

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: November 7, 2023—9:30 AM EST] Global equity markets are mostly lower this morning. In Europe, the Euro Stoxx 50 is down 0.5% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.2%. Chinese markets were mixed, with the Shanghai Composite down 0.4% from its previous close and the Shenzhen Composite up 0.2%. U.S. equity index futures are signaling a lower open.

With 414 companies having reported so far, S&P 500 earnings for Q3 are running at \$58.20 per share compared to estimates of \$57.42, which is up 1.7% from Q2 2023. Of the companies that have reported thus far, 82.1% have exceeded expectations while 14.5% have fallen short of expectations.

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](#)** (10/30/2023) (with associated [podcast](#)): “Investment Implications of the Israel-Hamas Conflict”
- [Weekly Energy Update](#) (11/2/2023): The weekly data was modestly bullish this week, although we do note that refining activity remains depressed due to seasonal maintenance. The conflict in Gaza continues, but so far, the fighting has remained contained. *Note: the next edition of this report will be published on November 16 as the DOE is delaying its data reporting due to system upgrades.*
- [Asset Allocation Quarterly – Q4 2023](#) (10/19/2023): Discussion of our asset allocation process, Q4 2023 portfolio changes, and our outlook for the markets.
- [Asset Allocation Q4 2023 Rebalance Presentation](#) (10/30/2023): Video presentation featuring the Asset Allocation Committee as they review the asset allocation strategies, recent portfolio changes, and the current macro environment.
- **[Asset Allocation Bi-Weekly](#)** (11/6/2023) (with associated [podcast](#)): “The Inflation Adjustment for Social Security Benefits in 2024”

Good morning. It’s a risk-off day in the markets. As we noted above, global equities are mostly lower. Commodities are weaker as well on fears of weaker economic growth. We are seeing a rally in Treasuries in light of broader market weakness. [It’s election day in the U.S.](#) Although today’s elections are local, political analysts will be looking hard at the results for any insights into next year’s presidential race.

In today's *Comment*, we start our coverage with an update on the situation in Gaza. China is up next, economic and finance news follows, and we close with our international overview.

Gaza: Netanyahu claims Israel will take “indefinite” control over the Gaza Strip, and the death toll is mounting.

- The [Israeli PM indicated overnight](#) that [Israel would take control over Gaza](#) to prevent Hamas from retaking power. For Israel, this is a “back to the future” moment, as Israel held control over the area until 2005, [when PM Sharon concluded it would make more sense to leave Gaza to the Palestinians](#) and create a hard border around the area. Returning to Gaza means re-occupation, which is difficult. However, it is now clear that a Hamas-controlled Gaza is a major threat to Israeli security, thus leaving Netanyahu with little choice.
- According to the health ministry in Gaza, [10k Palestinians have died](#) in Gaza and 25k have been injured.
- U.S. continues to [press Israel for a pause](#). So far, the Israeli government has refused any significant ceasefires [without the release of hostages](#), although it has allowed for some relief supplies to enter the area from Egypt.
- The Israeli military has surrounded Gaza City, [essentially cutting the area into two parts](#).

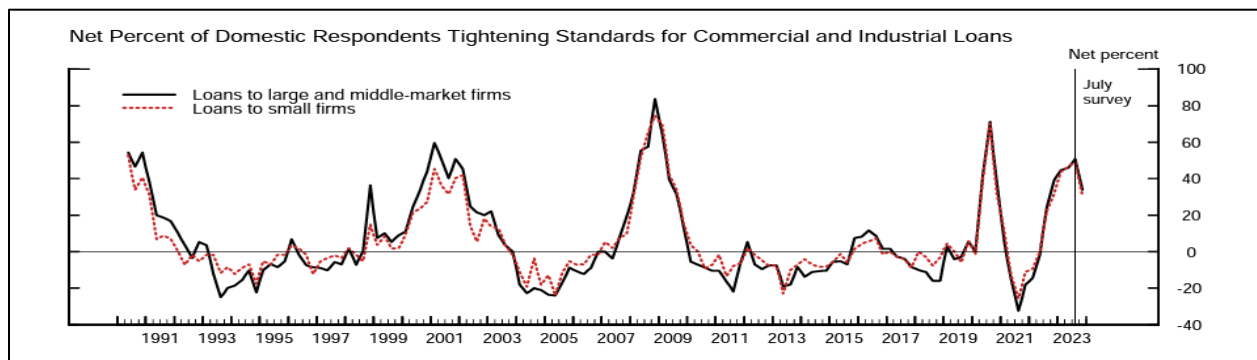
China Update: Australia is improving relations with Beijing, the U.S. and China are setting up meetings, as are EU officials, and China's exports remain weak.

- Relations between Australia and China deteriorated during the pandemic when Canberra called for an international inquiry into the origins of COVID-19. This week, Australian PM Albanese concluded trade meetings with Beijing which apparently have eased [Chinese restrictions on Australian products](#). General Secretary Xi spoke glowingly of the [improving relations](#) between the two nations, [suggesting ties](#) are now on the “[right path](#).” What Albanese is trying to do is what many nations in the region are also attempting, which is to have economic ties to China while also building security relations to contain Beijing. We note the [Australian PM remains cautious about China](#).
 - Interestingly enough, as trade relations between Australia and China improve, Australia's talks with the EU have “[collapsed](#).” It may be difficult to maintain security relations when economic activity is stunted.
- Australia isn't alone in trying to improve relations with Beijing. The Biden administration has been actively arranging talks all year. There are expectations that Xi and Biden will meet in San Francisco at the APEC summit later this month. Meanwhile, Treasury Secretary Yellen and Vice-Premier He [are scheduled to meet November 9 and 10](#).
 - [Invitations](#) were sent to U.S. business leaders to meet with Xi and Biden during the APEC summit.
 - There are reports the [U.S. and China will discuss nuclear weapons](#) in the near future. China has been [rapidly expanding its nuclear weapons arsenal](#) recently.

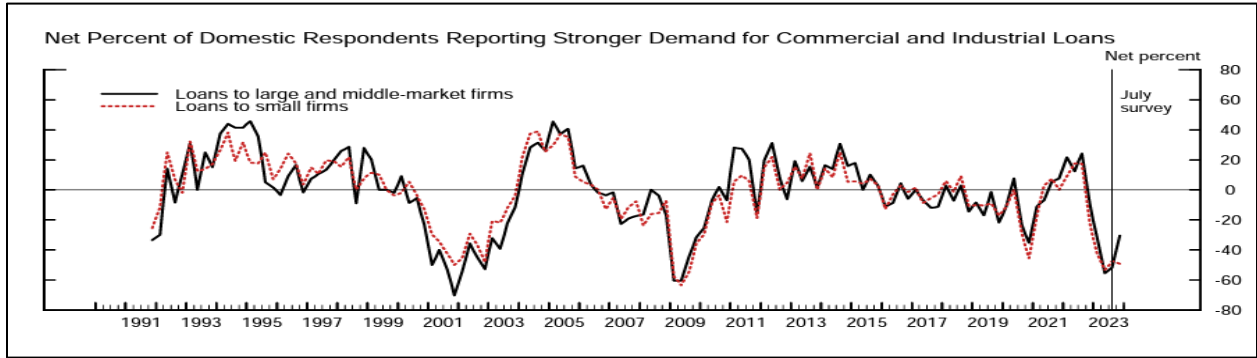
- The EU is also planning talks with China in December. [EC President von der Leyen is planning on traveling to Beijing for meetings](#), although the initial tone appears rather hawkish.
- [China is increasingly harassing Western surveillance flights](#) that are looking to see if nations are breaking sanctions on North Korea.
- On the economic and finance front, there were several interesting developments:
 - [Gallup is leaving China](#) because the government views its surveys as a “tool” to discredit the regime.
 - [The CPC has banned party members from owning private equity](#). Concerns about corruption led to the decision.
 - [Chinese tech mogul Chen Shaojie has been arrested](#). It is unclear with what he has been charged.
 - [China’s exports fell again in October](#).
 - [Slumping pork prices](#) could lead to a negative print on China’s CPI.
 - China’s #2 property developer, Vanke (000002, CNY, 11.93), [appears to be in trouble, prompting local governments to step up their support](#). There is evidence that [Beijing is responding to the property crisis](#) by moving to support other industries and through the expansion of central government spending.
 - [China has created a network of ports](#) as part of its maritime Belt and Road Initiative. This network could become a major military asset. The Belt and Road projects have become notorious for pushing nations into debt; China has become a [major source of aid](#) that may be designed to support its collection efforts as well.

Economic Roundup: The Senior Loan Officers Survey was released yesterday; we offer details.

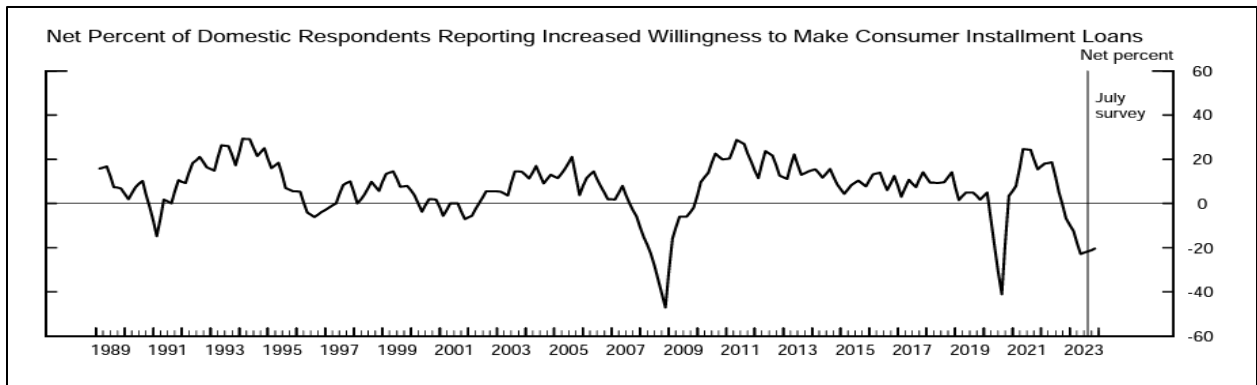
- The [Senior Loan Officer Survey](#) was released yesterday afternoon. For the most part, credit standards remain tight but have loosened somewhat.



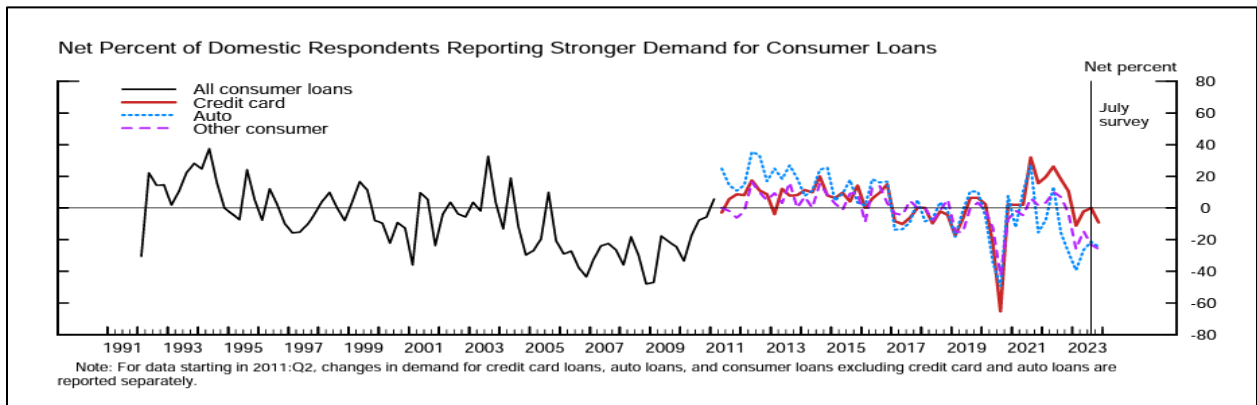
Demand also showed signs of improvement.



The willingness to make consumer loans was mostly steady.



However, demand from consumers remains soft.



Overall, the survey suggests financing conditions are not getting much worse, but overall, lending standards remain tight.

- Higher interest rates and dollar strength are taking their [toll on emerging markets](#).

- As commercial banks face increasing capital restrictions, they are developing novel ways to distribute lending risks. Banks are increasingly using [synthetic risk transfer products](#), which allow banks to reduce their capital charges on loans. In return, buyers of these instruments receive high returns.
- In general, funding for any asset can come from either debt or equity. The attractiveness of either method depends on the cost of the funding. As mortgage rates hit 8%, [homebuyers are being offered instruments](#) which are essentially equity participation in the home-buying process. The firms providing the equity are then creating bonds to sell to investors.

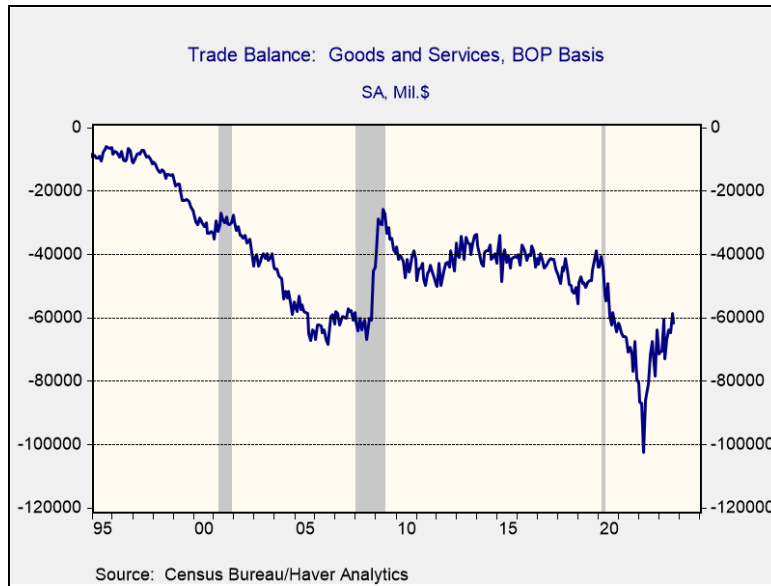
International Roundup: Germany is struggling to deal with the Alternative for Germany party (AfD), and the incumbent in El Salvador can run again.

- A close advisor to the head of Ukraine’s armed forces was killed yesterday by [a bomb hidden in a birthday gift](#). Major Gennadiy Chastyakov, an aide to General Zaluzhny, died when the package exploded.
- In democracies, there are situations where, if power is closely balanced, individuals can have an outsized impact on policy. In the U.S., such situations are uncommon because a two-party system tends to overwhelm its dissidents.¹ Multiparty systems, such as those seen in continental Europe, are much more prone to minority parties having significant power. Major parties rarely win a majority outright, and thus, must court minor parties to form governments. This means that if the lesser parties become unhappy, they can bring down governments. We are seeing something like this in Germany. The AfD has seen its power rise in recent local elections. The major parties are trying to avoid a situation where they need the AfD to form a government. What’s driving the AfD’s success is German’s anger over [immigration](#) and [energy policy](#). Sometimes, minor parties in government can force the larger parties into policies that are unpopular. If that occurs, as we are seeing in Germany now, it can lead to political tensions.
- In El Salvador, [an election tribunal decided to allow Nayib Bukele to run for a third term](#), in contradiction of the nation’s constitution. Bukele is very popular but was being prevented from running again due to legal restrictions. Now that those are out of the way, he will likely win; elections will be held in February 2024.

U.S. Economic Releases

The U.S. trade shortfall in goods and services widened from \$58.7 billion to \$61.5 billion in September. The reading came in above expectations of \$59.9 billion. The growth in the deficit was driven by an increase in imports which rose from \$314.3 billion to \$322.7 billion. However, there was an increase in exports as they rose from \$255.4 billion to \$261.1 billion.

¹ Although uncommon, it isn’t unprecedented. The power of Sen. Manchin and Sen. Sinema was in evidence from 2020-22. And, the power of the Freedom Caucus has had an impact on the House of Representatives.



The chart above shows the level of the trade balance. An increase in the trade deficit is a drag on GDP, which can increase the likelihood of an economic contraction.

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
15:00	Consumer Credit	m/m	Sep	\$9.500b	-\$15.628b	*
Federal Reserve						
EST	Speaker or Event	District or Position				
9:15	Michael Barr Speaks on Financial Technology	Federal Reserve Board Vice Chair for Supervision				
9:50	Jeffrey Schmid Speaks at Dallas/Kansas City Energy Conference	President of the Federal Reserve Bank of Kansas City				
10:00	Chris Waller Speaks at St. Louis Fed Conference	Member of the Board of Governors				
12:00	John Williams Moderates Discussion in New York	President of the Federal Reserve Bank of New York				
13:25	Lorie Logan Participates in Moderated Discussion	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								
Japan	Household Spending YoY	y/y	Sep	-2.8%	-2.5%	-2.9%	*	Equity and bond neutral
	Labor Cash Earnings	y/y	Sep	1.2%	1.1%	0.8%	***	Equity and bond neutral
China	Trade Balance	m/m	Oct	\$56.53b	\$77.71b	\$77.83b	***	Equity and bond neutral
	Exports	y/y	Oct	-6.4%	-6.2%	-3.5%	**	Equity bearish, bond bullish
	Imports	y/y	Oct	3.0%	-6.2%	-6.3%	**	Equity bullish, bond bearish
	Foreign Reserves	m/m	Oct	\$3101.22b	\$3115.07b	\$3102.5b	**	Equity and bond neutral
EUROPE								
Eurozone	PPI	y/y	Sep	-12.4%	-11.5%	-12.5%	*	Equity and bond neutral
Germany	Industrial Production WDA	y/y	Sep	-3.7%	-2.0%	-1.9%	**	Equity bearish, bond bullish
	HCOB Germany Construction PMI	m/m	Oct	38.3	39.3		*	Equity and bond neutral
Switzerland	Unemployment Rate	m/m	Oct	2.0%	2.0%	2.1%	**	Equity and bond neutral
	Foreign Currency Reserves	m/m	Oct	657.8b%	678.4b	678.3b	***	Equity and bond neutral
AMERICAS								
Brazil	Total Outstanding Loans	m/m	Sep	0.80%	5524b	1.20%	**	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)	564	565	-1	Up
3-mo T-bill yield (bps)	526	527	-1	Flat
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	537	536	1	Flat
U.S. Libor/OIS spread (bps)	538	538	0	Down
10-yr T-note (%)	4.62	4.64	-0.02	Flat
Euribor/OIS spread (bps)	396	396	0	Up
Currencies	Direction			
Dollar	Up			Up
Euro	Down			Down
Yen	Down			Down
Pound	Down			Down
Franc	Down			Down
Central Bank Action	Current	Prior	Expected	
RBA Cash Rate Target	4.350%	4.100%	4.350%	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.

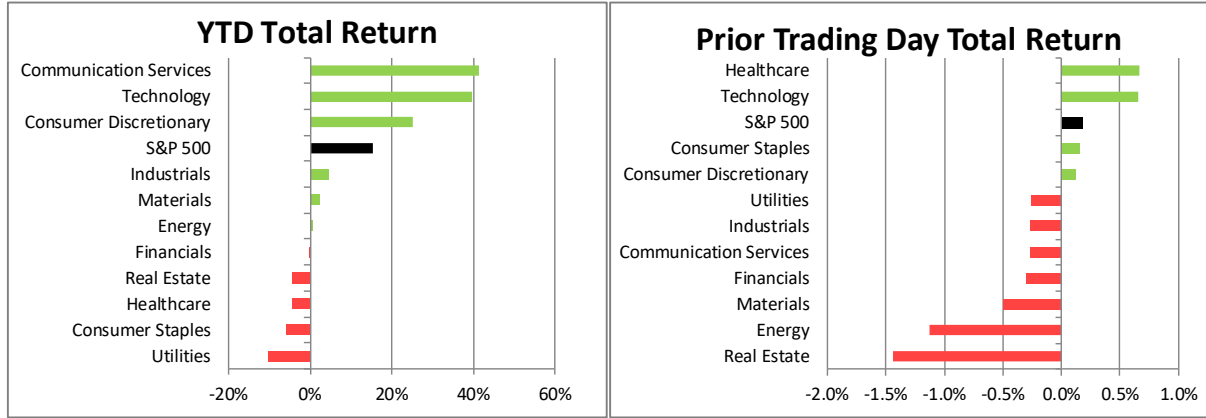
DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$83.39	\$85.18	-2.10%	
WTI	\$79.15	\$80.82	-2.07%	
Natural Gas	\$3.13	\$3.26	-4.20%	Supply Optimism
Crack Spread	\$22.58	\$23.16	-2.53%	
12-mo strip crack	\$23.86	\$24.32	-1.92%	
Ethanol rack	\$2.13	\$2.14	-0.66%	
Metals				
Gold	\$1,958.20	\$1,978.14	-1.01%	
Silver	\$22.54	\$23.03	-2.12%	
Copper contract	\$366.60	\$371.90	-1.43%	
Grains				
Corn contract	\$472.25	\$477.25	-1.05%	
Wheat contract	\$571.50	\$575.75	-0.74%	
Soybeans contract	\$1,362.75	\$1,364.00	-0.09%	
Shipping				
Baltic Dry Freight	1,523	1,462	61	
DOE Inventory Report				
	Actual	Expected	Difference	
Crude (mb)		1.8		
Gasoline (mb)		-0.1		
Distillates (mb)		-1.0		
Refinery run rates (%)		0.2%		
Natural gas (bcf)		79		

Weather

The 6-10 and 8-14 day forecasts predict warmer-than-normal temperatures for most of the country, with cooler temperatures expected on the West Coast and New England regions. The precipitation outlook shows that wetter-than-normal conditions are expected to spread from the West and South to most of the country, while dry conditions are expected in New England.

Data Section

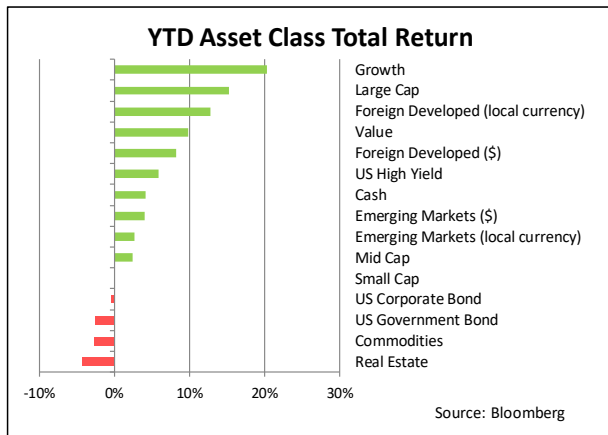
U.S. Equity Markets – (as of 11/6/2023 close)



(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 11/6/2023 close)

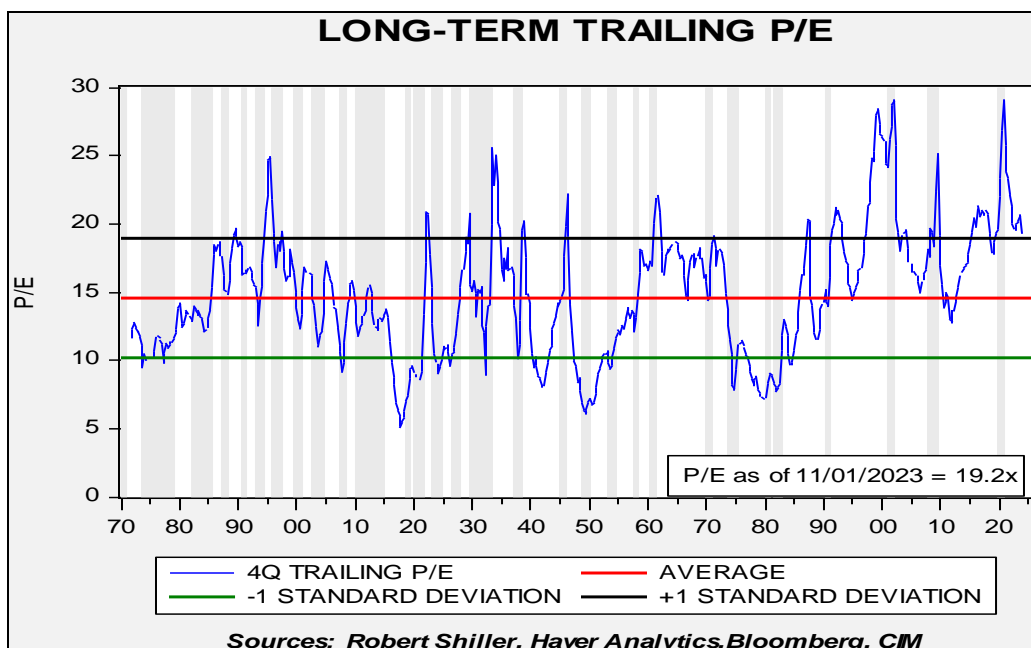


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

November 2, 2023



Based on our methodology,² the current P/E is 19.2x, down 0.3x from last week. The multiple contracted due to falling index values and improved earnings.

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 Bloomberg estimates which are updated regularly throughout the quarter; currently, the four-quarter earnings sum includes two actual quarters (Q1 and Q2) and two estimates (Q3 and Q4). 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.