# 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.*
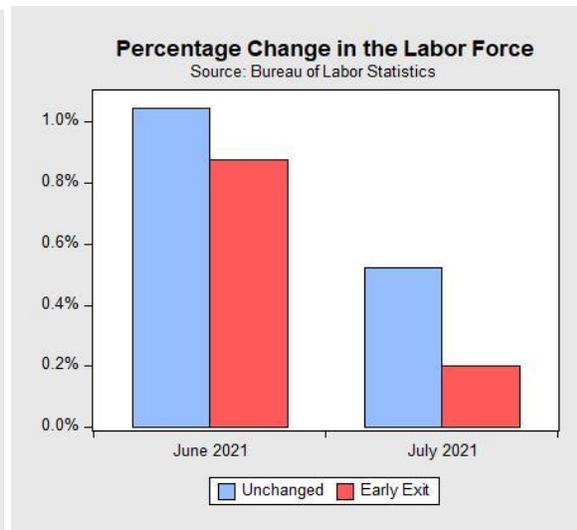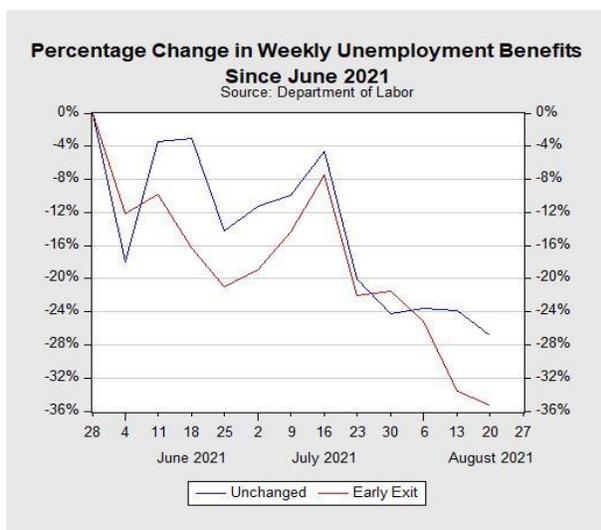
**[Posted: September 3, 2021—9:30 AM EDT]** Global equity markets are mixed this morning. In Europe, the EuroStoxx 50 is currently down 0.2% from its prior close.  In Asia, the MSCI Asia Apex 50 closed up 0.1%.  Chinese markets were lower, with the Shanghai Composite down 0.4% from its prior close and the Shenzhen Composite down 0.6%.  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 (9/3/2021) (no podcast episode this week): we look at profits relative to GDP and whether the surge in profits is sustainable**
- *Confluence of Ideas* podcast (7/7/2021): "The Geopolitics of Taiwan and the Issue of Globalization"

Good morning! U.S. equity futures are signaling a higher open this morning. Today's report begins with a discussion about the labor shortage and an update on Hurricane Ida. International news is up next. We cover U.S. economics and policy news, including details about the spending bill.  China news follows, and we end the report with our pandemic coverage.

**Labor shortage:** Next week, the enhanced unemployment benefits are set to expire nationwide. A massive labor shortage has led many to suspect that ending these benefits could lead to a surge of new entrants into the labor market. However, data released from the Bureau of Labor of Statistics suggests that this expectation may not happen. In June and July, roughly half of the states in the country exited the program that funded the enhanced unemployment benefits. Although the exiting states saw a sharper decline in the number of initial claims filed compared to the states that remained in the program, these states also had a slower increase in the number of workers entering the labor force.

**Percentage Change in Weekly Unemployment Benefits Since June 2021**
Source: Department of Labor

**Percentage Change in the Labor Force**
Source: Bureau of Labor Statistics

It should be worth noting that the time frame is too short to make any concrete conclusions. However, if the trend holds, it will likely mean that firms may have to increase their wages in order to attract more talent. In fact, there is growing evidence that firms have already begun to do so. Some firms that have been reluctant to raise wages have pressured the government to relax visa requirements to help resolve the worker shortage. Recently, fleet operators have petitioned Washington to allow more foreign operators into the country in order to resolve the shortage of truck drivers. If labor market conditions continue to show evidence of being rigid and tight, it will support the possibility of longer-term inflation. In this event, the Federal Reserve could become more assertive as it attempts to remove policy accommodation.

**Hurricane Ida:** Hurricane Ida continues to cause damages throughout the country. In the Northeast, there were over 45 deaths due to floods related to the storm.  In response to the mounting damages to property as well as temporary disruptions to businesses, the government has offered some support. The U.S. Energy Department announced that it will release 1.5 billion barrels of crude oil from the Strategic Petroleum Reserve to mediate price pressures. Meanwhile, the Federal Emergency Management Agency (FEMA) is expected to use funds to help local victims of the disaster. As of right now, departments have been able to meet the needs of regions impacted by the storm. However, as the costs of damages become more apparent, Congress will likely fight over additional assistance which could lead to further delays in President Biden's economic agenda.

**International news:**

- Japanese Prime Minister Yoshihide Suga announced that he will not run for reelection as party leader for the Liberal Democratic Party, effectively ending his term a year after he took office. Suga's popularity took a hit due to his handling of a recent wave of coronavirus cases and the Olympics. Two recent polls showed that support for the prime minister had fallen to historic lows, likely playing a part in his decision to step down. Following his departure, elections will be held sometime before November 28. At this time, his party is expected to maintain its majority. Suga's expected predecessor is unlikely to drastically alter the country's foreign policy, such as its relationship with the

U.S. That being said, his departure is reminiscent of a period throughout the 1990s and late aught years when prime ministers in Japan changed nearly every year. If this were to happen again, it will likely weaken Japan's presence on the world stage at the exact time that its chief rival, China, grows in prominence.

- Poland declared a state of emergency along two of its borders following a series of border crossings by Belarusian immigrants. The spike in migration comes as Belarus attempts to use the threat of mass migration as a way to put pressure on the European Union to lift sanctions imposed on Minsk.

- Mexican President Andres Manuel Lopez Obrador is trying to work out a deal with President Biden that will help ease the migrant crisis both countries are experiencing. The deal will involve providing work visas for these immigrants to help with reforestation efforts in the U.S.

- Russian regulators threatened to fine Apple (AAPL, $153.65) and Google (GOOGL, $2,865.74) if the companies do not remove an app that is associated with jailed opposition leader Alexei Navalny. The crackdown represents the growing pushback the tech industry is facing globally as governments seek to reduce tech companies' influence throughout their respective countries.

- The Scottish National Party has announced that it will not allow the U.K. to keep its nuclear arsenal in Scotland if the country votes to secede. The announcement means the U.K. will have to find a new location for its weapons. Australia, the U.S., and France are all being considered.

- The Pentagon announced on Friday that it is possible the U.S. may work with the Taliban in the fight against ISIS-K. It is also believed to be pressuring Pakistan to support the cause as well.

- Italian Prime Minister Mario Draghi has stated that he is not interested in running for president.

**Economics and policy:**
- The Democrats are struggling to come to terms with the $3.5 billion spending bill. Key vote and notable moderate Senator Joe Manchin (D-WV) has pushed for the party to "hit the pause button" on the spending bill as the government deals with inflation and the Afghan evacuation crisis.

- Fifty percent of small business firms have reported that they are having trouble filling open positions, according to the National Federation of Independent Business. Many of these firms have opted to raise wages in order to lure workers.

- Approval of labor unions rose to a nearly sixty-year high, according to the Gallup poll released on Thursday. The poll showed that 68% of Americans approve of unions, the highest recorded since 1965 when 71% of Americans approved of them. The growing popularity of unions highlights the increasing frustration with rising income inequality.

**China:**
- Chinese President Xi Jinping announced a proposal for a new stock exchange in Beijing designed to help small businesses. The measure will attempt to reduce the country's dependence on debt for financing by encouraging firms to rely more on their equity.

- China's media regulator has announced [a boycott of what it referred to as "sissy idols" in favor of celebrities who exhibit more traditional "macho" stereotypes](#). The change comes as regulators are pushing the country's entertainment industry to emphasize more traditional Chinese culture.

**COVID-19:** The [number of reported cases](#) is 219,126,141 with 4,542,726 fatalities. In the U.S. there are 39,550,163 confirmed cases with 643,683 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 445,672,595 doses of the vaccine have been distributed with 372,116,617 doses injected. The number receiving at least one dose is 205,911,640, while the number of second doses, which would grant the highest level of immunity, is 174,973,937. The *FT* has a page on [global vaccine distribution](#).

- The World Health Organization is [tracking a new coronavirus strain called Mu](#). The variant was first discovered in Colombia in January. Preliminary data collected by the WHO suggest the vaccines may not be as strong against the Mu variant.
- The White House's plan to have the third vaccine shot approved by September 20 [has been met with resistance](#) from the Food and Drug Administration and Centers for Disease Control and Prevention. The two departments overseeing the approval process have accused the Biden administration of placing politics over process in its push to have a vaccine ready by its self-imposed deadline.
- Hospitals are struggling to [deal with critical patients due to a surge in COVID cases](#).
- The rise in COVID cases has led to an oxygen shortage. Firms have had to curtail production as a result, including a [Texas oil refinery that was forced to restrict operations](#).

**U.S. Economic Releases**

In today's key economic release, August nonfarm payrolls rose by a seasonally adjusted 235,000, far short of both the expected gain of 733,000 and the revised July increase of 1.053 million. An initial look at the data suggests the weakness was mostly in the private-sector service industry as might be expected with the spread of the Delta variant of the coronavirus and some businesses' continued difficulty in finding workers. The chart below shows how nonfarm payrolls have grown since just before the prior recession.

## U.S. Nonfarm Payrolls
### Seasonally Adjusted
Source: U.S. Dept. of Labor
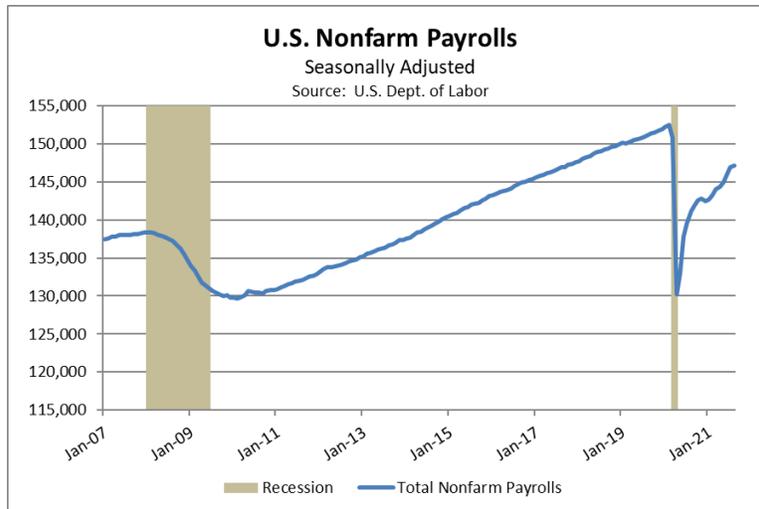


Despite the weak gain in jobs, the August unemployment rate came in at a seasonally adjusted 5.2%, matching expectations but down from the July jobless rate of 5.4%. Although more than half a million new workers entered the job market in August, more than half that number was offset by unemployed workers finding jobs. The chart below shows the fluctuations in the unemployment rate since right before the prior recession.

## U.S. Unemployment Rate
### Seasonally Adjusted
Source: U.S. Dept. of Labor
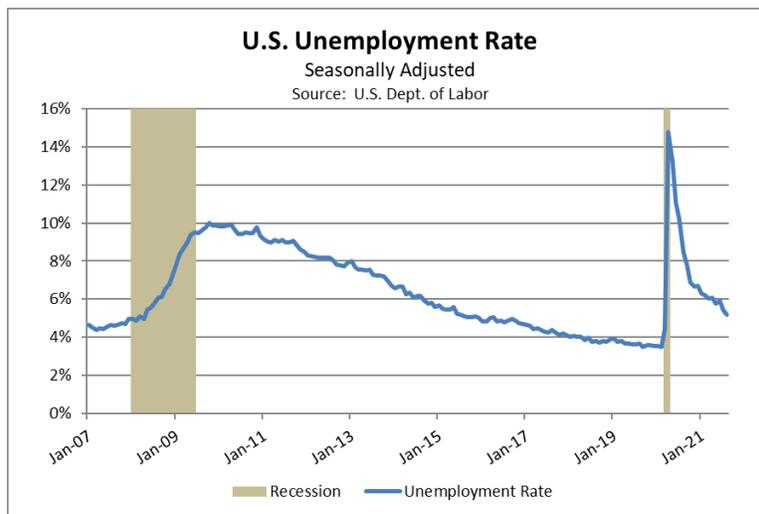


Another key indicator in the report showed that the August labor force participation rate was unchanged at 61.7% compared with an expected increase to 61.8%. While the continued shortfall in payrolls compared with the pre-pandemic period would suggest there is plenty of slack in the labor market, the falling unemployment rate and the continued low level of labor force participation suggests the labor market may be tighter than some observers think. An especially important issue is whether the legions of baby boomers who left the labor force during the pandemic will ever come back. If they remain retired or otherwise not working, labor supply will likely remain constrained, putting upward pressure on labor costs and encouraging some Fed policymakers to push for faster monetary tightening. The chart below shows the labor force participation rate since just before the prior recession.

**Labor Force Participation Rate**
Employed + Unemployed / Adult Civilian Non-Inst. Population, SA
Source: U.S. Dept. of Labor
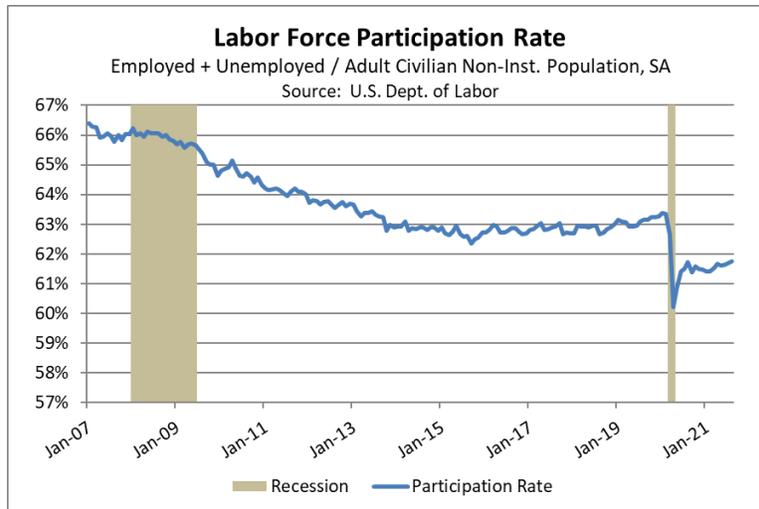
A final key indicator included in the employment report relates to wage income. Average hourly earnings in August rose to a seasonally adjusted $30.73, resulting in a rise of 4.3% from August 2020. The year-over-year rise in hourly earnings was better than both the anticipated increase of 3.9% and the revised gain of 4.1% in the year to July. The chart below shows the year-over-year change in average hourly earnings compared with the annual change in the consumer price index since just prior to the previous recession.

**Average Hourly Earnings, All Private Employees**
Yearly Change, NSA
Source: U.S. Dept. of Labor
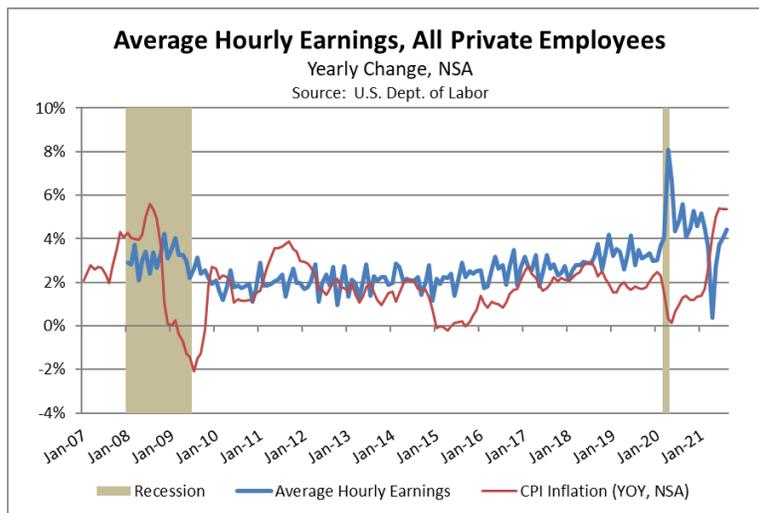
The table below lists the economic releases and/or Fed events scheduled for the rest of the day.

| Economic Releases | | | | | Expected | Prior | Rating |
|---|---|---|---|---|---|---|---|
| **EDT** | Indicator | | | | | | |
| **9:45** | Markit Services PMI | m/m | Aug F | | 55.2 | 55.2 | ** |
| **9:45** | Market Composite PMI | m/m | Aug F | | | 55.4 | ** |
| **10:00** | ISM Services Index | m/m | Aug | | 61.6 | 64.1 | ** |
| **Fed Speakers or Events** | | | | | | | |
| | | No Fed speakers or events today | | | | | |

## 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** | Jibun Bank Services PMI | m/m | Aug F | 42.9 | 43.5 | | ** | Equity bearish, bond bullish |
| | Jibun Bank Composite PMI | m/m | Aug F | 45.5 | 45.9 | | ** | Equity and bond neutral |
| **Australia** | Markit Services PMI | m/m | Aug F | 42.9 | 43.3 | | * | Equity and bond neutral |
| | Markit Composite PMI | m/m | Aug F | 43.3 | 43.5 | | * | Equity and bond neutral |
| **South Korea** | Foreign Reserves | m/m | Aug | $463.93b | $458.68b | | * | Equity and bond neutral |
| **China** | Caixin Services PMI | m/m | Aug F | 46.7 | 54.9 | 52.0 | ** | Equity bearish, bond bullish |
| | Caixin Composite PMI | m/m | Aug F | 47.2 | 53.1 | | ** | Equity bearish, bond bullish |
| **India** | Markit Services PMI | m/m | Aug F | 56.7 | 45.4 | | ** | Equity bullish, bond bearish |
| | Markit Composite PMI | m/m | Aug F | 55.4 | 49.2 | | ** | Equity bullish, bond bearish |
| **EUROPE** | | | | | | | | |
| **Eurozone** | Markit Services PMI | m/m | Aug F | 59.0 | 59.7 | 59.7 | ** | Equity bearish, bond bullish |
| | Markit Composite PMI | m/m | Aug F | 59.0 | 59.5 | 59.5 | ** | Equity bearish, bond bullish |
| | Retail Sales | y/y | Jul | 3.1% | 5.4% | 4.5% | * | Equity bearish, bond bullish |
| **Germany** | Markit Services PMI | m/m | Aug F | 60.8 | 61.5 | 61.5 | ** | Equity bearish, bond bullish |
| | Markit Composite PMI | m/m | Aug F | 60.0 | 60.6 | 60.6 | ** | Equity bearish, bond bullish |
| **France** | Markit Services PMI | m/m | Aug F | 56.3 | 56.4 | 56.4 | ** | Equity and bond neutral |
| | Markit Composite PMI | m/m | Aug F | 55.9 | 55.9 | 55.9 | ** | Equity and bond neutral |
| **Italy** | Markit Services PMI | m/m | Aug F | 58.0 | 58.0 | 58.5 | ** | Equity bearish, bond bullish |
| | Markit Composite PMI | m/m | Aug F | 59.1 | 58.6 | 58.9 | ** | Equity and bond neutral |
| **UK** | Markit Services PMI | m/m | Aug F | 55.0 | 55.5 | 55.5 | ** | Equity bearish, bond bullish |
| | Markit Composite PMI | m/m | Aug F | 54.8 | 55.3 | 55.3 | ** | Equity bearish, bond bullish |
| **Russia** | Markit Services PMI | m/m | Aug F | 49.3 | 53.5 | 53.5 | ** | Equity bearish, bond bullish |
| | Markit Composite PMI | m/m | Aug F | 48.2 | 51.7 | | ** | Equity bearish, bond bullish |
| **AMERICAS** | | | | | | | | |
| **Canada** | Labor Productivity | q/q | 2Q | 0.6% | -1.7% | 1.6% | * | 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.

| | Today | Prior | Change | Trend |
|---|---|---|---|---|
| **3-mo Libor yield (bps)** | 12 | 12 | 0 | Down |
| **3-mo T-bill yield (bps)** | 4 | 4 | 0 | Neutral |
| **TED spread (bps)** | 8 | 8 | 0 | Neutral |
| **U.S. Libor/OIS spread (bps)** | 8 | 8 | 0 | Down |
| **10-yr T-note (%)** | 1.29 | 1.28 | 0.01 | Down |
| **Euribor/OIS spread (bps)** | -55 | -55 | 0 | Neutral |
| **EUR/USD 3-mo swap (bps)** | 3 | 3 | 0 | Down |
| **Currencies** | **Direction** | | | |
| dollar | Down | | | Down |
| euro | Flat | | | 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.
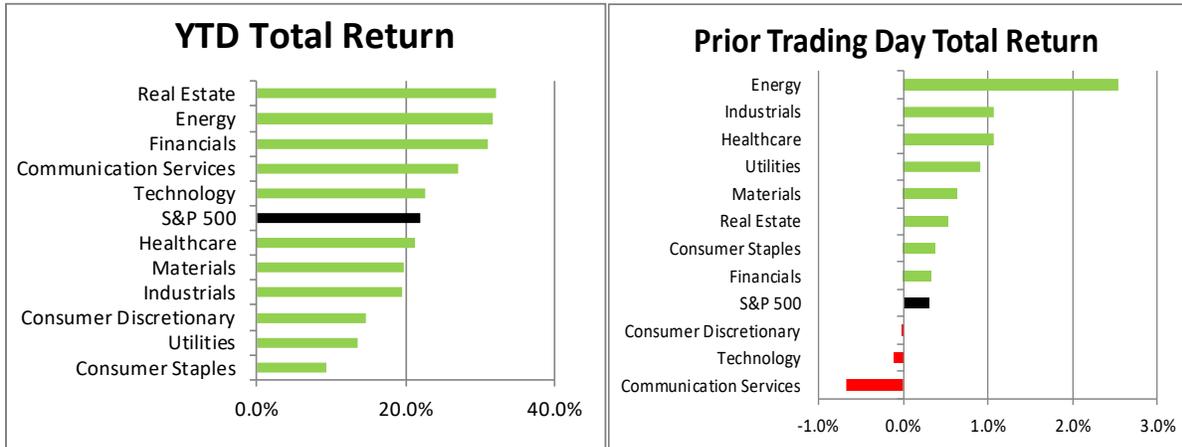
| | Price | Prior | Change | Explanation |
|---|---|---|---|---|
| **Energy Markets** | | | | |
| Brent | $73.48 | $73.03 | 0.62% | |
| WTI | $70.20 | $69.99 | 0.30% | |
| Natural Gas | $4.66 | $4.64 | 0.30% | |
| Crack Spread | $21.42 | $20.88 | 2.60% | |
| 12-mo strip crack | $20.65 | $20.35 | 1.48% | |
| Ethanol rack | $2.43 | $2.42 | 0.48% | |
| **Metals** | | | | |
| Gold | $1,815.13 | $1,809.66 | 0.30% | |
| Silver | $24.10 | $23.91 | 0.83% | |
| Copper contract | $430.10 | $430.40 | -0.07% | |
| **Grains** | | | | |
| Corn contract | $521.25 | $525.50 | -0.81% | |
| Wheat contract | $718.75 | $717.00 | 0.24% | |
| Soybeans contract | $1,287.25 | $1,283.25 | 0.31% | |
| **Shipping** | | | | |
| Baltic Dry Freight | 4,001 | 4,013 | -12 | |
| **DOE inventory report** | | | | |
| | **Actual** | **Expected** | **Difference** | |
| 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) | 20.0 | 25.0 | -5.0 | |

## Weather

The 6-10 day and 8-14 day forecasts currently call for warmer-than-normal temperatures for the entire western half of the country, with cooler temperatures in the Midwest and mid-Atlantic regions. The forecast calls for wetter-than-normal conditions in the far west, with dry conditions in the Great Plains and the Southeast. There are currently two cyclonic disturbances far out in the Atlantic Ocean. One has developed into Hurricane Larry and is moving northwestwardly toward Bermuda. The other remains off the coast of Africa. On average, hurricane activity peaks on September 10.
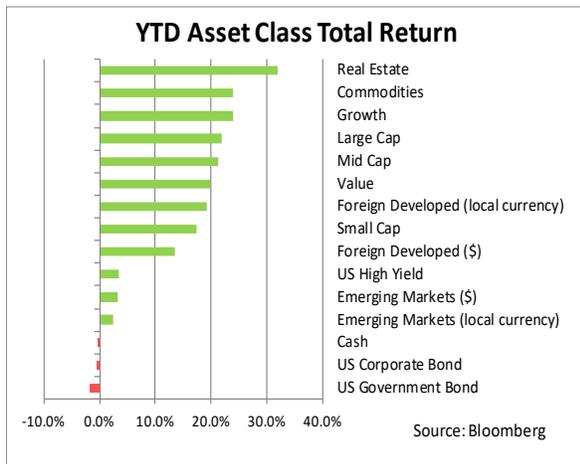
## Data Section

### U.S. Equity Markets – (as of 9/2/2021 close)



**YTD Total Return**

| Sector | |
|---|---|
| Real Estate | |
| Energy | |
| Financials | |
| Communication Services | |
| Technology | |
| S&P 500 | |
| Healthcare | |
| Materials | |
| Industrials | |
| Consumer Discretionary | |
| Utilities | |
| Consumer Staples | |

**Prior Trading Day Total Return**

| Sector | |
|---|---|
| Energy | |
| Industrials | |
| Healthcare | |
| Utilities | |
| Materials | |
| Real Estate | |
| Consumer Staples | |
| Financials | |
| S&P 500 | |
| Consumer Discretionary | |
| Technology | |
| Communication Services | |

(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 9/2/2021 close)



**YTD Asset Class Total Return**

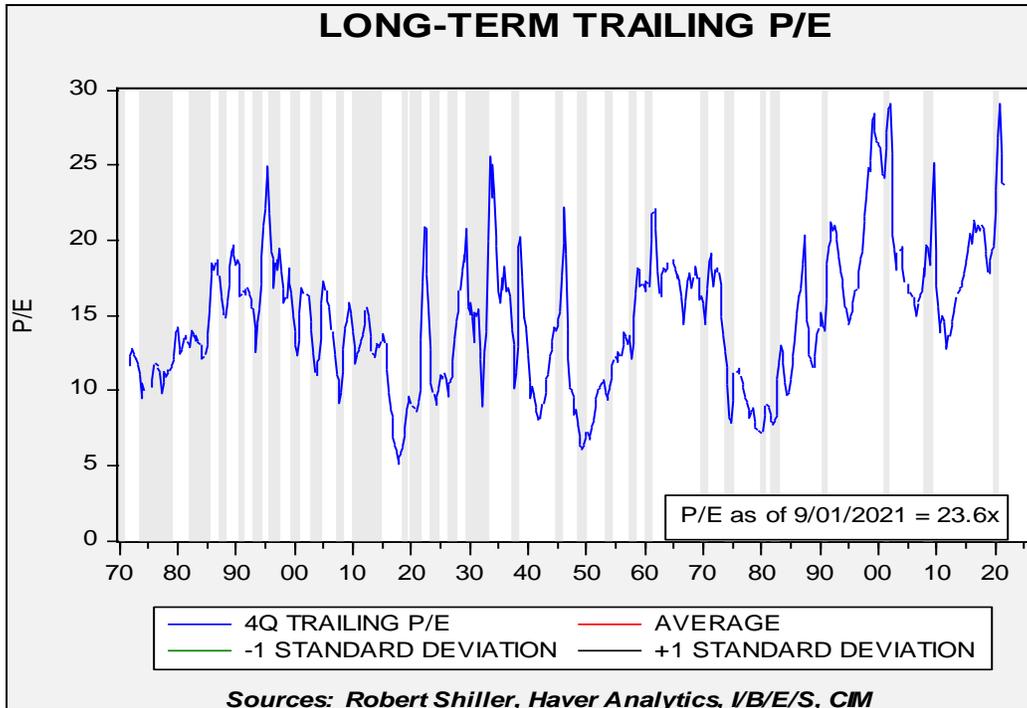| Asset Class | |
|---|---|
| Real Estate | |
| Commodities | |
| Growth | |
| Large Cap | |
| Mid Cap | |
| Value | |
| Foreign Developed (local currency) | |
| Small Cap | |
| Foreign Developed ($) | |
| US High Yield | |
| Emerging Markets ($) | |
| Emerging Markets (local currency) | |
| Cash | |
| US Corporate Bond | |
| US Government Bond | |

Source: Bloomberg

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



**LONG-TERM TRAILING P/E**

P/E as of 9/01/2021 = 23.6x

| 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 23.6x, 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.*

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[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.