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 15, 2023—9:30 AM EST] Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 is up 0.7% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 3.5%. Chinese markets were higher, with the Shanghai Composite up 0.6% from its previous close and the Shenzhen Composite up 0.7%. U.S. equity index futures are signaling a higher open.

With 461 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, 81.6% 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 impediments to U.S. investments in China. 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, new signs of economic weakness and falling inflation pressure in Europe, and House passage of a new stopgap funding bill for the U.S. government.

United States-China: The U.S.-China Economic and Security Review Commission, an advisory panel on China policy, issued a recommendation yesterday that Congress pass a law forcing U.S. publicly traded companies to disclose how their investors are exposed to risks related to China. For example, the commissioners recommended that the companies disclose the percentage of their total assets in China, their joint ventures with Chinese firms, the amount and nature of research and development they undertake in China, and the influence of any employee associated with the Chinese Communist Party in corporate decision-making.

- If passed, the disclosure requirement would be yet another impediment to U.S.-China capital flows.
- Separately, the Federal Retirement Thrift Investment Board, which oversees approximately $771 billion of retirement savings for federal workers, said today that it will change the benchmark index for its international fund to avoid exposure to stocks listed in China or Hong Kong, citing increased U.S.-China geopolitical tensions.
- Finally, we note that President Biden and President Xi plan to meet for four hours today at the Asia-Pacific Economic Cooperation summit in San Francisco. At the end of the meeting, Biden and Xi are expected to announce a number of smaller-scale agreements. More broadly, the summit may help slow the current downward spiral in U.S.-China relations.

Taiwan: The country's top two opposition parties, the China-friendly Kuomintang and the Taiwan People's Party, have struck a deal to field a joint ticket in January's presidential election. The deal aims to help the opposition compete better against Vice President Lai Ching-te, the leading candidate of the ruling Democratic Progressive Party, which has forged tighter ties with the U.S. and is currently leading in the polls.

Israel-Hamas Conflict: Hours after the U.S. officially backed Israeli assertions that the Hamas government in Gaza places military command posts in hospitals, the Israel Defense Forces said they launched a targeted strike against Hamas personnel in the territory's besieged Al-Shifa Hospital. The IDF says the raid turned up weapons and other "concrete evidence" that the facility was being used as a Hamas command post. The IDF says that evidence will be shared publicly in the near future.

- Meanwhile, Hamas authorities say Israel's airstrikes and other attacks on Gaza during the conflict have now killed about 11,000 people, many of them noncombatant women and children. If that figure is accurate at all, it is certainly brutal and horrifying, and it reflects an apparent policy decision by the Israeli government to defang Hamas no matter what the cost to civilians or to Israel's own reputation and political support.
- Still, given that Gaza had a population of about 2.0 million at the start of the conflict, 11,000 dead (and perhaps tens of thousands injured) seems low enough to suggest that the IDF really is taking some care to avoid hurting civilians. Besides, other reports suggest that up to 50% of all the structures in Gaza have been destroyed or severely damaged by Israel's attacks. If that translates to 11,000 structures hit, it suggests "only" one death and perhaps several other injuries for each structure targeted.

European Union: In a new sign that the European economy is failing to keep up with activity in the U.S., the European Commission today cut its 2023 growth forecasts for both the broad EU and the eurozone. In each region, the commission now forecasts that gross domestic product this year will expand just 0.6%, compared with a forecast of 0.8% in September. The faltering growth reflects a range of problems, from high inflation and interest rates to weaker global demand for European exports.

United Kingdom: In another sign that inflation pressures are easing worldwide, the U.K.'s October consumer price index was up just 4.6% from the same month one year earlier, less than expected and much less than the 6.7% increase in the year to September. Excluding food, energy, and other volatile categories, the October core CPI was up an annual 5.7%, versus 6.1% in the year to September. Signs of cooling inflation have boosted hopes that the Bank of England can forego further interest-rate hikes and may even start to cut rates in 2024.

Russia-Ukraine War: The Ukrainian government has struck a deal with major insurers to provide war-risk coverage for ships carrying grain and other foodstuffs out of Ukrainian ports. After Russia withdrew from a safe-passage deal with Ukraine over the summer, Kyiv has managed to get several ships moving out of its ports, but the new deal could further boost the country's agricultural shipments, bolstering global supplies and helping hold down prices.

- Separately, EU officials are looking for new ways to clamp down on Russian oil revenues following recent reports that Moscow is largely circumventing the West's $60-per-barrel cap on its exports.
- One proposal would have Denmark stop, inspect, and potentially impound tankers carrying Russian oil through Danish waters without Western insurance, under laws permitting states to check vessels they fear pose environmental threats.
- If implemented, the plan would naturally be high risk, potentially producing serious naval tensions in the Baltic region.

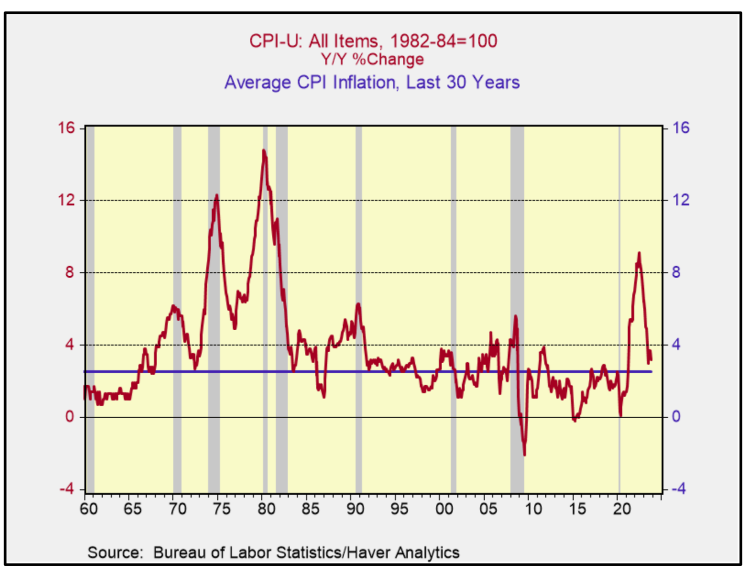
U.S. Fiscal Policy: The House of Representatives yesterday passed Speaker Johnson's two-step stopgap funding measure to keep some federal departments operating until mid-January and others until early February. Since many of Johnson's own Republican Party voted against the bill because it lacked spending cuts and other positions favored by the far right, passage of the measure required the votes of many Democrats.

- The "continuing resolution" now moves to the Senate, where prospects appear to be good that it will pass and be sent to President Biden to be signed into law.
- Nevertheless, even if the bill passes and averts a partial government shutdown this weekend, there will still be the chance of a fresh impasse and potential shutdown when the new bill expires early in 2024.

U.S. Labor Market: Despite the national sigh of relief when the United Auto Workers and the major U.S. automakers struck a tentative deal on a new labor contract, workers at several plants run by General Motors (GM, $28.20) have voted to reject the deal. That puts the GM tally to date at about 50%, with voting set to continue for another week or two. In contrast, the proposed deals at Ford (F, $9.86) and Stellantis (STLA, $20.25) are on track to be approved by comfortable margins. The neck-and-neck voting at GM is a further reflection of just how empowered workers feel in the midst of today's labor shortages.

U.S. Consumer Price Inflation: In the interest of acknowledging contrarian viewpoints, we note that the *Wall Street Journal* today carries an interview with Cathy Wood, the founder of ARK Investment Management and a major technology-stock cheerleader, in which she argues that new technologies and falling commodity prices will lead to a future of deflation rather than inflation. Of course, this could simply be an instance of Wood "talking her book," since lower inflation implies lower interest rates and higher valuations for long-duration stocks like technology start-ups. We continue to believe that consumer price inflation in the coming decades will be higher and more volatile than in the post-Cold War period of relative peace and globalization over the last three decades.

- It's difficult to forecast inflation rates over such a long period, but we would not be surprised if they average between 3.0% and 4.0% between now and mid-century, versus the average of 2.5% over the last 30 years (see chart below).
- While technology advancements will help bring down some costs, we think that will be offset by factors such as:
    - The global economy's fracturing into relatively separate blocs;
    - The shift to less efficient global supply chains;
    - The relocation of production back to relatively expensive countries in the West;
    - Increased corporate and government investment spending to support those shifts;
    - Higher commodity prices because of recent under-investment and the expected weaponization of supplies by the China/Russia bloc;
    - Population aging and its associated labor shortages; and
    - Potential increases in consumer spending as lower-skilled workers gain a bigger part of national income.

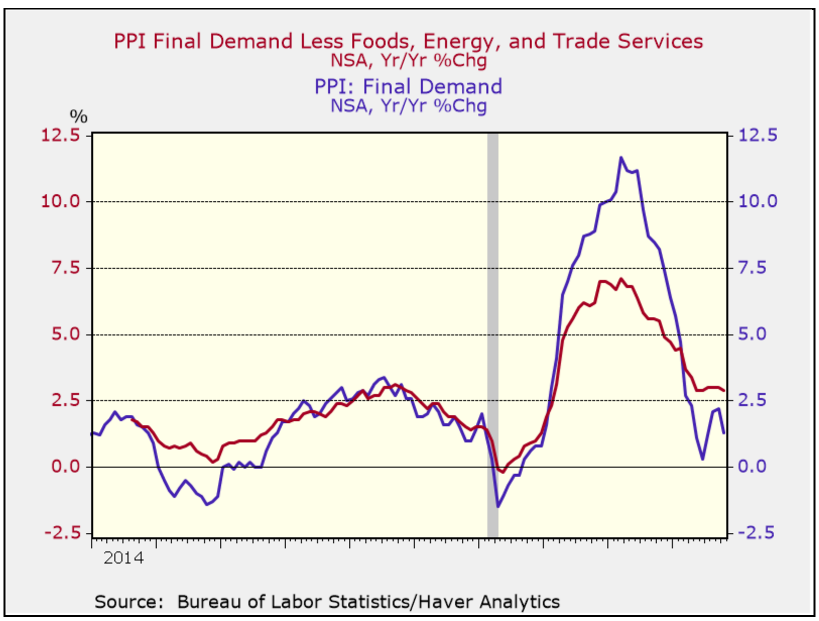


U.S. Financial Markets: After driving stock and bond prices sharply higher yesterday, the euphoria over yesterday's report of falling inflation as measured by the consumer price index appears set to continue today. After the S&P 500 stock price index surged 1.7% yesterday, it and all the other main U.S. equity indexes are pointing to a higher open at the moment. Precious metals are also a bit firmer today, but longer-maturity bonds have given back some of yesterday's rally, pushing yields up modestly so far this morning.

U.S. Economic Releases

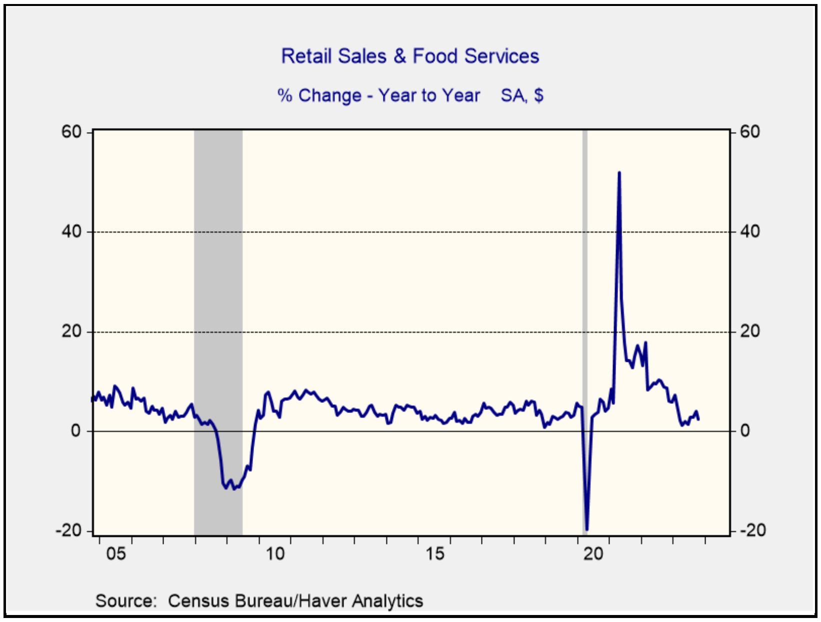
Interest in home loans persisted last week as borrowers sought to capitalize on the recent decline in borrowing rates. The Mortgage Bankers' Association (MBA) index for mortgage applications rose 2.8% in the week ending November 10, its second consecutive increase. This sustained demand comes as mortgage rates remained unchanged at 7.6%, which is below the previous month's peak of 7.9%. As a result, the applications index for purchases and refinancing rose 3.2% and 2.0%, respectively, from the previous week.

Meanwhile, supplier inflation continues to show signs of abating. The Bureau of Labor Statistics' producer price index (PPI) fell 0.5% in October, a significant decline from the previous month's 0.4% increase and well below the consensus estimate of a 0.5% rise. Excluding volatile food and energy components, producer prices remained relatively flat compared to the previous month. However, a stricter measure of PPI, which also excludes trade, edged up 0.1% from the previous month.



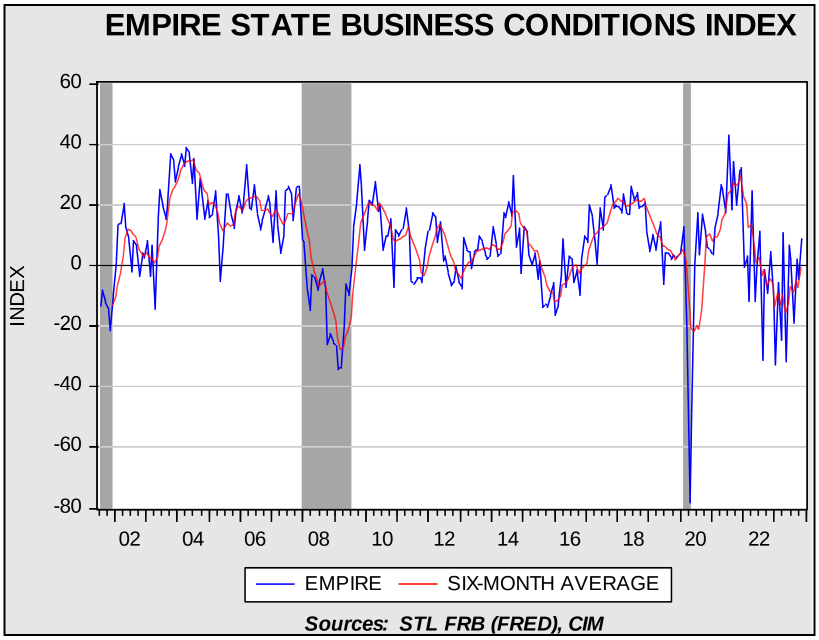
The chart above shows the annual change in headline and super core PPI. Headline PPI has risen 1.3% since October 2022, while super core PPI rose 2.9% in the same period.

Additionally, retail receipts indicate a moderation in consumer spending. Retail sales dipped 0.1% in October, a significant drop from the 0.9% growth in the previous month and falling short of the consensus estimate of a 0.3% decline. However, excluding autos and gas, retail sales showed a slight improvement, rising 0.1% from the previous month, although still below the forecasted 0.3% increase.



The chart above shows the annual change in retail sales. Overall retail receipts are up 2.5% from the previous year, below the median rise of 4.14%.

On a positive note, industrial output in New York rose to its highest level in eight months. The New York Empire State Manufacturing Index increased to +9.1 in November. The reading was well above estimates of -2.8 and the previous month's report of -4.6.



The chart above shows the Federal Reserve Board of New York's General Business Conditions Index. The index is still well below trend at -0.81.

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	Business Inventories	m/m	Sep	0.4%	0.4%	*
Federal Reserve						
EST	**Speaker or Event**	**District or Position**				
9:30	Michael Barr Testifies on Oversight of Financial Regulators	Federal Reserve Board Vice Chair for Supervision				
15:30	Thomas Barkin Speaks About Housing	President of the Federal Reserve Bank of Richmond				

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	GDP SA	q/q	3Q P	-0.5%	1.2%	1.1%	***	Equity bearish, bond bullish
	GDP Deflator	y/y	3Q P	5.1%	3.5%	4.8%	***	Equity and bond neutral
	Industrial Production	y/y	Sep F	-4.4%	-4.6%		***	Equity and bond neutral
	Capacity Utilization	m/m	Sep	0.4%	0.5%		**	Equity and bond neutral
Australia	Wage Price Index	y/y	3Q	4.0%	3.6%	3.9%	**	Equity and bond neutral
South Korea	Unemployment Rate	m/m	Oct	2.5%	2.6%	2.7%	**	Equity and bond neutral
China	Industrial Production	y/y	Oct	4.6%	4.5%	4.5%	***	Equity and bond neutral
	Retail Sales	y/y	Oct	7.6%	5.5%	7.0%	*	Equity bullish, bond bearish
India	Exports	y/y	Oct	6.2%	-2.6%		**	Equity and bond neutral
	Imports	y/y	Oct	12.3%	-15.0%		**	Equity and bond neutral
	Trade Balance	y/y	Oct	-31461m	-$19370.0m	-$20400.0m	**	Equity and bond neutral
EUROPE								
Eurozone	Industrial Production WDA	y/y	Sep	-6.9%	-5.1%	-6.3%	**	Equity bearish, bond bullish
	Trade Balance SA	m/m	Sep	9.2b%	11.9b	6.7b%	**	Equity and bond neutral
France	CPI	y/y	Oct F	4.0%	4.0%	4.0%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Oct F	4.5%	4.5%	4.5%	**	Equity and bond neutral
Italy	CPI, EU Harmonized	y/y	Oct F	1.8%	1.9%	1.9%	***	Equity and bond neutral
UK	CPI	y/y	Oct	4.6%	6.7%	4.7%	***	Equity and bond neutral
	Core CPI	y/y	Oct	5.7%	6.1%	5.8%	***	Equity and bond neutral
	Retail Price Index	m/m	Oct	377.8	378.4	378.9	**	Equity and bond neutral
	RPI YoY	y/y	Oct	6.1%	8.9%	6.3%	**	Equity and bond neutral
AMERICAS								
Mexico	International Reserves Weekly	w/w	10-Nov	$205262m	$204984m		*	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	Up
3-mo T-bill yield (bps)	525	524	1	Down
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	536	536	0	Down
U.S. Libor/OIS spread (bps)	537	536	1	Down
10-yr T-note (%)	4.48	4.45	0.03	Flat
Euribor/OIS spread (bps)	400	400	0	Up
Currencies	**Direction**			
Dollar	Up			Up
Euro	Down			Down
Yen	Flat			Down
Pound	Down			Down
Franc	Up			Down
Central Bank Action	**Current**	**Prior**	**Expected**	
PBOC 1-Year Med-Term Lending Facility	2.500%	2.500%	2.500%	On Forecast
PBOC 1-Year Med-Term Lending (Bil.)	1450.0b	789.0b	950.0b	Above Forecast

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.

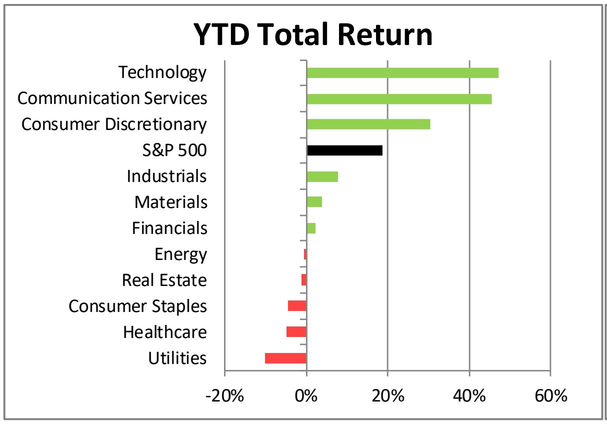
weco	Price	Prior	Change	Explanation
Energy Markets				
Brent	$82.21	$82.47	-0.32%	
WTI	$77.98	$78.26	-0.36%	
Natural Gas	$3.17	$3.11	2.19%	
Crack Spread	$23.05	$23.73	-2.88%	
12-mo strip crack	$23.70	$24.18	-1.99%	
Ethanol rack	$2.09	$2.09	0.10%	
Metals				
Gold	$1,971.55	$1,964.29	0.37%	
Silver	$23.43	$23.09	1.47%	
Copper contract	$370.50	$368.35	0.58%	
Grains				
Corn contract	$494.00	$494.25	-0.05%	
Wheat contract	$598.50	$597.75	0.13%	
Soybeans contract	$1,393.75	$1,389.75	0.29%	
Shipping				
Baltic Dry Freight	1,662	1,655	7	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		2.0		
Gasoline (mb)		1.5		
Distillates (mb)		-1.1		
Refinery run rates (%)		0.6%		
Natural gas (bcf)		38		

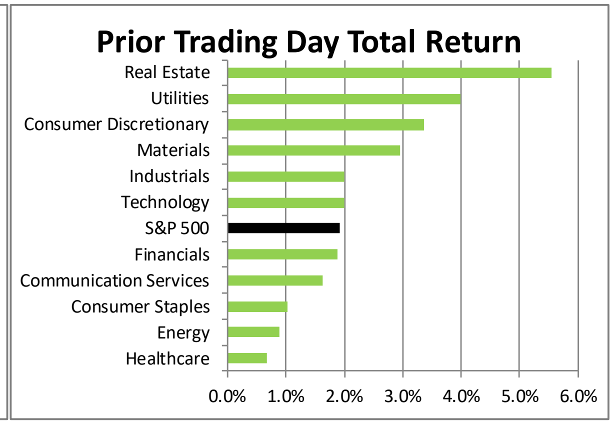
Weather

The 6-10 and 8-14 day forecasts currently call for cooler-than-normal temperatures for most of the country, with warmer conditions in the Pacific region. Meanwhile, the precipitation outlook calls for wetter-than-normal conditions in most states east of the Rockies, with dry conditions expected in the Pacific and Great Plains regions.

Data Section

U.S. Equity Markets – (as of 11/14/2023 close)

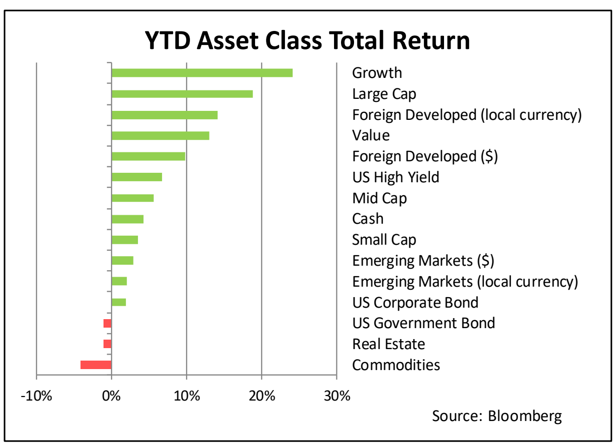




(Source: Bloomberg)

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 11/14/2023 close)

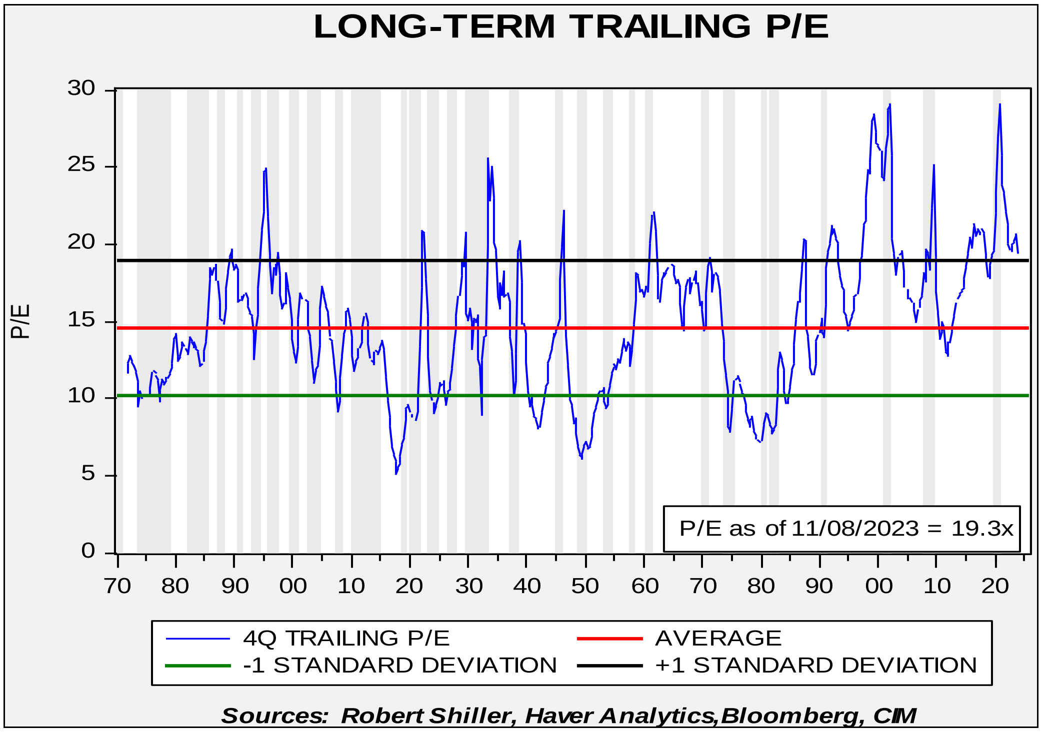


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.