Daily Comment

By Bill O'Grady, Thomas Wash, and Patrick Fearon-Hernandez, CFA

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 24, 2021—9:30 AM EDT] Global equity markets are lower this morning. In Europe, the EuroStoxx 50 is currently down 0.9% from its prior close. In Asia, the MSCI Asia Apex 50 closed down 0.3%. Chinese markets were lower, with the Shanghai Composite down 0.8% from its prior close and the Shenzhen Composite down 0.7%. 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:

- *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* **(9/24/2021) (with associated podcast): we discuss the supply side worry of inflation and whether it's likely to persist when the pandemic diminishes**
- *Confluence of Ideas* podcast (7/7/2021): "The Geopolitics of Taiwan and the Issue of Globalization"

Good morning, all! U.S. equity futures are signaling a lower open this morning. Today's report begins with an Evergrande (EGRNF, USD, 0.3550) update and international news roundup. Next, we cover U.S. economics and policy developments. China news follows, and we end with our pandemic coverage.

Evergrande update: U.S. markets closed higher yesterday as investors shrugged off concerns of an imminent Evergrande collapse. On Thursday, Evergrande failed to make an interest payment of $83.5 million on a $2 billion offshore bond and didn't provide clarity as to when it was going to make a payment or whether it planned to do so. It has been speculated that the market's reaction may have been related to a debt covenant that gave the company an additional 30-day grace period. Hence, the company likely has more time to make the payment than investors may have originally realized. Although this could be good news for markets now, Evergrande may not be out of the woods yet. It still has a $47.5 million interest payment due next week and it is unclear whether it will be able to make that payment. That being said, we suspect the possibility of an international market contagion may be less severe than reports suggest. At $20 billion, its international debt burden is relatively small and thus may not be enough to collapse international

markets. However, its $300 billion in total liabilities due largely to creditors and businesses in mainland China could be dangerous for the country. As a result, we suspect that if Evergrande and other similar firms collapse, it could be the beginning of the end of investment-led growth in China.

International news:

- North Korea rejected South Korea's request to formally end the Korean War. The two sides never agreed to a peace treaty after signing a ceasefire in 1953. Pyongyang insisted that the U.S. must end its hostility toward the country before it can agree to formally ending the war.
- The upcoming German elections have wealthy individuals on edge as it is widely believed that the next administration will be left-leaning. A new left-leaning parliament could result in the reintroduction of a wealth and inheritance tax. As a result, wealthy individuals have decided to move their assets into Switzerland.

Economics and policy:

- House Speaker Nancy Pelosi announced that Congress will not allow government funding to expire next week. The statement came hours after the Biden administration announced that it was preparing contingency plans in case of a partial government shutdown. Her remarks have been viewed as a signal that Democrats could decouple the government spending bill from the debt ceiling. A vote on the debt ceiling is expected to take place on Monday and Republicans are expected to vote against it. At this time, we are confident that the debt ceiling will be raised before the deadline because Democrats, who hold the majority in both houses, would have the most to lose in the event that it does not get lifted. However, we expect the debt ceiling to be lifted at the very last minute as the two sides continue to haggle.
  - Additionally, Nancy Pelosi and Senate Majority Leader Chuck Schumer announced an agreement for "a framework" of options to pay for the social spending ambitions in the $3.5 trillion government spending bill. The revelation has led to confusion among Democrats who claimed to have not been briefed on the framework. Although last minute changes to controversial bills are not unusual, the lack of transparency may make it harder for Democrats to rally around the bill.
- Treasury yields rose sharply due to a sell-off in bonds on Thursday. The increase in yields appears to be in response to tightening credit conditions. This week, the Federal Reserve and the Bank of England signaled that they could tighten monetary policy.
  - Fed reverse repo usage rose considerably over the last week after the Fed increased the limit for counter parties. The change allowed financial institutions another place to park their excess cash.
- U.S. household net worth rose to an all-time high in the second quarter bolstered by high equity prices and increases in home values.
- The White House is mulling over whether to invoke a cold-war era national security law that forces companies to provide information on the inventory and sale of

semiconductors. This is the latest attempt by the Biden administration to address the semiconductor shortage.

- Higher oil prices have made it easier for [private and small companies to enter the market](). It is expected that these companies will account for more than half of total output growth next year.

China:

- The People's Bank of China announced that [all forms of cryptocurrency transactions are illegal and must be banned](). Although sudden, the move was likely inevitable as the country prepares its own digital currency. Nevertheless, there are concerns that the ban may be related to the ongoing Evergrande crisis.
- Beijing escalated tensions with Taipei on Thursday by [sending 24 fighter jets over Taiwan's air defense identification zone](). The move comes in response to Taipei's bid to join the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP).
- China is [planning to consolidate all its rare earth mining and processing firms]() into two large firms. By having the two largest rare earth firms, Beijing believes it will have the ability to better control prices. Rare earth minerals are crucial in the production of clean energy, electric vehicles, consumer electronics, and some national defense technologies.
- On Friday, Commerce Secretary Gina Raimondo suggested that despite the friction between the U.S. and China, the [two countries will still look to strengthen business ties](). This is a huge shift in tone from the Biden administration. In July, the administration [warned companies about the risks of investing in Hong Kong]() following the passage of the national security law. Although it is possible that the change in tone could be related to [Xi and Biden's most recent call](), we suspect that it may be due to a divide within the administration on how to best deal with China.

[COVID-19:] The [number of reported cases]() is 230,663,767 with 4,729,308 fatalities. In the U.S., there are 42,672,241 confirmed cases with 684,349 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 462,561,625 doses of the vaccine have been distributed with 387,821,704 doses injected. The number receiving at least one dose is 212,564,346, while the number receiving second doses, which would grant the highest level of immunity, is 182,587,334. The *FT* has a page on [global vaccine distribution]().

- An advisory panel for the Centers for Disease Control and Prevention have [recommended that the Pfizer vaccine]() be limited to seniors, nursing home residents, and certain adults with underlying conditions. The recommendation for such a small group of people will likely hinder efforts from the Biden administration as it attempts to halt the spread of the delta variant through vaccinations.
  - The CDC chief [overruled the panel decision]() and recommended that workers at high risk of COVID-19 infection should receive the booster.

U.S. Economic Releases

There have been no major U.S. economic releases so far today. The table below lists the economic releases and/or Fed events scheduled for the rest of the day.

Economic Releases					Expected	Prior	Rating
EDT	**Indicator**				**Expected**	**Prior**	**Rating**
10:00	New Home Sales	m/m	Aug		715k	708k	***
10:00	New Home Sales MoM	m/m	Aug		1.0%	1.0%	*
Fed Speakers or Events							
EST	**Speaker or event**	**District or position**					
10:00	Jerome Powell Speaks at "Fed Listens" Event	Chairman of Board of Governors of Federal Reserve					
10:00	Richard Clarida Speaks at "Fed Listens" Event	Vice Chairman of Board of Governors of Federal Reserve					
10:00	Michelle Bowman Speaks at "Fed Listens" Event	Member of the Board of Governors					
10:05	Esther George Discusses Economic Outlook	President of the Federal Reserve Bank of Kansas City					
11:00	Raphael Bostic Discusses Equitable Community Development	President of the Federal Reserve Bank of Atlanta					

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	-0.4%	-0.3%	-0.3%	***	Equity and bond neutral
	National CPI Ex Fresh Food	y/y	Aug	0.0%	-0.2%	0.0%	**	Equity and bond neutral
	National CPI Ex Fresh Food, Energy	y/y	Aug	-0.5%	-0.6%	-0.4%	*	Equity and bond neutral
	Jibun Bank Japan PMI Mfg	m/m	Sep P	51.2	52.7		**	Equity bearish, bond bullish
	Jibun Bank Japan PMI Services	m/m	Sep P	47.4	42.9		**	Equity bullish, bond bearish
	Jibun Bank Japan PMI Composite	m/m	Sep P	47.7	45.5		**	Equity bullish, bond bearish
	Nationwide Department Store Sales	y/y	Aug	-11.7%	4.2%		*	Equity bearish, bond bullish
New Zealand	Trade Balance NZD	m/m	Aug	-2144m	-397m		**	Equity bearish, bond bullish
	Exports NZD	m/m	Aug	4.35b	5.77b		*	Equity bearish, bond bullish
	Imports NZD	m/m	Aug	6.49b	6.17b		*	Equity and bond neutral
South Korea	PPI	y/y	Aug	7.3%	7.4%		*	Equity and bond neutral
EUROPE								
Germany	IFO expectations	m/m	Sep	97.3	97.8	96.5	***	Equity bullish, bond bearish
	IFO current assessment	m/m	Sep	100.4	101.4	101.8	**	Equity and bond neutral
	IFO business climate	m/m	Sep	98.8	99.6	99.0	***	Equity and bond neutral
Italy	Consumer Confidence Index	m/m	Sep	119.6	116.2	115.8	***	Equity bullish, bond bearish
	Manufacturing Confidence Index	m/m	Sep	113.0	113.4	112.7	***	Equity bullish, bond bearish
	Economic Sentiment	m/m	Sep	113.8	114.2		**	Equity bullish, bond bearish
AMERICAS								
Mexico	Retail Sales	y/y	Jul	9.9%	17.7%	11.7%	***	Equity bearish, bond bullish
Brazil	IBGE Inflation IPCA-15	y/y	Sep	10.1%	9.3%	9.9%	***	Equity and bond neutral
	Current Account Balance	m/m	Aug	$1684m	-$1584m	$1250m	**	Equity bullish, bond bearish
	Foreign Direct Investment	m/m	Aug	$4451m	$6103m	$6000m	**	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)	13	13	0	Down
3-mo T-bill yield (bps)	3	3	0	Neutral
TED spread (bps)	10	10	0	Neutral
U.S. Libor/OIS spread (bps)	8	8	0	Down
10-yr T-note (%)	1.42	1.43	-0.01	Down
Euribor/OIS spread (bps)	-54	-54	0	Neutral
EUR/USD 3-mo swap (bps)	3	3	0	Down
Currencies	**Direction**			
dollar	Up			Neutral
euro	Down			Up
yen	Down			Neutral
pound	Down			Neutral
franc	Flat			Neutral

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	$77.28	$77.25	0.04%	
WTI	$73.22	$73.30	-0.11%	
Natural Gas	$5.13	$4.98	3.07%	
Crack Spread	$17.37	$17.59	-1.28%	
12-mo strip crack	$18.80	$19.06	-1.33%	
Ethanol rack	$2.56	$2.56	-0.10%	
Metals				
Gold	$1,751.31	$1,742.76	0.49%	
Silver	$22.57	$22.51	0.24%	
Copper contract	$422.75	$423.10	-0.08%	
Grains				
Corn contract	$527.50	$529.25	-0.33%	
Wheat contract	$716.75	$717.75	-0.14%	
Soybeans contract	$1,282.50	$1,284.25	-0.14%	
Shipping				
Baltic Dry Freight	4,651	4,560	91	
DOE inventory report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-3.5	-3.3	-0.3	
Gasoline (mb)	3.5	-1.2	4.7	
Distillates (mb)	-2.6	-1.2	-1.5	
Refinery run rates (%)	5.40%	2.25%	3.2%	
Natural gas (bcf)	76.0	73.0	3.0	

Weather

The 6-10 day and 8-14 day forecasts currently call for warmer-than-normal temperatures in the Southwest, the Great Plains, and the Northeast, with cooler-than-normal temperatures concentrated in the Deep South. The forecast calls for dry conditions throughout the Rocky Mountains and the Great Plains, with wet conditions in the Northeast.

There are currently three cyclonic disturbances in the Atlantic region. Hurricane Sam is currently off the coast of South America and moving westward toward the Caribbean Islands. There are also disturbances near Bermuda and in the North Atlantic, but they have only a limited probability of developing into cyclones during 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 9/23/2021 close)
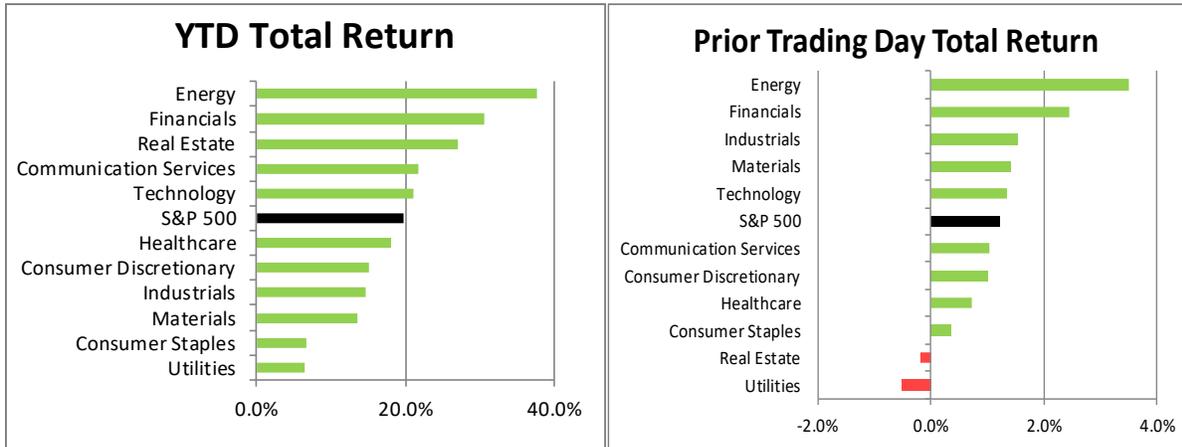
(Source: Bloomberg)

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.

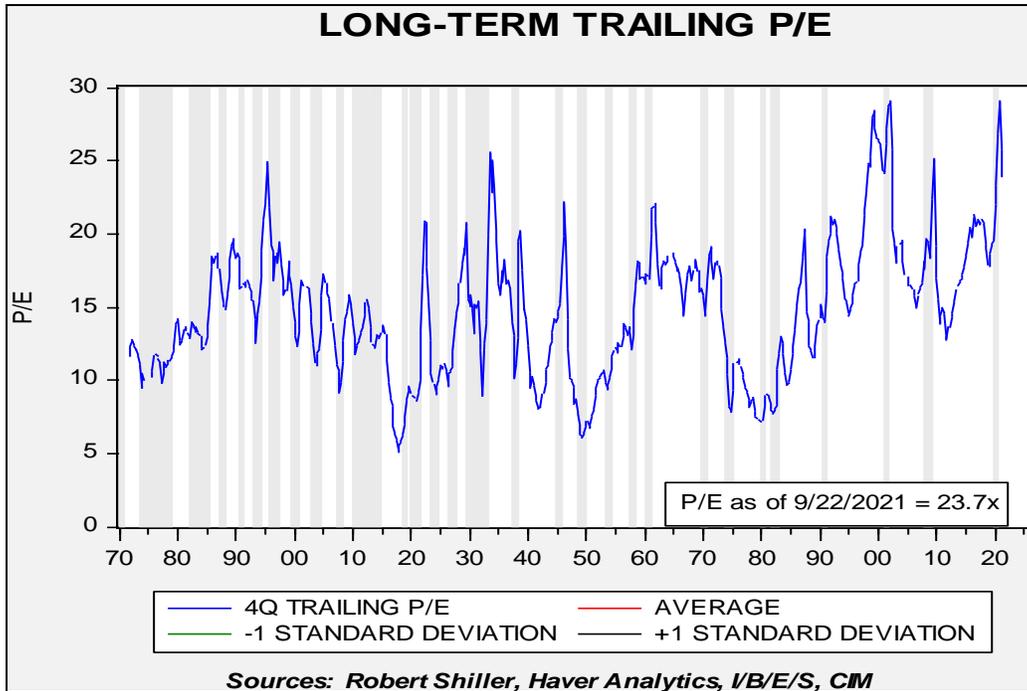**Asset Class Performance** – (as of 9/23/2021 close)
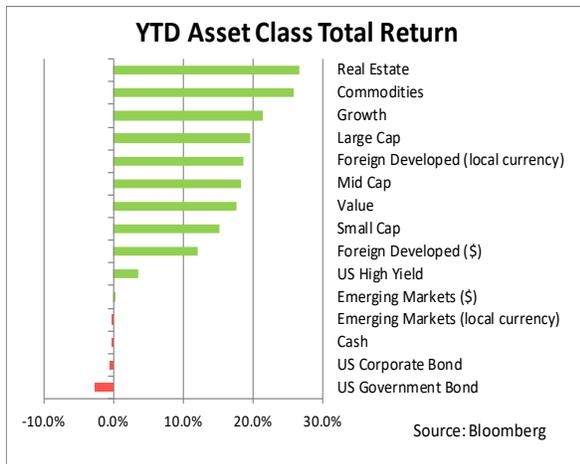
This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

LONG-TERM TRAILING P/E

P/E as of 9/22/2021 = 23.7x

Legend: 4Q TRAILING P/E — AVERAGE — -1 STANDARD DEVIATION — +1 STANDARD DEVIATION

Sources: Robert Shiller, Haver Analytics, I/B/E/S, CIM

Based on our methodology,[1] 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.

---

[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.