Daily Comment

Confluence INVESTMENT MANAGEMENT

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[Posted: December 11, 2024 — 9:30 AM ET] Global equity markets are generally higher this morning. In Europe, the Euro Stoxx 50 closed up 0.1% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.9%. Chinese markets were higher, with the Shanghai Composite up 0.3% from its previous close and the Shenzhen Composite up 0.8%. US equity index futures are signaling a higher open.

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 in bold:

Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
Implications of North Korean Soldiers in the Ukraine War (11/18/24) + podcast	*Household Cash Levels and the S&P 500* (12/9/24) + podcast	Q4 2024 Report Q4 2024 Rebalance Presentation	Business Cycle Report

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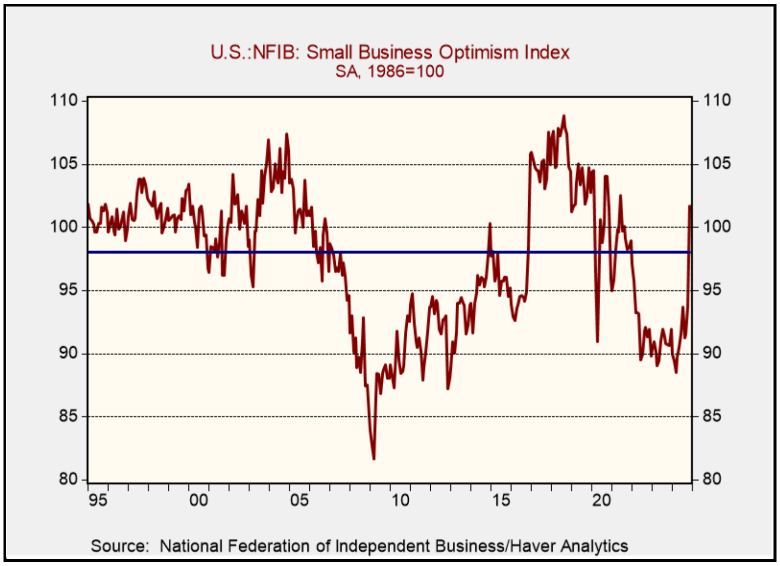
Good morning! The market is currently digesting the latest inflation data. In sports news, two-time All-Star left-handed pitcher Max Fried inked a $218 million deal with the New York Yankees. Today's *Comment* will delve into our thoughts on Trump's pick to head the Federal Trade Commission, the potential for a stronger dollar in 2025, and the latest developments in South Korean politics. As always, we'll conclude with a roundup of key domestic and international economic data releases.

Trump Anti-Trust Busting: The president-elect has chosen Andrew Ferguson to lead the Federal Trade Commission (FTC), signaling the administration's intent to moderate the agency's stance on monopoly power.

- The new agency head is set to continue the FTC's oversight of Big Tech, but will likely leave other sectors alone. He is also expected to adopt a softer approach to AI regulation and take a more lenient stance on merger standards compared to his predecessor, Lina Khan. His primary focus will be safeguarding free speech on social media platforms. In this role, which does not require Senate confirmation, he will oversee ongoing cases against tech giants, which could pave the way for the breakup of companies like Google and Meta.

- Ferguson is expected to limit the regulatory body's authority as he looks to create the pro-innovation environment pushed by the president. He has publicly opposed measures like judicial job protection, challenged the agency's rule-making authority, and argued against regulations that could stifle AI innovation. His appointment will likely bolster business optimism, as evidenced by the recent spike in the National Federation of Independent Business's Small Business Optimism Index. In November, it surpassed its long-term average of 98 for the first time in 34 months.

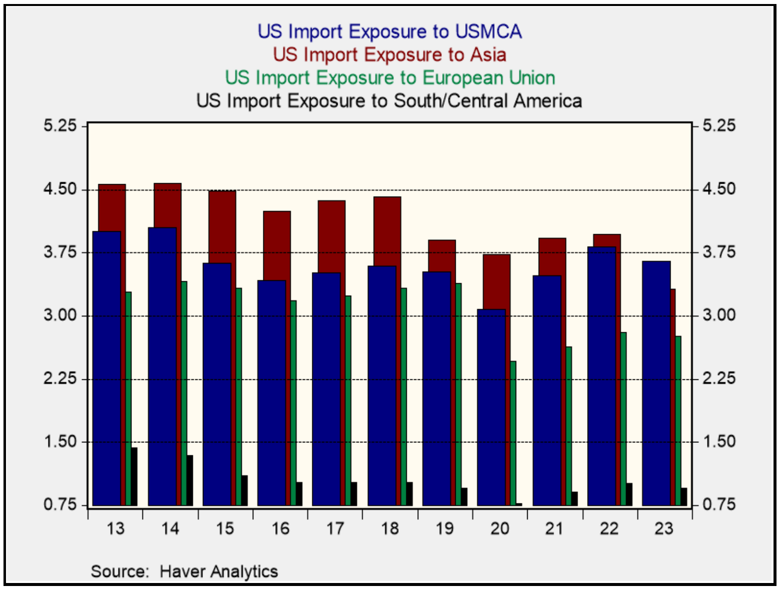


- A less stringent FTC could boost the broader equity market, as industries like finance, energy, and pharmaceuticals face reduced regulatory scrutiny. These industries have traditionally been focal points for regulatory actions concerning consumer protection. However, the outlook for tech stocks remains uncertain, as they are likely to remain under heightened scrutiny due to concerns about monopoly power and perceived biases against conservative speech. While we see some potential upside in tech, we believe investors may find better value opportunities in other industries as well.

Super Greenback: Hawkish trade policy and relatively restrictive monetary policy are expected to support the dollar in the coming year.

- Reports surfaced Wednesday that Beijing may allow its currency to depreciate next year as a potential response to a looming US trade war. The new measure along with additional stimulus from the government is intended to bolster the competitiveness of Chinese exports and revitalize its ailing manufacturing sector. Later today, Beijing is expected to outline its economic plans, including measures to stimulate growth, at its annual economic policy meeting.
- The looming threat of a US trade war has strengthened the dollar significantly against major currencies. Since September, the dollar has appreciated by 4.2% versus the Chinese yuan (CNY), 4.6% versus the Mexican peso (MXN), 6.0% versus the Canadian

dollar (CAD), and 6.7% versus the euro (EUR). As trade tensions intensify, growth prospects for these economies may deteriorate, potentially pushing them towards more accommodative monetary policies. Meanwhile, the Federal Reserve's stance on interest rate cuts remains uncertain, which could also exacerbate the dollar's strength.

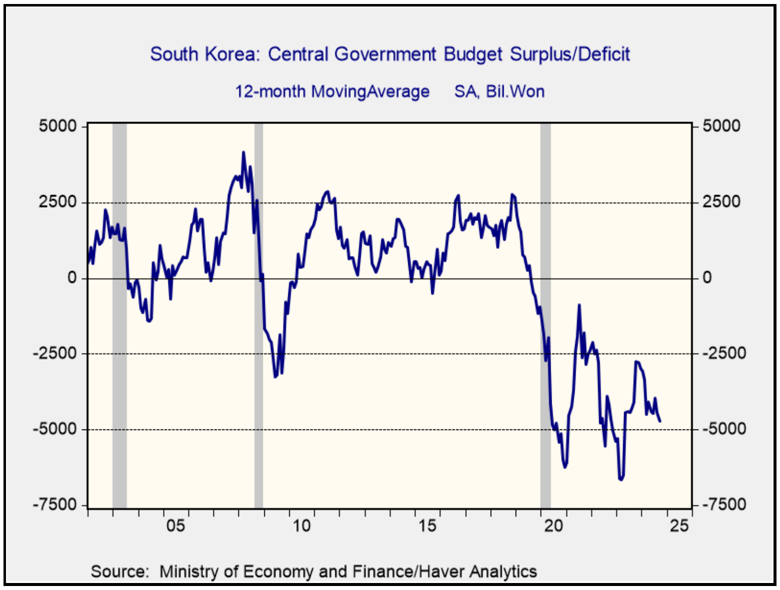


- The strengthening dollar poses a significant risk to the global economy, especially for nations with substantial US dollar-denominated debt. This trend could make the US an increasingly attractive investment destination, particularly if the incoming administration implements its promised tax cuts. For investors seeking international exposure, a prudent strategy would be to prioritize countries with low debt levels and minimal trade exposure to the US. This could involve focusing on nations within the European Union and South/Central America, given their relatively limited import exposure to the US.

Korea's Turmoil: South Korea is currently looking to pave the way forward as it tries to move past the recent attempt by its president to impose martial law.

- On Tuesday, in a historic move, South Korea's opposition-controlled parliament approved a government budget without the consent of government ministries. South Korea's budget has been a major point of contention with proposed cuts clashing with the president's desire for increased spending. This tension escalated to the point where the president attempted to declare martial law last week. However, South Korea's unique legislative system allows its lawmakers to implement budget cuts without presidential approval, which is likely to weigh on an already struggling economy and exacerbate political tensions.
- The budget dispute highlights a strategic move by the opposition party to leverage its position and impose austerity measures to both balance the nation's finances and weaken the ruling party. While the potential economic slowdown could aid in removing the ruling party from power, this questionable approach mirrors global trends as South Korea (like

many other countries) navigates the transition from pandemic-era deficit spending to fiscal sustainability. Despite a relatively low debt-to-GDP ratio of 45% compared to Western nations, the country still faces its largest-ever budget deficit.



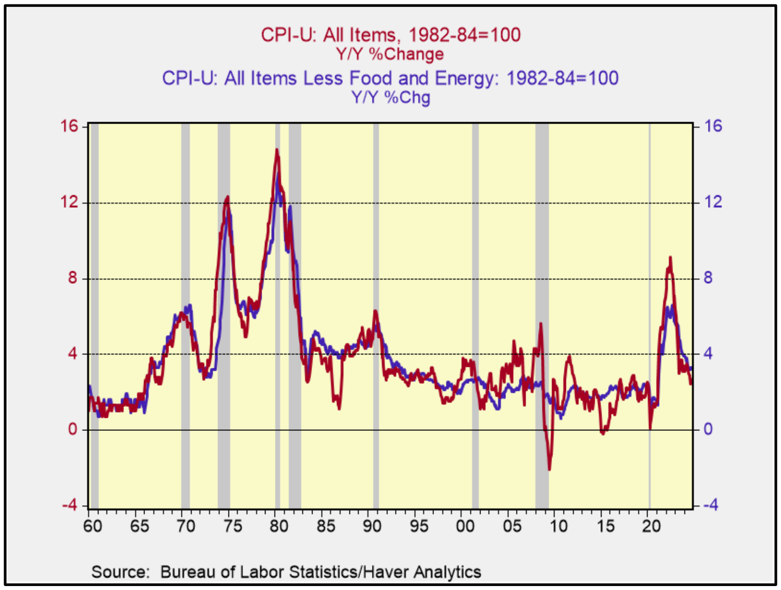
- While the new budget may not significantly boost economic prospects, it could provide some level of certainty amidst the country's ongoing crisis. The opposition party is poised to hold a second impeachment vote on Saturday, following the failure of the first attempt due to a lack of quorum. This second attempt may prove more successful, as the head of the ruling party has distanced himself from Yoon following his decision to impose martial law. However, the political uncertainty within the country is likely to persist, as it remains unclear who would succeed Yoon if the impeachment proceeding is successful.

In Other News: Two major mergers faced setbacks as President Biden moved to block the sale of US Steel to Nippon Steel, and a judge halted Kroger's acquisition of Albertsons. Meanwhile, French President Emmanuel Macron is working with moderates to select a new prime minister within the next 24 hours. President-elect Donald Trump has pledged to fast-track permits for a $1 billion US investment initiative.

US Economic Releases

The Mortgage Bankers Association today said ***mortgage applications*** in the week ended December 6 rose 5.4%, compared to last week’s gain of 2.8%, marking the fifth consecutive weekly increase. Applications for home purchase mortgages fell 4.1%, partially reversing the prior week’s gain of 5.6%; however, applications for refinancing mortgages surged 27.2%, after last week’s 0.6% decline. According to the report, the average interest rate on a 30-year mortgage eased two basis points to 6.67%.

The November ***consumer price index (CPI)*** results matched expectations across the board. The base number rose by a seasonally adjusted 0.3%, slightly accelerating from October's 0.2%. Excluding the volatile food and energy components, the ***"core" CPI*** also rose 0.3%, matching the October result. The overall CPI in November rose 2.7% from the same month one year earlier, versus 2.6% last month, while the core CPI rose 3.3%, the same as October's result. The chart below shows the year-over-year change in the CPI and the core CPI over time.



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

Economic Releases						
ET	Indicator			Expected	Prior	Rating
14:00	Federal Budget Balance	m/m	Nov	-$356.0b	-$314.0b	**
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	PPI	y/y	Nov	3.7%	3.6%	3.4%	***	Equity and bond neutral
New Zealand	Mfg Activity Volume	q/q	3Q	-1.2%	0.6%		**	Equity and bond neutral
	Mfg Activity SA	q/q	3Q	-0.1%	0.9%		*	Equity and bond neutral
South Korea	Unemployment Rate	m/m	Nov	2.7%	2.7%	2.8%	***	Equity and bond neutral
EUROPE								
AMERICAS								
Mexico	International Reserves Weekly	w/w	6-Dec	$228753m	$228392m		*	Equity and bond neutral
Brazil	IBGE Services Volume	y/y	Oct	6.30%	3.80%	5.60%	*	Equity bullish, bond bearish

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)	485	485	0	Down
3-mo T-bill yield (bps)	427	427	0	Down
U.S. Sibor/OIS spread (bps)	439	440	-1	Down
U.S. Libor/OIS spread (bps)	438	438	0	Down
10-yr T-note (%)	4.24	4.23	0.01	Up
Euribor/OIS spread (bps)	287	286	1	Down
Currencies	Direction			
Dollar	Up	US		Down
Euro	Down	Euro		Up
Yen	Down	Japan		Up
Pound	Down	UK		Up
Franc	Down	Switzerland		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.

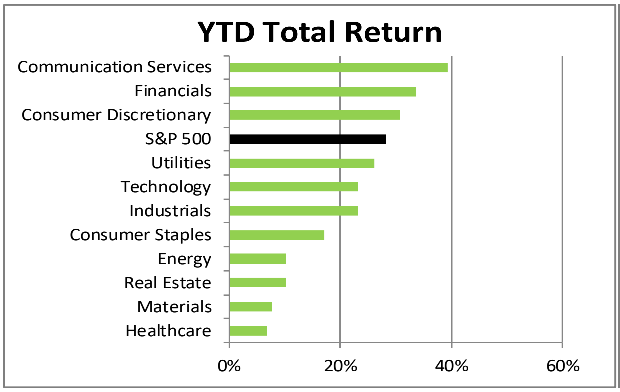
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$73.12	$72.19	1.29%	
WTI	$69.55	$68.59	1.40%	
Natural Gas	$3.25	$3.16	2.85%	
Crack Spread	$16.79	$16.72	0.42%	
12-mo strip crack	$19.92	$19.87	0.27%	
Ethanol rack	$1.76	$1.76	0.02%	
Metals				
Gold	$2,696.05	$2,694.25	0.07%	
Silver	$31.70	$31.91	-0.66%	
Copper contract	$426.65	$427.20	-0.13%	
Grains				
Corn contract	$449.50	$449.00	0.11%	
Wheat contract	$563.25	$561.75	0.27%	
Soybeans contract	$998.75	$1,000.25	-0.15%	
Shipping				
Baltic Dry Freight	1,156	1,168	-12	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-1.10		
Gasoline (mb)		1.20		
Distillates (mb)		1.00		
Refinery run rates (%)		-0.1%		
Natural gas (bcf)		-168		

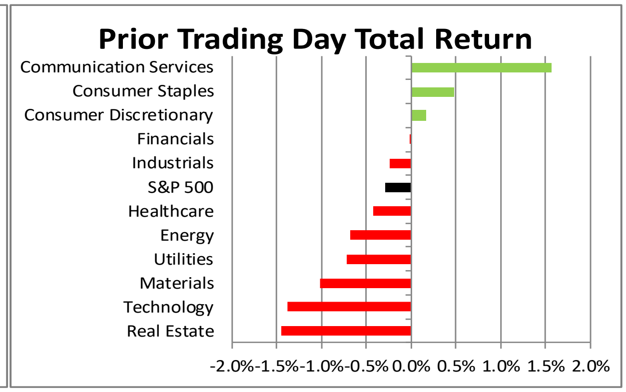
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures throughout the entire country except for the East Coast. The forecasts call for wetter-than-normal conditions in the Pacific Northwest and southern Texas, with dry conditions stretching from the Desert Southwest to Montana.

Data Section

US Equity Markets – (as of 12/10/2024 close)

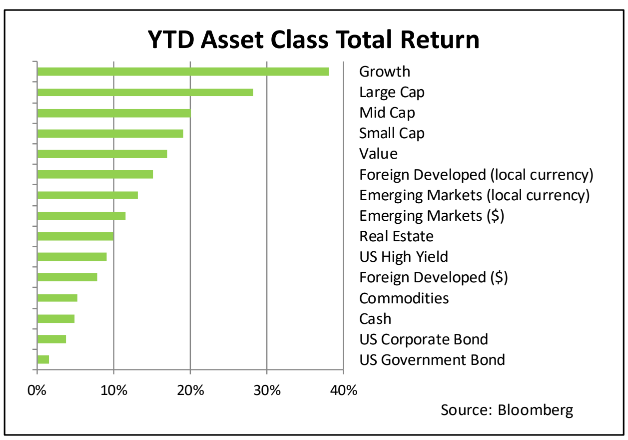




(Source: Bloomberg)

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 12/10/2024 close)

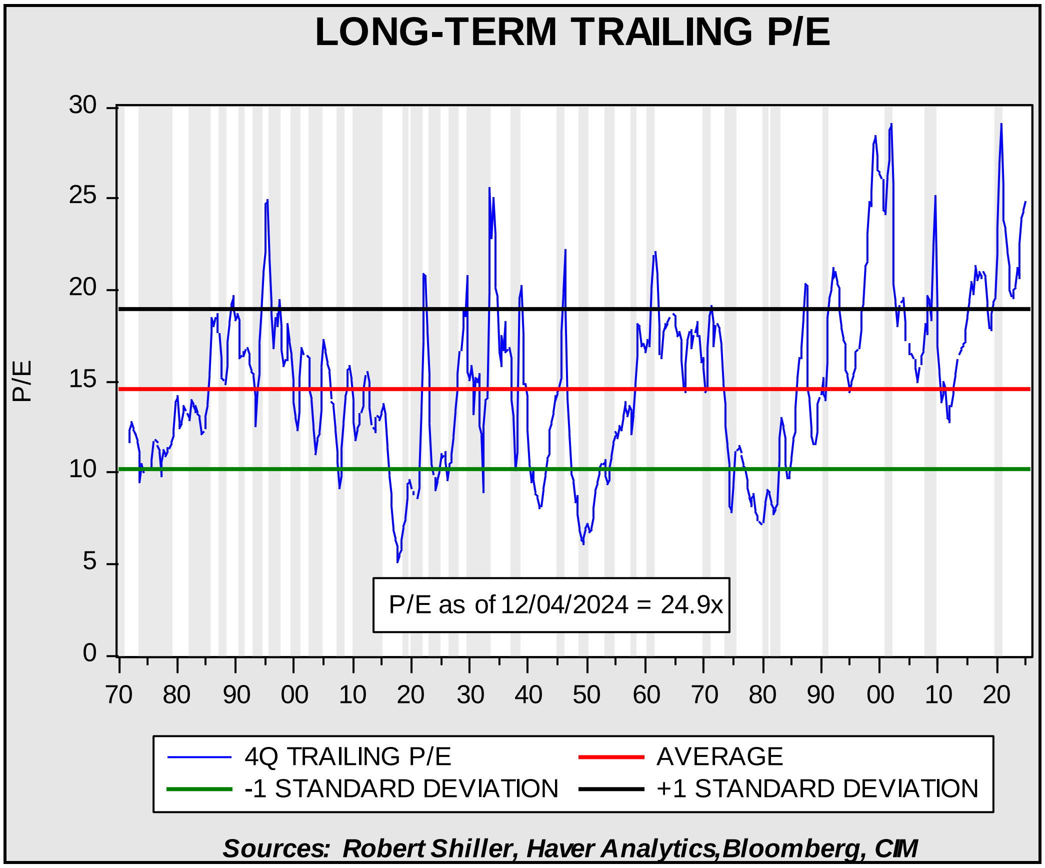


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

December 5, 2024



Based on our methodology,[1] the current P/E is 24.9x, up 0.3 from our last report. The increase in the multiple was driven by a decrease in earnings and a slight rise 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.

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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.