Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: January 14, 2025 — 9:30 AM ET] Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 closed up 0.8% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.4%. Chinese markets were higher, with the Shanghai Composite up 2.5% from its previous close and the Shenzhen Composite up 4.2%. US equity index futures are signaling a higher open.

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
Syrian Surprise: Implications of a Sudden Regime Change (1/13/25) + podcast	*Household Cash Levels and the S&P 500 (12/9/24)* + podcast	Q4 2024 Report Q4 2024 Rebalance Presentation	*The 2025 Outlook: A Year of Political and Policy Change*

Our *Comment* today opens with news that Israel and Hamas could be on the verge of a cease-fire deal that could help stabilize the Middle East and reduce the risk of disruption in the global energy market. We next review several other international and US developments with the potential to affect the financial markets today, including new trade tensions between the European Union and China and more signs that investors are turning to data centers as a key way to capitalize on the development of artificial intelligence.

Israel-Hamas Conflict: Negotiators from Israel and the militant Hamas government of Gaza are meeting today in Doha, Qatar, to finalize a cease-fire deal that would end Tel Aviv's attacks on the enclave and release some of the hostages held by Hamas. Officials from Qatar say the deal could be signed and announced as early as today. If signed and implemented, the deal could help stabilize the Middle East and ease concerns about the global energy market.

China-Taiwan: Western defense analysts have discovered that Chinese shipyards are building at least three large, unusual barges with the ability to extend road bridges from their bows. The ships are suspected of being prepared for an eventual Chinese invasion of Taiwan, despite many observers' expectations that China would more likely impose a naval blockade to force Taiwan into unification with the mainland. Of course, either scenario would likely touch off a security crisis that could draw in the US and the rest of its geopolitical bloc.

European Union-China: The European Commission today said its months-long probe into the Chinese government's procurement practices found that they discriminate against EU medical devices. The finding sets the stage for EU-China negotiations on changing the practices, but if no agreement is reached, then Brussels could impose retaliatory trade barriers against Beijing. The finding shows how the EU has increasingly aligned with US-style moves to counter China's aggressive trade practices, which raises the risk of a wider global trade war.

European Union-United States: The European Commission has reportedly launched a review of how it is applying its new digital markets regulation against major US technology firms such as Apple, Meta, and Google. The review could lead to the EU probes against those firms being scaled back or narrowed. The reassessment is apparently linked to concerns that the CEOs of those firms have now become close to President-elect Trump and that tough enforcement action against them could prompt retaliation from the new US administration.

Mexico-China-United States: Mexican President Sheinbaum has announced a plan to cut her country's big trade deficit with China and mollify critics who say Mexico is now a back-door conduit for Chinese goods being shipped to the US. Sheinbaum's "Plan Mexico" seeks to boost investment and production in a range of Mexican manufacturing industries, including autos and textiles. If the plan successfully broadens and deepens Mexico's industrial sector and better protects investors, it could give a boost to the Mexican economy and stock market.

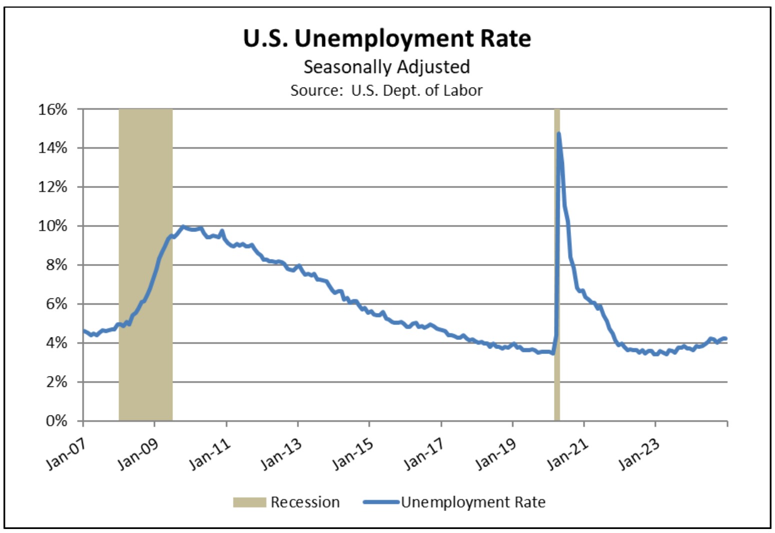
US Demographics: In its annual demographic outlook, the non-partisan Congressional Budget Office lowered its forecast for future US population growth, largely because it now expects even lower fertility and reduced net immigration. The slowdown in population growth and the associated rise in average ages are expected to weigh on overall economic growth and put added fiscal pressures on the federal government.

- The CBO now forecasts that the US population will grow from 346.6 million in 2024 to 361.8 million in 2033, for an average annual growth rate of about 0.48%. In 2033, the CBO expects US deaths to start outnumbering births, meaning all growth thereafter would have to come from net immigration.
- Between 2033 and 2054, the CBO now expects the population to grow to 372.0 million, for an average growth rate in that period of just 0.13%.

US Artificial Intelligence Industry: Major Australian bank Macquarie has agreed to invest up to $5 billion in AI-infrastructure company Applied Digital. Almost $1 billion of that will help cover the costs of a data campus the firm is building in North Dakota, while the rest represents a right of first refusal to invest in future Applied Digital data centers for 30 months. The commitment by Macquarie is yet another sign that top investors see data centers as a major opportunity amid the build-out of computing infrastructure for AI models and applications.

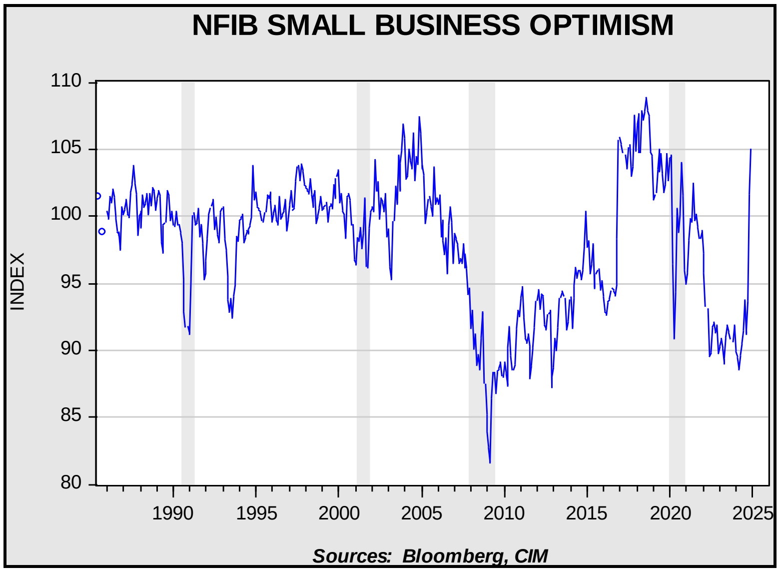
US Military: Internal data shows that the US Army has already enlisted 30,000 new recruits since October 1, achieving almost half its goal of 61,000 for the entire fiscal year and reversing the historically weak recruitment of recent years. Historically, the armed services have struggled to recruit in strong labor markets, so the improvement this fiscal year so far could partly reflect the modestly higher rate of civilian unemployment since early 2023.

- The improvement also reportedly reflects the Army's success with new recruiting programs.
- For example, since many youths today struggle to meet the Army's physical-fitness and educational standards, the new programs help young people get into shape and boost their scores on the Army entrance exam. Other programs have helped by giving recruits more freedom in choosing their initial duty station.

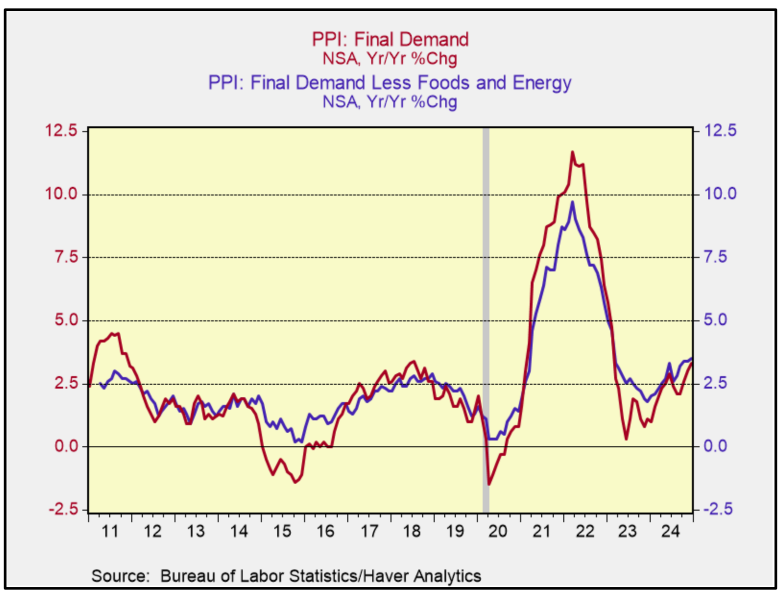


US Economic Releases

The National Federation of Independent Business' ***Small Business Optimism Index*** for December surged to 105.1 from 101.7 the prior month, exceeding the expected 102.1. This is the index's highest level in six years, dating back to 2018, reflecting expectations of favorable policies for small businesses under President-elect Trump. This increase builds on November's gain, which had been the sharpest single month increase in the index's history. Seven of the 10 components registered an increase. The chart below shows the course of the index through time.



The December ***producer price index (PPI)*** rose by a seasonally adjusted 0.2%, less than the expected 0.4% and the prior month's 0.4%. Excluding the volatile food and energy components, the December ***"core" PPI*** was unchanged, less than the expected 0.3% rise and the prior month's 0.2% rise. The overall PPI in December rose 3.3% from the same month one year earlier, while the core PPI rose 3.5%. The chart below shows the year-over-year change in the PPI and the core PPI over the last decade or so.



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

Economic Releases						
ET	Indicator			Expected	Prior	Rating
14:00	Federal Budget Balance	m/m	Dec	-$80.0b	-$366.8b	**

Federal Reserve		
ET	Speaker or Event	District or Position
10:00	Jeffrey Schmid Gives Remarks in Kansas City	President of the Federal Reserve Bank of Kansas City
15:05	John Williams Gives Opening Remarks at FED Event	President of the Federal Reserve Bank of New York

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	BoP Current Account Balance	m/m	Nov	¥3352.5b	¥2456.9b	¥2652.5b	***	Equity and bond neutral
	BoP Trade Balance	m/m	Nov	¥97.9b	-¥155.7b	-¥34.6b	**	Equity and bond neutral
Australia	Westpac Consumer Conf Index	m/m	Jan	92.1	92.8		**	Equity and bond neutral
	Westpac Consumer Conf SA	m/m	Jan	-0.7%	-2.0%		**	Equity and bond neutral
China	Money Supply M2	y/y	Dec	7.3%	7.1%	7.3%	***	Equity and bond neutral
	Money Supply M1	y/y	Dec	-1.4%	-3.7%	-1.8%	*	Equity and bond neutral
	Money Supply M0	y/y	Dec	13.0%	12.7%		*	Equity and bond neutral
	New Yuan Loans	m/m	Dec	18090.0b	17092.1b	17781.1b	**	Equity and bond neutral
India	Wholesale Prices	m/m	Dec	2.4	1.89%	2.20%	*	Equity and bond neutral
EUROPE								
Italy	Industrial Production WDA	y/y	Nov	-11.5%	-3.5%	-2.3%	***	Equity and bond neutral
Russia	Gold and Forex Reserves	m/m	3-Jan	$609.5b	$609.8b		***	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 Libor yield (bps)	485	485	0	Down
3-mo T-bill yield (bps)	420	421	-1	Down
U.S. Sibor/OIS spread (bps)	431	431	0	Down
U.S. Libor/OIS spread (bps)	433	433	0	Down
10-yr T-note (%)	4.79	4.78	0.01	Up
Euribor/OIS spread (bps)	279	277	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.

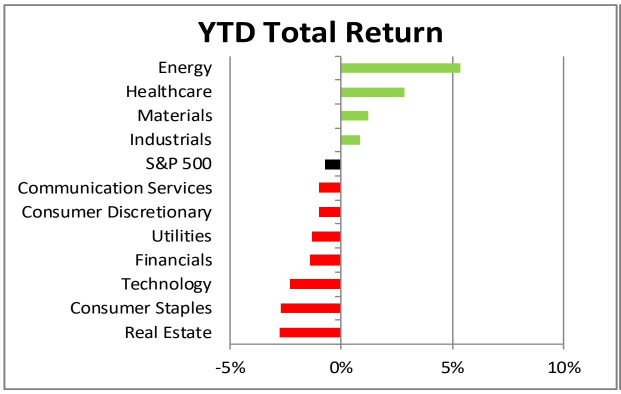
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$80.75	$81.01	-0.32%	
WTI	$78.63	$78.82	-0.24%	
Natural Gas	$3.77	$3.93	-4.14%	
Crack Spread	$15.46	$15.55	-0.61%	
12-mo strip crack	$21.05	$21.10	-0.24%	
Ethanol rack	$1.79	$1.78	0.74%	
Metals				
Gold	$2,668.83	$2,663.16	0.21%	
Silver	$29.74	$29.61	0.42%	
Copper contract	$433.55	$432.55	0.23%	
Grains				
Corn contract	$474.50	$476.50	-0.42%	
Wheat contract	$543.75	$545.00	-0.23%	
Soybeans contract	$1,050.00	$1,053.00	-0.28%	
Shipping				
Baltic Dry Freight	1,093	1,048	45	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-2.00		
Gasoline (mb)		0.50		
Distillates (mb)		0.50		
Refinery run rates (%)		-0.5%		
Natural gas (bcf)		-40		

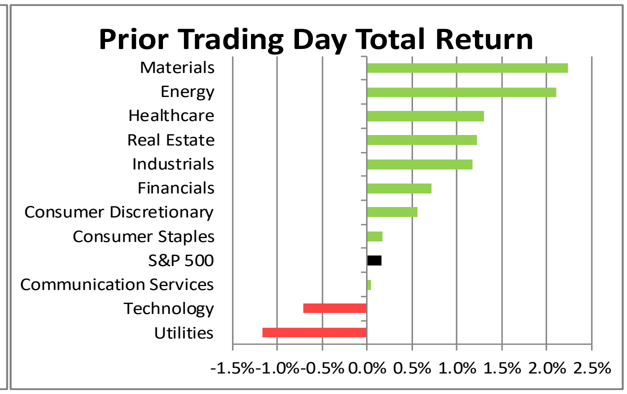
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for cooler-than-normal temperatures for most of the country. The precipitation outlook calls for wetter-than-normal conditions in the Rocky Mountain region and the East Coast, with dry conditions expected on the West Coast and the northern Midwest region.

Data Section

US Equity Markets – (as of 1/13/2025 close)

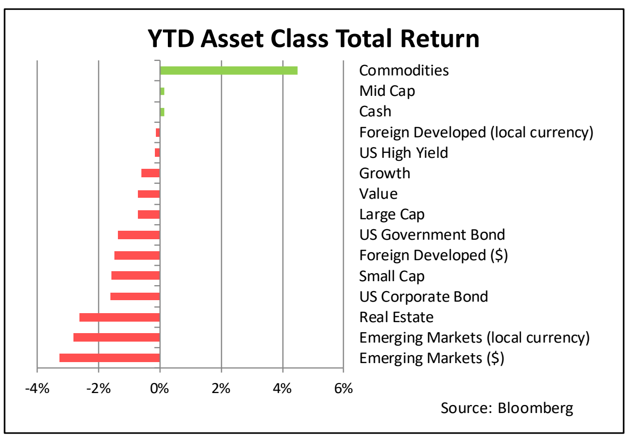




(Source: Bloomberg)

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 1/13/2025 close)

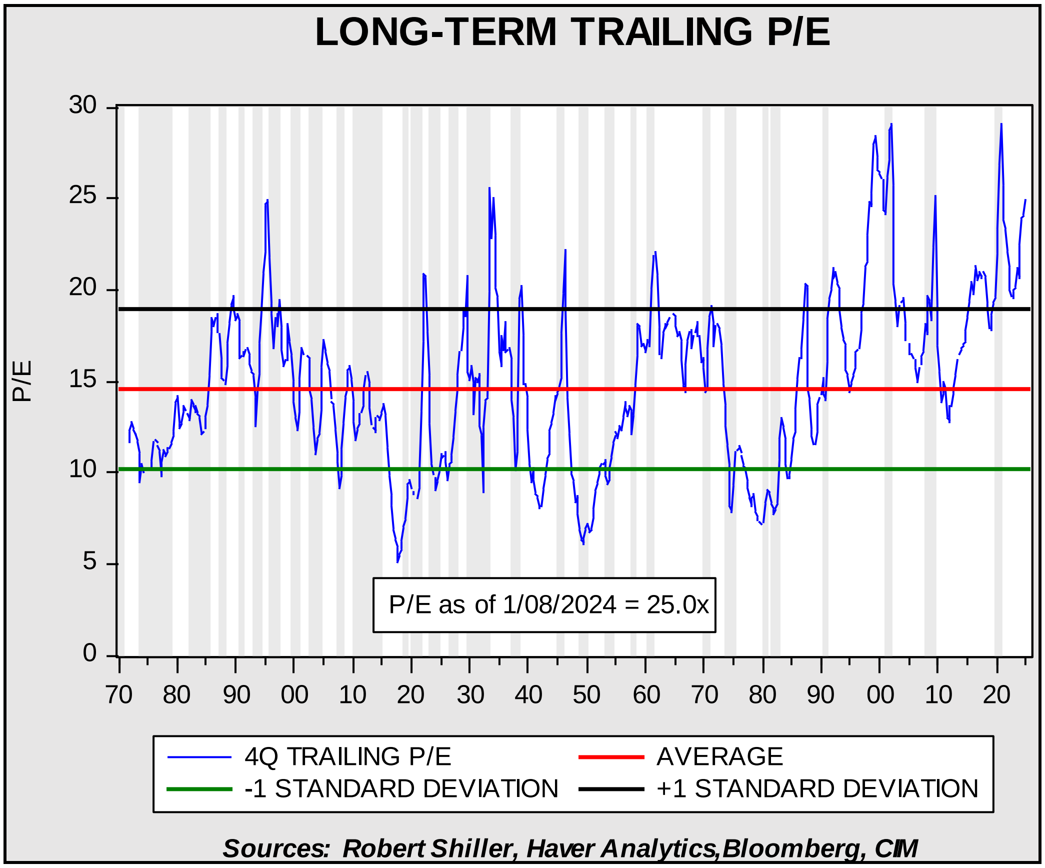


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 10, 2024



Based on our methodology,[1] the current P/E is 25.0x, down 0.1 from our last report. The decrease was due to a decline 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.