

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 25, 2023—9:30 AM EDT]** Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is up 0.5% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.8%. Chinese markets were lower, with the Shanghai Composite down 0.6% from its previous close and the Shenzhen Composite down 1.8%. U.S. equity index futures are signaling a higher open.

With 484 companies having reported so far, S&P 500 earnings for Q2 are running at \$54.60 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 14.5% 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:

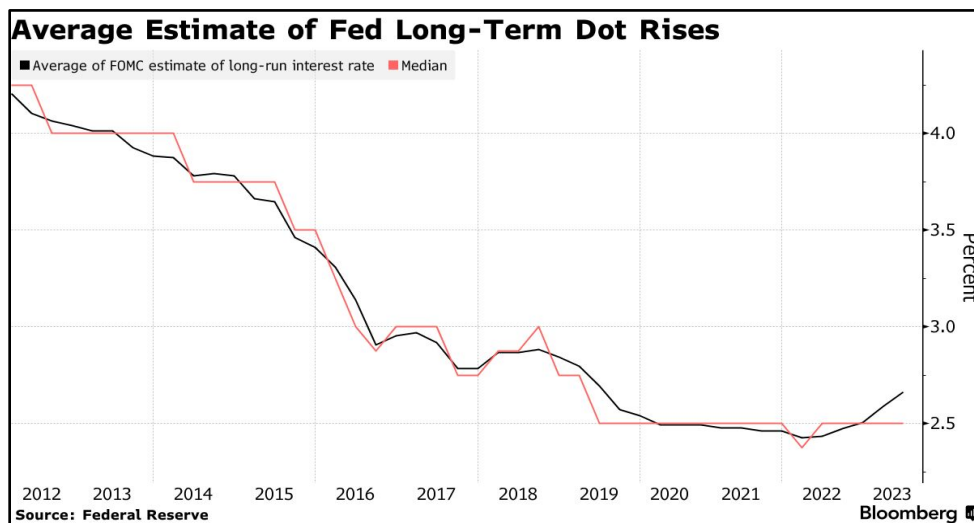
- [Bi-Weekly Geopolitical Report](#) (8/21/2023) (there will be no podcast for this report): “Reflections on the New Cold War”
- [Weekly Energy Update](#) (8/24/2023): European LNG prices are swinging due to the combination of ample storage and worries about shortages this winter. Tensions in the Middle East remain high; although the Gulf State and Iran have been making diplomatic overtures, overall improvements in relations remain scarce.
- [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”
- [Business Cycle Report](#) (8/24/23)

Good morning! Today’s *Comment* will be split into three main topics: 1) What investors will be looking for in Fed Chair Jerome Powell’s speech at Jackson Hole; 2) How China is using BRICS

as a way to challenge the U.S. and its allies; and 3) Why the export ban on semiconductors is making companies uneasy.

**Powell's Moment:** Investors will be glued to Fed Chair Jerome Powell's every word as he delivers his views on the future path of monetary policy at Jackson Hole.

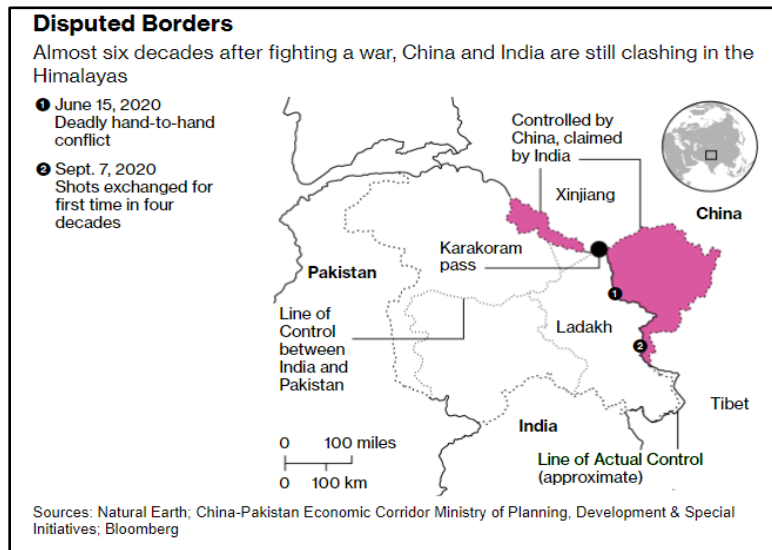
- Federal Reserve Chair Jerome Powell is likely to remain tight-lipped about the future of monetary policy in his upcoming speech. Last month, Powell indicated a shift toward reduced guidance and increased data dependence regarding the Federal Open Market Committee's next rate decision. Consequently, investors are still speculating about what he might say, given recent economic data that suggests the Fed may need to be more hawkish in its efforts to combat inflation. The latest nowcast from the Atlanta Fed shows that the [GDP likely accelerated in the third quarter of the year](#). Meanwhile, the latest jobless claims data suggests that the labor market remains stubbornly tight.
- In the lead-up to Powell's speech, Fed officials have expressed a range of views on the appropriate path of interest rates. [Boston Fed President Susan Collins](#) and [former St. Louis Fed President James Bullard](#) have both expressed support for additional rate hikes. At the same time, Philadelphia Fed President Patrick Harker [has suggested that interest rates do not need to be raised further](#). The divergence in views among Fed officials suggests that there is still uncertainty about the appropriate path of monetary policy. Despite their differences, there is a growing consensus that interest rates are close to peaking.



- The prevailing view is that interest rates will remain elevated for an extended period of time. The median long-term federal funds rate is still near 2.5%, but the average rate has begun to outpace it. This has led investors to revise their expectations upwards of future interest rates, as they believe that the central bank may not cut rates as quickly or aggressively as it did in the past. In fact, investors have already purchased protection against any sell-off that could occur if Powell reinforces this hawkish stance.

**BRICS United:** China is using the BRICS summit to consolidate its influence and build a bloc of emerging economies that can challenge the Western-led order.

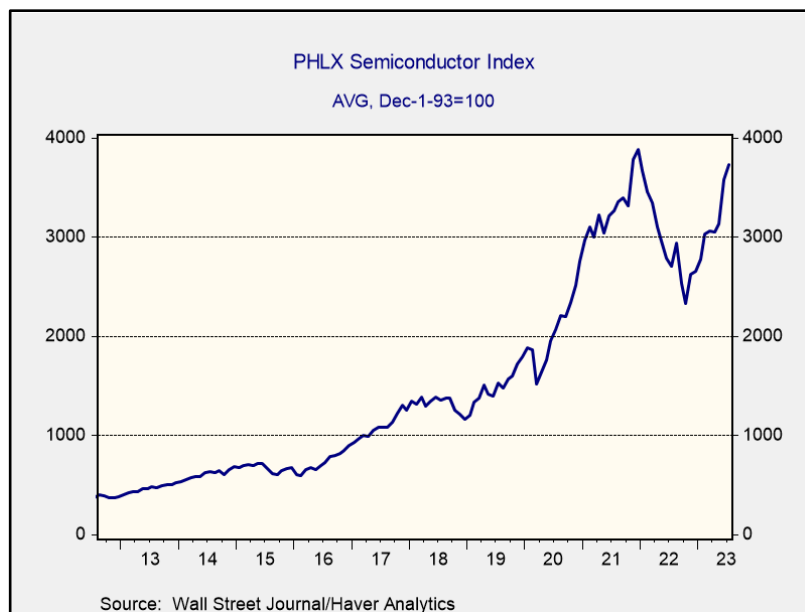
- On Thursday, the [BRICS countries \(Brazil, Russia, India, China, and South Africa\)](#) [extended invitations](#) to Saudi Arabia, Egypt, United Arab Emirates, Iran, Argentina, and Ethiopia to join their bloc. The possible admission of these countries appears to be an attempt to create an emerging markets bloc to counter the U.S.-led bloc in the G7. That said, it is unclear whether these countries are interested in joining the group, as many of them still have strong military and trade ties with the United States. Prior to the announcement, Indonesia asked not to be named. It is also possible that some BRICS countries may not support the expansion of the bloc, as it could dilute their own influence.
- Despite [suspected differences within the bloc](#), there are indications that China is willing to compromise with the members in exchange for cooperation. During the summit, Chinese President Xi Jinping and Indian Prime Minister Narendra Modi [pledged to work towards a peaceful resolution of the border dispute between their two countries](#). The two sides have been at odds over the territory ever since a 2020 clash between the countries' militaries. Modi was the one who initiated the discussion on the border dispute, suggesting that India's decision to welcome new members may have been made for transactional purposes.



- Together, the BRICS countries compose [37% of the global GDP and nearly half of the world's population](#), and its potential expansion will undoubtedly increase its influence on the world stage. However, it is still unlikely that China will be able to exercise the same level of influence over the BRICS countries as the United States has over the G7 members. The United States's ability to maintain open capital markets means it will continue to be an attractive trade and investment destination for other countries, especially emerging markets. Therefore, the rise of the BRICS countries is a potential challenge to U.S. dominance, but it is not yet a real threat.

**Chips Everywhere:** Semiconductor companies worry that trade restrictions targeting China could hurt their bottom lines.

- Chinese companies imported a record amount of semiconductor equipment in June and July as they scrambled to secure supplies ahead of the implementation of export curbs by the United States and other countries. Trade data from China showed that the country's [import of chip production tools increased by 70% compared to the same period last year](#). Chinese companies are looking to stock up before export restrictions come into effect on September 1. The surge in semiconductor imports by Chinese companies reflects Beijing's determination to maintain its technological advancement despite Washington's attempts to slow it.
- Semiconductor firms that view China as an essential market are worried about the harsh restrictions on exports. Chipmaker Nvidia (NVDA, \$471.63) [warned that additional curbs would further hinder their ability to compete](#) in the world's second-largest economy. The company reported earlier this week [that sales of its popular AI chips more than doubled from last year](#), and it expects demand to continue to grow. The news initially caused a surge in the PHLX Semiconductor Index, but investors later sold off as they remained uncertain about the full impact of the regulations on profits.



- The U.S. government's policy of asking businesses to "de-risk" their operations in China has been met with confusion and uncertainty. Some businesses have interpreted this policy as a call to completely sever ties with China, while others believe that it is simply a request to take steps to mitigate risk. This lack of clarity has made it difficult for businesses to plan for the future and has created anxiety among investors. Although we suspect that the U.S. and China are heading for a break-up, we believe that lobbying by firms will make it a long and drawn-out process.

## 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
10:00	U. of Michigan Consumer Sentiment	m/m	Aug F	71.2	71.2	***
10:00	U. of Michigan Current Conditions	m/m	Aug F		77.4	**
10:00	U. of Michigan Future Expectations	m/m	Aug F		67.3	**
10:00	U. of Michigan 1-Year Inflation Expectation	m/m	Aug F	3.3%	3.3%	*
10:00	U. of Michigan 5-10 Year Inflation Expectation	m/m	Aug F	2.9%	2.9%	*
11:00	Kansas City Fed Services Activity	m/m	Aug		-1	*
Federal Reserve						
EST	Speaker or Event	District or Position				
10:05	Jerome Powell Speaks at Jackson Hole Economic Policy Symposium	Chairman of the Board of Governors				
11:00	Patrick Harker Interview With Bloomberg TV	President of the Federal Reserve Bank of Philadelphia				
11:30	Patrick Harker Interview With Yahoo Finance Live	President of the Federal Reserve Bank of Philadelphia				
11:30	Loretta Mester Speaks on CNBC	President of the Federal Reserve Bank of Cleveland				
12:30	Austan Goolsbee Speaks on CNBC	President of the Federal Reserve Bank of Chicago				
14:00	Austan Goolsbee Speaks on Bloomberg TV	President of the Federal Reserve Bank of Chicago				
14:30	Loretta Mester Speaks on Bloomberg TV	President of the Federal Reserve Bank of Cleveland				

## 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
<b>ASIA-PACIFIC</b>								
Japan	Tokyo CPI	y/y	Aug	2.9%	3.2%	3.0%	**	Equity and bond neutral
	Tokyo CPI Ex-Fresh Food	y/y	Aug	2.8%	3.0%	2.9%	***	Equity and bond neutral
	Tokyo CPI Ex-Fresh Food & Energy	y/y	Aug	4.0%	4.0%	4.0%	*	Equity and bond neutral
	PPI Services	y/y	Jul	1.7%	1.2%	1.4%	*	Equity and bond neutral
	Nationwide Dept Sales	y/y	Jul	8.6%	7.0%		*	Equity and bond neutral
<b>EUROPE</b>								
Germany	GDP NSA	y/y	2Q F	-0.6%	-0.6%	-0.6%	**	Equity and bond neutral
	GDP WDA	y/y	2Q F	-0.2%	-0.2%	-0.2%	**	Equity and bond neutral
	IFO Business Climate	m/m	Aug	85.7	87.3	87.4	***	Equity bearish, bond bullish
	IFO Current Assessment	m/m	Aug	89.0	91.3	91.4	**	Equity bearish, bond bullish
	IFO Expectations	m/m	Aug	82.6	83.5	83.6	**	Equity bearish, bond bullish
UK	GfK Consumer Confidence	m/m	Aug	-25	-30	-29	**	Equity bullish, bond bearish
Russia	Gold and Forex Reserves	m/m	18-Aug	\$579.5b	\$585.8b		***	Equity and bond neutral
	Money Supply, Narrow Definition	w/w	18-Aug	18.72t	18.60t		*	Equity and bond neutral
<b>AMERICAS</b>								
Brazil	FGV Consumer Confidence	y/y	Aug	96.80%	94.80%		*	Equity bullish, bond bearish
	Current Account Balance	m/m	Jul	-\$3605m	-\$843m	-\$1268m	**	Equity and bond neutral
	IBGE Inflation IPCA - 15	y/y	Aug	4.2%	3.2%	4.1%	*	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.

doe	Today	Prior	Change	Trend
3-mo Libor yield (bps)	565	564	1	Up
3-mo T-bill yield (bps)	527	531	-4	Up
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	541	540	1	Up
U.S. Libor/OIS spread (bps)	543	543	0	Up
10-yr T-note (%)	4.24	4.24	0.00	Flat
Euribor/OIS spread (bps)	378	383	-5	Up
<b>Currencies</b>	<b>Direction</b>			
Dollar	Flat			Down
Euro	Flat			Up
Yen	Down			Down
Pound	Flat			Up
Franc	Down			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
<b>Energy Markets</b>				
Brent	\$84.42	\$83.36	1.27%	
WTI	\$80.08	\$79.05	1.30%	
Natural Gas	\$2.53	\$2.52	0.36%	
Crack Spread	\$36.94	\$36.69	0.68%	
12-mo strip crack	\$30.36	\$30.07	0.98%	
Ethanol rack	\$2.37	\$2.36	0.30%	
<b>Metals</b>				
Gold	\$1,917.37	\$1,916.91	0.02%	
Silver	\$24.19	\$24.12	0.27%	
Copper contract	\$381.60	\$379.35	0.59%	
<b>Grains</b>				
Corn contract	\$487.00	\$488.25	-0.26%	
Wheat contract	\$634.25	\$631.75	0.40%	
Soybeans contract	\$1,380.50	\$1,371.75	0.64%	
<b>Shipping</b>				
Baltic Dry Freight	1,110	1,151	-41	
<b>DOE Inventory Report</b>				
	<b>Actual</b>	<b>Expected</b>	<b>Difference</b>	
Crude (mb)	-6.1	-3.0	-3.1	
Gasoline (mb)	1.5	-0.5	1.9	
Distillates (mb)	0.9	0.7	0.2	
Refinery run rates (%)	-0.2%	0.5%	-0.7%	
Natural gas (bcf)	18	29	-11	

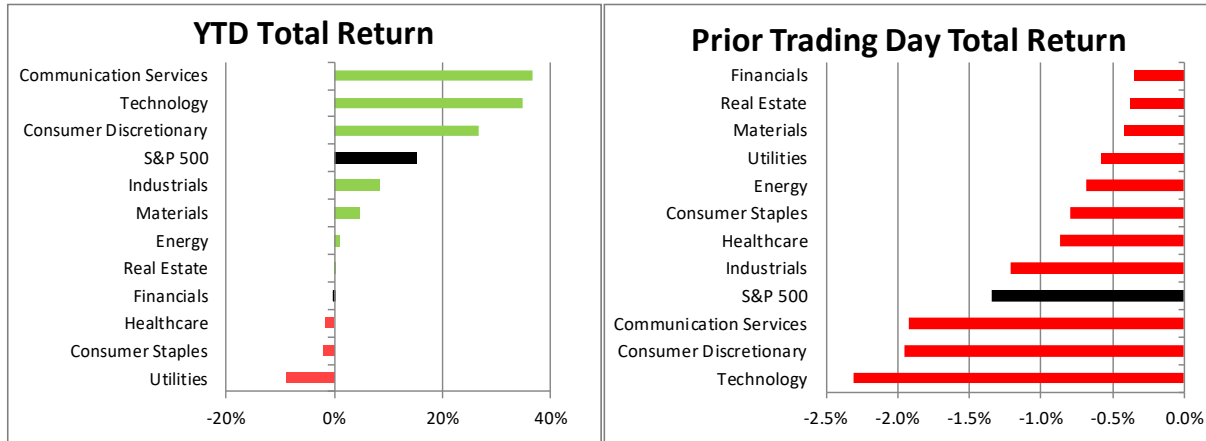
## **Weather**

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures for the western two-thirds of the nation, with below-normal temps for New England into the Midwest. A warming trend is expected to return in early September. Dry conditions are expected in most of the eastern half of the country, with wet conditions in Pacific and Rocky Mountain regions.

The Atlantic Ocean is currently showing four atmospheric disturbances, but only one remains a named storm. Tropical Storm Franklin has moved away from Turks and Caicos and is forecast to move directly north, possible toward Bermuda. Two other disturbances are currently in the central Atlantic Ocean, but both have a 20% chance of cyclone formation within the next 48 hours. The remaining tropical disturbance off the Yucatan Peninsula has a 30% chance of forming into a cyclone within the next two days.

**Data Section**

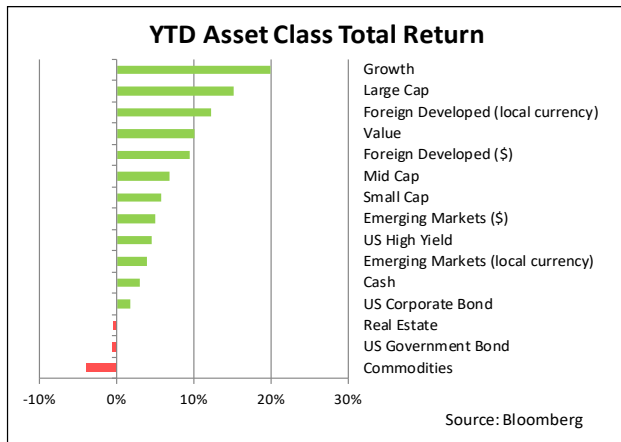
**U.S. Equity Markets – (as of 8/24/2023 close)**



(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 8/24/2023 close)**



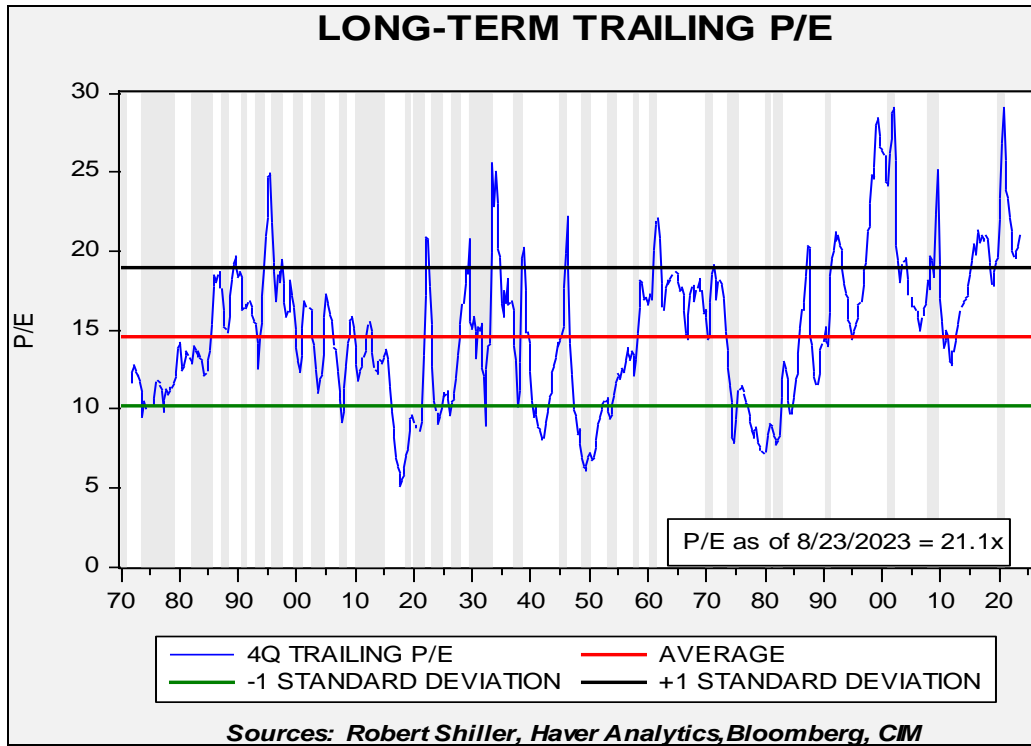
This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 24, 2023



Based on our methodology,<sup>1</sup> the current P/E is 21.1x, down 0.1x from last week. Improved earnings coupled with falling index values led to the modest 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.*

<sup>1</sup> 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.