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 24, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed up 0.8% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.0%. Chinese markets were lower, with the Shanghai Composite down 0.7% from its previous close and the Shenzhen Composite down 0.9%. US equity index futures are signaling a higher open.

With 138 companies having reported so far, S&P 500 earnings for Q3 are running at $60.30 per share, compared to estimates of $60.44, which is up 4.2% from Q3 2023. Of the companies that have reported thus far, 75.4% have exceeded expectations while 17.4% 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:

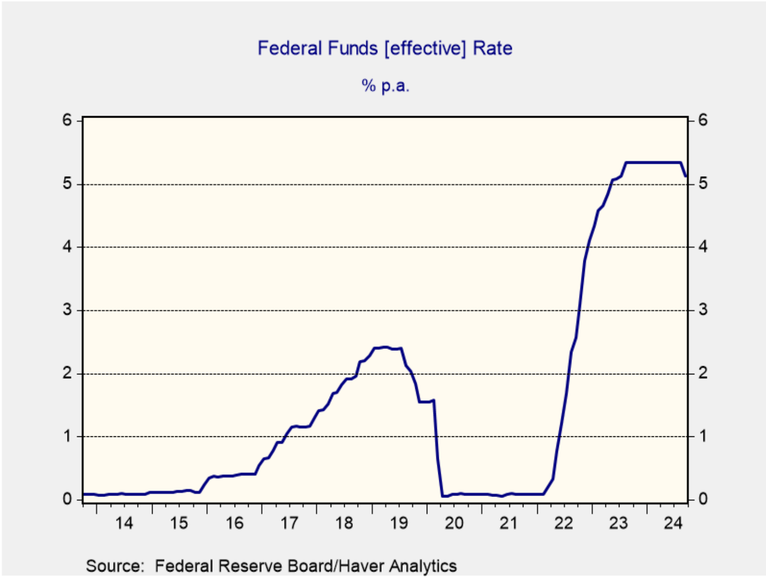
- *Bi-Weekly Geopolitical Report* (10/21/2024) (with associated podcast): "Israel's Pager Caper and Supply Chain Security"
- *Asset Allocation Bi-Weekly* (10/14/2024) (with associated podcast): "The Yield Curve Un-Inverts"
- ***Asset Allocation Quarterly – Q4 2024* (10/22/2024): Discussion of our asset allocation process, Q4 2024 portfolio changes, and our outlook for the markets.**

Good morning! The market is currently processing new earnings data. In sports news, Barcelona convincingly defeated Bayern Munich in the Champions League this week. Today's *Comment* will begin with our analysis of the latest Federal Reserve Beige Book. We will then share our thoughts on the housing market and provide an overview of why Brazil finds itself caught in the middle of the conflict between the US and China. As always, the report will conclude with a roundup of economic and domestic data releases.

Fed's Beige Book: The latest survey of business contacts in the Fed's twelve districts indicates that economic growth has begun to slow.

- The latest Fed Beige Book supports the central bank's recent decision to pivot, as contacts indicate a slowing economy. Nearly all Fed districts reported no change in economic activity since the previous September survey. Weakness was most evident in the manufacturing sector, with agriculture also showing signs of decline. In relation to the Fed's dual mandate, over half of the firms reported slight to moderate hiring growth, while most noted a moderation in selling prices. That said, despite the dim outlook from business contacts, Fed officials remain positive.

- On Monday, Federal Reserve officials expressed optimism about the economy's resilience, suggesting a cautious approach to interest rate cuts. While some favored a gradual reduction, others indicated that rate cuts could continue even in a strong economy. The latest dot plot reflects this divergence, showing a median expectation of 50 basis points in cuts for the rest of the year, but with nearly half of the committee favoring a more modest 25 basis point reduction. This varying degree of policy accommodation is likely to complicate the Fed's efforts to coordinate monetary policy.

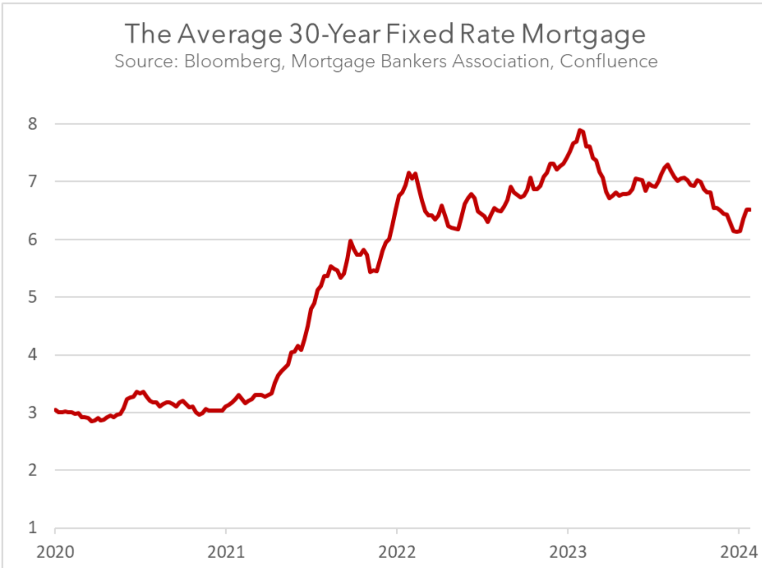


- While the Fed Beige Book may have emboldened dovish committee members, we believe the timing of the next rate cut hinges on the labor market's strength and the level of inflation. The upcoming jobs report is projected to show 135,000 jobs added in October, with the unemployment rate remaining at 4.1%. Stronger-than-expected job growth or a falling unemployment rate could lead officials to skip a rate cut at their November meeting. Moreover, a 0.4% month-over-month increase in the core PCE price index, may necessitate a reassessment of the easing cycle altogether.

Residential Market: It has been over a month since the Fed cut rates, and the housing market has not rebounded.

- US sales of existing homes dropped to a 14-year low in September, with a 1.0% decline bringing sales to a seasonally adjusted annual rate of 3.84 million units. The subdued demand is likely tied to elevated home prices, despite borrowing costs reaching their lowest level in two years. The average home price is now roughly 6.3 times the average income, up from five times a decade ago. While lower borrowing costs have made homes more attractive, the main beneficiaries have been existing homeowners refinancing their mortgages to lower rates.

- Many potential homebuyers remain on the sidelines, waiting for mortgage rates to drop further and offset high home prices. This stems from the belief that rates will decline, mirroring their sharp rise during the Federal Reserve's tightening cycle. In the first year of rate hikes, mortgage rates jumped from 3.5% to a peak of 7.2%, driven largely by uncertainty over how aggressively the Fed would raise rates. For rates to fall significantly, the Fed must clearly indicate how far it plans to cut interest rates. This is why rates have stopped their descent following the Fed's first rate cut.

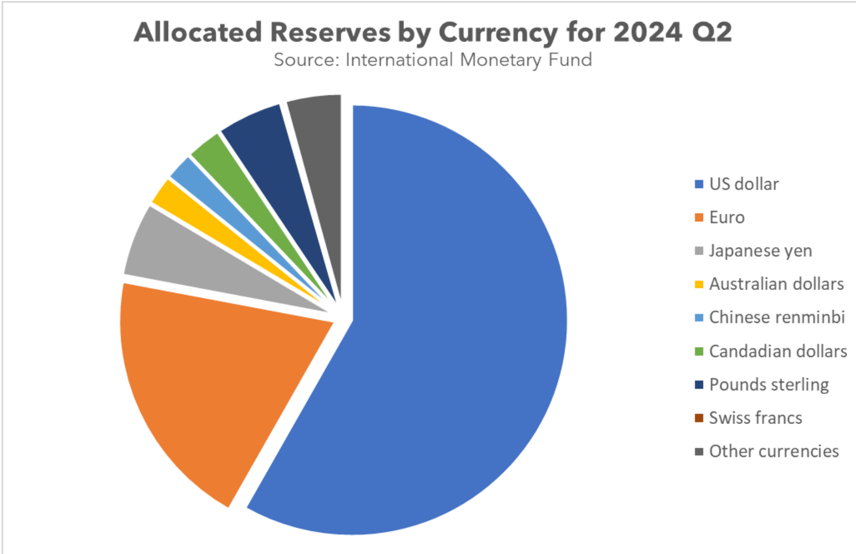


- The uncertainty surrounding the neutral interest rate (estimated to be between 2.25% and 4.00% according to the latest economic projections), complicates the outlook for mortgage rates. Inflation expectations, particularly the concerns about whether inflation will sustainably fall below 2%, play a significant role in determining the long-run path of Fed policy. As a result, mortgage rates are unlikely to decline significantly in the coming months, even if the central bank begins to cut rates. This could weigh on consumer sentiment and residential investment, hindering economic growth.

Brazil-China: Latin America's largest economy appears to be under pressure to take sides in the US-China rift.

- On Wednesday, a [US official urged Brazil to reconsider its plans to join China's Belt and Road Initiative] (BRI), cautioning that the agreement might not serve Brazil's best interests as it could lead to a loss of sovereignty. This warning came in response to Brazil's statements about potentially joining the initiative to counter protectionist measures from the US and the European Union. China remains one of Brazil's top trading partners, while the US is [one of the biggest contributors of foreign direct investment.]
- The escalating dispute underscores growing concerns about the diminishing interconnectedness of the global economy. The West's deliberate effort to reduce its role as the importer of last resort has prompted countries in the Global South to seek

alternatives. Many are diversifying their currency reserves, including gold, and some are exploring regional currencies tied to their key commodities. This trend suggests that these countries are increasingly looking to offset the loss of trade with the West by trading with one another.

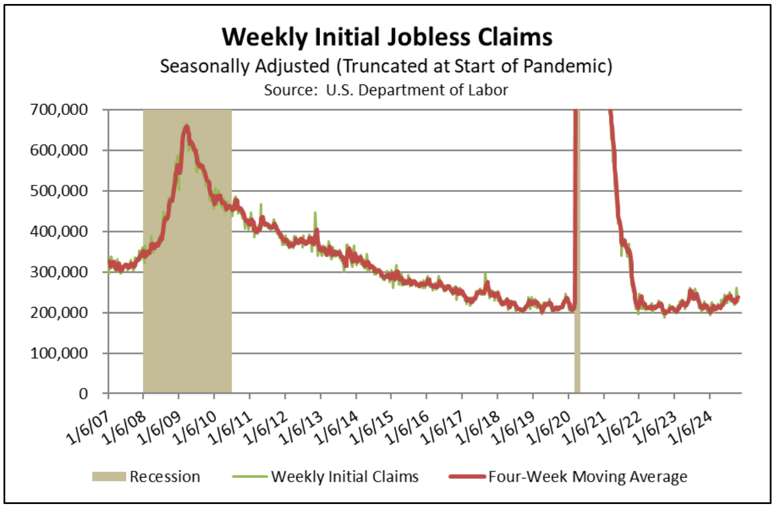


- As countries like Brazil navigate a less globalized world, we believe they will increasingly move away from using the US dollar. This shift is driven not only by the recent weaponization of the dollar but also by the desire to strengthen ties with other nations. In particular, countries aligned with China are likely to explore alternative currencies for trade as they reduce their reliance on the US. Although we don't expect the dollar to lose its dominance, its influence may diminish over the next decade.

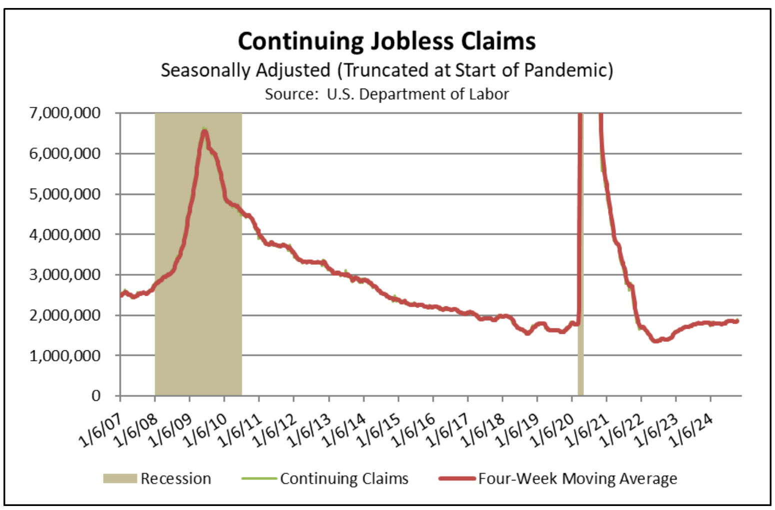
In Other News: The Bank of Canada cut its benchmark rate by 50 basis points, reflecting the global shift towards disinflation as it aims to normalize policy and shield Canada's economy from further decline. Boeing workers voted against the latest wage agreement, likely setting the stage for an extended strike. Additionally, Tesla's earnings report exceeded expectations, indicating that the worst may be over for the company.

US Economic Releases

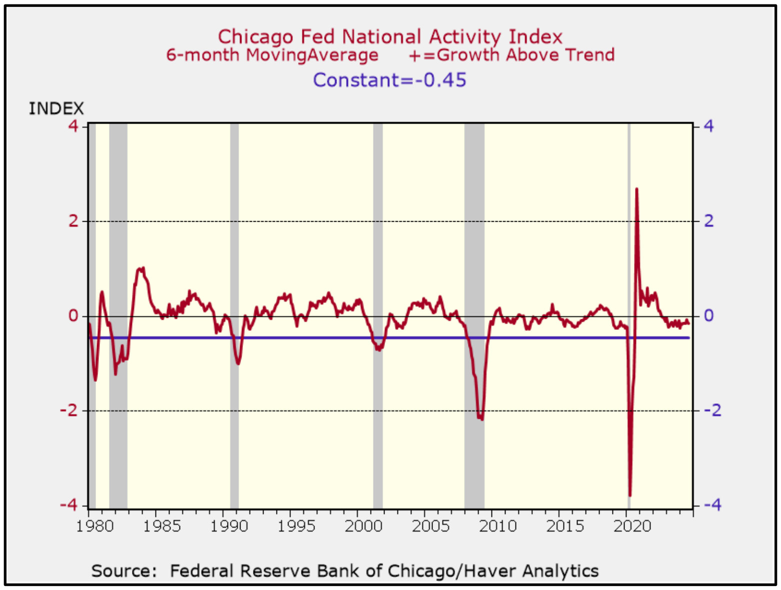
In the week ended October 19, ***initial claims for unemployment benefits*** fell to a seasonally adjusted 227,000, versus expectations they would match the prior week's revised level of 242,000. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, rose to 238,500. The chart below shows how initial jobless claims have fluctuated since just before the Great Financial Crisis. The chart is truncated through much of the pandemic period because of the extremely high level of claims at that time.



In the week ended October 12, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) rose to a seasonally adjusted 1.897 million, well above the anticipated reading of 1.875 million and the previous week's revised reading of 1.869 million. The four-week moving average of continuing claims rose to 1,860,750. These elevated readings could well reflect temporary business closures stemming from the recent hurricanes in the Southeast. The chart below shows how continuing claims have fluctuated since the GFC. It is also truncated during the pandemic period because of the high level of claims at the time.



Separately, the Chicago Fed said its September ***National Activity Index (CFNAI)*** fell to -0.28, far weaker than the expected reading of 0.50 and down from its revised reading of -0.01 for August. The CFNAI, encompassing dozens of separate indicators to capture all aspects of current economic activity, is designed so that readings above 0.00 reflect the economy growing at trend. Our analysis shows that when the six-month moving average of the CFNAI falls below -0.45, it suggests the economy is in recession. With the latest reading, the six-month moving average stands at -0.15, suggesting the economy is growing slightly below trend but is not in a contraction. The chart below shows how the CFNAI has fluctuated over the last several decades.



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

Economic Releases						
ET	Indicator			Expected	Prior	Rating
9:45	S&P Global US Manufacturing PMI	m/m	Oct P	47.5	47.3	***
9:45	S&P Global US Services PMI	m/m	Oct P	55	55.2	***
9:45	S&P Global US Composite PMI	m/m	Oct P	53.8	54.0	***
10:00	New Home Sales	m/m	Sep	720k	716k	***
10:00	New Home Sales MoM	m/m	Sep	0.6%	-4.7%	**
11:00	Kansas City Fed Manfacturing Index	m/m	Oct	-7	-8	*
Federal Reserve						
ET	Speaker or Event	District or Position				
14:30	Beth Hammack Gives Welcome Remarks	President of the Federal Reserve Bank of Cleveland				

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	Japan Buying Foreign Bonds	w/w	18-Oct	-¥613.0b	-¥358.6b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	18-Oct	-¥384.8b	-¥142.5b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	18-Oct	-¥487.5b	¥713.7b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	18-Oct	¥580.4b	¥972.6b		*	Equity and bond neutral
	Jibun bank Composite PMI	m/m	Oct P	49.4	52.0		*	Equity and bond neutral
	Jibun Bank Manufacturing PMI	m/m	Oct P	49.0	49.7		***	Equity and bond neutral
	Jibun Bank Services PMI	m/m	Oct P	49.3	53.1		**	Equity and bond neutral
	Machine tool orders	y/y	Sep F	-6.4%	-6.5%		**	Equity and bond neutral
South Korea	Business Survey - Manufacturing	m/m	Nov	71	73		**	Equity and bond neutral
	Business Survey - Non-Manufacturing	m/m	Nov	69	71		*	Equity and bond neutral
	GDP	q/q	3Q A	1.5%	2.3%	2.0%	**	Equity bearish, bond bullish
India	HSBC India PMI Mfg	m/m	Oct P	57.4	56.5		***	Equity and bond neutral
	HSBC India PMI Composite	m/m	Oct P	58.6	58.3		**	Equity and bond neutral
	HSBC India PMI Services	m/m	Oct P	57.9	57.7		**	Equity and bond neutral
EUROPE								
Eurozone	HCOB Eurozone Manufacturing PMI	m/m	Oct P	45.9	45.0	45.1	***	Equity bullish, bond bearish
	HCOB Eurozone Services PMI	m/m	Oct P	51.2	51.4	51.5	**	Equity and bond neutral
	HCOB Eurozone Composite PMI	m/m	Oct P	49.7	49.6	49.7	*	Equity and bond neutral
	Consumer Confidence	m/m	Oct P	-12.5	-12.9	-12.5	**	Equity and bond neutral
Germany	HCOB Germany Manufacturing PMI	m/m	Oct P	42.6	40.6	40.8	***	Equity bullish, bond bearish
	HCOB Germany Services PMI	m/m	Oct P	51.4	50.6	50.6	**	Equity bullish, bond bearish
	HCOB Germany Composite PMI	m/m	Oct P	48.4	47.5	47.6	**	Equity bullish, bond bearish
France	Business Confidence	m/m	Oct	97	98	98	*	Equity and bond neutral
	Manufacturing Confidence	m/m	Oct	92	99	99	**	Equity bearish, bond bullish
	HCOB France Manufacturing PMI	m/m	Oct P	44.5	44.6	45.0	***	Equity bearish, bond bullish
	HCOB France Services PMI	m/m	Oct P	48.3	49.6	49.9	**	Equity bearish, bond bullish
	HCOB France Composite PMI	m/m	Oct P	47.3	48.6	48.9	**	Equity bearish, bond bullish
UK	S&P Global UK Manufacturing PMI	m/m	Oct P	50.3	51.5	51.5	***	Equity bearish, bond bullish
	S&P Global UK Services PMI	m/m	Oct P	51.8	52.4	52.4	**	Equity bearish, bond bullish
	S&P Global UK Composite PMI	m/m	Oct P	51.7	52.6	52.6	**	Equity bearish, bond bullish
Russia	Industrial Production	y/y	Sep	3.2%	2.7%	3.2%	***	Equity and bond neutral
AMERICAS								
Brazil	IBGE Inflation IPCA-15	m/m	Oct	4.47%	4.12%	4.43%	***	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)	450	451	-1	Down
U.S. Sibor/OIS spread (bps)	461	463	-2	Down
U.S. Libor/OIS spread (bps)	457	459	-2	Down
10-yr T-note (%)	4.19	4.25	-0.06	Up
Euribor/OIS spread (bps)	309	310	-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	**ank section (otherwise, I ha**		**Expected**	
Bank of Canada Rate Decision	3.750%	4.250%	3.750%	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	$75.59	$74.96	0.84%	
WTI	$71.41	$70.77	0.90%	
Natural Gas	$2.38	$2.34	1.79%	
12-mo strip crack	$19.87	$19.98	-0.53%	
Ethanol rack	$1.72	$1.73	-0.34%	
Metals				
Gold	$2,738.96	$2,715.55	0.86%	
Silver	$34.14	$33.70	1.31%	
Copper contract	$435.65	$433.65	0.46%	
Grains				
Corn contract	$421.50	$419.00	0.60%	
Wheat contract	$577.00	$578.50	-0.26%	
Soybeans contract	$1,012.00	$1,005.00	0.70%	
Shipping				
Baltic Dry Freight	1,445	1,480	-35	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	5.47	1.00	4.47	
Gasoline (mb)	0.88	-1.90	2.78	
Distillates (mb)	-1.14	-1.01	-0.14	
Refinery run rates (%)	1.8%	-0.2%	2.0%	
Natural gas (bcf)		65	-65	

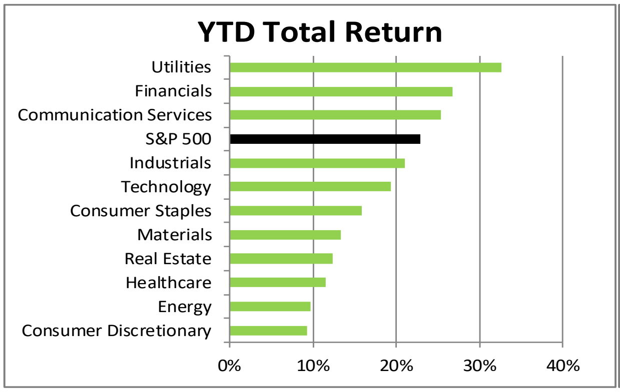
Weather

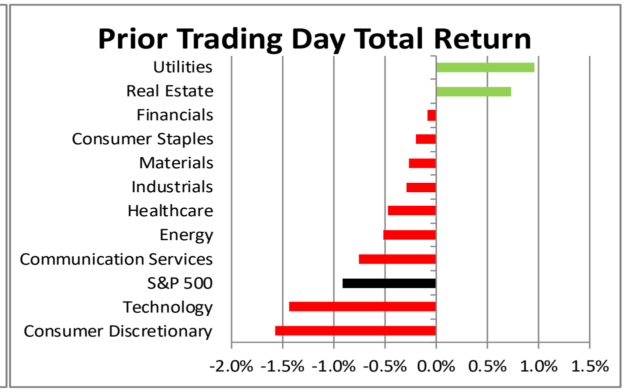
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures from the Great Plains eastward, with cooler-than-normal temperatures in the Far West. The forecasts call for wetter-than-normal conditions in the Rocky Mountains, the Great Plains, the Mississippi Valley, and Florida, with dry conditions in California and the Northeast.

There are currently no tropical disturbances in the Atlantic basin.

<u>Data Section</u>

US Equity Markets – (as of 10/23/2024 close)

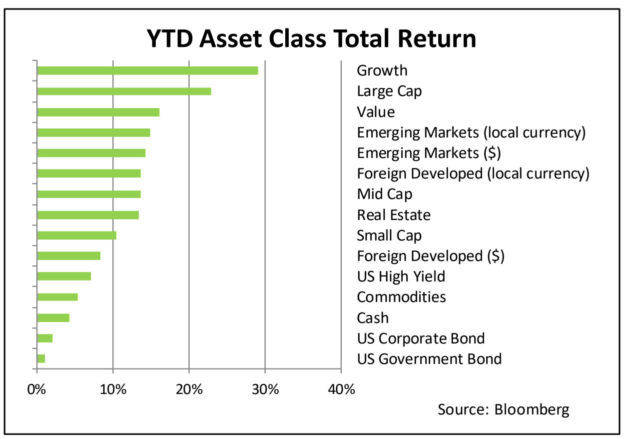




(Source: Bloomberg)

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 10/23/2024 close)

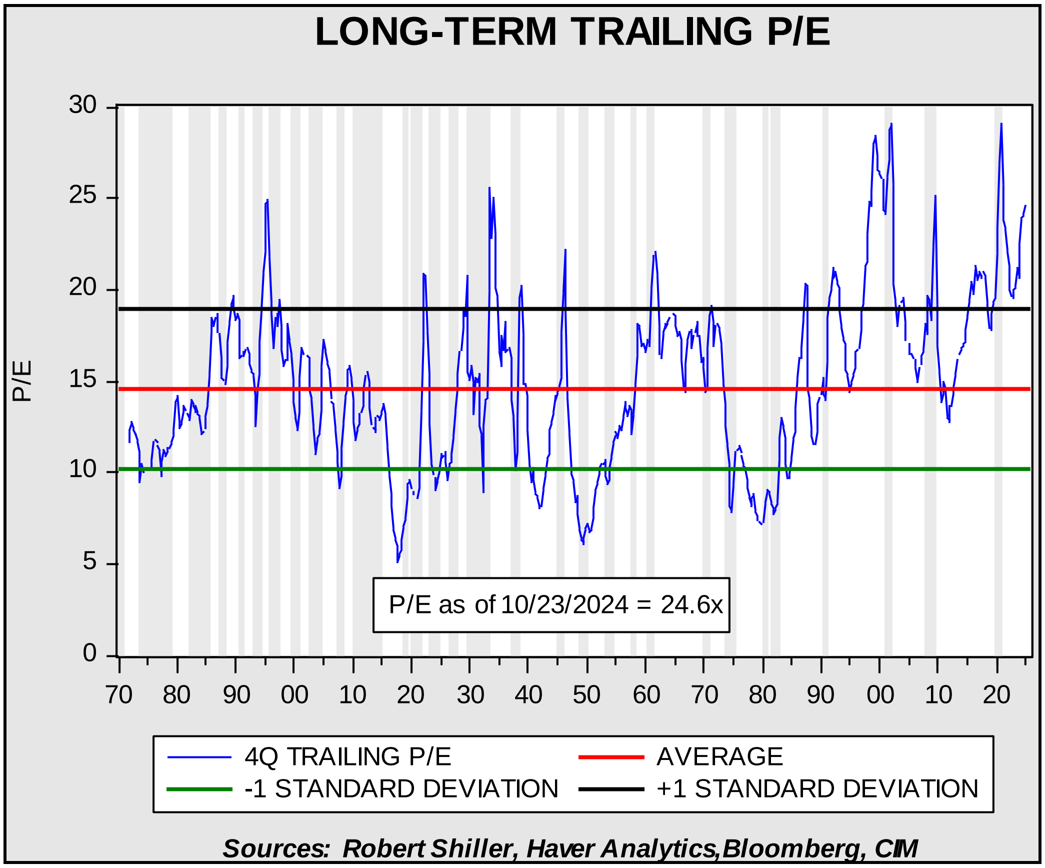


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 24, 2024



Based on our methodology,[1] the current P/E is 24.6x, unchanged from our last report. The stock price index increase was offset by an 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.