

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 27, 2021—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the EuroStoxx 50 is currently up 0.6% from its prior close. In Asia, the MSCI Asia Apex 50 closed up 0.2%. Chinese markets were lower, with the Shanghai Composite down 0.8% from its prior close and the Shenzhen Composite down 1.1%. 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](#) (9/24/2021) (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”

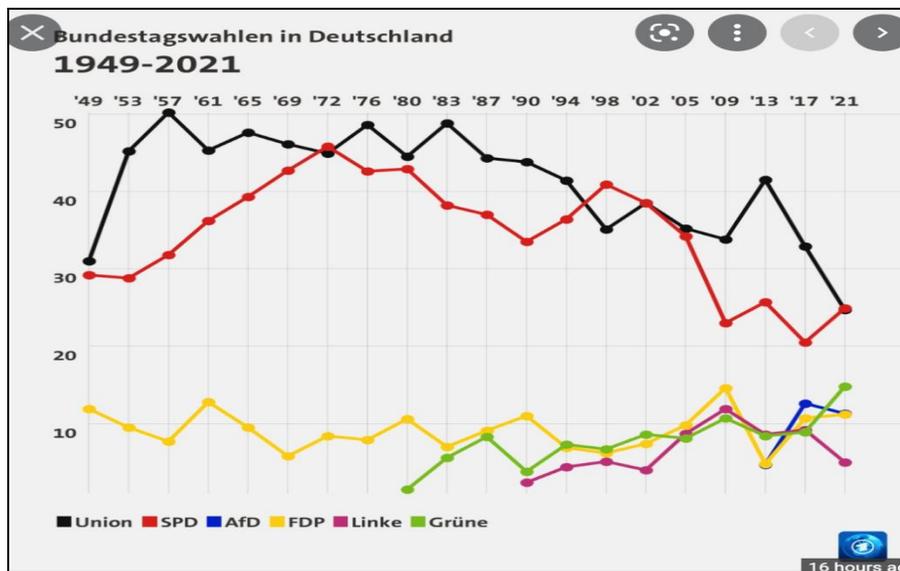
Good morning and happy Monday, the last one for September 2021 (time flies!). [U.S. equity futures are mostly flat this morning, while crude oil is near a three-year high](#). Our coverage leads off with the German elections, which were something of a draw. The Meng Wanzhou saga is up next, followed by an Evergrande (EGRNF, USD, 0.32) update and crypto news. The British supply crisis is next in line. We then take a look at the current state of the budget, the infrastructure bill, and the debt ceiling. We close our special coverage with an update on the SEC’s action regarding corporate bonds. Our regular coverage includes China news, international news, economics and policy, and our pandemic coverage.

BREAKING: Boston FRB President Rosengren announced his retirement. He, along with Dallas FRB President Kaplan, were aggressively trading their own accounts during the 2020 financial crisis and have come under harsh criticism for the appearance of trading on privileged information. His term didn’t end until 2026. We will be watching for news from Dallas. It should be noted that he has renal failure and is awaiting a kidney transplant, so his retirement may not be tied to the trading situation. If Kaplan resigns as well, Powell will have removed a

source of complaint against the Fed and may preserve regional bank control of the president selection.

German Elections: [The SPD won a plurality, ending 16 years of CDU/CSU dominance, but the vote was close. The SPD won 25.7% of the vote compared to 24.1 for the CDU/CSU. The Greens took 14.8% of the vote, while the FDP won 11.5%. Die Linke won 4.9%.](#) All other parties fell below the 5% threshold, meaning they won't get seats in the Bundestag. [Although both the SPD and CDU/CSU have claimed they won the right to form a government,](#) the Greens and the FDP will most likely be the basis of the new government. [These two parties are already in coalition talks,](#) and once they fix their agenda (like who gets what ministries), they will engage the two larger parties. However, talks between the Greens and the FDP won't be easy. The Greens stand for environmental policies and are pro-EU. The FDP leans libertarian and opposes higher taxes and the Eurobond. [Christian Linder, the FDP's leader,](#) will probably demand the finance ministry. If the Greens and FDP fail to build a bloc, the next government could take months to form. At this point, the German government is something of a "jump ball." We expect the FDP and the Greens to try hard to form an alliance, considering the power it will give them; [what happens after is anyone's guess.](#)

Coalitions are becoming more common as the two leading parties become less popular.



(Source: Adam Tooze)

Although the exit of Merkel creates a power vacuum of sorts, we don't see any other EU power that will be able to replace Germany.

Meng goes home: Huawei (002502, CNY, 6.64) [CFO Meng Wanzhou was detained in Canada](#) in 2019 on charges she and [her company sold telecom equipment to Iran in violation of U.S. sanctions.](#) She was held under house arrest until this weekend when she flew home to China. Under terms of the plea deal, [she admitted to assisting her company's attempt to conceal the sales to Iran.](#) The other element of this affair was that Beijing arrested two Canadians and held

them in conditions far harsher than Meng's palatial estate in British Columbia. [Meng's plea deal was also a prisoner swap; China freed the two detained Canadians](#). It appears the arrest of the [Canadians](#) was with the intent to swap for Meng. [We suspect this sort of thing will become more common in China](#) and should be taken as a warning to ex-pats living there.

Evergrande: The slow-motion collapse of Evergrande continued over the weekend. Last week, the company failed to make debt payments, and it is now in the 30-day grace period before there is an official default. Cities are starting to take the lead in managing the breakup of the company. [City governments have reportedly seized presales](#) to prevent the company from using the funds which should be escrowed. Although this move makes sense, it will deprive the company of funds. [The electric vehicle unit is warning that it is running out of cash](#). Meanwhile, [Beijing continues to manage the default by a strong security presence and control of social media](#).

Although there have been obvious analogs to LTCM and Lehman, [a better analog may be Japan in the early 1990s](#). When Japanese regulators allowed banks to fail, it ended the expectation that default wasn't possible. [China fears repeating Japan's experience of the 1990s](#) with good reason; excessive debt led to years to near-zero economic growth.

Cryptocurrencies: [On Friday, China announced a complete ban on the use of cryptocurrencies](#). We suspect there are two reasons behind the [ban](#). First, China is speedily moving to issue its own CBDC and likely doesn't want [alternative crypto as competition](#). Second, and likely the reason Beijing acted now, bitcoin and other cryptocurrencies can facilitate capital flight. The Evergrande situation will almost certainly lead to arrests, perhaps of corrupt officials, and Beijing likely wants to [prevent anyone under threat from moving their assets out of China](#) so those assets can be seized. [The next step will probably be attempting to corral offshore exchanges](#).

In the U.S., [stablecoins are the focus of regulators](#). The fear is that these funds are runnable, and given that [crypto has infiltrated into other financial assets](#), a crisis emanating from stablecoins could spread. [The Treasury and SEC are moving rapidly to regulate this space](#), but so far, we haven't seen a move to follow China.

And finally, a couple of other notes—bitcoin, which uses lots of electricity in its clearing process, has come under criticism from environmentalists. There are reports that [miners are teaming up with nuclear power operators with excess capacity](#). There are [emerging market economies with primitive financial systems](#) that are adopting bitcoin as a national currency. In some respects, this is not unlike a foreign nation setting up a currency board and using a foreign currency as the basis of its monetary system. The drawback with using bitcoin is that it is naturally deflationary and may make managing the economy a challenge.

U.K. supply crisis: A combination of Brexit restrictions on trade and the movement of labor, coupled with supply chain disruptions triggered by the pandemic, have left the U.K. looking like the 1970s, with lines at gasoline stations and [empty supermarket shelves](#). The transportation minister, Grant Shapps, has exacerbated the obvious political fallout from this evolving crisis, [blaming trucking firms for creating the situation](#). However, [the real problem is a lack of truck](#)

[drivers](#) who returned to Europe after Brexit and have not been replaced by locals. PM Johnson will issue [short-term visas](#) to try to [attract those drivers back](#). Albeit, after leaving, that might not be enough. As gas lines form, [Johnson is also planning to use the military](#) to haul fuel to gas stations. Panic buying (something we saw in the U.S. in the 1970s and recently during the Colonial Pipeline crisis) [is exacerbating the problem](#). Although Johnson remains secure, these types of events can consume political capital, undermining the government's ability to do other policies.

[Budget, infrastructure, and the debt ceiling—oh my!](#) First, the infrastructure bill is expected to come to the [House floor by Thursday before the budget bill](#). This action crosses a red line for progressives, who said they won't vote for it before the budget, fearing that if the infrastructure bill passes, [moderates will pare back the budget](#). This is a legitimate concern, but it may not matter. As all this drama occurs, the Treasury is facing a debt ceiling crisis and [is considering several emergency measures](#), including a government shutdown and [various actions to swap debt](#). So far, [financial markets are taking the news rather well](#). Perhaps they view the situation as [one described by the 1980s group Adam Ant](#). In the end, the Democrats will likely have to put the debt ceiling in the reconciliation process and give the GOP election talking points. Although we expect this "crisis" will be over by Halloween, with the infrastructure bill passed, a much smaller budget (\$2.0 trillion), and a new debt ceiling, the uncertainty could trigger some market volatility.

[About bonds:](#) Last week, we reported the SEC was considering changing the disclosure rules for corporate debt, which may have led brokers to stop placing bids/offers. Mercifully, [the SEC has postponed the action](#) and [may end it altogether](#).

China news: The IMF head is in trouble.

- [An investigation at the World Bank](#) found that the current IMF head, Kristalina Georgieva, pressured the body to boost China's ranking in the *Doing Business Report*. [She has denied the reports](#) but is [coming under scrutiny](#) for the World Bank's findings. China has been trying to increase its presence in international organizations and may have used Georgieva for this purpose.
- CNOOC (883, HKD, 8.48) is [preparing for U.S. delisting](#) by a large domestic stock issuance.
- [Commerce Dept head Raimondo called for strengthening U.S./China business ties](#). Although this is a clear exposition of the establishment's view of China, we see it as out of step.

International roundup: Washington and the EU talk trade.

- The U.S. and EU trade negotiators [are meeting in Pittsburgh](#) this week.
- Germany wasn't the only election over the weekend. [Iceland held them as well](#), and the ruling coalition won.

Economics and policy: Supply chain woes continue.

- A cascade of problems, from the lack of workers, too many empty shipping containers, and logistical snarls, [are all leading to continued supply chain problems](#). The longer this

goes on, the longer inflation remains elevated. [We are seeing firms aggressively bid for labor.](#)

- High crop prices are [boosting the farm economy.](#)

COVID-19: The [number of reported cases](#) is 231,913,317, with 4,749,880 fatalities. In the U.S., there are 42,932,211 confirmed cases with 688,041 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 471,814,235 doses of the vaccine have been distributed with 390,114,328 doses injected. The number receiving at least one dose is 213,456,787, while the number receiving second doses, which would grant the highest level of immunity, is 183,670,870. For the population older than 18, 66.6% have been vaccinated. The *FT* has a page on [global vaccine distribution.](#)

- Although we will probably never know for certain the origin of COVID-19, the [continued drip of reports from bio labs](#) raises fears about the nature of the research being conducted.
- Vaccine distribution continues to lag [in the developing world.](#)
- Given that none of the vaccines give sterilizing immunity (that means, once vaccinated or infected, you don't get the disease again), treatments for COVID-19 remain critical. There are reports of [great progress on anti-virals](#), which will be [critical in managing the ongoing endemic.](#)
- On the social side of the pandemic, [life expectancy took a dip last year](#), unusual outside of war. [Women especially are reporting career adjustments in the post-pandemic world.](#)

U.S. Economic Releases

In August, durable goods orders rose above expectations due to a jump in transportation orders. Durable goods orders rose 1.8% from the prior month compared to expectations of 0.6%. Excluding transportation, durable goods orders rose 0.2% from the prior month compared to expectations of 0.5%. Capital goods orders for nondefense excluding air rose 0.5% from the previous month compared to expectations of 0.4%. Meanwhile, capital goods shipments rose 0.6% from the prior month compared to expectations of 0.5%.



The chart above shows the annual increase in durable goods orders and shipments. Durable goods orders rose 9.35% from the prior year, while new orders rose 18.12%.

The table below lists the economic releases and/or Fed events scheduled for the rest of the day.

Economic Releases						
EDT	Indicator			Expected	Prior	Rating
10:30	Dallas Fed Manufacturing Activity	m/m	Sep	11.0	9.0	*
Fed Speakers or Events						
EST	Speaker or event	District or position				
8:00	Charles Evans Speaks at Annual NABE Conference	President of the Federal Reserve Bank of Chicago				
9:00	John Williams Makes Opening on conference on Culture	President of the Federal Reserve Bank of New York				
12:00	John Williams Discusses Economic Outlook	President of the Federal Reserve Bank of New York				
12:50	Lael Brainard Discusses Economic Outlook at NABE Conference	Members 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
ASIA-PACIFIC								
Japan	PPI Services	y/y	Aug	1.0%	1.1%	1.2%	**	Equity and bond neutral
	Leading Index CI	m/m	Jul	104.1	104.1		**	Equity and bond neutral
	Coincident Index	m/m	Jul	94.4	94.5		**	Equity and bond neutral
EUROPE								
Eurozone	M3 Money Supply	y/y	Aug	7.9%	7.6%	7.7%	**	Equity and bond neutral
Switzerland	Domestic Sight Deposits CHF	w/w	24-Sep	636.0b	636.0b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	24-Sep	714.5b	714.7b		*	Equity and bond neutral
AMERICAS								
Brazil	FIPE CPI - Weekly	w/w	22-Sep	1.2%	1.2%	1.2%	**	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)	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	\$75.39	\$74.36	1.39%	
WTI	\$71.62	\$70.49	1.60%	
Natural Gas	\$4.85	\$4.81	0.89%	
Crack Spread	\$17.53	\$18.91	-7.29%	
12-mo strip crack	\$19.09	\$19.34	-1.31%	
Ethanol rack	\$2.58	\$2.59	-0.41%	
Metals				
Gold	\$1,749.27	\$1,750.42	-0.07%	
Silver	\$22.51	\$22.42	0.38%	
Copper contract	\$429.10	\$428.55	0.13%	
Grains				
Corn contract	\$526.00	\$526.75	-0.14%	
Wheat contract	\$725.25	\$723.75	0.21%	
Soybeans contract	\$1,288.25	\$1,285.00	0.25%	
Shipping				
Baltic Dry Freight	4,644	4,651	-7	

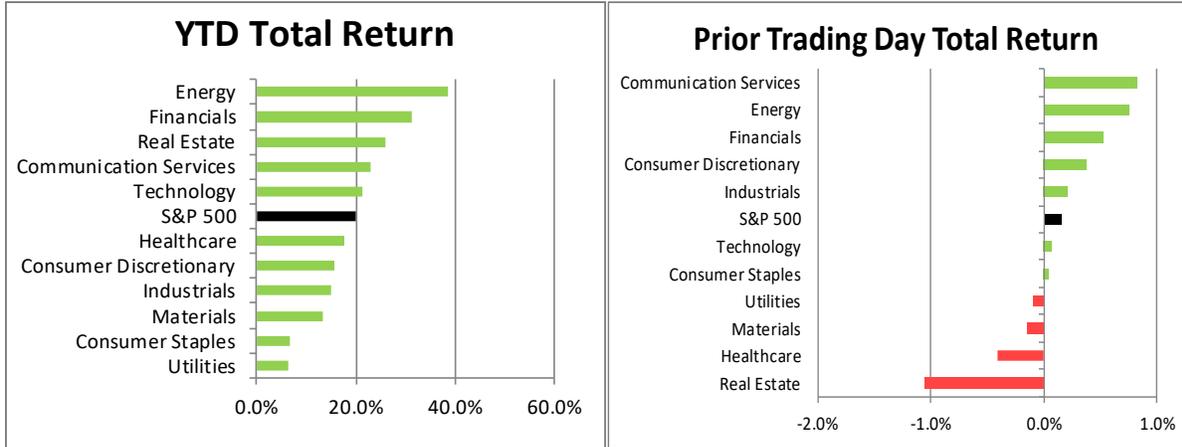
Weather

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 now 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 occurred on September 10.

Data Section

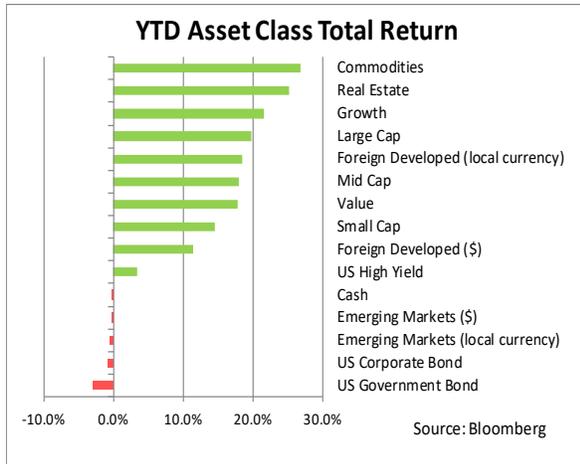
U.S. Equity Markets – (as of 9/24/2021 close)



(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 9/24/2021 close)

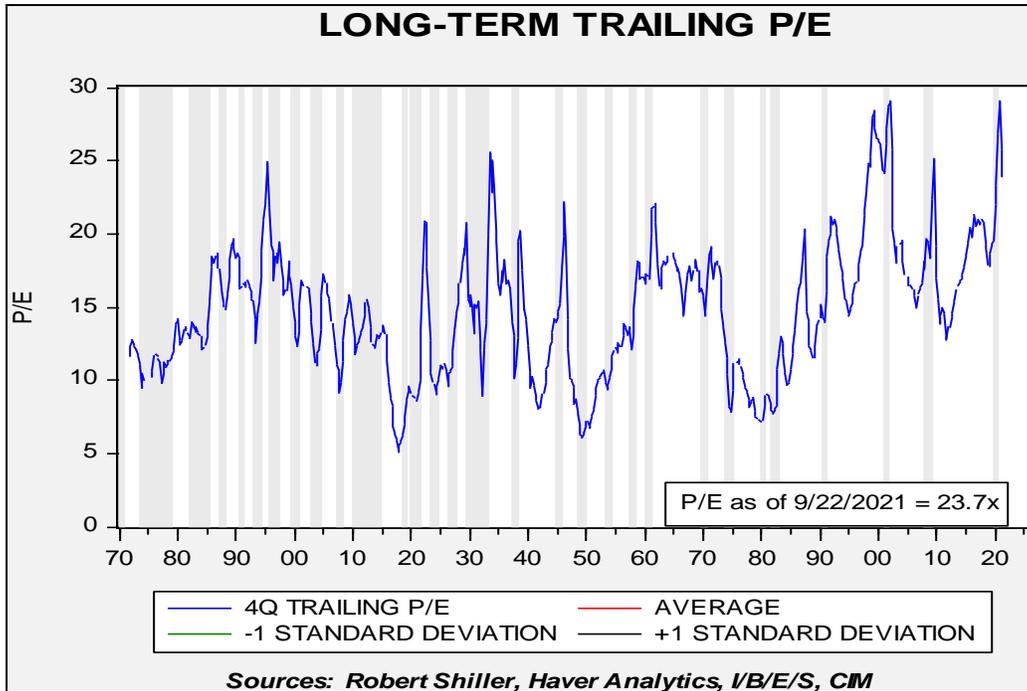


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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,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.