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 7, 2024—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is down 0.8% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.1%. Chinese markets were higher, with the Shanghai Composite up 0.1% from its previous close and the Shenzhen Composite also up 0.1%. 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* (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"

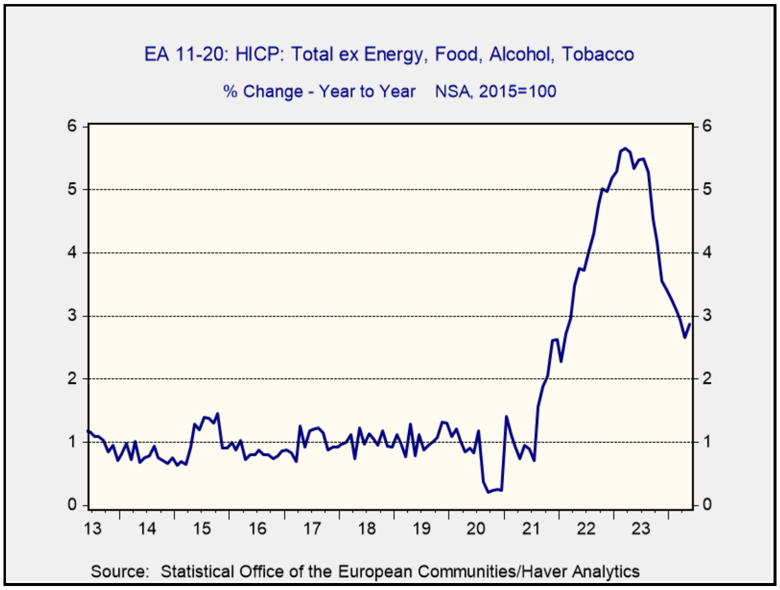
Good morning! Equities futures are down after strong employment data suggests that the economy remains robust. In sports news, the US Cricket team was able to score an upset victory over top contender Pakistan as it prepares for the World Cup. Today's *Comment* dives into the European Central Bank's latest rate decision, the recent flight to safety in the 10-year Treasury, and the ongoing investor uncertainty surrounding elections. As always, we'll wrap up with a look at key domestic and international data releases.

European Central Bank: The ECB decided to lower its benchmark policy rate on Thursday but was mum on future hikes until data provided support.

- The ECB lowered its key interest rate by 0.25% on Thursday, signaling a cautious approach to future reductions. The move was widely expected and followed weeks of hints from policymakers about their willingness to ease borrowing costs. While most council members supported the cut, there was one dissenter. Robert Holzmann, head of

Austria's central bank, believed the ECB acted too hastily given recent CPI data, which suggested a pick-up in price and wage pressures across the eurozone. Consequently, there's uncertainty about whether another rate cut will occur this year.

- The central bank's recent rate cut raises questions about the effectiveness of its tightening measures. Policymakers boosted inflation forecasts for 2024 and 2025 but held steady for 2026. The economic outlook has brightened with upwardly revised GDP for 2024 as the region recovers from the near recession of 2023. Despite a recent uptick in core CPI, which rose from 2.80% to 2.83% last month, the ECB remains confident that inflation will eventually decline. This confidence rests on its belief that the effects of past interest rate hikes are still filtering through the economy.

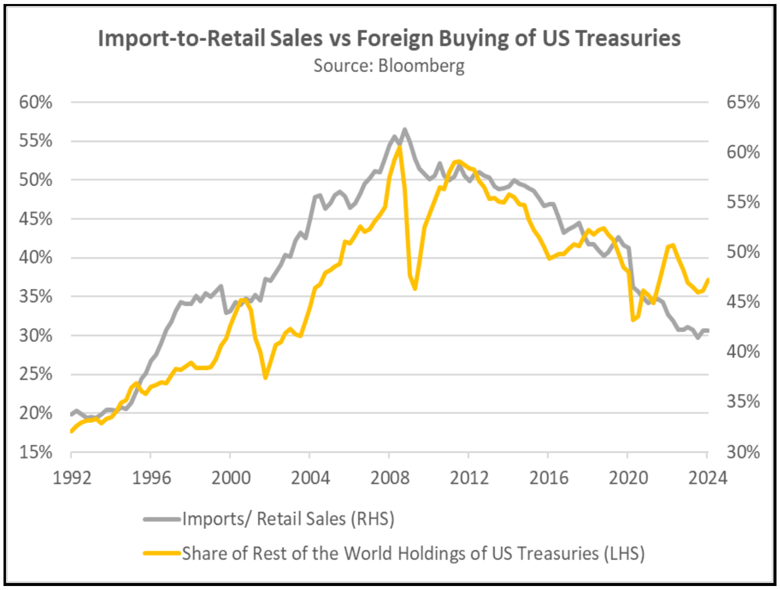


- The recent ECB rate cut could be a response to market pressures, following strong hints of a reduction in the weeks leading up to the meeting. This may lead the ECB to adopt a more cautious approach as they look to avoid boxing themselves in, or worse, be forced to make a U-turn to prevent a reacceleration in inflation. Wage pressures are in focus as they have been a key driver of service-sector inflation. However, leading economic indicators suggest a cooling labor market, potentially paving the way for one more cut later this year, as markets have anticipated. September or later seems to be the most likely timeframe.

US Treasurys: Subpar economic data has recently driven the yield on the 10-year Treasury to its lowest level in three months.

- US worker productivity rose by a modest 0.3% from the previous quarter, marking the slowest pace since early 2023. While exceeding expectations slightly, the increase reflects a broader slowdown in economic activity. This follows a string of concerning reports, particularly disappointing retail sales, job openings, and home prices. However, a glimmer of hope emerged in May. Both ISM and S&P Global PMI surveys reported a pick-up in service activity, while consumer confidence took a surprising leap. Despite these signs, the overall market sentiment leans toward slowing US GDP growth.

- Weak economic data is driving a dovish shift in investor sentiment. The 10-year Treasury yield has plunged nearly 30 bps in 10 days, reflecting hopes that the Fed can achieve a soft landing. Recent inflation reports, including April's CPI and PCE price index, showed a welcome deceleration in price pressures, suggesting inflation may be nearing the Fed's 2% target. In addition, labor's share of economic output has fallen significantly from its peak of 59% to 55%, reaching its lowest level in almost a decade. This suggests that wage pressure on inflation should continue to subside over the next few months.

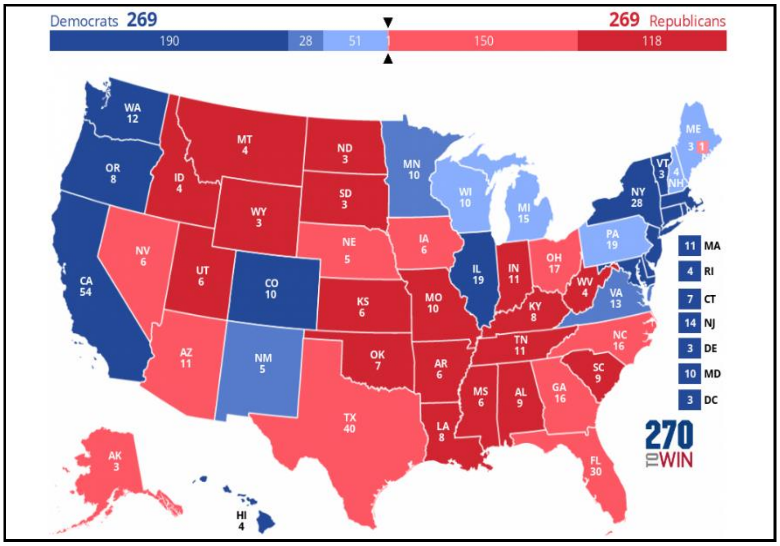


- The Federal Reserve's policy undeniably shapes long-term bond yields. However, investors shouldn't overlook the impact of geopolitical changes. Since the Great Financial Crisis, US foreign demand for Treasury bonds has fallen considerably. This loss represents a critical source of buyers who are less sensitive to interest rate fluctuations. Additionally, US reliance on imports, a major disinflationary force, has also been disrupted. Rising deficits coupled with growing trade tensions suggest a potential opportunity for investors to sell 10-year Treasurys before interest rates rise again.

Global Elections: At nearly the halfway point of the year, elections continue to present surprises, potentially causing trouble for investors.

- A notable trend has been the unexpected pushback against establishment candidates. Last week in India's elections, the Bharatiya Janata Party (BJP) was widely expected to increase its majority, but it instead suffered an embarrassing setback and was forced to form a coalition. Meanwhile, in Mexico, the overwhelming dominance of Morena also caught investors off guard. This trend is expected to carry over to Europe and the US, with elections likely to show major victories for far-right candidates, including Marine Le Pen's National Rally Party in France and the gaining popularity for former US President Donald Trump.

- The rise of less conventional candidates has yielded mixed results for emerging markets, as investors grapple with the uncertainty surrounding policy impacts. Argentine President Javier Milei initially received a positive response from markets following his victory in December, but sentiment shifted once the challenges of implementing his proposed changes became evident. India had the opposite impact as investors believed that the BJP may still be able to push its agenda despite losing seats. South African and Mexican markets have yet to recover from their recent elections, as investor pessimism persists due to a lack of clear policy direction.

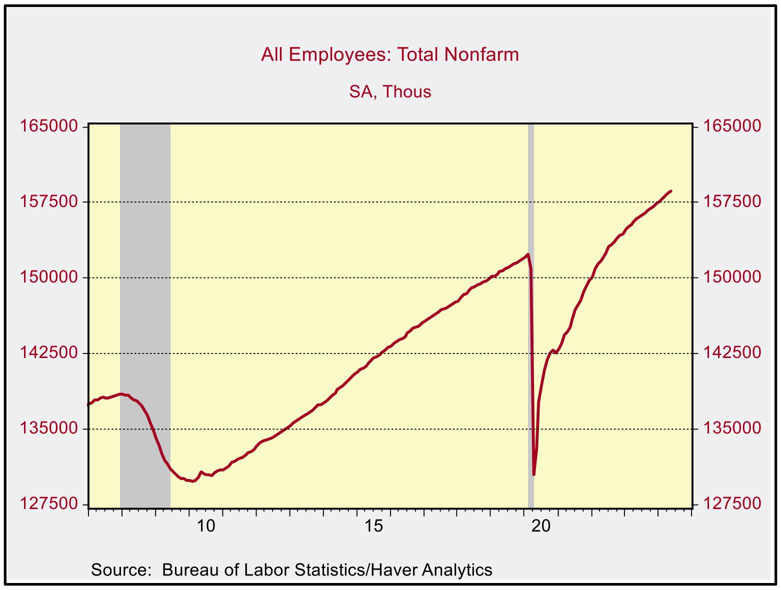


- Europe casts its first ballots this weekend, with parliamentary elections kicking off a wave of voting across the Atlantic. The UK follows next month, and the United States rounds out the year with its national elections in November. A common thread runs through these elections: anxieties over immigration, debt, and inflation. Early exit polls indicate a narrow victory for the left-wing parties in the Netherlands, with far-right candidate Geert Wilders making significant gains. Meanwhile, UK polls suggest that the Labour Party is poised to easily defeat the Tories. In the US, election polls show former President Trump leading in November, while other prediction markets show a dead heat.

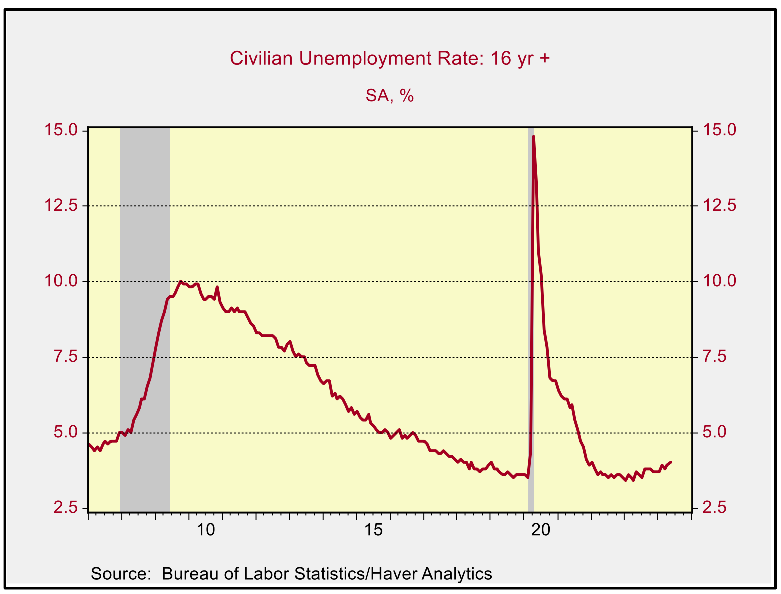
In Other News: A record heat wave in the western states could potentially weigh on economic activity in June. China is cracking down on mutual funds with large-scale audits as it continues to scrutinize the financial sector.

US Economic Releases

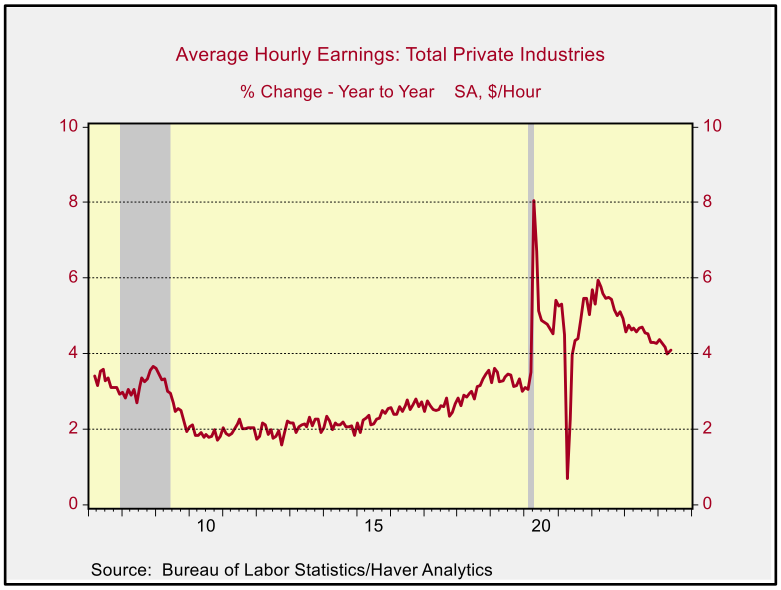
May ***nonfarm payrolls*** rose by a seasonally adjusted 272,000, well above both the expected increase of 180,000 and the downwardly revised April increase of 165,000. Most of the job gains came in the private sector, although manufacturing payrolls were only up by 8,000. The chart below shows the change in nonfarm payrolls since shortly before the Great Financial Crisis.



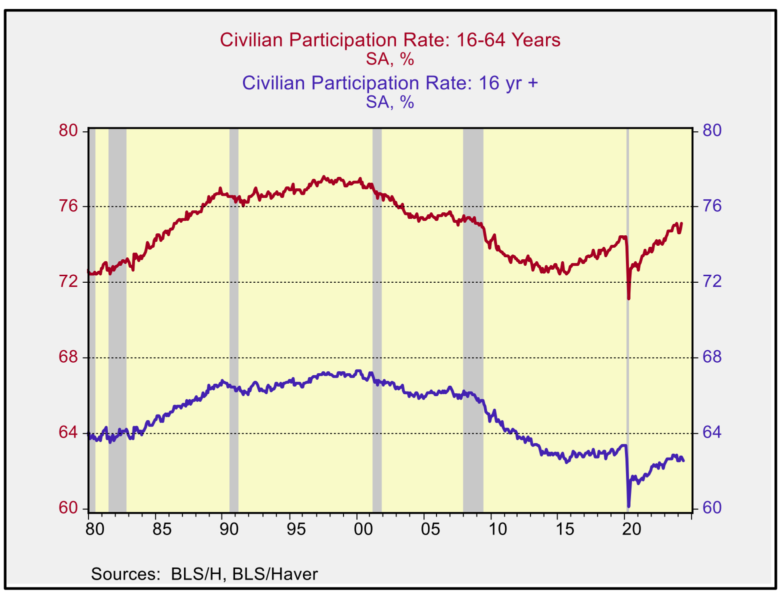
Despite the outsized increase in payrolls, the May ***unemployment rate*** rose to a seasonally adjusted 4.0%, versus expectations that it would be unchanged from April's 3.9% rate. The increase in the jobless rate stemmed largely from a big drop in the number of people in the labor force as the number of unemployed people rose modestly. The chart below shows how the unemployment rate has evolved since just before the GFC.



With payroll growth high and unemployment still relatively low, wages continue to be well supported. ***Average hourly earnings*** in May rose to a seasonally adjusted $34.91, up 4.1% from the same month one year earlier. The chart below shows the year-over-year growth in average hourly earnings since just before the GFC.



A final key indicator in the monthly employment report focuses on the share of the adult, civilian, noninstitutionalized population that is either working or looking for work. The May ***labor force participation rate (LFPR)*** dropped to a seasonally adjusted 62.5%. However, since the LFPR for working-age people remains high and even rose in May, it appears that the drop in the overall labor force last month largely reflected older people retiring or stopping work because of health or age issues. The chart below shows how the LFPRs have changed 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						
EST	Indicator			Expected	Prior	Rating
10:00	Wholesale Inventories	m/m	Apr F	0.2%	0.2%	**
10:00	Wholesale Trade Sales	m/m	Apr	0.5%	-1.3%	*
14:00	Consumer Credit	m/m	Apr	$10.000b	$6.274b	*
Federal Reserve						
EST	Speaker or Event	District or Position				
12:00	Lisa Cook Gives Commencement Speech	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	Household Spending	y/y	Apr	0.5%	-1.2%	0.5%	**	Equity and bond neutral
	Coincident Index	y/y	Apr P	115.2%	114.2%	114.5%	**	Equity and bond neutral
	Leading Economic Index	m/m	Apr P	111.6	111.7	111.6	**	Equity and bond neutral
New Zealand	Mfg Activity SA	q/q	1Q	0.7%	-0.5%		*	Equity and bond neutral
	Mfg Activity Volume	q/q	1Q	-0.4%	-0.7%		**	Equity and bond neutral
China	Foreign Reserves	m/m	May	$3232.04b	$3200.83b	$3223.5b	**	Equity and bond neutral
China	Exports	y/y	May	7.6%	1.5%	5.7%	**	Equity bullish, bond bearish
	Imports	y/y	May	1.8%	8.4%	4.3%	**	Equity bearish, bond bullish
	Trade Balance	m/m	May	$82.62b	$72.35b	$72.15b	***	Equity and bond neutral
EUROPE								
Eurozone	GDP	y/y	1Q F	0.4%	0.4%	0.4%	***	Equity and bond neutral
Germany	Industrial Production WDA	y/y	Apr	-3.9%	-4.3%	-3.0%	**	Equity bearish, bond bullish
	Trade Balance	m/m	Apr	22.1b	22.2b	22.7b	*	Equity and bond neutral
	Exports	m/m	Apr	1.6%	1.1%	1.1%	*	Equity and bond neutral
	Imports	m/m	Apr	2.0%	0.5%	0.5%	*	Equity and bond neutral
France	Current Account Balance	m/m	Apr	-1.58b	0.6b		*	Equity and bond neutral
	Trade Balance	m/m	Apr	-7579m	-5381m		*	Equity and bond neutral
Switzerland	Foreign Currency Reserves	m/m	May	717.6b%	720.3b		***	Equity and bond neutral
Russia	Gold and Forex Reserves	m/m	31-May	$599.0b	$605.9b		***	Equity and bond neutral
	Money Supply, Narrow Definition	w/w	31-May	18.14t	18.20t		*	Equity and bond neutral
AMERICAS								
Mexico	CPI	y/y	May	4.69%	4.65%	4.82%	***	Equity and bond neutral
	Core CPI	y/y	May	4.21%	4.37%	4.29%	**	Equity and bond neutral
Brazil	Imports Total	m/m	May	$21804m	$21895m	$22500m	*	Equity and bond neutral
	Exports Total	m/m	May	$30338m	$30584m	$31000m	*	Equity and bond neutral
	Trade Balance Monthly	m/m	May	8534.0	$8689m	$8500m	**	Equity and bond neutral
	FGV Inflation IGP-DI	y/y	May	0.88%	-2.32%	0.68%	**	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)	522	524	-2	Up
U.S. Sibor/OIS spread (bps)	533	533	0	Up
U.S. Libor/OIS spread (bps)	534	534	0	Up
10-yr T-note (%)	4.30	4.29	0.01	Down
Euribor/OIS spread (bps)	376	375	1	Down
Currencies	**Direction**			
Dollar	Flat			Up
Euro	Flat			Down
Yen	Flat			Down
Pound	Up			Flat
Franc	Flat			Down
Central Bank Action	**Current**	**Prior**	**Expected**	
Bank of Russia Key Rate	16.000%	16.000%	16.000%	On Forecast
RBI Cash Reserve Ratio	4.000%	4.500%	4.500%	Below Forecast
RBI Repurchase Rate	6.500%	6.500%	6.500%	On Forecast

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.

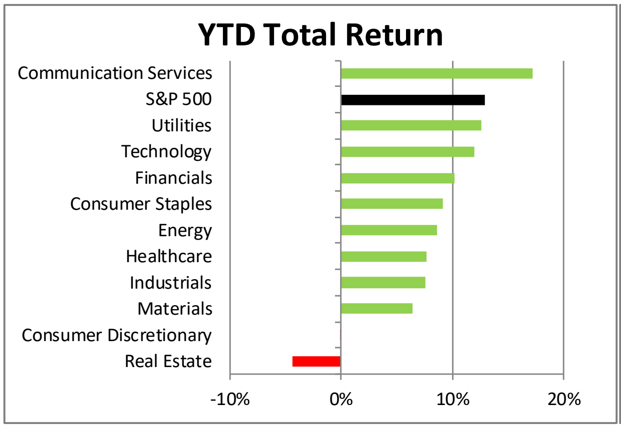
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$80.29	$79.87	0.53%	
WTI	$76.01	$75.55	0.61%	
Natural Gas	$2.86	$2.82	1.49%	
12-mo strip crack	$22.16	$22.13	0.16%	
Ethanol rack	$1.98	$1.97	0.50%	
Metals				
Gold	$2,335.27	$2,376.06	-1.72%	
Silver	$30.44	$31.33	-2.84%	
Copper contract	$457.05	$467.80	-2.30%	
Grains				
Corn contract	$450.75	$452.00	-0.28%	
Wheat contract	$628.00	$639.50	-1.80%	
Soybeans contract	$1,192.75	$1,200.00	-0.60%	
Shipping				
Baltic Dry Freight	1,869	1,852	17	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	1.23	-2.30	3.53	
Gasoline (mb)	2.10	1.70	0.40	
Distillates (mb)	3.20	2.17	1.03	
Refinery run rates (%)	1.1%	0.0%	1.1%	
Natural gas (bcf)	98	92	6	

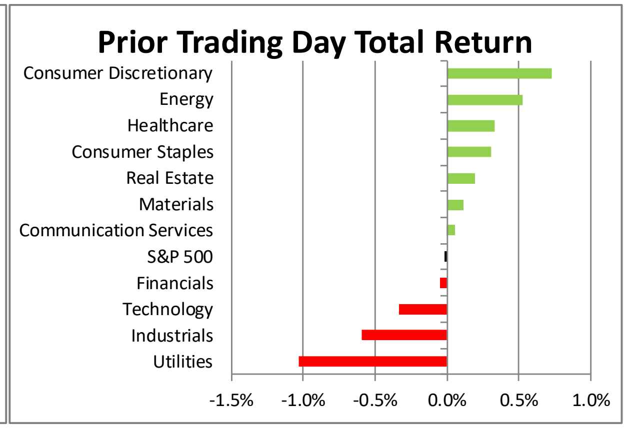
Weather

The 6-10 and 8-14 day forecasts call for warmer-than-normal temperatures in New England, Florida, the Rocky Mountains, and the Great Plains, 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 Mississippi and Ohio Valley regions.

Data Section

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

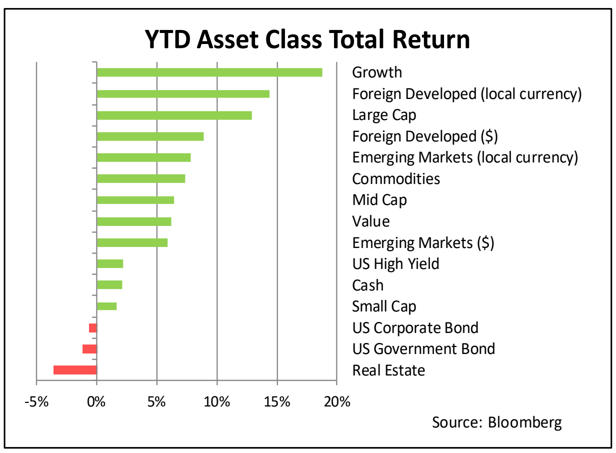




(Source: Bloomberg)

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 6/6/2024 close)

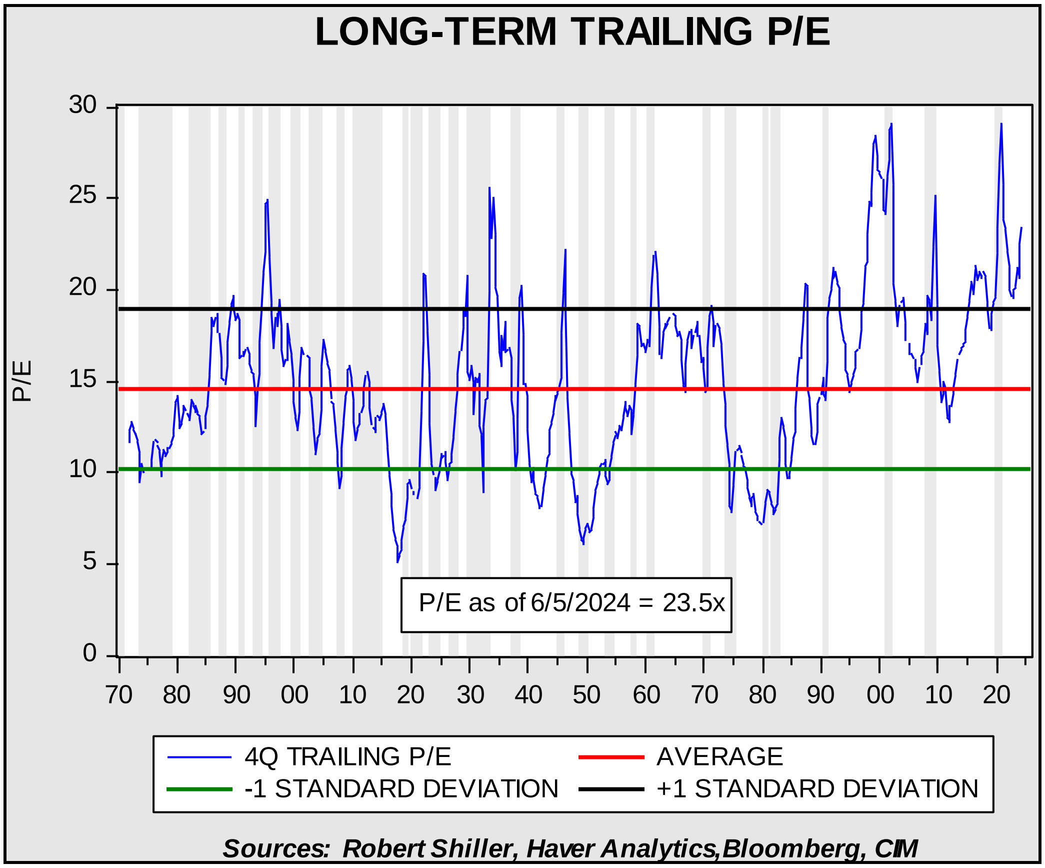


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.

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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.