

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 10, 2023—9:30 AM EDT]** Global equity markets are mostly lower this morning. In Europe, the Euro Stoxx 50 is down 0.6% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed essentially flat. Chinese markets were lower, with the Shanghai Composite closing down 0.4% and the Shenzhen Composite closing down 0.1%. 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:

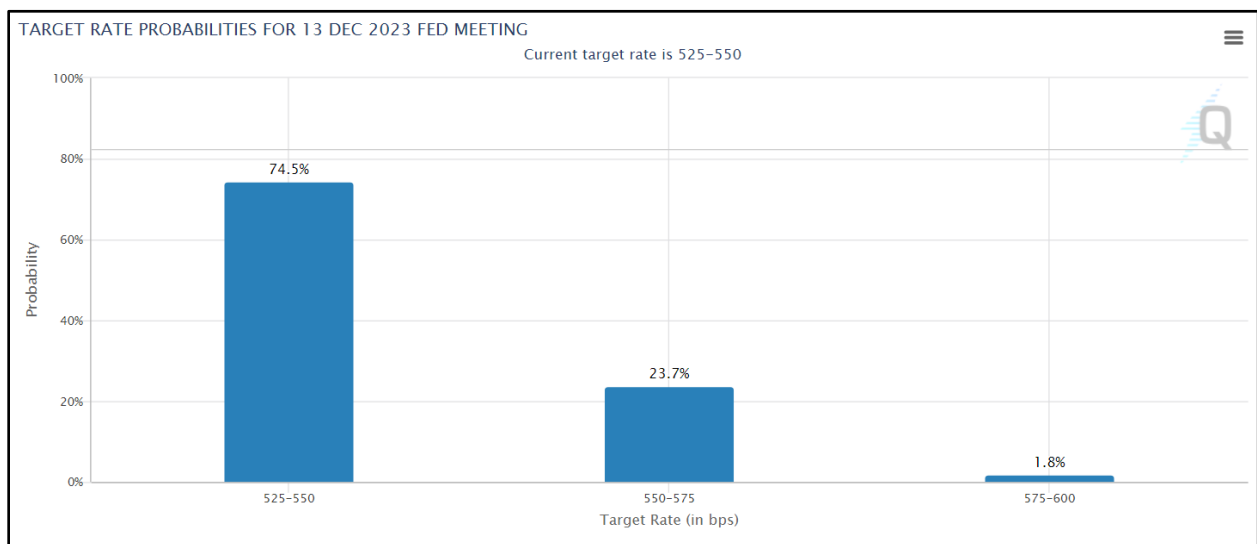
- [Bi-Weekly Geopolitical Report](#) (10/2/2023) (with associated [podcast](#)): “The Oil Weapon Returns”
- [Weekly Energy Update](#) (10/5/2023): Oil prices have been correcting from recent highs, most likely reflecting concerns surrounding the impact of rising interest rates on the economy. We note that U.S. commercial inventories are falling despite falling refinery operations due to seasonal maintenance.
- [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](#) (10/9/2023) (with associated [podcast](#)): “The FOMC in 2024”
- [Confluence of Ideas podcast](#) (8/22/2023): “The Economics of Defense in Great Power Competition”

Our *Comment* today opens with an update on the situation in Israel, where the country’s military is poised to launch a ground attack on Hamas fighters in the Gaza Strip and all eyes are watching for a potential widening of the conflict. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including a likely new anti-subsidy investigation by the EU against China and the latest on U.S. labor market unrest.

**Israel-Hamas:** In response to the weekend attack by the Hamas government in the Gaza Strip, the Israeli government yesterday [announced a “complete siege” of the territory, vowing to stop any food, water, electricity or other supplies from entering](#). After mobilizing some 300,000 reservists, the military also looks set to launch a full-scale ground invasion of Gaza, likely in an

effort to destroy Hamas. Meanwhile, Hamas threatened to kill one of its estimated 100 or so civilian hostages for every unannounced Israeli airstrike on the territory.

- Naturally, a key concern is whether the conflict will spread. So far, reports indicate there have only been sporadic sympathy attacks by the Iranian-backed Hezbollah militants in southern Lebanon, but that could change as the Israelis commit more forces to a ground incursion in Gaza.
- Meanwhile, the U.S. is reportedly sending a surge of ammunition and other military equipment and supplies to the Israelis. The U.S. has also deployed its aircraft carrier *USS Gerald R. Ford* and its battle group to the eastern Mediterranean Sea and has sent additional military aircraft to land bases in the region. This morning, Chair of the Joint Chiefs of Staff CQ Brown explicitly [said the deployments aim to deter Iran from getting involved in the conflict and warned Tehran to keep its distance](#). The U.S. and European leaders also continue to voice their support for Israel, but China still has not condemned the Hamas attack.
  - Separately, Saudi Arabia’s Crown Prince Mohammed bin Salman [said his kingdom stands by the Palestinians in the crisis](#).
  - That suggests Iran has had some success in achieving what was likely one of its goals in helping Hamas with its attack, i.e., scuttling the budding U.S.-brokered deal in which the Saudis would have recognized Israel.
- Yesterday, U.S. and other financial markets initially responded as would be expected in such a crisis: Investors [sold off equities and piled into safe havens like bonds, oil, and gold](#). By day’s end, however, investors had reversed much of those moves, and equities ended with impressive gains.
  - Such a turnaround is common in these types of crises. The initial selling clears out the weak longs, and once they’re out of the market, the selling stops. That allows for a rebound in stocks, but we wouldn’t count on it to last.



- Some of the late-day buying yesterday probably also stemmed from hopes that the crisis would convince the Federal Reserve to stop hiking interest rates and start easing policy. For example, the CME's fed funds target-rate probability gauge now shows that investors see only about a 25% chance that the Fed will hike rates further by the end of the year. That may prove prescient if the policymakers only focus on the ongoing slowdown in economic growth and cooling current inflation. Keep in mind, though, that they could just as easily keep hiking if they focus more on continuing threats, like the big federal budget deficit.

**Russia-Ukraine-North Korea:** In the world's other major war, new satellite imagery [suggests Russia has begun taking delivery of additional military supplies via railroad from North Korea](#). The imagery shows a huge increase in freight-car traffic at the Tumangang Rail Facility on the Russian-North Korean border. The cars are also carefully covered, further suggesting they are carrying sensitive equipment. The evidence of new shipments comes after Russian President Putin met with North Korean leader Kim Jong Un last month to request help with replenishing the ammunition and supplies that Russia has depleted in its continued invasion of Ukraine.

**China:** New data [shows consumer spending and home sales were weaker than expected during the Golden Week holiday that ended on Friday](#). Golden Week is typically one of the country's top periods for spending and home transactions, but the data shows tourism outlays were only 1.5% higher than in the pre-pandemic year of 2019, representing a decline after stripping out price inflation. The amount of residential floor space sold was also lower than in 2019. The figures are further evidence that China's economic growth is being held back by issues such as weak consumer demand, high debt levels, poor demographics, and de-coupling from the West.

- As further evidence of China's economic problems, the major real estate developer Country Garden (CTRY, \$2.71) [failed to make one of its international loan payments for the first time](#). It also warned that it doesn't expect to make upcoming payments to its foreign bond holders.
- Country Garden's troubles began after its apartment sales plunged in recent months, as the government's crackdown on highly indebted developers sparked a liquidity crisis and weighed on sales.

**European Union-China:** The EU [is expected to launch an anti-subsidy investigation against Chinese steel producers later this month](#). The probe would be part of a new, U.S.-led "Global Arrangement on Sustainable Steel and Aluminum" aimed at China's dumping of cheap, subsidized metal products to the detriment of developed-country producers. Countries including Japan and the U.K. would also be invited into the group if they agree to impose punitive tariffs on China's dumped metal products.

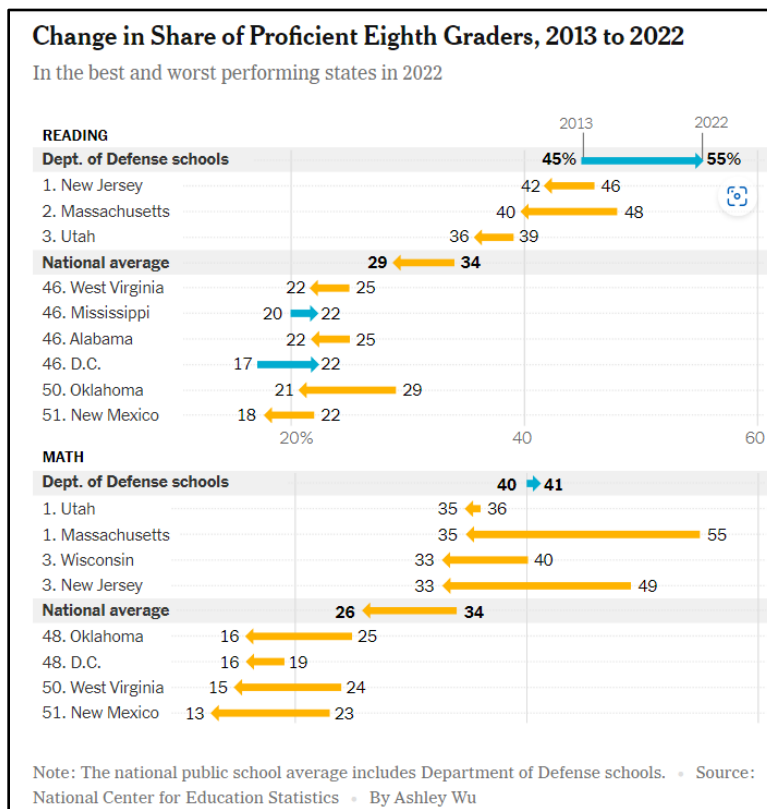
- The EU's move comes just weeks after it announced an anti-subsidy probe into Chinese electric vehicles, and shortly before it is expected to announce a separate probe into Chinese wind turbines.
- The initiatives by Brussels are sure to worsen EU-China relations and contribute further to the fracturing of the world into relatively separate geopolitical and economic blocs, as we have frequently described.

**Argentina:** The peso (ARS) [dropped 7.4% against the U.S. dollar on the black market yesterday](#) as right-wing firebrand Javier Milei, who is leading the opinion polls ahead of the October 22 presidential election, warned again that he plans to dollarize the economy if he wins. In a radio interview, Milei warned that Argentines shouldn't keep any investments denominated in ARS.

**Canada:** The Unifor auto workers' union today [has launched a strike against U.S. automaker General Motors \(GM, \\$30.99\)](#) after the workers and the company failed to agree on a new labor contract. The strike illustrates how tight labor markets have emboldened workers in Canada just as they have in the U.S. The work stoppage also piles pressure on GM, which is already dealing with the United Auto Workers strike in the U.S.

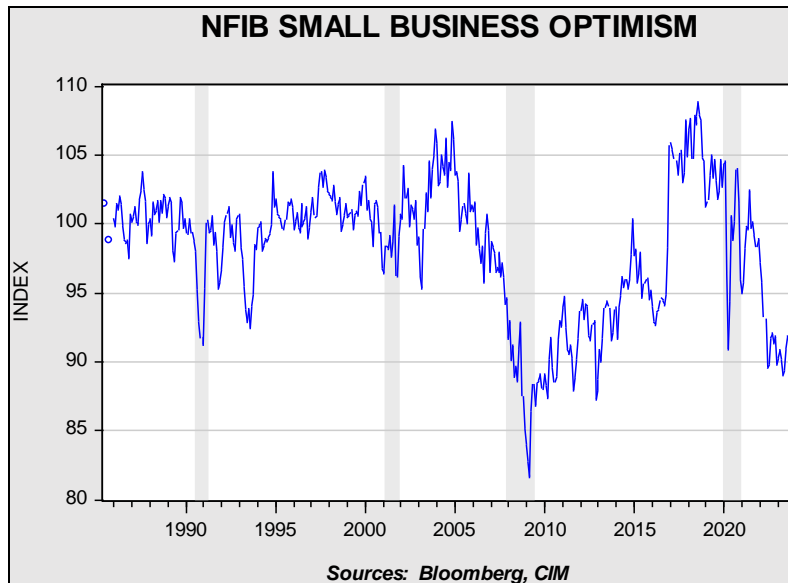
**U.S. Labor Market:** The 75,000 healthcare workers who launched a three-day strike against Kaiser Permanente last week [have now gone back to work, and negotiations on a new labor contract with the firm are set to begin again on Thursday](#). The union has warned that the workers will go out on strike again in November if they can't strike a deal for higher pay and increased staffing at Kaiser's facilities.

**U.S. Education System:** An intriguing story in the *New York Times* [notes that schools run by the Defense Department on U.S. military bases have begun to substantially out-perform typical public schools](#). The article ascribes their outperformance to a range of factors, including higher teacher pay, higher standards, stronger discipline, and quicker reopening after the coronavirus pandemic.



## U.S. Economic Releases

U.S. small business owners' perceptions of the state of the economy remain weak, with the NFIB optimism index falling to 90.8 in October, below both expectations and the previous month's reading. This marks the third consecutive decline in the index. The survey also showed that small business owners fear a weakening economy over the next six months and are worried about their ability to access credit.



The chart above shows the NFIB Index of Small Business Optimism.

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

Economic Releases	
No economic releases for the rest of today	
Federal Reserve	
EST	Speaker or Event
9:00	Lorie Logan Speaks on US Outlook, Monetary Policy
9:15	Michael Barr Speaks at American Bankers Association Conference
12:50	Phiip Jefferson Speaks at NABE Conference
District or Position	
	President of the Federal Reserve Bank of Dallas
	Federal Reserve Board Vice Chair for Supervision
	Member of the Board of Governors

## 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
<b>ASIA-PACIFIC</b>								
China	Foreign Reserves	m/m	--	\$3115.00b	\$3160.10b	\$3125.00b	**	Equity and bond neutral
<b>EUROPE</b>								
Germany	Industrial Production WDA	y/y	Aug	-2.0%	-1.7%	-1.5%	**	Equity bearish, bond bullish
Switzerland	Domestic Sight Deposits CHF	w/w	6-Oct	469.1b	--	--	--	Equity and bond neutral
	Total Sight Deposits CHF	w/w	6-Oct	479.9b	--	--	--	Equity and bond neutral
<b>AMERICAS</b>								
Mexico	CPI	y/y	Sep	4.45%	4.64%	--	***	Equity and bond neutral
	Core CPI	y/y	Sep	5.76%	6.08%	--	**	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)	567	567	0	Up
3-mo T-bill yield (bps)	535	535	0	Up
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	542	540	2	Up
U.S. Libor/OIS spread (bps)	544	542	2	Up
10-yr T-note (%)	4.80	4.80	0.00	Flat
Euribor/OIS spread (bps)	398	397	1	Up
<b>Currencies</b>	<b>Direction</b>			
Dollar	Up			Up
Euro	Down			Down
Yen	Up			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
<b>Energy Markets</b>				
Brent	\$87.96	\$84.58	4.00%	
WTI	\$86.26	\$82.79	4.19%	
Natural Gas	\$3.36	\$3.34	0.54%	
Crack Spread	\$18.52	\$19.28	-3.97%	
12-mo strip crack	\$22.33	\$22.59	-1.15%	
Ethanol rack	\$2.49	\$2.48	0.15%	
<b>Metals</b>				
Gold	\$1,845.88	\$1,833.01	0.70%	
Silver	\$21.60	\$21.60	0.00%	
Copper contract	\$364.70	\$362.75	0.54%	
<b>Grains</b>				
Corn contract	\$494.75	\$492.00	0.56%	
Wheat contract	\$579.50	\$568.25	1.98%	
Soybeans contract	\$1,272.00	\$1,266.00	0.47%	
<b>Shipping</b>				
Baltic Dry Freight	1,929	1,827	102	
<b>DOE Inventory Report</b>				
	<b>Actual</b>	<b>Expected</b>	<b>Difference</b>	
Crude (mb)	-2.2	0.1	-2.3	
Gasoline (mb)	6.5	-0.3	6.8	
Distillates (mb)	-1.3	-0.1	-1.2	
Refinery run rates (%)	-2.2%	-0.5%	-1.8%	
Natural gas (bcf)	86	94	-8	

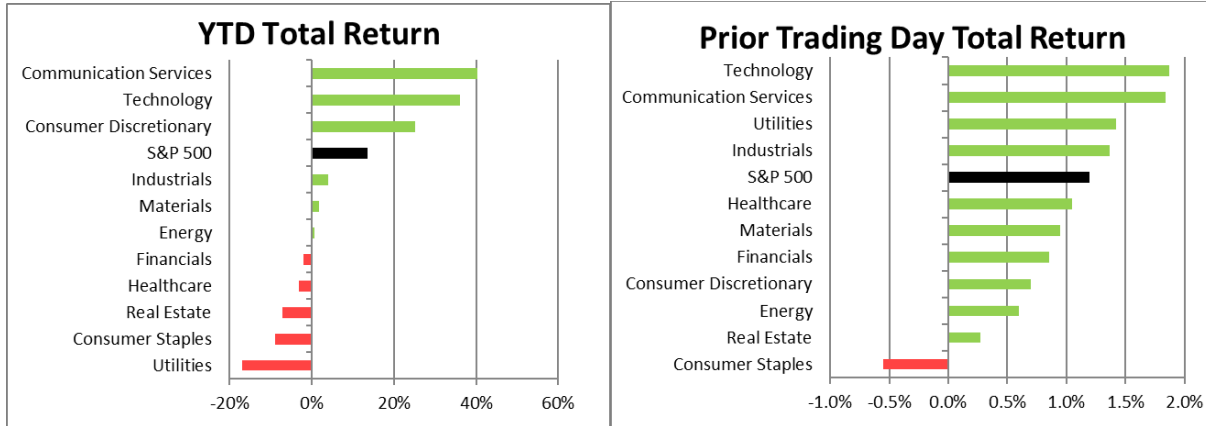
## Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures throughout the Pacific which is then expected to expand into the Midwest, with cooler-than-normal temperatures in the Deep South and the Mid-Atlantic. The forecasts call for wetter-than-normal conditions in the Pacific Northwest and in the Southwest, with dry conditions in the Rocky Mountains, the Great Plains, and the Mississippi Valley region.

There are two atmospheric disturbances currently active in the Atlantic Ocean. One is located in the Gulf of Mexico and has a 20% chance of cyclone formation within the next 48 hours. There is another storm off the West African coast which has a 70% chance of forming into a cyclone in the next 48 hours. On average, Atlantic hurricane activity peaks on September 15.

**Data Section**

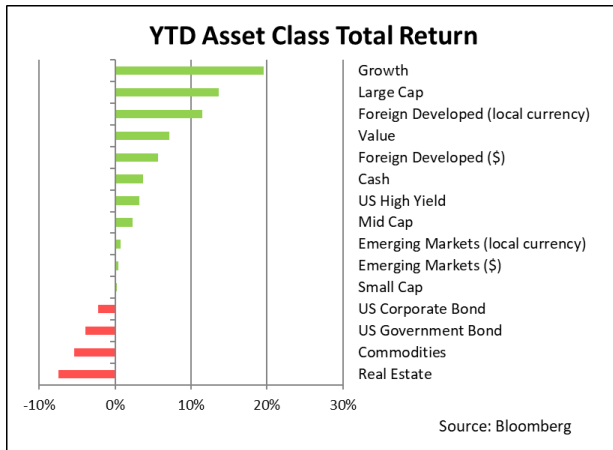
**U.S. Equity Markets – (as of 10/9/2023 close)**



(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 10/9/2023 close)**



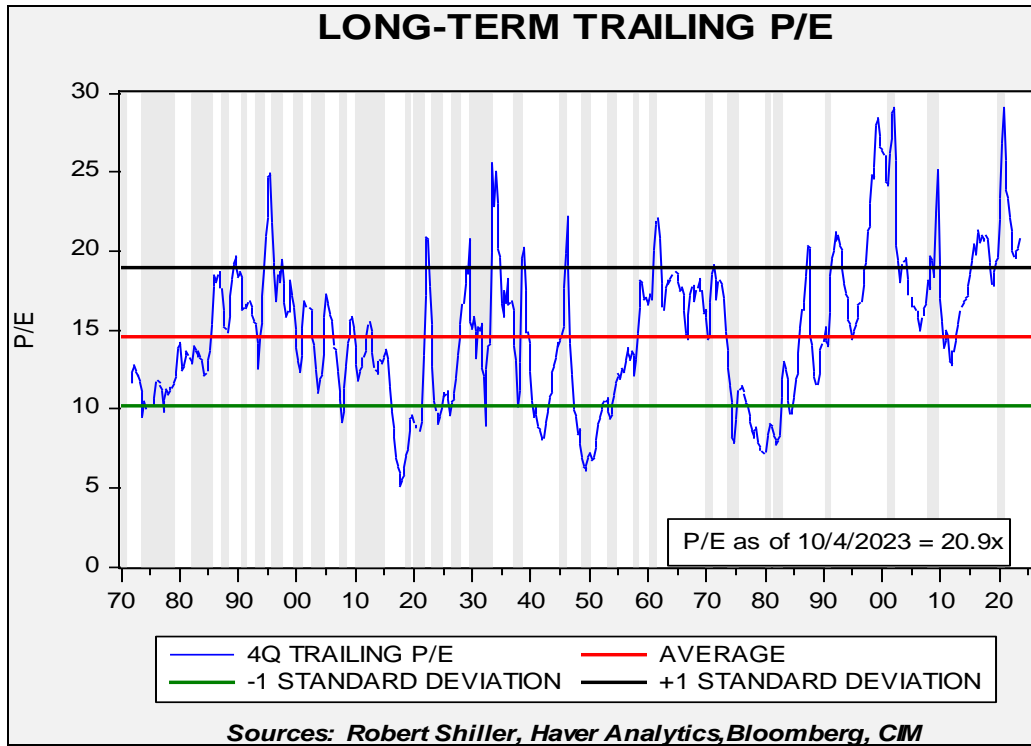
This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

October 5, 2023



Based on our methodology,<sup>1</sup> the current P/E is 20.9x, down 0.3x from last week. The decline in the multiple is mostly due to rolling to Q4.

*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 Bloomberg 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.