Daily Comment

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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 15, 2024—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is up 0.1% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.7%. Chinese markets were lower, with both the Shanghai and the Shenzhen Composites down 0.8% from their previous close. US equity index futures are signaling a higher open.

With 460 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.

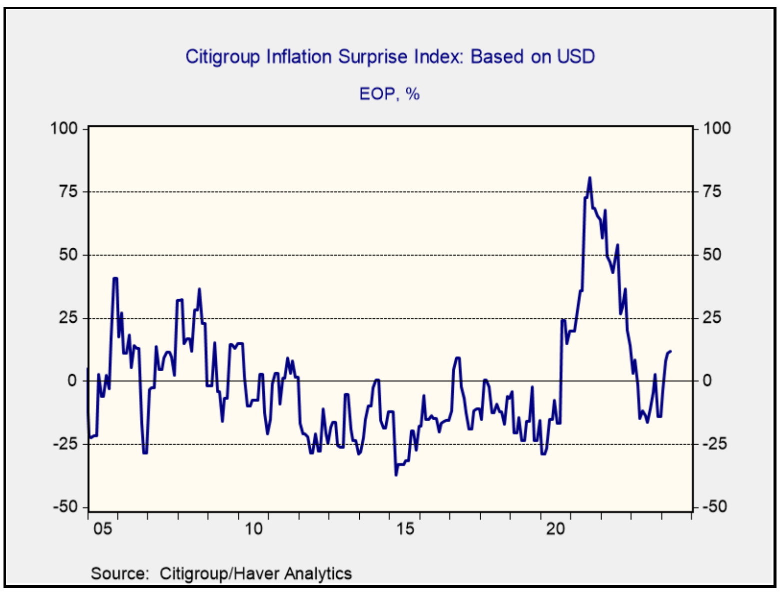
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *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! Equities futures are off to a great start as the consumer price index ended its streak of disappointments. In sports news, the Denver Nuggets took a commanding 3-2 lead in their series against the Minnesota Timberwolves. Today's *Comment* will explain why leaving rates unchanged was seen as bullish for investors on Tuesday, why young investors are drawn to risk assets, and why Turkey wants to restore trust that it can contain inflation. As usual, the report includes a summary of international and domestic data releases.

Fed Remains Calm: Federal Reserve Chair Jerome Powell has ruled out the possibility of a hike even as inflation continues to disappoint.

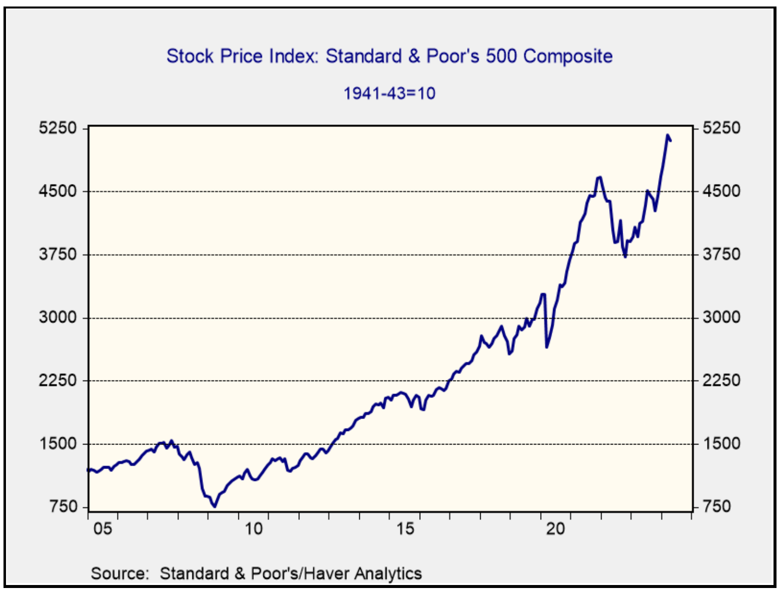
- The head of the Federal Reserve reiterated that inflation remains too high for the central bank to consider cutting rates in the near future. Speaking at the Foreign Bankers' Association, he acknowledged that disinflation, initially expected this year, hasn't progressed toward the central bank's 2% target. However, he surprised markets by indicating that the Fed's next move wouldn't be an interest rate hike. Instead, he emphasized the Fed will likely hold rates steady while the effects of current policy restrictions work their way through the economy. This downplaying of future monetary tightening boosted market sentiment, as investors continue to price in two rate cuts starting in September.
- Powell's comments coincide with the release of a hotter-than-expected producer price index (PPI). The index for input costs rose 0.5% in April, exceeding expectations of a 0.2% increase. Despite the concerning reading, the data offered a glimmer of hope. A downward revision of the previous month's number, from a 0.2% increase to a 0.1% decline, tempered the impact of the hot report. Additionally, the components feeding directly into the PCE price index, the Fed's preferred inflation gauge, showed a mixed bag, suggesting consumer inflation may still align with forecasts.



- Even with Powell downplaying the possibility of a rate hike, the threat remains significant. Historically, the Fed has tended to manage market expectations; thus, consistent inflation readings exceeding investor forecasts could force them to act. A positive sign is that core PCE has largely met market expectations and may still fall within the range of the 2.5% terminal rate outlined in the Fed's summary of economic projections. So far, our worst-case scenario is no rate change at all this year. However, if inflation continues to run hot, we may revise our forecast to include a possible hike at the beginning of 2025.

Meme Rally Back: In an attempt to close the wealth gap with other generations, some younger investors may be turning to riskier assets in hopes of higher returns.

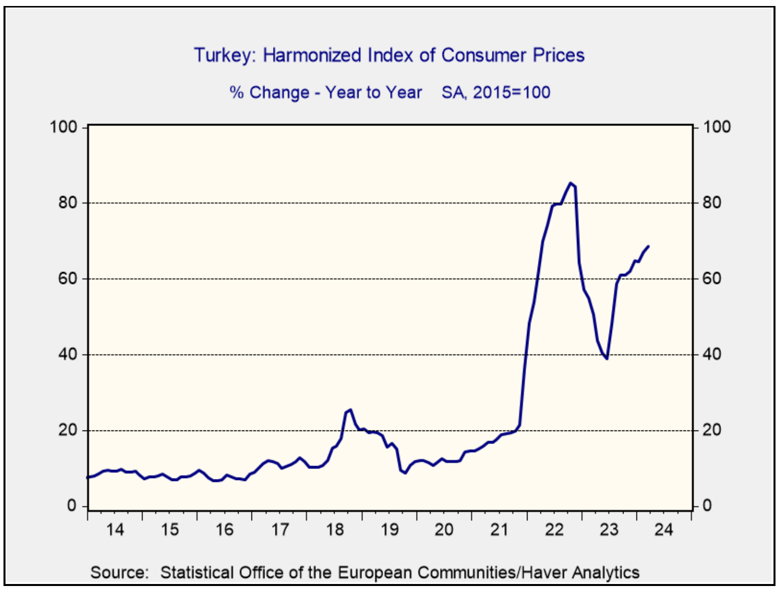
- The return of Roaring Kitty has led to another frenzy in the markets. The social media icon helped lead a charge of retail investors to squeeze hedge funds looking to profit from shorts. He has become a cult figure following the GameStop fiasco and the movie documenting it called *Dumb Money*. This return has led investors to flock to GameStop and AMC, with those stock prices each rising 30% on Tuesday. Despite the attractive yields offered by traditionally safe assets like Treasurys, Roaring Kitty's return highlights that risk appetite remains relatively high among investors.
- Limited savings, coupled with rising interest rates and home prices, may be pushing some investors, particularly millennials, towards riskier assets. The stock market appears to be an attractive option for faster financial growth, since it offers an alternative to traditional homeownership, which has become increasingly difficult to achieve for millennials. Supporting this trend, a 2023 National Association of Realtors survey shows the average first-time homebuyer is 35, while a World Economic Forum survey reveals that 70% of retail investors are under 45. Thus, preference for risk assets may be a generational trend.



- While Roaring Kitty's return might be a temporary market ripple, his influence highlights the ongoing investor appetite for stocks as a store of value. The lack of savings suggests younger generations may be more willing to take on risk to build their retirement funds. This could lead to less sophisticated investors having a greater impact on market prices compared to in the past. While strong fundamentals remain the key to sustainable growth, investors should be aware that bubbles may still form even in a rising interest rate environment.

Turkey's Inflation Fight: The country is looking for ways to win back investor confidence as it tackles surging inflation.

- On Tuesday, Turkish Finance Minister Mehmet Şimşek hinted that the government may be willing to implement tough fiscal measures to restore price stability. During an interview at the Qatar Economic Forum, he implied that President Recep Tayyip Erdoğan may be willing to tolerate slower growth as he looks to place the Turkish economy on a sustainable path. His comments come a day after investors shrugged off the government's announcement of a series of cuts to public spending of about 100 billion liras (TRY) ($3.1 billion) over the next three years. The response was due to doubts that the government would tolerate such a hit to its economy.
- The country's move to rein in its deficit stems from a decision to return to conventional economic policy. In the past, Erdoğan dismissed the idea that lower interest rates could bolster inflation, suggesting it might actually have the opposite effect. His logic hinged on the notion that higher rates would put more money in the hands of government bondholders, potentially leading to increased spending. To ensure that policymakers would follow his direction, he sacked and replaced the members of the central bank to get the policy that he desired. As a result, the annual change in inflation that year accelerated from 36% to over 80%, leading to a significant depreciation of the TRY.



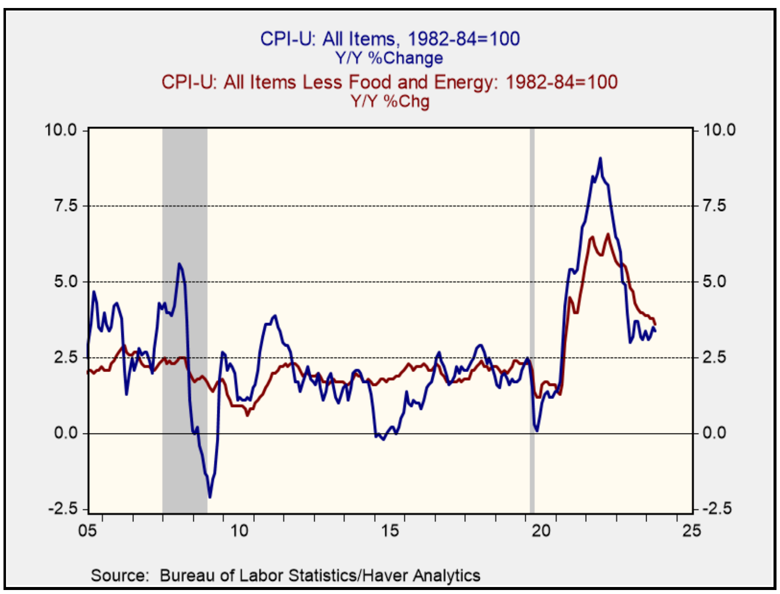
- Despite concerns over inflation, Turkey continues to boast one of the world's best-performing stock markets. The MSCI Share Price Index for Turkey is up nearly 40% year-over-year. The rally has been driven by investors seeking to protect their cash holdings from debasement, leading them to invest in stocks. However, this doesn't necessarily mean that containing inflation won't have benefits. Foreign investors still believe there may be opportunities if the country can get its fiscal house in order. As a result, it may be worth keeping an eye on Turkey as it may still have a lot of upside.

In Other News: The US announced additional funding for Ukraine in a sign that the war is likely to continue for the foreseeable future. Additionally, there is speculation that China may allow local governments to enter the housing market by purchasing homes, in a bid to reverse the country's property slump. President Biden [is set to provide $1 billion in new arm sales to Israel](), as tensions between him and Israeli Prime Minister Benjamin Netanyahu deepen.

US Economic Releases

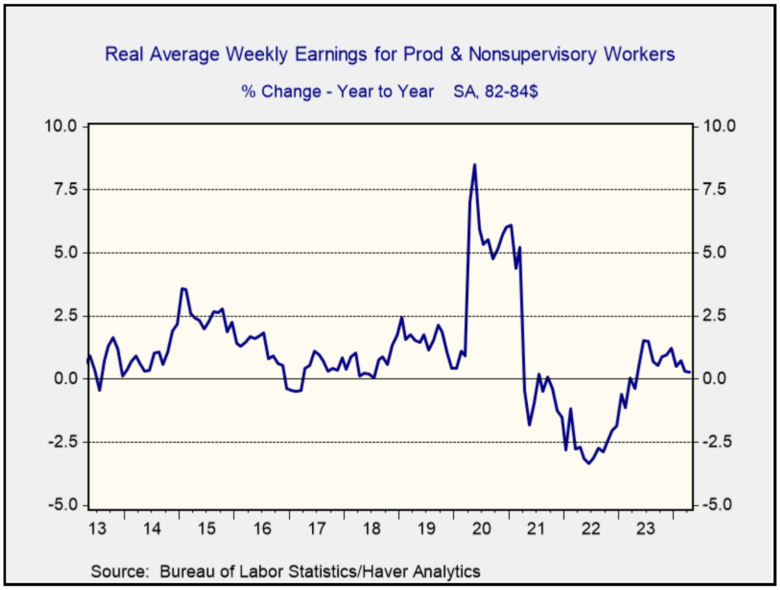
Mortgage applications inched up despite high borrowing costs. While interest rates dipped slightly last week, they remain elevated compared to recent years. According to the Mortgage Bankers Association (MBA), overall applications increased a modest 0.5% for the week ending May 10. This small rise is likely due, in part, to a 10 bps drop in the average 30-year fixed-rate mortgage, which now sits at 7.08%. As a result, the MBA purchase index, which tracks applications for new home loans, rose 1.7%, while the refinance index saw a slightly larger increase of 4.7%.

Consumer prices rose in line with expectations in a possible sign that inflation may not be on an upward swing. The consumer price index (CPI) rose 0.3% in April, below expectations and the previous month's reading of 0.4%. Excluding volatile energy and food prices, the index rose 0.3%, lower than the previous month's reading of 0.4%



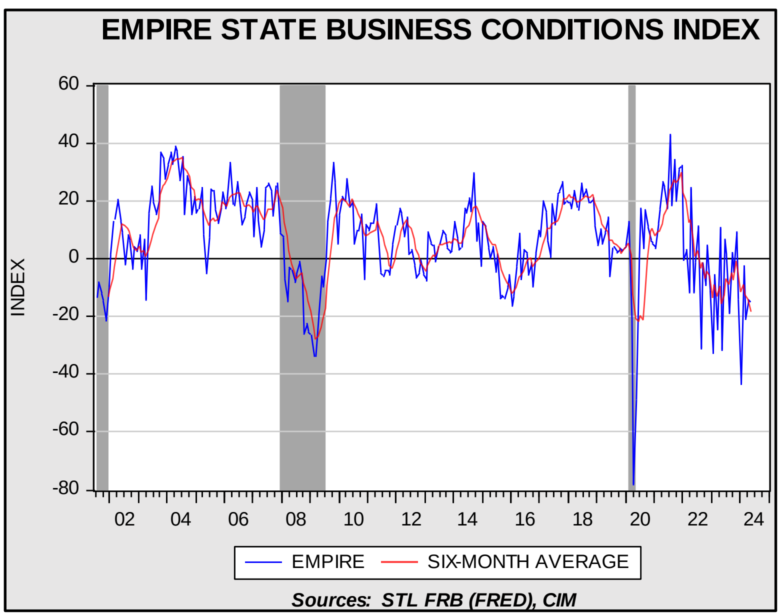
The above chart illustrates the annual change in core CPI and headline CPI. In April, core CPI moderated from 3.8% to 3.6%, while headline inflation also dipped slightly, falling from 3.5% to 3.4%. The slowdown will likely provide official reassurance that inflation will make progress toward its 2% target.

The rise in inflation has helped offset some wage increases. Real average weekly and hourly wages both increased 0.5% from the prior year. Meanwhile, the real average weekly wages for nonmanagerial workers fell 0.4% from the prior month.



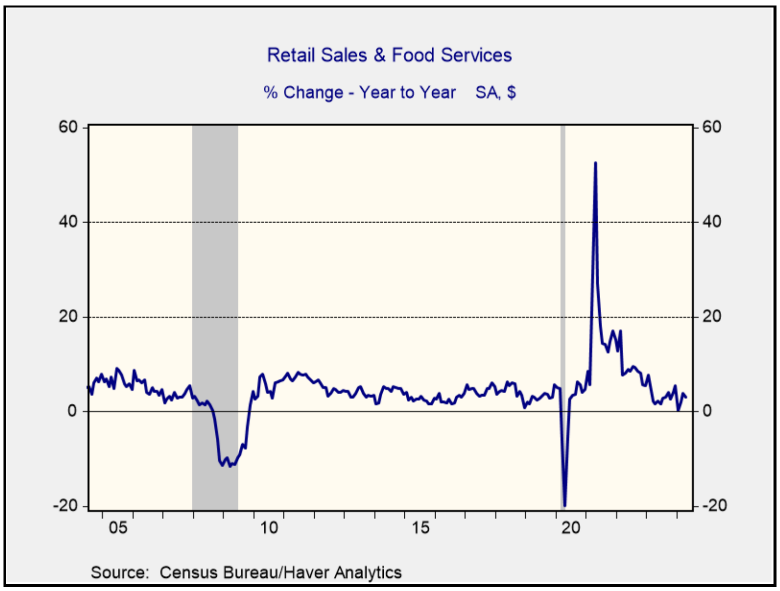
The chart above shows the year-over-year change in earnings for nonsupervisory and production workers. On a year-over-year basis, weekly wages for nonmanagerial workers have only increased 0.3% from the prior year.

Manufacturing in New York contracted for a sixth consecutive month. The Federal Reserve Bank of New York's General Business Conditions Index plunged to -15.6, worse than expectations of -10.0. Notably, the price paid component tumbled from 33.7 to 28.3, while new orders remained the biggest drag on the index, registering at -16.5.



The chart above shows the Empire State Manufacturing Index along with its six-month moving average, which fell from -14.45 to -18.57. The persistent contraction suggests that there is still weakness in the economy.

April retail sales data suggests a potential shift in consumer behavior. The overall value of purchases barely changed compared to March, indicating a muted response to rising prices. Sales excluding autos rose a modest 0.2%, meeting expectations. However, core retail sales, which exclude both autos and gasoline, dipped slightly by 0.1% from the previous month. An even stricter measure, the retail sales control group that removes building materials from the equation, saw a 0.3% decline. These figures suggest that households may be starting to rein in spending in response to inflation.



The chart above shows the annual change in retail sales. The value of retail purchases is up 3.0% from the prior year, suggesting that sales are still elevated despite last month's slow down.

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	Business Inventories	m/m	Mar	-1.0	0.4	*
10:00	NAHB Housing Market Index	m/m	May	50	51	*
16:00	Total Net TIC Flows	m/m	Mar	--	$51.6b	**
16:00	Net Long-Term TIC Flows	m/m	Mar	--	$71.5b	**
Federal Reserve						
EST	Speaker or Event	District or Position				
10:00	Michael Barr Testifies Before House Committee	U.S. Federal Reserve Vice Chairman for Supervision				
12:00	Neel Kashkari Speaks in Fireside Chat	President of the Federal Reserve Bank of Minneapolis				
15:20	Michelle Bowman Speaks on Financial Landscape	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								
Australia	Wage Price Index	m/m	1Q	4.10%	4.20%	4.20%	***	Equity and bond neutral
India	Trade Balance	m/m	Apr	-19103m	-$15598m	-$17300m	*	Equity and bond neutral
	Exports	y/y	Apr	1.1%	-0.7%		**	Equity and bond neutral
	Imports	y/y	Apr	10.3%	-6.0%		**	Equity and bond neutral
EUROPE								
Eurozone	GDP	y/y	1Q P	0.4%	0.4%	0.4%	***	Equity and bond neutral
	Employment YoY	y/y	1Q P	1.0%	1.2%		**	Equity and bond neutral
	Industrial Production WDA	y/y	Mar	-1.0%	-6.3%	-1.3%	**	Equity and bond neutral
France	CPI	y/y	Apr F	2.2%	2.2%	2.2%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Apr F	2.4%	2.4%	2.4%	**	Equity and bond neutral
	CPI Ex-Tobacco	y/y	Apr	119.01	118.4	119.03	**	Equity and bond neutral
AMERICAS								
Canada	Wholesale Sales ex Petroleum	m/m	Mar	-1.1%	0.0%	-1.30	**	Equity and bond neutral
Mexico	International Reserves Weekly	w/w	10-May	$218229m	$217713m		*	Equity and bond neutral
Brazil	Economic Activity Index	y/y	Mar	-2.18%	2.49%	-2.00%	**	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	558	0	Up
3-mo T-bill yield (bps)	523	523	0	Up
U.S. Sibor/OIS spread (bps)	532	533	-1	Up
U.S. Libor/OIS spread (bps)	534	534	0	Up
10-yr T-note (%)	4.41	4.44	-0.03	Down
Euribor/OIS spread (bps)	382	383	-1	Down
Currencies	**Direction**			
Dollar	Down			Up
Euro	Up			Up
Yen	Up			Down
Pound	Up			Up
Franc	Up			Down
Central Bank Action	**Current**	**Prior**	**Expected**	
PBOC 1-Year Med-Term Lending Facility	2.500%	2.500%	2.500%	On Forecast
PBOC 1-Year Med-Term Lending (Bil.)	125.0b	100.0b	100.0b	Above 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.

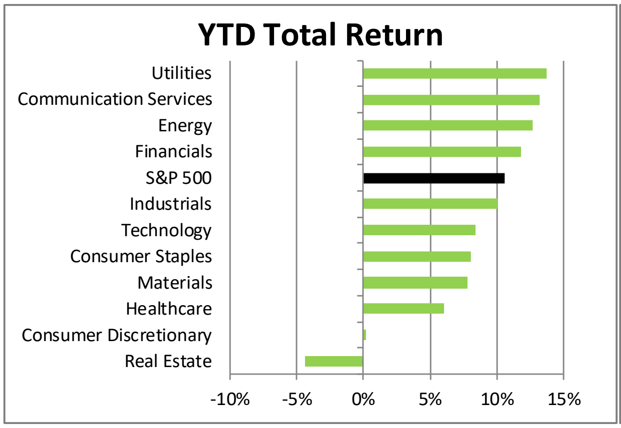
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$81.79	$82.38	-0.72%	
WTI	$77.47	$78.02	-0.70%	
Natural Gas	$2.36	$2.34	0.68%	
12-mo strip crack	$22.28	$22.19	0.44%	
Ethanol rack	$1.95	$1.95	0.03%	
Metals				
Gold	$2,362.66	$2,358.12	0.19%	
Silver	$28.78	$28.62	0.58%	
Copper contract	$498.60	$489.50	1.86%	
Grains				
Corn contract	$470.75	$467.50	0.70%	
Wheat contract	$688.00	$672.50	2.30%	
Soybeans contract	$1,220.50	$1,214.50	0.49%	
Shipping				
Baltic Dry Freight	1,993	2,066	-73	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-0.6		
Gasoline (mb)		1.0		
Distillates (mb)		0.7		
Refinery run rates (%)		0.8%		
Natural gas (bcf)		76		

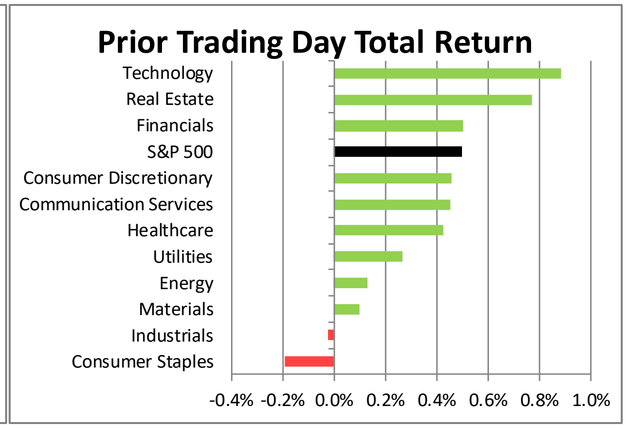
Weather

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 Pacific and Rocky Mountain regions. The forecasts call for wetter-than-average conditions for most of the country, with unusually dry conditions in the Southwest.

Data Section

US Equity Markets – (as of 5/14/2024 close)

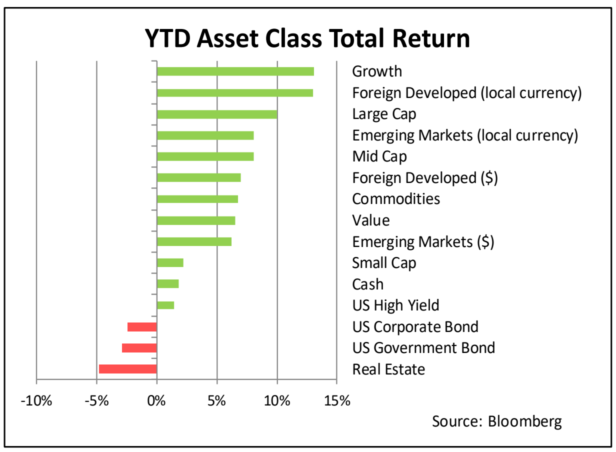




(Source: Bloomberg)

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 5/14/2024 close)

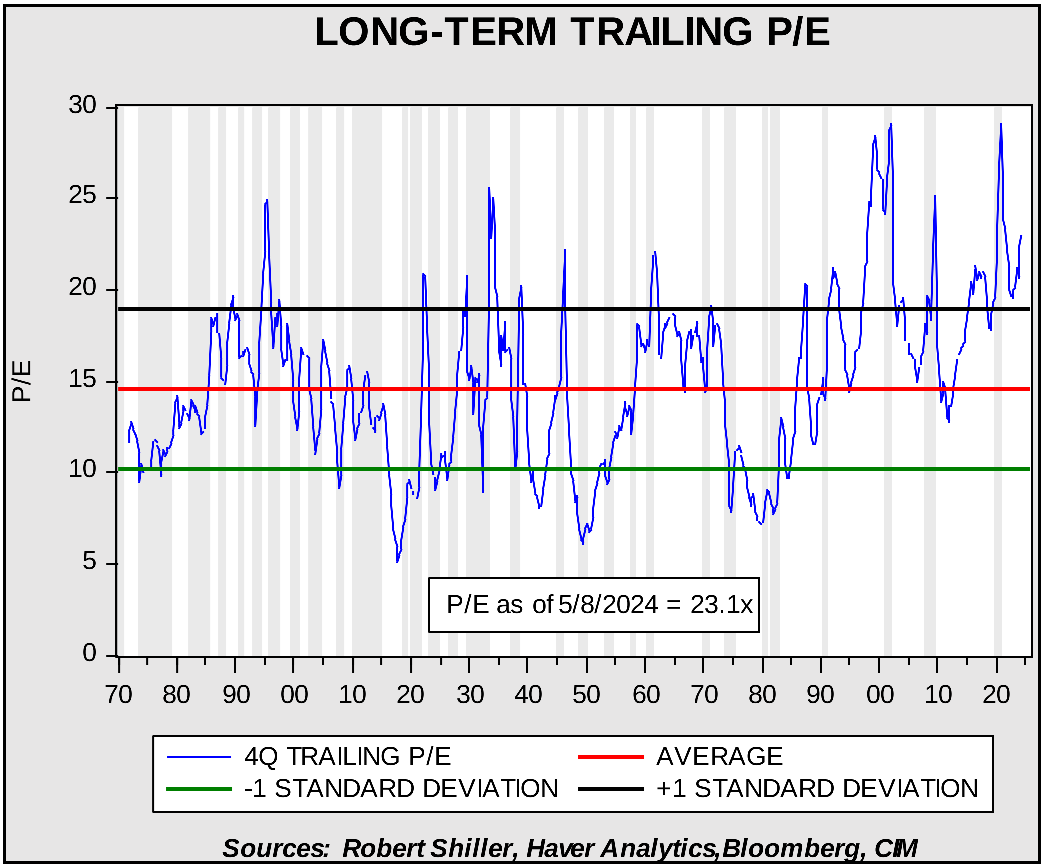


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.

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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.