

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 31, 2023—9:30 AM EDT] Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 is currently down 0.5% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.5%. Chinese markets were also lower, with the Shanghai Composite closing down 0.6% from its previous close and the Shenzhen Composite down 0.4%. U.S. equity index futures are signaling a lower open.

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:

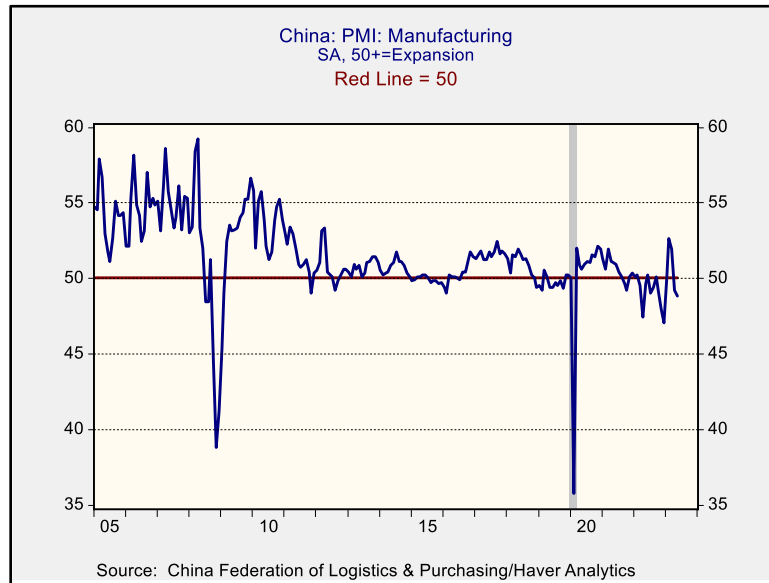
- **[Bi-Weekly Geopolitical Report \(5/30/2023\)](#) (with associated [podcast](#)) “China’s New National Security Law”**
- [Weekly Energy Update \(5/25/2023\)](#): We continue to monitor China’s dominance in EV metals and examine the weekly oil inventory data which recorded a massive drop in stockpiles.
- [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 Q2 2023 Rebalance Presentation \(5/11/2023\)](#): 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 \(5/22/2023\)](#) (with associated [podcast](#)): “The Case for New Home Sales”
- [Confluence of Ideas podcast \(3/8/2023\)](#): “Reflections on Inflation”
- [Business Cycle Report \(5/25/2023\)](#)

Our *Comment* today opens with some unexpectedly soft economic figures out of China, which are weighing on global stock markets so far today. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including new sources of tension between China, the U.S., and India and the latest on the deal to raise the U.S. government’s debt limit.

China: The National Bureau of Statistics said the country’s May purchasing managers’ index for manufacturing [fell to 48.8, well short of the expected reading of 49.5 and even lower than the April figure of 49.2](#). In contrast, the official PMI for nonmanufacturing industries only fell to

54.5 in May, compared with 56.4 in the previous month. China's official PMIs, like most such indexes, are designed so that readings over 50 indicate expansion.

- At their current levels, the PMIs provide more evidence that the economic rebound after the government lifted its draconian Zero-COVID policy is already petering out. Factory activity is shrinking further, and now even the services sector is suffering from slower growth.
- Stagnating demand in China has the potential to drag on economic activity around the world, pushing down commodity prices and weighing on stock markets. Chinese stocks [are now in a bear market](#).



China-United States: The Department of Defense revealed that on Friday, a Chinese fighter jet [flew dangerously close to a U.S. reconnaissance plane flying in international airspace over the South China Sea](#). In what the U.S. called an “unnecessarily aggressive maneuver,” the fighter jet crossed the path of the recon plane just 400 feet in front of its nose, forcing the U.S. plane to fly through its turbulence. The incident shows that U.S.-China tensions continue to spiral, creating greater risks of outright conflict and potentially causing collateral damage to investors.

China-India: New reports say Beijing [has recently ejected the last remaining Indian journalists from its country, while New Delhi has evicted the last Chinese journalists from India](#). The evictions reflect a further worsening of bilateral tensions over border disputes in the Himalayan mountains and other issues. While our analysis puts India in the China-leaning bloc of countries, the ongoing tensions suggest New Delhi is actually “in play” and will likely continue to increase its security cooperation with the U.S.

Japan: If you're a seasonal allergy sufferer and have always wondered what would give you real relief, the Japanese might have an answer for you. The government yesterday [proposed a program that would cut down 20% of the country's cedar forests over the next decade](#), with the goal of cutting average pollen counts by half over the next 30 years. The plan will expand the

acreage of artificially planted cedars subject to logging, promote the use of domestic wood, and allow more foreign lumberjacks to immigrate.

Eurozone: Similar to yesterday's report of moderating price growth in Spain, a report today [showed France's May consumer price index was up just 6.0% from the same month one year earlier](#), marking a significant cooling from the rise of 6.9% in the year to April and coming in lower than the expected increase of 6.4%.

- Moderating inflation in the eurozone has prompted speculation that the European Central Bank could stop its interest-rate hikes as early as July.
- In turn, that prospect is weighing on the EUR today. As of this writing, the single currency is trading at \$1.0686, down 0.5% for the day.

United Kingdom: The country's summer of strikes continues, with the U.K.'s main train drivers' union [walking off the job today](#). The action has paralyzed most of England's mainline railroads, heaping more headaches on Prime Minister Sunak and illustrating how inflation and wage demands remain potent issues in the U.K.

Russia-Ukraine War: According to the *Wall Street Journal*, Ukraine and its Western European allies [are planning a July summit of global leaders \(excluding Russia's\) to promote Kyiv's peace proposal](#). European leaders such as French President Macron have reportedly been lobbying for participation by countries that have sided with Russia or have declined to take a position on the war, such as Saudi Arabia and Brazil. News of the planned summit suggests that Kyiv is operating under a broad, comprehensive plan to win the war by quickly following its expected battlefield counteroffensive with a powerful political operation supporting its own peace plan over China's rival plan, all the while leaving Russia isolated.

U.S. Fiscal Policy: New analysis of the preliminary deal to lift the federal debt limit indicates it [will ensure that student loan payments and interest accruals will restart no later than August 30](#), with no further extensions to the pandemic-era pause. The need for former students to start making loan payments again could noticeably undermine consumer spending and help give the economy a final push into recession.

- The House Rules Committee [approved the debt-limit legislation yesterday and sent it for a final vote of the full House which could occur as early as today](#).
- The vote in the Rules Committee relied on votes from both moderate Republicans and Democrats, illustrating how passage of the bill in the full House will likely require the cooperation of centrists on both sides of the aisle.

U.S. Monetary Policy: In an interview with the *Financial Times*, Cleveland FRB President Mester [said she sees no compelling reason to pause the Federal Reserve's interest-rate hikes as long as inflation pressures remain high](#). Essentially, Mester argued that the risk involved with hiking rates too little was higher than the risk involved with hiking too much. Her hawkish statement feeds into growing expectations that the policymakers will lift their benchmark fed funds rate further at their upcoming meeting in June.

U.S. Labor Market: Goldman Sachs (GS, \$330.83) [is reportedly planning another round of layoffs, which would be its third since last September](#). This round will evidently be focused on employees in its investment banking group. Financial dealmaking has been crimped over the last year as the Fed hiked interest rates and, more recently, as regional banks ran into trouble.

- The layoffs underscore how the Fed’s rate-hiking campaign has had the biggest negative impacts, so far, on sectors such as housing, commercial real estate, mortgage finance, and investment banking.
- This [Wall Street Journal article](#) provides a useful overview of how the Fed’s rate hikes have tightened conditions in various credit sectors.

U.S. Oil Market: Starting tomorrow, the crude oil transactions used to calculate the Brent benchmark price [will include purchases and sales of U.S. oil](#). As output from the North Sea’s Brent field has fallen, the basket of prices that go into the Brent average has been gradually broadened in recent years. The inclusion of U.S. prices reflects the growing heft of U.S. producers in the global oil market. However, note that the U.S. oil to be included in Brent is not West Texas Intermediate, which is widely referred to as “U.S. crude.”

U.S. Economic Releases

Residential loan demand slowed for the third consecutive week as interest rates rose to the highest level since early November. According to an index tracked by the Mortgage Bankers Association, mortgage applications fell 3.7% in the week ending May 26. The lack of requests for loans may be related to a sharp increase in borrowing costs. Last week, the average 30-year fixed-rate mortgage rose 21 bps from 6.69% to 6.91%. As a result, the applications index for purchases and refinancing fell 2.5% and 6.9%, respectively, from the prior week.

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 |
| 9:45 | MNI Chicago PMI | m/m | May | 47.2 | 48.6 | *** |
| 10:00 | JOLTS Job Openings | m/m | Apr | 9400k | 9590k | ** |
| 10:30 | Dallas Fed Manufacturing Activity | m/m | May | -- | -14.4 | ** |
| Federal Reserve | | | | | | |
| EST | Speaker or Event | District or Position | | | | |
| 12:20 | Susan Collins Gives Closing Remarks at Fed Listens Event | President of the Federal Reserve Bank of Boston | | | | |
| 12:30 | Patrick Harker Speaks on Macroeconomic, Monetary Conditions | President of the Federal Reserve Bank of Philadelphia | | | | |
| 13:30 | Phiip Jefferson Speaks on Financial Stability and the US Economy | Member of the Board of Governors | | | | |
| 14:00 | U.S. Federal Reserve Releases Beige Book | Federal Reserve Board | | | | |

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 | Retail Sales | y/y | Apr | 5.0% | 7.2% | 7.1% | ** | Equity bearish, bond bullish |
| | Depart. Store & Supermarket Sales | y/y | Apr | 4.8% | 3.2% | | * | Equity bullish, bond bearish |
| | Industrial Production YoY | y/y | Apr P | -0.3% | -0.6% | 2.0% | *** | Equity bearish, bond bullish |
| | Housing Starts | y/y | Apr | -11.9% | -3.2% | -0.8% | ** | Equity bearish, bond bullish |
| | Annualized Housing Starts | y/y | Apr | 0.771m | 0.877m | 0.868m | * | Equity and bond neutral |
| Australia | Private Sector Credit | y/y | Apr | 6.6% | 6.8% | | ** | Equity and bond neutral |
| | CPI | y/y | Apr | 6.8% | 6.3% | 6.4% | ** | Equity and bond neutral |
| New Zealand | ANZ Activity Outlook | m/m | May | -4.5 | -7.6 | | ** | Equity bullish, bond bearish |
| | ANZ Business Confidence | m/m | May | -31.1 | -43.8 | | ** | Equity bullish, bond bearish |
| South Korea | Industrial Production | y/y | Apr | -8.9% | -7.6% | -7.8% | *** | Equity bearish, bond bullish |
| China | Official Manufacturing PMI | m/m | May | 48.8 | 49.2 | 49.5 | *** | Equity bearish, bond bullish |
| | Official Services PMI | m/m | May | 54.5 | 56.4 | 55.2 | ** | Equity bearish, bond bullish |
| | Official Composite PMI | m/m | May | 52.9 | 54.4 | | * | Equity bearish, bond bullish |
| India | GDP | y/y | 1Q | 6.1% | 4.4% | 5.0% | *** | Equity bullish, bond bearish |
| EUROPE | | | | | | | | |
| Germany | Unemployment Change | m/m | May | 9.0k | 24.0k | 23.0k | *** | Equity bullish, bond bearish |
| | Unemployment Claims Rate | m/m | May | 5.6% | 5.6% | 5.6% | ** | Equity and bond neutral |
| | CPI | y/y | May P | 6.1% | 7.2% | 6.5% | *** | Equity and bond neutral |
| | CPI, EU Harmonized | y/y | May P | 6.3% | 7.6% | 6.7% | ** | Equity and bond neutral |
| France | CPI | y/y | May P | 5.1% | 5.9% | 5.5% | *** | Equity and bond neutral |
| | CPI, EU Harmonized | y/y | May P | 6.0% | 6.9% | 6.4% | ** | Equity and bond neutral |
| | PPI | y/y | Apr | 7.0% | 12.9% | 12.8% | * | Equity bearish, bond bullish |
| | GDP | y/y | Q1 F | 0.9% | 0.8% | 0.8% | ** | Equity and bond neutral |
| Italy | CPI, EU Harmonized | y/y | May P | 8.1% | 8.7% | 7.5% | *** | Equity bearish, bond bearish |
| | CPI NIC Including Tobacco | y/y | May P | 7.6% | 8.3% | 7.2% | ** | Equity and bond neutral |
| | PPI | y/y | Apr | -3.5% | 3.0% | | ** | Equity and bond neutral |
| Switzerland | Real Retail Sales | y/y | Apr | -3.7% | -1.9% | | ** | Equity bearish, bond bullish |
| AMERICAS | | | | | | | | |
| Mexico | International Reserves Weekly | w/w | 26-May | \$202512m | \$202832m | | * | Equity and bond neutral |
| Brazil | Total Outstanding Loans | m/m | Apr | 5363b | 5361b | 5368b | ** | Equity and bond neutral |
| | Net Debt % GDP | m/m | Apr | 57.2 | 57.2 | 57.2 | *** | Equity and bond neutral |
| | National Unemployment Rate | m/m | Apr | 8.5% | 8.8% | 8.8% | * | 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) | 548 | 546 | 2 | Up |
| 3-mo T-bill yield (bps) | 524 | 524 | 0 | Up |
| TED spread (bps) | 24 | 23 | 1 | Widening |
| U.S. Sibor/OIS spread (bps) | 528 | 528 | 0 | Up |
| U.S. Libor/OIS spread (bps) | 528 | 528 | 0 | Up |
| 10-yr T-note (%) | 3.64 | 3.69 | -0.05 | Flat |
| Euribor/OIS spread (bps) | 347 | 348 | -1 | Up |
| Currencies | Direction | | | |
| Dollar | Up | | | Down |
| Euro | Flat | | | Up |
| Yen | Down | | | Down |
| Pound | Flat | | | 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.

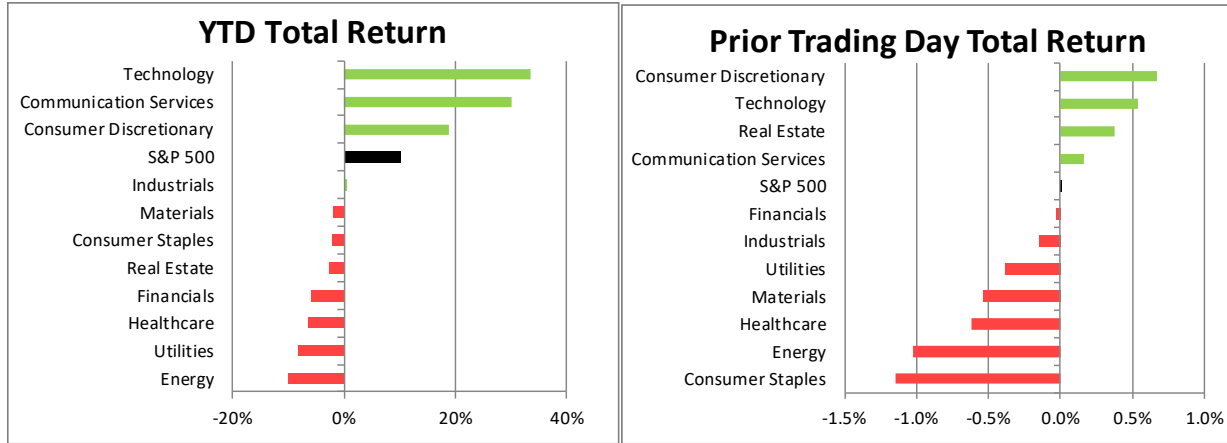
| DOE Inventory Report | Price | Prior | Change | Explanation |
|-----------------------------|------------|------------|------------|------------------|
| Energy Markets | | | | |
| Brent | \$71.78 | \$73.54 | -2.39% | Supply Pessimism |
| WTI | \$67.55 | \$69.46 | -2.75% | Supply Pessimism |
| Natural Gas | \$2.29 | \$2.33 | -1.59% | |
| Crack Spread | \$31.92 | \$31.86 | 0.19% | |
| 12-mo strip crack | \$24.74 | \$24.63 | 0.46% | |
| Ethanol rack | \$2.63 | \$2.64 | -0.29% | |
| Metals | | | | |
| Gold | \$1,961.43 | \$1,959.33 | 0.11% | |
| Silver | \$23.32 | \$23.17 | 0.62% | |
| Copper contract | \$363.20 | \$366.30 | -0.85% | |
| Grains | | | | |
| Corn contract | \$585.50 | \$594.00 | -1.43% | |
| Wheat contract | \$575.00 | \$591.00 | -2.71% | |
| Soybeans contract | \$1,275.50 | \$1,296.50 | -1.62% | |
| Shipping | | | | |
| Baltic Dry Freight | 1,123 | 1,172 | -49 | |
| DOE Inventory Report | | | | |
| | Actual | Expected | Difference | |
| Crude (mb) | | -1.0 | | |
| Gasoline (mb) | | -1.1 | | |
| Distillates (mb) | | 0.9 | | |
| Refinery run rates (%) | | 0.50% | | |
| Natural gas (bcf) | | 101 | | |

Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures in the Northern and Midwestern states, with cooler-than-normal conditions expected for the East Coast and Southwest. Meanwhile, the precipitation outlook shows wetter-than-normal conditions in most of the western half of the country, with dry conditions expected in the Midwest.

Data Section

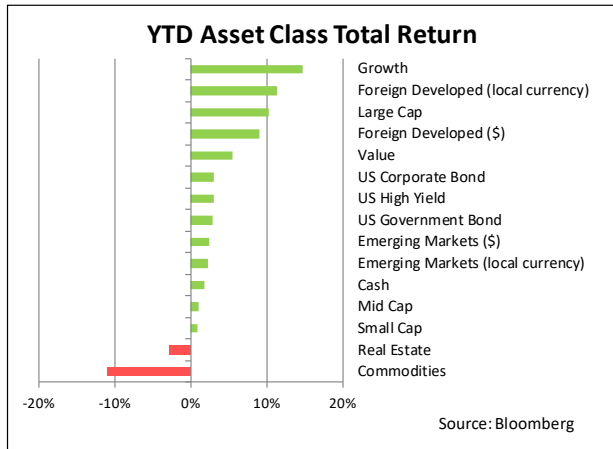
U.S. Equity Markets – (as of 5/30/2023 close)



(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 5/30/2023 close)

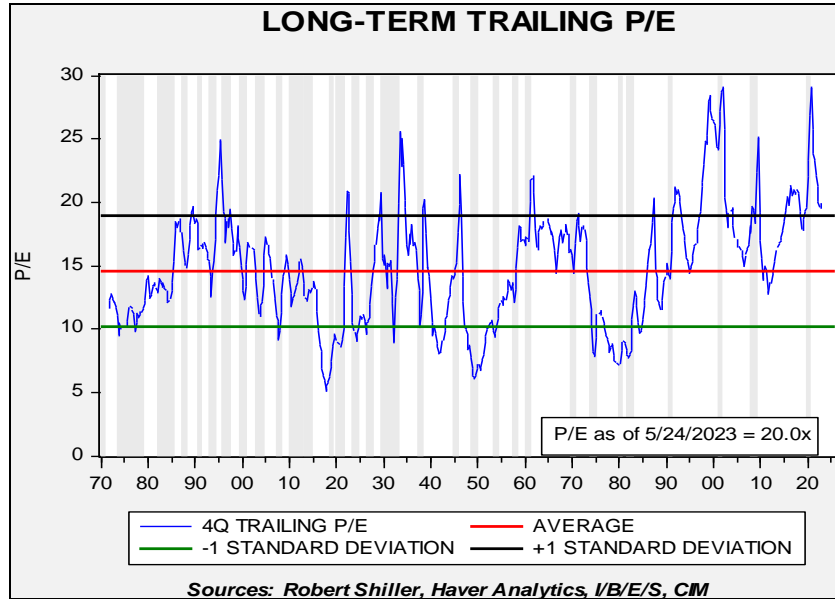


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 25, 2023



Based on our methodology,¹ the current P/E is 20.0x, up 0.1x from last week. Weaker earnings led to the lower 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.