Daily Comment

Confluence Investment Management

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[Posted: February 14, 2025 — 9:30 AM ET] Global equity markets are generally higher this morning. In Europe, the Euro Stoxx 50 closed up 0.1% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.7%. Chinese markets were higher, with the Shanghai Composite up 0.4% from its previous close and the Shenzhen Composite up 0.8%. Conversely, US equity index futures are signaling a lower open.

With 383 companies having reported so far, S&P 500 earnings for Q4 are running at $64.70 per share, compared to estimates of $64.79, which is up 11.7% from Q4 2023. Of the companies that have reported thus far, 75.9% have exceeded expectations while 17.5% 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:

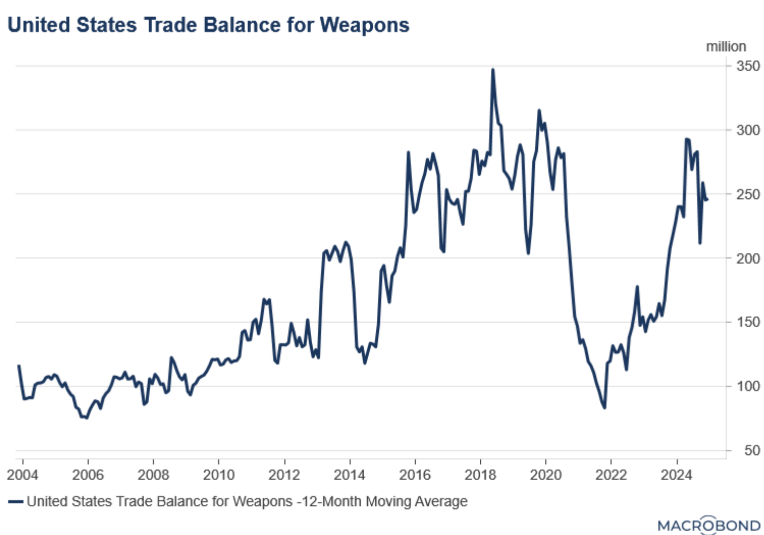
Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
Middle Eastern Stock Markets: An Overview (2/10/25) + podcast	*American Exceptionalism and the Markets* (2/3/25) + podcast	Q1 2025 Report Q1 2025 Rebalance Presentation	The Confluence of Ideas podcast **Business Cycle Report**

Note: Due to the holiday, the* Daily Comment *will not be published on Monday, February 17.

Happy Valentine's Day! The market is currently processing the latest retail sales data. In sports news, the US dominated Finland in the NHL 4 Nations Face-Off. Today's *Comment* will explore the shifting landscape of US foreign policy, examine the possibility of gold revaluation, and cover other market-related news. As usual, our report will include a summary of domestic and international data releases.

DIY Foreign Policy, We Can Help: President Trump has increasingly downplayed the US's traditional role as the "world's policeman," and instead is emphasizing its position as a leading defense supplier. This shift reflects a deliberate strategy to scale back America's global security responsibilities while encouraging other nations to enhance their own defense capabilities.

- On Thursday, President Trump raised the possibility of convening a meeting between Russia and European nations to discuss a joint agreement to reduce their defense expenditures. While it remains uncertain whether Putin or Xi would be open to such a proposal, the suggestion underscores President Trump's broader inclination to scale back US global influence.
- Additionally, this move reflects President Trump's broader strategy of engaging with rival powers to ease global tensions. By excluding the European Union from discussions on the Russia-Ukraine conflict and proposing the inclusion of China in future negotiations, the administration signals a willingness to bypass traditional allies in favor of direct diplomacy with major geopolitical competitors.
- This shift in US priorities has prompted Europe to reevaluate its security framework. French President Emmanuel Macron has been a vocal advocate for greater European self-reliance, urging EU member states to take more responsibility for their collective defense, particularly in supporting Ukraine.
- That said, President Trump has been actively pushing US allies to buy more American-made weapons, framing arms sales as a key tool for addressing trade imbalances and making countries more self-reliant for security. On Thursday, he underscored this strategy in talks with Indian Prime Minister Narendra Modi about a potential F-35 fighter jet deal. The announcement came as Defense Secretary Pete Hegseth pledged to accelerate arms sales to EU nations.



- The shift from being a global security provider to a leading defense supplier represents a calculated, albeit tactical, adjustment for the US as it seeks to balance its international influence with domestic economic priorities. By encouraging allies to take on greater defense responsibilities, the US aims to reduce its direct military burdens while maintaining its geopolitical clout. While there are some concerns about the impact this shift will have on defense stocks, we remain cautiously optimistic about the sector.

Gold As a Policy Tool? Despite disinterest from the Trump administration, a controversial proposal to revalue US gold reserves at the current market price of approximately $3,000 per ounce is gaining traction as the government seeks additional funding.

- Changing the book value from the fixed rate of $42 per ounce could generate a one-time windfall of roughly $760 billion, which could be used to support the president's agenda. This revaluation could allow the government to sell gold on the open market to help achieve some of its policy aims.
- One potential application would be to sell gold and use the proceeds to purchase other currencies, thereby weakening the US dollar. Alternatively, the revenue from gold sales could be used to fund government spending, potentially facilitating the passage of budget legislation.
- Two obstacles could impede the revaluation of gold. Because the price is fixed by law, congressional approval would be necessary. Also, significant gold sales could depress global prices, posing political risks and potentially harming the global financial system, given that many central banks hold gold as a reserve asset.
- While the revaluation of gold is not currently under consideration by the Trump administration, the idea could gain traction if the administration struggles to achieve its agenda, particularly in the realm of trade policy. In such a scenario, revisiting the revaluation of gold as a fiscal tool may become a viable option. Given this potential, gold remains an attractive investment for many, although future policy moves — such as revaluation — could significantly influence market sentiment.

Axis of Evil: The Pentagon's Indo-Pacific chief, Admiral Samuel Paparo, has expressed growing concerns that China may be preparing to assert control over Taiwan. This warning comes at a time when the US is actively encouraging allies and partners to reduce their reliance on American military protection and instead bolster their own defense capabilities.

- Speaking at the Honolulu Defense Forum, the Pentagon chief cautioned that the scale and frequency of China's military exercises could serve as a pretext to mask an actual offensive against the island. By conducting extensive drills, China might create a veil of ambiguity, making it difficult to distinguish between routine training and a genuine threat.

  Paparo also pointed to the deepening cooperation among Russia, China, and North Korea as they increasingly coordinate efforts to counter US influence and power projection worldwide. These nations have been actively sharing intelligence and technology, strengthening their strategic alignment to challenge American dominance.

- His message likely explains why the Trump administration is shifting its strategic focus toward the Indo-Pacific region, prioritizing efforts to counterbalance China's growing influence, while reducing its emphasis on protecting Europe.

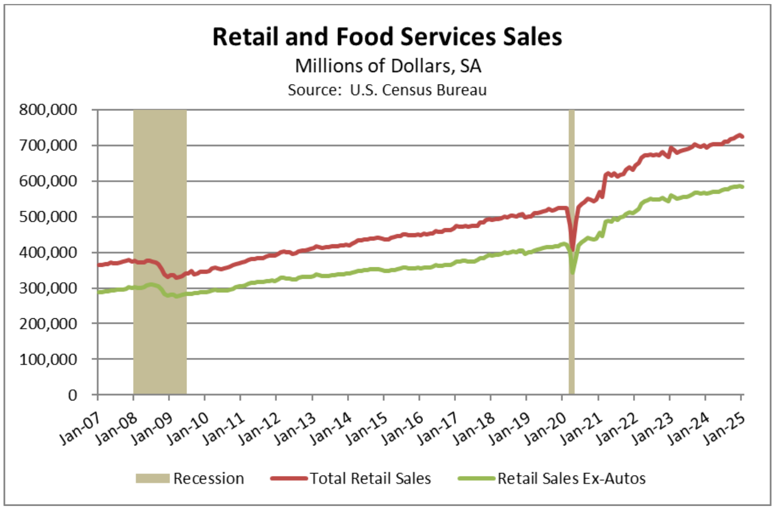
- A major threat to the global economy is large-scale warfare, particularly involving major powers. Increased assertiveness by China and its partners in the Indo-Pacific, coupled with the US pivot to the region, raises the risk of confrontation, especially as the two economies decouple. While an immediate military conflict is unlikely, the risk within the next decade may be increasing.

The Big Beautiful Bill Progresses: Conservative lawmakers have finally reached an agreement on a budget resolution aimed at advancing the president's initiatives through a single bill. The breakthrough came after fiscal hawks within the Republican Party insisted on guarantees for budget cuts to ensure that the proposed initiatives would not exacerbate the deficit.

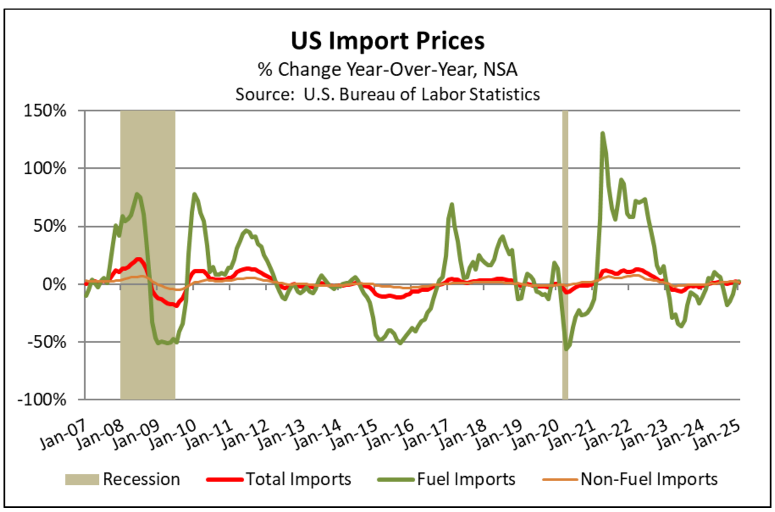
- The bill passed out of committee on Thursday, moving one step closer to becoming law. The proposal would authorize $1.5 trillion in spending cuts to help fund the president's tax initiatives, increase the defense budget, and provide funding for border security.
- One of the more controversial elements of the proposal includes potential cuts to Medicaid, a move supported by many Republican lawmakers who argue that the program is plagued by fraud and inefficiency. However, such reductions are likely to render the bill politically contentious, as critics warn the cuts could harm vulnerable populations who rely on the program for essential healthcare.
- While we anticipate that tax cuts will likely be enacted by the end of the year, we remain skeptical that the final bill will achieve the budget neutrality that current lawmakers are aiming for. That said, we believe the proposed tax reductions could provide a boost to equities and may also support bond markets if the administration successfully avoids significantly increasing the budget deficit in the process.

US Economic Releases

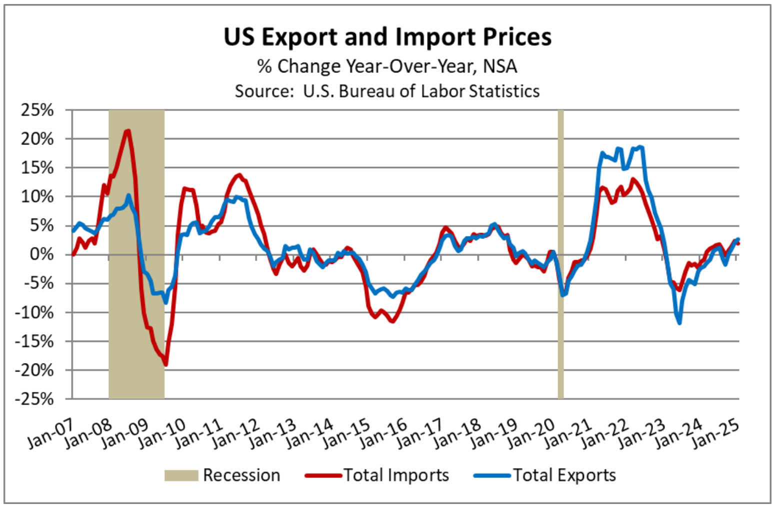
January ***retail sales*** fell by a seasonally adjusted 0.9%, far worse than the expected decline of 0.2%. However, the disappointment was partially offset by the fact that December sales were revised substantially upward to a gain of 0.7%. Of course, overall retail sales are often driven by the volatile auto and auto parts sector, which makes up almost one-fifth of the total. January ***retail sales excluding autos and auto parts*** were down 0.4%, versus their expected gain of 0.3% and their revised December increase of 0.7%. Overall retail sales in January were up 4.8% from the same month one year earlier, while sales excluding autos and auto parts were up 4.4%. The chart below shows how retail sales have changed since just before the Great Financial Crisis.



January ***import prices*** were up 0.3% from the previous month, a bit milder than the anticipated rise of 0.4% but still an acceleration from their revised increase of 0.2% in December. January ***import prices excluding fuels*** were up just 0.1%, versus expectations that they would rise 0.2% as they did in the prior month. Overall import prices in January were up 1.9% year-over-year, while import prices excluding fuels were up 1.8%. The chart below shows the year-over-year change in import prices since just before the GFC.



According to the report, ***export prices*** in January were up 2.7% from one year earlier, in large part because of the key agriculture category. Comparing the annual change in export prices versus import prices provides a sense of the US "terms of trade," or the relative advantage or disadvantage the country is facing because of trends in international trade prices. The chart below compares the year-over-year change in US export and import prices since just before the GFC.



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

Economic Releases						
EST	**Indicator**			**Expected**	**Prior**	**Rating**
10:00	Business Inventories	m/m	Dec	-0.1%	0.1%	*
Federal Reserve						
EST	**Speaker or Event**	**District or Position**				
15:00	Lorie Logan Speaks in Moderated Q&A	President of the Federal Reserve Bank of Dallas				

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	Japan Buying Foreign Bonds	w/w	7-Feb	¥1752.9b	-¥1458.4b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	7-Feb	¥126734b	¥199.2b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	7-Feb	¥187.2b	¥724.5b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	7-Feb	-¥384.4b	-¥315.2b		*	Equity and bond neutral
New Zealand	BusinessNZ Manufacturing PMI	m/m	Jan	514.0	46.2		***	Equity and bond neutral
	Food Prices	m/m	Jan	1.9%	0.1%		***	Equity and bond neutral
South Korea	Export Price Index	y/y	Jan	8.5%	10.5%		*	Equity and bond neutral
	Import Price Index	y/y	Jan	6.6%	6.8%		*	Equity and bond neutral
	Unemployment Rate	m/m	Jan	2.9%	3.7%	3.2%	***	Equity and bond neutral
China	New Yuan Loans CNY YTD	m/m	Jan	5130.0b	18087.3b	4530.0b	**	Equity and bond neutral
	Aggregate Financing CNY YTD	m/m	Jan	7060.0b	32255.8b	6500.0b	**	Equity and bond neutral
	Money Supply M1	y/y	Jan	0.4%	1.2%	-0.5%	*	Equity bullish, bond bearish
	Money Supply M2	y/y	Jan	7.0%	7.3%	7.3%	***	Equity and bond neutral
	Money Supply M0	y/y	Jan	17.2%	13.0%		*	Equity and bond neutral
India	Wholesale Prices	y/y	Jan	2%	2.37%	2.50%	*	Equity and bond neutral
EUROPE								
Eurozone	GDP SA	y/y	4Q P	9.0%	0.9%	0.9%	***	Equity and bond neutral
	Employment	y/y	4Q P	0.6%	1.0%		*	Equity and bond neutral
Germany	Wholesale Price Index	y/y	Jan	0.9%	0.1%		*	Equity and bond neutral
Switzerland	Producer & Import Prices	y/y	Jan	-0.3%	-0.9%		**	Equity and bond neutral
Russia	Money Supply, Narrow Definition	w/w	7-Feb	18.28t	18.27t		*	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)	421	422	-1	Down
U.S. Sibor/OIS spread (bps)	432	432	0	Down
U.S. Libor/OIS spread (bps)	434	434	0	Down
10-yr T-note (%)	4.53	4.53	0.00	Flat
Euribor/OIS spread (bps)	256	255	1	Down
Currencies	**Direction**			
Dollar	Down			Up
Euro	Flat			Down
Yen	Flat			Up
Pound	Up			Down
Franc	Up			Down
Central Bank Action	**Current**	**Prior**	**Expected**	
Bank of Russia Key Rate	21.00%	21.00%	21.00%	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.

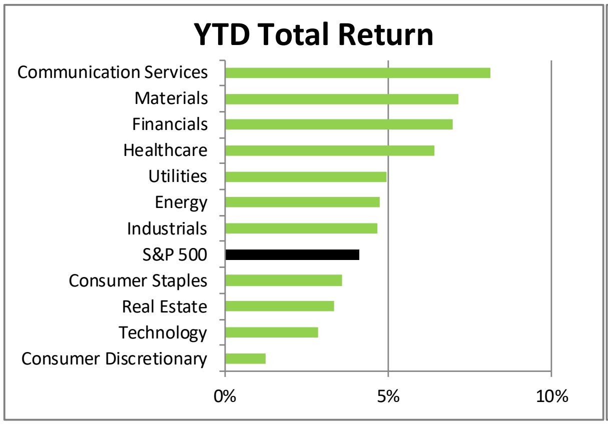
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$75.70	$75.02	0.91%	
WTI	$71.84	$71.29	0.77%	
Natural Gas	$3.75	$3.63	3.45%	
Crack Spread	$22.14	$22.04	0.48%	
12-mo strip crack	$22.73	$22.64	0.39%	
Ethanol rack	$1.86	$1.86	0.16%	
Metals				
Gold	$2,930.83	$2,928.21	0.09%	
Silver	$33.18	$32.34	2.57%	
Copper contract	$484.10	$482.55	0.32%	
Grains				
Corn contract	$511.00	$506.00	0.99%	
Wheat contract	$605.75	$592.00	2.32%	
Soybeans contract	$1,056.00	$1,047.00	0.86%	
Shipping				
Baltic Dry Freight	780	776	4	
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)	-100	-93	-7	

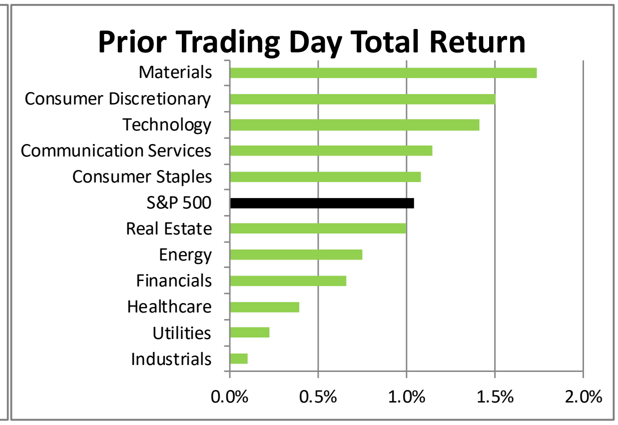
Weather

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 in the Far West. The forecasts call for wetter-than-normal conditions in the state of Washington, southern Texas, and Florida, with dry conditions in virtually all other areas.

Data Section

US Equity Markets – (as of 2/13/2025 close)

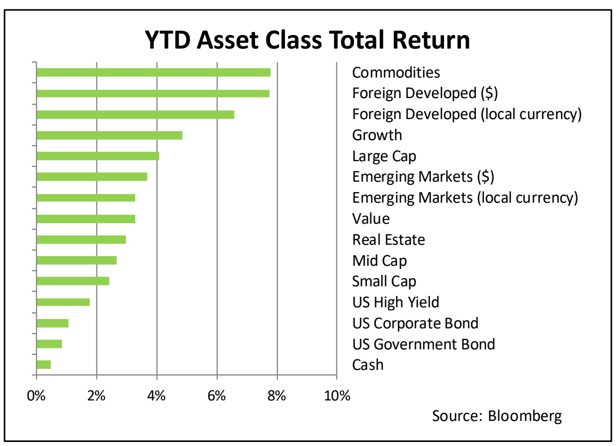




(Source: Bloomberg)

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 2/13/2025 close)

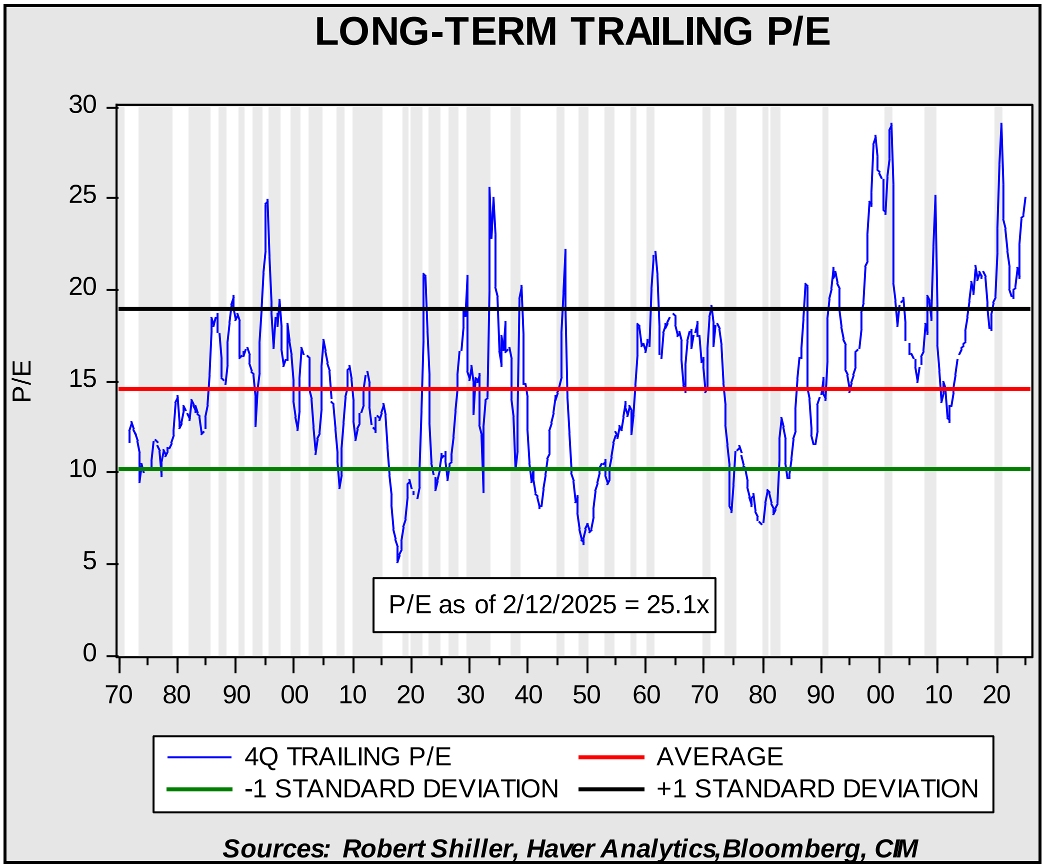


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.

[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.