

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 21, 2023—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is up 1.1% 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 1.2% from its previous close and the Shenzhen Composite down 1.0%. U.S. equity index futures are signaling a higher open.

With 473 companies having reported so far, S&P 500 earnings for Q2 are running at \$54.40 per share compared to estimates of \$53.55 (a decline of 6.8% from Q2 2022). Of the companies that have reported thus far, 81.0% have exceeded expectations, while 14.4% 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](#) (8/17/2023): The U.S. and Iran are continuing to discuss a prisoner release that may have more parts to the agreement. We also saw another modest increase in the SPR last week.
- [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 Q3 2023 Rebalance Presentation](#) (8/18/2023): **Video presentation featuring the Asset Allocation Committee as they review the 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 discussion of the important U.S.-Japan-South Korea summit on Friday and what it means for the global national security environment. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including further interest rate cuts in China, elections in Latin America, and real estate and weather news here at home.

United States-Japan-South Korea: President Biden, Japanese Prime Minister Kishida, and South Korean President Yoon on Friday [formalized an important new series of trilateral commitments on diplomatic, economic, and military cooperation](#) at a Camp David summit. For example, the military agreements include a multi-year plan for joint exercises, deeper coordination on ballistic missile defense, and a new crisis-communication hotline. The agreements don't include any mutual defense commitments like those of the North Atlantic Treaty Organization, but they do mark a stepped-up effort at unity and coordination as the democracies face rising geopolitical challenges from Beijing's evolving geopolitical bloc, which includes countries ranging from China and Russia to North Korea, Iran, and Cuba.

- The summit illustrates how the rising geopolitical threat from the China/Russia bloc [has forced the U.S. and its allies to coalesce and overcome some of their past divisions](#), such as the longstanding enmity between Tokyo and Seoul over Japan's brutal behavior on the Korean peninsula before and during World War II.
- The rising geopolitical threats have also generated a renewed bipartisan commitment to U.S. hegemony among centrist Republicans and Democrats. The Biden administration has relied heavily on their support as it tries to rebuild U.S. global leadership and rally allies to defend against the threat. However, it's important to remember that the overall trend over at least the last decade was for many U.S. voters to question the costs of maintaining global dominance. Strong populist forces remain on both the left and the right of the political spectrum, and they could still ultimately derail the U.S.'s new globalist approach and push policy back toward isolationism.

China-Africa: New reporting shows the Chinese Communist Party [has started to offer training in authoritarian governance to the ruling parties in key African countries](#). The training is offered through a "leadership school" that focuses on topics such as party governance, party discipline, anti-corruption methods, "Xi Jinping Thought," and poverty alleviation.

- The development suggests Beijing is becoming more comfortable with explicitly exporting its authoritarian political model.
- Since many of the targeted countries are important suppliers of key mineral resources, it appears the effort is partly aimed at locking up those resources to benefit China.

China: Following up the central bank's interest rate cut last week, the nation's banks today [cut their one-year prime lending rate slightly to 3.45% compared with 3.55% previously](#). Observers had expected the five-year prime rate to be cut as well, but it was left unchanged at 4.20%.

- The rate cuts are an effort to rebuild economic momentum in China, but the limited nature of the cuts also illustrates policymakers' reluctance to implement big changes.
- China continues to struggle with what some economists are calling the "four Ds": Demand weakness, Debt overhang, Demographic decline, and De-coupling in international trade, investment, and technology flows.
- With policymakers reluctant to revert to China's traditional countercyclical strategy of increased debt and infrastructure investment to offset those trends, investors are becoming increasingly pessimistic about Chinese assets. That's especially the case now that another major real estate developer is apparently facing liquidity problems and

property-sector debt issues are starting to affect the broader financial system. Chinese stocks trading on the mainland and in Hong Kong are trading lower so far this morning, and the renminbi has weakened to about 7.33 per dollar, near a record low.

European Union: Reports last week said the EU's natural gas storage facilities [have been almost completely filled, well ahead of the winter heating season](#), helping drive down the continent's gas prices. Nevertheless, new data from the Bruegel think tank suggests weak underlying demand is also putting downward pressure on prices.

- The slowdown in demand partly reflects Europe's slowing economic growth and slow passthrough of wholesale price cuts to consumers.
- Perhaps more interesting, the think tank says weaker gas demand is also being driven by surging investment in alternative heating technologies, such as electric heat pumps and solar panels.

Russia-Ukraine War: Officials in Ukraine [are reportedly negotiating a risk-sharing deal with global insurers so that the firms could cover up to 30 grain ships](#) traveling from the country's southeastern ports. Now that Russia has pulled out of the previous deal allowing Ukraine to export grain, such a deal could potentially help ensure that Ukrainian grain can get to world markets, which would likely help hold down future prices.

Turkey: The government and central bank yesterday [announced a series of moves aimed at discouraging savers and businesses from using foreign currency-protected savings accounts](#). Those accounts, which reimburse their owners at government expense when the lira weakens against the dollar and euro, were implemented in late 2021 to encourage people to keep holding lira. Along with recent interest rate hikes and import restrictions, the move signals that the government continues to shift toward more orthodox economic policies now that President Erdogan has been re-elected. Over the summer, that shift has given a significant boost to both the lira and Turkish stocks.

Cyprus: Ethnic Turks on Friday [violently pushed back United Nations peacekeepers who were trying to block the construction of an unauthorized road](#) in the buffer zone separating the recognized Turkish Cypriot territory from the Greek Cypriot territory. The road would link the Turkish Cypriot territory to what the UN says is an illegal military outpost in the buffer zone. The incident could signal aggressive new moves by Turkish Cypriots to expand their area of control on the island, which would likely generate increased tensions with Greece.

Guatemala: In a run-off presidential election yesterday, center-left sociologist and corruption fighter Bernardo Arévalo [won 58% of the vote, handily beating former first lady Sandra Torres, the conservative establishment candidate](#). Arévalo campaigned on promises to rejuvenate the country's democracy, stamp out corruption, reduce crime, and improve the public health and education systems. If he can overcome Guatemala's vested interests and make progress on those issues, there is a chance he could eventually reduce the high numbers of Guatemalans trying to emigrate to the U.S.

Ecuador: In the other major Latin American presidential election yesterday, leftist former lawmaker Luisa González [won 33% of the vote, and center-right businessman Daniel Noboa won 24%](#). They will now face each other in a run-off election on October 15, with the winner likely to be determined by the candidate voters think can re-establish social order and end the country's current out-of-control violence and crime. For U.S. investors, the key issues are probably how the eventual winner will manage Ecuador's extensive mineral resources and whether he or she can reduce crime enough to stem the flow of migrants to the U.S.

U.S. Commercial Real Estate Industry: Despite the challenges in commercial real estate sectors such as office buildings and regional malls, new data [suggests demand remains high for free-standing retail buildings and open-air malls](#). The good supply and demand dynamics in those areas partly reflect the dearth of building after the Great Financial Crisis, which allowed the market to absorb excess properties.

U.S. Weather: After being downgraded from hurricane status, Tropical Storm Hilary [roared into Southern California yesterday afternoon and evening](#), but the resulting rains, winds, flooding, and power outages were less severe than feared. Even a series of small earthquakes that happened at the same time weren't enough to cause major damage. Nevertheless, public facilities such as schools and the Death Valley and Joshua Tree national parks have been closed as a precautionary measure.

U.S. Economic Releases

No major U.S. economic reports or Fed events have been scheduled for 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								
New Zealand	Imports NZD	m/m	Jul	6.56b	6.30b	6.29b	**	Equity and bond neutral
	Exports NZD	m/m	Jul	5.45b	6.31b	6.18b	**	Equity and bond neutral
	Trade Balance NZD	m/m	Jul	-1107m	9m	-111m	**	Equity and bond neutral
EUROPE								
Germany	PPI	y/y	Jul	-6.0%	0.1%	-5.1%	**	Equity bullish, bond bearish
Uk	Rightmove House Prices	m/m	Aug	-0.1%	0.5%		**	Equity bullish, bond bearish
Switzerland	M3 Money Supply	y/y	Jul	-1.6%	-1.2%	-1.4%	**	Equity and bond neutral
	Domestic Sight Deposits CHF	w/w	18-Aug	466.4b	474.7b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	18-Aug	476.2b	484.8b		*	Equity and bond neutral
AMERICAS								
Canada	Industrial Product Price	m/m	Jul	0.4%	-0.6%	0.1%	**	Equity and bond neutral
	Raw Materials Price Inccx	m/m	Jul	3.5%	-1.5%	-2.0%	*	Equity bearish, bond bullish

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)	564	564	0	Up
3-mo T-bill yield (bps)	525	528	-3	Up
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	538	537	1	Up
U.S. Libor/OIS spread (bps)	540	540	0	Up
10-yr T-note (%)	4.30	4.26	0.04	Flat
Euribor/OIS spread (bps)	382	382	0	Up
Currencies	Direction			
Dollar	Down			Flat
Euro	Up			Up
Yen	Down			Down
Pound	Up			Up
Franc	Up			Up
Central Bank Action	Current	Prior	Expected	
PBOC 1-Year Loan Prime Rate	3.450%	3.550%	3.400%	Above Forecast
PBOC 5-Year Loan Prime Rate	4.200%	4.200%	4.050%	Above 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	\$85.74	\$84.80	1.11%	
WTI	\$82.35	\$81.25	1.35%	
Natural Gas	\$2.65	\$2.55	3.72%	Concerns about possible Australian LNG Strike
Crack Spread	\$41.49	\$41.78	-0.71%	
12-mo strip crack	\$30.53	\$30.45	0.27%	
Ethanol rack	\$2.31	\$2.31	-0.03%	
Metals				
Gold	\$1,894.64	\$1,889.31	0.28%	
Silver	\$23.16	\$22.75	1.79%	
Copper contract	\$374.70	\$374.05	0.17%	
Grains				
Corn contract	\$496.50	\$493.00	0.71%	
Wheat contract	\$635.25	\$639.00	-0.59%	
Soybeans contract	\$1,377.50	\$1,353.25	1.79%	
Shipping				
Baltic Dry Freight	1,237	1,247	-10	

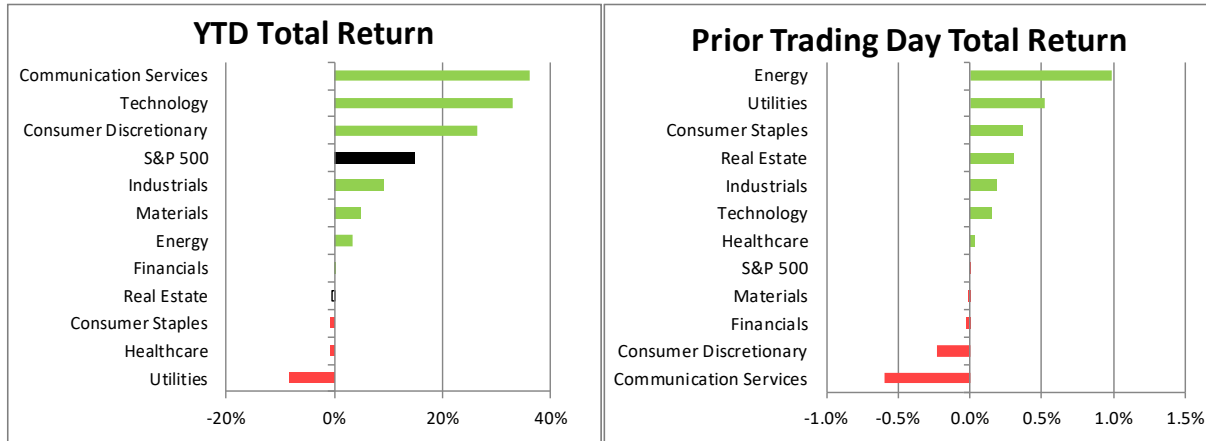
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures for most of the country, with cooler-than-normal temperatures in the New England region. The precipitation outlook calls for wetter-than-normal conditions throughout the Far West and East Coast, with dry conditions expected in the entire Mississippi Valley region.

The Atlantic region is currently showing five atmospheric disturbances, three of which are tropical storms. Two disturbances are located in the central Atlantic Ocean off the western coast of Africa, and one of these disturbances has a 40% chance of developing into a tropical cyclone within the next 48 hours. Tropical Storm Emily is expected to remain in the Atlantic Ocean over the next two days. The other three tropical cyclones are in the Caribbean Sea and the Gulf of Mexico. Tropical Storm Franklin and Tropical Storm Gert are heading toward Puerto Rico. Meanwhile, there is an 80% chance that the disturbance in the Gulf of Mexico will develop into a tropical storm within the next 48 hours.

Data Section

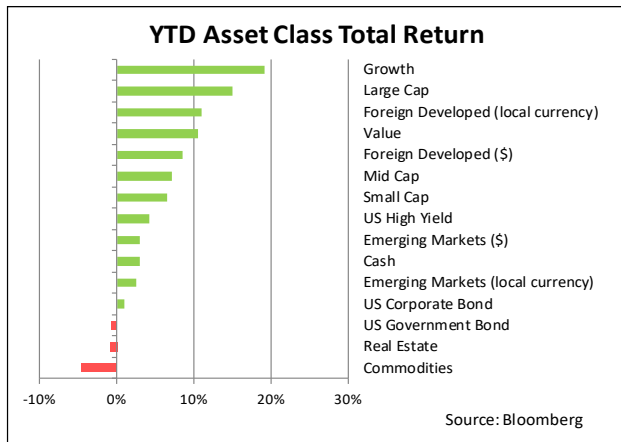
U.S. Equity Markets – (as of 8/18/2023 close)



(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 8/18/2023 close)

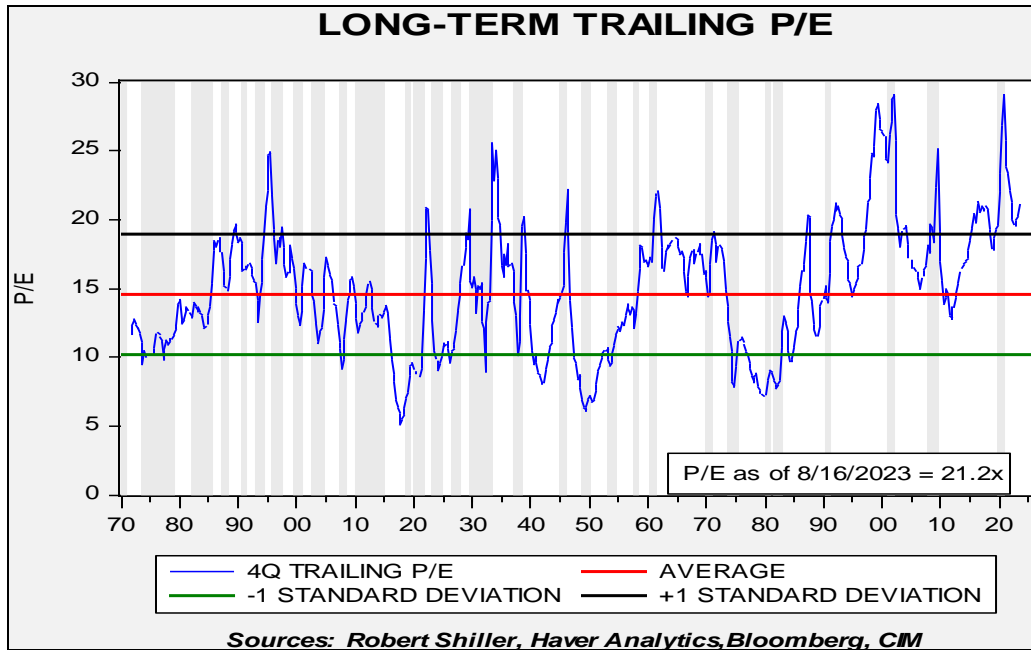


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 17, 2023



Based on our methodology,¹ the current P/E is 21.2x, unchanged from last week.

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.