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: April 18, 2022—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the EuroStoxx 50 index is currently up 0.5% from its prior close. In Asia, the MSCI Asia Apex 50 closed down 0.8% from its prior close. Chinese markets were higher, with the Shanghai Composite closing up 0.4% and the Shenzhen Composite up 1.0%. U.S. equity index futures are signaling a lower open. With 26 companies having reported, the S&P 500 Q1 2022 earnings stand at $51.70, lower than the $54.70 forecast for the quarter. The forecast reflects a 4.7% increase from Q1 2021 earnings. Thus far this quarter, 76.9% of the companies have reported earnings above forecast, while 23.1% have reported earnings below forecast.

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* (4/11/2022) (with associated podcast): "The Bosnian Divide"
- *Weekly Energy Update* (4/14/2022): *We have created a new oil chart that combines commercial and strategic inventories. We also discuss the current sanctions.*
- *Asset Allocation Quarterly - Q1 2022* (1/20/2022): Discussion of our asset allocation process, Q1 2022 portfolio changes, and our outlook for the markets
- ***Asset Allocation Bi-Weekly* (4/18/2022) (with associated podcast): "The Bank of Japan Cocks the Trigger"**
- *Confluence of Ideas* podcast (3/25/2022): "The 2022 Outlook: Update #1"
- *Current Perspectives*: *"2022 Outlook: Update #1"* (2/18/2022)

Our *Comment* today opens with an update on the Russia-Ukraine war, where it appears the southeastern city of Mariupol is about to fall to the Russians. We next review a range of international and U.S. developments with the potential to affect the financial markets today. We wrap up with the latest news on the coronavirus pandemic.

Russia-Ukraine: The military situation in Ukraine remained largely unchanged over the holiday weekend. Russian forces continue to regroup, reequip, and reposition for a concentrated effort to seize control of the Donbas region of eastern Ukraine and the country's southern coast. The initial skirmishes in that effort are already taking place, and the Ukrainian forces in the besieged southeastern port city of Mariupol may not be able to hold out much longer, although the Russians' main attack may still be a week or two away. In the meantime, the Russians continue

to attack primarily military targets throughout the country with artillery, missiles, and aerial bombardment.

- An eighth Russian general has reportedly been killed in combat in Ukraine. State media in Russia reports that Major General Vladimir Frolov, deputy commander of the 8th Army, was buried Saturday. Meanwhile, reports circulating on the internet state the commander of Russia's Black Sea Fleet, Igor Osipov, has been arrested following the sinking of the fleet's flagship *Moskva* late last week.
- As intriguing evidence of just how creative and flexible the Ukrainian forces are, reports indicate the Ukrainians first distracted the *Moskva* with at least one, and possibly a swarm, of Turkish-made Bayraktar TB2 drones. With the *Moskva* and its crew distracted by the threat from the drones, the Ukrainians were able to slip two Neptune anti-ship cruise missiles through the cruiser's defenses.

France: With just one week to go before the final round of France's presidential election on April 24, President Macron has tried to blunt far-right challenger Marine Le Pen's populist attacks by calling for an EU-wide cap on corporate executives' pay. Macron is also making a play for France's left-wing voters by emphasizing his support for renewable energy sources. The latest polls suggest Macron will win the election with 54% of the vote, compared with 44% for Le Pen, but the president clearly isn't leaving anything to chance.

- Given her past calls for France to leave the EU and her current calls to wrest powers from Brussels back to Paris, a Le Pen win would likely cast the future of the EU into doubt and be very negative for European markets.
- Last week, Le Pen also reiterated her call for France to pull out of NATO's military command and suggested the alliance make a "strategic rapprochement" with Russia. It illustrates that a Le Pen win would also have significant geopolitical implications that could undermine European stock values.

China: While U.S. markets were closed on Friday, the People's Bank of China announced it would cut its reserve requirement ratio for major banks to 8.10% from 8.35%. To counter the Chinese economy's slowdown in response to new pandemic lockdowns, high inflation, and the government's regulatory crackdown on key industries, the central bank's move is expected to spur an additional $80 billion in bank lending throughout the country.

- Notably, the central bank made no change to its benchmark interest rate. The rate on its one-year medium lending facility remained unchanged at 2.85%. The minimalist approach to monetary loosening shows how China's high debt levels constrain the government's ability to boost economic growth by making credit cheaper.
- The slow pace of monetary loosening will likely cap Chinese economic growth this year, which, in turn, will limit global economic growth and weigh on financial markets. As shown in the data tables below, China's first-quarter GDP was up 4.8% year-over-year, beating expectations and accelerating from the 4.0% rise in the year ended in the fourth quarter of 2021. However, weak figures for March industrial production and retail sales added to the evidence that growth in full-year 2022 will fall short of the government's goal of about 5.5%.

Israel: Palestinian-Israeli violence continued to boil over the weekend, with clashes in the area around Jerusalem's Al-Aqsa Mosque, Islam's third-holiest site. At the same time, Prime Minister Bennett is struggling to adjust to the defection of one of his party's parliament members, which has deprived him of his one-seat majority.

U.S. Economy: Amid mixed signals regarding just how pessimistic U.S. consumers are about the economy, earnings releases by major banks show credit-card spending is rising briskly. Higher card spending and continued consumer optimism would suggest that the economy can keep growing in the near term. Yet, we continue to think that factors like high inflation and rising interest rates are creating a significant risk for a recession in perhaps 12-18 months.

Global Bond Markets: With inflation surging and central banks around the world hiking interest rates, new data shows the value of global bonds offering a negative yield has fallen to $2.7 trillion from $14.0 trillion as recently as mid-December. In the U.S., the 10-year Treasury note is currently yielding 2.830%, its highest level since late 2018.
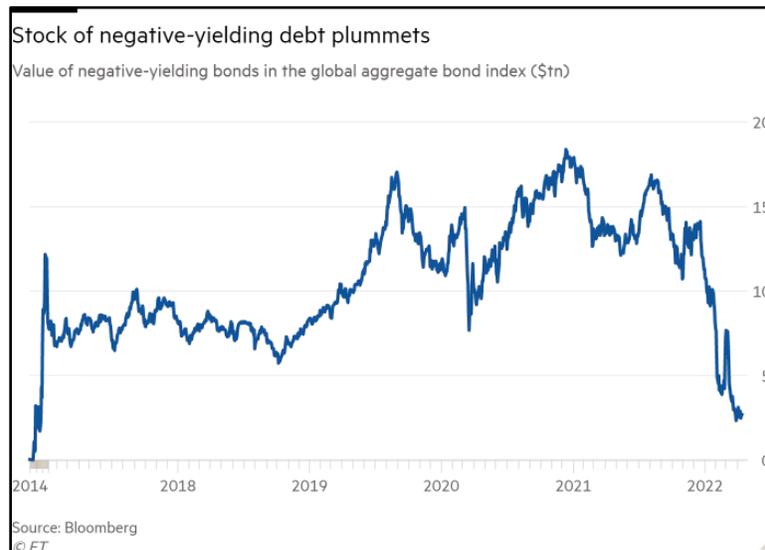
Latin American Agriculture: As we've noted before, food supply disruptions arising from the Russia-Ukraine war have further boosted global food prices. One region that seems well placed to take advantage of that is Latin America, where farmers are looking to help fill the gap for wheat, corn, soybeans, and other products that are no longer available from Russia and Ukraine. Because of the expected economic boost from stronger prices for food products, minerals, and other commodities, we think Latin American equities are now more intriguing than they have been in a long time.

Mexico: President Andrés Manuel López Obrador has failed to push through Congress a controversial reform of the country's energy industry that would have favored state-owned electricity utility CFE over private generators.

- The proposal, which also included canceling power generation permits and prioritizing CFE power over private renewables on the grid, had raised further fears about private property rights in Mexico.
- Failure of the measure in Congress is therefore positive news for private businesses and investors. However, the Mexican's heavy-handed regulatory approach remains a major constraint on the country's economy and financial markets.

COVID-19: Official data show confirmed cases have risen to 504,598,742 worldwide, with 6,198,694 deaths. In the U.S., confirmed cases rose to 80,632,301, with 988,618 deaths. (For an interactive chart that allows you to compare cases and deaths among countries, scaled by population, click here.) In data on the U.S. vaccination program, the number of people considered fully vaccinated now totals 218,907,165, equal to 65.9% of the total population.

Virology
- In the U.S., the Omicron BA.2 variant continues to spread, but it is still causing relatively few serious illnesses or hospitalizations. The seven-day average of people hospitalized with confirmed or suspected COVID-19 came in at 14,936 yesterday, down 6% from two weeks earlier. Because of the low level of hospitalizations and general fatigue with the pandemic, the new outbreak is generating few new policy responses.
- In China, where the Omicron BA.2 wave has kept parts of Shanghai under lockdown for weeks, small protests have now broken out against the government's stringent measures, including its decision to requisition citizens' apartments for quarantine facilities.
- Shanghai's health authorities said three COVID-19 patients have died, marking the first pandemic-related deaths to be reported in the city since the outbreak started last month. Despite the announcement, however, many observers still accuse the government of underreporting the death toll from the outbreak and associated lockdowns.

Economic and Financial Market Impacts
- As noted above and shown in the data tables below, the new pandemic lockdowns in Shanghai have already begun to weigh on Chinese economic data. China's March industrial production was up just 5.0% year-over-year, slowing from a rise of 7.5% in the first two months of the year. Retail sales were down 3.5% year-over-year.

U.S. Economic Releases

There were no economic releases prior to the publication of this report. The table below lists the economic releases and/or Fed events scheduled for the rest of the day.

Economic Releases					Expected	Prior	Rating
EST	**Indicator**				**Expected**	**Prior**	**Rating**
10:00	NAHB Housing Market Index	m/m	Apr		77.0	79.0	***
Federal Reserve							
EST	**Speaker or Event**	**District or Position**					
16:00	James Bullard Discusses the U.S. Economy and Monetary Policy	President of the Federal Reserve Bank of St. Louis					

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								
China	GDP	y/y	1Q	4.8%	4.0%	4.2%	***	Equity bullish, bond bearish
	Industrial Production	y/y	Mar	5.0%	4.3%	4.0%	***	Equity bullish, bond bearish
	Retail Sales	y/y	Mar	-3.5%	1.7%	-3.0%	**	Equity bearish, bond bullish
	Surveyed Jobless Rate	m/m	Mar	5.8%	5.5%	5.5%	***	Equity bearish, bond bullish
Japan	Tokyo Condominiums for Sale	y/y	Mar	-19.7%	2.0%		**	Equity bearish, bond bullish
India	Wholesale Prices	y/y	Mar	14.55%	13.11%	13.25%	**	Equity bearish, bond bullish
AMERICAS								
Brazil	FGV CPI IPC-S	w/w	15-Apr	1.84%	1.62%	1.72%	***	Equity and bond neutral
	FGV Inflation IGP-10	m/m	Apr	2.5%	1.2%	2.3%	**	Equity and bond neutral
Canada	Bloomberg Nanos Confidence	w/w	15-Apr	52.7	56.7		**	Equity bearish, bond bullish

Financial Markets

The table below highlights some of the indicators that we follow on a daily basis. 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)	106	104	2	Up
3-mo T-bill yield (bps)	74	76	-2	Neutral
TED spread (bps)	32	29	3	Widening
U.S. Sibor/OIS spread (bps)	88	86	2	Up
U.S. Libor/OIS spread (bps)	92	91	1	Up
10-yr T-note (%)	2.86	2.83	0.03	Up
Euribor/OIS spread (bps)	-45	-45	0	Neutral
Currencies	**Direction**			
Dollar	Up			Up
Euro	Down			Down
Yen	Down			Down
Pound	Down			Down
Franc	Down			Down

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	$111.32	$111.70	-0.34%	
WTI	$106.52	$106.95	-0.40%	
Natural Gas	$7.51	$7.30	2.82%	
Crack Spread	$40.97	$41.70	-1.74%	
12-mo strip crack	$29.78	$30.31	-1.75%	
Ethanol rack	$2.74	$2.73	0.10%	
Metals				
Gold	$1,993.12	$1,978.24	0.75%	
Silver	$25.91	$25.55	1.41%	
Copper contract	$478.80	$474.10	0.99%	
Grains				
Corn contract	$792.50	$783.75	1.12%	
Wheat contract	$1,123.50	$1,104.50	1.72%	
Soybeans contract	$1,674.50	$1,665.25	0.56%	
Shipping				
Baltic Dry Freight	2,137	2,068	69	

Weather

The 6-10 and 8-14 day forecasts currently call for a cold front to move from the northern Pacific and Rocky Mountain regions toward the Midwest and New England regions, meanwhile, the rest of the country is expected to have warm-to-normal weather conditions. Precipitation is expected for the Mississippi Valley and the Northern Pacific, with dry conditions expected in the Southwest.

Data Section

U.S. Equity Markets – (as of 4/14/2022 close)
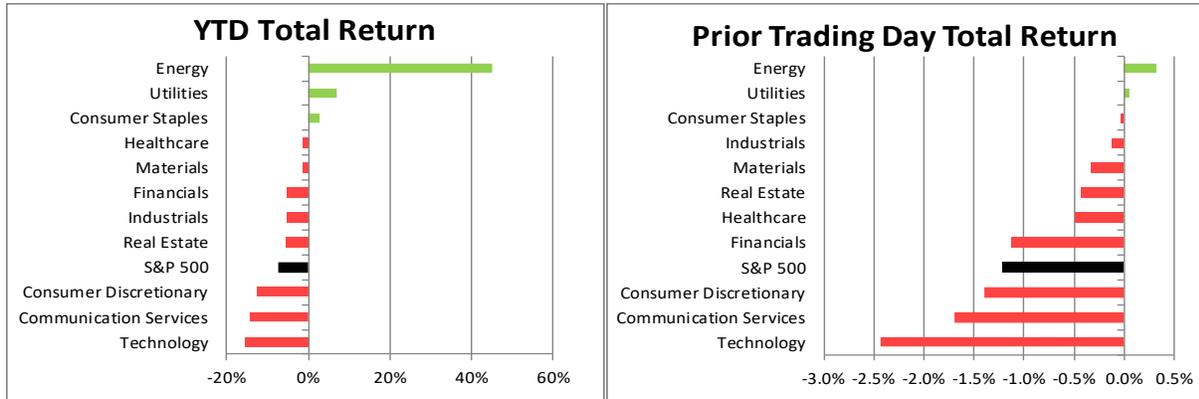
(Source: Bloomberg)

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.

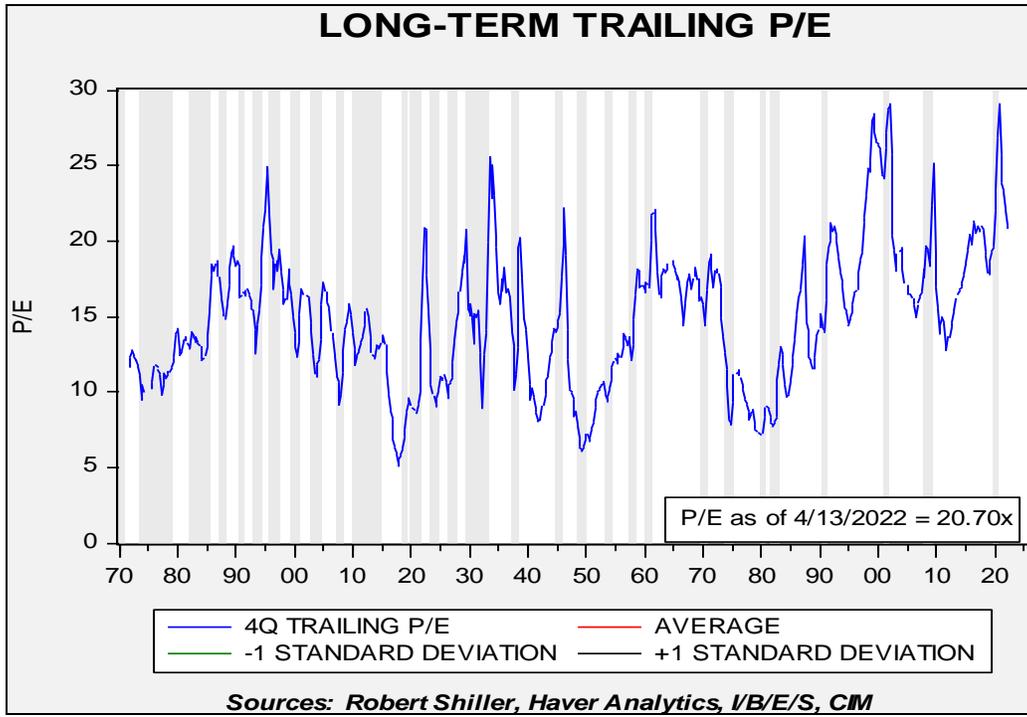### Asset Class Performance – (as of 4/14/2022 close)
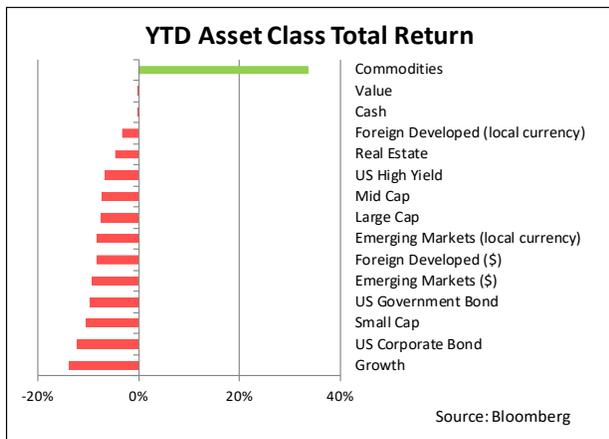
This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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), U.S. Corporate Bond (iShares iBoxx $ Investment Grade Corporate Bond ETF), U.S. Government Bond (iShares 7-10 Year Treasury Bond ETF), U.S. 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

April 14, 2022

LONG-TERM TRAILING P/E

P/E as of 4/13/2022 = 20.70x

4Q TRAILING P/E   AVERAGE
-1 STANDARD DEVIATION   +1 STANDARD DEVIATION

Sources: Robert Shiller, Haver Analytics, I/B/E/S, CIM

Based on our methodology,[1] the current P/E is 21.0x, down 0.4x from last week. Lower index values and higher earnings lowered the multiple.

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 I/B/E/S estimates which are updated regularly throughout the quarter; currently, the four-quarter earnings sum includes two actual quarters (Q3, and Q4) and two estimates (Q1 and 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.