Daily Comment

Confluence Investment Management

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: November 1, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed up 0.8% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.5%. Chinese markets were lower, with the Shanghai Composite down 0.2% from its previous close and the Shenzhen Composite down 2.3%. US equity index futures are signaling a higher open.

With 337 companies having reported so far, S&P 500 earnings for Q3 are running at $62.40 per share, compared to estimates of $60.44, which is up 4.2% from Q3 2023. Of the companies that have reported thus far, 74.8% have exceeded expectations while 17.2% 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:

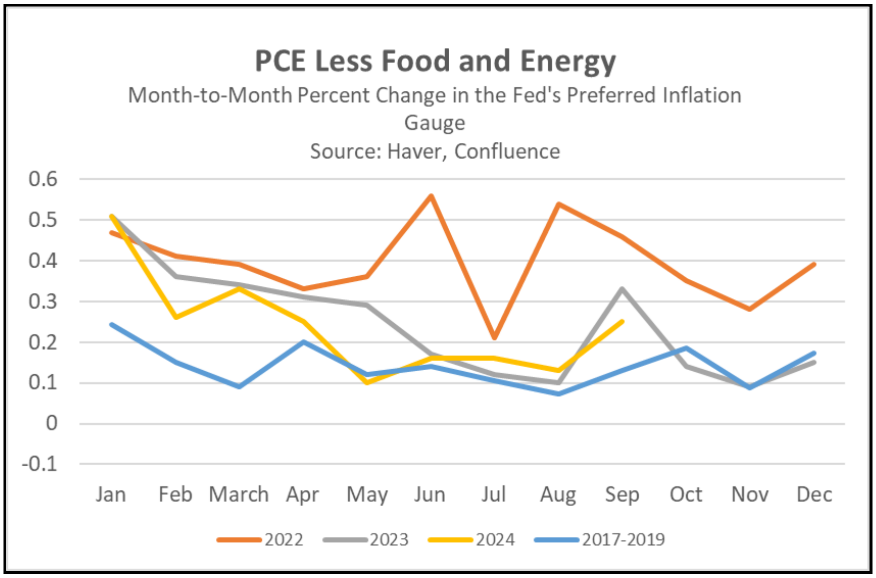
Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
Israel's Pager Caper and Supply Chain Security	The Inflation Adjustment for Social Security Benefits in 2025	Q4 2024	**Business Cycle Report**

Good morning! The market is currently processing the latest jobs data. In sports news, Carlos Alcaraz was eliminated from the Paris Masters' quarterfinals in a surprising upset. Today's *Comment* will discuss why the latest inflation figures further strengthen the Federal Reserve's case for achieving a soft landing. We will also share our thoughts on how OPEC may respond to the US's growing influence in the oil markets and conclude with a report on why the yen has begun to appreciate against the dollar. As always, our report includes both international and domestic data releases.

Inflation Cooling: The Fed's preferred inflation and wage indexes both showed signs of cooling, suggesting that the central bank may be on track for a soft landing.

- The Personal Consumption Expenditure (PCE) Price Index, a key inflation gauge, increased 2.1% year-over-year in September. This represents a slight deceleration from the previous month's 2.3% increase and aligns with market expectations. Core PCE, excluding volatile food and energy prices, remained stable at 2.7%. Meanwhile, the Employment Cost index, which tracks wage pressures, increased at an annualized rate of 0.8%, down from 0.9% in the previous quarter. The combined easing of inflation and wage growth provides further evidence that the Fed is closer to achieving its mandate.

- The Federal Reserve's potential for multiple rate cuts remains on the table as wage and price pressures ease. Market expectations, as reflected in the CME FedWatch Tool, currently point to a near-certainty of a rate cut next week with a 70% probability of another in December. This confidence stems from the fact that inflation has shown a consistent downward trend throughout the year, with price pressures rising at a slower pace compared to the previous year. As the chart illustrates, seven out of nine months in 2024 saw a deceleration in core PCE price growth compared to the previous year.

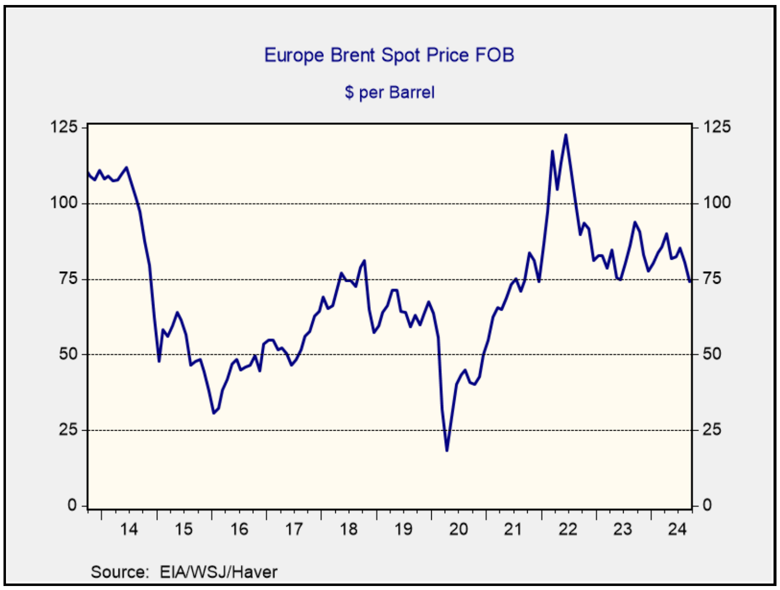


- The Fed's ability to navigate a soft landing hinges on its avoiding complacency. By carefully easing monetary policy and monitoring the normalizing labor market, the central bank can mitigate the risk of a reversal or hard landing. The next three months will be a critical test, as lower inflation readings are typically observed during this period. A substantial acceleration in October or November could lead the Fed to hold off on cutting rates in December. That said, a cut at next week's meeting does seem reasonable.

Market Share or Margins: OPEC is facing challenges in developing a strategy to address the growing competition from US oil production.

- US oil production reached a record 13.4 million barrels per day in August, helping to keep prices from surging despite escalating tensions in the Middle East. The increase was driven by Texas and New Mexico, which produced 5.8 million and 2.1 million barrels per day, respectively. Recently, strong US production has boosted its share of global oil production to nearly 22% in 2023, up from 19% in 2020. In contrast, top oil producer Saudi Arabia has maintained a steady output share of around 11%.

- The US's emergence as a major oil producer has curtailed OPEC's ability to influence global oil prices through production cuts. Despite efforts to curb supply, the oil market remains saturated due to weakening global demand, particularly from China. As a result, Saudi Arabia, OPEC's most influential member, has experienced declining revenue from both lower oil prices and reduced production. This has compelled OPEC to explore strategies to bolster profitability, as many of its member nations rely heavily on oil revenues to fund their governments.

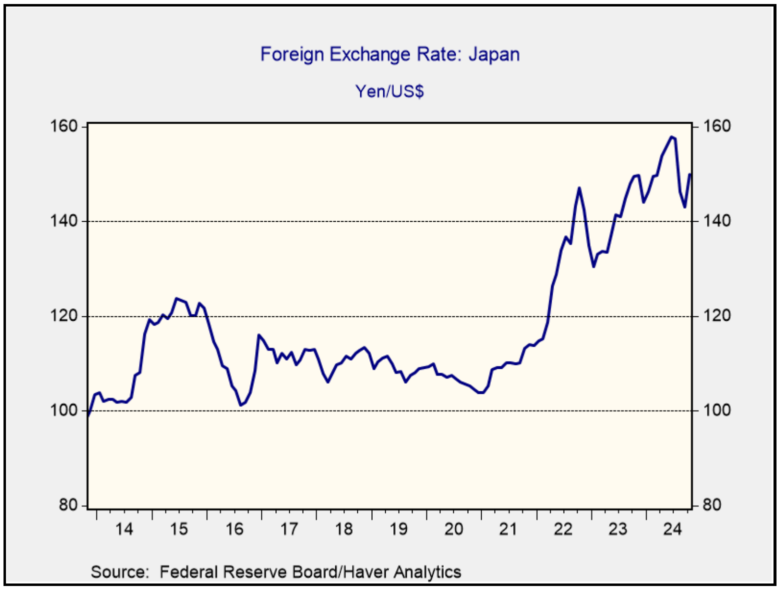


- OPEC is poised to address the global oil oversupply issue at its December meeting. While production cuts to bolster prices remain a possibility, the cartel may alternatively opt to flood the market to weaken competitors and regain market share. OPEC's decision will likely depend on its assessment of global economic growth in the coming months. A positive outlook on global growth could prompt production cuts, supporting oil prices. Conversely, a pessimistic forecast for the global economy may lead to increased production, putting downward pressure on prices.

Japanese Yen Resurgence: Speculation over monetary policy has led the yen (JPY) to strengthen and Japanese equities to fall.

- On Thursday, Bank of Japan Governor Kazuo Ueda announced that the central bank would no longer state that it can "afford time" on future rate hikes, acknowledging that fluctuations in foreign exchange rates are having an effect on domestic price pressures. His comments marked a hawkish shift from the previous day's more general BOJ statement, which had suggested that any rate increases would depend on economic and inflation trends aligning with the bank's forecasts. Following Ueda's remarks on Thursday, the Japanese yen surged 1% against the dollar at its highest.

- Since September, the country's currency has depreciated significantly against the dollar, falling nearly 7%. This sharp devaluation was likely driven by a sudden shift in global interest rate expectations, primarily due to changes in market sentiment regarding central bank policies in the US and Japan. Following the September FOMC meeting, investors have begun to price in fewer rate cuts over the next few years. Additionally, the July market turmoil caused by the unwinding of the yen carry trade has led investors to believe that the Bank of Japan will adopt a cautious approach to rate cuts.

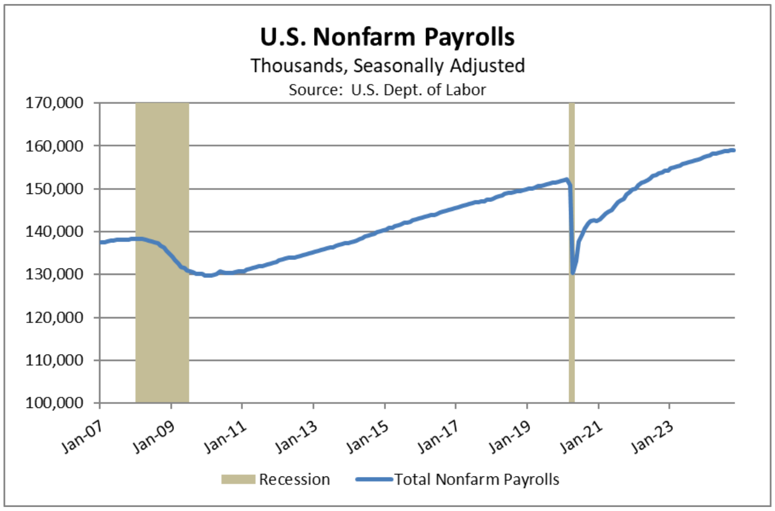


- Ueda's comment suggests a potential hawkish shift in the BOJ, which should help support the JPY. We suspect that as long as uncertainty persists regarding the extent of the Federal Reserve's planned rate cuts during its easing cycle, the BOJ will be forced to be more assertive with policy. Consequently, Japanese policymakers may seek to protect the yen by adopting a monetary policy stance that diverges from the Fed's, potentially including a more hawkish rate hike at the December BOJ meeting.

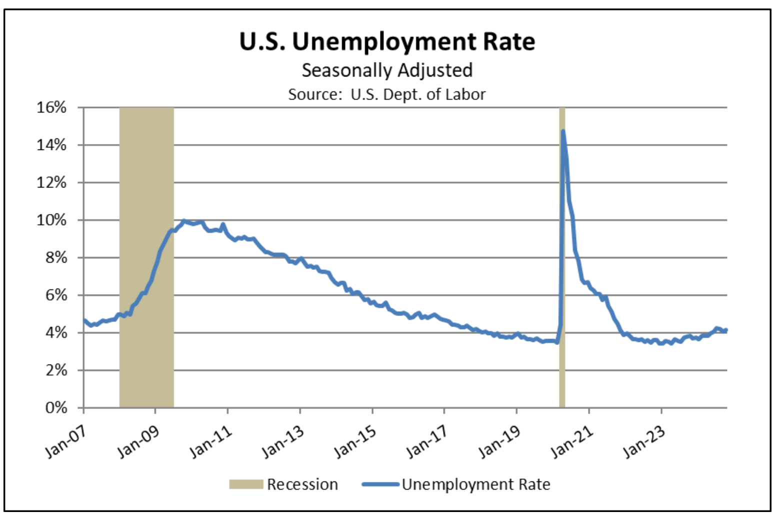
In Other News: Canadian ports are bracing for strikes starting Monday, which are expected to cause supply chain disruptions across the country. Additionally, Iran has threatened to retaliate against Israeli attacks through proxy groups, resulting in a rise in oil prices. Furthermore, China sanctioned the largest US drone maker to signal its potential response to further trade restrictions imposed by the US.

US Economic Releases

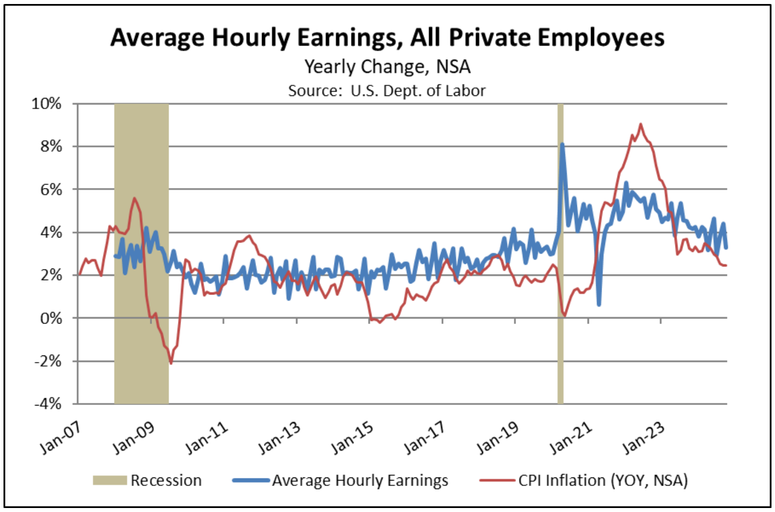
October ***nonfarm payrolls*** rose by a seasonally adjusted 12,000, far short of the expected increase of 100,000 and dramatically lower than September's revised gain of 223,000. However, the number was likely impacted heavily by the recent hurricanes in the Southeast, which caused massive destruction and at least temporarily shut down many businesses. Typically, the impact of such storms is relatively short-lived, so it would not be a surprise if payroll growth rebounds in the coming months. The chart below shows the change in nonfarm payrolls since shortly before the Great Financial Crisis.



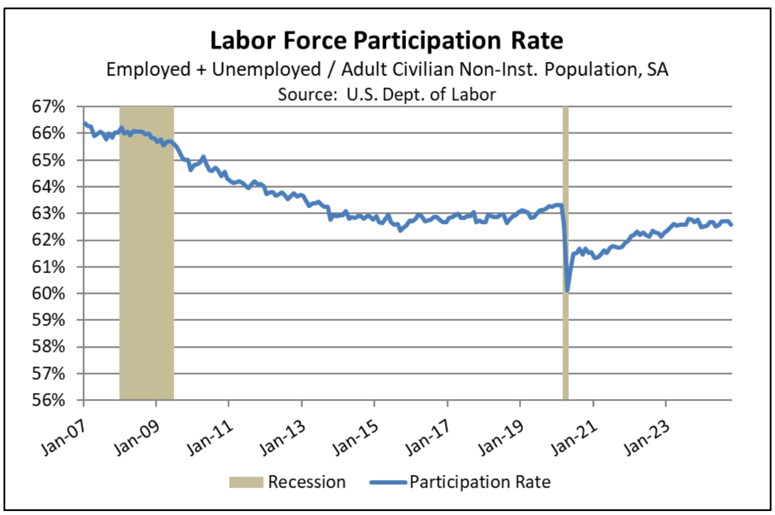
The October ***unemployment rate***, which is calculated from a survey of households rather than the survey of businesses that underlies the payroll estimate, held steady at a seasonally adjusted 4.1%, exactly as expected. The chart below shows how the unemployment rate has evolved since just before the GFC.



With the demand for labor still relatively strong, ***average hourly earnings*** in October rose to a seasonally adjusted $35.46, up 4.0% from the same month one year earlier. The annual increase was exactly as anticipated. It also marked a small acceleration from the 3.9% rise in the year to September. However, when calculated on a non-seasonally adjusted basis (our preferred methodology), the annual rise was a much more modest 3.3%. The chart below shows the year-over-year growth in average hourly earnings, in non-seasonally adjusted terms, since just before the GFC.



A final key indicator in the monthly employment report focuses on the share of the adult, civilian, noninstitutionalized population that is either working or looking for work. The October ***labor force participation rate (LFPR)*** fell to a seasonally adjusted 62.6%, short of expectations that it would be unchanged from the September rate of 62.7%. The LFPR remains far below the levels common before the coronavirus pandemic, largely reflecting the mass retirement of baby boomers and other changes in the labor market during the crisis. The chart below shows how the LFPR has changed since just before the GFC.



The following table lists the economic releases or Fed events scheduled for the rest of the day.

Economic Releases						
ET	Indicator			Expected	Prior	Rating
9:45	S&P Global US Manufacturing PMI	m/m	Oct F	47.8	47.8	***
10:00	Construction Spending MoM	m/m	Sep	0.00%	-0.10%	*
10:00	ISM Manufacturing	m/m	Oct	47.6	47.2	**
10:00	ISM Prices Paid	m/m	Oct	50.0	48.3	**
10:00	ISM New Orders	m/m	Oct	47.0	46.1	**
10:00	ISM Employment	m/m	Oct	45.0	43.9	*
	Wards Total Vehicle Sales	m/m	Oct	15.80m	15.77m	***
Federal Reserve						
ET	Speaker or Event	District or Position				
9:45	Lorie Logan Gives Welcoming Remarks	President of the Federal Reserve Bank of Dallas				

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	Housing Starts	y/y	Sep	-0.6%	-5.1%	-4.3%	**	Equity bullish, bond bearish
	Annualized Housing Starts	y/y	Sep	0.800m	0.777m	0.771m	*	Equity and bond neutral
	Jibun Bank Manufacturing PMI	m/m	Oct F	49.2	49.0		***	Equity and bond neutral
Australia	PPI	y/y	3Q	3.9%	4.8%		**	Equity and bond neutral
New Zealand	Building Permits	m/m	Sep	2.6%	-5.2%		**	Equity and bond neutral
South Korea	Imports	y/y	Oct	1.7%	22.3%	2.2%	**	Equity and bond neutral
	Trade Balance	m/m	Oct	$3167m	$6656m	$4100m	*	Equity and bond neutral
	Exports	y/y	Oct	4.6%	7.5%	7.0%	***	Equity and bond neutral
	S&P Global South Korea PMI Manufacturing	m/m	Oct	48.3	48.3		***	Equity and bond neutral
China	Caixin Manufacturing PMI	m/m	Oct	50.3	49.3	49.7	***	Equity and bond neutral
EUROPE								
UK	Nationwide House Price Index	y/y	Oct	2.4%	3.2%	2.8%	***	Equity and bond neutral
	S&P Global UK Manufacturing PMI	m/m	Oct F	49.9	50.3	50.3	***	Equity and bond neutral
Switzerland	CPI	y/y	Oct	0.6%	0.8%	0.8%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Oct	0.7%	0.9%	0.9%	*	Equity and bond neutral
	Core CPI	y/y	Oct	0.8%	1.0%	1.0%	*	Equity and bond neutral
	Real Retail Sales	y/y	Sep	2.2%	2.7%		**	Equity and bond neutral
	PMI Manufacturing	m/m	Oct	49.9	49.9	49.5	***	Equity and bond neutral
	PMI Services	m/m	Oct	51.8	49.8		*	Equity and bond neutral
Russia	Gold and Forex Reserves	m/m	25-Oct	$628.5b	$624.9b		***	Equity and bond neutral
	S&P Global Russia Manufacturing PMI	m/m	Oct	50.6	49.5	49.7	***	Equity bullish, bond bearish
	Money Supply, Narrow Definition	w/w	25-Oct	18.36t	18.47t		*	Equity and bond neutral
AMERICAS								
Canada	GDP	y/y	Aug	1.3%	1.4%	1.5%	**	Equity and bond neutral
Mexico	Unemployment Rate NSA	m/m	Sep	2.92%	3.04%	3.00%	***	Equity and bond neutral
Brazil	Industrial Production	y/y	Sep	3.4%	2.2%	3.4%	***	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	444	-2	Down
U.S. Sibor/OIS spread (bps)	456	456	0	Down
U.S. Libor/OIS spread (bps)	452	452	0	Down
10-yr T-note (%)	4.30	4.29	0.01	Up
Euribor/OIS spread (bps)	306	306	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	$74.30	$72.81	2.05%	
WTI	$70.78	$69.26	2.19%	
Natural Gas	$2.70	$2.71	-0.26%	
12-mo strip crack	$20.38	$20.41	-0.13%	
Ethanol rack	$1.74	$1.74	0.16%	
Metals				
Gold	$2,748.03	$2,743.97	0.15%	
Silver	$32.79	$32.66	0.39%	
Copper contract	$435.90	$434.00	0.44%	
Grains				
Corn contract	$412.50	$410.75	0.43%	
Wheat contract	$574.50	$570.50	0.70%	
Soybeans contract	$1,002.00	$994.50	0.75%	
Shipping				
Baltic Dry Freight	1,388	1,395	-7	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-0.52	1.81	-2.32	
Gasoline (mb)	-2.71	0.60	-3.31	
Distillates (mb)	-0.98	-0.97	0.00	
Refinery run rates (%)	-0.4%	0.1%	-0.5%	
Natural gas (bcf)	78	83	-5	

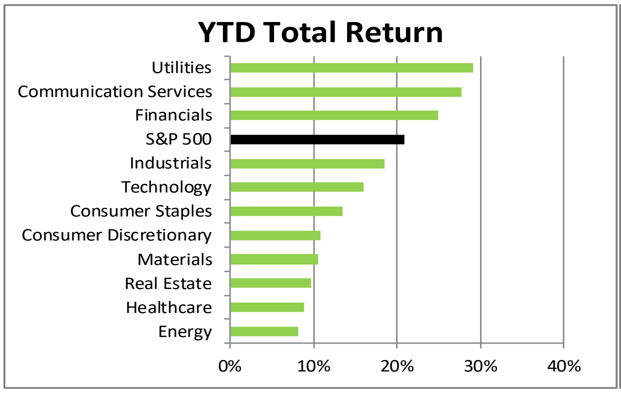
Weather

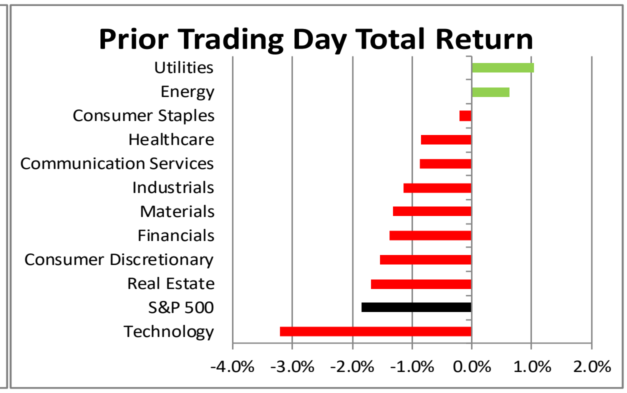
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures along the West Coast, in the Northern Tier states, and in all areas from the Great Plains eastward, with cooler-than-normal temperatures in the Southwest. The forecasts call for wetter-than-normal conditions in the Southwest and the southern stretches of the East Coast, with dry conditions in California, the Upper Midwest, and New England.

There are now three tropical disturbances in the Atlantic Ocean area. One is in the central Atlantic west of the Azores, but it is assessed to have only a 10% chance of cyclonic formation within the next 48 hours. The second is just north of Puerto Rico. It is producing large amounts of rain and high winds, but it also is assessed to have only a 10% chance of cyclonic formation in the next 48 hours. The last is in the southern Caribbean Sea off Panama, and it is assessed to have a 30% chance of cyclonic formation within the next 48 hours.

Data Section

US Equity Markets – (as of 10/31/2024 close)

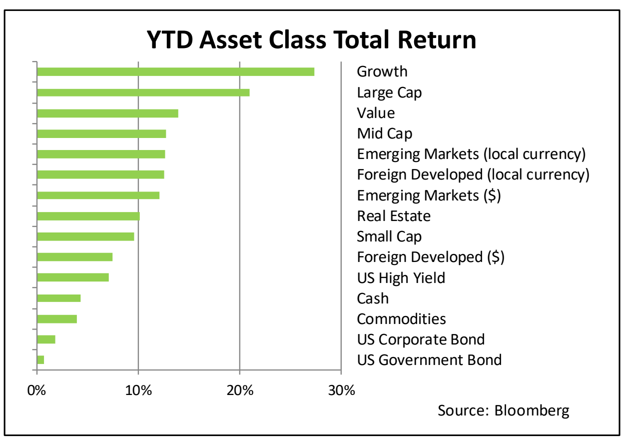




(Source: Bloomberg)

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 10/31/2024 close)

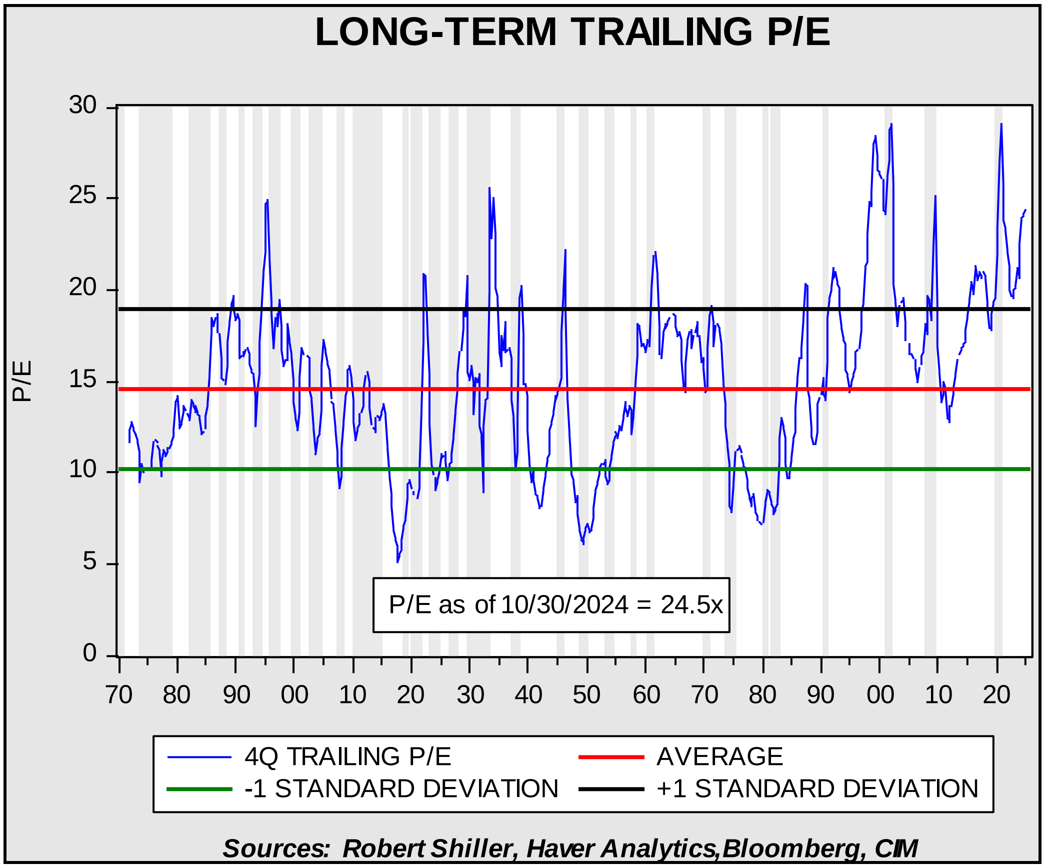


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

October 31, 2024



Based on our methodology,[1] the current P/E is 24.5x, 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.