Daily Comment

By Patrick Fearon-Hernandez, CFA,
and Thomas Wash

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 25, 2022—9:30 AM EST] Global equity markets are higher this morning. In Europe, the EuroStoxx 50 is currently up 2.5% from its prior close. In Asia, the MSCI Asia Apex 50 closed up 0.4%. Chinese markets were higher, with the Shanghai Composite up 0.6% from its prior close and the Shenzhen Composite up 1.2%. U.S. equity index futures are signaling a higher open. With 470 companies having reported, the S&P 500 Q4 2021 earnings stand at \$54.90, higher than the \$52.34 forecast for the quarter. The forecast reflects a 21.7% increase from Q4 2020 earnings. Thus far this quarter, 75.5% of the companies have reported earnings above forecast, while 20.0% have reported earnings below forecast.

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* (2/14/2022) (with associated podcast): "Ukraine: Key Questions"
- ***Weekly Energy Update*** **(2/25/2022): Oil inventories and price remain inversely correlated; if there is a supply panic, that relationship will reverse. See our discussion in this week's report.**
- *Asset Allocation Quarterly - Q1 2022* (1/20/2022): Discussion of our asset allocation process, Q1 2022 portfolio changes, and our outlook for the markets
- *Asset Allocation Bi-Weekly* (2/22/2022) (with associated podcast): "The U.S. Trade Deficit and Global Prices"
- *Confluence of Ideas* podcast (1/20/2022): "The 2022 Outlook"
- *Current Perspectives*: "2022 Outlook: Update #1" (2/18/2022)

Good morning! Today's *Comment* will keep our focus on the Russian invasion of Ukraine. We are seeing a modest "risk-on" this morning due to reports that Russia is open to talks on Ukraine. We have our doubts about Moscow's sincerity, but the news, on its face, is positive.

The Russian assault on Ukraine has entered its second day. The onslaught has started to become broader in its scope. On Thursday, Russian troops took over the Chernobyl nuclear plant and are holding the staff hostage. Additionally, Russia has engaged in cyber warfare, attacking several of Ukraine's banks and government offices, and several cities have seen a decrease in their internet connectivity. Ukraine remains resilient in the face of the bombardment, but it has now resorted to extreme measures as it tries to protect its homeland. Ukrainian President Volodymyr Zelensky has ordered males aged 18-60 to stay in the country and help fight. The latest report shows

Russian forces are now closing in on Kyiv, and Zelensky has warned he has been placed on a kill list. Russia has pledged to persist with these attacks until Ukraine surrenders but stated it is willing to meet in Minsk for talks. President Zelensky has indicated he will not surrender but is open to talks. Reports from U.S. intelligence officials are concerned that Kyiv could fall to Russia within days, and conditions will favor Russia.

Following the invasion into Ukraine, the U.S., EU, and the U.K. have moved to isolate Russia from the rest of the world. The trio has announced plans to impose new sanctions on Russian entities, some of which would curtail Russia's ability to access technology. The new sanctions were taken positively by financial markets, as they exclude the energy sector. Although there have been discussions about removing Russia from the SWIFT network, there is still not enough support within Europe for the move. Germany, in particular, appears to be reluctant to take such an extreme step. Widely considered the nuclear option, Europe's reluctance to remove Russia from SWIFT likely contributed to the rebound in equities.

Over the next few days, Western countries' ability to stay united will probably dictate whether or not Russia will feel emboldened. The biggest impediment appears to be Europe. Russia depends on Europe to sell its fuels and receive payments, so a blockade from receiving euros could potentially be a death knell to the Russian economy. However, Europe is very dependent on Russia for its energy needs; therefore, pain will be felt by both if Europe follows through with banning Russia from receiving euros. As the cost of inaction rises over the next few days, Europe will be more inclined to act. So far, we are not confident Europe is willing to go to the extreme to defend Ukraine, but if other countries are harmed, this may change. As a result, we suspect there will be a lot of market volatility as the situation plays out.

The West appears to be treating Ukraine as a prelude to a broader conquest into Eastern Europe and has been slowly hinting at the possibility of direct conflict with Russia if any NATO members are harmed. President Biden stated the U.S. is prepared to defend its NATO allies in the event of an attack from Russia. The U.S. plans to send 7000 additional troops into Germany to reinforce its defenses. Meanwhile, Putin claims he fears Ukraine may be developing nuclear weapons. Although there is no evidence of this being true, it suggests that he resents the fact that Russia is being treated differently than the U.S. when it invaded Iraq. To further voice his frustration, for what he feels to be a double standard, he vaguely threatened the West with nuclear war. Putin warned that intervention from the West will be met with "consequences that [they] have never encountered in [their] history." Thus, the risk of a broader conflict within Europe remains elevated.

The Ukraine crisis is already starting to impact other countries. In Europe, the UEFA Champions League has moved its championship final from St. Petersburg to Paris. In China, importers have temporarily stopped the seaborne purchases of Russian oil while evaluating the potential implications of handling these shipments. Additionally, food inflation will probably increase as a conflict in the black sea will limit shipments of commodities such as wheat. In the U.S., Cargill, an agricultural food company, stated its ship was hit while sailing in the Black Sea.

Non-Russia-Ukraine news:

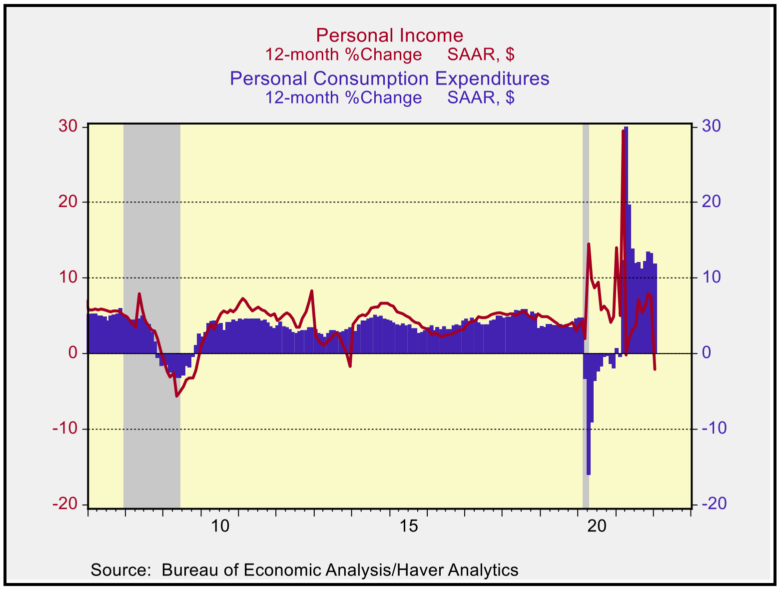
- The Federal Reserve appears to be undeterred by what is happening in Ukraine and is prepared to hike rates in its next meeting in March. Central bankers Loretta Mester and Raphael Bostic both stated they support a lift-off in rates at the next Fed meeting. Meanwhile, Fed Governor Christopher Waller said he is willing to support a 50 bps hike in March if the data keeps coming in hot.
- President Biden is expected to nominate Judge Kentaji Brown Jackson to the Supreme Court.

COVID-19: The number of reported cases is 431,799,542, with 5,930,216 fatalities. In the U.S., there are 78,799,264 confirmed cases with 944,831 deaths. For illustration purposes, the *FT* has created an interactive chart that allows one to compare cases across nations using similar scaling metrics. The CDC reports that 688,186,745 doses of the vaccine have been distributed, with 551,855,907 doses injected. The number receiving at least one dose is 253,307,984, while the number of second doses is 215,253,201, and the number who have received the third dose, granting the highest level of immunity, is 93,643,962. The *FT* has a page on global vaccine distribution.

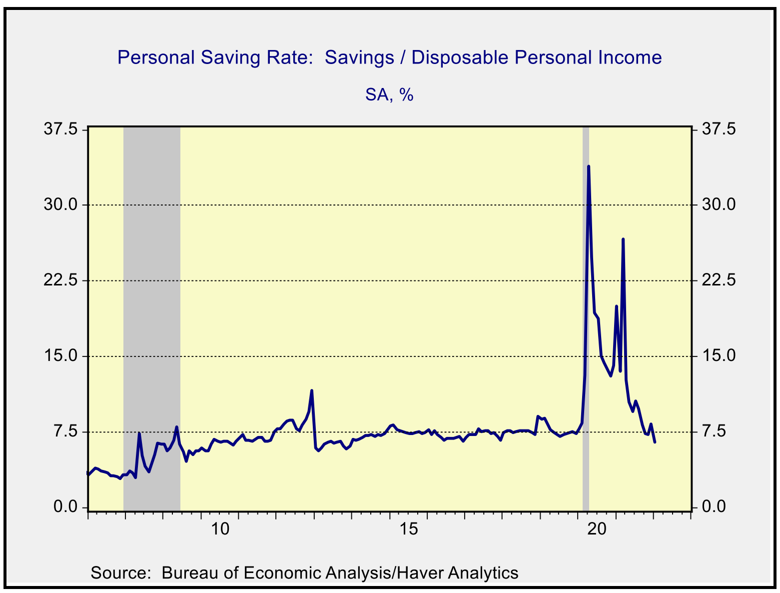
- The first plant-derived COVID vaccine won approval from Canada. Covifenz was developed by GlaxoSmithKline(GSK, $41.19) and Medicago (PLN, $12.38).
- China has ordered Hong Kong to contain the spread of the COVID-19 by July.

U.S. Economic Releases

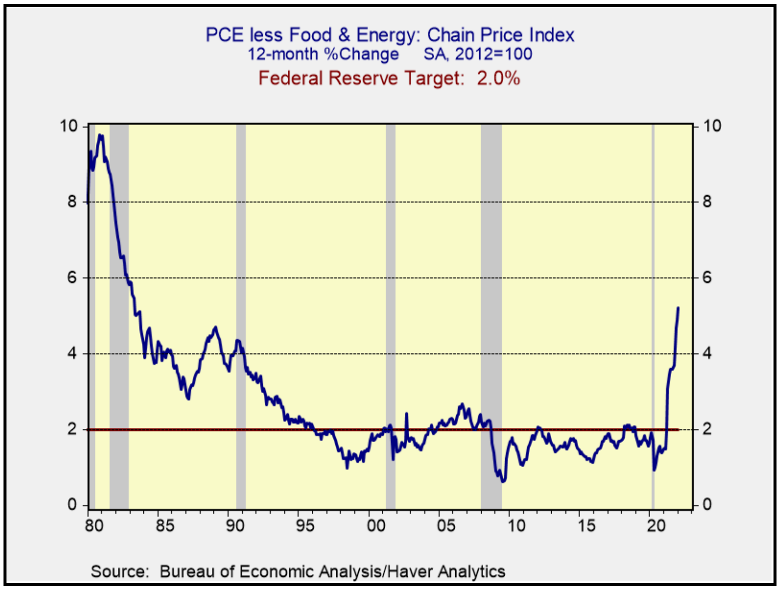
In today's most important economic release, January personal income came in unchanged on a seasonally adjusted basis, beating expectations for a 0.3% decline but still weaker than the revised gain of 0.4% in December. Despite the stagnation in income, January Personal Consumption Expenditures (PCE) jumped 2.1%, beating the expected rise of 1.6% and more than erasing the revised 0.8% decline in the previous month. Compared with January 2021, personal income was actually down 2.1%, mostly reflecting the federal government's pandemic relief spending in the year-earlier period. PCE in January was up 11.8% year-over-year, largely due to the lifting of pandemic restrictions and consumers' greater willingness to spend compared with early 2021. The chart below shows the year-over-year change in personal income and PCE since just before the previous recession.



The income and spending report also includes a measure of the personal savings rate, defined as the share of disposable (after-tax) income that isn't spent on goods and services consumption. In January, the report showed the personal savings rate came in at a seasonally adjusted 6.4%. The chart below shows how the savings rate has fluctuated since just before the prior recession.



Finally, the income and spending report includes the Fed's preferred measure of consumer price inflation. Excluding the volatile food and energy components, the January Core PCE Index was up 5.2% from the same month one year earlier, matching expectations but still an uncomfortable acceleration from the 4.9% increase in the year to December. Core PCE inflation is now at its highest level in four decades. The chart below shows the year-over-year change in the Core PCE Index since 1980.



In a separate report today, January durable goods orders rose by a seasonally adjusted 1.6%, better than both the expected rise of 1.0% and the revised 1.2% gain in December. Excluding the volatile transportation sector, where just a few airliner orders can have a big impact, January durable goods orders excluding transportation were up 0.7% compared with an expected gain of 0.4% and a revised 0.9% increase in the previous month. The durable goods report also includes an important proxy for corporate capital investment. In January, nondefense capital goods orders excluding aircraft were up a healthy 0.9%, far better than expectations for a modest gain of 0.3% and the December increase of 0.4%. Compared with January 2021, overall durable goods orders were up 16.5%, while durable orders ex-transportation were up 11.2%, and nondefense capital goods orders ex-aircraft were up 10.2%. The chart below shows the year-over-year change in nondefense capital goods orders ex-aircraft since before the previous recession.

The table below lists the economic releases and/or Fed events scheduled for the rest of today.

Economic Releases						
EST	Indicator			Expected	Prior	Rating
10:00	U. of Michigan Consumer Sentiment	m/m	Feb F	61.7	61.7	***
10:00	U. of Michigan Current Conditions	m/m	Feb F	68.5	68.5	**
10:00	U. of Michigan Expectations	m/m	Feb F	57.3	57.4	**
10:00	U. of Michigan 1-Year Inflation Expectation	m/m	Feb F		5.0%	*
10:00	U. of Michigan 5-10 Year Inflation Expectation	m/m	Feb F		3.1%	*
10:00	Pending Home Sales	y/y	Jan	-0.8%	-6.6%	*
Fed Speakers or Events						
No Fed speakers or events 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	Tokyo CPI	y/y	Feb	1.0%	0.6%	0.7%	**	Equity bearish, bond bearish
	Tokyo CPI Ex-Fresh Food	y/y	Feb	0.5%	0.2%	0.4%	***	Equity bearish, bond bearish
	Tokyo CPI Ex-Fresh Food & Energy	y/y	Feb	-0.6%	-0.7%	-0.7%	*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	4-Feb	¥40.7b	-¥1896.4b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	4-Feb	-¥56.0b	¥111.2b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	4-Feb	¥939.8b	-¥894.2b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	4-Feb	-¥261.9b	-¥29.5b		*	Equity and bond neutral
	Leading Index CI	m/m	Dec F	104.8	104.3		**	Equity bullish, bond bearish
New Zealand	Retail Sales Ex-Inflation	q/q	4Q	8.60%	-8.20%	6.10%	**	Equity bullish, bond bearish
	Trade Balance NZD	m/m	Jan	1.082b	-0.975b		**	Equity bullish, bond bearish
	Exports	m/m	Jan	4.860b	6.100b		*	Equity and bond neutral
	Imports	m/m	Jan	5.940b	67.070b		*	Equity and bond neutral
EUROPE								
Eurozone	Consumer Confidence Index	m/m	Feb F	-8.8	-8.8		**	Equity and bond neutral
	Economic Confidence Index	m/m	Feb	114.0	112.7	113.1	*	Equity bullish, bond bearish
	M3 Money Supply	y/y	Jan	6.4%	6.9%	6.7%	***	Equity and bond neutral
Germany	GDP	y/y	4Q F	1.8%	1.4%	1.4%	**	Equity bullish, bond bearish
	GDP WDA	y/y	4Q F	1.8%	1.4%	1.4%	**	Equity bullish, bond bearish
	Import Price Index	y/y	Jan	26.9%	24.0%	23.7%	*	Equity bearish, bond bearish
France	CPI	y/y	Feb P	3.6%	2.9%	3.0%	***	Equity bearish, bond bearish
	CPI, EU Harmonized	y/y	Feb P	4.1%	3.3%	3.7%	**	Equity bearish, bond bearish
	PPI	y/y	Jan	22.2%	18.0%		*	Equity bearish, bond bearish
	GDP	y/y	4Q F	5.4%	5.4%	5.4%	***	Equity and bond neutral
Italy	Consumer Confidence Index	m/m	Feb	112.4	114.2	114.4	***	Equity bearish, bond bullish
	Manufacturing Confidence	m/m	Feb	113.4	113.7	113.5	***	Equity bearish, bond bullish
	Economic Sentiment	m/m	Feb	108.2	105.3		**	Equity bullish, bond bearish
UK	GfK Consumer Confidence Index	m/m	Feb	-26	-19	-18	**	Equity bearish, bond bullish
AMERICAS								
Mexico	GDP	y/y	4Q F	1.1%	1.0%	1.0%	***	Equity and bond neutral
	Trade Balance	m/m	Jan	-$6286.3m	$590.3m	-$3834.4m	**	Equity bullish, bond bearish
	Economic Activity IGAE	y/y	Dec	1.3%	1.7%	1.3%	**	Equity bearish, bond bullish
Brazil	FGV Inflation IGPM	y/y	Feb	16.1%	16.9%	16.2%	**	Equity and bond neutral
	Net Debt, % of GDP	m/m	Jan	56.6%	57.3%	57.2%	*	Equity bullish, bond bearish
	Primary Budget Balance	m/m	Jan	101.8b	0.1b	80.0b	*	Equity bullish, bond bearish

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)	50	49	1	Up
3-mo T-bill yield (bps)	30	31	-1	Neutral
TED spread (bps)	20	18	2	Widening
U.S. Libor/OIS spread (bps)	43	40	3	Down
10-yr T-note (%)	1.99	1.97	0.02	Up
Euribor/OIS spread (bps)	-53	-53	0	Neutral
Currencies	**Direction**			
Dollar	Down			Neutral
Euro	Up			Up
Yen	Down			Neutral
Pound	Up			Up
Franc	Down			Neutral

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.

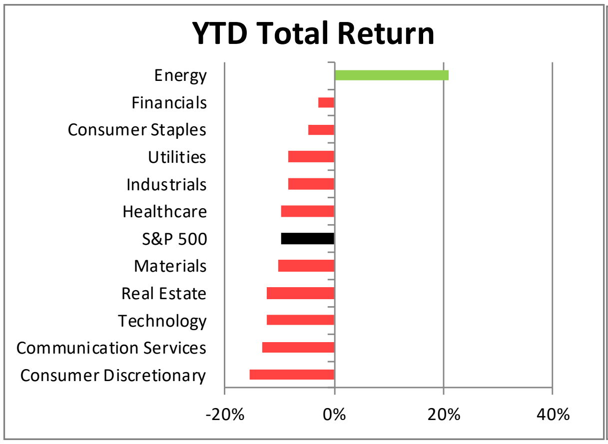
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$99.37	$99.08	0.29%	
WTI	$93.51	$92.81	0.75%	
Natural Gas	$4.51	$4.64	-2.84%	
Crack Spread	$28.48	$28.71	-0.80%	
12-mo strip crack	$25.14	$25.41	-1.07%	
Ethanol rack	$2.38	$2.37	0.60%	
Metals				
Gold	$1,904.30	$1,903.89	0.02%	
Silver	$24.25	$24.22	0.12%	
Copper contract	$449.05	$446.10	0.66%	
Grains				
Corn contract	$677.00	$690.25	-1.92%	
Wheat contract	$908.25	$934.75	-2.83%	
Soybeans contract	$1,619.00	$1,654.00	-2.12%	
Shipping				
Baltic Dry Freight	2,187	2,244	-57	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	4.5	0.0	4.5	
Gasoline (mb)	-0.6	-1.5	0.9	
Distillates (mb)	-0.6	-1.7	1.1	
Refinery run rates (%)	2.1%	-0.4%	2.5%	
Natural gas (bcf)	-129.0	-126.0	-3.0	

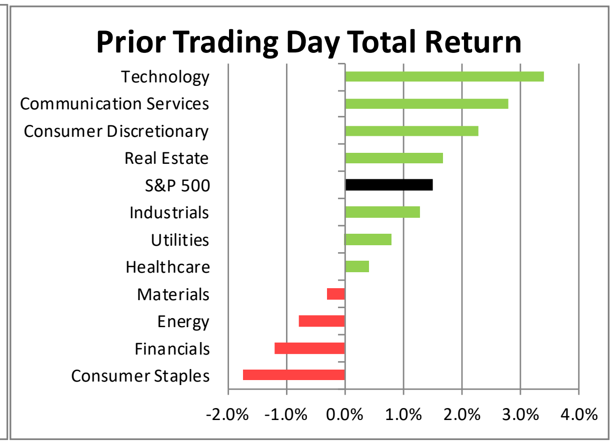
Weather

The 6-10 day and 8-14 day forecasts call for warmer-than-normal temperatures in a band running from the Southwest through the southern Great Plains and into the Southeast, with cooler-than-normal temperatures in the Pacific Northwest. The forecasts call for wetter-than-normal temperatures in the northern Rocky Mountains and the Great Plains, with dry conditions in the Southwest and the Southeast.

Data Section

U.S. Equity Markets – (as of 2/24/2022 close)

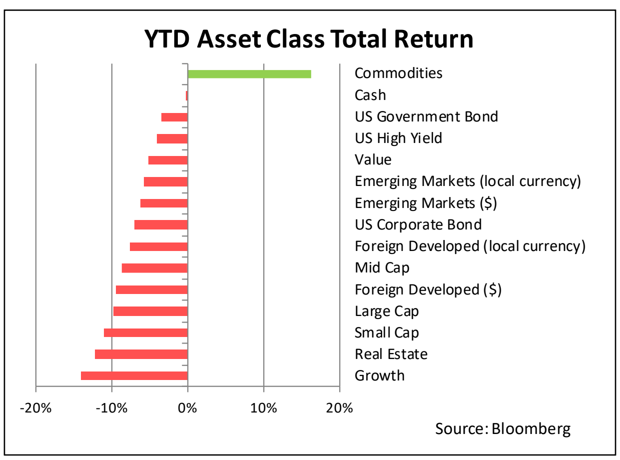




(Source: Bloomberg)

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 2/24/2022 close)

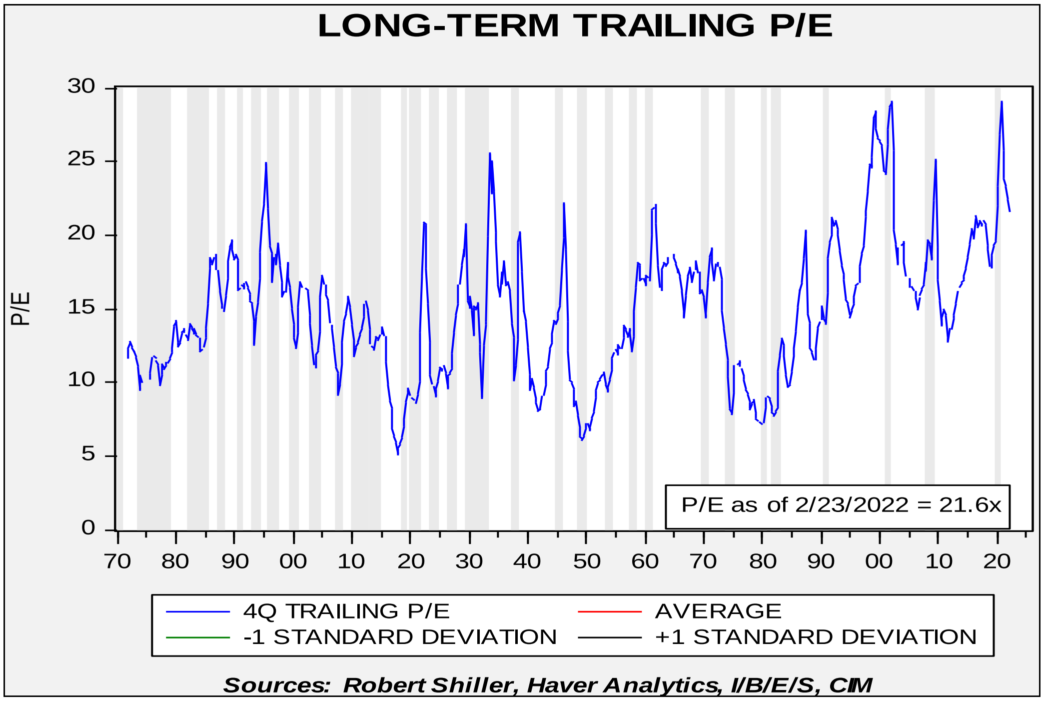


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

February 24, 2022



Based on our methodology,[1] the current P/E is 21.6x, down 0.1x from last week. The decline in the multiple is due to the decline in the index.

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.

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[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.