

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 26, 2023—9:30 AM EDT]** Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 is currently down 1.5% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.4%. Chinese markets were lower, with the Shanghai Composite down 0.3% from its previous close and the Shenzhen Composite down 0.5%. U.S. equity index futures are signaling a lower open.

With 132 companies having reported so far, S&P 500 earnings for Q2 are running at \$52.10 per share, compared to estimates of \$53.55 (a decline of 6.8% from Q2 2022). Of the companies that have reported thus far, 81.8% have exceeded expectations while 12.9% have fallen short of expectations.

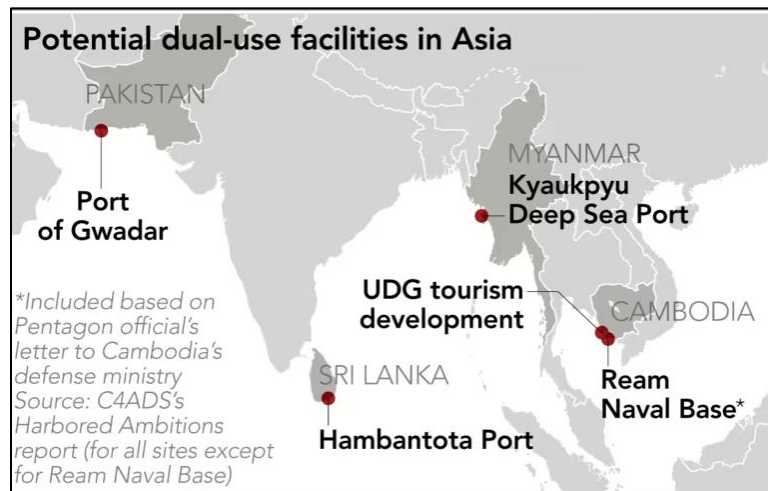
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our [website](#). We highlight recent publications below, with new items of the day emphasized in bold:

- **[Bi-Weekly Geopolitical Report](#)** (7/24/2023) (with associated [podcast](#)): “China’s Collapsing Population”
- [Weekly Energy Update](#) (7/20/2023): We discuss the hot weather, with an analysis of why it just isn’t climate change that’s having an impact. Sunspots and the ENSO cycle are likely lifting temperatures as well.
- [Asset Allocation Quarterly – Q3 2023](#) (7/20/2023): Discussion of our asset allocation process, Q3 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”
- [Keller Quarterly](#) (July 2023): Mark Keller’s (CEO/CIO) letter to investors.

Our *Comment* today opens with news that China is making new progress toward developing a network of naval facilities in the waters of the Indo-Pacific region. We next review a range of other international and U.S. developments with the potential to affect the financial markets today, including continued political unrest in Israel and a discussion of today’s upcoming decision on U.S. interest rates from the Federal Reserve.

**China-Cambodia:** New commercial satellite imagery shows China [has made considerable progress in its construction of naval facilities at Cambodia's Ream Naval Base](#). The imagery shows the Chinese have now nearly completed a pier that is strikingly similar in size and design to one the Chinese military already uses at its only official overseas naval base in Djibouti. Importantly, both piers are big enough to berth Chinese aircraft carriers.

- The report provides more evidence of China's large-scale, if secret, effort to build a network of dual civilian-military port facilities it could access in time of international conflict. Other such Chinese facilities include the Port of Hambantota in Sri Lanka and the Port of Gwadar in Pakistan.
- China continues trying to hide the extent of its military build-up, including by masking the military potential of the ostensibly civilian infrastructure it is helping to build. All the same, as Western leaders increasingly appreciate the scale of the Chinese build-up, we suspect it will worsen China's tensions with the West and make it even harder to maintain trade, investment, and technology flows.



**Russia-Ukraine-European Union:** Following Russia's pullout from the deal in which it allowed Ukraine to export grain from its southeastern ports, both Poland and Hungary [are threatening to block Ukrainian shipments to the West unless the European Union extends restrictions](#) on selling the Ukrainian products in their territory. The actions threaten to weaken Ukraine's economic resilience in the face of Russia's invasion and further complicate the EU's effort to support Ukraine.

**Spain:** As expected, Alberto Núñez Feijóo and his center-right Popular Party [have been left with no apparent route to forming a government after two key regional parties rejected his invitation](#) to form a coalition. Even though the PP won the most seats in Sunday's elections, and even though it has the support of the controversial hard-right Vox Party, it looks like it will be unable to control parliament. The most likely scenarios now would be for incumbent Prime Minister Sánchez and his Socialist Party to form a government with left-wing and regional parties, or for Spain to hold new elections in August.

**Israel:** Protests and strikes [continue to disrupt the economy and push stock prices lower](#) following this week's passage of a measure that would limit the supreme court's ability to block Knesset legislation. Ironically, the supreme court itself [said today that it would hear a case challenging the constitutionality of the law](#). Obviously, the optics of the court striking down a law limiting its powers would not be good, so it's unclear whether the court would really do so. In any case, the political and social instability in Israel looks set to continue in the near term.

**U.S. Monetary Policy:** Officials at the Federal Reserve [will wrap up their latest two-day policy meeting today, with their decision due to be released at 2:00 PM EDT](#). Fed Chairman Powell will also hold a news conference at 2:30 PM EDT. Along with most other analysts, we suspect that continued strong wage gains and price pressures will prompt the officials to hike their benchmark fed funds interest rate further after pausing last month. All the same, some other analysts think recent signs of modest economic slowing could convince them to hold rates steady again and simply signal the potential for more rate hikes later.

**U.S. Labor Market:** Yesterday, United Parcel Service (UPS, \$184.69) and the Teamsters Union [reached a tentative deal on a new contract](#). If approved by the firm's 340,000 union workers in a vote on August 3, the agreement will avert a massive strike that could have noticeably affected the economy.

- Under the deal:
  - Full-time workers will get wage increases that will bring their average top rate to \$49 per hour, making them the highest-paid delivery drivers in the U.S.
  - New part-time hires would start at \$21 per hour, up from \$15 in the previous contract.
  - A much-hated two-tier worker classification system, where some were paid less for doing essentially the same work, will be ended.
  - For the first time, union workers would get Martin Luther King Day off as a paid holiday.
- The agreement is likely to encourage other unions to strike a hard bargain in their negotiations with employers, potentially increasing average wages across the economy and helping boost consumer price inflation.

**U.S. Artificial Intelligence Market:** New reporting indicates investors [are snapping up shares of small biotechnology companies that are using artificial intelligence to aid in drug discovery](#). Some of those stocks have doubled or even tripled in value this year, even as the broad healthcare sector has lagged the overall market. For investors who worry they've missed the initial run-up in AI stocks, this development is a reminder that specialized, proprietary AI models and tools for specific industries or uses could well be the source of huge value creation in the coming years.

## U.S. Economic Releases

The Mortgage Bankers Association's (MBA) weekly application index fell 1.8% in the week ending July 21, as the average 30-year fixed-rate mortgage remained unchanged at 6.87%. This is more than 200 basis points higher than the same period last year. High interest rates have discouraged borrowers from taking on new debt. The MBA tracker for purchase applications fell 2.5% from the prior week, while the refinance tracker fell 0.4% in the same period. Purchase applications are down 22.7% year-over-year, while refinance applications are down 29.6%.

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 - Annualized Selling Rate	m/m	Jun	763k	725k	***	
10:00	New Home Sales - Monthly Change	m/m	Jun	12.2%	-5.0%	**	
14:00	FOMC Rate Decision (Lower Bound)	w/w	26-Jul	5.3%	5.5%	***	
14:00	FOMC Rate Decision (Upper Bound)	w/w	26-Jul	5.0%	5.3%	***	
14:00	Interest on Reserve Balances Rate	w/w	27-Jul	5.2%	5.4%	**	
Federal Reserve							
EST	Speaker or Event	District or Position					
14:30	Fed Chair Holds Press Conference Following FOMC Meeting	Chairman of the Board of Governors					

## 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>								
Japan	Leading Economic Index	m/m	May F	109.2	109.5		**	Equity and bond neutral
Australia	CPI	y/y	Q2	6.0%	7.0%	6.2%	***	Equity and bond neutral
South Korea	Depart. Store Sales	y/y	Jun	0.3%	-0.2%		*	Equity bullish, bond bearish
	Retail Sales	y/y	Jun	6.6%	5.7%	--	**	Equity bullish, bond bearish
	Discount Store Sales	y/y	Jun	0.3%	1.7%	--	*	Equity and bond neutral
South Korea	Consumer Confidence	y/y	Jul	103.2	100.7	--	***	Equity bullish, bond bearish
<b>EUROPE</b>								
Eurozone	M3 Money Supply	y/y	Jun	0.6%	1.4%	1.0%	***	Equity and bond neutral
France	Consumer Confidence	m/m	Jul	85.0	85.0	86.0	**	Equity and bond neutral
Switzerland	Credit Suisse Survey Expectations	m/m	Jul	-32.6	-30.8		**	Equity bearish, bond bullish
<b>AMERICAS</b>								
Mexico	International Reserves Weekly	w/w	21-Jul	204.164b	\$204.130b		*	Equity and bond neutral
Brazil	Current Account Balance	m/m	Jun	\$843m	\$649m	\$1000m	**	Equity and bond neutral
	Foreign Direct Investment	m/m	Jun	\$1880m	\$5380m	\$6183m	**	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)	561	561	0	Up
3-mo T-bill yield (bps)	524	526	-2	Up
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	536	536	0	Up
U.S. Libor/OIS spread (bps)	538	538	0	Up
10-yr T-note (%)	3.89	3.89	0.00	Flat
Euribor/OIS spread (bps)	371	372	-1	Up
Currencies	Direction			
Dollar	Down			Down
Euro	Flat			Up
Yen	Up			Down
Pound	Flat			Up
Franc	Up			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
<b>Energy Markets</b>				
Brent	\$82.74	\$83.64	-1.08%	
WTI	\$78.75	\$79.63	-1.11%	
Natural Gas	\$2.69	\$2.73	-1.47%	
Crack Spread	\$38.74	\$37.71	2.73%	
12-mo strip crack	\$29.07	\$28.95	0.42%	
Ethanol rack	\$2.64	\$2.65	-0.24%	
<b>Metals</b>				
Gold	\$1,972.23	\$1,964.96	0.37%	
Silver	\$24.64	\$24.69	-0.20%	
Copper contract	\$389.10	\$391.55	-0.63%	
<b>Grains</b>				
Corn contract	\$558.75	\$565.25	-1.15%	
Wheat contract	\$743.50	\$760.25	-2.20%	
Soybeans contract	\$1,421.50	\$1,420.00	0.11%	
<b>Shipping</b>				
Baltic Dry Freight	962	967	-5	
<b>DOE Inventory Report</b>				
	Actual	Expected	Difference	
Crude (mb)		-2.3		
Gasoline (mb)		-1.4		
Distillates (mb)		-0.4		
Refinery run rates (%)		0.2%		
Natural gas (bcf)		12		

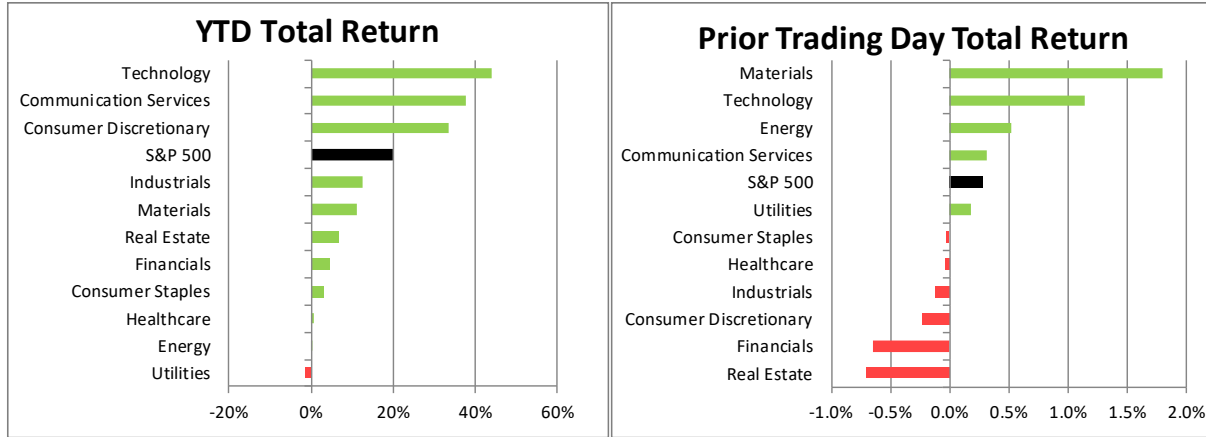
## **Weather**

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures throughout most of the country, with cooler-than-normal temperatures expected in the New England region. The precipitation outlook calls for wetter-than-normal conditions in the Rocky Mountain region and on the East Coast, with dry conditions predicted in the Deep South.

There is one tropical disturbance off the West African coast, but it has a less than 1% chance of cyclone formation within the next 48 hours.

**Data Section**

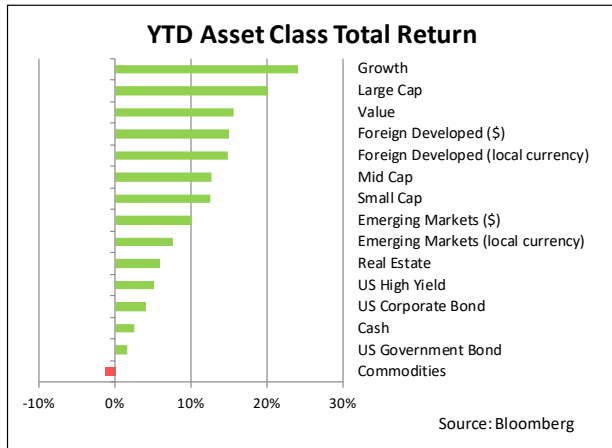
**U.S. Equity Markets – (as of 7/25/2023 close)**



(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 7/25/2023 close)**

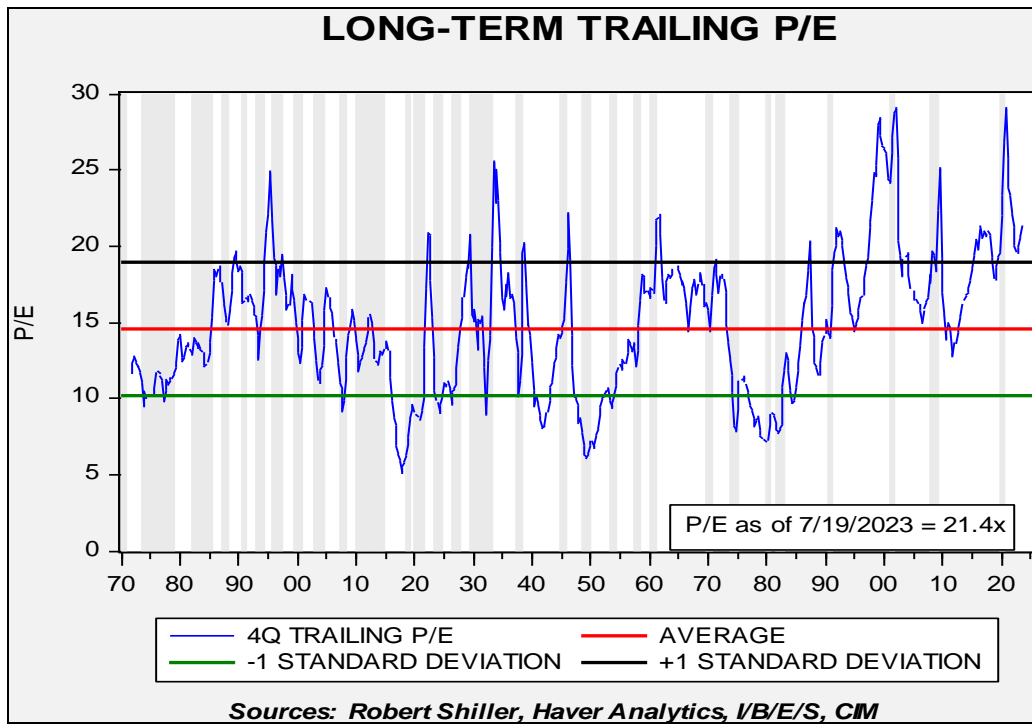


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 20, 2023



Based on our methodology,<sup>1</sup> the current P/E is 21.4x, up 0.5x from last week. Weaker earnings and rising index values led to the multiple expansion.

*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 (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.