Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

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 21, 2023—9:30 AM EDT] Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 is currently down 0.1% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.4%. Chinese markets were down, with the Shanghai Composite closing down 1.3% from its previous close and the Shenzhen Composite down 2.0%. 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:

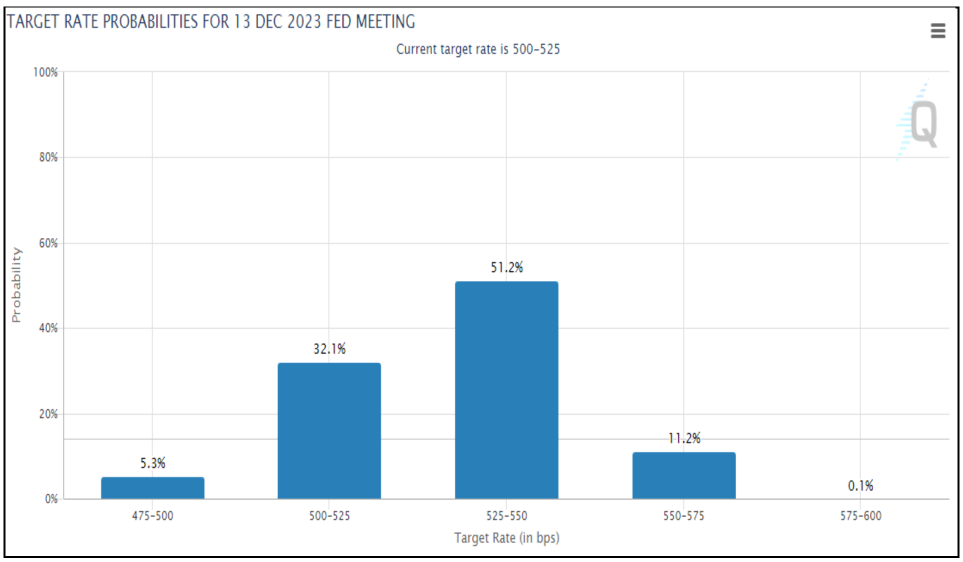
- *Bi-Weekly Geopolitical Report* (6/12/2023) (with associated podcast) "The Issue of the Terms of Trade"
- *Weekly Energy Update* (6/15/2023): The IEA is forecasting that we are near peak oil demand. We update the latest on the Nord Stream Pipeline sabotage and reports that Iran and the U.S. are talking about the nuclear deal.
- *Asset Allocation Quarterly – Q2 2023* (4/25/2023): Discussion of our asset allocation process, Q2 2023 portfolio changes, and our outlook for the markets.
- *Asset Allocation Q2 2023 Rebalance Presentation* (5/11/2023): Video presentation featuring the Asset Allocation Committee as they review our asset allocation strategies, recent portfolio changes, and the current macro environment.
- *Asset Allocation Bi-Weekly* (6/20/2023) (with associated podcast): "The Great Divergence"
- *Confluence of Ideas* podcast (3/8/2023): "Reflections on Inflation"

Good morning! Today's *Comment* begins with our thoughts on investor concerns regarding Federal Reserve Chair Jerome Powell's testimony to Congress later today. Next, we discuss how China may jump start its economy without relying solely on policy stimulus. Lastly, we explain why India's growing prominence makes it an attractive investment target.

Powell Speaks: Investors' fears of a more hawkish Federal Reserve have weighed on equity performance.

- Fed Chair Jerome Powell is slated to testify before Congress this week about the state of the economy and monetary policy. He is expected to provide clarity on the future path of interest rate hikes after markets were previously left confused following his comments at the Federal Open Market Committee's meeting on June 13-14. Powell will also update lawmakers on the state of the banking system following the turmoil that took place in March.

- The S&P 500 closed down 0.4% on Tuesday as strong economic data reinforced fears that Powell will deliver a hawkish message during his testimony to Congress. Despite concerns that the U.S. economy could fall into recession sometime this year, new government data showed that the economy remains resilient. Housing starts, a leading economic indicator, rose to their highest level in 14 months. The Atlanta Fed's GDPNow model also estimates that real GDP growth rose 1.9% in the second quarter, slightly higher than the previous quarter's reading of 1.3%.
    - The current CME FedWatch Tool shows that there is now only a 5% chance that the FOMC will hold rates below 5% before the end of the year, much lower than the 90% chance it predicted a month ago.



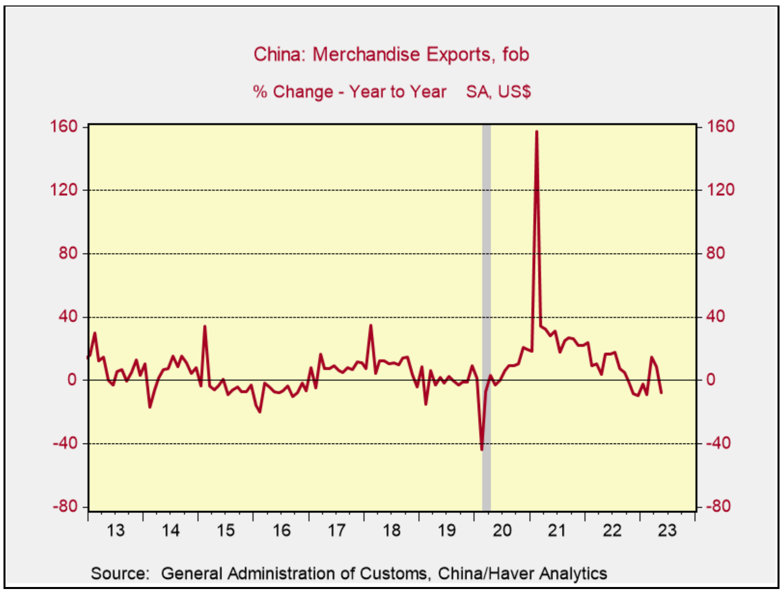
(Source: CME)

- It is unclear whether the Federal Reserve will ease off its inflation-fighting efforts as the economy heads into recession. Recent speeches from Fed officials suggest that they are more likely to hold interest rates stable in order to contain inflation, even if it means causing economic pain. This outcome would help accelerate the decline of inflation, but it would come at a cost. Therefore, any comments from Powell about the economy being resilient should be interpreted as evidence that the Fed is still committed to its hawkish monetary policy.

Emerging Markets: While the lack of stimulus in China may be a cause for concern, investors should not completely turn their backs on other emerging market countries.

- China's reluctance to provide sufficient stimulus to its economy has weighed on investor sentiment. Despite hints that the government would offer support after the country ended its Zero-COVID restrictions, it has yet to do so. Additionally, Chinese banks have not lowered lending rates as sharply as investors had expected following a series of rate cuts by the People's Bank of China. Concerns about the country's economy have pushed the offshore yuan (CNY) to 7.2 against the dollar, its lowest level since November. The currency has declined 4% since the start of the year and is the second worst-performing currency behind the yen (JPY).

- The drop in the CNY has been so fast that it has been speculated that the country may be looking to grow through exports. On Wednesday, the PBOC set the CNY's reference rate to 7.1795 per dollar, weaker than the previous fix of 7.1596. This decrease in the country's currency comes after government data showed Chinese exports slowed more than expected in May. As a result, the country may receive a boost through trade, especially if meetings with U.S. Secretary of State Antony Blinken go well.



- While China is a significant emerging market, investors should not overlook the opportunities offered by other individual countries. For example, Argentine stocks have risen 6.0% over the last seven days, highlighting the upside of looking abroad. The recent surge in stock prices in developing countries is likely due to a number of factors, including investors' desire to hedge against currency depreciation. However, it is important to remember that financial assets in developing countries are more volatile than those in developed countries. This means there is a greater risk of losing money on these types of investments. Therefore, investors should always do their due diligence before making investment decisions.

Is India a New Power? Rising geopolitical tensions have led countries to become more assertive as they look to have more global influence.

- On Wednesday, U.S. President Joe Biden and Indian Prime Minister Narendra Modi are set to meet in Washington to discuss ways to deepen their countries' strategic partnership. The meeting comes as the growing friction between the U.S. and rivals China and Russia is rising. Prior to his first official visit to the White House in nine years, Prime Minister Modi stressed that the relationship between the United States and India was "tighter than ever." Meanwhile, Washington views India as a crucial partner in its attempt to prevent China from expanding its influence throughout the Indo-Pacific region.

- Despite not having the best performance so far this year, India has a lot of potential. India's blue-chip stock index, the Nifty 50, is up 3.62% on the year, and even though this is not a bad performance, it does lag many of its Asian counterparts (as the chart below shows). That said, the country is a major target for foreign direct investment as firms look for supply chain diversification. Companies such as Apple (AAPL,$185.01), Tesla (TSLA, $274.45), and Google (GOOGL, $123.10) have announced a desire to set up factories in India.

Nifty 50 versus other Asian peers in 2023

Country	Index RIC	December 31, 2022	June 21, 2023	YTD % Change
Japan	.N225	26,095	33,575	29
Taiwan	.TWII	14,137.69	17,202	22
South Korea	.KS11	2,236	2,583	15
MSCI World	.MIWD00000PUS	605	678	12
Vietnam	.VNI	1,007	1,118	11
Sri Lanka	.CSE	8,502	9,309	9
India	.BSESN	60,841	63,483	4
Australia	.AORD	7,222	7,506	4
China	.SSEC	3,089	3,198	4
MSCI Asia ex-Japan	.MIAPJ0000PUS	506	523	3
New Zealand	.NZ50	11,473	11,776	3
Pakistan	.KSE	40,420	40,491	0
Singapore	.STI	3,251	3,227	-1

(Source: Reuters)

- India has been a major beneficiary of the conflict between the United States and China, particularly following Russia's invasion of Ukraine. New Delhi has been able to leverage the conflict to its advantage by playing the two sides against each other. On the one hand, India has received weapons and oil from Russia, while on the other hand, it has maintained trade ties with the United States. India's ability to remain neutral in the conflict has also boosted its global clout, as the country has ambitions to become a significant player on the world stage. As a result, India is well-positioned for long-term growth.

U.S. Economic Releases

Weekly mortgage applications rose 0.5% last week, down from a 7.2% increase the prior week. The bias in mortgages continues to be towards purchases, which rose 1.5%, offset by a 2.1% drop in refinancing. The 30-year average mortgage rate fell 4 bps to 6.73%.

The table below lists the economic releases and/or Fed events scheduled for the rest of the day.

Economic Releases		
No economic releases for the rest of today		
Federal Reserve		
EST	**Speaker or Event**	**District or Position**
10:00	Jerome Powell Appears Before House Financial Services Panel	Chairman of the Board of Governors
12:25	Austan Goolsbee Speaks at Global Food Forum	President of the Federal Reserve Bank of Chicago

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								
Australia	Westpac Leading Index	m/m	May	-0.27%	-0.03%		**	Equity bearish, bond bullish
South Korea	PPI	y/y	May	0.6%	1.6%		**	Equity bearish, bond bullish
EUROPE								
UK	CPI	y/y	May	8.7%	8.7%	8.4%	***	Equity and bond neutral
	Core CPI	y/y	May	7.1%	6.8%	6.8%	**	Equity and bond neutral
	Retail Price index	y/y	May	375.3	372.8	374.7	***	Equity and bond neutral
	RPI	y/y	May	11.3%	11.4%	11.2%	**	Equity and bond neutral
	RPI Ex Mort Int.Payments	m/m	May	10.3%	10.4%	10.2%	**	Equity and bond neutral
	Public Sector Net Borowing	m/m	May	19.2b	24.7b	22.0b	*	Equity and bond neutral
	PSNB ex Banking Groups	m/m	May	20.0b	25.6b	22.8b	**	Equity and bond neutral
	Nationwide House Price Index	y/y	Apr	3.5%	4.1%	2.5%	***	Equity bearish, bond bullish
Switzerland	M3 Money Supply	y/y	May	-1.2%	-0.3%	-0.2%	**	Equity and bond neutral
AMERICAS								
Mexico	Aggregate Supply and Demand	q/q	1Q	5.4%	4.1%	4.2%	*	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)	551	551	0	Up
3-mo T-bill yield (bps)	511	505	6	Up
TED spread (bps)	40	46	-6	Tightening
U.S. Sibor/OIS spread (bps)	524	523	1	Up
U.S. Libor/OIS spread (bps)	524	523	1	Up
10-yr T-note (%)	3.75	3.72	0.03	Flat
Euribor/OIS spread (bps)	359	355	4	Up
Currencies	**Direction**			
Dollar	Flat			Down
Euro	Flat			Up
Yen	Down			Down
Pound	Down			Up
Franc	Flat			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.

DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$75.80	$75.90	-0.13%	
WTI	$71.11	$71.19	-0.11%	
Natural Gas	$2.53	$2.49	1.32%	
Crack Spread	$32.84	$36.53	-10.11%	Contract Roll Distortion
12-mo strip crack	$25.17	$26.31	-4.33%	Contract Roll Distortion
Ethanol rack	$2.70	$2.70	0.00%	
Metals				
Gold	$1,934.79	$1,936.42	-0.08%	
Silver	$23.07	$23.13	-0.27%	
Copper contract	$385.90	$389.35	-0.89%	
Grains				
Corn contract	$616.00	$597.50	3.10%	
Wheat contract	$725.25	$708.75	2.33%	
Soybeans contract	$1,359.25	$1,342.75	1.23%	
Shipping				
Baltic Dry Freight	1,078	1,065	13	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-1.5		
Gasoline (mb)		1.0		
Distillates (mb)		1.8		
Refinery run rates (%)		0.0%		
Natural gas (bcf)		90		

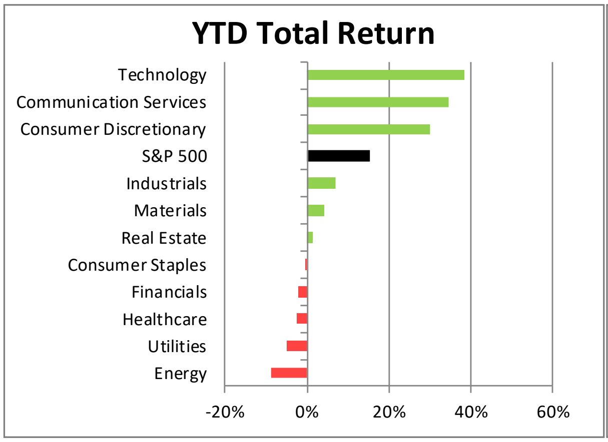
Weather

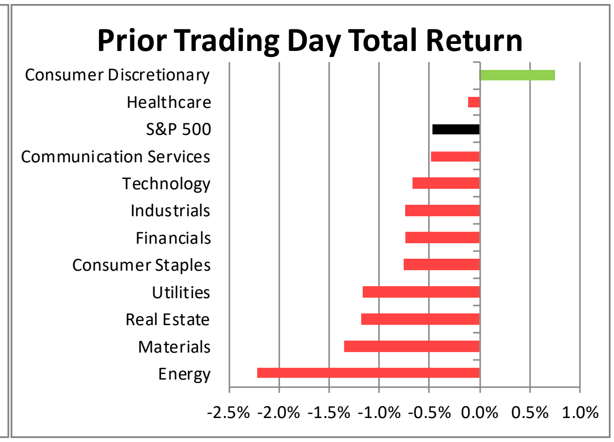
The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures throughout the South to the upper Midwest. Below normal temps are forecast for the Great Lakes and California into Wyoming. Over the forecast period, above-normal temperatures are forecast for most of the country.

TS Bret has formed east of the Leeward Islands. Its forecast path puts its south of Jamaica by early Sunday morning. At this juncture, we don't expect it to have a major effect on energy shipping from the GOM since the storm is not forecast to reach hurricane status. A second disturbance is southeast of Bret and has a strong chance of further development.

Data Section

U.S. Equity Markets – (as of 6/20/2023 close)

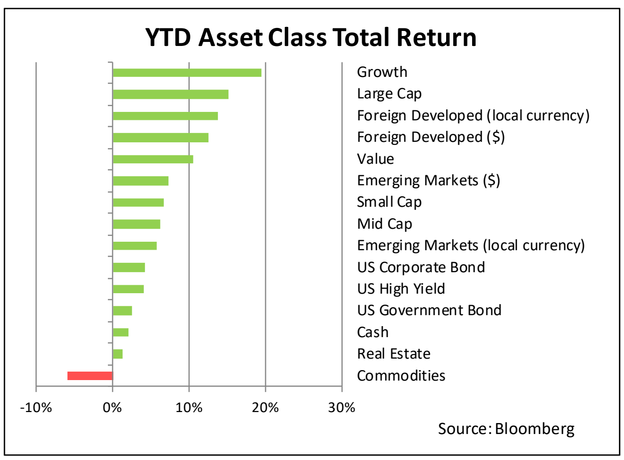




(Source: Bloomberg)

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 6/20/2023 close)

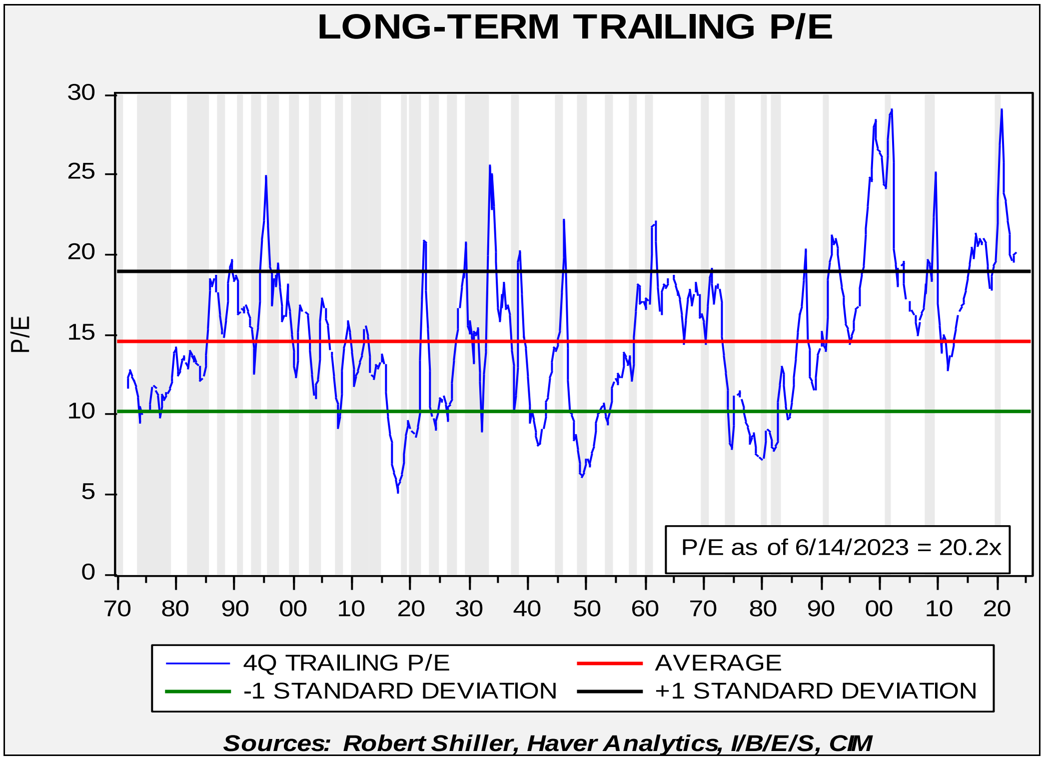


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 15, 2023



Based on our methodology,[1] the current P/E is 20.2x, up 0.2x from last week. Higher index values lifted 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.

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[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.