

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 27, 2021—9:30 AM EDT]** Global equity markets are lower this morning. In Europe, the EuroStoxx 50 is down 0.5% from its prior close. In Asia, the MSCI Asia Apex 50 closed down 2.9%. Chinese markets were lower, with the Shanghai Composite down 2.3% from its prior close and the Shenzhen Composite down 3.3%. U.S. equity index futures are signaling a lower open. With 120 companies having reported, the S&P 500 Q2 2021 earnings stand at \$48.10, higher than the \$45.31 forecast for the quarter. The forecast reflects a 60.0% increase from Q2 2020 earnings. Thus far this quarter, 86.7% of the companies have reported earnings above forecast, while 12.5% 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:

- **[Weekly Geopolitical Report \(7/26/2021\): “The Protests in Cuba”](#)**
- [Weekly Energy Update \(7/22/2021\)](#): OPEC+ has a deal, and a nuclear deal with Iran is looking less likely.
- [Asset Allocation Q2 2021 Rebalance Presentation \(5/20/2021\)](#): A video discussion of our asset allocation process, portfolio changes in Q2, and the macro environment
- [Asset Allocation Weekly \(7/23/2021\)](#) (with associated [podcast](#) and [chart book](#)): We look at the implications for investors and for the world economy of high corporate debt in China.
- [Confluence of Ideas podcast \(7/7/2021\)](#): “The Geopolitics of Taiwan and the Issue of Globalization”

In today's *Comment*, we open with multiple global and U.S. developments touching on taxes, fiscal policy, monetary policy, and labor market regulation. Next, we discuss a variety of foreign news ranging from the sharp drop in Chinese stocks stemming from that country's crackdown on its tech sector to cooling tensions between North Korea and South Korea. We close with the latest developments on the coronavirus pandemic.

**Global Corporate Tax Deal:** According to the *Wall Street Journal*, the pharmaceutical industry [is already quietly mobilizing to fight the recent global deal on a minimum corporate income tax rate](#) of 15% and other provisions to stop tax avoidance. Lawyers and company officials estimate the tax overhaul, if adopted, could cost some of the biggest pharmaceutical companies hundreds of millions of dollars more each year. Given the lobbying resources available to the industry and

its past success in protecting its interests, the drug-industry pushback could have a meaningful impact in watering down the proposal.

**U.S. Fiscal Policy:** Lawmakers negotiating over the bipartisan “hard” infrastructure bill totaling approximately \$1 trillion [continued to hit stumbling blocks late Monday](#), with the latest squabbles touching issues such as funding for water infrastructure, a requirement that federal contractors pay their employees a locally prevailing wage, and how to pay for the plan. Meanwhile, Senate Majority Leader Schumer said lawmakers might need to work through the coming weekend to finish the deal.

**U.S. Monetary Policy:** The Federal Reserve [will open its latest two-day policy meeting today](#), with a decision and a press conference with Chair Powell on Wednesday afternoon. We expect no change to the Fed’s benchmark fed funds interest rate or its bond-buying program. However, with multiple renegades on the policymaking committee calling for tighter monetary policy sooner rather than later, the officials are likely to signal continued discussion about the timing of an asset-purchase taper later in the year.

**U.S. Labor Market Regulation:** The Biden administration [is reportedly developing a series of regulatory changes aimed at increasing workers’ pay and gaining other benefits for them](#). The rule changes, most of which are still being drafted, would affect workers such as federal contractors, tipped employees, and workers who are jointly employed (such as those with jobs at franchised brands). In some cases, the changes seek to reverse Trump administration efforts. In others, the Labor Department is working to implement its own rules.

- The new rules would be separate from other administration proposals aimed at tilting the balance of power toward workers from employers, including raising the federal minimum wage for private-sector employees, increasing wages for caregivers, and making it easier for workers to organize labor unions. In contrast with those proposals, however, the new rules would not require Congress to pass new legislation.
- If the rules successfully shift the balance of power in the labor market towards workers, they could raise costs for businesses beyond the amount firms can recoup by raising prices. In other words, the proposals could work to push down margins over time, which could become a headwind for stocks.

**Chinese Technology Stocks:** Chinese tech stocks [plunged for a third day](#) amid investor fears about the government’s [mounting regulatory crackdown on the sector](#). The government continues to signal its attempts to bring this sector under its control because of multiple concerns ranging from anti-competitive behavior, data security infractions, child pornography, and even the high cost of online tutoring. We continue to note rising regulatory risks facing powerful technology companies worldwide, but perhaps most acutely in China.

- Hong Kong’s Hang Seng stock benchmark closed down more than 5% today, while the Hang Seng Tech sub-index declined 8.7%.
- The Nasdaq Golden Dragon China Index, a benchmark of Chinese tech stocks listed in New York, has dropped roughly 15% over the last two days — its worst fall since 2008.
- Some of the most widely held Chinese tech stocks fell even more.

**North Korea-South Korea:** North Korea [reactivated its direct communication lines with the South Korean government](#), raising the prospect that the Kim Jong Un regime could be ready for engagement after a protracted period of diplomatic silence. Pyongyang had severed all communication with the Seoul government since June 2020, after Kim Yo Jong, the dictator's sister, condemned South Korean activists for sending antiregime leaflets over the border. More recently, the regime has shown signs it is reeling under economic and other stresses. Faced with the threat of instability, it will most likely seek some kind of economic assistance in return for temporary good behavior.

**Turkey-Ukraine-Russia:** The Ukrainian Navy [has reportedly taken delivery of the first of six Bayraktar TB2 drones it is acquiring from Turkish defense firm Baykar](#). Last year, advanced Turkish drones were instrumental in giving Azerbaijan the upper hand over Armenia in their conflict over Nagorno-Karabakh. As might be expected, the Russian Defense Ministry issued a strong warning to Turkey that it shouldn't help build up Ukraine's military capabilities.

**Brazil:** The worst frost to strike Brazil's coffee-growing region in over 25 years [will cut a chunk out of next year's crop](#), just as drought cut the 2021 crop. As a result, coffee prices have surged to six-year highs, following a years-long stretch of depressed prices that prompted many farmers to abandon their fields.

- New York arabica bean futures have jumped to \$2.08 a pound, reaching their highest level since late 2014.
- Coffee futures have climbed 30% so far in July, and they have almost doubled over the past year.

**Tunisia:** The country [plunged deeper into a political crisis yesterday](#) as President Kais Saied tightened his grip on power, dismissing top government officials and deploying military forces around the prime minister's office in a dramatic move that opponents called a coup attempt. Saied has also issued a decree declaring a nighttime curfew and banning gatherings of more than three people.

**COVID-19:** Official data show confirmed cases [have risen to 194,885,476 worldwide, with 4,171,445 deaths](#). In the United States, confirmed cases rose to 34,535,436, with 611,007 deaths. [Vaccine doses delivered in the U.S. now total 394,949,575, while the number of people who have received at least their first shot totals 188,729,282](#). Finally, here is the [interactive chart](#) from the *Financial Times* that allows you to compare cases and deaths among countries, scaled by population.

#### *Virology*

- According to the latest CDC data, 56.8% of the U.S. population has now received at least one dose of a vaccine, and 49.1% of the population is fully vaccinated.
- With the Delta variant driving up new U.S. infections, especially among unvaccinated people, the Department of Veterans Affairs yesterday [became the first federal agency to require its workers to get vaccinated](#). Department employees who work in VA healthcare

facilities or provide direct care to veterans [will have eight weeks to get their shots or be at risk of losing their job](#).

- Meanwhile, California mandated that state employees working in healthcare facilities get their shots by August or be tested weekly for the virus. New York City issued a similar mandate that will be effective after Labor Day for all 350,000 municipal employees. In San Francisco, even an organization of private bar owners [said patrons who want to sit inside their establishments must show proof of vaccination or a recent, negative COVID-19 test](#). Vaccine or test mandates are also being imposed on people who want to enter certain facilities or venues in [France](#), [Italy](#), and other countries.
- While the California and New York City mandates touched off opposition from some employees, some 60 national groups representing doctors, nurses, and other healthcare workers [separately issued a call for employers to mandate vaccinations in all healthcare facilities](#). The groups, including the American Nurses Association, the American Medical Association, the Infectious Diseases Society of America, and the American Academy of Pediatrics, said unvaccinated healthcare workers are putting their patients and residents of long-term-care facilities at risk for infection.
- While good progress has been made on developing vaccines against COVID-19, much [less progress has been made on treatments for those who contract the disease](#). Of the ten drugs cleared or recommended for use in the U.S. to date, two later had their authorizations rescinded after they failed to work, and the government paused shipments of a third because it wasn't effective against new variants. The best medicines for early treatment are cumbersome to administer, and drugs for those in the hospital can only do so much for patients who are already severely ill.
  - Clinical trials are currently evaluating more than 225 drug treatments, including new medicines and some already approved for other conditions, to see whether they might also be effective against COVID-19.
  - A few potential therapies in development have shown promise, including antiviral drugs from Pfizer (PFE, \$41.81) and Merck (MRK, \$77.24).
- This week, the British government [will consider loosening travel restrictions for travelers from the EU and the U.S.](#), with one senior airport executive saying he's confident that ministers would broaden quarantine exemptions "imminently." The move, which one government official said was "finely balanced," would be a boost to the tourism sector and help to reopen the U.K. to mass foreign travelers.
- In contrast, the Biden administration [said it would maintain its pandemic-related travel bans for the foreseeable future on a range of countries](#), including the U.K., the EU, and China, due to the spread of the Delta variant.

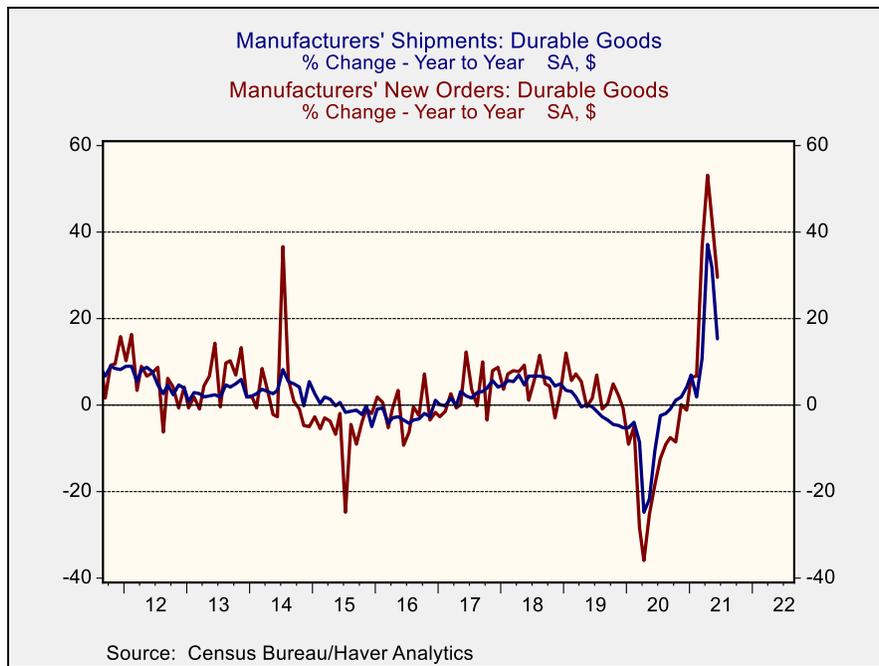
#### *Economic and Financial Market Impacts*

- In South Korea, second-quarter gross domestic product (GDP) [was up 5.9%](#) from one year earlier, partly reflecting base effects from the onset of the pandemic last year but

also reflecting strong exports and rebounding consumption. The year-over-year growth in the second quarter was the strongest in a decade. The fly in the ointment: Surging infections and low vaccination rates so far in July suggest growth could slow down dramatically in the third quarter.

### U.S. Economic Releases

The rise in durable goods orders was lower than anticipated in June, suggesting a mild slowdown in capital expenditure. Total durable goods orders rose 0.8% from the prior month compared to expectations of 2.1%. Excluding transportations, durable goods rose 0.3% from the prior month compared to expectations of 0.8%. Capital goods orders for nondefense excluding aircraft rose 0.6% from the prior month compared to expectations of a 0.8% rise. The shipment of capital goods for nondefense excluding air rose 1.7% from the previous month compared to expectations of 0.8%.



The chart above shows the annual change in durable goods orders and shipments. Durable goods orders rose 29.3% from the prior year, while durable shipments rose 15.2%.

In May, low interest rates continued to support higher home prices. The FHFA House Price Index rose 1.7% from the previous month compared to expectations of 1.6%. The S&P CoreLogic Case-Shiller Home Price Index rose 1.8% from the prior month. Meanwhile, the S&P CoreLogic Case-Shiller Home Price Index for the top 20 cities rose 1.8% from the prior month compared to expectations of a 1.5% increase.



The chart above shows the annual change in the S&P CoreLogic Case-Shiller Home Price Index. Home prices in the national composite index rose 16.6% from the prior year, while home prices for the top-20 cities rose 17%.

The table below shows the domestic releases scheduled for the rest of the day.

Economic Releases						
EDT	Indicator			Expected	Prior	Rating
10:00	Conf. Board Consumer Confidence	m/m	Jul	123.9	127.3	***
10:00	Conf. Board Present Situation	m/m	Jul		157.7	**
10:00	Conf. Board Expectations	m/m	Jul		107.0	**
10:00	Richmond Fed Manufact. Index	m/m	Jul	20	22	*
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.

Country	Indicator			Current	Prior	Expected	Rating	Market Impact
<b>ASIA-PACIFIC</b>								
China	Industrial Profits	y/y	Jun	0.204	36.4%		**	Equity and bond neutral
Japan	PPI Services	y/y	Jun	1.4%	1.5%	1.3%	**	Equity and bond neutral
Australia	ANZ Roy Morgan Consumer Confidence	w/w	25-Jul	100.7	104.3		**	Equity and bond neutral
<b>EUROPE</b>								
Eurozone	M3 Money Supply	y/y	Jun	0.1	8.4%	8.2%	**	Equity and bond neutral
France	Total Jobseekers	q/q	2Q	3510.5k	3560.6k		**	Equity and bond neutral
UK	CBI Retailing Reported Sales	m/m	Jul	23.0	25.0	20.0	**	Equity and bond neutral
	CBI Total Dist. Reported Sales	m/m	Jul	41.0	40.0		**	Equity and bond neutral
<b>AMERICAS</b>								
Brazil	FGV Consumer Confidence	m/m	Jul	82.2	80.9		***	Equity bullish, bond bearish
	Trade Balance Weekly	w/w	25-Jul	\$1869m	\$2036m		**	Equity and bond neutral
Canada	Bloomberg Nanos Confidence	w/w	23-Jul	66.0	66.3		***	Equity and bond bullish
Mexico	Unemployment Rate NSA	m/m	Jun	4.0%	4.0%	4.5%	***	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.

	Today	Prior	Change	Trend
3-mo Libor yield (bps)	13	13	0	Down
3-mo T-bill yield (bps)	3	4	-1	Neutral
TED spread (bps)	10	8	2	Neutral
U.S. Libor/OIS spread (bps)	9	9	0	Up
10-yr T-note (%)	1.25	1.29	-0.04	down
Euribor/OIS spread (bps)	-54	-54	0	Neutral
EUR/USD 3-mo swap (bps)	5	5	0	Down
<b>Currencies</b>	<b>Direction</b>			
dollar	Up			Down
euro	Down			Up
yen	Up			Up
pound	Down			Up
franc	Down			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.

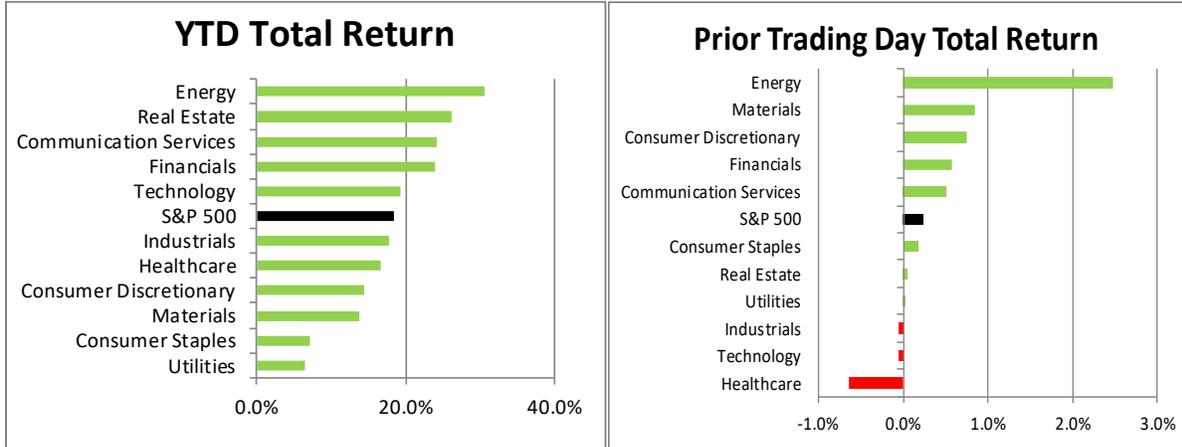
	Price	Prior	Change	Explanation
<b>Energy Markets</b>				
Brent	\$74.75	\$74.50	0.34%	
WTI	\$71.98	\$71.91	0.10%	
Natural Gas	\$4.10	\$4.10	0.02%	
Crack Spread	\$22.31	\$22.02	1.29%	
12-mo strip crack	\$20.45	\$20.32	0.68%	
Ethanol rack	\$2.38	\$2.38	0.06%	
<b>Metals</b>				
Gold	\$1,797.31	\$1,797.63	-0.02%	
Silver	\$25.16	\$25.19	-0.13%	
Copper contract	\$455.45	\$458.50	-0.67%	
<b>Grains</b>				
Corn contract	\$ 552.75	\$ 546.75	1.10%	
Wheat contract	\$ 675.50	\$ 677.00	-0.22%	
Soybeans contract	\$ 1,372.75	\$ 1,357.75	1.10%	
<b>Shipping</b>				
Baltic Dry Freight	3210	3199	11	
<b>DOE inventory report</b>				
	<b>Actual</b>	<b>Expected</b>	<b>Difference</b>	
Crude (mb)		-2.1		
Gasoline (mb)		-1.0		
Distillates (mb)		-0.3		
Refinery run rates (%)		0.45%		

## Weather

The 6-10 day and 8-14 day forecasts currently call for warmer-than-normal temperatures for virtually all of the middle tier of the country, from Northern California through the Great Plains and into the Mid-Atlantic states. New England is the only region expected to have cooler-than-normal temperatures. The forecast calls for wetter-than-normal conditions in the Pacific region, with dry conditions for most of the country. There is a cyclonic disturbance in the Atlantic off the coasts of South Carolina and Georgia, but it is not expected to develop into a tropical storm.

**Data Section**

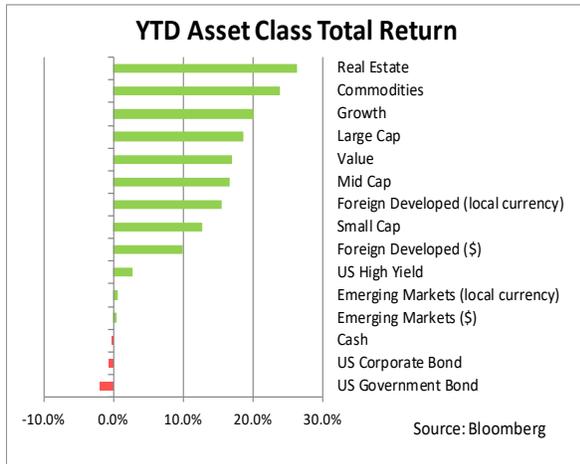
**U.S. Equity Markets – (as of 7/26/2021 close)**



(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 7/26/2021 close)**

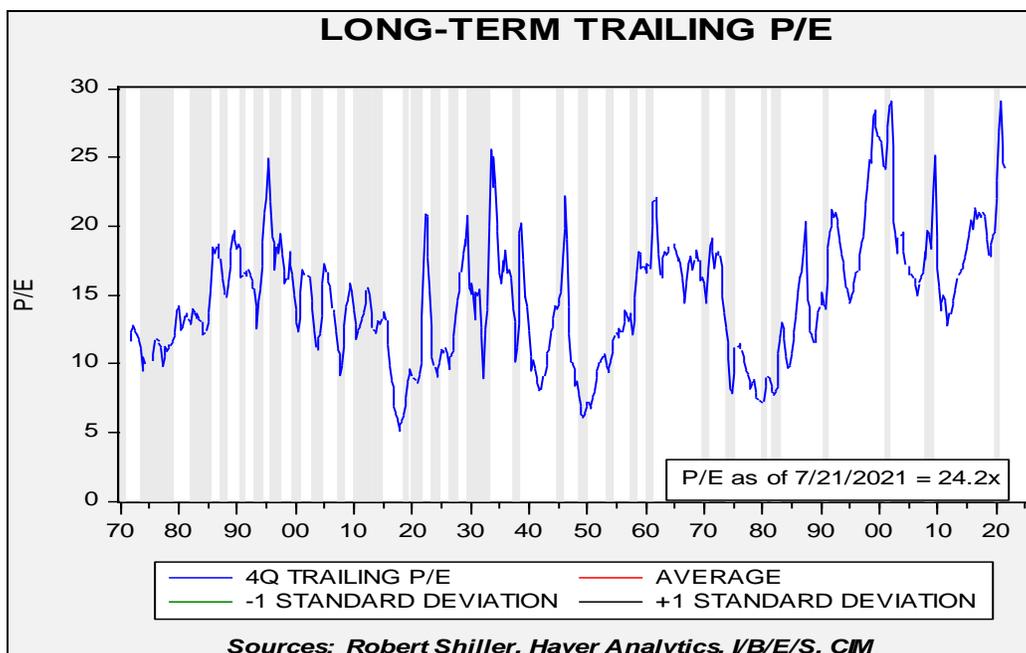


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 22, 2021



Based on our methodology,<sup>1</sup> the current P/E is 24.2x, -0.2x from last week. Rising earnings and steady index values led to the decline in the multiple.

*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 (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.