

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 22, 2023—9:30 AM EDT] Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 is up 1.51% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.5%. Chinese markets were higher, with the Shanghai Composite up 0.9% from its previous close and the Shenzhen Composite up 0.5%. 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](#) (8/21/2023) (there will be no podcast for this report): “Reflections on the New Cold War”**
- [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* opens with a curtain-raiser for the BRICS summit starting today in South Africa. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including news of growing trade ties between China and Russia, a vote for a new prime minister in Thailand, and the latest developments in the U.S. labor market.

Brazil-Russia-India-China-South Africa: The latest summit of the BRICS countries [will start today in Johannesburg, with appearances by top leaders ranging from Chinese President Xi to Indian Prime Minister Modi](#). Leaders from a number of other emerging markets will also be attending, although Russian President Putin will not.

- One key agenda item [is Xi's push to expand the group to countries](#) such as Indonesia and Iran. However, Modi and Brazilian President Luiz Inácio Lula da Silva are resisting that move out of fear it would give Xi too much power and dilute their influence.
- The leaders [reportedly also plan to discuss how the countries can reduce their reliance on the U.S. dollar](#), especially after seeing how Washington and its allies were able to freeze hundreds of billions of dollars of Russia's foreign reserves following its invasion of Ukraine.
 - Some observers think the summit will also discuss the creation of a new BRICS currency to replace the dollar, sparking fears of a sudden weakening in the greenback. However, other reporting suggests an alternative currency will not formally be on the agenda.
 - In any case, even though the greenback's dominance in international trade and foreign reserves has been falling gradually for years, we and [other observers](#) doubt the renminbi (CNY) or any other proposed alternative could suddenly and sharply displace it. At least for now, we think there are big political, economic, financial, and technical hurdles that would likely preclude the BRICS countries from a wholesale abandonment of the dollar.

China-Russia: New data shows that total trade between China and Russia in the first seven months of 2023 [jumped to \\$134 billion, up 36% from the same period one year earlier](#), putting Russia just behind Australia and Taiwan in the list of China's largest trading partners. The figures illustrate how Russia's invasion of Ukraine and the resulting Western sanctions have pushed China and Russia closer together economically, helping coalesce the evolving China/Russia geopolitical bloc. We think the continued war and the continued common interest of the two countries will lead to a further coalescing of the bloc in the coming years, making it even more difficult for U.S. investors wanting to invest in the members of the bloc.

- While China's overall exports from January through July were down 5% on the year, its exports to Russia were up 73%. That means China now accounts for almost half of all Russian imports. Importantly, China appears to be sending Russia many products with dual military/civilian uses that could help support Moscow's invasion Ukraine, such as semiconductors and heavy equipment.
- Russia's exports to China in the same period were up 17% on the year, boosting Russia's share of China's imports to 4.8%

China-United States: For the second time this month, the Chinese Ministry of State Security [reported that it has arrested a Chinese citizen on charges of spying for the Central Intelligence Agency](#). The announcement came just a month after CIA Director William Burns said his agency was making progress in rebuilding its spy network in China. That suggests the MSS statements may be as much public relations as anything else.

- In any case, the CIA evidently recruited both spies while they were studying abroad, one in Japan and the other in Italy.
- To do so, it appears that the CIA borrowed the very same techniques the MSS has used to recruit U.S. citizens to spy for China, i.e., it buttered them up with compliments, dinners, gifts, and offers to pay for written “research.” (We think that’s hilarious.)

Japan: The government [stated today that on Thursday it will start releasing tritium-laced water from the Fukushima No. 1 nuclear power plant](#) that is being decommissioned following its inundation and nuclear accident due to a tsunami in 2011. Release of the stored radioactive water is opposed not only by local residents and fishers, but also by a number of neighboring countries. Importantly, some countries have threatened to ban imports of Japanese seafood because of concerns about radioactivity.

Thailand: Today, parliament [picked real-estate tycoon Srettha Thavisin as the country’s next prime minister, marking a modest democratic advance](#) after almost a decade of military rule. Even though Thavisin had to rely on military-backed parties to be elected, the return of civilian rule and the fact that Thavisin is seen as pro-democracy will likely help the U.S. strengthen ties with Thailand again after it had drifted closer to China in recent years.

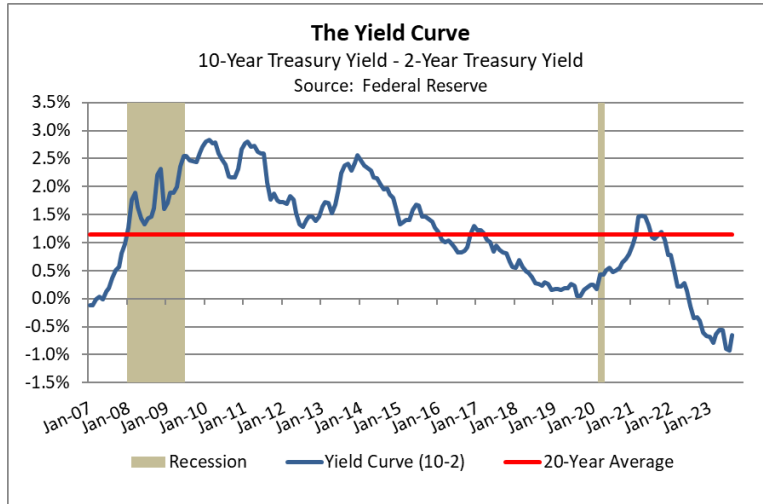
U.S. Labor Market: Unionized pilots at American Airlines (AAL, \$15.16) [ratified a new labor contract that will boost wages by more than 40% over its four-year term](#). The eye-popping wage increase reflects not only today’s general post-pandemic labor shortage, but also a shortfall in the number of available aviators and surging demand for leisure travel. Such lucrative new labor contracts will likely keep investors concerned about continuing inflation pressures and the likelihood that the Federal Reserve will keep interest rates “higher for longer.”

- All the same, other signs point to some cooling in labor demand. For example, new data from ZipRecruiter (ZIP, \$16.66) shows that most of the postings for some 20,000 different job titles on its site [are offering less pay than just one year ago](#).
- The biggest drops have been in technology, transportation, and other sectors that had hiring frenzies in 2021 and early 2022.

U.S. Bond Market: The rare “bear steepening” in the Treasury yield curve has continued this week, with the yield on the 10-year Treasury note [rising yesterday to a 16-year high of 4.339%](#) while the yield on the two-year obligation rose to 4.990%. The difference between the two has now narrowed to just 65 basis points, compared with 93 basis points as recently as the end of July. We believe the rise in longer-term yields primarily reflects a realization that the Fed is not likely to cut interest rates in the near term. Since the yield curve’s inversion remains quite large, we think there is plenty of room for longer-term yields to keep rising.

- Meanwhile, new data shows that the average interest rate on a 30-year, fixed-rate mortgage [has jumped to 7.48%, reaching its highest level since November 2000](#).
- That will likely continue to discourage current homeowners with ultralow mortgage interest rates from putting their homes on the market. That could make the supply of

existing homes even tighter and push their prices higher, while also creating further incentives for new home construction.



U.S. Economic Releases

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 |
| 10:00 | Existing Home Sales (monthly change) | m/m | Jul | 4.15m | 4.16m | ** |
| 10:00 | Existing Home Sales (annualized selling rate) | m/m | Jul | -0.2% | -3.3% | *** |
| 10:00 | Richmond Fed Manufact. Index | m/m | Aug | -10 | -9 | ** |
| 10:00 | Richmond Fed Manufact. Conditions | m/m | Aug | | -8 | ** |
| Federal Reserve | | | | | | |
| EST | Speaker or Event | District or Position | | | | |
| 14:30 | Austan Goolsbee Gives Welcome Remarks | President of the Federal Reserve Bank of Chicago | | | | |
| 15:30 | Austan Goolsbee and Michelle Bowman Participate in Fireside Chat | Chicago Fed President and Member of the Board of Governors | | | | |

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 | | | | | | | | |
| South Korea | Consumer Confidence | m/m | Aug | 103.1 | 103.2 | -- | ** | Equity and bond neutral |
| EUROPE | | | | | | | | |
| Eurozone | ECB Current Account SA | m/m | Jun | 35.8b | 9.1b | 7.9b | * | Equity bullish, bond bearish |
| France | Retail Sales | y/y | Jul | -2.1% | -2.0% | | ** | Equity and bond neutral |
| Italy | Current Account Balance | m/m | Jun | 5995m | 1403m | 1602m | * | Equity bullish, bond bearish |
| UK | Public Sector Net Borrowing | m/m | Jul | 3.5b | 17.7b | 17.1b | * | Equity and bond neutral |
| | PSNB ex Banking Groups | m/m | Jul | 4.3 | 18.5b | 17.9b | ** | Equity and bond neutral |
| Switzerland | Real Exports | m/m | Jul | -4.0% | -0.9% | -0.7% | * | Equity bearish, bond bullish |
| | Real Imports | m/m | Jul | -1.8% | 1.8% | 2.3% | * | 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) | 523 | 526 | -3 | Up |
| TED spread (bps) | LIBOR and the TED Spread have been discontinued. | | | |
| U.S. Sibor/OIS spread (bps) | 538 | 538 | 0 | Up |
| U.S. Libor/OIS spread (bps) | 541 | 541 | 0 | Up |
| 10-yr T-note (%) | 4.31 | 4.34 | -0.03 | Flat |
| Euribor/OIS spread (bps) | 381 | 382 | -1 | Up |
| Currencies | Direction | | | |
| Dollar | Flat | | | Flat |
| Euro | Flat | | | Up |
| Yen | Up | | | Down |
| Pound | Flat | | | Up |
| Franc | Flat | | | Up |

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 | \$83.91 | \$84.46 | -0.65% | |
| WTI | \$80.46 | \$80.72 | -0.32% | |
| Natural Gas | \$2.57 | \$2.63 | -2.47% | |
| Crack Spread | \$40.45 | \$40.78 | -0.83% | |
| 12-mo strip crack | \$30.25 | \$30.18 | 0.22% | |
| Ethanol rack | \$2.32 | \$2.31 | 0.13% | |
| Metals | | | | |
| Gold | \$1,902.16 | \$1,894.93 | 0.38% | |
| Silver | \$23.40 | \$23.31 | 0.42% | |
| Copper contract | \$380.20 | \$375.45 | 1.27% | |
| Grains | | | | |
| Corn contract | \$483.50 | \$482.50 | 0.21% | |
| Wheat contract | \$630.50 | \$625.50 | 0.80% | |
| Soybeans contract | \$1,359.75 | \$1,361.75 | -0.15% | |
| Shipping | | | | |
| Baltic Dry Freight | 1,223 | 1,237 | -14 | |
| 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) | | 34 | | |

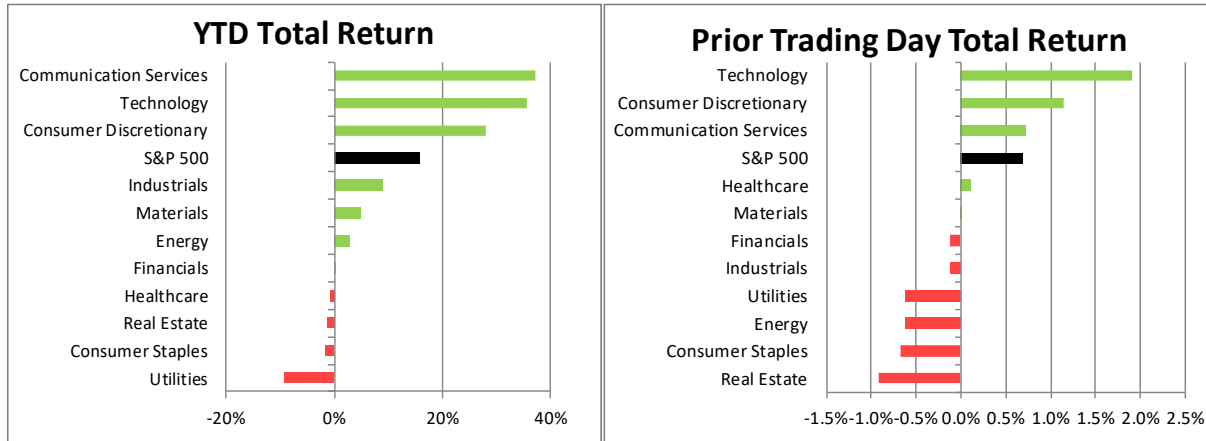
Weather

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 and have a 20% chance of developing into a tropical cyclone within the next 48 hours. 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, Tropical Storm Harold is expected to make landfall on the coast of Texas.

Data Section

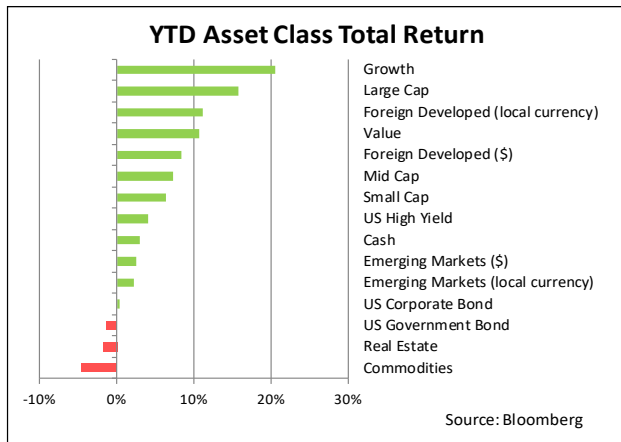
U.S. Equity Markets – (as of 8/21/2023 close)



(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 8/21/2023 close)

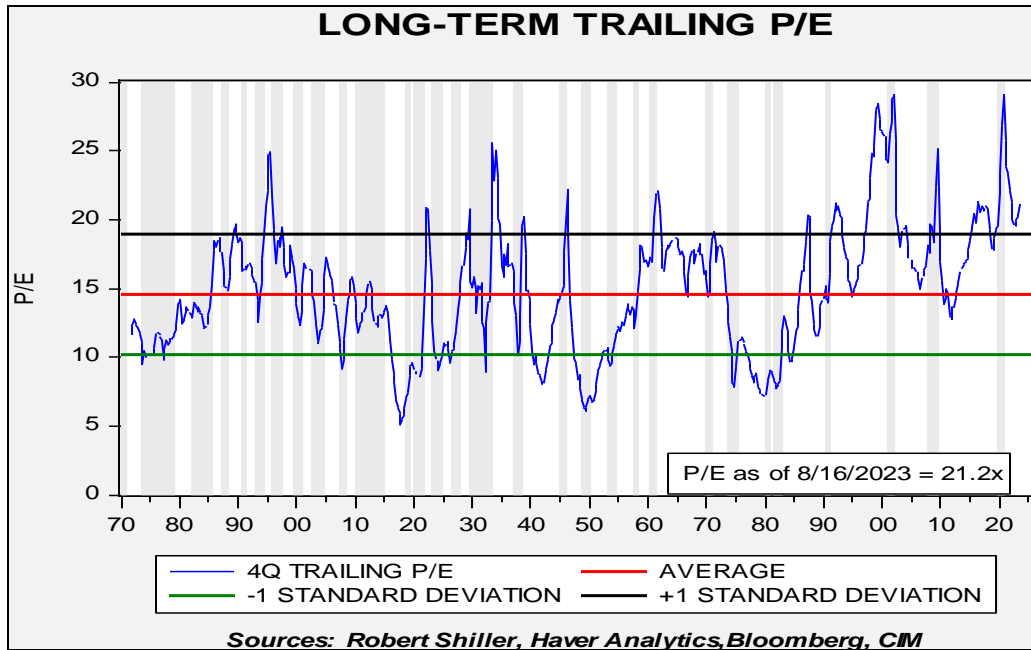


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.