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: September 20, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is down 0.7% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.9%. Chinese markets were mixed, with the Shanghai Composite relatively unchanged from its previous close and the Shenzhen Composite down 0.2%. 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:

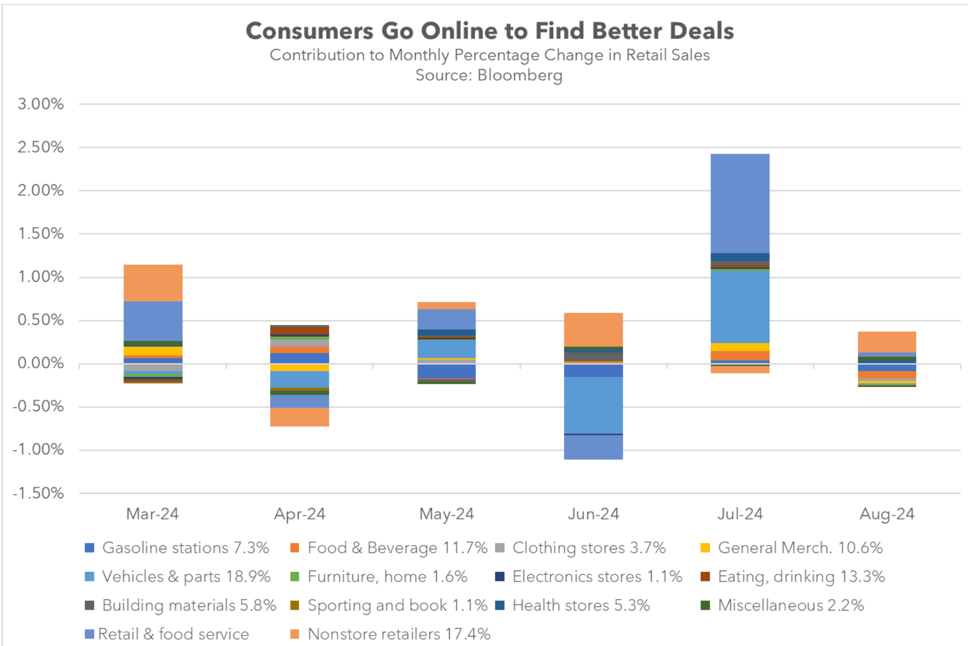
- *Bi-Weekly Geopolitical Report* (9/9/2024) (with associated podcast): "Prospects for the Dollar in a Fracturing World"
- *Asset Allocation Bi-Weekly* (9/16/2024) (with associated podcast): "The Benjamin Button Dividend"
- *Asset Allocation Quarterly – Q3 2024* (7/16/2024): Discussion of our asset allocation 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"

Good morning! Today's market is still grappling with the implications of the recent rate decision. In sports news, Tina Charles etched her name in WNBA history, setting new records for career rebounds and double-doubles. Today's *Comment* examines the market's guarded optimism amidst the recent milestone of the S&P 500, the EU's tightening regulations on US tech, and the implications of Japan's monetary policy. As always, the report will include a comprehensive overview of domestic and international economic data releases.

S&P 500 Hits Highs: Equities continue to march forward as investors believe that a soft landing is possible.

- The S&P 500 reached an all-time high by surpassing 5700 on Thursday, marking its 39th record of the year. The market's buoyant sentiment was fueled by optimism that the Federal Reserve might have pivoted in time to avert a recession. Thursday's decline in weekly jobless claims signaled continued reluctance among firms to lay off workers and showed a strong labor market. Meanwhile, the Atlanta GDPNow forecast model's positive outlook also adds to the market's optimism. Consequently, nearly every sector experienced gains, with technology stocks leading the way.

- However, beneath the surface, recessionary concerns linger. Despite recent mortgage rate decreases, existing home sales plummeted to a post-pandemic low in August. Moreover, FedEx, seen as an economic bellwether, missed profit targets and issued a warning of potential business slowdown in the coming quarters. The company attributed this to waning consumer demand for expedited shipping, further signaling rising price sensitivity within households. This sentiment was echoed in retail sales data released by the Commerce Department, indicating a growing number of online deal-seekers.



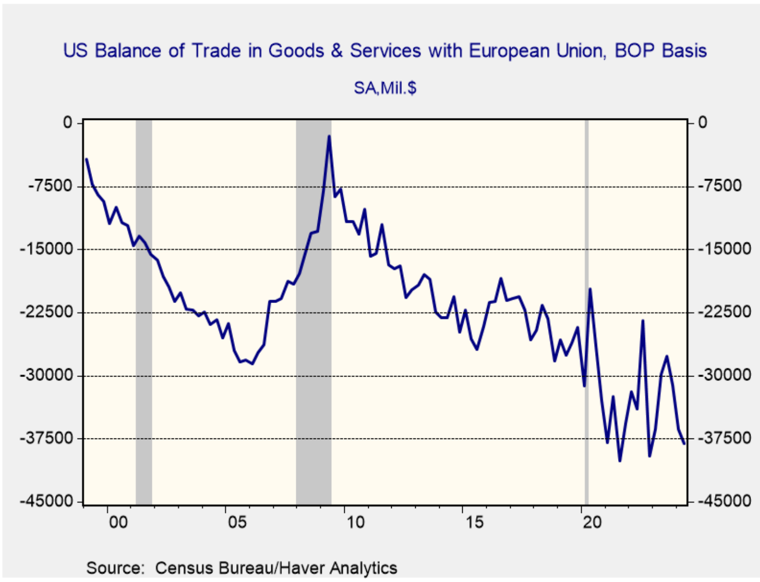
- The Fed's recent shift in focus toward maximum employment over price stability will be tested next week by the PCE price index report. Recent data suggests that core inflation has made significant progress toward the Fed's target, easing concerns about inflation risks. If core inflation rises modestly in August as expected, investors may become more confident in the Fed's ability to achieve a soft landing. Fed speeches over the next week should also help guide market expectations as officials look to make their case that the central bank is not worried about recession.

The EU's Digital Hurdle: The bloc has initiated a crackdown on foreign tech firms to bolster its regional presence in the industry.

- The EU has intensified its scrutiny of US tech giants under the Digital Markets Act. On Thursday, regulators cautioned Apple that it must allow competing tech firms access to its iPhone and iPad operating systems or face substantial fines. This warning reflects the EU's broader effort to dismantle the dominance of foreign tech companies within the European technology market. Earlier this week, Google successfully appealed a $1.7

billion fine levied against its advertising business but agreed to divest this section of its company in order to resolve the ongoing antitrust probe.

- The EU's escalating regulatory oversight of US companies signals a strategic pivot towards bolstering domestic industrial capabilities. As geopolitical tensions rise, the region is positioning itself for a more self-reliant future. A recent EU Commission study emphasized the imperative of developing a robust domestic technological infrastructure to mitigate risks associated with over-reliance on potential trade rivals, including China and the US. This shift is reflected in the region's increased investment in military technology, which will rise from 142 million EUR ($158 million) to 1 billion EUR ($1.1 billion) a year over the next few years.

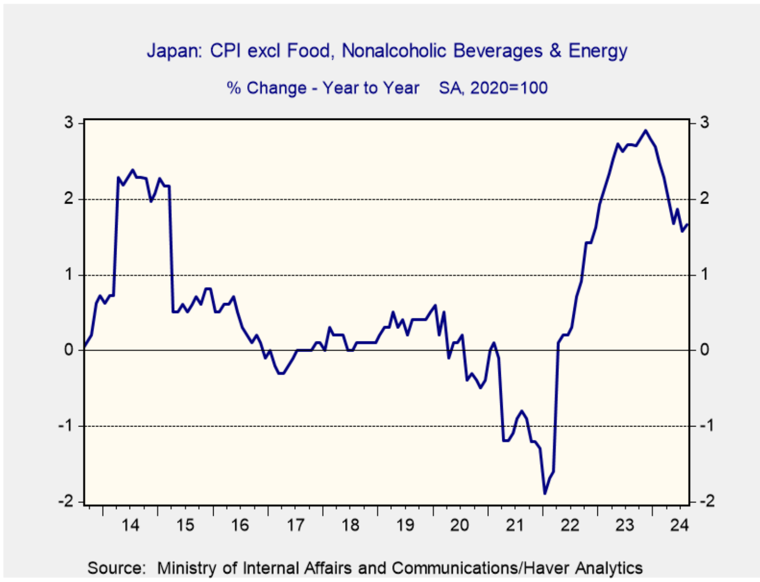


- A more assertive EU is expected to maintain its alliance with the US, driven by strong ties and shared interests. However, amid rising geopolitical tensions, EU governments are likely to prioritize industrial policies that bolster domestic firms. This strategic shift could lead to increased investment and higher debt levels for EU countries, but the long-term benefits may include greater corporate competitiveness. Meanwhile, US firms may need to adapt their business models to focus more on domestic markets, as access to foreign markets could become more challenging.

Bank of Japan Holds: The BOJ opted to maintain a patient stance on monetary tightening, awaiting the potential inflationary effects of the yen's (JPY) recent appreciation.

- On Friday, the central bank announced it would keep interest rates unchanged, signaling that further hikes are unlikely in the near term. During a press conference, BOJ Governor Kazuo Ueda stated that the bank would consider raising rates if inflation and economic conditions remain on their current path. He expressed optimism that the recent appreciation of the yen has provided more flexibility for policy decisions. Ueda also cited uncertainty around a potential US soft landing as a key factor in the rate decision.

- While inflation has been steadily rising, there are indications that underlying price pressures remain relatively contained. Although the central bank's headline inflation rate reached 2.8% in August, a substantial increase from the year's beginning, core inflation, excluding volatile food and energy components, remains below the target of 2%. This reinforces the central bank's stance that it can delay interest rate hikes, given that the recent currency appreciation is expected to place downward pressure on import prices. Japan's heavy reliance on imports for energy and food makes this particularly beneficial.



- The Federal Reserve's perceived delayed response to labor market pressures may have influenced the BOJ's decision to maintain a patient stance. Last month's market selloff was triggered by the BOJ's unexpected rate hike and the Sahm Rule activation. The event highlighted the financial markets' vulnerability to abrupt currency fluctuations, particularly in the context of yen carry trade unwinding. The BOJ's cautious approach may ultimately enhance financial stability, particularly if inflationary risks remain contained in both countries.

In Other News: The Biden administration admitted that it no longer believes it will be able to negotiate a peace agreement between Israel and Hamas, which may lead to the possibility of escalating tensions in the Middle East. A bipartisan group of lawmakers bypassed House Majority Leader Mike Johnson to force a vote on a bill to expand Social Security access, in a strong sign that his party is losing faith in him. Brazil fined X for defying a platform ban, demonstrating the escalating rift between the two sides.

US Economic Releases

No major US economic reports have been released so far today. The following table lists the economic releases or Fed events scheduled for the rest of the day.

Economic Releases		
No economic releases for the rest of today		
Federal Reserve		
ET	**Speaker or Event**	**District or Position**
14:00	Patrick Harker Gives Lecture at Tulane	President of the Federal Reserve Bank of Philadelphia

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	National CPI	y/y	Aug	3.0%	2.8%	3.0%	***	Equity and bond neutral
	National CPI Ex-Fresh Food	y/y	Aug	2.8%	2.7%	2.8%	**	Equity and bond neutral
	National CPI Ex-Fresh Food & Energy	y/y	Aug	2.0%	1.9%	2.0%	*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	13-Sep	¥2100.1b	-¥216.5b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	13-Sep	-¥87.2b	¥490.9b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	13-Sep	¥1383.9b	¥451.2b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	13-Sep	-¥3005.8b	-¥902.3b		*	Equity and bond neutral
EUROPE								
Germany	PPI	y/y	Aug	-0.8%	-0.8%	-1.0%	**	Equity and bond neutral
France	Business Confidence	m/m	Sep	98	97	98	**	Equity and bond neutral
	Manufacturing Confidence	m/m	Sep	99	99	99	*	Equity and bond neutral
UK	Retail Sales	y/y	Aug	2.5%	1.5%	1.3%	***	Equity bullish, bond bearish
	Retail Sales Ex-Auto Fuel	y/y	Aug	2.3%	1.4%	1.1%	**	Equity bullish, bond bearish
	Public Finances (PSNCR)	m/m	Aug	4.9b	16.9b		*	Equity and bond neutral
	Public Sector Net Borrowing	m/m	Aug	13.7b	3.1b	12.2b	*	Equity and bond neutral
	PSNB ex Banking Groups	m/m	Aug	13.7b	3.1b	12.6b	**	Equity and bond neutral
UK	GfK Consumer Confidence	m/m	Sep	-20	-13	-13	***	Equity bearish, bond bullish
Russia	Gold and Forex Reserves	m/m	13-Sep	$617.0b	$616.0b		***	Equity and bond neutral
	Money Supply, Narrow Definition	w/w	13-Sep	18.37t	18.33t		*	Equity and bond neutral
AMERICAS								
Brazil	Tax Collections	m/m	Aug	201622m	231044m	203500m	*	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)	508	508	0	Down
3-mo T-bill yield (bps)	459	460	-1	Down
U.S. Sibor/OIS spread (bps)	468	469	-1	Down
U.S. Libor/OIS spread (bps)	465	466	-1	Down
10-yr T-note (%)	3.73	3.72	0.01	Up
Euribor/OIS spread (bps)	346	346	0	Down
Currencies	**Direction**			
Dollar	Up			Down
Euro	Flat			Up
Yen	Down			Up
Pound	Up			Up
Franc	Down			Up
Central Bank Action	**Current**	**Prior**	**Expected**	
BOJ Target Rate	0.250%	0.250%	0.250%	On Forecast
PBOC 1-Year Loan Prime Rate	3.350%	3.350%	3.350%	On Forecast
PBOC 5-Year Loan Prime Rate	3.850%	3.850%	3.850%	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	$74.55	$74.88	-0.44%	
WTI	$71.72	$71.95	-0.32%	
Natural Gas	$2.34	$2.35	-0.51%	
12-mo strip crack	$19.26	$19.28	-0.13%	
Ethanol rack	$1.81	$1.83	-0.75%	
Metals				
Gold	$2,614.03	$2,586.74	1.05%	
Silver	$31.29	$30.79	1.64%	
Copper contract	$435.30	$434.70	0.14%	
Grains				
Corn contract	$405.50	$405.75	-0.06%	
Wheat contract	$571.00	$565.50	0.97%	
Soybeans contract	$1,015.25	$1,013.25	0.20%	
Shipping				
Baltic Dry Freight	1,976	1,890	86	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-1.63	-0.10	-1.53	
Gasoline (mb)	0.07	1.00	-0.93	
Distillates (mb)	0.13	1.00	-0.88	
Refinery run rates (%)	-0.7%	-1.1%	0.4%	
Natural gas (bcf)	58	53	5	

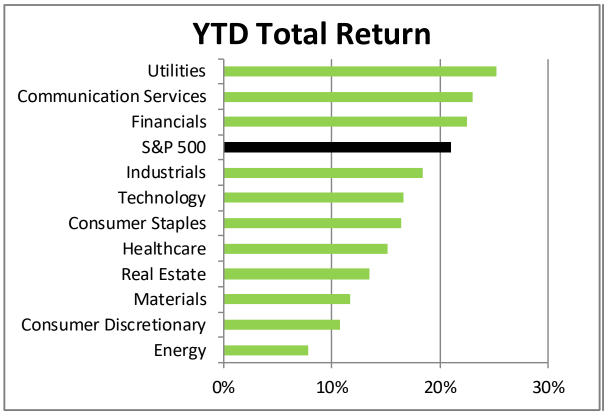
Weather

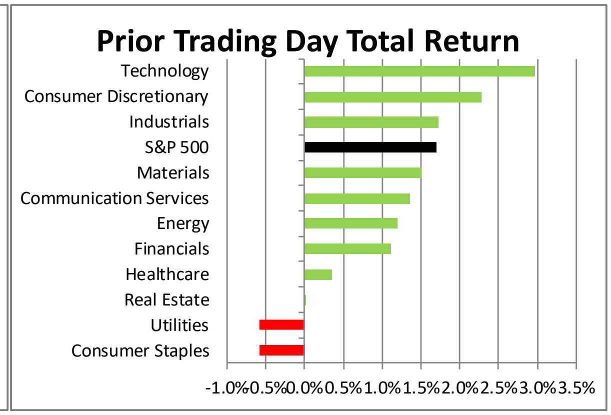
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures across the entire country; not a single area is expected to have normal or cooler-than-normal temperatures. The forecasts call for wetter-than-normal conditions from the Mississippi River eastward, with dry conditions in the Far West and Great Plains.

There are now two atmospheric disturbances in the central Atlantic Ocean, but both are assessed to have only a 20% chance of cyclonic formation within the next 48 hours.

Data Section

US Equity Markets – (as of 9/19/2024 close)

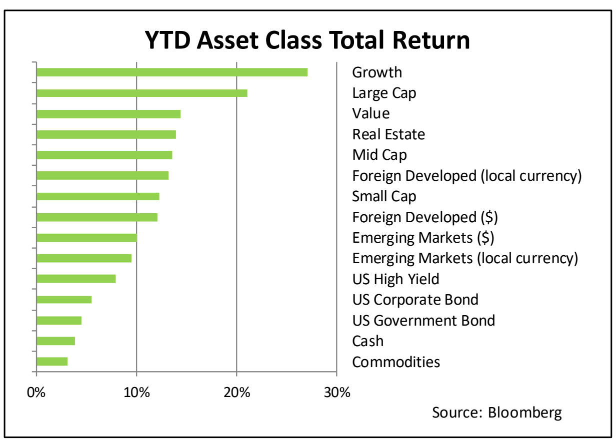




(Source: Bloomberg)

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 9/19/2024 close)

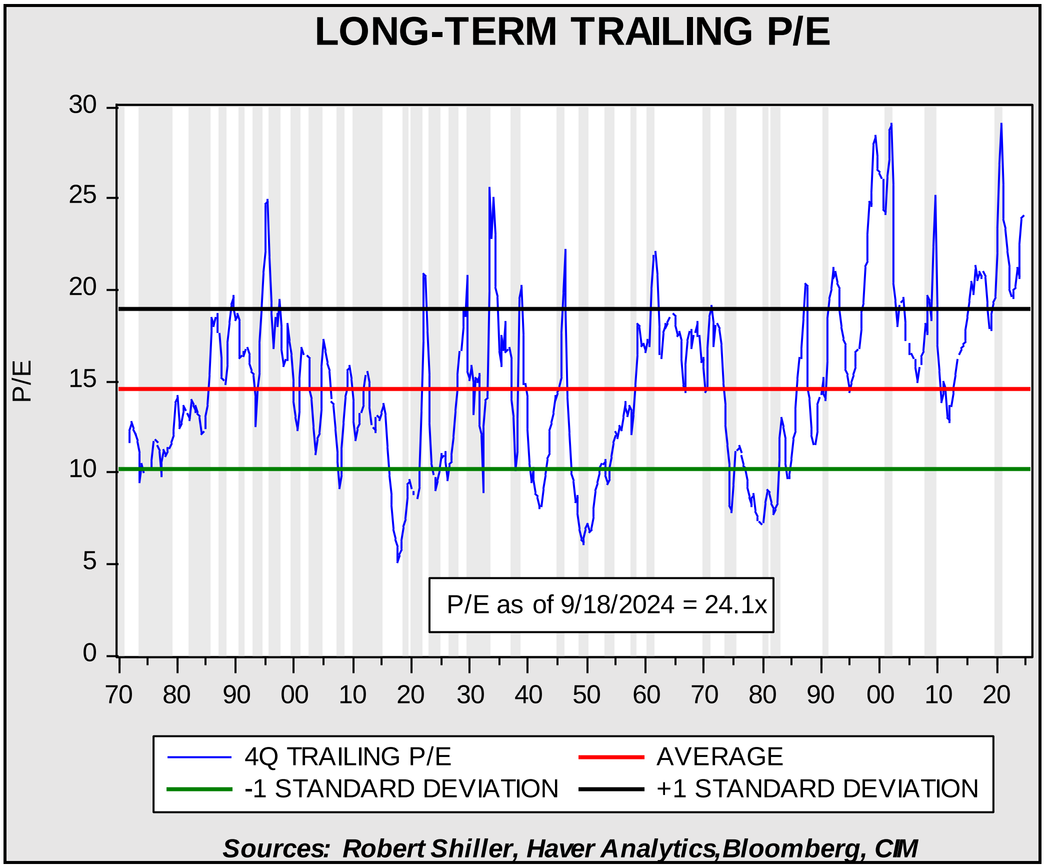


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

September 19, 2024



Based on our methodology,[1] the current P/E is 24.1x, unchanged from our last report. Both the stock price index and 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.

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