# 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: November 1, 2023—9:30 AM EDT]** Global equity markets are mildly lower 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 down 0.1%. Chinese markets were mixed, with the Shanghai Composite up 0.1% from its previous close and the Shenzhen Composite down 0.1%. U.S. equity index futures are signaling a lower open.

With 288 companies having reported so far, S&P 500 earnings for Q3 are running at $57.80 per share, compared to estimates of $57.42, which is up 1.7% from Q2 2023. Of the companies that have reported thus far, 79.5% have exceeded expectations while 16.7% 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* (10/30/2023) (with associated podcast): "Investment Implications of the Israel-Hamas Conflict"
- *Weekly Energy Update* (10/19/2023): The situation in the Middle East remains fraught with risk, supporting crude oil prices. Despite continued record crude oil production, commercial inventories declined this week while refinery activity rose modestly. *Note: the next edition of this report will be published on November 2.*
- *Asset Allocation Quarterly – Q4 2023* (10/19/2023): Discussion of our asset allocation process, Q4 2023 portfolio changes, and our outlook for the markets.
- *Asset Allocation Q4 2023 Rebalance Presentation* (10/30/2023): 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* (10/23/2023) (with associated podcast): "A Regime Change in Bonds?"

Our *Comment* today opens with new examples of how the Chinese Communist Party and government are intruding ever-more strongly into the economy. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including the latest on the Israel-Hamas conflict, its implications for other countries, and a word or two about the Federal Reserve's latest decision on interest rates, which is due today.

**Chinese International Data Regulation:** The Ministry of State Security yesterday said it has discovered and "dealt with" hundreds of foreign-run meteorological installations across the country that have been illegally transmitting weather data overseas in real time. The MSS announcement is the latest example of how China is clamping down on even seemingly innocuous information flows out of the country. Some of the weather monitoring equipment discovered and shut down simply appeared to serve foreign weather services and crop monitoring companies.

- More broadly, the clampdown on information flows is part-and-parcel of the global fracturing we have been writing about. As the world fractures into relatively separate geopolitical and economic blocs, we are seeing increased impediments to inter-bloc trade, investment, technology, data, and travel flows.
- As we have been arguing, new impediments to the international flow of merchandise, services, money, information, and people will likely lead to higher and more volatile inflation, interest rates, and production costs worldwide.

**Chinese Financial Industry Regulation:** With the completion of its quadrennial policy conference on the financial industry, the government yesterday stressed the need to tighten regulation over the sector and "adhere to the centralized and unified leadership of the Communist Party in financial work."

- Along with the clampdown on sending weather data abroad, the statement on financial regulation helps clarify that China's economy isn't just being held back by the "Four Ds" that we've discussed previously, i.e., weak consumer ***demand***, high ***debt*** levels, poor ***demographics***, and foreign ***decoupling***.
- Now, we would add another "D" to the list of problems, i.e., ***disincentives*** arising from government and party interference in company activities.

**India:** Apple (AAPL, $170.77) has reportedly notified several opposition lawmakers, journalists, and think tank leaders in India that "state-sponsored attackers" are trying to compromise their iPhones. Although Apple didn't identify what country was sponsoring the attempted hacking, the news has rekindled concern that Prime Minister Modi's government is trying to spy on its opponents.

- Modi is being increasingly dogged by concerns that he has developed an authoritarian, anti-democratic governing style. For example, his Hindu nationalist program has included a sharp crackdown on Muslims in the northern territory of Kashmir, a ban on foreign donations to a Christian charity founded by Mother Teresa, and a block on the social media accounts of opposition leader Rahul Ghandi.
- Along with accusations that Indian government agents recently killed a Sikh separatist leader living in Canada, these accusations could slow the U.S.'s effort to cozy up to Modi and enlist his help in countering China's increased geopolitical aggressiveness.

**Israel-Hamas Conflict:** The Israel Defense Force yesterday said it launched airstrikes against a residential area in the northern Gaza Strip that killed a Hamas commander and many other fighters affiliated with the terrorist group. In a measure of the relative death tolls involved in the fighting, medical officials in Gaza said dozens of civilians died in that one attack, while the IDF said two Israeli soldiers were killed in fighting around the compound. The continued high civilian death toll relative to the number of Hamas fighters killed could further erode foreign political support for Israel as it continues its campaign in Gaza. Separately, attacks on Israeli interests by Islamists in the West Bank, Lebanon, Syria, and Yemen—along with Israeli retaliatory strikes—continue to raise the risk of a broader regional conflict.

- In the U.S., Federal Bureau of Investigation director Christopher Wray yesterday warned that the Hamas attack on Israel last month has raised the risk of a copycat attack on the U.S. "to a whole other level."
- In France, police on high alert for Islamist terrorism yesterday shot an unarmed woman in a burka at a Paris train station after passengers reported that she was acting in a threatening manner.

**United Kingdom:** Just as the Israeli-Hamas conflict has exposed sharp divisions within the Democratic Party in the U.S., the leader of the Labor Party in the U.K., Keir Starmer, is dealing with sharp divisions in his party. Some Labor officials are furious at Starmer for his focus on Israel's right to self-defense. They want him to show more sympathy for the Palestinians and call for a ceasefire. However, Starmer is resisting that pressure so far as he tries to steer his party back toward the political center. The row threatens to erode Labor's big advantage in recent opinion polls.

**Canada:** A monthly measure of gross domestic product shows it was essentially flat in both July and August, while other data points to another soft month in September. The figures imply that Canadian GDP may have fallen at an annualized rate of 0.1% in the third quarter, after declining at a rate of 0.2% in the second quarter.

- Not only would that imply a mild technical recession, but it would suggest that Canada, like Europe, is now growing much more slowly than the U.S. As a reminder, an initial estimate of U.S. GDP indicates it rose at a robust 4.9% clip in July through September.
- Higher economic growth and higher interest rates in the U.S. versus Canada implied continued weakness in the Canadian dollar (CAD). Over the last three months, the currency has steadily weakened to the point where it now takes 1.3866 loonies to buy one U.S. dollar.

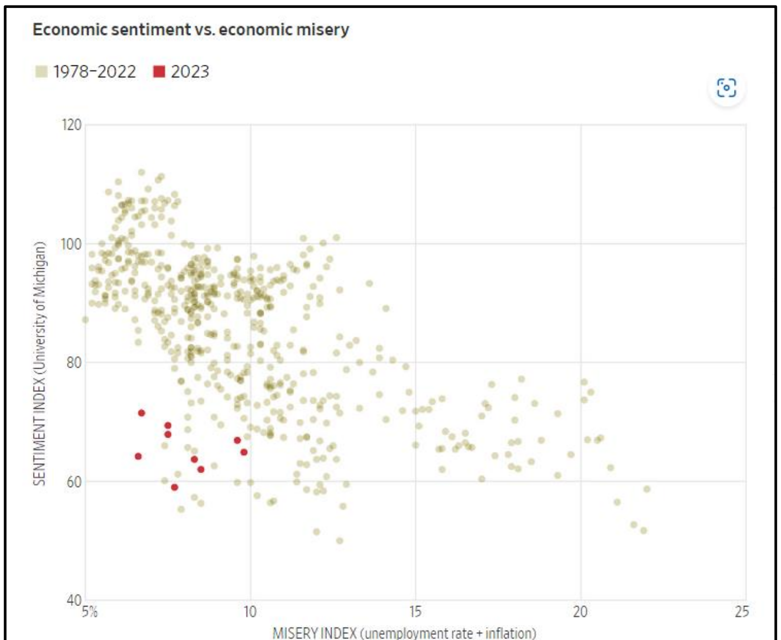
**U.S. Monetary Policy:** The Fed wraps up its latest policy meeting today, with the decision due to be released at 3:00 PM EDT. Investors are nearly unanimous in thinking the policymakers will hold the benchmark short-term interest rate unchanged at 5.25% to 5.50%. The focus will therefore be on any guidance regarding future rate changes in the committee's statement or in Chair Powell's post-meeting press conference.

- No new economic projections are due to be released at this meeting.
- Nevertheless, the statement and Powell's discussion could well express a bias toward further tightening, consistent with Powell's "higher for longer" mantra.

- We think it makes sense to take Powell at his word. Even though we think U.S. interest rates are probably near their peak, we continue to believe the Fed will try to hold them at elevated levels for an extended period to wring inflation out of the economy.

**U.S. Residential Real Estate Market:** A federal jury yesterday found the National Association of Realtors and several top real estate brokers guilty of illegal collusion to inflate commissions on real estate transactions. If upheld on appeal, the decision in the class-action lawsuit could scuttle the longstanding practice in which home sellers pay a 6% commission to their agents, which in turn is shared with the buyer's agent without the buyer knowing how much their agent is going to make on the transaction.

**U.S. Consumer Sentiment:** *Wall Street Journal* columnist Greg Ip today has an interesting article exploring why consumer optimism is so low when economic growth is humming along, unemployment is low, and wage gains are outpacing price inflation again. Ip's graph below shows just how low the University of Michigan's consumer sentiment index is now compared with its past relationship to the "misery index" (the unemployment rate plus the inflation rate as measured by the consumer price index). Ip posits that today's low consumer optimism may in part reflect dissatisfaction with broader national issues, such as political polarization.

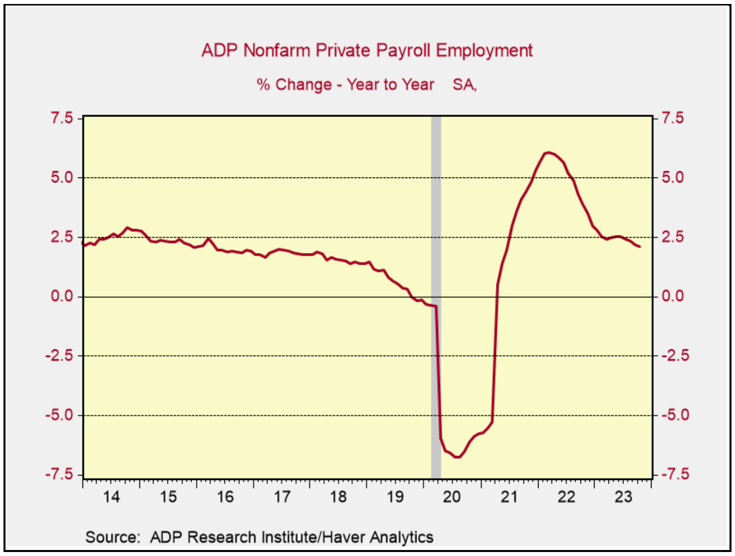


Sources: University of Michigan (sentiment); Labor Dept. (unemployment, inflation) via Federal Reserve Bank of St. Louis

**U.S. Economic Releases**

Demand for residential loans remains weak. Mortgage applications fell 2.1% in the week ending October 27, according to the Mortgage Banker's Association. The slowdown in lending is due to high borrowing costs, which remain near multi-decade highs despite the average 30-year fixed-rate mortgage falling 4 basis points to 7.86%. As a result, the MBA applications for purchases and refinancing remains subdued, falling 1.4% and 3.5%, respectively, from the prior week.

U.S. private sector job growth slowed in October, adding to signs that the labor market may be cooling. Employment payrolls expanded 113k last month, according to ADP Research Institute. Despite exceeding September's weak reading of 89k, job growth fell short of expectations of 150k. Most of the gains in employment came from education and health services as well as trade and transportation. That said, the professional and business services sector saw job cuts.




Despite a recent slowdown in hiring, ADP employment payrolls have increased by 2.13% since October 2022, as shown in the chart above. This indicates that employment levels remain elevated compared to the previous year.

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 Manufacturing PMI | m/m | Oct F | 50.0 | 50.0 | *** |
| **10:00** | Construction Spending MoM | m/m | Sep | 0.4% | 0.5% | ** |
| **10:00** | JOLTS Job Openings | m/m | Sep | 9400k | 9610k | ** |
| **10:00** | ISM Manufacturing PMI | m/m | Oct | 49 | 49 | ** |
| **10:00** | ISM Manufacturing PMI - Prices Paid | m/m | Oct | 45.0 | 43.8 | ** |
| **10:00** | ISM Manufacturing PMI - Employment | m/m | Oct | 50.6 | 51.2 | * |
| **10:00** | ISM Manufacturing PMI - New Orders | m/m | Oct | 49.8 | 49.2 | ** |
| **14:00** | FOMC Rate Decision (Lower Bound) | w/w | 1-Nov | 5.5% | 5.5% | *** |
| **14:00** | FOMC Rate Decision (Upper Bound) | w/w | 1-Nov | 5.3% | 5.3% | *** |
| **14:00** | Interest on Reserve Balances Rate | w/w | 2-Nov | 5.4% | 5.4% | ** |
| | Wards Total Vehicle Sales | m/m | Oct | 15.50m | 15.67m | * |
| **Federal Reserve** | | | | | | |
| **EST** | **Speaker or Event** | **District or Position** | | | | |
| **14:30** | Fed Chair Holds Press Conference Following FOMC Meeting | Chairman 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** | | | | | | | | |
| **Japan** | Jibun Bank Manufacturing PMI | m/m | Oct F | 48.7 | 48.5 | -- | *** | Equity and bond neutral |
| **Australia** | Building Approvals | m/m | Sep | -4.6% | 7.0% | 8.1% | *** | Equity bearish, bond bullish |
| **New Zealand** | Unemployment Rate | q/q | 3Q | 3.9% | 3.6% | 3.9% | *** | Equity and bond neutral |
| | Employment Change | q/q | 3Q | -0.2% | 1.0% | 0.4% | ** | Equity and bond neutral |
| **South Korea** | Trade Balance | m/m | Oct | $1636m | $3700m | $3697m | * | Equity and bond neutral |
| | Exports | y/y | Oct | 5.1% | -4.4% | 6.1% | *** | Equity and bond neutral |
| | Imports | y/y | Oct | -9.7% | -16.5% | -2.1% | ** | Equity bearish, bond bullish |
| | S&P Manufacturing PMI | m/m | Oct | 49.8 | 49.9 | | *** | Equity and bond neutral |
| **China** | Caixin Manufacturing PMI | m/m | Oct | 49.5 | 50.6 | 50.8 | *** | Equity bearish, bond bullish |
| **India** | S&P Manufacturing PMI | m/m | Oct | 55.5 | 57.5 | | *** | Equity and bond neutral |
| **EUROPE** | | | | | | | | |
| **UK** | Nationwide House Price Index | y/y | Oct | -3.3% | -5.3% | -4.8% | *** | Equity bullish, bond bearish |
| | S&P/CIPS Manufacturing PMI | m/m | Oct F | 44.8 | 45.2 | 45.2 | *** | Equity and bond neutral |
| **Switzerland** | Manufacturing PMI | m/m | Oct | 40.6 | 44.9 | 45.0 | *** | Equity bearish, bond bullish |
| **Russia** | S&P Global Russia Manufacturing PMI | m/m | Oct | 53.8 | 54.5 | | *** | Equity and bond neutral |
| **AMERICAS** | | | | | | | | |
| **Canada** | GDP | y/y | Aug | 0.9% | 1.1% | 0.9% | ** | Equity and bond neutral |
| **Mexico** | International Reserves Weekly | w/w | 27-Oct | $204220m | $204000m | | * | Equity and bond neutral |
| **Brazil** | Industrial Production | y/y | Sep | 0.6% | 0.5% | 0.6% | *** | Equity and bond neutral |

## Financial Markets

The table below highlights some of the indicators that we follow on a daily basis. 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)** | 564 | 564 | 0 | Flat |
| **3-mo T-bill yield (bps)** | 531 | 531 | 0 | Up |
| **TED spread (bps)** | LIBOR and the TED Spread have been discontinued. | | | |
| **U.S. Sibor/OIS spread (bps)** | 539 | 539 | 0 | Up |
| **U.S. Libor/OIS spread (bps)** | 541 | 540 | 1 | Up |
| **10-yr T-note (%)** | 4.90 | 4.93 | -0.03 | Flat |
| **Euribor/OIS spread (bps)** | 397 | 397 | 0 | Up |
| **Currencies** | **Direction** | | | |
| Dollar | Up | | | Up |
| Euro | Down | | | Down |
| Yen | Up | | | Down |
| Pound | Down | | | Down |
| 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 | $86.61 | $85.02 | 1.87% | |
| WTI | $82.63 | $81.02 | 1.99% | |
| Natural Gas | $3.49 | $3.58 | -2.41% | |
| Crack Spread | $21.83 | $21.98 | -0.71% | |
| 12-mo strip crack | $23.67 | $23.90 | -0.97% | |
| Ethanol rack | $2.23 | $2.24 | -0.51% | |
| **Metals** | | | | |
| Gold | $1,984.42 | $1,983.88 | 0.03% | |
| Silver | $22.65 | $22.85 | -0.84% | |
| Copper contract | $366.85 | $364.90 | 0.53% | |
| **Grains** | | | | |
| Corn contract | $479.25 | $478.75 | 0.10% | |
| Wheat contract | $561.25 | $556.25 | 0.90% | |
| Soybeans contract | $1,307.75 | $1,310.50 | -0.21% | |
| **Shipping** | | | | |
| Baltic Dry Freight | 1,459 | 1,502 | -43 | |
| **DOE Inventory Report** | | | | |
| | **Actual** | **Expected** | **Difference** | |
| Crude (mb) | | 1.8 | | |
| Gasoline (mb) | | -0.1 | | |
| Distillates (mb) | | -1.0 | | |
| Refinery run rates (%) | | 0.2% | | |
| Natural gas (bcf) | | 82 | | |

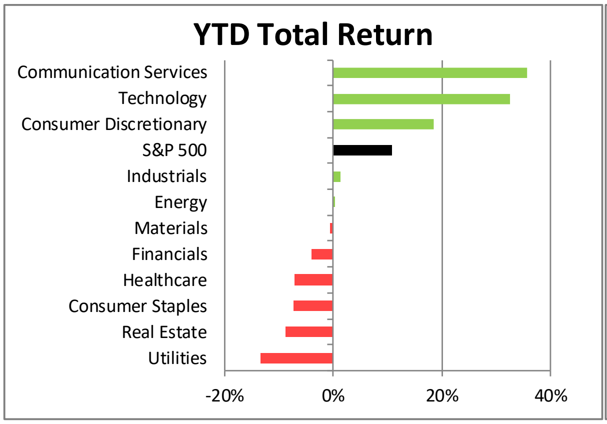
## Weather

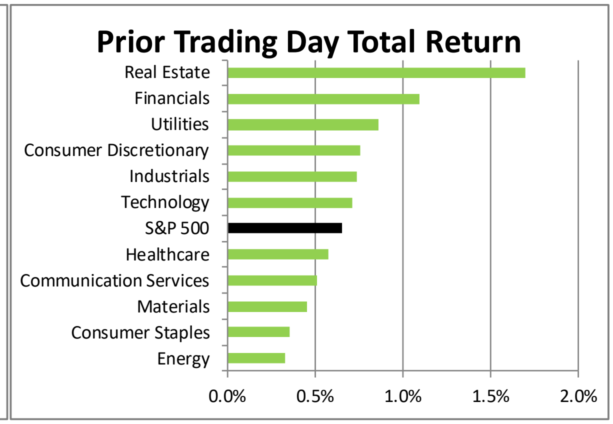
The 6-10 and 8-14 day forecasts predict warmer-than-normal temperatures for most of the country, with cooler temperatures expected in New England, the Midwest, and the Rocky Mountains. The precipitation outlook shows wetter-than-normal conditions in most states, with dry conditions expected in the Southwest.

There is one atmospheric disturbance in the Atlantic Ocean, but it is not expected to develop into a major storm within the next 48 hours. Located in the central Caribbean Sea, the disturbance has a 20% chance of cyclone formation. On average, Atlantic hurricane activity peaks on September 15.

## Data Section

**U.S. Equity Markets** – (as of 10/31/2023 close)

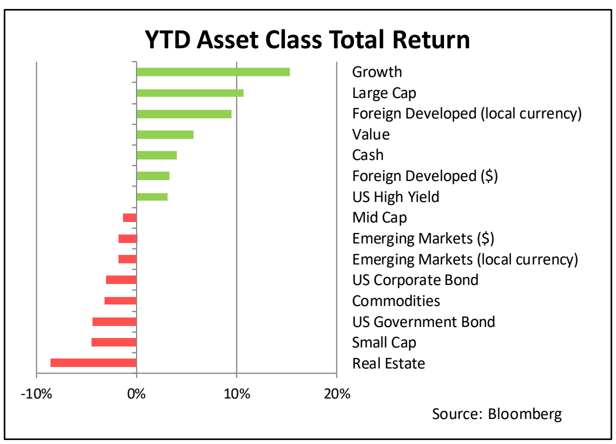



(Source: Bloomberg)

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 10/31/2023 close)

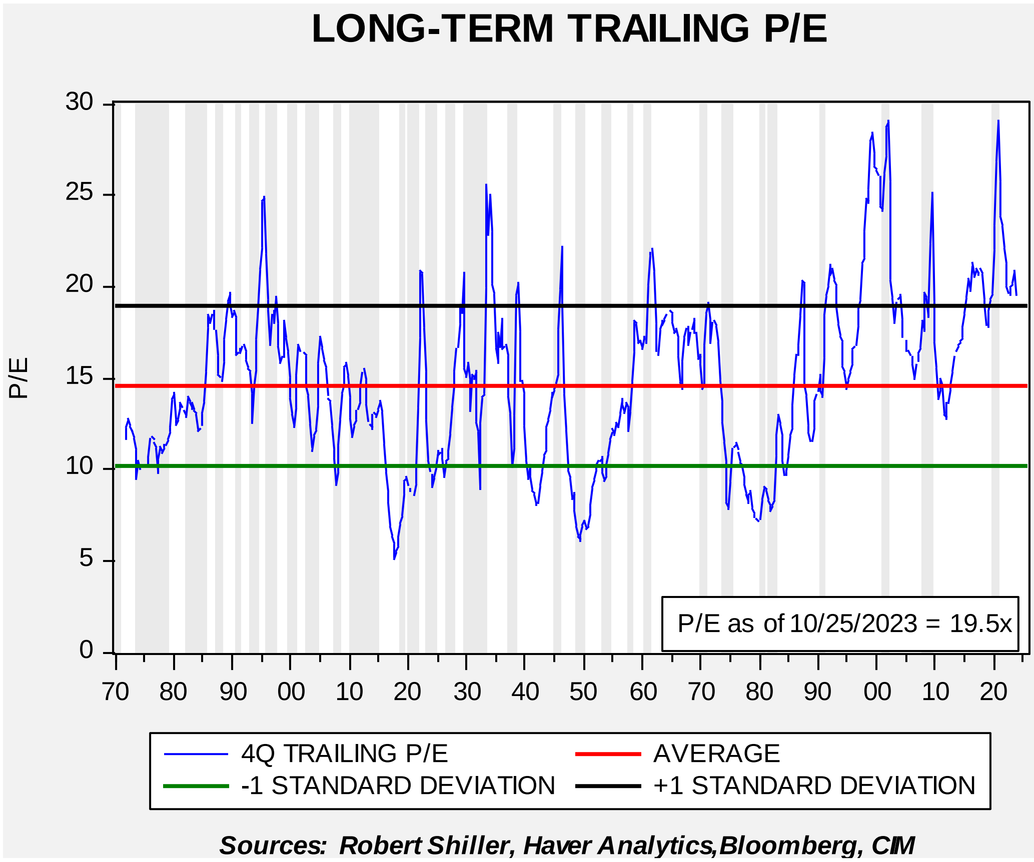



This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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), U.S. Corporate Bond (iShares iBoxx $ Investment Grade Corporate Bond ETF), U.S. Government Bond (iShares 7-10 Year Treasury Bond ETF), U.S. 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**

October 26, 2023




Based on our methodology,[1] the current P/E is 19.5x, down 0.1x from last week. The multiple contracted modestly on improved 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 two actual quarters (Q1 and Q2) and two estimates (Q3 and 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.