

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 16, 2023—9:30 AM EDT] Global equity markets are generally lower this morning. In Europe, the Euro Stoxx 50 is down 0.1% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.0%. Chinese markets were lower, with the Shanghai Composite down 0.8% from its previous close and the Shenzhen Composite down 1.0%. In contrast, U.S. equity index futures are signaling a higher open.

With 461 companies having reported so far, S&P 500 earnings for Q2 are running at \$54.00 per share, compared to estimates of \$53.55 (a decline of 6.8% from Q2 2022). Of the companies that have reported thus far, 80.7% have exceeded expectations while 14.5% have fallen short of expectations.

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](#)** (8/7/2023) (podcast available later this week in the *Confluence of Ideas* series): “The Economics of National Defense in Great Power Competition”
- **[Weekly Energy Update](#)** (8/10/2023): The DOE reported a large increase in U.S. oil production. Also, there was a 1.0 mb injection into the Strategic Petroleum Reserve. The U.S. is considering placing U.S. troops on commercial vessels in the Persian Gulf to discourage Iranian attacks on shipping.
- **[Asset Allocation Quarterly – Q3 2023](#)** (7/20/2023): Discussion of our asset allocation process, Q3 2023 portfolio changes, and our outlook for the markets.
- **[Asset Allocation Q2 2023 Rebalance Presentation](#)** (5/11/2023): 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](#)** (8/14/2023) (with associated [podcast](#)): “Where’s the Recession? Examining Employment”
- **[Confluence of Ideas podcast](#)** (7/10/2023): “The 2023 Mid-Year Geopolitical Outlook”

Our *Comment* today opens with a brief remark on the importance of linking geopolitics to investment strategy. We next review a range of international and U.S. developments with the potential to affect the financial markets today, including another instance in which U.S.-China

tensions have apparently scuttled an international transaction and ominous signs of a potential autoworkers' strike in the U.S.

Geopolitics and Investment Strategy: The *Financial Times* today carries an interesting opinion piece by Saker Nusseibeh, CEO of asset manager Federated Hermes (FHI, \$32.77), in which he [argues that de-globalization and the fracturing of the world into blocs requires asset managers to pay closer attention to geopolitics](#). According to Nusseibeh, asset managers today need to have a deep understanding of how geopolitics can affect asset values and prospects, and they need to actively develop the skill sets and human capital applicable to understanding those linkages. As our regular readers know, we are longtime practitioners of geopolitical analysis and take great pride in our ability to walk from an understanding of the world's political, security, and economic trends to the setting of investment strategy. Reading Nusseibeh's article today, our response is: We couldn't have said it better ourselves!

China-United States: As one great example of how geopolitics can directly affect company operations and prospects, semiconductor giant Intel (INTC, \$34.77) and Israeli computer-chip maker Tower Semiconductor (TSEM, \$33.78) today [said they will abandon their planned merger after failing to get timely approval from China's State Administration for Market Regulation](#). Beijing's failure to approve the deal is being widely interpreted as further retaliation against the West for its clampdown on advanced technology flows to China. As we have argued many times before, the increasing geopolitical rivalry between the U.S. bloc and the China/Russia bloc presents risks for any investor who has a position in Chinese assets or in assets dependent on the Chinese market and/or Chinese regulators.

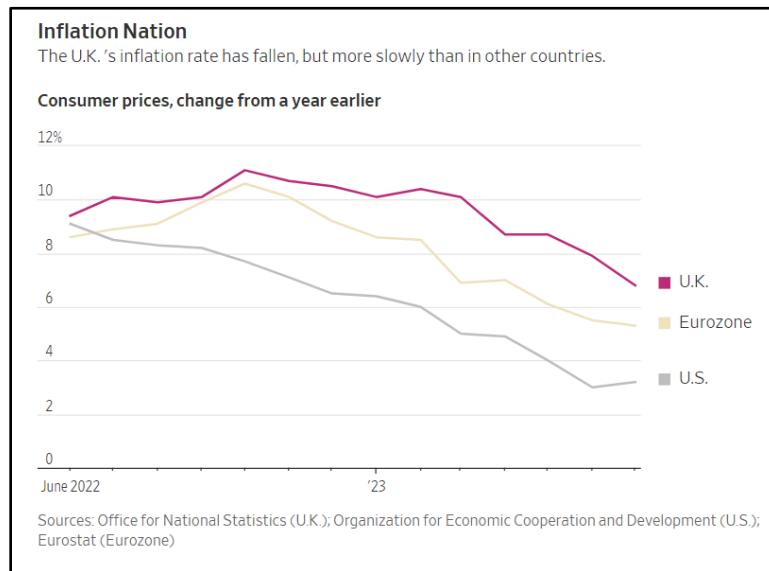
China-Vietnam: New commercial imagery shows China [has suddenly started building an airstrip on one of the disputed Paracel Islands in the South China Sea](#). At present, it appears the airstrip is too small to host larger military jets. Nevertheless, its location on Triton Island, which is the Paracel Island closest to Vietnam, will likely be disconcerting to Hanoi. While it's become commonplace to note Beijing's mistakes in economic management, this could be another instance of it over-playing its geopolitical and military hand, since construction of the airstrip could push Vietnamese officials even closer to the U.S.

Russia-United Kingdom: British police said that in February they [arrested five people, including three Bulgarians, on charges of working under non-official cover for the Russian intelligence services](#). The arrests are only the latest in a series of arrests of Russian intelligence operatives posing as common citizens in Western countries, rather than as diplomats and other officials. That likely reflects the damage done to Russian intelligence when Western countries expelled hundreds of official-cover spies immediately after Russia's invasion of Ukraine last year. To compensate, the Russians have activated their deep-cover operatives, raising their profiles and putting them at greater risk of arrest.

Russia: After the central bank's big interest-rate hike yesterday failed to stem the ruble's (RUB) steep depreciation, President Putin today [is holding an emergency meeting with his top economic officials to discuss ramping up currency controls](#). The measures being considered include requiring exporters to convert 80% of their foreign-currency revenue to RUB, banning foreign

loans and dividend payments, and cancelling import subsidies. In New York trading yesterday, the RUB closed at 98.001 per dollar (\$0.0102), down 1.0%.

United Kingdom: Just a day after a report of surging wage rates sparked renewed concerns about inflation, the Office for National Statistics today said the July consumer price index [was up 6.8% from the same month one year earlier, considerably better than the 7.9% rise in the year to June](#) and the lowest headline inflation reading since February 2022. However, after excluding the volatile food and energy components, the July “core” CPI was 6.9%, matching the core inflation rate in June and coming in above expectations. On balance, the reports suggest the Bank of England will have to continue hiking interest rates to get a handle on the U.K.’s sticky inflation problem.



Japan: Now that the country is seeing sustained inflation again and longer-term interest rates are moving up, Japanese banks [are starting to realize that their bond traders may not have the skill set to deal with higher yields and greater volatility](#). Some bankers are therefore actively seeking to hire older traders with experience extending back to the 1980s. At least one banker has likened the situation to this year’s *Top Gun: Maverick* movie, in which an aging pilot with specialized skills is called back into service.

Argentina: Even though the government implemented a sudden currency devaluation and interest-rate hike immediately after radical right-wing economist Javier Milei won the weekend’s presidential primary election, the peso (ARS) [has remained under pressure on concerns about Milei’s proposed austerity and currency policies](#). The markets increasingly suggest the government will have to devalue the currency further in the coming days, which would only add to Argentina’s sky-high price inflation. The chaos also puts at risk the International Monetary Fund’s final approval for the latest \$7.5-billion installment of its \$44-billion bailout package.

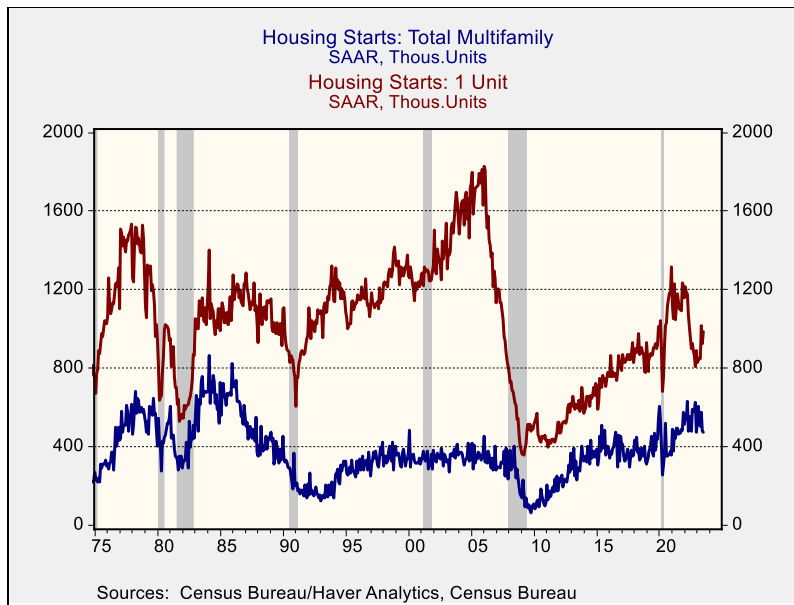
U.S. Labor Market: The United Autoworkers Union said new contract negotiations with the top U.S. automakers have been going too slowly, so it [will hold a strike vote next week](#). If at

least two-thirds of the union members vote to authorize the strike, union leaders would be able to formally call the walk-out as the September 14 expiration of the current contract draws closer. Based on the recent militant comments by union leaders and the fact that they have made such aggressive requests in the negotiations, the probability of a costly, disruptive strike is elevated.

U.S. Economic Releases

Elevated interest rates continue to weigh on demand for residential loans. The Mortgage Bankers Association’s (MBA) Mortgage Market Index, which tracks mortgage applications, fell 0.8% in the week ending August 11. The drop in the number of applications can be attributed to lending rates rising to their highest level since October 2022. The average 30-year fixed-rate mortgage rose 7 bps from 7.09% to 7.16%. As a result, the MBA trackers for purchases and refinancing fell 0.3% and 1.9%, from the prior week, respectively.

New construction on homes rose in July but plans for future construction were muted. According to the U.S. Census Bureau, housing starts increased by 3.9% to an annualized rate of 1452k units in July. This was higher than the 1.7% increase that economists had forecast, and significantly higher than June’s decline of 11.7%. Building permits, which are a measure of future construction activity, rose by only 0.1% to 1442k units last month. This was well below expectations of 1.1% but above the previous report’s decline of 3.7%.



The chart above shows the level of housing starts for single and multi-family homes. New construction for single family dwellings increased from 921k to 983k in July. Meanwhile, multi-family constructions decreased from 477k to 469k.

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

Economic Releases						
EST	Indicator			Expected	Prior	Rating
9:15	Industrial Production	m/m	Jul	0.3%	-0.5%	***
9:15	Industrial Capacity Utilization	m/m	Jul	79.1%	78.9%	**
Federal Reserve						
EST	Speaker or Event	District or Position				
14:00	FOMC Meeting Minutes	Federal Reserve Board				

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	Westpac Leading Index	m/m	Jul	-0.03%	0.11%	0.08%	**	Equity and bond neutral
EUROPE								
Eurozone	GDP	y/y	2Q P	0.6%	0.6%	0.6%	***	Equity and bond neutral
Eurozone	Industrial Production WDA	y/y	Jun	-1.2%	-2.2%	-2.5%	**	Equity bullish, bond bearish
UK	CPI	y/y	Jul	6.8%	7.9%	6.7%	***	Equity and bond neutral
	Core CPI	y/y	Jul	6.9%	6.9%	6.8%	**	Equity and bond neutral
	Retail Price Index	y/y	Jul	374.2%	376.4%	374.0%	***	Equity and bond neutral
	RPI	y/y	Jul	9.0%	10.7%	9.0%	*	Equity and bond neutral
	Nationwide House Price Index	y/y	Jun	1.7%	1.9%	1.8%	***	Equity and bond neutral
AMERICAS								
Canada	Manufacturing Sales	m/m	Jun	-1.7%	1.2%	-2.0%	**	Equity and bond neutral
Canada	CPI	y/y	Jul	3.30%	2.80%	3.00%	***	Equity and bond neutral
	Existing Home Sales	m/m	Jul	-0.7%	1.5%		**	Equity bearish, bond bullish
Mexico	International Reserves Weekly	w/w	11-Aug	\$203861m	\$203889m		*	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.

doe	Today	Prior	Change	Trend
3-mo Libor yield (bps)	563	563	0	Up
3-mo T-bill yield (bps)	527	527	0	Up
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	537	537	0	Up
U.S. Libor/OIS spread (bps)	539	539	0	Up
10-yr T-note (%)	4.20	4.21	-0.01	Flat
Euribor/OIS spread (bps)	379	380	-1	Up
Currencies	Direction			
Dollar	Flat			Up
Euro	Flat			Up
Yen	Down			Down
Pound	Up			Up
Franc	Down			Up
Central Bank Action	Current	Prior	Expected	
RBNZ Official Cash Rate	5.500%	5.500%	5.500%	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.

DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$85.09	\$84.89	0.24%	
WTI	\$81.21	\$80.99	0.27%	
Natural Gas	\$2.63	\$2.66	-1.24%	
Crack Spread	\$41.42	\$41.21	0.50%	
12-mo strip crack	\$30.59	\$30.50	0.30%	
Ethanol rack	\$2.34	\$2.34	-0.20%	
Metals				
Gold	\$1,901.11	\$1,902.00	-0.05%	
Silver	\$22.60	\$22.53	0.31%	
Copper contract	\$370.85	\$370.55	0.08%	
Grains				
Corn contract	\$478.75	\$475.50	0.68%	
Wheat contract	\$631.25	\$623.75	1.20%	
Soybeans contract	\$1,314.75	\$1,305.25	0.73%	
Shipping				
Baltic Dry Freight	1,166	1,135	31	
DOE Inventory Report				
	Actual	Expected	Difference	
Crude (mb)		-2.5		
Gasoline (mb)		-1.1		
Distillates (mb)		-0.5		
Refinery run rates (%)		0.5%		
Natural gas (bcf)		36		

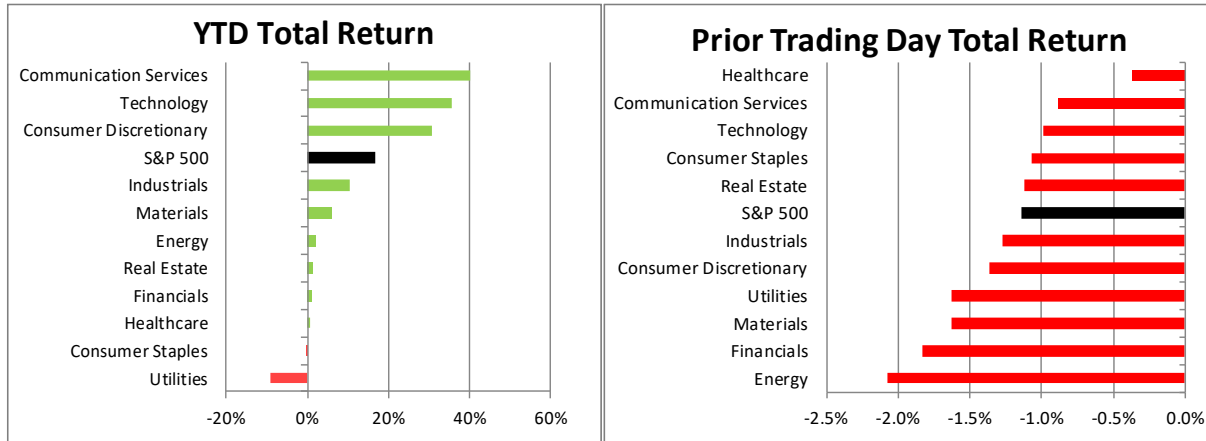
Weather

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 New England. The precipitation outlook calls for wetter-than-normal conditions in the Pacific region, Rocky Mountains, and New England, with dry conditions expected in the Midwest.

There are two disturbances located off the coast of West Africa. The National Hurricane Center (NHC) has given both disturbances a less than 40% chance of developing into tropical cyclones within the next 48 hours.

Data Section

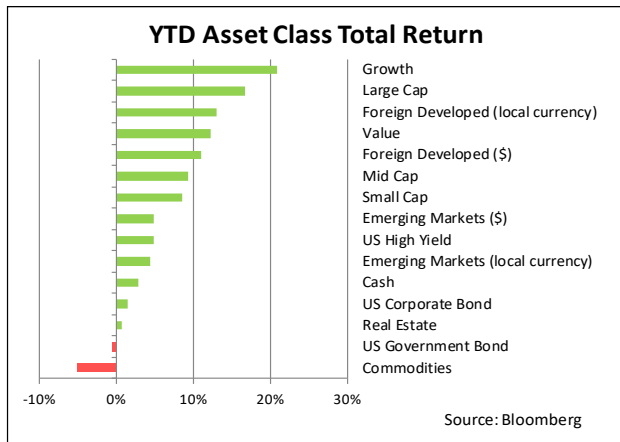
U.S. Equity Markets – (as of 8/15/2023 close)



(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 8/15/2023 close)

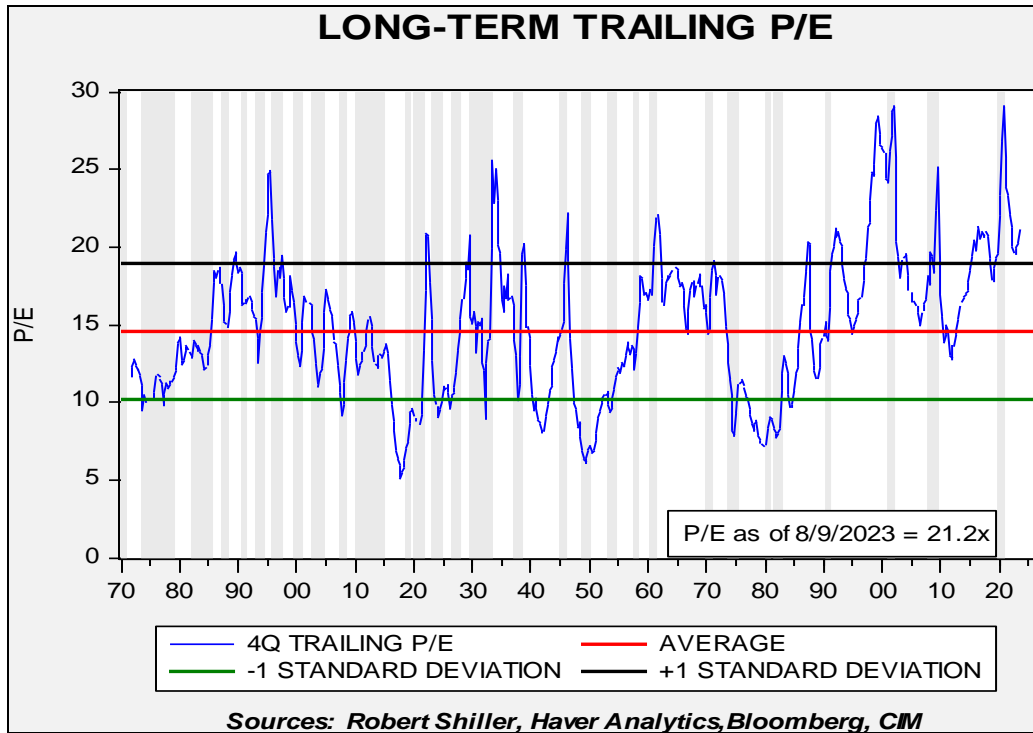


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 10, 2023



Based on our methodology,¹ the current P/E is 21.2x, -0.1x from last week. Stronger earnings led to the drop in 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.

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 Bloomberg 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.