

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 12, 2022—9:30 AM EDT] Global equity markets are mostly lower this morning. In Europe, the EuroStoxx 50 index is currently down 2.2% from its prior close. In Asia, the MSCI Asia Apex 50 index closed down 2.7%. Chinese markets were flattish, with the Shanghai Composite down 0.1% and the Shenzhen Composite up 0.2%. U.S. equity index futures are signaling a lower open. With 453 companies having reported, the S&P 500 Q1 2022 earnings stand at \$54.40, lower than the \$54.70 forecast for the quarter. The forecast reflects a 4.7% increase from Q1 2021 earnings. Thus far this quarter, 77.5% of the companies have reported earnings above forecast, while 19.0% have reported earnings below forecast.

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](#) (5/9/2022) (with associated [podcast](#)): “Parsing the World’s New Geopolitical Blocs”
- [Weekly Energy Update](#) (5/11/2022): **U.S. commercial crude oil inventories jump in the wake of the highest SPR withdrawal in history.**
- [Asset Allocation Quarterly - Q2 2022](#) (4/21/2022): Discussion of our asset allocation process, Q2 2022 portfolio changes, and our outlook for the markets
- [Asset Allocation Bi-Weekly](#) (5/2/2022) (with associated [podcast](#)): “The Tale of Two Surveys”
- [Confluence of Ideas podcast](#) (3/25/2022): “The 2022 Outlook: Update #1”
- *Current Perspectives*: “[2022 Outlook: Update #1](#)” (2/18/2022)

Good morning! Today, we begin with a discussion about yesterday’s CPI report. Next is an update on the Ukraine war. We then cover economic and policy news, focusing on cryptocurrencies. Last, we go over some international news and our coronavirus coverage.

Inflation worries

Wednesday’s disappointing CPI report led to a selloff in risk assets. Investors are concerned that the Fed will become more hawkish as it tries to contain inflation. CPI rose 8.3% from the prior year, slower than the previous month’s report of 8.5%, but above expectations of 8.1%. The rise in CPI was driven primarily by increased energy, food, and shelter prices. The elevated reading suggests that the possibility that inflation will fall by itself is fading. More worrisome is that

many of the categories are rising due to supply shortages, and the Fed's only way to address the issue is by bringing down demand. That being said, we believe conditions still favor commodities, as production constraints will continue to support higher prices. The sharp rise in commodity prices and the selloff in tech equities led Saudi Aramco(SAR, \$44.70) to overtake Apple (AAPL, \$147.50) as the world's most valuable company.

- Food prices will likely remain elevated throughout the year. The [WADE report is expected to show reduced farm production](#) resulting from drought and the Russian invasion leading to crop shortages.

Russian-Ukraine news

The Kremlin announced its intentions [to annex a southern part of Kherson](#). This statement is the first sign that Russia intends to occupy regions within Ukraine, a claim denied before invading Ukraine. Following the report, top U.S. defense officials reassured the Senate that it does not believe the conflict will spread beyond Ukraine. U.S. Defense Secretary Lloyd Austin stated Russian President Vladimir Putin [does not want a direct war with NATO](#). However, the officials maintained that the U.S. is [prepared to respond in the event of an attack](#). The comments by defense officials are another sign of the West's growing confidence that this war will weaken Russia's capabilities.

- In a sign that the Russian invasion is impacting Europe, Deutsche Bank (DB, \$9.73) announced that [it might meet its cost target](#). The bank's chief stated that supply chain disruptions, currency volatility, and rising inflation might not hurt profitability.
- The EU is struggling to maintain a united front against Russia. [Hungary is still negotiating with Brussels](#) over a ban on Russian crude. Meanwhile, Italian President Mario Draghi has stated that European firms [will be able to pay for gas in rubles](#) and not violate sanctions. His statement runs afoul of European Union guidance to the contrary. Tensions over dealing with Russian energy continue to be an issue for European countries.
- Russian forces have started [siphoning gas from a critical pipeline in Europe running through Ukraine](#). The disruption of gas flows likely heightened the EU's energy insecurity.

U.S. economic news and policy

- The slide in crypto continued on Wednesday after the collapse of stablecoin TerraUSD roiled markets. Tether, the world's largest stablecoin, [broke its \\$1 peg, falling 5% below its target](#). In response to the decline, the CTO of Tether vowed to maintain its peg and is prepared to sell its government bonds. The loss of confidence in cryptocurrency also [pushed bitcoin below \\$25,000](#). Investors shifting away from risky assets triggered the selloff in crypto as speculation grows that the Fed will become more hawkish. The crisis in stablecoin has [grabbed the attention of regulators](#) who fear that digital assets are becoming integrated into the financial system. As the crisis in stablecoin persists, we suspect the crypto platforms will face greater scrutiny from regulators.
 - Shares in cryptocurrency exchange Coinbase sank after it released a disclosure suggesting [customers could be on the hook if it files for bankruptcy](#). However, the CEO has reassured users that the exchange is not at risk of default. The concerns

come after investors fled risky assets due to rising interest rates and deteriorating financial conditions.

- The Dallas Fed has named [New York Fed staffer Lorie Logan its next President](#). She will fill the seat vacated by Robert Kaplan, following concerns over his trading activity. Before accepting the position, Logan managed the Federal Reserve Bank of New York's massive holdings of securities and cash.
 - Wednesday, the Senate [confirmed economist Philip Jefferson](#) as a governor of the Federal Reserve Board; Jefferson will have a vote on Fed policy.
- The U.S. economic framework is [drawing interest from Indo-Pacific countries](#). Vietnam, Korea, Australia, Japan and New Zealand have all expressed interest in joining the pact. Although the state goal of the framework is to create more stable supply chains, we suspect it has more to do with U.S. aims of isolating China by building ties with its Indo-Pacific neighbors. The framework still lacks detail as the Biden administration is trying to create an agreement that likely won't require congressional approval.

International news

- After meeting with President Biden, Italian President Mario Draghi [proposed creating a cartel of oil consumers](#). The proposal would have countries come together to pressure oil suppliers to boost production, or consumers would make purchases elsewhere. Governments attempted this idea in 1973 after the Arab oil embargo; however, it was not successful. The most significant obstacle the cartel faces is getting everyone on board. The proposal suggests the West is growing weary of OPEC, which could lead to friction in the future.
- Premier Li Keqiang has [urged the government to implement additional stimulus](#) to preserve economic growth. The Chinese economy is slowing due to the reimposition of lockdowns and a property meltdown. To help stimulate growth, Beijing announced subsidies for renewable energy, delays to student debt payments, and promoted the use of REITS to boost infrastructure spending.
- The U.K. and EU continue to wrestle over the North Ireland Protocol. [Brussels threatened to retaliate](#) if London followed through on its threat to take unilateral action and scrap the clause. The two sides created the North Ireland Protocol to avoid imposing a hard border between Ireland and North Ireland following Brexit. The agreement allows goods traded from the U.K. to go through checks, sparking outrage in Northern Ireland among loyalists to the Crown, who fear possible reunification with Ireland. A rift between the EU and the U.K. over the protocol could potentially pave the way for a trade war.
- The Hong Kong crackdown is still underway following the election of Hong Kong leader Johnny Lee. National security forces [locked up Cardinal Joseph Zen](#) on charges of working with "foreign forces." The arrest concerned his involvement in a relief fund designed to provide bail and legal aid to pro-democracy protesters.

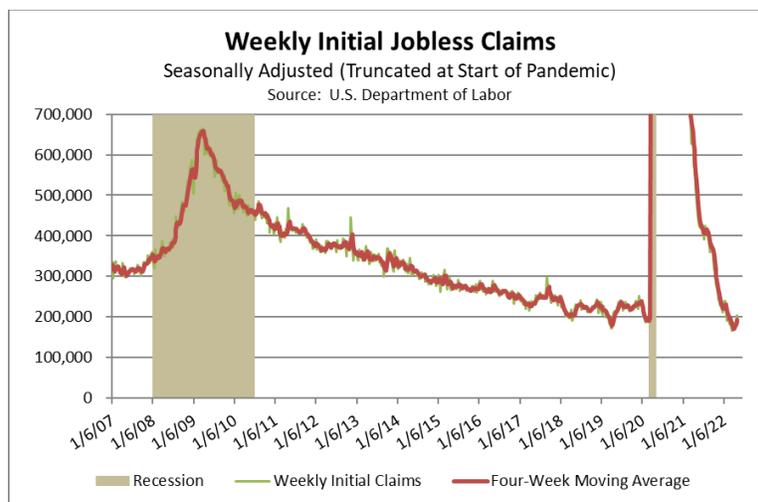
COVID-19: The [number of reported cases](#) is 519,304,197, with 6,257,653 fatalities. In the U.S., there are 82,227,294 confirmed cases with 998,739 deaths. For illustration purposes, the *FT* has created an [interactive chart](#) that allows one to compare cases across nations using similar scaling metrics. The [CDC reports](#) 733,497,155 doses of the vaccine have been distributed, with 580,038,981 doses injected. The number receiving at least one dose is 258,284,015, the number

of second doses is 220,287,778, and the number of the third dose is 101,451,546. The *FT* has a page on [global vaccine distribution](#).

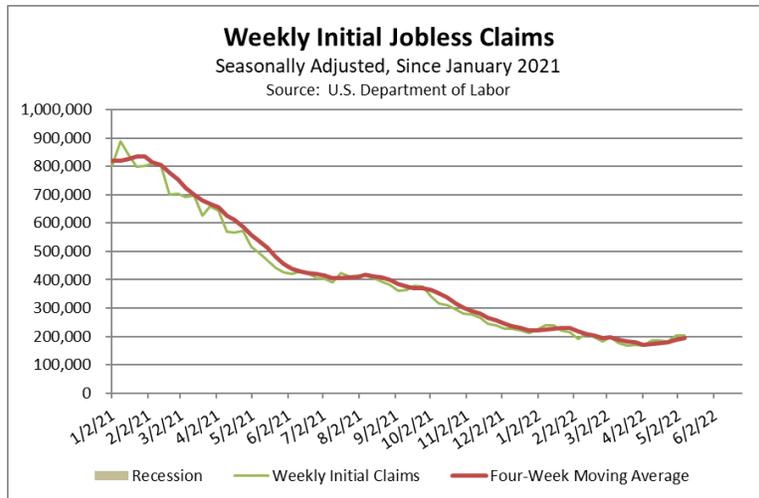
- Kim Jung Un ordered [a lockdown in North Korea](#) following the country's first reported case of COVID-19. Although the government has been rumored by experts from several countries to have COVID-19 cases, its recent announcement suggests the spread has gotten out of control. North Korea does not have access to a vaccine, and there are concerns that the country could become an epicenter of a new variant.
- A study showed that more [than half of all early COVID-19 patients](#) still show symptoms. The research suggests we are still learning about the side effects of COVID-19.

U.S. Economic Releases

Initial applications for unemployment benefits in the week ended May 7 rose to a seasonally adjusted 203K, versus the previous week's revised level of 202K and the expected level of 193K. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, rose to 192.75K, its highest level since early March. Initial jobless claims remain historically very low, but their modest uptrend in recent weeks suggests the labor market could be starting to weaken a bit in response to factors like high energy prices, rising interest rates, the pandemic-driven slowdown in China's economy, and the blow to confidence from the war in Ukraine. In contrast, the number of people continuing to draw benefits in the week ended April 30 declined to 1.343M, far better than both the previous week's revised tally of 1.387M and the anticipated level of 1.372M. 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 start of 2021.



Separately, the April Producer Price Index (PPI) rose by a seasonally adjusted 0.5%, matching expectations and marking a big slowdown from the revised rise of 1.6% in March. Excluding the volatile food and energy components, the April “core” PPI rose just 0.4%, much better than both its expected increase of 0.7% and its revised rise of 1.2% in the previous month. Because of the slowdown in price hikes during April, annual inflation at the producer level cooled a bit. The overall PPI in April was up 11.0% from the same month one year earlier, compared with a rise of 11.5% in the year through March. The core PPI in April was up 8.8% on the year, after a rise of 9.6% in the year through March. The chart below shows the year-over-year change in the PPI and the core PPI over the last decade or so.



There are no more economic releases or Federal Reserve events scheduled for the rest of today.

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	BoP Current Account Balance	m/m	Mar	¥1555.9b	¥1648.3b	¥1737.5b	***	Equity bearish, bond bullish
	BoP Trade Balance	m/m	Mar	-¥166.1b	-¥176.8b	¥100.5b	**	Equity bearish, bond bullish
	Bankruptcies	y/y	Apr	1.9%	-6.5%		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	29-Apr	¥81.2b	¥595.1b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	29-Apr	-¥212.9b	-¥1508.0b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	29-Apr	¥404.6b	¥246.3b		*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	29-Apr	-¥823.1b	-¥1155.6b		*	Equity and bond neutral
New Zealand	REINZ House Sales	y/y	Apr	-35.2%	-33.5%		**	Equity bearish, bond bullish
	Food Prices	m/m	Apr	0.1%	0.7%		***	Equity bullish, bond bearish
	2-Year Inflation Expectations	q/q	2Q	3.29%	3.27%		**	Equity and bond neutral
India	Industrial Production	y/y	Mar	1.9%	1.5%	1.3%	***	Equity bullish, bond bearish
	CPI	y/y	Apr	7.8%	7.0%	7.4%	***	Equity bearish, bond bearish
EUROPE								
UK	GDP	y/y	1Q P	8.7%	6.6%	8.9%	***	Equity and bond neutral
	Industrial Production	y/y	Mar	0.7%	2.1%	0.6%	***	Equity and bond neutral
	Manufacturing Production	y/y	Mar	1.9%	3.5%	2.3%	**	Equity bearish, bond bullish
	Trade Balance	m/m	Mar	-£11.552b	-£9.261b	-£7.800b	**	Equity bearish, bond bullish
	Visible Trade Balance	m/m	Mar	-£23.897b	-£20.594b	-£18.450b	**	Equity bearish, bond bullish
	Switzerland	Producer & Import Prices	y/y	Apr	6.7%	6.1%		**
AMERICAS								
Mexico	Industrial Production	y/y	Mar	2.6%	2.5%	2.1%	***	Equity bullish, bond bearish
	Manufacturing Production	y/y	Mar	3.6%	6.9%	4.0%	*	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)	140	140	0	Up
3-mo T-bill yield (bps)	87	89	-2	Neutral
TED spread (bps)	53	51	2	Widening
U.S. Sibor/OIS spread (bps)	123	122	1	Up
U.S. Libor/OIS spread (bps)	128	127	1	Up
10-yr T-note (%)	2.82	2.92	-0.10	Up
Euribor/OIS spread (bps)	-41	-42	1	Neutral
Currencies	Direction			
Dollar	Up			Up
Euro	Down			Down
Yen	Up			Down
Pound	Down			Down
Franc	Down			Down

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.

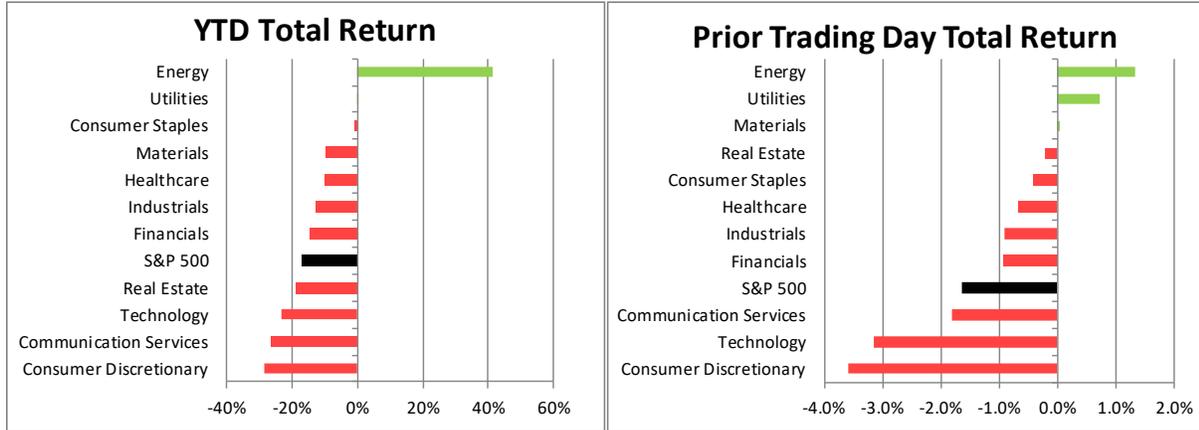
	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$105.64	\$107.51	-1.74%	
WTI	\$103.92	\$105.71	-1.69%	
Natural Gas	\$7.45	\$7.64	-2.43%	
Crack Spread	\$52.10	\$52.78	-1.28%	
12-mo strip crack	\$36.97	\$37.06	-0.25%	
Ethanol rack	\$2.92	\$2.91	0.20%	
Metals				
Gold	\$1,842.51	\$1,852.40	-0.53%	
Silver	\$20.90	\$21.57	-3.13%	
Copper contract	\$405.45	\$420.90	-3.67%	
Grains				
Corn contract	\$791.50	\$788.50	0.38%	
Wheat contract	\$1,107.75	\$1,113.00	-0.47%	
Soybeans contract	\$1,598.00	\$1,606.75	-0.54%	
Shipping				
Baltic Dry Freight	3,052	2,939	113	
DOE Inventory Report				
	Actual	Expected	Difference	
Crude (mb)	8.5	-1.0	9.4	
Gasoline (mb)	-3.6	-1.8	-1.8	
Distillates (mb)	-0.9	-1.2	0.2	
Refinery run rates (%)	1.6%	0.6%	1.1%	
Natural gas (bcf)		81.0		

Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures in the entire southern half of the country, with cooler-than-normal temperatures only in the Pacific Northwest. The forecasts call for wetter-than-normal conditions throughout the Northern Tier states and in the Mississippi Valley region, with dry conditions in the Southwest.

Data Section

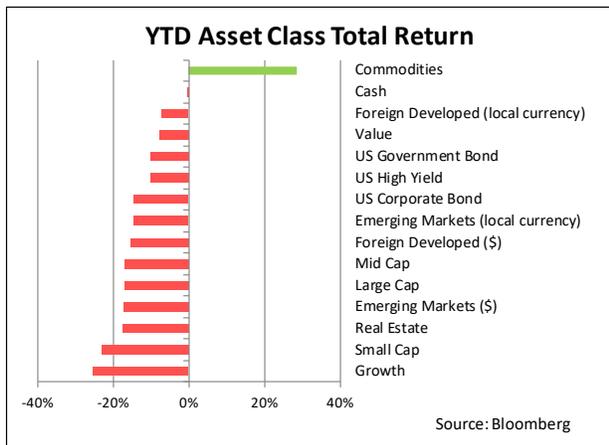
U.S. Equity Markets – (as of 5/11/2022 close)



(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 5/11/2022 close)

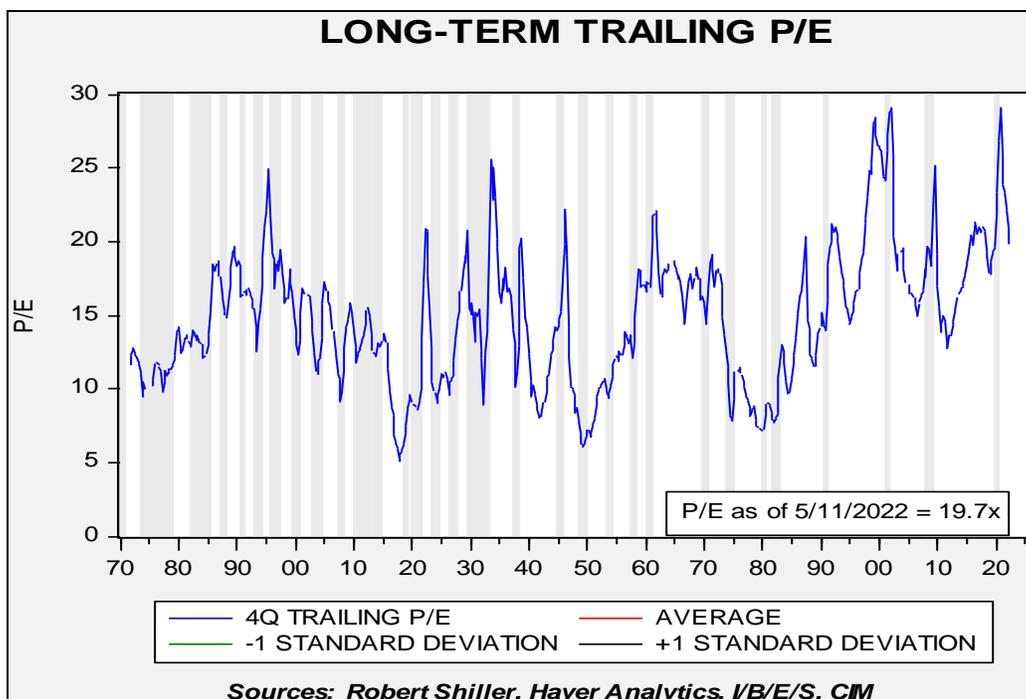


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 12, 2022



Based on our methodology,¹ the current P/E is 19.7x, down 0.3x from last week. Lower index values and higher earnings lowered the multiple.

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.