Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: February 5, 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 up 0.5%. Chinese markets were mixed, with the Shanghai Composite down 0.7% from its previous close and the Shenzhen Composite up 0.4%. US equity index futures are signaling a lower open.

With 230 companies having reported so far, S&P 500 earnings for Q4 are running at $63.60 per share, compared to estimates of $64.79, which is up 11.7% from Q4 2023. Of the companies that have reported thus far, 78.7% have exceeded expectations while 15.7% have fallen short of expectations.

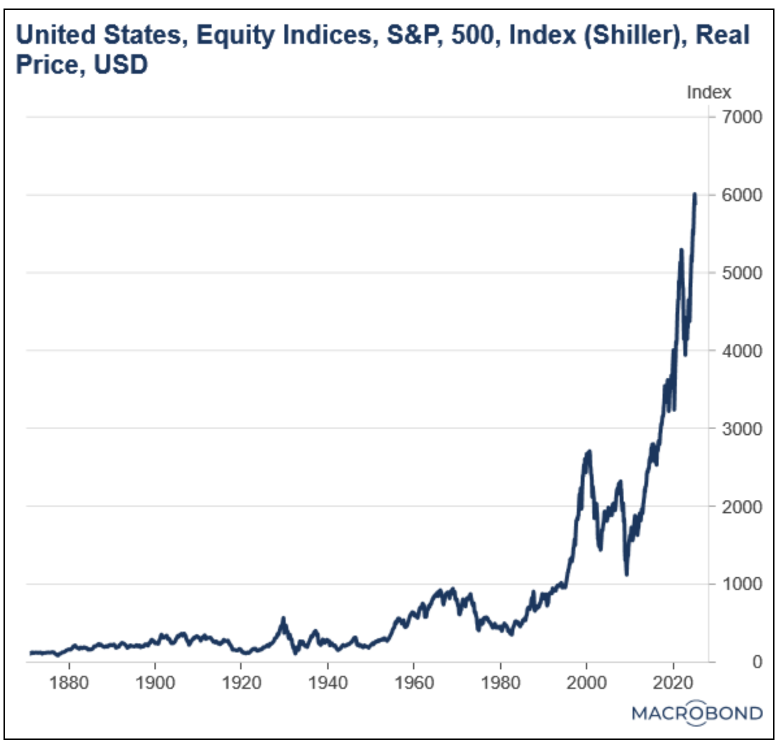
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below with new items of the day in bold:

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

Good morning! Investors will be closely watching tech earnings reports today. In sports, Atlético Madrid secured a resounding victory over Getafe and advanced to the Copa del Rey semi-finals. Today's comment will analyze the president's Gaza plan, explore why weakening labor demand keeps rate-cut hopes alive, and cover other key market developments. The report will also include a summary of domestic and international data releases.

Gaza Take Over? President Trump has suggested that Palestinians should be resettled in other Middle Eastern countries. This proposal represents a significant departure from longstanding US support for a two-state solution to the Israeli-Palestinian conflict. His remarks risk escalating tensions throughout the Arab world and further complicating regional diplomacy.

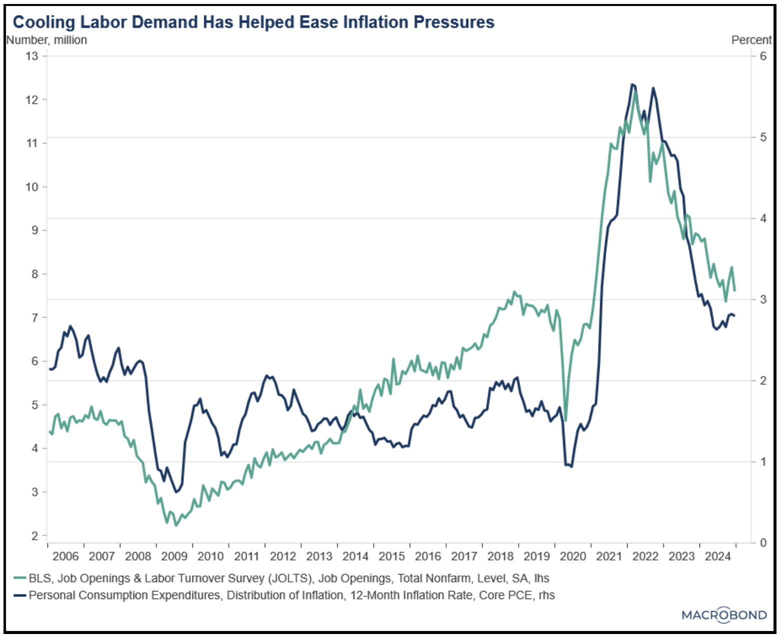
- His plan proposes that the US would assume full control of Gaza as it is being rebuilt following the extensive damage resulting from Israel's response to the Hamas attack of October 7. Additionally, the more than 2.2 million Palestinians living in the region would be relocated to other countries, notably Egypt and Jordan, in exchange for US aid.
- The feasibility of this plan remains unclear, given the lack of precedent. However, the proposal reflects the president's apparent interest in expanding US influence. In recent weeks, he has also expressed interest in acquiring Greenland and parts of Canada, as well as reasserting US control over the Panama Canal. These overtures have been met with resistance, but the president appears undeterred.
- Middle Eastern countries have largely rejected his proposal, drawing comparisons to the 1948 Nakba, or "catastrophe," when hundreds of thousands of Palestinians were displaced following the establishment of Israel. Although President Trump had claimed to have secured agreements with Egypt and Jordan, Egypt has publicly denied supporting the plan. Meanwhile, Jordan's King Abdullah is expected to meet with US officials in Washington to discuss the matter further.
- The president's emphasis on territorial expansion arguably reflects an ambition to establish the United States as a dominant force. This approach finds historical precedent in the policies of President William McKinley, whose expansionist agenda was similarly motivated by a desire to enhance international standing and strengthen the domestic economy.



- The primary distinction between Trump and McKinley lies in their approach to international influence. While McKinley favored military intervention to achieve his objectives, Trump is more likely to rely on diplomatic pressure, including strategic use of US aid and tariffs. This method is anticipated to be less destabilizing and, over time, could be advantageous for American companies.

Job Openings Drop: The number of job openings fell to a three-month low in December, which is a sign that firms are starting to slow hiring. US job listings fell to 7.6 million from a revised 8.2 million in November. US Treasurys rallied following the report as it likely leaves the door open for a rate cut this year.

- Despite the drop in the number of available jobs, several other indicators within the JOLTS report remained relatively unchanged. The hiring rate held steady at 3.4%, the lowest in over a decade, while the layoff rate remained at 1.1%, consistent with its long-term norm. The quits rate also remained unchanged at 2.0%, slightly below its pre-pandemic rate. Additionally, the ratio of openings to employment, which is closely watched by the Fed, was unchanged at 1.1, down from its peak of 2.
- The weak jobs report likely reinforces the Fed's view that it should hold policy steady for now, as data suggests a relatively balanced outlook for inflation and unemployment. This tame inflation and employment data has prompted several Fed officials to signal that the central bank is in no rush to cut rates.
- The Fed's hesitancy also stems from a desire to assess the impact of previous rate cuts and potential policy changes. Atlanta Fed President Raphael Bostic noted on Tuesday that he wants to see the effects of last year's 100 basis-point reduction. Concerns about a labor shortage due to immigration restrictions and potential tariffs have also led several Fed officials to raise the possibility of renewed inflation.



- Cooling labor markets had been a key driver of disinflation in 2024. For the Federal Reserve to continue its easing cycle, this trend likely needs to persist. The next few jobs reports will be crucial in determining the policy path for the remainder of the year. Currently, given prevailing economic conditions, we anticipate the Fed will cut rates by a maximum of 50 basis points this year.

Maximum Pressure: During his meeting with Israeli Prime Minister Benjamin Netanyahu, President Trump signed a memorandum directing the US government to use its resources to pressure Iran back to the negotiating table for nuclear talks. The potential for the loss of Iranian oil supply caused a temporary spike in crude oil prices.

- This memorandum comes as the United States pursues a strategy of using sanctions to compel Iran to abandon its nuclear weapons program. Although details regarding the mechanisms for future discussions have not been released, the US has indicated its intention to block the export of Iranian crude oil, a tactic previously employed against Russia.
- Iran's willingness to engage in discussions for sanctions relief contrasts with its recent displays of military strength. These include the unveiling of a new ballistic missile with the range to reach Israel, as well as large-scale military exercises and the showcasing of underground military installations.
- Heightened tensions between the US and Iran continue to pose a substantial risk to commodity markets. Reports of an alleged Iranian assassination plot against the US president, which Iran has denied, have further exacerbated these tensions. Therefore, we will be monitoring conversations between the two sides closely.

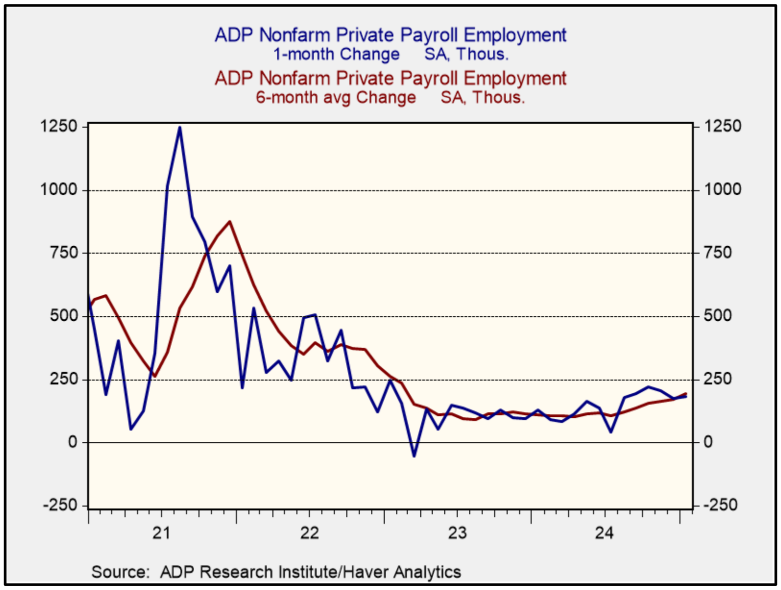
Government Shutdown Looming? Congress is preparing for budget negotiations to avert a government shutdown in mid-March. The primary obstacles are disagreements over spending freezes and the extent of potential cuts.

- Citing a lack of transparency from the new administration, Democrats have been hesitant to engage with their counterparts. Democrats point to developments such as Elon Musk's access to Treasury data related to the Department of Government Efficiency and the proposed termination of funding for programs benefiting USAID and Lutheran Social Services as examples of this lack of clarity.
- The budget impasse has led Republicans to pivot away from Trump's wish for a single "big, beautiful bill," in favor of a two-part strategy. While tax cuts remain a priority, the party recognizes the challenges involved and, due to the December 31 deadline to extend the tax cuts, is proceeding deliberately.

US Economic Releases

The Mortgage Bankers Association today said ***mortgage applications*** for the week ended January 31 rose 2.2%, reversing the prior week’s 2.0% fall. Applications for home purchase mortgages fell 3.5%, extending the prior’s week’s 0.4% decline. Applications for refinancing mortgages rose 12.2%, sharply reversing the declines of the previous two weeks. Readings of this index tend to be erratic early in the year, so these reversals may be less significant than they would be in coming weeks. Meanwhile, the average interest rate on a 30-year mortgage eased 5 basis points to 6.97%.

Separately, the ADP Research Institute estimated that ***private payroll employment*** rose in January by a seasonally adjusted 183,000. This notably exceeds the expected increase of 150,000 and marks a slight acceleration from December’s 176,000 gain. ADP’s estimate is widely seen as an indicator of what to expect when the Labor Department releases its measure of nonfarm payrolls on Friday. The chart below shows ADP’s estimate of private payrolls since the beginning of 2021.



Finally, the December ***trade balance*** showed a seasonally adjusted deficit of $98.4 billion, exceeding the expected $96.8 billion deficit and November's $78.9 billion deficit. According to the data, total ***exports*** fell 2.6%, while ***imports*** rose 3.5%. This sharp rise in the deficit, powered by rising imports, may represent efforts by US companies to secure products before the potential imposition of tariffs. Compared with the same month one year earlier, exports in December rose 2.5%, while imports rose 12.4%. The chart below shows the monthly value of US exports and imports 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						
EST	**Indicator**			**Expected**	**Prior**	**Rating**
10:00	ISM Services Index	m/m	Jan	54.0	54.0	***
10:00	ISM Services New Orders	m/m	Jan		54.4	*
10:00	ISM Services Employment	m/m	Jan		51.3	*
10:00	ISM Services Prices Paid	m/m	Jan	65.1	64.4	*
Federal Reserve						
EST	**Speaker or Event**	**District or Position**				
9:00	Thomas Barkin Speaks in Fireside Chat	President of the Federal Reserve Bank of Richmond				
14:30	Austan Goolsbee Gives Remarks at Auto Conference	President of the Federal Reserve Bank of Chicago				
15:00	Michelle Bowman Gives Update on Economy, Bank Regulation	Members of the Board of Governors				
19:30	Philip Jefferson Gives Lecture	Member 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	Labor Cash Earnings	y/y	Dec	4.8%	3.9%	3.7%	**	Equity bullish, bond bearish
	Real Cash Earnings	m/m	Dec	0.6%	0.5%	-0.1%	*	Equity bullish, bond bearish
	Jibun bank Composite PMI	m/m	Jan F	51.1	51.1		**	Equity and bond neutral
	Jibun Bank Services PMI	m/m	Jan F	53.0	52.7		**	Equity and bond neutral
Australia	S&P Global Australia Composite	m/m	Jan F	51.1	50.3		*	Equity and bond neutral
	S&P Global Australia Services PMI	m/m	Jan F	51.2	50.4		*	Equity and bond neutral
New Zealand	Unemployment Rate	q/q	4Q	5.1%	4.8%	5.1%	***	Equity and bond neutral
	Employment Change	q/q	4Q	-1.1%	-0.6%	-0.9%	**	Equity and bond neutral
	Participation Rate	q/q	4Q	71.0%	71.1%	71.1%	**	Equity and bond neutral
	ANZ Commodity Price	m/m	Jan	1.8%	0.1%		**	Equity and bond neutral
South Korea	Foreign Reserves	m/m	Jan	$411.01b	$415.60b		**	Equity and bond neutral
	CPI	m/m	Jan	2.2%	1.9%	22.1%	***	Equity and bond neutral
	CPI Ex Food and Energy	y/y	Jan	1.9%	1.8%	1.8%	*	Equity and bond neutral
China	Caixin Composite PMI	m/m	Jan	51.1	51.4		**	Equity and bond neutral
	Caixin Services PMI	m/m	Jan	51.0	52.2	52.4	**	Equity and bond neutral
India	HSBC India PMI Composite	m/m	Jan F	57.7	57.9		**	Equity and bond neutral
	HSBC India PMI Services	m/m	Jan F	56.5	56.8		**	Equity and bond neutral
EUROPE								
Eurozone	HCOB Eurozone Composite PMI	m/m	Jan F	50.2	50.2	50.2	*	Equity and bond neutral
	HCOB Eurozone Services PMI	m/m	Jan F	51.4	51.4	51.4	**	Equity and bond neutral
	PPI	y/y	Dec	0.0%	-1.2%	-0.1%	**	Equity and bond neutral
Germany	HCOB Germany Services PMI	m/m	Jan F	52.5	52.5	52.5	**	Equity and bond neutral
	HCOB Germany Composite PMI	m/m	Jan F	50.1	50.1	50.1	**	Equity and bond neutral
France	Industrial Production	y/y	Dec	-1.7%	-1.1%	-1.2%	***	Equity bearish, bond bullish
	Manufacturing Production	y/y	Dec	-2.6%	-1.5%		**	Equity and bond neutral
	HCOB France Services PMI	m/m	Jan F	48.2	48.9	48.9	**	Equity and bond neutral
	HCOB France Composite PMI	m/m	Jan F	47.6	48.3	48.3	**	Equity and bond neutral
Italy	HCOB Italy Composite PMI	m/m	Jan	49.7	49.7	49.7	**	Equity and bond neutral
	HCOB Italy Services PMI	m/m	Jan	50.4	50.7	50.4	**	Equity and bond neutral
	Retail Sales	y/y	Dec	0.6%	1.1%		**	Equity and bond neutral
UK	Official Reserves Changes	m/m	Jan	$2112m	-$1262m		*	Equity and bond neutral
	New Car Registrations	m/m	Jan	-2.5%	-0.2%		*	Equity and bond neutral
	S&P Global UK Services PMI	m/m	Jan F	50.8	51.2	51.2	**	Equity and bond neutral
	S&P Global UK Composite PMI	m/m	Jan F	50.6	50.9	50.9	**	Equity and bond neutral
Russia	S&P Global Russia Composite PMI	m/m	Jan	54.7	51.1	500.5	**	Equity and bond neutral
	S&P Global Russia Services PMI	m/m	Jan	54.6	51.2	50.5	**	Equity and bond neutral
AMERICAS								
Mexico	IMEF Manufacturing Index SA	m/m	Jan	45.6	47.5	47.2	*	Equity bearish, bond bullish
	IMEF Non-Manufacturing Index SA	m/m	Jan	49.1	49.6	49.2	*	Equity and bond neutral
	Gross Fixed Investment	y/y	Nov	-0.7%	-2.6%	-1.2%	**	Equity bullish, bond bearish
	Vehicle Domestic Sales	y/y	Jan	119811	146356		***	Equity and bond neutral
	Leading Indicators	y/y	Dec	-0.13	-0.14		**	Equity and bond neutral
Brazil	Industrial Production	y/y	Dec	1.6%	1.7%	-0.2%	***	Equity and bond neutral
	S&P Global Brazil Composite PMI	m/m	Jan F	48.2	51.5		***	Equity and bond neutral
	S&P Global Brazil Services PMI	m/m	Jan	47.6	51.6		***	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)	421	421	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 (%)	4.46	4.51	-0.05	Down
Euribor/OIS spread (bps)	254	256	-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.

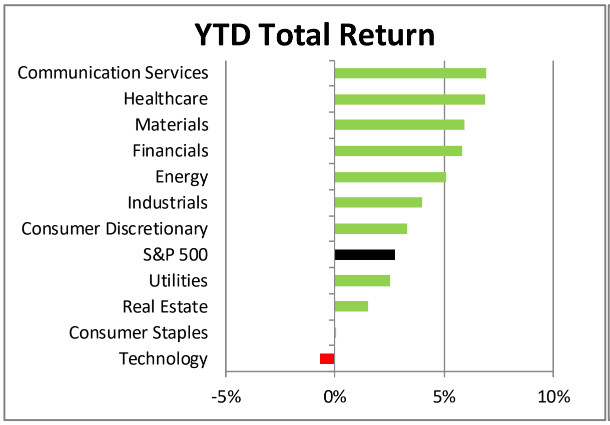
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$75.34	$76.20	-1.13%	
WTI	$71.92	$72.70	-1.07%	
Natural Gas	$3.22	$3.25	-1.11%	
Crack Spread	$19.78	$20.13	-1.73%	
12-mo strip crack	$21.96	$22.20	-1.09%	
Ethanol rack	$1.85	$1.84	0.26%	
Metals				
Gold	$2,870.21	$2,842.71	0.97%	
Silver	$32.39	$32.17	0.68%	
Copper contract	$436.30	$435.35	0.22%	
Grains				
Corn contract	$498.25	$494.50	0.76%	
Wheat contract	$583.50	$577.00	1.13%	
Soybeans contract	$1,075.00	$1,075.00	0.00%	
Shipping				
Baltic Dry Freight	753	738	15	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		1.90		
Gasoline (mb)		0.21		
Distillates (mb)		-2.07		
Refinery run rates (%)		-0.7%		
Natural gas (bcf)		-168		

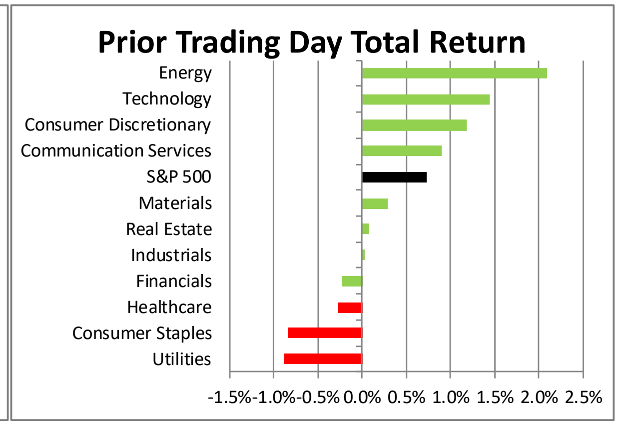
Weather

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 across most of the rest of the country. The forecasts call for wetter-than-normal conditions across most of the country.

Data Section

US Equity Markets – (as of 2/4/2025 close)

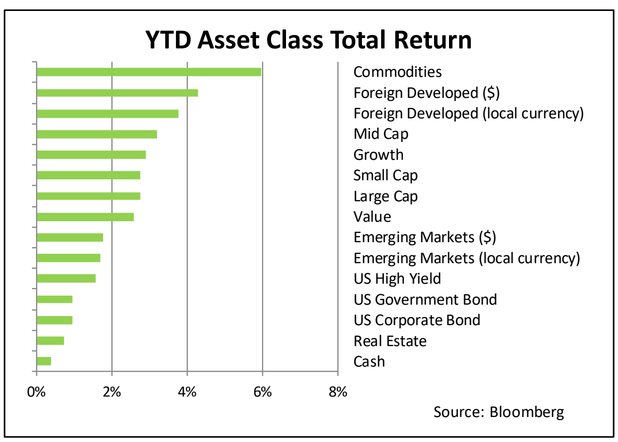




(Source: Bloomberg)

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 2/4/2025 close)

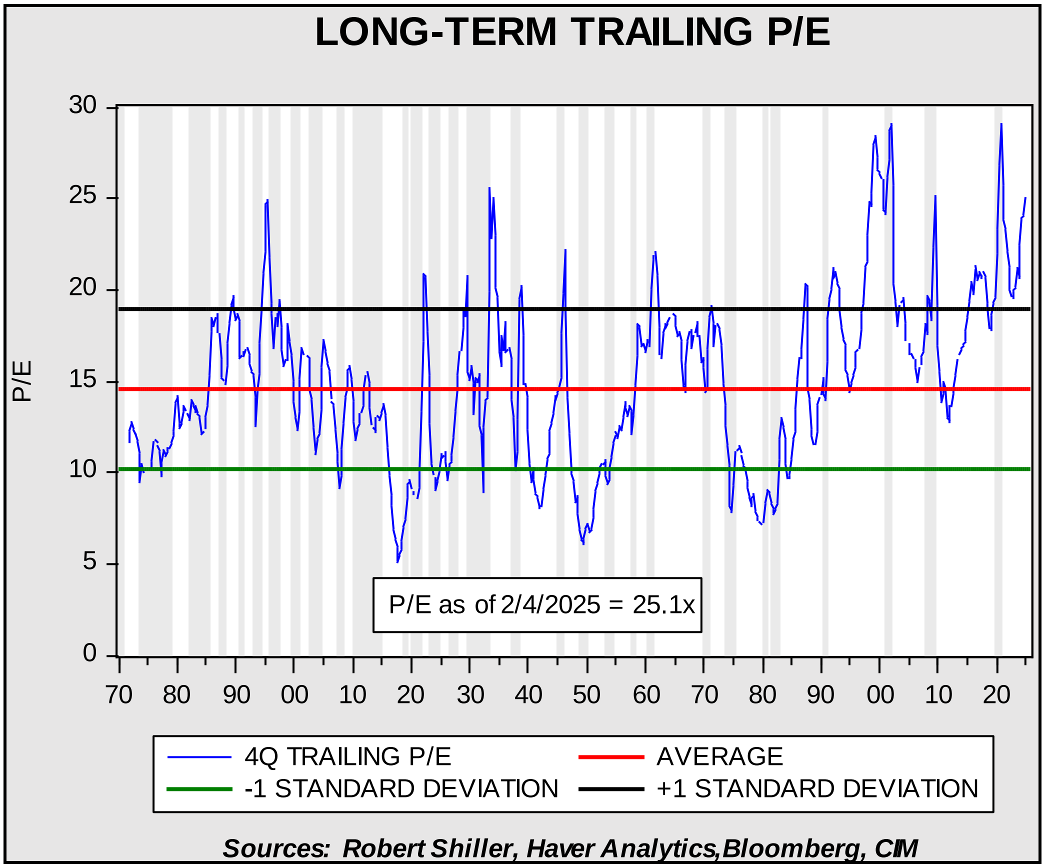


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 5, 2025



Based on our methodology,[1] the current P/E is 25.1x, 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.

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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.