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 16, 2023—9:30 AM EST] Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 is down 0.4% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.1%. Chinese markets were lower, with the Shanghai Composite down 0.7% from its previous close and the Shenzhen Composite down 1.0%. U.S. equity index futures are signaling a lower open.

With 464 companies having reported so far, S&P 500 earnings for Q3 are running at $58.40 per share compared to estimates of $57.42, which is up 1.7% from Q2 2023. Of the companies that have reported thus far, 81.7% have exceeded expectations while 14.9% have fallen short of expectations.

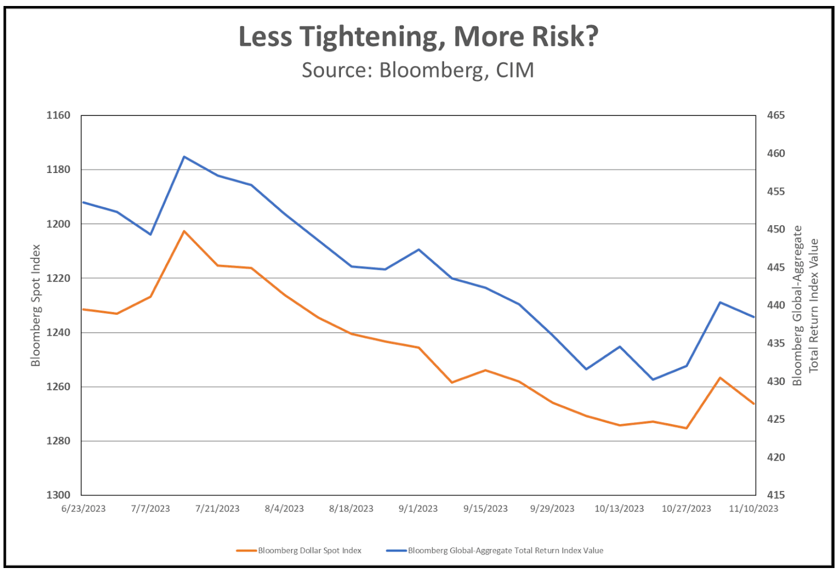
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *Bi-Weekly Geopolitical Report* (11/13/2023) (with associated podcast): "The Archetypes of American Foreign Policy: A Reprise"
- ***Weekly Energy Update*** **(11/16/2023): After the EIA delayed last week's data, we are seeing higher crude oil inventories. The Gaza conflict remains contained. The IEA boosts its demand forecasts.**
- *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! Gold prices are rising as investors eagerly await the Federal Reserve's next policy decision, while Gerrit Cole has been named the American League Cy Young Award winner. Today's *Comment* delves into the reasons behind the surge in investor risk taking being fueled by optimism over a possible end to interest rate hikes, the potential easing of commodity inflation next year, and Xi Jinping's softening stance towards certain adversaries. As always, our comprehensive report summarizes the latest domestic and international data releases.

Monetary Inflection Point? Risk appetite has started to pick up as investors are growing confident that monetary tightening is over.

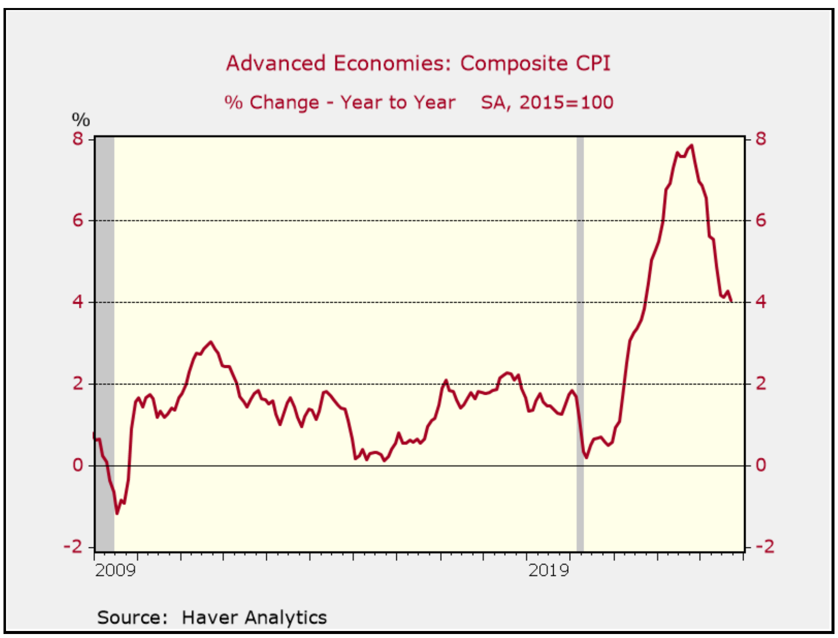
- Recent economic data suggests that central banks are making progress towards their inflation targets. The Bureau of Labor Statistics (BLS) released data earlier this week showing that producer prices (PPI) rose 1.4% since October 2022, while consumer prices (CPI) increased 3.2% in the same period. This trend is also evident in other countries, with the eurozone and the U.K. both making headway toward achieving their respective 2% inflation targets. While policymakers have not ruled out further rate hikes, fed funds futures contracts indicate a 97.3% probability that the central bank will hold rates steady at its next meeting and an 81% likelihood of a rate cut by June 2024.
- Expectations of a Fed pivot have led investors to diversify away from safe assets. The Bloomberg indexes for global bond and dollar performances have also reflected the recent shift in risk sentiment. The investment-grade debt index from a multitude of countries has surged 3.1% in the past two weeks, recouping half of the losses it had incurred since mid-July. This impressive rally aligns with the Bloomberg Dollar Index, which indicates a similar resurgence of global currencies against the greenback within the same period. While this market response to economic data is encouraging, some investors remain cautious, recognizing that underlying uncertainties may reverse the present trend.



- In the near term, this shift might provide some respite for investors who have endured losses in riskier assets earlier this year. Notably, the weakening U.S. dollar should uplift emerging market equities. However, the sustainability of this trend remains uncertain. Much of the performance of the dollar and risk assets has been driven by expectations of central banks halting their tightening cycle, which may or may not materialize. Nevertheless, investors should also be mindful that as monetary policy concerns recede, attention may shift back to GDP growth, which could favor U.S.-denominated assets due to the country's robust economic outlook.

Commodity Price Pressures: Increased supply and weakening demand are expected to put downward pressure on food and other commodity prices going into 2024.

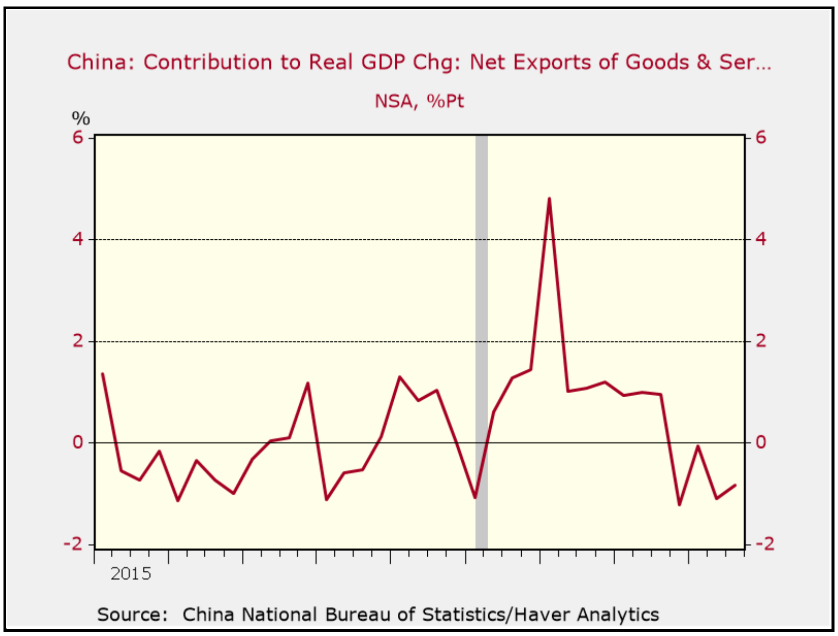
- Global food prices are expected to fall next year, according to agribusiness lender Rabobank's annual outlook. A key factor driving this downward trend is the surge in production resulting from firms seeking to capitalize on higher prices. Prices for sugar, coffee, corn, and soybeans are all expected to be impacted by the projected increase in supply. Conversely, China's anticipated growth in copper output is likely to keep metal prices below 2022 levels in 2024. S&P Global Market Intelligence expects the London Metal Exchange's three-month price per metric ton to hit $8602 in 2024, below its $8784 from two years prior and roughly in line with this year's estimated price of $8596. However, copper prices are expected to spike in 2025 and onwards.
- On the demand side, there are also indications that commodity prices may face resistance. Rabobank forecasts that slower economic growth due to higher interest rates and elevated prices could dampen demand. Several major economies are already teetering on the brink of recession. The German economy is projected to contract by 0.3% in 2023. Meanwhile, China's economic woes are expected to persist into the following year. The lack of growth across the globe could make it more challenging for commodities to sustain their current price levels.



- The moderation in commodity prices offers a glimmer of hope amidst the looming threat of a global economic downturn. The anticipated easing of food inflation should provide a much-needed boost for emerging markets, where high food prices have historically been linked to social unrest. Moreover, the relaxation of commodity pressures is likely to contribute to global efforts to curb inflation. If these supply and demand dynamics persist, the improvement in commodity prices could facilitate economic growth for non-commodity producers, even in the face of a potential recession.

Xi's Delicate Dance: The Chinese president faces difficulties in fostering cordial relations with his Indo-Pacific rivals.

- President Biden's seemingly impromptu remark calling Xi Jinping a "dictator" during a post-meeting Q&A session likely altered the tone of their discussions. Prior to this comment, the two leaders had reportedly engaged in productive talks, agreeing to collaborate on combating fentanyl trafficking and reestablishing military communication channels. Following his meeting with Biden, Xi is expected to meet with Japanese Prime Minister Fumio Kishida on Thursday. The two will likely discuss the recent detaining of well-known Japanese businessman Hiroshi Nishiyama on suspicion of espionage. His imprisonment has raised concerns about China's recent crackdowns on foreign workers.
- Xi Jinping's recent efforts to cultivate stronger ties with the international community underscore his determination to revitalize China's economy, which has encountered hurdles following its stringent pandemic lockdowns. While investment spending has traditionally been a cornerstone of China's growth, its aversion to accumulating debt necessitates a diversification of growth strategies. Trade emerges as an appealing option as it would allow the country to preserve its manufacturing base while alleviating deflationary concerns. In October, headline CPI dipped 0.1% year-over-year, while core CPI increased by 0.7%. A possible reset in relations with China and its rivals may help lead to an increase in its net exports which have been a drag on growth.



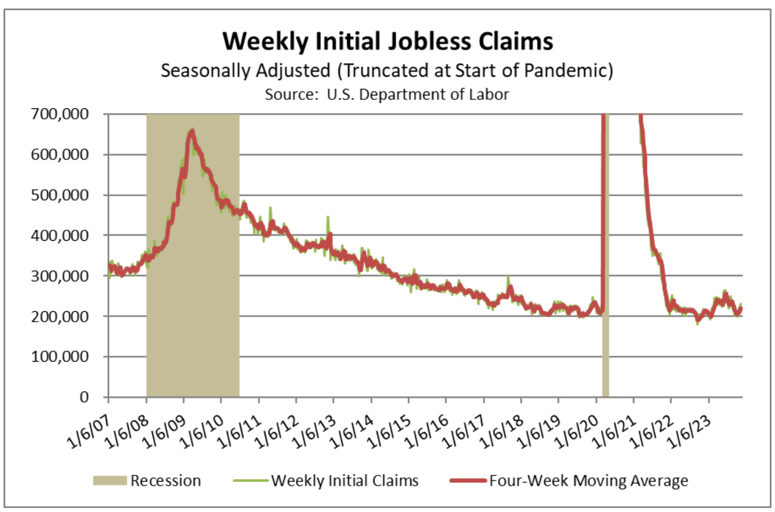
- Xi's recent overture should not be misinterpreted as a change of heart. He has offered no indication that he is prepared to retract his willingness to decouple from the U.S. or remove his country's backing of Russia. Therefore, the thaw in intentions is likely a tacit acknowledgment that he does not desire an abrupt end to relations with the world's largest economy. However, this does imply that he may be more focused on addressing domestic challenges rather than settling historical scores such as the reunification of

Taiwan, suggesting that the risk of conflict between the two largest economies may be diminishing.

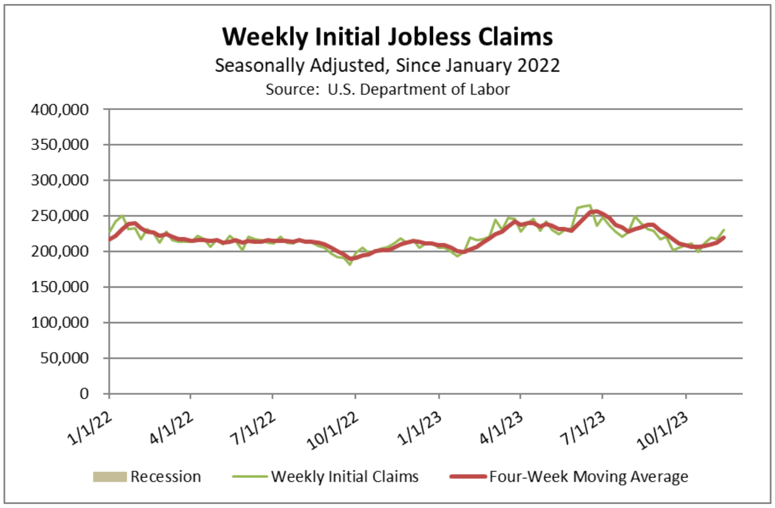
Other News: West Virginia Senator Joe Manchin [announced that he is contemplating a presidential bid](). His inclusion adds another layer of complexity to an already crowded field, further clouding the outlook for the 2024 election. The [GM-UAW contract is expected to be approved](), thus reducing the chance of another strike. The Senate [approved the stopgap spending bill]() to keep the government funded into 2024. This sets up another fight in two months but should calm nerves about disruption to governmental operations.

U.S. Economic Releases

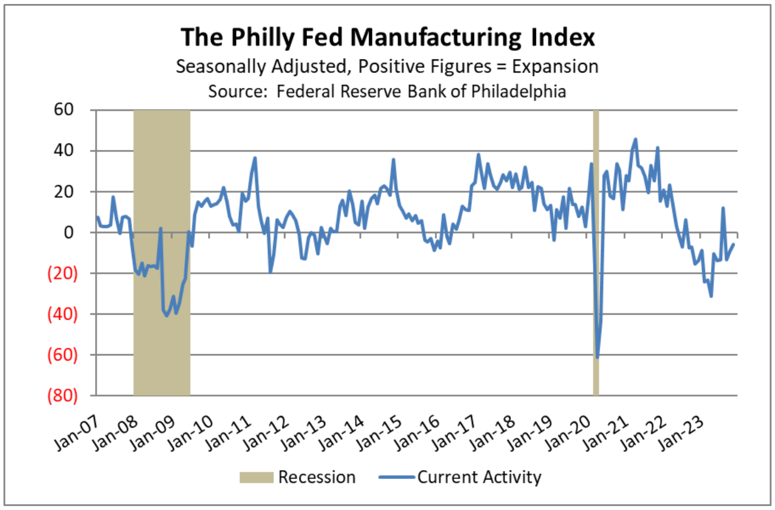
In the week ended November 11, ***initial claims for unemployment benefits*** jumped to a seasonally adjusted 231,000, far above both the expected level of 220,000 and the previous week's revised level of 218,000. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, rose to 220,250. Meanwhile, in the week ended November 4, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) rose to 1.865 million, above both the anticipated reading of 1.843 million and the prior week's revised reading of 1.833 million. The chart below shows how initial jobless claims have fluctuated since just before the Great Financial Crisis. The chart is truncated through much of the pandemic period because of the extremely high level of claims at that time.



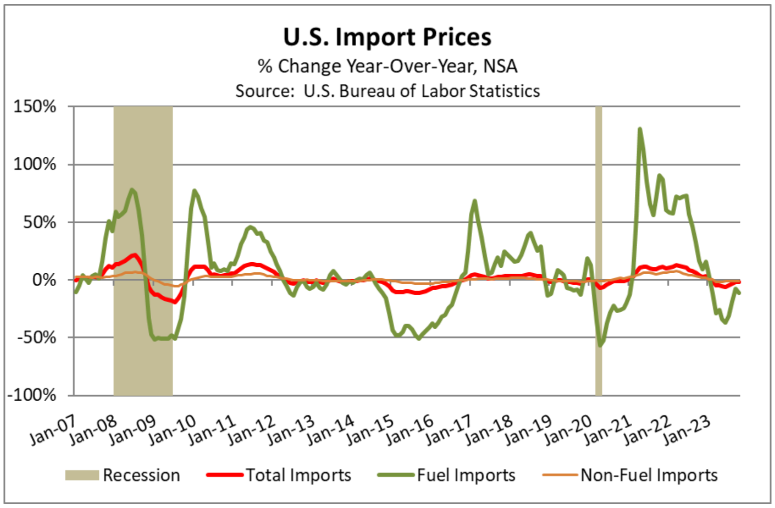
To provide more detail on recent trends, the following chart shows how initial jobless claims have changed just since the beginning of 2022.



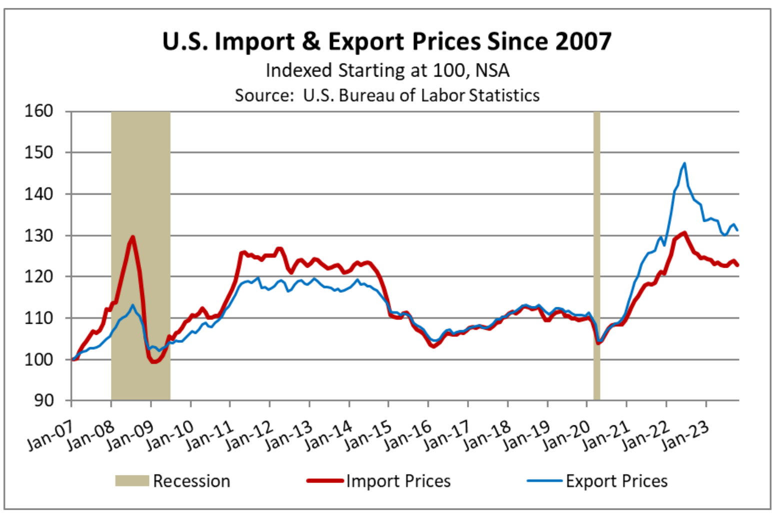
Separately, the Philadelphia FRB said its November ***Philly Fed Index*** improved to a seasonally adjusted -5.9, beating the expected reading of -8.0 and the October reading of -9.0. The index, officially designated as the Philadelphia FRB Manufacturing Activity Index, is designed so that positive readings point to expanding factory activity in the mid-Atlantic region. At its current level, the index suggests mid-Atlantic manufacturing is still declining, but not as fast as it was previously. The chart below shows how the index has fluctuated since just before the GFC.



Finally, October ***import prices*** were down 0.8% from the previous month, falling further than the expected decline of 0.3% and more than erasing the September increase of 0.4%. Of course, import prices are often driven by volatility in the petroleum fuels category, and that was the case last month. October ***import prices excluding fuels*** were down just 0.2% for a second straight month, versus their expected decline of 0.3%. Overall import prices in October were down 2.0% from the same month one year earlier, while import prices excluding fuels were down 0.9%. The chart below shows the year-over-year change in import prices since just before the GFC.



According to the report, ***export prices*** in October were down 4.9% from one year earlier, in large part because of the key agriculture category. Comparing the annual change in export prices versus import prices provides a sense of the U.S. "terms of trade," or the relative advantage or disadvantage the country is facing because of trends in international trade prices. The chart below compares the year-over-year change in U.S. export and import prices since just before the GFC.



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
9:15	Industrial Production	m/m	Oct	-0.4%	0.3%	***
9:15	Industrial Capacity Utilization	m/m	Oct	79.4%	79.7%	**
11:00	Kansas City Fed Manfacturing Index	m/m	Nov		-8	*
16:00	Net Long-Term TIC Flows	m/m	Sep		$63.5b	**
16:00	Total Net TIC Flows	m/m	Sep		$134.4b	**
Federal Reserve						
EST	Speaker or Event	District or Position				
9:25	John Williams at US Treasury Market Conference	President of the Federal Reserve Bank of New York				
10:30	Chris Waller Participates in Discussion on CBDCs	Member of the Board of Governors				
10:35	Michael Barr Speaks on Financial Stability	Federal Reserve Board Vice Chair for Supervision				
11:45	Loretta Mester Delivers Introductory Remarks	President of the Federal Reserve Bank of Cleveland				
12:00	Lisa Cook Speaks on Global Linkages and Spillovers	Member of the Board of Governors				
13:30	Loretta Mester Speaks on CNBC	President of the Federal Reserve Bank of Cleveland				

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	Trade Balance	m/m	Oct	-¥662.5b	¥62.4b	¥72.1b	***	Equity and bond neutral
	Exports	m/m	Oct	1.6%	4.3%	1.0%	*	Equity bullish, bond bearish
	Imports	m/m	Oct	-12.5%	-16.3%	-16.4%	*	Equity bullish, bond bearish
	Core Machine Orders	y/y	Sep	-2.2%	-7.7%	-3.7%	***	Equity bullish, bond bearish
	Foreign Buying Japan Stocks	w/w	10-Nov	¥388.4b	¥313.5b	¥312.9b	*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	10-Nov	-¥73.0b	¥145.0b		*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	10-Nov	-¥68.2b	-¥388.4b	-¥388.2b	*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	10-Nov	-¥296.2b	¥512.0b	¥514.0b	*	Equity and bond neutral
	Tertiary Industry Index	m/m	Sep	-1.0%	-0.1%	-0.7%	**	Equity and bond neutral
Australia	Employment Change	m/m	Oct	55.0k	6.7k	7.8k	***	Equity and bond neutral
	Unemployment Rate	m/m	Oct	3.7%	3.6%	3.7%	***	Equity and bond neutral
	Participation Rate	m/m	Oct	67.0%	66.7%	66.8%	**	Equity and bond neutral
New Zealand	REINZ House Sales	y/y	Oct	8.0%	5.1%		**	Equity bullish, bond bearish
EUROPE								
Russia	GDP	y/y	3Q A	5.5%	4.9%	5.1%	**	Equity and bond neutral
AMERICAS								
Canada	Manufacturing Sales	m/m	Sep	0.4%	0.7%	-0.1%	**	Equity and bond neutral
	Housing Starts	m/m	Oct	274.7k	270.5k	255.0k	**	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)	565	564	1	Up
3-mo T-bill yield (bps)	525	526	-1	Down
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	537	537	0	Down
U.S. Libor/OIS spread (bps)	537	537	0	Down
10-yr T-note (%)	4.48	4.53	-0.05	Flat
Euribor/OIS spread (bps)	399	400	-1	Up
Currencies	**Direction**			
Dollar	Flat			Up
Euro	Flat			Down
Yen	Up			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.

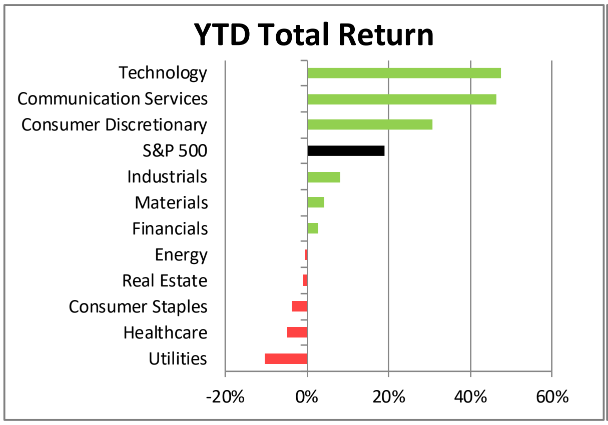
weco	Price	Prior	Change	Explanation
Energy Markets				
Brent	$80.79	$81.18	-0.48%	
WTI	$76.31	$76.66	-0.46%	
Natural Gas	$3.22	$3.19	0.88%	
Crack Spread	$24.87	$25.12	-0.97%	
12-mo strip crack	$24.16	$24.61	-1.81%	
Ethanol rack	$2.09	$2.09	0.02%	
Metals				
Gold	$1,964.91	$1,959.85	0.26%	
Silver	$23.60	$23.44	0.68%	
Copper contract	$372.10	$371.85	0.07%	
Grains				
Corn contract	$486.00	$488.50	-0.51%	
Wheat contract	$582.50	$588.00	-0.94%	
Soybeans contract	$1,373.75	$1,385.00	-0.81%	
Shipping				
Baltic Dry Freight	1,688	1,662	26	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	3.6	2.0	1.6	
Gasoline (mb)	-1.5	1.5	-3.0	
Distillates (mb)	-1.4	-1.1	-0.3	
Refinery run rates (%)	0.9%	0.6%	0.3%	
Natural gas (bcf)		42		

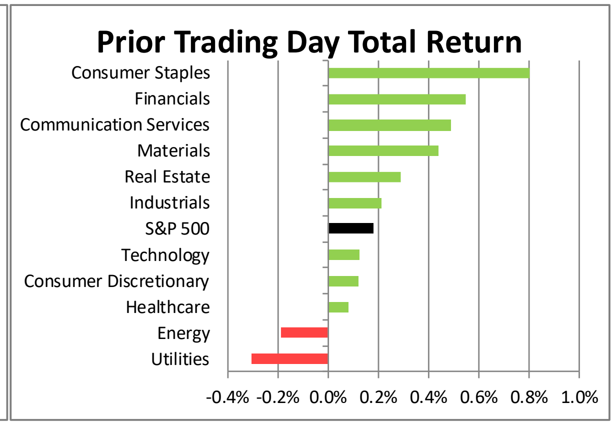
Weather

The 6-10 and 8-14 day forecasts currently call for cooler-than-normal temperatures from the Great Plains eastward, with warmer-than-normal conditions throughout the Far West. The forecasts are calling for wetter-than-normal conditions in the northern Rocky Mountains and the Southeast, with dry conditions expected in the Southwest and Midwest.

Data Section

U.S. Equity Markets – (as of 11/15/2023 close)

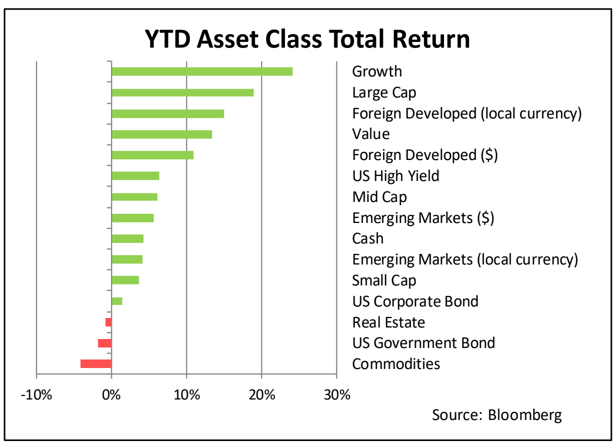




(Source: Bloomberg)

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 11/15/2023 close)

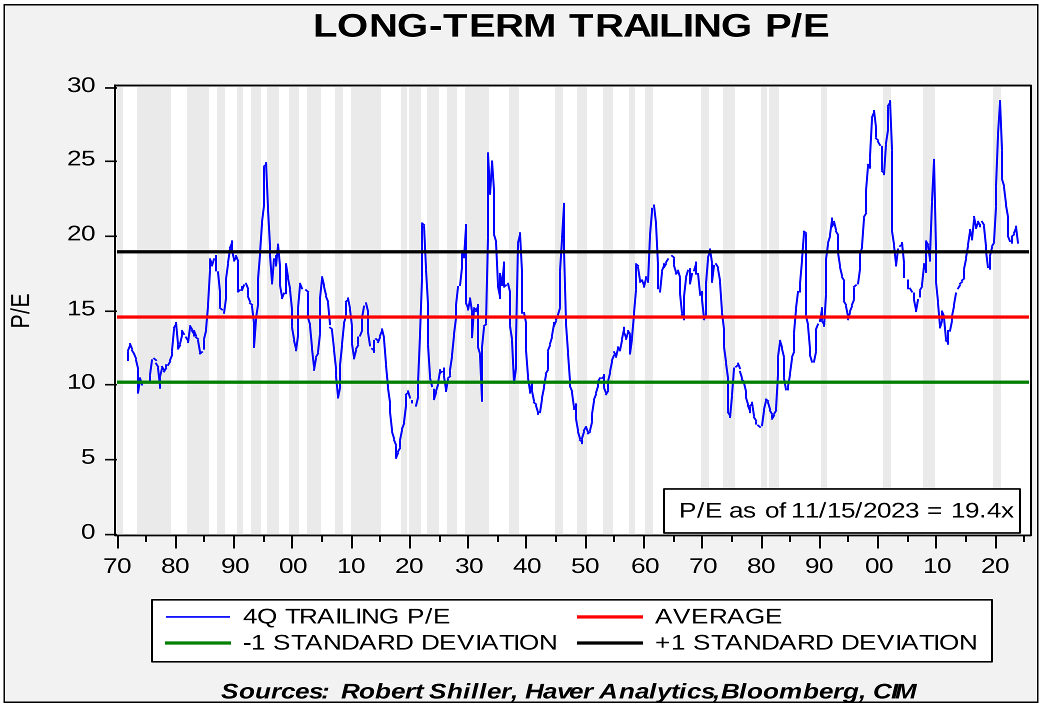


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 16, 2023



Based on our methodology,[1] the current P/E is 19.4x, up 0.1x from last week. The multiple rose on the 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.