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 22, 2024—9:30 AM EDT] Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 is down 0.5% 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 0.9% from its previous close and the Shenzhen Composite down 1.2%. US equity index futures are signaling a lower open.

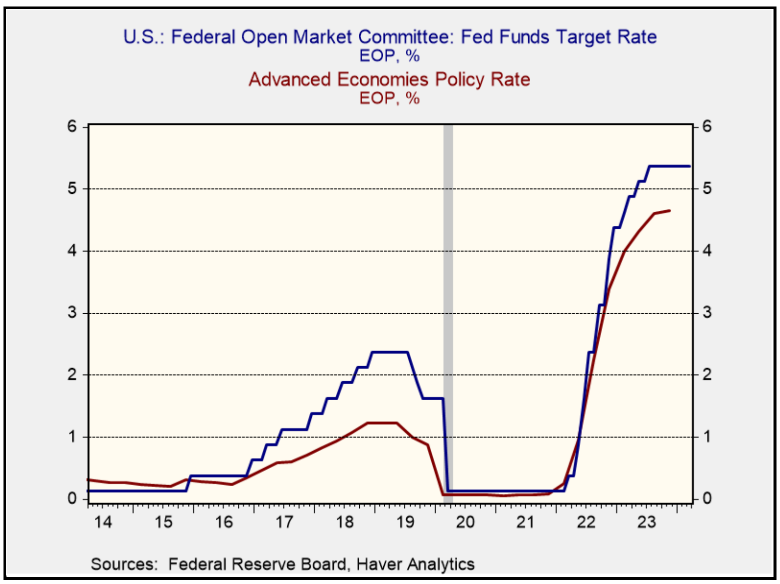
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *Bi-Weekly Geopolitical Report* (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* (3/18/2024) (with associated podcast): "The Fed's Other Policy Tool"
- *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! Stocks have pulled back from their recent highs after the Federal Reserve meeting, while the University of Oakland is writing its Cinderella story after upsetting powerhouse University of Kentucky in the NCAA tournament. Today's *Comment* examines why the recent global rate shift has us concerned about the market, how ongoing regulatory risks continue to impact big tech companies, and what the potential consequences of China's economic struggles are for other countries. As always, we wrap up with a summary of international and domestic news.

Cuts Aren't Guaranteed: All G-7 central banks have signaled a potential shift in monetary policy this year, but investors should remain patient before taking on risk.

- The Bank of Japan stands alone in its monetary policy. It recently raised rates but signaled a pause in tightening, aiming to keep rates accommodative. In contrast, all other major central banks are shifting towards looser policies. The Bank of England, European Central Bank, and Federal Reserve all hinted at potential rate cuts starting in June. Meanwhile, the Swiss National Bank took the most aggressive action, implementing its first rate cut in nearly a decade. The decision by rate-setters to adjust their policy language is likely to pave the way for looser financial conditions.
- Central banks' dovish tilts have triggered a global decline in interest rates, paradoxically strengthening the US dollar. Expectations of a robust US economy and the Fed's potential to maintain a tighter monetary policy stance are driving this rally compared to its peers. A strong dollar poses a challenge for foreign central banks, as it can lead to higher import prices, particularly for energy-related goods. Upward pressure on inflation could force them to choose between supporting their economies with lower rates or raising rates to combat inflation, potentially hindering growth.

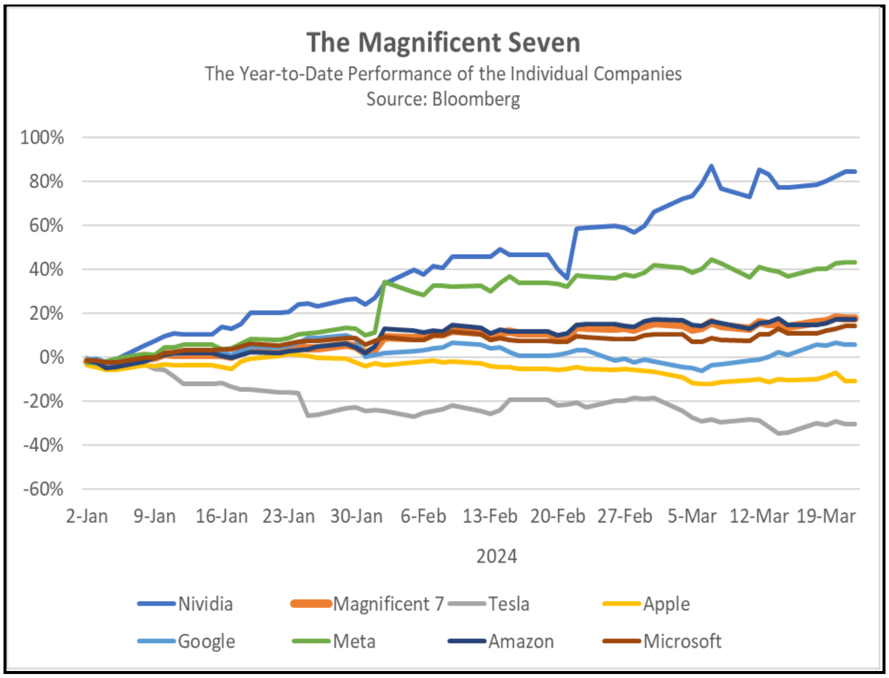


- The recent global equity rally rests on a precarious tightrope — a soft landing for the US economy and a mild or brief recession in other developed economies. While policymakers and the market seem confident in a central bank pivot by June, a more cautious approach is warranted for investors. The US economy's continued strength suggests the Fed may delay rate cuts until inflation shows clearer signs of abating. This, in turn, could lead other central banks to hesitate with aggressive rate reductions, potentially undermining the current market optimism. As a result, the recent rally may be short-lived.

Tech's Boogie Man: Recent lawsuits against Apple exemplify the significant regulatory risks facing the dominance of the Big Tech 7.

- Apple is facing mounting legal challenges. The US Department of Justice has filed an antitrust lawsuit, accusing the tech giant of stifling competition by restricting access to hardware and software features. This follows similar action from European regulators who charged Apple with non-compliance with the Digital Markets Act, alleging the company locks consumers into its service ecosystem. These legal battles, along with the potential for hefty fines and litigation costs, have weighed heavily on investor sentiment, contributing to an almost 8% year-to-date decline in Apple's stock price.

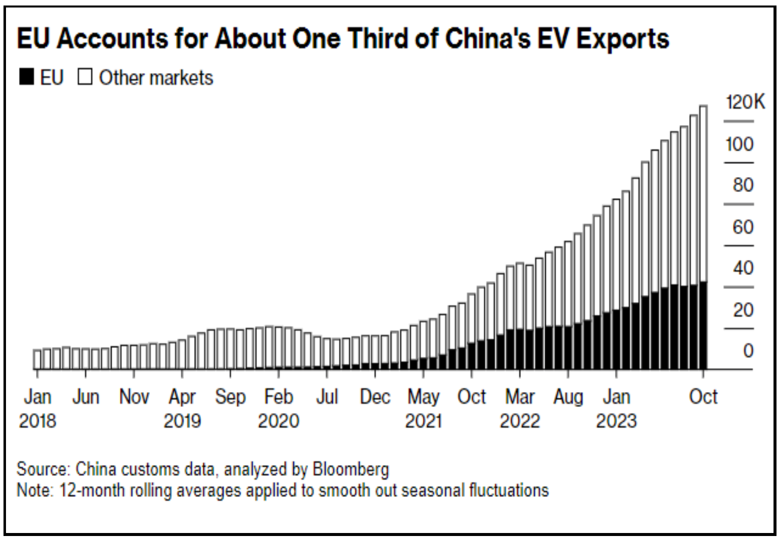
- The legal challenges facing Apple exemplify a growing trend of government intervention in the tech sector. One contentious issue is the potential for governments to restrict sales of cutting-edge semiconductors to rival nations. The US, for instance, has implemented measures limiting the supply of such semiconductors to China, aiming to curb its technological advancement. Companies like Nvidia, which previously relied on China for a significant portion of its data center revenue, have had to reduce sales. Additionally, lawsuits regarding copyright infringement, such as those filed by the *New York Times*, could further dampen the enthusiasm of firms seeking to profit from generative AI.



- Tech giants facing legal scrutiny can weather initial skirmishes, but protracted legal battles lasting years loom large. Unfavorable rulings will likely trigger a flurry of appeals, further bogging down the process. Even absent a final verdict, these lawsuits can be a strategic nightmare, forcing companies to make temporary business adjustments that could erode their competitive edge. This is already playing out, with Apple recently lowering app sales commissions and allowing developers more payment flexibility in response to regulatory pressure. This trend is likely to continue and impact other major tech companies as well.

Yuan Breaks Threshold: A strengthening dollar and a production surplus could trigger heightened scrutiny of Chinese exports.

- The yuan (CNY) plunged to a four-month low after China's central bank loosened its grip on the currency Friday, setting the dollar peg above 7.10 CNY. This move, likely driven by a strengthening dollar and soft data, weighed on the Chinese currency. The move fuels speculation of imminent stimulus to tackle slowing growth, partly caused by the property sector's debt burden. The central government's recent spending surge aligns with this, potentially aiming to alleviate pressure on local governments struggling with the ongoing property crisis. Finance Ministry data shows general public expenditure has surged 14% year-over-year, the fastest pace in over five years.
- China's drive to boost growth is stoking fears of a wave of cheap exports, which may be particularly damaging to electric carmakers. Tesla underscored these concerns on Friday, announcing production cuts in China due to their inability to compete with lower-cost rivals. In response, both the EU and US are taking steps to shield their domestic industries. EU lawmakers are crafting legislation that could impose tariffs on Chinese electric vehicles (EV) by November. The US, already imposing a 27.5% import tax on Chinese EVs, is contemplating a significant increase, potentially reaching a staggering 125% of a vehicle's value.



- China's economic slowdown presents a multifaceted global challenge. While a surge in Chinese exports might provide temporary relief from inflationary pressures for some countries, it could trigger protectionist responses from others seeking to shield domestic industries and jobs. Furthermore, a significant portion of these exports are likely to be directed towards Belt and Road Initiative participant countries. BYD, for instance, has struggled in developed markets but remains the top choice for EVs in Brazil and Thailand. This suggests that China's overproduction issue may continue to exert downward pressure on global prices, potentially harming Western companies indirectly.

Other News: Reddit's IPO burned bright in a sign that investors are warming up to riskier bets. The recent decline in interest rates has fueled a tech spending spree, with companies taking advantage of cheap debt to refinance loans. Meanwhile, investors are actively acquiring corporate debt, seizing the opportunity for high yields before the Fed potentially cuts interest rates. This surge reflects a growing belief that rates have plateaued and are headed downward.

US Economic Releases

No major US economic reports have been released so far today. 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**
9:00	Jerome Powell Delivers Opening Remarks in Fed Listens Event	Chairman of the Board of Governors
12:15	Michael Barr Speaks on International Economic, Monetary Design	U.S. Federal Reserve Vice Chair for Supervision
16:00	Raphael Bostic Participates in Moderated Conversation	President of the Federal Reserve Bank of Atlanta

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	National CPI	y/y	Feb	2.8%	2.2%	2.9%	***	Equity and bond neutral
	National CPI Ex-Fresh Food	y/y	Feb	2.8%	2.0%	2.9%	**	Equity and bond neutral
	National CPI Ex-Fresh Food & Energy	y/y	Feb	3.2%	3.5%	3.3%	*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	15-Mar	-¥1461.6b	¥374.3b		*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	15-Mar	-803.9b	¥1582.9b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	15-Mar	¥2157.7b	¥1156.1b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	15-Mar	-¥522.2b	-¥651.4b		*	Equity and bond neutral
New Zealand	Trade Balance NZD	m/m	Feb	-218m	-1089m		**	Equity and bond neutral
	Exports NZD	m/m	Feb	5.89b	4.82b		**	Equity and bond neutral
	Imports NZD	m/m	Feb	6.11b	5.90b		**	Equity and bond neutral
South Korea	PPI	y/y	Feb	1.5%	1.3%		**	Equity and bond neutral
EUROPE								
Germany	Import Price Index	y/y	Jan	-5.9%	-7.0%	-7.5%	**	Equity bullish, bond bearish
	IFO Business Climate	m/m	Mar	87.8	85.7	86.0	***	Equity and bond neutral
	IFO Current Assessment	m/m	Mar	88.1	86.9	86.8	**	Equity and bond neutral
	IFO Expectations	m/m	Mar	87.5	84.4	84.7	***	Equity and bond neutral
UK	Retail Sales	y/y	Feb	-0.4%	0.5%	-0.8%	***	Equity and bond neutral
	Retail Sales Ex-Auto Fuel	y/y	Feb	-0.5%	0.5%	-0.8%	**	Equity and bond neutral
Russia	Gold and Forex Reserves	m/m	15-Mar	$594.3b	$591.2b		***	Equity and bond neutral
	Money Supply, Narrow Definition	w/w	15-Mar	18.02t	18.06t		*	Equity and bond neutral
AMERICAS								
Mexico	Economic Activity IGAE	y/y	Jan	2.0%	1.09%	2.60%	**	Equity bearish, bond bullish
Brazil	FGV Consumer Confidence	y/y	Mar	91.30%	89.70%		*	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)	559	559	0	Down
3-mo T-bill yield (bps)	521	524	-3	Up
U.S. Sibor/OIS spread (bps)	531	532	-1	Down
U.S. Libor/OIS spread (bps)	532	532	0	Flat
10-yr T-note (%)	4.24	4.27	-0.03	Down
Euribor/OIS spread (bps)	393	392	1	Up
Currencies	**Direction**			
Dollar	Up			Up
Euro	Down			Down
Yen	Up			Down
Pound	Down			Down
Franc	Down			Down
Central Bank Action	**Current**	**Prior**	**Expected**	
Bank of Russia Key Rate	16.000%	16.000%	16.000%	On Forecast
Bank of Mexico Overnight Rate	11.000%	11.250%	11.000%	On 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.

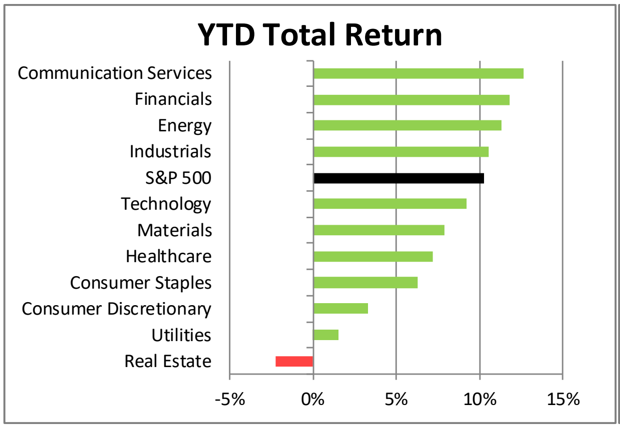
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$85.83	$85.78	0.06%	
WTI	$81.13	$81.07	0.07%	
Natural Gas	$1.69	$1.68	0.53%	
Crack Spread	$32.08	$31.96	0.37%	
12-mo strip crack	$25.38	$25.31	0.27%	
Ethanol rack	$1.76	$1.75	0.25%	
Metals				
Gold	$2,166.02	$2,181.33	-0.70%	
Silver	$24.58	$24.74	-0.64%	
Copper contract	$401.50	$405.85	-1.07%	
Grains				
Corn contract	$438.50	$440.75	-0.51%	
Wheat contract	$544.00	$546.75	-0.50%	
Soybeans contract	$1,199.50	$1,212.00	-1.03%	
Shipping				
Baltic Dry Freight	2,240	2,284	-44	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-2.0	-0.2	-1.8	
Gasoline (mb)	-3.3	-2.8	-0.5	
Distillates (mb)	0.62	-0.50	1.12	
Refinery run rates (%)	1.0%	0.8%	0.2%	
Natural gas (bcf)	7	5	2	

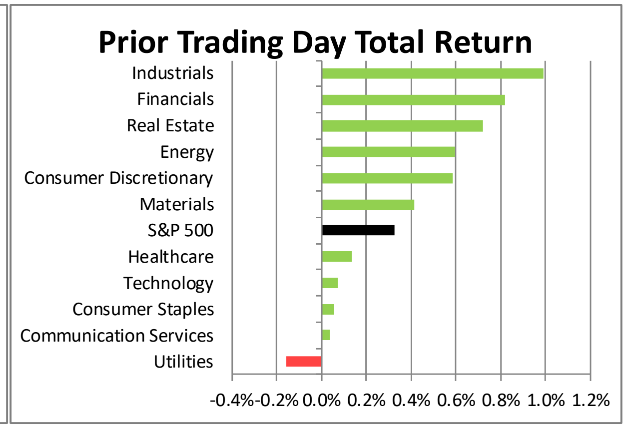
Weather

The 6-10 and 8-14 day forecasts currently call for cooler-than-normal temperatures for the northern half of the country from the Great Lakes westward, as well as for California and the Desert Southwest, with warmer-than-normal temperatures in New England. The forecasts call for wetter-than-normal conditions across most of the country except for Texas, Oklahoma, Arkansas, and Missouri, with dry conditions expected only in southern Texas.

Data Section

US Equity Markets – (as of 3/21/2024 close)

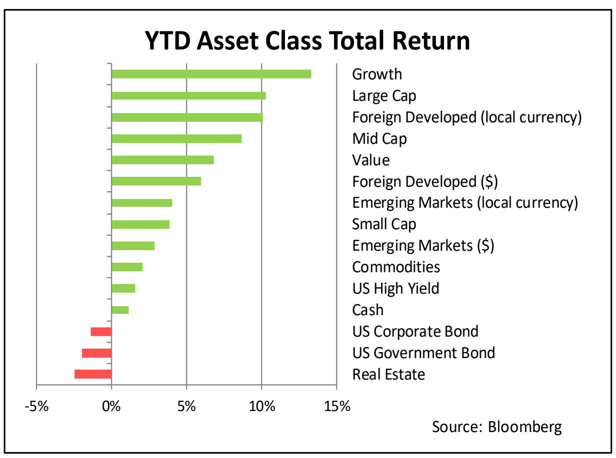




(Source: Bloomberg)

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 3/21/2024 close)

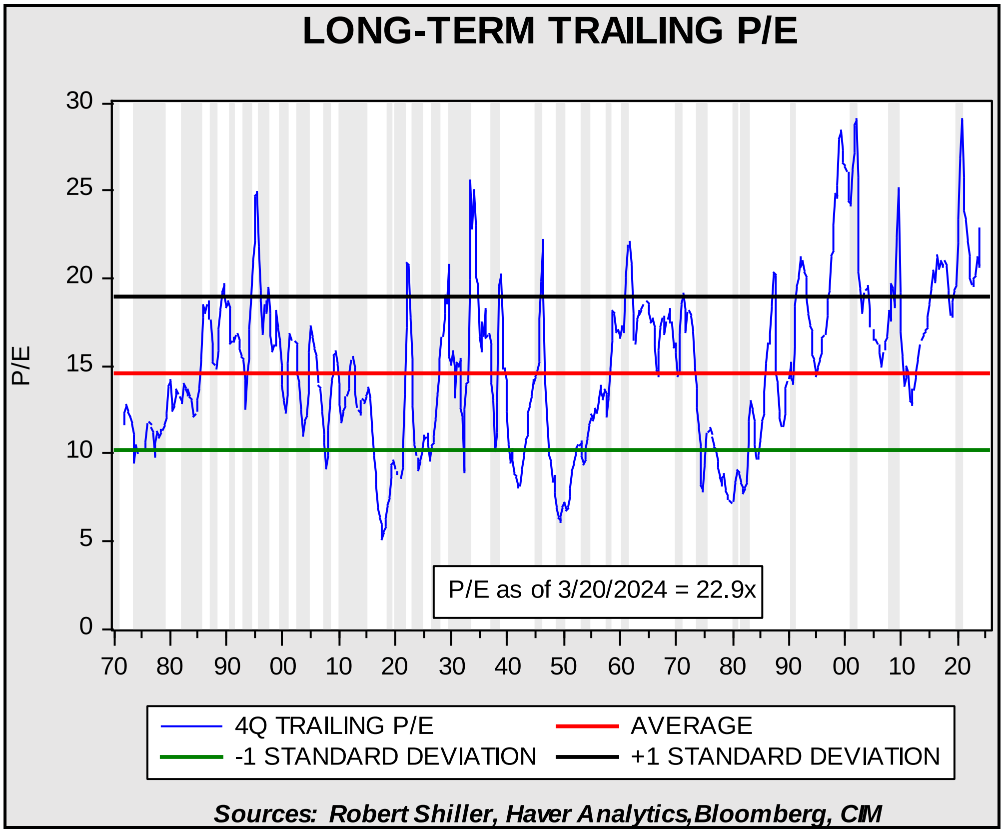


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 21, 2024



Based on our methodology,[1] the current P/E is 22.9x, up 0.5x from our last report. The improvement in the multiple reflects an increase in the stock price index, and a decrease 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 (Q2, Q3 and Q4) and one estimate (Q1). 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.