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 16, 2024—9:30 AM EDT] Global equity markets are mostly higher this morning. In Europe, the Euro Stoxx 50 is down 0.2% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.5%. Chinese markets were higher, with the Shanghai Composite up 0.1% from its previous close and the Shenzhen Composite up 0.3%. US equity index futures are signaling a higher open.

With 461 companies having reported so far, S&P 500 earnings for Q1 are running at $56.30 per share compared to estimates of $54.24, which is up 0.9% from Q1 2023. Of the companies that have reported thus far, 79.0% have exceeded expectations, while 16.9% have fallen short of expectations.

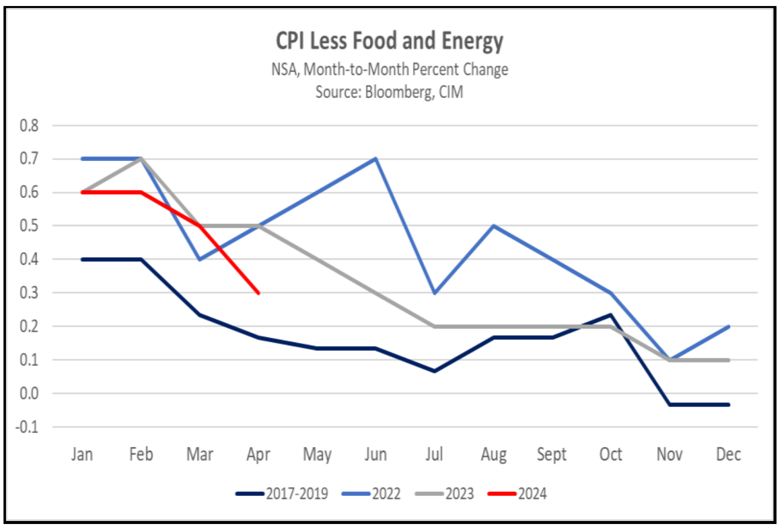
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *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"
- *Confluence of Ideas podcast* (5/8/2024) "Reviewing the Asset Allocation Rebalance: Q2 2024"

Good morning! Equity markets are calmer today after yesterday's investor enthusiasm over the inflation report cooled. In sports news, the Boston Celtics have eliminated the Cleveland Cavaliers and now advance to the Eastern Conference Finals. Today's *Comment* will examine the impact that recent economic data will have on Fed policy, explain why the first presidential debate will be historic no matter who wins, and explore rising political violence in Europe as parliamentary elections approach. As usual, the report concludes with a summary of international and domestic data releases.

There Is a Chance: Wednesday's economic data releases kept the possibility for rate cuts alive by confirming signs that demand is starting to cool.

- Inflation showed signs of cooling, while retail sales lagged. Consumer inflation eased slightly, with the Consumer Price Index (CPI) rising 3.4% year-over-year, down from 3.5% in the previous month. Core CPI, which excludes volatile food and energy prices, also slowed, increasing 3.6% year-over-year, down from 3.8% in the previous month. The slowdown may be related to weak demand. In the same month, real retail sales, which are adjusted for inflation, fell 0.3% from the previous year. Combined, the reports suggest firms may be having trouble moving volume as consumers struggle to absorb price increases.
- Weak economic data has likely kept the possibility of interest rate cuts on the table this year, making further hikes a less attractive option. Reinforcing this cautious stance, Minneapolis Fed President Neel Kashkari emphasized the need for stronger evidence that inflation is moving towards the Fed's 2% target before policymakers would consider a rate cut. So far this year, the non-seasonally adjusted CPI data, which is never revised, is currently showing that prices are trending at a slower pace than the previous two years, but still remain above the trend of the three years before the pandemic.

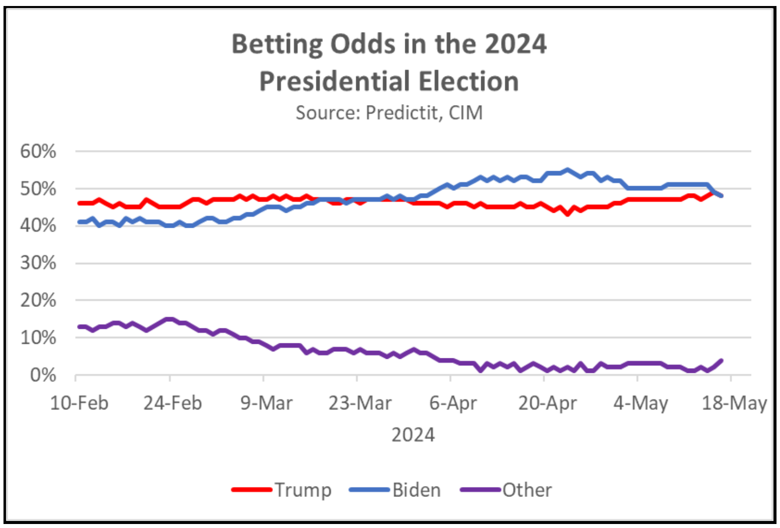


- The improvement in inflation is likely a welcome sign for Fed officials but not enough for them to consider lowering rates in June. Next week's FOMC meeting minutes may provide further clues about how committee members viewed inflation in the first quarter. Based on recent speeches, we suspect that at least one official has signaled a preference for a rate hike this year, which is unlikely to change following one month of subpar economic data and a better-than-expected inflation report. However, if this trend continues to hold over the next couple of months, sentiment could favor a September cut.

Presidential Faceoff: Prospective presidential nominees Joe Biden and Donald Trump will have their first debate next month as they look to set the tone for the election cycle.

- This will be the earliest televised presidential debate in history since the tradition began in 1960. Notably, it was announced before some states had even held their primary elections. The decision to fast-track the debate comes at a time when both candidates want to solidify their names as the leaders of their respective parties in hopes of generating more fundraising. Despite the initial bump after the State of the Union address, President Biden's approval ratings have significantly declined in recent polls. Meanwhile, former President Donald Trump has faced challenges in fundraising, largely due to ongoing legal expenses.

- An earlier debate should make it easier for the market to gauge which presidential candidate holds the advantage going into the election. The Republican candidate will likely capitalize on the perception that they are stronger on the economy and immigration issues, while the Democratic candidate will likely emphasize the strength of the labor market and the protection of women's reproductive rights. Although polls currently show that former President Trump has an advantage over President Biden in most swing states, the prediction market, which was a more reliable predictor during the 2020 election, indicates a dead heat with Biden holding a 2-point electoral lead.



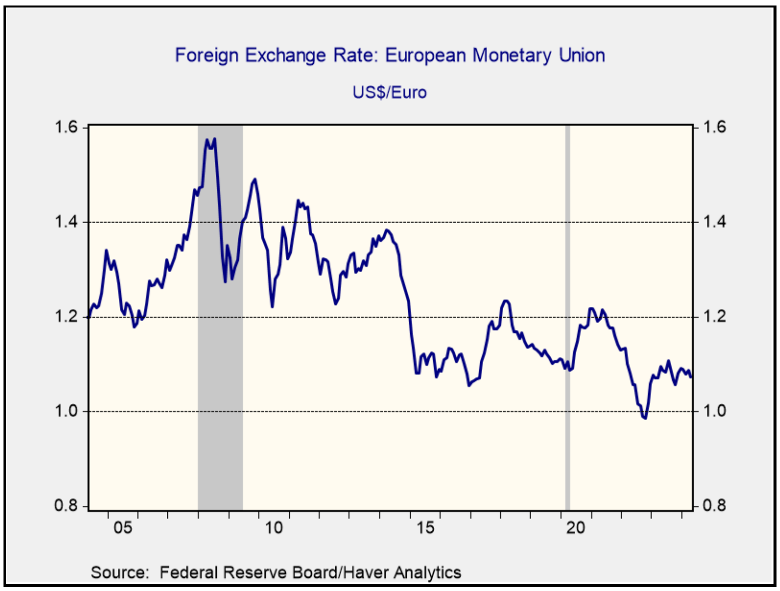
- This election is likely to be a toss-up, given that these candidates remain quite unpopular. This explains why both candidates are still facing a notable amount of protest votes during the primary contests. As a result, we suspect that the market is still underpricing the threat that a third-party candidate who has been excluded from the debate, Robert Kennedy, Jr., will have on the outcome of the election. His rising popularity, especially among fringe voters, has allowed him to pull votes from both sides. Currently, there is an elevated chance that the two major candidates will not reach the 270 votes needed to secure victory, which could lead to some market uncertainty.

European Violence: Attacks on government officials have started to pick up across Europe as the bloc prepares for parliamentary elections.

- On Wednesday, Slovakian Prime Minister Robert Fico was shot after leaving a government meeting. The politician's condition appears to be improving following the incident, although he is still considered to be in critical condition. The assassination attempt comes a week after two German lawmakers were attacked at two separate events.

These violent acts have likely added another level of complexity to European elections that are set to take place June 6-9. So far, lawmakers have sought to limit the gatherings of extreme groups due to concerns that it may lead to more hostilities.

- Recent violent acts in Europe raise questions about a potential link to the ongoing tensions surrounding the Russia-Ukraine conflict. Notably, Fico has publicly supported Russian President Vladimir Putin and is closely aligned with Hungarian President Viktor Orbán. In contrast, the recently targeted German politicians belonged to a coalition government that endorsed sending weapons to Ukraine. Tensions are high following speculation that Moscow has recruited extremists to launch attacks on European infrastructure.

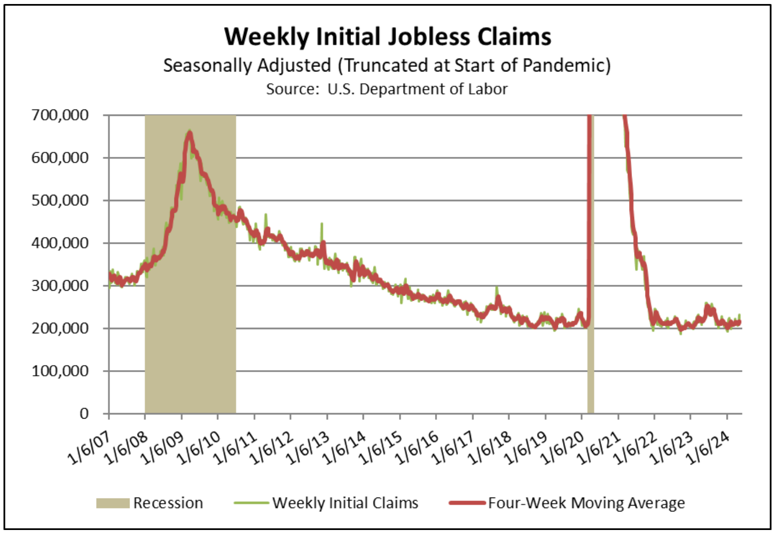


- The potential for rising conflict in Europe, particularly between pro-Moscow and anti-Moscow parties, has been largely ignored. These opposing sides have increasingly resorted to hostile tactics, reflecting the deep divide over Europe's role in the Ukrainian conflict. While Ukraine's supporters, particularly those among European leaders, remain vocal, it's clear that Putin also has allies. As the conflict between Ukraine and Russia extends beyond two years, the situation is likely to deteriorate further. Escalating tensions could weigh heavily on the euro, potentially leading to further supply chain disruptions and raising the specter of a direct confrontation.

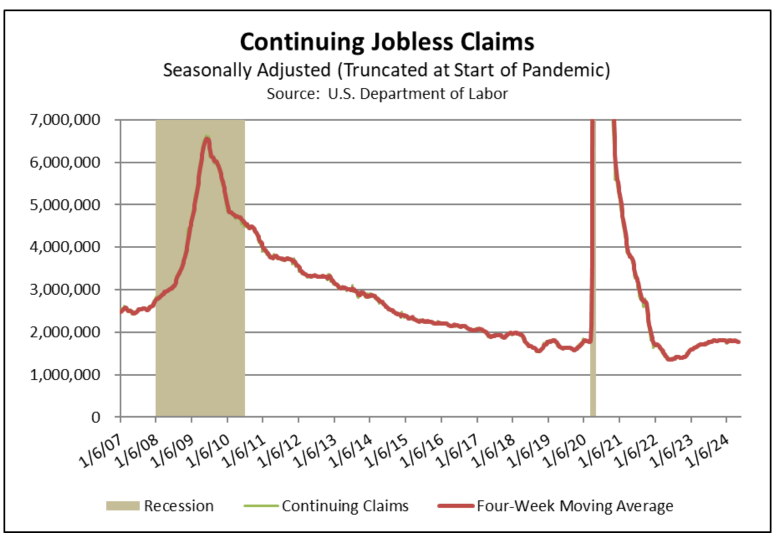
In Other News: President Putin and Chinese President Xi Jinping have renewed their vow to cooperate with each other in limiting the US's influence in the world. While the agreement is nothing new, it serves as a reminder of the two countries' unshakeable bond. Copper prices surged to a record high in a sign that the global economy may be starting to pick up.

US Economic Releases

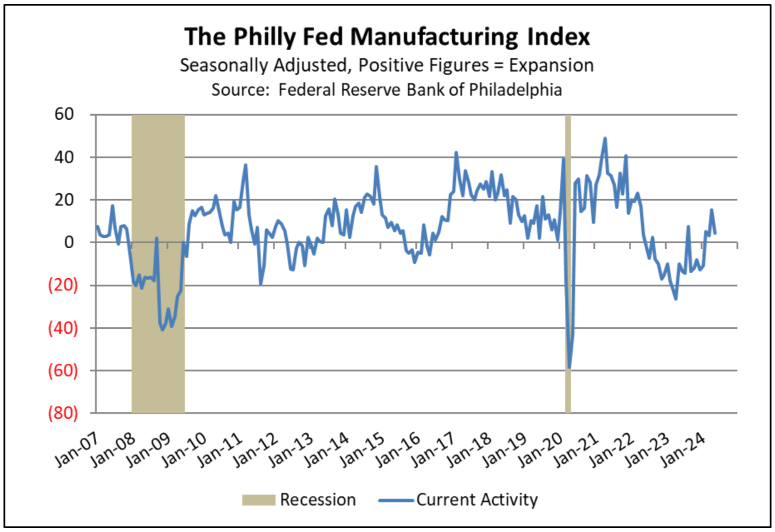
In the week ended May 11, ***initial claims for unemployment benefits*** fell to a seasonally adjusted 222,000, slightly above the expected level of 220,000 but well below the prior week's revised level of 232,000. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, rose to a three-month high of 217,750. The chart below shows how initial jobless claims have fluctuated since just before the Great Financial Crisis. The chart is truncated through much of the pandemic period because of the extremely high level of claims at that time.



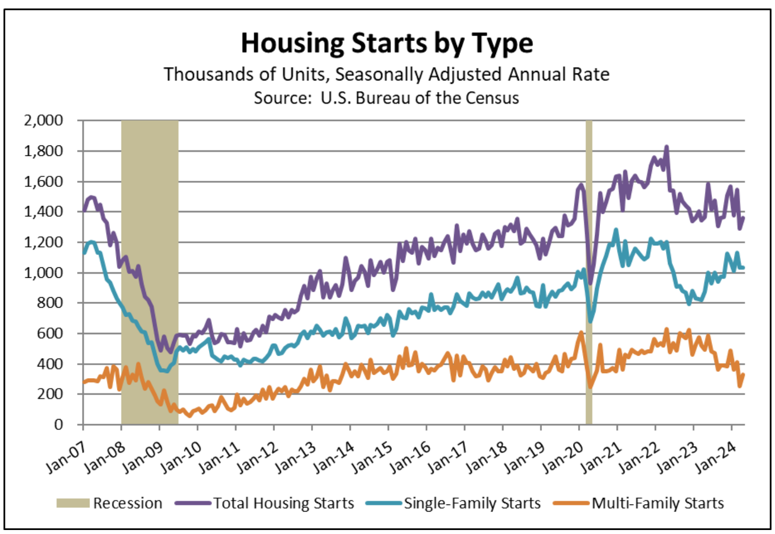
In the week ended May 4, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) rose to a seasonally adjusted 1.794 million, above both the anticipated reading of 1.780 million and the previous week's revised reading of 1.781 million. The chart below shows how continuing claims have fluctuated since the GFC. It is also truncated during the pandemic period because of the high level of claims at the time.



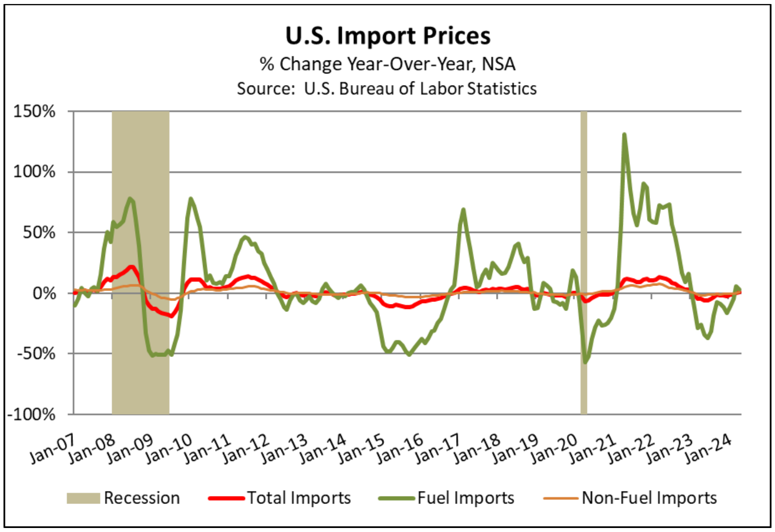
Separately, the Philadelphia FRB said its May ***Philly Fed Index*** fell to a seasonally adjusted 4.5, far short of both the expected level of 7.8 and the April level of 15.5. The index, officially designated as the Philadelphia FRB Manufacturing Activity Index, is designed so that positive readings point to expanding factory activity in the mid-Atlantic region. At its current level, the index suggests mid-Atlantic manufacturing is growing again, but only modestly. The chart below shows how the index has fluctuated since just before the GFC.



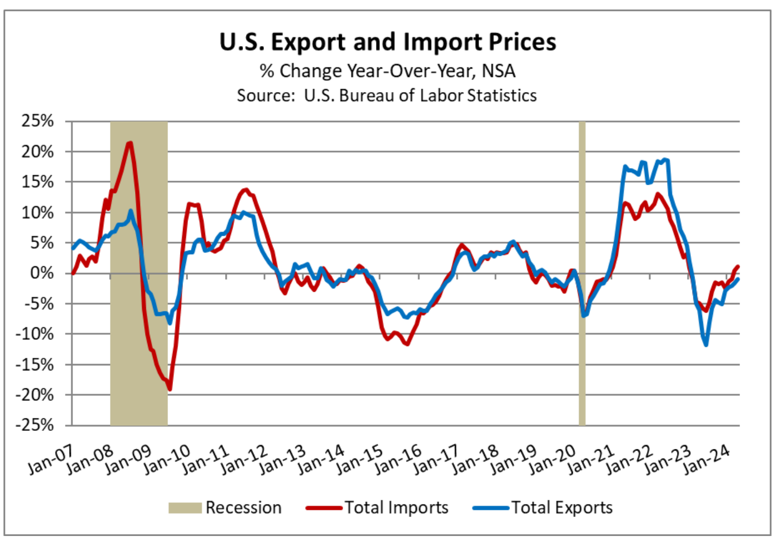
Separately, April ***housing starts*** rose to a seasonally adjusted, annualized rate of 1.360 million, short of the anticipated reading of 1.421 million units but above the downwardly revised March rate of 1.287 million. The rate of housing starts in April was up 5.7% from the rate in the previous month. April ***housing permits*** fell to a rate of 1.440 million units, short of their anticipated rate of 1.480 million units and the revised March rate of 1.485 million. Permits issued for new housing units in April were down 3.0% from the previous month. Compared with the same month one year earlier, housing starts in April were up 1.9%, while permits were up 9.0%. This chart shows the growth in new home starts by type of property since just before the GFC.



Finally, April ***import prices*** were up 0.9% from the previous month, above the expected increase of 0.3% and the revised March rise of 0.6%. Of course, import prices are often driven by volatility in the petroleum fuels category. April ***import prices excluding fuels*** were up 0.7%, much worse than expectations that they would increase 0.1%, just as they did in March. Overall import prices in April were up 1.1% year-over-year, while import prices excluding fuels were up 0.9%. The chart below shows the year-over-year change in import prices since just before the GFC.



According to the report, ***export prices*** in April were down 1.0% from one year earlier, in large part because of the key agriculture category. Comparing the annual change in export prices versus import prices provides a sense of the US "terms of trade," or the relative advantage or disadvantage the country is facing because of trends in international trade prices. The chart below compares the year-over-year change in US export and import prices since just before the GFC.



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**
10:00	Michael Barr Testifies to Senate Banking	U.S. Federal Reserve Vice Chair for Supervision
9:00	Thomas Barkin on CNBC	President of the Federal Reserve Bank of Richmond
10:30	Patrick Harker Speaks on Higher Education, Healthcare	President of the Federal Reserve Bank of Philadelphia
12:00	Loretta Mester Gives Remarks on Economic Outlook	President of the Federal Reserve Bank of Cleveland
15:50	Raphael Bostic Speaks in Moderated Chat on Economy	President of the Federal Reserve Bank of Atlanta

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	GDP SA	q/q	1Q P	-0.50%	0.00%	-0.30%	***	Equity and bond neutral
	GDP Deflator	q/q	1Q P	3.60%	3.90%	3.30%	***	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	10-May	-¥387.3b	¥291.2b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	10-May	¥660.8b	¥268.6b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	10-May	¥1698.5b	-¥1071.2b		*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	10-May	-¥396.6b	-¥1018.4b		*	Equity and bond neutral
	Industrial Production	y/y	Mar F	-6.2%	-6.7%		***	Equity and bond neutral
	Capacity Utilization	y/y	Mar F	1.3%	-0.5%		**	Equity and bond neutral
Australia	Participation Rate	m/m	Apr	66.7%	66.6%	66.6%	**	Equity and bond neutral
	Unemployment Rate	m/m	Apr	4.1%	3.9%	3.9%	***	Equity and bond neutral
	Employment Change	m/m	Apr	38.5k	-5.9k	23.7k	***	Equity and bond neutral
New Zealand	Non Resident Bond Holdings	m/m	Apr	62%	63%		*	Equity and bond neutral
EUROPE								
Italy	CPI, EU Harmonized	y/y	Apr F	0.9%	1.0%	1.0%	***	Equity and bond neutral
Russia	Trade Balance	m/m	Mar	18.8b	8.2b		**	Equity and bond neutral
	Exports	m/m	Mar	41.7b	30.8b		*	Equity and bond neutral
	Imports	m/m	Mar	22.9b	22.6b	--	*	Equity and bond neutral
AMERICAS								
Canada	Housing Starts	m/m	Apr	240.2k	242.3k	240.0k	**	Equity and bond neutral
	Manufacturing Sales	m/m	Mar	-2.1%	0.9%	-2.8%	**	Equity bullish, bond bearish
Brazil	FGV Inflation IGP-10	y/y	May	1.08%	-0.33%	0.95%	**	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	Flat
3-mo T-bill yield (bps)	523	525	-2	Up
U.S. Sibor/OIS spread (bps)	532	533	-1	Flat
U.S. Libor/OIS spread (bps)	534	534	0	Up
10-yr T-note (%)	4.33	4.34	-0.01	Down
Euribor/OIS spread (bps)	382	382	0	Down
Currencies	**Direction**			
Dollar	Up			Up
Euro	Down			Up
Yen	Flat			Down
Pound	Down			Up
Franc	Down			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.

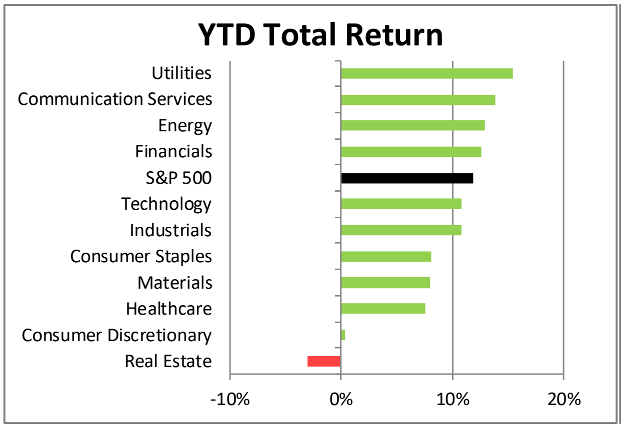
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$82.83	$82.75	0.10%	
WTI	$78.74	$78.63	0.14%	
Natural Gas	$2.44	$2.42	0.87%	
12-mo strip crack	$22.72	$22.42	1.35%	
Ethanol rack	$1.94	$1.95	-0.04%	
Metals				
Gold	$2,385.63	$2,385.99	-0.02%	
Silver	$29.67	$29.67	-0.01%	
Copper contract	$494.00	$492.45	0.31%	
Grains				
Corn contract	$464.75	$462.50	0.49%	
Wheat contract	$679.25	$665.75	2.03%	
Soybeans contract	$1,215.25	$1,213.50	0.14%	
Shipping				
Baltic Dry Freight	1,889	1,993	-104	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-2.51	-0.60	-1.91	
Gasoline (mb)	-0.24	1.00	-1.24	
Distillates (mb)	-0.05	0.70	-0.75	
Refinery run rates (%)	1.9%	0.8%	1.2%	
Natural gas (bcf)		77		

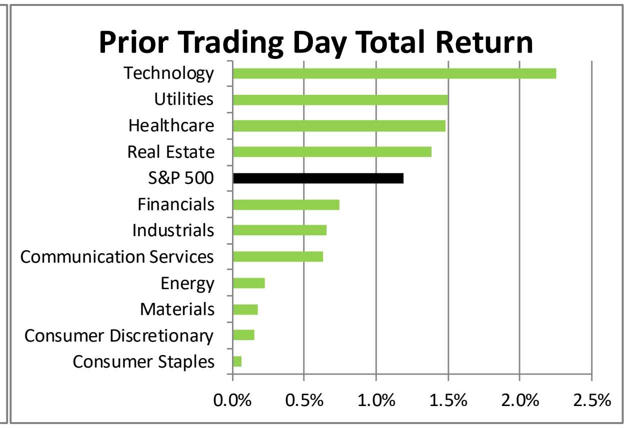
Weather

The 6-10 and 8-14 day forecasts call for warmer-than-normal temperatures throughout the southern Great Plains and the Southeast, with cooler-than-normal temperatures in the Far West and northern Great Plains. The forecasts call for wetter-than-average conditions throughout the northern half of the country, with dry conditions in New Mexico and along the Gulf Coast.

Data Section

US Equity Markets – (as of 5/15/2024 close)

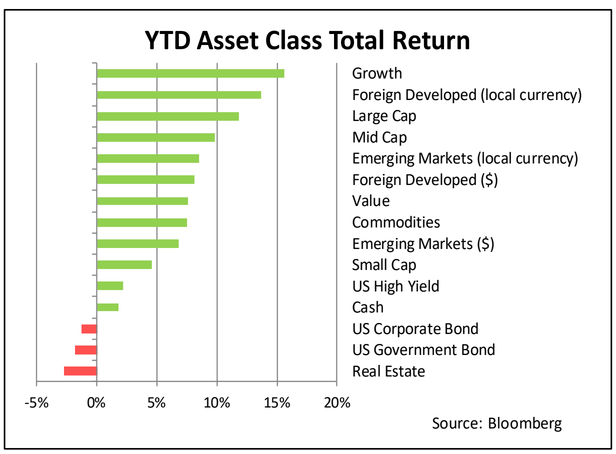




(Source: Bloomberg)

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 5/15/2024 close)

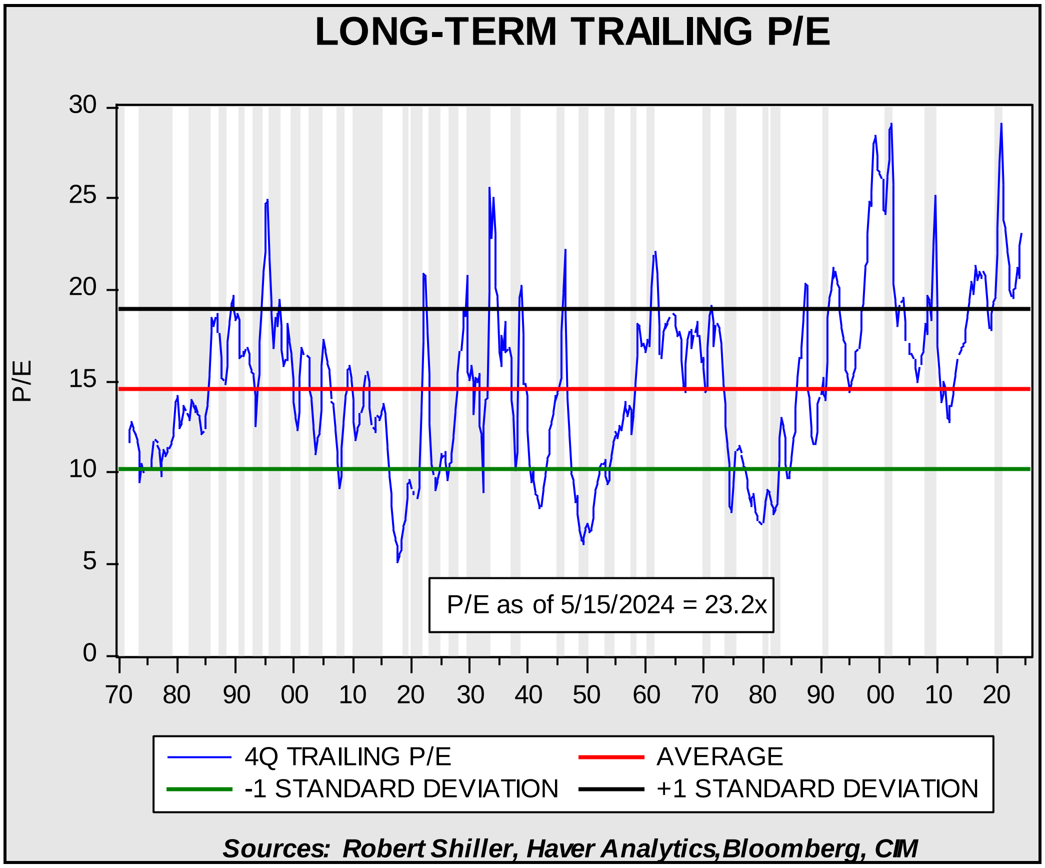


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 16, 2024



Based on our methodology,[1] the current P/E is 23.2x, 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.