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 14, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is essentially unchanged from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.1%. Chinese markets were higher, with the Shanghai Composite up 2.1% from its previous close and the Shenzhen Composite up 3.0%. US equity index futures are signaling a higher open.

With 29 companies having reported so far, S&P 500 earnings for Q3 are running at $60.70 per share, compared to estimates of $60.44, which is up 4.2% from Q3 2023. Of the companies that have reported thus far, 97.8% have exceeded expectations while 1.2% have fallen short of expectations.

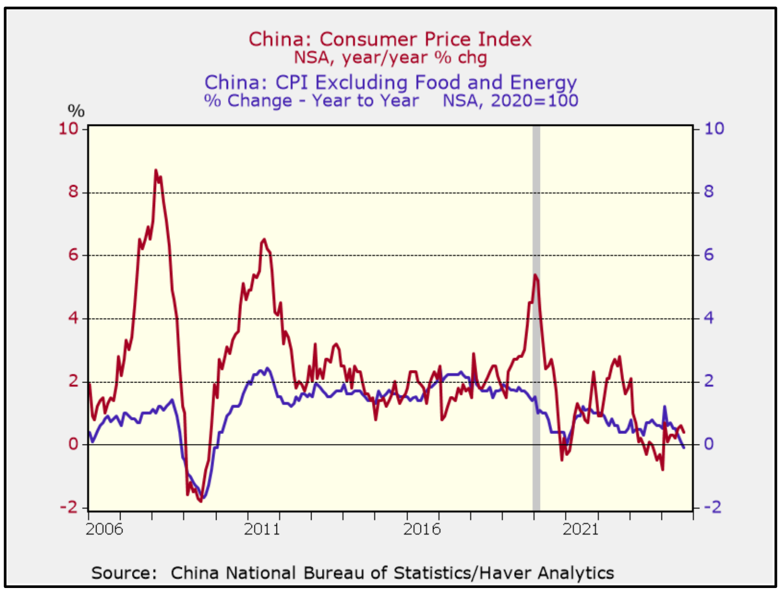
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below, with new items of the day emphasized in bold:

- *Bi-Weekly Geopolitical Report* (10/7/2024) (with associated podcast): "The US Presidential Election: Foreign Policy Implications"
- ***Asset Allocation Bi-Weekly*** **(10/14/2024) (with associated podcast): "The Yield Curve Un-Inverts"**
- *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)

Our *Comment* today opens with yet another disappointing press conference by a top Chinese economic official. We next review several other international and US developments with the potential to affect the financial markets today, including a cut in France's debt rating outlook and another study looking at US economic prospects in a new term for former President Trump or under Vice President Harris.

Chinese Economic Policy: At a news conference on Saturday, Finance Minister Lan Fo'an said the central government will issue special bonds in 2025 to fund new fiscal support for local governments and banks, but he gave no figure for the new spending and provided no detail on how much of it would go to boost consumer spending. As with the National Development and Reform Commission's disappointing news conference last week, the lack of detail miffed foreign investors. Local buyers were more positive, pushing China's markets higher today.

- When the government announced its big monetary stimulus last month, sources said it would also soon release a plan to issue the equivalent of $284 billion in special bonds to help local governments and banks. However, no official announcement has been made. That has prompted rabid speculation about how aggressive the government will be. Some observers are looking (or hoping) for a program of up to $425 billion, with significant amounts going to boost consumption spending.
- For now, the Chinese economy continues to struggle against big structural problems, including weak consumer demand, excess capacity and high debt, poor demographics, decoupling by the West, and disincentives from the Communist Party's intrusions into the free market. Without a strong dose of fiscal stimulus and new policies to promote consumer spending, Beijing may fail to generate lasting optimism among investors and consumers, with negative implications for global economic growth.
- In the latest piece of evidence showing China's economic weakness, the September consumer price index was up just 0.4% from the same month one year earlier, decelerating from a 0.6% rise in the year to August. Excluding the volatile food and energy components, China's "Core CPI" is already in deflation.



Chinese Financial Industry: The Supreme People's Procuratorate said on Saturday that it has arrested Li Quan, former chief executive of the New China Life Insurance Company for embezzlement and bribery. Along with other recent arrests, the action against Li shows how Beijing has focused on cleaning up the country's financial industry as part of its program to make China a "financial superpower." Cleaning up the industry would probably be positive in the long run, but it also presents regulatory risk for Chinese financial firms in the near term.

Russia-Ukraine Conflict: The Russian military has increased its attacks in recent days on Ukraine's Black Sea granaries, ports, and civilian ships serving them. The attacks appear to be an effort to undermine Ukraine's ability to export grain and hurt its economy. If Russian forces can cut Ukrainian exports in a meaningful way, the shock to supply could lead to higher grain prices worldwide. So far this morning, however, US corn and wheat futures are trading slightly lower.

Broader Emerging Markets: Although major central banks have finally started cutting interest rates, S&P Global Ratings today issued a report warning that sovereign bond defaults will likely accelerate in the coming decade. The report argues that when today's cutting cycle ends, interest rates will remain relatively high. Many emerging markets will also be left with higher debt and lower financial reserves, making them more susceptible to default.

France: On Friday, just a day after Prime Minister Barnier proposed an austere 2025 budget aimed at reining in the burgeoning fiscal deficit, Fitch cut France's bond rating outlook to negative. Although the firm kept France's overall sovereign rating unchanged at AA-, it warned that the rating could be reduced if the budget plan fails in the severely divided parliament. The move by Fitch follows an outright rating cut by S&P and an outlook cut by Moody's earlier in the year.

- France's public debt has now risen to more than 110% of gross domestic product, making it the third-most indebted country in the European Union after Greece and Italy. Clearly, emerging markets aren't the only ones that can face debt problems!
- The country's rapidly expanding debt reflects a range of factors, such as increased fuel subsidies, economic stimulus spending, rising interest rates, and tax cuts aimed at making the country more attractive for investment.

United Kingdom: At an investment conference in London today, Prime Minister Starmer promised to develop an industrial strategy, slash regulation, and get control of the country's fiscal situation to spur economic growth. As Starmer put it to the assembled executives, "You have to grow your business, I have to grow my country . . . We are determined to improve it and repair Britain's brand as an open, outward looking, confident, trading nation." Still, corporate confidence may not improve much if Starmer's government hikes taxes as expected.

Japan: With campaigning for the snap October 31 parliamentary elections due to start Tuesday, Prime Minister Ishiba said he is not contemplating raising or lowering the country's 10% sales tax "for the time being." The new prime minister and his cabinet have been criticized for making contradictory statements on economic policy, but Ishiba's statement appears to be a clear sign that he is looking for stability in tax policy. That will likely be celebrated by investors, although it also suggests Japan will face continued budget deficits and growing debt.

United States-Israel-Iran: As the Israeli government continues planning for a strike against Iran to retaliate for its recent missile attack, the US Defense Department yesterday said it will deploy an advanced missile defense system to Israel, including about 100 troops to operate it. Deploying the Terminal High Altitude Area Defense system, or THAAD, along with its crew, will raise the risk of the US getting directly involved in the conflict, especially if Iranian missiles or drones injure any US troops.

US Politics: Scott Bessent, the former hedge fund manager for liberal philanthropist George Soros, who has become a top economic advisor to former President Trump, said in an interview with the *Financial Times* that Trump's threats to weaken the dollar and impose big import tariffs on US allies are just bargaining positions. Bessent insisted that Trump would stand by the traditional US policy of keeping the dollar strong and maintaining its position as the world's key reserve currency.

- While Bessent cautioned that he does not speak for Trump, he asserted that the former president, at the end of the day, is a "free trader."
- Despite Bessent's assertions, Trump has shown that he is highly populist, with a focus on protecting blue-collar workers even if it imposes costs on capital owners and business managers. Bessent's comments may be aimed at shoring up support for Trump among business executives. Nevertheless, we suspect that if Trump is elected to a new term, he would indeed pursue populist policies, including high, protectionist import tariffs, a weaker dollar, and expansive fiscal spending for the working class.
- On that note, the latest study comparing economic prospects under Trump or Harris is out. In a *Wall Street Journal* survey of 50 economists, 68% predicted consumer price inflation would be higher under Trump than under Harris, while 12% thought inflation would be higher under Harris. Most of the respondents also expected higher interest rates and budget deficits under Trump, which is consistent with other recent studies.
- Of course, much will depend on what actually gets passed by Congress. In any case, the clear pattern in all these studies is that inflation, interest rates, and budget deficits are expected to be higher no matter who wins the presidency.

Nobel Prize: Finally, this year's Nobel Prize in economics was awarded today to Turkey's Daron Acemoglu, the UK's Simon Johnson, and the US's James Robinson for their analyses of why some countries are more prosperous than others. In their 2012 book "Why Nations Fail: The Origins of Power, Prosperity, and Poverty," the authors stress that prosperity relies largely on having good institutions that protect private property, allow free markets to work efficiently, mediate disputes, and promote innovation. Nations fail if they lack such institutions.

US Economic Releases

There were no economic releases prior to the publication of this report. The following table lists the economic releases or 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**
9:00	Neel Kashkari Participates in Panel Discussion	President of the Federal Reserve Bank of Minneapolis
15:00	Christopher Waller Speaks onEconomic Outlook	Member of the Board of Governors
17:00	Neel Kashkari Participates in Fireside Chat	President of the Federal Reserve Bank of Minneapolis

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								
China	Money Supply M2	y/y	Sep	6.8%	6.3%	6.4%	***	Equity and bond neutral
	Money Supply M1	y/y	Sep	-7.4%	-7.3%	-7.2%	*	Equity and bond neutral
	Money Supply M0	y/y	Sep	11.5%	12.2%		*	Equity and bond neutral
	New Yuan Loans	m/m	Sep	16020.0b	14426.1b	16368.1b	**	Equity and bond neutral
	Aggregate Financing CNY	m/m	Sep	25660.0b	21899.6b	25475.2b	**	Equity and bond neutral
	PPI	y/y	Sep	-2.8%	-1.8%	-2.6%	**	Equity and bond neutral
	CPI	y/y	Sep	0.4%	0.6%	0.6%	**	Equity and bond neutral
	Trade Balance	m/m	Sep	$81.71b	$91.02b	$90.50b	***	Equity and bond neutral
	Exports	y/y	Sep	2.4%	8.7%	6.0%	**	Equity bearish, bond bullish
	Imports	y/y	Sep	0.3%	0.5%	0.8%	**	Equity and bond neutral
India	Wholesale Prices	m/m	Sep	1.84%	1.31%	2.00%	**	Equity and bond neutral
	CPI	y/y	Sep	5.5%	3.65%	5.10%	***	Equity and bond neutral
EUROPE								
Switzerland	Producer & Import Prices	y/y	Sep	-1.3%	-1.2%		**	Equity and bond neutral
	Domestic Sight Deposits CHF	w/w	11-Oct	459.4b	460.3b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	11-Oct	467.1b	471.4b		*	Equity and bond neutral
Russia	Current Account Balance	q/q	3Q P	9100m	17403m	300m	**	Equity and bond neutral
	CPI	y/y	Sep	8.63%	9.00%	8.55%	***	Equity and bond neutral
	Core CPI	y/y	Sep	8.26%	8.44%		**	Equity and bond neutral
AMERICAS								
Canada	Net Change in Employment	m/m	Sep	46.7k	22.1k	27.0k	***	Equity and bond neutral
	Unemployment Rate	m/m	Sep	6.5%	6.6%	6.7%	***	Equity and bond neutral
	Participation Rate	m/m	Sep	64.9%	65.1%	65.1%	*	Equity and bond neutral
	Building Permits	m/m	Aug	-7.0%	22.8%	-7.80	**	Equity and bond neutral
Mexico	Consumer Confidence	m/m	Sep	47.1	47.6	47.6	*	Equity and bond neutral
Brazil	Econimic Activity	y/y	Aug	3.1%	5.3%	2.9%	*	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)	451	452	-1	Down
U.S. Sibor/OIS spread (bps)	466	465	1	Down
U.S. Libor/OIS spread (bps)	462	461	1	Down
10-yr T-note (%)	4.10	4.10	0.00	Up
Euribor/OIS spread (bps)	318	318	0	Down
Currencies	**Direction**			
Dollar	Down			Down
Euro	Flat			Up
Yen	Up			Up
Pound	Up			Up
Franc	Up			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	$77.36	$79.04	-2.13%	
WTI	$73.88	$75.56	-2.22%	
Natural Gas	$2.58	$2.63	-2.09%	
12-mo strip crack	$20.48	$20.92	-2.12%	
Ethanol rack	$1.72	$1.72	-0.13%	
Metals				
Gold	$2,654.30	$2,656.59	-0.09%	
Silver	$31.18	$31.54	-1.14%	
Copper contract	$441.45	$449.35	-1.76%	
Grains				
Corn contract	$413.00	$415.75	-0.66%	
Wheat contract	$598.25	$599.00	-0.13%	
Soybeans contract	$1,001.00	$1,005.50	-0.45%	
Shipping				
Baltic Dry Freight	1,809	1,790	19	

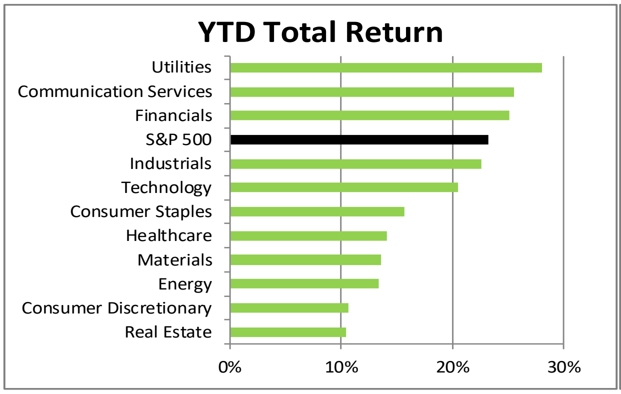
Weather

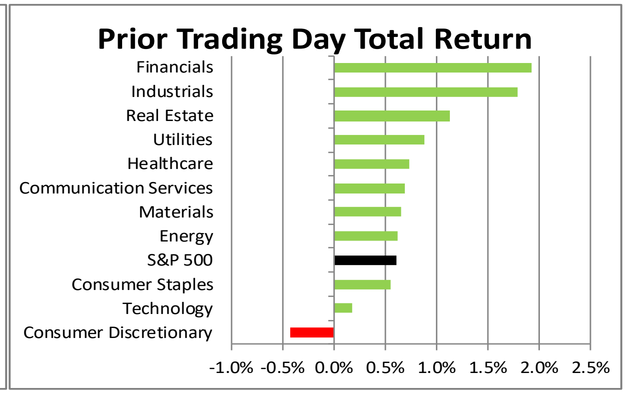
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures from the Rocky Mountains to the East Coast, with cooler-than-normal temperatures in the Pacific Northwest. The precipitation outlook calls for wetter-than-normal conditions in the Northern Tier states, the Great Plains, and Florida, with dry conditions in the Southwest, Midwest, and Northeast.

There is only one tropical disturbance in the Atlantic Ocean, but it is not expected to develop into a cyclone within the next 48 hours.

Data Section

US Equity Markets – (as of 10/11/2024 close)

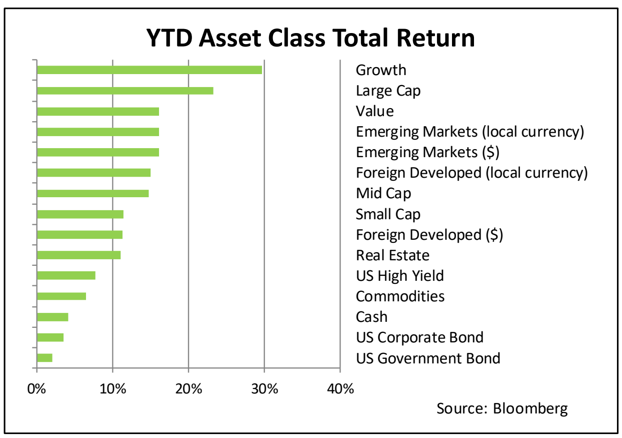




(Source: Bloomberg)

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 10/11/2024 close)

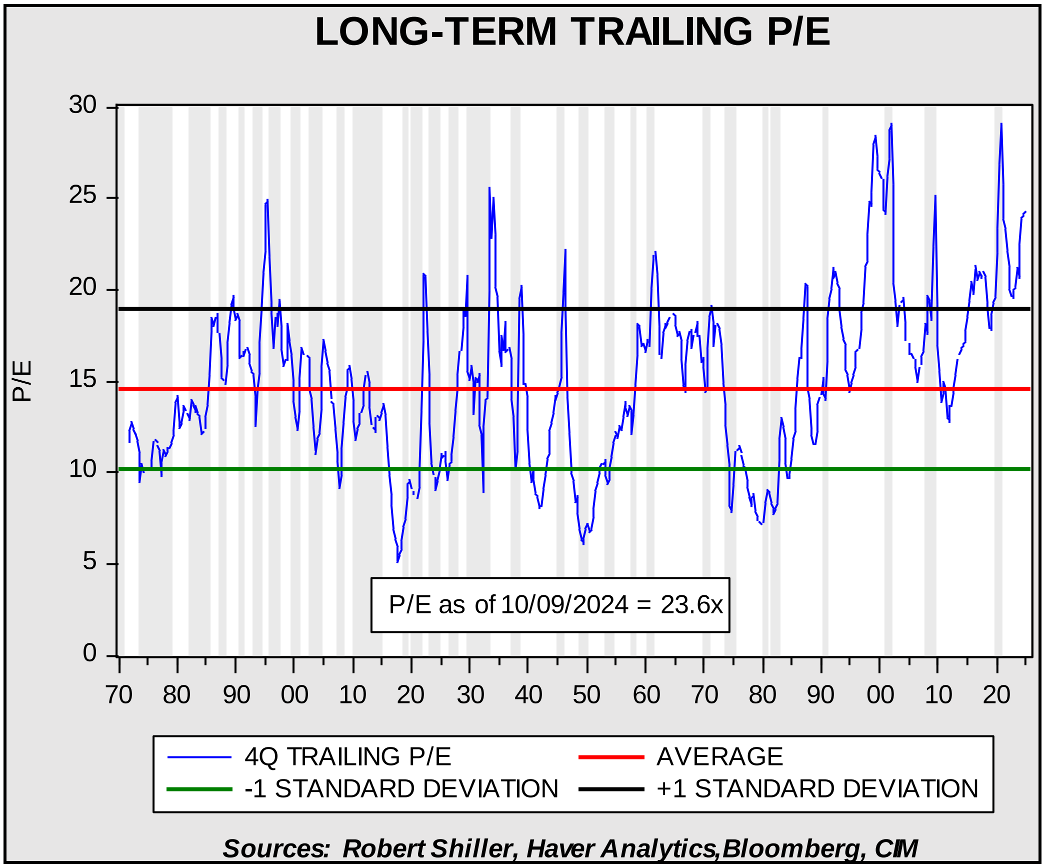


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.