Confluence INVESTMENT MANAGEMENT

Daily Comment

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[Posted: December 3, 2024 — 9:30 AM ET] Global equity markets are mostly higher this morning. In Europe, the Euro Stoxx 50 closed up 0.6% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.2%. Chinese markets were mixed, with the Shanghai Composite up 0.4% from its previous close and the Shenzhen Composite down 0.1%. US equity index futures are signaling a higher open.

With 483 companies having reported so far, S&P 500 earnings for Q3 are running at $63.10 per share compared to estimates of $60.44, which is up 4.2% from Q3 2023. Of the companies that have reported thus far, 75.3% have exceeded expectations, while 17.8% 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 in bold (***there will be no Geopolitical Report published this week***):

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	*Bonds and the Post-Election Environment* (11/25/24) + podcast	Q4 2024 Report Q4 2024 Rebalance Presentation	Confluence of Ideas Podcast *The Q4 Asset Allocation Rebalance*

Our *Comment* today opens with a provocative new operation by the Russian navy that may reflect the increased coordination and cooperation of the countries in the China-led bloc. We next review several other international and US developments with the potential to affect the financial markets today, including the impending downfall of the French government and new signs that the Federal Reserve is likely to cut US interest rates again later this month.

Russia-Philippines: New reports say the Russian navy surfaced an advanced attack submarine off the western Philippines late last week. Such a surfacing isn't necessarily outside the ordinary, and the sub's crew properly responded to a Philippine navy request for identification. All the same, we think the incident may have been designed to show Russian support for Beijing's territorial claims against Manila in the region.

- If so, the incident would be more evidence of increasing coordination and cooperation among the key countries of the China-led geopolitical bloc. On a separate note, NATO General Secretary Rutte said in an interview yesterday that he has warned President-elect Trump about the increasingly close coordination among the China-bloc countries. Rutte said he also advised Trump that an overly generous peace deal for Russia in its war against Ukraine would further incentivize greater cohesion in the China bloc.
- If China, Russia, Iran, and North Korea really are coordinating and cooperating more, global tensions would likely increase. In turn, that would likely spark further fracturing of the world into separate blocs, increased global defense spending, and higher and more volatile inflation and interest rates in the West.

Russia-Ukraine: In recent interviews and public statements, Ukrainian President Zelensky has shifted from his previous stance that Kyiv would keep fighting against the Kremlin's invasion forces until all Russian troops have been pushed out of the country. In his new statements, Zelensky has signaled that Ukraine would stop fighting to regain its Russian-held territory in exchange for membership in the North Atlantic Treaty Organization.

- Zelensky's new stance is consistent with our long-held view that the heavy losses on each side would eventually lead to peace negotiations, rather than any clear-cut victory for either Russia or Ukraine.
- Still, Zelensky's statements don't mean peace talks are imminent. We suspect the Ukrainians still have some fight left in them, while the US and its NATO allies also remain far from ready to bring Ukraine into the alliance.
- Perhaps most important, a Russian oligarch close to the Kremlin says President Putin will reject the peace plan President-elect Trump is working on, which reportedly would let Russia keep the territory it has seized in Ukraine in return for a truce supported by European peacekeepers.
- Emboldened by the support of his China-bloc allies, his recent successes on the Ukrainian battlefield, and the fact that he has gotten away with his recent sabotage campaign against NATO, Putin will reportedly seek maximalist goals in any peace talks involving Trump, such as broad, regional spheres of influence for Russia and its China-bloc partners.

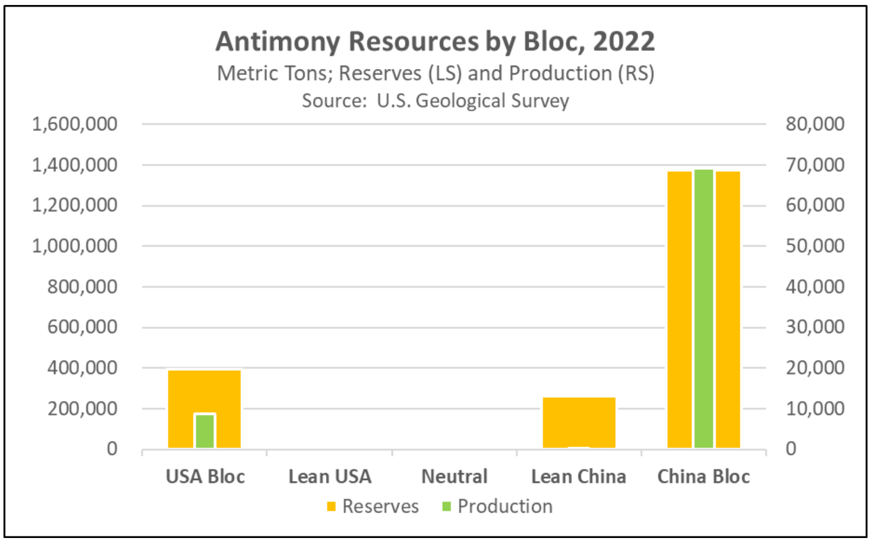
France: Faced with resistance from opposition lawmakers, Prime Minister Barnier yesterday used a special constitutional provision to push his austere 2025 social security budget into law. However, the maneuver set the stage for far-left lawmakers to request a no-confidence motion, which is likely to pass with the support of the far right when it takes place as early as Wednesday. The French government would then fall, creating a political and economic crisis that could shake the European Union and its markets.

- The chaos yesterday pushed the yield spread of 10-year French government bonds over German government bonds to nearly a 12-year high of 0.87%.

- The crisis also pushed the value of the euro (EUR) down sharply. As of this morning, the currency is trading at $1.0523, up 0.2% from yesterday but down approximately 5% since the end of September.

China-United States: The Chinese Ministry of Commerce today said it will ban exports to the US of gallium, germanium, antimony, and certain other dual-use minerals with both military and civilian uses. The ministry also said it will conduct stricter end-user and end-use reviews for graphite going to the US. The ban is consistent with our past warnings that China and its bloc will likely weaponize their dominance of key mineral markets amid growing tensions with the US and its bloc.

- The new ban is likely in retaliation for the Biden administration's new curbs on sending advanced memory chips and related technology to China, which was announced on Monday.
- The ban could disrupt supply chains in US industries ranging from semiconductors to defense.



United States-China: The outgoing Biden administration has imposed new anti-dumping tariffs on solar panels and components made by Chinese firms in Malaysia, Thailand, Cambodia, and Vietnam. To get around the existing US tariffs on solar energy goods shipped directly from China, the targeted firms have been setting up production facilities around Southeast Asia. The new tariffs likely aim to signal that the US won't tolerate this back-door entry of low-cost Chinese goods into the US market.

US Monetary Policy: Fed board member Christopher Waller said yesterday that he expects to support another cut in the benchmark fed funds interest rate at the central bank's next policy meeting on December 17-18. However, he warned that he would switch to supporting a pause if the economic data between now and then point to rebounding economic growth or reaccelerating price inflation.

- Waller's statement has helped increase investor confidence that the Fed will cut rates again this month. So far this morning, pricing in the fed-funds futures market suggests investors are putting a 73% probability on the policymakers cutting rates by 0.25%, up from a probability of 59% one week ago.
- Nevertheless, we think Waller's caution on the data is evidence of how the continued strength in the economy and remaining price pressures could keep interest rates from falling as fast as investors expect.

US Construction Industry: The *Wall Street Journal* today carries a story on the challenges that the construction industry could face under the tariff and migration policies of the incoming Trump administration. The article claims increased tariffs could raise the cost of the industry's many imported inputs, while mass deportations would reduce its labor supply. Nevertheless, it's important to remember that the policies put into place next year are likely to be adjusted and/or watered down from current discussions, so it's still too early to predict their exact impact.

US Agriculture Industry: Cargill, the privately held agricultural commodity giant, today said it will cut 5% of its global workforce and restructure to improve profitability. The move reflects softer agriculture markets over the last couple of years as the supply shortages and high prices associated with the coronavirus pandemic and the Ukraine war recede into memory. Now, ample supplies, modest demand, and lower prices are challenging major commodity traders such as Cargill, Bunge, and Archer Daniels Midland.

US Economic Releases

There were no economic releases prior to publication time. The following table lists the economic releases and Fed events scheduled for the rest of today.

Economic Releases						
ET	**Indicator**			**Expected**	**Prior**	**Rating**
10:00	JOLTS Job Openings	m/m	Oct	7519k	7443k	**
	Wards Total Vehicle Sales	m/m	Nov	16.10k	16.04m	***
Federal Reserve						
ET	**Speaker or Event**	**District or Position**				
12:15	Mary Daly Sis Interviewed Live on Fox Business	President of the Federal Reserve Bank of San Francisco				
12:35	Adriana Kugler Gives Speech on Labor Market and Monetary Policy	Member of the Board of Governors				
13:30	Austan Goolsbee Speaks in Moderated Q&A	President of the Federal Reserve Bank of Chicago				
15:45	Austan Goolsbee Gives Closing Remarks	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	Monetary Base	y/y	Nov	-0.3%	-0.3%		**	Equity and bond neutral
	Monetary Base, End of Period	m/m	Nov	¥667.9t	¥672.7t		*	Equity and bond neutral
	Jibun Bank Manufacturing PMI	m/m	Nov F	49.0	49.0		***	Equity and bond neutral
Australia	BoP Current Account Balance	q/q	3Q	-A$14.1b	-A$10.7b	-A$10.9b	***	Equity and bond neutral
South Korea	CPI	m/m	Nov	1.5%	1.3%	1.7%	***	Equity and bond neutral
EUROPE								
Switzerland	CPI	y/y	Nov	0.7%	0.6%	0.7%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Nov	0.7%	0.7%	0.8%	*	Equity and bond neutral
	Core CPI	y/y	Nov	0.9%	0.8%	0.9%	*	Equity and bond neutral
AMERICAS								
Canada	S&P Global Canada Manufacturing PMI	m/m	Nov	52.0	51.1		***	Equity and bond neutral
Mexico	S&P Global Mexico Manufacturing PMI	m/m	Nov	49.9	48.4		***	Equity and bond neutral
	Gross Fixed Investment	y/y	Sep	-0.8%	-2.2%	0.5%	**	Equity bearish, bond bullish
	Unemployment Rate NSA	m/m	Oct	2.50%	2.92%	2.89%	***	Equity and bond neutral
Brazil	S&P Global Brazil Manufacturing PMI	m/m	Nov	52.3	52.9		***	Equity and bond neutral
	GDP	q/q	3Q	4.0%	3.3%	3.9%	***	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)	435	435	0	Down
U.S. Sibor/OIS spread (bps)	445	445	0	Down
U.S. Libor/OIS spread (bps)	443	444	-1	Down
10-yr T-note (%)	4.21	4.19	0.02	Down
Euribor/OIS spread (bps)	292	293	-1	Down
Currencies	**3 Mo**			
Dollar	Down	US		Down
Euro	Down	Euro		Up
Yen	Up	Japan		Up
Pound	Up	UK		Up
Franc	Up	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.

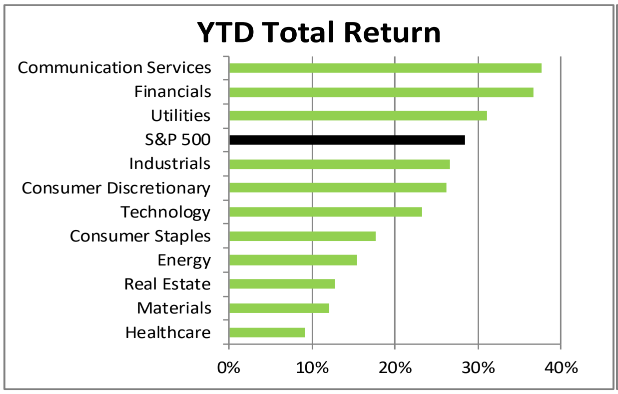
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$72.74	$71.83	1.27%	
WTI	$69.01	$68.10	1.34%	
Natural Gas	$3.15	$3.21	-2.05%	
Crack Spread	$16.05	$16.09	-0.23%	
12-mo strip crack	$19.38	$19.30	0.46%	
Ethanol rack	$1.72	$1.72	-0.33%	
Metals				
Gold	$2,640.97	$2,639.13	0.07%	
Silver	$30.86	$30.51	1.12%	
Copper contract	$417.45	$413.05	1.07%	
Grains				
Corn contract	$434.25	$432.50	0.40%	
Wheat contract	$553.50	$547.25	1.14%	
Soybeans contract	$992.25	$985.25	0.71%	
Shipping				
Baltic Dry Freight	1,298	1,354	-56	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-1.00		
Gasoline (mb)		-0.10		
Distillates (mb)		0.05		
Refinery run rates (%)		0.2%		
Natural gas (bcf)		-3		

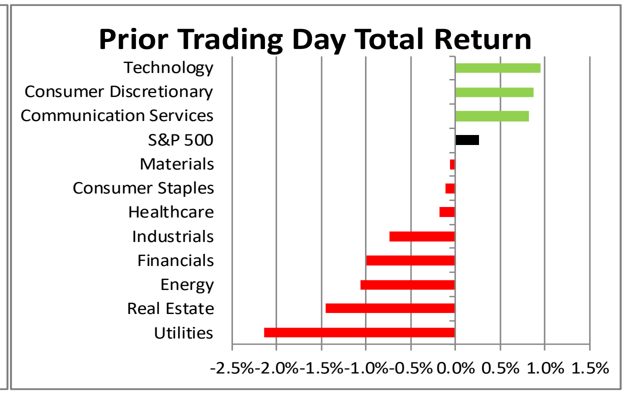
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures west of the Mississippi River, with normal temperatures elsewhere. The precipitation outlook calls for wetter-than-normal conditions in the northern Great Plains, Texas, and east of the Mississippi River, with dry conditions from the West Coast to the Four Corners region.

Data Section

US Equity Markets – (as of 12/2/2024 close)

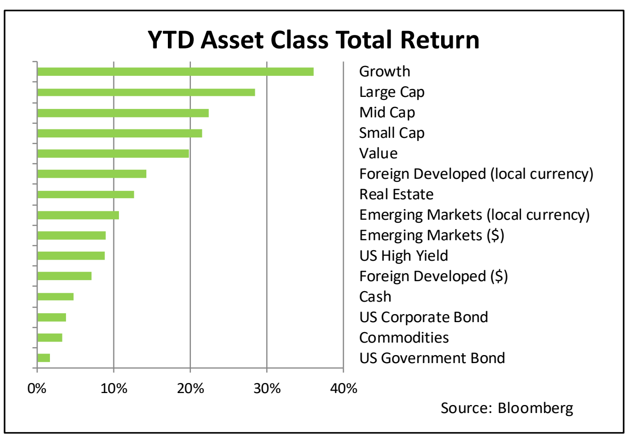




(Source: Bloomberg)

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 12/2/2024 close)

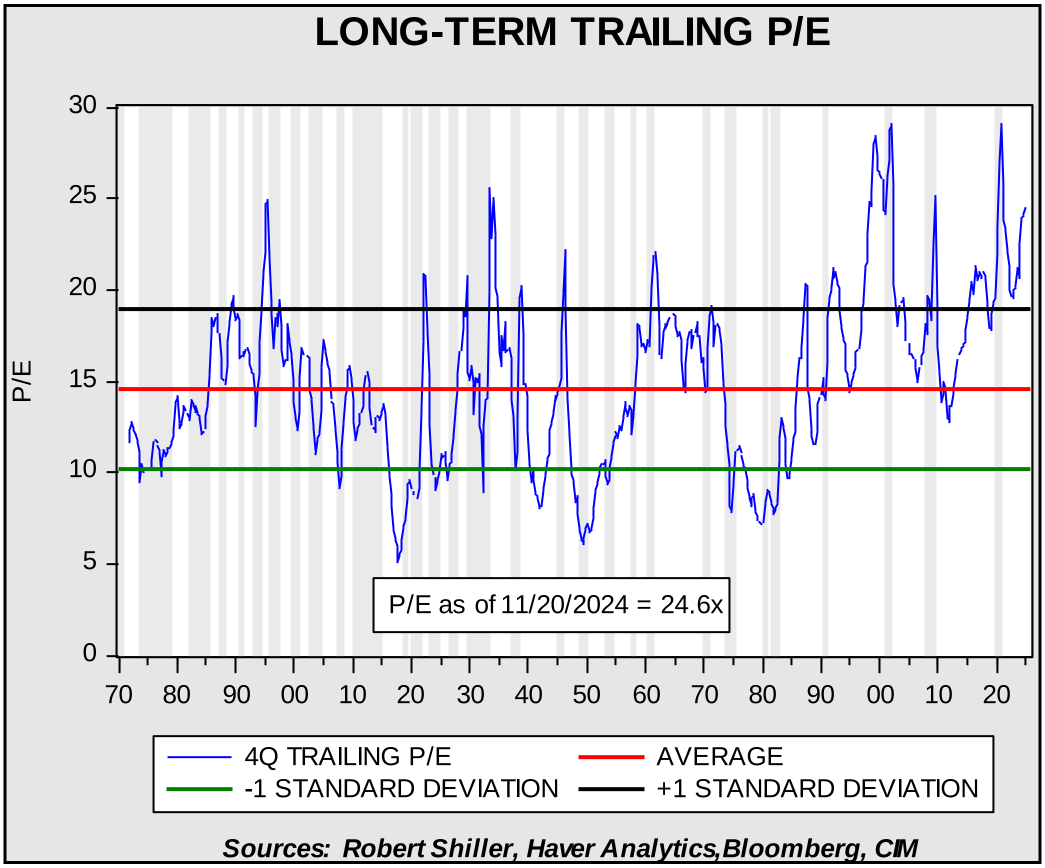


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

November 21, 2024



Based on our methodology,[1] the current P/E is 24.6x, up 0.1 from our last report. The increase in the multiple was driven by an increase 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.