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: March 19, 2019—9:30 AM EDT] Global equity markets are generally higher this morning. The EuroStoxx 50 is up 0.1% from the last close. In Asia, the MSCI Asia Apex 50 was up 0.9% from the prior close. Chinese markets were mixed, with the Shanghai composite down 0.2% and the Shenzhen index up 0.2%. U.S. equity index futures are signaling a higher open.

Financial markets are broadly higher this morning; the only exception is the dollar, which is coming under some modest pressure. Other than that, it's a very quiet morning as we await the Fed. Here is what we are watching this morning:

Brexit: PM May was dealt a probably fatal blow to her chances of getting her plan through as Speaker of the Parliament John Bercow ruled that the PM cannot keep cycling a bill before the legislature without making substantial changes, citing precedent dating back to 1604.[1] For now, May and her team are feverishly trying to make changes to the bill that Bercow might deem "substantial" without triggering protest from the EU. This pretty much means the outcome at the end of March is either (a) a chaotic exit, or (b) a long extension. Most likely, outcome (b) will be the result. The GBP did decline on the news but recovered and is higher this morning. A long delay is a middling outcome and will probably keep the currency about where it is now. A decision to remain would be quite bullish, whereas a hard Brexit would likely take the currency to around $1.10.

Populism in the Netherlands: We have been seeing a steady stream of reporting in recent months suggesting the populist threat in the West is overblown. There is an element of truth in this claim; in parliamentary systems with proportional representation, no populist party has gained control of a government. Instead, these parties have become "kingmakers," in a way, since no established parties will put them in coalitions. However, we think the brave talk from the establishment-centered media is probably misunderstanding the threat. The problem is that the populists are forcing restructuring on political alignments. In the Netherlands, Mark Rutte's government is facing a serious threat from the nationalist Forum for Democracy, led by Thierry Baudet, who has replaced Geert Wilders as the standard bearer for the populist right. Unlike Wilders, who has a difficult relationship with the media and has thus been characterized in the harshest terms, Baudet seeks out media coverage and manages it well. The Netherlands hold elections on March 20; we will be watching to see how the vote plays out but there is a chance

[1] https://www.ft.com/content/2c470dce-4995-11e9-bbc9-6917dce3dc62?emailId=5c907bace90de800047e326f&segmentId=22011ee7-896a-8c4c-22a0-7603348b7f22

that PM Rutte's coalition will fail to hold and new leadership could emerge from this important European country.[2]

Rising tensions between Germany and the U.S.: It is no secret that Chancellor Merkel and President Trump have a frosty relationship.[3] Merkel represents the liberal establishment and leads the largest economy in Europe. Trump is keen on overturning the liberal order. In recent weeks, we have been seeing several areas of dispute between the two nations. First, Germany has been among a number of nations that have been cool to the idea of banning Huawei (002502, Shenzhen, CNY 4.57) equipment on fears that the Chinese government has compromised the tech gear.[4] Second, Germany indicated today it would not boost defense spending, reversing an earlier pledge.[5] President Trump has been threatening the EU (read: Germany) with trade impediments if progress isn't made on trade talks.[6] The president has specifically included tariffs on autos,[7] which would be especially damaging for the German economy.[8] In our opinion, the U.S. does have legitimate concerns about German behavior; its macroeconomic policies have essentially colonized the Eurozone and forced the currency bloc to become a net absorber of global domestic demand.

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[2] https://www.politico.eu/article/the-netherlands-prime-minister-mark-rutte-last-stand-populism-far-right/?wpmm=1&wpisrc=nl_todayworld

[3] https://www.politico.eu/article/the-donald-trump-angela-merkel-doctrine-of-mutually-assured-detestation-nato-huawei/?utm_source=POLITICO.EU&utm_campaign=58847ecac2-EMAIL_CAMPAIGN_2019_03_15_05_52&utm_medium=email&utm_term=0_10959edeb5-58847ecac2-190334489

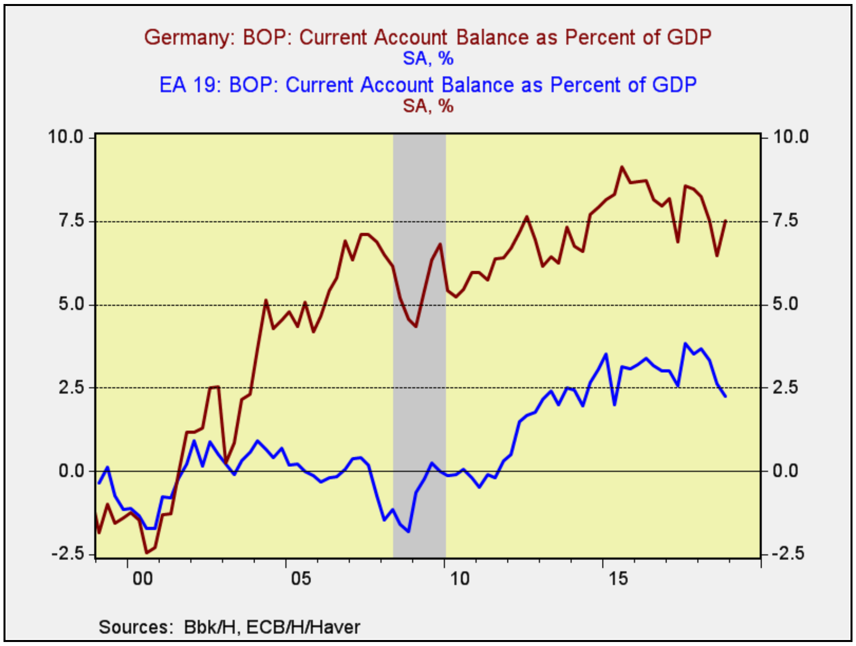
[4] https://www.nytimes.com/2019/03/17/us/politics/huawei-ban.html?emc=edit_mbe_20190318&module=inline&nl=morning-briefing-europe&nlid=5677267mbe_20190318&te=1 ; it should be noted that Germany isn't the only European nation being targeted by the U.S. on this issue: https://www.ft.com/content/12e42a00-499b-11e9-8b7f-d49067e0f50d?emailId=5c907bace90de800047e326f&segmentId=22011ee7-896a-8c4c-22a0-7603348b7f22

[5] https://www.wsj.com/articles/germany-plans-to-renege-on-pledge-to-raise-military-spending-defying-trump-11552922721

[6] https://www.ft.com/content/ce0cc7ea-4678-11e9-a965-23d669740bfb?emailId=5c8aeeb0cc534f000485fbec&segmentId=22011ee7-896a-8c4c-22a0-7603348b7f22&fbclid=IwAR1CzZL7FcWbK-zg0lhDEdmqN_dJxjSqfG3rwdmOfUHW2GEeyjZzJ0Ke2KE

[7] https://www.wsj.com/articles/trump-continues-to-weigh-eu-auto-tariffs-11550693479

[8] https://europe.autonews.com/automakers/german-automakers-most-risk-trump-tariffs



Although the Eurozone, as a whole, mostly had balanced trade until 2011 (when the PIIGS crisis developed), Germany has been running very large current account surpluses since 2005 and has led the Eurozone economy to become a microcosm of the German economy in the wake of the PIIGS crisis. At the same time, U.S. policymakers appear to have forgotten how dangerous the German Problem is for Europe; from the time of its founding, Germany has been a threat to European security and its economic strength coupled with its geopolitical vulnerability was the underlying cause of two world wars. It has only been the U.S. security domination of Europe that has led to extended peace on the continent. If the U.S. presses Germany to take a larger role in European security, the outcome might not be what American policymakers intend.

A couple of unintended consequences: First, in the 2016 election, both candidates from the major parties vowed to reject the Trans-Pacific Partnership (TPP), a multi-lateral trade deal that effectively encircled the Pacific Rim and isolated China. This trade deal, along with its twin for Europe (the TTIP), would have put the U.S. in the middle of the global trading system and forced the rest of the world, especially China and Russia, to accept the terms of the arrangement. However, the trade agreements were structured along the lines of those made in the 1990s that extended globalization at the cost of living standards for the Western middle class. By rejecting both TPP and TTIP, the U.S. (and, in fairness, Europe too) signaled an end to the trend of globalization that accelerated in the 1990s. Interestingly enough, USTR Lighthizer has noticed that the rejection of TPP was a significant blow to American farmers who now face trade barriers in a number of countries that accepted TPP without the U.S.[9]

Second, social technology platforms have severely damaged print media. Swap sites killed classified advertising and platforms that aggregated news essentially made reporting free to users even if the papers had to pay reporters for their work. That creates an unworkable business model for local print media and, over the past 15 years, around 1,800 newspapers have gone out

[9] https://www.ft.com/content/07d14730-4831-11e9-bbc9-6917dce3dc62

of business. Facebook (FB, 160.47) has been building a service that would provide local news information to users. However, it is discovering a profound lack of original reporting ~~it can steal~~ from local areas to publish on its platform. All those newspapers that have been driven out of business by the swap and social platforms are no longer reporting local news stories. The company notes "it doesn't have the answers," but "doesn't plan to launch newsgathering efforts on its own."[10]

U.S. Economic Releases

There were no economic releases prior to the publication of this report. The table below lists the economic releases scheduled for the rest of the day.

Economic Releases						
EDT	Indicator			Expected	Prior	Rating
10:00	Factory Orders	m/m	jan	0.3%	0.1%	**
10:00	Factory Orders ex Trans	m/m	jan		-0.6%	**
10:00	Durable Goods Orders	m/m	jan	0.4%	0.4%	**
10:00	Durable Goods Orders ex Transportation	m/m	jan	-0.1%	-0.1%	**
10:00	Cap Goods Orders Nondef Ex Air	m/m	jan	0.8%	0.8%	**
10:00	Cap Goods Ship Nondef Ex Air	m/m	jan		0.8%	**
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.

[10] https://apnews.com/790d194cbec347149be8b598009ad1c4?utm_source=Twitter&utm_medium=AP&utm_campaign=SocialFlow

Country	Indicator			Current	Prior	Expected	Rating	Market Impact
ASIA-PACIFIC								
Australia	ANZ Roy Morgan Weekly Consumption	y/y	mar	111.9	109.5		**	Equity and bond neutral
	House Price Index	y/y	4q	-5.1%	-1.9%	-5.0%	**	Equity and bond neutral
New Zealand	Westpac Consumer Confidence	q/q	1q	103.8	109.1		**	Equity and bond neutral
EUROPE								
Eurozone	Construction Output	m/m	jan	-0.7%	0.7%		**	Equity and bond bearish
	Labour Costs	y/y	mar	2.3%	2.5%		***	Equity and bond neutral
	ZEW Survey Expectations	m/m	mar	-2.5	-16.6		**	Equity and bond neutral
Germany	Zew Survey Current Situation	m/m	mar	11.1	15.0	13.0	**	Equity and bond neutral
	Zew Survey Expectations	m/m	mar	-3.6	-13.4	-11.0	**	Equity bearish, bond bullish
Italy	Trade Balance Total	m/m	jan	0.322 bn	3.658 bn		**	Equity and bond neutral
UK	Claimant Count Rate	m/m	jan	2.9%	2.8%		**	Equity and bond neutral
	Jobless Claims Change	m/m	jan	27.0k	14.2k		***	Equity and bond neutral
	Average Weekly Earnings 3m/3m	m/m	jan	3.4%	3.4%	3.4%	**	Equity and bond neutral
	ILO Unemployment Rate 3mths	m/m	jan	3.9%	4.0%	4.0%	*	Equity and bond neutral
	Employment Change	m/m	jan	222k	167k	120k	***	Equity and bond neutral
Switzerland	Swiss Watch Exports	y/y	feb	3.4%	0.2%		**	Equity and bond neutral
AMERICAS								
Canada	International Securities Transactions	m/m	jan	28.400 bn	-18.960 bn		**	Equity bullish, bond bearish
	Bloomberg Nanos Confidence	m/m	mar	55.2	55.5		**	Equity and bond neutral
Brazil	Economic Activity	y/y	jan	0.8%	0.2%	1.0%	***	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.

	Today	Prior	Change	Trend
3-mo Libor yield (bps)	263	261	2	Up
3-mo T-bill yield (bps)	239	239	0	Neutral
TED spread (bps)	24	22	2	Neutral
U.S. Libor/OIS spread (bps)	240	240	0	Up
10-yr T-note (%)	2.60	2.61	-0.01	Neutral
Euribor/OIS spread (bps)	-31	-31	0	Neutral
EUR/USD 3-mo swap (bps)	8	8	0	Down
Currencies	**Direction**			
dollar	down			Neutral
euro	up			Up
yen	up			Neutral
pound	up			Neutral
franc	flat			Neutral

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	$68.10	$67.54	0.83%	OPEC Production Cuts
WTI	$59.48	$59.09	0.66%	
Natural Gas	$2.88	$2.85	1.19%	
Crack Spread	$21.39	$21.26	0.62%	
12-mo strip crack	$17.26	$17.09	1.01%	
Ethanol rack	$1.49	$1.47	0.87%	
Metals				
Gold	$1,308.15	$1,303.71	0.34%	
Silver	$15.41	$15.35	0.38%	
Copper contract	$294.20	$290.90	1.13%	
Grains				
Corn contract	$ 371.75	$ 371.50	0.07%	
Wheat contract	$ 459.75	$ 456.75	0.66%	
Soybeans contract	$ 903.75	$ 905.75	-0.22%	
Shipping				
Baltic Dry Freight	721	730	-9	
DOE inventory report				
	Actual	**Expected**	**Difference**	
Crude (mb)		2.0		
Gasoline (mb)		-2.5		
Distillates (mb)		-1.2		
Refinery run rates (%)		0.40%		

Weather

The 6-10 and 8-14 day forecasts show cooler temperatures for most of the country. Precipitation is expected for the western half of the country.

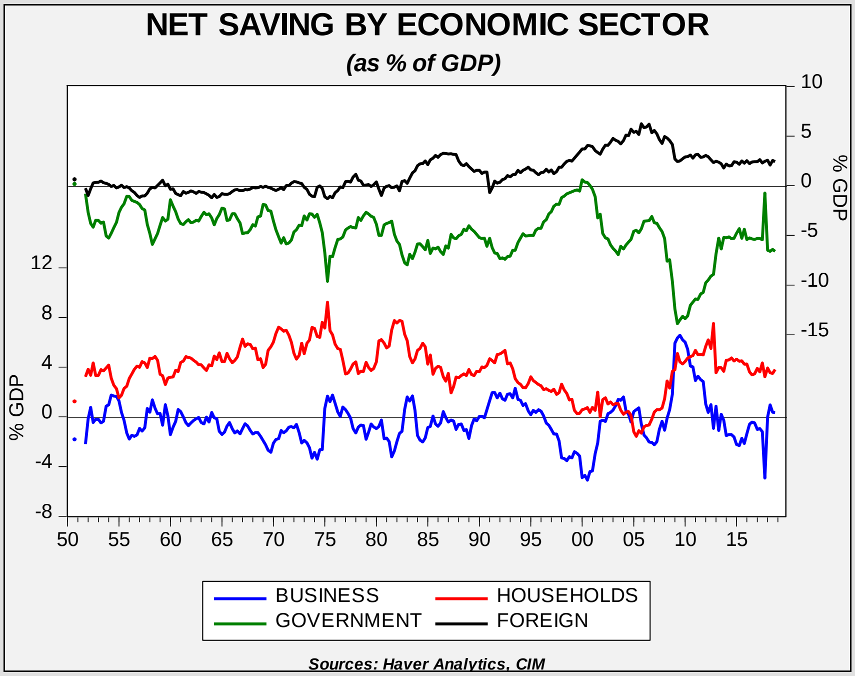
Asset Allocation Weekly Comment

Confluence Investment Management offers various asset allocation products which are managed using "top down," or macro, analysis. We report asset allocation thoughts on a weekly basis, updating this section every Friday.

March 15, 2019

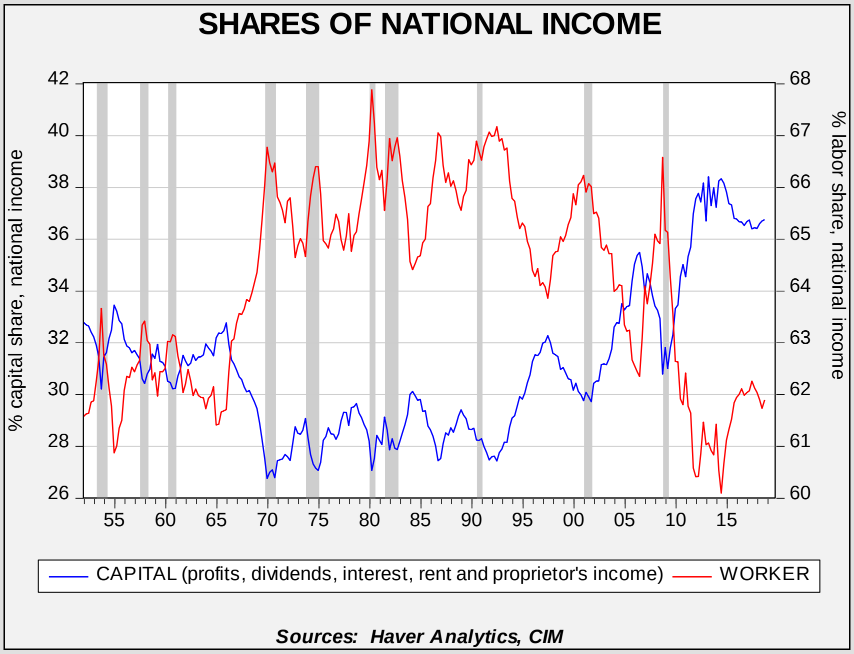
The Financial Accounts of the United States, formerly known as the Flow of Funds Report, was released last week. It is a plethora of information about the state of the economy. Below we discuss the charts we find most noteworthy.

First, here is the saving balance by sector.



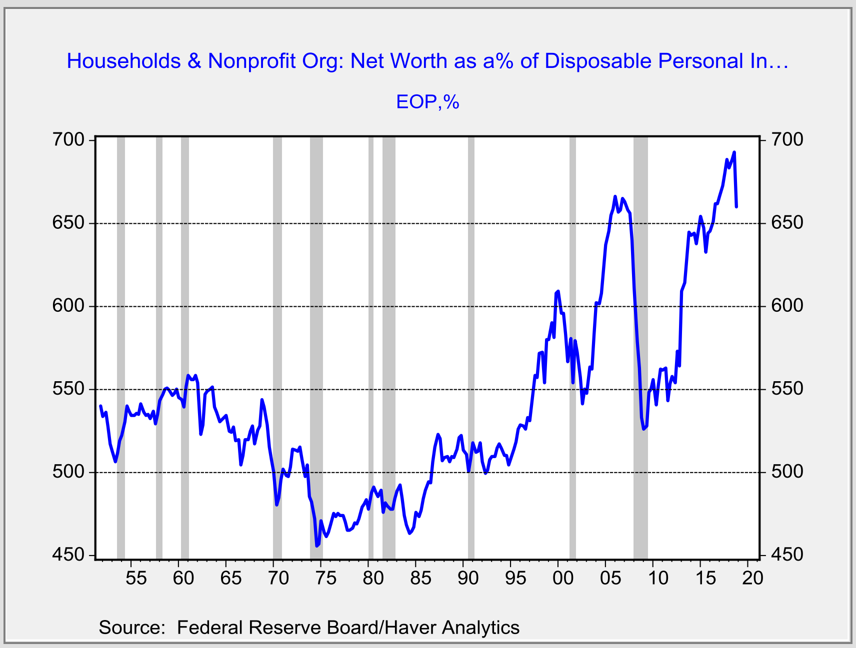
The tax cut has led to an increase in business saving and a wider fiscal deficit. Household and foreign saving was essentially unchanged. We are watching to see if the administration's trade policy reduces the trade deficit; if it does, then foreign saving, the inverse of the trade deficit, will decline and require higher saving from the other three sectors to offset that saving decline.

Second, the share of national income going to capital and labor were mostly stable.



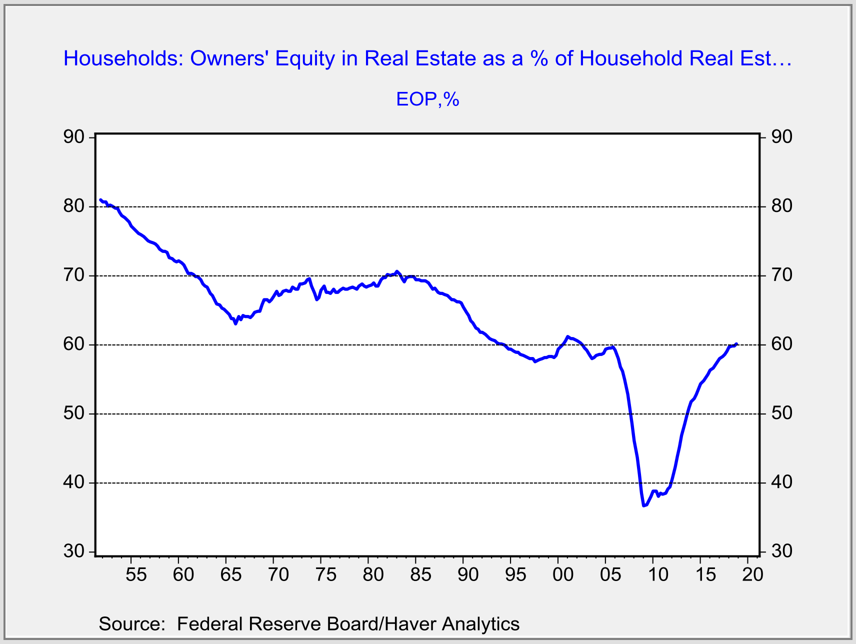
Since the end of communism in the early 1990s, capital has been taking a steadily larger share of national income. In each expansion, the capital share has made a higher peak.

Third, the drop in equity markets adversely affected household net worth.

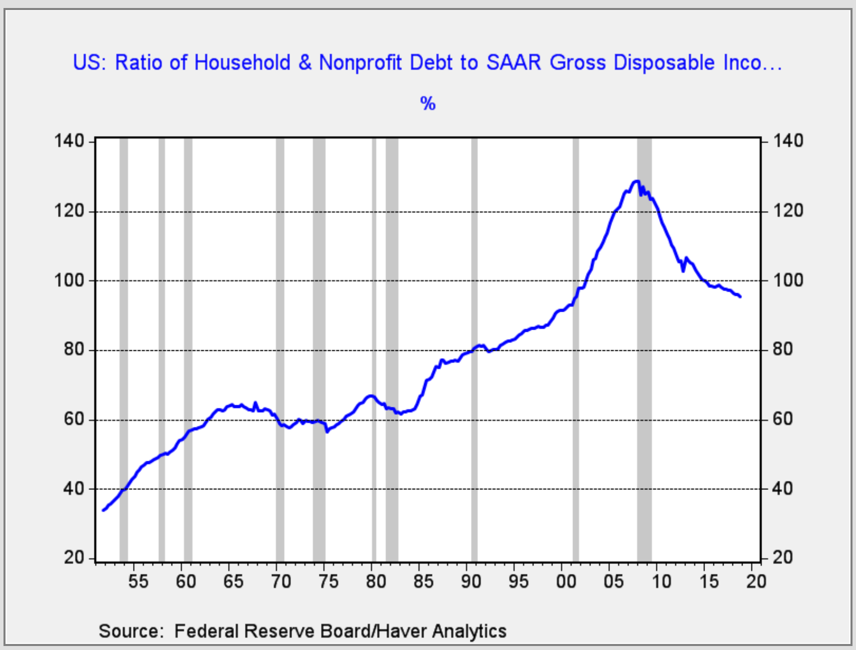


Net worth relative to after-tax income took a dive in Q4; the recent recovery in equity markets should reverse this dip, but we do note that in previous cycles such declines tended to signal that the business cycle was coming to a close.

Fourth, owners' equity in real estate finally reached 60%, a level which we consider normal. This was the level the market was at pre-1995, when the government eased the rules on home ownership. During the real estate crisis, equity plunged as falling home prices collided with excessive mortgage debt. From a financial perspective, this suggests the residential real estate market has overcome the trauma of the Great Financial Crisis.[11]



Finally, household deleveraging is continuing, although the pace has slowed.



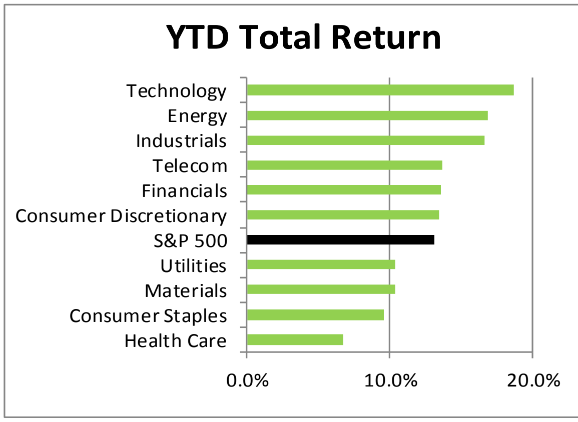
[11] This is only true for the financial system. Many communities are still struggling with the aftermath of the crisis.

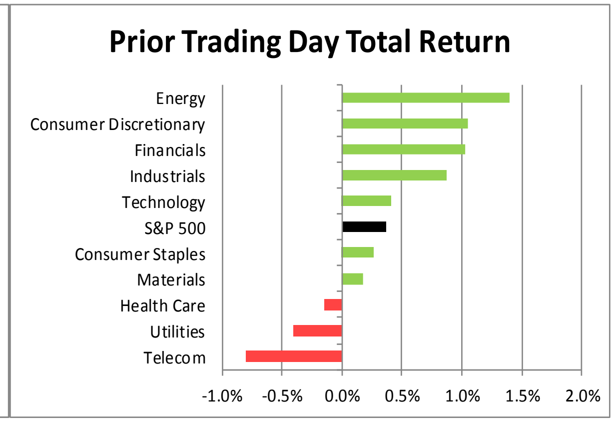
This chart shows household debt as a percentage of after-tax income. From the early 1980s into 2005, household debt rose steadily. The Great Financial Crisis led households to lower their debt levels relative to income. Although there is no generally accepted level that signals when deleveraging has been achieved (we would prefer around 80%), the continued decline is both good and bad. It is good because the reduction in debt is supportive for household balance sheets. However, growth will tend to be slower during periods of deleveraging.

Overall, the report does show the tax bill affected business saving and government dissaving. The recent market decline was reflected in the slide in household net worth. Capital is still gaining on labor; the housing market is now on a more solid footing compared to a decade ago. And, household balance sheets are improving. Overall, we view the report as consistent with steady, slow growth.

Data Section

U.S. Equity Markets – (as of 3/18/2019 close)

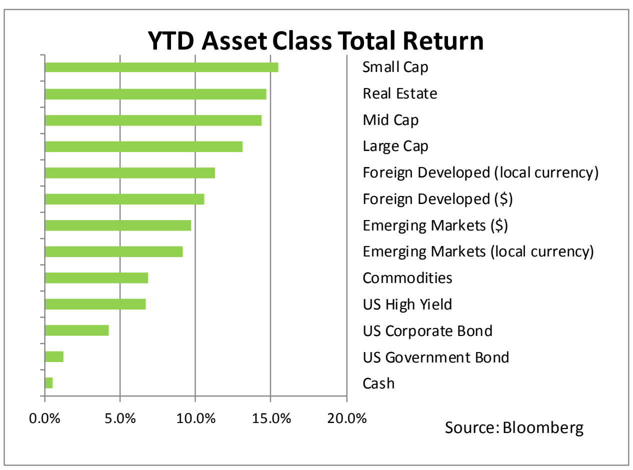




(Source: Bloomberg)

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.

Asset Class Performance – (as of 3/18/2019 close)

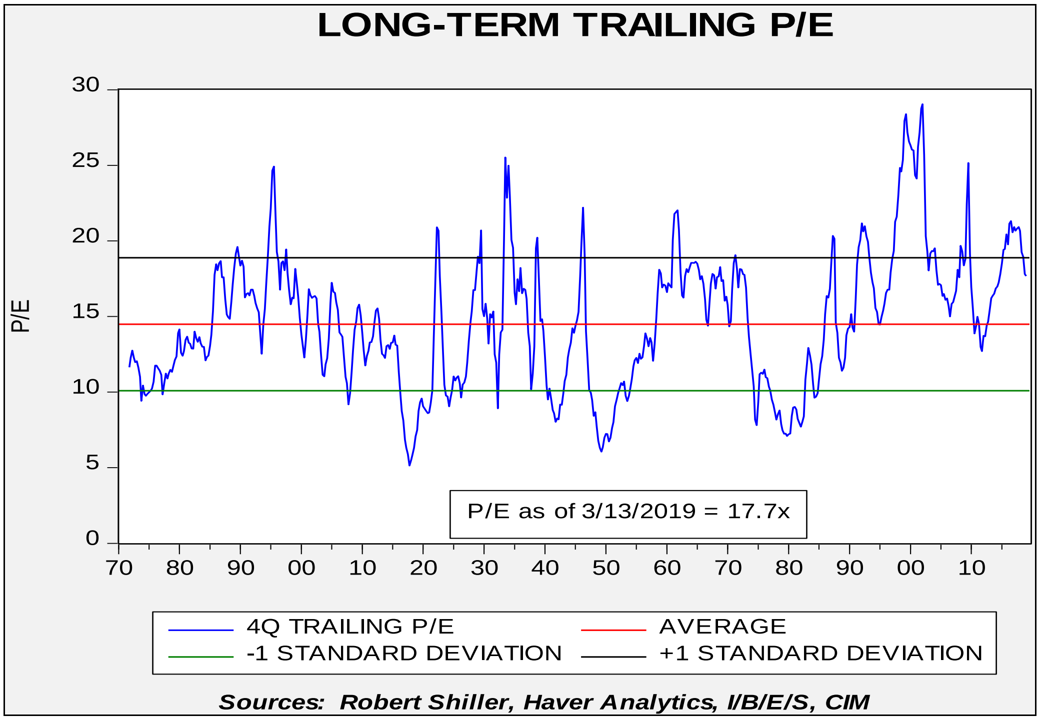


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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).

P/E Update

March 14, 2019



Based on our methodology,[12] the current P/E is 17.7x, up 0.2x from last week. The rise in the P/E was due to declining earnings estimates.

[12] 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 (Q2, Q3 and Q4) and one estimate (Q1). 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.