

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: September 12, 2022—9:30 AM EDT] Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 is currently up 1.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.6%. Chinese markets were closed for the Mid-Autumn Festival. 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:

- [Bi-Weekly Geopolitical Report](#) (8/29/2022) (with associated [podcast](#)): “Agricultural Commodities in the Evolving Geopolitical Blocs”
- [Weekly Energy Update](#) (9/1/2022): We take a look at the Iran nuclear deal, discuss the situation in Europe, and update the weekly inventory data.
- [Asset Allocation Quarterly – Q3 2022](#) (7/19/2022): Discussion of our asset allocation process, Q3 2022 portfolio changes, and our outlook for the markets
- [Asset Allocation Q3 2022 Rebalance Presentation](#) (8/4/2022): Video presentation featuring the Asset Allocation Committee as they review our asset allocation strategies, recent portfolio changes, and the current macro environment
- [Asset Allocation Bi-Weekly](#) (9/6/2022) (with associated [podcast](#)): “Storm Warning”
- [Confluence of Ideas podcast](#) (8/9/2022): “The 2022 Outlook: Update #2”
- *Current Perspectives*: “**[2022 Outlook: Update #2 – The Tails Become Fatter](#)**” (7/12/2022)

Our *Comment* today opens with an update on the Russia-Ukraine war, including some notes on Ukraine’s devastating victories over Russian forces since late last week. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including an important election in Sweden and new research on how COVID-19 continues to hold down the U.S. labor force.

Russia-Ukraine: Over the weekend, Ukrainian forces [continued to rout the Russians in the northern region of Kharkiv and make new territorial gains with their counteroffensive to retake the occupied city of Kherson](#) in the south. Ukrainian military officials indicate Kyiv has now retaken an area roughly the size of Rhode Island since the beginning of the month. All reports indicate the [Russian retreat](#) is disorganized and desperate. Nevertheless, the Ukrainians [are already slowing their advance this morning in order to consolidate their hold on the recaptured](#)

territories and prepare for a possible Russian counterattack. It is still much too early to expect a full Ukrainian victory or a complete withdrawal by the Russians, but the Ukrainian successes over the last week could mark a turning point that boosts the country's confidence, encourages further military and other support from the West, and worsens the Russia's shortfalls in morale, manpower, and equipment. The Ukrainian military is also likely to benefit greatly from the equipment and ammunition the Russians have abandoned in their retreat, as well as from the intelligence to be gleaned from the Russians' abandoned command posts.



- Importantly, the rout of Russian forces in Ukraine is generating intense criticism of the Ministry of Defense, although there is less discernable criticism of President Putin himself. Indeed, Putin may be to the point where he wants the MOD to take the criticism to deflect blame from himself. The Kremlin has even announced that Putin has postponed all his meetings with the leadership of the MOD and representatives of the Russian defense industry, which is a bizarre decision in the face of the military operational and defense industrial crisis facing Russia.

- On the energy front, Russia's nearly complete cutoff of natural gas supplies [is now idling more and more of Western Europe's industrial capacity](#), from steel and aluminum to cars, glass, ceramics, sugar, and toilet-paper makers. Some industries, such as the energy-intensive metals sector, [are shutting factories that analysts and executives say might never reopen, imperiling thousands of jobs](#). The shutdowns illustrate how important it is for Ukraine to continue showing battlefield successes as a way to hold out hope that the economic costs to Western Europe will be short-lived.

United Kingdom: Queen Elizabeth II's funeral [has now been set for Monday, September 19](#), in Westminster Abbey. Importantly, all indications are that leaders from across the world will descend on London for the event, making it a major unscheduled diplomatic meeting. Confirmed attendees so far include U.S. President Biden, European Commission President von der Leyen, Japanese Emperor Naruhito, and New Zealand Prime Minister Ardern. We would not be surprised if the funeral ends up spawning several important meetings and initiatives.

United Kingdom-European Union: To take advantage of the U.K. leadership change last week, Chief EU Brexit Negotiator Maroš Šefčovič [has offered an idea to resolve the EU-U.K. dispute over customs checks for goods going from the British mainland to Northern Ireland](#). Under his proposal, the U.K. would share data on the shipments with the EU in real time, and physical checks would only be required in rare instances in which there was a suspicion of smuggling or other issues.

- We have not seen a firm response to the idea from the British government so far, and it isn't clear whether the idea would mollify those in Northern Ireland who most oppose any arrangement that interferes with its connection to the mainland.
- All the same, the idea could potentially help resolve one of the main sources of tension between the U.K. and the EU.

Sweden: In parliamentary elections yesterday, preliminary results [showed a center-right bloc of parties with a slim majority over a center-left bloc](#), but the real news was that the right-wing nationalist Sweden Democrats took their biggest-ever share of votes in a general ballot. Final results are not due for several days, [but it appears that the Sweden Democrats will be the largest party in the right-wing bloc and the second-largest party overall](#). If the right wing takes power, one important implication is that they are likely to push more reliance on nuclear electricity generation in Sweden, further bolstering a global trend.

Colombia: In an interview with the *Financial Times*, Environment Minister Susana Muhamad said the government of leftist President Gustavo Petro [will, for the first time, require environmental licenses for mining exploration](#) as part of a wider overhaul of the process for awarding concessions. The move likely signals the kinds of new regulations that will be put in place as left-wing leaders take control of more governments in Latin America.

U.S. Dollar: Ahead of tomorrow's release of the August Consumer Price Index (CPI), the dollar [is weakening substantially against all major currencies except the yen](#). The softening in the greenback partly reflects expectations that CPI inflation will slow, potentially setting the stage for the Federal Reserve to slow its interest-rate hikes down the road. In addition, investors may

still be digesting the European Central Bank's aggressive 75 bps hike in its benchmark interest rate last week.

- At this writing, the euro is trading up approximately 1.1% against the dollar, at a value of \$1.0152.
- At the same time, the pound is up 0.9% to \$1.1694.

U.S. Labor Market: New research by economists at Stanford University indicates that illnesses caused by COVID-19 [have reduced the U.S. labor force by about 500,000](#) from what it would otherwise be. Retirements and other social impacts from the pandemic probably account for a greater share of today's workforce shortfall, but the research still illustrates the ongoing cost of not reducing infections further. The shortfall in the labor force from what it would be otherwise has likely contributed to labor shortages, spiking wage rates, and higher inflation.

U.S. Economic Releases

There were no domestic releases or Fed events scheduled prior to the publication of this report, nor are there any releases or Fed events scheduled for the day.

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	Machine tool orders	y/y	Aug P	10.7%	5.5%		**	Equity bullish, bond bearish
India	Industrial Production	y/y	Jul	2.4%	12.3%	4.2%	***	Equity bearish, bond bullish
	CPI	y/y	Aug	7.0%	6.7%	6.9%	***	Equity and bond neutral
EUROPE								
Italy	Industrial Production WDA	y/y	Jul	-1.4%	-1.2%	-1.1%	**	Equity and bond neutral
UK	Industrial Production	y/y	Jul	1.1%	2.4%	1.9%	***	Equity bearish, bond bullish
	Manufacturing Production	y/y	Jul	1.1%	1.3%	1.5%	**	Equity and bond neutral
	Visible Trade Balance	m/m	Jul	-\$19.362b	-\$22.847b	-\$22.350b	**	Equity and bond neutral
	Trade Balance	m/m	Jul	-\$7.793b	-\$11.387b	-\$11.300b	**	Equity and bond neutral
Switzerland	Domestic Sight Deposits CHF	w/w	9-Sep	638.6b	752.8b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	9-Sep	753.4b	640.8b		*	Equity and bond neutral
Russia	GDP	y/y	2Q P	-4.1%	-4.0%	-4.0%	**	Equity and bond neutral
	CPI	y/y	Aug	14.30%	15.10%	14.30%	***	Equity and bond neutral
	Core CPI	y/y	Aug	17.71%	18.40%	17.50%	**	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)	325	324	1	Up
3-mo T-bill yield (bps)	294	297	-3	Up
TED spread (bps)	31	27	4	Widening
U.S. Sibor/OIS spread (bps)	319	318	1	Up
U.S. Libor/OIS spread (bps)	324	323	1	Up
10-yr T-note (%)	3.29	3.31	-0.02	Up
Euribor/OIS spread (bps)	93	84	9	Neutral
Currencies	Direction			
Dollar	Down			Up
Euro	Up			Down
Yen	Down			Down
Pound	Up			Down
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	\$93.50	\$92.84	0.71%	
WTI	\$87.24	\$86.79	0.52%	
Natural Gas	\$8.07	\$8.00	0.98%	
Crack Spread	\$31.98	\$31.93	0.14%	
12-mo strip crack	\$29.98	\$29.83	0.50%	
Ethanol rack	\$2.76	\$2.76	-0.03%	
Metals				
Gold	\$1,726.47	\$1,716.83	0.56%	
Silver	\$19.31	\$18.86	2.38%	
Copper contract	\$358.80	\$356.80	0.56%	
Grains				
Corn contract	\$684.25	\$685.00	-0.11%	
Wheat contract	\$872.75	\$869.50	0.37%	
Soybeans contract	\$1,415.25	\$1,412.25	0.21%	
Shipping				
Baltic Dry Freight	1,213	1,178	35	

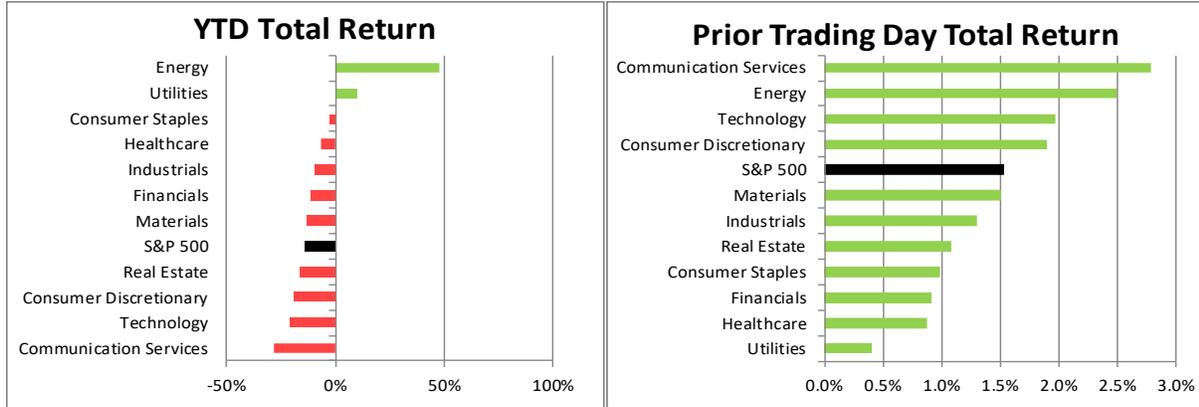
Weather

The 6-10 and 8-14 day forecasts call for warmer-than-normal temperatures for most of the country, with cooler-than-normal temperatures in the Northern Pacific. Wetter-than-normal conditions are expected in the Pacific Northwest, northern Rocky Mountains, and northern Great Plains, with dry conditions expected for the rest of the country.

In the Gulf Coast, the Caribbean, and western Atlantic Ocean areas, there are no tropical cyclones forecasted within the next 48 hours. However, there is chance of cyclone formation off the West African Coast and in the central Atlantic Ocean.

Data Section

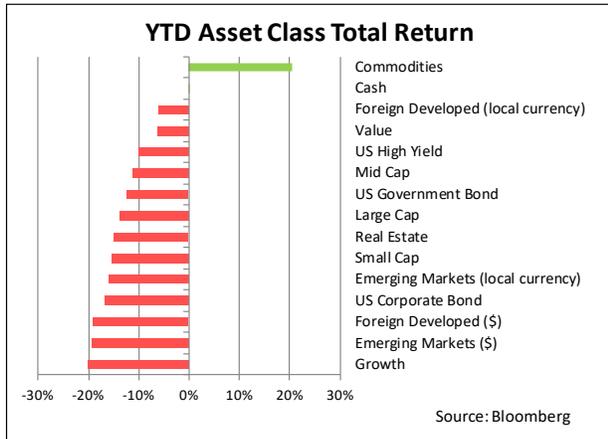
U.S. Equity Markets – (as of 9/9/2022 close)



(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 9/9/2022 close)

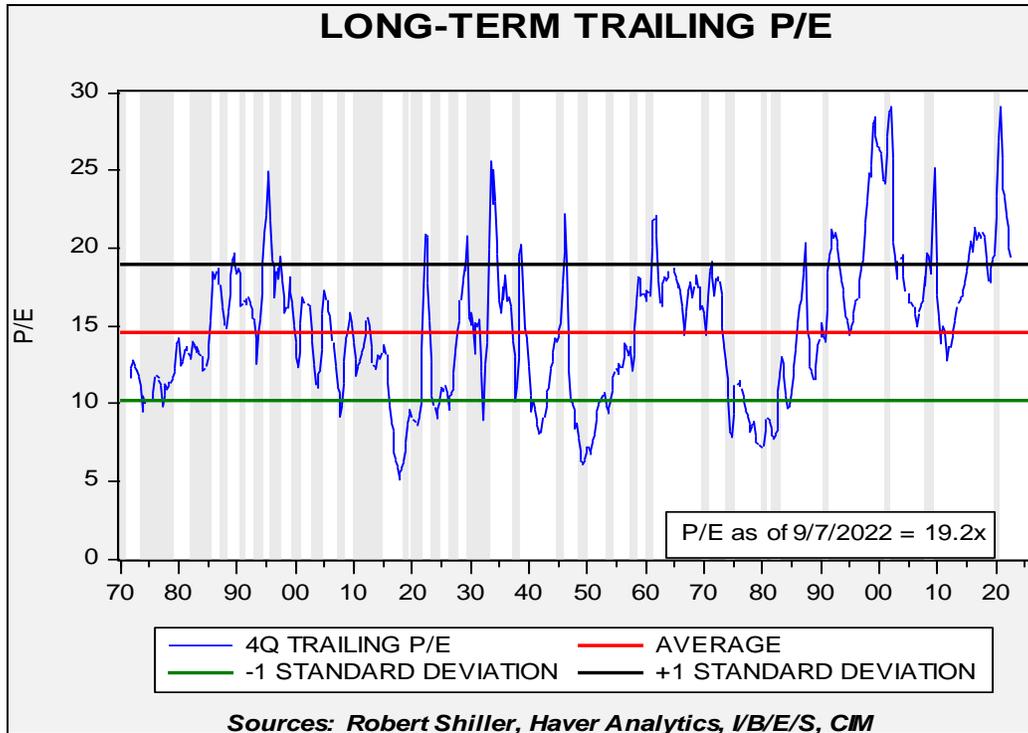


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

September 8, 2022



Based on our methodology,¹ the current P/E is 19.2x, down 0.1 from last week.

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 three actual quarters (Q4, Q1 and Q2) and one estimate (Q3). 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.