

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: October 7, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is essentially unchanged from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.0%. Chinese markets were higher, with the Shanghai Composite up 8.1% from its previous close and the Shenzhen Composite up 11.0%. Conversely, US equity index futures are signaling a lower open.

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](#) (9/23/2024) (with associated [podcast](#)): “Eight Megatrends Every Investor Should Know”
- [Asset Allocation Bi-Weekly](#) (9/30/2024) (with associated [podcast](#)): “Presidential Cycles and Stock Performance”
- [Asset Allocation Quarterly – Q3 2024](#) (7/16/2024): Discussion of our asset allocation process, Q3 2024 portfolio changes, and our outlook for the markets.
- [Asset Allocation Q3 2024 Rebalance Presentation](#) (8/6/2024): Video presentation featuring the Asset Allocation Committee as they review the asset allocation strategies, recent portfolio changes, and the current macro environment.
- [Confluence of Ideas podcast](#) (9/11/2024) “Reviewing the Asset Allocation Rebalance: Q3 2024”
- [Fixed Income Quarterly](#) (September 2024)

Our *Comment* today, the one-year anniversary of the Hamas attacks on Israel, opens with rumors that Iran may have tested a nuclear weapon as it tries to deter more Israeli attacks on its interests. We next review several other international and US developments with the potential to affect the financial markets today, including a statement by Japan’s new finance minister that suggests financial conditions in that country will remain accommodative and new analysis showing the US federal budget deficit is likely to expand no matter which presidential candidate wins the November election.

Iran: On Saturday night, seismic monitoring stations near the Middle East detected a moderate earthquake in Iran’s Kavir Desert, [raising concerns that Iran may have conducted a nuclear test to retaliate for Israel’s recent attacks on Iranian proxy forces in the region](#). Those concerns were heightened by reports that the seismic signature of the event was more consistent with a nuclear explosion than a natural earthquake. A test explosion would confirm Iran as a nuclear state.

- Although outside observers have long thought Iran could quickly produce a nuclear bomb, few thought the country had an operational one already. If Iran does have an operational bomb that could be delivered to Israel, it would greatly raise the stakes of the ongoing conflicts in the region. An Iranian nuclear test would probably aim to deter Israel from any further attacks.
- Even if the reports are erroneous and Iran hasn't conducted a nuclear test, there is still a heightened risk that Israel will soon attack Iranian oil facilities directly. Israel then might even strike at Iran's nuclear research and development facilities in an effort to keep Iran from making a bomb. Whichever way Iran would respond to such an attack, it would heighten the risk of a wider, more dangerous war in the region.
- In response to these concerns, global oil prices have jumped again so far this morning. Near WTI futures are currently trading up 2.6% to \$76.29 per barrel, while Brent futures are up 2.2% to \$79.79.

China: Provincial and local governments [have reportedly begun demanding that teachers and other rank-and-file school workers hand in their passports](#), preventing them from traveling abroad. It isn't clear to what extent the action has been directed by Beijing, but it appears that the reason for the crackdown is to prevent teachers from being influenced by non-Communist ideas in the West, which they might then pass on to their students.

- We have long noted that the world is fracturing into relatively separate geopolitical and economic blocs, and that key governments around the world are putting up barriers to inter-bloc trade, investment, technology, and information flows.
- To date, there have been relatively fewer new barriers to migration and human travel between the blocs. If China really is pushing to keep its people from visiting countries outside its bloc, it would suggest that global fracturing is now broadening to encompass people flows.

Japan: Newly appointed Finance Minister Katsunobu Katō today [insisted he will focus on stamping out the last vestiges of price deflation in Japan](#). The statement suggests Japanese financial conditions will remain more accommodative than investors originally expected under the new prime minister, Shigeru Ishiba. The prime minister's mixed messages on monetary and fiscal policies have made the yen extremely volatile over the last week, although it has been relatively stable today.

European Union: US private equity investors [have reportedly provided more than 65% of the venture capital flows into European defense technology start-ups so far this year](#). That's consistent with our view that US investors are increasingly attuned to the good prospects for smaller firms with dual-use or defense-related technology. Many of those firms will likely have their initial public offerings of equity in the coming years.

- On a related note, Ukrainian President Zelensky said late last week that his country [can now produce up to 4 million surveillance and attack drones per year, up from virtually](#)

[none when Russia invaded in February 2022](#). In Zelensky’s words, Ukraine has quickly developed a “virtually new defense industry.”

- In another example of how drones are becoming a bigger part of military force, the French navy [has signed a deal to buy underwater drones to conduct surveillance on subsea communications cables, pipelines, and other critical infrastructure](#) that could be attacked by an adversary.
- While we still think that global fracturing and rising geopolitical tensions will lead to higher defense budgets around the world, a key question is how those budgets will be structured. It appears that powerful, game-changing drones can be produced cheaply and in great numbers, so some defense budget funds currently spent on big, expensive assets like aircraft carriers will likely be diverted to drones and other new technologies over time. We think that will create opportunities for smaller defense and technology firms.

Germany: August factory orders [fell by a seasonally adjusted 5.8%](#), nearly three times as much as expected and more than enough to reverse the 3.9% rise in July. Importantly, the data shows that demand for German capital equipment is turning especially weak. That underlines the weak economic momentum in Europe and other key economies around the world outside the US.

US Fiscal Policy: New analysis by the nonpartisan Committee for a Responsible Federal Budget [estimates that former President Trump’s fiscal policies would expand the budget deficit by about \\$7.5 trillion](#) over current projections through 2035, while Vice President Harris’s policies would increase the deficit by about \$3.5 trillion. The difference stems in part from Trump’s desire to extend the 2017 income tax cuts versus Harris’s aim to increase corporate tax rates.

- The CRFB findings are similar to those of a recent study by the Wharton School.
- The studies assume each candidate can get his or her agenda passed. In reality, Congressional politics after the election will have a big impact on what parts of their agendas actually get passed into law. Neither candidate’s full agenda is likely to be passed.
- All the same, the important finding may simply be that the federal deficit is likely to widen no matter which candidate is elected. That means the federal debt is also likely to keep rising, leading to increased risk of a fiscal crisis at some point in the future.

US Energy Industry: The *Wall Street Journal* said over the weekend that several top oil and gas firms [have been meeting with former President Trump’s campaign team](#) to secure a commitment not to gut key elements of President Biden’s Inflation Reduction Act if Trump is elected again. The energy firms are reportedly worried that Trump would side with conservative lawmakers who want to end the law’s lucrative tax credits for their investments in renewable fuel, carbon capture, and hydrogen.

- Conservative Republicans in Congress have argued that President Biden’s policies have hamstrung the domestic energy industry, even though domestic oil output is now at or near a record high. To the extent that energy firms have become more restrained in their

investment spending, it appears that it is largely because investors are demanding capital discipline and more attention on cash flow.

- Obviously, it's still unclear who will control the White House and Congress after the November elections. Nevertheless, the oil and gas firms' early lobbying to protect their future-fuel investments suggests the environment for the green energy industry may not change as much as popularly assumed if Trump wins.

US Robotics Industry: New reports [say US manufacturers have greatly slowed their purchases of industrial robots over the last year](#). The slowdown apparently stems from the manufacturers' moderating production growth, improved labor supply, higher interest rates, and a realization that robots can require a lot of maintenance and programming skill. However, the report says robot purchases by aerospace and defense firms are still rising briskly.

US Economic Releases

There were no economic releases prior to the publication of this report. The following table lists the economic releases or Fed events scheduled for the rest of the day.

Economic Releases						
ET	Indicator			Expected	Prior	Rating
15:00	Consumer Credit	m/m	Aug	\$12.000b	\$25.452b	*
14:00	Monthly Budget Statement	m/m	Sep	\$4.3b	-\$380.1b	**
Federal Reserve						
ET	Speaker or Event	District or Position				
13:00	Michelle Bowman Speaks at Independent Bankers Assoc of Texas	Member of the Board of Governors				
13:50	Neel Kashkari Participates in Q&A	President of the Federal Reserve Bank of Minneapolis				
18:00	Raphael Bostic Moderates Conversation with Steve Koonin	President of the Federal Reserve Bank of Atlanta				
18:30	Alberto Musalem Speaks on Economy, Policy	President of the Federal Reserve Bank of St. Louis				

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	Coincident Index	y/y	Aug P	113.5	117.2	113.6	**	Equity and bond neutral
	Leading Economic Index	m/m	Aug P	106.7	109.3	106.9	**	Equity and bond neutral
Australia	Melbourne Institute Inflation	y/y	Sep	2.6%	2.5%		***	Equity and bond neutral
South Korea	Foreign Reserves	m/m	Sep	\$419.97b	\$415.92b		**	Equity and bond neutral
China	Foreign Reserves	m/m	Mar	\$3316.37b	\$3288.22b	\$3308.10b	***	Equity and bond neutral
EUROPE								
Eurozone	Retail Sales	y/y	Aug	0.8%	-0.1%	1.0%	*	Equity and bond neutral
Germany	Factory Orders WDA	y/y	Aug	-3.9%	4.6%	-1.6%	***	Equity bearish, bond bullish
Switzerland	Foreign Currency Reserves	m/m	Sep	715.6b	693.9b		*	Equity and bond neutral
	Domestic Sight Deposits CHF	w/w	4-Oct	460.3b	463.6b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	4-Oct	471.4b	472.2b		*	Equity and bond neutral
AMERICAS								
Brazil	FGV Inflation IGP-DI	y/y	Sep	1.03%	0.12%	0.85%	**	Equity and bond neutral

Financial Markets

The table below highlights some of the indicators that we follow daily. 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)	485	485	0	Down
3-mo T-bill yield (bps)	451	451	0	Down
U.S. Sibor/OIS spread (bps)	468	465	3	Down
U.S. Libor/OIS spread (bps)	464	462	2	Down
10-yr T-note (%)	4.00	3.97	0.03	Up
Euribor/OIS spread (bps)	325	324	1	Down
Currencies	Direction			
Dollar	Down			Down
Euro	Flat			Up
Yen	Up			Up
Pound	Up			Up
Franc	Up			Up

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	\$79.79	\$78.05	2.23%	
WTI	\$76.30	\$74.38	2.58%	
Natural Gas	\$2.81	\$2.85	-1.40%	
12-mo strip crack	\$20.63	\$20.79	-0.79%	
Ethanol rack	\$1.75	\$1.75	-0.34%	
Metals				
Gold	\$2,659.04	\$2,653.60	0.21%	
Silver	\$32.00	\$32.20	-0.61%	
Copper contract	\$457.55	\$457.40	0.03%	
Grains				
Corn contract	\$423.25	\$424.75	-0.35%	
Wheat contract	\$589.00	\$589.75	-0.13%	
Soybeans contract	\$1,031.00	\$1,037.75	-0.65%	
Shipping				
Baltic Dry Freight	1,928	1,941	-13	

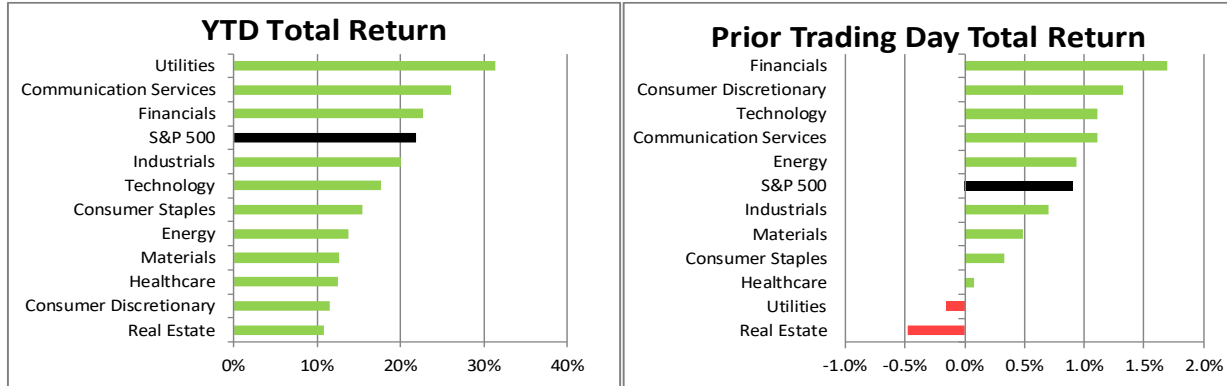
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures throughout most of the country, with near normal temperatures in New England. The precipitation outlooks show drier-than-normal conditions for most of the country with wet conditions in Washington state and Florida.

There are three tropical disturbances in the Atlantic Ocean. Hurricane Milton is moving through the Gulf and is expected to make landfall in Florida around mid-week. Hurricanes Kirk and Leslie are both located in the central Atlantic but neither are expected to make landfall.

Data Section

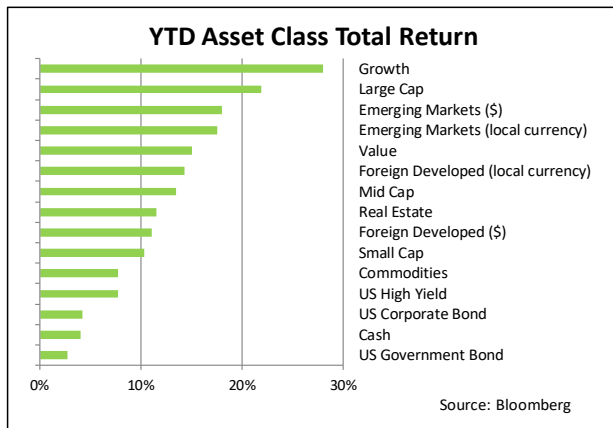
US Equity Markets – (as of 10/4/2024 close)



(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 10/4/2024 close)

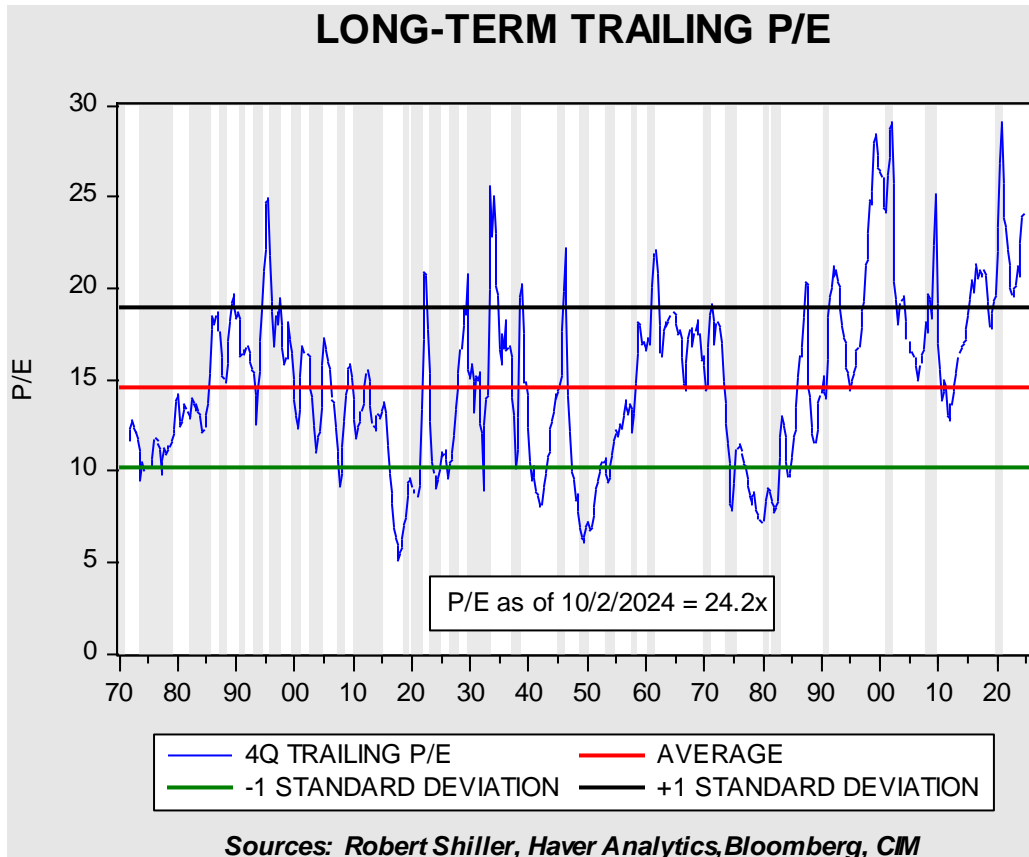


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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), US Corporate Bond (iShares iBoxx \$ Investment Grade Corporate Bond ETF), US Government Bond (iShares 7-10 Year Treasury Bond ETF), US 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

October 3, 2024



Based on our methodology,¹ the current P/E is 24.2x, up 0.1 from our last report. The stock price index increased due to a transition to a new quarter, while earnings were little changed from the previous week.

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 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.