Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

Looking for something to read? See our [Reading List](#); these books, separated by category, are ones we find interesting and insightful. We will be adding to the list over time.

[Posted: September 8, 2023—9:30 AM EDT] Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 is down 0.4% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.3%. Chinese markets were lower, with the Shanghai Composite down 0.2% from its previous close and the Shenzhen Composite down 0.1%. 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*](#) (9/8/2023): Russia and Saudi Arabia's decision to extend production cuts boosted prices. Seasonally we should be reaching the end of the summer withdraw for crude oil. If stockpiles continue to decline it will add to bullish sentiment.
- [*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"
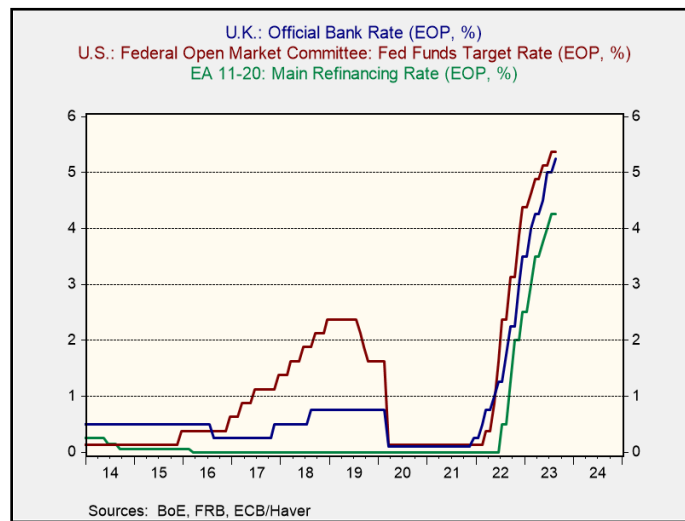- [*Confluence of Ideas* podcast](#) (8/22/2023): "The Economics of Defense in Great Power Competition"

Good morning! Today's *Comment* will be broken down into three sections: 1) Why more central banks are signaling an end to their tightening cycle; 2) How the no-shows by the U.S. and China reflect the waning relevance of multilateral organizations; and 3) Our thoughts on the leader widely expected to succeed AMLO as the president of Mexico.

Peaking Trend: The Bank of Canada has become the first G-7 central bank to signal that it may be nearing the end of its hiking cycle.

- Bank of Canada Governor Tiff Macklem [said that policymakers are nearing success in their battle against inflation.](#) The dovish comments come a day after Canadian policymakers agreed to hold rates steady at 5%. Although inflation remains well above

the central bank's 2% target at 3.3%, the bank's governor's change in tone suggests that the policymakers are shifting their stance. This comes amid signs that the labor market is easing, with the unemployment rate increasing for four consecutive months from 5.0% to 5.5%. The bank has said that it is willing to take further action if needed to bring inflation under control.

- His remarks come as other G-7 central banks are set to meet to discuss their latest policy decisions. The European Central Bank (ECB) has signaled that it is prepared to raise its benchmark interest rate one last time this year, possibly in September, while the Bank of England (BOE) has said that its policy rate is "near the top of the cycle." Meanwhile, the Federal Reserve is divided on whether more needs to be done to combat inflation, with some officials advocating for one more hike and others hinting that rates are high enough.

U.K.: Official Bank Rate (EOP, %)
U.S.: Federal Open Market Committee: Fed Funds Target Rate (EOP, %)
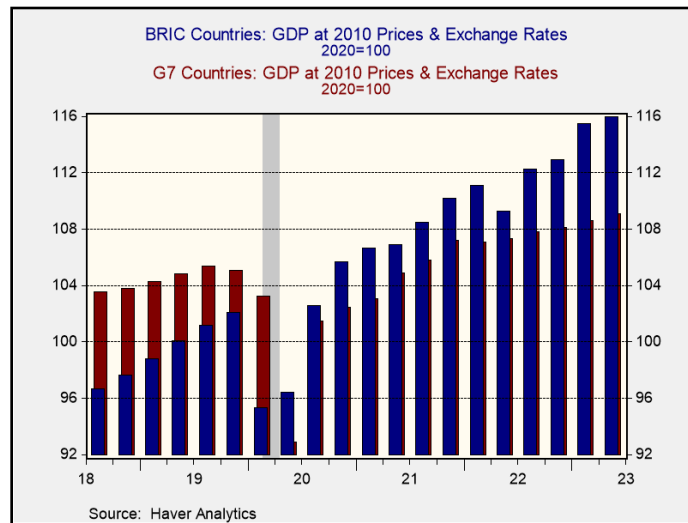EA 11-20: Main Refinancing Rate (EOP, %)

Sources: BoE, FRB, ECB/Haver

- The world is witnessing a change in monetary policy, with central banks potentially opting for holding rates steady or even cutting them. The Central Bank of Brazil has become the first notable central bank to reverse course on interest rates, cutting them in August for the first time since 2020. This move is likely to be followed by other central banks in the coming months, as global growth shows signs of slowing down. Nevertheless, inflation still remains significantly higher than the targets set by central banks. As a result, the process of easing policy may be more gradual than what investors are accustomed to, as central banks strive to strike a delicate balance between managing the risks of inflation and recession.

Choosing Sides: The G20 and ASEAN summits wrap up this week with key absences, as prominent world leaders chose not to attend.

- Chinese President Xi Jinping's absence from the ASEAN and G20 summits is a notable snub, suggesting that he is becoming increasingly disinclined to engage with countries that do not share China's worldview. His absence from the G20 is particularly significant, as he has not missed a meeting of the group in over 10 years. This suggests that Xi is cooling on the G20, or at least on the current format of the group. Xi's replacement at the ASEAN summit, Premier Li Qiang, used the platform to warn countries against taking

sides in what he described as a "new Cold War." China's recent actions are a clear sign that it is concerned about the growing international pressure and is seeking to isolate itself from groups that do not support its policies.
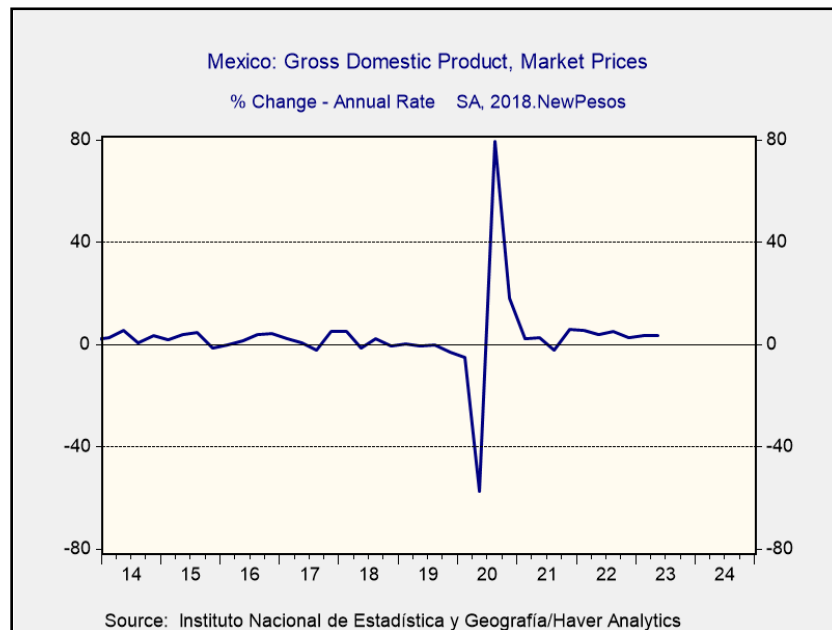
- Meanwhile, U.S. President Joe Biden's absence from the ASEAN summit unnerved some countries and is likely a reflection of his view that the group has not been effective in achieving its goals. The ASEAN declaration states that the group strives to ensure "durable peace, stability, and shared prosperity" in Southeast Asia. However, Myanmar's military coup and its continued participation in the ASEAN summit are in direct contradiction to this aim. Instead of traveling to Jakarta for the ASEAN summit, Biden will travel to Hanoi, Vietnam, to sign a "comprehensive strategic partnership." The President's decision to travel to Vietnam instead of attending the ASEAN summit suggests that he is more interested in building closer relationships with individual countries than with large groups of nations.

BRIC Countries: GDP at 2010 Prices & Exchange Rates
2020=100
G7 Countries: GDP at 2010 Prices & Exchange Rates
2020=100

Source: Haver Analytics

- o We believe the world will be split into two camps: the BRICS countries and the G7 countries. The chart above shows that the BRICS countries have been growing at a faster rate than their G7 counterparts since the onset of the pandemic.

- The decision by the two leaders to skip summits could be seen as a sign of the declining relevance of multilateral organizations. These organizations have often been used to get countries together to resolve their differences. However, recently, they have been seen as being biased towards either the United States or China. The lack of a neutral forum for countries to have dialogue and to prevent the further deterioration of relations raises the likelihood of conflict in the future. At this time, we do not believe that tensions have reached a level that warrants serious concern, but we are monitoring tensions between the U.S. and China closely.

AMLO's Successor: The Mexican president has chosen his replacement for after his tenure ends in 2024.

- Mexico's ruling party, the National Regeneration Movement (MORENA), [has nominated Claudia Sheinbaum, the former mayor of Mexico City, as its candidate](#) for the 2024 presidential election. Sheinbaum's close relationship with current President Andrés Manuel López Obrador (AMLO) makes her a strong contender to become the country's first female president. The opposition coalition [Frente Amplio por México has chosen Xóchitl Gálvez as its candidate](#). Current polls show that [Sheinbaum leads Gálvez by 17 percentage points](#), making her the heavy favorite to win the presidency. Sheinbaum has promoted [herself as a continuity candidate of her predecessor](#) and has promised to crack down on corruption, increase cash transfers to the poor, and improve the country's energy sovereignty.

- Despite the global slowdown, Mexico's economy has seen robust growth in recent months. In the first quarter of 2023, the country expanded at an annual rate of 3.4%, outpacing the growth rates of the United States (2.1%) and the European Area (0.5%). This impressive performance is due to a number of factors, [including strong consumption, a surge in exports to the United States, and an inflow of investment from companies](#) looking to build supply chains closer to the U.S. to mitigate disruptions from abroad. Additionally, the Mexican peso (MXN) has been one of the best-performing currencies in the world, which has mitigated inflationary pressures within the region.

Mexico: Gross Domestic Product, Market Prices
% Change - Annual Rate   SA, 2018.NewPesos
Source: Instituto Nacional de Estadística y Geografía/Haver Analytics

- The biggest question about a Sheinbaum presidency is whether she will be able to establish herself as her own political figure, independent of Andrés Manuel López Obrador. With approval ratings above 60%, it is widely believed that AMLO will try to maintain his influence on the party behind the scenes. The main difference between Sheinbaum and her predecessor is that she supports a transition to nationally subsidized renewable energy, while AMLO favors propping up Mexico's oil industry. That said, they both [agree on the need to protect Mexico's lithium resources from privatization.](#)

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					Expected	Prior	Rating
EST	**Indicator**				**Expected**	**Prior**	**Rating**
10:00	Wholesale Trade Sales	m/m	Jul		0.2%	-0.7%	**
10:00	Wholesale Inventories	m/m	Jul F		-0.1%	-0.1%	***
15:00	Consumer Credit	m/m	Jul		$16.000b	$17.847b	*
Federal Reserve							
EST	**Speaker or Event**		**District or Position**				
9:00	Michael Barr Speaks About Payments Innovation		Federal Reserve Board Vice Chair for Supervision				

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	GDP SA	q/q	2Q F	1.2%	1.5%	1.4%	***	Equity and bond neutral
	GDP Deflator	y/y	2Q F	3.5%	3.4%	3.4%	***	Equity and bond neutral
	BoP Current Account Balance	m/m	Jul	¥2771.7b	¥1508.8b	¥2245.9b	***	Equity and bond neutral
	BoP Trade Balance	m/m	Jul	¥68.2b	¥328.7b	¥165.4b	**	Equity and bond neutral
Australia	Foreign Reserves	m/m	Aug	A$94.9b	A$91.0b		**	Equity and bond neutral
EUROPE								
Germany	CPI	y/y	Aug F	6.1%	6.1%	6.1%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Aug F	6.4%	6.4%	6.4%	**	Equity and bond neutral
France	Industrial Production	y/y	Jul	2.7%	-0.3%	1.4%	***	Equity bullish, bond bearish
	Manufacturing Production	y/y	Jul	2.7%	-0.2%		**	Equity bullish, bond bearish
Russia	Money Supply, Narrow Definition	w/w	1-Sep	18.59t	18.62t		*	Equity and bond neutral
Russia	Official Reserve Assets	m/m	Aug	581.7b	590.0b		*	Equity and bond neutral
	Gold and Forex Reserves	m/m	1-Sep	$583.5b	$580.5b		***	Equity and bond neutral
AMERICAS								
Canada	Building Permits	m/m	Jul	--	6.1%	-2.4%	**	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	565	1	Up
3-mo T-bill yield (bps)	528	529	-1	Up
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	540	540	0	Up
U.S. Libor/OIS spread (bps)	543	542	1	Up
10-yr T-note (%)	4.26	4.25	0.01	Flat
Euribor/OIS spread (bps)	380	380	0	Up
Currencies	Direction			
Dollar	Flat			Up
Euro	Flat			Down
Yen	Down			Down
Pound	Flat			Down
Franc	Up			Up

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.

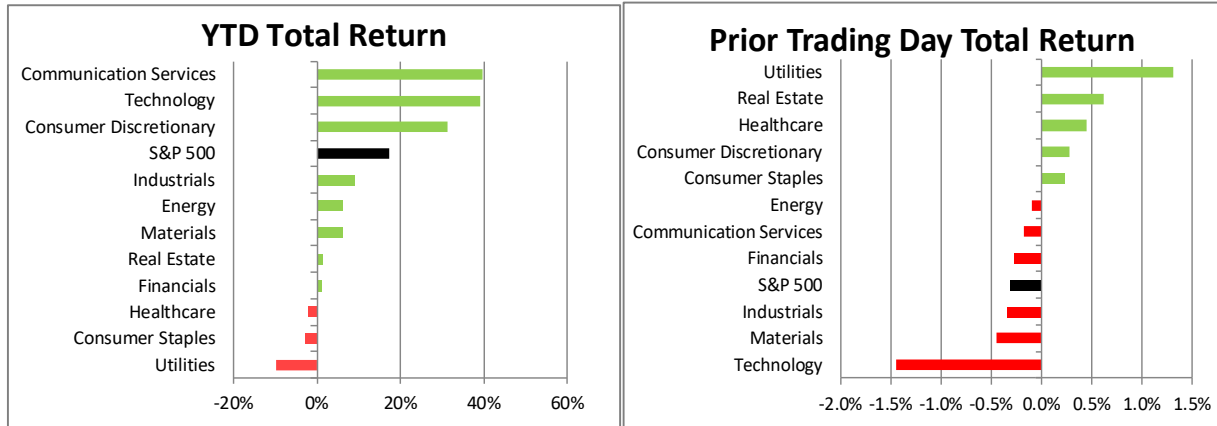| DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	$90.60	$89.92	0.76%	
WTI	$87.47	$86.87	0.69%	
Natural Gas	$2.63	$2.58	2.09%	
Crack Spread	$33.63	$31.81	5.72%	
12-mo strip crack	$29.24	$28.66	2.05%	
Ethanol rack	$2.44	$2.44	0.02%	
Metals				
Gold	$1,923.14	$1,919.68	0.18%	
Silver	$23.00	$22.97	0.16%	
Copper contract	$372.40	$376.20	-1.01%	
Grains				
Corn contract	$487.75	$486.25	0.31%	
Wheat contract	$598.75	$599.75	-0.17%	
Soybeans contract	$1,360.00	$1,359.50	0.04%	
Shipping				
Baltic Dry Freight	1,141	1,081	60	
DOE Inventory Report				
	Actual	Expected	Difference	
Crude (mb)	-6.3	-2.0	-4.3	
Gasoline (mb)	-2.7	-1.0	-1.7	
Distillates (mb)	0.7	1.0	-0.3	
Refinery run rates (%)	-0.2%	0.0%	-0.2%	
Natural gas (bcf)	33	41	-8	

Weather

The 6-10 and 8-14 day forecasts currently call for warmer-than-normal temperatures for the western half of the country and the Gulf states, with below-normal temperatures for New England and the Midwest. The forecasts call for wetter-than-normal conditions in most states on the East Coast and Great Plains, with dry conditions in the Midwest and Pacific Northwest.

There are currently two atmospheric disturbances in the Atlantic Ocean. Hurricane Lee is now a category 5 major storm but will move well north of the Virgin Islands and Puerto Rico going into the weekend and into early next week. It is too early to say at this time how strong the storm will be when it makes possible landfall on the East Coast. The other disturbance, Tropical Storm Margot, is locate in the Central Atlantic Ocean and is expected to move northward. We note that Atlantic hurricane activity peaks, on average, September 15.
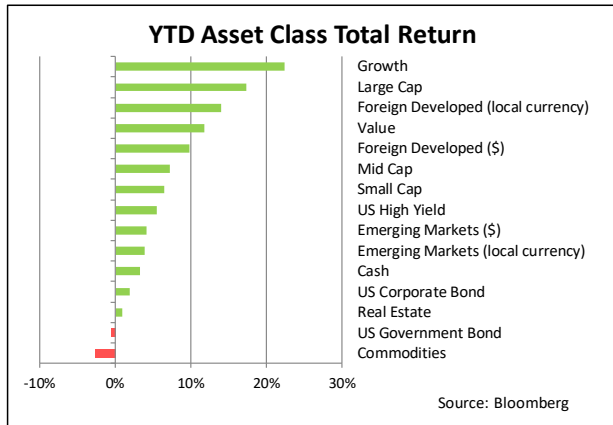
Data Section

U.S. Equity Markets – (as of 9/7/2023 close)

YTD Total Return

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

-20% 0% 20% 40% 60%

Prior Trading Day Total Return

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

-2.0% -1.5% -1.0% -0.5% 0.0% 0.5% 1.0% 1.5%

(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 9/7/2023 close)

YTD Asset Class Total Return

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

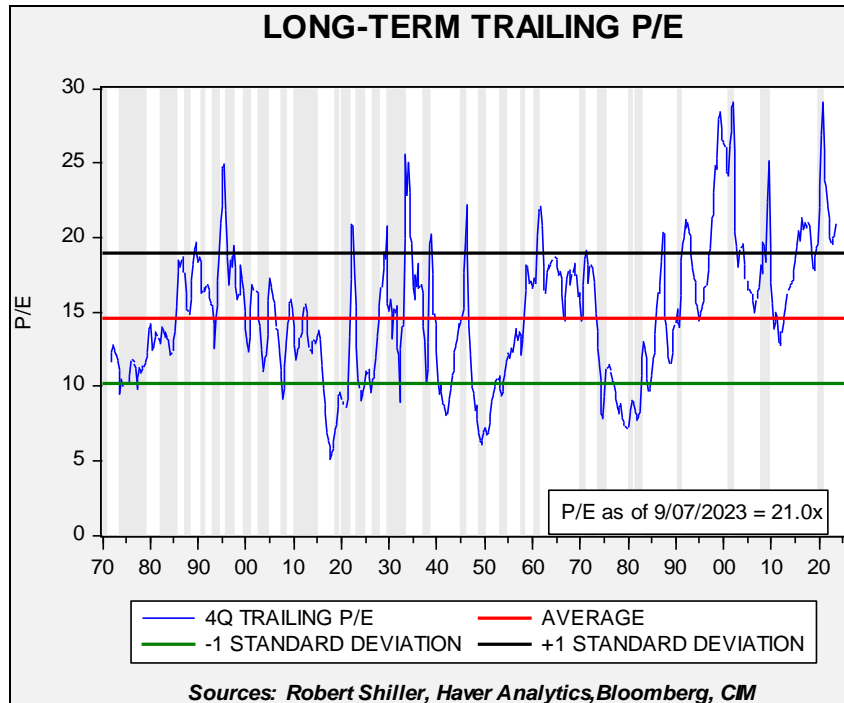-10% 0% 10% 20% 30%

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 7, 2023

LONG-TERM TRAILING P/E

P/E as of 9/07/2023 = 21.0x

Legend:
- 4Q TRAILING P/E
- AVERAGE
- -1 STANDARD DEVIATION
- +1 STANDARD DEVIATION

Sources: Robert Shiller, Haver Analytics,Bloomberg, CIM

Based on our methodology,[1] the current P/E is 21.0x, unchanged from last week.

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 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.