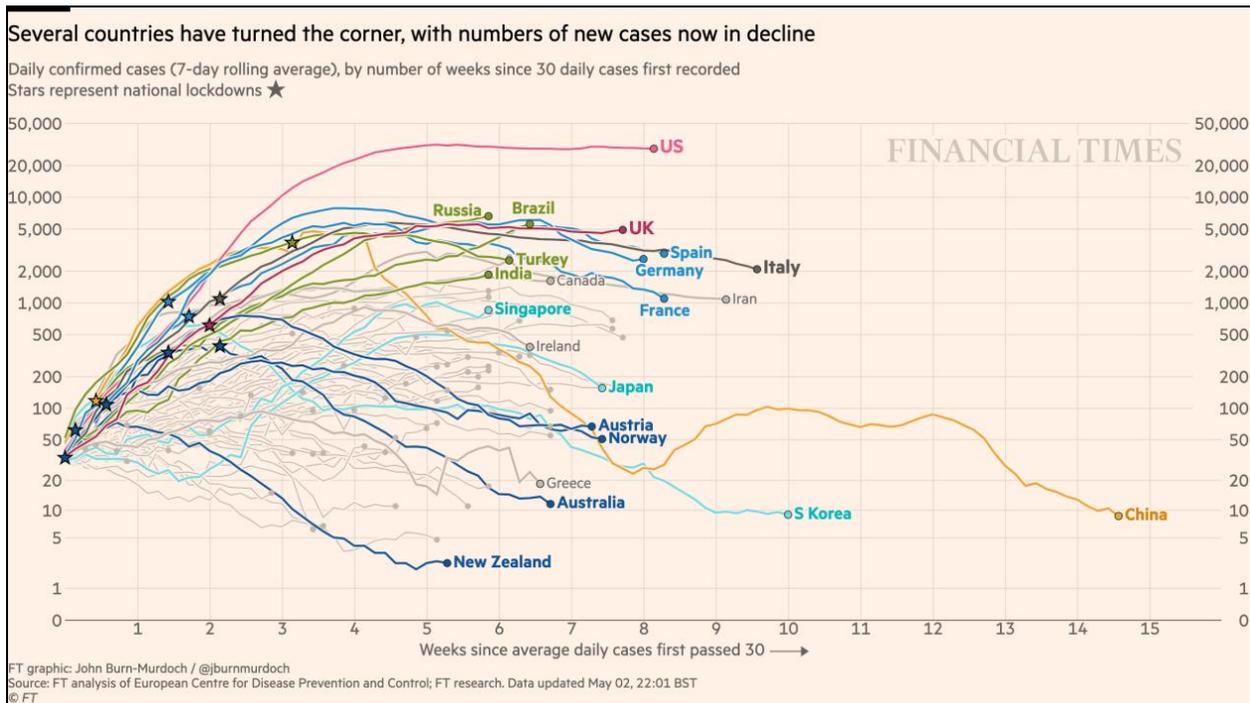


Looking for something to read? See our [Reading List](#); these books, separated by category, are ones we find interesting and insightful. We will be adding to the list over time.

**[Posted: May 4, 2020—9:30 AM EDT]** Global equity markets are generally lower this morning. The EuroStoxx 50 is down 3.5% from its last close. In Asia, the MSCI Asia Apex 50 closed down 2.9% from the prior close. Chinese markets were closed for Labour Day. U.S. equity index futures are signaling a lower open. With 277 companies having reported, the S&P 500 Q1 earnings stand at \$33.70, lower than the \$35.51 forecast for the quarter. The forecast reflects a 10.0% decrease from Q1 2019 earnings. Thus far this quarter, 68.6% of the companies have reported earnings above forecast, while 28.2% have reported earnings below forecast.

Good morning! It's employment week; we are [expecting a very weak report for April](#), with the unemployment rate in the 16% area. [Equity futures are lower](#). We update the [COVID-19](#) news. Here are the details:

**[COVID-19](#):** The number of reported cases is 3,523,121 with 247,752 deaths and 1,130,996 recoveries. In the U.S., there are 1,158,341 confirmed cases with 67,686 deaths and 180,152 recoveries. Here is the *FT* chart:



### ***The virus news:***

- The good news:
  - Roche (RHHBY, 42.84) [has received clearance for emergency use of an antibody test](#) from the FDA. The company claims an impressive accuracy—100% in detecting COVID-19 antibodies and a 0.2% false positive result.
  - There are currently [254 therapies](#) being tested for COVID-19 and [95 vaccines](#). That is good because [many of these will fail](#). Meanwhile, there is also something of a geopolitical race for a vaccine; the [soft power a nation would get by being the first to bring a vaccine would be large](#). So far, the U.S. has shown [little interest in global participation to find a vaccine](#). One would assume that if the U.S. does develop it first, we would protect Americans first and the rest of the world later.
  - Here's another oddity of COVID-19—[habitual smokers are underrepresented among those hospitalized](#). In France, this news has led to a run on smoking-cessation products on the idea that nicotine may act on the lungs in such a way that it slows the invasion of the virus in the body.
  - There is increasing investigation of [blood plasma](#) to treat COVID-19. Some studies are looking at introducing antibodies from those who have recovered from the virus, while others are looking at regulating the immune response.
- The bad news:
  - Meanwhile, in comparison to the Roche test, [others have been far less impressive](#) in (a) determining if a patient has been infected, or (b) suggesting they have been infected when they haven't. We hope the Roche test is as good as they say it is, but, compared to the others, we will go with Reagan's "trust but verify."
  - There are widespread reports that imported PPE, especially masks, [are substandard](#). The N95 mask, named because it filters out 95% of small particles and gives the standard of protection, is being imported but tests show that about 60% fail. News such as this will undermine confidence in global medical supply chains and bring production back to the U.S.
  - There are lingering concerns that if the virus is in the air, [HVAC systems could spread it through the ventilation system](#).
  - Although herd immunity can be achieved without a vaccine, [the cost is really high](#).
  - [Russia is seeing a surge in cases of the virus](#). The official case count jumped 10k on Sunday.

### ***The policy news:***

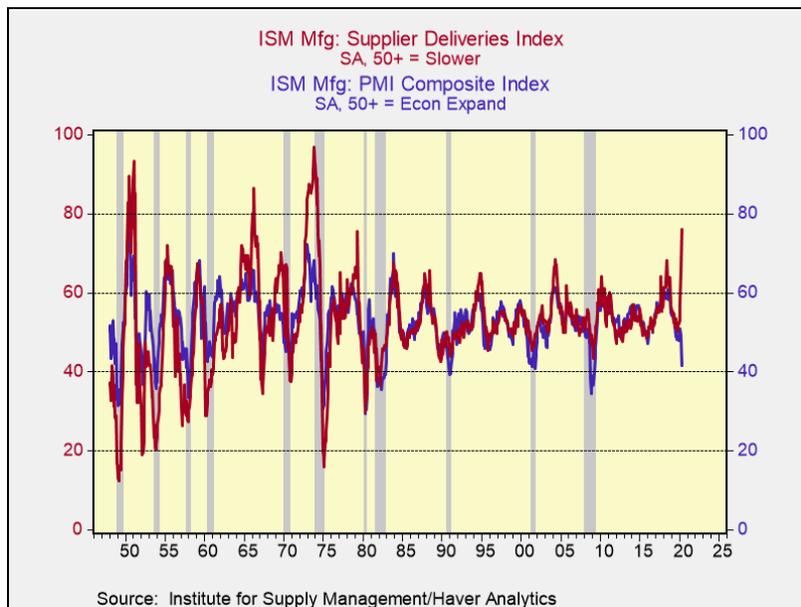
- The economic data released this month and next will look awful; this is no surprise. However, even though the downturn is well anticipated, the data will likely drive another round of fiscal action. Already, political camps are laying out their goals. Democrats want more aid for state and local governments. Congressional GOP leaders are pushing for liability protection. The White House is flirting with tax cuts and maybe a further delay in filing taxes this year. With divisions this wide, [bridging them means that another round of fiscal stimulus will take a while](#). For now, the official line from the

administration is that we should have a “[pause](#)” to see how approved spending affects the economy.

- Hurricane season is less than a month away. [Forecasts suggest it will be an active season.](#) On average, the Atlantic hurricane season generates 12 named storms of which three become major (category 3+) hurricanes. Most university projections are expecting mid-to-high teens for this year’s season. [FEMA is preparing for an elevated season with the added complication of COVID-19](#); one can imagine hurricane shelters, which often put lots of unrelated people in close quarters, as potential vectors for spreading the virus.
- The [EU will begin debating a €1.0 trillion stimulus package](#) to address COVID-19. This comes in the aftermath of a program half this size for the Eurozone. So far, we are seeing widening credits spreads between sovereign yields of the southern nations compared to the northern ones. This spending is, in part, designed to narrow that gap.

***The economic news:***

- Last Friday’s manufacturing ISM data came in better than expected. Don’t be fooled. It was much worse than expected. Why? The supply deliveries component has distorted the report. Under normal circumstances, slower deliveries usually coincide with a robust economy. Therefore, the ISM is constructed to treat slow deliveries as positive. However, in the current environment, slower deliveries are an artifact of shutdown orders; in other words, in a really strong economy, bottlenecks in deliveries occur due to tightening supplies. In the current situation, bottlenecks simply reflect the shelter-in-place orders. Here are a couple of charts:



Note that it is unprecedented to see a supplier delivery reading above 70 with an ISM less than 60. In this chart, we adjust the ISM by excluding supplier delivery. This leads to a reading of 33, which is more in line with a deep downturn in the economy.



- Bees are critically important to America’s food crops. Lockdown measures have reduced the ability of beekeepers to move their [hives to fruit and nut orchards](#). However, another threat has emerged in the northwest—the [Asian giant hornet](#). This insect, native to Asia, has recently been found in the U.S.
- Around the globe, [various levels of government](#) are starting to ease social distancing restrictions. In the U.S., three-fifths of the [states are allowing some businesses to reopen](#). It is unknown how this will go. We don’t know how the virus will behave in the summer months. There is some speculation it could act like influenza and spread less quickly. However, opening businesses is one thing; getting customers is something else. [Early evidence](#) suggests that business activity will recover slowly, at best. The other risk, of course, [is a return of the virus](#) and the need to reimplement lockdowns.
- Construction firms in the U.S. report slow activity. Although stalled projects have resumed as lockdowns ease, [order pipelines show little future activity](#) once current jobs are completed.

***The market news:***

- In the Great Financial Crisis, investors with cash were able to make investments in stricken firms at favorable rates. Interestingly enough, this time around, [the Fed has moved so fast to offer support that these same investors are finding themselves shut out of these opportunities](#).
- As the first week of May is upon us, [landlords and mortgage lenders are bracing for another round of missed payments](#). This is a classic case of “who bears the cost of adjustment.” Lenders and landlords clearly can’t get money from renters and borrowers who have no income but there has been varying responses on how these missed payments will be handled. Some of the lenders or landlords want a lump sum for the lost payments, which doesn’t appear likely. There have also been calls for [organized rent strikes](#). Although eviction and foreclosure are options, neither is all that attractive for mortgage holders or landlords; there is no guarantee that the unit can be re-rented, and if home prices fall foreclosure can mean a drop in mortgage values. ***We will be watching to see if***

*the Fed comes to the rescue here as well.* As we noted above, we doubt there will be fiscal action to resolve this situation anytime soon.

**The foreign policy news:**

- As we detailed last week, [relations with China continue to deteriorate, and it's not just the U.S. Punishing China](#) looks to be a major campaign point this November. The U.S. [is building alliances in the South China Sea](#) with those who are increasingly worried about China's aggressive actions in the area. SoS Pompeo continues to argue there is a "[significant amount of evidence](#)" that COVID-19 came from a Chinese bio lab. China is also [accused of hiding the virus's lethality](#) in order to hoard medical supplies. The administration [is accelerating plans](#) to remove China from the U.S. supply chain.

**Turkey:** Sensing that President Erdogan is in trouble, the U.S. is [increasing sanctions threats](#) to forestall the activation of Russia's S-400 missile defense system. The Fed has widened swap lines to foreign central banks and created a Treasury repo market for central banks that are not given swap lines so these excluded central banks can access dollars without having to sell their bonds in reserves. It appears that Ankara, facing a dollar supply crunch, [will not get help from either source](#). The Fed won't give a swap line to such a dodgy borrower and Turkey doesn't have enough reserves to repo.

**Iran:** Iran's new parliament is chock-full of hardliners and the election authorities restricted more liberal candidates. However, just because there is a large majority of a certain political leaning doesn't mean factions can be avoided. There is an [apparent battle for who will replace Ali Larijani for speaker of the parliament](#).

**North Korea:** Well, to paraphrase the early Weekend Updates, [Kim Jong Un is still not dead](#). He was seen at a [fertilizer factory over the weekend](#). We do note there was an [exchange of gunfire](#) on the DMZ; no casualties were reported.

**Venezuela:** Although details remain scant, [there was apparently some sort of mercenary incursion into Venezuela last month](#). There is no evidence that the U.S. government was directly involved in the action, but it is possible the U.S. was aware of the event. Apparently, it went badly.

**Argentina:** Buenos Aires is almost certainly going to default (again!) and require some sort of bailout. However, the economic minister of the country, Martin Guzman, suggests [in an FT op-ed](#) that much of the emerging world will require similar support. He seems to be suggesting we may see a broad debtors' strike which would roil the global financial system. In related news, growing financial stress is leading to trade tensions in South America and may [threaten the Mercosur](#), the free-trade zone on that continent.

**Germany:** The [Social Democrats are arguing that Germany would be better off without U.S. nuclear weapons on its soil](#). The presence of these warheads has been a sore point for the German left for decades. However, maintaining the alliance has always led Germany to allow the U.S. to deploy these weapons despite the misgivings. As the alliances fray, we may see these nukes go. If they do, Germany will need to dramatically boost its conventional defenses or develop nukes of its own in the face of the potential threat from Russia. Or, Germany could take

the route favored by the SDP for ages, which is to improve relations with Moscow. As long as Chancellor Merkel is in power, the nukes will likely stay. But, if the SDP can break free from the current coalition, and perhaps join the Greens, this issue may return.

**U.K./U.S. trade:** The two nations will [launch talks for a free-trade agreement tomorrow](#). If Brexit comes at the end of the year, it is clear Westminster wants to have a deal with the U.S. prepared.

## U.S. Economic Releases

There were no domestic releases prior to the publication of this report. The table below lists the economic releases scheduled for the rest of the day.

Economic Releases							
EDT	Indicator			Expected	Prior	Rating	
10:00	Factory Orders	m/m	Mar	-9.5%	0.0%	***	
10:00	Factory Orders Ex Trans	m/m	Mar		-0.9%	**	
10:00	Durable Goods Orders	m/m	Mar	-14.4%	-14.4%	***	
10:00	Durables Ex Transportation	m/m	Mar	-0.2%	-0.2%	**	
10:00	Cap Goods Orders Nondef Ex Air	m/m	Mar	0.1%	0.1%	**	
10:00	Cap Goods Ship Nondef Ex Air	m/m	Mar		-0.2%	**	
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
<b>ASIA-PACIFIC</b>								
India	Markit India PMI Mfg	m/m	Apr	27.4	51.8		**	Equity bearish, bond bullish
Australia	Melbourne Institute Inflation	m/m	Apr	-0.1%	0.2%		**	Equity bearish, bond bullish
	ANZ Job Advertisements	m/m	Apr	-53.1%	-10.3%		**	Equity bearish, bond bullish
	Building Approvals	m/m	Mar	-4.0%	19.9%	-15.0%	**	Equity and bond neutral
	Private Sector House	m/m	Mar	-1.2%	-0.8%		**	Equity and bond neutral
<b>Europe</b>								
Eurozone	Markit Eurozone Manufacturing	m/m	Apr	33.4	33.6	33.6	**	Equity bearish, bond bullish
	Sentix Investor Confidence	m/m	May	-41.8	-42.9	-28.0	**	Equity bearish, bond bullish
Germany	Markit/BME Germany Manufacturing	m/m	Apr	34.5	34.4	34.4	**	Equity and bond neutral
France	Markit France Manufacturing PMI	m/m	Apr	31.5	31.5	31.5	**	Equity and bond neutral
Italy	Markit Italy Manufacturing PMI	m/m	Apr	31.1	40.3	30.0	**	Equity and bond neutral
Switzerland	PMI Manufacturing	m/m	Apr	40.7	43.7	35.0	**	Equity and bond neutral
	Domestic Sight Deposits	w/w	1-May	579.5 Bil	573.9 Bil		*	Equity and bond neutral
	Total Sight Deposits	w/w	1-May	663.8 Bil	650.7 Bil		*	Equity and bond neutral
<b>AMERICAS</b>								
Canada	MLI Leading Indicator	m/m	Mar	-1.7%	0.3%		**	Equity bearish, bond bullish

## 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)	54	56	-2	Down
3-mo T-bill yield (bps)	10	11	-1	Neutral
TED spread (bps)	45	45	0	Up
U.S. Libor/OIS spread (bps)	5	5	0	Up
10-yr T-note (%)	0.60	0.61	-0.01	Neutral
Euribor/OIS spread (bps)	-27	-26	-1	Neutral
EUR/USD 3-mo swap (bps)	-4	-6	2	Down
<b>Currencies</b>	<b>Direction</b>			
dollar	UP			Neutral
euro	Down			Up
yen	UP			Up
pound	Down			Down
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
<b>Energy Markets</b>				
Brent	\$25.67	\$26.44	-2.91%	Supply Optimism
WTI	\$18.22	\$19.78	-7.89%	
Natural Gas	\$1.96	\$1.89	3.60%	
Crack Spread	\$13.87	\$13.07	6.07%	
12-mo strip crack	\$9.57	\$9.39	1.97%	
Ethanol rack	\$1.19	\$1.20	-0.19%	
<b>Metals</b>				
Gold	\$1,708.88	\$1,700.42	0.50%	
Silver	\$15.00	\$14.98	0.15%	
Copper contract	\$229.30	\$231.20	-0.82%	
<b>Grains</b>				
Corn contract	\$ 312.75	\$ 318.50	-1.81%	
Wheat contract	\$ 506.75	\$ 516.50	-1.89%	
Soybeans contract	\$ 838.50	\$ 849.50	-1.29%	
<b>Shipping</b>				
Baltic Dry Freight	617	635	-18	

## Weather

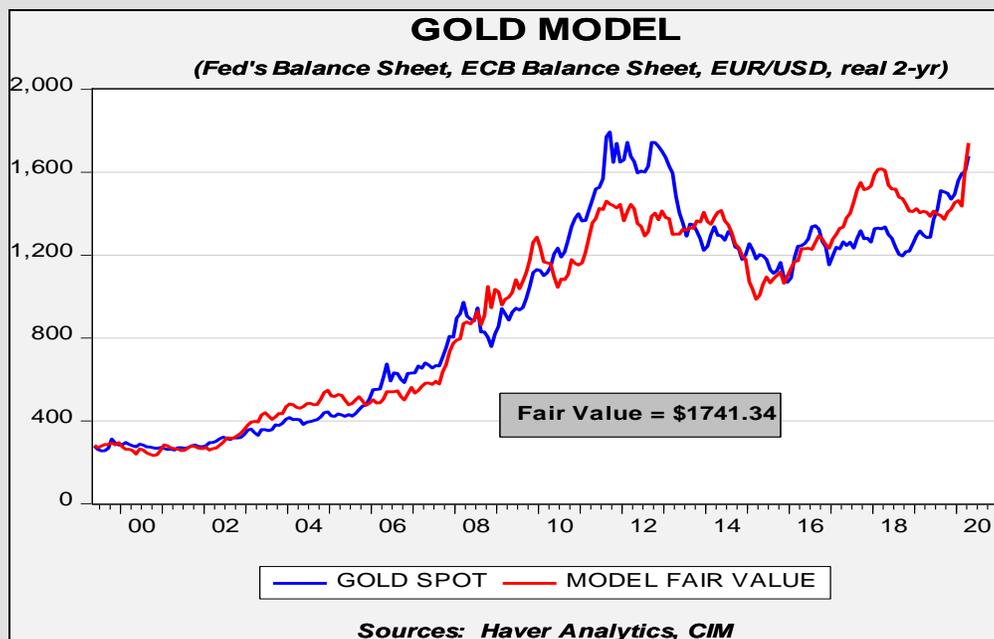
The 6-10 and 8-14 day forecasts currently call for cooler temps for most of the country, with warmer conditions in the Pacific and southwestern regions. Dry conditions are expected for most of the country, with wet conditions in the New England and southwestern regions.

## Asset Allocation Weekly

Confluence Investment Management offers various asset allocation products which are managed using “top down,” or macro, analysis. We report asset allocation thoughts on a weekly basis, updating this section every Friday. Note that this report is also offered as a separate document on our [website](#).

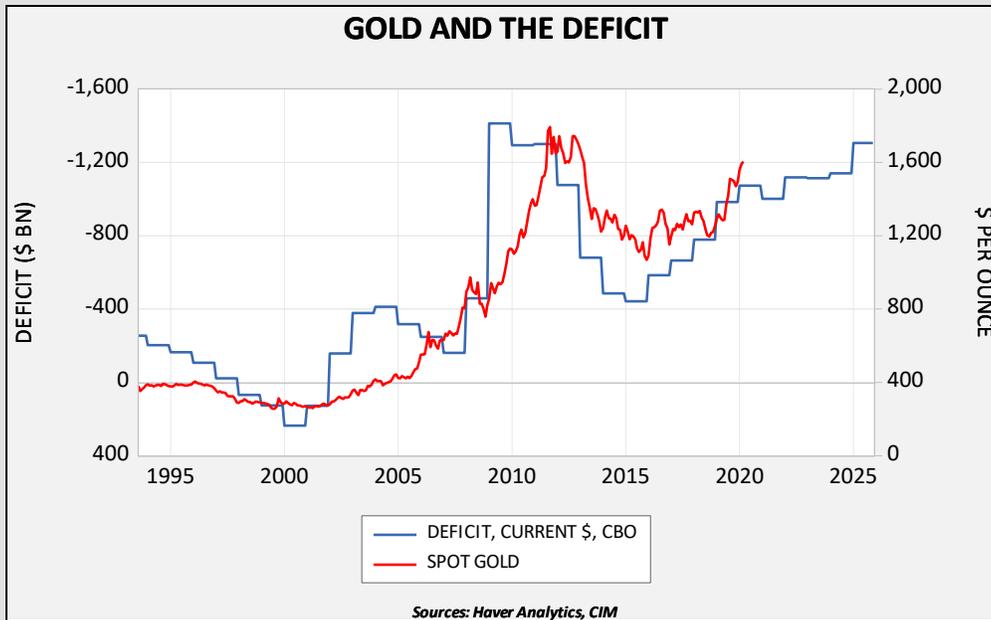
May 1, 2020

The policy response to COVID-19 has been mostly favorable for gold. Our gold model uses the balance sheets of the Federal Reserve and the European Central Bank, the EUR/USD exchange rate, and the real two-year T-note yield. The only variable that has been bearish for gold is the dollar, but the massive rise in central bank balance sheets and the drop in real yields has lifted the model’s fair value to 1,741.34.



In the coming months, we expect the fair value to rise; both the ECB and the Federal Reserve are likely to continue to expand their balance sheets, adding a broad spectrum of assets. We would also expect some modest declines in the real two-year T-note yield as inflation rises. Weakening the dollar may require direct action by the administration. Although this action may not occur this year, we would not be shocked to see it occur at some point in the future.

In addition, there is a long-term relationship between gold prices and the level of the fiscal deficit. Although the level of the current deficit does suggest that gold prices might be a bit overvalued currently, the likelihood of expanding deficits should offer underlying support for gold prices. The Congressional Budget Office recently increased its deficit forecasts; we still view them as conservative and would anticipate even higher deficits due to falling tax receipts and rising spending.

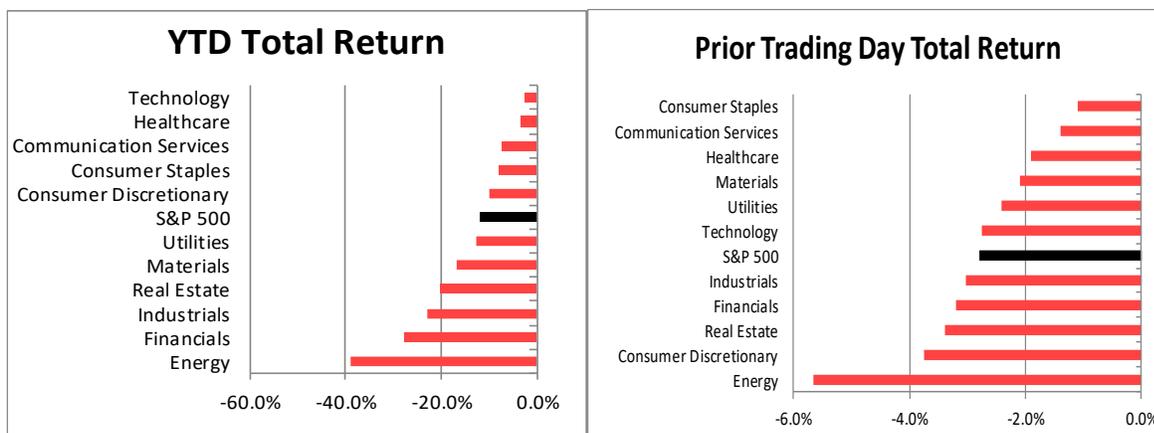


Therefore, our short- and long-term outlooks for gold remain positive.

*Past performance is no guarantee of future results. Information provided in this report is for educational and illustrative purposes only and should not be construed as individualized investment advice or a recommendation. The investment or strategy discussed may not be suitable for all investors. Investors must make their own decisions based on their specific investment objectives and financial circumstances. Opinions expressed are current as of the date shown and are subject to change.*

## Data Section

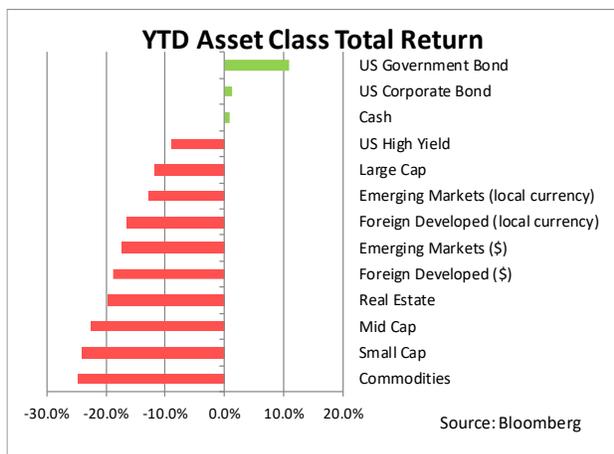
### U.S. Equity Markets – (as of 5/1/2020 close)



(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 5/1/2020 close)

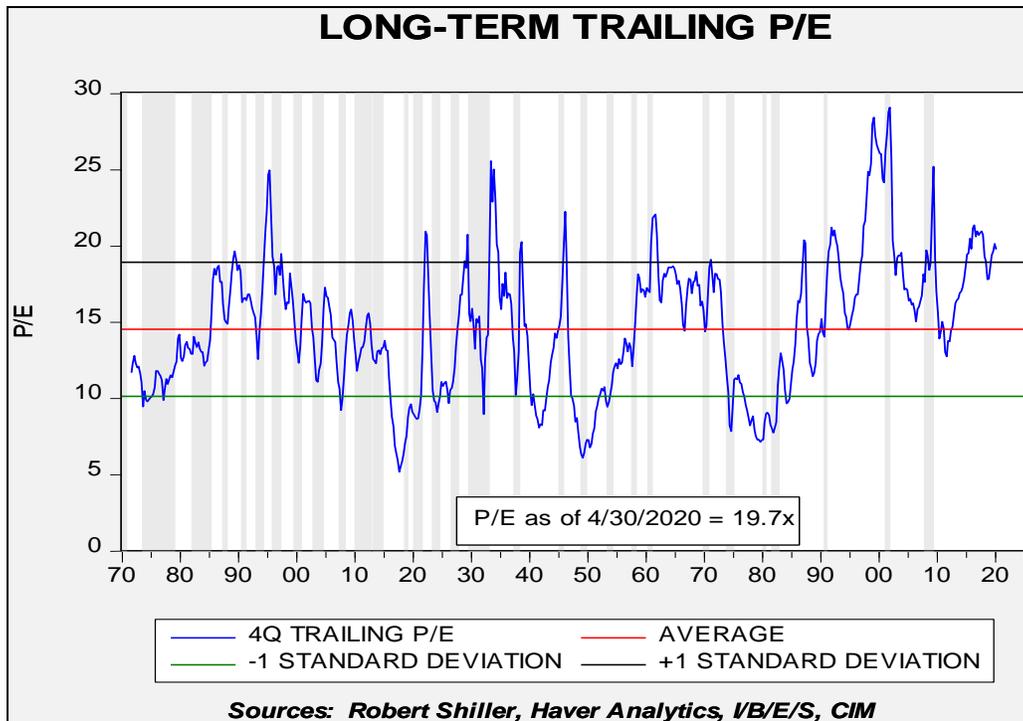


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

April 30, 2020



Based on our methodology,<sup>1</sup> the current P/E is 19.7x, up 0.6x from last week. The rise in the P/E was caused by the recovery in the S&P and falling earnings estimates.

*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.*

<sup>1</sup> 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). 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.