Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

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 1, 2023—9:30 AM EDT] Global equity markets are generally lower this morning. In Europe, the Euro Stoxx 50 is down 1.0% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed essentially unchanged. Chinese markets were generally lower, with the Shanghai Composite also unchanged and the Shenzhen Composite down 0.4% from its previous close. U.S. equity index futures are signaling a lower open.

With 266 companies having reported so far, S&P 500 earnings for Q2 are running at $52.70 per share, compared to estimates of $53.55 (a decline of 6.8% from Q2 2022). Of the companies that have reported thus far, 82.0% have exceeded expectations while 12.8% 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* (7/24/2023) (with associated podcast): "China's Collapsing Population"
- *Weekly Energy Update* (7/27/2023): The SPR sales appear to have ended, and the U.S. is sending additional military assets to the Middle East.
- *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* (7/31/2023) (with associated podcast): "Part-Time Troubles"
- *Confluence of Ideas* podcast (7/10/2023): "The 2023 Mid-Year Geopolitical Outlook"

Our *Comment* today opens with news that the coup leaders who seized power in Niger have announced an embargo on sending uranium and gold to France—a move that's entirely consistent with the type of behavior we've been warning about from the China/Russia bloc. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including modest new economic stimulus measures in China and more political pressure to clamp down on U.S. investment into Chinese companies.

Niger-France-Russia: The junta that seized power in a coup late last week accused France of plotting a military attack to return democratically-elected President Bazoum to power. The coup leaders also said they will immediately ban all exports of uranium and gold to France.

- Because of strong anti-Western sentiment in parts of Africa, we believe France (and the U.S.) would be reluctant to launch military action in Niger. The coup leaders' statement is more likely just an effort to ward off French interference, and their uranium embargo probably aims to inflict pain on Niger's former colonial master. Uranium from Niger reportedly provides 75% of the fuel for France's nuclear reactors.
- Some reports suggest the coup leaders had help from Russian mercenaries. Whether or not that's true, cutting France off from Niger's uranium is consistent with the behavior we've been warning about from members of the China/Russia geopolitical bloc. Since members of the China/Russia bloc, including Niger, control so much of the world's key mineral resources, we think they are likely to cut off those supplies to exert pressure against the U.S. and the rest of its bloc, exactly as Russia has done in its war with Ukraine.

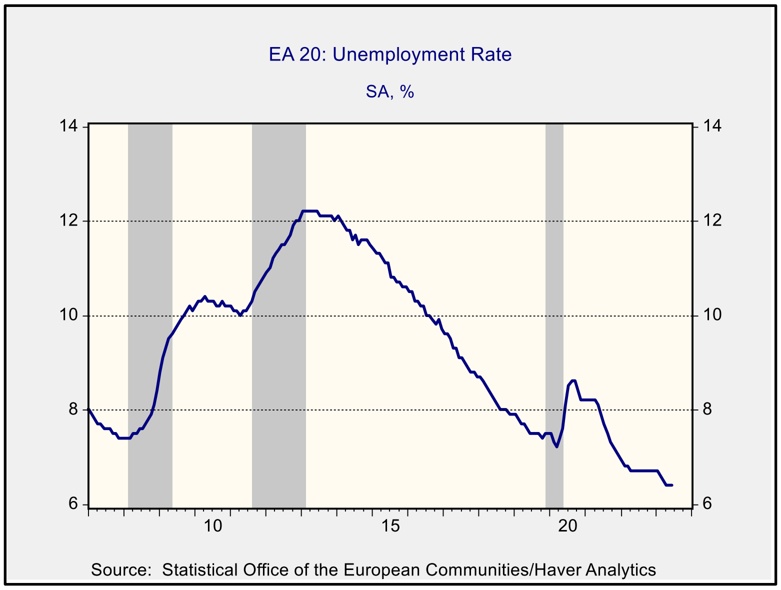
Russia-Ukraine War: For the second time in three days, Ukrainian drones have apparently struck Moscow's premier IQ-Quarter skyscraper, which houses several big government ministries and key Russian companies. The repeat attack suggests the Ukrainians are trying to bring the war home to the Russian elites and perhaps force the deployment of more air defense assets to the capital region. Meanwhile, Russian forces last night staged their own missile attacks against residential areas of Kharkiv, and combat remained intense on parts of the front line running from eastern to southern Ukraine.

Chinese Economy: The government yesterday published a long list of measures it said it would implement to encourage more consumer spending and help boost economic growth. However, the measures were generally vague and seemed quite modest. For example, people who trade in older automobiles for newer ones would receive a subsidy, as would people who buy insulation and other goods to cut home energy use. The announcement also suggested that the central government would leave it up to the cash-strapped provincial and local governments to pay for the programs.

- The modest measures show how the central government has become reluctant to rely on the big, dramatic, debt-fueled fiscal programs of the past, which have helped create a serious problem with excess debt among companies and provincial and local governments.
- In sum, the modest measures are unlikely to provide a significant boost to Chinese economic growth, which is likely to remain in the doldrums for the time being, although the positive side of that is that weaker Chinese demand will probably help bring down global inflation.

Chinese Armed Forces: President Xi has apparently purged the top two commanders of the People's Liberation Army Rocket Forces, which are responsible for the country's conventional and strategic nuclear missiles. The little press reporting available suggests the two commanders were sacked for "corruption," possibly related to selling military secrets. The firing comes fast on the heels of the sacking of former Foreign Minister Qin Gang. It also comes shortly after CIA Director Burns said his agency is making progress on rebuilding its spy network in China.

Eurozone: The region's June unemployment rate fell to 6.4%, and revisions showed the jobless rate was also at that level in each of the previous two months. The jobless rate was not only better than anticipated, but it also marked a record low for the eurozone. The figures will raise hopes that strong labor demand and firm wages will help the region's economy rebound in the coming months but falling vacancies in Germany and France suggest the labor market could soften from here.



European Union-China: On a visit to the Philippines today, European Commission President von der Leyen rebuked China for offering tacit support to Russia in its invasion of Ukraine, rather than supporting the principle of territorial integrity. She also warned that China's own territorial aggressiveness in the South China Sea could have "global repercussions." The speech illustrates von der Leyen's effort to align more closely with the U.S. in its approach to China, even though many other European politicians continue to resist any de-coupling.

United States-China: Yesterday, the House Select Committee on the Chinese Communist Party notified giant investment manager BlackRock (BLK, $738.85) and index provider MSCI that they are being investigated for facilitating investment in Chinese companies that the U.S. government has accused of bolstering China's military and violating human rights. The investment activities already studied aren't illegal, but the committee said they are "exacerbating an already significant national-security threat and undermining American values."

- Reporting so far suggests the HSCCCP is focusing on international or global index funds that channel a portion of assets into Chinese companies.
- To reiterate, the HSCCCP hasn't accused the firms of illegal activity. Indeed, the point here is the growing U.S. political pressure against economic ties with China. As we have warned repeatedly, the strengthening bipartisan trend toward clamping down on China

presents risks for investors, who could face new investment restrictions suddenly and unexpectedly.

U.S. Stock Market: Some of the nation's top active fund managers say they're having trouble attracting money from large investors, given that those investors today can enjoy such high yields in money market funds without taking much risk. Indeed, some fund managers are suffering net outflows from their funds as large, sophisticated investors pull back from equities. All the same, we also think the enormous amounts in money market funds represent future fuel for equities, especially if the stock market rally broadens and/or the Fed eventually starts to cut interest rates.

Global Gold Market: Data from the World Gold Council shows second-quarter demand for the yellow metal totaled 1,255 tons, up 7.0% year-over-year. In contrast with recent trends, buying by central banks fell to 103 tons, but that was mainly because of net sales by Turkey's central bank due to that country's unique economic turmoil. Central bank buying in the entire first half of the year hit a record 387 tons. We continue to believe that geopolitical tensions and the longer-term uptrend in central bank purchases will help boost gold prices over time.

U.S. Economic Releases

There were no economic releases prior to the publication of this report. 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
9:45	S&P Global Manufacturing PMI	m/m	Jul F	49.0	49.0	***
10:00	Construction Spending MoM	m/m	Jun	0.6%	0.9%	**
10:00	JOLTS Job Openings	m/m	Jun	9600k	9824k	**
10:00	ISM Manufacturing PMI	m/m	Jul	46.9	46	**
10:00	ISM Manufacturing PMI - Prices Paid	m/m	Jul	44.0	41.8	**
10:00	ISM Manufacturing PMI - Employment	m/m	Jul		48.1	*
10:00	ISM Manufacturing PMI - New Orders	m/m	Jul		45.6	**
10:30	Dallas Fed Services Activity	m/m	Jul		-8.2	**
	Wards Total Vehicle Sales	m/m	Jul	15.70m	15.68m	*

Federal Reserve		
EST	Speaker or Event	District or Position
10:00	Austan Goolsbee Gives Welcoming Remarks at Chicago FED Event	President of the Federal Reserve Bank of Chicago

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	Dec	2.5%	1.3%	2.6%	***	Equity and bond neutral
	Job-To-Applicant Ratio	m/m	Dec	1.3%	1.3%	1.3%	**	Equity and bond neutral
	Jibun Bank Manufacturing PMI	m/m	Aug F	49.6	49.4		***	Equity and bond neutral
Australia	Building Approvals	m/m	Jun	-7.7%	20.6%	20.5%	***	Equity bearish, bond bullish
New Zealand	CoreLogic House Prices	y/y	Jul	-10.1%	-10.6%		*	Equity and bond neutral
	Building Permits	m/m	Jun	3.5%	-2.2%	-2.30	**	Equity bullish, bond bearish
South Korea	Trade Balance	m/m	Jul	$1630m	$1130m	$1126m	*	Equity and bond neutral
	Exports	y/y	Jul	-16.5%	-6.0%	-15.0%	***	Equity and bond neutral
	Imports	y/y	Jul	-25.4%	-11.7%	-25.0%	**	Equity and bond neutral
	S&P Global Global Manufacturing PMI	m/m	Jul	49.4	47.8		***	Equity bullish, bond bearish
China	Caixin Manufacturing PMI	m/m	Jul	49.2	50.5	50.1	***	Equity and bond neutral
India	S&P Global Manufacturing PMI	m/m	Jul	57.7	57.8		***	Equity and bond neutral
EUROPE								
Eurozone	HCOB Manufacturing PMI	m/m	Jul F	42.7	42.7	42.7	***	Equity and bond neutral
	Unemployment Rate	m/m	Jun	6.4%	6.5%	6.4%	**	Equity and bond neutral
Germany	Unemployment Change	m/m	Jul	-4.0k	28.0k	30.0k	***	Equity bullish, bond bearish
	Unemployment Claims Rate	m/m	Jul	5.6%	5.7%	5.7%	**	Equity and bond neutral
	HCOB Manufacturing PMI	m/m	Jul F	38.8	38.8	38.8	***	Equity and bond neutral
France	HCOB Manufacturing PMI	m/m	Jul F	45.1	44.5	44.5	***	Equity and bond neutral
Italy	HCOB Manufacturing PMI	m/m	Jul	44.5	43.8	44.3	***	Equity and bond neutral
	Unemployment Rate	m/m	Jun	7.4%	7.6%	7.5%	**	Equity and bond neutral
UK	Nationwide House Price Index	y/y	Jul	-3.8%	-3.5%	-4.0%	***	Equity and bond neutral
	S&P/CIPS Manufacturing PMI	m/m	Jul F	45.3	45.0	45.0	***	Equity and bond neutral
Russia	S&P Global Manufacturing PMI	m/m	Jul	52.1	52.6		***	Equity and bond neutral
AMERICAS								
Brazil	Industrial Production	y/y	Jun	0.3%	1.9%	-0.1%	***	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)	563	563	0	Up
3-mo T-bill yield (bps)	524	526	-2	Up
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	537	536	1	Up
U.S. Libor/OIS spread (bps)	539	538	1	Up
10-yr T-note (%)	3.98	3.96	0.02	Flat
Euribor/OIS spread (bps)	372	373	-1	Up
Currencies	**Direction**			
Dollar	Up			Flat
Euro	Down			Flat
Yen	Down			Down
Pound	Down			Up
Franc	Down			Up
Central Bank Action	**Current**	**Prior**	**Expected**	
RBA Cash Rate Target	4.100%	4.100%	4.300%	Below 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	$85.38	$85.43	-0.06%	
WTI	$81.69	$81.80	-0.13%	
Natural Gas	$2.64	$2.63	0.04%	
Crack Spread	$42.40	$41.43	2.34%	
12-mo strip crack	$30.54	$30.33	0.69%	
Ethanol rack	$2.46	$2.49	-1.06%	
Metals				
Gold	$1,954.96	$1,965.09	-0.52%	
Silver	$24.46	$24.75	-1.14%	
Copper contract	$397.90	$400.80	-0.72%	
Grains				
Corn contract	$513.50	$513.00	0.10%	
Wheat contract	$657.00	$665.75	-1.31%	
Soybeans contract	$1,334.75	$1,331.75	0.23%	
Shipping				
Baltic Dry Freight	1,127	1,110	17	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-2.3		
Gasoline (mb)		-1.4		
Distillates (mb)		-0.4		
Refinery run rates (%)		0.2%		
Natural gas (bcf)		14		

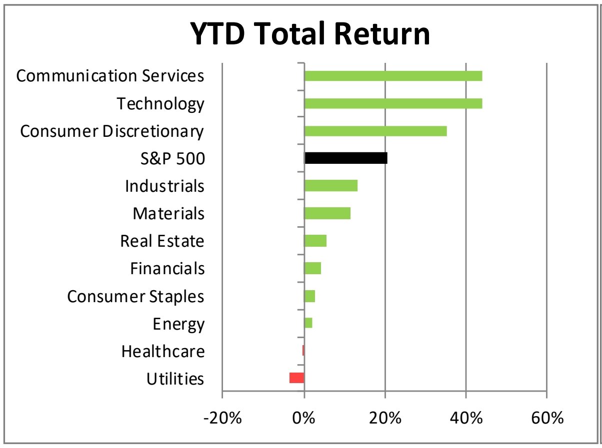
Weather

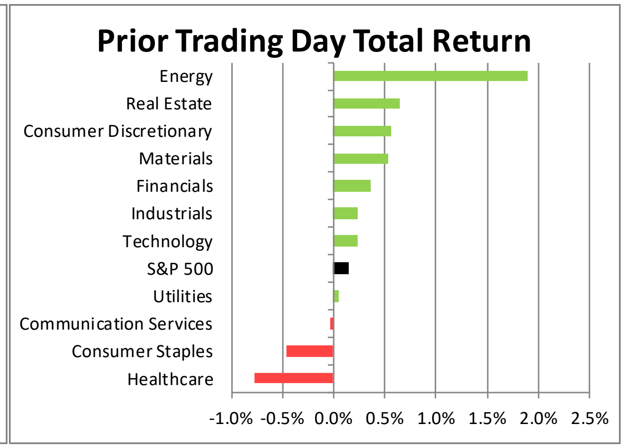
The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures in the Deep South and Pacific region, with cooler-than-normal temperatures expected for the rest of the country. The precipitation outlook calls for wetter-than-normal conditions in most states, with dry conditions expected in the Southwest.

Two disturbances in the Atlantic Ocean have a chance of developing into tropical cyclones. The first disturbance, located off the Mid-Atlantic coast, has less than a 1% chance of cyclone formation within the next 48 hours and the second disturbance, located northeast of the Leeward Islands, has a 40% chance of cyclone formation.

Data Section

U.S. Equity Markets – (as of 7/31/2023 close)

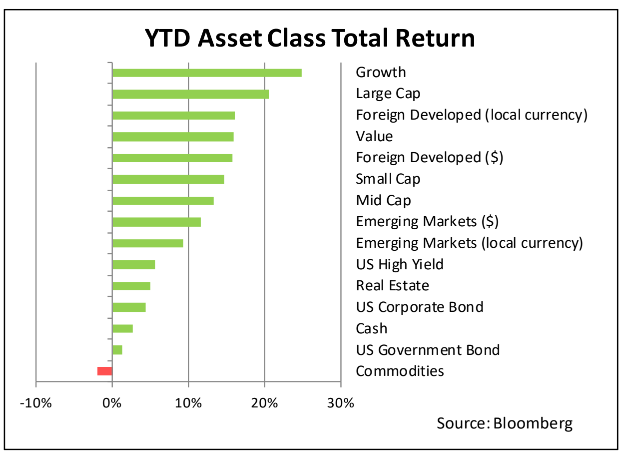




(Source: Bloomberg)

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 7/31/2023 close)

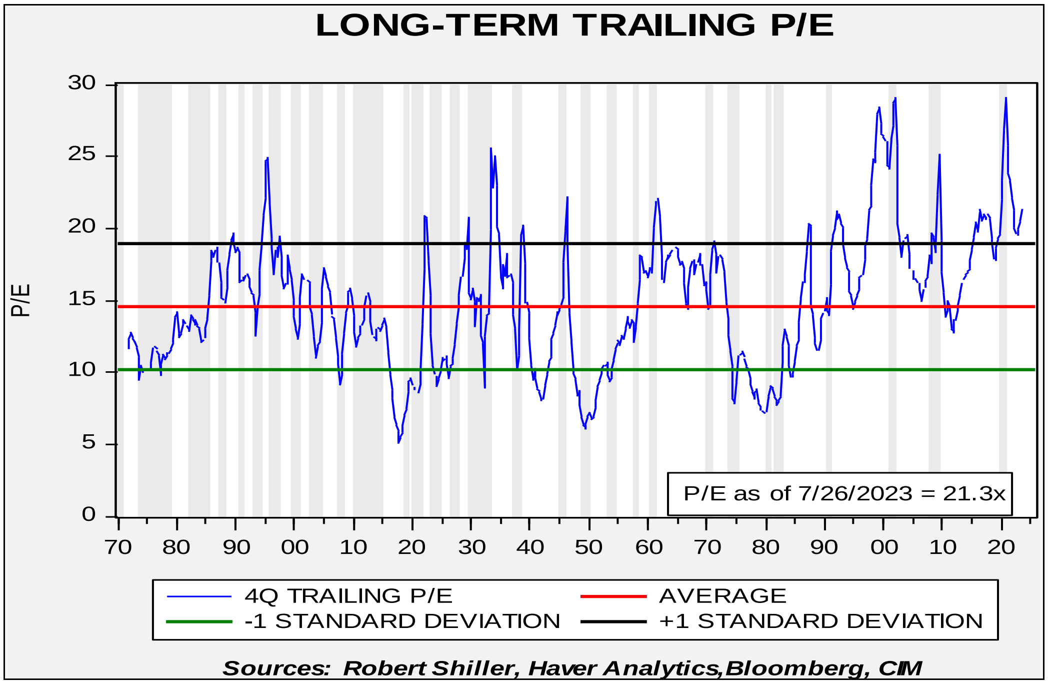


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

July 27, 2023



Based on our methodology,[1] the current P/E is 21.3x, down 0.1x from last week. Better earnings lowered 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.

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[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.