Daily Comment

Confluence INVESTMENT MANAGEMENT

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[Posted: April 11, 2025 — 9:30 AM ET] Global equity markets are generally higher this morning. In Europe, the Euro Stoxx 50 closed down 0.9% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.8%. Chinese markets were higher, with the Shanghai Composite up 0.5% from its previous close and the Shenzhen Composite up 0.7%. US 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 in bold:

Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
"Growing Fragility in the US Bloc" (4/7/25) + podcast	"Managing an Economic Slowdown" (3/31/25) + podcast	Q1 2025 Report Q1 2025 Rebalance Presentation	The Confluence of Ideas podcast Business Cycle Report

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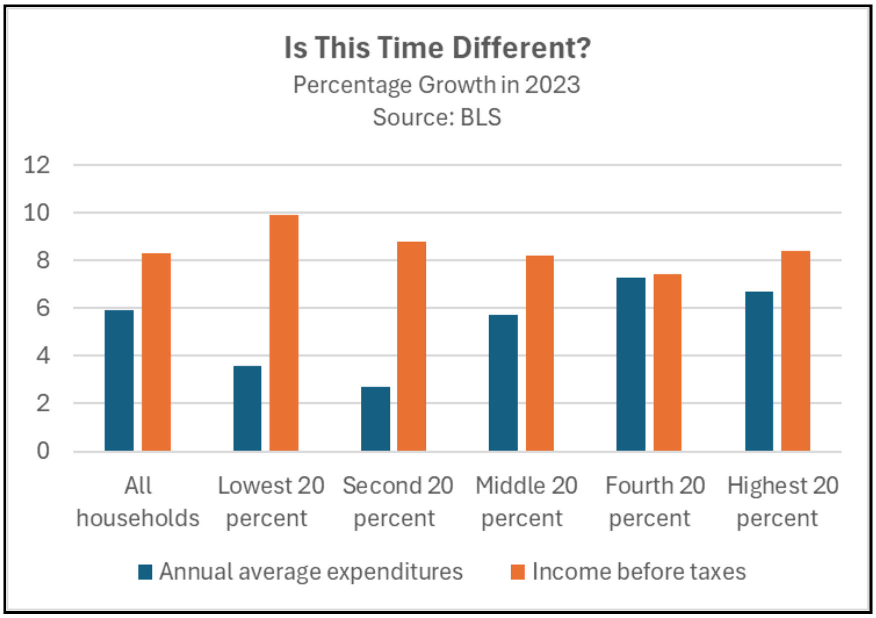
Good morning! Markets are closely tracking the latest trade developments. In sports, Alex Ovechkin has cemented his legacy as the NHL's all-time leading goal scorer. Today's *Comment* will explore why the bond market continues to shrug off inflation data, provide an update on the Trump tax bill, and discuss the EU's escalating regulatory push against Big Tech. We'll also cover other market-moving news and, as always, provide a roundup of key international and domestic data releases.

Bond Market Turmoil: In a telling sign of shifting market priorities, bond investors largely dismissed the better-than-expected inflation data.

- The Consumer Price Index (CPI) fell in March for the first time in nearly five years, suggesting that recent tariffs have not yet translated into higher consumer prices. The index dipped 0.1% month-over-month, defying economists' expectations of a 0.1% increase. Even the core CPI, which excludes volatile food and energy costs, inched up just 0.1%, well below the projected 0.3% rise. The moderation in inflation was driven largely by falling gasoline and used car prices.
- While the slowdown in the CPI report was welcomed, the exact drivers of the decline remain unclear. Weak demand — likely tied to broader economic concerns — appears to

have weighed heavily on gasoline prices and airline fares, which fell 6.3% and 5.3%, respectively. Meanwhile, shelter cost, the index's largest component, grew at its slowest pace since June of last year. The moderation in shelter costs suggests that the post-pandemic price distortions are gradually working their way through the economy.

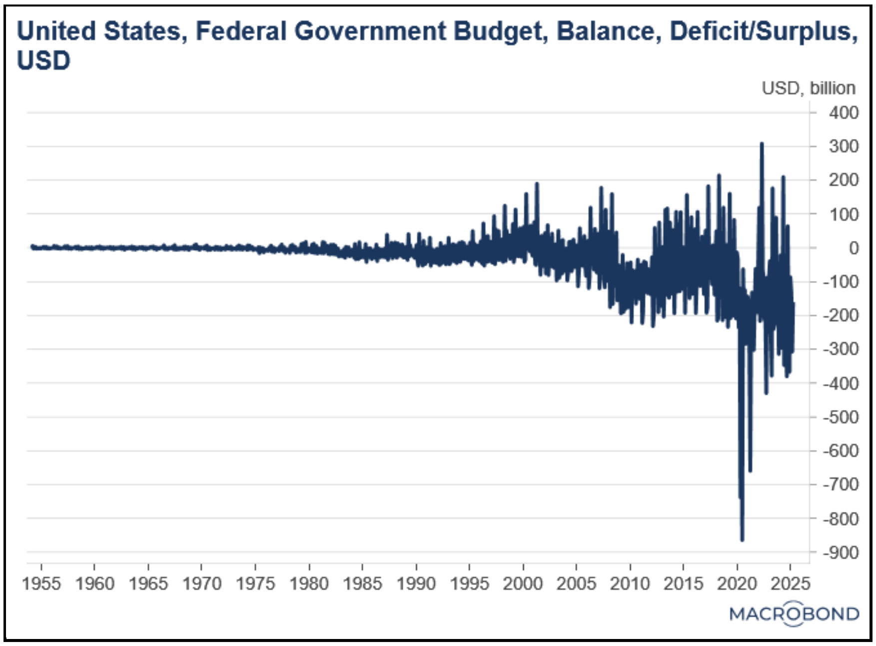
- While cooling inflation has traditionally been welcomed by markets, investors are growing increasingly concerned about persistent price pressures due to tariffs. Retailers are now warning of potential price hikes as rising costs and lower inventories squeeze margins. These increases could emerge across various sectors, from imported fruits (with the US importing roughly 65% of its supply) to bicycles (which rely heavily on foreign components).



- Corporations appear to be ready to test their pricing power, with firms passing input costs on to consumers. While this worked early in the business cycle, it is unclear if it will be effective in the current environment. Lower-income households, while initially protected by pandemic-era savings and wage growth, now face diminishing financial cushions. Simultaneously, equity market declines threaten to suppress consumption via the wealth effect among affluent demographics. As a result, firms may face resistance.
- While stagflation cannot be ruled out entirely, it's important to note this phenomenon typically occurs during severe energy shocks. In fact, before the 1970s, most economists considered stagflation theoretically impossible. That said, given the unexpected resilience of households in weathering inflation so far, we can't dismiss the possibility completely. Currently, the bond market appears to be establishing a new equilibrium, a process that may temporarily impair its traditional role as an economic indicator.

Fiscal Deficit Widens: As Republicans move closer to passing tax cuts, growing concerns emerge that investors may become wary of holding debt due to the rising deficit and uncertainty about future economic growth.

- [House Republicans advanced their budget blueprint, 216-214], targeting extensions of Trump-era tax cuts and deeper spending reductions. The close vote, which relied on almost complete GOP support, revealed the party's narrow majority. Lawmakers touted potential long-term savings of $1.5 trillion, but the bill only specifies $4 billion in cuts over the next decade, demonstrating a substantial discrepancy between their stated fiscal goals and the immediate impact of the legislation.
- Despite some fluctuations, the US deficit remains a significant concern. The federal government reported a $1.307 trillion shortfall for the first half of the fiscal year (October-March), marking the second-largest six-month deficit on record. This figure is close to the unprecedented $1.706 trillion deficit seen during the same period in 2021, when pandemic-related expenditures were at their highest.



- Luckily, investor appetite for long-term bonds in the primary market remains resilient in the face of headwinds. Thursday's $22 billion, 30-year Treasury auction saw robust demand, with the debt clearing at 4.435%, below the expected yield at the bid deadline. This strong showing follows Wednesday's solid 10-year Treasury auction, suggesting investor concerns about tariffs dampening demand for US debt may be overstated.
- While concerns persist about the recent rise in 10-year Treasury yields, there are no clear indicators this represents a crisis. The upward movement appears primarily driven by investors raising cash through position liquidations, though market speculation points to possible foreign central bank selling — the People's Bank of China being the most probable candidate. Should this yield momentum continue, Federal Reserve intervention may become increasingly likely.

EU Prepares for US Talks: The EU is prepared to protect its interests as it seeks to meet the US halfway in some of its demands.

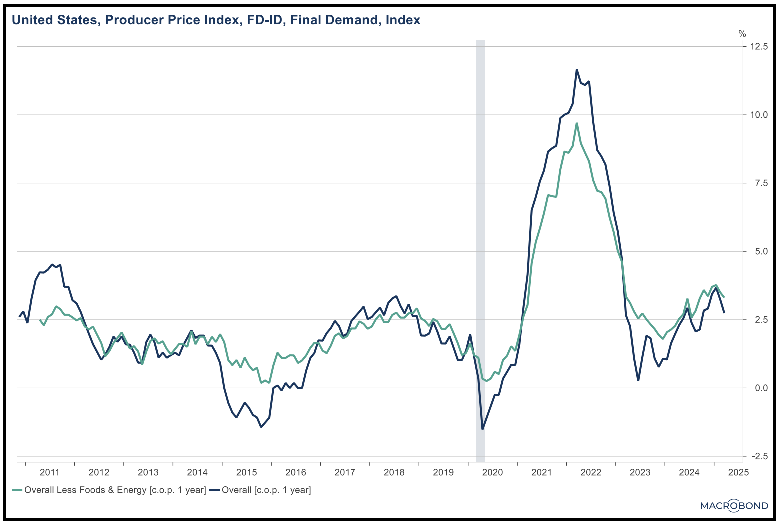
- European Commission President Ursula von der Leyen is set to negotiate with the US during a 90-day window. However, she has warned that the EU is prepared to walk away if talks are not conducted in good faith and potentially retaliate by targeting US trade in services, specifically tech firms, with digital taxes. Her threat follows US efforts to address the EU trade imbalance and scrutinize its tax policies.
- Her remarks follow the Trump administration's criticism of the EU, targeting not only its trade surplus with the US but also its defense spending, tax policies, and regulatory framework. While the European Union has shown a willingness to discuss military expenditure and trade issues, it has remained silent on addressing other American concerns such as getting rid of VAT or loosening tech regulation.
- The current standoff between the US and EU will likely center on establishing a mutually beneficial framework for cooperation. The most probable outcome would involve creating an economic ecosystem that simultaneously limits China's influence while advancing Western technological ambitions. Given these strategic imperatives, we believe negotiations could still foster closer transatlantic ties, provided both sides demonstrate a willingness to make concessions for a meaningful agreement.

End to Tariff Madness? China has retaliated against the US decision to impose 145% tariffs on its goods by introducing 125% tariffs on American products. However, Beijing has indicated it does not intend to escalate tariffs further.

- China's move to raise tariffs on US goods signals its readiness to withstand a prolonged trade conflict with Washington. While Beijing has pledged to avoid further tit-for-tat measures, it has firmly stated it will not back down. These tensions underscore the accelerating economic decoupling between the world's two largest economies.
- These escalating tariffs have now reached levels that make cross-border commerce commercially unviable for many firms. This development threatens corporate earnings in both nations, as US companies have depended on China's rapidly growing consumer market for overseas profits, while Chinese firms have relied on access to America's massive consumer base.

US Economic Releases

The March ***producer price index (PPI)*** fell by a seasonally adjusted 0.4%, versus an expected increase of 0.2% and a revised 0.1% rise in February. Excluding the volatile food and energy components, the March ***"core" PPI*** fell 0.1%, versus an anticipated rise of 0.3% and a revised gain of 0.1% in the previous month. The overall PPI in March was up just 2.7% from the same month one year earlier, while the core PPI was up 3.3%. Such softer-than-expected inflation readings would normally raise the possibility of more aggressive interest-rate cuts by the Fed, but that dynamic could be short-circuited this time because tariff-driven price increases could still be coming. The chart below shows the year-over-year change in the PPI and the core PPI over the last decade or so.



The following table lists the releases and/or Fed events scheduled for the rest of the day.

Economic Releases						
EST	Indicator			Expected	Prior	Rating
10:00	U. of Michigan Consumer Sentiment	m/m	Apr P	53.5	57.0	***
10:00	U. of Michigan Current Conditions	m/m	Apr P	60.8	63.8	**
10:00	U. of Michigan Future Expectations	m/m	Apr P	50.7	52.6	**
10:00	U. of Michigan 1-Year Inflation Expectation	m/m	Apr P	5.2%	5.0%	*
10:00	U. of Michigan 5-10 Year Inflation Expectation	m/m	Apr P	4.3%	4.1%	*
Federal Reserve						
EST	Speaker or Event	District or Position				
8:00	Neel Kashkari Appears on CNBC	President of the Federal Reserve Bank of Minneapolis				
9:00	Susan Collins Speaks on Yahoo Finance	President of the Federal Reserve Bank of Boston				
10:00	Alberto Musalem Speaks on US Economy and Monetary Policy	President of the Federal Reserve Bank of St. Louis				
11:00	John Williams Speaks on Economic Outlook and Monetary Policy	President of the Federal Reserve Bank of New York				

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	Money Stock M2	y/y	Mar	0.8%	1.2%		**	Equity and bond neutral
	Money Stock M3	y/y	Mar	0.4%	0.7%		**	Equity and bond neutral
New Zealand	BusinessNZ Manufacturing PMI	m/m	Mar	53.2	54.1		***	Equity and bond neutral
India	Industrial Production	y/y	Feb	2.9%	5.2%	3.6%	***	Equity bearish, bond bullish
EUROPE								
Germany	CPI	y/y	Mar F	2.2%	2.2%	2.2%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Mar F	2.3%	2.3%	2.3%	**	Equity and bond neutral
UK	GDP	y/y	Feb	0.5%	0.0%	-0.1%	***	Equity bullish, bond bearish
	Industrial Production	y/y	Feb	0.1%	-0.5%	-2.3%	***	Equity bullish, bond bearish
	Manufacturing Production	y/y	Feb	0.3%	-0.9%	-2.2%	**	Equity bullish, bond bearish
	Index of Services 3M/3M	m/m	Feb	0.6%	0.4%	0.5%	**	Equity and bond neutral
	Construction Output	m/m	Feb	1.6	0.0	1.7	**	Equity and bond neutral
	Visible Trade Balance GBP/Mn	m/m	Feb	-£20809m	-£18219m	-£17849m	**	Equity and bond neutral
	Trade Balance GBP/Mn	m/m	Feb	-£1956m	£301m	-£1400m	**	Equity and bond neutral
Russia	Gold and Forex Reserves	m/m	4-Apr	$658.0b	$645.6b		***	Equity and bond neutral
	Money Supply, Narrow Definition	w/w	4-Apr	17.95t	17.94t		*	Equity and bond neutral
AMERICAS								
Canada	Building Permits	m/m	Feb	2.9%	-4.3%	-0.50	**	Equity bullish, bond bearish
Mexico	Industrial Production	y/y	Feb	-1.3%	-2.9%	-3.5%	***	Equity bullish, bond bearish
	Manufacturing Production	y/y	Feb	-0.3%	-0.8%	-3.0%	***	Equity bullish, bond bearish
Brazil	IBGE Inflation IPCA	y/y	Mar	5.48%	5.06%		***	Equity and bond neutral
	Econimic Activity	y/y	Feb	4.1%	3..58%	3.6%	*	Equity bullish, bond bearish

Financial Markets

The table below highlights some of the indicators that we follow daily. 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.

Fixed Income	Today	Prior	Change	Trend
3-mo T-bill yield (bps)	419	421	-2	Up
U.S. Sibor/OIS spread (bps)	424	426	-2	Down
U.S. Libor/OIS spread (bps)	422	423	-1	Down
10-yr T-note (%)	4.42	4.43	-0.01	Up
Euribor/OIS spread (bps)	227	230	-3	Down
Currencies	**Direction**			
Dollar	Up			Down
Euro	Down			Up
Yen	Up			Up
Pound	Down			Up
Franc	Down			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.

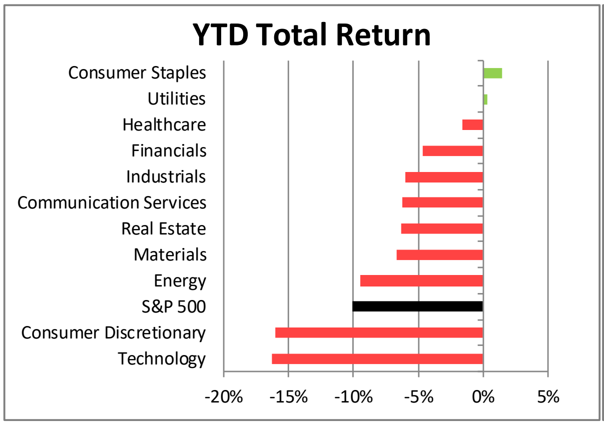
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$63.18	$63.33	-0.24%	
WTI	$59.91	$60.07	-0.27%	
Natural Gas	$3.47	$3.56	-2.53%	
Crack Spread	$23.88	$23.42	1.96%	
12-mo strip crack	$20.94	$20.60	1.68%	
Ethanol rack	$1.88	$1.88	0.10%	
Metals				
Gold	$3,214.25	$3,176.23	1.20%	
Silver	$31.49	$31.22	0.86%	
Copper contract	$445.05	$433.65	2.63%	
Grains				
Corn contract	$490.00	$488.75	0.26%	
Wheat contract	$547.00	$538.00	1.67%	
Soybeans contract	$1,037.75	$1,036.75	0.10%	
Shipping				
Baltic Dry Freight	1,269	1,259	10	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	2.55	2.60	-0.05	
Gasoline (mb)	-1.60	-1.42	-0.18	
Distillates (mb)	-3.54	0.10	-3.64	
Refinery run rates (%)	0.7%	0.5%	0.2%	
Natural gas (bcf)	57	58	-1	

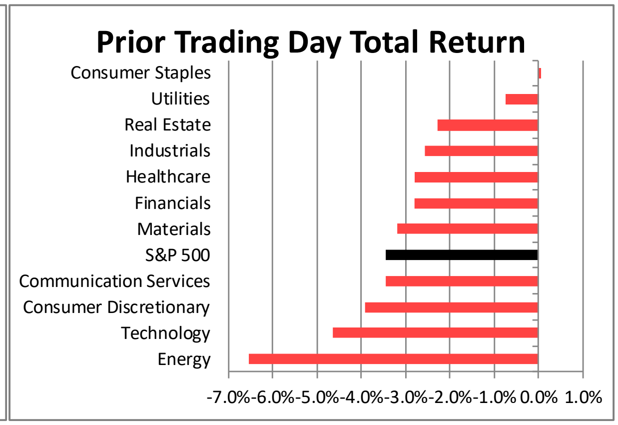
Weather

The 6-to-10 and 8-to-14-day forecasts show warmer-than-normal temperatures from the West Coast through the Great Plains, with cooler-than-normal temperatures in New England. The forecasts call for wetter-than-normal conditions only in western Texas and Maine, with dry conditions in the Far West and along the Gulf Coast.

Data Section

US Equity Markets – (as of 4/10/2025 close)

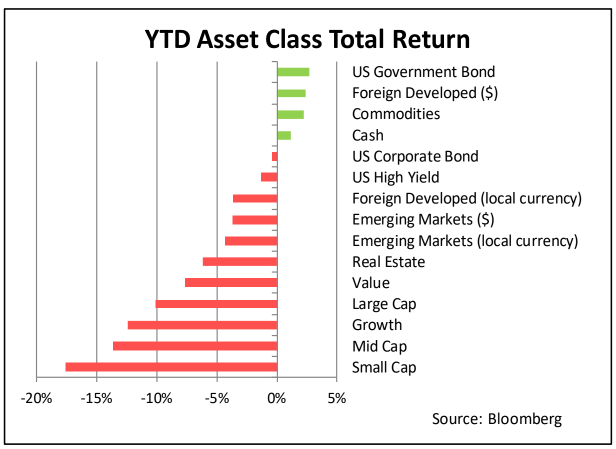




(Source: Bloomberg)

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 4/10/2025 close)

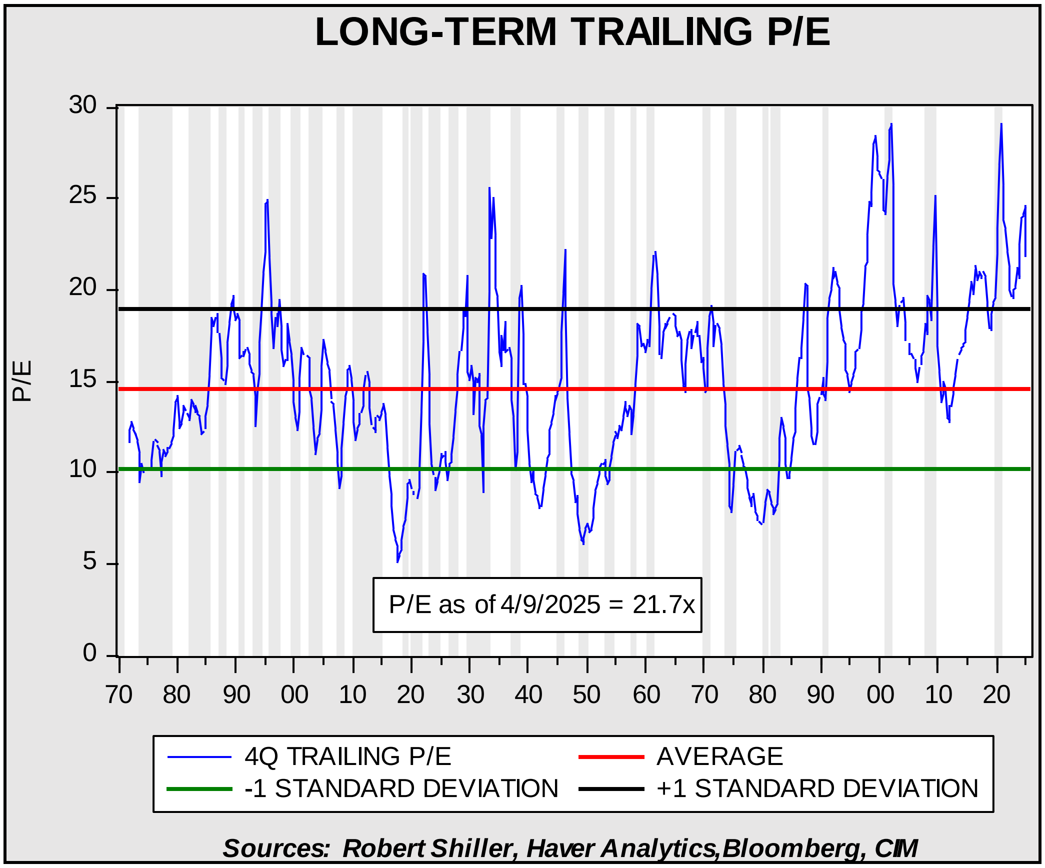


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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), US Corporate Bond (iShares iBoxx $ Investment Grade Corporate Bond ETF), US Government Bond (iShares 7-10 Year Treasury Bond ETF), US 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

April 10, 2025



Based on our methodology,[1] the current P/E is 21.7x, down 2.3 from our last report. The drop in the multiple resulted primarily from a sharp decrease in the stock price index, which offset the decline in Q1 earnings.

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 three actual quarters (Q2, Q3, and Q4) and one estimate (Q1). 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.