Daily Comment

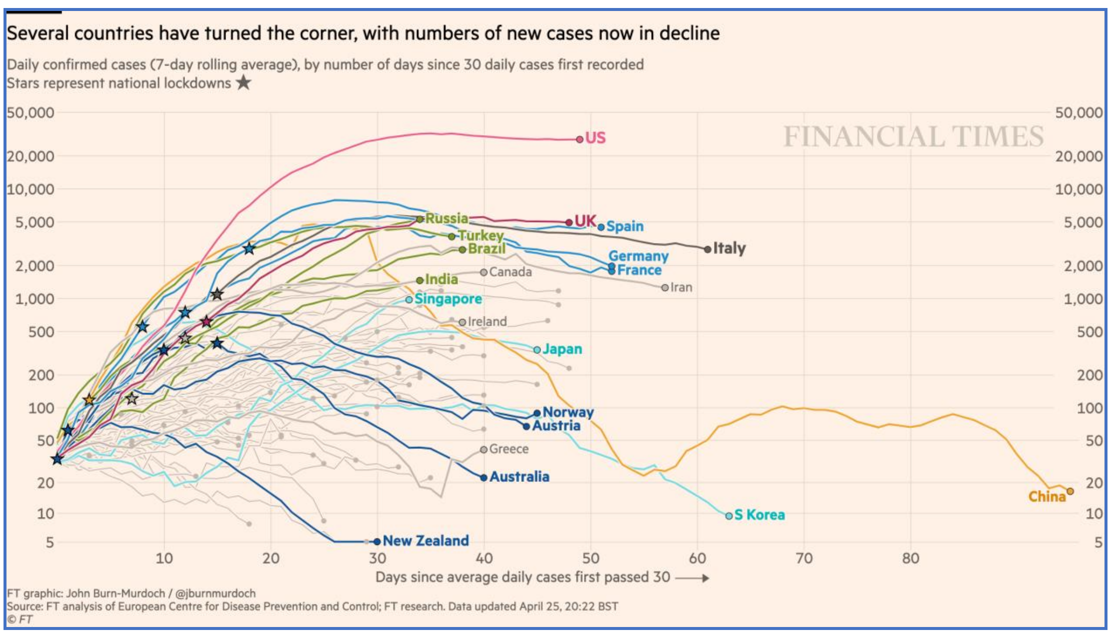
By Bill O'Grady, Thomas Wash, and Patrick Fearon-Hernandez, CFA

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 28, 2020—9:30 AM EDT] Global equity markets are mixed this morning. The EuroStoxx 50 is up 1.7% from its last close. In Asia, the MSCI Asia Apex 50 closed up 0.7% from the prior close. Chinese markets were lower, with the Shanghai Composite down 0.2% and the Shenzhen Composite down 0.3%. U.S. equity index futures are signaling a higher open. With 122 companies having reported, the S&P 500 Q1 earnings stand at $32.70, lower than the $35.51 forecast for the quarter. The forecast reflects a 10.0% decrease from Q1 2019 earnings. Thus far this quarter, 66.1% of the companies have reported earnings above forecast, while 32.2% have reported earnings below forecast.

Market sentiment continues to get a boost from the fact that many foreign governments and various U.S. states are easing their coronavirus restrictions. As always, we review all the latest virus news below. We also provide an update on the continued mystery of North Korean leader Kim Jong Un's whereabouts.

COVID-19: Official data show confirmed cases have risen to 3,060,152 worldwide, with 212,056 deaths and 905,662 recoveries. In the United States, confirmed cases rose to 988,469, with 56,253 deaths and 111,583 recoveries. Here is the chart of infections now being published by the *Financial Times*:



Virology

- A placebo-controlled study of the arthritis drug Kevzara was stopped early when it became clear that it wasn't likely to help patients with a severe form of COVID-19.
  - Highlighting the importance of using placebo controls to avoid wrongly judging a drug as being effective, patients taking the placebo and those taking the drug both did better than expected, but those taking the placebo did best.
  - A separate placebo-controlled study of Kevzara on patients with an even more severe form of the disease is continuing.
  - Studies are also continuing on dozens of other drugs, but the fast-developing science and changing dynamics of the pandemic are posing challenges for scientists.
- The Trump administration said it is prepared to send all 50 states enough tests to screen at least 2% of their residents for COVID-19, asserting that is the minimum level needed to help control the pandemic.
- The CDC announced it will start serum antibody testing in parts of Georgia where community spread of the disease is accelerating.
- The State of New York announced just 337 new deaths from the virus yesterday, marking its lowest daily tally since March 31.

Real Economy

- New analysis shows more than 30 million workers in Europe's five biggest economies have applied to participate in short-term leave plans because of the crisis.
  - That beats the 26 million or so U.S. workers who have applied for unemployment benefits in the crisis to date.
  - Designed to limit outright unemployment, the European plans provide funds to companies to cover part of participating workers' wages on condition that they be kept officially on the payroll.
- Because of the huge contribution that tourism makes to the overall European economy, observers are becoming increasingly worried about the impact if the virus extends or prevents traveling during the summer holiday.
- Though investors are focused on plunging crude oil prices as the world starts running out of places to store it, there is also a developing shortage of places to store refined product.

Financial Markets

- As companies scramble to preserve cash as the pandemic saps revenue, data from S&P shows more companies have suspended or canceled their dividends so far this year than in the previous 10 years combined.

U.S. Policy Responses

- Expanding support to states remains politically contentious. For example, President Trump said he was skeptical about providing any state funding in the next fiscal support bill. Senate Majority leader McConnell will likely end up supporting an aid package, but with restrictions on how and where the money will be spent.

- The SBA yesterday reopened its electronic portal for Payroll Protection Program loan applications, known as E-Tran. However, the overwhelmed system was plagued by instability, crashes, and long wait times, severely limiting the number of loans processed.
- New analysis shows roughly half of all U.S. workers stand to earn more in unemployment benefits than they did at their jobs before the coronavirus pandemic shut down the U.S. economy.
    - Adding the federal government's emergency weekly payment of $600 to the average state payment of about $378 will give workers a total income of $978, compared with the median weekly wage of $957 in the first quarter.
    - Until the federal payment expires at the end of July, the high level of unemployment aid could make it harder to entice some workers back to their jobs, especially if they are skittish about being exposed to the virus.
- State governments from California to South Carolina continue to gradually ease lockdown restrictions.

International Policy Responses

- The European Commission has proposed a temporary easing of bank capital standards in order to boost lending. If approved by the European Parliament and national governments, the relief aims to increase lending by as much as €450 billion this year.
- New Zealand and Australia are the latest major developed countries to start easing social distancing restrictions, with both nations reporting dramatic decreases in new infections over recent weeks.
- In the U.K., the government is expected to approve and announce a plan to ease its lockdown measures later this week.
- As China continues to lift its restrictions, heavy equipment makers are boosting prices to take advantage of a sharp rebound in construction and infrastructure investment.

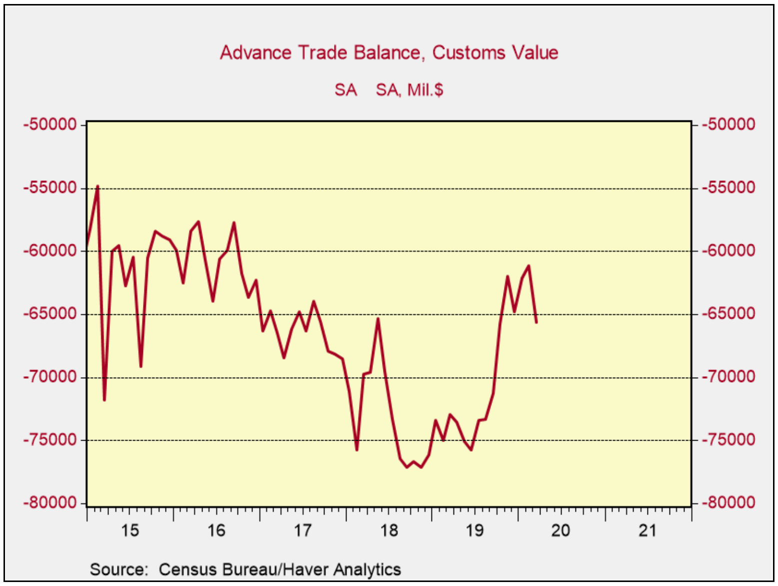
United States: The FOMC begins its latest policy meeting today. The policymakers are widely expected to leave the interest-rate policy unchanged when they announce their decision tomorrow. However, given the wide range of support programs the Fed has undertaken to help cushion the economy from the COVID-19 crisis, all eyes will be on any potential new moves that might be announced in the accompanying statement.

North Korea: Paramount leader Kim Jong Un remains out of sight, leaving foreign governments unsure about whether he is still alive and in control of the country. South Korean officials insist Kim is well, but South Korea and the U.S. scrambled six reconnaissance planes to spy on North Korea yesterday amid rumors he is dangerously ill. The North Korean government uses a highly refined system of secrecy and diversion to keep the outside world from knowing what's going on with its leader.

U.S. Economic Releases

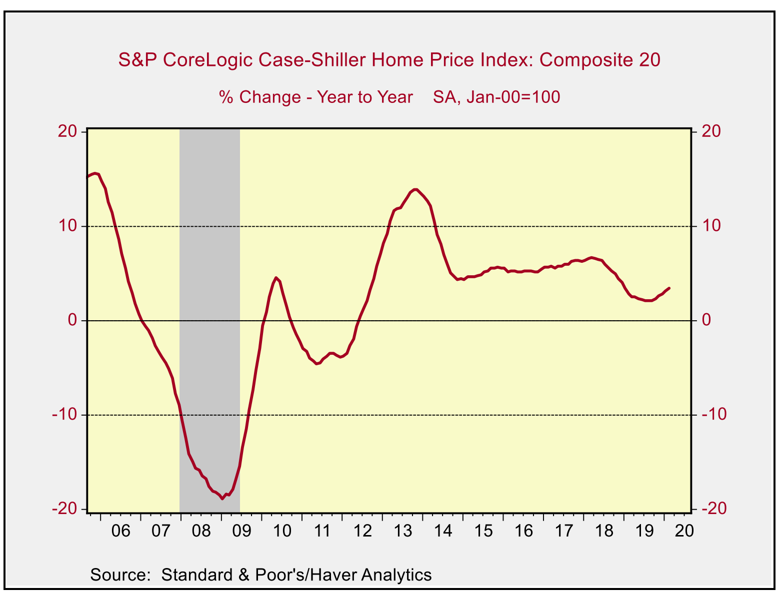
In March, the advance goods trade deficit widened unexpectedly to $64.2 billion. The prior month's report showed a deficit of $59.9 billion and analysts expected it to narrow to $55.0

billion. Wholesale inventories fell 1.0% from the prior month compared to expectations of a 0.4% drop. The prior report's loss was revised from 0.7% to 0.6%. Retail inventories rose 0.9% from the prior month compared to expectations of a 0.5% rise. The prior report's loss was revised from 0.3% to 0.4%.



The chart above shows the advance goods trade balance. The widening of the deficit is due to the decline in exports outweighing the decline in imports.

In February, the S&P CoreLogic Case-Shiller 20-City Index rose 3.47% from the prior year compared to expectations of a 3.19% rise. The S&P CoreLogic Case-Shiller U.S. Index rose 4.16% from the prior year compared to expectations of a 4.10% rise.



The chart above shows the annual change in the S&P CoreLogic 20-City Index. The rise in the index is a reflection of the underlying strength of the economy prior to the pandemic.

The table below lists the economic releases scheduled for the rest of the day.

Economic Releases						
EDT	Indicator			Expected	Prior	Rating
10:00	Conference Board Consumer Confidence	m/m	Apr	87.0	120.0	***
10:00	Conference Board Present Situation	m/m	Apr		88.2	**
10:00	Conference Board Expectations	m/m	Apr		167.7	**
10:00	Richmond Fed Manf. Activity	m/m	Apr	-42	2	**
Fed Speakers or Events						
No speakers or events scheduled						

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	Jobless Rate	m/m	Mar	2.5%	2.4%	2.5%	***	Equity and bond neutral
	Job-To-Applicant	m/m	Mar	1.39	1.45	1.40	***	Equity bullish, bond bearish
Australia	ANZ Roy Morgan Weekly Consumption	w/w	26-Apr	85.0	84.2		**	Equity bullish, bond bearish
Europe								
France	Consumer Confidence	m/m	Apr	95	103	80	***	Equity bullish, bond bearish
Russia	Construction	y/y	Mar	0.1%	2.3%	0.2%	**	Equity and bond neutral
	Retail Sales Real	y/y	Mar	5.6%	4.7%	2.0%	**	Equity bullish, bond bearish
	Cargo Shipments	y/y	Mar	-7.1%	-0.1%	-4.5%	**	Equity bearish, bond bullish
	Real Wages	y/y	Feb	5.7%	6.5%	5.5%	***	Equity and bond neutral
AMERICAS								
Mexico	Unemployment rate	m/m	Mar	3.3%	3.7%	4.1%	***	Equity bullish, bond bearish
Brazil	Trade Balance Weekly	w/w	26-Apr	$1.744 Bil	$1.036 Bil		**	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)	89	99	-10	Down
3-mo T-bill yield (bps)	8	11	-3	Neutral
TED spread (bps)	80	88	-8	Up
U.S. Libor/OIS spread (bps)	7	8	-1	Up
10-yr T-note (%)	0.66	0.66	0.00	Neutral
Euribor/OIS spread (bps)	-22	-19	-3	Neutral
EUR/USD 3-mo swap (bps)	-20	-22	2	Down
Currencies	**Direction**			
dollar	Down			Neutral
euro	Up			Up
yen	Up			Up
pound	Up			Down
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
Energy Markets				
Brent	$20.50	$19.99	2.55%	Market Optimism
WTI	$11.92	$12.78	-6.73%	Contango effect
Natural Gas	$1.79	$1.82	-1.70%	
Crack Spread	$17.97	$16.16	11.26%	
12-mo strip crack	$9.50	$9.47	0.26%	
Ethanol rack	$1.16	$1.16	0.09%	
Metals				
Gold	$1,708.46	$1,713.99	-0.32%	
Silver	$15.16	$15.21	-0.30%	
Copper contract	$235.10	$234.50	0.26%	
Grains				
Corn contract	$ 315.75	$ 313.25	0.80%	
Wheat contract	$ 527.50	$ 524.75	0.52%	
Soybeans contract	$ 837.75	$ 836.50	0.15%	
Shipping				
Baltic Dry Freight	661	665	-4	
DOE inventory report				
	Actual	**Expected**	**Difference**	
Crude (mb)		12.7		
Gasoline (mb)		2.2		
Distillates (mb)		4.8		
Refinery run rates (%)		1.20%		

Weather

The 6-10 and 8-14 day forecasts currently call for a cold front to move downward from the Midwest and New England into the Southeast, while warmer weather is expected for the western half of the country and Florida. Precipitation is expected to move eastward, with dry conditions expected for most of the country toward the end of the forecast period.

Asset Allocation Weekly

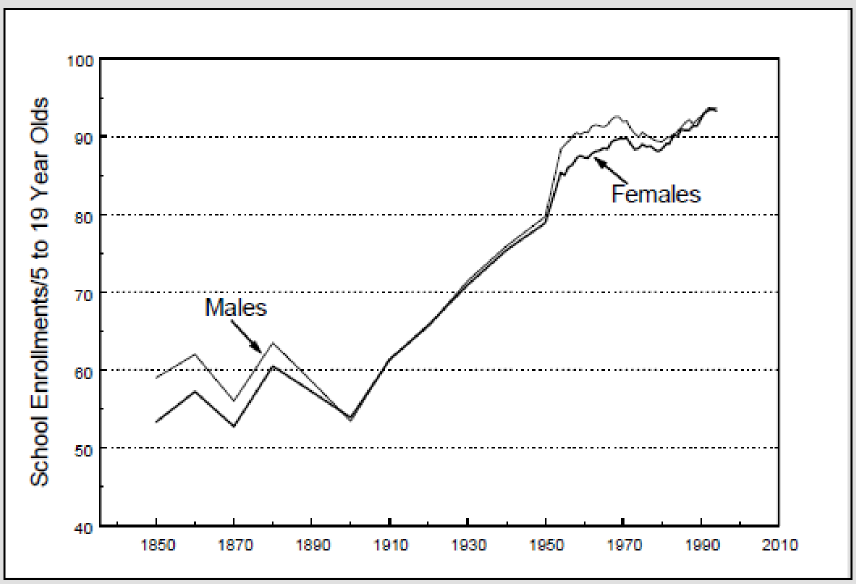
Confluence Investment Management offers various asset allocation products which are managed using "top down," or macro, analysis. We report asset allocation thoughts on a weekly basis, updating this section every Friday. Note that this report is also offered as a separate document on our website.

April 24, 2020

As the COVID-19 pandemic continues to evolve, we are watching to see how the disease will affect the economy longer term. Of course, projections of this sort are highly probabilistic; factors could and will likely emerge that could render these projections irrelevant. At the same, ignoring potential long-term consequences of the virus could lead to improper decisions, failing to fully appreciate the changes the disease has caused.

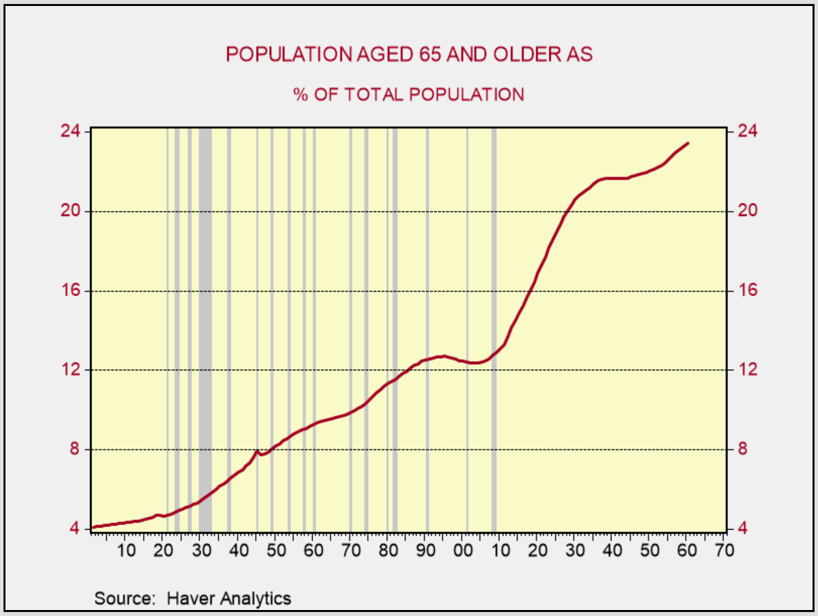
In this week's report, we will look at demographics. Demographic analysis is important because it is a "deep background" of what affects markets. Demographic change tends to occur slowly but can be rather easily forecast far into the future. Thus, if a variable is sensitive to changes in the population, it can be rather simple to forecast trends well into the future.

The baby boom, encompassing Americans born during 1946-64, has always been the "pig in the snake" for demographers. When this generation reached school age, the number of elementary enrollments jumped. Later, in the mid-1970s, enrollment fell and led to empty school buildings.

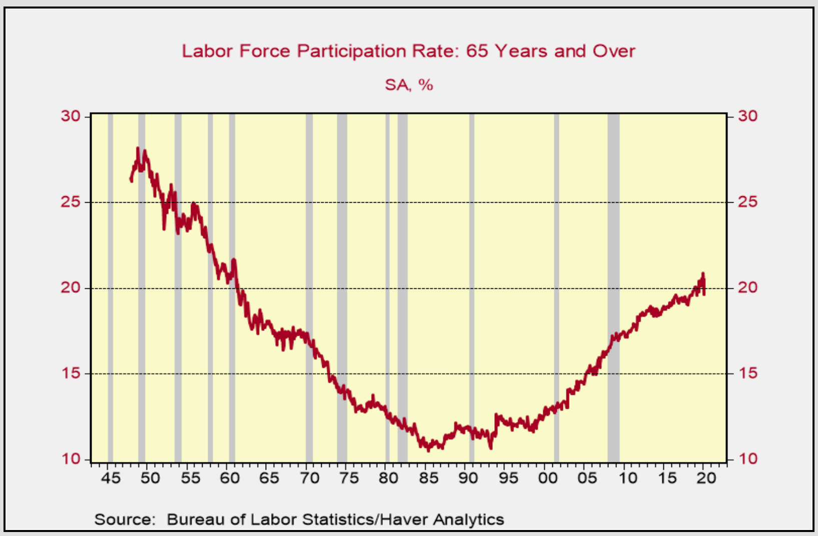


(Source: Goldin, Claudia. "A Brief History of Education in the United States," NBER, Aug. 1999.)

The current age range for the baby boom is 56 to 74. In another seven years, this entire generation will reach retirement age. The chart below shows that the population share 65 years and older is set to rise rapidly for the next two decades. Demographers for years have been warning that the mass retirement of this generation would cause problems in the labor market, predicting that employers would be scrambling to fill positions.



That hasn't happened yet for a number of reasons—globalization has allowed firms to tap labor resources abroad, immigration has offset some of the retirement numbers, and baby boomers have continued to work longer.



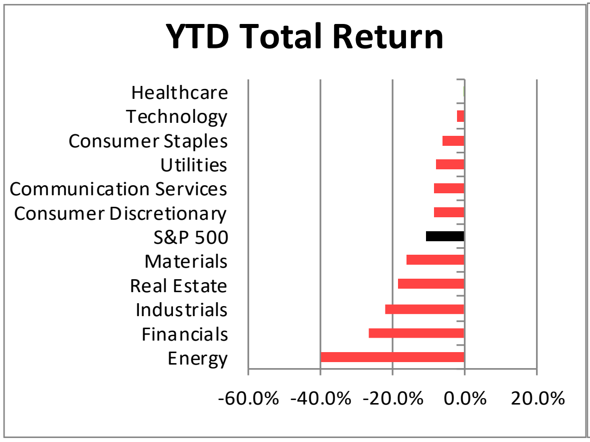
At the turn of the century, the participation rate[1] was around 12.5%. It has steadily increased to over 20%, although it has recently declined. Essentially, baby boomers, which include nine years of this group, appear to have remained in the labor force. We suspect there are two reasons. First, as life expectancies have increased, wealthier boomers, who are probably healthy, likely wanted to remain working. Second, less affluent boomers probably needed to keep working as long as possible due to the lack of retirement saving.

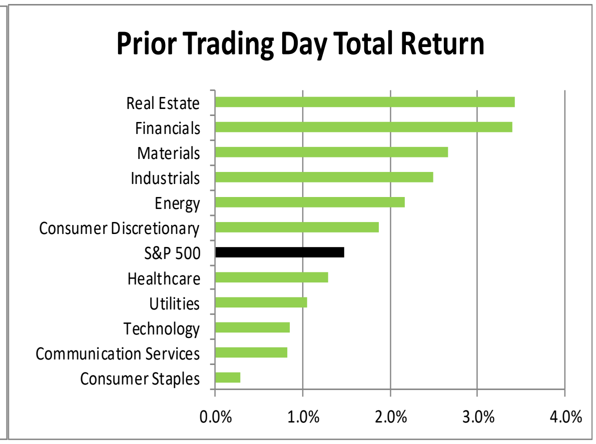
[1] The participation rate is the labor force (employed + unemployed seeking employment)/population eligible to be in the labor force.

COVID-19 could reverse this participation trend. The fatality rate of the virus tends to rise with age. Older workers who have stayed in the labor force may decide that the threat of infection is too high and thus opt to retire. If a broad-spectrum vaccine is developed, this potential trend could be thwarted, but if COVID-19 mutates like influenza and requires an annual vaccination of varying effectiveness, a vaccine might not be enough to prevent older workers from exiting the workforce. A decline in older worker participation would reduce the labor force; if that action occurs along with restrictions on immigration and trade impediments, all tenets of deglobalization, we would expect the labor share of national income to rise.

Data Section

U.S. Equity Markets – (as of 4/27/2020 close)

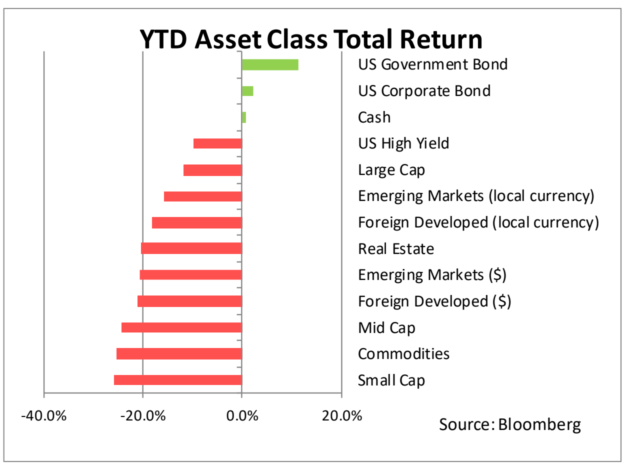




(Source: Bloomberg)

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 4/27/2020 close)

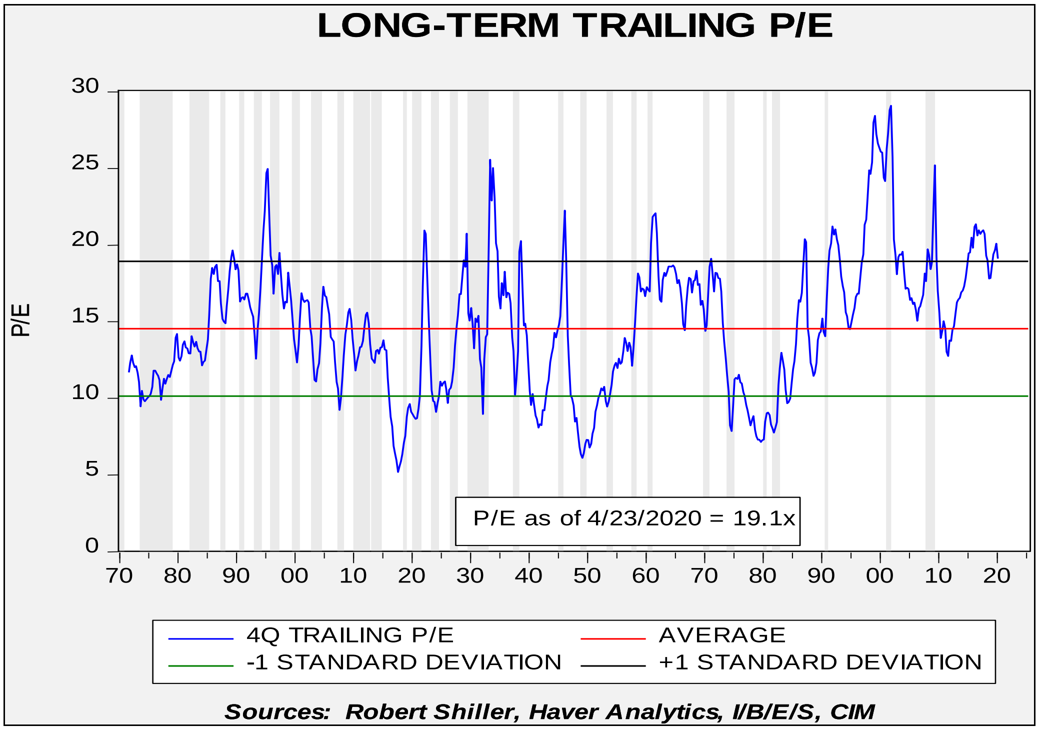


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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).

P/E Update

April 23, 2020



Based on our methodology,[2] the current P/E is 19.1x, up 0.9x from last week. The rise in the P/E was caused by the recovery in the S&P and falling earnings estimates.

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.

[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). 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.