

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 7, 2023—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is down 0.1% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.1%. Chinese markets were lower, with the Shanghai Composite down 0.6% from its previous close and the Shenzhen Composite down 0.7%. U.S. equity index futures are signaling a higher open.

With 417 companies having reported so far, S&P 500 earnings for Q2 are running at \$53.90 per share, compared to estimates of \$53.55 (a decline of 6.8% from Q2 2022). Of the companies that have reported thus far, 80.8% have exceeded expectations while 14.1% 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](#)** (7/24/2023) (with associated [podcast](#)): “China’s Collapsing Population”
- [Weekly Energy Update](#) (8/3/2023): The unusually large draw in crude oil stocks failed to lift prices. Fears of rising interest rates offset the bullish inventory data. We cover that data and other news in this week’s report.
- [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 Q2 2023 Rebalance Presentation](#) (5/11/2023): Video presentation featuring the Asset Allocation Committee as they review our asset allocation strategies, recent portfolio changes, and the current macro environment.
- [Asset Allocation Bi-Weekly](#) (7/31/2023) (with associated [podcast](#)): “Part-Time Troubles”
- [Confluence of Ideas podcast](#) (7/10/2023): “The 2023 Mid-Year Geopolitical Outlook”

Our *Comment* today opens with several items related to China and its relations with the rest of the world. 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 continuing moderate declines in U.K. home prices and more evidence that U.S. scientists are making progress on using fusion as a future energy source.

China-Australia: The Chinese Ministry of Commerce [said it will finally remove the 80.5% tariff on Australian barley that was imposed in May 2020](#) to retaliate against then-Prime Minister Morrison's call to investigate Beijing's role in the global coronavirus pandemic.

- Faced with slowing economic growth, worsening relations with the West, and a realization that the tariffs hadn't had much impact on Australia, the Chinese government in recent months has been signaling that it will ease off its punitive measures.
- Once the barley tariffs are lifted, Canberra is hoping Beijing will also lift its punitive tariffs on Australian wine.

China-Ukraine-Russia: The multilateral peace forum on the war in Ukraine held in Saudi Arabia over the weekend failed to produce any concrete results, but diplomats [are praising China's "constructive" participation and its commitment to also attend the next meeting](#). China's participation in the forum, which focused on Kyiv's 10-point plan to end the war, is being taken as a sign that it is putting a bit of distance between itself and Russia, despite President Xi and President Putin declaring a "no limits" partnership in the past.

China-Philippines: Despite China's improved behavior in some aspects of its international relations, the Chinese continue to harass some members of the U.S.-led geopolitical bloc. On Saturday, a Chinese coast guard vessel [blocked and water-cannoned a ship trying to resupply Philippine troops on a contested shoal in the South China Sea](#). The shoal is well within the Philippines' exclusive economic zone, but China claims it as its own territory.

- China's aggressive action [was apparently planned well in advance](#). The move likely aimed to punish the Philippines for its recent assertiveness in defending its exclusive economic zone, strengthening its U.S. alliance and other security partnerships, and publicizing China's gray-zone aggression in the South China Sea.
- The Chinese action is particularly concerning because any armed attack on Philippine public vessels, aircraft, or armed forces in the South China Sea would invoke U.S. mutual defense commitments under the U.S.-Philippine security treaty.

China-United States: Late last week, U.S. authorities [arrested two ethnic-Chinese sailors in the U.S. Navy for selling military secrets to a Chinese intelligence officer](#) in California. The arrests illustrate how China's Ministry of State Security focuses on recruiting Chinese Americans and ethnic Chinese people living in the U.S. to gain access to sensitive military secrets, technology, and other information.

United Kingdom: Data from housing firm Halifax [showed U.K. home prices declined in July to an average of £285,044, for a fourth straight monthly decline](#). Nevertheless, even as the air comes out of the British housing market in response to slow economic growth and a long string of interest-rate hikes by the Bank of England, the home-price declines remain relatively modest. The average home price reported by Halifax was down just 0.3% from June, and it was down just 2.4% from the same month one year earlier.

Niger: The junta that seized control of the government last week [closed the country's airspace](#), forcing several international airline flights to be re-routed. The airspace closure was apparently

to help thwart a threatened military intervention by the Economic Community of West African States (ECOWAS). The ECOWAS militaries had threatened to intervene if the coup plotters didn't step down by Sunday, but the deadline has passed with no action so far.

U.S. Private Property Rights: A nonprofit led by Edward Blum, the activist who pushed for this summer's Supreme Court decision outlawing affirmative action in college admissions, [has sued to block the Black-owned venture capital organization known as the Fearless Fund from running its program offering grants to small businesses owned by Black women](#). Alleging the program practices unlawful racial discrimination, the suit suggests that today's culture wars could potentially trip up private investment funds or investors who want to seed projects by historically undercapitalized groups.

U.S. Bond Market: Even as the yield on shorter-term fixed income remains relatively stable, the yield on benchmark 10-year Treasury obligations [settled at 4.060% on Friday, within striking distance of the 14-year high of 4.321% reached last October](#). The "bear steepening" is widely considered a reflection of growing optimism about the economy. We still think a mild recession is likely soon, but more investors and analysts seem to be looking for a "soft landing" that would encourage the monetary policymakers to keep interest rates high for an extended period.

U.S. Real Estate Market: New research from the University of Toronto [shows that diverse city downtowns with a mix of offices, residences, and attractions have nearly returned to, or even exceeded, their pre-pandemic foot traffic rates](#). In contrast, downtowns that feature mainly office buildings remain far below their pre-pandemic foot-traffic levels. That realization [is sparking downtown redevelopment projects in a number of cities](#), many of which involve municipal governments providing incentives for office-to-residential conversions.

U.S. Fusion Energy: Scientists at the Lawrence Livermore National Laboratory in California [said they have successfully repeated an experiment in which they sparked a fusion reaction that produced more energy than it used](#). The successful replication has led to increased optimism that scientists are now on track to eventually be able to produce copious amounts of clean energy, which could dramatically reshape the economy and produce new investment opportunities in the coming decades.

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
15:00	Consumer Credit	m/m	Jun	\$13.550b	\$7.240b	*
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	Leading Economic Index	m/m	Jun P	108.9	109.2	108.9	**	Equity and bond neutral
	Coincident index	m/m	June P	115.2%	114.3%	115.1%	*	Equity and bond neutral
China	Foreign Reserves	m/m	Jul	\$32040.27b	\$3193.00b	\$3203.00b	**	Equity and bond neutral
EUROPE								
Germany	Industrial Production WDA	y/y	Jun	-1.7%	0.7%	0.0%	**	Equity bearish, bond bullish
Switzerland	Unemployment Rate	m/m	Jul	1.9%	1.9%	1.9%	**	Equity and bond neutral
	Foreign Currency Reserves	m/m	Jul	697.6b	724.6b	725.2b%	*	Equity and bond neutral
	Domestic Sight Deposits CHF	w/w	4-Aug	477.4b	479.3b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	4-Aug	493.0b	490.1b		*	Equity and bond neutral
AMERICAS								
Canada	Net Change in Employment	m/m	Jul	-6.4k	59.9k	25.0k	***	Equity bearish, bond bullish
	Unemployment Rate	m/m	Jul	5.5%	5.4%	5.5%	***	Equity and bond neutral
	Participation Rate	m/m	Jul	65.6%	65.7%	65.7%	*	Equity and bond neutral
Brazil	FGV Inflation IGP-DI	y/y	Jul	-7.47%	-7.44%	-7.46%	**	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.

Fixed Income	Today	Prior	Change	Trend
3-mo Libor yield (bps)	563	563	0	Up
3-mo T-bill yield (bps)	525	526	-1	Up
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	537	536	1	Up
U.S. Libor/OIS spread (bps)	539	538	1	Up
10-yr T-note (%)	4.11	4.04	0.07	Flat
Euribor/OIS spread (bps)	374	372	2	Up
Currencies	Direction			
Dollar	Up			Up
Euro	Down			Down
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
Energy Markets				
Brent	\$85.55	\$86.24	-0.80%	
WTI	\$82.09	\$82.82	-0.88%	
Natural Gas	\$2.63	\$2.58	2.17%	
Crack Spread	\$38.78	\$38.13	1.70%	
12-mo strip crack	\$29.86	\$29.68	0.59%	
Ethanol rack	\$2.40	\$2.40	0.23%	
Metals				
Gold	\$1,936.24	\$1,942.91	-0.34%	
Silver	\$23.43	\$23.63	-0.87%	
Copper contract	\$385.20	\$386.75	-0.40%	
Grains				
Corn contract	\$496.75	\$497.25	-0.10%	
Wheat contract	\$646.75	\$633.00	2.17%	
Soybeans contract	\$1,306.50	\$1,333.25	-2.01%	
Shipping				
Baltic Dry Freight	1,136	1,128	8	

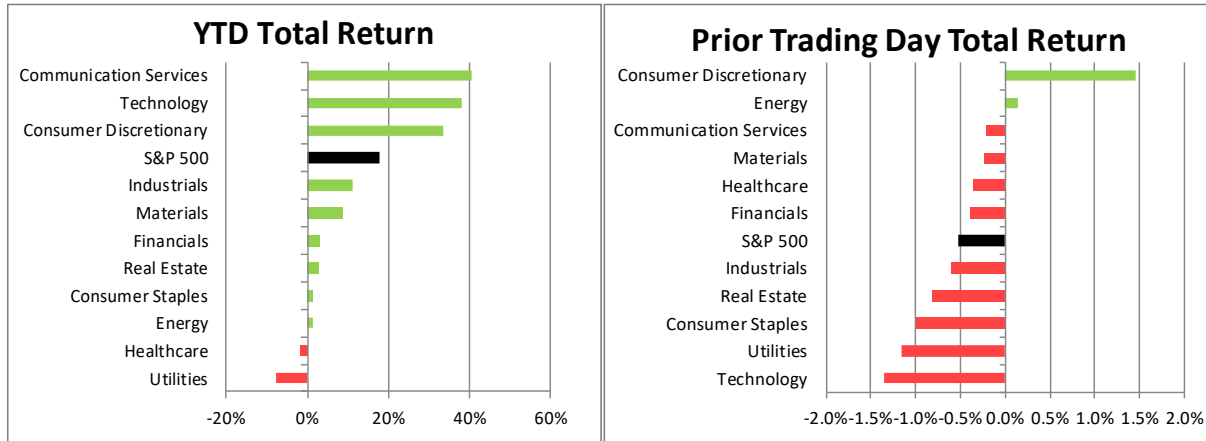
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures throughout most of the country, with cooler-than-normal temperatures in the northern Rockies. The precipitation outlook call for wetter-than-normal conditions in the majority of states, with drier conditions expected just in the Pacific region.

There are currently no tropical disturbances or cyclones being tracked in the Atlantic Ocean area.

Data Section

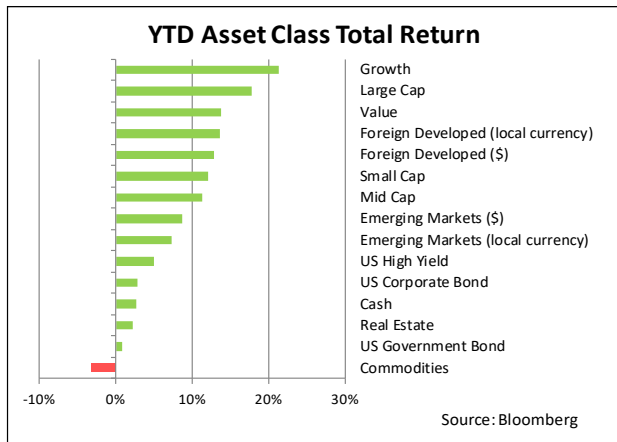
U.S. Equity Markets – (as of 8/4/2023 close)



(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 8/4/2023 close)

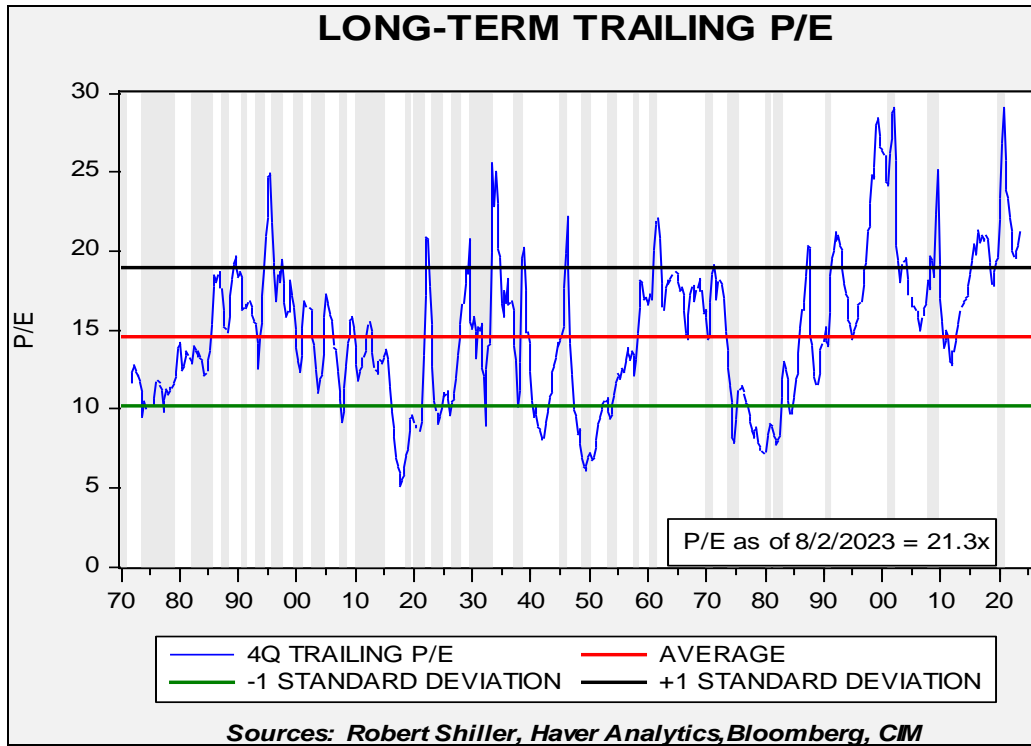


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 3, 2023



Based on our methodology,¹ the current P/E is 21.3x, 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.