

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 8, 2021—9:30 AM EST] Global equity markets are mixed this morning. The EuroStoxx 50 is up 0.6% from its last close. In Asia, the MSCI Asia Apex 50 is up 1.0%. Chinese markets were lower, with the Shanghai Composite down 0.2% from the prior close and the Shenzhen Composite down 0.3%. U.S. equity index futures are signaling a higher open.

The Asset Allocation Weekly is available [here](#).

Good morning. Today U.S. equity futures are elevated as investors anticipate more fiscal stimulus. A slowdown in job creation and a Democrat majority in both houses likely supports the case for more expansionary fiscal policy. Chinese shares took a dip as global indices continue to delist Chinese companies. Meanwhile, better than expected economic data has boosted equities in Europe. Below are the stories that we are following:

COVID-19: The [number of reported cases](#) is 87,588,168 with 1,890,824 fatalities. In the U.S., there are 21,394,326 confirmed cases with 362,828 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 21,419,800 doses of the vaccine have been distributed with 5,919,418 of first doses injected. This [map from Axios](#) indicates rising severe infections. The [R_t data](#) show that only five states have a reading of less than one, with Oregon having the lowest rate and Georgia with the highest.

Virology

- [A coronavirus vaccine developed in China](#) was declared effective by Brazilian officials. The vaccine developed by the Beijing-based Sinovac Biotech Ltd. was determined to be 78% effective against COVID-19. The new vaccine is expected to fill the gap left by the West.
- Japan [declared a state of emergency](#) in Tokyo and three surrounding areas on Thursday. There is growing pressure [to expand the emergency to other areas](#) in order to reflect the severity of the spread. Once praised for its ability to contain the virus, Japan has seen record COVID-19 infections and a rising death toll.
- A variant of COVID-19 has been [confirmed in Texas](#). The victim was an adult male between the ages of 30 and 40 with no history of travel, suggesting that the variant is already circulating throughout Texas. A strain has also appeared in [Pennsylvania](#).

- Iran has [banned vaccines from the U.S. and Europe](#) as it feels it cannot trust them.

The fallout: In response to riots at the U.S. Capitol that led to four deaths and 52 injuries, there has been a growing push for President Trump to resign or be removed from office. Although there were rumors that members of [the White House cabinet discussed invoking the 25th Amendment](#), it doesn't appear that [Vice President Pence will support it](#). There has also been a call for an impeachment hearing, but this is also unlikely to happen before Joe Biden's inauguration date of January 20.¹ Markets have largely shrugged off the outcry as they have primarily focused on a possible new round of stimulus.

China: Despite developments in its vaccines, the Chinese markets seem to be more focused on China's growing assertiveness to punish critics as well as the growing number of Chinese firms being excluded from global stock exchanges.

- Beijing continues to show no sign of letting up in its quest to crack down on Chinese tech billionaire Jack Ma's business empire. The Chinese government has told the country's [media to limit the reporting of its anti-trust probe](#) as it fears that it could lose control over the narrative. Jack Ma has come under increased scrutiny following a speech he gave [criticizing the country's regulators](#). So far, it appears that Jack Ma has been laying low to prevent further scrutiny regarding investigations into his businesses.
- Although Beijing's crackdown on members of the elite is not new, this one appears to have investors on edge. Given Jack Ma's prominence and popularity, the crackdown has raised concerns that the Chinese government could do the same to other businesses throughout the country. Additionally, fears about Chinese holdings have been elevated given the scrutiny they have already been getting from abroad. Last month, China was rebuffed by EU negotiators when it tried to add a clause in its EU investment deal that would punish countries restricting the access of Chinese telecom companies. On Thursday, MSCI announced it will be [delisting seven Chinese companies](#) from indices in compliance with the executive order passed by Trump.
- It appears China doesn't expect any improvement in U.S.-China relations given Biden's win. According to [the South China Morning Post](#), China will likely seek to form relationships with other countries as it expects Biden to continue promoting America First policies.
- China has continued to [diversify its holdings of U.S.-denominated assets](#) as it seeks to become less reliant on the U.S. Its holdings of U.S. Treasuries fell to the lowest level since January 2017.

U.S.-Europe: Strong economic data may be overshadowing other important stories impacting the U.S. and Europe.

- [A shortage in semiconductors](#) could hinder car production in Europe. The U.S. automobile manufacturers have been able to scale up production faster from the pandemic than manufacturers of semiconductors, resulting in a supply gap. If this continues it could possibly slow car production globally.

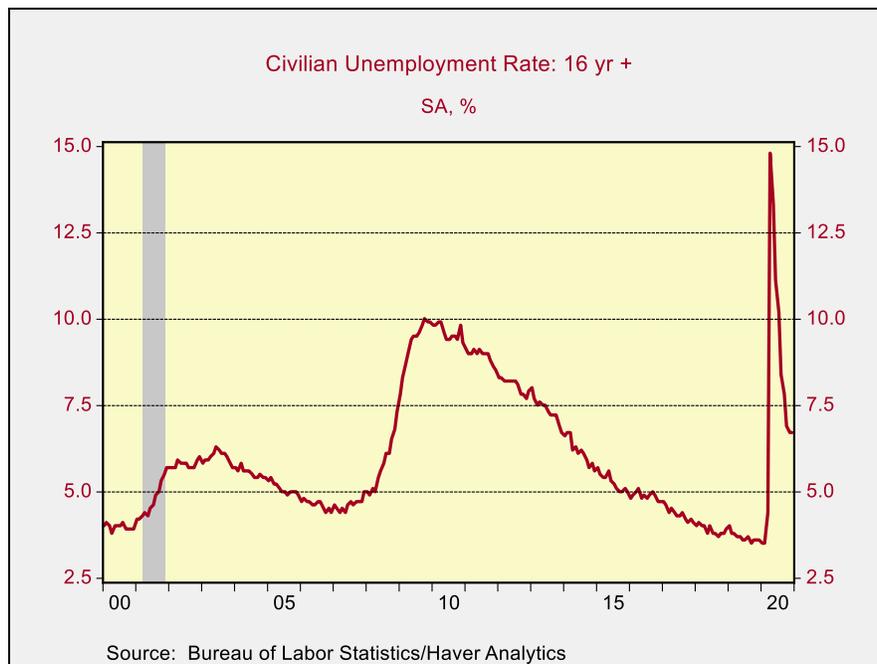
¹ If Trump is impeached, the Senate could vote to disqualify him from running for office in 2024.

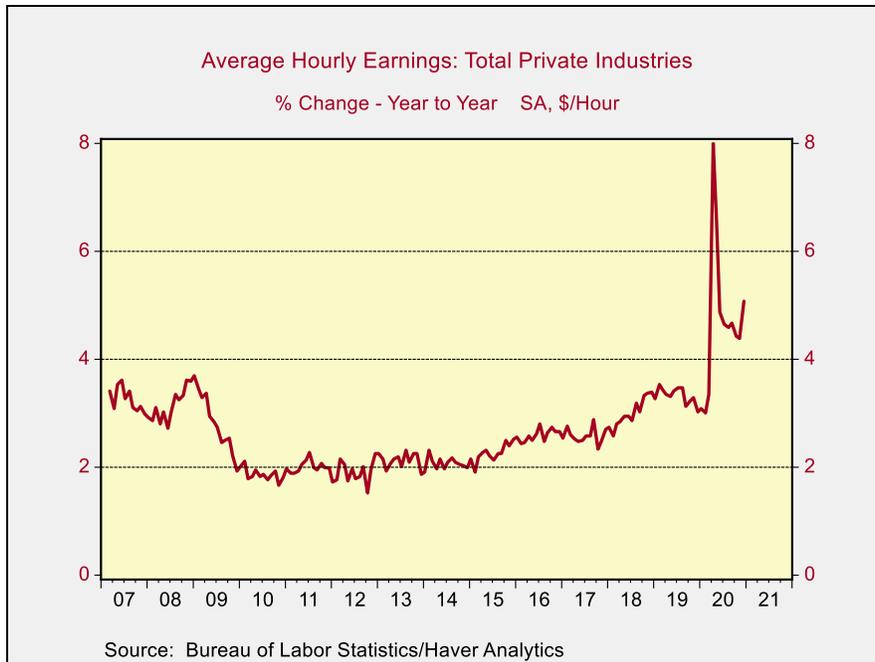
- The U.S. has decided to suspend its planned [import tariffs on French luxury goods](#). The tariffs were in response to France’s digital tax.
- The breakup of the U.K. and the EU appears to be having an impact on businesses. Grocery store Marks & Spencer (MAKSF, \$1.88) has [stated the deal has caused problems with its business models](#). Although the agreement preserves tariffs and quota free-trade between the U.K. and EU, rules around re-exported goods have complicated the way businesses set up supply chains.

U.S. Economic Releases

In the monthly employment report from the Department of Labor, December nonfarm payrolls unexpectedly fell by a seasonally adjusted 140,000. The November gain was revised sharply higher to a gain of 336,000. The data indicated that much of the decline in December was from the services sector, while payrolls in manufacturing jumped by 38,000. Meanwhile, the December unemployment rate held steady at 6.7%, rather than rising to 6.8% as anticipated. Finally, average hourly earnings in December rose strongly and were up a healthy 5.1% year-over-year, beating the expected annual gain of 4.5%. However, that rise probably reflects the fact that many of those who lost jobs in December were in the relatively lower-paid services sector, leaving the employed population with a larger proportion of higher-paid workers. In summary, the report was probably better than suggested by the drop in the headline payroll numbers, although it still reflected a cooling in the labor market last month as the coronavirus pandemic worsened.

The chart below shows the U.S. unemployment rate over the last couple of decades.





The chart above shows the recent trends in average hourly earnings.

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

EDT	Indicator			Expected	Prior	Rating
15:00	Consumer Credit	m/m	Nov		\$7.2b	*
Fed Speakers or Events						
	Speaker or event	District or position				
11:00	Richard Clarida Speaks on the Economy and Monetary Policy	Vice Chairman of Board of Governors of Federal Reserve				

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	Household Spending	y/y	Nov	1.1%	1.9%	-1.0%	*	Equity bullish, bond bearish
	Leading Index	m/m	Nov	96.6	94.3	96.6	**	Equity and bond neutral
South Korea	BoP Current Account Balance	m/m	Nov	\$89,669	\$11,657		**	Equity bullish, bond bearish
Europe								
Eurozone	Unemployment Rate	m/m	Nov	8.3%	8.4%	8.5%	**	Equity bullish, bond bearish
Italy	Unemployment Rate	m/m	Nov	8.9%	9.5%	10.0%	**	Equity bullish, bond bearish
Switzerland	Unemployment Rate	m/m	Dec	3.4%	3.4%	3.4%	**	Equity and bond neutral
Germany	Industrial Production	y/y	Nov	-2.6%	-3.0%	-2.3%	***	Equity and bond neutral
France	Industrial Production	y/y	Nov	-4.6%	-3.9%	-5.0%	***	Equity and bond neutral
AMERICAS								
Canada	Net Change in Employment	m/m	Dec	-62.6k	62.1k	-37.5kk	***	Equity bearish, bond bullish
	Unemployment Rate	m/m	Dec	8.6%	8.5%	8.7%	***	Equity and bond neutral
Brazil	Industrial Production	y/y	Nov	2.8%	0.3%	3.3%	***	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)	23	24	-1	Down
3-mo T-bill yield (bps)	8	8	0	Neutral
TED spread (bps)	15	16	-1	Up
U.S. Libor/OIS spread (bps)	8	8	0	Up
10-yr T-note (%)	1.09	1.08	0.01	Neutral
Euribor/OIS spread (bps)	-55	-56	1	Neutral
EUR/USD 3-mo swap (bps)	3	2	1	Down
Currencies	Direction			
dollar	Up			Down
euro	Down			Up
yen	Down			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.

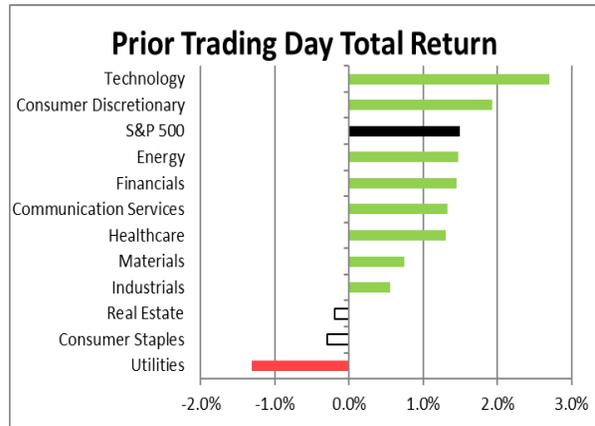
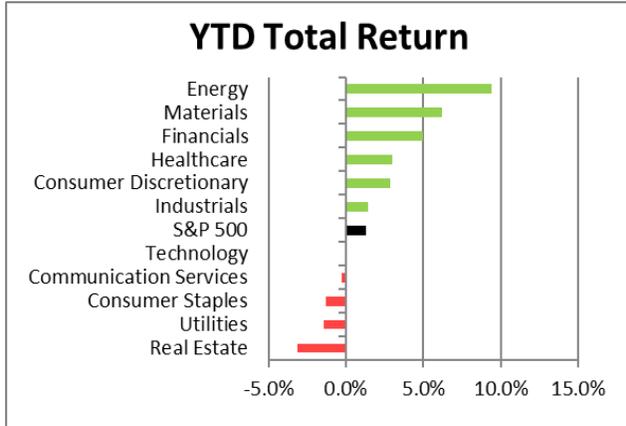
	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$55.35	\$54.38	1.78%	
WTI	\$51.67	\$50.83	1.65%	
Natural Gas	\$2.64	\$2.73	-3.30%	
Crack Spread	\$12.45	\$12.21	2.01%	
12-mo strip crack	\$14.18	\$13.89	2.08%	
Ethanol rack	\$1.60	\$1.59	0.14%	
Metals				
Gold	\$1,883.69	\$1,913.95	-1.58%	
Silver	\$26.56	\$27.14	-2.16%	
Copper contract	\$370.05	\$369.60	0.12%	
Grains				
Corn contract	\$496.25	\$494.00	0.46%	
Wheat contract	\$642.00	\$642.25	-0.04%	
Soybeans contract	\$1,373.50	\$1,355.25	1.35%	
Shipping				
Baltic Dry Freight	1448	1425	23	
DOE inventory report				
	Actual	Expected	Difference	
Crude (mb)	-8.0	-1.8	-6.3	
Gasoline (mb)	4.5	-0.9	5.4	
Distillates (mb)	6.4	2.1	4.3	
Refinery run rates (%)	1.30%	0.30%	1.00%	
Natural gas (bcf)	-130.0	-139.0	9.0	

Weather

The 6-10 and 8-14 day forecasts currently call for warmer temperatures for most of the country, especially in the northern and western regions, with cooler temperatures in the southern region. Dry conditions are expected throughout most of the country, with wet conditions expected in eastern Montana and the Dakotas.

Data Section

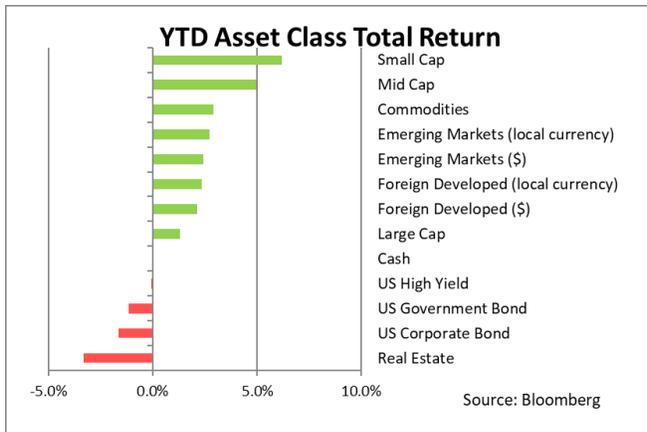
U.S. Equity Markets – (as of 1/7/2021 close)



(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 1/7/2021 close)

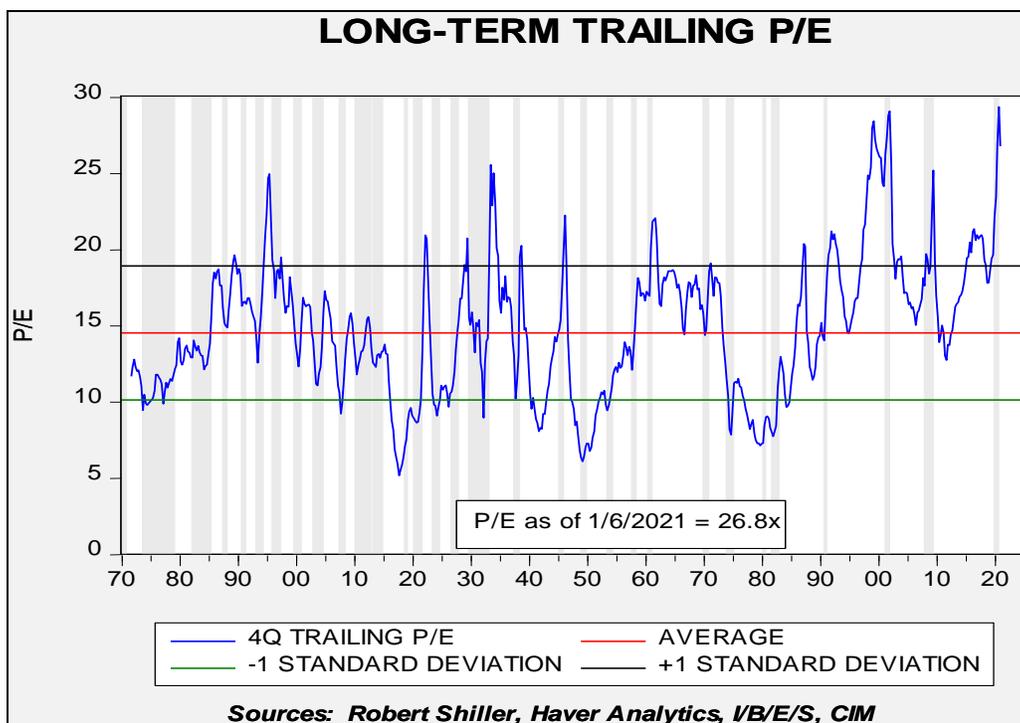


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

January 7, 2021



Based on our methodology,² the current P/E is 26.8x, down 2.2x from our last report in mid-December. The decline is due to higher earnings as we are now accounting for Q1 in our rolling calculation.

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 (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.