Daily Comment

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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: June 12, 2024—9:30 AM ET] Global equity markets are higher 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 up 0.5%. Chinese markets were higher, with the Shanghai Composite up 0.3% from its previous close and the Shenzhen Composite up 0.6%. US equity index futures are signaling a higher 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 a new medium-term forecast of global oil supply and demand from the International Energy Agency. We next review several other international and US developments with the potential to affect the financial markets today, including a risky decision by the European Union to impose steep antidumping tariffs on Chinese electric vehicles and a proposed new US rule that would keep medical bills out of credit reports.

Global Oil Market: The IEA, in its closely watched medium-term outlook, has forecast that the world's capacity to produce oil will far exceed demand by the end of this decade. The forecast is based on expectations of further fast supply growth in the US and elsewhere in the Americas, coupled with waning oil demand as green energy becomes more prevalent. The implication is that the supply/demand mismatch will drive down oil prices.

- The IEA now expects global oil production capacity to rise to 113.8 million barrels per day by 2029, but it expects demand to peak in that year at about 105.4 million bpd.

- Of course, the IEA forecasts are highly dependent on a continued transition to non-fossil fuels. Recent political trends and weaker-than-expected demand for electric vehicles suggests that the transition going forward may not be as significant as the IEA expects.

Global Shipping Market: Global shipping and logistics firms suffered big declines in their stock prices yesterday, reflecting the possibility of a ceasefire in the Israel-Hamas conflict. After the UN Security Council approved a US-proposed ceasefire plan late Monday and both Israel and Hamas showed signs that they are inching toward accepting the deal, hopes are rising that the Houthi rebels in Yemen would stop their sympathy attacks on shipping in the Red Sea.

- Of course, the complex interplay of various actors surrounding the Israel-Hamas conflict means it could still expand to a wider, regional war. For example, Iran-backed Hezbollah militants in southern Lebanon fired a barrage of missiles today into northern Israel to retaliate for an Israeli strike that killed one of the group's commanders.
- In any case, if the US peace deal is eventually put into place and allows the Red Sea to reopen, ships would no longer have to be re-routed around Africa, global capacity would be freed up, and freight rates would be driven lower.
- While lower freight rates would undermine shippers' profits, they could also help bring down consumer price inflation around the world.

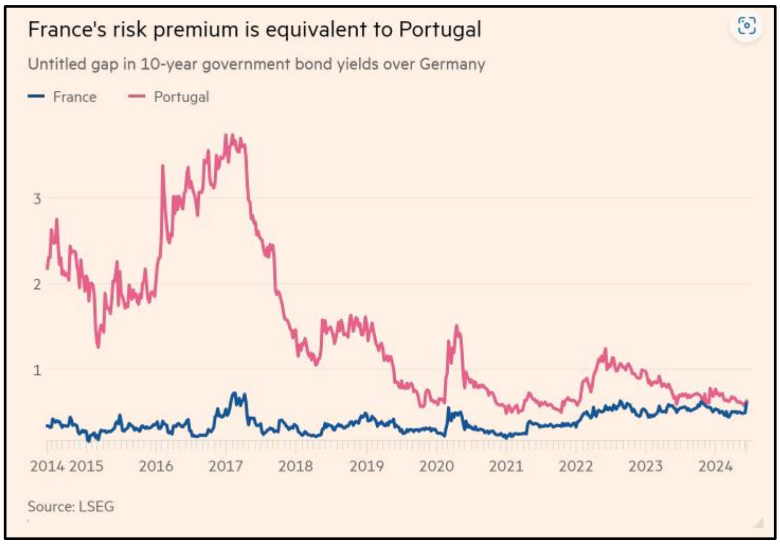
European Union-China: Risking a trade war, the European Union today said its antidumping probe into Chinese electric vehicles found that they are heavily subsidized and present "a threat of clearly foreseeable and imminent injury to EU industry." In response, the EU said it will impose antidumping tariffs on Chinese EVs, on top of the current 10% tariff. The move will bring total EU tariffs on Chinese EVs from 20% to almost 50%, depending on the brand and how much the producer cooperated with the EU probe. The new tariff will apply starting on July 4.

- The EU's move aims to protect the region's large auto and auto parts sector, which employs a large share of the EU workforce. Nevertheless, the new tariffs are opposed by European automakers, who fear Chinese retaliation against their exports to China. Those automakers themselves also make a lot of the Chinese EVs and import them to the EU under their own brands.
- The EU's move brings it into closer alignment with the tougher US approach to China's geopolitical and economic challenge. That raises the prospect that China might indeed retaliate against the EU, imposing its own tariffs and other trade barriers against European goods and services.
- In sum, the EU's new tariffs and any Chinese retaliation fits in with our often-stated view that the world is fracturing into relatively separate geopolitical and economic blocs. A few key results are likely to be higher and more volatile inflation and interest rates going forward.

China: The global fear of Chinese dumping these days stems largely from a new surge of investment in Chinese factories, leading to excess capacity, falling domestic prices, and firms exporting at fire-sale prices. Illustrating that the problem isn't just in EVs, the chair of the Asian Photovoltaic Industry Association says China's solar panel industry is dealing with a severe glut and falling prices, to the point where it is in an "ice age." The official called on the Chinese government to intervene to bring supply back into balance with demand.

- Separately, China's May consumer price index was up just 0.3% from the same month one year earlier, as anticipated. May factory-gate prices were down 1.4% year-over-year.
- The price data is consistent with continued weak domestic demand and broad excess capacity in the factory sector.

France: Ahead of the country's snap parliamentary election on June 30, Finance Minister Bruno Le Maire has warned that a victory by the far-right National Rally could spark a debt crisis like the UK suffered during the short-lived government of Liz Truss. Le Maire's warning smacks of scaremongering to discredit his political rivals, but market action does reflect investor concern that the surging NR's populist program could lead to a blow-out in France's budget deficit and debt levels. Some French debt is now trading at yields above Portugal's.



Canada: Yesterday, the government and the Public Service Alliance representing about 9,000 of the country's border agents reached a tentative deal on a new labor contract, averting a threatened "work to rule" strike that could have substantially disrupted US-Canadian trade starting on Friday.

US Monetary Policy: The Federal Reserve wraps up its latest policy meeting today, with its decision due at 2:00 PM ET. With price pressures still high, the policymakers are expected to keep their benchmark fed funds interest rate unchanged at 5.25% to 5.50%. They 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 to be in the autumn. The biggest uncertainty is whether the policymakers will implement further cuts later in the year.

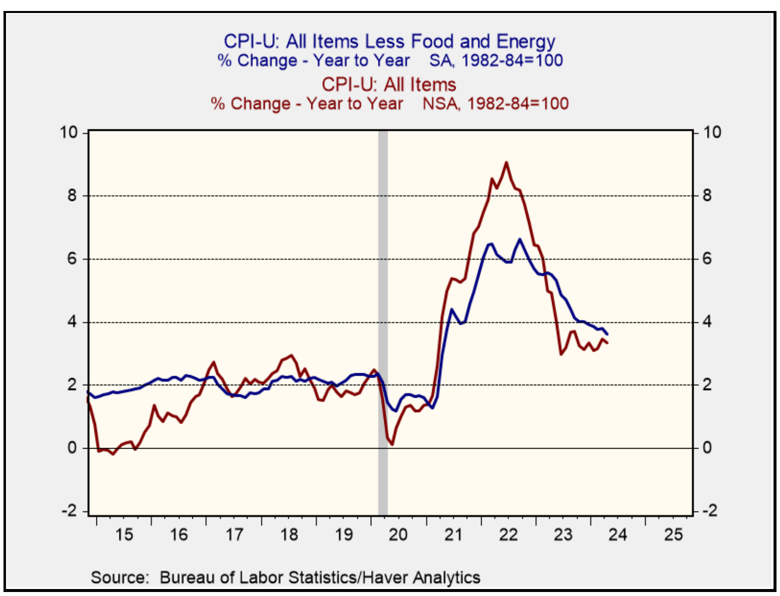
- Because of today's sticky inflation, we continue to believe the policymakers could keep rates "higher for longer" than investors currently believe.

US Regulatory Policy: The Consumer Financial Protection Bureau yesterday proposed a rule barring medical bills from credit reports. According to the CFPB, the rule would keep debt collectors from harassing consumers for inaccurate or false medical bills. The bureau also said its internal research shows medical bills on credit reports have "little or no value" in predicting whether consumers would repay their other debts. The CFPB said removing medical bills from a report would raise the relevant credit score by about 20 points.

US Economic Releases

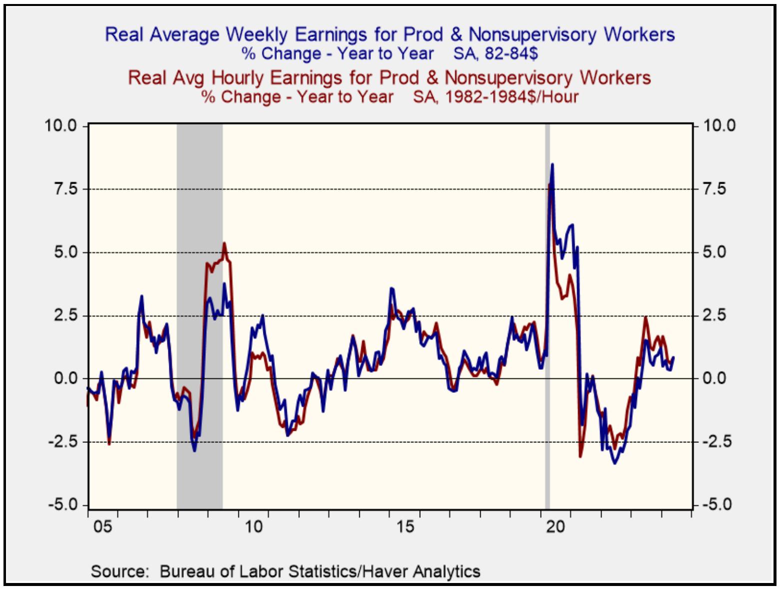
Home loan demand rebounded significantly last week, fueled by a drop in interest rates. According to the Mortgage Bankers Association, its mortgage application index surged 15.6% for the week ending June 7. This marks the biggest increase since early 2023, as borrowers rushed to lock in lower rates. The average 30-year fixed-rate mortgage dipped 5 basis points to 7.02% last week. This triggered a jump in applications for home purchases which rose 8.6% from the previous week, and refinancing applications which were up 28.4% in the same period.

Separately, consumer prices rose at a slower-than-expected pace in May. According to the Bureau of Labor Statistics' CPI index, overall prices were unchanged compared to the previous month. This reading was slightly below consensus estimates of a 0.1% increase and a sharp drop from the previous reported increase of 0.3%. Excluding volatile food and energy prices, core inflation rose 0.2% from the previous month, which is slightly below the consensus estimate and the previous month's reading of 0.3%.



The chart above shows the annual change in core and headline CPI. In May, the overall price level rose 3.3% from the previous year, while the core index rose 3.4%. The deceleration is a good sign for markets as it suggests that a soft landing is still possible.

A lower-than-anticipated CPI report indicates some relief for workers on the inflation front. While average hourly earnings rose from 0.5% to 0.8% year-over-year, real weekly earnings dipped slightly from a revised 0.6% to 0.5%.



The chart above shows the annual change in real weekly earnings for nonsupervisory and production workers. While hourly earnings adjusted for inflation increased 0.8% year-over-year, weekly earnings saw a slightly larger rise of 0.9% over the same period.

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**
14:00	FOMC Rate Decision (Lower Bound)	w/w	12-Jun	5.25%	5.25%	***
14:00	FOMC Rate Decision (Upper Bound)	w/w	12-Jun	5.50%	5.50%	***
14:00	Interest on Reserve Balances Rate	w/w	13-Jun	5.4%	5.4%	**
14:00	Monthly Budget Statement	m/m	may	-$276.5b	-$240.3b	**
Federal Reserve						
ET	**Speaker or Event**	**District or Position**				
14:00	FOMC Concludes Two-Day Meeting	Federal Reserve Board				
14:30	Jerome Powell Holds Post-Meeting Press Conference	Chair 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	PPI	y/y	May	2.4%	1.1%	2.0%	***	Equity and bond neutral
South Korea	Unemployment Rate	m/m	May	2.8%	2.8%	2.8%	***	Equity and bond neutral
China	PPI	y/y	May	-1.4%	-2.5%	-1.5%	**	Equity and bond neutral
	CPI	y/y	May	0.3%	0.3%	0.4%	**	Equity and bond neutral
India	CPI	y/y	May	4.75%	4.83%	4.85%	***	Equity and bond neutral
	Industrial Production	y/y	Apr	5.0%	5.4%	4.5%	***	Equity and bond neutral
EUROPE								
Germany	CPI	y/y	May F	2.4%	2.4%	2.4%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	May F	2.8%	2.8%	2.8%	**	Equity and bond neutral
UK	Industrial Production	y/y	Apr	-0.4%	0.5%	0.3%	***	Equity bearish, bond bullish
	Manufacturing Production	y/y	Apr	0.4%	2.3%	1.5%	**	Equity bearish, bond bullish
	Construction Output	y/y	Apr	-3.3%	-2.2%	-1.8%	*	Equity bearish, bond bullish
	Index of Services	m/m	Apr	0.2%	0.5%	-0.1%	*	Equity and bond neutral
	Visible Trade Balance	m/m	Apr	-£119607m	-£13967m	-£14200m	**	Equity and bond neutral
	Trade Balance	m/m	Apr	-£5490m	-£1098m	-£1817m	**	Equity and bond neutral
AMERICAS								
Canada	Building Permits	m/m	Apr	20.5%	-12.3%	5.0%	**	Equity bullish, bond bearish
Mexico	International Reserves Weekly	w/w	7-Jun	$219273m	$218726m		*	Equity and bond neutral
Brazil	IBGE Services Volume	y/y	Apr	3.93%	3.69%	3.88%	*	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)	524	523	1	Up
U.S. Sibor/OIS spread (bps)	534	535	-1	Up
U.S. Libor/OIS spread (bps)	535	535	0	Up
10-yr T-note (%)	4.40	4.41	-0.01	Up
Euribor/OIS spread (bps)	374	374	0	Down
Currencies	Direction			
Dollar	Down			Up
Euro	Up			Down
Yen	Down			Down
Pound	Up			Down
Franc	Up			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.

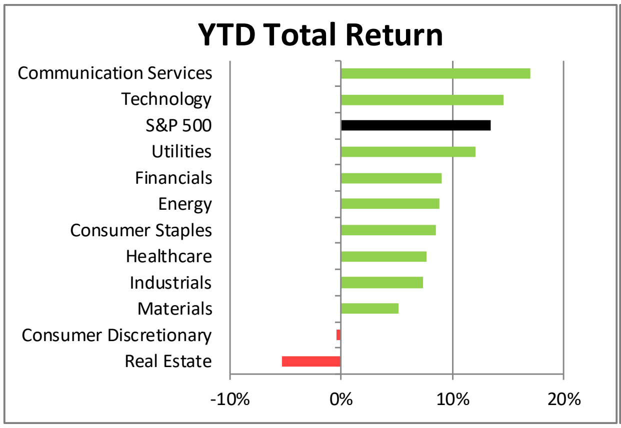
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$82.68	$81.92	0.93%	
WTI	$78.75	$77.90	1.09%	
Natural Gas	$3.05	$3.13	-2.43%	
12-mo strip crack	$21.73	$21.97	-1.10%	
Ethanol rack	$2.01	$2.00	0.31%	
Metals				
Gold	$2,312.93	$2,317.01	-0.18%	
Silver	$29.38	$29.28	0.37%	
Copper contract	$450.20	$449.40	0.18%	
Grains				
Corn contract	$452.00	$449.50	0.56%	
Wheat contract	$617.50	$626.50	-1.44%	
Soybeans contract	$1,181.50	$1,178.00	0.30%	
Shipping				
Baltic Dry Freight	1,831	1,883	-52	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-1.50		
Gasoline (mb)		1.50		
Distillates (mb)		2.15		
Refinery run rates (%)		0.4%		
Natural gas (bcf)		76		

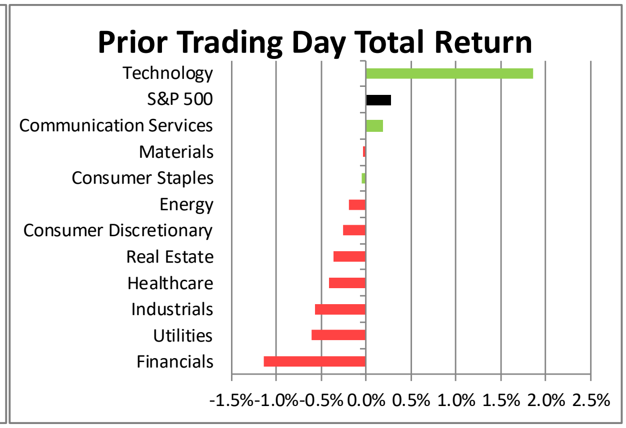
Weather

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 along the Northern Tier and the Gulf Coast, with dry conditions in the Midwest, Mid Atlantic, and New England.

Data Section

US Equity Markets – (as of 6/11/2024 close)

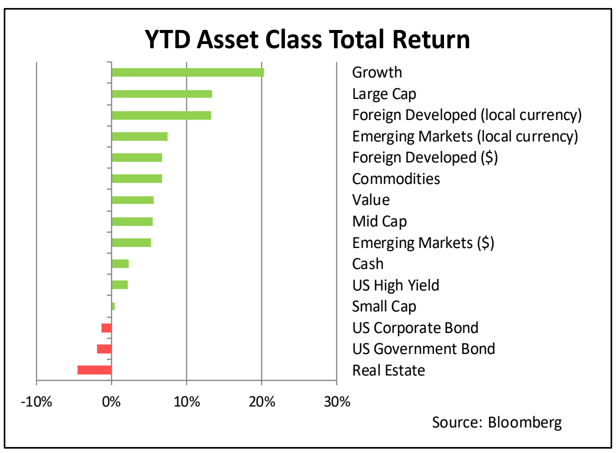




(Source: Bloomberg)

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 6/11/2024 close)

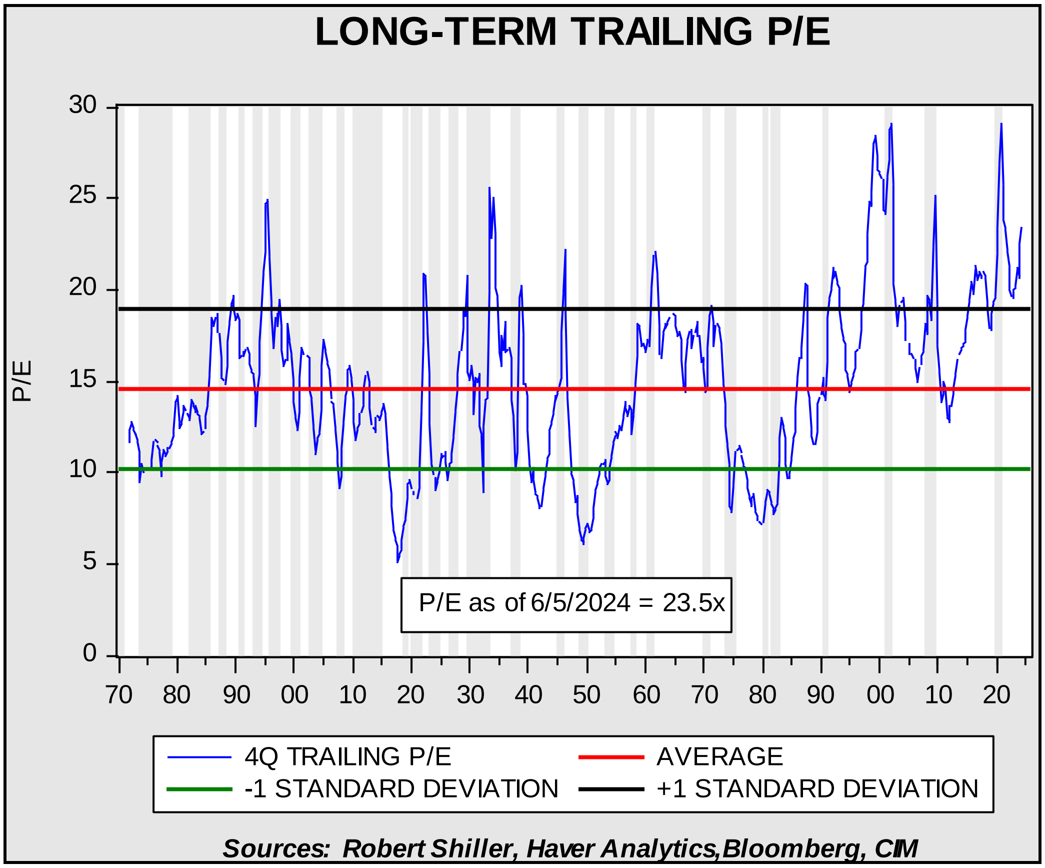


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.