

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: May 3, 2023—9:30 AM EDT]** Global equity markets are generally higher this morning. In Europe, the Euro Stoxx 50 Index closed up 0.7%. In Asia, the MSCI Asia Apex 50 Index closed down 0.8%. Chinese markets are closed for Labor Day. U.S. equity index futures are signaling a higher open.

With 326 companies having reported so far, S&P 500 earnings for Q1 are running at \$52.70 per share compared to the estimate of \$50.89, which is down 7.3% from Q1 2022. Of the companies that have reported thus far, 79.4% have exceeded expectations while 17.5% have fallen short of expectations.

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](#) (5/1/2023) (with associated [podcast](#)) “Implications of the Iran-Saudi Arabia Détente”
- [Weekly Energy Update](#) (4/27/2023): Along with our usual update of the weekly DOE data, we also show how EV sales are rising rapidly and could materially displace oil demand by the end of the decade.
- [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 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](#) (4/24/2023) (with associated [podcast](#)): “The Fed’s Employment Surprise”
- [Confluence of Ideas podcast](#) (3/8/2023): “Reflections on Inflation”

Our *Comment* today opens with a word on global oil supplies and prices, where a new tanker seizure by Iran would seemingly boost crude oil prices but growing concerns over recession have pushed those prices sharply lower so far today. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including an apparent Ukrainian drone strike against the Kremlin and a preview of today’s Federal Reserve decision on U.S. interest rates.

**Global Oil Market - Iran:** The U.S. Navy announced that Iran [has again seized an oil tanker in the Persian Gulf region, marking the second such incident in a week](#). Tehran has justified the harassment by saying the tankers violated maritime regulations, but the real reason is likely to retaliate for the ongoing U.S. sanctions against Iran and to undermine the U.S. security presence.

- If they continue, the tanker seizures could boost crude oil prices beyond what they otherwise would be.
- All the same, global prices for oil and other key commodities are trading sharply lower today on increasing concerns about the impending recession in the U.S. Front-month futures prices for WTI are currently down 3.0% to \$69.57, while prices for Brent are down 2.7% to \$73.29.

**Russia-Ukraine War:** Russia is dealing with another wave of what appear to be Ukrainian drone attacks today. In one key incident, two Ukrainian drones [were downed by Russian electronic warfare systems and crashed into the Kremlin in central Moscow](#), prompting Russian accusations that Ukraine was trying to assassinate President Putin. The Russians also threatened to retaliate in kind against the Ukrainian government, but we would note that Ukraine may have been emboldened to launch the strike against the Kremlin because the capital of Kyiv is now protected by sophisticated air defense systems like U.S. Patriot missiles. Other attacks apparently made by Ukraine today included a [strike against a major fuel depot](#), a strike on an airport, and the derailment of a fuel train in southern Russia. By disrupting Russian logistics, these attacks could signal that Ukraine is nearly finished preparing for its expected counteroffensive.

- Separately, the Turkish government announced that the deputy defense ministers of Turkey, Russia, and Ukraine will meet on Friday to discuss extending the agreement that unblocked some of Ukraine's Black Sea grain exports last year.
  - Russia has signaled that it expects sanctions relief before it would agree to extend the deal.
  - If the deal isn't extended and Ukrainian grain exports are again shut in, it could lead to another round of higher global food inflation.
- There is also new information on the explosions last September that damaged the Nord Stream 1 and 2 natural gas pipelines that run from Russia to Western Europe. Four Nordic media outlets have discovered that several Russian military ships, including a tug capable of launching mini-submarines, [were spotted in the area just days before the explosions](#). Indeed, the Russians could have had several motives for the attack. They may have meant to punish the European countries for lending support to Ukraine or to test the West's security for undersea infrastructure in the region.

**European Union:** The EU's single-market commissioner, Thierry Breton, will announce his plan to ramp up the bloc's production of ammunition and missiles in response to Russia's aggression against Ukraine. Breton's "Act in Support of Ammunition Production" (ASAP) would pour some €500 million from the EU budget into European defense industry factories to

boost weapons manufacturing. The plan is the [third leg of the EU's program to boost its defense capabilities after many years of muted efforts](#).

**Chile:** Leftist President Gabriel Boric [is making good on his plan for the government to take at least a 51% stake in key lithium-mining operations](#). In an interview with the *Financial Times*, the official charged with negotiating for the stakes revealed that he wants to complete the purchases by the end of this year. The process has spooked investors and driven down the value of Chilean mining firms. The move is also expected to shift investment toward other producers such as Australia, Argentina, and Africa.

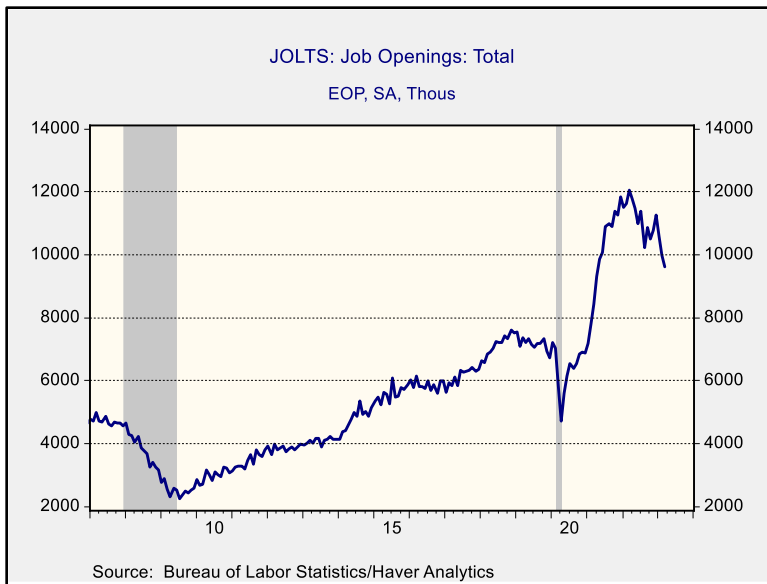
**U.S. Monetary Policy:** The Fed's policy making committee [will wrap up its latest meeting today, with its decision due to be announced at 2:00 PM EDT](#). The policymakers are widely expected to hike their benchmark fed funds interest rate by another 0.25%, to a 16-year high of 5.00% to 5.25%. However, the focus for investors will likely be the post-meeting statement and comments by Fed Chair Powell to see if they provide any hints that the rate hikes are finished. Given the damage inflicted on the economy from the current rate-hiking cycle, we continue to believe that any hint of a pause could give a boost to equities.

**U.S. Fiscal Policy:** Democrats in the House of Representatives [launched a "discharge petition" aimed at bringing a vote to the floor for a "clean" bill which would raise the federal debt limit with no associated spending cuts](#). The discharge petition would require the support of five Republicans, so it's considered a longshot, but it does suggest at least some in Congress are increasingly concerned about the economic damage that could be caused by brinksmanship around the debt limit or an outright default.

**U.S. Artificial Intelligence:** Arvind Krishna, the chief executive of IBM (IBM, \$125.16), [said in an interview that his company will pause all hiring of back-office positions that could be done with artificial intelligence](#). Going forward, Krishna suggested that about 7,800 positions at the company could eventually be replaced by AI and automation. The statement will likely fuel concerns that the rapid rollout of AI could boost unemployment.

- In another example of AI disruption, education technology firm Chegg (CHGG, \$9.08) yesterday [warned that popular AI chatbot ChatGPT is already starting to hurt its sales](#) of on-line study guides.
- Chegg's stock plunged 48.4% on the news.

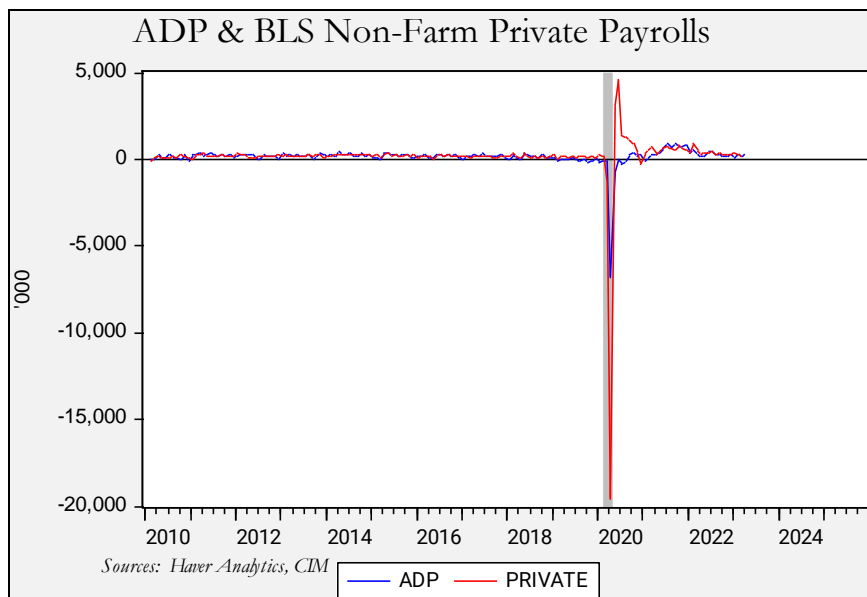
**U.S. Labor Market:** In yesterday's JOLTS report on the labor market, total job openings [fell in March to a seasonally adjusted 9.59 million, marking their lowest level in almost two years](#). In addition, March layoffs rose to 1.81 million, reaching their highest level in over two years. The figures point to a worse-than-expected softening in labor demand and add to other recent evidence that the economy could be slipping into recession even now, although we still think the recession will hit a bit later in the year. In any case, the weak JOLTS report helped push equities and other risk assets sharply lower yesterday.



**U.S. Economic Releases**

Weekly mortgage applications for the week ending April 28 fell by 1.2% compared to the prior week. Purchase applications declined 2% while refinancing applications rose 0.8%. The 30-year mortgage rate fell 5 bps to 6.50%.

The ADP private payroll report for April came in much stronger than expected at 296k compared to expectations of 150k.



This chart shows the monthly change in payrolls for both the ADP private payrolls and the BLS series for private payrolls. The ADP data has become a less reliable indicator of the BLS private payroll data over time. Clearly, the company struggled to reflect the wild swings in employment

during the pandemic. However, if we model the data from mid-2021, excluding the pandemic, it suggests a 367k forecast, with a standard error of 121k. That would give a range of 488k to 246k. Current expectations for private payrolls are 156k, so the ADP data will likely lead to an upward recalibrating of forecasts.

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
9:45	S&P Global Services PMI	m/m	Apr F	53.7	53.7	**
9:45	S&P Global Composite PMI	m/m	Apr F	53.5	53.5	**
10:00	ISM Nonmanufacturing PMI	m/m	Apr	51.8	51.2	***
10:00	ISM Manufacturing PMI - Prices Paid	m/m	Apr		59.5	**
10:00	ISM Manufacturing PMI - Employment	m/m	Apr		51.3	*
10:00	ISM Manufacturing PMI - New Orders	m/m	Apr		52.2	**
14:00	FOMC Rate Decision (Lower Bound)	w/w	3-May	5.00%	4.75%	***
14:00	FOMC Rate Decision (Upper Bound)	w/w	3-May	5.25%	5.00%	***
Federal Reserve						
EST	Speaker or Event	District or Position				
14:00	FOMC Concludes Two-Day Meeting	Federal Reserve Board				
14:30	Fed Chair Holds Press Conference Following FOMC Meeting	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
<b>ASIA-PACIFIC</b>								
Australia	Retail Sales	m/m	Mar	0.40%	0.20%	0.20%	***	Equity and bond neutral
New Zealand	Employment Change	y/y	1Q	2.5%	1.3%	1.6	**	Equity bullish, bond bearish
	Unemployment Rate	q/q	1Q	3.4%	3.4%	3.5%	*	Equity and bond neutral
India	S&P Global Services PMI	m/m	Apr	62.0	57.8		**	Equity bullish, bond bearish
	S&P Global Composite PMI	m/m	Apr	61.6	58.4		**	Equity bullish, bond bearish
<b>EUROPE</b>								
Eurozone	Unemployment Rate	m/m	Mar	6.5%	6.6%	6.6%	**	Equity and bond neutral
Italy	Unemployment Rate	m/m	Mar	7.8%	8.0%	7.9%	**	Equity and bond neutral
<b>AMERICAS</b>								
Mexico	S&P Global Manufacturing PMI	m/m	Apr	51.0	51.0		***	Equity and bond neutral
Brazil	S&P Global Manufacturing PMI	m/m	Apr	44.3	47.0		***	Equity and bond neutral
	Trade Balance	m/m	Apr	\$8225m	\$10956m	\$8400m	**	Equity and bond neutral
	Exports	m/m	Apr	\$27365m	\$33060m	\$27300m	*	Equity and bond neutral
	Imports	m/m	Apr	\$19140m	\$22104m	\$19119m	*	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)	530	530	0	Up
3-mo T-bill yield (bps)	506	501	5	Up
TED spread (bps)	25	29	-4	Tightening
U.S. Sibor/OIS spread (bps)	507	506	1	Up
U.S. Libor/OIS spread (bps)	508	507	1	Up
10-yr T-note (%)	3.41	3.43	-0.02	Flat
Euribor/OIS spread (bps)	327	327	0	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.

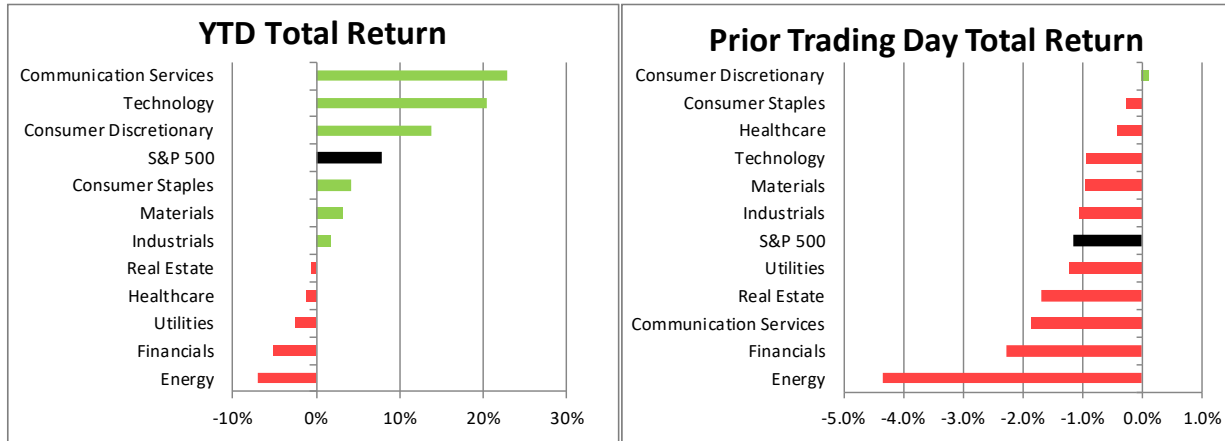
DOE Inventory Report	Price	Prior	Change	Explanation
<b>Energy Markets</b>				
Brent	\$73.15	\$75.32	-2.88%	
WTI	\$69.47	\$71.66	-3.06%	
Natural Gas	\$2.19	\$2.21	-0.90%	
Crack Spread	\$28.35	\$28.67	-1.12%	
12-mo strip crack	\$23.49	\$23.85	-1.52%	
Ethanol rack	\$2.55	\$2.55	-0.09%	
<b>Metals</b>				
Gold	\$2,015.97	\$2,016.68	-0.04%	
Silver	\$25.27	\$25.37	-0.39%	
Copper contract	\$385.75	\$386.25	-0.13%	
<b>Grains</b>				
Corn contract	\$570.25	\$580.00	-1.68%	
Wheat contract	\$605.75	\$609.25	-0.57%	
Soybeans contract	\$1,398.75	\$1,410.75	-0.85%	
<b>Shipping</b>				
Baltic Dry Freight	1,552	1,576	-24	
<b>DOE Inventory Report</b>				
	Actual	Expected	Difference	
Crude (mb)		-0.5		
Gasoline (mb)		-1.5		
Distillates (mb)		-0.8		
Refinery run rates (%)		0.55%		
Natural gas (bcf)		55		

## **Weather**

The 6-10 and 8-14 day forecasts currently call for cooler-than-normal temperatures in the Pacific region, with warmer-than-normal temperatures for the rest of the country. In fact, the central Midwest is expected to experience well-above-normal temperatures in the 6-10 day forecast; those warm temps will then migrate to the Eastern Seaboard by mid-May. The forecasts are calling for wetter-than-normal conditions for most states, with dry conditions expected in the New England, Great Lakes, and Southwest regions.

**Data Section**

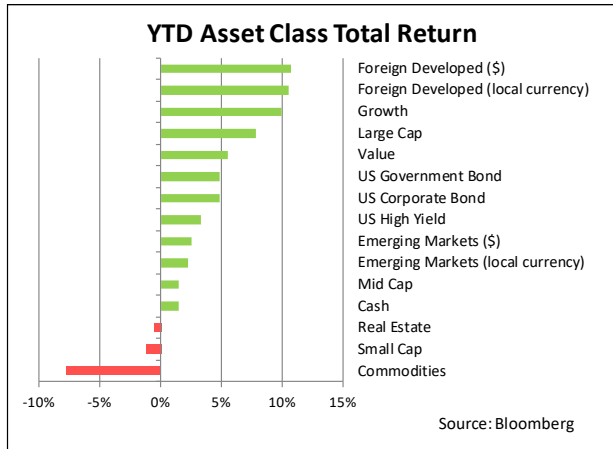
**U.S. Equity Markets – (as of 5/2/2023 close)**



(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 5/2/2023 close)**



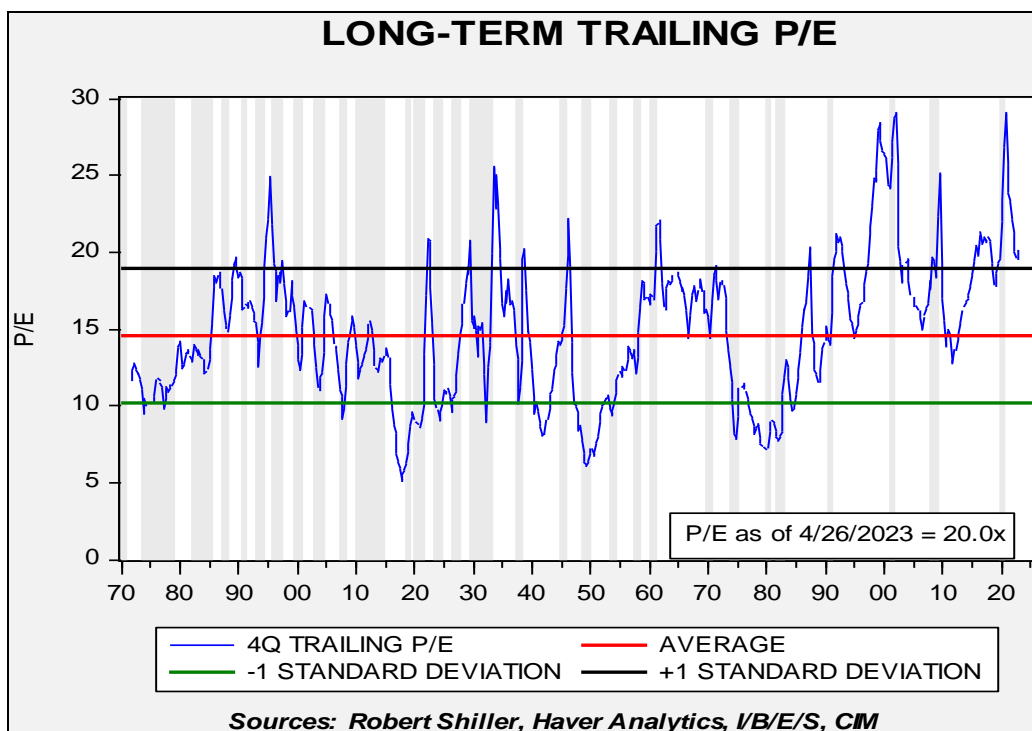
This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

April 27, 2023



Based on our methodology,<sup>1</sup> the current P/E is 20.0x, down 0.1x from last week. Rising earnings accounted for the modest downtick.

*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.*

<sup>1</sup> 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.