

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: June 2, 2021—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the EuroStoxx 50 is up 0.1% from its prior close. In Asia, the MSCI Asia Apex 50 closed down 0.7%. Chinese markets closed lower, with the Shanghai Composite down 0.8% from its prior close and the Shenzhen Composite down 1.1%. U.S. equity index futures are signaling a higher open. With 489 companies having reported, the S&P 500 Q1 2021 earnings stand at \$49.00, higher than the \$37.94 forecast for the quarter. The forecast reflects a 23.3% increase from Q1 2020 earnings. Thus far this quarter, 87.1% of the companies have reported earnings above forecast, while 11.3% 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](#) (5/24/2021): Taiwan and the Risk of Deglobalizing the World's Semiconductor Industry: Part I
- [Weekly Energy Update](#) (5/27/2021): We look at the "greening" of the supermajors and the IEA report.
- [Asset Allocation Q2 2021 Rebalance Presentation](#) (5/20/2021): video discussion of our asset allocation process, portfolio changes in Q2, and the macro environment
- [Asset Allocation Weekly](#) (with associated [podcast](#) and [chart book](#)) (5/28/2021): since last summer, there is an inverse correlation between bitcoin and gold prices.
- [Confluence of Ideas podcast](#) (4/30/2021): "The U.S.-China Balance of Power: Part II"

Good morning, all! U.S. equities appear to be headed for a sideways open this morning as investors remain cautious following recent market events in oil and cybersecurity. Today's report begins with a summary of the cyberattack on the largest meat producer in the world. International news follows, with the OPEC decision on oil production and a new Israeli government. Economics and policy news are up next, including possible friction at the Federal Reserve and the U.S. withdrawal from Afghanistan. China news follows, and we close with our pandemic coverage.

Another cyberattack: A cyberattack on JBS (JBSAY, \$12.14), the largest meat producer in the world, forced the [company to shut down all of its U.S. beef plants on Tuesday](#). The attacks started on Sunday and led the company to suspend its North American and Australian computer systems. Although the company announced that most of its plants would be operational by Wednesday, the attack highlights vulnerabilities in the critical infrastructure of the U.S. food supply chain as well as the growing capabilities of hackers.

Cyberattacks have picked up dramatically during the pandemic. There have been [40 publicly reported ransomware attacks against food companies](#) since March 2020. This recent attack comes only weeks after Colonial Pipeline was forced to shut down some of its operations following a hack on its computer system. The rise in these attacks coincides with the increased adoption of cryptocurrency and a decreased level of skills required to carry out these cyberattacks. Although Russian criminal groups have received most of the blame, these types of attacks will likely continue from criminals worldwide as long as computer systems are not updated and cryptocurrencies remain unregulated. In the meantime, the Department of Homeland Security has issued a directive that requires notification from pipeline operators when they are victims of a cyberattack. We suspect other critical industries will also follow this directive going forward. As the pandemic fades out of public focus, we expect cryptocurrencies will receive more scrutiny as it is becoming apparent that the semi-anonymous payment system poses severe national security risks.

International news: OPEC will slowly increase its production, Russia is looking to add more military units, and Benjamin Netanyahu is possibly out as Prime Minister.

- OPEC and its allies agreed to increase [their production of crude oil slowly as demand starts to pick up](#). The group expects this approach will allow prices to remain elevated as countries recover from the pandemic. The forecast calls for inventories to fall below the average 2015-2019 levels by the end of the month, which should be bullish for oil prices.
- [Peru is going to choose its fourth president](#) in less than a year on June 6. The frontrunner, Pedro Castillo, is considered to be a Marxist with nationalist views.
- The [Russian military will build an additional 20 units](#) to counter the rising NATO threat in its region.
- Prime Minister [Benjamin Netanyahu's reign could end on Wednesday](#). A cross-party coalition, including members from the far-left and far-right, has made an agreement to form a government that would replace Netanyahu with Naftali Bennet, a tech billionaire who is to the right of Netanyahu politically.

Economics and policy: STL Fed President James Bullard and Federal Reserve Governor Lael Brainard offered opposing views on the labor market, the Afghanistan withdrawal continues to progress ahead of schedule, and the U.S. Chamber of Commerce wants to increase the number of work visas.

- The U.S. Chamber of Commerce, a pro-business lobby group, is [pushing for a reform of employment-based visas](#) as a way to address the labor shortage. The group would like lawmakers to double the cap on employment-based and H-1B visas.
- St. Louis Fed President James Bullard [told the Financial Times that he believes the labor market may be tighter than it looks](#). He has stated that even though payrolls are lagging behind pre-pandemic levels, other measures such as unemployment-to-job openings indicate the labor market is favorable. Although he does not have a vote, his view may be shared by other FOMC members.

- Federal Reserve Governor [Lael Brainard argued that the labor market is far from achieving the Federal Reserve's target for employment](#) and has maintained that she is keeping an eye on inflation.
- The Biden administration is expected [to put a freeze on oil and gas leases in the Arctic National Wildlife Refuge](#) pending a review of its environmental impact.
- Israel [plans to request \\$1 billion in emergency military aid](#) as it tries to rebuild its armed forces following its skirmish with the Palestinians.
- President Biden plans to address the racial wealth gap through [government grants, small business loans, and other programs](#).
- The U.S. Supreme Court ruled that [it will not hear an appeal from Johnson & Johnson](#) (JNJ,\$165.53) over a judgment that requires it to pay \$2 billion in settlement claims.
- The U.S. [is nearly halfway to achieving full withdrawal from Afghanistan](#). The U.S. Central Command estimates that it has completed about 30% to 44% of the drawdown process. U.S. forces are expected to hand over its main Bagram Air Base to Afghan forces in roughly 20 days.

China: Malaysia seeks answers from China, and rising costs and power shortages are hurting manufacturing production.

- Malaysia will summon the ambassador of China for an explanation regarding why [16 Chinese air force planes flew through its airspace](#). The flight comes amid increasing tensions over the South China Sea.
- The Chinese-backed Asian Infrastructure Investment Bank has [left the door open for investing in Myanmar](#). Although it currently doesn't have any open projects with the country, it has expressed a willingness to work with any "de facto governments."
- The rising costs of materials has caused [problems for solar panel makers](#) in China. Polysilicon, the main component of panels, has quadrupled in price in recent months.
- The surge in manufacturing production [has caused power shortages throughout the country](#). Some factories have been asked to close down for several days a week in order to conserve energy.

COVID-19: The [number of reported cases](#) is 171,021,130 with 3,556,992 fatalities. In the U.S., there are 33,286,129 confirmed cases with 595,205 deaths. For illustration purposes, the *FT* has created an [interactive chart](#) that allows one to compare cases across nations using similar scaling metrics. The *FT* has also issued an [economic tracker](#) that looks across countries with high-frequency data on various factors. The [CDC reports](#) that 366,317,045 doses of the vaccine have been distributed with 296,404,240 doses injected. The number receiving at least one dose is 168,489,729, while the number of second doses, which would grant the highest level of immunity, is 135,867,425. The *FT* has a page on [global vaccine distribution](#).

- Moderna (MRNA, \$184.66) [applied for full approval of its COVID-19 vaccine on Tuesday](#). The vaccine has only been authorized for emergency use. If it is approved, Moderna would be allowed to market the vaccine directly to consumers.
- A [new digital vaccine passport has become popular in New York](#) and has made it easier for vaccinated people to attend events. Although paper passports are recognized as valid proof of vaccination, digital passports are more convenient.
- The World Health Organization [plans to label new variants of the COVID-19 virus using the Greek alphabet](#).
- The [United Kingdom had its first day without a COVID-19-related death](#) on Tuesday, raising the likelihood of easing restrictions.

U.S. Economic Releases

According to the Mortgage Bankers Association, mortgage applications fell 4.0% for the week ended May 28, almost matching their 4.2% decline in the previous week. Applications for home purchases were down 3.1%, while applications for refinancing dropped 4.6%. The average interest rate on a 30-year, fixed-rate mortgage edged down to 3.17%.

The table below lists the Fed events scheduled for the rest of the day.

Economic Releases		
No economic releases today		
Fed Speakers or Events		
EST	Speaker or event	District or position
12:00	Patrick Harker Discusses the Economic Outlook	President of the Federal Reserve Bank of Philadelphia
14:00	Patrick Harker Speaks at Fed Forum on Racism	President of the Federal Reserve Bank of Philadelphia
14:00	Robert Kaplan Speaks at Fed Forum on Racism	President of the Federal Reserve Bank of Dallas
14:00	Raphael Bostic Speaks at Fed Forum on Racism	President of the Federal Reserve Bank of Atlanta
14:00	Charles Evans Speaks at Fed Forum on Racism	President of the Federal Reserve Bank of Chicago
14:00	Federal Reserve Releases Beige Book	Federal Reserve Board

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	Monetary Base	y/y	May	22.4%	24.3%		**	Equity and bond neutral
Australia	GDP	y/y	1Q	1.1%	-1.0%	0.6%	***	Equity bullish, bond bearish
New Zealand	Terms of Trade Index	q/q	1Q	0.1%	1.5%	-0.3%	*	Equity bullish, bond bearish
South Korea	CPI	y/y	May	2.6%	2.3%	2.6%	***	Equity and bond neutral
	Core CPI	y/y	May	1.5%	1.4%	1.3%	*	Equity and bond neutral
EUROPE								
Eurozone	PPI	y/y	Apr	7.6%	4.3%	7.5%	*	Equity and bond neutral
Germany	Retail Sales	y/y	Apr	4.4%	11.6%	10.1%	*	Equity bearish, bond bullish
UK	Mortgage Approvals	m/m	Apr	86.9k	82.7k	81.0k	***	Equity bullish, bond bearish
	Net Lending on Dwellings	m/m	Apr	3.3b	11.8b	7.0b	*	Equity and bond neutral
	M4 Money Supply	y/y	Apr	9.1%	10.8%		*	Equity and bond neutral
AMERICAS								
Canada	Building Permits	m/m	Apr	-0.5%	5.7%	-5.0%	**	Equity bullish, bond bearish
Brazil	Industrial Production	y/y	Apr	34.7%	10.5%	36.6%	***	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	Up
3-mo T-bill yield (bps)	2	2	0	Neutral
TED spread (bps)	12	12	0	Up
U.S. Libor/OIS spread (bps)	8	8	0	Up
10-yr T-note (%)	1.60	1.61	-0.01	Neutral
Euribor/OIS spread (bps)	-55	-54	-1	Neutral
EUR/USD 3-mo swap (bps)	3	2	1	Down
Currencies				
dollar	Up			Down
euro	Down			Up
yen	Down			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.

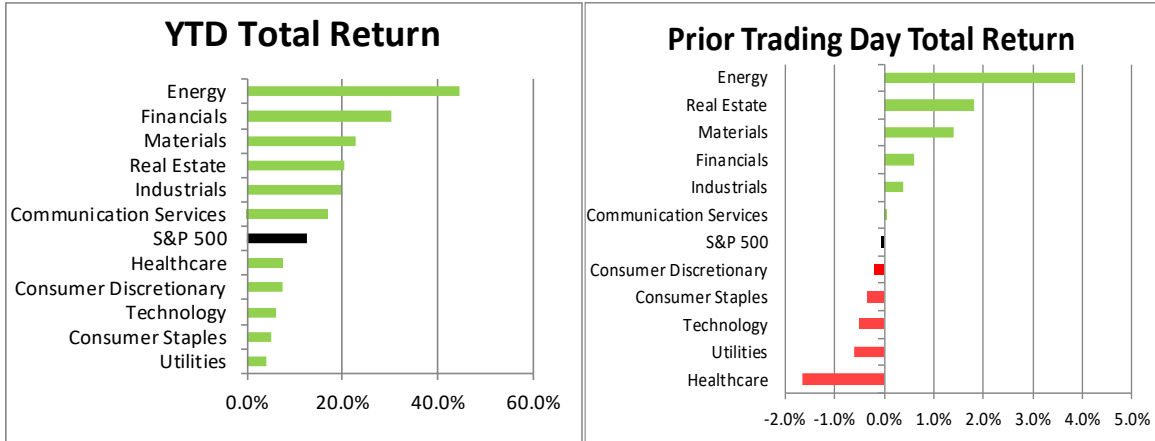
	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$71.04	\$70.25	1.12%	
WTI	\$68.37	\$67.72	0.96%	
Natural Gas	\$3.08	\$3.10	-0.74%	
Crack Spread	\$22.31	\$22.12	0.82%	
12-mo strip crack	\$21.34	\$21.20	0.67%	
Ethanol rack	\$2.75	\$2.74	0.43%	
Metals				
Gold	\$1,898.32	\$1,900.44	-0.11%	
Silver	\$27.84	\$27.89	-0.18%	
Copper contract	\$460.80	\$465.35	-0.98%	
Grains				
Corn contract	\$685.75	\$688.75	-0.44%	
Wheat contract	\$696.25	\$693.50	0.40%	
Soybeans contract	\$1,554.75	\$1,548.50	0.40%	
Shipping				
Baltic Dry Freight	2688	2754	-66	
DOE inventory report				
	Actual	Expected	Difference	
Crude (mb)		-1.7		
Gasoline (mb)		-1.7		
Distillates (mb)		-3.0		
Refinery run rates (%)		0.70%		

Weather

The 6-10 and 8-14 day forecasts currently call for cooler temperatures on the West Coast and in Texas, with warmer temperatures from the Upper Midwest to New England. The forecast calls for wet conditions from the Deep South to New England, with dry conditions primarily in the Rocky Mountain Region.

Data Section

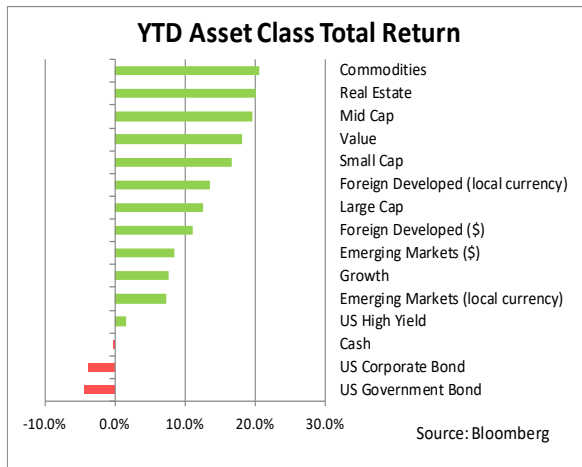
U.S. Equity Markets – (as of 6/1/2021 close)



(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 6/1/2021 close)

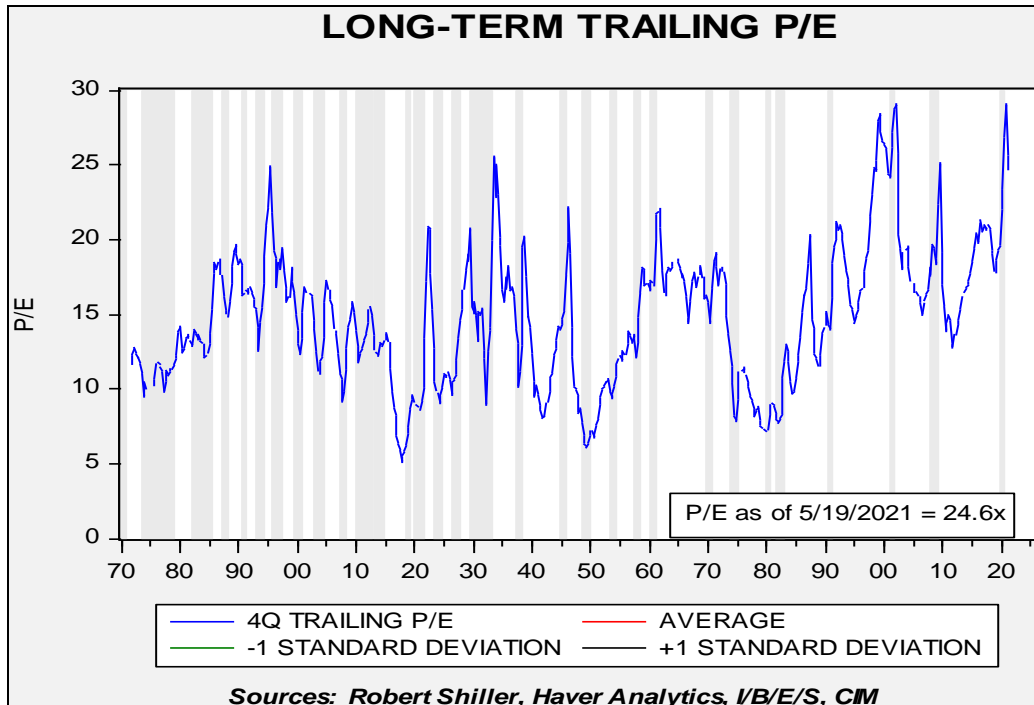


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

May 20, 2021



Based on our methodology,¹ the current P/E is 24.4x, down 0.4x from last week. Rising earnings 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.