

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 15, 2022—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is currently up 0.2% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.2%. Chinese markets were mixed, with the Shanghai Composite relatively unchanged from its prior close and the Shenzhen Composite up 0.5%. U.S. equity index futures are signaling a lower open. With 457 companies having reported, the S&P 500 Q2 2022 earnings stand at \$57.30, higher than the \$55.26 forecast for the quarter. The forecast reflects a 4.3% increase from Q2 2021 earnings. Thus far this quarter, 75.5% 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](#) (8/11/2022): We take a second look at the Inflation Reduction Act and continue our discussion on European weather, noting falling Rhine River levels. Also worth noting are European natural gas inventories, which are actually in good shape heading into autumn.
- [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](#) (8/9/2022): “The 2022 Outlook: Update #2”
- [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 disposition of forces has changed relatively little in recent days. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, most notably a bevy of disappointing economic news from China and a surprise interest-rate cut from the country’s central bank.

Russia-Ukraine: Russian invasion forces [continue to make only incremental territory gains in Ukraine's eastern Donbas region](#), while reinforcing their troops occupying the southern region around Kherson. The latest reports highlight that those reinforcement efforts have left the Russians with a hodgepodge of forces from different military districts and of different capabilities, which would likely make them hard to manage and relatively ineffective.



- Ukrainian forces continue to destroy the bridges linking Kherson with the rest of the territory occupied by the Russians, which will make it even harder for the Russians to defend the territory against Ukrainian counteroffensives.
- Meanwhile, global leaders are becoming increasingly alarmed about the fighting around the Zaporizhzhia nuclear power plant in eastern Ukraine. One concern is that the fighting could damage the reactors and cause a nuclear disaster. Another concern is that the Russians [are reportedly siphoning off electricity from the plant and sending it to Russia](#).

- On the energy front, the leaders of Spain and Portugal [said they support German Chancellor Scholz's call last week for a north-south natural gas pipeline](#) that would run from Portugal via Spain and France to Central Europe.
 - According to Spanish Ecological Transition Minister Teresa Ribera, the Spanish portion of the pipeline could be finished in eight or nine months.
 - The next major approval would have to come from France.

China: After a wide range of data today showed China's post-pandemic economic recovery stumbled in July, the People's Bank of China [announced a surprise interest-rate cut](#). However, the cut in the medium-term interest rate was just 0.1%, to 2.75%, perhaps signaling the central bank's reluctance to ease policy more aggressively after it recently warned about inflation pressures.

- Among the weak data points, July industrial production [was up just 3.8% year-over-year](#), well short of the expected rise of 4.5%. July retail sales were up 2.7% on the year, compared with an anticipated rise of 5.0%. A key index of new home prices was down 1.7% year-over-year, after being down 1.3% in the prior month.
- The broadly weak economic data and tepid interest-rate cuts suggest China's economy will offer little support to global economic activity this year. This news coupled with high inflation around the globe, aggressive interest-rate hikes by many key central banks, and the impact of the Russia-Ukraine war, suggests the U.S. economy and financial markets are likely to face headwinds in the coming months.
- One major impact so far this morning: commodity prices [have fallen dramatically](#), with Brent crude oil down 5.2% to \$93.06 and copper down 3.0% to \$3.5555.

China-Taiwan-United States: Following House Speaker Pelosi's controversial visit to Taiwan earlier this month, a bipartisan group of Congressmen [landed on the island yesterday](#), prompting [another round of protests and threatening military exercises by Beijing](#). Like Pelosi, the legislators said they were visiting Taiwan to express support for its democracy and to demonstrate their right to visit the island.

- Indeed, these Congressional visits could be seen as political "freedom of operation sailings" or FONOPS, similar to those the U.S. Navy makes throughout the waters around China to assert the right of foreign ships to sail in international waters.
- The Congressional visits, like their naval counterparts, help to push back against Beijing's geopolitical aggressiveness in the Indo-Pacific region, but they also raise U.S.-China tensions and increase political risks for cross-border investors.

United States-Iran: U.S. Secretary of State [Blinken has explicitly linked Iran to the attempted murder last week of irreverent novelist Salman Rushdie](#). Specifically, Blinken called out Iranian institutions for inciting violence against Rushdie for generations and then gloating over the news of his stabbing last week. The statement illustrates how the stabbing has become yet another source of tension between the U.S. and Iran.

European Drought: As Europe’s historic drought worsens, the depth of the Rhine River between Wiesbaden and Koblenz [fell to just 40 cm on Friday](#). At that depth, most barges can only carry a fraction of their capacity, meaning companies needing to send coal, chemicals, or components upstream from Rotterdam and Antwerp will have to use much more expensive truck and rail systems.

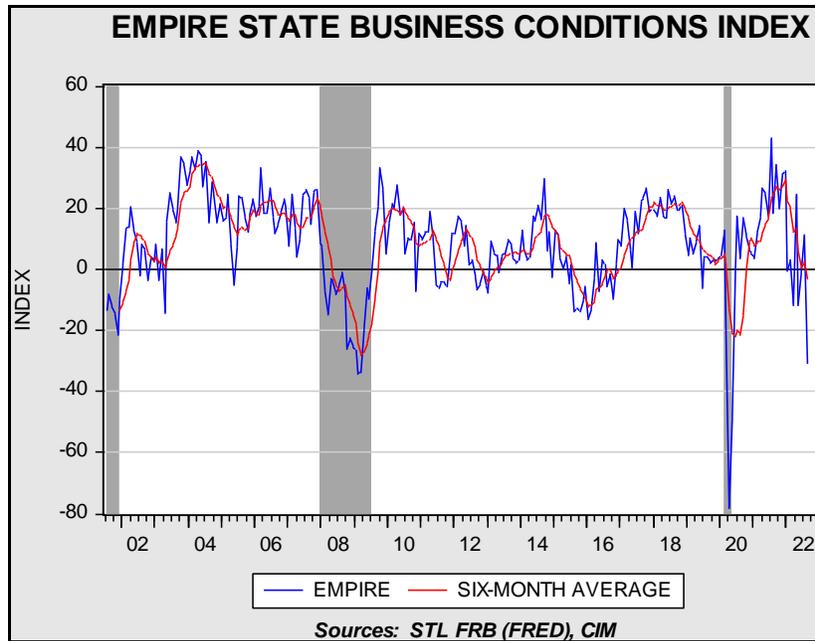
United Kingdom-Leadership Race: In the race to succeed Boris Johnson as Conservative Party leader and prime minister, polling over the weekend showed Foreign Minister Liz Truss’s lead over Former Chancellor Rishi Sunak [has narrowed to 22%](#). However, other reports say as many as 8 in 10 party members [have already sent in their ballots](#), which likely works in Truss’s favor because her lead hadn’t begun to narrow until recently.

United Kingdom-COVID: The Medicines and Healthcare Products Regulatory Authority [has approved a COVID-19 vaccine from Moderna \(MRNA, \\$171.18\) that is specifically targeted to the highly transmissible Omicron variant](#). The move makes the U.K. the first country in the world to approve an Omicron-specific vaccine and likely sets up an autumn vaccination drive for it.

U.S. Fiscal Policy: On Friday, the [House passed President Biden’s “Inflation Reduction Act,”](#) which includes higher taxes on corporations and increased funding for the IRS to raise funds for deficit reduction, as well as providing new funding for healthcare, climate-stabilization, and [sustainable agriculture](#) policies. As we’ve noted previously, passage of the bill [may marginally improve the Democrats’ prospects in the mid-term elections in November](#), but we still expect the Republicans to take control of at least the House.

U.S. Economic Releases

Industrial activity in New York state took a nosedive in August, according to a survey from the Federal Reserve Bank of New York. The Empire State Manufacturing general business conditions index fell to -31.3 from 11.1 in July. The reading was well below consensus expectations of 5.0.



The chart above shows the six-month moving average of the Empire State Manufacturing Index. The moving average declined to -3.36, slightly below the recession indicator of 0. Although this chart does not provide a complete picture of the entire economy, it does suggest that GDP growth is starting to slow.

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

Economic Releases						
EST	Indicator			Expected	Prior	Rating
10:00	NAHB Housing Market Index	m/m	Aug	55.0	55.0	**
16:00	Net Long-term TIC Flows	m/m	Jun		\$155.3b	**
16:00	Total Net TIC Flows	m/m	Jun		\$182.5b	*
Federal Reserve						
No Fed speakers or events for the rest of today						

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	GDP SA	y/y	Q2	0.5%	-0.1%	0.0%	***	Equity bullish, bond bearish
	Industrial Production	y/y	Jun	-2.8%	-3.1%		***	Equity and bond neutral
	Capacity Utilization	y/y	Jun	9.6%	-9.2%		***	Equity bullish, bond bearish
China	New Home Prices	m/m	Jul	-0.1%	-0.1%	-0.1%	*	Equity and bond neutral
	Industrial Production	y/y	Jul	3.8%	3.9%	4.3%	***	Equity and bond neutral
	Retail Sales	y/y	Jul	2.7%	3.1%	4.9%	**	Equity bearish, bond bullish
	Fixed Assets Ex Rural	y/y	Jul	5.7%	6.1%	6.2%	**	Equity bearish, bond bullish
EUROPE								
Switzerland	Producer & Import Prices	y/y	Jul	6.3%	6.9%		**	Equity and bond neutral
Russia	GDP	q/q	2Q	-4.0%	3.5%	-4.7%	**	Equity bullish, bond bearish
AMERICAS								
Canada	Manufacturing Sales	m/m	Jun	-0.8%	-2.0%	-1.1%	**	Equity and bond neutral
	Wholesale Trade Sales	m/m	Jun	0.1%	1.6%	0.9%	*	Equity and bond neutral
Brazil	Economic Activity Index	y/y	Jun	3.1%	3.7%	2.6%	**	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.

Fixed Income	Today	Prior	Change	Trend
3-mo Libor yield (bps)	292	291	1	Up
3-mo T-bill yield (bps)	249	250	-1	Up
TED spread (bps)	44	40	4	Widening
U.S. Sibor/OIS spread (bps)	274	272	2	Up
U.S. Libor/OIS spread (bps)	278	276	2	Up
10-yr T-note (%)	2.83	2.83	0.00	Up
Euribor/OIS spread (bps)	33	32	1	Neutral
Currencies	Direction			
Dollar	Up			Up
Euro	Down			Down
Yen	Flat			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	\$93.30	\$98.15	-4.94%	demand pessimism
WTI	\$87.57	\$92.09	-4.91%	demand pessimism
Natural Gas	\$8.70	\$8.77	-0.81%	
Crack Spread	\$41.41	\$42.59	-2.77%	
12-mo strip crack	\$31.59	\$32.49	-2.75%	
Ethanol rack	\$2.81	\$2.80	0.48%	
Metals				
Gold	\$1,773.82	\$1,802.40	-1.59%	
Silver	\$20.26	\$20.82	-2.69%	
Copper contract	\$356.25	\$366.85	-2.89%	
Grains				
Corn contract	\$626.25	\$642.25	-2.49%	
Wheat contract	\$804.50	\$822.50	-2.19%	
Soybeans contract	\$1,413.75	\$1,454.25	-2.78%	
Shipping				
Baltic Dry Freight	1,477	1,556	-79	
DOE Inventory Report				
	Actual	Expected	Difference	
Crude (mb)	5.5	-1.0	6.5	
Gasoline (mb)	-5.0	-1.1	-3.9	
Distillates (mb)	2.2	-1.0	3.2	
Refinery run rates (%)	3.3%	0.5%	2.8%	
Natural gas (bcf)	44	41	3.0	

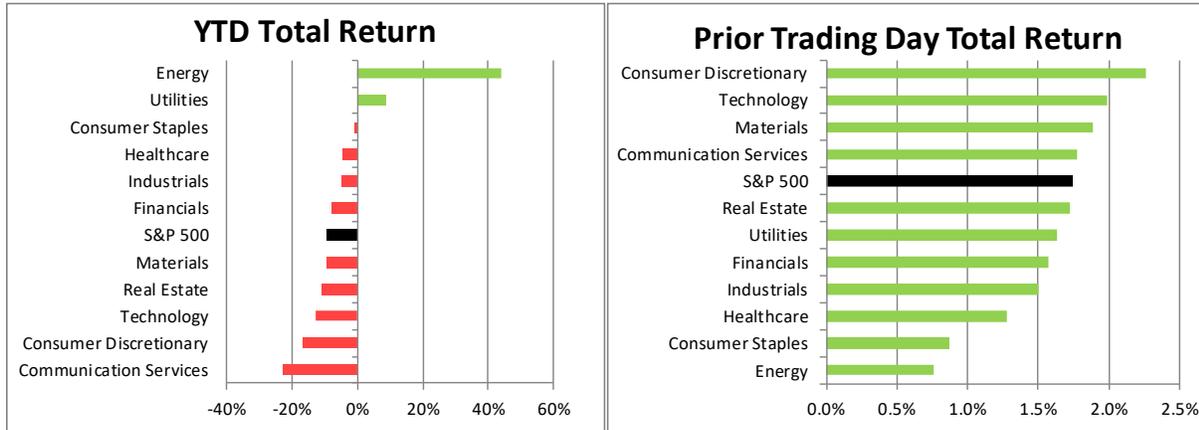
Weather

The 6-10 and 8-14 day forecasts call for warmer-than-normal temperatures in the Rocky Mountain, Pacific, and East Coast, with cooler-than-normal temperatures for the rest of the country. Wetter-than-normal conditions are expected for most of the country, with dry conditions expected along the border with Canada.

In the Gulf Coast, Caribbean, and Atlantic Ocean areas, there is a tropical disturbance near Southern Texas. However, it is unlikely to form into a cyclone within the next 48 hours.

Data Section

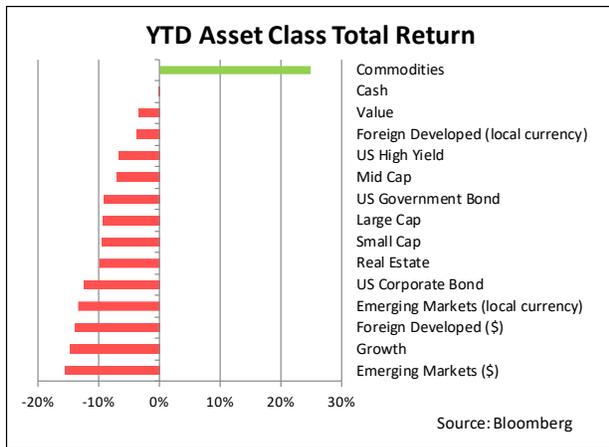
U.S. Equity Markets – (as of 8/12/2022 close)



(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 8/12/2022 close)

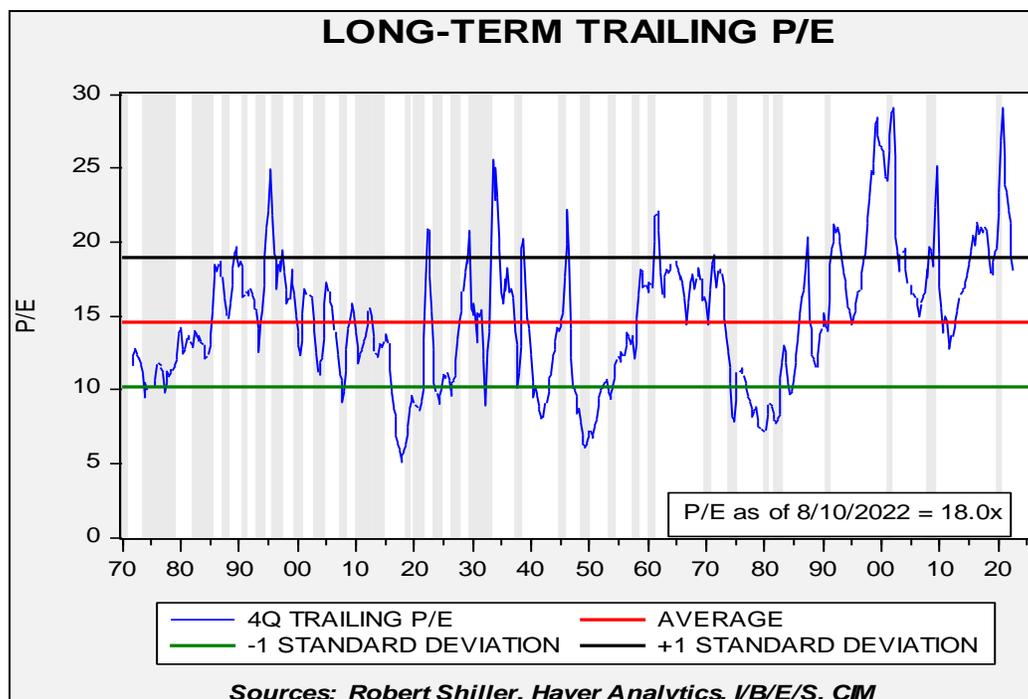


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 11, 2022



Based on our methodology,¹ the current P/E is 18.0x, up 0.1x from last week. The rise in the P/E is mostly due to the recovery in 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.