

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: October 2, 2023—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is down 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.3%. Chinese markets are closed for Golden Week. U.S. equity index futures are signaling a lower open.

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](#) (9/18/2023) (with associated [podcast](#)): “Goodbye Prigozhin”
- [Weekly Energy Update](#) (9/28/2023): Crude oil prices continue to rise as inventories decline. In the latest reporting week, crude oil stockpiles fell despite falling refining activity. We also discuss Europe’s rapid moves to prevent Chinese EVs from swamping their automobile markets.
- [Asset Allocation Quarterly – Q3 2023](#) (7/20/2023): Discussion of our asset allocation process, Q3 2023 portfolio changes, and our outlook for the markets.
- [Asset Allocation Q3 2023 Rebalance Presentation](#) (8/18/2023): 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](#) (9/25/2023) (with associated [podcast](#)): “Where’s the Recession? A Recap”
- [Confluence of Ideas podcast](#) (8/22/2023): “The Economics of Defense in Great Power Competition”
- [Business Cycle Report](#) (9/28/2023)

Our *Comment* today opens with a recap of the U.S. Congress’s last-minute deal on Saturday to avert a partial government shutdown. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including news on the Chinese economy, prospects for tighter monetary policy in Japan, and falling steel prices in the U.S. as the United Auto Workers continue their strike against the country’s top auto manufacturers.

U.S. Fiscal Policy: With just minutes to spare before the federal government would have run out of funding on Saturday night, the House and Senate [approved a stopgap bill that will provide](#)

[for spending at current levels to mid-November](#), giving Democrats and Republicans more time to negotiate over full-year appropriations. The breakthrough came as Republican House Speaker McCarthy [shifted gears and put forward a stopgap bill that Democrats could accept, and that the Senate was unwilling to reject](#).

- The stopgap spending bill has prevented a partial shutdown of the federal government, but perhaps only temporarily. If lawmakers can't agree by mid-November on a budget for the fiscal year that started Sunday, a disruptive shutdown is still possible.
- Meanwhile, hard-right Republicans in the House [have vowed to launch a vote to oust McCarthy for failing to implement their cherished spending cuts and other conservative goals](#). It is not yet clear whether they will be successful in that effort.

China-Taiwan: People who monitor aircraft tracking sites say a Chinese military plane recently [performed an unusual maneuver in which it closely followed and then dove beneath a civilian airliner as it flew close to Taiwanese waters](#). By flying directly beneath the civilian aircraft, the military plane temporarily dropped off ground-based tracking radar, suggesting the Chinese were practicing the maneuver as a way to keep their military aircraft from being tracked by Taiwanese radar in the event of a conflict.

China: In a win for President Xi's program to clean up the country's semiconductor industry, the former head of the state-backed computer chip giant Tsinghua Unigroup (600100.SS, CNY, 7.27) has [plead guilty to corruption charges](#). The executive, Zhao Weiguo, apparently misappropriated state-owned assets valued at more than \$60 million through shady real estate deals and similar crimes. Besides showing how Xi has made the semiconductor industry a new target of his anticorruption program, the case also illustrates how corruption has been one factor keeping the industry from catching up to its rivals in the West.

- Separately, the official purchasing managers' index for manufacturing [rose to a seasonally adjusted 50.2 in September, compared with 49.7 in August](#). The official PMI for the nonmanufacturing industries rose to 51.7 from 51.0. Both gauges are now above the 50.0 level that signals expanding activity. The PMI figures suggest the Chinese economy may have gotten through its recent rough patch and is growing again.
- All the same, that doesn't necessarily mean the economy is growing rapidly. Growth is still sluggish because of problems such as weak consumer demand, high debt levels, poor demographics, and "de-risking" moves by foreign companies.
 - Indeed, the World Bank today [released new forecasts showing it expects Chinese gross domestic product to increase just 4.4% in 2024](#), after stripping out price changes. That's down from the institution's forecast of 4.8% in April.
 - With weaker growth in China, the World Bank said it cut its growth forecast for the broader East Asia and Pacific regions to 4.5% in 2024, versus expected growth of 5.0% in 2023. Such poor growth rates would be among the region's worst in the last five decades.

Japan: In the minutes of the Bank of Japan's policy meeting last month, several officials [said they were seeing progress on bringing consumer price inflation up to target in a sustainable way](#)

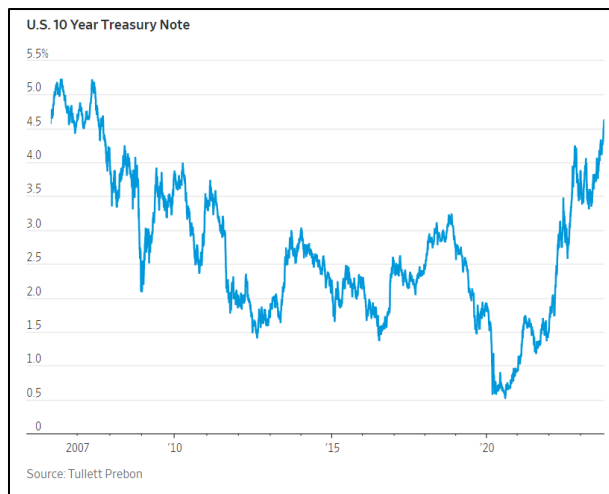
and indicated they should start planning to end their ultra-easy monetary policy. The minutes have intensified speculation that the BOJ will soon tighten monetary policy by eliminating its negative short-term interest rate and loosening up its control over longer-term bond yields.

United Kingdom: The Conservative Party [has opened its annual conference](#), with some participating officials warning that Prime Minister Sunak will have to do more to retain power at the next elections and others clearly jostling for position to potentially unseat him in the future. For example, some officials [are clamoring for tax cuts](#). On the eve of the meetings, Home Secretary Suella Braverman and Business Secretary Kemi Badenoch both floated the idea that the U.K. pulling out of the United Nations Convention on Human Rights was so the country could have a freer hand in blocking and deporting refugees.

Slovakia: In parliamentary elections over the weekend, former Prime Minister Robert Fico and his Russia-friendly, populist Smer Party [won about 23% of the vote, comfortably ahead of the Ukraine-friendly, liberal Progressive Slovakia Party and its 18%](#). However, an even more Russia-friendly, far-right party that likely would have allied with Smer failed to win any seats in parliament, so Fico could have an uphill battle to form a governing coalition.

Serbia-Kosovo: U.S. officials have [warned that Serbia is massing tanks, artillery, and other military equipment on the border with the breakaway province of Kosovo](#), in a move that points to a possible new Balkan war. Serbian President Aleksandar Vučić has denied that he intends to send Serbian troops into Kosovo but given the worsening of tensions between Serbia and Kosovo over the last few years, we cannot discount the possibility of a destabilizing new war in the Balkans.

U.S. Bond Market: The *Wall Street Journal* today [carries a useful article with multiple charts explaining the recent surge in bond yields](#). As we had been warning, bond yields prior to late summer had seemed much lower than they should have been. Now that investors [have focused on factors like the economy's relatively good economic growth \(for now\), its persistent price pressures, and the Fed's intention to keep interest rates higher for longer](#), it should be no surprise that bond yields have surged. As of this morning, the yield on the benchmark 10-year Treasury note has risen to 4.637%, its highest level since 2007, while the 2-year note has risen to 5.117%.



U.S. Steel Market: New reporting shows the United Auto Workers’ strike against the country’s top three automakers [has slammed the demand for steel, contributing to a 40% drop in its price over the last several months](#). Of course, steel demand is also likely waning as overall economic growth slows and the economy looks set to fall into recession in the coming months.

U.S. Economic Releases

There were no economic releases prior to the publication of this report. 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 | S&P Global Manufacturing PMI | m/m | Sep F | 48.9 | 48.9 | *** |
| 10:00 | Construction Spending MoM | m/m | Aug | 0.5% | 0.7% | ** |
| 10:00 | ISM Manufacturing PMI | m/m | Sep | 47.9 | 47.6 | ** |
| 10:00 | ISM Manufacturing PMI - Prices Paid | m/m | Sep | 49.0 | 48.4 | ** |
| 10:00 | ISM Manufacturing PMI - Employment | m/m | Sep | 48.6 | 48.5 | * |
| 10:00 | ISM Manufacturing PMI - New Orders | m/m | Sep | 47.8 | 16.8 | ** |
| Federal Reserve | | | | | | |
| EST | Speaker or Event | District or Position | | | | |
| 11:00 | Jerome Powell and Patrick Harker Participate in Round Table | Chair of the Board of Governors and Pres of the Fed Reserve Bank of Philadelphia | | | | |
| 13:00 | John Williams Moderates Discussion on Climate Risk | President of the Federal Reserve Bank of New York | | | | |
| 19:30 | Loretta Mester Speaks on Economic Outlook | President of the Federal Reserve Bank of Cleveland | | | | |

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 | Tankan Large Manufacturing Index | q/q | 3Q | 9 | 5 | 6 | *** | Equity bullish, bond bearish |
| | Tankan Large Non-Manufacturing Index | q/q | 3Q | 27 | 23 | 24 | *** | Equity bullish, bond bearish |
| | Tankan Large Manufacturing Outlook | q/q | 3Q | 10 | 9 | 6 | *** | Equity bullish, bond bearish |
| | Tankan Large Non-Manufacturing Outlook | q/q | 3Q | 21 | 20 | 23 | *** | Equity bearish, bond bullish |
| | Tankan Large All-Industry Capex | q/q | 3Q | 13.6% | 13.4% | 13.5% | *** | Equity and bond neutral |
| | Jibun Bank Manufacturing PMI | m/m | Sep F | 48.5 | 48.6 | | *** | Equity and bond neutral |
| Australia | Melbourne Institute Inflation | m/m | Sep | 5.7 | 6.1 | | * | Equity and bond neutral |
| New Zealand | Building Permits | m/m | Aug | -6.7% | -5.2% | -5.40 | ** | Equity and bond neutral |
| South Korea | Exports | y/y | Sep | -4.4% | -8.4% | -8.4% | *** | Equity bullish, bond bearish |
| | Trade Balance | m/m | Sep | \$3700m | \$870m | \$879m | * | Equity bullish, bond bearish |
| | Imports | y/y | Sep | -16.5% | -22.8% | -18.2% | ** | Equity bullish, bond bearish |
| China | Official Composite PMI | m/m | Sep | 52.0 | 51.3 | | * | Equity and bond neutral |
| | Official Manufacturing PMI | m/m | Sep | 50.2 | 49.7 | 50.1 | *** | Equity and bond neutral |
| | Official Services PMI | m/m | Sep | 51.7 | 51.0 | 51.6 | ** | Equity and bond neutral |
| | Caixin Composite PMI | m/m | Sep | 50.9 | 51.7 | | ** | Equity and bond neutral |
| | Caixin Manufacturing PMI | m/m | Sep | 50.6 | 51.0 | 51.2 | *** | Equity bearish, bond bullish |
| | Caixin Services PMI | m/m | Sep | 50.2 | 51.8 | 52.0 | ** | Equity bearish, bond bullish |
| EUROPE | | | | | | | | |
| Eurozone | HCOB Eurozone Manufacturing PMI | m/m | Sep F | 43.4 | 43.4 | 43.4 | *** | Equity and bond neutral |
| | Unemployment Rate | m/m | Aug | 6.4% | 6.4% | 6.5% | ** | Equity and bond neutral |
| Germany | HCOB Germany Manufacturing PMI | m/m | Sep F | 39.6 | 39.8 | 39.8 | ** | Equity and bond neutral |
| France | HCOB France Manufacturing PMI | y/y | Sep F | 44.2% | 43.6 | 43.6 | *** | Equity bullish, bond bearish |
| Italy | HCOB Italy Manufacturing PMI | m/m | Sep | 46.8 | 45.4 | 45.8 | *** | Equity and bond neutral |
| | Unemployment Rate | m/m | Aug | 7.3% | 7.6% | 7.5% | ** | Equity and bond neutral |
| UK | Nationwide House Price Index | y/y | Sep | -5.3% | -5.3% | -5.6% | *** | Equity and bond neutral |
| | S&P/CIPS Manufacturing PMI | m/m | Sep F | 44.3 | 44.2 | 44.2 | *** | Equity and bond neutral |
| Switzerland | Real Retail Sales | y/y | Aug | -1.8% | -2.2% | -2.5% | ** | Equity bearish, bond bullish |
| | Manufacturing PMI | m/m | Sep | 44.9 | 39.9 | 40.8 | *** | Equity bullish, bond bearish |
| | Domestic Sight Deposits CHF | w/w | 29-Sep | 466.1b | 465.3b | | * | Equity and bond neutral |
| | Total Sight Deposits CHF | w/w | 29-Sep | 476.3b | 475.1b | | * | Equity and bond neutral |
| Russia | Current Account Balance | q/q | 2Q F | 9562m | 8600m | 8600m | ** | Equity and bond neutral |
| | S&P Manufacturing PMI | m/m | Sep | 54.5 | 52.7 | | *** | Equity bullish, bond bearish |
| AMERICAS | | | | | | | | |
| Canada | GDP | y/y | Jul | 1.1% | 1.1% | 1.1% | ** | 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) | 566 | 566 | 0 | Up |
| 3-mo T-bill yield (bps) | 532 | 531 | 1 | Up |
| TED spread (bps) | LIBOR and the TED Spread have been discontinued. | | | |
| U.S. Sibor/OIS spread (bps) | 541 | 539 | 2 | Up |
| U.S. Libor/OIS spread (bps) | 543 | 541 | 2 | Up |
| 10-yr T-note (%) | 4.64 | 4.57 | 0.07 | Flat |
| Euribor/OIS spread (bps) | 395 | 396 | -1 | Up |
| Currencies | Direction | | | |
| Dollar | Up | | | Up |
| Euro | Down | | | Down |
| Yen | Down | | | Down |
| Pound | Down | | | Down |
| Franc | Flat | | | 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.

| DOE Inventory Report | Price | Prior | Change | Explanation |
|-----------------------------|---------------|-----------------|-------------------|-------------|
| Energy Markets | | | | |
| Brent | \$92.75 | \$92.20 | 0.60% | |
| WTI | \$91.19 | \$90.79 | 0.44% | |
| Natural Gas | \$2.89 | \$2.93 | -1.40% | |
| Crack Spread | \$23.21 | \$22.35 | 3.84% | |
| 12-mo strip crack | \$24.84 | \$24.29 | 2.29% | |
| Ethanol rack | \$2.48 | \$2.49 | -0.37% | |
| Metals | | | | |
| Gold | \$1,836.91 | \$1,848.63 | -0.63% | |
| Silver | \$21.72 | \$22.18 | -2.05% | |
| Copper contract | \$367.30 | \$373.75 | -1.73% | |
| Grains | | | | |
| Corn contract | \$479.50 | \$476.75 | 0.58% | |
| Wheat contract | \$547.50 | \$541.50 | 1.11% | |
| Soybeans contract | \$1,268.50 | \$1,275.00 | -0.51% | |
| Shipping | | | | |
| Baltic Dry Freight | 1,701 | 1,716 | -15 | |
| DOE Inventory Report | | | | |
| | Actual | Expected | Difference | |
| Crude (mb) | | | | |
| Gasoline (mb) | | | | |
| Distillates (mb) | | | | |
| Refinery run rates (%) | | | | |
| Natural gas (bcf) | | | | |

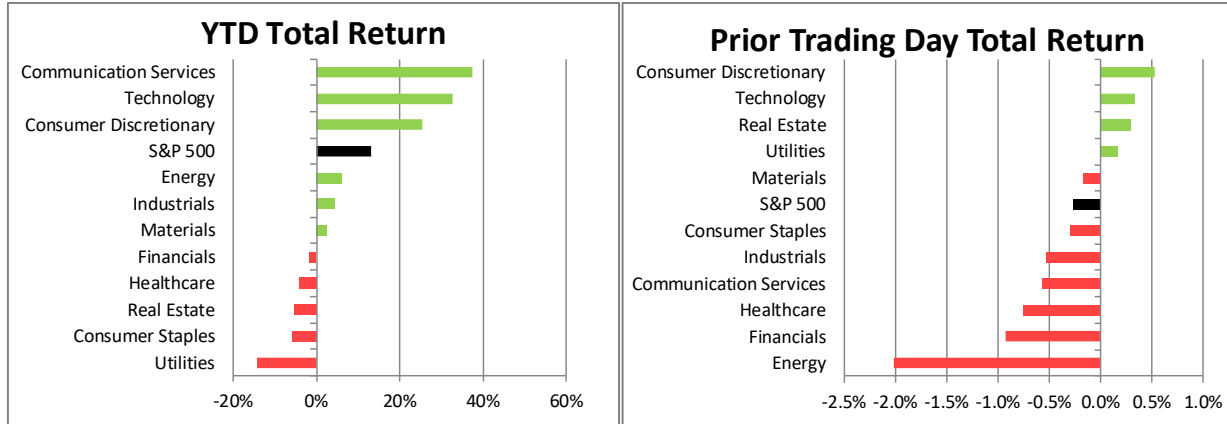
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures to spread from the Rocky Mountains and Great Plains toward the Midwest, with cooler-than-normal temperatures expected for the rest of the country. The forecasts call for wetter-than-normal conditions in the Pacific Northwest, the northern Rocky Mountains, and the Southeast, with dry conditions in the Midwest and the Northeast.

Only one atmospheric disturbance is active in the Atlantic Ocean. Tropical Storm Philippe is in the central Atlantic and is moving through the Leeward Islands and is headed toward Antigua and Barbuda. On average, Atlantic hurricane activity peaks on September 15.

Data Section

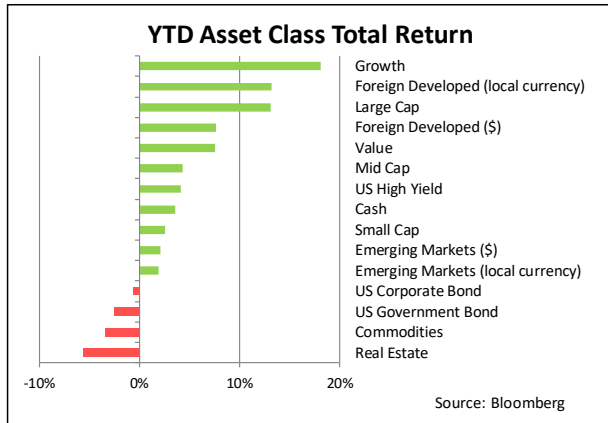
U.S. Equity Markets – (as of 9/30/2023 close)



(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 9/30/2023 close)

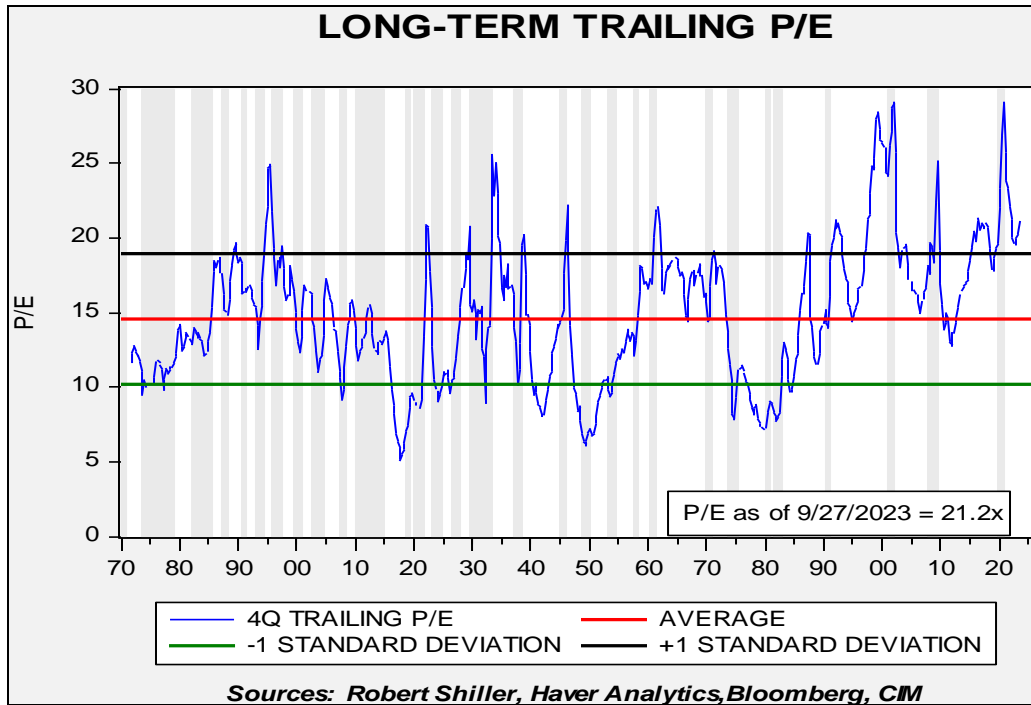


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

September 28, 2023



Based on our methodology,¹ the current P/E is 21.2x, up 0.1x from last week. Weaker earnings estimates 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 Bloomberg estimates which are updated regularly throughout the quarter; currently, the four-quarter earnings sum includes two actual quarters (Q3 and Q4) and two estimates (Q1 and Q2). 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.