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 1, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is down 0.6% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.8%. Chinese markets were lower, with the Shanghai Composite down 0.2% from its previous close and the Shenzhen Composite down 0.5%. US equity index futures are signaling a higher open.

With 314 companies having reported so far, S&P 500 earnings for Q2 are running at $60.50 per share, compared to estimates of $58.94, which is up 8.0% from Q2 2023. Of the companies that have reported thus far, 80.5% have exceeded expectations while 14.4% have fallen short of expectations.

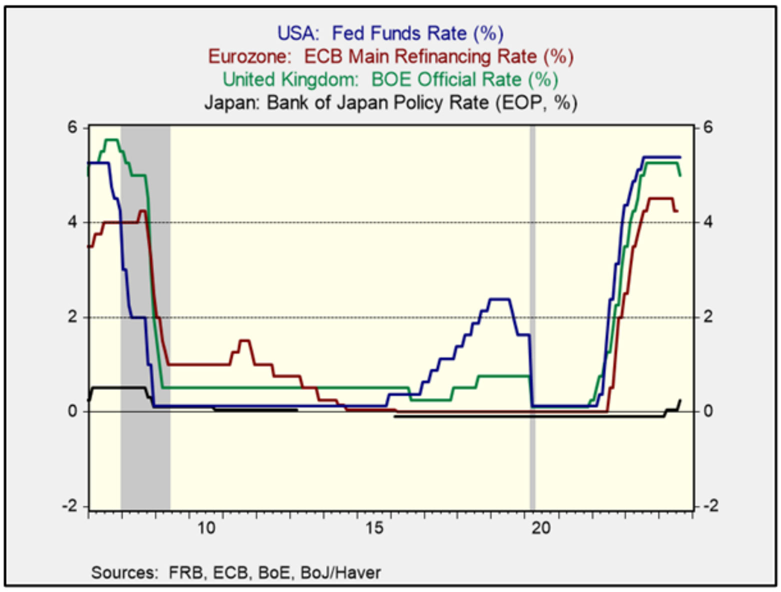
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *Bi-Weekly Geopolitical Report* (7/22/2024) (with associated podcast): "Meet Ferdinand Marcos Jr., President of the Philippines"
- *Asset Allocation Bi-Weekly* (7/29/2024) (with associated podcast): "The Price of Central Bank Independence"
- *Asset Allocation Quarterly – Q3 2024* (7/16/2024): Discussion of our asset allocation process, Q3 2024 portfolio changes, and our outlook for the markets.

Our *Comment* today opens with an overview of the Federal Reserve's latest monetary policy decision yesterday, in which it set the stage to potentially cut interest rates in September. We next review several other international and US developments with the potential to affect the financial markets today, including a rate cut by the Bank of England and signs that global and US climate-change spending is starting to shift from prevention to adaptation.

US Monetary Policy: Wrapping up their latest policy meeting yesterday, Fed officials held their benchmark fed funds interest rate unchanged at 5.25% to 5.50%, as widely expected. Just as important, their policy statement downgraded their assessment of consumer price inflation from "elevated" to "somewhat elevated" and said the risks of high inflation versus a weak labor market have "continued to move into better balance." In his press conference, Chair Powell also stressed that he doesn't want to see any "material further cooling in the labor market."

- Even though Powell stressed that the policymakers aren't ready to cut interest rates just yet, the statements point to a possible cut in September. All the same, the statement and press conference were probably a bit less dovish than initial press reports suggested. Both held far back from any commitment to cut rates at the next meeting in about six weeks, giving the policymakers some wiggle room if the inflation data turns against them.
- Powell's statement about avoiding further deterioration in the labor market seems warranted. Multiple indicators suggest labor demand has softened considerably. To avoid the risk of further deterioration, it does seem likely that the Fed will finally cut interest rates in September, marking its first election-year rate cut since 2008.
- The chart below shows how the world's major central banks have shifted their benchmark interest rates in recent years.



UK Monetary Policy: The BOE today cut its benchmark interest rate from 5.25% to 5.00%, but the vote to do so was extremely close. While five members of the policy committee voted to cut rates, four voted to hold them steady. Following the announcement, BOE Governor Bailey also cautioned that the officials must be careful "not to cut interest rates too quickly or by too much." In sum, the tenor of the action was cautious, suggesting the BOE may continue to cut rates only slowly or sporadically.

- In response to the Fed's decision yesterday and today's initial rate cut by the BOE, the pound (GBP) is trading down about 0.6% to $1.2782.
- The rate cut has also given a boost to the UK's two-year government bonds, pushing their yield down to 3.76%.

UK Public Security: During a vigil on Tuesday night for three children killed in a knife attack earlier this week, right-wing protestors attacked a mosque, rioted, and scuffled with police in the northern England city of Southport. The violence has now spread to other cities as well, including London. The rioting, which has injured dozens of police, arose despite investigators' insistence that the 17-year-old attacker was a native-born Briton, and that they have found no sign of an Islamist motive so far.

- It appears the protestors were largely inspired by misinformation and conspiracy theories on social media, including by Russian state-controlled media.
- The violence illustrates the risk that rapidly spreading misinformation and scapegoating could spark disruptive, destabilizing violence even in stable developed countries.

European Union-United Kingdom: Responding to British Prime Minister Starmer's overtures for improved EU-UK cooperation in international security and trade, the European Commission has issued a list of eight demands it wants London to meet as a sign of good faith. The demands center on measures to fully implement the Brexit deal under which the UK left the EU, including UK commitments related to Northern Ireland and the rights of EU citizens living in the UK. The demands suggest it may be harder to repair EU-UK relations than Starmer expected.

European Union-Hungary-Venezuela: As world leaders continue criticizing Venezuelan President Maduro's apparently false declaration that he won re-election in last weekend's balloting, Hungary's right-wing populist government has vetoed any official condemnation by the EU. The European Commission's foreign affairs chief, Josep Borrell, has issued a personal condemnation, but Budapest's veto signals that Hungarian Prime Minister Orbán intends to keep undermining democratic values in favor of authoritarianism around the globe.

Russia-Ukraine: New public opinion polls show a majority of Ukrainians still opposes ceding any territory to Russia to end its invasion of their country, but the share willing to consider such a concession has grown to as much as 45%. The shift in public opinion comes as top government officials begin to show more openness to negotiation in their statements and diplomatic activity.

- If the Ukrainians really are becoming more open to territorial concessions in return for peace, it likely stems from general war weariness, the armed forces' inability to stop Russia's slow advances, and skepticism about continued support from the West.
- We have long expected that the most likely outcome of the war is a negotiated settlement, once both sides are sufficiently exhausted. That point hasn't yet been reached, but it does appear to be coming closer.
- In any case, we continue to believe that any negotiated settlement could merely provide a temporary peace. With the support of his like-minded authoritarian revisionists in places like Beijing and Pyongyang, Russian President Putin would likely use any truce to rebuild his military and prepare for new assaults against Ukraine and potentially other countries in the future.
- Because of that possibility, we suspect Western European nations will continue working to rebuild their defense capabilities even after a Russia-Ukraine peace deal. That would likely lead to continued growth in Western European defense budgets and good prospects for the region's defense contractors.

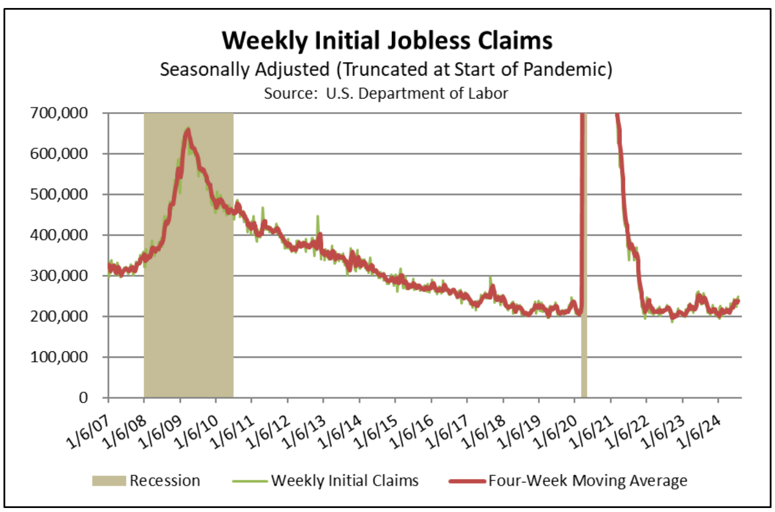
China: According to data provider Preqin, private capital fundraising in the second quarter fell to a record low of $3.4 billion, less than one-tenth the average quarterly fundraising of roughly

$45 billion from 2019 through 2021. The weak second-quarter fundraising figure — which includes all funds raised for private equity, venture capital, private debt, real estate, and infrastructure — reflects both China's worsening economic growth and weaker prospects for profitable exits in the future.

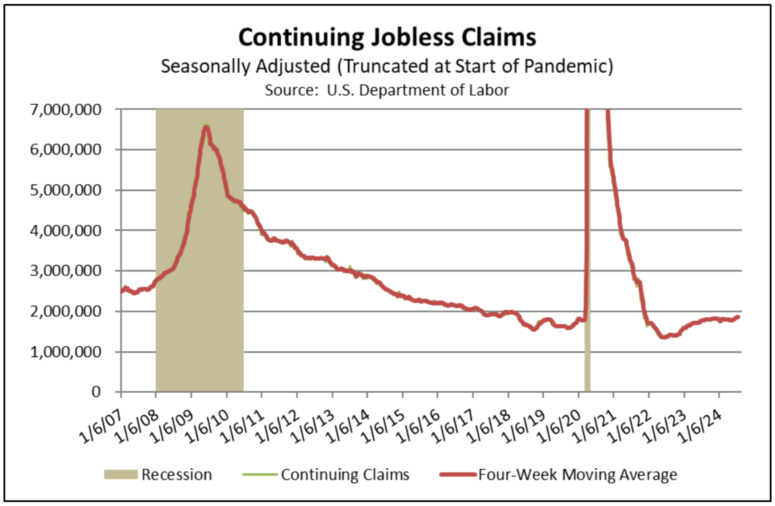
US Climate Policy: The *Wall Street Journal* today carries an interesting article claiming the $1.3 trillion or so spent globally and in the US to address global warming is gradually shifting away from prevention (reducing emissions, etc.) toward mitigation (shoring up infrastructure, etc.). According to the article, only about 5% of total climate spending is now on mitigation, but that share is rising. If the trend continues, an entirely new set of companies could be the beneficiaries, beyond today's solar cell makers, electric vehicle manufacturers, and the like.

US Economic Releases

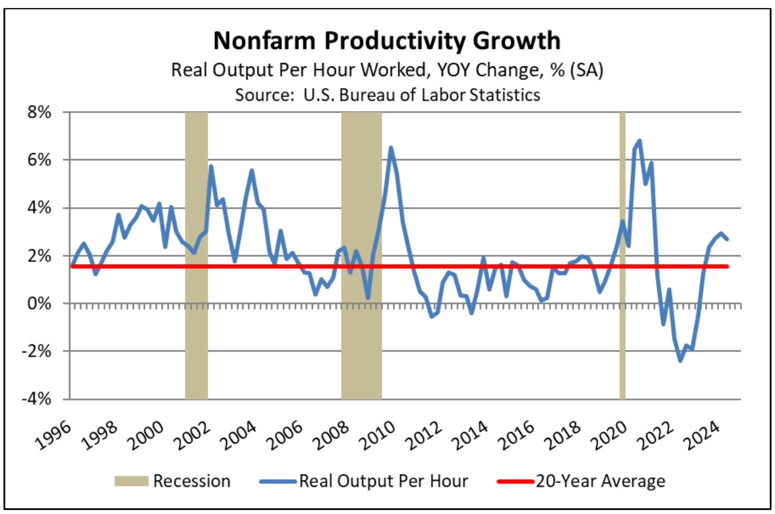
In the week ended July 27, ***initial claims for unemployment benefits*** rose to a seasonally adjusted 249,000, above both the expected level of 236,000 and the prior week's level of 235,000. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, rose to 238,000. 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.



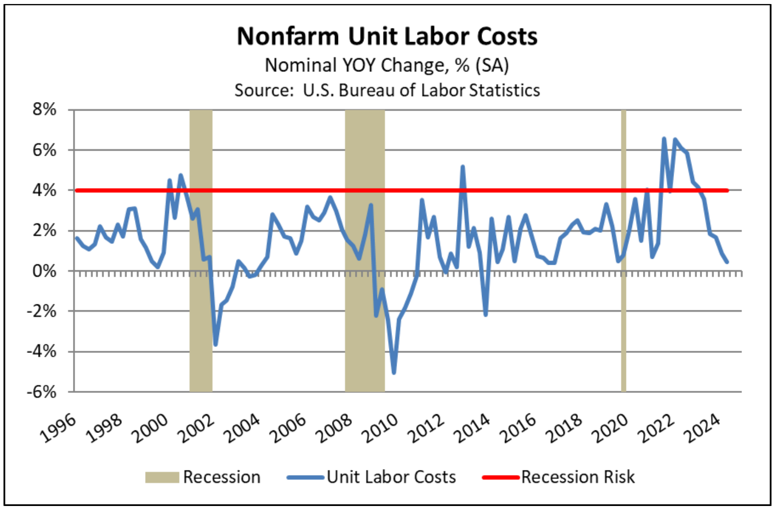
In the week ended July 20, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) rose to a seasonally adjusted 1.877 million, above both the anticipated reading of 1.855 million and the previous week's revised reading of 1.844 million. The four-week moving average of continuing claims rose to 1,857,000, moving farther above the levels seen just before the coronavirus pandemic and pointing to further cooling in the demand for labor. The chart below shows how continuing claims have fluctuated since the GFC. It is also truncated during the pandemic period because of the high level of claims at the time.



Another report today focused on the productivity of US workers, defined as the average value of output per hour worked. After stripping out price changes and normal seasonal fluctuations, second-quarter ***nonfarm productivity*** rose at an annualized rate of 2.3%, beating the expected rate of 1.8% and accelerating smartly from the revised first-quarter rate of 0.4%. Taking into account the fluctuations in each of the last four quarters, productivity in the second quarter was up 2.7% from the same period one year earlier. Productivity growth is key to boosting living standards and supporting higher wages, so the relatively strong increase over the last year should be positive for US workers. The chart below shows the year-over-year growth in real productivity over the last quarter-century or so.



Second-quarter ***unit labor costs*** rose at an annualized rate of just 0.9%, below the anticipated growth rate of 1.7% and well below the revised first-quarter growth rate of 3.8%. Unit labor costs in the second quarter were up just 0.5% year-over-year. That pullback is important because annual growth in unit labor costs of 4.0% or so has often been associated with recessions in the past. The chart below shows the year-over-year growth in unit labor costs since 1996.



The table below lists the economic releases and/or Fed events scheduled for the rest of the day.

Economic Releases						
ET	Indicator			Expected	Prior	Rating
9:45	S&P Global US Manufacturing PMI	m/m	Jul F	49.6	49.5	***
10:00	Construction Spending MoM	m/m	Jun	0.20%	-0.10%	*
10:00	ISM Manufacturing	m/m	Jul	48.8	48.5	**
10:00	ISM Prices Paid	m/m	Jul	51.8	52.1	**
10:00	ISM New Orders	m/m	Jul	49.0	49.3	**
10:00	ISM Employment	m/m	Jul	49.2%	49.3	*
10:00	Wards Total Vehicle Sales	m/m	Jul	16.20m	15.29m	***
Federal Reserve						
No Fed speakers or events for the rest of today						

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	Japan Buying Foreign Stocks	w/w	26-Jul	¥230.4b	¥12.1b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	26-Jul	-¥670.5b	-¥56.9b		*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	26-Jul	-¥700.5b	-¥730.7b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	26-Jul	¥1199.4b	-¥352.7b		*	Equity and bond neutral
	Jibun Bank Manufacturing PMI	m/m	Jul F	49.1	49.2		***	Equity and bond neutral
Australia	Trade Balance	m/m	Jun	A$5589m	A$5052m	A$5000m	***	Equity and bond neutral
	Exports	m/m	Jun	1.7%	1.3%		*	Equity and bond neutral
	Imports	m/m	Jun	0.5%	3.3%		*	Equity and bond neutral
South Korea	Trade Balance	m/m	Jul	$3617m	$7991m	$5000m	*	Equity and bond neutral
	Exports	y/y	Jul	13.9%	51.0%	18.4%	***	Equity and bond neutral
	Imports	y/y	Jul	10.5%	-7.5%	13.4%	**	Equity and bond neutral
	S&P Global South Korea Manufacturing PMI	m/m	Jul	51.4	52.0		***	Equity and bond neutral
China	Caixin Manufacturing PMI	m/m	Jul	49.8	51.8	51.5	***	Equity and bond neutral
India	HSBC India PMI Mfg	m/m	Jul F	58.1	58.5		***	Equity and bond neutral
EUROPE								
Eurozone	HCOB Eurozone Manufacturing PMI	m/m	Jul F	45.8	45.6	45.6	***	Equity and bond neutral
	Unemployment Rate	m/m	Jun	6.5%	6.4%	6.4%	**	Equity and bond neutral
Germany	HCOB Germany Manufacturing PMI	m/m	Jul F	43.2	42.6	42.6	***	Equity and bond neutral
France	HCOB France Manufacturing PMI	m/m	Jul F	44.0	44.1	44.1	***	Equity and bond neutral
Italy	HCOB Italy Manufacturing PMI	m/m	Jul	47.4	45.7	46.0	***	Equity bullish, bond bearish
	Unemployment Rate	m/m	Jun	7.0%	6.9%	6.8%	**	Equity and bond neutral
UK	Nationwide House Price Index	y/y	Jul	2.1%	1.5%	1.8%	***	Equity and bond neutral
	S&P Global UK Manufacturing PMI	m/m	Jul F	52.1	51.8	51.8	***	Equity and bond neutral
Russia	S&P Global Russia Manufacturing PMI	m/m	Jul	53.6	54.9	52.1	***	Equity bullish, bond bearish
	Retail Sales Real	y/y	Jun	6.30%	7.50%	6.40%	***	Equity and bond neutral
	Unemployment Rate	m/m	Jun	2.40%	2.60%	2.60%	***	Equity and bond neutral
	Real Wages	m/m	May	8.8%	8.5%	7.0%	*	Equity bullish, bond bearish
AMERICAS								
Canada	GDP	y/y	May	1.1%	1.1%	1.0%	**	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)	551	551	0	Down
3-mo T-bill yield (bps)	512	513	-1	Down
U.S. Sibor/OIS spread (bps)	524	524	0	Down
U.S. Libor/OIS spread (bps)	521	522	-1	Down
10-yr T-note (%)	4.05	4.03	0.02	Down
Euribor/OIS spread (bps)	365	363	2	Down
Currencies	**Direction**			
Dollar	Up			Down
Euro	Down			Up
Yen	Down			Up
Pound	Down			Up
Franc	Flat			Up
Central Bank Action	**Current**	**Prior**	**Expected**	
FOMC Rate Decision (Lower Bound)	5.500%	5.500%	5.500%	On Forecast
FOMC Rate Decision (Upper Bound)	10.750%	11.250%	10.750%	On Forecast
Bank of England Bank Rate	5.000%	5.250%	5.000%	On Forecast
Brazil Selic Rate	10.500%	10.500%	10.500%	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.

DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$81.42	$80.84	0.72%	
WTI	$78.46	$77.91	0.71%	
Natural Gas	$2.05	$2.04	0.54%	
12-mo strip crack	$22.33	$22.33	-0.02%	
Ethanol rack	$1.95	$1.96	-0.46%	
Metals				
Gold	$2,437.04	$2,447.60	-0.43%	
Silver	$28.94	$29.01	-0.24%	
Copper contract	$413.70	$417.65	-0.95%	
Grains				
Corn contract	$398.50	$399.75	-0.31%	
Wheat contract	$530.00	$527.25	0.52%	
Soybeans contract	$1,020.00	$1,022.50	-0.24%	
Shipping				
Baltic Dry Freight	1,708	1,762	-54	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-3.44	-1.10	-2.34	
Gasoline (mb)	-3.67	-1.29	-2.38	
Distillates (mb)	1.53	-0.90	2.43	
Refinery run rates (%)	-1.5%	0.8%	-2.3%	
Natural gas (bcf)		29		

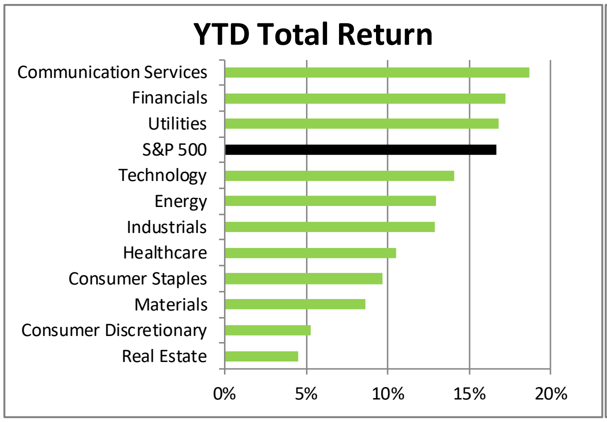
Weather

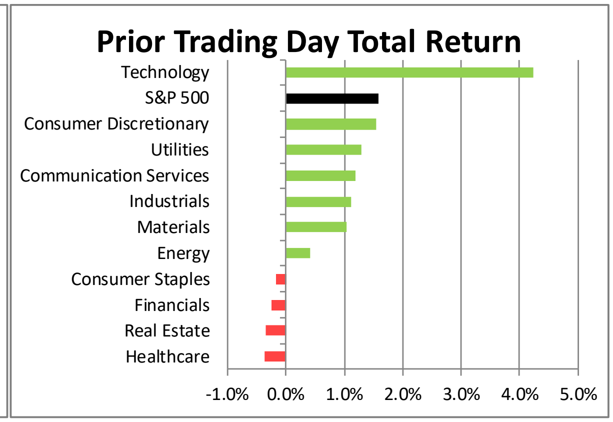
The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures throughout the Far West, the southern Great Plains, and the Deep South, with cooler-than-normal temperatures in the northern Great Plains, the Upper Midwest, and the Northeast. The forecasts call for wetter-than-normal conditions in all areas except the Upper Midwest and the southern Mississippi Valley region, where conditions will be near normal.

There is currently an atmospheric disturbance moving northwestward over Hispaniola, but it is assessed to have only a 20% chance of forming into a cyclone in the next 48 hours.

Data Section

US Equity Markets – (as of 7/31/2024 close)

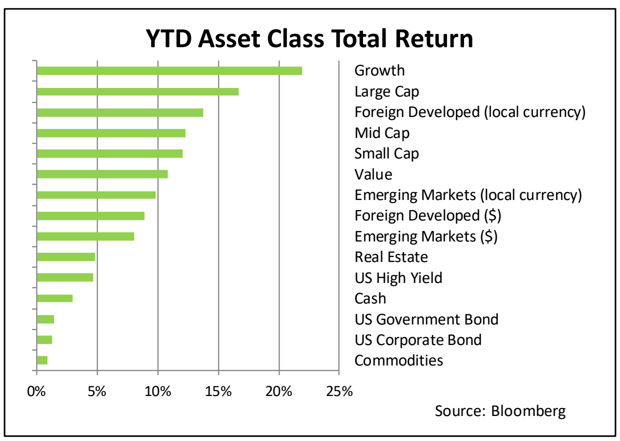




(Source: Bloomberg)

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 7/31/2024 close)

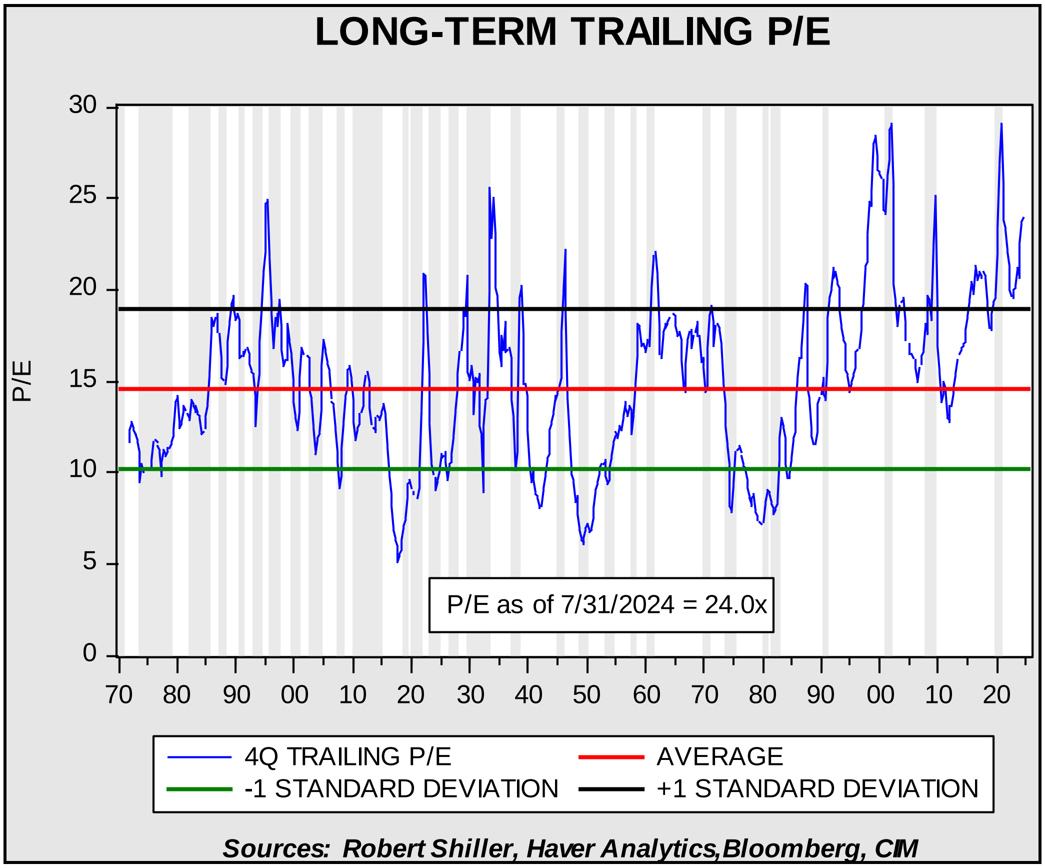


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 1, 2024



Based on our methodology,[1] the current P/E is 24.0x, down 0.2 from our last report. The decrease in the multiple was due to a slight decrease in the stock price index and an increase in earnings.

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.