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 14, 2023—9:30 AM EST] Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 is up 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed relatively unchanged. Chinese markets were higher, with the Shanghai Composite up 0.3% from its previous close and the Shenzhen Composite up 0.4%. U.S. equity index futures are signaling a higher open.

With 460 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, 81.5% have exceeded expectations while 15.0% 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*** **(11/13/2023) (with associated podcast): "The Archetypes of American Foreign Policy: A Reprise"**
- *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"

Our *Comment* today opens with new data suggesting Russia is now almost completely getting around the West's $60 price cap on its oil exports, potentially setting up new Western efforts to clamp down. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including a slowdown in British wage growth that could help ease consumer price inflation in the U.K. and the latest on efforts in the U.S.

Congress to avoid a partial shutdown of the federal government, which could begin this weekend.

Global Oil Supplies: New analysis shows virtually all of Russia's seaborne oil exports are now selling for more than the $60-per-barrel cap that Western nations have tried to enforce as a way to limit Russian revenues for its invasion of Ukraine. The Group of Seven countries and Australia had some initial success when they tried to enforce the cap by banning insurance and other services for shipments priced above $60 per barrel, but now it appears the Russians have learned to circumvent the ban with tactics such as buying up and using old tankers without Western insurance and falsifying price certifications.

- It should be no surprise that the $60 cap has been circumvented. From time immemorial, government efforts to control trade have been undermined by smugglers and sanctions busters.
- Nevertheless, the West's restrictions on trade have probably imposed additional costs on Russian oil exports. Even if the oil is sold at prices above $60, the profitability of that oil and the revenues it provides to the Kremlin have probably been reduced.
- In any case, the wide circumvention of the ban has prompted Western officials to start discussing ways to tighten the cap. If such tightening happens, it could potentially reduce global oil supplies and help buoy energy prices.

China-Taiwan: The Central Election Commission of Taiwan has certified the independent candidacy of Terry Gou, the founder of Foxconn (HNHPF, $5.93), for the presidential election coming up on January 13. Although Gou is currently trailing the three main candidates in opinion polls, Beijing is concerned that he will drain support from its preferred candidate, the Kuomintang Party's Hou Yu-ih.

- The Chinese government has recently opened a large-scale investigation into Foxconn's tax and land-use practices in China, in a move that has been widely interpreted as an effort to pressure Gou to drop out of the race. Company officials say they are bracing for additional such measures from China.
- Foxconn is best known as a supplier to Apple (AAPL, $184.80), and it is the key assembler of the company's flagship iPhone. Additional Chinese pressure on Foxconn to force Gou out of the Taiwanese race could therefore potentially have an impact on Apple.

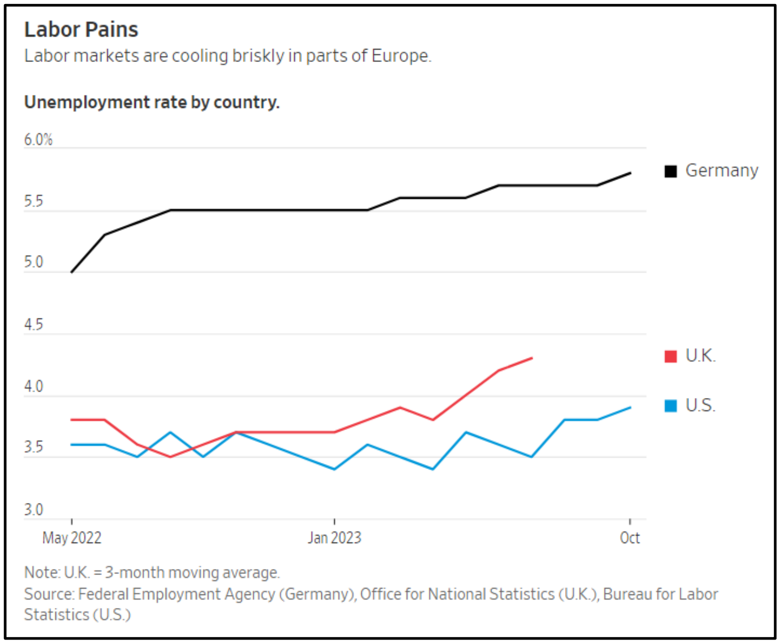
United States-Asia-China: After launching its Indo-Pacific Economic Forum last year to promote trade between the U.S. and the rest of the region and to loosen countries' economic ties to China, the Biden administration has unexpectedly withdrawn its support for IPEF measures designed to ease cross-border data flows and coordinate labor standards. The retreat on free data flows apparently stemmed from administration efforts to tighten regulations over U.S. technology firms, while the retreat from labor standards came at the request of at least one U.S. lawmaker facing a tough election.

- Because of domestic political opposition, the U.S. is currently precluded from offering traditional tariff cuts and reduced import barriers to tease Indo-Pacific countries away from China's economic pull. The administration, therefore, hoped that IPEF's non-tariff measures would be attractive enough.
- Without the promise of free data flows and common labor standards, the IPEF deal will lean heavily on less attractive features, such as initiatives related to supply chains, clean energy, anti-corruption measures, and taxation.
- Perhaps most significant, the pullback from free data flows suggests the U.S. may soon adopt Chinese-style restrictions on data transfers. If so, it's a sign that the fracturing of the world into relatively separate geopolitical and economic blocs, which we've been writing about so much, will disrupt not only trade, capital, and technology flows between the U.S. bloc and the China/Russia bloc, but it will also disrupt data flows.

United States-China Travel: New research by the Institute for International Education shows the number of U.S. citizens studying in China fell from more than 11,000 in the 2018-2019 academic year to just 211 in 2021-2022. The figures suggest many U.S. students have been put off by the Chinese government's draconian pandemic shutdowns and aggressive law enforcement actions. Although the number of Chinese students in the U.S. remains about 290,000, the study illustrates how global fracturing is disrupting human travel and migration, just as it's disrupting inter-bloc trade, capital, technology, and data flows.

United States-China Summit: When President Biden and General Secretary Xi meet tomorrow at the Asia-Pacific Economic Cooperation summit in San Francisco, they will reportedly announce a deal under which China will clamp down on companies exporting the precursor chemicals for fentanyl, the synthetic opioid that has spread addiction and death throughout the U.S. They are also expected to announce a deal to reopen military communication channels that Beijing shut after then-U.S. House Speaker Pelosi visited Taiwan in August 2022.

European Union: Recent data indicates the EU's labor market is softening much more dramatically than the U.S.'s, especially in the industrial powerhouse of Germany and other northern countries. Much of the problem can be traced to weakening demand overseas and high energy costs. Higher unemployment will likely impose new fiscal burdens on EU governments but could also weaken inflation pressures, discourage further interest-rate hikes, and hold down the value of the euro.



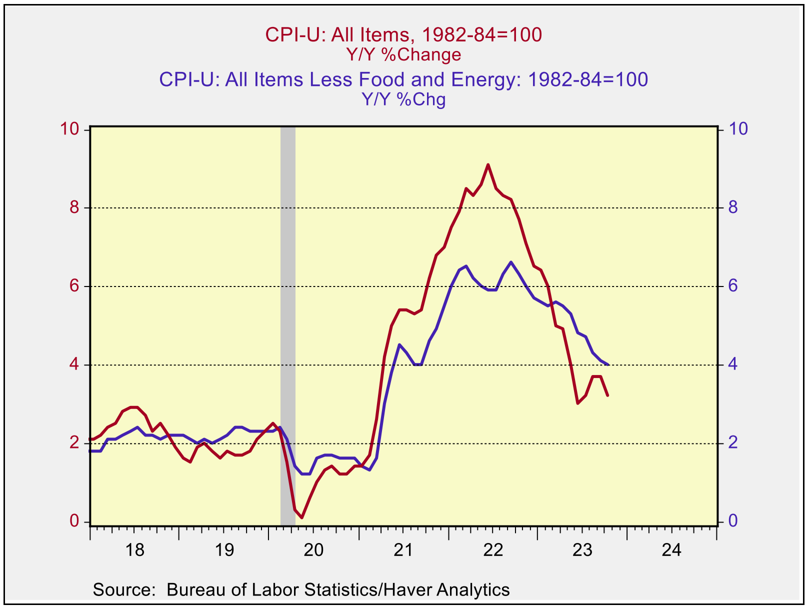
United Kingdom: Average wages in July through September, excluding bonuses, were up 7.7% from the same period one year earlier, marking a modest deceleration from the year-over-year increase of 7.9% in May through July. Total pay was up 7.9% on the year, versus 8.5% in the prior period. The figures point to a modest cooling in wage pressures, which could help bring down consumer price inflation in the U.K. and allow the Bank of England to hold off on further interest-rate hikes.

U.S. Fiscal Policy: In the House of Representatives, at least half a dozen Republican lawmakers have come out against Speaker Johnson's proposed two-part stopgap funding bill, which aims to avoid a partial government shutdown when the current stopgap expires on Friday. Since the Republicans only control 221 seats in the chamber, while the Democrats have 213, the defections from Johnson's own party mean his measure would likely need the support of at least some Democrats to advance the bill to the Senate, where its prospects seem better. At this point, prospects for a partial government shutdown this weekend appear to be too close to call.

U.S. Labor Market: Industry groups say the demand for seasonal workers during the upcoming holidays will be much cooler than in recent years, with public advertisements for such workers at the lowest level in a decade and hiring intentions down about 40% from their recent high in 2021. Individual companies are also reporting relatively modest hiring plans. Weaker demand for seasonal workers suggests the overall labor market is softening, which is likely to contribute to slower wage growth and weaker economic growth.

U.S. Economic Releases

Inflation made slight progress in November, but still remains elevated. The consumer price index (CPI) rose 3.2% from the prior year. The reading was below the previous month's reading of 3.7% and consensus estimate of 3.3%. Excluding volatile food and energy, CPI rose 4.0% since November 2022. The reading was slightly below the previous report's reading of 4.1% and in line with the consensus estimate of 4.0%.



The chart shows the year-over-year change in headline and core CPI, demonstrating a steadfast decline toward the 2% target. Over the past six months, headline and core inflation have exhibited annualized growth rates of 2.8% and 3.0%, respectively, indicating the Fed's successful efforts in achieving price stability.

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**
10:00	Michael Barr Testifies on Oversight of Financial Regulators	Federal Reserve Board Vice Chair for Supervision
10:00	Loretta Mester Delivers Opening Remarks	President of the Federal Reserve Bank of Cleveland
12:45	Austan Goolsbee Speaks on Economy and Monetary Policy	President of the Federal Reserve Bank of Chicago

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	Westpac Consumer Conf Index	m/m	Nov	79.9	82		**	Equity bearish, bond bullish
	Westpac Leading Index	m/m	Nov	-2.6%	2.9%		**	Equity bearish, bond bullish
	NAB Business Confidence	m/m	Oct	-2	1	0	**	Equity bearish, bond bullish
	NAB Business Conditions	m/m	Oct	13	11	0.12	**	Equity and bond neutral
New Zealand	Food Prices	m/m	Oct	0.9%	-0.4%		***	Equity and bond neutral
South Korea	Import Price Index	y/y	Oct	-10.2%	-9.6%		*	Equity and bond neutral
	Export Price Index	y/y	Oct	-9.5%	-8.9%		*	Equity and bond neutral
	Wholesale Prices	y/y	Oct	-0.5%	-0.3%	-0.4%	**	Equity and bond neutral
EUROPE								
Eurozone	ZEW Survey Expectations	m/m	Nov	13.8	2.3		**	Equity bullish, bond bearish
	GDP SA	q/q	3Q P	0.1%	0.1%	0.1%	***	Equity and bond neutral
Germany	ZEW Survey Expectations	m/m	Nov	9.8	-1.1	5	**	Equity bullish, bond bearish
	ZEW Survey Current Situation	m/m	Nov	-79.8	-79.9	-77.0	**	Equity and bond neutral
UK	Claimant Count Rate	m/m	Oct	4.0%	4.0%		***	Equity and bond neutral
	Jobless Claims Change	m/m	Oct	17.8k	20.4k	9.0k	***	Equity bearish, bond bullish
	Average Weekly Earnings 3M/YoY	m/m	Sep	7.9%	8.1%	8.2%	**	Equity and bond neutral
Switzerland	Producer & Import Prices	y/y	Oct	-0.9%	-1.0%		**	Equity and bond neutral
AMERICAS								
Brazil	IBGE Services Volume	y/y	Sep	-1.2%	0.9%	0.6%	*	Equity bearish, bond bullish

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	563	1	Up
3-mo T-bill yield (bps)	526	527	-1	Down
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	540	539	1	Up
U.S. Libor/OIS spread (bps)	540	539	1	Up
10-yr T-note (%)	4.62	4.64	-0.02	Flat
Euribor/OIS spread (bps)	400	399	1	Up
Currencies	**Direction**			
Dollar	Flat			Up
Euro	Up			Down
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.

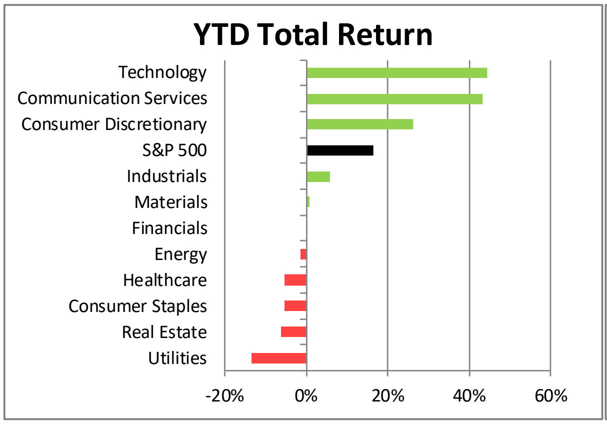
weco	Price	Prior	Change	Explanation
Energy Markets				
Brent	$82.50	$82.52	-0.02%	
WTI	$78.27	$78.26	0.01%	
Natural Gas	$3.20	$3.20	0.13%	
Crack Spread	$23.82	$24.01	-0.76%	
12-mo strip crack	$24.26	$24.42	-0.64%	
Ethanol rack	$2.10	$2.10	-0.12%	
Metals				
Gold	$1,945.11	$1,946.92	-0.09%	
Silver	$22.39	$22.33	0.29%	
Copper contract	$366.65	$366.60	0.01%	
Grains				
Corn contract	$475.50	$477.25	-0.37%	
Wheat contract	$601.50	$602.25	-0.12%	
Soybeans contract	$1,375.50	$1,382.50	-0.51%	
Shipping				
Baltic Dry Freight	1,655	1,643	12	

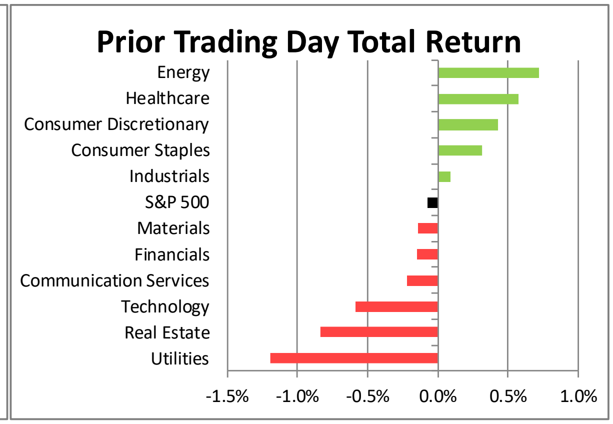
Weather

The 6-10 and 8-14 day forecasts currently call for cooler-than-normal temperatures in the Northern Pacific, which will spread into the eastern third of the country in the latter half of the forecast period. Meanwhile, the precipitation outlook calls for wetter-than-normal conditions in every state.

Data Section

U.S. Equity Markets – (as of 11/13/2023 close)

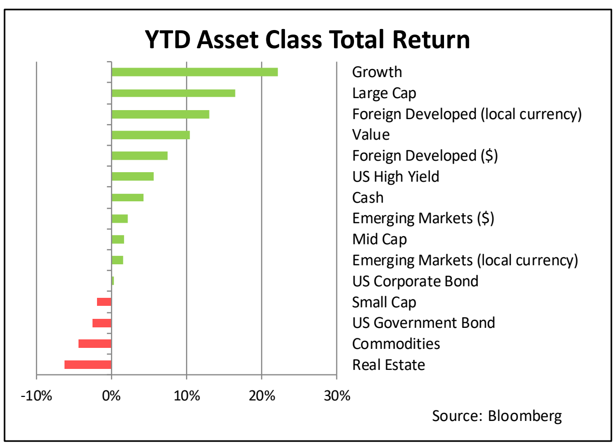




(Source: Bloomberg)

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 11/13/2023 close)

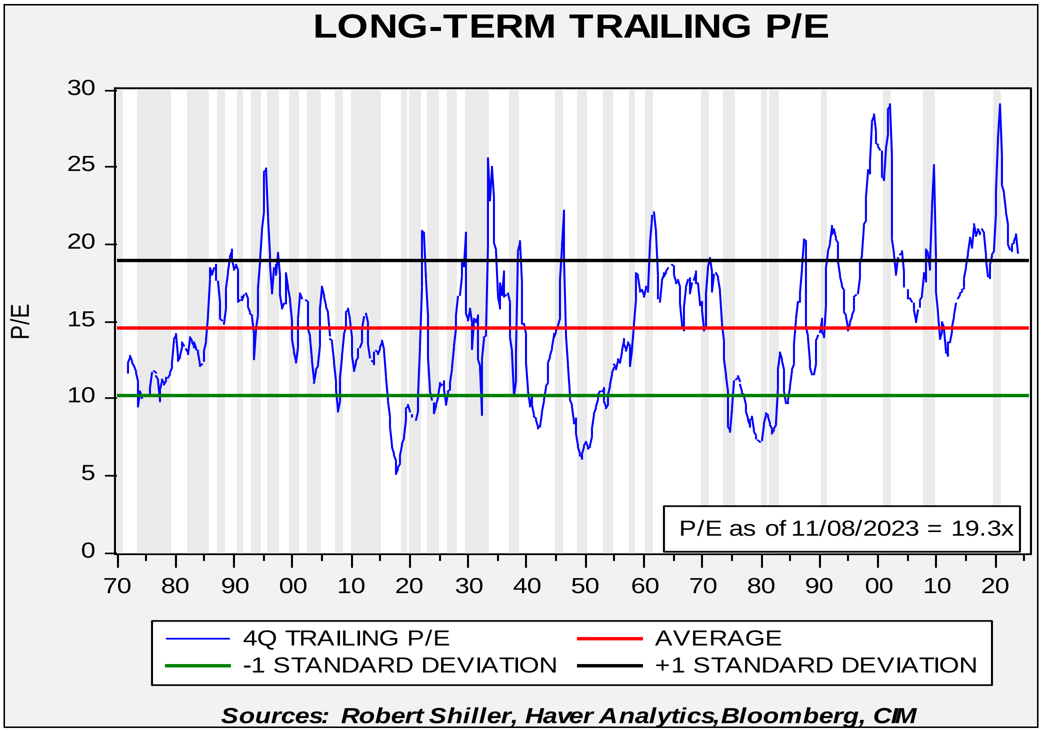


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 10, 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.

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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.