Daily Comment

Confluence INVESTMENT MANAGEMENT

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[Posted: December 4, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed up 0.7% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.2%. Chinese markets were lower, with the Shanghai Composite down 0.4% from its previous close and the Shenzhen Composite down 1.2%. US equity index futures are signaling a higher open.

With 486 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 17.9% 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***):

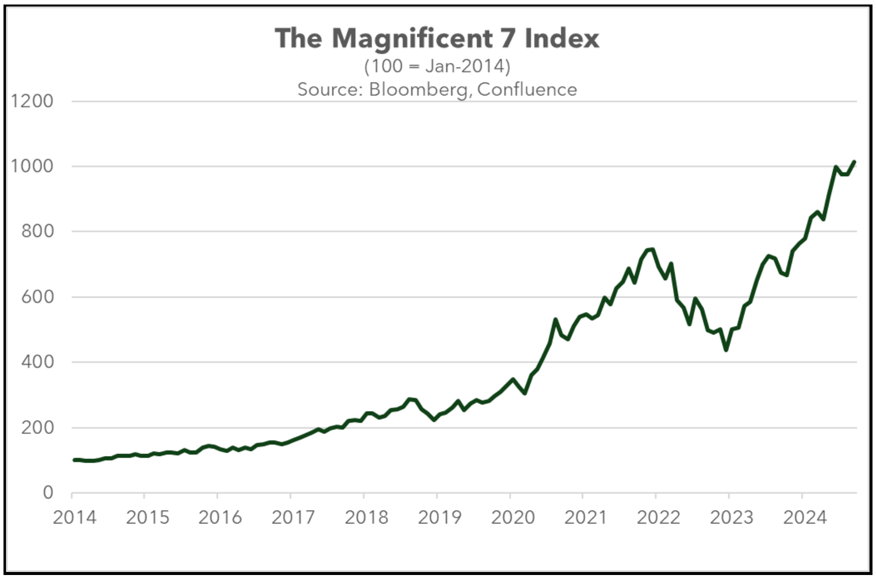
Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
Implications of North Korean Soldiers in the Ukraine War (11/18/24) + podcast	*Bonds and the Post-Election Environment* (11/25/24) + podcast	Q4 2024 Report Q4 2024 Rebalance Presentation	Confluence of Ideas Podcast *The Q4 Asset Allocation Rebalance*

Good morning! The market is processing the latest ADP employment change data. In sports news, MLB free agent Juan Soto is nearing a deal with a new team. Today's *Comment* will discuss why uncertainty abroad has helped boost US mega cap tech companies, explain how a strengthening labor market will likely hinder the Fed's ability to cut rates, and discuss the path of global interest rates and its implications for the dollar. As usual, the report will conclude with a roundup of international and domestic data releases.

Equities Shrug Off Turmoil: Despite rising geopolitical tensions in Asia, Europe, and the Middle East, the S&P 500 increased as investors sought safety in the US.

- Important news emerged from South Korea, where President Yoon Suk Yeol attempted to enforce martial law amid fears that the opposition was collaborating with North Korea. Although the order was ultimately rescinded, calls for his resignation or impeachment are increasing. In Europe, French President Emmanuel Macron pushed back against calls for his resignation as the nation approaches a no-confidence vote. Finally, there are rising worries in the Middle East that the recent ceasefire between Israel and Lebanon could fail, as well as concerns about a possible revitalization of the civil war in Syria.

- Investors responded to the news by pouring money into US equities, particularly technology stocks. On Tuesday, the S&P 500 saw a modest 0.05% increase, while the Magnificent 7 gained 1.01%. The strong interest in large US tech companies likely reflects optimism about robust economic growth and investor aversion to bonds, given the significant deficit. This likely explains why 10-year Treasury yields rose 3 bps on the day, despite their traditional role as a safe-haven asset.



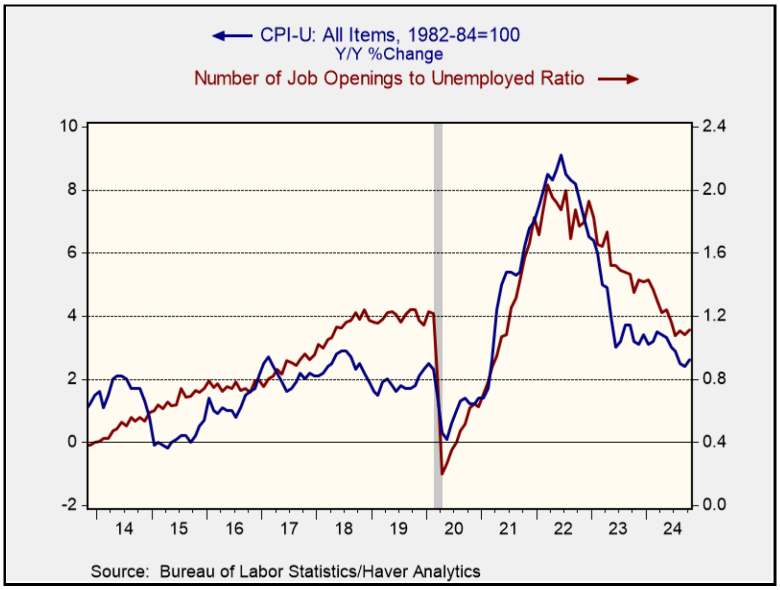
- Robust economic growth and a smooth presidential transition are expected to bolster the appeal of US assets for investors, especially amidst rising global uncertainty. Mega cap tech companies, well-positioned to capitalize on this trend, may continue to attract investors due to their capacity to sustain strong earnings, particularly in the short term. However, this trend may shift in favor of less valued stocks as the market gains confidence that the new administration will moderate some campaign promises, and the Federal Reserve will maintain its accommodative stance in 2025.

Job Market Heats Up: The Federal Reserve's willingness to ease policy is being challenged by signs of a rebound in the labor market.

- Several Fed officials spoke on Tuesday about the central bank's current policy outlook. San Francisco Fed President Mary Daly and Chicago Fed President Austan Goolsbee argued that while a December rate cut is not guaranteed, conditions still favor further easing in the future. Meanwhile, Fed Governor Adriana Kugler echoed this sentiment but dismissed criticism that incoming President Donald Trump's policies could impact the

Fed's decision at the upcoming meeting. She argued that it is too early to assess the impact of potential tariffs and immigration restrictions on inflation.

- While the Fed has assessed the risks to employment and inflation as balanced, mounting evidence points to a strengthening labor market. In October, job openings surged by 372,000 to 7.74 million, significantly exceeding market expectations of 7.48 million and the downwardly revised prior reading of 7.37 million. Also, layoffs declined at their fastest pace in over a year and a half. The surge in labor demand suggests that businesses may again turn to wage increases to attract workers. The ratio of job openings to unemployed rose from 1.08 to 1.11.

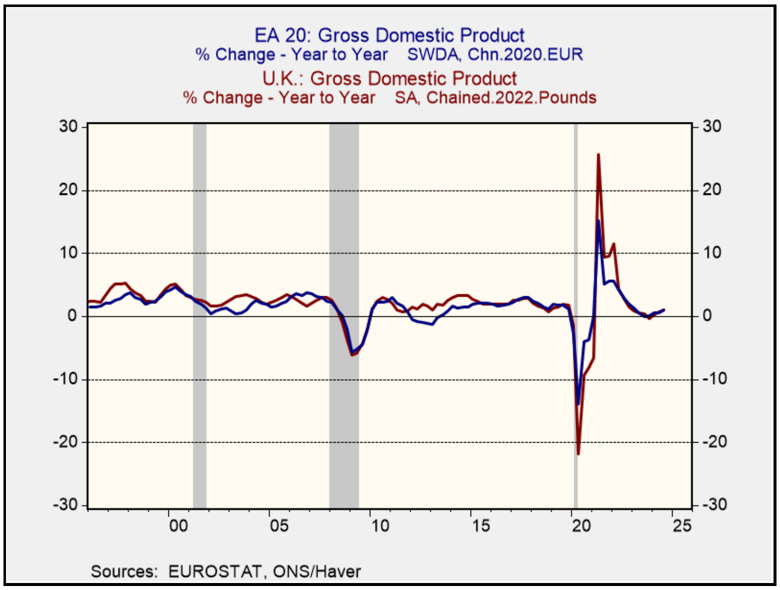


- Friday's job report and next week's CPI report will likely be pivotal in determining the Fed's rate-setting decision at its next meeting. An upside surprise in both reports could force the Fed to pause rate cuts indefinitely. However, if only one report surprises to the upside, a December rate cut remains on the table with the Fed possibly opting to reduce the number of expected rate cuts in its updated projections for 2025. Currently, the market is pricing in a 74% probability of a rate cut later this month and two rate cuts for next year, which we suspect is relatively high given the risks to inflation.

Global Rate Uncertainty: While the Fed's future policy direction is unclear, other G-7 rate setters seem to be maintaining their current course.

- The European Central Bank (ECB) and the Bank of England (BoE) are expected to continue cutting rates this year and next. European policymakers are poised to implement a 25 basis point rate cut next week and signal a commitment to further easing measures next year to avert a recession. Meanwhile, BoE Governor Andrew Bailey has indicated a willingness to cut rates four times next year, with the assumption that inflation will continue to make progress toward the central bank's 2% target. On the other end of the spectrum, the Bank of Japan has signaled a potential rate hike later this month.

- Changes in policy rates are likely to continue influencing dollar movements, although growth expectations will also be a significant factor. The US is expected to maintain a tighter monetary policy relative to many of its peers, and the interest rate differential with several G-7 countries is projected to widen. Additionally, the US economy appears to be better positioned to lead global growth. This combination of factors should make the US an attractive destination for capital flows, which should drive up the value of the dollar going into 2025.



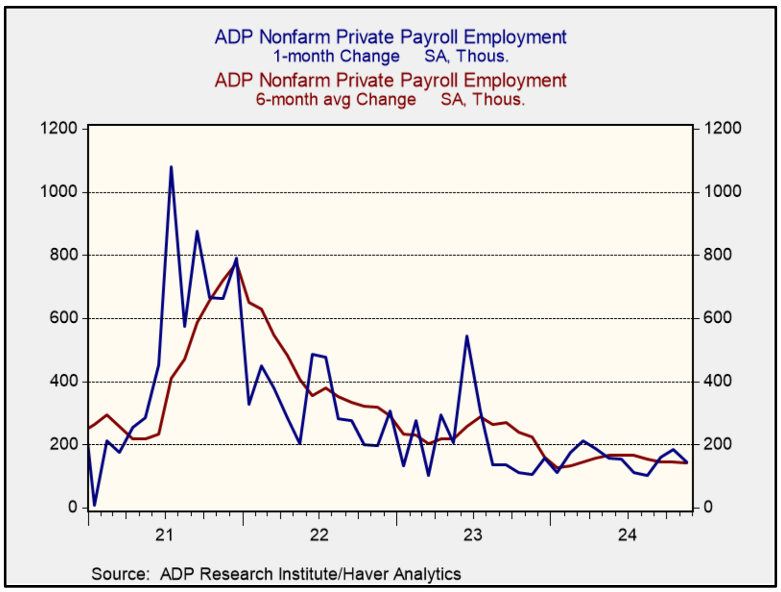
- The dollar's strength in the coming months is contingent on investors maintaining a weak outlook for the rest of the world. The economies of the eurozone and the UK are showing signs of growth despite fears of recession. At the same time, inflation in these regions appears to be stalling. As a result, these central banks may not ease as much as investors expect which could slow the dollar's upward trajectory. That said, given the potential for positive economic surprises abroad, international equities may present attractive investment opportunities.

In Other News: President-elect Donald Trump is considering selecting Florida Governor Ron DeSantis as a replacement for Pentagon nominee Pete Hegseth. This move suggests that he may be shifting toward more traditional choices for positions in his administration. Meanwhile, there are growing labor strikes in Germany to protest Volkswagen's decision to close plants in a sign that growth in the country could slow further. Lastly, A Chinese state newspaper suggested that the country may not need to achieve 5% annual growth to meet its long-term objectives. This signals that the country does not anticipate a rapid improvement in its economic challenges.

US Economic Releases

The Mortgage Bankers Association today said ***mortgage applications*** in the week ended November 30 rose 2.8%, compared to last week's gain of 6.3%. Applications for home purchase mortgages rose 5.6%, after rising 12.4% the prior week. Applications for refinancing mortgages fell a modest 0.6%, extending last week's 2.6% drop. According to the report, the average interest rate on a 30-year mortgage dropped 17 basis points to 6.69%.

Separately, the ADP Research Institute estimated that ***private payroll employment*** rose in November by a seasonally adjusted 146,000, slightly less than the expected 150,000 and marking a deceleration from October's gain of 184,000. ADP's estimate is widely seen as an indicator of what to expect when the Labor Department releases its measure of nonfarm payrolls on Friday. The chart below shows ADP's estimate of private payrolls since the beginning of 2021.



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	ISM Services Index	m/m	Nov	55.7	56	***
10:00	Factory Orders	m/m	Oct	0.2%	-0.5%	***
10:00	Factory Orders Ex Transportation	m/m	Oct		0.1%	*
10:00	Durable Goods Orders	m/m	Oct F	0.2%	0.2%	***
10:00	Durable Goods Orders ex Transportation	m/m	Oct F	0.1%	0.1%	**
10:00	Cap Goods Orders Nondef Ex Air	m/m	Oct F	-0.2%	-0.2%	*
10:00	Cap Goods Ship Nondef Ex Air	m/m	Oct F		0.2%	*

Federal Reserve		
ET	Speaker or Event	District or Position
8:45	Alberto Musalem Speaks on US Economy, Policy	President of the Federal Reserve Bank of St. Louis
9:00	Thomas Barkin Speaks in CNBC Interview	President of the Federal Reserve Bank of Richmond
13:40	Jerome Powell Speaks in Moderated Discussion	Chairman of the Board of Governors
14:00	U.S. Federal Reserve Releases Beige Book	Federal Reserve Board
18:00	Mary Daly Gives Interview to PBS News Hour	President of the Federal Reserve Bank of San Francisco

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	Jibun bank Composite PMI	m/m	Nov F	50.1	49.8		*	Equity and bond neutral
	Jibun Bank Services PMI	m/m	Nov F	50.5	50.2		**	Equity and bond neutral
Australia	S&P Global Australia Composite PMI	m/m	Nov F	50.2	49.4		*	Equity and bond neutral
	S&P Global Australia Services PMI	m/m	Nov F	50.5	49.6		**	Equity and bond neutral
	GDP	y/y	3Q	0.8%	1.0%	1.1%	**	Equity and bond neutral
New Zealand	ANZ Commodity Price	m/m	Nov F	2.9%	1.4%		**	Equity and bond neutral
South Korea	Foreign Reserves	m/m	Nov	$415.39b	$415.69b	--	**	Equity and bond neutral
China	Caixin Composite PMI	m/m	Nov	52.3	51.9		**	Equity and bond neutral
	Caixin Services PMI	m/m	Nov	51.5	52.0	52.4	**	Equity and bond neutral
India	S&P Composite PMI	m/m	Nov F	58.6	59.5		**	Equity and bond neutral
	S&P Services PMI	m/m	Nov F	58.4	59.2		**	Equity and bond neutral
EUROPE								
Eurozone	HCOB Eurozone Services PMI	m/m	Nov F	49.5	49.2	49.2	**	Equity and bond neutral
	HCOB Eurozone Composite PMI	m/m	Nov F	48.3	48.1	48.1	*	Equity and bond neutral
	PPI	y/y	Oct	-3.2%	-3.4%	-3.2%	**	Equity and bond neutral
Germany	HCOB Germany Services PMI	m/m	Nov F	49.3	49.4	49.4	**	Equity and bond neutral
	HCOB Germany Composite PMI	m/m	Nov F	47.2	47.3	47.3	**	Equity and bond neutral
France	HCOB France Services PMI	m/m	Nov F	46.9	45.7	45.7	**	Equity and bond neutral
	HCOB France Composite PMI	m/m	Nov F	45.9	44.8	44.8	**	Equity and bond neutral
Italy	HCOB Italy Composite PMI	m/m	Nov	47.7	51.0	49.6	**	Equity and bond neutral
	HCOB Italy Services PMI	m/m	Nov	49.2	52.4	50.8	**	Equity and bond neutral
UK	Official Reserves Changes	m/m	Nov	-$979m	-$945m	--	*	Equity and bond neutral
	S&P Global UK Services PMI	m/m	Nov F	50.8	50.0	50.0	**	Equity and bond neutral
	S&P Global UK Composite PMI	m/m	Nov F	50.5	49.9	49.9	**	Equity and bond neutral
Russia	S&P Global Russia Composite PMI	m/m	Nov	52.6	50.9		**	Equity and bond neutral
	S&P Global Russia Services PMI	m/m	Nov	53.2	51.6		**	Equity and bond neutral
AMERICAS								
Mexico	International Reserves Weekly	w/w	29-Nov	$228392m	$225528m		*	Equity and bond neutral
	Vehicle Domestic Sales	y/y	Nov	147971	122051	122241	***	Equity and bond neutral
	Leading Indicators	y/y	Oct	-0.11	-0.12		**	Equity and bond neutral
Brazil	Industrial Production	y/y	Oct	5.8%	3.4%	6.3%	***	Equity and bond neutral
	S&P Global Brazil Composite PMI	m/m	Nov	53.5	55.2		***	Equity and bond neutral
	S&P Global Brazil Services PMI	m/m	Nov	53.6	56.2		***	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)	444	445	-1	Down
U.S. Libor/OIS spread (bps)	443	443	0	Down
10-yr T-note (%)	4.26	4.23	0.03	Down
Euribor/OIS spread (bps)	288	292	-4	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.

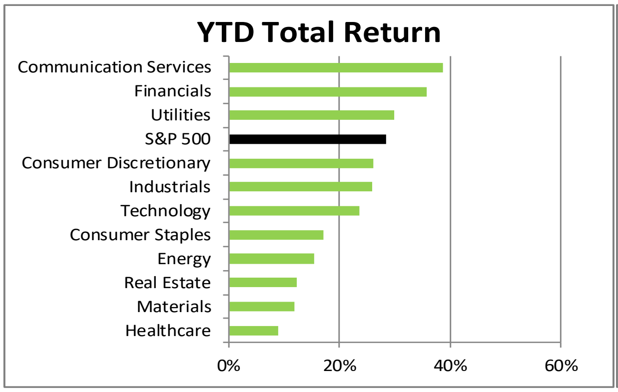
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$73.71	$73.62	0.12%	
WTI	$69.95	$69.94	0.01%	
Natural Gas	$3.00	$3.04	-1.55%	
Crack Spread	$15.97	$15.96	0.07%	
12-mo strip crack	$19.41	$19.45	-0.21%	
Ethanol rack	$1.73	$1.72	0.30%	
Metals				
Gold	$2,642.74	$2,643.49	-0.03%	
Silver	$30.73	$31.04	-0.99%	
Copper contract	$418.55	$420.20	-0.39%	
Grains				
Corn contract	$430.25	$432.25	-0.46%	
Wheat contract	$543.00	$547.50	-0.82%	
Soybeans contract	$983.75	$991.75	-0.81%	
Shipping				
Baltic Dry Freight	1,237	1,298	-61	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-1.82		
Gasoline (mb)		-0.68		
Distillates (mb)		1.00		
Refinery run rates (%)		0.4%		
Natural gas (bcf)		-3		

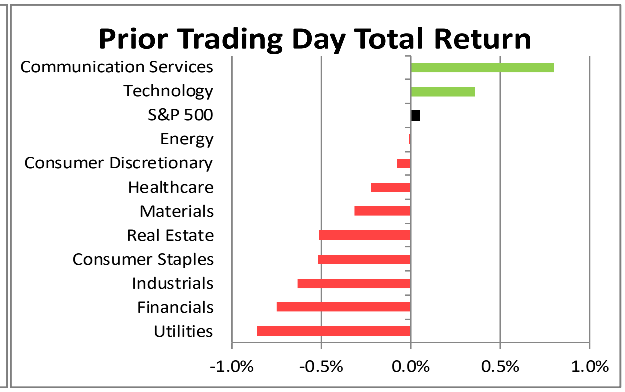
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures for most of the country, with normal temperatures in the south stretching from eastern Arizona to Mississippi. The precipitation outlook calls for wetter-than-normal conditions in the northern Great Plains, the Gulf Coast, and the East Coast, with drier-than-normal conditions in the Desert Southwest.

Data Section

US Equity Markets – (as of 12/3/2024 close)

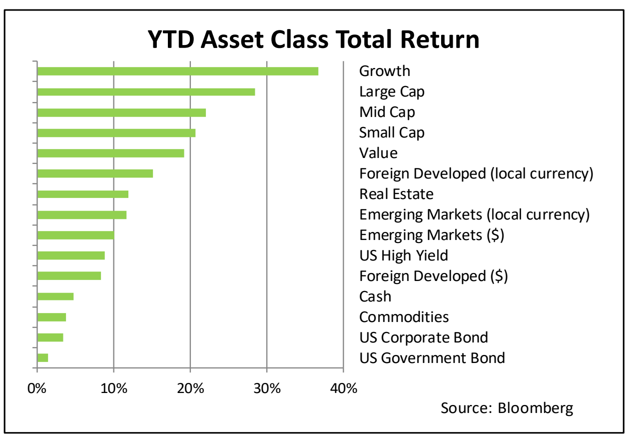




(Source: Bloomberg)

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 12/3/2024 close)

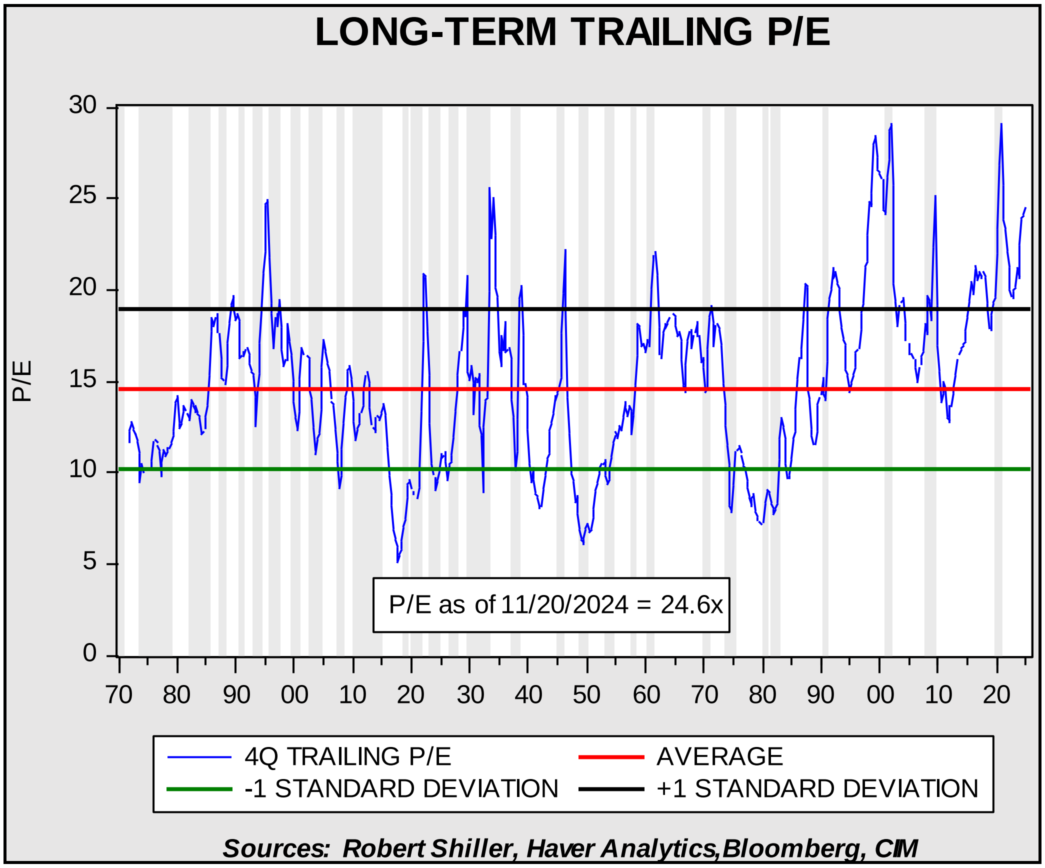


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.

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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.