Daily Comment

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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 29, 2021—9:30 AM EDT] Global equity markets are generally higher this morning. The EuroStoxx 50 is currently up 0.1% from its prior close. In Asia, the MSCI Asia Apex 50 closed up 0.5%. Chinese markets were higher, with the Shanghai Composite up 0.5% from prior close and the Shenzhen Composite up 0.2%. U.S. equity index futures are signaling a higher open. With 201 companies having reported, the S&P 500 Q4 earnings stand at $44.70, higher than the $37.94 forecast for the quarter. The forecast reflects a 23.3% increase from Q1 2020 earnings. Thus far this quarter, 87.1% of the companies have reported earnings above forecast, while 10.9% 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:
- *Weekly Geopolitical Report* (4/26/201): Irish Border Revisited
- ***Weekly Energy Update* (4/29/2021)**
- *Asset Allocation Weekly* with associated chart book and podcast (4/23/2021)
- *Confluence of Ideas* podcast (4/7/2021): "The U.S.-China Balance of Power: Part I"
- Asset Allocation Quarterly Rebalance Chart Book (Q1 2021): recaps recent changes to our Asset Allocation portfolios

Good morning on this GDP day. We cover the data in detail below, but the short take is that the data came in a bit below forecast. Although consumption was robust, falling inventories reduced the overall number. U.S. equity futures are higher this morning as stocks continue to trend higher. Our coverage leads off with President Biden's address to Congress and the spending plans. The FOMC meeting recap follows. Our roundup of China news is next, followed by international news. An update on economics and policy follows. Our usual update of pandemic news is next, and we close with technology.

The Biden address to Congress: There is a ton of media coverage of the speech, so our focus is more on two things—what the speech (and policy) signals and the chances of passage. In 1996, President Clinton's State of the Union address is remembered for the famous line "The era of big government is over." To a great extent, this was obvious by 1996. It wasn't so much that the government has shrunk, but the confidence that it could solve problems was mostly lost. Clinton's line was less a birthing and more of a funeral. The GOP had moved on from big government with Reagan; Clinton was indicating that the Democrats were too.

The Biden address has all sorts of details and spending plans, but the clear message is "big government is back." The Great Financial Crisis showed that the private sector alone couldn't fix the problems of excessive debt, slow growth, and inequality, at least in a way that was politically acceptable. So now, fiscal support and higher taxes are the order of the day.

What makes this change interesting from a political perspective is usually, these sorts of changes are accompanied by legislative dominance. Roosevelt enjoyed a strong Congressional majority. Reagan gained seats in Congress, reversing years of Democratic dominance. Biden has a very aggressive program, about $6.0 trillion in total spending, with very narrow majorities in Congress. The proposals include fiscal support for families, infrastructure spending, and funding to support the transition away from fossil fuels. Included is a redistributive tax proposal to pay for it. Getting everything through will likely require Congressional leaders to use reconciliation, which could reduce the scope of the proposals.

Here is what we are watching:
- It's important to remember that this legislative action is occurring in a period where party affiliations are in flux. The rising stars in the GOP are the "populist Turks" of Hawley, Rubio, Cotton, and Cruz. They might not be very opposed to the Biden tax plans and antitrust policies. There will be party differences. We expect the GOP to be less inclined to go "green." However, the idea that the GOP is the party of capital is probably out of date. If anything, Biden's strongest opposition could come from the tech/finance wing within the Democrats (e.g., the SALT controversy).
- President Biden, unlike most administrations, clearly realizes he is on the clock. We suspect he has another year, at most, to get everything done. The GOP will likely regain control of Congress at the midterms; history is on the Republican's side. The problem is that because the administration is working with slim majorities, the chances are high that some of what he gets passed is undone in the next administration (either in 2024 or 2028). In fact, this may be the greatest risk to investors. Policy swings will likely become increasingly violent, thus making long-term projections more difficult and lead to truncated market trends.
- If there is one trend we would not diminish, it's fiscal deficits. In MMT, there are limited reasons to tax. The first is to cool inflation by withdrawing liquidity (paradoxically, from a political standpoint, this requires taxing the less affluent). The second is to tax things you want less of…so "sin" taxes or levies on unwanted behavior.[1] Therefore, a government taxes the rich not to raise revenue but to reduce its influence. Thus, a tax rate that brings less revenue isn't the point. Expect both sides of the aisle to mostly give up on fiscal austerity. Of course, this will change at some point. Inflation control is usually when that trend changes. But, for the foreseeable future, high deficits will be the norm, and eventually, we expect that eventually yield curve control will be required.

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[1] One of our criticisms of MMT is that it ignores the financial markets. Hyman Minsky is claimed by MMT as being part of its intellectual "family tree," but Minsky argued that there can be situations where the government must reduce the deficit to improve financial confidence and reduce interest rates. MMT obliquely relies on the central bank to address this issue.

The FOMC: The Fed made almost no changes to policy or the statement. Rates are steady, as are bond purchases. It did admit that the economy is doing better and inflation, though rising, is transitory. Forward guidance indicates that policy is going to be steady for at least a couple of years. Not a whole lot of news emerged from the press conference either. The Fed is paying attention to the issues with money markets at what occurred with Archegos, but Powell made it clear he didn't view high asset prices, in isolation, as a sign of trouble. Initially, we did see a modest rally in Treasuries, gold recovered, and the dollar declined. The market reaction was consistent with a dovish policy statement.

China: German policy to China may change, the population is falling, and regulators that initially approved the Ant Financial IPO are probably in trouble.

- China has been able to use its trade with Germany as leverage against the EU. If German elections in the fall lead to a Green-led government, if party rhetoric can be believed, Germany, and likely the EU, would be less compliant toward China. This development has caught the attention of Beijing.
- Last year, when the Ant Financial IPO was scuttled, one of the remarkable issues was that the sale was pulled just before the IPO was to be held. Now, Chinese regulators are investigating why the IPO was initially approved in the first place. Of course, the issue is likely that the Xi government is looking to see if regulators were swayed by some factors to approve the stock sale. But, if we see bureaucrats punished for approving the sale, it could prove to be a dampener for future IPOs.
- As we noted earlier this week, China's population likely fell last year, the first annual decline since the famine triggered by the Great Leap Forward in the 1950s. We think it will take several weeks before Beijing officially confirms this news. The reports are, to some extent, a pre-release of this adverse news. However, we do note that Beijing's initial reaction to the news was to deny its accuracy. Although the pandemic played a role, China, through its one-child policy, has created a social situation that has discouraged family formation and childbearing. Such situations are very difficult to reverse.
  - Part of the way the CPC plans to address the population decline is to delay retirements. Currently, the retirement age for men is 60, 55 for white-collar women, and 50 for blue-collar women. Reports suggest that the idea of lifting the retirement age is deeply unpopular.
  - The decline in population will, over time, reduce China's economic growth and power. Although immigration could mitigate this, it is unlikely China would adopt this solution. The U.S. is also seeing slower population growth, but historically, America has been more open to immigration.
- China is considering a pricing mechanism for pollution. Usually, this would be something like a carbon tax; in economics, pollution is usually a "negative externality," meaning the costs of pollution are rarely fully reflected in the market price. It is not clear how China plans to do this, but the fact it is being discussed bears watching.

- Here is an interesting insight into China and the CPC. China's largest on-demand delivery company is called Meituan (MPNGY, USD, 80.29). It has come under scrutiny for its treatment of its drivers. General Secretary Xi referred to the drivers recently. A party official, adopting a version of "Undercover Boss," took a job as a delivery driver for the company and reported how difficult the job was. The party official has been widely complimented in the official press. Meanwhile, a driver who has become a labor activist has been detained for his criticism. The moral is that it's acceptable for the CPC to point out the failings and crimes of a company or official, but it is not acceptable for a common citizen to do so.
- We continue to monitor the situation with Huarong Asset Management (2799, HKD, 1.02); we note that China's Industrial and Commercial Bank (IDCBF, USD, 0.69) has given a loan to the company to ensure the company can pay its April 27 interest due on bonds. Chinese regulators have encouraged Chinese banks to offer credit for the next six months to facilitate the refinancing of debt. It is still unclear how China will deal with this issue and avoid creating moral hazards due to a bailout.
  - Two high-speed rail projects have been delayed due to debt concerns.
- There are increasing reports that China, though far from the Arctic, views the region as a key area to expand its influence.
- Remember the fad of bike rentals in major urban areas? In China, a number of firms have tried to grab market share by flooding cities with bike rentals. Pictures in this article show how China is now dealing with massive 'graveyards' of these bicycles that have been damaged and abandoned.

International roundup: Brexit is approved (finally!), and we continue to watch the German Greens.
- The European Parliament, calling Brexit a historic mistake, voted to approve the deal anyway. So, at long last, Brexit is now official. However, that doesn't mean everything is completely wrapped up.
- The Greens, as we noted above, are taking a harder line on China. They also appear supportive of fiscal spending and want to end the official policy of zero budget deficits.
- In recent reports, we noted that central European nations were expelling Russian diplomats over the actions of Russian operatives accused of destroying arms destined to be sent to Ukraine. We note that Bulgaria has joined the trend.

Economics and policy: Labor markets, semiconductors, and prices lead the news today.
- There is growing concern about the inability of firms to hire workers. It is a complicated issue, one that we will be commenting on in the coming weeks in the AAW. The expanded unemployment benefits and cash support may be leading potential workers away from accepting jobs they would have accepted before. Another factor has been the pattern of older workers opting for retirement during the pandemic. It's possible they won't return to the labor markets. An additional issue could be the use of a bachelor's degree as a screening device. Studies indicate that employers have been moving to use

the degree as a minimum job requirement for positions that arguably don't need one. Firms like the fact that a worker mad an effort to get a degree and perhaps hope that the worker taking a job he is overqualified for would eventually move up in the company. But, inflating the requirement for a job may be keeping some potentially qualified workers from some jobs, exacerbating the inability to fill positions. We will be watching in the next few months for signs that employers are relaxing standards for positions.

- The semiconductor crisis continues. One by one, automakers have been cutting production due to the lack of chips. Tech firms are not immune, either. Taiwan is warning that that drought is a threat to chip production. Taiwan is critical to semiconductor production, and the process uses lots of water.
- Grain prices have been on a tear. Corn, for example, is up 16% in April. Usually, high prices trigger a supply response from farmers. However, the response so far has been modest. Weather concerns are playing a role. The spring, cold weather (it was snowing last week in the Midwest) is putting planting behind schedule in the key corn states of Iowa and Illinois. For the country, 17% of the acreage has been planted compared to the 20% five-year average.
- We have been watching trends in residential real estate; namely, younger households are moving to the suburbs, and older households are downsizing into retirement. This report confirms these trends. Meanwhile, landlords are complaining about promised relief from the government.
- Canada's finance minister has called Biden's global tax plan a "breakthrough moment" for international trade talks.
- Amazon (AMZN, USD, 3458.50) announced pay increases.

COVID-19: The number of reported cases is 149,718,851 with 3,530,418 fatalities. In the U.S., there are 32,230,809 confirmed cases with 574,330 deaths. For illustration purposes, the *FT* has created an interactive chart that allows one to compare cases across nations using similar scaling metrics. The *FT* has also issued an economic tracker that looks across countries with high-frequency data on various factors. The CDC reports that 301,857,885 doses of the vaccine have been distributed with 234,639,414 doses injected. The number receiving at least one dose is 142,692,987, while the number of second doses, which would grant the highest level of immunity, is 98,044,421. The *FT* has a page on global vaccine distribution. The weekly Axios map shows the majority of states are reporting either steady cases or declines. Oregon, which had been reopening, has reinstituted restrictions due to a rise in cases.

Virology
- There is a growing concern about vaccine hesitancy; recently, the pace of vaccines has slowed, and reports of unused vaccinations have emerged. One way to address this issue is to follow the plan in West Virginia, which is to give recipients a $100 savings bond for their trouble.
 - New York City will fully reopen on July 1.

- o There is [growing evidence that vaccinations are slowing the spread of the virus](#) in the U.S.
- [Russia and China have engaged in a disinformation campaign](#) to undermine confidence in Western vaccines. [The EU is monitoring these activities](#).
  - o Brazil, which has been suffering from an uncontrolled outbreak, has rejected the Russian Sputnik vaccine due to the lack of documentation for "[safety, quality, and effectiveness](#)."
  - o Meanwhile, [Russia and China are resisting efforts by the WHO](#) to expand studies over the two countries' pandemic responses.
  - o The [Brazil variant is now spreading into South Africa](#).
  - o BioNTech (BNTX, USD, 175.77) [reports that it believes its vaccine will be effective against the Indian mutation](#).
- In India, where the virus is also raging, the new variants [appear to be spreading into the countryside.](#) The [Philippines is also facing a resurgence in infections](#).
- [Germany's domestic intelligence agencies are now monitoring coronavirus deniers](#).
- Vaccine manufacturers are [planning to increase](#) vaccine production.
- Japan, which is dealing with an uptick in cases, [outlined rules for the Summer Olympics](#).

Technology:
- [Foreign governments are getting increasingly hostile to large tech firms](#). Although the U.S. has been slower to react, we note two new books from [Sen. Hawley](#) (R-MO) and [Sen. Klobuchar](#) (D-MN) on antitrust and technology. Although these senators probably don't agree on much, it does appear there is a level of bipartisan support.

U.S. Economic Releases

Jobless claims were unexpectedly high during the week ending April 24. Initial claims came in at 553K compared to expectations of 540K. The prior report was revised from 547K to 566K. Continuing claims rose slightly from the prior week from 3.651MM to 3.660MM. Consensus estimates suggested a decline to 3.590MM.

## FOUR-WEEK AVERAGE OF INITIAL CLAIMS

Sources: BLS, CIM
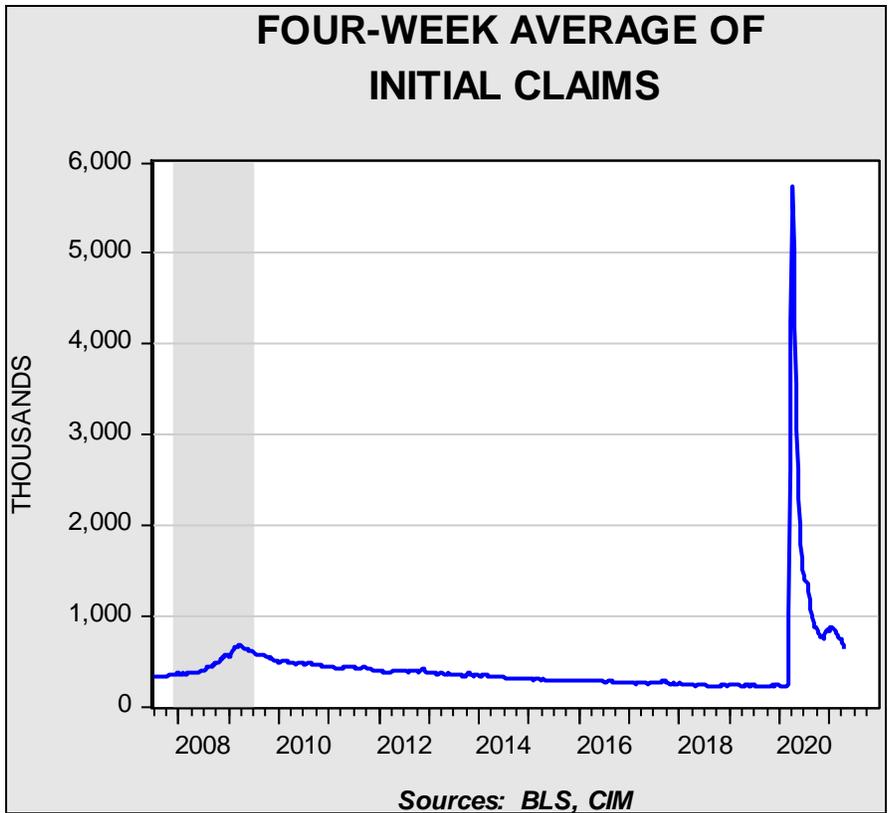
The chart above shows the four-week moving average of initial claims. The moving average fell from 655.75K to 611.75K.

Four-Week Average Continuing Claims by Region

Northeast   Southeast   Midwest
Southwest   West

Sources: BLS, CIM
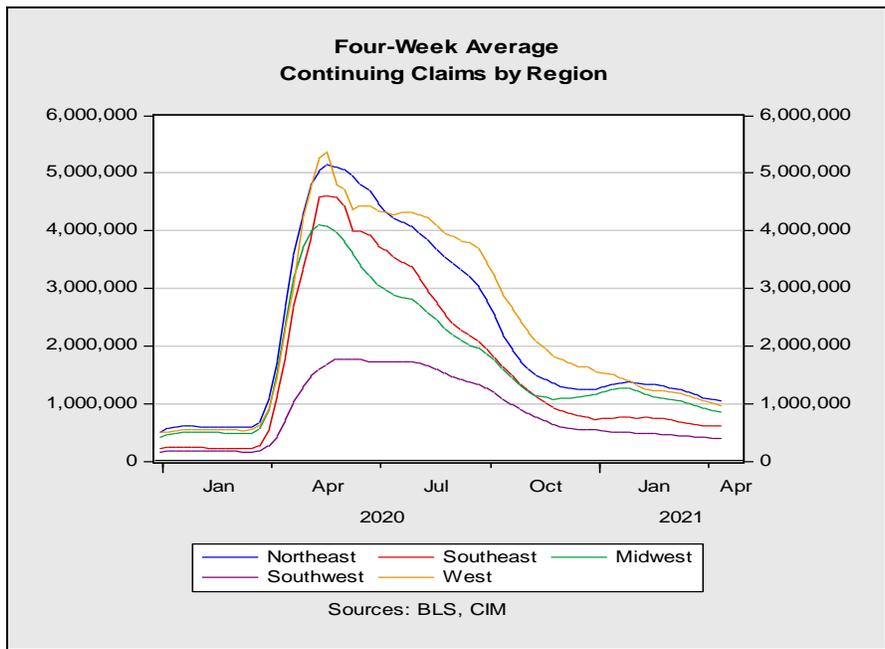
The chart above shows continuing claims by region as defined by the U.S. Census Bureau.

GDP expanded at an annualized rate of 6.4% in Q1 of 2020, slightly below expectations of 6.7%. The rise in GDP was largely supported by strong personal consumption, which rose at an annualized rate of 10.7% from the prior quarter, slightly above expectations of 10.5%. Core PCE rose at an annualized rate of 2.3%, while the GDP Price Index rose 4.1% in Q1 2020.
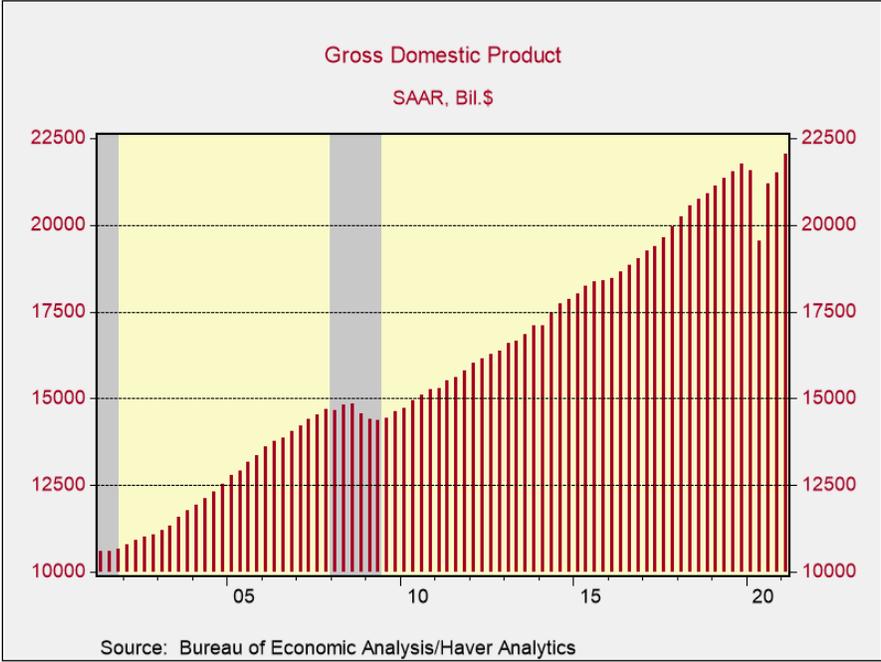
The chart above shows GDP in current dollars. It currently sits at 22.0T, which is above the pre-pandemic level of 21.5T.

	Q1 2021 First Reading	Q4 2020 Third Reading	Difference
GDP	6.4%	4.3%	2.1%
Consumption	7.0%	1.6%	5.4%
Investment	-0.9%	4.4%	-5.3%
Inventories	-2.6%	1.4%	-4.0%
Net Exports	-0.9%	-1.5%	0.7%
Government	1.1%	-0.1%	1.3%

The table above shows the contribution tables. Both net exports and investment spending were a drag on GDP, while consumption and government spending were the two biggest contributors. In the coming quarters, we expect businesses to restock their inventories. That being said, we expect net exports to decline as consumption rises.

Net Exports
Consumption
Investment
Government

Source: Bureau of Economic Analysis/Haver Analytics
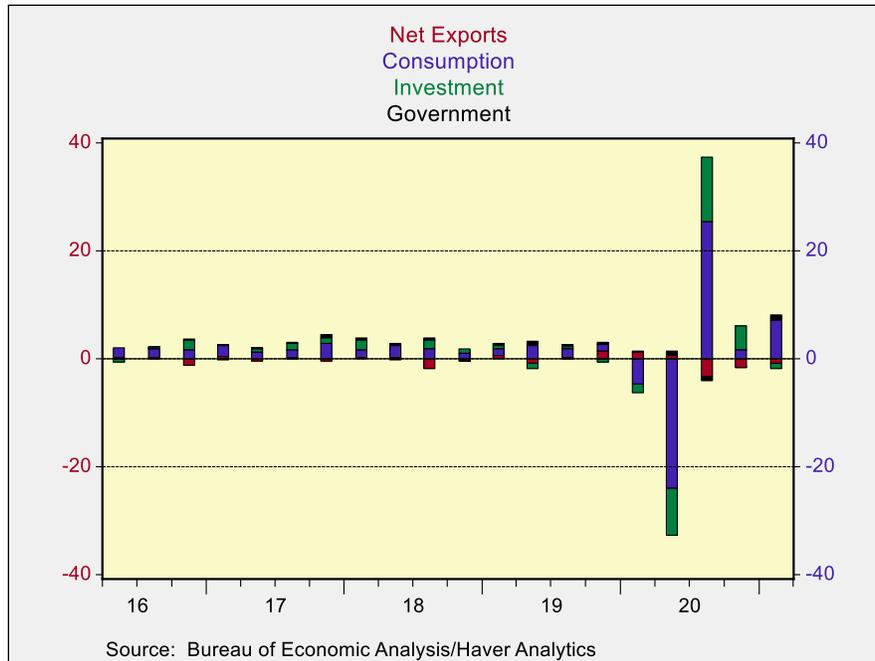
The chart above shows the contribution chart visually. As the restrictions start to loosen up and more people receive their vaccinations, we expect consumption and investment spending to pick up. In addition, at some point, inventories will need to be rebuilt, which will support future growth.

The table below lists the domestic releases and Fed events scheduled for the rest of the day.

Economic Releases					Expected	Prior	Rating
EDT	Indicator				Expected	Prior	Rating
9:45	Langer Consumer Comfort	w/w	25-Apr			54.2	***
10:00	Pending Home Sales	m/m	Mar		4.4%	-10.6%	**
10:00	Pending Home Sales NSA	y/y	Mar		27.5%	-2.7%	**
Fed Speakers or Events							
EST	Speaker or event	District or position					
11:00	Randal Quarles Discusses Financial Regulation	U.S. Federal Reserve Vice Chairman for Supervision					

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								
Australia	Import Price Index	q/q	1Q	0.2%	-1.0%	-1.6%	**	Equity bullish, bond bearish
	Export Price Index	q/q	1Q	11.2%	5.5%	9.0%	**	Equity bullish, bond bearish
New Zealand	Trade Balance NZD	m/m	Mar	33m	181m		**	Equity and bond neutral
	ANZ Activity Outlook	m/m	Apr	22.2	16.4		**	Equity bullish, bond bearish
	ANZ Business Confidence	m/m	Apr	-2.0	-8.4		**	Equity and bond neutral
EUROPE								
Eurozone	M3 Money Supply	y/y	Mar	10.1%	12.3%	10.2%	**	Equity and bond neutral
	Economic Confidence	m/m	Apr	110.3	101.0	102.2	**	Equity bullish, bond bearish
	Consumer Confidence	m/m	Apr	-8.1	-8.1		**	Equity and bond neutral
	Industrial Confidence	m/m	Apr	10.7	2.0	4.0	**	Equity bullish, bond bearish
	Services Confidence	m/m	Apr	2.1	-9.3	-8.5	**	Equity bullish, bond bearish
	Import Price Index	m/m	Mar	1.8%	1.7%	1.0%	**	Equity bearish, bond bullish
Germany	Unemployment Change (000's)	m/m	Apr	9.0k	-8.0k	-10.0k	***	Equity bullish, bond bearish
	Unemployment Claims Rate SA	m/m	Apr	6.0%	6.0%	6.0%	***	Equity and bond neutral
Italy	Hourly Wages	y/y	Mar	0.6%	0.6%		**	Equity and bond neutral
	PPI	m/m	Mar	1.0%	0.5%		**	Equity bearish, bond bullish
Russia	CPI Weekly YTD	w/w	26-Apr	2.7%	2.5%		***	Equity and bond neutral
	CPI WoW	w/w	26-Apr	0.2%	0.2%		***	Equity and bond neutral
AMERICAS								
Brazil	FGV Consumer Confidence	m/m	Apr	72.5	68.2		***	Equity bullish, bond bearish
	Formal Job Creation Total	m/m	Mar	184140	401639	150000	**	Equity bullish, bond bearish
	Federal Debt Total	m/m	Mar	5243b	5199b		**	Equity bullish, bond bearish
Canada	Retail Sales	m/m	Feb	4.8%	-1.1%	4.0%	**	Equity bullish, bond bearish
	Retail Sales Ex Auto	m/m	Feb	4.8%	-1.2%	3.5%	**	Equity bullish, bond bearish

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.

	Today	Prior	Change	Trend
3-mo Libor yield (bps)	18	18	0	Up
3-mo T-bill yield (bps)	1	1	0	Neutral
TED spread (bps)	17	17	0	Up
U.S. Libor/OIS spread (bps)	8	8	0	Up
10-yr T-note (%)	1.66	1.61	0.05	Neutral
Euribor/OIS spread (bps)	-53	-54	1	Neutral
EUR/USD 3-mo swap (bps)	3	2	1	Down
Currencies				
dollar	Up			Down
euro	Down			Up
yen	Down			Up
pound	Flat			Up
franc	Flat			Up
Central Bank Action		Prior	Expected	
FOMC Rate Decision (Lower Bound)	0.000%	0.000%	0.000%	On forecast
FOMC Rate Decision (Upper Bound)	0.250%	0.250%	0.250%	On forecast
Interest Rate on Excess Reserves	0.100%	0.100%	0.100%	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	$67.90	$67.27	0.94%	
WTI	$64.43	$63.86	0.89%	
Natural Gas	$2.95	$2.96	-0.24%	
Crack Spread	$21.24	$21.39	-0.71%	
12-mo strip crack	$19.35	$19.33	0.10%	
Ethanol rack	$2.50	$2.50	-0.02%	
Metals				
Gold	$1,775.18	$1,781.68	-0.36%	
Silver	$26.29	$26.20	0.32%	
Copper contract	$453.75	$449.75	0.89%	
Grains				
Corn contract	$651.00	$644.00	1.09%	
Wheat contract	$727.50	$722.75	0.66%	
Soybeans contract	$1,522.00	$1,513.75	0.55%	
Shipping				
Baltic Dry Freight	2957	2889	68	
DOE inventory report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-0.5	-1.0	0.6	
Gasoline (mb)	-0.1	-0.4	0.4	
Distillates (mb)	-1.2	-1.0	-0.2	
Refinery run rates (%)	0.25%	0.20%	0.05%	

Weather

The 6-10 and 8-14 day forecasts currently call for warmer than normal temperatures for most of the country, with cooler temperatures on the West Coast. The forecast calls for wetter than normal conditions throughout the Northern region.

Data Section

U.S. Equity Markets – (as of 4/28/2021 close)

YTD Total Return

Prior Trading Day Total Return
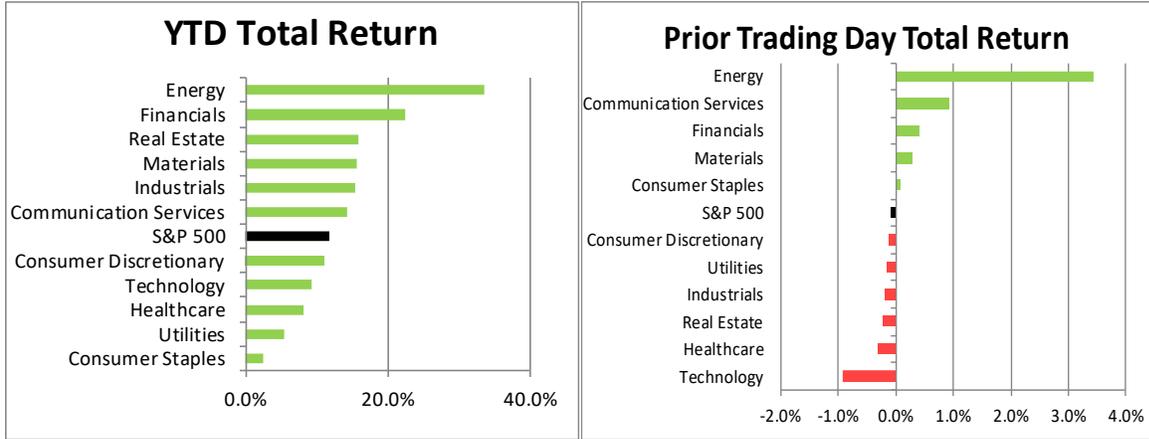
(Source: Bloomberg)

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 4/28/2021 close)

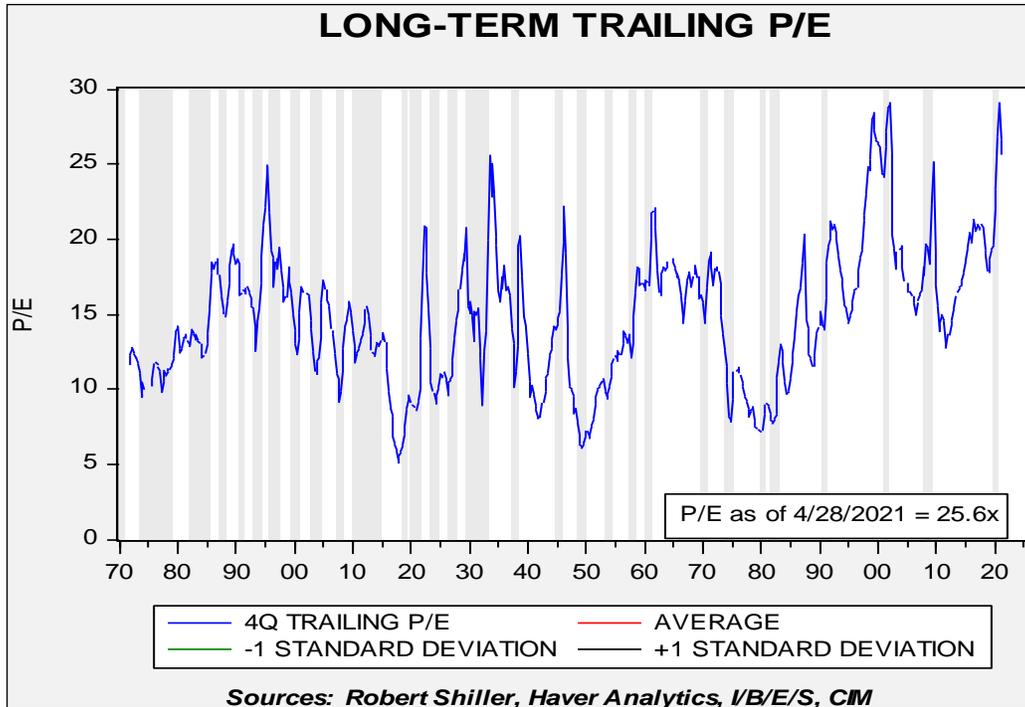**YTD Asset Class Total Return**

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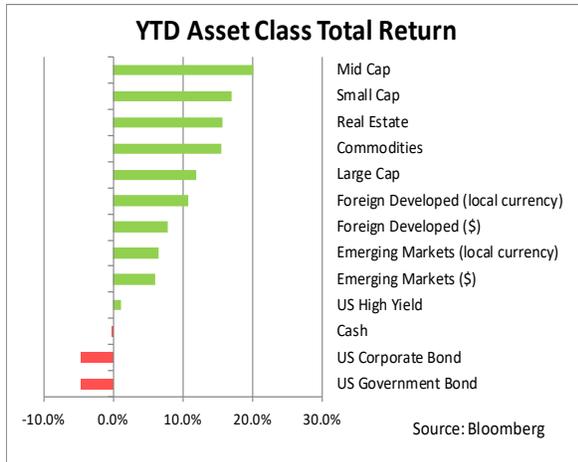
This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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).

P/E Update

April 29, 2021

LONG-TERM TRAILING P/E

P/E as of 4/28/2021 = 25.6x

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,[2] the current P/E is 25.6x, -0.1x from last 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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[2] 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.