

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 23, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed down 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.4%. Chinese markets were higher, with the Shanghai Composite up 0.5% from its previous close and the Shenzhen Composite up 0.2%. US equity index futures are signaling a lower open.

With 103 companies having reported so far, S&P 500 earnings for Q3 are running at \$60.20 per share, compared to estimates of \$60.44, which is up 4.2% from Q3 2023. Of the companies that have reported thus far, 75.7% have exceeded expectations while 14.6% have fallen short of expectations.

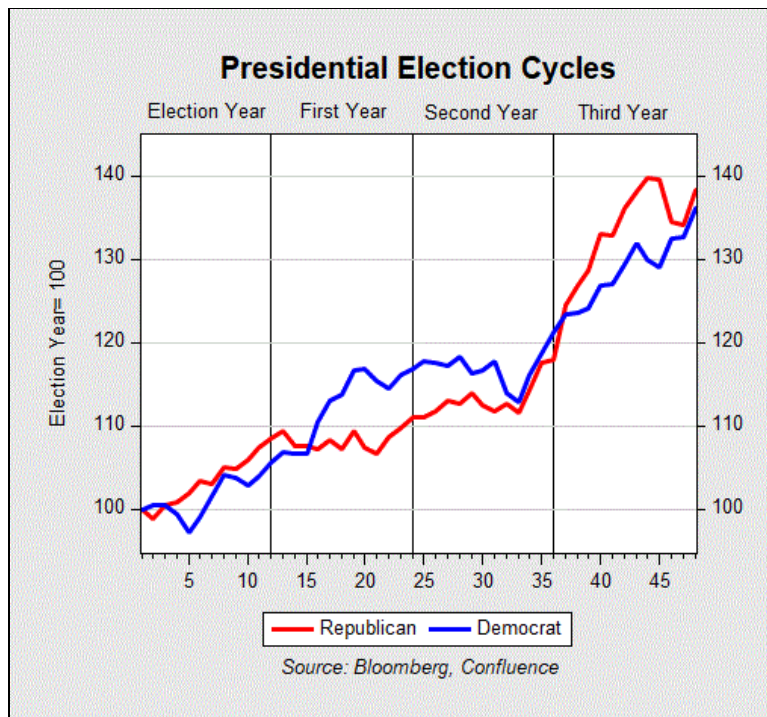
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our [website](#). We highlight recent publications below, with new items of the day emphasized in bold:

- [Bi-Weekly Geopolitical Report](#) (10/21/2024) (with associated [podcast](#)): “Israel’s Pager Caper and Supply Chain Security”
- [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)

Good morning! The market is eagerly awaiting the latest wave of earnings reports. In sports news, Real Madrid staged a remarkable comeback and defeated Borussia Dortmund 5-2 with five unanswered second-half goals. Today's *Comment* will explore the market's anticipation of a Republican sweep in the upcoming election, analyze the economic indicators suggesting a more dovish ECB compared to the Federal Reserve, and delve into the ongoing reluctance of Western companies to sever ties with China despite escalating tensions. As always, the report will include a summary of key domestic and international economic data releases.

Red Wave is Coming? Election jitters are starting to make their way into the market as investors grow bullish about a potential Republican sweep in November.

- Though the election remains a toss-up, [markets seem to be preparing for a potential Republican victory](#). The 10-year Treasury yield has been the most noticeably hit by concerns over higher inflation expectations driven by tariffs and rising deficits, triggering some selloffs. Meanwhile, the Mexican peso (MXN) has plunged amid fears that a new government could strain relations over trade, border security, and recent judicial reforms. The movement is likely a reflection of investors not wanting to hold on to certain assets until there is certainty regarding the outcome.
- The greatest uncertainty stems from how a Republican-controlled government will act on campaign promises. President Trump’s tax proposals, [including eliminating taxes on tips](#), lowering [corporate taxes](#), and offering [exemptions for military personnel, police, and firefighters](#), are expected to significantly increase the national deficit. There is also uncertainty surrounding tariffs, which have ranged from 10% on all imports to as high as [2000% on specific Chinese goods](#). Moreover, doubts persist about the seriousness of some of these proposals as there are concerns about their feasibility.

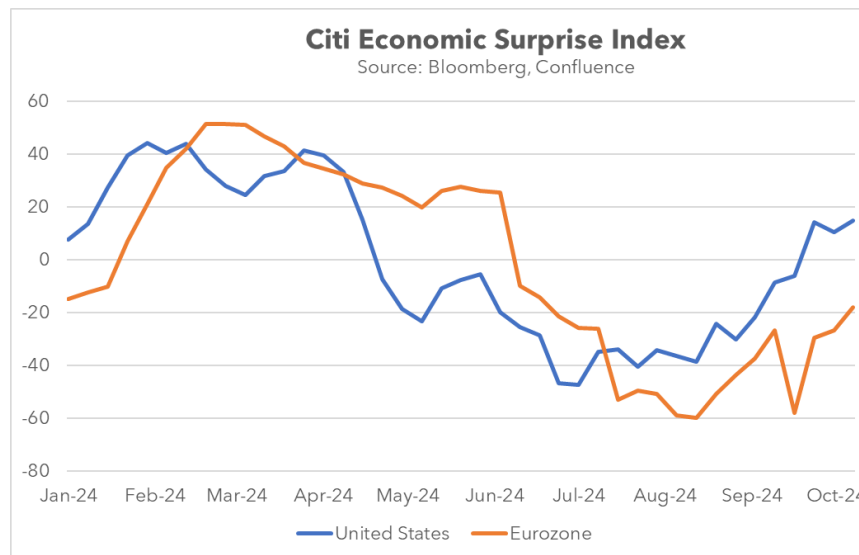


- The outcome of the congressional and presidential elections will likely depend on a few key votes, so investors should be cautious about assuming a clear winner and avoid being surprised by an unexpected result. The red wave optimism of 2022 serves as a reminder that polls can be unreliable. While we can anticipate some market volatility around election day, it is unlikely to significantly impact the long-term trends of Treasury yields

or equity performance. Regardless of the outcome in November, the winning party is likely to scale back on campaign promises quickly.

Leading the Pack: While the eurozone's growth remains uncertain, the US economy is beginning to gain traction.

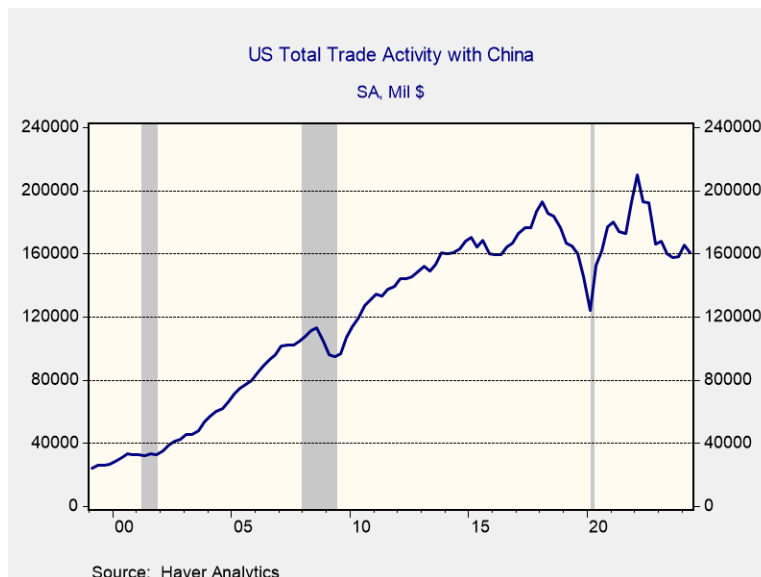
- The [United States was the only developed country to have its economic growth outlook upgraded](#) by the International Monetary Fund for the next two years. According to the supranational agency, the US is expected to maintain its position as the driving force of global growth, fueled by consumer spending this year and next. In contrast, the eurozone's growth outlook has been downgraded for the coming two years, weighed down primarily by a slowing in manufacturing, tightening of fiscal policy, and cooling of the labor market.
- Recent data suggests the ECB and Fed will ease at different rates. The US Citigroup Economic Surprise Index entered positive territory earlier this month, as economic data has consistently exceeded expectations. In contrast, the eurozone's economic surprise data, while improving, remains negative. The more robust US performance has led Fed officials to advocate for a more gradual approach to rate cuts. Meanwhile, the continued weakness in the eurozone has prompted ECB officials to push for aggressive easing to prevent the region from slipping into recession.



- Despite differing outlooks, the IMF maintains that global inflation has largely been defeated. This suggests that central banks should continue their easing cycles in the coming months. We anticipate that the Fed will likely cut rates by at least 25 basis points before the year's end, assuming there are no inflationary setbacks. Meanwhile, the European Central Bank could reduce rates by 50 basis points at its next meeting. The ECB's relatively dovish stance and economic weakness should lead the euro (EUR) to depreciate against the dollar.

Middle Ground on China: Firms appear to be unwilling to readily give up ties with China even as the West continues to reduce ties with the second largest economy.

- [Apple CEO Tim Cook has reaffirmed the company's commitment to investing in China](#), highlighting the country's crucial role in its supply chain. This statement follows a recent meeting with a top Chinese technology official to discuss strengthening bilateral ties as the Chinese economy has struggled to regain its footing following the pandemic. In the meeting, the Chinese officials pushed Cook to agree to invest in some of its key industries, such as cloud services and the secure management of data.
- Despite Beijing's reassurances of its commitment to prevent a prolonged economic slowdown, foreign direct investment in China has declined. Investors remain concerned about the potential for deflation and increased Western scrutiny of Chinese exports. In recent years, China's trade relationship with the United States has faced challenges as officials have raised import tariffs and tightened export restrictions on companies. As a result, trade activity between the US and China remains well below its long-term trend.



- Economic decoupling between the United States and China is likely to occur, despite potential resistance from some companies. While the transition may be slower than anticipated, the overall trend remains clear as both sides don't trust one another. US companies with significant revenue or supply chain exposure to China are particularly vulnerable to the disruptions associated with this shift. Investors should consider adjusting their portfolios accordingly to mitigate these risks.

In Other News: The latest [AI processors for Huawei Technologies were developed by TSMC](#), indicating that the company is circumventing some of the export restrictions imposed by the US. Additionally, [US officials have confirmed that they believe Russia has used North Korean troops](#) in its conflict with Ukraine. This decision exemplifies the growing threat posed by this new axis

of evil. Lastly, [Israel has confirmed the killing of a potential successor to Hezbollah](#), signaling that it is closer to achieving its objectives in Lebanon.

US Economic Releases

The Mortgage Bankers Association today said *mortgage applications* in the week ended October 18 fell 6.7%, compared to last week's fall of 17.0%. Applications for home purchase mortgages fell 5.1%, while refinancing applications fell 8.4%. According to the report, the average interest rate on a 30-year mortgage held steady at 6.52%. A month ago, the rate stood at a two-year low of 6.13%, but it has defied expectations of continuing a decreasing trend, and this surprising reversal is leading to a lengthening trend of declining mortgage activity.

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	Existing Home Sales	m/m	Sep	3.88m	3.86m	**
10:00	Existing Home Sales MoM	m/m	Sep	0.5%	-2.5%	*
Federal Reserve						
ET	Speaker or Event	District or Position				
9:00	Michelle Bowman Gives Opening Remarks	Member of the Board of Governors				
12:00	Tom Barkin Speaks About Community Colleges	President of the Federal Reserve Bank of Richmond				
14:00	U.S. Federal Reserve Releases Beige Book	Federal Reserve Board				

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								
South Korea	Consumer Confidence	m/m	Oct	101.7	100		*	Equity and bond neutral
AMERICAS								
Canada	Industrial Production	y/y	Sep	-0.6%	-0.9%	-0.5%	***	Equity and bond neutral
	Raw Material Prices	y/y	Sep	-3.1%	-3.0%	-1.6%	*	Equity bearish, bond bullish
Mexico	International Reserves Weekly	w/w	18-Oct	\$226436m	\$226002m		*	Equity and bond neutral
	Retail Sales	y/y	Aug	-0.8%	-0.6%	-0.2%	***	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)	450	451	-1	Down
U.S. Sibor/OIS spread (bps)	463	463	0	Down
U.S. Libor/OIS spread (bps)	458	459	-1	Down
10-yr T-note (%)	4.23	4.21	0.02	Up
Euribor/OIS spread (bps)	310	314	-4	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	\$74.77	\$76.04	-1.67%	
WTI	\$70.47	\$71.74	-1.77%	
Natural Gas	\$2.28	\$2.31	-1.38%	
12-mo strip crack	\$20.03	\$20.09	-0.26%	
Ethanol rack	\$1.73	\$1.73	0.41%	
Metals				
Gold	\$2,749.54	\$2,749.01	0.02%	
Silver	\$34.49	\$34.86	-1.06%	
Copper contract	\$433.15	\$438.05	-1.12%	
Grains				
Corn contract	\$414.75	\$416.50	-0.42%	
Wheat contract	\$567.25	\$576.00	-1.52%	
Soybeans contract	\$995.75	\$1,000.50	-0.47%	
Shipping				
Baltic Dry Freight	1,480	1,546	-66	
DOE Inventory Report				
	Actual	Expected	Difference	
Crude (mb)		1.00		
Gasoline (mb)		-1.90		
Distillates (mb)		-1.01		
Refinery run rates (%)		-0.2%		
Natural gas (bcf)		80		

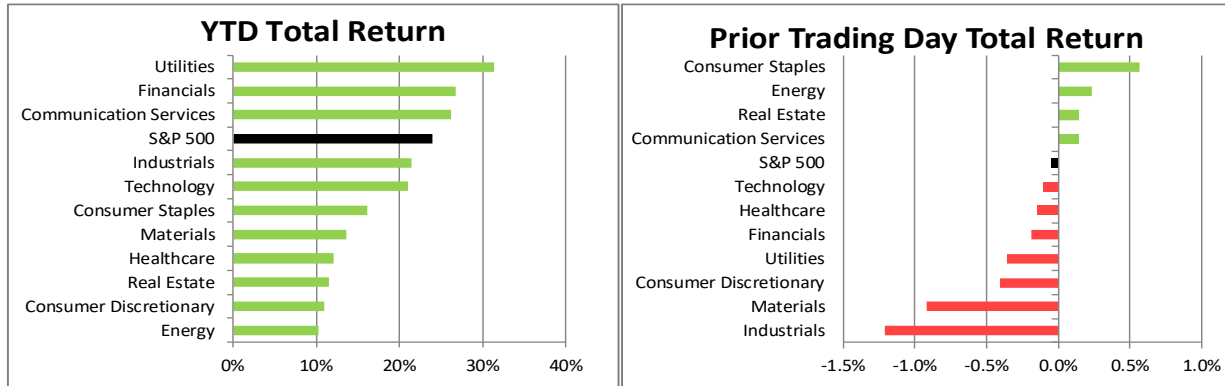
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures from the East Coast to the Great Plains, with cooler temperatures from the Rocky Mountains westward. The precipitation outlook calls for wetter-than-normal conditions in Florida, the central time zone, and the Pacific Northwest, with dry conditions along the East Coast from Maine to Virginia.

There are currently no tropical disturbances in the Atlantic basin.

Data Section

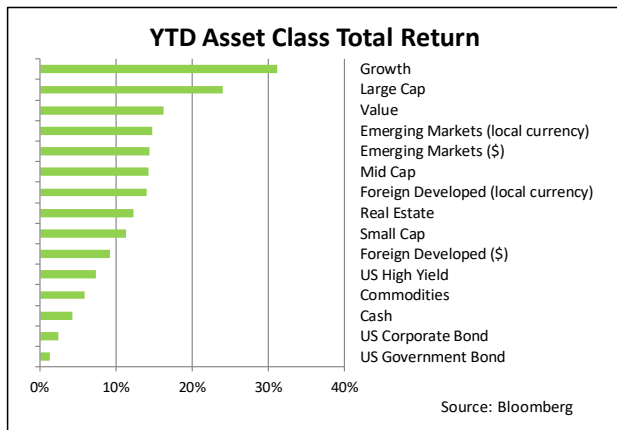
US Equity Markets – (as of 10/22/2024 close)



(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 10/22/2024 close)

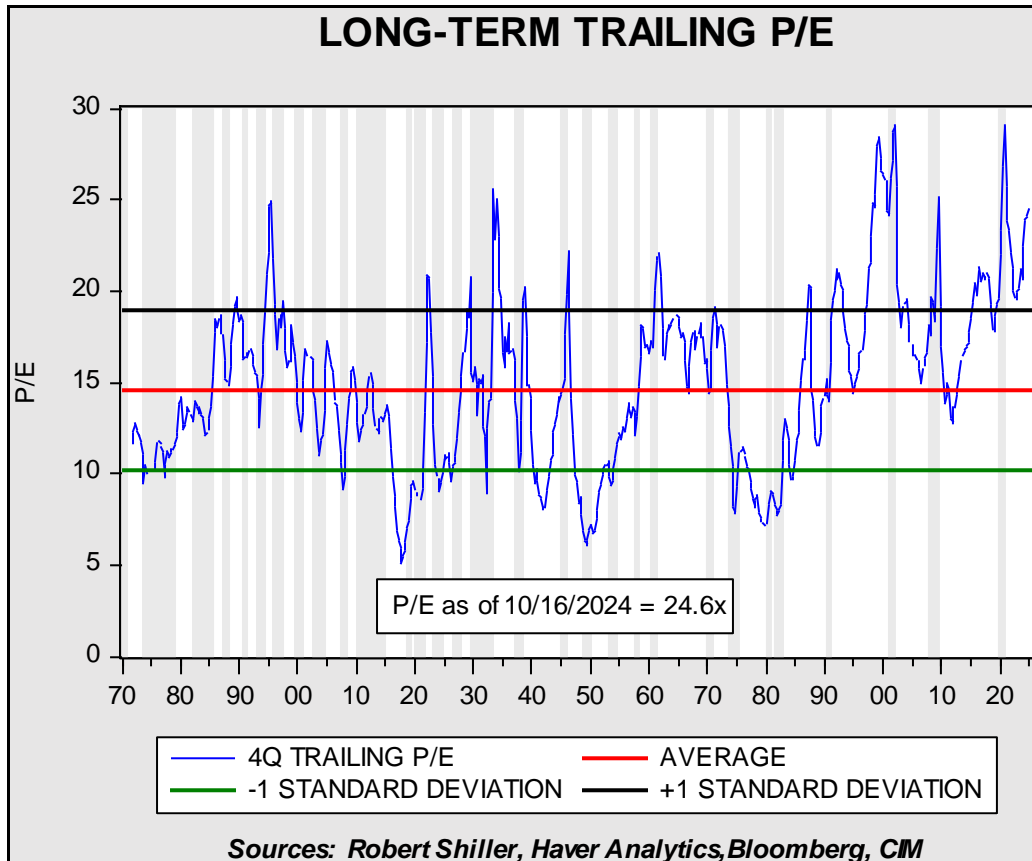


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 17, 2024



Based on our methodology,¹ the current P/E is 24.6x, up 1.0 from our last report. The stock price index increased last month, while earnings were revised downward.

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 (Q4). 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.