

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 28, 2021—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the EuroStoxx 50 is up 0.6% from its prior close. In Asia, the MSCI Asia Apex 50 closed up 0.5%. Chinese markets ended lower, with both the Shanghai Composite and the Shenzhen Composite down 0.2% from their prior closes. U.S. equity index futures are signaling a higher open. With 489 companies having reported, the S&P 500 Q1 2021 earnings stand at \$49.00, higher than the \$37.94 forecast for the quarter. The forecast reflects a 23.3% increase from Q1 2020 earnings. Thus far this quarter, 87.1% of the companies have reported earnings above forecast, while 11.3% 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:

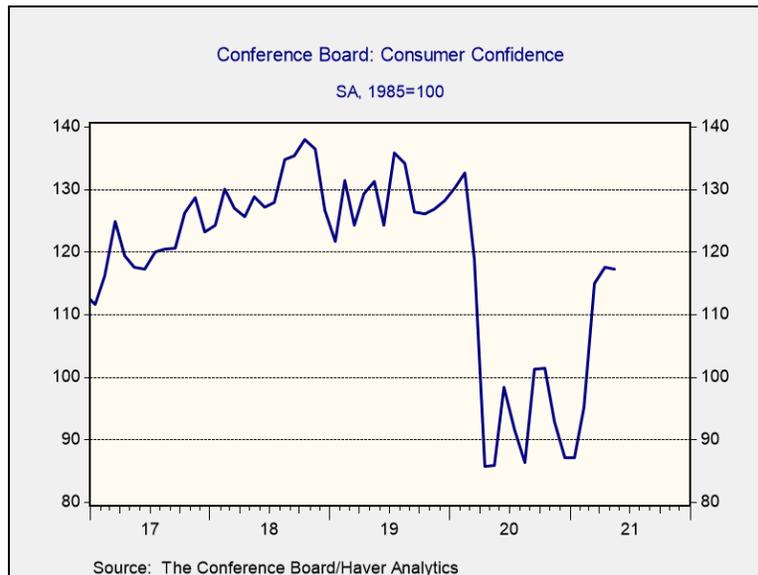
- [Weekly Geopolitical Report](#) (5/24/2021): Taiwan and the Risk of Deglobalizing the World's Semiconductor Industry: Part I
- [Weekly Energy Update](#) (5/27/2021): We look at the "greening" of the supermajors and the IEA report.
- [Asset Allocation Q2 2021 Rebalance Presentation](#) (5/20/2021): video discussion of our asset allocation process, portfolio changes in Q2, and the macro environment
- **[Asset Allocation Weekly](#) (with associated [podcast](#) and [chart book](#)) (5/28/2021)**: since last summer, there is an inverse correlation between bitcoin and gold prices.
- [Confluence of Ideas podcast](#) (4/30/2021): "The U.S.-China Balance of Power: Part II"

Good morning, all! U.S. equities are expected to open higher this morning as President Biden's new budget proposal caused a boost in investor optimism. Today's report starts off with a brief summary of the \$6 trillion proposal. International news follows, with an update on EU relations with Belarus following the recent plane incident and a crackdown on Big Tech by French authorities. Economics and policy news are up next, including reports of an automaker resuming production and the U.S. withdrawal from Afghanistan. China news follows, and we close with our pandemic coverage.

Biden's budget proposal: The Biden administration is [expected to unveil a budget proposal of \\$6 trillion](#) over the next decade. The proposal will likely include investments in infrastructure, childcare, and cybersecurity, and Biden plans to pay for this additional spending through taxes on corporations and high earners. This budget is expected to meet stiff opposition from Republican lawmakers who fear that the increase in fiscal spending could lead to a return to the

1970s era of stagflation. On the other hand, the administration believes the increase in spending will boost the economy's long-run health and predicts that the deficit will begin to narrow going into 2030.

The additional spending over the next decade should be supportive for equities. However, there are still concerns as to whether the increase in spending will translate into sustained economic growth. President Franklin D. Roosevelt, who President Biden is often compared to, was unable to avoid a downturn in 1938 despite the fiscal expansion. In our view, it is never wise to assume that all spending is good, and vice versa. That being said, we are optimistic that additional spending will likely provide a boost in consumer confidence after an unexpected decrease in the Conference Board Consumer Confidence Index in May.



International news: EU airlines forced to cancel flights to Moscow, French regulators agree to a settlement, and the BOJ to consider climate change.

- A few European airlines had [to cancel their flights heading to Moscow](#) after Russian aviation authorities failed to approve new routes that avoided Belarus's airspace. In response to a decision by Belarusian authorities to divert a Ryanair (RYAAY, \$150.42) flight, the EU had advised airlines to avoid the country's airspace.
- Alphabet Inc.'s (GOOG, \$2401.52) Google [is nearing a settlement with French regulators over accusations of anti-competitive behavior](#). The suit alleges that Google used its platform to advantage itself in auctioning ad space over its competitors. As part of the settlement, Google will pay a fine, admit no wrongdoing, and agree to change its platform to make it easier for other ad auctioneers to compete.
- [Syrian President Bashar Assad won a fourth term](#) in office in an election widely criticized by the West of not being free or fair. President Assad received over 95% of the vote.
- Canada is expected to [cut back its bond-buying program in July](#). This would be the second time this year the country dials back the program, the first time being in April. It also signaled that it may be willing to raise rates in July.

- Microsoft (MSFT, \$249.31) stated that the Russian hackers behind the SolarWinds (SWI, \$16.68) attack have [escalated their efforts to gather data from U.S. federal agencies, think tanks, and non-governmental organizations](#).
- Bank of Japan Governor Haruhiko Kuroda announced that the central bank will [consider climate change](#) in discussions about monetary policy.

Economics and policy: Republicans willing to add to the deficit, SOS Blinken warns of renewed conflict in Gaza, and the U.S. withdrawal ahead of schedule.

- Some Senate Republicans are willing [to add to the national debt if the infrastructure plan is scaled back](#) from \$1.7 trillion to \$1 trillion. President Biden is expected to make a decision by Memorial Day as to whether he will continue negotiating with Republicans or go it alone with Democrats.
- Secretary of State Tony Blinken warned that further evictions of Palestinians from East Jerusalem could [potentially “spark another round of violence.”](#)
- The China-focused global competition bill [advanced through the Senate](#) on Thursday. The bill has garnered bipartisan support, suggesting there is a good chance of it becoming law. If passed, the bill will provide \$52 billion to support domestic semiconductor manufacturing, \$16.9 billion to the Energy Department, and \$10 billion to NASA.
- The United States informed Russia that it [will not rejoin the Open Skies arms control pact](#).
- General Motors (GM, \$59.77) [has reopened two of its plants and added a second shift in a third plant](#). The moves indicate that the automaker may have found a way to source materials in spite of the semiconductor shortage.
- In his opening statement to the House Appropriations subcommittee, Defense Secretary Lloyd Austin stated that the [U.S. withdrawal from Afghanistan is slightly ahead of schedule](#). The process is believed to be between 16% and 25% complete.

China:

- Angered at renewed speculation that the coronavirus may have originated in a lab in Wuhan, China has resurfaced its claim that the [virus may have come from the U.S. military](#). In October 2019, Wuhan hosted the World Military Games which the U.S. participated in. China is suggesting that this event may have been the true source of the virus.
- China plans [to develop 12 of its top universities](#) to rival MIT and Stanford University in science and technology. The program will focus on teaching students artificial intelligence and data science.

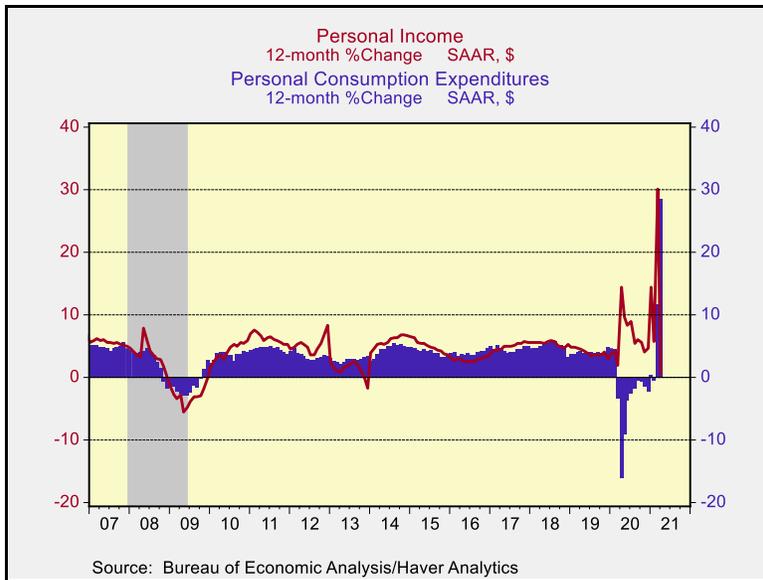
COVID-19: The [number of reported cases](#) is 168,520,476 with 3,501,002 fatalities. In the U.S., there are 33,192,974 confirmed cases with 592,432 deaths. For illustration purposes, the *FT* has created an [interactive chart](#) that allows one to compare cases across nations using similar scaling metrics. The *FT* has also issued an [economic tracker](#) that looks across countries with high-frequency data on various factors. The [CDC reports](#) that 359,849,035 doses of the vaccine have been distributed with 289,212,304 doses injected. The number receiving at least one dose is

165,074,907 while the number of second doses, which would grant the highest level of immunity, is 131,850,089. The *FT* has a page on [global vaccine distribution](#).

- Chile has announced that [it will need to borrow \\$10.8 billion](#) to help fund its response to the ongoing coronavirus outbreak. It plans to use money from copper prices to repay the debt.
- Germany is expected to open up [vaccinations to children 12 years and older](#) once the Pfizer (PFE, \$38.65)/BioNtech (BNTX, \$197.70) vaccine is approved by the European Medicines Agency.
- On Friday, the Food and Drug Administration is [expected to announce that the contamination problem in a COVID-19 vaccine plant](#) has been resolved. The plant is expected to resume production of vaccines for Johnson & Johnson (JNJ, \$168.81) and will now be cleared for use in both the U.S. and overseas. Prior to the agreement, vaccinations made in the Baltimore plant were slated to be shipped primarily to Europe.
- U.S. scientists will begin running [clinical trials that will test whether or not fully vaccinated people will be able to switch brands](#) when getting the COVID-19 booster shot. At this time, there is no timetable as to when people will need to receive their third/second dose (depending on brand) of the vaccine as scientists aren't sure when the antibodies will wear off.
- COVID-19 cases have dropped [dramatically on college campuses](#).
- According to a new study published by JAMAS Cardiology, some of the athletes from the Big Ten who [recovered from COVID-19 were later diagnosed with myocarditis](#), or inflammation of the heart. Exercising with the disease can increase the risk of cardiac arrest and sudden death.

U.S. Economic Releases

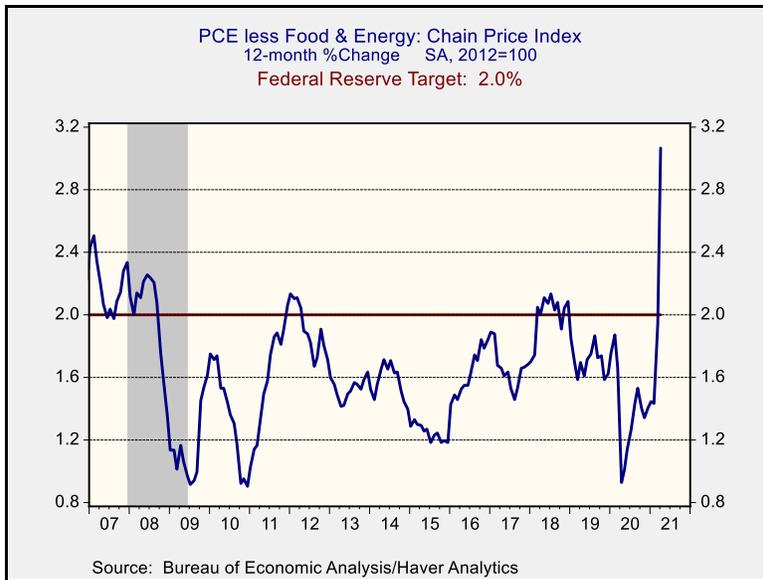
In today's key U.S. release, April personal income fell by a seasonally adjusted 13.1%. The decline was a bit better than the expected retrenchment of 14.2%, and it was still not enough to erase the revised 20.9% jump in March. Of course, the dramatic swings in this figure over the last year have been caused largely by the ebb and flow of federal pandemic support. The report also showed that April personal consumption expenditures (PCE) rose by a seasonally adjusted 0.5%, matching expectations but still a significant slowdown from the revised 4.7% increase in the previous month. Reflecting the first round of federal support that hit consumers' bank accounts last spring, the volume of personal income in April was only up 0.5% year-over-year, but the volume of PCE was up 28.5%. The chart below compares the annual changes in personal income and PCE since just before the previous recession.



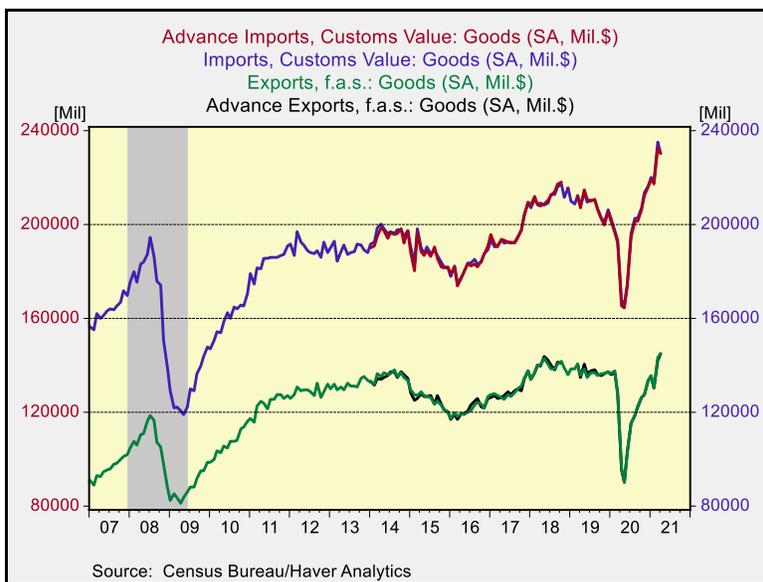
The personal savings rate, calculated as the difference between after-tax personal income and PCE, remained elevated at 14.9% in April. The continued high level of savings suggests that consumers retain a very large amount of excess cash that could be deployed to support spending later in the year. The chart below shows the progression of the personal savings rate since just before the prior recession.



Finally, the report included the Fed’s preferred gauge of inflation. Excluding the volatile food and energy components, the April “core” PCE deflator was up 3.1% from the same month one year earlier, beating both the expected year-over-year increase of 2.9% and the revised rise of 1.9% in the year to March. Importantly, consumer inflation by this measure is now well above the Fed’s target of 2.0%, although monetary policy officials continue to insist the above-target readings will only be transitory. The chart below shows the progression of core PCE inflation since just before the previous recession.



The only other major release this morning was the advance report on international trade in physical merchandise. According to the report, the April merchandise trade balance showed a seasonally adjusted deficit of \$85.2 billion. As big as that was, it was better than the expectation that the deficit would match the \$92.0 billion registered in March. The narrower deficit in April reflected a month-over-month rise in exports coupled with a monthly pullback in imports. Compared with April 2020, exports were up 51.0%, while imports were up 37.9%. The chart below shows the progression of U.S. exports and imports since just prior to the previous recession.



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

Economic Releases							
EDT	Indicator			Expected	Prior	Rating	
9:45	Chicago PMI	m/m	May	68.0	72.1	***	
10:00	U. of Michigan Consumer Sentiment	m/m	May F	83.0	82.8	***	
10:00	U. of Michigan Current Conditions	m/m	May F		90.8	**	
10:00	U. of Michigan Future Expectations	m/m	May F		77.6	**	
10:00	U. of Michigan 1 Yr Inflation Expectation	m/m	May F		4.6%	*	
10:00	U. of Michigan 5-10 Yr Inflation Expectation	m/m	May F		3.1%	*	
Fed Speakers or Events							
No speakers or events scheduled							

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	Jobless Rate	m/m	Apr	2.8%	2.6%	2.7%	***	Equity bearish, bond bullish
	Job/Applicant Ratio	m/m	Apr	1.09	1.10	1.10	***	Equity bearish, bond bullish
	Tokyo CPI	y/y	May	-0.4%	-0.6%	-0.5%	***	Equity and bond neutral
	Tokyo CPI Ex Fresh Food	y/y	May	-0.2%	-0.2%	-0.2%	**	Equity and bond neutral
	Tokyo CPI Ex Fresh Food, Energy	y/y	May	-0.1%	0.0%	-0.1%	*	Equity and bond neutral
EUROPE								
Eurozone	Consumer Confidence	m/m	May F	-5.1	-5.1		**	Equity and bond neutral
	Economic Confidence	m/m	May	114.5	110.5	112.3	*	Equity bullish, bond bearish
France	GDP	y/y	1Q F	1.2%	1.5%	1.5%	***	Equity bearish, bond bullish
	Consumer Spending	y/y	Apr	32.0%	16.8%	37.6%	*	Equity and bond neutral
	CPI	y/y	May P	1.4%	1.2%	1.4%	***	Equity and bond neutral
	CPI EU Harmonized	y/y	May P	1.8%	1.6%	1.8%	**	Equity and bond neutral
	PPI	y/y	May P	7.3%	4.6%		*	Equity and bond neutral
Italy	PPI	y/y	Apr	7.9%	3.0%		*	Equity and bond neutral
Switzerland	KOF Leading Indicator	m/m	May	143.2	136.4	132.0	*	Equity bullish, bond bearish
AMERICAS								
Brazil	FGV Inflation IGPM	y/y	May	37.0%	32.0%	36.9%	***	Equity bullish, bond bearish
	Total Outstanding Loans	m/m	Apr	4126b	4105b		**	Equity and bond neutral
	Outstanding Loan Growth	m/m	Apr	0.5%	1.5%		*	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)	14	14	0	Up
3-mo T-bill yield (bps)	1	1	0	Neutral
TED spread (bps)	13	13	0	Up
U.S. Libor/OIS spread (bps)	8	8	0	Up
10-yr T-note (%)	1.61	1.61	0.00	Neutral
Euribor/OIS spread (bps)	-54	-54	0	Neutral
EUR/USD 3-mo swap (bps)	1	1	0	Down
Currencies				
dollar	Up			Down
euro	Down			Up
yen	Down			Up
pound	Down			Up
franc	Down			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.

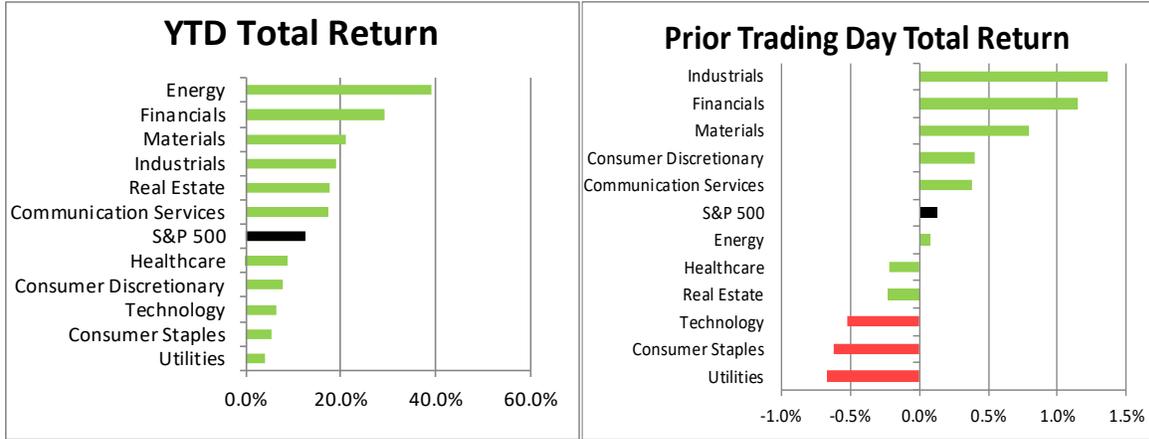
	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$69.74	\$69.46	0.40%	
WTI	\$67.25	\$66.85	0.60%	
Natural Gas	\$2.99	\$2.96	1.01%	
Crack Spread	\$22.41	\$22.34	0.31%	
12-mo strip crack	\$21.23	\$21.20	0.14%	
Ethanol rack	\$2.71	\$2.70	0.52%	
Metals				
Gold	\$1,891.27	\$1,896.54	-0.28%	
Silver	\$27.62	\$27.84	-0.82%	
Copper contract	\$461.50	\$466.30	-1.03%	
Grains				
Corn contract	\$666.25	\$664.50	0.26%	
Wheat contract	\$673.75	\$676.25	-0.37%	
Soybeans contract	\$1,538.25	\$1,537.00	0.08%	
Shipping				
Baltic Dry Freight	2688	2754	-66	
DOE inventory report				
	Actual	Expected	Difference	
Crude (mb)	-1.7	-1.0	-0.7	
Gasoline (mb)	-1.7	-1.6	-0.2	
Distillates (mb)	-3.0	-2.3	-0.7	
Refinery run rates (%)	0.70%	0.20%	0.50%	
Natural gas (bcf)	115.0	105.0	10.0	

Weather

The 6-10 and 8-14 day forecasts currently call for warmer than normal temperatures throughout the West Coast and the entire northern tier of the country, with cooler than normal temperatures in Texas and the Southeast. The forecast calls for wet conditions in Texas and the lower Mississippi Valley, with dry conditions primarily in the Pacific Northwest.

Data Section

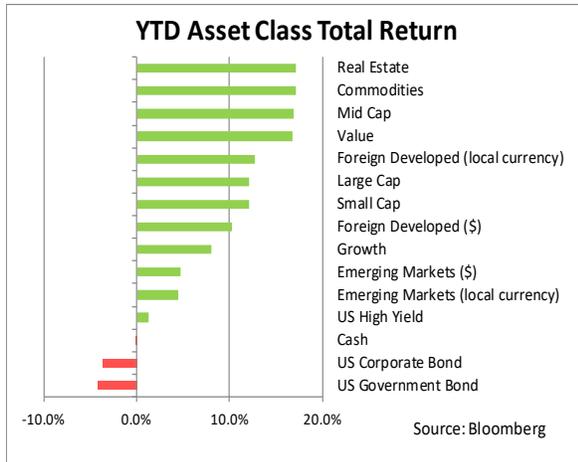
U.S. Equity Markets – (as of 5/27/2021 close)



(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 5/27/2021 close)

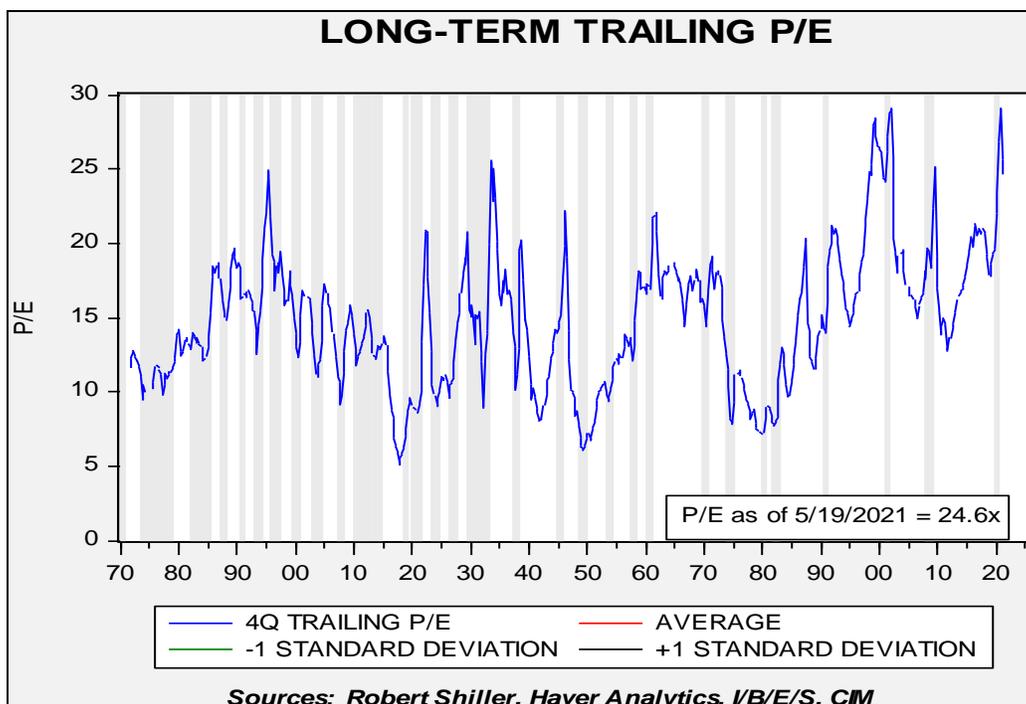


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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), Value (S&P 500 Value), Growth (S&P 500 Growth).

P/E Update

May 20, 2021



Based on our methodology,¹ the current P/E is 24.4x, down 0.4x 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.

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.