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 25, 2024 — 9:30 AM ET] Global equity markets are mixed 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 were higher, with the Shanghai Composite up 1.2% from its previous close and the Shenzhen Composite also up 1.2%. US equity index futures are signaling a lower 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:

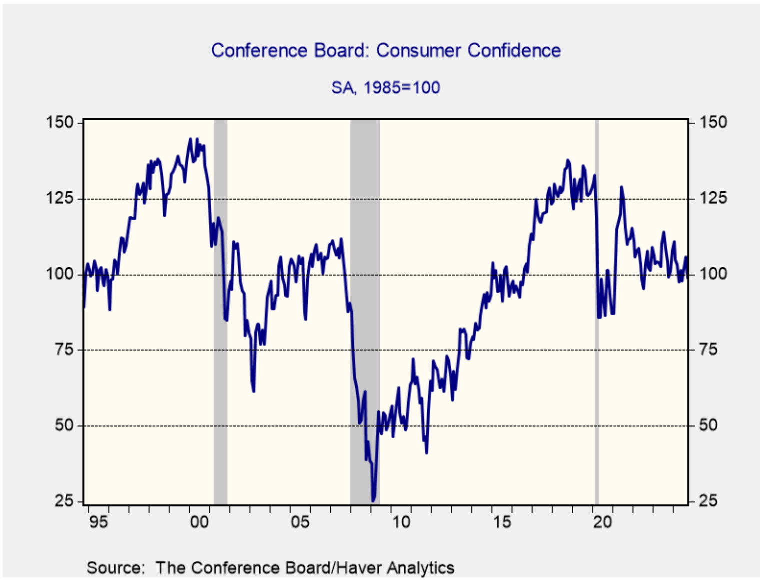
- *Bi-Weekly Geopolitical Report* (9/23/2024) (with associated podcast): "Eight Megatrends Every Investor Should Know"
- *Asset Allocation Bi-Weekly* (9/16/2024) (with associated podcast): "The Benjamin Button Dividend"
- *Asset Allocation Quarterly – Q3 2024* (7/16/2024): Discussion of our asset allocation 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"
- *Fixed Income Quarterly* (September 2024)

Good morning! Global markets are closely monitoring the impact of China's recent stimulus measures. In sports news, the New York Liberty have taken a commanding lead over the Atlanta Dream in the first round of the WNBA playoffs. Today's *Comment* will delve into why the Federal Reserve's rate cut has failed to inspire market confidence in a soft economic landing, how India's actions have been driving up silver prices, and the potential consequences of the Argentine president's declining popularity due to his economic reforms. As usual, this report will conclude with a review of domestic and international data releases.

Market Not Convinced: Despite the Fed's rate cut that was aimed at fostering a soft landing, concerns persist about the ongoing need to tame inflation.

- The Federal Reserve's unexpected 50 basis point interest rate cut last week continues to move markets, as investors are uncertain about the path of future policy. There was a bear steepening of the yield curve following the cut, with long-term interest rates rising rather than falling. This unexpected move fueled concerns that the Fed may be declaring victory prematurely. These fears were echoed by Federal Reserve Governor Michelle Bowman, who dissented from the rate cut, [advocating for a more measured approach to monetary policy].

- Despite the Fed's efforts to stimulate a soft landing, the labor market remains a growing concern. The September Consumer Confidence Index plummeted to 98.7 from 124.3, marking its sharpest decline in three years. This downturn was primarily driven by rising anxieties about the job market, with fewer respondents perceiving it as plentiful and more reporting difficulty in finding employment. While these labor market indicators have deteriorated, consumer optimism about the overall business cycle persists, largely due to the expectation of lower interest rates.

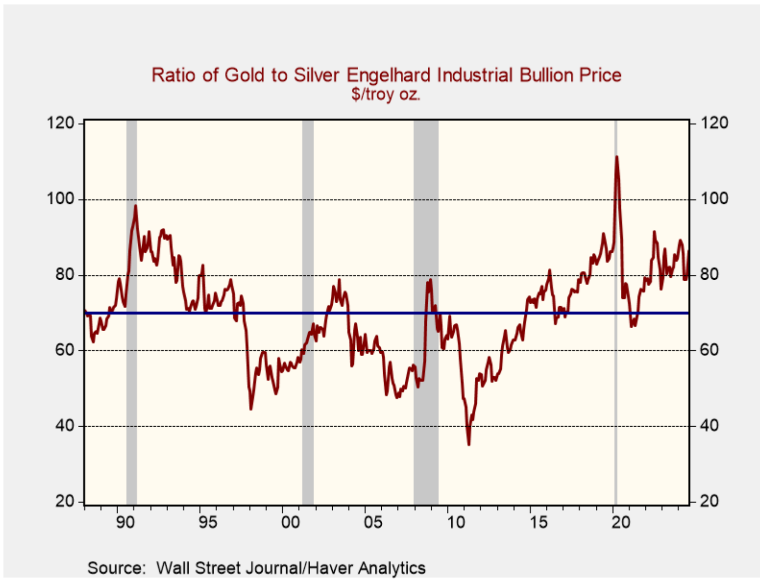


- The lack of downward movement in long-term interest rates could have a negative impact on the economy but may also provide the Federal Reserve with room for further monetary easing. As Dallas Fed President Lorie Logan suggested last October, higher term premiums could be used as a justification for less restrictive monetary policy. If inflation continues to decline and the labor market shows signs of cooling, this strategy may become more likely. While we don't anticipate another large rate cut, it's not entirely out of the question if economic data continues to follow current trends.

Silver on the Rise: While China has been a major buyer of gold, India has been steadily accumulating silver.

- India's silver imports are skyrocketing, driven by a combination of cultural tradition and industrial growth. The recent reduction in trade duties has further fueled India's longstanding demand for silver, particularly during the lead-up to Diwali. Additionally, the drop in duties has amplified the country's expanding solar panel and electronics industries as India looks to compete as a manufacturing power. Despite China's dominance in solar cell manufacturing, India's share of US imports has surged from less than 1% six years ago to nearly 11% in the second quarter of 2024.

- The escalating demand for silver, driven by countries' intensified efforts to expand solar cell production, is an important factor behind the widening silver deficit. The Silver Institute projects a 17% increase in this deficit, fueled by a 2% rise in demand and a 1% decline in supply. Silver's indispensable role in solar cell manufacturing, due to its superior electrical conductivity, thermal efficiency, and optical reflectivity, has contributed significantly to its outperformance of both the S&P 500 and gold so far this year.



- Despite potential upward pressure on both gold and silver prices due to heightened global power competition, silver may have a slight edge. The gold-to-silver price ratio currently exceeds its historical average of 70, suggesting a possible correction in the coming months. Furthermore, silver's industrial applications, particularly in green energy initiatives, provide a strong foundation for its price support. As a result, we do not expect silver to fall below the psychological barrier of $30 an ounce any time soon, especially as investors look to real assets due to rising geopolitical tensions.

Milei Losing His Hold: The Argentine president has seen his popularity fall as his economic policies have started to take hold.

- Support for Milei's government declined by 15% in September, in the sharpest decline since he took office. His approval rating now stands at 44.8% of the population, with 50.7% expressing dissatisfaction. His declining popularity has been linked to his pro-market reforms, which have received applause from investors but also pushed the country into recession. The drop in support comes as he struggles to manage a small minority government while attempting to address the country's ailing fiscal deficit and attract foreign investment.

- Despite the initial economic hardship, the government's reforms are beginning to yield positive results. While inflation in Argentina remains one of the world's highest, it has shown noticeable signs of easing over the last few months, with nearly all components of its inflation index moderating. Moreover, the country has achieved consecutive budget surpluses for the first time since 2010. These achievements have helped show that his policies, while not conventional, have the potential to put the country on the right track for growth, assuming that they can stay in place.

- Argentina's long-term outlook will continue to improve as long as Milei can help the country regain legitimacy following its 2020 sovereign default. Despite Argentina's history of market reforms, its sustainability remains uncertain. If Milei's popularity continues to decline, he may be forced to delay or abandon further reforms. If conditions deteriorate enough, it is possible that he may be pushed out of office in the next election, mirroring the fate of previous pro-market Argentine presidents. Therefore, it's crucial to consider the broader political landscape when evaluating the potential impact of a new leader on the market.

In Other News: Former President Donald Trump and Vice President Kamala Harris have committed to participating in town halls for Univision, which are aimed at providing voters with a deeper understanding of the presidential candidates. Meanwhile, optimism is rising that Congress will reach an agreement on a stopgap spending bill to avert a government shutdown ahead of the election. Additionally, the Department of Justice has announced plans to file a lawsuit against Visa, alleging that it holds a monopoly over debit card transactions.

US Economic Releases

The Mortgage Bankers Association today said ***mortgage applications*** in the week ended September 20 rose 11.0%, compared to last week's gain of 14.2%, continuing a robust positive trend. Applications for home purchase mortgages rose 1.4%; however, applications for refinancing mortgages again surged 20.3% as mortgage-holders took advantage of the cheapest borrowing costs in two years. According to the report, the average interest rate on a 30-year mortgage eased another two basis points to 6.13%, marking the eighth consecutive drop and the longest series of drops since 2018-19.

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	New Home Sales	m/m	Aug	700k%	739k	***
10:00	New Home Sales MoM	m/m	Aug	-5.3%	10.6%	**
Federal Reserve						
ET	Speaker or Event	District or Position				
16:00	Adriana Kugler Speaks on Eco Outlook at Harvard Kennedy School	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	PPI Services	y/y	Aug	2.7%	2.7%	2.6%	*	Equity and bond neutral
	Nationwide Dept Sales	y/y	Aug	3.9%	5.5%		***	Equity and bond neutral
Australia	CPI	y/y	Aug	2.7%	3.5%	2.7%	**	Equity and bond neutral
South Korea	Consumer Confidence	m/m	Sep	100.0	100.8		*	Equity and bond neutral
EUROPE								
France	Consumer Confidence	m/m	Sep	95	93	92	***	Equity and bond neutral
AMERICAS								
Mexico	International Reserves Weekly	w/w	20-Sep	$226465m	$226109m		*	Equity and bond neutral
Brazil	Current Account Balance	m/m	Aug	-$5000m	-$4946m	-$5100m	**	Equity and bond neutral
	Foreign Direct Investment	m/m	Aug	$6104m	$7258m	$7500m	**	Equity and bond neutral
	IBGE Inflation IPCA-15	y/y	Sep	4.12%	4.35%	4.28%	***	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)	493	495	-2	Down
3-mo T-bill yield (bps)	449	449	0	Down
U.S. Sibor/OIS spread (bps)	463	464	-1	Down
U.S. Libor/OIS spread (bps)	460	461	-1	Down
10-yr T-note (%)	3.76	3.73	0.03	Up
Euribor/OIS spread (bps)	340	343	-3	Down
Currencies	**Direction**			
Dollar	Flat			Down
Euro	Up			Up
Yen	Down			Up
Pound	Down			Up
Franc	Down			Up
Central Bank Action	**Current**	**Prior**	**Expected**	
PBOC 1-Year Med-Term Lending (Bil.)	300.0b	300.0b	300.0b	On Forecast
PBOC 1-Year Med-Term Lending Facility	2.00%	2.30%	2.00%	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	$74.33	$75.17	-1.12%	
WTI	$70.69	$71.56	-1.22%	
Natural Gas	$2.60	$2.55	1.76%	
12-mo strip crack	$19.03	$19.19	-0.83%	
Ethanol rack	$1.79	$1.79	0.16%	
Metals				
Gold	$2,657.58	$2,657.10	0.02%	
Silver	$31.91	$32.10	-0.59%	
Copper contract	$446.70	$449.15	-0.55%	
Grains				
Corn contract	$408.50	$411.75	-0.79%	
Wheat contract	$575.00	$578.00	-0.52%	
Soybeans contract	$1,032.00	$1,042.25	-0.98%	
Shipping				
Baltic Dry Freight	2,014	1,999	15	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-1.43		
Gasoline (mb)		0.20		
Distillates (mb)		-1.19		
Refinery run rates (%)		-0.5%		
Natural gas (bcf)		52		

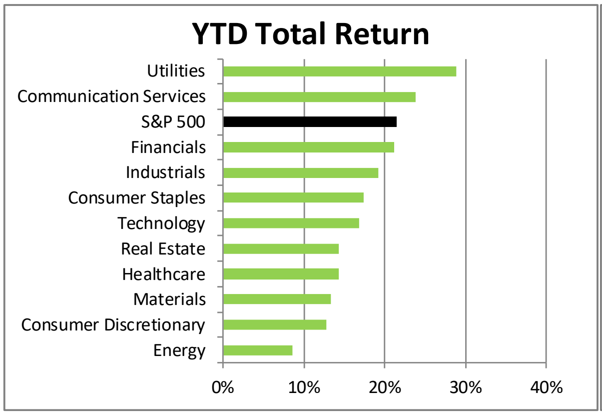
Weather

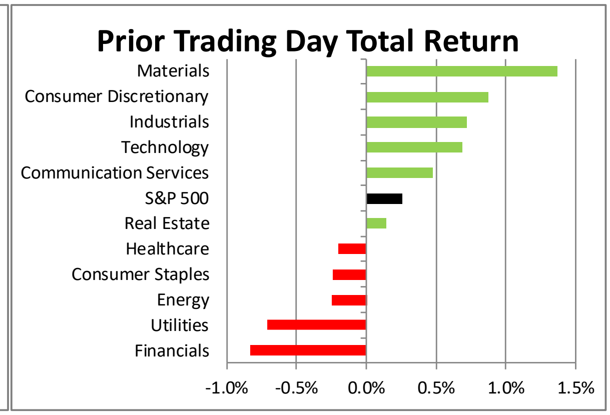
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures across the entire country, except for a small bubble in the Southeast. The forecasts call for wetter-than-normal conditions in Florida and along the lower East Coast, with dry conditions prevailing west of the Mississippi to the Sierra Nevada.

Hurricane Helene is transiting the gap between the Yucatán Peninsula and Cuba on a northward course. It is projected to continually strengthen over the course of the week and become a major hurricane by the time it makes landfall on Florida's Nature Coast on Thursday. Meanwhile, a tropical disturbance west of the Cape Verde islands continues to strengthen on a westward course with a 50% chance of cyclonic formation within the next 48 hours. A third disturbance has formed several hundred miles northeast of Bermuda; however, it does not show meaningful signs of cyclonic formation or of taking a menacing course toward land.

Data Section

US Equity Markets – (as of 9/24/2024 close)

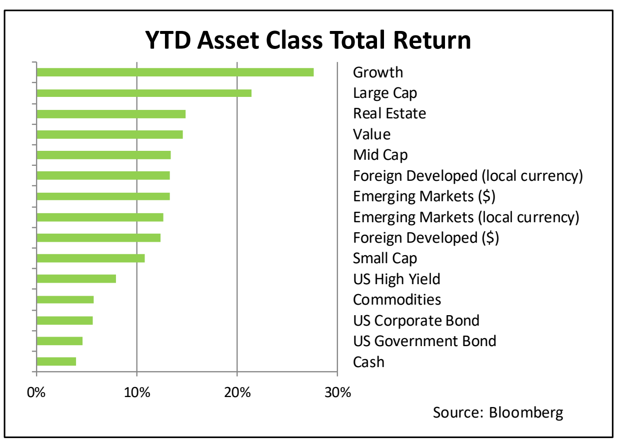




(Source: Bloomberg)

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 9/24/2024 close)

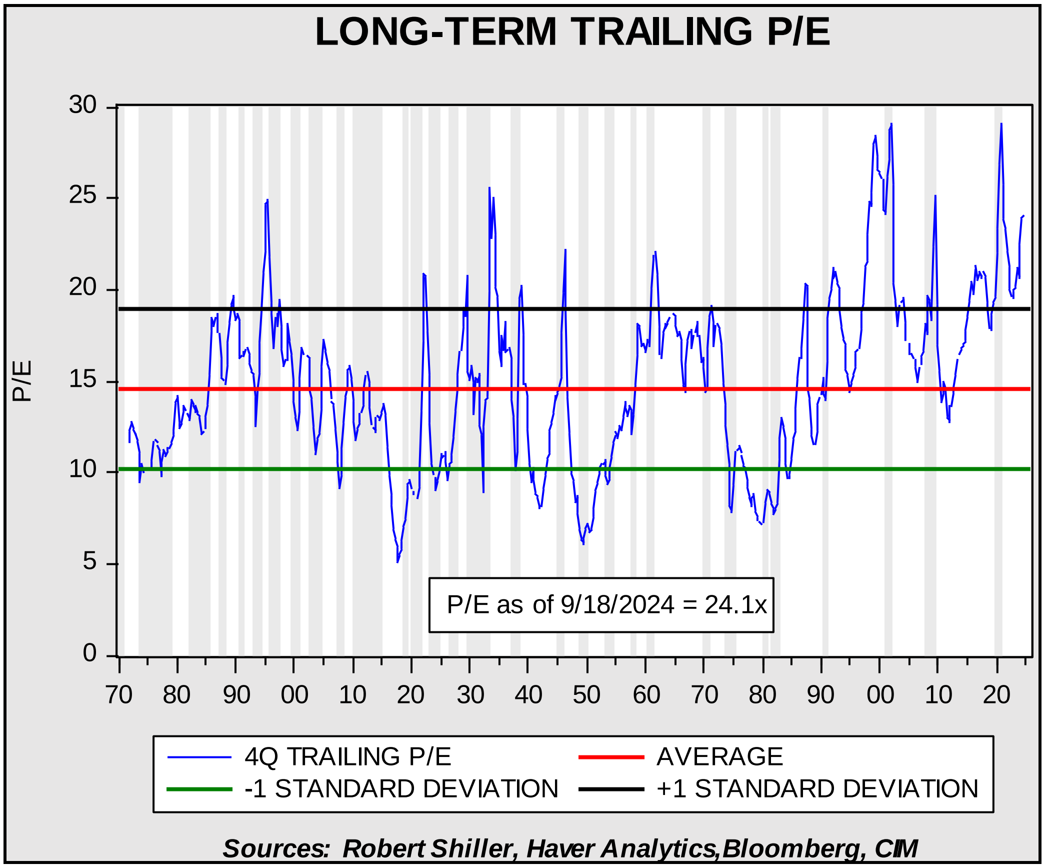


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 19, 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.