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 17, 2024—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is down 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed essentially unchanged. Chinese markets were higher, with the Shanghai Composite up 1.0% from its previous close and the Shenzhen Composite up 1.2%. US equity index futures are signaling a higher open.

With 463 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 16.8% have fallen short of expectations.

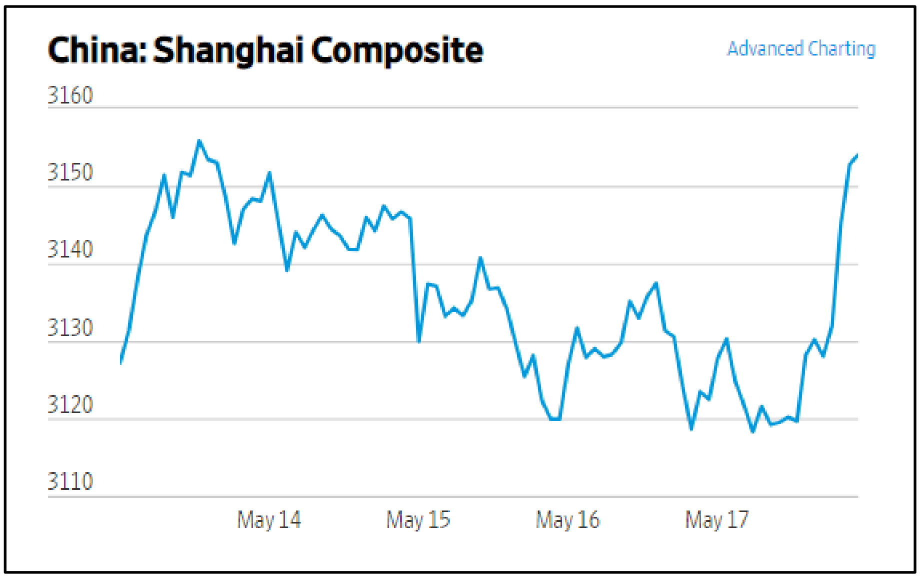
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *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"

Our *Comment* today opens with reports of a big new housing support program in China. We next review several other international and US developments with the potential to affect the financial markets today, including another possible election-driven tax cut in the UK and expectations for new US tariffs against foreign solar cells and panels.

Chinese Housing Market: The government today announced a large program to prop up the housing market, which was upended in 2021 by Beijing's clampdown on excess capacity and developers' high debts. The program encourages local governments to buy up unfinished homes now weighing on the market and convert them into affordable housing for low- and middle-income buyers. It also scraps minimum interest rates on mortgages and reduces minimum down payments by buyers.

- Excess capacity, high developer debt, and faltering home prices have become a major headwind for Chinese economic growth, so investors will be hopeful that the new program will be successful. However, Beijing hasn't been clear so far about how extensive the program will be and how local governments will fund the home purchases. As they say, the devil is in the details.
- Despite the lack of detail in the plan, it has apparently helped give Chinese stocks a lift today.



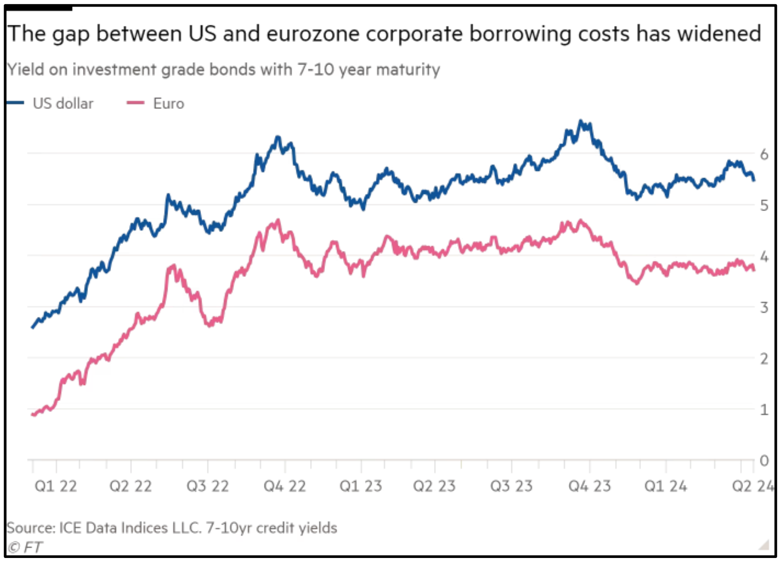
(Source: Dow Jones)

Chinese Economic Performance: April industrial production was up 6.7% year-over-year, beating expectations for a 5.5% rise and accelerating from the 4.7% increase in the year to March. The improving output stems in large part from government support for manufacturing and exports. In contrast, fixed-asset investment in January through April was up just 4.2%, falling short of expectations and slowing from the annual growth of 4.5% in January through March. The annual growth in retail sales also slowed in April.

Russia-Ukraine War: The Ukrainian government said Russian forces have advanced about 10 kilometers from the Russia-Ukraine border toward Kharkiv, leaving them just 25 km from the city. According to the Ukrainians, the Russian troops were stopped as they ran up against the first line of defense around Kharkiv. Nevertheless, the Russian advance in northeastern Ukraine illustrates how they are trying to capitalize on Kyiv's weakness in personnel and equipment before refreshed aid from the US arrives.

Eurozone: With investors now expecting the Federal Reserve to hold US interest rates higher for longer, many US firms are boosting their euro-denominated bond issuance in Europe. Data from

Bank of America shows US firms have borrowed some 30 billion EUR ($32.5 billion) via such "reverse Yankee" deals so far this year, which is on track to match or exceed the record 88 billion EUR ($95.5 billion) in reverse Yankee deals in 2019. This European issuance could help hold down US companies' interest charges even as they roll over lower-cost debt from previous years.



United Kingdom: With the ruling Conservative Party still trailing by some 20% in opinion polls ahead of the autumn elections, Chancellor Jeremy Hunt today hinted that the government wants to again cut national health insurance contributions, this time to 6% of wages and salary income. If put into place, the Tories will have cut the insurance contribution in half, potentially creating further fiscal challenges for the UK down the road.

US Fiscal Policy: New research by the University of Washington indicates metabolism-related health issues linked to aging and obesity will continue to rise, even as infectious diseases and maternal/child health issues become less prevalent. Since metabolism-driven health issues can be chronic and expensive, we suspect that this will lead to continued spending pressure for programs such as Medicare, Medicaid, and Veterans' health, making it even harder to cut the federal budget deficit.

US Trade Policy: Just days after announcing a range of big tariff increases aimed squarely at Chinese dumping, the Biden administration today is expected to announce a boost in tariffs on solar panels and cells that will be applied more globally. Because of China's huge excess capacity for solar-energy manufacturing, global prices for panels and cells have fallen dramatically, boosting US imports from Asian producers such as South Korea, Malaysia, and Vietnam. The new tariffs are designed to protect US producers.

US Financial Market Regulation: Yesterday, the Supreme Court affirmed by a vote of 7-2 that the Consumer Financial Protection Bureau (CFPB) is constitutional, overturning an appeals court ruling that the body's funding structure was unallowable. The broad consensus on the agency's constitutionality will likely cement its position in the nation's financial regulatory scheme.

US Housing Market: New analysis from the *Wall Street Journal* shows several major cities in Texas and Florida are posting higher inventories of homes for sale and falling home prices due to strong building activity in recent years. While most of the significant cities are dealing with reduced inventories and rising prices, the situation in cities such as Austin and Cape Coral is a reminder that home values could soon start to peak and even turn negative as inventories catch up to demand.

US Economic Releases

There were no domestic releases prior to the publication of this report. 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	Leading Economic Indicators	m/m	Apr	-0.3%	-0.3%	***
Federal Reserve						
	No Fed speakers or events for the rest of today					
EST	**Speaker or Event**	**District or Position**				
10:15	Christopher Waller Speaks on Payments Innovation	Member of the Board of Governors				
10:15	Neel Kashkari Gives Brief Introduction of Waller	President of the Federal Reserve Bank of Minneapolis				
12:15	Mary Daly Gives Commencement Speech	President of the Federal Reserve Bank of San Francisco				

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	Industrial Production	y/y	Mar F	-6.2%	-6.7%		***	Equity and bond neutral
	Capacity Utilization	y/y	Mar	1.3%	-0.5%		**	Equity and bond neutral
South Korea	Unemployment Rate	m/m	Apr	2.8%	2.8%	2.8%	***	Equity and bond neutral
China	Industrial Production	y/y	Apr	6.7%	4.5%	5.5%	***	Equity bullish, bond bearish
	Retail Sales	y/y	Apr	2.3%	3.1%	3.7%	**	Equity bearish, bond bullish
	Fixed Assets Ex Rural YTD	y/y	Apr	4.2%	4.5%	4.6%	**	Equity and bond neutral
EUROPE								
Eurozone	CPI	y/y	Apr F	2.4%	2.4%	2.4%	***	Equity and bond neutral
	Core CPI	y/y	Apr F	2.7%	2.7%	2.7%	**	Equity and bond neutral
France	ILO Unemployment Rate	q/q	Q1	7.5%	7.5%	7.5%	*	Equity and bond neutral
Switzerland	Industrial Output WDA	y/y	Q1	-3.1%	-0.5%		*	Equity and bond neutral
Russia	Money Supply, Narrow Definition	w/w	8-May	18.32t%	18.25t		*	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	559	0	Up
3-mo T-bill yield (bps)	524	524	0	Up
U.S. Sibor/OIS spread (bps)	533	533	0	Flat
U.S. Libor/OIS spread (bps)	534	534	0	Up
10-yr T-note (%)	4.40	4.38	0.02	Down
Euribor/OIS spread (bps)	383	382	1	Down
Currencies	**Direction**			
Dollar	Up			Up
Euro	Down			Up
Yen	Down			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.

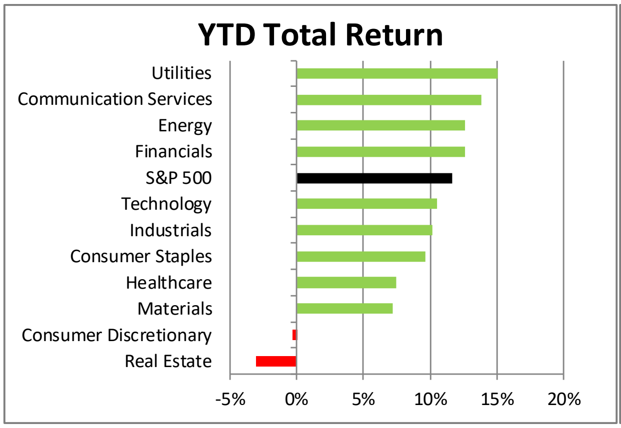
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$83.15	$83.27	-0.14%	
WTI	$79.07	$79.23	-0.20%	
Natural Gas	$2.53	$2.50	1.20%	
12-mo strip crack	$23.21	$22.75	2.03%	
Ethanol rack	$1.93	$1.94	-0.30%	
Metals				
Gold	$2,387.82	$2,376.86	0.46%	
Silver	$29.73	$29.58	0.53%	
Copper contract	$494.35	$487.70	1.36%	
Grains				
Corn contract	$457.75	$457.00	0.16%	
Wheat contract	$669.00	$663.25	0.87%	
Soybeans contract	$1,224.50	$1,216.25	0.68%	
Shipping				
Baltic Dry Freight	1,817	1,889	-72	
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)	70	77	-7	

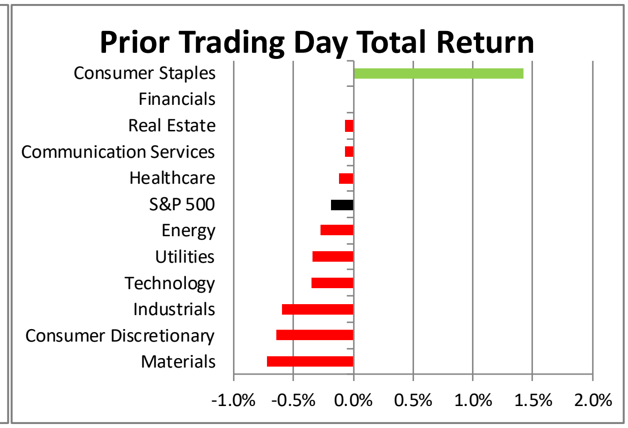
Weather

The 6-10 and 8-14 day forecasts call for warmer-than-normal temperatures throughout the southern Great Plains and throughout most of the South, with cooler-than-normal temperatures in the Pacific and Rocky Mountain regions. 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 5/16/2024 close)

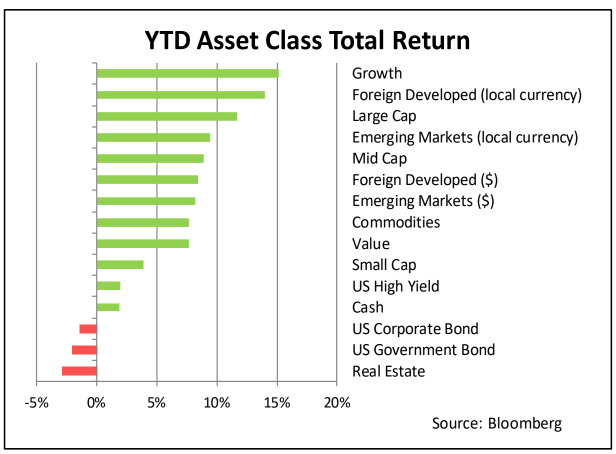




(Source: Bloomberg)

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 5/16/2024 close)

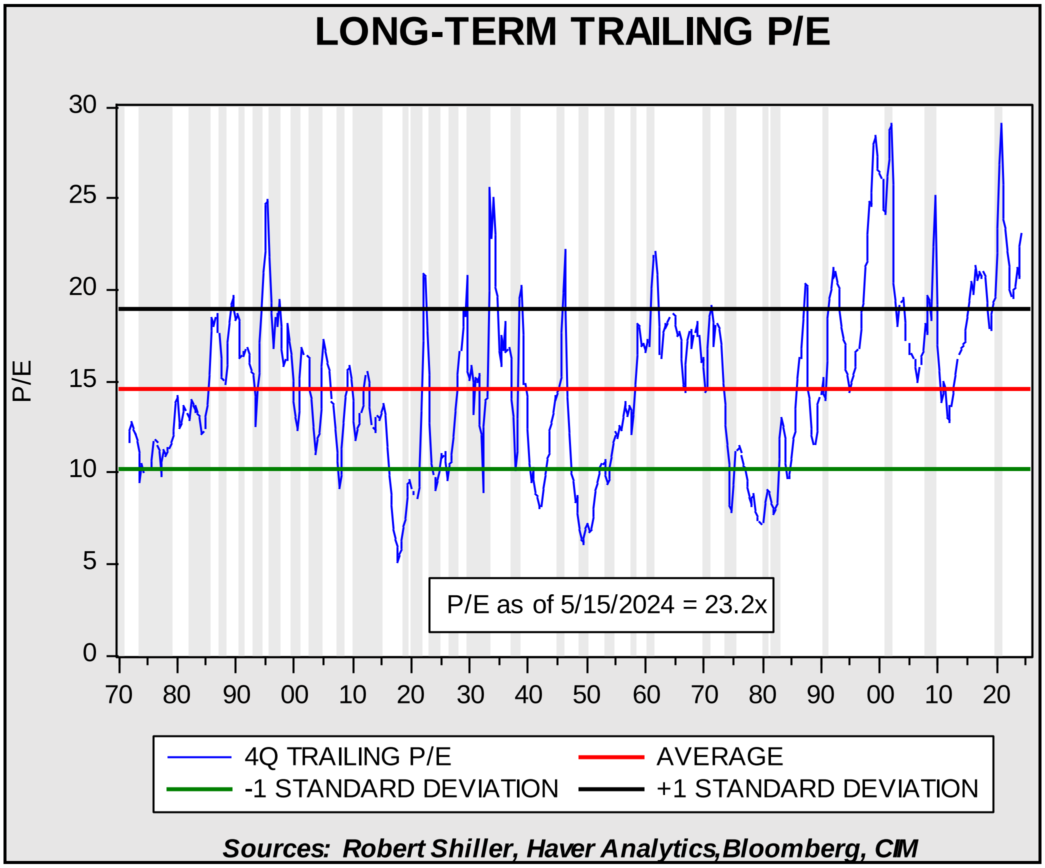


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.

[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.