Daily Comment

Confluence INVESTMENT MANAGEMENT

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: November 12, 2024 — 9:30 AM ET] Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 closed down 1.0% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 2.8%. Chinese markets were lower, with the Shanghai Composite down 1.4% from its previous close and the Shenzhen Composite down 0.8%. US equity index futures are signaling a lower open.

With 453 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 17.9% 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 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	**Confluence of Ideas Podcast** ***The Q4 Asset Allocation Rebalance***

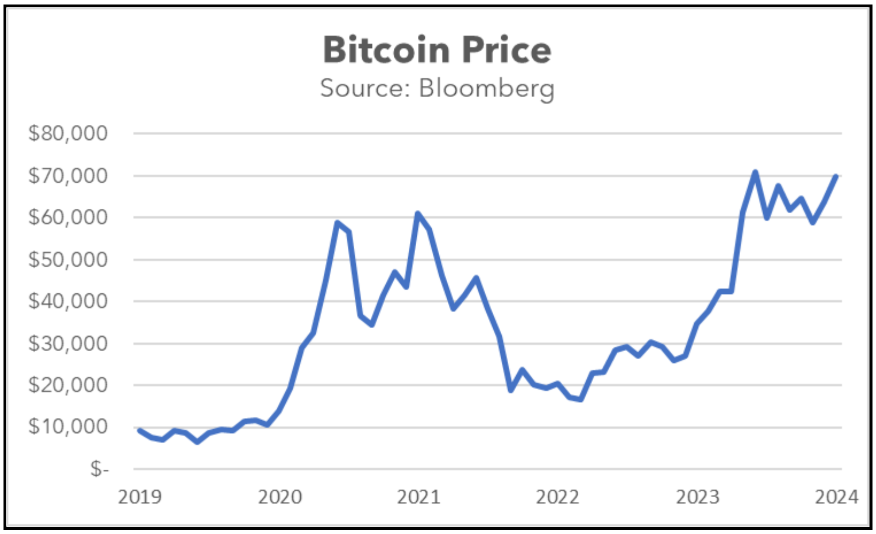
Good morning! The market is currently assessing the implications of Republican control over both chambers of Congress. In sports news, the Cleveland Cavaliers are experiencing their best start to an NBA season since 2015-2016. Today's *Comment* will cover the impact of the so-called "Trump trade" on cryptocurrency, provide our insights on why the recent market rally could indicate an equity market bubble, and discuss European defense spending. As always, the report will end with a roundup of international and domestic data releases.

Trump Trade Resumes: Risk assets continue to rally as investors price in the impact of a second Trump term.

- The news of a Republican sweep has sparked a surge in risk appetite, especially among retail investors, with cryptocurrencies leading the charge. According to the latest results, Republicans now hold 53 Senate seats compared to 46 for the Democrats, and the

Republicans have surpassed the 218-seat threshold for a House majority, with nine races still undecided. This strong showing has fueled investor optimism, as the Trump administration is expected to face minimal obstacles when pursuing favorable tax policies and regulatory reforms. Bitcoin, the world's leading cryptocurrency, surged past $88,000 following the result.

- Crypto is emerging as a potential competitor to gold as the preferred hedge against dollar debasement. While concerns over rising debt and inflation have traditionally driven investors toward gold, bitcoin has surged 20% since the election, while gold has dropped around 4%. This shift reflects growing confidence in bitcoin as a safe haven, especially as trust in government-backed assets wanes. With key figures in the incoming administration likely to champion broader crypto adoption, optimism is mounting that bitcoin could reach $100,000 by year's end.



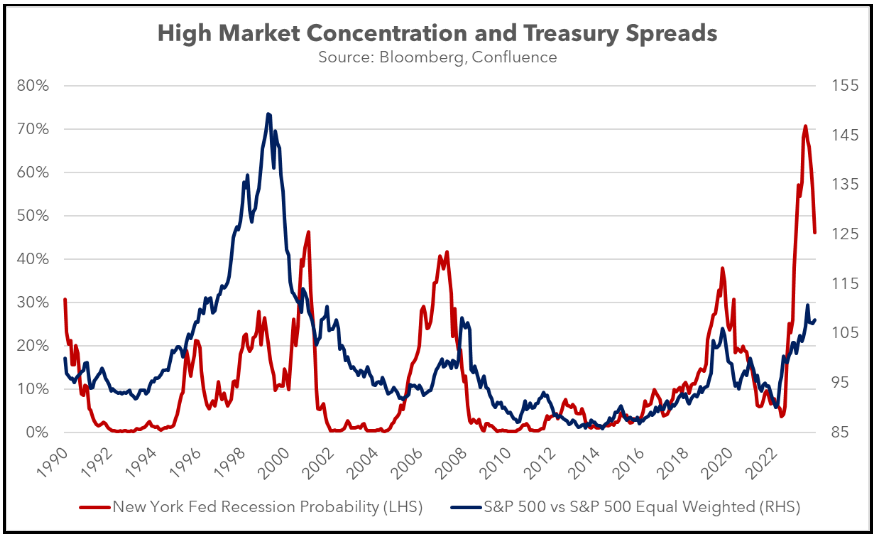
- While Trump's recent victory is viewed as a win for cryptocurrency, it's too early to gauge how effectively he will champion digital assets. Despite bitcoin's growing popularity, its usage remains limited, and benefits of the increased adoption of bitcoin are unclear, particularly with the US dollar still acting as the global reserve currency. Given this uncertainty, investors may be wise to wait and see how the administration approaches the cryptocurrency, as its current valuation appears somewhat inflated.

Bubble Brewing: Market euphoria continues to drive equities higher, but concerns about future inflation have led to rising bond yields.

- The S&P 500 and Dow Jones Industrial Average have scaled new heights, surpassing 6,000 and 44,000 points, respectively. This milestone is likely to attract increased investor interest in equities, potentially shifting funds from money markets to the stock market. However, the surge in market optimism has led to a flattening of the yield curve. The two-year US Treasury yield has climbed nearly 10 basis points since the Federal

Reserve's 25-basis-point rate cut last Thursday, while the 10-year Treasury yield has declined 12 basis points.

- Concerns about a potential market bubble have resurfaced as the Magnificent 7 tech giants have been the primary drivers of the S&P 500's performance over the past two years. This trend has continued over the last five days, with these mega-cap tech stocks significantly outperforming the broader market index. This outperformance has led the S&P 500 market cap index to its widest premium over its equal-weight counterpart since the dot-com bubble. The high market concentration has also led to concerns of a potential bursting of the tech-stock bubble.

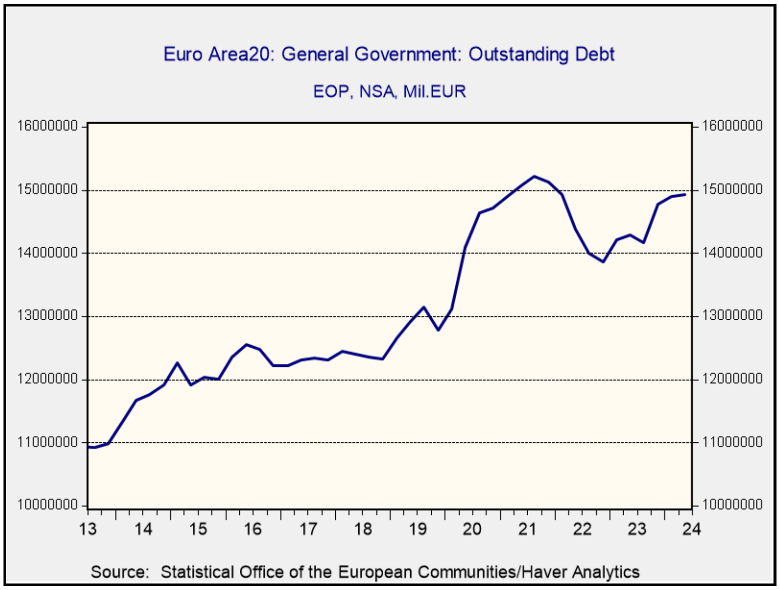


- We remain optimistic about the US economy's ability to avoid a recession absent a major external shock. However, we believe the market remains overweighted in a few sectors. The recent flattening of the yield curve is a concern, as it has historically been associated with economic downturns. Nonetheless, as long as inflation continues to moderate and corporate earnings remain robust, we expect market concentration to gradually normalize. As a result, we suspect that investors may begin to shift their focus toward sectors offering better value and solid fundamentals over the coming weeks.

European Defense: Trump's win of the US presidency has forced the European Union to accept that it will have to drastically increase its defense spending.

- European defense stocks rallied after the European Union opted to relax spending restrictions in anticipation of rising costs related to the Ukrainian conflict and NATO spending following the return of Donald Trump to the White House. The EU intends to reallocate funds previously earmarked for reducing income inequality among member states to directly support defense purchases and military funding. Moreover, these investments will be used to bolster critical infrastructure in Germany, given its geopolitical importance, and in Eastern European countries bordering Ukraine.

- This policy shift has boosted the pan-European Stoxx 600, which closed up 1.1% on Monday, marking its best day in six weeks. Investors are optimistic that increased spending will benefit European defense companies which have already been on a strong run. Many of these defense companies have already reaped record profits from supplying equipment and services to support the war effort in Ukraine. A significant portion of these windfall gains has been used to reward shareholders through share buybacks.

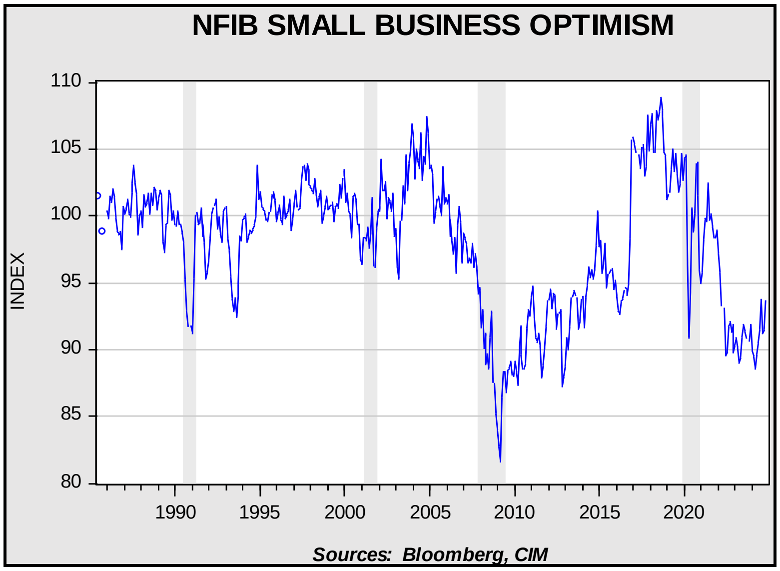


- The push to bolster European defense companies is likely to encounter significant political obstacles. Public sentiment generally opposes profiteering from war, and this could lead to increased scrutiny and potential backlash against defense companies. While the sector is poised to benefit from rising government defense spending, this could also trigger calls for greater corporate responsibility. As a result, these companies may face pressure to contribute a portion of their increased revenue back to society through higher taxes or other forms of public investment.

In Other News: Tesla CEO Elon Musk has started the push to end the Fed following Fed Chair Jerome Powell's decision not to step down, in a sign that the central bank is becoming more politicized. Germany agreed to hold snap elections on February 23, as the country readies for a no-confidence vote.

US Economic Releases

The National Federation of Independent Business' ***Small Business Optimism Index*** for October rose to 93.7 from 91.5 the prior month, exceeding the expected 92.0. This matched the highest reading for the index since 2022. Nine of the 10 components of the index rose in October, led by a seven-point improvement in the outlook for business conditions, which is on the verge of turning positive for the first time since President-elect Trump was last in office. The following chart shows the course of the index through time.



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

Economic Releases						
ET	**Indicator**			**Expected**	**Prior**	**Rating**
11:00	NY Fed 1-Yr Inflation Expectations	m/m	Oct	2.97%	3.00%	
Federal Reserve						
ET	**Speaker or Event**	**District or Position**				
10:00	Christopher Waller Speaks at Banking Conference	Member of the Board of Governors				
10:15	Thomas Barkin Speaks in Baltimore	President of the Federal Reserve Bank of Richmond				
14:00	Senior Loan Officer Opinion Survey on Bank Lending Practices	Federal Reserve Board				
14:00	Neel Kashkari Participates in Moderated Conversation	President of the Federal Reserve Bank of Minneapolis				
17:00	Patrick Harker Speaks on Fintech, AI	President of the Federal Reserve Bank of Philadelphia				
17:30	Thomas Barkin Repeats Speech, followed with Q&A	President of the Federal Reserve Bank of Richmond				

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	Money Stock M2	y/y	Oct P	1.2%	1.2%		**	Equity and bond neutral
	Money Stock M3	y/y	Oct	0.7%	0.7%		**	Equity and bond neutral
	Machine tool orders	y/y	Oct	9.3%	-6.4%		**	Equity and bond neutral
Australia	Westpac Consumer Conf SA	m/m	Nov	5.3%	6.2%		**	Equity and bond neutral
	Westpac Consumer Conf Index	m/m	Nov	94.6	89.8		**	Equity and bond neutral
	NAB Business Confidence	m/m	Oct	5	-2		***	Equity and bond neutral
	NAB Business Conditions	m/m	Oct	7	7		***	Equity and bond neutral
India	CPI	y/y	Oct	6.21%	5.49%	5.90%	***	Equity and bond neutral
	Industrial Production	y/y	Sep	3.1%	-0.1%	2.5%	***	Equity and bond neutral
EUROPE								
Eurozone	ZEW Survey Expectations	m/m	Nov	12.5	20.1		**	Equity and bond neutral
Germany	CPI	y/y	Oct F	2.0%	2.0%	2.0%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Oct F	2.4%	2.4%	2.4%	**	Equity and bond neutral
	ZEW Survey Expectations	m/m	Nov	7.4	13.1	13.2	**	Equity bearish, bond bullish
	ZEW Survey Current Situation	m/m	Nov	-94.4	-86.9	-85.0	**	Equity and bond neutral
UK	Average Weekly Earnings 3M/YoY	m/m	Sep	4.3%	3.9%	3.9%	**	Equity bullish, bond bearish
	ILO Unemployment Rate 3Mths	m/m	Sep	4.3%	4.0%	4.1%	**	Equity and bond neutral
	Claimant Count Rate	m/m	Oct	4.7%	4.7%		**	Equity and bond neutral
	Jobless Claims Change	m/m	Oct	26.7k	10.1k		**	Equity and bond neutral
Russia	Trade Balance	m/m	Sep	12.6b	9.3b		**	Equity and bond neutral
	Exports	m/m	Sep	39.1b	34.5b		*	Equity and bond neutral
	Imports	m/m	Sep	26.5b	25.2b		*	Equity and bond neutral
AMERICAS								
Brazil	Retail Sales	y/y	Sep	2.1%	5.3%	3.7%	***	Equity bearish, bond bullish

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)	443	442	1	Down
U.S. Sibor/OIS spread (bps)	452	453	-1	Down
U.S. Libor/OIS spread (bps)	449	449	0	Down
10-yr T-note (%)	4.36	4.31	0.05	Up
Euribor/OIS spread (bps)	304	303	1	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	$72.38	$71.83	0.77%	
WTI	$68.55	$68.04	0.75%	
Natural Gas	$2.92	$2.92	0.03%	
Crack Spread	$17.82	$17.51	1.78%	
12-mo strip crack	$20.35	$20.10	1.25%	
Ethanol rack	$1.75	$1.75	0.05%	
Metals				
Gold	$2,601.89	$2,618.82	-0.65%	
Silver	$30.41	$30.68	-0.89%	
Copper contract	$415.35	$422.85	-1.77%	
Grains				
Corn contract	$431.00	$430.00	0.23%	
Wheat contract	$564.50	$565.50	-0.18%	
Soybeans contract	$1,013.50	$1,022.25	-0.86%	
Shipping				
Baltic Dry Freight	1,558	1,495	63	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-0.09		
Gasoline (mb)		-0.52		
Distillates (mb)		-0.50		
Refinery run rates (%)		0.6%		
Natural gas (bcf)		68		

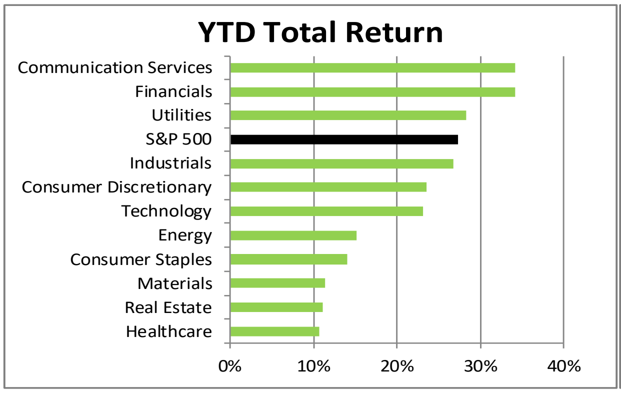
Weather

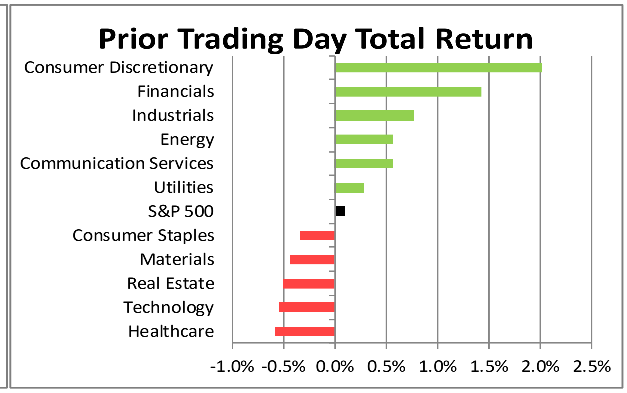
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures from the Mississippi River eastward, with cooler-than-normal temperatures from the Rocky Mountains westward. The forecasts call for wetter-than-normal conditions from the Appalachians to the Great Plains.

A tropical wave is tracking westward across the northern Caribbean Sea just south of the Cayman Islands with a 40% chance of cyclonic formation within the next 48 hours.

Data Section

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

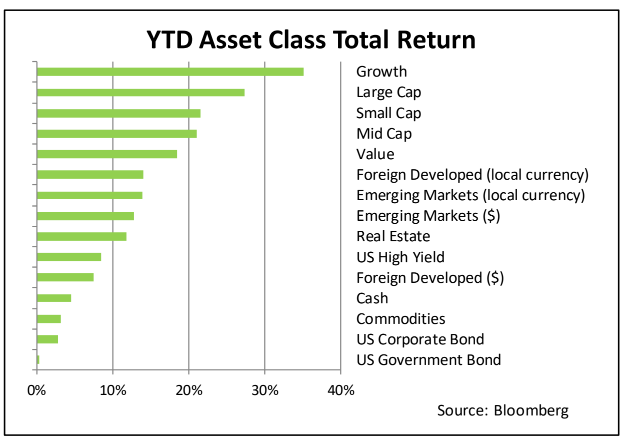




(Source: Bloomberg)

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 11/11/2024 close)

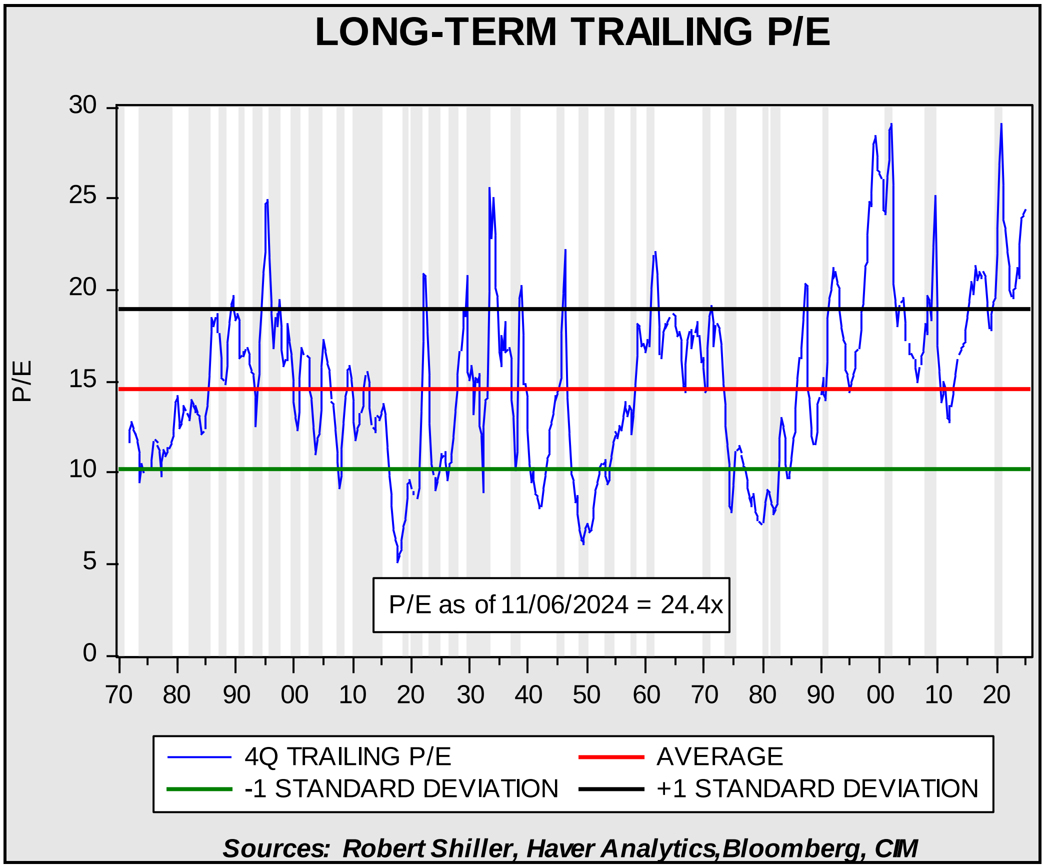


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.

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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 (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.