

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 17, 2021—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the EuroStoxx 50 is currently down 0.2% from its prior close. In Asia, the MSCI Asia Apex 50 closed up 0.2%. Chinese markets closed higher, with the Shanghai Composite up 1.8% from its prior close and the Shenzhen Composite also up 1.2%. U.S. equity index futures are signaling a lower open. With 457 companies having reported, the S&P 500 Q1 2021 earnings stand at \$48.40, higher than the \$37.94 forecast for the quarter. The forecast reflects a 23.3% increase from Q1 2020 earnings. Thus far this quarter, 86.8% of the companies have reported earnings above forecast, while 11.4% 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:

- [Weekly Geopolitical Report](#) (5/10/2021): The Geopolitics of Taiwan: Part II
- [Weekly Energy Update](#) (5/13/2021)
- [Asset Allocation Weekly](#) (with associated [podcast](#) and [chart book](#)) (5/14/2021)
- [Confluence of Ideas podcast](#) (4/30/2021): “The U.S.-China Balance of Power: Part II”

Good morning and happy Monday! It's a [down day for equities this morning](#). Our coverage begins with a recap of the situation in Israel, a second look at the retail sales data, and the Atlanta FRB's GDPNow forecast. Our update on economics and policy is up next, followed by China news. The international roundup is next in line, and we close with the pandemic update.

Israel: Despite [international calls for a ceasefire](#), violence continued unabated over the weekend. For now, [Israel says it will continue operations](#) against Hamas in Gaza. The IDF is conducting airstrikes against Hamas infrastructure, targeting its office facilities and [tunnels](#) that allow Hamas fighters to find shelter and conduct operations. [Hamas has been steadily launching missiles into Israel](#). An [office building used by the Associated Press](#) was hit by airstrikes over the weekend; [Israel claims it was also used by Hamas](#). The usual pattern is for international pressure to increase to the point where Israel calls off the offensive. It is likely that, expecting such pressure, [Israel is moving quickly to attack as much of Hamas's infrastructure](#) as it can [before operations end](#). [The U.N.S.C. met over the weekend to discuss this issue](#), but [no action was taken](#).

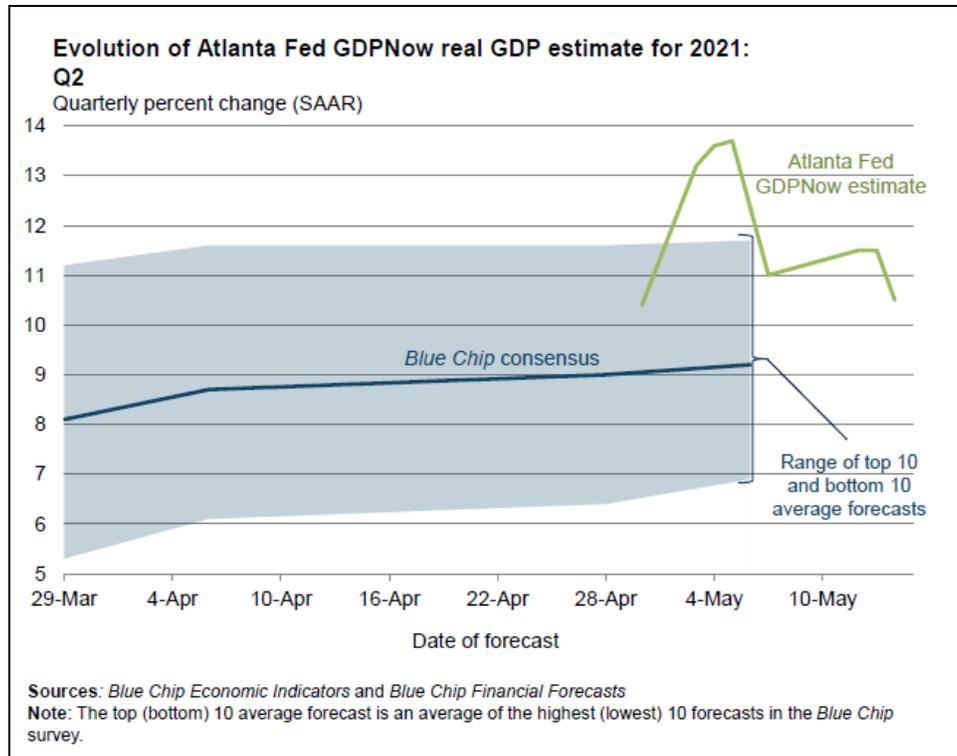
So far, this tragedy has not affected financial markets to any significant degree. Geopolitically, we note that outside nations are reluctant to get involved. The Arab states have been mostly

quiet. These nations have been normalizing relations with Israel and are not all that fond of Hamas. Its ties to the Muslim Brotherhood make Arab state leaders disinclined to help. Iran has become perhaps the most notable foreign ally, but its ability to assist has limits. Turkey has made negative comments towards Israel, but we doubt Ankara's actions will go beyond jawboning. The difference this time is that foreign nations are bringing less pressure to bear on Israel, meaning that the current conflict may drag on longer than normal.

About that retail sales data: For the inflation data, we used a two-year change to avoid the base effect impact on CPI. We did the same thing with regard to the retail sales data, which was flat relative to March. The longer-term look shows that retail activity is robust.



The latest data has the Atlanta FRB's GDPNow forecast running at 10.5%.



(Source: Atlanta FRB)

Individual data releases have shown wide dispersion recently, but the GDPNow calculation reveals that the economy is doing quite well. Reading too much into individual data releases is probably ill-advised.

Economics and policy: Semiconductor issues will persist, and the fog of data may reduce the likelihood that the president’s tax and spending policies will be enacted.

- Industry analysts warn that the semiconductor chip shortage [could last until 2023](#).
- We have been surprised at the pace of policy coming from the administration, especially given the narrow margins the Democrats have in Congress. However, [it is starting to look like momentum is slowing](#). On taxes, there is a growing pushback against the current tax plans. As the Democratic Party increasingly represents big business, [its lobby is growing confident](#) that it can stem the drive for tax hikes. [Although “soaking the rich” is still popular among many Democrats](#), we tend to side with the business lobby. Meanwhile, the current “fog of data” is muddling the political message and [making it difficult for the administration to craft a plan forward](#).
- The [expanded childcare credit will be sending up to \\$300 per month to households with children starting July 15](#). What is significant about the new credit is that it will be distributed monthly and has the makings of a basic income grant to households with children.

- In the wake of the Colonial cyberattack, government authorities are taking a harder look at cryptocurrencies, which are often used in ransomware attacks. Binance Holdings¹, the world's largest crypto exchange, is [under investigation by the DOJ in a probe](#) of money laundering and tax violations. The [IRS is forcing crypto exchanges to provide customer information](#) for tax investigations.
- [California is bracing for an extended fire season](#) as drought and early hot weather create ideal conditions for wildfires.
- In the aftermath of the Great Financial Crisis, sawmills consolidated as lumber demand fell. As demand has soared due to strong housing demand, [the industry is not boosting investment to any significant degree](#), concerned about the cyclicity of the industry. This lack of capacity expansion will tend to keep lumber prices elevated. Meanwhile, [the administration is facing pressure to reduce tariffs](#) on Canadian lumber.
- [Retailers are undertaking extensive training of employees](#) to boost staff productivity.
- Former ECB economists warn that current policy [may put the central bank in a debt trap](#). If the ECB raises rates, its large holdings of sovereign debt will put its balance sheet at risk.

China: The administration is taking a longer look at Chinese disinvestment policy.

- [The Pentagon has delayed a report to Congress](#) detailing Chinese companies with ties to the People's Liberation Army. The report, mandated by an executive order from the Trump administration, banned Americans from investing in Chinese companies with military ties. The deadline for implementing the rule is May 27, but the U.S. military says it won't have the report ready until fall. It appears the Biden administration is inclined to keep the rule but will likely adjust it.
- A Chinese agricultural consultancy [mysteriously suspended operations](#) on April 29, and the company's offices were sealed by security forces. The company, Cofeed, provided price data and analysis of grain and oilseed prices. There is speculation that the CPC wants to keep the information secret, and thus, closed the firm and may have arrested the principals.
- One of the inconsistencies of administration policy is that it wants to reshore investment and jobs to the U.S. while building a coalition to contain China. During the Cold War, an element of coalition-building allowed potential partners access to U.S. consumers. In other words, the U.S. tolerated trade deficits and the loss of jobs to trade for foreign policy purposes. That policy has come under fire in recent years. The Obama administration was unable to move the Trans-Pacific Partnership (TPP) through Congress, and in the 2016 presidential election, both major party candidates vowed to pull the U.S. from the trade pact. The remaining partners in the TPP went ahead without Washington and created the Comprehensive and Progressive Agreement for the Trans-Pacific Partnership (CPATPP). Interestingly enough, the Senate Finance Committee is [pressing the USTR Tai to engage in talks to potentially join the CPATPP](#). The support is based on the idea that the U.S. needs trade to build support for allies in Asia.

¹ The company is Chinese and has issued a coin that is \$603.60.

- [China's credit rating agencies have been rapidly downgrading Chinese corporate debt.](#) Foreign rating agencies have been critical of the domestic agencies, which have tended to give favorable grades to Chinese corporations. However, as Beijing cracks down on corporate defaults, the rating agencies are also moving in that direction.
- Although China's industrial sector continues to recover, [retail sales have been disappointing.](#) This divergence could lead to higher Chinese exports.

International roundup: Armenia and Azerbaijan are seeing tension rise, and Venezuela moves against the last independent newspaper.

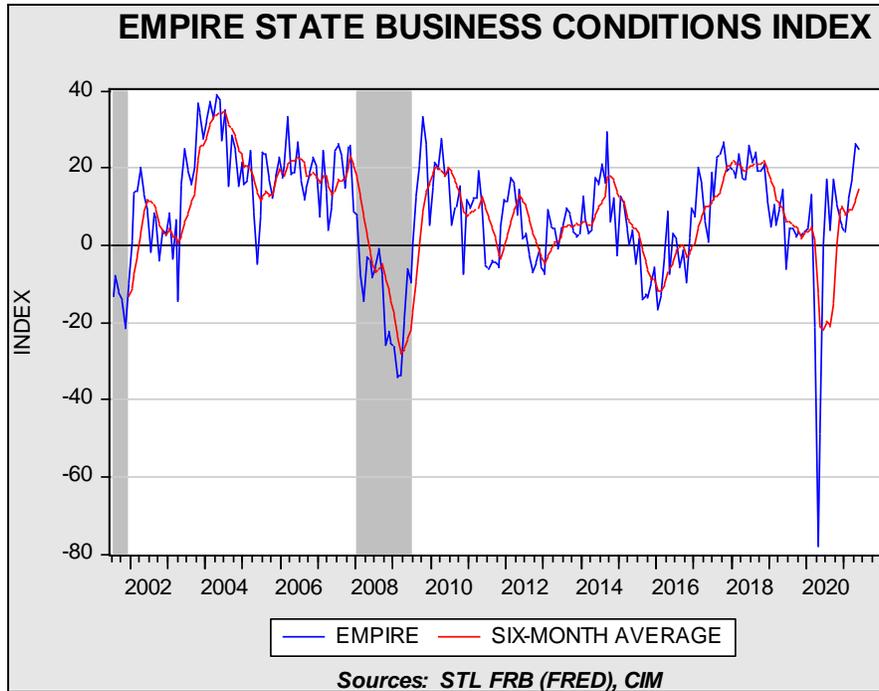
- [Armenia has accused Azerbaijan of violating its territory](#) by [moving Azerbaijani troops](#) into areas controlled by Armenia. [The two sides are in talks,](#) but tensions remain elevated. Armenia is [asking for support from Russia,](#) which has tried to mediate the dispute. Last year, Armenia and Azerbaijan had a war, which led to the latter gaining territory.
- The [Maduro government seized the headquarters of the last remaining independent newspaper.](#) Ostensibly, the action was to satisfy a court judgment against the paper, but Venezuela's authoritarian government has been steadily working to control the media for years. The paper *El Nacional* has been online since 2018 when the government, which controls the supply of newsprint, denied the paper supplies. Although it is hard to conceive of relations between the U.S. and Venezuela getting worse, this action certainly won't help.

COVID-19: The [number of reported cases](#) is 163,112,783 with 3,380,404 fatalities. In the U.S., there are 32,941,053 confirmed cases with 585,970 deaths. For illustration purposes, the *FT* has created an [interactive chart](#) that allows one to compare cases across nations using similar scaling metrics. The *FT* has also issued an [economic tracker](#) that looks across countries with high-frequency data on various factors. The [CDC reports](#) that 344,503,495 doses of the vaccine have been distributed with 273,545,207 doses injected. The number receiving at least one dose is 157,485,596, while the number of second doses, which would grant the highest level of immunity, is 123,282,685. The *FT* has a page on [global vaccine distribution.](#)

- Although U.S. cases are declining, the rest of the world is seeing infections rise.
 - Hong Kong just announced it will require a 21-day quarantine for all arrivals from Singapore; the latter has seen [a surge in cases](#) recently tied to its airport.
 - Japanese towns are [canceling plans to house Olympic athletes](#) due to infection fears. This development could adversely affect training for some teams, as the lack of housing near training facilities could pose a logistical problem.
 - Taiwan, which had [mostly managed the pandemic well,](#) is [implementing social distancing controls](#) in an effort to slow the rise in cases.
 - Cases of the Indian variant have been reported in the U.K., [threatening plans to relax restrictions.](#)
- A [letter signed by 18 scientists in the journal Science](#) argues the fact that COVID-19 escaped from a lab has not been disproven and indicated that further investigation is warranted. This development will likely anger Beijing.

U.S. Economic Releases

In May, manufacturing activity continues to expand at a stable pace in New York, according to the Federal Reserve Empire State Manufacturing Survey. The current general business conditions index came in at 24.3, slightly above expectations of 23.9.



The chart above shows the six-month moving average of the Empire State Business Conditions Index. The moving average rose from 11.75 to 14.75.

The table below lists the economic releases and Fed events scheduled for the rest of the day.

Economic Releases						
EDT	Indicator			Expected	Prior	Rating
10:00	NAHB Housing Market Index	m/m	May	83.0	83.0	**
16:00	Total Net TIC Flows	m/m	Mar	\$72.6b		**
16:00	Net Long-term TIC Flows	m/m	Mar	\$4.2b		**
Fed Speakers or Events						
EST	Speaker or event	District or position				
10:00	Robert Kaplan Takes Part in Moderated Q&A	President of the Federal Reserve Bank of Dallas				

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								
China	New Home Prices	m/m	Apr	0.5%	0.4%		**	Equity and bond neutral
	Fixed Assets Ex Rural YTD	y/y	Apr	19.9%	25.6%	20.0%	**	Equity and bond neutral
	Property Investment YTD	y/y	Apr	21.6%	25.6%	20.0%	**	Equity and bond neutral
	Surveyed Jobless Rate	m/m	Apr	5.1%	5.3%	5.2%	***	Equity and bond neutral
	Retail Sales	y/y	Apr	17.7%	34.2%	25.0%	***	Equity and bond neutral
Japan	Industrial Production	y/y	Apr	9.8%	14.1%	10.0%	***	Equity and bond neutral
	Loans & Discounts Corp	y/y	Mar	6.3%	7.5%		**	Equity and bond neutral
	PPI	y/y	Apr	3.6%	1.0%	3.1%	**	Equity and bond neutral
India	Machine Tool Orders	y/y	Apr	120.8%	65.1%		*	Equity bullish, bond bearish
	Wholesale Prices	y/y	Apr	10.5%	7.4%	9.4%	**	Equity bearish, bond bullish
New Zealand	Performance Services Index	m/m	Apr	61.2	52.4		**	Equity bullish, bond bearish
	Net Migration SA	m/m	Mar	825	674		**	Equity bullish, bond bearish
EUROPE								
Italy	CPI FOI Index Ex Tobacco	y/y	Apr	103.7	103.3		***	Equity and bond neutral
	CPI EU Harmonized	y/y	Apr	1.0%	1.0%	1.0%	***	Equity and bond neutral
Switzerland	Producer & Import Prices	m/m	Apr	0.7%	0.6%		**	Equity and bond neutral
	Domestic Sight Deposits CHF	w/w	14-May	631.1b	634.1b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	14-May	707.8b	705.0b		*	Equity and bond neutral
AMERICAS								
Canada	Manufacturing Sales	m/m	Mar	3.5%	-1.6%	3.3%	**	Equity and bond neutral
	Wholesale Trade Sales	y/y	Mar	2.8%	-0.7%	1.0%	*	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.

	Today	Prior	Change	Trend
3-mo Libor yield (bps)	16	16	0	Up
3-mo T-bill yield (bps)	0	1	-1	Neutral
TED spread (bps)	16	15	1	Up
U.S. Libor/OIS spread (bps)	8	7	1	Up
10-yr T-note (%)	1.63	1.63	0.00	Neutral
Euribor/OIS spread (bps)	-55	-54	-1	Neutral
EUR/USD 3-mo swap (bps)	0	0	0	Down
Currencies				
dollar	Flat			Down
euro	Flat			Up
yen	Down			Up
pound	Flat			Up
franc	Flat			Up
Central Bank Action				
PBOC 1-Yr Medium Term Lending Rate	2.950%	2.950%		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.

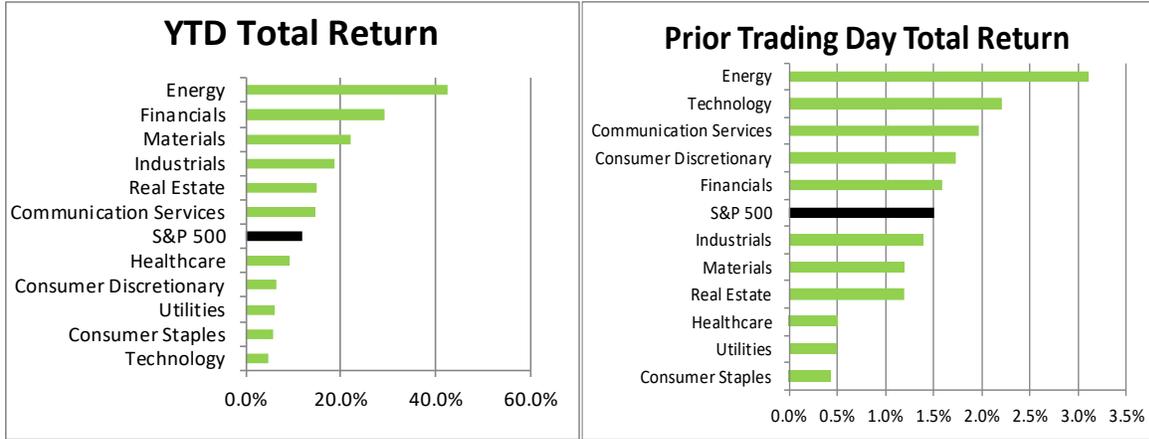
	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$68.82	\$68.71	0.16%	
WTI	\$65.50	\$65.37	0.20%	
Natural Gas	\$3.03	\$2.96	2.47%	
Crack Spread	\$22.90	\$22.67	1.03%	
12-mo strip crack	\$20.82	\$20.70	0.60%	
Ethanol rack	\$2.70	\$2.71	-0.34%	
Metals				
Gold	\$1,849.09	\$1,843.43	0.31%	
Silver	\$27.60	\$27.42	0.65%	
Copper contract	\$466.35	\$465.45	0.19%	
Grains				
Corn contract	\$639.25	\$643.75	-0.70%	
Wheat contract	\$693.75	\$707.25	-1.91%	
Soybeans contract	\$1,582.50	\$1,586.25	-0.24%	
Shipping				
Baltic Dry Freight	2939	3077	-138	

Weather

The 6-10 and 8-14 day forecasts currently call for warmer than normal temperatures, primarily in the upper Midwest, with cooler temperatures in the Pacific Northwest and Texas. The forecast calls for wet conditions along the Gulf Coast, with drier conditions expected in the Intermountain West and Northeast regions.

Data Section

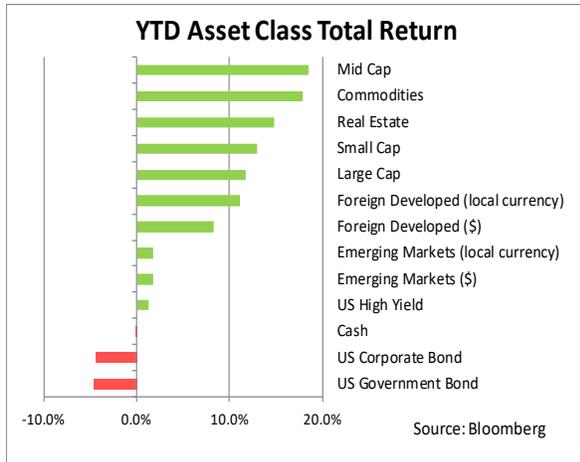
U.S. Equity Markets – (as of 5/14/2021 close)



(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 5/14/2021 close)

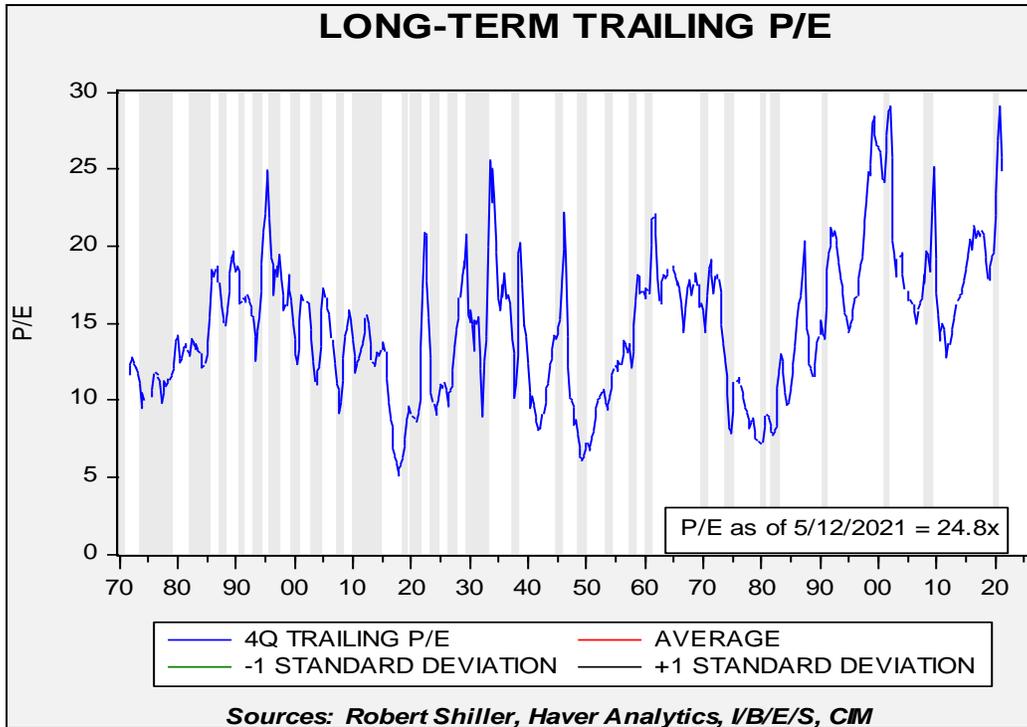


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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).

P/E Update

May 13, 2021



Based on our methodology,² the current P/E is 24.8x, down 0.3x from last week. Rising earnings led to the decline in 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.

² 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.