

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: December 14, 2020—9:30 AM EST] Global equity markets are generally higher this morning. The EuroStoxx 50 is up 1.1% from its last close. In Asia, the MSCI Asia Apex 50 is down 0.6%. Chinese markets were higher, with the Shanghai Composite up 0.7% from the prior close and the Shenzhen Composite up 1.1%. U.S. equity index futures are signaling a higher open.

Good morning and happy Monday! [U.S. equity futures are higher this morning](#) as vaccine distribution begins. [The Electoral College votes today](#). There are two big items today—Brexit and the vaccine, so we lead off with those two categories. There was a major hack announced over the weekend. The Fed meets this week. We update economics and policy and close with a roundup of foreign news. *A note to readers—the Daily Comment will go on holiday hiatus starting December 23 and return on January 4. And, watch for our 2021 Outlooks; we will publish both the 2021 Outlook and the 2021 Geopolitical Outlook later today.* Here are the details:

Brexit: That “whoosh” you heard over the weekend was the passing of another deadline! Last week, after PM Johnson and EC President von der Leyen met, Sunday was said to be the end of talks. However, as we have seen throughout this whole process, the real deadline is that last possible day, which in this case, will be December 31, 2020. The [leadership indicated it would continue talking](#), even though the [tone was decidedly pessimistic](#). The [GBP rallied](#) on the news. Here are the details of what we know so far:

- The “level playing field” issue has been a key sticking point. According to reports, although the [two sides are not in agreement](#), there was a [hint of progress](#) on this issue, which is probably why talks were extended.
- The EU is clearly worried that if talks fail, [individual EU states will try to make their own deals with the British](#). This action would undermine the EU and Brussels is warning them to continue to work in concert.
- The [Royal Navy is preparing four patrol ships to guard British fishing areas](#) if a hard Brexit occurs.
- The U.K. appears woefully unprepared for a hard Brexit. [There are warnings that food shortages are possible](#); such warnings will only [trigger hoarding](#), which will exacerbate the problem. There are said to be [two thousand vacancies in Britain’s civil service](#) related to trade and other issues if a hard Brexit occurs. Perhaps the lack of planning for a hard break has led EU negotiators to postulate that the Johnson government isn’t really

serious about a sudden exit. We suspect that if true, this is probably a miscalculation on the part of the EU.

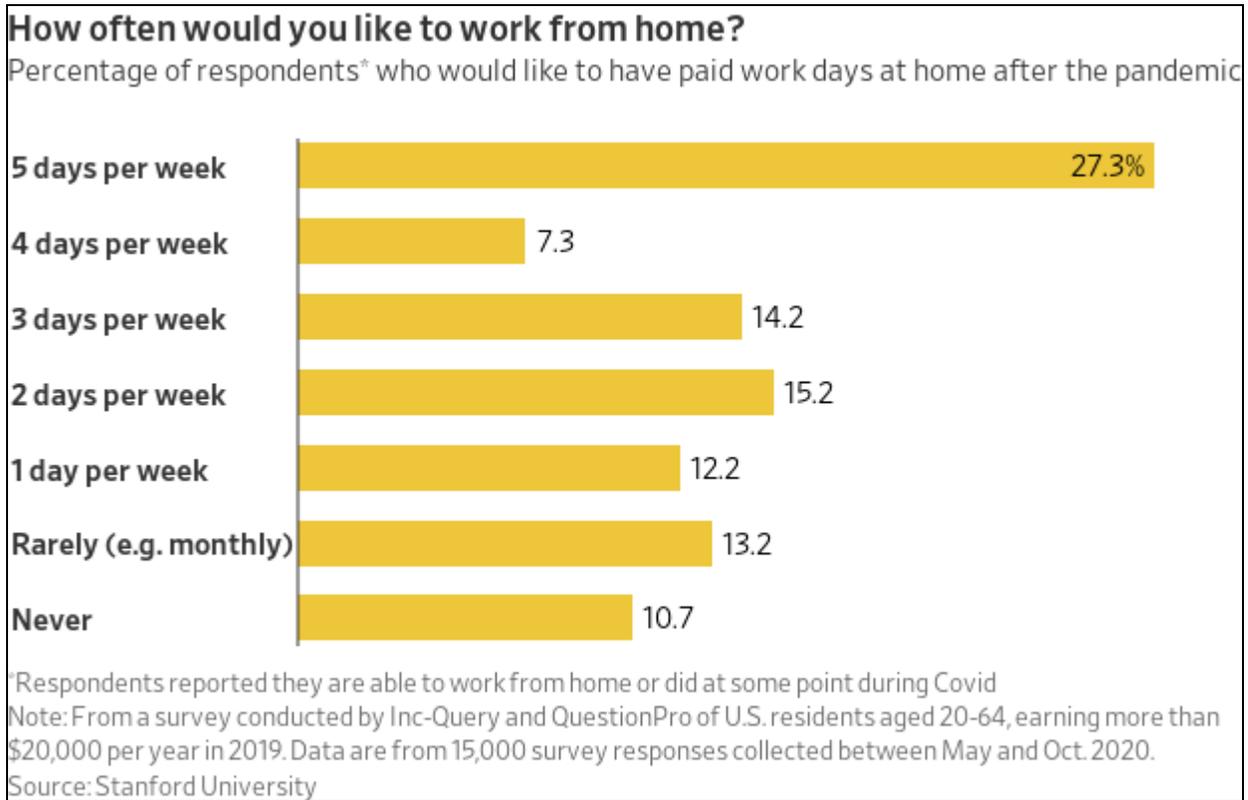
- An interesting development is occurring in Norway. That nation has a trade arrangement with the EU even though it is not a member. In the arrangement, Norway pays to be in the EU, but it has no say in its governance. It has been offered as a model to the U.K., although it looks unattractive. This arrangement has apparently become unpopular in Norway. Next year, elections will be held, and [Euroskeptic parties are making gains by promising to renegotiate the current arrangement](#).
- Overall, we still expect some sort of deal to be struck but not until the last possible moment. That is usually how EU negotiations work.

COVID-19: The [number of reported cases](#) is 72,336,167 with 1,314,159 fatalities. In the U.S., there are 16,257,899 confirmed cases with 299,191 deaths. For illustration purposes, the *FT* has created an [interactive chart](#) that allows one to compare cases across nations using similar scaling metrics. The *FT* has also issued an [economic tracker](#) that looks across countries with high-frequency data on various factors.

Virology

- [And so it begins—vaccine distribution](#) of the Pfizer (PFE, USD, 41.12)/BioNTech (BNTX, USD, 127.30) is [now underway](#). It is a logistical challenge; the mRNA-based vaccine must be kept at -94° until it reaches its final destination. [The first doses left Gerald R. Ford International Airport in Grand Rapids, MI from Pfizer’s Portage, MI facility over the weekend](#). Injections at nursing homes are expected to begin today. We also expect a [massive public relations blitz](#) to begin to encourage Americans to take the vaccine.
- Meanwhile, around the world, the news on the pandemic is grim:
 - South Korea, which has generally managed to keep the virus under control, [is facing a new wave of infections as winter sets in](#). There is a reluctance to implement restrictions due to the negative effect on the economy. [Japan is also seeing a rise in cases](#).
 - [Germany is implementing new restrictions](#) as [cases and fatalities rise](#).
 - Sweden, which had famously opted for light restrictions and allowing for the virus spread to bring herd immunity, is facing serious ICU capacity constraints as infections rise. [Its Nordic neighbors are offering help](#).
 - Russia is facing a [wave of anti-vaccine online content](#) which is apparently slowing the acceptance of Russia’s vaccine.
 - Peru has suspended its trials of China’s Sinopharm (SHTDY, USD, 12.28) vaccine due to a “[serious adverse event](#).”
 - [Sanofi \(SNY, USD, 47.83\) has suffered a serious setback](#) in its vaccine as inadequate controls led to some participants getting too small a dose. The problem will delay its Phase 3 trials to H2 2021.
- Work from home has become part of the response to the pandemic. [Google \(GOOGL, USD, 1774.80\) announced it won’t allow workers to return to the office until September](#)

[2021](#), and when they do, it will only be for 3 days a week. It is looking increasingly like work from home will become a permanent part of the landscape going forward.



This chart shows nearly 50% of respondents to this survey would prefer to work more than three days per week from home.

The hack: Over the weekend, several government departments, including Treasury and Commerce, admitted they had been hacked by what appears to be a foreign government, [very likely Russia](#). The hack came to light after the [cybersecurity firm](#) FireEye (FEYE, USD, 13.83) announced its systems had been penetrated through a [software distribution management firm called SolarWinds](#) (SWI, USD, 23.55). [The government has ordered all its departments to disconnect from the software](#). According to reports, the hackers have been placing [malware in U.S. computer systems since early spring](#), meaning they have had nine months to capture data. [It is still too early to tell what has been lost or what the hackers were after](#). [Apparently, it was a massive breach](#).

- Although it may not be related, [Google has indicated it is facing a widespread outage](#).

The Fed: The FOMC meets this week and is trying to manage an upcoming problem. It is clear that the economy is going to face a serious slump in Q4 and Q1, but there could be a notable rebound as the vaccine is distributed. Thus, should it add stimulus now to help the economy in the short run and run the risk of inflation or dealing with the signaling challenge of tapering stimulus later in 2021? The good news about the vaccine [is that it probably avoids the worst-](#)

[case scenarios](#). Nonetheless, the chances of a bad outcome are not zero; fiscal stimulus could disappoint, and the current vaccine is a new technology that hasn't been used beyond clinical trials. Thus, [we expect the FOMC to extend its QE program](#).

Economics and policy: Fiscal stimulus talks continue and are tied to vaccine distribution.

- The political standoff on a large fiscal support package has not been resolved, so [Congress is preparing a smaller bill with what it hopes can pass](#). Although we suspect the current bill is inadequate to support the economy, something is better than nothing and would help. We do note that some of the [vaccine distribution is expected to be funded by state governments](#) which may not have the revenue for this leg of the vaccine journey.
- [It looks like a wave of evictions may be coming as Federal protections expire at the end of the year](#). We would not be surprised to see fewer evictions than expected, as landlords have little likelihood of getting back lost rent and finding solvent tenants might be difficult. Thus, coming to some sort of terms might make more sense.
- [Independent delivery drivers are putting burner phones in trees](#) around distribution centers to get the first crack at delivery orders.
- We have seen a surge in industrial metals prices. [Steel firms are reporting stronger demand and are restarting mills](#). Prices are rising as well.

Foreign news: A roundup.

- The [BOJ's Tankan survey](#) of manufactures showed a stronger than expected rise in Q4.
- One of the challenges of moving production out of China is that Beijing has tended to keep a lid on worker unrest. [Indian production workers attacked an iPhone factory](#) owned by Winstron (3231, NTD, 31.05) over wages and working conditions.
- China announced it is [prosecuting a rating agency manager who apparently took bribes](#) to give companies favorable ratings.
- It is looking increasingly like the Belt and Road initiative is [going to end up being China's first overseas debt crisis](#).
- [Iran's execution of Ruhollah Zam, a journalist, was condemned by the EU](#). Iran has summoned the ambassadors of France and Germany to protest the interference in Iran's internal affairs. Iran's decision to execute Zam will not help their goal of easing sanctions.
- [Stagflation in Pakistan led to widespread protests yesterday](#).
- The [Mexican legislature is fast-tracking a law that would reduce cooperation with the U.S. on drug trafficking](#). According to reports, the U.S. was caught off guard by the new law, which was proposed by AMLO. The action stems from the U.S. decision to arrest former defense minister Gen. Salvador Cienfuegos earlier in the year on drug trafficking charges; [the charges were later dropped](#).
- Iraq has struggled to maintain order this year. An area that had been relatively calm, the Kurdish north, [faced protestors angry about delayed payments of government salaries and pensions](#). The Kurdish leadership and Baghdad have been at loggerheads for some time, and the latter has retaliated by not sending funds to the Kurds.

- For years, Cuba’s official exchange rate of pesos to the USD has been parity. The market rate has been nowhere close to that level, but the parallel exchange rates have likely benefited insiders in the government. In a surprise move, [the government announced a massive devaluation, taking the official rate from 1:1 to 24:1](#). We reported last week that there were protests by artists; the leadership wants to make sure that this devaluation won’t trigger civil unrest. Although dollars circulate in Cuba, this devaluation will almost certainly trigger inflation and further impoverish those who don’t have access to dollars.
- The [ECB will allow banks to resume paying dividends](#) with some limits.

U.S. Economic Releases

There were no economic releases scheduled prior to the publication of this report nor are there any releases or Fed events scheduled for the day.

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.

	Indicator			Current	Prior	Expected	Rating	Market Impact
ASIA-PACIFIC								
China	New Home Prices	m/m	Nov	0.1%	0.2%		**	Equity and bond neutral
Japan	Tankan Large Mfg Index	q/q	4Q	-10	-27	-15	**	Equity and bond neutral
	Tankan Large All Industry Capex	q/q	4Q	-1.2%	1.4%	0.1%	**	Equity bearish, bond bullish
	Tertiary Industry Index	m/m	Oct	1.0%	1.8%	1.2%	**	Equity bearish, bond bullish
	Industrial Production	m/m	Oct	4.0%	3.8%		**	Equity and bond neutral
	Capacity Utilization	m/m	Oct	6.0%	6.4%		**	Equity and bond neutral
India	Wholesale Prices	y/y	Nov	1.6%	1.5%	1.7%	**	Equity and bond neutral
New Zealand	Performance Services Index	m/m	Nov	46.7	51.4		**	Equity bearish, bond bullish
	Net Migration SA	m/m	Oct	884	808		*	Equity and bond neutral
Europe								
Eurozone	Industrial Production SA	m/m	Oct	2.1%	-0.4%	2.0%	***	Equity and bond neutral
France	Bank of France Ind. Sentiment	m/m	Nov	96	97	95	***	Equity and bond neutral
Germany	Wholesale Price Index	m/m	Nov	0.1%	-0.2%		**	Equity and bond neutral
UK	Rightmove House Prices	m/m	Dec	-0.6%	-0.5%		**	Equity and bond neutral
Switzerland	Domestic Sight Deposits CHF	w/w	11-Dec	636.3b	639.3b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	11-Dec	704.9b	705.3b		*	Equity and bond neutral
AMERICAS								
Mexico	Industrial Production NSA	y/y	Oct	-3.3%	-6.2%	-5.5%	***	Equity bullish, bond bearish
	Manuf. Production NSA	y/y	Oct	-1.3%	-3.1%	-2.1%	***	Equity bullish, bond bearish
	Formal Job Creation Total	m/m	Nov	148.7k	200.6k		**	Equity and bond neutral
Canada	Capacity Utilization Rate	q/q	3Q	76.5%	70.3%	78.0%	**	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.

	Today	Prior	Change	Trend
3-mo Libor yield (bps)	22	22	0	Down
3-mo T-bill yield (bps)	7	7	0	Neutral
TED spread (bps)	15	15	0	Up
U.S. Libor/OIS spread (bps)	8	8	0	Up
10-yr T-note (%)	0.93	0.90	0.03	Neutral
Euribor/OIS spread (bps)	-54	-55	1	Neutral
EUR/USD 3-mo swap (bps)	20	22	-2	Down
Currencies	Direction			
dollar	Down			Down
euro	Up			Up
yen	Up			Up
pound	Up			Down
franc	Up			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.

	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$50.67	\$49.97	1.40%	Uncertainty in the Middle East
WTI	\$47.20	\$46.57	1.35%	
Natural Gas	\$2.70	\$2.59	4.21%	
Crack Spread	\$10.22	\$10.13	0.87%	
12-mo strip crack	\$12.48	\$12.45	0.18%	
Ethanol rack	\$1.40	\$1.40	0.09%	
Metals				
Gold	\$1,825.26	\$1,839.85	-0.79%	
Silver	\$23.84	\$23.95	-0.45%	
Copper contract	\$354.00	\$352.80	0.34%	
Grains				
Corn contract	\$ 425.50	\$ 423.50	0.47%	
Wheat contract	\$ 609.00	\$ 614.50	-0.90%	
Soybeans contract	\$ 1,176.25	\$ 1,166.00	0.88%	
Shipping				
Baltic Dry Freight	1211	1161	50	

Weather

The 6-10 and 8-14 day forecasts currently call for warmer temperatures for most of the country. Wet conditions are expected throughout most of the country, with dry conditions expected in the Southwest.

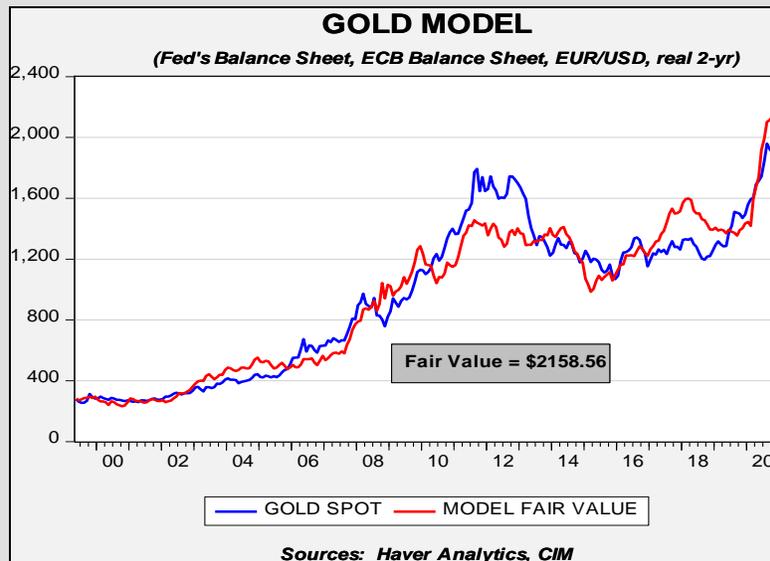
Asset Allocation Weekly

Confluence Investment Management offers various asset allocation products which are managed using “top down,” or macro, analysis. We report asset allocation thoughts on a weekly basis, updating this section every Friday. Note that this report is also offered as a separate document on our [website](#).

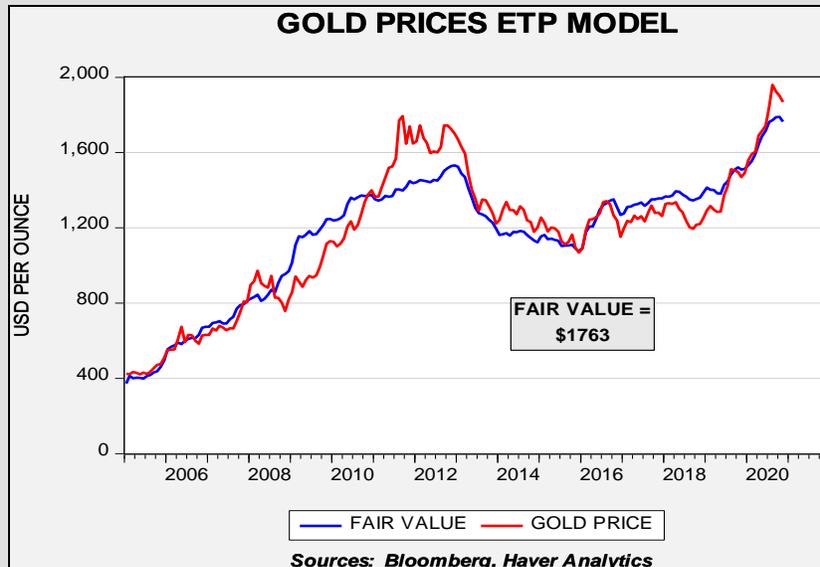
December 11, 2020

After peaking at \$2,063 in early August, gold prices fell to \$1,760 at the end of November. This is a notable decline and, because our asset allocation models have included precious metals since 2018, it makes sense to see if anything has changed. We have several different ways to examine the price of gold. In general, the outlook is mixed; the underlying fundamentals remain solid, but competition for investment flows is putting a damper on gold prices.

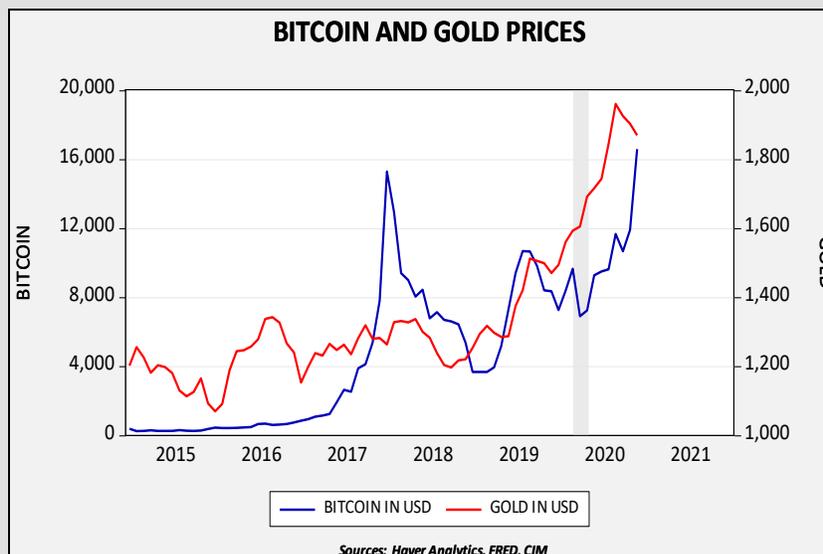
Based on our gold model, prices are attractive at current levels. The model uses real two-year Treasury yields, the EUR/USD exchange rate, the balance sheets of the Federal Reserve and the European Central Bank, and the U.S. fiscal account scaled to GDP. As the chart suggests, current prices are below the model’s forecast.



At the same time, a model based on the amount of gold held by exchange-traded products (ETPs) suggests gold isn't attracting investment flows relative to its fundamental attractiveness.



Although optimism surrounding equities is likely diverting funds that may have gone into gold, the price action in bitcoin may also be having an impact. Bitcoin remains a controversial topic; its value appears to be ephemeral (in theory, one can create scarcity of anything, but it has little value without demand for it). Its initial construction suggested it was a digital currency designed for transactions. It has mostly failed in that endeavor, at least for legal transactions, but it has shown to have store-of-value characteristics. As such, it has similar characteristics to gold without the same issues of storage.¹ Recently, we have seen a sharp rise in bitcoin prices, which may be siphoning off demand that would usually go to gold.



¹ Both assets require storage, but one is quite physical whereas the other has, in theory, unlimited storage capacity. For example, if one is trying to live in a failing state, gold may have little value due to its weight but a cryptocurrency that can be easily transferred is attractive.

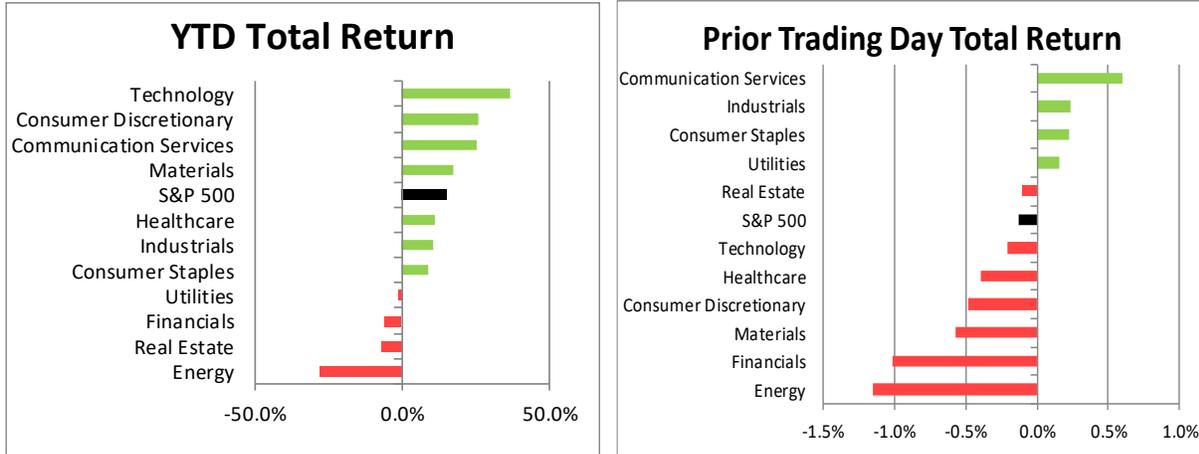
Since late 2014, gold and bitcoin prices are positively correlated at the 70.9% level. In 2017, we saw a spike in bitcoin that collapsed. The key question is whether we are seeing a repeat in the current situation or something different. It is difficult to tell, but the most likely situation is that bitcoin isn't replacing gold but is a complement. Currently, bitcoin appears a bit expensive compared to gold (a simple model suggests bitcoin should be closer to 12,000), but it had been running below gold for most of this year. Thus, we view the recent rally as more corrective in nature, although the recent spike suggests bitcoin is now excessively valued. Another item of note is that when we had a financial crisis in February into late March, bitcoin plunged while gold maintained its value. The financial system was in a perilous position in late Q1 and bitcoin was not the safety asset of choice when there were high levels of fear. At the same time, we cannot discount the attractiveness of bitcoin and, if investable products are eventually created, it may have a place in portfolios.

Overall, we remain bullish on gold. The underlying fundamentals, as shown in our base model, are very attractive and suggest current prices are undervalued. We do think bitcoin has taken some of the luster from gold, but in the long run we believe the two assets are complementary. With monetary and fiscal policy remaining expansive, the case for commodities, in general, and gold, in particular, is favorable.

Past performance is no guarantee of future results. Information provided in this report is for educational and illustrative purposes only and should not be construed as individualized investment advice or a recommendation. The investment or strategy discussed may not be suitable for all investors. Investors must make their own decisions based on their specific investment objectives and financial circumstances. Opinions expressed are current as of the date shown and are subject to change.

Data Section

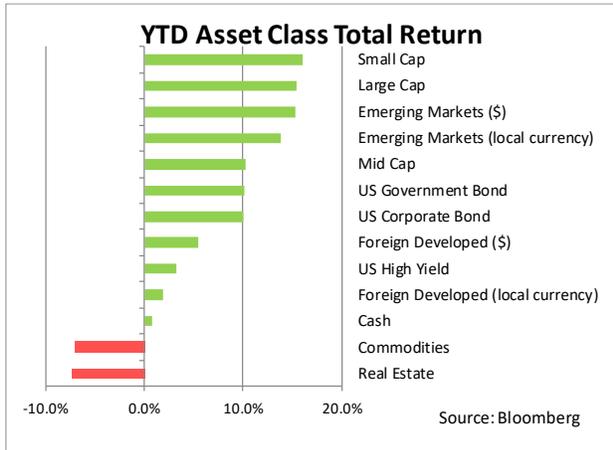
U.S. Equity Markets – (as of 12/11/2020 close)



(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 12/11/2020 close)

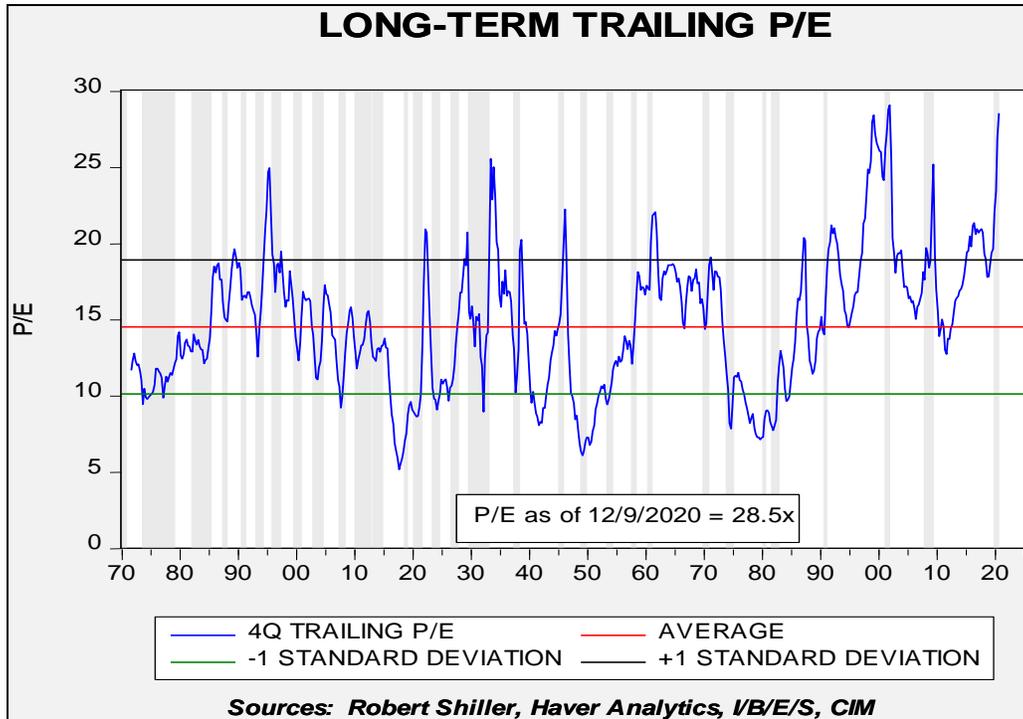


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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).

P/E Update

December 10, 2020



Based on our methodology,² the current P/E is 28.5x, up 0.1x 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.

² 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 I/B/E/S estimates which are updated regularly throughout the quarter; currently, the four-quarter earnings sum includes two actual quarters (Q1 and Q2) and two estimates (Q3 and Q4). 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.