

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, 2023—9:30 AM EDT]** Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 is up 0.2% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.4%. Chinese markets were higher, with the Shanghai Composite up 0.2% from its previous close and the Shenzhen Composite up 0.4%. 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](#) (9/25/2023) (with associated [podcast](#)): “Where’s the Recession? A Recap”
- [Confluence of Ideas podcast](#) (8/22/2023): “The Economics of Defense in Great Power Competition”

Our *Comment* today opens with the latest on the prospects for a partial shutdown of the U.S. government starting this weekend due to budget gridlock. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including an improvement in British Prime Minister Sunak’s approval ratings after he eased the U.K.’s climate-stabilization policies and a few words on U.S. antitrust policy.

**U.S. Government Shutdown:** The Senate last night [advanced a bipartisan stopgap spending bill](#) that would keep the federal government funded at today’s levels from the expiration of the

current fiscal year on Saturday until November 17. The bill is designed to give Democrats and Republicans more time to negotiate and pass the needed full-year appropriations bills.

- However, Republicans in the House said they wouldn't consider the Senate's bill.
- Instead, they voted to clear the way for debate on just four of the 12 appropriations bills, i.e., those for the Departments of Defense, Homeland Security, Agriculture, and State.
- While setting up debate on the four spending bills is a win for House Speaker McCarthy, final passage of the four bills before fiscal year-end on Saturday would still leave the departments that rely on the remaining eight bills unfunded.
  - Since those departments are often top budget-cutting targets, many right-wing Republicans would probably try to drive a very hard bargain before passing their funding bills.
  - Their approach could well include refusing to pass a stopgap spending bill, setting the stage for a partial government shutdown.

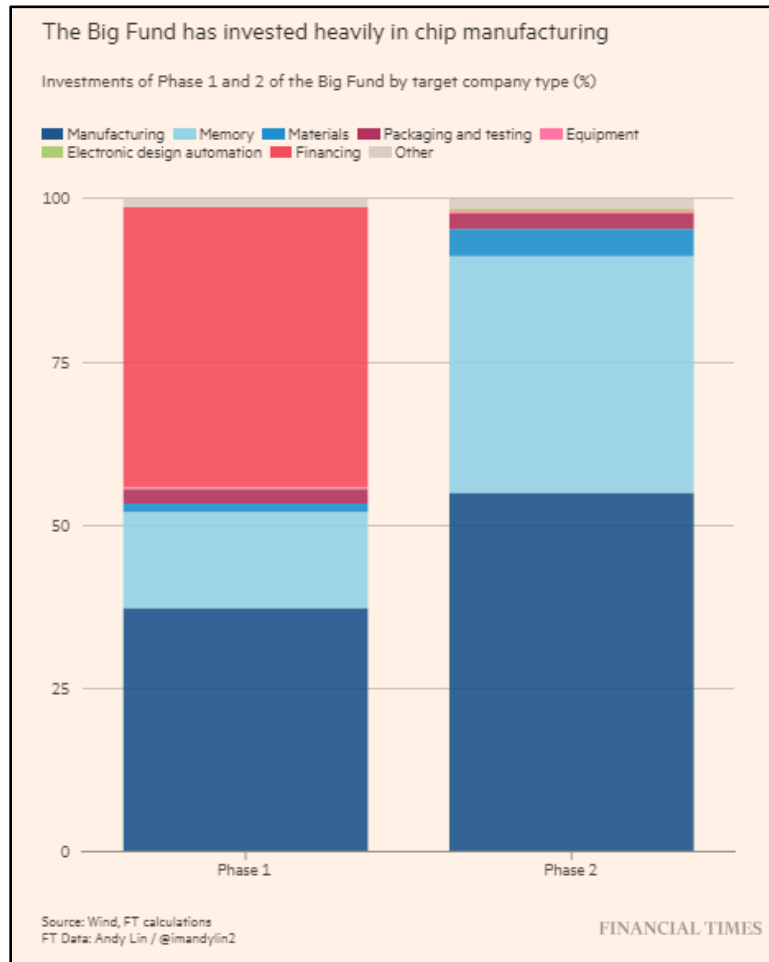
**China-Philippines-United States:** After China installed floating barriers to keep Philippine fishing boats out of a contested shoal in the South China Sea, as we reported in our *Comment* on Monday, the Philippines [has taken the risky step of removing the barrier and now plans to step up military, coast guard, and administrative patrols of the area](#). It is still not clear how Beijing will respond to Manila's new self-assertiveness, but because of the U.S.-Philippines mutual defense treaty, the action probably raises the risk of increased tension or conflict between the U.S. and China.

**China-Australia:** Although bilateral relations have improved under Australian Prime Minister Albanese, with China lifting its punitive import restrictions on Australian coal and barley, the country [is still struggling with Chinese punitive import tariffs on Australian wine](#). New data shows Australia now has about two billion liters of excess wine in storage, equal to about 859 Olympic-sized swimming pools. Albanese reportedly urged the end of wine restrictions when he met with Chinese Premier Li Qiang this month, but in the meantime, the glut of supply suggests there may be some good bargains on Australian Shiraz, Cabernet Sauvignon, or other varietals in your local supermarket.

**China:** The government's China Integrated Circuit Investment Fund, known as the "Big Fund," [is reportedly having trouble raising new money from its target investor base](#) of state-owned enterprises and local governments. The fund, which has been instrumental in developing China's semiconductor industry since it was established in 2014, raised the equivalent of about \$20 billion and \$28 billion in its first two funding rounds, but it is falling short of its goal to raise an additional \$41 billion in the current round.

- The shortfall in funding reflects China's sharp slowdown in economic growth and the increased debt loads faced by state-owned firms and local governments. The country's finance ministry could step in to make up the shortfall but appears reluctant to do so.

- The funding shortfall not only could temper the further development of China’s technology industry, but it also illustrates the potential that sluggish economic growth and high debt have to slow China’s military buildup over time.
- On the other hand, if President Xi senses that a prolonged growth slowdown and debt burden will limit future military investments, he could potentially be tempted to launch his long-desired takeover of Taiwan earlier rather than later.



**United Kingdom Politics:** Following Prime Minister Sunak’s decision last week to delay or jettison some of the government’s climate-stabilization regulations, a new poll suggests that the move [will be a political winner](#). According to the poll, public approval for Sunak’s Conservative Party has risen by eight percentage points since the announcement, cutting the Labor Party’s lead to 16 percentage points from 24 previously. The results suggest governments in Europe may continue to water down their green-energy policies as households begin to push back against their costs and inconveniences.

**United Kingdom Regulatory Policy:** The Financial Conduct Authority, the U.K.’s top financial regulator, [said it will open an investigation into asset valuations in private markets](#). The probe reflects growing concerns in the U.K. and elsewhere that valuations on private assets

are often overly rosy, potentially setting up financial volatility in time of crisis or falling valuations.

**Greece:** The right-wing government of Prime Minister Mitsotakis yesterday [said it will grant legal status to as many as 300,000 illegal immigrants to help ease the country's labor shortages in agriculture, tourism, and construction](#). Similar to the scandal in which Poland's right-wing, anti-immigrant government was discovered to be selling immigration visas, the new policy in Greece illustrates the tension between conservative governments' rhetoric against immigration and the opportunity for immigrants to ease labor shortages in the developed world.

**U.S. Antitrust Policy:** Yesterday, the Federal Trade Commission and 17 states [filed a long-expected antitrust complaint against Amazon \(AMZN, \\$125.98\)](#), alleging the online retailer illegally wields monopoly power that harms its competitors and keeps prices artificially high. Nevertheless, FTC Chairwoman Khan has had a spotty record with her antitrust suits, so it isn't clear at this point whether the company would really be convicted and forced to change its operations.

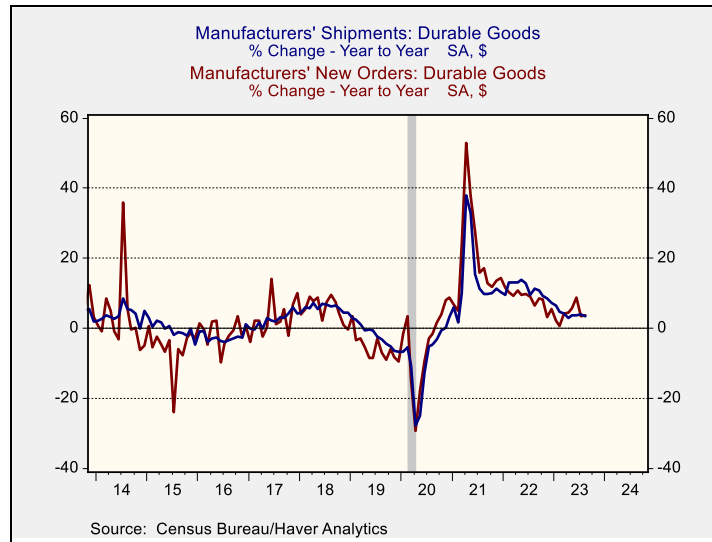
**U.S. Labor Market:** The Writers Guild of America [said its members can go back to work today](#) under the union's tentative new labor contract with the major movie studios, streamers, and television networks. However, members won't vote to give formal approval of the new contract until a poll that will run from October 2 to October 9.

- According to the WGA, its initial proposal in the negotiations would have had a value of \$429 million annually, while the Alliance of Motion Picture and Television Producers made an initial offer worth just \$86 million per year.
- The WGA estimates that the tentative deal will be worth \$233 million per year. That's just 54% of its initial ask, but it's 2.7x what the employers initially offered.

## U.S. Economic Releases

Mortgage demand slipped last week, as high borrowing costs continued to deter potential homebuyers. Mortgage applications declined 1.3% in the week ending September 22, according to the Mortgage Bankers Association (MBA). The drop was partly attributed to a 10-basis-point increase in the 30-year fixed-rate mortgage, which rose from 7.31% to 7.41%. The MBA purchase index fell 1.5% from the prior week, while the refinance index fell 0.9%.

Business investment rebounded in August, defying expectations. Durable goods orders, a key indicator of business investment, rose 0.2% from the prior month, according to the U.S. Census Bureau. This was a significant turnaround from the previous month's decline of 5.6% and beat economists' estimates of a 0.5% drop. The growth was broad-based, with orders excluding transportation rising 0.4% and orders excluding defense rising 0.9%.



The chart above shows the annual change in durable goods orders and shipments. In August, durable goods orders accelerated from 3.21% to 3.52%. However, durable goods shipments declined from 3.86% to 3.37%.

There are no economic releases or Fed events scheduled for the rest of 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
<b>ASIA-PACIFIC</b>								
Japan	Leading Economic Index	m/m	Jul F	108.2	107.6		**	Equity and bond neutral
	Machine tool orders	y/y	Aug F	-17.6%	-17.6%		**	Equity and bond neutral
Australia	CPI	y/y	Aug	5.2%	4.9%	5.2%	*	Equity and bond neutral
South Korea	Business Survey - Manufacturing	m/m	Oct	67	69		**	Equity bearish, bond bullish
	Business Survey - Non-Manufacturing	m/m	Oct	77	76		*	Equity bullish, bond bearish
China	Profits	y/y	Aug	17.2%	-6.7%		*	Equity bullish, bond bearish
<b>EUROPE</b>								
Eurozone	M3 Money Supply	y/y	Aug	-1.3%	-0.4%	-1.0%	***	Equity and bond neutral
Germany	GfK Consumer Confidence	m/m	Oct	-26.5	-25.5	-25.6	**	Equity bearish, bond bullish
France	Consumer Confidence	m/m	Sep	83	85	84	**	Equity and bond neutral
<b>AMERICAS</b>								
Mexico	Trade Balance	m/m	Aug	-\$1377.1m	-\$881.2b	-\$1100.0m	**	Equity and bond neutral
Brazil	Total Outstanding Loans	m/m	Aug	5524b	5405b	5463b	**	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)	565	566	-1	Up
3-mo T-bill yield (bps)	532	532	0	Up
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	538	538	0	Up
U.S. Libor/OIS spread (bps)	540	540	0	Up
10-yr T-note (%)	4.51	4.54	-0.03	Flat
Euribor/OIS spread (bps)	394	398	-4	Up
Currencies	Direction			
Dollar	Up			Up
Euro	Down			Down
Yen	Flat			Down
Pound	Down			Down
Franc	Down			Down

## 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
<b>Energy Markets</b>				
Brent	\$95.42	\$93.96	1.55%	
WTI	\$92.14	\$90.39	1.94%	
Natural Gas	\$2.69	\$2.66	1.09%	
Crack Spread	\$23.86	\$24.98	-4.48%	
12-mo strip crack	\$26.07	\$26.39	-1.21%	
Ethanol rack	\$2.49	\$2.50	-0.40%	
<b>Metals</b>				
Gold	\$1,893.09	\$1,900.65	-0.40%	
Silver	\$22.80	\$22.85	-0.21%	
Copper contract	\$363.40	\$364.90	-0.41%	
<b>Grains</b>				
Corn contract	\$481.50	\$479.75	0.36%	
Wheat contract	\$587.50	\$589.00	-0.25%	
Soybeans contract	\$1,309.00	\$1,302.75	0.48%	
<b>Shipping</b>				
Baltic Dry Freight	1,694	1,614	80	
<b>DOE Inventory Report</b>				
	Actual	Expected	Difference	
Crude (mb)		-0.9		
Gasoline (mb)		-0.5		
Distillates (mb)		-1.0		
Refinery run rates (%)		-0.7%		
Natural gas (bcf)		88		

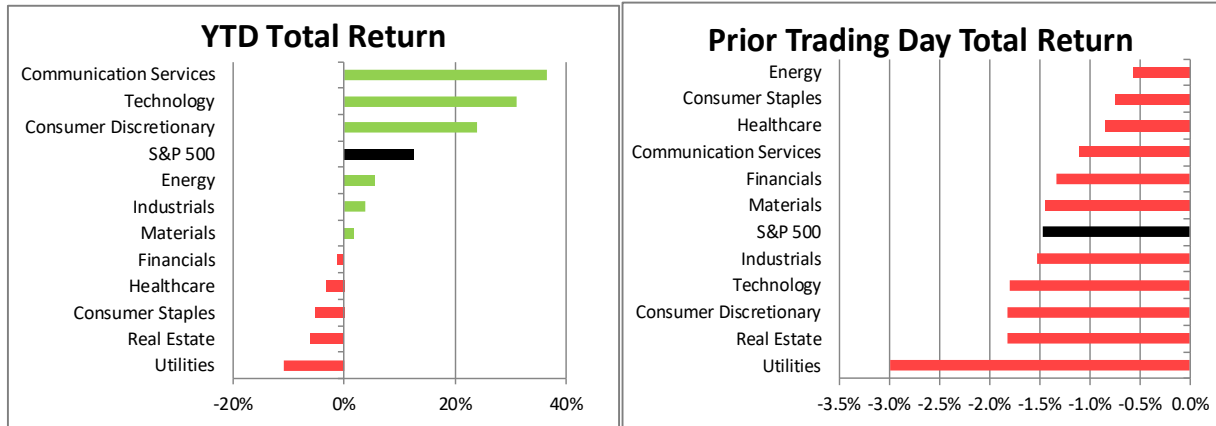
## **Weather**

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures throughout most of the country with below-normal temperatures in the Far West. The precipitation outlook calls for wetter-than-normal conditions for most states west of the Mississippi River with dry conditions in the parts of the Southeast, Midwest, and New England.

Two atmospheric disturbances are currently active in the Atlantic Ocean, with one already a major storm and another likely to form within the next 48 hours. Tropical Storm Philippe is in the central Atlantic Ocean and is expected to weaken to a depression as it approaches Puerto Rico. The other disturbance is also located in the central Atlantic Ocean and away from any nearby landmasses. It has a 90% chance of forming into a cyclone in the next two days. On average, Atlantic hurricane activity peaks on September 15.

**Data Section**

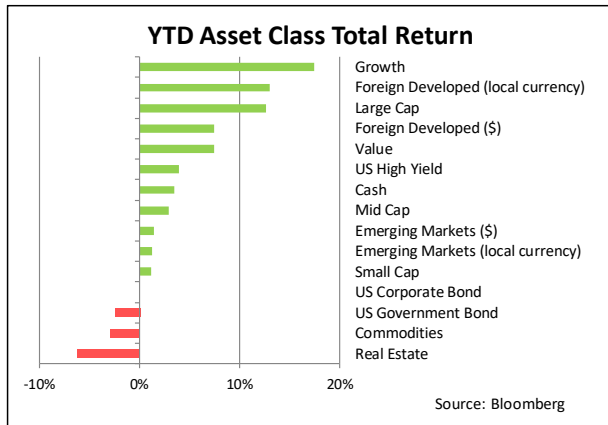
**U.S. Equity Markets – (as of 9/26/2023 close)**



(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 9/26/2023 close)**



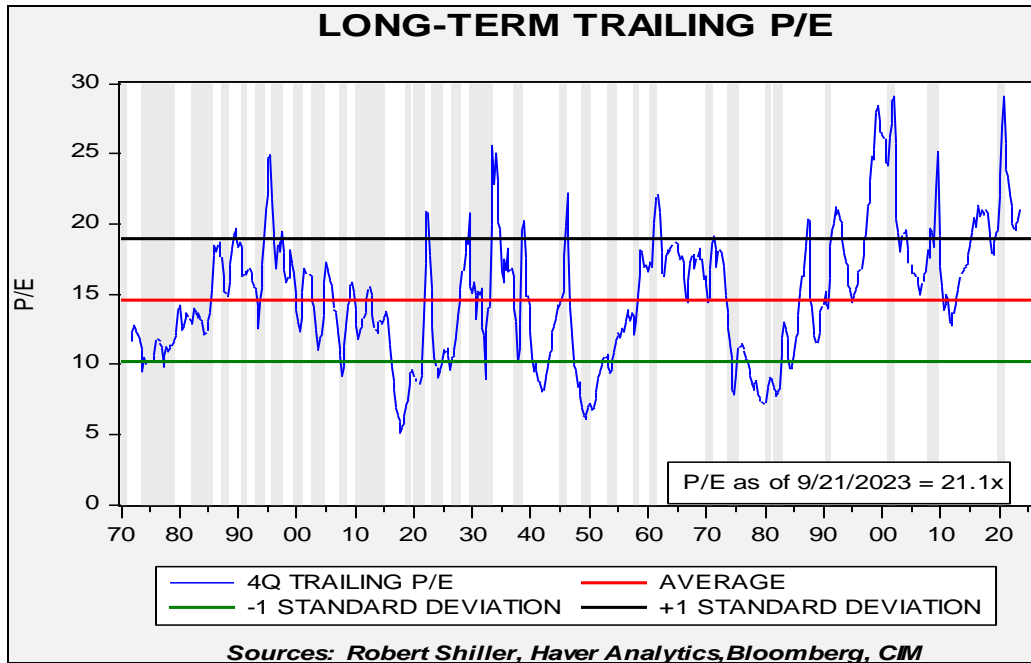
This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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,<sup>1</sup> 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.*

<sup>1</sup> 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.