

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 27, 2022—9:30 AM EDT] Global equity markets are higher this morning. In Europe, the EuroStoxx 50 is currently up 0.9% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 2.0%. Chinese markets were higher, with the Shanghai Composite closing up 0.9% from its prior close and the Shenzhen Composite closing up 1.1%. 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:

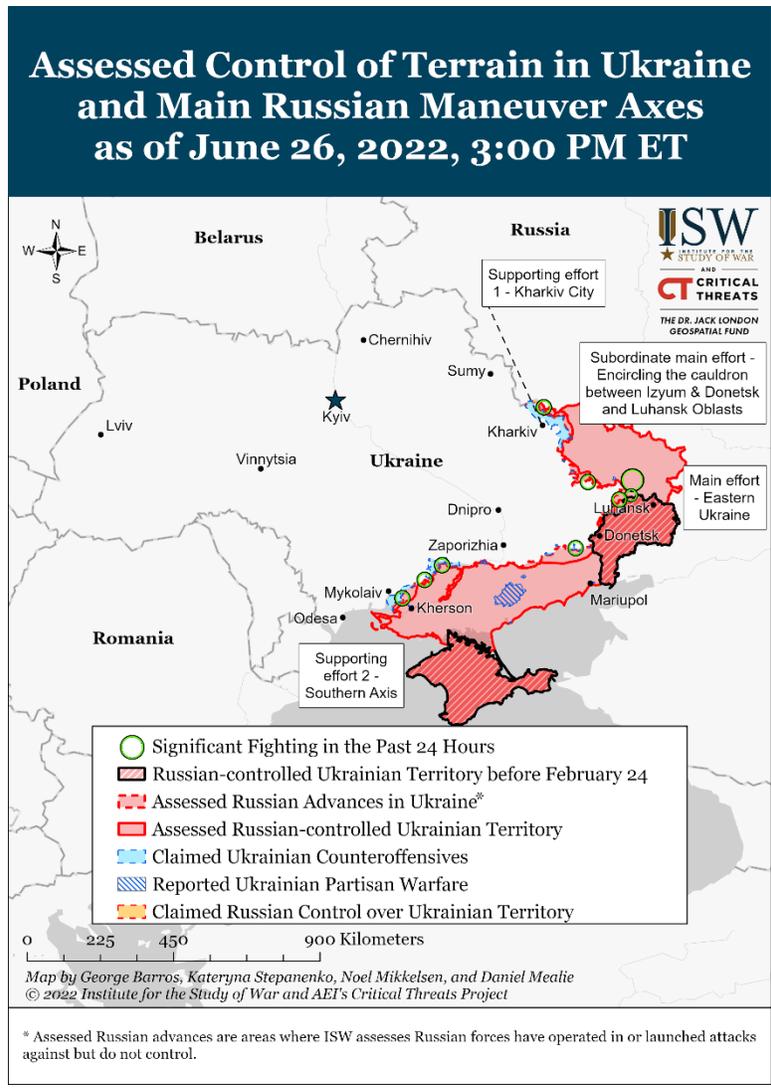
- [Bi-Weekly Geopolitical Report](#) (6/21/2022) (with associated [podcast](#)): “The 2022 Mid-Year Geopolitical Outlook”
- [Weekly Energy Update](#) (6/24/2022): We discuss the Urals/Brents spread as an indicator of sanctions violations. We also report on Germany’s natural gas situation. N.B. The DOE has a data issue, so the inventory data isn’t updated. We will update the data when it becomes available.
- [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](#) (6/27/2022) (with associated [podcast](#)): “The Selling of Austerity”
- [Confluence of Ideas podcast](#) (3/25/2022): “The 2022 Outlook: Update #1”
- *Current Perspectives*: “[2022 Outlook: Update #1](#)” (2/18/2022)

Our *Comment* today opens with an update on the Russia-Ukraine war. New sanctions are being discussed by Western leaders. We next review other international and U.S. developments with the potential to affect the financial markets today, including multiple items relating to China. We wrap up with the latest news on the coronavirus pandemic.

Note: *Because COVID-19 has become more endemic and in most countries isn’t disrupting the economy or politics as much as it did previously, we will drop our dedicated COVID-19 section beginning July 1. We will continue to cover pandemic news as needed within our main text.*

Russia-Ukraine: As Russian forces [continue to make slow, plodding progress in seizing territory in Ukraine’s eastern Donbas region](#), Ukrainian forces [continue their increasingly](#)

[successful counterattacks in southern Ukraine around the port city of Kherson](#). Both countries face worsening shortages of personnel and equipment, and Russian President Putin continues to implement a “cover mobilization” to raise more troops. According to reports, the Russian State Duma will consider a bill that would allow military officials to offer contracts to young men immediately upon “coming of age” or graduating high school. It circumvents the need for conscripts to complete military service before being sent to fight in the war. On the Ukrainian side, Western [leaders will discuss providing further, “sustained” military aid](#) to the country at their summits this week.



- Not only has Putin’s invasion backfired on him by making Ukraine a candidate for membership in the EU, but it has also hastened Ukraine’s integration into the EU economy. As early as July, the EU [will begin importing small amounts of electricity from Ukraine](#), with greater amounts expected in the future as power infrastructure is linked. Since so many people have fled Ukraine because of the war, the country now has surplus generating capacity, even as many EU countries face a deficit.

- U.S. and British officials indicated the [Group of Seven summit](#) this week [would approve a broad ban on importing Russian gold, one of the country's key commodity exports after energy](#). The Russian central bank reportedly holds some 2,000 metric tons of the metal, worth approximately \$140 billion. Russia has exported tens of billions of dollars of gold to G7 countries in recent years (especially to the U.K.). The officials [are also considering imposing a price cap on Russian oil exports and new tariffs on other Russian goods](#).
 - The ban on Russian gold can be seen as the logical corollary of the Western countries' freeze on Russian reserve assets. Indeed, it appears an informal ban on Russian gold has already been in place. The weekend announcement was notable for making it public.
 - In the immediate term, the ban could give a modest boost to gold prices. So far this morning, gold is trading up about 0.4% to \$1,837.00. In the longer term, however, prices could reverse and even go lower. For one thing, Russia has proven adept at getting its commodities to market, despite Western sanctions, by leveraging their fungibility and the willingness of China, India, and other countries to deal with them. For another, the G7 action will likely reduce the attractiveness of holding gold and therefore lead to lower demand. In each case, at least some Western officials probably understand the difficulty in making such sanctions truly painful for Russia, but that concern is probably outweighed by the need to make a political statement against the invasion.
- The G7 nations are also considering a change to their bans on Russian oil imports. To stop Russia from earning high prices by exporting oil to non-sanctioning countries, the [G7 is looking at allowing Western shipping, insurance, and other financial services firms to deal with Russian oil exports as long as the importer observes a price cap](#). Besides cutting Russian oil revenues, the goal would be to bring down global oil prices. All the same, Brent crude is trading 0.7% higher so far this morning, at \$109.89 per barrel.
- Reflecting the impact of the West's previous sanctions, Russia yesterday [defaulted on its sovereign foreign debt for the first time in over a century](#). Moscow has set up a mechanism to deposit rubles in special bank accounts for the benefit of bondholders that doesn't appear to match the \$100 million or so of dollar and euro payments required to be paid by yesterday under the bond documents.

G7 Summit: Besides the ban on Russian gold imports mentioned above, the G7 leaders announced a new “Partnership for Global Infrastructure and Investment” program that [will jointly provide \\$600 billion for infrastructure investments in less-developed countries by 2025](#) to counter China's Belt and Road Initiative. Relying on both public and private funds, the program will finance investments in projects such as climate resilience, secure information and communications technology, gender equity, and modernizing health systems, including vaccine manufacturing facilities.

Global Monetary Policy: In its annual report, the Bank for International Settlements [warned that global central banks must raise interest rates sharply, even if it significantly hurts growth](#). Otherwise, the “central banks' central bank” said the world risks a 1970s-style inflationary

spiral. While central banks like the Federal Reserve are clearly behind the curve in fighting inflation, the BIS warning could help push the policymakers into tightening monetary policy so quickly that they produce a recession, most likely sometime in 2023.

Chinese Economy: New reports indicate small and medium-sized businesses throughout China [are drastically cutting their hiring plans](#) in response to the country's draconian pandemic lockdowns, rising costs, and waning orders from overseas. Some firms have even been cutting wage rates and laying off workers.

- The development will make it even harder for officials to meet their official goal of 5.5% economic growth this year.
- The slowdown also increases the chance that officials will resort to their traditional strategy to boost growth: a debt-funded public investment that will further exacerbate China's high debt levels.

Chinese Politics: Ahead of the Chinese Communist Party's 20th National Congress this fall, where President Xi will try to win a groundbreaking third term in power, at least nine provincial party chiefs [have published fawning articles extolling the president and pledging loyalty to him](#). The articles have even used over-the-top reverential terms for Xi that have rarely been used since Mao's cult of personality decades ago.

- The articles have generally coincided with this month's provincial party congresses, where delegates to the national congress are being confirmed.
- The articles reflect the provincial chiefs' jockeying for plum positions at the autumn congress, but they alone indicate widespread certainty that Xi will secure his third term at the meeting, further enhancing his power and setting him up to be president for life.

Japan: Amid a blistering heat wave, the government today [called on businesses and the public in the Tokyo area to cut electricity use](#), saying a lack of generating capacity risked plunging the capital into a power blackout. If prolonged, any resulting power outages could be a headwind for Japanese economic growth.

China-United States-Japan, et al.: Alarmed by China's effort to court the island nations of the western Pacific Ocean, the U.S. and several key allies [have launched a new initiative to bolster and coordinate their engagement with those nations](#). The "Partners in the Blue Pacific" initiative encompasses the U.S., Japan, Britain, Australia, and New Zealand and is designed to blunt Chinese overtures to nations in the region, such as the new pact potentially allowing China to send military forces to the Solomon Islands.

United States-Israel-Saudi Arabia-Egypt-Iran: New reporting shows top military officials from the U.S., Israel, Saudi Arabia, Egypt, and other Middle Eastern states [met in March to discuss how they could defend against Iran's growing missile and drone threats](#). As the U.S. seeks to step back from its role as the guarantor of Middle Eastern security to focus on threats from China and Russia, the report suggests it is seeking to install Israel in its place, at least in terms of air defense.

- At the March talks, the participants reached an agreement in principle on procedures for rapid notification when aerial threats are detected. The officials also discussed how

decisions might be made on which nation's forces would intercept aerial threats. However, top national leaders need to approve the evolving "Middle East Air Defense Alliance," which may be helped along when President Biden visits Saudi Arabia and Israel in mid-July.

- Even though the new initiative appears to be in its early stages, other recent events [suggest Israel may be preparing to attack Iran's nuclear weapons facilities as that country gets ever closer to having a workable bomb](#), just as it took out Iraq's nuclear reactor in 1981 and Syria's in 2007. Any such attack would likely spark a global crisis that would push oil prices dramatically higher and cause a steep decline in economic activity.
 - Israeli Prime Minister Bennett has recently referred to a new "Octopus Doctrine," relating to Iran, saying, "We no longer play with the tentacles, with Iran's proxies: We've created a new equation by going for the head."
 - In recent weeks, Israel has also carried out several targeted assassinations in Iran itself, taking out top Iranian military operatives as well as nuclear scientists. It is not the first time that Israel has taken out high-level targets inside Iran, but the increase in strikes suggests a shift.
 - Israel has also recently stepped up its military exercises designed to increase its readiness and prepare for a conflict that would involve long-range air attacks on its enemies. Israeli media report a May exercise was explicitly designed to practice a long-range attack on Iran's nuclear facilities.
 - Other Israeli media reporting says the country's air force can now fly F-35 fighter jets from Israel to Iran without refueling. Those jets can also be equipped with a new one-ton bomb "that can be carried inside the plane's internal weapons compartment without jeopardizing its stealth radar signature."

U.S. Housing Market: Reflecting the difficulty in buying a house amid today's hot home market and rising interest rates, people trying to rent [are now getting into bidding wars](#). That could help push up rental housing costs in the consumer price index and worsen or prolong today's high inflation rate.

U.S. Regulatory Policy: While Friday's Supreme Court decision voiding *Roe v. Wade* and its recognition of a constitutional right to abortion continue to generate intense debate, we suspect it won't have any immediate, broad impact on the economy or financial markets (our key focus). However, it [probably puts particular companies at risk of legal or political blowback](#), depending in large part on their public statements regarding the issue and their healthcare benefit policies.

- In the coming months, the key issue for investors may be whether the decision will energize left-leaning abortion rights voters enough to limit the Democratic Party's expected losses in the Congressional elections in November.
- In the longer term, it will also be interesting to see whether overturning *Roe v. Wade* saps or bolsters the political energy of right-leaning cultural conservatives. On the one hand, the decision satisfies a longstanding goal of those voters, even if decisions on implementing or expanding abortion restrictions will now move to many state legislatures. On the other hand, right-wing elite politicians may try to capitalize on the

victory by doubling down on other social issues important to populists, such as gun rights or history teaching in schools.

COVID-19: Official data show confirmed cases have risen to [543,646,378 worldwide, with 6,329,214 deaths](#). The countries currently reporting the highest rates of new infections include the U.S., Taiwan, Germany, and Brazil. (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 86,967,639, with 1,015,938 deaths. In data on the U.S. vaccination program, [the number of people considered fully vaccinated now totals 222,123,223](#), equal to 66.9% of the total population.

- In the U.S., the latest wave of infections appears to be topping out, but hospitalizations are still accelerating with their usual lag. The seven-day average of newly reported cases stands at 102,818, unchanged from two weeks ago. The seven-day average of people hospitalized with confirmed or suspected COVID-19 [came in at 31,650 yesterday](#), up 7% from two weeks earlier. New COVID-19 deaths are now averaging 348 per day, up 5% from two weeks earlier.
- In China, the electronics manufacturing powerhouse of Shenzhen [has partially locked down a district bordering Hong Kong after almost a dozen local cases were discovered](#) there over the weekend. Illustrating how President Xi's zero-COVID policy continues to disrupt the economy, the Shenzhen shutdown applies to businesses like wholesale markets, bars, cinemas, gyms, parks, and some bus and subway services.
 - Under the new rules, anyone wanting to use public transport or enter public venues in Shenzhen must show a negative COVID test taken within the previous 24 hours—literally once a day.
 - The daily test requirement has reportedly helped the city government avoid a more extensive lockdown, but we suspect it will still crimp economic activity in the region, further weighing on Chinese growth and global demand.

U.S. Economic Releases

New orders for manufactured goods rose faster than expected in May, a possible sign that investment spending is firm. Durable goods orders rose 0.7% from the previous month to \$267.2B. The sharp rise in orders beat the consensus estimates of 0.1% and was fairly broad-based. Excluding transportation, durable goods orders rose 0.7% from the prior month compared to expectations of 0.3%. Meanwhile, core capital orders, which excludes nondefense goods and aircraft, rose 0.5% from the previous month, well above expectations of 0.1%.



The chart above shows the annual change in new orders and shipments. Factory shipment and orders for manufactured goods rose 12.74% and 10.62% from the prior year, respectively. In contrast to the recent weak manufacturing data, the pickup in new orders for durable goods suggests firms are willing to increase their capital expenditure, even as interest rates rise.

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	Pending Home Sales	m/m	May	-4.0%	-3.9%	**
10:00	Pending Home Sales NSA	y/y	May		-11.5%	**
10:00	Dallas Fed Manf. Activity	m/m	Jun	-5.8	-7.3	*
Federal Reserve						
EST	Speaker or Event	District or Position				
12:30	Mary Daly Interviewed During LinkedIn Event	President of the Federal Reserve Bank of San Francisco				

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								
China	Industrial Profits YTD	y/y	May	1.0%	3.5%		**	Equity bearish, bond bullish
	Industrial Profits	y/y	May	-6.5%	-8.5%		**	Equity and bond neutral
Japan	Coincident Index	m/m	Apr	102.9	96.8		**	Equity bullish, bond bearish
	Leading Index CI	m/m	Apr	96.8	102.9		**	Equity and bond neutral
EUROPE								
Switzerland	Domestic Sight Deposits CHF	w/w	24-Jun	653.5b	661.7b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	24-Jun	748.5b	751.8b		*	Equity and bond neutral
AMERICAS								
Canada	Bloomberg Nanos Confidence	w/w	24-Jun	48.3	50.0		**	Equity bearish, bond bearish
Brazil	FIPE CPI - Weekly	w/w	22-Jun	0.13%	0.04%	0.08%	**	Equity and bond neutral
	FGV Construction Costs	m/m	Jun	2.81%	1.49%	3.41%	**	Equity and bond neutral
Mexico	Trade Balance	m/m	May	-2215.3m	-1884.1m	-1560.0m	**	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)	223	220	3	Up
3-mo T-bill yield (bps)	157	163	-6	Up
TED spread (bps)	67	56	11	Widening
U.S. Sibor/OIS spread (bps)	203	201	2	Up
U.S. Libor/OIS spread (bps)	213	210	3	Up
10-yr T-note (%)	3.17	3.13	0.04	Up
Euribor/OIS spread (bps)	-22	-19	-3	Neutral
Currencies	Direction			
Dollar	Down			Up
Euro	Up			Down
Yen	Flat			Down
Pound	Up			Down
Franc	Up			Down

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	\$113.24	\$113.12	0.11%	
WTI	\$107.56	\$107.62	-0.06%	
Natural Gas	\$6.11	\$6.22	-1.83%	
Crack Spread	\$56.98	\$57.86	-1.52%	
12-mo strip crack	\$39.71	\$40.34	-1.55%	
Ethanol rack	\$2.96	\$2.95	0.43%	
Metals				
Gold	\$1,838.41	\$1,826.88	0.63%	
Silver	\$21.51	\$21.16	1.63%	
Copper contract	\$377.20	\$374.45	0.73%	
Grains				
Corn contract	\$661.00	\$674.00	-1.93%	
Wheat contract	\$949.75	\$936.50	1.41%	
Soybeans contract	\$1,430.00	\$1,424.25	0.40%	
Shipping				
Baltic Dry Freight	2,331	2,354	-23	

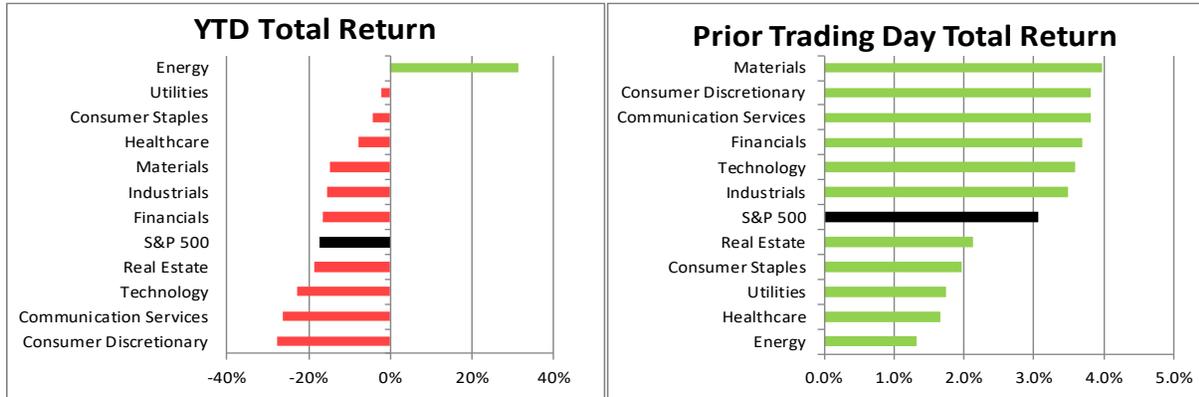
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures throughout most of the country, with cooler-than-normal temperatures in the Pacific, Southwest, and New England regions. Meanwhile, wetter-than-normal conditions are expected in the Rocky Mountain, the Southwest, and the Great Plains, with dry conditions expected in Nevada and Texas.

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. Currently, three tropical disruptions are forming east of the U.S. In the Gulf of Mexico, there is some cyclone formation off the coast of Louisiana; however, it is not expected to develop into a tropical storm within the next 48 hours. In the Atlantic Ocean, two storms are forming, but only one is expected to develop into a tropical storm within the next 48 hours.

Data Section

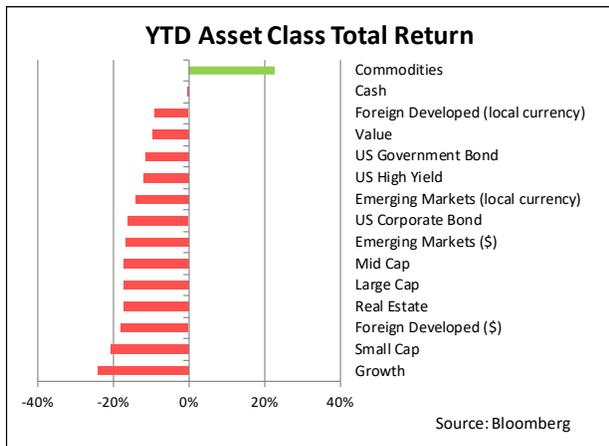
U.S. Equity Markets – (as of 6/24/2022 close)



(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 6/24/2022 close)

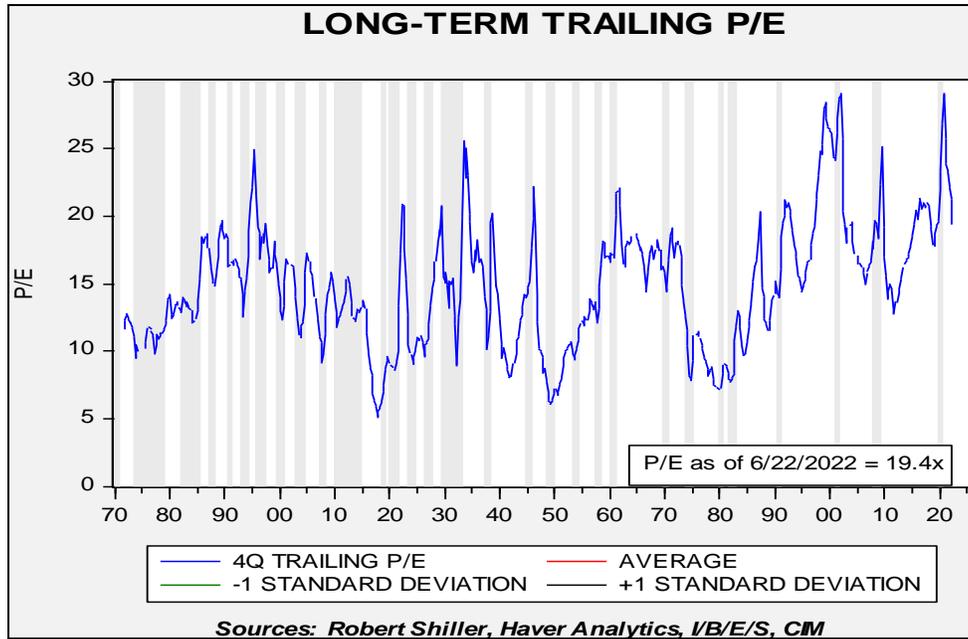


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 23, 2022



Based on our methodology,¹ the current P/E is 19.4x, down 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 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.