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 25, 2024—9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is down 0.6% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.3%. Chinese markets were lower, with the Shanghai Composite down 0.4% from its previous close and the Shenzhen Composite down 0.5%. 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* (6/17/2024) (with associated podcast): "Mid-Year Geopolitical Outlook: Uncertainty Reigns"
- *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* (6/24/2024) (with associated podcast): "Small Caps and the Hope for a Soft Landing"
- *Confluence of Ideas podcast* (5/8/2024) "Reviewing the Asset Allocation Rebalance: Q2 2024"

Our *Comment* today opens with further details on how Canada is considering antidumping tariffs against Chinese electric vehicles, as we flagged in a short blurb late last week. We next review several other international and US developments with the potential to affect the financial markets today, including another EU antitrust complaint against a major US technology firm and a statement by a Federal Reserve governor saying she would be open to raising interest rates if consumer price inflation doesn't keep falling.

Canada-China: Following up on an item we flagged without detail late last week, the Canadian government is seeking public opinion on whether to impose antidumping tariffs or other barriers against Chinese EVs. Starting July 2, citizens will have 30 days to register their opinion, after which the government can decide on what it believes will be the optimal path.

- To justify the action, Ottawa cited "unfair competition from China's intentional, state-directed policy of overcapacity and lack of rigorous labor and environmental standards."

- More interesting, Ottawa said its goal is not only "to protect Canada's auto workers and its growing EV industry" but also to "prevent trade diversion resulting from recent action taken by Canadian trading partners." In other words, it is worried that the new US and EU tariffs against Chinese EVs will divert them toward Canada, where they likely would be sold at fire-sale prices.

European Union-United States: One day after accusing US tech giant Apple of using its app store to snuff out online competition, the European Commission today accused Microsoft of uncompetitive practices for the way it bundles its Teams collaboration tool with its Office products. The move appears to be another use of the EU's new Digital Markets Act, signaling it will be applied aggressively and could trip up other US tech firms. If found guilty under the DMA, a firm could face a fine of 10% to 20% of its global annual revenue.

European Union-Ukraine-Moldova: EU officials today will meet with Ukrainian and Moldovan officials in Luxembourg to begin talks on their accession to the bloc. At the meetings, the EU will outline the reforms and legislation each country needs to adopt before being deemed ready to join. However, both Ukraine and Moldova are likely to need several years to meet the EU's standards, so joining is by no means imminent.

- In large part, the talks will be symbolic, since they are merely aimed at getting the ball rolling before Ukraine-skeptic Hungary takes over the six-month rotating presidency of the Council of the European Union on July 1.

- Our next *Bi-Weekly Geopolitical Report*, to be published on Monday, will provide a full explanation of what that Council is and how it fits into the EU's decision making.

France: With polls showing the far-right National Rally could win the parliamentary elections starting on Sunday, leader Jordan Bardella yesterday held a press conference to unveil new details on the party's economic, immigration, and foreign policies. To counter concerns that the party's populist bent would lead to tax cuts and spending hikes, blowing out the French budget deficit, Bardella vowed that National Rally would actually bring the deficit back down to the European Union limit of 3.0% of gross domestic product by 2027, versus 5.5% of GDP last year.

- Besides vowing "reasonable" fiscal policies, Bardella also outlined an economic program that largely echoed President Macron's mainstream goals of strengthening the French industrial base, boosting employment, and cutting regulation. The main difference was that Bardella said National Rally would reverse Macron's pension reform, which raised the national retirement age from 62 to 64 years.

- Bardella's economic proposals illustrate how many of Europe's populist, far-right parties have moderated their policies once they attained power. One example of that has been Italian Prime Minister Giorgia Meloni and her Brothers of Italy party.

- If that turns out to be the case in France, the recent sell-off in French stocks and bonds could well be an attractive buying opportunity.

Israel: The Israeli Supreme Court today ruled that ultra-orthodox Jewish students cannot be legally exempted from military conscription. It also ruled that those students aren't entitled to

government funding if they don't have a valid conscription exemption. While it remains unclear when the ruling will be implemented, it will eventually end a controversial practice that many Israelis see as unfairly benefiting ultra-conservative citizens. It could also weaken the cohesion of Prime Minister Netanyahu's right-wing coalition government.

Kenya: Protestors have launched nationwide demonstrations against a new set of tax hikes the government hopes will raise some $2.1 billion and help cut the budget deficit from the current 5.7% of GDP to 3.3% of GDP next year. The tax hikes are required under Kenya's most recent bailout deal with the International Monetary Fund. The protests have already turned violent, threatening political and economic instability in the country.

US Monetary Policy: In a speech today, Fed board member Michelle Bowman said she would be willing to raise the benchmark fed funds rate again if progress on lowering consumer price inflation stalls or reverses. According to Bowman, one key upside risk for inflation is the large federal budget deficit, which reflects factors such as weak tax revenue, higher interest costs, and increased outlays on Social Security, Medicare, and other programs. She also said high immigration could drive up the price of housing, even if it helps hold down wage rates.

US Manufacturing Sector: Danish pharmaceutical giant Novo-Nordisk yesterday said it will invest $4.1 billion to build a new factory in Raleigh, North Carolina and expand production of its blockbuster weight-loss drugs Wegovy and Ozempic. The move will likely put pressure on US drug giant Eli Lilly to expand output of its rival drugs Zepbound and Mounjaro. The investments would add to the current boom in US factory construction, which to date has been driven more by manufacturing facilities for electronic goods such as electric cars and semiconductors.

Sources: Census Bureau/Haver Analytics, Census Bureau
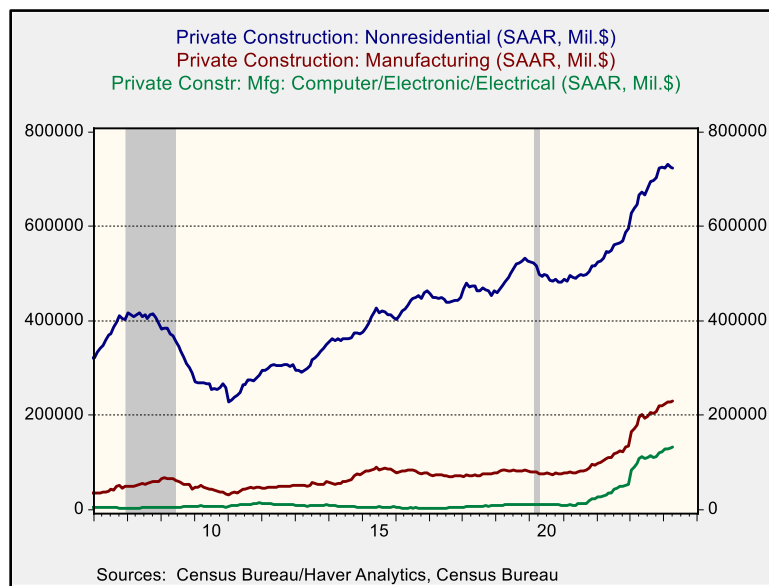
**US Artificial Intelligence Industry:** The Recording Industry Association of America has filed copyright infringement suits against two AI startups developing products that allow users to generate new music using text prompts. The suits, brought on behalf of major music companies, allege that the startups used copyrighted works scraped from the internet to train their models.

- The suits illustrate the legal challenges that have to be sorted out for the AI industry to continue growing.

- One likely result of such suits is that specialized data sets that are useful for training AI models will become increasingly valuable. Those data sets will be guarded furiously, potentially to the point where specialized, focused AI models will proliferate and become even more important to the economy than the general AI models getting so much attention today.

US Economic Releases

Signs of life emerge in the US economy as the Chicago Fed's National Activity Index rebounded to positive territory in May. The index rose from a revised -0.25 to +0.18, exceeding expectations of -0.4.
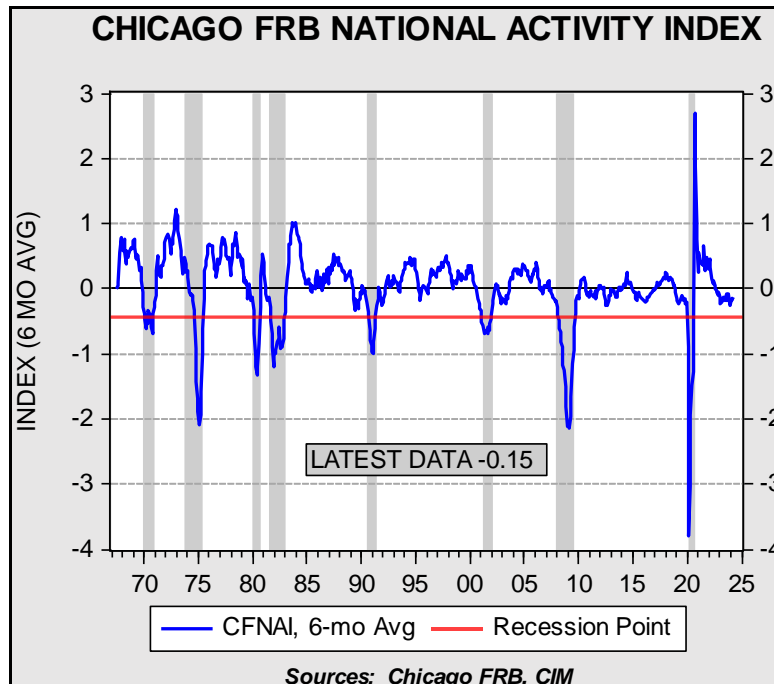
The chart above shows the Chicago Fed National Activity Index along with its six-month moving average. The moving average fell from -0.14 to -0.15 but remains firmly above the contraction signal of -0.4.

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**						
10:00	Conf. Board Consumer Confidence	m/m	Jun		100.0	102.0	***
10:00	Richmond Fed Manufact. Index	m/m	Jun		-3.0	0.0	**
Federal Reserve							
ET	**Speaker or Event**	**District or Position**					
9:10	Lisa Cook Speaks on Economic Outlook	Member of the Board of Governors					
9:30	Michelle Bowman Gives Recorded Opening Remarks	Member 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	Services PPI	y/y	May	2.5%	2.7%	3.0%	*	Equity bullish, bond bearish
	Leading Economic Index	m/m	Apr F	110.9	111.6		**	Equity and bond neutral
	Coincident Index	y/y	Apr F	115.2	115.2		**	Equity and bond neutral
	Machine tool orders	y/y	May F	4.2%	4.2%		**	Equity and bond neutral
Australia	Westpac Consumer Conf SA	m/m	Jun	1.7%	-0.3%		**	Equity and bond neutral
	Westpac Consumer Conf Index	m/m	Jun	83.6	82.2		**	Equity and bond neutral
South Korea	Consumer Confidence	m/m	Jun	100.9	98.4		*	Equity and bond neutral
	Retail Sales	y/y	May	8.8%	10.8%		**	Equity and bond neutral
	Depart. Store Sales	y/y	May	-0.1%	-2.0%		*	Equity and bond neutral
	Discount Store Sales	y/y	May	-3.1%	-6.7%		*	Equity and bond neutral
AMERICAS								
Brazil	IBGE Inflation IPCA-S	m/m	6/22	0.45%	0.57%		**	Equity and bond neutral
	Current Account Balance	m/m	May	-$3400m	-$2868m	-$3350m	**	Equity and bond neutral
	Foreign Direct Investment	m/m	May	$3023m	$3867m	$4700m	**	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)	561	561	0	Up
3-mo T-bill yield (bps)	522	521	1	Up
U.S. Sibor/OIS spread (bps)	534	534	0	Up
U.S. Libor/OIS spread (bps)	533	533	0	Up
10-yr T-note (%)	4.22	4.23	-0.01	Down
Euribor/OIS spread (bps)	368	369	-1	Down
Currencies	**Direction**			
Dollar	Up			Up
Euro	Down			Down
Yen	Up			Down
Pound	Flat			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.
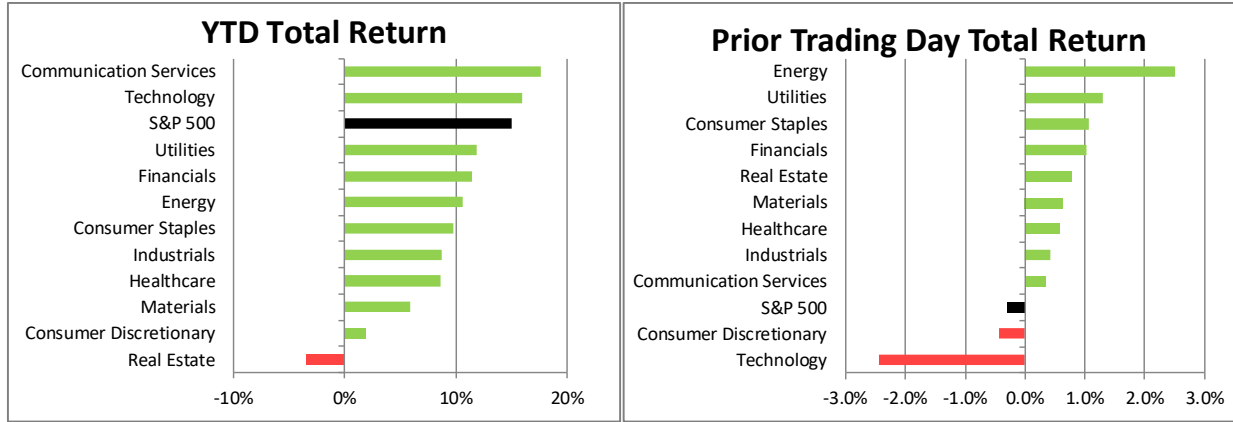
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$85.50	$86.01	-0.59%	
WTI	$81.12	$81.63	-0.62%	
Natural Gas	$2.80	$2.81	-0.46%	
12-mo strip crack	$22.39	$22.32	0.33%	
Ethanol rack	$2.16	$2.15	0.84%	
Metals				
Gold	$2,329.54	$2,334.65	-0.22%	
Silver	$29.50	$29.58	-0.28%	
Copper contract	$441.20	$442.50	-0.29%	
Grains				
Corn contract	$446.50	$451.75	-1.16%	
Wheat contract	$568.25	$571.00	-0.48%	
Soybeans contract	$1,121.00	$1,130.50	-0.84%	
Shipping				
Baltic Dry Freight	1,973	1,997	-24	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-2.91		
Gasoline (mb)		-1.25		
Distillates (mb)		-0.38		
Refinery run rates (%)		-0.1%		
Natural gas (bcf)		69		

Weather

The 6-10 and 8-14 day forecasts call for warmer-than-normal temperatures throughout almost the entire country with cooler temps only in the Northern tier states. Meanwhile, the precipitation outlook projects wetter-than-normal conditions for most of the country with dry conditions expected in Northern California, the southern Atlantic coast, and Texas. There are signs of cyclone formation in the Caribbean Sea, but it is not expected to develop into a tropical storm within the next 48 hours.
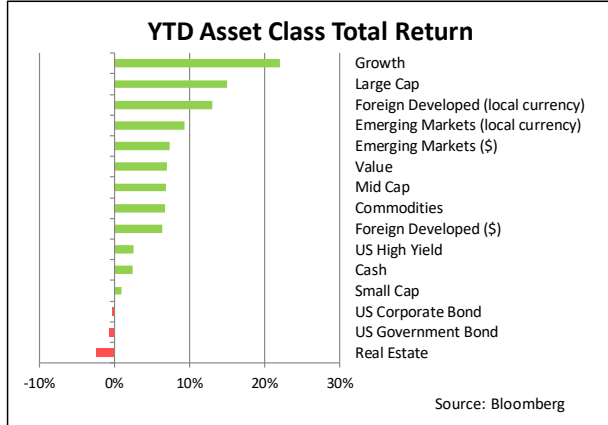
Data Section

US Equity Markets – (as of 6/24/2024 close)

YTD Total Return

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

Prior Trading Day Total Return

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

(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 6/24/2024 close)

YTD Asset Class Total Return

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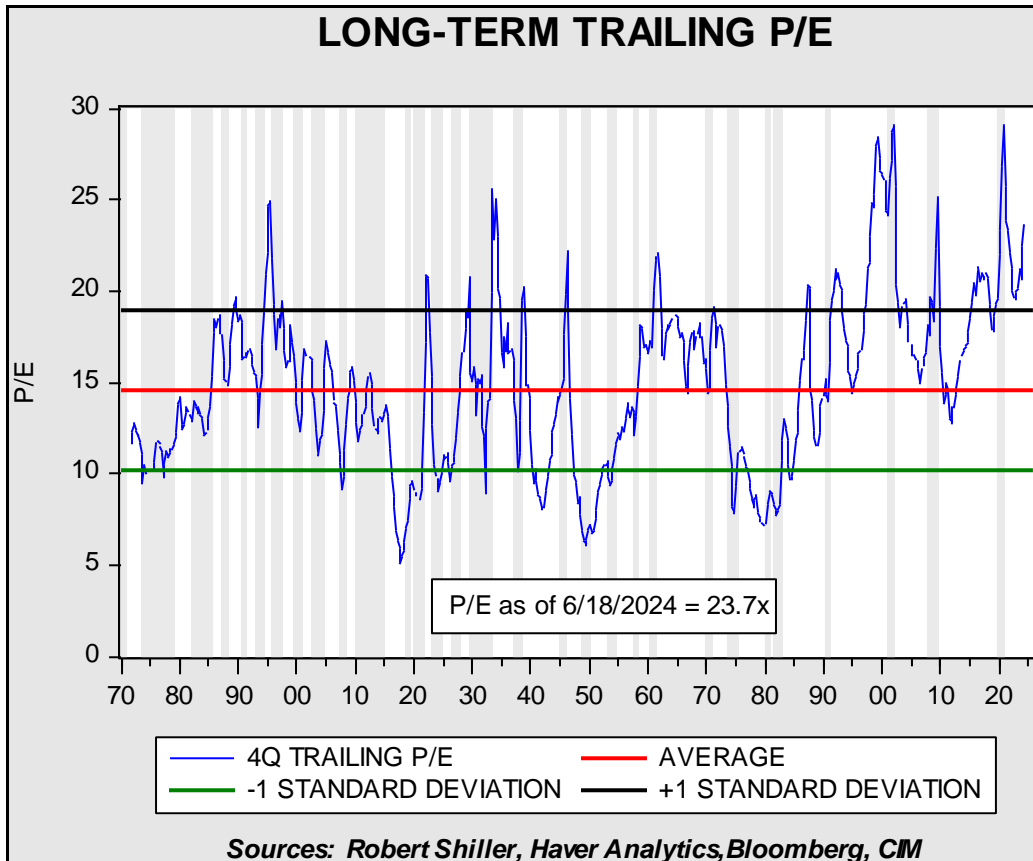- US Government Bond
- Real Estate

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

June 20, 2024

LONG-TERM TRAILING P/E

P/E as of 6/18/2024 = 23.7x

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 23.7x, up 0.1 from our last report. The increase in the multiple was due to an increase in the stock price index, and a slight decline 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.