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: September 10, 2024 — 9:30 AM ET] Global equity markets are generally higher this morning. In Europe, the Euro Stoxx 50 is down 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.2%. Chinese markets were higher, with the Shanghai Composite up 0.3% from its previous close and the Shenzhen Composite up 0.3%. 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*** **(9/9/2024) (with associated podcast): "Prospects for the Dollar in a Fracturing World"**
- *Asset Allocation Bi-Weekly* (8/26/2024) (with associated podcast): "Activist vs. Accommodative Treasury Issuance"
- *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.

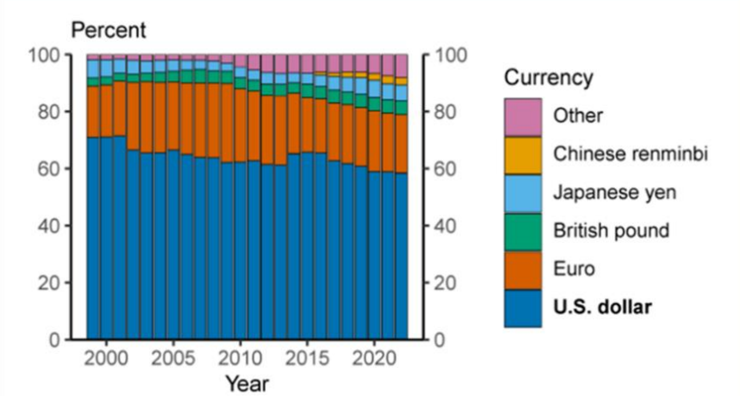
Our *Comment* today opens with a preview of tonight's presidential debate and the latest major economic policy statement from former President Trump. We next review several other international and US developments with the potential to affect the financial markets today, including new European court decisions against major US technology companies and the broadening impacts from the re-industrialization of the US.

US Politics: Presidential candidates Donald Trump and Kamala Harris are scheduled to have their televised debate tonight on the ABC network, starting at 9:00 pm ET. Former President Trump and Vice President Harris have never met in person, so the battle could be as interesting as two unbeaten prize fighters meeting for the first time. The *Wall Street Journal* last night published a useful overview of the likely strategies the two candidates will use in their meeting.

- Separately, Trump made a confusing vow over the weekend to impose a 100% import tariffs against any country "leaving" the dollar. Based on the context of the statement, Trump was apparently saying that he would impose the tariffs against countries reducing their use of the dollar in international trade or investment.

- Many people are fearful that if other countries reduce their use of the dollar, its value will decline, undermining its purchasing power and boosting consumer price inflation. But Trump and his aides have previously indicated that they *want* to depreciate the dollar in order to bolster US exports and discourage imports. The contradictory statements suggest Trump wants to both keep demand for the dollar high and drive down its value.
- Tracking and measuring all the different ways that the greenback is used in trade and investment is difficult, so economists look at the dollar's share in global central bank foreign exchange reserves as a proxy. The dollar's share in those reserves has actually been declining gradually for two decades, and yet the currency has been in a bull market and is now close to a record high.
- In our latest *Bi-Weekly Geopolitical Report*, published yesterday, we look at the prospects for the dollar as the world fractures into relatively separate geopolitical and economic blocs. The report notes that strong economic growth and better investment prospects in the US continue to draw in foreign capital, boosting the dollar's exchange rate despite its reduced share in global trade and investment flows. For the time being, those factors could continue buoying the dollar.

Figure 2. Foreign exchange reserves



Note: Share of globally disclosed foreign exchange reserves. At current exchange rates. Data are annual and extend from 1999 through 2022. Legend entries appear in graph order from top to bottom. Chinese renminbi is 0 until 2015-Q2.

Source: IMF COFER.

European Union-United States: The European Court of Justice today overturned an appeals court decision and reinstated a 2016 court ruling that Ireland provided US tech giant Apple with illegal subsidies. The ruling today subjects Apple to 13 billion EUR ($14.3 billion) in back taxes. The ECJ today also affirmed a 2.4-billion EUR ($2.6 billion) fine against Google for antitrust violations. The rulings are likely to worsen US-EU economic tensions, especially if Trump is re-elected. The rulings also illustrate the growing regulatory risks for large US tech firms operating around the world.

Germany: Interior Minister Fraser yesterday said the government will extend and strengthen its border controls to reduce "irregular" migration and lower the risk that Islamist terrorists could enter the country. The move is likely a response by the centrist coalition government to the recent surge in political support for populist, anti-immigrant parties. It also illustrates how illegal immigration has become a political issue for many developed countries around the world.

United Kingdom: During the three months ended in July, average earnings excluding bonuses were up just 5.1% from the same period one year earlier, marking the weakest wage gains in two years. Average earnings in the service sector alone were up just 3.8%. The figures suggest the Bank of England's tight monetary policy is continuing to wring price pressures out of the economy, although the policymakers are still expected to cut interest rates only slowly.

Russia-Ukraine Conflict: New polling shows the share of Ukrainians who want to compromise with Russia to end the war has risen to 26%, with younger people more inclined to negotiate. However, those in the military are least likely to want compromise. According to the report, enlisted personnel, who are influential in Ukrainian society, see any talk of compromise as an affront to those who have died resisting the Russians. They also argue that the Kremlin would only use a truce to rearm and prepare for a new attack.

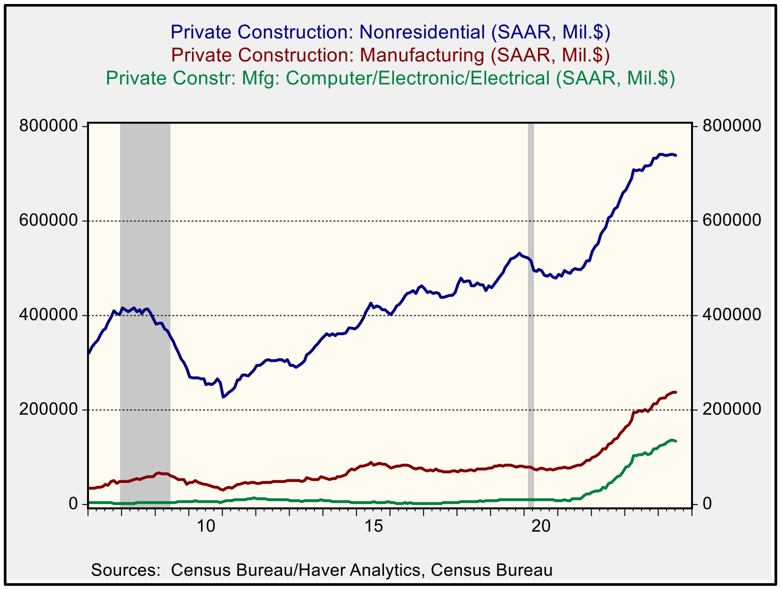
Russia-Kazakhstan-China: Meirzhan Yussupov, chief of Kazakhstan's state mining company Kazatomprom, said in a *Financial Times* interview that Western sanctions after Russia's invasion of Ukraine have forced his company to favor uranium exports to Russia and China, even though it would prefer to maintain a more diversified customer base. The company, which is now the world's largest uranium producer, earlier warned that its output would be crimped by supply shortages and delays in building new mining facilities.

- Yussupov's effort to blame Western sanctions for crimped uranium exports, along with the firm's statement about production challenges, may aim to mask Russian and Chinese pressure to reserve Kazatomprom's low-cost uranium for themselves.
- As we noted in our *Bi-Weekly Asset Allocation Report* from April 15, 2024, the Chinese government is likely using enormous volumes of uranium as it works to massively expand its arsenal of strategic nuclear weapons. We suspect Chinese weapons demand has been a significant reason for the run-up in spot uranium prices since 2022. Beijing would want to hide where it's getting its uranium supplies, and the statements by Yussupov and his company could be a part of that effort.
- To the extent that Russia and China can sew up Kazakhstan's low-cost uranium ore, the result would be increased upward pressure on spot uranium prices in the West. That's one reason why we are currently maintaining our exposure to uranium and uranium miners in Confluence's Asset Allocation Strategies.

US Re-Industrialization: As the US-China rivalry and global fracturing continue to spur re-shoring and a boom in US factory construction, new data shows the long-awaited secondary effects are also becoming noticeable. The data, from real estate analytics firm Green Street, shows that investors are ramping up their plans to acquire or build warehouses, hotels, office buildings, and apartments near coming factories across the Sunbelt and Rust Belt, where most of these so-called onshoring projects are under way.

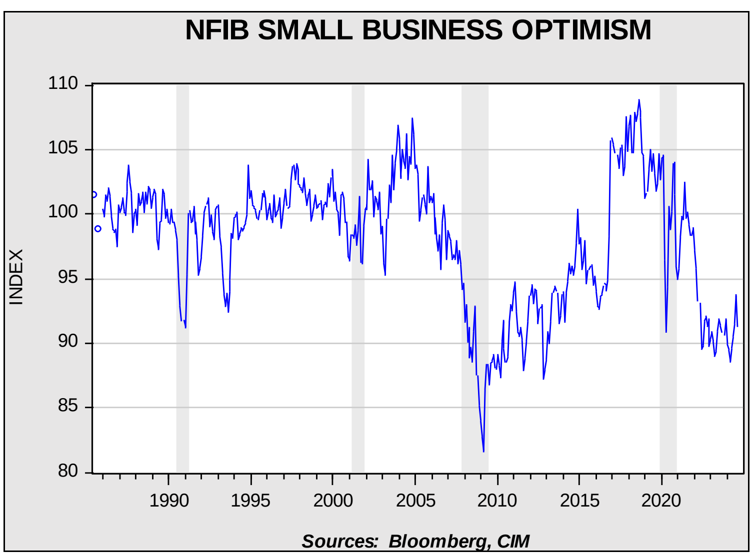
- The planned real estate development around emerging factories are an example of the "multiplier effect" of new investment.

- Although parts of the real estate sector, such as office buildings, are still broadly challenged by today's high interest rates and the work-from-home trend, the multiplier on re-industrialization is a reminder that other types of real estate and particular localities continue to have good prospects.



US Economic Releases

The National Federation of Independent Business' Small Business Optimism Index for August fell to 91.2 from 93.7 the prior month, which also fell short of the expected value of 93.6. This drop erases all of July's gain and is the largest single-month decline in more than two years. Eight of the 10 components of the index weakened, led by a nine-point slide in sales expectations. Elevated prices, interest rates, and labor costs also continue to take a toll. One result of this decline is a dialing back of surveyed firms that plan to add jobs to only 13% of the total. The following chart shows the course of the index through time.



There are no economic releases 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**
10:00	Michael Barr Speaks on Basel III Endgame	U.S. Federal Reserve Vice Chair for Supervision
12:15	Gives Speech on Stress Testing	Member of the Board of Governors

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	Money Stock M2	y/y	Aug	1.3%	1.5%		**	Equity and bond neutral
	Money Stock M3	y/y	Aug	0.9%	1.0%		**	Equity and bond neutral
	Machine tool orders	m/m	Aug P	-3.5	8.4		**	Equity and bond neutral
Australia	Westpac Consumer Conf SA	m/m	Sep	-0.5%	2.8%		**	Equity and bond neutral
	Westpac Consumer Conf Index	m/m	Sep	84.6	85.0		**	Equity and bond neutral
	NAB Business Confidence	m/m	Aug	-4	1		***	Equity and bond neutral
	NAB Business Conditions	m/m	Aug	3	6		***	Equity and bond neutral
New Zealand	Mfg Activity Volume	q/q	2Q	0.6%	-0.3%		**	Equity and bond neutral
	Mfg Activity SA	q/q	2Q	0.1%	0.8%		*	Equity and bond neutral
China	Exports	y/y	Aug	8.7%	7.0%	6.6%	**	Equity bullish, bond bearish
	Imports	y/y	Aug	0.5%	7.2%	2.5%	**	Equity bearish, bond bullish
	Trade Balance	m/m	Aug	$91.2b	$84.65b	$81.10b	***	Equity and bond neutral
EUROPE								
Germany	CPI	y/y	Aug F	1.9%	1.9%	1.9%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Aug F	2.0%	2.0%	2.0%	**	Equity and bond neutral
Italy	Industrial Production WDA	y/y	Jul	-3.3%	-2.6%	-1.8%	***	Equity bearish, bond bullish
UK	Average Weekly Earnings 3M/YoY	m/m	Jul	4.00%	4.60%	4.10%	**	Equity and bond neutral
	ILO Unemployment Rate 3Mths	m/m	Jul	4.10%	4.20%	4.10%	**	Equity and bond neutral
	Claimant Count Rate	m/m	Aug	4.70%	4.60%		**	Equity and bond neutral
	Jobless Claims Change	m/m	Aug	23.7k	102.3k		**	Equity and bond neutral
AMERICAS								
Brazil	IBGE Inflation IPCA	m/m	Aug	4.24%	4.50%	4.27%	***	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)	520	521	-1	Down
3-mo T-bill yield (bps)	486	485	1	Down
U.S. Sibor/OIS spread (bps)	495	495	0	Down
U.S. Libor/OIS spread (bps)	492	493	-1	Down
10-yr T-note (%)	3.71	3.70	0.01	Down
Euribor/OIS spread (bps)	346	347	-1	Down
Currencies	**Direction**			
Dollar	Flat			Down
Euro	Flat			Up
Yen	Flat			Up
Pound	Flat			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	$70.93	$71.84	-1.27%	
WTI	$67.75	$68.71	-1.40%	
Natural Gas	$2.22	$2.17	2.44%	
12-mo strip crack	$18.81	$19.08	-1.38%	
Ethanol rack	$1.94	$1.95	-0.56%	
Metals				
Gold	$2,505.04	$2,506.38	-0.05%	
Silver	$28.45	$28.35	0.36%	
Copper contract	$412.80	$414.45	-0.40%	
Grains				
Corn contract	$406.75	$407.25	-0.12%	
Wheat contract	$572.00	$568.50	0.62%	
Soybeans contract	$1,007.50	$1,018.00	-1.03%	
Shipping				
Baltic Dry Freight	1,958	1,941	17	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		0.50		
Gasoline (mb)		-0.50		
Distillates (mb)		0.05		
Refinery run rates (%)		-0.8%		
Natural gas (bcf)		27		

Weather

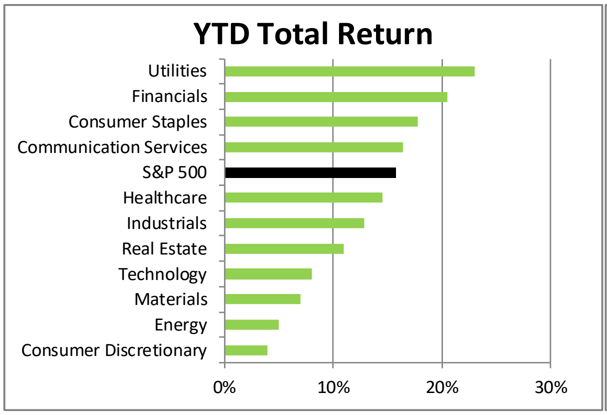
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures for most of the country, with cooler-than-normal temperatures west of the Continental Divide. The forecasts are calling for wetter-than-normal conditions for the northern two-thirds of the country west of the Mississippi and along the Atlantic Coast, with dry conditions in New England and the Great Lakes region.

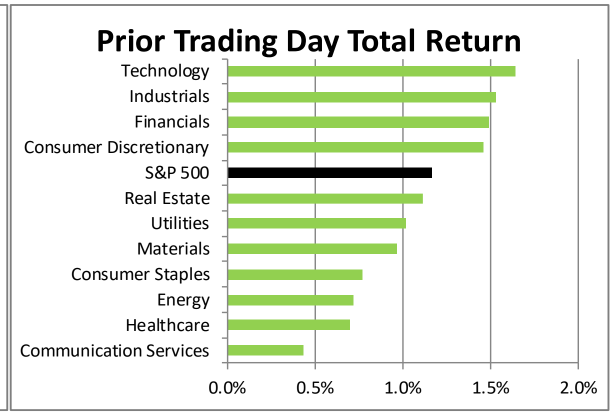
Tropical Storm Francine is lurking along the east coast of Mexico, where it is tracking northward and strengthening, likely to hurricane status, before making landfall in Louisiana on Thursday. This forecast has inspired evacuation orders along the western Gulf Coast, in response to forecasts for life-threatening storm surges and heavy rains.

Two additional disturbances are traversing the mid-Atlantic Ocean. The lead disturbance, now about halfway between Africa and America, has a 40% chance of developing into a cyclone over the next 48 hours, whilst the trailing disturbance, several hundred miles to the east, has a 30% chance of cyclonic development in the same period.

Data Section

US Equity Markets – (as of 9/9/2024 close)

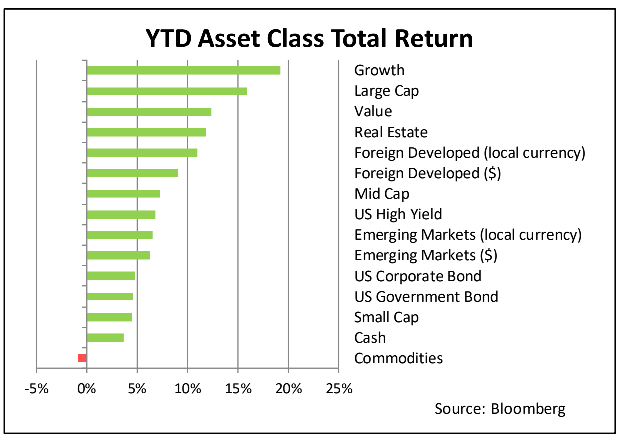




(Source: Bloomberg)

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 9/9/2024 close)

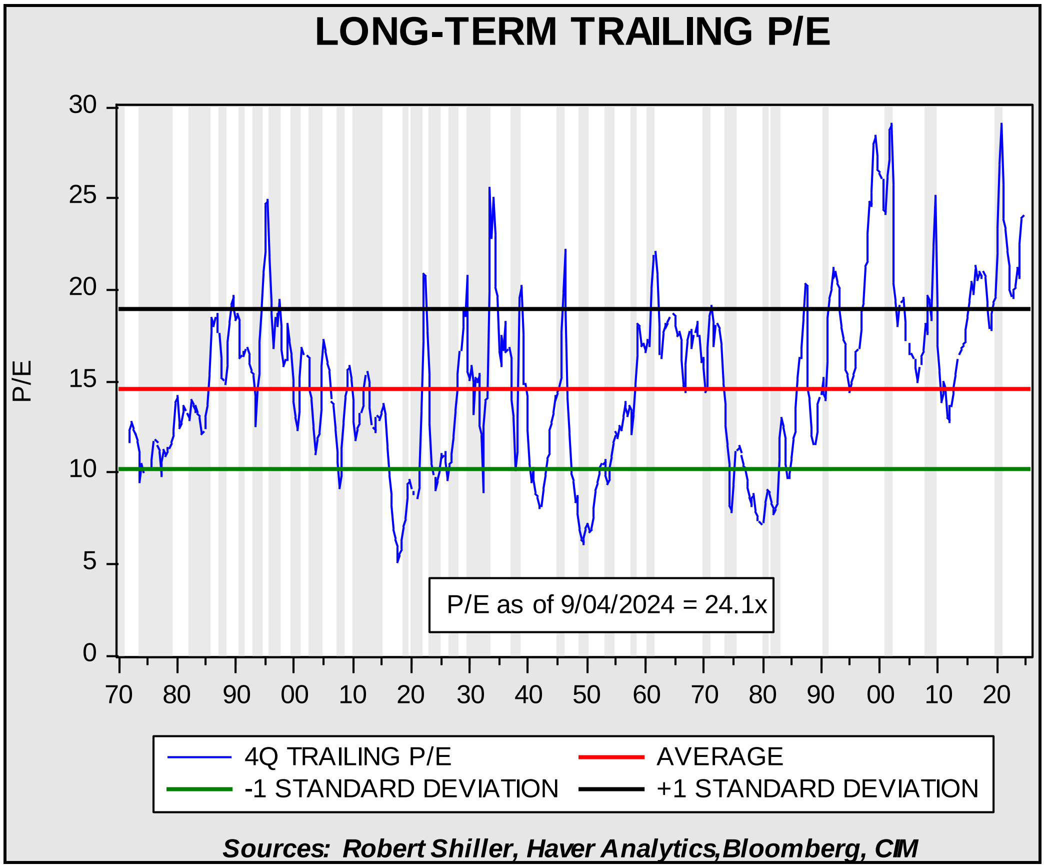


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

September 5, 2024



Based on our methodology,[1] the current P/E is 24.1x, rising 0.4 from our last report. The increase in the multiple was due to an increase in the stock price index and a decline 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.

[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.