Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

ooking 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 30, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed down 1.4% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.8%. Chinese markets were mixed, with the Shanghai Composite down 0.6% from its previous close and the Shenzhen Composite essentially unchanged. US equity index futures are signaling a mildly higher open.

With 231 companies having reported so far, S&P 500 earnings for Q3 are running at $61.30 per share, compared to estimates of $60.44, which is up 4.2% from Q3 2023. Of the companies that have reported thus far, 74.5% have exceeded expectations while 17.3% 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:

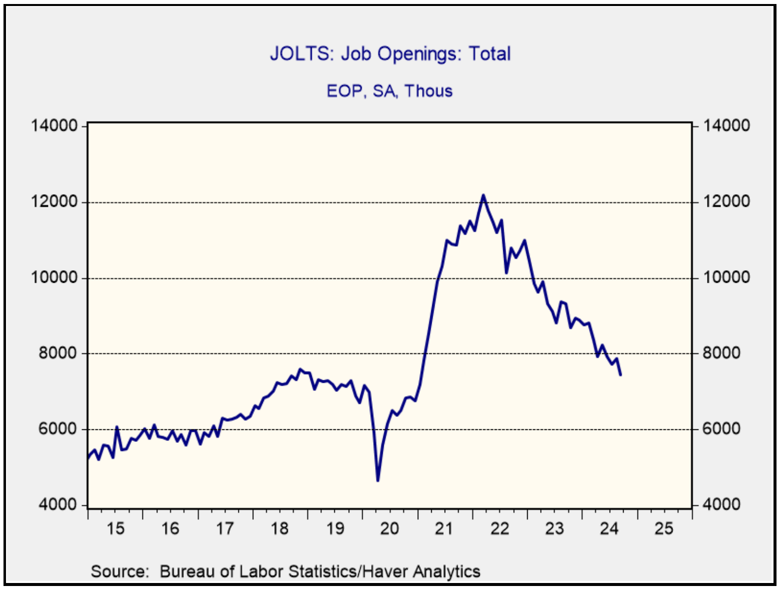
- *Bi-Weekly Geopolitical Report* (10/21/2024) (with associated podcast): "Israel's Pager Caper and Supply Chain Security"
- *Asset Allocation Bi-Weekly* (10/28/2024) (with associated podcast): "The Inflation Adjustment for Social Security Benefits in 2025"
- *Asset Allocation Quarterly – Q4 2024* (10/22/2024): Discussion of our asset allocation process, Q4 2024 portfolio changes, and our outlook for the markets.

Good morning! The market is still processing the latest earnings data from Alphabet. In sports news, the New York Yankees managed to avoid being swept by the LA Dodgers. Today's *Comment* will discuss why consumers remain content despite a cooling labor market. We will also review the latest earnings report from tech companies and explain why the EU is starting to get tough on trade. As usual, our report will include a roundup of international and domestic data releases.

The Job Market: As a precautionary measure against additional layoffs, employers are beginning to reduce the number of job postings.

- The Bureau of Labor Statistics reported a surprising decline in job openings to a three-year low in September. Last month, job postings fell from 7.861 million to 7.443 million, significantly below the consensus estimate of 7.990 million. Despite this decrease, the report also contained some positive news — hiring actually increased from 5.43 million to 5.55 million. The combination of fewer openings and an increase in hiring suggests that the labor market may be cooling but remains relatively tight.

- Even as job openings decline, consumers' confidence in their job prospects has seen a significant uptick, reaching its highest point since March 2021. The Conference Board's Consumer Confidence Index rose from 99.2 to 108.7, primarily fueled by consumers' growing optimism about their present situation given the overall economy and the strength of the labor market. This positive sentiment is further underscored by the widening gap between those who perceive jobs as plentiful and those who believe jobs are scarce, a trend not observed since January.

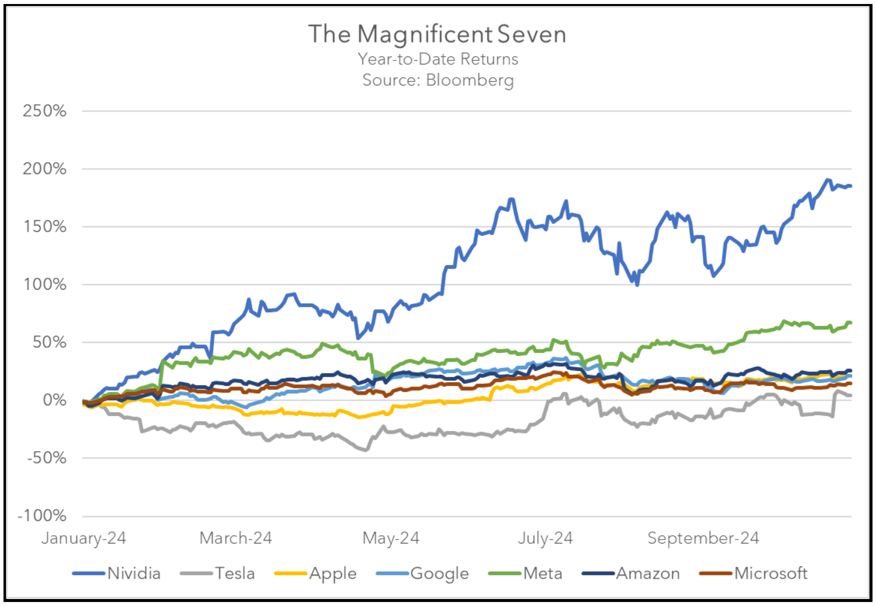


- The data on job openings and consumer confidence aligns with our view of a resilient economy. While the decline in openings indicates cooling labor demand, it also reinforces our belief that firms are hesitant to lay off workers. This sentiment has likely translated into increased job security for consumers. However, a key question remains: How will this impact wage growth? If wages continue to rise above historical trends, it could exert upward pressure on inflation. Conversely, if wage growth moderates, it may alleviate price pressures and potentially prompt the Fed to ease monetary policy.

AI Is Back: After concerns about overspending on AI, Google's parent company Alphabet demonstrated that its investments may be paying off.

- On Thursday, the tech giant exceeded expectations for both profit and revenue, driven by strong growth in its cloud business. The company has faced significant pressure due to concerns about excessive spending to compete with Microsoft following its partnership with OpenAI. Despite increased capital spending in the third quarter, Google's cloud division saw a 35% growth in revenue year-over-year. Additionally, the company has been able to reduce the cost of its search engine business by over 90% in 18 months.
- Alphabet was the second of the Magnificent 7 companies, after Tesla, to report stronger-than-expected third-quarter earnings. This robust performance is likely to bolster investor optimism for the broader index further, as investors seek signs that mega-cap tech

companies can sustain their momentum despite concerns about AI-related overspending that have plagued other companies within the index. While the Magnificent 7 index has surged nearly 50% year-to-date, Nvidia and Meta have been the primary drivers, accounting for over 60% of the gains.

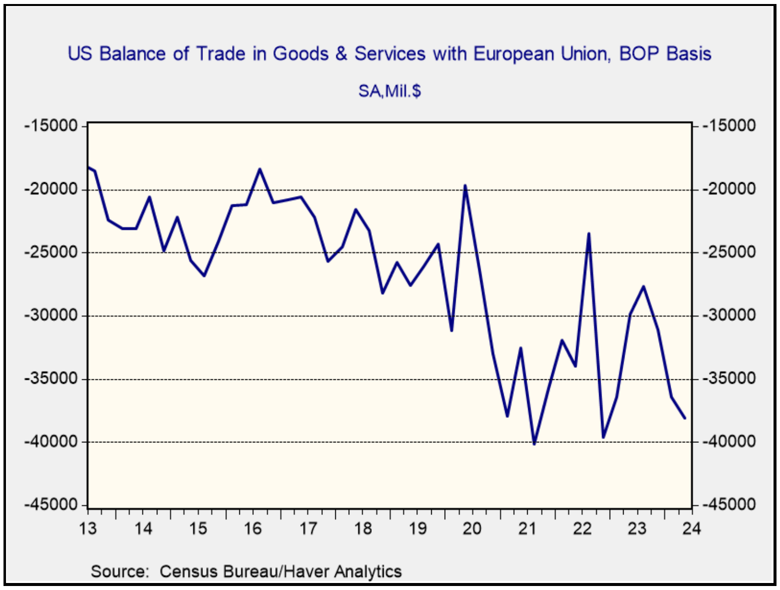


- Alphabet's strong performance bodes well for other mega-cap tech companies. Last quarter, Google, Microsoft, Meta, and Amazon increased their AI investments, betting on significant untapped demand for these services. Increased capital spending reflects their belief in the potential for future revenue growth. If other companies report similar sales growth this quarter, investors may take a closer look at the Magnificent 7 stocks, especially if interest rates rise. However, we believe that other non-tech sectors offer more long-term value.

European Protectionism: The EU has started to crack down on Chinese dumping as it looks to protect its own domestic industries.

- The EU will impose tariffs on Chinese electric vehicles (EV) on Thursday, as negotiations to resolve trade disputes between the two sides have failed. These tariffs aim to prevent China from dominating the region's EV market. EU regulators have accused Beijing of unfair trade practices, such as providing substantial subsidies, which have allowed Chinese EVs to undercut prices of domestically produced cars. The rapid growth of Chinese EV sales is evident, increasing from a mere 3.9% of the market in 2020 to a significant 25% in 2023.
- The decision to impose tariffs comes as the West's efforts to develop its own green technology industry have faced significant headwinds. The region has struggled to nurture domestic firms, unable to compete with the lower prices of Chinese imports or the generous incentives offered by the US to boost clean-tech manufacturing. For instance, since the passage of the Inflation Reduction Act, US solar investments have

surged from $200 million to over $2 billion, while EU investments have declined to $141 million, despite starting from a similar level.



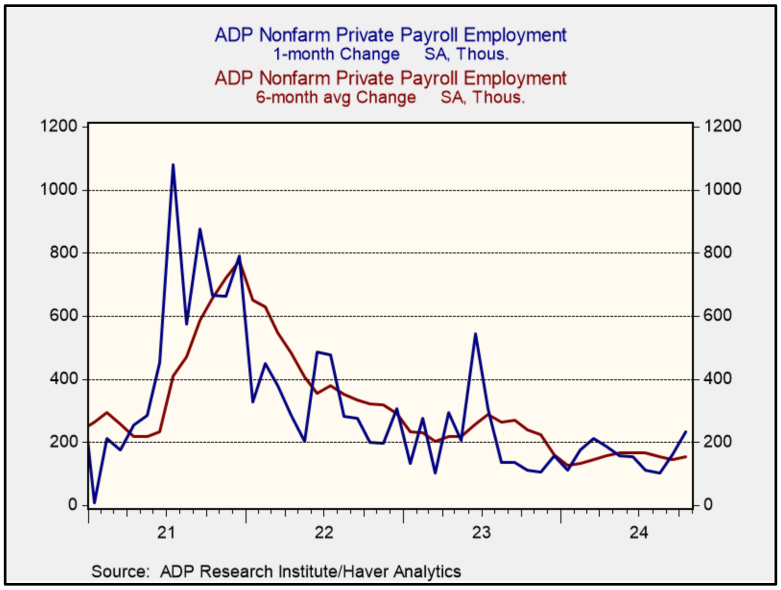
- The EU tariffs on Chinese electric vehicles sends a clear signal that the EU intends to bolster its domestic clean-tech industry. This move could also foreshadow potential retaliatory measures by the EU against the US if the next administration imposes tariffs on EU goods. While the EU may seek to retaliate, it is also likely to pressure the US to reduce tax incentives and subsidies for foreign firms building factories domestically. While a trade war between the US and EU may not be desirable for either party, it is something that could be an issue as it is unclear which side will back down.

In Other News: Israeli Prime Minister Benjamin Netanyahu has expressed interest in negotiating a short truce with Hamas. The German economy unexpectedly grew in the third quarter in a sign that the worst of the downturn may be behind it. Russia has fined Google $2.5 decillion for not allowing propaganda on its YouTube platform.

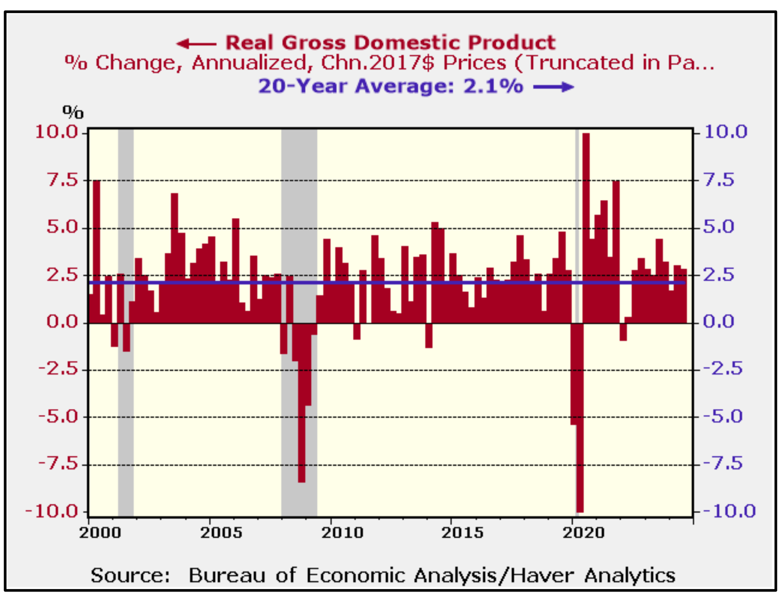
US Economic Releases

The Mortgage Bankers Association today said mortgage applications in the week ended October 25 fell 0.1% compared to last week's fall of 6.7%. This was the fifth straight week that the index declined. Applications for home purchase mortgages rose 5.0%, reversing last week's 5.1% decline, while refinancing applications fell 6.3%, further extending last week's 8.4% decline. According to the report, the average interest rate on a 30-year mortgage rose 21 basis points to 6.73%, extending the trend of rising rates.

Separately, the ADP Research Institute estimated that ***private payroll employment*** rose in September by a seasonally adjusted 233,000, which is an extreme upside surprise relative to the expected 111,000 and the previous month's 159,000. Manufacturing was the only sector to lose jobs, whilst education, health services, trade, and transportation all posted strong gains. ADP's estimate is widely seen as an indicator of what to expect when the Labor Department releases its measure of nonfarm payrolls on Friday. The chart below shows ADP's estimate of private payrolls since the beginning of 2021.



Separately, the Commerce Department released its advance estimate of economic activity in the third quarter. After stripping out seasonal factors and price changes, third-quarter ***gross domestic product (GDP)*** rose at an annualized rate of 2.8%, just a tick shy of the expected 2.9%. Meanwhile, the GDP price index posted a rise of 1.8%, also just a tick shy of the expected 1.9%. The chart below shows the annualized growth rate of US GDP since the turn of the century.



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	Pending Home Sales	m/m	Sep	1.9%	0.6%	**
10:00	Pending Home Sales NSA	y/y	Sep	-1.1%	-4.3%	**
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								
Japan	Consumer Confidence	m/m	Oct	36.2	36.9	36.7	*	Equity and bond neutral
Australia	CPI	y/y	Sep	2.1%	2.7%	2.3%	**	Equity and bond neutral
EUROPE								
Eurozone	Consumer Confidence	m/m	Oct F	-12.5	-12.5		**	Equity and bond neutral
	Services Confidence	m/m	Oct	7.1	7.1	6.6	**	Equity and bond neutral
	Industrial Confidence	m/m	Oct	-13.0	-11.0	-10.5	***	Equity bearish, bond bullish
	Economic Confidence	m/m	Oct	95.6	96.2	96.3	***	Equity bearish, bond bullish
	GDP SA	y/y	3Q A	0.9%	0.6%	0.8%	***	Equity and bond neutral
Germany	Unemployment Change	m/m	Oct	27.0k	19.0k	15.0k	***	Equity and bond neutral
	Unemployment Claims Rate	m/m	Oct	6.1%	6.1%	6.1%	**	Equity and bond neutral
	GDP NSA	y/y	3Q P	0.2%	0.1%	0.1%	**	Equity and bond neutral
	GDP WDA	y/y	3Q P	-0.2%	-0.3%	-0.3%	**	Equity and bond neutral
France	Consumer Spending	m/m	Sep	-0.1%	-0.3%	0.0%	*	Equity and bond neutral
	GDP	y/y	Q3 P	1.3%	1.0%	1.2%	**	Equity and bond neutral
Italy	GDP WDA	y/y	Q3 P	0.4%	0.6%	0.7%	**	Equity and bond neutral
	PPI	y/y	Sep	-2.7%	-1.1%		**	Equity and bond neutral
Switzerland	KOF Leading Indicator	m/m	Oct	99.5	104.5	105.0	**	Equity bearish, bond bullish
AMERICAS								
Mexico	International Reserves Weekly	w/w	25-Oct	$226067m	$226436m		*	Equity and bond neutral
	GDP NSA	y/y	3Q P	1.5%	2.1%	1.3%	***	Equity and bond neutral
Brazil	FGV Inflation IGPM YoY	y/y	Oct	5.59%	4.53%	5.58%	***	Equity and bond neutral
	Total Outstanding Loans	m/m	Sep	6180b	6105b		**	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)	447	448	-1	Down
U.S. Sibor/OIS spread (bps)	456	458	-2	Down
U.S. Libor/OIS spread (bps)	453	454	-1	Down
10-yr T-note (%)	4.23	4.26	-0.03	Down
Euribor/OIS spread (bps)	306	305	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	$71.84	$71.12	1.01%	
WTI	$67.96	$67.21	1.12%	
Natural Gas	$2.86	$2.86	0.00%	
12-mo strip crack	$19.83	$19.77	0.29%	
Ethanol rack	$1.72	$1.72	0.01%	
Metals				
Gold	$2,778.83	$2,774.74	0.15%	
Silver	$34.03	$34.45	-1.22%	
Copper contract	$433.65	$436.05	-0.55%	
Grains				
Corn contract	$412.00	$413.75	-0.42%	
Wheat contract	$564.50	$570.50	-1.05%	
Soybeans contract	$982.75	$979.00	0.38%	
Shipping				
Baltic Dry Freight	1,402	1,382	20	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		1.81		
Gasoline (mb)		0.60		
Distillates (mb)		-0.97		
Refinery run rates (%)		0.1%		
Natural gas (bcf)		79		

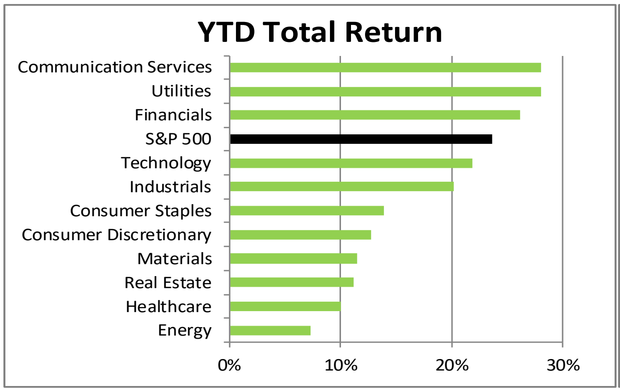
Weather

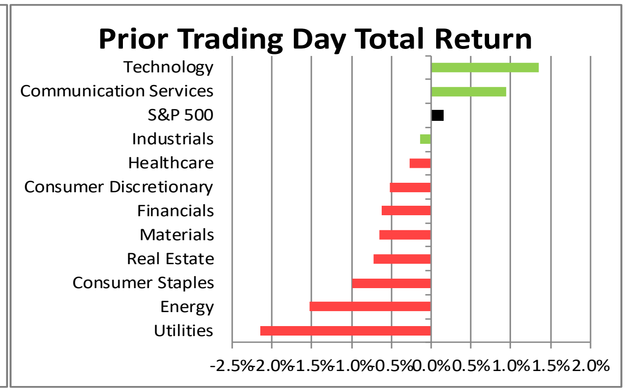
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures from the Great Plains to the East Coast, with cooler-than-normal temperatures in the Desert Southwest. The precipitation outlook calls for wetter-than-normal conditions across the majority of the country, with drier conditions expected in California, Oregon, and Nevada.

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

Data Section

US Equity Markets – (as of 10/29/2024 close)

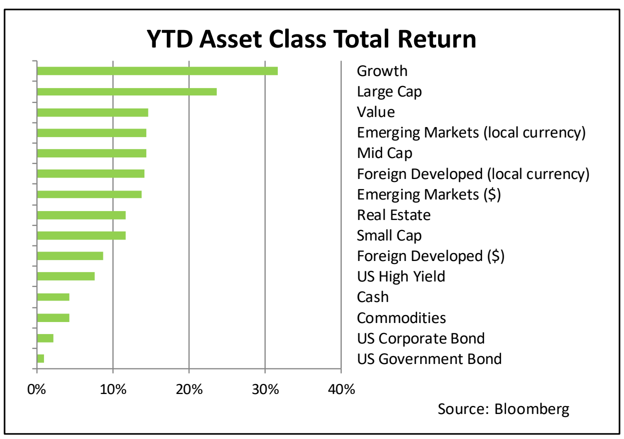




(Source: Bloomberg)

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 10/29/2024 close)

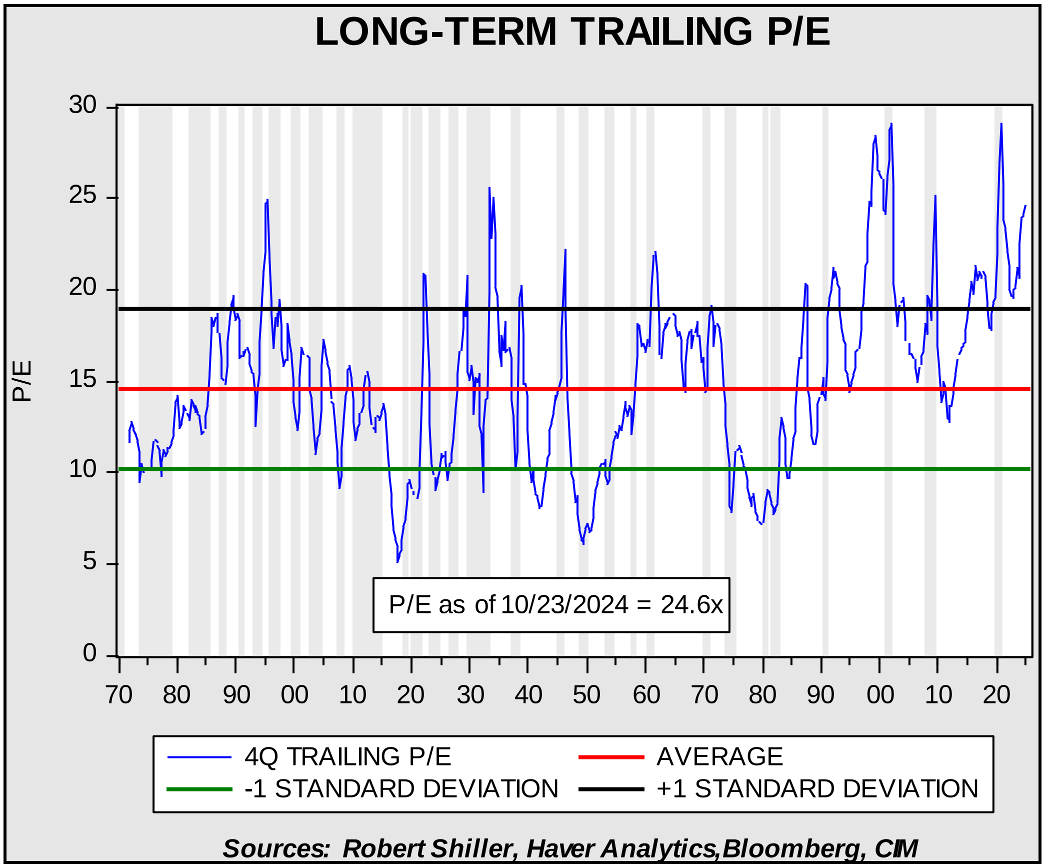


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.