Daily Comment

Confluence INVESTMENT MANAGEMENT

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[Posted: November 14, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed up 1.9% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.9%. Chinese markets were lower, with the Shanghai Composite down 1.7% from its previous close and the Shenzhen Composite down 2.8%. US equity index futures are signaling a higher open.

With 459 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, 75.3% 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:

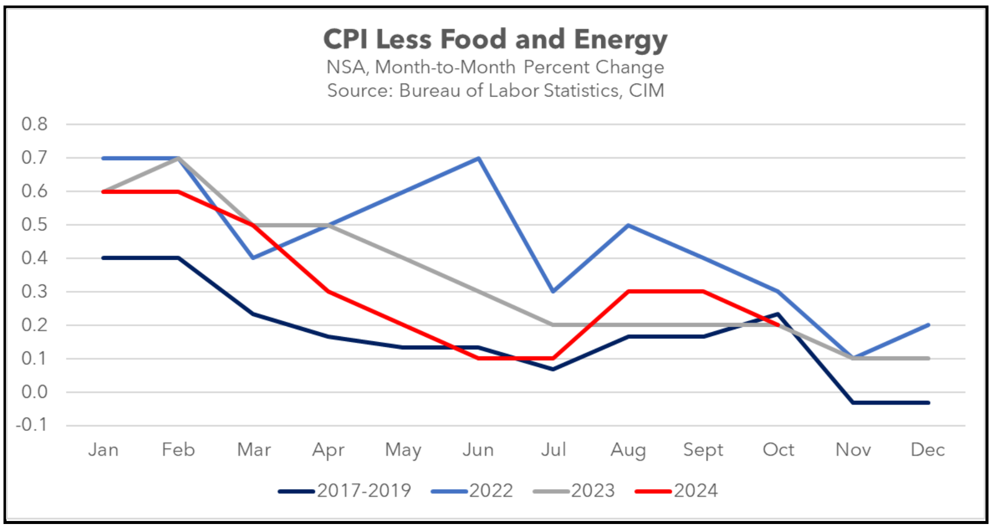
Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
Rising US & Global Debt: A Perspective Check (11/4/24) + podcast	*Let's Talk About Tariffs!* (11/11/24) + podcast	Q4 2024 Report Q4 2024 Rebalance Presentation	Confluence of Ideas Podcast *The Q4 Asset Allocation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

Good morning! Markets are closely watching the latest producer price inflation data for insights into the Fed's upcoming rate decision. In sports, the Cleveland Cavaliers extended their unbeaten streak to thirteen, becoming the sixth NBA team to reach this milestone. Today's *Comment* will cover our analysis of the latest CPI data, explore why gold and the US dollar are moving in opposite directions, and provide an update on Brazil. As always, we'll conclude with a roundup of key international and domestic data releases.

CPI on Target: While inflation progress showed signs of stalling in October, the report still leaves the door open for a December rate cut.

- October's Consumer Price Index (CPI) data, released by the Bureau of Labor Statistics, revealed a slight uptick in annual inflation from 2.4% to 2.6%. While this figure met market expectations, it also underscored the persistence of inflationary pressures and the ongoing challenge of reaching the Federal Reserve's 2% target. Core inflation, which excludes volatile food and energy prices, remained relatively stable at 3.3% year-over-year. This stability was attributed to a combination of factors, including a resurgence in used car price inflation and volatile shelter prices.

- The temporary pause in inflation progress can largely be attributed to seasonal adjustments. A more accurate picture emerges when examining non-seasonally adjusted data, which is not susceptible to annual revisions. This data reveals a deceleration in inflation from the previous month, with the October rate falling below the three-year pre-pandemic average and matching the previous year's pace. This modest easing of price pressures likely explains the market's increased confidence in a December rate cut, which accelerated from a projected 65% likelihood to over 80% yesterday.



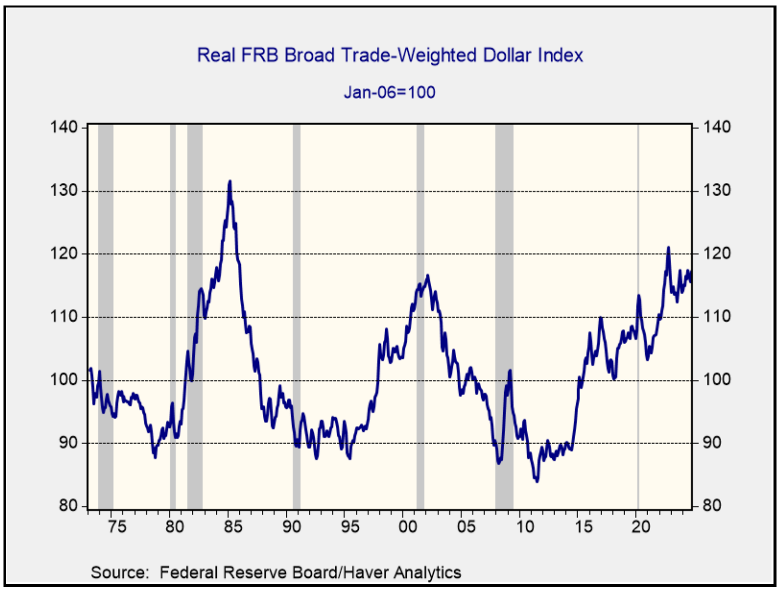
- The true test of the Fed's progress toward its 2% inflation target will come with the release of next month's report, a week before the Fed's upcoming meeting. November typically sees the year's lowest inflation readings. If inflation doesn't show signs of easing, the Fed may be reluctant to lower its benchmark interest rate. The Cleveland Fed's current estimate of a 0.27% change for both core and headline CPI in November is unlikely to appease policymakers. As a result, we believe that market expectations of another rate cut may be overly optimistic.

Gold and the Dollar: Gold has plummeted but the dollar has gained since the election as investors weigh the impact of tariffs on the global economy.

- Since Trump's election, gold bullion prices have dropped by 5% as investors grow increasingly concerned about the potential impact of US tariffs on the global economy. This recent sell-off reflects fears that US trade restrictions could further strain major exporters already facing weaker GDP growth. Bundesbank President Joachim Nagel cautioned that tariffs could reduce Germany's GDP growth by 1%, while tariffs on

Chinese goods risk exacerbating China's overcapacity issues, complicating Beijing's economic stimulus efforts.

- The decline in gold prices has coincided with a sharp appreciation of the US dollar, signaling a potential policy shift. Markets are factoring in the inflationary impact of import tariffs, which could constrain the Fed's ability to cut rates next year. Speculation also suggests that policymakers in China and the EU may reconsider aggressive stimulus measures, aiming instead to keep exports competitive. Trump's election has fueled expectations that China may ramp up fiscal spending, while Europe is anticipated to pursue deeper rate cuts.

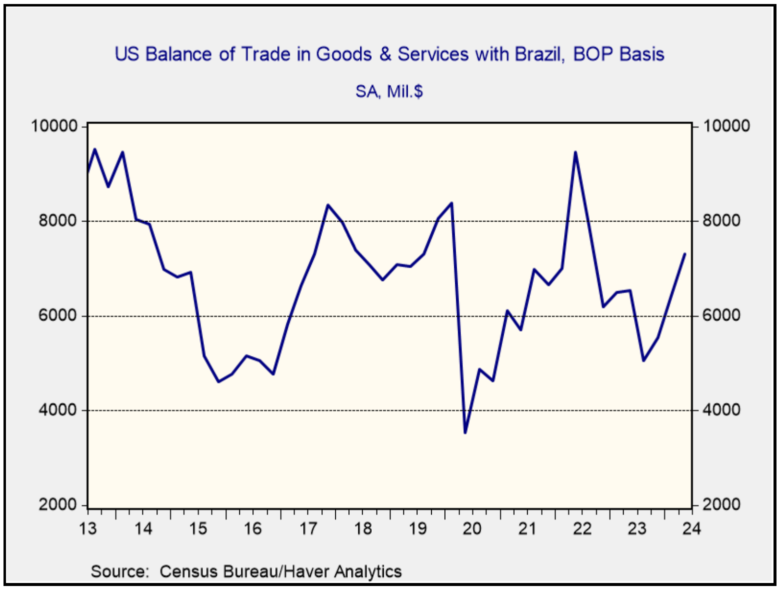


- The inverse relationship between gold and the dollar is likely a short-term trend, as markets gain clarity on US fiscal and monetary policies. The market appears to have largely priced in the potential negative impacts of a trade war. We expect gold to bottom out in the coming days as growth concerns subside. We also anticipate that the central bank will prioritize protecting the labor market over counteracting inflationary pressures from tariffs. As a result, both the dollar and gold are likely to lose momentum in the near future.

Brazil's Delicate Dance: Latin America's largest economy will likely face a tough test as it decides whether it will prioritize its relationship with the US or China.

- Brazilian President Luiz Inácio Lula da Silva has prioritized deepening Brazil's relationship with China, often at the expense of its ties with the United States. This shift will be highlighted as Xi Jinping meets with Latin American leaders at the APEC forum in Peru, attends the G-20 summit in Rio de Janeiro, and travels to Brasilia for a state visit. Lula is expected to advocate for an increase in Chinese infrastructure investment to reduce shipping times, elevate Brazil's position in the global value chain, and boost its economic potential.

- Despite its traditional non-aligned stance, Brazil has increasingly tilted towards China, drawing US criticism. Last month, Brazil's agriculture minister advocated joining the Belt and Road Initiative as a shield against Western protectionism. This move could further solidify Brazil's position within China's sphere of influence, potentially provoking a negative response from a Trump administration that favors clear-cut alliances. Furthermore, Brazil's growing competition with the US agricultural sector in the Chinese market is likely to intensify tensions between the two countries.



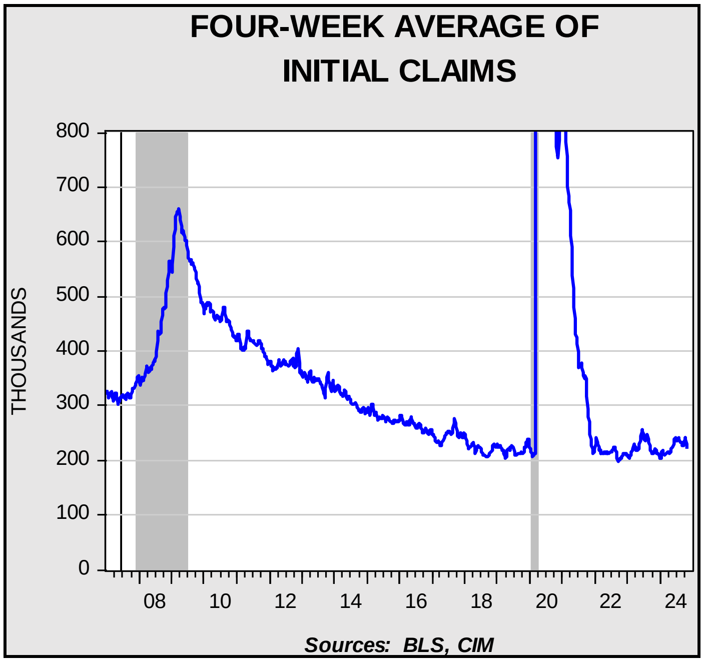
- While our analysis indicates a slight tilt towards China, Brazil's economic growth hinges on maintaining strong relationships with both the US and China. To navigate this delicate balance, Brazil must demonstrate its independence from either power. Failure to do so could lead to potential US retaliation, particularly in the form of reduced foreign direct investment. The Biden administration's recent establishment of an outbound investment security program, aimed at monitoring countries supporting Chinese development, underscores this risk as this will be passed onto the next administration to use as well.

In Other News: President-elect Donald Trump has selected a slew of controversial leaders to take over various government positions, in what looks to be a test of his influence within the party. US dockworkers have decided to end negotiations in a sign that another strike could take place in January.

US Economic Releases

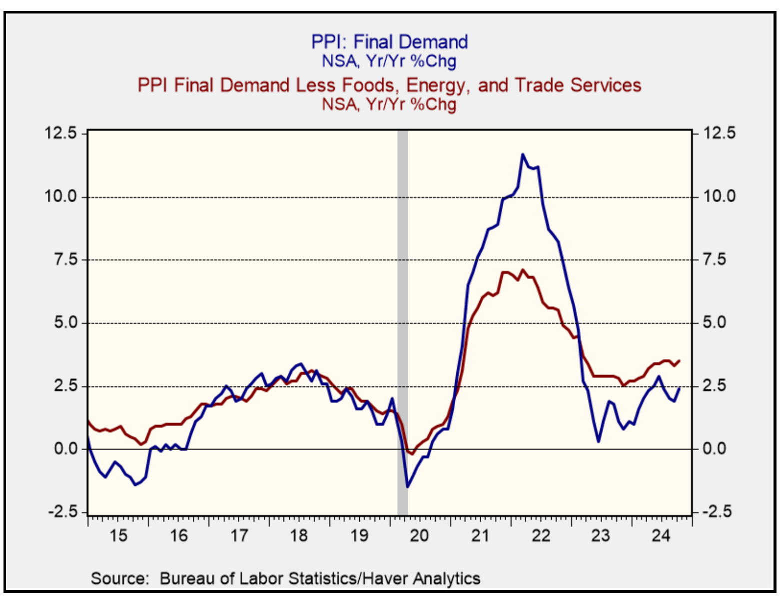
Initial jobless claims for the week ending November 9 declined to 217,000, marking a decrease from the previous week's 221,000. This figure also undershot market expectations of 223,000.

Additionally, continuing claims fell from 1,892,000 to 1,873,000. This sustained decline in jobless claims reinforces the notion of a tight labor market.



The chart above displays the four-week moving average of initial jobless claims. This moving average decreased from 227,250 to 221,000.

Wholesale inflation edged up slightly in October, largely in line with market expectations. The Producer Price Index (PPI) increased by 0.2% month-over-month, matching forecasts. The previous month's reading was revised downward from 0.2% to 0.1%. Core PPI, which excludes volatile food, energy, and trade costs, rose by 0.3% over the same period.



The chart above shows the year-over-year change for both core and headline PPI. While the overall index accelerated from a 1.9% increase to 2.4%, the core index saw a more modest rise from 3.3% to 3.5%. This leveling off in PPI growth raises concerns that inflationary pressures may be returning.

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

Economic Releases		
	No economic releases for the rest of today	
Federal Reserve		
ET	**Speaker or Event**	**District or Position**
7:00	Adriana Kugler Speaks on Economic Outlook	Member of the Board of Governors
9:00	Thomas Barkin Discusses Economy in Fireside Chat	President of the Federal Reserve Bank of Richmond
15:00	Jerome Powell Speaks on Economic Outlook in Dallas	Chairman of the Board of Governors
16:45	John Williams Speaks at NYFed Event	President of the Federal Reserve Bank of New York

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	Japan Buying Foreign Bonds	w/w	8-Nov	¥1724.6b	-¥4457.9b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	8-Nov	-¥922.1b	-¥1173.6b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	8-Nov	-¥308.6b	-¥43.6b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	8-Nov	¥513.9b	¥153.2b		*	Equity and bond neutral
Australia	Employment Change	m/m	Oct	15.9k	61.3k	25.0k	***	Equity and bond neutral
	Unemployment Rate	m/m	Oct	4.1%	4.1%	4.1%	***	Equity and bond neutral
	Participation Rate	m/m	Oct	67.1%	67.2%	67.2%	**	Equity and bond neutral
New Zealand	REINZ House Sales	y/y	Oct	20.0%	3.2%		**	Equity and bond neutral
	Food Prices	m/m	Oct	-0.9%	0.5%		***	Equity and bond neutral
India	Trade Balance	m/m	Oct	-$27142m	-$20781m	-$22000m	*	Equity and bond neutral
	Exports	y/y	Oct	17.2%	0.5%		**	Equity and bond neutral
	Imports	y/y	Oct	3.9%	1.6%		**	Equity and bond neutral
EUROPE								
Eurozone	GDP SA	y/y	3Q P	0.9%	0.9%	0.9%	***	Equity and bond neutral
	Industrial Production WDA	y/y	Sep	-2.8%	-0.1%	-2.0%	**	Equity bearish, bond bullish
UK	RICS House Price Balance	y/y	Oct	16.0%	11.0%	11.0%	**	Equity bearish, bond bullish
Russia	GDP	y/y	3Q A	3.1%	4.1%	3.0%	**	Equity and bond neutral
	CPI	y/y	Oct	8.5%	8.6%	8.6%	***	Equity and bond neutral
	Core CPI	y/y	Oct	8.2%	8.3%	8.2%	**	Equity and bond neutral
AMERICAS								
Brazil	FGV Inflation IGP-10	m/m	Nov	1.45%	1.34%	1.46%	**	Equity and bond neutral
	Econimic Activity	y/y	Sep	5.1%	3.4%	4.4%	*	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)	438	439	-1	Down
U.S. Sibor/OIS spread (bps)	449	449	0	Down
U.S. Libor/OIS spread (bps)	445	445	0	Down
10-yr T-note (%)	4.45	4.45	0.00	Up
Euribor/OIS spread (bps)	302	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	$72.59	$72.28	0.43%	
WTI	$68.76	$68.43	0.48%	
Natural Gas	$2.94	$2.98	-1.34%	
Crack Spread	$17.49	$17.66	-0.95%	
12-mo strip crack	$20.18	$20.31	-0.62%	
Ethanol rack	$1.75	$1.75	0.05%	
Metals				
Gold	$2,556.26	$2,572.98	-0.65%	
Silver	$30.00	$30.31	-1.02%	
Copper contract	$402.90	$408.30	-1.32%	
Grains				
Corn contract	$437.00	$437.50	-0.11%	
Wheat contract	$553.25	$556.50	-0.58%	
Soybeans contract	$1,010.00	$1,007.75	0.22%	
Shipping				
Baltic Dry Freight	1,630	1,634	-4	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		1.60		
Gasoline (mb)		1.00		
Distillates (mb)		1.27		
Refinery run rates (%)		0.7%		

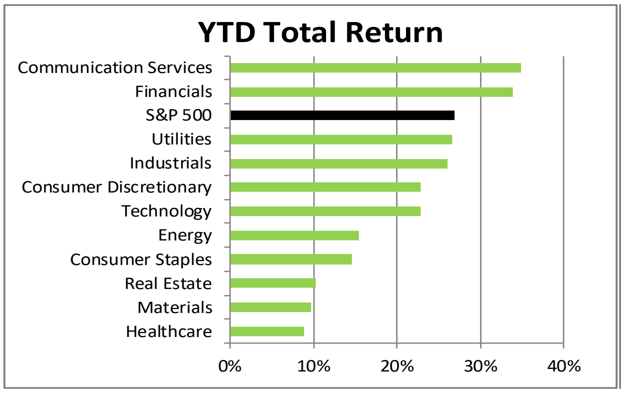
Weather

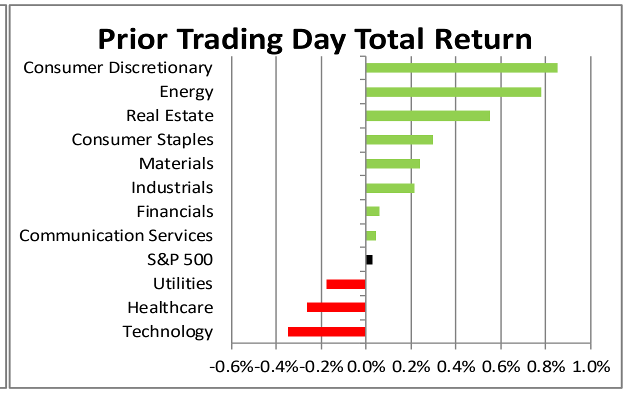
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures in the Northeast and on the Pacific Coast, with cooler temperatures expected in the Southwest and Midwest. The precipitation outlook calls for wetter-than-normal conditions in the Rockies and New England, and dry conditions throughout the Southern states.

A tropical depression has developed along the Yucatán peninsula, but it is not expected to develop into a hurricane within the next seven days.

Data Section

US Equity Markets – (as of 11/13/2024 close)

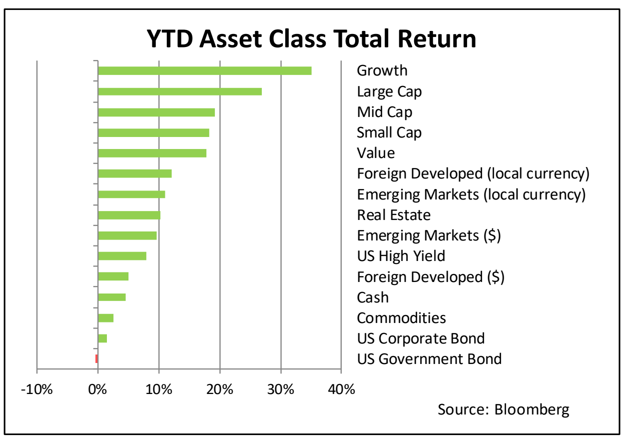




(Source: Bloomberg)

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 11/13/2024 close)

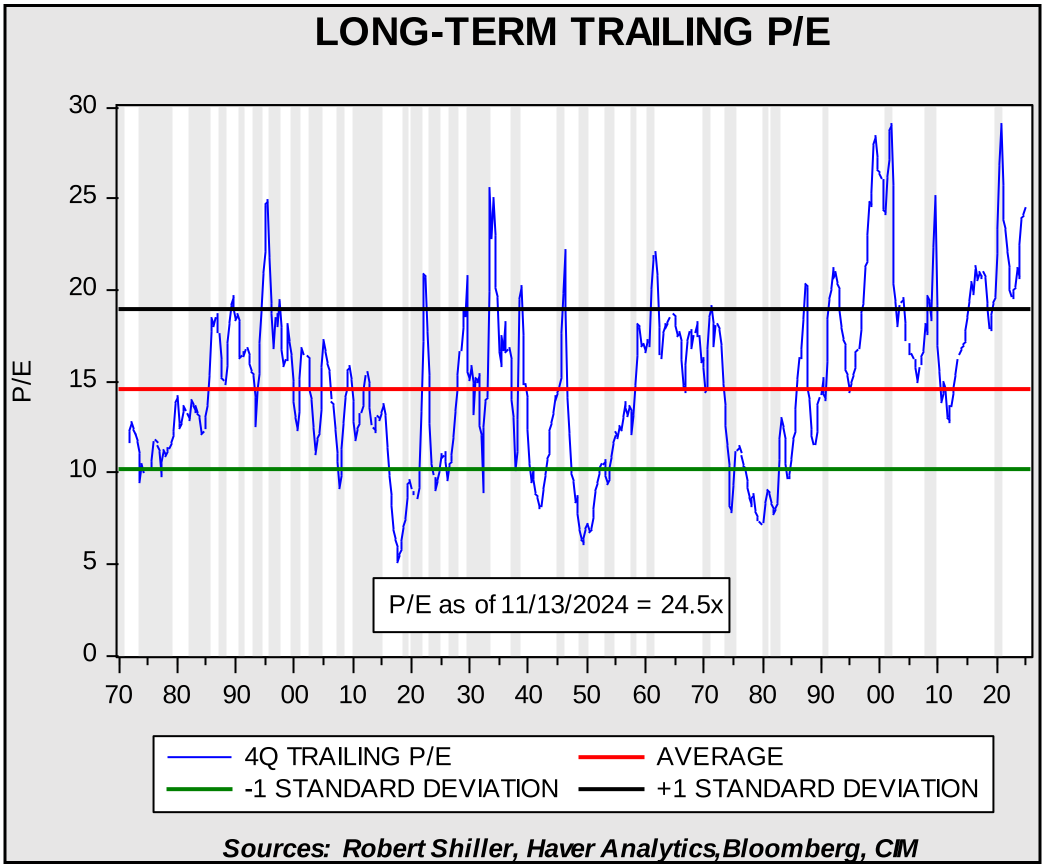


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 14, 2024



Based on our methodology,[1] the current P/E is 24.5x, up 0.1 from our last report. The increase is the multiple was driven by an increase in the stock price index.

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.