

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 23, 2021—9:30 AM EDT] Global equity markets are higher this morning. In Europe, the EuroStoxx 50 is currently up 1.2% from its prior close. In Asia, the MSCI Asia Apex 50 closed up 0.8%. Chinese markets were higher, with the Shanghai Composite up 0.4% from its prior close and the Shenzhen Composite up 0.5%. U.S. equity index futures are signaling a higher open.

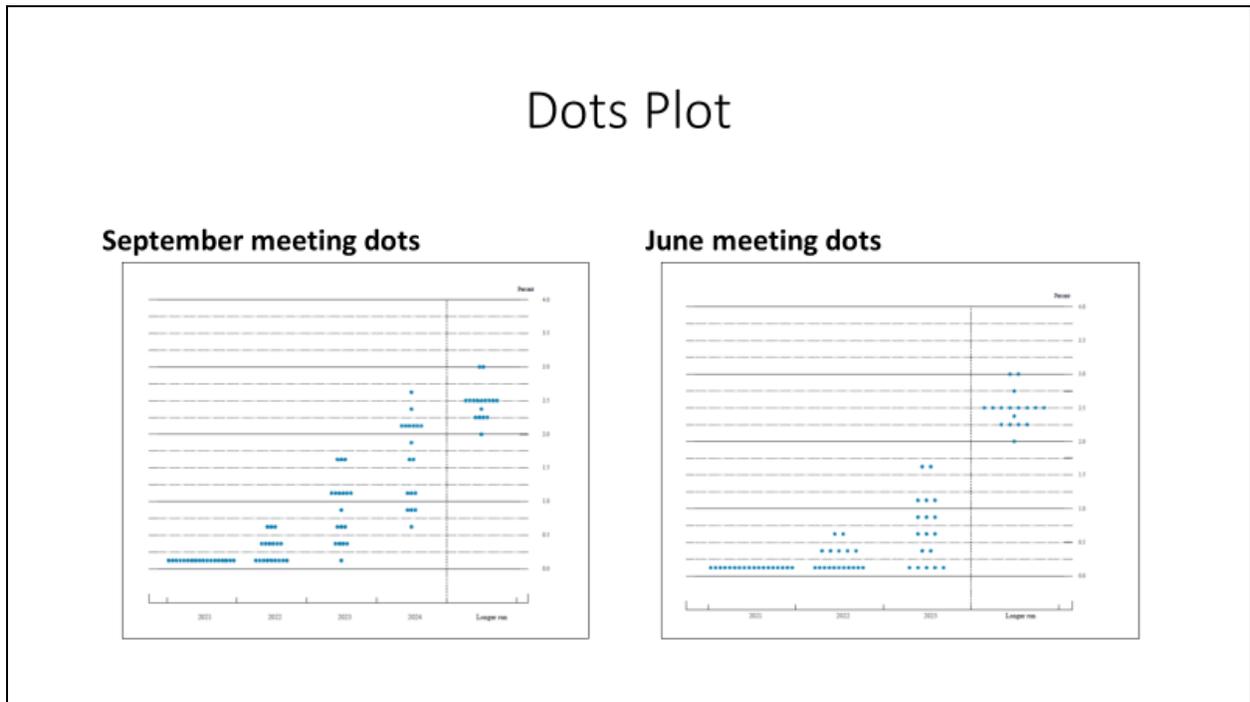
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our [website](#). We highlight recent publications below, with new items of the day emphasized in bold:

- [Weekly Geopolitical Report](#) (9/20/2021): “Afghanistan, Part II: Pakistan, India, and Iran”
- [Weekly Energy Update](#) (9/23/2021): **U.S. crude oil stockpiles continue to decline, and there is a natural gas crisis in Europe.**
- [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](#) (9/17/2021) (with associated [podcast](#)): we discuss the size of the workforce and how quickly workers are reentering the jobs market, and how this data impacts the Fed’s timetable for withdrawing stimulus and raising rates
- [Confluence of Ideas podcast](#) (7/7/2021): “The Geopolitics of Taiwan and the Issue of Globalization”

Good morning! [U.S. equity futures are higher this morning](#) as the market digests the continuing Evergrande (EGRNF, USD, 0.40) issue and the Fed meeting. Our coverage begins with the FOMC meeting. Evergrande is up next, followed by China news. We then discuss technology and cryptocurrency news along with economics and policy. We conclude with the international roundup and a pandemic update.

The FOMC meeting: As expected, the Fed didn’t change policy rates. But the [bank is clearly signaling that the balance sheet will be reduced soon](#). In examining [the statement](#), the FOMC has acknowledged that the economy is improving but noted that the pandemic continues to act as a drag on growth. The committee also admitted that inflation is elevated but continues to hold the opinion that it is transitory. The biggest change indicates that “If progress continues broadly as expected...a moderation in the pace of asset purchases may soon be warranted.” There were no dissents.

In the median economic projections, real GDP for 2021 was lowered to 5.9% from 7.0%, with next year lowered to 3.3% from 3.8%. The unemployment rate projection for this year was raised to 4.8% from 4.5%, with no change in the out years (the FOMC expected 3.5% by 2023). Core PCE was raised to 3.7% from 3.0% for 2021, 2.3% for next year compared to 2.1% and 2.2% from 2.1% in 2023. The primary message from the projections is that growth is expected to weaken and inflation to rise, but the latter is expected to decline steadily, consistent with the transitory messaging.



The dots plot has become more hawkish. In June, seven members wanted to raise rates next year, now nine do. So, the 18-member committee is now split on rate hikes in 2022. For 2023, five members expected a steady fed funds rate through that year. Now, only one lonely member expects the policy rate to remain steady.¹

The financial market's initial reaction seemed to lean dovish; equities rose, Treasury yields declined, and the dollar fell. This appeared to be quite odd given that the report seemed to be rather hawkish, but perhaps the market thought it would be worse. So far, Chair Powell is managing expectations rather well, but inflation will likely be a greater challenge in the coming months, so will the growth sentiment toward rate hikes in 2022.

On a related note, [calls for Dallas FRB President Kaplan and Boston FRB President Rosengren to resign](#) are rising due to their trading activity. This situation bears watching. There has been a call for requiring Senate approval for FRB presidents, and this event might just lead to that outcome.

¹ Our guess? Neil Kashkari, the Minneapolis FRB president, is likely the "lonesome dove."

Evergrande: It's now a foregone conclusion that [Evergrande is going to default](#) and will need to restructure. In any restructuring, creditors are ranked by their claims and then fight over what remains. In a normal restructuring, bondholders are usually the highest ranked, with equity holders last. [That isn't likely how this one will go.](#) One way that Evergrande financed itself was through pre-sales. Future homeowners would put up a portion of the value of the property and wait, sometimes for years, to take possession. Since much of what Evergrande sold was considered a form of saving, waiting wasn't seen as an issue. [For social reasons](#), these creditors will be first in line, even though in the West, they would be considered unsecured and farther down the line of claimants. We are not sure who would come next; it might be local governments. We feel rather confident that foreign bondholders will be last in line.

Although the immediate issues surrounding the collapse of Evergrande are front and center, there are longer-term ramifications that are also important. One of the more insightful observers of China is [Michael Pettis](#). His recent missive points out that addressing China's debt problem most likely means that [economic growth is going to be weaker](#) going forward...[perhaps much weaker](#). The growth of China's debt has been a problem for a while. China's trend growth is probably 2% to 3%, so any growth above that required investment funded by debt. If that avenue for excess growth is lost, the world will have to cope with [much weaker Chinese growth](#). Since the CPC has made its name by facilitating growth, some other reason for its existence has to emerge. We suspect the growing "cult of Xi" is the substitute. We will see how it works.

The [ripple effects of the Chinese debt crisis](#) will be closely watched and could trigger some unexpected downside surprises. [Some of this is because of tighter regulations](#). Another problem will be that debt crises have a [habit of unveiling previously hidden problems](#) or triggering new [ones](#). To address the debt problem, for example, overindebted firms will start liquidating assets to raise liquidity. As they dump assets, their prices fall, triggering fears of further declines and causing prices to fall in other parts of the economy. For example, [iron ore prices have plunged](#) on fears of falling Chinese property development. We note the [PBOC has been aggressively injecting liquidity](#). Another problem that often develops is that [the groups protected in the bailout become a source of moral hazard](#) emboldened to take on more risks due to the perception of safety.

Although we can't rule out a Lehman-style debt crisis, the odds of that outcome are probably not elevated. The bigger issue is that the world will have to adapt to a China with much slower growth, and the impact on the global economy will be significant.

China news: China pledges to stop building coal plants overseas, and Taiwan wants into the CPTPP.

- At the U.N., [General Secretary Xi promised to stop building coal-fired electricity plants](#) overseas. [Although the pledge was welcomed by environmentalists](#), it isn't obvious whether China will stop building such plants domestically.
- [In what will certainly cause a dust-up](#), Taiwan applied to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the successor to the TPP. Taipei made this [request soon after Beijing applied to join](#). If Taiwan were to be

approved while Beijing refused, it would cause a diplomatic firestorm. Imagine if California tried to join the TPP after the U.S. pulled out.

- Honor (300870, CNY, 72.00), the smartphone spinoff of Huawei (002502, CNY, 7.48) has not yet been blacklisted by the U.S. [Washington is debating how it wants to proceed](#). In related news, the [DoJ is in talks over a plea deal with Meng Wanzhou](#).
- China is planning to [expand its tax crackdown on high-profile entertainers](#).
- Ant Financial says it will [fully share its customer data](#) with the Chinese government.
- Lithuania has been in a diplomatic fight with Beijing over the Baltic nation's relations with Taiwan. The Lithuanian government is telling its citizens to "[throw away Chinese cell phones](#)."
- In our WEU (see link above), we have been tracking the natural gas crisis in Europe. Exacerbating the problem is [aggressive Chinese LNG buying](#), which is tightening supplies further and lifting prices.

Technology: Facebook (FB, USD, 343.21) has been facing a spate of reports that put the company in a bad light. The [WSJ had a series of investigative reports](#) on the company's actions, for example. Apparently, it is [fighting back by planting reports in Facebook's news feed](#) that put the [company in a favorable light](#).

Cryptocurrencies: Increasingly, regulators are moving to regulate the crypto market. [Of particular concern are stablecoins](#), which may be prone to bank runs. There are increasing signs [that regulators are going to move against stablecoins](#), which, if true, will weaken the ability of that market to function. When holders of bitcoin or other cryptocurrencies want to "cash out," they often purchase stablecoins, avoiding the traditional financial system. The SEC's Gensler is taking a particularly dim view of crypto, suggesting it is similar [to the private wildcat banking of the 1800s](#). Another area of concern is the use of crypto for ransomware payments; the U.S. is [building regulations against such payments](#).

Economics and policy: Talks on the budget and debt ceiling continue, and the administration nominates a professor for the position of Comptroller of the Currency.

- Budget negotiations and debt ceiling measures continue. Yesterday, [President Biden met with Congressional moderates](#) to try to work out a deal that will be acceptable to progressives. Both sides are threatening to not vote for the other's goals. Meanwhile, [the House passed a spending bill that will avoid hitting the debt ceiling](#). It is unlikely that the bill would pass the Senate with 60 votes, although the GOP might not filibuster it. After all, merely forcing the Democrats to vote on the debt ceiling gives them the political fodder they want without [running the risk of a debt default](#).
- **This one bears watching closely!** [The administration has nominated Saule Omarova, a Cornell law professor, to the position of the Comptroller of the Currency](#). She supports a plan to create something similar to Japan's Postal Saving system, where the Fed would provide households with deposit accounts, essentially moving retail deposits from commercial banks. Such plans have been knocked around in Washington for years. Creating this system would end the problem of the "unbanked," the situation where low-income households can't get workable banking services from the private sector. This

action might be the end of community banking. Although large banks don't really need deposits to fund themselves, small banks do. We doubt she will pass through the nomination process, but the fact she was nominated at all is important. If we see CBDC emerge, something similar to this would be possible.

- Inflation ripples continue to pass through the economy. General Mills (GIS, USD, 59.92) is [expected to raise prices across a whole host of goods](#).
- [Ireland appears to be softening its stance on a minimum OECD corporate tax](#). If Ireland complies, it increases the odds of a hike in the U.S. corporate tax.
- It is becoming increasingly [evident that the U.S. needs increased home building](#).

International roundup: Washington and Paris are trying to make up.

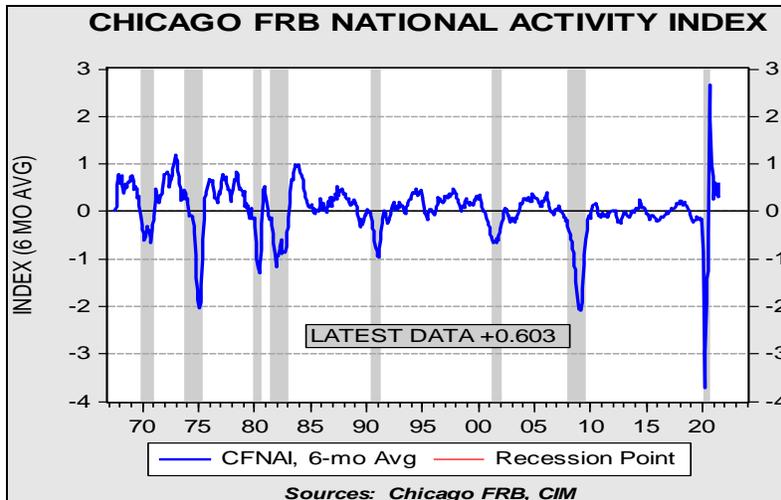
- The U.S. and France are [trying to patch up the recent row](#) over nuclear submarines.
- The U.K. [is interested in some sort of trade deal](#) with the U.S. Washington will tend to push Westminster to make a [deal on Northern Ireland](#).
- There was an [assassination attempt on a key aid to Ukrainian President Zelensky](#).
- The Norwegian central bank, Norges Bank, [became the first major central bank to raise rates](#).
- [Islamic State is becoming a key threat to Taliban rule](#) in Afghanistan.

COVID-19: The [number of reported cases](#) is 230,189,529, with 4,721,127 fatalities. In the U.S., there are 4,182,893 confirmed cases with 681,222 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 468,248,675 doses of the vaccine have been distributed with 387,493,716 doses injected. The number receiving at least one dose is 212,545,360, while the number receiving second doses, which would grant the highest level of immunity, is 182,387,840. For the population older than 18, 66.1% have been vaccinated. The *FT* has a page on [global vaccine distribution](#). The [Axios map](#) shows that the South is seeing a decline in cases. As temperatures cool in the North, cases are rising.

- The [FDA has approved Pfizer \(PFE, USD, 43.95\) booster shots](#) of its vaccine to older and at-risk patients.
- Rising COVID-19 cases is leading to [partial lockdowns in the northern Chinese city of Harbin](#).
- [2020 saw a surge in the U.S. murder rate](#), likely a result of the stresses caused by the pandemic.

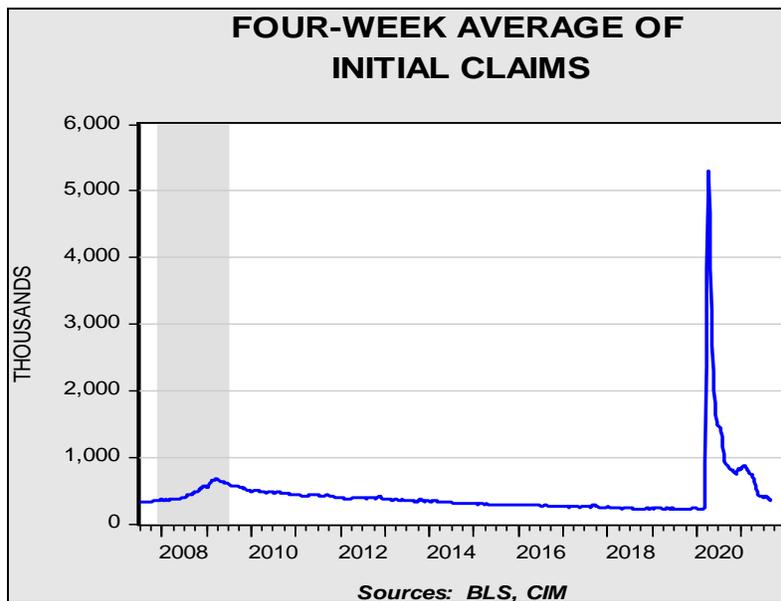
U.S. Economic Releases

The U.S. economic activity improved at a slower than expected pace in August, according to the Federal Reserve Bank of Chicago. The Chicago National Activity Index came in at +0.29 compared to expectations of +0.50. The prior report was revised from +0.53 to +0.75.

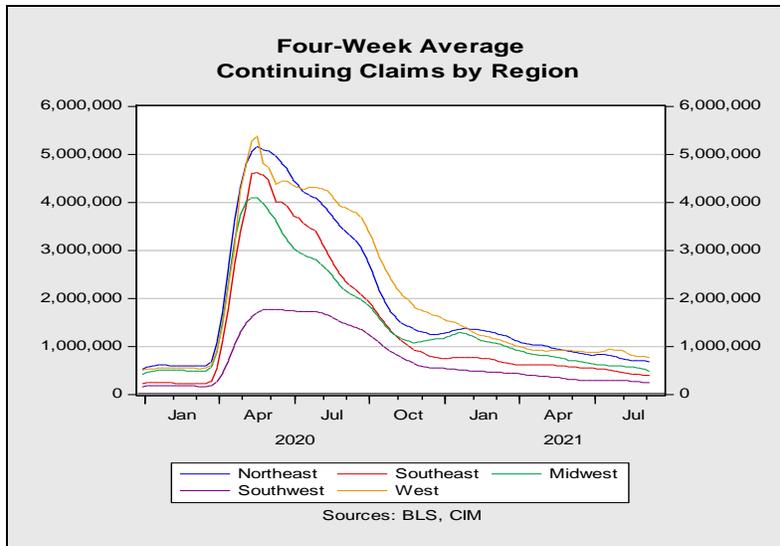


The chart above shows the six-month moving average of the Chicago National Activity Index.

Jobless claims rose unexpectedly in the week ending September 18. Initial claims came in at 351K compared to expectations of 320K. The prior report was revised from 332K to 320K. Continuing claims from the prior week came in at 2,845K compared to expectations of 2,600K.



The chart above shows the four-week moving average of initial claims. The moving average fell from 340.00K to 335.75K.



The chart above shows the four-week moving average of continuing claims by region.

The table below lists the economic releases scheduled for the rest of the day.

Economic Releases						
EDT	Indicator			Expected	Prior	Rating
9:45	Langer Consumer Comfort	w/w	19-Sep		57.7	***
9:45	Markit US Manufacturing PMI	m/m	Sep	61.0	61.1	***
9:45	Markit US Services PMI	m/m	Sep	54.9	55.1	**
9:45	Markit US Composite PMI	m/m	Sep		55.4	**
10:00	Leading Index	m/m	Aug	0.7%	0.9%	**
11:00	Kansas City Fed Manf. Activity	m/m	Sep	25	29	**
12:00	Household Change in Net Worth	q/q	2Q		\$4997b	**
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.

Country	Indicator			Current	Prior	Expected	Rating	Market Impact
ASIA-PACIFIC								
China	Swift Global Payments CNY	m/m	Aug	2.2%	2.2%		*	Equity and bond neutral
Australia	Markit Australia PMI Services	m/m	Sep	44.9	42.9		**	Equity bullish, bond bearish
	Markit Australia PMI Composite	m/m	Sep	46.0	43.3		**	Equity bullish, bond bearish
	Markit Australia PMI Mfg	m/m	Sep	57.3	52.0		**	Equity bullish, bond bearish
EUROPE								
Eurozone	Markit Eurozone Manufacturing PMI	m/m	Sep	58.7	61.4	60.3	**	Equity bearish, bond bullish
	Markit Eurozone Services PMI	m/m	Sep	56.3	59.0	58.5	**	Equity bearish, bond bullish
	Markit Eurozone Composite PMI	m/m	Sep	56.1	59.0	58.5	**	Equity bearish, bond bullish
France	Manufacturing Confidence	m/m	Sep	106	110	109	**	Equity and bond neutral
	Markit France Manufacturing PMI	m/m	Sep	55.2	57.5	57.0	**	Equity and bond neutral
	Markit France Services PMI	m/m	Sep	56.0	56.3	56.1	**	Equity and bond neutral
	Markit France Composite PMI	m/m	Sep	55.1	55.9	55.7	**	Equity bearish, bond bullish
Germany	Markit Germany Manufacturing PMI	m/m	Sep	55.2	62.6	61.4	**	Equity bearish, bond bullish
	Markit Germany Services PMI	m/m	Sep	56.0	60.8	60.3	**	Equity bearish, bond bullish
	Markit/BME Germany Composite PMI	m/m	Sep	55.3	60.0	59.2	**	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.

	Today	Prior	Change	Trend
3-mo Libor yield (bps)	13	13	0	Down
3-mo T-bill yield (bps)	2	3	-1	Neutral
TED spread (bps)	11	10	1	Neutral
U.S. Libor/OIS spread (bps)	8	8	0	Down
10-yr T-note (%)	1.34	1.30	0.04	Down
Euribor/OIS spread (bps)	-54	-55	1	Neutral
EUR/USD 3-mo swap (bps)	4	3	1	Down
Currencies	Direction			
dollar	Down			Neutral
euro	Up			Up
yen	Down			Neutral
pound	Up			Neutral
franc	Down			Neutral
Central Bank Action	Current	Prior	Expected	
FOMC Rate Decision (Lower Bound)	0.000%	0.000%	0.000%	On forecast
FOMC Rate Decision (Upper Bound)	0.250%	0.250%	0.250%	On forecast
Interest on Reserve Balances Rate	0.150%	0.150%	0.150%	On forecast
SNB Policy Rate	-0.750%	-0.750%	-0.750%	On forecast
SNB Sight Deposit Interest Rate	-0.750%	-0.750%	-0.750%	On forecast
Brazil Selic Rate	6.250%	5.250%	6.250%	On forecast
Bank of England Bank Rate	0.100%	0.100%	0.100%	On forecast
BOE Corporate Bond Target	20b	20b	20b	On forecast
BOE Gilt Purchase Target	875b	875b	875b	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	\$76.10	\$76.19	-0.12%	
WTI	\$72.09	\$72.23	-0.19%	
Natural Gas	\$4.79	\$4.81	-0.25%	
Crack Spread	\$17.10	\$16.99	0.67%	
12-mo strip crack	\$18.85	\$18.73	0.59%	
Ethanol rack	\$2.57	\$2.57	-0.16%	
Metals				
Gold	\$1,770.77	\$1,768.16	0.15%	
Silver	\$22.79	\$22.70	0.40%	
Copper contract	\$425.60	\$425.20	0.09%	
Grains				
Corn contract	\$524.00	\$525.50	-0.29%	
Wheat contract	\$710.50	\$705.75	0.67%	
Soybeans contract	\$1,287.75	\$1,282.75	0.39%	
Shipping				
Baltic Dry Freight	4,560	4,410	150	
DOE inventory report				
	Actual	Expected	Difference	
Crude (mb)	-3.5	-3.3	-0.2	
Gasoline (mb)	3.5	-1.2	4.7	
Distillates (mb)	-2.6	-1.2	-1.4	
Refinery run rates (%)	5.40%	2.25%	3.15%	

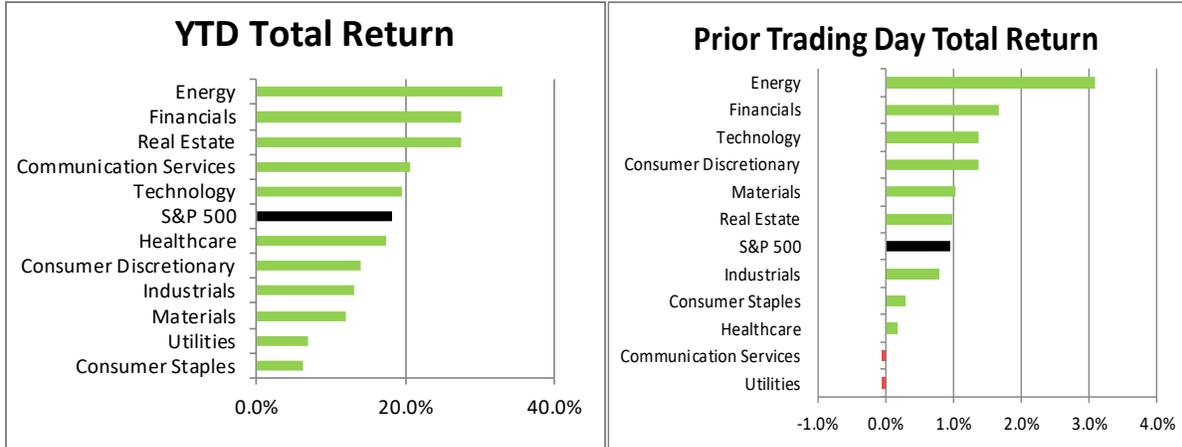
Weather

The 6-10 day and 8-14 day forecasts currently call for warmer temperatures for most of the country, with cooler-than-normal temperatures in the Eastern region. The forecast calls for dry conditions everywhere but the Southwest Region.

There are currently four cyclonic disturbances in the Atlantic region. Tropical Storm Peter and Tropical Storm Rose have both been downgraded to Tropical Depressions. The third disturbance is moving further toward the Atlantic and is not expected to make landfall anywhere, while a fourth disturbance is moving toward the Cape Verde Islands and is expected to develop into a tropical storm within the next 48 hours. We are past the normal peak of hurricane activity, which occurs on September 10.

Data Section

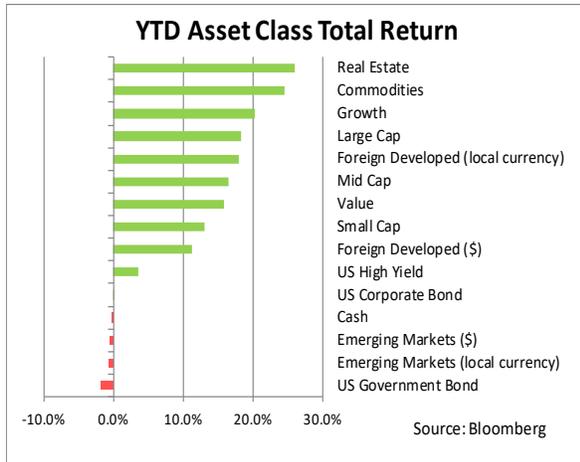
U.S. Equity Markets – (as of 9/22/2021 close)



(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 9/22/2021 close)

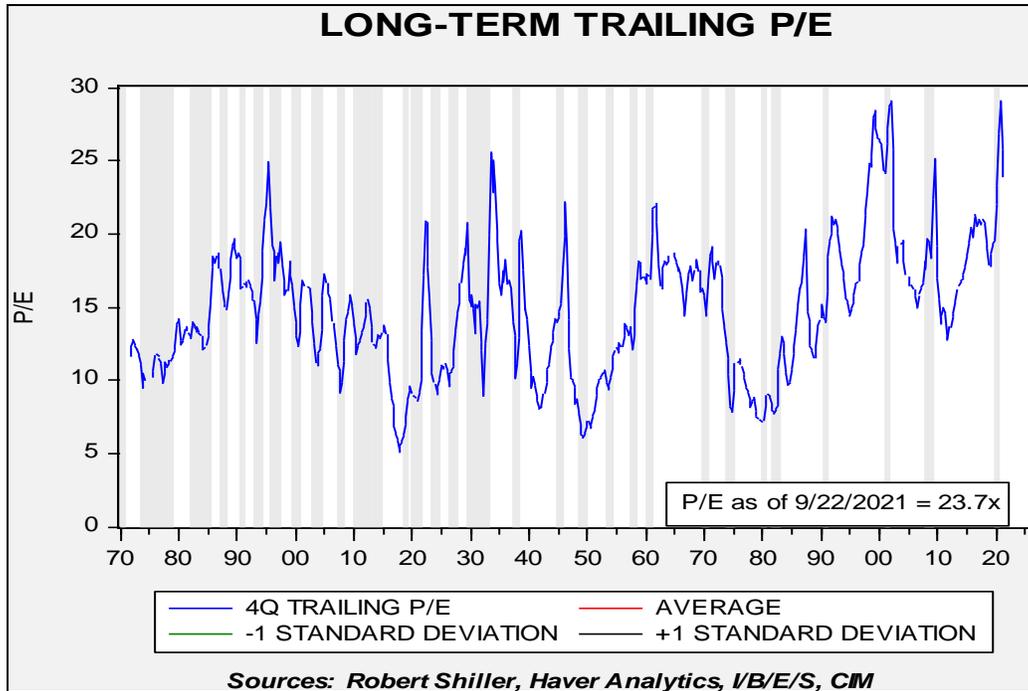


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

September 23, 2021



Based on our methodology,² the current P/E is 23.7x, unchanged 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.

² 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.