

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 8, 2023—9:30 AM EDT] Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 is currently up 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.7%. Chinese markets were higher, with the Shanghai Composite up 1.8% from its previous close and the Shenzhen Composite up 0.4%. U.S. equity index futures are signaling a higher open.

With 427 companies having reported so far, S&P 500 earnings for Q1 are running at \$53.00 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, 78.7% have exceeded expectations while 17.6% 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](#) (5/8/2023) (with associated [podcast](#)): **“Why We Are Keeping Duration Short”**
- [Confluence of Ideas podcast](#) (3/8/2023): “Reflections on Inflation”

Our *Comment* today opens with more signs that major countries and companies are shoring up their alliances and operations to counter China’s increasing geopolitical aggressiveness. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including new data suggesting the German economy may finally be

slipping into recession and the latest on the U.S. political standoff over the federal government's debt limit.

Japan-South Korea: Japanese Prime Minister Kishida yesterday [visited Seoul for a summit with South Korean President Yoon, marking the first visit by a Japanese leader in 12 years](#). The meeting, which led to several bilateral agreements, illustrates the two countries' rapid rapprochement as they both begin to focus on the growing geopolitical threat from China.

- The recent rapprochement comes after more than three years of estrangement over Japan's behavior in Korea before and during World War II.
 - Illustrating just how far Japan was willing to go to solidify its relationship with Seoul, Kishida expressed his "unwavering" commitment to the 1998 joint declaration that expressed Japan's "deep remorse and heartfelt apology" for its wartime aggressions.
 - According to Kishida, "My heart aches as many people went through very difficult and sad experiences in the harsh environment at that time."
- Kishida's remarks could give Yoon space to maneuver amid domestic political opposition to a closer relationship with Japan without a fresh apology.

China-Singapore: FedEx (FDX, \$229.30) [confirmed it will move its regional headquarters for Asia Pacific, the Middle East, and Africa from Hong Kong to Singapore](#), including about 15% of office jobs. The firm insisted the move simply aims to connect the regional headquarters and its operational units "with greater speed and agility," but we suspect it really aims to protect FedEx workers from the draconian security law that China imposed on Hong Kong in 2019. If so, the move is another example of global fracturing and the way U.S. firms are "friend-shoring" investment into the U.S.-led bloc and away from the China-led bloc.

Russia-Ukraine War: Ukraine has still not launched its much-anticipated counteroffensive against the Kremlin's invasion forces, but it continues to stage drone attacks against Russian logistics facilities behind the front lines in an apparent effort to soften up Russian forces. Meanwhile, the Russian forces today [launched what local officials said was the biggest wave of drone and missile strikes against Kyiv since the war started](#). The Russian attacks came as Yevgeny Prigozhin, the leader of Russia's Wagner Group of mercenaries, [backtracked on threats to withdraw his forces from the embattled city of Bakhmut because of insufficient ammunition and supplies](#) from the Russian Ministry of Defense. Reports suggest Prigozhin may have been assuaged after former invasion commander Gen. Sergei Surovikin was named as liaison between the Defense Ministry and the Wagner forces.

- Separately, the Kremlin [has hiked taxes on Russian oil producers](#) to help make up for the loss of revenue due to Western sanctions on the country's energy exports. Analysts expect the move to further crimp the producers' ability to invest in future production.
- The European Union [has proposed sanctions on Chinese companies supporting the Russian military for the first time since the Ukraine war began](#). The move is likely to further heighten tensions between Brussels and Beijing, hastening the EU's economic decoupling from China.

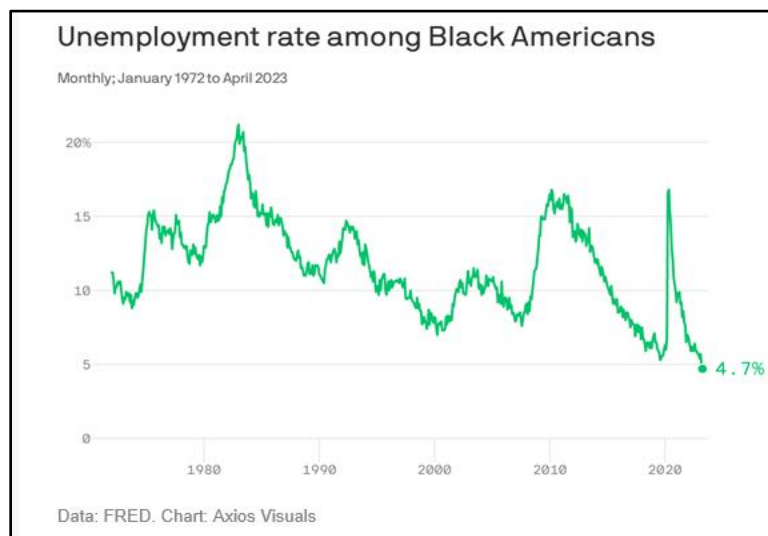
Arab League-Syria: In an emergency session in Cairo, national leaders of the Arab League [decided to readmit Syria after more than a decade of isolation](#) over its brutal tactics in its civil war. The move is being seen as a sign of waning U.S. influence in the Middle East as it will complicate U.S. efforts to isolate Syrian President Bashar al-Assad.

Germany: March industrial production [fell by a seasonally adjusted 3.4%](#), much worse than expected and enough to mark its biggest monthly drop in a year. Along with other recent data showing March declines in factory orders, retail sales, and exports, the data suggests that Germany, the EU's biggest economy, may have slipped into recession in the first quarter.

U.S. Fiscal Policy: Treasury Secretary Yellen yesterday [warned that if Congress refuses to pass an increase in the federal debt limit by June 1, the administration would consider invoking the Constitution's 14th Amendment](#) to continue paying the government's bills, including its debt service. However, Yellen called the potential move a "not good option" that would likely cause a constitutional crisis as scholars dispute whether the amendment could be used in such a way.

- Separately, President Biden and members of his administration [plan to meet tomorrow](#) with House Speaker McCarthy and other congressional leaders to discuss a way out of the impasse.
- We continue to believe that brinksmanship surrounding the debt ceiling could prompt elevated volatility in the financial markets as we approach the June 1 deadline by which Yellen has warned that the government could no longer pay its bills.

U.S. Labor Market: The monthly labor report, released on Friday, showed the unemployment rate for Black Americans [fell to a record-low of just 4.7% in April](#). In tight labor markets, workers who have historically been underemployed are typically drawn into jobs over time. The longer those workers remain in their jobs, the greater the chance they will build valuable skills, become more productive, and be better able to ease the growing shortage of labor in the economy.



U.S. Manufacturing Sector: Organizers said this year's SelectUSA summit in Washington, where state and local governments woo foreign investors, [had record attendance](#). Reports say the

hundreds of billions of dollars in federal subsidies for new manufacturing facilities in last year's Inflation Reduction Act and CHIPS Act have sparked a massive competition by state and local governments to draw in foreign investors.

U.S. Economic Releases

There were no economic releases prior to the publication of this report. 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
10:00	Wholesale Inventories	m/m	Mar F	0.1%	0.1%	***
10:00	Wholesale Trade Sales	m/m	Mar	0.4%	0.4%	**
Federal Reserve						
EST	Speaker or Event	District or Position				
14:00	U.S. Federal Reserve Releases Senior Loan Officer Opinion Survey	Federal Reserve Board				
14:00	U.S. Federal Reserve Releases May 2023 Financial Stability Report	Federal Reserve Board				
16:45	Neel Kashkari Moderates Panel Discussion on Minimum Wages	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	Jibun bank Composite PMI	m/m	Apr P	52.9	52.5	--	*	Equity and bond neutral
	Jibun Bank Services PMI	m/m	Apr P	55.4	54.9	--	**	Equity and bond neutral
Australia	NAB Business Confidence	m/m	Apr	0.0%	-1	--	**	Equity and bond neutral
	NAB Business Conditions	m/m	Apr	14	16	--	**	Equity bearish, bond bullish
	Building Approvals	m/m	Mar	-0.1%	4.0%	3.9%	***	Equity bearish, bond bullish
China	Foreign Reserves	m/m	Apr	\$3204.80	\$3183.87b	\$3193.80b	**	Equity and bond neutral
EUROPE								
Germany	Industrial Production WDA	y/y	Mar	1.8%	0.6%	0.7%	**	Equity bullish, bond bearish
Switzerland	Domestic Sight Deposits CHF	w/w	5-May	505.7b	506.5b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	5-May	525.6b	523.9b		*	Equity and bond neutral
Russia	Gold and Forex Reserves	m/m	28-Apr		\$598.9b		***	Equity and bond neutral
AMERICAS								
Canada	Net Change in Employment	m/m	Apr	20.0k	34.7k	20.0k	***	Equity and bond neutral
	Unemployment Rate	m/m	Apr	5.0%	5.0%	5.1%	***	Equity and bond neutral
	Participation Rate	m/m	Apr	65.6%	65.6%		*	Equity and bond neutral
Brazil	FGV Inflation IGP-DI	y/y	Apr	-2.57%	-1.16%	-2.61%	**	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	532	2	Up
3-mo T-bill yield (bps)	509	509	0	Up
TED spread (bps)	25	24	1	Tightening
U.S. Sibor/OIS spread (bps)	509	507	2	Up
U.S. Libor/OIS spread (bps)	510	508	2	Up
10-yr T-note (%)	3.49	3.44	0.05	Flat
Euribor/OIS spread (bps)	328	328	0	Up
Currencies	Direction			
Dollar	Flat			Down
Euro	Up			Up
Yen	Down			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.

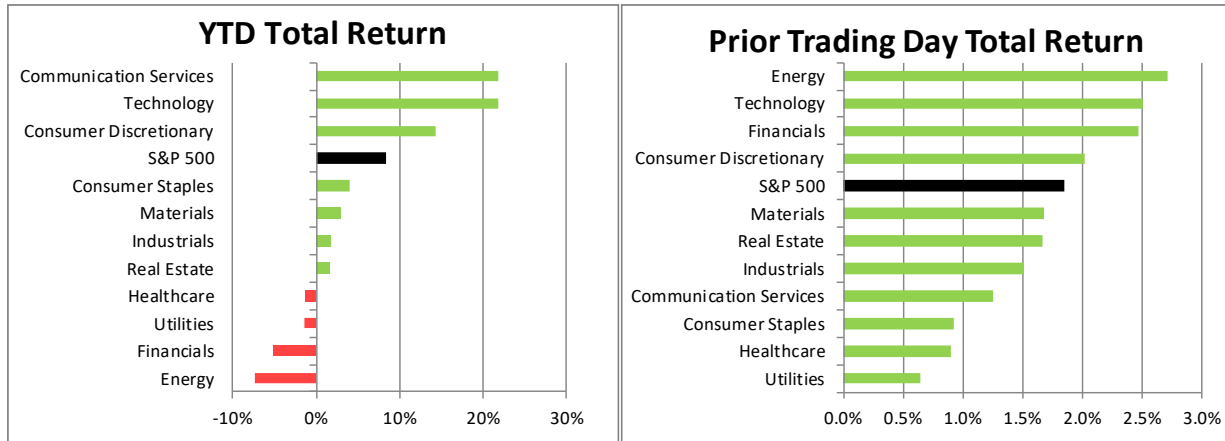
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$77.18	\$75.30	2.50%	Recession Fears Fade
WTI	\$73.36	\$71.34	2.83%	Recession Fears Fade
Natural Gas	\$2.20	\$2.14	2.90%	
Crack Spread	\$27.62	\$27.96	-1.21%	
12-mo strip crack	\$23.66	\$23.77	-0.44%	
Ethanol rack	\$2.55	\$2.55	0.13%	
Metals				
Gold	\$2,022.83	\$2,016.79	0.30%	
Silver	\$25.60	\$25.67	-0.24%	
Copper contract	\$394.30	\$388.30	1.55%	
Grains				
Corn contract	\$599.25	\$596.50	0.46%	
Wheat contract	\$666.75	\$660.25	0.98%	
Soybeans contract	\$1,444.50	\$1,436.50	0.56%	
Shipping				
Baltic Dry Freight	1,558	1,545	13	

Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures for most of the country, with cooler-than-normal temperatures in the Southwest. Additionally, the precipitation outlook is calling for wetter-than-normal conditions throughout the South and Mid-Atlantic region, with dry conditions expected in the Northern Rocky Mountain region.

Data Section

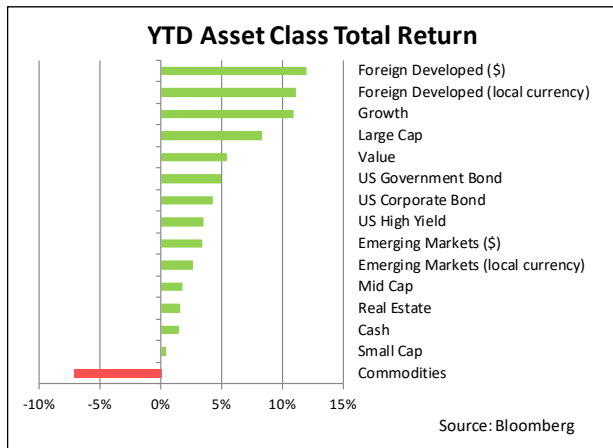
U.S. Equity Markets – (as of 5/5/2023 close)



(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 5/5/2023 close)

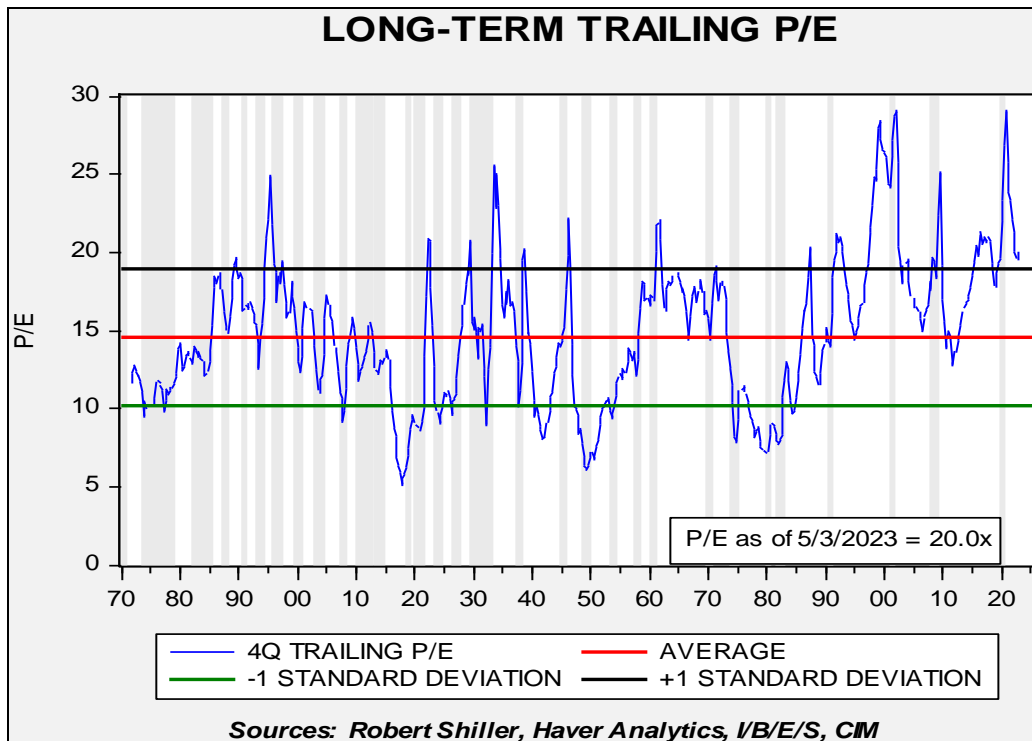


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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,¹ the current P/E is 20.0x, unchanged from last week.

This report was prepared by Confluence Investment Management LLC and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward-looking statements expressed are subject to change. This is not a solicitation or an offer to buy or sell any security.

¹ This chart offers a running snapshot of the S&P 500 P/E in a long-term historical context. We are using a specific measurement process, similar to *Value Line*, which combines earnings estimates and actual data. We use an adjusted operating earnings number going back to 1870 (we adjust as-reported earnings to operating earnings through a regression process until 1988), and actual operating earnings after 1988. For the current quarter, we use the I/B/E/S estimates which are updated regularly throughout the quarter; currently, the four-quarter earnings sum includes two actual quarters (Q3 and Q4) and two estimates (Q1 and Q2). We take the S&P average for the quarter and divide by the rolling four-quarter sum of earnings to calculate the P/E. This methodology isn't perfect (it will tend to inflate the P/E on a trailing basis and deflate it on a forward basis), but it will also smooth the data and avoid P/E volatility caused by unusual market activity (through the average price process). Why this process? Given the constraints of the long-term data series, this is the best way to create a long-term dataset for P/E ratios.