Confluence INVESTMENT MANAGEMENT

# 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 30, 2024 — 9:30 AM ET]** Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 is up 0.1% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.6%. Chinese markets were higher, with the Shanghai Composite up 0.7% from its previous close and the Shenzhen Composite up 2.2%. US equity index futures are signaling a higher open.

With 494 companies having reported so far, S&P 500 earnings for Q2 are running at $61.60 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 15.2% have fallen short of expectations.

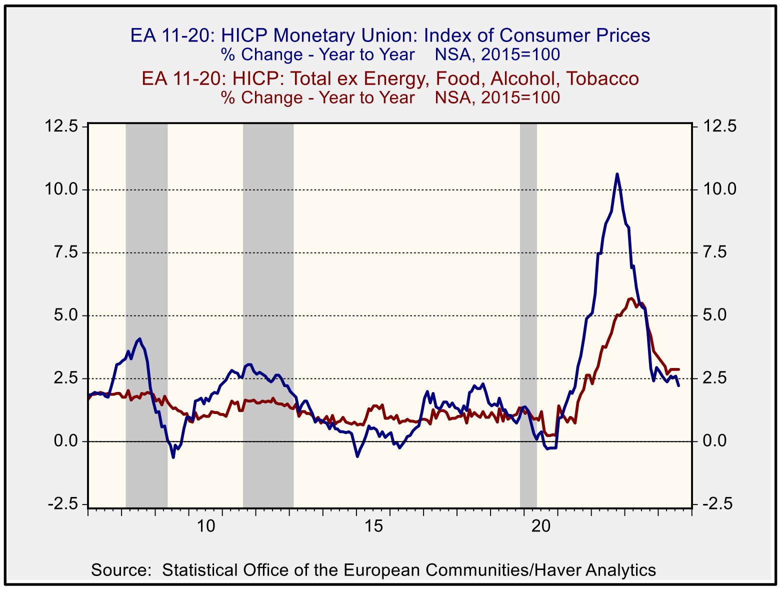
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *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.
- ***Business Cycle Report* (8/29/24)**

Our *Comment* today opens with a note on the eurozone's consumer price inflation, which has become (shall we say it?) more demure. We next review several other international and US developments with the potential to affect the financial markets today, including a look at the upcoming weekend elections in Germany and new research on the fiscal impact of the policies proposed by both US presidential candidates.

**Eurozone:** The August consumer price index was up just 2.2% from the same month one year earlier, matching expectations and marking a big slowdown from the 2.6% rise in the year to July. Excluding the volatile food, energy, and tobacco components, the August "core" CPI was up 2.8%, cooling only slightly from the 2.9% rise in the year to July. The data may help convince the European Central Bank (ECB) to institute a second interest-rate cut at its next policy meeting.

- Still, a new ECB rate cut isn't assured. For example, in a speech in Tallinn today, ECB board member Isabel Schnabel warned the drop in the eurozone's headline inflation rate is misleading because prices in the region's service sector continue to rise rapidly.
- The pace of rate cuts by the ECB and Federal Reserve could be especially important for exchange rates. If the Fed cuts rates relatively slowly, as we think it may, faster rate cuts by the ECB could help buoy the dollar and weaken the euro. In contrast, if the Fed cuts rates at the same pace or even faster than the ECB, it could catalyze a drop in the value of the greenback.




**Germany:** Much of the economic weakness pulling down eurozone price inflation is a reflection of Germany's faltering economy. A potential further risk for Germany is the balloting to be held in the eastern states of Thuringia and Saxony on Sunday. Polling suggests the far-right Alternative for Germany (AfD) could take control of one or both of those state parliaments. If the AfD manages that, business groups fear the party's sharp anti-immigrant rhetoric and agenda could further worsen eastern Germany's demographic decline.

**Poland:** Prime Minister Tusk's government has proposed a 2025 defense budget equivalent to $48.7 billion, up about 17.3% from the $41.5 billion in 2024. If approved by parliament, Poland's defense spending would top 4.7% of gross domestic product, giving it one of the biggest defense burdens in the North Atlantic Treaty Organization and cementing its role as a leader in European defense and politics.

**Australia:** The Australian government and Norwegian defense firm Kongsberg said they will jointly build a new factory in New South Wales to produce Naval Strike Missiles and Joint Strike Missiles. Initially, the missiles will be for the Australian armed forces, but they will eventually also be for export. The announcement illustrates the reindustrialization of countries in the US geopolitical bloc and the revitalization of the defense industry in many countries.

**South Korea:** New data shows that the South Korean acreage committed to growing bananas and other subtropical fruits and crops has expanded tenfold just since 2021. According to analysts, the expansion reflects rising average temperatures associated with global warming. In our view, the expansion also illustrates why investors should avoid politicized views of global trends and instead look for the investment opportunities and the risks they might provide.

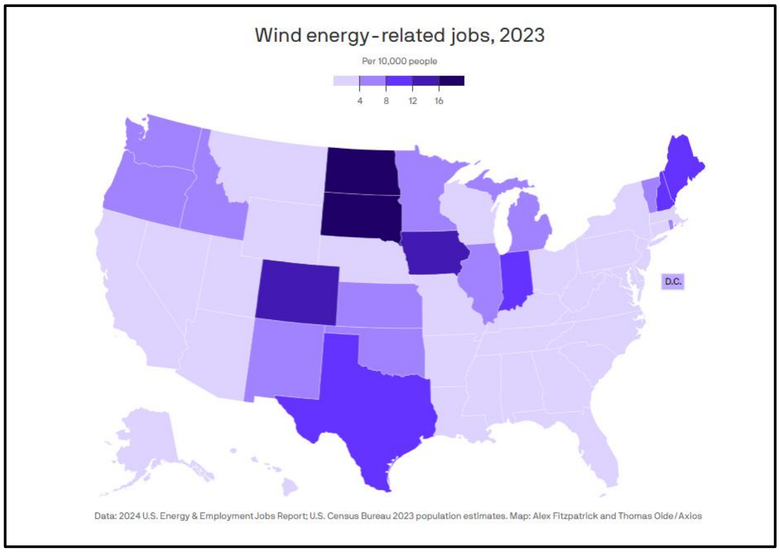
**China:** The People's Bank of China (PBOC) today announced that it made a small net purchase of sovereign foreign notes in the country's secondary bond market this month, marking its first such intervention in decades and illustrating how the central bank is trying to keep Chinese bond yields from falling further. The PBOC is especially concerned that volatile bond values could destabilize the Chinese banking system.

- Illustrating the continuing economic lethargy that has prompted strong bond buying at the expense of stocks and other risk assets, new data shows office utilization in China's major cities is now below even the low rates seen during the coronavirus pandemic. Office rents are reportedly at least 10% lower than they were two years ago.
- Unlike in the US, where the work-from-home phenomenon is a major reason for high office vacancy rates, property managers and brokers say China's vacancy problem is mostly a reflection of slow economic growth.

**US Fiscal Policy:** New analyses by the Penn Wharton School of Business show the economic proposals of presidential candidates Donald Trump and Kamala Harris would both expand the federal budget deficit over the coming decade. According to the research, former President Trump's proposals would expand the deficit by $5.8 trillion over current projections, mostly because of his aim to extend his 2017 individual income-tax cuts. Vice President Harris's proposals would boost the deficit by $1.2 trillion, mostly by expanding the child tax credit.

- According to the research, total federal debt in 2034 would be 9.3% bigger than current projections under Trump, while it would be 4.4% bigger than current projections under Harris.
- The Wharton projections are consistent with our view that the populism embedded in each candidate's proposals would expand the US budget deficit and boost overall debt.

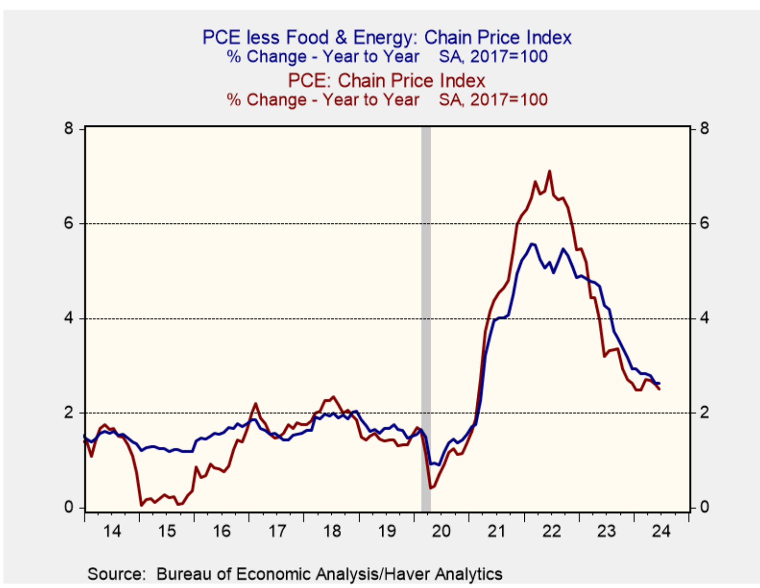
**US Labor Market:** New projections from the Census Bureau show the fastest-growing job type in the coming decade will be "wind turbine service technician." By 2023, the Census Bureau projects the country will have 60% more jobs of that type than it currently has. The jobs are currently concentrated in the Dakotas, Iowa, and Colorado.




**US Military:** According to a US Navy spokesman, the service [will meet its goal of 40,600 recruits in the fiscal year ended in September, after two straight years of shortfalls]. The other armed services have also seen an improvement in recruiting, especially over the last four to five months. That's consistent with the recent cooling in the civilian labor market. Historically, the armed services have found it more challenging to find recruits when the civilian labor market is strong.

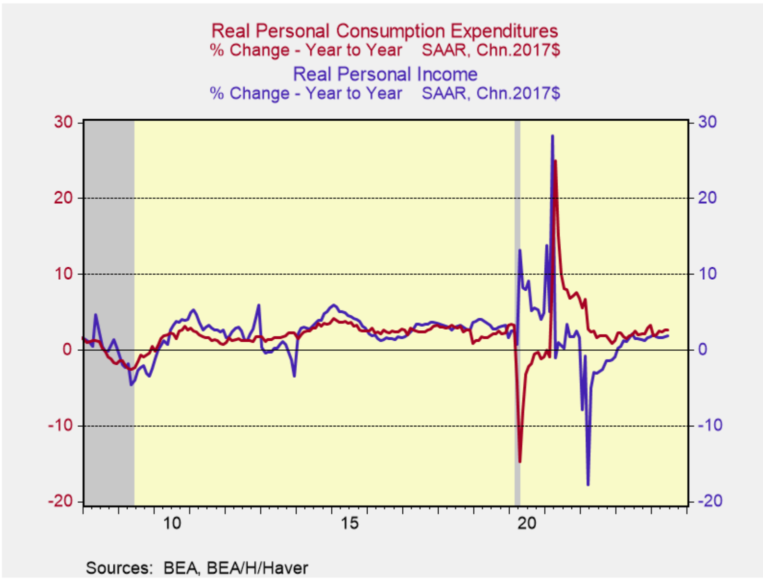
**US Economic Releases**

The Fed's preferred inflation gauge rose modestly in July, in a further sign that price pressures are cooling. The ***PCE price index*** rose 0.2% from the prior month in line with market expectations. Similarly, the ***Core PCE price index***, which excludes food and energy, rose 0.2% from the prior month, also in line with market expectations.



The chart above shows the year-over-year change in the headline and core PCE price index. The report showed that overall inflation has increased 2.5% from the prior year, while core inflation increased 2.6% in the same period. While inflation is far from the Fed's 2% target, this should not prevent the Fed from cutting at its next meeting.

Overall spending remains strong, even as income shows signs of moderating in July. According to the BEA, ***consumer spending*** increased 0.5% from the previous month. The reading was in line with expectations and above the previous month's increase of 0.3%. At the same time, ***personal income*** increased 0.3% last month, above both expectations and the previous month's reading of 0.2%




The chart above illustrates the annual change in real personal income and consumption. Real personal income rose 2.6%, while real personal consumption rose 1.9%. This divergence between prices and income may explain why households are still worried about inflation.

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

| **Economic Releases** | | | | | | |
|---|---|---|---|---|---|---|
| No economic releases for the rest of today | | | | | | |
| **ET** | **Indicator** | | | **Expected** | **Prior** | **Rating** |
| **9:45** | MNI Chicago PMI | m/m | Aug | 44.8 | 45.3 | *** |
| **10:00** | U. of Michigan Consumer Sentiment | m/m | Aug F | 68.1 | 67.8 | *** |
| **10:00** | U. of Michigan Current Conditions | m/m | Aug F | 61.2 | 60.9 | ** |
| **10:00** | U. of Michigan Future Expectations | m/m | Aug F | 72.4 | 72.1 | ** |
| **10:00** | U. of Michigan 1-Year Inflation Expectation | m/m | Aug F | 2.9% | 2.9% | * |
| **10:00** | U. of Michigan 5-10 Year Inflation Expectation | m/m | Aug F | 3.0% | 3.0% | * |
| **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** | Jobless Rate | m/m | Jul | 2.7% | 2.5% | 2.5% | *** | Equity and bond neutral |
| | Job-To-Applicant Ratio | m/m | Jul | 1.2% | 1.2% | 1.2% | *** | Equity and bond neutral |
| | Tokyo CPI | y/y | Aug | 2.6% | 2.2% | 2.3% | ** | Equity and bond neutral |
| | Tokyo CPI Ex-Fresh Food | y/y | Aug | 2.4% | 2.2% | 2.2% | *** | Equity and bond neutral |
| | Tokyo CPI Ex-Fresh Food & Energy | y/y | Aug | 1.6% | 1.5% | 1.4% | * | Equity and bond neutral |
| | Retail Sales | y/y | Jul | 2.6% | 3.8% | 2.8% | ** | Equity and bond neutral |
| | Industrial Production | y/y | Jul P | 2.7% | -7.9% | 2.7% | *** | Equity and bond neutral |
| | Depart. Store & Supermarket Sales | y/y | Jul | 1.1% | 6.6% | | * | Equity and bond neutral |
| | Housing Starts | y/y | Jul | -0.2% | -6.7% | -1.0% | ** | Equity and bond neutral |
| | Annualized Housing Starts | y/y | Jul | 0.773m% | 0.765m | 0.783m | * | Equity and bond neutral |
| **Australia** | Retail Sales | m/m | Jul | 0.0% | 0.5% | 0.3% | *** | Equity and bond neutral |
| | Private Sector Credit | y/y | Jul | 57.0% | 5.6% | | ** | Equity and bond neutral |
| **New Zealand** | ANZ Consumer Confidence Index | m/m | Aug | 92.2 | 87.9 | -- | * | Equity and bond neutral |
| | Building Permits | m/m | Jul | 26.2% | -17.0% | | ** | Equity and bond neutral |
| **South Korea** | Industrial Production | y/y | Jul | 5.5% | 3.8% | 7.5% | *** | Equity bearish, bond bullish |
| **India** | GDP | y/y | 2Q | 6.7% | 7.8% | 6.8% | ** | Equity and bond neutral |
| **EUROPE** | | | | | | | | |
| **Eurozone** | CPI | y/y | Aug | 2.2% | 2.6% | 2.2% | *** | Equity and bond neutral |
| | Core CPI | y/y | Aug P | 2.8% | 2.9% | 2.8% | ** | Equity and bond neutral |
| | Unemployment Rate | m/m | Jul | 6.4% | 6.5% | 6.5% | ** | Equity and bond neutral |
| **Germany** | Import Price Index | y/y | Jul | 0.9% | 0.7% | 1.5% | ** | Equity and bond neutral |
| | Unemployment Change | m/m | Aug | 2.0k | 17.0k | 16.0k | *** | Equity bearish, bond bullish |
| | Unemployment Claims Rate | m/m | Aug | 6.0% | 6.0% | 6.0% | ** | Equity and bond neutral |
| **France** | CPI | y/y | Aug P | 1.9% | 2.3% | 1.8% | *** | Equity and bond neutral |
| | CPI, EU Harmonized | y/y | Aug P | 2.2% | 2.7% | 2.1% | ** | Equity and bond neutral |
| | GDP | y/y | 2Q F | 1.0% | 1.1% | 1.1% | ** | Equity and bond neutral |
| | PPI | y/y | Jul | -5.4% | -5.9% | | * | Equity and bond neutral |
| **Italy** | Unemployment Rate | m/m | Jul | 6.5% | 6.9% | 7.0% | ** | Equity and bond neutral |
| | CPI, EU Harmonized | y/y | Aug P | 1.3% | 1.6% | 1.3% | *** | Equity and bond neutral |
| | CPI NIC Including Tobacco | y/y | Aug P | 1.1% | 1.3% | 1.2% | ** | Equity and bond neutral |
| | Consumer Confidence | m/m | Aug | 96.1 | 98.9 | 99.1 | *** | Equity bearish, bond bullish |
| | Manufacturing Confidence | m/m | Aug | 87.1 | 87.6 | 87.4 | *** | Equity and bond neutral |
| | Economic Sentiment | m/m | Aug | 94.7 | 94.3 | | ** | Equity and bond neutral |
| **UK** | Nationwide House Price Index | y/y | Aug | 2.4% | 2.1% | 2.9% | *** | Equity and bond neutral |
| | Mortgage Approvals | m/m | Jul | 62.0k | 60.6k | 60.5k | *** | Equity and bond neutral |
| | M4 Money Supply | y/y | Jul | 2.1% | 1.0% | | * | Equity and bond neutral |
| **Russia** | Gold and Forex Reserves | m/m | 23-Aug | $614.5b | $609.9b | | *** | Equity and bond neutral |
| | Money Supply, Narrow Definition | w/w | 23-Aug | 18.33t | 18.37t | | * | Equity and bond neutral |
| **AMERICAS** | | | | | | | | |
| **Canada** | Current Account Balance | q/q | 2Q | -$8.48b | -$5.37b | -$6.00b | ** | Equity and bond neutral |
| **Brazil** | Net Debt % GDP | m/m | Jul | 61.90% | 62.20% | 62.40% | ** | Equity and bond neutral |
| | National Unemployment Rate | m/m | Jul | 6.8% | 6.9% | 6.8% | * | Equity and bond neutral |
| | Total Outstanding Loans | m/m | Jul | 6046b | 6035b | | ** | 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)** | 532 | 532 | 0 | Down |
| **3-mo T-bill yield (bps)** | 496 | 498 | -2 | Down |
| **U.S. Sibor/OIS spread (bps)** | 502 | 503 | -1 | Down |
| **U.S. Libor/OIS spread (bps)** | 499 | 500 | -1 | Down |
| **10-yr T-note (%)** | 3.86 | 3.86 | 0.00 | Up |
| **Euribor/OIS spread (bps)** | 351 | 351 | 0 | Down |
| **Currencies** | **Direction** | | | |
| Dollar | Flat | | | Down |
| Euro | Flat | | | Up |
| Yen | Down | | | Up |
| Pound | Up | | | Up |
| Franc | Down | | | Up |

## 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 | $79.93 | $79.94 | -0.01% | |
| WTI | $75.90 | $75.91 | -0.01% | |
| Natural Gas | $2.14 | $2.14 | 0.23% | |
| 12-mo strip crack | $20.03 | $19.78 | 1.28% | |
| Ethanol rack | $2.03 | $2.02 | 0.35% | |
| **Metals** | | | | |
| Gold | $2,519.79 | $2,521.40 | -0.06% | |
| Silver | $29.51 | $29.42 | 0.29% | |
| Copper contract | $425.50 | $422.25 | 0.77% | |
| **Grains** | | | | |
| Corn contract | $398.50 | $396.00 | 0.63% | |
| Wheat contract | $550.25 | $548.75 | 0.27% | |
| Soybeans contract | $1,002.75 | $992.50 | 1.03% | |
| **Shipping** | | | | |
| Baltic Dry Freight | 1,827 | 1,755 | 72 | |
| **DOE Inventory Report** | | | | |
| | **Actual** | **Expected** | **Difference** | |
| Crude (mb) | -0.85 | -2.78 | 1.93 | |
| Gasoline (mb) | -2.20 | -2.15 | -0.05 | |
| Distillates (mb) | 0.28 | -0.82 | 1.09 | |
| Refinery run rates (%) | 1.0% | 0.1% | 0.9% | |
| Natural gas (bcf) | 35 | 35 | 0 | |

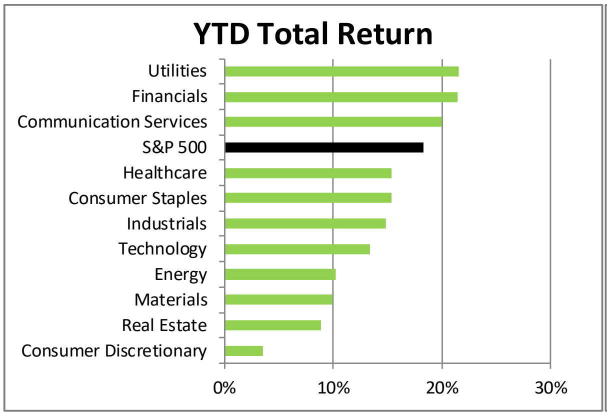
**Weather**

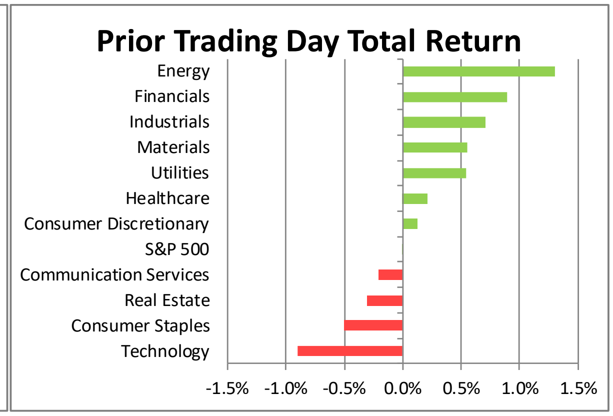
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures in most of the western half of the country, with cooler temperatures expected on the Atlantic Coast and in the Midwest. The precipitation outlooks call for wetter-than-normal conditions throughout the South and on the East Coast, with drier than normal conditions in the Desert Southwest, northern Great Plains, and the Great Lakes region.

There are two tropical disturbances developing in the Atlantic Ocean, but both have less than a 1% chance of cyclone formation within the next 48 hours.

## Data Section

**US Equity Markets** – (as of 8/29/2024 close)

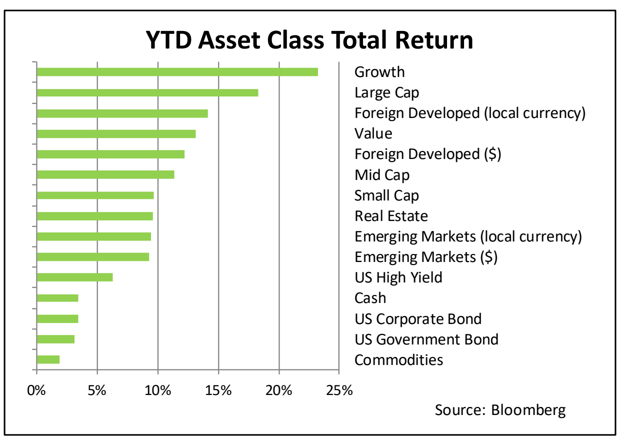



(Source: Bloomberg)

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 8/29/2024 close)

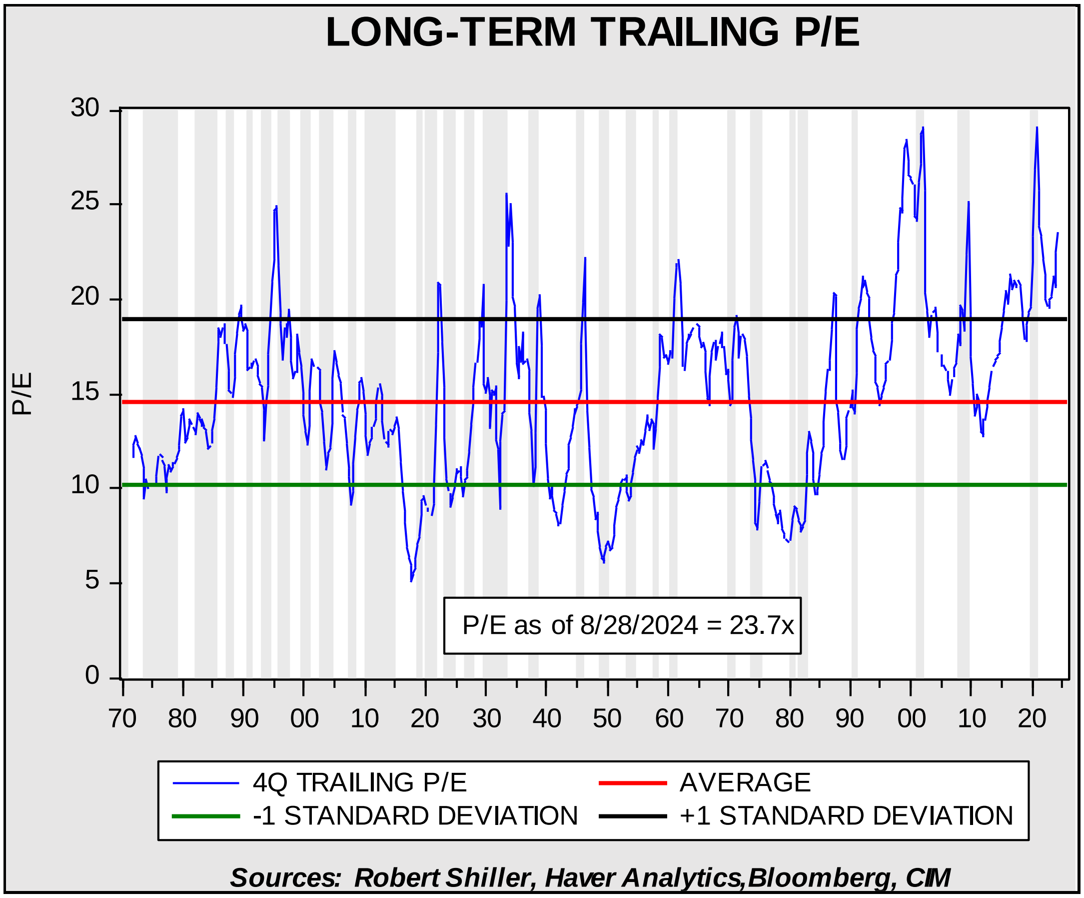



This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 29, 2024




Based on our methodology,[1] the current P/E is 23.7x, unchanged from our last report. The increase in stock price index was offset mostly by 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.