

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 18, 2021—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the EuroStoxx 50 is down 0.9% from its prior close. In Asia, the MSCI Asia Apex 50 closed up 0.4%. Chinese markets were also mixed, with the Shanghai Composite ending essentially unchanged from its prior close and the Shenzhen Composite up 0.8%. U.S. equity index futures are signaling a lower 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:

- [Weekly Geopolitical Report](#) (6/14/2021): The Geopolitics of the Colonial Pipeline Ransomware Attack: Part I
- [Weekly Energy Update](#) (6/17/2021): Hydrogen is gaining more attention and crude oil stockpiles continue to decline
- [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](#) (6/18/2021) (with associated [podcast](#) and [chart book](#)): we discuss how “base effects” are affecting today's economic and financial data**
- [Confluence of Ideas podcast](#) (4/30/2021): “The U.S.-China Balance of Power: Part II”

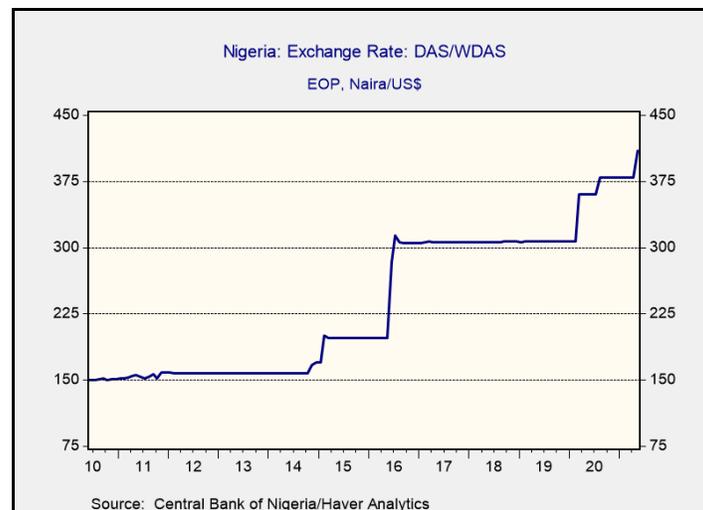
Good morning, all! U.S. equities appear to be headed for a lower open this morning. Today's report begins with a discussion on the surge in reverse repos. International news follows, with reports on the Iranian presidential election and Nicholas Maduro hinting at a possible truce with the U.S. We review economics and policy news next, including a new federal holiday and the House's withdrawal of authorization for the Iraq war. China news follows, and we close with our pandemic coverage.

Reverse Repos: The Federal Reserve's reverse repos [rose to a record \\$756 billion](#) following the central bank's rate increase in the interest it pays banks for its excess reserves (IOER) and overnight reverse repo facility. The attractiveness of reverse repos may be due to a collateral shortage caused by a lack of Treasury bills. Recently, the Treasury Department has been reluctant to issue new bills in fear of surpassing the debt ceiling before its deadline in July. This has forced financial institutions to obtain Treasury bills through the reverse repo facility. Although these financial institutions could have gone to money market funds, the yields on those funds, in some cases, were approaching zero. Hence, the rise in rates made reverse repos relatively more attractive when compared to the alternative.

The surge in reverse repos is likely a signal of the growing imbalances within the financial system. Over the last year, financial institutions have been flush with cash due to both fiscal and monetary expansionary policy. These institutions now have excess cash and, as a result, have struggled to find places to store it. Ironically, it was the opposite problem in September 2019, when the lack of cash caused repo rates to skyrocket. The issue illustrates the growing complexity of the financial system and the Fed's inability to foresee problems before they occur. The problem also highlights the Fed's need to pay closer attention to how its decisions may impact financial markets.

International news: Nigeria forces dealers to get rid of dollar holdings, Iran votes for a new president, and Maduro seeks a deal.

- The U.S. and the EU have joined forces [to develop technology to counter Russia and China](#). Both groups are boosting their investment spending in order to reduce their dependence on tech imports. Additionally, it appears that the two sides will work together in improving their technology related to artificial intelligence.
- Nigeria's forex trading body has asked dealers to sell [their stock of dollars](#) in an attempt to narrow the spread between spot price and illegal market price. The country has struggled to maintain its peg with the U.S. dollar in recent months.



- In the U.K., the Conservative Party [lost a party seat in one of its strongholds](#). On Friday, a Liberal Democrat – a centrist, pro-EU group – was able to win a by-election in the constituency of Chesham and Amersham. The region is a few miles away from West London, where PM Boris Johnson holds a parliamentary seat. The Liberal Democrat victory in the region highlights a growing fracture within the Conservative Party.
- The Iranian elections are taking place on Friday and it is [expected that ultra-conservative candidate Ebrahim Raisi](#) will win. The election appears to be a formality as other serious contenders were barred from the race. Raisi is a close ally of the Supreme Leader Ayatollah Ali Khamenei and his election could signal a more isolationist Iran. Although Raisi is known to be skeptical of the West, he [has come out in favor of the nuclear deal](#).
- In an interview with Bloomberg Television, Venezuelan President Nicolas Maduro [hinted that he is ready to make a deal with the U.S.](#) to remove sanctions. Venezuela is in

desperate need of foreign investment as economic conditions continue to deteriorate. The gesture by Maduro highlights the crippling effects of the sanctions and could be a sign that he may be losing influence within the country. In 2018, the U.S., along with other countries in South America and Europe, recognized a member of his opposition, Juan Guaido, as the rightful leader of the country. The move came after Maduro's 2018 re-election victory was declared fraudulent. As a result, it will be difficult for President Biden to make a deal that will allow Maduro to stay in power. At this point, it is unclear whether Maduro will consider stepping down, but it is obvious that he doesn't have much leverage.

Economics and policy: Juneteenth becomes a federal holiday, the house revokes authorization of the Iraq invasion, and the Affordable Care Act survives.

- The Supreme Court [rejected a challenge to the Affordable Care Act](#). The ruling, however, left the door open for another lawsuit.
- The House voted to revoke [authorization of the 2002 Iraq invasion](#). The authorization was used in the fight against Islamic State in Iraq as well as the killing of Iranian general Qassim Soleimani. The vote symbolizes the growing withdrawal of the U.S. from the superpower role.
- The Federal Communications Commission voted unanimously to study the effect of [banning U.S. companies from purchasing telecommunications](#) equipment from Chinese companies. Additionally, it voted to consider revoking previous authorization of equipment from five Chinese companies that were deemed to be a national security threat.
- On Thursday, President Biden signed legislation that officially made Juneteenth a [federal holiday](#). So far, government agencies and financial institutions have struggled to determine whether their offices should be closed on Friday in acknowledgment of the holiday.

China:

- Chinese astronauts have [made their way to the Tiangong space station](#). They will be in the space station for three months.
- Bitcoin miners are now [leaving China and coming to the U.S.](#) China has begun to crack down on the industry due to the amount of energy it consumes, and the shift to the U.S. comes as investment firms are becoming more accepting of the digital commodity.
- A pro-democracy tabloid [Apple Daily was raided by Hong Kong police officers](#) on Thursday. Authorities cited potential violations of its national security law.
- China is hoping that the higher than expected inflation will [encourage the U.S. to remove tariffs](#).
- Officials in China are discussing the possibility of [lifting birth restrictions completely by 2025](#) as the country continues to struggle with low birth rates.

COVID-19: The [number of reported cases](#) is 177,201,586 with 3,836,092 fatalities. In the U.S., there are 33,505,563 confirmed cases with 600,880 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 377,215,060 doses of the vaccine have been distributed with 314,969,386 doses injected. The number receiving at least one dose is 175,867,860 while the number of second doses, which would grant the highest level of immunity, is 147,758,585. The *FT* has a page on [global vaccine distribution](#).

- The U.K. reported its [highest number of cases since February](#) of this year. The rise in cases highlights the dilemma as to whether the country should reduce its restrictions. There are growing concerns that if the virus isn't contained, the U.K. [could see another surge in cases in the winter](#).
- The U.S. plans to invest more than \$3 billion into developing [an antiviral pill to treat COVID-19](#). The money will come from the coronavirus relief package that was passed in March. Although the vaccine will remain the centerpiece to ending the pandemic, the pill will be looked at as a way to treat those who may have contracted the virus.
- The Japanese government has stated that it is considering [relaxing some of the lockdown restrictions](#) as it prepares to host the Olympic Games. Although the country has seen a decline in cases, it hasn't been successful in convincing people to get vaccinated.
- A new coronavirus [variant has made its way to Moscow](#) and it appears to be more aggressive and infectious than previous variants.

U.S. Economic Releases

There have been no major U.S. economic releases so far today, and there are no domestic releases or Fed events scheduled for the rest of the day.

Economic Releases	No economic releases today
Fed Speakers or Events	No speakers or events scheduled

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	National CPI	y/y	May	-0.1%	-0.4%	-0.2%	***	Equity and bond neutral
	National CPI Ex Fresh Food	y/y	May	0.1%	-0.1%	0.0%	**	Equity and bond neutral
	National CPI Ex Fresh Food, Energy	y/y	May	-0.2%	-0.2%	-0.3%	*	Equity and bond neutral
EUROPE								
Germany	PPI	y/y	May	7.2%	5.2%	6.4%	*	Equity and bond neutral
UK	Retail Sales	y/y	May	24.6%	42.4%	29.3%	**	Equity bearish, bond bullish
	Retail Sales Ex-Auto Fuel	y/y	May	21.7%	37.7%	27.1%	**	Equity bearish, bond bullish
AMERICAS								
Mexico	Aggregate Supply & Demand	y/y	1Q	-2.9%	-5.1%	-2.5%	*	Equity bearish, bond bullish

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)	12	12	0	Up
3-mo T-bill yield (bps)	3	3	0	Neutral
TED spread (bps)	10	9	1	Neutral
U.S. Libor/OIS spread (bps)	10	10	0	Up
10-yr T-note (%)	1.49	1.51	-0.02	Neutral
Euribor/OIS spread (bps)	-54	-55	1	Neutral
EUR/USD 3-mo swap (bps)	3	3	0	Down
Currencies				
Dollar	Flat			Down
Euro	Flat			Up
Yen	Up			Up
Pound	Down			Up
Franc	Down			Up
Central Bank Action				
	Current	Prior	Expected	
BOJ Policy Balance Rate	-0.100%	-0.100%	-0.100%	On forecast
BOJ 10-yr Yield Target	0.000%	0.000%	0.000%	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.

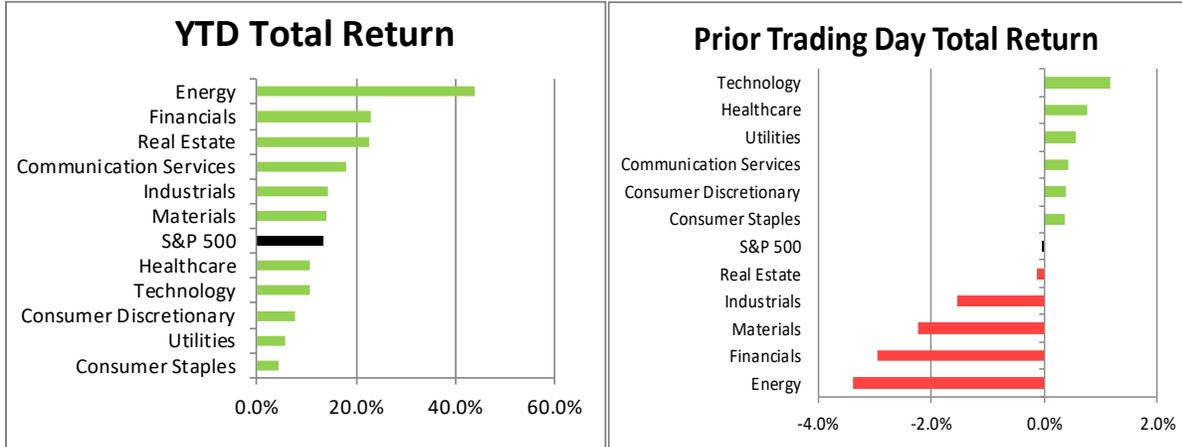
	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$72.53	\$73.08	-0.75%	
WTI	\$70.59	\$71.04	-0.63%	
Natural Gas	\$3.19	\$3.25	-1.81%	
Crack Spread	\$17.74	\$17.57	0.98%	
12-mo strip crack	\$18.17	\$18.00	0.91%	
Ethanol rack	\$2.50	\$2.52	-0.80%	
Metals				
Gold	\$1,793.28	\$1,773.50	1.12%	
Silver	\$26.40	\$25.90	1.91%	
Copper contract	\$419.75	\$418.55	0.29%	
Grains				
Corn contract	\$550.00	\$532.50	3.29%	
Wheat contract	\$660.00	\$643.00	2.64%	
Soybeans contract	\$1,308.50	\$1,252.75	4.45%	
Shipping				
Baltic Dry Freight	3267	3176	91	
DOE inventory report				
	Actual	Expected	Difference	
Crude (mb)	-7.4	-2.0	-5.4	
Gasoline (mb)	2.0	2.4	-0.4	
Distillates (mb)	-1.0	2.4	-3.4	
Refinery run rates (%)	1.30%	0.40%	0.90%	
Natural gas (bcf)	16.0	71.0	-55.0	

Weather

The 6-10 day and 8-14 day forecasts currently call for warmer-than-normal temperatures throughout the entire western half of the country, with cooler temperatures in the Midwest and South. The forecast calls for wet conditions across the entire Great Lakes region and dry conditions in the Pacific Northwest and Rocky Mountains. Meanwhile, a potential cyclonic formation is building in the northern Gulf of Mexico.

Data Section

U.S. Equity Markets – (as of 6/17/2021 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 6/17/2021 close)

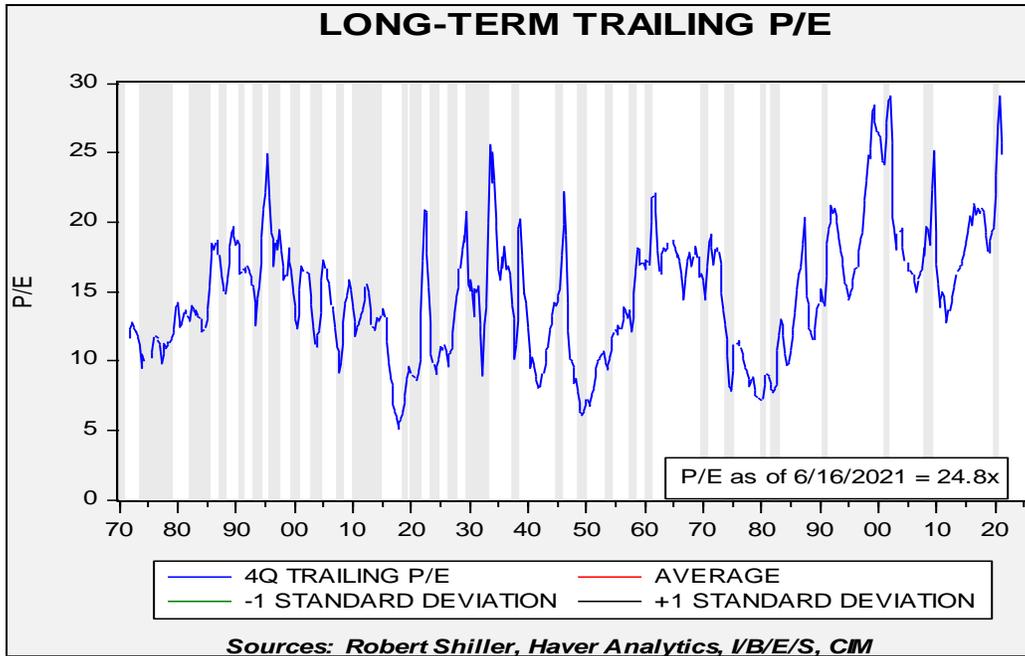


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

June 17, 2021



Based on our methodology,¹ the current P/E is 24.8x, up 0.1x 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 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.