Daily Comment

Confluence Investment Management

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[Posted: November 19, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed down 1.2% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.6%. Chinese markets were higher, with the Shanghai Composite up 0.7% from its previous close and the Shenzhen Composite up 2.2%. US equity index futures are signaling a lower open.

With 461 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, 75.4% have exceeded expectations, while 17.8% 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 in bold:

Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
Implications of North Korean Soldiers in the Ukraine War **(11/18/24)** **+ 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*

Our *Comment* today opens with the latest sign of further global fracturing: a new Chinese policy further restricting the export of critical minerals with dual military and civilian uses. We next review several other international and US developments with the potential to affect the financial markets today, including an apparent new instance of Russian sabotage against members of the North Atlantic Treaty Organization in Europe and a Walmart earnings report that suggests US consumer spending remains strong enough to support overall economic growth.

China: The Ministry of Commerce has announced it will begin restricting the export of more critical minerals with dual military and civilian uses, including tungsten, graphite, magnesium, and aluminum alloys. The new restrictions, which will be effective December 1, will supplement current export restrictions on dual-use minerals such as germanium and gallium.

- All the restricted minerals are important to certain advanced technologies, such as semiconductors and electric vehicles.
- As we have argued many times before, China is likely to keep weaponizing its mineral resources to retaliate for the West's new trade and technology barriers, which in turn aim to thwart China's growing geopolitical, military, and economic power.
- As a result, we believe tensions between China and the West will continue to spiral, creating ever more risks for the global economy and financial markets.

Russia-Hezbollah-Israel: Israeli forces battling Islamist Hezbollah militants in southern Lebanon are reportedly finding they have large amounts of modern, powerful Russian weapons. Some of the weapons apparently came from Syria, which itself buys Russian weapons but also hosts Russian military bases. The findings suggest the Iran-backed Hezbollah fighters have access to more and better-quality Russian weapons than was previously known.

- Hezbollah's unexpectedly large and modern arsenal of Russian weapons illustrates the increasing inter-connectedness and internationalization of today's major wars. In Israel's fight against Hamas in Gaza and Hezbollah in Lebanon, for example, those militants are being supported by Iran and Russia. In Ukraine's effort to defend itself against Russia's invasion, the Russians are being supported by China, Iran, and North Korea.
- In our latest *Bi-Weekly Geopolitical Report*, published on Monday, we wrote in more detail about the North Korean troops in Russia.
- This inter-connectedness and internationalization of conflicts seems to be a symptom of the way the world is fracturing into relatively separate geopolitical and economic blocs. The development seems to be progressing most strongly within the US bloc's most powerful rival: the China bloc. Greater geopolitical and military cooperation by China, Russia, Iran, North Korea, and the rest of Beijing's bloc is another reason to expect worsening global tensions and investment risks going forward.

Russia-Germany-Finland-Sweden-Lithuania: In another potential sign of conflicts becoming more inter-connected and internationalized, two undersea communications cables under the Baltic Sea have been cut so far this week. One of the cables connected Germany and Finland, while the other connected Sweden and Lithuania.

- The German defense minister has stated unequivocally that the damage was deliberate sabotage, rather than an accident.
- That implies the perpetrator was Russia, which has staged increasingly brazen attacks on defense, industrial, and infrastructure targets in NATO countries over the last year. Those attacks apparently aim to punish NATO countries for helping Ukraine fend off Russia's invasion.
- For investors, the key risk is that Russia's increasingly aggressive sabotage attacks could eventually draw NATO or at least Western European countries more deeply into the Russia-Ukraine conflict.

European Union: As part of a new program supporting the EU's advanced battery industry, the European Commission reportedly plans to provide subsidies to Chinese manufacturers only if they open new factories in the EU and share technological know-how with local partners. The policy would turn the tables on Beijing, which long took the same approach to Western firms investing in China. It also represents a further hardening of the EU's stance against Chinese economic competition.

US National Security Policy: The Office of the Director of National Intelligence and the Central Intelligence Agency both said their inspector generals (IG) have announced an intention to resign before President-elect Trump is inaugurated again. The announcements come as Trump is widely expected to fire existing IGs and replace them with loyalists, as called for in the Heritage Foundation's "Project 2025" plan.

- Although appointed by the president, each IG is supposed to investigate cases of waste, fraud, and abuse of power independently and impartially and report them to their agency chief and Congress.
- Observers fear that if an agency's IG is overly deferential to the president, it could operate less efficiently, and its officials would have a free hand to violate the law or otherwise abuse their power.

US Economic Policy: President-elect Trump has broadened his search for a Treasury secretary after getting irritated by the rivalry and jostling of his two initial candidates: hedge-fund manager Scott Bessent and Cantor Fitzgerald co-chair Howard Lutnick. Trump is now also considering former Federal Reserve board member Kevin Warsh, private-equity CEO Marc Rowan, Tennessee Sen. Bill Hagerty, and former US Trade Representative Robert Lighthizer. Betting markets currently give Warsh the nod, with a 43% chance of winning the nomination.

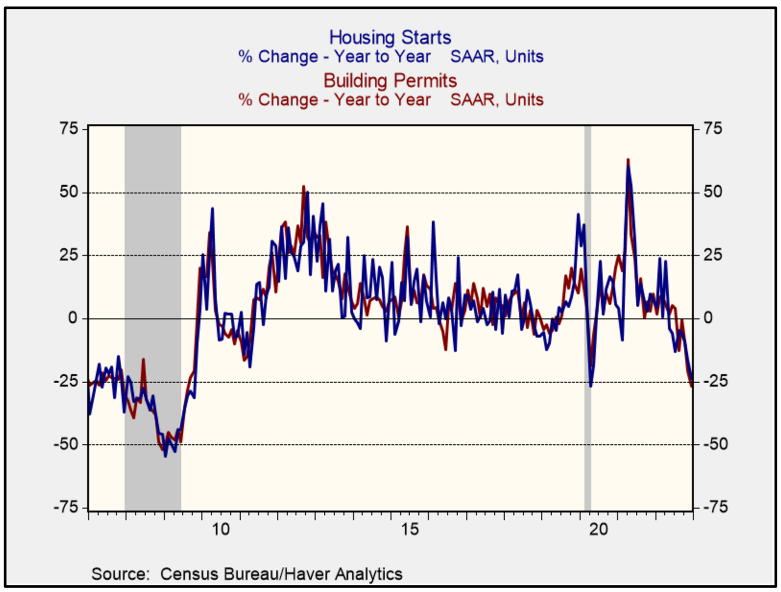
US Retail Industry: Retail giant Walmart this morning said sales from its digital channels and stores that were open at least 12 months were up 5.3% from one year earlier in its fiscal quarter ended on October 25, beating the expected rise of 3.9%. According to the company, the sales gain came from growth across a wide range of products and customer income levels. Adjusted earnings in the quarter came in at $0.58 per share, also beating estimates, and the company boosted its outlook for the full fiscal year.

- Given its enormous size and footprint, Walmart is a bellwether for US consumer demand. Its healthy sales, profit, and outlook in the latest quarter suggest consumption spending will continue to boost the overall US economy in the near term.
- Nevertheless, because of Walmart's competitive pricing, its sales gains may also reflect trading down by some consumers stressed by high costs and continued inflation pressures at other retailers.

US Stock Market: According to VerityData, executives at firms in the Wilshire 5000 stock index have been selling equities in their own companies at a record place amid the run-up in prices after President-elect Trump's victory in the November election. The strong insider selling suggests at least some corporate managers see their stock price as inflated and want to take profits.

US Economic Releases

October ***housing starts*** fell to a seasonally adjusted, annualized rate of 1.31 million units, falling short of the expected rate of 1.33 million units and the revised 1.35 million units. The rate of housing starts in October fell 3.1% from the rate in the previous month. October ***residential building permits*** fell to a rate of 1.42 million units, falling short of the expected rate of 1.44 million units and the revised 1.43 million units. Permits issued for new housing units in October fell 0.6% from the previous month. Compared with the same month one year earlier, housing starts in October fell 3.96%, while permits fell 7.69%. The chart below shows the growth in new home starts by type of property since just before the Global Financial Crisis.



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**
13:10	Jeffrey Schmid Speaks on Economic Outlook and Monetary Policy	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
EUROPE								
Eurozone	CPI	y/y	Oct F	2.0%	1.8%	2.0%	***	Equity and bond neutral
	Core CPI	y/y	Oct F	2.7%	2.7%	2.7%	**	Equity and bond neutral
Italy	Current Account Balance	m/m	Sep	1068m	895m		*	Equity and bond neutral
Switzerland	Real Exports	m/m	Oct	11.2%	-2.3%		*	Equity and bond neutral
	Real Imports	m/m	Oct	0.7%	0.7%		*	Equity and bond neutral
AMERICAS								
Canada	Housing Starts	m/m	Oct	240.8k	223.4k	240.0k	**	Equity and bond neutral
	Int'l Securities Transactions	m/m	Sep	29.30b	10.33b		**	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)	440	439	1	Down
U.S. Sibor/OIS spread (bps)	451	452	-1	Down
U.S. Libor/OIS spread (bps)	448	449	-1	Down
10-yr T-note (%)	4.38	4.41	-0.03	Down
Euribor/OIS spread (bps)	300	300	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	$73.06	$73.30	-0.33%	
WTI	$68.82	$69.16	-0.49%	
Natural Gas	$2.95	$2.97	-0.71%	
Crack Spread	$18.98	$18.97	0.06%	
12-mo strip crack	$20.87	$20.96	-0.42%	
Ethanol rack	$1.79	$1.78	0.47%	
Metals				
Gold	$2,636.74	$2,611.83	0.95%	
Silver	$31.34	$31.17	0.54%	
Copper contract	$415.65	$416.55	-0.22%	
Grains				
Corn contract	$440.75	$439.75	0.23%	
Wheat contract	$568.75	$565.75	0.53%	
Soybeans contract	$1,007.25	$1,009.75	-0.25%	
Shipping				
Baltic Dry Freight	1,756	1,785	-29	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-0.57		
Gasoline (mb)		0.50		
Distillates (mb)		-0.20		
Refinery run rates (%)		0.4%		
Natural gas (bcf)		39		

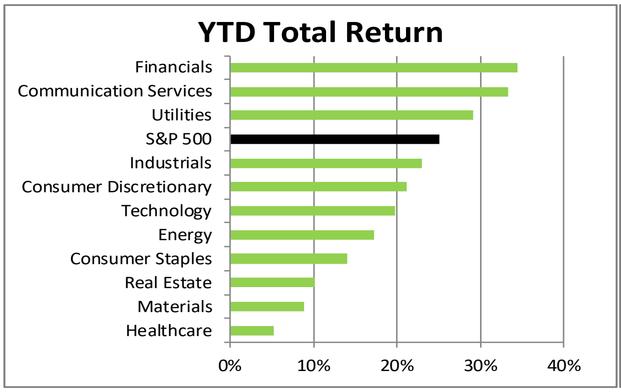
Weather

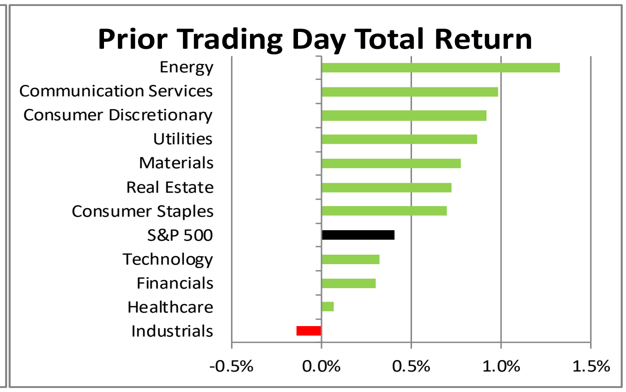
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures in Texas, the Southeast, the Ohio Valley, and the Northeast, with cooler temperatures in the northwestern third of the country. The precipitation outlook calls for wetter-than-normal conditions for most of the Pacific and Mountain states and the Ohio and Mississippi Valleys, with drier conditions expected in West Texas and southern New Mexico.

There is no cyclone formation expected within the next 48 hours. As we approach the end of the Atlantic hurricane season on November 30, we will discontinue our regular tropical storm updates.

Data Section

US Equity Markets – (as of 11/18/2024 close)

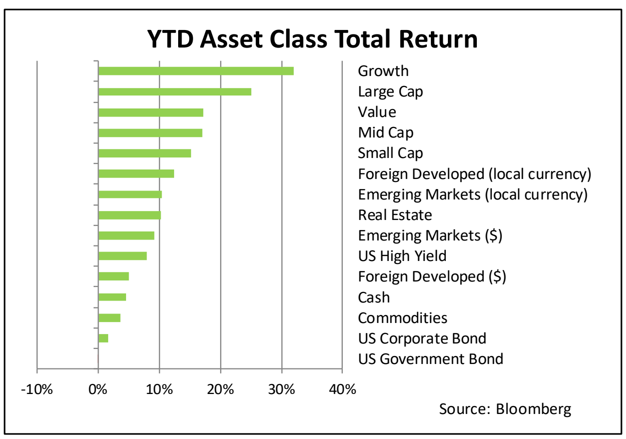




(Source: Bloomberg)

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 11/18/2024 close)

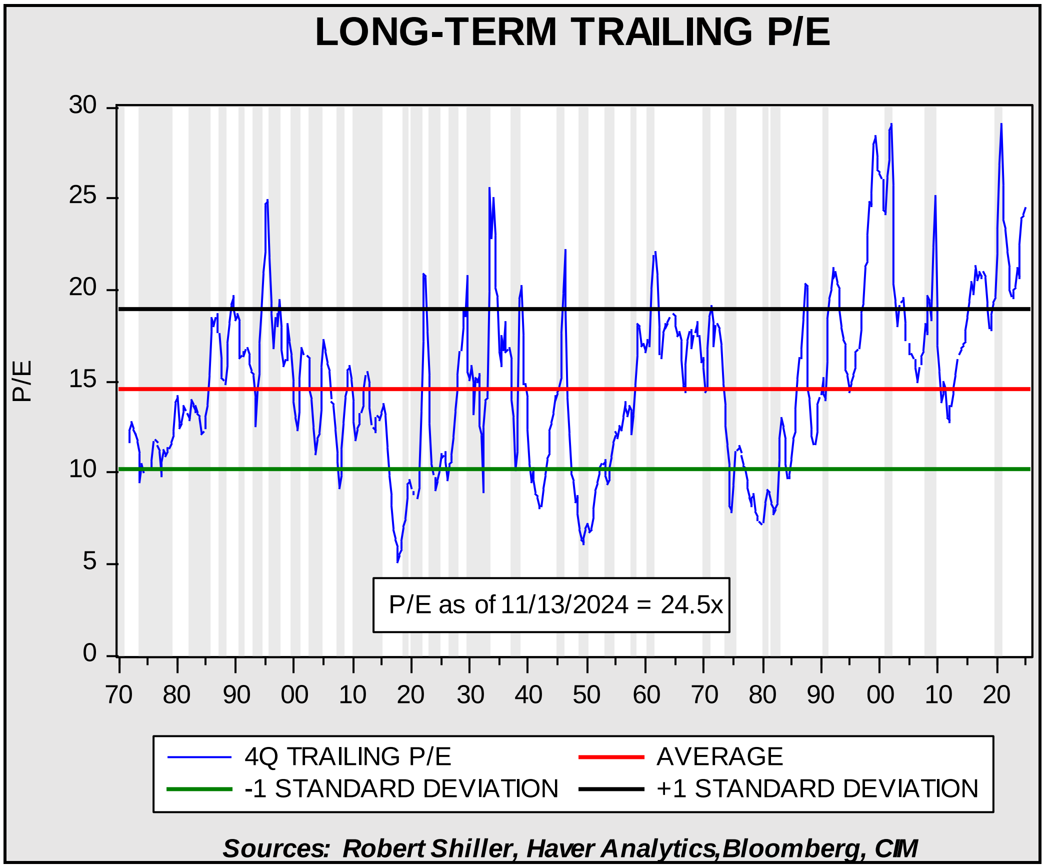


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.