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[Posted: August 26, 2024 — 9:30 AM ET] Global equity markets are slightly higher this morning. In Europe, the Euro Stoxx 50 relatively unchanged from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.4%. Chinese markets were mostly higher, with the Shanghai Composite relatively unchanged from its previous close and the Shenzhen Composite up 0.4%. US equity index futures are signaling a mildly higher open.

With 477 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, 80.7% have exceeded expectations, while 14.9% 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](#) (8/26/2024) (with associated [podcast](#)): “Activist vs. Accommodative Treasury Issuance”**
- [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.

Our *Comment* today opens with some new research confirming our positive view on the global defense industry going forward. We next review several other international and US developments with the potential to affect the financial markets today, including some notes on the Israel-Hezbollah attacks over the weekend, a shut-off of petroleum exports from Tunisia, and a wrap-up of the Federal Reserve’s conference at Jackson Hole, Wyoming.

Global Defense Industry: New research by Vertical Research Partners suggests the world’s top 15 defense contractors [will log total free cash flow of \\$52 billion by 2026, double the amount they generated in 2021](#). Half the free cash flow in 2026 will come from five top US defense firms (excluding Boeing), while much of the rest will come from top European producers. The

analysis is consistent with our often-stated view that today's increased geopolitical tensions will prompt higher defense budgets around the world in the coming years.

- Separately, the head of the International Atomic Energy Agency, Rafael Grossi, [warned in a *Financial Times* interview that more countries are feeling pressure to develop their own nuclear weapons](#). According to Grossi, “There are all these tensions, this possibility of alliances being weakened and countries having to fend for themselves. This is where the nuclear weapon factor, and attraction, comes back in a very unexpected way.”
- Grossi's analysis echoes our view that factors such as the geopolitical aggressiveness of key authoritarian countries and weakening alliances within the US bloc could spark a new, global nuclear arms race in the coming years. From an investment standpoint, that suggests that there could be opportunities not only in defense stocks, but in commodities such as uranium.

Israel-Hezbollah: On Sunday, after US and Israeli intelligence suggested the Hezbollah militants were preparing a major attack on Israel, the Israel Defense Forces [launched a large number of airstrikes against the militant group's rocket launchers in southern Lebanon](#). Hezbollah later said it had gotten off about 300 missile launches against Israel, but it tried to signal no more attacks would be coming for now.

- It's not yet clear if the Hezbollah attack was meant to be the main retaliation for Israel's recent assassinations of Islamist militants in Lebanon and Iran. If it was, it may suggest that Iran wanted to limit its direct involvement to insulate it from further hostilities with Israel. In any case, reports say Hezbollah's rank-and-file were disappointed with the relatively small scale of the attack.
- In any case, it's still impossible to rule out further attacks on Israel by Hezbollah, Hamas, or their Iranian benefactors. With Israel's war on the Hamas government in Gaza continuing, the risk of dangerous escalation into a broader regional conflict remains.

China-United States: Some artificial-intelligence developers in China [are reportedly getting around the US ban on selling advanced AI computer chips to the country](#) by remotely and secretly accessing computer power based on top-of-the-line Nvidia chips in foreign facilities. These “decentralized GPU” services apparently aren't illegal right now, but the US government may well take steps to clamp down on the practice as the US-China technology rivalry continues.

China-Philippines: Yesterday, Chinese navy and coast guard vessels again [harassed a Philippine government ship bringing supplies to Philippine fishermen near Sabine Shoal](#), an area inside Manila's exclusive economic zone claimed by both countries. The Philippine ship may have been intending to bring supplies to one of Manila's coast guard ships, which has been anchored in the area since April, much to the chagrin of Beijing.

- As we've noted previously, Sabine Shoal is developing into another potential flashpoint between China and the Philippines, after the two sides recently agreed to cool tensions over the disputed Second Thomas Shoal.
- To reiterate, any Chinese-Philippine military confrontation has the potential to draw in the US, which has a mutual defense treaty with Manila.

China: New data from Dealogic shows the world's top private-equity firms [have virtually given up on new acquisitions in China as the country hits structural economic headwinds](#) and geopolitical tensions with the West are making such deals riskier. The data is consistent with our view that slowing growth, worsening international tensions, and the world's fracturing into relatively separate geopolitical blocs will make Chinese investments riskier going forward.

Tunisia: The government controlling Tunisia's eastern half today [said it will stop all petroleum production and exports](#) to retaliate for the rival western government's effort to take over the country's central bank. The eastern government has declared *force majeure* over all oil fields, terminals, and export facilities, closing them down. The news has pushed global oil prices sharply higher today, with near WTI futures currently up 3.0% to \$77.06 per barrel and Brent up 2.5% to \$80.13.

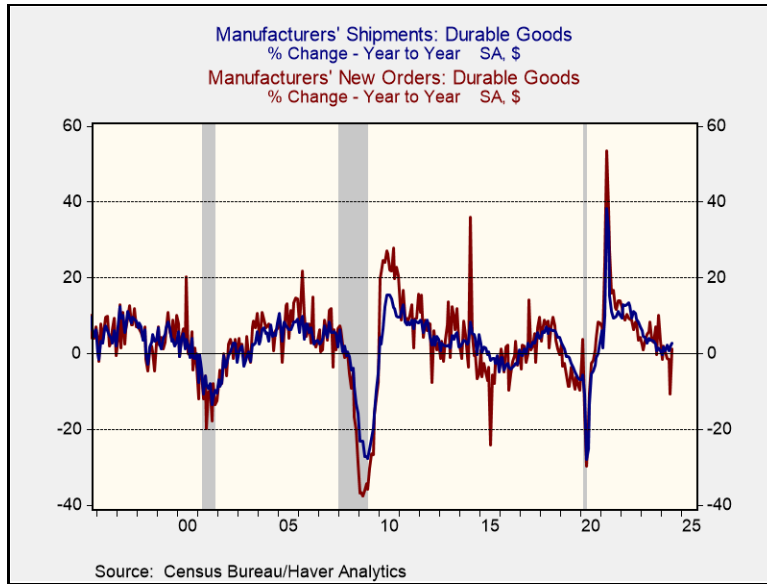
Canada-China: Canadian Prime Minister Trudeau today [said his government will impose new anti-dumping tariffs on a range of imports from China](#), including a 100% tariff on Chinese electric vehicles and 25% tariffs on Chinese steel and aluminum. The tariffs, which Trudeau said were aimed at "leveling the playing field" for Canadian workers, are another example of how the US geopolitical bloc is decoupling from China and its bloc. The spread of anti-Chinese tariffs is bound to anger Beijing and complicate its effort to re-ignite economic growth.

US Monetary Policy: As we previewed in our *Comment* on Friday, Fed Chair Powell [used his speech at the opening of the central bank's summer conference in Jackson Hole to confirm the policymakers will begin cutting interest rates](#) in September. In a line for the ages, Powell said, "We do not seek or welcome further cooling in labor market conditions . . . The time has come for policy to adjust." The most likely scenario is for the Fed to cut the benchmark fed funds rate by a modest 25 basis points to a range of 5.00% to 5.25%.

- Even though investors had long been expecting an interest-rate cut in September, the confirmation by Powell gave a boost to stocks and bonds on Friday. The S&P 500 price index jumped 1.15% to a near-record 5,634.61, while the yield on the 10-year Treasury note fell to 3.8070%.
- Going forward, there is still some question about the pace of any further cuts. Unless there are more signs of real stress in the economy, the policymakers could well prefer a slow, steady series of 25-basis-point cuts extending into 2025. With investors holding massive amounts in money market accounts, an erosion of the yield on those accounts coupled with a soft landing in the economy could potentially prompt a massive rotation back into stocks and a melt-up in equity prices.

US Economic Releases

Transportation helped push up durable goods orders last month, but there still seems to be tepid demand. US **durable goods orders** surged 9.9% in July, exceeding expectations of a 5% increase. While the overall reading was strong, it was not evenly distributed across all sectors. **Excluding transportation, durable goods orders** actually fell 0.2% from the previous month. **Capital goods orders, excluding aircraft** (a reliable indicator of business spending), also declined slightly by 0.1%.



The chart above shows the year-over-year change in durable goods orders and shipments. Durable goods orders increased 1.3% since July 2023, while shipments rose by 2.8% in the same period. This indicates solid business investment, but also suggests some caution among firms.

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

Economic Releases						
ET	Indicator			Expected	Prior	Rating
10:30	Dallas Fed Manufacturing Activity	m/m	Aug	-16.0	-17.5	**
Federal Reserve						
ET	Speaker or Event	District or Position				
14:00	Mary Daly appears on Bloomberg Television	President of the Federal Reserve Bank of San Francisco				

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	Nationwide Dept Sales	y/y	Jul	5.50%	14.00%		***	Equity and bond neutral
	Leading Economic Index	m/m	Jun F	109.0	108.6		**	Equity and bond neutral
	Coincident Index	y/y	Jun F	113.2	113.7	--	**	Equity and bond neutral
EUROPE								
Germany	Ifo Business Climate	m/m	Aug	86.6	87.0	86.0	***	Equity and bond neutral
	Ifo Current Assessment	m/m	Aug	86.5	87.1	86.5	**	Equity and bond neutral
	Ifo Expectations	m/m	Aug	86.8	87.0	85.8	**	Equity and bond neutral
Switzerland	Domestic Sight Deposits CHF	w/w	23-Aug	455.7b	457.2b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	23-Aug	463.6b	464.9b		*	Equity and bond neutral
AMERICAS								
Canada	Retail Sales	m/m	Jun	-0.3%	-0.8%	-0.3%	**	Equity and bond neutral
	Retail Sales Ex-Autos	m/m	Jun	0.3%	-1.2%	-0.2%	**	Equity and bond neutral
Mexico	Current Account Balance	q/q	2Q	\$3639m	-\$21374m	\$3400m	*	Equity and bond neutral
Brazil	Current Account Balance	m/m	Jul	-\$5162m	-\$4355m	-\$4000m	**	Equity and bond neutral
	Foreign Direct Investment	m/m	Jul	\$7258m	\$6270m	\$7150m	**	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)	534	533	1	Down
3-mo T-bill yield (bps)	500	500	0	Down
U.S. Sibor/OIS spread (bps)	506	506	0	Down
U.S. Libor/OIS spread (bps)	503	503	0	Down
10-yr T-note (%)	3.81	3.80	0.01	Down
Euribor/OIS spread (bps)	353	354	-1	Down
Currencies	Direction			
Dollar	Up			Down
Euro	Down			Up
Yen	Up			Up
Pound	Down			Up
Franc	Flat			Up
Central Bank Action	Current	Prior	Expected	
PBOC 1-Year Med-Term Lending (Bil.)	300.0b	200.0b	275.0b	Above Forecast
PBOC 1-Year Med-Term Lending Facility	2.30%	2.30%	2.30%	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	\$81.18	\$79.02	2.73%	
WTI	\$76.89	\$74.83	2.75%	
Natural Gas	\$1.96	\$2.02	-3.12%	
12-mo strip crack	\$20.23	\$20.19	0.16%	
Ethanol rack	\$1.96	\$1.96	0.25%	
Metals				
Gold	\$2,523.31	\$2,512.59	0.43%	
Silver	\$30.05	\$29.82	0.79%	
Copper contract	\$426.80	\$424.50	0.54%	
Grains				
Corn contract	\$386.25	\$391.00	-1.21%	
Wheat contract	\$523.75	\$528.00	-0.80%	
Soybeans contract	\$963.50	\$973.00	-0.98%	
Shipping				
Baltic Dry Freight	1,762	1,768	-6	
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)	35	25	10	

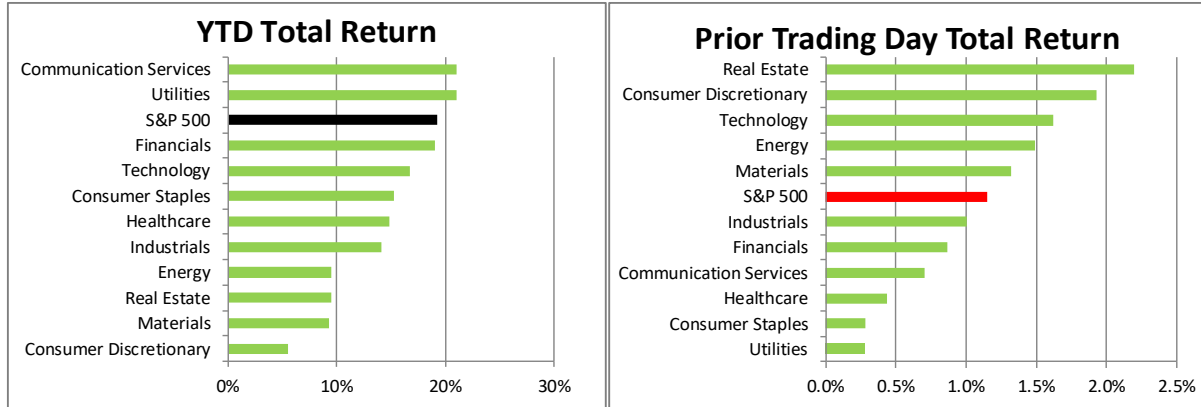
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures west of the Rocky Mountains and across much of the eastern United States. Cooler temperatures are expected in most of the central states. The precipitation outlooks call for wetter-than-normal conditions in the Great Plains region and east of the Mississippi River. In contrast, the Southwest and Northern Rockies are likely to experience drier conditions.

There are no tropical disturbances expected in the Atlantic Ocean within the next 48 hours.

Data Section

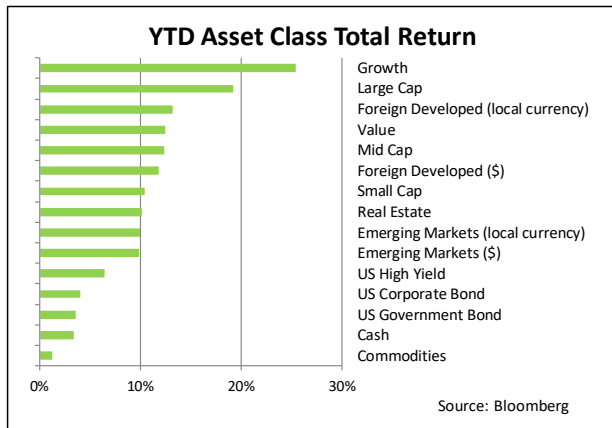
US Equity Markets – (as of 8/23/2024 close)



(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 8/23/2024 close)

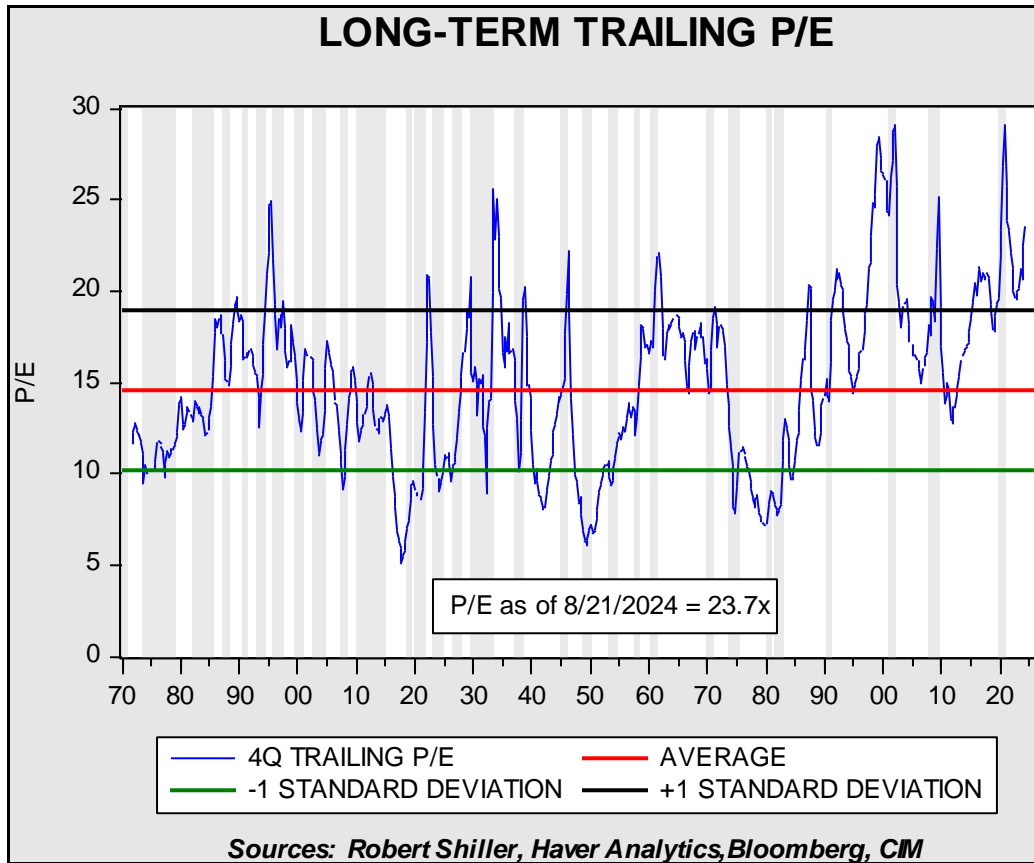


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 pickup 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.