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 3, 2024—9:30 AM EDT] 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 up 2.7%. Chinese markets were lower, with the Shanghai Composite down 0.3% from its previous close and the Shenzhen Composite down 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* (5/20/2024) (there is no associated podcast): "The Great COVID Labor Reform"
- *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* (5/28/2024) (with associated podcast): "The Importance of the Federal Reserve's Inflation Target"
- *Confluence of Ideas podcast* (5/8/2024) "Reviewing the Asset Allocation Rebalance: Q2 2024"
- Business Cycle Report (5/30/24)

Our *Comment* today opens with notes on the global energy market. We next review several other international and US developments with the potential to affect the financial markets today, including a cut to France's sovereign debt rating, election results in several key emerging markets, and another Federal Reserve policymaker's statement suggesting US interest rates will remain high for an extended period.

Global Energy Market: The Organization of the Petroleum Exporting Countries and its Russian-led allies agreed to keep most of their current output cuts in place until late 2025, as they try to boost prices in the face of weak global demand and rising non-OPEC production. The cuts that will remain in place amount to more than three million barrels per day of potential output. With little change in production for now, the announcement has had almost no impact on the oil markets. So far today, Brent crude is trading virtually unchanged at $78.91 per barrel.

- Separately, European natural gas prices have surged some 13% so far today, following an outage at a Norwegian gas processing facility. Sources say the outage could eventually reduce Norway's gas exports to Europe by about one-fifth.

- The outage is important because Norway has now become the single-largest supplier of gas to Europe, accounting for about 30% of the Continent's total supply. The outage compounds other recent problems driving up European gas prices, such as a court ruling that could cut the remaining supplies of Russian gas through Austria and hot weather and high demand in Asia, which have diverted global supplies there.

European gas price jumps
TTF (euros/mwh)
Source: LSEG
© FT

France: On Friday, S&P cut France's long-term sovereign credit rating from AA to AA-, with a stable outlook. According to S&P, the country's weak economic growth is a key reason why it will be hard to cut its debt/GDP ratio in the coming years. The firm warned that political polarization will likely preclude passing economic reforms that could boost growth and/or reduce the budget deficit.

China-Australia: Based on national security concerns identified by its Foreign Investment Review Board, Canberra has ordered funds linked to a Chinese businessman to divest or cut their stakes in an Australian rare-earths miner. The move illustrates how growing frictions between China and the West continue to sever trade, capital, and technology flows around the world. The move could also anger Beijing and reverse the recent improvement in Chinese-Australian relations.

China: The private Caixin/S&P Global purchasing managers' index for manufacturing rose to a seasonally adjusted 51.7 in May from 51.4 in April. That's in contrast with the official PMI last week, which dropped to 49.5 from 50.4. Like most major PMIs, both these are designed so that readings over 50 indicate expanding activity. Since the index from Caixin/S&P Global puts a higher weight on smaller firms, its outperformance suggests that China's smaller companies are now doing better than its bigger enterprises.

India: With official election results due out tomorrow, exit polls over the weekend showed the coalition led by Prime Minister Modi's Hindu-nationalist Bharatiya Janata Party is on track to control at least 353 of the 543 seats in the lower house of parliament. If confirmed, the results would put Modi in a position to win a third consecutive term as the nation's leader and continue his business-friendly economic policies, including strong infrastructure spending. That prospect has driven India's stock market indexes up some 3.5% so far today.

South Africa: Official results from last week's elections show the African National Congress has failed to garner a majority of votes for the first time since the end of apartheid in 1994. According to the results, the party won only about 40% of the votes, down from 58% in the 2019 elections, reflecting perceptions that it has become corrupt and arrogant. The ANC will therefore have less than a majority in parliament, forcing it to form a coalition with opposition lawmakers to form a government and potentially scaring off investors concerned about political stability.

Mexico: In elections yesterday, former Mexico City mayor and environmental scientist Claudia Sheinbaum of the ruling Morena party won the presidency with about 60% of the vote, although the final count isn't expected until later today. It appears Morena will also have a two-thirds majority in the legislature, which would allow it to push through unfinished constitutional changes favored by outgoing President Andrés Manuel López Obrador.

- Those changes include moves to increase state control over the energy industry and weaken the electoral oversight agency.

- Faced with the prospect of continued leftist policies in Mexico, investors have driven down the value of Mexican stocks and the Mexican currency. So far today, the peso (MXN) is 2.4% weaker, trading at 17.4205 per dollar ($0.0574).

US Monetary Policy: In a podcast released today, Minneapolis FRB President Kashkari said the Fed should keep interest rates high for an "extended" period, given the current strength in the economy and Americans' "visceral" aversion to consumer price inflation. The statement fits with many other recent statements by Fed policymakers indicating they are inclined to keep interest rates high for much longer than investors initially expected.

US Artificial Intelligence Industry: In a surprise move yesterday, Nvidia announced the next generation of its market leading AI processors, codenamed "Rubin," just three months after announcing its previous generation, known as "Blackwell." Amid concern about the energy consumed by Nvidia's chips, the company noted that the Rubin processors have been designed to increase energy efficiency. Nvidia's aggressive move and apparent success in innovating reduced energy consumption could well boost its stock price and the overall market today.

US Postal Service: The Postal Regulatory Commission late last week approved a five-cent hike in the price of a first-class stamp. Starting July 14, sending a first-class letter will cost $0.73, or 7.8% more than the current price. The price increase is the nineteenth since the year 2000, and the fifth in the last two years.

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
9:45	S&P Global US Manufacturing PMI	m/m	May F	50.9	50.9	***
10:00	Construction Spending MoM	m/m	Apr	0.20%	-0.20%	*
10:00	ISM Manufacturing	m/m	May	49.6	49.2	**
10:00	ISM Prices Paid	m/m	May	59.5	60.9	**
10:00	ISM New Orders	m/m	May		49.1	**
10:00	ISM Employment	m/m	May		48.6	*
	Wards Total Vehicle Sales		May	15.8	15.74m	
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	Capital Spending	y/y	1Q	6.8%	16.4%	11.0%	***	Equity bearish, bond bullish
	Jibun Bank Japan PMI Manuf	m/m	May F	50.4	50.5		***	Equity and bond neutral
Australia	Melbourne Institute Inflation	y/y	May	3.1%	3.7%		***	Equity and bond neutral
South Korea	Trade Balance	m/m	May	$4957m	$1529m	$4200m	*	Equity and bond neutral
	Exports	y/y	May	11.7%	13.8%	15.3%	***	Equity bearish, bond bullish
	Imports	y/y	May	-2.0%	5.4%	2.7%	**	Equity bearish, bond bullish
	S&P Global South Korea PMI Manuf	m/m	May	51.6	49.4		***	Equity and bond neutral
China	Caixin Manufacturing PMI	m/m	May	51.7	51.4	51.6	***	Equity and bond neutral
India	HSBC India PMI Mfg	m/m	May F	57.5	58.4		***	Equity and bond neutral
EUROPE								
Eurozone	HCOB Eurozone Manufacturing PMI	m/m	May F	47.3	47.4	47.4	***	Equity and bond neutral
Germany	HCOB Germany Manufacturing PMI	m/m	May F	45.4	45.4	45.4	***	Equity and bond neutral
France	HCOB France Manufacturing PMI	m/m	May F	46.4	46.7	46.7	***	Equity and bond neutral
Italy	HCOB Italy Manufacturing PMI	m/m	May	45.6	47.3	48.0	***	Equity bearish, bond bullish
UK	S&P Global UK Manufacturing PMI	m/m	May F	51.2	51.3	51.3	***	Equity and bond neutral
Switzerland	PMI Manufacturing	m/m	May	46.4	41.4	44	*-**	Equity bullish, bond bearish
	PMI Services	m/m	May	48.8	55.6		*	Equity and bond neutral
	Domestic Sight Deposits CHF	w/w	31-May	452.4b	452.5b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	31-May	462.0b	461.2b		*	Equity and bond neutral
Russia	S&P Manufacturing PMI	m/m	May	54.4	54.3		***	Equity and bond neutral
AMERICAS								
Canada	GDP	y/y	Mar	0.6%	0.8%	0.7%	**	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	561	-1	Up
3-mo T-bill yield (bps)	524	525	-1	Up
U.S. Sibor/OIS spread (bps)	534	534	0	Up
U.S. Libor/OIS spread (bps)	535	535	0	Up
10-yr T-note (%)	4.46	4.50	-0.04	Flat
Euribor/OIS spread (bps)	379	379	0	Down
Currencies	**Direction**			
Dollar	Flat			Up
Euro	Flat			Down
Yen	Up			Down
Pound	Down			Up
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	$81.26	$81.11	0.18%	
WTI	$77.08	$76.99	0.12%	
Natural Gas	$2.69	$2.59	3.98%	
12-mo strip crack	$21.44	$21.55	-0.50%	
Ethanol rack	$1.97	$1.97	-0.01%	
Metals				
Gold	$2,329.97	$2,327.33	0.11%	
Silver	$30.36	$30.41	-0.15%	
Copper contract	$464.35	$460.20	0.90%	
Grains				
Corn contract	$444.75	$446.25	-0.34%	
Wheat contract	$686.75	$678.50	1.22%	
Soybeans contract	$1,194.75	$1,205.00	-0.85%	
Shipping				
Baltic Dry Freight	1,815	1,801	14	

Weather

The 6-10 and 8-14 day forecasts call for warmer-than-normal temperatures along the Gulf Coast, in Texas, and the western third of the country, with cooler-than-normal temperatures across the rest of the country. The forecasts call for wetter-than-average conditions in New England, Southern Florida, and from Arkansas to the West Coast, with dry conditions along the Northern Tier states.

Data Section

US Equity Markets – (as of 5/31/2024 close)
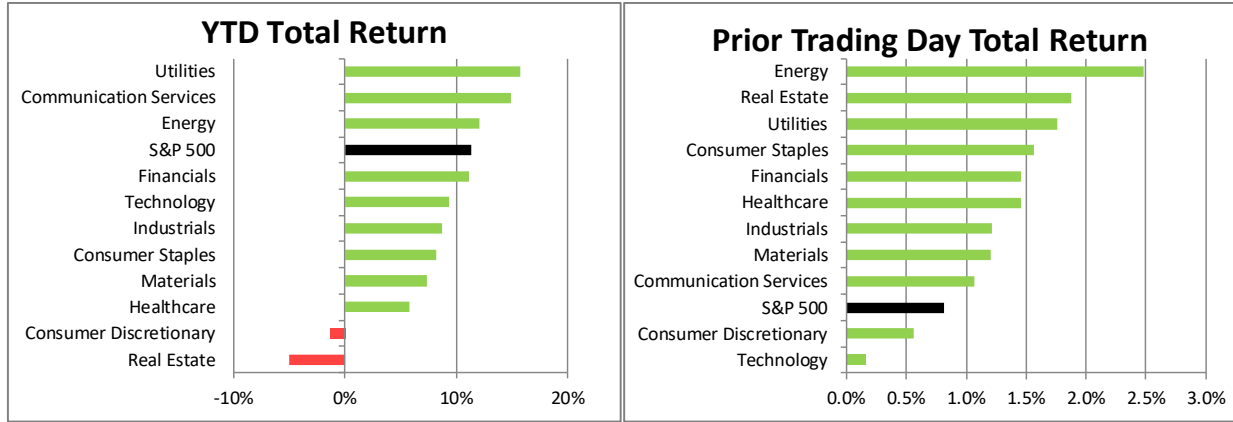
(Source: Bloomberg)

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.

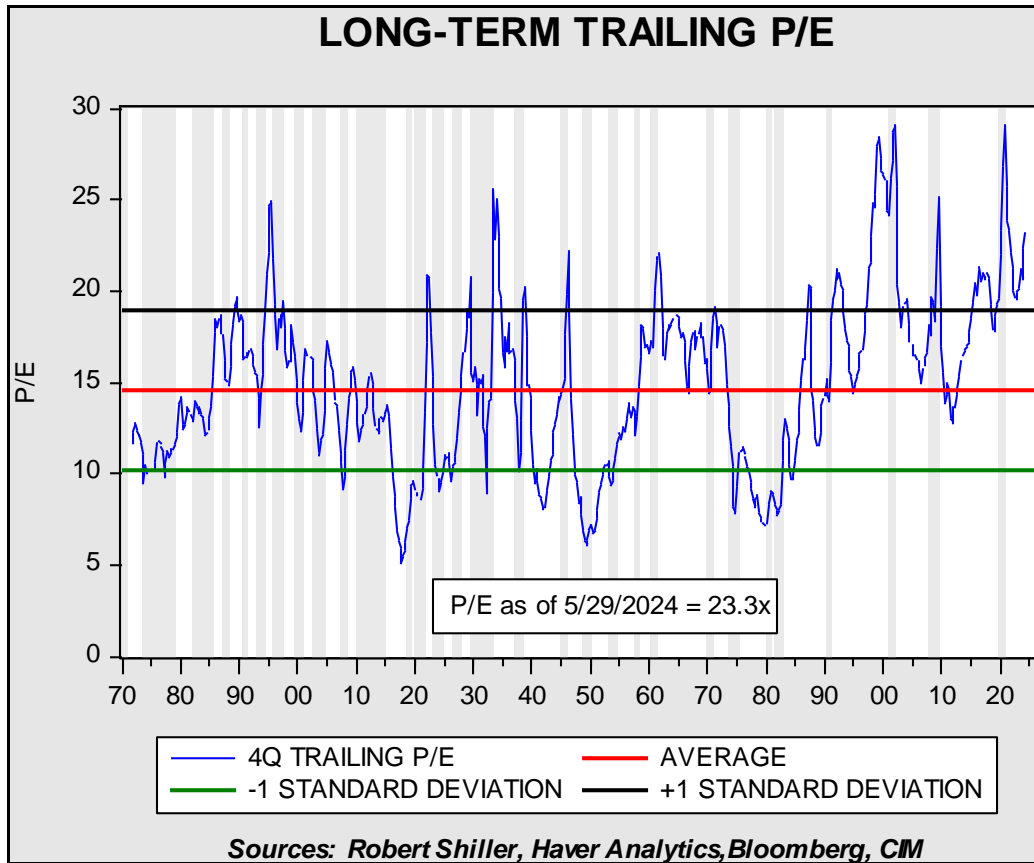**Asset Class Performance** – (as of 5/31/2024 close)
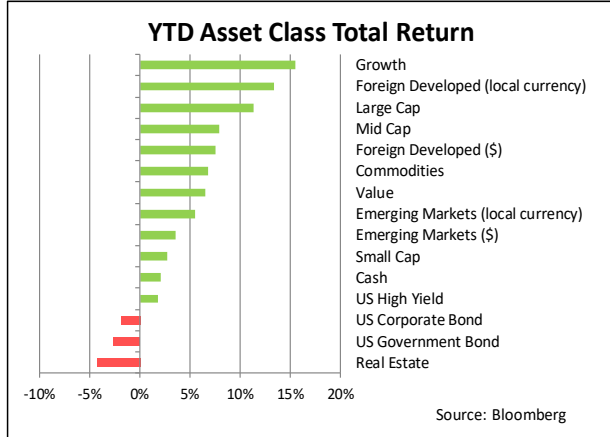
This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

May 30, 2024

LONG-TERM TRAILING P/E

P/E as of 5/29/2024 = 23.3x

- 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 23.3x, up 0.1 from our last report. The increase in the multiple was due to an increase in the stock price index, outpacing the 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.

---

[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 (Q2, Q3 and Q4) and one estimate (Q1). 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.