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 4, 2024 — 9:30 AM ET] Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 is up 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.8%. Chinese markets are closed for Golden Week. US equity index futures are signaling a higher open.

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:

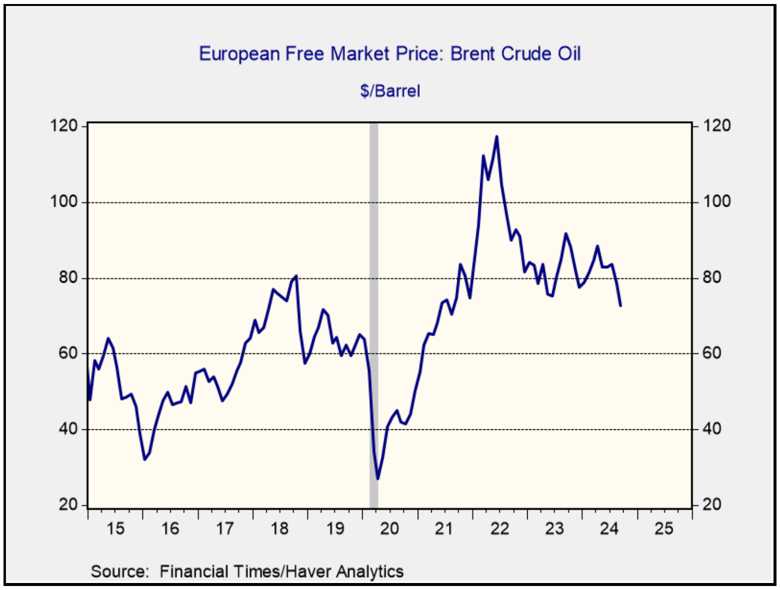
- *Bi-Weekly Geopolitical Report* (9/23/2024) (with associated podcast): "Eight Megatrends Every Investor Should Know"
- *Asset Allocation Bi-Weekly* (9/30/2024) (with associated podcast): "Presidential Cycles and Stock Performance"
- *Asset Allocation Quarterly – Q3 2024* (7/16/2024): Discussion of 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! Markets are currently reacting to the fresh jobs report. In sports news, Caitlin Clark of the Indiana Fever has been named the WNBA Rookie of the Year. Today's *Comment* will delve into the ongoing Israel-Iran conflict, explore why a soft economic landing is beneficial for speculative bonds, and discuss the rise of European protectionism. As always, we will conclude our report with a comprehensive overview of international and domestic data releases.

Israel-Iran: The prospect of Israel bombing oil patches in Iran has led to concerns of a broadening war in the Middle East.

- President Biden suggested that a potential strike on Iran's oil fields is under discussion between the US and Israel in response to Iran's missile barrage. While details remain unclear, the possibility of Israeli strikes fueled a surge in global oil prices and pushed the VIX above 20. Rising tensions between Israel and Iran, along with fears of disrupted Iranian oil production and further conflict escalation, have driven the increase in market volatility. Meanwhile, Israel escalated its offensive in Lebanon, launching airstrikes near Beirut Airport and targeting Hezbollah's potential successors.

- The ongoing conflict has challenged the traditional safe-haven paradigm. While the 10-year Treasury and gold have historically been considered reliable during times of fear, the US dollar has emerged as the dominant safe-haven asset, consistently maintaining its value. Despite the dollar's recent rally, bond prices have declined, and gold has relinquished some gains. This shift in investor sentiment likely reflects a reassessment of relative valuations, with gold and bonds perceived as overvalued compared to the dollar amid concerns about central bank monetary policies.



- In the coming weeks, we should gain clearer insights into how US monetary policy compares to its global peers. The [Bank of England and European Central Bank have indicated a readiness to implement more aggressive rate cuts] if inflation aligns with projections. Conversely, the Bank of Japan faces pressure to refrain from further tightening. The US is prepared to adjust its policy if necessary, but its decisions are likely to continue to be more sensitive to evidence of weakness in the labor market rather than to cooling inflationary pressures.

Soft Landing and Credit Spreads: Recent ISM and S&P Global data confirms a strong economy, narrowing high-yield bond spreads.

- The purchasing managers indexes (PMI) for the two most well-known reporting agencies [suggest that service activity remained comfortably above the contraction threshold of 50] in September. The service index from the Institute of Supply Management increased from 51.5 in August to 54.9 in the following month. Meanwhile, the S&P Global index decreased modestly from 55.7 to 55.2. These reports reinforce the notion that despite weakness in the labor market, the economy is still on solid footing, which has boosted confidence in a soft landing.
- The positive economic outlook has led to a sharp increase in the demand for speculative bonds. This trend has coincided with a decrease in credit spreads to their lowest level

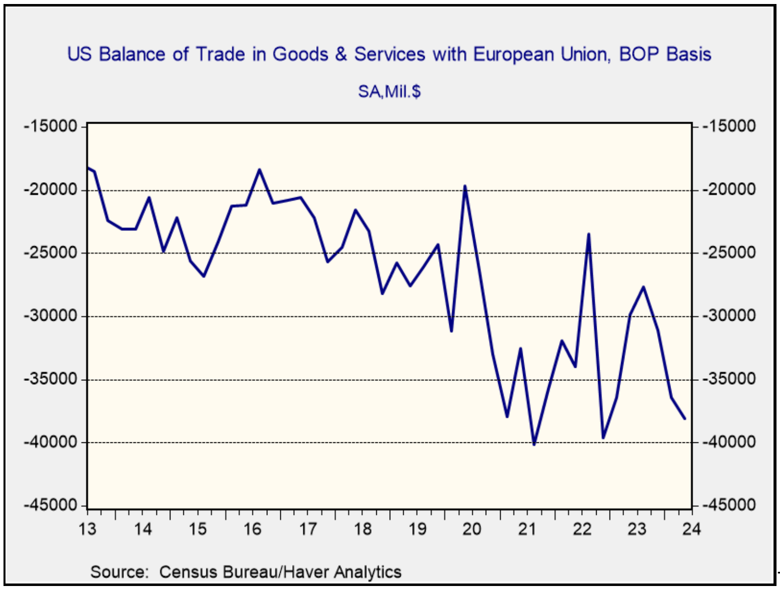
since 2021, as investors expect a gentle economic slowdown. The decrease in spreads is influenced by the potential interest rate cuts by the Federal Reserve and the ongoing strong demand for credit, especially from companies looking to refinance expiring debts. This is likely to continue as long as the market maintains confidence in the Fed's ability to control inflation and prevent a recession.

- The positive readings from the two PMIs are encouraging, but only time will determine whether the Federal Reserve can successfully navigate a soft landing. Despite the thriving service sector, manufacturing continues to struggle. Furthermore, concerns about a potential resurgence of inflation persist. As a result, a hard landing or a possible Fed U-turn remains a distinct possibility. Consequently, while credit spreads are currently tight, they may widen if economic conditions deteriorate. This may mean that investors should be patient before going into speculative grade bonds.

Europe's Protectionist Shift: EU officials have crossed a key hurdle as they try to decide whether to impose tariffs on Chinese EVs .

- Amid ongoing trade negotiations with China, the EU has announced its intention to impose tariffs of up to 45% on Chinese electric vehicles. This reflects a growing desire to protect domestic industries. Additionally, the EU has been positioning itself for the possible return of Donald Trump as president, since he has warned of a more hostile trade relationship with the bloc. This move aligns with recent warnings from French President Macron about the need for fairer trade rules to prevent the EU from falling behind the US and China.
- The EU's increasing vulnerability has spurred a drive for greater independence. Although the bloc aspires to be a pioneer in the green energy shift, it continues to be heavily reliant on China for renewable technology and remains a major buyer of US natural gas. Eurostat data reveals that Europe imported 93% of its solar panels. Moreover, its imports of Chinese vehicles surged from 3.5% in 2020 to 27.2% by the second quarter of 2024.

This dependence has impeded the growth of domestic industries and left the bloc exposed to external threats.

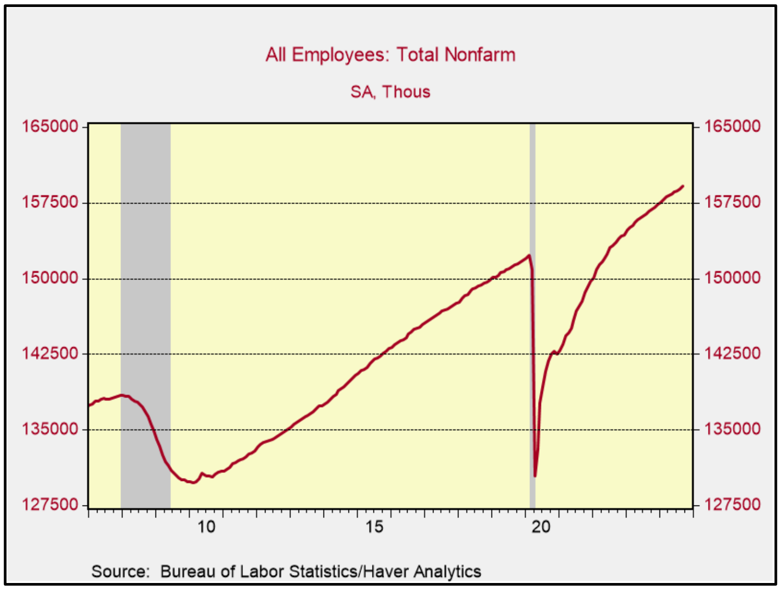


- While we expect the EU to retain strong ties with the US due to its historical and security interests, we believe the increasing competition between the two has become more understated. This tension is evident in the bloc's crackdown on US big tech firms and its calls for issuing its own bonds. The EU's growing assertiveness could compel the US to have less influence in shaping EU affairs, especially as these countries begin to contribute more to their joint defense. In the long run, this could have an impact on firms with foreign revenue exposure.

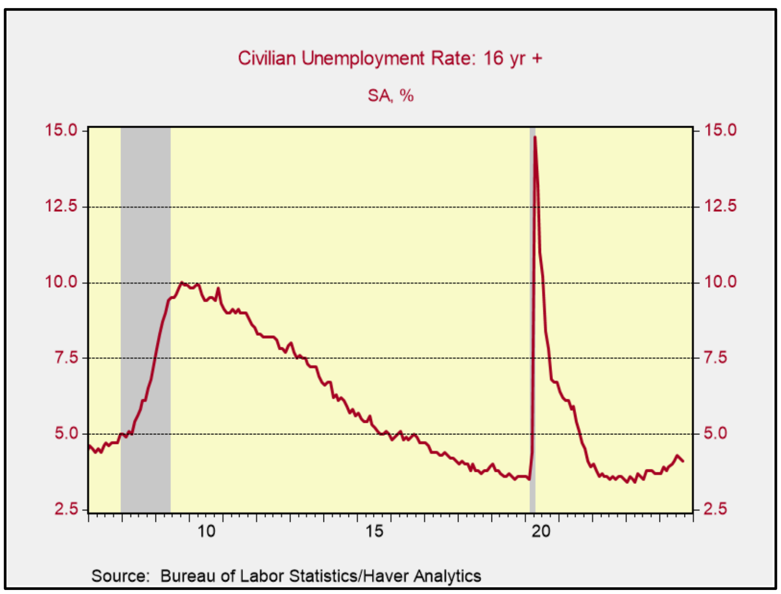
In Other News: Dockworkers and operators have agreed to put the strike on hold until January 15. The UK has struck a deal with Mauritius in which it gave back the islands but was able keep the region that holds a UK military base. Italy is looking to raise taxes on corporations earning windfall profits as it looks to tackle its growing deficit.

US Economic Releases

September ***nonfarm payrolls*** rose by a seasonally adjusted 254,000, roughly double the expected increase and much stronger than the upwardly revised gain of 159,000 in August. Most of the new jobs came in the private sector. Along with the other positive indicators in the report (described below), the data confirms the assertion we made in our write-up of the initial jobless claims data in our *Comment* yesterday: US labor demand is apparently strengthening again, which may discourage the Fed from cutting interest rates aggressively going forward. The chart below shows the change in nonfarm payrolls since shortly before the Great Financial Crisis.

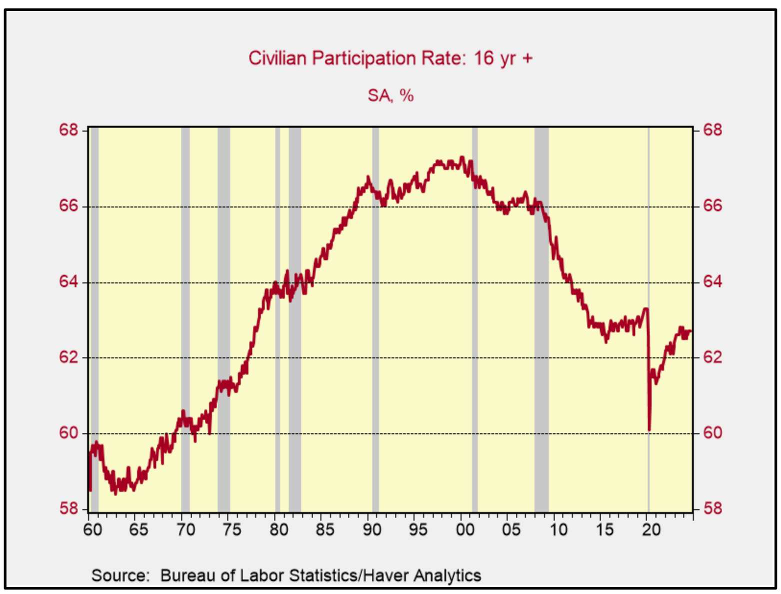


Also in today's report, September ***unemployment rate*** fell to a seasonally adjusted 4.1%, versus expectations that it would be unchanged at the August rate of 4.2%. The rate of joblessness is now back to its lowest level since June. The chart below shows how the unemployment rate has evolved since just before the GFC.



With the demand for labor high and the "inventory" of unemployed workers low, wage rates remain high. ***Average hourly earnings*** in September rose to a seasonally adjusted $35.36, up 4.0% from the same month one year earlier. The annual wage growth marked an acceleration from the 3.9% gain in the year to August and just 3.6% in the year to July. The chart below shows the year-over-year growth in average hourly earnings since just before the GFC.

A final key indicator in the monthly employment report focuses on the share of the adult, civilian, noninstitutionalized population that is either working or looking for work. The September ***labor force participation rate (LFPR)*** held steady at a seasonally adjusted 62.7% for the third straight month and remains below the rates seen prior to the coronavirus pandemic. The muted LFPR appears to largely reflect the legions of baby boomers who retired or otherwise left the workforce during the pandemic. Without those workers in the labor force, future labor demand is likely to be reflected in labor shortages and relatively high wage gains. The chart below shows how the LFPR has changed over the last several decades.



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	John Williams Gives Opening Remarks at Jobs Conference	President of the Federal Reserve Bank of New York
10:00	Austan Goolsbee on Bloomberg Television	President of the Federal Reserve Bank of Chicago
10:30	Austan Goolsbee on Yahoo Finance	President of the Federal Reserve Bank of Chicago
16:00	Austan Goolsbee on Meet the Press NOW	President of the Federal Reserve Bank of Chicago

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								
India	HSBC India PMI Composite	m/m	Sep F	58.3	59.3		**	Equity and bond neutral
	HSBC India PMI Services	m/m	Sep F	57.7	58.9		**	Equity and bond neutral
EUROPE								
Germany	HCOB Germany Construction PMI	m/m	Sep	41.7	38.9		*	Equity and bond neutral
France	Industrial Production	y/y	Aug	0.5%	-1.2%	-2.0%	***	Equity bullish, bond bearish
	Manufacturing Production	y/y	Aug	0.3%	-3.0%	-1.8%	**	Equity bullish, bond bearish
Italy	Retail Sales	y/y	Aug	0.8%	0.9%	1.3%	**	Equity bearish, bond bullish
UK	New Car Registrations	y/y	Sep	1.00%	-1.3%		*	Equity bullish, bond bearish
	S&P Global Construction PMI	m/m	Sep	57.2	53.6	53.1	**	Equity bullish, bond bearish
Switzerland	Unemployment Rate	m/m	Sep	2.6%	2.5%	2.6%	**	Equity and bond neutral
Russia	Money Supply, Narrow Definition	w/w	27-Sep	18.3t	18.39t		*	Equity and bond neutral
AMERICAS								
Mexico	Unemployment Rate NSA	m/m	Aug	3.04%	2.93%	2.91%	***	Equity and bond neutral
	Vehicle Production	m/m	Sep	378583	352615		*	Equity and bond neutral
Brazil	Trade Balance	m/m	Sep	$4.700b	$4.828b	$4.700b	**	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)	459	459	0	Down
U.S. Libor/OIS spread (bps)	456	456	0	Down
10-yr T-note (%)	3.87	3.85	0.02	Up
Euribor/OIS spread (bps)	324	325	-1	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	$78.39	$77.62	0.99%	
WTI	$74.44	$73.71	0.99%	
Natural Gas	$2.99	$2.97	0.74%	
12-mo strip crack	$20.79	$20.68	0.53%	
Ethanol rack	$1.76	$1.77	-0.73%	
Metals				
Gold	$2,657.83	$2,655.89	0.07%	
Silver	$32.07	$32.02	0.18%	
Copper contract	$456.40	$455.30	0.24%	
Grains				
Corn contract	$424.00	$428.25	-0.99%	
Wheat contract	$593.00	$603.50	-1.74%	
Soybeans contract	$1,048.00	$1,046.00	0.19%	
Shipping				
Baltic Dry Freight	1,941	1,978	-37	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	3.89	-1.43	5.32	
Gasoline (mb)	1.12	0.20	0.92	
Distillates (mb)	-1.28	-2.00	0.72	
Refinery run rates (%)	-3.3%	-0.7%	-2.6%	
Natural gas (bcf)	55	57	-2	

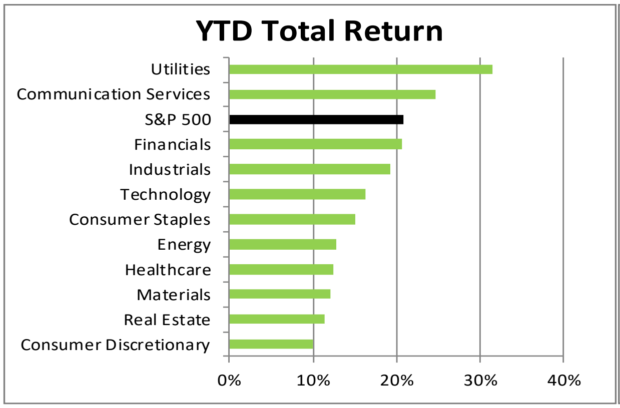
Weather

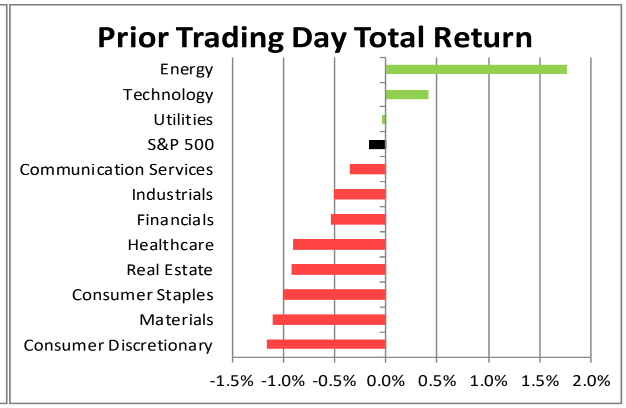
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures throughout the entire country west of the Mississippi River, with cooler-than-normal temperatures along the East Coast north of Florida. The forecasts call for wetter-than-normal conditions in Florida, with dry conditions in the northern Rocky Mountains, the Great Plains, the Midwest, the Mississippi Valley, and along the East Coast north of Florida.

Hurricane Kirk is currently moving northward through the central Atlantic Ocean, but it is not expected to make landfall anywhere. Tropical Storm Leslie is off the western coast of Africa and moving to the northwest, but it also is not expected to make landfall.

Data Section

US Equity Markets – (as of 10/3/2024 close)

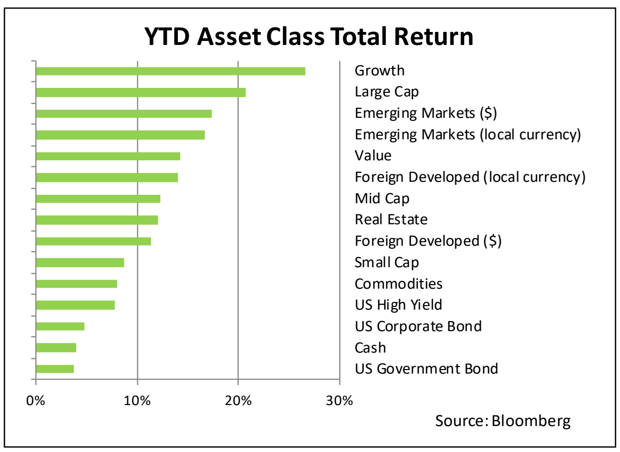




(Source: Bloomberg)

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 10/3/2024 close)

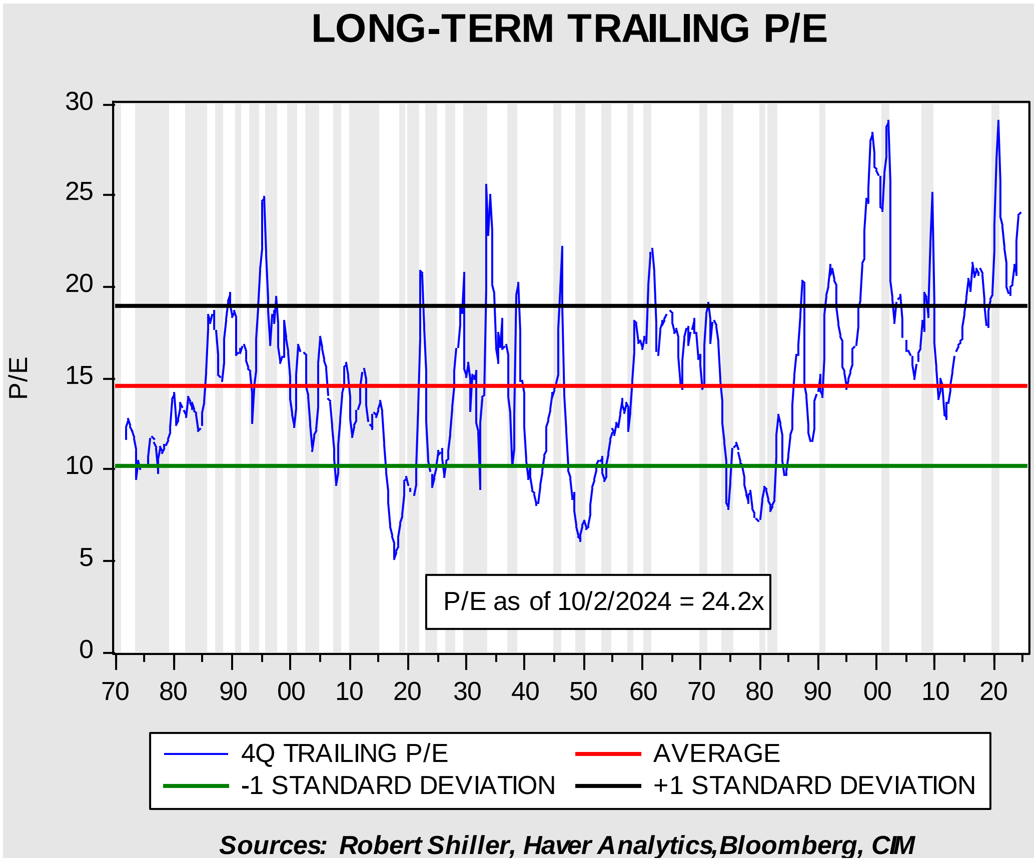


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 3, 2024



Based on our methodology,[1] the current P/E is 24.2x, up 0.1 from our last report. The stock price index increased due to a transition to a new quarter, while earnings were little changed from the previous week.

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.