

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 7, 2022—9:30 AM EST] Global equity markets are mixed this morning. In Europe, the EuroStoxx 50 is currently down 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 closed up 0.9%. Chinese markets were lower, with the Shanghai Composite down 0.2% from its prior close and the Shenzhen Composite down 1.2%. U.S. equity index futures are signaling a flat 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:

- [Weekly Geopolitical Report](#) (12/13/2021): “The 2022 Geopolitical Outlook”
- [Weekly Energy Update](#) (1/6/2022): The WEU returns with a wrap-up of last year’s data and a recap of OPEC+’s decision to raise production next month.
- [Asset Allocation Q4 2021 Rebalance Presentation](#) (11/4/2021): A video discussion of our asset allocation process, Q4 2021 portfolio changes, and the macro environment
- [Asset Allocation Weekly](#) (12/17/2021) (with associated [podcast](#)): “What’s Causing the Yield Curve to Flatten?”
- [Confluence of Ideas podcast](#) (12/14/2021): “The Regional Threats from the Taliban in Afghanistan”
- *Current Perspectives*: “[2022 Outlook: The Year of Fat Tails](#)” (12/16/2021)

Good morning! We begin today’s report with news from the Fed followed by China-related stories, including the latest on the real estate situation. Next is an update on the protests in Kazakhstan and various other international news. We conclude with our pandemic coverage.

Economics and policy:

- Federal Reserve Vice Chair Richard Clarida [admitted he failed to disclose fully the financial trades](#) he made in 2020. Clarida, whose term expires at the end of the month, attributed the lack of disclosure to an “inadvertent error.” The new disclosures showed Clarida sold his stock fund as the market plummeted and then repurchased the fund a day before Fed Chair Powell announced the Fed would act to protect financial markets. Initially, the Fed described Clarida’s decision to purchase the stock fund as a portfolio rebalancing; however, the additional disclosure suggests he may have repurchased the stock fund based on insider information. The new disclosure will likely put the Federal

Reserve under additional scrutiny as policymakers look to restrict Fed officials' ability to benefit from the decisions it makes.

- [Treasury yields on long-duration bonds continue to rise](#) as fears of an economic setback due to Omicron subside and the Fed signals tighter monetary policy. The 30-year Treasury yield has risen to its highest level since October, while the 10-year Treasury yield rose more than 20 bps just this week. Although some of the sell-off in treasuries may be related to traders returning to work this week, there is some fear that the rise in rates could remain elevated for longer than previous peaks in the cycle. In October, when rates were last this high, concerns that the Fed would raise rates were waved off as being a far-out event, thus allowing rates to fall over time. However, the recent Fed minutes indicate that the central bank may be more aggressive in tightening policy than investors originally anticipated. The [weak payroll numbers](#) have likely added to those concerns. The rise in bond yields pushed mortgage rates [higher than at any time in 2021](#), and if rates continue on that path, it could lead to a reduction in residential investment spending in 2022, thus slowing GDP growth. If tightening leads to financial instability, we expect the Fed could dampen expectations.
 - Rising rates have had a detrimental impact on tech stocks. They are down 50% from their 52-week high and are close to hitting a record. The sharp drop in tech stocks has [drawn parallels to the dotcom crash](#).
- [Adverse weather conditions in the eastern United States](#), from Tennessee to New York, could contribute to a surge in energy prices. The White House [is expected to provide low-income households with additional funding](#) from the American Recovery Plan to help offset the rise in costs.

China:

- Contagion from China's real estate crisis [may have spread into investment-grade companies](#). On Friday, Chinese property developer Shimao Group Holdings (0831 HK, HKD, 4.7) failed to make a debt payment leading to a selloff of its bonds. The Shanghai Stock exchange suspended trading of several of the company's bonds due to this rapid selling. The missed payments highlight the pressure Chinese real estate companies are facing following defaults from Kaisa Property Holdings (HKG 1638, HKD, 0.81) and Evergrande (EGRNF, USD, 0.21). The real estate crisis has led to a decline in housing prices and investor confidence.
- The recent spread of the Omicron variant may [slow economic growth in China](#). The country is expected to reimpose more COVID-related restrictions as it looks to contain the spread of the virus. Restrictions will likely lead to a slowdown in consumption.
- A rise in COVID cases [led to a suspension of trucking services](#) in several parts of East China's Zhejiang province. The slowdown in the transportation of goods could hurt suppliers that rely on parts from China to boost their inventory.

International news:

- Kazakhstan President Kassym-Jomart Tokayev has ordered [authorities to shoot without warning](#), as the government attempts to end violent protests in the country's major cities. The move by the president signals a steep escalation by the government as it tries to contain protests due to the rise in fuel prices. Afterward, the president claimed that order has been restored to most of the country, but military operations would remain in effect until forces are able to completely remove violent protesters.

There is speculation that the outbreak in Kazakhstan [may have altered Russian President Vladimir Putin's desire to invade Ukraine](#). He is getting a firsthand look at the level of instability within Eastern Europe. Although it may not deter him from invading, it could sway him to reconsider the scale of such an invasion if it were to take place.

- Nigerian manufacturers have asked the government to [reverse a tax on sugary drinks](#) that is due to go into effect this month. The country has struggled to generate government revenue following the drop in the price of oil in 2020. Although oil prices rebounded in 2021, the country's weak infrastructure has made it difficult for it to [deliver cargo out of its ports](#).

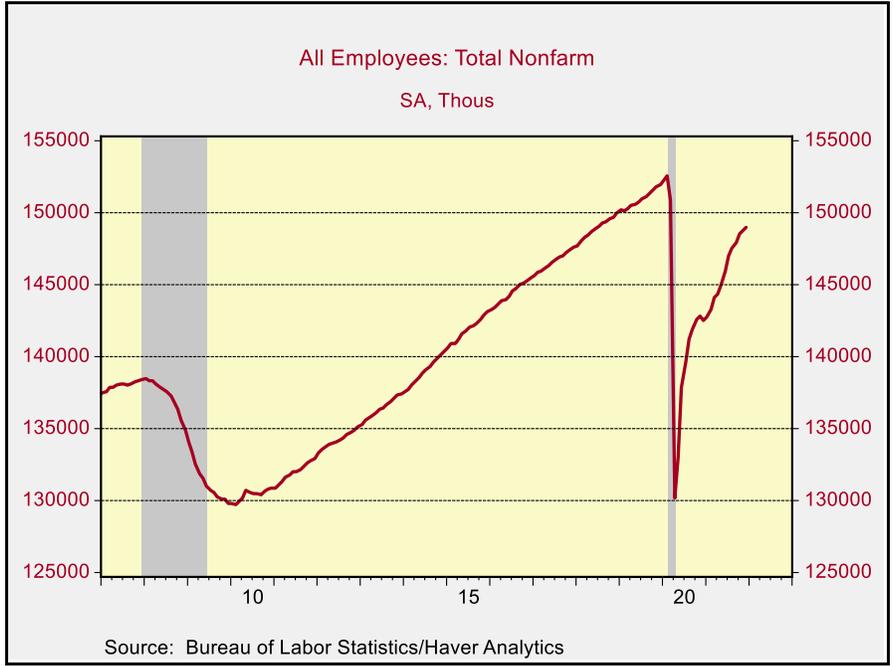
COVID-19: The [number of reported cases](#) is 297,997,595 with 5,467,568 fatalities. In the U.S., there are 57,762,144 confirmed cases with 832,148 deaths. For illustration purposes, the *FT* has created an [interactive chart](#) that allows one to compare cases across nations using similar scaling metrics. The *FT* has also issued an [economic tracker](#) that looks across countries with high-frequency data on various factors. The [CDC reports](#) that 618,076,045 doses of the vaccine have been distributed, with 513,839,973 doses injected. The number receiving at least one dose is 245,278,020, the number of second doses is 206,797,799, and the number of the third dose, the highest level of immunity, is 72,262,703. The *FT* has a page on [global vaccine distribution](#).

- A U.K. study showed there [is not enough conclusive evidence](#) that masks in schools prevent the spread of COVID.
- Moderna (MRNA, USD, 215.23) CEO Stéphane Bancel has stated [there may be a need for a fourth shot](#) of the coronavirus vaccine in the Fall. However, he added that he would not know for sure until additional data is released in the coming weeks.

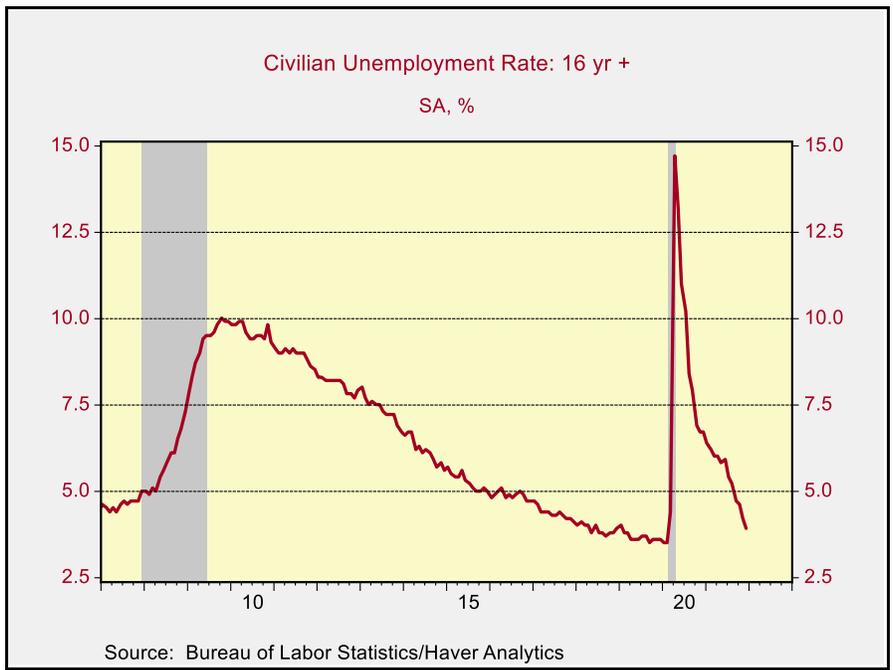
U.S. Economic Releases

In today's key economic report, December nonfarm payrolls rose by a seasonally adjusted 199K, well short of the expected increase of 450K. The November gain was revised significantly higher to 249K, but that did little to offset the disappointment with the December increase. Continuing recent trends, the private sector accounted for all the expansion in jobs last month, while employment in the public sector fell. The chart below shows how nonfarm payrolls have grown since just before the previous recession. Considering the regular corrections, updating, and other revisions to the historical data in this month's release, it appears total U.S. payrolls at the end of

2021 were just 3.572 M short of the previous peak employment right before the coronavirus pandemic hit in early 2020.



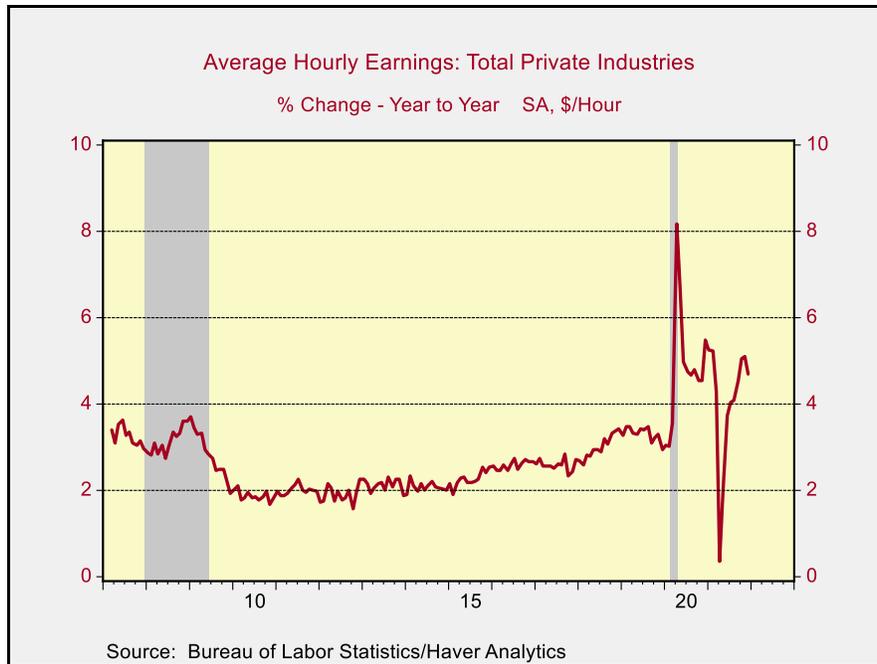
On a more positive note, the December unemployment rate fell sharply to a seasonally adjusted 3.9%, much lower than the anticipated rate of 4.1% and the November rate of 4.2%. The chart below shows how the unemployment rate has fluctuated since just prior to the previous recession.



Also in the report, the December labor force participation rate came in at a seasonally adjusted 61.9%, matching the revised figure for November. The LFPR measures the share of the adult, civilian, noninstitutionalized population in the labor force, i.e., either working or looking for work. The chart below shows how the LFPR has evolved over the last several decades.



Finally, the report showed that average hourly earnings in December rose to a seasonally adjusted \$31.31. That marked a rise of 4.7% year-over-year. The rise in the year through December was better than the expected 4.2%, but it nevertheless marked a slowdown from the revised increase of 5.1% through November. It was also likely weaker than the rise in the consumer price index in the year to December, suggesting the wage gains are not keeping up with the recent surge in costs for goods and services. The chart below shows the growth of average hourly earnings since just before the last recession.



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	Nov	\$20.000b	\$16.897bb	*
Fed Speakers or Events						
EST	Speaker or event	District or position				
10:00	Mary Daly Discusses Monetary Policy on AEA Panel	President of the Federal Reserve Bank of San Francisco				
12:30	Raphael Bostic Takes Part in AEA Panel on Black Entrepreneurs	President of the Federal Reserve Bank of Atlanta				

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	Tokyo CPI	y/y	Dec	0.8%	0.5%	0.7%	**	Equity and bond neutral
	Tokyo CPI Ex-Fresh Food	y/y	Dec	0.5%	0.3%	0.5%	***	Equity and bond neutral
	Tokyo CPI Ex-Fresh Food and Energy	y/y	Dec	-0.3%	-0.4%	-0.3%	*	Equity and bond neutral
	Labor Cash Earnings	y/y	Nov	0.0%	0.2%	0.5%	**	Equity and bond neutral
	Household Spending	y/y	Nov	-1.3%	-0.6%	1.2%	*	Equity and bond neutral
	Japan Buying of Foreign Bonds	w/w	31-Dec	-¥416.5b	-¥1588.5b		*	Equity and bond neutral
	Japan Buying of Foreign Stocks	w/w	31-Dec	¥213.6b	¥247.4b		*	Equity and bond neutral
	Foreign Buying of Japan Bonds	w/w	31-Dec	¥447.2b	¥1251.8b		*	Equity and bond neutral
	Foreign Buying of Japan Stocks	w/w	31-Dec	¥17.1b	-¥841.3b		*	Equity and bond neutral
China	Foreign Reserves	m/m	Dec	\$3250.1b	\$3222.3b	\$3230.0b	**	Equity and bond neutral
EUROPE								
Eurozone	CPI	y/y	Dec	5.0%	4.9%	4.8%	**	Equity and bond bearish
	Core CPI	y/y	Dec P	2.6%	2.6%	2.5%	**	Equity and bond bearish
	Consumer Confidence Index	m/m	Dec F	-8.3	-8.3		**	Equity and bond neutral
	Economic Confidence Index	m/m	Dec	115.3	117.6	116.0	*	Equity bearish, bond bullish
	Retail Sales	y/y	Nov	7.8%	1.7%	5.6%	**	Equity bullish, bond bearish
Germany	Industrial Production WDA	y/y	Nov	-2.4%	-0.9%	-0.8%	**	Equity bearish, bond bullish
	Trade Balance	m/m	Nov	12.0b	12.7b	12.8b	**	Equity bearish, bond bullish
	Current Account Balance	m/m	Nov	18.9b	17.6b	17.0b	*	Equity and bond neutral
	Exports	m/m	Nov	1.7%	4.2%	-0.2%	*	Equity bullish, bond bearish
	Imports	m/m	Nov	3.3%	5.2%	-1.3%	*	Equity bullish, bond bearish
France	Industrial Production	y/y	Nov	-0.5%	-0.6%	0.6%	***	Equity bearish, bond bullish
	Manufacturing Production	y/y	Nov	-1.2%	0.2%		*	Equity bearish, bond bullish
	Consumer Spending	y/y	Nov	14.8%	-5.6%	13.9%	*	Equity bullish, bond bearish
	Trade Balance	y/y	Nov	-9.727b	-7.697b	-7.230b	*	Equity bearish, bond bullish
UK	Markit/CIPS Construction PMI	m/m	Dec F	54.3	55.5	54.0	**	Equity and bond neutral
Switzerland	Foreign Currency Reserves	m/m	Dec	944.5b	921.7b		***	Equity and bond neutral
	Unemployment Rate	m/m	Dec	2.4%	2.5%	2.5%	**	Equity bullish, bond bearish
	Real Retail Sales	y/y	Nov	5.8%	2.2%		**	Equity bullish, bond bearish
AMERICAS								
Canada	Net Change in Employment	m/m	Dec	54.7k	153.7k	25.0k	***	Equity bullish, bond bearish
	Unemployment Rate	m/m	Dec	5.9%	6.0%	6.0%	***	Equity bullish, bond bearish
Mexico	CPI	y/y	Dec	7.4%	7.4%	7.5%	***	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)	23	22	1	Down
3-mo T-bill yield (bps)	9	10	-1	Neutral
TED spread (bps)	14	12	2	Neutral
U.S. Libor/OIS spread (bps)	14	14	0	Down
10-yr T-note (%)	1.73	1.72	0.01	Down
Euribor/OIS spread (bps)	-57	-58	1	Neutral
EUR/USD 3-mo swap (bps)	-2	-1	-1	Down
Currencies	Direction			
Dollar	Down			Neutral
Euro	Flat			Up
Yen	Flat			Neutral
Pound	Up			Neutral
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.

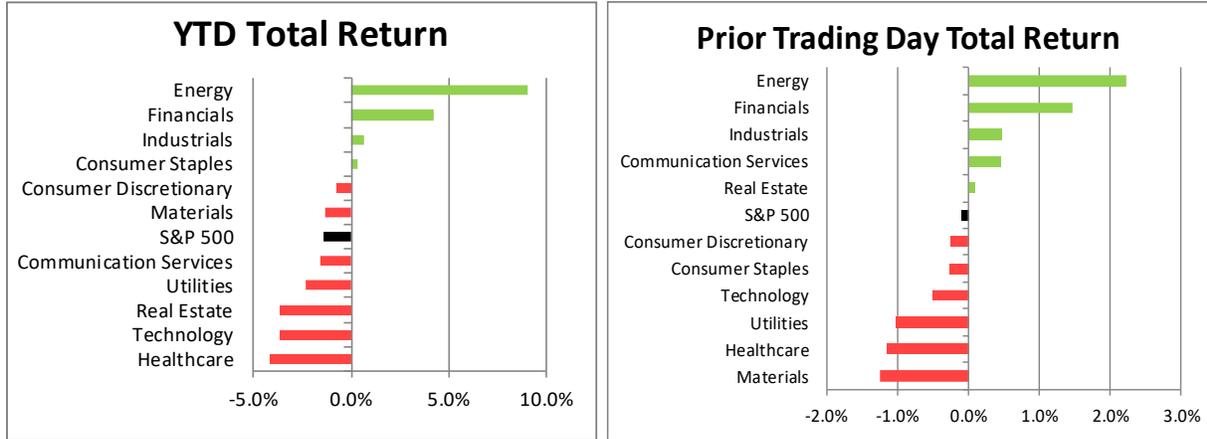
	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$82.68	\$81.99	0.84%	
WTI	\$80.03	\$79.46	0.72%	
Natural Gas	\$3.86	\$3.81	1.36%	
Crack Spread	\$19.96	\$19.67	1.51%	
12-mo strip crack	\$21.40	\$21.26	0.65%	
Ethanol rack	\$2.42	\$2.45	-1.37%	
Metals				
Gold	\$1,788.49	\$1,791.16	-0.15%	
Silver	\$22.11	\$22.20	-0.39%	
Copper contract	\$436.30	\$435.45	0.20%	
Grains				
Corn contract	\$600.50	\$603.75	-0.54%	
Wheat contract	\$737.50	\$746.00	-1.14%	
Soybeans contract	\$1,381.50	\$1,387.25	-0.41%	
Shipping				
Baltic Dry Freight	2,296	2,289	7	
DOE inventory report				
	Actual	Expected	Difference	
Crude (mb)	-2.1	-3.4	1.3	
Gasoline (mb)	10.1	2.5	7.6	
Distillates (mb)	4.4	-1.0	5.4	
Refinery run rates (%)	0.10%	0.35%	-0.25%	
Natural gas (bcf)	-31.0	-55.0	24.0	

Weather

The 6-10 day and 8-14-day forecasts currently call for warmer-than-normal temperatures throughout the West Coast, the Rocky Mountains, and the Great Plains, with cooler-than-normal temperatures in the Northeast. The forecasts call for dry conditions throughout the Far West, with wet conditions in the Southeast.

Data Section

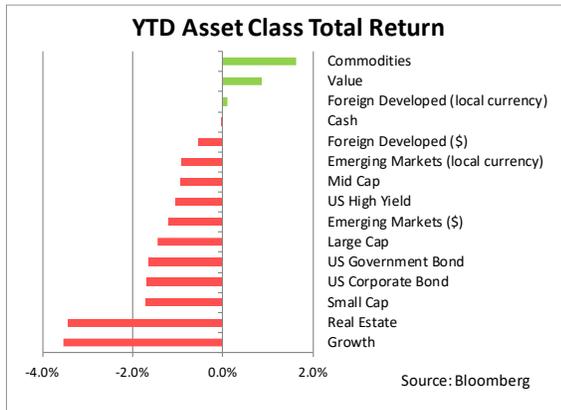
U.S. Equity Markets – (as of 1/6/2022 close)



(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 1/6/2022 close)

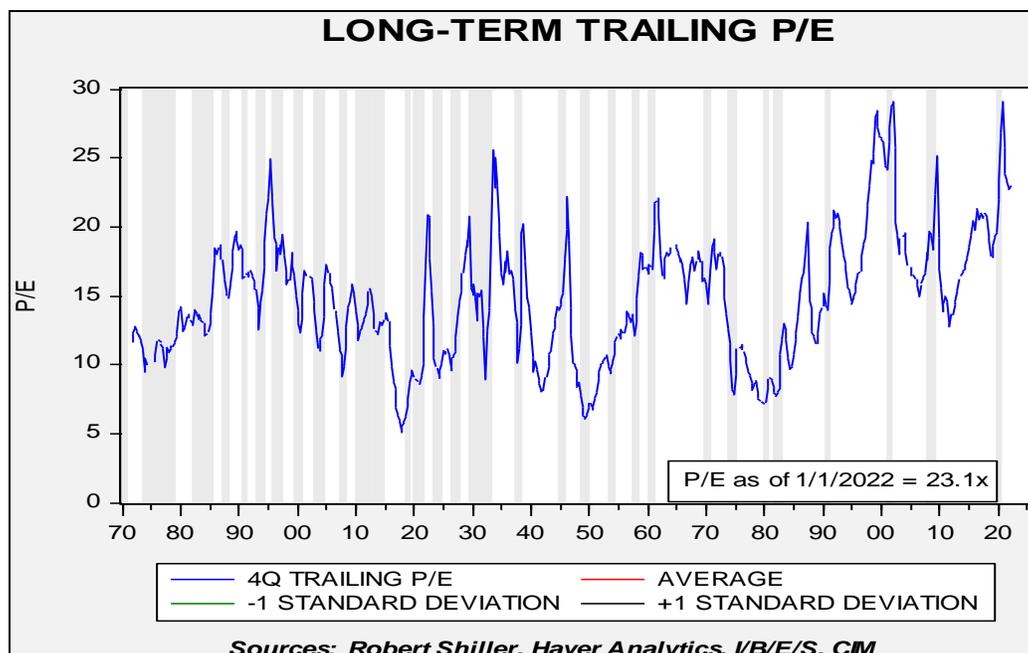


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

January 6, 2022



Based on our methodology,¹ the current P/E is 23.1x, up 0.5x from our last report. The rise in the multiple is due to higher index prices.

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.