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 7, 2024—9:30 AM EST] Global equity markets are mixed 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 up 0.5%. Chinese markets were lower, with the Shanghai Composite down 0.4% from its previous close and the Shenzhen Composite down 1.2%. 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* (2/26/2024) (with associated podcast): "Posen vs. Pettis"
- *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"

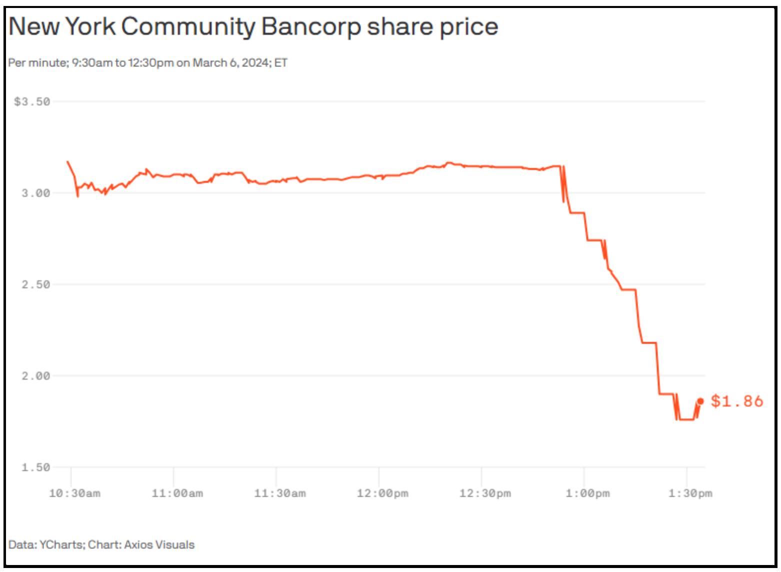
Good morning! Stocks are rallying this morning as investors gain confidence in the possibility of central banks lowering interest rates later in 2024. On the sports front, Real Madrid secured a hard-fought victory against RB Leipzig, advancing to the Champions League quarterfinals. Today's *Comment* begins with our thoughts on the financial system following Fed Chair Powell's testimony before Congress. We also include an analysis of the current state of the labor market and explore why emerging economies, particularly Turkey, have recently captured investor interest. As usual, our report concludes with a round-up of international and domestic data.

Financial System Focus: Banks take the spotlight as the Fed chair testifies before Congress, while New York Community Bank seeks a lifeline.

- In a surprise move on Wednesday, Federal Reserve Chair Jerome Powell announced that regulators intend to ease some of the stricter banking requirements introduced under the

Basel III framework. This shift in policy follows complaints from Wall Street that the regulations could limit lending to businesses and consumers. However, the claims remain fiercely contested. Powell's comments suggest the Fed might be aiming to avoid a major regulatory overhaul during a volatile election year. The issue is highly partisan, with Democrats advocating for increased bank regulations, while Republicans lean toward looser regulations.

- At the same time, New York Community Bank is seeking to shore up investor confidence. The struggling commercial lender secured a much-needed $1 billion equity investment led by a group that includes former Treasury Secretary Steven Mnuchin. This significant cash infusion aims to alleviate concerns about NYCB's ability to weather potential losses, stemming from revelations of inadequate internal controls that exposed the bank to riskier loans than previously reported. The company's stock price surged by 7.45%, reaching $3.46 per share following the announcement. Nevertheless, this increase only partially mitigates previous losses, thus leaving the stock price still considerably below its starting level at the beginning of the year.

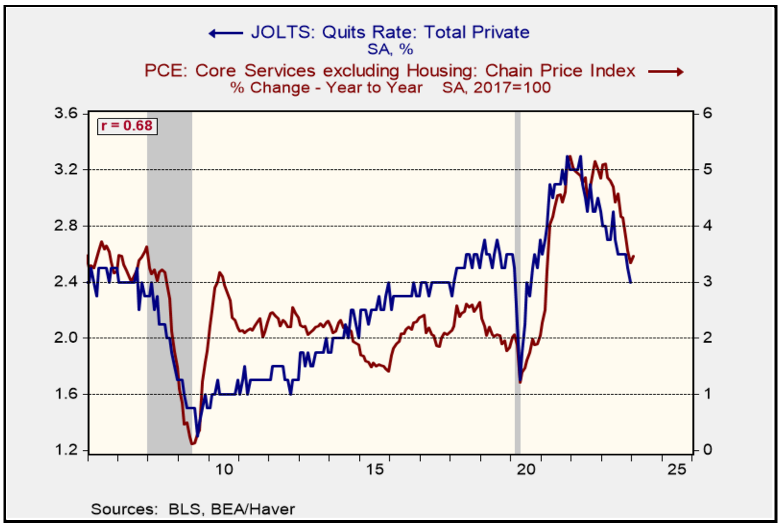


- Despite significant uncertainty in the US regional banking system, investor confidence remains somewhat resilient. The KBW Nasdaq Regional Banking Index, while down nearly 8.5% year-to-date, has shown mixed performance since the NYCB issues surfaced. Homestreet Bank, another bank facing scrutiny, has also seen its stock hold steady recently. However, the lack of immediate changes to capital requirements offers a positive sign, particularly as banks prepare for a potential rise in loan defaults as repayments come due in the coming months. Therefore, we do not see any evidence of a possible financial crisis at this time.

Labor Softening: Even though labor markets remain tight, there are signs that employers might be hitting the brakes on hiring.

- A recent JOLTS report indicates a decline in job listings by US employers. January saw a drop in job openings from 8.89 million to 8.86 million, the lowest level in over three months. This significant decrease in job postings reflects a broader trend within the labor market, where employers are reevaluating their workforce needs. The ongoing uncertainty regarding job security likely contributes to the persistently low quit rates. At 2.1%, the quit rate remains below pre-pandemic levels, suggesting a lack of confidence among workers in their job prospects.

- A weakening labor market could signal a return to a more balanced relationship between employment and inflation. This aligns with the historical trend of PCE Core Services excluding housing, a measure sensitive to wage pressures, tracking closely with quit rates. Fewer worker resignations likely translate to a gradual decline in overall inflationary pressures. However, this trend could exacerbate if businesses continue to grapple with passing higher costs onto customers, as highlighted in the latest Fed Beige Book. The resulting profit squeeze may impede firms' capacity to retain employees.

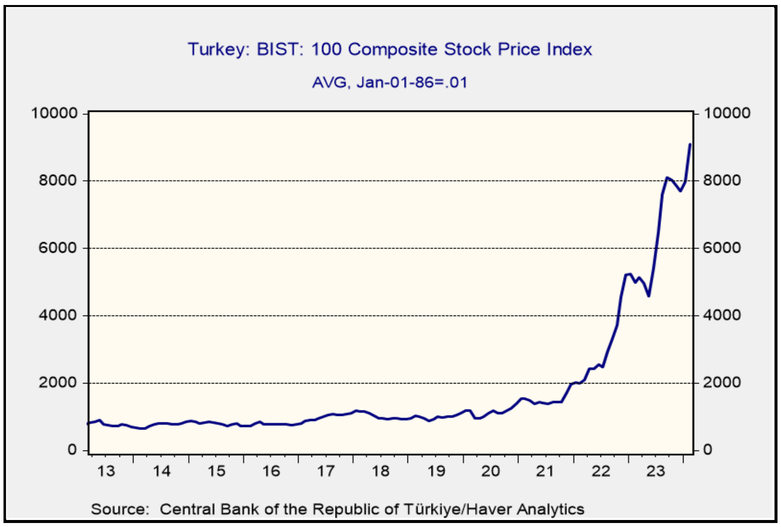


- This Friday's jobs report will likely provide more clarity on the health of the labor market. While the latest estimate projects the creation of around 200,000 jobs in February, this represents a slowdown compared to the robust 350,000 increase seen in the previous month. We will be paying close attention to the prior month's data revisions as these often provide valuable insights into underlying trends. Three consecutive months of downward revisions could signal potential labor market troubles. While the previous report did see upward revisions, it's worth noting that downward revisions were more common throughout 2023, suggesting potential limitations in capturing the complete economic picture.

Emerging Markets En Vogue: Emerging market equities have defied expectations, posting strong gains in the year's first quarter despite lingering concerns about high interest rates and a potential global slowdown.

- Fueled by a surge in its technology sector, Turkey has become a leader in the recent emerging market rally. The sector's growing prominence has captured significant investor attention, [propelling Turkey's benchmark Borsa Istanbul 100 Index up nearly 20% year-to-date](). Notably, the technology sector itself has skyrocketed over 60%. This performance aligns with a broader trend of investors seeking undervalued stocks outside the US to capitalize on the global tech investment boom. However, Turkey's case is unique in that it also seems to be attracting domestic investors seeking a hedge against inflation.

- Turkey's booming tech sector has fueled its impressive performance in the emerging market rally. However, some uncertainties cloud this optimistic outlook. The upcoming municipal elections in March presents a hurdle as these elections are seen as a test of Erdoğan's popularity in the country. A strong victory for Erdoğan's party could raise the prospect of a constitutional change to extend his rule. Additionally, this could complicate efforts from the opposition to field a strong candidate for prime minister in the next election, potentially impacting investor confidence in Turkey's long-term ability to undertake much-needed economic structural reforms.

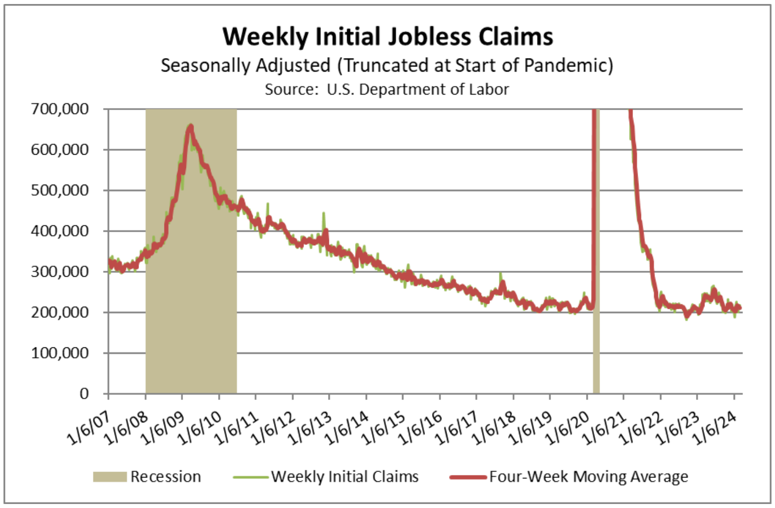


- Turkey's case exemplifies the growing interest in emerging markets as investors seek attractive valuations and potentially higher yields. This trend could be further amplified by a potential decrease in US interest rates, weakening the dollar against other currencies. As a result, countries like Poland, Mexico, Vietnam, Indonesia, and Morocco, often viewed as bridge economies due to their strong trade ties with both the US and China, could become attractive destinations for investors seeking to diversify their portfolios and mitigate risks associated with a US-China trade war escalation.

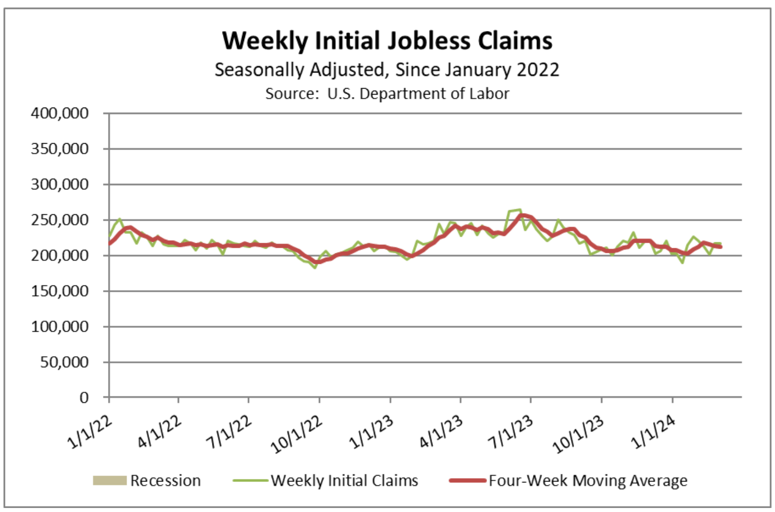
Other News: The European Central Bank (ECB) kept its interest rates unchanged but hinted at the possibility of a reduction later in 2024. This move aligns with market expectations of central banks adopting more dovish stances. Meanwhile, President Biden proposed a moderate 1% increase in defense spending for 2025, falling short of expectations as concerns over the debt ceiling resurface.

US Economic Releases

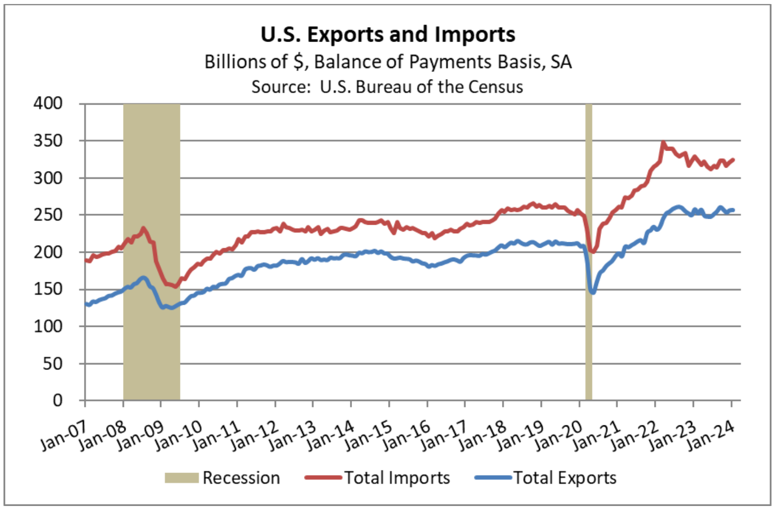
In the week ended March 2, ***initial claims for unemployment benefits*** were unchanged from the previous week at a seasonally adjusted level of 217,000, only slightly above the expected level of 216,000. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, fell to 212,250, its lowest level since mid-January. In the week ended February 24, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) rose to 1.906 million, above both the anticipated reading of 1.880 million and the previous week's revised reading of 1.898 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.



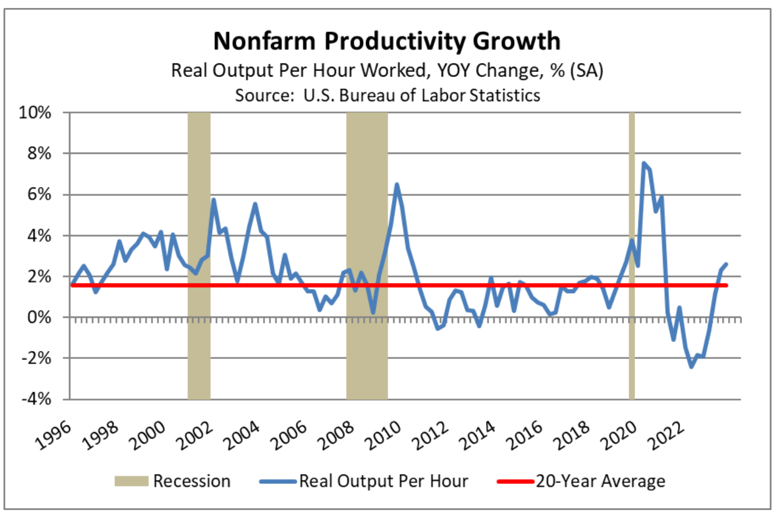
To provide more detail on recent trends, the chart below shows how initial jobless claims have changed just since the beginning of 2022.



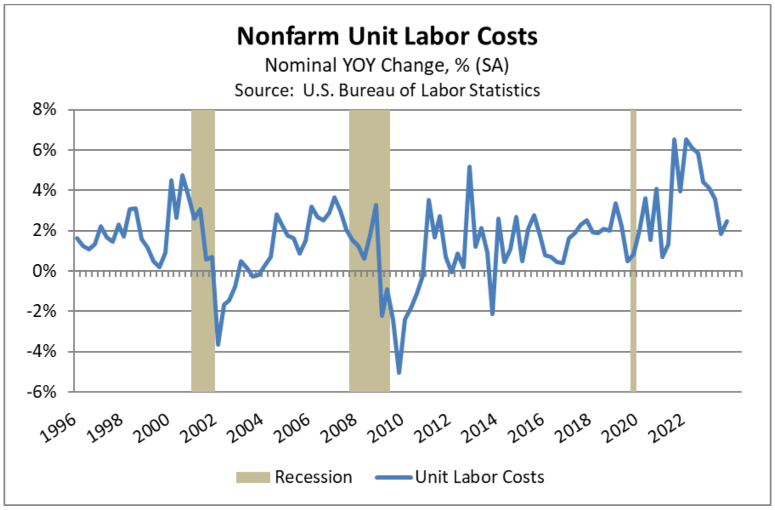
In a separate report today, the January ***trade balance*** showed a seasonally adjusted deficit of $67.4 billion, worse than the expected shortfall of $63.5 billion and the revised December deficit of $64.2 billion. According to the data, total ***exports*** rose 0.1%, while ***imports*** rose 1.1%. However, the performance of exports versus imports was more favorable from a longer perspective. Compared with the same month one year earlier, exports in January were down a modest 0.4%, while imports were down a more substantial 1.2%. The chart below shows the monthly value of US exports and imports since just before the Great Financial Crisis.



A final report today focused on the productivity of US workers, defined as the average value of output per hour worked. After stripping out price changes and normal seasonal fluctuations, final fourth quarter ***nonfarm productivity*** rose at an annualized rate of 3.2%, unchanged from the preliminary estimate and higher than the expected growth rate of 3.1%. Taking account of the fluctuations in each of the last four quarters, productivity in the fourth quarter was up 2.6% from the same period one year earlier. Excluding the distorted figures of the pandemic era, the annual growth in productivity was the strongest since late 2019. Productivity growth is key to boosting living standards and supporting higher wages, so if the strong productivity in the fourth quarter can be sustained, it would be a positive omen for US workers and consumers. The chart below shows the annual growth in real productivity over the last quarter-century or so.



Fourth quarter ***unit labor costs*** rose at an annualized rate of just 0.4%, up from the annual growth rate of just 0.1% in the third quarter but low enough to suggest that better productivity growth is helping to hold down cost pressures. Unit labor costs in the fourth quarter were up 2.5% year-over-year, well within the range typically seen before the pandemic. The chart below shows the year-over-year growth in unit labor costs since 1996.



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**
15:00	Consumer Credit	m/m	Jan	$10.000b	$1.561b	*
Federal Reserve						
EST	**Speaker or Event**	**District or Position**				
10:00	Jerome Powell Testifies Before Congress	Chairman of the Board of Governors				
11:30	Loretta Mester Gives Speech on Economic Outlook	President of the Federal Reserve Bank of Cleveland				
13:15	Loretta Mester on CNBC	President of the Federal Reserve Bank of Cleveland				

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	Labor Cash Earnings	y/y	Jan	2.0	1.0	0.8	**	Equity bullish, bond bearish
	Foreign Buying Japan Stocks	w/w	1-Mar	¥283.9b	-¥206.0b	-¥206.3b	*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	1-Mar	¥484.6b	-¥257.0b	-¥250.1b	*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	1-Mar	¥572.5b	-¥19.0b	-¥46.3b	*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	1-Mar	-¥517.2b	¥225.9b		*	Equity and bond neutral
Australia	Trade Balance	m/m	Jan	A$11027m	A$10959m	A$10743m	***	Equity and bond neutral
	Exports	m/m	Jan	1.6%	1.8%	1.5%	*	Equity and bond neutral
	Imports	m/m	Jan	1.3%	4.8%	4.0%	*	Equity bearish, bond bullish
New Zealand	Mfg Activity Volume	q/q	4Q	-0.7%	-2.8%		**	Equity and bond neutral
	Mfg Activity SA	q/q	4Q	-6.0%	-2.7%	-3.2%	*	Equity bearish, bond bullish
EUROPE								
Germany	Factory Orders WDA	y/y	Jan	-6.0%	2.7%	6.6%	***	Equity bearish, bond bullish
Switzerland	Unemployment Rate	m/m	Feb	2.4%	2.5%	2.4%	**	Equity and bond neutral
	Foreign Currency Reserves	m/m	Feb	677.6b	662.4b	662.2b	***	Equity and bond neutral
Russia	Money Supply, Narrow Definition	w/w	1-Mar	17.98t	18.08t		*	Equity and bond neutral
	Official Reserve Assets	m/m	Feb	582.6b	585.4b		*	Equity and bond neutral
	Gold and Forex Reserves	m/m	1-Mar	$581.1b	$582.0b		***	Equity and bond neutral
AMERICAS								
Mexico	CPI	y/y	Feb	4.40%	4.88%	4.42%	***	Equity and bond neutral
	Core CPI	y/y	Feb	4.64%	4.76%	4.63%	**	Equity and bond neutral
Brazil	Imports	m/m	Feb	$18091m	$20490m	$20474m	*	Equity and bond neutral
	Exports	m/m	Feb	$23538m	$27016m	$26968m	*	Equity and bond neutral
	Trade Balance	m/m	Feb	$5447m	$6527m	$6495m	**	Equity and bond neutral
Brazil	FGV Inflation IGP-DI	y/y	Feb	-4.04%	-3.61%	-3.99%	***	Equity and bond neutral
Brazil	Net Debt % GDP	m/m	Jan	60.0%	60.8%	60.0%	***	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)	522	523	-1	Up
U.S. Sibor/OIS spread (bps)	533	532	1	Down
U.S. Libor/OIS spread (bps)	534	534	0	Down
10-yr T-note (%)	4.09	4.10	-0.01	Down
Euribor/OIS spread (bps)	394	393	1	Down
Currencies	**Direction**			
Dollar	Down			Down
Euro	Down			Up
Yen	Up			Down
Pound	Up			Up
Franc	Up			Down
Central Bank Action	**Current**	**Prior**	**Expected**	
ECB Main Refinancing Rate	4.500%	4.500%	4.500%	On Forecast
ECB Marginal Lending Facility	4.750%	4.750%	4.750%	On Forecast
ECB Deposit Facility Rate	4.000%	4.000%	4.000%	On Forecast
Bank of Canada Rate Decision	5.000%	5.000%	5.000%	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.

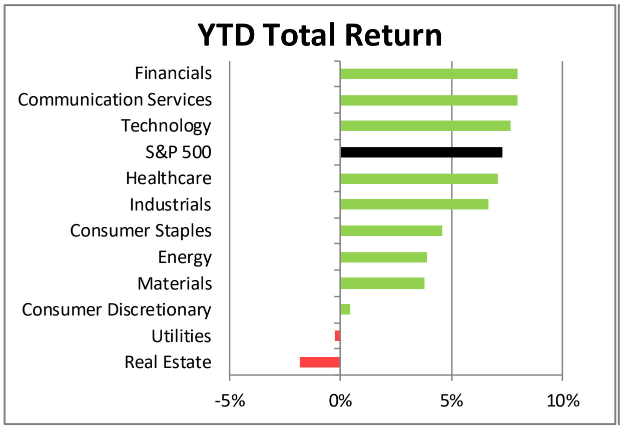
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$82.51	$82.96	-0.54%	
WTI	$78.66	$79.13	-0.59%	
Natural Gas	$1.94	$1.93	0.31%	
Crack Spread	$29.98	$29.46	1.77%	
12-mo strip crack	$24.09	$23.99	0.40%	
Ethanol rack	$1.70	$1.68	0.96%	
Metals				
Gold	$2,159.83	$2,148.18	0.54%	
Silver	$24.23	$24.17	0.27%	
Copper contract	$392.55	$387.50	1.30%	
Grains				
Corn contract	$436.50	$428.75	1.81%	
Wheat contract	$538.00	$531.00	1.32%	
Soybeans contract	$1,160.75	$1,148.25	1.09%	
Shipping				
Baltic Dry Freight	2,176	2,291	-115	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	1.4	2.7	-1.4	
Gasoline (mb)	-4.5	-1.8	-2.7	
Distillates (mb)	-4.1	-0.7	-3.5	
Refinery run rates (%)	3.4%	1.1%	0.0	
Natural gas (bcf)		-36		

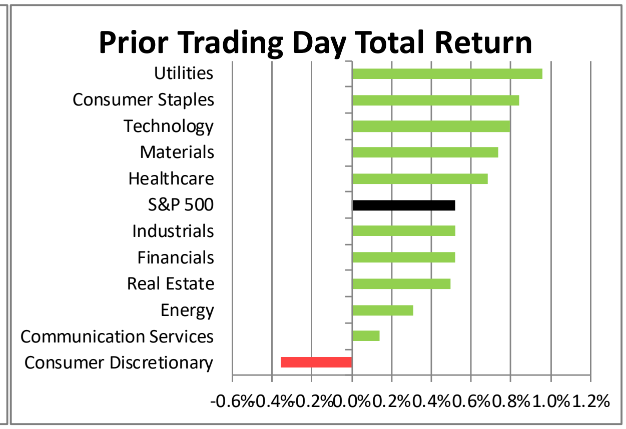
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures along the West Coast, in the northern Rocky Mountains, and from the Great Plains eastward, with cooler-than-normal temperatures in the central and southern Rocky Mountains. The forecasts call for wetter-than-normal conditions in the Southwest, the Great Plains, the Deep South, and the Midwest, with dry conditions on the West Coast.

Data Section

US Equity Markets – (as of 3/6/2024 close)

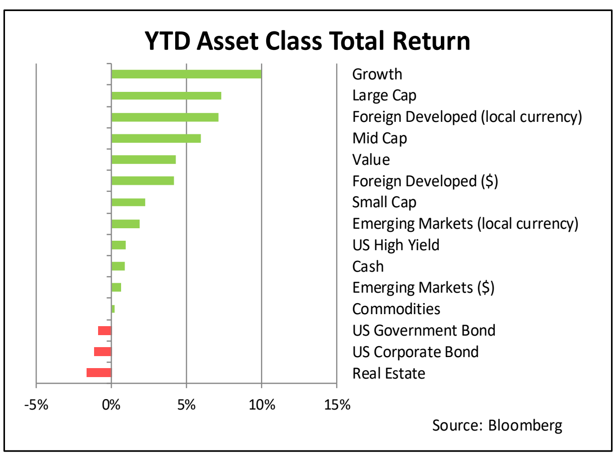




(Source: Bloomberg)

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 3/6/2024 close)

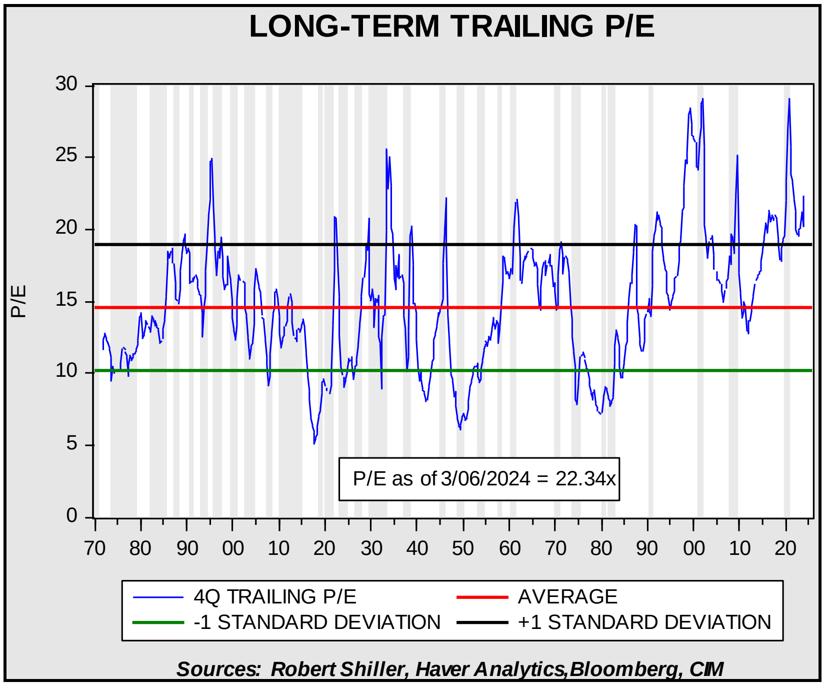


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.

[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.