# 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: November 9, 2023—9:30 AM EST]** Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is up 0.9% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed unchanged. Chinese markets were mixed, with the Shanghai Composite relatively unchanged from its previous close and the Shenzhen Composite down 0.5%. U.S. equity index futures are signaling a higher open.

With 441 companies having reported so far, S&P 500 earnings for Q3 are running at $58.30 per share compared to estimates of $57.42, which is up 1.7% from Q2 2023. Of the companies that have reported thus far, 82.1% have exceeded expectations while 14.5% have fallen short of expectations.

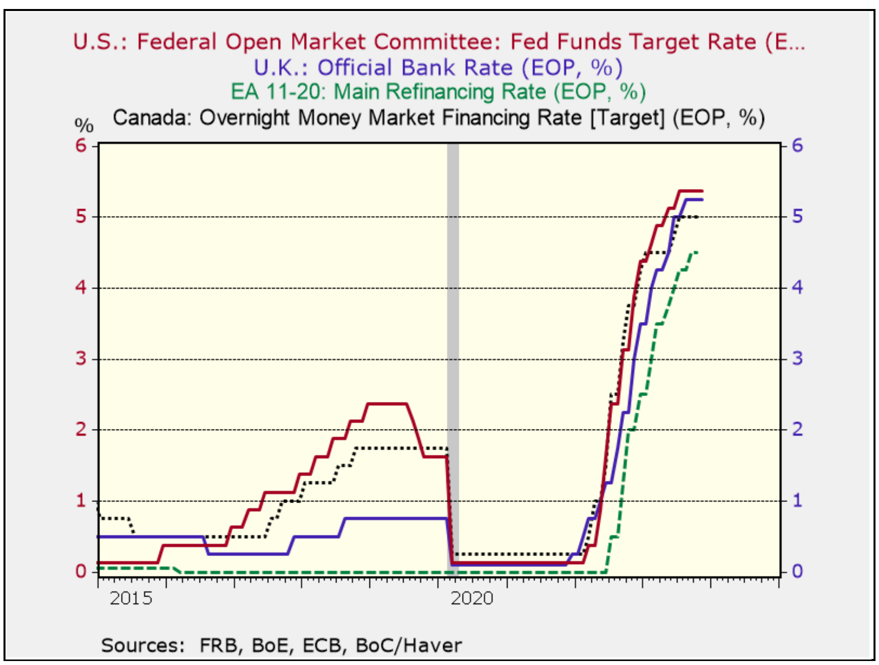
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *Bi-Weekly Geopolitical Report* (10/30/2023) (with associated podcast): "Investment Implications of the Israel-Hamas Conflict"
- *Weekly Energy Update* (11/2/2023): The weekly data was modestly bullish this week, although we do note that refining activity remains depressed due to seasonal maintenance. The conflict in Gaza continues, but so far, the fighting has remained contained. *Note: the next edition of this report will be published on November 16 as the DOE is delaying its data reporting due to system upgrades.*
- *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* (11/6/2023) (with associated podcast): "The Inflation Adjustment for Social Security Benefits in 2024"

Good morning! Equity markets are treading cautiously ahead of Fed Chair Jerome Powell's speech, while Real Madrid advances to the Champions League knockout stages for the 27th consecutive year. Today's *Comment* begins with why investors should remain cautiously optimistic about the shift in central bank sentiment. We then give our thoughts on the potential impact of proposed bank regulation changes, and how the Republican debate may hint at future foreign policy direction. As always, our report includes a summary of the latest domestic and international data releases.

**Policy Sentiment Shift:** Bond investors are convinced that rates have already peaked. However, policymakers seem less certain.

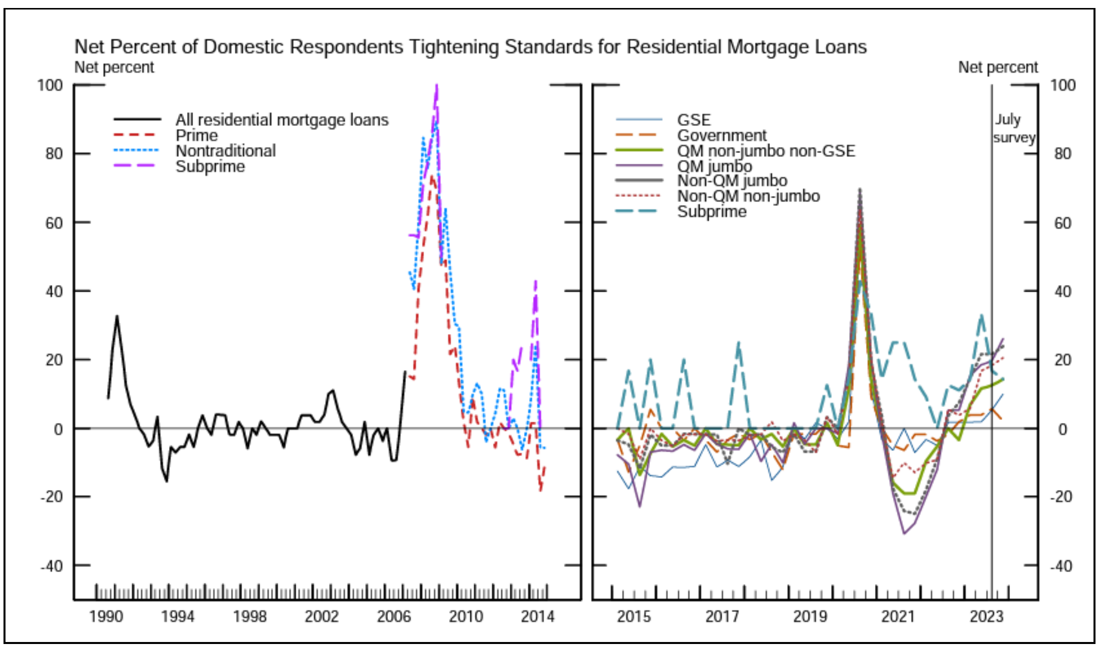
- After reaching their October highs, global bond yields have embarked on a downward trajectory. The 10-year Treasury yield has plummeted nearly 50 basis points since its peak two weeks ago, mirroring the retreat observed in its British and German counterparts, which have shed 40 and 30 basis points, respectively, during the same period. This surge in bond demand has extended to mortgage rates, with the average 30-year fixed-rate mortgage experiencing a 25 basis point decline in a week, settling at 7.61%. The collective pause adopted by central banks has fueled investor speculation about a potential bond rally, leading to a renewed interest in fixed-income securities.
- While investors appear to believe that central banks have concluded their rate-hike cycle, central bankers themselves remain more cautious. Bank of England Governor Andrew Bailey has decisively dismissed speculation of a policy easing in mid-2024, underscoring the ongoing struggle against inflation. Echoing this sentiment, Bank of Canada Governor Tiff Macklem has warned that the lingering effects of energy price shocks could hinder inflation control efforts. Reinforcing this cautious outlook, Federal Reserve Governor Michelle Bowman and Minneapolis Fed President Neel Kashkari have hinted at the possibility of further interest rate increases to ensure inflation's return to the 2% target.




- The future course of monetary policy will largely hinge on expectations for economic growth. While concerns about a potential recession in 2024 are mounting, similar worries were prevalent at the beginning of this year. One encouraging aspect is the continued resilience of the labor market across the developed world. Even Canada, which experienced a technical recession in the third quarter, boasts an unemployment rate of 5.7%, below its historical average of 7.6%. Most evidence suggests that even if there is a downturn, it is likely to be mild. Hence, a recession may not be enough to pivot policy, especially if inflation returns.

**Regional Banks**: Several months after endangering the financial system, small to midsize lenders may begin another chapter.

- Regulators want to limit bank access to funds from Federal Home Loan Banks (FHLB). The decision comes after lenders relied heavily on the $1.3 trillion system meant to encourage mortgage loans to meet their short-term funding needs after the fall of Silicon Valley Bank. Several months after the March banking turmoil, FHLB had over $880 billion in outstanding loans to U.S. banks and credit unions. The Federal Housing Finance Agency (FHFA) has proposed requiring banks to hold 10% of their assets in mortgage loans, establishing new safeguards for lending to struggling banks, and implementing stricter stress tests.
- The new rules are designed to help FHLB return to their original mission of supporting banks in providing loans to potential homebuyers, but banks argue that the regulators are overreaching. The banking industry has rejected claims that its problems were due to a lack of regulation and instead are blaming the Federal Reserve's lack of guidance. JPMorgan CEO Jamie Dimon has ridiculed policymakers for being "dead wrong" on inflation and pleaded for the Fed to show greater humility, given its proposal for more capital requirements. The pushback suggests that regulators may not be able to implement all the changes they want to protect the banking system.

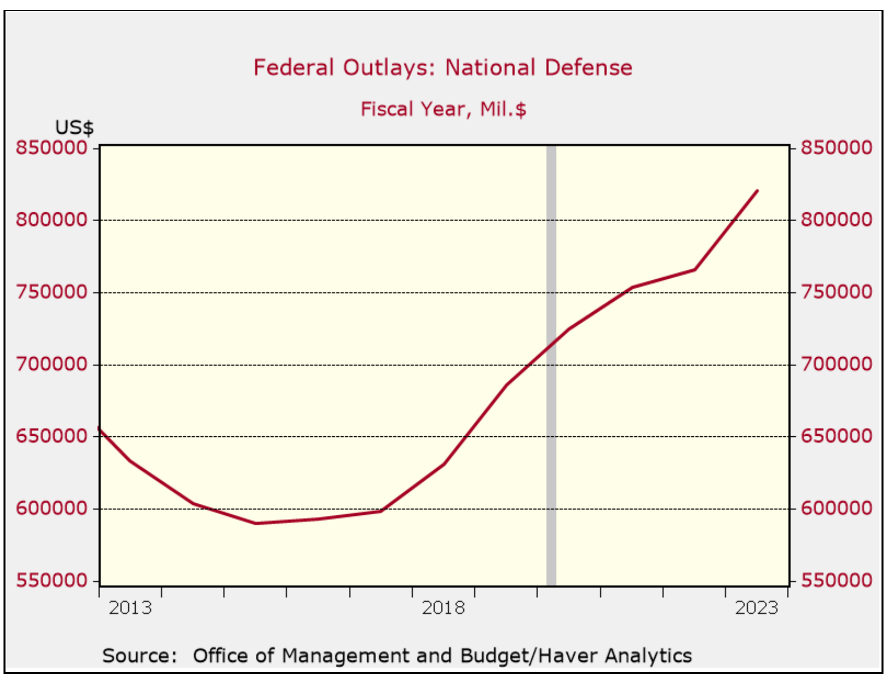


(Source: Federal Reserve)

- New capital restrictions would complicate banks' efforts to lend across the country. The latest Senior Loan Officer Opinion Survey (SLOOS) shows that banks are already tightening their lending standards, particularly for non-government-backed and non-residential loans. If these rules are implemented, they could dampen the potential stimulative impact of a pivot in Fed policy, which is likely to be less aggressive than in previous easing cycles. This may mean that when the Fed does decide to make the policy change, it might be less successful in generating demand than in previous easing cycles, especially if the rate cuts are modest as we would expect.

**Rethinking Defense:** Although all Republican presidential candidates have voiced support for Israel in its fight against Hamas, they have taken a more Jeffersonian stance on other foreign policy issues.

- During the debate, most candidates expressed skepticism about further funding for Ukraine. Former UN Ambassador Nikki Haley said the U.S. should support Ukraine by sending weapons, not aid. Entrepreneur Vivek Ramaswamy argued that Ukraine's occupied areas should remain with Moscow. Republican Gov. Ron DeSantis of Florida and Sen. Tim Scott of South Carolina both expressed concerns about how the money is being spent. In contrast, former New Jersey Gov. Chris Christie was the only candidate to show restraint, warning that the cost was warranted to prevent another world war.
- Their wariness regarding Ukraine comes as Americans are voicing more concern about deteriorating law and order in the United States. A recent Gallup poll showed that Americans' perception of safety has fallen to its lowest level in five years. The most frequently proposed solution to the rising crime problem discussed on the debate stage was to increase security along the U.S.-Mexico border. Candidates also proposed finishing the border wall and possibly designating drug cartels as foreign terrorist organizations. China was also mentioned, with Haley vowing to stop all trade with the world's second-largest economy until it prevents fentanyl from entering the U.S.

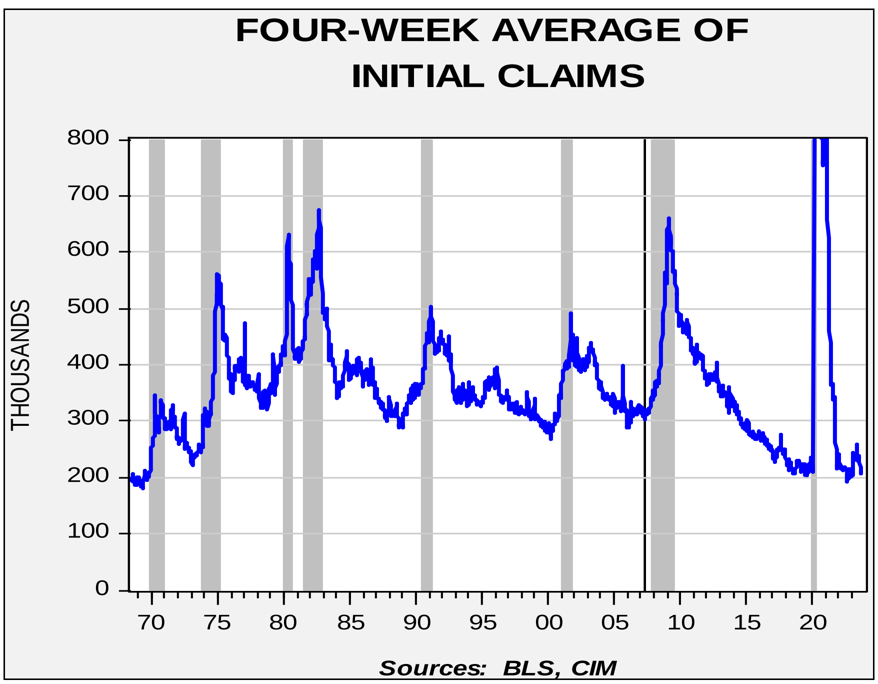


- The candidates' notable tone on the debate stage suggests that a sizeable Republican base may now prefer a more Jeffersonian approach to foreign policy, with a focus on domestic issues over global affairs. While the United States may not completely abandon its leadership role in the world, it may need to redefine that role to be more palatable to a populace that has grown tired of its hegemonic status. This could involve off-budget spending programs similar to the Lend-Lease Act or aid packages with strings attached akin to the Marshall Plan.

**Other News:** Bank of Japan Governor Kazuo Ueda has stated that the central bank will proceed cautiously as it moves away from its ultra-accommodative policy. His remarks suggest that Japanese policymakers may be averse to significant changes in policy. Hollywood actors and studios have reached a tentative agreement to end the 118-day strike, with new restrictions on the use of artificial intelligence technology. The agreement reflects labor concerns about the threat that AI poses. Spanish Prime Minister Pedro Sánchez and the Catalan separatist Junts have reached an agreement that could pave the way for a new government.

**U.S. Economic Releases**

Initial claims for the week ending November 2 came in at 217k compared to expectations of 218k. Last week's number was revised to 220k from 217k. The four-week average of claims rose to 212.25k from last week's 210.75k.




This chart shows the four-week average of claims. In general, there is an uptick in claims prior to recessions, although it is also clear that the series has a lot of false positives. However, what we are seeing now is not consistent with recession. The labor markets remain robust.

The table below lists the economic releases and/or Fed events scheduled for the rest of the day.

| Economic Releases | | |
|---|---|---|
| No economic releases for the rest of today | | |
| **Federal Reserve** | | |
| **EST** | **Speaker or Event** | **District or Position** |
| **9:30** | Raphael Bostic and Thoms Barkin Speak on Survey Data | Presidents of Federal Reserve Bank of Atlanta and Richmond |
| **11:00** | Thomas Barkin Discusses Fed Policy, US Economy Outlook | President of the Federal Reserve Bank of Richmond |
| **12:00** | Kathleen Paese Speaks About the Economy and Monetary Policy | Interim President of the Federal Reserve Bank of St. Louis |
| **14:00** | Jerome Powell Speaks on Panel at IMF Conference | Chair 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** | Foreign Buying Japan Stocks | w/w | 3-Nov | ¥313.5b | ¥10.6b | ¥10.5b | * | Equity and bond neutral |
| | Japan Buying Foreign Stocks | w/w | 3-Nov | ¥145.0b | ¥311.4b | ¥306.3b | * | Equity and bond neutral |
| | Japan Buying Foreign Bonds | w/w | 3-Nov | -¥388.4b | ¥238.5b | ¥240.8b | * | Equity and bond neutral |
| | Foreign Buying Japan Bonds | w/w | 3-Nov | ¥1512.0b | -¥1672.7b | | * | Equity and bond neutral |
| | BoP Current Account Balance | m/m | Sep | ¥2723.6b | ¥2279.7b | ¥2142.0b | *** | Equity and bond neutral |
| | BoP Trade Balance | m/m | Sep | ¥341.2b | -¥749.5b | ¥244.5b | ** | Equity and bond neutral |
| **China** | PPI | y/y | Oct | -2.6% | -2.5% | -2.7% | ** | Equity and bond neutral |
| | CPI | y/y | Oct | -0.2% | 0.0% | -0.1% | *** | Equity and bond neutral |
| **EUROPE** | | | | | | | | |
| **UK** | RICS House Price Balance | m/m | Oct | -63.0% | -669.0% | -67.0% | ** | Equity and bond neutral |
| **AMERICAS** | | | | | | | | |
| **Canada** | Building Permits | m/m | Sep | -6.5% | 3.4% | -1.2% | ** | Equity bearish, bond bullish |
| **Mexico** | CPI | y/y | Oct | 4.26% | 4.45% | 4.26% | *** | Equity and bond neutral |
| | Core CPI | y/y | Oct | 5.50% | 5.76% | 5.49% | ** | 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) | 563 | 563 | 0 | Flat |
| 3-mo T-bill yield (bps) | 526 | 527 | -1 | Flat |
| TED spread (bps) | LIBOR and the TED Spread have been discontinued. | | | |
| U.S. Sibor/OIS spread (bps) | 537 | 537 | 0 | Up |
| U.S. Libor/OIS spread (bps) | 539 | 538 | 1 | Flat |
| 10-yr T-note (%) | 4.55 | 4.48 | 0.07 | Flat |
| Euribor/OIS spread (bps) | 397 | 397 | 0 | Up |
| **Currencies** | **Direction** | | | |
| Dollar | Flat | | | Up |
| Euro | Down | | | Down |
| Yen | Flat | | | Down |
| Pound | Down | | | Down |
| Franc | Down | | | 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.

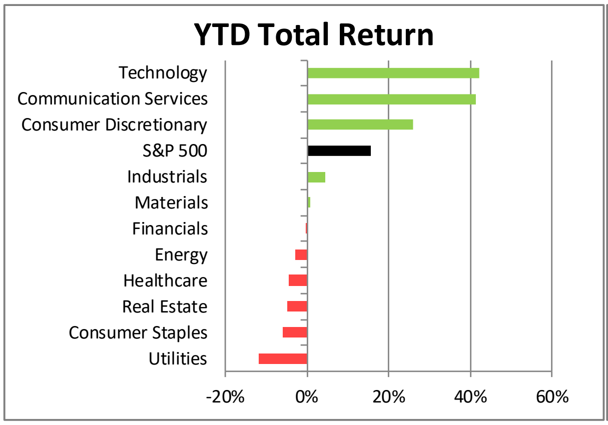
| DOE Inventory Report | Price | Prior | Change | Explanation |
|---|---|---|---|---|
| **Energy Markets** | | | | |
| Brent | $80.13 | $79.54 | 0.74% | |
| WTI | $75.86 | $75.33 | 0.70% | |
| Natural Gas | $3.10 | $3.11 | -0.26% | |
| Crack Spread | $22.43 | $22.81 | -1.69% | |
| 12-mo strip crack | $23.56 | $23.82 | -1.12% | |
| Ethanol rack | $2.12 | $2.12 | 0.29% | |
| **Metals** | | | | |
| Gold | $1,946.32 | $1,950.20 | -0.20% | |
| Silver | $22.53 | $22.56 | -0.13% | |
| Copper contract | $363.15 | $363.80 | -0.18% | |
| **Grains** | | | | |
| Corn contract | $473.75 | $476.00 | -0.47% | |
| Wheat contract | $585.00 | $592.25 | -1.22% | |
| Soybeans contract | $1,366.75 | $1,365.75 | 0.07% | |
| **Shipping** | | | | |
| Baltic Dry Freight | 1,530 | 1,559 | -29 | |

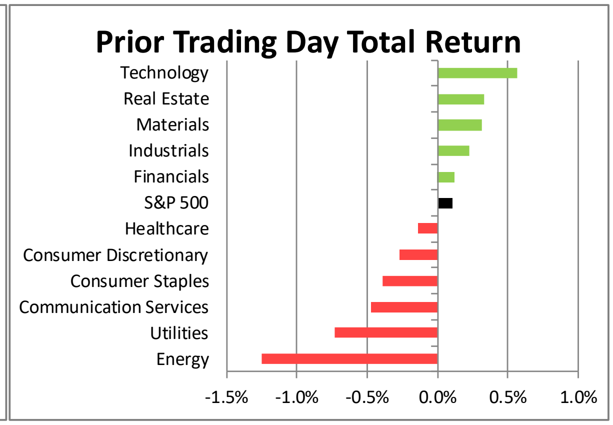
## Weather

The warm November continues. The 6-10 and 8-14 day forecasts predict warmer-than-normal temperatures for most of the country, with cooler temperatures expected on the West Coast and New England regions. The precipitation outlook shows that wetter-than-normal conditions are expected to spread from the West and South to most of the country, while dry conditions are expected on the New England coast.

## Data Section

**U.S. Equity Markets** – (as of 11/8/2023 close)

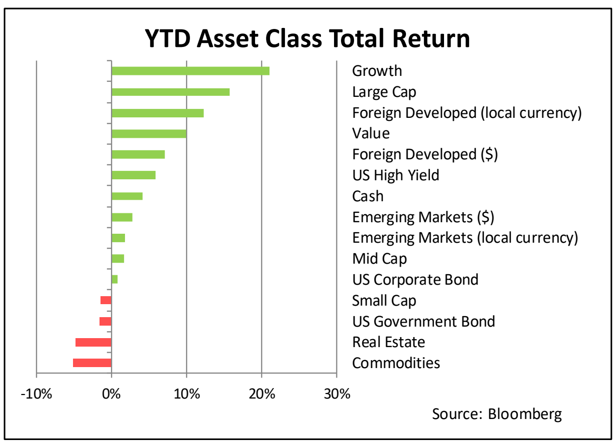



(Source: Bloomberg)

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 11/8/2023 close)

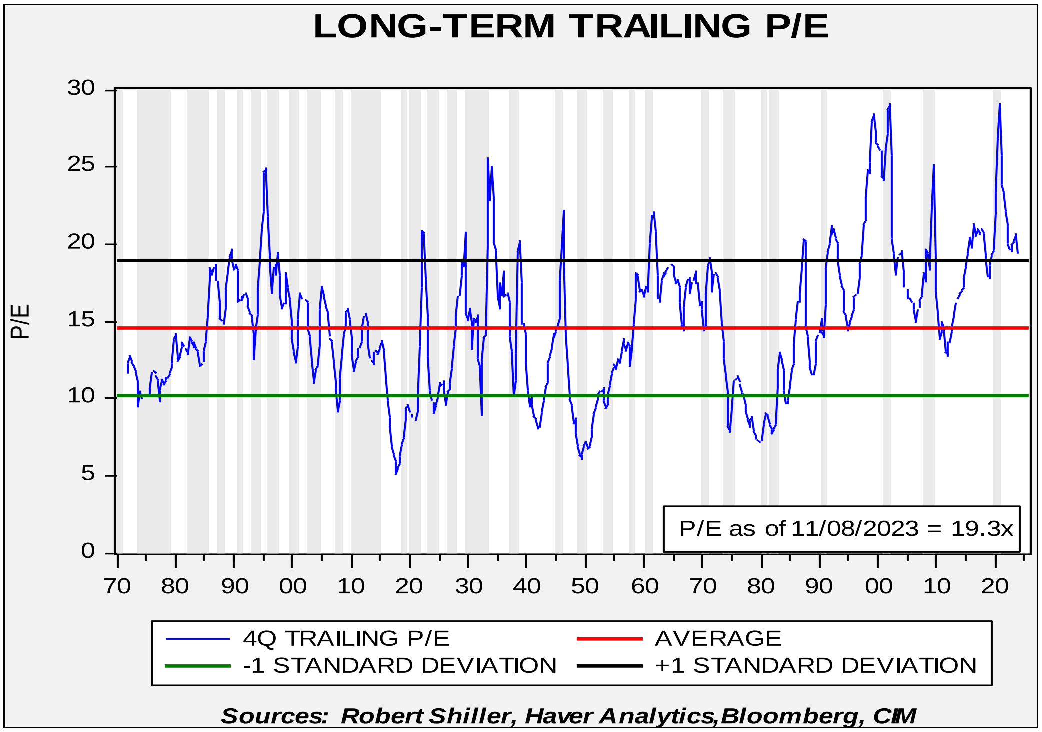



This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

November 9, 2023




Based on our methodology,[1] the current P/E is 19.3x, up 0.1x from last week. The multiple rose on the modest rise in index values.

*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 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.