

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: January 2, 2024—9:30 AM EST] Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 is down 0.7% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.1%. Chinese markets were lower, with the Shanghai Composite down 0.4% from its previous close and the Shenzhen Composite down 0.8%. U.S. equity index futures are signaling a lower 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](#) (12/11/2023) (with associated *Confluence of Ideas* [podcast](#)): “The 2024 Geopolitical Outlook”
- [Weekly Energy Update](#) (12/14/2023): Oil prices have been under pressure as geopolitical risk premium evaporates; COP28 ended with a deal to “shift” from fossil fuels, softer language than the “phase out” comment that was rejected by oil producers. (N.B. The *Weekly Energy Update* will go on indefinite hiatus following this report.)
- [Asset Allocation Quarterly – Q4 2023](#) (10/19/2023): Discussion of our asset allocation process, Q4 2023 portfolio changes, and our outlook for the markets.
- [Asset Allocation Q4 2023 Rebalance Presentation](#) (10/30/2023): 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](#) (12/4/2023) (with associated [podcast](#)): “A Pause That Refreshes?”
- [The 2024 Outlook: Slow-Bicycle Economy](#) (12/18/2023) (with associated *Confluence of Ideas* [podcast](#))

Our *Comment* today opens with a discussion of what some observers are starting to describe as a Stalinist purge by General Secretary Xi. We note that Xi’s firing of military officers and defense industry officials may not be for corruption, but for real or imagined susceptibility to being recruited by the CIA. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including more attacks on Red Sea shipping and a range of new labor laws in the U.S.

China: The country’s top legislative body, the National People’s Congress, said on Friday that it [has kicked out nine People’s Liberation Army generals](#), including five from the scandal-ridden

PLA Rocket Force, two working on weapons procurement at the Central Military Commission, and one each from the PLA Air Force and the PLA Navy. Also late last week, the Chinese People's Political Consultative Conference, a prestigious government advisory body, said it has [removed three top-level defense industry leaders from its membership](#).

- The sackings come three months after the mysterious firings of former Defense Minister Li Shangfu, who had previously been involved with procurement at the CMC, and former Foreign Minister Qin Gang, who was rumored to have had an affair that led to the birth of a child in the U.S. Prior to that, several top PLARF leaders [were fired and put under investigation](#) in July, sparking a scandal that has now reportedly caught up more than 70 officials.
- At first glance, the common thread linking most of these firings is that the officials were involved with developing and procuring equipment for the military. That suggests the officials were involved with kickbacks or other types of financial corruption, and that's how most press reports [seem to be describing the story](#). That alone would point to some organizational weakness and lack of loyalty in the Chinese military. However, we think there may be a more profound implication for U.S. security and global investors:
 - China's widespread corruption among government and business leaders is usually described as a political challenge or economic risk, but it has also been a key source of leverage for Western spies to recruit Chinese sources.
 - Like other intelligence services, the Central Intelligence Agency knows that the way to convince a Chinese citizen to sell Beijing's secrets is to use MICE: **Money, Ideology, Compromise, or Ego**. Corrupt officials or lower-ranking workers are already susceptible to being bought with *money*. If the CIA threatens to expose their corruption, they can also be susceptible to *compromise*.
- What many people don't realize is that the CIA had leveraged Chinese corruption to build an extensive and effective network of human intelligence sources within China in the first decade of this century, [but it was compromised and destroyed by the Chinese Ministry of State Security from 2010 to 2012](#), just as General Secretary Xi was coming to power. Discovery of the CIA's network in China was reportedly a key factor in sensitizing Xi to the threat from Western spies and corruption in his own ranks.
 - CIA Director Burns has recently said his agency is successfully rebuilding its network in China. If so, it's probably doing so by leveraging corruption again, and the corrupt Chinese officials with some of the most valuable secrets would be those associated with procuring weapons — especially the PLARF missiles that threaten U.S. forces in the Western Pacific Ocean and even the U.S. mainland.
 - In sum, the U.S.-China intelligence war is already in full swing, so the true import of Beijing's military corruption scandal is that it suggests large numbers of Chinese military and defense industry personnel are susceptible to being turned by the CIA. We suspect that will exacerbate Xi's security concerns, prompting further aggressive moves against the U.S. geopolitical bloc and even more of the global fracturing that is creating risks for investors.

China-Philippines: Responding to Manila’s stated plan to build permanent civilian facilities on a disputed shoal in the South China Sea, Beijing on Friday [warned that such an action would “seriously impinge on China’s sovereignty” and prompt it to “respond resolutely.”](#) The warning shows how the increasingly acrimonious territorial dispute between China and the Philippines could spark a conflict. Given that the U.S. and the Philippines have a mutual defense treaty, any such conflict could potentially lead to a U.S.-China conflict.

China-Mexico: Late last week, the Mexican government [imposed an anti-dumping tariff of almost 80% on some types of steel imported from China.](#) The action came in response to complaints by Mexican producers that Chinese steelmakers have been disposing of their excess output abroad at artificially low prices.

- One little noticed aspect of China’s economic rise over the last two decades is that the country’s state-supported, low-cost producers have often undercut budding manufacturers in other so-called emerging markets around the world. Waves of cheap Chinese goods have often put domestic producers in Latin America, Africa, and South Asia out of business, short-circuiting their governments’ economic development strategy of boosting manufacturing and forcing them to stick with low-value added commodity production.
- Under pressure from imports, domestic steel production in Latin America is expected to cover just 83% of the region’s needs in 2023.
- More broadly, various reports suggest that China’s current economic slowdown is prompting many of its manufacturers in multiple industries to dump goods at low prices on world markets. In turn, that’s pushing down import prices and helping push down consumer price inflation in the U.S. and elsewhere.

Taiwan: As campaigning ramps up for the presidential election on January 13, front-runner Lai Ching-te of the ruling Democratic Progressive Party [has come under fire for the government’s 2019 decision to slash readings of classical Chinese literature in school curricula.](#) The DPP has long leaned toward independence from China, but Lai’s opponents are casting the curriculum change as an example of anti-Chinese extremism that could prompt Beijing to attack if the DPP stays in power. It’s still unclear if the controversy could throw the election to the China-friendly KMT.

Japan: An earthquake registering 7.6 on the Richter scale [hit the western coast of Japan yesterday, causing widespread damage and prompting a tsunami warning.](#) At this point, it appears the quake has produced [relatively limited casualties and damage,](#) probably because it struck a sparsely populated area on the coast.

South Korea: Lee Jae-myung, head of the opposition Democratic Party, [was attacked and stabbed in the neck today by an assailant at a public event in Busan.](#) His injuries are considered serious but not life threatening. Nevertheless, the incident is a reminder of the potential political volatility we could see in 2024 [as countries ranging from South Korea and Taiwan to Mexico and the U.S. hold important elections.](#) South Korea holds legislative elections in April.

United Kingdom: Although many of the strikes the country faced last year have died down, some labor actions continue. Today, junior physicians [are launching a six-day strike against the National Health Service for better pay and working conditions](#), in what may turn out to be one of the most disruptive labor actions to date. Continued labor unrest is feeding into the sense of economic malaise gripping the U.K. as it deals with challenges like high interest rates, slow growth, continuing trade lethargy due to Brexit, and the uncertainty of upcoming elections.

Israel-Hamas Conflict: As Iran-backed Houthi rebels in Yemen continue to aggressively attack commercial shipping in the Red Sea in sympathy with the Hamas government in Gaza, the U.S. Navy [sank three Houthi vessels over the weekend that were attacking a private container ship](#). With the [threat of the Israeli-Hamas conflict now escalating again](#), global oil prices so far this morning have risen about 2%, with Brent trading at \$78.58 per barrel.

U.S. Labor Market: Even though the federal minimum wage remains at the same \$7.25/hour rate that it's been at since 2009, 22 states [lifted their minimum rate starting yesterday](#). The highest minimum wage in 2024 will be in the state of Washington, where it will stand at \$16.28, up 3.4% from the previous rate of \$15.74. However, a new analysis by the *Wall Street Journal* suggests the minimum wage is becoming increasingly irrelevant, as even the lowest-paid workers in most states typically make almost 50% more than their state's wage floor.

- In an interesting new law going into effect in Alabama, any employee hours in excess of 40 per week [will be exempt from state income taxes](#).
- Essentially, the law will exempt overtime from state taxation. The law could therefore help incentivize overtime work, effectively increasing the labor supply.

U.S. Business and the Elections: As mentioned above in the paragraph on South Korea, business leaders around the world are looking warily at the large number of countries holding key elections in 2024. In the U.S., a new survey [indicates that senior executives and risk managers now see escalating political polarization as their second-most important emerging risk](#), right after generative artificial intelligence. The report shows many leaders are starting to prepare for the possibility that political protests could disrupt their companies' operations.

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
9:45	S&P Global US Manufacturing PMI	m/m	Dec F	48.4	48.2	***
10:00	Construction Spending MoM	m/m	Nov	0.5%	0.6%	**
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								
Australia	CoreLogic House Prices	y/y	Dec	0.4	0.60%		*	Equity and bond neutral
South Korea	Trade Balance	m/m	Dec	\$4480m	\$3800m	\$3778m	*	Equity and bond neutral
	Exports	y/y	Dec	5.1%	7.8%	7.7%	***	Equity bearish, bond bullish
	Imports	y/y	Dec	-10.8%	-11.6%	-11.1%	**	Equity and bond neutral
	S&P Manufacturing PMI	m/m	Dec	49.9	50.0		***	Equity and bond neutral
China	Official Composite PMI	m/m	Dec	50.3	50.4		***	Equity and bond neutral
	Official Manufacturing PMI	m/m	Dec	49.0	49.4	49.6	**	Equity bearish, bond bullish
	Official Services PMI	m/m	Dec	50.4	50.2	50.5	*	Equity and bond neutral
	Caixin Manufacturing PMI	m/m	Dec	50.8	50.7	50.3	***	Equity and bond neutral
EUROPE								
Eurozone	M3 Money Supply	y/y	Nov	-0.9%	-1.0%	-1.0%	***	Equity and bond neutral
	HCOB Eurozone Manufacturing PMI	m/m	Dec F	44.4	44.2	44.2	***	Equity and bond neutral
Germany	HCOB Germany Manufacturing PMI	m/m	Dec F	43.3	43.1	43.1	**	Equity and bond neutral
France	HCOB France Manufacturing PMI	m/m	Dec F	42.1	42.0	42.0	**	Equity and bond neutral
Italy	HCOB Italy Manufacturing PMI	m/m	Dec	45.3	44.4	44.2	***	Equity bullish, bond bearish
UK	Nationwide House Price Index	y/y	Dec	-1.8%	-2.0%	-1.3%	***	Equity bearish, bond bullish
	S&P Global Manufacturing PMI	m/m	Dec F	46.2	46.4	46.4	***	Equity and bond neutral
Switzerland	KOF Leading Indicator	m/m	Dec	97.8	96.7	97.2	**	Equity bullish, bond bearish
Russia	S&P Global Russia Manufacturing PMI	m/m	Dec	54.6	53.8		***	Equity and bond neutral
	S&P Global Russia Composite PMI	m/m	Dec	55.7	52.4		**	Equity and bond neutral
	S&P Global Russia Services PMI	m/m	Dec	56.2	52.2		**	Equity and bond neutral
	Money Supply, Narrow Definition	w/w	22-Dec	18.31t	18.25t		*	Equity and bond neutral
	Current Account Balance	y/y	3Q F	16261m	16600m		**	Equity and bond neutral
	GDP	y/y	3Q F	5.5%	5.5%	5.5%	**	Equity and bond neutral
AMERICAS								
Brazil	National Unemployment Rate	m/m	Nov	7.5%	7.6%	7.5%	*	Equity and bond neutral
	S&P Global Brazil Manufacturing PMI	m/m	Dec	48.4	49.4		***	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.

Fixed Income	Today	Prior	Change	Trend
3-mo Libor yield (bps)	559	559	0	Down
3-mo T-bill yield (bps)	518	519	-1	Down
U.S. Sibor/OIS spread (bps)	533	533	0	Down
U.S. Libor/OIS spread (bps)	531	531	0	Down
10-yr T-note (%)	3.96	3.88	0.08	Flat
Euribor/OIS spread (bps)	391	389	2	Down
Currencies	Direction			
Dollar	Up			Down
Euro	Down			Up
Yen	Down			Up
Pound	Down			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.

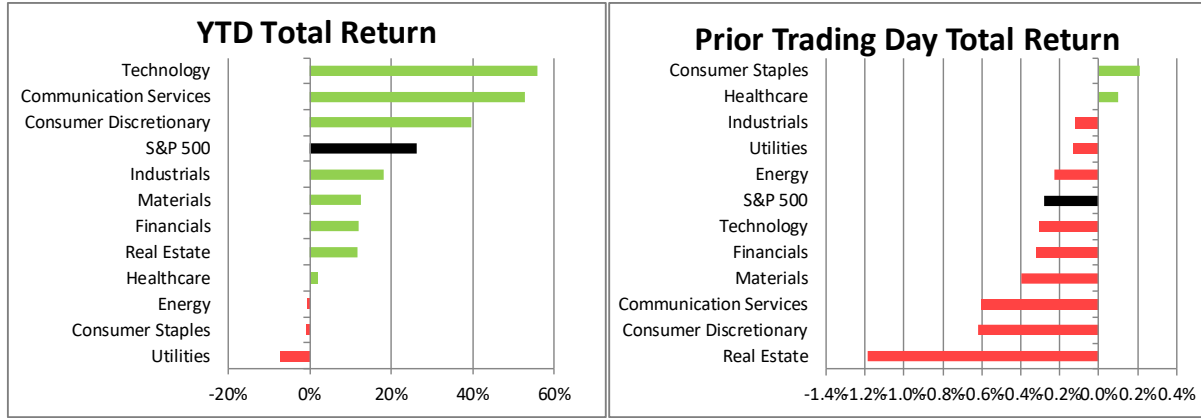
	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$78.50	\$77.04	1.90%	
WTI	\$73.05	\$71.65	1.95%	
Natural Gas	\$2.65	\$2.51	5.25%	Demand optimism
Crack Spread	\$23.15	\$22.73	1.85%	
12-mo strip crack	\$23.25	\$22.87	1.67%	
Ethanol rack	\$1.77	\$1.77	0.00%	
Metals				
Gold	\$2,067.23	\$2,062.98	0.21%	
Silver	\$23.89	\$23.80	0.41%	
Copper contract	\$387.65	\$389.05	-0.36%	
Grains				
Corn contract	\$471.25	\$474.25	-0.63%	
Wheat contract	\$628.00	\$631.50	-0.55%	
Soybeans contract	\$1,298.00	\$1,312.00	-1.07%	
Shipping				
Baltic Dry Freight	2,094	2,087	7	

Weather

The 6-10 and 8-14 day forecasts currently call for cooler-than-normal temperatures in most of the country, with warmer-than-normal temperatures throughout the East Coast. The precipitation outlook calls for wetter-than-normal conditions across most of the country.

Data Section

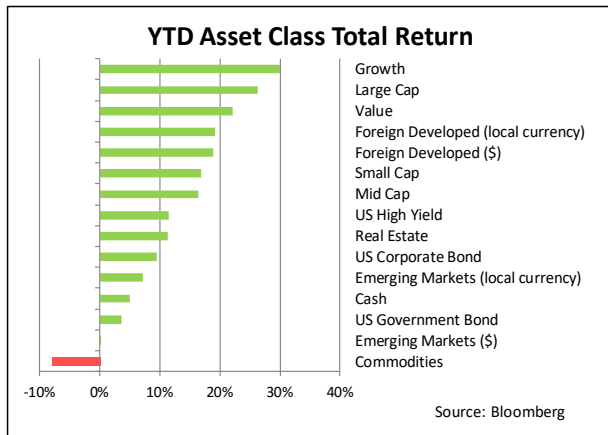
U.S. Equity Markets – (as of 12/29/2023 close)



(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 12/29/2023 close)

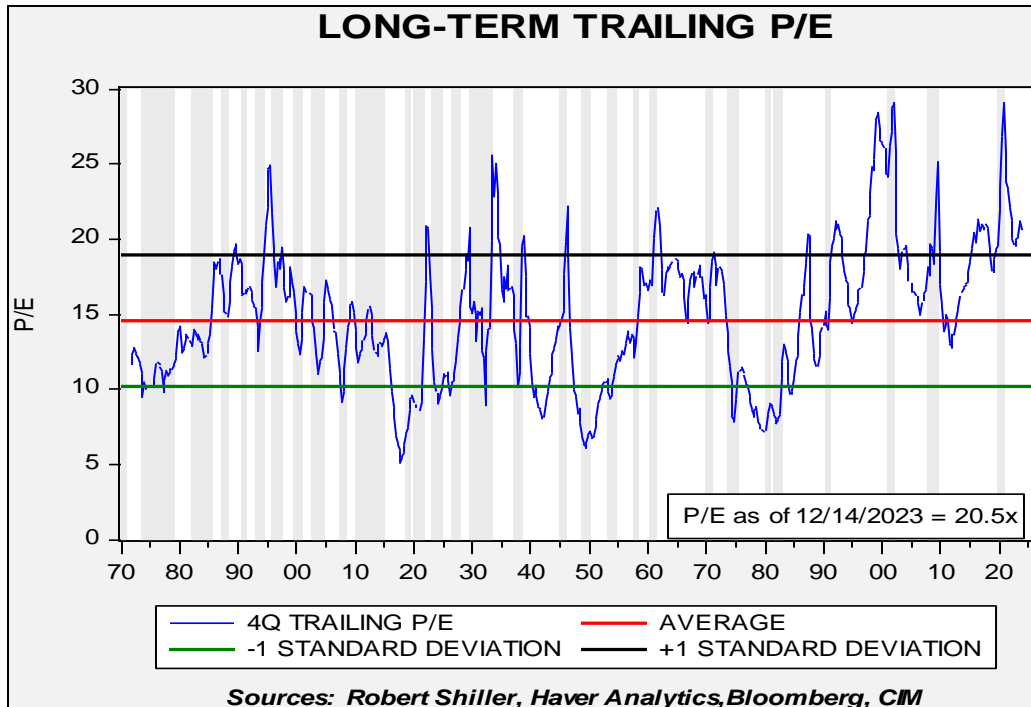


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

December 14, 2023



Based on our methodology,¹ the current P/E is 20.5x, up 0.1x from our last report. Rising index values lifted 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 Bloomberg estimates which are updated regularly throughout the quarter; currently, the four-quarter earnings sum includes three actual quarters (Q1, Q2 and Q3) and one estimate (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.