

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 7, 2021—9:30 AM EDT] Global equity markets are mixed this morning. In Europe, the EuroStoxx 50 is currently down 0.4% from its prior close. In Asia, the MSCI Asia Apex 50 closed relatively unchanged. Chinese markets were higher, with the Shanghai Composite up 1.5% from its prior close and the Shenzhen Composite up 1.1%. U.S. equity index futures are signaling a flat 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”

In today's *Comment*, we open with international developments ranging from a worsening outlook for Chinese corporate debt to a budding political fight in the United Kingdom over higher taxes for the National Health System. We also cover the latest developments in Afghanistan and the coup in Guinea, which has pushed up aluminum prices today. We close with the latest news on the coronavirus pandemic.

U.S. Pension System: As state and local governments continue to struggle with underfunded pension systems, they are [increasingly borrowing to meet their pension obligations](#). According to an analysis by Municipal Market Analytics, state and local governments have borrowed about \$10 billion for pension funding through the end of August this year, more than in any of the previous 15 full calendar years. The number of individual municipalities borrowing for pensions soared to 72 from a 15-year average of 25.

- With borrowing rates extraordinarily low, municipalities are betting they can make more on their existing pension investments than they will have to pay in interest.

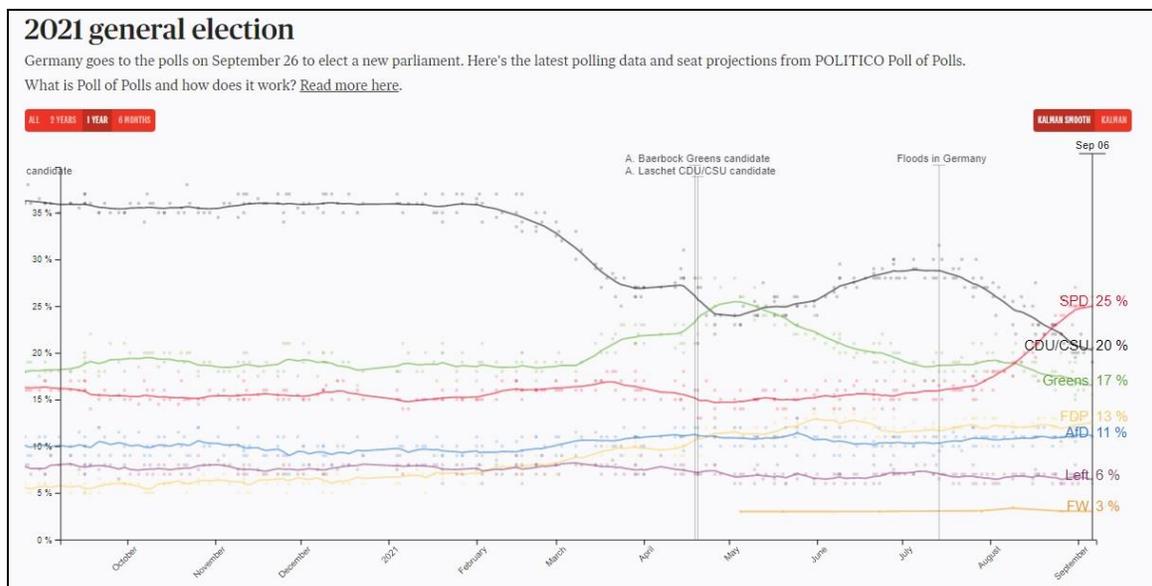
- The practice amounts to a leveraged bet that the pension systems can keep making good returns in the financial markets. Of course, a key test would come in a significant market downturn and/or a steep rise in borrowing rates.

China: As we've said many times, one notable economic vulnerability facing China is its high level of debt. Throughout 2021, that problem has been especially evident among the country's major real estate developers, especially the largest, Evergrande Group (EGRNY, \$13.49). Chinese trading in the company's bonds [has now been suspended for the second time in as many days](#) after it admitted last week that it might default, and Moody's twice downgraded the issues.

- Evergrande's bonds fell approximately 20% in Shenzhen today, after a similar sharp decline last Friday.
- More ominously, concerns about Evergrande appear to be weighing on other Chinese developers' bonds and stocks, raising the specter of broader market contagion.

Russia-Germany: The German government [has accused Russia of launching a series of cyberattacks against national and regional politicians](#) as part of an [effort to interfere with Germany's national elections later this month](#). The warning comes ahead of what appears to be the most open election in recent German history, with polls pointing to an inconclusive outcome that could usher in months of uncertainty in Europe's most powerful country.

- Not only is Russia losing a relative friend and ally in Chancellor Merkel, who is retiring, but Merkel's center-right Christian Democratic Union (CDU) has been losing support faster than most observers expected.
- In contrast, the center-left Social Democratic Party (SPD) has been surging. Perhaps even more concerning for Russia is that the Greens may be able to garner enough votes to enter the next government. They have become some of the most vocal proponents of pushing back against Russia and China for their economic, environmental, and human rights policies.



Source: POLITICO research

European Union-Poland: The European Commission [has asked the European Court of Justice to fine Poland for ignoring court rulings over the country's controversial judicial reform](#), in a significant escalation of a stand-off between Brussels and Warsaw over the supremacy of EU law over national rules.

United Kingdom: Prime Minister Johnson appears to be throwing himself into a political crisis. He [plans this week to introduce tax hikes and benefit cuts to shore up the national health insurance program](#), despite promising explicitly not to take those actions in the Conservative Party's 2019 manifesto. Importantly, he faces widespread opposition to the plan, including his own cabinet, even though the expectation of a personnel reshuffle later this week is causing members reluctant to take a public stand. In any case, the proposal [will face widespread opposition from both Conservatives and the opposition Labor Party in parliament](#).

- The coronavirus pandemic appears to be a key driver behind the proposal. For one thing, the pandemic has boosted the National Health Service's backlog of cases, which Johnson had promised to whittle down.
- In addition, the Conservatives manifesto had promised to boost state pensions each year by the greatest of average earnings growth, price inflation, or 2.5%. Because of labor market distortions brought on by the pandemic, the earnings growth bogey would have boosted pensions by approximately 8% starting next April.

Afghanistan: Taliban sources yesterday [said they had eliminated the last vestiges of armed resistance to them in the province of Panjshir](#). If true, it would mean that they now control all of Afghanistan. Perhaps more significantly, it would also mean that the Taliban have even more control over the country than they did when they last ruled in the 1990s.

- The State Department confirmed that it had facilitated the evacuation of four U.S. citizens from Afghanistan on Monday via an undisclosed overland route. It is believed to be the first confirmed exit since the U.S. finished evacuating troops and civilians last month via the Kabul airport. According to the State Department, the Taliban were aware of the evacuation and didn't attempt to impede it.
- In a press conference today, Secretary of State Blinken [said the U.S. is negotiating with the Taliban on resolving issues preventing other American citizens](#) and vulnerable Afghans from leaving Afghanistan through charter flights. Other countries are working to open the airport in Kabul for international flights within days.
- The Russia-led Collective Security Treaty Organization (CSTO) [has started three days of military exercises in Kyrgyzstan](#) that it says are needed in response to the ongoing situation in Afghanistan. The exercises involve military units from Russia, Kazakhstan, and Kyrgyzstan. Tajik troops were also scheduled to take part but withdrew at the last moment for unspecified reasons.

Guinea: On Sunday, officers from an elite special forces unit [said they have detained President Alpha Condé and suspended the West African country's constitution](#). A power struggle appeared to be underway in the capital of Conakry as night fell; the Defense Ministry claimed in

a contradictory statement that the coup had been foiled. Western security officials said the situation was “fluid,” but the putschists, who controlled state television, “held the cards.”

- Once celebrated as Guinea’s first democratically elected president when he swept to victory in 2010, Condé has since centralized power around his personal authority and cracked down on opposition. Last year he deployed the military to push through controversial constitutional amendments that would have enabled him to stay in power until 2032—when he would be 94 years old.
- The country, which has bountiful deposits of bauxite, iron ore, gold, and diamonds, has logged robust economic growth over much of the past decade, but few of its citizens have seen the benefits. Facing a pandemic-related collapse in revenue, the government has significantly raised taxes in recent weeks. The price of fuel has increased by 20%, aggravating the sense of discontent among many Guineans.
 - On fears that the political instability could snarl global supplies, aluminum prices on Monday [jumped to as much as \\$2,768 per metric ton](#), their highest level since 2011.
 - Shares of major global aluminum firms have also jumped on the news.



El Salvador: The country today [becomes the first in the world to make bitcoin one of its legal tenders, along with the U.S. dollar](#). Proponents of the plan by populist President Nayib Bukele say it will promote financial inclusion for those without bank accounts, facilitate access to a potentially high-yielding asset, and cut the fees Salvadorans pay to send home remittances, which represent one-quarter of the country’s gross domestic product. Critics say the rushed plan could cost poorer Salvadorans when the price falls, raise costs for banks and insurers, provide a shield for money launderers, and risk economic stability.

COVID-19: Official data show confirmed cases [have risen to 221,244,447 worldwide, with 4,578,393 deaths](#). In the United States, confirmed cases rose to 40,019,441, with 649,168 deaths. [Vaccine doses delivered in the U.S. now total 450,175,825, while the number of people who have received at least their first shot totals 206,908,710](#). Finally, here is the [interactive chart](#) from the *Financial Times* that allows you to compare cases and deaths among countries, scaled by population.

Virology

- According to the latest CDC data, 62.3% of the U.S. population has now received at least one dose of a vaccine, and 53.0% of the population is fully vaccinated.
- As impatience for a children's vaccine grows, new reporting illustrates that additional safety protocols and other special requirements [are slowing the process](#). Trial results of the vaccine from Pfizer (PFE, \$46.84) for 5- to 12-year-olds could come by the end of this month, which could mean shots aren't authorized for use until October or November, months after those cleared for adolescents. Data for younger children could come in October.
- With more countries easing entry restrictions in line with their vaccine rollouts, Japan's most powerful business lobby [is nudging the government to exempt vaccinated travelers from the country's mandatory 14-day quarantine](#).
- Also in Japan, government sources say the current state of emergency in Tokyo and other areas [could be extended by up to one month beyond its planned September 12 end date](#) to allow the next prime minister to decide when the measures should end. Prime Minister Suga will give up his post as leader of the Liberal Democratic Party later in September; his successor will have to battle it out in new parliamentary elections by the end of November.

Economic and Financial Market Impacts

- Travel, tourism, and hospitality businesses that were hoping to see normalizing business conditions this fall [are increasingly being disappointed](#). The Delta-driven resurgence in infections is prompting more companies to delay calling workers back to the office or renewing business trips. The more contagious new variant is reportedly affecting the appetite for both business and leisure travel.

U.S. Policy Response

- The federal government's extra unemployment benefit of up to \$300 per week [is ending in the roughly half of states still taking part in the program](#), potentially creating an air pocket in consumer demand but also possibly pushing more people into the labor market.

U.S. Economic Releases

There were no economic 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						
EDT	Indicator			Expected	Prior	Rating
9:45	Market 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								
China	Trade Balance	m/m	Aug	\$58.34b	\$56.58b	\$53.20b	**	Equity bullish, bond bearish
	Foreign Reserves	m/m	Aug	\$3231.16b	\$3235.89b	\$3233.00b	*	Equity and bond neutral
Japan	Labor Cash Earnings	y/y	Jul	1.0%	-0.1%	0.4%	**	Equity bullish, bond bearish
	Real Cash Earnings	y/y	Jul	0.7%	-0.4%	0.6%	**	Equity bullish, bond bearish
	Household Spending	y/y	Jul	0.7%	-5.1%	2.4%	**	Equity bearish, bond bullish
	Leading Index CI	m/m	Jul	104.1	104.1	103.5	***	Equity bullish, bond bearish
	Coincident Index	m/m	Jul	94.5	94.5	94.3	***	Equity and bond neutral
Australia	Foreign Reserves	m/m	Aug	A\$78.7b	A\$64.0b		*	Equity bullish, bond bearish
EUROPE								
Eurozone	Employment	y/y	2Q F	1.8%	1.8%		***	Equity and bond neutral
	GDP SA	q/q	2Q F	2.2%	2.0%	2.0%	***	Equity bullish, bond bearish
	ZEW Survey Expectations	m/m	Sep	31.1	42.7		**	Equity bearish, bond bullish
Germany	Industrial Production SA	m/m	Jul	1.0%	-1.3%	0.8%	***	Equity bullish, bond bearish
	ZEW Survey Expectations	m/m	Sep	26.5	40.4	30.3	**	Equity bearish, bond bullish
	ZEW Survey Current Situation	m/m	Sep	31.9	29.3	34.0	**	Equity and bond neutral
Switzerland	Unemployment Rate	m/m	Aug	2.7%	2.8%	2.8%	***	Equity and bond neutral
	Foreign Currency Reserves	m/m	Aug	923.9b	923.2b		*	Equity and bond neutral
Russia	Light Vehicle Car Sales	y/y	Aug	-17.0%	-6.5%	0.5%	**	Equity bearish, bond bullish
	Wellbeing Fund	m/m	Aug	\$190.5b	\$188.1b		*	Equity bearish, bond bullish
AMERICAS								
Mexico	Gross Fixed Investment	m/m	Jun	17.1%	46.5%	17.7%	**	Equity and bond neutral
	Vehicle Exports	m/m	Aug	212687	202021		**	Equity and bond neutral
	Vehicle Production	m/m	Aug	237040	221843		**	Equity and bond neutral
Brazil	Trade Balance Weekly	w/w	5-Sep	\$673m	\$1389m		**	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
3-mo Libor yield (bps)	12	12	0	Down
3-mo T-bill yield (bps)	3	4	-1	Neutral
TED spread (bps)	9	8	1	Neutral
U.S. Libor/OIS spread (bps)	7	8	-1	Down
10-yr T-note (%)	1.36	1.32	0.04	Down
Euribor/OIS spread (bps)	-55	-55	0	Neutral
EUR/USD 3-mo swap (bps)	4	3	1	Down
Currencies	Direction			
dollar	Up			Down
euro	Flat			Up
yen	Flat			Neutral
pound	Down			Neutral
franc	Flat			Neutral
Central Bank Action	Current	Prior	Expected	
RBA Cash Rate Target		0.100%	0.100%	On forecast
RBA 3-Yr Yield Target		0.100%	0.100%	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.

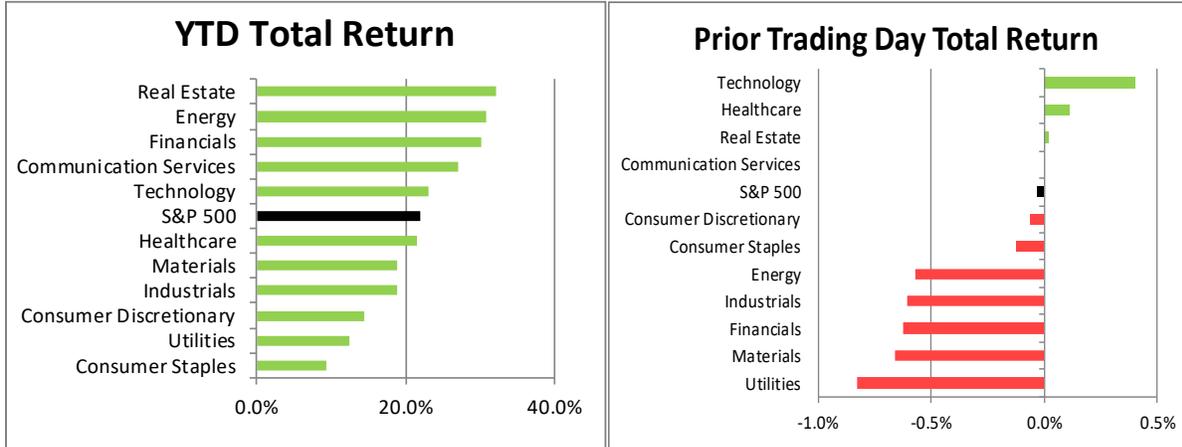
	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$72.32	\$72.22	0.14%	
WTI	\$68.81	\$69.29	-0.69%	
Natural Gas	\$4.66	\$4.71	-1.02%	
Crack Spread	\$21.24	\$21.29	-0.24%	
12-mo strip crack	\$20.44	\$20.49	-0.20%	
Ethanol rack	\$2.47	\$2.47	0.00%	
Metals				
Gold	\$1,812.41	\$1,823.29	-0.60%	
Silver	\$24.35	\$24.68	-1.36%	
Copper contract	\$428.00	\$433.40	-1.25%	
Grains				
Corn contract	\$524.25	\$524.00	0.05%	
Wheat contract	\$728.50	\$726.25	0.31%	
Soybeans contract	\$1,298.50	\$1,292.00	0.50%	
Shipping				
Baltic Dry Freight	3,822	3,944	-122	

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 Pacific region. The forecast calls for wetter-than-normal conditions throughout the Mississippi Valley and the Midwest region. There are currently two cyclonic disturbances far out in the Atlantic Ocean. One has developed into Hurricane Larry and is moving northwestwardly toward the Bahamas. The other is in the Gulf of Mexico and is not expected to develop into a tropical storm within the next 48 hours. On average, hurricane activity peaks on September 10.

Data Section

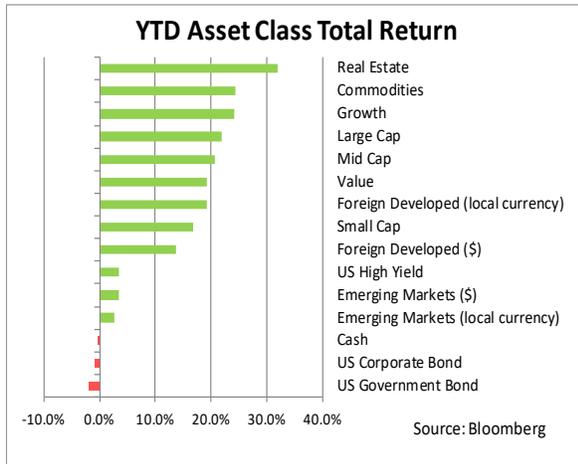
U.S. Equity Markets – (as of 9/3/2021 close)



(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 9/3/2021 close)

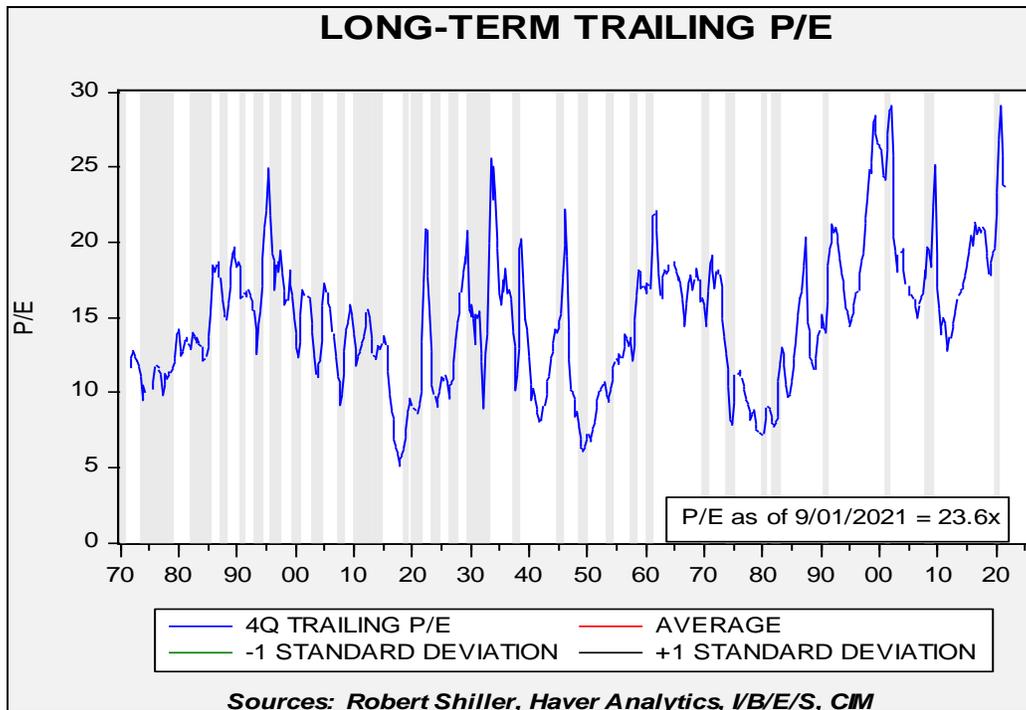


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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,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.

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.