

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 23, 2023—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is down 0.2% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.5%. Chinese markets were lower, with the Shanghai Composite down 1.3% from its previous close and the Shenzhen Composite down 2.0%. U.S. equity index futures are signaling a higher open.

With 477 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 14.3% 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](#) (8/22/2023): “The Economics of Defense in Great Power Competition”**

Good morning from [a blistering hot St. Louis](#)! It’s the “dog days” of August, and as we noted above, [U.S. equity futures are pointing to a higher open](#). Unfortunately, we have been experiencing this pattern recently, where we see stronger futures overnight only to see the gains fade as the day wears on. Overall, August has been a tough month for equity investors as [global](#)

[stocks are having the worst month](#) so far in over a year. Meanwhile, the early signs of the political season are upon us—[tonight is the first GOP debate](#). The leading candidate, Donald Trump, is sitting this one out.

In today's *Comment*, we open with a recap of the BRICS meetings being held in South Africa. Up next is a quick look at the upcoming Jackson Hole conference. A roundup of economic news follows, including a look at the U.S. housing market. The China update is next as the U.S. Commerce Secretary makes her way to Beijing. We close with the international roundup and a look at the critical Suwałki Gap.

BRICS Meeting: The five official nations of the BRICS—Brazil, Russia, India, China, and South Africa—[are considering expanding the group](#). China's President Xi, who caused a bit of a stir when he [failed to show up at a business meeting](#), met with South African President Ramaphosa to discuss expanding the group. Xi's vision for [BRICS is to create a counterweight to the G-7](#). Although China wants to expand the group (with Iran and Indonesia expressing interest in joining), India and Brazil are more cautious, worried that additional members will dilute their influence. We suspect that Xi's support for expanding the body is designed to [enhance China's clout](#).

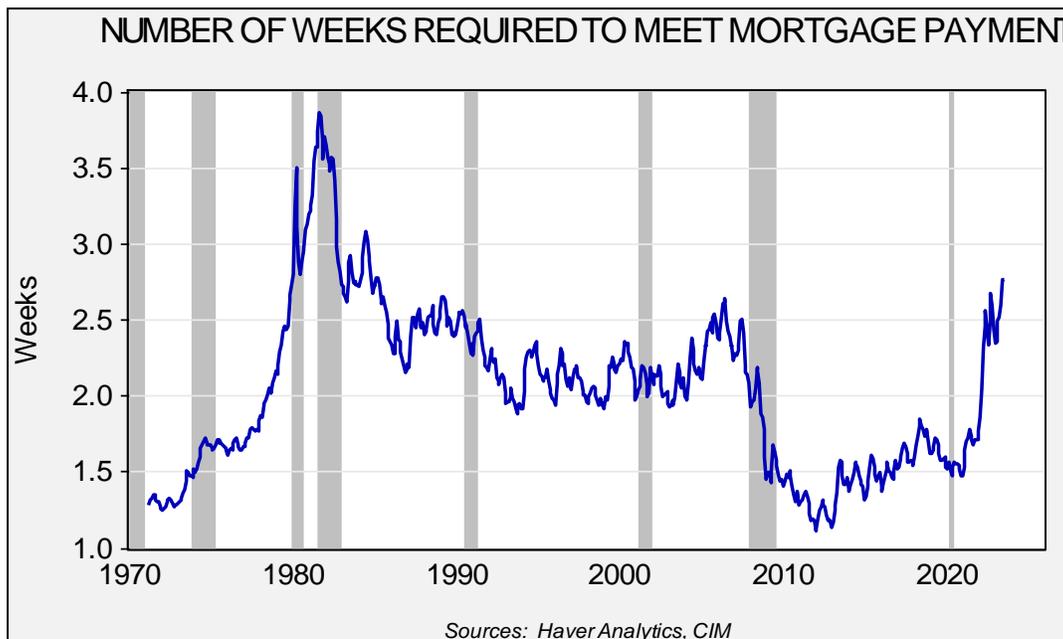
Perhaps the biggest concern comes from rumblings that BRICS will create an alternative to the dollar system. The [body has ties to the New Development Bank](#), which is lending in local currencies to members. Although there has been talk of creating a BRICS currency, the idea it would emerge from these meetings was mostly scotched by President Ramaphosa, who flatly stated that there would be [no discussions about a common currency](#). All members have expressed interest in trading in their own currencies, which makes sense. The problem is that without a reserve asset to hold surpluses, the utility for the exporter to hold the local currency of another country is rather low. A [classic example is that Russia](#), who is selling oil to India, is now holding billions of INR that it can't do much with, since it doesn't want imports from India, and India restricts capital inflows. There has also been talk of using gold as the reserve asset. Although this might work (and could be profoundly bullish for gold), a gold standard is inflexible and thus tends to lose its allure for trade.

Our take is that there will be more talking, but we are not likely to see the membership group expand yet. Also, the expectation of a BRICS currency is probably premature.

Jackson Hole: Later this week, the KC FRB annual meetings in Jackson Hole will be held, with Chair Powell's speech due on Friday. Last year, Powell ditched his prepared remarks and kept it simple—expect higher rates and get used to them. We don't expect a repeat this year. If anything, he will likely be non-committal on further increases, and will probably signal that a rapid decline in the policy rate is unlikely. The contours of the debate are framed between two poles. On the one side is that the economy is too strong and inflation too hot so the policy rate needs to rise further. In his first interview since leaving the St. Louis FRB, [Jim Bullard laid out the case](#) that the state of the economy warrants higher rates. The other side was discussed by the current "Fed whisperer" Nick Timiraos of the *WSJ*, who begged the question...[is the 2% target worth the pain necessary to get there?](#) We suspect this is what Powell will need to address on Friday.

Economic Roundup: Housing woes continue, labor unrest does too, and the Biden administration looks to help student loan borrowers.

- Later today, we will get new home sales data, with a modest rise expected. Yesterday, [existing home sales came in weaker than expected](#). Compared to last year, sales are down 16.3% for single family homes. However, despite weak sales, prices for existing single family homes rose 1.6% from last year. In our affordability study, which measures how many weeks a worker earning the median wage for non-supervisory workers to service a mortgage at the prevailing wage, median home price, and [mortgage rate](#), the level reached nearly 2.8 weeks, the highest level since 1985.



So far, this development hasn't hurt the economy because most [existing home borrowers are simply not selling their homes](#), reducing supply. We expect to see new home sales rise relative to existing homes when the data comes out later this morning.

- United Parcel Service (UPS, \$166.86) workers, represented by the Teamsters Union, announced the [two parties had come to an agreement](#), averting a strike. Terms suggest about a \$7 per hour jump in the average hourly pay. [Next up is the UAW](#), which is trying to claw back earlier concessions. Meanwhile, the labor market news is somewhat mixed. Pay for new hires is [reportedly stabilizing](#) after rising rapidly in recent years. At the same time, [tech layoffs are falling](#), suggesting an improvement for those workers. Later today, we get benchmark revisions to the payroll data which could result in about a 600k reduction in reported jobs.
- The Biden administration has launched [the SAVE Plan](#) which is designed to [scale student loan payments to incomes and cap interest costs](#). The courts struck down earlier efforts to cancel some student loans, so the administration is taking another path, [essentially reducing debt service costs](#). There have been concerns that when households with

outstanding student debt begin paying on these loans in the fall, the economy would suffer. This plan will likely blunt some of that negative pressure.

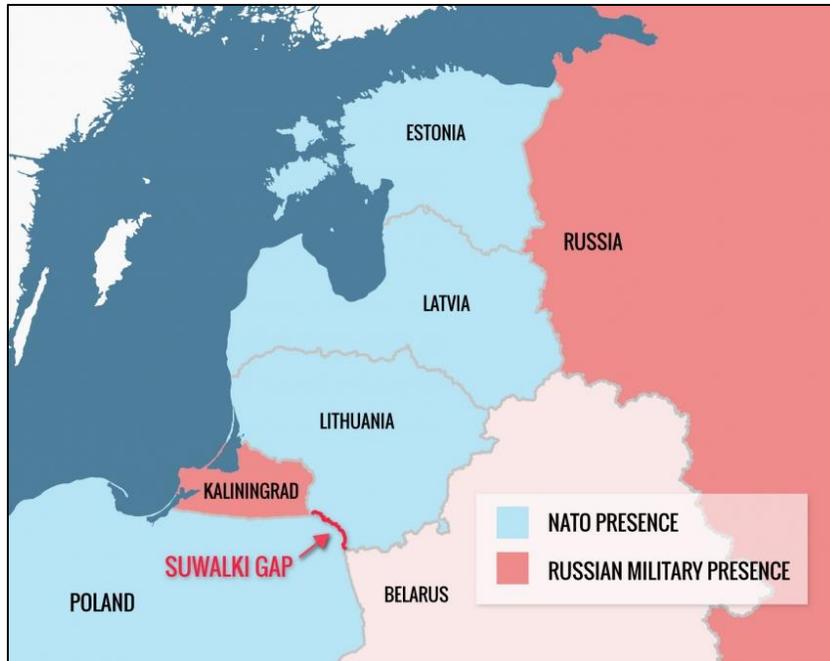
- Margin protection has been an element in keeping inflation elevated. There is evidence we have reached the end of that protection as [firms are signaling](#) that they probably won't be able to pass along further cost increases. However, there is no evidence to suggest a rollback in prices is likely.
- On the battered commercial real estate side, it's a "[good news, bad news](#)" story. The good news is that office tenants are renewing their leases, but the bad news is that they are doing so while taking less space.
- The Bank for International Settlements warns that [cryptocurrencies seem to be increasing financial fragility](#) in emerging markets.

China update: Gina Raimondo is off to China where the economy continues to struggle.

- [Commerce Secretary Raimondo is on her way to China](#), part of a parade of administration officials trying to at least stabilize U.S./China relations. As part of the trip, the U.S. has eased some controls, [removing 27 Chinese entities from the "unverified list."](#) We doubt this action will make much of a difference. We note that National Security Director Sullivan warned China to be more "[transparent](#)" about its economic data, reacting to news that Beijing won't publish youth unemployment data anymore.
- Due to concerns about the Chinese financial system, [policymakers are moving cautiously on potentially reducing rates](#), likely worried that aggressive cuts will trigger capital flight and a rout of the CNY. Unfortunately, without stimulus, the Chinese economy will continue to struggle.
- As geopolitical tensions rise between China and the U.S., [American financial firms are seeing reduced opportunities in China](#).

International Roundup: Here are other news items of note.

- [There are reports of local fuel shortages in Russia](#). Between the reconfiguring of supply chains, resources being diverted for the war effort, and sanctions, the domestic economy is bound to have periodic supply issues. What remains uncertain is if these outages will result in a drop in production or civil unrest. So far, there isn't much evidence of either.
- The State Department has warned Americans in Belarus to "leave immediately." The government notes that the presence of Russian troops is rising in the country and local law enforcement can be "arbitrary." The department also notes that European nations bordering Belarus have been closing borders. Last week, Lithuania closed two border crossings, and Poland and Latvia are considering closing crossings as well. Direct flights out of Belarus are limited.
 - There is a growing concern that Russia might forcibly take the Suwałki Gap which separates Belarus from Russian-controlled Kaliningrad.



(Source: The Baltic Times)

If this gap were seized, there would be no land bridge between NATO and the Baltic state, making their defense difficult. The vulnerability of this [area isn't anything new](#), but the reported build-up of Russian troops in [Belarus has raised alarms](#). The State Department's warning adds to this concern.

- We also note that Russia has reportedly placed nuclear weapons in Belarus. In the context of the increasing threat to the Suwalki Gap, this is a further Russian provocation.
- Russia may be [considering annexing](#) the regions in Georgia it seized in 2008.
- It's settled—[Srettha Thavisin will be the next PM of Thailand](#). Thailand has been under a caretaker government since March.
- [Spain's king has asked the conservative party leadership to form a government](#). Given that the coalition isn't a majority, this effort will likely fail and so new elections later this year are increasingly likely.
- Azerbaijan is [essentially blockading](#) the disputed region of Nagorno-Karabakh. The region, which has an Armenian majority, is beginning to see shortages of essential items develop.

U.S. Economic Releases

High interest rates continue to dampen demand for residential mortgages. Mortgage applications fell 4.2% in the week ending August 18, according to the Mortgage Bankers Association (MBA). This is the fifth consecutive week of declines. The persistent rise in borrowing costs is discouraging many buyers from taking out mortgages. The average 30-year fixed-rate mortgage

rose 13 basis points from 7.18% to 7.31% during the week. As a result, the MBA's purchase and refinance indexes fell 5.1% and 2.8%, respectively, from the prior week.

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	Aug F	49.0	49.0	***
9:45	S&P Services PMI	m/m	Aug P	52.2	52.3	**
9:45	S&P Composite PMI	m/m	Aug P	51.5	52.0	**
10:00	New Home Sales - Annualized Selling Rate	m/m	Aug P	0.90%	-2.50%	***
10:00	New Home Sales - Monthly Change	m/m	Jul	703k	697k	**
Federal Reserve						
No Fed speakers or events for the rest of 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								
Japan	Jibun bank Composite PMI	m/m	Aug P	52.6	52.2		*	Equity and bond neutral
	Jibun Bank Manufacturing PMI	m/m	Aug P	49.7	49.6		***	Equity and bond neutral
	Jibun Bank Services PMI	m/m	Aug P	54.3	53.8		**	Equity and bond neutral
	Machine tool orders	y/y	Jul F	-19.7%	-19.8%		**	Equity and bond neutral
New Zealand	Retail Sales Ex Inflation	q/q	2Q	-1.0%	-1.4%	-1.6%	**	Equity bearish, bond bullish
South Korea	Business Survey - Non-Manufacturing	m/m	Sep	76	76		*	Equity and bond neutral
	Business Survey - Manufacturing	m/m	Sep	69	69		**	Equity and bond neutral
EUROPE								
Eurozone	HCOB Manufacturing PMI	m/m	Aug P	43.7	42.7	42.7	***	Equity bullish, bond bearish
	HCOB Services PMI	m/m	Aug P	48.3	50.9	50.5	**	Equity bearish, bond bullish
	HCOB Composite PMI	m/m	Aug P	47.0	48.6	48.5	*	Equity bearish, bond bullish
Germany	HCOB Manufacturing PMI	m/m	Aug P	39.1	38.8	38.6	***	Equity and bond neutral
	HCOB Services PMI	m/m	Aug P	47.3	52.3	51.5	**	Equity bearish, bond bullish
	HCOB Composite PMI	m/m	Aug P	44.7	48.5	48.3	*	Equity bearish, bond bullish
France	HCOB Manufacturing PMI	m/m	Aug P	46.4	45.1	45.0	***	Equity bullish, bond bearish
	HCOB Services PMI	m/m	Aug P	46.7	47.1	47.5	**	Equity bearish, bond bullish
	HCOB Composite PMI	m/m	Aug P	46.6	46.6	47.1	*	Equity and bond neutral
UK	S&P/CIPS Manufacturing PMI	m/m	Aug P	42.5	45.3	45.0	***	Equity bearish, bond bullish
	S&P/CIPS Services PMI	m/m	Aug P	48.7	51.5	51.0	**	Equity bearish, bond bullish
	S&P/CIPS Composite PMI	m/m	Aug P	47.9	50.8	50.4	**	Equity bearish, bond bullish
AMERICAS								
Mexico	International Reserves Weekly	w/w	18-Aug	\$203482m	\$203861m		*	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)	564	564	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)	539	539	0	Up
U.S. Libor/OIS spread (bps)	541	541	0	Up
10-yr T-note (%)	4.27	4.33	-0.06	Flat
Euribor/OIS spread (bps)	381	381	0	Up
Currencies	Direction			
Dollar	Up			Up
Euro	Down			Up
Yen	Up			Down
Pound	Down			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	\$82.84	\$84.03	-1.42%	
WTI	\$78.45	\$79.64	-1.49%	
Natural Gas	\$2.53	\$2.56	-1.09%	
Crack Spread	\$35.68	\$41.21	-13.43%	Roll Distortion
12-mo strip crack	\$29.73	\$30.74	-3.29%	
Ethanol rack	\$2.32	\$2.32	-0.04%	
Metals				
Gold	\$1,903.61	\$1,897.48	0.32%	
Silver	\$23.82	\$23.41	1.75%	
Copper contract	\$381.35	\$378.85	0.66%	
Grains				
Corn contract	\$482.25	\$479.50	0.57%	
Wheat contract	\$629.00	\$627.50	0.24%	
Soybeans contract	\$1,341.25	\$1,346.00	-0.35%	
Shipping				
Baltic Dry Freight	1,194	1,223	-29	
DOE Inventory Report				
	Actual	Expected	Difference	
Crude (mb)		-3.0		
Gasoline (mb)		-0.5		
Distillates (mb)		0.7		
Refinery run rates (%)		0.5%		
Natural gas (bcf)		33		

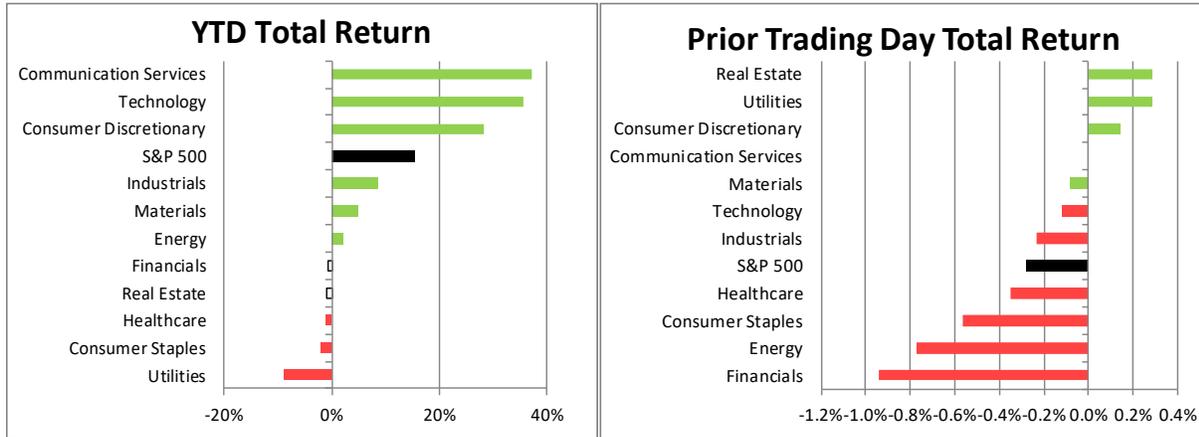
Weather

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 New England and the Midwest. The precipitation outlook calls for wetter-than-normal conditions throughout the Pacific region, Southwest, and East Coast, with dry conditions expected in the entire Mississippi Valley and Great Lakes regions.

The Atlantic Ocean is currently showing four atmospheric disturbances, two of which have formed into cyclones. Tropical Depression Harold has made its way into Mexico after crossing the Texas border. It is expected to weaken as it moves inland but could still produce heavy rain and flooding. Meanwhile, Tropical Storm Franklin has made landfall in Hispaniola and is expected to strengthen as it moves across the Caribbean Sea. The other two disturbances are located in the central Atlantic Ocean and have, at most, a 50% chance of forming into a cyclone within the next 48 hours.

Data Section

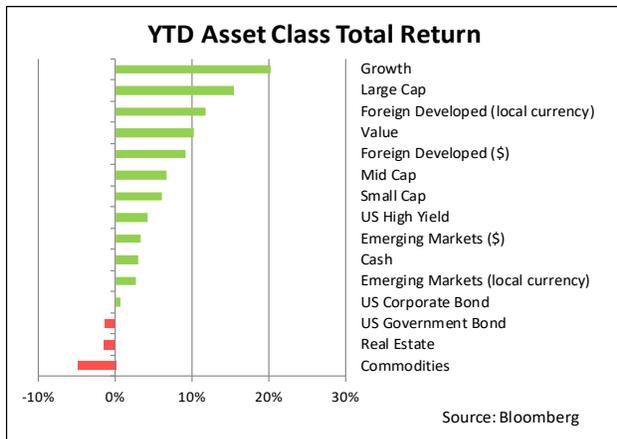
U.S. Equity Markets – (as of 8/22/2023 close)



(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 8/22/2023 close)

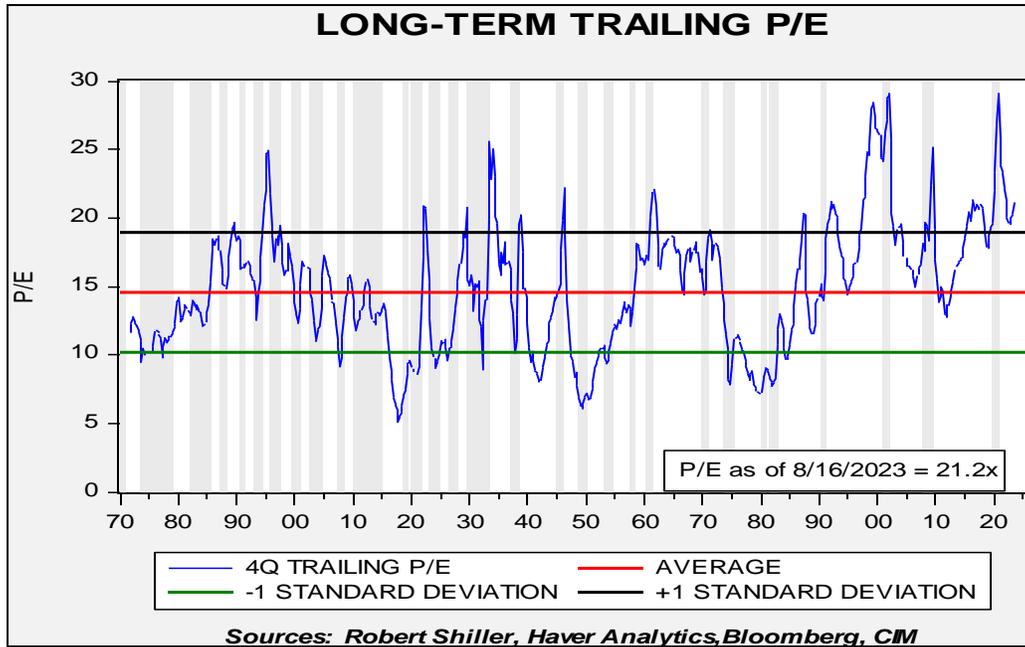


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.