Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: November 21, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed up 0.1% 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 0.1% from its previous close and the Shenzhen Composite also up 0.1%. US equity index futures are signaling a higher open.

With 471 companies having reported so far, S&P 500 earnings for Q3 are running at $63.00 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 18.1% 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:

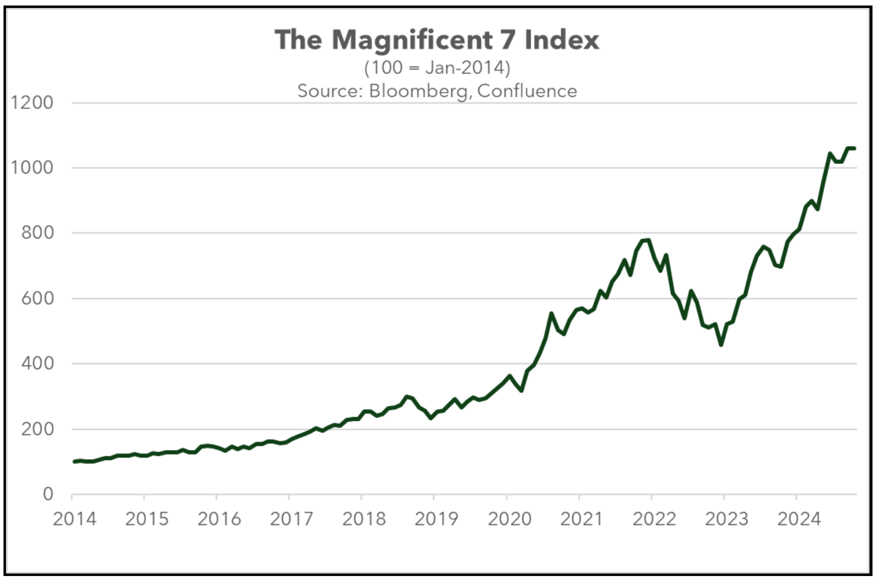
Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
Implications of North Korean Soldiers in the Ukraine War (11/18/24) + podcast	*Let's Talk About Tariffs!* (11/11/24) + podcast	Q4 2024 Report Q4 2024 Rebalance Presentation	Confluence of Ideas Podcast *The Q4 Asset Allocation Rebalance*

Good morning! Markets are digesting Nvidia's earnings report. In sports, Caitlin Clark has declined an offer to play in the Unrivaled three-on-three basketball league. Today's *Comment* will cover Nvidia's impact on the AI rally, the unintended consequences of trade restrictions, and updates on the Ukraine war. We'll wrap up with a roundup of international and domestic data releases.

Nvidia's Momentum: Spending on building AI-related infrastructure by Big Tech companies remains strong but is showing signs of waning.

- On Wednesday, Nvidia reported earnings that were nearly double the previous year's, but still disappointed investors as it barely beat expectations. Fourth-quarter sales of $47.5 billion slightly exceeded estimates of $47.1 billion. While the modest beat suggests continued strong demand for the company's products, concerns have emerged about the sustainability of its current growth trajectory. As investors assess the outlook for the AI-fueled rally that has propelled the S&P 500 to new highs, doubts have grown about its ability to carry over to next year.

- As a leading AI player, Nvidia has significantly benefited from the technology's rapid adoption and is now a key industry barometer. Big Tech companies like Google, Amazon, Meta, and Microsoft rely on Nvidia's high-performance chips to build and maintain their vast and complex data infrastructures. As a result, strong Nvidia earnings are often seen as a positive indicator of these tech giants' continued investment in AI and cloud computing. According to Bloomberg Intelligence, capex spending by Big Tech firms is on pace for $165.2 billion this year, up from $120 billion last year.

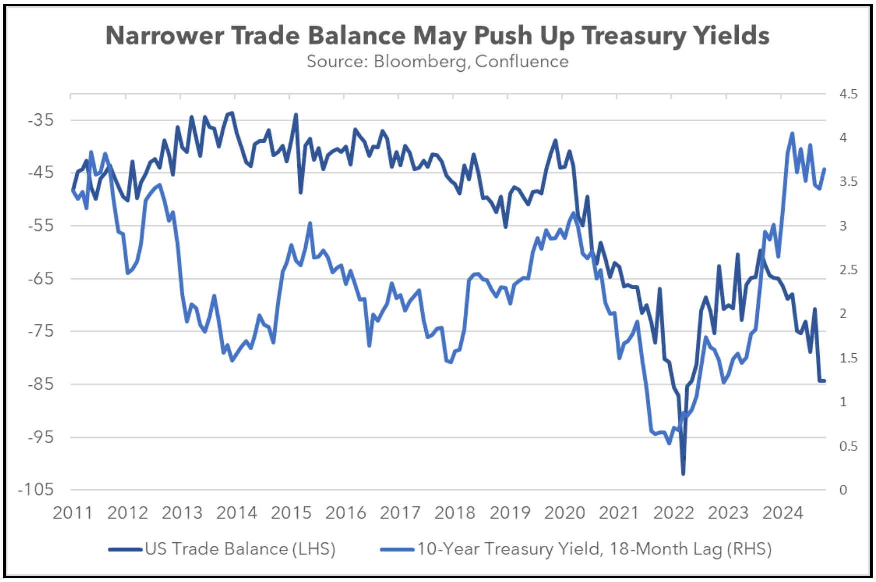


- While AI advancements have been a catalyst for the Magnificent 7's growth, a significant portion of their recent momentum can be attributed to investor demand for higher returns. In an environment of elevated interest rates, investors have sought out large, established companies with strong growth potential. These tech giants, with their substantial financial resources and low risk of insolvency, are perceived as attractive investments capable of capturing market share through aggressive spending. As these stocks become more expensive, small and mid-cap stocks could become more appealing to investors.

Imports, Tariffs, and Yields: Firms have started to ramp up their purchases of imports as they look to get ahead of potential tariffs from the incoming administration.

- West Coast ports, such as Long Beach and Los Angeles, have experienced a significant increase in activity as investors and businesses seek to mitigate the potential impact of future trade restrictions. Last month, the Port of Long Beach handled nearly 1 million containers, surpassing records set two months ago. Together, the ports of Long Beach and Los Angeles account for approximately one-third of all US container imports and are expected to remain busy through the end of the year as companies build up inventory to safeguard against potential supply chain disruptions.

- Firms are increasing foreign purchases to preempt potential tariffs from the incoming administration. Deficit nations rely on foreign capital, while surplus nations provide it. Consequently, resolving a trade dispute involves altering the flow of capital. This could manifest in the US borrowing less from the rest of the world by issuing fewer Treasurys or global investors reducing their Treasury holdings. We observed the latter dynamic in October when markets began to anticipate a Trump victory, leading to increased Treasury yields as foreign investors, particularly in Japan and China, reduced their holdings.

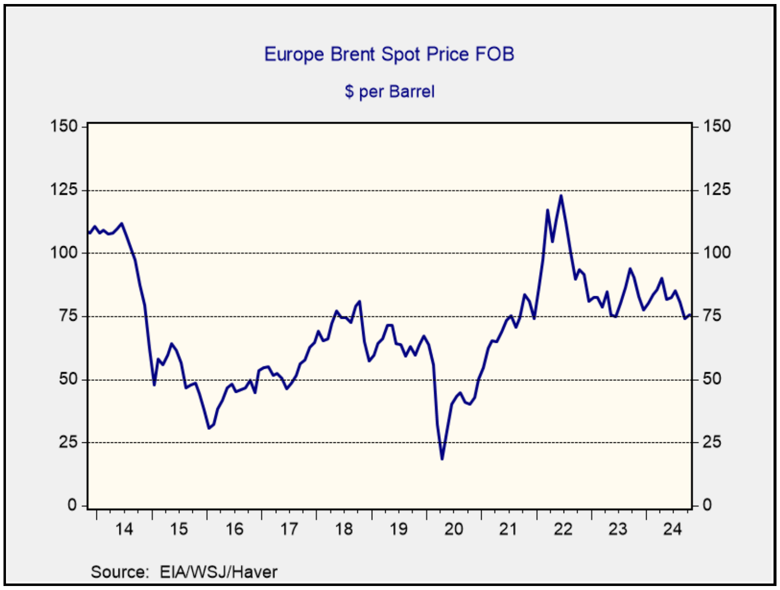


- Although Treasury yields are influenced by various factors, including monetary policy, economic outlook, and inflationary expectations, we believe a potential trade war could significantly impact the bond market. Increased tariffs could strengthen the US dollar, making it more expensive for foreign countries to purchase US goods. To acquire the necessary dollars for these imports, these countries may be forced to liquidate their US Treasury bond holdings. The lack of demand for US Treasurys could exacerbate an existing supply-demand imbalance, potentially leading to higher Treasury yields in 2025.

Tensions on the Rise: As Ukraine's defensive efforts against Russia intensify, the geopolitical implications of the conflict are broadening.

- A Danish naval encounter earlier this week revealed that the ships involved in severing two undersea communication cables in the Baltic Sea were of Chinese origin. Notably, the crews aboard those vessels were reportedly Russian. While China's support for Russia's war effort has been widely speculated, this incident provides concrete evidence of direct Chinese involvement, including the supply of critical equipment. The sabotage comes amongst threats from Russia that it views NATO’s assistance to Ukraine as proof of its involvement in the war.

- After Ukraine employed US-supplied weapons in attacks within Russian territory, Moscow intensified its rhetoric, including explicit nuclear threats. Last night, Russia escalated further by [launching an intercontinental ballistic missile at Ukraine](). While armed with conventional explosives, the missile's nuclear capability underscores the growing risk of nuclear escalation. In response to this attack, Ukraine deployed specialized UK-supplied missiles to target military installations in the region.

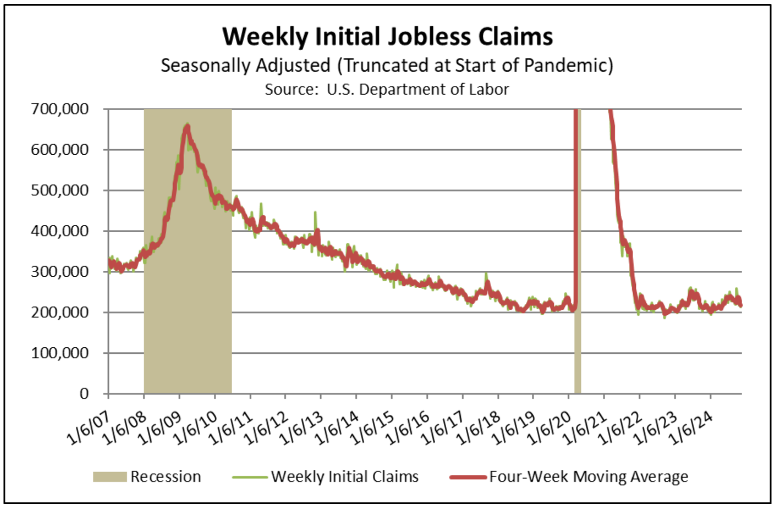


- The escalating geopolitical tensions present a significant risk to global markets. As hostilities intensify, commodity markets, particularly crude oil, are experiencing heightened volatility. Brent crude oil prices have surged 3.1% over the past five days, driven by concerns of potential supply disruptions. Should the conflict escalate further, oil prices could climb toward $80 per barrel by December, exerting inflationary pressure on global economies and weighing on economic growth. Additionally, European equities may face downward pressure due to the region's proximity to the conflict.

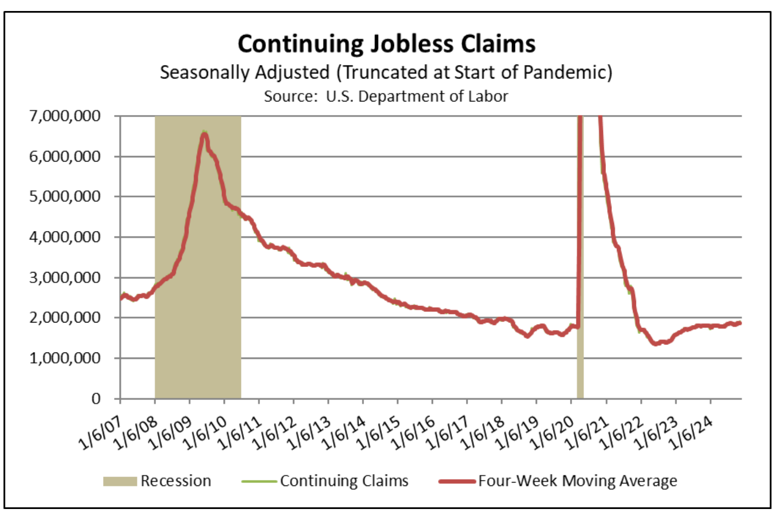
In Other News: The International Criminal Court has charged Israeli President Benjamin Netanyahu with war crimes, a move likely to spark conflict with the US, which has threatened sanctions in response. The Department of Justice has requested that Google sell its Chrome browser in what is shaping up to be one of the biggest anti-trust fights of this century. Bitcoin exceeded $98,000 after news that the Trump administration is considering the appointment of a cryptocurrency czar.

US Economic Releases

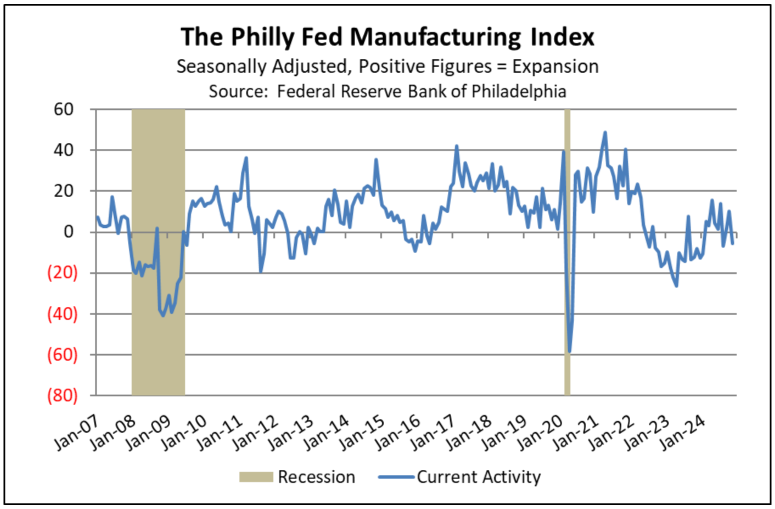
In the week ended November 16, ***initial claims for unemployment benefits*** fell to a seasonally adjusted 213,000, well below both the expected level of 220,000 and the prior week's revised level of 219,000. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, fell to a seven-month low of 217,750. Taken together, these figures suggest the demand for labor has strengthened considerably again after weakening in the summer and autumn. The chart below shows how initial jobless claims have fluctuated since just before the Great Financial Crisis. The chart is truncated through much of the pandemic period because of the extremely high level of claims at that time.



In the week ended November 9, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) rose to a seasonally adjusted 1.908 million, above both the anticipated reading of 1.880 million and the previous week's revised reading of 1.872 million. In contrast with the recent decline in initial claims, the four-week moving average of continuing claims rose to a nearly three-year high of 1,879,250. That suggests that while the current demand for labor is strong again, those who have been laid off are finding it harder to land another job and/or don't have the requisite skills for open positions. The chart below shows how continuing claims have fluctuated since the GFC. It is also truncated during the pandemic period because of the high level of claims at the time.



Separately, the Philadelphia FRB said its November ***Philly Fed Index*** dropped sharply to -5.5, far short of the expected reading of 8.0 and the October reading of 10.3. The index, officially designated as the Philadelphia FRB Manufacturing Activity Index, is designed so that positive readings point to expanding factory activity in the mid-Atlantic region. At its current level, the index suggests mid-Atlantic manufacturing is slipping again after rebounding modestly earlier in the year. The chart below shows how the index has fluctuated since just before the GFC.



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

Economic Releases						
ET	**Indicator**			**Expected**	**Prior**	**Rating**
10:00	Leading Economic Indicators	m/m	Oct	-0.3%	-0.5%	***
10:00	Existing Home Sales	m/m	Oct	3.95m	3.84m	**
11:00	Kansas City Fed Manfacturing Index	m/m	Nov	-5	-4	*
Federal Reserve						
ET	**Speaker or Event**	**District or Position**				
8:45	Beth Hammack Gives Weocome Remarks	President of the Federal Reserve Bank of Cleveland				
12:25	Austan Goolsbee Participates in Moderatied Q&A	President of the Federal Reserve Bank of Chicago				
12:30	Beth Hammack Moderates Conversation	President of the Federal Reserve Bank of Cleveland				
12:40	Jeffrey Schmid Gives Speech on Long-Term Policy	President of the Federal Reserve Bank of Kansas City				
14:00	Michael Barr Discusses Banks and AI	U.S. Federal Reserve Vice Chair for Supervision				

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	15-Nov	-¥966.9b	¥1724.6b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	15-Nov	¥169.1b	-¥922.10		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	15-Nov	¥1155.9b	-¥288.5b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	15-Nov	¥127.6b	¥514.2b		*	Equity and bond neutral
EUROPE								
Eurozone	EU27 New Car Registrations	y/y	Oct	1.1%	6.1%		***	Equity and bond neutral
France	Business Confidence	m/m	Nov	96	97	97	**	Equity and bond neutral
	Manufacturing Confidence	m/m	Nov	97	93	94	*	Equity and bond neutral
UK	Public Finances (PSNCR)	m/m	Oct	11.1b	-20.4b		*	Equity and bond neutral
	Public Sector Net Borrowing	m/m	Oct	17.4b	16.1b	12.9b	*	Equity and bond neutral
	PSNB ex Banking Groups	m/m	Oct	17.4b	16.1b	13.3b	**	Equity and bond neutral
Switzerland	M3 Money Supply	y/y	Oct	1.4%	1.8%		**	Equity and bond neutral
Russia	PPI	y/y	Oct	2.7%	5.6%		***	Equity and bond neutral
AMERICAS								
Mexico	Retail Sales	y/y	Sep	-1.5%	-0.8%	-1.2%	***	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	441	0	Down
U.S. Sibor/OIS spread (bps)	452	453	-1	Down
U.S. Libor/OIS spread (bps)	448	449	-1	Down
10-yr T-note (%)	4.40	4.41	-0.01	Down
Euribor/OIS spread (bps)	300	301	-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	$74.00	$72.81	1.63%	
WTI	$69.96	$68.75	1.76%	
Natural Gas	$3.39	$3.19	6.23%	Supply Pesssimism
Crack Spread	$18.15	$19.31	-5.99%	Economic Pessimism
12-mo strip crack	$20.79	$20.93	-0.68%	
Ethanol rack	$1.77	$1.78	-0.47%	
Metals				
Gold	$2,671.90	$2,650.60	0.80%	
Silver	$31.08	$30.85	0.75%	
Copper contract	$417.55	$419.00	-0.35%	
Grains				
Corn contract	$442.00	$440.00	0.45%	
Wheat contract	$576.50	$572.25	0.74%	
Soybeans contract	$998.25	$990.50	0.78%	
Shipping				
Baltic Dry Freight	1,616	1,627	-11	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	0.55	-0.85		
Gasoline (mb)	2.05	0.75		
Distillates (mb)	-0.11	0.40		
Refinery run rates (%)	-1.2%	0.1%		
Natural gas (bcf)		1		

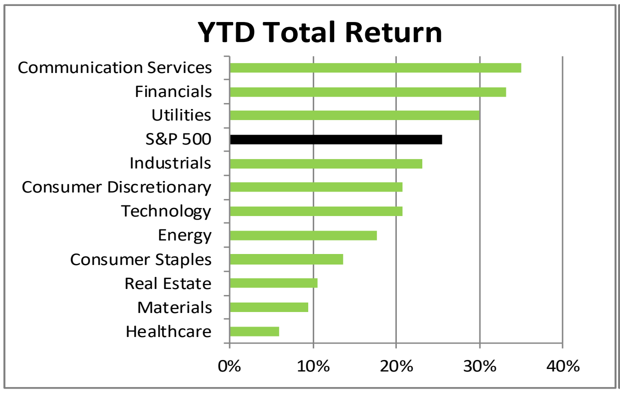
Weather

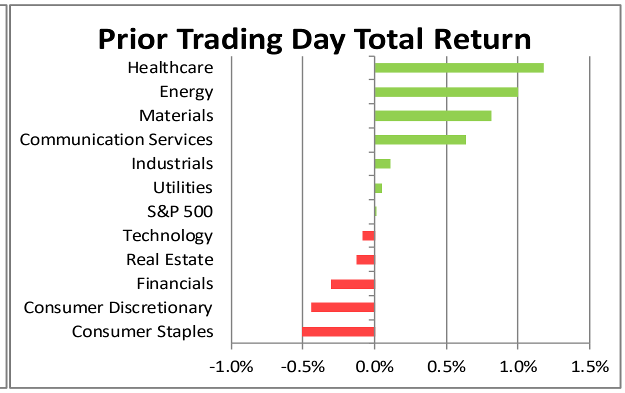
The 6-to-10-day and 8-to-14-day forecasts currently call for cooler-than-normal temperatures in the Far West, the northern Rocky Mountains, and the northern Great Plains, with warmer-than-normal temperatures only in Florida. The forecasts call for wetter-than-normal conditions in the northern Rocky Mountains, the northern Great Plains, the Southeast, and the mid-Atlantic states, with dry conditions only in California and along the Mexican border.

There are currently no major atmospheric disturbances in the Atlantic Ocean area. Once we reach 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 11/20/2024 close)

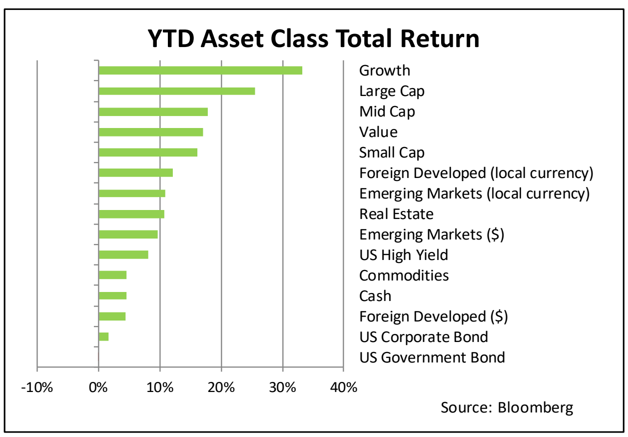




(Source: Bloomberg)

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 11/20/2024 close)

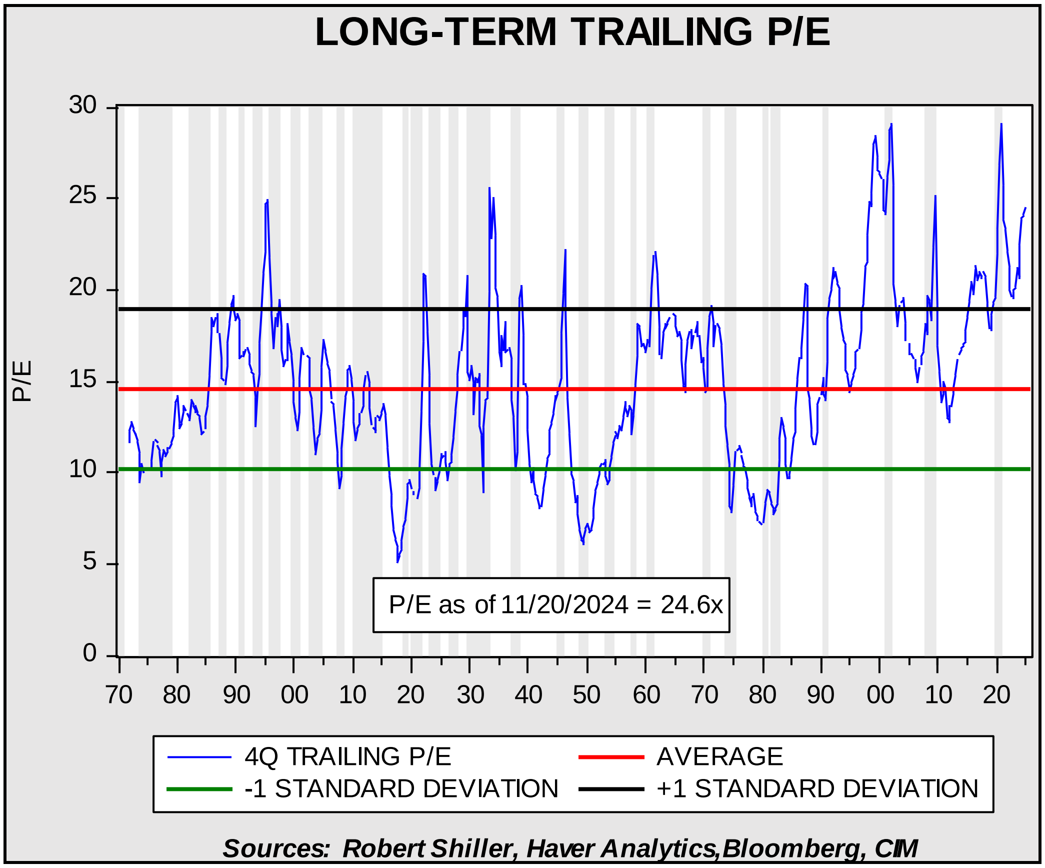


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 21, 2024



Based on our methodology,[1] the current P/E is 24.6x, up 0.1 from our last report. The increase in 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.

[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.