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[Posted: February 3, 2025 — 9:30 AM ET] Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 closed down 1.9% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 2.4%. Chinese markets were closed for the Chinese Lunar New Year. US equity index futures are signaling a lower open.

With 179 companies having reported so far, S&P 500 earnings for Q4 are running at \$63.30 per share, compared to estimates of \$64.79, which is up 11.7% from Q4 2023. Of the companies that have reported thus far, 78.8% have exceeded expectations while 16.2% 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:

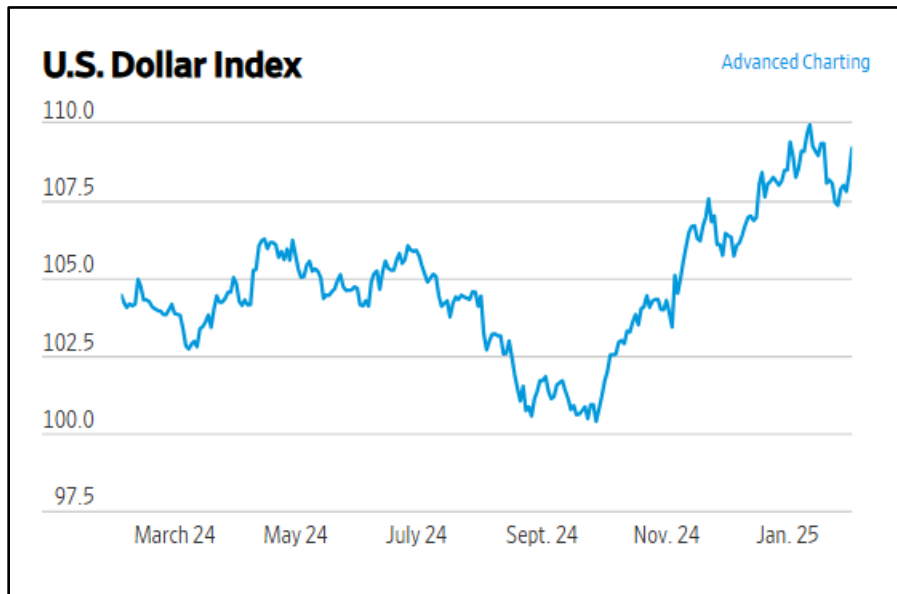
Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
<u>Trump and the Political Economy of Alliances</u> (1/27/25) + podcast	<u>American Exceptionalism and the Markets</u> (2/3/25) + podcast	Q1 2025 Report	<u>The 2025 Outlook: A Year of Political and Policy Change</u>

Our *Comment* today opens with President Trump’s decision over the weekend to impose big, new import tariffs against Canada, Mexico, and China. The move is dominating the financial media this morning, as it has the potential to spark a long, painful trade war and leave the US isolated from its traditional allies. We next review several other international and US developments with the potential to affect the financial markets today, including new revelations on the biased answers that can be generated by China’s DeepSeek artificial-intelligence platform and news that Elon Musk has gained access to the US Treasury Department’s sensitive payments platform.

United States-Canada-Mexico-China: The Trump administration on Saturday [imposed 25% import tariffs on most goods from Canada and Mexico, 10% tariffs on Canadian energy imports, and additional 10% tariffs on all imports from China](#), effective Tuesday. For legal basis, the White House cited emergency economic authority based on fentanyl trafficking from the

countries. The administration said the tariffs will have no exemptions and will be in place until officials are satisfied that illicit fentanyl trafficking across the US border has ceased.

- The new tariffs on Canada, Mexico, and China would affect imports with a total value of about \$1.3 trillion in 2023, making them much more significant than the tariffs against China in Trump's first term. Those tariffs applied to about \$360 billion of Chinese imports at the time.
- President Trump indicated on Friday that any tariffs against Canada, Mexico, and China would only be the first of many. He vowed to also slap broad tariffs on semiconductors, pharmaceuticals, steel, aluminum, copper, oil and gas imports as soon as mid-February.
- Beijing [said it would file a WTO action against the tariffs and take retaliatory measures](#). Canadian Prime Minister Trudeau [called the new US tariffs a "betrayal" and imposed 25% tariffs on \\$107 billion of US-made products](#) going to Canada, the first phase of which will affect products including motorcycles, cosmetics, wine, and orange juice.
- In addition, the imposition of the tariffs will now likely accelerate efforts to get around them. For example, Chinese electric-vehicle battery maker CNGR Advanced Material last week [opened a new battery materials plant in Morocco](#) to take advantage of that country's free-trade agreements with the European Union and the US.
- Even though the members of the United Steelworkers broadly supported President Trump in his 2024 election campaign, the union criticized the new tariffs as overly broad. However, the union's opposition was not enough to derail the tariffs.
- For US consumers, the big tariff hikes [could well result in higher prices for automobiles, electronics, winter produce, and many other products](#) in the coming weeks and months.
- Finally, the tariffs have rippled through all major markets today, sending US stock futures down, upending many foreign stocks, and especially weighing on global auto makers. The dollar has also appreciated, with the US Dollar Index currently at 109.19, up 0.8% on the day. The VIX has also spiked above 20, and cryptocurrency prices have fallen sharply.



(Source: Wall Street Journal)

US-China Artificial Intelligence: As investors continue to digest last week’s news that Chinese firm DeepSeek has built a cheap, powerful AI model, a study by a disinformation watchdog [has found that DeepSeek’s model often spouts the Chinese Communist Party’s line when queried about international controversies](#). The slanted results appear when the model is accessed from China-based servers. Other reports [say US firms such as Nvidia, Microsoft, and Amazon are supporting uncensored versions of the DeepSeek model](#) for customers outside of China.

- While it’s tempting to think that DeepSeek’s censored output would be a liability, that may not necessarily be the case. Other Chinese tech products, such as Huawei telecom equipment and the TikTok social media app, also present surveillance or propaganda risks, but many Westerners still covet them because of their low cost and ease of use.
- The decision by Nvidia, Microsoft, and other US firms to support the DeepSeek model likely reflects their realization that its low cost and ease of use stand to greatly expand the use of AI, boosting demand for their products.
- A key question going forward is whether Western governments will eventually try to restrict or ban the use of Chinese models on national security concerns.

Japan-China: Following on US efforts to curb Chinese access to advanced technologies, Japan [is reportedly preparing to tighten its export controls on advanced semiconductors](#), chipmaking equipment, and quantum-computing technology. It is also preparing to put dozens more Chinese firms on its “entity list,” which names companies restricted from receiving certain Japanese exports that have both civilian and military uses.

- In some respects, Japanese Prime Minister Ishiba in recent months has seemed eager for warmer ties with China, sparking worries about the strength of the US-Japanese security alliance. The tougher curbs on Japanese exports to China could help ease those concerns.

- Of course, the flip side is that Beijing will certainly be perturbed by the new Japanese rules. The move therefore could worsen Japan-China relations again and potentially prompt China to impose retaliatory trade barriers against Japan.

China-Philippines: Late last week, Manila [arrested five more Chinese nationals on suspicion of spying, after arresting the group's apparent ringleader in mid-January](#). Among other activities, the spies had allegedly set up cameras and other surveillance equipment to monitor Philippine coast guard ships en route to resupply marines on the Second Thomas Shoal, a disputed outcrop in the South China Sea. The shoal is claimed by both Beijing and Manila.

- The spies' activities help explain how the Chinese navy and coast guard have been so successful in intercepting Philippine vessels trying to resupply the marines and assert Manila's territorial claims in the South China Sea.
- More broadly, the arrests suggest that the Philippines has become a hotbed of espionage activity as China tries to take control of Philippine territory and the US deploys more military assets to the region.

Germany: Friedrich Merz, the center-right Christian Democratic Union's (CDU) candidate for chancellor in this month's election and the current leader in opinion polls, [suffered a humiliating defeat in parliament for his tough anti-immigration bill on Friday](#), as his controversial reliance on the far-right Alternative for Germany (AfD) party for an earlier procedural vote backfired spectacularly.

- It's now clear that Merz's flirtation with the AfD has irritated many legislators and citizens from the center-left to the center-right.
- Even if Merz remains the frontrunner and wins the election, there is now an increased chance that he may turn to the AfD to form a government. That would give the far-right its strongest position in German politics since World War II.

United States-Denmark-Greenland: After a poll last week showed that 85% of Greenland's residents reject President Trump's plan for the US to take over the autonomous Danish island, a new poll [shows 78% of Danish citizens also oppose selling to the US](#). The new poll also found that 46% of Danes now see the US as a "very big threat" or "fairly big threat" to Denmark, exceeding the share who say the same about Iran or North Korea.

- If foreign citizens increasingly see the US as a threatening country, foreign political leaders may come under pressure to reduce their cooperation or support for Washington.
- As we discussed in our [Bi-Weekly Geopolitical Report from January 27](#), such a development could potentially undermine the US alliance structure and weaken the country's security position against China, Russia, Iran, and North Korea.

United States-Panama: Secretary of State Rubio [visited Panama over the weekend to talk with Panamanian President José Raúl Mulino about US concerns over Chinese involvement with the Panama Canal](#). Mulino reportedly offered several concessions, such as ending a 2017 deal for

Chinese infrastructure funding, but he insisted Panama would not return the facility to the US. In response, President Trump reiterated that if Panama does not return the canal, “something very powerful is going to happen.”

US Politics: The Democratic National Committee [has selected Ken Martin to be its new party chairman](#), charged with making the party competitive again after its broad losses in the 2024 election. Martin is the long-time chair of Minnesota’s Democratic-Farmer-Labor Party and has said he wants to push the party back toward a focus on helping working class voters.

US Fiscal Policy: Despite resistance from career employees, Treasury Secretary Bessent on Friday [gave associates of Elon Musk and the so-called Department of Government Efficiency access](#) to the Treasury Department’s electronic payments system, which handles most federal payments to individuals, businesses, educational and medical agencies, and states. The move is quickly becoming controversial because it could theoretically allow Musk and his team to stop federal spending even if it has been appropriated by Congress.

- Allowing Musk’s team into the payments system will also likely rekindle concerns that he and many of his Silicon Valley recruits to the DOGE have conflicts of interest.
- For example, companies that serve as contractors for the federal government and compete against Musk’s businesses could theoretically see their payments shut off. The payment system also carries a lot of sensitive information on companies and individuals, which helps explain why access to it has been closely restricted until now.

US Economic Releases

There were no economic releases today prior to publication of this report. The table below lists the economic releases and Fed events scheduled for the rest of the day.

Economic Releases						
ET	Indicator			Expected	Prior	Rating
9:45	S&P Global US Manufacturing PMI	m/m	Jan F	50.1	50.1	***
10:00	Construction Spending MoM	m/m	Dec	0.20%	0.0%	*
10:00	ISM Manufacturing	m/m	Jan	49.9	49.2	**
10:00	ISM New Orders	m/m	Jan		52.1	**
10:00	ISM Employment	m/m	Jan		45.4	*
10:00	ISM Prices Paid	m/m	Jan	54.8	52.5	**
	Wards Total Vehicle Sales	m/m	Jan	16.00m	16.8m	***
Federal Reserve						
ET	Speaker or Event	District or Position				
12:30	Raphael Bostic Speaks on Economic Outlook	President of the Federal Reserve Bank of Atlanta				
18:30	Alberto Musalem Gives Welcoming Remarks	President of the Federal Reserve Bank of St. Louis				

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	Jibun Bank Manufacturing PMI	m/m	Jan F	48.7	48.8		***	Equity and bond neutral
Australia	S&P Global Australia Manufacturing PMI	m/m	Jan F	50.2	49.8		***	Equity and bond neutral
	Melbourne Institute Inflation	y/y	Jan	2.3%	2.6%		***	Equity and bond neutral
	Retail Sales	m/m	Dec	-0.1%	0.7%	-0.7%	***	Equity bullish, bond bearish
	Building Approvals	m/m	Dec	0.7%	-3.4%	1.0%	***	Equity and bond neutral
South Korea	Trade Balance	m/m	Jan	-\$1886m	\$6492m	-\$1065m	*	Equity and bond neutral
	Exports	y/y	Jan	-10.3%	6.6%	-14.0%	***	Equity bullish, bond bearish
	Imports	y/y	Jan	-6.4%	3.3%	-10.6%	**	Equity bullish, bond bearish
	Industrial Production	y/y	Dec	5.3%	0.1%	1.2%	***	Equity bullish, bond bearish
	S&P Global South Korea PMI Manufacturing	m/m	Jan	50.3	49.0		***	Equity and bond neutral
China	Caixin Manufacturing PMI	m/m	Jan	50.1	50.5	50.6	***	Equity and bond neutral
India	HSBC India PMI Mfg	m/m	Jan F	57.7	58.0		***	Equity and bond neutral
EUROPE								
Eurozone	HCOB Eurozone Manufacturing PMI	m/m	Jan F	46.6	46.1	46.1	***	Equity and bond neutral
	CPI	y/y	Jan P	2.5%	2.4%	2.4%	***	Equity and bond neutral
	Core CPI	y/y	Jan P	2.7%	2.7%	2.6%	**	Equity and bond neutral
Germany	HCOB Germany Manufacturing PMI	m/m	Jan F	45.0	44.1	44.1	***	Equity and bond neutral
France	HCOB France Manufacturing PMI	m/m	Jan F	45.0	45.3	45.3	***	Equity and bond neutral
Italy	HCOB Italy Manufacturing PMI	m/m	Jan	46.3	46.2	46.9	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Jan P	1.7%	1.4%	1.4%	***	Equity and bond neutral
	CPI NIC Including Tobacco	y/y	Jan P	0.6%	1.3%	1.4%	**	Equity and bond neutral
UK	S&P Global UK Manufacturing PMI	m/m	Jan F	48.3	48.2	48.2	***	Equity and bond neutral
Switzerland	PMI Manufacturing	m/m	Jan	47.5	47.0	49.1	***	Equity and bond neutral
	PMI Services	m/m	Jan	57.2	51.3		*	Equity and bond neutral
	Domestic Sight Deposits CHF	w/w	31-Jan	432.9b	433.3b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	31-Jan	441.9b	441.3b		*	Equity and bond neutral
Russia	S&P Global Russia Manufacturing PMI	m/m	Jan	53.1	50.8		***	Equity and bond neutral
AMERICAS								
Canada	GDP	y/y	Nov	1.5%	1.9%	1.6%	**	Equity and bond neutral
Brazil	S&P Global Brazil Manufacturing PMI	m/m	Jan	50.7	50.4		***	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	419	0	Down
U.S. Sibor/OIS spread (bps)	430	430	0	Down
U.S. Libor/OIS spread (bps)	433	433	0	Down
10-yr T-note (%)	4.50	4.54	-0.04	Down
Euribor/OIS spread (bps)	259	261	-2	Down
Currencies	Direction			
Dollar	Up	US		Down
Euro	Down	Euro		Up
Yen	Down	Japan		Up
Pound	Down	UK		Up
Franc	Down	Switzerland		Up

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.

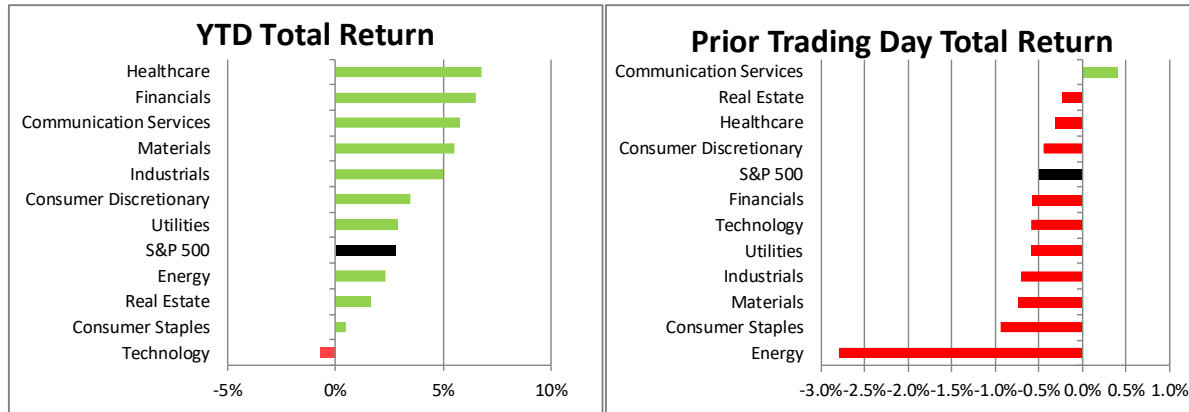
	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$76.97	\$75.67	1.72%	
WTI	\$74.43	\$72.53	2.62%	
Natural Gas	\$3.31	\$3.04	8.74%	Expected Increased Demand
Crack Spread	\$20.46	\$18.74	9.16%	
12-mo strip crack	\$22.53	\$21.73	3.69%	
Ethanol rack	\$1.82	\$1.82	0.09%	
Metals				
Gold	\$2,807.87	\$2,798.41	0.34%	
Silver	\$31.33	\$31.30	0.08%	
Copper contract	\$425.35	\$427.90	-0.60%	
Grains				
Corn contract	\$474.75	\$482.00	-1.50%	
Wheat contract	\$556.25	\$559.50	-0.58%	
Soybeans contract	\$1,035.00	\$1,042.00	-0.67%	
Shipping				
Baltic Dry Freight	735	715	20	

Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures in the Southeast, with cooler-than-normal temperatures in New England and the northern two thirds of the country, stretching from California to the Great Lakes. The forecasts call for wetter-than-normal conditions across most of the country, with dry conditions in northern Minnesota and North Dakota.

Data Section

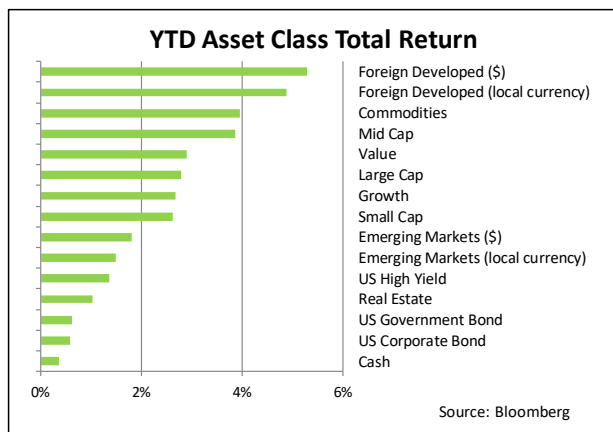
US Equity Markets – (as of 1/31/2025 close)



(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 1/31/2025 close)

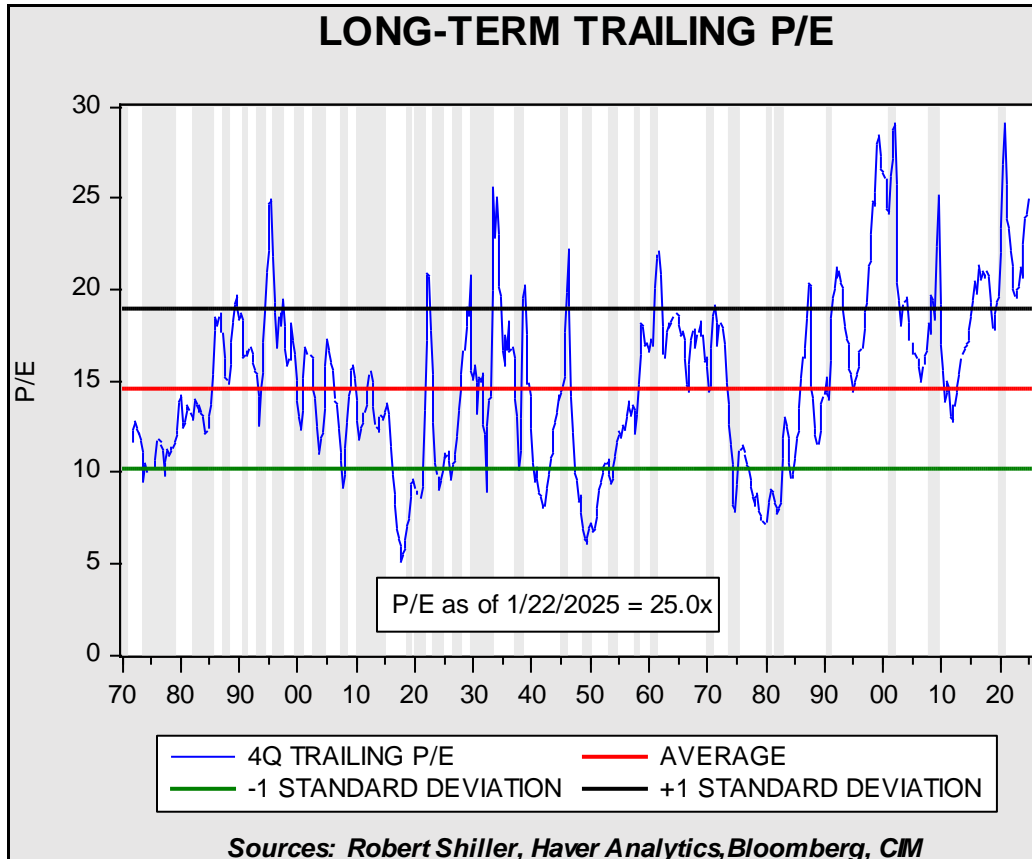


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

January 23, 2025



Based on our methodology,¹ the current P/E is 25.0x, up 0.1 from our last report. The increase was due to a rise in the stock price index.

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.