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 27, 2024—9:30 AM ET] Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 closed down 0.1% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.4%. Chinese markets were lower, with the Shanghai Composite down 0.9% from its previous close and the Shenzhen Composite down 1.7%. 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* (6/17/2024) (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"

Good morning! Equity markets are off to a sluggish start as investors await Friday's inflation data. In sports news, the Atlanta Hawks chose Zaccharie Risacher with the first overall pick in the NBA draft. Today's *Comment* will delve into the impact that immigration may have on monetary policy, our thoughts on the latest Fed stress tests, and a summary of the attempted coup in Bolivia. As usual, our report includes a roundup of international and domestic data releases.

The Immigration Conundrum: Foreign workers have played a pivotal role in filling job vacancies and easing inflationary pressures; however, the broader public wants fewer of them.

- Switzerland is set to address immigration concerns through a constitutional amendment that would require government action if the number of permanent residents surpasses 9.5 million. It would also impose a cap of 10 million on the total number of permanent residents. This vote coincides with Switzerland's negotiations for an updated agreement with the European Union, where disagreements over wages and immigration persist.

Businesses, especially in hospitality, share these concerns, highlighting their reliance on foreign workers to fill vacancies. The sentiment reflects a broader trend of rising skepticism towards immigration in Western countries.

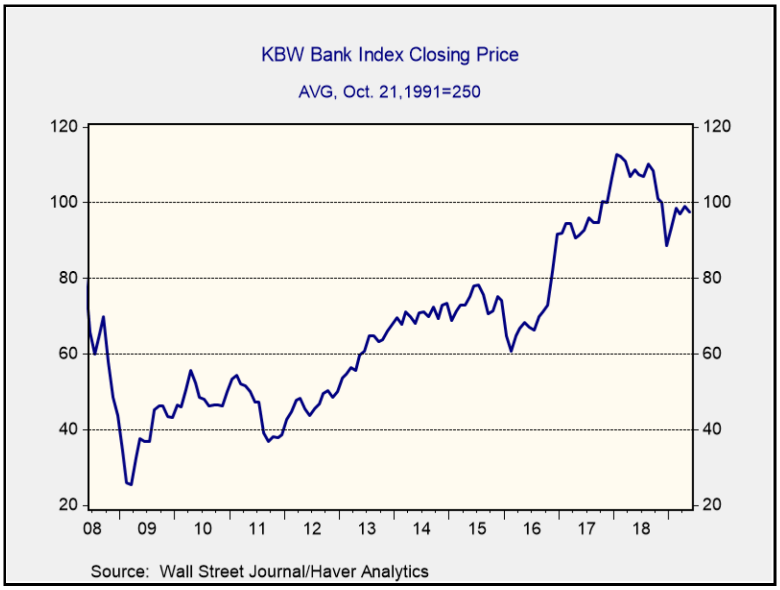
- The debate over immigration intensifies as central bankers grapple with the pandemic's impact on labor markets and inflation. A recent report by French economist Olivier Blanchard and former Fed Chair Ben Bernanke warns that persistent wage pressures — a key driver of inflation — are making it difficult for central banks to achieve their goals. Immigration has offered some relief by easing labor shortages. However, policy changes could undermine this progress, potentially forcing central banks to take stronger measures like rate hikes. As Fed Governor Michelle Bowman noted, stricter immigration policies could put upward pressure on inflation.

- The recent rise in anti-immigration sentiment could eventually influence monetary policy discussions. While increased immigration has helped address labor shortages and ease wage pressures, its impact is not one directional. Despite Fed Governor Bowman's acknowledgement that the influx of foreign workers has helped alleviate inflationary pressures, she also suggested that it may have also contributed to rising rents due to the group's housing needs. This mixed effect means immigration may become a factor that central banks consider, but it is unlikely to be the sole driver of policy decisions.

Is This Time Different? Major US banks all passed the Fed's annual stress test this year, but there are still concerns that a financial crisis could hurt the economy.

- The stress test results indicate that these firms can withstand a major loss during a recession and still maintain sufficient capital to meet their obligations. According to the report, the group of banks would incur approximately $685 billion in losses, lower than the previous year's figure and still within the acceptable range established by recent stress tests. While the success of these firms, as a whole, allows for more generous payouts through dividends and stock buybacks, the results did vary by individual firm. In the first, quarter, [banks repurchased $14 billion worth of shares].

- The health of the financial system has been a major concern for investors ever since the Federal Reserve began raising rates in 2022. This concern is heightened by the FDIC's latest quarterly report, [which estimates that banks are currently holding a staggering $525 billion of unrealized losses] on their balance sheets — a figure about seven times higher than what was recorded during the financial crisis. While banks can avoid recognizing these losses as long as they maintain sufficient liquidity, a liquidity crunch similar to the one that forced Silicon Valley Bank's collapse in 2023 could trigger a wave of bank losses.

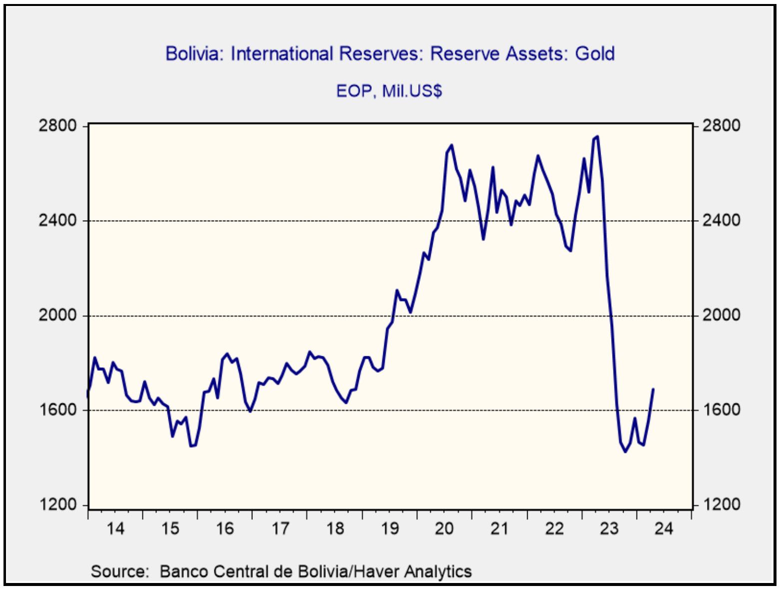


- The Federal Reserve, keenly aware of the financial system's vulnerabilities, has been implementing measures to mitigate crisis risks. These include requiring banks to hold more collateral and making the standing repo facility permanent in July 2021. However, unforeseen geopolitical or financial events could still trigger a crisis, forcing the Fed to take more drastic actions. While there are currently no signs of an imminent crisis, the risk remains elevated as long as the Fed maintains restrictive interest rates. That said, any signs of a pivot should benefit these firms, especially small to mid-sized banks.

Bolivia Unrest: One of the largest producers of lithium narrowly avoided a coup on Thursday, highlighting the political uncertainty in small resource-rich countries.

- [Bolivia narrowly avoided a coup attempt on Wednesday]. Soldiers led by dismissed army chief Juan José Zúñiga stormed the presidential palace in an attempt to remove socialist President Luis Arce. Luckily, Arce was able to rally public support and regain control later that day. The motive behind the uprising remains unclear, but it may be linked to Arce's recent efforts to reconcile with his predecessor, Evo Morales, ahead of upcoming elections. Notably, Zúñiga had been fired earlier this week for expressing opposition to Morales' return to office.

- The recent coup attempt in Bolivia throws a wrench into South America's efforts for regional integration. Last year, Brazilian President Lula da Silva spearheaded efforts, alongside other leftist leaders, to reunite President Arce and his exiled predecessor, Evo Morales, in the run-up to elections. Bolivia's economy has sputtered since Morales' departure in 2019, but the discovery of vast lithium reserves in July 2023 has offered a glimmer of hope. Last year, the country narrowly avoided a financial crisis after draining its gold reserves to sustain spending.

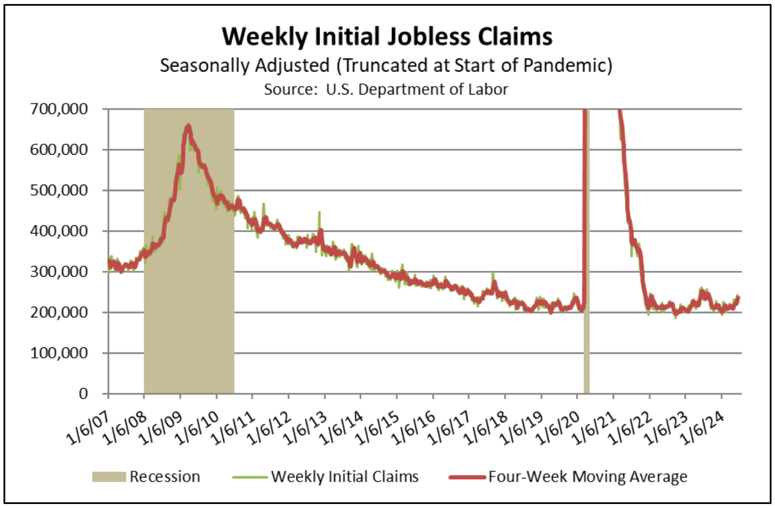


- Bolivia has a long history of coups with 23 attempts since 1950, 12 of which failed. In fact, the previous coup took place only five years ago. Unfortunately, political instability has long plagued emerging markets, particularly those reliant on resource exports. This trend is likely to worsen in a deglobalizing world and will likely have an impact on global commodity prices. As a result, investors should expect energy prices to become volatile over the next few years as countries look to form into regional blocs. Additionally, this fragmentation could potentially lead to higher global inflation due to persistent supply disruptions.

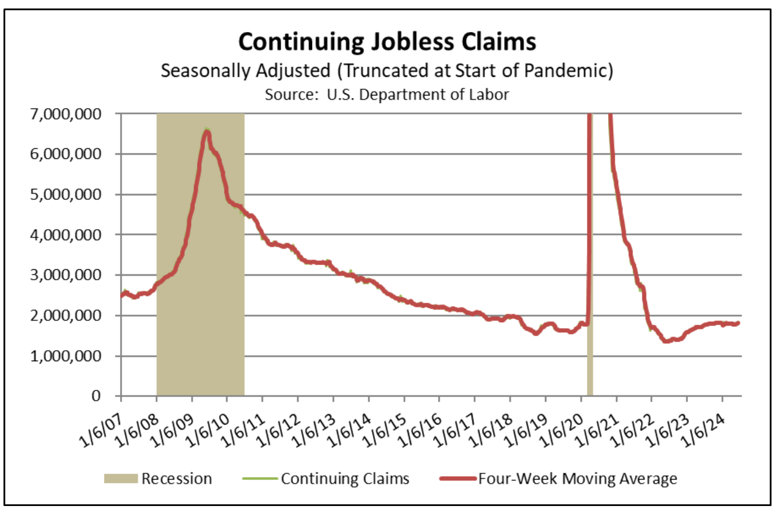
In Other News: Bulgaria and Romania failed to meet the economic requirements needed to adopt the euro. Their failure is a reminder of the difficulty in joining the economic bloc, particularly for Ukraine. A census report has shown that Hispanics fueled the US population boom in 2023, signaling their growing political influence.

US Economic Releases

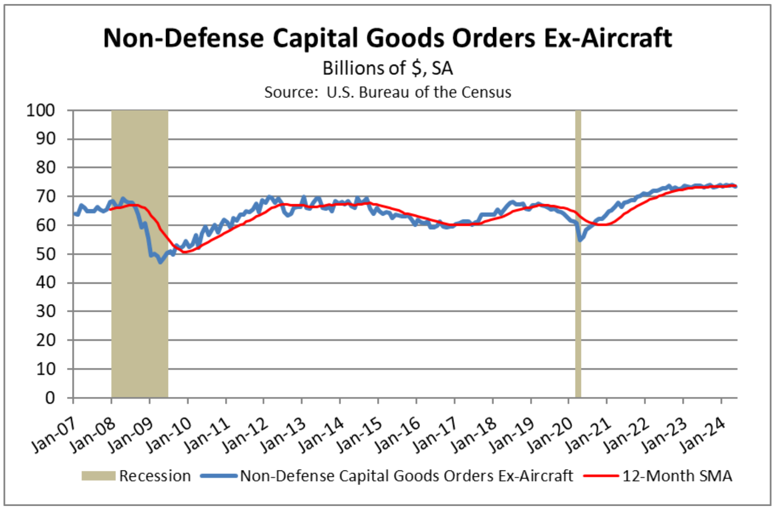
In the week ended June 22, ***initial claims for unemployment benefits*** fell to a seasonally adjusted 233,000, below both the expected level of 235,000 and the prior week's revised level of 239,000. Nevertheless, the four-week moving average of initial claims, which helps smooth out some of the volatility in the series, rose to a nearly 10-month high of 236,000. That points to significant weakening in the demand for labor, which could help reignite hopes that the Fed will cut interest rates more aggressively than currently planned. The chart below shows how initial jobless claims have fluctuated since just before the Great Financial Crisis. The chart is truncated through much of the pandemic period because of the extremely high level of claims at that time.



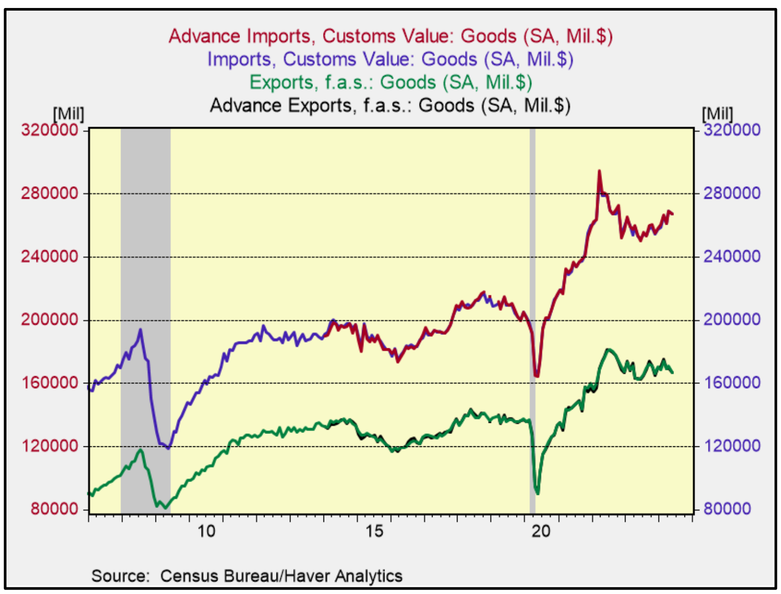
In the week ended June 15, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) rose to a seasonally adjusted 1.839 million, above both the anticipated reading of 1.828 million and the previous week's revised reading of 1.821 million. The four-week moving average of continuing claims rose to 1,816,000, reaching its highest level since December 2021. The chart below shows how continuing claims have fluctuated since the GFC. It is also truncated during the pandemic period because of the high level of claims at the time.



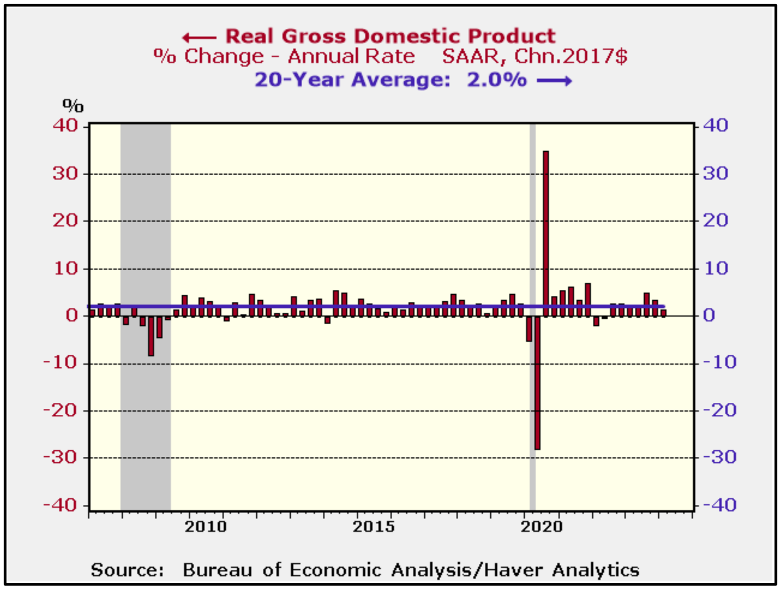
Separately, May ***durable goods orders*** rose slightly by a seasonally adjusted 0.1%, beating the expected decline of 0.5% but much weaker than April's revised gain of 0.2%. Durable goods orders are often driven by transportation equipment, where just a few airliner orders can have a big impact. May ***durable goods orders excluding transportation*** edged down 0.1%, weaker than the expected rise of 0.2% and April's rise of 0.4%. Finally, the durable goods report also includes a key proxy for corporate capital investment. In May, nondefense capital goods orders ex-aircraft dropped 0.6%, falling short of the anticipated increase of 0.1% and easily erasing April's revised gain of 0.3%. Compared with the same month one year earlier, overall durable goods orders in May were down 1.2%, while durable orders ex-transport were up 1.3%. Nondefense capital goods orders ex-aircraft were down 0.2%. The chart below shows the progression of nondefense capital goods orders ex-aircraft since the GFC.



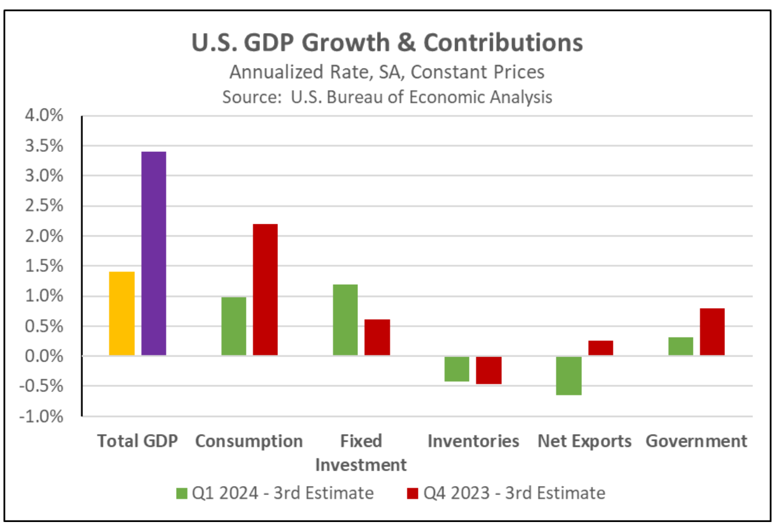
In a separate report today, a preliminary estimate showed the US ***merchandise trade balance*** in May came in at a seasonally adjusted deficit of $100.6 billion, worse than both the anticipated shortfall of $96.0 billion and April's revised shortfall of $98.0 billion. According to the data, total merchandise exports fell 0.7%, while imports fell 2.7%. Compared with the same month one year earlier, exports in May were up 2.9%, while imports were up 4.3%. The chart below shows the monthly value of U.S. exports and imports since just before the GFC.



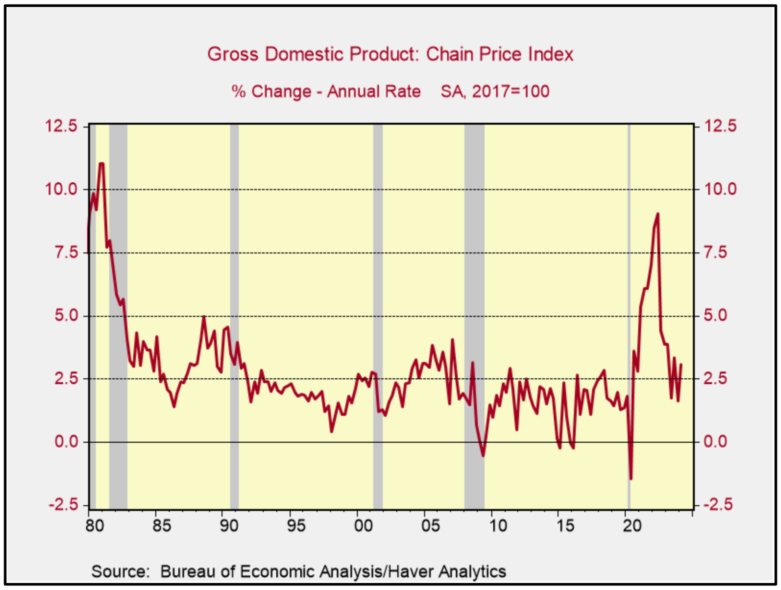
Finally, the Commerce Department released its third and final regular estimate of economic activity in the first quarter. After stripping out seasonal factors and price changes, first-quarter ***gross domestic product (GDP)*** rose at an annualized rate of 1.4%, matching expectations and modestly higher than the previously estimated growth rate of 1.3%. Nevertheless, the growth rate was far weaker than the 3.4% in the fourth quarter of 2023 and 4.9% in the third quarter. The chart below shows the annualized growth rate of US GDP since just before the GFC.



A close look at the details in the report shows that the main drag on activity in the first quarter was net exports, along with a fall in inventory investment. The main contributor to growth was fixed investment, which rebounded smartly from the third quarter. Consumption was also a contributor, although it slowed markedly from the previous quarter. The chart below shows the contributions to the annualized growth rate in the first quarter.



The GDP report also includes the broadest measure of US inflation. According to the report, the first-quarter ***GDP Price Index*** rose at an annualized rate of 3.1%, slightly worse than expectations that the rate of increase would match the previous estimate of 3.0%. The chart below shows the year-over-year change in the GDP Price Index over the last several decades.



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	Pending Home Sales	m/m	May	0.5%	-7.7%	**
10:00	Pending Home Sales NSA	y/y	May	-4.6%	-0.8%	**
10:00	Kansas City Fed Manufact. Activity	m/m	Jun	-5.0	-2.0	**
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	Retail Sales	y/y	May	3.0%	2.0%	2.0%	**	Equity bullish, bond bearish
	Depart. Store & Supermarket Sales	y/y	May	4.1%	2.7%		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	21-Jun	¥119.3b	-¥108.4b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	21-Jun	-¥85.5b	¥81.6b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	21-Jun	-¥1605.2b	-¥242.8b		*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	21-Jun	-¥1062.0b	¥655.1b		*	Equity and bond neutral
New Zealand	ANZ Consumer Confidence Index	m/m	Jun	83.2	84.9		*	Equity and bond neutral
	ANZ Activity Outlook	m/m	Jun	12.2	11.8		*	Equity and bond neutral
	ANZ Business Confidence	m/m	Jun	6.1	11.2		**	Equity and bond neutral
South Korea	Business Survey Manufacturing	y/y	Jul	75	76		**	Equity and bond neutral
	Business Survey Non-Manufacturing	y/y	Jul	70	72		*	Equity and bond neutral
China	Industrial Profits	y/y	May	0.7%	4.0%		*	Equity and bond neutral
EUROPE								
Eurozone	M3 Money Supply	y/y	May	1.6%	1.3%	1.5%	***	Equity and bond neutral
	Consumer Confidence	m/m	Jun F	-14.0	-14.0		**	Equity and bond neutral
	Services Confidence	m/m	Jun	6.5	6.8	6.3	**	Equity and bond neutral
	Industrial Confidence	m/m	Jun	-10.1	-9.9	-9.6	***	Equity and bond neutral
	Economic Confidence	m/m	Jun	95.9	96.1	96.1	***	Equity and bond neutral
Italy	Consumer Confidence	m/m	Jun	98.3	96.4	97.0	***	Equity bullish, bond bearish
	Manufacturing Confidence	m/m	Jun	86.8	88.2	88.6	***	Equity bearish, bond bullish
	Economic Sentiment	m/m	Jun	94.5	95.1		**	Equity and bond neutral
	PPI	y/y	May	-4.9%	-8.0%		**	Equity and bond neutral
Russia	Industrial Production	y/y	May	5.3%	3.9%	2.3%	***	Equity bullish, bond bearish
AMERICAS								
Mexico	Unemployment Rate NSA	m/m	May	2.62%	2.61%	2.68%	***	Equity and bond neutral
	Trade Balance	m/m	May	1991.2m	-3746.2m	-2089.5m	**	Equity and bond neutral
	Exports	m/m	May	55671m	51319m		*	Equity and bond neutral
	Imports	m/m	May	53680m	55066m		*	Equity and bond neutral
Brazil	FGV Inflation IGPM	y/y	Jun	2.45%	-0.34%	2.49%	***	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	523	0	Up
U.S. Sibor/OIS spread (bps)	533	533	0	Up
U.S. Libor/OIS spread (bps)	533	533	0	Up
10-yr T-note (%)	4.33	4.33	0.00	Up
Euribor/OIS spread (bps)	372	370	2	Down
Currencies	Direction			
Dollar	Down			Up
Euro	Up			Down
Yen	Up			Down
Pound	Up			Flat
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	$85.67	$85.25	0.49%	
WTI	$81.25	$80.90	0.43%	
Natural Gas	$2.75	$2.75	0.29%	
12-mo strip crack	$22.78	$22.78	-0.01%	
Ethanol rack	$2.24	$2.23	0.61%	
Metals				
Gold	$2,315.71	$2,298.23	0.76%	
Silver	$28.87	$28.77	0.34%	
Copper contract	$436.85	$436.70	0.03%	
Grains				
Corn contract	$433.75	$436.50	-0.63%	
Wheat contract	$562.50	$560.50	0.36%	
Soybeans contract	$1,107.00	$1,107.00	0.00%	
Shipping				
Baltic Dry Freight	1,964	1,926	38	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	3.59	-2.82	6.41	
Gasoline (mb)	5.65	-1.50	7.15	
Distillates (mb)	-0.38	-1.05	0.67	
Refinery run rates (%)	-1.3%	-0.2%	-1.1%	
Natural gas (bcf)		54		

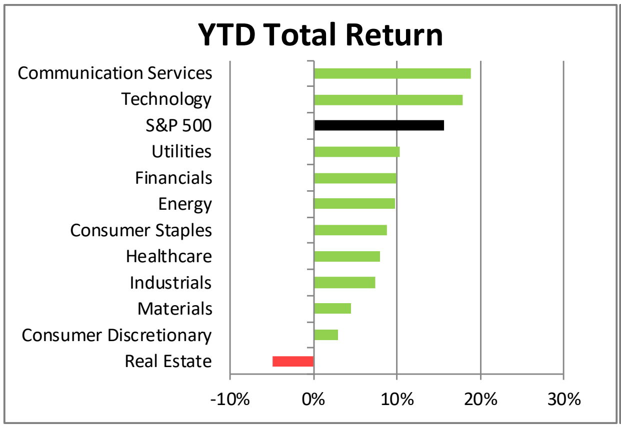
Weather

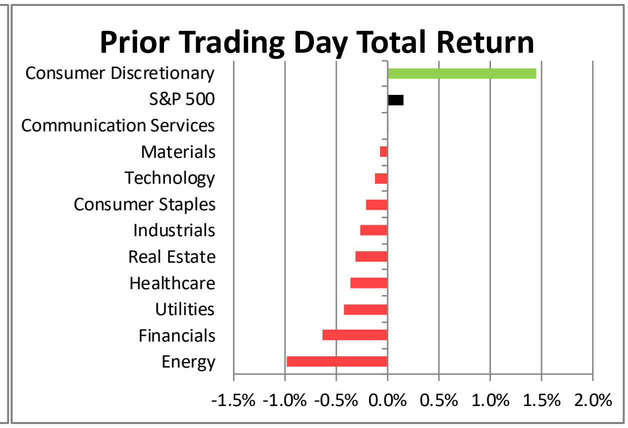
The 6-10 and 8-14 day forecasts call for warmer-than-normal temperatures throughout most of the southern half of the country, with cooler-than-normal temperatures in the Pacific Northwest. The forecasts call for wetter-than-normal conditions in the southern Rocky Mountains, the northern Great Plains, and the Midwest, with dry conditions in California, Nevada, and the Deep South.

There are currently two atmospheric disturbances in the Atlantic Ocean area. The first, located south of Cuba, is moving westward but is assessed to have only a 10% chance of forming a cyclone in the next 48 hours. The second, off the western coast of Africa, is moving westward and is assessed to have a 40% chance of turning into a cyclone in the next 48 hours.

Data Section

US Equity Markets – (as of 6/26/2024 close)

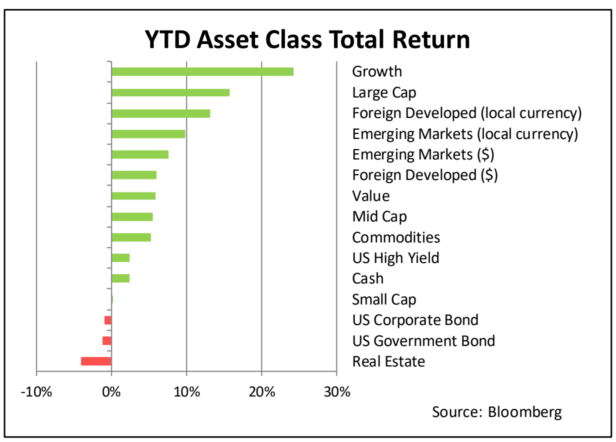




(Source: Bloomberg)

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 6/26/2024 close)

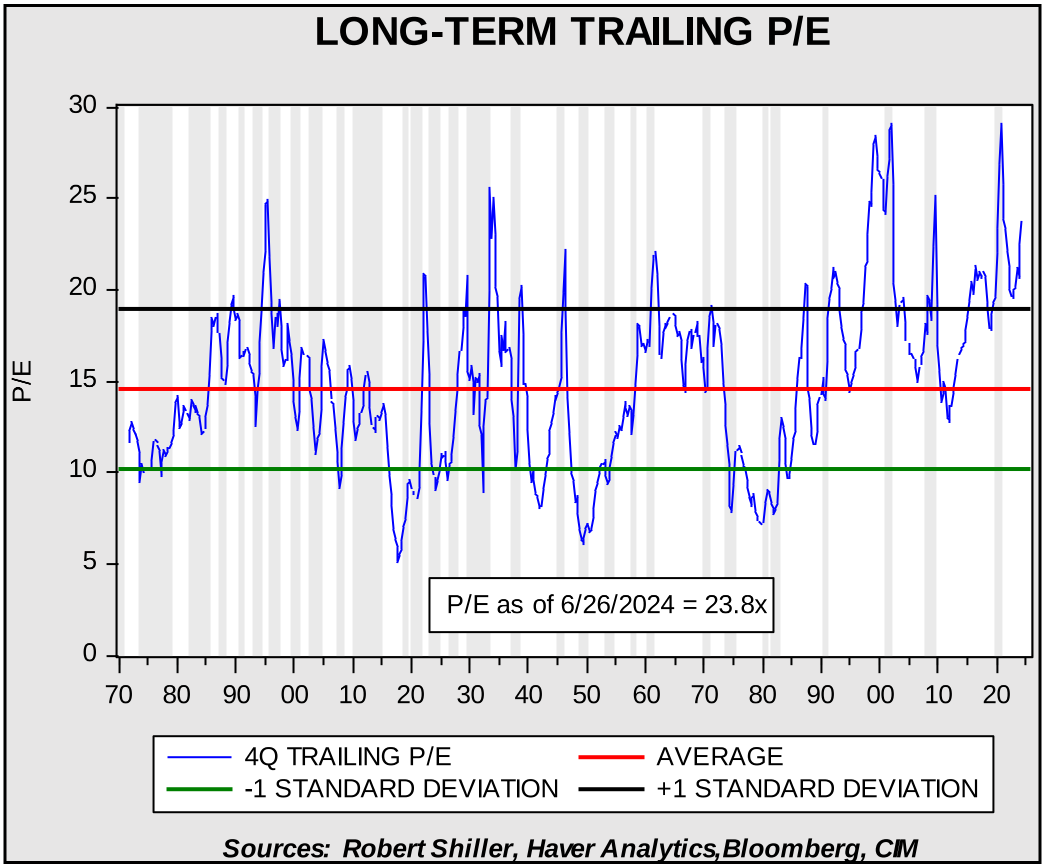


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 27, 2024



Based on our methodology,[1] the current P/E is 23.8x, up 0.1 from our last report. The increase in the multiple was due to an increase in the stock price index offsetting 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.