

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 22, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is up 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.4%. Chinese markets were lower, with the Shanghai Composite down 0.3% from its previous close and the Shenzhen Composite down 1.1%. US equity index futures are signaling a higher open.

With 475 companies having reported so far, S&P 500 earnings for Q2 are running at \$61.40 per share, compared to estimates of \$58.94, which is up 8.0% from Q2 2023. Of the companies that have reported thus far, 80.6% have exceeded expectations while 15.0% have fallen short of expectations.

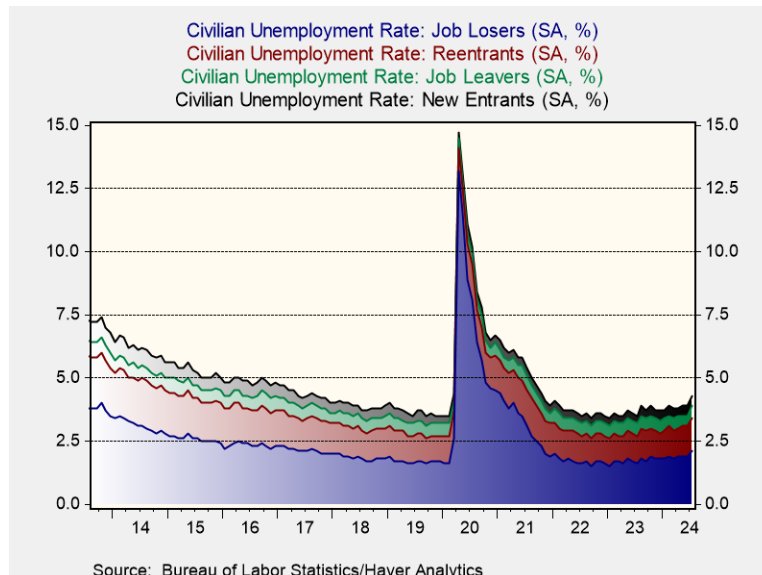
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our [website](#). We highlight recent publications below, with new items of the day emphasized in bold:

- [Bi-Weekly Geopolitical Report](#) (8/19/2024) (no accompanying podcast for this report): “The Recent Iranian Election: Results & Implications”
- [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! The stock market is currently grappling with the potential for interest rate cuts, fueled by the recent downward revisions to BLS payroll data and dovish commentary from Federal Reserve officials. In sports news, Cincinnati Reds first baseman and 2010 NL MVP Joey Votto has announced his retirement at the age of 40. Today’s *Comment* delves into the recent Federal Reserve meeting minutes, explores the escalating tensions between the West and China in the race for clean energy dominance, offers a comprehensive update on Mexico, and discusses the increase in US concern about China’s nuclear capabilities. As always, our report concludes with a concise overview of key domestic and international data releases.

Doves Take the Wheel: Expectation of a rate cut in September appear locked in after it was revealed that some policymakers were willing to cut in July.

- The [Federal Open Market Committee \(FOMC\) released the minutes from its July 30-31 meeting](#), which highlighted the growing shift in Fed officials' focus away from its inflation mandate and toward employment. Nonfarm payroll data and the unemployment rate have exhibited signs of increasing and raised red flags for the committee. Additionally, FOMC members expressed optimism that inflation is likely to continue its downward trend. Despite a unanimous vote to maintain interest rates, several members expressed an openness to supporting a decision to cut interest rates by 25 basis points.
- While the recent triggering of the Sahm Rule has fueled expectations for a substantial interest rate cut at the Fed's upcoming meeting, we maintain a cautious outlook. Although the rule (which measures the three-month moving average of the unemployment rate against its 12-month minimum) has surpassed its recession threshold of 0.5%, the spike could be transitory. The early July passage of Hurricane Beryl through the southern states likely contributed to a temporary surge in job losses.



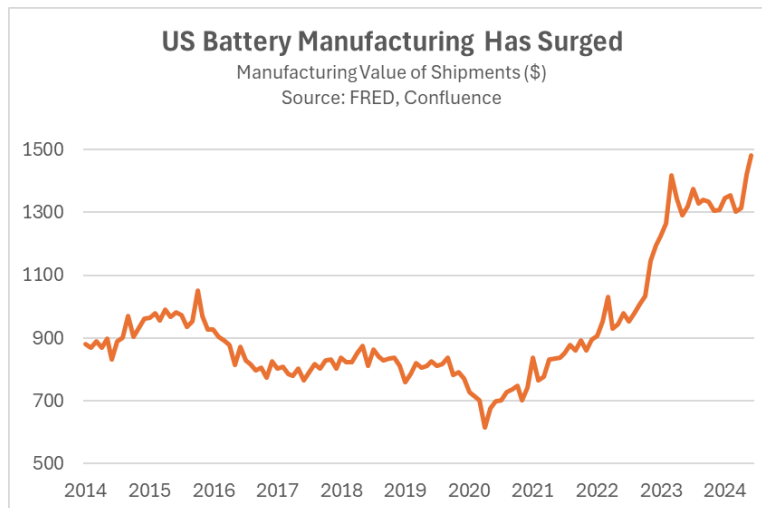
- The Federal Reserve's decision on interest rate cuts will likely be influenced by the August employment and Consumer Price Index (CPI) reports. While the July Personal Consumption Expenditure (PCE) data may offer some insights, its impact is expected to be relatively minor. If these figures continue to support the notion of a cooling labor market and inflation, the Fed is likely to implement a 25-bps rate cut in September. A larger, more substantial cut would likely only be considered if there is another unexpected surge in the unemployment rate.

The Great Split: While it appears that demand for EVs have waned, the geopolitical war over dominance in the space has started to heat up.

- The West is actively working to prevent China from dominating the clean energy sector. Next month, the [EU plans to impose tariffs as high as 36% on Chinese-made electric vehicles](#), including Tesla, due to unfair competition concerns. This move is intended to protect its struggling industrial sector by preventing China from dumping its artificially

cheap plug-in vehicles in Europe. The production of electric vehicles in the West has faced challenges due to limited consumer demand. Recently, Ford scrapped plans to build a fully electric SUV.

- Despite weak demand, the West has continued efforts to bridge the technological gap with China. Earlier this week, the [Department of Defense approved a \\$20 million grant to fund a cobalt sulfate refinery in Canada](#), a mineral that is a critical precursor for battery production. Meanwhile, the [EU secured a deal with Serbia to allow lithium mining](#) last month. These moves align with both regions' plans to expand their renewable energy capacity. US battery production is expected [to increase from 257 to 1000 gigawatts hours over the next decade](#), while Europe aims [to become battery cell self-sufficient by 2026](#).



- The battle for clean energy dominance is likely to intensify over the coming years. The Inflation Reduction Act, designed to incentivize clean energy projects, has strategically targeted Republican districts to counter conservative efforts to undermine its goals. Meanwhile, Europe's ability to wean itself off imported fossil fuels from hostile powers like Russia hinges on the successful development of its renewable energy resources. While China will likely dominate the space for now, we expect the West to push through plans for renewable energy despite the political headwinds.

The New Mexico: Growing concerns surround the country's direction as Claudia Sheinbaum prepares to become president.

- [Mexican judicial officials staged a strike on Wednesday in protest of controversial reforms](#) aimed at overhauling the country's court system. The proposed system would elect judges, including those in the high court, through popular vote. This initiative, championed by outgoing President Andrés Manuel López Obrador (AMLO), is intended to combat corruption and impunity within the judiciary. However, it has been widely criticized as a tactic to replace judges who oppose his agenda with those who will support it. The push has led to concerns about the lacking balance of powers within the government.

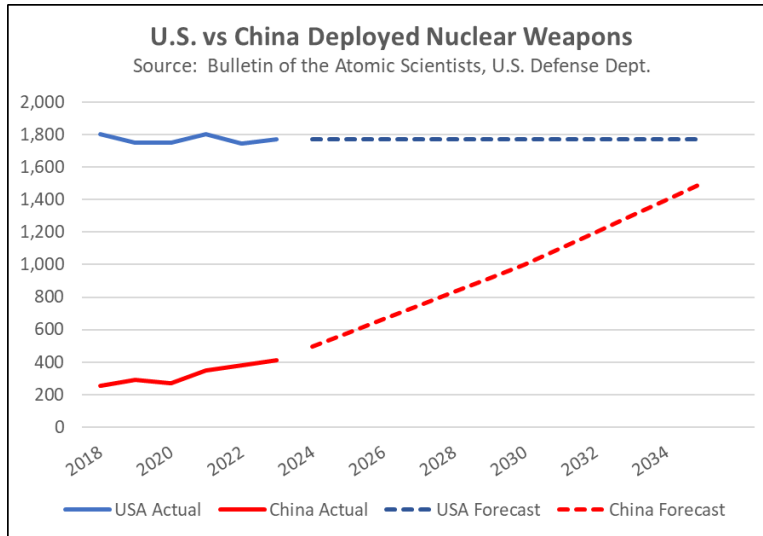
- The push to reform the country's judicial system could further tarnish Mexico's reputation as a nearshoring hub for companies seeking proximity to the US supply chain. During the AMLO presidency, the judiciary served as a valuable check on the president's overreach. For instance, earlier this year, [the Supreme Court struck down a law](#) that would have favored state-owned power companies over private ones. The proposed reforms could pave the way for more policies that would increase the costs of doing business in Mexico for foreign investors.



- With AMLO's Morena party securing a supermajority, a sweeping overhaul of the judicial system appears inevitable. The market has already reacted, leading to a sharp sell-off in the country's currency, with the Mexican peso (MXN) dropping 10% against the dollar since the election. Meanwhile, Mexican equities have also suffered. This trend could shift after the US election if the next American president pushes for changes to the USMCA. As a result, we believe the situation in Mexico remains fluid.

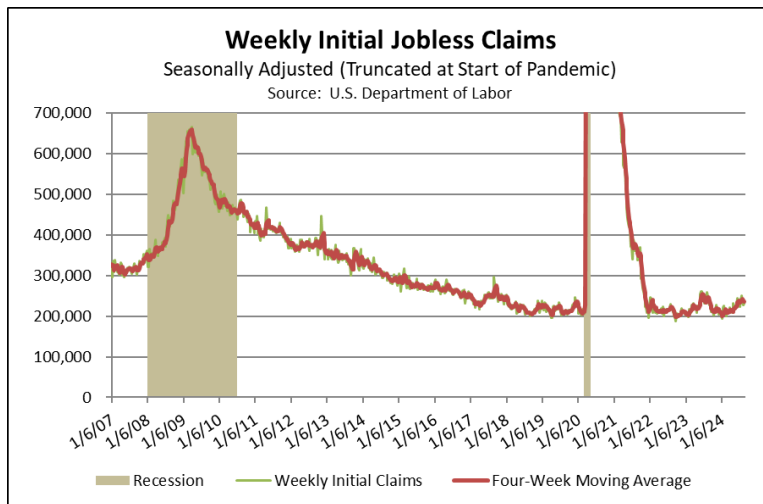
United States-China-Russia: According to the *New York Times*, [President Biden in March approved a highly classified nuclear strategic plan](#), the “Nuclear Employment Guidance,” that prioritizes China ahead of Russia for the first time. It also directs preparation for a coordinated joint nuclear attack from China, Russia, and North Korea. The new plan is consistent with fears that China’s nuclear arsenal will match or exceed the deployed US arsenal within 10 years.

- The rapid growth in China’s strategic nuclear arsenal will likely reinforce the US’s emerging bipartisan support for nuclear modernization and rising defense budgets.
- More broadly, it will probably also contribute to further tensions between the Chinese bloc and the West.

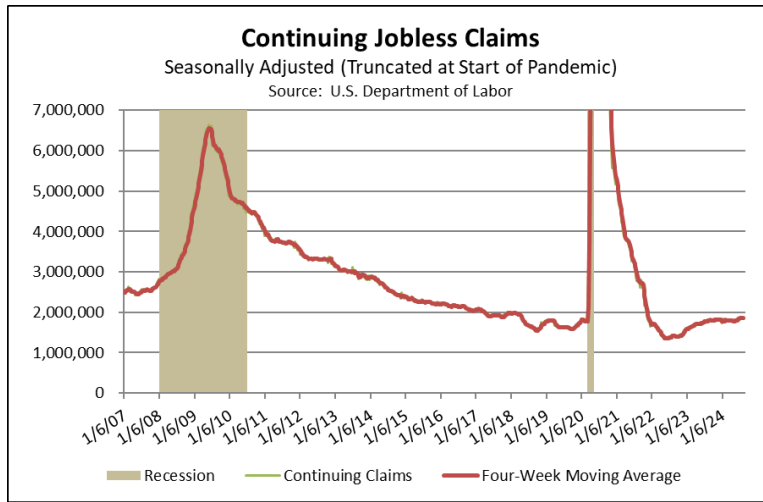


US Economic Releases

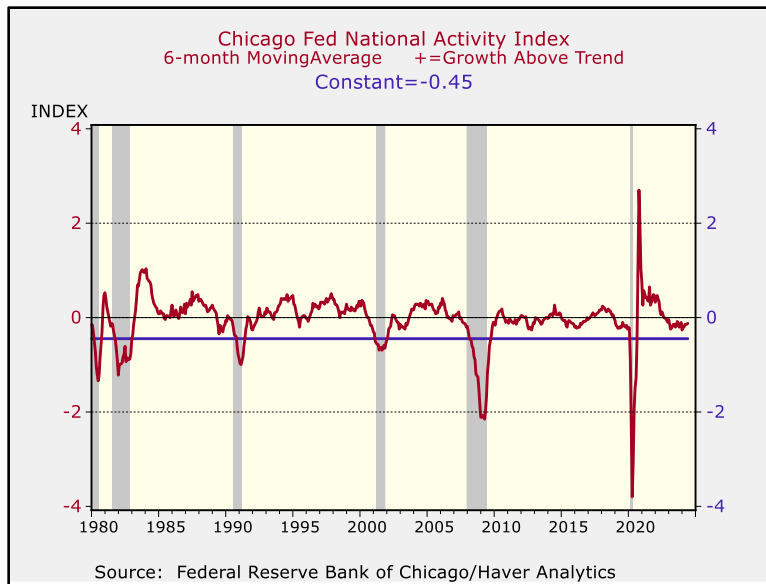
In the week ended August 17, *initial claims for unemployment benefits* rose to a seasonally adjusted 232,000, matching expectations and modestly exceeding the revised 228,000 in the previous week. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, fell to 236,000. 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 August 10, the number of *continuing claims for unemployment benefits* (people continuing to draw benefits) rose to a seasonally adjusted 1.863 million, below the anticipated level of 1.870 million but above the prior week's revised level of 1.859 million. The four-week moving average of continuing claims jumped to 1,865,500, as it continues to move farther above the levels prevailing right before the pandemic. 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.



Separately, the Chicago Fed said its July *National Activity Index (CFNAI)* declined to -0.34, well short of the expected reading of 0.03 and the revised June reading of -0.09. The CFNAI, which encompasses dozens of separate indicators to capture all aspects of current economic activity, is designed so that readings above 0.00 reflect the economy growing at trend. Our analysis shows that when the six-month moving average of the CFNAI falls below -0.45, it suggests the economy is in recession. With the latest reading, the index suggests the economy is now growing modestly below trend, but it is not in a recession. The chart below shows how the CFNAI has fluctuated over the last several decades.



The table below lists the economic releases and 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	Aug P	49.5	496	***
9:45	S&P Global US Services PMI	m/m	Aug P	54	55	***
9:45	S&P Global US Composite PMI	m/m	Aug P	53.2	54.3	***
10:00	Existing Home Sales	m/m	Jul	3.94m%	3.89m	**
11:00	Kansas City Fed Manufacturing Index	m/m	Aug	-9	-13	*
Federal Reserve						
ET	Speaker or Event	District or Position				
8:00	Susan Collins Speaks on Fox Business	President of the Federal Reserve Bank of Boston				

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	16-Aug	353.2b	-328.1b	-322.9b	*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	16-Aug	1854.0b	1539.2b	1539.7b	*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	16-Aug	-47.9b	521.9b	521.7b	*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	16-Aug	1532.8b	1435.0b	1433.8b	*	Equity and bond neutral
	Jibun bank Composite PMI	m/m	Aug P	53.0	52.5		*	Equity and bond neutral
	Jibun Bank Manufacturing PMI	m/m	Aug P	49.5	49.1		***	Equity and bond neutral
	Jibun Bank Services PMI	m/m	Aug P	54.0	53.7		**	Equity and bond neutral
	Machine tool orders	y/y	Jul F	8.4%	8.4%		**	Equity and bond neutral
India	HSBC India PMI Mfg	m/m	Aug P	57.9	58.1		***	Equity and bond neutral
	HSBC India PMI Composite	m/m	Aug P	60.5	60.7		**	Equity and bond neutral
	HSBC India PMI Services	m/m	Aug P	60.4	60.3		**	Equity and bond neutral
EUROPE								
Eurozone	HCOB Eurozone Manufacturing PMI	m/m	Aug P	45.6	45.8	45.8	***	Equity and bond neutral
	HCOB Eurozone Services PMI	m/m	Aug P	53.3	51.9	51.7	**	Equity bullish, bond bearish
	HCOB Eurozone Composite PMI	m/m	Aug P	51.2	50.2	50.1	*	Equity bullish, bond bearish
Germany	HCOB Germany Manufacturing PMI	m/m	Aug P	42.1	43.2	43.5	***	Equity bearish, bond bullish
	HCOB Germany Services PMI	m/m	Aug P	54.4	52.5	52.3	**	Equity bullish, bond bearish
	HCOB Germany Composite PMI	m/m	Aug P	48.5	49.1	49.3	**	Equity bearish, bond bullish
France	HCOB France Manufacturing PMI	m/m	Aug P	42.1	44.0	44.5	***	Equity bearish, bond bullish
	HCOB France Services PMI	m/m	Aug P	55.0	50.1	50.3	**	Equity bullish, bond bearish
	HCOB France Composite PMI	m/m	Aug P	52.7	49.1	49.2	**	Equity bullish, bond bearish
	Retail Sales SA	y/y	Jul	-0.5%	-0.6%		*	Equity and bond neutral
UK	S&P Global UK Manufacturing PMI	m/m	Aug P	52.5	52.1	52.2	***	Equity and bond neutral
	S&P Global UK Services PMI	m/m	Aug P	53.3	52.5	52.8	**	Equity and bond neutral
	S&P Global UK Composite PMI	m/m	Aug P	53.4	52.8	53.0	**	Equity and bond neutral
Switzerland	M3 Money Supply	y/y	Jul	0.3%	0.2%		*	Equity and bond neutral
Russia	PPI	y/y	Jul	13.7%	14.0%		***	Equity and bond neutral
AMERICAS								
Canada	Industrial Prices	m/m	Jul	0.0%	-0.1%	-0.3%	**	Equity and bond neutral
	Raw Material Prices	m/m	Jul	0.7%	-1.7%	-0.8%	*	Equity bullish, bond bearish
Mexico	Economic Activity IGAE	y/y	Jun	-0.60%	1.58%	-0.05%	**	Equity and bond neutral
	GDP NSA	y/y	2Q F	2.1%	2.2%		***	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)	538	539	-1	Down
3-mo T-bill yield (bps)	501	501	0	Down
U.S. Sibor/OIS spread (bps)	508	508	0	Down
U.S. Libor/OIS spread (bps)	505	505	0	Down
10-yr T-note (%)	3.84	3.80	0.04	Down
Euribor/OIS spread (bps)	354	354	0	Down
Currencies	Direction			
Dollar	Up			Down
Euro	Down			Up
Yen	Down			Up
Pound	Up			Up
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	\$76.45	\$76.05	0.53%	
WTI	\$72.22	\$71.93	0.40%	
Natural Gas	\$2.15	\$2.18	-1.19%	
12-mo strip crack	\$19.87	\$19.93	-0.29%	
Ethanol rack	\$1.95	\$1.95	-0.13%	
Metals				
Gold	\$2,500.92	\$2,512.56	-0.46%	
Silver	\$29.50	\$29.60	-0.35%	
Copper contract	\$419.85	\$422.65	-0.66%	
Grains				
Corn contract	\$397.00	\$398.25	-0.31%	
Wheat contract	\$544.25	\$544.00	0.05%	
Soybeans contract	\$973.25	\$981.50	-0.84%	
Shipping				
Baltic Dry Freight	1,759	1,735	24	
DOE Inventory Report				
	Actual	Expected	Difference	
Crude (mb)	-4.65	-2.20	-2.45	
Gasoline (mb)	-1.61	-1.80	0.19	
Distillates (mb)	-3.31	-1.00	-2.31	
Refinery run rates (%)	0.8%	0.3%	0.5%	
Natural gas (bcf)		25		

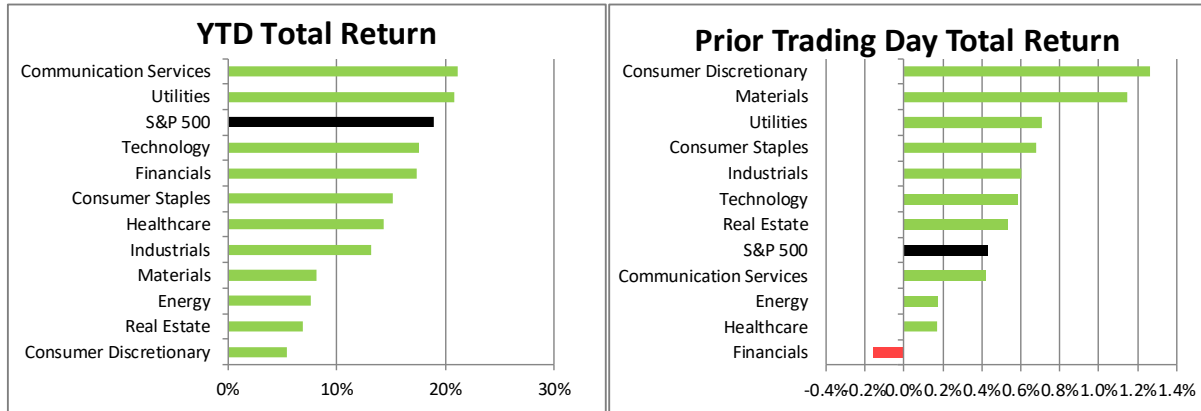
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures across the entire country except for the northern and central Rocky Mountains, where temperatures will be normal or below normal. The forecasts call for wetter-than-normal conditions in the Southwest and Florida, with dry conditions in the Pacific Northwest and the Midwest.

There are currently no atmospheric disturbances in the Atlantic Ocean region.

Data Section

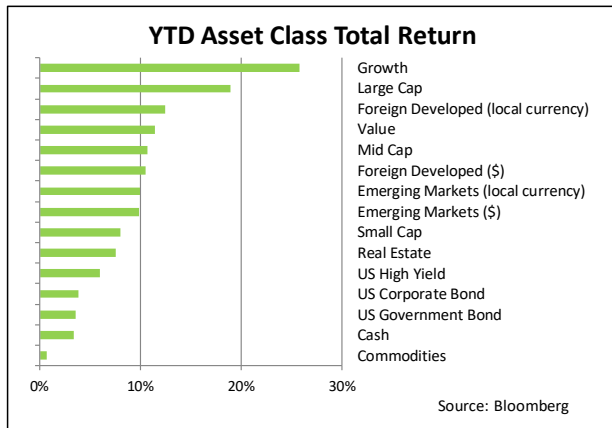
US Equity Markets – (as of 8/21/2024 close)



(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 8/21/2024 close)

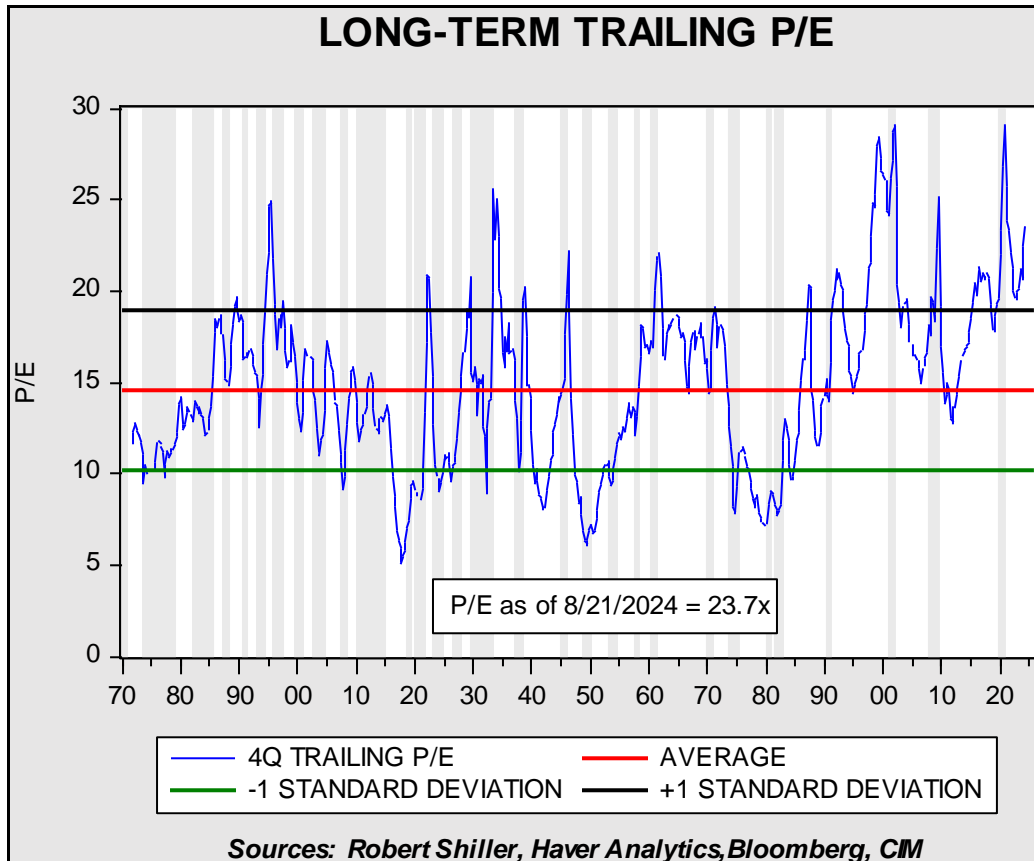


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 22, 2024



Based on our methodology,¹ the current P/E is 23.7x, up 0.1 from our last report. The increase in the multiple was due to a slight pick up in the stock price index.

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.