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 28, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed down 0.1% 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 0.7% from its previous close and the Shenzhen Composite up 1.4%. US equity index futures are signaling a higher open.

With 182 companies having reported so far, S&P 500 earnings for Q3 are running at $60.40 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 17.0% 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*** **(10/28/2024) (with associated podcast): "The Inflation Adjustment for Social Security Benefits in 2025"**
- *Asset Allocation Quarterly – Q4 2024* (10/22/2024): Discussion of our asset allocation process, Q4 2024 portfolio changes, and our outlook for the markets.

Our *Comment* today opens with the aftermath of Israel's airstrikes on Iran over the weekend. The bottom line is that both countries are showing signs of restraint, which has reduced the risk of a broader regional conflict and therefore pushed global energy prices down so far today. We next review several other international and US developments with the potential to affect the financial markets today, including an electoral loss for Japan's ruling party and a new US directive to focus on artificial intelligence in the military.

Israel-Iran: Over the weekend, Israel launched a large number of airstrikes against Iran to retaliate for Tehran's big missile attack on October 1. However, all reports suggest both the Israelis and the Iranians are pulling their punches and trying to avoid escalating the conflict. For example, the Israelis only targeted military-related facilities, and reports say Tel Aviv secretly warned Iran of the upcoming strikes via intermediary countries. Meanwhile, Iranian officials have avoided dramatizing the strikes and took care not to threaten a near-term response.

- For now, it appears Israel and Iran will keep a lid on their confrontation. That should help reduce the risk of the conflict widening into a regional war. For example, if Israel would have attacked Iran's oil or nuclear infrastructure, Tehran might well have retaliated by striking Saudi Arabia's oil facilities, disrupting global energy supplies, and forcing Riyadh to strike back. So far today, global oil prices are down about 5.5%.

- Despite Israel's discipline in the attacks over the weekend, they probably weren't inconsequential. Some reporting suggests that by striking Iran's missile production facilities, Israel has crimped Iran's ability to produce new replacement missiles, which could discourage it from launching new large-scale attacks against Israel.

European Union: Reports today say automaker Volkswagen plans to shut at least three German plants, eliminate tens of thousands of jobs, and slash pay by 10%. In response, the company's worker council has hinted that union workers might strike. The downsizing and labor woes reflect the firm's struggles as it faces intense competition in China, slowing sales across other major markets, and a costly transition to making electric vehicles — challenges faced by auto companies across the EU.

France: Moody's Ratings today affirmed France's sovereign bond rating of Aa2 but cut its outlook from stable to negative. The lowered outlook reflects the splintered government's likely inability to meaningfully cut its budget deficit in the near term. The move is consistent with other recent rating actions and economic forecast cuts by private economists. Nevertheless, the action today has had no apparent effect on the spread between French and German bonds.

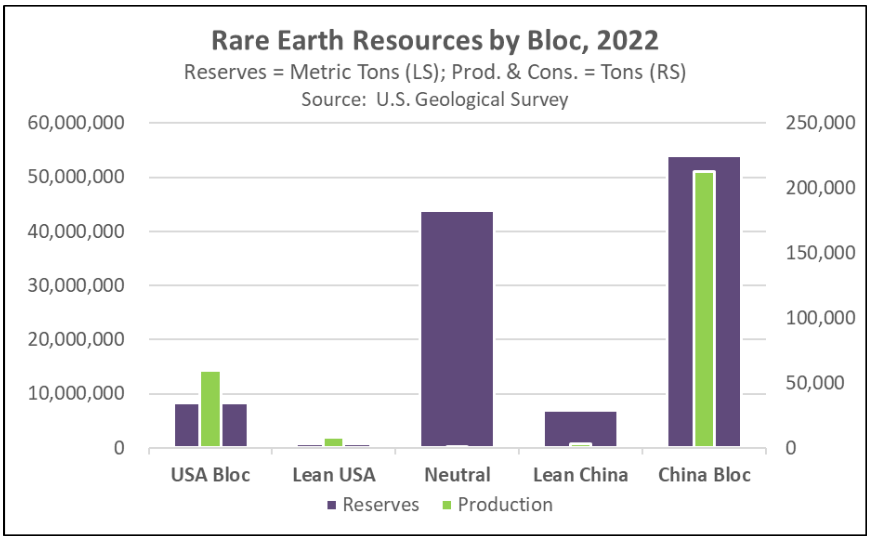
United Kingdom: New data shows the fertility rate in England and Wales fell to just 1.44 births over the lifetime of the average woman in 2023, the lowest since record keeping began in 1938 and far below the 2.10 rate that is considered necessary for a stable population with no immigration. The new figure points to further population aging in the UK in the coming years, which will probably put upward pressure on government spending and debt.

Georgia: In national elections on Saturday, officials said the Caucasus country's Russia-aligned ruling party Georgia Dream came in first with 54.2% of the vote. The results came amid multiple reports of voting irregularities and voter intimidation, following weeks of reported interference by Russia, which wants to keep the country from joining the European Union. The losing opposition parties have called for protests later today.

Japan: In national elections yesterday, the ruling Liberal Democratic Party and its much smaller coalition partner Komeito lost their parliamentary majority, winning just 215 of the 465 seats in the Diet. Since the result was much worse than anticipated for the ruling coalition, Prime Minister Ishiba is widely expected to resign in the coming days. Japan is therefore likely to enter a period of political instability, which we suspect will be negative in the short-term for Japan's economy, stocks, and currency.

Chinese Rare Earths Industry: According to the *New York Times*, the last two foreign-owned rare earth refineries in China have been acquired by state-owned companies, giving Beijing even greater control over the exotic minerals that are key to technologies such as advanced semiconductors and electric vehicles. Beijing's acquisition of the refineries comes as it also tightens restrictions on the export of gallium, germanium, antimony, and other rare earths.

- Most of the world's commercially viable rare earth resources are in China and the rest of its geopolitical and economic bloc. Not only does that include reserves in the ground, but also production and refining capacity.
- Separately, a new report from Benchmark Mineral Intelligence warns that Chinese companies now control about two-thirds of the cobalt resources in the Democratic Republic of the Congo, which produces about 74% of the global cobalt supply. Cobalt is also a key mineral for the electrification of the global economy.
- As the US-China geopolitical rivalry intensifies over time, we continue to believe that China will increasingly weaponize its control over rare earths, cobalt, and other key mineral resources. By cutting off access to these minerals, Beijing would hope to crimp the West's economy and drive up prices.



Chinese Demographics: New data from the Ministry of Education shows that the number of operating kindergartens in the country fell by 5.1% in 2023, while the number of enrolled students fell by 11.6%. That marks the third straight year of declining kindergarten enrollment, reflecting China's low birthrate and the demographic threat to its economic growth going forward.

US Military: The Biden administration issued a directive late last week prioritizing defense-related artificial-intelligence projects. The directive illustrates how information processing and other advanced technologies are increasingly critical to maintaining US military dominance. The directive could also spur even greater government and industry investment in AI projects going forward.

US Immigration Policy: With just eight days to go until the elections and much of the presidential candidates' rhetoric touching on immigration, the *Los Angeles Times* last week carried a useful primer on how former President Trump might approach his promise to deport millions of illegal immigrants if he were elected. The article highlights the legal and logistical challenges to mass deportation, as well as the risk that US citizens would be caught up in the program. Another risk could be a disruption to labor supply in certain industries.

US Economic Releases

There were no domestic 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						
ET	Indicator			Expected	Prior	Rating
10:30	Dallas Fed Manufacturing Activity	m/m	Oct	-9.2	-9.0	**
Federal Reserve						
No Fed speakers or events for the rest of today						

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	Industrial Profits	y/y	Sep	-27.1%	-17.8%		*	Equity and bond neutral
EUROPE								
Switzerland	Domestic Sight Deposits CHF	w/w	25-Oct	449.4b	454.1b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	25-Oct	457.4b	462.3b		*	Equity and bond neutral
AMERICAS								
Canada	Retail Sales	m/m	Aug	0.4%	0.9%	0.5%	**	Equity and bond neutral
	Retail Sales Ex-Autos	m/m	Aug	-0.7%	0.4%	0.3%	**	Equity bearish, bond bullish
Mexico	Trade Balance	m/m	Sep	-578.9m	-4868.0m	-1620.4m	**	Equity and bond neutral
	Exports	m/m	Sep	49626m	51915m		*	Equity and bond neutral
	Imports	m/m	Sep	50205m	56784m		*	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)	459	459	0	Down
U.S. Libor/OIS spread (bps)	455	456	-1	Down
10-yr T-note (%)	4.26	4.24	0.02	Up
Euribor/OIS spread (bps)	306	307	-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

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	$71.78	$76.05	-5.61%	
WTI	$67.54	$71.78	-5.91%	
Natural Gas	$2.40	$2.56	-6.17%	
12-mo strip crack	$19.80	$20.00	-0.96%	
Ethanol rack	$1.73	$1.73	-0.01%	
Metals				
Gold	$2,732.47	$2,747.56	-0.55%	
Silver	$33.41	$33.72	-0.92%	
Copper contract	$435.45	$437.05	-0.37%	
Grains				
Corn contract	$414.00	$415.25	-0.30%	
Wheat contract	$569.75	$569.00	0.13%	
Soybeans contract	$990.25	$997.50	-0.73%	
Shipping				
Baltic Dry Freight	1,410	1,417	-7	

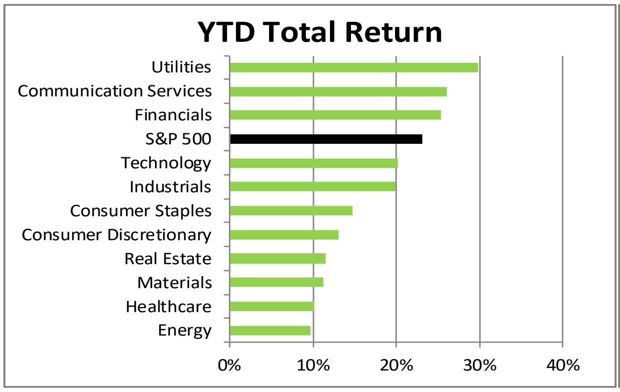
Weather

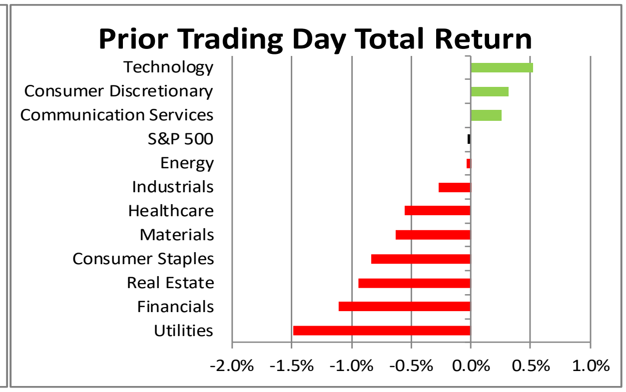
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures for most of the country. The precipitation outlook calls for wetter-than-normal conditions in the Rocky Mountains, the Great Plains, the Mississippi Valley, and the Southwest, with drier conditions expected in the Northern Pacific.

There are currently no tropical disturbances anticipated in the Atlantic Ocean over the next 48 hours.

Data Section

US Equity Markets – (as of 10/25/2024 close)

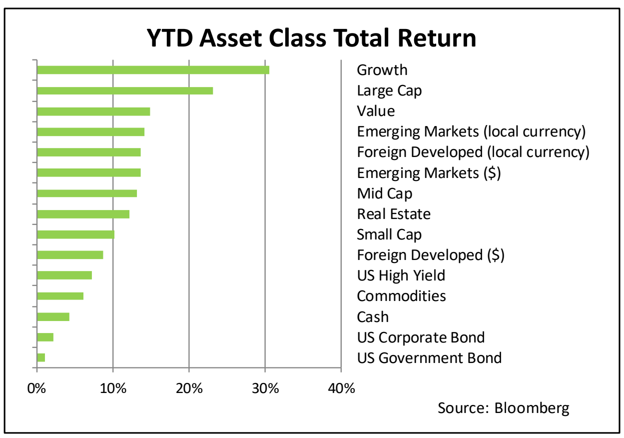




(Source: Bloomberg)

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 10/25/2024 close)

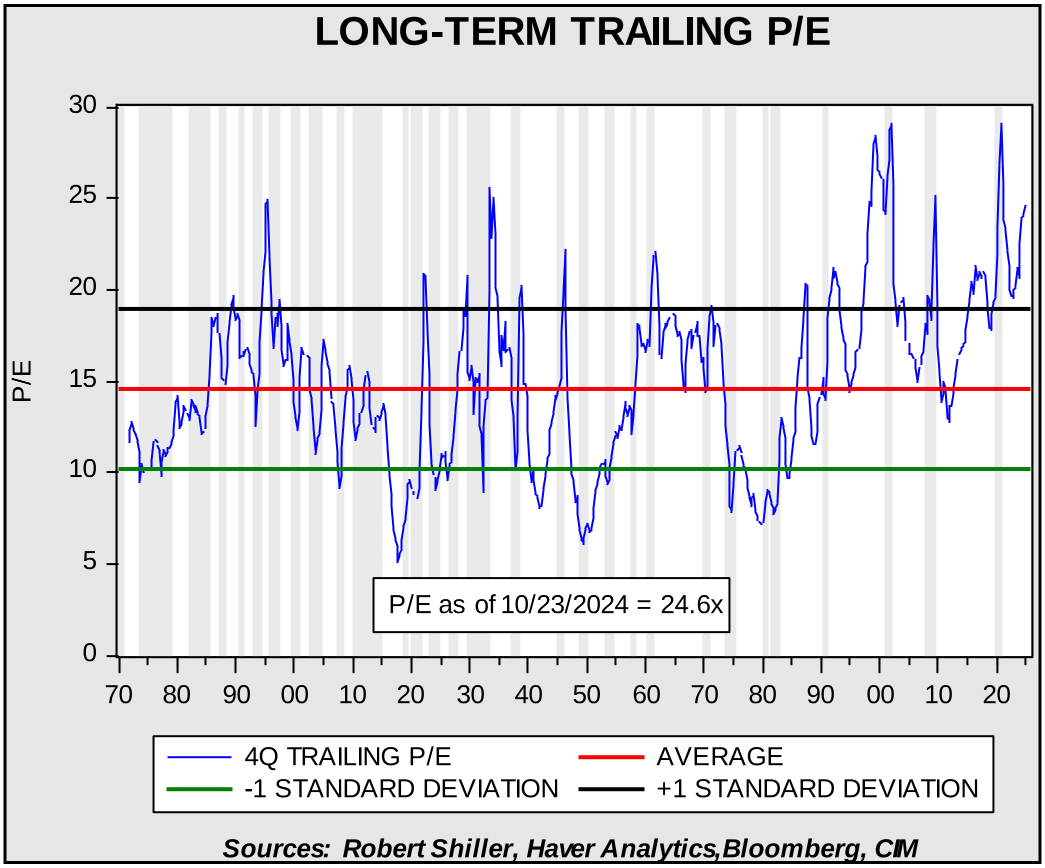


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.