

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 31, 2023—9:30 AM EDT] Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 is up 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.5%. Chinese markets were higher, with the Shanghai Composite up 0.5% from its previous close and the Shenzhen Composite up 0.8%. U.S. equity index futures are signaling a higher open.

With 254 companies having reported so far, S&P 500 earnings for Q2 are running at \$52.60 per share, compared to estimates of \$53.55 (a decline of 6.8% from Q2 2022). Of the companies that have reported thus far, 81.9% have exceeded expectations while 12.6% have fallen short of expectations.

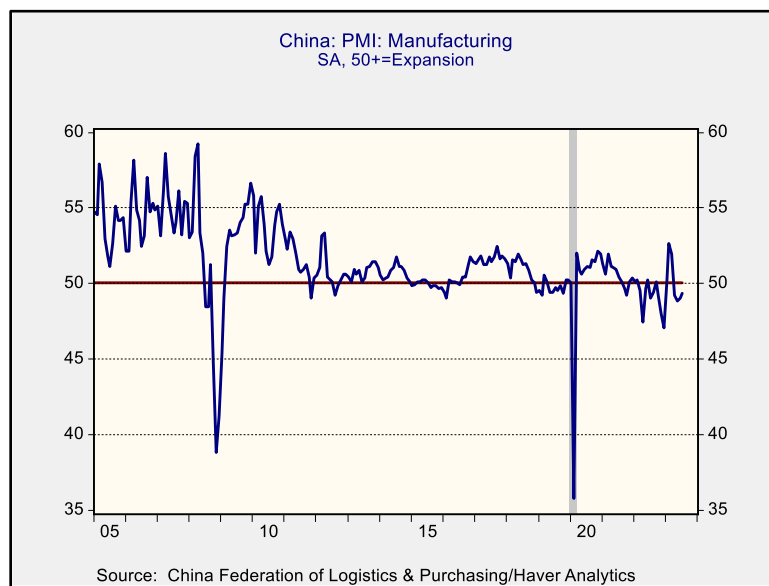
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our [website](#). We highlight recent publications below, with new items of the day emphasized in bold:

- [Bi-Weekly Geopolitical Report](#) (7/24/2023) (with associated [podcast](#)): “China’s Collapsing Population”
- [Weekly Energy Update](#) (7/27/2023): The SPR sales appear to have ended, and the U.S. is sending additional military assets to the Middle East.
- [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](#) (7/31/2023) (with associated [podcast](#)): **“Part-Time Troubles”**
- [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.
- [Business Cycle Report](#) (7/27/23)

Our *Comment* today opens with several reports touching on China’s economy and foreign relations. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including a modest acceleration in eurozone economic growth and news of an important bankruptcy in the U.S. trucking industry.

China: Financial data provider Prequin [reported that China-focused venture capital funds raised just \\$2.7 billion in the second quarter, down 54.2% from the first quarter](#). Separately, a Beijing think tank on Friday said total investments in China’s internet sector during the second quarter were down 69.8% from the same period one year earlier. The figures illustrate how global investors, especially those from the U.S., are channeling capital away from China in response to its slowing economic growth, increased government interference in the economy, dire demographics, and increasing geopolitical tensions with the West.

- Separately, the official July purchasing managers index for manufacturing [rose slightly to 49.3, beating expectations that it would remain at its June reading of 49.0](#). Nevertheless, the July reading marks the fourth straight month in which the index was below the level of 50 that points to expanding activity.
- The July nonmanufacturing index fell to 51.5 from 53.2 in June, suggesting that growth in that sector is now at its weakest all year.



China-United States: U.S. military, intelligence, and national security officials now believe the Chinese malware discovered in May within the telecommunications systems on Guam was only the tip of the iceberg. The officials now [believe Chinese hackers have inserted well-hidden malware in networks controlling power grids, communications systems, and water supplies](#) that feed military bases in the U.S. and around the world, with the goal of disrupting or slowing U.S. military deployments and resupply operations in a future conflict. If activated, the malware would probably also disrupt civilian communications and economic activity.

- The reports say U.S. officials have been working to hunt down and eradicate the malware, although it isn’t clear how successful they’ve been.
- Even though Western business elites continue to resist “de-risking” or “de-coupling” with China, based largely on their own economic interests, we still think increased Chinese military threats will prompt Western leaders to clamp down further on trade, investment,

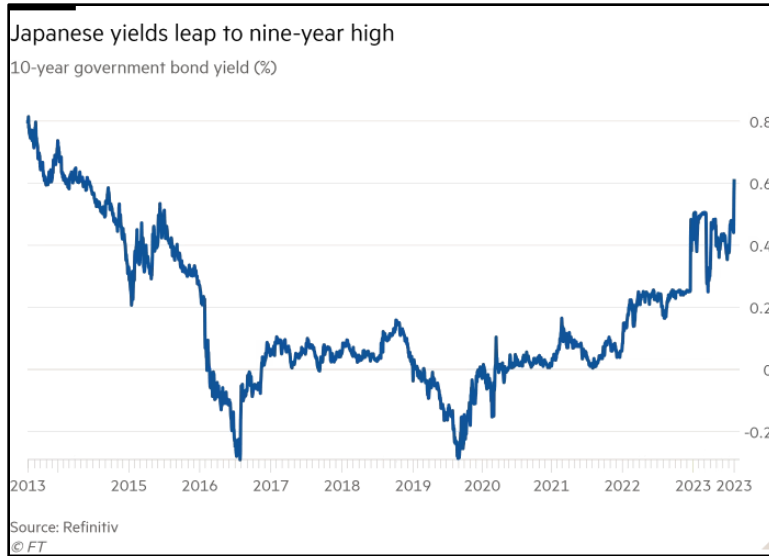
technology, and personnel flows with the China/Russia bloc over time, raising risks for investors with exposure to China or to companies that are highly dependent on China.

United States-Australia: Over the weekend, the U.S. and Australia [struck a deal in which Australian manufacturers, in partnership with U.S. defense firms, will produce missiles and potentially other ammunition for the U.S. military](#) beginning in 2025. The officials also agreed on a further expansion of U.S. military rotations through Australia to help build a bulwark against Chinese geopolitical aggressiveness in the region.

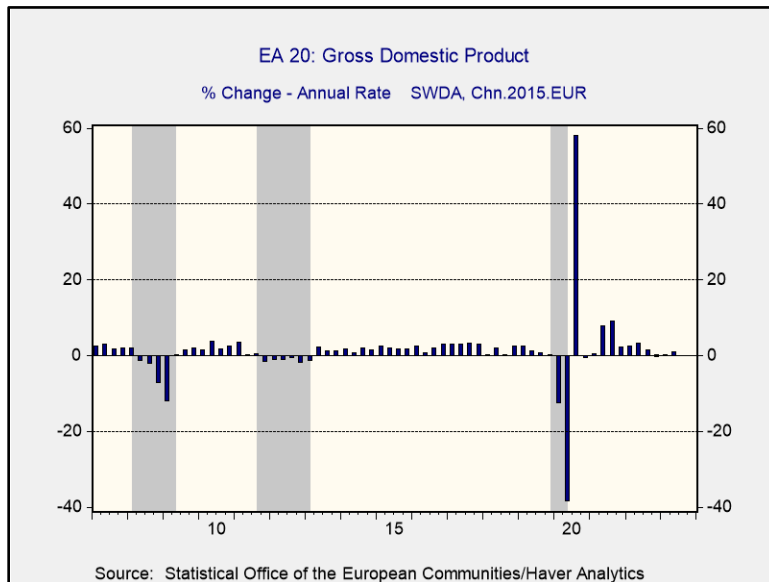
- Among the Western allies, the large U.S. defense industry still has the bulk of the arms production capability. All the same, replenishing equipment and ammunition sent to Ukraine to help it in its defense against Russia's invasion and rebuilding the U.S. military to deal with the Chinese threat have stretched the weapon makers' capacity.
- U.S. defense budgets are rising, but we see increasing evidence that the country will need to rely on innovative new schemes to increase its stockpile of weapons and ammunition in the near term. Relying more on allied producers is clearly one part of that.
- We've been arguing that re-industrialization is already becoming apparent in the U.S., and that an increased defense effort will feed into it. We therefore think U.S. industrial stocks are poised for good growth, as are U.S. defense stocks in particular. If the U.S. continues to buy more weapons and other material from allied countries, despite the obvious supply-chain security risks, it suggests there could also be good opportunities in foreign industrials and defense industry stocks.

United States-Japan-South Korea: The White House announced that President Biden [will host Japanese Prime Minister Kishida and South Korean President Yoon for a trilateral summit](#) at Camp David on August 18. The meeting will focus on further steps to increase the three nations' security against the growing threats from North Korea and the rest of the China/Russia bloc in the Indo-Pacific region. The announcement came just as new reports suggest Russia has been buying North Korean missiles and using them in its invasion against Ukraine.

Japan: As global investors continue to digest last week's move by the Bank of Japan to loosen its yield curve control and allow longer-term bond yields to rise, the yield on 10-year government bonds [today rose to a nine-year high of 0.607% before falling back to 0.590%](#) after the BOJ announced unscheduled purchases of 300 billion JPY in five- to 10-year government bonds. Higher bond yields are expected to draw funds back to Japan, driving up the JPY, and the currency so far today is up 0.7% to 142.10 per dollar.



Eurozone: New data today shows second-quarter gross domestic product [grew at an annualized rate of 1.1%, still very weak but better than the tiny 0.1% growth rate in the first quarter](#) and a modest decline in the fourth quarter of 2022. The region’s economy continues to struggle with weakening exports to China, high interest rates, and high price inflation.



Chile: On Friday, the central bank [slashed its benchmark short-term interest rate by 100 basis points to 10.25%](#), citing reduced inflation pressure and prospects for weaker economic growth in developed countries. Some major Latin American central banks were among the first to hike interest rates in the current global cycle, helping support their currencies. Responding to the Friday rate cut, the Chilean peso (CLP) so far this morning has weakened 0.9%, trading at 834.77 per dollar.

Niger: Responding to last week’s coup, the Economic Community of West African States warned that if the coup leaders don’t restore Niger’s democratically-elected government to power within one week, the bloc [will launch military action to do so](#). The statement follows calls by the U.S. and France for President Mohamed Bazoum to be restored to power. The coup leaders have rejected those calls, portending a likely period of instability ahead.

U.S. Labor Market: Over the weekend, debt-ridden trucking firm Yellow (YELL, \$0.7069) said it [has shut down operations and will file for bankruptcy](#). The move will throw as many as 30,000 employees out of work, including 22,000 members of the Teamsters union. The firm clearly had its own issues, so its failure doesn’t necessarily say anything about the health of the overall economy or the recession that we still think is likely to arrive in the coming months. All the same, the failure may help to soften the labor market slightly.

U.S. Commercial Real Estate Market: Blackstone Real Estate Income Trust, a unit of Blackstone (BX, \$105.05) that is also known as BREIT, [has reportedly sold some \\$10 billion in assets since last autumn, allowing it to return \\$8 billion to investors](#) and raise cash for new investments related to artificial intelligence, such as data centers. The move marks a big turnaround from last autumn, when BREIT’s decision to limit withdrawals helped spark fears of commercial real estate calamity.

U.S. Economic Releases

There were no economic releases prior to the publication of this report. 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
9:45	MNI Chicago PMI	m/m	Jul	43.4	41.5	***
10:30	Dallas Fed Manufacturing Activity	m/m	Jul	-22.5	-23.2	**
Federal Reserve						
EST	Speaker or Event	District or Position				
9:20	Austan Goolsbee Speaks on Yahoo! Finance Live	President of the Federal Reserve Bank of Chicago				

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.

ASIA-PACIFIC								
Japan	Retail Sales	y/y	Jun	55.9%	5.7%	5.8%	**	Equity and bond neutral
	Depart. Store & Supermarket Sales	y/y	Jun	4.1%	3.4%		*	Equity bullish, bond bearish
	Industrial Production	y/y	Jun P	-0.4%	4.2%	0.3%	***	Equity bearish, bond bullish
	Annualized Housing Starts	y/y	Jun	0.811m	0.862m	0.8%	*	Equity and bond neutral
	Housing Starts	y/y	Jun	-4.8%	3.5%	-0.5%	**	Equity bearish, bond bullish
Australia	Melbourne Institute Inflation	m/m	Jul	5.4%	5.7%		***	Equity and bond neutral
	Private Sector Credit	y/y	Jun	5.5%	6.2%		**	Equity bearish, bond bullish
New Zealand	ANZ Activity Outlook	m/m	Jul	0.8	2.7		**	Equity bearish, bond bullish
	ANZ Business Confidence	m/m	Jul	-13.1	-18.0		**	Equity bullish, bond bearish
China	Official Composite PMI	m/m	Jul	51.1	52.3		*	Equity bearish, bond bullish
	Manufacturing PMI	m/m	Jul	49.3	49.0	48.9	***	Equity bearish, bond bullish
	Services PMI	m/m	Jul	51.5	53.2	53.0	**	Equity bearish, bond bullish
EUROPE								
Eurozone	GDP	y/y	2Q A	0.6%	1.0%	1.1%	***	Equity bearish, bond bullish
	CPI	y/y	Jul	5.5%	5.5%	5.4%	***	Equity and bond neutral
	Core CPI	y/y	Jul P	5.5%	5.5%	5.4%	**	Equity and bond neutral
Germany	Import Price Index	y/y	Jun	-11.4%	-9.1%	-10.7%	**	Equity bearish, bond bullish
	Retail Sales NSA	y/y	Jun	0.1%	-5.1%	-3.6%	*	Equity bullish, bond bearish
Italy	GDP WDA	y/y	2Q P	0.6%	1.9%	2.0%	**	Equity bearish, bond bullish
	CPI, EU Harmonized	y/y	Jul P	6.4%	6.7%	6.5%	***	Equity and bond neutral
	CPI NIC Including Tobacco	y/y	Jul P	6.0%	6.4%	5.9%	**	Equity and bond neutral
UK	Mortgage Approvals	m/m	17-Jan	54.7k	50.5k	51.1k	**	Equity bearish, bond bullish
Switzerland	Domestic Sight Deposits CHF	w/w	28-Jul	479.3b	478.5b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	28-Jul	490.1b	489.3b		*	Equity and bond neutral
AMERICAS								
Mexico	GDP NSA	y/y	2Q P	3.7%	3.7%	3.3%	***	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)	563	563	0	Up
3-mo T-bill yield (bps)	523	527	-4	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 (%)	3.96	3.95	0.01	Flat
Euribor/OIS spread (bps)	373	371	2	Up
Currencies	Direction			
Dollar	Flat			Flat
Euro	Up			Up
Yen	Down			Down
Pound	Up			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.

DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$85.59	\$84.99	0.71%	
WTI	\$81.37	\$80.58	0.98%	
Natural Gas	\$2.69	\$2.64	1.86%	
Crack Spread	\$40.35	\$41.47	-2.69%	
12-mo strip crack	\$29.76	\$30.15	-1.30%	
Ethanol rack	\$2.53	\$2.54	-0.61%	
Metals				
Gold	\$1,959.21	\$1,959.49	-0.01%	
Silver	\$24.37	\$24.34	0.09%	
Copper contract	\$393.80	\$392.65	0.29%	
Grains				
Corn contract	\$517.00	\$530.25	-2.50%	
Wheat contract	\$681.25	\$704.25	-3.27%	
Soybeans contract	\$1,355.25	\$1,382.50	-1.97%	
Shipping				
Baltic Dry Freight	1,110	1,097	13	

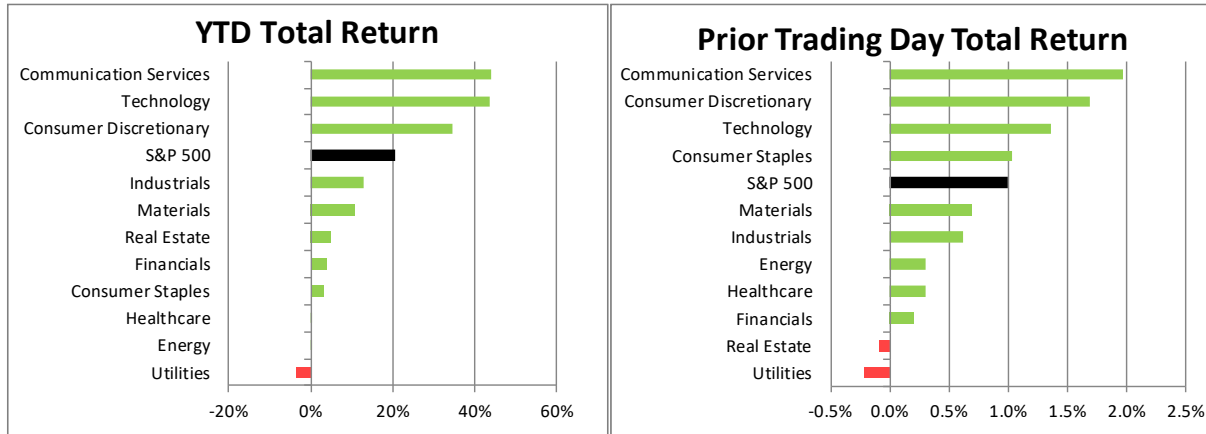
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures in the Deep South, with cooler-than-normal temperatures expected for the rest of the country. The precipitation outlook call for wetter-than-normal conditions in most states, with dry conditions expected in the Southwest.

Two disturbances in the Atlantic Ocean have a chance of developing into tropical cyclones. The first disturbance, located off the Mid-Atlantic coast, has a 30% chance of cyclone formation within the next 48 hours and the second disturbance, located northwest of the Leeward Islands, has a 70% chance of cyclone formation.

Data Section

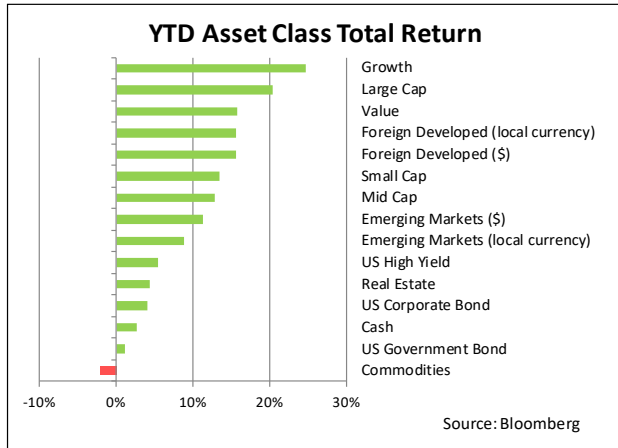
U.S. Equity Markets – (as of 7/28/2023 close)



(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 7/28/2023 close)

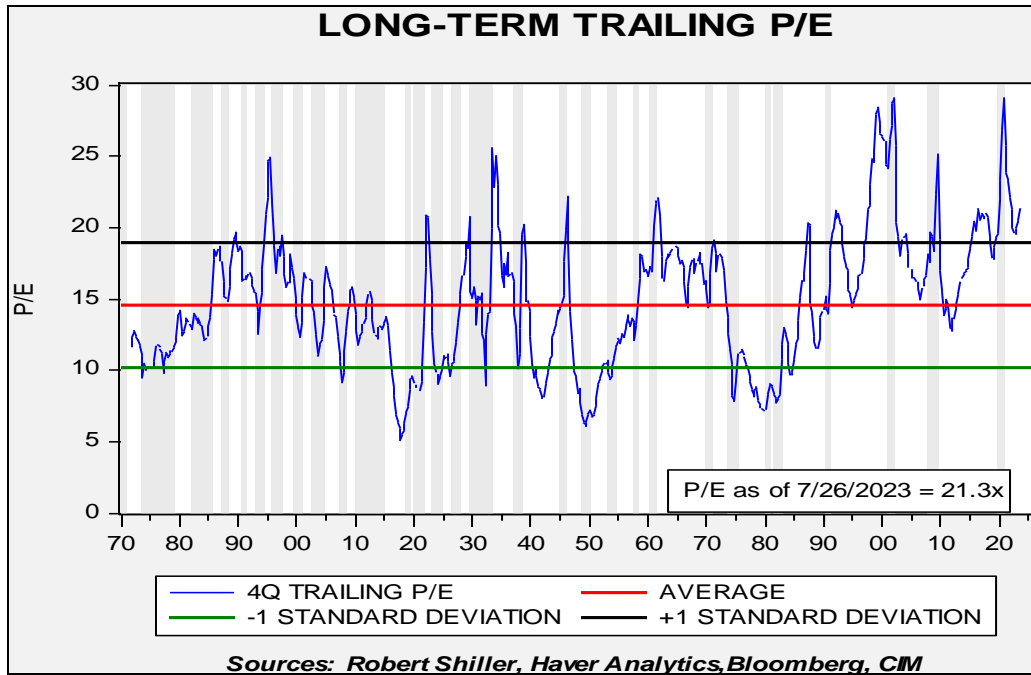


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 27, 2023



Based on our methodology,¹ the current P/E is 21.3x, down 0.1x from last week. Better earnings lowered 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 Bloomberg 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.