

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: July 12, 2022—9:30 AM EDT] Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 is currently down 0.8% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.9%. Chinese markets were lower, with the Shanghai Composite closing down 1.0% from its prior close and the Shenzhen Composite closing down 1.5%. U.S. equity index futures are signaling a lower open.

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](#) (6/21/2022) (with associated [podcast](#)): “The 2022 Mid-Year Geopolitical Outlook”
- [Weekly Energy Update](#) (6/30/2022): The DOE updated the past 2 weeks of data; we have updated our charts too. We discuss the G-7 meeting and note the SPR is not only seeing an aggressive withdrawal, but the majority of the oil sold is heavy/sour, meaning its use as a strategic stock is being compromised.
- [Asset Allocation Quarterly - Q2 2022](#) (4/21/2022): Discussion of our asset allocation process, Q2 2022 portfolio changes, and our outlook for the markets
- [Asset Allocation Bi-Weekly](#) (7/11/2022) (with associated [podcast](#)): “The ECB Dilemma”
- [Confluence of Ideas podcast](#) (3/25/2022): “The 2022 Outlook: Update #1”
- *Current Perspectives*: “[2022 Outlook: Update #1](#)” (2/18/2022)

Our *Comment* today opens with an update on the Russia-Ukraine war, focusing on the two sides’ artillery attacks even as they remain generally in an operational pause. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including an important warning from a Federal Reserve official that the central bank may be tightening policy too rapidly.

Russia-Ukraine: Russian and Ukrainian forces both remain in a relative operational pause, with both sides engaging in only limited, sporadic ground attacks. However, both sides also continue to stage more substantial long-range artillery attacks on each other. According to Kyiv, the Ukrainian military used advanced artillery systems recently delivered from the West to destroy at least one Russian command post and ammunition depot near the occupied southern city of Kherson, killing a dozen Russian officers. Other reporting suggests the Ukrainians may have destroyed as many as 20 ammunition depots with the new weapons, producing increasingly

severe shortages for the Russian forces. Meanwhile, the U.S. announced last week that it will [send four more HIMARS long-range artillery systems to Ukraine](#), bringing the total sent to 12. Finally, in a welcome sign that Ukraine could eventually resume some food exports despite the war, officials said the recent liberation of the strategically located Snake Island off Ukraine's southern coast [has allowed eight foreign ships to access Ukrainian ports](#).

- U.S. National Security Advisor Sullivan said intelligence [indicates Iran is preparing to provide Russia several hundred drones, including weapons-capable versions](#), to help on the Ukrainian battlefield. Under the deal, Iran will also train Russian troops to use the drones, beginning as early as this month.
- In a sign that at least France hasn't yet lost its urgency to rebuild its armed forces in response to Russian aggression, Defense Minister Lecornu [proposed a €44-billion military budget for 2023, up €3 billion from the 2022 budget](#). If enacted, the defense budget increase would be nearly twice as large as any in the last two years.
 - In part, the higher defense spending is needed to replenish munitions and equipment that have been sent to Ukraine.
 - The government is also looking to fund major modernization efforts, support ongoing efforts to combat terrorism, and boost its defense industrial base.

Eurozone: Reflecting Europe's wartime energy crisis, record-high inflation, and lagging monetary policy, the euro continues to lose value and [almost fell to parity with the dollar](#) earlier today. At its lowest point, the euro could be bought for just \$1.0002, its lowest level since 2002.

- Despite the inopportune timing, EU finance ministers this morning will give their final thumbs up to Croatia's adoption of the euro from January 1. According to [studies of how the euro transition in other countries worked out](#), we would look for a modest increase in Croatian inflation early next year as shopkeepers take advantage of the opportunity to round up their new euro prices.
- We also note that with its adoption of the euro, Croatia will gain a seat on the ECB's policy board.

European Travel Industry: London's Heathrow Airport [said it would cap the number of departing passengers from the facility at 100,000 a day until September](#) and has asked airlines to stop selling new tickets from the airport for the summer season. The move follows similar caps imposed at London's Gatwick Airport and Amsterdam's Schiphol Airport as rebounding travel demand collides with post-pandemic labor shortages.

United Kingdom: Former Chancellor Rishi Sunak [has emerged as the front-runner in the race to replace Boris Johnson as Conservative Party leader and prime minister](#). Sunak currently has more publicly declared support from other members of parliament than any of the other remaining nine candidates, including several high-profile supporters. However, his challenge is to head off opposition from the right of the party, notably from other contenders with more aggressive tax-cutting platforms.

Argentina: In her first official press conference yesterday, newly appointed Finance Minister Batakis said she [is committed to the IMF-Argentina financing deal struck earlier this year](#). She also promised that Argentina "is not going to spend more than we have." Meanwhile, IMF

Managing Director Georgieva said she felt positive after her first meeting with Batakis last week. Despite the good vibes, however, we think the Peronist government in Buenos Aires will have a hard time regaining investor confidence after its long string of debt defaults.

South Pacific: After months of controversy over China's move to build security ties among the island nations of the South Pacific, both Kiribati and the Marshall Islands [have abruptly pulled out of a Pacific Islands Forum summit meeting](#). The news has stoked concern that Chinese meddling was behind the rupture, as it tries to weaken the region's most important diplomatic body and assert its own leadership instead.

Global Personal Computer Market: Data firm Gartner (IT, \$244.37) said global PC shipments in the second quarter [were down 12.6% year-over-year](#), marking their steepest annual decline in nine years. The decline reflects several challenges for PC makers, including geopolitical uncertainty sparked by the Russia-Ukraine war, spending shifts as consumers adjust to higher inflation, a reversal of pandemic-driven electronics demand, and ongoing supply chain issues. The report could be a further headwind for technology stocks in the near term.

United States – Saudi Arabia: As President Biden embarks on a trip to the Middle East tomorrow, his administration [is reportedly considering reversing its policy of only selling defensive weapons to Saudi Arabia](#). As Biden seeks to repair U.S.-Saudi relations and secure a boost in OPEC oil production, the reports suggest that the Saudis will demand renewed U.S. commitments to the defense of the kingdom in return, probably in conjunction with warmer rhetoric on Biden's part.

U.S. Monetary Policy: Kansas City FRB President Esther George, who has traditionally been one of the strongest inflation hawks on the Fed's policymaking board, said in a speech that the Fed [may be hiking interest rates and pulling back its balance sheet too rapidly for the economy and financial markets to absorb](#).

- The statement supports the view that the Fed's rapid policy tightening will produce a recession in the coming months and force it to reverse course much earlier than planned.
- Coupled with other recent signs suggesting that the economy may be losing momentum, George's statement about economic problems spurred by monetary policy is probably one reason for the further downdraft in risk assets so far today.

U.S. Labor Market: According to new data from the National Labor Relations Board, the number of workplaces where employees have started trying to organize unions [jumped to 1,411 in the first half of 2022, up 69% from the same period in 2021](#).

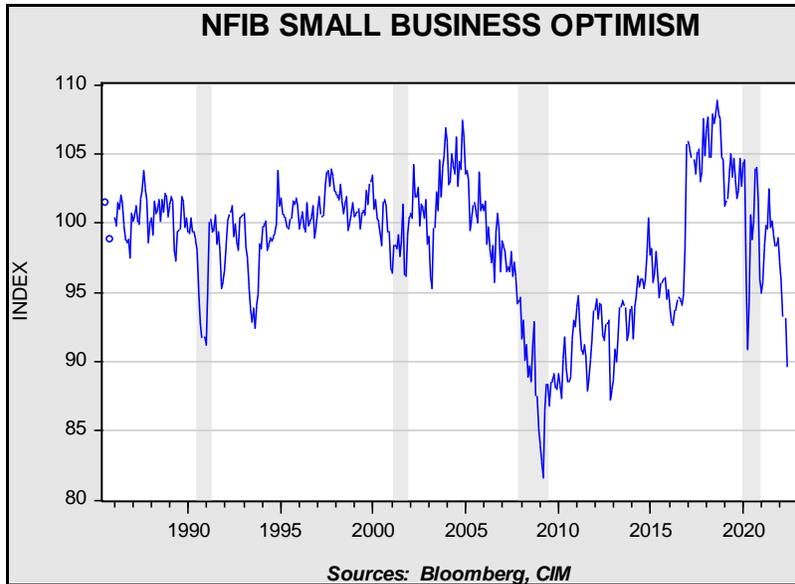
- In large part, the rise probably reflects the increased bargaining power that workers feel after so many people dropped out of the labor force during the coronavirus pandemic. In addition, greater unionization efforts may reflect improved sentiment toward unions among the broader public.
- All the same, we note that the unionization efforts in the first half of the year were no higher than in 2015. The long-term trend has been for decreased unionization in the U.S., which has contributed to economic inequality but probably supported corporate profit

margins. We suspect that new unionization efforts would need to expand much further to reverse those trends.

U.S. Energy Market: Yesterday, the Electric Reliability Council of Texas [asked residents to conserve electricity as extreme heat blanketed much of the state and threatened the power grid's capacity](#). If electricity supplies get stretched too thin, the organization can order large customers or transmission companies to turn off their power. In extreme circumstances, it can also begin rolling blackouts, which could meaningfully disrupt economic activity in the state.

U.S. Economic Releases

U.S. small business optimism fell to a nine-year low due to concerns of elevated inflation and labor shortages. The National Federation of Independent Business (NFIB) small business optimism index fell from 93.5 to 89.5 in June.



The decline in the index was driven by concerns that firms may not be able to pass on higher prices to consumers. The net percent of small business owners surveyed who expect higher sales fell from -15% to -28%, meanwhile the share of owners that believe that they can raise selling price declined from 72% to 69%. Despite the decline in sentiment, 50% of survey respondent stated that they are filling vacancies.

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

Economic Releases		
No economic releases for the rest of today		
Federal Reserve		
EST	Speaker or Event	District or Position
12:30	Thomas Barkin Discusses the 'Recession Question'	President of the Federal Reserve Bank of Richmond

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	PPI	y/y	Jun	9.2%	8.9%	8.9%	***	Equity bearish, bond bullish
Australia	Westpac Consumer Conf Index	m/m	Jul	83.8	86.4		**	Equity and bond neutral
	Westpac Consumer Conf SA	m/m	Jul	-3.0%	-4.5%		**	Equity and bond neutral
	NAB Business Conditions	m/m	Jun	13.0	15.0		***	Equity and bond neutral
	NAB Business Confidence	m/m	Jun	1.0	6.0		***	Equity bearish, bond bearish
China	Aggregate Financing CNY	m/m	Jun	5.170t	2.720t	4.200t	**	Equity and bond neutral
	New Yuan Loans	m/m	Jun	2.810t	1.889t	2.400t	**	Equity and bond neutral
	Money Supply M0	y/y	Jun	13.8%	13.5%	12.0%	*	Equity bullish, bond bearish
	Money Supply M1	y/y	Jun	5.8%	4.6%	4.9%	*	Equity and bond neutral
	Money Supply M2	y/y	Jun	11.4%	11.1%	11.0%	***	Equity and bond neutral
India	Industrial Production	y/y	May	19.6%	7.1%	20.8%	***	Equity and bond neutral
	CPI	y/y	Jun	7.0%	7.0%	7.1%	***	Equity and bond neutral
EUROPE								
Eurozone	ZEW Survey Expectations	m/m	Jul	-51.1	-28.0		**	Equity bearish, bond bearish
Germany	ZEW Survey Current Situation	m/m	Jul	-45.8	-27.6	-34.5	**	Equity bearish, bond bearish
Russia	Current Account Balance	m/m	2Q P	70.100b	\$68.384b		**	Equity and bond neutral
AMERICAS								
Mexico	Industrial Production	y/y	May	3.3%	2.7%	3.0%	***	Equity and bond neutral
	Manufacturing Production	y/y	May	6.1%	3.9%	5.2%	*	Equity bullish, bond bearish
Brazil	IBGE Services Volume	y/y	May	9.2%	9.4%	8.5%	*	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)	242	243	-1	Up
3-mo T-bill yield (bps)	203	209	-6	Up
TED spread (bps)	40	34	6	Widening
U.S. Sibor/OIS spread (bps)	230	229	1	Up
U.S. Libor/OIS spread (bps)	236	234	2	Up
10-yr T-note (%)	2.92	2.99	-0.07	Up
Euribor/OIS spread (bps)	-7	-9	2	Neutral
Currencies	Direction			
Dollar	Up			Up
Euro	Down			Down
Yen	Up			Down
Pound	Down			Down
Franc	Down			Down

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	\$104.72	\$107.10	-2.22%	Global growth pessimism
WTI	\$101.49	\$104.09	-2.50%	
Natural Gas	\$6.56	\$6.43	2.05%	
Crack Spread	\$45.62	\$45.93	-0.67%	
12-mo strip crack	\$35.16	\$35.67	-1.43%	
Ethanol rack	\$2.85	\$2.85	0.15%	
Metals				
Gold	\$1,735.57	\$1,733.96	0.09%	
Silver	\$18.91	\$19.12	-1.09%	
Copper contract	\$335.85	\$343.05	-2.10%	
Grains				
Corn contract	\$620.75	\$629.00	-1.31%	
Wheat contract	\$839.75	\$856.50	-1.96%	
Soybeans contract	\$1,385.50	\$1,405.00	-1.39%	
Shipping				
Baltic Dry Freight	2,081	2,067	14	
DOE Inventory Report				
	Actual	Expected	Difference	
Crude (mb)		-1.5		
Gasoline (mb)		-1.0		
Distillates (mb)		1.7		
Refinery run rates (%)		5.0%		

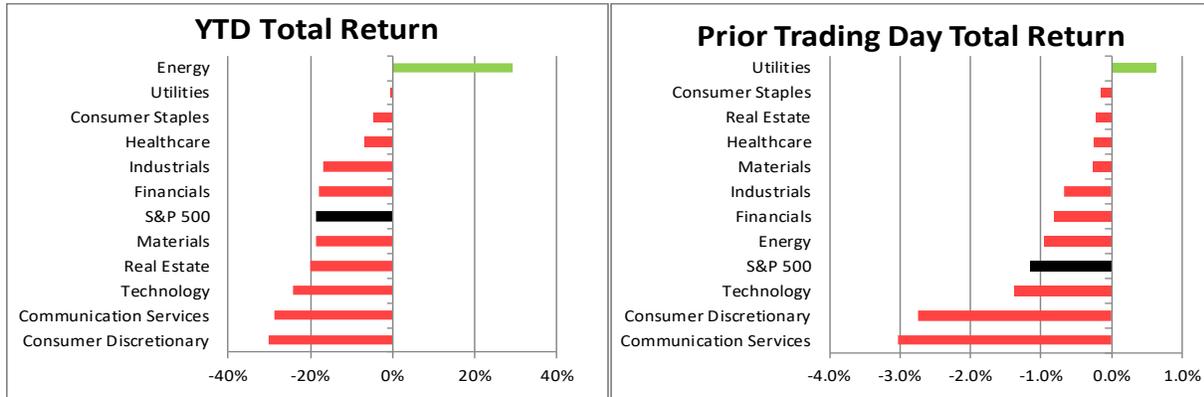
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures throughout most of the country west of the Pacific, with cooler temperatures in the Southwest. Wetter-than-normal conditions are expected throughout the Southwest and Mid-Atlantic, with dry conditions expected in the Midwest, Great Plains, and Rocky Mountain regions.

There is some cyclone formation around the border of Mississippi and Georgia; however, it is not expected to develop into a tropical storm within the next 48 hours.

Data Section

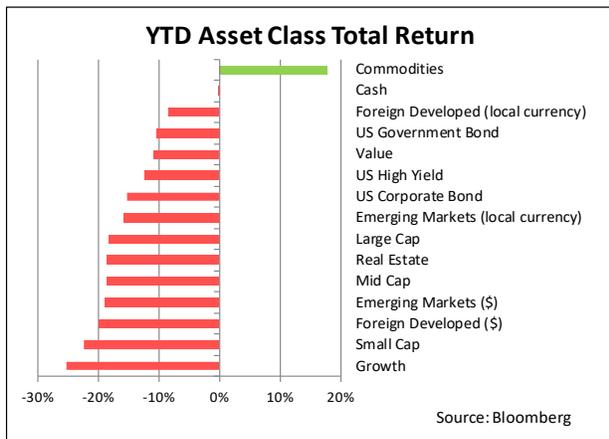
U.S. Equity Markets – (as of 7/11/2022 close)



(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 7/11/2022 close)

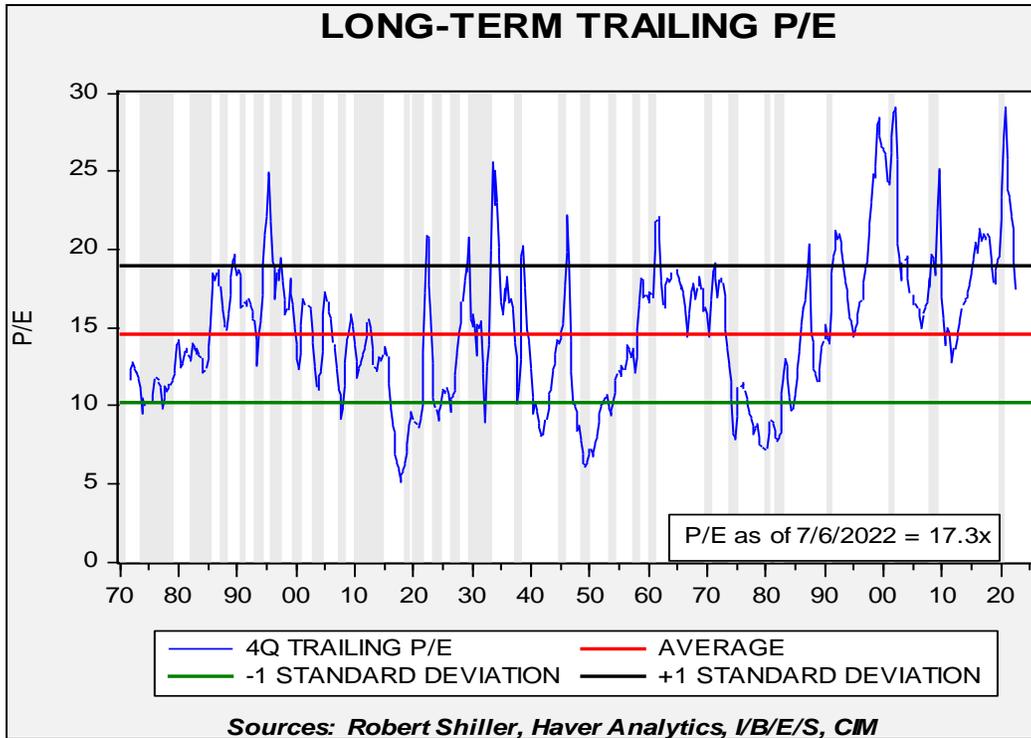


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

July 7, 2022



Based on our methodology,¹ the current P/E is 17.3x, down 2.0x from last week. The drop in the P/E is due to the calendar; we are now in Q3 which resets the index average and incorporates earnings estimates for Q3.

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 (Q4 and Q1) and two estimates (Q2 and Q3). 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.