

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 5, 2023—9:30 AM EDT] Global equity markets are generally lower this morning. In Europe, the Euro Stoxx 50 is unchanged from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.3%. Chinese markets were lower, with the Shanghai Composite down 0.7% from its previous close and the Shenzhen Composite down 0.6%. 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](#) (8/21/2023) (there will be no podcast for this report and there is no report for 9/4 due to the holiday): “Reflections on the New Cold War”
- [Weekly Energy Update](#) (8/31/2023): We take a short look at the forecasts for oil demand and note that a major oil ETF is reverting to an earlier method of managing its investment in various contract months. We also note that one reason why Iran prefers to live under sanctions is that it benefits those in power. Saudi Arabia is wooing both the U.S. and China to build nuclear power. Also, a coming battery glut may be looming as China steps up production.
- [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](#) (8/28/2023) (there will be no podcast for this report): “Examining the Rise in T-Note Yields”
- [Confluence of Ideas podcast](#) (8/22/2023): “The Economics of Defense in Great Power Competition”

Our *Comment* today opens with Chinese economic news. We next review a wide range of other international and U.S. developments with the potential to affect the financial markets today, including shocking new revelations about corruption in Mexico and unsettling news that the United Auto Workers are increasingly likely to go out on strike against one or more major U.S. automakers.

China: In a bid to bolster confidence and investment among private businesses, the National Development and Reform Commission [said it will set up a new bureau to coordinate government policy for the private sector](#) and improve conditions for non-state owned firms. However, the bureau's leadership won't hold vice-ministerial rank, which suggests it won't be a heavyweight in policymaking. That's consistent with the way that Beijing's recent economic initiatives have appeared to be half-measures with only limited prospects for boosting growth.

- Separately, major housing developer Country Garden (CTRY, \$3.10) [narrowly averted a default on \\$1 billion of its international bonds by paying \\$22.5 million in overdue coupons](#) just before their grace period expired.
- Despite the company's success in averting a default this time around, its recent troubles are a reminder that China's property developers remain in dire straits as the government works to rein in their debt and as home buyers pull back.

China-United States: The *Wall Street Journal* yesterday published a story saying Chinese nationals, sometimes posing as tourists, [have entered U.S. military bases and other sensitive defense sites as many as 100 times in recent years](#). The "gate crashers" appear to be practicing a nontraditional form of spying under the direction of their handlers in Beijing. Since many of these amateur spies can only be charged with state or local trespassing crimes, the growing problem has sparked an effort in Congress to tighten up federal security laws.

China-India: As we noted in our *Comment* on Friday, the Chinese government has published a controversial new "official" map that shows chunks of India and other countries as belonging to China. New reporting now [suggests the map may have been a response to India's announcement in mid-August that it would move forward with the construction of a dozen new hydroelectric dams](#) in the Himalaya mountain range, including in areas claimed by both India and China. The Chinese government also continues to build its own hydroelectric dams in the disputed region. The competing dams illustrate how resource disputes are an important but little-appreciated aspect of the worsening relations between the two countries.

Russia-Ukraine War: Amid rumors of procurement and recruitment corruption, Ukrainian President Zelensky [has named a new defense minister in the midst of the country's ongoing effort to push out the invading Russians](#). The new defense minister will be Rustem Umerov, a Crimean Tatar who was formerly the head of Ukraine's state property fund and a special presidential envoy.

- Separately, U.S. intelligence reportedly indicates North Korean leader Kim Jong Un [will soon meet Russian President Putin in Russia to discuss further North Korean arms deliveries to support the invasion of Ukraine](#). The meeting would highlight Russia's dwindling arsenal and inability to rebuild it as the war continues.
 - The meeting would also highlight how countries in the China/Russia bloc are increasingly cooperating in military affairs. A separate report today indicates Russian Defense Minister Shoigu recently [invited Pyongyang to participate in joint Chinese-Russian-North Korean naval exercises](#).

- In turn, Russia's proposal for three-way naval drills is consistent with the way it has been leaning on its large, capable, blue-water navy to boost its position in the China/Russia bloc.
- In still other Russia-related news, the high-level general arrested in connection with Wagner mercenary leader Prigozhin's June insurrection [has reportedly been released](#). However, it isn't clear whether the general, Sergei Surovikin, is still subject to restrictions or could still be punished for his prior knowledge of the insurrection.
- Finally, after meeting with Turkish President Erdoğan, President Putin [said Russia won't rejoin the deal allowing Ukraine to export grain through the Black Sea unmolested unless the West does more to ease Russian food shipments](#). Erdoğan insisted that progress was being made on that demand, but Putin's position has raised the chance that more Ukrainian food products will be kept off the market, potentially boosting grain prices.

Iran: The International Atomic Energy Agency [issued a report that Tehran sharply slowed its production of enriched uranium over the summer](#), adding just 7.5 kg of 60% enriched material in the three months to August after producing 51.8 kg in the previous six months. Coupled with Iran's recent release of two U.S. citizens from prison to home confinement, the slowdown in enrichment could mean Tehran is responding to backchannel efforts to ease tensions with the U.S. and the rest of the West.

Mexico: A blockbuster story in the *New York Times* over the weekend [sheds new light on the infamous disappearance of 43 college students near Acapulco in 2014](#). Based on some 23,000 previously unknown wire taps by the U.S. Drug Enforcement Agency, which were provided to Mexico only last year, the story says the students were killed by a local drug cartel merely because it wrongly believed them to be members of a rival gang. The tragedy unfolded when the students, from a nearby teachers' college, marched into a small town that served as the cartel's stronghold. In what appears to have been essentially a college prank, they commandeered buses to go to Mexico City for a political protest. However, the cartel had so successfully corrupted the local military units, police, and public officials, that it was able to kill the students and incinerate their bodies with impunity.

- The story highlights the depth of corruption among Mexican public officials, who are often on the payroll of the country's drug cartels. In small towns like the one where the student massacre happened, the cartels can have a virtual monopoly on government power. In fact, the DEA was reluctant to share its wire taps with Mexican officials precisely because it feared they would pass the taps on to the cartels.
- The corruption in the Mexican government remains a key hurdle to its development and an important impediment to investment by both local businesses and foreign firms, in spite of the opportunities presented as U.S.-China tensions prompt companies to shift production out of Asia.

Argentina: The running mate of radical libertarian presidential candidate Javier Milei has [touched off a controversy by holding an event that appeared to justify the crimes of the rightwing military dictatorship that ruled the country from 1976 to 1983](#). Nevertheless, Milei remains the frontrunner for the October election, where voters will give their judgement on his plans to

dramatically shrink the Argentine state, shut down the central bank, and dollarize the economy in an attempt to control rampant inflation.

U.S. Labor Market: Various reports [suggest it is increasingly likely that the United Auto Workers will go out on strike when their current labor contract with the top U.S. automakers expires on September 14](#). Given UAW President Shawn Fain’s maximalist demands and the reluctance among auto firms, some observers say the only question is whether the union will strike just one of the Big 3, or all at the same time.

- Separately, new analysis of last week’s employment report shows that local government payrolls—which are dominated by school employees—have still not recovered from the coronavirus pandemic.
- Because of [mass teacher retirements](#), furloughs, and the inability to attract new educators and staff because of [low pay](#), local government employment is now stuck at about 2018 levels, even as students have already begun to return to the classrooms.



U.S. Green Energy Investing: Even as high interest rates and shifting sentiment have soured some investors in green energy recently, big players like BlackRock (BLK, \$706.19) are reportedly [pouring money into battery recyclers](#). Their big investments are based on the premise that battery recyclers will thrive into the future even when the government’s green subsidies end.

U.S. Economic Releases

There were no domestic releases prior to the publication of this report. 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	Factory Orders	m/m	Jul	-2.5%	2.3%	***
10:00	Factory Orders Ex Transportation	m/m	Jul	0.1%	0.2%	**
10:00	Durable Goods Orders	m/m	Jul F	--	-5.2%	***
10:00	Durable Goods Orders Ex Transportation	m/m	Jul F	--	0.5%	**
10:00	Nondefense Capital Goods Orders Ex Aircraft	m/m	Jul F	--	0.1%	**
10:00	Nondefense Capital Goods Shipments Ex Aircraft	m/m	Jul F	--	-0.2%	**
Federal Reserve						
No Fed speakers or events for the rest of 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	Monetary Base	y/y	Aug	1.2%	-1.3%		**	Equity and bond neutral
	Monetary Base, End of Period	m/m	Aug	¥674.4t	¥668.9t		*	Equity and bond neutral
	Household Spending	y/y	Jul	-5.0%	-4.2%	-2.5%	***	Equity bearish, bond bullish
	Jibun bank Composite PMI	m/m	Aug F	52.6	52.6	--	*	Equity and bond neutral
	Jibun Bank Services PMI	m/m	Aug F	54.3	54.3	--	**	Equity and bond neutral
Australia	Melbourne Institute Inflation	m/m	Aug	6.1%	5.4%		***	Equity bearish, bond bearish
	BoP Current Account Balance	q/q	2Q	A\$7.7b	A\$12.3b	A\$12.5b	**	Equity and bond neutral
New Zealand	Terms of Trade	q/q	2Q	0.4%	-1.5%	-0.10	**	Equity and bond neutral
	ANZ Commodity Price	m/m	Aug	-2.9	-2.6		**	Equity and bond neutral
South Korea	Foreign Reserves	m/m	Aug	\$418.3b	\$421.80b		***	Equity and bond neutral
	GDP	y/y	2Q P	0.9%	0.9%	0.9%	**	Equity and bond neutral
	CPI	y/y	Aug	3.4%	2.3%	2.9%	***	Equity bearish, bond bearish
China	Caixin Composite PMI	m/m	Aug	51.7	51.9		**	Equity and bond neutral
	Caixin Services PMI	m/m	Aug	51.8	54.1	53.5	**	Equity bearish, bond bullish
India	S&P Global Manufacturing PMI	m/m	Aug	58.6	57.7		***	Equity and bond neutral
	S&P Global Composite PMI	m/m	Aug	60.9	61.9		**	Equity and bond neutral
India	S&P Global Services PMI	m/m	Aug	60.1	62.3		**	Equity and bond neutral
EUROPE								
Eurozone	S&P Global Services PMI	m/m	Aug F	47.9	48.3	48.3	**	Equity and bond neutral
	S&P Global Composite PMI	m/m	Aug F	46.7	47.0	47.0	*	Equity and bond neutral
	PPI	y/y	Jul	-7.6%	-3.4%	-7.6%	**	Equity and bond neutral
Germany	Trade Balance	m/m	Jul	15.9b	18.7b	17.8b	*	Equity and bond neutral
	Exports	m/m	Jul	-0.90%	0.10%	0.20%	*	Equity and bond neutral
	Imports	m/m	Jul	1.40%	-3.40%	-3.20%	*	Equity and bond neutral
	HCOB Composite PMI	m/m	Aug F	47.3	47.3	47.3	*	Equity and bond neutral
	HCOB Services PMI	m/m	Aug F	44.6	44.7	44.7	**	Equity and bond neutral
France	HCOB Services PMI	m/m	Aug F	46.0	46.7	46.7	**	Equity and bond neutral
	HCOB Composite PMI	m/m	Aug F	46.0	46.6	46.6	*	Equity and bond neutral
Italy	HCOB Composite PMI	m/m	Aug	48.2	48.9	48.3	*	Equity and bond neutral
	HCOB Services PMI	m/m	Aug	49.8	51.5	50.4	**	Equity bearish, bond bullish
UK	New Car Registrations	y/y	Aug	24.4%	28.3%	--	*	Equity bearish, bond bullish
	S&P/CIPS Services PMI	m/m	Aug F	49.5	48.7	48.7	**	Equity bullish, bond bearish
	S&P/CIPS Composite PMI	m/m	Aug F	48.6	47.9	47.9	**	Equity and bond neutral
Switzerland	GDP	q/q	2Q	0.50%	0.60%	1.50%	**	Equity and bond neutral
	Domestic Sight Deposits CHF	m/m	1-Sep	458.0b	471.4b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	1-Sep	467.6b	461.7b		*	Equity and bond neutral
Russia	S&P/CIPS Services PMI	m/m	Aug	57.6	54.0	--	**	Equity bullish, bond bearish
	S&P/CIPS Composite PMI	m/m	Aug	55.9	53.3	--	**	Equity bullish, bond bearish
AMERICAS								
Canada	GDP	y/y	Jun	1.1%	1.9%	1.4%	**	Equity and bond neutral
	S&P Global Manufacturing PMI	m/m	Aug	48.0	49.6		***	Equity bearish, bond bullish
Mexico	S&P Global Manufacturing PMI	m/m	Aug	51.2	53.2		***	Equity bearish, bond bullish
	Gross Fixed Investment	y/y	Jun	28.8%	17.4%	25.2%	**	Equity bullish, bond bearish
Brazil	S&P Global Manufacturing PMI	m/m	Aug	50.1	47.8	--	***	Equity and bond neutral
	Trade Balance	m/m	Aug	\$9767m	\$9035m	\$8890m	**	Equity and bond neutral
	Exports	m/m	Aug	\$31211m	\$29062m	\$28920m	*	Equity and bond neutral
	Imports	m/m	Aug	\$21444m	\$20027m	\$20030m	*	Equity and bond neutral
	Industrial Production	y/y	Jul	-1.1%	0.3%	-0.5%	***	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.

doe	Today	Prior	Change	Trend
3-mo Libor yield (bps)	566	566	0	Up
3-mo T-bill yield (bps)	527	528	-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 (%)	4.23	4.18	0.05	Flat
Euribor/OIS spread (bps)	380	377	3	Up
Currencies	Direction			
Dollar	Up			Up
Euro	Down			Up
Yen	Down			Down
Pound	Down			Up
Franc	Down			Up
Central Bank Action	Current	Prior	Expected	
RBA Cash Rate Target	4.100%	4.100%	4.100%	On Forecast

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	\$88.51	\$89.00	-0.55%	
WTI	\$85.44	\$85.55	-0.13%	
Natural Gas	\$2.61	\$2.77	-5.75%	
Crack Spread	\$31.72	\$30.81	2.96%	
12-mo strip crack	\$28.18	\$27.81	1.32%	
Ethanol rack	\$2.46	\$2.46	0.00%	
Metals				
Gold	\$1,931.07	\$1,942.69	-0.60%	
Silver	\$23.57	\$23.99	-1.75%	
Copper contract	\$382.45	\$385.20	-0.71%	
Grains				
Corn contract	\$481.50	\$481.50	0.00%	
Wheat contract	\$599.25	\$595.50	0.63%	
Soybeans contract	\$1,364.00	\$1,369.25	-0.38%	
Shipping				
Baltic Dry Freight	1,083	1,065	18	

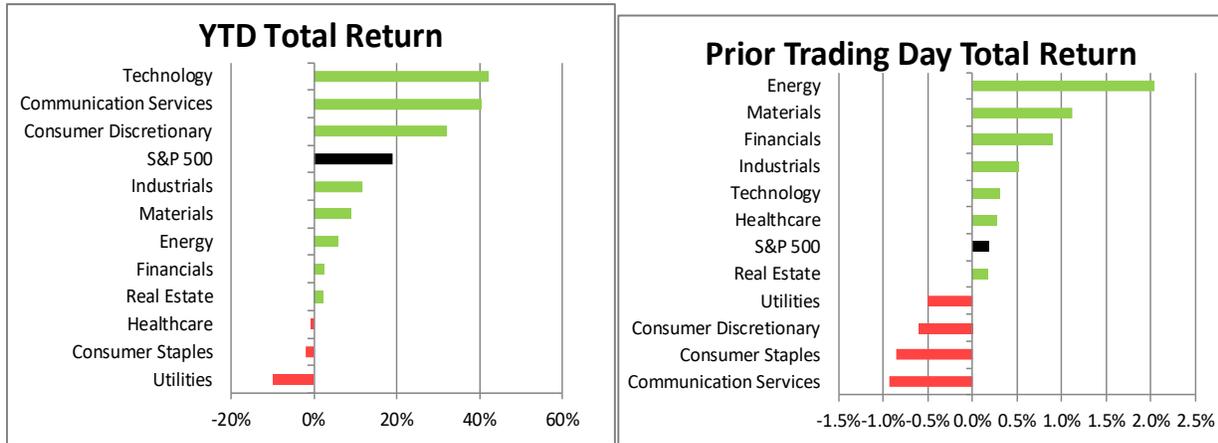
Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures for most of the country, with below-normal temperatures only in New England and parts of the Midwest. The forecasts call for wetter-than-normal conditions in most states east of the Pacific region, with dry conditions in the Southwest and Pacific Northwest.

There are currently three atmospheric disturbances in the Atlantic Ocean area, but none are expected to develop into a tropical storm within the next 48 hours.

Data Section

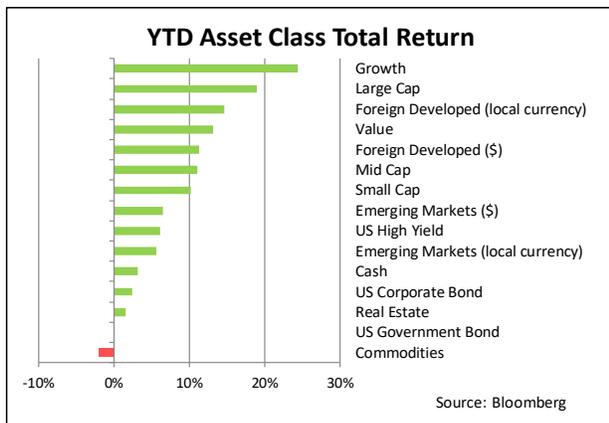
U.S. Equity Markets – (as of 9/1/2023 close)



(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 9/1/2023 close)

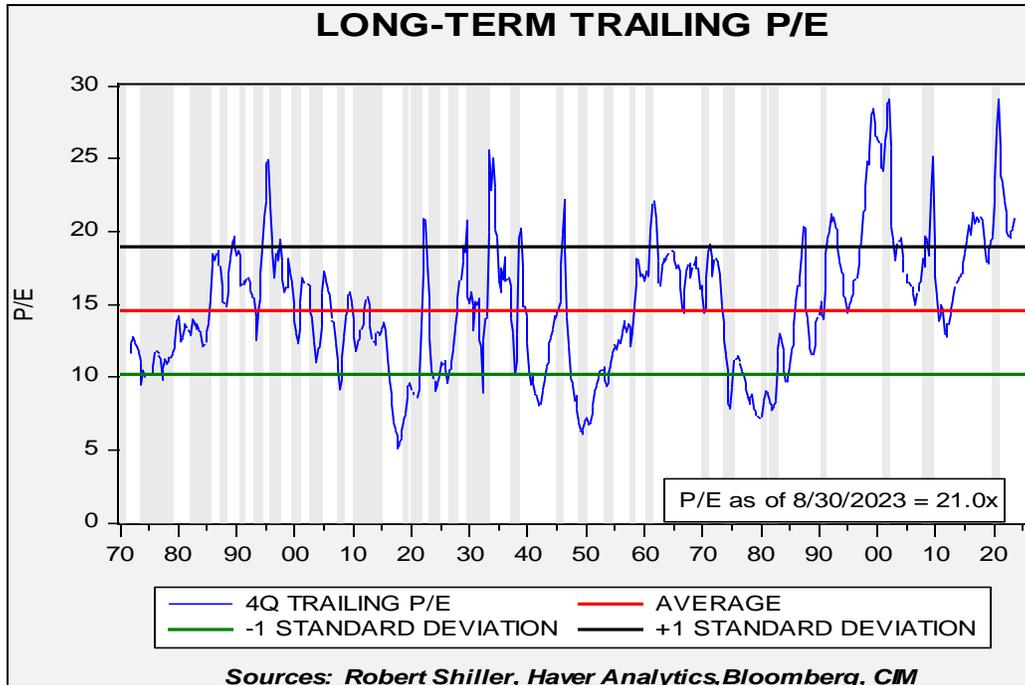


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

August 31, 2023



Based on our methodology,¹ the current P/E is 21.0x, down 0.1x from last week. Improved earnings coupled with falling index values led to the modest decline 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.