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 30, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is up 0.6% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.6%. Chinese markets were lower, with the Shanghai Composite down 0.4% from its previous close and the Shenzhen Composite down 0.4%. US equity index futures are signaling a higher open.

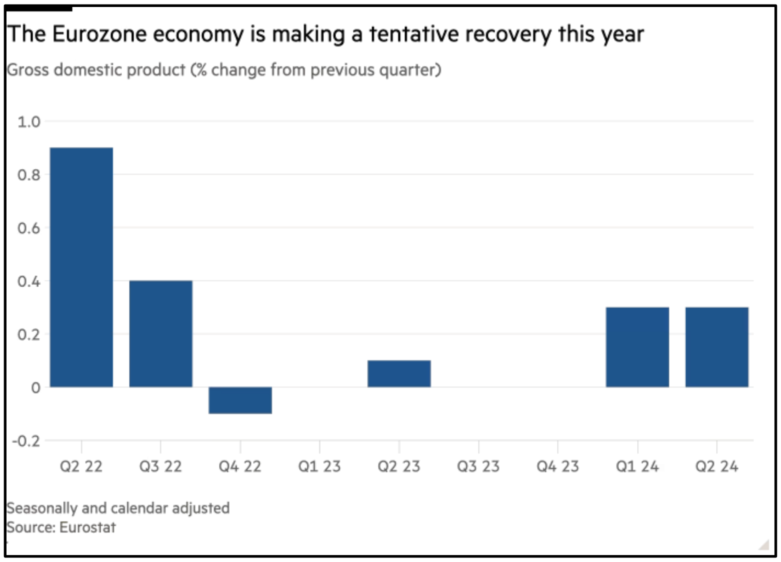
With 216 companies having reported so far, S&P 500 earnings for Q2 are running at $60.10 per share, compared to estimates of $58.94, which is up 8.0% from Q2 2023. Of the companies that have reported thus far, 79.6% have exceeded expectations while 14.8% have fallen short of expectations.

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* (7/22/2024) (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 new data on economic growth in the eurozone and the prospects for more interest-rate cuts by the European Central Bank. We next review several other international and US developments with the potential to affect the financial markets today, including emergency spending cuts to bring down the UK's budget deficit and a preview of the Federal Reserve's latest policy meeting, which starts today.

Eurozone: In an initial estimate, second-quarter gross domestic product rose by a seasonally adjusted 0.3%, beating the expected increase of 0.2% and matching the first-quarter growth rate. That translates to an annualized growth rate of only about 1.2% in each quarter, and the region's GDP in the second quarter was up just 0.6% from the same period one year earlier. The figures do reflect a modest improvement in the eurozone's economy in 2024, but they remain weak enough to suggest the European Central Bank will continue to cut interest rates.



United Kingdom: The new Labour Party chancellor, Rachel Reeves, yesterday revealed a series of emergency spending cuts to help plug what she called an undisclosed 22-billion GBP budget hole left by the previous Conservative Party government. The spending cuts include measures to end winter fuel subsidies for higher-income pensioners and eliminate outlays on roads and hospitals. The measures are being seen as a prelude to tax hikes in the next fiscal year budget, due to be released on October 30.

Japan: Global investors continue to brace for the Bank of Japan's latest policy decision tomorrow. After the central bank ended its previous policy of negative interest rates in March, market indicators now suggest investors see about a 40% chance that the BOJ will lift its benchmark short-term interest rate further to 0.25%. It is also expected to release a plan for starting to unload its $3.8 trillion in Japanese government bond holdings (JGB). (See our preview of the Fed's Wednesday policy decision below.)

- Amid investor anticipation of the BOJ's rate hike and bond sales, the yen (JPY) has appreciated and JGBs have depreciated sharply so far this month.
- Since the JPY is used globally as a funding currency, the recent currency moves and investor repositioning has also fed an increase in volatility in global markets over recent weeks.

China: At the Communist Party's latest Politburo meeting yesterday, top officials reportedly decided to implement aggressive new economic measures to boost China's consumer spending and corporate investment. However, the announcement in state media offered few specifics.

- Any new measures would supplement the central bank's interest-rate cuts last week and a range of other modest measures implemented earlier, such as easier rules for home purchases and subsidized appliance trade-in programs.
- All the same, General Secretary Xi and his top officials have shown little inclination to adopt the wide-ranging, consumer-oriented reforms that many economists believe are necessary to reignite Chinese growth. Going forward, we suspect Chinese economic

growth will continue to be held back by factors such as weak consumer demand, excess capacity and high debt, poor demographics, disincentives from the Communist Party's interventions in the markets, and decoupling by the West.

China-Philippines: Following a recent deal by Beijing and Manila, the Philippine military has reportedly carried out a resupply mission for the marines it has stationed on an old, grounded naval vessel in an area of the South China Sea claimed by both countries. According to Beijing, the Philippines allowed China to inspect the shipment beforehand, but Manila denies it gave up its sovereignty in such a manner.

- Given that Philippine President Ferdinand Marcos Jr., is so politically skilled and probably intent on avoiding a conflict, it would not be surprising if he has secretly shown some flexibility with the Chinese demands for control over the situation. (For an in-depth discussion of Marcos's background and character, see our *Bi-Weekly Geopolitical Report* from July 22, 2024.) Indeed, Manila has admitted to an "exchange of information" with the Chinese prior to carrying out the mission.
- All the same, to the extent that Manila is willing to overtly or secretly bow to China's demands, it could potentially be a sign that the Philippines has lost some faith in the strength of its alliance with the US and the US's commitment to its defense. If that is true, and if the sentiment spreads among other US allies, it would reflect a worrisome weakening of the US alliance system in the Indo-Pacific region.

Russia: President Putin has reportedly signed a decree allowing military equipment designers to utilize foreign intellectual property without the owner's consent, bypassing traditional patent protections. At one level, the move highlights Russia's desperate attempt to catch up to Western technological advances as it faces greater sanctions over its invasion of Ukraine. The move also shows how Russia has become a rogue state that no longer operates under accepted economic rules, which will likely further cut it off from Western trade and capital.

North Korea: In a report to lawmakers yesterday, South Korea's intelligence service reportedly said North Korean Supreme Leader Kim Jong-un has chosen his pre-teen daughter, Ju-ae, to be his eventual successor. According to the intelligence service, the younger Kim is being educated specifically to take over the reins of power, although there is still some chance that a sibling could displace her.

Venezuela: A day after President Maduro claimed he won a third term in office in the weekend election, mass protests have broken out in Caracas and other cities across the country. The US, the European Union, and several Latin American nations also criticized the apparently fraudulent outcome, prompting the Maduro government to sever diplomatic ties with Argentina, Chile, Costa Rica, Peru, Panama, Uruguay, and the Dominican Republic.

- As we noted in our *Comment* yesterday, the apparently fraudulent outcome is likely to further isolate Venezuela. It could also lead to a snap back of economic sanctions on the country, including on its energy sector.

- On top of that, the size of the popular protests suggests Maduro could also face rising internal dissent and increased political instability. That could further harm the Venezuelan economy and push even more of its citizens to emigrate, including to the US.

US Monetary Policy: The Fed today begins its latest two-day policy meeting, with its decision due tomorrow at 2:00 PM ET. Despite growing calls from some observers to start cutting interest rates now, the more likely course is for the officials to signal an initial cut in September. Recent data has certainly shown 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.

US Energy Industry: British energy giant BP today said it will start drilling a new oilfield in the Gulf of Mexico. The move is a reminder that the Gulf remains an important energy resource, despite the prolific expansion of onshore shale fields in places like the Permian Basin over the last two decades. The move also shows that traditional energy resources can remain attractive in an era of policy preferences for renewable energy, tough regulation, and shareholder demands for cash returns.

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						
ET	**Indicator**			**Expected**	**Prior**	**Rating**
10:00	JOLTS Job Openings	m/m	Jun	8000k	8140k	**
10:00	Conf. Board Consumer Confidence	m/m	Jul	99.7	100.4	***
10:00	Conf. Board Present Situation	m/m	Jul		14150.0%	*
10:00	Conf. Board Expectations	m/m	Jul		7300.0%	*
10:00	Dallas Fed Services Activity	m/m	Jul		-410.0%	*
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								
Japan	Jobless Rate	m/m	Jun	2.5%	2.6%	2.6%	***	Equity and bond neutral
	Job-To-Applicant Ratio	m/m	Jun	1.2%	124.0%	124.0%	***	Equity and bond neutral
Australia	Building Approvals	m/m	Jun	-6.5%	5.7%	-2.3%	***	Equity bearish, bond bullish
South Korea	Retail Sales	y/y	Jun	11.1%	8.8%		**	Equity and bond neutral
	Depart. Store Sales	y/y	Jun	5.0%	-0.1%		*	Equity and bond neutral
	Discount Store Sales	y/y	Jun	2.1%	-3.1%		*	Equity and bond neutral
EUROPE								
Eurozone	Consumer Confidence	m/m	Jul F	-13.0	-13.0	--	**	Equity and bond neutral
	Services Confidence	m/m	Jul	4.8	6.2	6.3	**	Equity bearish, bond bullish
	Industrial Confidence	m/m	Jul	-10.5	-10.2	-10.6	***	Equity and bond neutral
	Economic Confidence	m/m	Jul	95.8	95.9	95.2	***	Equity and bond neutral
	GDP SA	y/y	2Q A	0.6%	0.5%	0.5%	***	Equity and bond neutral
Germany	GDP NSA	y/y	2Q P	0.3%	-0.8%	0.3%	**	Equity and bond neutral
	GDP WDA	y/y	2Q P	-0.1%	-0.1%	0.0%	**	Equity and bond neutral
	CPI	y/y	Jul P	2.3%	2.2%	2.2%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Jul P	2.6%	2.5%	2.5%	**	Equity and bond neutral
France	Consumer Spending	y/y	Jun	-1.0%	0.5%	-0.2%	*	Equity bearish, bond bullish
	GDP	y/y	2Q P	1.1%	1.5%	0.7%	**	Equity and bond neutral
Italy	GDP WDA	y/y	2Q P	0.9%	0.6%	1.0%	**	Equity and bond neutral
Switzerland	KOF Leading Indicator	m/m	Jul	101	102.7	102.5	**	Equity and bond neutral
AMERICAS								
Mexico	GDP NSA	y/y	2Q P	2.2%	1.6%	2.4%	***	Equity and bond neutral
Brazil	FGV Inflation IGPM	y/y	Jul	3.82%	2.45%	3.68%	***	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)	513	513	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 (%)	4.17	4.18	-0.01	Down
Euribor/OIS spread (bps)	364	366	-2	Down
Currencies	**Direction**			
Dollar	Flat			Down
Euro	Flat			Up
Yen	Down			Up
Pound	Down			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	$79.22	$79.78	-0.70%	
WTI	$75.35	$75.81	-0.61%	
Natural Gas	$2.03	$2.04	-0.49%	
12-mo strip crack	$21.73	$21.86	-0.57%	
Ethanol rack	$1.98	$1.99	-0.43%	
Metals				
Gold	$2,388.33	$2,384.19	0.17%	
Silver	$27.79	$27.86	-0.27%	
Copper contract	$405.00	$408.45	-0.84%	
Grains				
Corn contract	$408.25	$412.25	-0.97%	
Wheat contract	$520.50	$531.00	-1.98%	
Soybeans contract	$1,024.00	$1,039.50	-1.49%	
Shipping				
Baltic Dry Freight	1,797	1,808	-11	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-1.55		
Gasoline (mb)		-1.65		
Distillates (mb)		-0.35		
Refinery run rates (%)		0.2%		
Natural gas (bcf)		11		

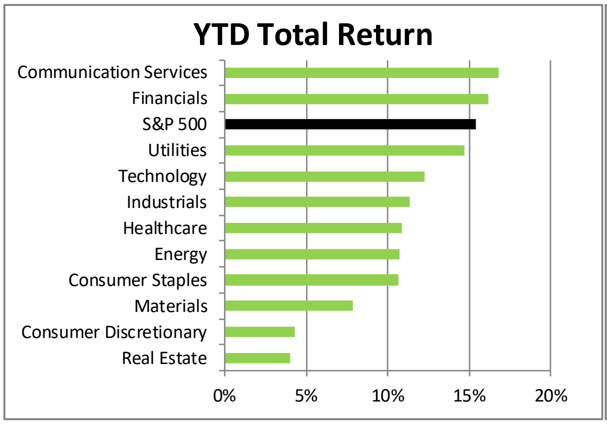
Weather

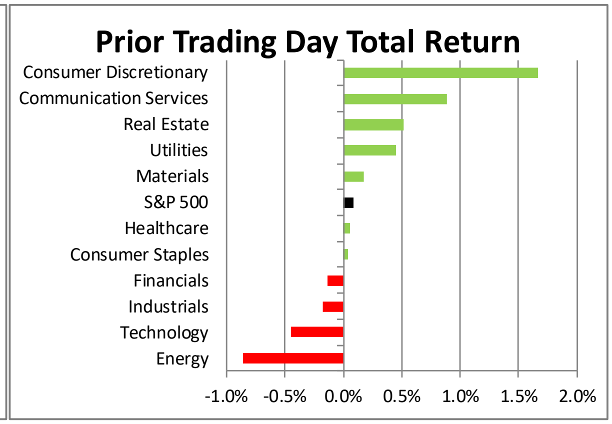
The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures across the entire country, except for a patch of below normal temperatures in the northern Great Plains and Maine. The precipitation outlook calls for wetter-than-normal conditions along the lower Atlantic and Gulf Coasts, Texas, California, the Rocky Mountains, and western Great Lakes region, with drier-than-normal conditions in the Pacific Northwest and a patch stretching from Kansas to Kentucky.

A strong tropical wave several hundred miles east of the Lesser Antilles, which is producing limited shower activity, has a 0% chance of forming into a cyclone in the next 48 hours and a 60% chance in the next seven days.

Data Section

US Equity Markets – (as of 7/29/2024 close)

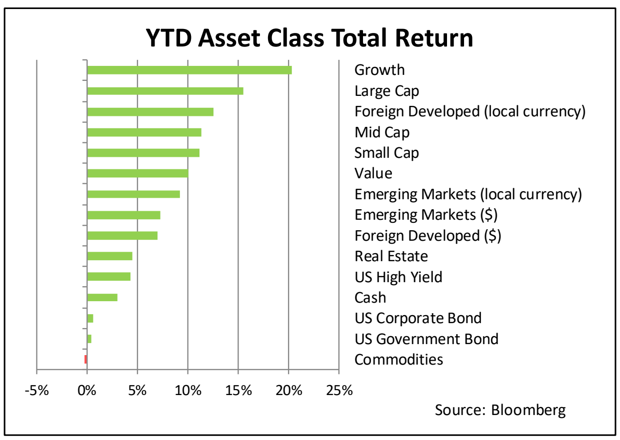




(Source: Bloomberg)

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 7/29/2024 close)

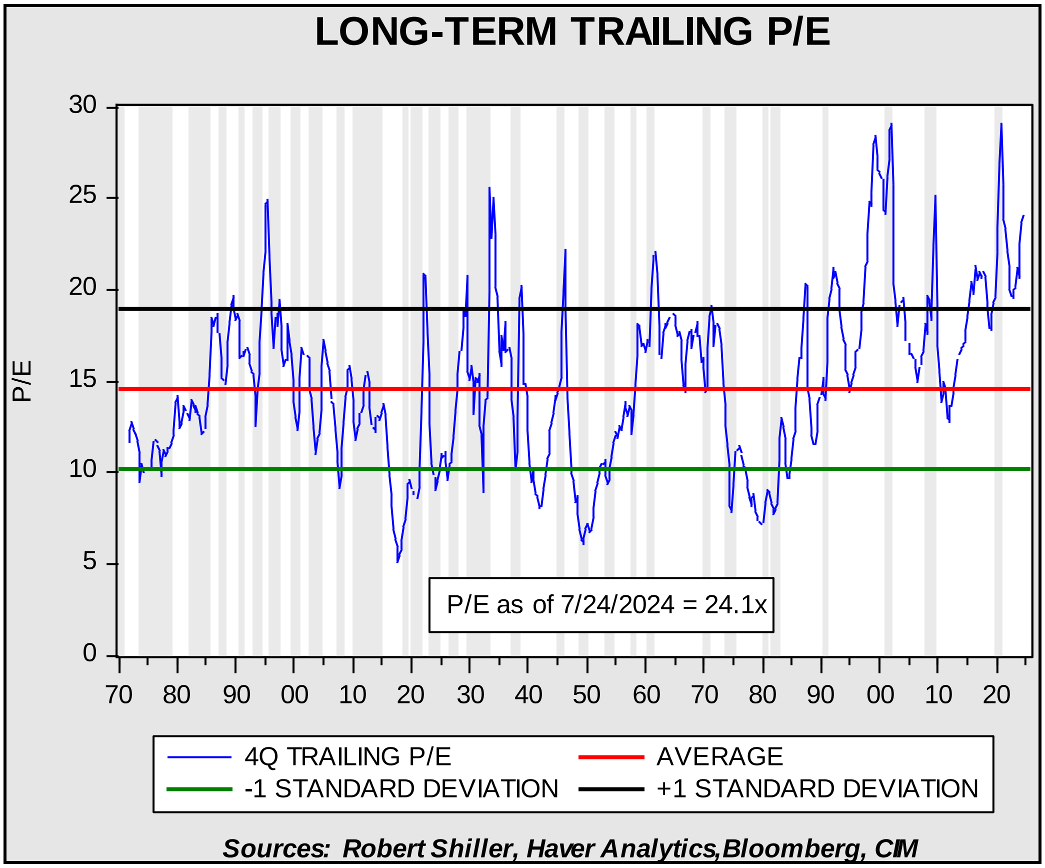


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 25, 2024



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.