

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 30, 2023—9:30 AM EDT] Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 is currently up 1.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.4%. Chinese markets were higher, with the Shanghai Composite closing up 0.7% and the Shenzhen Composite closing up 0.2%. 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](#) (3/20/2023) (with associated [podcast](#)) “Update on the U.S.-China Military Balance of Power”
- [Weekly Energy Update](#) (3/30/2023): **We discuss China’s growing influence on the Middle East and the recent détente between Iran and the KSA. The usual data update is provided; this week, we saw a large rise in refinery operations which contributed to an unexpected slide in commercial oil inventories.**
- [Asset Allocation Quarterly – Q1 2023](#) (1/19/2023): Discussion of our asset allocation process, Q1 2023 portfolio changes, and our outlook for the markets.
- [Asset Allocation Q1 2023 Rebalance Presentation](#) (2/2/2023): 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](#) (3/27/2023) (with associated [podcast](#)): “Have Policymakers Solved the Tinbergen Problem?”
- [Confluence of Ideas podcast](#) (3/8/2023): “Reflections on Inflation”

Good morning! It’s Opening Day for major league baseball. In the financial markets, it’s a “[risk on](#)” day: equities and commodities are moving higher, while the dollar is weaker but interest rates have reversed higher.

In today’s *Comment*, we open with China news where Taiwan’s president has arrived in the U.S., and both China and the U.S. are hardening their blocs. Markets are up next, with a look at banking. International news follows, and we close with an update on the war in Ukraine.

China News: Taiwan's president is arriving in the U.S. today. Steadily, China and the U.S. are pressing other nations to choose with whom they will align despite resistance from nations wanting to avoid such a choice.

- Taiwan President Tsai Ing-wen will [visit the U.S. and Central America this and next week](#). Semi-official visits of Taiwanese leaders tend to aggravate Beijing and this [trip is no exception](#). The [focus of the tension](#) is an expected meeting between House Speaker McCarthy and Tsai. Much like former Speaker Pelosi's visit to Taiwan, China is threatening to [respond negatively](#) to the meeting. The administration is taking great pains to portray the tour as "private," meaning it isn't officially a state visit. We also note that [McCarthy is meeting Tsai in California](#), not Washington, [next week](#).
 - We will be closely watching to see how Beijing reacts to the trip. In the wake of Pelosi's visit, China seemed to be practicing a blockade. Our expectation is that China is less likely to invade Taiwan, but more likely to blockade it instead. Amphibious invasions are very hard, and China has no real experience with such operations. Given that the official position is that Taiwan is a province of China, exercising such a control, like a blockade, would fall into an unclear legal situation. If China does something similar this time, it would likely increase the odds that if/when China moves to take control of Taiwan, a blockade may be the preferred tactic.
 - We also note that [National Security Advisor Sullivan had a call with Wang Yi](#), China's top diplomat. The White House has been trying to place guardrails around the U.S./China relationship for some time, but events continue to keep tensions elevated. We note that there was no readout from the call, but we would not be surprised to hear that the Tsai visit was part of the discussion.
- One of our geopolitical themes has been the idea that the [world is evolving](#) into a [China-led bloc and a U.S.-led bloc](#). As this process continues, [both group leaders are trying to woo nations into "their" alignment](#). This process is taking on multiple forms.
 - We [note VP Harris has recently made a trip to Africa](#). This continent is [likely to become increasingly important](#) in the coming decades. Not only is it a source of key minerals for the energy transition, but it also has young people, something that the developed nations are increasingly beginning to lack. The U.S. is [promising increased investment in Africa](#).
 - It isn't just countries that are being pressed to choose. [Companies are too](#). After three decades of globalization when production was moved to China, the U.S. and China [are slowly unwinding their economic interdependence](#).
 - As part of its Belt and Road Initiative, China has lent large sums to frontier economies. As often occurs, some of these loans have failed, forcing China into the unfamiliar role of providing emergency support. Although this is a short-term problem for Beijing, if it is handled well, [it could increase China's influence](#).
- In a [recent Bi-Weekly Geopolitical Report](#), we discussed China's moves to undermine the dollar system. We note that [Brazil and China have agreed to use their own currencies in bilateral trade](#). China has also [settled an LNG trade in CNY](#). In a related

development, [Saudi Arabia is taking preliminary steps to join the Shanghai Cooperation Organization](#), a China-led Eurasian bloc.

- The southern U.S. border is perhaps the prime gateway for immigrants. Although most of those attempting to cross the border are from the Americas, there has been a surge of [Chinese nationals reportedly showing up on the Mexican/U.S. frontier seeking asylum](#).
- As it turns out, the crypto exchange Binance (BNB, \$319.21) [has deep ties to China](#), something it tried to hide from U.S. financial regulators.
- China is seeing a [new surge in African swine fever](#), and if not contained, this event could lead to reduced pork supplies.

Markets, Economics and Policy: We update the latest on the banking issue. There is also a growing realization that margins matter to inflation.

- Fractional reserve banking is fraught with risk. Banks take deposits and, through leverage, expand the money supply through lending. Depositors don't think of their money in the bank as a loan; there is almost a belief that the bank has taken your money and is holding it in an envelope with your name on it. Of course, that isn't the case. It instead lends that money into the economy, and, as long as depositors don't demand their funds all at the same time, the system provides ample, low-cost credit to the economy. However, if a large number of depositors decide to get their money back, chaos can develop. Essentially, societies that use fractional reserve banking make a tradeoff—cheap credit but with the potential for occasional crises.
 - Over time, governments have tried to address this problem. Deposit insurance has been one response. By ensuring that the money will be there, the impetus to “go get it” and thus triggering a bank run is dampened. But by guaranteeing deposits, bankers can take excessive risks, leading to the moral hazard problem. In the U.S., the response has been to limit deposit coverage, although in practice, all deposits are usually covered.
 - Another way governments have addressed this issue is to allow banks to avoid pricing their assets at market. This means that there is a bit of uncertainty as to the value of bank assets at any given time. Since bank loans are often unique, it may be difficult to actually price these assets.¹ Although when banks have securities on their books, these can be priced. To avoid asset price volatility, [banks are allowed to claim that a security will be held to maturity](#). Since bonds usually expire at par, there is *no price risk as long as the bond doesn't need to be sold in order to meet depositor demands*.
 - It has become increasingly apparent that large banks become so important to the economy that governments can't allow bank runs or failure. To deal with this situation, large banks are heavily regulated. In most nations, large banks are the only choice, but in the U.S., due to our fear of economic concentration² (especially in banking), we have a strange mix of a few very large banks and a

¹ Private equity does something similar.

² This is why we have 12 Federal Reserve districts, for example.

whole bunch of small ones. Unfortunately for the [small banks, there is some degree of uncertainty](#) about how depositors will be treated. Thus, we are seeing something of a “[slow motion](#)” run on small banks. Although most financial crises occur quickly, some take a long time. For example, the savings and loan debacle took over a decade to resolve. This problem of large vs. small banks might be similar.

- Because small bank failures are rarely systemic, they tend to get a lighter regulatory treatment. But after recent bank failures, [regulators are looking to expand regulation](#), which may lead to fewer banks.
- In economic theory, inflation is usually addressed in simple terms; e.g., it’s all about the money supply or supply constraints. In reality, it can be devilishly complicated. One factor gaining attention is that [market power can lead to inflation](#) if margins are maintained.
- The debt ceiling issue has sort of fallen from the news, but it remains a threat to stability. The [House GOP seems no closer to a plan](#) on how to address it.
- Young graduates are [finding a tentative job market](#). As we note below, initial claims remain remarkably low and stable, which likely reflects labor hoarding. Firms loath to lose current employees, fearing the cost of replacement. However, it may be leading to a lower number of new graduates being hired.

International News: Russia detains a *Wall Street Journal* reporter, Britain gets a trade deal, and Cargill stops carrying Russian grain.

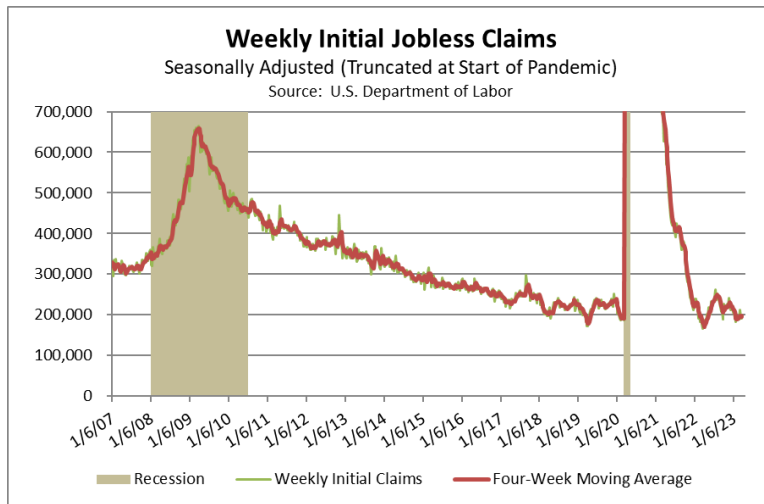
- [WSJ reporter Evan Gershkovich](#) has been detained by Russian security services on [charges of spying](#). He was reportedly investigating the Wagner group. This is a high-profile event and will likely weaken already fraught relations.
- Britain has joined the [Indo-Pacific trade bloc](#), the CPTPP, which is the successor of the failed TPP. The U.K. is the first nation to join the group since its founding in 2018.
- Cargill, a top 10 exporter, [announced it will stop handling Russian grain](#).
- The German ruling coalition is [showing signs of stress](#). The Greens are increasingly out of step with the Social Democrats and the Free Democrats.

War in Ukraine: There are renewed concerns over the safety of the Zaporizhzhia nuclear plant. Russia has been shelling the region around the plant and [both sides are increasing troop strength around it](#). [The IAEA is trying to work out an arrangement](#) to prevent the plant from being directly attacked. This is the largest nuclear plant in Europe and although the cores are in hardened containment units, a direct attack could lead to a potential catastrophe.

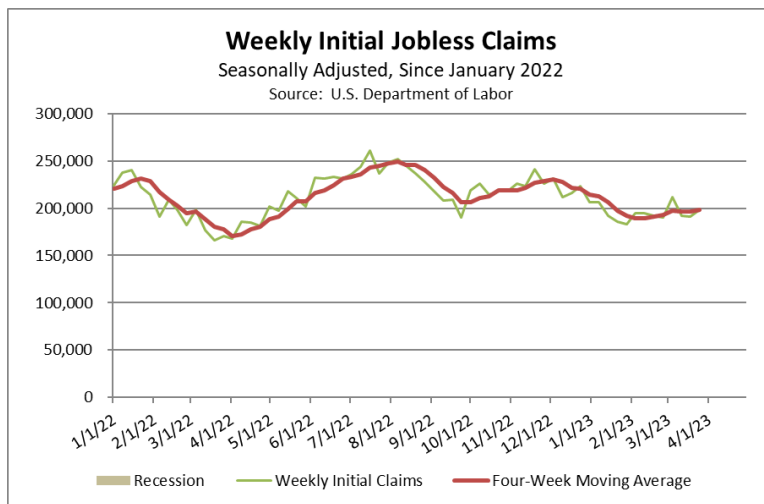
U.S. Economic Releases

In today’s first major economic report, *initial claims for unemployment benefits* in the week ending March 25 rose to a seasonally adjusted 198,000, only modestly above the expected level of 196,000 and the prior week’s level of 191,000. The four-week moving average of initial

applications, which helps smooth out some of the volatility in the series, rose to 198,250, but that’s still consistent with very high demand for labor and very few corporate layoffs. Separately, *continuing jobless claims* in the week ending March 18 edged up to 1.689 million, below the anticipated reading of 1.700 million but modestly above the previous week’s revised reading of 1.685 million. The chart below shows how initial jobless claims have fluctuated since just before the prior recession. The chart is truncated through much of the pandemic period because of the extremely high level of claims at that time.

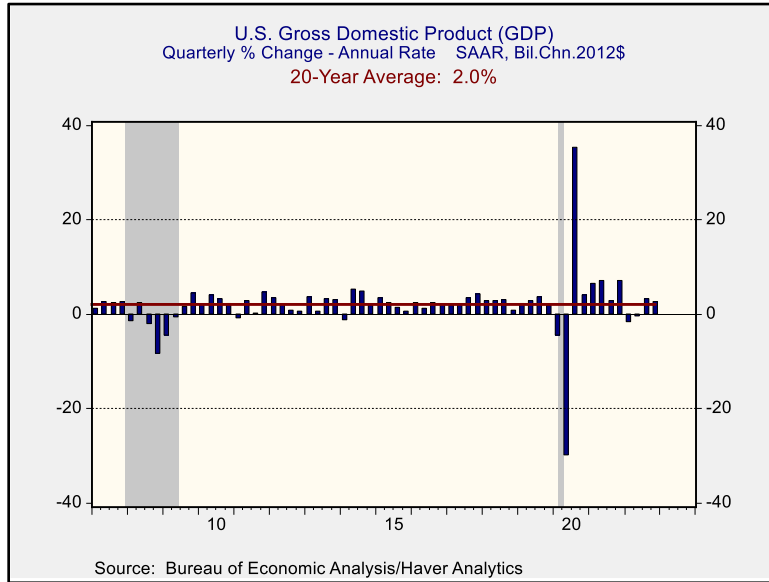


To provide more detail on recent trends, the chart below shows how initial jobless claims have changed just since the beginning of 2022.

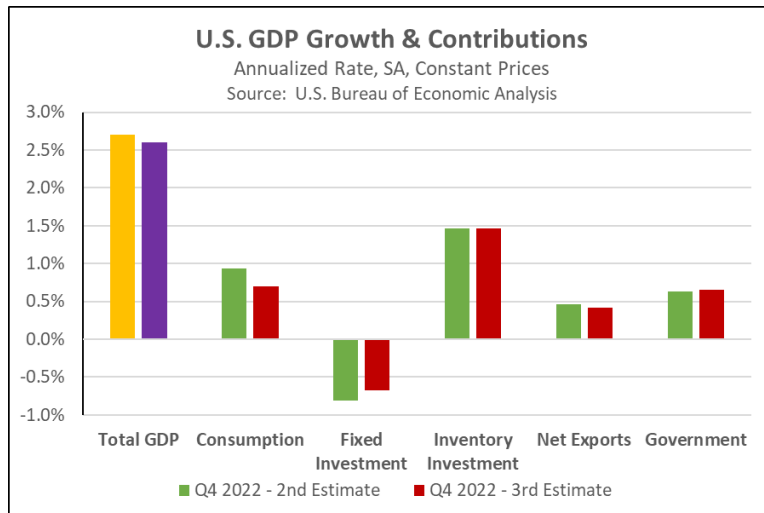


Separately, the Commerce Department released its third estimate of economic activity for the fourth quarter of 2022. After stripping out seasonal factors and price changes, fourth-quarter *gross domestic product (GDP)* rose at an annualized rate of 2.6%, slightly worse than expectations that the growth rate would be unchanged from the previous estimate of 2.7%. The change mostly reflected a downward revision in the estimate of personal consumption spending. In any case, the figures suggest economic output slowed modestly in the fourth quarter following

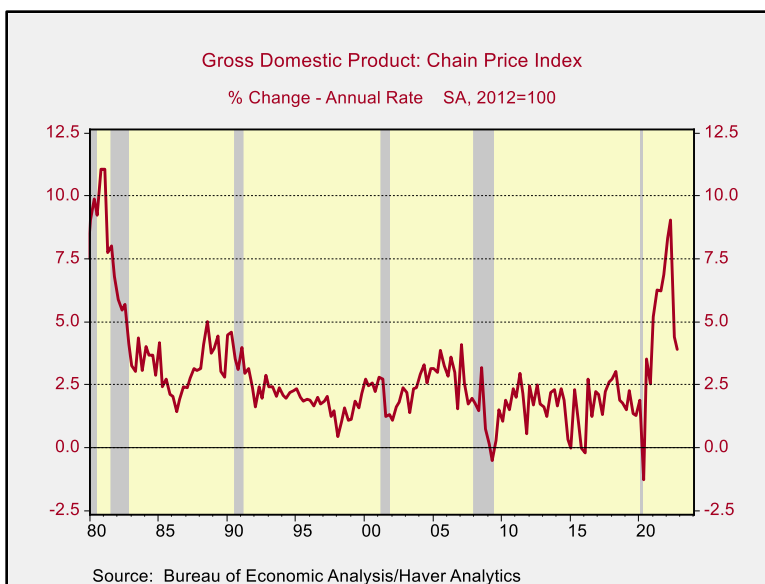
the annualized expansion of 3.2% in the third quarter. The chart below shows the annualized growth rate of U.S. GDP since just before the previous recession.



A close look at the details in the report shows that the main source of growth in the fourth quarter was inventory rebuilding. The chart below shows the contributions to the annualized growth rate in the fourth quarter.



The GDP report also includes the broadest measure of U.S. price inflation. The fourth-quarter **GDP Price Index** rose at a rate of 3.9%, exactly matching the previous estimate, as anticipated. The following chart shows the annualized change in the GDP Price Index over the last several decades.



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
12:45	Thomas Barkin Speaks at Virginia Council of CEOs Event	President of the Federal Reserve Bank of Richmond
12:45	Susan Collins Speaks at NABE in Washington	President of the Federal Reserve Bank of Boston
13:00	Neel Kashkari Speaks in town-Hall Event	President of the Federal Reserve Bank of Minneapolis

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	Japan Buying Foreign Bonds	w/w	24-Mar	¥1182.0b	¥3334.8b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	24-Mar	-¥1682.6b	¥4095.7b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	24-Mar	-¥42.2b	¥118.2b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	24-Mar	-¥1285.8b	-¥1080.6b		*	Equity and bond neutral
New Zealand	Building Permits	m/m	Feb	-9.0%	-1.5%	-5.20	**	Equity bearish, bond bullish
	ANZ Activity Outlook	m/m	Mar	-8.5	-9.2		**	Equity bullish, bond bearish
	ANZ Business Confidence	m/m	Mar	-43.4	-43.3		**	Equity and bond neutral
South Korea	Business Survey - Manufacturing	m/m	Apr	75	66		**	Equity bullish, bond bearish
	Business Survey - Non-Manufacturing	m/m	Apr	69	74		*	Equity bearish, bond bullish
EUROPE								
Eurozone	Consumer Confidence	m/m	Mar F	-19.2	-19.2		**	Equity and bond neutral
	Economic Confidence	m/m	Mar	99.3	99.7	99.6	***	Equity and bond neutral
	Industrial Confidence	m/m	Mar	-0.2	0.5	0.4	***	Equity bearish, bond bullish
	Services Confidence	m/m	Mar	9.4	9.5	10.0	**	Equity bearish, bond bullish
Germany	CPI	y/y	Mar P	7.4%	8.7%	7.3%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Mar P	7.8%	9.3%	7.5%	**	Equity and bond neutral
Italy	Unemployment Rate	m/m	Feb	8.0%	7.9%	8.0%	**	Equity and bond neutral
	PPI	y/y	Feb	10.0%	11.6%		**	Equity bearish, bond bullish
Russia	Industrial Production	y/y	Feb	-1.7%	-2.4%	-1.5%	**	Equity and bond neutral
	Retail Sales	m/m	Feb	-7.8%	-6.6%	-8.0%	**	Equity and bond neutral
	Unemployment Rate	m/m	Feb	3.5%	3.6%		***	Equity and bond neutral
AMERICAS								
Brazil	FGV Inflation IGPM	y/y	Mar	0.17%	1.86%	0.25%	***	Equity and bond neutral
	Industrial Production	y/y	Jan	0.3%	-1.3%	1.1%	***	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)	516	514	2	Up
3-mo T-bill yield (bps)	452	463	-11	Down
TED spread (bps)	64	51	13	Widening
U.S. Sibor/OIS spread (bps)	490	489	1	Up
U.S. Libor/OIS spread (bps)	492	491	1	Up
10-yr T-note (%)	3.56	3.57	-0.01	Flat
Euribor/OIS spread (bps)	302	299	3	Up
Currencies	Direction			
Dollar	Down			Down
Euro	Up			Up
Yen	Up			Down
Pound	Up			Up
Franc	Up			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.

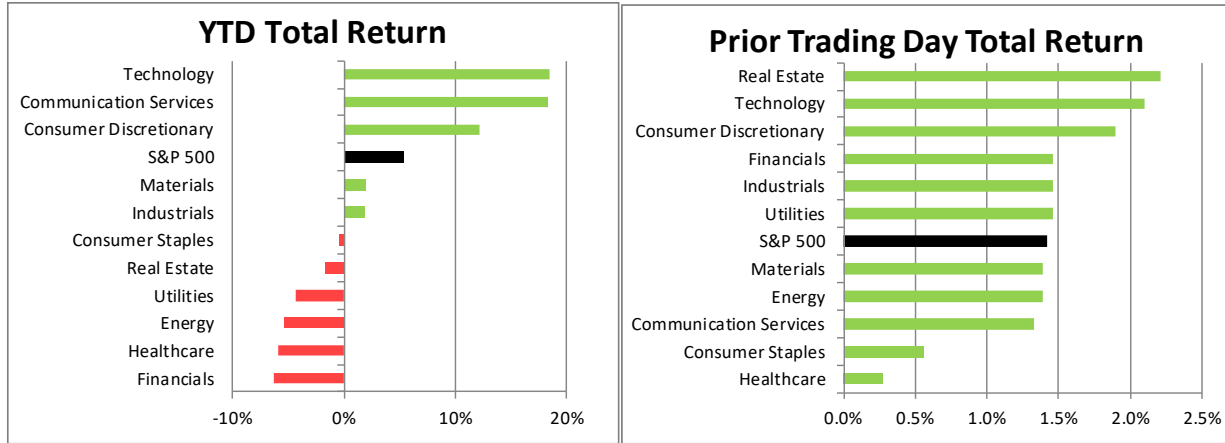
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$78.71	\$78.28	0.55%	
WTI	\$73.51	\$72.97	0.74%	
Natural Gas	\$2.16	\$2.18	-1.19%	
Crack Spread	\$36.12	\$36.57	-1.23%	
12-mo strip crack	\$27.63	\$27.79	-0.59%	
Ethanol rack	\$2.49	\$2.49	0.09%	
Metals				
Gold	\$1,969.12	\$1,964.70	0.22%	
Silver	\$23.76	\$23.34	1.81%	
Copper contract	\$410.85	\$408.65	0.54%	
Grains				
Corn contract	\$654.00	\$650.50	0.54%	
Wheat contract	\$707.50	\$704.75	0.39%	
Soybeans contract	\$1,480.50	\$1,477.25	0.22%	
Shipping				
Baltic Dry Freight	1,407	1,402	5	
DOE Inventory Report				
	Actual	Expected	Difference	
Crude (mb)	-7.5	1.8	-9.2	
Gasoline (mb)	-2.9	-2.3	-0.7	
Distillates (mb)	0.3	-1.6	1.8	
Refinery run rates (%)	1.7%	0.6%	1.2%	
Natural gas (bcf)		-54		

Weather

The 6-10 and 8-14 day forecasts currently call for colder-than-normal temperatures throughout the entire western half of the country, with warmer-than-normal temperatures anticipated across the entire eastern half. The forecasts are calling for wetter-than-normal conditions in California, the Southwest, and the lower Mississippi Valley region, with nearly normal conditions in all other areas.

Data Section

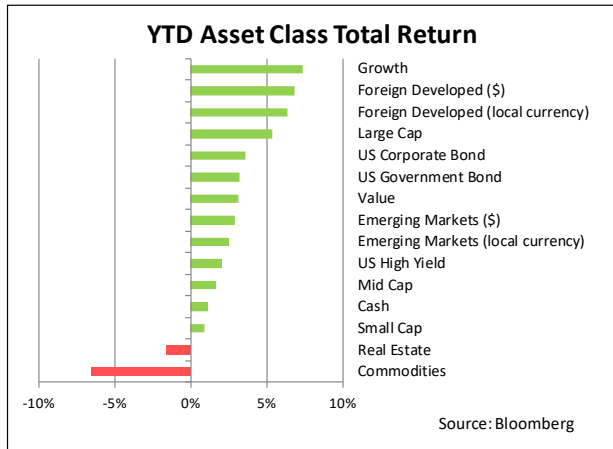
U.S. Equity Markets – (as of 3/29/2023 close)



(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 3/29/2023 close)

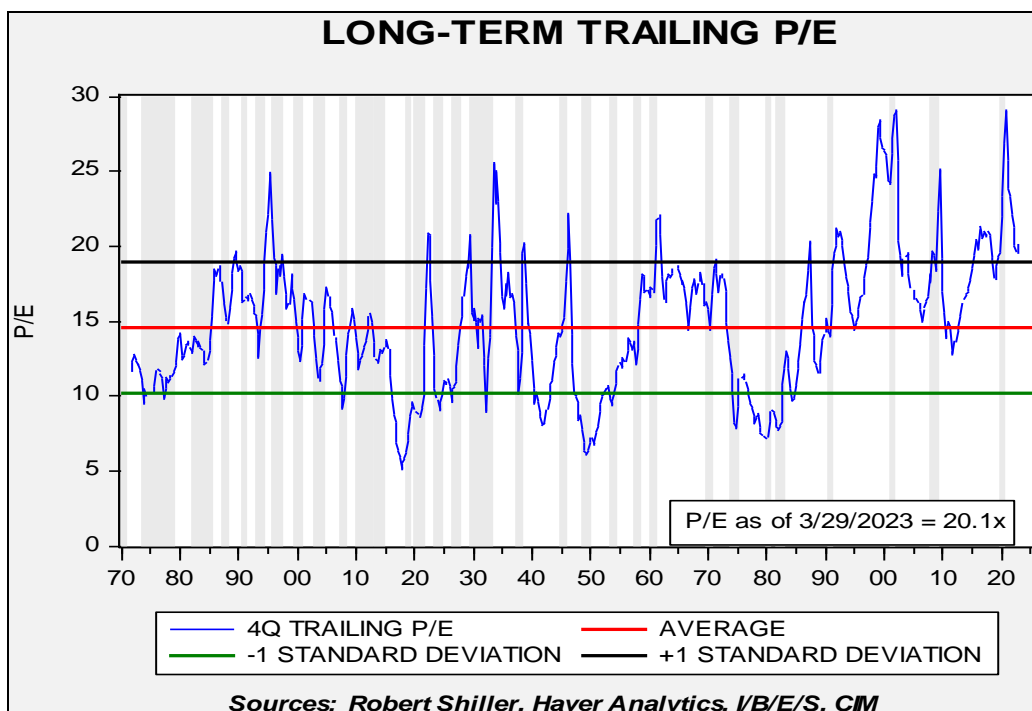


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

March 30, 2023



Based on our methodology,³ the current P/E is 20.1x, down 0.1 from last week. Falling index values led to the decline.

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.

³ 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 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.