

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 18, 2021—9:30 AM EDT] Global equity markets are lower this morning. In Europe, the EuroStoxx 50 is down 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 closed down 1.6%. Chinese markets were higher, with the Shanghai Composite up 1.1% from its prior close and the Shenzhen Composite also up 0.8%. U.S. equity index futures are signaling a lower open. With 462 companies having reported, the S&P 500 Q2 2021 earnings stand at \$52.40, higher than the \$45.31 forecast for the quarter. The forecast reflects a 60.0% increase from Q2 2020 earnings. Thus far this quarter, 86.4% of the companies have reported earnings above forecast, while 11.9% 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](#) (8/16/2021): “Data and Geopolitics: Part I”
- [Weekly Energy Update](#) (8/12/2021): We cover the administration’s curious call for more OPEC+ oil
- [Asset Allocation Q2 2021 Rebalance Presentation](#) (5/20/2021): A video discussion of our asset allocation process, portfolio changes in Q2, and the macro environment
- [Asset Allocation Weekly](#) (8/13/2021) (with associated [podcast](#) and [chart book](#)): we focus on the implications of growing intellectual property investment
- [Confluence of Ideas podcast](#) (7/7/2021): “The Geopolitics of Taiwan and the Issue of Globalization”

Today’s *Comment* begins with news showing China’s crackdown on big, fast-growing tech companies is perhaps even worse than we’ve been describing. On top of that, President Xi has signaled a broader prioritization of income redistribution that could also be a significant threat to Chinese companies. We next review a range of U.S. and international news, including the latest on Afghanistan. We wrap up with the latest developments related to the coronavirus pandemic.

China: We’ve written a lot about Beijing’s regulatory clampdown on big, fast-growing technology firms, but new reports show the government is going even further to make sure those companies act in accordance with the Chinese Communist Party’s goals. According to corporate filings and people familiar with the matter, the government [is taking a more direct hand in managing its internet-content companies by acquiring stakes, filling board seats, and sending dedicated regulators](#) to police content at firms more frequently.

- The moves build on guidelines first proposed in 2016 but only enacted vigorously over the past year. Under the rules, state-owned entities have purchased small “special management stakes” of 1% or so in publicly traded companies like ByteDance and Weibo (WB, \$46.35). The stakes grant the right to a seat on the companies’ boards of directors, and in at least one instance, the stake also includes veto rights over certain matters related to content and specific future financings.
- The corporate stakes are the latest move in a multiyear campaign by Beijing to establish a foothold inside influential social-media and news platforms and, more broadly, to tighten control over public opinion on China’s internet. More broadly, the stakes suggest the government won’t be content with merely regulating Chinese internet firms and other technology companies. The government is seeking much more control over those companies, which almost certainly won’t support their long-run profitability.
- In addition, President Xi reportedly told a high-level Communist Party committee yesterday that China [needs to “regulate excessively high incomes and encourage high-income groups and enterprises to return more to society.”](#) The committee added that while the party had allowed some people and regions to “get rich first” in the early decades of China’s reform period, it would now prioritize “common prosperity for all.”
- Note to investors: China really is run by a bunch of Communists! The government’s “special management shares” may not be outright nationalization, but it’s important to remember that there can be a fine line between regulation and ownership. After all, even in the U.S., heavy government regulation can trigger lawsuits over the “takings” clause of the constitution. Beijing’s small stakes basically amount to “golden shares” that provide the government with much more control than is compatible with a wholly profit-seeking company. Coupled with the government’s apparent turn to income control and redistribution, this is bad news for investors in Chinese companies.

Afghanistan: To keep hundreds of millions of dollars from the Taliban, the administration [last week canceled bulk shipments of dollars to Afghanistan and imposed a block on Taliban access to government accounts](#) managed by the Federal Reserve and other U.S. banks.

- The administration is also working to prevent the group’s access to nearly half-billion dollars’ worth of reserves at the International Monetary Fund. As the de facto government of Afghanistan, the Taliban could seek to tap those funds, but the U.S., as the IMF’s main shareholder, would be in a powerful position to block it.
 - If the Taliban gets access to the IMF account, it will require another country to exchange the IMF unit of lending into usable currency.
 - [China and Russia both have made political and economic overtures to the Taliban](#) in recent years, so either one might perform that function, which would likely go far toward cementing their relationship with the group.
- The moves may give the administration a small amount of leverage over the Taliban.

U.S. Fiscal Policy: Top Democrats in the House [said they would move forward with a vote on a budget blueprint funding the progressive wing’s \\$3.5 trillion antipoverty and climate change plan](#), despite moderates’ demand to move the Senate-passed \$1 trillion “hard” infrastructure plan

first. The decision by the House Democratic leadership probably reflects the fact that dozens of party progressives have threatened to scuttle the infrastructure plan if the antipoverty bill isn't passed first, versus just nine moderates who have insisted the infrastructure plan be prioritized.

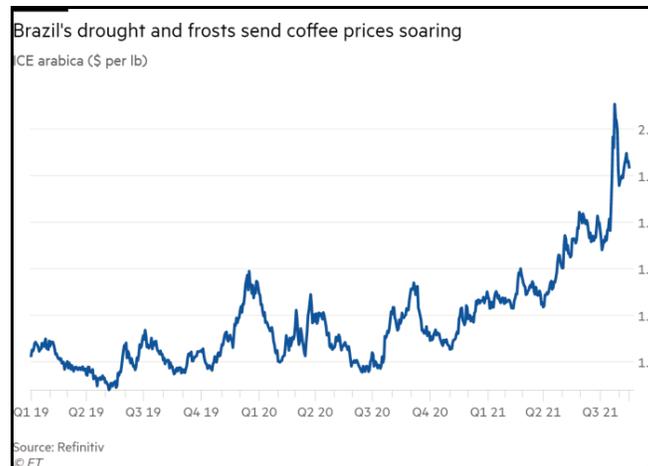
United States-Germany-Russia: At least two U.S. officials stationed in Germany [sought medical treatment after developing symptoms of the mysterious health complaint known as Havana Syndrome](#), which includes symptoms like nausea, severe headaches, ear pain, fatigue, insomnia, and sluggishness. Moreover, U.S. officials said other intelligence and diplomatic personnel in other NATO countries have also been affected, leaving some unable to work.

- The Syndrome, first identified among U.S. diplomats stationed in Cuba, is suspected of being initiated by foreign intelligence services.
- Some victims in NATO countries were intelligence officers or diplomats working on Russia-related issues, such as gas exports, cybersecurity, and political interference.

Japan-Taiwan-China: Reflecting Japanese leaders' increasing realization that a Chinese takeover of Taiwan would threaten Japan's security, the Liberal Democratic Party [is planning to launch online talks on security issues with Taiwan's ruling Democratic Progressive Party](#) as early as this month. The moves follow a decision by the LDP in February to establish a project team under its Foreign Affairs Division to discuss Japan-Taiwan relations.

Peru: The country's new president, former schoolteacher Pedro Castillo, [has had significant problems getting his cabinet in place](#). Yesterday, his foreign minister, Héctor Béjar, resigned amid an uproar over his accusations that the Maoist Shining Path rebels who terrorized Peru during the 1970s and 1980s were actually linked to the country's navy and the CIA. Castillo has also generated controversy over his appointment of a hardline leftist, Guido Bellido, as his prime minister. The moves have been weighing heavily on Peruvian currency.

Global Commodity Markets: After enduring the worst drought in nearly a century followed by a bout of cold temperatures, areas within Brazil's farming belt [are braced for further adversity as the La Niña weather phenomenon threatens to bring more dry conditions later this year](#). If conditions worsen as expected, prices for key Brazilian exports such as coffee and sugar would likely rise further than they already have.



COVID-19: Official data show confirmed cases [have risen to 208,757,350 worldwide, with 4,385,726 deaths](#). In the United States, confirmed cases rose to 37,020,723, with 623,329 deaths. [Vaccine doses delivered in the U.S. now total 417,477,975, while the number of people who have received at least their first shot totals 198,929,642](#). Finally, here is the [interactive chart](#) from the *Financial Times* that allows you to compare cases and deaths among countries, scaled by population.

Virology

- According to the latest CDC data, 59.9% of the U.S. population has now received at least one dose of a vaccine, and 50.9% of the population is fully vaccinated.
- Yesterday in Texas, Governor Abbott [tested positive for COVID-19](#), but his office noted that he was fully vaccinated and was not symptomatic. If he avoids becoming seriously ill, his experience could encourage more people in Texas to be vaccinated, regardless of the state's relatively low uptake to date.
- In Japan, Prime Minister Suga [asked the country's largest business lobby to help reduce the number of commuters through telework](#), as the increasingly rampant Delta mutation puts a strain on the country's medical system.
- Health officials in Sydney, Australia, [are rushing to vaccinate thousands of high school students ahead of in-person end-of-school exams](#) they fear could accelerate the spread of the virus in a country that, until recently, had avoided the worst of the pandemic.
- After months in which antibody treatments were heavily underutilized, doctors are [increasingly turning to them in a bid to keep hospitals from being overwhelmed](#) by the latest surge in cases.
 - Primary provider Regeneron Pharmaceuticals (REGN, \$647.44) delivered 135,023 doses of its drug to U.S. healthcare providers last week, marking a ninefold increase from a month earlier.
 - Regeneron estimates that as recently as June, fewer than 5% of high-risk patients were receiving treatment, before increasing recently to as much as 30%.

Economic and Financial Market Impacts

- Against the backdrop of the super-loose monetary policy launched by the Fed in response to the pandemic, analysts at both S&P and Moody's [have warned that the frenzy for higher-yielding, speculative-grade bonds is setting the market up for a wave of future defaults](#). According to S&P, sales of low-rated, speculative-grade debt have already reached \$650 billion this year, putting them on track to surpass all-time borrowing records with more than four months left in 2021. Companies of all types had already borrowed record amounts of cash in 2020 in an effort to ride out the coronavirus downturn.
- Now that many big businesses are postponing bringing their workforces back to the office, [many small downtown businesses that are dependent on them face new uncertainty and economic difficulties](#).

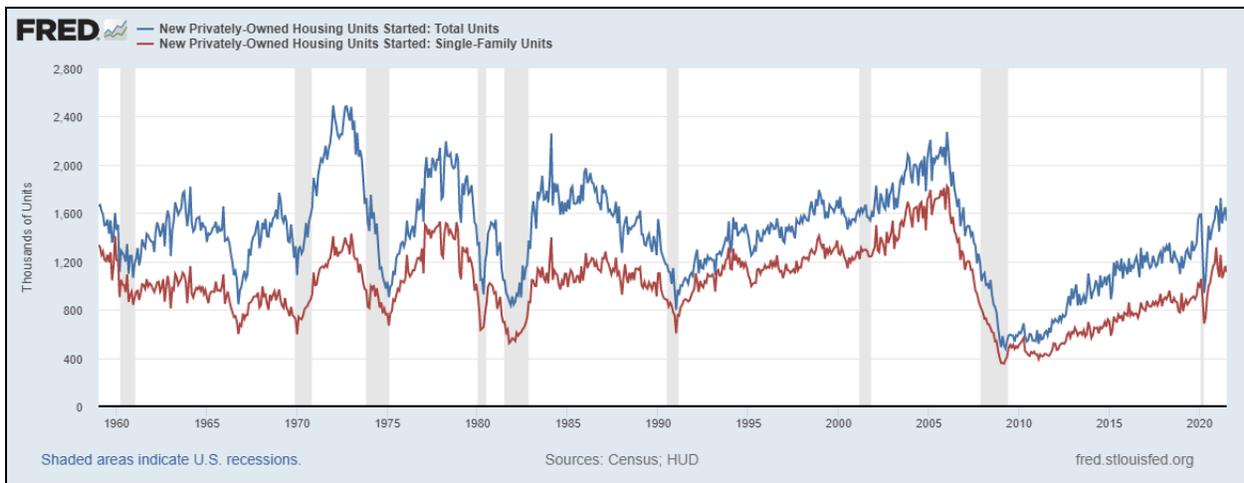
Foreign Policy Responses

- In New Zealand, the government’s decision this week to impose a new lockdown on the country after discovering a small number of new cases [has prompted the central bank to put off an interest-rate hike](#). Instead, the Reserve Bank of New Zealand decided to keep its benchmark short-term interest rate steady at 0.25%.

U.S. Economic Releases

Weekly mortgage applications fell 3.9% last week. Refinancing applications fell 5.3%, while purchase applications declined 0.8%. The interest rate on a 30-year fixed-rate mortgage rose to 3.06% from 2.99% last week.

July housing starts came in well below forecast at 1.534 million units annualized compared to expectations of 1.6 million units annualized. Building permits came in at 1.635 million units annualized, stronger than the forecast of 1.610 million units annualized.



Although starts are clearly in a longer-term uptrend, the momentum is starting to slow, raising concerns about the economy. There are several complicating factors with housing. Building material supplies have been difficult or costly to source, high prices have led to some drop in demand, and the impact of corporate and foreign investment is a factor. However, in the longer run, the U.S. has a housing gap that will take years of building to close. Thus, we remain favorable to this industry.

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

Economic Releases						
EDT	Indicator			Expected	Prior	Rating
	Mortgage Delinquencies	q/q	2Q		6.4%	**
	MBA Mortgage Foreclosures	q/q	2Q		0.5%	**
Fed Speakers or Events						
EST	Speaker or event	District or position				
12:00	James Bullard Discusses the Economic Outlook	President of the Federal Reserve Bank of St. Louis				

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.

	Indicator			Current	Prior	Expected	Rating	Market Impact
ASIA-PACIFIC								
Japan	Trade Balance	m/m	Jul	¥441.0b	¥383.2b	¥196.4b	**	Equity bullish, bond bearish
	Core Machine Orders	m/m	Jun	-1.5%	7.8%	-2.8%	**	Equity bullish, bond bearish
New Zealand	PPI Input	q/q	2Q	3.0%	2.1%		*	Equity bullish, bond bearish
	PPI Output	q/q	2Q	2.6%	1.2%		*	Equity bullish, bond bearish
Australia	Westpac Leading Index	m/m	Jul	-0.11%	-0.07%		***	Equity bullish, bond bearish
	Wage Price Index	q/q	2Q	0.4%	0.6%	0.6%	**	Equity bullish, bond bearish
EUROPE								
Eurozone	Construction Output	y/y	Jun	2.8%	13.6%		**	Equity and bond neutral
	CPI	y/y	Jul	2.2%	2.2%	2.2%	***	Equity and bond neutral
	CPI Core	y/y	Jul	0.7%	0.7%	0.7%	***	Equity and bond neutral
UK	CPI	y/y	Jul	2.0%	2.5%	2.3%	***	Equity and bond neutral
	CPI Core	y/y	Jul	1.8%	2.3%	2.0%	***	Equity and bond neutral
	RPI	m/m	Jul	0.5%	0.7%	0.3%	**	Equity and bond neutral
	RPI Ex Mort Int. Payments	y/y	Jul	3.9%	3.9%	3.7%	**	Equity and bond neutral
	PPI Output NSA	y/y	Jul	4.9%	4.3%	4.4%	**	Equity and bond neutral
	PPI Input NSA	y/y	Jul	9.9%	9.1%	9.1%	**	Equity and bond neutral
	House Price Index	y/y	Jun	13.2%	10.0%		***	Equity and bond neutral
AMERICAS								
Canada	Housing Starts	m/m	Jul	272.2k	282.1k	280.0k	**	Equity bullish, bond bearish
	Int'l Securities Transactions	m/m	Jun	19.70b	20.79b		**	Equity and bond neutral
Mexico	International Reserves Weekly	w/w	13-Aug	\$193214m	\$193278m		*	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)	12	12	0	Down
3-mo T-bill yield (bps)	6	7	-1	Neutral
TED spread (bps)	6	6	0	Neutral
U.S. Libor/OIS spread (bps)	9	9	0	Up
10-yr T-note (%)	1.26	1.26	0.00	down
Euribor/OIS spread (bps)	-55	-55	0	Neutral
EUR/USD 3-mo swap (bps)	3	3	0	Down
Currencies	Direction			
dollar	Up			Down
euro	Flat			Up
yen	Down			Up
pound	Down			Up
franc	Up			Up
Central Bank Action	Current	Prior	Expected	
RBNZ Official Cash Rate	0.500%	0.250%	0.500%	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.

	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$69.47	\$69.03	0.64%	
WTI	\$66.91	\$66.59	0.48%	
Natural Gas	\$3.84	\$3.84	0.03%	
Crack Spread	\$22.53	\$22.33	0.87%	
12-mo strip crack	\$20.11	\$19.97	0.70%	
Ethanol rack	\$2.46	\$2.46	0.02%	
Metals				
Gold	\$1,787.57	\$1,786.19	0.08%	
Silver	\$23.70	\$23.66	0.19%	
Copper contract	\$417.25	\$420.45	-0.76%	
Grains				
Corn contract	\$565.50	\$563.50	0.35%	
Wheat contract	\$747.00	\$748.50	-0.20%	
Soybeans contract	\$1,356.50	\$1,361.50	-0.37%	
Shipping				
Baltic Dry Freight	3,657	3,606	51	
DOE inventory report				
	Actual	Expected	Difference	
Crude (mb)		-1.5		
Gasoline (mb)		-2.0		
Distillates (mb)		-0.2		
Refinery run rates (%)		0.20%		
Natural gas (bcf)		29.0		

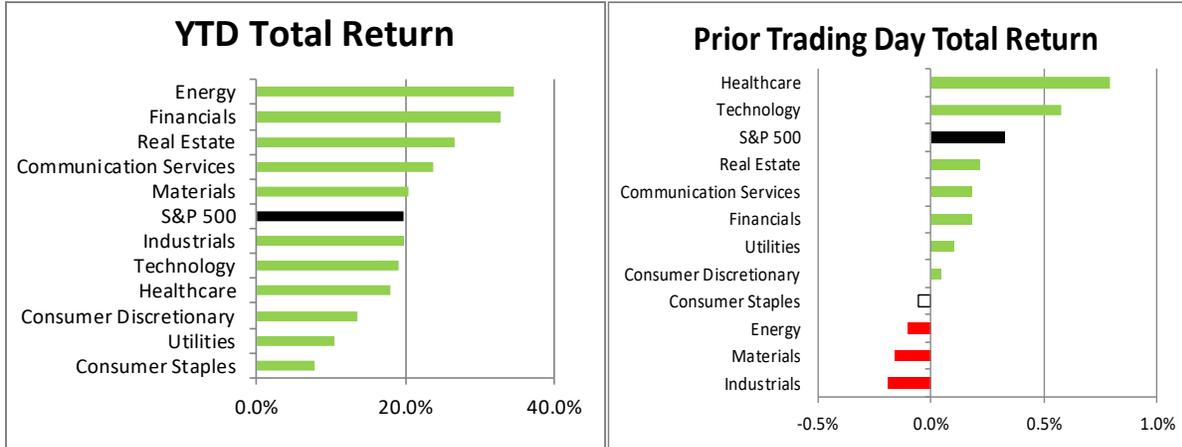
Weather

The 6-10 day and 8-14 day forecasts currently call for cooler-than-normal temperatures throughout the Rocky Mountain Region, with warmer-than-normal temperatures in the Midwest and Northeast. The forecast calls for wetter-than-normal conditions in the Great Plains, with dry conditions concentrated in the Pacific Northwest, the Rocky Mountains, South Texas, and New England. Tropical Depression Fred has developed into a tropical storm and is currently moving

throughout the Gulf of Mexico. There are two disturbances off the coast of Bermuda and another moving through the Dominican Republic.

Data Section

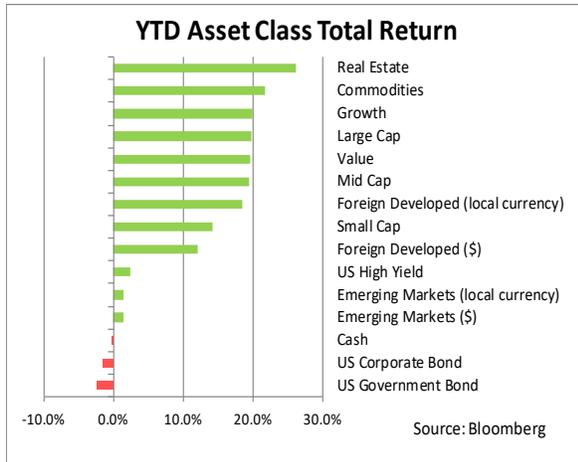
U.S. Equity Markets – (as of 8/17/2021 close)



(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 8/17/2021 close)

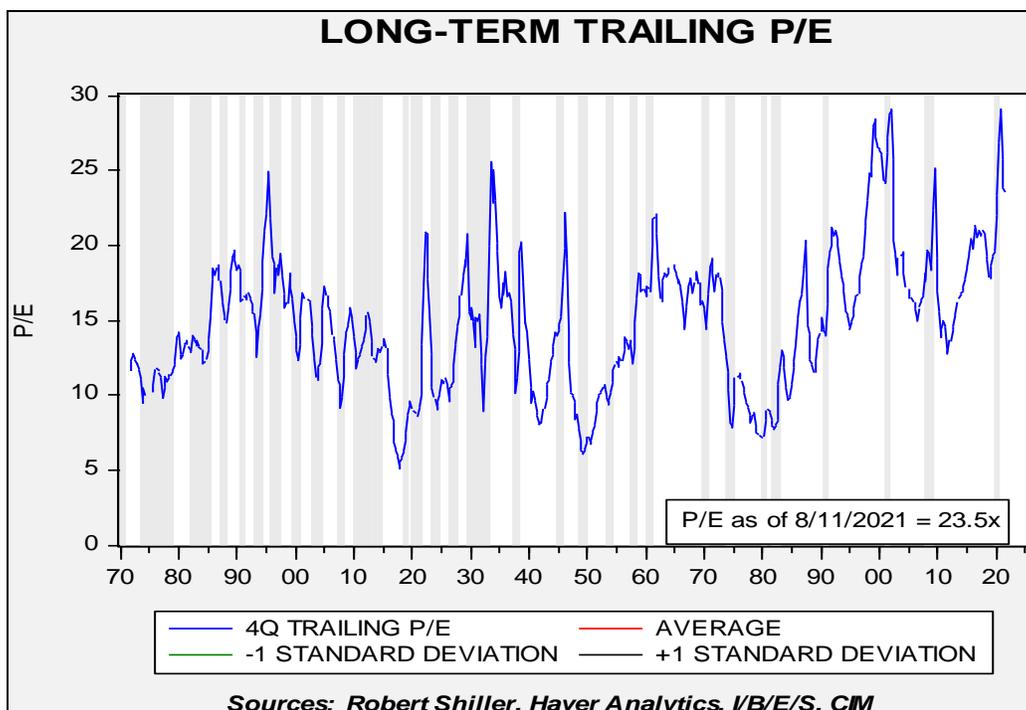


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 12, 2021



Based on our methodology,¹ the current P/E is 23.5x, down 0.6x from last week. Rising earnings and steady index values led to the decline 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 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.