

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 12, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is up 1.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 2.4%. Chinese markets were lower, with the Shanghai Composite down 0.2% from its previous close and the Shenzhen Composite down 0.5%. 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.

Good morning! Markets are digesting the latest inflation data and closely watching for clues on the Federal Reserve's upcoming rate decisions. In the sports world, WNBA star A’ja Wilson has etched her name in the history books by breaking the single-season scoring record and solidifying her bid for another MVP award. In today's *Comment*, we will delve into the continued investor optimism surrounding AI technology, analyze the mixed implications of the CPI report on inflation, and explore the potential impact of Mexican judicial reforms on trade. As always, we'll conclude with a review of the latest domestic and international economic indicators.

AI Hype is Back? OpenAI’s latest funding round has boosted investor confidence that AI is here to stay.

- The [Microsoft-backed AI startup is in negotiations to secure \\$6.5 billion in new funding](#) from investors. This significant investment could nearly double the company's valuation from \$86 billion to \$150 billion. Such a valuation would further solidify the company's position as one of the most promising startups globally. The AI company claims that the fresh capital will be used to expand its computing power and cover operational costs.

However, there is speculation that this financing round could signal the company's ambition to go public.

- OpenAI's recent initiative underscores the surging demand for generative AI technology, a trend echoed by the escalating investments of the “Magnificent 7.” Notably, [Amazon](#), [Microsoft](#), [Google](#), and [Meta](#) have all recently announced plans to significantly bolster their AI spending. While these moves have been met with a degree of skepticism from investors who would prefer a more diversified approach, they highlight the intensifying competition among these tech giants as they vie for dominance in the burgeoning AI market.

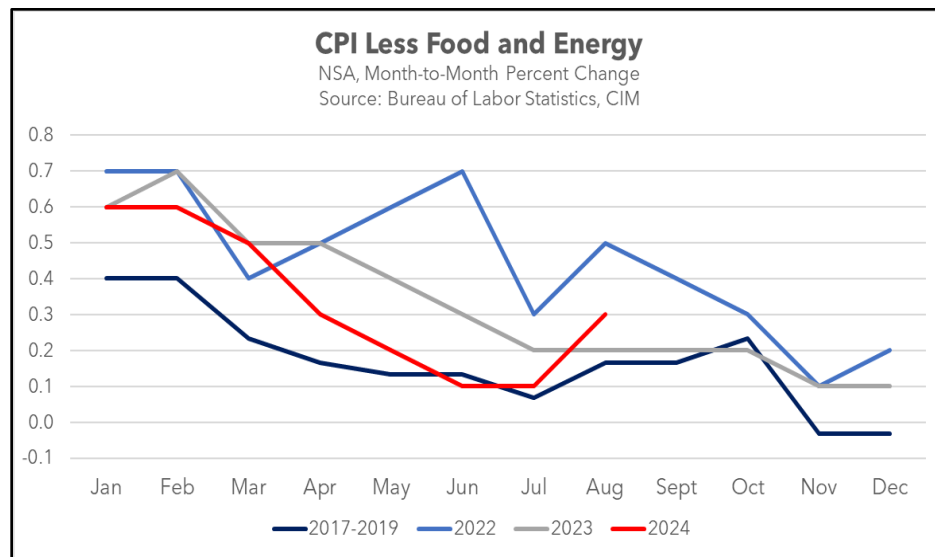


- As Big Tech companies continue to scale their AI operations, they will require access to advanced, energy-efficient chips. This surging demand has already pushed chip [manufacturers like Nvidia to their limits](#), with the company struggling to keep up with the overwhelming demand for its latest-generation Blackwell chip. [Utility companies have also faced mounting pressure](#) to supply the substantial energy needs of these firms that are expanding their data centers. While some investors may have cooled on the Magnificent 7, it's clear that these companies still command significant investor interest.

Shelter Still a Problem: While consumer inflation dipped in August, persistent underlying price pressures suggest that the fight against inflation is far from over.

- The [overall consumer price index \(CPI\) increased a modest 0.2% last month](#), while core CPI, excluding food and energy, rose 0.3%. While this data suggests a general alignment with the central bank's inflation mandate, significant hurdles remain in achieving its ultimate goal. Commodities continue to provide a bright spot, with *food at home* and *energy* prices contracting last month. However, price pressures in services remain a major concern, particularly shelter costs, which accelerated at more than twice the pace of the overall index.

- The disproportionate impact of shelter inflation on the broader price index reflects a lingering effect of the pandemic. The government's cautious stance on ending eviction moratoriums, coupled with uneven state-level policies, has slowed the pass-through effects of home and rent prices on the CPI. As a result, overall and core CPI have risen by 2.5% and 3.2%, respectively, compared to the previous year. In contrast, overall and core CPI excluding shelter costs reveals much smaller increases of 1.1% and 1.6%, highlighting the significant role of shelter inflation in driving up these measures.



- As a result, the Federal Reserve may be more inclined to downplay the recent sharp increase in core inflation to avoid the further cooling of the labor market. This could indicate a greater willingness to lower interest rates than previously expected, potentially revisiting the March projection of a 50-75 basis point reduction by year-end. However, due to the recent rise in month-over-month inflation figures, the Fed is likely to adopt a more cautious approach. Consequently, we anticipate that the initial interest rate cut will be a modest 25 basis points.

Mexico Judicial Reforms: Mexican President Andrés Manuel López Obrador (AMLO) has made significant progress toward consolidating his ruling party's control over the judiciary before the end of his term.

- On Wednesday, [the Mexican Senate passed a significant judicial reform](#) that would require judges at all levels, including the Supreme Court, to be elected by the public rather than appointed. This follows the lower house's approval of the legislation last week. The reform now awaits ratification by state legislatures, which are largely controlled by AMLO's Morena party. Once the legislation becomes law, it is likely to lead to a confrontation between Mexico and its USMCA trade partners as they seek to ensure fair arbitration mechanisms.
- Since taking office, AMLO has pursued a strategy of government control over the country's energy market, creating conditions that favor state-owned companies in

securing contracts over foreign competitors. This approach has strained Mexico's relationship with its two major trading partners, particularly the United States, as it is in violation of the USMCA agreement. Last year, a [federal court struck down an electricity law](#) backed by AMLO, citing anti-competitive practices. Earlier this year, the Supreme Court also [ruled against his initiative to grant favorable contracts to state companies](#).



- Incoming President Claudia Sheinbaum, who is set to assume office on October 1, has sent mixed signals to investors by affirming her commitment to judicial reforms while simultaneously pledging to protect private investors. This ambiguity has heightened investor concerns about her stance on nationalization, leading to a pause in further investments. If she continues to follow in the footsteps of her predecessor, Mexico's reputation as a reshoring hub could be tarnished. Additionally, it may lead to a trade war and jeopardize the future of USMCA, which is scheduled for a review in July 2026.

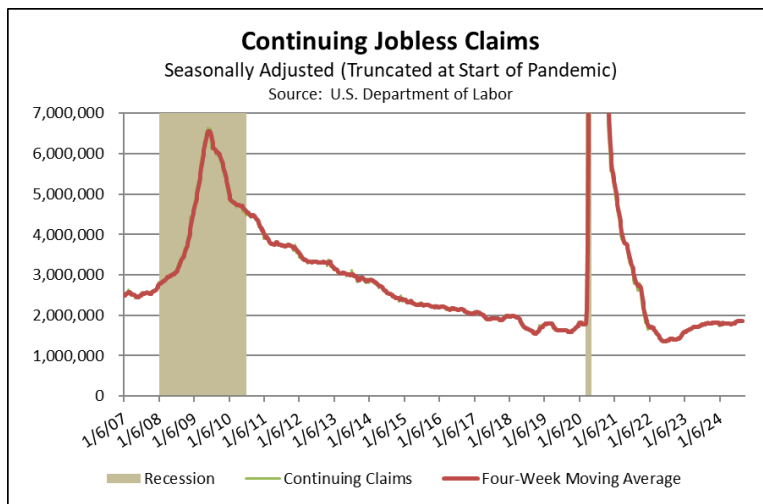
In Other News: Canada's defense minister [has thrown cold water on the idea of an Asian NATO](#), as the West looks to prevent an unnecessary escalation of tensions with China. The [European Central Bank cut rates by 25 bps](#) as it looks to prevent the economy from slowing down further. Spanish Prime Minister Pedro Sánchez has urged the [EU to seek a compromise on Chinese EV imports](#) rather than to follow through on planned tariffs. His reluctance is a reminder of how divided the EU is when it comes to China.

US Economic Releases

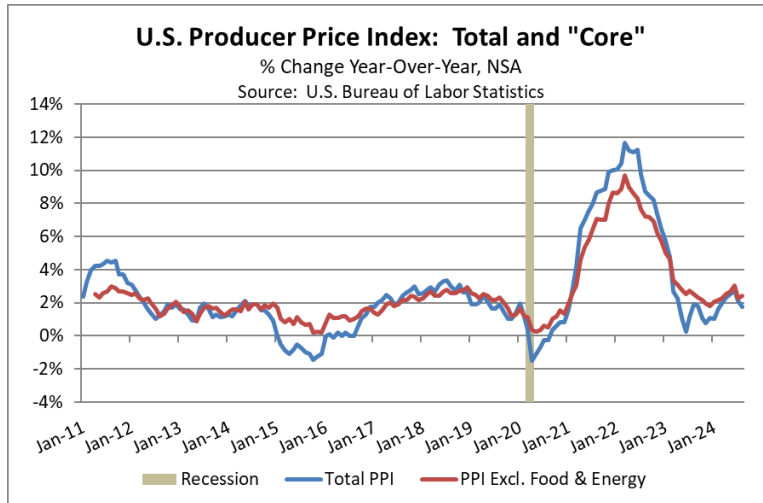
In the week ended September 7, *initial claims for unemployment benefits* rose slightly to a seasonally adjusted 230,000, a bit better than the expected level of 234,000 but up from a revised 228,000 in the prior week. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, rose to 230,750. 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 August 31, *continuing claims for unemployment benefits* (people continuing to draw benefits) rose to 1.850 million compared with a revised 1.845 million in the previous week. Taken together, the claims figures confirm the US labor market has cooled this year but has not fallen off a cliff.



Separately, the August *producer price index (PPI)* rose by a seasonally adjusted 0.2%, ahead of the expected increase of 0.1%, but the July increase was revised downward to show a flat reading. Excluding the volatile food and energy components, August *core PPI* was up 0.3%, beating the anticipated rise of 0.2%, but the July change was revised to show a decline of 0.2%. Compared with August 2023, overall PPI was up a modest 1.7% and core PPI was up 2.4%. The figures help confirm that US price pressures continue to cool.



The table below lists the economic releases and Fed events scheduled for the rest of the day.

Economic Releases						
ET	Indicator			Expected	Prior	Rating
14:00	Monthly Budget Statement	m/m	Aug	-\$292.5b	-\$243.7b	**
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	PPI	y/y	Aug	2.5%	3.0%	2.8%	***	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	6-Sep	-¥222.6b	¥1640.5b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	6-Sep	¥496.5b	¥384.7b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	6-Sep	¥452.7b	-¥1398.5b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	6-Sep	-¥902.3b	-¥824.4b		*	Equity and bond neutral
New Zealand	Food Prices	m/m	Aug	0.2%	0.4%		***	Equity and bond neutral
India	CPI	y/y	Aug	3.7%	3.5%	3.5%	***	Equity and bond neutral
	Industrial Production	y/y	Jul	4.8%	4.7%	4.6%	***	Equity and bond neutral
EUROPE								
Russia	Trade Balance	m/m	Jul	8.7b	11.6b		**	Equity and bond neutral
	Exports	m/m	Jul	33.7b	35.4b		*	Equity and bond neutral
	Imports	m/m	Jul	25.0b	23.8b		*	Equity and bond neutral
Russia	CPI	y/y	Aug	9.05%	9.13%	9.00%	***	Equity and bond neutral
	Core CPI	y/y	Aug	8.44%	8.60%	8.23%	**	Equity and bond neutral
AMERICAS								
Brazil	Retail Sales	y/y	Jul	4.4%	4.0%	4.4%	***	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)	521	519	2	Down
3-mo T-bill yield (bps)	486	488	-2	Down
U.S. Sibor/OIS spread (bps)	496	498	-2	Down
U.S. Libor/OIS spread (bps)	493	495	-2	Down
10-yr T-note (%)	3.67	3.65	0.02	Down
Euribor/OIS spread (bps)	347	346	1	Down
Currencies	Direction			
Dollar	Flat			Down
Euro	Up			Up
Yen	Down			Up
Pound	Flat			Up
Franc	Down			Up
Central Bank Action	Current	Prior	Expected	
ECB Main Refinancing Rate	3.650%	4.250%	3.650%	On Forecast
ECB Marginal Lending Facility	3.900%	4.500%	3.900%	On Forecast
ECB Deposit Facility Rate	3.500%	3.750%	3.500%	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	\$71.69	\$70.61	1.53%	
WTI	\$68.44	\$67.31	1.68%	
Natural Gas	\$2.28	\$2.27	0.40%	
12-mo strip crack	\$18.45	\$18.67	-1.20%	
Ethanol rack	\$1.89	\$1.90	-0.19%	
Metals				
Gold	\$2,519.83	\$2,511.76	0.32%	
Silver	\$28.79	\$28.68	0.39%	
Copper contract	\$421.45	\$414.20	1.75%	
Grains				
Corn contract	\$408.50	\$404.75	0.93%	
Wheat contract	\$588.00	\$579.25	1.51%	
Soybeans contract	\$1,007.25	\$1,000.50	0.67%	
Shipping				
Baltic Dry Freight	1,963	1,941	22	
DOE Inventory Report				
	Actual	Expected	Difference	
Crude (mb)	0.83	1.05	-0.22	
Gasoline (mb)	2.31	0.00	2.31	
Distillates (mb)	2.31	0.28	2.03	
Refinery run rates (%)	-0.5%	-0.8%	0.3%	
Natural gas (bcf)		48		

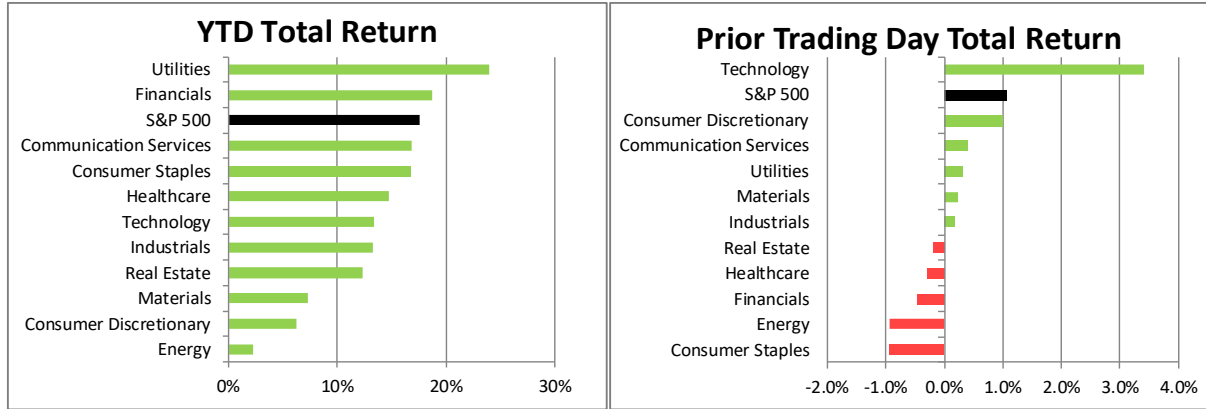
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures from the Rocky Mountains eastward, with cooler-than-normal temperatures in the Far West. The forecasts call for wetter-than-normal conditions in the Pacific Northwest, the northern Rockies, the northern Great Plains, and the Southeast, with dry conditions in the Southwest, the Texas coast, the Midwest, and New England.

After coming ashore yesterday, Hurricane Francine is now heading north through Alabama, bringing heavy rains and winds. Separately, Tropical Depression Seven has formed in the eastern Atlantic near the Azore Islands and is moving slowly to the northwest. There are also two atmospheric disturbances in the central Atlantic, but they are assessed to have only a modest chance of turning cyclonic in the next 48 hours.

Data Section

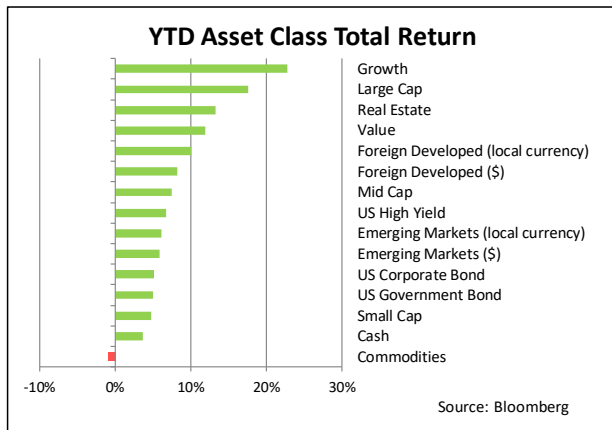
US Equity Markets – (as of 9/11/2024 close)



(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 9/11/2024 close)

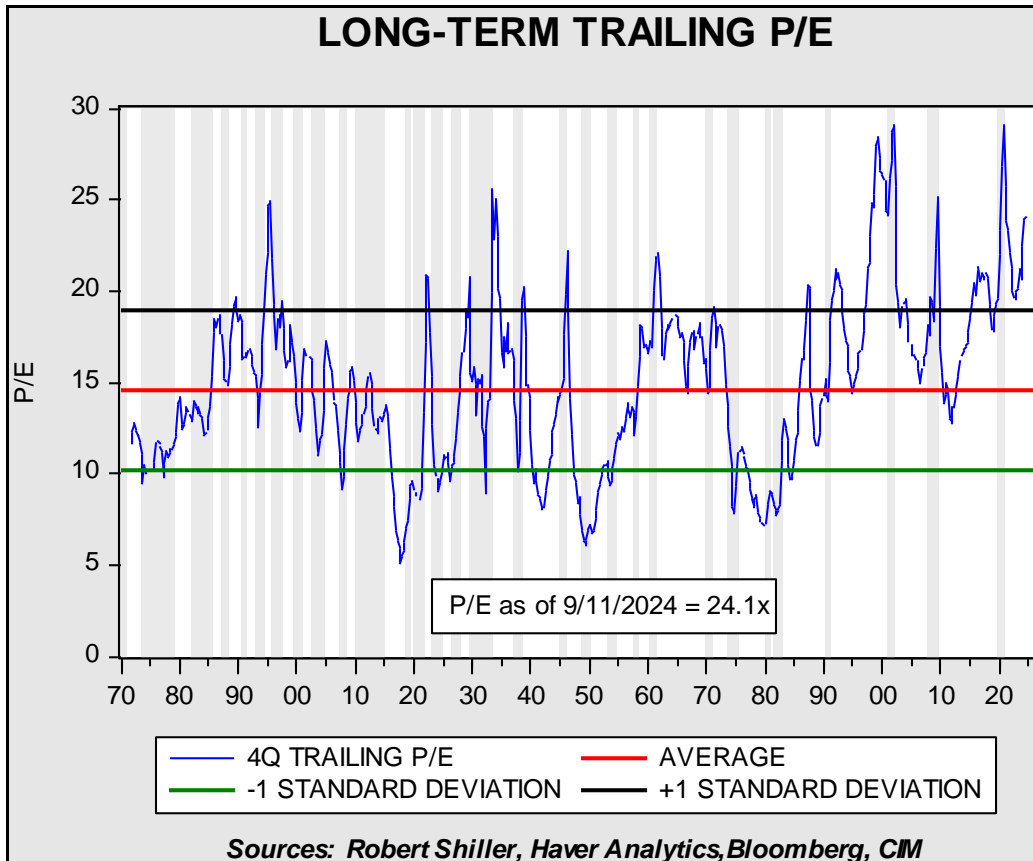


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 12, 2024



Based on our methodology,¹ the current P/E is 24.1x, unchanged from our last report. Both the stock price index and 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.