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 17, 2024 — 9:30 AM ET] Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 is up 0.8% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.6%. Chinese markets are closed in observance of the Mid-Autumn Festival. 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:

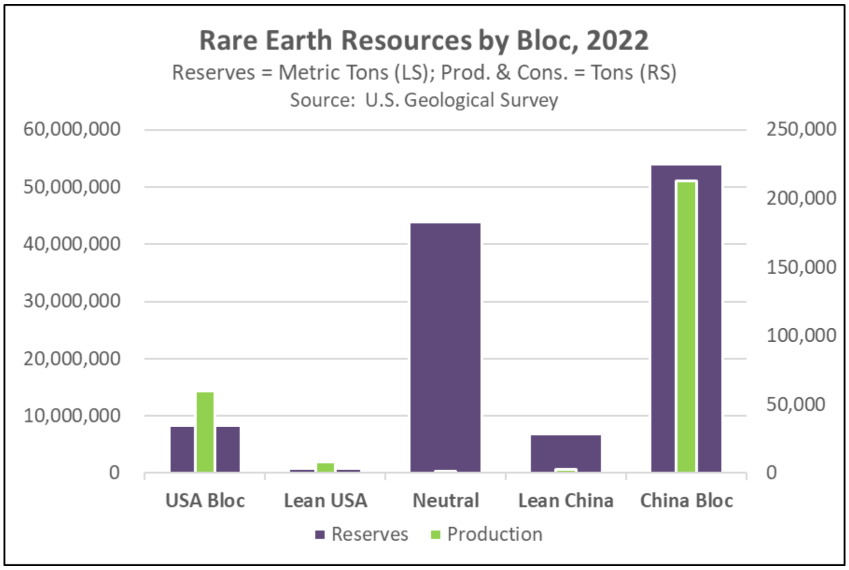
- *Bi-Weekly Geopolitical Report* (9/9/2024) (with associated podcast): "Prospects for the Dollar in a Fracturing World"
- *Asset Allocation Bi-Weekly* (9/16/2024) (with associated podcast): "The Benjamin Button Dividend"
- *Asset Allocation Quarterly – Q3 2024* (7/16/2024): Discussion of our asset allocation 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"

Our *Comment* today opens with news that China has purportedly found a big, new deposit of rare earth minerals, possibly further cementing its lock on this key resource as the world electrifies. We next review several other international and US developments with the potential to affect the financial markets today, including a proposed European Commission cabinet that could lead the European Union toward adopting French-style economic policy and a few words on the fallout from the second assassination attempt against former US President Trump.

China: A Chinese mining firm told an international conference last week that it has discovered a 5-million-ton deposit of rare earth minerals in the southwestern Sichuan province. If confirmed, the find would increase China's recognized reserves of rare earths by approximately 5%.

- Rare earths are a critical class of minerals for the electrified economy of the future, and China and its geopolitical bloc already account for the bulk of the world's reserves, production, and refining.

- The new reserves would further boost China’s control over the key minerals, increasing the risk that Beijing could weaponize the minerals. Indeed, Beijing has already started to clamp down on exports of the minerals to the US and its allies.



United States-Japan-China: Washington and Tokyo are reportedly close to a deal that would cut exports of advanced semiconductor manufacturing equipment from Japan to China. Washington has also pressured The Hague to cut China’s access to Dutch exports of such equipment. The US demands aim to limit China’s economic and military development, but reports say Japan is especially worried that China could retaliate for such a deal by cutting off exports of key minerals, as discussed above.

Japan: The yen (JPY) yesterday appreciated to 139.56 per dollar ($0.0717), marking a 13.5% rise in just the last two months and leaving it at its highest level in more than a year. The appreciation largely expects rising expectations for an aggressive 0.50% interest-rate cut by the Federal Reserve on Wednesday.

European Union: European Commission President von der Leyen today revealed her nominees for the commissioners who will fill out her cabinet. In the EU system, each member country gets to appoint a commissioner, and the commission president gets to decide what portfolio each will get, subject to approval by the European Parliament. In her nominating statement, von der Leyen vowed her commission would focus on economic competitiveness and defense, while de-emphasizing the climate policies that were prevalent in her first term.

- France’s nominee, Stéphane Séjourné, who is a close ally of President Macron, will lead EU industrial strategy, with a charge to focus on investment and innovation. Under the last-minute deal between Macron and von der Leyen that we noted yesterday, Macron will now have increased influence over EU economic policy, while von der Leyen will be rid of former French Commissioner Thierry Breton, a bitter political rival.

- Spain's Teresa Ribera, the commission's most senior Socialist, will be in charge of EU competition policy, with a charge to modernize it and develop a new state-aid policy.
- Slovakia's Maroš Šefčovič will head up the EU's foreign trade policy.
- Lithuania's Andrius Kubilius will have a newly created post for EU defense policy.

United Kingdom-European Union: New modeling by an Aston University economist shows that British trade with the EU has plummeted after Brexit and the UK-EU Trade and Cooperation Agreement that came into force in 2021. According to the study, UK exports to the EU are now 17% lower than they would have been without Brexit, while imports from the EU are 23% lower. Prime Minister Starmer has ruled out rejoining the single market or forming a customs union with the EU, but the report will likely put new pressure on him to improve UK-EU trade.

United Kingdom: As British businesses increasingly worry that the government will impose new taxes to close its big fiscal deficit, Prime Minister Starmer yesterday insisted next month's budget will include no provisions that would hurt economic growth. However, since Starmer has now ruled out increases in income tax, value added tax, corporation tax, and employee national insurance, it appears that he may be setting the stage for increased taxes on capital gains or assets held by the wealthy.

US Politics: As we continue to monitor the aftermath of the second assassination attempt against former President Trump on Sunday, we are struck by two issues.

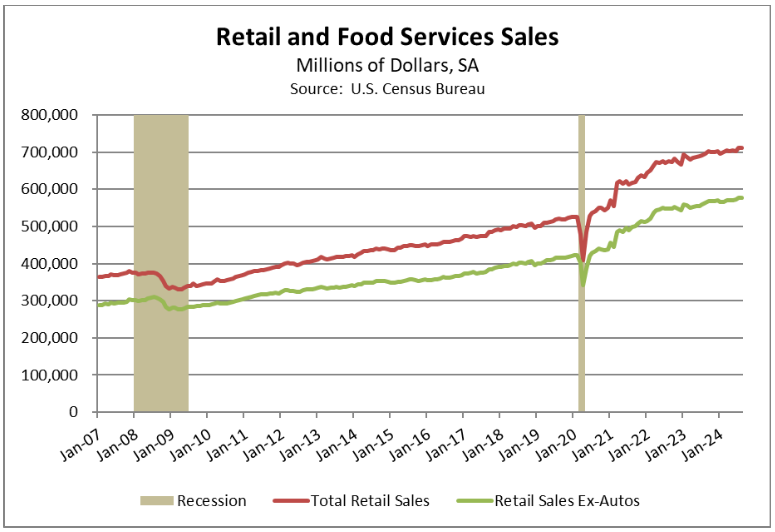
- First, there was very little market reaction to the incident either Sunday or Monday. Volatility measures remained relatively low. In a sense, that is disturbing, since it suggests the markets and perhaps the broader society is becoming desensitized to political violence. Of course, a successful assassination attempt could well have a bigger impact.
- Second, the reports we've seen so far suggest the would-be assassin traversed a wide range of political positions and grievances over time, similar to the first attempted assassin. Whether or not that is ultimately confirmed, there will be plenty of fodder for accusations on either side of the political divide, which could exacerbate political tensions as the November election approaches. In other words, the relative calm in the markets yesterday could still give way to market volatility in the coming weeks.

US Monetary Policy: The Fed begins its latest policy meeting today, with its decision due tomorrow at 2:00 PM ET. The policymakers are widely expected to cut the benchmark fed funds interest rate at least 0.25% from its current range of 5.25% to 5.50%. Of course, some investors are still looking for a cut of 0.50%, but we think it's more likely that lingering concerns about price inflation will keep the policymakers from being that aggressive.

US Labor Market: Amazon yesterday told its full-time office workers that they must be on site five days a week beginning in January. The move is one of the most aggressive back-to-office directives among US companies. If successful, the directive could prompt a more general return to the office, which would benefit both office building owners and related service businesses surrounding major office buildings.

US Economic Releases

August ***retail sales*** rose by a seasonally adjusted 0.1%. While this marks a considerable deceleration from July's 1.1% gain, it exceeds the expected value of a 0.2% decline. Of course, overall retail sales are often driven by the volatile auto and auto parts sector, which makes up almost one-fifth of the total. August ***retail sales excluding autos and auto parts*** also rose 0.1%. Again, this marks a deceleration from July's 0.4% gain, but it also falls short of the expected August gain of 0.2%. Overall retail sales in August rose 2.5%, and excluding autos rose 2.7% from the same month one year earlier. Taken together, these results may lend further support to a decision by the Fed to lower rates tomorrow. The chart below shows how retail sales have changed since just before the global financial crisis.



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	Business Inventories	m/m	Jul	0.3	0.3	*
10:00	NAHB Housing Market Index	m/m	Sep	41.0	39.0	*
Federal Reserve						
ET	**Speaker or Event**	**District or Position**				
10:00	Lorie Logan Gives Welcome Remarks	President of the Federal Reserve Bank of Dallas				

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	Tertiary Industry Index	m/m	Jul	1.4%	-1.2%	0.9%	***	Equity and bond neutral
India	Wholesale Prices	m/m	Aug	1.3	-$23497m	-$22759m	*	Equity and bond neutral
India	Imports	y/y	Aug	3.3%	7.5%		**	Equity and bond neutral
	Trade Balance	m/m	Aug	-$29650m	-$23497m	-$22800m	**	Equity and bond neutral
	Exports	y/y	Aug	-9.3%	-1.5%		**	Equity and bond neutral
EUROPE								
Eurozone	ZEW Survey Expectations	m/m	Sep	9.3	17.9		**	Equity and bond neutral
Germany	ZEW Survey Expectations	m/m	Sep	3.6	19.2	17.0	**	Equity and bond neutral
	ZEW Survey Current Situation	m/m	Sep	-84.5	-77.3	-80.0	**	Equity bearish, bond bullish
AMERICAS								
Canada	Manufacturing Sales	m/m	Jul	1.4%	-1.7%	1.1%	**	Equity and bond neutral
Brazil	FGV Inflation IGP-10	m/m	Sep	0.18%	0.72%	0.10%	**	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)	472	471	1	Down
U.S. Sibor/OIS spread (bps)	481	482	-1	Down
U.S. Libor/OIS spread (bps)	478	478	0	Down
10-yr T-note (%)	3.63	3.62	0.01	Down
Euribor/OIS spread (bps)	349	347	2	Down
Currencies	**Direction**			
Dollar	Flat			Down
Euro	Down			Up
Yen	Down			Up
Pound	Down			Up
Franc	Down			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	$72.80	$72.75	0.07%	
WTI	$70.31	$70.09	0.31%	
Natural Gas	$2.43	$2.37	2.23%	
12-mo strip crack	$18.23	$18.32	-0.49%	
Ethanol rack	$1.85	$1.86	-0.41%	
Metals				
Gold	$2,576.40	$2,582.45	-0.23%	
Silver	$30.71	$30.73	-0.07%	
Copper contract	$426.95	$427.35	-0.09%	
Grains				
Corn contract	$411.25	$410.75	0.12%	
Wheat contract	$581.25	$578.50	0.48%	
Soybeans contract	$1,008.25	$1,004.50	0.37%	
Shipping				
Baltic Dry Freight	1,896	1,890	6	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		1.00		
Gasoline (mb)		1.00		
Distillates (mb)		0.50		
Refinery run rates (%)		-1.1%		
Natural gas (bcf)		48		

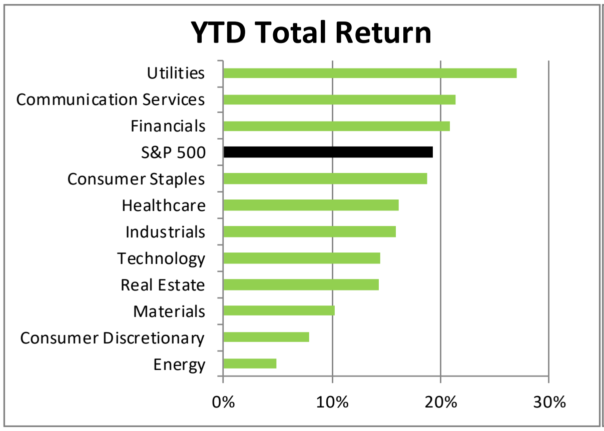
Weather

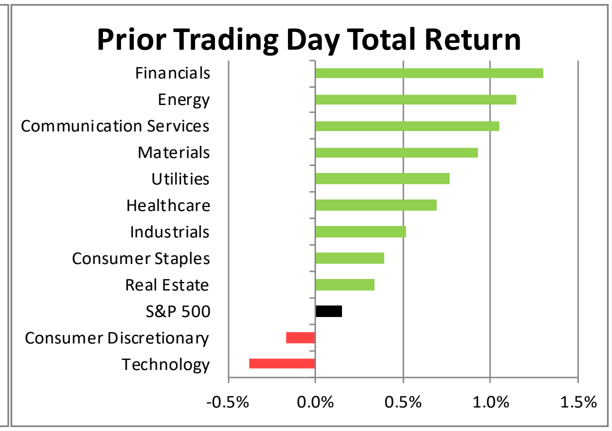
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures for the West Coast, the country's midsection, New England, and Florida, with colder-than-normal temperatures expected in Idaho and the surrounding environs. The precipitation outlook calls for wetter-than-normal conditions in the northern Great Plains and Southeast, with dry conditions in the Desert Southwest and New England.

Tropical Depression Gordon is slowly circling in the mid-Atlantic, where it is projected to drift northward in the open ocean and mildly strengthen into a tropical storm.

Data Section

US Equity Markets – (as of 9/16/2024 close)

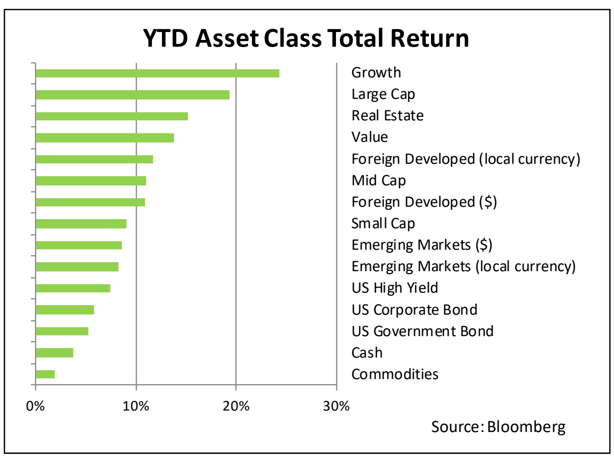




(Source: Bloomberg)

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 9/16/2024 close)

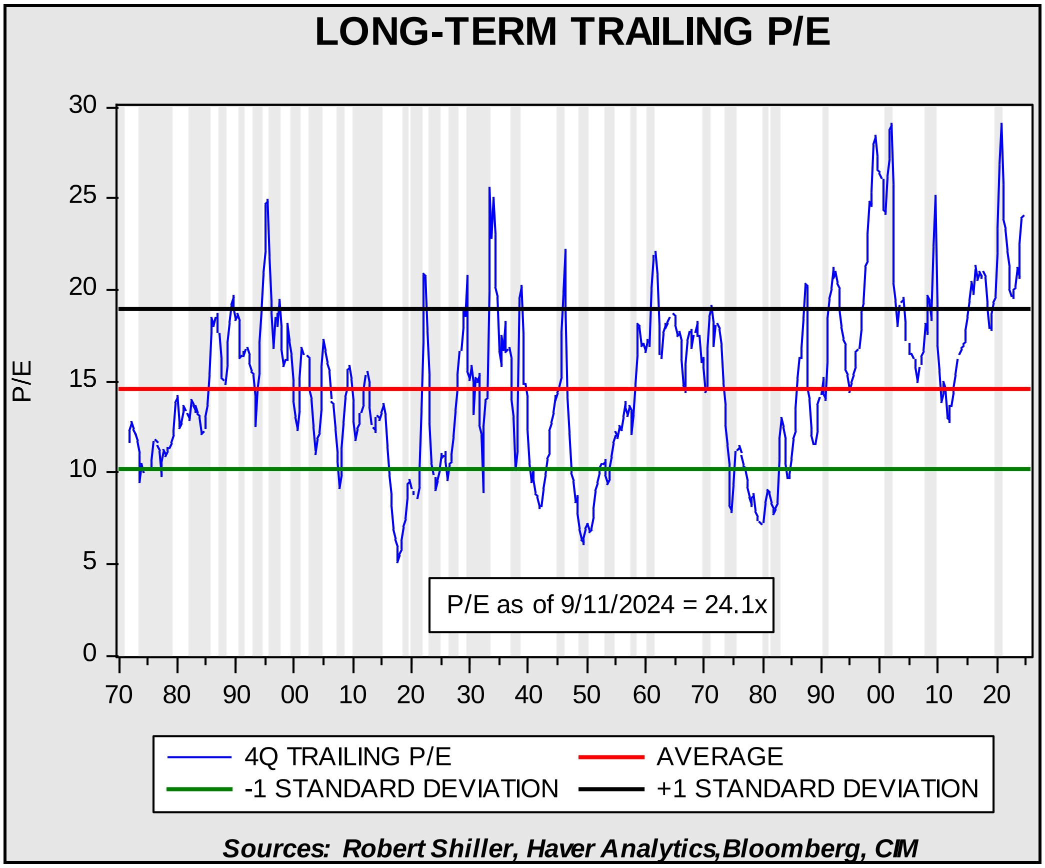


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.

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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.