Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: February 19, 2025 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed down 0.7% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.4%. Chinese markets were higher, with the Shanghai Composite up 0.8% from its previous close and the Shenzhen Composite up 1.9%. US equity index futures are signaling a lower open.

With 399 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, 76.1% have exceeded expectations, while 17.6% 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	"Our Take on the Initial Trump Tariffs" (2/18/25) + podcast	Q1 2025 Report Q1 2025 Rebalance Presentation	The Confluence of Ideas podcast Business Cycle Report

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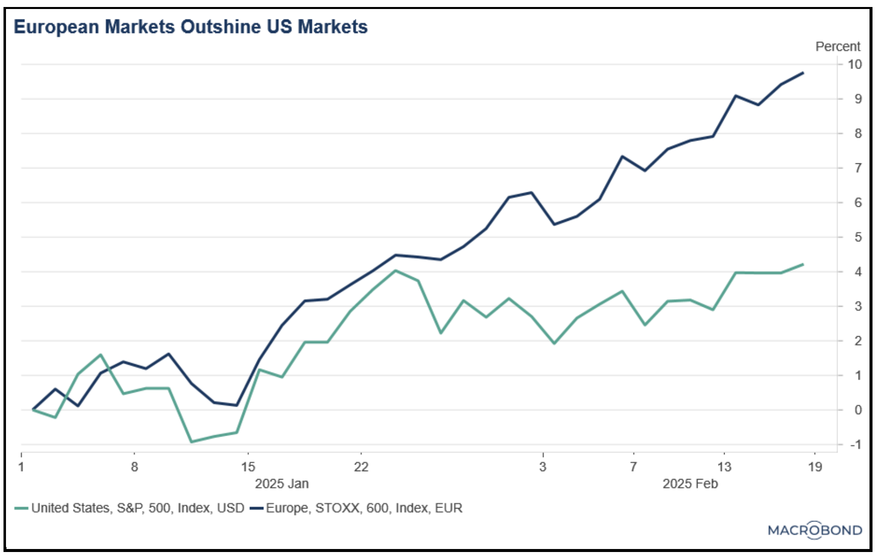
Good morning! Markets are weighing the threat of new tariffs. In sports news, Bayern Munich secured a Champions League playoff spot with a dramatic last-minute goal. Today's *Comment* covers the latest tariff developments, updates on the Ukraine-Russia peace talks, and other key market news. As always, we'll also spotlight crucial domestic and international data releases.

Tariffs Are Coming? Howard Lutnick has been confirmed as the new Commerce Secretary, just in time to assist the president in imposing new tariff measures. He will oversee the implementation of the president's tariff and trade policies, with direct responsibility for managing the Office of the US Trade Representative.

- On Tuesday, President Trump unveiled a plan to impose 25% tariffs on automobiles, semiconductors, and pharmaceuticals as part of his strategy to overhaul international trade. The tariffs will be rolled out in stages, with auto tariffs set to take effect on April 2, while tariffs on pharmaceuticals and semiconductors will follow at a later, yet-to-be-determined date.

- These new tariffs are designed to achieve two of the three key trade objectives — restriction and reciprocity — as the president aims to leverage reciprocal measures to pressure Europe into reducing its auto tariffs, which are currently four times higher than those in the US. Additionally, restrictive tariffs are intended to incentivize companies to reshore production of pharmaceuticals and semiconductors to the US, bolstering American manufacturing capabilities.
- As the president begins rolling out tariffs, early signs indicate growing unease among households and businesses. According to CreditCards.com, consumers have already started accelerating purchases in anticipation of the new tariffs. Meanwhile, the National Association of Home Builders has reported that the tariffs are dampening sentiment, driven by fears of rising costs associated with the increased duties on materials such as steel.



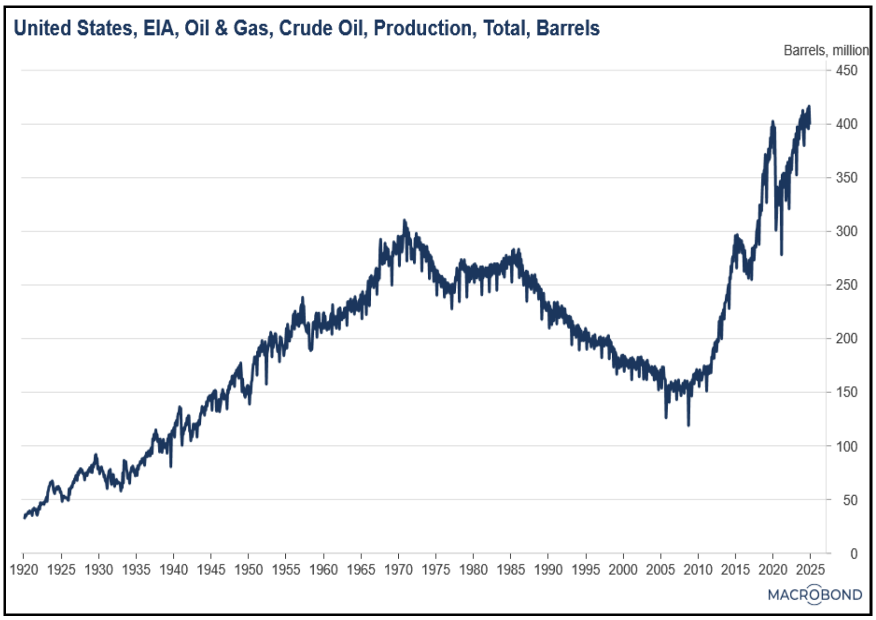
European Markets Outshine US Markets

- So far, the tariffs have had little meaningful impact on the economy, and their influence on equities appears to be fading. As a result, US stocks may begin to demonstrate greater resilience, provided companies continue to deliver strong earnings. The real challenge, however, lies abroad. International markets, particularly in Europe, have had a strong start, with the Stoxx Europe 600 up 9.11% compared to the S&P 500's 4.45% gain. US tariffs on EU exports could undermine this trend.

Trump Pressures Ukraine: As the US and Russia continue discussions aimed at resolving the conflict in Ukraine, speculation is growing about the potential terms of a deal. The Trump administration's efforts to rebuild ties with Moscow have added further intrigue to the negotiations, raising questions about the direction of US-Russia relations and the broader implications for energy prices.

- President Trump has adopted a firm stance toward Ukraine, controversially suggesting that the country bears some responsibility for the Russian invasion. He has also insisted that Ukraine must hold elections before it can participate in peace talks, a position that has drawn scrutiny and raised questions about the administration's commitment to the region.

- The development comes as the US weighs whether to lift sanctions on Russia's energy sector. US Secretary of State Marco Rubio has emphasized that the sanctions are likely to remain in place until a final agreement is reached, signaling a cautious approach to any potential easing of economic pressure on Moscow.
- His reluctance may be related to how the reintroduction of Russian energy will impact global markets. Discussions about ending the conflict were held in Saudi Arabia and included both Russia and the US, leading many to speculate that the location was chosen to align all parties on the potential market implications of resuming Russian energy supplies.



- The US would like to push oil prices lower to ease inflationary pressures. However, other key players, particularly major producers, favor keeping prices higher to protect profit margins, creating a delicate balancing act in the energy market. As a result, sanctions are likely to remain in place until all parties reach an agreement on how to reintegrate Russian energy into the global market in a way that balances economic and geopolitical interests.

ECB to Hold Steady? The European Central Bank is considering pausing further interest rate cuts after its next meeting as it evaluates whether its current policy stance is sufficiently restrictive following six consecutive rate cuts since June 2024.

- The ECB's current rate stands at 2.75%, roughly 100 basis points above the estimated neutral rate or the level at which rates neither stimulate nor restrict growth. ECB officials have been gradually cutting rates in an effort to prevent further economic slowdown.

- The decision to reassess the pace of easing follows growing concerns over the central bank's ability to achieve its 2% inflation target. Recent data from January showed overall price levels rising by 2.5% year-on-year, further complicating the path to reaching its goal of hitting its target by 2026.
- While the ECB is anticipated to announce another rate cut at its March meeting, a potential pause in further easing measures could lend some support to the euro against the dollar. This is because it would prevent the interest rate differential between Europe and the US from widening further.

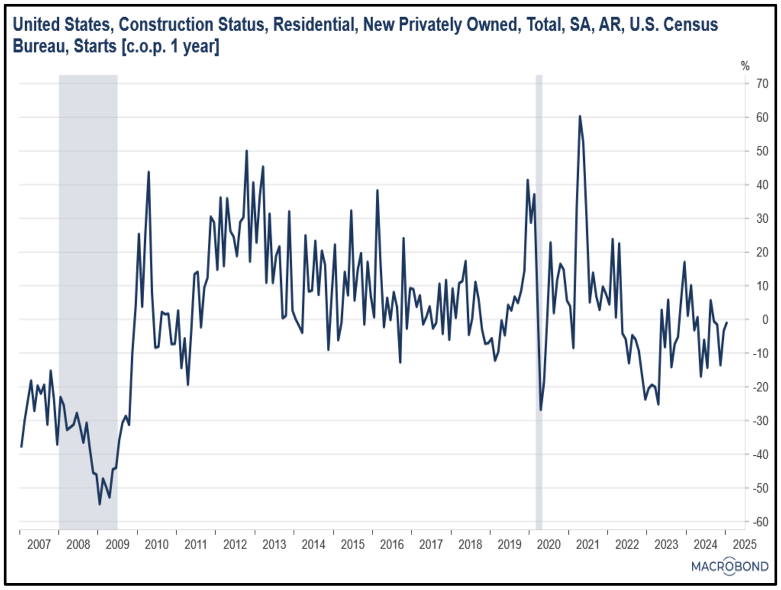
BOJ to Pay for Schools? Japan's opposition party is calling on the Bank of Japan to sell its exchange-traded funds (ETFs) to finance free high school education nationwide. The proposal emerges amid ongoing uncertainty about how the central bank plans to unwind its massive balance sheet.

- The focus on ETFs arises as the central bank nears the completion of offloading stocks acquired during the financial crisis. BOJ policymakers have proceeded cautiously with the sell-off, staggering the process to avoid potential market disruptions that could have occurred if stocks and ETFs were sold simultaneously.
- Under the proposal, the BOJ would sell its ETFs to the government in exchange for grant bonds, and the dividend income from those shares would be used to fund policy initiatives aimed at reversing declining birth rates and education.
- The Japanese proposal highlights how lawmakers are increasingly exploring unconventional methods to fund policy initiatives, particularly as they seek to manage the country's substantial government debt burden.

US Economic Releases

The Mortgage Bankers Association today said ***mortgage applications*** for the week ended February 14 fell 6.6%, reversing the previous week's 2.3% rise. Applications for home purchase mortgages fell 5.9%, extending the previous week's 2.3% slide. Applications for refinancing mortgages also fell 7.3%, building on the previous week's 9.6% decline. Meanwhile, the average interest rate on a 30-year mortgage eased 2 basis points to 6.93%, in a continuation of a gentle trend of retreat from highs reached at the beginning of the year.

January ***housing starts*** fell to a seasonally adjusted, annualized rate of 1.36 million units, falling short of the expected rate of 1.39 million units and the prior month's 1.51 million units. The rate of housing starts in January fell 9.8% from the rate in the previous month, a faster decline than the expected 7.3%, and a sharp reversal of the previous month's 16.1% gain. January ***residential building permits*** ever so slightly rose to a rate of 1.483 million units from the previous month's 1.482 million units, exceeding the expected rate of 1.46 million units. Permits issued for new housing units in January rose 0.1% from the previous month, which exceeds the expected 1.5% decline and the previous month's 0.7% decline. Compared with the same month one year earlier, housing starts in January fell 2.5%, while permits fell 2.0%. The chart below shows the growth in new home starts by type of property since just before the Global Financial Crisis.



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**
14:00	FOMC Meeting Minutes	Federal Reserve Board
17:00	Philip Jefferson Speaks on Household Balance Sheet	Vice Chair 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	Tokyo Condominiums for Sale	y/y	Jan	-44.2%	-2.40%		*	Equity and bond neutral
	Trade Balance	y/y	Jan	-¥2758.8b	¥132.5b	-¥2103.8b	**	Equity and bond neutral
	Exports	y/y	Jan	7.2	2.8	7.7	*	Equity and bond neutral
	Imports	y/y	Jan	16.7	1.7	9.3	*	Equity and bond neutral
	Core Machine Orders	y/y	Dec	4.3%	10.3%	7.5%	**	Equity bearish, bond bullish
Australia	Westpac Leading Index	m/m	Jan	0.12%	-0.02%		**	Equity and bond neutral
	Wage Price Index	m/m	4Q	3.20%	3.60%	3.20%	***	Equity and bond neutral
New Zealand	PPI Output	q/q	4Q	-0.9%	1.9%		***	Equity and bond neutral
	PPI Input	q/q	4Q	-0.1%	1.5%		***	Equity and bond neutral
	Non Resident Bond Holdings	m/m	Jan	61.9%	61.7%		*	Equity and bond neutral
EUROPE								
Eurozone	ECB Current Account SA	m/m	Dec	38.4b	25.1b		*	Equity and bond neutral
Italy	Current Account Balance	y/y	Dec	4228m	-493m		*	Equity and bond neutral
UK	CPI	y/y	Jan	3.0%	2.5%	2.8%	***	Equity and bond neutral
	CPI Core	y/y	Jan	3.7%	3.2%	3.7%	***	Equity and bond neutral
	Retail Price Index	m/m	Jan	391.7	392.1	391.9	**	Equity and bond neutral
	RPI	y/y	Jan	3.6%	3.5%	3.7%	**	Equity and bond neutral
AMERICAS								
Canada	CPI NSA MoM	m/m	Jan	0.1%	-0.4%	0.1%	***	Equity and bond neutral
	CPI YoY	y/y	Jan	1.9%	1.8%	1.9%	***	Equity and bond neutral
Mexico	International Reserves Weekly	w/w	14-Feb	$232724m	$231400m		*	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)	422	422	0	Down
U.S. Sibor/OIS spread (bps)	433	433	0	Down
U.S. Libor/OIS spread (bps)	434	434	0	Down
10-yr T-note (%)	4.57	4.55	0.02	Down
Euribor/OIS spread (bps)	252	251	1	Down
Currencies	**3 Mo**			
Dollar	Up	US		Up
Euro	Down	Euro		Down
Yen	Up	Japan		Up
Pound	Down	UK		Down
Franc	Down	Switzerland		Down
Central Bank Action	**Bank section (otherwise, I have**		**Expected**	
RBNZ Official Cash Rate	3.75%	4.25%	3.75%	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.

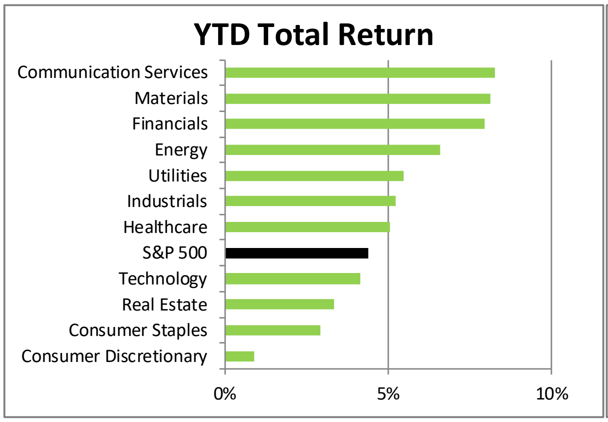
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$76.34	$75.84	0.66%	
WTI	$72.43	$71.85	0.81%	
Natural Gas	$4.16	$4.01	3.87%	
Crack Spread	$20.72	$20.80	-0.37%	
12-mo strip crack	$22.22	$22.17	0.22%	
Ethanol rack	$1.93	$1.92	0.63%	
Metals				
Gold	$2,935.21	$2,936.02	-0.03%	
Silver	$32.87	$32.88	-0.04%	
Copper contract	$464.30	$464.25	0.01%	
Grains				
Corn contract	$517.00	$515.75	0.24%	
Wheat contract	$616.75	$617.75	-0.16%	
Soybeans contract	$1,057.25	$1,055.50	0.17%	
Shipping				
Baltic Dry Freight	841	806	35	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		2.31		
Gasoline (mb)		1.21		
Distillates (mb)		-2.25		
Refinery run rates (%)		0.2%		
Natural gas (bcf)		-93		

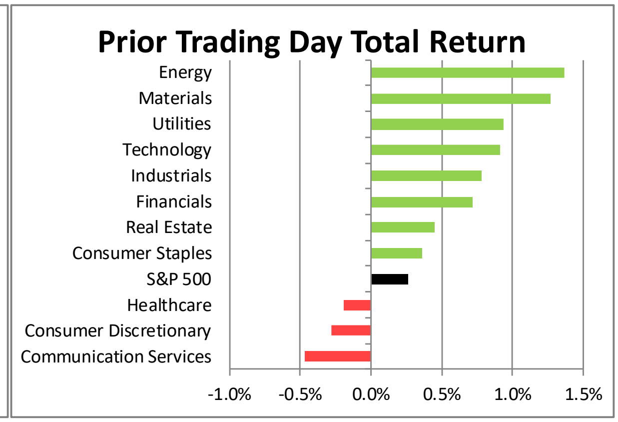
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for cooler-than-normal temperatures in Florida, with warmer-than-normal temperatures across the western two-thirds of the country. The forecasts call for wetter-than-normal conditions in Maine and across the northern tier, from the Great Lakes to the West Coast, with dry conditions on the West Coast extending into Idaho and Nevada.

Data Section

US Equity Markets – (as of 2/18/2025 close)

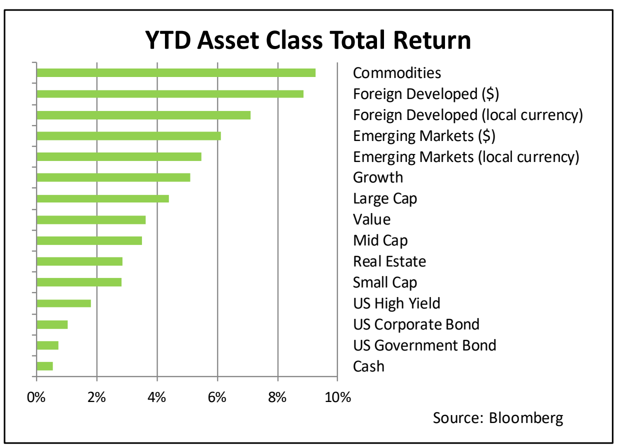




(Source: Bloomberg)

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 2/18/2025 close)

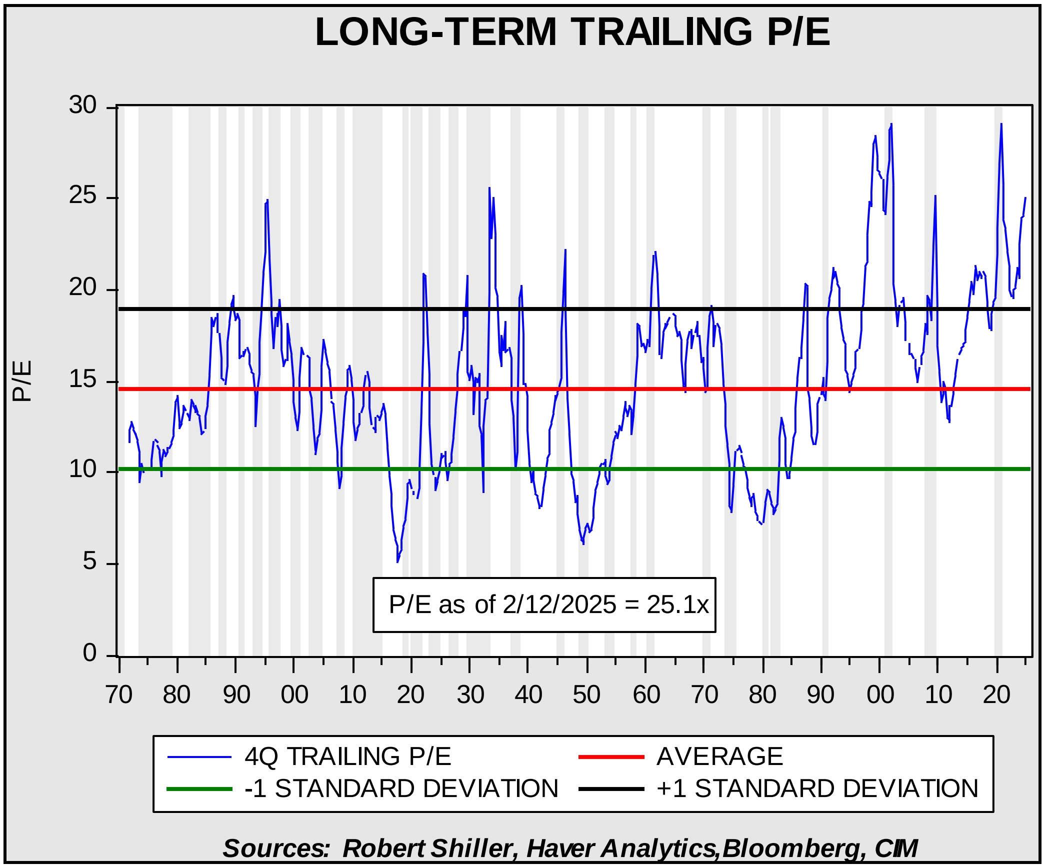


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.