

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 25, 2023—9:30 AM EST] Global equity markets are generally lower this morning. In Europe, the Euro Stoxx 50 is currently down 0.7% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.5%. Chinese markets are closed due to the Lunar New Year. U.S. equity index futures are signaling a lower open.

With 77 companies having reported so far, S&P 500 earnings for Q4 are running at \$53.90 per share, compared to estimates of \$52.85. Of the companies that have reported thus far, 70.1% have exceeded expectations while 26.0% have fallen short of expectations.

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](#) (1/23/2023) (podcast will be available later this week) “The New German Problem”
- [Weekly Energy Update](#) (1/20/2023): Slow refining activity caused a large build in crude stockpiles as the SPR withdrawals end. We cover these issues in this week’s report.
- [Asset Allocation Quarterly – Q1 2023](#) (1/19/2023): Discussion of our asset allocation process, Q1 2023 portfolio changes, and our outlook for the markets.
- [Asset Allocation Bi-Weekly](#) (1/17/2023) (with associated [podcast](#)): “The Master of Surprise”
- [Asset Allocation Q4 2022 Rebalance Presentation](#) (11/14/2022): Video presentation featuring the Asset Allocation Committee as they review our asset allocation strategies, recent portfolio changes, and the current macro environment.
- [Confluence of Ideas podcast](#) (12/19/2022): “The 2023 Geopolitical Outlook”

Our *Comment* today opens with an apparent agreement between the U.S. and Germany that will unlock the transfer of advanced tanks to Ukraine. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including some thoughts on how the Biden administration may be hoping to leverage its green energy subsidies from last year’s Inflation Reduction Act.

Russia-Ukraine War: As we previewed in our *Comment* yesterday, the U.S. and Germany are set to announce a deal in which the U.S. [would reverse its earlier position and donate about 30 of its best-in-class Abrams tanks to Ukraine, while Germany would send a smaller number of its](#)

[own advanced Leopard 2 tanks](#) and authorize other European countries to send many more. To get the deal done, President Biden reportedly overruled Pentagon concerns that the Abrams would be too costly and difficult for the Ukrainians to use effectively.

- The Ukrainians reportedly hope to build an entirely new tank division around the donated Abrams and Leopards. Having those tanks would enhance Ukraine's firepower and help it defend against a new Russian offensive expected in the coming months.
- The Abrams and Leopards could also help Ukraine recapture more territory from the Russians. However, they wouldn't necessarily guarantee a Ukrainian victory in the war.

Russia-U.S. Arms Control: The new Republican leaders of the House armed services, foreign affairs, and intelligence committees [have requested that the Biden administration formally confirm whether Russia is complying with the New Start nuclear arms control treaty](#). That treaty, which governs the number of strategic nuclear weapons Russia and the U.S. can have, is the only remaining arms-control treaty in force that traces its origins back to the Cold War period.

- The congressional concern was triggered by Russia's decision last November to suspend New Start inspections and its subsequent refusal to participate in the consultations required under the treaty to support its implementation. President Putin's veiled threats to use nuclear weapons in the war in Ukraine have also raised concerns about Russia's intentions.
- If the administration determines that Russia has abrogated the treaty, and if no resolution is reached with Russia, it would free the U.S. to respond to the new geopolitical reality in which it will soon have to deter two major nuclear powers, both Russia and China, given that China is so rapidly building up its force of strategic nuclear weapons. The result could be a global arms race, consistent with our view that the world is embarking on a prolonged period of rising military spending.

United Kingdom: Not only is the country continuing to deal with strikes across its transport and public sectors, but now workers at an Amazon (AMZN, \$96.32) facility in Coventry said they [will walk off the job in a dispute over pay](#). Leaders of the Amazon union said they plan to widen the strike to other Amazon facilities as well.

Italy: Gasoline station owners across the country [are turning off their pumps for two days to protest government pressure on them to hold down prices](#) following the expiration of a subsidy program at the end of last year. When the subsidies ended, gas prices jumped, prompting the government to require stations to post average prices along with their own at the pumps.

- The pump owners' strike may cause some disruption to the Italian economy and create political headaches for Prime Minister Meloni.
- On the other hand, some outside observers have praised her for the fiscal discipline she has shown with ending the subsidies after the retreat in energy prices late last year.

U.S.-EU Energy Policy: Sen. Joe Manchin (D-WV) [said he will introduce a bill requiring the Treasury Department to delay issuing its rules governing the \\$7,500 tax credit for purchasers of](#)

[an electric vehicle](#) under last year's Inflation Reduction Act. Separately, even as top EU leaders float the idea of [establishing their own big subsidies to spur investment in European green energy](#), Dutch Prime Minister Rutte [said he would oppose issuing new, common EU debt to fund the effort](#). Financing limits could keep the EU subsidies too small to compete with the \$369 billion or so of U.S. subsidies available under the law.

- Responding to European protests against the law's requirement that eligible vehicles must get at least 40% of their value from countries that have a free-trade deal with the U.S., the Treasury Department tweaked its rules to make it easier for some foreign automakers to qualify for subsidies in December.
- Manchin is now arguing that the Treasury's action undermines the aim of the law, which he said was squarely to promote domestic manufacturing and energy security. Manchin's bill is currently given little likelihood of passage, but it does reflect how nationalist populism is strengthening in both major U.S. political parties.
- Nevertheless, a final interesting wrinkle is that Treasury Secretary Yellen has revealed that the administration [may be planning to use the law's subsidies as leverage to entice U.S. allies into limited free-trade agreements](#) focused on critical technologies and minerals, such as semiconductors and lithium. U.S. Trade Representative Tai has also suggested that the U.S. wants the EU to adopt aggressive industrial policies to strengthen its economy and reduce its dependence on China. It appears that the administration's goal is to create a common, integrated industrial policy for key technologies and natural resources across the entire U.S.-led bloc. The goal may be to keep the free trade and capital flows associated with the policy limited enough to avoid antagonizing the nationalist populists, but still sufficiently meaningful to strengthen the U.S.-led bloc for its geopolitical competition with China and its bloc.

U.S. Antitrust Regulation: The Justice Department and eight states yesterday [sued Google, a subsidiary of Alphabet \(GOOG, \\$99.21\), for abusing what they call monopoly power over the internet ad industry](#). The suit alleges that Google's behavior hurts web publishers and advertisers and seeks to force Google to unwind "uncompetitive" acquisitions such as its 2008 purchase of DoubleClick. The lawsuit illustrates the Biden administration's more aggressive antitrust enforcement and the increased regulatory risks faced by the technology sector.

U.S. Labor Market: Walmart (WMT, \$143.02) [stated that it will hike its minimum wage to \\$14 per hour, from \\$12 per hour currently, beginning in February](#). The company said that should boost its average hourly wage to about \$17.50 from the current \$17.00, helping it compete for workers with rivals that pay even more. The move points to a continued tight labor market, despite some recent signs of cooling demand for workers.

U.S. Economic Releases

A steady decline in borrowing costs continues to boost mortgage loan demand. According to an index tracked by the Mortgage Bankers Association, applications rose 7.0% in the week ending January 20. The average 30-year fixed-rate mortgage fell from 6.26% to 6.20%. As a result, the

tracker for purchase applications rose 3.0% from last week, while the refinance tracker rose 15.0% in the same period.

There are no economic releases or Fed events scheduled for the rest of the day.

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.

Country	Indicator			Current	Prior	Expected	Rating	Market Impact
ASIA-PACIFIC								
Japan	Leading Economic Index	m/m	Nov F	97.4	97.6		**	Equity and bond neutral
Australia	Westpac Leading Index	m/m	Dec	-0.13	-0.13	-0.16	**	Equity and bond neutral
New Zealand	CPI	y/y	Q4	7.2%	7.2%	7.1%	**	Equity and bond neutral
	Credit Card Spending	y/y	Dec	12.4%	16.0%	16.2%	**	Equity bearish, bond bullish
EUROPE								
Germany	IFO Business Climate	m/m	Jan	90.2	88.6	90.3	***	Equity and bond neutral
	IFO Current Assessment	m/m	Jan	94.1	94.4	94.9	**	Equity and bond neutral
	IFO Expectations	m/m	Jan	86.4	83.2	85.3	**	Equity bullish, bond bearish
AMERICAS								
Mexico	Economic Activity IGAE	y/y	Nov	3.28%	4.41%	3.95%	**	Equity bearish, bond bullish
	International Reserves Weekly	w/w	20-Jan	\$200.889b	\$200.620b		*	Equity and bond neutral
Brazil	FGV Consumer Confidence	y/y	Jan	85.8	88.0		*	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)	482	482	0	Up
3-mo T-bill yield (bps)	455	456	-1	Up
TED spread (bps)	27	25	2	Tightening
U.S. Sibor/OIS spread (bps)	466	466	0	Up
U.S. Libor/OIS spread (bps)	468	468	0	Up
10-yr T-note (%)	3.42	3.45	-0.03	Up
Euribor/OIS spread (bps)	250	245	5	Up
Currencies	Direction			
Dollar	Flat			Down
Euro	Flat			Up
Yen	Up			Up
Pound	Down			Up
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.

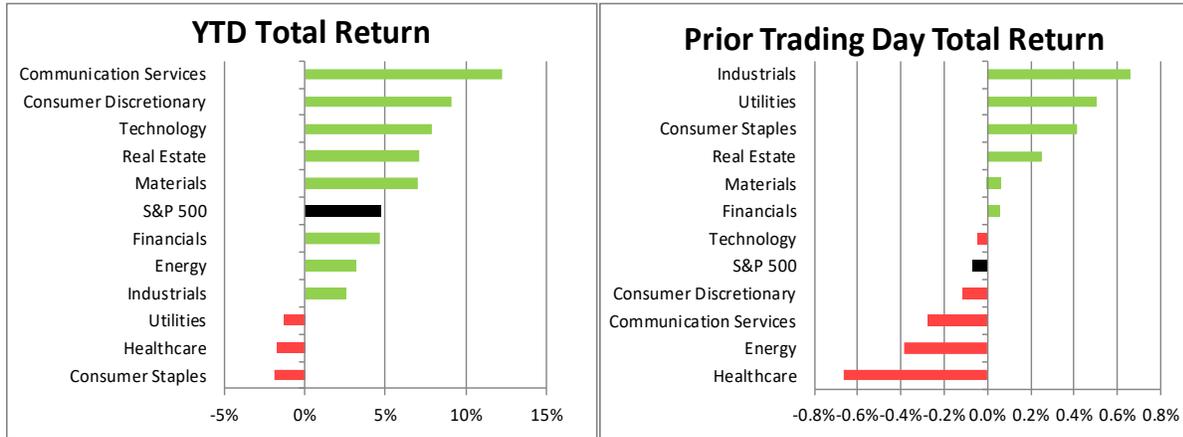
	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$86.20	\$86.13	0.08%	
WTI	\$80.26	\$80.13	0.16%	
Natural Gas	\$3.09	\$3.26	-5.06%	Demand Pessimism
Crack Spread	\$40.43	\$41.41	-2.35%	
12-mo strip crack	\$32.58	\$33.48	-2.70%	
Ethanol rack	\$2.34	\$2.35	-0.07%	
Metals				
Gold	\$1,924.83	\$1,937.36	-0.65%	
Silver	\$23.45	\$23.68	-0.94%	
Copper contract	\$423.45	\$424.85	-0.33%	
Grains				
Corn contract	\$678.00	\$677.00	0.15%	
Wheat contract	\$743.25	\$734.50	1.19%	
Soybeans contract	\$1,480.50	\$1,488.50	-0.54%	
Shipping				
Baltic Dry Freight	721	740	-19	
DOE Inventory Report				
	Actual	Expected	Difference	
Crude (mb)		1.5		
Gasoline (mb)		1.5		
Distillates (mb)		-1.6		
Refinery run rates (%)		1.9%		
Natural gas (bcf)		-76		

Weather

The 6-10 and 8-14 day forecasts show cooler-than-normal temperatures for most of the country, while warmer-than-normal temperatures are expected in most of the Southeast region. Wet conditions are expected throughout most of the entire country, with dry conditions forecasted for the Southwest.

Data Section

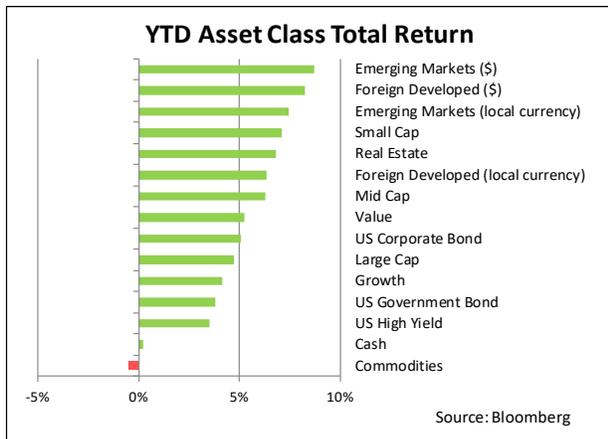
U.S. Equity Markets – (as of 1/24/2023 close)



(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 1/24/2023 close)

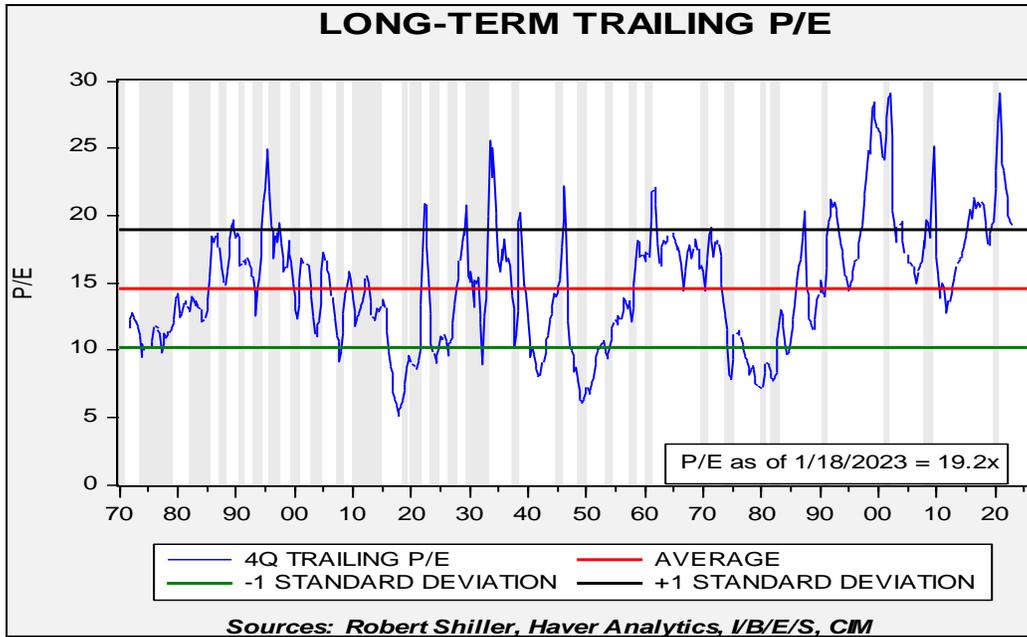


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 19, 2023



Based on our methodology,¹ the current P/E is 19.2x, up 0.3x from last week. Falling earnings estimates and higher index values led to the multiple 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.