Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: December 5, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed up 0.5% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.1%. Chinese markets were higher, with the Shanghai Composite up 0.1% from its previous close and the Shenzhen Composite up 0.7%. US equity index futures are signaling a lower open.

With 488 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, 75.2% have exceeded expectations, while 18.1% 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*

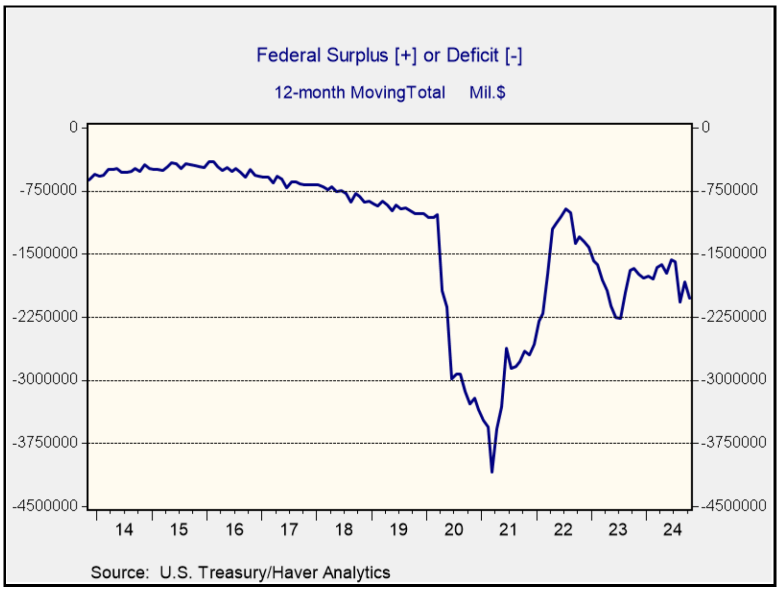
Good morning! The markets have US jobs data in focus as they look to gauge the Fed's next move. In sports, unranked Creighton pulled off an upset against No.1 ranked Kansas. Today's *Comment* will explore why Republicans have postponed their push for tax reforms in favor of prioritizing border security. We will then analyze the Federal Reserve's confidence in achieving a soft landing and provide an update on the no-confidence vote in France. As always, the report will include a roundup of key international and domestic data releases.

Trump Tax Doubts: Despite controlling both houses of Congress, Republican apprehension regarding the feasibility of comprehensive tax reform has led to a prioritization of border security.

- The decision to prioritize immigration over taxes came after a five-hour closed-door meeting, which included a phone call with incoming President Donald Trump. The

Republicans plan to advance his agenda by passing a border security bill, along with legislation on defense and energy, within Trump's first 30 days in office. They intend to achieve this through the use of budget reconciliation — a process that allows bills to pass with only a simple majority. After completing the initial legislation, the GOP intends to revisit and extend Trump's tax cuts using the same procedure later in the year.

- Hesitation by the Republicans to address taxes likely stems from concerns that a budget battle could complicate efforts to raise the debt ceiling, which is set to be reinstated on January 2. Although the party controls both chambers of Congress, its majority is narrow, especially in the House of Representatives where it holds only a five-seat advantage. While the border security vote is expected to garner bipartisan support, passing tax cuts may require every Republican vote. This could prove challenging, as several Republicans voiced concerns about the impact that tax cuts could have on the deficit.

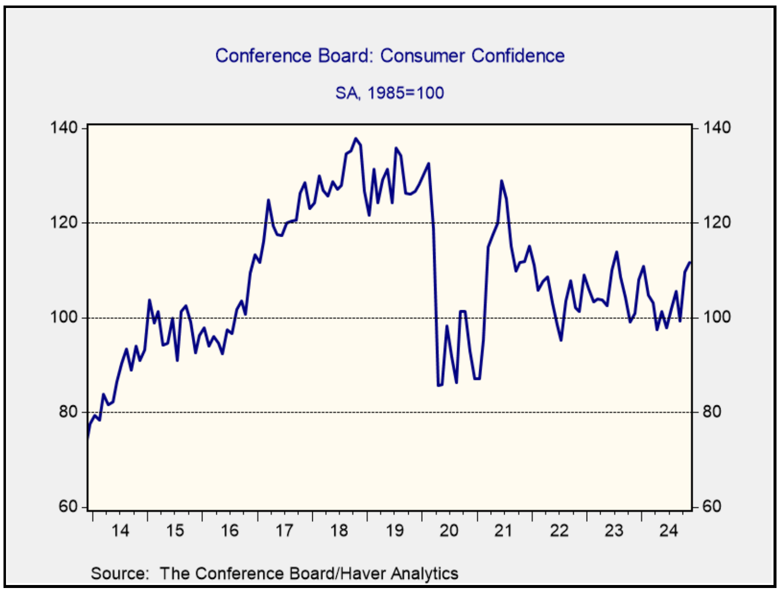


- Although delaying tax legislation in favor of border security entails certain risks, it may afford lawmakers an opportunity to secure an easy legislative win and build momentum before addressing the tax reform. One of the primary challenges will be ensuring the permanence of tax cuts, as this may necessitate offsetting measures to comply with budget reconciliation rules. Such measures could involve unpopular budget cuts. Nonetheless, the decision to postpone tax reform may alleviate pressure on Treasury yields, as it could mitigate concerns about the ballooning deficit.

Central Bank Confidence: Federal Reserve Chair Jerome Powell has doubled down on his view that the central bank will be able to achieve a soft landing.

- On Wednesday, the central bank head reassured markets that the Fed is in no rush to cut interest rates further. He added that the current economic outlook appears stronger than in September, when the Fed cut rates by 50 basis points. His comments suggest that the Fed is leaning toward a more gradual approach to future rate cuts and aiming to balance economic growth with inflation concerns. Powell emphasized that this year's rate cuts were intended to provide insurance against potential economic weakness and to support the labor market but were not a declaration of victory over inflation.

- Fed Chair Jerome Powell's cautious stance on future rate cuts may be in response to a recent surge in optimism following Donald Trump's election victory. The latest Beige Book reported that although economic activity has been relatively sluggish in recent months, many of the central bank's business contacts are optimistic about a potential rebound in demand. This optimism was also reflected in the latest Conference Board Consumer Confidence Index, which showed that the gap between respondents saying jobs are "plentiful" versus "hard to get" has reached its highest level since June.

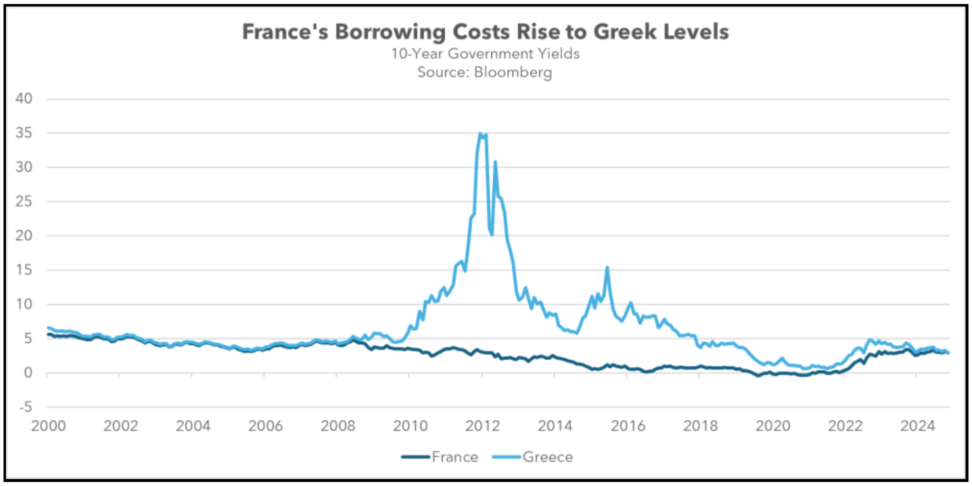


- Powell's comments highlight the prevailing belief that the Fed is prioritizing maximum employment over price stability. As a result, the central bank may hold off on rate cuts if Friday's payroll report significantly exceeds expectations, with the consensus projecting a gain of 215,000 jobs for November. According to the latest CME FedWatch Tool, markets currently assign a 74% probability of a rate cut at the Fed's meeting in two weeks. A stronger-than-expected jobs report, however, could spoil those expectations.

French No-Confidence Vote: The political crisis in France deepened as right- and left-wing lawmakers joined forces to topple the government.

- French Prime Minister Michel Barnier lost a no-confidence vote on Wednesday after he bypassed the lower house of parliament to push through an unpopular portion of the budget. This is the first time in nearly 60 years that a prime minister has been ousted, raising significant uncertainty about how the government will tackle its budget challenges. Barnier is expected to tender his resignation later today but will remain in office until French President Emmanuel Macron appoints a successor.

- Barnier's ouster leaves the French government without a functioning budget or stable leadership as it heads into 2025. This instability has created significant uncertainty in the markets, with investors increasingly reluctant to hold French assets due to the country's growing deficit and slowing economic growth. While the market exhibited relative indifference to Wednesday's no-confidence vote, underlying concerns remain. France's benchmark stock market index has declined by 11% since its 2024 peak in May, and its borrowing costs have converged to parity with Greece's for the first time in 16 years.

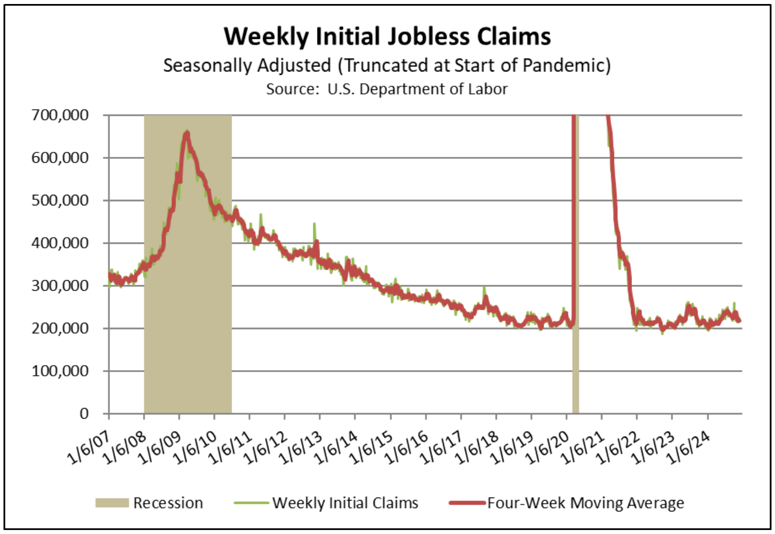


- The muted response from investors following the government's collapse suggests that the market had anticipated the outcome. However, significant uncertainty remains about France's future after the no-confidence vote. President Macron has limited options for appointing a Prime Minister, given the deeply divided parliament, which is likely to prolong political gridlock. If Macron remains in office, this stalemate could persist, adding to the uncertainty. We believe these developments may weigh on the euro (EUR) in the coming months.

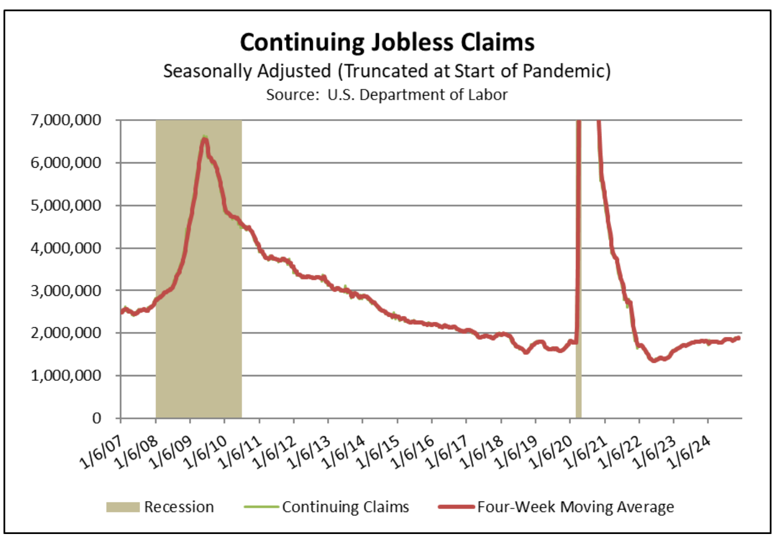
In Other News: Bitcoin surged past $100,000 for the first time, as crypto investors celebrated Trump's decision to appoint a pro-crypto advocate to lead the SEC. Meanwhile, in South Korea, the People Power Party leader has pledged to vote against impeachment proceedings but called on President Yoon Suk Yeol to step down from the ruling party. In the US, projections from the Congressional Budget Office suggest that Trump's tax cuts are unlikely to generate sufficient economic growth to offset the resulting increase in the budget deficit.

US Economic Releases

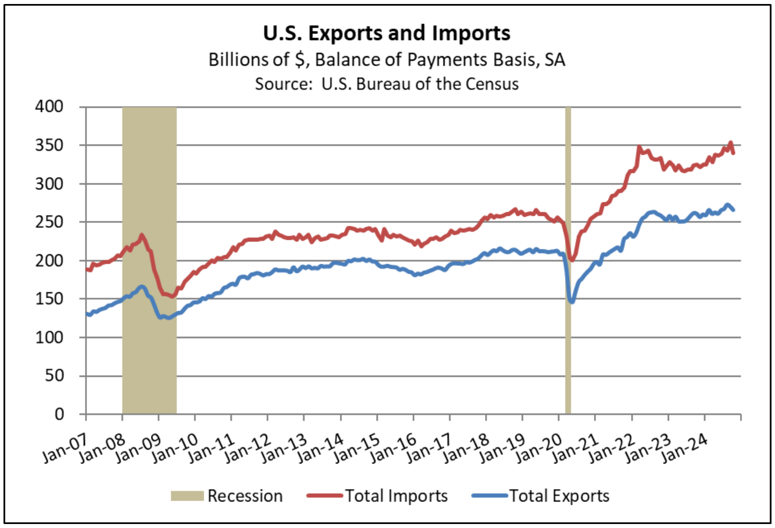
In the week ended November 30, ***initial claims for unemployment benefits*** rose to a seasonally adjusted 224,000, versus expectations that they would be unchanged at the prior week's revised level of 215,000. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, rose modestly to 218,250. The chart below shows how initial jobless claims have fluctuated since just before the Great Financial Crisis. The chart is truncated through much of the pandemic period because of the extremely high level of claims at that time.



In the week ended November 23, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) fell to a seasonally adjusted 1.871 million, below both the anticipated reading of 1.904 million and the prior week's revised reading of 1.896 million. The four-week moving average of continuing claims fell to 1,884,250. The chart below shows how continuing claims have fluctuated since the GFC. It is also truncated during the pandemic period because of the high level of claims at the time.



In a separate report today, the October ***trade balance*** showed a seasonally adjusted deficit of $73.8 billion, narrower than both the expected deficit of $75.0 billion and the revised September deficit of $83.8 billion. According to the data, total ***exports*** fell 1.6% to $265.7 billion, while *imports* fell 4.0% to $339.6 billion. Compared with the same month one year earlier, the trade dynamics looked much different, with exports in October up 1.9% and imports up 4.4%. The chart below shows the monthly value of US exports and imports since just before the previous recession.



The following table lists the economic releases and Fed events scheduled for the rest of today.

Economic Releases		
	No economic releases for the rest of today	
Federal Reserve		
ET	**Speaker or Event**	**District or Position**
12:15	Thomas Barkin Speaks Economic Outlook	President of the Federal Reserve Bank of Richmond

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	Japan Buying Foreign Bonds	w/w	29-Nov	¥922.4b	-¥779.1		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	29-Nov	-¥544.7b	-¥316.7b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	29-Nov	¥176.1b	-¥314.1b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	29-Nov	-¥607.7b	-¥445.8b		*	Equity and bond neutral
Australia	Household Spending	y/y	Oct	2.8%	0.9%	2.2%	*	Equity bullish, bond bearish
	Trade Balance	m/m	Oct	A$5953m	A$4532m	A$4500m	***	Equity and bond neutral
	Exports	m/m	Oct	3.6%	-4.7%		*	Equity and bond neutral
	Imports	m/m	Oct	0.1%	-2.8%		*	Equity and bond neutral
South Korea	GDP	q/q	3Q P	1.5%	1.5%	1.5%	**	Equity and bond neutral
EUROPE								
Eurozone	Retail Sales	y/y	Oct	1.9%	3.0%	1.7%	*	Equity and bond neutral
Germany	Factory Orders WDA	y/y	Oct	5.7%	4.2%	1.8%	***	Equity bullish, bond bearish
	HCOB Germany Construction PMI	m/m	Nov	38.0	40.2		*	Equity and bond neutral
France	Industrial Production	y/y	Oct	-0.6%	-0.6%	-0.2%	***	Equity and bond neutral
	Manufacturing Production	y/y	Oct	-1.4%	-0.8%		**	Equity and bond neutral
UK	New Car Registrations	y/y	Nov	-1.9%	-6.0%		*	Equity and bond neutral
	S&P Global UK Construction PMI	m/m	Nov	55.2	54.3	53.5	**	Equity and bond neutral
Switzerland	Unemployment Rate	m/m	Nov	2.6%	2.6%	2.7%	**	Equity and bond neutral
Russia	Gold and Forex Reserves	m/m	29-Nov	$614.1b	$614.2b		***	Equity and bond neutral
AMERICAS								
Canada	S&P Global Canada Composite PMI	m/m	Nov	51.5	50.7		*	Equity and bond neutral
	S&P Global Canada Services PMI	m/m	Nov	51.2	50.4		*	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)	434	435	-1	Down
U.S. Sibor/OIS spread (bps)	443	443	0	Down
U.S. Libor/OIS spread (bps)	442	442	0	Down
10-yr T-note (%)	4.21	4.18	0.03	Down
Euribor/OIS spread (bps)	288	288	0	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.

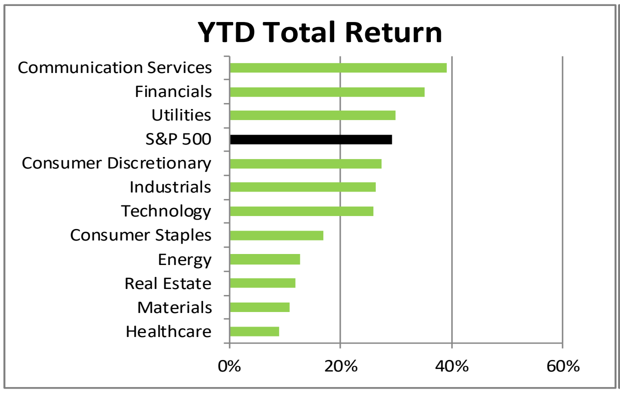
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$72.35	$72.31	0.06%	
WTI	$68.55	$68.54	0.01%	
Natural Gas	$3.07	$3.04	0.95%	
Crack Spread	$15.81	$15.98	-1.07%	
12-mo strip crack	$19.30	$19.43	-0.64%	
Ethanol rack	$1.74	$1.74	0.27%	
Metals				
Gold	$2,653.31	$2,649.90	0.13%	
Silver	$31.37	$31.30	0.20%	
Copper contract	$420.15	$420.15	0.00%	
Grains				
Corn contract	$429.50	$430.00	-0.12%	
Wheat contract	$552.75	$548.25	0.82%	
Soybeans contract	$984.75	$983.75	0.10%	
Shipping				
Baltic Dry Freight	1,180	1,237	-57	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-5.07	-1.41	-3.66	
Gasoline (mb)	2.36	-1.04	3.40	
Distillates (mb)	3.38	-0.42	3.81	
Refinery run rates (%)	2.8%	0.5%	2.4%	
Natural gas (bcf)		-38		

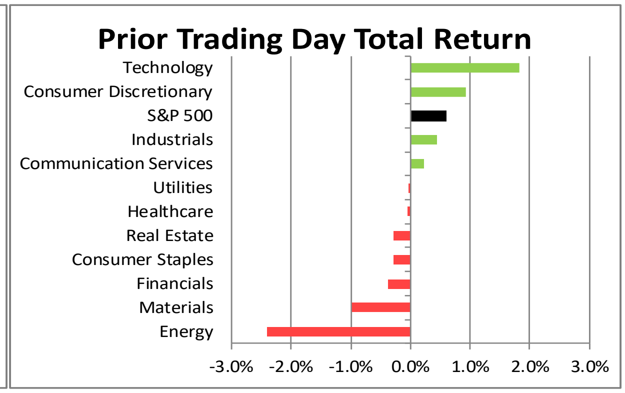
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for colder-than-normal temperatures in southern Texas and Louisiana, with warmer-than-normal temperatures in all other regions. The forecasts call for wetter-than-normal conditions in the Pacific Northwest and the Northeast, with dry conditions in the Desert Southwest.

Data Section

US Equity Markets – (as of 12/4/2024 close)

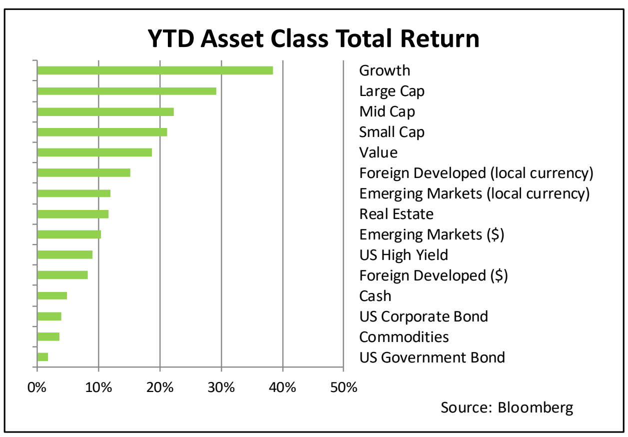




(Source: Bloomberg)

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 12/4/2024 close)

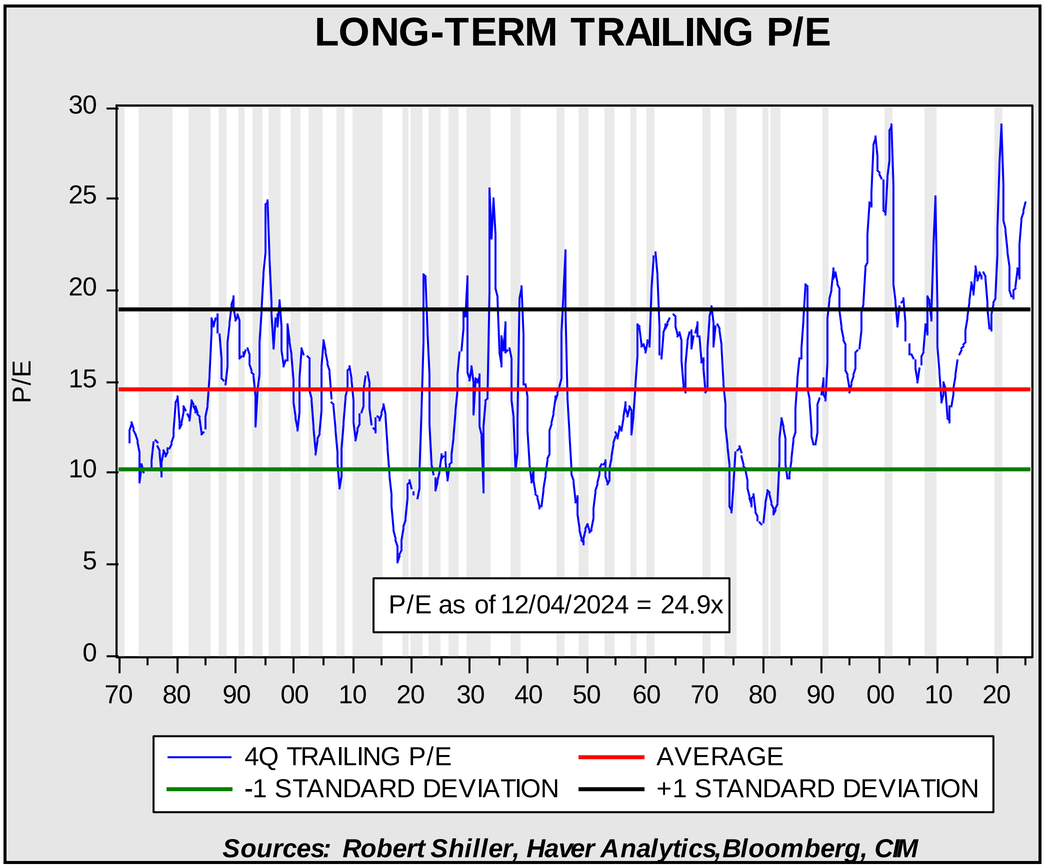


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 5, 2024



Based on our methodology,[1] the current P/E is 24.9x, up 0.3 from our last report. The increase in the multiple was driven by a decrease in earnings and a slight 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.

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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.