

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 28, 2023—9:30 AM EDT]** Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 is up 0.7% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.7%. Chinese markets were higher, with the Shanghai Composite up 1.1% from its previous close and the Shenzhen Composite up 1.0%. U.S. equity index futures are signaling a higher open.

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](#) (8/28/2023) (there will be no podcast for this report): “Examining the Rise in T-Note Yields”**
- [Confluence of Ideas podcast](#) (8/22/2023): “The Economics of Defense in Great Power Competition”
- [Business Cycle Report](#) (8/24/23)

Our *Comment* today opens with a review of Federal Reserve Chair Powell’s address to the Kansas City FRB’s symposium in Jackson Hole on Friday. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including signs that U.S. private investments in China are already starting to fall sharply while China launches a new cut in securities transaction taxes to spur more demand.

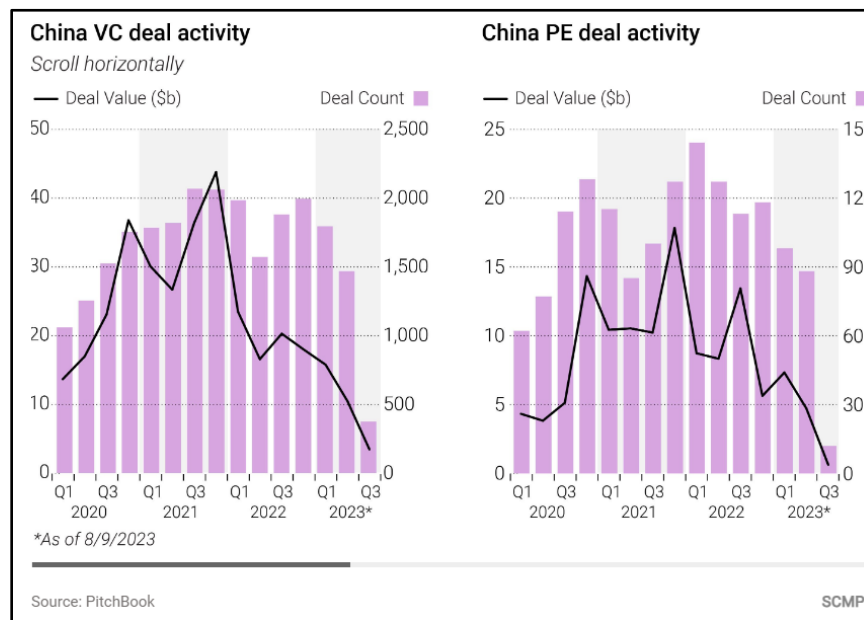
**U.S. Monetary Policy:** At the conference in Jackson Hole on Friday, Fed Chair Powell [suggested that the monetary policymakers would likely hold interest rates steady at their](#)

[upcoming meeting in September](#), but that they would be prepared to hike rates further if economic growth accelerates and pushes price pressures higher. He also [reiterated his warning that the Fed is likely to hold interest rates “higher for longer” in order to make sure consumer price inflation comes down to the policymakers’ 2% target](#).

- Based on market indicators, it appears that investors have bought into that view. We also believe the policymakers will try to hold rates at a high level for an extended period, although it is unclear whether they could maintain that discipline if a financial crisis were to erupt or if the economy starts to slow precipitously.
- Investors’ focus on the likelihood of a pause in the Fed’s rate-hiking campaign allowed risk assets to appreciate in value on Friday, while bond yields rose. So far today, however, the yield on the benchmark 10-year Treasury note has fallen back to 4.201%.

**United States-China:** Based on new data, the U.S.’s move to restrict investors from privately funding certain advanced-technology startups in China [has already begun to discourage private equity and venture capital investments in the country](#). The restrictions, which were confirmed in a recent executive order, are apparently freezing investment flows not only into the targeted industries, but also into related industries that the funds and their investors fear could be restricted in the future. Separately, in her visit to Beijing today, U.S. Commerce Secretary Raimondo [warned that the U.S. would not compromise its national security to maintain trade and investment flows](#), but she argued that there would still be opportunities in non-sensitive areas.

- It’s important to remember that the private investment restrictions don’t just cut the amount of funding available to Chinese firms. Private-equity and venture-capital funds also tend to take a hands-on approach to the companies they invest in, including providing strategic and operational guidance or consulting from the funds’ network of experts. If the funds stop investing in China’s high-tech startups, the Chinese firms as a whole are likely to develop more slowly than they otherwise would.



- The development is therefore just the latest example of how U.S.-China tensions are exacerbating the other factors weighing on Chinese economic growth, including weak consumer demand, high debt levels, and poor demographics.

**Russia-China:** Now that China has banned all food imports from Japan in response to the country’s release of treated radioactive water from the stricken Fukushima nuclear plant, Russia’s food safety agency [said it will try to sharply increase Russian food exports to China](#). The move comes as Beijing [is also whipping up popular boycotts against Japanese imports](#). The statement shows how China and Russia are drawing closer to each other amid their various disputes with the West.

- More broadly, the move illustrates how the evolving geopolitical and economic blocs that we’ve written so much about are coalescing, with countries pulling back from their ties with other blocs but deepening ties with countries in their own bloc.
- We count Japan as a key member of the U.S.-led bloc, while we see Russia as the junior partner in the China-led bloc.

**Russia-Ukraine War:** In a report that suggests Kyiv’s counteroffensive may now be making more substantial progress, Ukrainian forces [are said to have penetrated the first line of Russian defenses at the village of Robotyne, in Ukraine’s eastern Zaporizhzhia region](#). The Ukrainian defense ministry says its forces are now driving southeast despite fierce Russian resistance.

- If the report from Kyiv is true, and if the Ukrainians can maintain or build their momentum, it would revive optimism that they can push the Russian forces out of more territory and perhaps even sever the important “land bridge” linking Russia proper with the occupied Crimean Peninsula.



- That kind of progress could also help maintain Western resolve to keep sending arms and supplies to the Ukrainians without putting undue pressure on Kyiv to go to the negotiating table.

**China:** In a further move to shore up the local stock market, the Ministry of Finance and the State Tax Administration [said the stamp duty of 0.1% on securities transactions will be halved](#) starting today. The China Securities Regulatory Commission also said it will cut the margin requirement for securities purchases from 100% to 80% starting September 8.

- The moves aim to give a boost to Chinese securities markets, but we suspect buying activity will remain weak in the face of slowing economic growth and increased regulatory risk because of the worsening in U.S.-China trade tensions.
- In fact, Chinese stocks [initially jumped some 5% on today's news](#), but then they gave up most of those gains and closed up only about 1%.

**Taiwan:** Terry Gou, the founder of iPhone assembler Foxconn Technology (HNHPF, \$6.72), [announced he will run as an independent candidate in January's presidential election](#). The move will further split the relatively pro-China opposition parties on the island. According to recent polls, current Vice President Lai Ching-te of the anti-China, pro-U.S. Democratic Progressive Party maintains a comfortable lead over the Kuomintang Party and a smaller third party. Since Gou argues that the government is needlessly stirring up tensions with Beijing, his candidacy is expected to draw further support from the Kuomintang.

**Eurozone:** In a release today, the European Central Bank's key measure of the money supply [showed an annual decline for the first time since 2010](#). The new data showed that M3 (which encompasses deposits, loans, cash in circulation, and various other financial instruments) was down 0.4% in the year ended in July, after being up 0.6% in the year to June. The figures illustrate the impact of the ECB's monetary tightening over the last year, which has helped reduce price pressures but also threatens to further weigh on economic growth going forward.

**Japan:** At the Kansas City FRB's conference in Jackson Hole, Bank of Japan Governor Ueda said he and his fellow policymakers [are maintaining their basic yield-curve control strategy because they still see underlying inflation running below their target](#) of 2.0%. Even though Japan's core consumer price index for July was up 3.1% year-over-year, Ueda said he expected core inflation to fall back before the end of the year. Since the statement suggests it's still too early to expect the BOJ to abandon its yield-curve control strategy, the news helped boost Japanese stocks by about 1.7% today.

## 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
10:30	Dallas Fed Manufacturing Activity	m/m	Aug	-19	-20	**
Federal Reserve						
EST	Speaker or Event	District or Position				
12:30	Michael Barr Speaks About Banking Services	Federal Reserve Board Vice Chair for Supervision				

## 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	Leading Economic Index	m/m	Jun F	108.9	108.9		**	Equity and bond neutral
Australia	Retail Sales	m/m	Jul	0.50%	-0.80%	0.30%	***	Equity and bond neutral
China	Industrial Profits	m/m	Jul	-6.7	-8.3		***	Equity bullish, bond bearish
<b>EUROPE</b>								
Eurozone	M3 Money Supply	y/y	Jul	-0.4%	0.6%	0.0%	***	Equity and bond neutral
Switzerland	Domestic Sight Deposits CHF	w/w	25-Aug	461.7b	466.4b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	25-Aug	471.4b	476.2b		*	Equity and bond neutral
<b>AMERICAS</b>								
Mexico	Current Account Balance	q/q	2Q	-\$20289m	-\$20289m	-\$20289m	**	Equity and bond neutral
	Exports	m/m	Jul	47550m	51762m		*	Equity and bond neutral
	Imports	m/m	Jul	48432m	51800m		*	Equity and bond neutral
	Trade Balance	m/m	Jul	-881.2m	38.2m	-1813.5m	**	Equity and bond neutral
Brazil	Total Outstanding Loans	m/m	Jul	5405b	5402b	5415b	**	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)	567	565	2	Up
3-mo T-bill yield (bps)	531	532	-1	Up
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	542	541	1	Up
U.S. Libor/OIS spread (bps)	544	543	1	Up
10-yr T-note (%)	4.23	4.24	-0.01	Flat
Euribor/OIS spread (bps)	379	378	1	Up
<b>Currencies</b>	<b>Direction</b>			
Dollar	Flat			Down
Euro	Up			Up
Yen	Flat			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
<b>Energy Markets</b>				
Brent	\$84.33	\$84.48	-0.18%	
WTI	\$79.82	\$79.83	-0.01%	
Natural Gas	\$2.64	\$2.54	4.02%	
Crack Spread	\$38.23	\$39.39	-2.94%	
12-mo strip crack	\$30.80	\$30.91	-0.35%	
Ethanol rack	\$2.37	\$2.37	0.17%	
<b>Metals</b>				
Gold	\$1,915.38	\$1,914.96	0.02%	
Silver	\$24.22	\$24.23	-0.03%	
Copper contract	\$379.80	\$378.40	0.37%	
<b>Grains</b>				
Corn contract	\$492.75	\$488.00	0.97%	
Wheat contract	\$618.00	\$621.75	-0.60%	
Soybeans contract	\$1,401.00	\$1,387.75	0.95%	
<b>Shipping</b>				
Baltic Dry Freight	1,080	1,110	-30	

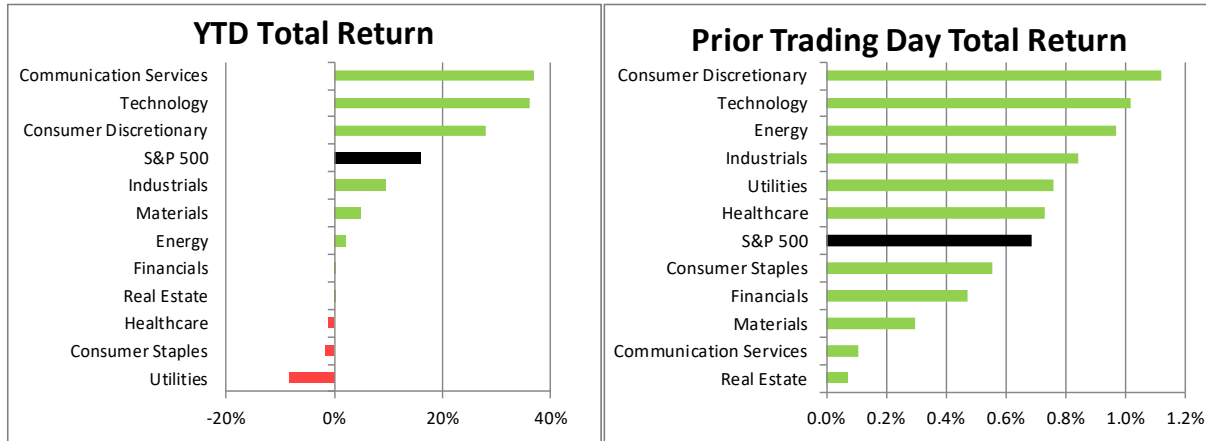
## Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures for most of the country, with below-normal temps in the Pacific. The precipitation outlook shows dry conditions are expected in most states, with wet conditions in the northern Pacific region.

The Atlantic Ocean is currently home to two tropical cyclones. Hurricane Franklin, a Category 2 storm, is located southwest of Bermuda and is expected to turn away from the East Coast before moving farther north. Tropical Storm Idalia is located just below the Yucatan Peninsula and is expected to strengthen as makes it way toward the Gulf of Mexico.

**Data Section**

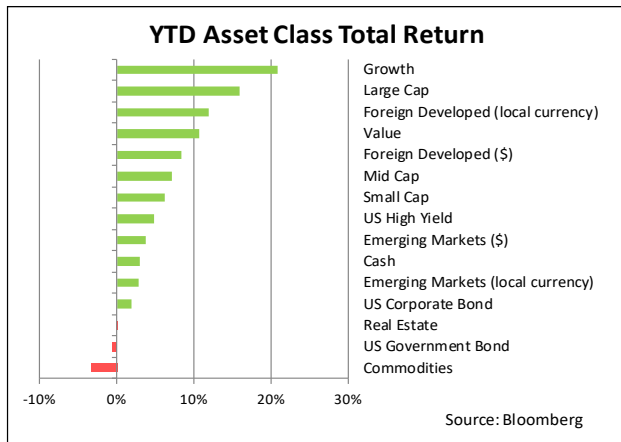
**U.S. Equity Markets – (as of 8/25/2023 close)**



(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 8/25/2023 close)**

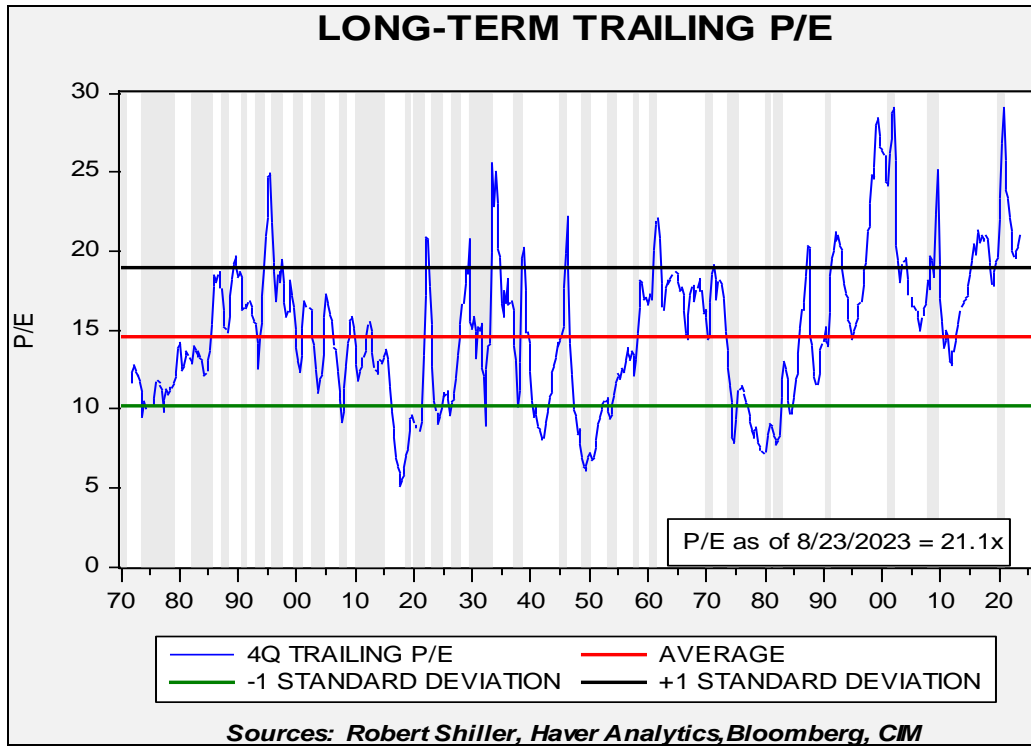


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.