

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 8, 2022—9:30 AM EST] Global equity markets are generally higher this morning. In Europe, the Euro Stoxx 50 is currently up 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.4%. Chinese markets were lower, with the Shanghai Composite closing down 0.4% from its prior close and the Shenzhen Composite closing down 0.4%. U.S. equity index futures are signaling a slightly higher open.

With 437 companies having reported so far, S&P 500 earnings for Q3 are running at \$56.40 per share, compared to estimates of \$55.45. Of the companies that have reported thus far, 70.3% have exceeded expectations while 23.8% 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 \(11/07/2022\)](#) (with associated [podcast](#)) “Reflections on the 20th Party Congress”**
- [Weekly Energy Update \(11/3/2022\)](#): In this week’s report we include a special discussion on the distillate situation since concerns have been raised in the media and we wanted to address them in detail. We then update the natural gas market as the northern hemisphere winter approaches. We also recap major stories and last week’s data.
- [Asset Allocation Quarterly – Q4 2022 \(10/18/2022\)](#): Discussion of our asset allocation process, Q4 2022 portfolio changes, and our outlook for the markets
- [Asset Allocation Bi-Weekly \(10/31/2022\)](#) (with associated [podcast](#)): “The Inflation Adjustment for Social Security Benefits in 2023”

Our *Comment* today opens with an update on the Russia-Ukraine war, including a new statement by Ukrainian President Zelensky that he is open to peace talks with Russia, subject to tough conditions. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including a series of speeches by policymakers at the European Central Bank that indicate they will continue to hike interest rates aggressively.

[Russia-Ukraine:](#) The Ukrainians [continue to slowly and methodically press their counteroffensives in the northeastern Donbas region and in the southern region around Kherson](#). Meanwhile, the Russians increasingly look like they are preparing to defend Kherson, although perhaps with only a blocking force of minimally trained, recently mobilized troops. The Russians also continue to attack civilian infrastructure targets throughout Ukraine using air,

missile, and kamikaze drones. However, Ukrainian intelligence officials say that Russia has now run through some 80% of their modern, high-precision missiles, which could mean their campaign against the Ukrainian infrastructure will soon slow enough for the Ukrainians to get much of their energy grid back into operation.

- President Zelensky [stated that he was open to peace negotiations with Russia if they are focused on safeguarding Ukraine’s territorial integrity, compensating Kyiv, and bringing perpetrators of war crimes to justice.](#) The U.S. and other allies have been pressuring Zelensky to say he is open to talks in order to firm up international support for Ukraine. However, Russia is unlikely to accept Zelensky’s tough terms, at least for now.
- Separately, Zelensky [said his government has used its wartime powers to temporarily take control of five “strategic” companies owned by the country’s oligarchs.](#)
 - The nationalized companies include Ukraine’s top oil producer, its top oil refiner, and a key manufacturer of engines for airplanes and helicopters.
 - Importantly, some of the nationalized firms were previously owned by Igor Kolomoisky, an oligarch who backed Zelensky’s presidential bid in 2019 and who is now facing probes into the insolvency of PrivatBank, another of his previous businesses. That suggests that Zelensky may be using his wartime powers to carry out his program of weakening the country’s corrupt oligarchs.

Eurozone Monetary Policy: Pushing back against politicians and investors hoping for a “dovish pivot” toward stabilizing or even falling interest rates soon, several senior policymakers at the ECB today [insisted that the fight against price inflation will require them to keep hiking interest rates, even beyond the point at which they constrain demand and weaken growth.](#) The well-coordinated statements signal that the ECB will continue to hike rates aggressively, even as it tries to keep a lid on longer-term bond yields in the bloc’s weaker economies.

Pakistan: Supporters of Former Prime Minister Imran Khan [have blockaded roads around the capital of Islamabad in an effort to topple the government](#) following an attempted assassination of Khan last week. The protestors are angry at what they see as the government’s reluctance to investigate allegations that current Prime Minister Sharif and senior civilian and military officials conspired to kill Khan.

China: The latest figures [show that new COVID-19 infections nationwide have topped 5,400 cases per day for the first time since May.](#) Although there are now multiple conflicting reports about whether the government will end its disruptive Zero-COVID policies in the coming months, the current surge suggests that the government could impose new lockdowns in the coming days. As we have discussed before, such lockdowns have been challenging for the Chinese economy, the broader global economy, and global financial markets.

United States-China: In another example of how the world’s technology industry is finding work-arounds to the strict new U.S. restrictions on selling semiconductor technology, equipment, and services to China, Nvidia (NVDA, \$143.01) [announced it has developed a new graphics chip for advanced Chinese companies that can be exported to China without restriction.](#)

- According to Nvidia, the new chip has the same computational performance but a narrower interconnect bandwidth, i.e., the capacity of the chip to send and receive data from other chips, which is crucial for training large-scale AI models or building supercomputers.
- Nvidia hopes the new chip will allow it to retain hundreds of millions of dollars of revenue from China that otherwise would be lost.
- Nevertheless, it appears that the new, restricted chip will help meet the U.S. goal of further suppressing the overall computational capacity of China and the Chinese military.

U.S. Labor Market-Impact of COVID-19: Even though new COVID-19 infections have fallen sharply, pandemic restrictions are practically gone, and life in many respects is approaching normal, new research [indicates that the disease continues to impede labor force participation and productivity growth](#). In turn, the resulting labor shortages are contributing to upward pressure on wages and inflation.

- According to the new studies, the number of workers who missed at least one week of work because of illness in any given month is now up 630,000 from the average levels before the pandemic.
- At least 500,000 more workers have dropped out of the labor force because of the lingering effects of a previous COVID-19 infection.
- In a Census Bureau survey in October, 1.1 million people said they hadn't worked the week before because they were concerned about contracting or spreading the virus.
- The pandemic's lingering suppression of the labor force has forced many firms to keep payrolls higher than they otherwise would in order to ensure adequate personnel for operations. That means those firms are now operating less efficiently than they would have before the pandemic. The resulting drop in productivity per worker hour has raised labor costs and fed into inflation.

U.S. Labor Market-Impact of Recession: Recent layoff announcements by major employers [suggest that middle managers may be particularly at risk as the economy slips into recession](#). Skilled production workers and other non-supervisors are typically the first to be let go as firms trim their labor costs going into a downturn, but today's massive shortage of such workers means firms will probably be loathe to let them go. Rather, the economy may be slipping into a "white collar recession."

U.S. Real Estate Market: New data shows developers [are slowing their major office projects already under way and shelving new projects](#) as they face soaring interest rates and high office vacancy rates after the COVID-19 pandemic.

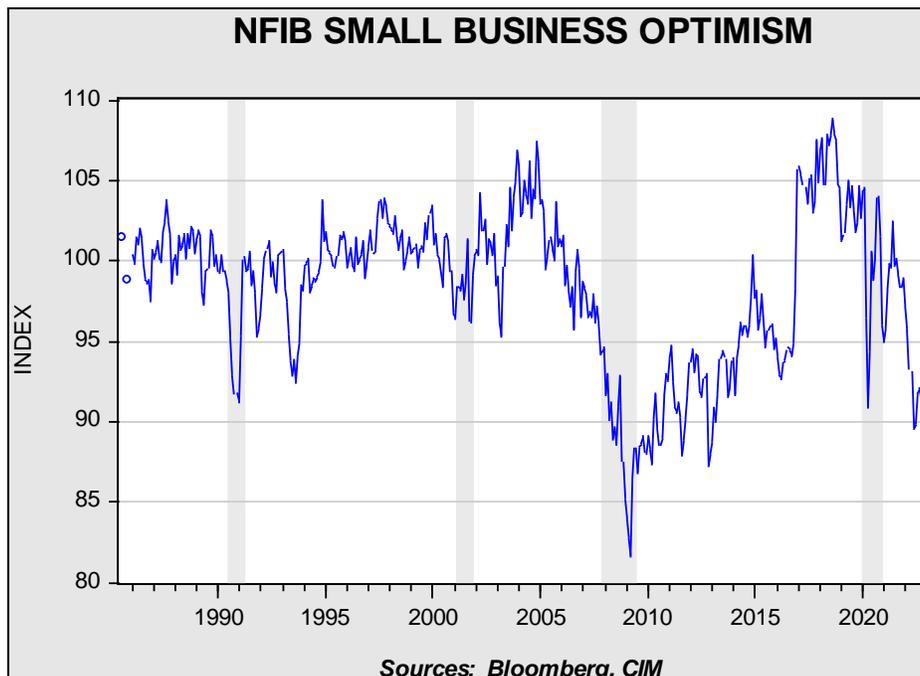
- Reduced office construction will help slow the economy and push it into recession, but it could eventually help bring the supply of office space down to the lower, post-pandemic level of demand. In time, that could help stabilize office rents.

- The boom-and-bust cycles in property development can be difficult for investors, but they also hold out the promise that excess space and low rents today can eventually reverse.

U.S. Elections: Voters across the U.S. [go to the polls today for mid-term elections in which all seats in the House of Representatives and one-third of the seats in the Senate will be contested.](#) The latest polls suggest that the summer swing of voting intentions toward the Democrats [has now largely dissipated, raising the chance that the Republicans could take control of both chambers.](#)

U.S. Economic Releases

Inflation concerns weighed on the sentiment of independent business owners. According to an index tracked by the National Federation of Independent Business, small business optimism dipped 0.8 points in October to 91.3. This is the tenth consecutive month the tracker was below its historical average of 98.0.



The chart above shows the NFIB Small Business Optimism Index. The weakness in sentiment is likely related to business owners struggling to push costs onto their consumers. The net percentage of respondents who reported the ability to raise average selling prices decreased by 1 point in September to a net 50% seasonally adjusted. Meanwhile, 34% of owners who reported lower profits blamed the higher decline in earnings on the rise in the cost of materials. This disappointing report reinforces our view that the economy is slowing.

There are no economic releases or Fed events scheduled for the rest of the day.

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	y/y	Sep	2.3%	5.1%	2.6%	**	Equity and bond neutral
	Labor Cash Earnings	y/y	Sep	2.1%	1.7%	1.7%	*	Equity and bond neutral
	Real Cash Earnings YoY	y/y	Sep	-1.3%	-1.7%	-1.8%	*	Equity and bond neutral
	Leading Economic Index	m/m	Sep P	97.4	101.3	97.6	**	Equity and bond neutral
Australia	Westpac Consumer Conf Index	m/m	Nov	78.0	83.7		**	Equity bearish, bond bullish
	Westpac Consumer Conf SA	m/m	Nov	-6.9%	-0.9%		**	Equity bearish, bond bullish
	NAB Business Conditions	m/m	Oct	22.0	25.0	23.0	**	Equity and bond neutral
	NAB Business Confidence	m/m	Oct	0.0	5.0		**	Equity and bond neutral
New Zealand	2-Year Inflation Expectations	q/q	4Q	3.62%	3.07%		**	Equity bearish, bond bearish
South Korea	BoP Current Account Balance	m/m	Sep	\$1.6112b	-\$3.0491b		**	Equity and bond neutral
	BoP Goods Balance	m/m	Sep	\$494.0b	-\$4.4493b		*	Equity and bond neutral
EUROPE								
Eurozone	Retail Sales	y/y	Sep	-0.6%	-2.0%	-1.1%	*	Equity and bond neutral
France	Trade Balance	m/m	Sep	-£173487b	-£15.301b	-£14.650b	**	Equity and bond neutral
	Current Account Balance	m/m	Sep	-\$7.3b	-\$5.1b	-\$5.9b	**	Equity and bond neutral
Italy	Retail Sales	y/y	Sep	4.1%	4.3%	4.4%	**	Equity and bond neutral
AMERICAS								
Brazil	FGV Inflation IGP-DI	y/y	Oct	5.59%	7.94%	5.47%	**	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)	455	453	2	Up
3-mo T-bill yield (bps)	406	406	0	Up
TED spread (bps)	50	47	3	Widening
U.S. Sibor/OIS spread (bps)	422	421	1	Up
U.S. Libor/OIS spread (bps)	426	425	1	Up
10-yr T-note (%)	4.21	4.22	-0.01	Up
Euribor/OIS spread (bps)	174	173	1	Neutral
Currencies	Direction			
Dollar	Up			Up
Euro	Down			Down
Yen	Up			Down
Pound	Down			Down
Franc	Down			Down

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.

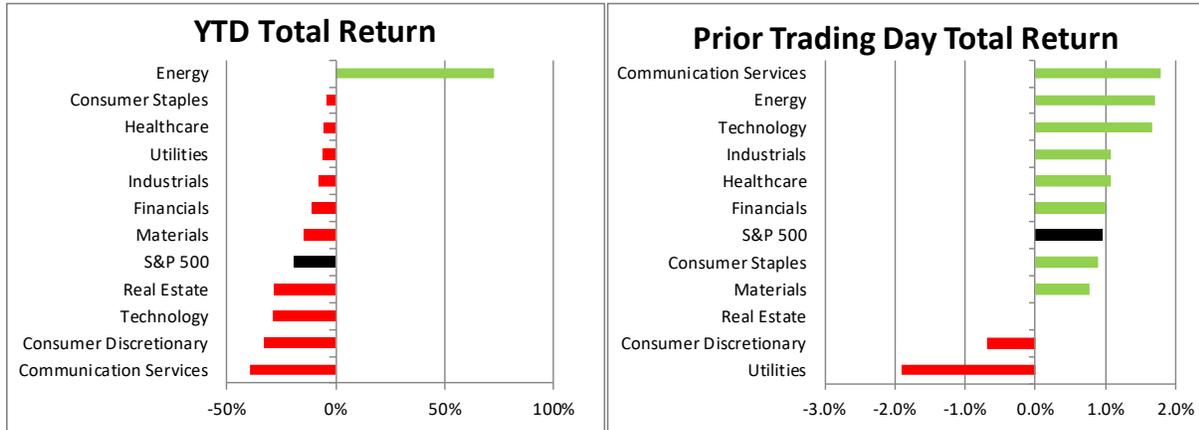
	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$97.42	\$97.92	-0.51%	
WTI	\$91.03	\$91.79	-0.83%	
Natural Gas	\$6.57	\$6.94	-5.41%	
Crack Spread	\$36.03	\$35.73	0.86%	
12-mo strip crack	\$32.60	\$32.64	-0.12%	
Ethanol rack	\$3.07	\$3.05	0.50%	
Metals				
Gold	\$1,672.05	\$1,675.63	-0.21%	
Silver	\$20.75	\$20.80	-0.22%	
Copper contract	\$361.70	\$360.35	0.37%	
Grains				
Corn contract	\$673.00	\$675.75	-0.41%	
Wheat contract	\$836.75	\$845.75	-1.06%	
Soybeans contract	\$1,442.50	\$1,450.25	-0.53%	
Shipping				
Baltic Dry Freight	1,337	1,323	14	
DOE Inventory Report				
	Actual	Expected	Difference	
Crude (mb)		-0.2		
Gasoline (mb)		-1.0		
Distillates (mb)		-0.5		
Refinery run rates (%)		0.5%		
Natural gas (bcf)		101		

Weather

The 6-10 and 8-14 day forecasts currently call for a deep cold snap for the broad midsection of the lower 48 states with cooler-than-normal temperatures for the coasts. Some moderation is expected later in November, but the cold weather did trigger a jump in natural gas prices yesterday. Wetter-than-normal conditions are anticipated for states in the Southeast, with dry conditions expected in the Northern Pacific and Midwest. Subtropical storm Nicole is heading for Florida and is expected to make landfall as a hurricane tomorrow. It is expected to move up the Atlantic coast and dissipate in Delaware by Saturday.

Data Section

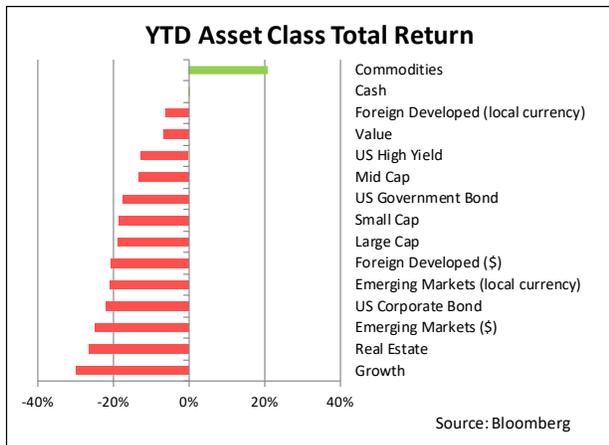
U.S. Equity Markets – (as of 11/7/2022 close)



(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 11/7/2022 close)

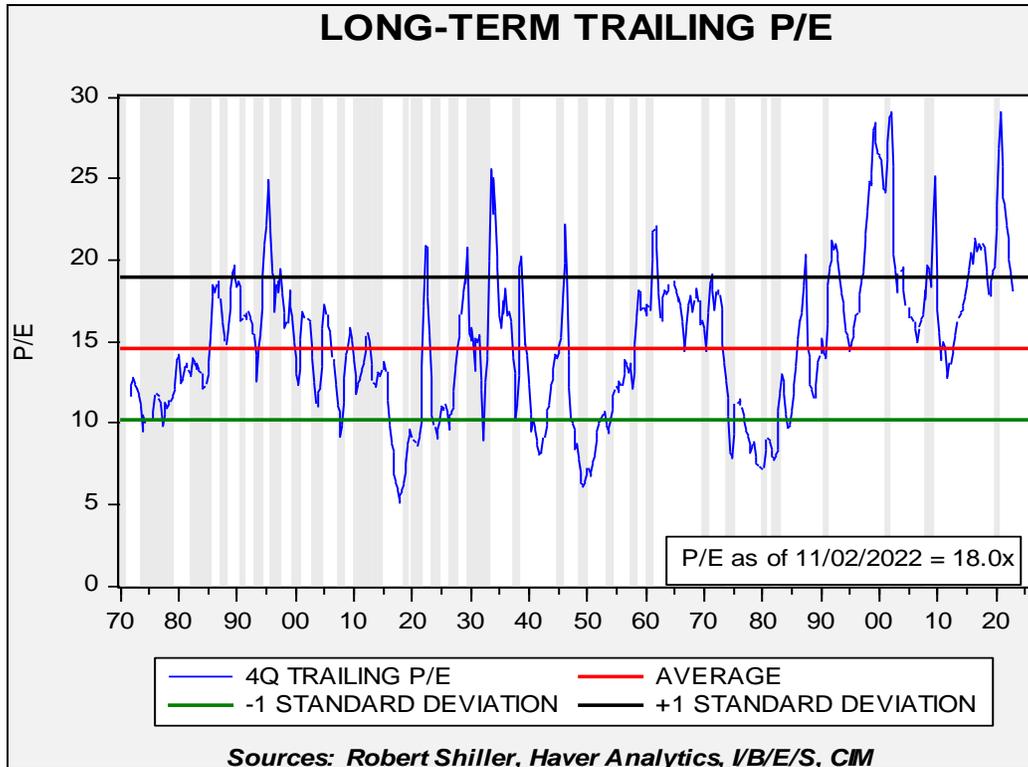


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 3, 2022



Based on our methodology,¹ the current P/E is 18.0x, up 0.2x from last week. Rising index values and falling earnings led to the rise 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 (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.