

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 20, 2021—9:30 AM EST] Global equity markets are higher this morning. The EuroStoxx 50 is up 0.4% from its last close. In Asia, the MSCI Asia Apex 50 is up 1.4%. Chinese markets were higher with the Shanghai Composite up 0.5% from the prior close, and the Shenzhen Composite up 1.4%. U.S. equity index futures are signaling a higher open. With 36 companies having reported, the S&P 500 Q4 earnings stand at \$38.30, higher than the \$37.94 forecast for the quarter. The forecast reflects a 9.7% decrease from Q4 2019 earnings. Thus far this quarter, 94.4% of the companies have reported earnings above forecast, while 5.6% have reported earnings below forecast.

Our *Comment* today opens with U.S. political news related to Joe Biden's inauguration as president today. We next turn to overseas news, focusing mostly on Chinese and Japanese developments. As always, we end with a discussion of the latest on the coronavirus pandemic.

U.S. Politics: As Joe Biden prepares to be inaugurated today, Republican Senate leader Mitch McConnell and Democratic Senate leader Chuck Schumer are [negotiating a power-sharing deal](#) regarding how to operate the evenly-divided Senate. The main stumbling block appears to be the filibuster, which some Democrats want to eliminate, but McConnell has vowed to preserve it.

- In his Senate confirmation hearing, Secretary of State nominee Tony Blinken found common ground with many key Republicans by [striking a hard line on China](#). In his testimony, Blinken said he supports Tuesday's finding by Mike Pompeo, the current Secretary of State, that China has committed genocide in Xinjiang with its policies toward the Uighur ethnic group. He also backed military and global diplomatic support for Taiwan as it faces pressure from Beijing.
- In addition, Blinken questioned the future of Hong Kong as a center for global businesses, and he echoed President Trump and others in criticizing China for misleading the world about the origin of the coronavirus pandemic and contributing to its spread.

China-Australia: Not only has China's retaliatory ban against Australian coal upended global trade flows of the commodity, as we've reported previously, but it now appears that coal [shippers are being forced to wait out the dispute](#). The flotilla of coal carriers sitting outside Chinese ports has grown to some 65 vessels, and one vessel has been waiting outside port since May of last year.

China: Technology entrepreneur Jack Ma [resurfaced in a public video](#) for the first time since late autumn, after angering Chinese officials by pushing back against financial regulations and

was punished by having his IPO of fintech firm Ant Financial scuttled. Ma's reappearance has been positive for Chinese tech stocks so far today, as it provides reassurance that his firms won't be nationalized, and that there may be a limit to how strongly the government wants to punish him for his pushback against their policies.

Japan: New rules at the Tokyo Stock Exchange and more aggressive guidelines by proxy advisors are [threatening to force a massive unwinding of companies' cross-shareholding networks](#) by a deadline of March 31. Although businesses will probably try to water down the rules before then, the approaching deadline could produce volatility in Japanese equities over the coming two months.

- Cross-shareholdings are interconnected portfolios of ownership, where listed Japanese companies own shares in each other, which protect underperforming managements with a cushion of automatic investor support.
- Although cross-holdings have been in decline since a peak in the 1990s, companies justify them as necessary to "maintain business relationships." This infuriates fund managers who view such webs as a recipe for complacency, low returns on equity, and poor governance.

European Union: EU Competition Chief Margrethe Vestager [warned large technology firms that it would be better to work with the EU on developing new digital market rules](#) since failure to do so would lead to a complex patchwork of different rules in each country.

Italy: Prime Minister Conte [narrowly won his vote of confidence](#) in the country's Senate yesterday. However, the vote still left Conte's government severely weakened after the party of the former prime minister pulled out of the ruling coalition last week.

Russia: The Kremlin [reiterated its commitment to extending the New START nuclear arms-control treaty with the U.S.](#), saying it would welcome efforts promised by the administration of U.S. President-Elect Biden to reach an agreement on the last remaining major nuclear arms pact between the two countries.

COVID-19: Official data show confirmed cases [have risen to 96,284,292 worldwide, with 2,060,232 deaths](#). In the United States, confirmed cases rose to 24,256,319, with 401,797 deaths. [Vaccine doses distributed in the U.S. now total 31,161,075, while the number of people who have received at least their first shot totals 13,595,803](#). Finally, here is the [interactive chart](#) from the *Financial Times* that allows you to compare cases and deaths among countries, scaled by population.

Virology

- Newly confirmed U.S infections [totaled about 168,000 yesterday](#), although that was still significantly lower than one week ago. Just as important, the number of hospitalizations related to the virus edged down to 123,820, including 23,029 in intensive care. On a less positive note, the number of daily deaths rose back above 2,500.

- In China, health authorities [have ramped up their efforts to contain a resurgence of cases](#). As the country faces its worst flare-up since the pandemic first exploded there early last year, cities across the northern provinces of Hebei, Heilongjiang, and Jilin have built temporary quarantine facilities, imposed lockdown measures on millions of residents, and rolled out rounds of citywide testing.
- In the U.K., the government [remains on track to meet its goal of vaccinating 15 million of its most vulnerable citizens by mid-February](#). The apparent success of the program to date is due in part to its reliance on the homegrown vaccine from Oxford University and AstraZeneca (AZN, 52.57), which is easier to store and handle than some rival vaccines.
- A study by German researchers found that the vaccine developed by Pfizer (PFE, 36.73) and BioNTech (BNTX, 104.70) [is equally effective against all known mutations](#), including the rapidly transmitting mutation in the U.K. Since the news could help ease concerns about vaccine effectiveness, it should be positive for risk assets.
- As major developed countries prioritize acquiring vaccine doses for their own people and contribute little to the WHO program for poorer countries, [China is ramping up its vaccine diplomacy](#). Foreign Minister Wang Yi pledged last week to hand out more than a million doses of Chinese vaccines during a swing through Southeast Asia.

Economic and Political Impacts

- According to Boston College's Center for Retirement Research, the economic and financial impacts of the pandemic [only had a modest negative impact on American's retirement security](#). Even though many workers lost jobs or income last year, the difference was made up partially by the strong stock prices. As a result, the Center estimates that 51% of workers aged 30 to 59 are in danger of not being able to maintain their standard of living in retirement, up just a bit from 49% in the previous year.

U.S. Policy Response

- In her confirmation hearing before the Senate Finance Committee yesterday, Treasury Secretary-Nominee Janet Yellen [argued forcefully for President-Elect Biden's proposed \\$1.9 trillion pandemic relief proposal](#), as anticipated. That aspect of her testimony was probably behind much of the rise in equities yesterday. However, it's notable that she also signaled the Biden Administration will continue to take a tough line on China's aggressive trade policies. In a sign that U.S.-China economic tensions could well continue, she promised to use the "full array" of U.S. policy tools to address China's unfair trade practices and low labor and environmental standards.
- According to the Small Business Administration, roughly 60,000 borrowers were [approved for more than \\$5 billion in forgivable loans](#) during the first week of the reopened Paycheck Protection Program, which was relaunched on January 11.

Foreign Policy Response

- In Europe, strong central bank-bond buying [is helping support property-backed debt](#), but it is also raising concerns that it is distorting the market and causing long-term risks.

U.S. Economic Releases

For the week ending January 15, mortgage applications fell 1.9% from the prior week. Home purchase applications rose 2.7% from the prior week, while applications for refinancing fell 4.7%. The average 30-year fixed-rate mortgage rose 4 bps from 2.88% to 2.92%.

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

Economic Releases						
EDT	Indicator			Expected	Prior	Rating
10:00	NAHB Housing Market Index	m/m	Jan	86	86	**
Fed speakers or events						
No speakers or events scheduled						

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								
China	1-Year Loan Prime Rate	w/w	20-Jan	3.9%	3.9%	3.9%	**	Equity and bond neutral
	5-Year Loan Prime Rate	w/w	20-Jan	4.7%	4.7%	4.7%	**	Equity and bond neutral
Japan	Convenience Store Sales	y/y	Dec	-4.0%	-2.2%		**	Equity and bond neutral
Australia	Westpac Consumer Conf SA	m/m	Jan	-4.5%	4.1%		***	Equity bullish, bond bearish
Europe								
Eurozone	CPI	y/y	Dec	-0.3%	-0.3%	-0.3%	***	Equity and bond neutral
	CPI Core	y/y	Dec	0.2%	0.2%	0.2%	***	Equity and bond neutral
Germany	PPI	y/y	Dec	0.8%	0.2%	0.3%	**	Equity bullish, bond bearish
UK	CPI	y/y	Dec	0.6%	0.3%	0.5%	***	Equity bullish, bond bearish
	CPI Core	y/y	Dec	1.4%	1.1%	1.3%	***	Equity and bond neutral
	RPI	y/y	Dec	1.2%	0.9%	1.2%	**	Equity and bond neutral
	RPI Ex Mort Int. Payments	y/y	Dec	1.4%	1.1%	1.3%	**	Equity and bond neutral
	PPI Output NSA	y/y	Dec	-0.4%	-0.8%	-0.6%	**	Equity and bond neutral
	PPI Input NSA	y/y	Dec	0.2%	-0.5%	0.5%	**	Equity and bond neutral
	House Price Index	y/y	Nov	7.6%	5.4%	5.6%	**	Equity and bond neutral
Russia	Current Account Balance	q/q	4Q	5500m	3181m	8800m	**	Equity and bond neutral
	Consumer Confidence Index	q/q	4Q	-26.0	-22.0		***	Equity and bond neutral
AMERICAS								
Canada	Wholesale Trade Sales	m/m	Nov	0.70%	1.00%	1.00%	***	Equity bearish, bond bullish
	Manufacturing Sales	m/m	Nov	-0.6%	0.3%	-0.4%	**	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.

	Today	Prior	Change	Trend
3-mo Libor yield (bps)	22	22	0	Down
3-mo T-bill yield (bps)	7	8	-1	Neutral
TED spread (bps)	15	14	1	Up
U.S. Libor/OIS spread (bps)	8	8	0	Up
10-yr T-note (%)	1.10	1.09	0.01	Neutral
Euribor/OIS spread (bps)	-55	-55	0	Neutral
EUR/USD 3-mo swap (bps)	5	4	1	Down
Currencies	Direction			
dollar	Flat			Down
euro	Flat			Up
yen	Up			Up
pound	Up			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.

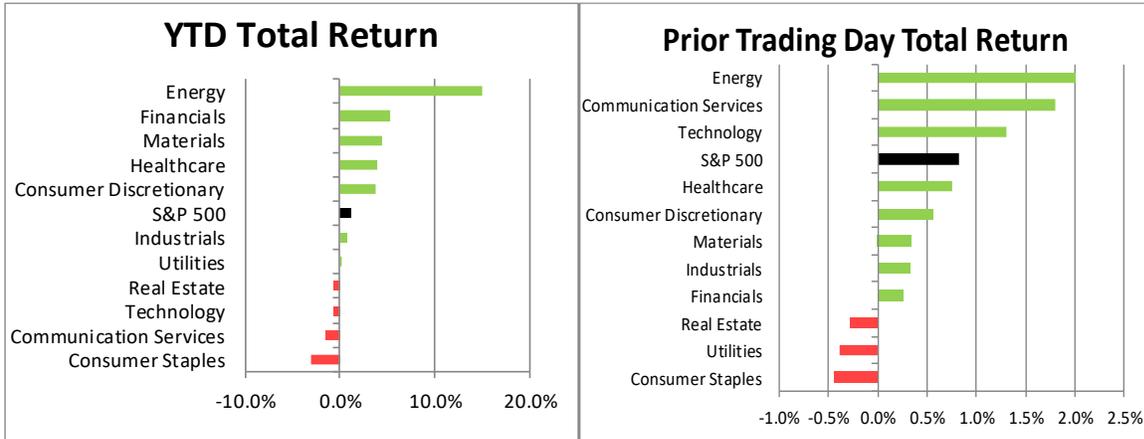
	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$56.35	\$55.90	0.81%	
WTI	\$53.53	\$52.98	1.04%	
Natural Gas	\$2.47	\$2.55	-3.10%	
Crack Spread	\$12.25	\$12.44	-1.54%	
12-mo strip crack	\$14.05	\$14.12	-0.50%	
Ethanol rack	\$1.66	\$1.67	-0.42%	
Metals				
Gold	\$1,853.80	\$1,840.28	0.73%	
Silver	\$25.41	\$25.22	0.73%	
Copper contract	\$365.25	\$363.35	0.52%	
Grains				
Corn contract	\$514.25	\$526.00	-2.23%	
Wheat contract	\$661.25	\$672.25	-1.64%	
Soybeans contract	\$1,358.75	\$1,385.75	-1.95%	
Shipping				
Baltic Dry Freight	1766	1740	26	
DOE inventory report				
	Actual	Expected	Difference	
Crude (mb)		-1.3		
Gasoline (mb)		2.6		
Distillates (mb)		1.6		
Refinery run rates (%)		-0.50%		

Weather

The 6-10 and 8-14 day forecasts currently call for cooler than normal temperatures on the West Coast and throughout the Intermountain West, with warmer temperatures along the Gulf Coast. Wetter than normal conditions are expected on the West Coast and throughout the Midwest and South, with dry conditions expected in Texas and Florida.

Data Section

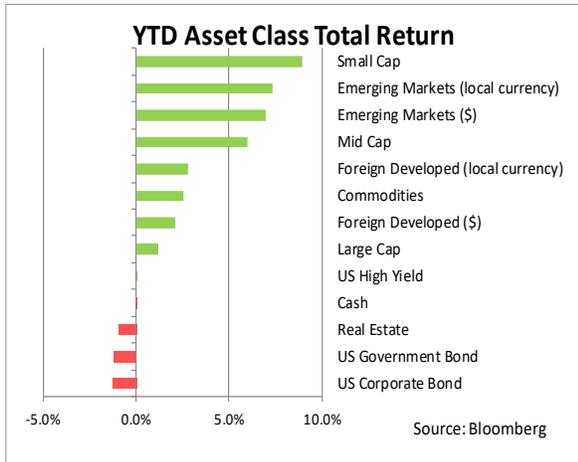
U.S. Equity Markets – (as of 1/19/2021 close)



(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 1/19/2021 close)

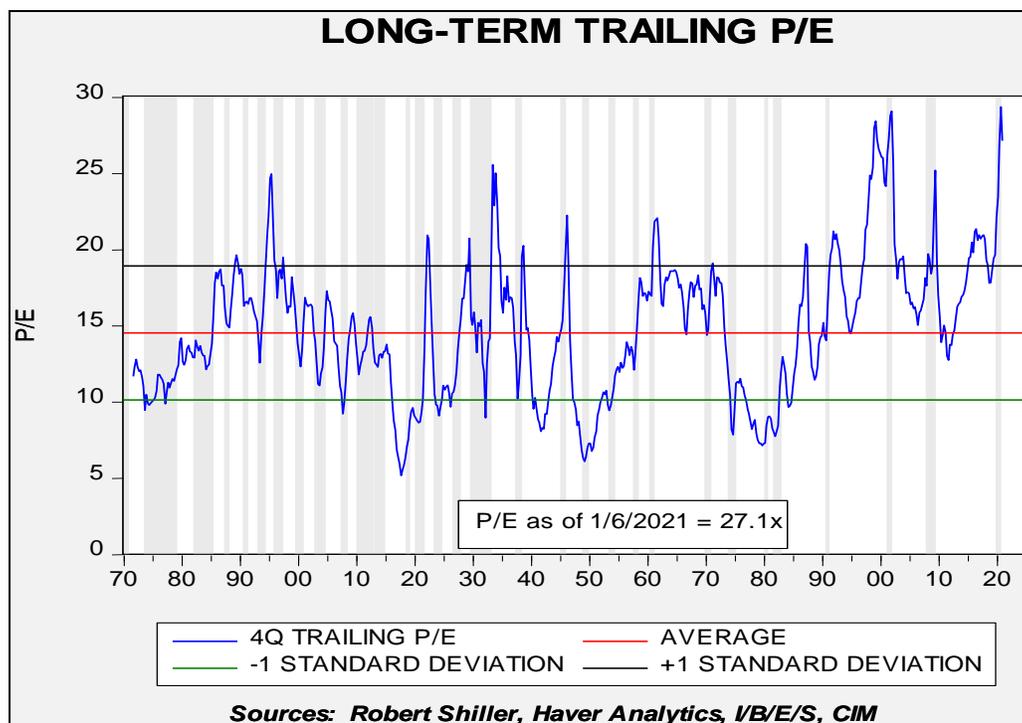


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 14, 2021



Based on our methodology,¹ the current P/E is 27.1x, up 0.3x from last week. Higher equity values accounted for the expansion.

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.