

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 13, 2024—9:30 AM EDT]** Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is down 0.2% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.0%. Chinese markets were lower, with the Shanghai Composite down 0.2% from its previous close and the Shenzhen Composite down 1.0%. US equity index futures are signaling a higher open.

With 459 companies having reported so far, S&P 500 earnings for Q1 are running at \$56.20 per share compared to estimates of \$54.24, which is up 0.9% from Q1 2023. Of the companies that have reported thus far, 78.9% have exceeded expectations, while 17.0% have fallen short of expectations.

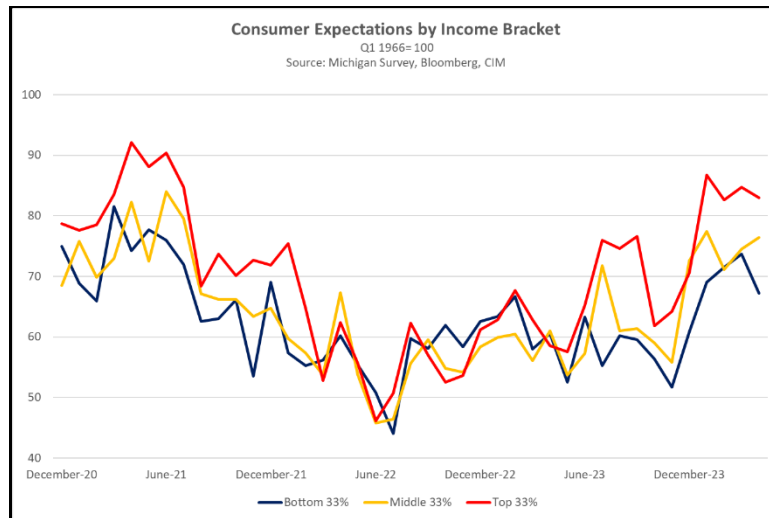
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our [website](#). We highlight recent publications below, with new items of the day emphasized in bold:

- [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](#) (5/13/2024) (with associated [podcast](#)): “The Immigration Paradox”**
- [The 2024 Outlook: Slow-Bicycle Economy](#) (12/18/2023) (with associated *Confluence of Ideas* [podcast](#))
- [Confluence of Ideas podcast](#) (5/8/2024) “Reviewing the Asset Allocation Rebalance: Q2 2024”

Good morning! Equity futures are higher as investors await this week's economic releases. In sports news, the Indiana Pacers were able to tie up the series with the New York Knicks. Today's *Comment* explores why declining consumer sentiment may spell bad news for some companies and why small-cap companies are eager for a Fed pivot. We also provide an update on the war in Ukraine. As usual, our report ends with a summary of the latest international and domestic data releases.

**Feeling the Squeeze:** May saw the biggest one-month drop in consumer sentiment since 2021; however, the pain was not evenly spread.

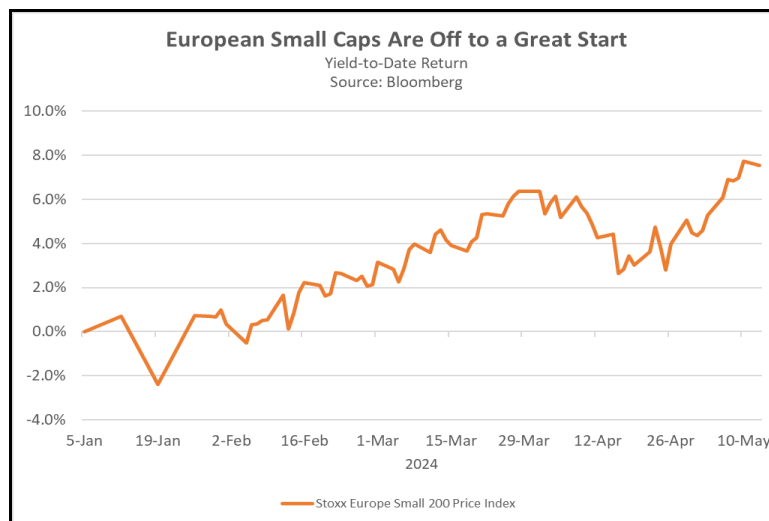
- The [University of Michigan Survey of Consumer Sentiment fell from 77.2 to 67.4](#), missing expectations of an increase to 78.0. This disappointing report was driven by rising inflation expectations, as households grew increasingly pessimistic about price increases moderating to pre-pandemic levels. The survey showed that consumers expected inflation to increase to 3.5% next year and eventually to moderate to 3.1% in the next five years. Although there is a lack of strong correlation between inflation expectations and indexes like CPI or PCE, the change in sentiment reflects a broadening trend of weak economic data.
- The recent drop in consumer sentiment reinforces concerns about slowing consumer spending — a trend that many companies hinted at in their latest earnings reports. Despite exceeding expectations, [corporate earnings suggest executives are noticing that households are tightening their belts](#). This cautious spending is particularly evident among discretionary purchases, since companies like McDonald's, KFC, and Starbucks have reported significant pushback against higher prices. The impact is felt most acutely by low-income households, while higher-income earners have shown greater resilience. In Q2, mentions of low-income consumers by companies have more than doubled when compared to the highest level seen in the past five quarters.



- Although consumer surveys suggest that households are under pressure, it is unclear whether that will lead to a broader consumption pullback. A breakdown by income shows consumer expectations remain relatively optimistic among middle and high-income households. Notably, attitudes of middle-income earners improved from the previous month. However, the sizeable decline in the overall index suggests that low-income earners are feeling less confident in dealing with rising prices. In the short term, there might be a more significant impact on the upcoming election than on the broader economy, but this trend could have long-term consequences.

**Small Cap Risk:** Despite attractive valuations, investors remain wary of smaller companies, perhaps until the Fed signals an interest rate cut.

- [Over 75% of the debt held by companies within the Russell 2000 index](#) needs to be refinanced within the next five years. This is a significantly higher proportion compared to the S&P 500, where nearly 50% of the debt is due at that time. These companies are particularly vulnerable to changes in interest rates because they rely more heavily on floating-rate debt compared to their larger, investment-grade counterparts. As a result, these companies have a heightened dependence on monetary policy decisions as a decrease in policy rates could drastically improve their financial performance.
- Small-cap investors stand to benefit significantly from a successful soft landing by the Fed. These companies are also [highly sensitive to fluctuations in the business cycle and real interest rates](#). Thus, the possibility of declining borrowing costs and improved growth [led these companies to outperform their large-cap counterparts](#) toward the end of 2023, for the most part. This relationship is not just a US phenomenon. European small caps have also been able to take off this year due to interest rate cut expectations and signs of an impending economic recovery. The Stoxx Europe Small 200 Price Index has surged 7.5% year-to-date, nearing its 2023 return of 10%.



- Despite some economic setbacks, a strong case can be made for US small and mid-cap companies. Not only do these firms have better valuations when compared to their large-cap counterparts, but their strong domestic focus likely protects their revenue from being significantly impacted by currency fluctuations and geopolitical events. Additionally, while [Fed Governor Bowman's recent comments dampen hopes for a rate cut](#), the possibility remains for one if inflation eases and unemployment keeps climbing. Nevertheless, this week's release of the PPI and CPI reports for April could provide crucial clues on the Fed's path, as inflation is expected to cool from the previous month.

**Next Phase in Ukraine:** Russian President Vladimir Putin is seeking a new approach as his country faces growing financial pressure from the West.

- [Putin replaced Defense Minister Sergei Shoigu with Andrei Belousov](#), an economist and former first deputy prime minister. This reshuffle highlights Putin’s attempt to re-evaluate Russia's military strategy, as Russian forces aim to consolidate their gains before Ukraine can leverage additional Western funding. The apparent uneasiness in these moves may also be reflected in [Russia's consideration of lowering the threshold for activating its nuclear weapons](#) and its decision to ramp up recruitment as it [recently brought female convicts to serve on the battlefield](#). These efforts have become more pressing as [Putin gets closer to taking over Kharkiv](#).
- The Russian need for a victory in Ukraine comes amidst growing signs that it is becoming increasingly more costly for Moscow to maintain its war efforts. The European Commission [has proposed the first-ever sanctions on Russia's liquefied natural gas industry](#), signaling a significant escalation in efforts to sever economic ties with Moscow. Although it would not affect imports, it would prevent EU countries from re-exporting Russian LNG. The measure would complicate purchases of Russian [gas for Asian countries like China and India](#), which have become key buyers since the war began in February.



- Despite waning media attention, the war in Ukraine remains a critical issue, which demands close monitoring. French President Emmanuel Macron's [emphasis on the potential need to send troops to Ukraine](#) underscores the possibility of a wider European conflict. Furthermore, the growing push by the West to restrict Russia's ability to get help from other countries is likely to exacerbate the trend toward global fracturing and undermine supply-chain security. Therefore, the recent reprieve in gold and oil prices may not hold if European threats continue to escalate.

**In Other News:** China is expected [to hold a major bond sale as it looks to boost its economy](#). This is a sign that global growth may pick up this year. Meanwhile, [more Americans are eyeing retirement](#), indicating that the labor market may remain tight for some time. In Spain's Catalonia region, [the Socialist Party dominated recent regional elections](#). This suggests that the pro-independence movement is losing favor.

## 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						
EST	Indicator			Expected	Prior	Rating
11:00	NY Fed 1-Yr Inflation Expectations	m/m	Apr		3.0%	
Federal Reserve						
EST	Speaker or Event	District or Position				
10:00	Loretta Mester and Philip Jefferson Discuss Central Bank Communications	Pres of the Federal Reserve Bank of Cleveland and Fed Vice Chair				

## 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
<b>ASIA-PACIFIC</b>								
Japan	Money Supply M2	y/y	Apr	2.2	2.50%		***	Equity and bond neutral
	Money Stock M3	y/y	Apr	1.6	1.8%		**	Equity and bond neutral
Australia	NAB Business Confidence	m/m	Apr	1	1		***	Equity and bond neutral
	NAB Business Conditions	m/m	Apr	7	9		***	Equity and bond neutral
New Zealand	Food Prices	m/m	Apr	0.6%	-0.5%		***	Equity and bond neutral
	2-Year Inflation Expectations	q/q	2Q	2.33%	2.50%		**	Equity and bond neutral
China	New Yuan Loans CNY	m/m	Apr	10190.0b	9460.0b	10374.4b	*	Equity and bond neutral
China	Money Supply M2	y/y	Apr	7.2%	8.3%	8.3%	***	Equity bearish, bond bullish
	Money Supply M1	y/y	Apr	-1.4%	1.1%	1.2%	*	Equity bearish, bond bullish
	Money Supply M0	y/y	Apr	10.8%	11.0%		*	Equity and bond neutral
China	PPI	y/y	Apr	-2.5%	-2.8%	-2.3%	**	Equity and bond neutral
China	CPI	y/y	Apr	0.3%	0.1%	0.2%	**	Equity and bond neutral
India	CPI	y/y	Apr	4.8%	4.85%	4.80%	***	Equity and bond neutral
<b>EUROPE</b>								
Switzerland	Domestic Sight Deposits CHF	w/w	10-May	460.3b	461.5b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	10-May	468.9b	473.2b		*	Equity and bond neutral
<b>AMERICAS</b>								
Canada	Net Change in Employment	m/m	Apr	90.4k	-2.2k	20.0k	***	Equity bullish, bond bearish
	Unemployment Rate	m/m	Apr	6.1%	6.1%	6.2%	***	Equity and bond neutral
	Participation Rate	m/m	Apr	65.4%	65.3%	65.3%	*	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)	558	559	-1	Up
3-mo T-bill yield (bps)	524	525	-1	Up
U.S. Sibor/OIS spread (bps)	533	533	0	Flat
U.S. Libor/OIS spread (bps)	534	534	0	Flat
10-yr T-note (%)	4.48	4.50	-0.02	down
Euribor/OIS spread (bps)	382	381	1	Down
Currencies	Direction			
Dollar	Flat			Up
Euro	Up			Up
Yen	Flat			Down
Pound	Up			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.

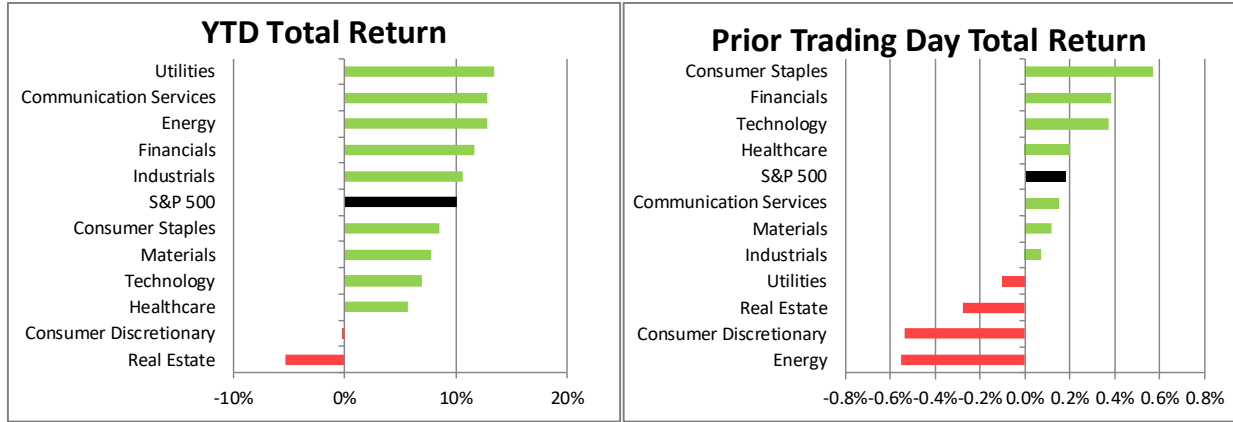
DOE Inventory Report	Price	Prior	Change	Explanation
<b>Energy Markets</b>				
Brent	\$83.37	\$82.79	0.70%	
WTI	\$78.90	\$78.26	0.82%	
Natural Gas	\$2.26	\$2.25	0.22%	
12-mo strip crack	\$22.82	\$22.56	1.17%	
Ethanol rack	\$1.93	\$1.92	0.16%	
<b>Metals</b>				
Gold	\$2,344.69	\$2,360.50	-0.67%	
Silver	\$28.22	\$28.18	0.12%	
Copper contract	\$469.80	\$466.25	0.76%	
<b>Grains</b>				
Corn contract	\$469.00	\$469.75	-0.16%	
Wheat contract	\$665.50	\$663.50	0.30%	
Soybeans contract	\$1,214.25	\$1,219.00	-0.39%	
<b>Shipping</b>				
Baltic Dry Freight	2,129	2,166	-37	

## Weather

The 6-10 and 8-14 day forecasts call for warmer-than-normal temperatures from the eastern half of the country to the South Central states, with cooler temperatures in the Northern Pacific. The forecasts call for wetter-than-average conditions for most of the country, with dry conditions in the Southwest.

**Data Section**

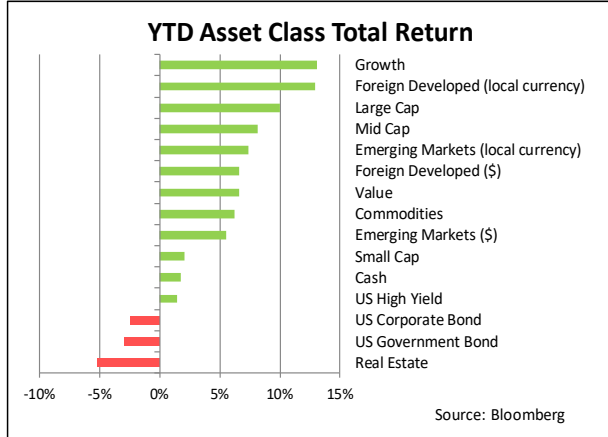
**US Equity Markets – (as of 5/10/2024 close)**



(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 5/10/2024 close)**

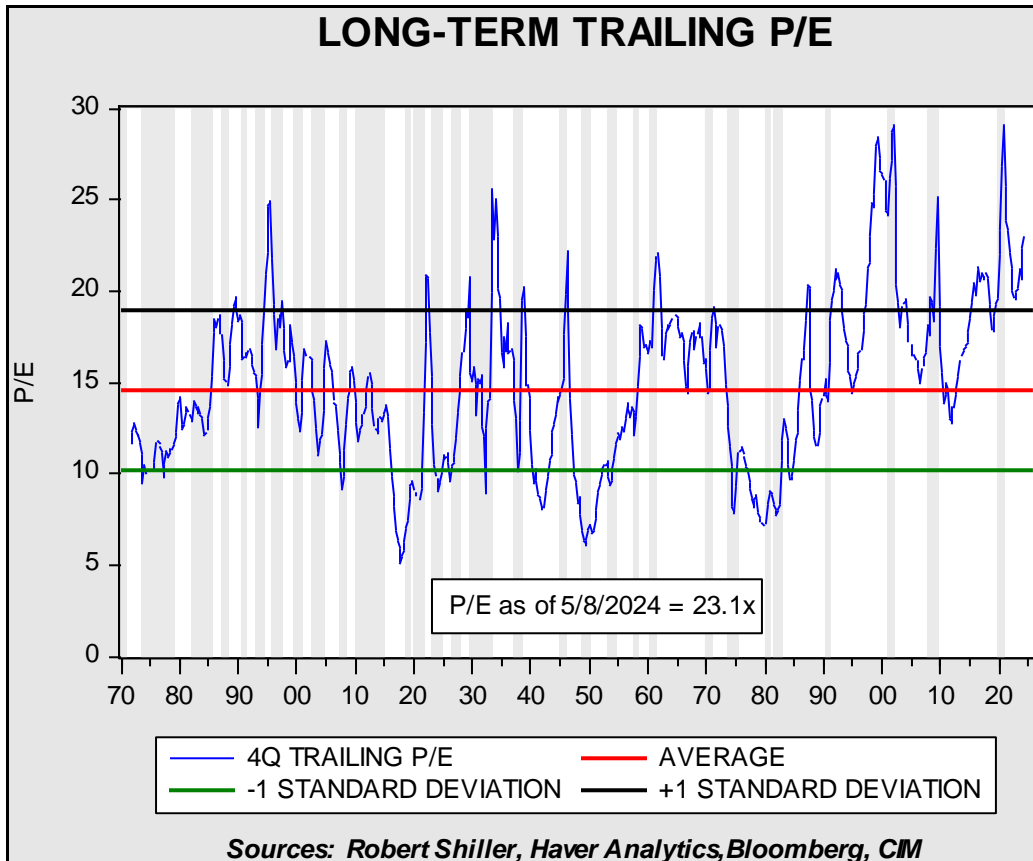


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 9, 2024



Based on our methodology,<sup>1</sup> the current P/E is 23.1x, up 0.1x from our last report. The increase in the multiple reflects an increase in the S&P 500 Index, outweighing the 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.*

<sup>1</sup> 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.