

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 18, 2021—9:30 AM EST]** Global equity markets are mixed this morning. In Europe, the EuroStoxx 50 is up 0.1% from its prior close. In Asia, the MSCI Asia Apex 50 closed down 0.9%. Chinese markets were lower, with the Shanghai Composite down 0.5% from its prior close and the Shenzhen Composite down 0.7%. U.S. equity index futures are signaling a higher open. With 468 companies having reported, the S&P 500 Q3 2021 earnings stand at \$54.00, higher than the \$50.34 forecast for the quarter. The forecast reflects a 27.5% increase from Q3 2020 earnings. Thus far this quarter, 81.5% of the companies have reported earnings above forecast, while 14.6% 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](#) (11/15/2021): “The Special Relationship”
- [Weekly Energy Update](#) (11/18/2021): **The Biden administration is trying to cope with higher energy prices and inflation fears.**
- [Asset Allocation Q4 2021 Rebalance Presentation](#) (11/4/2021): A video discussion of our asset allocation process, Q4 2021 portfolio changes, and the macro environment
- [Asset Allocation Weekly](#) (11/12/2021) (with associated [podcast](#)): We discuss the Citigroup Economic Surprise Index and how it might provide valuable clues about future bond yields

Good morning on the [eve of a major lunar eclipse!](#) [U.S. equity futures are moving higher](#) this morning, and oil prices are ticking higher as well, despite U.S. pressure for a wider SPR release. Our coverage begins with comments on debt market stability. There is a lot of China news as we try to analyze recent CPC meetings. Up next is economic and policy news, with the international news roundup afterward. We close with our regular pandemic update.

**Market stability:** One area we watch closely is the resiliency of the Treasury market. Treasuries are the backbone of the financial markets and the internal financial plumbing of the financial markets. Recent market events, such as the repo crisis in August 2019 and the March 2020 financial freeze, are all tied to the market’s inability to manage the flow of credit. We are seeing some hints of problems now. Our take is that the massive borrowing by the Federal government, coupled with capital requirements of the primary dealers, is leading to instability. The [recent poor 30-year T-bond auction](#) appears tied to this issue. Regulators are attuned to the problem [but seem to lack a deep understanding of how to address it.](#) [Regulators met yesterday to](#)

[discuss the issue](#). [The general conclusion is that central clearinghouses are the answer](#). Perhaps. We have long experience with futures clearinghouses, and we know they are very good at protecting the exchanges and the clearinghouses themselves but generally don't care about the participants. At the same time, a properly functioning clearinghouse can force participants out of positions before they become a systemic problem. Another potential response is to fortify the Fed's lender of last resort to become a dealer of last resort. However, until these issues are resolved, the financial system will remain susceptible to sudden stops in liquidity that can trigger financial crises.

**China news:** A crackdown on crypto, an easing on real estate lending, and more on the recent party conference lead today's comments.

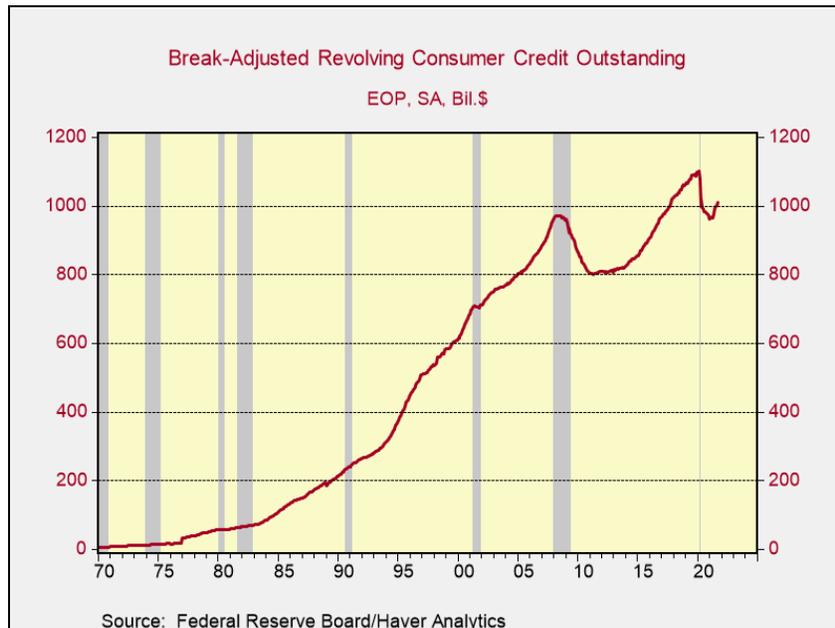
- The crackdown on crypto mining in China snared a high-ranking CPC provincial official in [Jiangxi](#). According to [party documents](#) and reported [in the media](#), Xiao Yi was accused of taking bribes and other nefarious activities in allowing crypto mining operations to be established in the province. Although Texas has seen an influx of mining operations, Chinese operators are apparently moving their [talents to Singapore](#), which has a large Chinese diaspora.
- In the face of [continued pressure in the real estate market](#), Chinese officials appear to be easing regulations to increase available liquidity to the sector. State-owned real estate developers are [boosting land auction activity](#), a key funding source for local governments. [Regulations on asset-backed security \(ABS\) sales appear to have eased as well](#), leading to increased issuance. The ability to borrow using assets as collateral will increase available liquidity.
- The recent party meetings [where Xi was portrayed as the natural successor to Mao and Deng](#) are still resonating; analysts are combing through the lengthy documents for clues to future behavior.
  - The “[throwback](#)” references to the Mao era in Xi's writings are remarkable. Deng was able to move on from Mao by openly discussing his failures. Xi appears to be using Mao's nostalgia to undercut Deng's policies. It is clear that Xi is [portraying himself as the next major CPC figure](#). He has indicated that his drive to consolidate power was all about moving the country forward and [making sure he stays in office as long as he likes](#).
  - [Xi seems to be downplaying the role of GDP targets](#). If China is going to bring its debt growth under control, investments driven by debt will likely need to stop. The downside is that this action will lead to slower economic growth. If the GDP targets are deemphasized, there is a better chance that economic restructuring can occur.
  - There [also seems to be a return to the earlier position on Taiwan](#), which is that unification can happen naturally in the future. Xi did warn that any action to declare independence would trigger a military response.
- Although recent actions suggest China may be trying to walk back recent belligerence, the U.S. is moving in a direction that assumes a hostile relationship with China.

- The U.S. is [looking to bolster trade relations in Asia](#), although not joining the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) [undercuts the effort](#).
- A [Congressional commission](#) recommends the U.S. scale back commercial relations with China.
- We are [seeing financial firms getting increased access to China](#), but it is unclear how long this opening will last. It is possible the U.S. may be the bigger obstacle. Meanwhile, it is abundantly clear that Beijing sees the [U.S. business community as an ally](#) and pressure point against China hawks.
- We see one area of cooperation; Washington [has asked Beijing to release oil from their SPR](#) in a bid to lower prices.
- At the same time, this potential “thaw” should be treated with caution. China is still trying to expand its reach across the globe, [especially in data control](#). This data control is also [affecting global shipping](#).
- The EU is [delaying its trade upgrade legislation](#) regarding Taiwan.
- The [World Tennis Association continues to express concern over Peng Shuai](#), the Grand Slam doubles champion linked to a sex scandal with a high-ranking CPC official. There has been a new release purporting to be from Peng, but there is little confidence she actually issued the press release.
- Tsinghua Unigroup (600100.ss, CNY, 5.68) is [seeking a deep-pocketed buyer](#). The company is an important element in China’s goal of tech independence.
- The [U.S. has named a director for AUKUS](#).
- Australia has named [63 areas of technology](#) that won’t be shared with China.
- Longer-term, [China is facing a nearly insurmountable demographic problem](#).

**Economics and policy:** Inflation dominates the newsflow.

- The White House is growing increasingly worried about inflation. Unfortunately, the executive branch has [limited tools](#) to affect price levels.
  - Oil prices have become a sensitive issue for the administration. Not only has Washington asked Beijing to release SPR oil, but [other Asian nations have received similar requests](#).
- An [increasing number of FOMC members](#) are pushing for tighter policy. It remains to be seen if Chair Powell can overcome growing opposition to accommodation.
- We are starting to see mainstream center-left economists calling for rate hikes. [Jason Furman](#) is a potential candidate for a Fed governor role, but a recent op-ed may eliminate him as a nominee. Or not. If President Biden is serious about controlling inflation, [he should be looking for a hawk](#) to replace Chair Powell. Presidents supporting hawkish monetary policy are quite rare; President Carter was arguably the only one since Fed independence since 1951 (even President Truman, who approved the deal for independence, was uncomfortable with the arrangement). The political cost Carter paid should be a cautionary tale for any president.

- As prices rise, households are adapting. [Retail traffic is rising at discount stores](#) as shoppers try to stretch their incomes. The [nascent goods exchange network](#) reports increased activity as well.
- Saule Omarova, the nominee for comptroller of the currency, [is scheduled to appear before the Senate Banking Committee](#). She is a controversial selection, supporting ideas like government saving accounts for the unbanked. Given that she won't get any GOP support needed to be approved by the committee, she will need all the Democrats to sign off on her nomination. That may not be possible.
- [Banks are boosting credit card offers](#), hoping to encourage households to carry balances. Balances fell sharply during the pandemic, as households used their support payments to pay down balances.



- Despite calls for 24/7 port activities, [in practice, it isn't happening](#). Truckers who handle container shipments to warehouses have not been coming to take cargos at night. Part of the issue is due to truckers wanting to avoid night work. Another factor is that warehouses are not structured for 24/7 activities. In some cases, local community rules prevent night work.
- John Deere (DE, USD, 353.52) workers [have ended their strike](#) after the company boosted its [base productivity pay offer](#).
- [National defense legislation](#) appears poised to move through Congress.
- [The population center of the U.S.](#), from the most recent census, is Wright County, MO.

**International roundup:** The Turkish lira plunges, the “three amigos” meet today in Washington, and Belarus is starting to ponder a plan for all these refugees.

- [Turkey's central bank cut its main policy rate by 100 bps to 15%](#), sending the [TRY to new lows](#) against [the dollar](#). [President Erdogan holds the position that high-interest rates](#)

[contribute to inflation](#) and has undercut the central bank's independence to force unorthodox rate reductions.

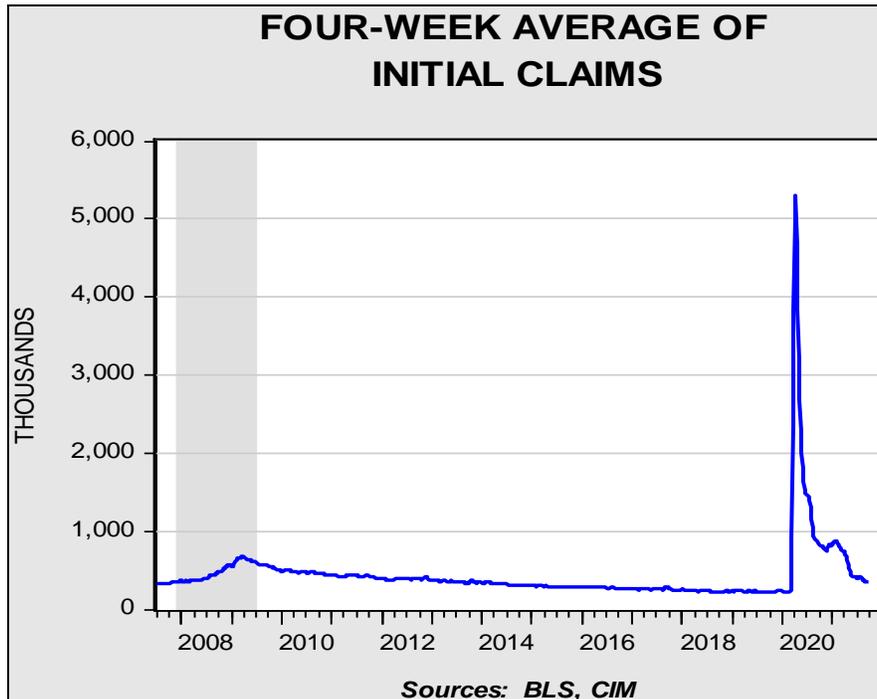
- The dollar has been stronger recently across the board, mostly on ideas that [the Fed will need to raise rates sooner than other central banks](#).
- As we have been discussing recently, Belarus has been using Middle East refugees as a weapon against EU sanctions. However, one problem with this [policy is that if it fails](#) and the refugees can't enter the EU, [what does Minsk do with all these people?](#) We doubt he can send them back, and the country doesn't really have the resources to house them.
- Leaders of the [USMCA meet today in Washington](#) in what could be an acrimonious summit. Canada and Mexico are deeply intertwined in the U.S. auto industry supply chain, and recent legislation that would give [higher tax credits to U.S. UAW EVs](#) is a [sore point for both nations](#). [It's not popular with non-UAW auto firms either](#).
- The EU's top court [says Poland's rules on appointing judges violate EU law](#), setting the stage for a confrontation between Warsaw and Brussels.
- The U.S. and U.K. say [Iran is behind recent cyberattacks](#).

**COVID-19:** The [number of reported cases](#) is 255,174,017, with 5,127,127 fatalities. In the U.S., there are 47,421,879 confirmed cases with 767,439 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 558,460,315 doses of the vaccine have been distributed, with 444,789,186 doses injected. The number receiving at least one dose is 228,175,638, while the number receiving second doses, which would grant the highest level of immunity, is 195,612,365. For the population older than 18, 70.7% of the population has been fully vaccinated, with 58.9% of the entire population fully vaccinated. The *FT* has a page on [global vaccine distribution](#). The [Axios map](#) shows rising cases as colder weather increases indoor gatherings.

- One downside of lockdowns is that they increased the incidence of mental health problems. In the 12-month period ending in April 2021, [drug overdose fatalities topped 100,000](#), a [new record](#). [This map](#) shows the distribution of drug overdose deaths.
- Pfizer (PFE, USD, 50.87) announced it will allow [developing nations to acquire its antiviral drug at a low cost](#). The U.S. is [also pressing vaccine makers to expand global supplies](#).
- The [FT has an in-depth investigation](#) of “gain-of-function” gene experiments. Not only is the lax security and safety precautions worrisome, but the reason for doing such work is hard to justify.
- Europe is facing a [new surge in cases](#), especially in central and eastern areas of the continent. Already, [nations are imposing](#) various [levels of lockdowns](#) and [other restrictions](#).
- Reports indicate that schools inadvertently purchased air quality systems that [either failed to work or were dangerous](#).

## U.S. Economic Releases

Jobless claims fell for the seventh consecutive week, according to the Department of Labor. Initial jobless claims came in at 268K compared to expectations of 260K. The prior month's report was revised upward from 267K to 269K. Continuing claims came in at 2,080K compared to expectations of 2,120K. The prior week's report was revised from 2,160K to 2,209K.



The chart above shows the four-week moving average of initial claims. The moving average fell from 278.50K to 272.75K.

Manufacturing activity for the Philadelphia area picked up in October, according to the Federal Reserve Bank of Philadelphia. The Philadelphia Business Outlook Index came in at 39.0 compared to expectations of 24.0. The increase in the index has been driven by a rise in new orders, shipments, and employment. The strong demand for goods has led to a notable upward swing in expectations for future growth. However, survey respondents have continued to report higher input and labor prices. As a result, it is possible that firms will begin to offset the burden of those costs by raising prices on goods sold to consumers.



The chart above shows the six-month moving average of the Philadelphia Fed Business Outlook.

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	Langer Consumer Comfort	w/w	14-Nov		50.3	***
10:00	Leading Index	m/m	Oct	0.8%	0.2%	**
11:00	Kansas City Fed Manf. Activity	m/m	Nov	28	31	**
Fed Speakers or Events						
EST	Speaker or event	District or position				
8:00	Raphael Bostic Discusses Regional Outlook	President of the Federal Reserve Bank of Atlanta				
9:30	John Williams Speaks on Transatlantic Responses to Pandemic	President of the Federal Reserve Bank of New York				
14:00	Charles Evans Takes Part in Moderated Q&A	President of the Federal Reserve Bank of Chicago				
15:30	Mary Daly Takes Part in Fed Listens Event	President of the Federal Reserve Bank of San Francisco				

## 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.

	Indicator			Current	Prior	Expected	Rating	Market Impact
<b>ASIA-PACIFIC</b>								
<b>China</b>	Swift Global Payments CNY	m/m	Oct	1.85%	2.19%		*	Equity bearish, bond bullish
<b>Japan</b>	Japan Buying Foreign Bonds	w/w	12-Nov	¥456.3b	¥1289.8b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	12-Nov	-¥492.7b	-¥227.6b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	12-Nov	¥1266.4b	¥441.9b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	12-Nov	¥164.9b	¥147.0b		*	Equity and bond neutral
	Tokyo Condominiums for Sale	y/y	Oct	-38.8%	-6.70%		**	Equity bearish, bond bullish
<b>New Zealand</b>	2Yr Inflation Expectation	q/q	4Q	2.96%	2.27%		**	Equity and bond neutral
<b>EUROPE</b>								
<b>Eurozone</b>	EU27 New Car Registrations	m/m	Oct	-30.3%	-23.10%		*	Equity bearish, bond bullish
<b>Switzerland</b>	Exports Real	m/m	Oct	-1.5%	0.4%		**	Equity bearish, bond bullish
	Imports Real	m/m	Oct	-4.4%	-0.8%		**	Equity bearish, bond bullish
	Swiss Watch Exports	y/y	Oct	12.5%	16.6%		**	Equity and bond neutral
	Industry & Construction Output WDA	y/y	3Q	7.3%	14.2%		**	Equity and bond neutral
	Industrial Output WDA	y/y	3Q	8.3%	15.7%	9.8%	**	Equity and bond neutral
<b>Russia</b>	GDP	y/y	3Q A	4.3%	10.5%	4.5%	***	Equity and bond neutral
	CPI	w/w	15-Nov	0.2%	0.1%		***	Equity and bond neutral
<b>AMERICAS</b>								
<b>Brazil</b>	FIPE CPI - Weekly	w/w	15-Nov	0.98%	1.01%	1.01%	**	Equity and bond neutral
<b>Canada</b>	CPI NSA	m/m	Oct	0.70%	0.20%	0.70%	***	Equity and bond neutral
	CPI	y/y	Oct	4.7%	4.4%	4.7%	***	Equity and bond neutral
	Teranet/National Bank HPI	m/m	Oct	0.00%	0.1%		***	Equity and bond neutral
<b>Mexico</b>	International Reserves Weekly	w/w	12-Nov	\$198788m	\$198920m		**	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)	16	16	0	Down
3-mo T-bill yield (bps)	4	5	-1	Neutral
TED spread (bps)	12	11	1	Neutral
U.S. Libor/OIS spread (bps)	8	8	0	Down
10-yr T-note (%)	1.60	1.59	0.01	Down
Euribor/OIS spread (bps)	-57	-56	-1	Neutral
EUR/USD 3-mo swap (bps)	23	21	2	Down
Currencies	Direction			
dollar	Down			Neutral
euro	Up			Up
yen	Down			Neutral
pound	Flat			Neutral
franc	Down			Neutral
Central Bank Action	Current	Prior	Expected	
RBA FX Transactions Government		-A\$1505m		On forecast
RBA FX Transactions Market		A\$1518m		On forecast
RBA FX Transactions Other		A\$1759m		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.

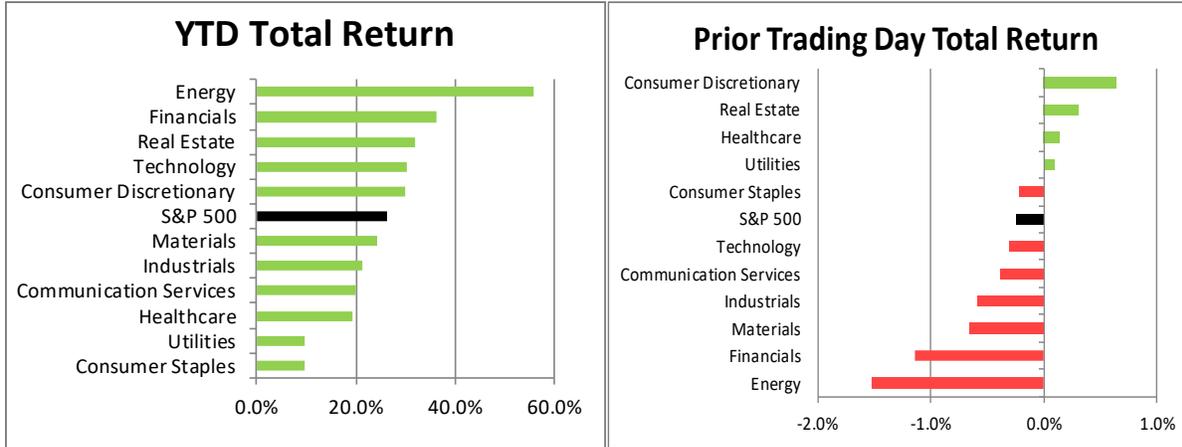
	Price	Prior	Change	Explanation
<b>Energy Markets</b>				
Brent	\$80.04	\$80.28	-0.30%	
WTI	\$77.95	\$78.36	-0.52%	
Natural Gas	\$4.93	\$4.82	2.33%	
Crack Spread	\$18.80	\$19.01	-1.07%	
12-mo strip crack	\$20.42	\$20.70	-1.34%	
Ethanol rack	\$3.57	\$3.54	0.76%	
<b>Metals</b>				
Gold	\$1,861.90	\$1,867.48	-0.30%	
Silver	\$24.98	\$25.09	-0.41%	
Copper contract	\$424.25	\$427.20	-0.69%	
<b>Grains</b>				
Corn contract	\$583.25	\$581.50	0.30%	
Wheat contract	\$845.75	\$833.00	1.53%	
Soybeans contract	\$1,284.75	\$1,277.00	0.61%	
<b>Shipping</b>				
Baltic Dry Freight	2,430	2,591	-161	
<b>DOE inventory report</b>				
	<b>Actual</b>	<b>Expected</b>	<b>Difference</b>	
Crude (mb)	-2.1	1.1	-3.2	
Gasoline (mb)	-0.71	-0.75	0.04	
Distillates (mb)	-0.8	-1.5	0.68	
Refinery run rates (%)	1.2%	0.45%	0.75%	
Natural gas (bcf)		24.0		

## Weather

The 6-10 day and 8-14-day forecasts currently call for warmer-to-normal temperatures in the western half of the country, with cooler temperatures expected for the rest of the country. The forecasts call for wet conditions throughout most of the south and the east, with dry conditions in the Pacific. There is currently no cyclonic activity in the Atlantic Ocean region. We are now approaching the end of hurricane season, which concludes on November 30.

**Data Section**

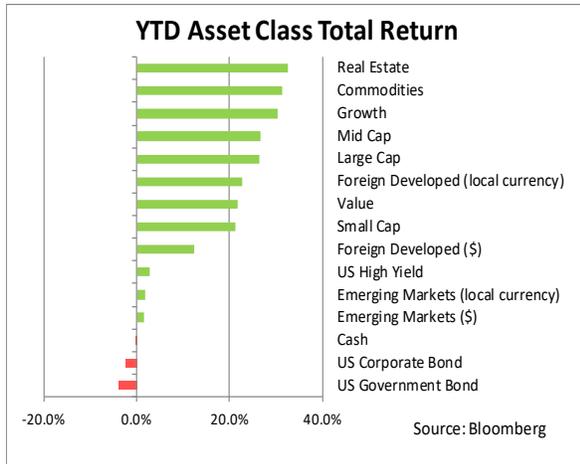
**U.S. Equity Markets – (as of 11/17/2021 close)**



(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 11/17/2021 close)**

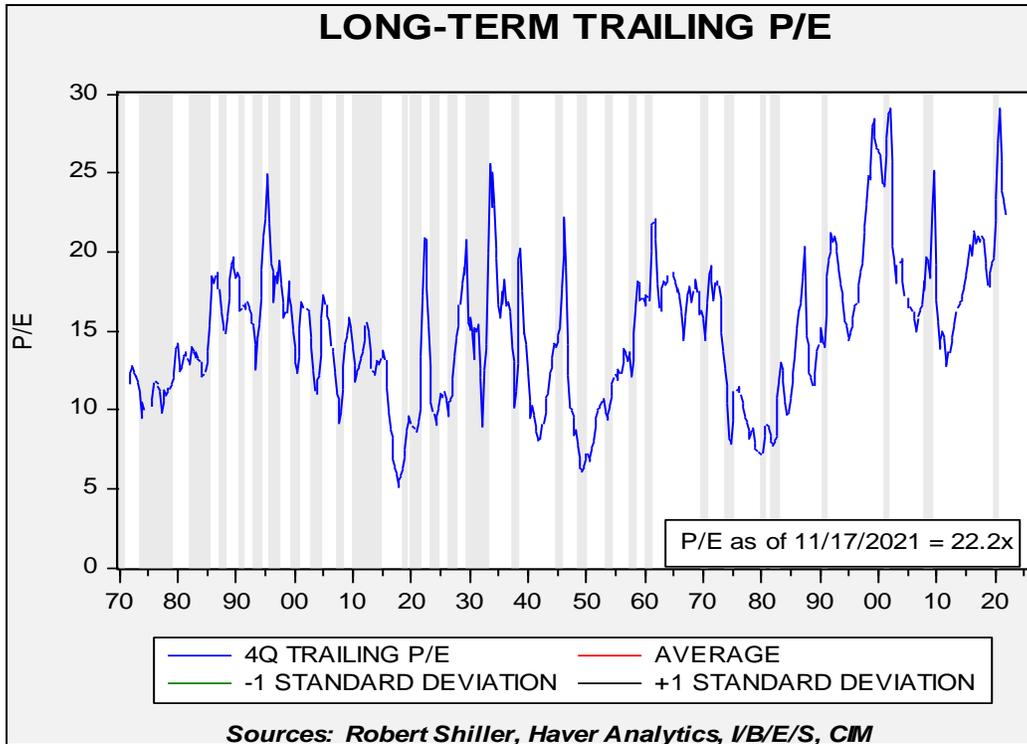


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

November 18, 2021



Based on our methodology,<sup>1</sup> the current P/E is 22.2x, unchanged from last week.

*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 (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.