By Patrick Fearon-Hernandez, CFA,
and Thomas Wash

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 28, 2023—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is unchanged from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.8%. Chinese markets were higher, with the Shanghai Composite up 0.1% from its previous close and the Shenzhen Composite up 0.4%. 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:

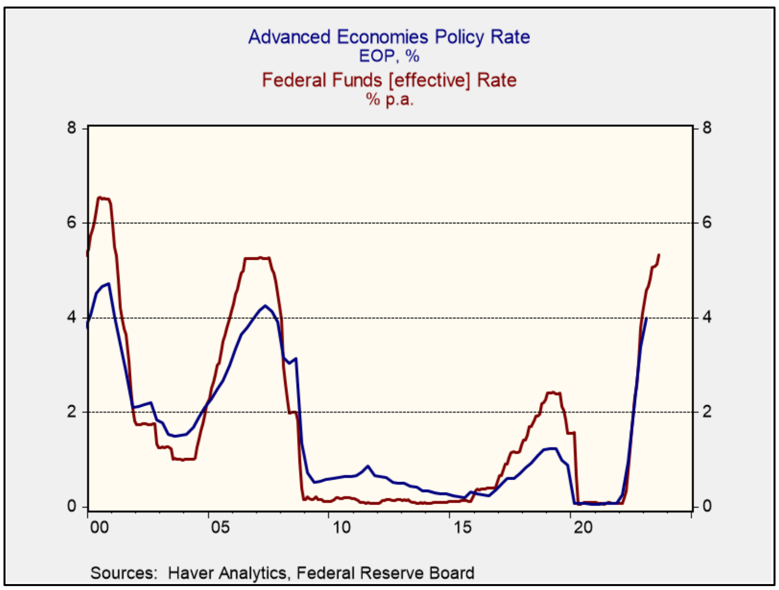
- *Bi-Weekly Geopolitical Report* (9/18/2023) (with associated podcast): "Goodbye Prigozhin"
- ***Weekly Energy Update*** **(9/28/2023): Crude oil prices continue to rise as inventories decline. In the latest reporting week, crude oil stockpiles fell despite falling refining activity. We also discuss Europe's rapid moves to prevent Chinese EVs from swamping their automobile markets**.
- *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"

Good morning! The S&P 500 is off to a decent start, 10-year Treasury yields are up, and Republican contenders failed to make a spark at last night's debate. Today's *Comment* will cover the rising dollar, several unions' fights against AI, and Russia's waning influence over neighboring regions.

Fed Lifting the Dollar: The U.S. dollar has hit a 10-month high against its peers as investors accept the Fed's "restrictive for longer" narrative.

- Bolstered by stronger-than-expected economic growth and hawkish monetary policy from the Federal Reserve, the dollar index is poised for its eleventh consecutive week of gains, outperforming its G-10 peers. Meanwhile, Fed policymakers have shown a greater willingness to tighten policy than their counterparts at the ECB and BOJ who have both maintained a preference for keeping rates at their current levels at least for the rest of 2023. Earlier this month, Fed Governor Michelle Bowman and Boston Fed President Susan Collins called for further tightening to address rising inflation. However, Minneapolis Fed President Neel Kashkari has cautioned that economic disruptions, such as a government shutdown or union strikes, could lead FOMC members to hold off on another rate increase.

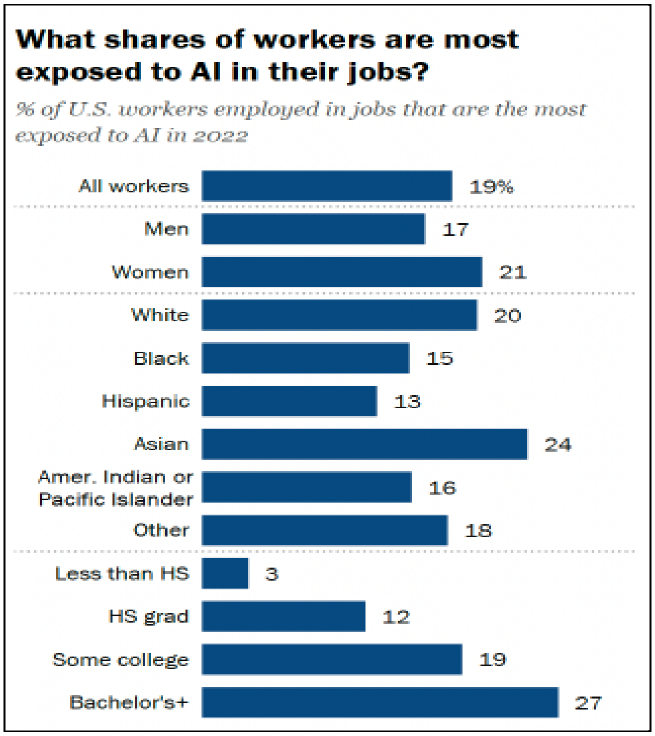
- The USD is likely to remain strong in the near term due to expectations of higher interest rates and faster economic growth in the U.S. than in other major economies. Interest rate swaps suggest that U.S. policy rates will rise faster than most other advanced economies in the coming three months. At the same time, GDP growth is expected to accelerate in the U.S. from an annual rate of 2.2% to 4.9% in the third quarter. In contrast, nowcasts show that the eurozone economy will contract an annualized 0.9% from July to September, and Canada's economy will expand by a scant annual rate of 1.2% in the same period.



- Despite its current strength, the dollar is likely to face some headwinds in 2024. This is because Fed officials expect to cut interest rates at least once next year, while other central banks may keep rates steady or even tighten. As this chart above shows, U.S. policy rates generally rise and fall faster when compared to other advanced economies. The divergence in monetary policy could lead to a period in which other currencies start to gain on the dollar. This may make foreign stocks more attractive, especially as countries start to exit the trough phase of the business cycle.

Unions Against AI: The new labor contract for screenwriters may provide a roadmap of how labor unions can protect themselves against AI.

- [Hollywood screenwriters have ended their five-month strike] against studios and are expected to return to work this week. Under the new agreement, studios are required to disclose [whether material given to them has been sourced from AI,] either partially or in full. AI cannot receive a writer's credit, and AI cannot be used to rewrite scripts. These new rules are the first time that guardrails have been established for this burgeoning technology, and similar agreements are expected to follow. Not long after the agreement, [Hollywood video game actors announced their own strike], seeking further limits on AI.
- The movement to combat the threat of AI is likely to spread to other industries, as workers across the globe become concerned about its potential to displace them. A recent study from [Goldman Sachs suggests that over 300 million jobs may be at risk], and a Pew Research [study found that 27% of jobs that require a bachelor's degrees may also be vulnerable.] This rising fear has led to increased political scrutiny, as governments seek to understand and mitigate the potentially negative impacts of AI. In order to alleviate concerns, President Biden [is expected to release an executive order on AI in the coming weeks.]

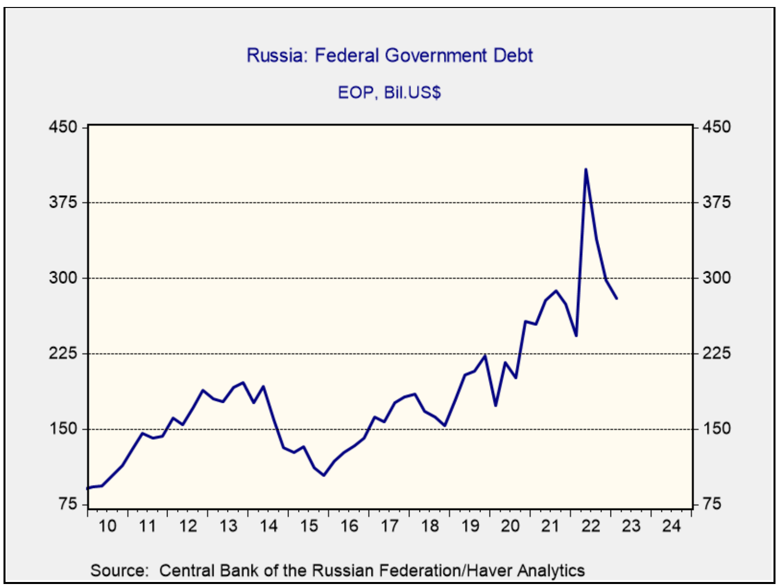


(Source: Pew Research Center)

- Despite its growing significance, the labor struggles against AI have, so far, flown under the radar. During Wednesday's Republican debate, there were few references to the new technology. This is likely to change during the election season, as candidates will be forced to discuss how they plan to mitigate the impact of AI on the job market, while still incentivizing firms to innovate as the U.S. looks to maintain its lead on China in that area. Although AI is likely to offer a lot of productivity gains and make firms more profitable, regulatory uncertainty still makes investment in the space relatively difficult, especially at current valuations.

Russia's Waning Influence: An ally of Moscow was forced to cede territory to a rival after a tumultuous conflict.

- The self-governing Nagorno-Karabakh, an Armenian enclave within a territory internationally recognized as part of Azerbaijan, surrendered to Azerbaijan following a military clash last week, and announced it will dissolve on January 1, 2024. Many Armenian residents were allowed to leave, but some were forced to stay, including billionaire Ruben Vardanyan, who has close ties to the Kremlin. The region, which many believed was under Russian protection, now faces accusations of ethnic cleansing, as locals fear retaliation from their Azerbaijani captors. This situation reflects Russia's inability to enforce the ceasefire that it brokered with Azerbaijan in 2020.
- Russia's reluctance to get involved in conflicts outside of Ukraine may be due to budget constraints. As a result of Western isolation and sanctions, the Kremlin has had trouble funding its expenditures and has been working to reduce its debt burden. The government has been able to lower its debt by around $128 billion since the start of the war, as it adapts to a changing environment. The recent rebound in oil prices has offered the country some relief, but domestic shortages have forced the country to ban exports of certain fuels.



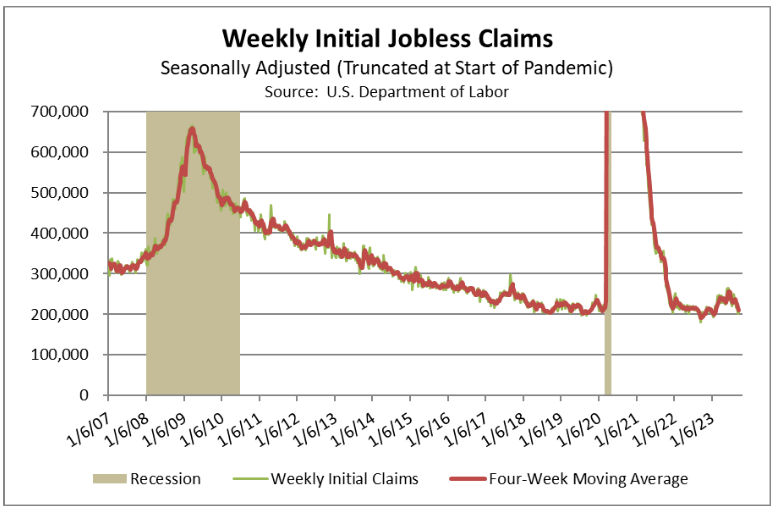
- Russia's waning influence in the Caucasus and Central Asia could create a power vacuum that could be exploited by other actors and potentially lead to increased conflict. Countries such as Georgia and Kazakhstan are likely vulnerable to heightened tensions given the lack of a Russian counterweight. At this time, it appear that China and the U.S. are looking to fill the void left by Moscow, but it isn't clear whether either side can offer the same level of security commitments. An outbreak of violence, particularly in the countries surrounding the Caspian Sea, could further exacerbate commodity uncertainty and drive up oil prices, as the region supplies over 20% of global oil and 26% of global gas supplies. Investors should pay close attention to tensions in this part of the world.

Other stories that made us think:

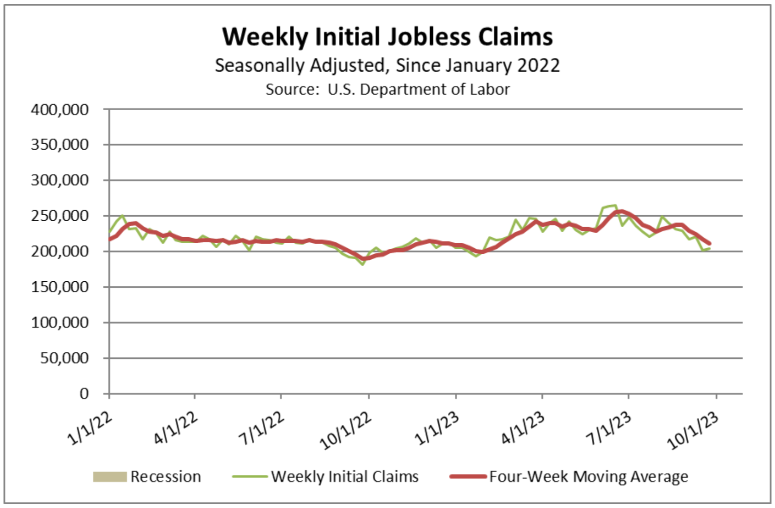
- Why Hasn't the Gold Price Fallen Further?- Bloomberg
- Oil Prices Are Rising. Shale Isn't Coming to the Rescue- *Wall Street Journal*
- Rising headwinds threaten US economy's resilience- *Financial Times*

U.S. Economic Releases

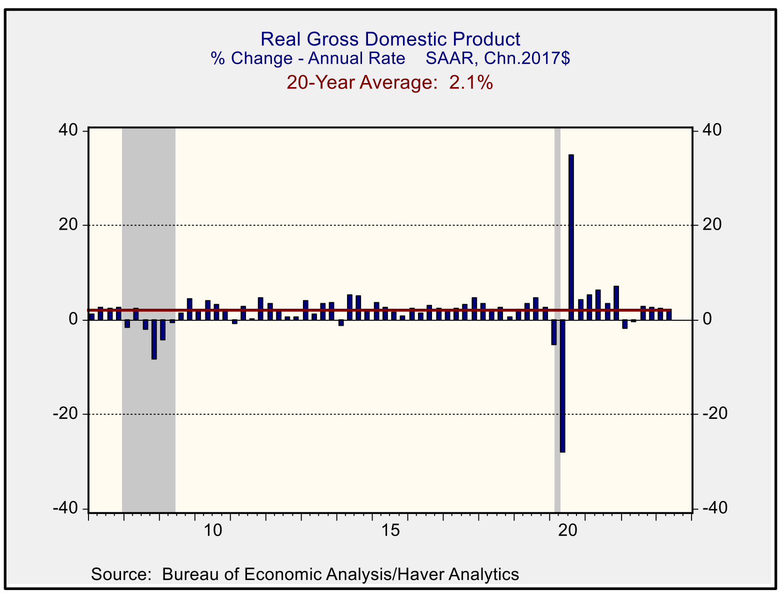
In the week ended September 23, ***initial claims for unemployment benefits*** rose to a seasonally adjusted 204,000, short of the expected level of 215,000 but still slightly higher than the previous week's revised level of 202,000. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, fell to a more than seven-month low of 211,000, suggesting the labor market has recently tightened once again. Meanwhile, in the week ended September 16, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) rose to 1.670 million, short of the anticipated reading of 1.675 million but up from the prior week's revised reading of 1.658 million. The chart below shows how initial jobless claims have fluctuated since just before the Great Financial Crisis. The chart is truncated through much of the pandemic period because of the extremely high level of claims at that time.



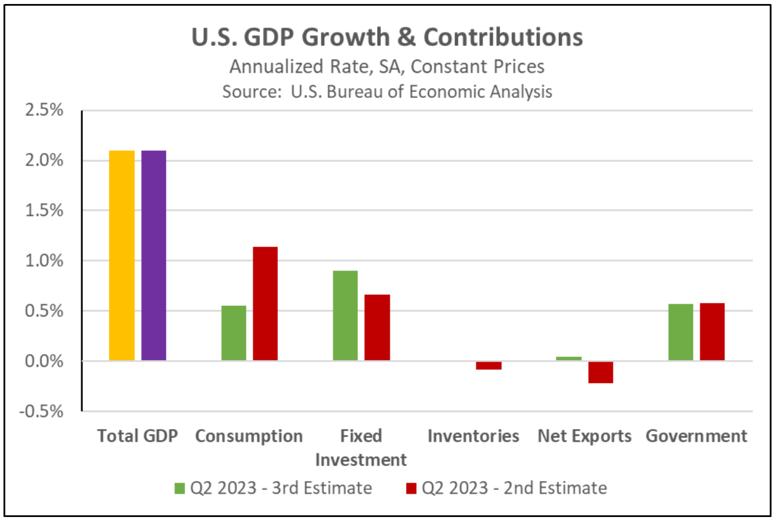
To provide more detail on recent trends, the following chart shows how initial jobless claims have changed just since the beginning of 2022.



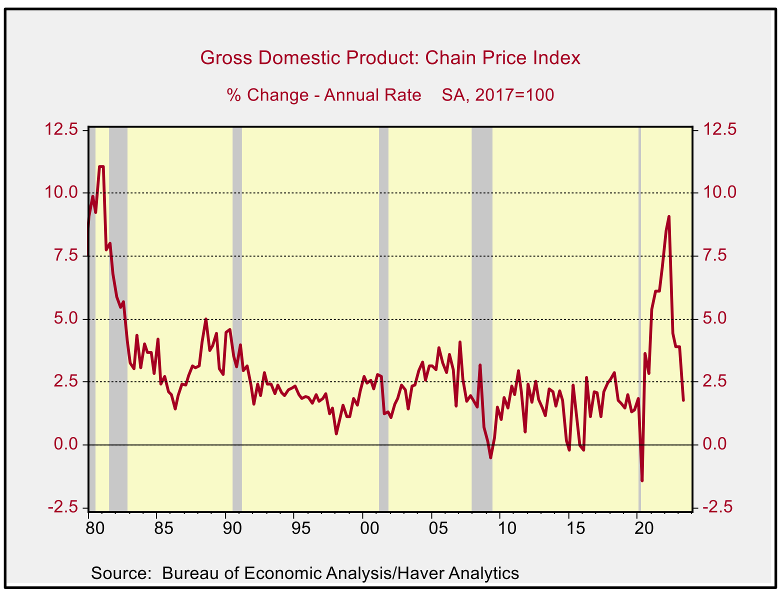
Separately, the Commerce Department released its third and final regular estimate of economic activity in the second quarter of 2023. After stripping out seasonal factors and price changes, second-quarter ***gross domestic product (GDP)*** rose at an annualized rate of 2.1%, matching the previous estimate but coming in slightly worse than expectations that the growth rate would be revised upward to 2.2%. The final growth rate in the first quarter was 2.2%. The chart below shows the annualized growth rate of U.S. GDP since just before the Great Financial Crisis.



A close look at the details in the report shows that the biggest source of growth in the second quarter was fixed investment, especially in new commercial buildings and equipment. The main drags on activity in the quarter were flat inventory investment and very weak growth in net exports. The following chart shows the contributions to the annualized growth rate in the second quarter.



The GDP report also includes the broadest measure of U.S. price inflation. The second-quarter ***GDP Price Index*** rose at an annualized rate of just 1.7%, short of expectations that it would be unchanged at the previous estimate of 2.0%. The chart below shows the year-over-year change in the GDP Price Index over the last several decades.



Finally, we note that the GDP report also included the government's first comprehensive revisions and corrections to the data since 2018. With the revisions extending all the way back to 2013, many economists had expected recent GDP growth rates to be revised significantly downward, based on the way the gross domestic income (the flip side of GDP) has been growing slower than output. From a first glance, however, it appears that the main change was to increase the income data so that it now shows increases more in line with GDP growth. The change in incomes apparently stemmed in large part from wage and salary growth being higher than initially thought. Since the new figures point to stronger economic growth and higher wage growth, they will likely be seen as another reason for the Fed to keep hiking interest rates and/or to keep them high for an extended period.

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
10:00	Pending Home Sales	m/m	Aug	-0.1%	0.9%	**
10:00	Pending Home Sales NSA	y/y	Aug	-13.0%	-13.8%	**
11:00	Kansas City Fed Manfacturing Activity	m/m	Sep	-2	0	*
Federal Reserve						
	No Fed speakers or events for the rest of today					
EST	Speaker or Event	District or Position				
9:00	Austan Goolsbee Speaks at Peterson Institute in Washington	President of the Federal Reserve Bank of Chicago				
13:00	Lisa Cook Speaks at Minorities in Banking Forum	Member of the Board of Governors				
16:00	Jerome Powell Hosts Town Hall With Educators	Chair of the Board of Governors				
19:00	Thomas Barkin Gives Speech on Monetary Policy Outlook	President of the Federal Reserve Bank of Richmond				

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	Foreign Buying Japan Stocks	w/w	22-Sep	-¥3025.3b	-¥1583.9b	-¥1578.4b	*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	22-Sep	-¥6.2.b	¥62.6b		*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	22-Sep	-¥544.4b	¥885.5b	-¥880.9b	*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	22-Sep	-¥2025.1b	¥439.4b	¥435.2b	*	Equity and bond neutral
Australia	Retail Sales	m/m	Aug	0.2%	0.5%	0.3%	**	Equity and bond neutral
New Zealand	ANZ Activity Outlook	m/m	Sep	10.9	11.2		**	Equity and bond neutral
	ANZ Business Confidence	m/m	Sep	1.5	-3.7		**	Equity bullish, bond bearish
EUROPE								
Eurozone	Consumer Confidence	m/m	Sep F	-17.8	-17.8		**	Equity and bond neutral
	Economic Confidence	m/m	Sep	93.3	93.3	93.6	***	Equity and bond neutral
	Industrial Confidence	m/m	Sep	-9.0	-10.3	-9.9	***	Equity bearish, bond bullish
	Services Confidence	m/m	Sep	4.0	3.9	4.3	**	Equity and bond neutral
Germany	CPI	y/y	Sep P	4.5%	6.1%	4.6%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Sep P	4.3%	6.4%	4.5%	**	Equity and bond neutral
Italy	Consumer Confidence	m/m	Sep	105.4	106.5	105.5	***	Equity and bond neutral
	Manufacturing Confidence	m/m	Sep	96.4	97.8	97.7	***	Equity bearish, bond bullish
	Economic Sentiment	m/m	Sep	104.9	106.8	106.7	**	Equity bearish, bond bullish
	PPI	y/y	Aug	-16.1%	-13.8%		**	Equity and bond neutral
Russia	Industrial Production	y/y	Aug	5.4	4.9	4.5	***	Equity bullish, bond bearish
	Retail Sales Real	y/y	Aug	11.0%	10.5%	10.8%	**	Equity and bond neutral
	Unemployment Rate	m/m	Aug	3.0%	3.0%	3.0%	***	Equity and bond neutral
	Real Wages	y/y	Jul	9.2%	10.5%		*	Equity and bond neutral
AMERICAS								
Mexico	Unemployment Rate NSA	m/m	Aug	2.96%	3.13%	3.13%	***	Equity and bond neutral
Brazil	FGV Inflation IGPM	y/y	Sep	-5.97%	-7.20%	-5.97%	***	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	565	0	Up
3-mo T-bill yield (bps)	533	534	-1	Up
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	540	539	1	Up
U.S. Libor/OIS spread (bps)	542	541	1	Up
10-yr T-note (%)	4.65	4.61	0.04	Flat
Euribor/OIS spread (bps)	397	394	3	Up
Currencies	**Direction**			
Dollar	Down			Up
Euro	Up			Down
Yen	Up			Down
Pound	Up			Down
Franc	Up			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
Energy Markets				
Brent	$95.94	$96.55	-0.63%	
WTI	$93.06	$93.68	-0.66%	
Natural Gas	$2.92	$2.90	0.62%	
Crack Spread	$23.32	$23.28	0.17%	
12-mo strip crack	$25.83	$25.80	0.14%	
Ethanol rack	$2.49	$2.49	0.02%	
Metals				
Gold	$1,876.36	$1,875.12	0.07%	
Silver	$22.57	$22.55	0.13%	
Copper contract	$367.70	$363.65	1.11%	
Grains				
Corn contract	$481.75	$483.25	-0.31%	
Wheat contract	$578.75	$579.50	-0.13%	
Soybeans contract	$1,294.00	$1,303.25	-0.71%	
Shipping				
Baltic Dry Freight	1,752	1,694	58	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-2.2	-0.9	-1.3	
Gasoline (mb)	1.0	-0.5	1.5	
Distillates (mb)	0.4	-1.0	1.4	
Refinery run rates (%)	-2.4%	-0.7%	-1.7%	
Natural gas (bcf)		88		

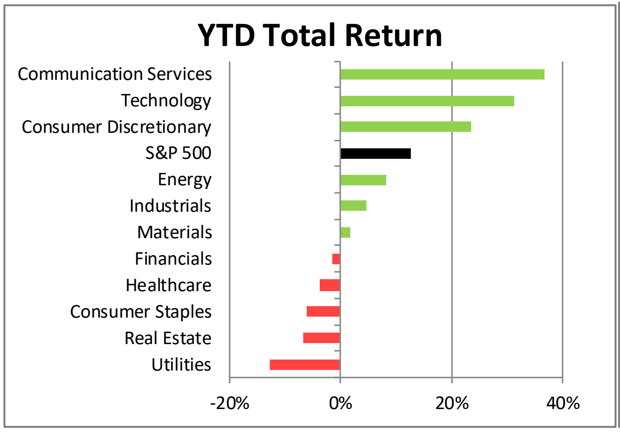
Weather

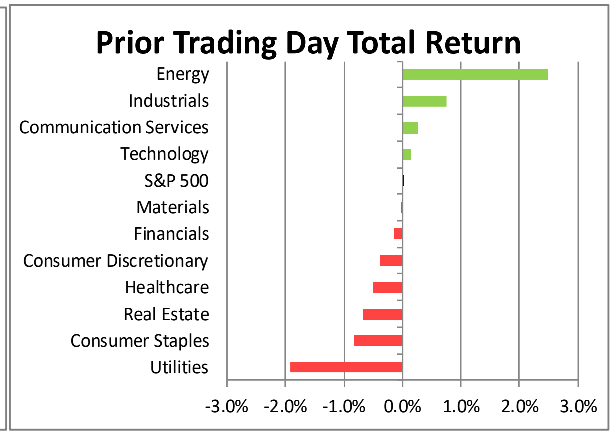
The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures for the entire country from the Great Plains eastward, with cooler-than-normal temperatures throughout the Far West. The forecasts call for wetter-than-normal conditions in the Pacific Northwest, the northern Rocky Mountains,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

Two atmospheric disturbances are now active in the Atlantic Ocean. Tropical Storm Philippe is in the central Atlantic and moving westward toward the Caribbean islands. There is also a disturbance to the southeast of Philippe that is assessed to have 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 9/27/2023 close)

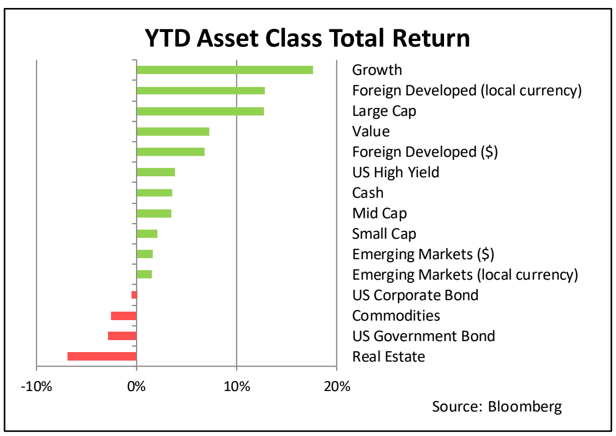




(Source: Bloomberg)

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 9/27/2023 close)

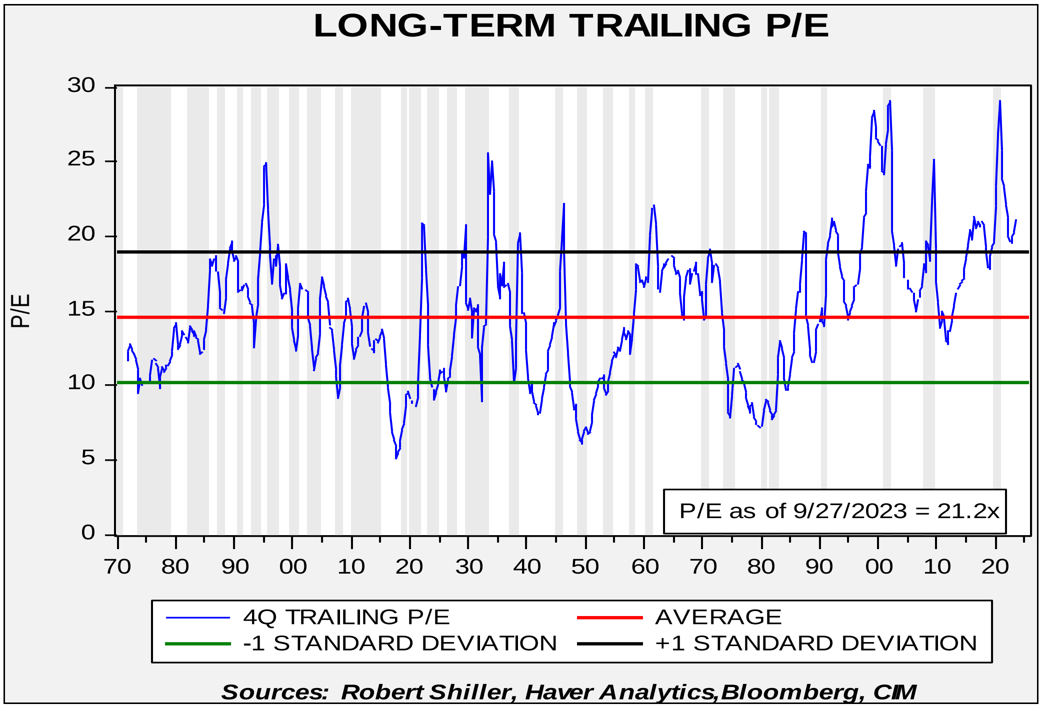


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 28, 2023



Based on our methodology,[1] the current P/E is 21.2x, 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.