

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: February 22, 2021—9:30 AM EST] Global equity markets are generally lower this morning. The EuroStoxx 50 is up 0.7% from its last close. In Asia, the MSCI Asia Apex 50 is down 1.4% from the prior close. Chinese markets were lower, with the Shanghai Composite down 1.5% from the prior close and the Shenzhen Composite down 2.1%. U.S. equity index futures are signaling a lower open. With 393 companies having reported, the S&P 500 Q4 earnings stand at \$43.00, higher than the \$37.94 forecast for the quarter. The forecast reflects a 9.7% decrease from Q4 2019 earnings. Thus far this quarter, 80.3% of the companies have reported earnings above forecast, while 16.1% have reported earnings below forecast.

We have several recent multimedia offerings. We have a new [chart book](#) recapping the recent changes we made to our Asset Allocation portfolios. Here is the latest [Confluence of Ideas podcast](#). The most recent [Asset Allocation Weekly](#), [chart book](#), and [podcast](#) are also available. You can find all this research and more on our [website](#).

Good morning and happy Monday! The southern reaches of the middle of the country are finally seeing a thaw as temperatures moderate. [Equity futures are falling again this morning](#), mostly due to [rising long-duration bond yields](#). Although the rise in yields reflects an improving economy, there are concerns that the lift in rates will pressure multiples and depress equity prices. We note that some of the index weakness is a function of pressure on the highest-flying names from the past year. Over the past 12 months, the S&P ETF (SPY, USD, 390.03) is up 17.2% compared to the equal weight S&P ETF (RSP, USD, 135.60), which is up 15.3%. However, over the past six months, the latter is outpacing the former, 24.1% to 15.1%. This outperformance suggests rotation within the index; stocks that lagged during the downturn are playing “catch up.” With the U.S. COVID-19 death toll approaching 500,000, we start today with pandemic news. China news comes next. A look at the U.S. economy follows along with political developments, and we close with an international news roundup.

COVID-19: The [number of reported cases](#) is 111,434,139 with 2,467,481 fatalities. In the U.S., there are 28,134,803 confirmed cases with 498,901 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. The [CDC reports](#) that 75,204,965 doses of the vaccine have been distributed, with 63,090,634 doses injected. The number receiving a first dose is 43,628,092, while the number of second doses, which would grant the highest level of immunity, is 18,865,319.

Virology

- Although we will likely cross the 500,000 fatality mark this week, [trends are improving](#). New cases are falling rapidly. Fatalities and hospitalizations, perhaps the best measure, are as well. The steady increase in vaccinations, coupled with enough Americans who have survived an infection, is likely getting the U.S. closer to some degree of herd immunity.
- One of the questions surrounding the virus and vaccination is whether the latter grants sterilizing immunity or if it merely protects the recipient from infection. If the latter is true, vaccination is still important, but it does mean that a vaccinated person could be an asymptomatic carrier. An Israeli study of the Pfizer (PFE, USD, 34.44) [vaccine seems to indicate that it grants near sterilizing immunity by reducing virus transmission](#).
 - In Europe, [health workers are rejecting the AstraZeneca \(AZN, USD, 50.59\) vaccine](#) because of concerns that it is less effective than other vaccines.
 - [Border restrictions in the EU have returned](#) due to virus transmission concerns. Although the EU continues to hold the dream of creating conditions of a single state, the reality is that nationalism tends to return during periods of stress.
- [Most researchers expect COVID-19 to become endemic over time](#). Much like influenza, it will be with us for good, but with vaccines and potential mutation to less virulent forms, it will not pose the same degree of disruption in future years.
- China [led a massive disinformation campaign on COVID-19](#), blaming a U.S. bioweapons lab for the disease. Chinese pushed this prevarication through the web. In reality, there is growing evidence that the virus not only started in China [but was spreading undetected in Wuhan in November 2019](#).

China: Washington and Beijing continue to circle warily; China admits fatalities regarding border clashes with India, and stirrings of democracy are seen with local government.

- Diplomats from both China and the U.S. have been making public statements recently. Today, Senior diplomat Wang Yi called for a “[reset](#)” in a speech. What does that mean in practice? The [U.S. should lift sanctions and stop interfering in China’s internal affairs](#). We have seen nothing to date that suggests the U.S. policy strategy towards China is changing. Tactics are, as the Biden administration is courting allies, a change from the Trump administration. The overall thrust of policy, which is curtailing China’s international ambitions, remains the same.
- [China admitted that four soldiers died](#) in various clashes on the India/China frontier.
- Beijing is trying to introduce a degree of local governance, creating homeowners’ associations. These bodies would be self-governing, deciding such issues as maintenance fees, superintendents, and other local matters. The goal is to improve social stability. However, the CPC wants to install its handpicked leaders for these groups. [Homeowners are rejecting these choices](#), creating a quandary for the CPC. The party doesn’t want to get mired in these local disputes; conflict between property managers and homeowners is common, as their interests don’t coincide. But, if homeowners get to pick their own association leaders, it looks like a democracy.

Economics: Mortgages, the Midwest, and the British pound are in the news.

- [The rise in long-duration Treasury yields is starting to lift mortgage rates](#). The average 30-year mortgage rate is now 2.99%, up nearly 20 bps over the past two weeks. It is not unusual that buyers will rush to complete purchases when rates begin to rise, but eventually, the rise in rates will cool the housing market until home prices adjust lower.
- [The Midwest labor market is showing signs of strength](#). First, the economy has seen a rise in goods consumption relative to services, and this area of the country is more dedicated to goods output. Second, the relative lack of tourism in the region relative to the coasts means that fewer leisure and hospitality jobs have been lost. Finally, working from home is apparently more manageable in the Midwest due to relatively inexpensive housing.
- The British pound took a dive after the Brexit vote and has remained depressed since then. However, now that Brexit is behind us, [the GBP is beginning to make a comeback](#). Our fair value, based on relative inflation, is in the \$1.60 area, suggesting the currency has significant room to rally.

Politics: It appears that the [administration's pick for OMB director may not be confirmed by the Senate](#). Sen. Manchin (D-WV) [has indicated he will not vote to confirm Neera Tanden](#). She was a controversial choice, given her aggressive stances taken on social media, where she has been critical of senators. This is the first Biden pick that has not had the full support of the Democratic caucus. Although it is possible that a GOP vote could be found to save her nomination, the odds of her confirmation have lengthened considerably.

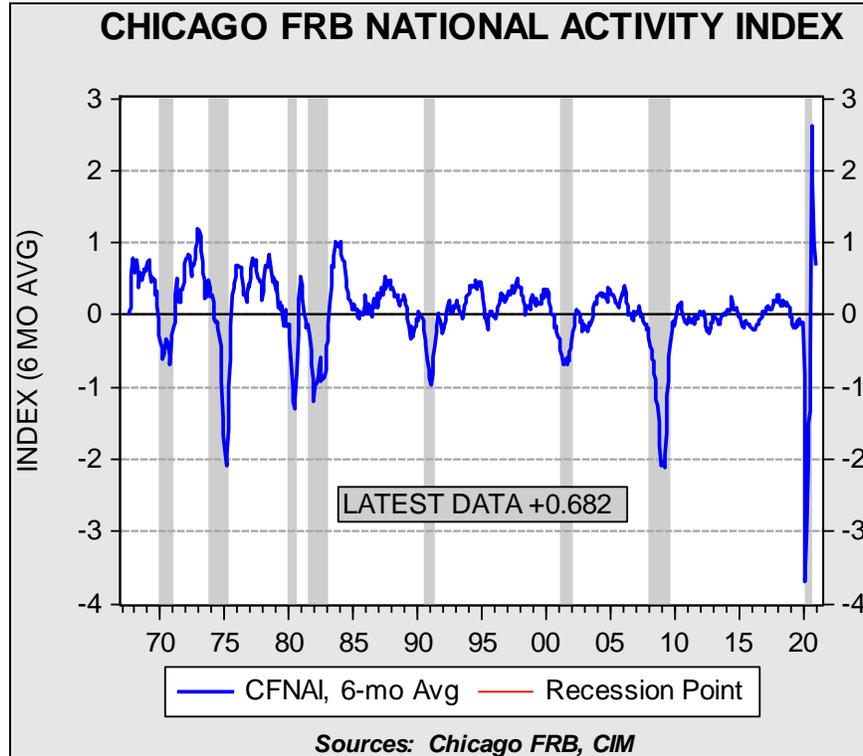
International news: Iran, Myanmar, North Korea, the EU were in the news.

- Although Iran has been pushing for sanctions relief as a prerequisite for talks with the U.S., it does appear Tehran is softening a bit. Iran had threatened to end or limit IAEA inspections. In the end, [Tehran has ended "snap" inspections by the IAEA but will allow for "satisfactory" oversight](#). Although this outcome is better than a complete restriction of inspections, it isn't clear that Tehran has moved enough to prompt the U.S. to reengage in talks.
- Since the recent coup, protests have continued in Myanmar. Over the weekend, security forces used [deadly force against protestors, killing two and wounding at least 40 people](#).
- In our 2021 Geopolitical Outlook, we included North Korea as an item to watch. [Reports suggest that the combination of sanctions and self-imposed border controls to prevent the spread of COVID-19 has led to a collapse in economic activity](#). Kim Jong-un is reacting by cracking down on private market activity and trying to return to Stalinist economic policies of central control. It is not unusual during periods of economic stress that North Korea engages in external threats to extract support from the rest of the world. Given the current turmoil, we would not be surprised to see tensions rise in the coming weeks.
- The U.S. has not ["named names"](#) with regard to the Nord Stream II project, meaning that actual sanctions are less likely. This second natural gas pipeline will make Europe increasingly dependent on Russian natural gas and deprive Ukraine of transit fees. Previous administrations have opposed the pipeline, although none took aggressive

enough steps to halt its progress. Without new sanctions, it is more likely the pipeline will be completed.

U.S. Economic Releases

Manufacturing activity picked up in January according to the Chicago Fed National Activity Index. The latest reading came in at 0.66, above expectations of 0.50.



The chart above shows the six-month moving average of the Chicago National Activity Index.

The table below lists the domestic releases and Fed events scheduled for the rest of the day.

Economic Releases						
EDT	Indicator			Expected	Prior	Rating
10:00	Leading Index	m/m	Jan	0.4%	0.3%	***
10:30	Dallas Fed Manf. Activity	m/m	Feb	5.0	7	**
Fed Speakers or Events						
EST	Speaker or event	District or position				
12:00	Robert Kaplan Takes Part in Moderated Q&A	President of the Federal Reserve Bank of Dallas				
15:30	Michelle Bowman Discusses Economic Inclusion	Member of the Board of Governors				

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								
Japan	PPI Services	y/y	Jan	-0.5%	-0.4%	-0.4%	**	Equity and bond neutral
	Convenience Store Sales	y/y	Jan	-4.9%	-4.0%		**	Equity and bond neutral
Europe								
	IFO Expectations	m/m	Feb	94.2	91.1	91.7	**	Equity and bond neutral
	IFO Current Assessment	m/m	Feb	90.6	89.2	89.1	**	Equity and bond neutral
	IFO Business Climate	m/m	Feb	92.4	90.1	90.5	**	Equity and bond neutral
Switzerland	Money Supply M3	y/y	Jan	7.0%	6.5%		***	Equity and bond neutral
	Domestic Sight Deposits CHF	w/w	19-Feb	642.2b	643.1b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	19-Feb	704.4b	704.3b		*	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.

	Today	Prior	Change	Trend
3-mo Libor yield (bps)	18	18	0	Down
3-mo T-bill yield (bps)	2	3	-1	Neutral
TED spread (bps)	16	15	1	Up
U.S. Libor/OIS spread (bps)	7	7	0	Up
10-yr T-note (%)	1.37	1.34	0.03	Neutral
Euribor/OIS spread (bps)	-54	-54	0	Neutral
EUR/USD 3-mo swap (bps)	3	3	0	Down
Currencies	Direction			
dollar	Down			Down
euro	Up			Up
yen	Up			Up
pound	Up			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.

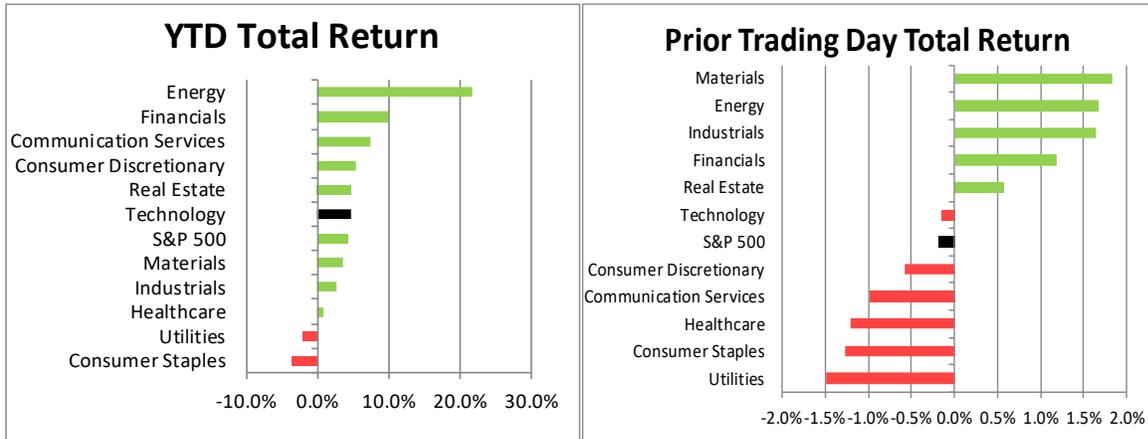
	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$63.19	\$62.91	0.45%	
WTI	\$59.65	\$59.24	0.69%	
Natural Gas	\$2.97	\$3.07	-3.32%	
Crack Spread	\$15.92	\$16.44	-3.12%	
12-mo strip crack	\$16.29	\$16.62	-2.00%	
Ethanol rack	\$1.83	\$1.83	0.20%	
Metals				
Gold	\$1,797.31	\$1,784.25	0.73%	
Silver	\$27.53	\$27.29	0.87%	
Copper contract	\$409.85	\$407.75	0.52%	
Grains				
Corn contract	\$547.50	\$541.75	1.06%	
Wheat contract	\$656.75	\$655.50	0.19%	
Soybeans contract	\$1,381.75	\$1,380.00	0.13%	
Shipping				
Baltic Dry Freight	1698	1770	-72	

Weather

The 6-10 and 8-14 day forecasts currently call for colder than normal temperatures for most of the country, with warmer temperatures in the eastern third. In addition, the forecast calls for wetter than normal conditions in the Midwest, with dry conditions expected for the West Coast.

Data Section

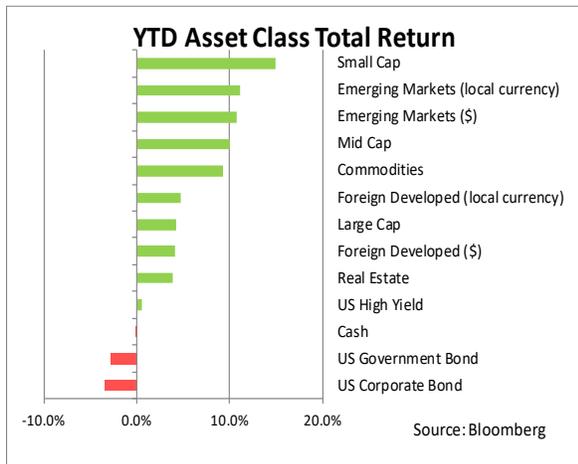
U.S. Equity Markets – (as of 2/19/2021 close)



(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 2/19/2021 close)

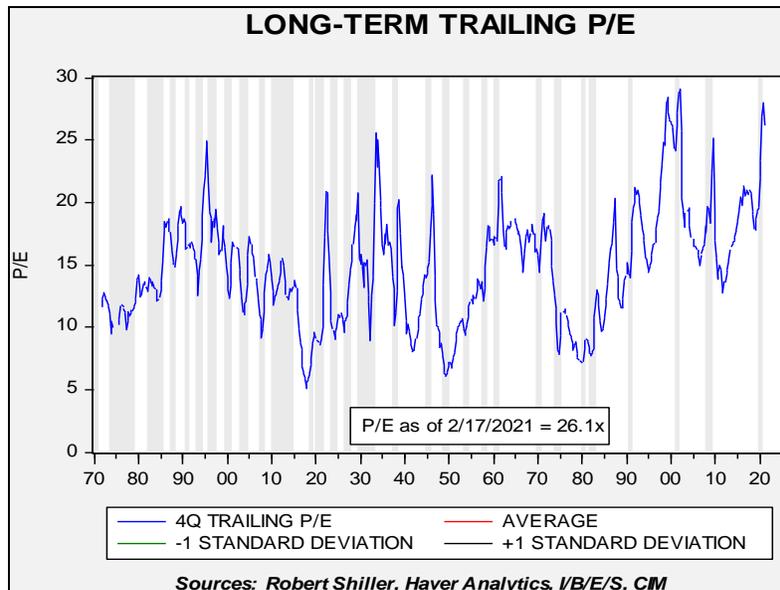


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

February 19, 2021



Based on our methodology,¹ the current P/E is 26.0x, down 0.1x from last week. Improving earnings contracted 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.

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