

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 11, 2022—9:30 AM EST] Global equity markets are mixed this morning. In Europe, the EuroStoxx 50 is currently up 1.1% from its prior close. In Asia, the MSCI Asia Apex 50 closed up 0.6%. Chinese markets were lower, with the Shanghai Composite down 0.7% from its prior close and the Shenzhen Composite down 1.1%. 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:

- [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 Bi-Weekly](#) (1/10/2022) (with associated [podcast](#)): “The Path of Monetary Policy”
- [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)

We open today’s *Comment* with a preview of Federal Reserve Chair Powell’s testimony before Congress today. We also cover other U.S. news, including the U.S.-Russia meeting yesterday over Eastern European security issues. We next review several international items that could affect the financial markets today. We close with the latest developments related to the coronavirus pandemic.

U.S. Monetary Policy: Federal Reserve Chair Powell today [faces a Senate confirmation hearing for his second term leading the central bank](#). Although his confirmation isn’t in doubt, Powell will probably face a grilling over the Fed’s recent shift toward tighter monetary policy to fight inflation after insisting just months ago that the current fast price rises would be transitory.

- In his written introductory comments released yesterday, Powell justified the abrupt shift on grounds that, “We can begin to see that the post-pandemic economy is likely to be different in some respects. The pursuit of our goals will need to take these differences into account.”

- The coronavirus pandemic that prompted today’s ultra-loose monetary policy was truly novel, but Powell’s “this time is different” statement sounds more than a bit like cover for the monetary officials’ apparent panic over inflation. That panic raises the prospect of a policy mistake in which the Fed tightens policy too sharply and causes a slowdown in the economy or undermines its own credibility by having to walk back its inflation concerns after just a few months.
- Despite the sharp runup in bond yields and some modest steepening of the yield curve over the last two weeks, the bond market still seems to be pricing in just such a monetary policy mistake or, at the very least, a modest amount of policy tightening that quickly succeeds in capping inflation, albeit at the expense of slower economic growth.
 - Bolstering expectations for a rate hike as early as March, Atlanta FRB President Bostic [said he is “totally open” to the central bank raising the benchmark fed funds rate at its March policy meeting](#), adding he expects the Fed will likely raise its interest rate target three times over the course of the year.
 - Despite the risk that tighter monetary policy could spark a slowdown in the economy, the prospect of near-term rate hikes [continues to bolster bank equities](#).

U.S. Energy Industry: Citing environment protection goals, the Interior Department yesterday [said it plans to block oil and gas leasing on about 11 million acres on Alaska’s North Slope](#), reversing an effort by the Trump administration to expand oil exploration in Alaska. The move will likely boost concerns that environmental restrictions on the oil and gas industry and efforts to favor green energy will crimp overall energy supplies and boost energy prices for years into the future.

- Separately, market intelligence firm Kpler said China [doubled down on imports of Iranian and Venezuelan crude in 2021, taking the most U.S.-sanctioned oil in three years](#) as refiners brushed off the risk of penalties to scoop up supplies at low prices.
- According to Kpler, crude processors in China bought 324 million barrels from Iran and Venezuela in 2021, about 53% more than the year before. That’s the most since 2018, when China took 352 million barrels from the two nations.

United States-Russia: At their meeting in Geneva yesterday to soothe tensions over Ukraine, U.S. and Russian officials [apparently failed to narrow their differences](#), although they later [signaled there would be more U.S.-Russia talks in the future](#). On Wednesday, the Russian delegation will meet in Brussels with all NATO members, and on Thursday, they will meet in Vienna with the Organization for Security and Cooperation in Europe, which includes Ukraine.

- As we discussed in our *Comment* yesterday, Putin’s key demands include a commitment from NATO that it will not admit Ukraine or other new Eastern European members into the defense alliance, and it rolls back its military infrastructure and deployments in the former Soviet states.
- The U.S. and its European allies have rejected Putin’s demands out of hand, but reports over the weekend said the Biden administration [is prepared to discuss reciprocal limits on intermediate-range missiles in Europe, as well as mutual restrictions on the scope of military exercises on the continent](#).

- If no agreement is reached and Russia does invade Ukraine, the U.S. has threatened massive economic sanctions, including possibly cutting Russia off from the SWIFT system of international dollar payments. U.S. officials have also discussed more targeted measures, including erecting export barriers to block international sales to Russia of products with a certain percentage of American content, as well as preventing Moscow from getting access to cutting-edge microchips used in everything from aircraft to consumer electronics. Those options would likely impose steep costs on the Russian economy and financial assets.

Kazakhstan: President Tokayev today [said the Russian “peacekeeping” troops that entered the country at his request to help quell anti-government protests would depart within ten days.](#)

Tokayev asserted that the situation in the country is already calming down, and press reports say businesses and people are getting back to normal in Almaty, the largest city.

- Even if the situation is calming, the political dimension is still evolving. After forcing the prime minister and his government to resign as the protests erupted last week, Tokayev said he would bring back former Finance Minister Alikhan Smailov to be prime minister over a new government.
- Tokayev has also used the unrest to sideline Kazakhstan’s previous president, Nursultan Nazarbayev, who built up a cult of personality and strenuously guarded the country’s independence in the nearly 30 years he was in power. Since stepping down in 2019, Nazarbayev had retained significant power as head of the nation’s security council.
 - It’s unclear whether Tokayev instigated the unrest to justify pushing out Nazarbayev or whether he merely took advantage of the protests. In any case, the protests allowed Tokayev to push Nazarbayev off the security council and into full retirement.
 - By calling in Russian troops to support him, Tokayev has also shown that he is willing to trade off much of Kazakhstan’s independence in return for Russian protection. That will strengthen Russian influence over the former Soviet republics in the region and help build the sphere of influence Russian President Putin is trying to establish.

Argentina: In a meeting with state governors last week, Finance Minister Guzmán admitted the government [is still at loggerheads with the IMF over the terms of a debt restructuring](#), just weeks ahead of a March debt payment the country can’t make. The key sticking point is the government’s refusal to balance its budget as rapidly as the IMF wants.

Venezuela: Opposition candidate Sergio Garrido [has dealt an embarrassing blow to President Maduro’s ruling Socialist Party](#) by winning an election in the state where former President Chávez was born and nurtured his “Bolivarian revolution.” The result vindicates those within the opposition who argue that they should take part in elections, even if they are skewed towards the Socialists.

COVID-19: Official data show confirmed cases [have risen to 310,645,175 worldwide, with 5,497,215 deaths.](#) In the U.S., confirmed cases rose to 61,558,507, with 839,500 deaths. (For an

interactive chart that allows you to compare cases and deaths among countries, scaled by population, click [here](#).) Meanwhile, in data on the U.S. vaccination program, [the number of people who have received at least their first shot totals 247,051,363](#). The data show that 74.4% of the U.S. population has now received at least one dose of a vaccine, and 62.6% of the population is fully vaccinated.

Virology

- Much of the Biden administration's vaccination mandate for larger employers [went into effect yesterday](#). The Supreme Court could halt the rule, but as of now, all employers with more than 100 employees must have a procedure in place to ensure employees are vaccinated and keep track of workers' vaccination status.
 - Employers must also track whether their workers are infected and keep those who test positive away from work. Workers who aren't vaccinated must wear a mask while indoors.
 - In December, the Labor Department gave employers an extra month to require that unvaccinated employees take weekly COVID-19 tests. That part of the policy goes into effect on February 9.
- In Chicago, city officials and the teacher's union [have resolved a walkout by educators over COVID-19 protocols](#). According to Mayor Lightfoot, the key to the agreement was setting a metric for how many infections would be needed to trigger a move to online instruction at individual schools. With the deal, Chicago students will be back in the classroom on Wednesday.
- In Japan, the government [said it would extend its near-total ban on foreigners entering the country until at least the end of February](#), citing the risk of the Omicron variant.
- In Mexico, President Andrés Manuel López Obrador yesterday [announced he has contracted COVID-19 a second time](#), making him one of the first major world leaders to contract the virus twice. Earlier in the day, he had held a two-hour press conference without a mask, despite saying he had cold-like symptoms and a cough. During the press conference, he talked about the importance of people assuming they were sick with COVID-19 if they had cold-like symptoms.

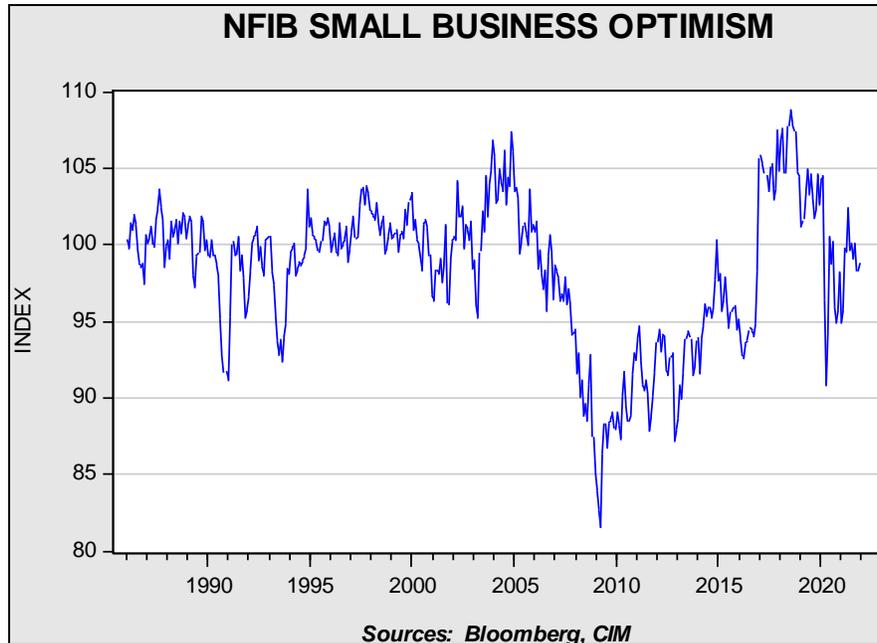
Economic and Financial Market Impacts

- Faced with the new wave of fast-spreading Omicron infections, a wide range of companies [is once again postponing the date when they expect their workers to return to the office](#). Although Omicron is expected to have a much less negative impact on the economy than earlier waves with their mass lockdowns, delayed back-to-office dates will cause further pain in certain areas, especially downtowns or office parks with many restaurants and other businesses geared toward serving office employees.

U.S. Economic Releases

Small business sentiment rose in December as small business owners expressed interest in expanding their payrolls and boosting investment spending. The NFIB Small Business Index

came in at 98.9, above expectations of 98.7 and the previous report’s reading of 98.4. Despite the rise in the index, small business owners were concerned about inflation and the lack of qualified applicants.



The chart above shows the level of the NFIB Small Business Optimism Index.

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

Economic Releases		
No economic releases today		
Fed Speakers or Events		
EST	Speaker or event	District or position
9:12	Loretta Mester on Bloomberg Television	President of the Federal Reserve Bank of Cleveland
9:30	Esther George Discusses Economic and Policy Outlook	President of the Federal Reserve Bank of Kansas City
10:00	Senate Banking Committee holds hearing on Powell Nomination	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.

	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$81.98	\$80.87	1.37%	Higher Demand
WTI	\$79.33	\$78.23	1.41%	
Natural Gas	\$4.03	\$4.08	-1.15%	
Crack Spread	\$20.43	\$20.30	0.62%	
12-mo strip crack	\$21.61	\$21.54	0.32%	
Ethanol rack	\$2.34	\$2.36	-0.84%	
Metals				
Gold	\$1,806.07	\$1,801.68	0.24%	
Silver	\$22.53	\$22.47	0.28%	
Copper contract	\$438.40	\$435.20	0.74%	
Grains				
Corn contract	\$603.25	\$599.75	0.58%	
Wheat contract	\$765.25	\$762.00	0.43%	
Soybeans contract	\$1,386.75	\$1,384.75	0.14%	
Shipping				
Baltic Dry Freight	2,277	2,289	-12	
DOE inventory report				
	Actual	Expected	Difference	
Crude (mb)		-1.7		
Gasoline (mb)		3.1		
Distillates (mb)		1.7		
Refinery run rates (%)		-0.20%		

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)	24	23	1	Down
3-mo T-bill yield (bps)	9	11	-2	Neutral
TED spread (bps)	15	12	3	Neutral
U.S. Libor/OIS spread (bps)	16	16	0	Down
10-yr T-note (%)	1.76	1.76	0.00	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	Down			Neutral
Pound	Up			Neutral
Franc	Up			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.

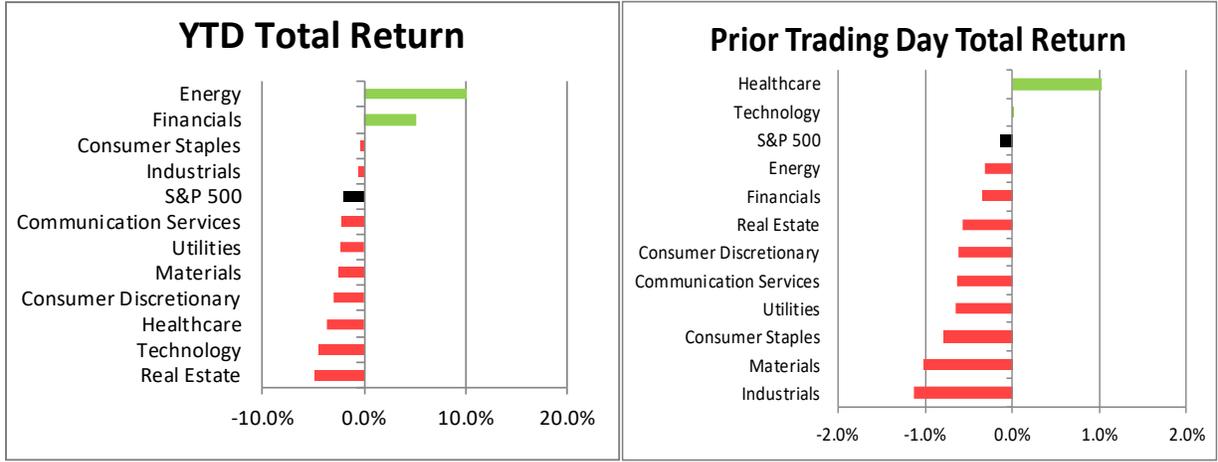
	Price	Prior	Change	Explanation
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Shipping				
Baltic Dry Freight	2,277	2,289	-12	

Weather

The 6-10 day and 8-14-day forecasts currently call for warmer-than-normal temperatures throughout the West Coast, the Rocky Mountains, the Great Plains, and the Southwest, with cooler-than-normal temperatures in the eastern third of the country. The forecasts call for wet conditions for most of the country, with dry conditions on the West Coast.

Data Section

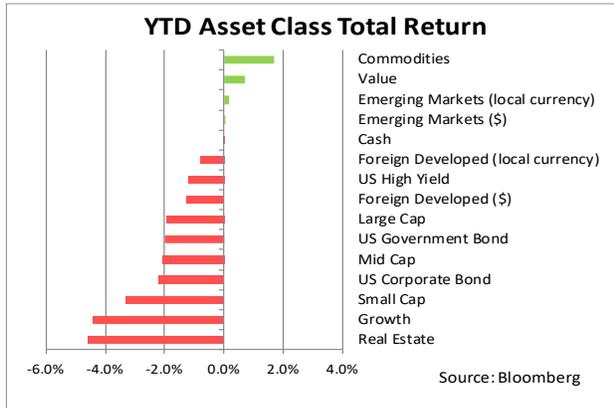
U.S. Equity Markets – (as of 1/10/2022 close)



(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 1/10/2022 close)

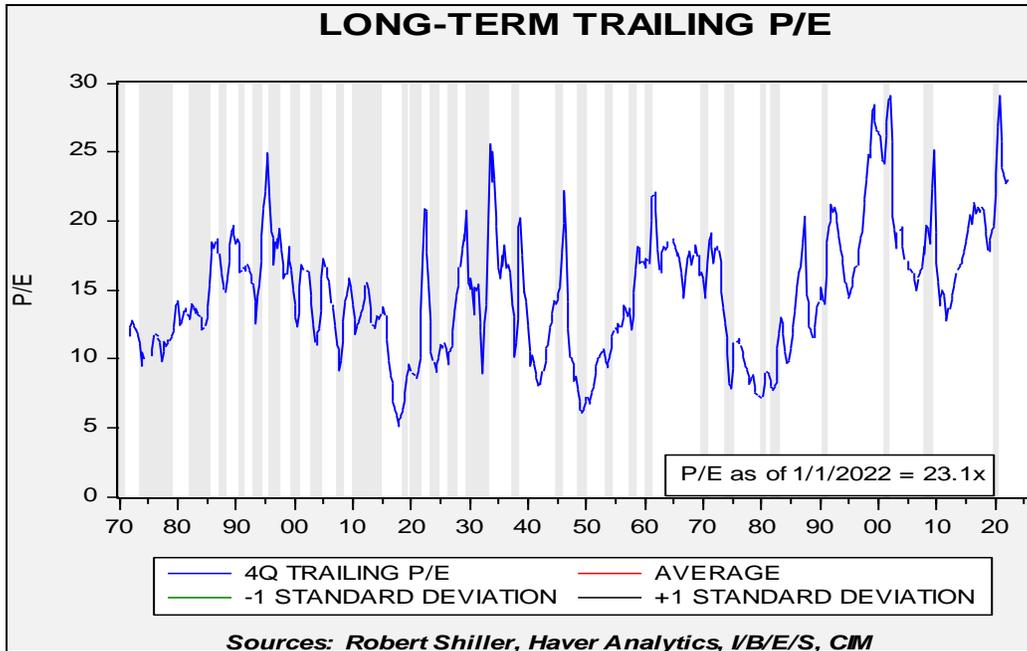


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.