Daily Comment

Confluence INVESTMENT MANAGEMENT

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[Posted: November 5, 2024 — 9:30 AM ET] Global equity markets higher 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 up 1.0%. Chinese markets were higher, with the Shanghai Composite up 2.3% from its previous close and the Shenzhen Composite up 3.2%. US equity index futures are signaling a higher open.

With 371 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, 74.6% have exceeded expectations, while 17.6% 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	The Inflation Adjustment for Social Security Benefits in 2025	Q4 2024	Business Cycle Report

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Our *Comment* on this Election Day opens with a few words on opinion polls. After all, those are all we'll have to look at until actual voting results start to come in later this evening. We next review several other international and US developments with the potential to affect the financial markets today, including a potential reprieve for Germany's fragile coalition government and an end to the machinists' strike at Boeing.

US Politics: As the US holds its elections today, the latest FiveThirtyEight average of national polls shows Harris with 48.0% support and Trump with 46.8%, well within all the surveys' margins of error. In the swing states, the support for each candidate is also evenly matched and within the margins of error. Since we're all likely to hear a lot about polls today, we thought it might be useful to provide a quick reminder of how these polls work and what the margin of error really means:

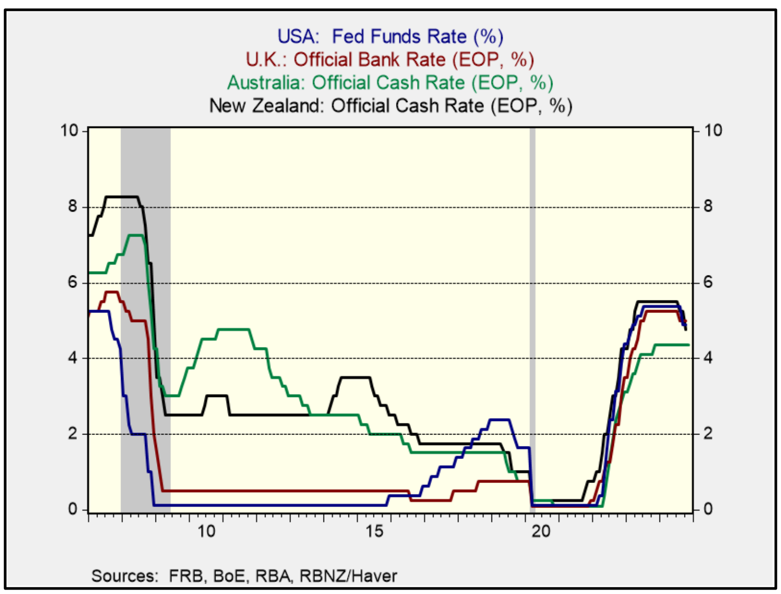
- For whatever measure we're interested in — say, the share of voters who support former President Trump — there is a certain, specific number within the ***population*** as a whole. Let's say it's 49.2%. The problem is that to find this ***actual*** number, you'd have to ask each and every person in the population. That would be expensive and probably impractical.
- As an alternative, polling firms select a random ***sample*** of individuals in the population and use that to develop an ***estimate*** of the actual population number. Under the laws of mathematics, and assuming the sample is designed correctly, it's possible to estimate the number of individuals you need in the random sample to generate a reasonably accurate estimate of the actual number in the population. Polling is expensive, so pollsters don't want to over-do it. This is why you often see samples sizes of just 1,000 to 3,000.
- Let's say you conduct your survey, and 50.5% of the individuals in your random sample say they support Trump. This is higher than the actual population number of 49.2%, but you don't know that. However, based on the size of the random sample and the characteristics of the population, it's possible to calculate how certain you should be that the actual population number is within a certain distance of your calculated sample estimate. This is the margin of error.
- The margin of error basically says that if you used the same sampling methodology 100 times, you would expect some share of the 100 sample estimates to fall within a number x and a number y, at a specific level of certainty. A commonly used level of certainty is 95%. Based on mathematical laws, for example, you may estimate that in your hypothetical 100 samples, 95% of your calculated support numbers for Trump would fall between 49.0% and 52.0%.
- Indeed, rather than focusing on the specific point estimates of the various polls, it may be good to focus more on the range implied by the margin of error. Think of the polls as saying, "We think there is a 95% chance that the true population support level for Candidate Z is between x% and y%." Maybe that's another way of saying we should all be careful about relying too much on the polls!

Germany: Just days after Finance Minister Lindner of the liberal Free Democratic Party proposed spending reforms that threatened to end the coalition government, as we reported in our *Comment* yesterday, Deputy Chancellor Habeck of the Greens offered a budget compromise aimed at keeping the coalition together. However, it isn't clear if Habeck's proposal will keep the three-party coalition together. As a result, Germany is likely to face continued political and economic uncertainty in the coming months.

Russia-United States: In an in-depth article yesterday, the *Wall Street Journal* described an apparent effort by Russia's intelligence services to start fires on passenger or cargo aircraft flying to the US. In an apparent test run of the plan, magnesium-based devices in packages shipped via DHL ignited at sorting facilities in the UK and Germany. We first saw reporting on the incidents several months ago, but only now has the story been picked up by the major media.

- US and European national security officials warn that the sabotage program marks an unusually aggressive and risky new approach for the Russian intelligence services. They warn that the services could even be acting outside of the control of the Kremlin.
- The risk for investors is that a successful attack could cause a catastrophic airliner crash that kills US citizens. Even though former President Trump is often seen as supportive of authoritarian leaders such as Russian President Putin, we also note that his foreign policy type is "Jacksonian." If he is re-elected today, his instinct for isolationism could abruptly shift toward punching back hard if US honor is besmirched or if US citizens are killed by a foreign power, even if that power is Russia.

Australia: The Reserve Bank of Australia today held its benchmark short-term interest rate steady at 4.35%, meeting expectations and marking a full year at that level. In its policy statement, the RBA noted that while Australian economic growth has slowed markedly, core price inflation remains stubbornly high. The result is that the RBA is now a clear outlier among major central banks, most of which have been cutting rates.



China: The Caixin purchasing managers' index for services rose to a seasonally adjusted 52.0 in October, up from 50.3 in September. Like most major PMIs, the private-sector Caixin gauge is designed so that readings over 50 indicate expanding activity. The Caixin services index has now been above that level for 22 straight months, illustrating how the current headwinds in China's economic growth is in the manufacturing sector, which is saddled with excess capacity.

United States-China: Under pressure from Washington, top US semiconductor equipment makers Applied Materials and Lam Research have told their suppliers to stop using certain components from China or they will risk losing their status as vendors. The firms have also told their suppliers that they can't have Chinese investors or shareholders.

- The warnings are the latest example of how the US and China are putting up barriers to the flow of technology between the two countries.
- As we have argued many times before, those barriers may enhance national security and resilience, but they could also raise costs and contribute to higher price inflation and interest rates going forward.

US Monetary Policy: As a reminder, the Fed holds its latest monetary policy meeting this week, with its decision due on Thursday at 2:00 PM ET. The policymakers are widely expected to cut the benchmark fed funds interest rate by 25 basis points to a range of 4.50% to 4.75%, and we agree with that assessment. However, because of the underlying strength in economic growth, relatively tight labor markets, and continued price pressures, we still think the pace and endpoint of future cuts could leave investors disappointed.

US Labor Market: Boeing's 33,000 union machinists have finally ratified a new labor contract that will give them a 38% pay hike spread over four years and end their nearly two-month strike against the company. However, we note that the pay hike is more muted than workers gained in some other recent high-profile strikes. In part, that likely reflects Boeing's idiosyncratic operational and financial challenges. However, it could also partly reflect the nation's somewhat slower economic growth and cooler labor market.

US Residential Real Estate Market: According to data firm CoStar, the third-quarter apartment vacancy rate held steady at 7.9%, marking the first time in three years that the share of empty units didn't increase. The figures suggest the recent slowdown in apartment construction and still rising demand will help reduce excess supply and lead to improved rental rates in the coming year.

US Economic Releases

The September ***trade balance*** showed a seasonally adjusted deficit of $84.4 billion, which nearly exactly met the expectation of $84.0 billion. This is a rise from the August deficit of $70.8 billion. According to the data, total ***exports*** fell 1.2%, while ***imports*** rose 3.0%. Compared with the same month one year earlier, exports in September rose 2.4%, while imports rose 8.8%. The chart below shows the monthly value of U.S. exports and imports since just before the global financial crisis.

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

Economic Releases						
ET	Indicator			Expected	Prior	Rating
10:00	ISM Services Index	m/m	Oct	53.8	54.9	***
10:00	ISM Prices Paid	m/m	Oct	58	59..4	*
10:00	ISM Employment	m/m	Oct	48.0%	48.1	*
10:00	ISM New Orders	m/m	Oct	58.0	59.4	*
Federal Reserve						
No Fed speakers or events for the rest of today						

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	Monetary Base	y/y	Oct	-0.3%	-0.1%		**	Equity and bond neutral
	Monetary Base, End of Period	m/m	Oct	¥672.7t	¥673.5t		*	Equity and bond neutral
New Zealand	ANZ Commodity Price	m/m	Oct	1.4%	1.8%		**	Equity and bond neutral
South Korea	CPI	m/m	Oct	1.3%	1.6%	1.4%	***	Equity and bond neutral
	Foreign Reserves	m/m	Oct	$415.69b	$419.97b		**	Equity and bond neutral
China	Caixin Composite PMI	m/m	Oct	51.9	50.3		**	Equity and bond neutral
	Caixin Services PMI	m/m	Oct	52.0	50.3	50.5	**	Equity and bond neutral
EUROPE								
France	Industrial Production	y/y	Sep	-0.6%	0.5%	-0.4%	***	Equity and bond neutral
	Manufacturing Production	y/y	Sep	-0.9%	0.3%		**	Equity and bond neutral
UK	New Car Registrations	m/m	Oct	-6.0%	1.0%		*	Equity and bond neutral
	Official Reserves Changes	m/m	Oct	-$945m	$2133m		*	Equity and bond neutral
	S&P Global UK Services PMI	m/m	Oct F	52.0	51.8	51.8	**	Equity and bond neutral
	S&P Global UK Composite PMI	m/m	Oct F	51.8	51.7	51.7	**	Equity and bond neutral
Switzerland	Unemployment Rate	m/m	Oct	2.5%	2.5%	2.5%	**	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	442	0	Down
U.S. Sibor/OIS spread (bps)	452	453	-1	Down
U.S. Libor/OIS spread (bps)	449	449	0	Down
10-yr T-note (%)	4.31	4.29	0.02	Up
Euribor/OIS spread (bps)	308	309	-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**	
RBA Cash Rate Target	4.350%	4.350%	4.350%	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	$75.34	$75.08	0.35%	
WTI	$71.71	$71.47	0.34%	
Natural Gas	$2.75	$2.78	-1.04%	
12-mo strip crack	$20.50	$20.42	0.39%	
Ethanol rack	$1.76	$1.75	0.15%	
Metals				
Gold	$2,742.90	$2,736.78	0.22%	
Silver	$32.65	$32.45	0.60%	
Copper contract	$447.05	$443.15	0.88%	
Grains				
Corn contract	$417.25	$416.50	0.18%	
Wheat contract	$570.25	$568.75	0.26%	
Soybeans contract	$999.75	$997.25	0.25%	
Shipping				
Baltic Dry Freight	1,374	1,378	-4	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		1.81		
Gasoline (mb)		0.60		
Distillates (mb)		-0.97		
Refinery run rates (%)		0.1%		
Natural gas (bcf)		83		

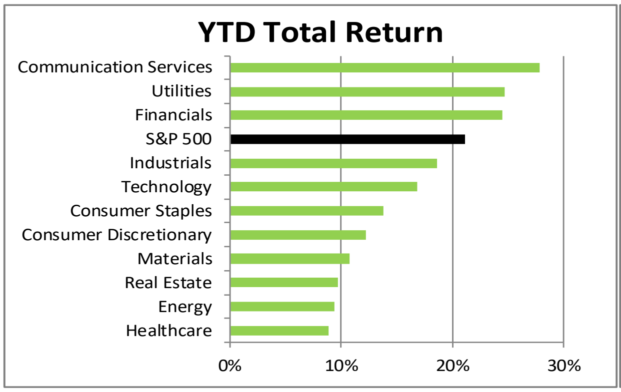
Weather

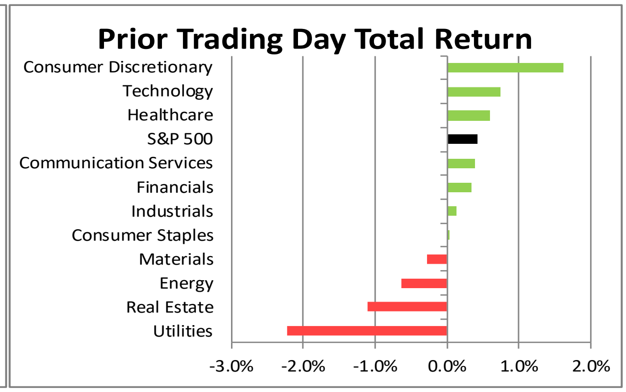
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures from the Great Plains to the East Coast, with cooler-than-normal temperatures in the Pacific and Rocky Mountain regions. The precipitation outlook calls for wetter-than-normal conditions throughout most states with normal conditions in the Southwest, New England, and Florida.

Tropical Storm Rafael is clocking maximum sustained winds of 50 knots as it tracks northwestward from the central Caribbean toward western Cuba. The system is strengthening and could enter the Gulf of Mexico on Thursday as a hurricane.

Data Section

US Equity Markets – (as of 11/4/2024 close)

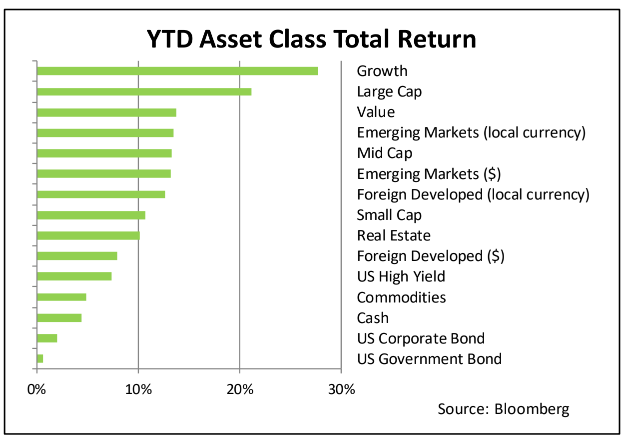




(Source: Bloomberg)

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 11/4/2024 close)

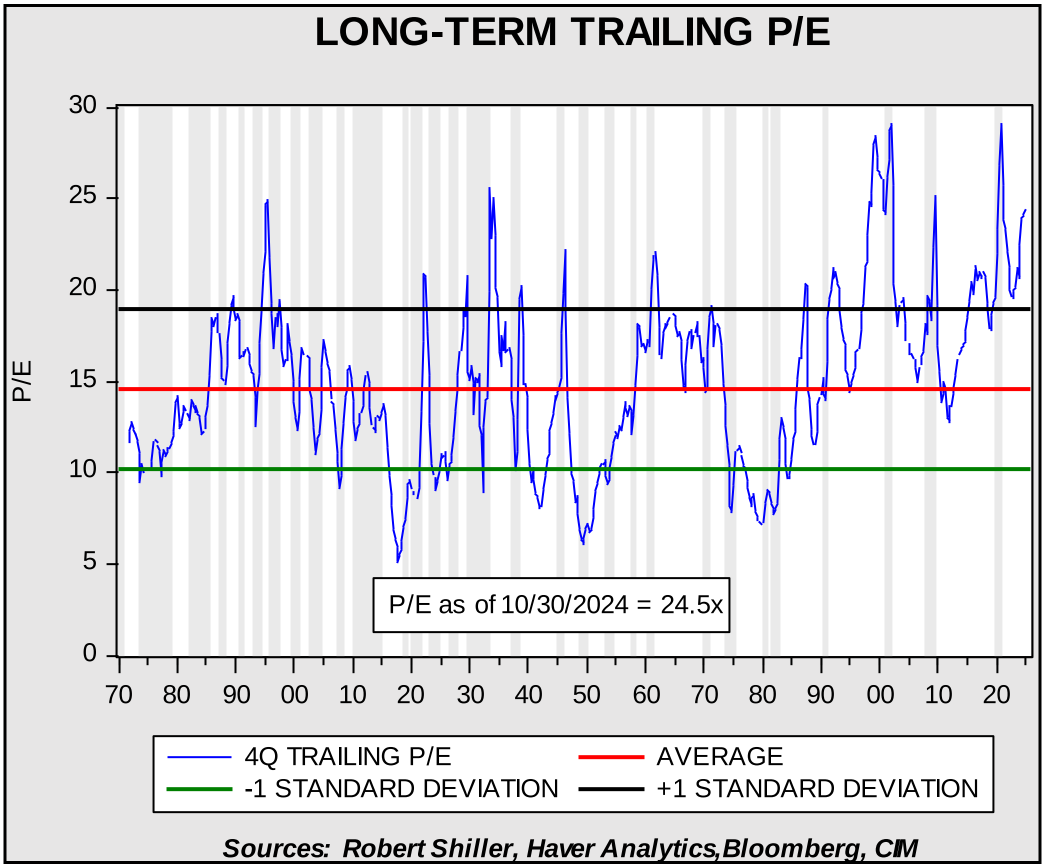


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.

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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.