

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: May 10, 2024—9:30 AM EDT]** Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is up 0.7% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.0%. Chinese markets were mixed, with the Shanghai Composite essentially unchanged from its previous close and the Shenzhen Composite down 0.7%. US equity index futures are signaling a higher open.

With 459 companies having reported so far, S&P 500 earnings for Q1 are running at \$56.20 per share compared to estimates of \$54.24, which is up 0.9% from Q1 2023. Of the companies that have reported thus far, 78.9% have exceeded expectations, while 17.0% have fallen short of expectations.

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:

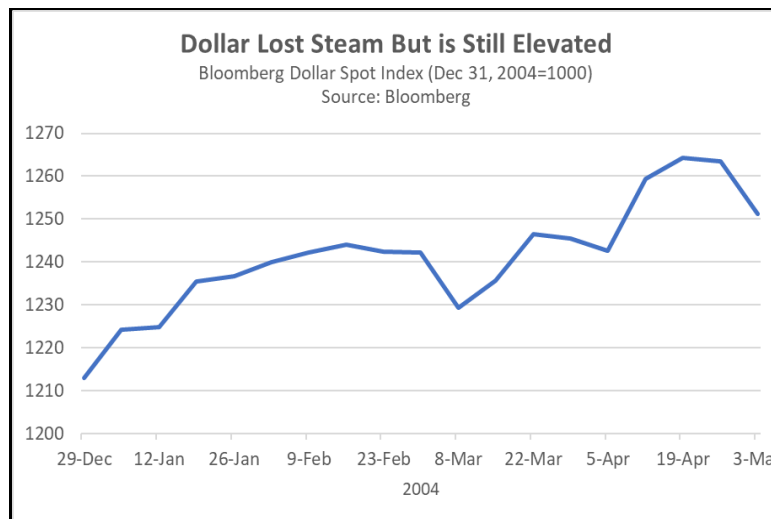
- **[Bi-Weekly Geopolitical Report](#)** (5/6/2024) (with associated [podcast](#)): “Middle East: Land of Fault Lines”
- [Asset Allocation Quarterly – Q2 2024](#) (4/25/2024): Discussion of our asset allocation process, Q2 2024 portfolio changes, and our outlook for the markets.
- [Asset Allocation Q2 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](#) (4/29/2024) (no accompanying podcast): “The Peace Dividend, Government Debt, and Yield Curve Control”
- [The 2024 Outlook: Slow-Bicycle Economy](#) (12/18/2023) (with associated *Confluence of Ideas* [podcast](#))
- [Confluence of Ideas podcast](#) (5/8/2024) “Reviewing the Asset Allocation Rebalance: Q2 2024”

Good morning! Equities are off to a great start as investors welcome signs of an economic slowdown. In sports news, the Cleveland Cavaliers scored an upset victory over the Boston Celtics last night. Today’s *Comment* explores how decisions by foreign central banks to cut rates before the US Fed will influence the dollar's strength. We also explain how recent changes to money market redemption rules will affect bond yields. Finally, the report explores the specific

difficulties Canada is facing with immigration. As always, our report concludes with a summary of recent international and domestic data releases.

**Lead from Behind:** Most central banks in the West are set to cut policy rates this summer, while US monetary policy remains in limbo.

- Central banks around the world are signaling a shift toward looser monetary policy. This week, the [Bank of England](#) joined the [Bank of Canada](#) and the [European Central Bank](#) in hinting at potential interest rate reductions in June. These follow the Swiss National Bank's recent rate cut, with [further easing expected from it this year](#). In contrast, the Federal Reserve in the United States is on a different path. It is expected [to hold rates steady at least until September](#), with most market participants anticipating cuts only later in the year, likely November or December.
- A Federal Reserve which is hawkish compared to its global counterparts could buoy the dollar, particularly given the robust growth of the US economy. In 2023, GDP growth in the US accelerated to its fastest pace in two years, while the eurozone and UK economies stagnated. This strong performance has attracted investors to the dollar, especially as the Fed signaled a more cautious approach to potential interest rate cuts earlier in March. If this trend holds, the dollar's strength against other currencies could accelerate, especially if Fed officials continue hinting at the possibility of holding rates steady or even raising them by the end of 2024.



- Nevertheless, there is still a good chance that the dollar's rise will face some resistance. Despite the Fed likely holding off on rate cuts in June, tapering quantitative tightening could ease financial pressures and lower Treasury yields. This would narrow the interest rate differential for longer-term government bonds compared to other countries. Additionally, recent data suggests a potential slowdown in US GDP growth, while some peer economies [appear to be gaining momentum](#). As a result, the divergence between interest rate and growth may narrow later this year.

**Regulatory Shift:** New SEC guidelines may help the government resolve some of its Treasury supply problems.

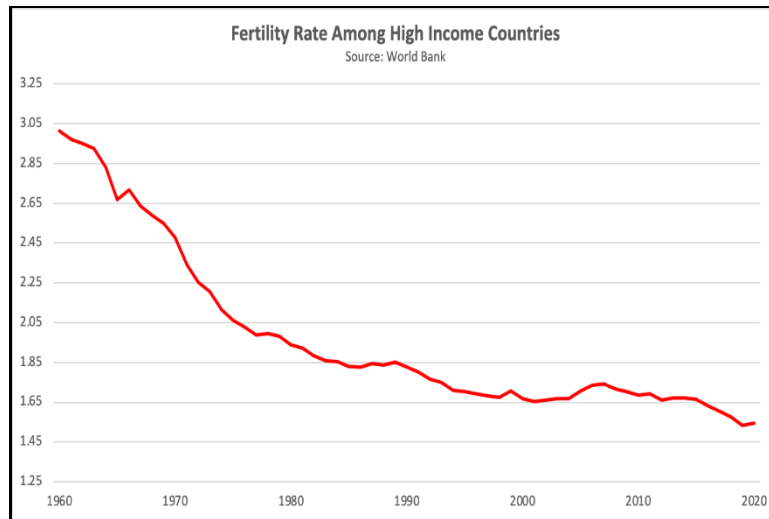
- In 2023, the [SEC implemented new rules requiring liquidity fees for investors redeeming shares from certain money market funds](#) during periods of financial stress. This regulation aims to prevent a repeat of the liquidity issues seen in March 2020 and will take effect in October of this year. To avoid these fees, some [money managers are exploring strategies to navigate the rules](#), while others have chosen to close their funds altogether. The new regulations are expected to impact roughly \$6 trillion in money market fund assets and will likely have some spillover effect into the fixed-income market.
- This rule change arrives at a critical juncture, coinciding with rising fiscal debt and a hawkish monetary policy stance. [Money market funds have surged in popularity](#) as investors seek to capitalize on both the potential for higher short-term interest rates and daily redemptions. However, with fees now attached to withdrawing funds during times of market stress, institutional investors may be forced to park more of their money at the Fed overnight facilities. This shift should allow the [Treasury to tap into additional funds as it seeks to finance government expenditures](#).



- The recent market rule change for money market funds, coupled with the observed market reaction, suggests the government may be seeking to cultivate banks and institutional investors as a primary source of demand for government debt. This shift in dynamics implies that lawmakers might be strategically using regulations to maintain the attractiveness of bonds, particularly as government issuance is expected to increase over time. If this is the case, it could help the government control yields, particularly as it prioritizes short-term debt issuance. Theoretically, this approach could help mitigate the overall rise in government borrowing costs, which should improve financial conditions.

**Build It, They Will Come:** A Canadian solution to its demographic problem has mixed results as the government looks for a middle ground.

- This year, Canada is adjusting its immigration approach to address strains on social services and housing. The [government is taking steps to manage immigration levels](#) by limiting student visas, reducing admissions of temporary foreign workers, and capping the number of permanent residents. This shift marks a change from Canada's previous focus on attracting immigrants to offset its demographic challenges caused by an aging population and low birth rates. Notably, immigration fueled a significant portion of Canada's population growth in 2023, with nearly 98% of the 3.2% increase coming from newcomers.
- Despite recent adjustments to its immigration policy, Canada's focus on attracting skilled workers has yielded positive results. [Immigration in the first quarter of 2024 significantly boosted the workforce in skilled trades](#), with 13 occupations seeing their numbers double the average of the previous year. This influx of skilled labor has helped address the shortage of construction workers, a crucial factor in Canada's plans to ramp up residential construction and tackle the housing shortage. The Royal Bank of Canada predicts that it will need an additional 500,000 workers by 2030 to help balance the housing market.



- Canada's recent adjustments to its immigration policy highlight the demographic challenges facing many developed nations. Strict immigration policies, coupled with low birth rates, could strain government finances in the future. As a result, repaying the debt might necessitate unpopular measures like austerity or higher taxes. To address these challenges, governments might explore coordinated monetary policies. However, this approach could lead to unintended consequences like inflation or lower consumption. The market environment has generally benefited commodity assets as investors look to real goods during times of uncertainty.

**In Other News:** President Biden [is preparing to impose tariffs on Chinese EVs](#) as he seeks to prevent Beijing from dumping its overcapacity into the US. Separately, Israeli Prime Minister Benjamin Netanyahu [has vowed that his country is willing to stand alone](#) as it looks to defend itself from Hamas.

## US Economic Releases

No major US economic reports have been released so far today. 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	U. of Michigan Consumer Sentiment	m/m	May P	76.2	77.2	***
10:00	U. of Michigan Current Conditions	m/m	May P	79.0	79.0	**
10:00	U. of Michigan Future Expectations	m/m	May P	75.0	76.0	**
10:00	U. of Michigan 1-Year Inflation Expectation	m/m	May P	3.2%	3.2%	*
10:00	U. of Michigan 5-10 Year Inflation Expectation	m/m	May P	3.0%	3.0%	*
14:00	Monthly Budget Statement	m/m	Apr	\$250.0b	\$176.2b	**
Federal Reserve						
EST	Speaker or Event	District or Position				
9:00	Michelle Bowman Speaks on Financial Stability Risks	Member of the Board of Governors				
10:00	Lorie Logan Participates in Moderated Q&A	New York Federal Reserve Executive Vice President				
10:00	Neel Kashkari Participates in Q&A	President of the Federal Reserve Bank of Minneapolis				
12:45	Austan Goolsbee Speaks in Moderated Q&A	President of the Federal Reserve Bank of Chicago				
13:30	Michael Barr Gives Commencement Speech	U.S. Federal Reserve Vice Chairman for Supervision				
14:15	Neel Kashkari and Austan Gooldsbee on CNBC	Presidents of the Federal Reserve Banks of Chicago and Minneapolis				

## 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
<b>ASIA-PACIFIC</b>								
Japan	Household Spending	y/y	Mar	0.0	0.0	0.0	***	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	3-May	¥271.2b	¥544.3b	--	*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	3-May	¥268.8b	¥153.2b	--	*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	3-May	-¥1071.9b	-¥517.8b	--	*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	3-May	-¥1013.0b	-¥727.6b	--	*	Equity and bond neutral
	BoP Current Account Balance	m/m	Mar	¥3398.8b	¥2644.2b	¥3454.6b	***	Equity and bond neutral
	BoP Trade Balance	m/m	Mar	¥491.0b	-¥280.9b	¥549.6b	**	Equity and bond neutral
New Zealand	BusinessNZ Manufacturing PMI	m/m	Apr	48.9	46.8		***	Equity and bond neutral
India	Industrial Production	y/y	Mar	4.9%	5.7%	5.2%	***	Equity and bond neutral
<b>EUROPE</b>								
Italy	Industrial Sales WDA	y/y	May	-1.7%	-3.9%		*	Equity and bond neutral
	Industrial Production WDA	m/m	Mar	-3.5%	-3.3%		***	Equity and bond neutral
UK	GDP	y/y	1Q P	0.2%	-0.2%	0.0%	***	Equity and bond neutral
	Industrial Production	y/y	Mar	0.5%	1.0%	0.3%	***	Equity and bond neutral
	Manufacturing Production	y/y	Mar	2.3%	2.6%	1.7%	**	Equity bullish, bond bearish
	Construction Output	m/m	Mar	-2.20%	-2.00%	-1.10%	**	Equity bearish, bond bullish
	Visible Trade Balance	m/m	Mar	-£13967m	-£14133m	-£14450m	**	Equity and bond neutral
	Trade Balance	m/m	Mar	-£1098m	-£1478m	-£2100m	**	Equity and bond neutral
<b>AMERICAS</b>								
Mexico	Industrial Production	y/y	Mar	-3.0%	3.3%	-2.9%	***	Equity and bond neutral
	Manufacturing Production	y/y	Mar	-5.0%	2.3%	-3.2%	*	Equity and bond neutral
Brazil	IBGE Inflation IPCA	y/y	Mar	3.69%	3.93%	3.66%	***	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)	559	558	1	Up
3-mo T-bill yield (bps)	524	524	0	Up
U.S. Sibor/OIS spread (bps)	532	532	0	Up
U.S. Libor/OIS spread (bps)	534	534	0	Up
10-yr T-note (%)	4.47	4.45	0.02	down
Euribor/OIS spread (bps)	381	381	0	Down
Currencies	Direction			
Dollar	Flat			Up
Euro	Flat			Flat
Yen	Down			Down
Pound	Flat			Down
Franc	Down			Down
Central Bank Action	Current	Prior	Expected	
Bank of Mexico Overnight Rate	11.000%	11.000%	11.000%	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.

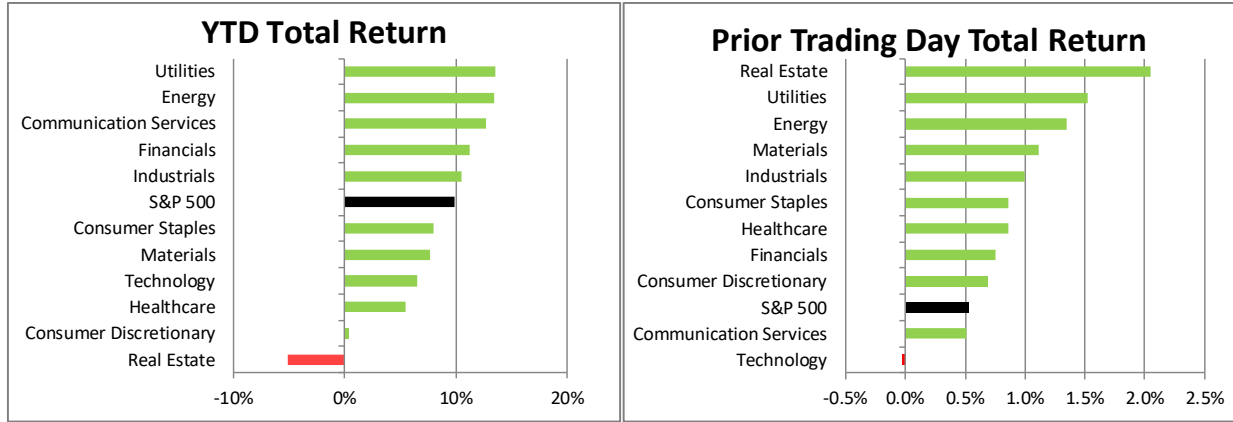
DOE Inventory Report	Price	Prior	Change	Explanation
<b>Energy Markets</b>				
Brent	\$84.32	\$83.88	0.52%	
WTI	\$79.77	\$79.26	0.64%	
Natural Gas	\$2.30	\$2.30	-0.22%	
12-mo strip crack	\$22.86	\$22.93	-0.28%	
Ethanol rack	\$1.91	\$1.91	0.17%	
<b>Metals</b>				
Gold	\$2,372.69	\$2,346.33	1.12%	
Silver	\$28.58	\$28.32	0.92%	
Copper contract	\$468.50	\$458.50	2.18%	
<b>Grains</b>				
Corn contract	\$459.25	\$456.50	0.60%	
Wheat contract	\$651.25	\$637.50	2.16%	
Soybeans contract	\$1,210.75	\$1,208.50	0.19%	
<b>Shipping</b>				
Baltic Dry Freight	2,166	2,203	-37	
<b>DOE Inventory Report</b>				
	Actual	Expected	Difference	
Crude (mb)	-1.4	-0.4	-1.0	
Gasoline (mb)	-0.7	0.9	-1.6	
Distillates (mb)	0.6	-0.8	1.36	
Refinery run rates (%)	1.0%	1.1%	-0.1%	
Natural gas (bcf)	79	86	-7	

## **Weather**

The 6-10 and 8-14 day forecasts call for warmer-than-normal temperatures from the West Coast through the Great Plains and Florida, with normal temperatures in the Midwest and Mississippi Valley regions. The forecasts call for wetter-than-average conditions from the Great Plains eastward, with dry conditions in the Rocky Mountains.

**Data Section**

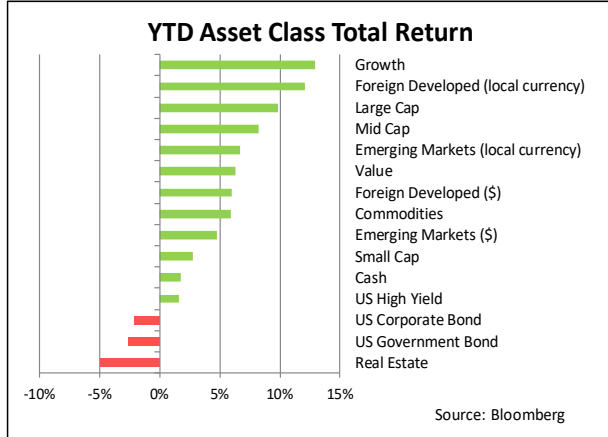
**US Equity Markets – (as of 5/9/2024 close)**



(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 5/9/2024 close)**



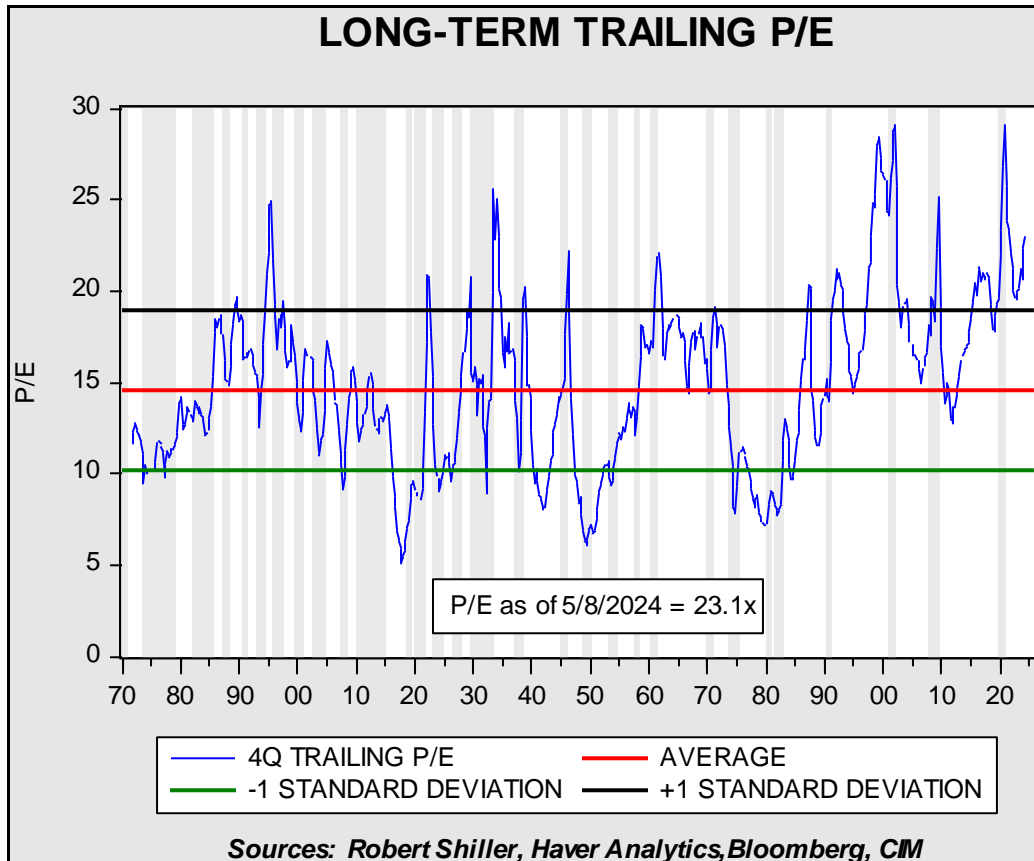
This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 9, 2024



Based on our methodology,<sup>1</sup> the current P/E is 23.1x, up 0.1x from our last report. The increase in the multiple reflects an increase in the S&P 500 Index, outweighing 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.*

<sup>1</sup> 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.