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: August 14, 2024 — 9:30 AM ET] Global equity markets are mixed 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 0.7%. Chinese markets were lower, with the Shanghai Composite down 0.6% from its previous close and the Shenzhen Composite down 0.9%. US equity index futures are signaling a higher open.

With 456 companies having reported so far, S&P 500 earnings for Q2 are running at $61.30 per share, compared to estimates of $58.94, which is up 8.0% from Q2 2023. Of the companies that have reported thus far, 79.8% have exceeded expectations while 15.6% have fallen short of expectations.

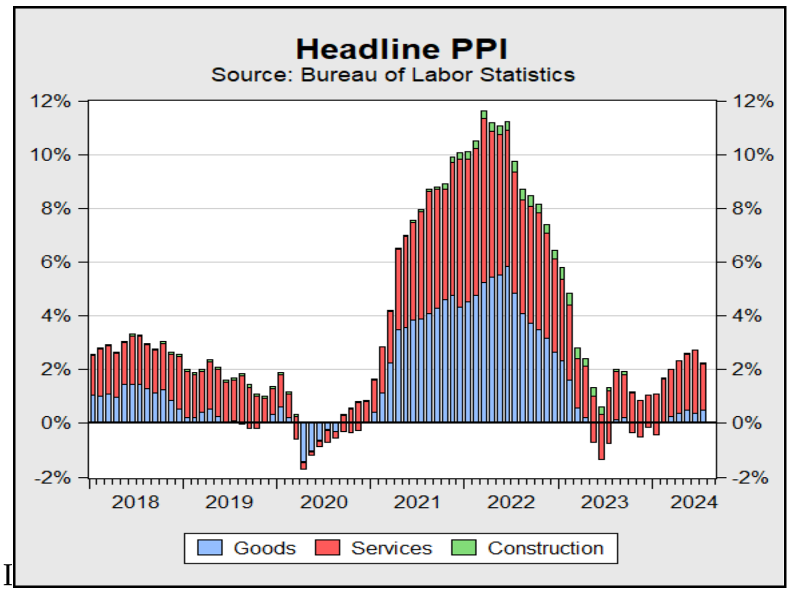
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *Bi-Weekly Geopolitical Report* (8/5/2024) (no accompanying podcast for this report): "The US Geopolitical and Economic Bloc as an Investment Region"
- *Asset Allocation Bi-Weekly* (8/12/2024) (no accompanying podcast for this report): "Is the Sahm Rule Right?"
- *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.

Good morning! S&P 500 futures are trading sideways as investors process the latest CPI figures. In sports news, the St. Louis Blues made a significant move by submitting offer sheets to Edmonton Oilers' prospects Broberg and Holloway. Today's *Comment* will discuss why the Fed may be hesitant to cut rates despite market expectations, why we remain skeptical of chip companies, and why the latest developments in the war in Ukraine could lead to a broader conflict. As always, we'll conclude with a roundup of key economic indicators.

Market is Moving Too Fast: Fed officials continue to push back against market expectations of imminent rate cuts, even as price pressures show signs of easing.

- While market anxieties center on a potential recession, Federal Reserve officials remain steadfast in their focus on taming inflation. [Atlanta Fed President Raphael Bostic offered a tempered view of the recent surge in the unemployment rate] on Tuesday, suggesting that an influx of new workers, rather than a weakening labor market, accounted for much of the increase. Despite acknowledging progress in the fight against inflation, Bostic indicated a desire for more concrete evidence of its sustained decline before considering a policy shift. Nevertheless, he maintained his stance on favoring a rate cut later this year.
- The [ease in supplier inflation has likely boosted sentiment]. The July PPI report released on Tuesday indicated a deceleration in price pressures. Trade services, which measure the margin charged by wholesalers, were the biggest drag on the index, suggesting firms are losing pricing power. Notably, the components that feed into the Fed's preferred inflation gauge (the PCE price index), such as financial services, airline fares, and healthcare, were all relatively tame. This positive data encouraged bond investors, leading to a rally in 10-year Treasury bonds and a pick-up in equities prices.



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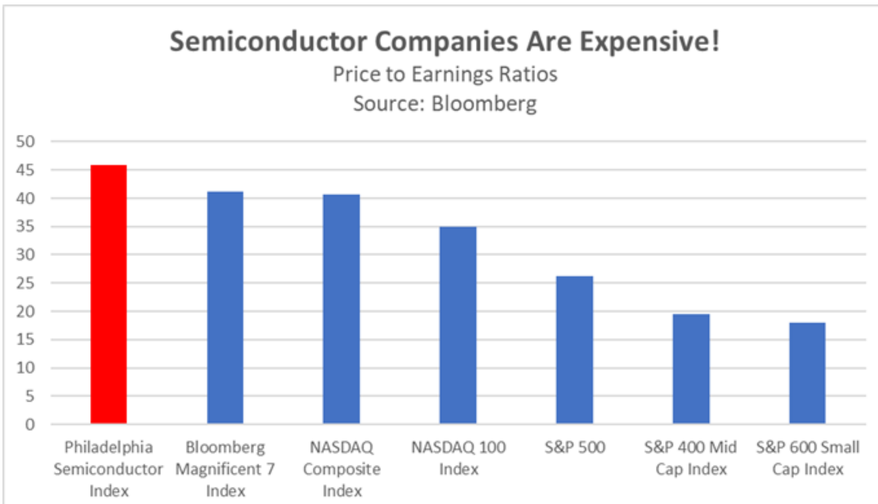
- The [CME FedWatch Tool projects a 70% probability of at least a 100 basis-point] decline in the fed funds rate, but that seems overly optimistic. The robust economy, as indicated by the Atlanta Fed's GDPNow forecast of 2.9% growth this quarter, suggests that the economy is still resilient. Moreover, the Fed will likely seek confirmation of sustained inflation stability over the next two months before committing to more than one rate cut. Consequently, we anticipate a 25-bps rate reduction in September, with the potential for additional cuts contingent upon supportive economic data.

Chipmakers Bounce: A benchmark for semiconductor companies rallied on Tuesday, but skepticism remains about the sustainability of this momentum.

- The PHLX Semiconductor Sector Index surged 4.15% on Tuesday, significantly outperforming both the S&P 500 and the Bloomberg Magnificent 7 Index. Nvidia led the rally after announcing [a less severe delay for its Blackwell B200 AI processor].

Additionally, Intel contributed to the gains following its announcement of a restructuring plan to bolster its competitiveness. While other chipmakers benefited from improved investor sentiment fueled by positive inflation data, concerns about the industry's long-term outlook remain prevalent.

- The semiconductor sector is likely to encounter significant headwinds in the coming months. The index, comprising roughly 30 companies, has heavily relied on Nvidia's performance, which has surged nearly 141% year-to-date and disproportionately contributes to the sector's earnings. Nvidia's upcoming report is expected to face intense scrutiny after many peers failed to meet investor expectations for future sales. While Nvidia's biggest clients have plowed ahead with investments in AI capabilities, they also face investor pressure to deliver profits, which could impact the demand for chips.

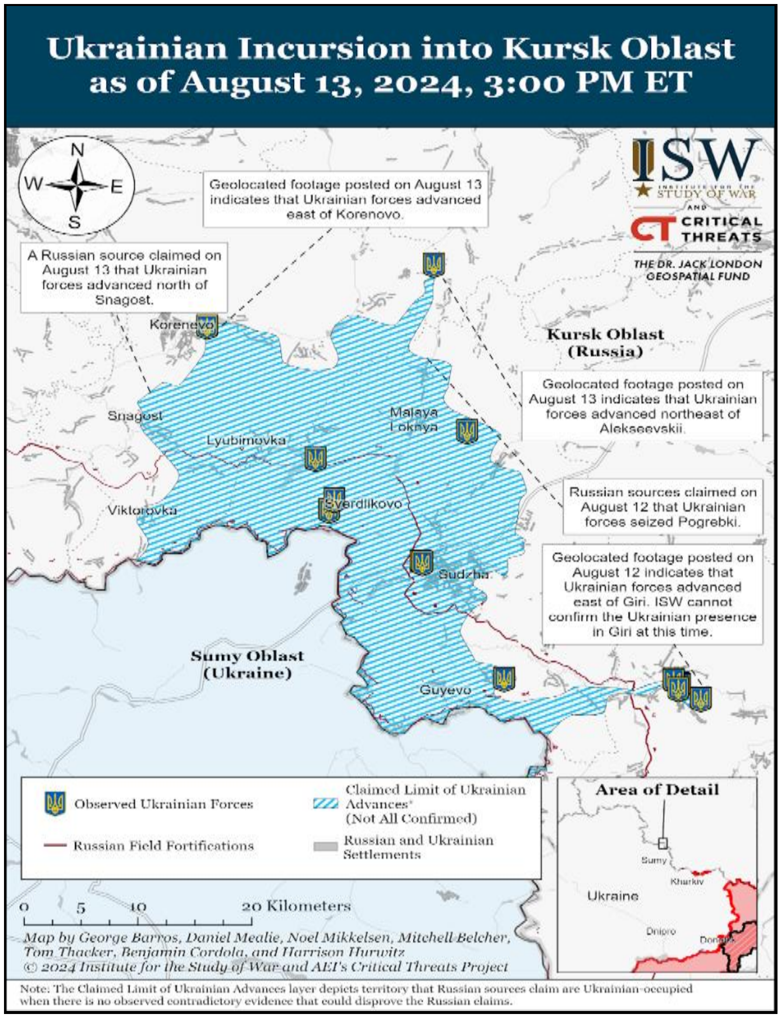


- Despite the recent rally in tech stocks, we maintain a cautious outlook due to overvaluation concerns. Many of the sector's leading companies have already priced in substantial growth over the next several years, limiting potential upside. Furthermore, the sector's heavy reliance on Nvidia's performance poses risks, as the company's ability to consistently deliver earnings surprises is unlikely to persist. We believe smaller companies with solid fundamentals offer more attractive growth prospects, particularly if the Fed successfully engineers a soft landing.

Ukraine Gambit: Kyiv's decision to move into Russian territory may have won it early gains, but it is also likely to ramp up the risks of a broader war in Europe.

- A week-long Ukrainian offensive into Kursk province has compelled Russia to redirect some troops from Ukraine to bolster its own defenses. While the scale of the troop withdrawal remains unclear, this strategic adjustment signals a significant re-evaluation of Moscow's military campaign. Ukrainian forces have, thus far, seized approximately 390 miles, an area comparable to San Antonio, Texas. Moscow has struggled to give an adequate response to the incursion and is now considering broadening out its campaign.
- Ukraine's invasion of Russia was a high-stakes gamble with an uncertain outcome. Despite initial territorial gains, holding these positions will prove difficult as Russia

mobilizes a larger force through renewed conscription. Ukraine may have calculated that seizing Russian territory would strengthen its bargaining position in potential peace negotiations. However, Russia has rescinded its original peace proposal, which demanded a ceasefire in exchange for retaining occupied Ukrainian territory and permanently blocking Ukraine's NATO membership.



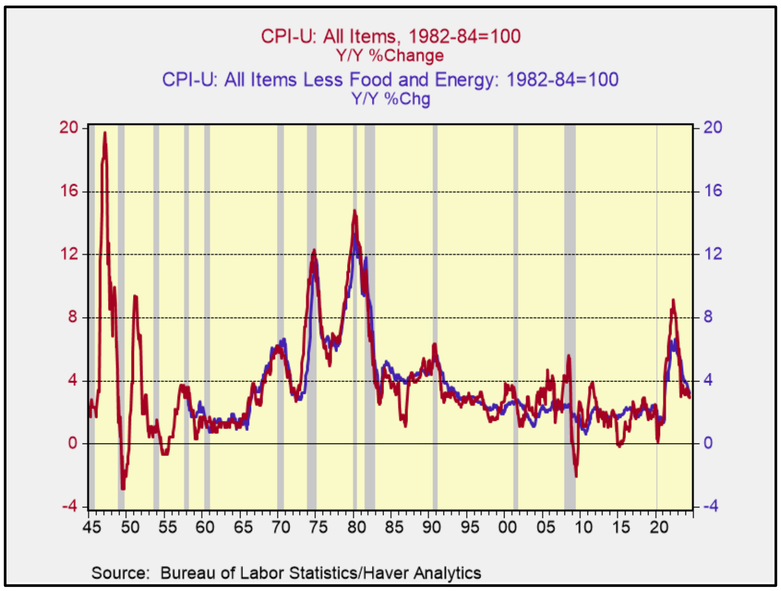
(Source: ISW)

- The incursion could heighten the risk of miscalculation, particularly from Russia. Since the conflict began, Moscow has repeatedly alluded to the potential use of strategic nuclear weapons. Moreover, there has been speculation about a possible Russian attack on Poland. While the consequences of employing tactical nuclear weapons remain uncertain, an attack on a NATO member state could directly involve the United States. Although a broader European conflict remains unlikely, the risk has escalated significantly in recent weeks.

In Other News: Japan's Prime Minister Fumio Kishida is expected to step down next month in a move that would usher in new leadership and potentially delay parts of his pro-growth agenda. Meanwhile, US President Joe Biden has expressed confidence that Iran will refrain from aggression if a ceasefire is reached in Gaza, a development that could help prevent the conflict in the Middle East from escalating further. Additionally, the US Department of Justice may pursue action to break up Google following a court ruling that deemed the company to have monopolistic power.

US Economic Releases

The July ***consumer price index (CPI)*** rose by a seasonally adjusted 0.2%, in line with expectations and greater than last month's -0.1%. Excluding the volatile food and energy components, the ***"core" CPI*** also rose 0.2%, again in line with expectations and slightly ahead of last month's 0.1%. The overall CPI in July rose 2.9% from the same month one year earlier, while the core CPI rose 3.2%. Both numbers are essentially in line with both expectations and the prior month. With all of these numbers so closely aligning with expectations, we do not anticipate a meaningful effect on markets. The chart below shows the year-over-year change in the CPI and the core CPI over time.



The Mortgage Bankers Association today said ***mortgage applications*** in the week ended August 9 rose 16.8%, compared to last week's gain of 6.9%. Applications for home purchase mortgages rose a modest 2.8%; however, applications for refinancing mortgages surged 34.5% to a two-year high. According to the report, the average interest rate on a 30-year mortgage eased one basis point from the prior week to 6.54%.

There are no economic releases or Fed events scheduled for the rest of the day.

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								
South Korea	Unemployment Rate	m/m	Jul	2.5%	2.8%	2.9%	***	Equity and bond neutral
India	Wholesale Prices	m/m	Jul	2.04%	3.36%	1.87%	*	Equity and bond neutral
India	Trade Balance	m/m	Jul	-$23497m	-$20977m	-$21500m	**	Equity and bond neutral
	Exports	y/y	Jul	-1.5%	2.6%		**	Equity and bond neutral
	Imports	y/y	Jul	7.5%	5.0%		**	Equity and bond neutral
EUROPE								
Eurozone	GDP SA	y/y	2Q P	0.6%	0.6%	0.6%	***	Equity and bond neutral
	Industrial Production WDA	y/y	Jun	-3.9%	-3.3%	-2.9%	**	Equity bearish, bond bullish
France	CPI	y/y	Jul F	2.3%	2.3%	2.3%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Jul F	2.7%	2.6%	2.6%	**	Equity and bond neutral
	CPI Ex-Tobacco Index	q/q	Jul	119.37	119.14	119.3	*	Equity and bond neutral
UK	CPI	y/y	Jul	2.2%	2.0%	2.3%	***	Equity and bond neutral
	CPI Core	y/y	Jul	3.3%	3.5%	3.4%	***	Equity and bond neutral
	Retail Price Index	m/m	Jul	387.5	387.3	387.7	**	Equity and bond neutral
	RPI	y/y	Jul	3.6%	2.9%	3.5%	**	Equity and bond neutral
AMERICAS								
Mexico	International Reserves Weekly	w/w	9-Aug	$223233m	$223162m		*	Equity and bond neutral
Brazil	Retail Sales	y/y	Jun	4.0%	7.8%	5.7%	***	Equity bearish, bond bullish

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)	538	537	1	Down
3-mo T-bill yield (bps)	505	504	1	Down
U.S. Sibor/OIS spread (bps)	510	511	-1	Down
U.S. Libor/OIS spread (bps)	507	508	-1	Down
10-yr T-note (%)	3.83	3.84	-0.01	Down
Euribor/OIS spread (bps)	354	355	-1	Down
Currencies	**Direction**			
Dollar	Down			Down
Euro	Up			Up
Yen	Flat			Up
Pound	Flat			Up
Franc	Up			Up
Central Bank Action	**Current**	**Prior**	**Expected**	
RBNZ Official Cash Rate	5.250%	5.500%	5.500%	Below 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.

DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$80.66	$80.69	-0.04%	
WTI	$78.23	$78.35	-0.15%	
Natural Gas	$2.16	$2.15	0.61%	
12-mo strip crack	$20.94	$21.28	-1.59%	
Ethanol rack	$1.93	$1.94	-0.24%	
Metals				
Gold	$2,474.95	$2,465.16	0.40%	
Silver	$27.92	$27.85	0.23%	
Copper contract	$411.10	$408.55	0.62%	
Grains				
Corn contract	$396.75	$397.25	-0.13%	
Wheat contract	$549.25	$551.75	-0.45%	
Soybeans contract	$967.50	$962.50	0.52%	
Shipping				
Baltic Dry Freight	1,670	1,655	15	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-2.00		
Gasoline (mb)		-1.42		
Distillates (mb)		0.25		
Refinery run rates (%)		-0.1%		
Natural gas (bcf)		1		

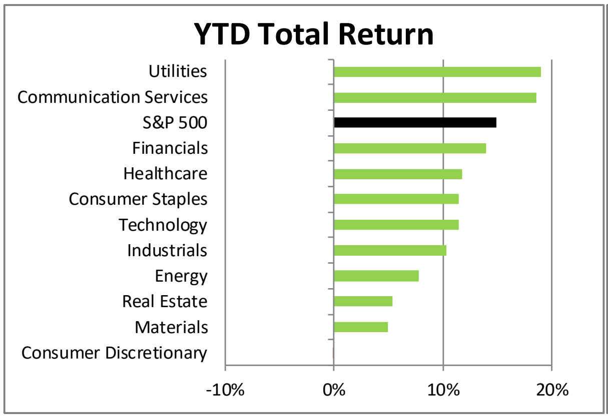
Weather

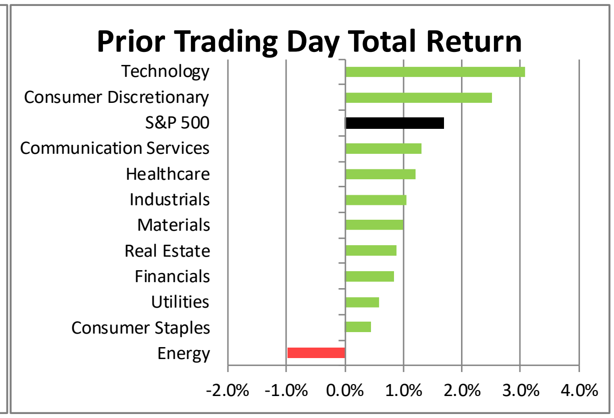
The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures in the Rocky Mountains, Great Plains, South, and New England, with cooler temperatures on the West Coast and in the Ohio Valley. The precipitation outlook calls for wetter-than-normal conditions in the Pacific Northwest, the Four Corners region, and New England, with dry conditions from New Mexico to Alabama and the lower Ohio Valley.

Tropical Storm Ernesto is transiting Puerto Rico this morning, bringing heavy rain and flooding. It is then expected to veer northward into the Atlantic well east of the United States later in the week.

Data Section

US Equity Markets – (as of 8/13/2024 close)

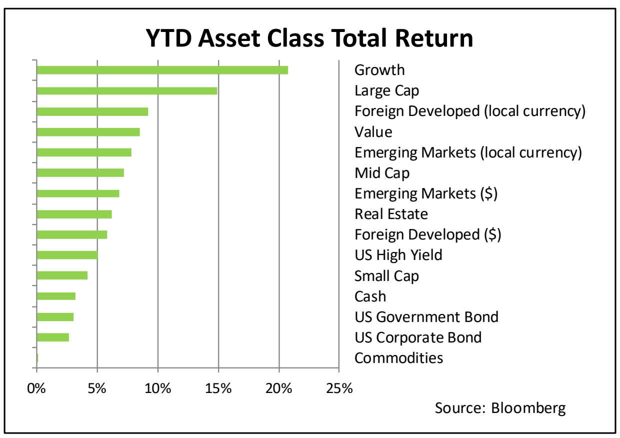




(Source: Bloomberg)

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 8/13/2024 close)

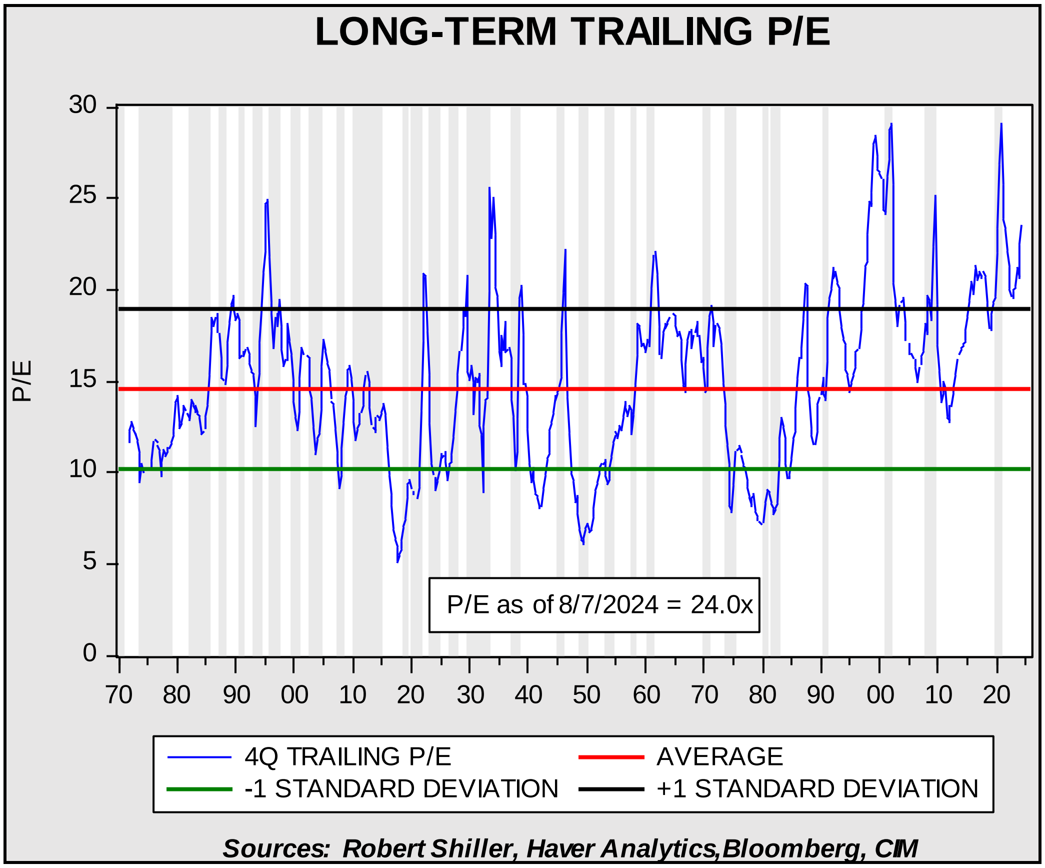


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

August 8, 2024



Based on our methodology,[1] the current P/E is 24.0x, unchanged from our last report. The lack of movement in the multiple was due to the decline in the stock price index, which was offset by a decline in earnings.

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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.