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: May 3, 2024—9:30 AM EDT] Global equity markets are higher 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 1.3%. Chinese markets were closed for Labor Day. US equity index futures are signaling a higher open.

With 396 companies having reported so far, S&P 500 earnings for Q1 are running at $56.00 per share compared to estimates of $54.24, which is up 0.9% from Q1 2023. Of the companies that have reported thus far, 79.0% have exceeded expectations, while 16.9% have fallen short of expectations.

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:

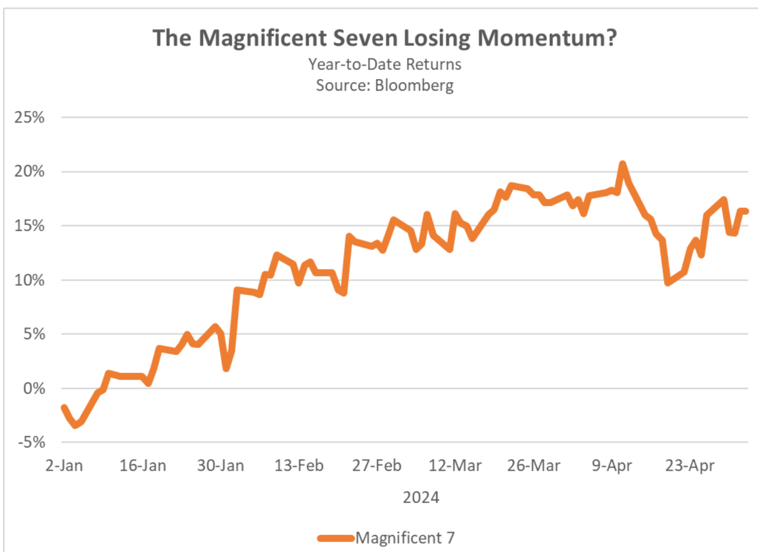
- *Bi-Weekly Geopolitical Report* (4/22/2024) (with associated podcast): "The Changing Face of War"
- *Asset Allocation Quarterly – Q2 2024* (4/25/2024): Discussion of our asset allocation process, Q2 2024 portfolio changes, and our outlook for the markets.
- *Asset Allocation Q1 2024 Rebalance Presentation* (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* (4/29/2024) (no accompanying podcast): "The Peace Dividend, Government Debt, and Yield Curve Control"
- *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"
- *Keller Quarterly* (4/18/24)

Good morning! Equity futures are higher as a relatively weak jobs report has reaffirmed hopes for Fed easing. In sports news, the New York Knicks edged out the Philadelphia 76ers in a thrilling playoff victory! Today's *Comment* dissects how big tech companies are increasingly prioritizing shareholder rewards, explores the impact of the Federal Reserve's policies on central banks worldwide, and examines the potential hurdles that upcoming local elections pose for UK

Prime Minister Rishi Sunak. To wrap things up, we provide a comprehensive overview of key international and domestic data releases.

Big Tech Brings Value: Apple becomes the third company in the "Magnificent 7" to return capital to investors this year, a move that might signal a trend.

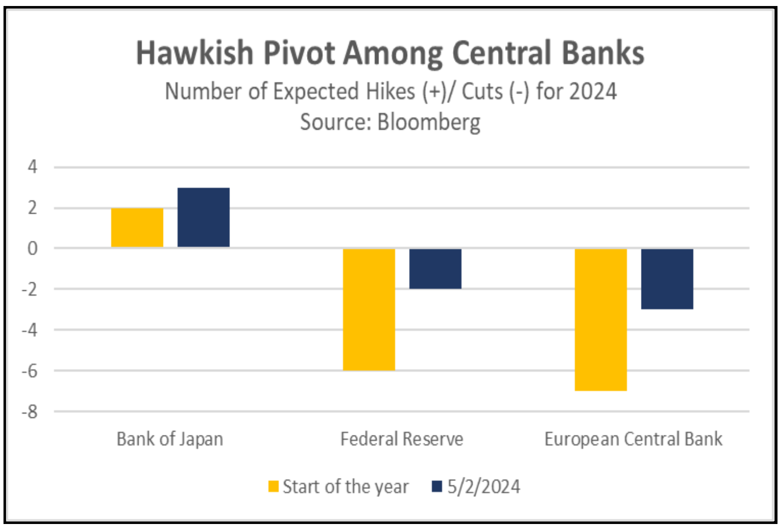
- Apple made a splash on Thursday by announcing a record-breaking $110 billion share buyback program, surpassing its previous high set six years ago. The company further emphasized its financial strength by raising its quarterly dividend for the 12th consecutive year. Before the announcement, investor concerns ran high due to anticipated disappointing sales figures stemming from the recent decline in iPhone market share in China, a crucial market for the company. However, the company was not only able to beat estimates, but it also expects to return to growth in the current period.
- Following Meta and Alphabet's inaugural dividends this year, Apple's decision further underscores a growing focus on shareholder returns among the tech giants. Fueled by investor expectations of high future growth, these companies have channeled significant resources into burgeoning areas like virtual reality, electric vehicles, and artificial intelligence, albeit with mixed results. This move to reward investors is likely a way of signaling strength even as the company looks to meet its lofty valuation and comes at a time of rising speculation that big tech stocks may be nearing their peak valuations.



- In a higher interest rate environment, value stocks tend to outperform growth stocks. This is because value stocks, trading at lower valuations (e.g., price-to-earnings ratio), offer more attractive current cash flows compared to the higher cost of borrowing. While buybacks and dividends from the big tech companies signal financial strength and the ability to return capital, this strategy is probably not sustainable for all companies in the sector, especially those prioritizing reinvestment for future growth. Investors will likely remain interested in the long-term potential of big tech, but they will also be looking for continued growth to justify valuations.

No Fear, Powell is Here: Central banks are growing more confident in maintaining a relatively accommodative policy stance this year, buoyed by Federal Reserve Chair Jerome Powell's dovish signals on interest rates.

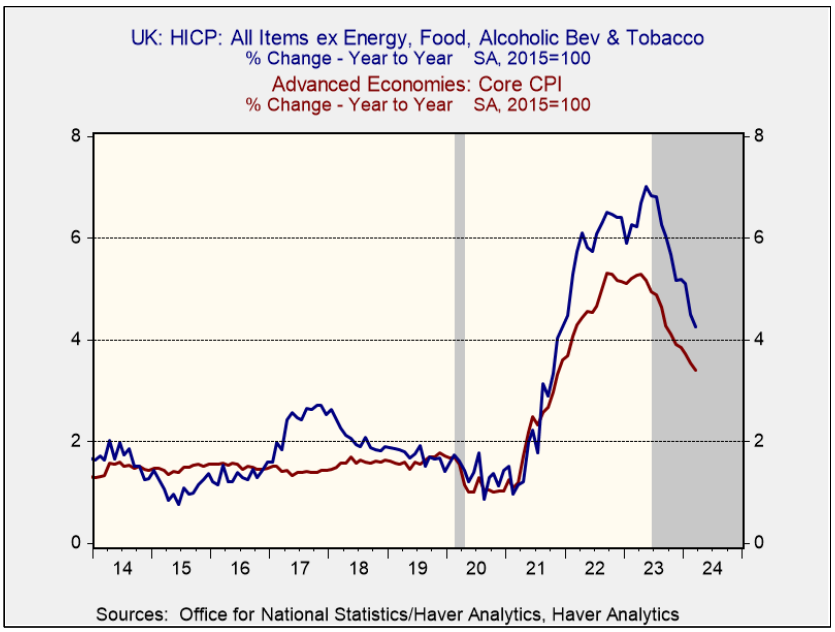
- A day after Powell's dovish comments on Wednesday, ECB Governing Council member Yannis Stournas offered a glimpse into the bank's evolving plan. In a recent interview with the Greek media site Liberal, he indicated the ECB might institute three rate cuts this year, revising down prior expectations of four. This revision suggests European policymakers, despite concerns about future inflation, appear confident in their ability to navigate an easing cycle. Additionally, the Bank of Japan's efforts to prop up the yen on Thursday signal its reluctance to use monetary policy to combat currency weakness.
- Recently, strong economic data in the US has caused the Fed to dampen market enthusiasm for rate cuts. Expectations peaked at six cuts in January and have dwindled to just two as of this Thursday. This shift in sentiment has strengthened the US dollar against its peers, raising concerns about whether other central banks with more accommodative policies can hold their ground. As a result, expectations for ECB rate cuts have fallen from seven to three, while the BOJ is now anticipated to hike rates three times, up from previous estimates of two.



- Despite holding off on interest rate hikes in 2024 so far, central banks could find themselves constrained in their ability to cut rates aggressively. Premature rate cuts in the US could undermine the Fed's fight against inflation, a risk that makes policymakers hesitant to commit. This hesitancy extends to economies like Japan and the eurozone, which rely heavily on dollar-denominated energy imports. Easing monetary policy in these regions could exacerbate inflation due to weakening exchange rates. Therefore, investors should brace for the possibility of tighter global financial conditions driven, in part, by US monetary policy.

Tories in Trouble: The UK's Conservative Party suffered significant losses in local elections, signaling potential challenges ahead for them in upcoming general elections.

- Early reports indicate the Conservative Party has lost over 120 seats as of the time of this writing. This setback is worse than anticipated and fuels speculation the party is losing ground to the rival Labour Party. The poor performance reflects public desire for change as evidenced by national polls that showed the Conservative Party trailing Labour over the last 18 months. UK Prime Minister Rishi Sunak faces mounting pressure to schedule general elections, although he's not legally required to do so until January 2025.
- Since taking office, Sunak has struggled to fulfill his economic promises, which include halving inflation, growing the economy, reducing debt, cutting hospital waitlists, and moderating immigration. While inflation shows signs of approaching the target rate of 2%, price pressures remain high compared to other countries. This is compounded by a 1.2% GDP contraction in the first quarter of this year. Additionally, public debt as a share of GDP has grown since he took office, and long wait times for medical care continue to be a significant concern. However, he did address immigration problems with the passage of legislation allowing asylum-seeker transfers to Rwanda.

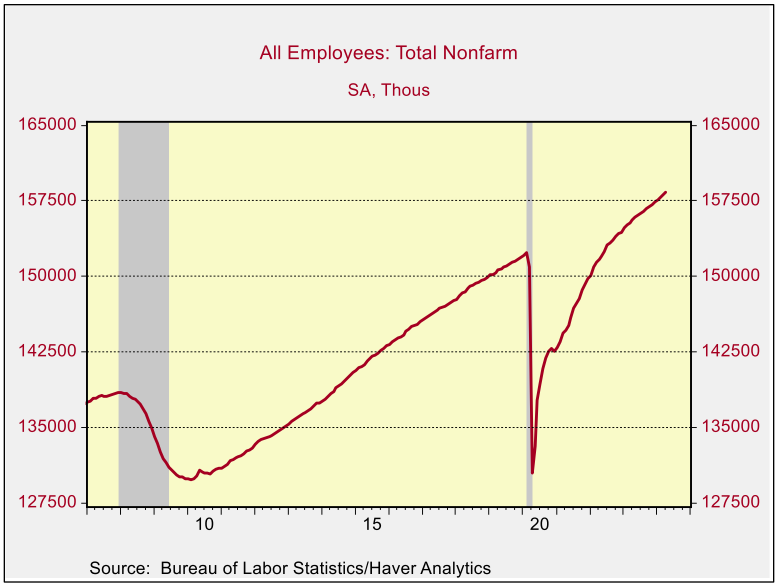


- One concern is the potential for the UK to resemble the recent political instability of Italy. If local indicators accurately reflect public opinion, the UK is on track to have its sixth prime minister in eight years since Brexit. This would be a significant change as the country only saw the same number in the previous 40 years. The lack of consistency in leadership is a concern for investors as it makes it hard to push the country in a single direction. As a result, we believe the country may be relatively risky as a long-term investment.

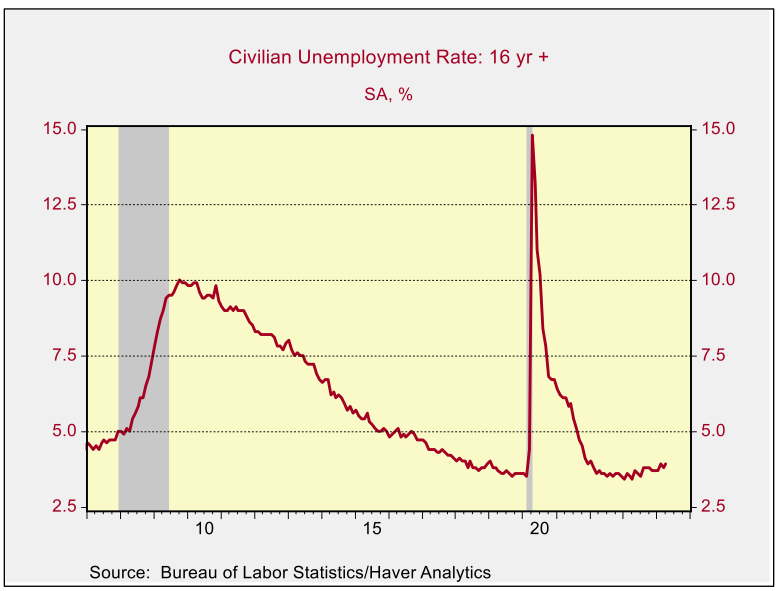
In Other News: Germany's rebuke of Russia for cyberattacks targeting a political party provides evidence of a worsening relationship between Europe and Russia. In a twist of irony, Boris Johnson faced difficulty voting in local elections after reportedly failing to provide the proper identification mandated by legislation that he championed and helped pass.

US Economic Releases

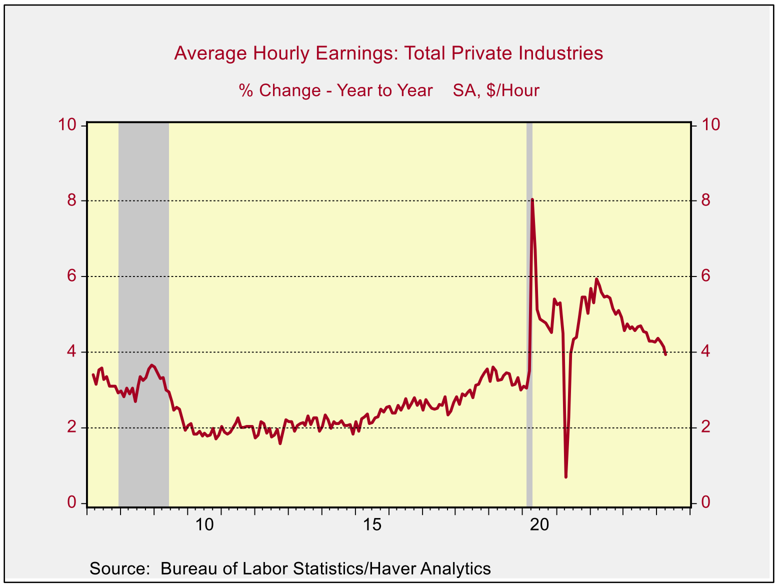
April ***nonfarm payrolls*** rose by a seasonally adjusted 175,000, well below both the expected rise of 240,000 and the upwardly revised March increase of 315,000. The job gains in April were the weakest since last October. One key reason for the cooling in overall job growth was a sharp decline in payrolls within the leisure and hospitality industries. The chart below shows the change in nonfarm payrolls since shortly before the Great Financial Crisis (GFC).



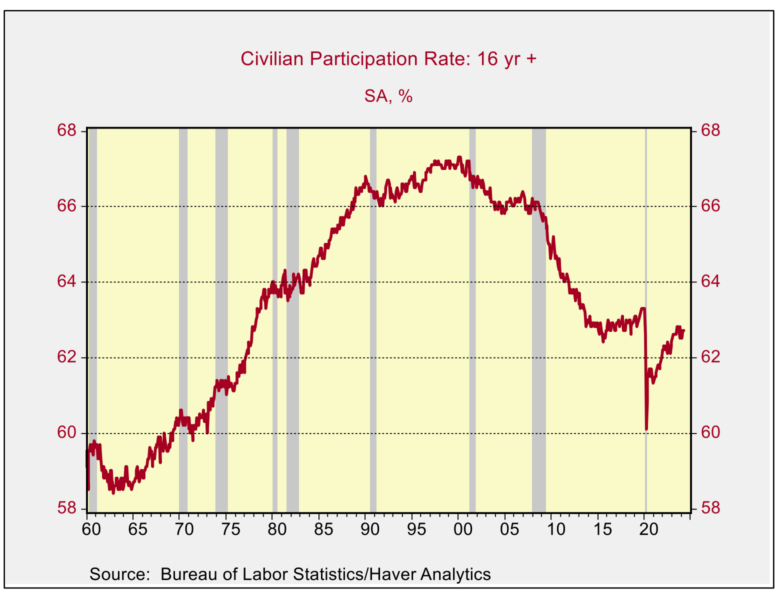
Consistent with the slowdown in job growth, the April ***unemployment rate*** rose to a seasonally adjusted 3.9% versus expectations that it would be unchanged at 3.8%. The jobless rate is now significantly higher than the cycle low of 3.4% reached in April 2023. The chart below shows how the unemployment rate has evolved since just before the GFC.



Also consistent with the cooling in labor demand, ***average hourly earnings*** in April rose to a seasonally adjusted $34.75, up 3.9% from the same month one year earlier. That was weaker than both the anticipated rise of 4.0% and the increase of 4.1% in the year to March. The chart below shows the year-over-year growth in average hourly earnings since just before the GFC.



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 April ***labor force participation rate (LFPR)*** was unchanged at a seasonally adjusted 62.7%. Although the LFPR for working-age people remains elevated, the overall LFPR remains below its level in 2019 in large part because so many baby boomers and others left the labor market during the coronavirus pandemic. The chart below shows how the LFPR has changed over the last several decades.



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
9:45	S&P Global US Composite PMI	m/m	Apr F	51.0	50.9	***
9:45	S&P Global US Services PMI	m/m	Apr F	51.0	50.9	***
10:00	ISM Services Index	m/m	Apr	52.0	51.4	***

Federal Reserve		
EST	Speaker or Event	District or Position
10:30	Austan Goolsbee on Bloomberg TV	President of the Federal Reserve Bank of Chicago
19:45	Austan Goolsbee and John Williams Participate in a Panel Discussion	Presidents of the Federal Reserve Banks of Chicago and New York

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								
Australia	Judo Bank Australia Services PMI	m/m	Apr F	53.6	54.2		*	Equity and bond neutral
	Judo Bank Australia Composite PMI	m/m	Apr F	53.0	53.6		*	Equity and bond neutral
EUROPE								
Eurozone	Unemployment Rate	m/m	Mar	6.5%	6.5%	6.5%	**	Equity and bond neutral
France	Industrial Production	y/y	Mar	0.7%	-0.6%	1.4%	***	Equity bearish, bond bullish
	Manufacturing Production	y/y	Mar	1.0%	-0.1%	1.2%	**	Equity and bond neutral
Italy	Unemployment Rate	m/m	Mar	7.2%	7.4%	7.5%	**	Equity and bond neutral
UK	S&P Global UK Services PMI	m/m	Apr F	55.0	54.9	54.9	**	Equity and bond neutral
	S&P Global UK Composite PMI	m/m	Apr F	54.1	54.0	54.0	**	Equity and bond neutral
Russia	Money Supply, Narrow Definition	w/w	26-Apr	18.24t	18.26t		*	Equity and bond neutral
AMERICAS								
Canada	International Merchandise Trade	m/m	Mar	-2.28b	0.48b	1.21b	**	Equity and bond neutral
Mexico	S&P Global Manufacturing PMI	m/m	Apr	51.0	52.2		***	Equity and bond neutral
	Gross Fixed Investment	y/y	Feb	12.5%	14.6%	12.7%	**	Equity and bond neutral
	Vehicle Domestic Sales	m/m	Apr	112048.0	124395.0		*	Equity and bond neutral
Brazil	S&P Global Manufacturing PMI	m/m	Apr	55.9	53.6		***	Equity and bond neutral
	Total Outstanding Loans	m/m	Dec	5873b	5655b		**	Equity and bond neutral
	Industrial Production	y/y	Mar	-2.8%	5.4%	-2.4%	***	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	Up
3-mo T-bill yield (bps)	524	524	0	Up
U.S. Sibor/OIS spread (bps)	532	533	-1	Flat
U.S. Libor/OIS spread (bps)	534	534	0	Up
10-yr T-note (%)	4.56	4.58	-0.02	Down
Euribor/OIS spread (bps)	385	383	2	Down
Currencies	**Direction**			
Dollar	Down			Up
Euro	Up			Flat
Yen	Up			Down
Pound	Up			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.

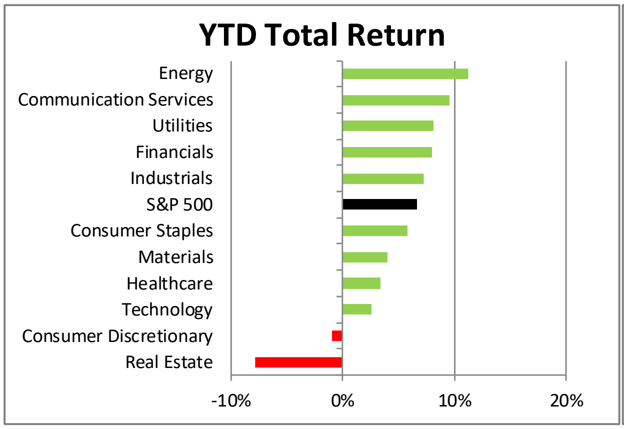
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$84.08	$83.67	0.49%	
WTI	$79.26	$78.95	0.39%	
Natural Gas	$2.05	$2.04	0.74%	
12-mo strip crack	$23.36	$23.33	0.10%	
Ethanol rack	$1.86	$1.85	0.42%	
Metals				
Gold	$2,298.40	$2,303.83	-0.24%	
Silver	$26.46	$26.68	-0.82%	
Copper contract	$452.55	$448.45	0.91%	
Grains				
Corn contract	$464.00	$459.75	0.92%	
Wheat contract	$617.00	$604.25	2.11%	
Soybeans contract	$1,210.00	$1,199.00	0.92%	
Shipping				
Baltic Dry Freight	1,774	1,688	86	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	7.3	-2.5	9.8	
Gasoline (mb)	0.3	-1.0	1.4	
Distillates (mb)	-0.7	1.0	-1.73	
Refinery run rates (%)	-1.0%	0.5%	-1.5%	
Natural gas (bcf)	59	58	1	

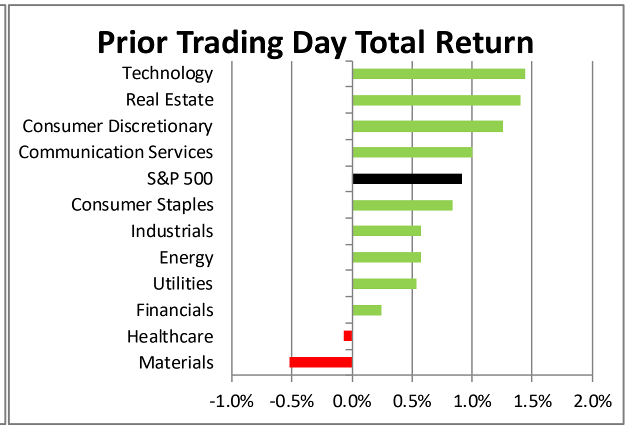
Weather

The 6-10 and 8-14 day forecasts call for warmer-than-normal temperatures in the southern Great Plains, the Mississippi Valley region, and the Southeast, with cooler-than-normal temperatures in the Rocky Mountains. The forecasts call for wetter-than-average conditions in the Rocky Mountains, the Mississippi Valley region, and along the East Coast, with dry conditions expected in the Pacific Northwest and southern Florida.

Data Section

US Equity Markets – (as of 5/2/2024 close)

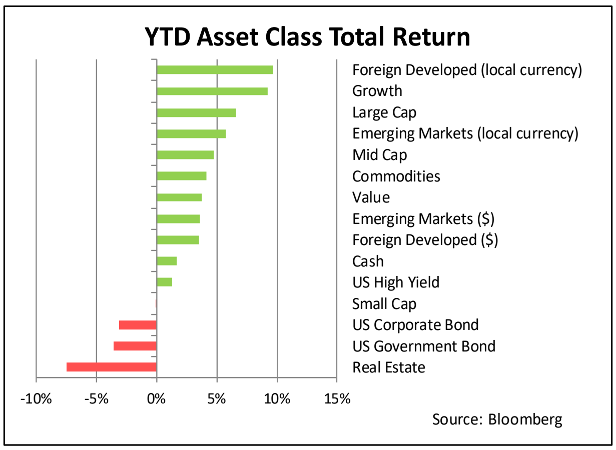




(Source: Bloomberg)

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 5/2/2024 close)

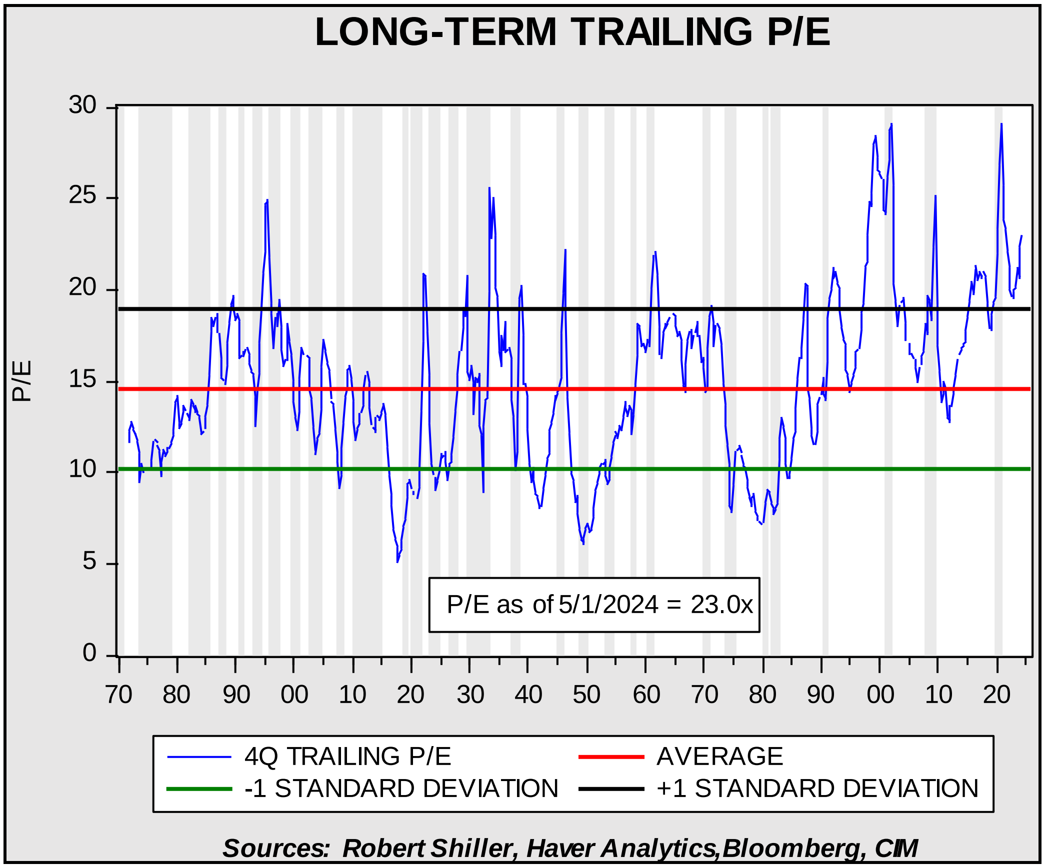


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

May 2, 2024



Based on our methodology,[1] the current P/E is 23.0x, down 0.2x from our last report. The decrease in the multiple reflects a decline in the S&P 500 Index.

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.