Daily Comment

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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 8, 2024—9:30 AM EDT] Global equity markets are generally lower 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 0.4%. Chinese markets were lower, with the Shanghai Composite down 0.6% from its previous close and the Shenzhen Composite down 1.3%. US equity index futures are signaling a lower open.

With 426 companies having reported so far, S&P 500 earnings for Q1 are running at $56.40 per share compared to estimates of $54.24, which is up 0.9% from Q1 2023. Of the companies that have reported thus far, 79.8% have exceeded expectations, while 16.2% have fallen short of expectations.

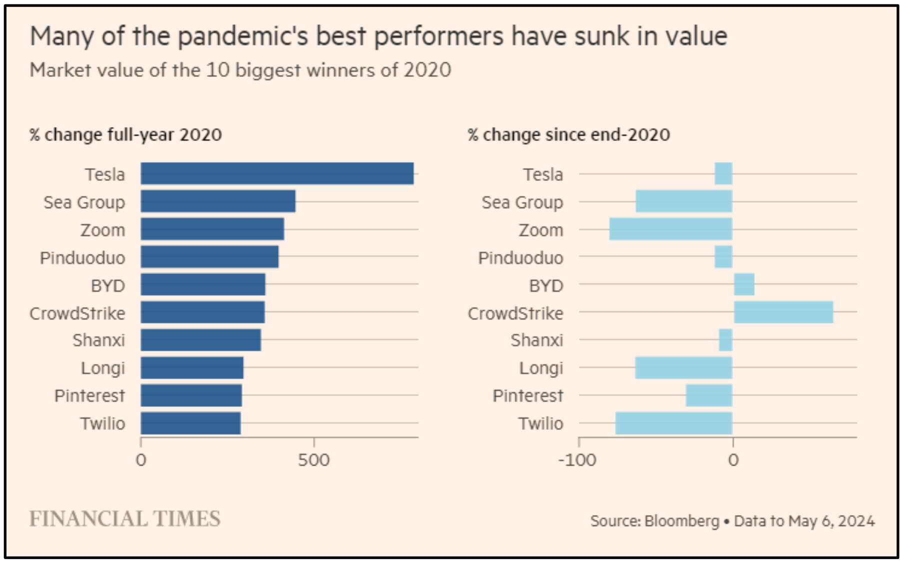
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *Bi-Weekly Geopolitical Report* (5/6/2024) (with associated podcast): "Middle East: Land of Fault Lines"
- *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 Q2 2024 Rebalance Presentation*** **(5/7/2024): 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"

Our *Comment* today opens with some notes on the stock market winners of the pandemic years and fundamentals in the silver market. We next review several other international and US developments with the potential to affect the financial markets today, including notes on Japanese and Swedish monetary policy and prospects for inflation in the US.

Global Stock Markets: The *Financial Times* today carries an interesting report noting that the 50 large-cap stocks that appreciated the most in 2020, amid coronavirus pandemic, have lost about one-third of their value, or $1.5 trillion, since then. The data shows just how short-lived many of the changes and disruptions of the pandemic actually were. Importantly, we've noted similar snap-backs in some key economic data series.

- Without a doubt, the pandemic also caused many longer-lasting stock market winners and economic changes.
- Nevertheless, the dramatic short-term disruptions in the finance and economic data will make it harder for economists and investment strategist to use pandemic-era figures for their models in the future.



Global Silver Market: Data from the International Energy Agency shows China and other countries around the world are boosting their investment in photovoltaic cell factories. Since solar cells use a lot of silver because of its high electrical conductivity and other features, the new investment is driving increased silver demand and higher silver prices. The data helps explain why we have recently added silver to our more aggressive asset allocation strategies.

Japan: At an economic conference today, Bank of Japan Governor Ueda said he would be willing to hike interest rates earlier than planned if consumer price inflation looks set to worsen again. He specifically cited a risk that the weak yen (JPY) could feed into broad price increases. The statement adds to the evidence that many major central banks are pulling back from their previous predisposition to cut interest rates.

Sweden: Despite the "higher for longer" approach to interest rates taken by the Federal Reserve, the Bank of Japan, and other major central banks, other institutions are proceeding with cautious rate cuts. The Riksbank today cut its benchmark short-term interest rate from 4.00% to 3.75%, as widely expected. That makes Sweden only the second rich, industrialized country to cut rates this cycle, following Switzerland's cut in March. Both central banks are responding to Europe's recent soft economic growth and falling inflation.

United Kingdom: In a fresh sign of chaos and falling political fortunes, two members of parliament for the ruling Conservative Party have defected to the main opposition Labour Party in the last two weeks. In an especially dramatic move yesterday, Dover MP Natalie Elphicke "crossed the floor" just moments before the start of Prime Minister's Questions, the weekly debate in the parliament chamber between Prime Minister Sunak and Labour Leader Starmer. The developments add to the sense that the Conservatives will lose big in this autumn's elections.

Argentina: Faced with persistently high inflation that has eroded the purchasing power of the peso (ARS) and forced consumers to pay for purchases with huge wads of bills, the central bank for the first time has begun printing 10,000-peso notes. The new notes are five times more valuable than the largest previous denomination, consisting of 2,000-peso notes.

United States-China: The US Commerce Department has revoked export licenses that until now allowed Intel and Qualcomm to supply semiconductors to Chinese telecom technology giant Huawei for its laptop computers and mobile phones. The move signals that the Biden administration intends to keep up its effort to weaken China's geopolitical threat by impeding the country's technological development. The change is also likely to spur Chinese retaliation, further advancing the spiral of tensions between Washington and Beijing.

US Consumer Price Inflation: While President Biden contends with the political fallout from the high inflation of 2022 and 2023, new analysis from Axios warns that if former President Trump is re-elected in November, key planks of his agenda could boost inflation again. Specifically, the analysis says Trump's goals such as increasing import tariffs, cutting taxes, clamping down on immigration, and pressuring the Fed to keep interest rates low would all be potentially inflationary.

- We take no position on who should win the election, as it remains too close to call.
- Rather, we think the significance of the Axios analysis is that broader geopolitical forces and domestic political realities in the US are likely to make the economic environment more inflationary going forward, no matter who wins the election.

US Economic Releases

Home loan demand rose for the first time in three weeks due a decline in borrowing costs. According to the Mortgage Bankers Association (MBA), mortgage applications increased 2.6% for the week ending May 3. This rise can be partly attributed to a decline in interest rates, with the average 30-year fixed-rate mortgage falling 11 basis points from 7.29% to 7.18%. As a result, purchase applications rose 1.7% from the prior week, while refinance applications increased 4.5%.

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	Wholesale Inventories	m/m	Mar F	-0.4%	-0.4%	**
10:00	Wholesale Trade Sales	m/m	Mar	0.8%	2.3%	*
Federal Reserve						
EST	**Speaker or Event**	**District or Position**				
11:00	Philip Jefferson Speaks About Careers in Economics	Vice-Chair of the Board of Governors				
11:45	Susan Collins Speaks ato MIT Students	President of the Federal Reserve Bank of Boston				
13:30	Lisa Cook Speaks on Financial Stability	Member of the Board of Governors				

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	Foreign Reserves	m/m	Apr	A$89.8b	A$89.7b		*	Equity and bond neutral
EUROPE								
Germany	Industrial Production WDA	y/y	Mar	-3.3%	-5.3%	-3.6%	**	Equity and bond neutral
Italy	Retail Sales	y/y	Mar	2.0%	2.4%		**	Equity and bond neutral
Russia	Money Supply, Narrow Definition	w/w	3-May	18.25t	18.24t		*	Equity and bond neutral
AMERICAS								
Mexico	International Reserves Weekly	w/w	3-May	$217713m	$217248m		*	Equity and bond neutral
Brazil	Retail Sales	y/y	Mar	5.7%	8.2%	5.2%	***	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	560	-1	Up
3-mo T-bill yield (bps)	524	524	0	Up
U.S. Sibor/OIS spread (bps)	533	533	0	Up
U.S. Libor/OIS spread (bps)	534	534	0	Up
10-yr T-note (%)	4.49	4.46	0.03	Down
Euribor/OIS spread (bps)	379	382	-3	Down
Currencies	**Direction**			
Dollar	Up			Up
Euro	Down			Down
Yen	Down			Down
Pound	Down			Down
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.

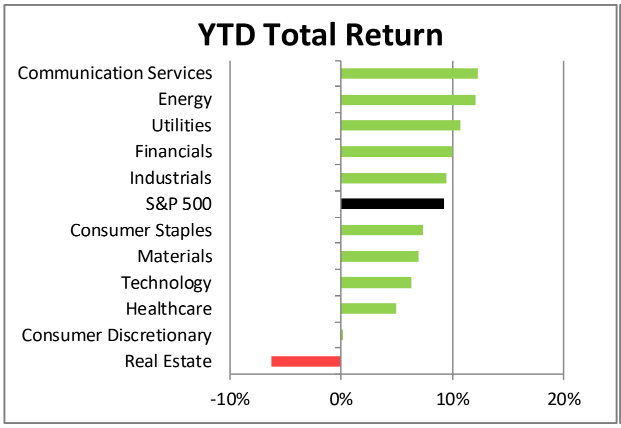
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$82.20	$83.16	-1.15%	
WTI	$77.43	$78.38	-1.21%	
Natural Gas	$2.26	$2.21	2.40%	
12-mo strip crack	$22.54	$22.94	-1.76%	
Ethanol rack	$1.88	$1.88	0.17%	
Metals				
Gold	$2,316.11	$2,314.10	0.09%	
Silver	$27.26	$27.24	0.06%	
Copper contract	$453.15	$460.55	-1.61%	
Grains				
Corn contract	$466.00	$467.00	-0.21%	
Wheat contract	$637.50	$642.75	-0.82%	
Soybeans contract	$1,243.25	$1,246.50	-0.26%	
Shipping				
Baltic Dry Freight	2,083	1,876	207	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-2.5		
Gasoline (mb)		-1.0		
Distillates (mb)		1.0		
Refinery run rates (%)		0.5%		
Natural gas (bcf)		88		

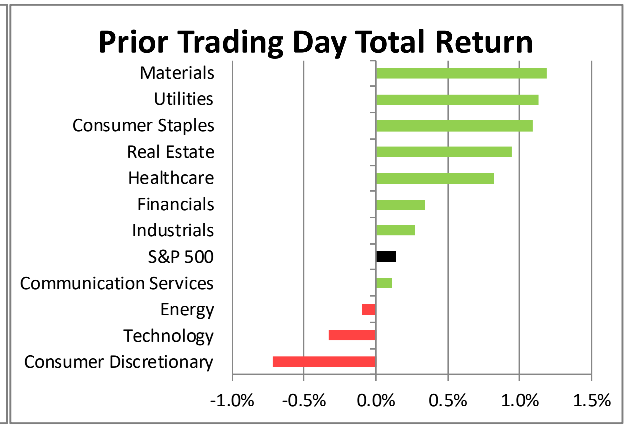
Weather

The 6-10 and 8-14 day forecasts call for warmer-than-normal temperatures throughout the entire country. The precipitation outlook calls for wetter-than-average conditions for most states, with dry conditions expected in the Pacific Northwest.

Data Section

US Equity Markets – (as of 5/7/2024 close)

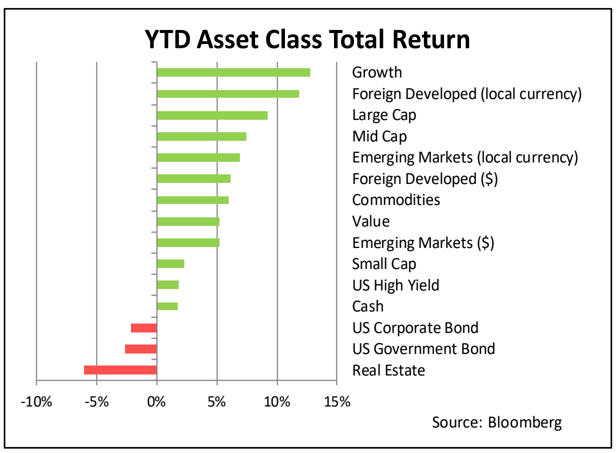




(Source: Bloomberg)

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 5/7/2024 close)

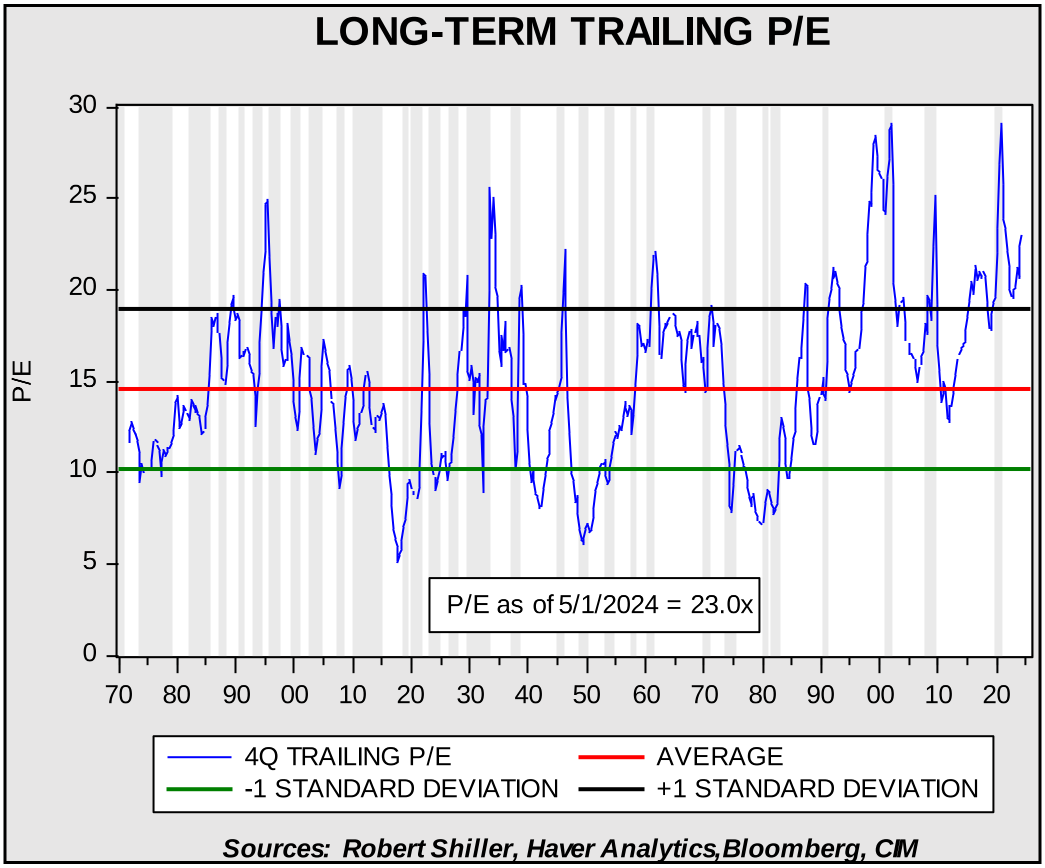


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

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.

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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 (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.