

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 26, 2022—9:30 AM EST]** Global equity markets are generally higher this morning. In Europe, the EuroStoxx 50 is currently up 2.3% from its prior close. In Asia, the MSCI Asia Apex 50 closed 0.2% lower. Chinese markets were higher, with the Shanghai Composite up 0.7% from its prior close and the Shenzhen Composite also up 0.7%. U.S. equity index futures are signaling a higher open. With 83 companies having reported, the S&P 500 Q4 2021 earnings stand at \$52.50, higher than the \$52.34 forecast for the quarter. The forecast reflects a 21.7% increase from Q4 2020 earnings. Thus far this quarter, 81.9% of the companies have reported earnings above forecast, while 16.9% 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)

Today’s *Comment* opens with an update on the Russia-Ukraine crisis, in which the U.S. and its European allies are apparently coalescing around a set of sanctions and other actions to deter Russia from attacking. We next preview today’s Federal Reserve decision on monetary policy and highlight a range of other U.S. and international issues that have the potential to move the markets today. We end with an update on the coronavirus pandemic.

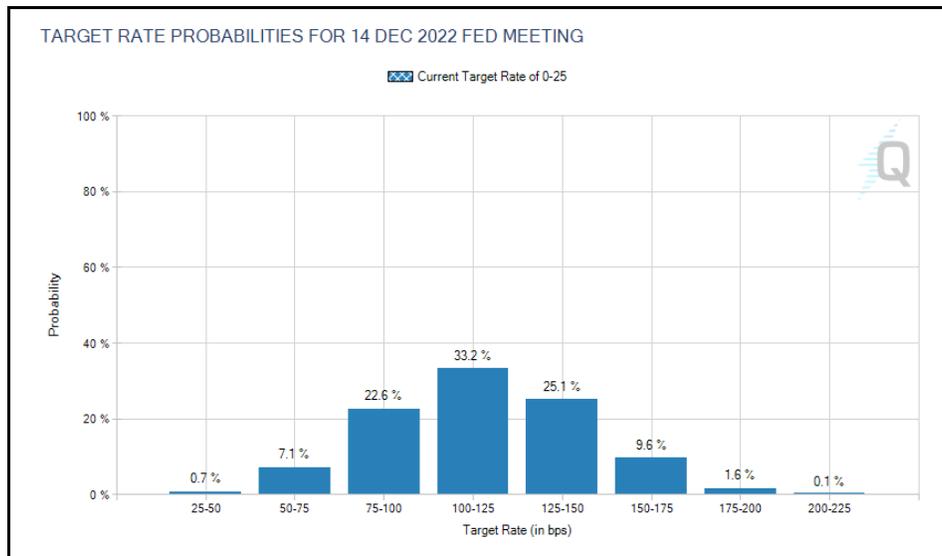
**Russia-Ukraine:** White House officials said that if Russia attacks Ukraine as feared, [they want the allied economic sanctions imposed on Moscow to include export controls on sensitive technologies](#) needed by key Russian industries. The export controls would be similar to those imposed by the Trump administration on Chinese telecom giant Huawei. Analysts believe such controls [could weigh heavily on Russia](#), despite government efforts to make the economy more sanctions-proof in recent years. The officials said the moves would exacerbate the selloff in

Russian markets, increase the country's cost of borrowing, and hurt the value of Russia's currency, which would raise the domestic political costs for Mr. Putin of moving on Ukraine. The U.S. and the U.K. [have also warned that they have not ruled out implementing sanctions directly on President Putin](#) if Russia invades Ukraine.

- After weeks of calls and meetings in European cities, U.S. officials yesterday [said they were seeing convergence on prospective sanctions among the U.S. and European nations](#), in part because of assurances that the U.S. is working to secure energy supplies should Russia invade Ukraine and cut off exports of energy westward.
- U.S. officials said they are seeking energy stockpiles in North Africa, the Middle East, Asia, and inside the U.S. that could fill Europe's energy supply gap should the Kremlin cut the flow of gas.
- However, the task remains daunting. In mid-winter and with energy prices already high, Europe would need to find alternatives for the 40% of its gas supply that comes from Russia.

**U.S. Monetary Policy:** Fed officials [today end a two-day policy meeting](#), 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](#). Some policymakers' statements have recently sounded almost panicky about inflation, [creating uncertainty about how fast or how far they will hike rates](#) and driving high volatility in financial markets in recent days. The uncertainty [is exacerbated by the way the Fed has abandoned decision-making based on models and systematic analytical frameworks](#) that are transparent to all; in their place, the policymakers are relying much more on personal judgment.

- Futures markets currently suggest expectations for four or more quarter-point rate hikes by December (see chart below).
- Markets could remain volatile at least until the results of today's meeting are released.



(Source: CME Group)

**U.S. Banking Sector:** While cash-rich companies and households have been slow to take loans over the last year, new data show banks [have enjoyed a big increase in their auto lending](#). U.S. banks increased their auto-loan balances by 12% over the course of 2021, even though their total loan books increased only marginally.

**Global Supply Chain Disruptions:** Preliminary data show imports unloaded in December at the ports of Long Beach and Los Angeles [were down approximately 14% from the same month one year earlier](#), marking the fourth straight month of year-over-year declines. The queue of vessels waiting to enter the port complex rose past 100 during December and reached a record 109 ships in early January.

- The reasons for the backups are complex: ships can't unload quickly because terminals are full of containers. Truckers can't pick up loads due to a shortage of drivers and the steel trailers used to pull boxes. Warehouses near the ports and at nearby logistics hubs are short workers and don't have space for more deliveries.
- The backups are exacerbating supply-chain delays and driving up shipping costs, which in turn are contributing to inflation reaching its highest level in decades.
- In updated forecasts, the International Monetary Fund said global supply chain disruptions, high inflation, and the latest wave of the coronavirus pandemic [will weigh more heavily on global economic growth this year than previously thought](#). The organization now projects that global economic output growth will slow to 4.4% in 2022, compared with 5.9% in 2021 and a previous estimate of 4.9% last October.

**European Union:** The EU's General Court in Luxembourg [struck down a \\$1.2 billion antitrust fine levied by the European Commission against U.S. semiconductor giant Intel](#) (INTC, 51.00). The ruling, which called the commission's analytical methods incomplete and insufficient to establish damages, may make it more difficult for EU antitrust officials to rein in big U.S. technology companies based on antitrust issues.

**Portugal:** New polling shows the far-right Chega Party led by firebrand television commentator André Ventura [is now the country's third-most popular political group](#).

- With parliamentary elections due on Sunday, and with the poll gap between the ruling Socialist Party and the opposition center-right Social Democratic Party narrowing, Chega's support could now be vital to the formation of a right-of-center government.
- In any case, the surge in Chega's support shows that Portugal isn't as immune to far-right populism as many in the country thought.

**El Salvador:** International Monetary Fund officials reviewing El Salvador's economic prospects ahead of a potential \$1 billion financing [have urged the government to stop recognizing bitcoin as a legal tender in the country](#) and expressed concern over its plan to issue bonds linked to the cryptocurrency. The IMF concerns centered on the risks involved in the cryptocurrency, underlined by the government's money-losing purchases of it in recent months.

**COVID-19:** Official data show confirmed cases have risen to [359,140,962 worldwide, with 5,618,197 deaths](#). In the U.S., confirmed cases rose to 72,178,003, with 872,126 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 251,289,667](#). The data show that 75.7% of the U.S. population has now received at least one dose of a vaccine, and 63.5% of the population is fully vaccinated.

- Even though data continue to show new infections and hospitalizations related to the omicron mutation are falling back rapidly, [deaths \(a lagging indicator\) are still on the rise](#). The seven-day average for newly reported COVID-19 deaths reached 2,258 per day on Tuesday, up about 1,000 from daily death counts two months ago. The current daily death toll is now at its highest level since February 2021.
- Despite the omicron retreat in some countries, others are still seeing rapid increases in new infections and hospitalizations. In Japan, the seven-day average of new cases now stands at 62,613, [exceeding 60,000 for the first time](#). Hospitalizations, hospital bed occupancy rates, and new deaths are also at or near record highs.

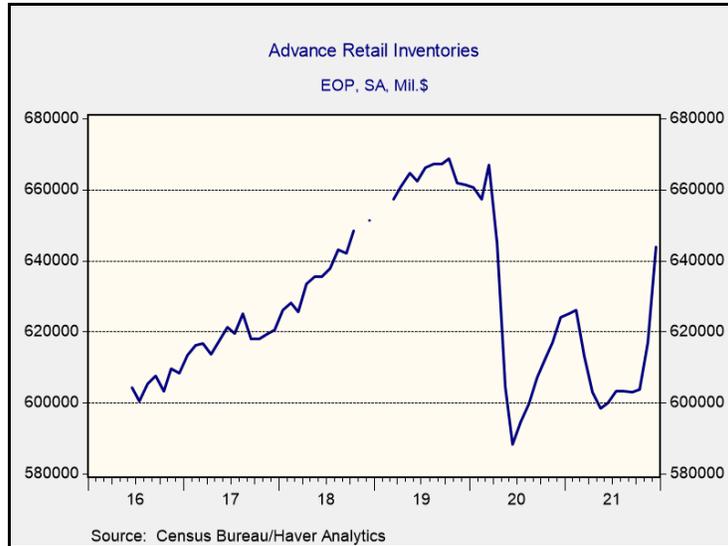
## U.S. Economic Releases

Mortgage applications fell for the first time in three weeks, according to the Mortgage Bankers Association. The MBA mortgage applications index fell 7.1% from the prior week. The drop in applications impacted both purchases and refinancing. The index for purchases fell 1.8% from the prior week, while the index for refinancing fell 12.6%. The drop in demand for home financing is likely related to higher mortgage rates. The average 30-year fixed rate rose 8 bps last week from 3.64% to 3.72%.

In other news, the U.S. trade deficit in goods widened in December, according to the U.S. Census Bureau. The trade gap increased to \$101 billion last month, above expectations of \$96 billion. In addition, the Census Bureau also reported an increase in U.S. inventories. Wholesale inventories increased 2.1% from the prior month, while retail inventories increased 4.4%.



The chart above shows the U.S. trade deficit in goods. In December, the trade deficit fell to a new low as consumption supports an increase in imports.



The chart above shows that retail inventories have surged over the last few months. The sharp pick up in inventories suggests that supply chains may be improving.

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

Economic Releases						
EST	Indicator			Expected	Prior	Rating
10:00	New Home Sales	m/m	Dec	760k	744k	***
10:00	New Home Sales MoM	m/m	Dec	2.2%	12.4%	***
14:00	FOMC Rate Decision (Lower Bound)	w/w	26-Jan	0.0%	0.0%	***
14:00	FOMC Rate Decision (Upper Bound)	w/w	26-Jan	0.3%	0.3%	***
14:00	Interest on Reserve Balances Rate	w/w	27-Jan	0.2%	0.2%	**
Fed Speakers or Events						
EST	Speaker or event	District or position				
14:00	FOMC Concludes Two-Day Meeting	Federal Reserve Board				
14:30	Federal Reserve Chairman Powell Holds Press Conference	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.

	Indicator			Current	Prior	Expected	Rating	Market Impact
<b>ASIA-PACIFIC</b>								
<b>Japan</b>	PPI Services	y/y	Dec	1.1%	1.1%	1.0%	**	Equity and bond neutral
	Leading Index CI	m/m	Nov	103.2	103.0		**	Equity and bond neutral
	Coincident Index	m/m	Nov	92.8	93.6		**	Equity and bond neutral
<b>New Zealand</b>	Credit Card Spending	m/m	Dec	-0.1%	1.2%		***	Equity and bond neutral
<b>EUROPE</b>								
<b>Germany</b>	Consumer Confidence	m/m	Jan	99.0	100.0	99.0	***	Equity and bond neutral
	Total Jobseekers	q/q	4Q	3101.8k	3307.4k		***	Equity and bond neutral
<b>Switzerland</b>	Credit Suisse Survey Expectations	m/m	Jan	9.5	0.0		***	Equity and bond neutral
<b>Russia</b>	CPI Weekly YTD	w/w	21-Jan	0.10%			***	Equity and bond neutral
<b>AMERICAS</b>								
<b>Brazil</b>	FGV Construction Costs	m/m	Jan	0.64%	0.30%	0.58%	***	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)	27	26	1	Down
3-mo T-bill yield (bps)	18	19	-1	Neutral
TED spread (bps)	9	7	2	Neutral
U.S. Libor/OIS spread (bps)	21	20	1	Down
10-yr T-note (%)	1.78	1.77	0.01	Down
Euribor/OIS spread (bps)	-55	-54	-1	Neutral
<b>Currencies</b>	<b>Direction</b>			
Dollar	Up			Neutral
Euro	Down			Up
Yen	Down			Neutral
Pound	Up			Neutral
Franc	Down			Neutral
<b>Central Bank Action</b>	<b>Current</b>	<b>Prior</b>	<b>Expected</b>	
Bank of Canada Rate Decision		0.250%	0.250%	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.

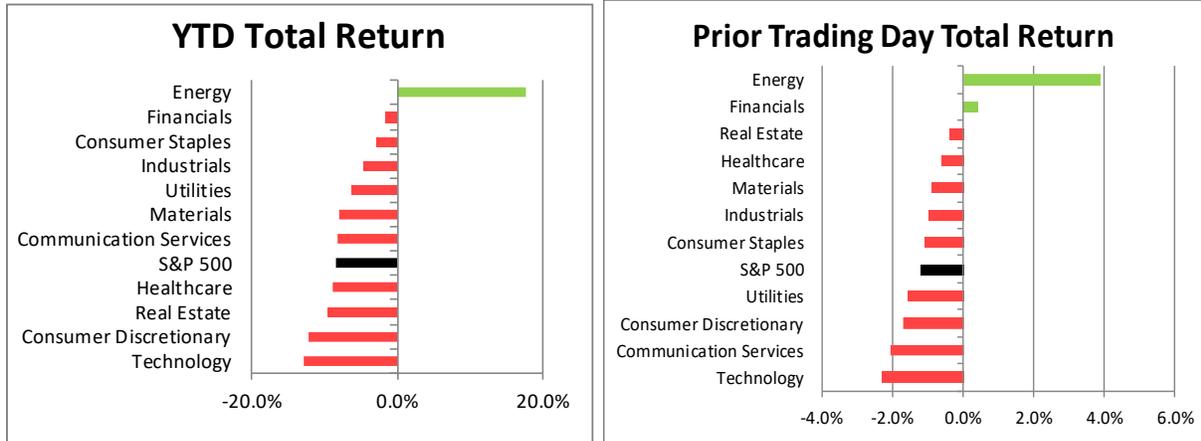
	Price	Prior	Change	Explanation
<b>Energy Markets</b>				
Brent	\$89.00	\$88.20	0.91%	
WTI	\$86.18	\$85.60	0.68%	
Natural Gas	\$4.26	\$4.05	5.18%	
Crack Spread	\$20.80	\$20.36	2.17%	
12-mo Strip Crack	\$21.70	\$21.38	1.53%	
Ethanol Rack	\$2.27	\$2.27	0.10%	
<b>Metals</b>				
Gold	\$1,845.03	\$1,848.02	-0.16%	
Silver	\$23.89	\$23.81	0.32%	
Copper contract	\$452.05	\$445.00	1.58%	
<b>Grains</b>				
Corn contract	\$617.75	\$620.00	-0.36%	
Wheat contract	\$804.50	\$818.00	-1.65%	
Soybeans contract	\$1,408.75	\$1,407.25	0.11%	
<b>Shipping</b>				
Baltic Dry Freight	1,343	1,391	-48	
<b>DOE inventory report</b>				
	<b>Actual</b>	<b>Expected</b>	<b>Difference</b>	
Crude (mb)		1.0		
Gasoline (mb)		1.9		
Distillates (mb)		-1.2		
Refinery run rates (%)		-0.40%		
Natural gas (bcf)		-215.0		

## Weather

The 6-10 day and 8-14-day forecasts currently call for warmer-than-normal temperatures throughout the eastern third of the country and the South, with cooler-than-normal temperatures in the West, Southwest, and Rocky Mountain regions. The forecasts call for wet conditions for most of the country, with dry conditions in California.

**Data Section**

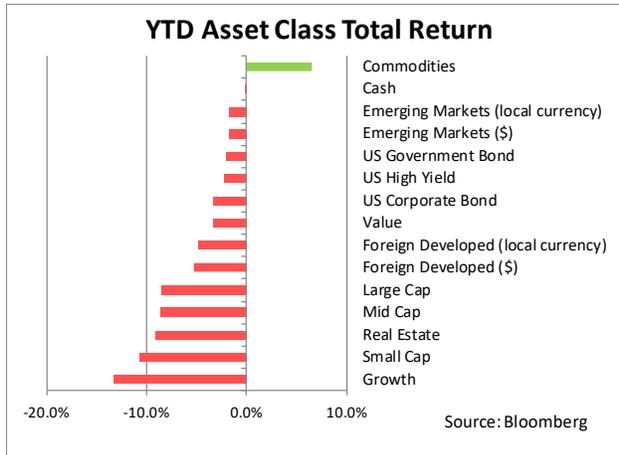
**U.S. Equity Markets – (as of 1/25/2022 close)**



(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 1/25/2022 close)**

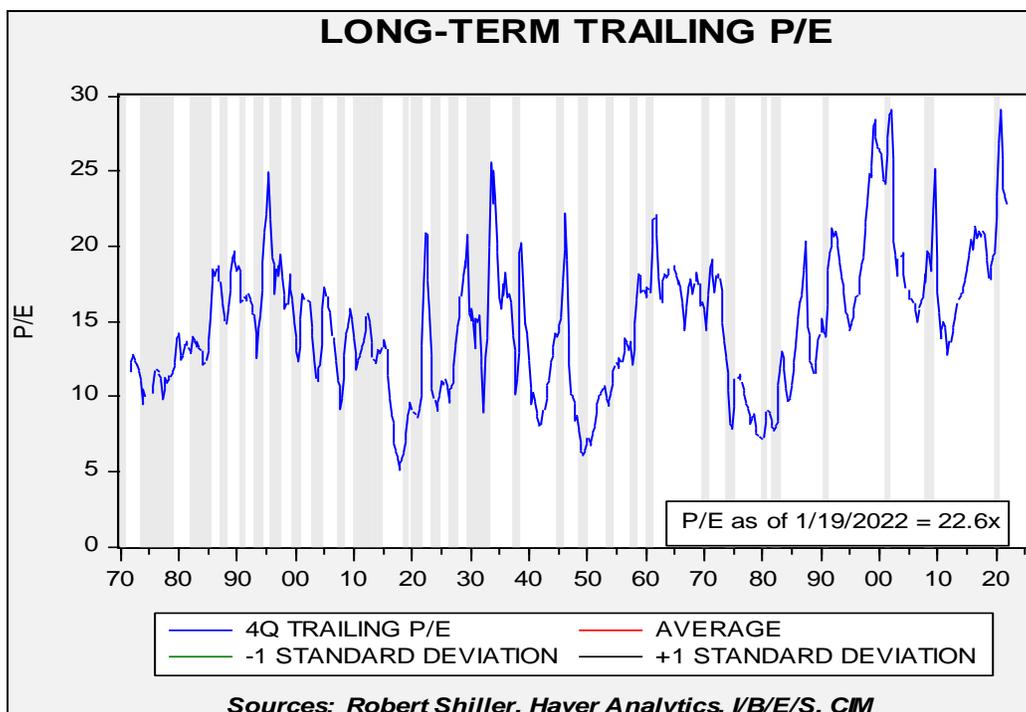


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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



Based on our methodology,<sup>1</sup> 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.*

<sup>1</sup> 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.