

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, 2022—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the EuroStoxx 50 index is currently up 0.9% from its prior close. In Asia, the MSCI Asia Apex 50 index closed down 1.0%. Chinese markets were higher, with the Shanghai Composite closing up 0.4% from its prior close and the Shenzhen Composite closing up 0.7%. U.S. equity index futures are signaling a higher open.

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](#) (5/23/2022) (with associated [podcast](#)): “Going Nuclear with North Korea”
- [Weekly Energy Update](#) (5/26/2022): Due to Memorial Day, this report will be published tomorrow.
- [Asset Allocation Quarterly - Q2 2022](#) (4/21/2022): Discussion of our asset allocation process, Q2 2022 portfolio changes, and our outlook for the markets
- [Asset Allocation Bi-Weekly](#) (5/31/2022) (with associated [podcast](#)): “The Problem of Financial Conditions”
- [Confluence of Ideas podcast](#) (3/25/2022): “The 2022 Outlook: Update #1”
- *Current Perspectives*: **[“2022 Outlook: Update #1”](#)** (2/18/2022)

Optimism about a possible increase in Saudi oil production boosted S&P 500 futures this morning; however, relatively weak private payroll numbers have led to some moderation. Today's report opens with an overview of the Federal Reserve Beige Book. Next, we give an update on the war in Ukraine. Afterward, we review U.S. economic and policy news and international news. We close with our COVID-19 coverage.

The Beige Book: [All 12 of the Federal Reserve districts remain in expansion](#), according to the Federal Reserve Beige Book. The publication provides an update on economic conditions for each of the Fed's regions. Although most areas showed solid growth, four districts reported a moderate slowdown. This weakness in growth was related to consumer pushback against higher prices. That being said, all regions indicated that the labor market remained tight, with half of the districts reporting that firms still have pricing power.

- The latest JOLTS report reinforces the views shared in the Beige Book. In April, Job openings [dropped 455,000 from the prior month to 11.4 million](#). There are almost twice

as many job openings as there are available workers. However, the tight labor market suggests that the Federal Reserve still has a long way to go to bring the job market back into equilibrium.

- In other Fed-related news, the Federal Reserve is set [to start shrinking its balance sheet](#) this month as it looks to tighten monetary policy to curb inflation. By reducing its holdings of bonds, the Federal Reserve would allow credit spreads to widen, thereby dampening the attractiveness of risky fixed-income securities.

Russia-Ukraine update: Russian forces are on the verge of [taking over two-thirds of the city of Severodonetsk in the eastern region of Luhansk](#), while, the Ukraine counteroffensive in the northern parts of the country is getting closer to cutting off some of Russia's supply lines. In other news, the West is still struggling to reach a consensus on how to secure another sanctions package against Moscow. In Europe, Hungary's insistence that it [should be able to sell the Russian oil it refines](#) has led to a deadlock in talks. Meanwhile, officials with the Biden administration are hesitant to include secondary sanctions in its next package due to fears that it will hurt the economy.

Disputes over how to further punish Russia for its invasion of Ukraine highlight the war's growing divisiveness. Western countries were willing to support Ukraine at the start of the conflict because the war did not adversely impact their constituents. However, as the cost of the war becomes more widespread through higher energy and food prices, Western leaders' willingness to go to bat for Ukraine is waning. This is seen in the decision by France and Germany to [hold talks with Putin over ending Russia's blockade of the Black Sea](#). We suspect European countries, in particular, would like to see this war end sooner rather than later. Nevertheless, we do not think the West is ready to pull its support anytime soon.

At this moment, the West and Russia have both dug in their heels and have no obvious way out of this conflict over Ukraine. The West does not want the world to believe that it is not prepared to back its allies; meanwhile, Russia does not want to appear weak to its rivals. As a result, it is unlikely that either side will divert from its current path without a sudden change in leadership. In other words, barring Putin's ousting or significant shift in any of the major Western governments, this war will likely persist. We suspect that the environment will continue to have an elevated risk as rising prices, tightening financial conditions, and increasing global uncertainty hinder global growth.

U.S. economic and policy news

- The U.S. and Taiwan [agreed to build closer trade ties](#). The U.S. decision to build a relationship with Taiwan was partly due to wanting to ensure the region remains autonomous and promote its Indo-Pacific Economic Framework.
 - Although we have mentioned the U.S. uses the economic framework to build closer relationships with other Pacific countries, it is not Washington's only aim. The U.S. believes the current trade rules established by the 1994 GATT agreement are outdated, and the Indo-Pacific Economic Framework looks to update these guidelines. The Biden administration's goal is to modernize global

trade by establishing rules on digital trade, promoting clean energy initiatives, and improving labor rights.

- Officials within the Biden administration [are considering a cap on Russian oil prices](#). This decision would limit energy revenue for Moscow while also easing some of the supply pressures.
- The Atlantic hurricane season started on Wednesday, and forecasters predict that [there will be an above-average number of tropical storms for the seventh consecutive year](#). The U.S. National Weather Service expects over 21 storms; the average is 14. Tropical storms have led to a surge in commodity prices.

International news

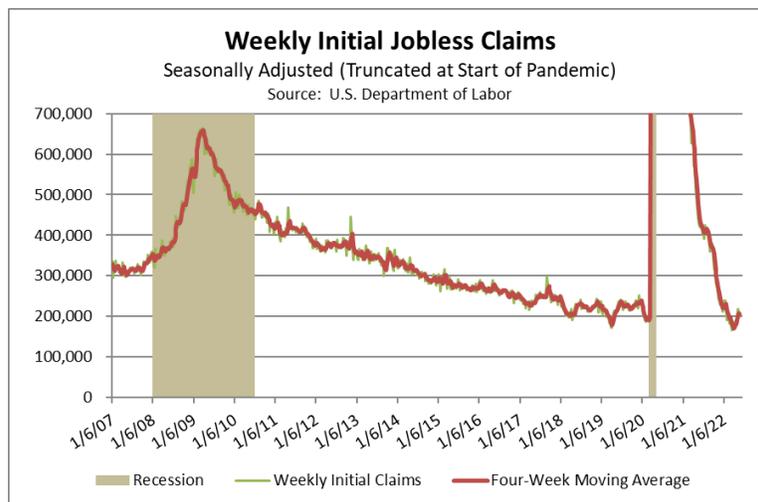
- The U.K. government [will allow food makers to use sunflower oil alternatives](#) without changing labels.
- Saudi Arabia has stated that it is prepared [to pump more oil if Russian production falls](#). The move comes after several OPEC countries have debated [suspending Russia from the oil production deal](#), given that sanctions have undercut the country's ability to meet production targets.
 - Saudi Arabia's decision to pump more may be related to President Biden's trip to the Middle East. The president is expected to meet with Saudi Crown Prince Mohammed bin Salman (MBS) during the visit. The two have not yet met due to the prince's rumored involvement in the killing of *Washington Post* journalist Jamal Khashoggi. On the campaign trail, Biden stated that he would make [Saudi Arabia a pariah in response to its involvement in the murder](#); however, the war in Ukraine has forced the president to backtrack.
 - Biden's agreement to meet the MBS suggests the political cost of the war has risen to a level that the president believes is unsustainable for him and his party to remain in power. Thus, the reversal is a sign that the Biden administration is starting to factor in the political cost of the Ukraine war.
- Croatia is set to [join the Eurozone in 2023](#). The European Commission ruled that the country has met all the criteria needed to join the bloc. As a result of its admission into the Eurozone, Croatia will likely become a more attractive destination for foreign direct investment.

COVID-19: The [number of reported cases](#) is 530,617,830, with 6,294,337 fatalities. In the U.S., there are 84,440,566 confirmed cases with 1,007,682 deaths. For illustration purposes, the *FT* has created an [interactive chart](#) that allows one to compare cases across nations using similar scaling metrics. The [CDC reports](#) that 744,812,955 doses of the vaccine have been distributed, with 586,008,740 doses injected. The number receiving at least one dose is 258,655,540, the number of second doses is 221,350,544, the number receiving the first booster is 103,535,610, and the number receiving the second booster is 14,066,061. The *FT* has a page on [global vaccine distribution](#).

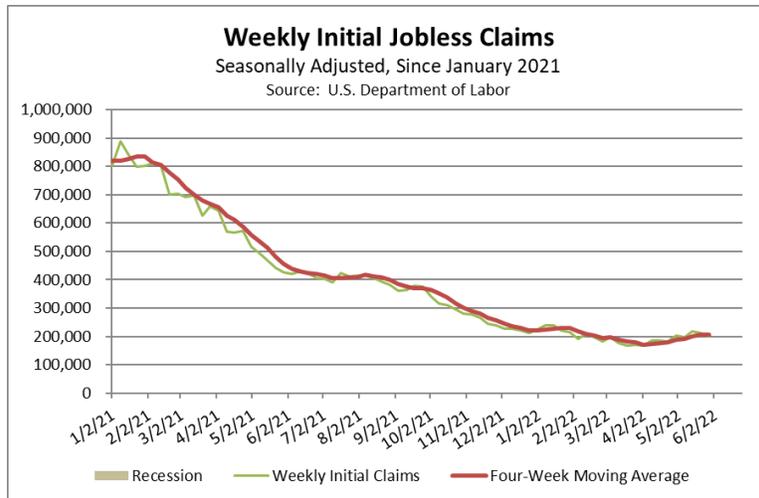
- As the U.S. deals with the current surge in COVID-19 cases, research suggests that [new variants of the omicron virus will likely cause new waves](#) throughout the summer.
- Pfizer has requested the FDA to clear its vaccine to be [authorized for emergency use in children under 5](#).
- In a setback, Hong Kong [has revived COVID-19 restrictions to contain the spread of new sub-variants of Omicron](#). Patients with mild infections and close contacts will be forced into centralized quarantine.

U.S. Economic Releases

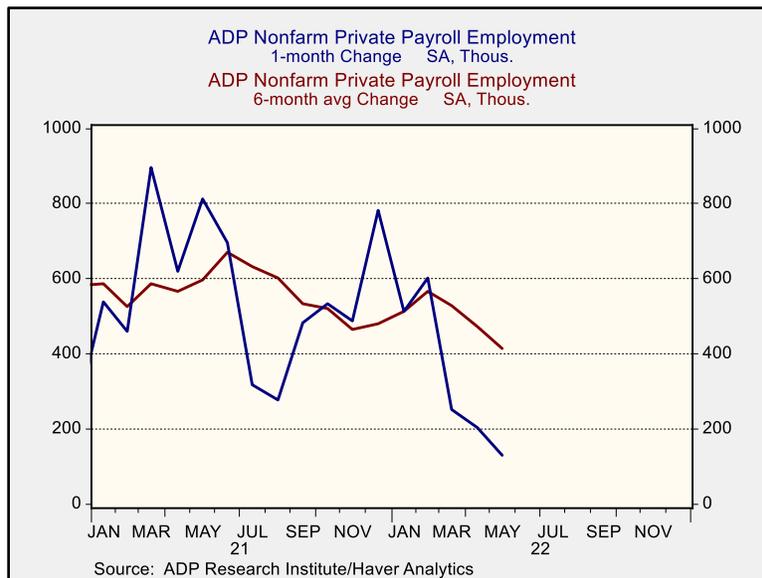
Initial applications for unemployment benefits in the week ended May 28 fell to a seasonally adjusted 200K, coming in better than the expected level of 210K and the previous week’s revised level of 211K. Of course, we pay especially close attention to the four-week moving average of initial claims, which helps smooth out some of the volatility in the series. That figure fell slightly to 206,500, suggesting layoffs remain unusually low. Meanwhile, the number of people continuing to draw benefits in the week ended May 21 fell to 1.309M, better than both the anticipated level of 1.340M and the prior week’s revised level of 1.343M. The chart below shows how initial jobless claims have fluctuated since just before the prior recession. The chart is truncated through much of the pandemic period because of the extremely high level of claims at that time.



To provide more detail on recent trends, the chart below shows how initial jobless claims have changed just since the start of 2021.

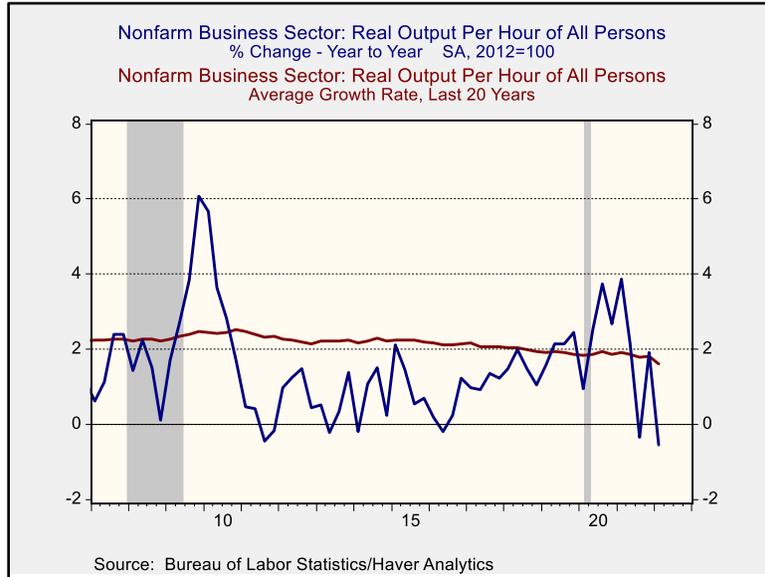


Separately, the ADP Research Institute estimated U.S. businesses added just 128K jobs in May, far below the expected increase of 300K and the previous month’s revised increase of 202K. Although the low level of initial jobless claims suggests employers are trying to hold on to their current employees and aren’t laying off many people, the ADP data points to a potential weakening trend in new hires. The chart below shows ADP’s estimated monthly payroll gains since the beginning of 2021.

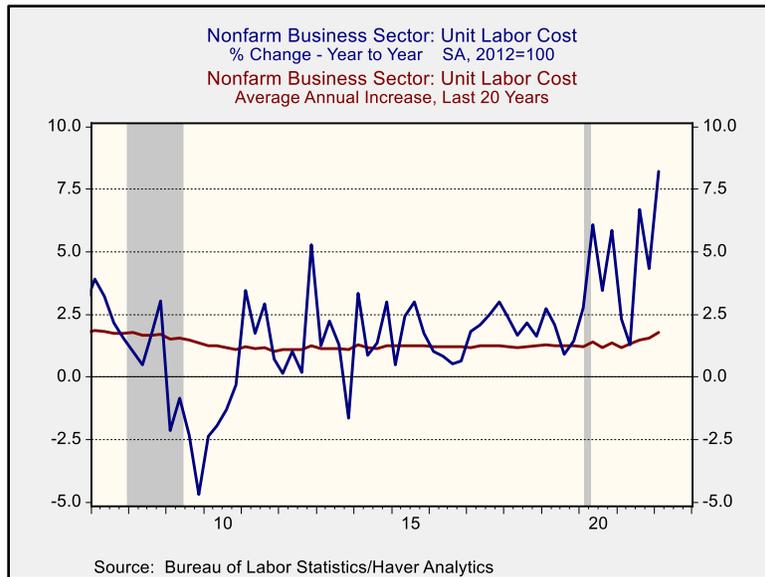


Another report today focused on the productivity of U.S. workers, defined as the average value of output per hour worked. After stripping out price changes and normal seasonal fluctuations, revised first-quarter nonfarm productivity declined at an annualized rate of 7.3%, slightly better than expectations that the decline would be unrevised at 7.5%. Reflecting the fluctuations in each of the last four quarters, productivity in the first quarter was down 0.6% from the same period one year earlier. Productivity growth is key to boosting living standards and supporting higher

wages, so the drop in productivity early this year is a negative sign for the economy. The chart below shows the year-over-year growth in productivity since just before the prior recession.



In an even more negative aspect of the report, revised first-quarter unit labor costs jumped at an annualized rate of 12.6%, far worse than expectations that the rate of increase would be unrevised at 11.6%. Unit labor costs in the first quarter were up 8.2% year-over-year, likely contributing to today’s high consumer price inflation. The chart below shows the year-over-year growth in real unit labor costs since just before the prior recession.



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	Factory Orders	m/m	Apr	0.7%	1.8%	***
10:00	Factory Orders Ex Transportation	m/m	Apr		2.1%	**
10:00	Durable Goods Orders	m/m	Apr F	0.4%	0.4%	***
10:00	Durable Goods Orders Ex Transportation	m/m	Apr F	0.3%	0.3%	**
10:00	Nondefense Capital Goods Orders Ex Aircraft	m/m	Apr F	0.4%	0.3%	**
Federal Reserve						
EST	Speaker or Event	District or Position				
12:00	Lorie Logan Makes Closing Remarks	New York Federal Reserve Executive Vice President				
13:00	Loretta Mester Discusses the Economic Outlook	President of the Federal Reserve Bank of Cleveland				

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	4.6%	6.6%		**	Equity bearish, bond bullish
	Monetary Base, End of Period	m/m	May	¥673.4t	¥688.4t		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	27-May	¥0.9b	¥4.2b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	27-May	-¥26.2b	¥1281.8b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	27-May	-¥274.4b	¥330.1b		*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	27-May	-¥1138.9b	¥628.6b		*	Equity and bond neutral
Australia	Trade Balance	m/m	Apr	A\$10.495b	A\$9.738b	A\$9.000b	***	Equity bullish, bond bearish
	Exports	m/m	Apr	1.0%	0.0%		*	Equity and bond neutral
	Imports	m/m	Apr	-1.0%	-5.0%	1.0%	*	Equity and bond neutral
New Zealand	Terms of Trade Index	q/q	1Q	0.5%	-0.9%	1.3%	*	Equity and bond neutral
South Korea	S&P Manufacturing PMI	m/m	May	51.8	52.1		***	Equity and bond neutral
EUROPE								
Eurozone	PPI	y/y	Apr	37.1%	36.9%	38.2%	***	Equity and bond neutral
Switzerland	CPI	y/y	May	2.9%	2.5%	2.6%	***	Equity bearish, bond bearish
	Core CPI	y/y	May	1.7%	1.5%	1.6%	*	Equity bearish, bond bearish
AMERICAS								
Canada	Building Permits	m/m	Apr	-0.6%	-9.3%	0.8%	**	Equity bearish, bond bullish
Mexico	S&P Manufacturing PMI	m/m	May	50.6	49.3		***	Equity and bond neutral
	Consumer Confidence	m/m	May	44.2	44.2	43.5	*	Equity bullish, bond bearish
	Leading Economic Indicators	m/m	Apr	-0.14	-0.07		*	Equity and bond neutral
Brazil	GDP	y/y	1Q	1.7%	1.6%	2.1%	***	Equity bearish, bond bullish
	GDP - 4-Quarters Accumulated	y/y	1Q	4.7%	4.6%	4.8%	*	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)	161	158	3	Up
3-mo T-bill yield (bps)	109	111	-2	Up
TED spread (bps)	53	47	6	Widening
U.S. Sibor/OIS spread (bps)	146	144	2	Up
U.S. Libor/OIS spread (bps)	150	149	1	Up
10-yr T-note (%)	2.90	2.91	-0.01	Up
Euribor/OIS spread (bps)	-34	-34	0	Neutral
Currencies	Direction			
Dollar	Down			Up
Euro	Up			Down
Yen	Up			Down
Pound	Up			Down
Franc	Up			Down
Central Bank Action	Current	Prior	Expected	
Bank of Canada Rate Decision	1.500%	1.000%	1.500%	On Forecast

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	\$113.18	\$116.29	-2.67%	Rumors of Saudi Arabian production hike.
WTI	\$111.99	\$115.26	-2.84%	Rumors of Saudi Arabian production hike.
Natural Gas	\$8.92	\$8.70	2.53%	
Crack Spread	\$57.55	\$56.53	1.81%	
12-mo strip crack	\$37.10	\$37.09	0.04%	
Ethanol rack	\$2.97	\$2.97	0.19%	
Metals				
Gold	\$1,855.90	\$1,846.60	0.50%	
Silver	\$22.11	\$21.83	1.29%	
Copper contract	\$446.80	\$432.85	3.22%	
Grains				
Corn contract	\$734.50	\$731.25	0.44%	
Wheat contract	\$1,054.75	\$1,041.25	1.30%	
Soybeans contract	\$1,701.25	\$1,690.25	0.65%	
Shipping				
Baltic Dry Freight	2,633	2,566	67	
DOE Inventory Report				
	Actual	Expected	Difference	
Crude (mb)		-2.1		
Gasoline (mb)		-0.1		
Distillates (mb)		0.8		
Refinery run rates (%)		0.5%		
Natural gas (bcf)		88.0		

Weather

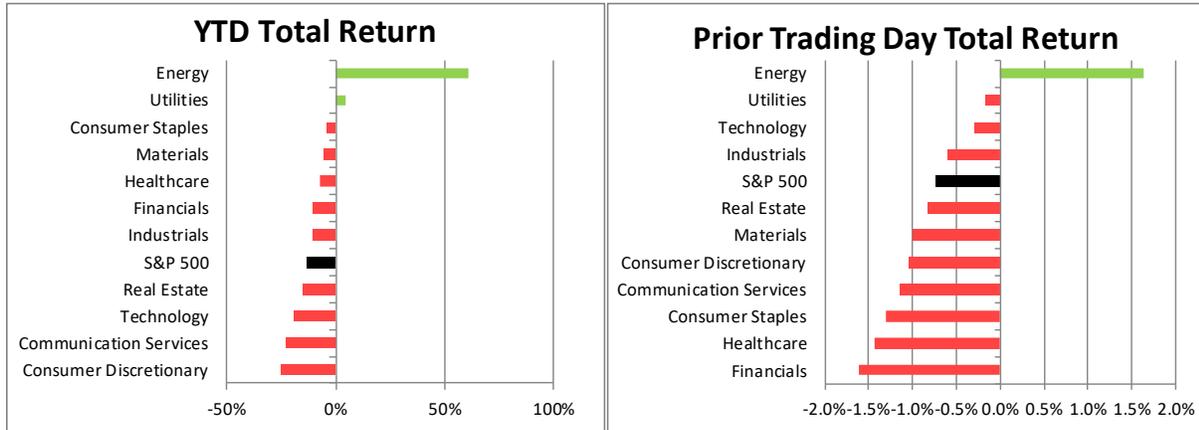
The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures throughout the southern states from California to Florida, with cooler temperatures in the Pacific Northwest,

the northern Rocky Mountains, and the northern Great Plains. Wetter-than-normal conditions are expected in the Pacific Northwest, the Midwest, and New England, with dry conditions in the Southwest.

Separately, we note that the Atlantic hurricane season has now begun. The season runs from June 1 to November 30, although storms typically don't peak until mid-September. Currently, there is a storm near the east coast of the Yucatan Peninsula in Mexico that is expected to become cyclonic within the next 48 hours. There is also a disturbance northeast of the Bahama Islands in the Atlantic, but it is not expected to become cyclonic.

Data Section

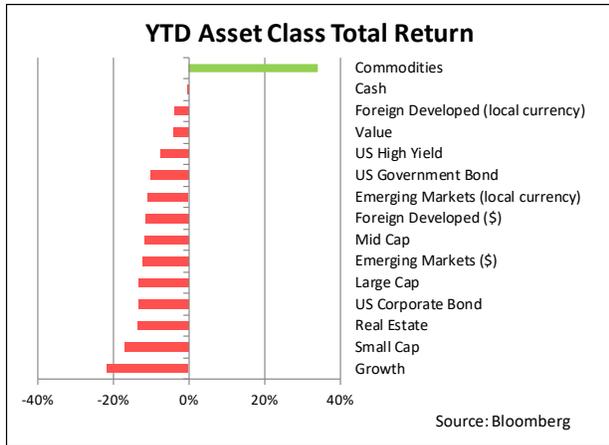
U.S. Equity Markets – (as of 6/1/2022 close)



(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 6/1/2022 close)

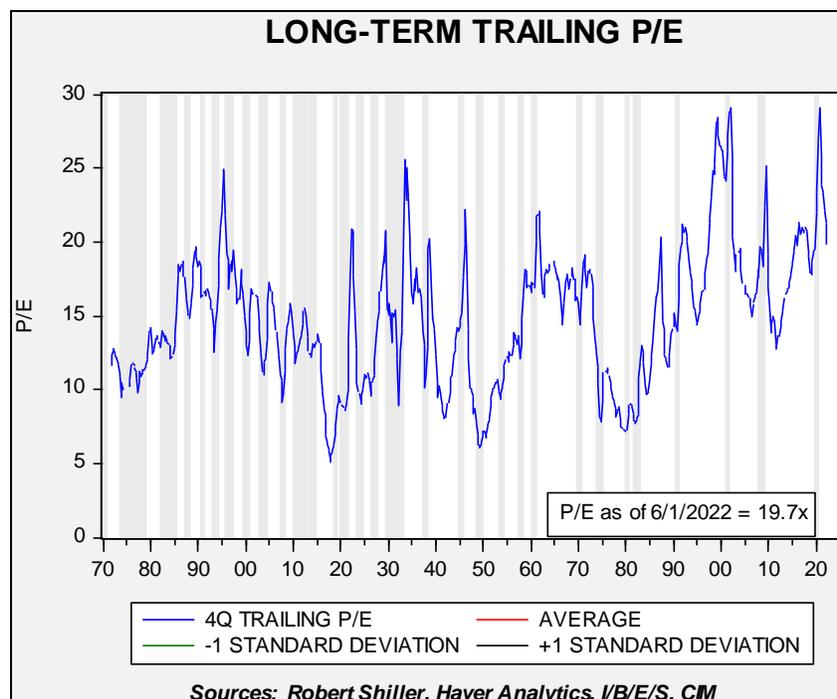


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

June 2, 2022



Based on our methodology,¹ the current P/E is 19.7x, unchanged from last week.

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 three actual quarters (Q3, Q4 and Q1) and one estimate (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.