

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 22, 2023—9:30 AM EDT] Global equity markets are generally higher this morning. In Europe, the Euro Stoxx 50 is down 0.2% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.3%. Chinese markets were higher, with the Shanghai Composite up 1.6% from its previous close and the Shenzhen Composite 1.9%. 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](#) (9/18/2023) (with associated [podcast](#)): “Goodbye Prigozhin”
- [Weekly Energy Update](#) (9/21/2023): Crude oil prices remain elevated due to the recent OPEC+ supply restrictions. The Iranian prisoner swap has been completed, but Iran’s relations with the IAEA remain strained due to the expelling of about a third of the nuclear weapons inspectors.
- [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](#) (9/11/2023) (with associated [podcast](#)): “Fiscal Tightening Looms”
- [Confluence of Ideas podcast](#) (8/22/2023): “The Economics of Defense in Great Power Competition”

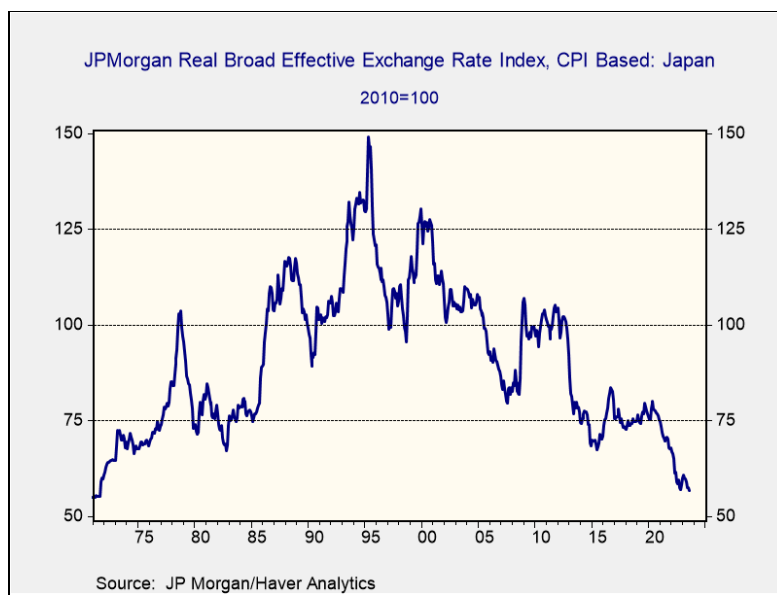
Good morning! Today’s *Comment* is divided into three sections: 1) Why the BOJ may not change policy anytime soon; 2) How the media narrative may either help or hurt strikers; and 3) Why improved relations with Saudi Arabia and Israel may help the U.S. fend off China.

Yen Under Pressure: One year after the Bank of the Japan surprised markets when it intervened to protect its currency, it is currently on standby to do so again following its recent rate decision.

- The Japanese central bank kept interest rates unchanged at their current levels. Following the Bank of Japan’s decision, [central bank governor Kazuo Ueda vowed to maintain negative interest rates](#) as a means to support the economy. Despite Japan’s economy

experiencing relatively high inflation, GDP growth has failed to exceed 2.0% for eight consecutive quarters. Although Governor Ueda acknowledged that inflation has consistently exceeded the central bank's target, he said that policymakers are not yet prepared to change their current monetary stance. He added that the BOJ does not foresee inflation sustainably reaching 2%, due to both downside and upside risks.

- The BOJ's policy decision comes amid concerns that inflation is getting out of control. Last month, Japan's core inflation index, which excludes fresh food and energy, rose 4.3% from the previous year. It also surpassed U.S. core inflation for the first time since 2014. Rising inflation has sapped investor confidence in the JPY, [sending the real exchange rate to an all-time low against its peers](#). To avert a potential currency crisis, the Bank of Japan has signaled its willingness to intervene in currency markets and is [working closely with the U.S. Treasury to prevent major swings in exchange rates](#).



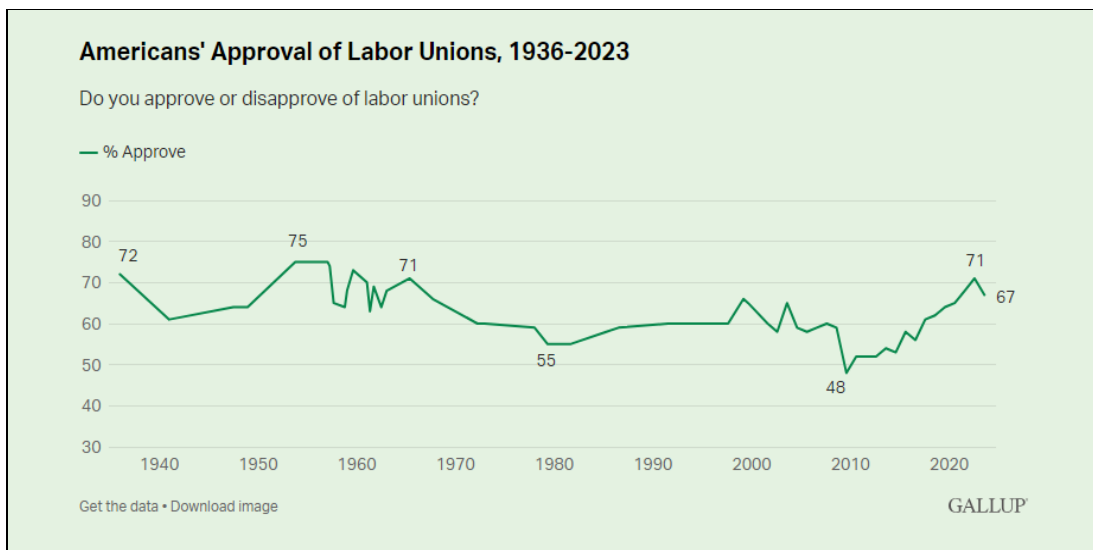
- Although the central bank has maintained its ultra-accommodative monetary policy stance, [economists expect it to hike rates starting around March 2024](#), according to a Reuters poll. This transition is poised to result in a strengthening of the JPY against the U.S. Dollar. Furthermore, this policy shift may exert an influence on yields for long-term U.S. Treasuries. The weaker JPY has benefited Japanese automakers by [allowing them to increase car exports to the United States due to improved terms of trade](#). Japanese automakers' stocks, such as Mazda (MZDAY, \$6.00), Honda (HMC, \$35.30), and Toyota (TM, \$188.39), have outperformed the market, returning 30.0% in USD over the past six months.

Labor Comeback: One union strike appears to be nearing its end, while another is escalating.

- [Hollywood writers are nearing a deal with studios](#) on a new labor contract, after holding marathon talks for 10 hours on Thursday. While a final agreement was not reached, there are rumors that a deal is in sight, and the sides are expected to meet again on Friday. Meanwhile, tensions are rising in the auto worker dispute, after [leaked messages from a](#)

[top aide](#) to UAW president Shawn Fain provided fresh fuel to critics of the union's strike strategy. The leaked messages reveal that union leaders had long planned a protracted and disruptive dispute with automakers, suggesting that they were not negotiating in good faith.

- Labor disputes are often settled in the court of public opinion, rather than behind closed doors. As Robert Schiller points out in his book [Narrative Economics](#), the drop in support in the 1960s and 1970s coincided with the fall of [Teamster leader Jimmy Hoffa](#), who was sent to prison for jury tampering, mail fraud, and bribery. While the current leader, Shawn Fain, might reap the benefits of a resurgence in union support, he could also face heightened scrutiny for quoting controversial civil rights leader Malcolm X. That said, this dispute is far from over as the [UAW is considering expanding the strike to Ford's Chicago assembly plant on Friday](#).



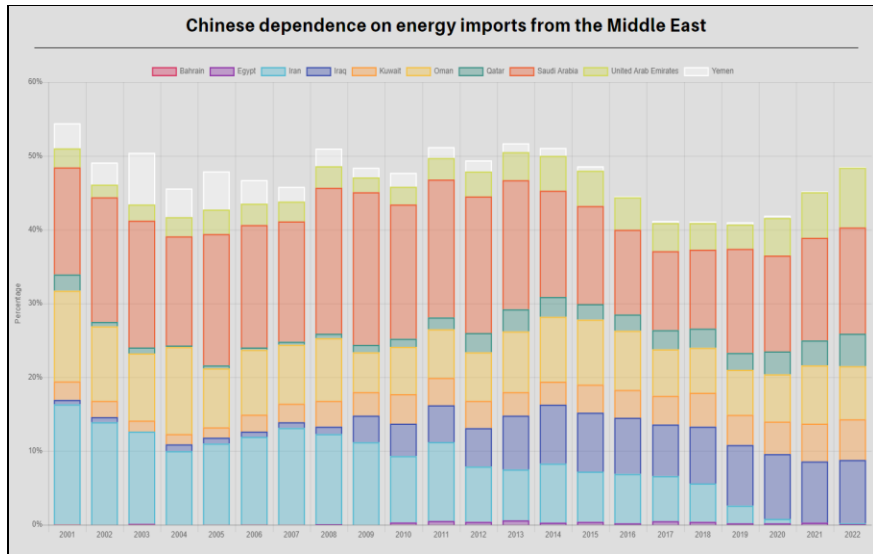
- The rise in labor union popularity is related to a shift in economic preferences away from efficiency and towards equality. This shift will benefit workers through stronger wage increases and better working conditions, but it is likely to come at the expense of higher inflation, as firms may be encouraged to cut back production or increase prices. The transition to a more equitable economy will not be fast or smooth, and it will probably face many hurdles. However, firms with monopoly power may prosper from this shift, as they are likely to be better positioned to make adjustments in the changing landscape.

Saudi Arabia-Israel Normalization: Diplomatic normalization talks between the two major Middle Eastern powers are gaining momentum.

- [Saudi Arabia's Crown Prince Mohammed bin Salman \(MBS\) has expressed optimism](#) that his country and Israel can overcome their differences and build a more cooperative relationship. This potential breakthrough comes on the heels of a visit to Washington by [Israeli President Benjamin Netanyahu, where he mended ties with his American counterpart, Joe Biden](#). The [potential arrangement between Saudi Arabia and Israel includes](#) a possible security guarantee similar to the one between Japan and South Korea,

a show of support by Israel for the development of a Saudi uranium enrichment program, and concessions to the Palestinians. The arrangement will be a major win for Biden but is far from certain.

- Lawmakers are likely to be hesitant to accept the proposed terms of the Saudi-Israeli peace deal for a number of reasons. Democrats have long raised concerns about Saudi Arabia's human rights record, especially [following the 2018 killing of Washington Post journalist Jamal Khashoggi](#). Meanwhile, the Republican Party remains divided on the issue of security guarantees for other countries, with some conservatives advocating for a more Jeffersonian approach to foreign policy, in which the military is less involved in the affairs of other countries. The contentious nature of the proposed Saudi-Israeli peace deal could complicate negotiations and make a final agreement less certain.



(Source: Chinamed.it)

- The potential security guarantee between the U.S. and Saudi Arabia could undermine China's efforts to draw Saudi Arabia into its sphere of influence.
- A diplomatic relationship between Saudi Arabia and Israel would benefit the United States in its competition with China for influence in the Middle East. While China often uses its economic clout to win friends, it is less willing than the United States to make security commitments. Therefore, the deal would likely prevent Saudi Arabia from completely aligning itself with China, as some feared following Riyadh's talks with Beijing regarding a petroyuan and its invitation to the BRICS group. Additionally, it could provide a blueprint for how the United States plans to win over emerging countries without offering access to its consumer base.

U.S. Economic Releases

No major U.S. economic reports have 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	
9:45	S&P Global Manufacturing PMI	m/m	Sep P	48.2	47.9	***	
9:45	S&P Services PMI	m/m	Sep P	50.7	50.5	**	
9:45	S&P Composite PMI	m/m	Sep P	50.4	50.2	**	
Federal Reserve							
EST	Speaker or Event	District or Position					
13:00	Neel Kashkari Speaks at Fireside Chat	President of the Federal Reserve Bank of Minneapolis					
13:00	Mary Daly to Discuss Monetary Policy, Economy	President of the Federal Reserve Bank of San Francisco					

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	National CPI	y/y	Aug	3.2%	3.3%	3.0%	***	Equity and bond neutral
	National CPI Ex-Fresh Food	y/y	Aug	3.1%	3.1%	3.0%	**	Equity and bond neutral
	National CPI Ex-Fresh Food & Energy	y/y	Aug	4.3%	4.3%	4.3%	*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	15-Sep	-¥1583.9b	-¥854.7b	-¥851.5b	*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	15-Sep	¥62.6b	¥96.6b	¥96.8b	*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	15-Sep	¥885.5b	¥3631.9b	¥3631.5b	*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	15-Sep	¥439.4b	¥79.3b	¥83.7b	*	Equity and bond neutral
	Jibun Bank Composite PMI	m/m	Sep P	51.8	52.6		*	Equity bearish, bond bullish
	Jibun Bank Manufacturing PMI	m/m	Sep P	48.6	49.6		***	Equity bearish, bond bullish
Jibun Bank Services PMI	m/m	Sep P	53.3	54.3		**	Equity bearish, bond bullish	
New Zealand	Wespac Consumer Confidence	m/m	3Q	80.2	83.1	--	*	Equity bearish, bond bullish
	Exports NZD	m/m	Aug	4.99b	5.45b	5.38b	**	Equity and bond neutral
	Imports NZD	m/m	Aug	7.28b	6.56b	6.55b	**	Equity and bond neutral
	Trade Balance NZD	m/m	Aug	-2291m	-1107m	-1177m	**	Equity and bond neutral
EUROPE								
Eurozone	HCOB Eurozone Manufacturing PMI	m/m	Sep P	43.4	43.5	44.0	***	Equity bearish, bond bullish
	HCOB Eurozone Services PMI	m/m	Sep P	48.4	47.9	47.6	**	Equity bullish, bond bearish
	HCOB Eurozone Composite PMI	m/m	Sep P	47.1	46.7	46.5	**	Equity bullish, bond bearish
Germany	HCOB Germany Manufacturing PMI	m/m	Sep P	39.8	39.1	39.5	***	Equity and bond neutral
	HCOB Germany Services PMI	m/m	Sep P	49.8	47.3	47.1	**	Equity bullish, bond bearish
	HCOB Germany Composite PMI	m/m	Sep P	46.2	44.6	44.7	**	Equity bullish, bond bearish
France	HCOB France Manufacturing PMI	m/m	Sep P	43.6	46.0	46.1	***	Equity bearish, bond bullish
	HCOB France Services PMI	m/m	Sep P	43.9	46.0	46.0	**	Equity bearish, bond bullish
	HCOB France Composite PMI	m/m	Sep P	43.5	46.0	46.0	**	Equity bearish, bond bullish
UK	GfK Consumer Confidence	m/m	Sep	-21	-25	-26	**	Equity bearish, bond bullish
	Retail Sales	y/y	Aug	-1.4%	-3.2%	-3.1%	***	Equity bullish, bond bearish
	Retail Sales Ex-Auto Fuel	y/y	Aug	-1.4%	-3.4%	-3.3%	**	Equity bullish, bond bearish
	S&P/CIPS Manufacturing PMI	m/m	Sep P	44.2	43.0	43.2	***	Equity bullish, bond bearish
	S&P/CIPS Services PMI	m/m	Sep P	47.2	49.5	49.4	**	Equity bearish, bond bullish
Russia	S&P/CIPS Composite PMI	m/m	Sep P	46.8	48.6	48.7	**	Equity bearish, bond bullish
	Gold and Forex Reserves	m/m	15-Sep	\$576.70	\$576.6b		***	Equity and bond neutral
	Money Supply, Narrow Definition	w/w	15-Sep	18.74t	18.67t		*	Equity and bond neutral
AMERICAS								
Canada	Retail Sales	m/m	Jul	--	0.1%	0.4%	**	Equity and bond neutral
	Retail Sales Ex-Autos	m/m	Jul	--	-0.8%	0.3%	**	Equity and bond neutral
Mexico	Economic Activity IGAE	y/y	Jul	3.2%	4.11%	-1.47%	**	Equity bullish, bond bearish

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)	531	532	-1	Up
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	539	540	-1	Up
U.S. Libor/OIS spread (bps)	541	541	0	Up
10-yr T-note (%)	4.48	4.50	-0.02	Flat
Euribor/OIS spread (bps)	396	393	3	Up
Currencies	Direction			
Dollar	Up			Up
Euro	Down			Down
Yen	Down			Down
Pound	Down			Down
Franc	Down			Down
Central Bank Action	Current	Prior	Expected	
BOJ Policy Balance Rate	-0.100%	-0.100%	-0.100%	On Forecast
BOJ 10-yr Yield Target	0.000%	0.000%	0.000%	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.

DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$94.08	\$93.30	0.84%	
WTI	\$90.56	\$89.63	1.04%	
Natural Gas	\$2.63	\$2.61	0.84%	
Crack Spread	\$28.39	\$28.23	0.58%	
12-mo strip crack	\$27.85	\$27.74	0.38%	
Ethanol rack	\$2.49	\$2.49	0.05%	
Metals				
Gold	\$1,924.57	\$1,920.02	0.24%	
Silver	\$23.67	\$23.40	1.16%	
Copper contract	\$372.65	\$369.60	0.83%	
Grains				
Corn contract	\$476.25	\$475.25	0.21%	
Wheat contract	\$579.50	\$575.75	0.65%	
Soybeans contract	\$1,301.25	\$1,293.75	0.58%	
Shipping				
Baltic Dry Freight	1,569	1,584	-15	
DOE Inventory Report				
	Actual	Expected	Difference	
Crude (mb)	-2.1	-1.7	-0.4	
Gasoline (mb)	-0.8	1.1	-1.9	
Distillates (mb)	-2.9	1.1	-3.9	
Refinery run rates (%)	-1.8%	-1.0%	-0.8%	
Natural gas (bcf)	64	66	-2	

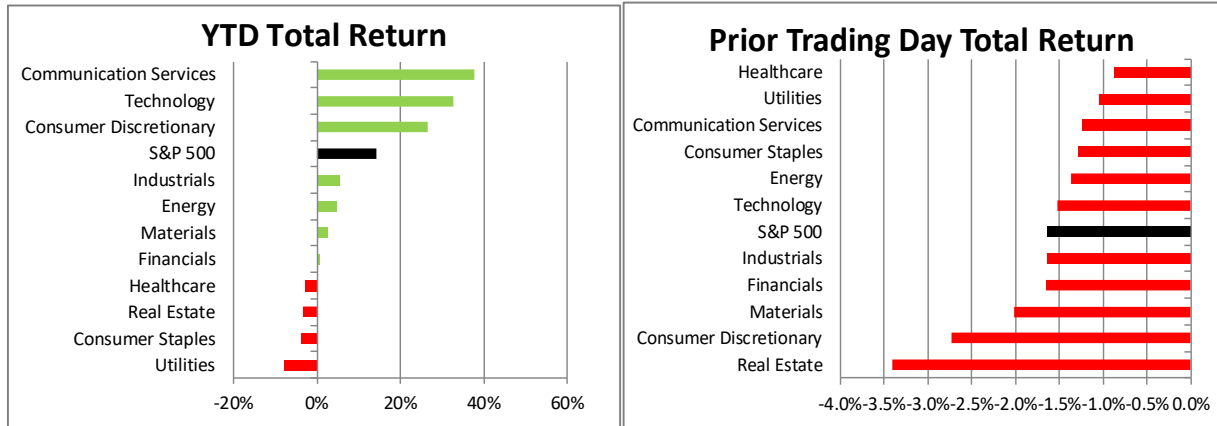
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures throughout the Great Plains and Mississippi Valley regions, with below-normal temperatures throughout the Far West. The forecasts call for wetter-than-normal conditions in the Pacific Northwest, the northern Rocky Mountains, and the northern Great Plains with dry conditions in the Southwest, the Mississippi Valley region, and the Northeast.

There are currently three atmospheric disturbances in the Atlantic Ocean. Hurricane Nigel, now downgraded to a tropical storm, is in the north central Atlantic and traveling northeasterly. There is also a disturbance off the Carolinas that is assessed to have a 70% chance of developing into a cyclone. A third disturbance off the western coast of Africa is assessed to have a 60% chance of developing into a cyclone. On average, Atlantic hurricane activity peaks on September 15.

Data Section

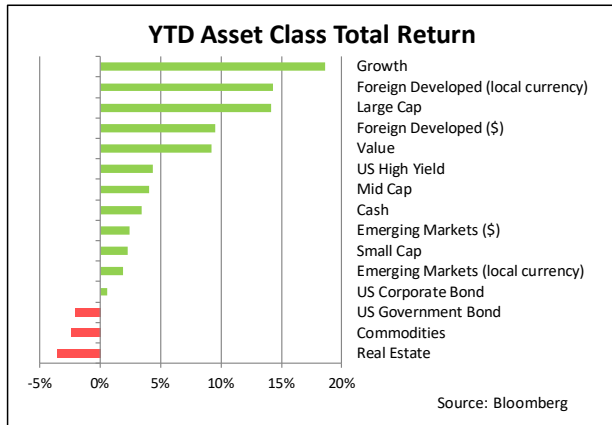
U.S. Equity Markets – (as of 9/21/2023 close)



(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 9/21/2023 close)

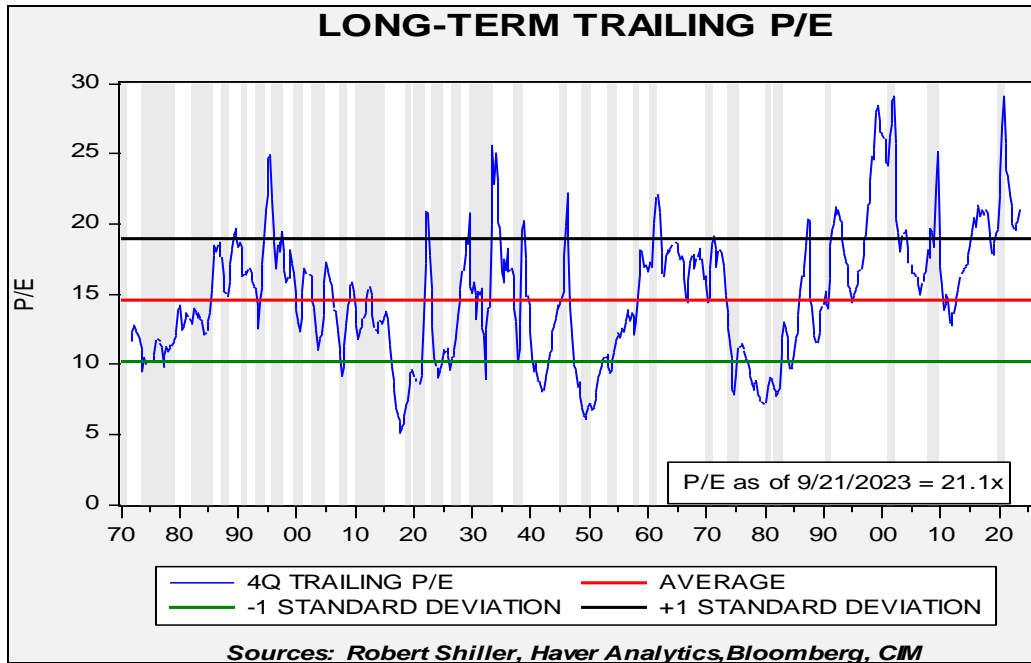


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 21, 2023



Based on our methodology,¹ the current P/E is 21.1x, 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.