Daily Comment

Confluence Investment Management

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: February 26, 2025 — 9:30 AM ET] Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 closed up 1.5% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 2.0%. Chinese markets were higher, with the Shanghai Composite up 1.0% from its previous close and the Shenzhen Composite up 1.1%. US equity index futures are signaling a higher open.

With 452 companies having reported so far, S&P 500 earnings for Q4 are running at $65.40 per share compared to estimates of $64.79, which is up 11.7% from Q4 2023. Of the companies that have reported thus far, 75.8% have exceeded expectations, while 18.0% 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
"Sanctions as an Investment Risk" (2/24/25) + 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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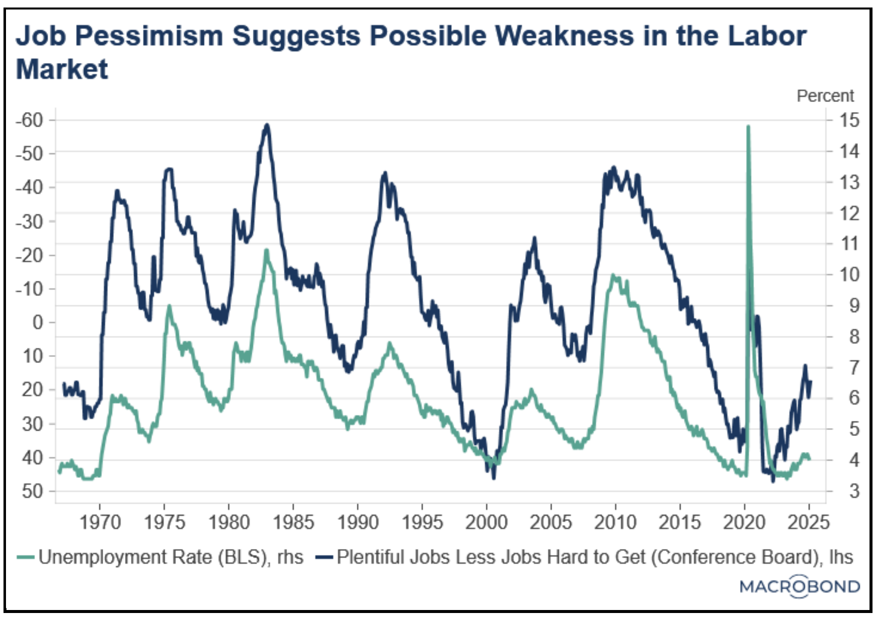
Good morning! Markets are closely watching the Republican budget bill, as the likelihood of extended tax cuts grows. In sports news, Alex Ovechkin made history by scoring 30 goals in a season for the 19th consecutive year, setting a new NHL record. Today's commentary will delve into the sharp decline in consumer confidence, provide an update on the ambitious efforts by House Republicans to pass a new budget, and highlight other market-moving developments. As always, it will also include a roundup of key international and domestic data releases.

Consumer Sentiment Dips: A sharper-than-anticipated decline in the Conference Board's Consumer Confidence Index has heightened concerns that the economy may be on the brink of a slowdown. The S&P 500 plunged below 6,000, and the 10-year Treasury yield dropped below 4.30%, as investors sought refuge in bonds.

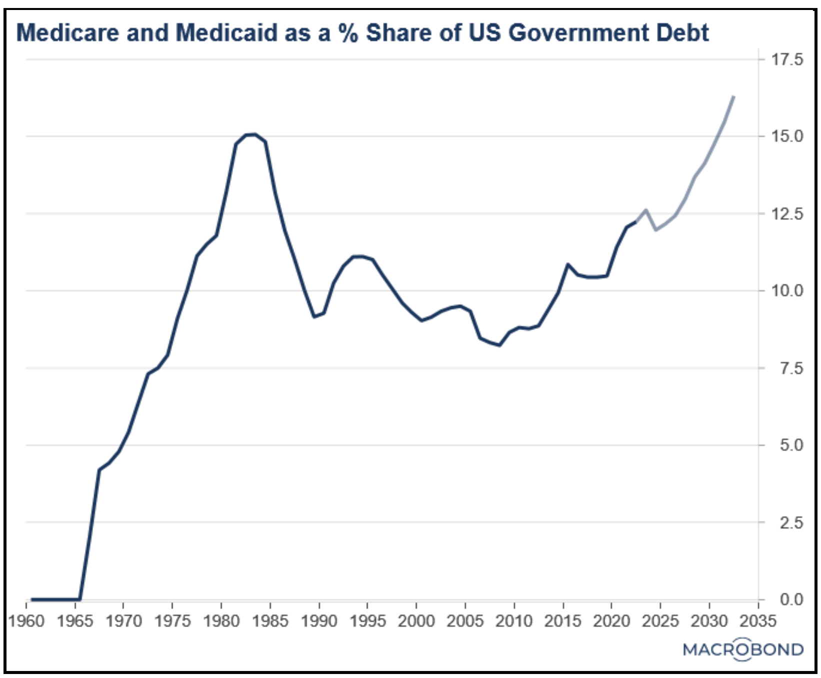
- The February Consumer Confidence Index dropped sharply from 105.3 to 98.3, marking its largest decline since August 2021. The significant downturn in overall sentiment was primarily driven by growing concerns about the future, as the Expectations Index plunged 9.3 points to 72.9, falling below the critical recession threshold of 80 for the first time since June 2024. Additionally, consumer assessment of the current economic situation also weakened, with the Present Situation Index declining by 3.4 points to 136.5.
- The decline in sentiment was driven mostly by inflation fears. Rising egg prices and the perceived threat of tariffs are key contributors. The Conference Board survey revealed widespread unease about tariff impacts, with both businesses and households expressing heightened concern. Alarmingly, 12-month inflation expectations surged from 5.2% to 6.0%, signaling a growing belief in renewed inflationary pressures.
- Beyond inflation, respondents voiced growing unease about the labor market, particularly in light of recent federal government layoffs. The proportion of respondents saying jobs were "plentiful" dropped from 33.9% to 33.4%, while those reporting jobs as "hard to get" climbed from 14.5% to 16.3%. As a result, the net labor market reading, which measures the difference between "plentiful" and "hard to get" responses, narrowed to 17.1, the lowest level observed since October 2024.



- We believe the recent decline in confidence may partly reflect the initial shock effect of the Trump administration's policies, particularly around tariffs and layoffs. As markets and consumers adjust to these changes, the negative sentiment could begin to ease in the coming months. However, continued monitoring of economic indicators will be essential to gauge whether this is a temporary dip or the start of a more sustained decline.

The Big Beautiful Bill: House Republicans successfully passed a budget blueprint on Tuesday that paves the way for extending the Trump tax cuts and raising the debt ceiling but is contingent on cuts to the social safety net. However, significant hurdles remain before the proposal can become law. Concerns over its impact on the deficit, coupled with potential revisions in the Senate, pose challenges to its passage.

- The bill passed by a razor-thin margin, 217-215, after last-minute presidential lobbying swayed several moderates. It now heads to the Senate, where it faces further amendments. Republicans aim to use budget reconciliation to extend the tax cuts with a simple majority once the bill is finalized.
- The overall cost of the bill continues to be a significant concern for the incoming administration, which aims to reduce the deficit as a strategy to lower long-term interest rates. According to estimates from the nonpartisan Committee for a Responsible Federal Budget, the new measure would add $2.8 trillion to the deficit by 2034. While this figure is substantial, it represents a notable reduction from the pre-election estimate of $7.5 trillion.
- Most of the projected savings appear to stem from cuts to the social safety net. The budget directs the House Energy and Commerce Committee to identify $880 billion in spending reductions, raising concerns that lawmakers may target Medicaid as a primary area for cuts. Furthermore, the Agriculture Committee has been tasked with reducing $230 billion from food aid programs, specifically the Supplemental Nutrition Assistance Program (SNAP).



- Although the budget resolution offers a nonbinding framework, the combination of tax cuts and a lower-than-anticipated deficit may bolster investor confidence, signaling that the incoming administration is more fiscally disciplined than initially expected. Should lawmakers successfully enact these measures, the resulting stimulus could provide a moderate lift to equities.

Ukraine Agrees to Deal: Officials in Kyiv indicated that Ukraine is prepared to sign an agreement with the US, exchanging access to critical minerals for security assurances. The deal was finalized after Washington withdrew its initial demand for $500 billion worth of mineral resources. However, the agreement does not include any formal, written security guarantees, leaving the specifics of US support unclear.

- The new agreement stipulates that Ukraine will contribute 50% of the proceeds from the "future monetization" of state-owned mineral resources. These funds will also be allocated for investments within Ukraine. However, the agreement excludes mineral resources that directly contribute to the Ukrainian government's budget, ensuring that the country's gas and oil companies remain unaffected by the arrangement.
- Ukraine is a resource-rich nation, boasting critical minerals essential for defense technology and electric vehicle production, such as titanium, rare earth elements, cobalt, lithium, and graphite. Access to these resources provides the US with a strong incentive to ensure Ukraine is treated fairly during peace negotiations with Russia.
- The minerals deal will continue to be negotiated by both sides as they work to resolve any disagreements over the specifics of the arrangement. Once finalized, it will require approval from the Ukrainian Parliament before it can take effect. The US, however, does not intend to pursue a formal treaty, as that would necessitate a two-thirds Senate vote, making it politically challenging to achieve.

Joint European Bonds: There is increasing speculation that the EU may turn to the bond market to finance a significant increase in defense spending. This move reflects the region's growing recognition that it can no longer depend solely on the US for its security.

- This sentiment stems from recent discussions among European leaders regarding the need to enhance the region's military capabilities. The group of countries is expected to convene on March 6 to develop a bloc-wide defense package, estimated to cost around 500 billion EUR ($524 billion), with the potential for additional funding.
- Additionally, several countries are already planning to increase their defense expenditures. On Tuesday, Irish Finance Minister Paschal Donohoe advocated for higher defense spending at the national level. Meanwhile, in Germany, the likely ruling conservative CDU/CSU party is drafting a bill to approve a 200 billion EUR ($210 billion) special fund for defense spending.
- The decision by European countries to increase defense spending is expected to provide a boost to regional equities, as heightened investment in the sector could stimulate corporate earnings for defense firms. However, this fiscal expansion is also likely to exert upward pressure on bond yields, as governments continue to grapple with the challenge of curbing expenditures in the aftermath of the pandemic.

US Economic Releases

The Mortgage Bankers Association today said ***mortgage applications*** for the week ended February 21 fell 1.2%, after the previous week's decline of 6.6%. Applications for home purchase mortgages were unchanged in the latest week, but applications for refinancing mortgages declined 4.0%. Meanwhile, the average interest rate on a 30-year mortgage fell 5 basis points to 6.88%.

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	New Home Sales	m/m	Jan	680k	698k	0
10:00	New Home Sales MoM	m/m	Jan	3.6%	-2.6%	**
	Building Permits	m/m	Jan F		1483k	**
	Building Permits MoM	m/m	Jan F		0.1%	*
Federal Reserve						
EST	**Speaker or Event**	**District or Position**				
8:30	Thomas Barkin Repeats Speech on Inflation	President of the Federal Reserve Bank of Richmond				
12:00	Raphael Bostic Speaks on Economic Outlook, Housing	President of the Federal Reserve Bank of Atlanta				

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	Leading Economic Index	m/m	Dec F	108.3	108.9		**	Equity and bond neutral
	Coincident Index	y/y	Dec F	116.4	116.8		**	Equity and bond neutral
Australia	CPI	y/y	Jan	2.5%	2.5%	2.6%	**	Equity and bond neutral
EUROPE								
Germany	GfK Consumer Confidence	m/m	Mar	-24.7	-22.6	-21.6	**	Equity bearish, bond bullish
France	Consumer Confidence	m/m	Feb	93.0	92.0	92.0	***	Equity and bond neutral
AMERICAS								
Mexico	Current Account Balance	q/q	4Q	$12601m	$1104m	$9200m	*	Equity and bond neutral
	International Reserves Weekly	w/w	25-Mar	$233910m	$232724m		*	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)	418	419	-1	Down
U.S. Sibor/OIS spread (bps)	432	432	0	Down
U.S. Libor/OIS spread (bps)	433	433	0	Down
10-yr T-note (%)	4.30	4.30	0.00	Down
Euribor/OIS spread (bps)	253	252	1	Down
Currencies	**3 Mo**			
Dollar	Up	US		Down
Euro	Down	Euro		Flat
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.

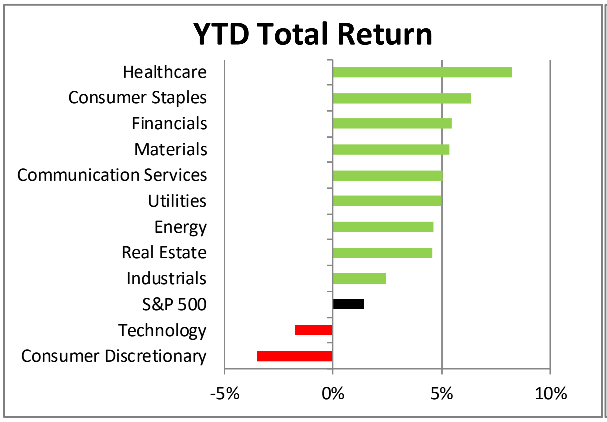
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$72.75	$73.02	-0.37%	
WTI	$68.72	$68.93	-0.30%	
Natural Gas	$4.13	$4.17	-1.15%	
Crack Spread	$25.18	$25.63	-1.76%	
12-mo strip crack	$20.97	$21.19	-1.07%	
Ethanol rack	$1.87	$1.88	-0.67%	
Metals				
Gold	$2,913.40	$2,914.98	-0.05%	
Silver	$31.77	$31.74	0.10%	
Copper contract	$468.15	$452.75	3.40%	
Grains				
Corn contract	$493.75	$494.25	-0.10%	
Wheat contract	$585.50	$587.75	-0.38%	
Soybeans contract	$1,042.00	$1,048.75	-0.64%	
Shipping				
Baltic Dry Freight	1,039	1,002	37	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		2.40		
Gasoline (mb)		-1.40		
Distillates (mb)		-2.76		
Refinery run rates (%)		-0.2%		
Natural gas (bcf)		-277		

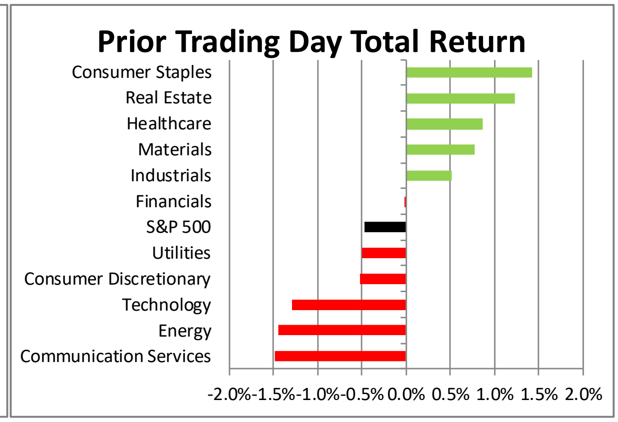
Weather

The 6-to-10 and 8-to-14 day forecasts call for cooler-than-normal temperatures only in California, with warmer-than-normal temperatures across the Great Plains. The forecasts call for wetter-than-normal conditions in the Far West and along the East Coast, with dry conditions in western Texas.

Data Section

US Equity Markets – (as of 2/25/2025 close)

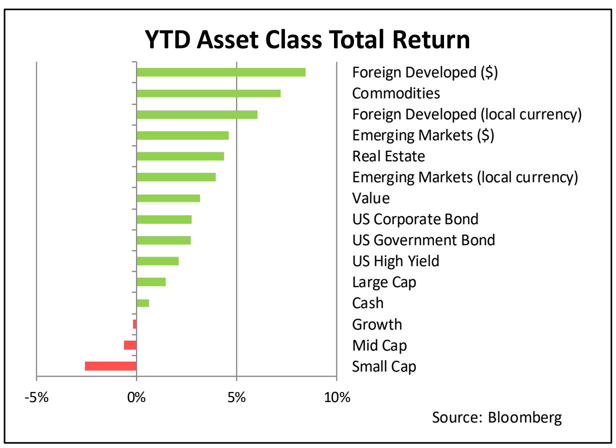




(Source: Bloomberg)

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 2/25/2025 close)

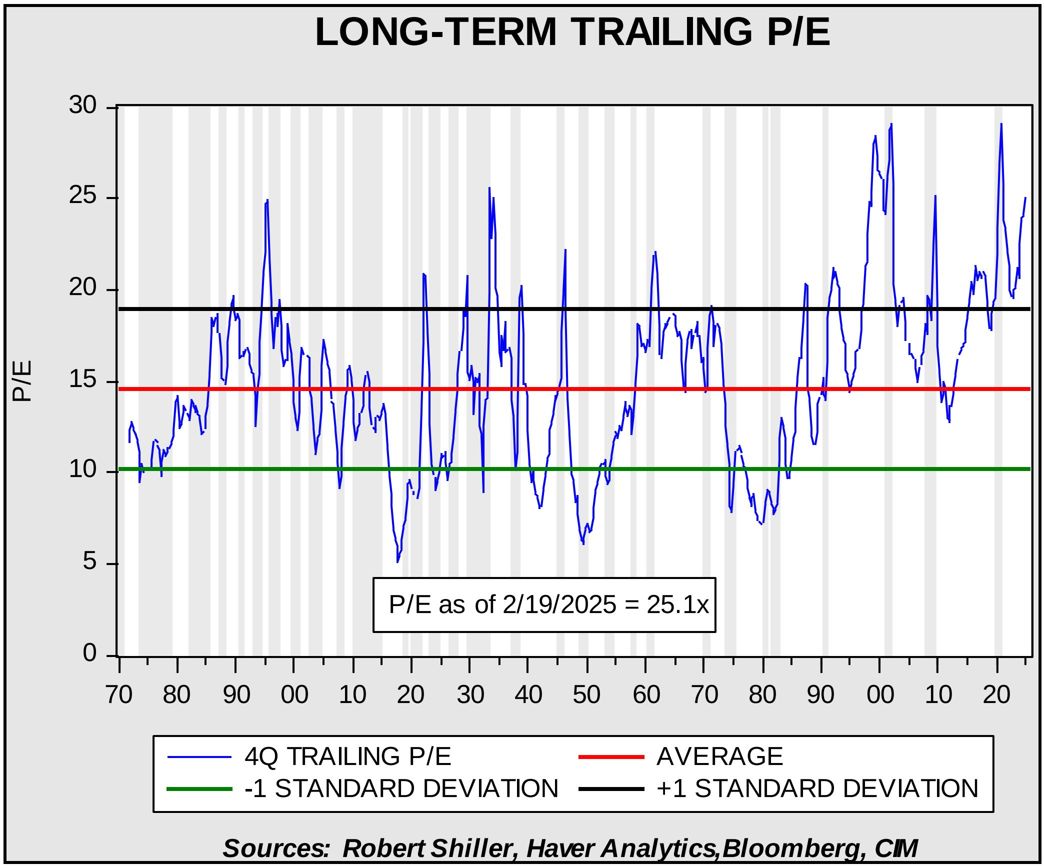


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.

[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.