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 30, 2023—9:30 AM EST] Global equity markets are generally higher this morning. In Europe, the Euro Stoxx 50 is up 0.4% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.2%. Chinese markets were mixed, with the Shanghai Composite up 0.3% from its previous close and the Shenzhen Composite down 0.4%. U.S. equity index futures are signaling a higher open.

With 489 companies having reported so far, S&P 500 earnings for Q3 are running at $58.80 per share compared to estimates of $57.42, which is up 1.7% from Q2 2023. Of the companies that have reported thus far, 81.4% have exceeded expectations while 14.9% have fallen short of expectations.

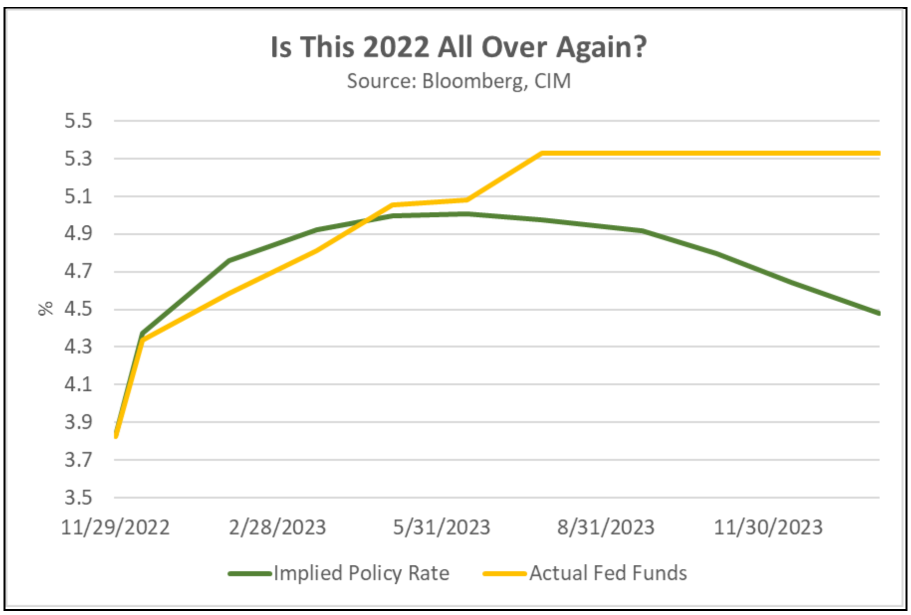
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *Bi-Weekly Geopolitical Report* (11/13/2023) (with associated podcast): "The Archetypes of American Foreign Policy: A Reprise" (Note: the next BWGR will be published on 12/11/2023)
- ***Weekly Energy Update*** **(11/30/2023): We continue to monitor the OPEC+ meeting. COP28 is underway; we expect little content to emerge. Two geopolitical items of note: Russia is struggling to manage an excess of Indian rupees and Venezuela is making threatening moves against Guyana**.
- *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"

Good morning! The day is off to a lively start, with equities surging and Arkansas pulling off an upset victory over Duke. In today's *Comment*, we delve into the reasons behind investor rate expectations that may be amiss, explore the waning influence of the Magnificent Seven, and provide our insights into how the world might respond to a reduced U.S. presence. As always, our comprehensive report encompasses the latest domestic and international data releases.

Investor Deja Vu? Ignoring the lessons of the previous year, investors have eagerly embraced riskier and longer-duration assets in anticipation of a Fed pivot.

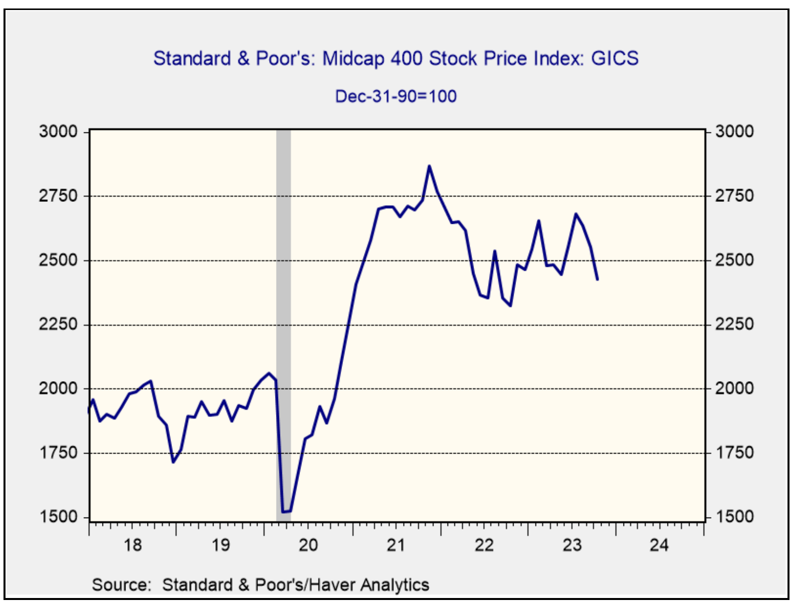
- The fed futures market has signaled investor anticipation for a rate cut in early 2024, with estimates indicating an almost 80% likelihood by May. This optimism stems from recent progress in inflation and Fed commentary, which have bolstered expectations that the current rate-hike cycle is nearing its end. On Wednesday, 2024 voting member and Atlanta Fed President Raphael Bostic stated that price pressures could subside as the economy slows. However, some Fed officials, including Richmond Fed President Thomas Barkin, Fed Governor Michelle Bowman, and Minneapolis Fed President Neel Kashakari, have all advocated the possibility of another rate hike if inflation resurges.
- As 2023 draws to a close, the stock market is displaying a pattern reminiscent of the year's beginning. In 2022, inflation exhibited persistent signs of easing after reaching a peak of 9.1% in June, followed by a 140-basis-point decline four months later. Similarly, investors had been anticipating a potential recession in the first half of 2023. While inflation has continued its downward trend this year, investor optimism proved to be premature. A resilient labor market and improved household balance sheets supported economic growth, giving the Federal Reserve more leeway to raise interest rates further.



- Without a substantial economic downturn, it is prudent to trust the Federal Reserve's commitment to maintaining elevated interest rates for an extended period. The latest Atlanta GDPNow estimate suggests the economy likely expanded at an annualized seasonally adjusted pace of 2.1% in the fourth quarter, indicating that economic momentum remains. Additionally, central bankers have shown a growing interest in incorporating anecdotal evidence into future policy decisions. Although the latest Beige Book indicated signs of economic moderation, policymakers remain vigilant about future price developments, seeking early signs of a potential resurgence in inflation. As a result, government data may have less of an impact on Fed rate decisions going forward.

Down With the Kings? The Magnificent Seven have been the market's top performers in 2023, but their continued dominance into the new year is uncertain.

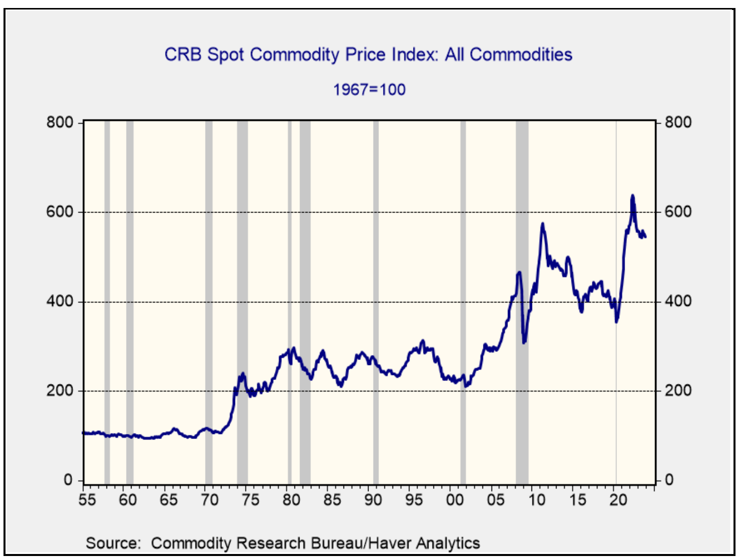
- These titans of the S&P 500, including Apple (AAPL, $189.37), Amazon (AMZN, $146.32), Alphabet (GOOGL, $134.99), Meta (META, $332.20), Microsoft (MSFT, $378.85), Nvidia (NVDA, $481.40), and Tesla (TSLA, $244.14), stand as the dominant forces within the index. Collectively, these behemoths account for nearly 30% of the S&P 500's value, eclipsing their 493 counterparts. While the broader market has gained 19% this year, the Magnificent Seven have surged by an astounding 80%. However, this remarkable growth has been accompanied by a concerning rise in their P/E ratios from 29 to 45, prompting questions about potential overvaluation.
- Maintaining the remarkable performance of the Magnificent Seven in 2023 could be challenging. Their exponential growth was fueled by investor optimism in their ability to capitalize on artificial intelligence advancements that would translate into exceptional future returns, which is offsetting the risk of sacrificing higher-yielding safe-haven assets today. Their ascent has drawn parallels to the Nifty 50s of the 1970s and the dot-com boom of the 1990s, leading to speculation that these companies could face a correction if expectations are not met. The latest earnings reports show that Amazon and Microsoft may still have some momentum, while the remaining companies are seeing less favorable attention.



- As the prospect of higher interest rates diminishes, investors may redirect their focus to stocks that were largely neglected throughout 2023. This sentiment shift is evidenced by the recent performance of the S&P 400, an index that tracks mid-cap companies. Despite starting November down nearly 2% for the year, the index surged by an impressive 7.7% during the month, indicating a renewed interest in these often-overlooked companies. This improved performance can be attributed to a resurgence of bargain hunting among investors seeking opportunities to reenter the market. If favorable conditions persist, this trend could extend into the coming year.

A More Hostile World: With the United States gradually relinquishing its mantle as the world's preeminent superpower, the global community faces the daunting task of navigating a world without a global hegemon.

- The United Nations and NATO have urged Western nations to address the growing influence of fringe powers in Eurasia and the Middle East. The director general of the International Atomic Energy Agency emphasized the need for renewed engagement with Iran to avert its nuclear ambitions. Meanwhile, NATO's secretary-general has cautioned that Russia has amassed a significant stockpile of missiles specifically aimed at disrupting Ukraine's power grid and energy infrastructure during the harsh winter months. India's brazen assassination attempts in foreign nations (see below) also underscore the potential for escalating geopolitical tensions in the absence of a robust global authority.
- The intensifying global conflicts have prompted non-U.S. nations to reevaluate their approaches to addressing these challenges. The European Council president has advocated for the issuance of defense bonds within the economic bloc. This proposed legislation would facilitate the expansion of Europe's defense capabilities. Meanwhile, to counter Iran's nuclear ambitions, UN officials have urged the West to abandon the current Iran nuclear deal and negotiate a new one, considering the situation has deteriorated significantly since the initial agreement in 2015.

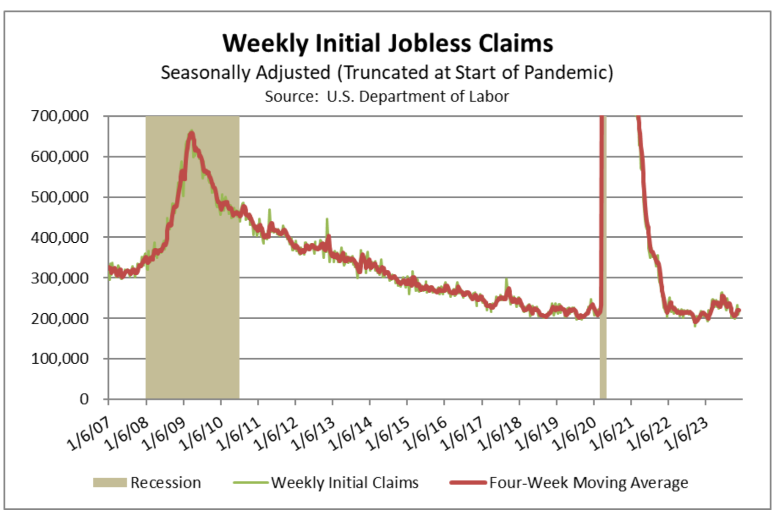


- The world's fracturing into regional blocs is likely to unfold over the next few years. While the U.S. shows no immediate signs of relinquishing its superpower status, political currents are clearly nudging Washington in a different direction. This shift is evident in the growing congressional gridlock over aid packages for Israel and Ukraine. The geopolitical transformation is likely to trigger an upsurge in global military spending, which should bode well for the aerospace and defense industry for the foreseeable future. Furthermore, the burgeoning political uncertainty is poised to render commodities as an attractive haven, since intensifying competition will compel nations to drive up resource prices.

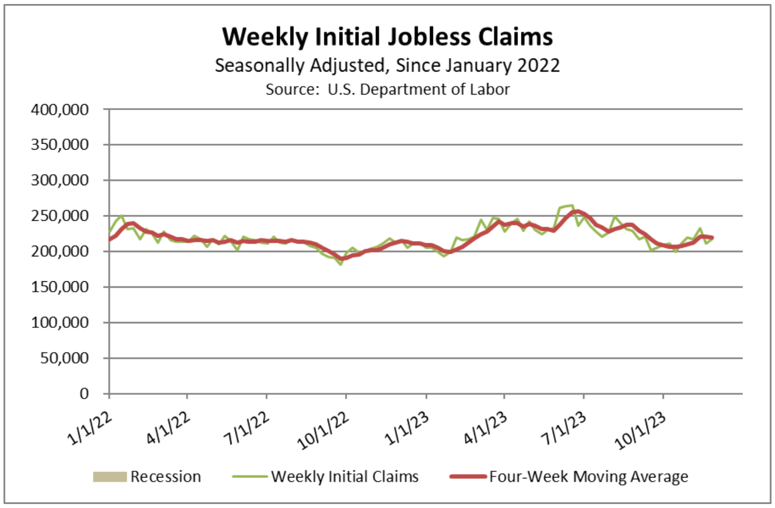
Other news: The U.S. charged an Indian official with plotting to assassinate a Sikh separatist. The incident underscores the challenges the U.S. faces in aligning India with its interests, as India has repeatedly asserted its autonomy as a rising power. Meanwhile, the U.S. and China are poised for a clash of influence in Micronesia, a reflection of their intensifying competition for global influence. On a somber note, political mastermind Henry Kissinger passed away at the age of 100. Renowned as the architect of U.S. foreign policy for decades, his legacy will continue to shape how people view international relations even after his death.

U.S. Economic Releases

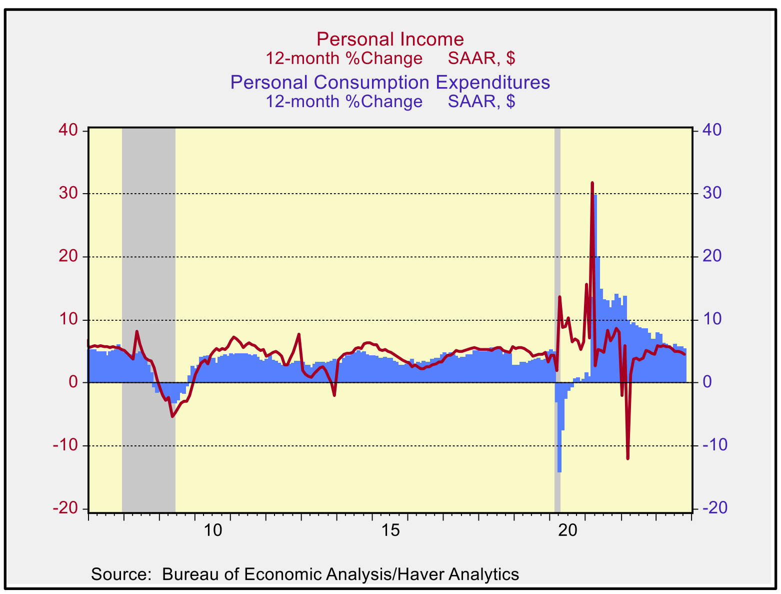
In the week ended November 25, ***initial claims for unemployment benefits*** rose to a seasonally adjusted 218,000, exactly as expected and up from a revised 211,000 in the prior week. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, fell back to just 220,000. Meanwhile, in the week ended November 18, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) jumped to 1.927 million, much higher than both the anticipated level of 1.865 million and the previous week's revised level of 1.841 million. In fact, continuing claims are now at their highest level since November 2021. They're even above the levels prevailing right before the coronavirus pandemic. Continued low initial claims coupled with rising continuing claims suggest that while businesses aren't laying off many people, they have cooled their hiring. 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.



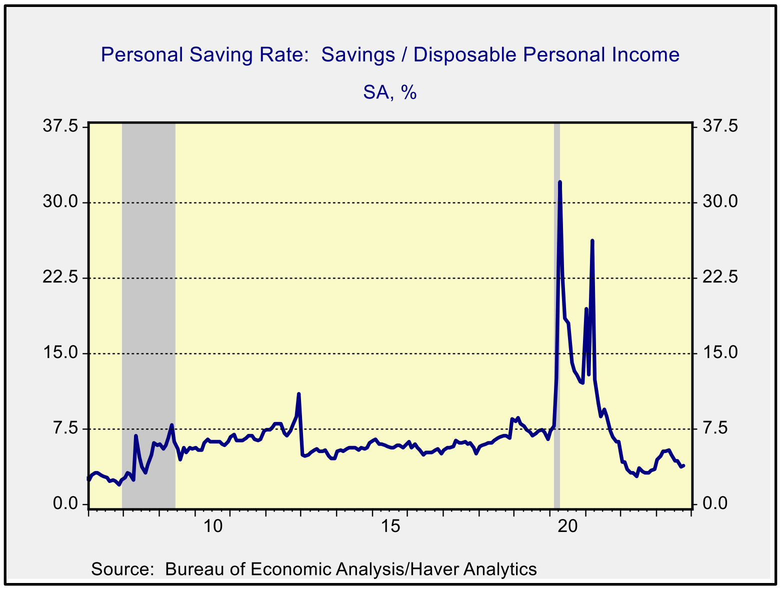
To provide more detail on recent trends, the chart below shows how initial jobless claims have changed just since the beginning of 2022.



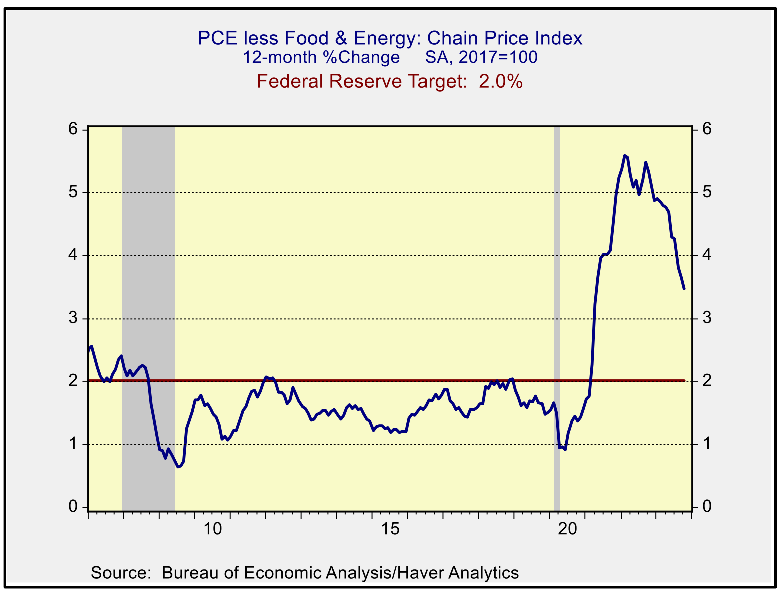
Separately, October ***personal income*** rose by a seasonally adjusted 0.2%, matching expectations but slowing significantly from the revised increase of 0.4% in September. Meanwhile, October ***personal consumption expenditures (PCE)*** rose by 0.2% as well, matching their anticipated rise but slowing more dramatically from their September increase of 0.7%. The chart below shows the year-over-year change in personal income and PCE since just before the Great Financial Crisis.



The personal income and spending report also includes a measure of personal saving, defined as disposable (after tax) income less consumption spending on goods and services. The October ***personal savings rate*** rose to a seasonally adjusted 3.8%. The chart below shows how the personal savings rate has fluctuated since just before the GFC.



Finally, the income and spending report includes the Federal Reserve's preferred measure of consumer price inflation. After stripping out the volatile food and energy components, the October ***Core PCE Deflator*** was up 3.5% from the same month one year earlier, compared with 3.7% in the year to September. The chart below shows the year-over-year change in the Core PCE Deflator 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**
9:45	MNI Chicago PMI	m/m	Nov	46.0	44.0	***
10:00	Pending Home Sales	m/m	Oct	-2.0%	1.1%	**
10:00	Pending Home Sales NSA	y/y	Oct	-8.8%	-13.1%	**
Federal Reserve						
EST	**Speaker or Event**	**District or Position**				
9:15	John Williams Speaks on innovations in Central Banking	President of the Federal Reserve Bank of New York				

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	Retail Sales	y/y	Oct	4.2%	5.8%	6.2%	**	Equity bearish, bond bullish
	Depart. Store & Supermarket Sales	y/y	Oct	3.7%	4.5%		*	Equity bearish, bond bullish
	Industrial Production	y/y	Oct P	0.9%	-4.4%	0.4%	***	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	24-Nov	¥4.2b	¥285.9b	¥286.0b	*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	24-Nov	-¥209.8b	¥120.5b	¥120.7b	*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	24-Nov	-¥84.5b	¥2.5b	¥4.0b	*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	24-Nov	¥864.1b	¥422.6b	¥421.9b	*	Equity and bond neutral
	Housing Starts	y/y	Oct	-6.3%	-6.8%	-7.0%	**	Equity bullish, bond bearish
	Annualized Housing Starts	y/y	Oct	0.808m	0.800m	0.802m	*	Equity and bond neutral
	Consumer Confidence	m/m	Nov	36.1	35.7	35.6	*	Equity bullish, bond bearish
Australia	Private Sector Credit	y/y	Oct	4.8%	4.9%	5.0%	**	Equity and bond neutral
	Private Capital Expenditure	y/y	3Q	0.6%	2.8%	3.4%	**	Equity bearish, bond bullish
	Building Approvals	m/m	Oct	7.5%	-4.6%	-4.0%	***	Equity bullish, bond bearish
	CoreLogic House Prices	y/y	Nov	0.6%	0.9%		*	Equity and bond neutral
New Zealand	Building Permits	m/m	Oct	8.7%	-4.7%	-4.60	**	Equity bullish, bond bearish
	ANZ Activity Outlook	m/m	Nov	26.3	23.1		**	Equity bullish, bond bearish
	ANZ Business Confidence	m/m	Nov	30.8	23.4		**	Equity bullish, bond bearish
	CoreLogic House Prices	y/y	Nov	-4.5%	-5.7%		*	Equity and bond neutral
South Korea	Industrial Production	y/y	Oct	1.1%	3.0%	2.9%	***	Equity bearish, bond bullish
China	Official Manufacturing PMI	m/m	Nov	49.4	49.5	49.8	**	Equity and bond neutral
	Official Services PMI	m/m	Nov	50.2	50.6	50.9	*	Equity and bond neutral
India	GDP	q/q	3Q	7.6	7.8	7.8	**	Equity and bond neutral
EUROPE								
Eurozone	CPI	y/y	Nov	2.4%	2.9%	2.7%	***	Equity and bond neutral
	Core CPI	y/y	Nov P	3.6%	4.2%	3.9%	**	Equity and bond neutral
	Unemployment Rate	m/m	Oct	6.5%	6.5%	6.5%	**	Equity and bond neutral
Germany	Retail Sales	y/y	Oct	-0.1%	-4.6%	-3.9%	*	Equity bullish, bond bearish
Germany	Unemployment Change	m/m	Nov	22.0k	30.0k	31.0k	***	Equity bullish, bond bearish
	Unemployment Claims Rate	m/m	Nov	5.9%	5.8%	5.8%	**	Equity and bond neutral
France	CPI, EU Harmonized	y/y	Nov P	3.8%	4.5%	4.1%	**	Equity and bond neutral
	CPI	y/y	Nov P	3.4%	4.0%	3.7%	***	Equity and bond neutral
	PPI	y/y	Oct	-1.2%	-1.7%	-1.5%	*	Equity and bond neutral
	GDP	y/y	3Q F	0.6%	0.7%	0.7%	**	Equity and bond neutral
Italy	Unemployment Rate	m/m	Oct	7.8%	7.4%	7.6%	**	Equity and bond neutral
	CPI, EU Harmonized	y/y	Nov P	0.7%	1.8%	1.1%	***	Equity and bond neutral
	CPI NIC Including Tobacco	y/y	Nov P	0.8%	1.8%	1.7%	**	Equity bullish, bond bearish
Switzerland	Real Retail Sales	y/y	Oct	-0.1%	-0.6%	-1.2%	**	Equity and bond neutral
	KOF Leading Indicator	m/m	Nov	96.7	95.8	95.1	**	Equity bullish, bond bearish
Russia	Industrial Production YoY	y/y	Oct	5.3	5.6	5.3	***	Equity and bond neutral
	Real Retail Sales	y/y	Oct	12.7%	12.2%	11.7%	***	Equity bullish, bond bearish
	Unemployment Rate	m/m	Oct	2.9%	3.0%	3.1%	***	Equity and bond neutral
	Real Wages	y/y	Sep	7.2%	9.5%	9.0%	*	Equity bearish, bond bullish
AMERICAS								
Canada	Current Account Balance	q/q	3Q	-3.22b	-$6.63b	1.00b	*	Equity and bond neutral
Mexico	Unemployment Rate NSA	m/m	Oct	2.75%	2.88%	2.80%	***	Equity and bond neutral
Brazil	National Unemployment Rate	m/m	Oct	7.6%	7.7%	7.6%	*	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	565	0	Down
3-mo T-bill yield (bps)	524	524	0	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 (%)	4.29	4.26	0.03	Flat
Euribor/OIS spread (bps)	398	396	2	Up
Currencies	**Direction**			
Dollar	Up			Down
Euro	Down			Up
Yen	Down			Down
Pound	Down			Down
Franc	Flat			Up
Central Bank Action	**Current**	**Prior**	**Expected**	
Bank of Korea Base Rate	3.500%	3.500%	3.500%	On 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.

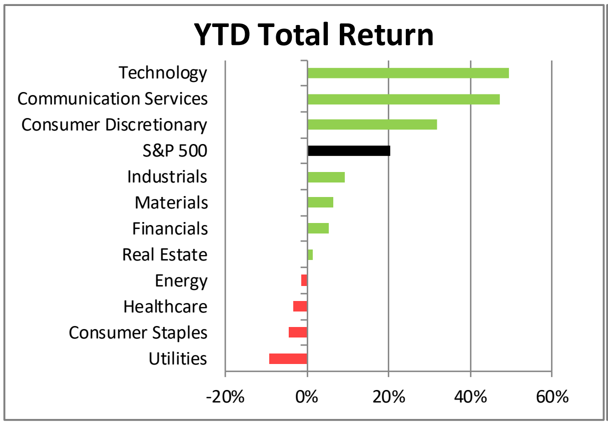
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$84.02	$83.10	1.11%	
WTI	$78.70	$77.86	1.08%	
Natural Gas	$2.84	$2.80	1.32%	
Crack Spread	$24.27	$24.33	-0.27%	
12-mo strip crack	$24.82	$24.84	-0.04%	
Ethanol rack	$1.99	$1.99	-0.04%	
Metals				
Gold	$2,040.13	$2,044.24	-0.20%	
Silver	$25.08	$25.02	0.26%	
Copper contract	$382.20	$382.55	-0.09%	
Grains				
Corn contract	$476.00	$475.75	0.05%	
Wheat contract	$582.50	$585.75	-0.55%	
Soybeans contract	$1,343.75	$1,347.00	-0.24%	
Shipping				
Baltic Dry Freight	2,696	2,391	305	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	1.6	-0.1	1.7	
Gasoline (mb)	1.8	-0.7	2.5	
Distillates (mb)	5.2	-1.3	6.6	
Refinery run rates (%)	2.8%	0.9%	1.9%	
Natural gas (bcf)		-8		

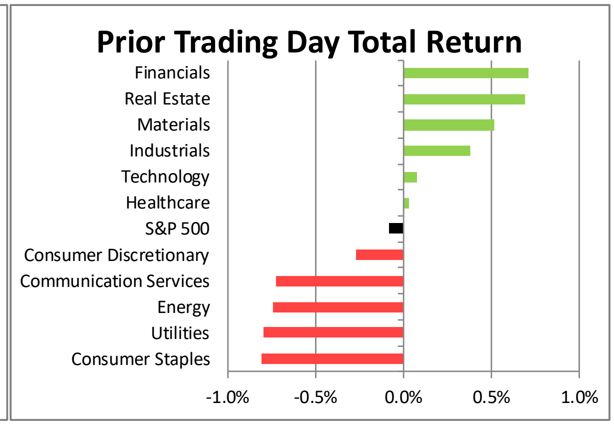
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures in the western two-thirds of the country, with cooler-than-normal temperatures only in South Florida. The forecasts call for wetter-than-normal conditions in the Pacific Northwest, the northern Rocky Mountains, and the northern Great Plains, with dry conditions in the Southwest.

Data Section

U.S. Equity Markets – (as of 11/29/2023 close)

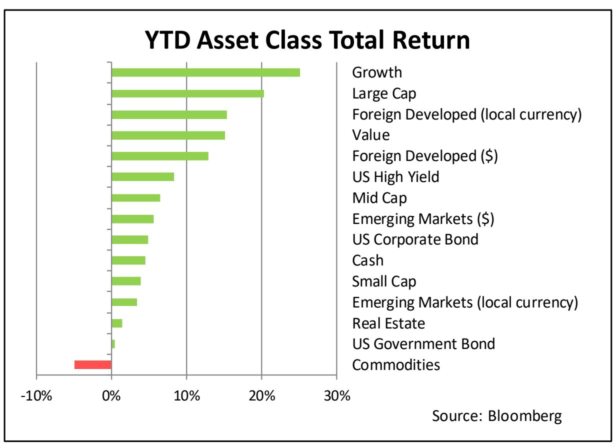




(Source: Bloomberg)

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 11/29/2023 close)

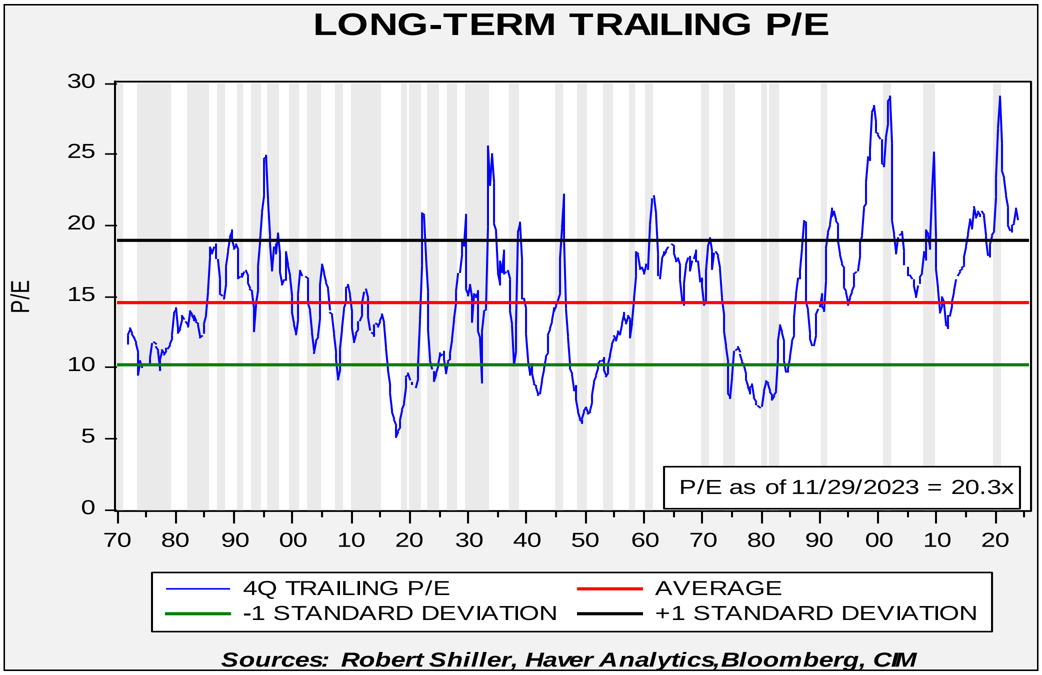


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 30, 2023



Based on our methodology,[1] the current P/E is 20.3x, up 0.9x from our last report. The large increase in the multiple is due mostly to implementing the actual earning number for Q3 from Standard and Poor's compared to the estimate from Bloomberg. This quarter's divergence was unusually large but not unprecedented. Our historical data is from Standard and Poor's; we use the Bloomberg estimated earnings data for the current and subsequent quarters. Overall, the multiple remains elevated.

[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 three actual quarters (Q1, Q2 and Q3) and one estimate (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.