Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

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 24, 2022—9:30 AM EST] Global equity markets are mixed this morning. In Europe, the EuroStoxx 50 is currently down 2.1% from its prior close. In Asia, the MSCI Asia Apex 50 closed 0.7% lower. Chinese markets were slightly higher, with the Shanghai Composite relatively unchanged from its prior close and the Shenzhen Composite up 0.2%. U.S. equity index futures are signaling a lower open. With 64 companies having reported, the S&P 500 Q4 2021 earnings stand at $52.10, lower than the $52.34 forecast for the quarter. The forecast reflects a 21.7% increase from Q4 2020 earnings. Thus far this quarter, 79.7% of the companies have reported earnings above forecast, while 18.8% have reported earnings below forecast.

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:

- *[Bi-Weekly Geopolitical Report](#)* (1/18/2022) (with associated [podcast](#)): "What Would a U.S.-China War Look Like?"
- *[Weekly Energy Update](#)* (1/21/2022): Oil prices are being supported by geopolitical tensions in Europe and the Middle East.
- *[Asset Allocation Quarterly - Q1 2022](#)* (1/20/2022): Discussion of our asset allocation process, Q1 2022 portfolio changes, and our outlook for the markets
- ***[Asset Allocation Bi-Weekly](#) (1/24/2022) (with associated [podcast](#)): "Real Income versus the Wealth Effect; What is Driving Consumption?"***
- *[Confluence of Ideas](#) podcast* (1/20/2022): "The 2022 Outlook"
- *Current Perspectives*: "[2022 Outlook: The Year of Fat Tails](#)" (12/16/2021)

In today's *Comment*, we open with the building of geopolitical tensions along the Russia-Ukraine border and in the waters off the coast of China. We next review various political and economic developments around the world, including a brief comment regarding this week's Federal Reserve meeting on U.S. monetary policy. We wrap up with the latest news on the coronavirus pandemic.

Russia-Ukraine: As Russia continues its menacing military buildup along the northern, eastern, and southern borders of Ukraine, the State Department [instructed the families of U.S. diplomats in Ukraine to leave the country and authorized some embassy staff members to leave as well](#). The department also recommended that all U.S. citizens in Ukraine consider leaving now on the

grounds that the U.S. Embassy won't be in a position to help Americans depart if a Russian attack is underway.

- Separately, the *New York Times* reported that President Biden is considering deploying several thousand U.S. troops, as well as warships and aircraft, to NATO allies in the Baltics and Eastern Europe. If true, it would signal a major pivot after several months of relying only on diplomatic and economic pressure to warn off the Russians.
- The *Financial Times* reports other NATO allies are also reducing their embassy staff in Ukraine, putting their military forces on standby, and sending additional ships and fighter jets to bolster the defenses of its members in Eastern Europe.
- In other key news over the weekend, the British government announced it has uncovered a Russian plot to install a new, friendly government in Kyiv. According to the statement, an ex-Ukrainian politician is the Kremlin's preferred leader, although the statement also cited Russian intelligence links with four other former senior officials who fled to Russia in 2014 and have reportedly been plotting to return to power in Kyiv ever since.
- The continuing Russian troop buildup, reports of Moscow-friendly officials waiting in the wings, and the U.S. order to draw down its embassy staff all have started to contribute to a war scare within Ukraine, with many citizens reportedly rushing to withdraw their funds from banks. The longer the standoff continues, the greater the risk it will sap Ukraine's economy and therefore generally weaken the country more.
- The threat of military conflict and the potential for new Western sanctions have also begun to affect the Russian economy and financial markets. The Moscow stock market fell over 7.5% today; yields on Russia's government debt hit their highest level in six years. The ruble lost 1.5% to trade at 78.9 to the dollar, a 14-month low.


Source: The Daily Mail

China-Taiwan-Japan: Although the Russia-Ukraine crisis has garnered the most attention recently, it's important to remember that military tensions also continue to rise in the waters between China, Taiwan, and Japan. For at least the last six months, the Chinese navy has maintained the continual presence of at least one warship in the waters south and east of the southernmost Japanese islands. That marks China's first consistent deployment of naval forces

beyond the "first island chain" and demonstrates the military and economic threat it poses to Japan, especially if it were ever able to control Taiwan.

- Separately, China sent dozens of warplanes on threatening trajectories near Taiwan's airspace over the last two days, in their biggest such show of force since October.
- The sorties were apparently meant to register Beijing's anger over a joint U.S.-Japan naval exercise involving two U.S. aircraft carriers that concluded over the weekend.
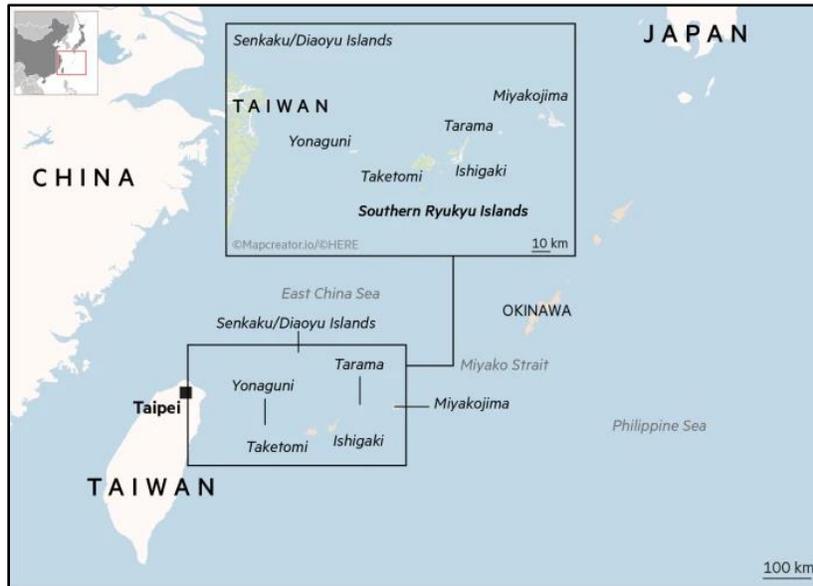
Source: Financial Times

China: In a sign that President Xi continues to clamp down on powerful private businesses and what he sees as threats to China's moral fabric, the government has launched an investigation into "disciplinary violations" by vaping tycoon Chu Lam You. In Hong Kong, news of the investigation sent her company, Huabao International Holdings (336 HK, HKD, 4.86), tumbling by over 65%.

Italy: Parliament members and other senior politicians today begin the process of voting for the country's new president, with all eyes on whether they will keep Italy's most celebrated technocrat, former ECB chief Mario Draghi, as prime minister, allowing him to forge ahead with an ambitious EU-funded reform program, or elevate him to head of state, potentially triggering a paralyzing crisis over a successor to head the government.

- As the voting gets started, media tycoon and four-time prime minister Silvio Berlusconi has given up on his long-shot bid for the presidency.
- Berlusconi, who was convicted of tax fraud in October 2012, said he decided to pull his name from consideration so lawmakers from across the political spectrum could choose a less divisive candidate.

Yemen-United Arab Emirates: The UAE intercepted two missiles launched by the Iran-allied Houthi rebels in Yemen, one week after a strike by the group killed three people in Abu Dhabi.

The attack highlighted the growing threat from the Houthis, who have targeted neighboring Saudi Arabia with missile and drone strikes for years.

U.S. Monetary Policy: Fed officials begin their next two-day policy meeting tomorrow, after which Chair Powell is expected to confirm that the central bank's asset purchase program will end by March and set the stage for a new round of interest-rate hikes. As if that isn't unsettling enough for the financial markets, some policymakers' statements have recently sounded almost panicky about inflation, creating uncertainty about how fast or how far they will hike rates.

COVID-19: Official data show confirmed cases have risen to 351,903,261 worldwide, with 5,598,042 deaths. In the U.S., confirmed cases rose to 70,700,678, with 866,540 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 250,763,600. The data show that 75.5% of the U.S. population has now received at least one dose of a vaccine, and 63.4% of the population is fully vaccinated.

Virology
- The seven-day average of people in U.S. hospitals with confirmed or suspected cases of COVID-19 declined for the third consecutive day, reaching 157,425 on Sunday. The number of new COVID-19 admissions to hospitals across the U.S. was also down.
- Even though the highly transmissible Omicron mutation is quickly subsiding in much of the country, a monthly poll by the U.S. Census Bureau indicated almost 8.8 million people were out of work in January because they were sick or caring for someone with COVID-19. That's by far the highest such figure since the survey began in mid-2020, exceeding the 6.6 million recorded in January 2021 and three million from December's survey.
  - In addition, the number of people reporting they weren't working due to concern about getting or spreading the disease rose to 3.2 million in the January survey from 2.6 million in December.
  - Other recent studies suggest concern about COVID-19 is continuing to push people into retirement.
  - The resulting business disruptions could be a key reason for the jump in initial jobless claims reported last week. Some economists fear "peak Omicron" could even lead to a decline in January nonfarm payrolls, although the momentum in the economy would probably quickly reverse any payroll decline.

Economic and Financial Market Impacts
- In the U.K., airlines still battling to get ridership up to pre-pandemic levels, have warned they will be forced to run half-empty and highly polluting "ghost flights." New government rules compel carriers to fly more regularly to retain their lucrative take-off and landing slots at busy airports. The Department for Transport today said airlines would have to hand back airport slots if they were not used 70% of the time from March 27, up from the current threshold of 50%.

U.S. Economic Releases

U.S. economic activity slowed in December, according to the Federal Reserve Bank of Chicago. The Chicago National Activity Index came in at -0.15, down from the +0.44 in November. The deceleration may have been related to a slowdown in consumption due to rising inflation. The Personal Consumption and Housing category was the biggest drag on the index, followed by Production and Income. Meanwhile, the categories related to employment and sales contributed positively.

CHICAGO FRB NATIONAL ACTIVITY INDEX

LATEST DATA +0.298

CFNAI, 6-mo Avg — Recession Point

Sources: Chicago FRB, CIM
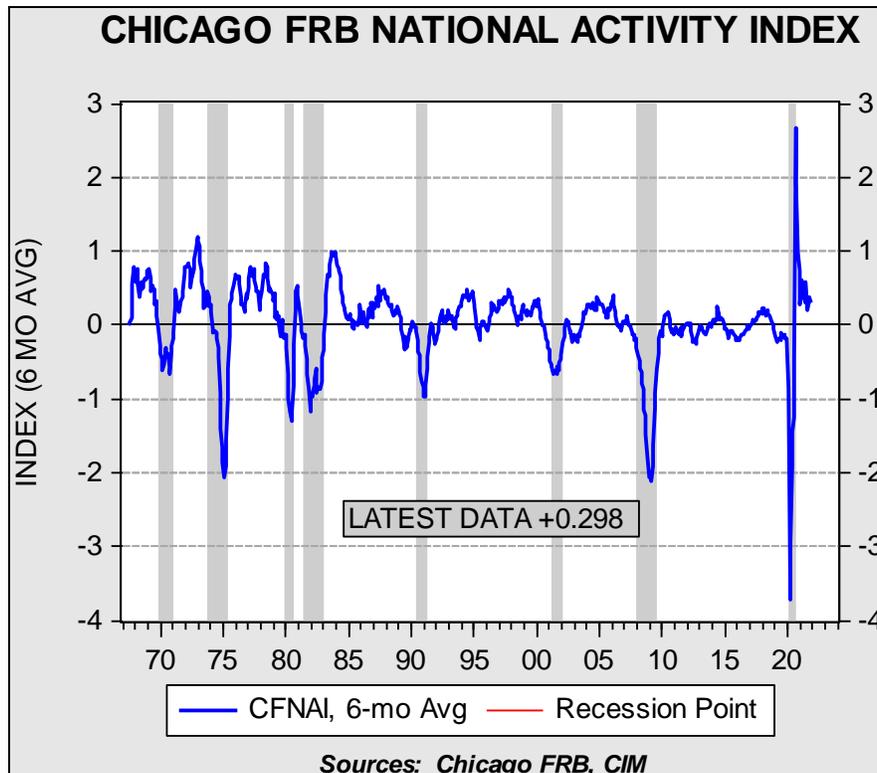
The chart above shows the six-month moving average of the Chicago National Activity Index. Despite the setback in December, the moving average remains well above the recession point, suggesting that the economy is still growing.

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

Economic Releases					Expected	Prior	Rating
EST	**Indicator**						
9:45	Markit US Manufacturing PMI	m/m	Jan		56.7	57.7	***
9:45	Markit US Services PMI	m/m	Jan		54.8	57.6	***
9:45	Markit US Composite PMI	m/m	Jan			57.0	***
Fed Speakers or Events							
	No Fed speakers or events today						

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 Jibun Bank Japan PMI Services	m/m	Jan	46.6	52.1		***	Equity and bond bearish
Jibun Bank Japan PMI Composite	m/m	Jan	48.8	52.5		***	Equity and bond bearish
Jibun Bank Japan PMI Mfg	m/m	Jan	54.6	54.3		***	Equity and bond neutral
Australia Markit Australia PMI Composite	m/m	Jan	45.3	54.9		***	Equity and bond bearish
Markit Australia PMI Services	m/m	Jan	45.0	55.1		**	Equity and bond bearish
Markit Australia PMI Mfg	m/m	Jan	55.3	57.7		**	Equity and bond neutral
EUROPE							
Eurozone Markit Eurozone Manufacturing PMI	m/m	Jan	59.0	58.0	57.5	***	Equity and bond neutral
Markit Eurozone Services PMI	m/m	Jan	51.2	53.1	52.0	***	Equity and bond neutral
Markit Eurozone Composite PMI	m/m	Jan	52.4	53.3	52.6	***	Equity and bond neutral
France Markit France Services PMI	m/m	Jan	53.1	57.0	55.3	***	Equity and bond neutral
Markit France Manufacturing PMI	m/m	Jan	55.5	55.6	55.3	***	Equity and bond neutral
Markit France Composite PMI	m/m	Jan	52.7	55.8	54.7	***	Equity and bond neutral
Germany Markit/BME Germany Manufacturing PMI	m/m	Jan	60.5	57.4	57.0	***	Equity and bond neutral
Markit Germany Services PMI	m/m	Jan	52.2	48.7	48.0	***	Equity and bond neutral
Markit/BME Germany Composite PMI	m/m	Jan	54.3	49.9	49.4	***	Equity and bond neutral
UK Markit/CIPS UK Services PMI	m/m	Jan	53.3	53.6	54.0	***	Equity and bond neutral
Markit/CIPS UK Composite PMI	m/m	Jan	53.4	53.6	54.0	***	Equity and bond neutral
Markit UK PMI Manufacturing SA	m/m	Jan	56.9	57.9	57.6	***	Equity and bond neutral
Switzerland Domestic Sight Deposits CHF	w/w	21-Jan	657.4b	655.1b		*	Equity and bond neutral
Total Sight Deposits CHF	w/w	21-Jan	724.8b	724.5b		*	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)	26	26	0	Down
3-mo T-bill yield (bps)	16	17	-1	Neutral
TED spread (bps)	10	9	1	Neutral
U.S. Libor/OIS spread (bps)	20	20	0	Down
10-yr T-note (%)	1.73	1.76	-0.03	Down
Euribor/OIS spread (bps)	-55	-55	0	Neutral
Currencies	**Direction**			
Dollar	Up			Neutral
Euro	Down			Up
Yen	Down			Neutral
Pound	Down			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
Energy Markets				
Brent	$87.75	$87.89	-0.16%	
WTI	$84.91	$85.14	-0.27%	
Natural Gas	$3.91	$4.00	-2.20%	
Crack Spread	$20.55	$20.44	0.52%	
12-mo Strip Crack	$21.19	$21.11	0.35%	
Ethanol Rack	$2.27	$2.27	0.10%	
Metals				
Gold	$1,839.09	$1,835.38	0.20%	
Silver	$24.06	$24.30	-0.98%	
Copper contract	$444.20	$452.40	-1.81%	
Grains				
Corn contract	$614.75	$616.25	-0.24%	
Wheat contract	$782.75	$780.00	0.35%	
Soybeans contract	$1,408.50	$1,414.25	-0.41%	
Shipping				
Baltic Dry Freight	1,415	1,474	-59	

Weather

The 6-10 day and 8-14-day forecasts currently call for cooler-than-normal temperatures throughout most of the country, with warmer-than-normal temperatures in the Southwest. The forecasts call for wet conditions for most of the country, with dry conditions throughout the Southwest.

Data Section

U.S. Equity Markets – (as of 1/21/2022 close)
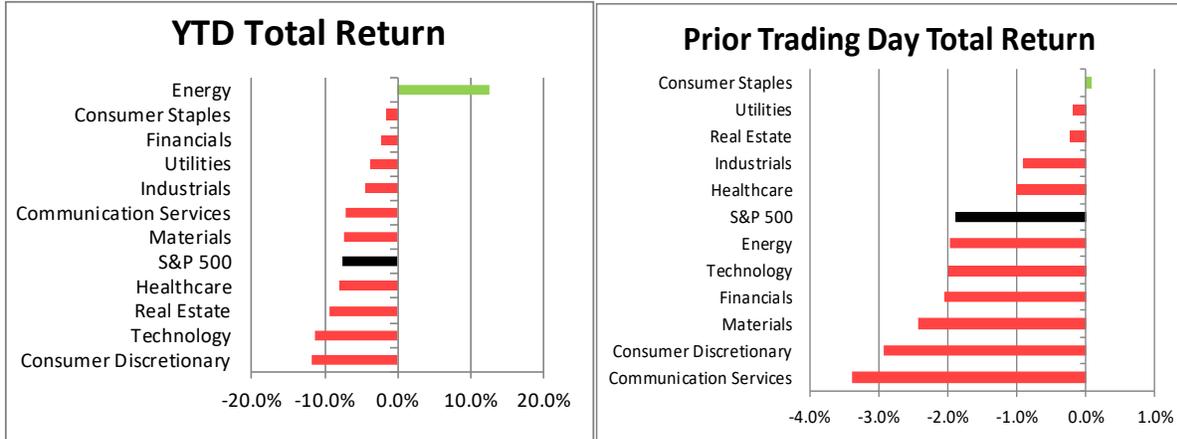
(Source: Bloomberg)

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.

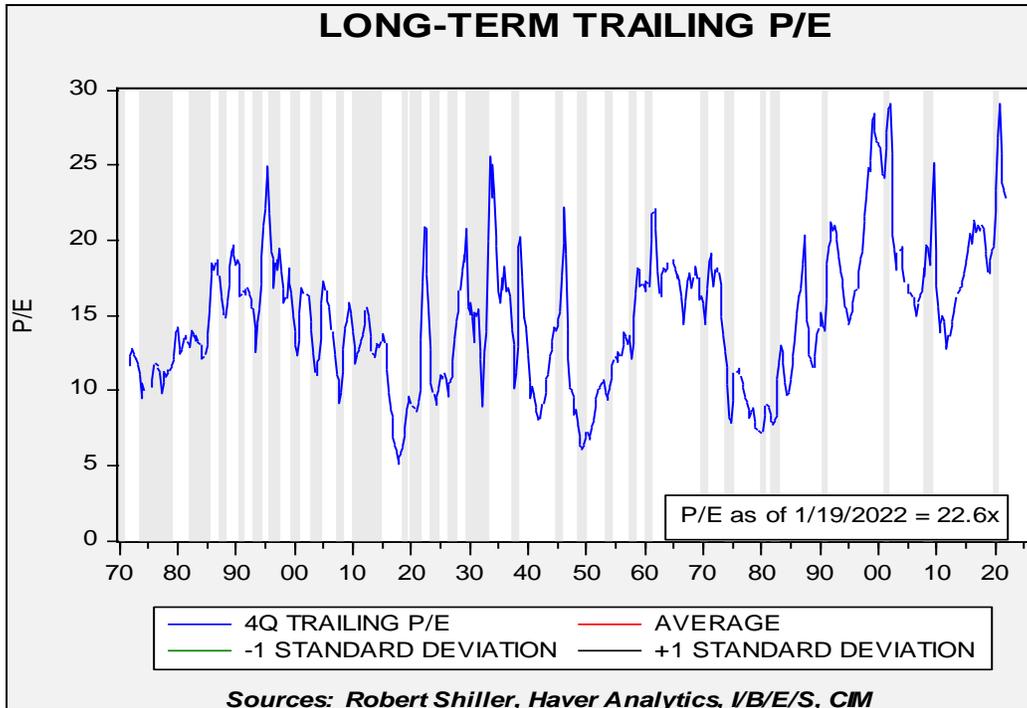**Asset Class Performance** – (as of 1/21/2022 close)
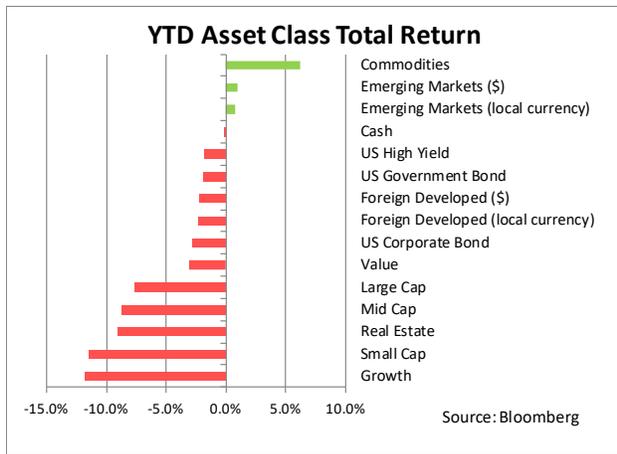
This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 20, 2022

LONG-TERM TRAILING P/E

P/E as of 1/19/2022 = 22.6x

Legend:
- 4Q TRAILING P/E
- AVERAGE
- -1 STANDARD DEVIATION
- +1 STANDARD DEVIATION

Sources: Robert Shiller, Haver Analytics, I/B/E/S, CIM

Based on our methodology,[1] the current P/E is 22.6x, down 0.1x from last week. The decline in the multiple is due to lower 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.

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[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.