

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 21, 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 1.0%. Chinese markets were higher with the Shanghai Composite up 1.1% from the prior close and the Shenzhen Composite up 1.5%. U.S. equity index futures are signaling a higher open. With 45 companies having reported, the S&P 500 Q4 earnings stand at \$38.50, higher than the \$37.94 forecast for the quarter. The forecast reflects a 9.7% decrease from Q4 2019 earnings. Thus far this quarter, 93.3% of the companies have reported earnings above forecast, while 4.4% have reported earnings below forecast.

Good morning. [U.S. equity futures are higher this morning](#). The ECB meets today and leads off our coverage. A recap of President Biden's first day follows. There is a plethora of news out of China. A pandemic update follows, with a roundup of economic and international news to wrap up our comments. Due to the Monday holiday (which delays the weekly DOE data), the Weekly Energy report will be published tomorrow along with a new Asset Allocation Weekly report, podcast and, chart book. The current [Asset Allocation Weekly](#) is available.

ECB: The statement held no surprises—the ECB kept rates unchanged and will continue to absorb bonds at the current pace. Policy looks to remain in place at least into 2023. Nothing new emerged in the press conference. Although nothing changed, financial markets took the statement as hawkish (bond yields rose, and the EUR appreciated) probably because nothing new was unveiled.

Biden: One of the concerns we have registered is that a deeply divided nation is leading to government by executive order and thus notable swings in policy. Yesterday was a prime example. On his first day, President Biden issued a [flurry of executive orders](#), reversing some of President Trump's policies. These swings complicate long-term investing for business. Here are some highlights:

- The U.S. [returned to the Paris Accord](#).
- The [moratorium on student loans and evictions](#) was extended.
- Several orders were [tied to dealing with the pandemic](#). This includes using the [Defense Production Act](#) to direct the production of goods, e.g., PPE.

We also note the incoming administration is proposing a [first-time homebuyer tax credit of \\$15 thousand](#), which would offer down payment assistance. This is potentially a big deal. As we noted in recent AAW's and our 2021 Outlook, for the bottom 90% of households by income,

their largest asset is their home. Supporting home values and encouraging home building could boost the wealth of this majority of households and increase construction jobs. We have been looking for policies of this sort. If this policy is adopted, we would expect a couple of other measures to emerge:

- Yield curve control will probably become necessary. Part of housing affordability is keeping mortgage rates under control, and the most effective way to do this is to cap the 10-year Treasury note yield. Our guess is that somewhere between 1.25% to 1.50% the FOMC will move to try to cap further increases.
- The recent trend of build-to-let for single-family homes may be threatened. Some of the demand for single-family home rentals may be from risk-averse households who simply don't want to take the risk of a mortgage. But, if this trend is driven by the lack of a down payment, the aforementioned policy might address that and boost homeownership further.
 - An important element of expanding homebuilding will be local zoning. There are situations where it is difficult to increase the home supply due to regulations. These will need to be addressed.
 - It will be difficult to expand suburbs without allowing some degree of work from home. In many urban areas, we are probably near the limits of suburban expansion if jobs require a daily commute. However, if the commute is less, it is conceivable that living "further out" becomes possible.

To wrap up, the [EU is welcoming the new president](#); although the contrast with the outgoing government is clear, we expect conflicts to return rather quickly. We also expect [the business community to push back against tax increases and the minimum wage](#). That doesn't mean that no tax increases will come. We expect them to be less than some expect (for example, if the individual rate rises, look for the SALT deductions to return). Also, some phase-in on the minimum wage would not be a shock. And finally, we are seeing [continued evidence that fiscal deficits don't trigger inflation](#). Why? IOHO, the relationship between income inequality and inflation is probably the key element. Fiscal and monetary policy stimulus is less inflationary under conditions of high inequality. In fact, the more likely outcome (especially from monetary stimulus) is asset price inflation.

China: The Xi government [appears happy to see Trump go](#). That doesn't mean they will give Biden any slack.

- As a parting shot, [China imposed personal sanctions](#) on members of the outgoing administration, including Peter Navarro and Mike Pompeo.
- [Jack Ma](#) is back; he [participated in a videoconference](#), a sort of "[proof of existence](#)" event.
 - Although Jack may be back, Ant Financial is probably facing a much more adverse regulatory environment going forward as [Chinese regulators try to take control of the shadow banking system](#).
- One way Beijing is working to divide the U.S. is through supporting the American business community. During the Cold War, the Soviets had limited ability to use the business community to create inroads. But the U.S. and Chinese economies are deeply

integrated, and business has an interest in maintaining ties. We note that President Xi directly [contacted Howard Schultz](#), the chairman emeritus of Starbucks (SBUX, USD, 105.58) in a bid to improve relations.

- Despite this attempt to woo the business community, [the Commerce Department has issued new powers](#) to block Chinese technology, making Beijing's outreach more difficult.
- One of the last acts of the outgoing Trump administration [was to further restrict the exports of technology to Huawei](#) (002502, CNY, 2.62). This administration also asked the [government to minimize procurement](#) from Chinese sources. Although these rules could be reversed by the new Biden administration, we doubt it will be a high priority.
- During the Cold War, countries tended to play off the Americans and the Soviets for aid and support. We note that [Ecuador negotiated a deal to use U.S. loans to repay Chinese debt](#). In exchange, Quito will outlaw the use of Chinese equipment in its telecom networks. This arrangement is politically controversial in Ecuador, pitting followers of former president Rafael Correa, who negotiated the loans with China, against current president Lenin Moreno.
- [Chinese investors are purchasing shares of companies that were blacklisted](#) by the U.S., and [Chinese telecoms](#) that were blacklisted [are seeking to be relisted on the NYSE](#).
- China is [tightening rare earth regulations](#), which will affect the entire supply chain. This is a potential threat to numerous high-tech items, from smartphones to electric vehicles.
- [Ely Ratner will be the new administration's Pentagon expert on China](#).
- Zoom Video Communications (ZM, USD, 382.80) has become ubiquitous during the pandemic. Here is some sobering news about the company. [The DOJ has issued a complaint against Jin Xinjiang, a former executive at the firm, for using the tool to surveil and disrupt users](#).
- The [strong CNY is reportedly putting pressure on Chinese exporters](#).
- [Although China's Q4 GDP was remarkable](#), the high growth rate was mostly a function of state-led investment and exports, the formula that has been a key element of growth for this century. [Michael Pettis described the process](#). [Consumers, on the other hand, didn't participate to the same degree](#).

COVID-19: The [number of reported cases](#) is 96,958,794 with 2,077,332 fatalities. In the U.S., there are 24,439,427 confirmed cases with 406,162 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 39,990,150 doses of the vaccine have been distributed, with 14,270,441 doses injected. The number of second doses, which would grant the highest level of immunity, is 2,161,419. The [number of vaccinations to 100 people for the world is available here](#); Israel is the world's front-runner. [The R_t data](#) shows dramatic improvement, as does the [Axios state chart](#). The next challenge will be when the U.K./South African variant becomes more common in the U.S. Both variants spread faster and could lead to another surge in the coming weeks.

Virology

- [Another COVID-19 variant has emerged in Germany](#) and is different from those recently isolated in South Africa and the U.K. Little is known about its characteristics, but we will continue to monitor it.
 - Meanwhile, laboratory studies suggest the BioNTech (BNTX, USD, 103.23)/Pfizer (PFE, USD, 36.50) [vaccine is effective against recent variants](#).
 - [The EU is accusing](#) the aforementioned companies of shortchanging its vaccine deliveries.
- [China has reported its first COVID-19 fatality since May](#). The country is facing new outbreaks just before the New Year's travel season. Authorities are trying to encourage citizens to avoid travel, but that will be difficult to execute. Some [local governments are resorting to paying workers](#) to stay in place. In response to higher case rates, [China built a hospital, reportedly in five days](#). [New quarantine facilities are being constructed as well](#). It is not clear whether or not this new surge is tied to the U.K./South African variants.
 - China is continuing its efforts to [discredit ideas that COVID-19 originated in Wuhan](#) and is trying to [discredit Western vaccines](#).
- Although we report case and fatality data regularly, we acknowledge that the data is less than perfect. [Data from the emerging world is especially suspect](#).
- Brazil is using the Chinese vaccine but is [finding it difficult to source key parts of the product](#).
- [Iraq has decided it has achieved herd immunity](#); there isn't strong evidence to confirm this idea, but Iraqis are returning to pre-pandemic behavior. If the country hasn't achieved herd immunity, the new behaviors could lead to rising infection rates.
- Venezuela, experiencing profound economic problems, scored something of a public relations coup [by sending oxygen to Brazil](#), which is facing a deep shortage of the gas due to COVID-19 issues. The Bolsonaro administration was not amused.
- The Netherlands has [implemented curfews and has barred flights from Britain](#), South Africa, and from most South American nations in a bid to reduce the spread of the emerging variants.

Policy and Economics: As we noted last week, President-elect Biden has floated a \$1.9 trillion spending package. We suspect much of it will be passed, although some of the more controversial measures, i.e., minimum wage increase, might be phased in or separated from the bill. We view every action by a new government as the spending of political capital. Biden using his political capital in this manner is a good sign. There can be quibbles about what and how money should be spent. In an economy that remains well below its long-term trend, going big early makes sense. However, this action will reduce the chances of other agenda items getting passed.

- One way to look at the gap that fiscal spending could address is the unpaid rent situation. In NYC alone, [it is estimated that there is \\$1 billion of unpaid rent](#). This is a classic funding chain problem. If the renter can't pay, the landlord can evict, but that action won't allow the landlord to become current on whatever mortgage is held. Giving

households cash will give them at least some ability to reduce the unpaid rent and allow payment flows to resume. Essentially, fiscal spending provides a public borrowing mechanism to prevent the rental market from seizing.

- One unresolved issue of the Great Financial Crisis is the situation with Fannie Mae (FNMA, USD, \$1.870) and Freddie Mac (FMCC, USD, 1.86). The mortgage guarantors were taken over by the government during the crisis and have remained in government control since. [The FHFA wanted to return the two back to private control but was never able to execute the transaction](#). Under the incoming administration, we suspect the status quo will continue. One change was that the [two companies will be able to keep their earnings](#) for now.
- Housing markets remain active, but one of the reasons home prices are strong is that [Americans are moving less](#). An aging population, the potential for remote work, and the pandemic have led to a rise in the average holding period of a home to 13 years.
- There are [widespread reports](#) of [semiconductor shortages](#) in the global auto industry. [European automakers](#) are facing a short-term supply problem, whereas [China's industry](#) may be dealing with a much longer-term situation due to trade restrictions.
- A series of problems, from misallocated shipping containers to vessels that are too large for the deglobalizing world, are [creating bottlenecks and boosting shipping prices](#). Here is a recent [podcast](#) we would recommend on this issue.
- Tyson Foods (TSN, USD, 66.25) [has settled price-fixing claims](#) in the chicken market.
- LIBOR is expected to be completely phased out by mid-2023, but there are worries that old loan contracts may retain their rate (and may end up fixing the rate for the life of the loan when LIBOR expires). [New York state is proposing legislation](#) that could become a model for national regulation.
- Here is a case of unintended consequences. New entrants into an industry can have a disruptive effect on the industry. Perhaps no industry was more primed for disruption than the men's shaving market. The industry was a duopoly that created increasingly complicated high-priced productions. Harry's entered the market in 2013; initially, it used a direct to consumer model but eventually went into retail distribution. Their products were popular and began to take market share from the dominant participants. In 2019, Edgewell Personal Care (EPC, USD, 34.19), the owner of Schick, approached the company for a buyout. Interestingly enough, the [FTC blocked the sale](#).
 - From a pure industrial organization perspective, this makes sense. Harry's was adding competition to the industry, and being purchased by one of the duopolists defeats the point of competition.
 - However, from a financial market's perspective, this decision is a problem. Venture capital firms have fund disrupters like these with the idea of a payoff at some point. The buyout is one of the ways for that to occur. The other is to go public. The FTC is signaling that buyouts may be a problem, leaving only one real avenue for the initial backers to get rewarded.
 - If this becomes a broad FTC policy, it could have the perverse effect of discouraging the initial investment in startups. There may be cases where going

public isn't the preferred option. Therefore, this outcome could actually decrease new entrants and reduce future competition.

International roundup:

- Thailand has strict lèse-majesté laws that can punish individuals who criticize the royal family. A former government worker who shared an audio clip that was critical of the king on social media was [sentenced to 43 years in prison](#), the longest sentence for violating this law in Thailand's history. The harshness of the sentence reflects the deep unpopularity of the king, who is facing protests.
- As we noted earlier this week, [Japan is considering regulatory changes](#) that would reduce cross-holdings. The impact on stock is still uncertain prices, but ending cross-holdings should improve governance.
- The European Commission published a report on the economic and financial system of the EU and suggested it wants to expand the "[international role of the euro.](#)" Despite having this goal for some time, the EUR remains a minor reserve currency. Although the recent decision to issue a Eurobond is important in expanding the reserve role, the biggest hurdle is Germany. For the EUR to become a true reserve currency in a fiat system, the Eurozone would need to start running persistent current account deficits (otherwise, the supply of the currency to global markets would decline), and Germany has no interest.
- [European banks are facing a serious risk from small businesses.](#) The pandemic has hurt small businesses, and it is highly likely that they will face rising loans in default.

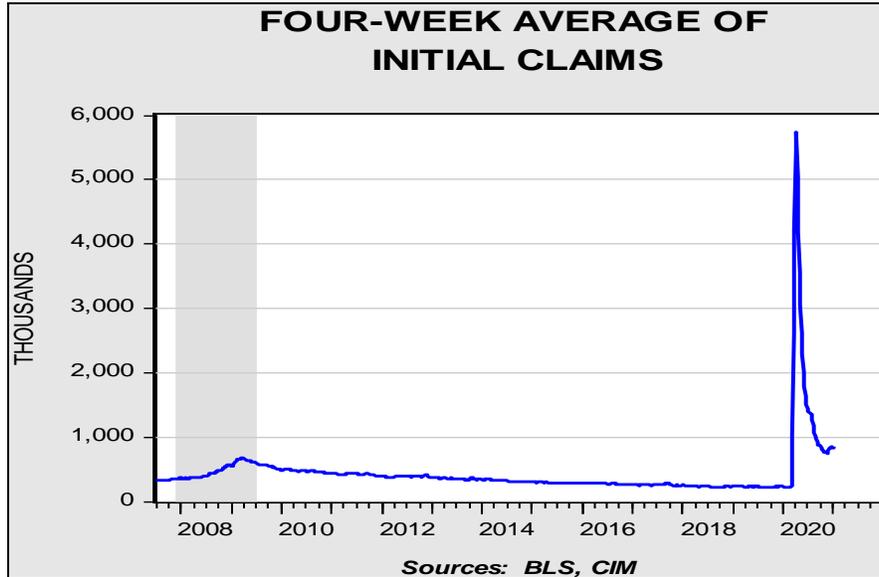
U.S. Economic Releases

A surge in the construction of single-family homes led to a stronger than expected rise in housing starts, which expanded at an annualized pace of 1.669MM, up 5.4% from the prior month. Meanwhile, building permits expanded at an annualized rate of 1.709MM, up 4.5% from the previous month. Both building permits and housing starts were well above estimates of 1.560MM and 1.608MM, respectively.



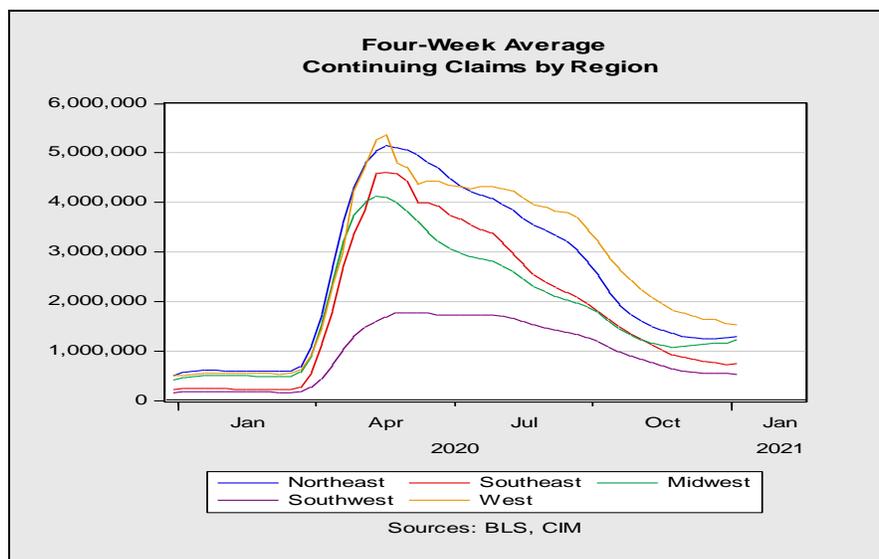
The chart above shows the annualized change in housing starts for single and multi-family homes. Single-family homes expanded at an annualized rate of 1.338MM, while multi-family homes expanded at an annualized rate of 0.338MM. The rise in single-family homes is likely a result of an increase in demand due to near-record-low interest rates.

For the week ending January 16, initial claims came in below expectations at 900K compared to estimates of 935K. The prior month's report of 965K was revised downward to 926K.



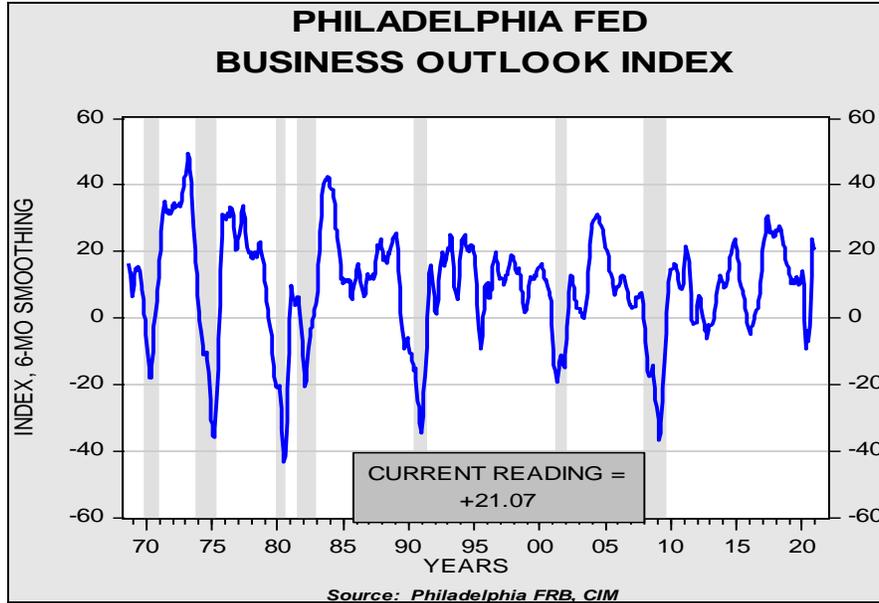
The chart above shows the four-week moving average of initial jobless claims.

For the week ending January 9, continuing claims came in at 5.054MM compared to expectations 5.300MM. The prior report was revised from 5.181MM to 5.271MM.



The chart above shows the four-week moving average of continuing claims by region.

An overall improvement in the index led to an increase in the Philadelphia Fed Business Outlook in January. The index came in at 26.5, well above expectations of 11.8. The prior month's report was revised downward from 11.1 to 9.1.



The chart above shows the six-month moving average of the Philadelphia Fed Business Outlook.

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

Economic Releases						
EDT	Indicator			Expected	Prior	Rating
9:45	Bloomberg Consumer Comfort	m/m	Jan		38.5	**
9:45	Bloomberg Economic Expectations	w/w	17-Jan		43.2	**
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	Swift Global Payments CNY	m/m	Dec	1.9%	2.0%		**	Equity and bond neutral
Japan	Trade Balance	m/m	Dec	¥751.0b	¥366.8b	¥930.5b	**	Equity bearish, bond bullish
	Japan Buying Foreign Stocks	w/w	15-Jan	-¥37.7b	¥282.9b		*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	15-Jan	¥272.4b	¥730.7b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	15-Jan	¥169.9b	¥580.8b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	15-Jan	¥548.4b	-¥245.0b		*	Equity and bond neutral
	Supermarket Sales	y/y	Dec	2.7%	1.2%		**	Equity bullish, bond bearish
	Machine Tool Orders	y/y	Dec	9.9%	8.7%		**	Equity bullish, bond bearish
Australia	Consumer Inflation Expectation	m/m	Jan	3.4%	3.5%		*	Equity and bond neutral
	Participation Rate	m/m	Dec	66.2%	66.1%	66.2%	**	Equity and bond neutral
	Employment Change	m/m	Dec	50.0k	90.0k	50.0k	**	Equity and bond neutral
	Unemployment Rate	m/m	Dec	6.6%	6.8%	6.7%	***	Equity and bond neutral
New Zealand	Net Migration SA	m/m	Nov	672	884		**	Equity and bond neutral
	Non Resident Bond Holdings	m/m	Dec	49.9%	49.7%		**	Equity and bond neutral
Europe								
France	Business Confidence	m/m	Jan	92	91	92	**	Equity and bond neutral
	Manufacturing Confidence	m/m	Jan	98	93	94	**	Equity bullish, bond bearish
	Production Outlook Indicator	m/m	Jan	-9	-4	-3	**	Equity and bond neutral
	Own-Company Production Outlook	m/m	Jan	7	1	2	**	Equity bullish, bond bearish
	Business Survey Overall Demand	m/m	Jan	2	6		**	Equity and bond neutral
Italy	Industrial Orders	m/m	Nov	-1.3%	3.0%		**	Equity and bond neutral
	Industrial Sales	m/m	Nov	-2.0%	2.2%		**	Equity and bond neutral
UK	CBI Trends Total Orders	m/m	Jan	-38	-25	-35	**	Equity bearish, bond bullish
	CBI Trends Selling Prices	m/m	Jan	4	0		**	Equity and bond neutral
	CBI Business Optimism	m/m	Jan	-22	0		**	Equity and bond neutral
Switzerland	Money Supply M3	y/y	Dec	6.5%	5.7%		**	Equity bearish, bond bullish
Russia	Budget Balance YTD	m/m	Dec	-4101.8b	-2511.7b	-3625.0b	***	Equity and bond neutral
AMERICAS								
Canada	Teranet/National Bank HPI	m/m	Dec	0.60%	0.90%		**	Equity and bond neutral
	CPI	y/y	Dec	0.7%	1.0%	1.0%	***	Equity and bond neutral
Mexico	ANTAD Same-Store Sales	y/y	Dec	-6.2%	2.6%		**	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	15	0	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)	-54	-55	1	Neutral
EUR/USD 3-mo swap (bps)	4	5	-1	Down
Currencies	Direction			
dollar	Down			Down
euro	Up			Up
yen	Up			Up
pound	Up			Up
franc	Up			Up
Central Bank Action	Current	Prior	Expected	
Bank of Canada Rate Decision	0.250%	0.250%	0.250%	On forecast
ECB Marginal Lending Facility	0.250%	0.250%	0.250%	On forecast
ECB Deposit Facility Rate	-0.500%	-0.500%	-0.500%	On forecast
ECB Main Refinancing Rate	0.000%	0.000%	0.000%	On forecast
BOJ Policy Balance Rate	-0.100%	-0.100%	-0.100%	On forecast
BOJ 10-Yr Yield Target	0.000%	0.000%	0.000%	On forecast
RBA FX Transactions Government	-A\$1283m	-A\$1436m		On forecast
RBA FX Transactions Market	A\$1254m	A\$1394m		On forecast
RBA FX Transactions Other	A\$1534m	A\$1m		On forecast

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.

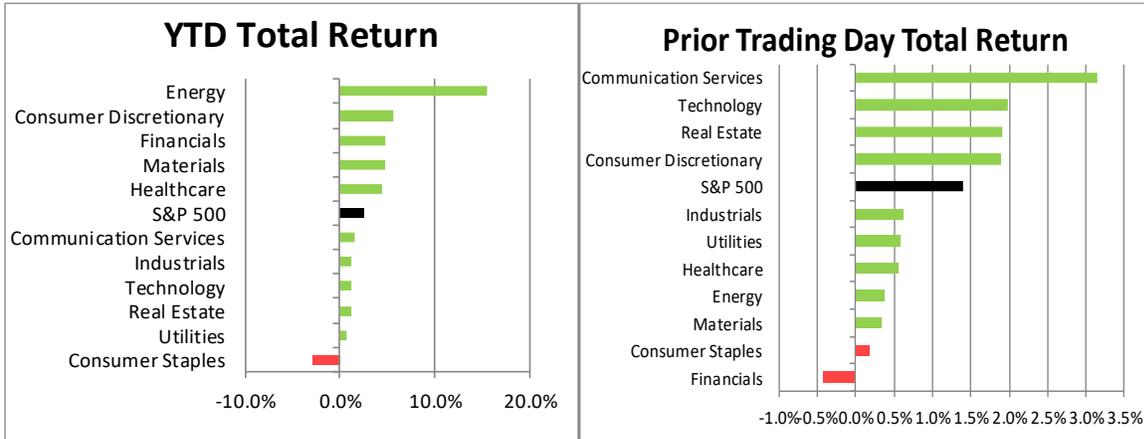
	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$55.76	\$56.08	-0.57%	
WTI	\$53.00	\$53.31	-0.58%	
Natural Gas	\$2.48	\$2.54	-2.21%	
Crack Spread	\$12.30	\$12.24	0.49%	
12-mo strip crack	\$14.10	\$13.99	0.79%	
Ethanol rack	\$1.66	\$1.66	-0.22%	
Metals				
Gold	\$1,870.35	\$1,871.84	-0.08%	
Silver	\$25.92	\$25.84	0.32%	
Copper contract	\$365.45	\$364.15	0.36%	
Grains				
Corn contract	\$529.00	\$522.00	1.34%	
Wheat contract	\$671.75	\$667.75	0.60%	
Soybeans contract	\$1,379.75	\$1,369.50	0.75%	
Shipping				
Baltic Dry Freight	1828	1766	62	
DOE inventory report				
	Actual	Expected	Difference	
Crude (mb)		-1.3		
Gasoline (mb)		2.6		
Distillates (mb)		1.6		
Refinery run rates (%)		-0.50%		
Natural gas (bcf)		-169.0		

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

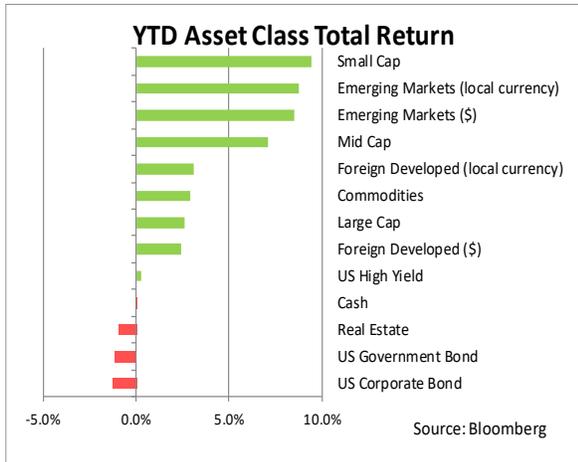
U.S. Equity Markets – (as of 1/20/2021 close)



(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 1/20/2021 close)

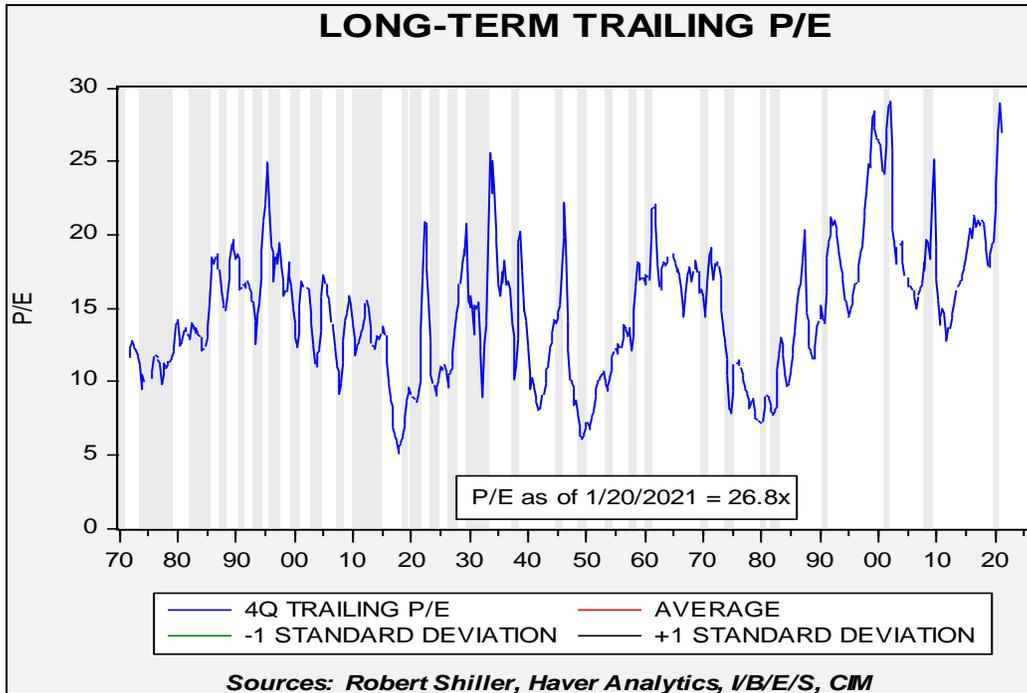


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 21, 2021



Based on our methodology,¹ the current P/E is 26.8x, down 0.3x from last week. Improving earnings offset higher equity values to bring a contraction of 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 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.