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: May 14, 2024—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is essentially unchanged from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.5%. Chinese markets were mixed, with the Shanghai Composite down 0.1% from its previous close and the Shenzhen Composite up 0.4%. US equity index futures are signaling a lower 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.

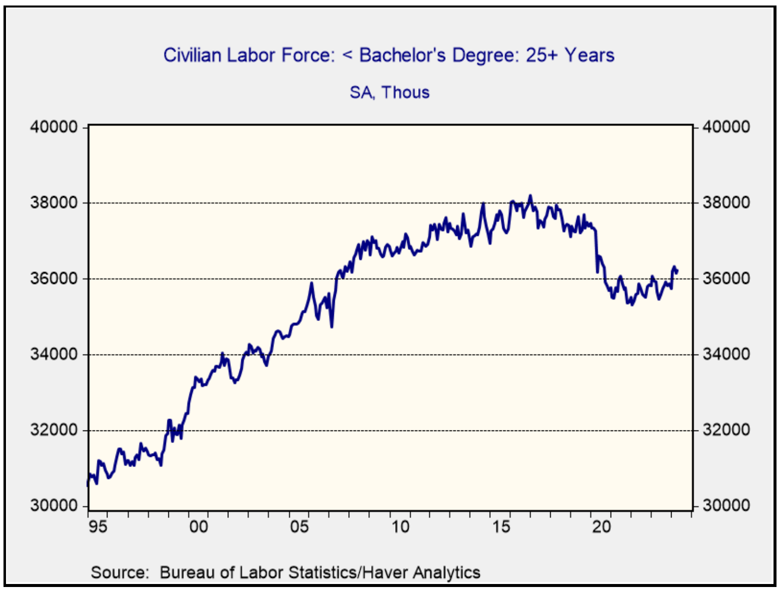
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *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* (5/13/2024) (with associated podcast): "The Immigration Paradox"
- *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! Equity futures are off to a slow start due to a hotter-than-expected PPI report. In sports news, the Boston Celtics were able to snatch a 3-1 lead in the series against the Cleveland Cavaliers. Today's *Comment* will explore why white-collar workers are facing a tough job market, explain the rise in demand for used electric vehicles despite weakening overall demand, and discuss China's potential economic stimulus measures ahead of its July Politburo meeting.

Labor Losing Leverage: While the labor market remains tight for the broader population, there are signs that certain sectors are struggling.

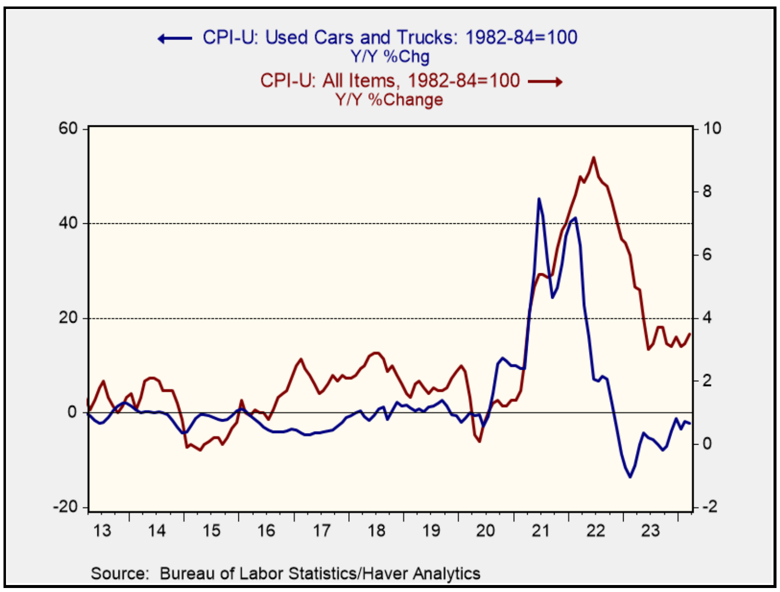
- Walmart, the country's largest employer, is set to lay off hundreds of corporate jobs and ask many of its work-from-home staff to return to the office. This shift aligns with a broader trend within the company. In April, the company announced that it plans for 65% of its stores to be serviced by automation by the end of 2026. Last year, it closed three of its tech hubs, requiring workers to relocate to other hubs in the country. This shift comes as the firm looks to shrink its workforce as a way to cut costs and improve its profitability.
- The recent cooling of the labor market has been unusual in that it has disproportionately impacted the services sector. Hiring for white-collar jobs is up 0.6% from the previous year, while the overall job market is up 1.8%. The reason for the slowdown may be related to costs. Proprietary data from Vanguard shows that the greatest demand for workers comes from jobs that pay less than $55,000 a year. This preference for low-wage workers may be related to some firms' reluctance to hold onto higher-paid workers whose skills are not essential for their current needs.



- The selectivity of the labor market may complicate the Federal Reserve's ability to balance its price stability and maximum employment mandate. Since many of these roles are relatively high-paying, laid-off workers may rely on savings before turning to government assistance. This could delay their appearance in unemployment figures and potentially raise the chance that the Fed may keep rates higher for longer than the economy can tolerate. While a hard landing is not our base case for this year, we do believe the risks are elevated given the signs of sticky inflation.

Renewable Comeback: While electric vehicle (EV) sales are hurting the bottom lines of major automakers, the used car market is seeing an uptick in the sales of EVs.

- A report from used car retailer Carvana showed that demand for EVs has more than doubled from the previous year. The demand rose by 4.8% in the last quarter, which is more than double the rate observed in the same period of 2023. The increase in sales comes amidst a surge in supply in the used car market, which has helped push the price of EVs down, making them more accessible to the typical consumer. According to the sales data, the difference in selling price for an EV and an internal combustion engine has dropped from $13,000 to $7,000.
- The rising demand for EVs comes at a time when automakers are struggling to contain a drop in profitability. Major US automaker Ford announced that it is losing $100,000 on every EV it sells, while a Kelley Blue Book report showed that new EV sales were down in the first quarter of the year. This weakness in the sector is likely driven by two factors: a surge of new EVs entering the market and waning demand from consumers. Consumers who cannot afford the high sticker price or who don't see the need for an EV due to relatively low gasoline prices are contributing to the slowdown.

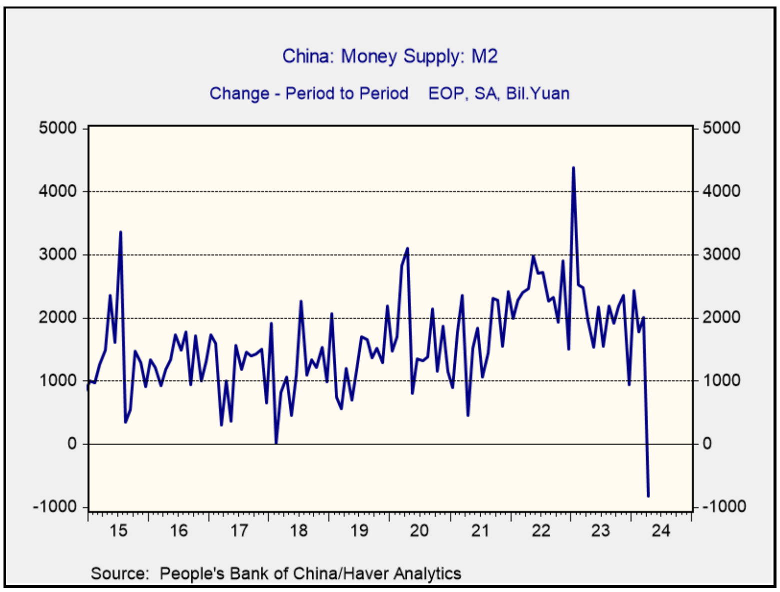


- The improved affordability of EVs will likely serve the US's needs both geopolitically and domestically. The US government is promoting a switch away from combustion vehicles as a way to wean households off their reliance on energy sources increasingly dominated by countries with hostile governments. At the same time, the drop in used car prices has been a major contributor to the decline in overall inflation. As the world fights for market share in the green energy space, we can expect volatility in the electric vehicle market.

China Boom: Beijing may use fiscal and monetary policy to help boost the economy in time for the Third Plenum.

- On Monday, China's Ministry of Finance announced plans to raise over 1 trillion CNY ($138 billion) in its fourth such issuance of long-dated bonds in 26 years. The new funds will be used to finance national strategies, including improvements to its defense capabilities and the semiconductor industry. Additionally, there is speculation that the People's Bank of China (PBOC) could use its tools to improve market liquidity by buying and selling bonds. The recent collaboration between the central authority and monetary policymakers paves the way for improved policy coordination as Beijing seeks to reassure skeptics that it can address the country's ongoing economic challenges.

- China's first-quarter economic growth surpassed expectations, but challenges persist. The prior quarter witnessed a slowdown in consumption and investment spending, fueled by a reluctance to lend by banks. The PBOC has required banks to have the capacity to absorb 16% of risk-weighted assets by 2025 and 18% by 2028. This requirement is designed to protect the broader economy from the ongoing property market meltdown and prevent it from leading to a broader financial crisis. However, this change is likely behind the unprecedented contraction in aggregate financing seen in April.

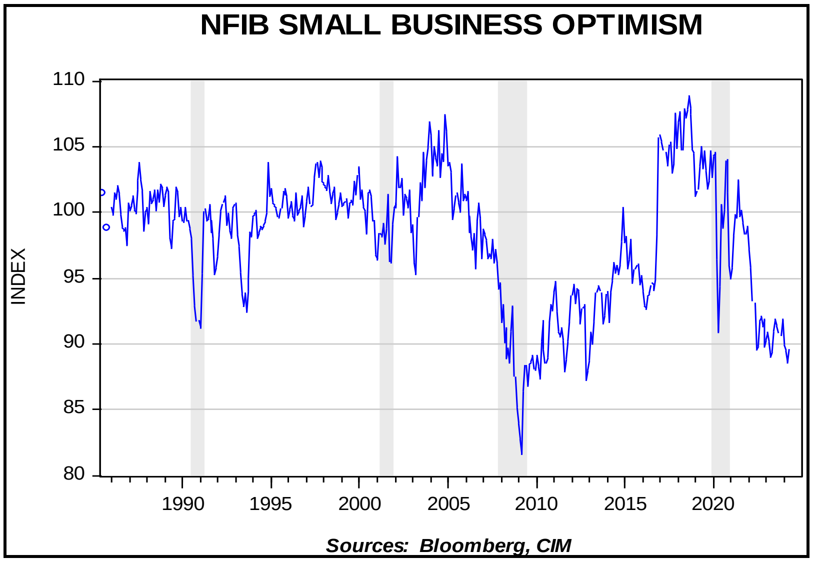


- The lack of lending by banks may explain why the government is taking a more proactive role in stimulating the economy. It likely needs to take the lead until banks improve their balance sheets. The increases in bond issuance may be a prelude to a much larger announcement at the Third Plenum. While the exact nature of the announcement remains unclear, there is a strong possibility that the government could use the funds to help stabilize the real estate market. If true, this may help give the economy an extra jolt but could also weigh on the yuan.

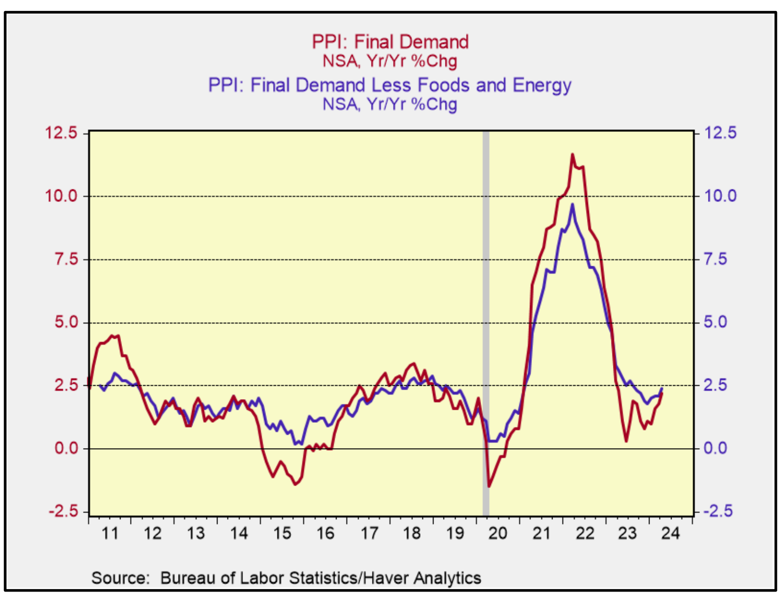
In Other News: The US and China are set to meet to discuss AI as the two sides look to prevent a possible miscalculation. The return of Roaring Kitty has led to a surge in GameStop shares, a sign that retail investors are still willing to take on risk.

US Economic Releases

The National Federation of Independent Businesses Small Business Optimism Index for April rose from 88.5 to 89.7. This marks the 28th consecutive month below its 50-year average value of 98 and its lowest value since 2012. Inflation and a tight labor market remain significant headwinds for this portion of the economy. The following chart shows the course of its value through time.



The ***producer price index (PPI)*** for April rose by a seasonally adjusted 0.5%. Excluding the volatile food and energy components, the ***"core" PPI*** for April rose 0.5% as well. The overall PPI in April rose 2.2% from the same month one year earlier, while the core PPI rose 2.4%. These results generally exceed what was expected and mark an acceleration from the prior month. Serving as a sign of continued persistent inflation, these results will likely have a depressive effect on markets, since it reduces the likelihood of near-term cuts to interest rates. The chart below shows the year-over-year change in the PPI and the core PPI over the last decade or so.



The table below lists the economic releases and/or Fed events scheduled for the rest of the day.

Economic Releases		
	No economic releases for the rest of today	
Federal Reserve		
EST	**Speaker or Event**	**District or Position**
9:10	Lisa Cook Speaks at NY Fed Event	Member of the Board of Governors
10:00	Jerome Powell and Klass Knot Speak at Event	Chair of the Board of Governors and ECB Governing Council Member

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	PPI	y/y	Apr	0.9%	0.9%	0.8%	**	Equity and bond neutral
	Machine tool orders	y/y	Apr P	-11.6%	-3.8%		**	Equity and bond neutral
New Zealand	REINZ House Sales	y/y	Apr	25.3%	8.0%		**	Equity and bond neutral
South Korea	Export Price Index	y/y	Apr	6.2%	2.3%		*	Equity and bond neutral
	Import Price Index	y/y	Apr	2.9%	-0.5%		*	Equity and bond neutral
India	Wholesale Prices	m/m	Apr	1.26%	0.53%	1.10%	**	Equity and bond neutral
EUROPE								
Eurozone	ZEW Survey Current Situation	m/m	May	47.0	43.9		**	Equity and bond neutral
Germany	CPI	y/y	Apr P	2.2%	2.2%	2.2%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Apr P	2.4%	2.4%	2.4%	**	Equity and bond neutral
	ZEW Survey Expectations	m/m	Mar	47.1	42.9	46.4	**	Equity and bond neutral
	ZEW Survey Current Situation	m/m	Mar	-72.3	-79.2	-75.9	**	Equity and bond neutral
UK	Average Weekly Earnings 3M/YoY	m/m	Mar	5.70%	5.70%	5.50%	**	Equity and bond neutral
	ILO Unemployment Rate 3Mths	m/m	Mar	4.30%	4.20%	4.30%	**	Equity and bond neutral
	Claimant Count Rate	m/m	Apr	4.10%	4.10%		**	Equity and bond neutral
	Jobless Claims Change	m/m	Apr	8.9k	-2.4k		**	Equity and bond neutral
Switzerland	Producer & Import Prices	y/y	Apr	-1.8	-2.1%		**	Equity and bond neutral
	Gold and Forex Reserves	m/m	3-May	595.7b%	$596.8b		***	Equity and bond neutral
AMERICAS								
Canada	Building Permits	m/m	Mar	-11.7%	8.9%	-4.30	**	Equity bearish, bond bullish
Brazil	IBGE Services Volume	y/y	Mar	-2.3%	2.5%	-2.5%	*	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)	558	559	-1	Up
3-mo T-bill yield (bps)	522	522	0	Up
U.S. Sibor/OIS spread (bps)	533	533	0	Up
U.S. Libor/OIS spread (bps)	534	535	-1	Up
10-yr T-note (%)	4.48	4.49	-0.01	Down
Euribor/OIS spread (bps)	383	382	1	Down
Currencies	**Direction**			
Dollar	Flat			Up
Euro	Flat			Up
Yen	Down			Down
Pound	Flat			Down
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.

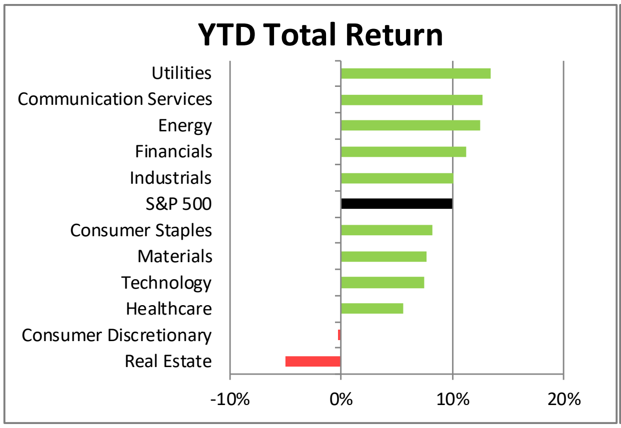
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$83.20	$83.36	-0.19%	
WTI	$78.95	$79.12	-0.21%	
Natural Gas	$2.35	$2.38	-1.34%	
12-mo strip crack	$22.29	$22.55	-1.13%	
Ethanol rack	$1.94	$1.94	0.35%	
Metals				
Gold	$2,343.87	$2,336.32	0.32%	
Silver	$28.36	$28.20	0.56%	
Copper contract	$485.40	$476.60	1.85%	
Grains				
Corn contract	$475.00	$472.50	0.53%	
Wheat contract	$683.75	$687.00	-0.47%	
Soybeans contract	$1,212.25	$1,219.50	-0.59%	
Shipping				
Baltic Dry Freight	2,066	2,129	-63	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-1.1		
Gasoline (mb)		1.0		
Distillates (mb)		0.6		
Refinery run rates (%)		0.8%		
Natural gas (bcf)		76		

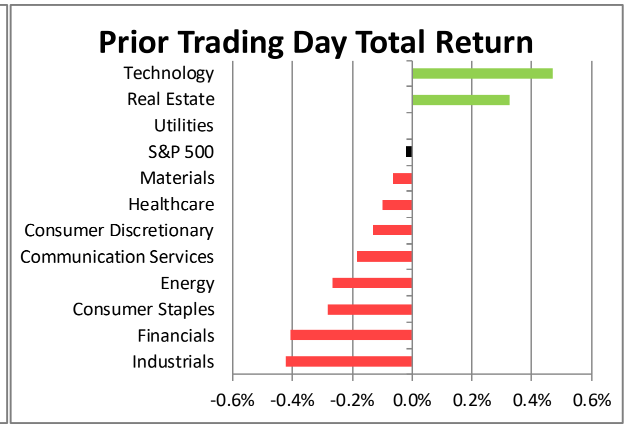
Weather

The 6-10 and 8-14 day forecasts call for warmer-than-normal temperatures throughout the Southeast and in Texas, with cooler temperatures in the northwest quadrant of the country. The forecasts call for wetter-than-average conditions for most of the country, with unusually dry conditions in New Mexico.

Data Section

US Equity Markets – (as of 5/13/2024 close)

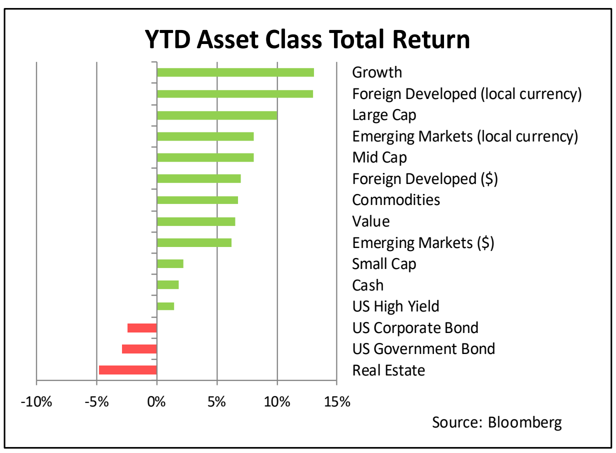




(Source: Bloomberg)

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 5/13/2024 close)

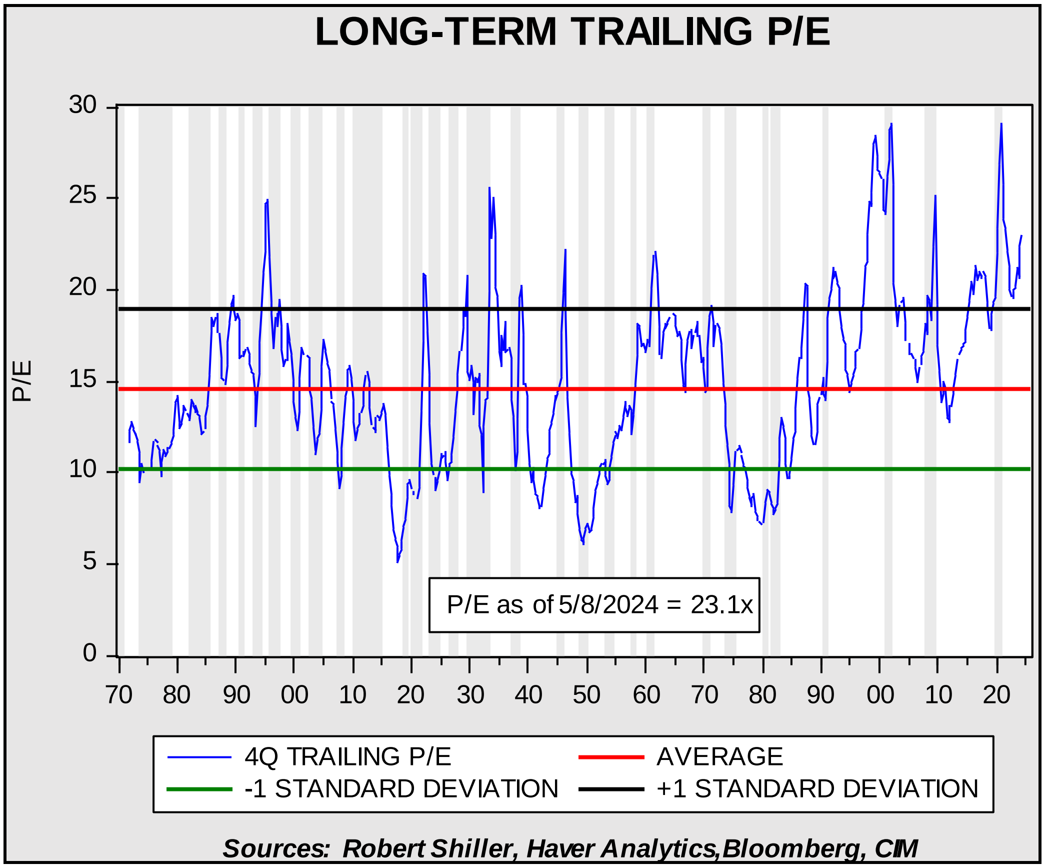


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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,[1] 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.

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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 (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.