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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 19, 2019—9:30 AM EST] Global equity markets are higher this morning. The EuroStoxx 50 is up 0.5% from its last close. In Asia, the MSCI Asia Apex 50 closed up 0.7%. Chinese markets were higher, with the Shanghai composite up 0.9% and the Shenzhen index up 1.8% from the prior close. U.S. equity index futures are signaling a higher open. With 460 companies having reported, the S&P 500 Q3 earnings stand at $42.60, higher than the $41.08 forecast for the quarter. The forecast reflects a 4.0% decrease from Q3 2018 earnings. Thus far this quarter, 75.9% of the companies reported earnings above forecast, while 17.4% reported earnings below forecast.

Episode #3 of our *Confluence of Ideas* podcast is now available.

It's rather quiet this morning with a modest risk-on tone to the markets. Yesterday, on the other hand, was active. Trump and Powell met. The government might shut down due to a lack of funding legislation. Hong Kong remains in turmoil. Bolivia is in turmoil too. Tory poll numbers improve. Trade news and other times from northeast Asia. Here are the details.

The president and the chair: President Trump and Chair Powell met at the White House yesterday. Meetings between these two officials are not historically all that unusual but have, at times, led to strong pressure from the White House. Both the president and the chair felt compelled to offer a public comment. The president continues to press the Fed for easier policy.[1] Chair Powell continues to protect the independence of the Federal Reserve. Of all the Fed related items out yesterday, the most intriguing, in our opinion, comes from Boston FRB Rosengren. He opposed the last rate cut; in fact, he has opposed all the most recent cuts. However, this isn't because he is an inflation hawk. He is part of a small but growing faction of what we call "financial sensitives" who worry that rate cuts to lift price inflation are destabilizing the financial system. This stance is probably never going to dominate Fed thinking because it would put the bank in an impossible position; it would be setting policy based on financial conditions. Imagine a chair indicating rates were lifted because the P/E was too high. However, what makes the financial sensitives interesting is that they would take financial conditions into account when setting policy and if conditions are easy, they would be hawkish. In some respects, Rosengren, Brainard and Evans are perhaps the three FOMC members that would be the most difficult for markets to take. As a matter of record, neither Rosengren or Evans will be voters next year.

[1] This is nothing new. We have nothing in the historical record of a president begging the central bank for higher rates.

Government shutdown? With all the focus in Washington on impeachment, the need to fund the government is being lost in the noise. However, the potential for a shutdown in the next two weeks is rising.

China-Hong Kong: China's parliamentary committee on law and labor issued a statement of "strong dissatisfaction" with Monday's Hong Kong court decision overturning the city's ban on protest masks. To make matters worse, a committee spokesman noted that under Hong Kong's mini-constitution, China's parliament has the final say on whether a municipal law is legal. By implying yet another trampling on Hong Kong's autonomy, the statement is likely to further inflame the ongoing anti-China protests, which have already been weighing on the city's economy and financial markets. Meanwhile, politicians and professors helped negotiate the evacuation of hundreds of protestors who had been holed up at the Hong Kong Polytechnic University. Under the deal, police said they wouldn't immediately arrest anyone under 18, and would be lenient to any older protestors. However, approximately 100 protestors who don't trust those assurances are reportedly still in the facility, and it isn't clear what the police will do to get them out. We also note that Congress is getting increasingly active on condemning China. If a bill that condemns China's actions in Hong Kong passes Congress, the president will almost be forced to veto it or see the trade talks fail.

Bolivia: Although Bolivia's current (and self-proclaimed) interim President Jeanine Áñez said she would operate a caretaker government until the next elections, in fact, she has moved to unwind much of the nativist and populist policies of her predecessor, Evo Morales, currently enjoying exile in Mexico. Bolivians have noticed and are starting to express their opposition.

Trade: In the China/U.S. talks, the latter continues to spin optimism while the former remains skeptical that a deal will occur. Meanwhile, reports indicate the White House has waited too long to apply auto tariffs on European or Japan. Japan's lower house has passed the slimmed down U.S./Japan trade agreement.

United States-South Korea: Negotiations on the financial burden sharing for U.S. military forces in South Korea broke down today, just six weeks before the current agreement expires. The U.S. side reportedly walked out of the talks after the South Koreans balked at quintupling their current annual contribution of almost $1 billion. He who pays the piper gets to call the tune, but the Trump administration finds little motivation in controlling the U.S. security environment around the globe. Rather, its motivation is in reducing the costs of global hegemony, even if that risks damaging relationships with allies like South Korea or Japan.

United States-North Korea: State media in Pyongyang claims the Trump administration proposed resuming the U.S.-North Korea nuclear talks in December, ahead of the year-end deadline for new ideas set by Kim Jong Un. However, the report didn't say whether the North Koreans would accept the offer.

Iran: The Islamic Revolutionary Guard Corps have threatened to crack down on the continuing protests against a hike in fuel prices. The massive, violent protests suggest the renewed U.S.

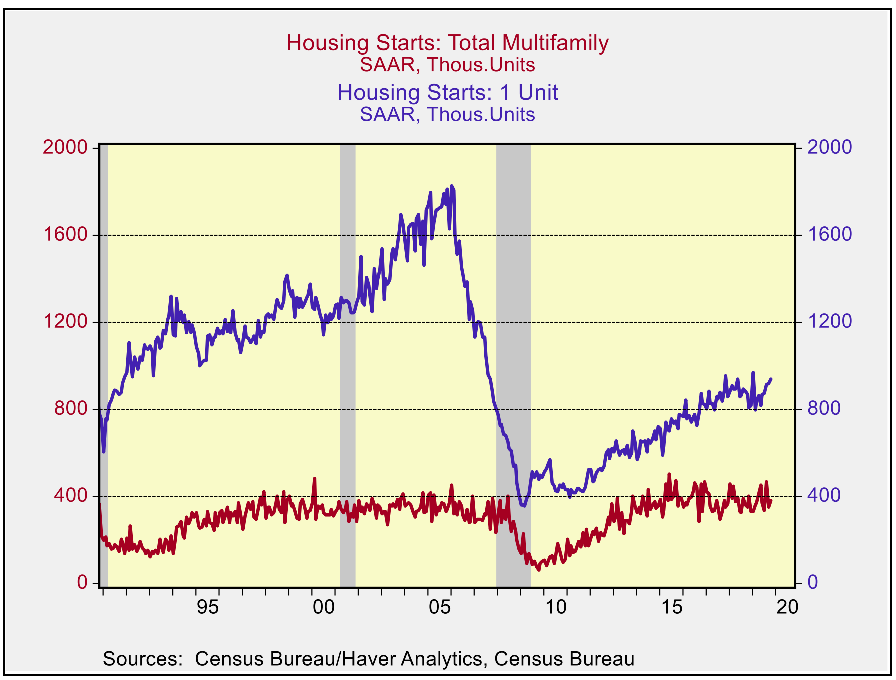
sanctions on Iran are creating social tensions as planned, though it isn't clear whether the government will feel enough pressure to meet U.S. demands.

Eurozone Monetary Policy: Almost 60% of German banks are [now charging negative interest]() rates on at least some large corporate deposits, while more than 20% are doing the same for large retail deposits, based on new data. The growing prevalence of negative rates in high-saving Germany is likely to generate stronger pushback against the ECB's loose monetary policy, and help turn policymakers' attention toward looser fiscal policy to stimulate economic growth.

Brexit and the elections: PM Johnson reversed himself on corporate tax cuts, citing costs. The Labor Party continues to strike a hard-left stance in its campaign for the December election, today releasing a hyper-intrusive, rigid plan for reining in business. This may account for recent polling action showing a surge for the Tories. Meanwhile the EU is warning Britain that a comprehensive trade deal by the end of next year is probably impossible, meaning that either a small deal is done, or hard Brexit occurs anyway.

U.S. Economic Releases

October housing starts came in below expectations at 1.314 mm units compared to the forecast of 1.320 mm. The prior report was revised downward to 1.256 mm from 1.266 mm units. Permits were above forecast at an annual rate of 1.461 mm units compared to the forecast of 1.385 mm units. The prior report was revised upward from 1.387 mm to 1.391 mm.



The chart above shows the level of starts for both multi-family and single-family. Single-family housing starts rose 8.2% from the prior year, while multi-family starts rose 9.3%. Housing starts fell 1.1% in the Northeast and 6.4% in the Midwest, while housing starts in the West and the South rose 15.6% and 6.8%, respectively.

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								
China	FX Net Settlement- Clients CNY	m/m	oct	-30.0 Bil	-41.2 Bil		*	Equity and bond neutral
Australia	ANZ Roy Morgan Weekly Consumption	w/w	17-Nov	109.9	111.1		*	Equity bearish, bond bullish
New Zealand	PPI Output	q/q	3q	1.0%	0.5%		**	Equity bullish, bond bearish
	PPI Input	q/q	3q	0.9%	0.3%		**	Equity bullish, bond bearish
	Non Resident Bond Holdings	m/m	oct	52.8%	53.0%		**	Equity and bond neutral
EUROPE								
Eurozone	EU27 New Car Registration	m/m	oct	8.7%	14.5%		**	Equity and bond neutral
	ECB Current Account Balance	m/m	sep	28.2 Bil	26.6 Bil		**	Equity bullish, bond bearish
	Construction Output	y/y	sep	-0.7%	1.2%		**	Equity and bond bearish
UK	CBI Trends Total Orders	m/m	nov	-26	-37	-30	**	Equity and bond neutral
	CBI Trends Selling Prices	m/m	nov	-1	-3		**	Equity and bond neutral
Switzerland	Exports Real	m/m	oct	-1.3%	2.5%		**	Equity and bond neutral
	Imports Real	m/m	oct	-2.4%	-1.3%		**	Equity and bond bearish
	Swiss Watch Exports	y/y	oct	1.5%	10.2%		**	Equity and bond neutral
Russia	Industrial Production	y/y	3q	2.6%	3.0%	2.5%	***	Equity and bond neutral
AMERICAS								
Canada	Bloomberg Nanos Confidence	w/w	15-Nov	56.2	57.0		**	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.

	Today	Prior	Change	Trend
3-mo Libor yield (bps)	190	190	0	Down
3-mo T-bill yield (bps)	152	153	-1	Neutral
TED spread (bps)	38	38	0	Neutral
U.S. Libor/OIS spread (bps)	154	154	0	Up
10-yr T-note (%)	1.82	1.82	0.00	Down
Euribor/OIS spread (bps)	-40	-40	0	Neutral
EUR/USD 3-mo swap (bps)	13	12	1	Down
Currencies	**Direction**			
dollar	Up			Up
euro	Flat			Down
yen	Down			Down
pound	Down			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.

	Price	Prior	Change	Explanation
Energy Markets				
Brent	$61.91	$62.44	-0.85%	
WTI	$56.50	$57.05	-0.96%	
Natural Gas	$2.55	$2.57	-0.70%	
Crack Spread	$15.20	$15.07	0.83%	
12-mo strip crack	$17.54	$17.57	-0.14%	
Ethanol rack	$1.69	$1.69	-0.11%	
Metals				
Gold	$1,467.60	$1,471.51	-0.27%	
Silver	$17.10	$17.05	0.30%	
Copper contract	$264.75	$263.40	0.51%	
Grains				
Corn contract	$ 378.25	$ 377.25	0.27%	
Wheat contract	$ 511.75	$ 510.75	0.20%	
Soybeans contract	$ 912.25	$ 910.25	0.22%	
Shipping				
Baltic Dry Freight	1338	1357	-19	
DOE inventory report				
	Actual	**Expected**	**Difference**	
Crude (mb)		1.5		
Gasoline (mb)		0.8		
Distillates (mb)		-1.0		
Refinery run rates (%)		1.00%		

Weather

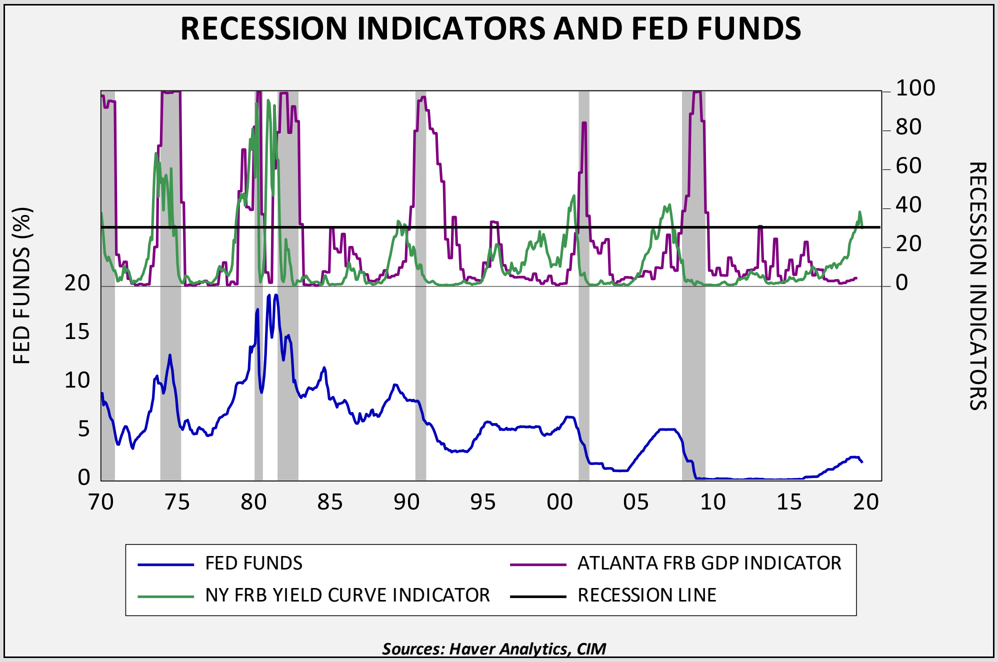
The 6-10 and 8-14 day forecast are calling for colder temperatures for most of the country, with warmer temperatures in California and the East Coast. Wet conditions are expected for most of the country, excluding the northwestern region of the country.

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.

November 15, 2019

The yield curve has steepened since the FOMC started cutting rates, raising hope that a recession can be avoided. In this report, we will examine whether these hopes make sense.



The above chart shows two recession indicators from two different regional Federal Reserve banks, Atlanta and New York. The former is a GDP-based indicator and the latter is based on the yield curve. The New York indicator is designed to signal economic activity a year into the future. We like to combine the two indicators because the Atlanta indicator tends to give false positives. However, in the past, when the New York indicator has moved above 30 followed by an Atlanta indicator rising above 40, a recession has been unavoidable.

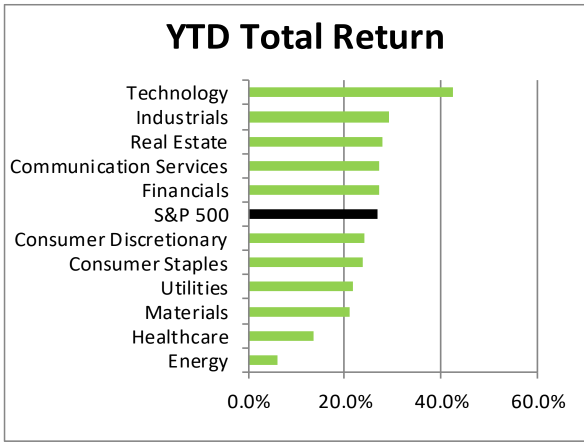
Fed funds show us that easing doesn't necessarily protect the economy from a downturn. Even though the FOMC has usually cut rates as the New York FRB indicator penetrated 30, it was not enough to fend off a downturn. Thus, even with the recent rate cuts, the risk of recession remains elevated.

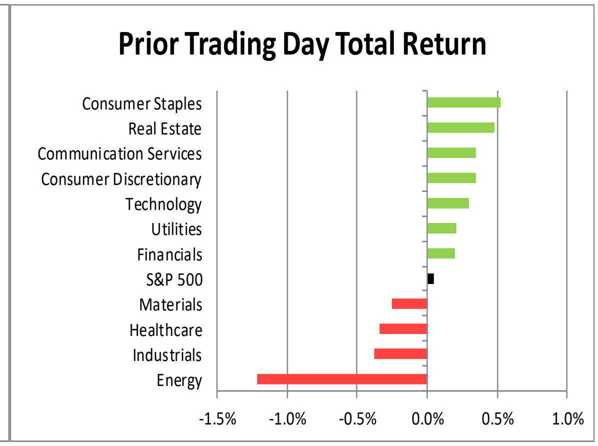
The good news is that the Atlanta indicator is at a level where a recession isn't imminent. The bad news is that the New York indicator has signaled a downturn is coming. Since the 1969-70 recession, the average lead time from the New York recession indicator has been 10 months, with a range of five to 15 months. Thus, by next spring, we could see evidence of a downturn. However, if we use the Atlanta indicator as a signal-confirming device, we should have a better idea of when a recession is actually underway. So, for now, investors should not become overly cautious but, by the end of Q1, increased vigilance will likely be warranted.

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 11/18/2019 close)

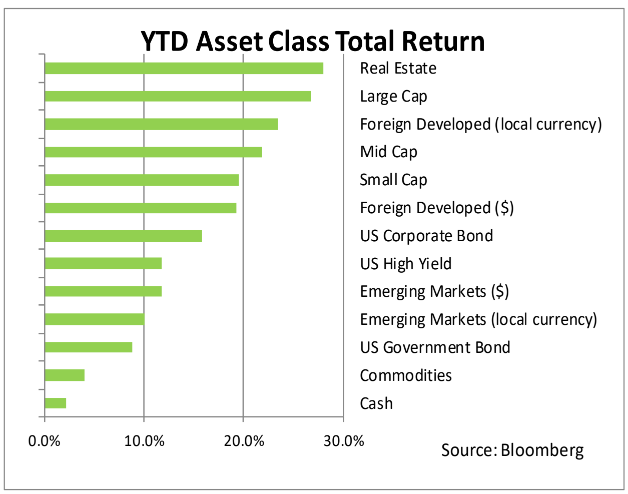




(Source: Bloomberg)

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 11/18/2019 close)

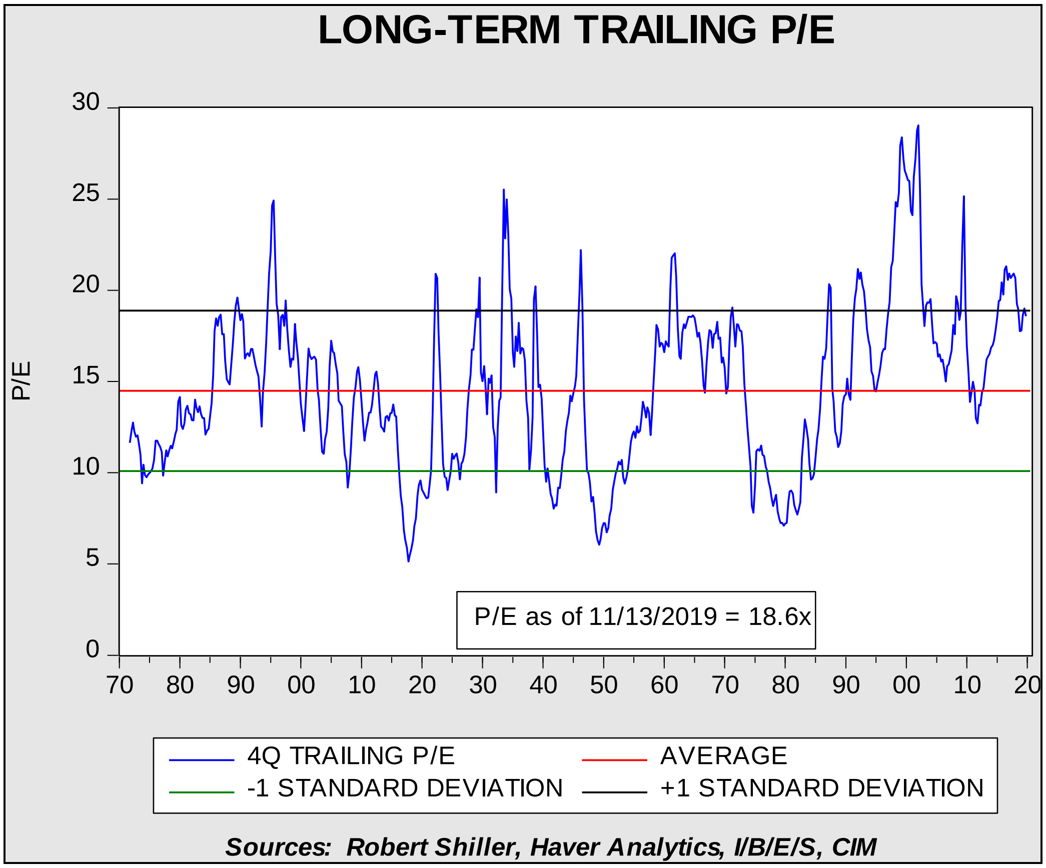


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

November 14, 2019



Based on our methodology,[2] the current P/E is 18.5x, up 0.1x from last week. The rise in the P/E is due to higher equity prices.

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.

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[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 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.