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.

The* Daily Comment *will go on hiatus beginning Wednesday, November 22, and will return on Monday, November 27.

[Posted: November 21, 2023—9:30 AM EST] Global equity markets are mostly lower this morning. In Europe, the Euro Stoxx 50 is down 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.5%. Chinese markets were generally lower, with the Shanghai Composite relatively unchanged from its previous close and the Shenzhen Composite down 0.4%. U.S. equity index futures are signaling a lower open.

With 473 companies having reported so far, S&P 500 earnings for Q3 are running at $58.50 per share compared to estimates of $57.42, which is up 1.7% from Q2 2023. Of the companies that have reported thus far, 82.0% have exceeded expectations while 14.6% 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* (11/20/2023) (with associated podcast): "Reflections on Earnings"

Our *Comment* today opens with a discussion of how the recent cooling in U.S.-China tensions seems to be worrying Russia. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including what is likely to be a painful government spending freeze in Germany, a report showing cooler price inflation in Canada, and an overview of a key U.S. earnings report due out after market close today.

China-Russia-United States: At an international cultural forum in St. Petersburg last week, Russian President Putin went to extraordinary lengths to tout current China-Russia relations, claiming the relationship has progressed to the point where it is now "truly unique" and had "never reached such a height and quality in the history of our states."

- According to experts in China-Russia relations, Putin's obsequious remarks (technically known as "brown nosing") were probably an effort to curry favor with Beijing and remind Chinese leaders of Russia's value as a geopolitical partner, even as President Xi works to cool tensions with the U.S.
- If so, Putin's insecurity reflects how dependent Russia has become on China as the junior member of the evolving China/Russia geopolitical bloc. Putin's insecurity underscores that Russia has much to lose if U.S.-China relations improve.

China-Saudi Arabia: The People's Bank of China and the Saudi Central Bank yesterday said they have agreed on a three-year currency swap program totaling up to $7 billion. The swap facility will support Beijing's effort to internationalize the renminbi (CNY) and reduce the two countries' dependence on the dollar for bilateral trade and investment. In the long run, such efforts may contribute to the ongoing gradual decline in global demand for the greenback. In the near term, however, our research suggests the dollar will be buoyed by other factors, such as the U.S.'s current innovation and capital investment cycle.

China: The National Data Administration proposed by Beijing early this year has now been established as a unit of the National Development and Reform Commission. Taking over some of the responsibilities of the Cyberspace Administration of China, the NDA is expected to play a key role in China's future digital development. Its responsibilities include drawing up development plans, establishing common standards for data storage and sharing, regulating digital industries, and promoting the digitalization of public services.

- Establishment of the NDA shows how China is working feverishly to advance its digital industries and leapfrog the U.S in technology.
- Nevertheless, based on the Chinese government's recent record, the NDA is probably just as likely to over-regulate as it is to promote China's digital economy. If the NDA tightens regulation and state control too much, it could stymie Chinese firms' innovation. Greater state control over China's digital industries could also invite further U.S. limits on bilateral data and technology flows.

Taiwan: Yesterday, Vice President Lai Ching-te, the current front-runner in January's presidential election, named the island's envoy to the U.S. as his running mate. The move probably helps consolidate Lai's advantage in the race, especially since the opposition Kuomintang and Taiwan People's Party have hit a roadblock in their effort to form a joint ticket to better challenge Lai. Even though the Kuomintang and the TPP last week agreed to explore a joint ticket, they failed over the weekend to agree on which party would get to field their candidate.

Japan: Early indications suggest corporations will again boost their pay rates in 2024, largely matching the big raises they offered in 2023. The planned wage hikes reflect both labor shortages and workers' demand for increased income to compensate for continued high price inflation. If companies follow through with the planned hikes, the Bank of Japan would be more likely to abandon its longstanding loose monetary policy.

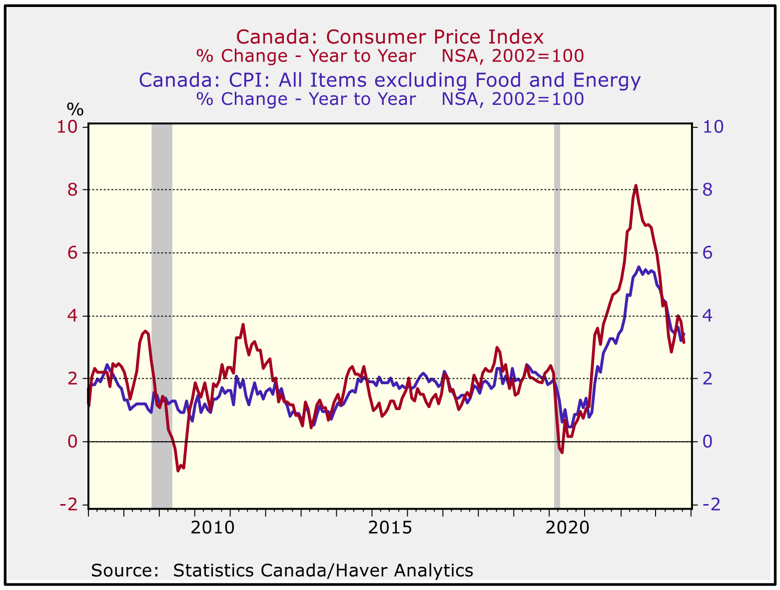
Germany: The government has announced it will freeze spending for the rest of the year in response to a recent court ruling that the constitutional "debt brake" prevents transferring unused emergency pandemic funds to finance the government's big green energy program.

- Chancellor Scholz and his government are now working feverishly to decide how much of the green energy program to retain and whether to fund it by tax hikes, spending cuts elsewhere, or both.
- In any case, the spending freeze will probably be a further headwind for the German economy, on top of other factors such as high energy prices, high interest rates, weakening global demand for German exports, and poor demographics.
- Given the huge size of Germany's economy, its slowing growth will likely be an important drag on the overall European economy in the near term.

Netherlands: Ahead of tomorrow's parliamentary elections, new public opinion polling shows far-right, anti-Islam firebrand Geert Wilders and his Freedom Party are now tied for first place with the liberal VVD party of outgoing Prime Minister Mark Rutte. Under the Dutch electoral system, the polling suggests the most likely outcome of the election will be a right-wing coalition government.

United Kingdom: Treasury Secretary Trott confirmed that Chancellor Hunt will propose cutting both corporate and personal income taxes when he delivers his "Autumn Budget Statement" on Wednesday. Although justified as a reasonable move to promote economic growth now that British inflation has come down sharply, the tax cuts are widely seen as an effort to boost the Conservative Party's lagging support in public opinion polls. Given the planned rise in other levies, many voters will still likely see their overall tax burden increase in the coming years.

Canada: Consistent with recent trends in other key developed countries, the October consumer price index was up just 3.1% from the same month one year earlier, slowing from the gains of 3.8% in the year to September and 4.0% in the year to August. Excluding the volatile food and energy components, the October Core CPI was up 3.4% year-over-year. That marked a slight acceleration from the previous month's core inflation; the average of the Bank of Canada's preferred trimmed mean and weighted median measures for underlying core inflation was 3.55% in the year to October, decelerating from 3.8% the month before.



United States-Israel-Hamas: Illustrating how there is still a risk that the Israel-Hamas conflict could widen, the Israel Defense Forces and many Israeli citizens are increasingly agitating for Prime Minister Netanyahu to approve stronger attacks on the Iran-backed Hezbollah militants who are launching harassment fire into northern Israel from southern Lebanon. Meanwhile, in the U.S., the Defense Department and some Congressional leaders are pressuring President Biden to retaliate more strongly against other Iran-backed militants in the region, who have now launched 61 separate attacks on U.S. military bases since the Israel-Hamas conflict began on October 7, injuring dozens of U.S. personnel.

- If intensifying political pressures in the U.S. or Israel lead to stronger military attacks against the various Iran-backed militants in the region, the militants and potentially even Iran could respond with even stronger attacks.
- As the U.S. presidential election draws closer, Biden may be especially vulnerable to domestic political pressure. His administration is already gaining a reputation for being excessively cautious in foreign policy, so he may feel compelled to unleash the U.S. military to avoid looking "soft on defense."

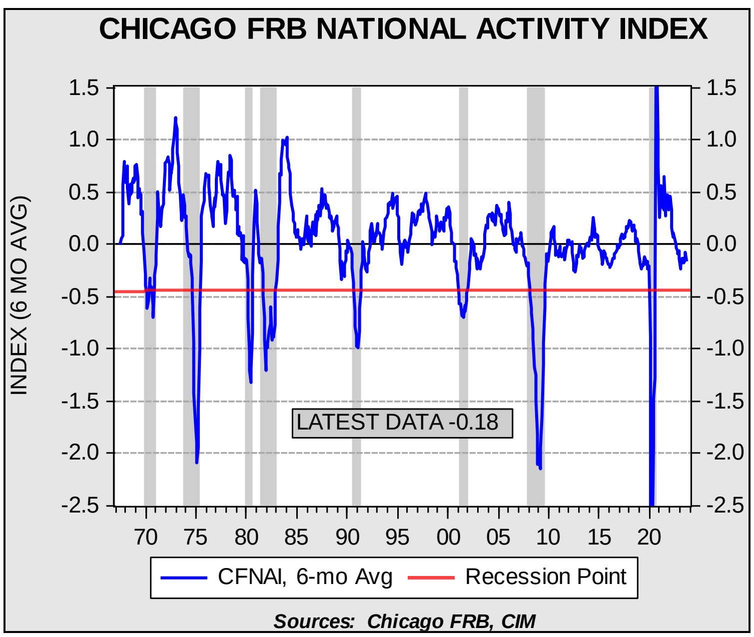
U.S. Artificial Intelligence Industry: In a continuation of the chaos at artificial intelligence darling OpenAI, virtually all the remaining employees of the for-profit AI unit have warned they will resign and seek to follow former CEO Sam Altman to Microsoft (MSFT, $369.84) unless the nonprofit governing board resigns *en masse* and brings Altman back. The employees' threat underscores how the for-profit AI unit's brash, risk-on approach to the technology clashed with the nonprofit board's much more cautious approach. In broader terms, how societies handle the clashing visions between rapid AI development and cautious regulation could profoundly affect the technology's progression over the coming years.

- Meanwhile, major U.S. stock price indexes weighted by market capitalization may be heavily influenced today and tomorrow by AI chip giant and "Magnificent Seven" member Nvidia (NVDA, $504.09), as investors look ahead and then respond to its latest quarterly earnings report, due out after market close today.

- Wall Street analysts currently expect Nvidia to report quarterly sales of $16.2 billion, almost triple its $5.9 billion in sales for the same quarter last year. The analysts expect the company's quarterly profit to come in at $7.2 billion, more than 10 times its profit of $680 million one year ago.
- Despite those projections, it's important to remember that Nvidia has beat expectations in 19 of the last 20 quarters. If the firm fails to beat this time around, or if it fails to confirm the market's rosy long-term expectations, the stock could fall and pull down the indexes.

U.S. Economic Releases

The U.S. economy exhibited signs of deceleration in October, as indicated by the Chicago Fed National Activity Index (CFNAI). The index dipped from -0.02 in September to -0.49 in October, suggesting that economic growth is currently falling short of the historical trend of zero. All four components of the CFNAI contracted last month, with production-related indicators declining the most at -0.33, followed by labor market-related indicators at -0.10, sales, orders, and inventories at -0.04, and personal consumption and housing at -0.02.



The chart above shows the level of the Chicago Fed National Activity Index. The six-month moving average fell from -0.08 to -0.18. This decline in the CFNAI aligns with other recent economic indicators pointing to a potential slowdown in the U.S. economy.

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	Existing Home Sales (monthly change)	m/m	Oct	-1.5%	-2.0%	**
10:00	Existing Home Sales (annualized selling rate)	m/m	Oct	3.90m	3.96m	***
Federal Reserve						
EST	**Speaker or Event**	**District or Position**				
14:00	FOMC Meeting Minuts	Federal Reserve Board				

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								
New Zealand	Trade Balance NZD	m/m	Oct	-1709m	-2329m	-2425m	**	Equity and bond neutral
	Exports NZD	m/m	Oct	5.40b	4.87b	4.77b	**	Equity and bond neutral
	Imports NZD	m/m	Oct	7.11b	7.20b	7.19b	**	Equity and bond neutral
South Korea	PPI	y/y	Oct	0.8%	1.3%	1.4%	**	Equity bullish, bond bearish
EUROPE								
Eurozone	EU27 New Car Registrations	y/y	Oct	14.6%	9.2%		*	Equity and bond neutral
UK	PSNB ex Banking Groups	m/m	Oct	14.9b	14.3b	14.6b	**	Equity and bond neutral
Switzerland	M3 Money Supply	y/y	Oct	-2.5%	-2.7%	-2.9%	**	Equity and bond neutral
	Real Exports	m/m	Oct	-7.2%	3.6%	3.8%	*	Equity bearish, bond bullish
	Real Imports	m/m	Oct	-3.1%	-1.0%	-0.7%	*	Equity bearish, bond bullish
AMERICAS								
Canada	CPI YoY	m/m	Oct	3.1%	3.8%	3.1%	***	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	Down
3-mo T-bill yield (bps)	524	525	-1	Up
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	538	538	0	Down
U.S. Libor/OIS spread (bps)	537	537	0	Down
10-yr T-note (%)	4.41	4.42	-0.01	Flat
Euribor/OIS spread (bps)	396	398	-2	Up
Currencies	**Direction**			
Dollar	Down			Flat
Euro	Up			Up
Yen	Up			Down
Pound	Up			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.

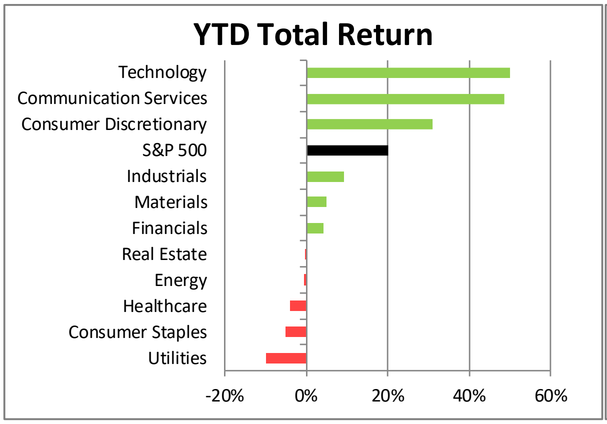
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$81.94	$82.32	-0.46%	
WTI	$77.43	$77.83	-0.51%	
Natural Gas	$2.89	$2.88	0.21%	
Crack Spread	$22.50	$24.73	-9.00%	Contract Roll
12-mo strip crack	$23.81	$24.50	-2.81%	
Ethanol rack	$2.08	$2.09	-0.16%	
Metals				
Gold	$1,989.09	$1,978.07	0.56%	
Silver	$23.62	$23.44	0.74%	
Copper contract	$383.00	$384.10	-0.29%	
Grains				
Corn contract	$489.50	$487.50	0.41%	
Wheat contract	$572.00	$570.50	0.26%	
Soybeans contract	$1,373.50	$1,367.25	0.46%	
Shipping				
Baltic Dry Freight	1,817	1,820	-3	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		2.0		
Gasoline (mb)		-1.0		
Distillates (mb)		-1.0		
Refinery run rates (%)		0.5%		
Natural gas (bcf)		3		

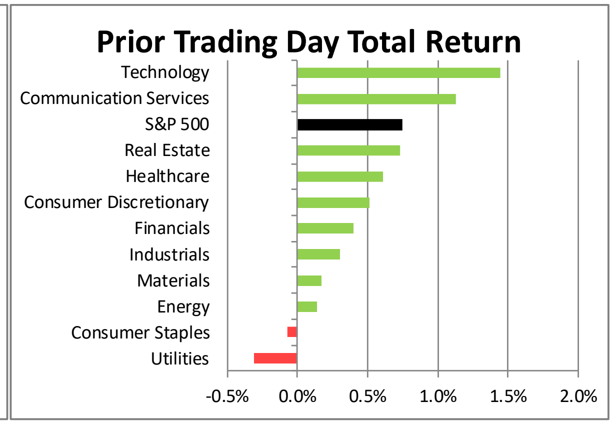
Weather

The 6-10 and 8-14 day forecasts currently call for cooler-than-normal temperatures for most the country, with warmer temperatures in the Pacific and Rocky Mountain regions. The precipitation outlook is calling for wetter-than-normal conditions throughout the South, with dry conditions expected in the New England, Far West, and Midwest regions.

Data Section

U.S. Equity Markets – (as of 11/20/2023 close)

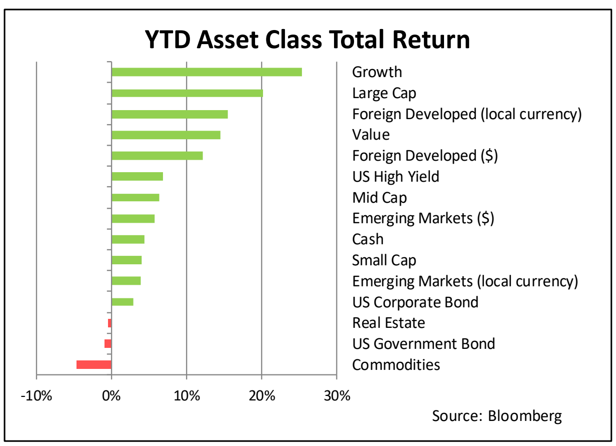




(Source: Bloomberg)

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 11/20/2023 close)

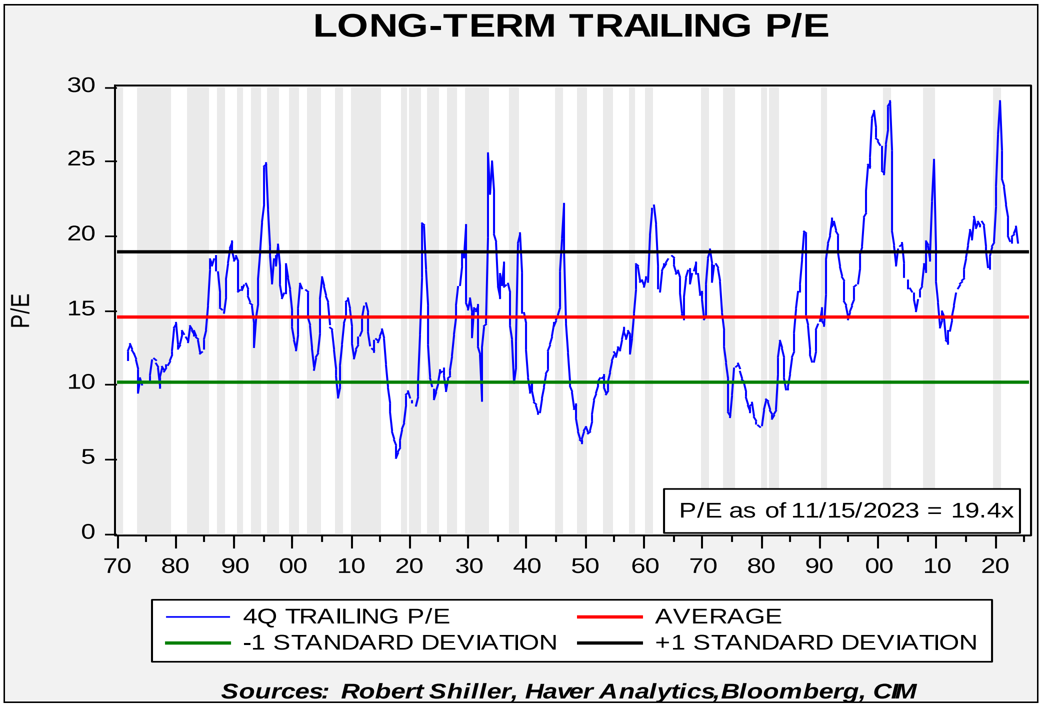


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.

[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.