Daily Comment

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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 7, 2024 — 9:30 AM ET] Global equity markets are mostly higher this morning. In Europe, the Euro Stoxx 50 is up 1.5% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 2.5%. Chinese markets were mixed, with the Shanghai Composite up 0.1% from its previous close and the Shenzhen Composite down 0.1%. US equity index futures are signaling a higher open.

With 419 companies having reported so far, S&P 500 earnings for Q2 are running at $61.10 per share, compared to estimates of $58.94, which is up 8.0% from Q2 2023. Of the companies that have reported thus far, 79.4% have exceeded expectations while 15.8% 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:

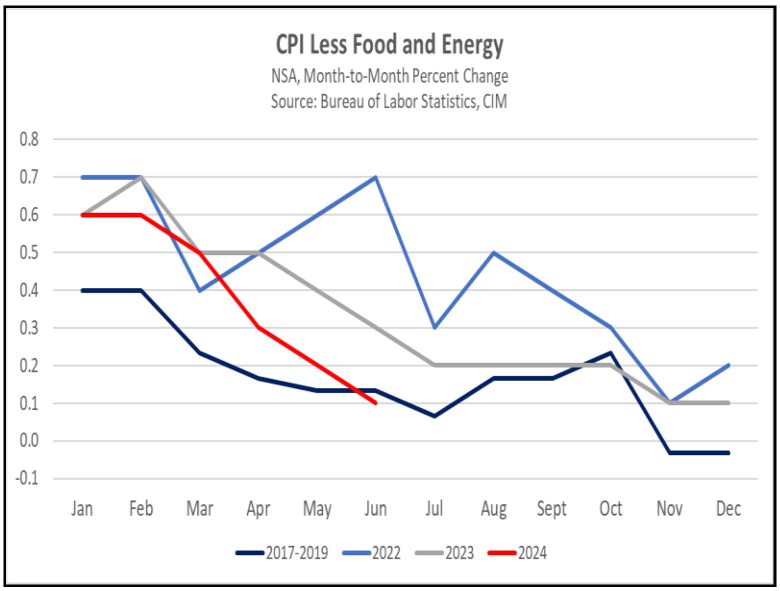
- *Bi-Weekly Geopolitical Report* (8/5/2024) (no accompanying podcast for this report): "The US Geopolitical and Economic Bloc as an Investment Region"
- *Asset Allocation Bi-Weekly* (7/29/2024) (with associated podcast): "The Price of Central Bank Independence"
- *Asset Allocation Quarterly – Q3 2024* (7/16/2024): Discussion of our asset allocation process, Q3 2024 portfolio changes, and our outlook for the markets.
- ***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 off to a strong start as risk sentiment improves. In sports news, Team USA's basketball team dominated Brazil, securing their spot in the semifinals against Serbia. Today's *Comment* will explore why the market has stabilized since Monday's sell-off, share our thoughts on carry trades, and provide an update on the UK budget situation. As usual, our report includes a summary of international and domestic data releases.

All Calm on the Market Front: Equities staged a recovery from Monday's sharp decline, yet investors remain cautious about potential future turbulence.

- The S&P 500 surged 1.7% on Tuesday, rebounding from a global sell-off ignited by recession concerns. Despite these fears, recent economic indicators point to a resilient economy. Wednesday's S&P Global and ISM Purchasing Managers Indexes not only confirmed continued expansion but also surpassed market forecasts. Moreover, the Senior Loan Officer Opinion Survey revealed that while banks have tightened lending standards overall, the net share of lenders which have tightened conditions has decreased from the previous quarter, signaling potential optimism in the lending market.

- While the market has experienced a slight reprieve, underlying uncertainty persists. The CBOE Volatility Index (VIX) declined from 32.38 to 27.71 on Tuesday, though it remains significantly elevated above the 20 level, indicating continued market anxiety. This elevated reading reflects investors' continued uncertainty about the Federal Reserve's interest rate trajectory. While policymakers have indicated that recent events won't prompt an immediate rate cut, market participants still anticipate potential adjustments to the rate cut outlook beyond the previously projected single reduction this year.

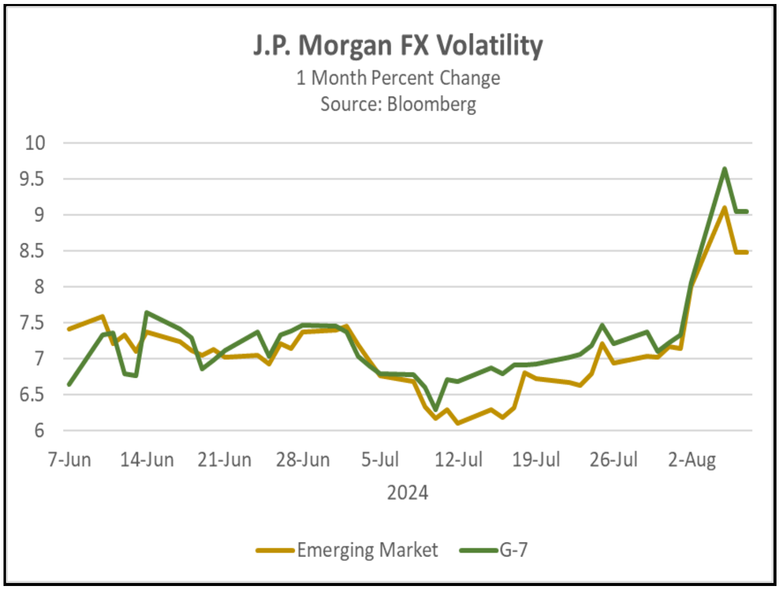


- The market will closely watch economic data in the coming weeks as investors anticipate the Federal Open Market Committee's next move on September 18. Two additional CPI reports and another employment report will be released prior to the meeting and will likely influence market reactions. While a September rate cut is still expected if inflation continues its downward trajectory, the magnitude of the cut will hinge on labor market conditions. A rise in the unemployment rate to 4.4% could increase the odds of a substantial 50-basis-point reduction.

More than Japan: While the Japanese yen (JPY) dominated market attention, other currencies were also adversely affected by the downturn in the broader market.

- Emerging market currencies were battered by the market turmoil as carry trades unwound since the start of the week, with the Mexican peso (MXN) plunging below the critical 20 level against the dollar, marking its weakest point in two years. The Chinese yuan (CNY) also declined against the dollar. In contrast, the Swiss franc (CHF), a safe haven currency, soared to a six-month high, prompting some Swiss National Bank policymakers to consider currency intervention to curb its appreciation. Ironically, the dollar's value has remained relatively stable amid these volatile currency movements.

- This turmoil was ignited by the JPY's sharp appreciation following the Bank of Japan's (BOJ) surprise rate hike and weak US economic data. Although the BOJ has subsequently indicated no plans for further tightening, which has offered some relief, currencies continue to fluctuate amid growing recession fears in the United States. J.P. Morgan's one-month volatility index indicates persistent uncertainty in currency markets as the duration of the current unwind remains unclear. By one estimate, the carry trade unwind is somewhere between 50%-60% complete.

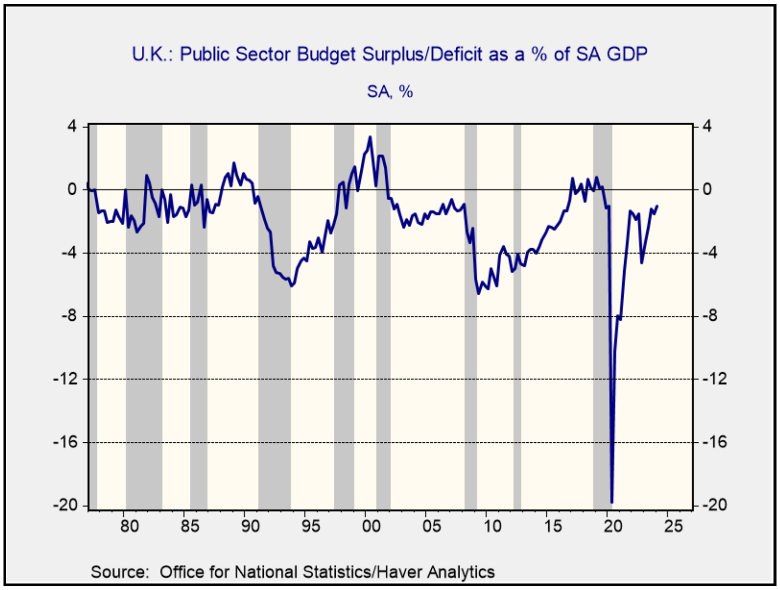


- The unwinding of carry trades continues to threaten the equity market, particularly the tech sector, due to its heavy reliance on this funding. While recent market stability is encouraging, normalization is expected in the coming days. Following the BOJ's announcement, European and Asian stocks rallied this morning, a trend we anticipate will continue. Despite our optimistic outlook, we remain vigilant for signs of significant market disruption, especially if US recession fears intensify.

Labor Party Plan: A month after their decisive victory in the UK Parliament, the Labour Party is finally unveiling its plan to address the government budget deficit.

- UK Chancellor Rachel Reeves is expected to push for higher taxes and pension reform as she seeks to submit her budget by October 30. During a Bloomberg TV appearance this week, she announced plans to strike a balance on taxes and hinted that an increase in the capital gains tax could be on the table. Separately, rumors circulated on Wednesday about her exploring a public pension overhaul modeled after Canada's system. This could involve consolidating local government pension plans to channel funds to infrastructure projects while also reducing costs and fees.

- Concerns about the new government's fiscal policy have intensified following the revelation of a 22 billion GBP ($28 billion) public spending overrun last week. This deficit compounds the nation's efforts to curb spending, as the Office for Budget Responsibility has reported that borrowing has exceeded its March forecast by 3 billion GPB ($3.8 billion) year-to-date. While a surprising first-quarter economic uptick has mitigated some of these costs, there are fears that the Labour Party may need to implement austerity measures unless growth accelerates significantly.



- While the UK's market influence has diminished since its 2020 departure from the European Union, it remains a key country to monitor. The infamous Truss mini-budget and its subsequent financial market turmoil underscore the UK's capacity to impact global markets. Unlike Truss's administration, which triggered market instability with its unfunded tax cuts, the current government has been more measured in its fiscal policy, avoiding lofty spending pledges that could erode investor confidence. If the Labour Party can present a viable budget plan in October, it should support UK assets.

In Other News: Kamala Harris, Democratic presidential nominee, has selected Minnesota Governor Tim Walz as her vice-presidential running mate, a strategic choice aimed at enhancing her appeal among voters in the Rust Belt. Rioting continues in Bangladesh after the prime minister resigned following widespread protests. The country is a significant hub for garment manufacturers supplying US retailers.

US Economic Releases

The Mortgage Bankers Association today said ***mortgage applications*** in the week ended August 2 rose an impressive 6.9%. Applications for home purchase mortgages rose a relatively modest 0.8%; however, this marked the first gain for this portion of the index in a month. Meanwhile, applications for refinancing mortgages surged 16% in response to a plunge in mortgage rates. According to the report, the average interest rate on a 30-year mortgage declined 27 basis points from 6.82% to 6.55%. This is the biggest drop in two years. Along with spurring a wave of refinancing, this move could portend an acceleration in the housing market.

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**
15:00	Consumer Credit	m/m	Jun	$10.000b	$11.354b	*
Federal Reserve						
ET	**Speaker or Event**	**District or Position**				
12:00	Susan Collins Visits Rhode Island	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	Leading Economic Index	m/m	Jun P	108.6	111.2	108.8	**	Equity and bond neutral
	Coincident Index	y/y	Jun P	113.7	117.1	113.8	**	Equity and bond neutral
New Zealand	Unemployment Rate	q/q	2Q	4.6%	4.4%	4.7%	***	Equity and bond neutral
	Employment Change	q/q	2Q	0.6%	1.3%	0.0%	**	Equity bearish, bond bullish
South Korea	BoP Current Account Balance	m/m	Jun	$12259.2m	$8922.5m		**	Equity and bond neutral
	BoP Goods Balance	m/m	Jun	$11468.6m	$8751.5m		*	Equity and bond neutral
China	Exports	y/y	Jul	7.0%	8.6%	10.0%	**	Equity and bond neutral
	Imports	y/y	Jul	7.2%	-2.3%	3.3%	**	Equity and bond neutral
	Trade Balance	m/m	Jul	$84.65b	$99.05b	$100.10b	***	Equity and bond neutral
	Foreign Reserves	m/m	Jul	$3256.37b	$3222.36b	$3252.00b	**	Equity and bond neutral
EUROPE								
Germany	Industrial Production WDA	y/y	Jun	-4.1%	-7.2%	-4.2%	**	Equity and bond neutral
	Trade Balance	m/m	Jun	20.4b	25.3b	21.5b	*	Equity and bond neutral
	Exports	m/m	Jun	-3.4%	-3.1%	-1.5%	*	Equity and bond neutral
	Imports	m/m	Jun	0.3%	-5.5%	2.5%	*	Equity and bond neutral
France	Current Account Balance	m/m	Jun	-2.6b	-2.5b		*	Equity and bond neutral
	Trade Balance	m/m	Jun	-6088m	-7716m		*	Equity and bond neutral
Switzerland	Foreign Currency Reserves	m/m	Jul	703.5b	711.8b		*	Equity and bond neutral
AMERICAS								
Canada	Int'l Merchandise Trade	m/m	Jun	0.64b	-1.61b	-2.04b	*	Equity bullish, bond bearish
	S&P Global Canada Composite PMI	m/m	Jul	47.0	47.5		*	Equity and bond neutral
	S&P Global Canada Services PMI	m/m	Jul	47.3	47.1		*	Equity and bond neutral
Mexico	International Reserves Weekly	w/w	2-Aug	$223,162	$221725m		*	Equity and bond neutral
Brazil	Imports Total	m/m	Jul	$23279m	$22381m	$23490m	*	Equity and bond neutral
	Exports Total	m/m	Jul	31240m	$28766m	$31240m	*	Equity and bond neutral
	Trade Balance Monthly	m/m	Jul	7796m	$6385m	$7796m	**	Equity and bond neutral
	FGV Inflation IGP-DI	y/y	Jul	4.16%	2.88%	4.02%	**	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)	539	549	-10	Down
3-mo T-bill yield (bps)	508	507	1	Down
U.S. Sibor/OIS spread (bps)	512	513	-1	Down
U.S. Libor/OIS spread (bps)	510	510	0	Down
10-yr T-note (%)	3.93	3.89	0.04	Down
Euribor/OIS spread (bps)	352	358	-6	Down
Currencies	**Direction**			
Dollar	Up			Down
Euro	Down			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.

DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$78.07	$76.48	2.08%	
WTI	$74.81	$73.20	2.20%	
Natural Gas	$2.07	$2.01	3.13%	
12-mo strip crack	$21.41	$21.37	0.17%	
Ethanol rack	$1.96	$1.96	-0.18%	
Metals				
Gold	$2,402.18	$2,390.82	0.48%	
Silver	$27.11	$26.98	0.46%	
Copper contract	$398.55	$402.70	-1.03%	
Grains				
Corn contract	$401.50	$405.25	-0.93%	
Wheat contract	$546.00	$543.25	0.51%	
Soybeans contract	$1,016.25	$1,026.75	-1.02%	
Shipping				
Baltic Dry Freight	1,685	1,677	8	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-1.80		
Gasoline (mb)		-1.80		
Distillates (mb)		1.00		
Refinery run rates (%)		0.6%		
Natural gas (bcf)		22		

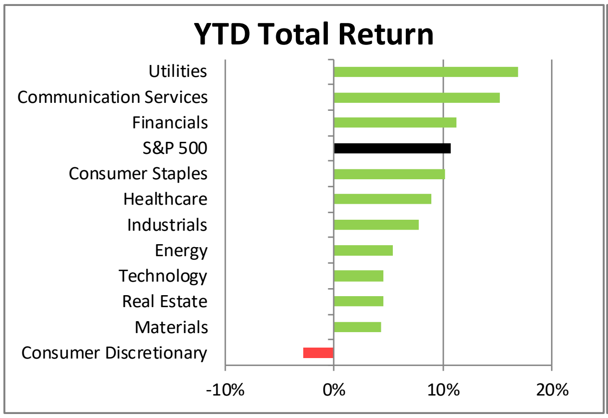
Weather

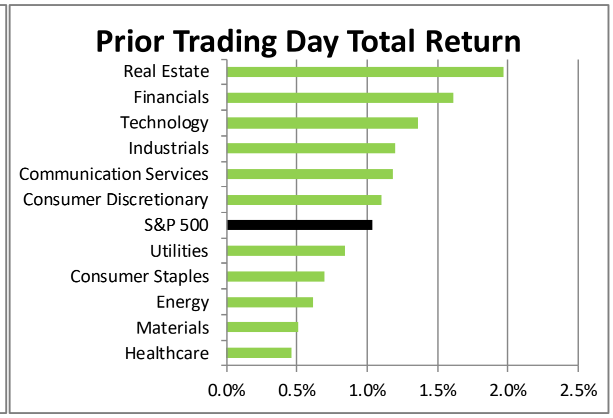
The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures in the southern portion of the country stretching from Florida and the Carolina coast to Utah and Arizona, with cooler-than-normal temperatures in California and the Mid-Atlantic coast. The precipitation outlook calls for wet conditions from coast-to-coast in the northern third of the country, with dry conditions expected in Nevada.

Tropical Storm Debby is tracking along the Carolina Coast, drenching the area with potentially historic rainfall, flooding, and storm surges. It will remain a hazard throughout the week. Another tropical disturbance is traversing the southern Caribbean Sea on course for Nicaragua, but it poses a minimal threat, with only a 10% chance of developing into a cyclone.

Data Section

US Equity Markets – (as of 8/6/2024 close)

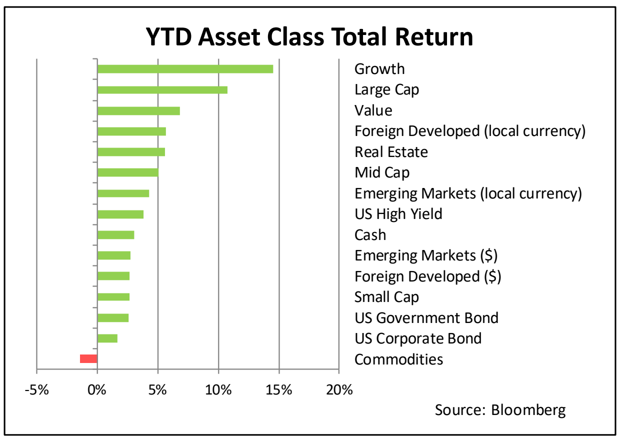




(Source: Bloomberg)

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 8/6/2024 close)

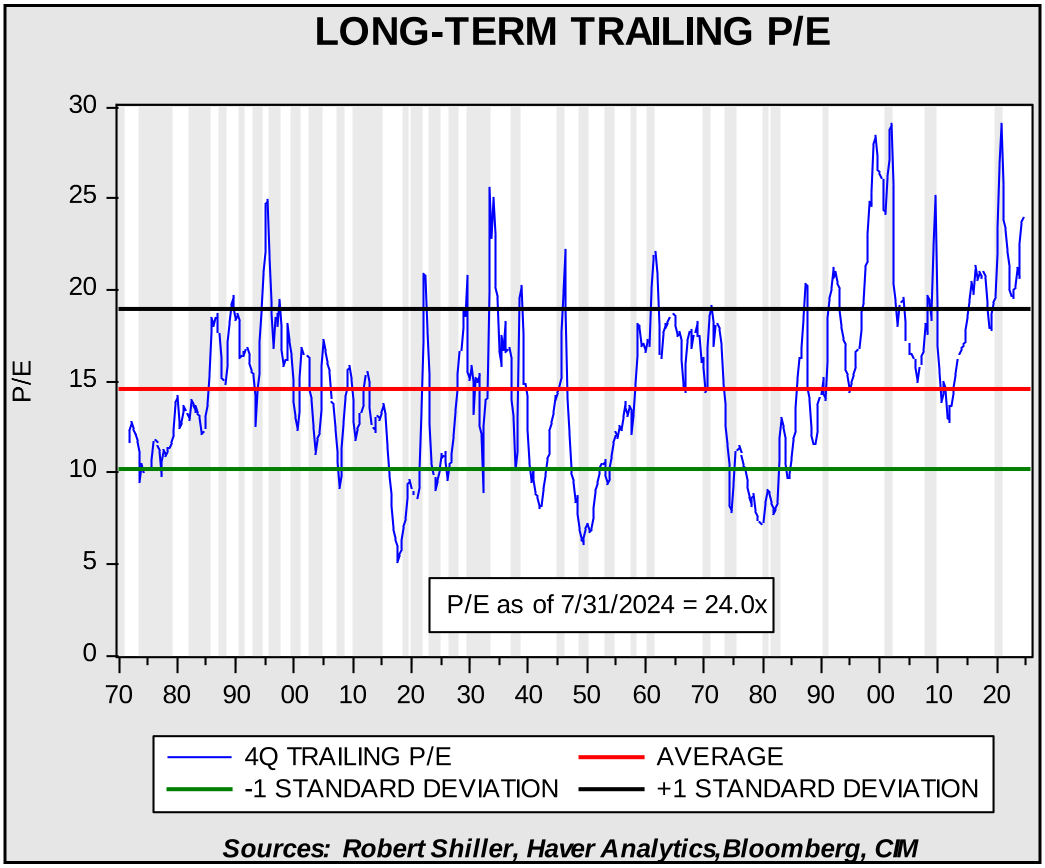


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.