

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 4, 2024 — 9:30 AM ET]** Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 is down 1.2% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 2.6%. Chinese markets were lower, with the Shanghai Composite down 0.7% from its previous close and the Shenzhen Composite down 0.6%. 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](#) (8/19/2024) (no accompanying podcast for this report): “The Recent Iranian Election: Results & Implications” (the next report will be published on 9/9/2024)
- [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.
- [Business Cycle Report](#) (8/29/24)

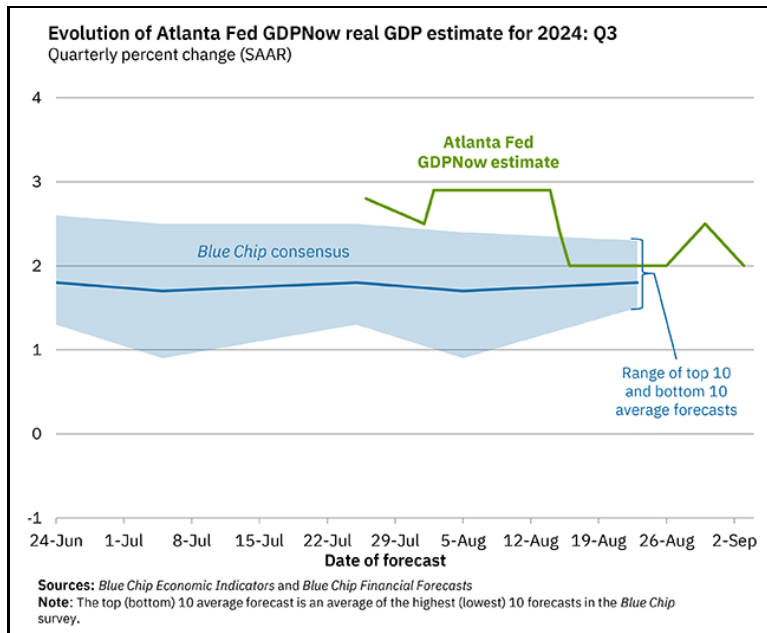
Good morning! Markets remain cautious amid lingering concerns about a potential recession. In sports news, Taylor Fritz advanced to his first Grand Slam semifinal at the US Open by defeating Alexander Zverev. Today's *Comment* will delve into why recent manufacturing data has not dampened our economic outlook, explain why setbacks have not hindered the development of semiconductor factories, and provide insights on the impact that the Bank of Japan's monetary tightening is having on financial markets. As always, our report will conclude with a summary of key international and domestic data releases.

**Market Jitters:** Weaker-than-expected purchasing manager reports weighed on equities on Tuesday as investors grew concerned about the economic outlook.

- The [August purchasing managers' indexes \(PMI\) from ISM and S&P Global both confirmed](#) a sustained contraction in the manufacturing sector for the second month in a row. Although the ISM index, which is weighted toward larger companies, showed a

slight increase, both indexes remained below the expansion threshold of 50. These weak reports were further supported by evidence of declining demand. The ISM index indicated a deeper contraction in new orders and a pickup in inventory levels. Meanwhile, S&P Global reported a seventh consecutive month of declining sales.

- Despite ongoing challenges in the manufacturing sector, the overall economy remains resilient. The service industry, which constitutes nearly half of economic output, continues to drive growth. Meanwhile, goods consumption accounts for approximately a fifth of the economy. Moreover, the labor market remains relatively insulated from the industrial downturn, with over 80% of private sector jobs being service oriented. As a result, the latest [Atlanta GDPNow forecast indicates a projected annualized growth rate of 2.0%](#) for the third quarter of 2024, down slightly from the previous forecast of 2.5%.



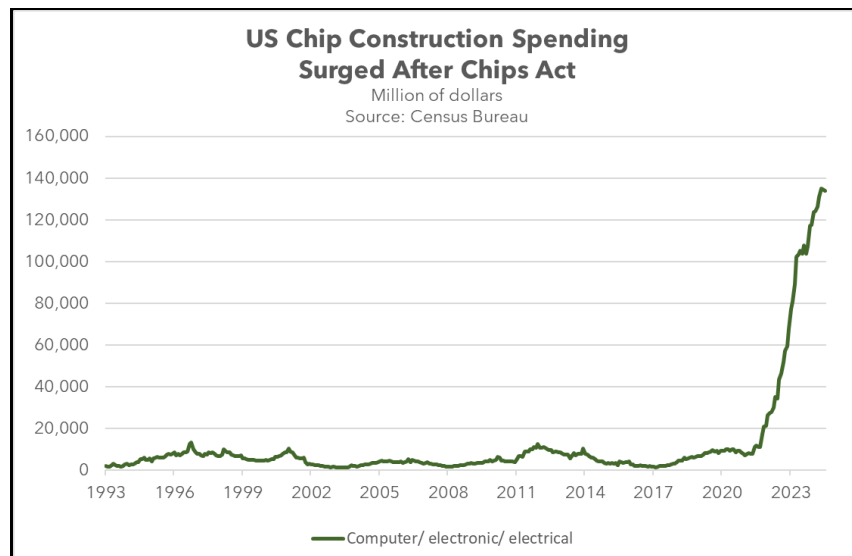
- Market volatility is expected in the coming weeks as investors await the Federal Reserve's next policy decision. Although the Fed has hinted at a possible rate cut this month, uncertainty persists regarding the extent of cuts this year. The Fed's recent economic projections suggest a more cautious approach with just one cut, which contrasts [with the market expectations of three to four cuts](#). In our view, the Fed's strategy will largely depend on Friday's jobs report. A strong report could prompt a moderate rate reduction, while a weaker report might lead to strong policy measures to prevent a hard landing.

**The Construction Goes On:** Semiconductor factory construction spending continues to skyrocket even as firms face roadblocks.

- Concerns are mounting that not all CHIPS Act projects will be fully realized. Intel, in particular, faces significant challenges. The company reported a \$1.61 billion net loss last quarter and is [exploring the sale or spin-off of its manufacturing division](#). This setback has raised concerns about the company's ability to meet production targets necessary for

securing CHIPS Act funding. Additionally, companies across the semiconductor industry have [encountered opposition from local community groups due to environmental concerns](#), potentially delaying permit approvals.

- Despite significant funding challenges, the trajectory of domestic semiconductor facility construction remains robust. The development of semiconductor manufacturing hubs has reached its highest level in nearly half a century, with investments in facilities specifically for computer, electronics, and electrical manufacturing accounting for nearly 60% of the total spending as of July. This represents a substantial increase compared to a decade ago, when such investments accounted for approximately 8%. The sharp uptick suggests that firms may be willing to take a chance in hopes that it will pay off in the future.

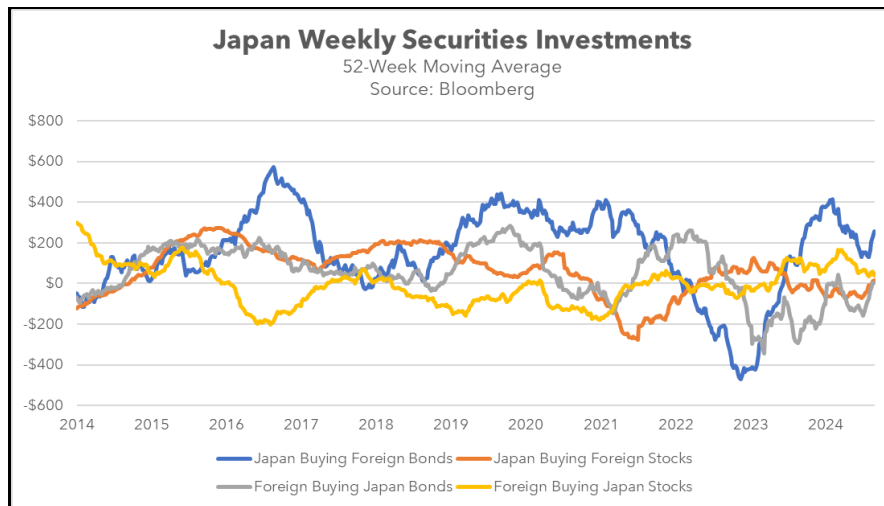


- The development of domestic semiconductor fabrication plants (fabs) is likely to continue for national security reasons, but their long-term viability may be a concern if firms cannot significantly reduce costs. It has been widely speculated that firms may rely heavily on automation in these new facilities to maintain profitability. However, this could lead to push back from lawmakers who want the firms that have received funding to increase hiring for manufacturing workers. While we do not currently see this as a significant issue, it could become a potential problem in the future.

**BOJ Hawkish Turn:** Despite growing recessionary concerns in Japan, the central bank remains committed to its ongoing interest rate hike cycle.

- [Bank of Japan \(BOJ\) Governor Kazuo Ueda reaffirmed that the central bank will raise rates](#) if the economy and inflation evolve as expected. His comments come after the market sell-off in early August, partly triggered by the bank's unexpected decision to raise interest rates. Following this move to tighten monetary policy, the central bank cited the weakness of the country's currency as one of the reasons for the increase, adding that it [believes the decision could support, rather than hinder, economic growth](#). Following the comments from Ueda, [the JPY strengthened against the USD](#).

- Despite recent market volatility, Japanese investors continue to show a strong appetite for foreign assets. Over the last few years, the [BOJ's historically low rates have encouraged them to seek higher yields abroad](#), fueling demand for foreign bonds and equities. This foreign investment has helped lower borrowing costs for governments worldwide, especially the United States, and has supported global equity markets. As interest rates rise and the yen strengthens, some foreign capital may be repatriated to Japan, but the overall trend currently remains supportive of overseas investment.



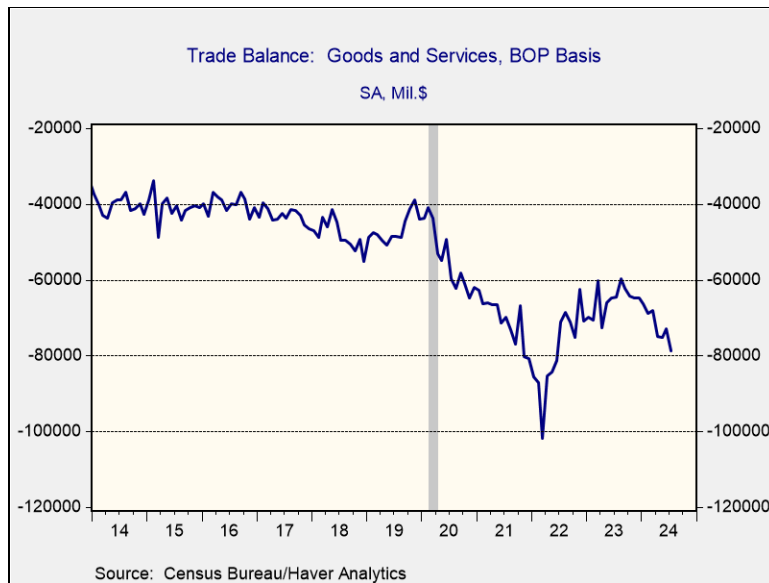
- Although concerns about a more aggressive Bank of Japan have unnerved global investors, it's crucial to note that Japanese bond yields remain exceptionally low relative to their G-10 peers. Despite hawkish rhetoric, the central bank is still likely to implement a gradual tightening cycle as the world adapts to post-pandemic conditions. While the possibility of another [carry-trade driven market panic](#) cannot be entirely dismissed, the market seems to be accepting that ultra-easy monetary policy is nearing its end. This shift should temper the market's reaction for the BOJ's next hike which is expected in January.

**In Other News:** [The Department of Justice has subpoenaed Nvidia](#) over allegations of antitrust violations, signaling a tougher government stance on tech firms. Meanwhile, a former aide to New York Governor Kathy Hochul has been [arrested on charges of working on behalf of the Chinese government](#). Additionally, the [People's Bank of China is considering a policy adjustment that could result in an 80 basis point rate cut for mortgages](#), indicating a willingness to adopt more aggressive measures to stimulate growth.

## US Economic Releases

Home loan demand increased for the second consecutive week, as buyers capitalized on lower rates. The Mortgage Bankers Association's mortgage applications index rose 1.6% for the week ending August 30. This uptick is partly due to a slight drop in the 30-year fixed-rate mortgage, which decreased by 1 basis point from 6.44% to 6.43%. Consequently, the MBA's purchase tracker climbed 3.3%, while the refinance tracker dipped by 0.3%.

The US deficit in traded goods and services widened less than expected in July. According to the Department of Commerce, the trade shortfall increased from \$73.0 billion to \$78.8 billion. The reading was slightly below the expectation of \$79.0 billion.



The increase in the deficit was driven by US purchases of foreign goods and services outpacing foreign sales. Imports rose 2.1% to \$345.39 billion, while exports rose 0.5% to \$266.60 billion. The widening deficit will be a drag on growth but should reinforce views that demand remains strong.

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	JOLTS Job Openings	m/m	Jul	8100k	8184k	**
10:00	Factory Orders	m/m	Jul	4.8%	-3.3%	***
10:00	Factory Orders Ex Transportation	m/m	Jul		0.1%	*
10:00	Durable Goods Orders	m/m	Jul F	9.9%	9.9%	***
10:00	Durable Goods Orders ex Transportation	m/m	Jul F	-0.2%	-0.2%	**
10:00	Cap Goods Orders Nondef Ex Air	m/m	Jul F		-0.1%	*
10:00	Cap Goods Ship Nondef Ex Air	m/m	Jul F		-0.4%	*
	Wards Total Vehicle Sales	m/m	Aug	15.40m	**	***
Federal Reserve						
ET	Speaker or Event	District or Position				
14:00	U.S. Federal Reserve Releases Beige Book	Federal Reserve Board				

## 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>								
Japan	Jibun bank Composite PMI	m/m	Aug F	52.9	53.0		*	Equity and bond neutral
	Jibun Bank Services PMI	m/m	Aug F	53.7	54.0		**	Equity and bond neutral
Australia	GDP	y/y	2Q	1.0%	1.3%	0.9%	**	Equity and bond neutral
New Zealand	ANZ Commodity Price	m/m	Aug	2.1%	-1.7%		**	Equity and bond neutral
South Korea	Foreign Reserves	m/m	Aug	\$415.92b	\$413.51b		**	Equity and bond neutral
China	Caixin Composite PMI	m/m	Aug	51.2	51.2		**	Equity and bond neutral
	Caixin Services PMI	m/m	Aug	51.6	52.1	51.8	**	Equity and bond neutral
India	HSBC India PMI Composite	m/m	Aug F	60.7	60.5		**	Equity and bond neutral
	HSBC India PMI Services	m/m	Aug F	60.9	60.4		**	Equity and bond neutral
<b>EUROPE</b>								
Eurozone	HCOB Eurozone Services PMI	m/m	Aug F	52.9	53.3	53.3	**	Equity and bond neutral
	HCOB Eurozone Composite PMI	m/m	Aug F	51.0	51.2	51.2	*	Equity and bond neutral
	PPI	y/y	Jul	-2.1%	-3.3%	-2.5%	**	Equity and bond neutral
Germany	HCOB Germany Services PMI	m/m	Aug F	51.2	51.4	51.4	**	Equity and bond neutral
	HCOB Germany Composite PMI	m/m	Aug F	48.4	48.5	48.5	**	Equity and bond neutral
France	HCOB France Services PMI	m/m	Aug F	55.0	55.0	55.0	**	Equity and bond neutral
	HCOB France Composite PMI	m/m	Aug F	53.1	52.7	52.7	**	Equity and bond neutral
Italy	HCOB Italy Composite PMI	m/m	Aug	50.8	50.3	51.4	**	Equity and bond neutral
	HCOB Italy Services PMI	m/m	Aug	51.4	51.7	52.5	**	Equity and bond neutral
UK	S&P Global UK Services PMI	m/m	Aug F	53.7	53.3	53.3	**	Equity and bond neutral
	S&P Global UK Composite PMI	m/m	Aug F	53.8	53.4	53.4	**	Equity and bond neutral
Russia	S&P Global Russia Composite PMI	m/m	Aug	52.1	51.9		**	Equity and bond neutral
	S&P Global Russia Services PMI	m/m	Aug	52.3	51.1		**	Equity and bond neutral
<b>AMERICAS</b>								
Canada	S&P Global Canada Manufacturing PMI	m/m	Aug	49.5	47.8		***	Equity and bond neutral
Mexico	International Reserves Weekly	w/w	30-Aug	\$224778m	\$224709m		*	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)	528	528	0	Down
3-mo T-bill yield (bps)	495	495	0	Down
U.S. Sibor/OIS spread (bps)	499	499	0	Down
U.S. Libor/OIS spread (bps)	496	497	-1	Down
10-yr T-note (%)	3.82	3.83	-0.01	Down
Euribor/OIS spread (bps)	346	347	-1	Down
Currencies	Direction			
Dollar	Down			Down
Euro	Up			Up
Yen	Up			Up
Pound	Flat			Up
Franc	Up			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
<b>Energy Markets</b>				
Brent	\$73.80	\$73.75	0.07%	
WTI	\$70.42	\$70.34	0.11%	
Natural Gas	\$2.19	\$2.20	-0.59%	
12-mo strip crack	\$19.51	\$19.71	-1.05%	
Ethanol rack	\$2.01	\$2.02	-0.40%	
<b>Metals</b>				
Gold	\$2,478.30	\$2,492.91	-0.59%	
Silver	\$27.94	\$28.05	-0.38%	
Copper contract	\$405.90	\$409.20	-0.81%	
<b>Grains</b>				
Corn contract	\$408.25	\$409.25	-0.24%	
Wheat contract	\$566.50	\$566.75	-0.04%	
Soybeans contract	\$1,004.50	\$1,012.00	-0.74%	
<b>Shipping</b>				
Baltic Dry Freight	1,947	1,919	28	
<b>DOE Inventory Report</b>				
	Actual	Expected	Difference	
Crude (mb)		-2.78		
Gasoline (mb)		-2.15		
Distillates (mb)		-0.82		
Refinery run rates (%)		0.1%		
Natural gas (bcf)		35		

## Weather

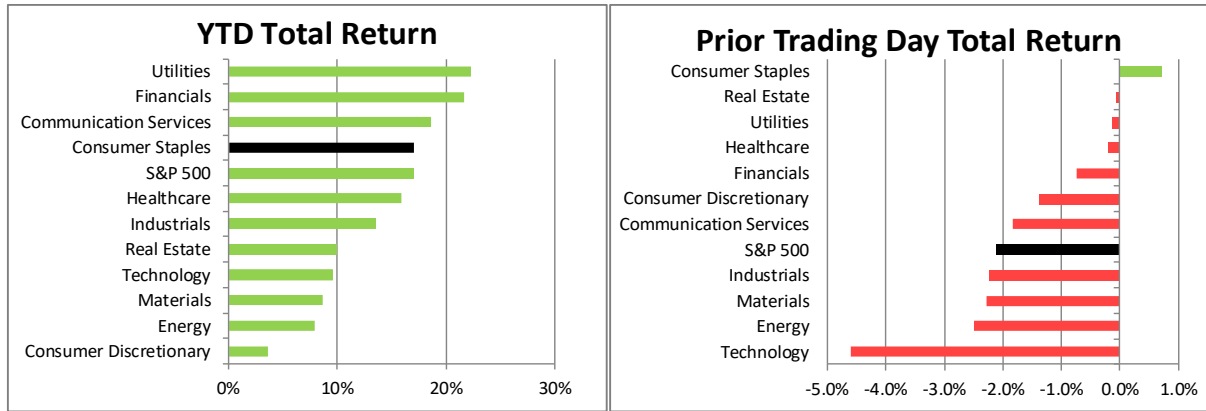
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures for most of the country, with cooler temperatures expected in the Southeast. The precipitation outlooks call for wetter-than-normal conditions along the Gulf Coast, in Florida and the Pacific Northwest, with drier than normal conditions in the middle third of the country.

Three tropical disturbances are developing in the Caribbean Sea and Atlantic Ocean, none of which have a significant chance of cyclone formation within the next 48 hours.



**Data Section**

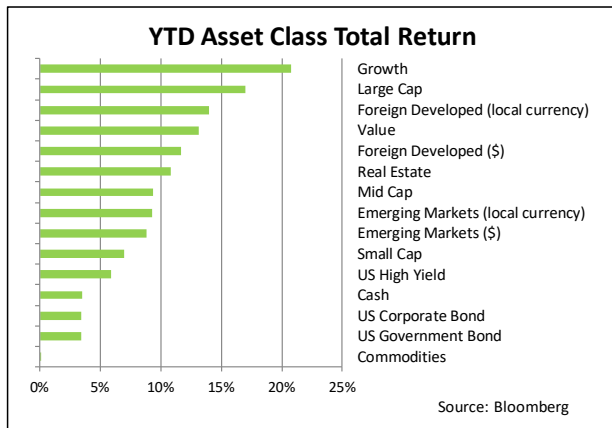
**US Equity Markets – (as of 9/3/2024 close)**



(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 9/3/2024 close)**



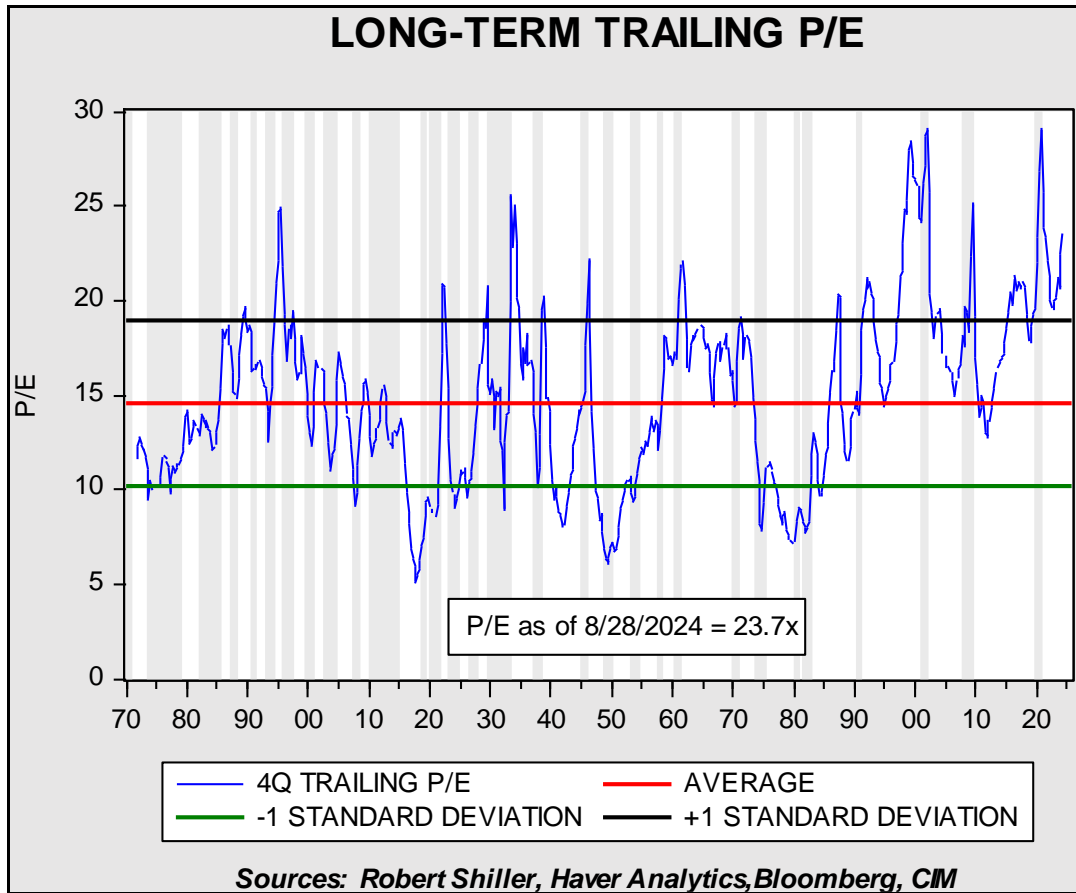
This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

August 29, 2024



Based on our methodology,<sup>1</sup> the current P/E is 23.7x, unchanged from our last report. The increase in stock price index was offset mostly by an increase in earnings.

*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.