Confluence INVESTMENT MANAGEMENT

# Daily Comment

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[Posted: November 6, 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 1.1%. Chinese markets were mixed, with the Shanghai Composite down 0.1% from its previous close and the Shenzhen Composite up 0.1%. US equity index futures are signaling a higher open.

With 388 companies having reported so far, S&P 500 earnings for Q3 are running at $61.90 per share, compared to estimates of $60.44, which is up 4.2% from Q3 2023. Of the companies that have reported thus far, 74.7% have exceeded expectations, while 17.8% have fallen short of expectations.

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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 | **Asset Allocation Rebalance Presentation** |

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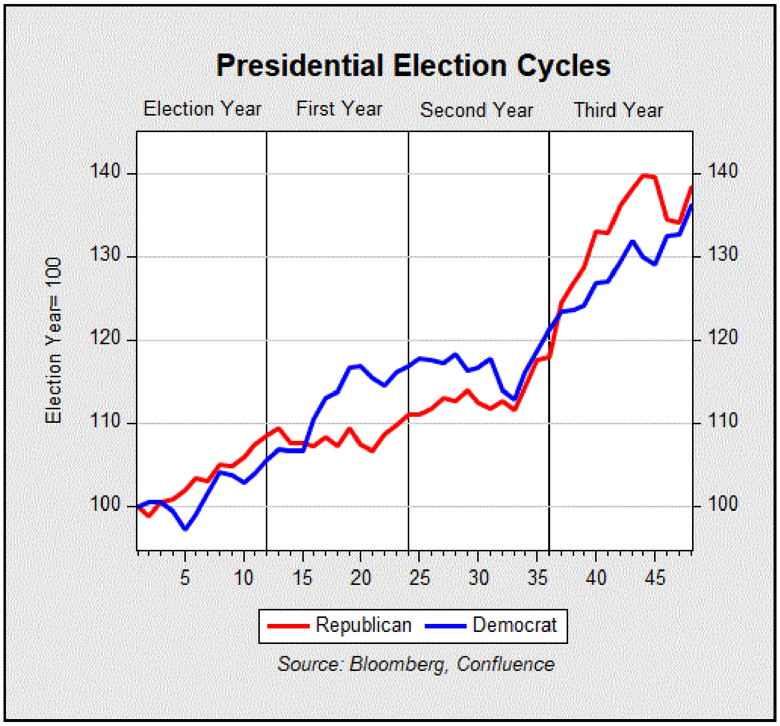
Good morning! The market is currently processing the election results. In sports news, Sporting Lisbon achieved a stunning upset by defeating Manchester, the defending champions, with a score of 4-1. Today's *Comment* will discuss the election results, provide a preview of the upcoming FOMC meeting, and offer an update on the Iran-Israel conflict. As usual, the report will conclude with a roundup of both international and domestic data releases.

**Election 2024:** The Republican party appears to be on pace to sweep all three houses of government.

- Donald Trump secured another presidential term after successfully sweeping all of the swing states. He currently holds over 277 electoral votes and is expected to finish with around 312. His victory also lifted several down-ballot Republicans, including Bernie Moreno in Ohio, who unseated Democratic incumbent Sherrod Brown. The House remains closely contested, with Republicans gaining one seat and slightly increasing their majority, while swing seats are still in play for Democrats. Following Trump's win, equities rallied, the dollar strengthened, and 10-year Treasury yields surged as investors doubled down on the so-called "Trump trade."

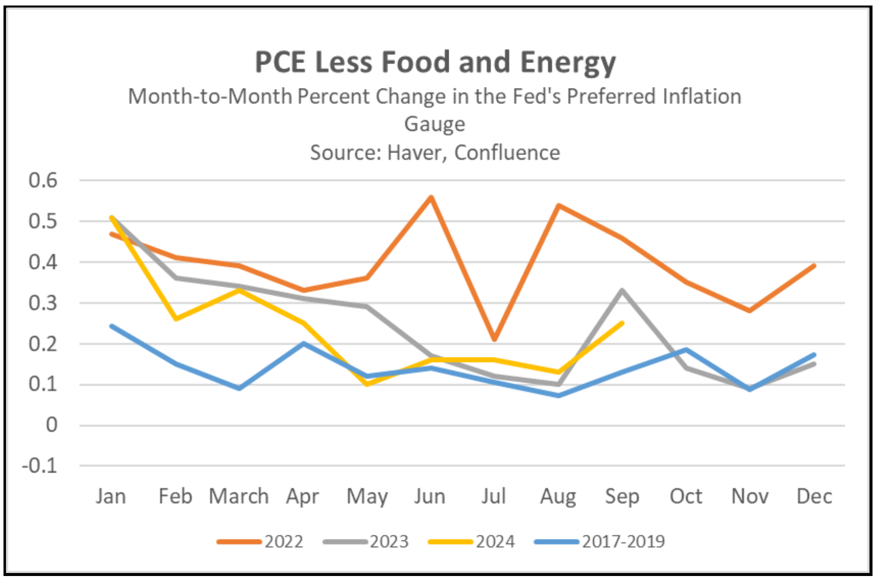
- Trump's return to power has sparked speculation about a possible growth shock. On the campaign trail, he proposed a series of stimulus measures that included lowering the capital gains tax, removing of the cap on SALT deductions, eliminating taxes on tips, and exempting firefighters, police officers, active-duty military, and veterans from paying taxes. Additionally, the decision to deregulate is also likely to help boost corporate profits. While campaign promises are likely to face some sort of adjustment to make them more palatable, it seems that the market is taking Trump at his word.




- Post-election optimism is expected to buoy equity markets in the coming weeks as investors speculate about the potential impact of the next presidency. A Republican president with a divided Congress often provides a balance that can temper more extreme policy shifts, potentially supporting equities and mitigating a rise in yields. Conversely, a Republican sweep could boost equities but also lead to increased bond yields. While Republicans currently hold a slight advantage, the final majority could be razor-thin, potentially as close as a single seat.

**The Fed's Next Move:** The FOMC is set to start its two-day meeting on Wednesday as it looks to bring down policy rates and continue its easing cycle.

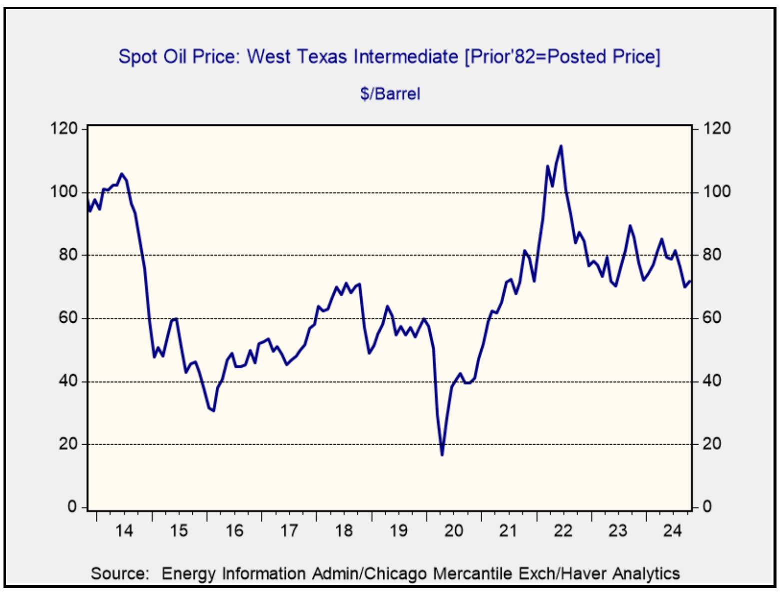
- Market sentiment strongly favors a 25 basis point interest rate cut by the Federal Reserve on Thursday, with the CME FedWatch Tool indicating a 97.5% probability. This expectation is fueled by recent economic data, which shows a cooling inflation and labor market. The Personal Consumption Expenditure (PCE) price index, the Fed's preferred inflation gauge, declined to 2.1% in September, while core PCE remained steady at 2.7%. Additionally, the Bureau of Labor Statistics' payroll report revealed a significant slowdown in job growth, with only 12,000 jobs added in October, which is well below the consensus estimate of 100,000.
- That said, investors will also seek clarification on the Fed's future policy direction. While the previous dot plot indicated a median projection of a 50-basis-point cut for the federal funds rate, it was driven a single vote majority. This suggests that the November cut may be the last for the year. The Fed's decision will likely hinge on whether it observes sufficient progress in reducing inflation over the next two months. For core PCE to decline below 2.7% in this timeframe, prices would need to remain essentially unchanged from October levels, which seems unlikely given current trends.




- The key focus of this week's FOMC meeting will be the committee's interpretation of recent economic data. If it dismisses the weak employment figures as an anomaly, it may become more cautious about further rate cuts. However, if it maintains its assessment of a cooling labor market, it could signal a more accommodative stance. Given the inconsistent nature of recent data, it's difficult to draw definitive conclusions about the trajectory of inflation and the labor market. As such, we anticipate that the Fed will likely provide limited guidance, leading to relatively muted market reactions.

**Israel Uncertainty:** Prime Minister Benjamin Netanyahu has fired a member of his cabinet who was one of the strong proponents for a ceasefire in a sign that the conflict is not getting any closer to ending.

- Israeli Defense Minister Yoav Gallant was dismissed by Prime Minister Netanyahu amid ongoing disagreements over conflict strategy, with Netanyahu citing trust issues as the primary reason. Gallant, a strong advocate for a Gaza ceasefire to secure the release of hostages, is now absent from the cabinet, removing a prominent voice for negotiation. His removal has sparked nationwide protests, reflecting distrust with the handling of the war. This decision comes as Israel fights on two fronts against Iranian proxies Hezbollah in Lebanon and Hamas in Gaza, while bracing for possible retaliatory action from Iran.
- Israel's deepening internal divisions are making it increasingly difficult for the US to prevent a wider regional conflict. On Tuesday, the US issued a stark warning to Iraq, demanding that it prevent Iran from launching attacks on Israel from its territory. According to US intelligence, the Islamic Revolutionary Guard Corps recently transferred ballistic missiles to Shia militias in Iraq, signaling preparations for imminent attacks. These heightened tensions have already caused oil prices to surge nearly 6% since Iran threatened retaliation for Israeli airstrikes.




- Gallant's dismissal signals that a ceasefire may not be imminent, though the potential for further escalation remains uncertain. While Iran has expressed intent to retaliate for recent strikes, it remains vulnerable to counterattacks on its energy and nuclear facilities after Israeli forces recently weakened its air defenses. Meanwhile, ongoing protests within Israel reflect growing public discontent, suggesting limited tolerance for prolonged conflict. In the coming weeks, Netanyahu may face increasing pressure to pursue a ceasefire, which could clarify the conflict's trajectory.

**In Other News:** EU regulators have fined Apple under the Digital Markets Act, signaling that the European Union is preparing to adopt a stricter approach toward US tech companies. Meanwhile, German Chancellor Olaf Scholz is expected to convene a meeting with his three coalition partners as he seeks to avert a potential breakup. Brazil's central bank is expected to raise its benchmark rate by 50 basis points later today to combat rising inflation.

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## US Economic Releases

The Mortgage Bankers Association today said ***mortgage applications*** in the week ended November 1 fell 10.8% compared to last week's fall of 0.1%. Applications for home purchase mortgages fell 5.1%, after rising 5.0% the prior week, to its lowest level since August, while refinancing applications fell 18.5%, marking the sixth consecutive drop to its lowest level since May. According to the report, the average interest rate on a 30-year mortgage rose 8 basis points to 6.81%, the highest since July. In the last five weeks, the rate has risen 67 basis points, the most in two years.

There are no economic releases or Fed events scheduled for the rest of the day.

## 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 | Jibun bank Composite PMI | m/m | Oct F | 49.6 | 49.4 | | * | Equity and bond neutral |
| | Jibun Bank Services PMI | m/m | Oct F | 49.7 | 49.3 | | ** | Equity and bond neutral |
| New Zealand | Unemployment Rate | q/q | 3Q | 4.8% | 4.6% | 5.0% | *** | Equity and bond neutral |
| | Employment Change | q/q | 3Q | -0.5% | 0.3% | -0.4% | ** | Equity and bond neutral |
| India | HSBC India PMI Composite | m/m | Oct F | 59.1 | 58.6 | | ** | Equity and bond neutral |
| | HSBC India PMI Services | m/m | Oct F | 58.5 | 57.9 | | ** | Equity and bond neutral |
| EUROPE | | | | | | | | |
| Eurozone | HCOB Eurozone Services PMI | m/m | Oct F | 51.6 | 51.2 | 51.2 | ** | Equity and bond neutral |
| | HCOB Eurozone Composite PMI | m/m | Oct F | 50.0 | 49.7 | 49.7 | * | Equity and bond neutral |
| | PPI | y/y | Sep | -3.4% | -2.3% | -3.4% | ** | Equity and bond neutral |
| Germany | Factory Orders WDA | y/y | Sep | 1.0% | -3.4% | -2.1% | *** | Equity bullish, bond bearish |
| | HCOB Germany Services PMI | m/m | Oct F | 51.6 | 51.4 | 51.4 | ** | Equity and bond neutral |
| | HCOB Germany Composite PMI | m/m | Oct F | 48.6 | 48.4 | 48.4 | ** | Equity and bond neutral |
| France | HCOB France Services PMI | m/m | Oct F | 49.2 | 48.3 | 48.3 | ** | Equity bullish, bond bearish |
| | HCOB France Composite PMI | m/m | Oct F | 48.1 | 47.3 | 47.3 | ** | Equity bullish, bond bearish |
| Italy | HCOB Italy Services PMI | m/m | Oct | 52.4 | 50.5 | 50.2 | ** | Equity bullish, bond bearish |
| | HCOB Italy Composite PMI | m/m | Oct | 51.0 | 49.7 | 50.0 | ** | Equity bullish, bond bearish |
| UK | S&P/CIPS Construction PMI | m/m | Oct | 54.3 | 57.2 | 55.1 | ** | Equity bearish, bond bullish |
| AMERICAS | | | | | | | | |
| Canada | Int'l Merchandise Trade | m/m | Sep | -1.26b | -1.47b | -0.95b | * | Equity bearish, bond bullish |
| | S&P Global Canada Composite PMI | m/m | Oct | 50.7 | 47.0 | | * | Equity and bond neutral |
| | S&P Global Canada Services PMI | m/m | Oct | 50.4 | 46.4 | | * | Equity and bond neutral |
| Mexico | International Reserves Weekly | w/w | 1-Nov | $226024m | $226067m | | * | Equity and bond neutral |
| Brazil | FGV Inflation IGP-DI | y/y | Oct | 5.91% | 4.83% | 5.95% | ** | 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)** | 443 | 442 | 1 | Down |
| **U.S. Sibor/OIS spread (bps)** | 453 | 452 | 1 | Down |
| **U.S. Libor/OIS spread (bps)** | 450 | 449 | 1 | Down |
| **10-yr T-note (%)** | 4.46 | 4.27 | 0.19 | Up |
| **Euribor/OIS spread (bps)** | 306 | 308 | -2 | 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 | $74.25 | $75.53 | -1.69% | |
| WTI | $70.73 | $71.99 | -1.75% | |
| Natural Gas | $2.70 | $2.67 | 1.05% | |
| 12-mo strip crack | $20.39 | $20.70 | -1.50% | |
| Ethanol rack | $1.75 | $1.75 | -0.11% | |
| **Metals** | | | | |
| Gold | $2,702.25 | $2,743.99 | -1.52% | |
| Silver | $31.87 | $32.66 | -2.41% | |
| Copper contract | $430.25 | $447.50 | -3.85% | |
| **Grains** | | | | |
| Corn contract | $416.00 | $418.50 | -0.60% | |
| Wheat contract | $563.75 | $572.50 | -1.53% | |
| Soybeans contract | $982.75 | $1,001.75 | -1.90% | |
| **Shipping** | | | | |
| Baltic Dry Freight | 1,405 | 1,374 | 31 | |
| **DOE Inventory Report** | | | | |
| | **Actual** | **Expected** | **Difference** | |
| Crude (mb) | | -0.09 | | |
| Gasoline (mb) | | -0.52 | | |
| Distillates (mb) | | -0.50 | | |
| Refinery run rates (%) | | 0.6% | | |
| Natural gas (bcf) | | 68 | | |

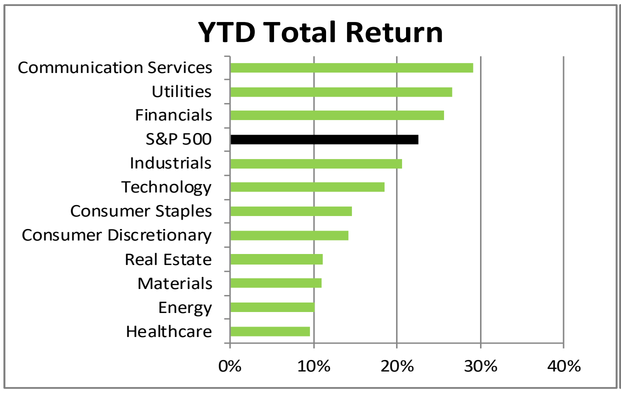
## Weather

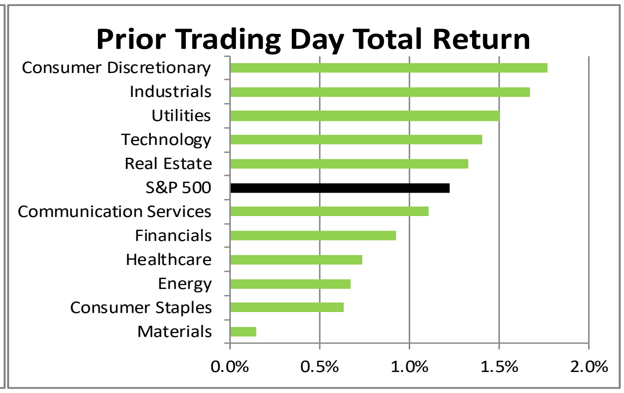
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures from the Great Plains to the East Coast, with cooler-than-normal temperatures in the Pacific and Rocky Mountain regions. The precipitation outlook calls for wetter-than-normal conditions throughout most states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

Hurricane Rafael is expected to strengthen to near-major hurricane status as it tracks northwestward from the central Caribbean toward western Cuba. The system is strengthening and will enter the Gulf of Mexico on Thursday. Meanwhile, a second tropical disturbance has formed just west of the Leeward Islands and has a 20% chance of cyclonic formation within the next 48 hours.

## Data Section

**US Equity Markets** – (as of 11/5/2024 close)

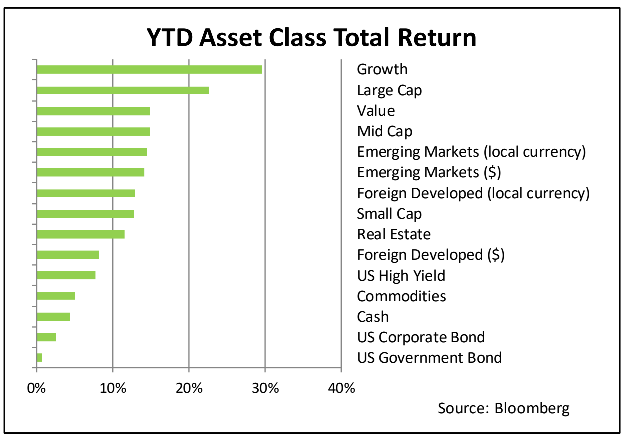



(Source: Bloomberg)

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 11/5/2024 close)

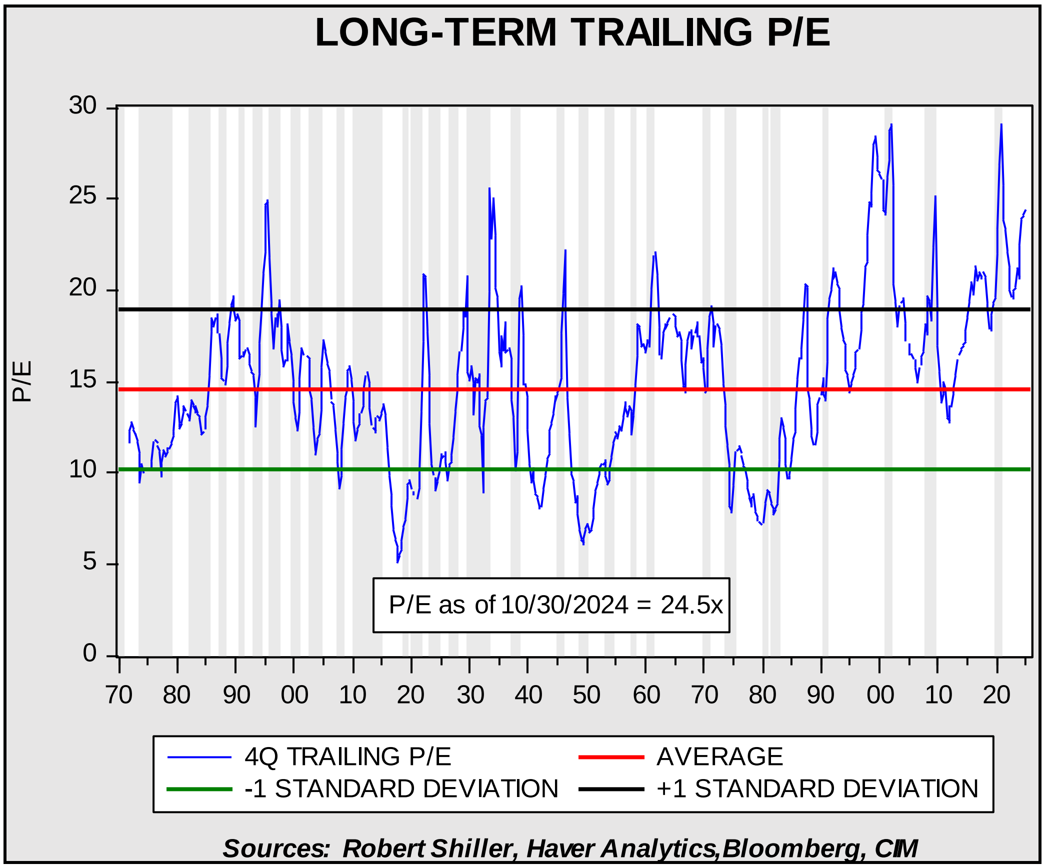



This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.*

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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.