

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 2, 2021—9:30 AM EDT]** Global equity markets are higher this morning. In Europe, the EuroStoxx 50 is up 0.1% from its prior close. In Asia, the MSCI Asia Apex 50 closed up 0.2%. Chinese markets were higher, with the Shanghai Composite up 0.8% from its prior 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:

- [Weekly Geopolitical Report](#) (8/30/2021): “A Storm Before the Calm: A Review”
- [Weekly Energy Update](#) (9/2/2021): **OPEC+ increases output as expected, and we begin tracking the impact of Hurricane Ida.**
- [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](#) (8/27/2021) (with associated [podcast](#)): we look at the composition of the FOMC and the history of monetary policy in past recoveries, focusing on job recoveries
- [Confluence of Ideas podcast](#) (7/7/2021): “The Geopolitics of Taiwan and the Issue of Globalization”

Good morning. As the markets wind down before the holiday weekend, [U.S. equity futures continue to grind higher](#). [Hurricane Ida is leaving the U.S.](#) but not [before causing flooding in New York City](#). Our coverage begins with Afghanistan. China is up next, followed by economics and policy. The international roundup precedes our pandemic coverage.

**Afghanistan:** The world begins the next phase of the Afghan situation, which is the political fallout and the Taliban’s attempt at governance.

- With the evacuation essentially over, the aftermath begins. The administration will [face months of Congressional scrutiny](#) and may find some of it coming from Democrats. The withdrawal was [viscerally opposed by the foreign policy establishment of both parties](#). One area of investigation will be [who was left behind](#) and what should be done about it.
- Meanwhile, the Taliban, [who has proven adept in taking power](#), now faces the daunting task of governing. Capital flight and aid restrictions have created a cash shortage; [remittances have become increasingly difficult](#) as money transfer firms have stopped moving cash. The Taliban hasn’t established a governance structure yet, [although it says](#)

[it will soon](#). The current supreme leader, [Hibatullah Akhundzada](#), is more of a religious figure and has kept a low profile. It isn't clear if he intends to rule or play the role of kingmakers. [Groups from Qatar have been sent to Kabul to help reopen the airport](#), which will be critical for the economy.

- The withdrawal from Afghanistan is yet another example that the U.S. isn't all that concerned about Europe. EU leaders, for the most part, welcomed Biden's election, seeing it as a return to normal relations. But, as is often the case, the focus is improperly on leaders instead of trends. The simple fact is that the U.S. isn't all that interested in Europe anymore, as shown by the decision to leave Afghanistan without consulting the EU. Europe finds itself terribly dependent on the U.S. for security and [now isn't sure if it can rely on that security anymore](#). The obvious response is EU rearmament, but the nation most likely to lead that effort is Germany. Anyone with any knowledge of history should view that outcome with some degree of concern.

**China:** There are worries over an unnecessary military confrontation, credit market worries are rising, and Xi continues to portray himself as a decisive leader.

- China has issued a new rule requiring vessels entering the South China Sea to register with Beijing. The U.S. opposes the rule, calling it a "[serious threat](#)" to freedom of navigation. China has claimed almost all of the South China Sea, which the U.S. opposes. Former military leaders warn that [military-to-military communications are inadequate](#), which creates conditions for an unwanted confrontation.
- China's credit markets have been an area of concern for some time. Rapid growth in credit has been shown to be a risk factor. Since 2009, China's non-financial corporate debt has increased by an average of 12.9% per year, compared to the U.S., at 4.5%. The collapse of China Evergrande (EGRNF, USD, 0.53) has [warned that construction on some projects has been halted](#), increasing the [odds of default](#). Although we haven't seen a clear indication that the stoppages have occurred due to concerns regarding payment, we suspect that this may be the case.
  - China Evergrande isn't the only company in trouble. Huarong (2799, HKD, 1.02) has [released a report on its \\$16 billion losses from last year](#). The report had been delayed by four months, prompting concerns that the firm was failing. [State-owned companies](#) have been [drafted into a bailout plan](#).
  - Problems at these firms have led investors to [avoid Chinese high-yield debt](#).
- We are hearing a steady undercurrent that [General Secretary Xi](#) is bringing a "[profound transformation](#)" of China. [Xi appears to have aspirations](#) of being the next Mao and Deng. So far, it isn't completely clear what this change means, although we are getting signs that it likely means slower economic growth with less inequality. In addition, he is pressing for the centralization of the party; the individual initiative is getting quashed. There is a [recent case of a student being arrested for researching Chinese labor movements](#), while at the same time, Didi (DIDI, USD, 9.20) JD.com (JD, USD, 80.78) [recently agreed to establish unions](#). These examples suggest the CPC doesn't oppose unionization as long as it is led by the party. It appears Xi is emulating Mao, not Deng.

- Although it is becoming clear that relations with China are deteriorating, multinational firms with supply chains in [China are pushing back against the break with Beijing](#). They want the Biden administration to remove tariffs and [provide “clarity” on the relationship](#). We suspect they are facing a lost cause.
- The CPC has shut down the tutoring industry with the goal of reducing stress for households. This move has solved little for most households. If anything, [it has made conditions worse](#), as parents still worry that their children won’t get ahead and now lack the tools to give their offspring a leg up.
- The African Swine flu, a deadly disease for pigs, ravaged China’s pork industry last year. Indications are that in its wake, the supply disruption [has changed consumption patterns](#), leading to what may be lasting demand destruction.

**Economics and policy:** Bitcoin may no longer represent the crypto space and more trouble for tech.

- For a long time, bitcoin was considered a proxy for all cryptocurrencies. That may not be the case much longer. The expansion of crypto assets is leading to fewer funds flowing to bitcoin. The lack of price momentum in bitcoin [is masking strong price increases in other parts of the space](#). We view the entire crypto space as a reaction against currency debasement. Our expectation is that, over time, governments will snuff out this avenue of debasement protection, similar to the way the Roosevelt administration made it illegal to hold gold.
  - Investors considering this space should note that the area is mostly unregulated. The fraud seen in financial markets in the past, which happened infrequently in regulated markets, is a [common occurrence in the crypto space](#).
- The [DOJ is preparing to sue Google](#) (GOOGL, USD, 2904.31) over its dominance in digital advertising. This is the second lawsuit on this issue against the company.
- Major tech firms in the U.S. and China are moving into the chipmaking business, although this effort [appears to be more about design than manufacturing](#). The goal is to make custom chips for their hardware, which will allow them to create better products.
- Modi’s increasing authoritarian tendencies [are creating problems for U.S. tech firms](#)

**International roundup:** The ECB is considering tapering and the Scots make noise about independence.

- Some ECB members are pushing for tapering. Although the leadership isn’t leaning that direction, we suspect the Europeans will probably, at some point, start following the Fed on this issue. [European bond markets are preparing](#) for the [slowdown in buying](#).
- The new government in Tehran has shown little interest in restarting nuclear talks. However, there are [reports that discussions may resume soon](#). We still harbor strong doubts the agreement can be revived.
- The Scottish National Party (SNP), which supports independence from the U.K., currently runs a minority government in the region. [It recently added two Green party members](#) to the government. The Greens support independence and this development will be a problem for Boris Johnson.

- The SNP has indicated it won't allow nuclear weapons to be stored on its soil if it gains independence. The [U.K. may be forced to move its nuclear submarines](#) to the U.S. or France if they can't remain in Scotland.
- Brexit-related supply problems are becoming critical; there are [reports that beer supplies are running low](#).
- President Biden met with Ukrainian President Zelensky yesterday. [Although Biden attempted to assure the Ukrainian leader of U.S. support](#), we suspect Zelensky remains concerned. [The U.S. did commit to \\$60 million of military aid](#).

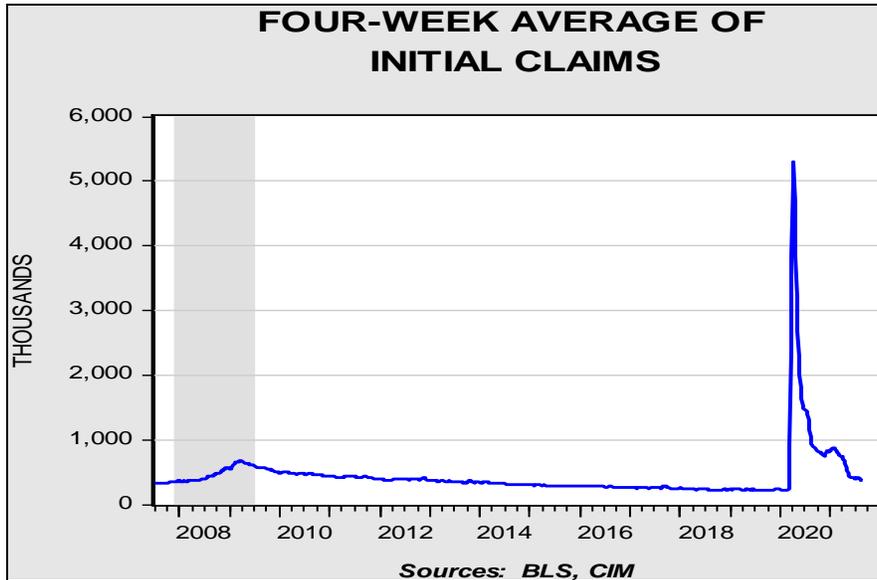
**COVID-19:** The [number of reported cases](#) is 218,516,990, with 4,544,777 fatalities. In the U.S., there are 39,399,080 confirmed cases with 642,093 deaths. For illustration purposes, the *FT* has created an [interactive chart](#) that allows one to compare cases across nations using similar scaling metrics. The *FT* has also issued an [economic tracker](#) that looks across countries with high-frequency data on various factors. The [CDC reports](#) that 443,741,705 doses of the vaccine have been distributed, with 371,280,129 doses injected. The number receiving at least one dose is 205,527,578, while the number receiving second doses, which would grant the highest level of immunity, is 174,600,017. For the population older than 18, 63.6% of the population has been vaccinated. The *FT* has a page on [global vaccine distribution](#). Although some of the southern states are seeing a decline in cases, [the majority of states are reporting increases](#).

- Recent polling is showing evidence that [vaccine hesitancy is weakening](#). It appears the combination of [FDA approval and vaccine mandates](#) by companies are slowly leading to more vaccine acceptance.
  - [Studies from Israel support booster shots](#).
- Each surge in infections tends to be followed by falling cases. There are multiple reasons behind this outcome. Rising cases lead to increased caution. As infections rise, the disease can find fewer victims. Weather plays a role. As temperatures cool and crowds move outdoors, the virus has less opportunity to circulate. [We could see a decline in cases in the coming weeks in the U.S.](#) resulting from all these factors.
- Vaccination does not grant complete immunity. Those vaccinated are infected, and some suffer symptoms. However, there is evidence that these “breakthrough” cases are not as severe. And, it also appears that the vaccinated are [less likely to suffer from “long COVID” cases](#).
- Although children have been less affected by COVID-19, there are cases where kids suffer inflammatory complications, called [MIS-C](#). A U.K. study suggests that for those children who came down with these complications, [there were no long-term medical issues](#).
- Rising cases in Asia are leading to [supply disruptions in factories](#) there. The surge is threatening the [manufacturing of parts for key consumer electronics](#).

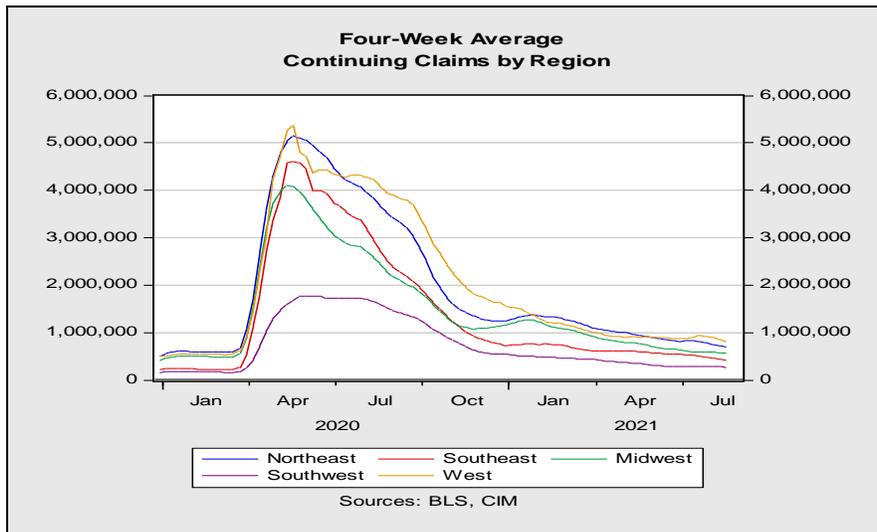
## U.S. Economic Releases

The number of job cut announcements continues to be well below last year's level, as firms are reluctant to lay off workers in a relatively tight market. According to the global outplacement firm Challenger, Gray & Christmas, job cut announcements fell 86.4% from the previous year.

In other news, jobless claims declined slightly from the previous week. Initial jobless claims came in at 340K compared to expectations of 345K. The previous report was revised from 353K to 354K. Continuing claims came in at 2.748MM compared to expectations of 2.775MM. The previous report was revised from 2.862MM to 2.908MM.

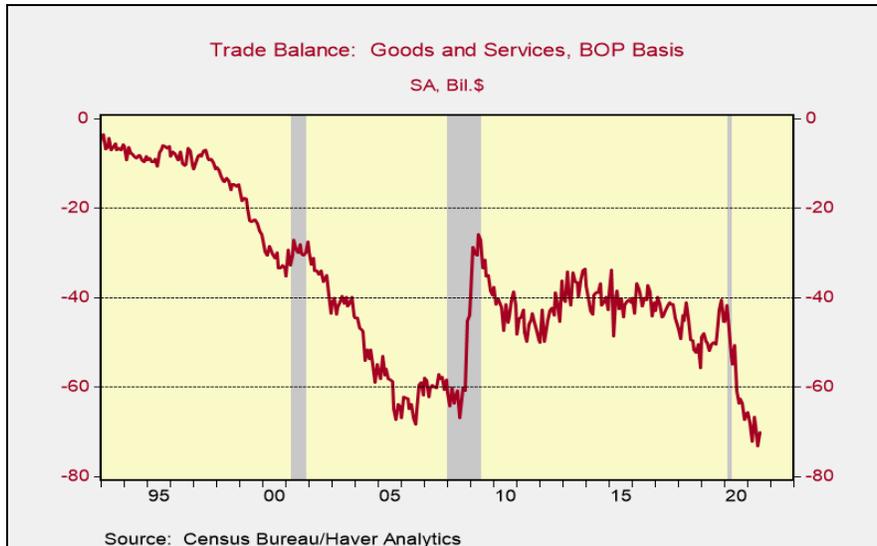


The chart above shows the four-week moving average of initial claims. The four-week average fell from 366.75K to 355.00K.



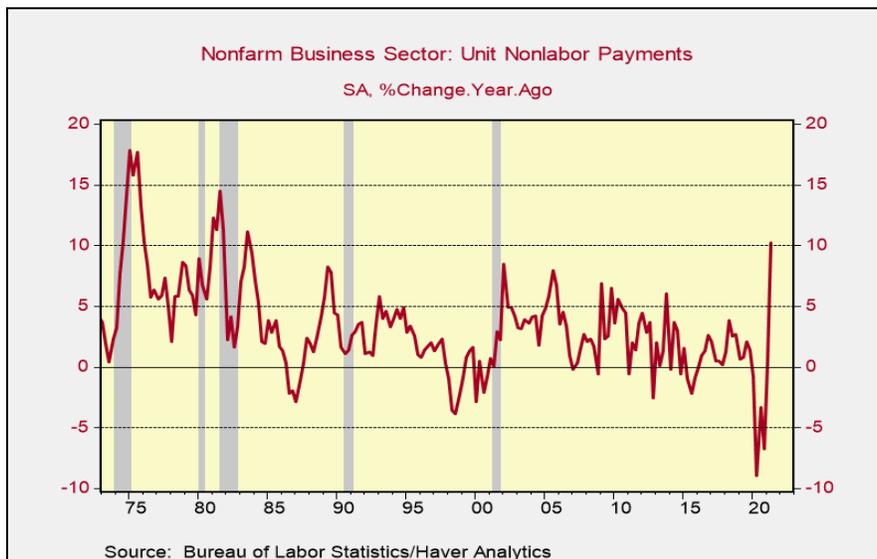
The above chart shows the four-week moving average of continuing claims by region.

In trade news, the U.S. trade deficit narrowed in August, as supply chains problems contributed to a decline in imports. The trade deficit came in at \$70.1B compared to expectations of \$70.9B. The prior report was revised from \$75.7B to \$73.2B.



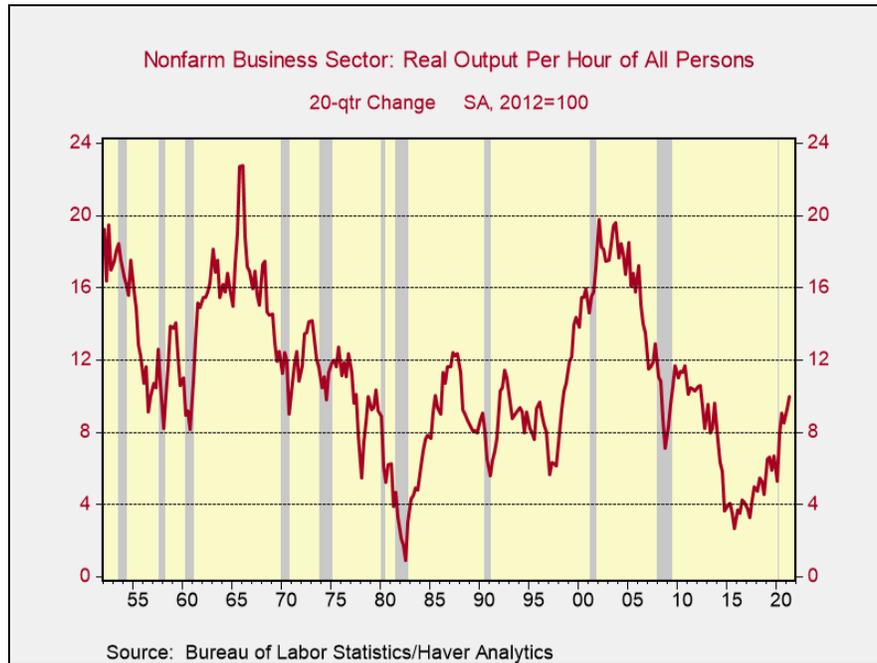
The chart above shows the level of the U.S. trade balance.

Lastly, U.S. non-farm productivity rose at a slower than expected pace, as firms struggle to make do with rising material costs. U.S. nonfarm productivity expanded at an annual pace of 2.1% in the second quarter. This was below expectations of a rise of 2.5%. Unit labor costs rose at an annual pace of 1.3% in the second quarter, above expectations of a 1.0% rise.



The chart above shows the annual change in the unit non-labor costs. The rise in materials has led to a near 30-year high spike in unit non-labor costs.

At the same time, the underlying trend in productivity is rising. The five-year change in productivity is showing a clear uptrend.



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
9:45	Langer Consumer Comfort	w/w	29-Aug		57.2	***
10:00	Factory Orders	m/m	Jul	0.3%	1.5%	**
10:00	Factory Orders Ex Trans	m/m	Jul	0.5%	1.4%	**
10:00	Durable Goods Orders	m/m	Jul	-0.1%	-0.1%	**
10:00	Durables Ex Transportation	m/m	Jul	0.7%	0.7%	**
10:00	Cap Goods Orders Nondef Ex Air	m/m	Jul	0.0%	0.0%	**
	Cap Goods Ship Nondef Ex Air	m/m	Jul		1.0%	**
Fed Speakers or Events						
EST	Speaker or event	District or position				
13:00	Raphael Bostic Discusses Creating an Economic Opportunity	President of the Federal Reserve Bank of Atlanta				
14:00	Mary Daly Takes Part in Webinar on an Inclusive Economy	President of the Federal Reserve Bank of San Francisco				

## 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>								
<b>Japan</b>	Vehicle Sales	y/y	Aug	4.4%	3.3%		**	Equity and bond neutral
	Monetary Base	y/y	Aug	14.9%	15.4%		***	Equity and bond neutral
<b>Australia</b>	Trade Balance	m/m	Jul	A\$12117m	A\$10496m	A\$10000m	**	Equity bullish, bond bearish
	Home Loans Value	m/m	Jul	0.2%	-1.6%	-0.2%	**	Equity bullish, bond bearish
	Owner-Occupier Loan Value	m/m	Jul	-0.4%	-2.5%	-3.0%	**	Equity and bond neutral
	Investor Loan Value	m/m	Jul	1.8%	0.7%		**	Equity bullish, bond bearish
<b>New Zealand</b>	Terms of Trade Index	q/q	2Q	3.3%	0.1%	0.3%	**	Equity bullish, bond bearish
<b>EUROPE</b>								
<b>Eurozone</b>	PPI	y/y	Jul	12.1%	10.2%	11.1%	**	Equity bearish, bond bullish
<b>Switzerland</b>	CPI	y/y	Aug	0.9%	0.7%	0.7%	***	Equity and bond neutral
	CPI EU Harmonized	y/y	Aug	0.8%	0.5%		***	Equity and bond neutral
	CPI Core	y/y	Aug	0.4%	0.2%	0.3%	***	Equity and bond neutral
	Retail Sales Real	y/y	Jul	-2.6%	0.1%		***	Equity bearish, bond bullish
<b>Russia</b>	Unemployment Rate	m/m	Jul	4.5%	4.8%	4.8%	***	Equity bullish, bond bearish
	Retail Sales Real	y/y	Jul	4.7%	10.9%	5.0%	***	Equity bullish, bond bearish
	Real Wages	y/y	Jun	4.9%	3.3%	2.9%	**	Equity bullish, bond bearish
	CPI	w/w	30-Aug	0.1%	0.1%		***	Equity and bond neutral
<b>AMERICAS</b>								
<b>Brazil</b>	FGV CPI IPC-S	w/w	31-Aug	0.7%	0.8%	0.7%	***	Equity and bond neutral
	GDP	y/y	2Q	12.4%	1.0%	12.7%	**	Equity and bond neutral
	Markit Brazil PMI Manufacturing	m/m	Aug	53.6	56.7		***	Equity and bond bullish
	Trade Balance Monthly	m/m	Aug	\$7665m	\$7395m	\$7500m	**	Equity and bond neutral
	FIPE CPI - Monthly	m/m	Aug	1.4%	1.0%	1.4%	***	Equity and bond neutral
<b>Mexico</b>	Remittances Total	m/m	Jul	\$4540.3m	\$4440.0m	\$4310.0m	**	Equity and bond neutral
	Markit Mexico PMI Mfg	m/m	Aug	47.1	49.6		**	Equity bearish, bond bullish
	IMEF Manufacturing Index SA	m/m	Aug	51.3	52.2		**	Equity and bond neutral
	IMEF Non-Manufacturing Index SA	m/m	Aug	50.1	52.9		***	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.

	Today	Prior	Change	Trend
<b>3-mo Libor yield (bps)</b>	12	12	0	Down
<b>3-mo T-bill yield (bps)</b>	2	4	-2	Neutral
<b>TED spread (bps)</b>	10	8	2	Neutral
<b>U.S. Libor/OIS spread (bps)</b>	7	8	-1	Down
<b>10-yr T-note (%)</b>	1.29	1.30	-0.01	Down
<b>Euribor/OIS spread (bps)</b>	-55	-55	0	Neutral
<b>EUR/USD 3-mo swap (bps)</b>	2	2	0	Down
<b>Currencies</b>	<b>Direction</b>			
dollar	Down			Down
euro	Up			Up
yen	Flat			Neutral
pound	Up			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.

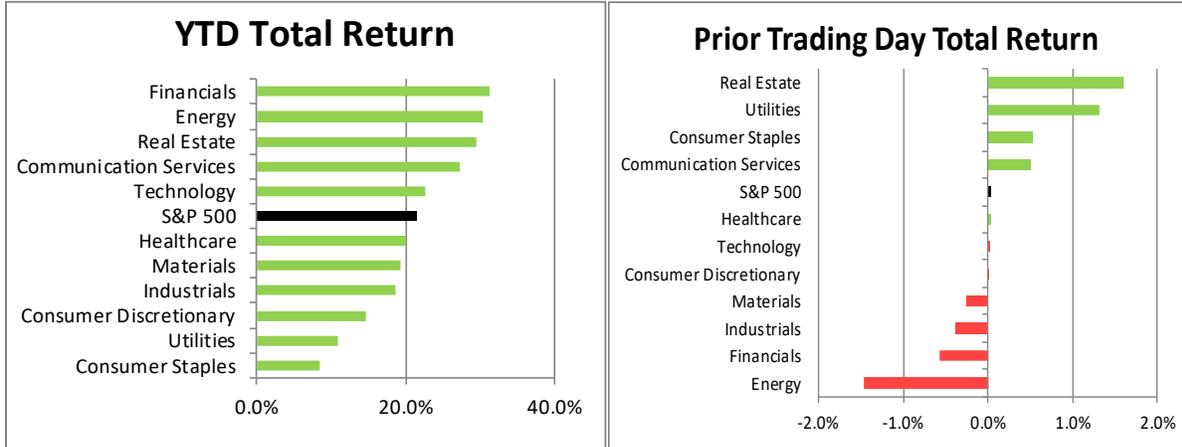
	Price	Prior	Change	Explanation
<b>Energy Markets</b>				
Brent	\$71.92	\$71.59	0.46%	
WTI	\$68.90	\$68.59	0.45%	
Natural Gas	\$4.64	\$4.62	0.50%	
Crack Spread	\$20.31	\$20.46	-0.70%	
12-mo strip crack	\$20.12	\$20.18	-0.30%	
Ethanol rack	\$2.40	\$2.41	-0.17%	
<b>Metals</b>				
Gold	\$1,816.41	\$1,813.90	0.14%	
Silver	\$24.20	\$24.14	0.26%	
Copper contract	\$428.45	\$427.80	0.15%	
<b>Grains</b>				
Corn contract	\$ 517.50	\$ 522.75	-1.00%	
Wheat contract	\$ 711.50	\$ 714.25	-0.39%	
Soybeans contract	\$ 1,273.00	\$ 1,277.75	-0.37%	
<b>Shipping</b>				
Baltic Dry Freight	4013	4132	-119	
<b>DOE inventory report</b>				
	<b>Actual</b>	<b>Expected</b>	<b>Difference</b>	
Crude (mb)	-7.2	-2.5	-4.7	
Gasoline (mb)	1.3	-1.5	2.8	
Distillates (mb)	-1.7	-0.5	-1.2	
Refinery run rates (%)	-1.10%	0.50%	-1.60%	
Natural gas (bcf)		25.0		

## Weather

The 6-10 day and 8-14 day forecasts currently call for warmer-than-normal temperatures for most of the country, with cooler temperatures in the Northern Pacific, New England, and Midwest regions. The forecast calls for wetter-than-normal conditions in the Pacific and New England regions. Tropical Depression Ida has been downgraded to a Post-Tropical Cyclone. There are two other cyclonic disturbances far out in the Atlantic Ocean. One has developed into a hurricane far into the Atlantic Ocean, and the other has made its way onto the Yucatan Peninsula. On average, hurricane activity peaks on September 10.

**Data Section**

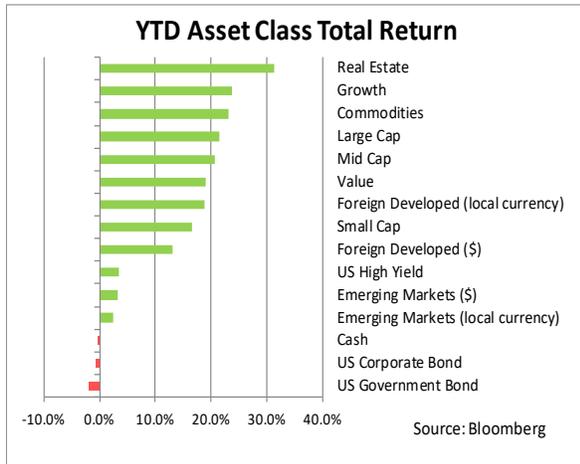
**U.S. Equity Markets – (as of 9/1/2021 close)**



(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 9/1/2021 close)**

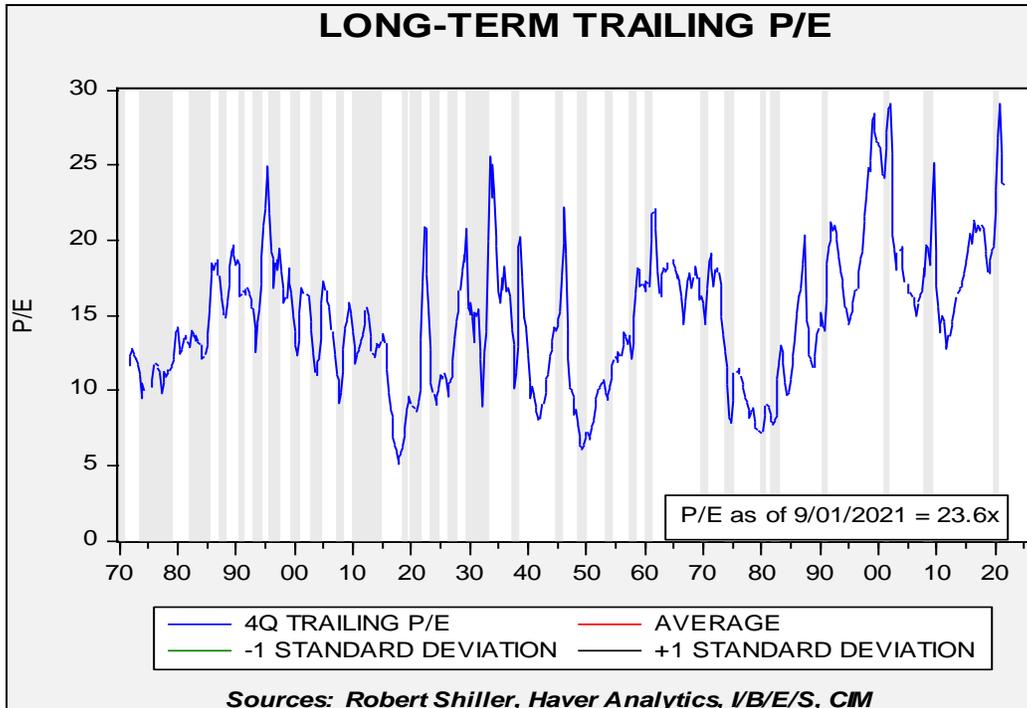


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 2, 2021



Based on our methodology,<sup>1</sup> the current P/E is 23.6x, up 0.1x from last week. Higher index values 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 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.