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 8, 2024—9:30 AM EST] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is down 0.1% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.5%. Chinese markets were higher, with the Shanghai Composite up 0.6% from its previous close and the Shenzhen Composite up 1.4%. 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:

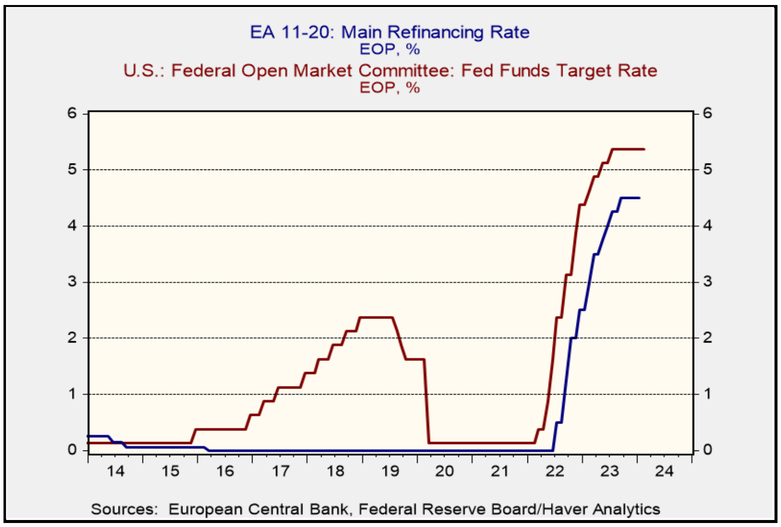
- *Bi-Weekly Geopolitical Report* (2/26/2024) (with associated podcast): "Posen vs. Pettis"
- *Asset Allocation Quarterly – Q1 2024* (1/26/2024): Discussion of our asset allocation process, Q1 2024 portfolio changes, and our outlook for the markets.
- *Asset Allocation Q1 2024 Rebalance Presentation* (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! Equities are off to a blazing start today, fueled by a stellar jobs report. Adding to the excitement, Phoenix secured its place as the host city for next year's NBA All-Star Game! Today's *Comment* delves into central bank views on the economy and interest rates, why gold is still king, and the regulatory challenges facing Big Tech giants. We've also got a comprehensive roundup of international and domestic news to keep readers informed on the latest developments.

Together but Different: While the European Central Bank (ECB) and Federal Reserve agree on interest rate cuts in 2024, their stances diverge on economic health and financial stability.

- The heads of the two central banks recently spoke publicly to offer their perspectives on the future of policy and the economy's condition. ECB President Christine Lagarde announced the bank will maintain its current policy, keeping the benchmark interest rate at 4.0%. Similarly, Fed Chair Jerome Powell, testifying before the Senate Committee, signaled the [Fed won't rush rate cuts at their next meeting](). However, both central bankers anticipate inflation subsiding later this year, with markets pricing in the first rate cut potentially happening in June.

- Despite their shared focus on inflation, Christine Lagarde and Jerome Powell offered contrasting views on the economic outlook. Lagarde, reflecting the eurozone's current struggles, took a cautious approach. She acknowledged surveys suggesting a later-year bounce but highlighted existing economic weakness. Conversely, Powell struck a more optimistic tone, emphasizing sustained and healthy growth in the US economy. He even expressed confidence in the Fed's ability to handle a potential commercial real estate crisis. Interestingly, while Lagarde hasn't addressed commercial real estate directly, ECB Vice President Luis de Guindos has raised concerns about its potential impact on financial stability.

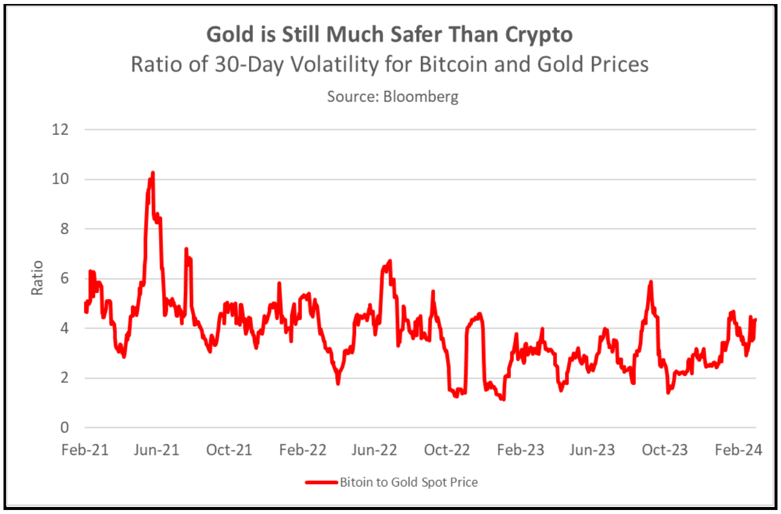


- Although usually in sync on policy decisions, the ECB and the Fed might diverge this time around. A slowing economy and worries about the commercial real estate market are pushing the ECB toward considering looser monetary policy. An April rate cut is even on the table if current trends hold. Historically, the ECB has preferred a more accommodative stance, likely aiming to keep the euro weaker relative to the dollar to boost exports. However, deep cuts are unlikely from either central bank this year as both remain concerned about the persistent threat of inflation.

Flight to Safety: Gold and Bitcoin soar as investors seek safe haven amid rising uncertainty.

- Gold prices have surged 5% in the past month, fueled by a buying spree from China. The Asian nation has become the world's largest gold purchaser, partly driven by its central bank's strategy to diversify reserves away from the US dollar. This diversification allows China greater flexibility in conducting trade and potentially mitigating sanctions, especially as it seeks to strengthen economic ties with Russia. Increased trade between these two countries benefits both as China boosts its exports, while Russia gains access to essential imports.
- Gold's resurgence as a safe-haven asset faces a unique challenge—the rise of Bitcoin. While gold regains investor interest, the most popular cryptocurrency has surged 51.5%

in the last 30 days. This digital asset's popularity is partly fueled by potential applications in traditional finance, like the SEC considering its use in options trading. However, Bitcoin's high volatility casts doubt on its reliability as a store of value. As the chart below shows, Bitcoin is about four times as volatile as gold prices, indicating it may be a riskier option for long-term investors.

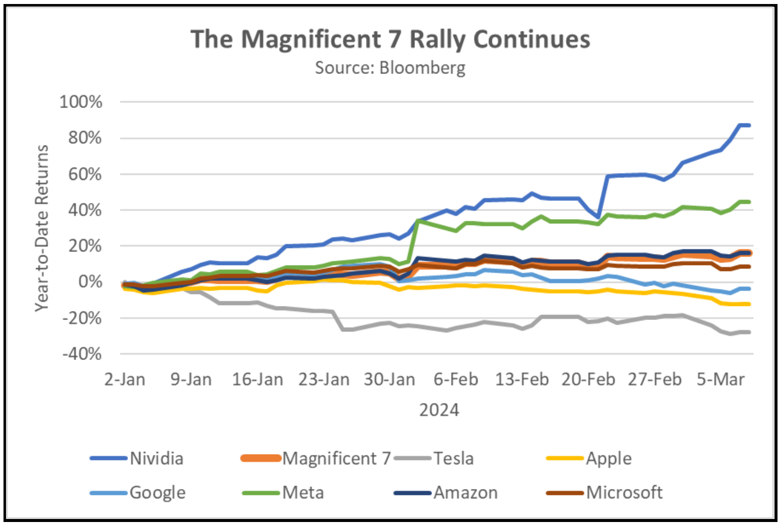


- The choice between gold and Bitcoin might hinge on age. Younger investors, comfortable with technology, may embrace the potential of digital assets like Bitcoin. Older generations, valuing stability, might favor the established security of physical gold. Gold boasts advantages; its tangibility and long history as a store of value inspire greater trust among some. Bitcoin, however, faces regulatory uncertainty and limited mainstream adoption, reflected in its lower trading volume compared to traditional financial instruments. It's essential to conduct thorough due diligence before venturing into this asset class as cryptocurrencies are still susceptible to significant price corrections.

Tech's Regulatory Dance: Geopolitical tensions are fueling growing concerns from US lawmakers about the expanding influence of Big Tech.

- House Majority Leader Steve Scalise (R-LA) is poised to introduce a bill that could force TikTok's parent company ByteDance to divest the popular video-sharing platform due to national security concerns. The House Committee on Energy and Commerce unanimously approved the measure (50-0) on Thursday, propelling it closer to a vote on the House floor. This push to restrict access to TikTok, a favorite app among Gen Z, stems from anxieties that the Chinese government could be using it for surveillance and propaganda purposes. If ByteDance refuses to sell TikTok, the legislation could lead to a nationwide ban.
- In the wake of congressional restrictions on TikTok due to national security concerns, speculation is rising that similar actions could target generative AI. This is being underscored by the European Parliament, which is poised to pass legislation on March 13 regulating AI based on potential risks. For instance, the law would ban the use of AI for "emotion recognition" systems in workplaces. Importantly, this legislation applies to any provider or developer whose products enter the EU market, meaning US companies will

also be impacted. Although the US is considering its own AI legislation, it has not formally introduced a bill to regulate its use.

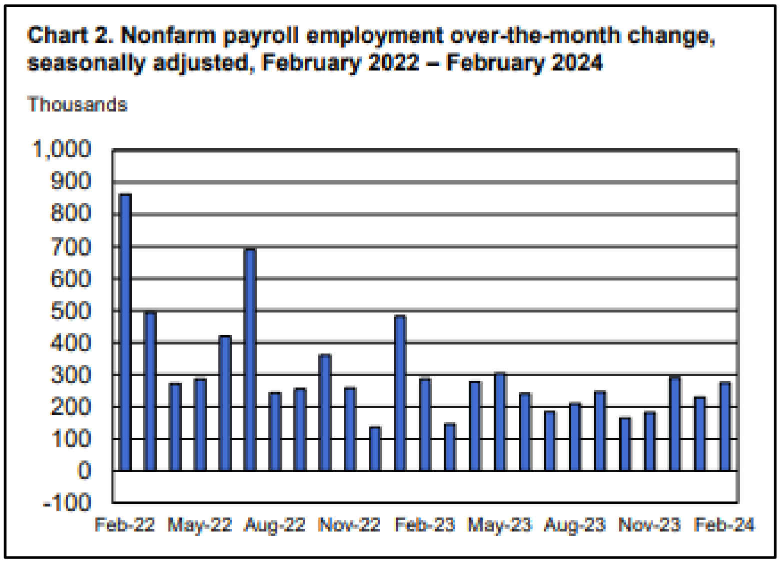


- Escalating tensions, particularly between the US and China, threaten to ensnare major tech companies in a global regulatory web. Their vast international presence makes them especially vulnerable to a shifting regulatory landscape. Western companies could face the brunt of this, with increased restrictions inflating development costs and limiting access to crucial foreign markets. China's push for self-sufficiency in key components like semiconductors further complicates the picture. For investors, this environment suggests a need for diversification. Investors may consider broadening their portfolios beyond traditional tech giants and exploring sectors with stronger fundamentals that are less susceptible to geopolitical headwinds.

In Other News: In his State of the Union address, President Joe Biden championed a call for increased taxes on billionaires and corporations, marking a notable shift toward a more populist stance. The US embassy warned of an extremist attack in Moscow, another sign of growing geopolitical risks. There is growing speculation that the Bank of Japan could tighten monetary policy in March.

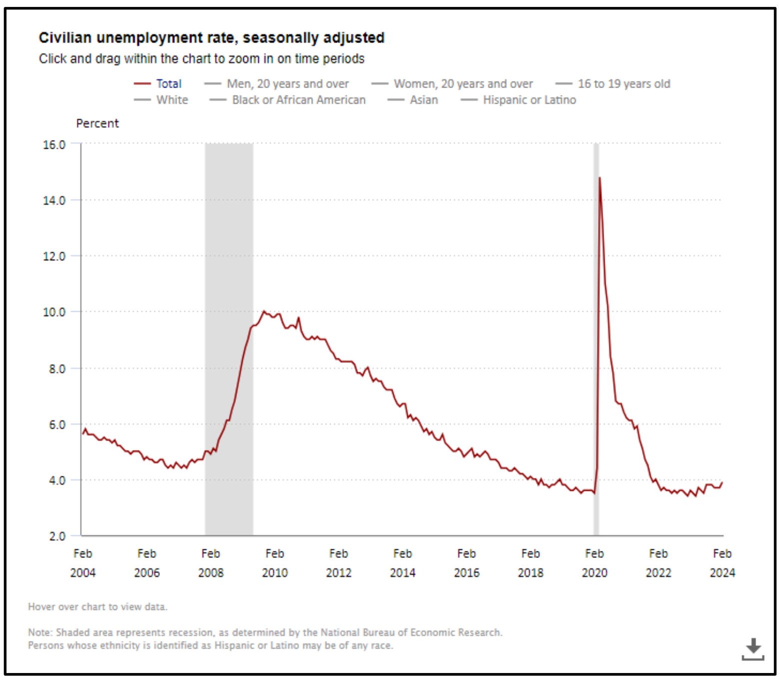
US Economic Releases

February ***nonfarm payrolls*** rose by a seasonally adjusted 275,000, well above the expected gain of 200,000. However, the January increase was revised sharply lower to 229,000, and December's increase was revised lower as well. Manufacturing payrolls showed a small decline in February, but not enough to offset the modest gain in the previous month. The chart below shows the monthly change in nonfarm payrolls over the last couple of years.



(Source: Bureau of Labor Statistics)

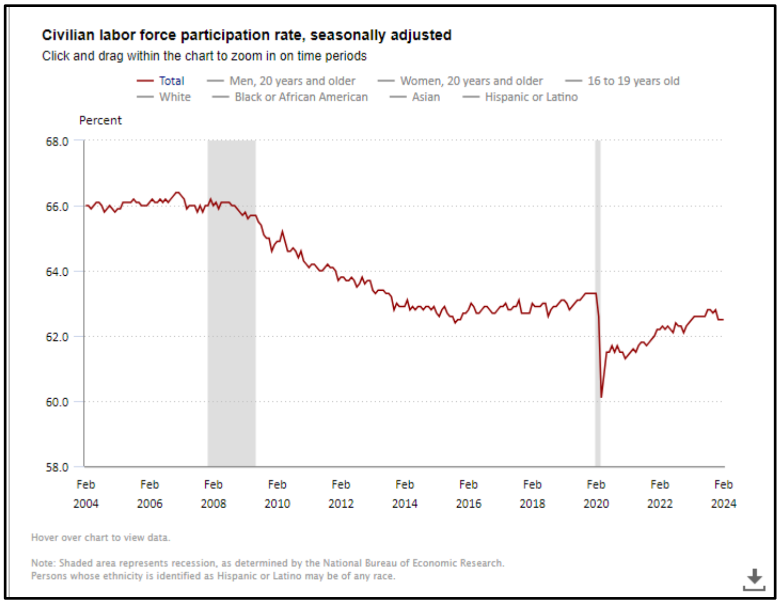
The February ***unemployment rate*** rose to a seasonally adjusted 3.9%, in contrast with expectations that joblessness would remain unchanged at 3.7%. The chart below shows how the unemployment rate has evolved over recent years.



(Source: Bureau of Labor Statistics)

With the demand for labor high and the "inventory" of unemployed workers low, it should be no surprise that wage rates remain high. ***Average hourly earnings*** in February rose to a seasonally adjusted $34.57, up 4.3% from the same month one year earlier. The annual increase in wage rates was in line with expectations and a bit cooler than the 4.4% increase in the year to January.

A final key indicator in the monthly employment report focuses on the share of the adult, civilian, noninstitutionalized population that is either working or looking for work. The February ***labor force participation rate (LFPR)*** held steady at a seasonally adjusted 62.5%, despite expectations that it would edge up to 62.6%. The chart below shows how the LFPR has changed over recent years.



(Source: Bureau of Labor Statistics)

There are no other economic releases or Fed events scheduled for the rest of the day.

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	Household Spending	y/y	Jan	-6.3	-2.5	-4.1	***	Equity bearish, bond bullish
	BoP Trade Balance	m/m	Jan	-¥1442.7b	¥115.5b	-¥1483.2b	**	Equity and bond neutral
	BoP Current Account Balance	m/m	Jan	¥438.2b	¥744.3b	-¥330.4b	***	Equity and bond neutral
	Leading Economic Index	m/m	Jan P	109.9	110.5	109.7	**	Equity and bond neutral
	Coincident Index	m/m	Jan P	110.2	116.0	110.2	*	Equity and bond neutral
South Korea	BoP Goods Balance	m/m	Jan	$4240.4m	$8037.4m		*	Equity and bond neutral
	BoP Current Account Balance	m/m	Jan	$3045.7m	$7414.6m		**	Equity and bond neutral
EUROPE								
Eurozone	GDP	y/y	4Q F	0.1%	0.1%	0.1%	***	Equity and bond neutral
Germany	Industrial Production WDA	y/y	Jan	-5.5%	-3.5%	-4.8%	**	Equity bearish, bond bullish
	PPI	y/y	Jan	-4.4%	-8.6%	-6.9%	**	Equity bearish, bond bullish
France	Trade Balance	m/m	Jan	-£7388m	-£6829m	-£6421m	**	Equity and bond neutral
	Current Account Balance	m/m	Jan	-1.0b	-0.7b		*	Equity and bond neutral
Italy	PPI	y/y	Jan	-14.0%	-20.5%		*	Equity and bond neutral
AMERICAS								
Canada	Building Permits	m/m	Jan	13.5%	-11.5%	4.5%	**	Equity bullish, bond bearish
	International Merchandise Trade	m/m	Jan	0.5b	-0.86b	0.00b	**	Equity and bond neutral
Brazil	Total Outstanding Loans	m/m	Jan	5777b	5749b		**	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)	523	523	0	Up
U.S. Sibor/OIS spread (bps)	531	532	-1	Down
U.S. Libor/OIS spread (bps)	533	533	0	Down
10-yr T-note (%)	4.07	4.08	-0.01	Down
Euribor/OIS spread (bps)	393	394	-1	Down
Currencies	**Direction**			
Dollar	Flat			Down
Euro	Down			Up
Yen	Up			Down
Pound	Up			Up
Franc	Up			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.

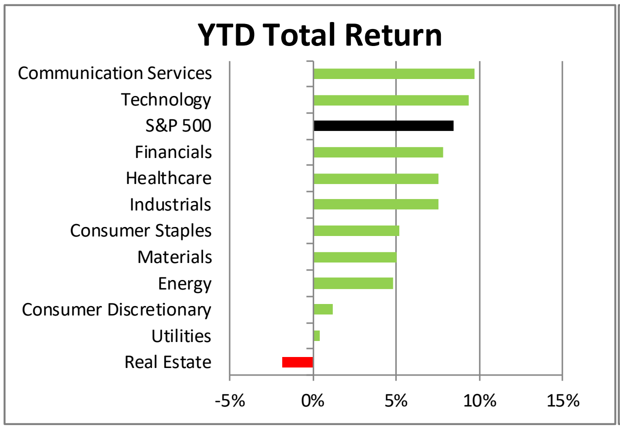
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$82.42	$82.96	-0.65%	
WTI	$78.37	$78.93	-0.71%	
Natural Gas	$1.77	$1.82	-2.81%	
Crack Spread	$30.08	$30.02	0.19%	
12-mo strip crack	$24.13	$24.40	-1.08%	
Ethanol rack	$1.72	$1.72	0.36%	
Metals				
Gold	$2,167.51	$2,159.98	0.35%	
Silver	$24.50	$24.33	0.72%	
Copper contract	$392.75	$392.60	0.04%	
Grains				
Corn contract	$434.50	$438.00	-0.80%	
Wheat contract	$532.00	$528.50	0.66%	
Soybeans contract	$1,165.00	$1,166.25	-0.11%	
Shipping				
Baltic Dry Freight	2,251	2,176	75	
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)	-40	-37	-3	

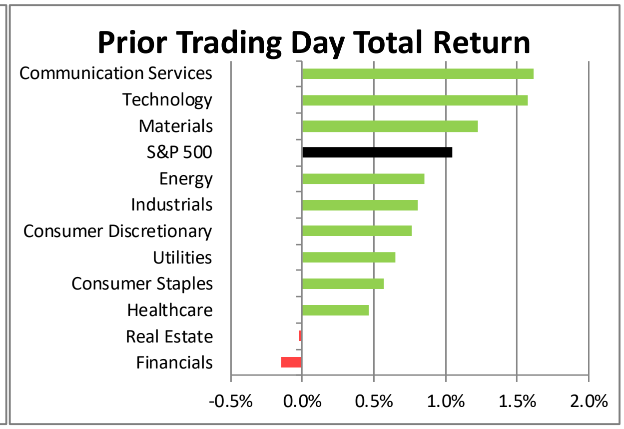
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures in the Far West, the northern Great Plains, and the Northeast, with cooler-than-normal temperatures in the Southwest. The forecasts call for wetter-than-normal conditions in the Southwest, the Deep South, and the East Coast, with dry conditions in the Far West.

Data Section

US Equity Markets – (as of 3/7/2024 close)

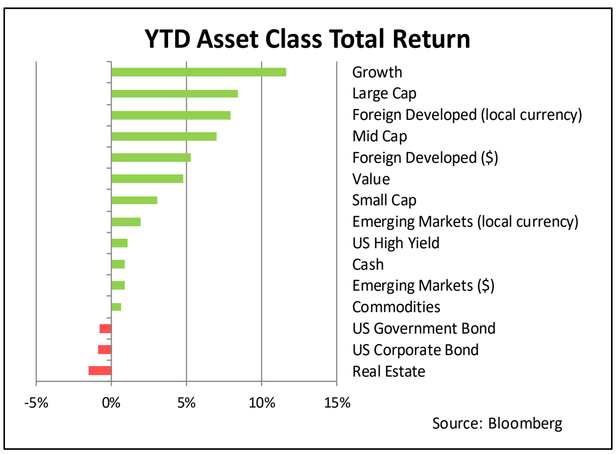




(Source: Bloomberg)

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 3/7/2024 close)

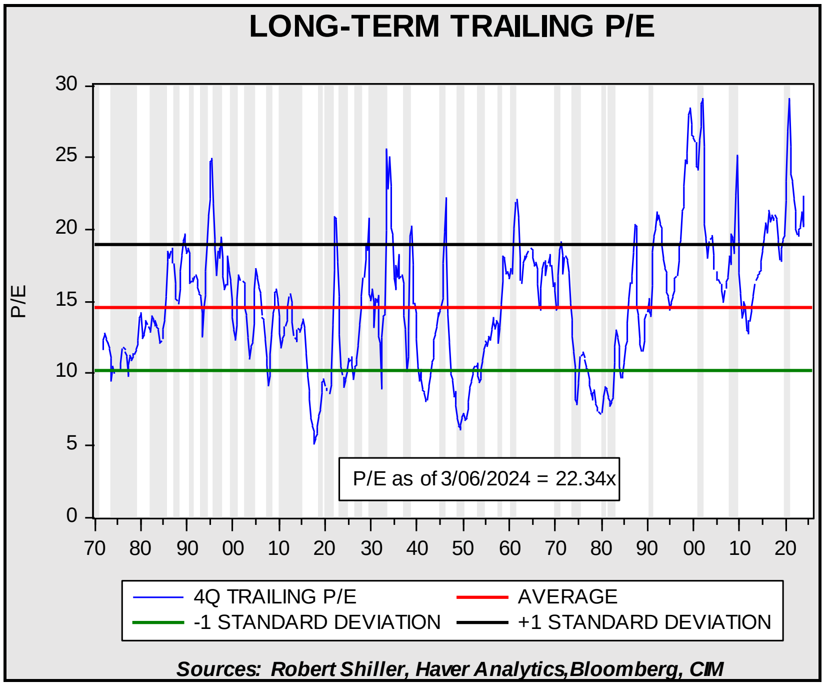


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.