Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

Looking for something to read? See our Reading List; these books, separated by category, are ones we find interesting and insightful. We will be adding to the list over time.

[Posted: July 16, 2024—9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed down 0.7% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.4%. Chinese markets were higher, with the Shanghai Composite up 0.1% from its previous close and the Shenzhen Composite up 0.5%. US equity index futures are signaling a higher open.

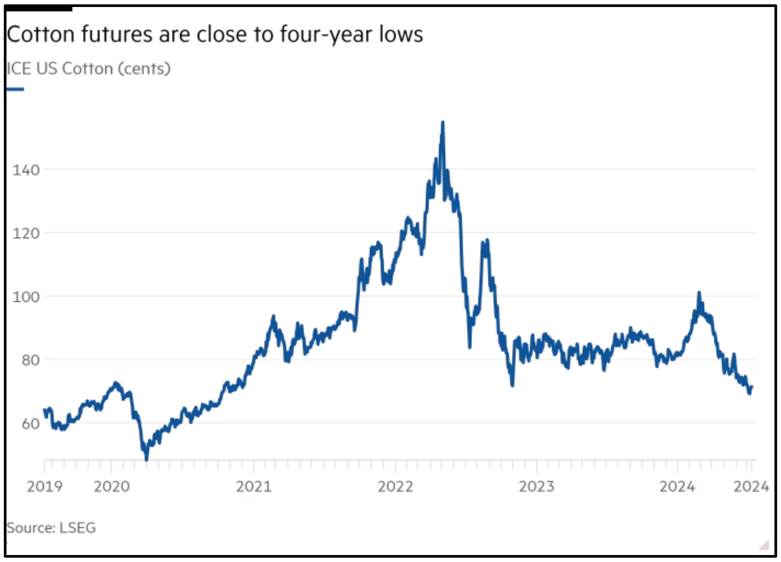
With 29 companies having reported so far, S&P 500 earnings for Q2 are running at $58.70 per share, compared to estimates of $58.94, which is up 8.0% from Q2 2023. Of the companies that have reported thus far, 82.8% have exceeded expectations while 13.8% have fallen short of expectations.

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 emphasized in bold:

- *Bi-Weekly Geopolitical Report* (7/1/2024) (with associated podcast): "The EU Parliamentary Elections: New Strength for the Right"
- *Asset Allocation Bi-Weekly* (7/15/2024) (with associated podcast): "A New Factor for Gold Prices"

Our *Comment* today opens with a note on the recent plunge in global cotton prices, which has been driven by surging output in Brazil. We next review several other international and US developments with the potential to affect the financial markets today, including a major new tax reform in Turkey and a few words on US political developments.

Global Commodity Market: Global cotton prices have plunged to about $0.69 per pound so far in July, reaching their lowest levels since October 2020 and less than half their 10-year peak in May 2022. The decline largely reflects surging exports from top-producer Brazil, where low corn prices have pushed farmers to plant cotton instead. The drop in cotton prices will hurt farm incomes in other major cotton-producing countries, but it could also help boost margins for clothing manufacturers.



China: The Communist Party yesterday opened its latest "Third Plenum" meeting, which takes place every five years and often focuses on new economic reforms. Reports in state media say General Secretary Xi will use the meeting to push China's "self-confidence and self-reliance," in part by supporting the development of "new productive forces," such as the increased production and export of advanced technologies like electric vehicles and solar panels.

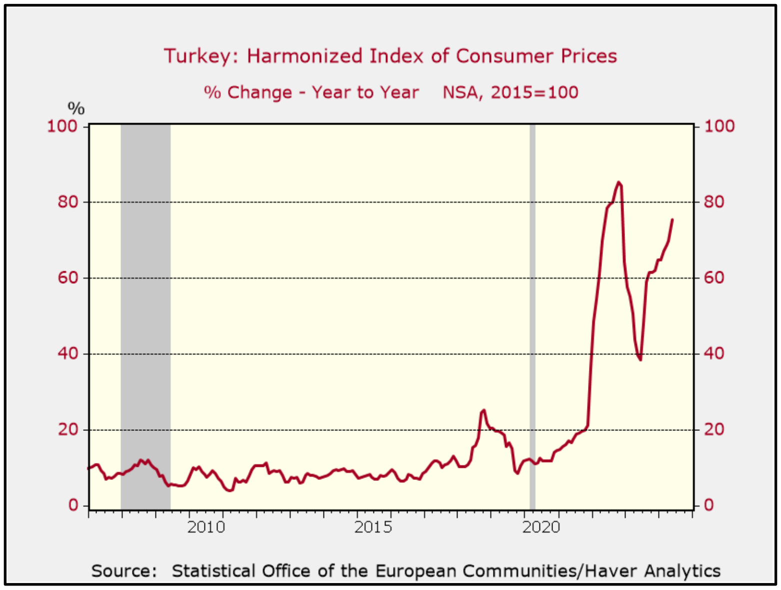
South Korea: New polling shows 66% of South Koreans now support or strongly support their country developing its own nuclear weapons, up from 60% in a poll from last year. Prime Minister Han Duck-soo recently said the government isn't in a position to develop nukes "for now," but Seoul's conservative mayor, Oh Se-hoon, who is seen as a likely presidential candidate in 2027, last week called for South Korea to go nuclear immediately.

- The developments are consistent with our view that rising geopolitical tensions and foreign doubts about US security commitments could spark a new nuclear arms race around the world.
- Our *Bi-Weekly Geopolitical Report* from February 12, 2024, provides a detailed discussion of this possibility.

France: As politicians keep jockeying for power after this month's inconclusive parliamentary elections, the left-wing New Popular Front alliance that came in first is being riven by infighting. Its most radical faction, the far-left France Unbowed, has pulled out of the alliance's negotiations on a candidate for prime minister after its leader, anti-capitalist firebrand Jean-Luc Mélenchon, was blocked by the Socialists.

- If the leftists within New Popular Front can't agree on a candidate, it raises the chance that President Macron's centrists could retain the prime minister's post.
- That would likely be a relief to investors, as it would probably ensure at least some continuity with Macron's pro-business policies, but the fractured nature of the new parliament would still leave French politics unstable in the near term.

Turkey: President Erdoğan's government is reportedly prepping a major tax reform aimed at broadening the tax base, cooling economic growth, and helping reduce consumer price inflation. Among other measures, the reform would introduce a minimum corporate tax rate of 10% and toughen tax audits. The moves would complement last year's hike in the value-added tax and cuts in fuel subsidies, as well as the central bank's recent boost to interest rates. Those moves have yet to rein in Turkey's big post-election surge in prices.



Canada: In a release yesterday, the Bank of Canada's quarterly business-outlook survey showed many businesses expect softer demand and reduced cost pressures going forward. The survey results have increased expectations that the central bank will cut interest rates again at its policy meeting on July 24, despite recent data showing a re-acceleration in consumer price inflation in May. The renewed expectations for a rate cut have put pressure on the Canadian dollar, which is now trading at about 1.37 per greenback, a depreciation of 0.7% from one week ago.

US Politics: Former President Trump, the presumptive Republican nominee for president in the November elections, chose Senator J. D. Vance of Ohio as his running mate yesterday. Vance, who will turn 40 in August, is expected to shore up Trump's support among younger white males, especially in the industrial Midwest, who are a critical group supporting Trump-style populism.

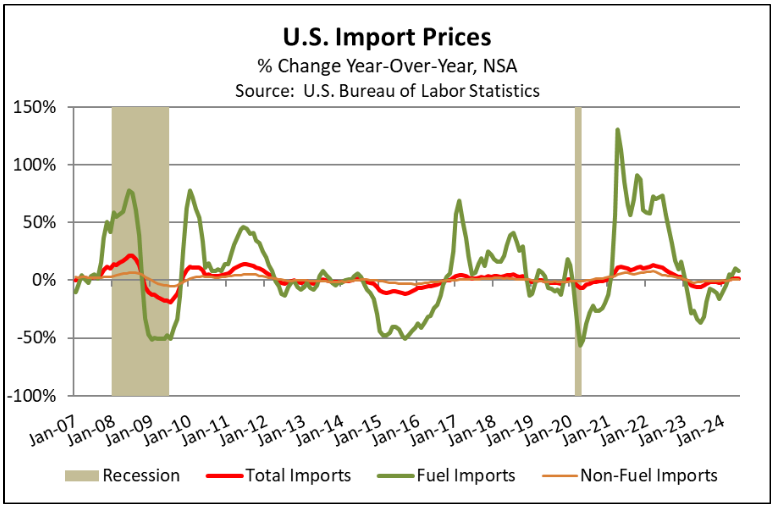
- The politically savvy move is likely to further cement expectations that Trump will win in November. It will also probably increase expectations that the Republicans will win added seats in the Senate and the House of Representatives.
- In turn, that will likely add to the revived "Trump trade," which is reflected in falling bond prices, higher bond yields, increased prices for many equities, and stronger valuations for bitcoin and other cryptocurrencies.

US Monetary Policy: At an event in Washington yesterday, Fed Chair Powell said recent economic data "do add somewhat to confidence" that inflation will return to the Fed's target after price pressures remained elevated earlier in the year. However, he declined to provide any hint as to when the monetary policymakers will start to cut interest rates. We continue to expect the Fed will start cutting rates at its September policy meeting, potentially following that with one more rate cut later in the year.

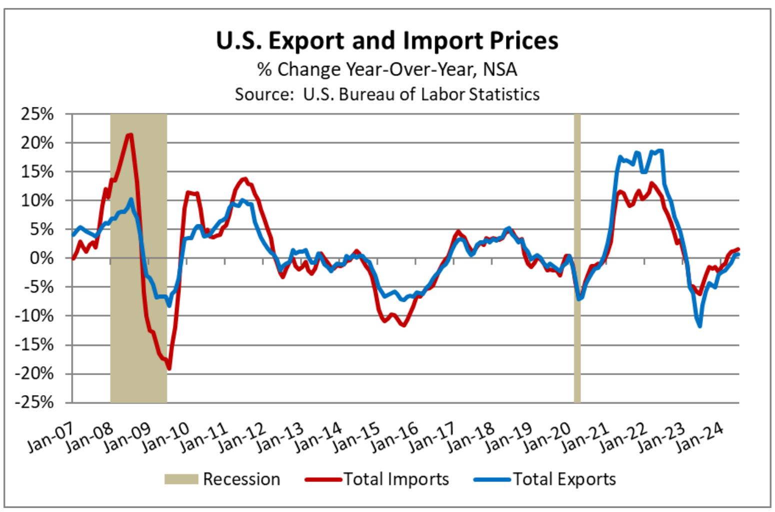
US Economic Releases

June ***retail sales*** on a seasonally adjusted basis were flat (0.0% change), exceeding the expected value of -0.3%, but falling short of May's 0.3% increase. Of course, overall retail sales are often driven by the volatile auto and auto parts sector, which makes up almost one-fifth of the total. June ***retail sales excluding autos and auto parts*** rose 0.4%, again exceeding the expected value of 0.1% and May's value of 0.1%. The strength of these values relative to expectations portends strength in markets today, although it could have an impact on expectations for Fed rate cuts this year, which could have an adverse effect, given the possibility of heightened inflation concerns. Overall retail sales in June were up 0.2% from the same month one year earlier, while sales excluding autos and auto parts rose 1.4%. The chart below shows how retail sales have changed since just before the previous recession.

June ***import prices*** were also flat (0.0% change from the previous month), exceeding the expected value of -0.2% and the previous month's -0.2%. Of course, import prices are often driven by volatility in the petroleum fuels category. June ***import prices excluding fuels*** rose 0.2%, exceeding the expected value of -0.2% and the previous month's 0.0%. We expect similar effects from these strong numbers as the ones we discuss in our commentary on retail sales (above). Overall import prices in June rose 1.6% year-over-year, again exceeding the expected 1.0% and the previous month's 1.4%. The chart below shows the year-over-year change in import prices since just before the Great Financial Crisis.



According to the report, ***export prices*** in June rose 0.7% from one year earlier, which is less than the expected 1.0% gain, but greater than the previous month's 0.5%. Comparing the annual change in export prices versus import prices provides a sense of the US "terms of trade," or the relative advantage or disadvantage the country is facing because of trends in international trade prices. The chart below compares the year-over-year change in US export and import prices since just before the Great Financial Crisis.



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

Economic Releases						
ET	**Indicator**			**Expected**	**Prior**	**Rating**
10:00	Business Inventories	m/m	May	0.5	0.3	*
10:00	NAHB Housing Market Index	m/m	Jul	43	43	*
Federal Reserve						
ET	**Speaker or Event**	**District or Position**				
14:45	Adriana Kugler Speaks at NABE Conference	Member of the Board of Governors				

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	Tertiary Industry Index	m/m	May	-0.4%	2.2%	0.1%	***	Equity bearish, bond bullish
South Korea	Import Price Index	y/y	Jun	9.7%	4.7%		*	Equity and bond neutral
	Export Price Index	y/y	Jun	12.2%	7.6%		*	Equity and bond neutral
EUROPE								
Eurozone	ZEW Survey Expectations	m/m	Jul	43.7	51.3		**	Equity and bond neutral
	Trade Balance SA	m/m	May	12.3b	18.5b	18.1b	**	Equity and bond neutral
Germany	ZEW Survey Expectations	m/m	Jul	41.8	47.5	41.0	**	Equity and bond neutral
	ZEW Survey Current Situation	m/m	Jul	-68.9	-73.8	-74.8	**	Equity bullish, bond bearish
France	Current Account Balance	m/m	May	-3.1b	-3.5b		*	Equity and bond neutral
Italy	CPI, EU Harmonized	y/y	Jun F	0.9%	0.9%	0.9%	***	Equity and bond neutral
AMERICAS								
Canada	Manufacturing Sales	m/m	May	0.4%	1.4%	0.2%	**	Equity and bond neutral
	Wholesale Sales ex Petroleum	m/m	May	-0.8%	2.0%	-0.9%	*	Equity and bond neutral
Brazil	Economic Activity Index	y/y	Jan	1.30%	4.28%	1.10%	**	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)	555	556	-1	Down
3-mo T-bill yield (bps)	518	518	0	Up
U.S. Sibor/OIS spread (bps)	528	528	0	Down
U.S. Libor/OIS spread (bps)	526	527	-1	Down
10-yr T-note (%)	4.17	4.23	-0.06	Down
Euribor/OIS spread (bps)	366	366	0	Down
Currencies	**Direction**			
Dollar	Flat			Down
Euro	Flat			Up
Yen	Down			Down
Pound	Flat			Up
Franc	Flat			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.

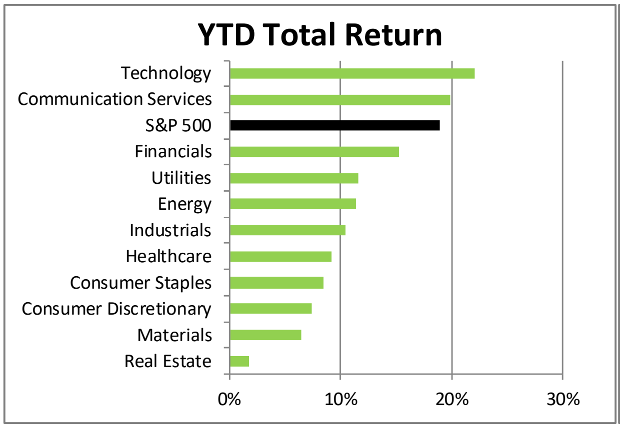
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$83.52	$84.85	-1.57%	
WTI	$80.45	$81.91	-1.78%	
Natural Gas	$2.18	$2.16	1.02%	
12-mo strip crack	$21.58	$21.95	-1.70%	
Ethanol rack	$2.09	$2.11	-0.79%	
Metals				
Gold	$2,439.62	$2,422.27	0.72%	
Silver	$30.81	$30.68	0.44%	
Copper contract	$449.90	$452.65	-0.61%	
Grains				
Corn contract	$407.25	$404.25	0.74%	
Wheat contract	$533.00	$532.50	0.09%	
Soybeans contract	$1,041.50	$1,040.00	0.14%	
Shipping				
Baltic Dry Freight	1,993	1,997	-4	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-1.49		
Gasoline (mb)		-1.92		
Distillates (mb)		-0.75		
Refinery run rates (%)		-0.7%		
Natural gas (bcf)		30		

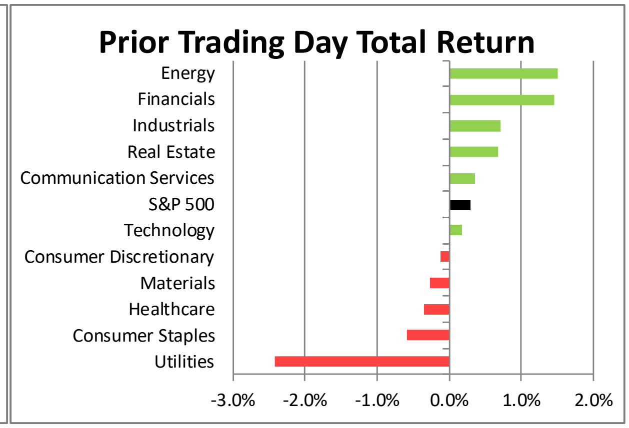
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures across the Pacific, Northern Rockies, Great Lakes, Florida, and New England regions, with colder-than-normal temperatures stretching from Texas and Oklahoma to Tennessee. The precipitation outlook calls for wetter-than-normal conditions across the southern two-thirds of the country, with dry conditions expected in the Northern Great Plains. There is no cyclone activity expected in the Atlantic within the next 48 hours.

Data Section

US Equity Markets – (as of 7/15/2024 close)

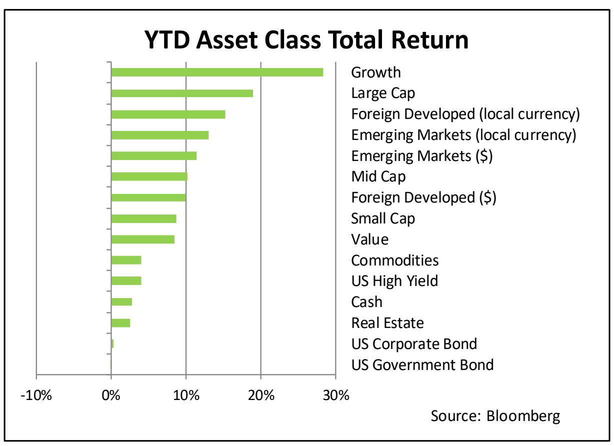




(Source: Bloomberg)

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 7/15/2024 close)

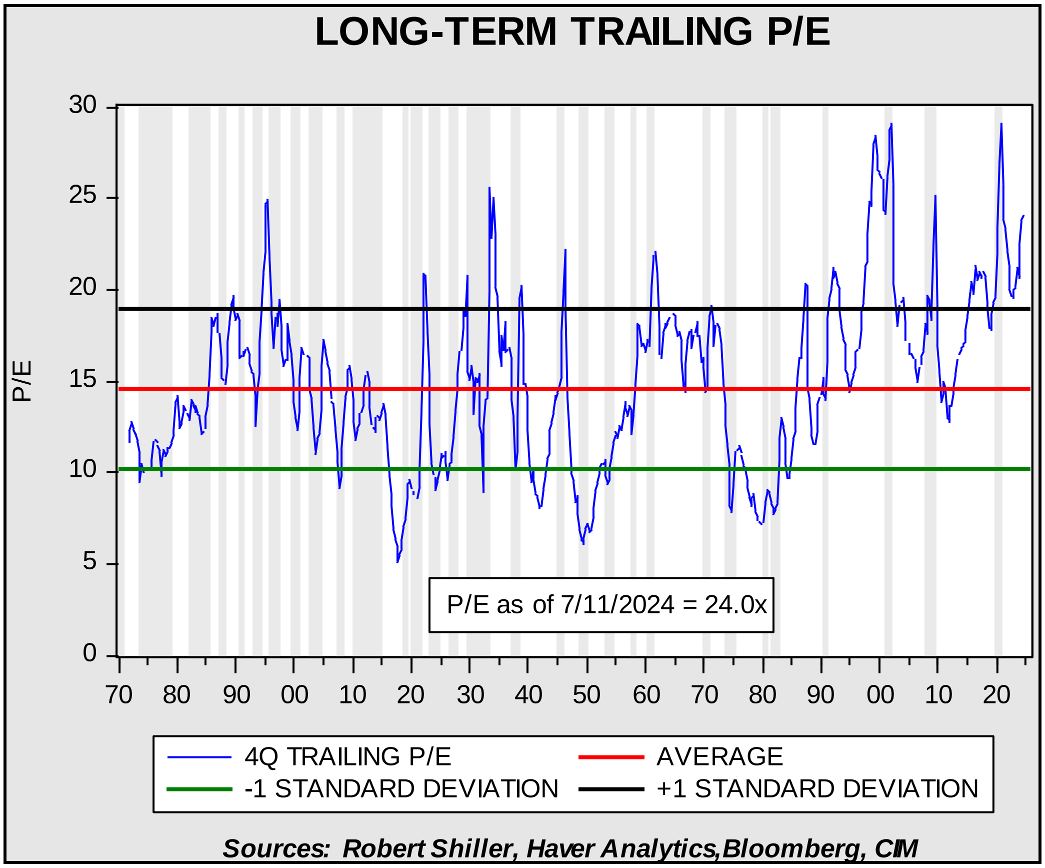


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

July 11, 2024



Based on our methodology,[1] the current P/E is 24.0x, up 0.2 from our last report. The increase in the multiple was due to an increase in the stock price index offsetting a slight increase in earnings.

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.