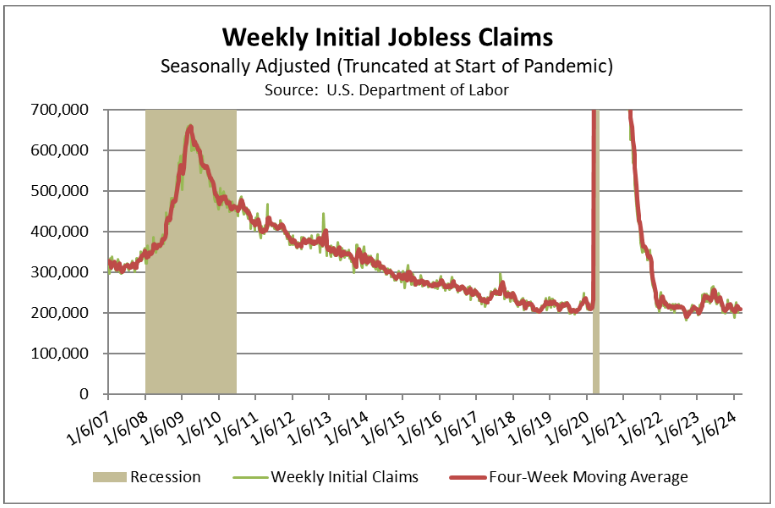


- Inflation volatility, particularly due to swings in commodity prices, is a major concern for the committee. While oil prices have garnered significant attention, rising copper prices are also emerging as an issue. This volatility is amplified by the uncertainty surrounding geopolitical tensions. Despite recent low oil prices amidst the Middle East conflict, we lack confidence in their long-term stability. Our primary concern lies in the potential for countries to hoard and weaponize their resource exports as global political fractures widen, aiming to extract concessions from rivals. As a result, we remain skeptical that inflation will be able to remain, sustainably, under the Fed's 2% target.

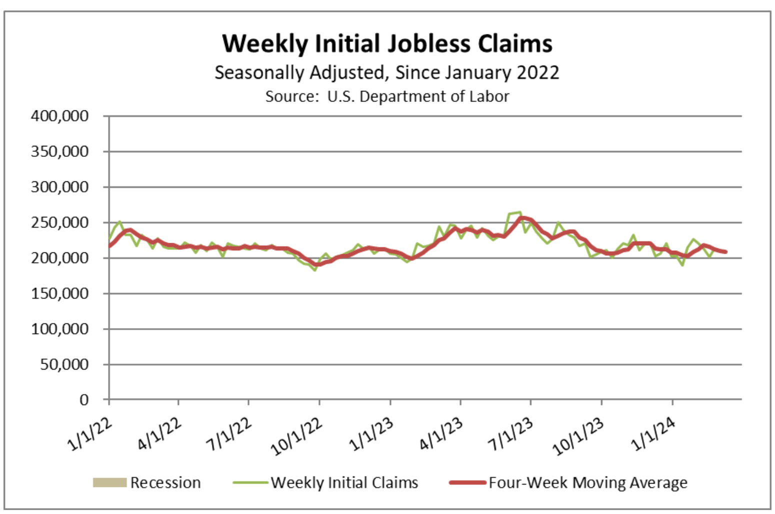
Other News: The US has held secret talks with Iran about ending the violence in the Red Sea, and these discussions highlight efforts from both sides to prevent a broader conflict in the region. Donald Trump, the presumptive Republican presidential nominee, is eying John Paulson as Treasury Secretary, signaling a strategic move to populate his administration with trusted allies. Meanwhile, SpaceX, led by Elon Musk, is poised for its third launch, with ambitions to successfully land a spacecraft on the moon. This endeavor underscores the increasing reliance of the United States on private enterprises for cutting-edge research and exploration.

US Economic Releases

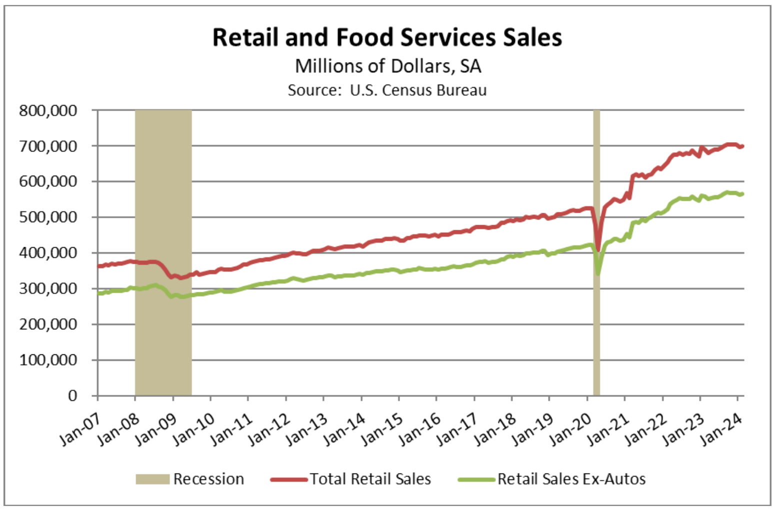
In the week ended March 9, ***initial claims for unemployment benefits*** fell to a seasonally adjusted 209,000, lower than both the expected level of 218,000 and the prior week's revised level of 210,000. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, fell to a low of 208,500. Meanwhile, in the week ended March 2, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) increased to 1.811 million, below the anticipated reading of 1.905 million but above the previous week's revised reading of 1.794 million. The chart below shows how initial jobless claims have fluctuated since just before the Great Financial Crisis. The chart is truncated through much of the pandemic period because of the extremely high level of claims at that time.



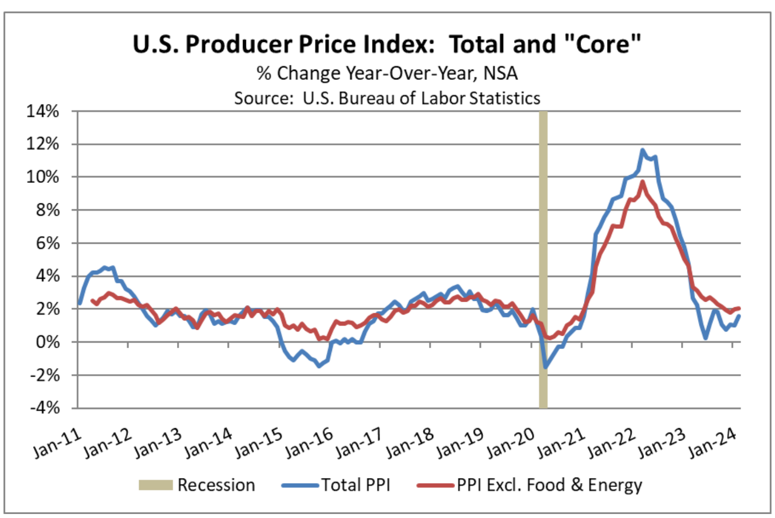
To provide more detail on recent trends, the chart below shows how initial jobless claims have changed just since the beginning of 2022.



Separately, February ***retail sales*** rose by a seasonally adjusted 0.6%, short of the expected increase of 0.8% and not nearly enough to reverse the revised January decline of 1.1%. Of course, overall retail sales are often driven by the volatile auto and auto parts sector, which makes up almost one-fifth of the total. February ***retail sales excluding autos and auto parts*** were up 0.3%, short of their anticipated rise of 0.5% and not enough to reverse January's revised fall of 0.8%. Overall retail sales and sales excluding autos and auto parts in February were up 5.5% from the same month one year earlier. The chart below shows how retail sales have changed since just before the GFC.



Finally, the February ***producer price index (PPI)*** rose by a seasonally adjusted 0.6%, versus expectations that the increase would match January's 0.3%. Excluding the volatile food and energy components, the February ***"core" PPI*** rose 0.3%, higher than the anticipated increase of 0.2% but weaker than its January rise of 0.5%. The overall PPI in February was up 1.6% from the same month one year earlier, while the core PPI was up 2.0%. The chart below shows the year-over-year change in the PPI and the core PPI over the last decade or so.



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	Business Inventories	m/m	Jan	0.2%	0.4%	*
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	Foreign Buying Japan Stocks	w/w	8-Mar	¥376.6b	¥283.7b		*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	8-Mar	¥1579.6b	¥490.1b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	8-Mar	¥1152.6b	¥567.8b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	8-Mar	-¥661.5b	-¥515.2b		*	Equity and bond neutral
New Zealand	REINZ House Sales	y/y	Feb	37.9%	4.9%		**	Equity bullish, bond bearish
	Wholesale Prices	y/y	Feb	0.20%	0.27%	0.20%	**	Equity and bond neutral
EUROPE								
UK	RICS House Price Balance	m/m	Feb	-10.0%	-19.0%	-10.0%	**	Equity and bond neutral
Switzerland	Producer & Import Prices	y/y	Feb	-2.0%	-2.3%		**	Equity and bond neutral
Russia	Trade Balance	m/m	Jan	7.8b	10.9b		**	Equity and bond neutral
	Exports	m/m	Jan	28.9b	38.6b		*	Equity and bond neutral
	Imports	m/m	Jan	21.0b	27.6b		*	Equity and bond neutral
	CPI	y/y	Feb	7.7%	7.4%	7.6%	***	Equity and bond neutral
	Core CPI	y/y	Feb	7.6%	7.2%		*	Equity and bond neutral
AMERICAS								
Brazil	Retail Sales	y/y	Jan	4.1%	1.2%	0.8%	***	Equity bullish, bond bearish

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)	559	558	1	Down
3-mo T-bill yield (bps)	523	524	-1	Up
U.S. Sibor/OIS spread (bps)	533	533	0	Down
U.S. Libor/OIS spread (bps)	534	534	0	Down
10-yr T-note (%)	4.19	4.19	0.00	Up
Euribor/OIS spread (bps)	394	393	1	Up
Currencies	**Direction**			
Dollar	Flat			Up
Euro	Flat			Down
Yen	Flat			Down
Pound	Flat			Up
Franc	Flat			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.

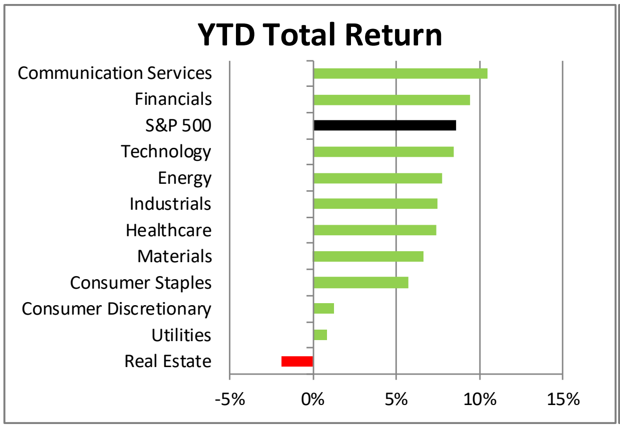
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$84.54	$84.03	0.61%	
WTI	$80.29	$79.72	0.72%	
Natural Gas	$1.66	$1.66	0.24%	
Crack Spread	$32.32	$32.39	-0.19%	
12-mo strip crack	$26.04	$25.88	0.62%	
Ethanol rack	$1.79	$1.78	0.74%	
Metals				
Gold	$2,169.72	$2,174.41	-0.22%	
Silver	$25.03	$25.01	0.10%	
Copper contract	$404.20	$406.00	-0.44%	
Grains				
Corn contract	$439.00	$441.25	-0.51%	
Wheat contract	$535.00	$544.25	-1.70%	
Soybeans contract	$1,201.25	$1,196.75	0.38%	
Shipping				
Baltic Dry Freight	2,370	2,315	55	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-1.5	1.0	-2.5	
Gasoline (mb)	-5.7	-2.2	-3.5	
Distillates (mb)	0.89	-1.05	1.94	
Refinery run rates (%)	1.9%	0.7%	1.2%	
Natural gas (bcf)		-2		

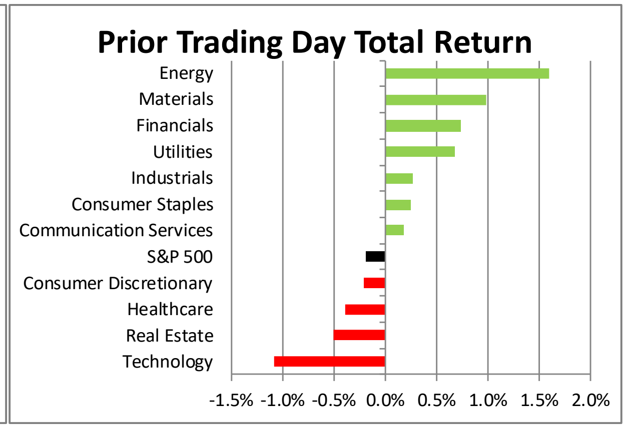
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures in the central Rocky Mountain area, with cooler-than-normal temperatures in the Northern Tier states. The precipitation outlook calls for wetter-than-normal conditions in the Rocky Mountains, the Great Plains, and the Southeast, with conditions in all other areas close to normal.

Data Section

US Equity Markets – (as of 3/13/2024 close)

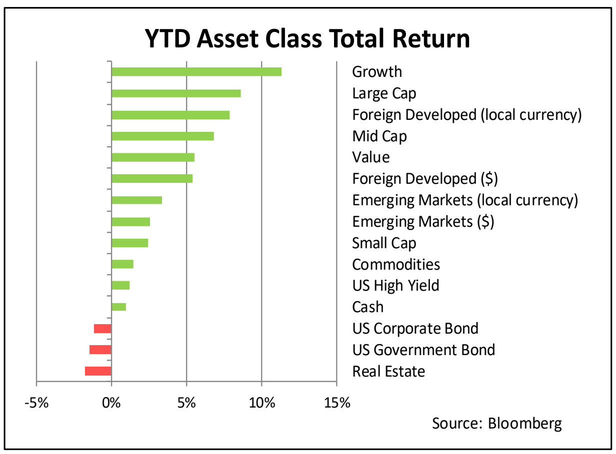




(Source: Bloomberg)

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 3/13/2024 close)

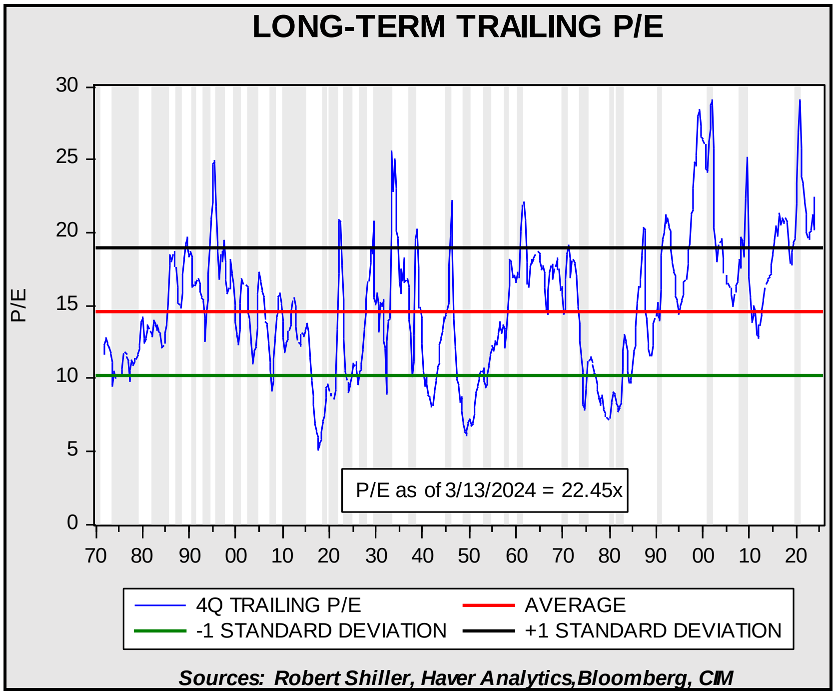


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 14, 2024



Based on our methodology,[1] the current P/E is 22.45x, up 0.11x 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.

---

[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.