Daily Comment

Confluence Investment Management

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: December 6, 2024 — 9:30 AM ET] Global equity markets are 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 0.4%. Chinese markets were higher, with the Shanghai Composite up 1.1% from its previous close and the Shenzhen Composite up 1.2%. US equity index futures are signaling a higher open.

With 496 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, 74.9% have exceeded expectations, while 18.2% 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***):

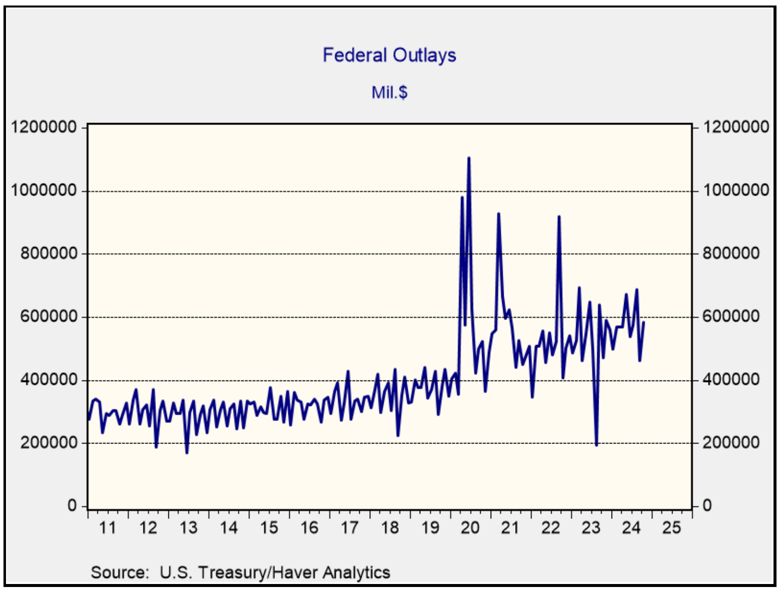
Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
Implications of North Korean Soldiers in the Ukraine War (11/18/24) + podcast	*Bonds and the Post-Election Environment* (11/25/24) + podcast	Q4 2024 Report Q4 2024 Rebalance Presentation	**Business Cycle Report**

Good morning! The market is processing the latest jobs data. In sports news, the Detroit Lions pulled off an impressive comeback against the Green Bay Packers, continuing their historically strong season. In today's *Comment*, we'll delve into the highly anticipated task force led by Elon Musk and Vivek Ramaswamy and its budget-cutting plans. Next, we'll examine the future of US chip manufacturing. Finally, we'll analyze Brazil's fiscal policies and the renewed tensions they've caused with the military. As always, we'll conclude with a roundup of key domestic and international data releases.

Trump Budget Cuts: The Department of Government Efficiency is beginning to unveil its strategy to reduce government spending by over $2 trillion.

- Elon Musk and Vivek Ramaswamy met with lawmakers to advocate for cost-cutting initiatives aimed at "reducing the federal deficit. The newly appointed group seeks to dismantle government bureaucracy, curtail government regulations, eliminate wasteful expenditures, and restructure federal agencies." The Trump appointed commission's outline plans to reduce the number of federal agencies from 428 to 99 and mandate a return to the office for all federal employees. Most changes will require congressional approval, but the duo will seek to implement some reforms through executive order.

- While reducing the government workforce could alleviate some budgetary pressures, deeper spending cuts will likely be necessary to achieve significant savings. Federal employee compensation, including wages, salaries, and benefits, has been declining as a percentage of the federal budget since 2005, dropping from a peak of 11.7% to 8.7% in 2023, according to the Bureau of Economic Analysis. Although, even if all federal employees were eliminated, there would still be approximately $1.5 trillion needed annually in order to meet the deficit reduction goal.

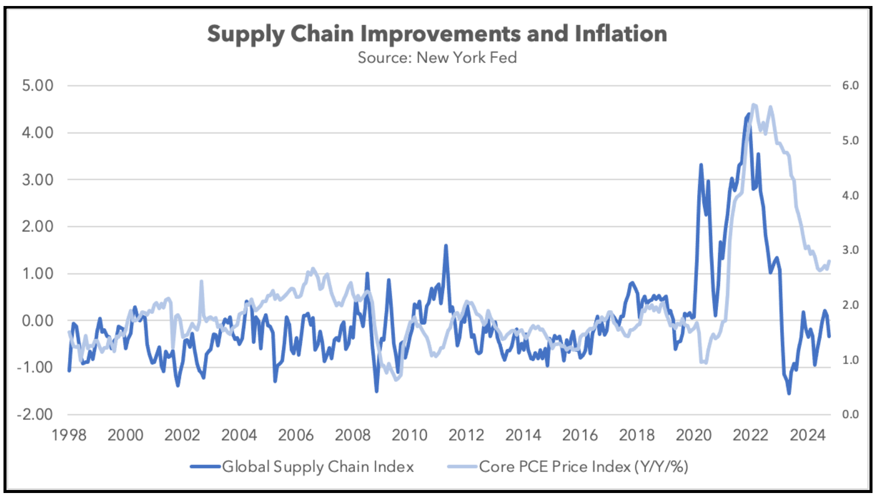


- The push for government efficiency might be little more than a distraction as Republicans concentrate on addressing the budget deficit and securing funding to make the Trump tax cuts permanent. While the group can recommend spending cuts, it lacks the authority to enact them without approval from Congress. However, the creation of the task force indicates that the incoming administration may be more mindful of the fiscal deficit than markets anticipated in the run up to the election. Consequently, we remain optimistic that prior deficit projections for the Trump budget are higher than what the reality will be.

CHIPS Act: While achieving US self-reliance remains a long-term objective, many firms are reluctant to make the necessary investments due to prevailing uncertainty.

- Intel's recent dismissal of its CEO Pat Gelsinger highlights the challenges faced by US chipmakers in reshoring manufacturing operations. The company failed in its ability to grab market share from its competitors AMD and TSMC. Also, the financial losses incurred by its independent foundry have raised significant concerns about the future of its manufacturing initiatives. Despite securing contracts with Microsoft and Amazon, the Intel foundry's primary customer remains Intel itself. As a result, the possibility of a pivot has led to concerns that it may lose out on the $7.9 billion it was granted by the CHIPS Act.

- Reshoring chipmaking is poised to evolve under the next administration, which has traditionally prioritized tariffs over subsidies to bolster American manufacturing. While incoming President Trump has criticized the CHIPS and Science Act as inefficient, he is widely expected to preserve much of the funding for semiconductor factories initiated by his predecessor. Furthermore, he is anticipated to push for supply chain restructuring by introducing component-based tariffs, which tax products based on the origin of their components rather than their final assembly location.

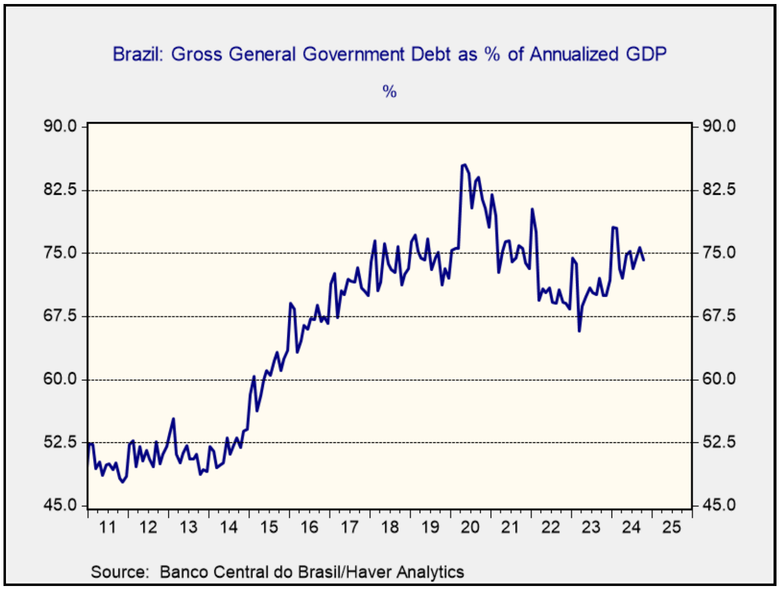


- The shift toward a more aggressive trade policy to support the reshoring of chipmaking is likely to have both positive and negative effects on the US economy. On the positive side, it could reduce the need for additional subsidies, making the approach more cost-effective, while generating increased revenue through tariffs. However, this strategy may also trigger a costly restructuring of supply chains, raising domestic costs for firms, dampening global growth, and potentially fueling inflationary pressures and weighing on equity prices.

Brazil's Military Austerity: Brazilian President Luiz Inácio Lula da Silva has targeted defense as a way to reduce the country's ballooning debt problem.

- Lula's administration is proposing a mandatory minimum retirement age for its military personnel. This decision, part of Lula's broader plan to curb the country's spending, would cap the tenure of those serving in the armed forces. So far, the proposal has faced significant pushback, with officials urging for a less stringent approach. This has led to the idea being put on hold. However, it is likely to further strain relations between Lula and the military, particularly in light of recent revelations about a plot to overthrow the government in favor of the former president Jair Bolsonaro.

• The decision comes as Lula's administration seeks to make constitutional adjustments and complementary laws to control public sector salary spending. Under the new arrangement, only salaries explicitly authorized by supplementary law will be exempt from the salary cap. Additionally, the country's new fiscal framework has been amended to allow for expenditure growth of 0.6% to 2.5% above inflation, which is also expected to change the minimum wage.

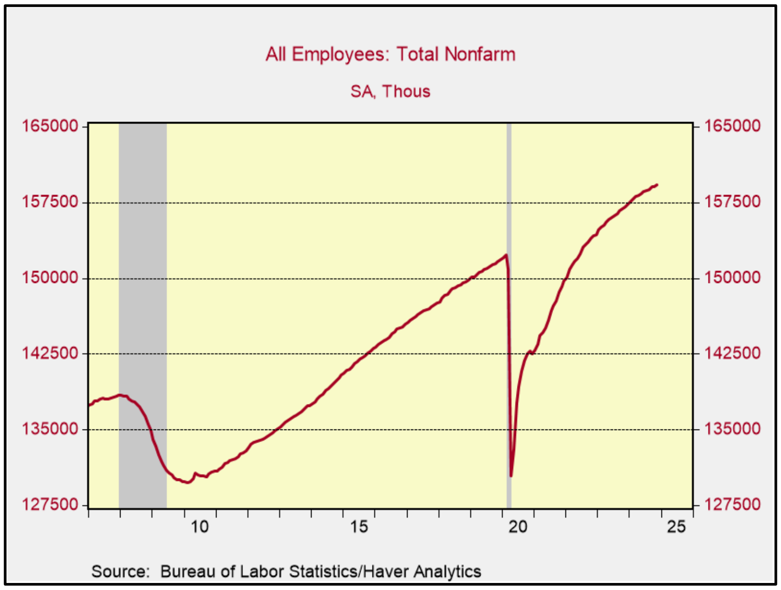


• The Lula administration's comprehensive approach to addressing the country's deficit challenges is expected to face significant obstacles, as various groups may resist these changes. The complexities of establishing a stable fiscal framework could hinder efforts to reduce inflation, which, in turn, may negatively impact the country's currency. Given the country's history of military dictatorship, we will be paying closer attention to the ongoing rift between the military and Lula, as there clearly appears to be a divide between the two.

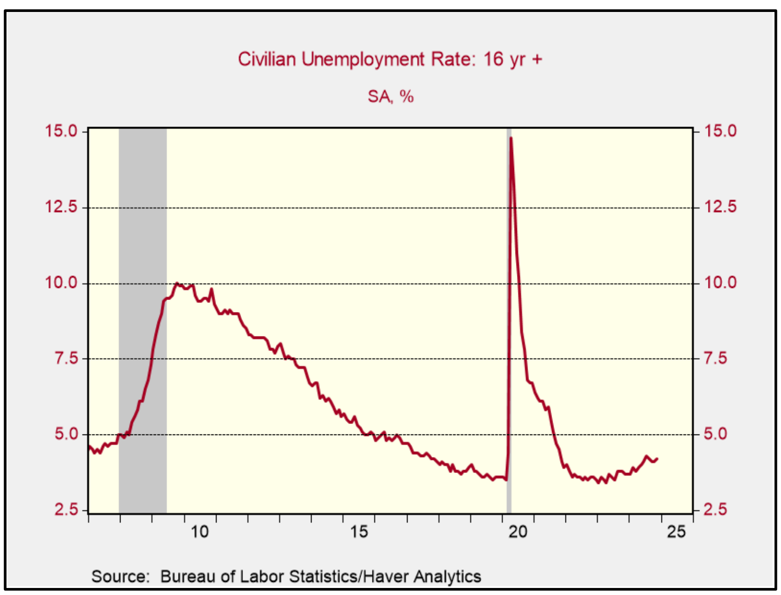
In Other News: OPEC+ has again delayed its plan to increase oil production for the third time, aiming to stabilize prices at current levels. Meanwhile, French far-right leader Marine Le Pen has signaled a willingness to support the government's budget proposal if President Macron agrees to a slower pace of deficit reduction.

US Economic Releases

November ***nonfarm payrolls*** rose by a seasonally adjusted 227,000, slightly better than the expected gain of 220,000 and much more than the revised October increase of just 36,000 (a figure that was held down by strikes and hurricanes in that month). The rebound in job creation in November is a welcome sign that the economy still has momentum. However, it's important to note that the average growth in payrolls over the last six months has now cooled to 143,000, versus 236,000 in the previous six months. The chart below shows the change in nonfarm payrolls since shortly before the Great Financial Crisis.

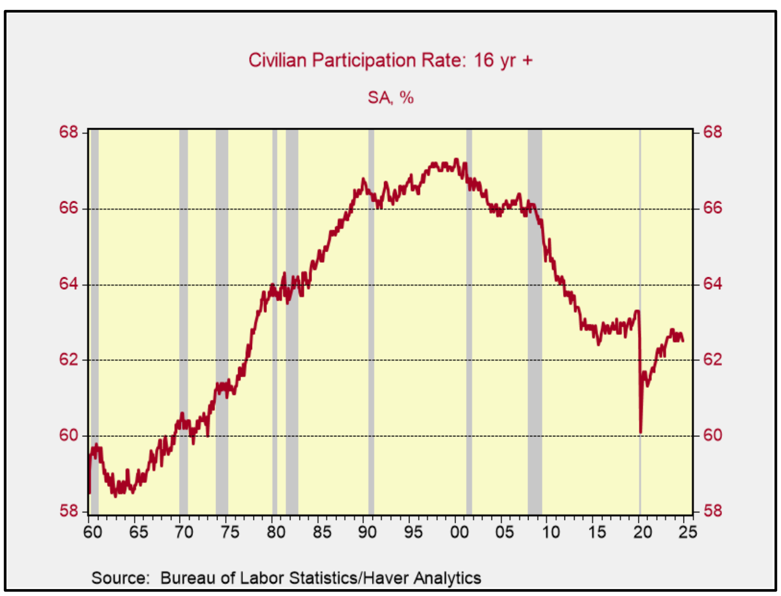


The November ***unemployment rate*** rose to a seasonally adjusted 4.2%, worse than expectations that it would remain at the 4.1% rate registered in each of the previous two months. The chart below shows how the unemployment rate has evolved since just before the GFC.



Also in the report, ***average hourly earnings*** in November rose to a seasonally adjusted $35.61, up 4.0% from the same month one year earlier. The annual increase in average hourly earnings was a bit above the anticipated 3.9%, but it was no higher than the 4.0% increase in the year to October. The chart below shows the year-over-year growth in average hourly earnings since just before the GFC.

A final key indicator in the monthly employment report focuses on the share of the adult, civilian, noninstitutionalized population that is either working or looking for work. The November ***labor force participation rate (LFPR)*** fell to a seasonally adjusted 62.5%, reaching its lowest level since May. The chart below shows how the LFPR has changed over the last several decades.



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	U. of Michigan Consumer Sentiment	m/m	Dec P	73.3	71.8	***
10:00	U. of Michigan Current Conditions	m/m	Dec P	65.2	63.9	**
10:00	U. of Michigan Future Expectations	m/m	Dec P	77.7	76.9	**
10:00	U. of Michigan 1-Year Inflation Expectation	m/m	Dec P	2.7%	2.6%	*
10:00	U. of Michigan 5-10 Year Inflation Expectation	m/m	Dec P	3.1%	3.2%	*
15:00	Consumer Credit	m/m	Oct	$10.000b	$6.002b	*

Federal Reserve		
ET	**Speaker or Event**	**District or Position**
9:15	Michelle Bowman Speaks to Missouri Bankers Association	Member of the Board of Governors
10:30	Austan Goolsbee Participates in Fireside Chat	President of the Federal Reserve Bank of Chicago
12:00	Beth Hammack Speaks on the US Economy	President of the Federal Reserve Bank of Cleveland
13:00	Mary Daly Speaks on Moderated Conversation	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	Labor Cash Earnings	y/y	Oct	2.6%	2.5%	2.6%	**	Equity and bond neutral
	Real Cash Earnings	m/m	Oct	0.0%	-0.4%	-0.1%	*	Equity and bond neutral
	Household Spending	y/y	Oct	-1.3%	-1.1%	-2.5%	**	Equity bearish, bond bullish
	Leading Economic Index	m/m	Oct P	108.6	109.1	108.8	**	Equity and bond neutral
	Coincident Index	y/y	Oct P	116.5	115.3	117.7	**	Equity and bond neutral
Australia	Foreign Reserves	m/m	Nov	A$98.4b	A$99.0b		*	Equity and bond neutral
South Korea	BoP Current Account Balance	m/m	Oct	$9783.6m	$10940.4m		**	Equity and bond neutral
	BoP Goods Balance	m/m	Oct	$9783.6m	$10486.2m		*	Equity and bond neutral
EUROPE								
Eurozone	GDP	y/y	3Q F	0.9%	0.9%	0.9%	***	Equity and bond neutral
Germany	Industrial Production WDA	y/y	Oct	-4.5%	-4.3%	-3.3%	**	Equity bearish, bond bullish
France	Trade Balance	m/m	Oct	-7666m	-8418m		*	Equity and bond neutral
Italy	Retail Sales	y/y	Oct	2.6%	0.7%		**	Equity and bond neutral
Switzerland	Foreign Currency Reserves	m/m	Nov	724.6b	718.7b		*	Equity and bond neutral
Russia	Money Supply, Narrow Definition	w/w	29-Nov	18.23t	18.27t		*	Equity and bond neutral
AMERICAS								
Canada	Int'l Merchandise Trade	m/m	Oct	-0.92b	-1.30b	-1.05b	**	Equity and bond neutral
Brazil	Trade Balance	m/m	Nov	$7030m	$4195m	$7500m	**	Equity and bond neutral
	Exports	m/m	Nov	$28021m	$29304m	$29100m	*	Equity and bond neutral
	Imports	m/m	Nov	$20991m	$25109m	$21150m	*	Equity and bond neutral
	FGV Inflation IGP-DI	y/y	Nov	6.62%	5.91%	6.48%	**	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)	433	434	-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 (%)	4.18	4.18	0.00	Up
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
Central Bank Action	**6.5**	**Prior**	**Expected**	
RBI Cash Reserve Ratio	4.000%	4.500%	4.500%	Below Forecast
RBI Repurchase Rate	6.500%	6.500%	6.500%	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.

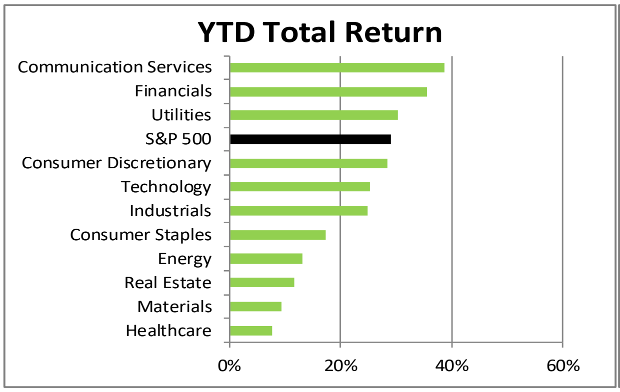
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$71.53	$72.09	-0.78%	
WTI	$67.75	$68.30	-0.81%	
Natural Gas	$3.02	$3.08	-2.05%	
Crack Spread	$15.99	$16.01	-0.11%	
12-mo strip crack	$19.49	$19.49	0.01%	
Ethanol rack	$1.75	$1.75	0.11%	
Metals				
Gold	$2,641.13	$2,631.67	0.36%	
Silver	$31.24	$31.31	-0.24%	
Copper contract	$423.35	$419.25	0.98%	
Grains				
Corn contract	$435.75	$435.00	0.17%	
Wheat contract	$558.00	$558.25	-0.04%	
Soybeans contract	$994.50	$993.75	0.08%	
Shipping				
Baltic Dry Freight	1,160	1,180	-20	
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)	-30	-36	6	

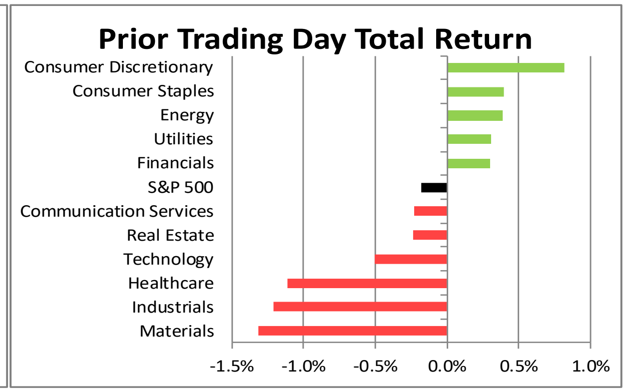
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for colder-than-normal temperatures in the Deep South, with warmer-than-normal temperatures in all other regions. The forecasts call for wetter-than-normal conditions in the Pacific Northwest and Texas, with dry conditions in the Deep South and along the East Coast.

Data Section

US Equity Markets – (as of 12/5/2024 close)

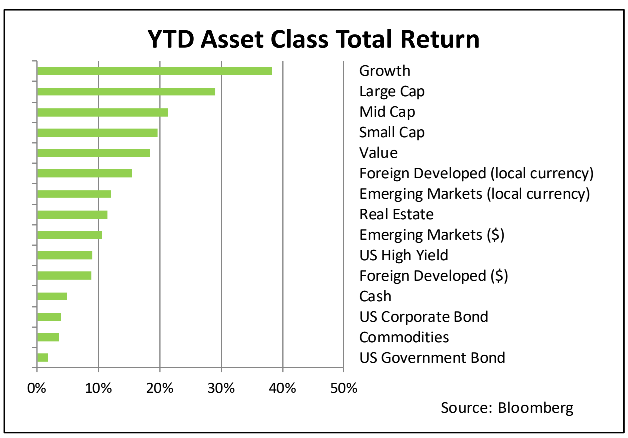




(Source: Bloomberg)

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 12/5/2024 close)

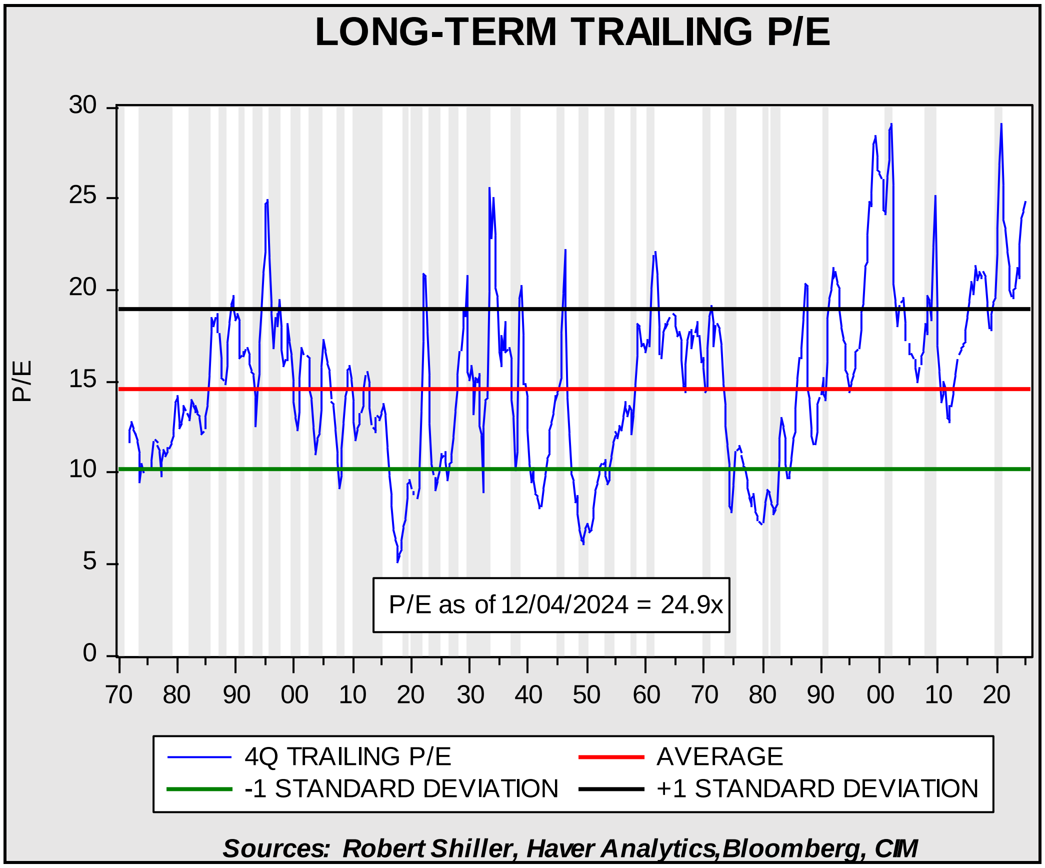


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.

---

[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.