Daily Comment

Confluence
INVESTMENT MANAGEMENT

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: April 7, 2025 — 9:30 AM ET] Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 closed down 5.1% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 10.5%. Chinese markets were lower, with the Shanghai Composite down 7.3% from its previous close and the Shenzhen Composite down 10.8%. US 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 in bold:

Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
"The Bessent Gambit" (3/24/25) + podcast	"Managing an Economic Slowdown" (3/31/25) + podcast	Q1 2025 Report Q1 2025 Rebalance Presentation	The Confluence of Ideas podcast Business Cycle Report

---

Our *Comment* today opens with the very latest on the Trump administration's new tariff policies. We next review several other international and US developments with the potential to affect the financial markets today, including potential policy responses to the tariffs from countries such Japan and Germany, and news that the administration is considering a massive cut in the US Army's active-duty troop count.

US Tariff Policy: President Trump's baseline 10% tariff on most US imports went into effect over the weekend, and Treasury Secretary Bessent and Commerce Secretary Lutnick said in press interviews that the additional "reciprocal" tariffs on dozens of countries will start as planned on Wednesday. They also warned that even if foreign countries offer concessions to reduce their tariff rates, any negotiations will take time, and the maximum tariffs would be in place until then.

- Bessent also downplayed the drop in the value of risk assets because of last week's tariff announcement, saying, "Americans who want to retire right now, Americans who have put away for years in their savings accounts, I think they don't look at the day-to-day fluctuations of what's happening."

- Bessent's statement is further evidence that the administration intends to stick by its economic policies even if economic activity weakens or risk assets continue to lose value. That raises a risk that any needed course correction may not come until it's too late to avoid a recession or an even steeper market downturn.
- In a continuing response to the tariffs, stock prices in Asia and Europe plunged overnight, and US stock futures are signaling another sharp drop at market open. Oil prices also continue their sharp drop, while investors are bidding up bonds, which is driving down yields.
- Just as concerning, we have noted that gold, cryptocurrencies, European defense stocks, and other assets that had recently been appreciating are now turning downward as well. That suggests that at least some investors are now facing margin calls and are selling what they can, not what they want to. That creates a risk of the financial markets entering into a self-reinforcing downward spiral that causes lasting economic damage.
- Of course, US investors have a very high level of cash "on the sidelines" in money market funds, which could theoretically be used to buy stocks once they look like a good value. However, the administration's promise to stay the course with its aggressive policies and its past backtracking have created so much uncertainty that investors may be unusually wary about buying the market's current decline.

Eurozone: Greek central bank chief Yannis Stournaras, who sits on the policymaking board of the European Central Bank, warned in an interview today that the Trump administration's new tariffs would create an unexpected demand shock for the eurozone, potentially pushing down consumer price inflation below the ECB's target. The statement signals that some of the region's policymakers may want to keep cutting interest rates at the ECB's policy meeting next week, despite ECB President Lagarde's recent hints of a pause in rate cuts.

Germany: Friedrich Merz, who is negotiating to form the country's next government and is likely to become its chancellor, warned today that the economic and financial market turbulence from the US's new tariffs mean that Germany must regain economic competitiveness as quickly as possible. Indeed, Merz said that strategies to deal with the US tariffs will now be a key focus for his center-right CDU party and the center-left SPD as they continue talks to form a coalition. That raises the prospect for big economic reforms in Germany once the government is formed.

United Kingdom: According to lender Halifax, the average price of a home in March was up just 2.8% year-over-year, matching the increase in the year to February but coming in short of the expected increase of 3.5%. On a month-over-month basis, UK home prices fell in each of the last two months, adding to the evidence that the rapid home price appreciation of 2024 has come to an end.

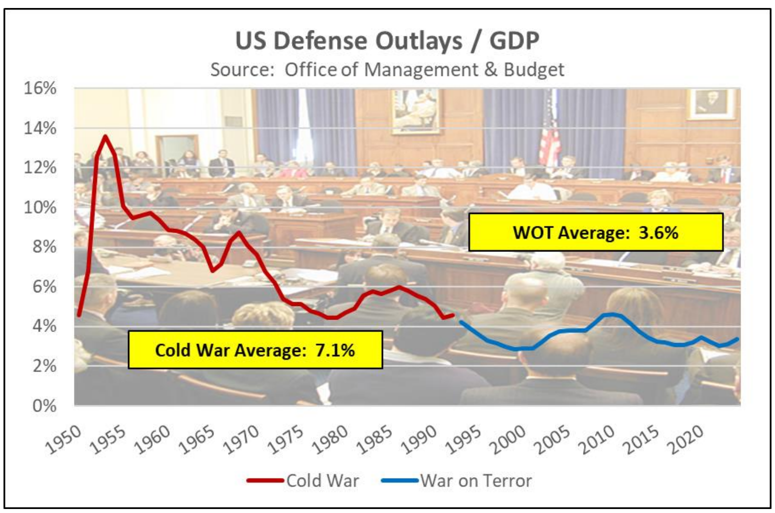
Japan: With the Japanese economy facing both brutal import tariffs in the US and fast-rising prices for food and other basics at home, some politicians in the ruling Liberal Democratic Party are pushing for a cut in the country's consumption tax. Top LDP leaders are still reluctant to go that far, fearing wider budget deficits and increased debt, but rank-and-file party members are pushing to put such a tax cut in the LDP's platform for this summer's Upper House elections.

- The rising calls for consumption tax cuts in Japan illustrate how countries around the world will feel pressure for stimulus programs as their exports run up against the Trump administration's new tariffs.
- As the debate in Japan shows, any such stimulus programs could lead to bigger fiscal problems and exacerbate the economic disruptions from the new US trade policies.
- Separately, press reports say Chinese officials are also mulling significant economic stimulus measures, including a devaluation of the renminbi, to cushion the blow of the tariffs.

European Union-United States: European Commission Vice-President Séjourné today [hinted in an interview that the EU won't put tariffs on US bourbon as it retaliates for the Trump administration's new imposts]. That suggests that the EU executive has caved to demands from the wine and spirits industries of countries such as France, Italy, and Ireland, which feared the US would impose even higher tariffs on their products if the EU retaliated against US whiskey.

US Military: According to a report late last week, the US Army [is "quietly" mulling a cut in its active-duty troop count from about 450,000 now to as little as 360,000 in the coming years]. It is unknown whether any cuts are being considered for the Army Reserve or the National Guard. The contemplated cuts reflect a number of pressures, including President Trump's directive to cut the defense budget by 8% and the administration's plan to shift military resources away from land maneuver forces in Europe to naval and air forces in the Asia-Pacific region.

- If the US downsizes its ground forces and shifts military assets out of Europe before the Europeans can rebuild their own defense capabilities, Russia would likely be emboldened to assert itself in the region, if not by actual territorial aggression, then perhaps by political pressure.
- In any case, the drive to cut defense spending comes even though the US defense burden (military outlays as a share of gross domestic product) is now at a historic low of only about 3.3%, versus an average of 3.6% during the War on Terror and 7.1% during the long Cold War.



US Agriculture Industry: A report on Friday said administration officials and congressional lawmakers are considering new fiscal support for farmers hurt by retaliatory tariffs or other trade barriers imposed by other countries in response to President Trump's tariffs on US imports. The talks are in the early stages, so it isn't yet clear how big any such relief program would be. Still, the news suggests that US agribusiness stocks may hold up better than expected amid the evolving global trade war.

- On a related note, new analysis shows that the recent retreat in US egg prices likely stemmed from a massive surge of imports. According to the data, February egg imports from Mexico and Turkey were about four times higher than they were in the same month one year earlier.
- As avian influenza decimated US flocks earlier this year, prompting egg shortages and driving prices higher, Mexican and Turkish producers evidently responded to the price signal by shipping more to the US, exactly as economic theory would suggest. One key question now is whether the administration's new tariffs will push those egg imports down again, creating another fowl price experience for US egg buyers.

US Economic Releases

There were no economic releases prior to the publication of this report. The following table lists the releases and/or Fed events scheduled for the rest of the day.

Economic Releases						
EST	**Indicator**			**Expected**	**Prior**	**Rating**
15:00	Consumer Credit	m/m	Feb	$18.084b	$15.000b	*
Federal Reserve						
EST	**Speaker or Event**	**District or Position**				
12:00	Adriana Kugler Speaks on Inflation Dynamics, Phillips Curve	Member of the Board of Governors				

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	Labor Cash Earnings	y/y	Feb	3.1%	2.8%	3.0%	**	Equity and bond neutral
	Real Cash Earnings	m/m	Feb	-1.2%	-1.8%	-1.3%	*	Equity and bond neutral
	Leading Economic Index	m/m	Feb P	107.9	108.3	107.8	**	Equity and bond neutral
	Coincident Index	y/y	Feb P	116.9	116.1	116.7	**	Equity and bond neutral
Australia	Foreign Reserves	m/m	Mar	A$105.2	A$104.8b		**	Equity and bond neutral
China	Foreign Reserves	m/m	Mar	$3240.67b	$3227.22b	$3260.00b	**	Equity and bond neutral
EUROPE								
Eurozone	Retail Sales	y/y	Feb	2.3%	1.8%	1.9%	*	Equity bullish, bond bearish
Germany	Industrial Production WDA	y/y	Feb	-4.0%	-1.6%	-3.6%	**	Equity and bond neutral
	Trade Balance	m/m	Feb	17.7b	16.2b	18.5b	*	Equity and bond neutral
	Exports	m/m	Feb	1.8%	0.0%	1.5%	*	Equity and bond neutral
	Imports	m/m	Feb	0.7%	5.0%	-0.4%	*	Equity and bond neutral
Switzerland	Foreign Currency Reserves	m/m	Mar	725.6b	735.4b		***	Equity and bond neutral
	Domestic Sight Deposits CHF	w/w	4-Apr	433.4b	441.7b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	4-Apr	433.7b	451.2b		*	Equity and bond neutral
AMERICAS								
Canada	Net Change in Employment	m/m	Mar	-32.6k	1.1k	10.0k	***	Equity bearish, bond bullish
	Unemployment Rate	m/m	Mar	6.7%	6.6%	6.7%	***	Equity and bond neutral
	Participation Rate	m/m	Mar	65.2%	65.3%		*	Equity and bond neutral
Mexico	Vehicle Production	y/y	Mar	338669	320321		***	Equity and bond neutral
	Vehicle Exports	y/y	Mar	296964	259480		**	Equity and bond neutral

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)	413	415	-2	Down
U.S. Sibor/OIS spread (bps)	418	421	-3	Down
U.S. Libor/OIS spread (bps)	418	421	-3	Down
10-yr T-note (%)	3.99	4.00	-0.01	Down
Euribor/OIS spread (bps)	232	235	-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.

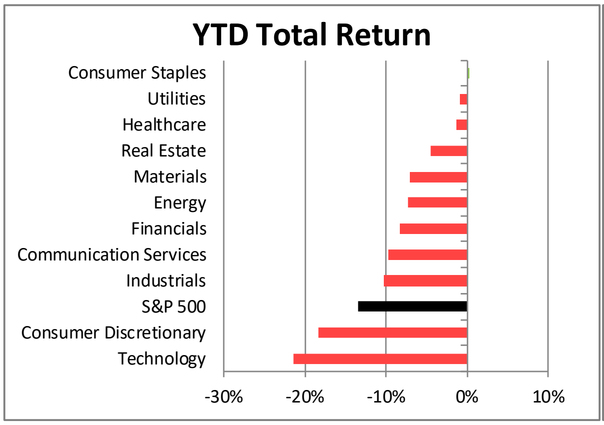
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$64.25	$65.58	-2.03%	
WTI	$60.65	$61.99	-2.16%	
Natural Gas	$3.80	$3.84	-1.09%	
Crack Spread	$24.92	$24.77	0.64%	
12-mo strip crack	$21.28	$21.28	-0.01%	
Ethanol rack	$1.89	$1.89	-0.18%	
Metals				
Gold	$3,041.43	$3,038.24	0.10%	
Silver	$30.48	$29.59	3.03%	
Copper contract	$437.45	$440.20	-0.62%	
Grains				
Corn contract	$459.00	$460.25	-0.27%	
Wheat contract	$528.25	$529.00	-0.14%	
Soybeans contract	$979.50	$977.00	0.26%	
Shipping				
Baltic Dry Freight	1,489	1,540	-51	

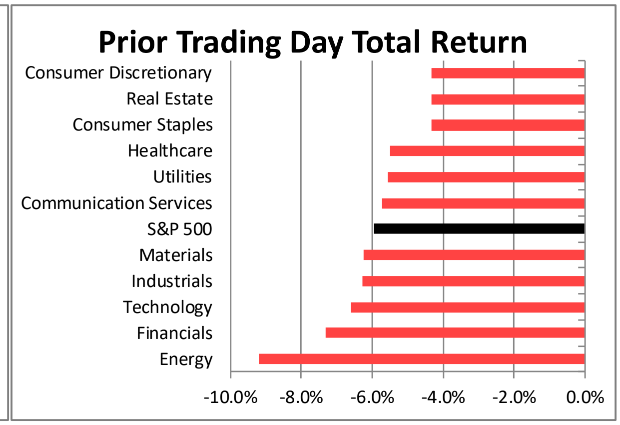
Weather

The 6-to-10 and 8-to-14-day forecasts show warmer-than-normal temperatures for most of the country. The precipitation outlook shows wetter-than-normal conditions in Northern states that border Canada, with drier-than-normal conditions for the rest of the country.

Data Section

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

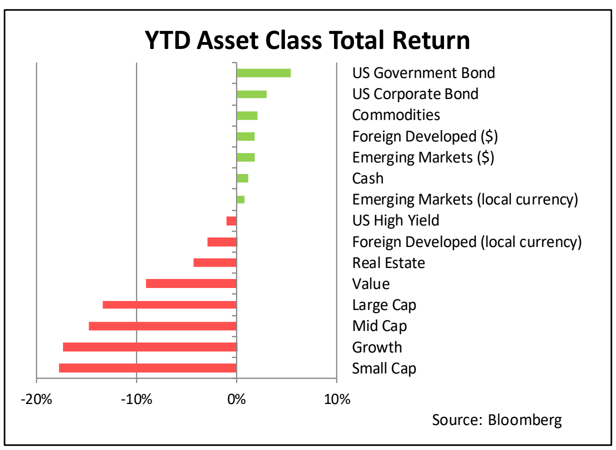




(Source: Bloomberg)

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 4/4/2025 close)

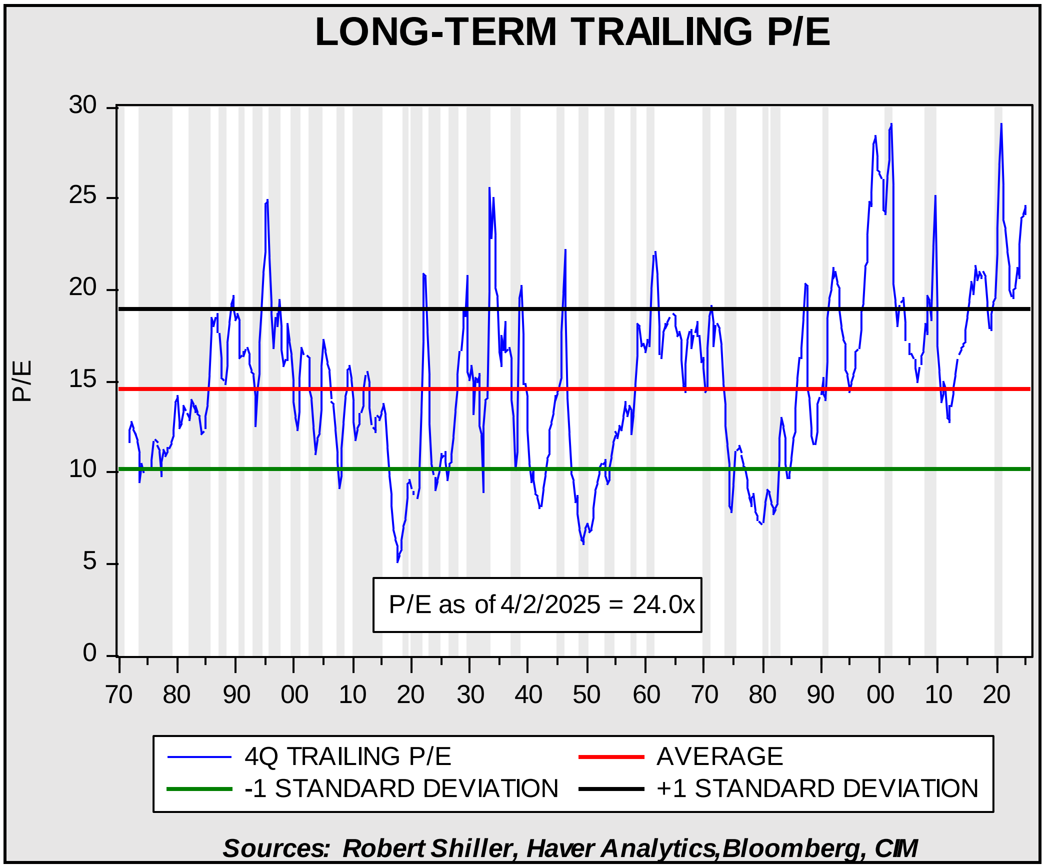


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 3, 2025



Based on our methodology,[1] the current P/E is 24.0x, down 0.7 from our last report. The drop in the multiple resulted primarily from a decrease in the stock price index and an increase in 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.

[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 (Q1, Q2, and Q3) and one estimate (Q4). 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.