Daily Comment

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[Posted: February 13, 2025 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed up 1.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.1%. Chinese markets were lower, with the Shanghai Composite down 0.4% from its previous close and the Shenzhen Composite down 0.8%. US equity index futures are signaling a lower open.

With 345 companies having reported so far, S&P 500 earnings for Q4 are running at $64.60 per share, compared to estimates of $64.79, which is up 11.7% from Q4 2023. Of the companies that have reported thus far, 77.3% have exceeded expectations while 17.2% have fallen short of expectations.

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
Middle Eastern Stock Markets: An Overview (2/10/25) + podcast	*American Exceptionalism and the Markets* (2/3/25) + podcast	Q1 2025 Report Q1 2025 Rebalance Presentation	**The Confluence of Ideas podcast** Value Equities Quarterly Update

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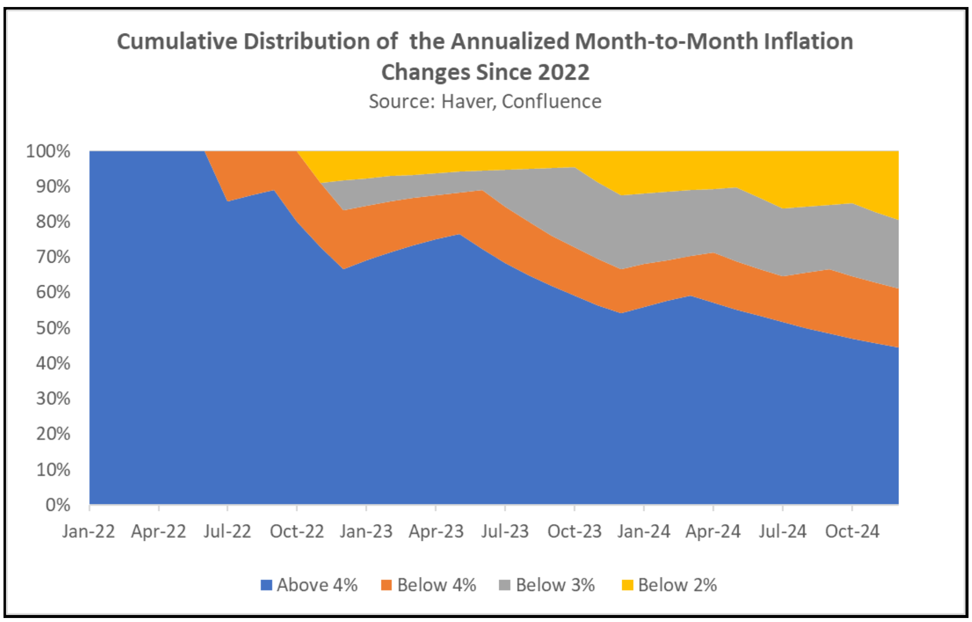
Good morning! The market is processing the latest developments in Ukraine. In sports news, Canada was able to defeat Sweden in the NHL 4 Nations Face-Off. Today's *Comment* will take a deeper dive into the CPI report, discuss the latest developments in the Ukraine-Russia talks, and provide updates on US congressional budget talks as well as other market news. As usual, it will include a roundup of international and domestic data releases.

CPI Fails First Test: The January CPI report surprised markets with a stronger-than-expected acceleration. Headline inflation rose to 3.0% from 2.9% year-over-year, and core inflation edged up to 3.3% from 3.2%. This higher reading led traders to scale back their forecasts for rate cuts this year from two to one and drove the 10-year Treasury yield upward.

- The good news is that despite the rise in the inflation report many of the sharp increases appear to be temporary. For instance, financial insurance was one of the primary drivers of inflation, and the increase is likely tied to the adjustment of premiums for the costs associated with the natural disasters that occurred toward the end of the year. Additionally, owners' equivalent rent and rent for primary residences, which are heavily weighted in the index, remained relatively subdued.
- The bad news is that the disinflationary pressure from new and used car prices, which had been a significant drag on the index, seems to be fading. This could mean that services, lately a persistent source of inflationary stickiness, will need to bear a greater burden in reducing overall inflation. Moreover, this development raises the risk of a resurgence in goods inflation, particularly if tariffs are implemented.
- The ugly news is that the window for making substantial progress toward the Fed’s 2% inflation target is narrowing. As highlighted in earlier reports, the first few months of the year typically offer the best opportunity for the Fed to make meaningful strides in lowering inflation. This is because the high readings from early 2024 are more likely to be replaced by figures that align with the long-run average as the year progresses.



- While the January inflation report was disappointing, with Fed Chair Powell noting that "more work needs to be done," Fed officials remain confident that inflation could fall to 2% by early 2026. This optimism is rooted in the growing frequency of inflation reports showing that inflationary momentum continues to trend downward.
- As illustrated in the chart above, the number of annualized monthly inflation reports exceeding 4% has dropped significantly and now represents less than half of the reports since 2022. This marks a sharp decline from the first few months of that period, when all

reports exceeded this threshold. Furthermore, a growing share of reports now show inflation below 3% and even at 2%, reinforcing the downward trajectory.

Ukraine War Talks: President Trump announced plans to hold talks with Russian President Vladimir Putin in an effort to help resolve the ongoing conflict in Ukraine. While no concrete plans to end the war have been proposed so far, it appears that Ukraine may need to make concessions and could increasingly rely on the European Union for additional support.

- Prior to the announcement, Defense Secretary Pete Hegseth stated that Ukraine's expectation of regaining its pre-2014 borders was unrealistic. He also expressed skepticism about the possibility of Ukraine joining NATO if a deal to resolve the conflict were to be reached.
- Hegseth emphasized that the US would not deploy troops on the ground to ensure Ukraine's security, adding that Europe would need to bolster its own presence to protect its borders as the US shifts more of its strategic focus toward countering China.
- The decision to push for concessions from Ukraine and Europe underscores the Trump administration's view of the EU as a junior partner in the relationship. While this approach is likely to raise tensions between Washington and Brussels, it could also facilitate a resolution to the conflict — a prospect that has already strengthened European equities and boosted the euro.

Budget Breakthrough: Senate Republicans advanced their budget resolution out of committee on Wednesday, moving closer to meeting the president's goal of securing funding for energy, defense, and border security. The measure establishes a fiscal framework that paves the way for conservative lawmakers to advance the Trump administration's agenda through the budget reconciliation process.

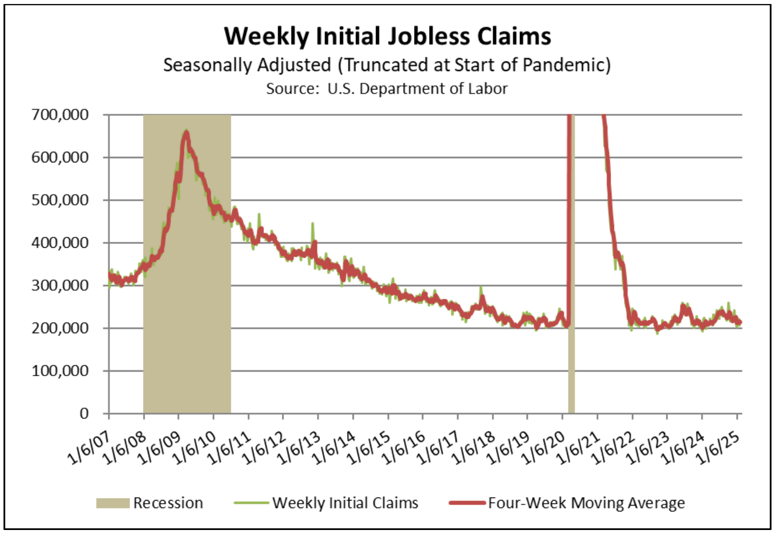
- Despite progress in the Senate, House Republicans have struggled to gain momentum as they work to fulfill President Trump's vision of a single "big, beautiful bill" that incorporates key elements of the Senate's proposal, including the highly touted tax cuts. However, their efforts are being hampered by fiscal hawks, who are demanding deeper budget cuts before they agree to support the deal.
- The latest proposal from House Republicans has sparked significant controversy, as it seeks to identify $2 trillion in budget cuts, raising concerns that they may consider reductions to social programs like Medicaid and food assistance for low-income households.
- Lawmakers in both chambers of Congress are expected to vote along party lines on any portion of President Trump's bill that includes tax cuts, making it increasingly likely that two separate bills will be passed rather than one. That said, any progress toward enacting tax cuts would likely be welcomed by equity markets, while proposed budget cuts could be favorable for bonds.

Reciprocal Tariffs: President Trump has vowed to impose tariffs on any country that levies duties on US goods. While the president has not specified which countries could be targeted, the timing of this announcement — coming just ahead of his scheduled meeting with Indian Prime Minister Narendra Modi — suggests it may serve as a negotiating tactic.

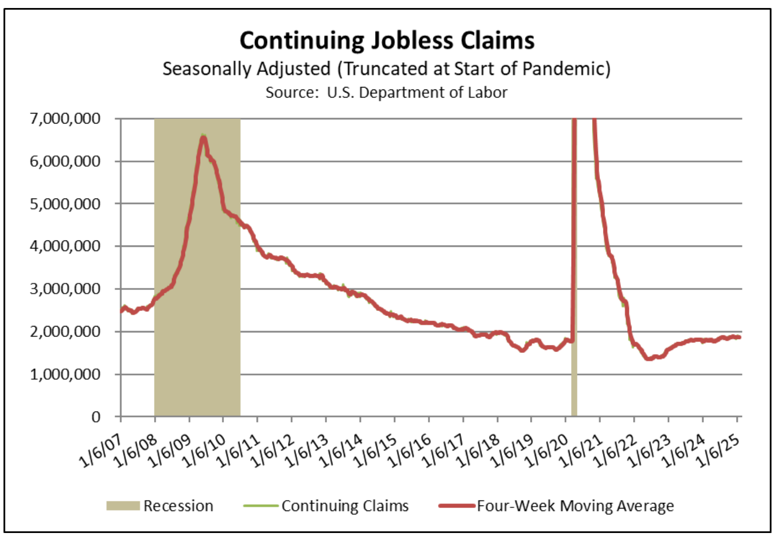
- The move is part of the president's three three-prong approach to tariffs, known as the three Rs (Restriction, Revenue, and Reciprocity), which come from former President William McKinley.
- Restrictions involve leveraging trade policies to boost domestic manufacturing by limiting imports. Revenue tariffs impose taxes on imported goods, creating an additional income stream for the government. Reciprocal tariffs, on the other hand, are used as a tool to pressure other countries into lowering their own tariffs.
- While William McKinley achieved some success in advancing his trade goals, President Trump may face a more daunting challenge. The key difference lies in the two approaches — Trump is attempting to implement all three Rs simultaneously, whereas McKinley applied them in combination over time.
- Trump's widespread use of tariffs to achieve multiple objectives may weigh on economic growth by making the investment environment less predictable. However, in the long run, these measures could potentially benefit exporters.

US Economic Releases

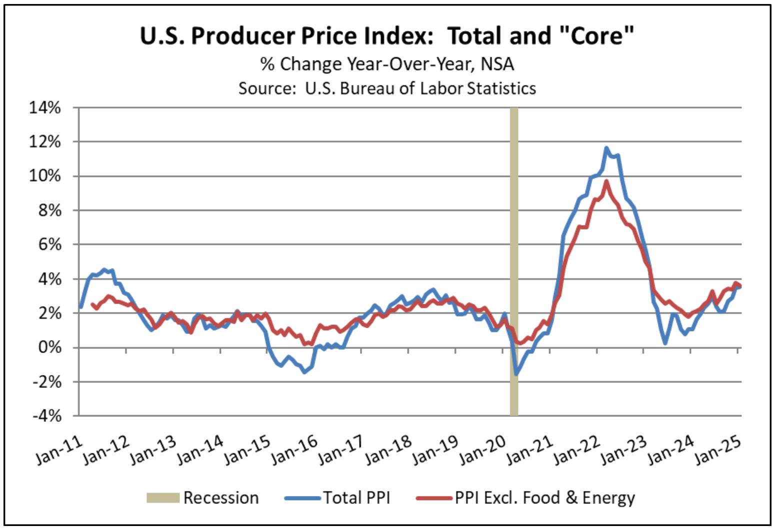
In the week ended February 8, ***initial claims for unemployment benefits*** fell to a seasonally adjusted 213,000, lower than both the expected level of 216,000 and the previous week's revised level of 220,000. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, fell to a low 216,000. The chart below shows how initial jobless claims have fluctuated since just before the Great Financial Crisis. The chart is truncated through much of the pandemic period because of the extremely high level of claims at that time.



In the week ended February 1, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) fell to a seasonally adjusted 1.850 million, below both the anticipated reading of 1.882 million and the prior week's reading of 1.886 million. The four-week moving average of continuing claims fell to 1,871,500, but it remains above the levels seen right before the coronavirus pandemic, suggesting it has become relatively hard for those who are laid off to find a new job quickly. The chart below shows how continuing claims have fluctuated since the GFC. It is also truncated during the pandemic period because of the high level of claims at the time.



Separately, the January ***producer price index (PPI)*** rose by a seasonally adjusted 0.4%, overshooting the expected increase of 0.3% but still marking a modest deceleration from the revised December rise of 0.5%. Excluding the volatile food and energy components, the January ***"core" PPI*** rose 0.3%, matching expectations and decelerating from the revised December increase of 0.4%. The overall PPI in January was up 3.5% from the same month one year earlier, while the core PPI was up 3.6%. The chart below shows the year-over-year change in the PPI and the core PPI over the last decade or so.



The table below lists the economic releases and Fed events scheduled for the rest of the day.

Economic Releases		
	No economic releases for the rest of today	
Federal Reserve		
EST	**Speaker or Event**	**District or Position**
4:00	Austan Goolsbee Apprears on Odd Lots	President of the Federal Reserve Bank of Chicago

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	PPI	y/y	Jan	4.2%	3.9%	4.0%	***	Equity and bond neutral
Australia	Consumer Inflation Expectation	m/m	Feb	4.6%	4.0%		*	Equity and bond neutral
New Zealand	2-Year Inflation Expectations	q/q	1Q	2.06%	2.12%		**	Equity and bond neutral
EUROPE								
Eurozone	Industrial Production WDA	y/y	Dec	-2.0%	-1.8%	-3.1%	**	Equity bullish, bond bearish
Germany	Current Account Balance	m/m	Dec	24.0b	21.9b		**	Equity and bond neutral
	CPI	y/y	Jan F	2.3%	2.3%	2.3%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Jan F	2.8%	2.8%	2.8%	**	Equity and bond neutral
UK	RICS House Price Balance	y/y	Jan	22%	26%	28%	**	Equity bullish, bond bearish
	Industrial Production	y/y	Dec	-1.9%	-2.0%	-2.1%	***	Equity and bond neutral
	Manufacturing Production	y/y	Dec	-1.4%	-1.1%	-1.9%	**	Equity and bond neutral
	Index of Services 3M/3M	m/m	Dec	0.2%	0.1%	0.1%	**	Equity and bond neutral
	Construction Output	m/m	Dec	1.5	1.0%	1.2%	**	Equity and bond neutral
	Visible Trade Balance	m/m	Dec	-£17447m	-£18900m	-£18400m	**	Equity and bond neutral
	GDP	y/y	4Q P	1.4%	1.0%	1.1%	***	Equity and bond neutral
	Total Business Investment	y/y	4Q P	-0.7%	4.4%	3.3%	*	Equity bearish, bond bullish
Switzerland	CPI	y/y	Jan	0.4%	0.6%	0.4%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Jan	0.2%	0.4%		*	Equity and bond neutral
	Core CPI	y/y	Jan	0.9%	0.7%	0.6%	*	Equity and bond neutral
Russia	Gold and Forex Reserves	m/m	7-Feb	$626.9b	$620.8b		***	Equity and bond neutral
AMERICAS								
Brazil	Retail Sales	y/y	Dec	2.0%	5.2%	3.1%	***	Equity bearish, bond bullish

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)	422	423	-1	Down
U.S. Sibor/OIS spread (bps)	432	433	-1	Down
U.S. Libor/OIS spread (bps)	434	435	-1	Down
10-yr T-note (%)	4.60	4.62	-0.02	Down
Euribor/OIS spread (bps)	255	254	1	Down
Currencies	**Direction**			
Dollar	Down			Up
Euro	Flat			Down
Yen	Up			Up
Pound	Up			Down
Franc	Up			Down

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.

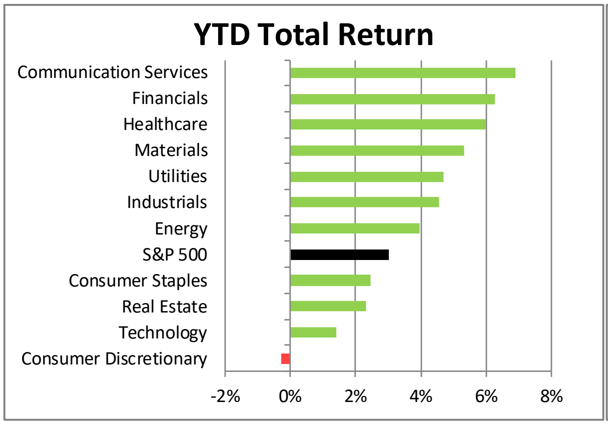
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$74.21	$75.18	-1.29%	
WTI	$70.36	$71.37	-1.42%	
Natural Gas	$3.67	$3.57	2.86%	
Crack Spread	$21.19	$21.19	-0.01%	
12-mo strip crack	$22.12	$22.22	-0.41%	
Ethanol rack	$1.85	$1.85	0.38%	
Metals				
Gold	$2,918.22	$2,904.04	0.49%	
Silver	$32.27	$32.24	0.10%	
Copper contract	$473.85	$470.45	0.72%	
Grains				
Corn contract	$500.50	$504.00	-0.69%	
Wheat contract	$591.25	$588.00	0.55%	
Soybeans contract	$1,043.50	$1,045.75	-0.22%	
Shipping				
Baltic Dry Freight	776	801	-25	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	4.07	2.31	1.77	
Gasoline (mb)	-3.04	1.21	-4.25	
Distillates (mb)	0.14	-2.25	2.39	
Refinery run rates (%)	0.5%	0.2%	0.3%	
Natural gas (bcf)		-92		

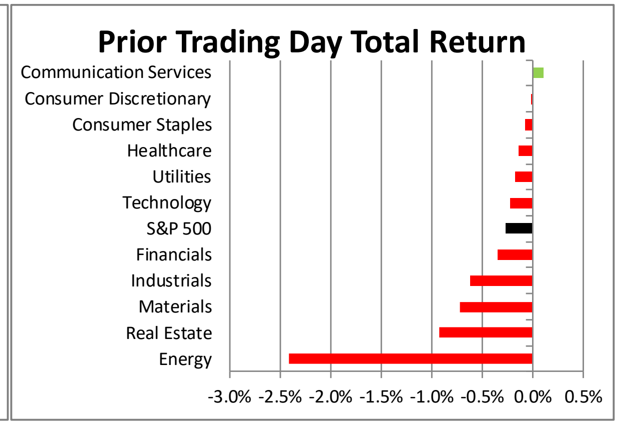
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for cooler-than-normal temperatures from the Great Plains eastward, with warmer-than-normal conditions only in the Southwest. The forecasts call for wetter-than-normal conditions in the Southeast, with dry conditions expected in the Southwest, the Upper Midwest, and New England.

Data Section

US Equity Markets – (as of 2/12/2025 close)

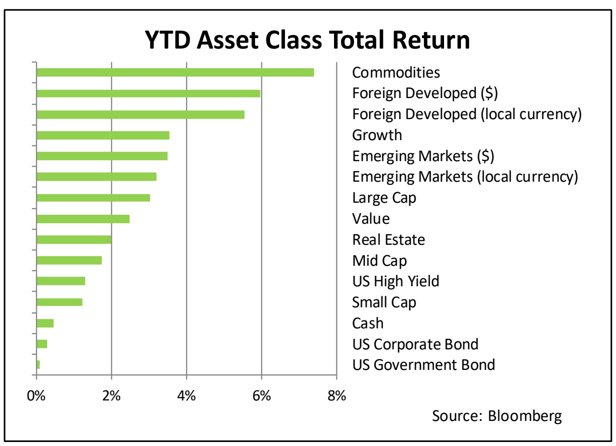




(Source: Bloomberg)

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 2/12/2025 close)

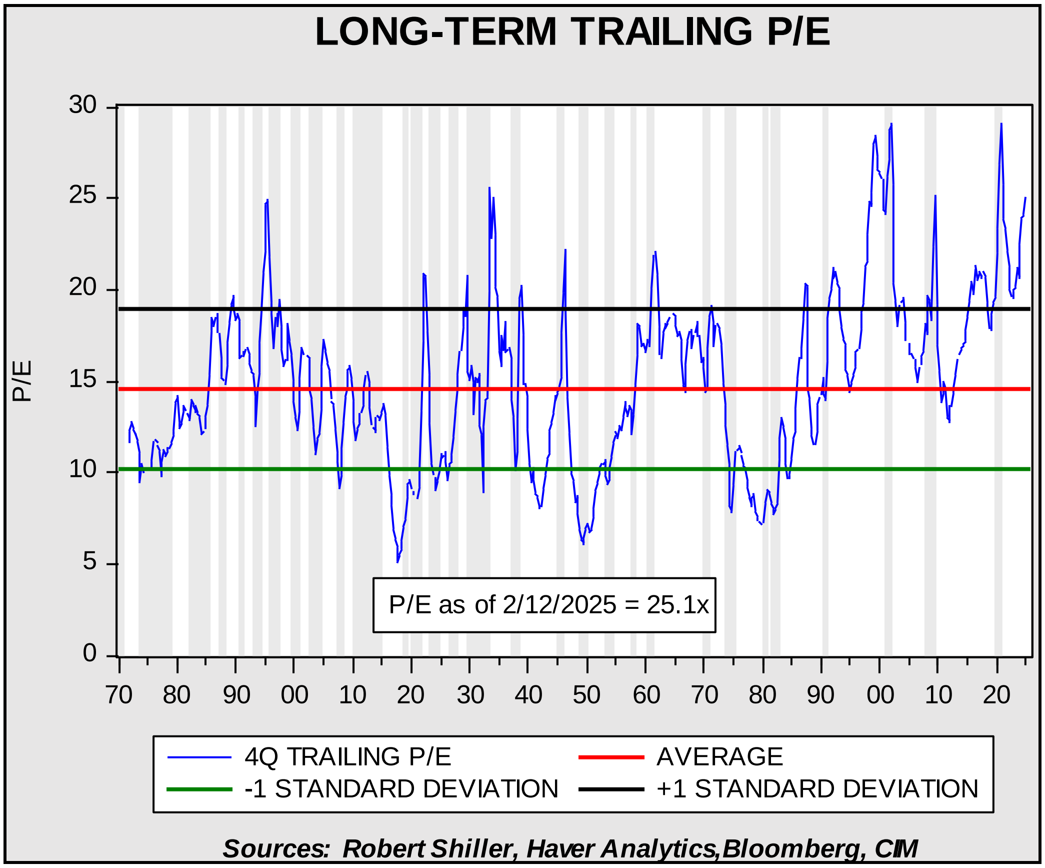


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

February 13, 2025



Based on our methodology,[1] the current P/E is 25.1x, unchanged from our last report. The increase in the stock price index was offset by a rise 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.

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