

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 28, 2023—9:30 AM EDT] Global equity markets are mostly lower this morning. In Europe, the Euro Stoxx 50 is currently up 0.9% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.2%. Chinese markets were generally down, with the Shanghai Composite closing unchanged from its previous close and the Shenzhen Composite down 0.4%. 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](#) (6/26/2023) (with associated [podcast](#)): “Distinguishing My Wife From a Hat, an AI Story”
- [Weekly Energy Update](#) (6/22/2023): We discuss how the war in Ukraine has changed the global energy market and update the weekly oil inventory data.
- [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”

Our *Comment* today opens with some interesting new revelations on the weekend’s short-lived rebellion in Russia. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including signs of growing pushback against the European Central Bank’s aggressive interest rate hikes and news of a potential new clampdown on the sale of artificial intelligence-related computer chips to China, which is weighing significantly on technology stocks so far today.

Russia Rebellion: Reports yesterday confirmed that Yevgeniy Prigozhin, the erstwhile ally of President Putin who led his Wagner Group mercenaries in a short-lived mutiny against the Ministry of Defense over the weekend, [has landed in Belarus](#) as agreed upon in a deal brokered by Belarusian President Lukashenko to defuse the crisis. However, the extent to which the

Wagner mercenaries will be disarmed or subsumed into the traditional armed forces remains unclear.

- Separately, President Putin claims the deal that convinced Prigozhin to cease his march on Moscow involved paying off him and his fighters with billions of dollars from the Russian government.
- As we have assessed previously, the incident has surely weakened Putin by undermining his popular image as a strong leader who doesn't brook dissent and doesn't back down from a fight. Putin's admission that he paid Prigozhin and the Wagner fighters billions of dollars would likely further undermine Putin's image.
 - Separately, new reports say Prigozhin initially [planned to seize Defense Minister Shoigu and Chief of the General Staff Gerasimov when they visited southern Russia over the weekend](#). Prigozhin apparently expected that lower-level officers and troops would then swing to his support. Indeed, he apparently sounded out some top generals about their potential support. It looks like one of those officials alerted Russian domestic intelligence, forcing Prigozhin to move up his timetable and improvise his mad dash toward Moscow.
 - As if to confirm that scenario, U.S. intelligence [has reportedly discovered that one or more senior Russian generals knew about Prigozhin's plans ahead of time](#) and may even have helped him.
 - If true, the reports suggest the Defense Ministry and the military leadership may be deeply fractured and riddled with dissent. That, too, would weaken Putin politically, although reports today say Putin is carrying out a widescale purge of disloyal officers throughout the military.
- At the same time, it's entirely possible that Putin is whitewashing the real deal that got Prigozhin to back down. One theory that we find compelling is that the payoff to Prigozhin and his fighters actually came from powerful Russian oligarchs who had much to lose if the country descended into civil war or if Putin were deposed.
- In any case, if Prigozhin remains safely ensconced in Belarus, he will likely remain a political threat to Putin and his government for the foreseeable future.

Eurozone: Italian Prime Minister Meloni, in an impassioned speech to parliament earlier today, [lashed out at the European Central Bank for its aggressive interest rate hikes](#). According to Meloni, the ECB's "simplistic" approach to fighting consumer price inflation would hurt Eurozone member countries more than it would help them. Meloni said today's high inflation was tied to the last year's energy price shock, implicitly arguing that the ECB should look past the problem. In any case, her statement points to growing pushback against the ECB's plan to keep raising rates in the near term.

France: The suburbs surrounding Paris [were wracked by rioting overnight](#) following an incident in which police officers shot and killed a teenager during a traffic stop. The violence was touched off after citizen video of the killing showed that police killed the driver, who was apparently unarmed, as he attempted to drive away. Thousands of police have been deployed to control the rioting, which exacerbates the disruptions caused by this summer's frequent protests against President Macron's unpopular new retirement system reform.

United Kingdom: Senior physicians working for the National Health Service in England have [voted to strike for higher pay next month](#). We haven't written much about the summer of labor action in the U.K. recently, but the latest vote shows that the country (and government) continues to face increased demands from employees in both the public and private sectors. To the extent that the strikers win higher pay, it will likely bolster the U.K.'s current high price inflation and prompt still more interest rate hikes by the Bank of England.

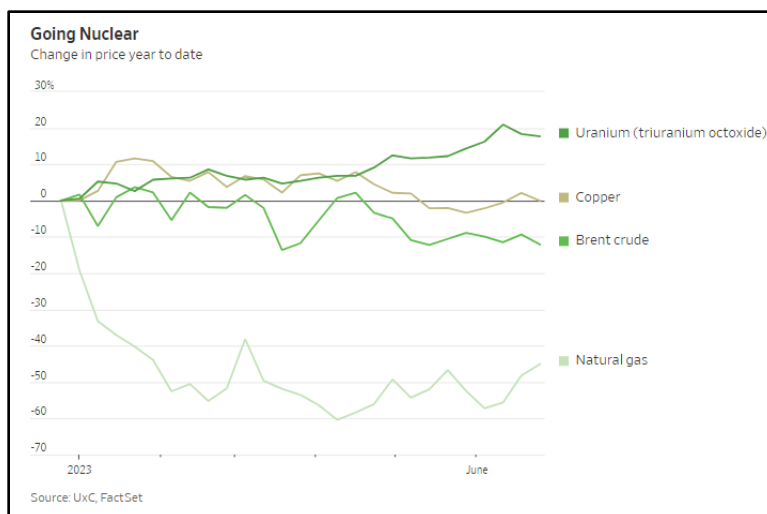
Japan-China: In another apparent case of Chinese technology theft, a Chinese researcher at Japan's National Institute of Advanced Industrial Science and Technology (AIST) [has been arrested on suspicion of illegally sending research data obtained at the institute to a Chinese company](#). The spate of these cases is likely to further worsen relations between China and the major developed countries, which we have frequently argued will likely present risks to investors.

United States-China: As the U.S. clamps down on selling advanced technology with potential military applications to China, sources say Chinese users [have developed a large black market in smuggled U.S. computer chips](#). The Chinese are reportedly focused on acquiring the graphics processing units (GPUs) needed to train artificial intelligence systems, such as the A100 and H100 from Nvidia (NVDA, 418.76). The report says the black market has thousands of individual intermediaries sourcing the chips, often at a considerable premium to list prices.

- This news suggests the U.S. technology clampdown will merely slow China's AI development but probably won't completely stop it.
- In response, reports say the Biden [administration is considering further restrictions on the sale of AI-related chips to China](#). Any such action would be included in the final rules codifying and expanding the administration's October export control measures. Since the new rules [would apply even to the less-advanced chips that Nvidia and other makers are currently allowed to sell to China](#), the news is weighing heavily on semiconductor firms so far this morning.

U.S. Cybersecurity: Cybersecurity experts [are becoming increasingly concerned about a recent, little-noticed hack of software firm Progress Software Corp. \(PRGS, \\$54.00\)](#). After Russian hackers broke into the company's systems and stole sensitive data from hundreds of its corporate customers, investigators expected the criminals to launch extortion scams against them. However, now it appears the criminals are focused on sensitive personal data that could be used, in conjunction with deepfake software, to launch more lucrative extortion scams against masses of individuals.

U.S. Uranium Market: As we wrote in our [Bi-Weekly Geopolitical Report from May 15, 2023](#), we think global uranium prices will be buoyed in the coming years by heightened U.S.-China tensions and a potential new nuclear arms race between the two countries. As if to confirm that viewpoint, a number of nuclear-related asset prices [have recently been climbing](#). The latest data shows spot prices for uranium (triuranium octoxide) are up roughly 18% year-to-date, while the share price for Canadian uranium miner Cameco Corp. (CCJ, \$29.58) is up 29%.

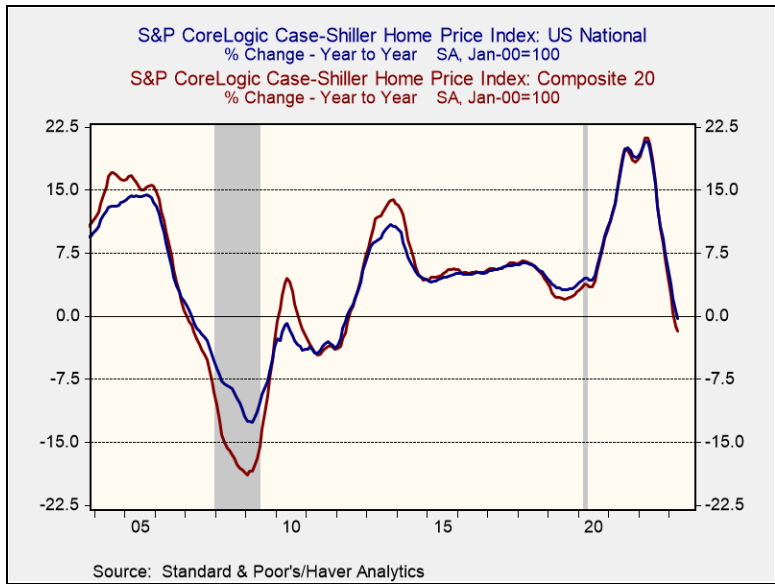


U.S. Private Credit Market: Moody’s (MCO, \$338.83) [has issued a report warning that the young private credit industry faces its first serious challenge](#) as tens of billions of dollars of loans underwritten at the top of the market in 2021 are strained by sharply higher interest costs and a slowing economy. Nevertheless, the credit rater didn’t downgrade its ratings or outlook for any of the major, publicly traded firms in the sector.

U.S. Supreme Court: As we noted in our *Comment* yesterday, investors [are still bracing for the release of several key decisions over the coming days before the court ends its current term](#) on Friday. The expected decision with perhaps the most implications for businesses will relate to the legality of affirmative action in college admissions. Whatever the justices rule, the decision is likely to affect affirmative-action policies in corporate settings as well.

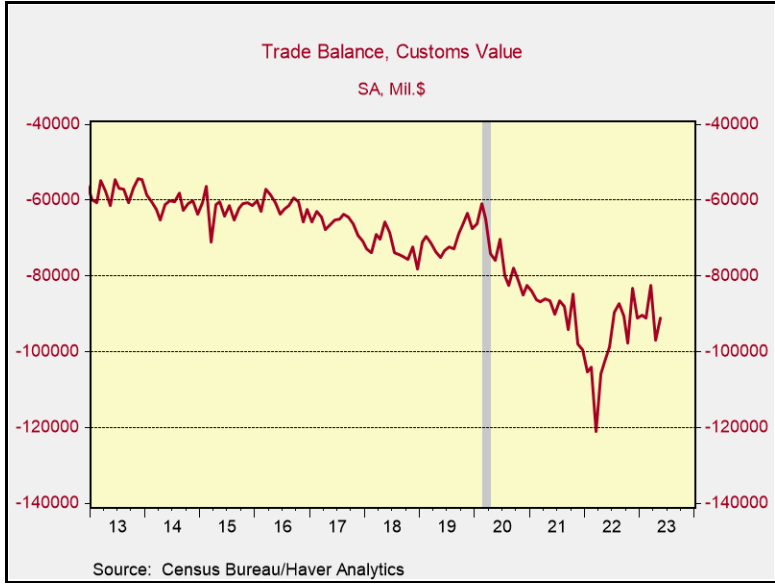
U.S. Economic Releases

Mortgage applications rose for a third consecutive week. According to data collected by the Mortgage Bankers Association, requests for residential loans rose 3.0% in the week ending June 23. Borrowers were undeterred by higher rates as they look to take advantage of declines in home prices. Last week, the average 30-year fixed rate mortgage rose 2 bps from 6.73% to 6.75%. As a result, the MBA Purchase and Refinance indexes rose 2.8% and 3.3%, respectively, from the prior week.



The S&P CoreLogic Home Price Index showed that, in April 2023, home prices in the U.S. fell below the previous year's level for the first time in over a decade. The national index is down 0.3% since April 2022, while the urban area index is down 1.8% in the same period. The slowdown in home prices reflects the impact of tight monetary policy, which has made it more expensive for buyers to finance a home. The decline in home prices is good news for potential buyers, who are now facing less competition and lower prices. However, it is also a sign that the housing market is cooling off.

The U.S. trade deficit in goods narrowed more than expected in May, thanks to a sharp drop in imports. According to the U.S. Census Bureau, the trade shortfall fell from \$97.1 billion to \$91.1 billion. The reading was below expectations of a \$93.7 billion deficit. Last month, exports declined 0.6% to 162.8 billion, while imports fell 2.7% to \$254 billion. In other news, wholesale inventories fell 0.1% from the prior month, while retail inventories rose 0.8% in the same period.



The previous chart shows the level of the U.S. goods trade balance. Although an improvement in the trade balance should have a positive impact on Q2 GDP figures, the sharp drop in imported goods may be a signal that consumption is slowing. As a result, we still think investors should not rule out the possibility of a recession over the next few months.

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
9:30	Jerome Powell with Policy Panel in Sintra, Portugal
District or Position	
Chairman of the Board of Governors	

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	CPI	m/m	May	5.6	6.8	6.1%	**	Equity bullish, bond bearish
South Korea	Consumer Confidence	m/m	Jun	100.7	98		**	Equity and bond neutral
	Retail Sales	y/y	May	5.7%	4.0%		**	Equity bullish, bond bearish
China	Industrial Profits	y/y	May	-12.6%	-18.2%		*	Equity bullish, bond bearish
EUROPE								
Eurozone	M3 Money Supply	y/y	May	1.4%	1.9%	1.5%	***	Equity and bond neutral
Germany	GfK Consumer Confidence	m/m	Jul	-25.4	-24.2	-24.4	**	Equity bearish, bond bullish
France	Consumer Confidence	m/m	Jun	85.0	83.0	84.0	**	Equity and bond neutral
Italy	PPI	y/y	May	-6.8%	-3.5%		**	Equity bearish, bond bullish
	CPI, EU Harmonized	y/y	Jun P	6.7%	8.0%	6.8%	***	Equity and bond neutral
	CPI NIC Including Tobacco	y/y	Jun P	6.4%	7.6%	6.7%	**	Equity and bond neutral
Switzerland	Credit Suisse Survey Expectations	m/m	Jun	-30.8	-32.2		**	Equity bullish, bond bearish
AMERICAS								
Canada	CPI	y/y	May	3.40%	4.40%	3.40%	***	Equity and bond neutral
Mexico	International Reserves Weekly	w/w	23-Jun	\$203269m	\$203262m		*	Equity and bond neutral
Brazil	Total Outstanding Loans	m/m	May	5387b	5363b	5370b	**	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)	552	554	-2	Up
3-mo T-bill yield (bps)	516	514	2	Up
TED spread (bps)	36	40	-4	Widning
U.S. Sibor/OIS spread (bps)	523	524	-1	Up
U.S. Libor/OIS spread (bps)	524	524	0	Up
10-yr T-note (%)	3.74	3.77	-0.03	Flat
Euribor/OIS spread (bps)	355	358	-3	Up
Currencies	Direction			
Dollar	Up			Up
Euro	Down			Up
Yen	Flat			Down
Pound	Down			Up
Franc	Down			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	\$72.38	\$72.26	0.17%	
WTI	\$67.83	\$67.70	0.19%	
Natural Gas	\$2.77	\$2.76	0.18%	
Crack Spread	\$34.13	\$34.02	0.31%	
12-mo strip crack	\$25.00	\$25.17	-0.67%	
Ethanol rack	\$2.77	\$2.78	-0.34%	
Metals				
Gold	\$1,907.03	\$1,913.69	-0.35%	
Silver	\$22.67	\$22.86	-0.84%	
Copper contract	\$375.10	\$378.85	-0.99%	
Grains				
Corn contract	\$548.00	\$561.00	-2.32%	
Wheat contract	\$690.50	\$699.00	-1.22%	
Soybeans contract	\$1,274.00	\$1,294.25	-1.56%	
Shipping				
Baltic Dry Freight	1,183	1,233	-50	
DOE Inventory Report				
	Actual	Expected	Difference	
Crude (mb)		-1.5		
Gasoline (mb)		1.0		
Distillates (mb)		0.9		
Refinery run rates (%)		0.4%		
Natural gas (bcf)		82		

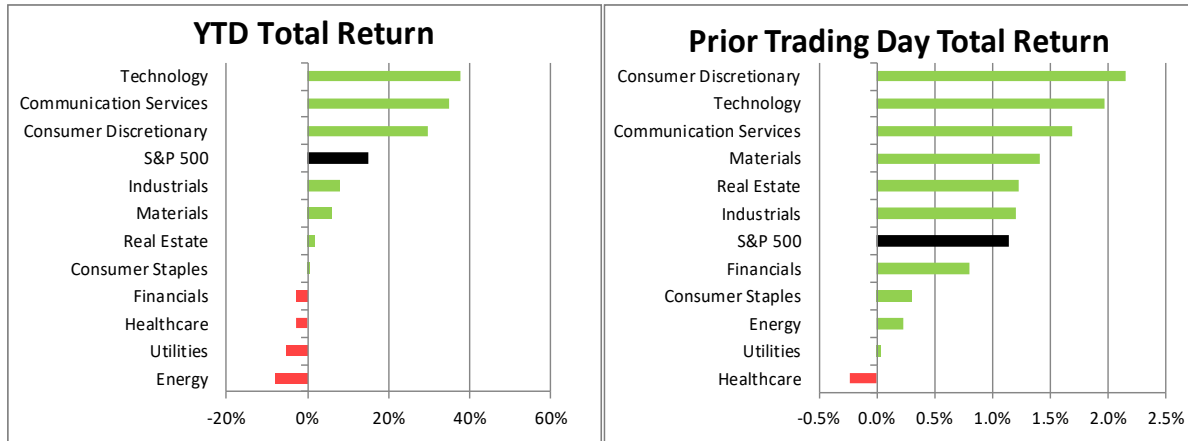
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures for most of the country, with cooler-than-normal temperatures expected in the Great Plains region. The precipitation outlook predicts wetter-than-normal conditions for most of the country, with drier conditions expected in the Pacific region.

Although there are signs of cyclone formation in the Atlantic, a tropical disturbance is not expected within the next 48 hours.

Data Section

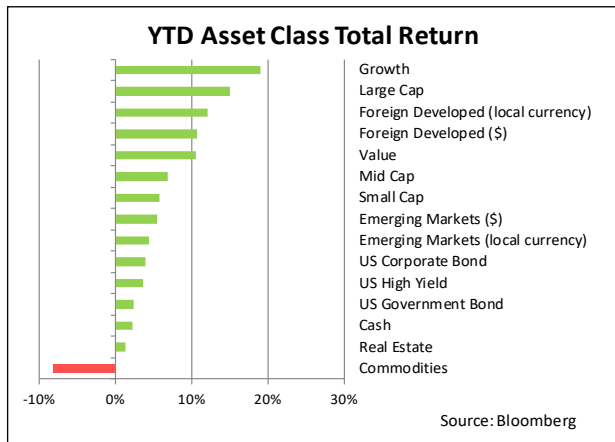
U.S. Equity Markets – (as of 6/27/2023 close)



(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 6/27/2023 close)

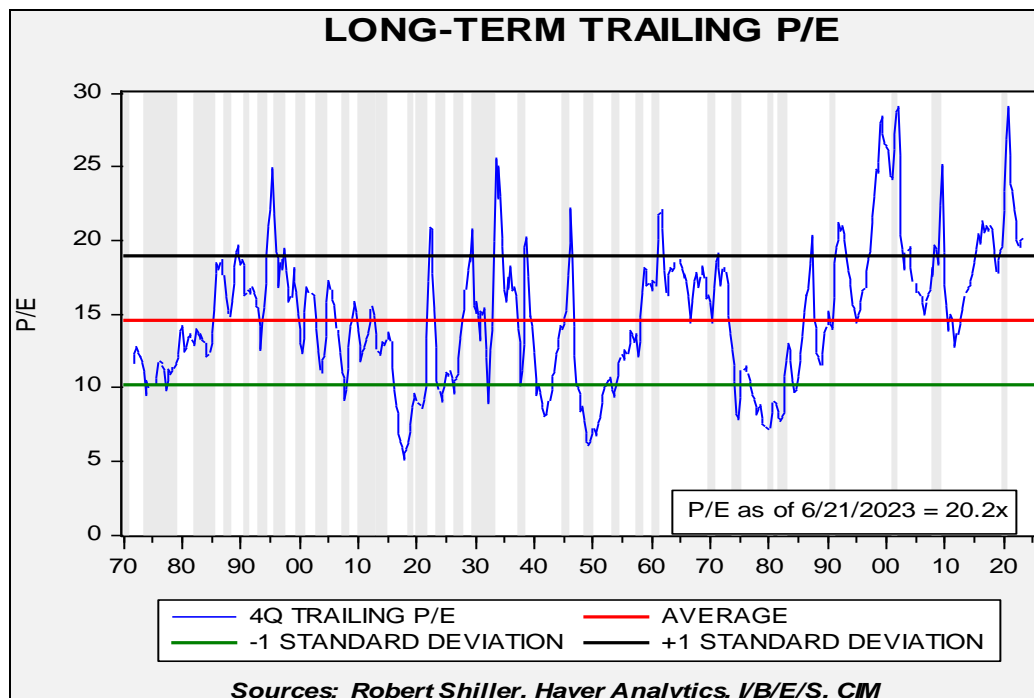


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 22, 2023



Based on our methodology,¹ the current P/E is 20.2x, 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 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.