Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

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.

The Daily Comment will go on hiatus beginning Wednesday, November 23, and will return on Monday, November 28.

[Posted: November 22, 2022—9:30 AM EST] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is currently up 0.2% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.8%. Chinese markets were mixed, with the Shanghai Composite closing up 0.1% from its prior close and the Shenzhen Composite closing down 1.3%. U.S. equity index futures are signaling a higher open.

With 476 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, 69.3% have exceeded expectations while 24.6% 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." Due to the upcoming holiday, the next BWGR will be our 2023 Outlook published on December 12.
- *Weekly Energy Update* (11/17/2022): In this week's report we discuss Iran's increasingly reckless behavior. We also note the upcoming changes to Europe's oil purchases from the EU on December 5. As usual, we recap major stories and last week's data. Due to the upcoming holiday, our next report will be published December 1.
- *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* (11/14/2022) (with associated podcast): "The Impossible Trinity" Due to the upcoming holiday, our next report will be published December 5.
- *Asset Allocation Q4 2022 Rebalance Presentation* (11/14/2022): Video presentation featuring the Asset Allocation Committee as they review our asset allocation strategies, recent portfolio changes, and the current macro environment

Our *Comment* today opens with an update on the Russia-Ukraine war, including news of an important new Ukrainian effort to recapture land in the southern part of the country. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including conflicting reports about whether the OPEC+ oil exporters will boost or cut production.

Russia-Ukraine: Ukrainian forces continue to press their counteroffensive in the northeastern Donbas region and in southern Ukraine on the east bank of the Dnipro River, while Russian forces continue to attack the northeastern city of Bakhmut while simultaneously building out their defensive lines in preparation for winter.

- The Ukrainian activity on the east bank of the Dnipro River is reportedly focusing on taking control of the Kinburn Spit, a strategic peninsula jutting out into the Black Sea at the mouth of the river. If the Ukrainians can push the Russians out of the peninsula, they could reduce the artillery attacks on the key southern port city of Mykolaiv and gain control over the southernmost reaches of the river.
- We continue to believe that the Russian offensive around Bakhmut, led by Russia's Wagner Group mercenaries, is designed, at least in part, to burnish the leadership credentials of Wagner Group leader Yevgeny Prigozhin as he works to boost his position in preparation to eventually challenge President Putin for power.

Global Oil Market: Officials with the Organization of the Petroleum Exporting Countries said that the cartel and its Russia-led allies are considering a boost of 500,000 barrels per day in their crude oil production to help keep global supplies steady as the West imposes new sanctions on Russian oil. However, Saudi Arabia and some other major exporters later pushed back on the idea and insisted that the group will follow through with its recent decision to cut output.

- Various reports in recent months have suggested that the OPEC+ group would be hard pressed to boost its output by 500,000 barrels per day. Besides, with China imposing big new pandemic lockdowns and much of the world teetering on the brink of recession, it would seem that OPEC+ would prefer to cut production and buoy prices rather than boost output and drive prices lower.
- Therefore, the statement about boosting output is being taken as a sop to President Biden now that federal officials have said that Saudi Crown Prince Mohammad bin Salman cannot be prosecuted for his role in the 2018 killing of a Saudi dissident journalist.

China: New COVID-19 infections rose to nearly 28,000 today, close to a record and enough to raise concerns that the latest wave will weigh on the economic activity in China and beyond. Despite Beijing's directive to refine and water down President Xi's draconian Zero-COVID policies, the new, widespread wave is prompting local officials to impose mass lockdowns in cities around the country.

United Kingdom: In its latest economic forecasts, the Organization for Economic Cooperation and Development (OECD) projected that the U.K. will be the weakest G20 economy except for Russia over the next two years. Reflecting challenges such as severed trade relationships after Brexit and the impact of high energy prices, the OECD forecasts that British gross domestic product will fall 0.4% in 2023 and rise just 0.2% in 2024.

Eurozone: National Bank of Austria Governor Robert Holzmann, who is also a member of the European Central Bank's governing council, backed a third straight 75 bps rise in the ECB's benchmark interest rate at its next policy meeting in mid-December. The move, which Holzmann argued was necessary to show the ECB's commitment to fighting inflation, would raise benchmark borrowing costs to 2.25%.

- As in the U.S., rising interest rates are creating challenges for borrowers in the Eurozone and threatening to help push the economy into recession.
- Illustrating the impact in Spain, where most mortgage borrowers have variable-rate loans, major banks and the government have agreed on a relief package for the country's most vulnerable borrowers. The package includes reduced interest rates on mortgage loans for a five-year period.

United States-European Union: With the Biden administration's $369 billion package of subsidies to boost U.S. technology investment set to come into force on January 1, officials from Germany and other EU states are considering whether to launch their own subsidy program to keep firms investing on the Continent. The officials have become increasingly alarmed at how the new U.S. program has already convinced many EU firms to shift their capital investments to the U.S.

United States-Philippines-China: In a meeting with Philippine President Marcos yesterday, U.S. Vice President Harris reaffirmed Washington's commitment to defending the country against aggression under a 1951 treaty. Harris also announced a range of U.S. assistance programs and initiatives to help the Philippines deal with climate change and looming food and energy crises.

- Separately, under a 1999 "Visiting Forces Agreement" and a 2014 "Enhanced Defense Cooperation Agreement," the U.S. has been boosting the number of troops it sends on a rotating basis to Philippine military bases.
- Despite the Philippine government's effort to keep from antagonizing China as it steps up military cooperation with the U.S., the moves underline how much the Philippines feels threatened by China's territorial aggressiveness in the maritime realm.

U.S. Railroad Industry: Yesterday, one of the country's largest railroad unions said that its members voted to reject a new wage deal brokered by the White House, raising the risk of a major labor strike as soon as early December. That means four of the 12 major railroad unions have rejected the brokered deal, primarily over sick-leave policies. This has triggered a cooling-off period that requires the companies and unions to go back to the negotiating table. If the companies and unions can't reach a deal by December 9, and if Congress doesn't intervene to prevent it by legislation, the nation could face a crippling railroad strike that would be an important headwind for the economy and financial markets.

U.S. Housing Market: According to data from real-estate brokerage Redfin (RDFN, $4.61), investor purchases of homes in the third quarter were down 30% from the same period one year earlier. The big drop reflects the sudden, sharp weakening in the housing market as the Federal Reserve keeps pushing interest rates higher. We continue to believe that the impending recession will probably be rather garden-variety, but a sharper-than-anticipated drop in the housing market could make it a more severe.

U.S. Economic Releases

There were economic releases prior to the publication of this report. The table below lists the economic releases and/or Federal Reserve events scheduled for the rest of the day.

Economic Releases						
EST	**Indicator**			**Expected**	**Prior**	**Rating**
10:00	Richmond Fed Manufact. Index	m/m	Nov	-8.0	-10.0	**
Federal Reserve						
EST	**Speaker or Event**	**District or Position**				
11:00	Loretta Mester Discusses Wages and Inflation	President of the Federal Reserve Bank of Cleveland				
14:15	Esther George Takes Part in Policy Panel	President of the Federal Reserve Bank of Kansas City				
14:45	James Bullard Discusses Heterogeneity in Macroeconomics	President of the Federal Reserve Bank of St. Louis				

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								
New Zealand	Trade Balance NZD	m/m	OCt	-2.129b	-1.615b	-1.696b	**	Equity and bond neutral
	Exports NZD	m/m	OCt	6.14b	6.03b	5.94b	**	Equity and bond neutral
	Imports NZD	m/m	OCt	8.27b	7.64b	7.63b	**	Equity and bond neutral
South Korea	Consumer Confidence	m/m	Nov	86.5	88.8		*	Equity and bond neutral
EUROPE								
UK	Public Finances (PSNCR)	m/m	Oct	9.7b	10.1b	10.0b	*	Equity and bond neutral
	Public Sector Net Borrowing	m/m	Oct	12.7b	19.2b	16.9b	*	Equity and bond neutral
	PSNB ex Banking Groups	m/m	Oct	13.5b	20.0b	17.8b	**	Equity and bond neutral
AMERICAS								
Canada	Retail Sales	m/m	Sep	-0.5%	0.7%	0.4%	**	Equity bearish, bond bullish
	Retail Sales Ex-Autos	m/m	Sep	-0.7%	0.7%	-0.6%	**	Equity and bond neutral
Mexico	Retail Sales	y/y	Sep	3.3%	4.7%	3.9%	***	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.

Fixed Income	Today	Prior	Change	Trend
3-mo Libor yield (bps)	466	468	-2	Up
3-mo T-bill yield (bps)	415	415	0	Up
TED spread (bps)	51	52	-1	Widening
U.S. Sibor/OIS spread (bps)	436	433	3	Up
U.S. Libor/OIS spread (bps)	439	436	3	Up
10-yr T-note (%)	3.81	3.83	-0.02	Up
Euribor/OIS spread (bps)	182	182	0	Neutral
Currencies	**Direction**			
Dollar	Down			Down
Euro	Up			Up
Yen	Up			Down
Pound	Up			Up
Franc	Up			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.

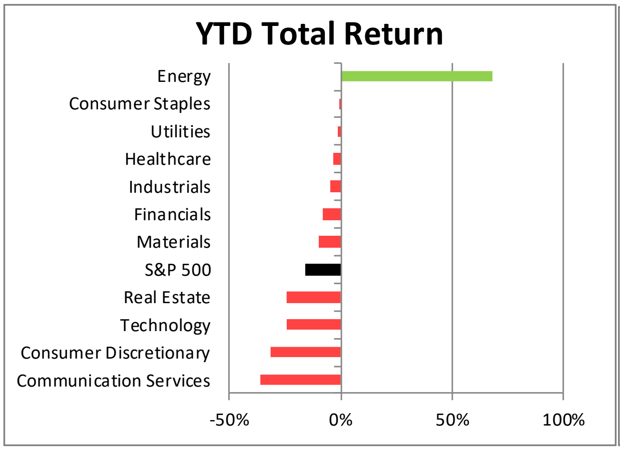
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$88.86	$87.45	1.61%	
WTI	$81.31	$80.04	1.59%	
Natural Gas	$6.64	$6.78	-1.96%	
Crack Spread	$34.11	$37.40	-8.79%	
12-mo strip crack	$31.64	$32.04	-1.23%	
Ethanol rack	$2.66	$2.66	-0.13%	
Metals				
Gold	$1,746.03	$1,738.05	0.46%	
Silver	$21.20	$20.85	1.69%	
Copper contract	$365.10	$357.60	2.10%	
Grains				
Corn contract	$665.75	$663.50	0.34%	
Wheat contract	$819.00	$818.25	0.09%	
Soybeans contract	$1,437.00	$1,436.75	0.02%	
Shipping				
Baltic Dry Freight	1,177	1,189	-12	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-2.4		
Gasoline (mb)		1.2		
Distillates (mb)		0.5		
Refinery run rates (%)		0.3%		
Natural gas (bcf)		-86		

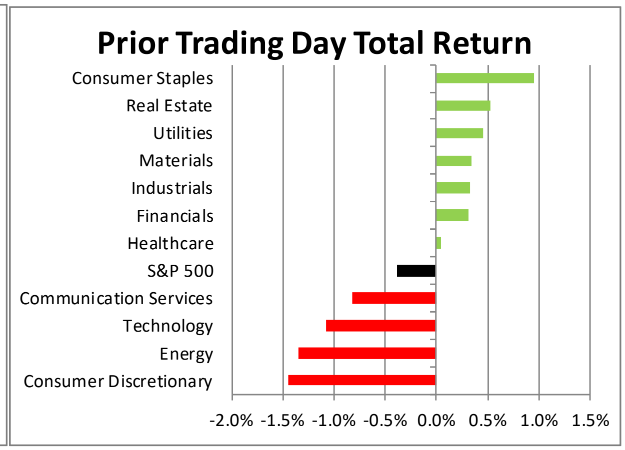
Weather

The 6-10 and 8-14 day forecasts are showing moderating temperatures which are expected to be cooler-than-normal in the Pacific and Rocky Mountain regions. Wet conditions are expected in the Pacific, Rocky Mountain and Midwest regions, with dry conditions expected throughout most of Texas.

Data Section

U.S. Equity Markets – (as of 11/21/2022 close)

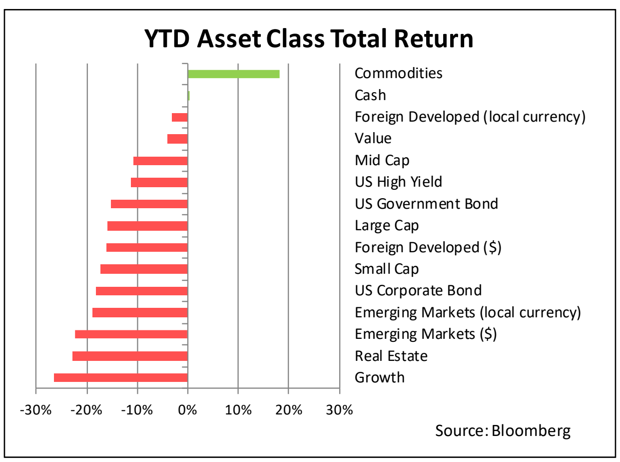




(Source: Bloomberg)

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 11/21/2022 close)

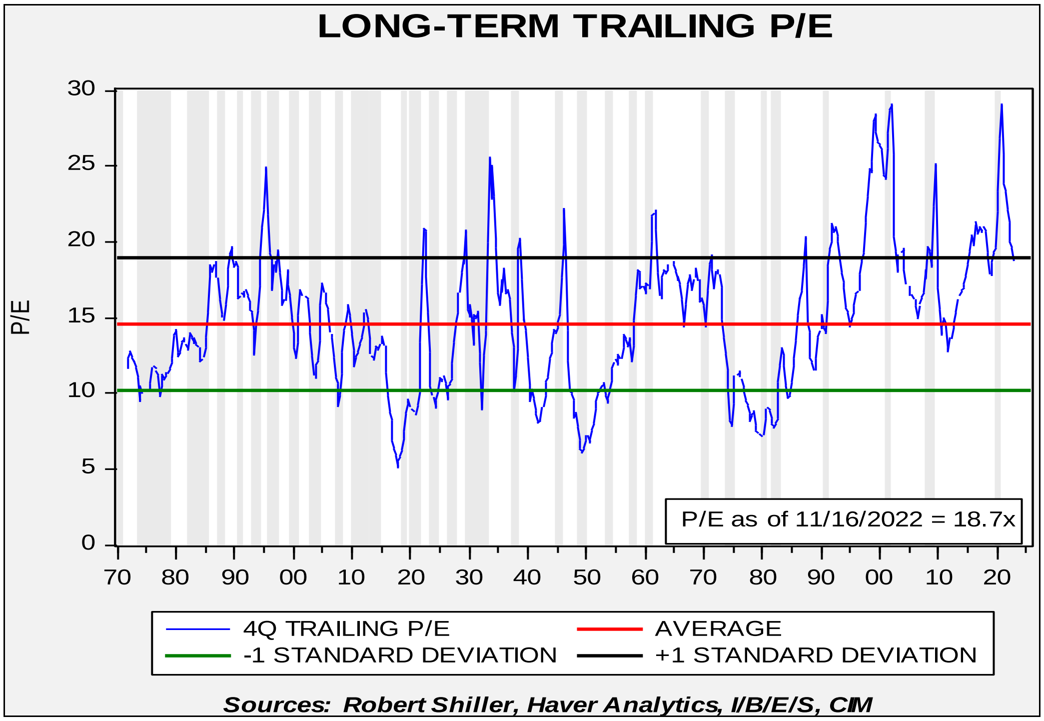


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 17, 2022



Based on our methodology,[1] the current P/E is 18.7x, up 0.7x from last week. The primary reason for the rise in the multiple is the switch from Thomson/Reuter's calculation of earnings for Q3 to that of Standard and Poor's. There are periods where the two series diverge, and this quarter was one of them.

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[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 three actual quarters (Q1, Q2 and Q3) and one estimate (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.