

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 25, 2023—9:30 AM EDT]** Global equity markets are generally higher this morning. In Europe, the Euro Stoxx 50 is up 0.1% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.1%. Chinese markets were higher, with the Shanghai Composite up 0.4% from its previous close and the Shenzhen Composite up 0.9%. In contrast, U.S. equity index futures are signaling a lower open.

With 126 companies having reported so far, S&P 500 earnings for Q3 are running at \$56.30 per share, compared to estimates of \$57.42, which is up 1.7% from Q2 2023. Of the companies that have reported thus far, 79.4% have exceeded expectations while 15.9% 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:

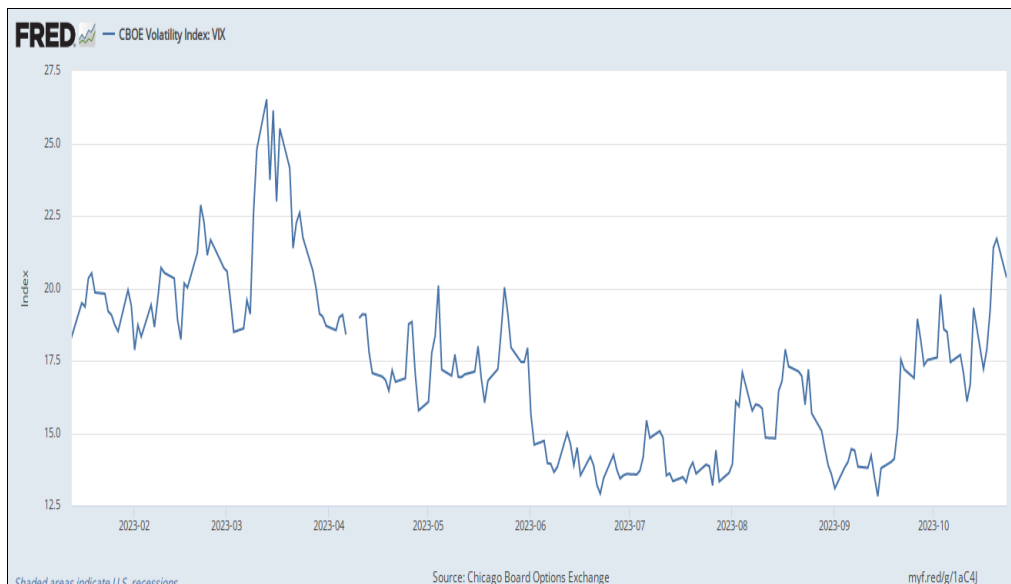
- **[Bi-Weekly Geopolitical Report](#)** (10/16/2023) (with associated [podcast](#)): “What Shall We Call the New Era?”
- [Weekly Energy Update](#) (10/19/2023): The situation in the Middle East remains fraught with risk, supporting crude oil prices. Despite continued record crude oil production, commercial inventories declined this week while refinery activity rose modestly. *Note: the next edition of this report will be published on November 2.*
- [Asset Allocation Quarterly – Q4 2023](#) (10/19/2023): Discussion of our asset allocation process, Q4 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](#) (10/23/2023) (with associated [podcast](#)): “A Regime Change in Bonds?”
- [Confluence of Ideas podcast](#) (8/22/2023): “The Economics of Defense in Great Power Competition”
- [Keller Quarterly](#) (October 2023)

Good morning! S&P 500 futures are trading lower before the open and the Diamondbacks made it to the World Series for the second time in franchise history. Today’s *Comment* starts with a discussion about the resurgence of the S&P 500. Next, we will give our thoughts on the recent

rally in bitcoin and China’s hardball tactics with foreign companies. As always, our report includes an overview of the latest domestic and international data releases.

**There is Life:** The S&P 500 rebounded after briefly testing the 4,200 support level earlier this week, but it doesn’t appear that the asset class is out of the woods yet.

- Strong earnings and positive economic data boosted the large-cap equity index performance on Tuesday. Several companies, including Verizon (VZ, \$34.30), 3M (MMM, \$90.12), and Coca-Cola (KO, \$55.64), reported better-than-expected earnings, lifting sentiment that companies are becoming more profitable. Microsoft’s (MSFT, \$330.12) results also supported an improved outlook, with the second-largest company by market capitalization rising 4% overnight after posting strong growth for its cloud services business. Additionally, S&P Global data [showed that U.S. manufacturing activity entered expansion for the first time in six months](#), with the Purchasing Manager Index hitting 51. The report suggests that economic momentum from Q3 may carry over into the next quarter.
- However, negative news for the tech sector has dampened some of the S&P’s momentum. Google parent company Alphabet (GOOG, \$140.12) reported a failure in its cloud services business, which overshadowed its estimate-beating revenue and earnings. Investors are concerned that Alphabet may not be able to catch up to rivals Amazon (AMZN, \$128.56) and Microsoft, especially as it looks to make gains in generative artificial intelligence. Meanwhile, [Meta \(META, \\$312.55\) is facing lawsuits from 41 different states and the District of Columbia](#), alleging that the tech giant has harmed children by making its platform too addictive. The allegation comes as lawmakers from both parties are becoming increasingly concerned with the impact social media is having on society.

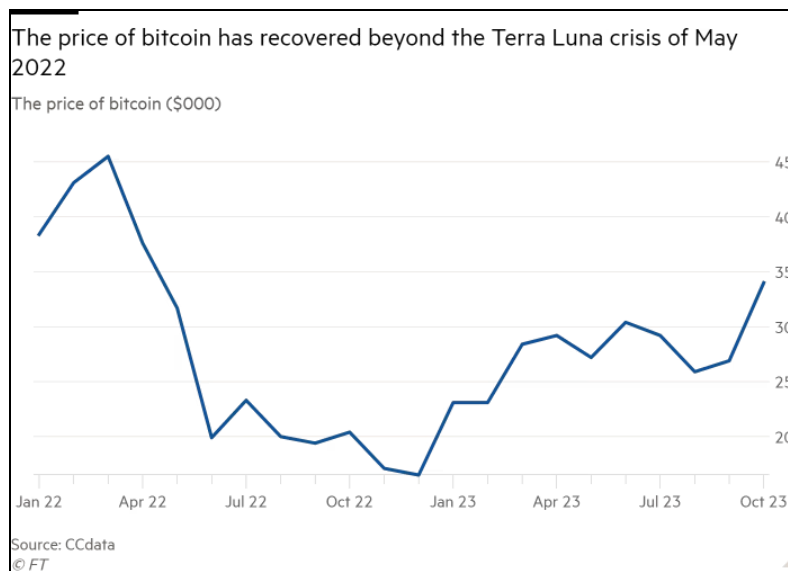


- A sustained rally in large caps is far from assured, given the lingering risks both domestically and abroad. The Federal Reserve [has maintained the possibility of another](#)

[rate hike](#), defying suggestions that rate increases are coming to an end. Furthermore, concerns about an escalating conflict in the Middle East are growing, with the [U.S. issuing a warning to Iran against exploiting the situation in Gaza to target American troops](#). This heightened uncertainty explains why the CBOE [VIX index briefly exceeded 20 on Tuesday](#), as investors worry about more volatility over the next 30 days.

**Crypto Rally:** Investors have flocked to digital currencies, drawn by the prospect of exchange-traded funds based on crypto and rising global tensions.

- A federal judge ruled against the SEC in its bid to block Grayscale's Bitcoin ETF on Monday. The regulator argued that the [ETF lacked adequate oversight to detect fraudulent activity and manipulation](#). Earlier this week, the [SEC stated that it will no longer contest the ruling](#), boosting optimism that it was ready to allow Grayscale's Bitcoin Trust to become a listed BTC ETF. So far, regulators have not approved a single spot crypto ETF to be listed on U.S. exchanges but have paved the way for [similar investment vehicles containing futures for bitcoin and ether](#).
- The ongoing conflict in the Middle East has prompted investors to flock to digital currencies as safe-haven assets. Bitcoin rose 7% in the days leading up to the court's ruling and following the outbreak of the Israel-Hamas conflict. Comparatively, gold price futures rose about 8% within the same period. Bitcoin's strong performance has led to optimism that it may be maturing past the early adoption stage and into a legitimate asset class. [Several asset managers have argued that cryptocurrencies](#) can be used to diversify geopolitical risks similar to other hard assets.

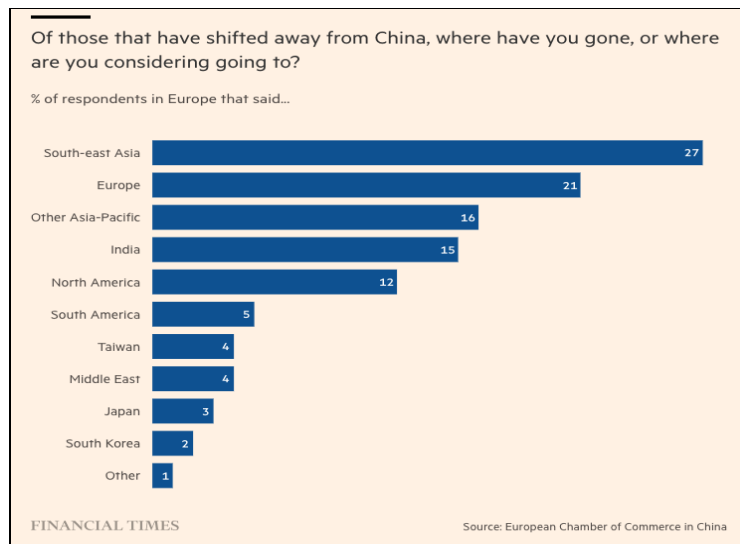


- Despite cryptocurrency's recent momentum, we remain skeptical of its readiness for widespread adoption. Persistently low trading volumes and [a 30-day moving average below pre-stablecoin](#) crash levels suggest that confidence in the asset class remains relatively low, making it vulnerable to substantial price fluctuations. Additionally, significant regulatory challenges loom ahead, including demands for more oversight of the crypto industry, especially related to anti-money laundering. [Senators Elizabeth](#)

[Warren \(D-MA\)](#) and [Kristen Gillibrand \(D-NY\)](#) are pushing their party to take a stand against the industry. Consequently, we believe that more traditional hard assets and commodities are better suited for conservative investors looking to hedge against geopolitical risks.

**Companies Must Choose:** Beijing is increasingly assertive in pushing foreign companies to lobby their governments for better trade ties with China.

- [Chinese regulators opened an investigation into Foxconn \(2354.TW, TWD, 53.30\)](#), a Taiwan-based Apple (AAPL, \$173.44) iPhone supplier, over alleged tax and land violations. The [crackdown appears to target Terry Gou, the company's founder and largest shareholder](#), who is running as a long-shot independent candidate in Taiwan's presidential election in January. Although he has stated that he would push to improve ties between the sovereign island and Beijing, he has maintained that he will not be bullied. The probe has unnerved investors, suggesting that [Beijing may be preparing to crack down on other foreign multinational companies](#) as well. Shares of the Foxconn's stock have dropped 2.2% over the past two days.
- Beijing's heavy-handedness may have discouraged Western companies from taking sides in the escalating feud with China. Mercedes-Benz (MBGYY, \$16.26) CEO Ola Källenius has walked back his claims that [China was a potential growth market by describing it as maturing](#). Tesla (TSLA, \$216.52) CEO Elon Musk has warned that the U.S. [no longer has a significant edge over its geopolitical rivals](#) and could be defeated in a conflict. European auto suppliers have advocated for regulators to focus on creating incentives for cheaper car production in Europe instead of imposing tariffs on Chinese car imports. However, many companies [have responded to China's actions by redirecting investments to other countries](#).



- China's decision to target companies that do not comply with its demands comes with significant risks. Increased pressure on foreign businesses could lead them to seek out alternatives, undermining China's efforts to attract foreign investment to resolve its debt

problems. Additionally, China's tactics could encourage governments to increase scrutiny of Chinese investment. [U.S. regulators are already cracking down on Chinese partnerships and purchases](#) of American tech companies, and this trend could spread to other industries. The growing friction between the West and China suggests that domestic companies with exposure to the other's market may become less attractive as global tensions rise.

## U.S. Economic Releases

Demand for residential loans remains weak due to elevated borrowing costs. Mortgage applications fell 1.0% in the week ending October 20. The drop in loan requests is related to elevated borrowing costs, as the average 30-year fixed-rate mortgage rose 20 bps to 7.9%. As a result, the MBA tracker for purchases fell 2.0 bps from the prior week, while the refinancing index increased 2% in the same period.

No major U.S. data has been released so far today.

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
10:00	New Home Sales - Annualized Selling Rate	m/m	Sep	680k	675k	***
10:00	New Home Sales - Monthly Change	m/m	Sep	0.7%	-8.7%	**
Federal Reserve						
EST	Speaker or Event	District or Position				
16:35	Jerome Powell Delivers Welcoming Remarks	Chair 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>								
Japan	Leading Economic Index	m/m	Aug F	109.2	109.5		**	Equity and bond neutral
Australia	CPI	y/y	3Q	5.4%	6.0%	5.3%	***	Equity and bond neutral
South Korea	Consumer Confidence	m/m	Oct	98	100		*	Equity and bond neutral
<b>EUROPE</b>								
Eurozone	M3 Money Supply	y/y	Sep	-1.2%	-1.3%	-1.8%	***	Equity and bond neutral
Germany	IFO Business Climate	m/m	Oct	86.9	85.7	85.8	***	Equity bullish, bond bearish
	IFO Current Assessment	m/m	Oct	89.2	88.7	88.5	**	Equity bullish, bond bearish
	IFO Expectations	m/m	Oct	84.7	82.9	83.1	***	Equity bullish, bond bearish
<b>AMERICAS</b>								
Mexico	International Reserves Weekly	w/w	20-Oct	\$204000m	\$204127m		*	Equity and bond neutral
Brazil	FGV Consumer Confidence	y/y	Oct	93.2	97		*	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)	564	566	-2	Up
3-mo T-bill yield (bps)	531	529	2	Up
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	539	538	1	Up
U.S. Libor/OIS spread (bps)	540	540	0	Up
10-yr T-note (%)	4.86	4.83	0.03	Flat
Euribor/OIS spread (bps)	394	396	-2	Up
Currencies	Direction			
Dollar	Up			Up
Euro	Down			Down
Yen	Flat			Down
Pound	Down			Down
Franc	Down			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	\$88.27	\$88.07	0.23%	
WTI	\$83.85	\$83.74	0.13%	
Natural Gas	\$2.98	\$2.97	0.20%	
Crack Spread	\$20.94	\$21.04	-0.49%	
12-mo strip crack	\$23.75	\$23.75	0.00%	
Ethanol rack	\$2.38	\$2.39	-0.46%	
<b>Metals</b>				
Gold	\$1,974.49	\$1,970.97	0.18%	
Silver	\$22.81	\$22.92	-0.48%	
Copper contract	\$360.65	\$362.40	-0.48%	
<b>Grains</b>				
Corn contract	\$481.50	\$484.00	-0.52%	
Wheat contract	\$580.50	\$580.50	0.00%	
Soybeans contract	\$1,313.75	\$1,314.50	-0.06%	
<b>Shipping</b>				
Baltic Dry Freight	1,949	2,017	-68	
<b>DOE Inventory Report</b>				
	Actual	Expected	Difference	
Crude (mb)		0.5		
Gasoline (mb)		-1.3		
Distillates (mb)		-1.8		
Refinery run rates (%)		0.6%		
Natural gas (bcf)		82		

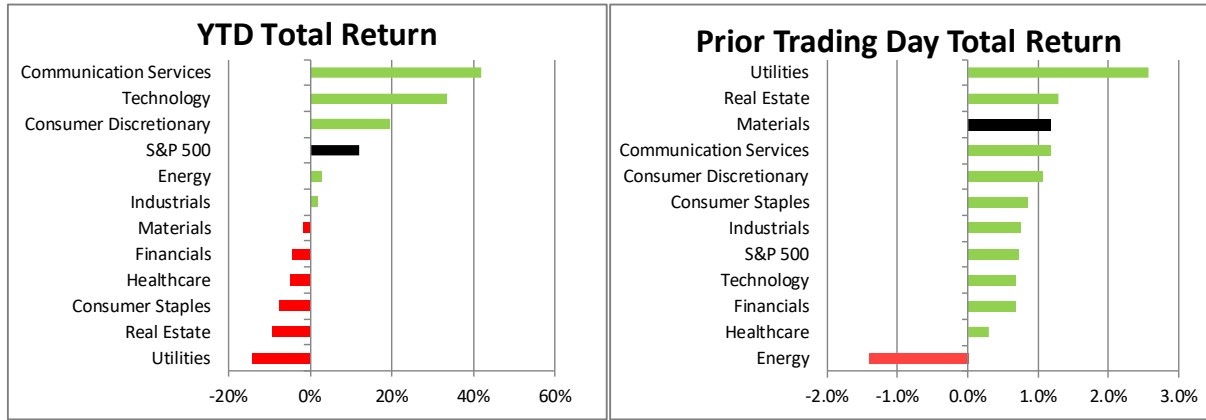
## **Weather**

The 6-10 and 8-14 day forecasts predict cooler-than-normal temperatures for most of the eastern half of the country, with warmer-than-normal temperatures expected for the rest of the country. The precipitation outlook shows wetter-than-normal temperatures throughout the northern Pacific and Texas regions, with dry conditions expected for the Midwest, New England, and Great Plains regions.

There is currently one atmospheric disturbance in the Atlantic Ocean. Hurricane Tammy is tracking northward through the central Atlantic Ocean and is not expected to make landfall anywhere. On average, Atlantic hurricane activity peaks on September 15.

**Data Section**

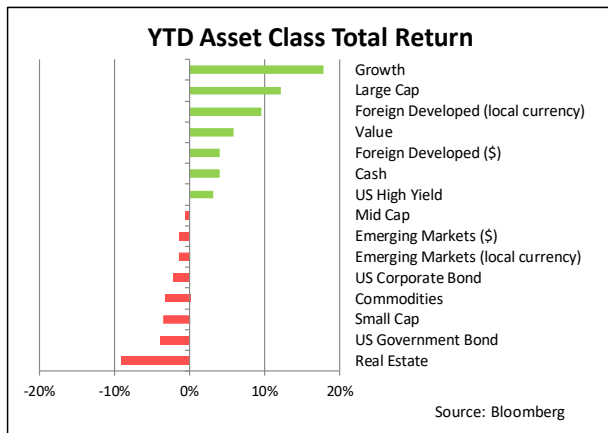
**U.S. Equity Markets – (as of 10/24/2023 close)**



(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 10/24/2023 close)**



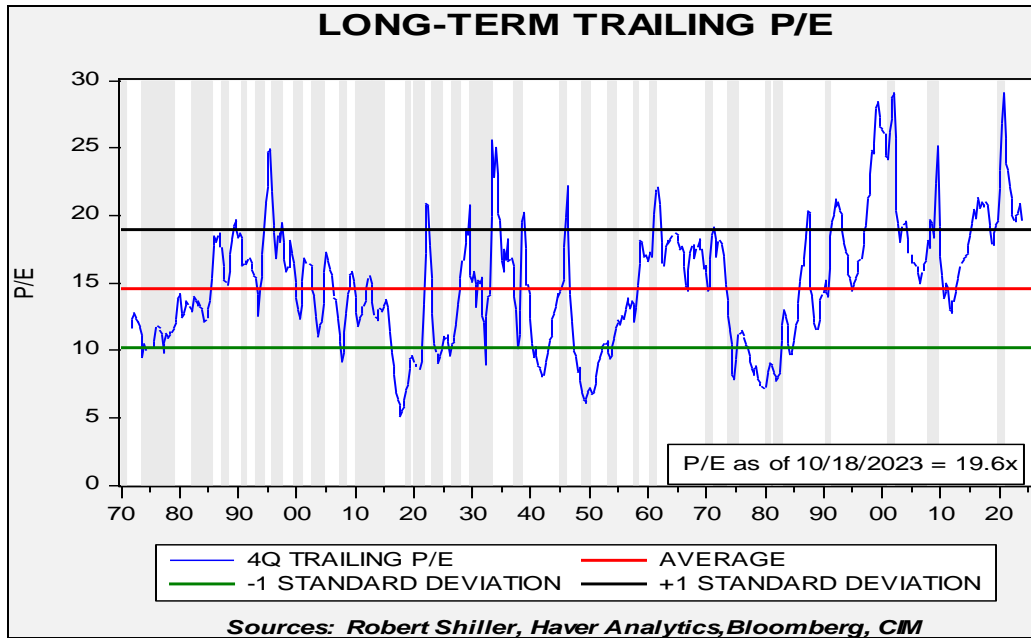
This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 19, 2023



Based on our methodology,<sup>1</sup> the current P/E is 19.6x, down 0.3x from last week. The decline in the multiple is mostly due to lower index values although earnings estimates were modestly higher as well.

*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.