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 22, 2024—9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed up 1.4% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.9%. Chinese markets were lower, with the Shanghai Composite down 0.6% from its previous close and the Shenzhen Composite down 0.1%. US equity index futures are signaling a higher open.

With 71 companies having reported so far, S&P 500 earnings for Q2 are running at $59.50 per share, compared to estimates of $58.94, which is up 8.0% from Q2 2023. Of the companies that have reported thus far, 83.1% have exceeded expectations while 14.1% 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 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"
- *Asset Allocation Quarterly – Q3 2024* (7/16/2024): Discussion of our asset allocation process, Q3 2024 portfolio changes, and our outlook for the markets.

Our *Comment* today opens with some initial comments on President Biden's decision over the weekend to withdraw from the November election. We next review several other international and US developments with the potential to affect the financial markets today, including an apparent agreement between China and the Philippines to diffuse their dangerous tensions in the South China Sea and a statement by a former Federal Reserve official predicting that monetary policymakers could still cut interest rates as many as three times this year.

US Politics: Obviously, the key development to watch in the coming days will be the fallout from President Biden's decision to pull out of the 2024 presidential election in favor of Vice President Harris. Polls suggest Harris might have a modestly better chance at beating former President Trump than Biden did. Keeping the White House in Democratic hands would have big implications for geopolitics, national security policy, international trade, fiscal policy, and other aspects of economic policy. It still seems too early to call a winner.

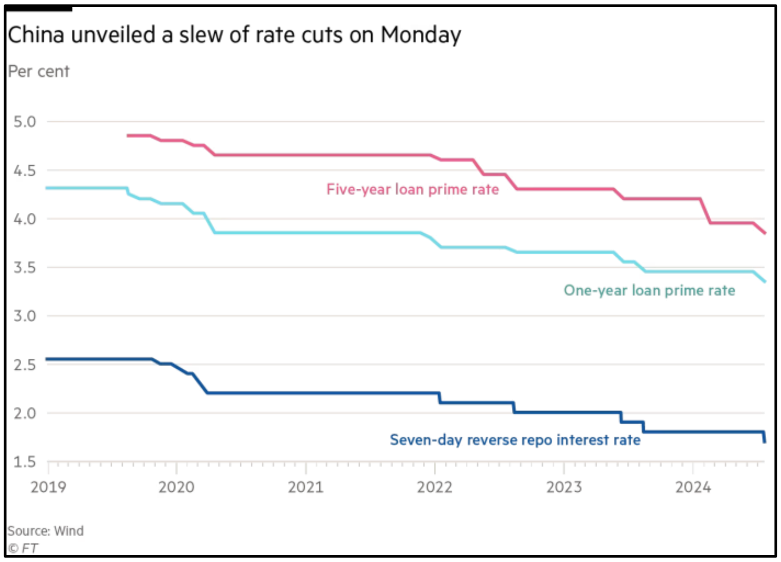
- Until the dust settles, it wouldn't be a surprise to see the "Trump trade" temporarily cool or go into reverse. Indeed, both the dollar and US Treasury yields are trading lower so far this morning.
- All the same, the betting markets, which have been reliable predictors of electoral outcomes in the past, are currently showing Harris trailing Trump substantially. Of course, this could change as Harris gets her campaign up and running. Again, it is too early to say who will win in November.
- Much will probably depend on whom Harris chooses as her running mate. A strong choice that helps the Democrats win a key battleground state would help keep the race wide open.
- Another key consideration is whether Harris and her eventual vice-presidential nominee can help the Democrats keep control of at least one chamber of Congress. Investors often look favorably on a divided government, in which no party controls both the White House and all of Congress.

China-Philippines: Manila yesterday reiterated it would not rely on US help to resupply its marines on an outpost coveted by Beijing in the South China Sea. The statement comes despite Chinese coast guard harassment of the resupply missions and an offer by US National Security Advisor Sullivan for the US to do "what is necessary" to make sure they succeed. Keeping the US at arm's length suggests Manila understands how dangerous the China-Philippine standoff had become and is now trying to keep the dispute under control.

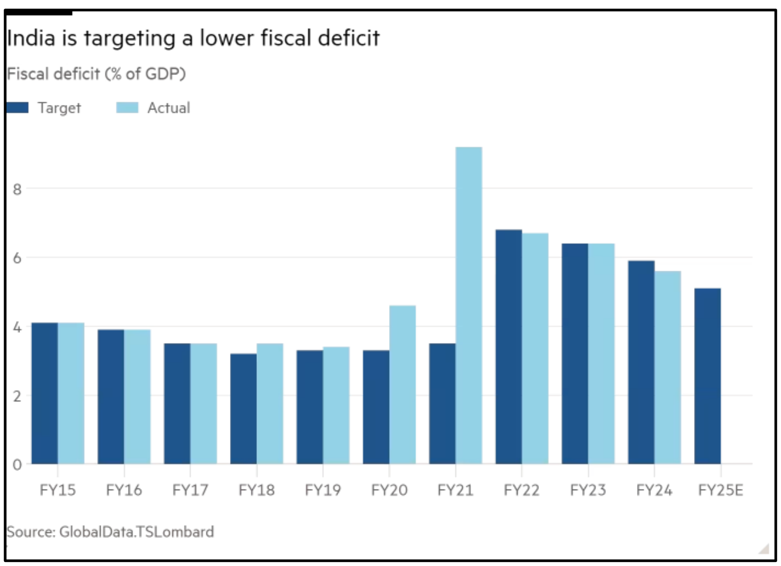
- Indeed, the Philippine Department of Foreign Affairs yesterday said Manila and Beijing have struck a "preliminary" deal allowing resupply missions to the outpost. However, Beijing has not yet confirmed such an agreement.
- If the agreement is confirmed and holds, it could help diffuse a crisis that we believe had become even more dangerous than China's aggressiveness against Taiwan. After all, the Philippines has a mutual defense treaty with the US, so any armed attack by the Chinese against the Philippines could potentially draw in the US.

Brazil-China: Brazilian President Lula da Silva revealed late Friday that his government is drawing up plans to join China's controversial "Belt and Road Initiative," under which Beijing has provided more than $1 trillion in grants and loans to mostly less-developed countries for ports, highways, railroads, and other trade-related infrastructure. The revelation suggests Brasilia is again drawing closer to Beijing, despite the risk that doing so could worsen ties with the US and potentially invite trade or capital retribution.

China: The People's Bank of China today cut several of its key interest rates in a new effort to spur the flagging economy. For example, the central bank cut its one-year prime interest rate by 0.1%, marking its first such rate cut since last August. The new prime rate is 3.35%. The central bank also cut its five-year prime rate, which is a benchmark for mortgage lending, by 0.1% to 3.85%. The years-long downtrend in interest rates reflects how the wind has come out of the Chinese economy because of challenges such as weak consumption and high debt.

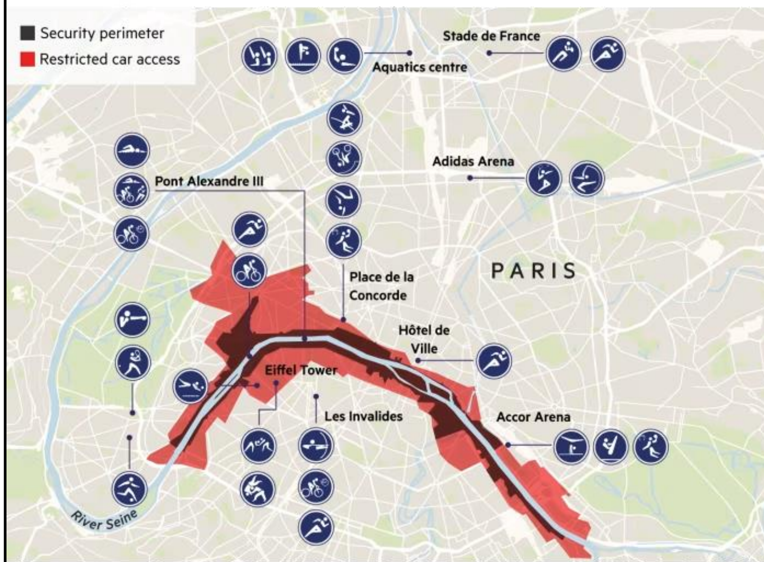


India: As Prime Minister Modi works to develop his proposed budget for the upcoming fiscal year, the two regional parties brought into his coalition in June [are reportedly demanding the equivalent of billions of dollars in new funding for their states]. The demands threaten to derail Modi's plan to bring India's budget deficit back under control after it blew out during the coronavirus pandemic. Failure to rein in the deficit could undermine foreign investors' faith in the Modi government and reduce foreign investment in the country.



France: We want to extend our condolences to anyone taking a summer jaunt to Paris this week. With the Summer Olympic Games starting on Friday, authorities [have begun locking down large sections of central Paris, including installing metal barriers to block car traffic along about 6 km of the Seine]. Opening ceremonies begin Friday evening with a procession of athletes in boats along the river — the first such opening ceremony outside of a stadium.

A metal barricade will lock down areas around 6km of the Seine



Sources: FT research; French ministry for transport; Mapcreator.io | OSM.org
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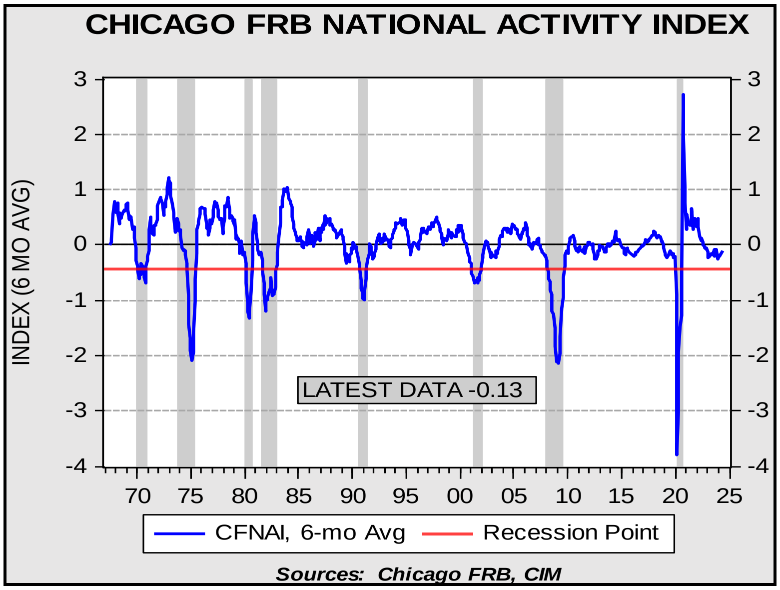
US Monetary Policy: In an interview, former Federal Reserve Vice Chair Richard Clarida said there is "a real possibility" that the monetary policymakers could cut interest rates three times this year, due to rapidly cooling price inflation. We think that many cuts would be on the aggressive side, given that the Fed officials have expressed extreme caution about cutting too early and allowing inflation to rebound. The consensus among investors is still around two cuts, beginning in September.

US Airline Industry: Large numbers of US flights were canceled again yesterday and today as airlines continue trying to recover from last week's global cybersecurity software glitch. Delta and United are reportedly the two most affected airlines. The cancellations have compounded the challenge of faltering consumer demand as the post-pandemic travel surge now seems to be petering out worldwide.

US Economic Releases

US economic activity slowed in June according to the Federal Reserve Bank of Chicago. The regional bank's ***National Activity Index*** slipped from May's revised reading of +0.23 to +0.05 in the following month. The reading was well above expectations of -0.09. Production related indicators slipped from +0.23 to +0.11. The sales, orders, and inventories category fell from +0.01 to -0.02.



The chart above shows the Chicago Fed National Activity Index and its six-month average. Last month, the moving average improved from -0.16 to -0.13.

There are no economic releases or Fed events scheduled for the rest of the day.

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	Tokyo Condominiums for Sale	y/y	Jun	-12.8%	-19.9%		*	Equity and bond neutral
New Zealand	Trade Balance NZD	m/m	Jun	699m	54m		**	Equity and bond neutral
	Exports NZD	m/m	Jun	7.16b	7.00b		**	Equity and bond neutral
	Imports NZD	m/m	Jun	5.47b	6.94b		**	Equity and bond neutral
EUROPE								
France	Retail Sales SA	y/y	Jun	-0.7%	-1.4%		*	Equity and bond neutral
Switzerland	M3 Money Supply	y/y	Jun	0.4%	-0.6%		**	Equity and bond neutral
	Domestic Sight Deposits CHF	w/w	19-Jul	452.9b	450.3b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	19-Jul	461.3b	458.9b		*	Equity and bond neutral
AMERICAS								
Canada	Retail Sales	m/m	May	-0.8%	0.6%	-0.6%	**	Equity and bond neutral
	Retail Sales Ex-Autos	m/m	May	-1.3%	1.7%	-0.5%	**	Equity bearish, bond bullish
	Industrial Prices	m/m	Jun	0.0%	0.2%		**	Equity and bond neutral
	Raw Material Prices	m/m	Jun	-1.4%	-1.5%		*	Equity and bond neutral
Mexico	Retail Sales	y/y	May	0.3%	3.2%	2.3%	***	Equity bearish, bond bullish
	Economic Activity IGAE	y/y	May	1.57%	5.42%	1.40%	**	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)	554	554	0	Down
3-mo T-bill yield (bps)	519	520	-1	Up
U.S. Sibor/OIS spread (bps)	528	528	0	Down
U.S. Libor/OIS spread (bps)	526	526	0	Down
10-yr T-note (%)	4.22	4.24	-0.02	Down
Euribor/OIS spread (bps)	370	369	1	Down
Currencies	**Direction**			
Dollar	Down			Down
Euro	Flat			Up
Yen	Up			Down
Pound	Up			Up
Franc	Flat			Up
Central Bank Action	**Current**	**Prior**	**Expected**	
PBOC 1-Year Loan Prime Rate	3.350%	3.450%	3.450%	Below Forecast
PBOC 5-Year Loan Prime Rate	3.850%	3.950%	3.950%	Below 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.

DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$82.39	$82.63	-0.29%	
WTI	$79.72	$80.13	-0.51%	
Natural Gas	$2.20	$2.13	3.34%	
12-mo strip crack	$21.48	$21.49	-0.02%	
Ethanol rack	$2.01	$2.01	0.18%	
Metals				
Gold	$2,401.89	$2,400.83	0.04%	
Silver	$28.99	$29.22	-0.80%	
Copper contract	$420.90	$423.65	-0.65%	
Grains				
Corn contract	$411.00	$404.75	1.54%	
Wheat contract	$546.75	$542.75	0.74%	
Soybeans contract	$1,055.00	$1,036.00	1.83%	
Shipping				
Baltic Dry Freight	1,902	1,912	-10	

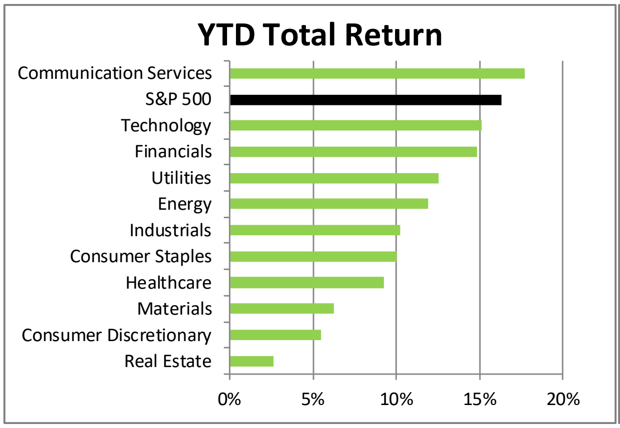
Weather

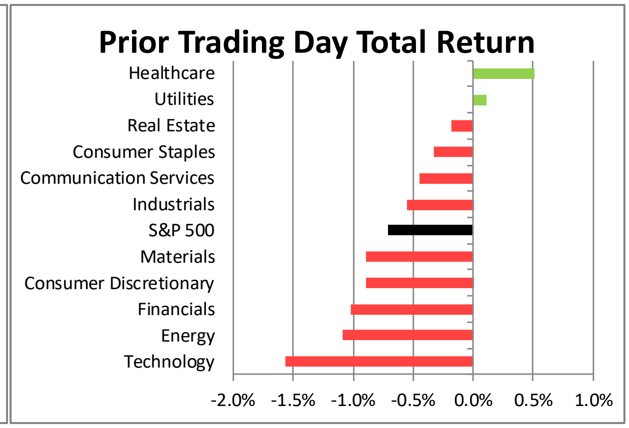
The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures for most of the country, with cooler-than-normal temperatures in southern Texas. The precipitations outlook calls for wetter-than-normal conditions for most states east of the Mississippi River, with dry conditions expected in New England and the Rocky Mountain regions.

There is no cyclone activity expected in the Atlantic Ocean region within the next 48 hours.

Data Section

US Equity Markets – (as of 7/19/2024 close)

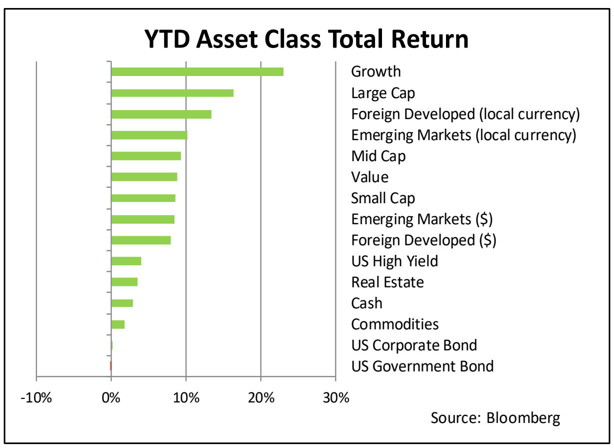




(Source: Bloomberg)

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 7/19/2024 close)

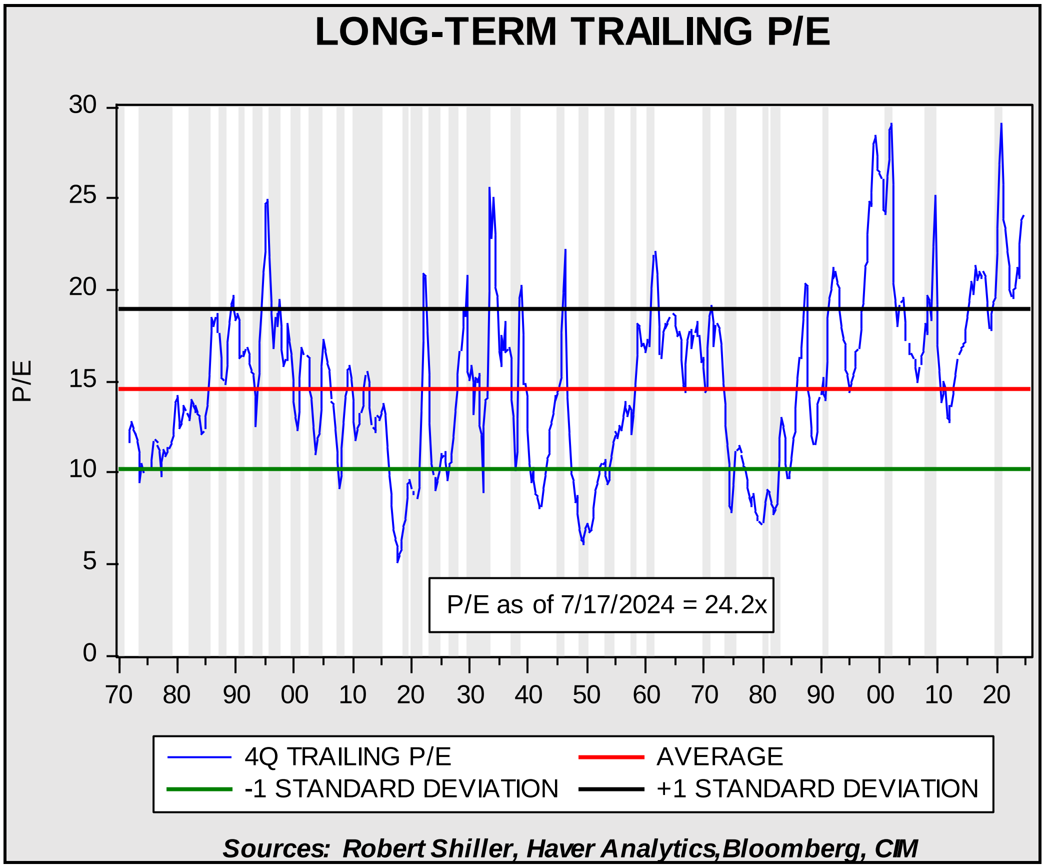


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 18, 2024



Based on our methodology,[1] the current P/E is 24.2x, up 0.2 from our last report. The increase in the multiple was due to an increase in the stock price index and a slight decrease 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.

[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.