Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: November 13, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed down 0.2% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.8%. Chinese markets were higher, with the Shanghai Composite up 0.5% from its previous close and the Shenzhen Composite up 0.2%. US equity index futures are signaling a lower open.

With 456 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:

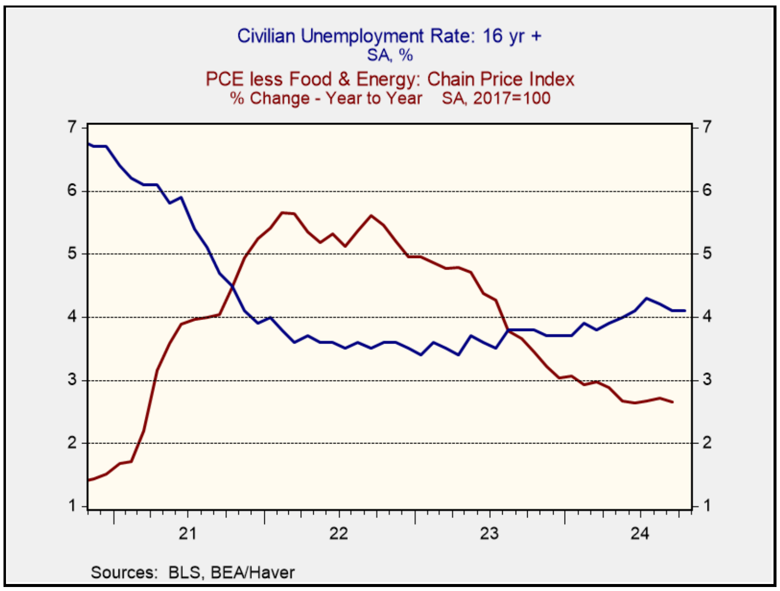
Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
Rising US & Global Debt: A Perspective Check (11/4/24) + podcast	*Let's Talk About Tariffs!* (11/11/24) + podcast	Q4 2024 Report Q4 2024 Rebalance Presentation	Confluence of Ideas Podcast *The Q4 Asset Allocation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

Good morning! The market is currently reacting to the latest inflation data. In sports news, the University of Oregon has maintained its number one ranking in college football. Today's *Comment* will cover our insights on monetary policy, discuss the recent breakthrough in nuclear fusion, and provide an update on the Bank of Japan. As usual, the report will include a summary of both international and domestic data releases.

Fed Cuts in Doubt: Uncertainty about inflation and the labor market has led the market to reassess its bets regarding the future path of rate cuts.

- Federal Reserve officials Neel Kashkari and Thomas Barkin presented contrasting views on the path of interest rates. Kashkari, the Minneapolis Fed President, advocated for a rate cut in December provided that inflation remains within expectations over the next two months. In contrast, Richmond Fed President Thomas Barkin adopted a more cautious stance. While acknowledging current restrictive conditions, he indicated the Fed's readiness to adjust rates to address inflation or labor market risks, potentially signaling a preference for a December pause.

- While the central bank has implemented 75 basis points worth of rate cuts since September, growing concerns persist about the delicate balance between its price stability and maximum employment mandates. The latest unemployment data reveals a persistent rate above 4.0% over the past five months, while the Fed's preferred inflation gauge, the core Personal Consumption Expenditure (PCE) price index, remains relatively stable at around 2.7%. The labor market's resilience and persistent inflation have reduced rate cut expectations from 70% to 60% this week.

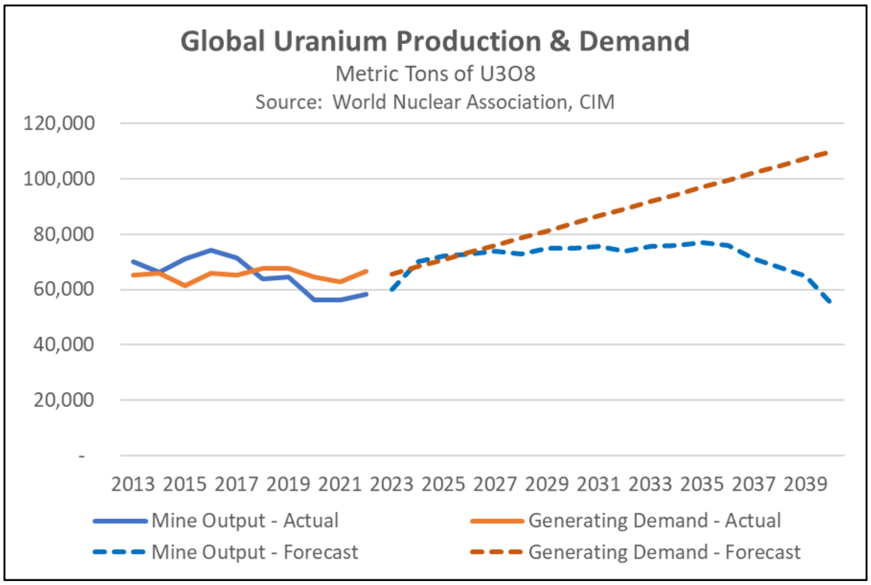


- [Although the market is heavily favoring a rate cut in December](), the decision is far from settled. A major determinant of the Federal Reserve's decision to further ease monetary policy will be the November jobs report. A report indicating an uptick in the unemployment rate or another payroll figure below 100k could solidify the case for another interest rate cut. However, given the likelihood of hurricane-displaced workers reentering the labor force, we believe that the probability of a rate cut in the next month is still a coin flip.

Nuclear Fusion: A breakthrough in fusion technology is set to attract interest as investors seek innovations to make nuclear energy more efficient.

- A [New Zealand startup has demonstrated a promising step towards fusion energy]() by generating a plasma cloud at 300,000 degrees Celsius for 20 seconds in its first experimental reactor. While this temperature and duration fall short of the requirements for practical fusion power, the experiment highlights the technology's potential for future research and development. Over the last two years, public and private funding into nuclear fusion has waned due to a lack of progress, with investment growth falling from $2.8 billion in 2022 to roughly $900 million as of this year.

- Successful fusion energy development could revolutionize the global energy landscape by providing a virtually unlimited, inexpensive, and clean energy source. This is especially critical as global energy consumption is projected to skyrocket due to the rapid growth of AI and cryptocurrency mining. Morgan Stanley estimates that AI-related power consumption could increase fivefold in the next three years, prompting major tech companies to invest in their own nuclear reactors. This surge in demand for nuclear power has led to a significant mismatch in the supply and demand for uranium.

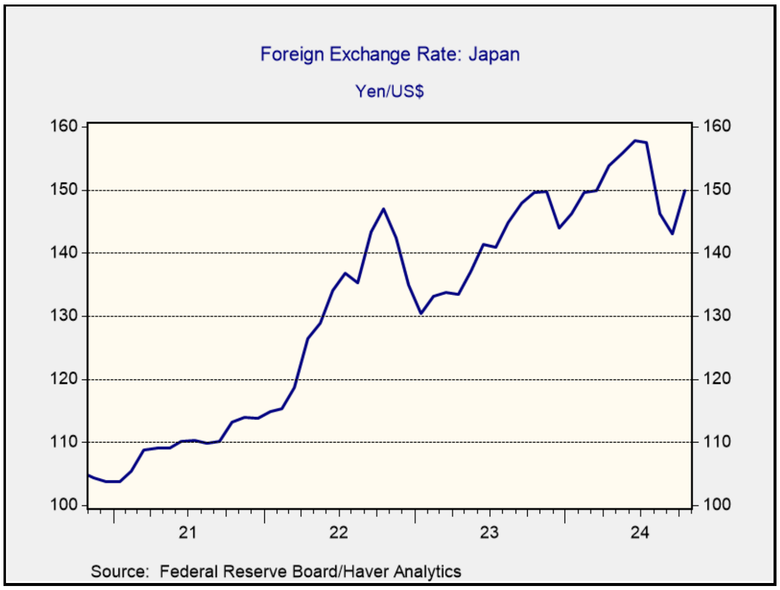


- While practical fusion energy remains years away, its potential to revolutionize the energy sector highlights the urgent need for ongoing research and development, particularly as global energy demands rise, and climate concerns intensify. We anticipate significant public and private investment across the industry as countries aim to achieve greater energy independence. Meanwhile, growing demand for uranium from the nuclear energy industry and the tech industry's expanding data centers could further support elevated uranium prices.

Yen Back in the Spotlight: The weakening of the Japanese currency is likely to increase pressure on the Bank of Japan (BOJ) to tighten policy and potentially intervene in the foreign exchange market.

- The Japanese yen (JPY) weakened to 155 per dollar on Tuesday, affected by market reactions to the "Trump trade." The decline stems from concerns that potential US policy shifts under the new administration could lead the Fed to cut rates less than anticipated, thereby maintaining a wide policy rate differential between the US and Japan. Additionally, there are fears that Japan may suffer in a potential tariff war, as the incoming administration has pledged to impose tariffs on imports, which could hamper Japan's economic growth.

- Recent currency volatility has heightened market fears of impending monetary policy tightening by the central bank. The October meeting minutes from the BOJ revealed internal debates about the appropriate timing for such a move, with some policymakers expressing concerns about potential market volatility following the US election. While the bank ultimately decided to hold rates unchanged, the sentiment suggests that the central bank would need to take more action to prevent the currency from weakening, adding to inflationary pressures. Nevertheless, most policymakers favored a cautious approach to rate hikes.



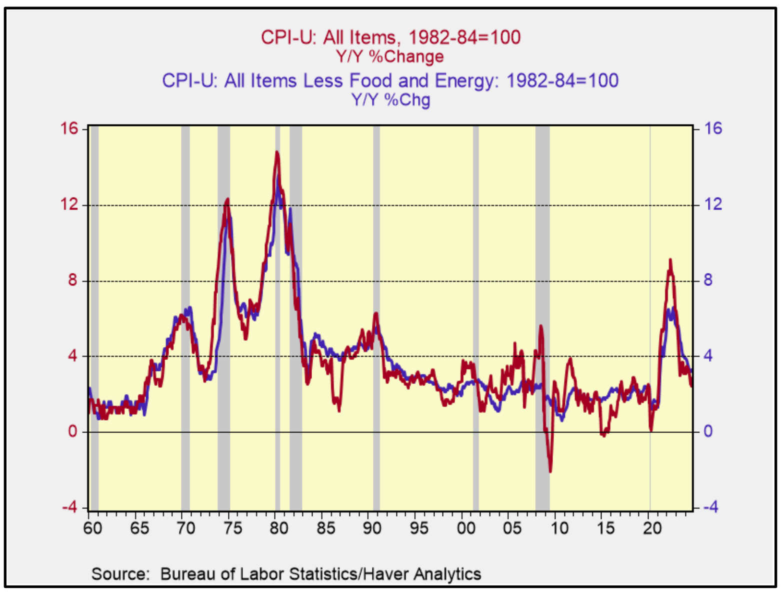
- BOJ policymakers are expected to tighten policy at their December meeting, though the path forward will largely hinge on future Fed actions. Japanese officials are keen to avoid a repeat of July's market turmoil, when the rapid unwinding of the yen carry trade led to widespread panic. As a result, the BOJ may be hesitant to hike rates if the Federal Reserve does not continue its easing cycle. If this scenario unfolds, we anticipate the BOJ may lean toward currency market interventions to prevent exchange rate fluctuations from adding to price pressures.

In Other News: President-elect Donald Trump is expected to sign an executive order to establish a board overseeing military generals. In southern China, a deadly attack resulted in 35 fatalities, exacerbating public anxiety amid significant economic concerns. The German government has admitted defeat in its quest to stop the acquisition of Commerzbank by UniCredit.

US Economic Releases

The Mortgage Bankers Association today said ***mortgage applications*** in the week ended November 8 rose 0.5%, compared to last week's loss of 10.8%. Applications for home purchase mortgages rose 1.9%, after falling 5.1% last week. Applications for refinancing mortgages fell 1.5%, the seventh consecutive decline for this portion of the index, the longest such stretch since April 2022. According to the report, the average interest rate on a 30-year mortgage rose five basis points to 6.86%, continuing its streak of weekly increases. The rate has climbed 72 basis points in the last six weeks to its highest level since July.

The October ***consumer price index (CPI)*** rose by a seasonally adjusted 0.2%. Excluding the volatile food and energy components, the ***"core" CPI*** rose 0.3%. The overall CPI in October rose 2.6% from the same month one year earlier, while the core CPI rose 3.3%. Each of these numbers exactly matches the surveyed expectation, inspiring an initial positive reaction from the market. The chart below shows the year-over-year change in the CPI and the core CPI since 1960.



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

Economic Releases						
ET	**Indicator**			**Expected**	**Prior**	**Rating**
14:00	Federal Budget Balance	m/m	Oct	-$225.0b	$64.3b	***
Federal Reserve						
ET	**Speaker or Event**	**District or Position**				
8:30	Neel Kashkari Appears on Bloomberg Television	President of the Federal Reserve Bank of Minneapolis				
9:30	John Williams Gives Welcome Remarks	President of the Federal Reserve Bank of New York				
9:45	Lorie Logan Gives Opening Remarks at Energy Conference	President of the Federal Reserve Bank of Dallas				
13:00	Alberto Musalem Speaks on Ecomomy, Monetary Policy	President of the Federal Reserve Bank of St. Louis				
13:30	Jeffrey Schmid Gives Keynote Remarks at Energy Conference	President of the Federal Reserve Bank of Kansas City				

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	PPI	y/y	Oct	3.4%	3.1%	2.9%	***	Equity bearish, bond bullish
Australia	Wage Price Index	m/m	3Q	3.50%	4.1%	3.6%	***	Equity and bond neutral
South Korea	Export Price Index	y/y	Oct	2.0%	1.0%		*	Equity and bond neutral
	Import Price Index	y/y	Oct	-2.5%	-3.7%		*	Equity and bond neutral
	Unemployment Rate	m/m	Oct	2.7%	2.5%	2.6%	***	Equity and bond neutral
EUROPE								
France	ILO Unemployment Rate	q/q	Q3	7.4%	7.3%	7.4%	*	Equity and bond neutral
AMERICAS								
Canada	Building Permits	m/m	Sep	11.5%	-6.3%	3.20	**	Equity bullish, bond bearish
Mexico	International Reserves Weekly	w/w	8-Nov	$226058m	$226024m		*	Equity and bond neutral
	ANTAD Same-Store Sales	y/y	Oct	1.70%	3.10%		*	Equity and bond neutral
Brazil	IBGE Services Volume	y/y	Sep	4.0%	1.9%	3.4%	*	Equity bullish, bond bearish

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)	452	453	-1	Down
U.S. Libor/OIS spread (bps)	449	450	-1	Down
10-yr T-note (%)	4.41	4.43	-0.02	Down
Euribor/OIS spread (bps)	303	304	-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	$71.97	$71.89	0.11%	
WTI	$68.21	$68.12	0.13%	
Natural Gas	$2.87	$2.91	-1.24%	
Crack Spread	$17.95	$17.80	0.88%	
12-mo strip crack	$20.37	$20.31	0.34%	
Ethanol rack	$1.75	$1.75	0.08%	
Metals				
Gold	$2,610.58	$2,598.39	0.47%	
Silver	$30.91	$30.72	0.61%	
Copper contract	$413.15	$413.65	-0.12%	
Grains				
Corn contract	$428.50	$428.50	0.00%	
Wheat contract	$548.00	$552.25	-0.77%	
Soybeans contract	$1,009.25	$1,010.50	-0.12%	
Shipping				
Baltic Dry Freight	1,634	1,558	76	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		0.42		
Gasoline (mb)		0.27		
Distillates (mb)		0.98		
Refinery run rates (%)		0.6%		
Natural gas (bcf)		68		

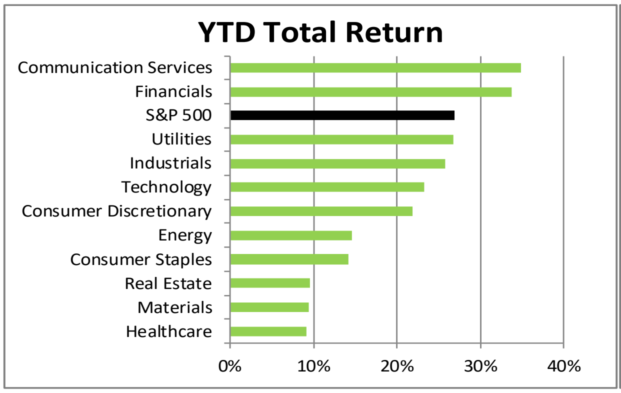
Weather

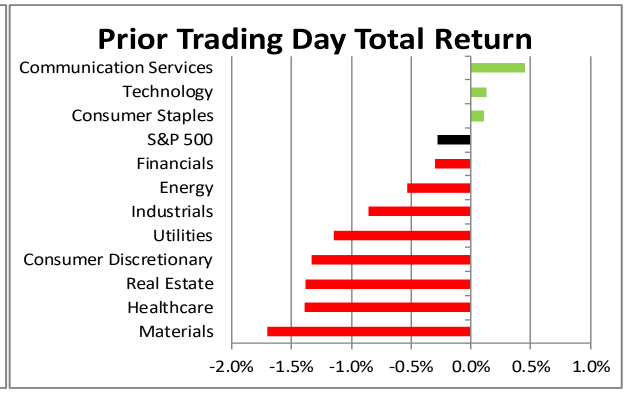
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures in the Northeast and Great Lakes region, with cooler-than-normal temperatures from the Rocky Mountains westward. The forecasts call for wetter-than-normal conditions in Florida and the northern part of the country stretching from the Great Plains to the East Coast, with drier-than-normal conditions in the Pacific Northwest.

A tropical disturbance is tracking westward across the northern Caribbean Sea just south of Jamaica with a 90% chance of cyclonic formation within the next 48 hours.

Data Section

US Equity Markets – (as of 11/12/2024 close)

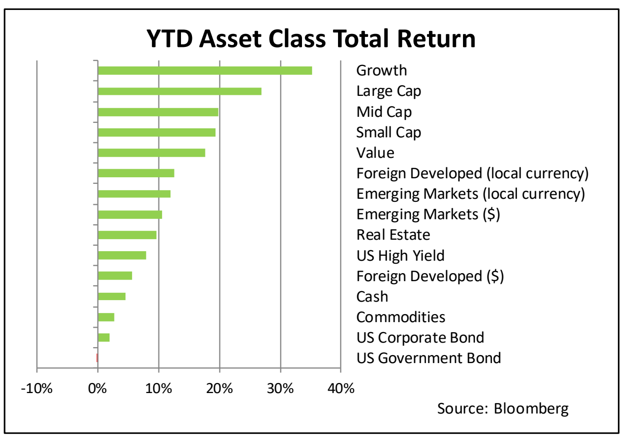




(Source: Bloomberg)

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 11/12/2024 close)

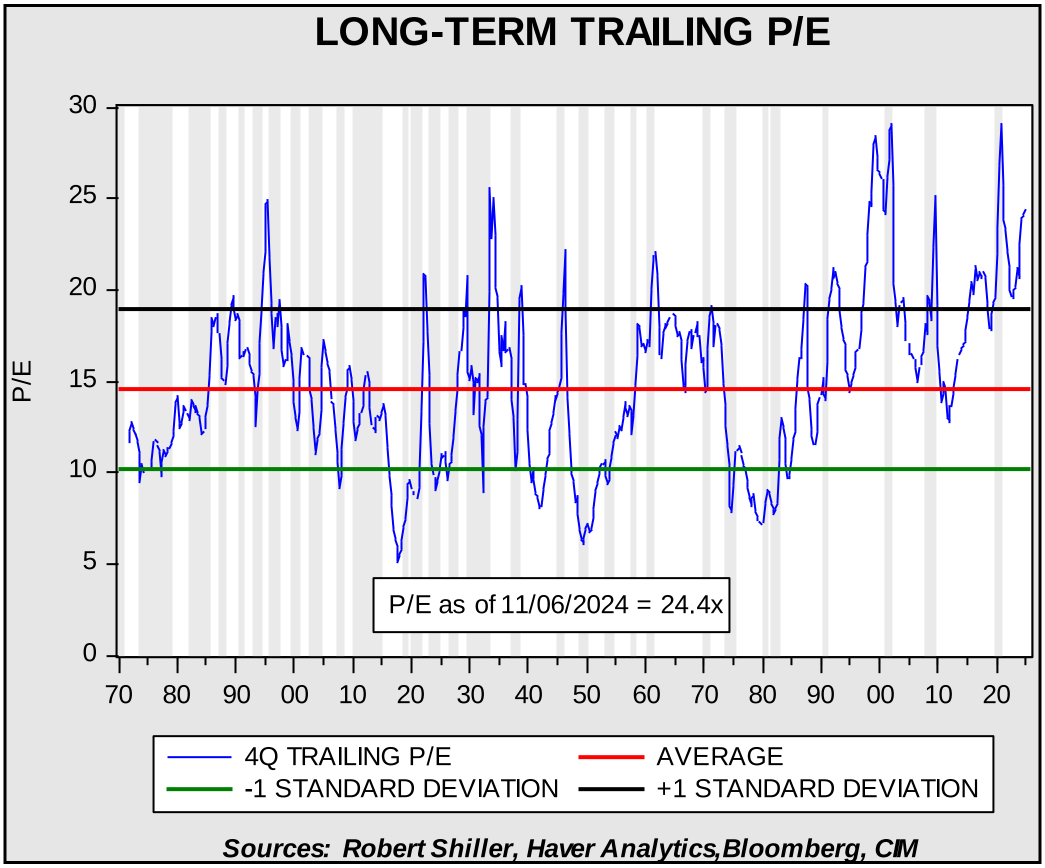


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.