

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 27, 2024 — 9:30 AM ET]** Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 is up 0.5% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.6%. Chinese markets were higher, with the Shanghai Composite up 2.9% from its previous close and the Shenzhen Composite up 6.1%. 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](#) (9/23/2024) (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)
- **[Business Cycle Report](#) (9/26/2024)**

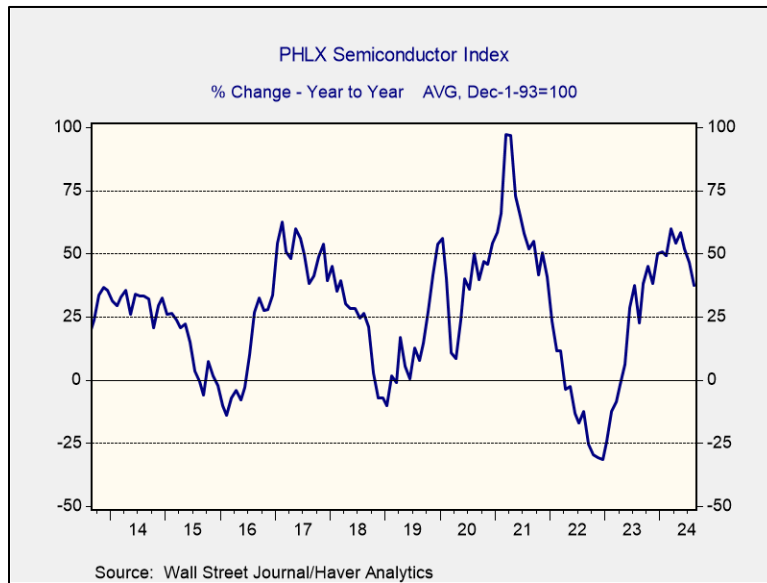
Good morning! The market is currently digesting the latest inflation data as it tries to gauge the Fed’s next move. In sports news, the New York Yankees clinched the AL East title for the second time in three years. Today’s *Comment* will dive into why chip companies are regaining popularity. We also give our thoughts on why interest rate benchmarks are important to the Fed and explain the impact that China’s stimulus will have on its economy. As usual, the report will end with a roundup of international and domestic data releases.

**Chips Are Back:** Chipmakers received a boost after Micron Technology’s results challenged the notion that the AI rally was fading.

- The [US chipmaker announced a 93% year-over-year increase](#) in its earnings for the fiscal year ending August 29. Moreover, the company revised its outlook for future revenue upward, indicating growing optimism about its growth potential in the AI sector. Following the results, the CEO credited the company's strong performance to high

demand for AI-related products. The impressive earnings and guidance sparked a post-earnings rally — the company's largest since 2011. This positive news also boosted chipmakers broadly, pushing the PHLX Semiconductor Index up 3.5% on Thursday.

- Despite ongoing concerns about valuations in the AI sector, there is clear evidence of continued strong demand for AI technology. Major tech companies like [Google, Meta, and Amazon are investing heavily in AI](#) to establish a dominant position in the market. Meanwhile, demand for related products, such as smartphones and personal computers, has led to concerns about a possible chip shortage. Research from Bain Capital suggests that [a modest 20% increase in demand could potentially disrupt supply](#).



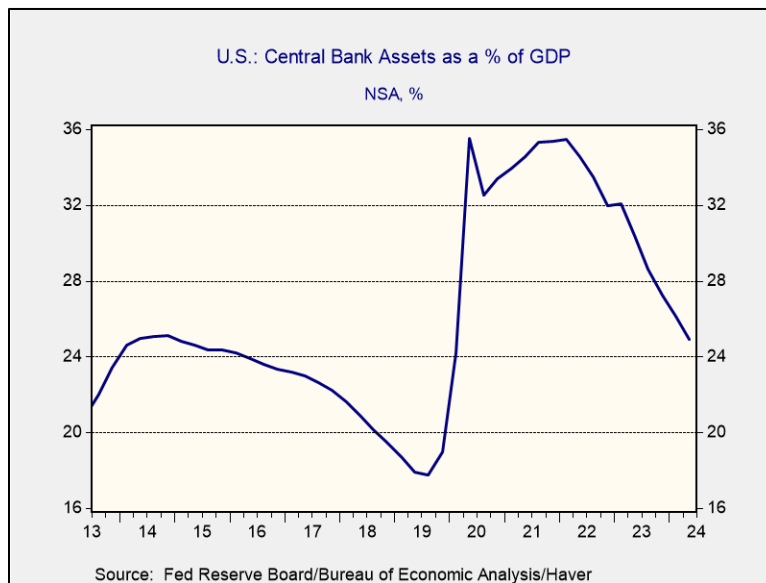
- Despite the potential for a decline in current AI hype, we foresee that the underlying demand for AI products will ultimately benefit tech companies. While long-term concerns may emerge, they are unlikely to eclipse the inflated expectations surrounding the technology's future applications. One of the primary concerns within the AI sector is valuation, as chip and other AI-related stocks still appear overvalued compared to other sectors. Consequently, we anticipate that some of the larger, highly valued companies in the space may experience continued growth, but the momentum is likely to moderate.

**After LIBOR:** Despite it being over a year since the shift from London Interbank Overnight Rate (LIBOR) to Secured Overnight Financing Rate (SOFR), Federal Reserve officials remain concerned about potential oversights.

- New York Fed President John Williams [announced the establishment of a group of private market participants to oversee the use of interest rate](#) benchmarks across financial markets. The decision comes amid ongoing concerns about the transition from LIBOR to SOFR and its potential impact on interbank lending. Although SOFR has served as a viable replacement for LIBOR, its lack of a component measuring bank funding costs has

hindered the central bank's ability to identify risks within the financial market and compromised its capacity to ensure financial stability.

- Increased oversight of reference rates is crucial as the central bank navigates its quantitative tightening program, which aims to shift the central bank's balance sheet from "abundant" to "ample" reserves. Despite the lack of a definitive benchmark for optimal reserve levels, a previous attempt to reduce reserves [resulted in a repo market crisis in 2019](#). Overnight repo rates skyrocketed due to an excess of Treasury securities and insufficient cash, forcing the central bank to prematurely halt its balance sheet reduction and lower policy rates.

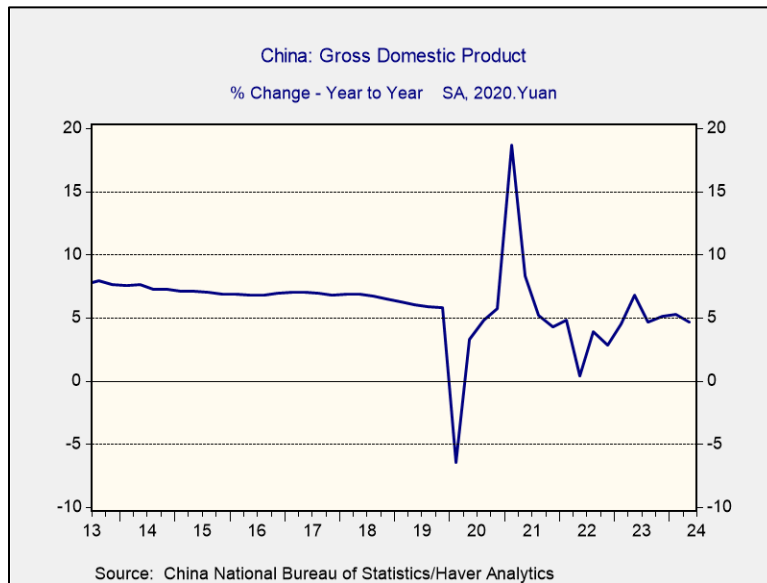


- The establishment of a reference-rate-use committee might indicate that the Federal Reserve is nearing the conclusion of its quantitative tightening policy. The central bank began [decelerating its balance sheet reduction in June, aiming to prolong this process for as long as feasible](#). While a complete cessation of tightening this year seems improbable, 2025 could offer a potential timeline. The end of quantitative tightening may place downward pressure on long-term bond yields, as the Fed would then be able to reinvest some of its holdings and absorb more of the Treasury market supply.

**China Brings Out the Bazooka:** To counter speculation about its willingness to employ all available economic tools, Beijing announced a new round of stimulus measures.

- On Thursday, [the Politburo announced its intention to employ fiscal measures](#) to revitalize the economy and bolster the struggling property sector. Although no official figure was disclosed, [Reuters reported a planned issuance of \\$284 billion in sovereign debt](#). To complement increased spending, Beijing also expressed support for measured risk-taking. [Under its "three E" policy](#), the country would grant immunity to individuals who make mistakes due to inexperience, experimentation, or unintentional errors while striving to promote development.

- The shift in policy may be attributed to concerns that the economy was on track to fall short of its growth target. Earlier this month, [several investment banks lowered their growth projections for China](#) following the weaker-than-expected second-quarter GDP growth of 4.7% year-over-year. More recent data also reinforces the view that the economy is in trouble. China's National Bureau of Statistics reported that [industrial profits experienced the most significant decline this year](#), accompanied by a slowdown in overall earnings. The cited cause of this weakness was insufficient market demand.



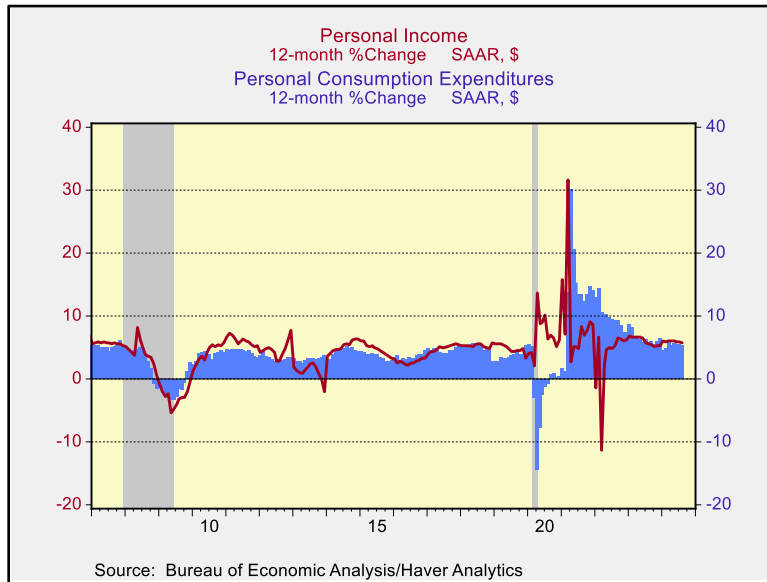
- The additional stimulus should provide investors with confidence that China is willing to pull out all the stops to revive the economy. However, it is unclear whether this will be enough to overcome the challenges known as the *five Ds*: weak consumer *demand*, excess capacity and *high debt*, poor *demographics*, economic *disincentives* from the Communist Party’s intervention in the markets, and Western *decoupling* from trade, technology and capital flows. Although we anticipate short-term improvements in Chinese and European equities, we will closely monitor their long-term performance.

**In Other News:** [President Trump has announced that he is meeting with Ukrainian president Volodymyr Zelensky](#). The meeting will likely go over how Zelensky plans to end the conflict. [China’s nuclear-powered submarine sank](#), which will likely foster doubts about the country’s military advancements. [Shigeru Ishiba will become Japan’s next prime minister](#) after winning the presidency of the ruling Liberal Democratic Party.

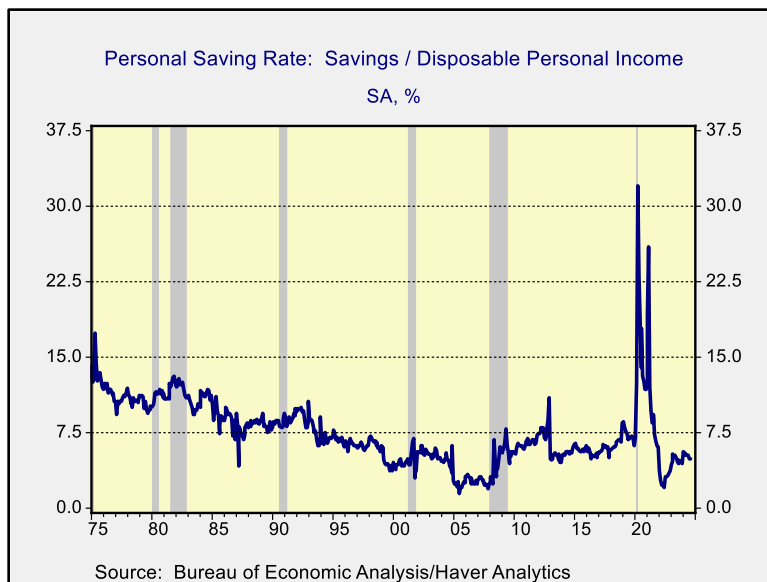
## US Economic Releases

August *personal income* rose by a seasonally adjusted 0.2%, short of both the expected increase of 0.4% and the July rise of 0.3%. August *personal consumption expenditures (PCE)* also rose 0.2%, short of their anticipated gain of 0.3% and their July rise of 0.5%. Personal income in August was up 5.6% from the same month one year earlier, while PCE was up 5.2%. The chart

below shows the year-over-year change in personal income and PCE since just before the Great Financial Crisis.

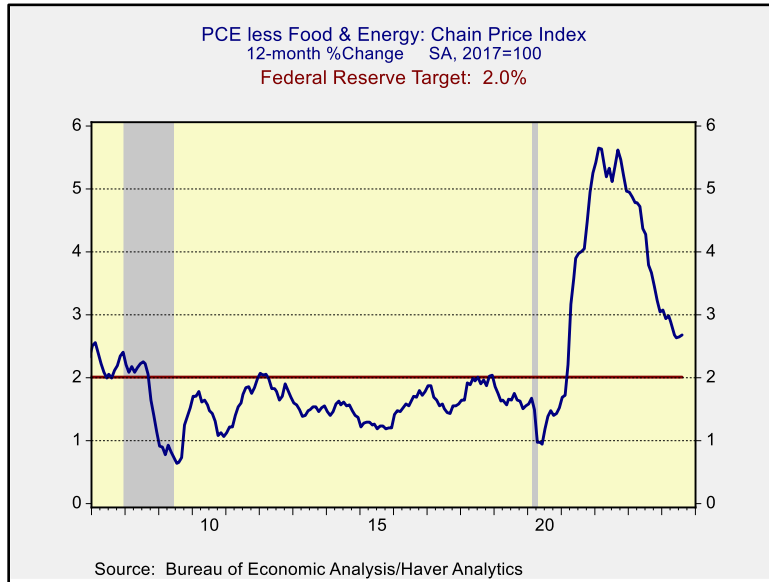


The personal income and spending report also includes a measure of personal saving, defined as disposable (after tax) income less consumption spending on goods and services. The August *personal savings rate* fell to a seasonally adjusted 4.8%, reaching its lowest level since last December. The chart below shows how the personal savings rate has fluctuated in recent decades.

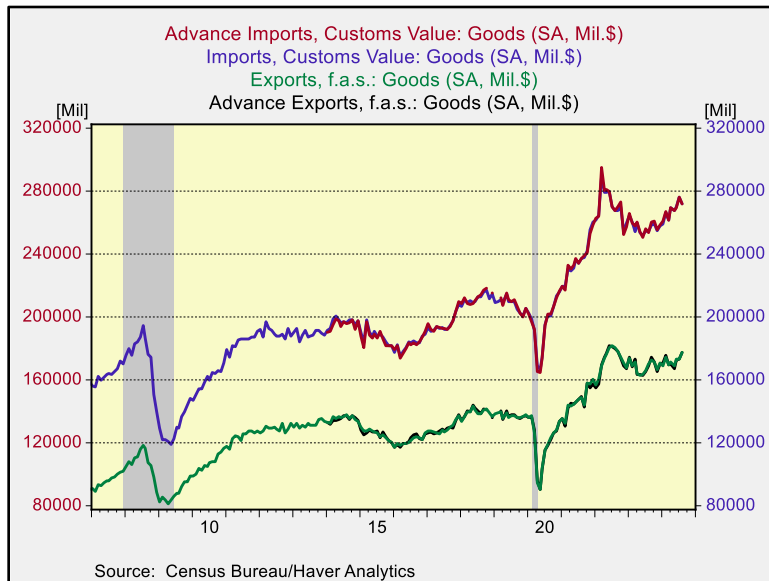


Finally, the income and spending report includes the Fed’s preferred measure of consumer price inflation. After stripping out the volatile food and energy components, the *Core PCE Deflator*

for August was up 2.7% from one year earlier, matching expectations but accelerating a bit from the 2.6% rise in the year to July. The chart below shows the year-over-year change in the Core PCE Deflator since just before the GFC.



In a separate report today, a preliminary estimate showed the US *merchandise trade balance* in August came in at a seasonally adjusted deficit of \$94.3 billion. However, that was a bit better than the anticipated shortfall of \$100.2 billion and July’s revised shortfall of \$102.8 billion. According to the data, the deficit narrowed because total merchandise exports rose 2.4% in August while imports fell 1.6%. Compared with the same month one year earlier, exports in August were up 4.9%, while imports were up 4.3%. The chart below shows the monthly value of US exports and imports since just before the GFC.



The following table lists the economic releases or Fed events scheduled for the rest of the day.

Economic Releases						
No economic releases for the rest of today						
ET	Indicator			Expected	Prior	Rating
10:00	U. of Michigan Consumer Sentiment	m/m	Sep F	69.4	69.0	***
10:00	U. of Michigan Current Conditions	m/m	Sep F	63.0	62.9	**
10:00	U. of Michigan Future Expectations	m/m	Sep F	73.4	73.0	**
10:00	U. of Michigan 1-Year Inflation Expectation	m/m	Sep F	2.7%	2.7%	*
10:00	U. of Michigan 5-10 Year Inflation Expectation	m/m	Sep F	3.0%	3.1%	*
11:00	Kansas City Fed Services Activity	m/m	Sep		5	*
Federal Reserve						
ET	Speaker or Event	District or Position				
9:30	Susan Collins and Adrianna Kugler Travel to Fitchburg, Mass.	President of the Federal Res Bank of Boston & Member of the Board of Governors				
13:15	Michelle Bowman Speaks to Alabama Bankers' Association	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
<b>ASIA-PACIFIC</b>								
<b>Japan</b>	Tokyo CPI	y/y	Sep	2.2%	2.6%	2.2%	**	Equity and bond neutral
	Tokyo CPI Ex-Fresh Food	y/y	Sep	2.0%	2.4%	2.0%	***	Equity and bond neutral
	Tokyo CPI Ex-Fresh Food & Energy	y/y	Sep	1.6%	1.6%	1.6%	*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	20-Sep	¥774.0b	¥2103.4b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	20-Sep	-¥427.9b	-¥87.2b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	20-Sep	-¥2014.9b	¥1393.4b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	20-Sep	-¥1926.4b	-¥3006.8b		*	Equity and bond neutral
	Coincident Index	y/y	Jul F	117.2	117.1		**	Equity and bond neutral
	Leading Economic Index	m/m	Jul F	109.3	109.5		**	Equity and bond neutral
<b>New Zealand</b>	ANZ Consumer Confidence Index	m/m	Sep	95.1	92.2		*	Equity and bond neutral
<b>South Korea</b>	Business Survey - Manufacturing	m/m	Oct	73	73		**	Equity and bond neutral
	Business Survey - Non-Manufacturing	m/m	Oct	71	71		*	Equity and bond neutral
<b>China</b>	Industrial Profits	y/y	Aug	-17.8%	4.1%		*	Equity bearish, bond bullish
<b>EUROPE</b>								
<b>Eurozone</b>	Consumer Confidence	m/m	Sep F	-12.9	-12.9		**	Equity and bond neutral
	Services Confidence	m/m	Sep	6.7	6.4	6.1	**	Equity bullish, bond bearish
	Industrial Confidence	m/m	Sep	-10.9	-9.9	-9.9	***	Equity bearish, bond bullish
	Economic Confidence	m/m	Sep	96.2	96.5	96.5	***	Equity and bond neutral
<b>Germany</b>	Unemployment Change	m/m	Sep	17.0k	4.0k	13.5k	***	Equity and bond neutral
	Unemployment Claims Rate	m/m	Sep	6.0%	6.0%	6.0%	**	Equity and bond neutral
<b>France</b>	CPI	y/y	Sep P	1.2%	1.8%	1.6%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Sep P	1.5%	2.2%	1.9%	**	Equity and bond neutral
	PPI	y/y	Aug	-6.3%	-5.7%		*	Equity and bond neutral
<b>Italy</b>	Industrial Sales WDA	y/y	Jul	-4.7%	-4.4%		*	Equity and bond neutral
	PPI	y/y	Aug	-1.1%	-1.6%		**	Equity and bond neutral
<b>Russia</b>	Gold and Forex Reserves	m/m	20-Sep	\$625.2b	\$617.0b		***	Equity and bond neutral
	Money Supply, Narrow Definition	w/w	20-Sep	18.39t	18.37t		*	Equity and bond neutral
<b>AMERICAS</b>								
<b>Mexico</b>	Exports	m/m	Aug	51915m	54789m		*	Equity and bond neutral
	Imports	m/m	Aug	56784m	54861m		*	Equity and bond neutral
	Trade Balance	m/m	Aug	-4868.0m	-72.0m	-149.0m	***	Equity and bond neutral
<b>Brazil</b>	FGV Inflation IGPM	y/y	Sep	4.53%	4.26%	4.39%	***	Equity and bond neutral
	Total Outstanding Loans	m/m	Aug	6117b	6065b		**	Equity and bond neutral
	National Unemployment Rate	m/m	Aug	6.6%	6.8%	6.7%	*	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)	490	492	-2	Down
3-mo T-bill yield (bps)	448	449	-1	Down
U.S. Sibor/OIS spread (bps)	460	462	-2	Down
U.S. Libor/OIS spread (bps)	457	459	-2	Down
10-yr T-note (%)	3.79	3.80	-0.01	Up
Euribor/OIS spread (bps)	335	335	0	Down
Currencies	Direction			
Dollar	Down			Down
Euro	Down			Up
Yen	Up			Up
Pound	Down			Up
Franc	Up			Up
Central Bank Action	Current	Prior	Expected	
Bank of Mexico Overnight Rate	10.500%	10.750%	10.500%	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
<b>Energy Markets</b>				
Brent	\$71.65	\$71.60	0.07%	
WTI	\$67.79	\$67.67	0.18%	
Natural Gas	\$2.73	\$2.75	-0.91%	
12-mo strip crack	\$19.42	\$19.67	-1.26%	
Ethanol rack	\$1.79	\$1.79	-0.29%	
<b>Metals</b>				
Gold	\$2,667.56	\$2,672.38	-0.18%	
Silver	\$31.97	\$32.02	-0.16%	
Copper contract	\$462.30	\$463.90	-0.34%	
<b>Grains</b>				
Corn contract	\$412.50	\$413.25	-0.18%	
Wheat contract	\$579.25	\$584.25	-0.86%	
Soybeans contract	\$1,039.50	\$1,041.00	-0.14%	
<b>Shipping</b>				
Baltic Dry Freight	2,091	2,016	75	
<b>DOE Inventory Report</b>				
	Actual	Expected	Difference	
Crude (mb)	-4.47	-1.43	-3.04	
Gasoline (mb)	-1.54	0.20	-1.74	
Distillates (mb)	-2.23	-1.19	-1.04	
Refinery run rates (%)	-1.2%	-0.5%	-0.7%	
Natural gas (bcf)	47	52	-5	

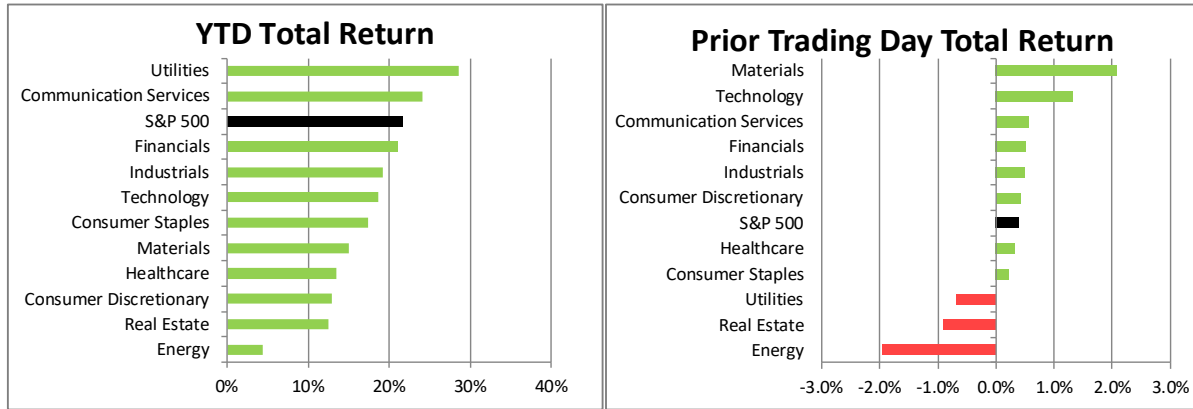
## **Weather**

The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures across the entire country except for the Pacific Northwest, Virginia, and the Carolinas, where temperatures will be near normal. The forecasts call for wetter-than-normal conditions in the Pacific Northwest, Florida, and Gulf Coast regions, with dry conditions in the Rocky Mountains, the Great Plains, the Midwest, and the Mississippi Valley.

Hurricane Helene has now made landfall and moved into the western Carolinas, where it will bring heavy rainfall and high winds today. Meanwhile, Hurricane Isaac has formed in the central Atlantic Ocean, but it is moving northeasterly and is not expected to make landfall before it dissipates. A third disturbance has formed in the Atlantic Ocean west of Africa, and it is assessed to have a 90% chance of cyclonic formation within the next 48 hours.

**Data Section**

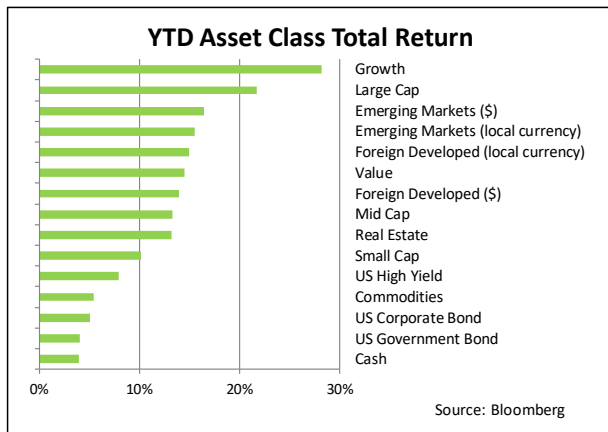
**US Equity Markets – (as of 9/26/2024 close)**



(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 9/26/2024 close)**

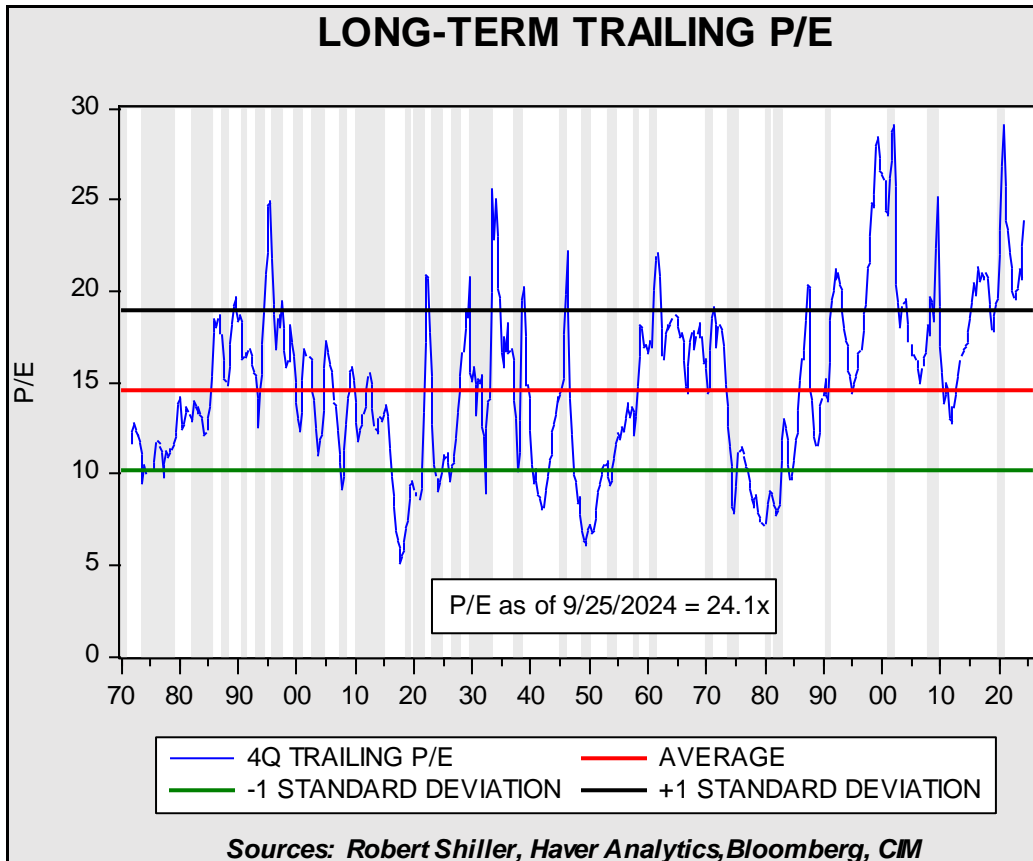


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 26, 2024



Based on our methodology,<sup>1</sup> the current P/E is 24.1x, unchanged from our last report. The stock price index improved slightly, while 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.*

<sup>1</sup> 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.