Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: December 20, 2024 — 9:30 AM ET] Global equity markets are mostly down this morning. In Europe, the Euro Stoxx 50 closed down 1.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.1%. Chinese markets were mixed, with the Shanghai Composite down 0.1% from its previous close and the Shenzhen Composite up 0.4%. US equity index futures are signaling a lower 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
The 2025 Geopolitical Outlook (12/16/24) + 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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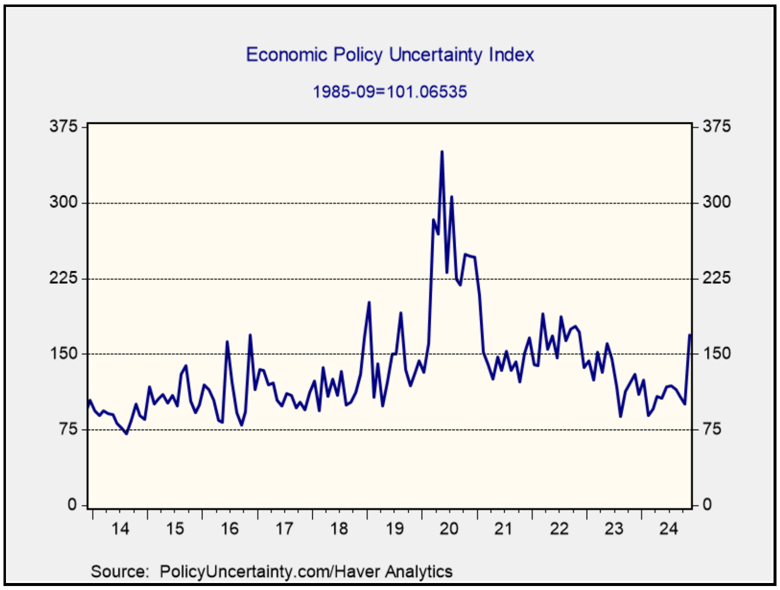
Good morning! The market is processing the latest PCE price index data. In sports news, Tottenham Hotspur defeated Manchester United to make it to the semifinals of the Carabao Cup. In today's *Comment*, we will discuss why the government may be headed for a shutdown, explain the reasons we remain confident that dollar strength will continue, and provide an update on Germany as it prepares for new elections. As usual, the report will conclude with a roundup of international and domestic data releases.

Government Shutdown: A government shutdown looms after President-elect Donald Trump and Elon Musk rejected a stopgap spending bill and called for the elimination of the debt ceiling.

- There is growing uncertainty about whether a shutdown can be avoided before the Friday deadline. Republican lawmakers met on Thursday to discuss an alternative spending package aimed at reaching broader consensus. The proposal would extend funding until mid-March, similar to the previous plan, but would exclude unpopular provisions such as a pay increase. It would also allow Congress to raise the debt ceiling twice through budget reconciliation. These adjustments are designed to give lawmakers greater flexibility next year to advance their agenda without negotiating with Democrats.

- This week's dispute over government funding is likely a way to prevent a bigger fight over the debt ceiling, which expires January, from derailing Trump's agenda. Typically, there are three budget reconciliation processes used for revenue, spending, and the debt ceiling. The purpose of these bills is to allow for government funding without the threat of a filibuster. While this measure has facilitated the passage of legislation to keep the government funded, it has also been used to push through major legislation like the Affordable Care Act, the Tax Cuts and Jobs Act, and the Inflation Reduction Act.

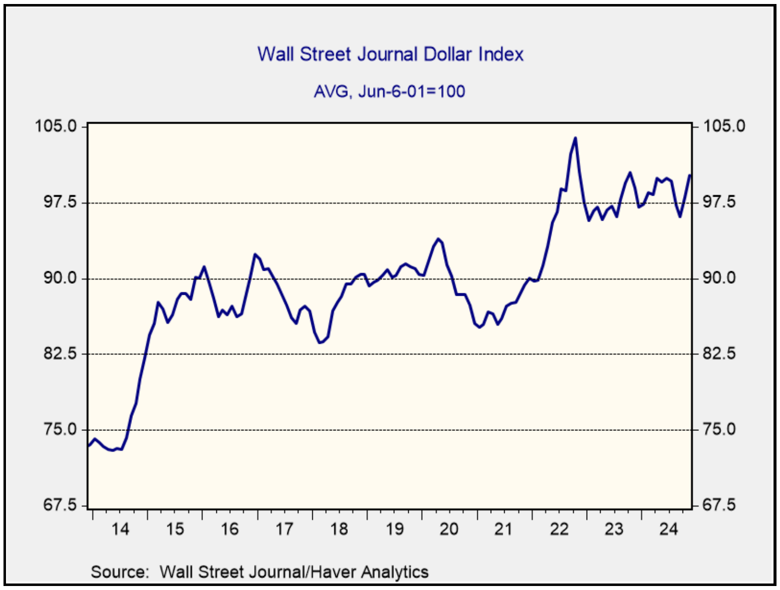


- The market's best chance of replicating its 2024 performance hinges on confidence in the incoming administration's ability to implement its agenda with minimal obstacles. While high expectations for growth (which have been driven by anticipated tax cuts and deregulation) create optimism, they also heighten the risk of a market pullback if complications arise. A comprehensive budget resolution that facilitates legislative progress and avoids another divisive debt ceiling debate could strengthen investor confidence and drive higher asset prices as 2024 concludes.

Greenback's Rise: The US dollar is on track to have its biggest annual rally since 2015, and we think there is evidence that this could continue in the coming year.

- The US dollar spot index has surged 7% year-to-date, primarily driven by market expectations of increased US GDP growth and relatively restrictive monetary policy. Despite concerns about a potential economic slowdown in 2024, the US economy managed to outperform other G-7 nations. This robust economic performance has enabled the Federal Reserve to exercise greater restraint in easing monetary policy compared to its peers, ensuring that inflation continues to progress toward its target.
- Tariffs are likely to have a positive impact on the US dollar. The possibility of a universal tariff regime has led investors to flock to the dollar as a safe-haven asset. This is because

if the US were to implement such tariffs, it could have significant negative consequences for the global economy, particularly for major exporters to the US. In response to these potential economic risks, central banks such as the Bank of Japan, European Central Bank, and People's Bank of China have recently shown reluctance in maintaining tight monetary policies.

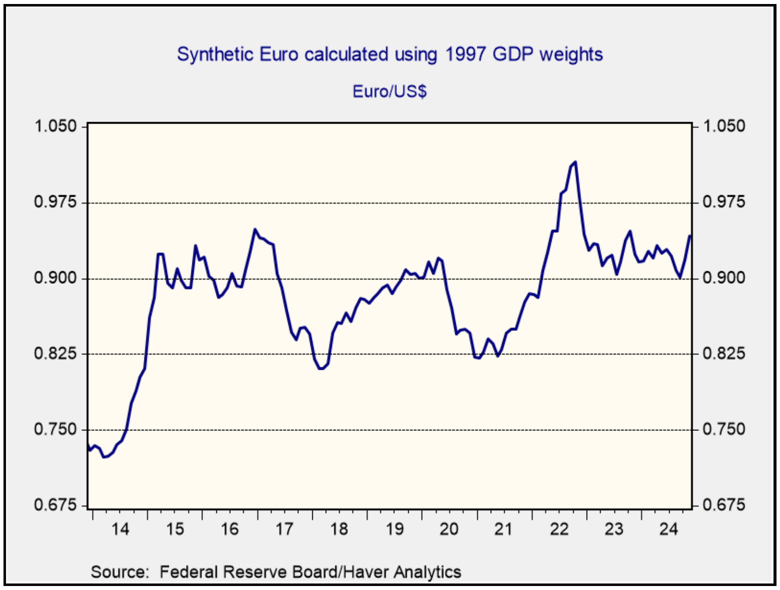


- The continued strength of the US dollar will likely persist as long as investors maintain confidence in the stability of the US economy and the Federal Reserve's cautious approach to reducing its policy rate. However, the dollar may become vulnerable to changes in market expectations, particularly if global economic growth begins to accelerate or if there are doubts about the severity of potential tariffs. For the time being, we believe that the US dollar will continue to strengthen throughout the coming year.

German Elections: Europe's largest economy is heading for early elections in February as voters seek a party capable of reversing the country’s economic slump.

- Current polls indicate that voters are likely to shift to the right in the next election, with the center-right Union parties (CDU/CSU) and the far-right Alternative for Germany (AfD) projected to secure 32% and 18% of the vote, respectively. While this would theoretically give them enough support to form a government, ideological differences make a coalition between the two unlikely. This could create opportunities for left-leaning parties to play a role in the next government. Despite declining popularity, the center left Social Democratic Party's expected 16% share could prove pivotal in forming a centrist coalition.
- A stronger-than-expected victory for the AfD party could significantly impact European markets. The party advocates for Germany's withdrawal from both the European Union and the shared currency system. In its place, it proposes a "Europe of Fatherlands," emphasizing cooperation among sovereign states without forming a unified superstate. If

victorious, AfD plans to push for a Brexit-style referendum, allowing voters to decide whether Germany should remain in the EU. A poll earlier this year revealed that only 29% of Germans saw more advantages than disadvantages in EU membership.

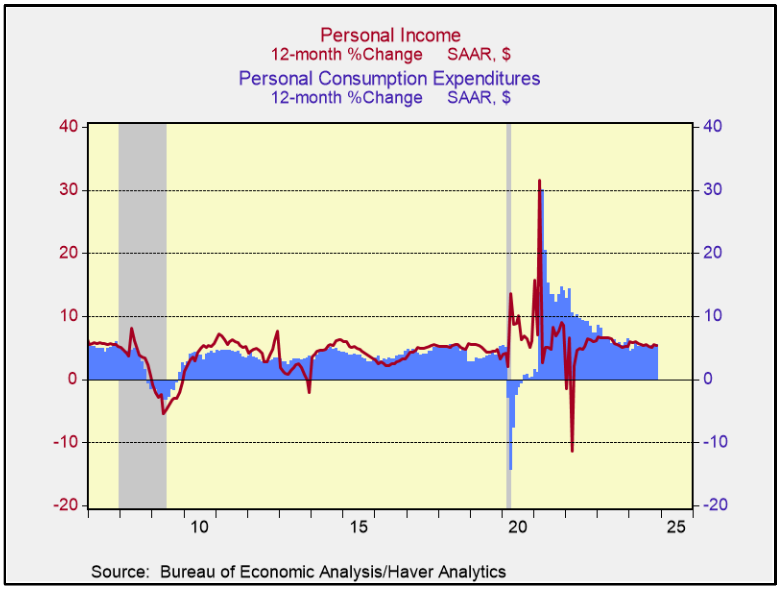


- Although the chances of AfD gaining power remain slim, its new platform is likely to pressure other parties into resisting some of the EU's stricter regulations. This could lead to a softening of the country's unpopular climate goals as it seeks to bolster its weakening manufacturing sector. Additionally, there may be efforts to limit the number of asylum seekers accepted. A strong performance by AfD, however, could weigh on the euro and potentially drive-up bond yields across Europe.

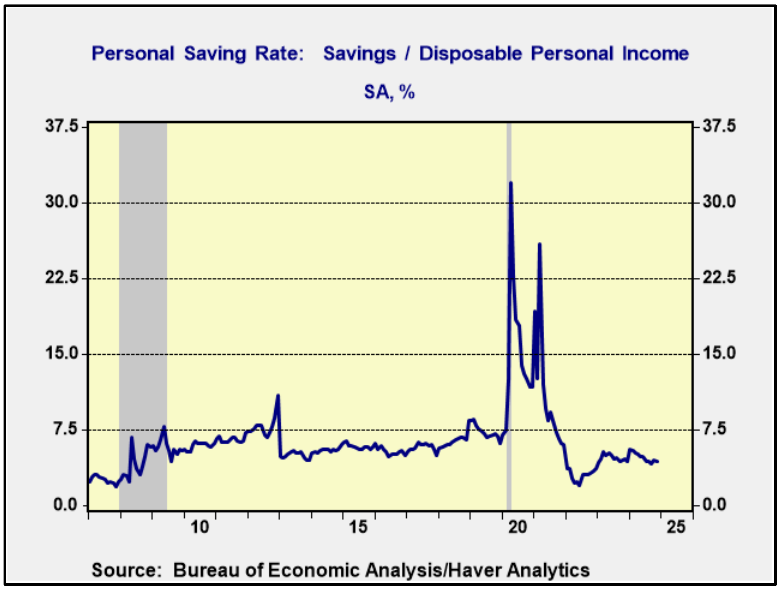
In Other News: Amazon workers have gone on strike at several locations, indicating that labor still has leverage to demand higher wages. Senators are urging President Biden to extend the deadline by 90 days for ByteDance to sell the US assets of TikTok, in a sign that law is facing renewed pushback.

US Economic Releases

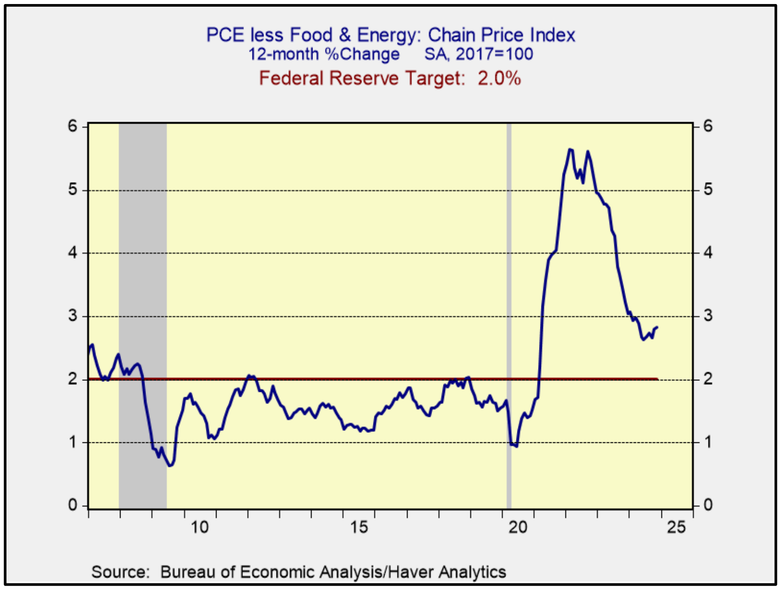
November ***personal income*** rose by a seasonally adjusted 0.3%, coming in short of the expected gain of 0.4% and decelerating from the revised October increase of 0.7%. Meanwhile, November ***personal consumption expenditures (PCE)*** rose 0.4%, short of the anticipated increase of 0.5% but enough to mark an acceleration from the revised 0.3% gain in October. Personal income in November was up 5.3% from the same month one year earlier, while PCE was up 5.5%. The chart below shows the year-over-year change in personal income and PCE since just before the Great Financial Crisis.



The personal income and spending report also includes a measure of personal savings, defined as disposable (after tax) income less consumption spending on goods and services. The November ***personal savings rate*** fell to a seasonally adjusted 4.4%. The chart below shows how the personal savings rate has fluctuated since just before the GFC.



Finally, the income and spending report includes the Fed's preferred measure of consumer price inflation. Excluding the volatile food and energy components, the ***Core PCE Deflator*** for November was up just 2.8% from the same month one year earlier. That was the same annual increase as in the year to October, but it was better than the anticipated rise of 2.9%. The chart below shows the year-over-year change in the Core PCE Deflator since just before the GFC.



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

Economic Releases						
ET	**Indicator**			**Expected**	**Prior**	**Rating**
10:00	U. of Michigan Consumer Sentiment	m/m	Dec F	74.2	74.0	***
10:00	U. of Michigan Current Conditions	m/m	Dec F	77.1	77.7	**
10:00	U. of Michigan Future Expectations	m/m	Dec F	71.9	71.6	**
10:00	U. of Michigan 1-Year Inflation Expectation	m/m	Dec F	2.9%	2.9%	*
10:00	U. of Michigan 5-10 Year Inflation Expectation	m/m	Dec F	3.1%	3.1%	*
11:00	Kansas City Fed Services Activity	m/m	Dec		9	*
Federal Reserve						
ET	**Speaker or Event**	**District or Position**				
8:30	John Williams Appreas on CNBC	President of the Federal Reserve Bank of New York				
10:00	Austan Goolsbee Appreas on CNBC	President of the Federal Reserve Bank of Chicago				
16:00	Austan Goolsbee Appreas on Fox News	President of the Federal Reserve Bank of Chicago				
19:00	Austan Goolsbee Appreas on CNN	President of the Federal Reserve Bank of Chicago				

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	National CPI	y/y	Nov	2.9%	2.3%	2.9%	***	Equity and bond neutral
	National CPI Ex-Fresh Food	y/y	Nov	2.7%	2.3%	2.6%	**	Equity and bond neutral
	National CPI Ex-Fresh Food & Energy	y/y	Nov	2.4%	2.3%	2.4%	*	Equity and bond neutral
Australia	Private Sector Credit	y/y	Nov	6.2%	6.1%		**	Equity and bond neutral
New Zealand	ANZ Consumer Confidence Index	m/m	Dec	0.40%	9.40%		*	Equity and bond neutral
	Trade Balance NZD	m/m	Nov	-437m	-1658m		**	Equity and bond neutral
	Exports NZD	m/m	Nov	6.48b	5.61b		**	Equity and bond neutral
	Imports NZD	m/m	Nov	6.92b	7.27b		**	Equity and bond neutral
South Korea	PPI	y/y	Nov	1.4%	1.0%		**	Equity and bond neutral
EUROPE								
Germany	PPI	y/y	Nov	0.1%	-1.1%	-0.3%	**	Equity bearish, bond bullish
France	PPI	y/y	Nov	-5.2%	-6.0%		*	Equity and bond neutral
Italy	Consumer Confidence	m/m	Dec	96.3	96.6	97.0	***	Equity and bond neutral
	Manufacturing Confidence	m/m	Dec	85.8	86.5	86.0	***	Equity and bond neutral
	Economic Sentiment	m/m	Dec	95.3	93.2		**	Equity and bond neutral
	Industrial Sales WDA	y/y	Oct	-5.3%	-5.7%		*	Equity and bond neutral
	PPI	y/y	Nov	-0.7%	-3.8%		**	Equity and bond neutral
UK	Public Finances (PSNCR)	m/m	Nov	13.0b	17.4b		*	Equity and bond neutral
	Public Sector Net Borrowing	m/m	Nov	11.2b	18.2		*	Equity and bond neutral
	PSNB ex Banking Groups	m/m	Nov	11.2b	18.2b	13.6b	**	Equity and bond neutral
	Retail Sales	y/y	Nov	0.5%	2.4%	1.0%	***	Equity bearish, bond bullish
	Retail Sales Ex-Auto Fuel	y/y	Nov	0.1%	1.6%	0.9%	**	Equity bearish, bond bullish
Russia	Gold and Forex Reserves	m/m	13-Dec	$618.20	$614.4b		***	Equity and bond neutral
	Money Supply, Narrow Definition	w/w	13-Dec	18.56t	18.37t		*	Equity and bond neutral
AMERICAS								
Brazil	FGV Consumer Confidence	m/m	Dec	92	95.6		*	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	423	-1	Down
U.S. Sibor/OIS spread (bps)	433	433	0	Down
U.S. Libor/OIS spread (bps)	433	433	0	Down
10-yr T-note (%)	4.54	4.56	-0.02	Up
Euribor/OIS spread (bps)	284	285	-1	Down
Currencies	**Direction**			
Dollar	Up	US		Down
Euro	Down	Euro		Up
Yen	Down	Japan		Up
Pound	Down	UK		Up
Franc	Down	Switzerland		Up
Central Bank Action	**Current**	**Prior**	**Expected**	
Bank of Russia Key Rate	21.000%	21.000%	23.000%	Below Forecast
PBOC 1-Year Loan Prime Rate	3.100%	3.100%	3.100%	On Forecast
PBOC 5-Year Loan Prime Rate	3.600%	3.600%	3.600%	On Forecast
Bank of Mexico Overnight Rate	10.000%	10.250%	10.000%	On Forecast

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.

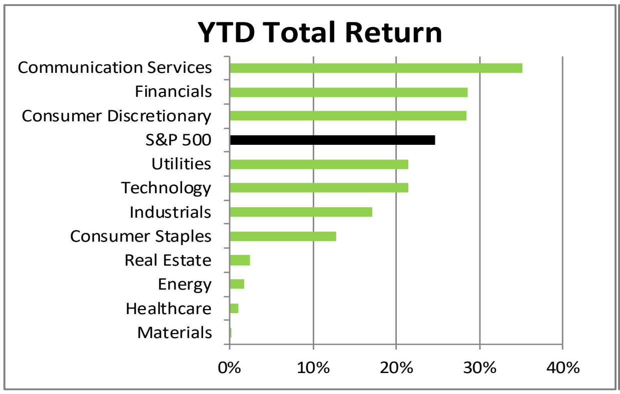
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$72.55	$72.88	-0.45%	
WTI	$69.02	$69.38	-0.52%	
Natural Gas	$3.63	$3.58	1.40%	
Crack Spread	$16.20	$15.13	7.10%	roll distortion
12-mo strip crack	$19.17	$19.05	0.62%	
Ethanol rack	$1.73	$1.73	0.05%	
Metals				
Gold	$2,604.50	$2,594.01	0.40%	
Silver	$28.94	$29.05	-0.37%	
Copper contract	$409.00	$407.70	0.32%	
Grains				
Corn contract	$443.75	$440.75	0.68%	
Wheat contract	$534.00	$533.00	0.19%	
Soybeans contract	$974.50	$966.50	0.83%	
Shipping				
Baltic Dry Freight	976	1,028	-52	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-0.93	-1.70	0.77	
Gasoline (mb)	2.35	2.00	0.35	
Distillates (mb)	-3.18	1.10	-4.28	
Refinery run rates (%)	-0.6%	0.0%	-0.6%	
Natural gas (bcf)	-125	-126	1	

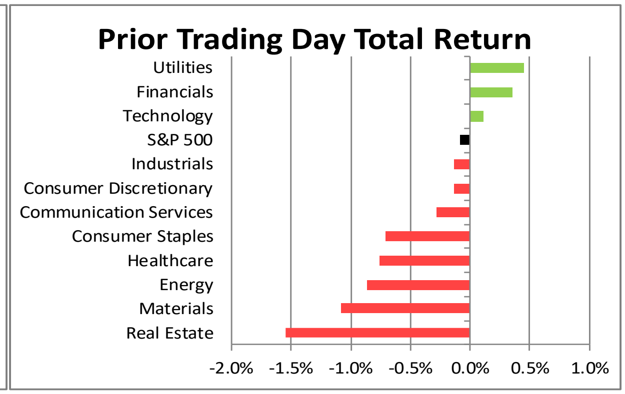
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures for almost the entire country, with normal temperatures only on the mid-Atlantic Coast. The forecasts call for wetter-than-normal conditions in all regions except the Desert Southwest and Maine, where conditions will be dry.

Data Section

US Equity Markets – (as of 12/19/2024 close)

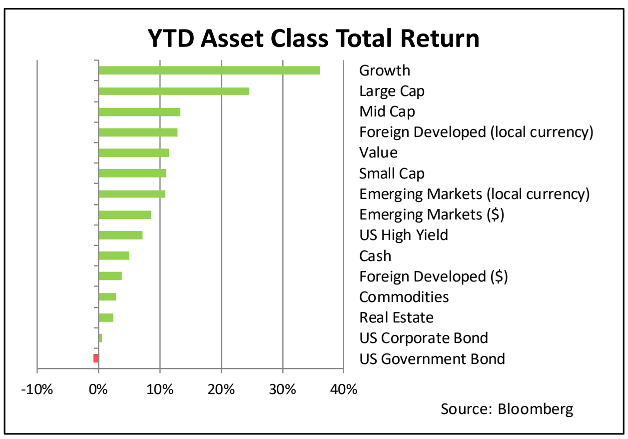




(Source: Bloomberg)

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 12/19/2024 close)

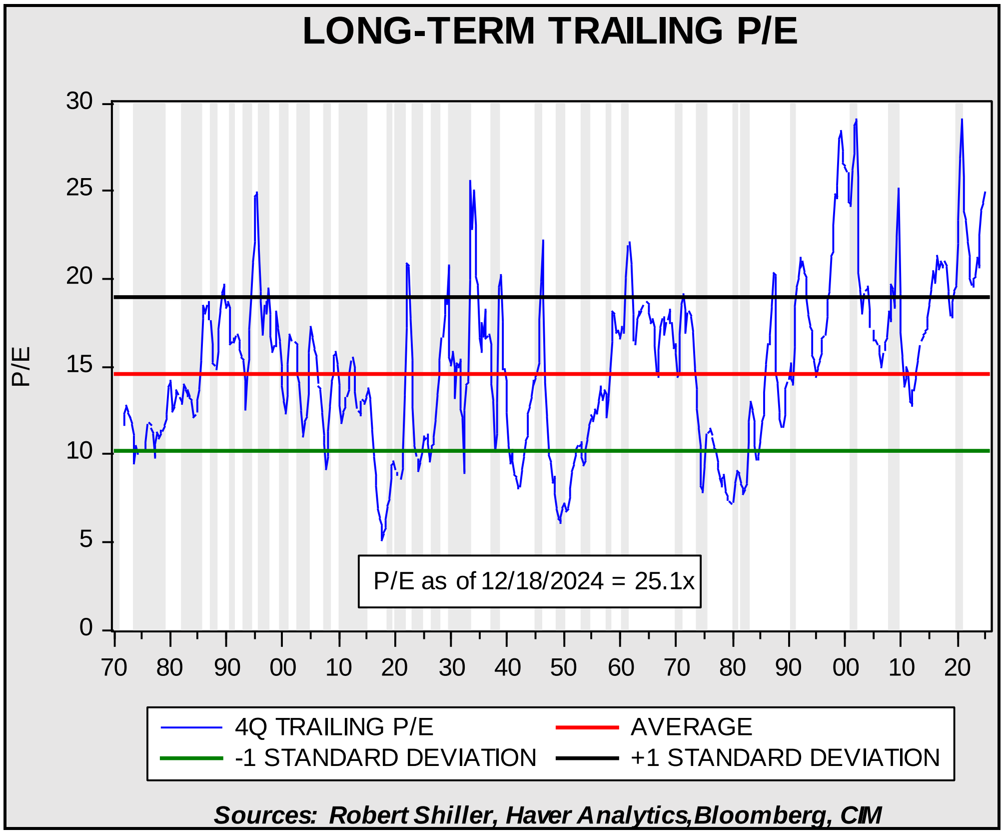


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 19, 2024



Based on our methodology,[1] the current P/E is 25.1x, up 0.3 from our last report. The increase in the multiple was due to downward revisions to Q3 earnings and a 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.