Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: November 20, 2024 — 9:30 AM ET] Global equity markets are mostly higher this morning. In Europe, the Euro Stoxx 50 closed up 0.5% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.5%. Chinese markets were higher, with the Shanghai Composite up 0.7% from its previous close and the Shenzhen Composite up 1.4%. US equity index futures are signaling a higher open.

With 467 companies having reported so far, S&P 500 earnings for Q3 are running at $62.90 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 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
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*

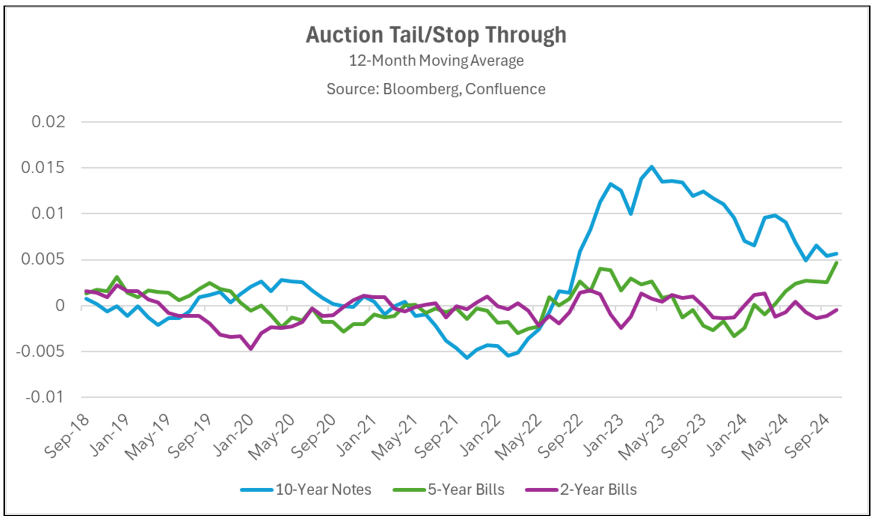
Good morning! Markets are eagerly awaiting Nvidia's earnings report, due to be released later today. In sports, the Boston Celtics ended the Cleveland Cavaliers' winning streak. Today's *Comment* will cover potential candidates for US Treasury secretary, the role of high-income earners in driving US consumption, and our insights on the escalating conflict in Ukraine. As always, we'll include a comprehensive roundup of international and domestic data releases.

The Battle for the Treasury: While Scott Bessent is viewed as the front-runner to take over the Treasury, the market is hoping that former Fed Governor Warsh will get the job.

- While Trump has been naming candidates for key roles in his administration, market attention has largely centered on who will lead the US Treasury. Howard Lutnick, previously a top contender, is out of the race after accepting the Commerce secretary role, narrowing the field to Kevin Warsh and Scott Bessent. Warsh, once considered for the

Federal Reserve chair, is a key advisor to Trump's economic transition team. Bessent, a major supporter of the president-elect, has faced criticism for his "business as usual" approach, particularly after describing tariffs as merely a bargaining tool.

- The debate over the next Treasury secretary — tasked with managing the nation's $28 trillion debt — carries significant market implications. Growing uncertainty surrounding future debt management strategies has raised concerns among fixed-income investors, especially given the persistent US deficit. This has dampened demand for US Treasurys, as seen in recent auctions where investor appetite for longer-term securities has waned. In recent years, Treasury auctions have increasingly resulted in "tails," indicating that investors require higher yields to absorb the supply of government debt.

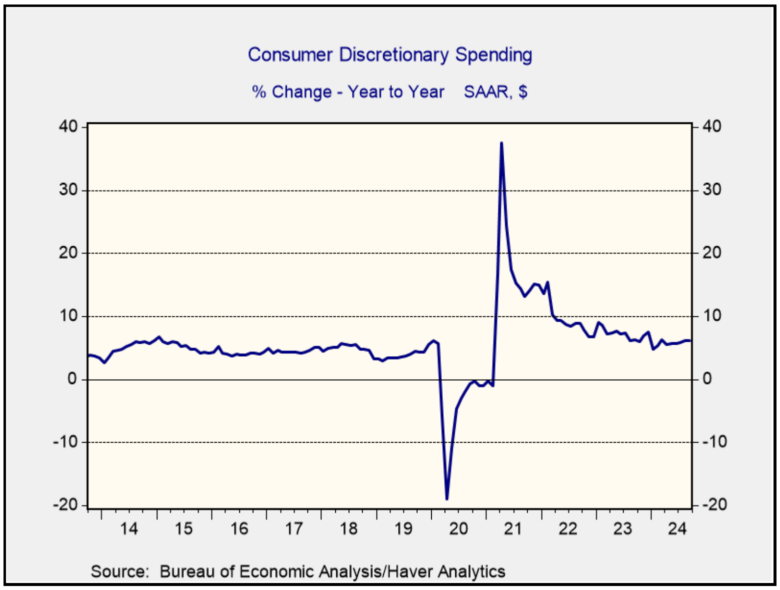


- The selection of the next Treasury secretary is likely to hinge on loyalty, which would potentially give Scott Bessent an advantage. However, the inclusion of Kevin Warsh in the discussion — widely considered a contender to succeed Fed Chair Jerome Powell when his term ends in May 2026 — could serve as a trial balloon to gauge market reactions to his potential leadership of the central bank. President-elect Donald Trump is rumored to be exploring naming a new Fed chair up to a year before Powell's term ends. If true, this could spark market volatility as investors grapple with uncertainty over leadership.

High Earners Save the Day: The nation's largest retailers reported mixed earnings, signaling that the economy remains strong but is gradually slowing.

- Target reported sluggish growth in the third quarter as the retailer failed to match the revenue gains of its peers Costco and Walmart. The slowdown in sales growth comes as more shoppers prioritize value, showing less willingness to absorb price increases. Its main competitor, Walmart, performed better, driven by strong performance from households earning over $100,000 annually. These consumers, seeking to offset rising prices, have been more willing to trade down to lower-cost options.

- While overall consumption has slowed in recent years, higher-income households have remained relatively unaffected. According to the Bureau of Labor Statistics, households in the top two income quintiles contributed to over 70% of the total spending increase in 2023. This represents a substantial rise from the previous two years, when their share was 62% in 2022 and 61% in 2021. Conversely, lower-income households have moderated their spending due to financial strain. Having depleted much of their pandemic savings, these households have been forced to curb their expenditures.



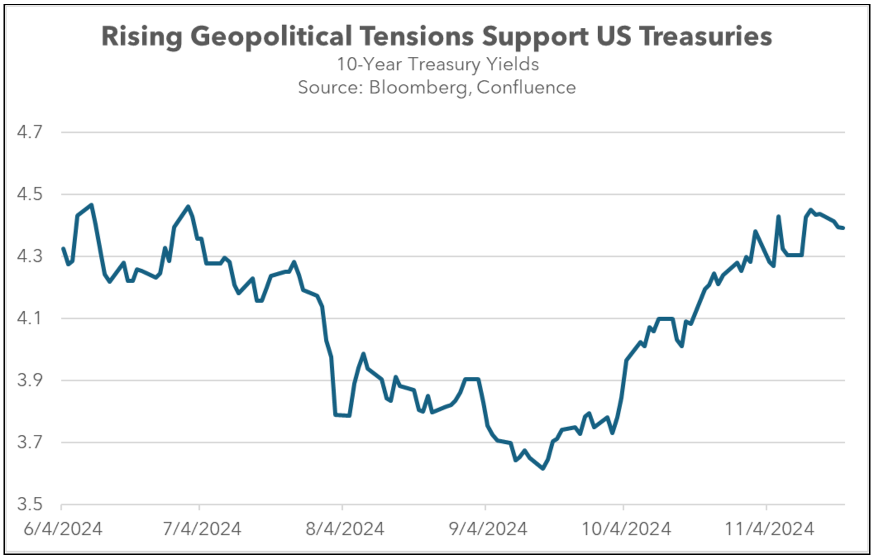
- The slowdown in spending is likely due to cumulative inflation and a cooling labor market. This dynamic could complicate the Fed's efforts to communicate a clear monetary policy path, as it aims to balance price stability and its maximum employment mandate. Lowering interest rates could alleviate financial pressure, particularly for debt-dependent households, and potentially stimulate consumption. However, it could also exacerbate inflationary pressures. As a result, we expect the Fed may moderate its easing cycle, especially if the labor market shows signs of heating up.

Ukraine War Escalation: Investors turn to safe-haven assets as Ukraine escalates its efforts to defend against Russia by taking greater risks on the battlefield.

- Ukraine has utilized US-supplied weapons to target locations within Russia, following President Joe Biden's decision to lift previous restrictions. This significant escalation marks a turning point in the war, as Russian President Vladimir Putin has previously warned that such actions would be interpreted as NATO involvement and suggested that this could lead to a broader conflict beyond Ukraine's borders. In response to the attack, Putin lowered the threshold for using nuclear weapons to include critical threats to the territorial integrity of Russia or Belarus.

- The deployment of these weapons comes as Ukraine takes greater risks on the battlefield, while Western support for the war shows signs of waning. German Chancellor Olaf

Scholz, who recently [held his first talks with Putin in two years], is centering his reelection campaign on a more cautious approach to supporting Ukraine, [firmly ruling out the supply of long-range missiles]. Meanwhile, US President-elect Donald Trump has proposed a peace plan that could involve [Ukraine ceding some of its territory]. The escalation of the war is prompting investors to seek safety in US-denominated assets.



- As geopolitical tensions escalate in 2025, we anticipate that the US will be perceived as a relatively safer investment haven. The US economy, while facing significant fiscal challenges, appears more resilient compared to its global peers. In particular, the EU and China are grappling with their own systemic issues. While China's debt concerns are well-documented, the EU is now facing increasing scrutiny due to its high debt levels and slow growth. The ECB recently warned [that these factors could potentially trigger a eurozone crisis.]

In Other News: The [EU is expected to push Chinese EV makers to transfer intellectual property to access subsidies,] in another sign that the bloc plans on getting tougher with China in regards to trade. The [US is recognizing Edmundo González Urrutia as president-elect,] a decision likely to reignite tensions with Venezuela. [Iran has expressed a willingness to curb its nuclear program] as it looks to avoid tough sanctions under the new US administration.

US Economic Releases

The Mortgage Bankers Association today said ***mortgage applications*** in the week ended November 15 rose 1.7% compared to last week's rise of 0.5%. Applications for home purchase mortgages rose 2.0%, after rising 1.9% the prior week, while refinancing applications rose 1.8%, after rising 1.5% the prior week. According to the report, the average interest rate on a 30-year mortgage rose 4 basis points to 6.9%, continuing its lengthening streak dating back to the summer of increases.

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**
10:00	Michael Barr Testifies Before House Financial Services Committee	U.S. Federal Reserve Vice Chair for Supervision
11:00	Lisa Cook Speaks on Economic Outlook and Monetary Policy	Member of the Board of Governors
12:15	Michelle Bowman Speaks on Agency Policymaking	Member of the Board of Governors
16:00	Susan Collins Speaks on Monetary Policy and Career	President of the Federal Reserve Bank of Boston

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	Trade Balance	y/y	Oct	-¥461.2b	-¥294.1b	-¥391.9b	**	Equity and bond neutral
	Exports	y/y	Oct	3.1%	-1.7%	1.0%	*	Equity bullish, bond bearish
	Imports	y/y	Oct	0.4%	1.8%	-1.9%	*	Equity bullish, bond bearish
	Machine tool orders	y/y	Oct F	9.4%	9.3%		**	Equity and bond neutral
Australia	Westpac Leading Index	m/m	Oct	0.18%	0.03%	0.01%	**	Equity and bond neutral
South Korea	PPI	y/y	Oct	1.0%	1.0%		**	Equity and bond neutral
EUROPE								
Germany	PPI	y/y	Oct	-1.1%	-1.4%	-1.0%	**	Equity and bond neutral
UK	CPI	y/y	Oct	2.3%	1.7%	2.2%	***	Equity and bond neutral
	CPI Core	y/y	Oct	3.3%	3.2%	3.1%	***	Equity and bond neutral
	Retail Price Index	m/m	Oct	390.7	388.6	390.5	**	Equity and bond neutral
	RPI	y/y	Oct	3.4%	2.7%	3.4%	**	Equity and bond neutral
AMERICAS								
Canada	CPI	y/y	Oct	2.0%	1.6%	1.9%	***	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)	441	440	1	Down
U.S. Sibor/OIS spread (bps)	452	452	0	Down
U.S. Libor/OIS spread (bps)	449	449	0	Down
10-yr T-note (%)	4.43	4.40	0.03	Down
Euribor/OIS spread (bps)	301	300	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
Central Bank Action	**Actual**	**Prior**	**Expected**	
PBOC 1-Year Loan Prime Rate	3.100%	3.100%	3.100%	On Forecast
PBOC 5-Year Loan Prime Rate	3.600%	3.600%	3.600%	On Forecast

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	$73.73	$73.31	0.57%	
WTI	$70.00	$69.39	0.88%	
Natural Gas	$3.12	$3.00	4.17%	
Crack Spread	$18.97	$18.87	0.49%	
12-mo strip crack	$20.65	$20.71	-0.27%	
Ethanol rack	$1.79	$1.79	0.03%	
Metals				
Gold	$2,630.84	$2,632.08	-0.05%	
Silver	$31.01	$31.21	-0.64%	
Copper contract	$420.35	$418.20	0.51%	
Grains				
Corn contract	$436.00	$437.75	-0.40%	
Wheat contract	$563.50	$567.75	-0.75%	
Soybeans contract	$991.50	$998.50	-0.70%	
Shipping				
Baltic Dry Freight	1,627	1,756	-129	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-0.85		
Gasoline (mb)		0.75		
Distillates (mb)		0.40		
Refinery run rates (%)		0.1%		
Natural gas (bcf)		39		

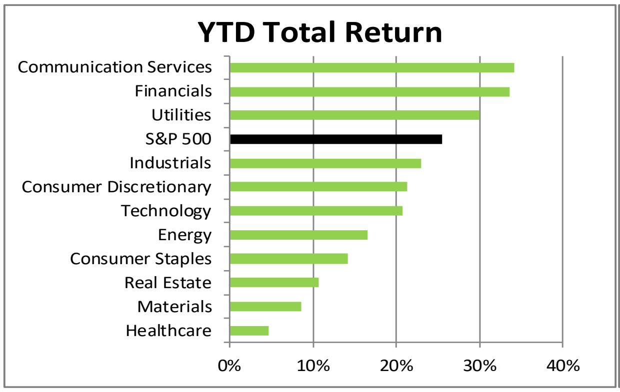
Weather

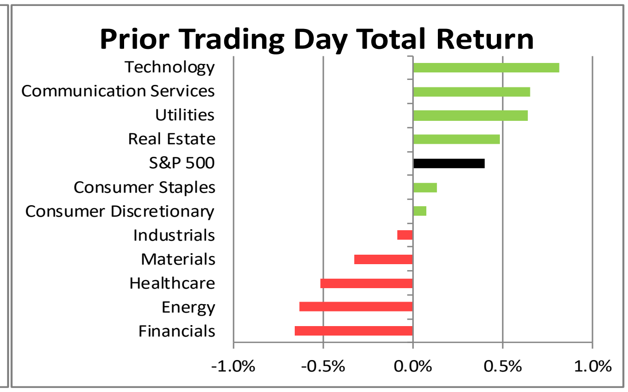
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures in the Southeast, with cooler temperatures in the northern Great Plains, Rocky Mountains, and West Coast. The precipitation outlook calls for wetter-than-normal conditions in the eastern third of the country and northern Rocky Mountains, with drier-than-normal conditions in the Desert Southwest.

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 11/19/2024 close)

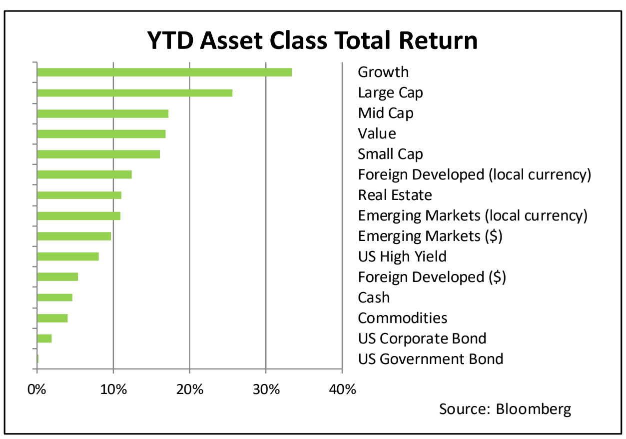




(Source: Bloomberg)

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 11/19/2024 close)

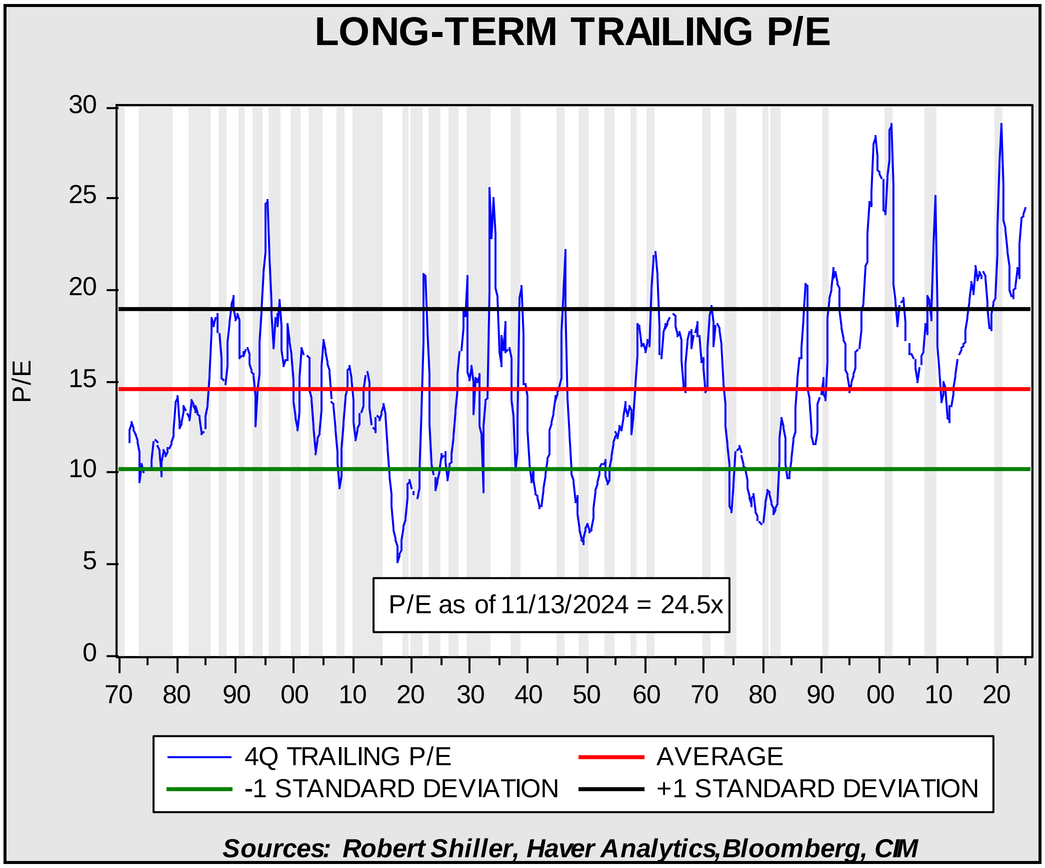


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.