Daily Comment

By Patrick Fearon-Hernandez, CFA,
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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 29, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is relatively unchanged from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.2%. Chinese markets were mixed, with the Shanghai Composite essentially unchanged from its previous close and the Shenzhen Composite down 0.5%. US equity index futures are signaling a higher open.

With 207 companies having reported so far, S&P 500 earnings for Q2 are running at $60.20 per share, compared to estimates of $58.94, which is up 8.0% from Q2 2023. Of the companies that have reported thus far, 79.7% have exceeded expectations while 14.5% 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*](#) (7/22/2024) (with associated [podcast](#)): "Meet Ferdinand Marcos Jr., President of the Philippines"
- [***Asset Allocation Bi-Weekly***](#) **(7/29/2024) (with associated [podcast](#)): "The Price of Central Bank Independence"**
- [*Asset Allocation Quarterly – Q3 2024*](#) (7/16/2024): Discussion of our asset allocation process, Q3 2024 portfolio changes, and our outlook for the markets.
- [*Business Cycle Report*](#) (7/25/2024)

Our *Comment* today opens with a quick note on the renewed risk of a wider war between Israel and Iran-backed militants in Gaza and southern Lebanon. We next review several other international and US developments with the potential to affect the financial markets today, including a potential trade deal that the European Union might offer to former President Trump if he is re-elected in November and a preview of the Federal Reserve's upcoming policy meeting this week.

Israel-Hezbollah: A rocket apparently fired from Lebanon by Iran-backed Hezbollah militants [struck a soccer field in the Golan Heights on Saturday, killing a dozen Israeli children and teenagers](#). In response, the Israeli military [launched airstrikes against militant positions](#) across Lebanon yesterday. The retaliatory strikes by the Israelis have the potential to widen the

continuing Israel-Hamas conflict into a regional war with bigger economic and security consequences for the world, as has long been feared.

European Union-United States: According to the *Financial Times*, European Union officials [are planning a two-step, carrot-and-stick response if former President Trump is re-elected in November and imposes minimum 10% tariffs](#) against all imports. Under the plan, the EU would approach Trump even before inauguration day to explore which US products the EU could import more of in order to forestall Trump's tariffs. If no deal is reached, the EU would retaliate with tariffs of 50% or more against some US goods.

- EU officials reportedly estimate the minimum 10% tariffs floated by Trump would reduce EU exports by around 150 billion EUR annually.

- The EU plan clearly draws lessons from the so-called "Phase I" trade deal that the US and China sealed under Trump in 2020. Under that deal, China was supposed to dramatically boost its imports of certain US products, [but ultimately fell far short](#), with few US complaints from either Republicans or Democrats.

France: Interior Minister Gérald Darmanin today said far-left radicals [could have been behind the big sabotage attacks that disrupted high-speed rail service last week](#) on the opening day of the Olympic Games in Paris. However, he also noted that the perpetrators could have been acting on behalf of other entities, keeping alive the possibility that the sabotage was ultimately inspired by Russia or its allies.

United Kingdom: In an effort to finally stop the periodic strikes by junior physicians in the National Health Service, the new Labour government of Prime Minister Starmer [has offered them a pay hike of 22% over two years](#). That would still fall short of the 35% raise sought by the doctors, but it is much richer than what the previous Conservative government was willing to offer. Clearly, price inflation and labor shortages still have the potential to spark labor unrest and pay demands, even though the global surge of strikes has cooled over the last year or so.

Venezuela: With four-fifths of voting stations counted in yesterday's election, the national electoral authority [said President Maduro won with 51.2% of the vote](#). The authority said Edmundo González, the main opposition candidate, garnered only 44.2% of the vote, despite media reports saying he enjoyed strong, widespread support. There were also reports of voter intimidation and irregularities. The disputed results are likely to further isolate the Venezuelan government and possibly lead to new US sanctions, including on the national energy industry.

United States-Japan: In a new sign that the US and its allies are prepping for a possible conflict with China sometime in the future, the Pentagon yesterday [said it will upgrade US Forces Japan to a joint force headquarters with expanded missions and operational responsibilities](#). With the change, the US's roughly 55,000 personnel in Japan will be led locally, potentially by a four-star commander, rather than from the Indo-Pacific Command in Hawaii.

- Separately, US Secretary of State Blinken and Secretary of Defense Austin met with the Japanese cabinet to discuss measures clarifying the circumstances in which US nuclear forces could be used to deter a threat to Japan, from China or North Korea, for example.

- The officials also discussed further defense industrial cooperation, including having Japanese factories produce advanced US missiles to help get around the US's current capacity shortfalls at home. The two sides also already have an agreement for Japanese firms to provide maintenance and repair services for US navy ships and aircraft.

US Monetary Policy: The Fed's policy committee holds its latest meeting this week, with its decision due on Wednesday at 2:00 PM ET. Despite growing calls from some observers to start cutting interest rates at this meeting, we think the more likely course is for the officials to signal an initial cut in September. Recent data has certainly revealed that the economy is cooling and price pressures have fallen, but the officials still say they want to see more evidence that those changes will be sustained, despite a risk that continued high rates could spark an economic downturn.

- As investors anticipate rate cuts starting this fall, new reports show they have been pouring cash into exchange-traded funds focused on bonds.
- The data indicates that flows into bond ETFs and mutual funds accounted for almost 90% of all net fund inflows in the US in the first half of the year.

US Commercial Real Estate Industry: Data from MSCI shows lender portfolios of foreclosed and seized office buildings, apartments and other commercial property jumped 13% in just the second quarter, to a value of $20.5 billion. That marked the highest level of seized properties since 2015 and suggests many lenders have finally given up on those property owners struggling with high interest rates, weak demand, and low occupancy rates.

Foreclosures on the rise
Value of seized commercial properties held by lenders

Source: MSCI
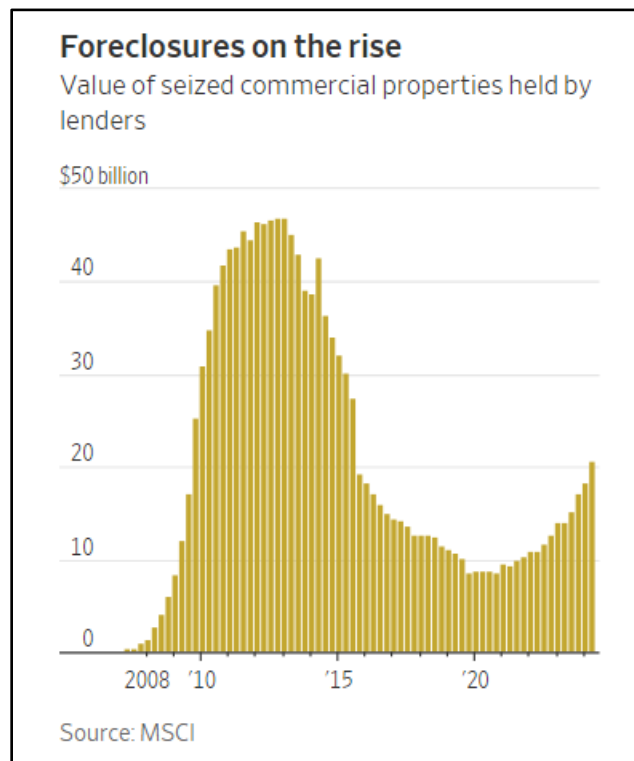
US Property Insurance Industry: New reports from rating firm AM Best indicate that property insurers in the US suffered a total net underwriting loss (premiums minus claims) of $15.2 billion on their homeowner polices last year. That marked their worst underwriting loss since at least 2000. The analysis shows the big losses stemmed from the increasing frequency and severity of weather events, rapid price increases for building materials, more people moving to disaster-prone areas, and regulators' slow approvals for premium increases.

US home insurers made a huge loss last year
Net underwriting profit or loss ($bn)

Source: AM Best
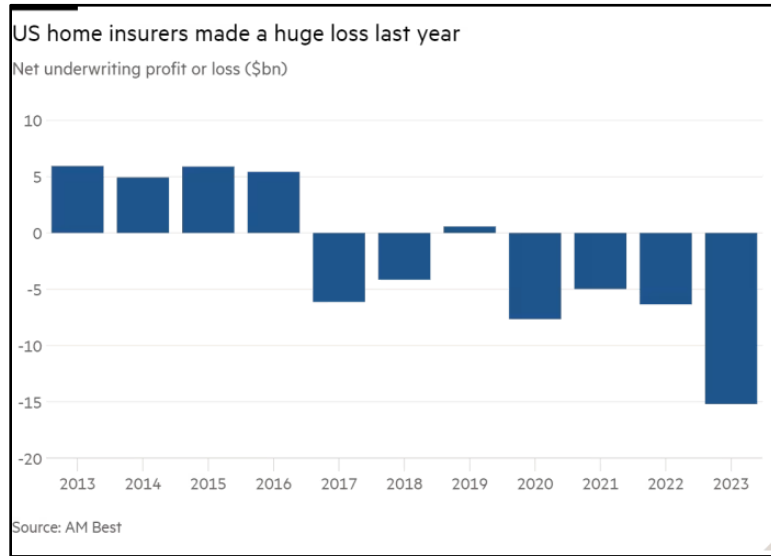
US Cryptocurrency Industry: In a speech at a bitcoin conference on Saturday, former President Trump made a strong pitch for cryptocurrency supporters. If re-elected, Trump vowed to sack Securities and Exchange Commission leader Gary Gensler over his efforts to restrict cryptocurrency investments. He also promised to end the Biden administration's "persecution" of the industry. Meanwhile, reports say Vice President Harris's advisors have reached out to key cryptocurrency leaders in an effort to reset relations.

- The Trump and Harris overtures show each side recognizes that younger voters have a more favorable view of cryptocurrencies and want to see the industry succeed.

- This suggests that the SEC's current resistance to the industry will likely be dismantled following the election, no matter who wins the White House.

US Economic Releases

There were no domestic releases prior to the publication of this report. The table below lists the economic releases and/or Fed events scheduled for the rest of the day.

Economic Releases					Expected	Prior	Rating
ET	**Indicator**				**Expected**	**Prior**	**Rating**
10:30	Dallas Fed Manufacturing Activity	m/m	Jul		-15.5	-15.1	**
Federal Reserve							
No Fed speakers or events for the rest of today							

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								
China	Industrial Profits	y/y	Jun	3.6%	0.7%		*	Equity and bond neutral
EUROPE								
UK	Net Lending Sec. on Dwellings	m/m	Jun	2.7b	1.3b	1.1b	*	Equity and bond neutral
	Mortgage Approvals	m/m	Jun	60.0k	60.1k	60.3k	***	Equity and bond neutral
	M4 Money Supply	y/y	Jun	1%	0%		*	Equity and bond neutral
Switzerland	Domestic Sight Deposits CHF	w/w	26-Jul	449.5b	452.9b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	26-Jul	458.2b	461.3b		*	Equity and bond neutral
AMERICAS								
Brazil	Central Govt Budget Balance	m/m	Jun	-38.8b	-60.8b	-39.5b	*	Equity and bond neutral
	Primary Budget Balance	m/m	Jun	-40.9b	-63.9b	-39.5b	*	Equity and bond neutral
	Net Debt % GDP	m/m	Jun	62.20%	62.10%	62.50%	**	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)	552	553	-1	Down
3-mo T-bill yield (bps)	516	516	0	Down
U.S. Sibor/OIS spread (bps)	525	525	0	Down
U.S. Libor/OIS spread (bps)	523	523	0	Down
10-yr T-note (%)	4.16	4.19	-0.03	Down
Euribor/OIS spread (bps)	366	369	-3	Down
Currencies	Direction			
Dollar	Up			Down
Euro	Down			Up
Yen	Flat			Up
Pound	Down			Up
Franc	Down			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.

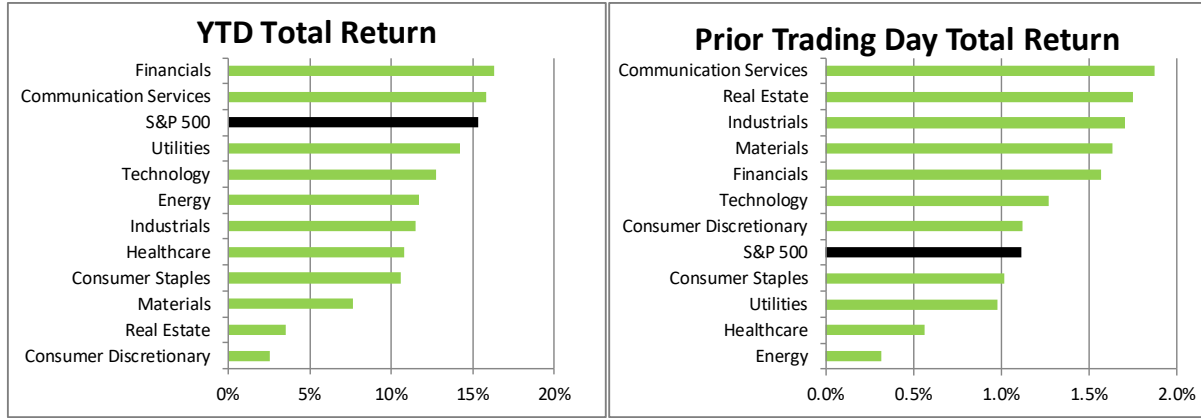| DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$80.63	$81.13	-0.62%	
WTI	$76.64	$77.16	-0.67%	
Natural Gas	$1.98	$2.01	-1.10%	
12-mo strip crack	$22.29	$22.57	-1.22%	
Ethanol rack	$1.99	$2.00	-0.48%	
Metals				
Gold	$2,390.36	$2,387.19	0.13%	
Silver	$28.07	$27.93	0.53%	
Copper contract	$408.55	$412.40	-0.93%	
Grains				
Corn contract	$407.00	$410.00	-0.73%	
Wheat contract	$519.25	$523.50	-0.81%	
Soybeans contract	$1,030.25	$1,048.50	-1.74%	
Shipping				
Baltic Dry Freight	1,808	1,834	-26	

Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures across the entire country, with near normal temperatures in the Great Lakes region. The precipitation outlook calls for wetter-than-normal conditions for most of the country, with near normal conditions in central states located in the Midwest and Great Plains regions.

There is one tropical disturbance located in the Atlantic Ocean near the Leeward Islands, but it only has a 40% chance of forming into a cyclone within the next 48 hours.
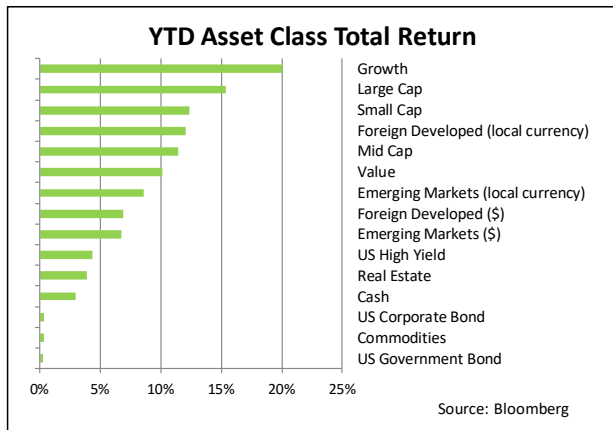
Data Section

US Equity Markets – (as of 7/26/2024 close)

YTD Total Return

Sector	
Financials	
Communication Services	
S&P 500	
Utilities	
Technology	
Energy	
Industrials	
Healthcare	
Consumer Staples	
Materials	
Real Estate	
Consumer Discretionary	

Prior Trading Day Total Return

Sector	
Communication Services	
Real Estate	
Industrials	
Materials	
Financials	
Technology	
Consumer Discretionary	
S&P 500	
Consumer Staples	
Utilities	
Healthcare	
Energy	

(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 7/26/2024 close)

YTD Asset Class Total Return

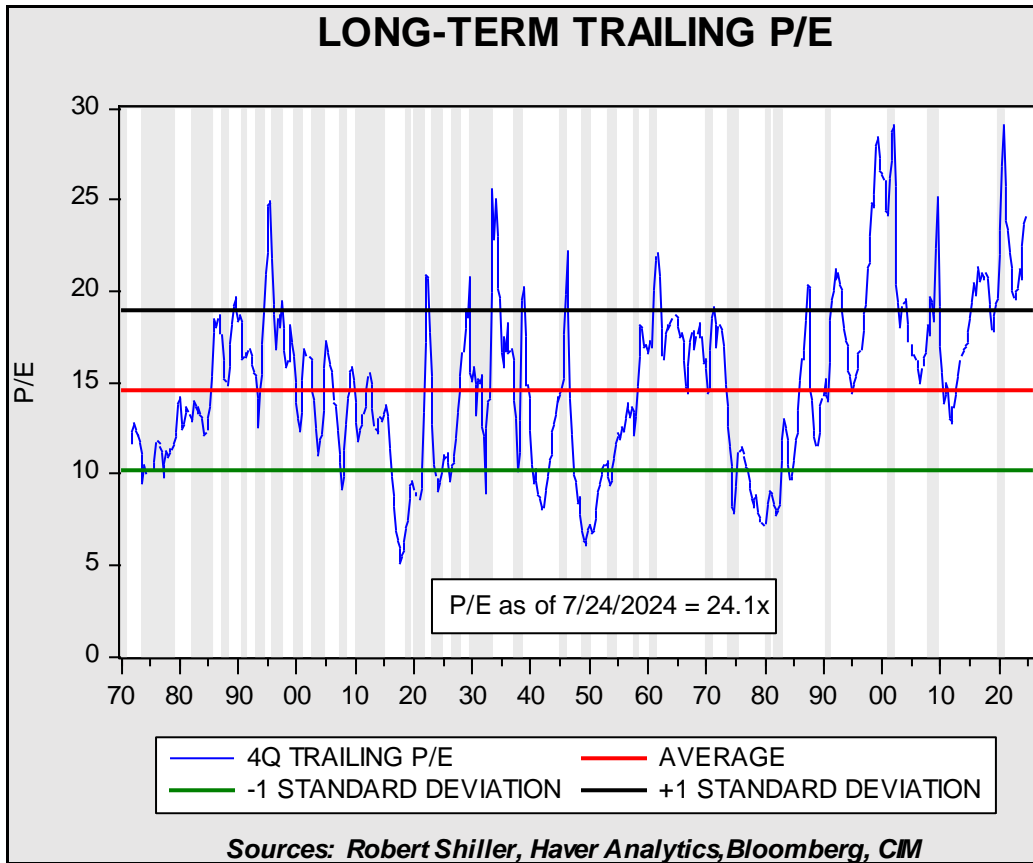| Asset Class	
Growth	
Large Cap	
Small Cap	
Foreign Developed (local currency)	
Mid Cap	
Value	
Emerging Markets (local currency)	
Foreign Developed ($)	
Emerging Markets ($)	
US High Yield	
Real Estate	
Cash	
US Corporate Bond	
Commodities	
US Government Bond	

Source: Bloomberg

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 25, 2024

LONG-TERM TRAILING P/E

P/E as of 7/24/2024 = 24.1x

Legend: 4Q TRAILING P/E | AVERAGE | -1 STANDARD DEVIATION | +1 STANDARD DEVIATION

Sources: Robert Shiller, Haver Analytics, Bloomberg, CIM

Based on our methodology,[1] the current P/E is 24.2x, down 0.1 from our last report. The decrease in the multiple was due to a slight decrease in the stock price index and 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.