Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: November 11, 2024 — 9:30 AM ET] Global equity markets are mostly higher this morning. In Europe, the Euro Stoxx 50 closed up 1.2% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.3%. Chinese markets were higher, with the Shanghai Composite up 0.7% from its previous close and the Shenzhen Composite up 0.1.9%. US equity index futures are signaling a higher open.

With 452 companies having reported so far, S&P 500 earnings for Q3 are running at $62.80 per share compared to estimates of $60.44, which is up 4.2% from Q3 2023. Of the companies that have reported thus far, 75.2% have exceeded expectations, while 18.0% 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 in bold:

Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
Rising US & Global Debt: A Perspective Check (11/4/24) + podcast	***Let's Talk About Tariffs!* (11/11/24) + podcast**	Q4 2024 Report Q4 2024 Rebalance Presentation	Value Equities Quarterly Update (Q3 2024)

Our *Comment* today opens with news of an impending Russian and North Korean attack to push the Ukrainians out of their small foothold in the Kursk region. We next review several other international and US developments with the potential to affect the financial markets today, including new details on China's latest fiscal stimulus program and President-Elect Trump's latest personnel and policy moves.

Russia-Ukraine Conflict: US and Ukrainian officials say Russia has massed some 50,000 troops, including North Koreans, around the small Kursk area currently held by Ukraine. The officials believe the Kremlin will launch a major attack on the Ukrainians in the coming days, hoping to finally eject them from their only substantial position in Russia proper. If such an offensive is successful, it would leave the Ukrainians without a key bargaining chip in the event that the new Trump administration forces them into negotiations with the Russians.

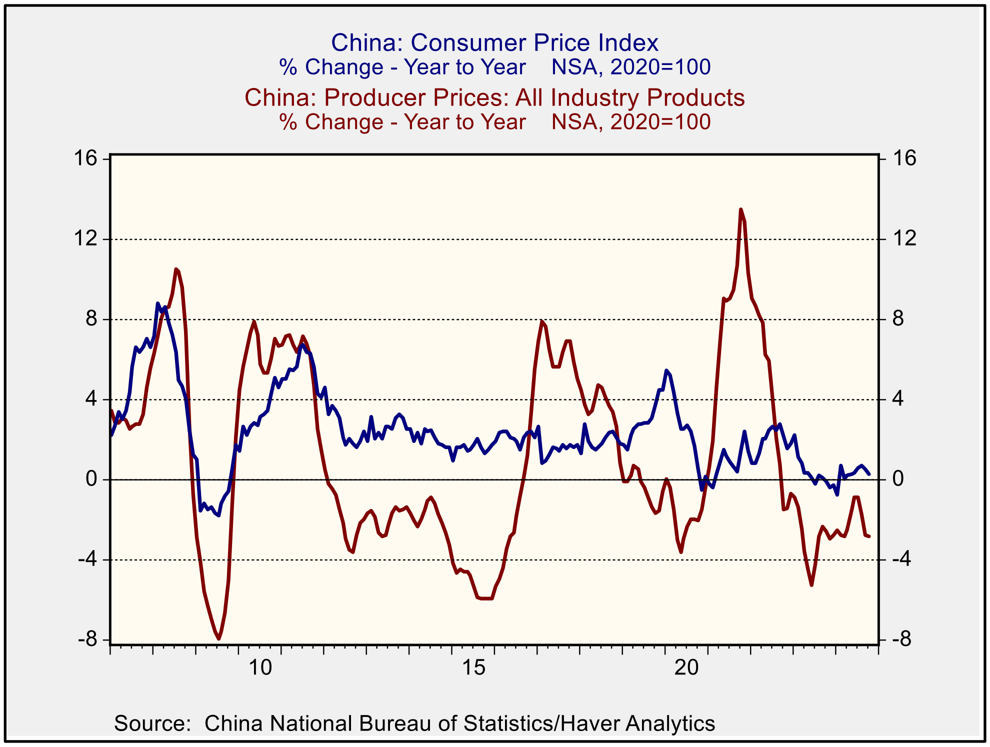
Russia: The Kremlin is reportedly exploring a plan to merge Russia's three largest oil companies into one national champion. The plan would fuse state-owned firms Rosneft and Gazprom Neft with independently owned Lukoil, forming what would be the world's second-largest oil company after Saudi Aramco. If it's consummated, the merger would also give President Putin more control over the Russian energy sector and global oil prices.

Japan: The Diet today voted to keep Prime Minister Ishiba in power, even though his long-ruling coalition between the Liberal Democratic Party and Komeito lost its parliamentary majority in the October election. Ishiba won his victory only with the support of the newly popular, center-right Democratic Party for the People. Going forward, that means Ishiba will be one of Japan's weakest prime ministers, crimping his ability to enact new economic or security measures.

Chinese Fiscal Policy: We now have more detail on the new local-government refinance plan from the National People's Congress, which we flagged in our *Comment* on Friday. The program gives local governments new debt quotas and budget flexibility to refinance 10 trillion renminbi (about $1.4 trillion) in high-cost, risky debt currently hidden in off-budget financing vehicles. Spread over five years, the plan could help local governments replace most of their current high-cost hidden debt with lower-cost, on-budget debt approved by Beijing.

- As part of the announcement, the government said local governments currently have about 14.3 trillion RMB (about $2.0 trillion) in hidden debt. The program aims to cut the total to just 2.3 trillion RMB (about $320 billion) by 2028.
- By replacing local investors' high-interest loans with lower-cost, on-budget loans, the program aims to ease local governments' current fiscal squeeze, giving a modest boost to overall economic growth.
- All the same, the main impact of the program might be to reduce the risk of defaults and financial crises by local governments. In other words, the priority may have been fiscal stability more than spurring economic growth. We continue to think the program will only provide a modest boost to Chinese economic growth going forward, meaning China will probably not regain its position as a prime engine of global economic growth.

Chinese Price Inflation: Reflecting China's weak economic growth, the October consumer price index was up just 0.3% from the same month one year earlier versus a 0.4% rise in the year to September. The October producer price index was down 2.9% on the year compared with an annual 28% fall in the previous month. The deflation at the wholesale level is consistent with Western criticism that China has over-invested in its manufacturing sector and is now dealing with excess production, much of which is being exported at fire-sale prices.



United States-Taiwan-China: According to confidential sources, Taiwan Semiconductor Manufacturing Company (TSM) has told its mainland China customers that it will no longer accept their orders for advanced artificial-intelligence semiconductors. The move comes after reports that Chinese telecom equipment giant Huawei apparently used front companies to buy such chips from TSM despite US rules blocking it from acquiring the technology. New reporting over the weekend said the US Commerce Department ordered TSM to take the action.

- The TSM move is yet another example of how technology flows between the US geopolitical bloc and the China bloc are being curtailed.
- TSM's move to stop all advanced sales to China is extreme, but we suspect it will be followed up by similar moves in the future. In our view, global fracturing into relatively separate geopolitical and economic blocs will continue. These conditions will result in less efficient global supply chains, higher costs, higher inflation, and higher interest rates going forward.

United States-Taiwan: The Taiwanese government is reportedly considering a large purchase of US ships, jets, missiles, and other weapons systems to signal to the new Trump administration that it is serious about defending itself against China. Of course, the large purchase could also be a boon to US defense firms such as Lockheed Martin and Northrop Grumman. If completed, the purchase would help validate our view that geopolitical tensions will spur higher defense spending worldwide in the coming years, producing good returns for global defense firms.

US Politics: President-Elect Trump said on Saturday that his new administration [would not include either Mike Pompeo, his former secretary of state and CIA director, or Nikki Haley, his former ambassador to the UN](). It seems highly likely that the announcement was retribution for Pompeo's and Haley's past attacks on Trump's policies. An early, highly public punishment against them would help signal that Trump will prioritize loyalty in his new administration.

- Nevertheless, it is notable that both Pompeo and Haley are strong hawks regarding the national security threat from China.
- It still seems certain that Trump will be tough on China when it comes to trade and other economic concerns, but now that he's jettisoned Pompeo and Haley, we'll be looking closely at future personnel and policy announcements to gauge how tough he'll be against China's military and geopolitical aggressiveness, especially in the Indo-Pacific.

US Fiscal Policy: The *Wall Street Journal* today carries a useful article on the challenges Republicans now face in deciding how much of an expansion in the federal budget deficit they will accept to advance their tax cuts in 2025. According to the article, Republican leaders are kicking around various figures for "The Number," but the negotiations are only beginning, and a final proposal may not be ready until early next year. The decision is considered a test of strength between the party's deficit hawks and its tax cutters.

US Economic Releases

No major US economic reports have been released so far today, and there are no economic releases or Fed events scheduled for the rest of the day.

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	BoP Current Account Balance	m/m	Sep	¥1717.1b	¥3803.6b	¥3933.1b	***	Equity and bond neutral
	BoP Trade Balance	m/m	Sep	-¥315.2b	-¥377.9b	-¥66.2b	**	Equity and bond neutral
New Zealand	2-Year Inflation Expectations	q/q	4Q	2.12%	2.03%		**	Equity and bond neutral
China	PPI	y/y	Oct	-2.9%	-2.8%	-2.5%	**	Equity and bond neutral
China	CPI	y/y	Oct	0.3%	0.4%	0.4%	**	Equity and bond neutral
China	Money Supply M2	y/y	Oct	7.5%	6.8%	7.0%	***	Equity and bond neutral
	Money Supply M1	y/y	Oct	-6.1%	-7.4%	-7.0%	*	Equity and bond neutral
	Money Supply M0	y/y	Oct	12.8%	11.5%		*	Equity and bond neutral
	New Yuan Loans	m/m	Oct	16520.0b	16020.3b	16720.3b	**	Equity and bond neutral
EUROPE								
Switzerland	Domestic Sight Deposits CHF	w/w	8-Nov	455.4b	447.8b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	8-Nov	463.5b	456.6b		*	Equity and bond neutral
AMERICAS								
Canada	Net Change in Employment	m/m	Oct	14.5k	46.7k	27.2k	***	Equity and bond neutral
	Unemployment Rate	m/m	Oct	6.5%	6.5%	6.6%	***	Equity and bond neutral
	Participation Rate	m/m	Oct	64.8%	64.9%	64.9%	*	Equity and bond neutral
Mexico	Industrial Production	y/y	Sep	-0.4%	-0.4%	0.3%	***	Equity bearish, bond bullish
	Manufacturing Production	y/y	Sep	0.8%	0.4%	-0.9%	*	Equity bullish, bond bearish
Brazil	Primary Budget Balance	y/y	Sep	-7.3b	-21.4b	-7.3b	*	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)	485	485	0	Down
3-mo T-bill yield (bps)	442	442	0	Down
U.S. Sibor/OIS spread (bps)	453	452	1	Down
U.S. Libor/OIS spread (bps)	449	448	1	Down
10-yr T-note (%)	4.31	4.31	0.00	Up
Euribor/OIS spread (bps)	303	303	0	Down
Currencies	**3 Mo**			
Dollar	Down	US		Down
Euro	Down	Euro		Up
Yen	Up	Japan		Up
Pound	Up	UK		Up
Franc	Up	Switzerland		Up

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.

	Price	Prior	Change	Explanation
Energy Markets				
Brent	$72.65	$73.87	-1.65%	
WTI	$69.07	$70.38	-1.86%	
Natural Gas	$2.87	$2.67	7.46%	
Crack Spread	$17.39	$17.30	0.50%	
12-mo strip crack	$20.22	$20.29	-0.37%	
Ethanol rack	$1.75	$1.75	0.00%	
Metals				
Gold	$2,659.62	$2,684.77	-0.94%	
Silver	$31.25	$31.31	-0.19%	
Copper contract	$428.50	$430.60	-0.49%	
Grains				
Corn contract	$429.50	$431.00	-0.35%	
Wheat contract	$560.25	$572.50	-2.14%	
Soybeans contract	$1,034.25	$1,030.25	0.39%	
Shipping				
Baltic Dry Freight	1,495	1,451	44	

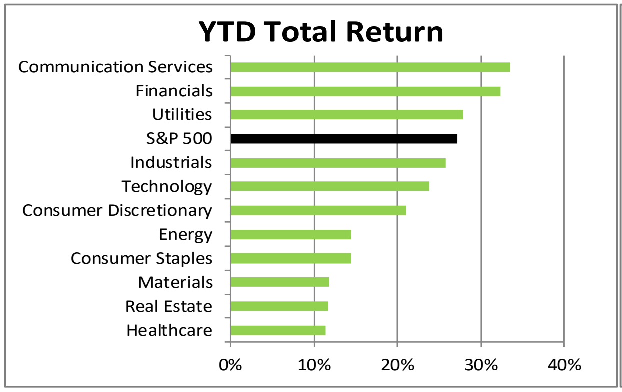
Weather

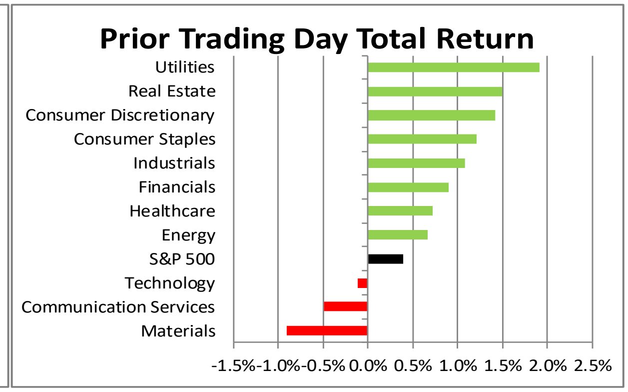
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures from the Great Plains eastward, with cooler-than-normal temperatures in the Far West. The forecasts call for wetter-than-normal conditions for most of the country.

There are currently no tropical storms expected within the next 48 hours.

Data Section

US Equity Markets – (as of 11/8/2024 close)

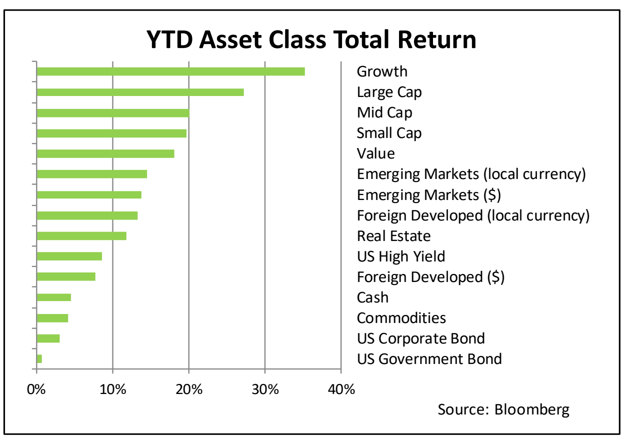




(Source: Bloomberg)

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 11/8/2024 close)

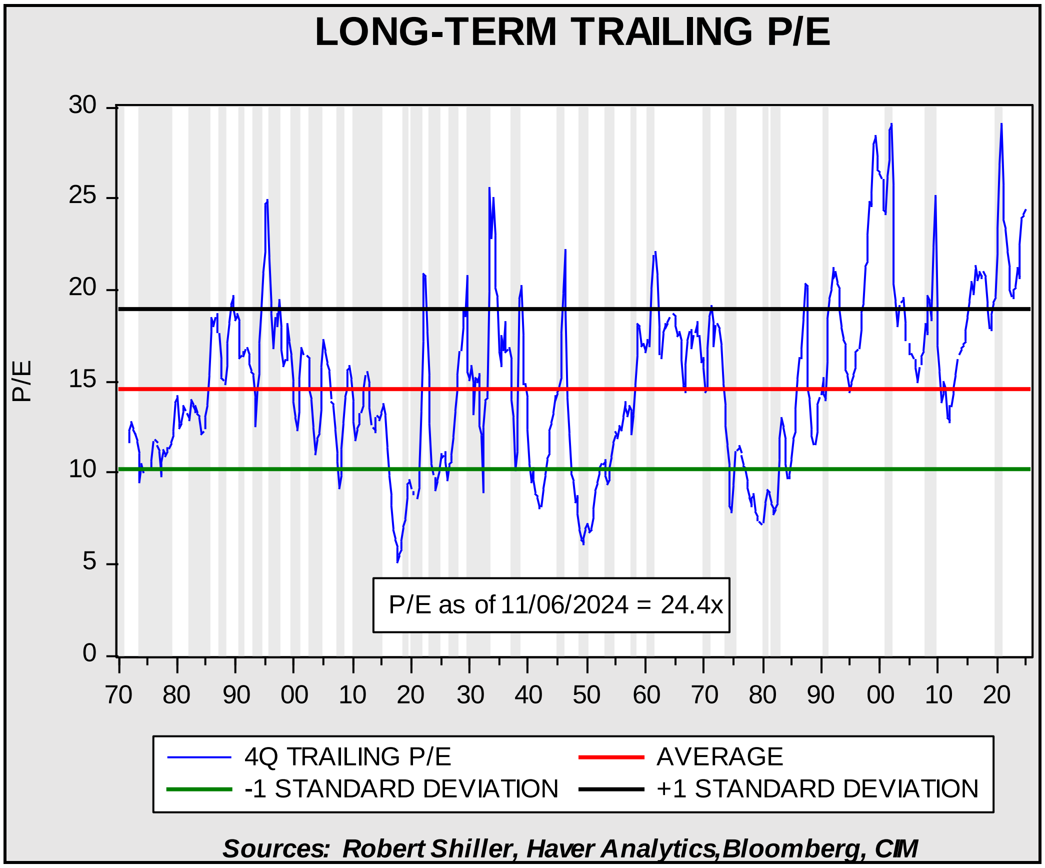


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

November 7, 2024



Based on our methodology,[1] the current P/E is 24.4x, down 0.1 from our last report. The stock price index increase was offset by a relatively larger 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 (Q1, Q2 and Q3) and one estimate (Q2). 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.