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: May 4, 2023—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is currently down 0.9% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.9%. Chinese markets were mixed, with the Shanghai Composite up 0.8% from its previous close and the Shenzhen Composite down 0.1%. U.S. equity index futures are signaling a lower open.

With 365 companies having reported so far, S&P 500 earnings for Q1 are running at $52.90 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, 79.2% have exceeded expectations while 17.0% 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:

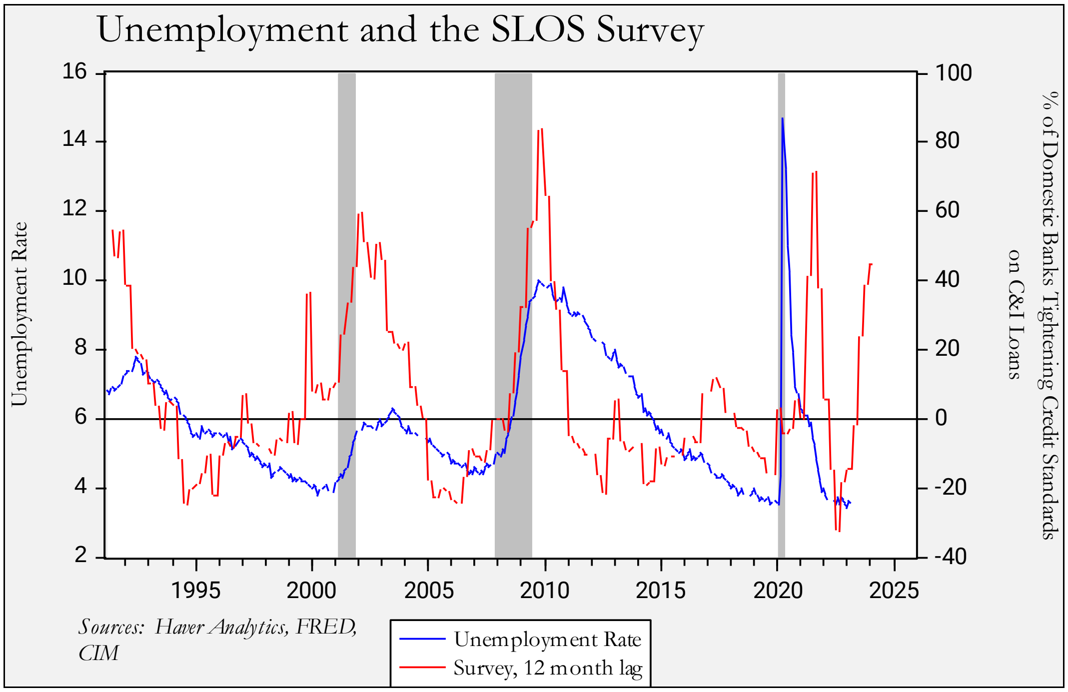
- *Bi-Weekly Geopolitical Report* (5/1/2023) (with associated podcast) "Implications of the Iran-Saudi Arabia Détente"
- ***Weekly Energy Update*** **(5/4/2023): We note the recent weakness in oil prices, which appears to be due to worries about global growth. We also note a surprising proponent of nuclear power.**
- *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"

Good morning! In the wake of the FOMC, it's mostly a risk off day so far this morning. Treasury yields were lower overnight, but have reversed higher, the dollar and equities are lower, oil is modestly higher after a hard sell off, and gold is higher.

In today's *Comment,* we lead off with a recap of the Fed meeting. The ECB meets today, so we offer our first impressions from that meeting too. The ongoing banking crisis is up next, followed by an update on the debt ceiling situation. In the market section, we cover the changes coming to the southern U.S. border and then close with a look at the world: China, Ukraine, and general international news.

The FOMC Recap: As expected, the Fed raised rates 25 bps and signaled a pause. Here is the official statement and our take:

- The key difference between the May and March statement is the pause signal:
    - March: *The Committee will closely monitor incoming information and assess the implications for monetary policy.* ***The Committee anticipates that some additional policy firming may be appropriate*** *in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time. In determining the extent of future increases in the target range, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments.*
    - May: *The Committee will closely monitor incoming information and assess the implications for monetary policy. In determining the extent to which additional policy firming may be appropriate to return inflation to 2 percent over time, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments.*
- Note that the bolded sentence from the March statement is missing in the May statement. The committee has left itself some leeway to raise rates if necessary, but the markets are signaling a near certainty of steady policy at the June 14 meeting. Current market projections for the July 26 meeting suggest a near even chance of steady policy or a rate cut. The market is starting to anticipate rate cuts as, even if it's a bit early, the September 20 meeting is projecting an +80% chance of a rate cut.
- So far, the White House has backed Fed policy tightening, but left-leaning members of Congress are increasing their criticism of monetary policy. A group of Senators and Representatives sent an official letter to Chair Powell, calling on the committee to pause its rate hikes. Although the signers of the missive are not surprising, a case can be made that a slowing economy and stress in the banking system support a cautious approach to policy tightening. The Fed has a dual mandate for price stability and full employment, and the signers of this letter tend to focus on the latter mandate.
- Surprisingly, the FOMC statement took a rather sanguine view of banking stress. The turmoil we have seen in the banking system has raised fears of restricted credit—the so-called "credit crunch." In looking at the Senior Loan Officer Survey, which is the current reading regarding commercial and industrial loans for large and medium firms, we are at levels that tend to signal recession over the next year. It also suggests, which shouldn't be a shock, that unemployment is rising.



This chart shows the survey and the unemployment rate. The lags are not consistent, but it's rather clear that readings above 40% increase the odds of a recession.

- Market reactions were interesting. The initial reactions suggested the markets took the statements as dovish. For example, the dollar weakened, and gold jumped to $2045 per ounce. Equities rallied and Treasury yields fell. During the press conference, the chair made it clear that a pause was not a signal of easing, notwithstanding expectations noted above. In addition, he said that, in his opinion, he expects inflation to fall slowly. Since he also noted that he doesn't expect a recession, his outlook on inflation is consistent. FWIW, we think a recession is more likely than the chair does, and thus inflation will also fall much more quickly than he expects. However, on Powell's comments, the equity market fell off rather sharply, and the other markets mostly moved to areas seen prior to the statement.
- To a great extent, we are now at a critical crossroads. If the economy heads into recession, inflation will fall and the FOMC will cut rates. This is what the financial markets appear to be discounting. Powell may genuinely believe that a recession isn't likely, despite the fact that his staff expects one. Or it may simply not be politically possible for the chair to signal that a recession is likely; after all, if that is what the FOMC members expect, they should be cutting now. Paradoxically, if the political problem is why Powell doesn't expect a recession, his position's impact on markets raises the odds that we will have a recession.

The ECB: As expected, the ECB raised rates by 25 bps. This was widely expected, but the tone of the statement was rather hawkish. The bank indicated that policy would remain tight because inflation remains sticky. Similar to what we are seeing in the U.S., European banks are tightening credit. And, as we are seeing in the U.S., corporate market power is boosting inflation as firms pass along higher costs to consumers to maintain their profit margins. The press conference was underway as we were writing this report, but market reaction appears to suggest that market participants were wanting more aggressive tightening; we are seeing the EUR weaken in the aftermath of the release.

The Banking Crisis continues: As the coronation of King Charles III looms, in deference to another Queen, yet another regional bank looks like it's in deep trouble. After the Powell press conference yesterday, PacWest Bank (PACW, $6.42) announced it was in talks with investors about strategic alternatives, which likely means it will need to be sold. Its shares plunged in afterhours trading. Overall, mid-sized banks continue to lose ground.

- As we note above, the FOMC seems rather unconcerned about the banking situation. We believe this is because they think that stopping the bank run was sufficient. As we have stated on numerous occasions, the problem isn't just the bank run situation, it's disintermediation. Banks can't offer market yields on deposits since their assets were purchased in the ZIRP era and doing so would lead to insolvency. This situation is very similar to the S&L problems of the 1980s. ***There is probably only one solution to this problem—the Fed must lower rates to protect the asset bases of these banks***.
- Meanwhile, we are starting to see increasing evidence of a credit crunch. Bank lending fell towards the end of March and it's likely the slump will continue. Slowing lending will act as a brake on the economy and increase the odds of recession.
- Adding to problems was the announcement that Toronto-Dominion Bank (TD, $59.76) was terminating an agreement to purchase First Horizon Bank (FHN, $15.05), citing regulatory constraints. Toronto-Dominion Bank will pay First Horizon around $225 million for ending the deal. First Horizon shares fell sharply overnight.

The Debt Ceiling: Treasury Secretary Yellen's recent signal that the Treasury would "run out of cash" by as early as June 1 has increased the tension on Congress to avoid a debt default or a government shutdown. Speaker McCarthy is expected to meet President Biden on May 9, but there is little evidence that either the president or speaker are prepared to make concessions. The president simply wants an increase in the debt ceiling—a "clean bill." McCarthy, fresh off his budget vote, wants to use his legislation as the basis for negotiations. We doubt these meetings will accomplish much. Meanwhile, there are various tactics and ideas being considered.

- Democrats are crafting a discharge petition, which would force a vote on increasing or suspending the debt ceiling. The petition would put the bill on the floor for a vote over the Speaker's objections, and given the narrow GOP majority, only a few defections could lead to a clean debt ceiling resolution, which would likely pass the Senate. If five GOP reps defect, this bill could reach the floor. However, getting five will still be difficult.
- Whenever the debt ceiling becomes a problem, the argument emerges that the 14th Amendment makes defaulting unconstitutional. The key clause is as follows:

> *The validity of the public debt of the United States, authorized by law, including debts incurred for payment of pensions and bounties for services in suppressing insurrection or rebellion, shall not be questioned…*

This clause was designed to prevent Southern Congressmen from attempting to repudiate the Federal debt accumulated to fight the Civil War. The fear was that the southern states, with voter rolls bolstered by free slaves, could legislate to avoid servicing the war debt. The 14th Amendment was designed to prevent that outcome. Some legal scholars believe the clause could be used to skirt the debt ceiling issue. Of course, this clause conflicts with Congress's "power of the purse," so a unilateral action by the executive branch to keep spending and borrowing would eventually be decided by the courts. However, it should be noted that it is unclear who exactly could sue. The Supreme Court ruled in 1997 that individual lawmakers lack standing, but Congress as a whole might. Given the risks involved, previous administrations have avoided this outcome. But, it is being considered, apparently.

- Another possibility is Congress could agree to extend the deadline by either raising the debt ceiling by an amount estimated by legislators to be a few week's or month's worth in order to negotiate further or suspend the limit while negotiations are going on. This idea may be gaining some traction. It should be noted that, due to recesses scheduled in both houses, the House is only in session 12 days and the Senate 15 days this month. Complicating matters further, President Biden will be out of the country this month, visiting Japan and Australia. At the same time, "kicking the can" doesn't really resolve the issue and without the deadline looming, it's unlikely progress will be made.
- Other more arcane solutions have come up in these debates. A favorite of Joe Wiesenthal of Bloomberg (and co-host of the Odd Lots podcast) is the $1.0 trillion platinum coin.
- Another odd twist to the deadline is that the IRS has improved its efficiency in sending refund checks. Because it is sending checks faster, the Treasury General Account is draining faster too.

Markets, Economics and Policy: The strike in Hollywood continues, and the border crisis is increasing.

- The writers have gone on strike in Hollywood. Late night talk shows tend to be affected first, as the hosts lose their joke pipeline. Taped shows are usually done a few weeks in advance, so it may be a month or so before TV dramas and sitcoms go to reruns. Usually, we wouldn't see this issue as market moving. But the decision to strike, the first in 15 years, is due to the accelerating shift away from broadcasting to streaming. Writers are finding that the new environment is turning them into "gig" workers with little job security. Often, the streaming firms make content that is short-term in nature and is hiring writers for short term projects. The network broadcast model was designed to put a team of writers on a drama or sitcom which generated steady work. Breaking work into small segments and hiring workers for only those jobs is a factor across the economy; organized labor is trying to respond. We note this is a factor in the delivery industry as well.
- Title 42, which has allowed immigration officials to turn away potential immigrants and asylum seekers due to the pandemic, will expire on May 11. The government is moving 1500 troops to assist processers and help secure the border. The expiry is expected to

increase flows to the border and is not just a political problem for the White House, but it will also affect the southwestern border states as they cope with the increased flow.

- Drought is reducing the water levels of the Panama Canal, forcing vessels to reduce their cargo to transverse the waterway.

China News: We are monitoring recent changes to China's national security laws which are affecting Western firms. And Florida is joining other states in restricting the foreign purchasing of real estate.

- Governments have multiple policy goals. In particular, there can be a tension between economic growth and national security which is especially evident in foreign investment. In our *Weekly Energy Update*, we have regularly reported on such tensions rising as Chinese EV battery firms look to make investments in the U.S. Given China's lead in this area, it makes economic sense to use their technology. However, given national security concerns, we should avoid such endeavors. Recently, China issued a new national security law, effective July 1, which is so broad and vague that just about anything (perhaps even reporting on the economy) could be seen as violating the law. We will have more to say on this in the coming weeks, but in the meantime, there are reports suggesting that incoming foreign direct investment into China is waning and this decline may be tied to these new regulations.
- When a nation runs current account deficits, it must fund them via a capital account surplus. The dollar's reserve currency status essentially requires the U.S. to run a current account deficit, which means foreigners have dollars they need to invest in the U.S. Most of the time, those dollars flow into Treasuries,[1] but, foreigners sometimes prefer other investments. Real estate is popular for numerous reasons. Wealthy foreigners may want a place in the U.S. if they need to move quickly. U.S. farmland has attracted foreign buyers.[2] Florida has introduced legislation to restrict and regulate "hostile nations" from purchasing real estate in the Sunshine State. Florida has been a popular destination for foreign capital flight, especially from South America. There are concerns the legislation may to too broad and introduce unnecessary restrictions.

International News: We update the Ukraine War, we have a new head of the World Bank, and England holds local elections.

- The day after an apparent drone attack on the Kremlin, we still aren't sure who is responsible. Russia is blaming Ukraine for the attack, calling it an assassination attempt. President Zelensky denies the claim. If Ukraine was behind the attack, it didn't signal the action to the U.S. If Ukraine was responsible, it was ill-advised as it is unlikely that such an attack would be successful, and it would open the possibility for Russia to retaliate in kind. This is why some analysts are arguing it was a "false flag" operation, made by the Russians themselves. Or, it could have been elements within Russia, either trying to eliminate Putin, or making the feeble attack to trigger a massive, and perhaps

[1] Which is one of the reasons why a debt ceiling default is so risky.

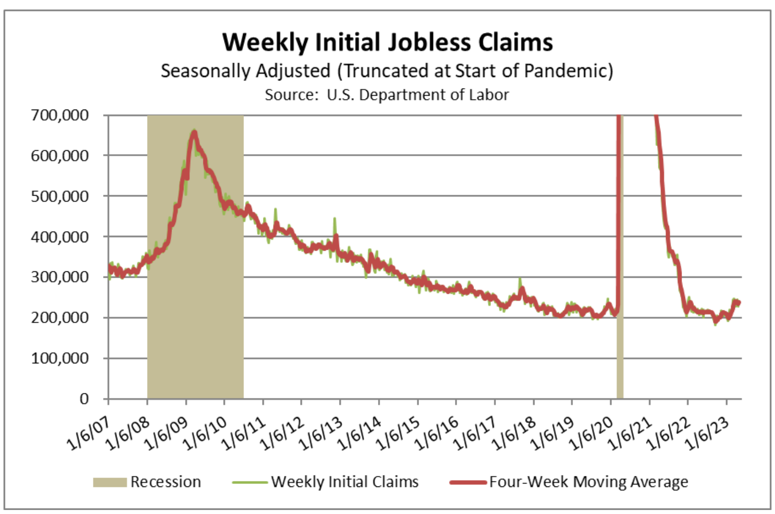
[2] Chinese buyers of Missouri farmland has been a "hot button" issue, for example.

unconventional response. We will continue to monitor the situation, but we do doubt it was a Ukrainian operation.

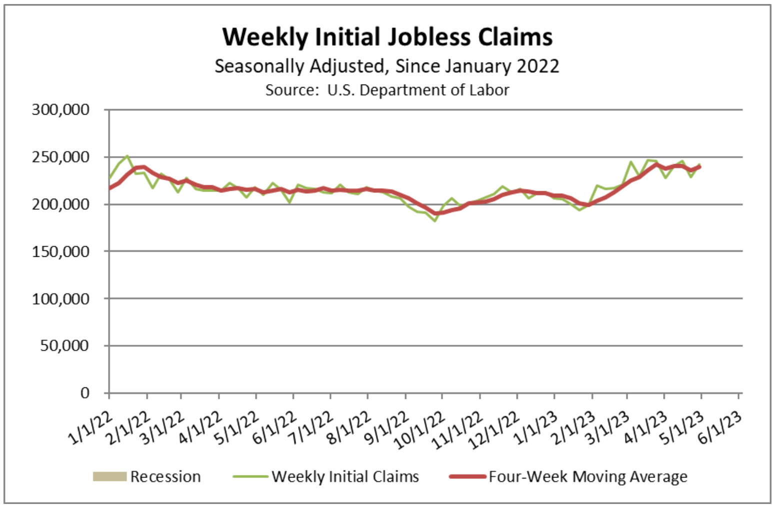
- NATO is warning members that Russia may be targeting undersea pipelines and cables. Intelligence officials say Russia is actively mapping these assets.
- An op-ed in the *Atlantic* makes the case for overwhelming support of the upcoming Ukraine offensive. We note the U.S. announced additional support.
- Zelensky is visiting the Hague today.
- Ajay Banga has been confirmed as the president of the World Bank.
- England holds local elections today, the first major test for PM Sunak.
- The civil conflict in Sudan is clearly a tragedy. Wars often expose wider vulnerabilities. It turns out that the country is the world's primary supplier of gum arabic, which is used as a thickener and stabilizer in numerous food products. Currently, suppliers are using current inventories but if the conflict continues, it could become a problem.

U.S. Economic Releases

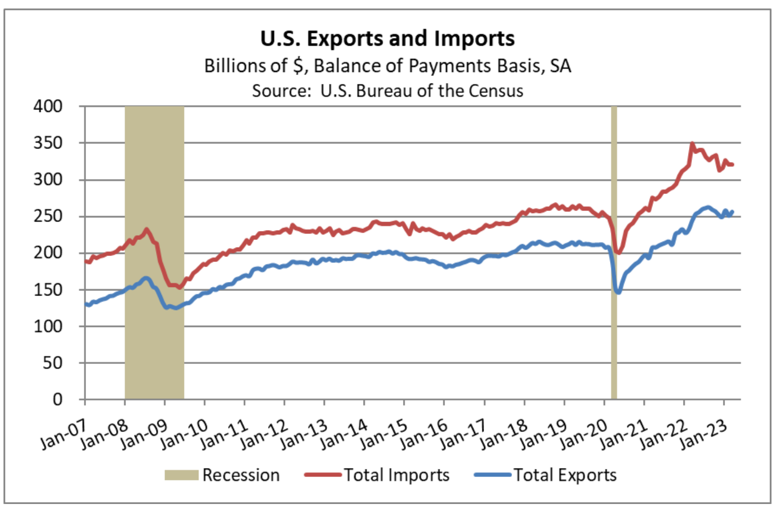
In the week ending April 29, ***initial claims for unemployment benefits*** rose to a seasonally adjusted 242,000, slightly above the expected level of 240,000 and substantially above the previous week's revised level of 229,000. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, rose to 239,250. During the week ending April 22, ***continuing claims for unemployment benefits*** (people continuing to draw benefits) fell to 1.805 million, less than the anticipated level of 1.865 million and less than the previous week's revised level of 1.843 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.



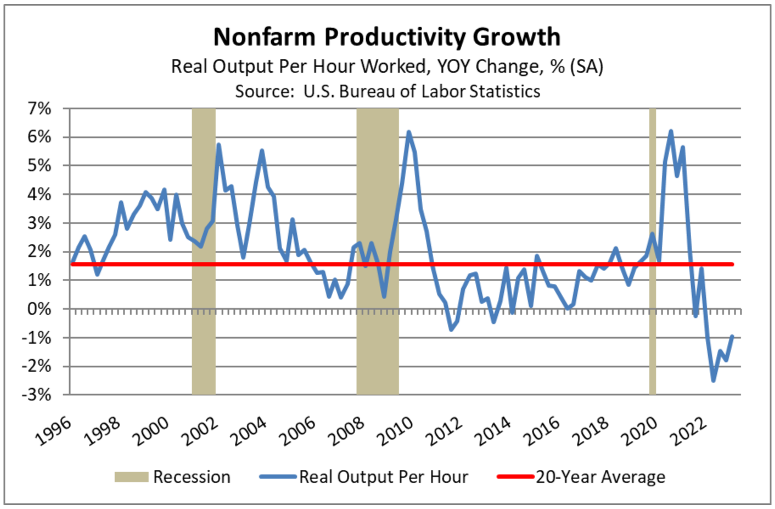
To provide more detail on recent trends, the chart below shows how initial jobless claims have changed just since the beginning of 2022. The chart shows how initial claims jumped following the end of January, but they have stabilized over the last month.



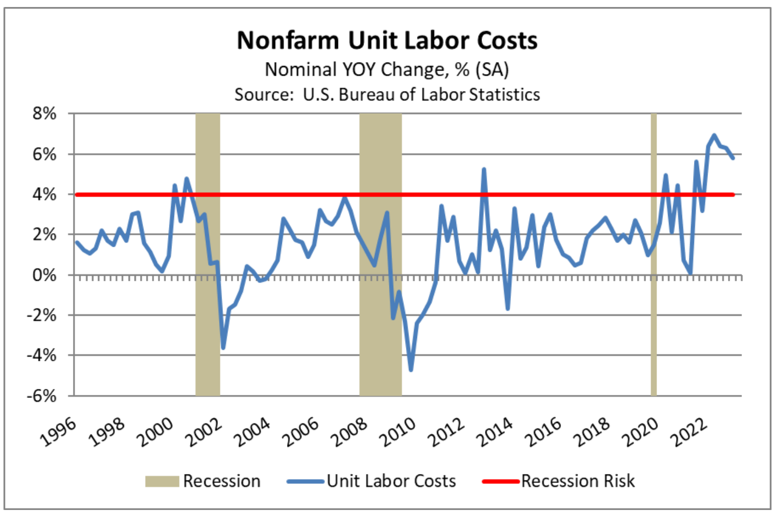
In a separate report, the March ***trade balance*** improved to show a seasonally adjusted deficit of $64.2 billion. The deficit wasn't quite as small as the $63.1 billion that was anticipated, but it was still better than the revised February shortfall of $70.6 billion. According to the data, total U.S. exports rose 2.1% in March, while imports declined 0.3%. Compared with the same month one year earlier, exports in March were up 5.0%, while imports were down 8.6%. The chart below shows the monthly value of U.S. exports and imports since just before the previous recession.



A final report so far today focused on the productivity of U.S. workers, defined as the average value of output per hour worked, and labor costs. After stripping out price changes and normal seasonal fluctuations, first-quarter ***nonfarm productivity*** declined at an annualized rate of 2.7%, far worse than the expected rate of decline of 2.0% and more than enough to offset the 1.6% rate of increase in the fourth quarter of 2022. Taking into account the fluctuations in each of the last four quarters, productivity in the first quarter was down 0.9% from the same period one year earlier. The chart below shows the year-over-year growth in real productivity over the last quarter century or so.



First-quarter ***unit labor costs*** jumped at an annualized rate of 6.3%, significantly worse than the expected rate of increase of 5.6% and nearly double the fourth quarter's revised rate of increase of 3.3%. Unit labor costs in the first quarter were up 5.8% year-over-year. Historically, the U.S. has been at heightened risk of a recession when the annual growth in unit labor costs has exceeded 4.0%. The chart below shows the year-over-year growth in unit labor costs since 1996.



There are no economic releases or Fed events scheduled for the rest of the day.

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	Exports	m/m	Mar	4.0%	-3.0%		*	Equity bullish, bond bearish
	Imports	m/m	Mar	2.0%	-9.0%	10.0%	*	Equity bullish, bond bearish
	Trade Balance	m/m	Mar	A$15269m	A$13870m	A$14151m	***	Equity and bond neutral
New Zealand	Building Permits	m/m	Mar	7.0%	-0.9%	-9.40	**	Equity bullish, bond bearish
	ANZ Commodity Price	m/m	Apr	-1.7	1.3		**	Equity bullish, bond bearish
China	Caixin Manufacturing PMI	m/m	Apr	49.5	50.0	50.0	***	Equity and bond neutral
EUROPE								
Eurozone	HCOB Eurozone Composite PMI	m/m	Apr F	54.1	54.4	54.4	*	Equity and bond neutral
	HCOB Eurozone Services PMI	m/m	Apr F	56.2	56.6	56.6	**	Equity and bond neutral
	PPI	y/y	Mar	5.9%	13.2%	13.3%	**	Equity bearish, bond bullish
Germany	HCOB France Composite PMI	m/m	Apr F	54.2	53.9	53.9	**	Equity bullish, bond bearish
	HCOB France Services PMI	m/m	Apr F	56.0	55.7	55.7	**	Equity bullish, bond bearish
France	HCOB France Composite PMI	m/m	Apr F	52.4	53.8	53.8	**	Equity bearish, bond bullish
	HCOB France Services PMI	m/m	Apr F	54.6	56.3	56.3	**	Equity bearish, bond bullish
Italy	HCOB Italy Composite PMI	m/m	Apr	55.3	55.2	55.5	***	Equity and bond neutral
	HCOB Italy Services PMI	y/y	Apr	57.6	55.7	56.5	***	Equity bullish, bond bearish
UK	New Car Registrations	y/y	Apr	11.6%	18.2%		*	Equity bearish, bond bullish
	Mortgage Approvals	m/m	Mar	52.0k	43.5k	44.1k	**	Equity bullish, bond bearish
	S&P Global/CIPS Services PMI	m/m	Apr F	55.9	54.9	54.9	**	Equity bullish, bond bearish
	S&P Global/CIPS Composite PMI	m/m	Apr F	54.9	53.9	53.9	**	Equity bullish, bond bearish
Russia	Retail Sales Real	m/m	Mar	-5.1%	-7.8%	-9.0%	**	Equity bullish, bond bearish
	Unemployment Rate	m/m	Mar	3.50%	3.50%	3.60%	***	Equity bullish, bond bearish
	S&P Global Services PMI	m/m	Apr	55.9	58.1	58.1	**	Equity bearish, bond bullish
	S&P Global Composite PMI	m/m	Apr	55.1	56.8	56.8	**	Equity bearish, bond bullish
AMERICAS								
Mexico	Gross Fixed Investment	y/y	Feb	12.7%	7.9%	9.1%	**	Equity bullish, bond bearish
	International Reserves Weekly	w/w	28-Apr	$203104m	$2206673m		*	Equity and bond neutral
	Unemployment Rate NSA	m/m	Mar	2.39%	2.72%	2.68%	***	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)	534	530	4	Up
3-mo T-bill yield (bps)	504	507	-3	Up
TED spread (bps)	29	23	6	Widening
U.S. Sibor/OIS spread (bps)	505	506	-1	Up
U.S. Libor/OIS spread (bps)	506	507	-1	Up
10-yr T-note (%)	3.35	3.34	0.01	Flat
Euribor/OIS spread (bps)	328	327	1	Up
Currencies	**Direction**			
Dollar	Down			Down
Euro	Down			Up
Yen	Up			Down
Pound	Flat			Up
Franc	Down			Up
Central Bank Action	**Current**	**Prior**	**Expected**	
FOMC Rate Decision (Upper Bound)	5.250%	5.000%	5.250%	On Forecast
FOMC Rate Decision (Lower Bound)	5.000%	4.750%	5.000%	On Forecast
ECB Main Refinancing Rate	3.750%	3.500%	3.750%	On Forecast
ECB Marginal Lending Facility	4.000%	3.750%	4.000%	On Forecast
ECB Deposit Facility Rate	3.250%	3.000%	3.250%	On Forecast
Brazil Selic Rate	13.750%	13.750%	13.750%	On Forecast

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.

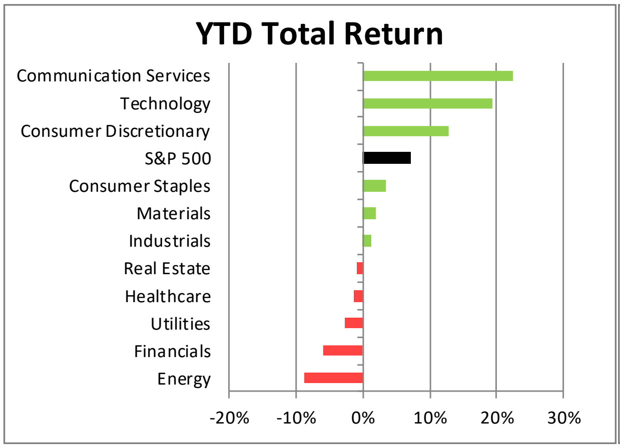
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$72.44	$72.33	0.15%	
WTI	$68.47	$68.60	-0.19%	
Natural Gas	$2.17	$2.17	0.05%	
Crack Spread	$27.63	$27.57	0.21%	
12-mo strip crack	$23.29	$23.05	1.04%	
Ethanol rack	$2.56	$2.55	0.14%	
Metals				
Gold	$2,043.19	$2,038.97	0.21%	
Silver	$25.66	$25.58	0.31%	
Copper contract	$387.55	$384.50	0.79%	
Grains				
Corn contract	$585.50	$588.50	-0.51%	
Wheat contract	$635.25	$639.75	-0.70%	
Soybeans contract	$1,413.00	$1,417.50	-0.32%	
Shipping				
Baltic Dry Freight	1,558	1,552	6	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-1.3	-0.5	-0.8	
Gasoline (mb)	1.7	-1.5	3.2	
Distillates (mb)	-1.2	-0.8	-0.4	
Refinery run rates (%)	-0.6%	0.55%	-1.2%	
Natural gas (bcf)		52		

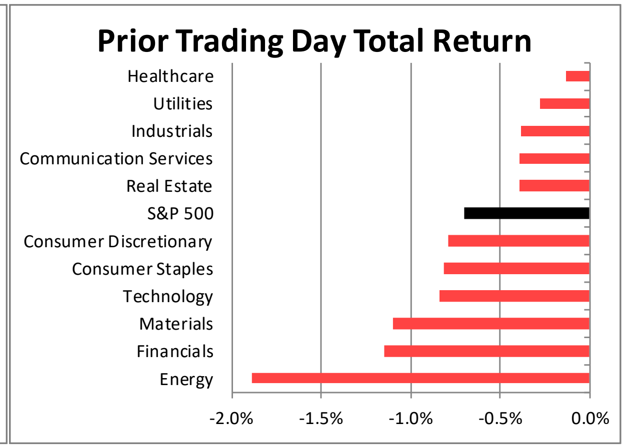
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures from the Great Plains eastward, with cooler-than-normal temperatures along the West Coast and in the Southwest. The forecasts are calling for wetter-than-normal conditions in the northern Rocky Mountain region, Texas, and the Southeast, with dry conditions expected in the Far West and Midwest.

Data Section

U.S. Equity Markets – (as of 5/3/2023 close)

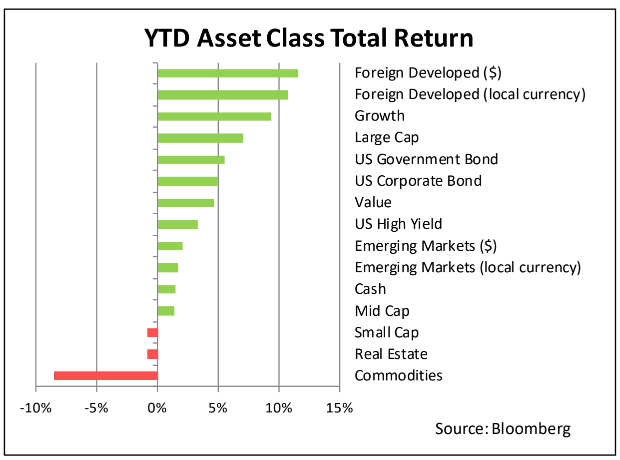




(Source: Bloomberg)

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 5/3/2023 close)

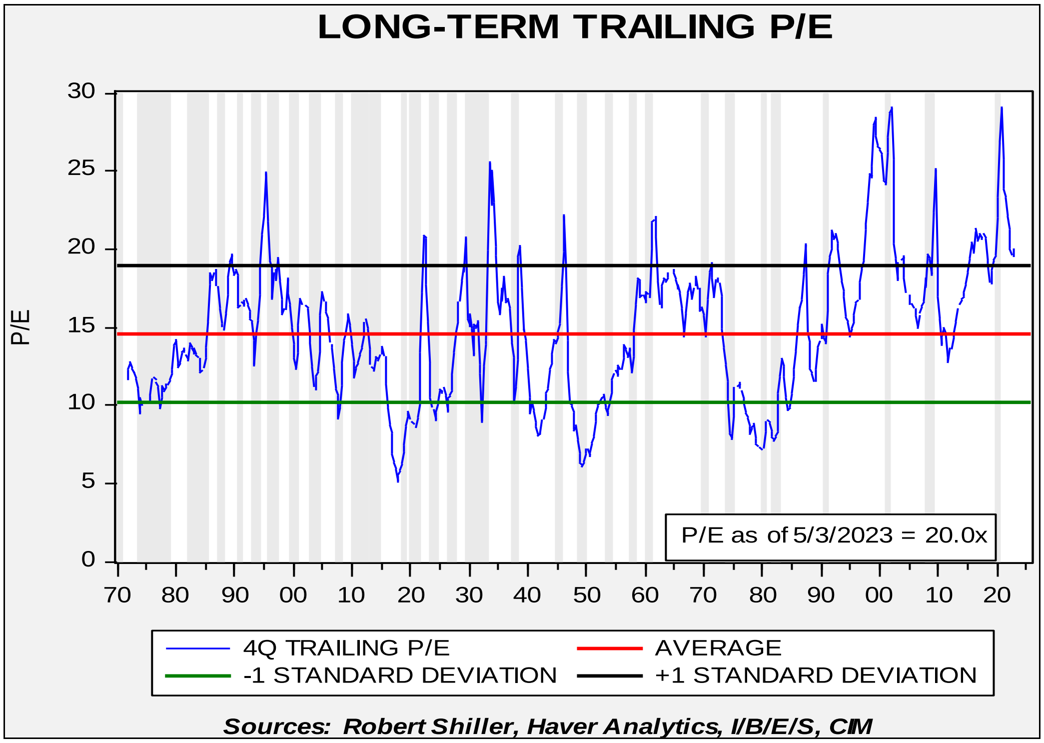


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

May 4, 2023



Based on our methodology,[3] the current P/E is 20.0x, unchanged from last week.

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[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 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.