Daily Comment

Confluence INVESTMENT MANAGEMENT

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[Posted: December 16, 2024 — 9:30 AM ET] Global equity markets are mostly lower this morning. In Europe, the Euro Stoxx 50 closed down 0.4% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.1%. Chinese markets were lower, with the Shanghai Composite down 0.2% from its previous close and the Shenzhen Composite down 1.0%. Conversely, 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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Our *Comment* today opens with the latest signs of economic weakness in the eurozone. We next review several other international and US developments with the potential to affect the financial markets today, including the naming of a new prime minister in France, disappointing economic data from China, and a few words on monetary and fiscal policy in the US.

Eurozone: In a speech today, European Central Bank Chief Lagarde signaled that she believes the ECB has re-established price stability in the region and can now continue to cut interest rates. According to Lagarde, "The direction of travel is clear, and we expect to lower interest rates further." The statement confirms widely held expectations that the ECB will continue to cut rates to support the eurozone's flagging economic growth. Reflecting that, the euro today is trading slightly weaker at $1.0503, near its lowest level in more than a year.

- In the latest evidence of the eurozone's economic malaise, S&P Global and Hamburg Commercial Bank today said their December composite purchasing managers' index came in at just 49.5, slightly higher than last month but still below the level of 50 that indicates expansion.

- The weakness stemmed largely from contracting activity in the manufacturing sector, while the service sector posted growth.

Germany: To set the stage for new elections, parliament is expected to hold a confidence vote today on Chancellor Scholz, who leads the center-left Social Democratic Party. If Scholz loses as anticipated, the elections would likely be held in mid-February, and the winner would probably be Friedrich Merz of the center-right Christian Democratic Union. However, the ascendant far-right Alternative for Germany party is considering tactically voting for Scholz to keep him in office and delay the rise of Merz, who wants to increase Germany's support for Ukraine.

France: Days after his previous prime minister was deposed in a no-confidence vote, President Macron on Saturday named veteran centrist politician François Bayrou to replace him. Bayrou is expected to name his ministers in the coming days. However, Bayrou will face the same political problems that the previous prime minister faced, such as his proximity to the unpopular Macron and the fact that his coalition's minority government can easily be toppled if parliament's large left-wing and right-wing blocs decide on another no-confidence vote.

- Bayrou's priorities now will be to pass a special law to roll over the 2024 budget and then to pass a formal 2025 budget that begins to address France's yawning budget deficit, which has started to spook investors.
- The most likely scenario going forward will be for France to face an extended period of political and policy uncertainty, with negative implications for the French economy and financial markets.
- Underscoring the bleak prospects for France's budget consolidation and improved economic competitiveness, Moody's on Saturday unexpectedly cut the country's sovereign debt rating to Aa3, three notches below its top rating. However, in a sign that France's troubles are already priced into the markets, the yield on the country's benchmark 10-year government bond is barely changed this morning at 3.029%.

United Kingdom: On Sunday, the UK officially joined the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, as originally announced last year. Acceding to the TPP marks Britain's biggest trade deal since Brexit, granting lower tariffs and easier trade rules with countries including Japan, Australia, New Zealand, Canada, Mexico, Chile, and Peru.

- Since the US isn't a member of the TPP, the economic benefits of accession are limited. London estimates that joining the TPP will only boost the UK's annual economic output by about 2 billion GBP ($2.5 billion) a year in the long run — less than 0.1% of gross domestic product.
- The more important impact of Britain's accession may geopolitical. As a full member of the trade pact, Britain can now influence whether applicants China and Taiwan may join the group.

United Kingdom-China: British authorities have banned a suspected Chinese intelligence agent from re-entering the country after discovering he had ties to Prince Andrew (the king's brother).

The authorities have reportedly discovered that the Chinese agent gave money to the prince, who then gave the agent access to Buckingham Palace, the Ministry of Defense, and meetings with former UK prime ministers.

- In response, King Charles is reportedly considering banning Prince Andrew from Buckingham Palace's Christmas celebrations. The reports also claim the prince could be forced to move to the Gulf region for asylum.
- Both China and Russia have adopted aggressive, no-holds-barred approaches to their intelligence gathering and secret influence campaigns against the West. If the allegations against Prince Andrew are true, it would only be the latest example of how successful those intelligence operations have become. Western media and voters have been quite complacent about these attacks to date, but there is some chance that an especially egregious operation could spark pushback and ratchet up geopolitical tensions.

China: Official data from this weekend showed November industrial production was up 5.4% from the same month one year earlier, versus a rise of 5.3% in the year to October. Fixed-asset investment in January through November was up 3.3% year-over-year, versus 3.4% in the January-October period. In contrast, November retail sales were up just 3.0% on the year, after a 4.8% rise in the year to October. The data suggests Beijing's recent economic stimulus program has boosted corporate activity, but consumers remain more skeptical.

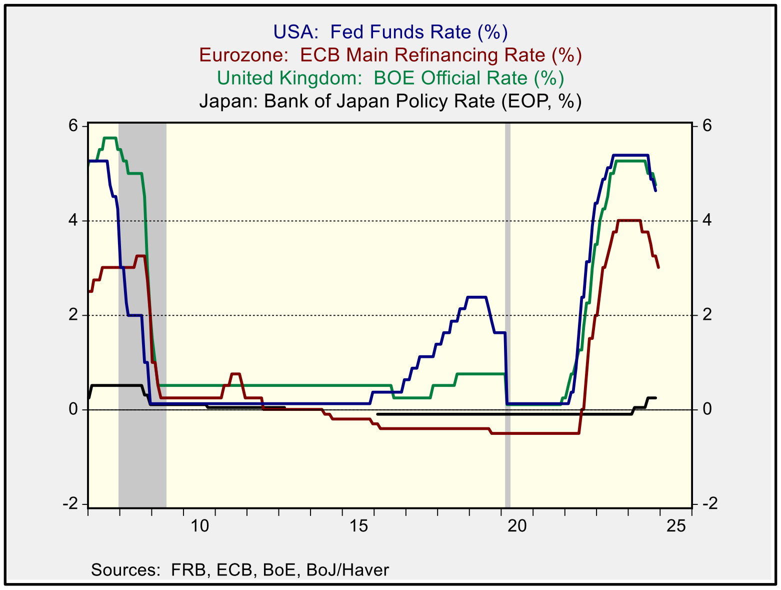
South Korea: On Saturday, Parliament impeached President Yoon for his attempt to declare martial law on December 3. Fully 204 of the chamber's 300 members voted in favor of the measure. Prime Minister Han Duck-soo will now be acting president until the Constitutional Court decides whether to affirm the impeachment, which could take as long as 180 days. If the court affirms, new presidential elections would have to be held within 60 days.

- The court is currently short-handed due to recent resignations and a stalemate over their replacements. Therefore, all six of its current members would have to vote to affirm the impeachment before Yoon can be thrown out of office.
- Yoon therefore probably still has a chance to keep his position. Nevertheless, because of his deep unpopularity and the strength of the political forces against him, South Korea could be in political limbo for some time, which will likely weigh on the country's economy and financial markets.

US Monetary Policy: The Federal Reserve will hold its latest monetary policy meeting this week, with its decision due on Wednesday at 2:00 PM ET. Based on current futures trading, the policymakers are widely expected to cut the benchmark fed funds interest rate by 25 basis points to a range of 4.25% to 4.50%. The bigger question is what their updated economic and financial market forecasts will look like.

- In their September projections, the policymakers expected to cut the fed funds rate by another 1.00% over 2025, to a range of 3.25% to 3.50% at year's end. They expected perhaps another couple of small rate cuts in 2026.

- Given the US economy's continued growth and sticky price pressures, we would not be surprised if the new projections this week call for fewer future rate cuts and a terminal rate higher than what investors currently expect. That could set the stage for some financial market volatility when the decision is released on Wednesday.

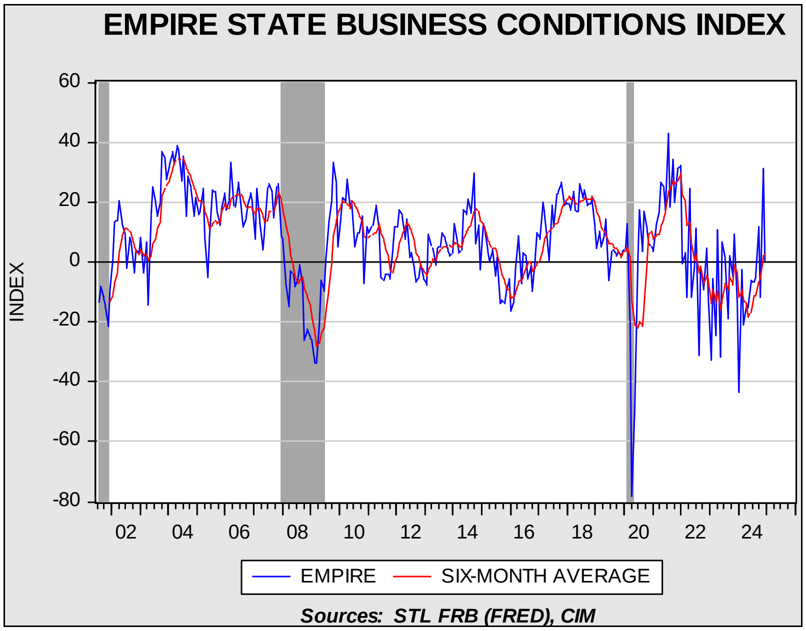


US Fiscal Policy: The *Wall Street Journal* today reports that Republican leaders in Congress [are leaning toward prioritizing tax cuts over measures to reduce the federal budget deficit]() when the new legislative term starts next year. To mask the impact of extending the 2017 tax cuts, some of the leaders reportedly advocate changing the official methodology for calculating how their decisions affect the budget. The debate suggests at least some Republicans are looking to do whatever it takes to extend the tax cuts, despite the impact on the deficit.

- Under current budget rules, the baseline deficit in future years is the estimated shortfall assuming today's legislation is in place or expires as currently written. The 2017 tax-cut law expires at the end of 2025, so under today's rules, the baseline deficit for 2026 and beyond would reflect a snap-back of tax rates to the higher levels prevailing before 2017, i.e., tax revenues would likely rise, and the baseline deficit would be smaller.
- The proposal being considered would assume the 2017 tax cuts don't expire, even though extending them would require an act of the new Congress. Under this methodology, baseline tax rates would stay low, and the assumed deficit for comparison would remain large. In other words, extending the tax cuts would be "free," and deficit impacts would be calculated only for new measures, such as President-elect Trump's promise to eliminate taxes on workers' tips.

US Economic Releases

The New York manufacturing sector experienced a significant slowdown in November. The ***Empire State Manufacturing Index*** plummeted from 31.2 to 0.2, a stark contrast to the anticipated 12.0. This sharp decrease was primarily driven by a decline in new orders and shipments. Despite the index's decline, businesses in the region remain hopeful about future economic conditions.



The six-month moving average of the index increased from +2.25 to +3.28, indicating a strengthening trend in factory activity.

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

Economic Releases						
ET	**Indicator**			**Expected**	**Prior**	**Rating**
9:45	S&P Global US Manufacturing PMI	m/m	Dec P	49.5	49.7	***
9:45	S&P Global US Services PMI	m/m	Dec P	55.8	56.1	***
9:45	S&P Global US Composite PMI	m/m	Dec P	55.1	54.9	***
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	Core Machine Orders	y/y	Oct	5.6%	-4.8%	1.2%	**	Equity bullish, bond bearish
	Jibun bank Composite PMI	m/m	Dec P	50.8	50.1		*	Equity and bond neutral
	Jibun Bank Manufacturing PMI	m/m	Dec P	49.5	49.0		***	Equity and bond neutral
	Jibun Bank Services PMI	m/m	Dec P	51.4	50.5		**	Equity and bond neutral
	Tertiary Industry Index	m/m	Oct	0.3%	-0.1%	-0.1%	***	Equity bullish, bond bearish
Australia	S&P Global Australia Composite PMI	m/m	Dec P	49.9	50.2		*	Equity and bond neutral
	S&P Global Australia Manufacturing PMI	m/m	Dec P	48.2	49.4		***	Equity and bond neutral
	S&P Global Australia Services PMI	m/m	Dec P	50.4	50.5		**	Equity and bond neutral
New Zealand	Food Prices	m/m	Nov	-0.1%	-0.9%		***	Equity and bond neutral
China	Industrial Production	y/y	Nov	5.4%	5.3%	5.4%	***	Equity and bond neutral
	Fixed Assets Ex Rural YTD	y/y	Nov	3.3%	3.4%	3.5%	**	Equity and bond neutral
	Retail Sales	y/y	Nov	3.0%	4.8%	5.0%	**	Equity bearish, bond bullish
India	HSBC India PMI Composite	m/m	Dec P	60.7	58.6		**	Equity and bond neutral
	HSBC India PMI Mfg	m/m	Dec P	57.4	56.5		***	Equity and bond neutral
	HSBC India PMI Services	m/m	Dec P	60.8	58.4		**	Equity and bond neutral
	Wholesale Prices	m/m	Nov	1.89%	2.36%	2.00%	*	Equity and bond neutral
India	Trade Balance	m/m	Apr	-$37837m	-$27142m	-23000m	**	Equity and bond neutral
	Exports	y/y	Apr	-4.8%	17.2%		**	Equity and bond neutral
	Imports	y/y	Apr	27.0%	3.9%		**	Equity and bond neutral
EUROPE								
Eurozone	HCOB Eurozone Composite PMI	m/m	Dec P	49.5	48.3	48.2	*	Equity bullish, bond bearish
	HCOB Eurozone Manufacturing PMI	m/m	Dec P	45.2	45.2	45.3	***	Equity and bond neutral
	HCOB Eurozone Services PMI	m/m	Dec P	51.4	49.4	49.5	**	Equity bullish, bond bearish
Germany	HCOB Germany Manufacturing PMI	m/m	Dec P	42.5	43.0	43.1	***	Equity bearish, bond bullish
	HCOB Germany Services PMI	m/m	Dec P	51.0	49.3	49.3	**	Equity and bond neutral
	HCOB Germany Composite PMI	m/m	Dec P	47.8	47.2	47.5	**	Equity and bond neutral
France	HCOB France Manufacturing PMI	m/m	Dec P	41.9	43.1	43.0	***	Equity bearish, bond bullish
	HCOB France Services PMI	m/m	Dec P	48.2	46.9	46.9	**	Equity bullish, bond bearish
	HCOB France Composite PMI	m/m	Dec P	46.7	45.9	46.0	**	Equity and bond neutral
Italy	CPI, EU Harmonized	y/y	Nov F	1.5%	1.6%	1.6%	***	Equity and bond neutral
UK	Rightmove House Prices	y/y	Dec	1.40%	1.20%		**	Equity and bond neutral
	S&P Global UK Manufacturing PMI	m/m	Dec P	47.3	48.0	48.5	***	Equity bearish, bond bullish
	S&P Global UK Services PMI	m/m	Dec P	51.4	50.8	51.0	**	Equity and bond neutral
	S&P Global UK Composite PMI	m/m	Dec P	50.5	50.5	50.6	**	Equity and bond neutral
Switzerland	Producer & Import Prices	y/y	Nov	-1.5%	-1.8%		**	Equity and bond neutral
	Domestic Sight Deposits CHF	w/w	13-Dec	448.2b	450.5b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	13-Dec	456.4b	458.8b		*	Equity and bond neutral
Russia	GDP	y/y	3Q P	3.1%	3.1%	3.1%	**	Equity and bond neutral
AMERICAS								
Canada	Manufacturing Sales	m/m	Oct	2.1%	-0.6%	1.3%	**	Equity bullish, bond bearish
	Wholesale Sales ex Petroleum	m/m	Oct	1.0%	1.3%	0.5%	**	Equity and bond neutral
	Capacity Utilization Rate	m/m	3Q	79.3%	79.1%	78.9%	*	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)	485	485	0	Down
3-mo T-bill yield (bps)	422	422	0	Down
U.S. Sibor/OIS spread (bps)	436	436	0	Down
U.S. Libor/OIS spread (bps)	434	435	-1	Down
10-yr T-note (%)	4.37	4.40	-0.03	Up
Euribor/OIS spread (bps)	284	289	-5	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.

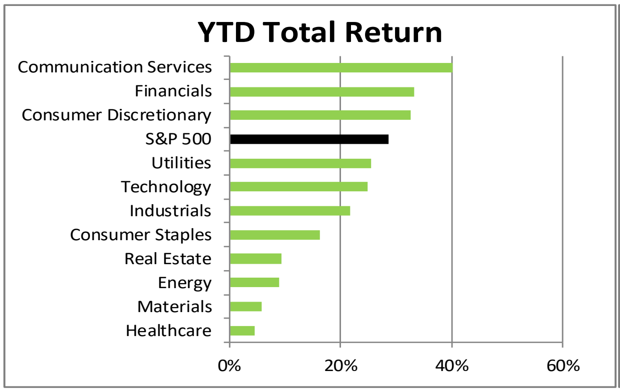
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$73.96	$74.49	-0.71%	
WTI	$70.64	$71.29	-0.91%	
Natural Gas	$3.17	$3.28	-3.26%	
Crack Spread	$16.72	$16.53	1.15%	
12-mo strip crack	$19.96	$19.92	0.22%	
Ethanol rack	$1.74	$1.74	0.12%	
Metals				
Gold	$2,660.14	$2,648.23	0.45%	
Silver	$30.67	$30.55	0.37%	
Copper contract	$418.70	$419.70	-0.24%	
Grains				
Corn contract	$444.25	$442.00	0.51%	
Wheat contract	$557.00	$552.25	0.86%	
Soybeans contract	$997.00	$995.00	0.20%	
Shipping				
Baltic Dry Freight	1,051	1,055	-4	
DOE Inventory Report				

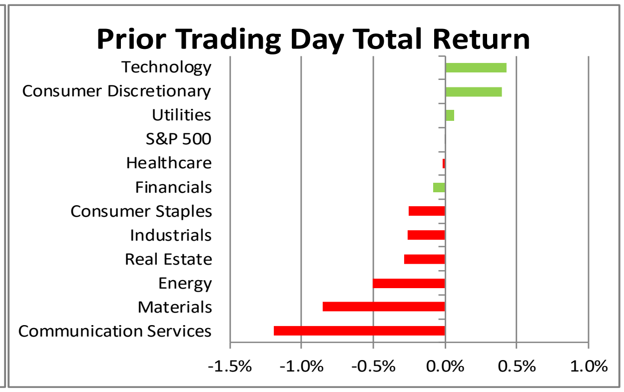
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures for most of the country, with cooler-than-normal temperatures on the East Coast. The forecasts call for wetter-than-normal conditions in the Pacific Northwest, with dry conditions in New England and the Great Plains.

Data Section

US Equity Markets – (as of 12/13/2024 close)

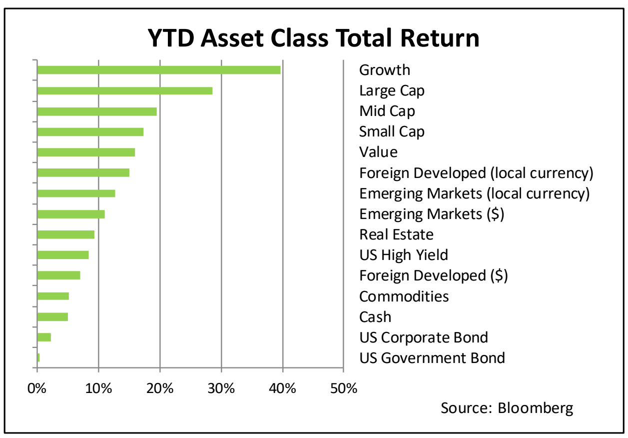




(Source: Bloomberg)

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 12/13/2024 close)

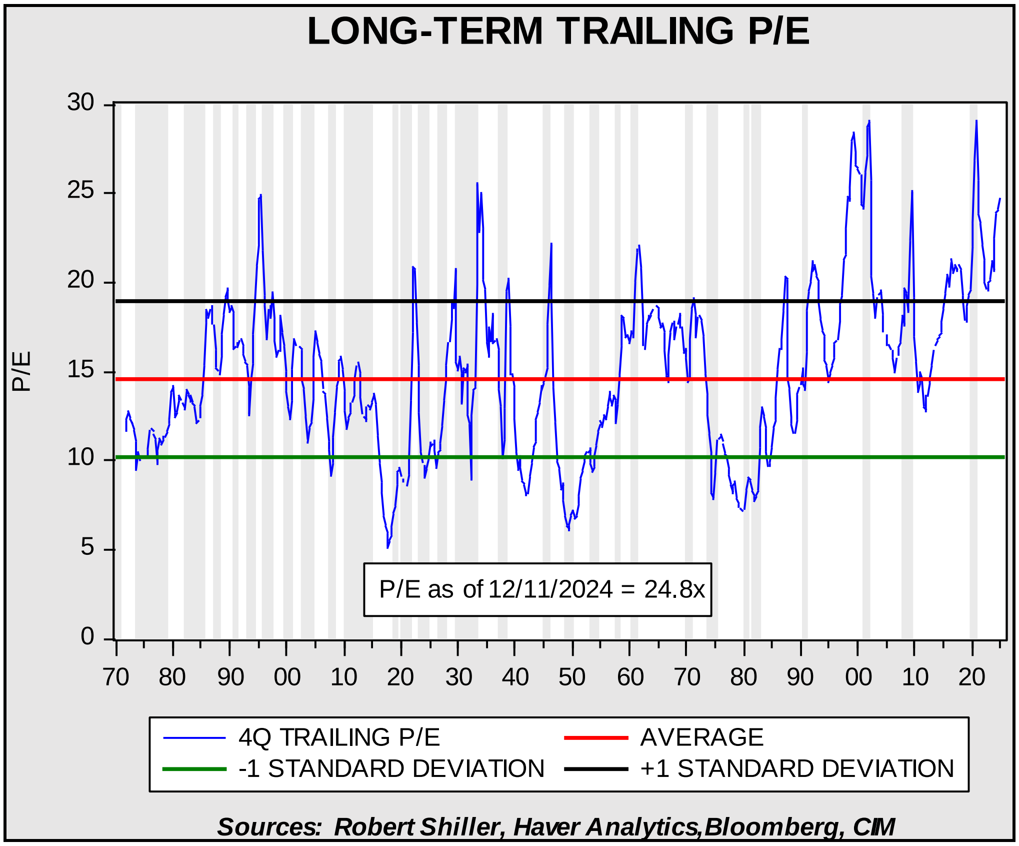


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.