

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 28, 2022—9:30 AM EST]** Global equity markets are lower this morning. In Europe, the EuroStoxx 50 is currently down 2.3% from its prior close. In Asia, the MSCI Asia Apex 50 closed 0.3% lower. Chinese markets were mixed, with the Shanghai Composite down 1.0% from its prior close and the Shenzhen Composite flat. U.S. equity index futures are signaling a lower open. With 117 companies having reported, the S&P 500 Q4 2021 earnings stand at \$53.20, higher than the \$52.34 forecast for the quarter. The forecast reflects a 21.7% increase from Q4 2020 earnings. Thus far this quarter, 77.8% of the companies have reported earnings above forecast, while 19.6% 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](#) (1/27/2022): Oil prices are breaking out above recent highs. Some state governments are pushing back against measures to restrict investment in fossil fuels.
- [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)

Good morning! Today's report begins with an update on the Ukraine situation, where tensions may be easing. We then look at U.S. economic and policy news and China-related stories. International news is next, and we conclude with our pandemic coverage.

After weeks of rising tensions between NATO and Moscow, the two sides appear to be ready to move toward de-escalation. Ukraine and Russian officials are [now in talks about implementing the Minsk-2 accords again](#). The original agreement between Kyiv and Moscow gave Russia more of a say in Ukraine's future; however, the deal had remained dormant. The two sides have agreed to continue the discussion in two weeks, which, if fruitful, could relieve fears of war and give Putin a way to save face. Despite being somewhat dismissive of the NATO letter on Thursday, Foreign Minister Sergei Lavrov said Moscow sees "rational elements on secondary issues" in U.S. responses to its demands.

To prepare for a worst-case scenario, President Biden reassured Ukrainian President Volodymyr Zelensky that [the U.S. and its allies are willing to respond decisively if Russia invades](#). The U.S., EU, and the U.K. are preparing to [impose sanctions on new Russian gas projects](#) if Moscow decides to send troops into Ukraine. Given its heavy reliance on Russian gas, the EU was initially reluctant to make such a threat without assurances from the U.S. that it would help find alternative ways for Europe to meet its energy needs. Recently, the U.S. has been [in talks with Qatar and other major energy producers](#) to reroute gas to Europe in case it is cut off from Russian gas. Although no formal deal has been announced, it appears the talks have been positive enough that Europe feels confident the U.S. can follow through with this commitment.

From our perspective, we believe Putin may have realized that he overplayed his hand and may be looking for a pathway out. We suspect he viewed the growing unrest and division in the U.S. and Europe over COVID-19 as an opportunity to push its own interests. However, it appears his over-assertiveness may have driven the two sides closer together. Although we believe there remains an elevated likelihood of conflict, recent developments suggest the situation is improving.

### **Economics and policy:**

- Democrats are making another push [to get the social spending and climate bill passed before the midterm elections](#). The party is considering lowering income caps and means-testing the Child Care tax credit to win Senator Joe Manchin's (D-WV) elusive vote.
- The [U.S. housing market gained almost \\$10 trillion during the pandemic](#), according to data gathered by Zillow (ZG, \$45.99).
- The China [anti-competitiveness bill is meeting partisan opposition](#) in the Senate. The bill dubbed the America Competes Act is designed to help improve supply chains and promote the domestic production of critical goods such as semiconductors. Opposers to the bill have argued that it does not adequately address the threat posed by China and contains provisions that promote wasteful spending. The bill is likely to have some bipartisan support if brought to the Senate floor, but there are concerns it will fall short of the 60 votes needed to overcome a filibuster.
- Nearly 45 million people in the [Northeast and Mid-Atlantic are going to be impacted by winter storms over the weekend](#). The storms have the potential for hurricane-force winds and heavy snow, and they could potentially lead to power outages and a sharp rise in energy prices.

### **China:**

- Chinese regulators [plan to ramp up the pace of its antitrust crackdown](#) as it looks to create a level playing field for small and medium-sized companies. These smaller companies make up the majority of the country's economy and will be vital as the country moves away from relying on residential investment for GDP growth.

- China will [jail forty-seven steel company officials for violating the country's air pollution standards](#). The officials are accused of using fake data to get around environmental regulations. Over the last decade, China has intensified its crackdown on pollution as it looks to clean up the air.
- Officials from the China National Space Administration announced that [China and Russia have agreed to build a research station on the moon](#). The alliance could set the stage for a new space race.

### International news:

- Argentina and the IMF [reached an agreement on Friday regarding when the country will balance its primary budget](#). The deal states that the government will be required to balance this budget by 2025. The new arrangement allows the two sides to continue discussions about renegotiating Argentina's \$40 billion of debt. Additionally, Argentina plans to make a \$700 million payment on Friday and another \$365 million payment on Tuesday. The pact between the Argentine government and the IMF has sparked outrage throughout the country. Protesters have filled the streets of Buenos Aires over concerns that a deal with the IMF could lead to more austerity. The opposition party has refused to attend IMF talks as it suspects that [the issue could help them in next year's general election](#).
- The ECB is [projected to be more than a year and a half away from raising rates](#), according to respondents to a Bloomberg survey. Those surveyed stated they believe that the central bank could end its bond-buying program in March 2023 and could start raising rates the following September. The respondents also said inflation in the euro area, which is 5%, will probably fall throughout the year, easing the pressure on officials to act.

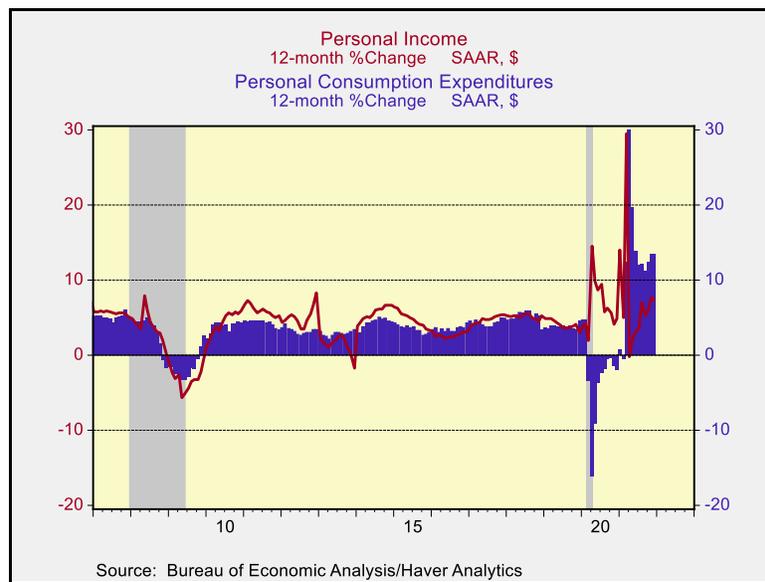
**COVID-19:** The [number of reported cases](#) is 366,589,668, with 5,638,962 fatalities. In the U.S., there are 73,428,433 confirmed cases with 878,467 deaths. For illustration purposes, the *FT* has created an [interactive chart](#) that allows one to compare cases across nations using similar scaling metrics. The [CDC reports](#) that 663,451,855 doses of the vaccine have been distributed, with 536,370,947 doses injected. The number receiving at least one dose is 249,267,851, the number of second doses is 211,162,083, and the number of the third dose, the highest level of immunity, is 86,484,618. The *FT* has a page on [global vaccine distribution](#).

- The U.S. [is pushing China to change some of its quarantine and testing requirements](#) for American diplomats. The increase in restrictions has resulted in a request for some officials at the U.S. embassy in Beijing to leave China.
- A [sub-variant of Omicron has been detected in Colorado](#). The new variant can spread faster than the original, but there is no evidence that it leads to more severe outcomes.
- About [1,700 dockworkers at West Coast ports tested positive for COVID-19](#) in January. The number of infections in January surpasses the total number of cases in all 2021.

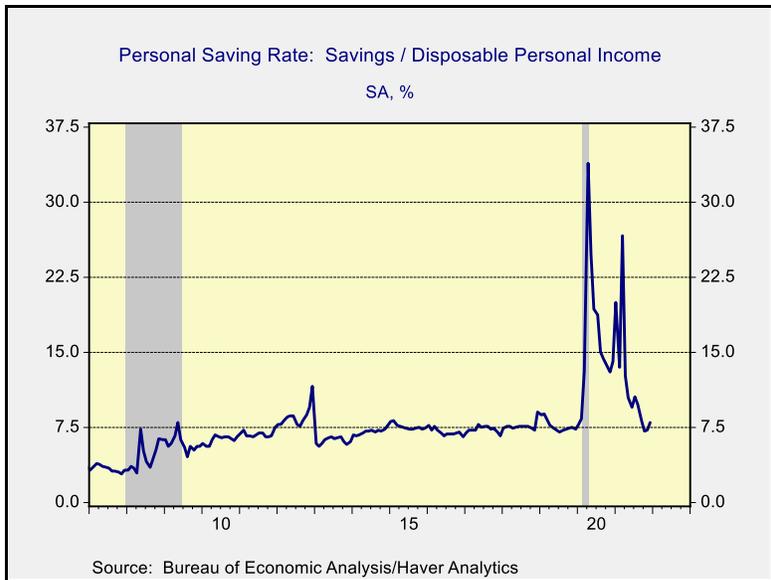
- [More than 300 scientists and public health officials have urged the U.K. government to waive IP rights](#) on vaccines to aid efforts to combat the pandemic.

## U.S. Economic Releases

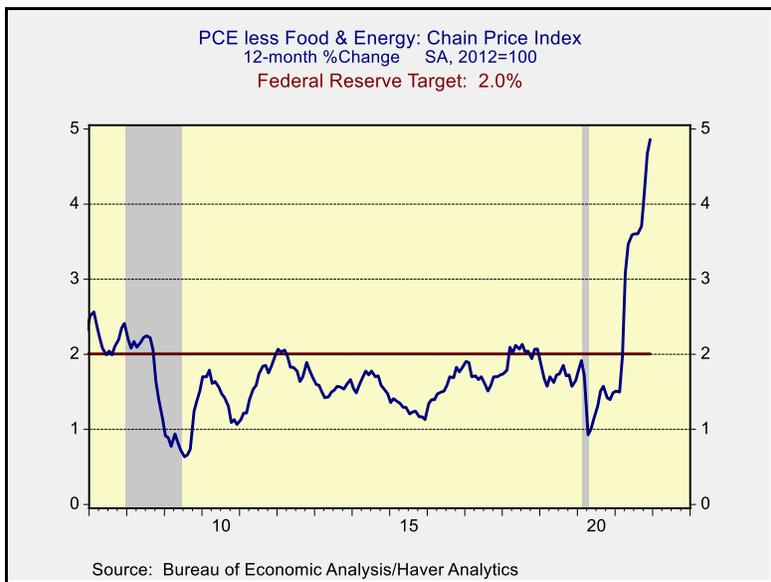
December personal income increased by a seasonally adjusted 0.3%, short of expectations for a 0.5% rise that would have matched the revised November gain. Meanwhile, December personal consumption expenditures (PCE) declined 0.6%, as anticipated, after a revised increase of 0.4% in the previous month. In December 2020, the volume of personal income was up 7.3%, while the volume of PCE was up 13.3%, which illustrates how consumers are dramatically ratcheting down their savings compared with earlier in the pandemic. The chart below shows the year-over-year change in personal income and PCE since just before the prior recession.



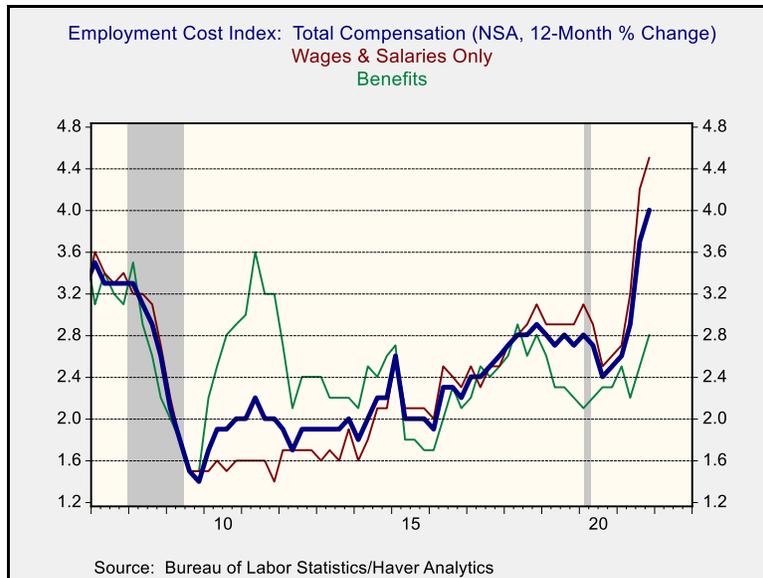
The personal income and spending report also includes a measure of the personal savings rate, defined as the share of disposable income (i.e., income after taxes) that wasn't spent on PCE. The December savings rate rebounded modestly to a seasonally adjusted 7.9%, up from 7.2% in November but still far below the enormous rates seen earlier in the pandemic. The chart below shows how the personal savings rate has changed since the prior recession.



The personal income and spending report also includes the Fed’s preferred gauge of inflation. Excluding the volatile food and energy components, the December “core PCE deflator” was up 4.9% from December 2020, slightly worse than the expected rise of 4.8% and well above the 4.7% rise in the year to November. The chart below shows the annual change in the core PCE deflator since just before the previous recession.



In a separate report, the fourth-quarter Employment Cost Index increased by a seasonally adjusted 1.0%. That was better than both the anticipated rise of 1.2% and the 1.3% rise in the third quarter. Still, the overall index in the fourth quarter was up a strong 4.0% from the same period one year earlier, with the subindex on wages and salaries up 4.5% and the subindex on benefits up 2.8%. The chart below shows the year-over-year change in the overall ECI and its components since just before the previous recession.



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                           | U. of Michigan Consumer Sentiment              | m/m | Jan F | 68.8     | 68.8  | ***    |
| 10:00                           | U. of Michigan Current Conditions              | m/m | Jan F | 73.2     | 73.2  | **     |
| 10:00                           | U. of Michigan Expectations                    | m/m | Jan F | 65.9     | 65.9  | **     |
| 10:00                           | U. of Michigan 1-Year Inflation Expectation    | m/m | Jan F | 4.9%     | 4.9%  | *      |
| 10:00                           | U. of Michigan 5-10 Year Inflation Expectation | m/m | Jan F |          | 3.1%  | *      |
| 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                |
|---------------------|------------------------------------|-----|--------|---------|--------|----------|--------|------------------------------|
| <b>ASIA-PACIFIC</b> |                                    |     |        |         |        |          |        |                              |
| <b>Japan</b>        | Tokyo CPI                          | y/y | Jan    | 0.5%    | 0.8%   | 0.5%     | ***    | Equity and bond neutral      |
|                     | Tokyo CPI Ex-Fresh Food            | y/y | Jan    | 0.2%    | 0.5%   | 0.3%     | **     | Equity and bond neutral      |
|                     | Tokyo CPI Ex-Fresh Food and Energy | y/y | Jan    | -0.7%   | -0.3%  | -0.7%    | *      | Equity and bond neutral      |
| <b>Australia</b>    | PPI                                | y/y | 4Q     | 3.7%    | 2.9%   |          | **     | Equity and bond bearish      |
| <b>South Korea</b>  | Industrial Production              | y/y | Dec    | 6.2%    | 6.3%   | 1.8%     | *      | Equity bullish, bond bearish |
| <b>EUROPE</b>       |                                    |     |        |         |        |          |        |                              |
| <b>Eurozone</b>     | M3 Money Supply                    | y/y | Dec    | 6.9%    | 7.4%   | 6.8%     | ***    | Equity and bond neutral      |
|                     | Economic Confidence                | m/m | Jan    | 112.7   | 113.8  | 114.5    | **     | Equity bearish, bond bullish |
|                     | Consumer Confidence                | m/m | Jan    | -8.5    | -8.5   |          | ***    | Equity and bond neutral      |
| <b>Germany</b>      | Import Price Index                 | y/y | Dec    | 24.0%   | 24.7%  | 26.2%    | *      | Equity and bond neutral      |
|                     | GDP                                | y/y | 4Q P   | 1.4%    | 2.8%   | 1.8%     | **     | Equity bearish, bond bullish |
|                     | GDP WDA                            | y/y | 4Q P   | 1.4%    | 2.9%   | 1.8%     | **     | Equity bearish, bond bullish |
| <b>France</b>       | GDP                                | y/y | 4Q P   | 5.4%    | 3.5%   | 4.9%     | ***    | Equity bullish, bond bearish |
|                     | Consumer Spending                  | y/y | Dec    | -5.1%   | 14.8%  | -5.2%    | *      | Equity and bond neutral      |
|                     | PPI                                | y/y | Dec    | 17.7%   | 17.9%  |          | *      | Equity and bond neutral      |
| <b>Italy</b>        | Consumer Confidence                | m/m | Jan    | 114.2   | 117.7  | 116.5    | ***    | Equity bearish, bond bullish |
|                     | Manufacturing Confidence           | m/m | Jan    | 113.9   | 115.0  | 115.0    | ***    | Equity bearish, bond bullish |
|                     | Economic Sentiment                 | m/m | Jan    | 105.4   | 112.7  |          | **     | Equity bearish, bond bullish |
|                     | PPI                                | y/y | Dec    | 27.8%   | 27.3%  |          | *      | Equity and bond neutral      |
| <b>Russia</b>       | Money Supply, Narrow Definition    | w/w | 21-Jan | 14.38t  | 14.39t |          | *      | Equity and bond neutral      |
| <b>AMERICAS</b>     |                                    |     |        |         |        |          |        |                              |
| <b>Brazil</b>       | FGV Inflation IGPM                 | y/y | Jan    | 16.9%   | 17.8%  | 17.1%    | ***    | Equity bullish, bond bearish |
|                     | Total Outstanding Loans            | m/m | Dec    | 4684b   | 4595b  |          | **     | Equity bullish, bond bearish |
|                     | Unemployment Rate                  | m/m | Nov    | 11.6%   | 12.1%  | 11.7%    | *      | Equity bullish, bond bearish |

## 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)      | 28        | 27    | 1      | Down    |
| 3-mo T-bill yield (bps)     | 19        | 20    | -1     | Neutral |
| TED spread (bps)            | 9         | 7     | 2      | Neutral |
| U.S. Libor/OIS spread (bps) | 25        | 23    | 2      | Down    |
| 10-yr T-note (%)            | 1.83      | 1.80  | 0.03   | Down    |
| Euribor/OIS spread (bps)    | -55       | -55   | 0      | Neutral |
| Currencies                  | Direction |       |        |         |
| Dollar                      | Up        |       |        | Neutral |
| Euro                        | Down      |       |        | Up      |
| Yen                         | Down      |       |        | Neutral |
| Pound                       | Flat      |       |        | Neutral |
| Franc                       | Down      |       |        | 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.

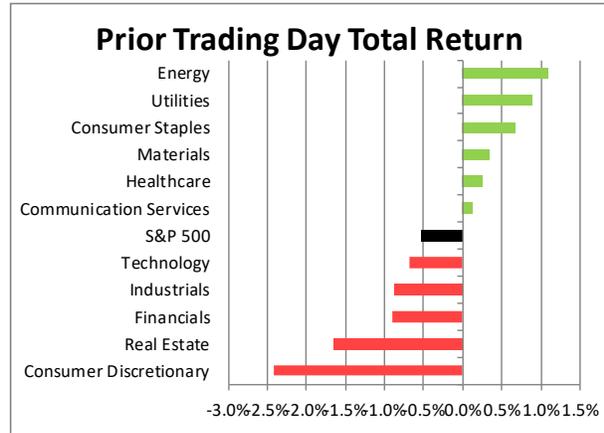
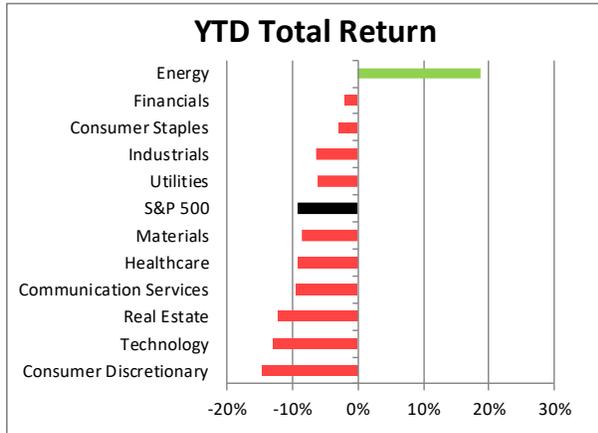
|                             | Price         | Prior           | Change            | Explanation |
|-----------------------------|---------------|-----------------|-------------------|-------------|
| <b>Energy Markets</b>       |               |                 |                   |             |
| Brent                       | \$90.59       | \$89.34         | 1.40%             |             |
| WTI                         | \$87.75       | \$86.61         | 1.32%             |             |
| Natural Gas                 | \$4.49        | \$4.28          | 4.81%             |             |
| Crack Spread                | \$22.60       | \$22.65         | -0.22%            |             |
| 12-mo Strip Crack           | \$22.60       | \$22.77         | -0.74%            |             |
| Ethanol Rack                | \$2.27        | \$2.27          | 0.10%             |             |
| <b>Metals</b>               |               |                 |                   |             |
| Gold                        | \$1,790.84    | \$1,797.43      | -0.37%            |             |
| Silver                      | \$22.59       | \$22.77         | -0.80%            |             |
| Copper contract             | \$434.20      | \$442.35        | -1.84%            |             |
| <b>Grains</b>               |               |                 |                   |             |
| Corn contract               | \$627.75      | \$625.25        | 0.40%             |             |
| Wheat contract              | \$776.75      | \$777.00        | -0.03%            |             |
| Soybeans contract           | \$1,459.25    | \$1,448.25      | 0.76%             |             |
| <b>Shipping</b>             |               |                 |                   |             |
| Baltic Dry Freight          | 1,302         | 1,296           | 6                 |             |
| <b>DOE inventory report</b> |               |                 |                   |             |
|                             | <b>Actual</b> | <b>Expected</b> | <b>Difference</b> |             |
| Crude (mb)                  | 2.4           | 1.0             | 1.4               |             |
| Gasoline (mb)               | 1.3           | 1.9             | -0.6              |             |
| Distillates (mb)            | -2.8          | -1.2            | -1.6              |             |
| Refinery run rates (%)      | -0.40%        | -0.40%          | 0.00%             |             |
| Natural gas (bcf)           | -219.0        | -216.0          | -3.0              |             |

## Weather

The 6-10 day and 8-14-day forecasts currently call for warmer-than-normal temperatures throughout the entire region east of the Mississippi River, with cooler-than-normal temperatures in the Southwest and Upper Midwest. The forecasts call for wet conditions throughout the eastern half of the country and dry conditions in California.

**Data Section**

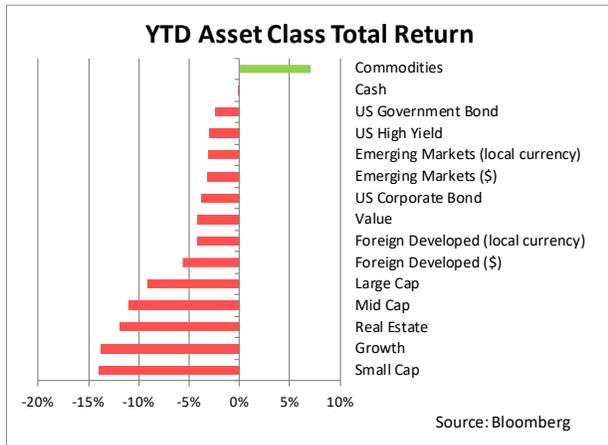
**U.S. Equity Markets – (as of 1/27/2022 close)**



(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 1/27/2022 close)**

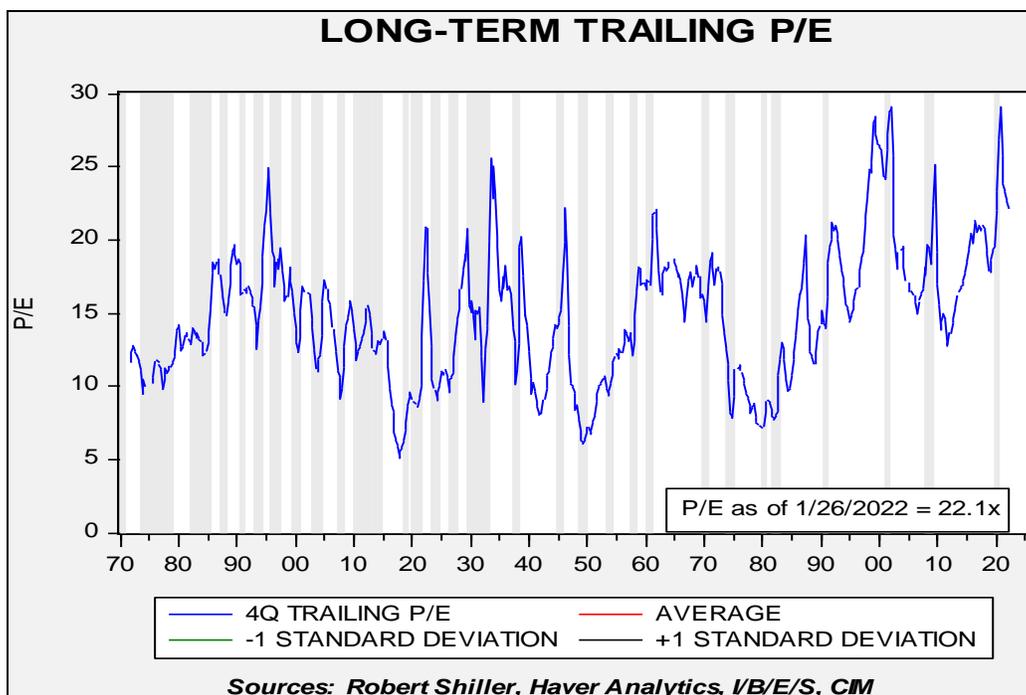


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 27, 2022



Based on our methodology,<sup>1</sup> the current P/E is 22.1x, down 0.5x 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.