Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: February 27, 2025 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed down 0.6% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.2%. Chinese markets were mixed, with the Shanghai Composite up 0.2% from its previous close and the Shenzhen Composite down 0.3%. US equity index futures are signaling a higher open.

With 466 companies having reported so far, S&P 500 earnings for Q4 are running at $65.50 per share compared to estimates of $64.79, which is up 11.7% from Q4 2023. Of the companies that have reported thus far, 75.2% have exceeded expectations, while 18.5% 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
"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

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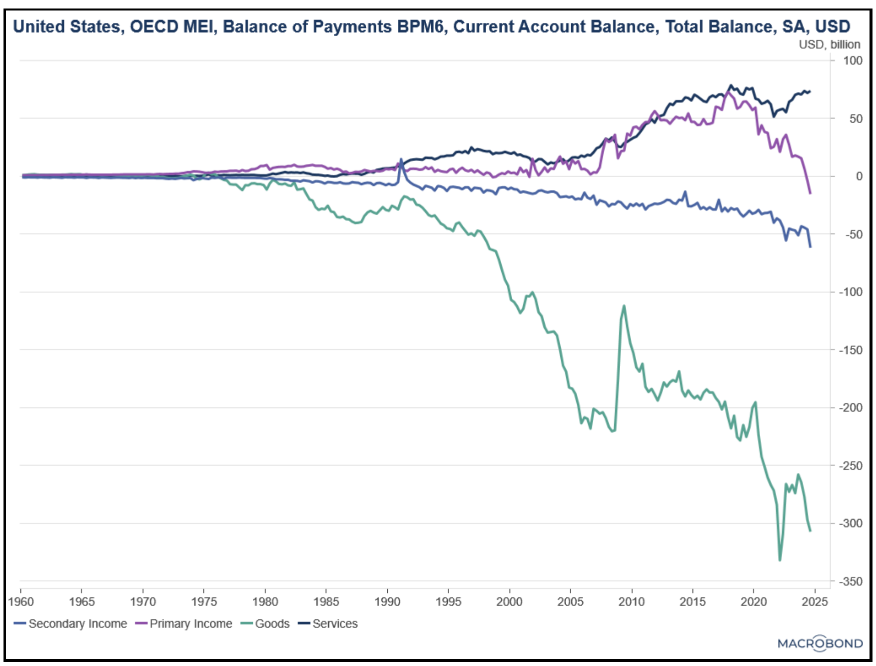
Good morning! The market is digesting the president's recent tariff announcements. In sports news, Real Madrid secured a victory against Real Sociedad in the first leg of their Copa del Rey semifinal clash. Today's *Comment* will explore why the trade deficit may not be the Trump administration's sole concern, analyze the Magnificent 7's weak start to the year, and cover other market-related developments. As usual, the report will also include a roundup of key international and domestic data releases.

Trump Tariffs: President Trump has pledged to proceed with tariffs on Mexico, Canada, and the European Union starting next week, though he left room for a potential extension that could delay them until April. The announcement sent shockwaves through markets, as uncertainty grows over how far his administration will escalate this global trade war.

- Originally, [Trump planned to impose these levies on March 4], proposing a 25% tariff on goods from Mexico and Canada due to concerns that the countries were not taking sufficient actions to curb the flow of fentanyl into the United States. Simultaneously, the EU was targeted over allegations of unfair trade practices, which have placed the US agriculture and automotive industries at a competitive disadvantage.
- That said, his threats have caused some confusion, particularly for Mexico and Canada, as it remains unclear whether they will receive an extension. The president's team has been evaluating various goods that could potentially be targeted by tariffs, which were also set to take effect on April 2. As a result, the president may consider imposing additional tariffs on Mexican and Canadian goods a month after implementing 25% tariffs, rather than extending the March deadline.
- Regardless of whether tariffs take effect in March or April, the uncertainty surrounding how events will unfold has already contributed to volatile equity markets. The US is expected to start with relatively low tariffs, with the possibility of increasing them if trading partners retaliate. Meanwhile, other countries have been preparing contingency plans in case their goods face tariffs, potentially targeting swing-state economies as part of their response.
- One key area of focus in analyzing the trade war will be the current account balance. While the US trade deficit has been widely discussed in the media, far less attention has been given to the deficit in primary income. For the first time in recorded history, American residents are earning less on their overseas assets than foreigners are earning on their US assets. This suggests that the US is paying more to the rest of the world in dividend and interest than it is receiving from them in return.

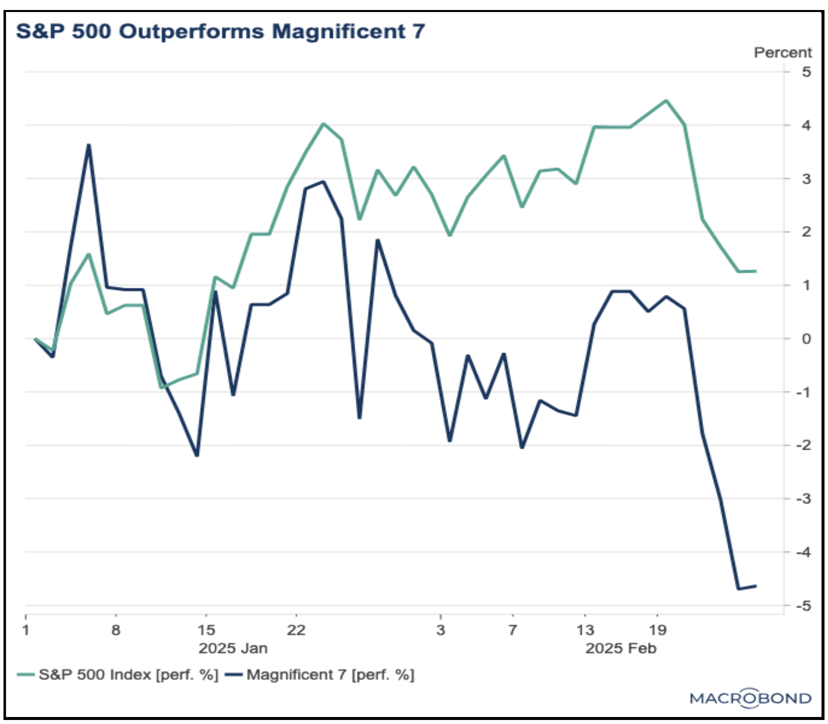


- The concern with having both a trade deficit and a primary income deficit is that it indicates other countries are not only gaining an advantage in trade but also demanding higher returns on their investments. In the long run, this dynamic is unsustainable, as it could lead to a rapid increase in US debt or a currency crisis.

- It is important to note that the president may be using the current account as a scorecard to assess whether the US is being taken advantage of. As a result, the Trump administration's pressure on the rest of the world could extend beyond trade and potentially into financial flows if these imbalances persist. This could introduce additional uncertainty into equity markets while simultaneously strengthening the case for gold as a safe-haven asset.

Magnificent 7: Nvidia was unable to provide a boost for the group of seven mega cap tech stocks, which have slipped into correction territory this week. Their collective weak start to the year comes as investors continue to assess the potential of AI and other emerging technologies.

- The chipmaker posted another strong earnings report in the fourth quarter of 2024. The company's sales surged by 78% in the final three months of the year, reflecting robust demand for its chips. Additionally, it was able to counter concerns that demand for its products was under threat following the release of DeepSeek.
- That said, the strong earnings report failed to excite investors, as the company's stock price remained relatively flat compared to the previous day, despite rising as much as 3.4% in the lead-up to the announcement. The muted reaction comes as investors have begun rotating away from the Magnificent 7 in favor of other large cap stocks.
- Following two exceptionally strong years in 2023 and 2024, during which the Magnificent 7's collective stock price nearly tripled the performance of the S&P 500, investors appear to be seeking new leadership. While the Magnificent 7 is down 4.4% year-to-date, the rest of the S&P 500 has gained 4.5% over the same period.



- One of the key uncertainties is whether investors will continue to pressure the companies' collective capital expenditure (capex) spending, particularly amid growing uncertainty surrounding US policy and geopolitical tensions. As a result, investors may adopt a wait-and-see approach for now, as they assess how these companies navigate emerging challenges.

Taiwan in Danger? Chinese military exercises around Taiwan are growing increasingly assertive, signaling that Beijing may be seriously considering the possibility of an invasion.

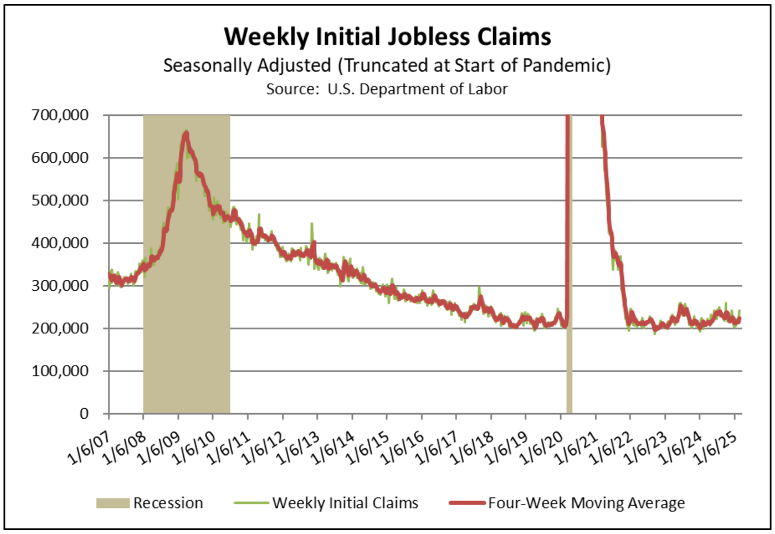
- A senior Chinese official responsible for Taiwan relations issued a strong call on Wednesday, urging the island to consider "the inevitable reunification of the motherland." This bold statement indicates Beijing's potential for increased action to maintain Taiwan within its orbit.
- This assertive stance, coupled with escalating Chinese military exercises near the island, has fueled concerns of a potential false flag invasion. Furthermore, the severing of undersea cables by Chinese entities has raised fears of hybrid warfare, suggesting a significant escalation in cross-strait tensions.
- While the US has consistently stated its support for Taiwan's self-governance, President Trump has been reluctant to explicitly promise military defense of the region in the event of an attack by China.

Rubio Russia Pivot: Secretary of State Marco Rubio has warned that the US should not allow Moscow to become a junior partner to China. This strategy, which some have dubbed the "reverse Nixon," underscores the Trump administration's willingness to pull Moscow away from Beijing's influence.

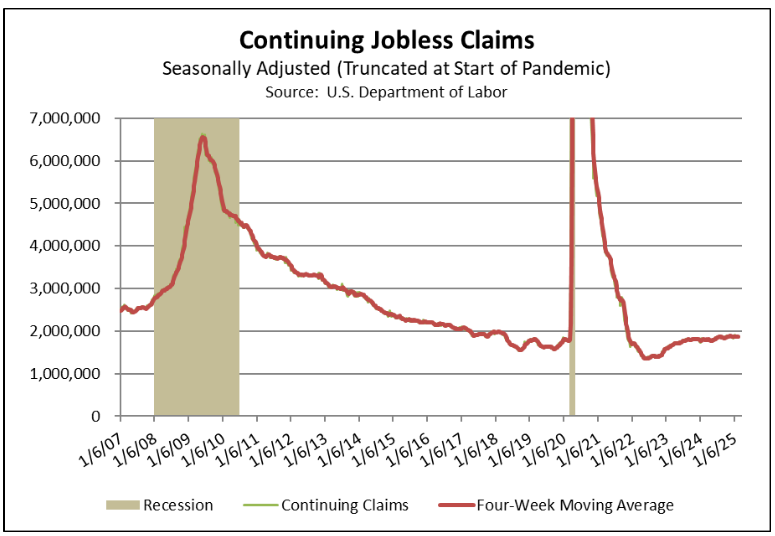
- While the rhetoric may sound appealing, the practicality of this goal appears highly questionable, especially considering Russia's already heavy economic reliance on China and the growing competition between the US and Moscow over energy markets in Europe.
- That said, the warming of ties between the US and Russia serves as another reminder to the EU that Washington no longer prioritizes its transatlantic relationships. This shift could potentially push Europe to seriously reconsider and accelerate its own defense buildup.

US Economic Releases

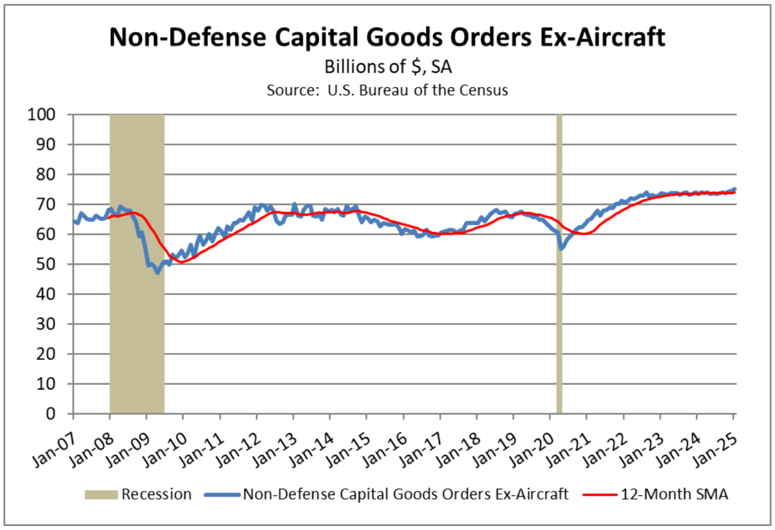
In the week ended February 22, ***initial claims for unemployment benefits*** rose to a seasonally adjusted 242,000, much higher than both the expected level of 221,000 and the previous week's revised level of 220,000. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, rose to a two-month high of 224,000. 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.



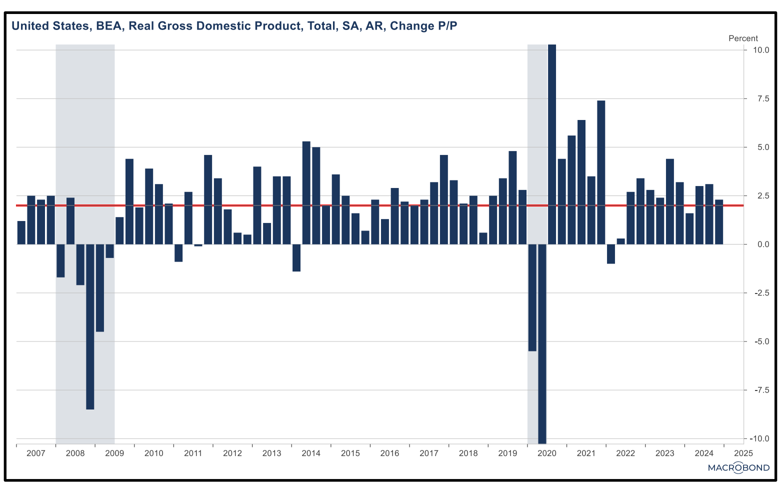
In the week ended February 15, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) edged down to a seasonally adjusted 1.862 million, below the anticipated reading 1.871 million, and the prior week's revised reading of 1.867 million. The four-week moving average of continuing claims rose to 1.865 million. 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.



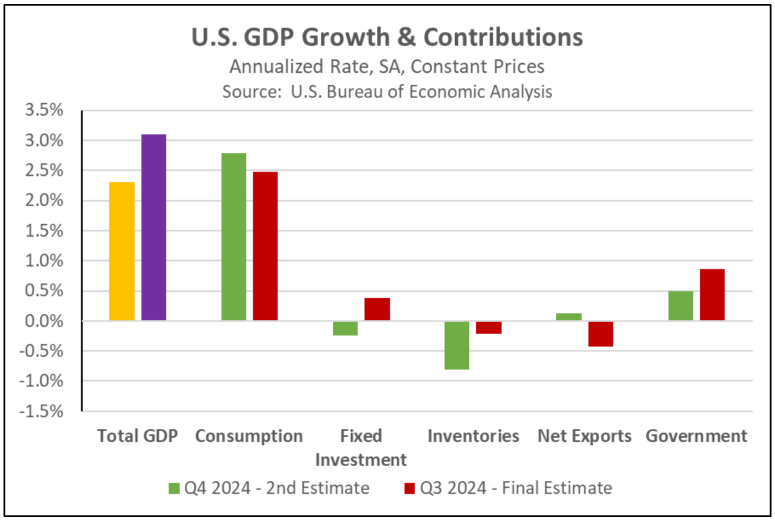
Separately, January ***durable goods orders*** rose by a seasonally adjusted 3.1%, beating the expected increase of 2.0% and more than reversing the revised December decline of 1.8%. Durable goods orders are often driven by transportation equipment, where just a few airliner orders can have a big impact, and that certainly seemed to be the case at the beginning of 2025. January ***durable goods orders excluding transportation*** came in unchanged, short of both the anticipated rise of 0.3% and December's revised gain of 0.1%. Finally, the durable goods report also includes a key proxy for corporate capital investment. In January, nondefense capital goods orders ex-aircraft rose 0.8%, beating their expected rise of 0.3% and December's revised rise of 0.2%. Compared with the same month one year earlier, overall durable goods orders in January were up 4.3%, while durable orders ex-transport were up 1.7%. Nondefense capital goods orders ex-aircraft were unchanged. The chart below shows the progression of nondefense capital goods orders ex-aircraft since just before the GFC.



Finally, the Commerce Department released its second estimate of economic activity in the fourth quarter of 2024. After stripping out seasonal factors and price changes, fourth-quarter ***gross domestic product (GDP)*** rose at an annualized rate of 2.3%, matching expectations that the growth rate would be the same as in the initial estimate. The chart below shows the annualized growth rate of US GDP since just before the GFC, with the 20-year average growth rate of 2.1% shown by the red line.



A close look at the details in the report shows that the main source of growth in the quarter was consumer spending, probably reflecting today's healthy demand for labor, low unemployment, and rising wage rates. Government spending was also a contributor to growth. The chart below shows the contributions to the annualized growth rate in the fourth quarter.



The GDP report also includes the broadest measure of US price inflation. The fourth-quarter ***GDP Price Index*** rose at an annualized rate of 2.4%, versus expectations that the rate of increase would match the initial estimate of 2.2%.

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	Pending Home Sales	m/m	Jan	-0.9%	-5.5%	**
10:00	Pending Home Sales NSA	y/y	Jan	-1.1%	-2.9%	**
11:00	Kansas City Fed Manfacturing Index	m/m	Feb	-4	-5	*
Federal Reserve						
	No Fed speakers or events for the rest of today					
EST	**Speaker or Event**	**District or Position**				
8:15	Thomas Barkin Repeats Speech on Inflation	President of the Federal Reserve Bank of Richmond				
9:15	Jeff Schmid Gives Remarks on Monetary Policy, Economy	President of the Federal Reserve Bank of Kansas City				
10:00	Michael Barr Speaks on Novel Activity Supervision	U.S. Federal Reserve Vice Chairman for Supervision				
11:45	Michelle Bowman Speaks on Community Banking	Member of the Board of Governors				
13:15	Beth Hammack Gives Keynote Speech at conference	President of the Federal Reserve Bank of Cleveland				
15:15	Patrick Harker Gives Speech on Economic Outlook	President of the Federal Reserve Bank of Philadelphia				

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								
Australia	Private Capital Expenditure	q/q	4Q	-0.2%	1.6%	0.5%	**	Equity bearish, bond bullish
New Zealand	ANZ Activity Outlook	m/m	Feb	45.1	45.8		*	Equity and bond neutral
	ANZ Business Confidence	m/m	Feb	58.4	54.4		**	Equity and bond neutral
EUROPE								
Eurozone	M3 Money Supply	y/y	Jan	3.6%	3.4%	3.8%	***	Equity and bond neutral
	Consumer Confidence	m/m	Feb F	-13.6	-18.7		**	Equity and bond neutral
	Economic Confidence	m/m	Feb	96.3	95.3	95.9	***	Equity and bond neutral
	Industrial Confidence	m/m	Feb	-11.4	-12.7	-12.0	***	Equity bullish, bond bearish
	Services Confidence	m/m	Feb	6.2	6.7	6.8	**	Equity bearish, bond bullish
France	PPI	y/y	Feb	-2.3%	-3.8%		*	Equity and bond neutral
Italy	Consumer Confidence	m/m	Feb	98.8	98.2	98.5	***	Equity and bond neutral
	Manufacturing Confidence	m/m	Feb	87.0	86.8	87.0	***	Equity and bond neutral
	Economic Sentiment	m/m	Feb	94.8	95.7		**	Equity and bond neutral
	Industrial Sales WDA	y/y	Dec	-7.2%	-2.5%		*	Equity and bond neutral
Switzerland	GDP	y/y	4Q	1.5%	1.9%	1.6%	**	Equity and bond neutral
Russia	Industrial Production	y/y	Jan	2.2%	8.2%	5.4%	***	Equity and bond neutral
AMERICAS								
Mexico	Unemployment Rate NSA	m/m	Jan	2.70%	3.74%	3.40%	***	Equity and bond neutral
	Trade Balance	m/m	Jan	-4558.0m	2566.8m	-3808.0m	**	Equity and bond neutral
	Exports	m/m	Jan	44446m	51687m	$31.200b	*	Equity and bond neutral
	Imports	m/m	Jan	49004m	49120m	$21.400b	*	Equity and bond neutral
Brazil	FGV Inflation IGPM	y/y	Feb	8.44%	6.75%	8.43%	***	Equity and bond neutral
	Current Account Balance	m/m	Jan	-$8655m	-$9033m	-$9000m	**	Equity and bond neutral
	Foreign Direct Investment	m/m	Jan	$6501m	$2765m	$5700m	**	Equity and bond neutral
	National Unemployment Rate	m/m	Jan	6.5%	6.2%	6.6%	*	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)	419	420	-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 (%)	4.29	4.26	0.03	Down
Euribor/OIS spread (bps)	250	253	-3	Down
Currencies	**3 Mo**			
Dollar	Up	US		Up
Euro	Down	Euro		Down
Yen	Up	Japan		Up
Pound	Down	UK		Flat
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.

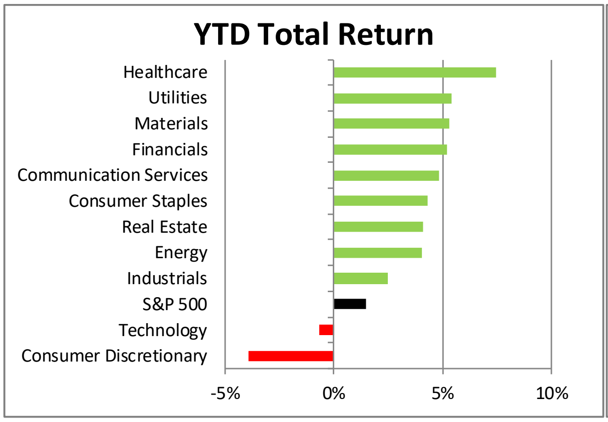
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$73.39	$72.53	1.19%	
WTI	$69.38	$68.62	1.11%	
Natural Gas	$3.93	$3.96	-0.76%	
Crack Spread	$24.65	$24.75	-0.42%	
12-mo strip crack	$20.79	$20.75	0.17%	
Ethanol rack	$1.82	$1.84	-0.98%	
Metals				
Gold	$2,884.77	$2,916.39	-1.08%	
Silver	$31.85	$31.86	-0.02%	
Copper contract	$462.20	$458.65	0.77%	
Grains				
Corn contract	$494.00	$493.50	0.10%	
Wheat contract	$574.50	$579.75	-0.91%	
Soybeans contract	$1,046.75	$1,041.25	0.53%	
Shipping				
Baltic Dry Freight	1,112	1,039	73	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-2.33	2.40	-4.73	
Gasoline (mb)	0.37	-1.40	1.77	
Distillates (mb)	3.91	-2.76	6.67	
Refinery run rates (%)	1.6%	-0.2%	1.8%	
Natural gas (bcf)		-271		

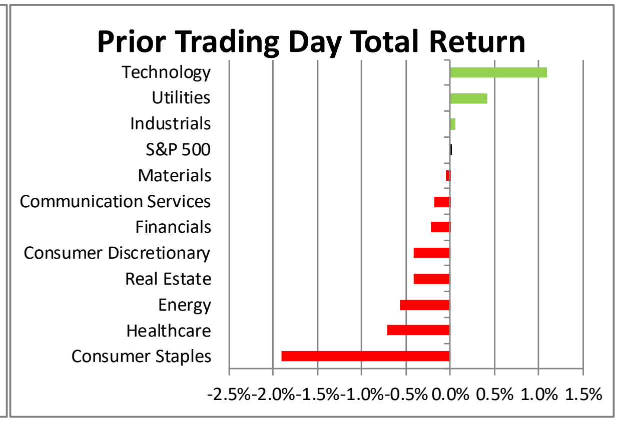
Weather

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 and Midwest. 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 2/26/2025 close)

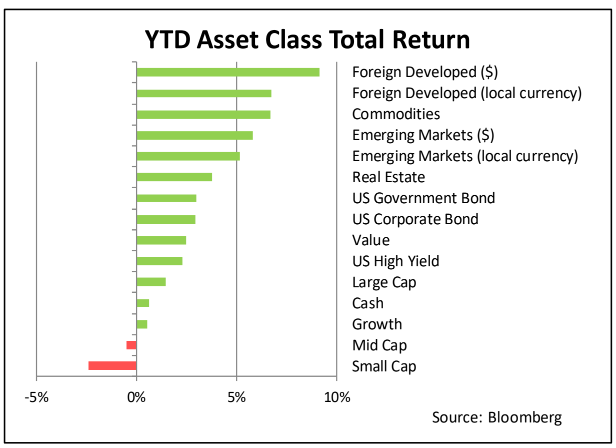




(Source: Bloomberg)

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 2/26/2025 close)

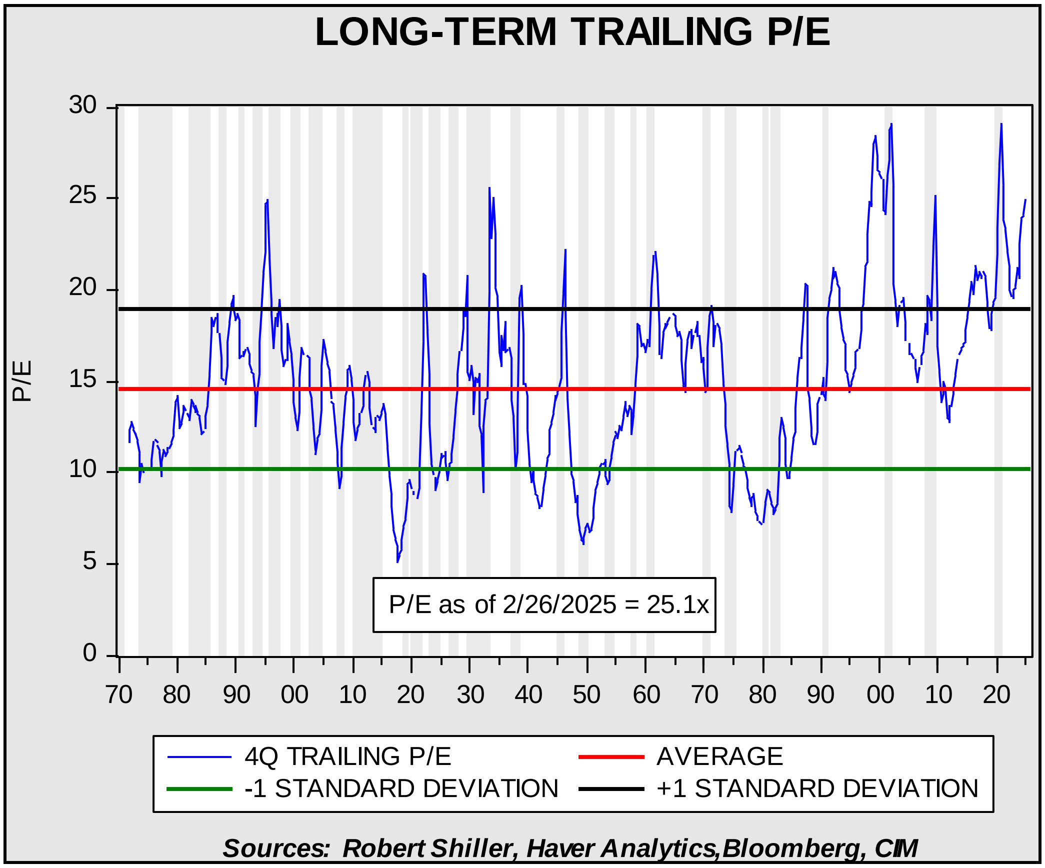


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 27, 2025



Based on our methodology,[1] the current P/E is 25.1x, unchanged from our last report. There was minimal change in the index and earnings from the previous week.

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.