

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 8, 2021—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the EuroStoxx 50 is down 0.2% from its prior close. In Asia, the MSCI Asia Apex 50 closed up 0.5%. Chinese markets were higher, with the Shanghai Composite up 0.7% from its prior close and the Shenzhen Composite up 0.8%. U.S. equity index futures are signaling a higher 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:

- [Weekly Geopolitical Report](#) (10/4/2021): “Afghanistan, Part IV: China”
- [Weekly Energy Update](#) (10/7/2021): Oil inventories rose last week as the energy industry recovers from Hurricane Ida; Vladimir Putin offers to resolve Europe’s natural gas crisis
- [Asset Allocation Q3 2021 Rebalance Presentation](#) (8/26/2021): A video discussion of our asset allocation process, portfolio changes in Q3, and the macro environment
- [Asset Allocation Weekly \(10/8/2021\) \(with associated podcast\): Has Bitcoin become a substitute for gold, and is there a fit for it within a risk-sensitive portfolio?](#)
- [Confluence of Ideas podcast](#) (7/7/2021): “The Geopolitics of Taiwan and the Issue of Globalization”

Good morning! Today's report begins with our thoughts on China-U.S. trade relations. We then review various international news items followed by U.S. economics and policy. China news is next, and we end with our pandemic coverage.

China-U.S.: Tensions between the U.S. and China continue to escalate after several reports showed that Washington has made a concerted effort to refocus its attention on protecting the South China Sea and Taiwan. On Thursday, the *Wall Street Journal* reported that as early as last year the Pentagon [sent a U.S. special operations unit and a contingent of Marines to Taiwan](#) to train military forces. Additionally, it was widely reported that the Central Intelligence Agency announced the formation of a [new mission center](#) that will focus its attention on China. The maneuvers by the U.S. highlight its growing concern with China’s assertiveness in the Pacific. Over the [last five years](#), China has increased its presence throughout the South China Sea and has become more hostile toward Taiwan.

In reaction to the news that the U.S. has sent troops into Taiwan, China has called on the U.S. [to adhere to the One China Principle](#). The principle states that the U.S. would recognize there is

only one Chinese government and not get involved in the dispute over Taiwan. During the time of the agreement, both Beijing and Taipei each believed they were the rightful leader of China, which is why the U.S. agreed to abide by the principle. However, the agreement was made under the guise that the dispute between China and Taiwan would resolve itself peacefully. Hence, the U.S. decision to send troops as well as military weapons to Taiwan suggests that the Pentagon believes the chances of possible conflict are elevated.

Although we do not believe war in the Pacific is imminent, there does seem to be an increase in provocation by both the U.S. and China. In our view, wars aren't generally planned but are rather triggered by miscalculations of the response of the opposing side. For example, the assassination of the Austrian Archduke Franz Ferdinand triggered a series of events that led to World War I. So far, China's reactions to developments in Taiwan have been more for demonstration purposes rather than seizing territory. Recent overflights clearly gain attention but really don't support taking control of Taiwan. What has occurred to date suggests posturing rather than invasion. However, there is a clear escalation in tensions and no obvious off-ramp to de-escalation. And so, we remain deeply concerned about Taiwan and continue to monitor events closely.

International news:

- Ireland has joined the global agreement [that would set a 15% minimum tax rate for corporations](#). Being a low-tax country, Ireland was one of the last holdouts of the 140 governments and jurisdictions looking to overhaul the international tax system. The laws still need to make it through each government's legislature, but it is expected to be implemented by 2023.
- Mexican President Andres Manuel Lopez Obrador (AMLO) may have enough support to push through his controversial bill [to nationalize Mexico's electricity sector](#). Although the bill is expected to pass the house, it is expected to fail in the senate.
- The head of the International Energy Agency has stated that [Russia has the ability to supply Europe](#) with more natural gas and has urged Moscow to ramp up production in order to assure the world that it can be trusted as a reliable partner.
- Poland may be on course for a possible [exit out of the European Union](#) after its Supreme Court ruled that EU laws are not compatible with the Polish constitution. The ruling comes in response to a controversial bill that gave politicians more power over the Polish judiciary. Brussels has argued that the bill undermines the rule of law and therefore runs afoul of EU governing rules. So far, Brussels has responded to the Polish government's refusal to drop the bill by issuing fines and threatening to withdraw aid. However, if this trend continues, Brussels may be forced to kick Poland out of the EU. In light of the dispute, Polish Prime Minister Mateusz Morawiecki has stated that [Poland would like to remain in the European Union](#).
- South Korea has expressed interest in [joining the Comprehensive and Progressive Agreement for Trans-Pacific Partnership \(CPTPP\)](#). South Korea's interest in joining the partnership appears to be in response to China and Taiwan submitting a formal request last week.
- The primary election contest in Hungary was upended when one of the frontrunners, [Budapest Mayor Gergely Karacsony, quit the race](#). His exit has forced a run-off election between Hódmezővásárhely Mayor Peter Marki-Zay and European Parliament Vice

President Klara Dobrev. Both candidates have vowed that if elected they would roll back the executive powers accumulated under current President Viktor Orban.

Economics and policy:

- The Senate voted to raise the debt ceiling on Thursday. Earlier in the day, Senate Majority Leader Chuck Schumer announced that Senate Democrats and Republicans have reached a deal to [raise the debt ceiling through early December](#). The agreement raises the limit to \$480 billion and would allow the government to be funded up until December 3.
- Fed Governor Lael Brainard suggested that the Federal Reserve should [conduct analysis on how climate change can impact the economy](#).
- Retailers have started to [charter their own cargo ships in order to ensure shipments](#) arrive on time. This move comes after logjams at ports in Asia have forced retailers to seek alternative ways to receive their shipments.

China:

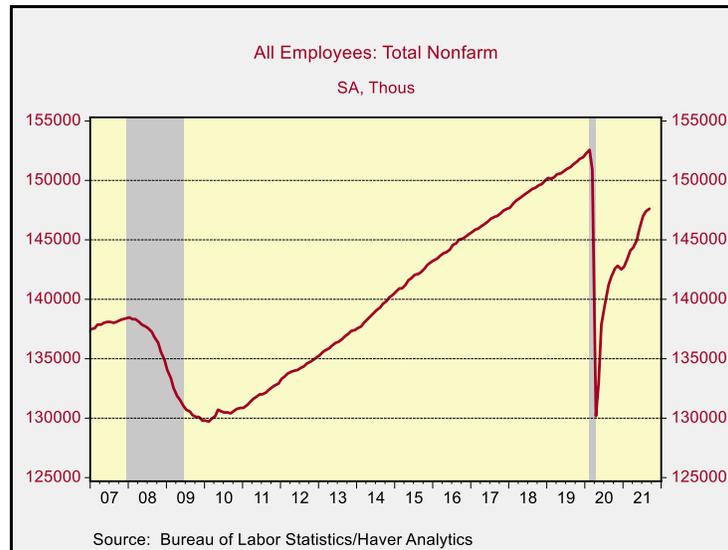
- In the battle to dominate the electric vehicle market, the U.S. appears to be gaining ground in the race to secure lithium batteries. The U.S. is now [second in BloombergNEF's global lithium-ion battery supply chain](#) ranking. The U.S. has made significant investments in building out the supply chains for electric vehicles as it attempts to phase out cars with internal combustion engines.
- Following a seven-day break due to China's Golden Week, Chinese markets opened with more angst regarding real estate development firm Evergrande (EGRNF, \$0.38). There have been [rumors of a possible takeover](#), but so far nothing has materialized.
- Chinese food delivery order service Meituan (MPNGF, \$32.56) was [fined \\$533 million for violating anti-monopoly regulations](#) on Friday. The fine is seen as a slap on the wrist.
- The People's Bank of China has [reduced liquidity support as markets](#) open following the week-long holiday. Additionally, the bank stated it will continue to take steps to make the [benchmark loan and deposit rates more market-based](#). The moves suggest that China may be less worried about the contagion effect from Evergrande.

COVID-19: The [number of reported cases](#) is 236,854,356 with 4,836,281 fatalities. In the U.S., there are 44,159,120 confirmed cases with 710,180 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 482,326,275 doses of the vaccine have been distributed with 399,552,444 doses injected. The number receiving at least one dose is 216,268,034, while the number receiving second doses, which would grant the highest level of immunity, is 186,618,184. The *FT* has a page on [global vaccine distribution](#).

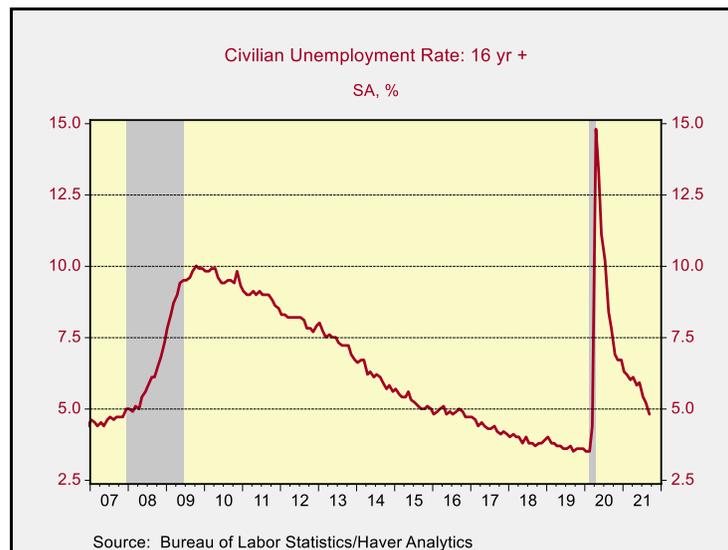
- Pfizer (PFE, \$42.74) and BioNTech (BNTX, \$246.57) have requested that the U.S. Food and Drug Administration [authorize the use of their COVID-19 vaccine for children ages 5-11](#). If approved, the shots could be available for younger kids by November.

U.S. Economic Releases

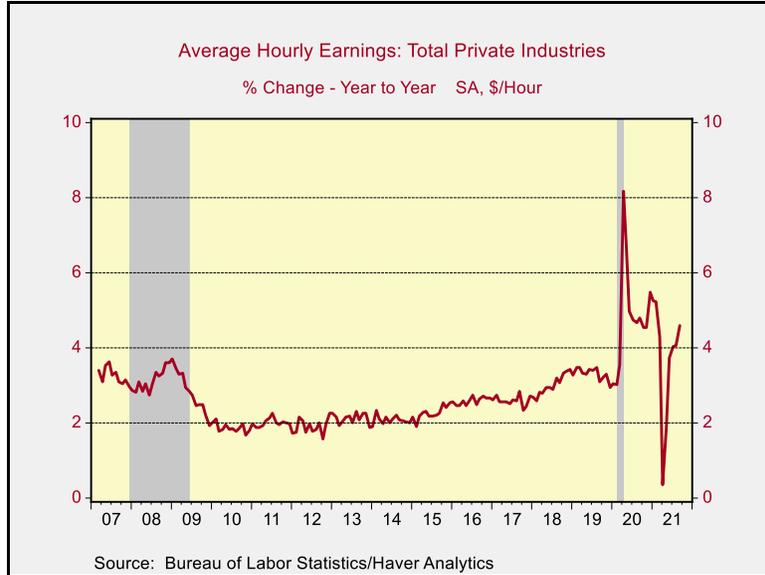
In today's key U.S. release, September nonfarm payrolls increased by a seasonally adjusted 194,000, far short of both the revised August gain of 366,000 and the expected increase of 500,000. Despite net upward revisions of 169,000 for the previous two months, and in spite of the fact that private sector job growth was roughly in line with the previous month's gain, the topline figure will still be taken as a significant disappointment. The chart below shows the growth in nonfarm payrolls since just before the prior recession.



Despite the disappointing job growth last month, the September unemployment rate fell sharply to 4.8%. That was much better than both the expected rate of 5.1% and the August rate of 5.2%. On the other hand, the data suggest that the drop in the rate of joblessness stemmed in large part from people dropping out of the labor force. The labor force participation rate declined to just 61.6% versus expectations that it would rise to 61.8%. The chart below shows the progression of the U.S. unemployment rate since just before the previous recession.



Another important indicator in the employment report was the latest figure for average wage income. Average hourly earnings in September rose to \$30.85, up 4.6% from September 2020, as anticipated. The chart below shows the trend in average hourly earnings since just before the prior recession.



The table below lists the economic releases and/or Fed events scheduled for the rest of the day.

Economic Releases						
EDT	Indicator			Expected	Prior	Rating
10:00	Wholesale Inventories	m/m	Aug F	1.2%	1.2%	**
Fed Speakers or Events						
No Fed speakers or events today						

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
ASIA-PACIFIC								
Japan	Current Account Balance	m/m	Aug	¥1665.6b	¥1910.8b	¥1473.6b	***	Equity bullish, bond bearish
	Current Account Balance, Adjusted	m/m	Aug	¥1042.6b	¥1413.4b	¥1145.9b	*	Equity and bond neutral
	Trade Balance, BoP Basis	m/m	Aug	-¥372.4b	¥622.3b	-¥385.3b	**	Equity bullish, bond bearish
	Labor Cash Earnings	y/y	Aug	0.7%	0.6%	0.4%	**	Equity bullish, bond bearish
	Household Spending	y/y	Aug	-3.0%	0.7%	-1.2%	*	Equity bearish, bond bullish
Australia	Foreign Reserves	m/m	Sep	A\$82.1b	A\$79.1b		*	Equity and bond neutral
China	Caixin Services PMI	m/m	Sep	53.4	46.7	49.2	**	Equity bullish, bond bearish
	Caixin Composite PMI	m/m	Sep	51.4	47.2		**	Equity bullish, bond bearish
EUROPE								
Germany	Current Account Balance	m/m	Aug	11.8b	17.9b	17.6b	*	Equity bullish, bond bearish
	Trade Balance	m/m	Aug	10.7b	17.9b	15.0b	*	Equity bearish, bond bullish
	Exports	m/m	Aug	-1.2%	0.6%	0.5%	*	Equity bearish, bond bullish
	Imports	m/m	Aug	3.5%	-3.6%	1.8%	*	Equity and bond neutral
AMERICAS								
Canada	Net Change in Employment	m/m	Sep	157.1k	90.2k	60.0k	***	Equity bullish, bond bearish
	Unemployment Rate	m/m	Sep	6.9%	7.1%	6.9%	***	Equity bullish, bond bearish
Brazil	IBGE Inflation IPCA	y/y	Sep	10.3%	9.7%	10.3%	***	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)	12	12	0	Down
3-mo T-bill yield (bps)	4	5	-1	Neutral
TED spread (bps)	8	8	0	Neutral
U.S. Libor/OIS spread (bps)	8	8	0	Down
10-yr T-note (%)	1.58	1.57	0.01	Down
Euribor/OIS spread (bps)	-55	-55	0	Neutral
EUR/USD 3-mo swap (bps)	18	18	0	Down
Currencies	Direction			
dollar	Flat			Down
euro	Flat			Up
yen	Flat			Neutral
pound	Flat			Neutral
franc	Flat			Neutral
Central Bank Action	Current	Prior	Expected	
RBI Repurchase Rate	4.000%	4.000%	4.000%	On forecast
RBI Reverse Repo Rate	3.350%	3.350%	3.350%	On forecast
RBI Cash Reserve Ratio	4.000%	4.000%	4.000%	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.

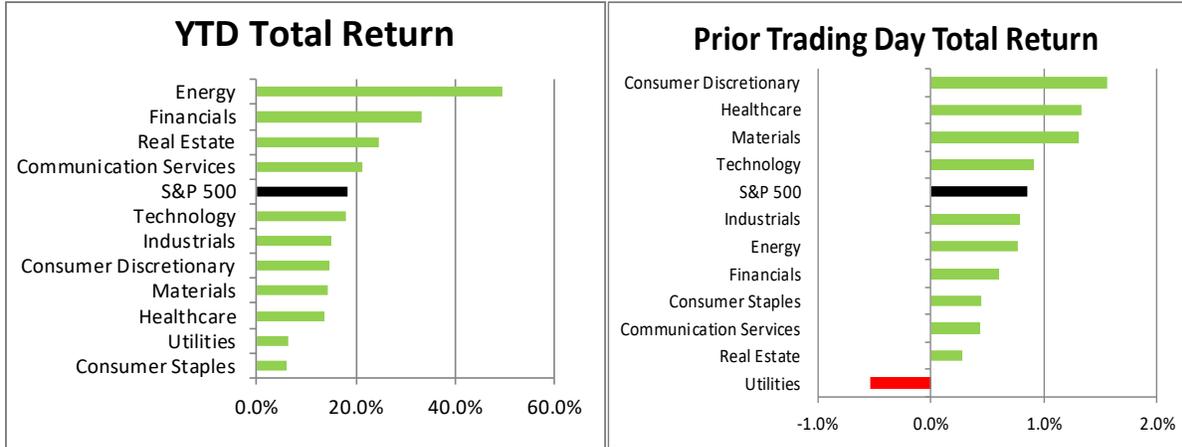
	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$82.52	\$81.95	0.70%	
WTI	\$78.90	\$78.30	0.77%	
Natural Gas	\$5.73	\$5.68	0.88%	
Crack Spread	\$21.37	\$21.43	-0.32%	
12-mo strip crack	\$22.05	\$22.20	-0.64%	
Ethanol rack	\$2.58	\$2.55	0.93%	
Metals				
Gold	\$1,761.84	\$1,755.78	0.35%	
Silver	\$22.56	\$22.60	-0.18%	
Copper contract	\$423.40	\$424.35	-0.22%	
Grains				
Corn contract	\$536.25	\$534.00	0.42%	
Wheat contract	\$744.25	\$741.25	0.40%	
Soybeans contract	\$1,256.00	\$1,247.25	0.70%	
Shipping				
Baltic Dry Freight	5,650	5,647	3	
DOE inventory report				
	Actual	Expected	Difference	
Crude (mb)	2.3	0.7	1.6	
Gasoline (mb)	3.3	0.4	2.9	
Distillates (mb)	-0.4	0.8	-1.2	
Refinery run rates (%)	1.50%	0.35%	1.15%	
Natural gas (bcf)	118.0	86.0	32.0	

Weather

The 6-10 day and 8-14 day forecasts currently call for warmer-than-normal temperatures throughout the entire eastern half of the country, with cooler-than-normal temperatures throughout the Far West. The forecast calls for dry conditions throughout the Rocky Mountain, Great Lakes, and southeastern regions, with wet conditions in the Pacific Northwest and Texas. There is currently one tropical disturbance off the coast of South Carolina, but it is not expected to develop into a tropical storm within the next 48 hours. We are past the normal peak of hurricane activity, which occurred on September 10.

Data Section

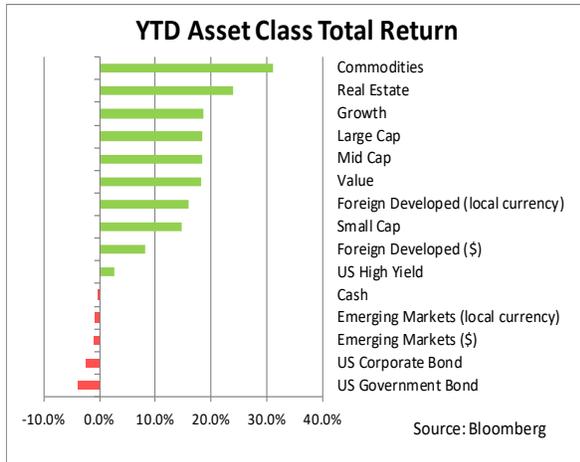
U.S. Equity Markets – (as of 10/7/2021 close)



(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 10/7/2021 close)

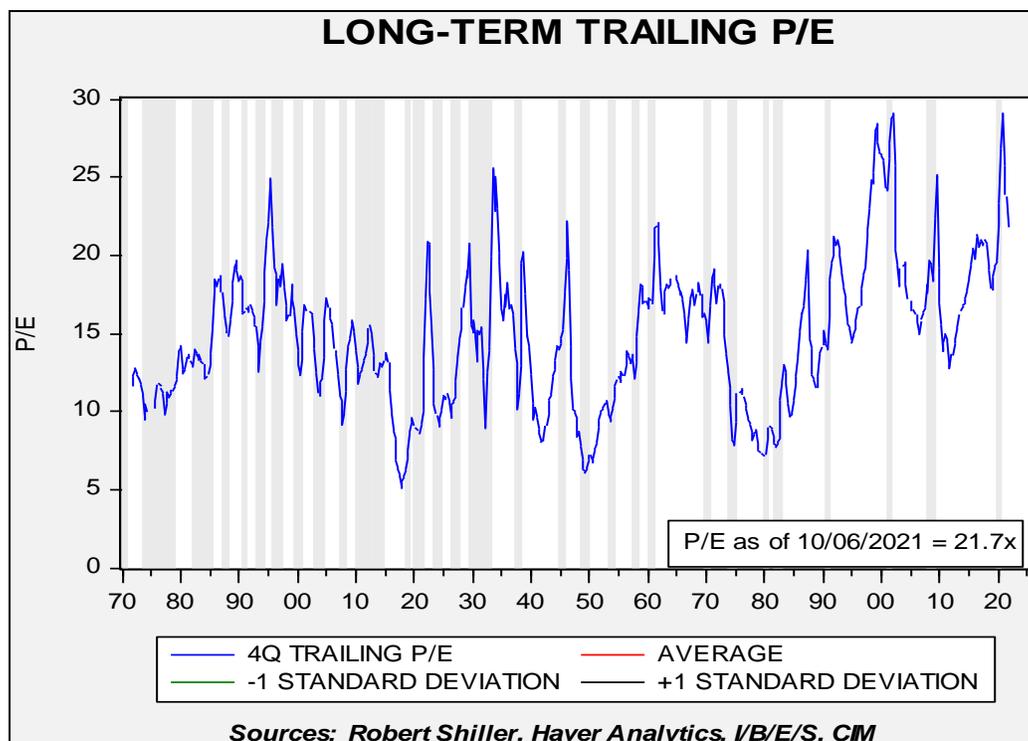


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

October 7, 2021



Based on our methodology,¹ the current P/E is 21.7x, down 2.0x from last week. The drop in the multiple reflects the shift to Q4, which has higher earnings in the calculation.

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.