Daily Comment

Confluence INVESTMENT MANAGEMENT

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[Posted: December 13, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed up 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.5%. Chinese markets were lower, with both the Shanghai and the Shenzhen Composites down 2.0% from the previous close. 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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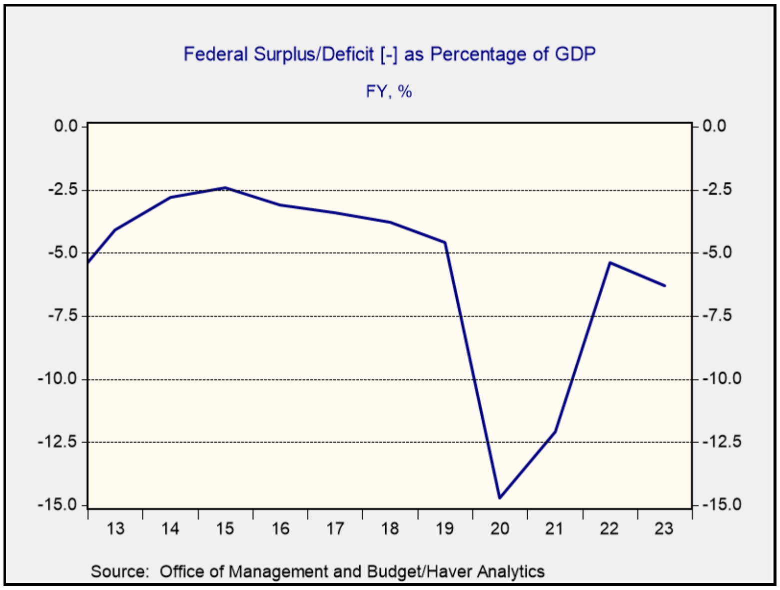
Good morning! The market is digesting the latest data from Broadcom as it assesses the outlook for chipmakers heading into the new year. In sports, LeBron James's son achieved a career-high 30 points during his first G League road game. In today's *Comment*, we delve into the incoming Trump administration's latest tax proposal, the impact of the automation debate on inflation, and the factors behind the British economy's recent struggles. As always, our report includes a summary of key international and domestic data releases.

Tax Details: The Trump administration provided a glimpse of what may be included in a tax package on Thursday.

- Economic advisors within the administration have proposed doubling the State and Local Tax (SALT) deduction cap from $10,000 to $20,000. This measure is positioned as a compromise to address the concerns of residents in high-tax states, following the president's campaign promise to eliminate the cap entirely. The proposal aims to improve middle-class living standards while mitigating perceptions of favoring the wealthy. The move also suggests that the incoming president may take a more pragmatic approach in office than he did on the campaign trail.

- The decision to increase the SALT deduction cap rather than eliminating it was driven by concerns over the growing national deficit. Before the election, Treasury yields rose as investors worried about an increase in government borrowing to finance additional spending. Initial estimates projected that these spending plans would add $7.5 trillion to the deficit over the next decade. While the administration expressed optimism that stronger GDP growth could potentially offset these costs, recent Congressional Budget Office estimates suggest a more mixed economic impact from the tax changes.

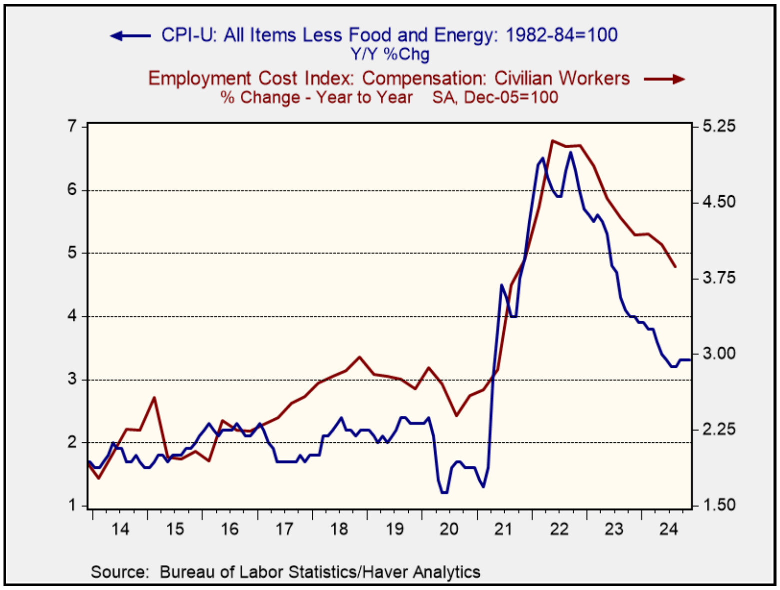


- The market's assessment of the future US budget deficit may be overly pessimistic. As previously discussed, the Trump administration, like its predecessors, is likely to temper its campaign promises to make them more budget friendly. A potential compromise could involve extending the Trump tax cuts for an additional four years, rather than making them permanent. That said, we remain most optimistic about the proposed corporate tax rate cut, as it could be essential in securing continued corporate support while implementing potentially less business-friendly policies.

Labor Fights Back: The possibility of another port workers' strike in January will likely test the new president's ability to balance the interests of labor and capital.

- President-elect Donald Trump voiced support for the International Longshoremen's Association, which represents over 45,000 union port workers on the East and Gulf coasts. In October, workers went on strike to oppose employer use of automation. Employers argue that automation is necessary to reduce costs and maintain competitiveness, while the union contends that it will lead to significant job losses. On Truth Social, Trump argued that "the amount of money saved [through automation] is nowhere near the distress, hurt, and harm it causes for American Workers."
- The ongoing debate about automation and artificial intelligence (AI) carries significant implications for long-term inflation. Federal Reserve officials believe that productivity

gains from technological advancements and increased efficiency could help lower inflation to the 2% target while supporting economic growth. As a result, the implementation of automation and AI will be important if the government would like to pursue tougher immigration and trade policies without negatively impacting inflation.

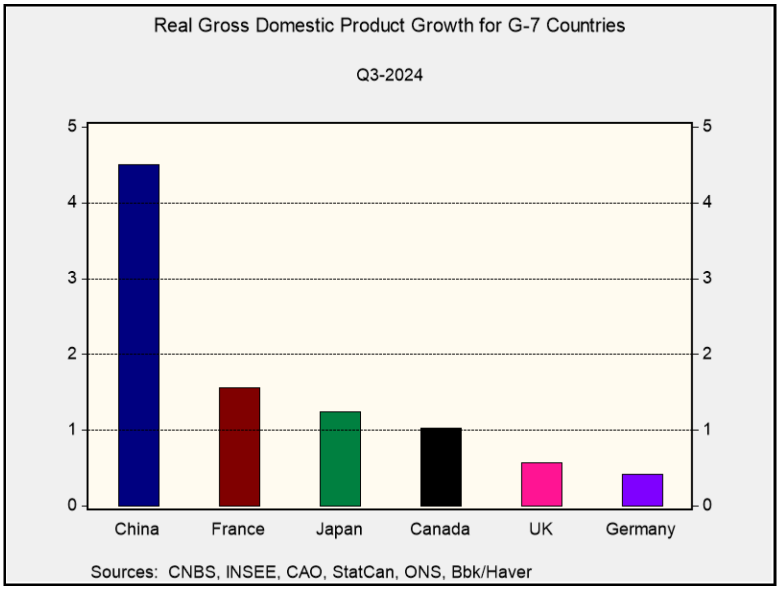


- Keeping a close watch on the dynamic between labor and capital will be crucial in assessing the president's ability to navigate opposing factions within his coalition. His primary challenge lies in balancing his goal of bringing down inflation without hurting wage growth. As shown in the chart above, much of the inflation reduction over the past two years has come at the expense of workers. To rebalance this, the Trump administration may need to shift the wage burden away from consumers and onto corporations, possibly by encouraging firms to slow their adoption of certain disruptive technologies.

British Slowdown: The UK economy contracted again, marking the second consecutive month of decline and hindering the Labour government's growth goals.

- Economic output dropped 0.1% in October, according to the Office for National Statistics. The weak performance was a surprise, as initial forecasts had predicted an uptick. Now, there are concerns that the economy may also contract in the fourth quarter. Following the report's release, the pound sterling (GBP) weakened by 0.3% against the dollar to $1.26, as investors began to factor in a potential widening gap between UK and US interest rates and weakening GDP growth projections for 2025.
- The decline is a major setback for Prime Minister Keir Starmer's Labour government, which has made economic recovery a cornerstone of its agenda. The party has pledged to deliver the fastest per capita GDP growth in the G7 for two consecutive years by the end of this parliamentary term — a feat last achieved in the 1970s. However, the goal remains

far out of reach, with the UK's economic growth ranking second to last among G7 countries in Q3.

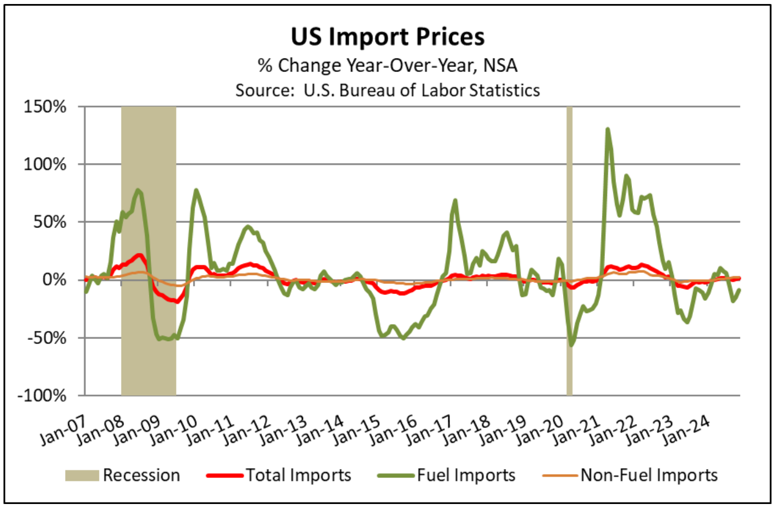


- The weakness in growth is likely to prompt the Bank of England to lower interest rates more aggressively to prevent the economy from further deceleration. Recent forecasts from policymakers within the BOE projected 0.3% growth in the fourth quarter, leading the group to believe a more gradual approach to rate cuts would suffice. However, the latest negative economic data could necessitate more rapid rate cuts than initially anticipated. Assuming this is correct, we can expect downward pressure on the pound sterling and upward pressure on the US dollar.

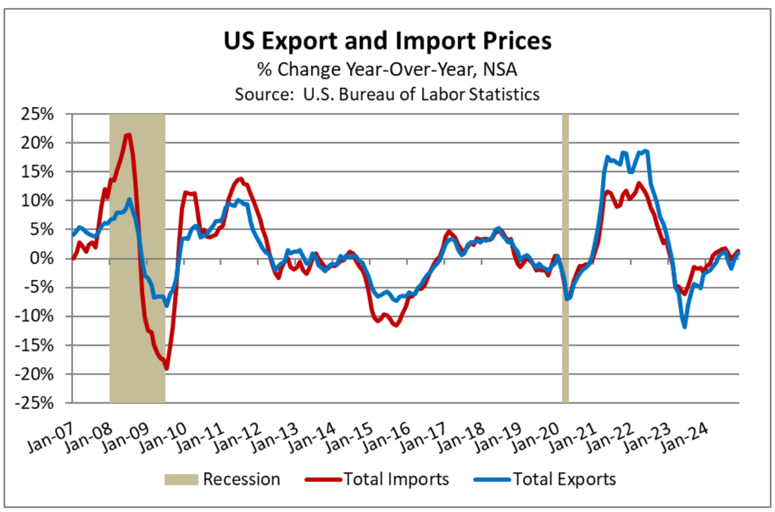
In Other News: The Trump administration is reportedly aiming to curb the influence of bank regulators by placing them under the Treasury Department in a move that could have significant implications for the Federal Reserve's independence. French President Emmanuel Macron has appointed François Bayrou as prime minister in a bid to ease concerns over political instability.

US Economic Releases

November ***import prices*** were up 0.1% from the previous month, versus an expected decline of 0.2% and a gain of 0.3% in October. Import prices are often driven by volatility in the petroleum fuels category, and that was the case last month. November ***import prices excluding fuels*** were up 0.2%, versus expectations that they would be unchanged following their gain of 0.2% in the previous month. Overall import prices in November were up 1.3% year-over-year, while import prices excluding fuels were up 2.3%. The chart below shows the year-over-year change in import prices since just before the GFC.



According to the report, ***export prices*** in November were up just 0.8% from one year earlier, mostly because of falling agriculture prices. Comparing the annual change in export prices versus import prices provides a sense of the US "terms of trade," or the relative advantage or disadvantage the country is facing because of trends in international trade prices. The chart below compares the year-over-year change in US export and import prices since just before the GFC.



There are no economic releases or Fed events scheduled for the rest of the day.

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	Tankan Large Manufacturing Index	q/q	4Q	14	13	13	***	Equity and bond neutral
	Tankan Large Manufacturing Outlook	q/q	4Q	13	14	12	***	Equity and bond neutral
	Tankan Large Non-Manufacturing Index	q/q	4Q	33	34	33	***	Equity and bond neutral
	Tankan Large Non-Manufacturing Outlook	q/q	4Q	28	28	28	***	Equity and bond neutral
	Tankan Large All-Industry Capex	q/q	4Q	11.3%	10.6%	10.0%	***	Equity and bond neutral
	Industrial Production	y/y	Oct F	1.4%	1.6%		***	Equity and bond neutral
	Capacity Utilization	y/y	Oct	2.6%	4.4%		**	Equity and bond neutral
New Zealand	BusinessNZ Manufacturing PMI	m/m	Nov	45.5	45.8		***	Equity and bond neutral
South Korea	Export Price Index	y/y	Nov	7.0%	1.7%		*	Equity and bond neutral
	Import Price Index	y/y	Nov	3.0%	-2.5%		*	Equity and bond neutral
China	Money Supply M2	y/y	Nov	7.0%	7.5%	7.5%	***	Equity and bond neutral
	Money Supply M1	y/y	Nov	-3.7%	-6.1%	-5.0%	*	Equity and bond neutral
	Money Supply M0	y/y	Nov	12.7%	12.8%		*	Equity and bond neutral
	New Yuan Loans	m/m	Nov	17100.0b	16520.0b	17515.0b	**	Equity and bond neutral
EUROPE								
Eurozone	Industrial Production WDA	y/y	Oct	-1.2%	2.2%	-1.9%	**	Equity bullish, bond bearish
Germany	Trade Balance	m/m	Oct	13.4b	16.9b	15.7b	*	Equity and bond neutral
	Exports	m/m	Oct	-2.8%	-1.7%	-2.6%	*	Equity and bond neutral
	Imports	m/m	Oct	-0.1%	2.1%	-1.0%	*	Equity and bond neutral
France	CPI	y/y	Nov F	1.3%	1.3%	1.3%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Nov F	1.7%	1.7%	1.7%	**	Equity and bond neutral
	CPI Ex-Tobacco Index	q/q	Nov	118.66	118.83	118.76	*	Equity and bond neutral
UK	Industrial Production	y/y	Oct	-0.7%	-1.8%	0.2%	***	Equity bearish, bond bullish
	Manufacturing Production	y/y	Oct	0.0%	-0.7%	0.9%	**	Equity bearish, bond bullish
	Index of Services 3M/3M	m/m	Oct	0.10%	0.10%	0.20%	**	Equity and bond neutral
	Visible Trade Balance	m/m	Oct	-£18969m	-£16321m	-£16000m	**	Equity and bond neutral
	Trade Balance	m/m	Oct	-£3718m	-£3462m	-£3500m	**	Equity and bond neutral
Russia	Money Supply, Narrow Definition	w/w	6-Dec	18.37t	18.23t		*	Equity and bond neutral
AMERICAS								
Canada	Building Permits	m/m	Oct	-3.1%	11.5%	-4.90	**	Equity bullish, bond bearish
Brazil	FGV Inflation IGP-10	m/m	Dec	1.14%	1.45%	1.07%	**	Equity and bond neutral
	Economic Activity Index	y/y	Oct	7.31%	5.30%	6..40%	**	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)	422	423	-1	Down
U.S. Sibor/OIS spread (bps)	436	436	0	Down
U.S. Libor/OIS spread (bps)	434	434	0	Down
10-yr T-note (%)	4.35	4.33	0.02	Up
Euribor/OIS spread (bps)	289	289	0	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.

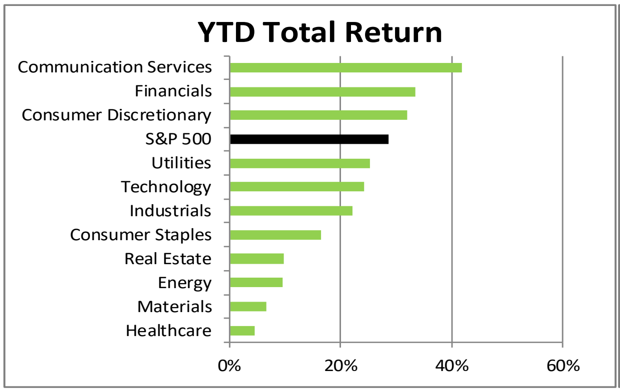
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$74.00	$73.41	0.80%	
WTI	$70.63	$70.02	0.87%	
Natural Gas	$3.43	$3.46	-0.81%	
Crack Spread	$17.00	$17.05	-0.30%	
12-mo strip crack	$20.13	$20.10	0.11%	
Ethanol rack	$1.73	$1.74	-0.35%	
Metals				
Gold	$2,669.91	$2,680.73	-0.40%	
Silver	$30.82	$31.00	-0.56%	
Copper contract	$423.30	$424.45	-0.27%	
Grains				
Corn contract	$443.25	$443.50	-0.06%	
Wheat contract	$559.50	$558.50	0.18%	
Soybeans contract	$999.50	$1,003.25	-0.37%	
Shipping				
Baltic Dry Freight	1,055	1,106	-51	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-1.43	-1.10	-0.33	
Gasoline (mb)	5.09	1.20	3.89	
Distillates (mb)	3.24	1.00	2.24	
Refinery run rates (%)	-0.9%	-0.1%	-0.8%	
Natural gas (bcf)	-190	-172	-18	

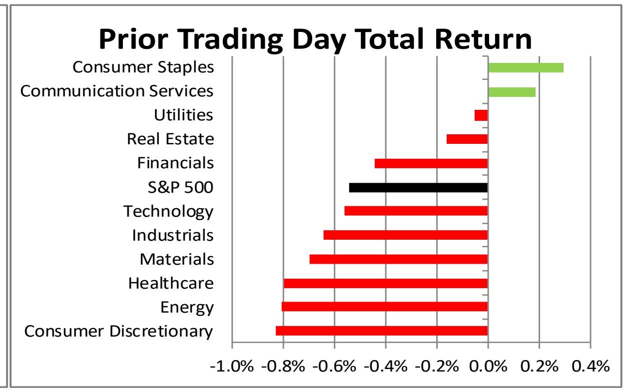
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures from the West Coast to the Great Plains, with cooler-than-normal temperatures in the Southeast. The forecasts call for wetter-than-normal conditions in the Pacific Northwest, southern Texas, and East Coast regions, with dry conditions in the Rocky Mountains and Great Plains.

Data Section

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

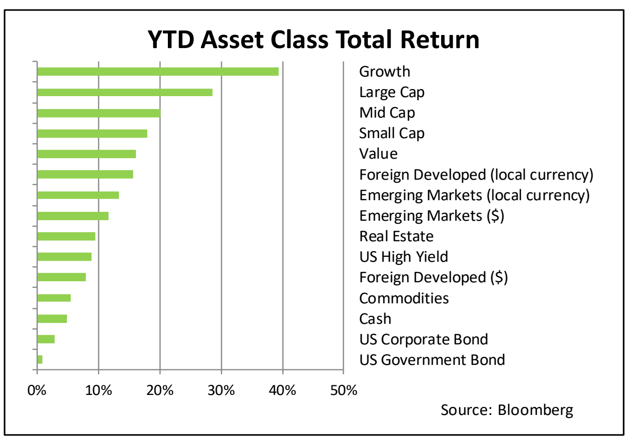




(Source: Bloomberg)

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 12/12/2024 close)

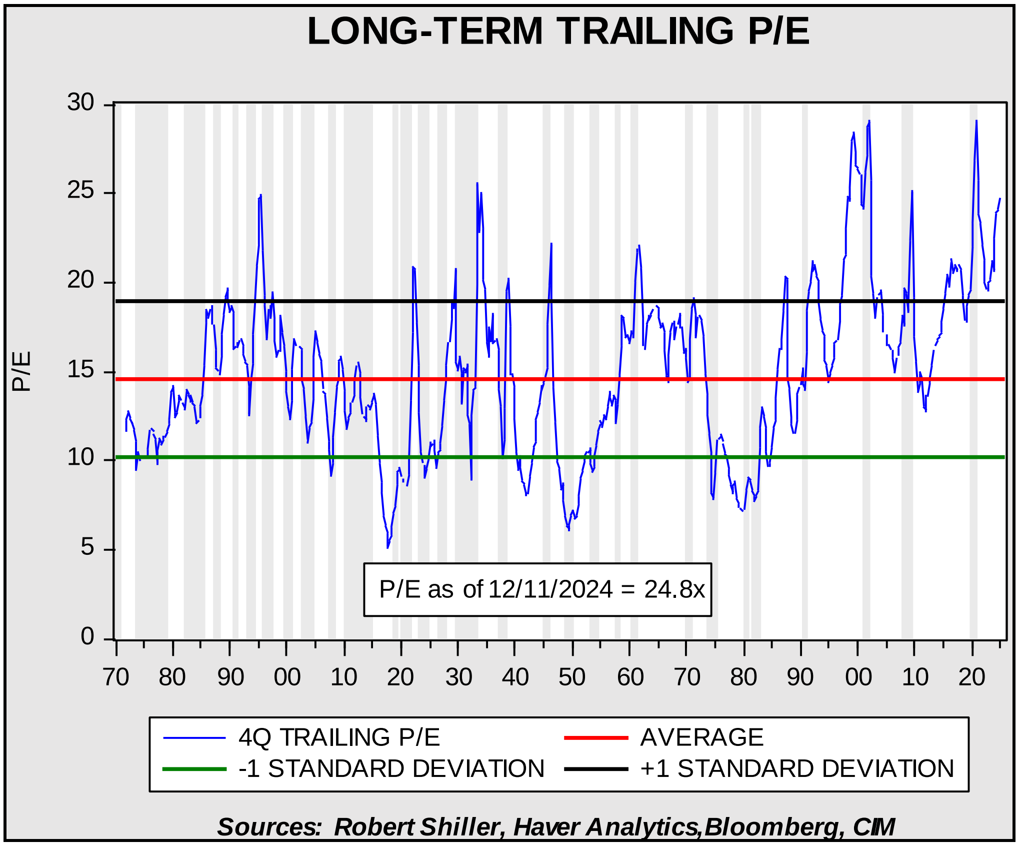


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 12, 2024



Based on our methodology,[1] the current P/E is 24.8x, down 0.1 from our last report. The decrease in the multiple was driven by an increase in earnings offsetting the 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.

[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.