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: June 10, 2024—9:30 AM EDT] Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 is down 1.0% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.6%. Chinese markets were closed for the Dragon Boat Festival. US equity index futures are signaling a lower open.

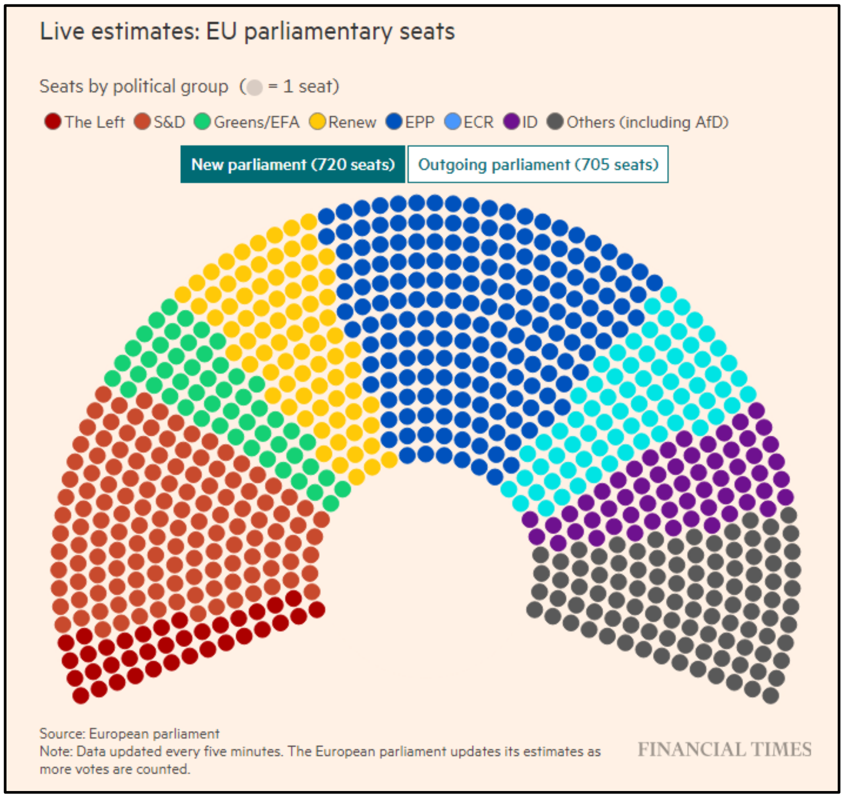
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *Bi-Weekly Geopolitical Report* (6/3/2024) (with associated podcast): "The Philippines, China & Escalation in the South China Sea"
- *Asset Allocation Quarterly – Q2 2024* (4/25/2024): Discussion of our asset allocation process, Q2 2024 portfolio changes, and our outlook for the markets.
- *Asset Allocation Q2 2024 Rebalance Presentation* (5/7/2024): Video presentation featuring the Asset Allocation Committee as they review the asset allocation strategies, recent portfolio changes, and the current macro environment.
- ***Asset Allocation Bi-Weekly* (6/10/2024) (with associated podcast): "Copper, Gold, Treasurys, and the New World"**
- *Confluence of Ideas podcast* (5/8/2024) "Reviewing the Asset Allocation Rebalance: Q2 2024"

Our *Comment* today opens with the initial results from the European Parliament elections over the weekend, which suggest that surging support for right-wing parties will produce big changes in the European Union's economic and social policies. We next review several other international and US developments with the potential to affect the financial markets today, including an update on China's effort to rescue its residential real estate market and some notes on US fiscal policy.

European Union: In weekend elections for the European Parliament, centrist parties kept their majority, but far-right parties did better than in the 2019 elections and appear to have won almost 180 of the 720 seats in the body. Support for the right grew strongly in Germany and France, prompting French President Macron to call snap elections on June 30 and driving down EU stocks and the euro so far today. The new parliament will likely shift European Union policies in a more anti-immigration direction and roll back the EU's climate stabilization policies.

- Results so far suggest the center-right European People's Party (EPP) alone will have 186 seats, making it the biggest party in the parliament. The center-left Socialists and Democrats (S&D) are projected to have 134 seats, while the center-left Renew party is on track to end up with 79 seats.
- The hard-right European Conservatives and Reformists (ECR) are expected to have 73 seats, and the hard-right Identity and Democracy (ID) group will have 58 seats. Along with smaller parties that share their ideology, the hard right will have almost one-fifth of the seats.
- The environmentalist-leftist Greens are expected to have only 53 seats.



Israel: Centrist politician and former general Benny Gantz said he is resigning from Prime Minister Netanyahu's emergency cabinet to protest what he called Netanyahu's mistakes in prosecuting Israel's war against the terrorist Hamas government in Gaza. Gantz also called for early elections. Netanyahu's conservative party and its right-wing allies retain a majority in parliament even without Gantz's support, so the move doesn't immediately topple Netanyahu. However, Gantz's move adds to the destabilizing political uncertainty in Israel.

China: Major residential real estate developers Country Garden, Vanke, and Shimao have now all reported significantly higher home sales in May than in April. The firms' sales are still down dramatically from year-earlier levels, but the reports suggest the government's new plan to rescue the sector is having at least some success. However, we remain skeptical that the sector can regain its former luster merely based on the plan's eased mortgage standards and financial incentives for local governments to buy up excess properties.

Iran: Ahead of the presidential election later this month, the Guardian Council has approved a list of candidates consisting almost entirely of hardline conservatives. The Council, made up of clerics charged with defending the nation's theocracy, banned two prominent reformers who had called for more moderate religious policies and rapprochement with the US. The Council's decision helps ensure that tensions between Tehran and the West will continue to present risks to global investors in the coming years.

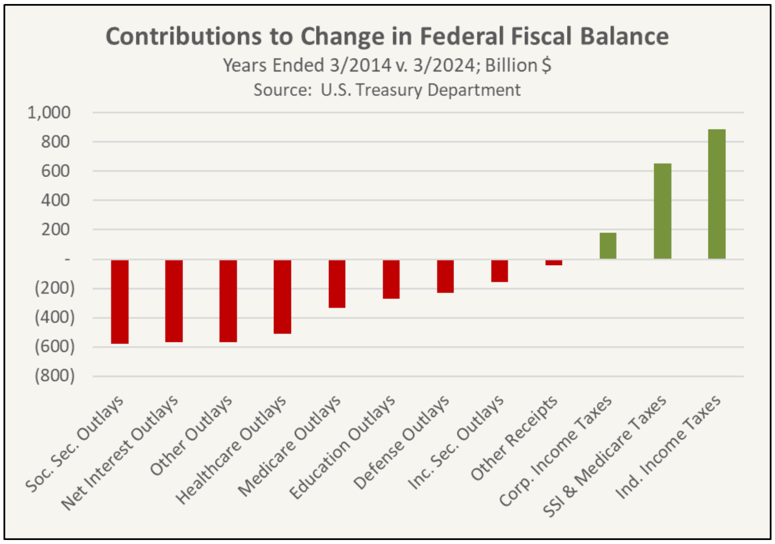
Chile: New reporting shows that a powerful and dangerous criminal gang from Venezuela has rapidly built a presence in Chile, boosting the incidence of extortion, kidnapping, murder, and other crimes. Although Chile retains its reputation as one of Latin America's most developed and safest investment locations, the new spike in violence and the inequality protests that ushered in a leftist president in 2021 continue to raise investor concerns.

US Monetary Policy: The Federal Reserve holds its latest policy meeting this week, with its decision due on Wednesday at 2:00 PM EDT. With price pressures stubbornly high, the policymakers are widely expected to keep the benchmark fed funds interest rate unchanged at 5.25% to 5.50%. Just as important, the officials will also release their updated economic projections, including their "dot plot" of expected rate changes going forward.

- Based on interest-rate futures pricing, investors currently look for the Fed's first rate cut in the autumn. The biggest uncertainty is whether the policymakers will implement further cuts later in the year.
- Because of today's sticky inflation, we continue to believe the policymakers could keep rates "higher for longer" than investors currently believe.

US Fiscal Policy: In an interview with the *Financial Times*, the International Monetary Fund's second-ranking official argued the US has "ample" resources to bring down its fiscal deficit to more sustainable levels. In the interview, First Deputy Managing Director Gita Gopinath said that US policymakers should consider boosting taxes on high-income individuals. She also said that in the US, as in all advanced economies, there is "no way of getting around" the fact that population aging will require fundamental reforms to pension systems and medical spending.

- The volume of individual income taxes, Social Security and Medicare taxes, and corporate income taxes has certainly risen over the last decade, as shown in the chart below. However, the increase has been much smaller than it would have been without the tax cuts of 2017.
- Importantly, the rise in tax revenues hasn't been nearly enough to cover the rise in spending. The biggest increases in spending have come from Social Security, Medicare, Medicaid and other healthcare, and net interest.



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							
EST	**Indicator**			**Expected**	**Prior**	**Rating**
11:00	NY Fed 1-Yr Inflation Expectations	m/m	May		3.3%	
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	GDP SA	q/q	1Q F	-0.50%	-0.50%	-0.50%	***	Equity and bond neutral
	GDP Deflator	q/q	1Q F	3.40%	3.60%	3.60%	***	Equity and bond neutral
	BoP Current Account Balance	m/m	Apr	¥2050.5b	¥3398.8b	¥1783.5b	***	Equity and bond neutral
	BoP Trade Balance	m/m	Apr	-¥661.5b	¥491.0b	-¥346.7b	**	Equity and bond neutral
EUROPE								
Italy	Industrial Production WDA	y/y	Apr	-2.9%	-3.2%	-2.1%	***	Equity bearish, bond bullish
Switzerland	Domestic Sight Deposits CHF	w/w	7-Jun	450.1	452.4b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	7-Jun	459.8b	462.0b		*	Equity and bond neutral
Russia	Official Reserve Assets	m/m	May	599.0b	597.9b		*	Equity and bond neutral
AMERICAS								
Canada	Net Change in Employment	m/m	May	26.7k	90.4k	22.5k	***	Equity and bond neutral
	Unemployment Rate	m/m	May	6.2%	6.1%	6.2%	***	Equity and bond neutral
	Participation Rate	m/m	May	65.4%	65.4%	65.5%	*	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)	560	560	0	Up
3-mo T-bill yield (bps)	523	524	-1	Up
U.S. Sibor/OIS spread (bps)	535	535	0	Up
U.S. Libor/OIS spread (bps)	535	535	0	Up
10-yr T-note (%)	4.47	4.43	0.04	Up
Euribor/OIS spread (bps)	376	376	0	Down
Currencies	**Direction**			
Dollar	Up			Up
Euro	Down			Down
Yen	Down			Down
Pound	Flat			Down
Franc	Flat			Down

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.

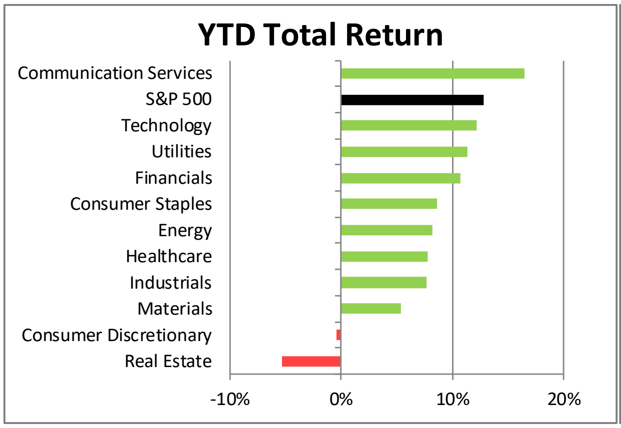
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$79.91	$79.62	0.36%	
WTI	$75.78	$75.53	0.33%	
Natural Gas	$3.01	$2.92	3.29%	
12-mo strip crack	$21.99	$21.95	0.16%	
Ethanol rack	$1.97	$1.98	-0.25%	
Metals				
Gold	$2,300.22	$2,293.78	0.28%	
Silver	$29.71	$29.15	1.91%	
Copper contract	$451.85	$448.35	0.78%	
Grains				
Corn contract	$451.00	$448.75	0.50%	
Wheat contract	$622.75	$627.50	-0.76%	
Soybeans contract	$1,182.75	$1,179.25	0.30%	
Shipping				
Baltic Dry Freight	1,881	1,869	12	

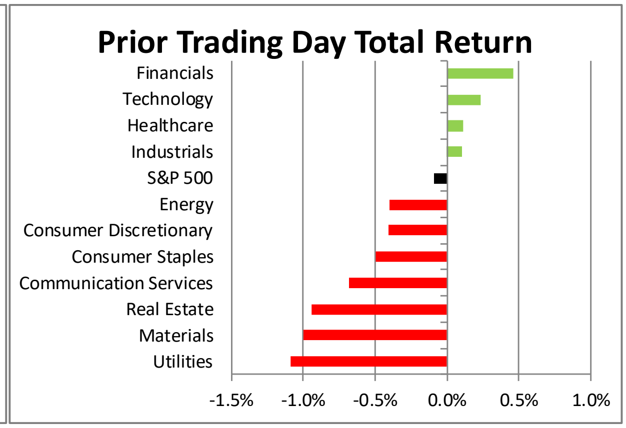
Weather

The 6-10 and 8-14 day forecasts call for warmer-than-normal temperatures for most of the country with cooler-than-normal temperatures in the Pacific Northwest. The forecasts call for wetter-than-average conditions in the Southeast, with dry conditions in the Northern and Central states.

Data Section

US Equity Markets – (as of 6/7/2024 close)

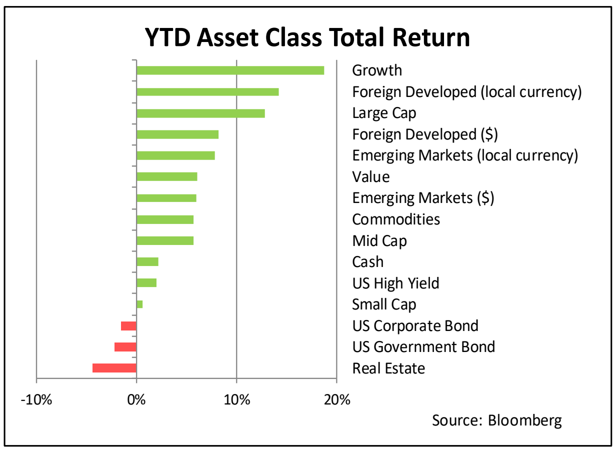




(Source: Bloomberg)

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 6/7/2024 close)

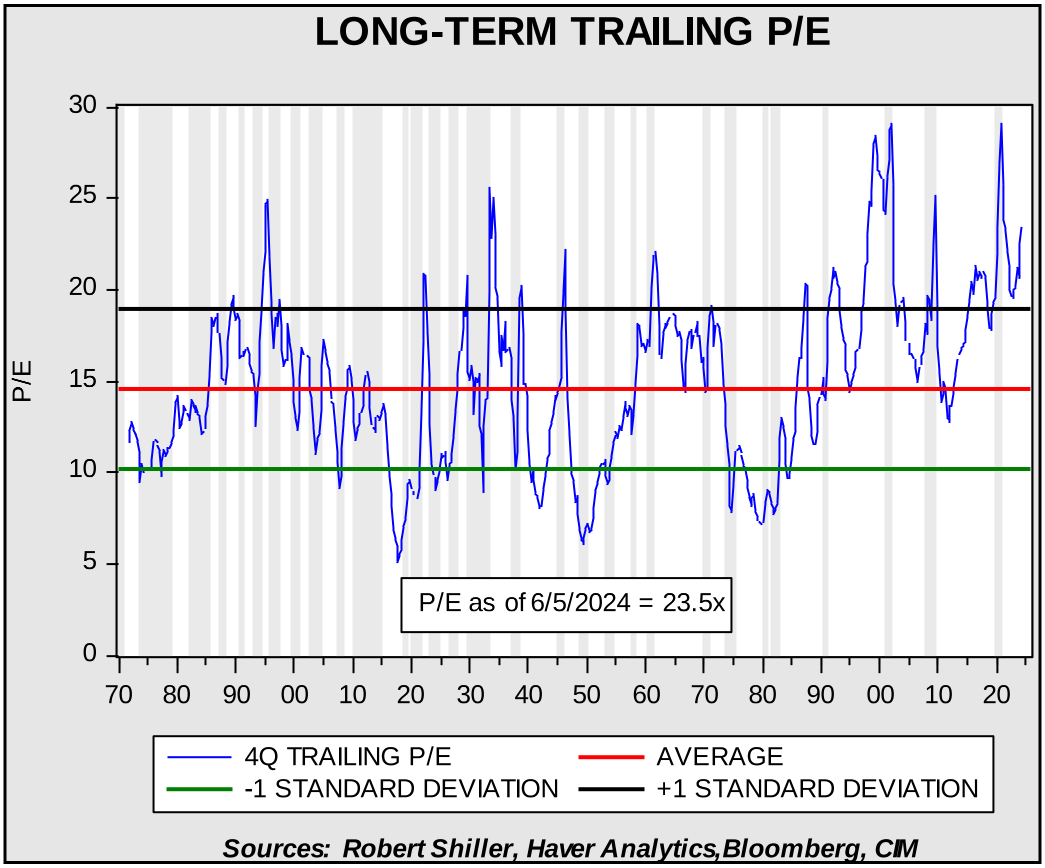


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

June 6, 2024



Based on our methodology,[1] the current P/E is 23.5x, up 0.2 from our last report. The increase in the multiple was due to an increase in the stock price index, and a downward revision in Q1 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.