

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: August 8, 2022—9:30 AM EDT] Global equity markets are generally higher this morning. In Europe, the Euro Stoxx 50 is currently up 0.6% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.1%. Chinese markets were higher, with the Shanghai Composite up 0.3% from its prior close and the Shenzhen Composite up 0.8%. U.S. equity index futures are signaling a higher open. With 432 companies having reported, the S&P 500 Q2 2022 earnings stand at \$57.40, higher than the \$55.26 forecast for the quarter. The forecast reflects a 4.3% increase from Q2 2021 earnings. Thus far this quarter, 75.3% of the companies have reported earnings above forecast, while 20.1% 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](#) (8/1/2022) (with associated [podcast](#)): “Political Crises for Top U.S. Allies”
- [Weekly Energy Update](#) (8/4/2022): We take a look at some of the potential effects of the inflation bill on energy and update our “gallons per hour” metric for gasoline
- [Asset Allocation Quarterly – Q3 2022](#) (7/19/2022): Discussion of our asset allocation process, Q3 2022 portfolio changes, and our outlook for the markets
- [Asset Allocation Q3 2022 Rebalance Presentation](#) (8/4/2022): Video presentation featuring the Asset Allocation Committee as they review our asset allocation strategies, recent portfolio changes, and the current macro environment
- [Asset Allocation Bi-Weekly](#) (8/8/2022) (with associated [podcast](#)): “The Devil Is in the Details”
- [Confluence of Ideas podcast](#) (3/25/2022): “The 2022 Outlook: Update #1”
- *Current Perspectives*: “[2022 Outlook: Update #2 – The Tails Become Fatter](#)” (7/12/2022)

Our *Comment* today opens with an update on the Russia-Ukraine war, where the main news focuses on fighting around a major nuclear power plant and Russian preparations to hold a sham referendum on annexing the territories it occupies to Russia. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today.

Russia-Ukraine: Over the weekend, [there was little change in the overall disposition and activity of the Russian and Ukrainian forces in theater.](#) The Russians made only very limited territorial gains in Ukraine’s northeastern Donbas region, while they continued trying to reinforce their positions to defend against a slow-moving Ukrainian counteroffensive designed to retake the city of Kherson, which the Russians have held since early in the war. Meanwhile, in a development that highlights the broader risks of the war, shelling near the Zaporizhzhia nuclear power plant in eastern Ukraine [severed some high-voltage power lines serving the facility,](#) forcing engineers to shut down one of its six reactors over the weekend.



- Separately, reports indicate that Russian occupation authorities are accelerating their plans for a pseudo-referendum in occupied territories on annexation to Russia. Facing limited cooperation from Ukrainian citizens and partisan threats to any officials that might help legitimize a Russian annexation, the Russian authorities are reportedly planning to dispense with polling places and have the Ukrainians “vote from home,” i.e., have Russian troops visit each home and survey each voter at gunpoint.

- In his regular video address last night, Ukrainian President Zelensky vowed that if Moscow holds referendums on joining Russia in occupied areas of his country, there [could be no chance that Kyiv and its Western allies would hold peace talks](#) with Russia.

China-Taiwan: The People’s Liberation Army [has continued its aggressive military exercises around Taiwan](#), despite saying last week that the maneuvers would end on Saturday. The continued exercises suggest Beijing might intend to keep pressuring Taiwan over time to punish it for House Speaker Pelosi’s visit to the island last week.

- With China’s maneuvers already disrupting sea and air access to Taiwan, continued exercises could amount to a “soft” blockade of the island, raising a thorny dilemma for the U.S. and the island’s other allies.
- Such a soft blockade would force Taiwan’s allies to make the tough decision of whether and how to break it. Whatever strategy they would adopt could potentially lead to greatly increased tension or military conflict, with massive impacts on the financial markets.

China: In data over the weekend, China’s July trade surplus [expanded to a seasonally adjusted \\$101.26 billion, beating expectations and marking a rise from the surplus of \\$97.90 billion](#) in June. The expansion came mostly in exports as trading and logistics firms continued to catch up from the disruptions of China’s mass pandemic shutdowns during the spring.

- The country’s July exports were up a robust 18.0% year-over-year, accelerating from a 17.9% year-to-date gain.
- In a significant note of caution, however, the country’s July imports were up just 2.3% from the same month one year earlier, after a weak annual rise of 1.0% in June. The import figures suggest that China’s domestic demand continues to grow tepidly, with negative implications for the global economy and financial markets.

Israel: The Israeli government and the Gaza militant group Islamic Jihad [agreed to a ceasefire yesterday after three days of fighting](#) that killed more than 40 Palestinians and sent rockets flying deep into Israel’s heartland. The exchange of fire had been the most intense since an 11-day conflict between the Israelis and the military group last year.

Colombia: Gustavo Petro, a former leftist guerilla and longtime congressman, [was inaugurated as president](#) yesterday. In his inaugural speech, Petro pledged to lower poverty and hunger in Colombia and secure peace by engaging in talks with several armed groups. He also laid out a platform to redistribute wealth, modernize the countryside, and adopt environmentally friendly economic policies.

Greece: Prime Minister Mitsotakis [is facing a major political scandal](#) after local media reported that the phone of Nikos Androulakis, a European Parliament member who is the leader of the opposition socialist PASOK party, had been bugged by the Greek intelligence service. The prime minister’s chief of staff (who is also Mitsotakis’s nephew) and the head of the intelligence service resigned on Friday.

Eurozone Monetary Policy: According to the *Financial Times*, the ECB in June and July [used €17 billion of maturing bonds in its emergency pandemic relief fund to buy Italian, Spanish, and](#)

[Greek government obligations](#), while allowing its portfolio of German, Dutch, and French debt to fall by €18 billion. The transactions illustrate the ECB’s “anti-fragmentation” effort to keep bond yields from blowing out in the Eurozone’s weaker economies.

- The reinvestments under the pandemic relief program are separate from the ECB’s new “Transmission Protection Instrument” (TPI), which can be used in case the pandemic relief program reinvestments fail to keep spreads under control. The TPI allows the ECB to buy the bonds, at unlimited scale, of any country it deems to be facing market pressures outside the economic outlook.
- In any case, the reinvestments show that the ECB had already embarked on the controversial anti-fragmentation effort before early this summer. Nevertheless, there is still some risk that the central bank will run into difficulties in both raising interest rates and trying to control yields in the Eurozone.

U.S. Fiscal Policy: The Senate yesterday [passed President Biden’s “Inflation Reduction Act,”](#) consisting of hundreds of billions of dollars of income tax increases on large, profitable companies to cut the federal budget deficit, partially offset by increased spending on a range of healthcare and climate-stabilization programs. The bill [will now go to the House](#), where it is likely to be approved on Friday before being sent to President Biden to be signed into law.

- Among its [major provisions](#), the bill would:
 - Impose a minimum corporate income tax of 15% and a 1% excise tax on stock buybacks. It would also boost funding to the Internal Revenue Service in order to reduce tax evasion. Of the funds raised, the bill sets aside approximately \$300 billion to reduce the budget deficit.
 - Among its key spending provisions, the bill would provide new tax incentives for investments that reduce carbon emissions, extend health insurance subsidies under the Affordable Care Act, and allow the federal government to negotiate pricing for some drugs covered by Medicare.
- Politically, final passage of the bill [would mark an unexpected and improbable string of legislative victories for Biden](#), although it remains to be seen whether the White House political team can finally get that message out and reverse what is still likely to be massive losses in the November midterm elections. Despite the name of the legislation, a wide range of analysts expect the bill will have very little impact on bringing down inflation, especially in the near term. Biden’s unlikely tally of legislative wins to date, along with their spending totals, include:
 - American Recovery Act: \$1.9 trillion
 - Infrastructure Investment and Jobs Act: \$550 billion
 - Chips and Science Act: \$280 billion
 - Inflation Reduction Act: ~\$700 billion
 - NATO Enlargement to include Sweden and Finland
 - Gun Safety Legislation
 - Veterans’ Burn Pit Healthcare Legislation

U.S. Labor Market: Despite the strong headline numbers in the July employment report, released last Friday, some major employers [are reporting that it’s getting easier to hire and keep](#)

[workers](#). That's consistent with our view that the July report probably overstated the actual strength of the labor market, in large part because of challenging seasonal adjustment issues. While it does appear that payrolls increased in July, the true pace is probably moderating.

- All the same, the labor market remains tight as the pool of available workers continues to grow sluggishly.
- Importantly, the strong headline numbers in the July report and continued inflation pressures suggest the Fed will continue to hike interest rates aggressively in the coming months.

U.S. Coronavirus Vaccines: Pfizer (PFE, 49.27) and partner BioNTech (BNTX, 183.11) [said they will soon start clinical trials for a COVID-19 vaccine designed to block the BA.4 and BA.5 variants](#) of Omicron. If the trials are successful and the vaccine is approved, the shot could become available as early as October.

U.S. Economic Releases

There were no domestic releases or Fed events scheduled prior to the publication of this report.

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	BoP Current Account Balance	m/m	Jun	-¥132.4b	¥128.4b	-¥706.2b	***	Equity and bond neutral
	BoP Trade Balance	m/m	Jun	-¥1.114t	-¥1.951b	-¥985.9t	**	Equity and bond neutral
New Zealand	2-Year Inflation Expectations	q/q	2Q	3.07%	3.29%		**	Equity and bond neutral
China	Foreign Reserves	m/m	Jul	\$3.104t	\$3.071t	\$3.051t	**	Equity and bond neutral
	Trade Balance	m/m	Jul	\$101.26b	\$97.94b	\$89.04b	***	Equity and bond neutral
	Exports	y/y	Jul	18.0%	17.9%	14.0%	**	Equity bullish, bond bearish
	Imports	y/y	Jul	2.3%	1.0%	4.0%	**	Equity bearish, bond bullish
EUROPE								
Switzerland	Foreign Currency Reserves	m/m	Jul	849.4b	849.8b	849.0b	*	Equity and bond neutral
	Domestic Sight Deposits CHF	w/w	5-Aug	642.1b	635.3b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	5-Aug	749.6b	747.1b		*	Equity and bond neutral
	Unemployment Rate	m/m	Jul	2.2%	2.2%	2.2%	**	Equity and bond neutral
AMERICAS								
Canada	Bloomberg Nanos Confidence	w/w	5-Aug	46.7	46.2		**	Equity and bond neutral

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)	287	286	1	Up
3-mo T-bill yield (bps)	244	246	-2	Up
TED spread (bps)	43	41	2	Widening
U.S. Sibor/OIS spread (bps)	269	269	0	Up
U.S. Libor/OIS spread (bps)	274	273	1	Up
10-yr T-note (%)	2.79	2.83	-0.04	Up
Euribor/OIS spread (bps)	28	27	1	Neutral
Currencies	Direction			
Dollar	Down			Up
Euro	Flat			Down
Yen	Up			Down
Pound	Up			Down
Franc	Up			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	\$93.23	\$94.92	-1.78%	
WTI	\$87.47	\$89.01	-1.73%	
Natural Gas	\$7.76	\$8.06	-3.72%	Improving weather conditions
Crack Spread	\$36.10	\$36.15	-0.16%	
12-mo strip crack	\$28.30	\$28.63	-1.14%	
Ethanol rack	\$2.71	\$2.70	0.11%	
Metals				
Gold	\$1,782.58	\$1,775.50	0.40%	
Silver	\$20.24	\$19.90	1.75%	
Copper contract	\$353.55	\$355.20	-0.46%	
Grains				
Corn contract	\$603.50	\$610.00	-1.07%	
Wheat contract	\$766.25	\$775.75	-1.22%	
Soybeans contract	\$1,407.50	\$1,408.75	-0.09%	
Shipping				
Baltic Dry Freight	1,560	1,603	-43	

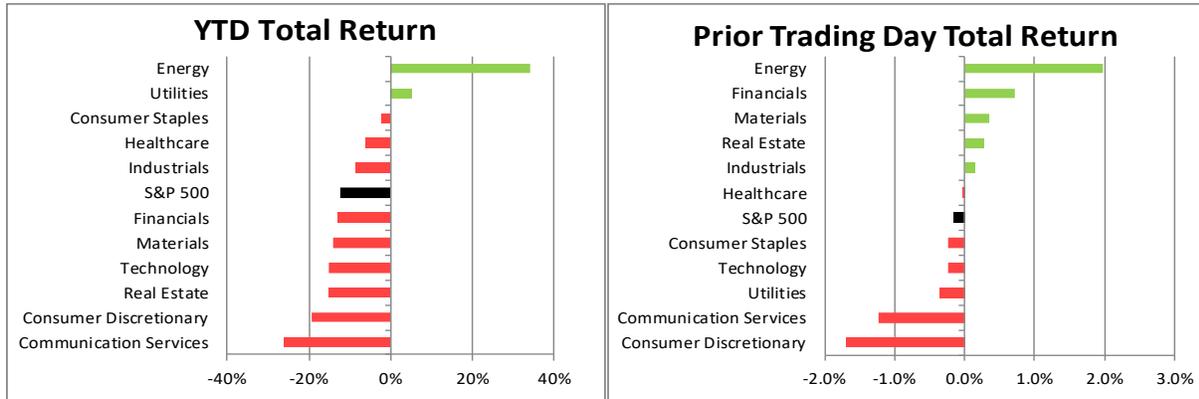
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures throughout most of the country, with cooler-than-normal temperatures in the Southwest and Mid-Atlantic. Wetter-than-normal conditions are expected in the Southwest, Pacific, and parts of the Great Plains, with dry conditions expected in the Midwest.

In the Gulf Coast, Caribbean, and Atlantic Ocean areas, there is cyclone formation off the coast of West Africa; however, it is not expected to develop into a tropical storm.

Data Section

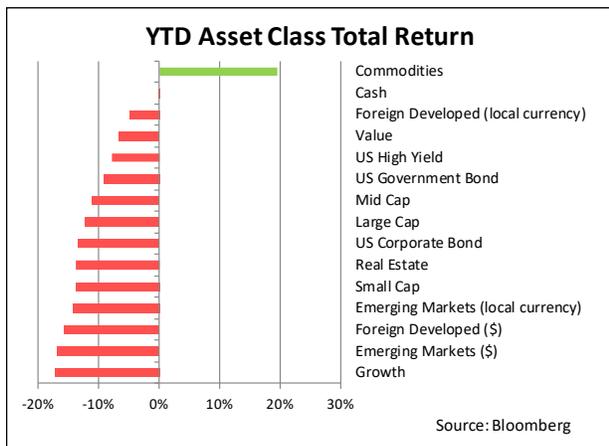
U.S. Equity Markets – (as of 8/5/2022 close)



(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 8/5/2022 close)

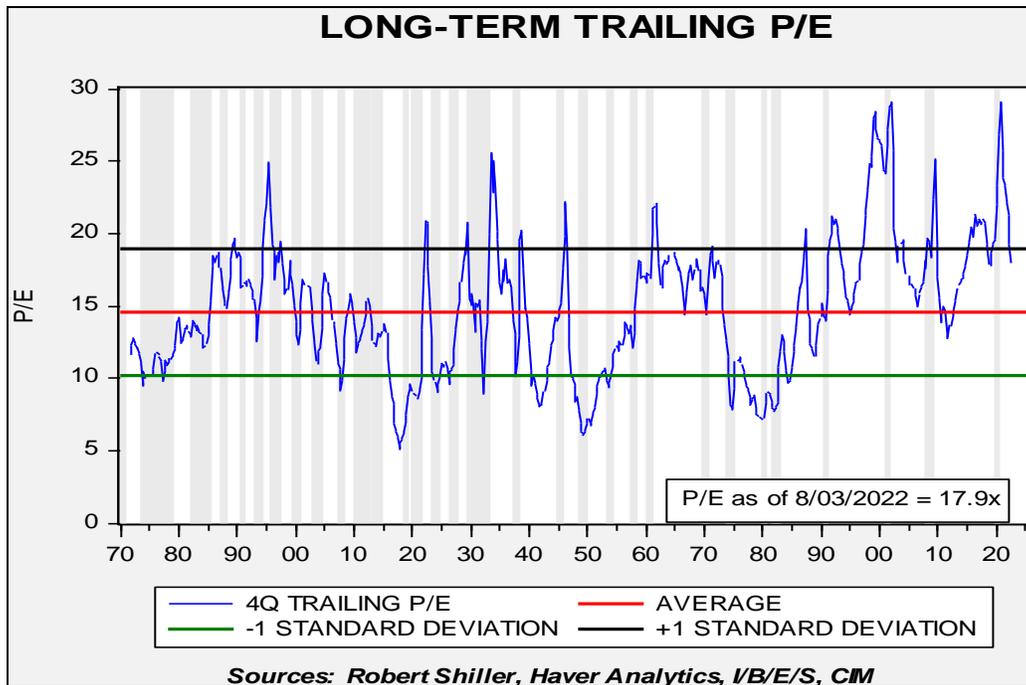


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

August 4, 2022



Based on our methodology,¹ the current P/E is 17.9x, up 0.3x from last week. The rise in the P/E is due to higher equity prices.

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.

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 (Q4 and Q1) and two estimates (Q2 and Q3). 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.