Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: February 24, 2025 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed down 0.1% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.2%. Chinese markets were mixed, with the Shanghai Composite down 0.2% from its previous close and the Shenzhen Composite up 0.1%. US equity index futures are signaling a higher open.

With 429 companies having reported so far, S&P 500 earnings for Q4 are running at $64.90 per share compared to estimates of $64.79, which is up 11.7% from Q4 2023. Of the companies that have reported thus far, 76.6% have exceeded expectations, while 17.1% 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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Our *Comment* today opens with yesterday's parliamentary elections in Germany, which will make center-right politician Friedrich Merz the country's new chancellor. We next review several other international and US developments with the potential to affect the financial markets today, including a US proposal to slap big new fees on Chinese shipping firms and Chinese-built ships accessing US ports and what appears to be a new effort by the Trump administration to cull the federal workforce.

Germany: In national elections yesterday, the center-right CDU/CSU party came in first with about 29% of the vote, putting leader Friedrich Merz in position to become chancellor if he can cobble together a coalition. The far-right Alternative for Germany came in second with about 21%, but because of its controversial positions, Merz is more likely to form a coalition with the outgoing center-left SPD, whose support fell below 17%. The environmentalist Greens garnered about 11%.

- Merz has vowed to reignite economic growth by rolling back Germany's tough environmental and climate-stabilization regulations and cutting taxes, but the SPD may resist that effort. Even if Merz can cut Germany's environmental regulations and taxes, the economy would still face challenges from issues such as high energy costs, poor demographics, tough competition from China, and legal limits to fiscal spending.
- More broadly, a Merz government is likely to be much more aggressive in European policymaking. As we will note below, Merz has also strongly pushed for Europeans to stop trusting the US to support their national security, arguing instead for Europe and Germany to build their own military capabilities (and this from a country whose militarism arguably led to two world wars).

United States-Germany: In a Friday interview ahead of Germany's elections, Merz warned that Europeans shouldn't trust President Trump to live up to the US's mutual defense commitments under the North Atlantic Treaty Organization. Rather, Merz said European nations need to prepare to defend themselves against Russian aggression, perhaps by developing and broadening their own nuclear weapons strategy.

- The statement by Merz shows how the US's new embrace of revanchist, authoritarian Russia, and its threats to abandon Western European democracies, have made the US geopolitical and economic bloc more fragile.
- The US's new pro-Russia stance is often excused as a mere negotiating tactic to force the Europeans into taking greater responsibility for their own defense. However, the risk is that European leaders might lose so much trust in the US that they go their own way, potentially with countries such as Germany, Poland, and the Baltics developing their own nuclear weapons.
- The increased fragility of the US bloc can be seen using the scoring methodology we use to categorize countries into the US bloc, the China bloc, or several intermediate blocs. Based on 13 criteria ranging from trade relationships to military alliances, our method assigns each country a score ranging from +12 (for countries adhering to the US) to -12 (for countries adhering to China).
- If we eliminate all scoring for NATO membership (reflecting the alliance breaking up) and assume that tariffs and other protectionist moves eliminate all the US's bilateral trade deficits, our method suggests only a handful of countries would leave the US bloc outright. However, the average score for the US bloc would fall from 4.70 to 3.75, suggesting weaker ties. (The average score for the China bloc would be little changed, going from -3.11 to -3.08.)

United States-Poland: After a meeting between President Trump and Polish President Duda on Saturday, the White House said it "reaffirmed" the US-Polish alliance and Duda said there was "no fear that the American presence in Poland will decrease." However, given that the meeting was downgraded to just 10 minutes after Trump arrived late, and given that neither side detailed a firm US commitment to keeping troops in Poland, the positive comments may not ease European concerns that Trump will further reduce the US military presence in the region.

Russia-Ukraine War: Ahead of today's three-year anniversary of the start of Russia's invasion, Ukrainian President Zelensky yesterday offered to resign if necessary to secure Western security guarantees and ensure long-term peace for his country. The statement came as US officials claimed they were closing in on a deal in which the US would get a stake in Ukraine's natural resources and infrastructure in return for its past support of Kyiv. However, Ukrainian officials were less positive, saying they still needed to see changes in the deal.

United Kingdom-India: The UK's center-left Labour Party government today is launching a renewed effort to strike a free-trade deal with India. The two sides have already agreed on several key issues, but they are still at odds on a number of points, including reciprocal tariffs and short-term employment rights for Indians in the UK. If a deal is ultimately reached, it could boost trade and investment opportunities for both counties.

China: The government earlier this month said it would allow 10 of the country's top insurers to invest up to 1% of their assets in gold as a way to improve their portfolio diversification. The move could create a significant new source of demand for the yellow metal, on top of today's strong buying by central banks and the recent safe-haven buying related to US policy changes. We remain positive on the outlook for gold prices even as they stand near record highs.

US-China Investment: President Trump on Saturday signed a new executive order directing the federal government to "use all necessary legal instruments" to block Chinese investments in US "technology, critical infrastructure, healthcare, agriculture, energy, raw materials or other strategic sectors." The order also called for applying new legal tools to stop US citizens from investing in China's defense industrial sector. The Chinese government quickly vowed retaliatory measures "to defend its legitimate rights and interests."

- The new order expands the investing bans already put in place by Trump in his first term and by President Biden in his.
- The previous bans focused on cross-border investments related to technology and defense. By broadening the bans far beyond those sectors, the new order has the potential to sharply accelerate the decoupling of the US and Chinese economies.

US-China Trade: The US Trade Representative on Friday proposed massive new fees on Chinese shipping firms and Chinese-built ships accessing US ports. The proposal is open to public comments until a March 24 hearing, when the Trump administration will decide whether to go ahead with the fees.

- The proposed fees are the result of a US probe launched last year that found China engages in unfair trade practices in the maritime, logistics, and shipbuilding sectors.
- Together with the new US-China investment restrictions mentioned above, the shipping fees suggest the administration is ratcheting up its pressure on China despite initially seeming to be softer than expected on Beijing.

United States-Japan-South Korea-Taiwan: New reports say the Trump administration is pushing Japan, South Korea, and Taiwan to ramp up their purchases of liquified natural gas from the US. According to the sources, the administration is also pushing the Asian allies to invest in new LNG export facilities on the US West Coast, including a $44-billion project in Alaska that some observers believe is uneconomic because of high costs. The administration is reportedly using its tariff threats as a cudgel to push the allies toward a deal.

- As we've noted before, the administration's evolving trade policy is largely geared toward eliminating the US trade deficit, if not to generate large trade surpluses. Energy and other commodity exports are expected to be a big part of any such rebalancing.
- The reports say the administration is arguing to the allies that greater reliance on LNG from the US would help insulate them from Chinese and Russian geopolitical pressure. According to the reports, the administration also hopes that making the allies more dependent on the US will force them to bow to Washington's policy goals.
- However, as we noted in our *Bi-Weekly Geopolitical Report* from January 27 and in our discussion above, there is a risk in employing sharp threats and saddling the allies with big, new economic burdens, such as potentially uneconomic energy purchases or investments. Even if the tactics make the allies more dependent on US energy, resentment over the cudgeling to get there and the high costs involved may make the alliances more fragile.

US Fiscal Policy: At the apparent urging of Elon Musk, the Office of Personnel Management over the weekend sent an email to legions of federal workers directing them to reply with approximately five bullet points saying what they accomplished over the previous week. Even though the emails didn't include Musk's warning on X that anyone who didn't reply would be out of a job, and even though some agency chiefs told their employees not to respond, the move has reportedly further rattled federal workers.

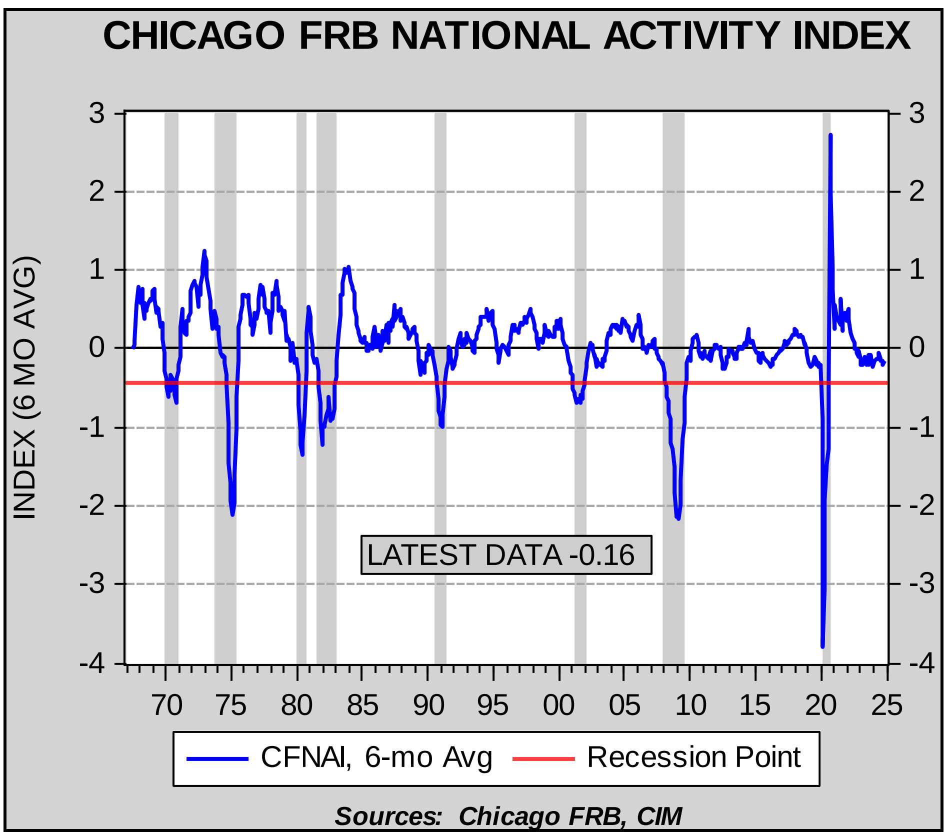
- Since many federal workers have already been laid off, and since Musk has aggressively pressed several other tactics to push employees out of their jobs, the new move is nearly certain to prompt more federal contractors, workers, and those who depend on them to rein in their spending and prepare for the worst.
- Incoming analyses suggest the $55 billion or more in spending cuts that Musk has claimed for his Department of Government Efficiency, so far, are highly inflated. Nevertheless, substantial cuts have occurred, and given that federal workers are distributed widely throughout the country, consumer spending and investment could be affected nationwide, raising the risk of an economic slowdown.

US Industrial Policy: Apple today said that it will invest more than $500 billion in the US over the next four years to expand its domestic footprint in research and development, engineering, software development, and manufacturing. According to Apple, the investment will create about 20,000 new jobs, including a major new factory for artificial-intelligence servers in Houston. The news suggests that the cajoling of President Trump is accelerating US re-industrialization, building on the industrial policies of the Biden administration and his own first administration.

US Stock Market: In his annual letter to shareholders on Saturday, famed Berkshire Hathaway CEO Warren Buffet assured investors that the firm hasn't changed its management approach and is still looking to use its $321-billion cash pile to buy equities. However, he suggested that rich valuations are the main obstacle to doing so, saying, "Often, nothing looks very compelling." The statement is consistent with the high valuations we see in the market, but we note that momentum could still drive stock prices higher.

US Economic Releases

Economic activity unexpectedly contracted in January, as revealed by the Chicago Fed National Activity Index (CFNAI). The index fell to -0.03, down from a revised 0.18 in the previous month. While production, employment, and sales made positive contributions to the index, a sharp decline in personal consumption outweighed these gains, dragging the overall index into negative territory.



The chart displays the CFNAI's six-month moving average, with a recession threshold of -0.4. While the latest average remains below trend, it's significantly above the recession signal.

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

Economic Releases						
EST	Indicator			Expected	Prior	Rating
10:30	Dallas Fed Manufacturing Activity	m/m	Feb	6.4	14.1	**
Federal Reserve						
No Fed speakers or events for the rest of today						

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								
New Zealand	Retail Sales Ex Inflation	q/q	4Q	9.0%	0.0%	0.5%	***	Equity and bond neutral
EUROPE								
Eurozone	CPI	y/y	Jan F	2.5%	2.4%	2.5%	***	Equity and bond neutral
	Core CPI	y/y	Jan F	2.7%	2.7%	2.7%	**	Equity and bond neutral
Germany	IFO Business Climate	m/m	Feb	85.2	85.2	85.8	***	Equity bearish, bond bullish
	IFO Current Assessment	m/m	Feb	85.0	86.0	86.3	**	Equity bearish, bond bullish
	IFO Expectations	m/m	Feb	85.4	84.3	85.0	**	Equity bearish, bond bullish
Switzerland	Domestic Sight Deposits CHF	w/w	21-Feb	430.2b	424.4b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	21-Feb	438.1b	432.5b		*	Equity and bond neutral
AMERICAS								
Canada	Retail Sales	m/m	Dec	2.5%	0.2%	1.6%	**	Equity bullish, bond bearish
	Retail Sales Ex-Autos	m/m	Dec	2.7%	-0.7%	2.0%	**	Equity bullish, bond bearish
Brazil	FGV Consumer Confidence	y/y	Feb	83.60%	86.2		*	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)	420	420	0	Down
U.S. Sibor/OIS spread (bps)	432	431	1	Down
U.S. Libor/OIS spread (bps)	433	433	0	Down
10-yr T-note (%)	4.45	4.43	0.02	Down
Euribor/OIS spread (bps)	252	253	-1	Down
Currencies	**3 Mo**			
Dollar	Up	US		Down
Euro	Down	Euro		Down
Yen	Up	Japan		Up
Pound	Down	UK		Up
Franc	Down	Switzerland		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.

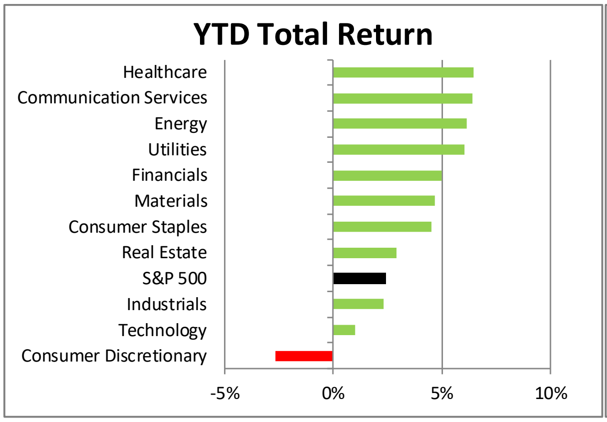
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$74.46	$74.43	0.04%	
WTI	$70.38	$70.40	-0.03%	
Natural Gas	$3.96	$4.23	-6.47%	
Crack Spread	$26.27	$26.61	-1.25%	
12-mo strip crack	$21.72	$21.92	-0.93%	
Ethanol rack	$1.91	$1.91	-0.27%	
Metals				
Gold	$2,946.46	$2,936.05	0.35%	
Silver	$32.54	$32.46	0.25%	
Copper contract	$458.75	$461.55	-0.61%	
Grains				
Corn contract	$501.50	$505.00	-0.69%	
Wheat contract	$594.50	$604.00	-1.57%	
Soybeans contract	$1,055.25	$1,057.25	-0.19%	
Shipping				
Baltic Dry Freight	981	941	40	

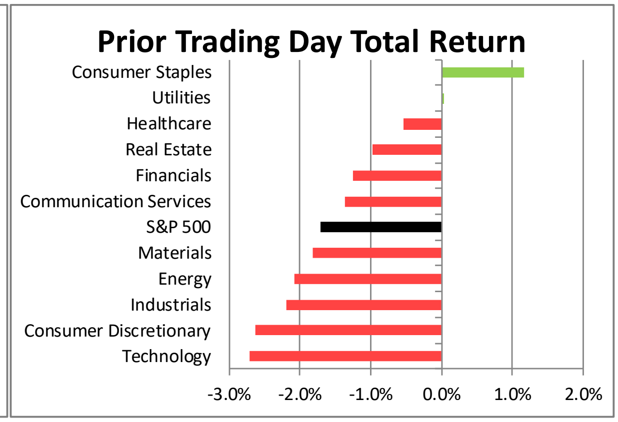
Weather

The 6-to-10 and 8-to-14 day forecasts indicate above-average temperatures across the central US during the first half of the period. Cooler conditions are expected to spread into the Pacific, Rocky Mountain, and New England regions in the latter half. Most of the country is likely to experience above-normal precipitation, with drier conditions limited to southern Texas.

Data Section

US Equity Markets – (as of 2/21/2025 close)

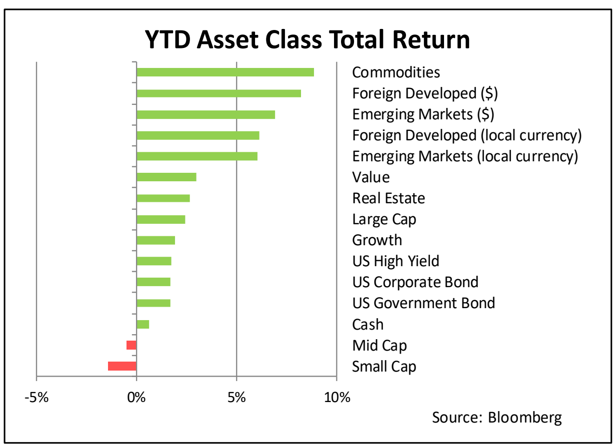




(Source: Bloomberg)

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 2/21/2025 close)

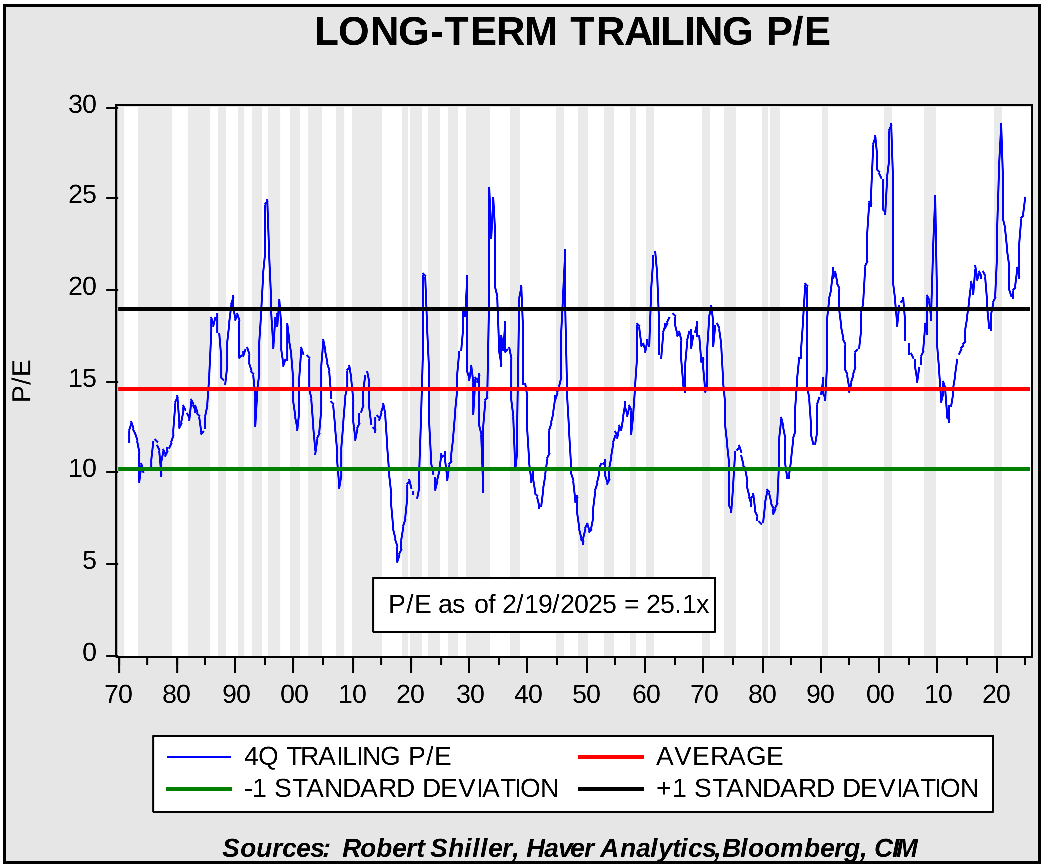


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 20, 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.