

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 13, 2024 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is up 0.2% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.3%. Chinese markets were lower, with the Shanghai Composite down 0.5% from its previous close and the Shenzhen Composite down 1.1%. 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.
- **[Confluence of Ideas podcast](#) (9/11/2024) “Reviewing the Asset Allocation Rebalance: Q3 2024”**

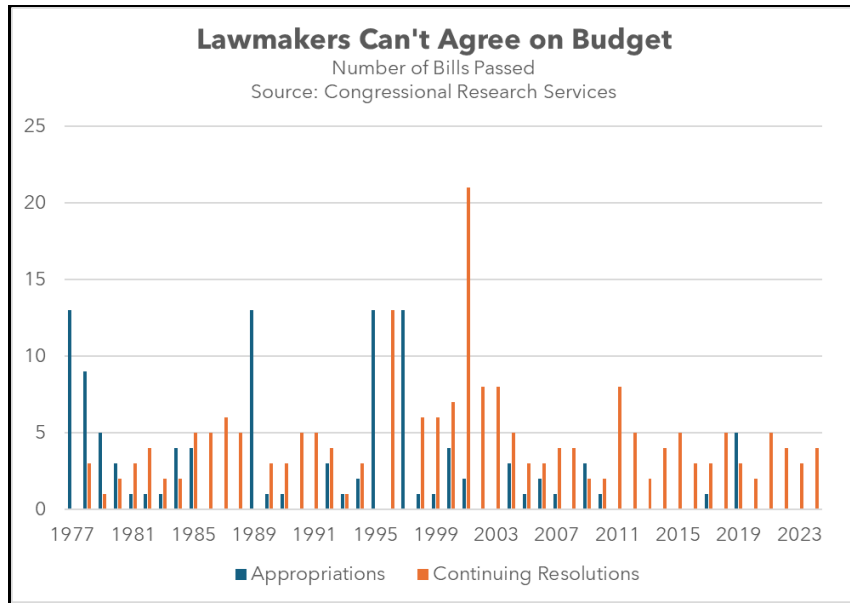
Good morning! Markets await more data to assess the economy’s health. In sports news, Dolphins quarterback Tua Tagovailoa suffered multiple concussions during the team’s loss to the Buffalo Bills. Today’s *Comment* delves into growing concerns about a government shutdown, explains why the Fed may not ease as aggressively as the market expects, and offers our perspective on the recent European Central Bank’s rate decision. As always, the report concludes with international and domestic data releases.

Shutdown Coming? With time running out, House officials are racing to prevent a government shutdown in October.

- House Minority Leader Hakeem Jeffries firmly [stated that Democrats will not support the Republican funding bill](#). Earlier this week, Republican leader [Mike Johnson had to withdraw a vote on the stopgap measure](#) due to strong opposition from both House Democrats and members of his own party. A major sticking point is the proposed

requirement for proof of citizenship to vote. Despite this, there is hope that a short-term funding agreement will keep the government open until mid-December.

- In the post-financial crisis era, political infighting has forced lawmakers to repeatedly extend government funding with temporary measures known as continuing resolutions. Only once since 2009 has more than one appropriation bill been passed before the October 1 deadline. These stopgaps prevent government shutdowns but also prolong the appropriation process and contribute to the ballooning budget deficit. The government has already relied on four continuing resolutions this year, [which have helped push the deficit to \\$1.9 trillion](#). This puts it on track to be the largest deficit outside the pandemic era.



- While budget disputes are common, there seems to be a heightened risk of a government shutdown during the election this year. The ongoing political infighting over the budget is likely to raise investor concerns about the US government's ability to address its fiscal challenges. The [two major rating agencies have already downgraded the US credit rating](#), citing concerns about partisan gridlock preventing an agreement to reduce the deficit. As a result, we anticipate that continued political bickering over the debt will likely impact long-term interest rates in the future.

Too Much, Too Soon: The market remains optimistic about a significant shift in monetary policy, even though the economy is still demonstrating signs of resilience.

- As of today, [market sentiment suggests a nearly 60% likelihood of the Fed implementing a rate cut of 125 basis points](#) or more before year's end. This expectation is fueled by concerns about a potential economic slowdown, which have been exacerbated by a series of weak labor market indicators. The rise in the unemployment rate in July, which triggered the Sahm Rule, along with this month's confirmation of slowing hiring trends, has heightened concerns. However, we remain optimistic that the market may be getting ahead of itself.

- Historically, the Fed “takes the stairs up” during rate-hike cycles and “takes the elevator down” during rate cuts, typically in response to recessions. However, there are currently no clear signs of an economic downturn. The recent uptick in the unemployment rate is largely due to new entrants into the labor force. Meanwhile, the Atlanta Fed's GDPNow forecast indicates a modest economic slowdown in the third quarter, [with growth projected at an annualized rate of 2.5%](#), down from 3.0% in the previous month.

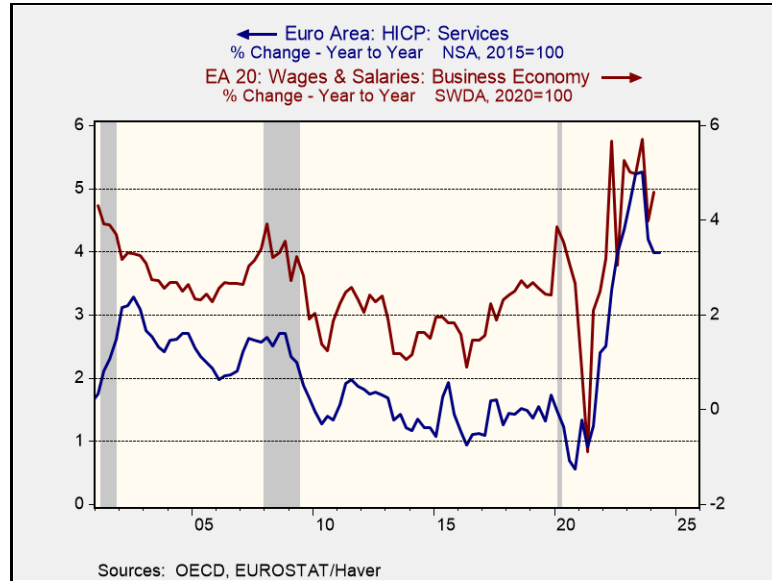


- The recent market reaction aligns with a pattern observed in the past two years, where investors often overestimate the likelihood of aggressive rate cuts in response to perceived economic weakness. This tendency has consistently been met with resistance from the Fed. Despite recent unfavorable data, the economy is expected to remain in expansion, suggesting that this pattern may continue in the coming months. While we anticipate a rate cut in September, we believe the Fed will adopt a more measured approach, with less reliance on jumbo cuts than the market currently expects.

ECB Rate Decision: The European Central Bank (ECB) has lowered benchmark interest rates for the second time in three months and has signaled more to come.

- The ECB on Thursday [lowered its deposit rate by 25 basis points to 3.50%](#), signaling a shift in focus from inflation control to economic support. ECB President Christine Lagarde emphasized during a press conference that interest rates are not predetermined but are on a downward trajectory. While the central bank has not ruled out a rate cut in October, there is speculation that it might do so at the December meeting, when the central bankers will have more data to paint a better picture of the economy.
- Closely monitoring regional wage trends will provide valuable insights into the trajectory of services inflation. Unlike the US, which has experienced a steady rise in unemployment, the EU has witnessed a historic decline. This tight labor market has contributed to persistent wage pressures that have defied the central bank's tightening efforts and the economic slowdown. This has translated to higher earnings, which

explains nearly 60% of its variation of services inflation. As a result, if these wage pressures persist, the ECB may be forced to halt its easing cycle prematurely.

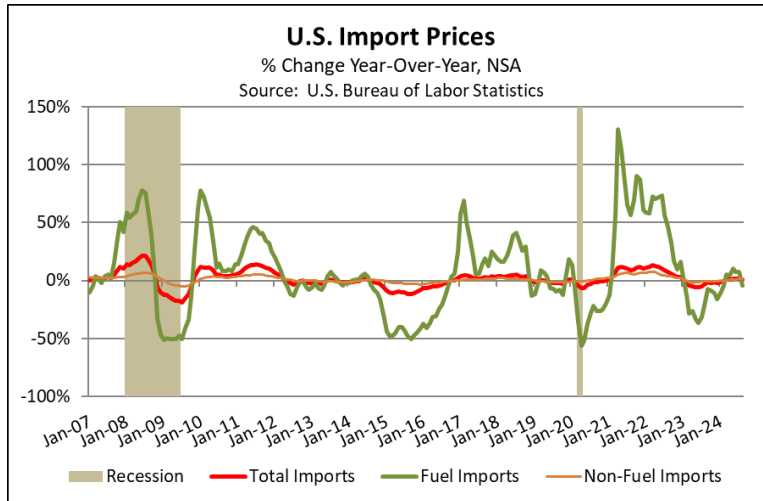


- Historically, the ECB has tended to be less aggressive than the US in raising rates during easing cycles but more cautious in lowering them. Given the persistent tightness of the labor market and its impact on wages, we anticipate that the ECB will likely adopt a more moderate approach to rate cuts to prevent a resurgence of inflation. This could help narrow the interest rate gap between the ECB and the US, potentially providing a boost to the euro. However, the currency could face downward pressure if inflation unexpectedly returns.

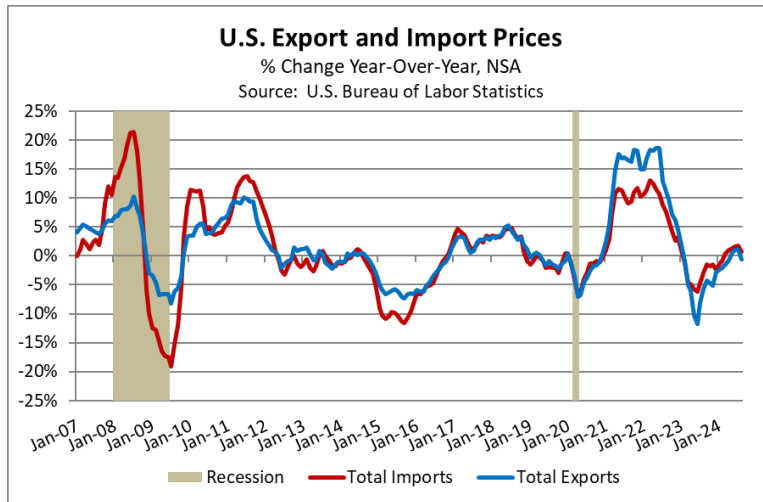
In Other News: OpenAI [released a new artificial intelligence model](#) that will help process complicated mathematical and coding problems. The development is a reminder of how AI capabilities are evolving. Former members of the [Trump administration are considering selling shares in Fannie Mae and Freddie Mac](#) in a move that could disrupt the housing market. Meanwhile, Russian President Vladimir Putin [has threatened retaliation against a NATO ally if Ukraine is allowed to use US weapons to attack military bases in Russia](#), raising concerns about escalating tensions.

US Economic Releases

August **import prices** were down 0.3% from the previous month, falling even more than the expected 0.2% and wiping out the 0.1% increases in each of the prior two months. Of course, import prices are often driven by volatility in the petroleum fuels category. Nevertheless, August **import prices excluding fuels** also fell, posting a decline of 0.1%. Overall import prices in August were up just 0.8% year-over-year, while import prices excluding fuels were up 1.3%. The chart below shows the year-over-year change in import prices since just before the Great Financial Crisis.



According to the report, *export prices* in August were down 0.7% from one year earlier, in large part because of the key agriculture category. Comparing the annual change in export prices versus import prices provides a sense of the US “terms of trade,” or the relative advantage or disadvantage the country is facing because of trends in international trade prices. The chart below compares the year-over-year change in US export and import prices since just before the GFC.



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

Economic Releases							
ET	Indicator			Expected	Prior	Rating	
10:00	U. of Michigan Consumer Sentiment	m/m	Sep P	68.5	67.9	***	
10:00	U. of Michigan Current Conditions	m/m	Sep P	61.6	61.3	**	
10:00	U. of Michigan Future Expectations	m/m	Sep P	72.2	72.1	**	
10:00	U. of Michigan 1-Year Inflation Expectation	m/m	Sep P	2.8%	2.8%	*	
10:00	U. of Michigan 5-10 Year Inflation Expectation	m/m	Sep P	3.0%	3.0%	*	
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								
Japan	Industrial Production	y/y	Jul F	2.9%	2.7%		***	Equity and bond neutral
	Capacity Utilization	y/y	Jul	2.5%	-3.1%		**	Equity and bond neutral
New Zealand	REINZ House Sales	y/y	Aug	-0.7%	14.5%		**	Equity and bond neutral
	BusinessNZ Manufacturing PMI	m/m	Aug	45.8	44.4		***	Equity and bond neutral
South Korea	Import Price Index	y/y	Aug	1.8%	9.9%		*	Equity and bond neutral
	Export Price Index	y/y	Aug	5.7%	13.0%		*	Equity and bond neutral
China	Money Supply M2	y/y	Aug	6.3%	6.3%	6.2%	***	Equity and bond neutral
	Money Supply M1	y/y	Aug	-7.3%	-6.6%	-6.8%	*	Equity and bond neutral
	Money Supply M0	y/y	Aug	12.2%	12.0%		*	Equity and bond neutral
	New Yuan Loans CNY	m/m	Aug	14430.0b	13523.2b		**	Equity and bond neutral
	Aggregate Financing CNY	y/y	Aug	21900.0b	18870.2b		**	Equity and bond neutral
EUROPE								
Eurozone	Industrial Production WDA	y/y	Jul	-2.2%	-4.1%	-2.3%	**	Equity and bond neutral
France	CPI, EU Harmonized	y/y	Aug F	2.2%	2.2%	2.2%	**	Equity and bond neutral
	CPI	y/y	Aug F	1.8%	1.9%	1.9%	***	Equity and bond neutral
	CPI Ex-Tobacco Index	q/q	Aug	120.0%	119.4%	120.1%	*	Equity and bond neutral
Russia	Gold and Forex Reserves	m/m	6-Sep	\$616.0b	\$613.5b		***	Equity and bond neutral
	Money Supply, Narrow Definition	w/w	6-Sep	18.33t	18.30t		*	Equity and bond neutral
AMERICAS								
Canada	Building Permits	m/m	Jul	22.1%	13.0%	6.60	**	Equity and bond neutral
Brazil	Economic Activity Index	y/y	Jul	5.30%	3.18%	4.80%	**	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)	519	521	-2	Down
3-mo T-bill yield (bps)	479	484	-5	Down
U.S. Sibor/OIS spread (bps)	488	491	-3	Down
U.S. Libor/OIS spread (bps)	484	488	-4	Down
10-yr T-note (%)	3.65	3.67	-0.02	Down
Euribor/OIS spread (bps)	348	347	1	Down
Currencies	Direction			
Dollar	Down			Down
Euro	Flat			Up
Yen	Up			Up
Pound	Flat			Up
Franc	Up			Up
Central Bank Action	Current	Prior	Expected	
Bank of Russia Key Rate	18.000%	19.000%	18.000%	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	\$72.65	\$71.97	0.94%	
WTI	\$69.75	\$68.97	1.13%	
Natural Gas	\$2.36	\$2.36	0.21%	
12-mo strip crack	\$18.45	\$18.64	-1.01%	
Ethanol rack	\$1.89	\$1.89	-0.08%	
Metals				
Gold	\$2,565.06	\$2,557.90	0.28%	
Silver	\$29.97	\$29.88	0.29%	
Copper contract	\$419.55	\$419.55	0.00%	
Grains				
Corn contract	\$409.75	\$406.00	0.92%	
Wheat contract	\$589.50	\$578.50	1.90%	
Soybeans contract	\$1,014.50	\$1,010.75	0.37%	
Shipping				
Baltic Dry Freight	1,927	1,963	-36	
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)	40	48	-8	

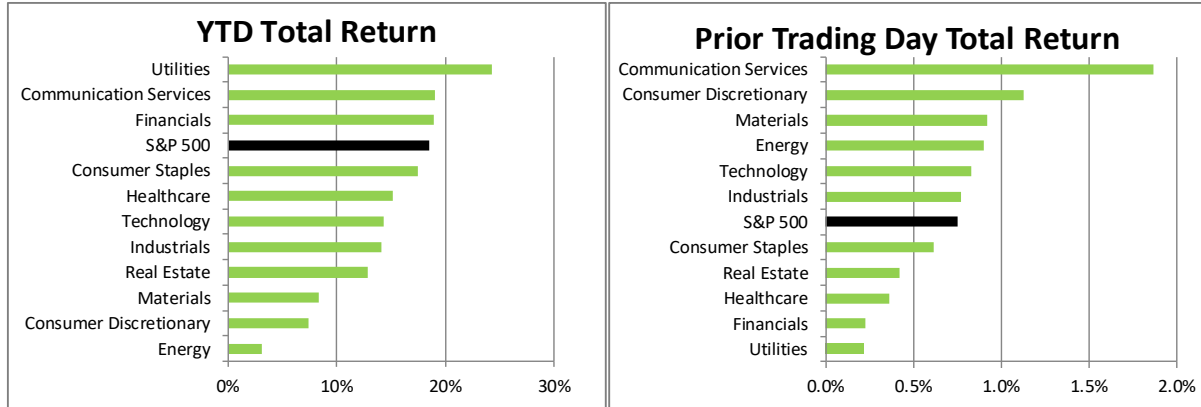
Weather

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 Upper Midwest, and New England.

Tropical Depression Seven is now in the central Atlantic Ocean and moving westward toward the Caribbean. There is also an atmospheric disturbance over the Leeward Islands, but it is assessed to have only a 20% chance of turning cyclonic in the next 48 hours.

Data Section

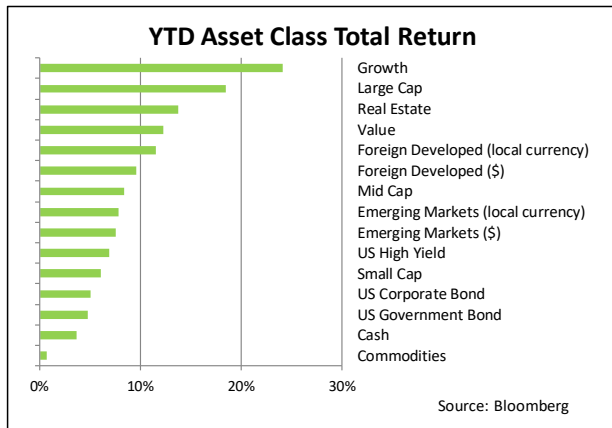
US Equity Markets – (as of 9/12/2024 close)



(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 9/12/2024 close)

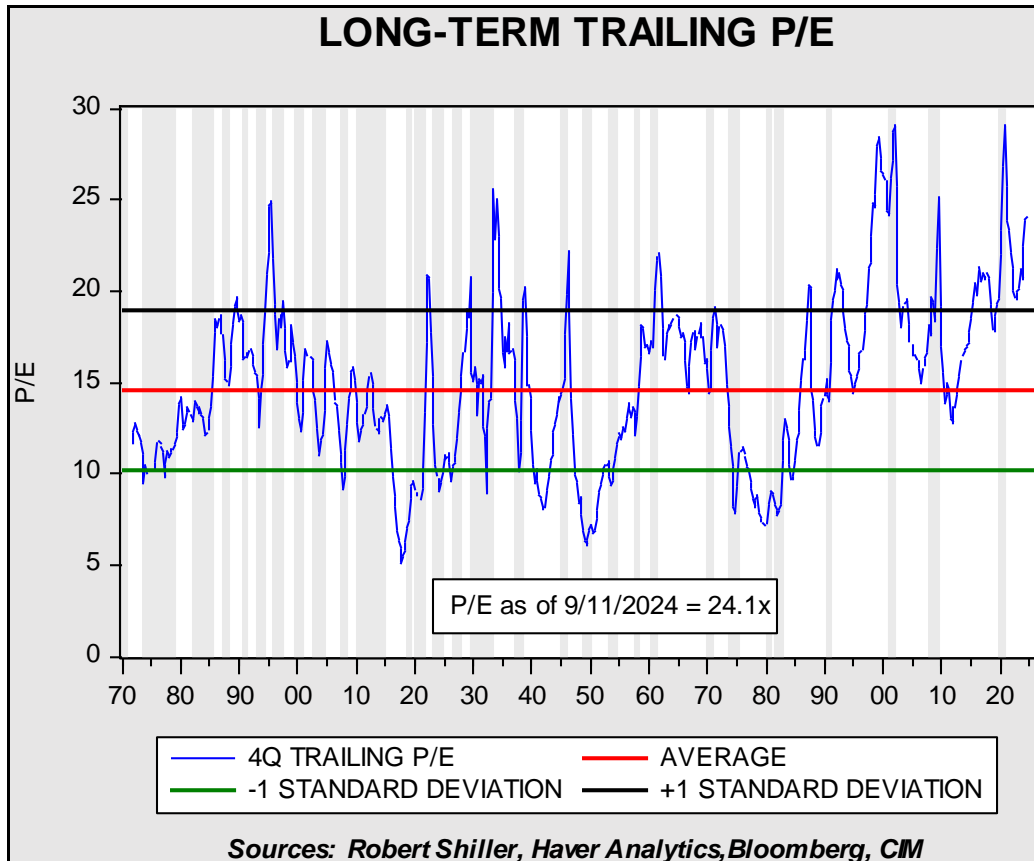


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 (Q4). 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.