Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

Looking for something to read? See our Reading List; these books, separated by category, are ones we find interesting and insightful. We will be adding to the list over time.

[Posted: October 11, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is up 0.1% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.7%. Chinese markets were lower, with the Shanghai Composite down 2.6% from its previous close and the Shenzhen Composite down 3.9%. US equity index futures are signaling a lower open.

With 24 companies having reported so far, S&P 500 earnings for Q3 are running at $60.50 per share, compared to estimates of $60.44, which is up 4.2% from Q3 2023. Of the companies that have reported thus far, 98.0% have exceeded expectations while 1.2% have fallen short of expectations.

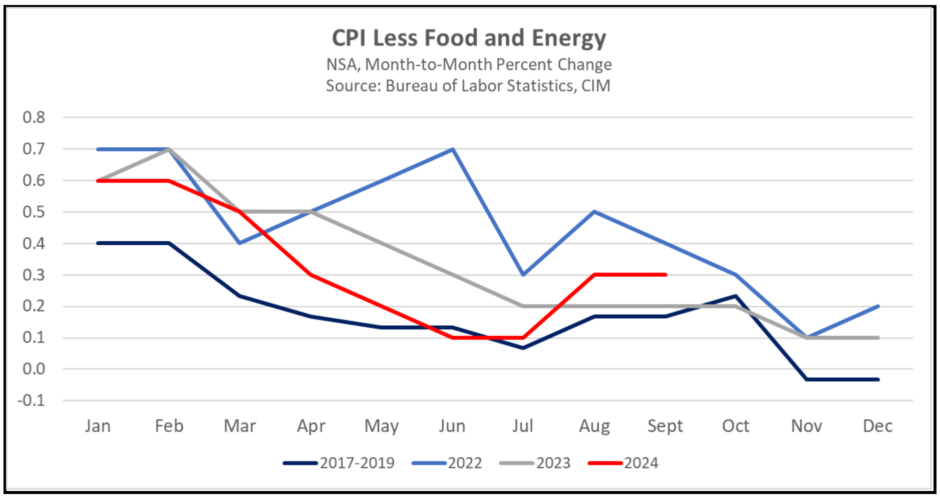
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *Bi-Weekly Geopolitical Report* (10/7/2024) (with associated podcast): "The US Presidential Election: Foreign Policy Implications"
- *Asset Allocation Bi-Weekly* (9/30/2024) (with associated podcast): "Presidential Cycles and Stock Performance"
- *Asset Allocation Quarterly – Q3 2024* (7/16/2024): Discussion of our asset allocation process, Q3 2024 portfolio changes, and our outlook for the markets.
- *Asset Allocation Q3 2024 Rebalance Presentation* (8/6/2024): Video presentation featuring the Asset Allocation Committee as they review the asset allocation strategies, recent portfolio changes, and the current macro environment.
- *Confluence of Ideas podcast* (9/11/2024) "Reviewing the Asset Allocation Rebalance: Q3 2024"
- *Fixed Income Quarterly* (September 2024)

Good morning! The market is currently analyzing the latest PPI data. In sports news, the Minnesota Lynx managed to win game one against the New York Liberty in the WNBA Final. Today's *Comment* will cover our thoughts on the latest inflation report, explore reasons behind the upward movement of the 10-year Treasury, and provide a review of France's government budget proposal. Additionally, the report will include a roundup of international and domestic data releases.

Mixed Bag Inflation: While the BLS inflation report offered some relief about the path of inflation, it also raised some concerns.

- The September CPI report surpassed consensus expectations, with core goods and services inflation accelerating from the prior month. Overall inflation rose 0.2% month-over-month and 2.4% year-over-year, exceeding the projection of 2.3%. Excluding energy and food, inflation increased by 0.3% month-over-month and by 3.3% year-over-year, surpassing the anticipated 3.2%. The broad-based jump in the inflation report was driven by spikes in apparel, new cars, and medical services. However, shelter inflation decelerated to its slowest pace since August 2021.
- Although a significant decrease in shelter inflation might be seen as a positive development, other offsetting factors suggest persistent underlying inflationary pressures. Throughout the year, Fed officials have emphasized that shelter inflation is a key factor in their efforts to bring overall inflation down to the 2% target. However, the latest report highlights the risk posed by other components to the Fed's inflation target. This marks the second consecutive month where inflation has risen at a pace exceeding that of the previous year.



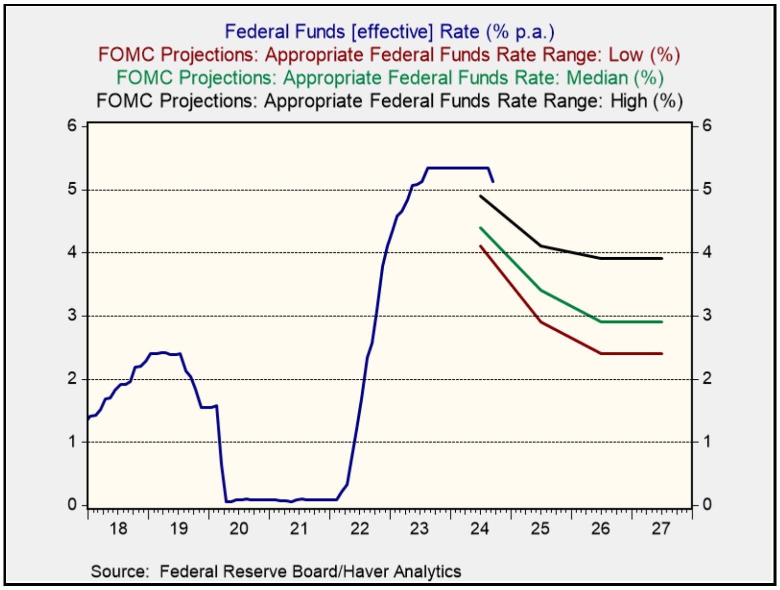
- While the report is concerning, we think it is too soon to become overly worried. As the chart above shows, it is normal for inflation to accelerate in the fall, and this should moderate over the next few months. Additionally, many of the factors that drove the spike may have been related to Hurricane Helene, particularly for medical services. Nevertheless, we believe the Fed will closely monitor inflation to ensure its convergence toward the target. If inflation begins to accelerate, we anticipate the Fed will slow the pace of its easing cycle.

Treasurys Not Convinced: Investors have become less willing to take on longer-duration debt as supply continues to be a problem.

- The 10-year Treasury yield has increased by 40 basis points since the latest FOMC rate decision, as investors have become increasingly concerned about the policy path. The sharp rise was primarily driven by concerns that the Fed may have shifted away from prioritizing maximum employment too quickly. Furthermore, there is a growing concern that the market may not be able to absorb the large issuance of government debt as the

US continues to run large deficits. Earlier this week, the Treasury auction for 10-year bonds experienced somewhat weaker demand due to the uncertainty.

- The main source of concern in the Treasury bonds market may be attributed to uncertainty regarding the Fed's neutral rate, which is the policy rate at which it neither stimulates nor restricts the economy. The latest FOMC dot plots highlight the substantial disagreement among Fed officials on this issue, with the highest long-run fed funds rate at 3.75% and the lowest at 2.25%. Assuming one more rate cut this year, the central bank could potentially cut rates another 4-10 times over the next few years.

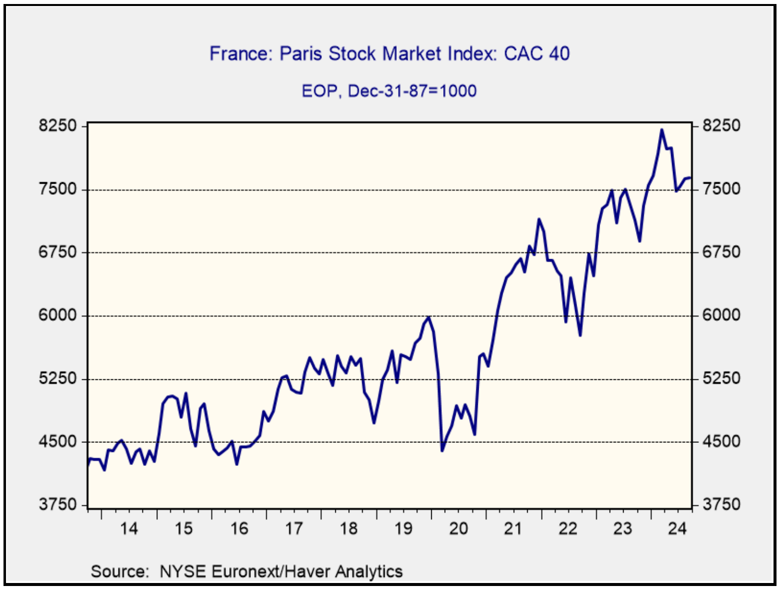


- The wide dispersion in the FOMC dot plots is likely to be a key focus for the market in the coming months as it assesses the Fed's terminal rate. Consequently, we believe that speculation about rate cuts will have less influence on bond markets than the broader trajectory of monetary policy. While favorable inflation data has historically impacted bonds, we expect weak labor and economic data to play a more significant role. Fed officials are likely to be more responsive to signals of an economic slowdown than to indications of easing inflation when deciding the size of future cuts.

French Austerity: French Prime Minister Michel Barnier has released details of the budget for the next fiscal year as he looks to solve the country's deficit problem.

- The budget proposes over 60 billion EUR ($65 billion) in spending cuts and tax increases on large corporations. A new exceptional tax would be imposed on corporations with annual revenue exceeding 1 billion EUR ($1.1 billion), aiming to generate over 12 billion EUR ($13.1 billion) in revenue over two years. Additionally, the state-owned utility company, EDF, would be required to pay a special dividend of 13.6 billion EUR ($14.8 billion) to the government. Furthermore, the government plans to raise two-thirds of the funding through cuts to medical costs, unemployment benefits, and staff reductions.

- If enacted, the budget plan could dampen investor sentiment toward French financial markets. France already faces relatively high 10-year bond yields compared to its peers, and concerns over corporate profitability under the new proposal may further deter investment. The country's benchmark index, the CAC 40, is currently down nearly 10% from its May peak. In contrast, Germany's benchmark stock index, the DAX 50, is hovering near an all-time high, despite the country's recession.



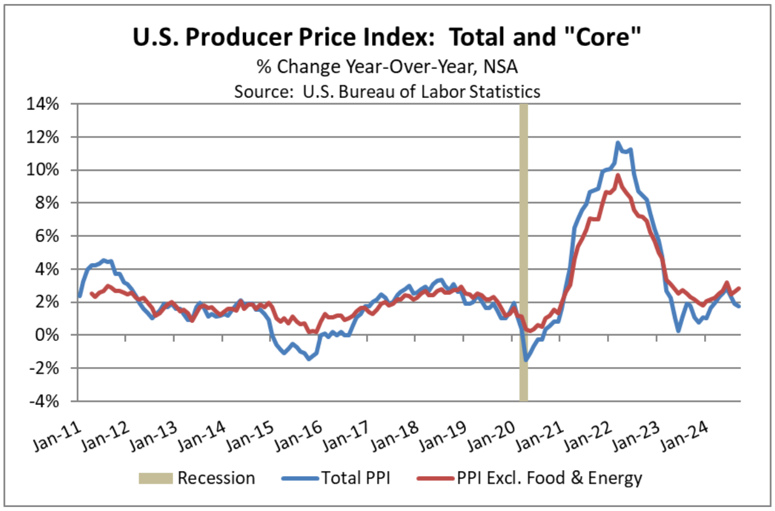
- Nevertheless, the budget remains subject to several hurdles before its finalization. The proposal has faced opposition from lawmakers concerned that the tax increases could hinder efforts to improve the country's competitiveness. Additionally, today's Fitch rating outlook will offer insights into investor views on the budget's credibility. If it is able to pass through parliament and avoid a downgrade in its outlook, French yields should fall. However, a major concern moving forward will be avoiding a budget that is so onerous as to negatively affect tax receipts in the upcoming year.

In Other News: Iran has warned that a strike on its nuclear sites would potentially cause the country to change its nuclear doctrine. Atlanta Fed President Raphael Bostic was the first Fed official to signal a willingness for a pause in rate cuts following the hotter-than-expected CPI report. China is expected to release $283 billion in new stimulus over the weekend, in a sign that it is ready to follow through on its promise to boost its economy.

US Economic Releases

The September ***producer price index (PPI)*** was essentially unchanged on a seasonally adjusted basis, coming in better than both the expected rise of 0.1% and the August increase of 0.2%. Excluding the volatile food and energy components, the September ***"core" PPI*** rose 0.2%, matching expectations and decelerating from its 0.3% rise in the previous month. The overall PPI in September was up 1.8% from the same month one year earlier, while the core PPI was up

2.8%. The chart below shows the year-over-year change in the PPI and the core PPI over the last decade or so.



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

Economic Releases						
EST	**Indicator**			**Expected**	**Prior**	**Rating**
10:00	U. of Michigan Sentiment	m/m	Oct P	71.0	70.1	***
10:00	U. of Michigan Current Conditions	m/m	Oct P	64.3	63.3	**
10:00	U. of Michigan Expectations	m/m	Oct P	74.8	74.4	**
10:00	U. of Michigan 1-Year Inflation Expectation	m/m	Oct P	2.7%	2.7%	*
10:00	U. of Michigan 5-10 Year Inflation Expectation	m/m	Oct P	3.0%	3.1%	*
Federal Reserve						
EST	**Speaker or Event**	**District or Position**				
9:45	Austan Goolsbee Gives Opening Remarks	President of the Federal Reserve Bank of Chicago				
10:45	Lorie Logan Participates in Panel Discussion	President of the Federal Reserve Bank of Dallas				
13:10	Michelle Bowman Speaks on Community Banking	Member of the Board of Governors				

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	Money Stock M2	y/y	Sep	1.3%	1.3%		**	Equity and bond neutral
	Money Stock M3	y/y	Sep	0.8%	0.8%		**	Equity and bond neutral
New Zealand	BusinessNZ Manufacturing PMI	m/m	Sep	46.9	46.1		***	Equity and bond neutral
	Food Prices	m/m	Sep	0.0%	0.2%		***	Equity and bond neutral
India	Industrial Production	y/y	Aug	0.1%	4.8%	1.0%	***	Equity bearish, bond bullish
EUROPE								
Germany	CPI	y/y	Sep F	1.6%	1.6%	1.6%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Sep F	1.8%	1.8%	1.8%	**	Equity and bond neutral
UK	Industrial Production	y/y	Aug	-1.6%	-2.2%	-0.5%	***	Equity bearish, bond bullish
	Manufacturing Production	y/y	Aug	-0.3%	-2.0%	-0.4%	**	Equity and bond neutral
	Index of Services 3M/3M	m/m	Aug	0%	0.4%	0.3%	**	Equity and bond neutral
	Visible Trade Balance	m/m	Aug	-£15060m	-£18871m	-£18900m	**	Equity and bond neutral
	Trade Balance	m/m	Aug	-£955m	-£4712m	-£5925m	**	Equity and bond neutral
Russia	Gold and Forex Reserves	m/m	4-Oct	$629.9b	$633.6b		***	Equity and bond neutral
	Money Supply, Narrow	w/w	4-Oct	18.35t	18.30t		*	Equity and bond neutral
	Current Account Balance	q/q	3Q P		17403m		**	Equity and bond neutral
	CPI	y/y	Sep		9.00%	8.55%	***	Equity and bond neutral
	Core CPI	y/y	Sep		8.44%	--	**	Equity and bond neutral
AMERICAS								
Mexico	Industrial Production	y/y	Aug	-0.9%	2.2%	0.4%	***	Equity bearish, bond bullish
	Manufacturing Production	y/y	Aug	0.1%	1.6%	0.9%	*	Equity and bond neutral
Brazil	IBGE Services Volume	y/y	Aug	1.7%	4.3%	3.7%	*	Equity bearish, bond bullish

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)	452	453	-1	Down
U.S. Sibor/OIS spread (bps)	466	466	0	Down
U.S. Libor/OIS spread (bps)	462	462	0	Down
10-yr T-note (%)	4.10	4.06	0.04	Up
Euribor/OIS spread (bps)	318	322	-4	Down
Currencies	**Direction**			
Dollar	Down			Down
Euro	Flat			Up
Yen	Up			Up
Pound	Up			Up
Franc	Up			Up
Central Bank Action	**Current**	**Prior**	**Expected**	
Bank of Korea Base Rate	3.250%	3.500%	3.250%	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	$78.70	$79.40	-0.88%	
WTI	$75.17	$75.85	-0.90%	
Natural Gas	$2.71	$2.68	1.42%	
12-mo strip crack	$20.85	$21.05	-0.97%	
Ethanol rack	$1.72	$1.73	-0.31%	
Metals				
Gold	$2,640.31	$2,629.74	0.40%	
Silver	$31.17	$31.16	0.01%	
Copper contract	$444.70	$442.75	0.44%	
Grains				
Corn contract	$420.00	$418.50	0.36%	
Wheat contract	$606.75	$603.75	0.50%	
Soybeans contract	$1,021.00	$1,014.75	0.62%	
Shipping				
Baltic Dry Freight	1,790	1,799	-9	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	5.81	1.60	4.21	
Gasoline (mb)	-6.30	-1.00	-5.30	
Distillates (mb)	3.12	-1.75	4.88	
Refinery run rates (%)	-0.9%	0.0%	-0.9%	
Natural gas (bcf)	82	76	6	

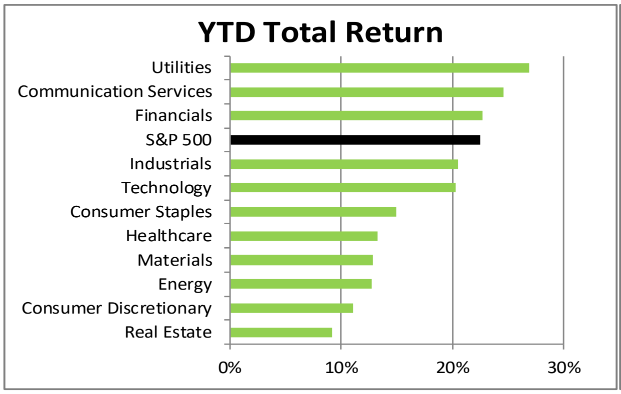
Weather

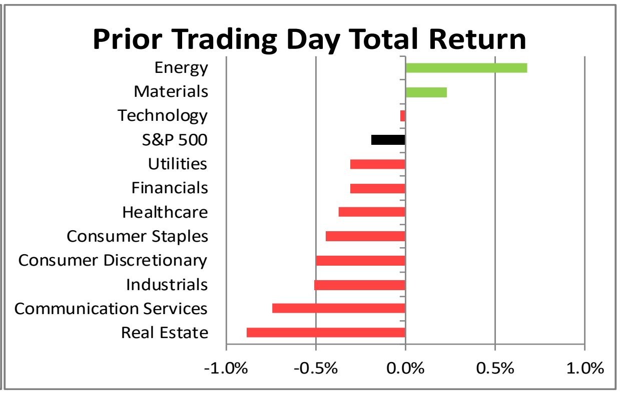
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures from the Rocky Mountains to the Mississippi River, with cooler-than-normal temperatures in the Pacific Northwest. The forecasts call for wetter-than-normal conditions in the Pacific Northwest, the northern Rocky Mountains, the Great Plains, and Florida, with dry conditions in the Midwest and Northeast.

Tropical Storm Leslie continues to travel northward through the central Atlantic Ocean, but it is not expected to make landfall before it dissipates. There is also an atmospheric disturbance just off the coast of western Africa. It is assessed to have a 50% chance of forming a cyclone within the next 48 hours.

Data Section

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

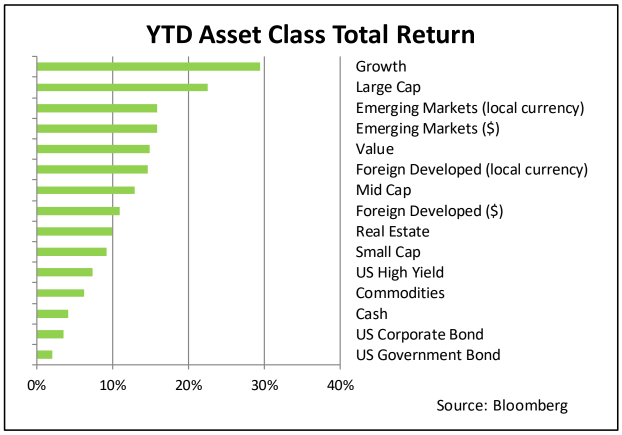




(Source: Bloomberg)

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 10/10/2024 close)

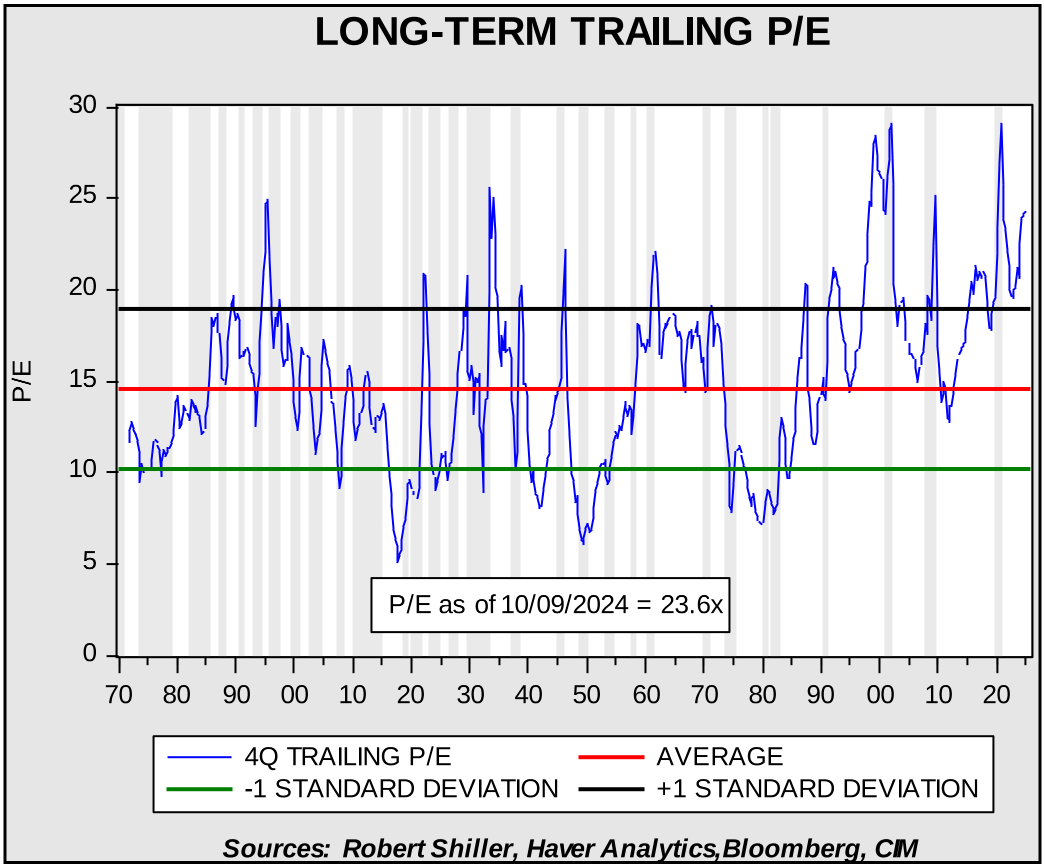


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 10, 2024



Based on our methodology,[1] the current P/E is 23.6x, up 0.6 from our last report. The stock price index increased slightly, while earnings were revised upward.

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.