

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.

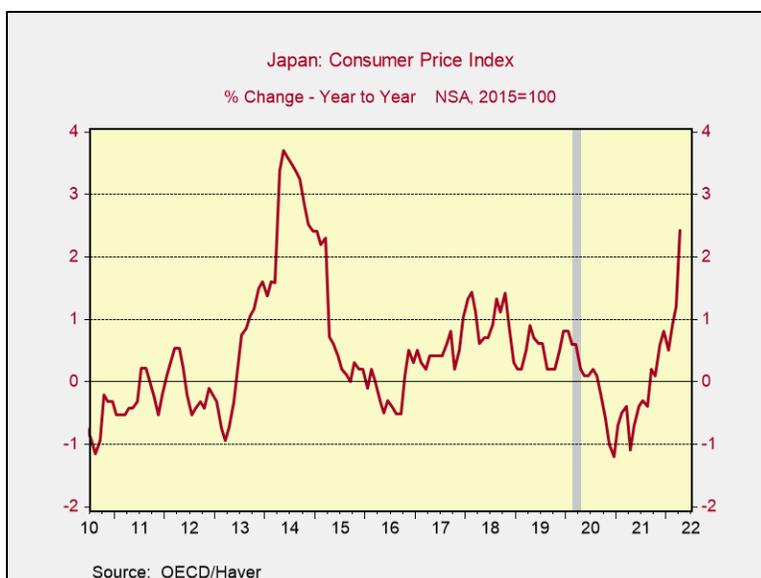
[Posted: June 9, 2022—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the EuroStoxx 50 index is currently down 0.2% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed essentially unchanged. Chinese markets were lower, with the Shanghai Composite closing down 0.8% from its prior close and the Shenzhen Composite closing down 1.8%. In contrast, 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](#) (6/6/2022) (with associated [podcast](#)): “Mineral Commodities in the World’s New Geopolitical Blocs”
- [Weekly Energy Update](#) (6/9/2022): **We update the oil and products data.**
- [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)
- [Charts Worth Noting](#): **We update our housing index, which suggests the housing market has become richly valued.**

In today’s report, we examine the recent weakness in the yen. Up next, we review the latest developments in the Russia-Ukraine war. We briefly discuss some international and U.S. news stories and close with our COVID-19 coverage.

Dovish BOJ: The [yen depreciated to a 20-year low against the dollar](#) following concerns that the Bank of Japan will maintain its accommodative monetary policy while other central banks tighten. The sell-off in the currency was ignited after BOJ Governor Haruhiko Kuroda stated consumers have become more tolerant of higher price rises. Although Kuroda issued a retraction, the remark was viewed as a signal that the central bank may not remove policy accommodation to rein in rising inflation. The latest CPI report showed prices rose 2.4% in April, the fastest pace in over eight years.



Japan's high debt burden and reliance on exports for growth likely contributed to the country's hesitancy to raise rates. Earlier this month, Prime Minister Fumio Kishida walked back [an audacious pledge to balance the government's budget by 2025](#). The change in tone suggests Tokyo would like to reduce its debt burden without hurting the economy. Japan has the highest government debt among advanced economies, so raising rates would complicate government efforts to reduce its debt burden. Moreover, Japan's reluctance to raise rates along with other countries would also allow its currency to depreciate against other countries, therefore making its exports relatively more competitive. Delaying monetary tightening could potentially backfire. Japan imports over 90% of its energy resources. As a result, a declining yen would worsen the inflationary impact of rising commodity prices, therefore hurting business profitability, household budgets, and possibly slowing economic growth. That being said, the yen could strengthen if the U.S. were to slow down significantly or contract.

Russia-Ukraine update: Russian forces continue focusing on taking over the Donetsk and Luhansk oblasts in Eastern Ukraine. There have been reports that Russia has seized control over Severodonetsk; however, Ukrainian officials have maintained that fighting is still taking place in the city. Ukrainian forces have focused their strategy on increasing the number of casualties rather than controlling the entire city. Meanwhile, Russia has engaged in informational warfare through social media and text on personal devices. Russia has used these platforms to threaten to harm Ukrainian soldiers or their family members if they do not surrender. The messages are intended to dent Ukrainian troops' confidence, so they will not keep up the fight. Russia has been able to make substantial gains within Severodonetsk.

Other Russia-Ukraine news:

- The West appears to be less committed to isolating Russia. Former German Chancellor Angela Merkel warned that isolating [Russia cannot be sustained in the long run](#). Her comments contrasted starkly with President Biden, who stated he wanted [Russia to be a](#)

[pariah state as long as Putin was in charge](#). The difference in viewpoint suggests the West, particularly the U.S. and EU, are not on the same page regarding how to deal with Russia, particularly as the war continues indefinitely. The divide over how to proceed with Russia could lead to further disagreements further down the road.

- The UN warns that the war in Ukraine [will increase the risk of world hunger](#). Talks to help end the blockade of the Black Sea have stalled due to Russia's refusal to allow ships to leave the main port of Odesa and Ukraine's reluctance to open itself up to more attacks. Food shortages have been associated with rising instability in developing countries, particularly in the Middle East and Sub-Saharan Africa. We could see political turmoil spread in other parts of the world due to food shortages.
- Russian inflation [decelerated at a faster than expected pace in May](#). The slowdown in price increases suggests households may be adjusting to the sanctions. Inflation remains elevated, rising 17.1% from the prior year in May.
 - The Russian Central Bank is expected to reduce interest rates at its next meeting on Friday. The move is designed to encourage lending and stimulate economic growth.

International news:

- Chinese regulatory crackdown on its tech sector appears to be easing. This week, authorities ended their probe of the [Chinese ride-sharing app Didi](#) (DIDI, \$2.51), cleared [several video games for release](#), and there are rumors of a [potential revival of the ANT Group Co. IPO](#)¹. The change in sentiment appears to be driven by Beijing's desire to encourage more investment. It may be too soon to say whether the crackdown is ending, but the recent activity provides a favorable outlook for Chinese tech stocks.
- The OECD and the World Bank slashed [their global growth forecast for the year](#). The OECD revised its 2022 estimate from 4.5% to 3.0%. Meanwhile, World Bank downgraded its 2022 GDP forecast from 4.1% to 2.9%. Both groups warned that the war in Ukraine and China's aggressive COVID-19 policy were slowing down economic activity.
- The United Arab Emirates Energy Minister [has warned that oil prices have not peaked yet](#), citing China's demand has not fully returned. His remarks may be a sign that the UAE could push OPEC members to increase their output targets. Most members have maxed out their production, but Saudi Arabia and the UAE appear to have the ability to pump more.
- Turkey has demanded that [Greece demilitarize islands in the Aegean Sea](#). Although the two countries are NATO allies, they routinely engage in disputes. This spat is unlikely to develop into a major conflict.

¹ Officials have stated that [these rumors were false](#).

- The European Central Bank announced [it would start its interest rate hike next month](#). The ECB is expected to raise rates by 25 bps in July but hinted at steeper rate increases in the future.

U.S. Economic and Policy news:

- The SEC is looking into [overhauling the equity market to increase competition](#) among traders. One potential rule change would require firms to route individual investors' orders into auctions. The proposed measures appear to be in response to last year's meme stock trading bonanza and suggest retail brokerages are coming under increased scrutiny from regulators.
- The Biden administration is [looking to “reconfigure” tariffs imposed under President Trump](#) to reduce price pressures. Treasury Secretary Janet Yellen stated that even though removing tariffs could help ease inflation, it is not the remedy.
- The U.S. is actively [discussing with its European allies about forming a buyer’s cartel](#) and setting a cap on Russian oil. The goal would be to keep Russian oil on the market to satisfy the demand from India and China while limiting the amount of revenue Moscow can generate from sales. Buyers’ cartels have existed in the past; however, they have not lasted long due to conflicting interests among members.

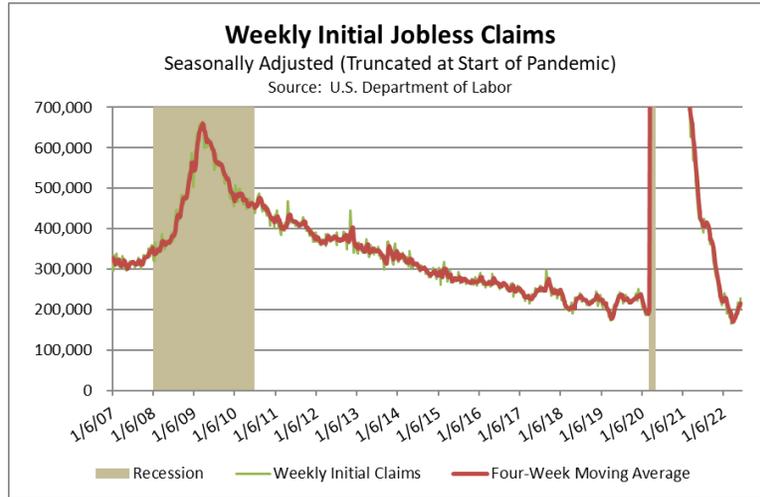
COVID-19: Official data show confirmed cases have risen to [533,761,253 worldwide, with 6,305,225 deaths](#). The countries currently reporting the highest rates of new infections include the U.S., Taiwan, Australia, and Germany. (For an interactive chart that allows you to compare cases and deaths among countries, scaled by population, click [here](#).) In the U.S., confirmed cases have risen to 85,214,036, with 1,010,520 deaths. In data on the U.S. vaccination program, [the number of people considered fully vaccinated now totals 221,567,092](#), equal to 66.7% of the total population.

- The Biden administration is [preparing to distribute vaccines for children under the age of 5](#). The FDA is expected to authorize shots for emergency use later this month. The vaccination drive could help slow the spread of COVID-19.

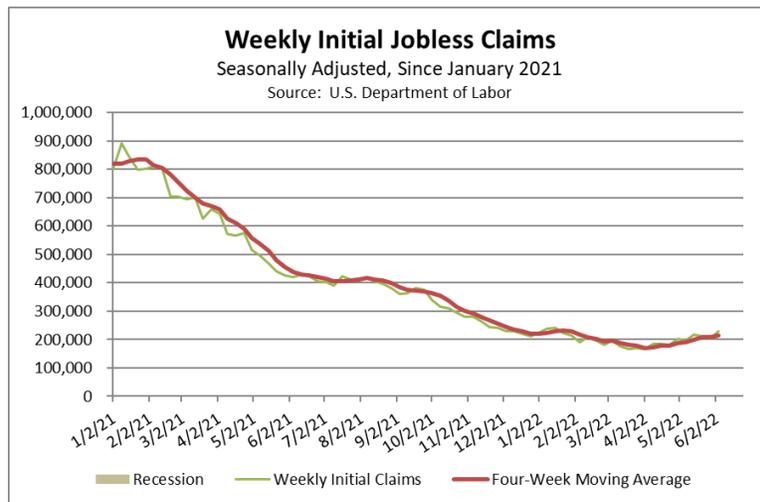
U.S. Economic Releases

Initial applications for unemployment benefits in the week ended June 4 rose to a seasonally adjusted 229K, far worse than both the expected level of 206K and the previous week’s revised level of 202K. Of course, the Memorial Day holiday could have caused some distortion in the figure, but it’s still notable that initial jobless claims are now at their highest level since the Omicron wave of the pandemic was cresting in mid-January. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, rose to 215K, reaching its highest level since early February. Meanwhile, the number of people continuing to draw benefits in the week ended May 28 held steady at the previous week’s revised level of 1.306M, rather than falling to 1.303M as anticipated. 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.



There are no more economic releases and/or Fed events scheduled for the rest of the day.

Charts Worth Noting: Residential real estate is critical to the path of the economy. For the bottom 90% of households, a home is the largest asset and even slowing home price growth can weaken the wealth effect. Existing home sales prices have averaged +5.7% since the late 1960s and rarely do we experience falling yearly price growth. A yearly decline of 2% or more usually coincides with a recession. In 2009, home prices plunged by over 15% as part of the Great Financial Crisis.



This chart measures the number of weeks a person earning the average weekly wage for a non-supervisory position would need to work to pay the mortgage on an existing home at the median sales price and the prevailing mortgage rate. At

the peak of the housing bubble, it took 2.6 weeks to make the mortgage. In May, this measure reached 2.4 weeks. We note that the official NAR Affordability Index fell to 121.21 in March; using the chart data above, which runs through May, it would imply an affordability index of 103.8, which would be worse than the lows observed in 2005. Without a decline in home prices, mortgage rates, or an increase in wages, the housing market is poised for a downturn.

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	Money Stock M2	y/y	May	3.2%	3.4%	3.6%	**	Equity bearish, bond bullish
	Money Stock M3	y/y	May	2.9%	3.1%	3.2%	**	Equity bearish, bond bullish
	Machine tool orders	y/y	May P	23.7%	25.0%		**	Equity bearish, bond bullish
	Foreign Buying Japan Stocks	w/w	3-Jun	-¥122.2b	-¥12.3b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	3-Jun	¥59.1b	-¥27.4b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	3-Jun	¥738.8b	-¥273.9b		*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	3-Jun	-¥840.8b	-¥1137.7b		*	Equity and bond neutral
China	Trade Balance	m/m	May	\$78.76b	\$51.12b	\$57.70b	***	Equity bullish, bond bearish
	Exports	y/y	May	16.9%	3.9%	8.0%	**	Equity bullish, bond bearish
	Imports	y/y	May	4.1%	0.0%	2.8%	**	Equity bullish, bond bearish
EUROPE								
France	Total Payrolls	q/q	Q1	0.3%	0.6%	0.3%	*	Equity and bond neutral
	Private Sector Payrolls	q/q	Q1 F	0.3%	0.3%	0.3%	*	Equity and bond neutral
UK	RICS House Price Balance	m/m	May	73.0%	80.0%	76.0%	**	Equity bearish, bond bullish
AMERICAS								
Mexico	CPI	y/y	May	7.65%	7.68%	7.63%	***	Equity and bond neutral
	Core CPI	y/y	May	7.28%	7.22%	7.25%	**	Equity and bond neutral
Brazil	IBGE Inflation IPCA	y/y	May	11.73%	12.13%	11.88%	***	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)	169	167	2	Up
3-mo T-bill yield (bps)	122	123	-1	Up
TED spread (bps)	47	44	3	Widening
U.S. Sibor/OIS spread (bps)	155	152	3	Up
U.S. Libor/OIS spread (bps)	160	157	3	Up
10-yr T-note (%)	3.05	3.02	0.03	Up
Euribor/OIS spread (bps)	-30	-30	0	Neutral
Currencies	Direction			
Dollar	Down			Up
Euro	Up			Down
Yen	Up			Down
Pound	Flat			Down
Franc	Up			Down
Central Bank Action	Current	Prior	Expected	
ECB Main Refinancing Rate	0.000%	0.000%	0.000%	On Forecast
ECB Marginal Lending Facility	0.250%	0.250%	0.250%	On Forecast
ECB Deposit Facility Rate	-0.500%	-0.500%	-0.500%	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	\$123.38	\$123.58	-0.16%	
WTI	\$121.84	\$122.11	-0.22%	
Natural Gas	\$8.20	\$8.70	-5.79%	
Crack Spread	\$57.34	\$56.13	2.15%	
12-mo strip crack	\$39.65	\$39.39	0.68%	
Ethanol rack	\$3.04	\$3.03	0.18%	
Metals				
Gold	\$1,846.22	\$1,853.36	-0.39%	
Silver	\$21.91	\$22.05	-0.64%	
Copper contract	\$439.00	\$445.45	-1.45%	
Grains				
Corn contract	\$712.25	\$717.75	-0.77%	
Wheat contract	\$1,058.00	\$1,074.75	-1.56%	
Soybeans contract	\$1,557.75	\$1,568.00	-0.65%	
Shipping				
Baltic Dry Freight	2,410	2,514	-104	
DOE Inventory Report				
	Actual	Expected	Difference	
Crude (mb)	2.0	-2.5	4.5	
Gasoline (mb)	-0.8	0.8	-1.6	
Distillates (mb)	2.6	0.6	2.0	
Refinery run rates (%)	1.6%	0.4%	1.2%	
Natural gas (bcf)		98.0		

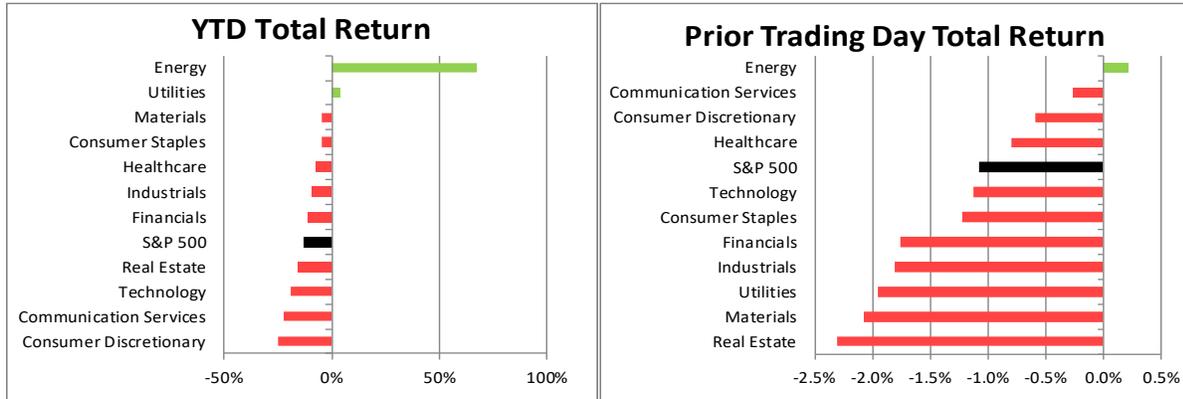
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures in the southern Great Plains and into the Deep South, with cooler-than-normal temperatures only in the Pacific Northwest. Wetter-than-normal conditions are expected in the Northern Tier states and along the Southwest border region, with dry conditions expected in the southern Great Plains and into the Deep South.

Separately, we note 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. There are currently no tropical storms to report in the Atlantic region.

Data Section

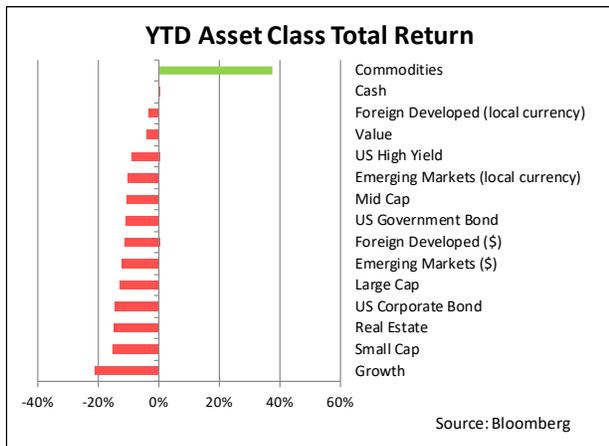
U.S. Equity Markets – (as of 6/8/2022 close)



(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 6/8/2022 close)

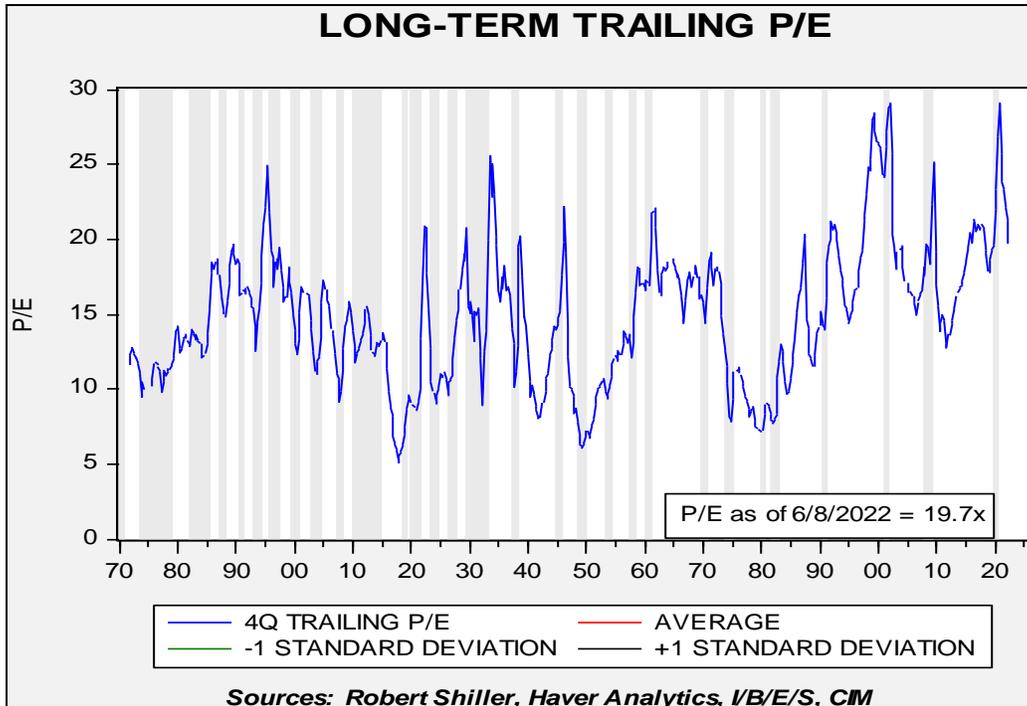


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 9, 2022



Based on our methodology,² 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.

² 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.