

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 19, 2023—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is currently up 0.2% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.4%. Chinese markets were mostly lower, with the Shanghai Composite relatively unchanged from its previous close and the Shenzhen Composite down 0.3%. U.S. equity index futures are signaling a lower open.

With 38 companies having reported so far, S&P 500 earnings for Q2 are running at \$52.80 per share, compared to estimates of \$53.55, which is down 6.8% from Q2 2022. Of the companies that have reported thus far, 84.2% have exceeded expectations while 7.9% have fallen short of expectations.

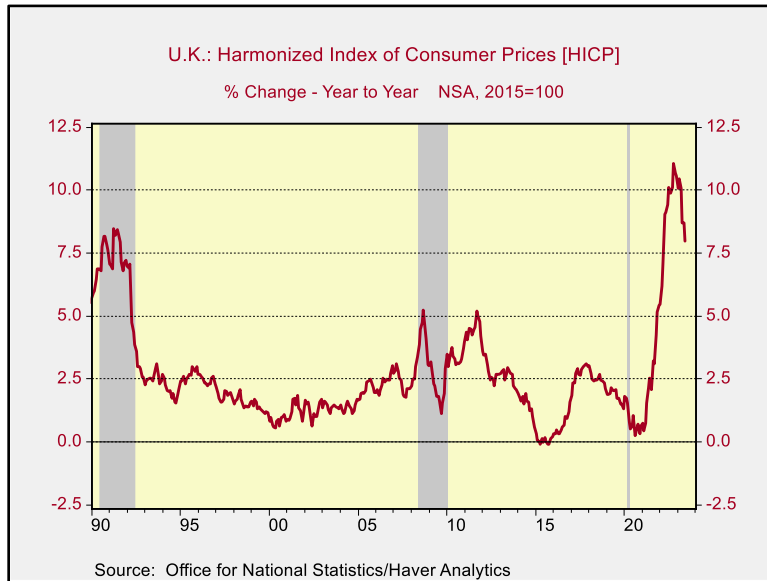
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our [website](#). We highlight recent publications below, with new items of the day emphasized in bold:

- [Bi-Weekly Geopolitical Report](#) (7/10/2023) (see podcast link below): “The 2023 Mid-Year Geopolitical Outlook: The Polycrisis”
- [Weekly Energy Update](#) (7/13/2023): Hot weather continues to dominate in much of the southern U.S. The race for EV battery materials continues.
- [Asset Allocation Quarterly – Q2 2023](#) (4/25/2023): Discussion of our asset allocation process, Q2 2023 portfolio changes, and our outlook for the markets.
- [Asset Allocation Q2 2023 Rebalance Presentation](#) (5/11/2023): Video presentation featuring the Asset Allocation Committee as they review our asset allocation strategies, recent portfolio changes, and the current macro environment.
- [Asset Allocation Bi-Weekly](#) (7/17/2023) (with associated [podcast](#)): “Are Higher Interest Rates Bearish for Risk Assets?”
- [Confluence of Ideas podcast](#) (7/10/2023): “The 2023 Mid-Year Geopolitical Outlook”

Our *Comment* today opens with good news on consumer price inflation in the United Kingdom, which has helped push down bond yields so far this morning. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including news that Russian President Putin is handing control of expropriated Western assets to his cronies and a discussion of new antitrust policies issued yesterday in the U.S.

United Kingdom: The June consumer price index [was up just 7.9% from the same month one year earlier, much cooler than expected after the rise of 8.7% in the year to May](#). Obviously, the U.K. inflation rate remains very high, but it now appears it could be on the verge of falling more rapidly, as the U.S. inflation rate has.

- The moderation in inflation has sparked hopes that the Bank of England might respond by slowing or stopping its aggressive interest rate hikes.
- That hope has sparked a furious rally in U.K. government bond prices so far today, driving yields lower. Currently, the yield on the benchmark two-year Gilt has fallen sharply to 4.858%, while the yield on the 10-year Gilt has declined to 4.185%. The yield on 10-year U.S. Treasury notes has fallen only modestly to 3.763%.
- The sharp decline in U.K. yields has also pushed down the value of the pound so far today. At this writing, the GBP is trading down 1.0% versus the dollar, to \$1.2910.



Japan: In contrast with the pound's fall today, the yen (JPY) [continues to rally in response to investor expectations that the Bank of Japan will soon loosen its policy of yield curve control](#) and allow longer-term bond yields to rise. So far this morning, the JPY is trading up 0.8% to 139.94 per dollar (\$0.0071 per JPY). That translates to an increase of approximately 4.0% just in July.

China: Foreign Minister Qin Gang [has not been seen in public now for almost a full month](#), and with government spokesmen unable to give a consistent explanation of his whereabouts, rumors are swirling about what might have happened. The rumors range from a health issue to the possibility that he has been caught up in some kind of scandal.

- Of course, Communist Party Foreign Affairs Chief Wang Yi remains very much in the public's view. Therefore, no matter what has happened to Qin, it wouldn't necessarily mean a substantial change in China's foreign policy.

- All the same, Qin’s mysterious absence raises questions about Chinese leadership politics and policy disputes.

Russia: Days after the government “temporarily” seized the Russian assets of French dairy firm Danone (DANOY, \$12.42) and Danish brewer Carlsberg (CABGY, \$30.63), new reporting says President Putin [ordered the expropriations after businessmen close to the Kremlin expressed an interest in the businesses](#). The key allies of Putin were named to lead the companies yesterday. The transfers are being widely seen as a sign that other seized Western assets in Russia will be transferred to Putin loyalists.

Thailand: The constitutional court yesterday [temporarily suspended the parliamentary duties of Pita Limjaroenrat, leader of the progressive Move Forward Party that won May’s elections](#). The suspension gave conservatives in the senate an opening to declare Pita ineligible to serve as prime minister, adding to their moves against his premiership last week.

- The maneuvers involving the constitutional court and senate illustrate how Thailand’s conservative establishment of generals, oligarchs, and royal officials are determined to keep Pita out of power.
- Some of Pita’s supporters have called for mass protests in the streets, creating a risk of political instability in what we consider a member of the evolving U.S. geopolitical and economic bloc. Indeed, Thailand has been benefiting as global businesses and investors shift away from the China/Russia bloc.

Kenya: Opposition leaders, including the former prime minister and five-time presidential candidate Raila Odinga, [have called for three days of mass protests against new taxes signed into law last month by President William Ruto](#). Previous violent demonstrations in recent weeks have already killed dozens, despite widespread beliefs that the conflict is really a personal feud fed by Odinga’s frustration at never having won the presidency.

United States-North Korea: A low-ranking U.S. soldier stationed in South Korea yesterday [crossed into North Korea and was taken into custody](#), apparently in a willful effort to escape prosecution for an assault charge south of the border. The soldier is now the only known U.S. citizen in North Korean custody, potentially creating more tensions between the two countries.

U.S. Antitrust Policy: In an announcement yesterday, the Justice Department and the Federal Trade Commission [jointly issued draft guidelines on how they will police proposed mergers](#). According to the agencies, the new guidelines have been designed to reflect current business practices and recent court rulings on company combinations.

- For the first time, the guidelines explicitly address problems that can result from deals involving dominant technology companies and private-equity firms.
- In another first, the guidelines say the agencies will examine whether a merger will leave the combined company so dominant in a local labor market that it reduces the competition for workers, potentially pushing down their wages.

U.S. Stock Market: New research from S&P Global (SPGI, \$421.85) found that nonfinancial investment-grade companies in the S&P 500 stock index [cut their total operating expenses](#) by 5.3% in the first quarter. The figures illustrate the way firms turned their attention to cost cutting as wages and interest rates rose and sales growth slowed in the period. Nevertheless, the cost cuts were mostly offset by a 3.9% fall in sales, leaving only a small rise in operating profits.

U.S. Economic Releases

A decrease in borrowing costs has led to a mild rise in residential loan requests. According to the Mortgage Bankers Association, mortgage applications rose 1.1% in the week ending July 14. The increase in applications is related to a sharp drop in mortgage rates. The average 30-year fixed-rate mortgage fell 20 bps from 7.07% to 6.87%. As a result, the MBA tracker for refinancing rose 7.0% from the prior week, while the purchase tracker fell 1.0% in the same period.

A reduction in multifamily projects led to a slowdown in construction activity in June. According to the U.S. Census Bureau, housing starts decelerated from a revised annualized pace of 1559k in May to 1434k in the following month. Similarly, the number of housing permits expanded at an annualized rate of 1444k last month, below expectations of 1462k.



The chart above shows the annualized pace of single and multifamily housing starts. The number of single-family dwelling projects expanded at annualized rate of 939k in June, meanwhile the multifamily dwelling projects increased at a rate of 499k 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								
Australia	Westpac Leading Index	m/m	Jun	0.1%	-0.3%	-0.26	**	Equity and bond neutral
New Zealand	CPI	y/y	Q2	6.0%	6.7%	5.9%	**	Equity and bond neutral
EUROPE								
Eurozone	CPI	y/y	Jun F	5.5%	6.1%	6.1%	***	Equity and bond neutral
	Core CPI	y/y	Jun F	5.5%	5.4%	5.4%	**	Equity and bond neutral
	Construction output	y/y	May	0.1%	0.2%	0.4%	*	Equity and bond neutral
UK	CPI	y/y	Jun	7.9%	8.7%	8.2%	***	Equity and bond neutral
	Core CPI	y/y	Jun	6.9%	7.1%	7.1%	**	Equity and bond neutral
	Retail Price index	y/y	Jun	376.40	375.30	377.10	***	Equity and bond neutral
	RPI	y/y	Jun	10.7%	11.3%	10.9%	*	Equity and bond neutral
AMERICAS								
Canada	Housing Starts	m/m	Jun	281.4k	202.5k	200.0k	**	Equity and bond neutral
	CPI	y/y	Jun	2.80%	3.40%	3.00%	***	Equity and bond neutral
	Industrial Product Price	m/m	Jun	-0.6%	-1.0%	-0.6%	**	Equity and bond neutral
	Raw Materials Price Incex	m/m	Jun	-1.5%	-4.9%	-5.0%	*	Equity bearish, bond bullish
Mexico	International Reserves Weekly	w/w	14-Jul	\$204.130b	\$203.071b		*	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)	558	557	1	Up
3-mo T-bill yield (bps)	523	524	-1	Up
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	534	533	1	Up
U.S. Libor/OIS spread (bps)	535	534	1	Up
10-yr T-note (%)	3.76	3.79	-0.03	Flat
Euribor/OIS spread (bps)	371	369	2	Up
Currencies	Direction			
Dollar	Up			Down
Euro	Flat			Up
Yen	Down			Down
Pound	Down			Up
Franc	Flat			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.

DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$80.01	\$79.63	0.48%	
WTI	\$75.98	\$75.75	0.30%	
Natural Gas	\$2.63	\$2.63	-0.15%	
Crack Spread	\$36.10	\$36.43	-0.91%	
12-mo strip crack	\$27.72	\$27.91	-0.68%	
Ethanol rack	\$2.69	\$2.69	0.24%	
Metals				
Gold	\$1,973.95	\$1,978.72	-0.24%	
Silver	\$25.03	\$25.06	-0.12%	
Copper contract	\$379.55	\$382.95	-0.89%	
Grains				
Corn contract	\$550.75	\$534.50	3.04%	
Wheat contract	\$693.50	\$670.75	3.39%	
Soybeans contract	\$1,413.50	\$1,395.25	1.31%	
Shipping				
Baltic Dry Freight	1,037	1,073	-36	
DOE Inventory Report				
	Actual	Expected	Difference	
Crude (mb)		-2.5		
Gasoline (mb)		-1.5		
Distillates (mb)		1.0		
Refinery run rates (%)		0.0%		
Natural gas (bcf)		43		

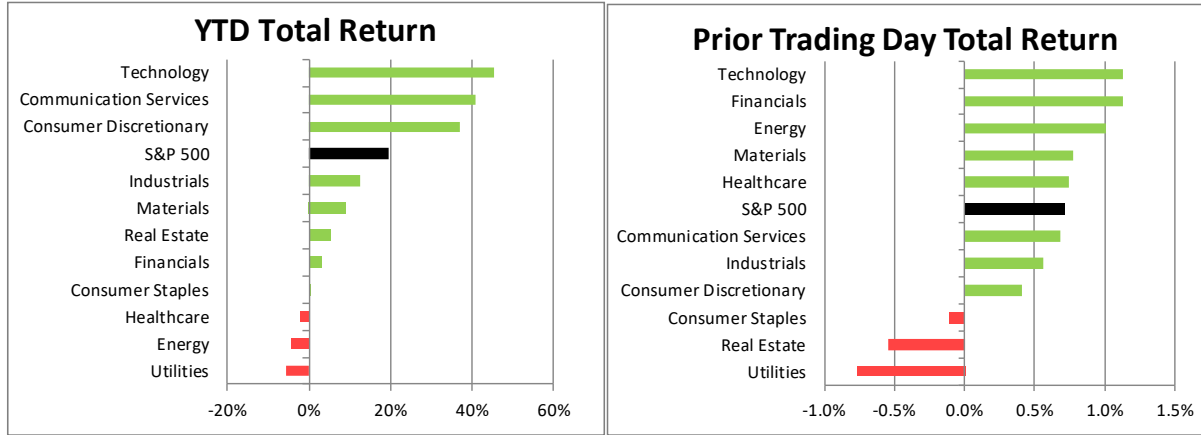
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures throughout the entire country. Meanwhile, the precipitation outlook calls for wetter-than-normal conditions in the Rocky Mountains and Midwest toward the end of the forecasting period, with dry conditions in the Pacific Northwest and northern Great Plains.

Tropical Storm Don has been downgraded to a depression at the very center of the Atlantic Ocean and is currently moving slowly northward. It is not expected to threaten any land mass.

Data Section

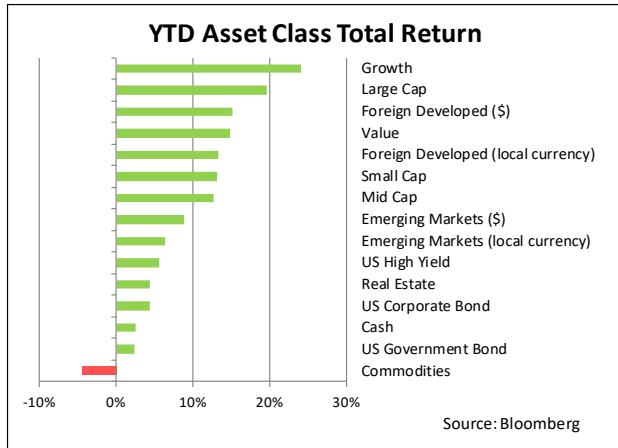
U.S. Equity Markets – (as of 7/18/2023 close)



(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 7/18/2023 close)

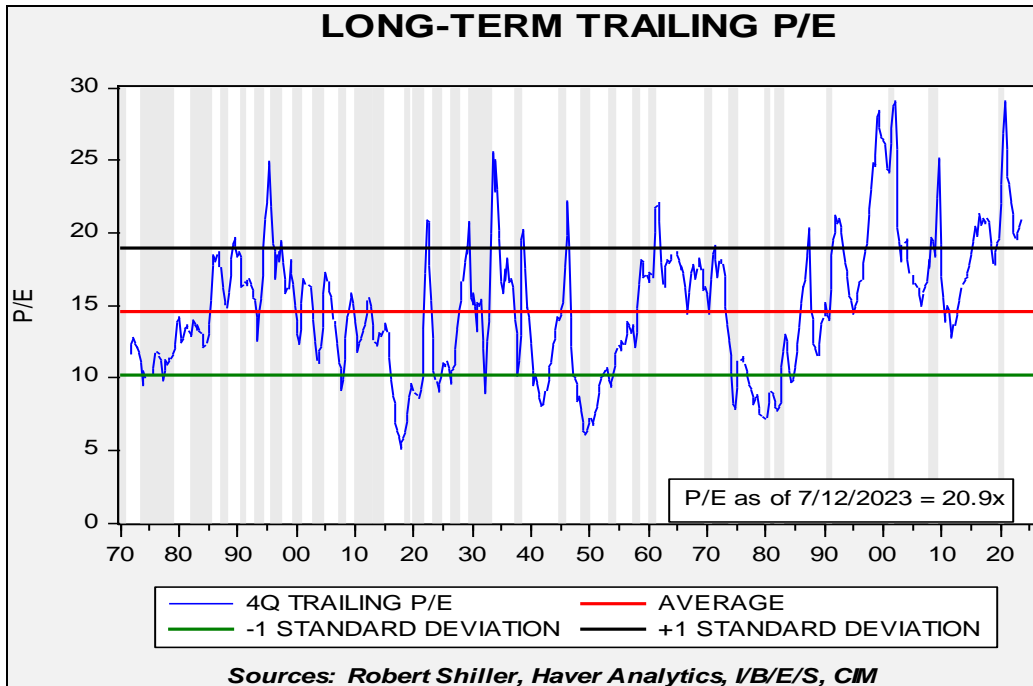


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

July 13, 2023



Based on our methodology,¹ the current P/E is 20.9x, down 0.1x from last week. The modest decline in the index 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.

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