Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: January 15, 2025 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed up 0.7% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.2%. Chinese markets were lower, with the Shanghai Composite down 0.4% from its previous close and the Shenzhen Composite down 0.8%. 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:

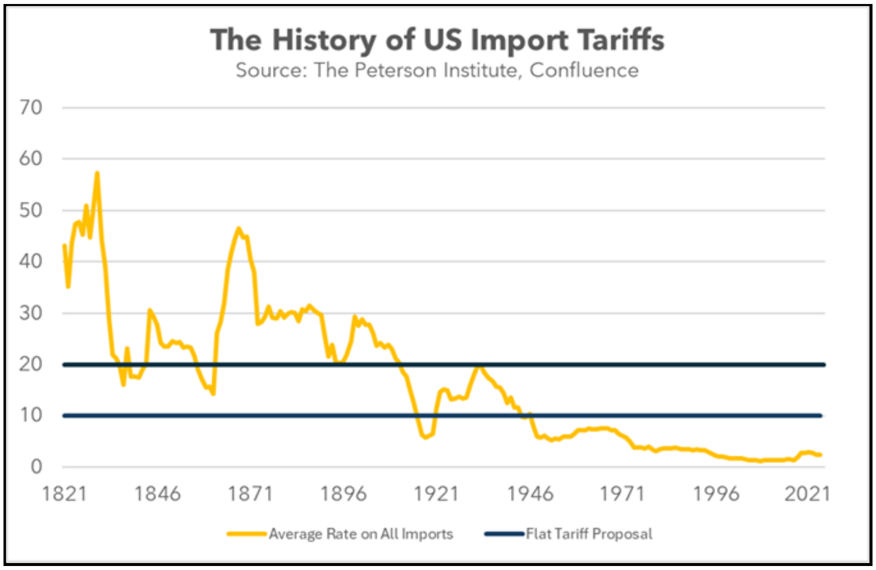
Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
Syrian Surprise: Implications of a Sudden Regime Change (1/13/25) + podcast	*Household Cash Levels and the S&P 500* (12/9/24) + podcast	Q4 2024 Report Q4 2024 Rebalance Presentation	*The 2025 Outlook: A Year of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

Good morning! Markets are closely analyzing the latest CPI inflation data as they assess the Federal Reserve's next steps. In sports, more than 100 Olympic athletes from the Paris games have returned their medals due to unexpected deterioration. Today's *Comment* will explore Trump's proposal to establish a new agency to monitor tariff revenue, the potential impact of new export curbs on chipmakers, and other significant developments. As always, we'll conclude with a summary of key international and domestic data releases.

External Revenue Service: President-elect Donald Trump announced plans to establish a new government agency dedicated to collecting revenue from import tariffs and taxes on foreign services on his first day in office. This move will likely solidify fears that the incoming president intends to implement wide-scale tariffs, a policy that has made both bond and equity investors wary.

- While US Customs and Border Protection traditionally handles the collection of foreign duties and tariffs, the creation of this new office signals the president's intention to leverage tariffs as a significant revenue source. This move is likely aimed at reassuring the public that his proposed tax cuts will not substantially increase the national budget deficit.

- His reliance on tariff revenue to address the deficit comes as his administration seeks to deliver on key promises to extend the Trump tax cuts, raise the SALT deduction cap from $10,000 to $20,000, lower corporate tax rates, and, if possible, implement additional tax cuts aimed at benefiting working-class households.

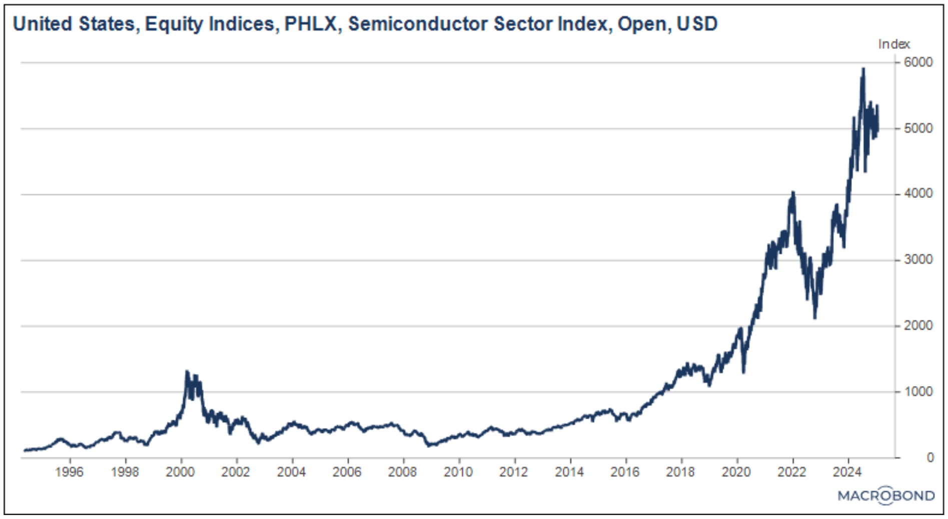


- Trump intends to impose a blanket tariff of 10 to 20% on all imports, with additional tariffs of 60 to 100% on goods originating from China. This would significantly increase the average tariff rate to its highest level in nearly six decades.
- Tariffs were a [primary source of US government revenue in the 1800s], a time when the government was significantly smaller. Today, taxes on international trade contribute just 1.7% of government revenue, down from a recent peak of 2.1% over the past decade but well short of what would be needed to fund government spending. As a result, the president must either cut spending or rely on Americans continuing to purchase imported goods despite the tariffs.
- While we anticipate the president may impose tariffs, we are skeptical they will be as extensively applied as the market expects. Trump may need to scale back some of his proposals to make them more budget-friendly to increase their chances of becoming law.

Chipmakers Under Pressure: President Biden is expected to release new regulations aimed at preventing chipmakers from selling advanced chips to China. These moves are likely to further complicate the operating environment for semiconductor firms as they strive to maintain strong earnings amidst a growingly complex economic and geopolitical landscape.

- The new rules will place restrictions on all chips with a node size of 16 nanometers or smaller under a global regulatory framework. Those that meet the criteria will need an export license to sell to China and other countries deemed as posing a national security threat.

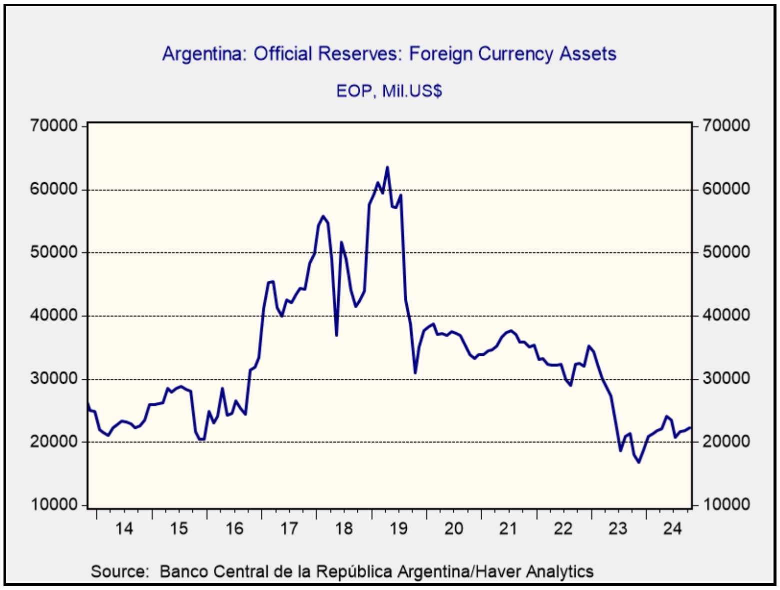
- The regulations will include provisions for companies to challenge these restrictions. This may involve demonstrating that their chip designs comply with the established criteria for permissible sales or providing evidence that their chips contain fewer than 30 billion transistors and are packaged by a trusted manufacturer.



- The companies targeted by the restrictions, Taiwan Semiconductor Manufacturing Co. (TSMC), Samsung Electronics, and Intel Corp., will likely be negatively impacted by the order. Intel receives nearly 27% of its revenue from China, while Samsung derives nearly a fifth of its chip revenue from the region. Ironically, TSMC has the lowest exposure of the three at 12.5%.
- Despite a robust 2024 with nearly 30% growth, the semiconductor sector has failed to surpass its July peak, indicating a potential slowdown. This weakness stems from growing concerns about a global economic recession, the looming threat of a global trade war, and the tightening of chip export restrictions. Consequently, the future performance of this sector hinges heavily on the policy decisions of the incoming administration.

Argentine Inflation: President Javier Milei intends to decelerate the monthly devaluation rate of the Argentine peso (ARS). He has implemented stringent currency and capital controls as a strategy to mitigate rapid currency depreciation and, consequently, curb inflationary pressures.

- Milei's unorthodox approach has effectively reduced month-over-month inflation from a peak of 26% in December 2023 to 2.7% twelve months later. This significant progress is likely to encourage investors to take another look at the country as it appears to be on the path to economic sustainability.
- A crucial next step for the country will be for the central bank to rebuild its foreign currency reserves. This will serve as a key indicator of the long-term effectiveness of the implemented policies.



President In Custody: South Korean President Yoon Suk Yeol was arrested on Tuesday after repeatedly refusing to cooperate with an investigation into his decision to impose martial law last month. His arrest has eased concerns, as the peaceful nature of his detainment has alleviated fears of an escalating constitutional crisis. In response, the Korean won (KRW) strengthened by 0.2% against the dollar.

OPEC Optimism: The OPEC+ cartel is anticipating increased crude oil demand from India and China by 2026, suggesting a potential openness to lifting production cuts. Although the group's next meeting is not scheduled until February 3, a growing sense of optimism regarding global economic recovery is emerging among its members. The potential for increased oil supply is likely to exert downward pressure on oil prices.

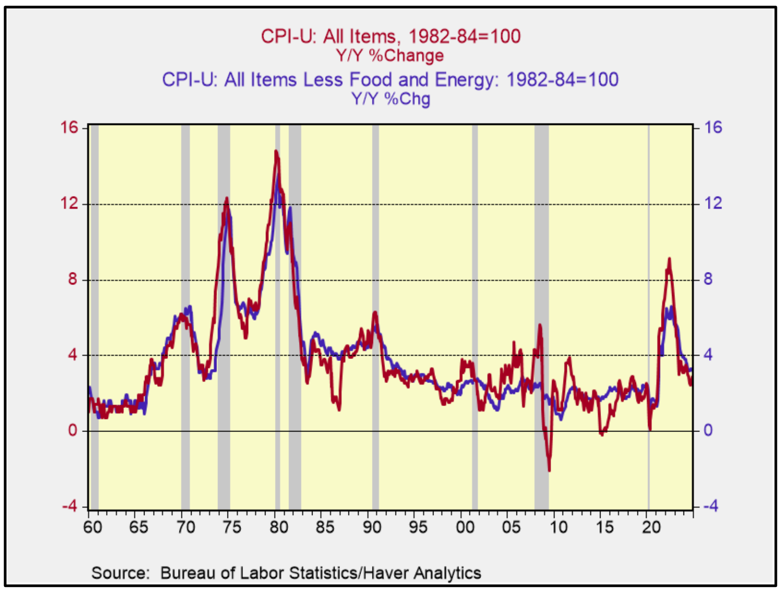
French Pension Plan: The country's new prime minister, François Bayrou, has proposed "renegotiating" the controversial pension reform introduced by Emmanuel Macron, which raised the retirement age from 62 to 64. This offer appears to be an olive branch to leftists as he seeks support for passing the budget; however, he has maintained that any changes should not hurt the country's public finances.

US Economic Releases

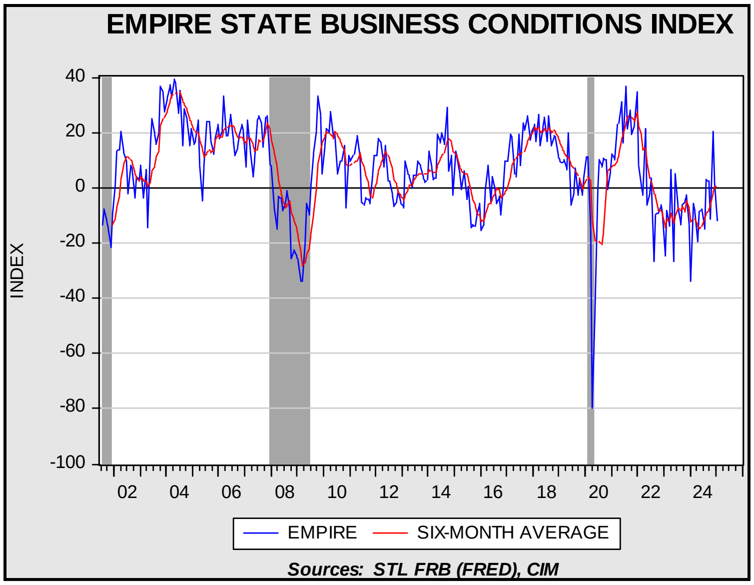
The Mortgage Bankers Association today said mortgage applications for the week ended January 10 rose 33.3%, compared to last week's decline of 3.7%. This is the first rise since December 6 and the largest weekly percentage gain since March 2020; however, this is typically a volatile time of year for application volumes. Applications for home purchase mortgages rose 26.9%, after falling 6.6% the prior week. Meanwhile, applications for refinancing mortgages rose 43.5%, after rising 1.5% the prior week. According to the report, the average interest rate on a

30-year mortgage rose 10 basis points to 7.09%. By exceeding 7%, the rate has reached its highest level since May of last year.

The December ***consumer price index (CPI)*** rose by a seasonally adjusted 0.4%, matching expectations and slightly accelerating from the prior month's rise of 0.3%. Excluding the volatile food and energy components, the ***"core" CPI*** rose 0.2%, slightly below the expected rise of 0.3% and the prior month's increase of 0.3%. The overall CPI in December rose 2.9%% from the same month one year earlier, while the core CPI rose 3.2%, both numbers essentially meeting expectations. The chart below shows the year-over-year change in the CPI and the core CPI since 1980.



The New York FRB said its January ***Empire State Manufacturing Index*** surprisingly fell to a seasonally adjusted -12.6, compared to an expected reading of 3.0 and the prior month's 2.1. This index is designed so that positive readings point to expanding factory activity in New York state. At its current level, the index suggests that manufacturing activity has, at least temporarily, sharply contracted. The chart below shows how the index has fluctuated since just before the Great Financial Crisis.



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

Economic Releases		
No economic releases for the rest of today		
Federal Reserve		
ET	**Speaker or Event**	**District or Position**
9:00	Thomas Barkin Speaks in Annapolis	President of the Federal Reserve Bank of Richmond
10:00	Neel Kashkari Participates in Q&A	President of the Federal Reserve Bank of Minneapolis
11:00	John Williams Gives Keynote Remarks	President of the Federal Reserve Bank of New York
12:00	Austan Goolsbee Speaks at Midwest Economic Forecast Forum	President of the Federal Reserve Bank of Chicago
14:00	U.S. Federal Reserve Releases Beige Book	Federal Reserve Board

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	Machine tool orders	y/y	Dec P	11.2%	3.0%		**	Equity and bond neutral
	Money Stock M2	y/y	Dec	1.3%	1.2%		**	Equity and bond neutral
	Money Stock M3	y/y	Dec	0.8%	0.7%		**	Equity and bond neutral
South Korea	Unemployment Rate	m/m	Dec	3.7%	2.7%	2.9%	***	Equity bearish, bond bullish
India	Trade Balance	m/m	Dec	-$21937m	-$31825m	-$25600m	**	Equity and bond neutral
	Exports	y/y	Dec	-1.0%	-5.1%		**	Equity and bond neutral
	Imports	y/y	Dec	4.9%	16.0%		**	Equity and bond neutral
EUROPE								
Eurozone	Industrial Production WDA	y/y	Nov	-1.9%	-1.1%	-1.9%	**	Equity and bond neutral
Germany	GDP NSA	y/y	16-Jul	-0.2%	-0.3%	-0.2%	*	Equity and bond neutral
France	CPI	y/y	Dec F	1.3%	1.3%	1.3%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Dec F	1.8%	1.8%	1.8%	**	Equity and bond neutral
	CPI Ex-Tobacco Index	q/q	Dec F	118.88	118.66	118.93	*	Equity and bond neutral
UK	CPI	y/y	Dec	2.5%	2.6%	2.6%	***	Equity and bond neutral
	CPI Core	y/y	Dec	3.2%	3.5%	3.4%	***	Equity and bond neutral
	Retail Price Index	m/m	Dec	392.1	390.9	393.5	**	Equity and bond neutral
	RPI	y/y	Dec	3.5%	3.6%	3.8%	**	Equity and bond neutral
	House Price Index	y/y	Nov	3.3%	3.0%		***	Equity and bond neutral
Russia	Official Reserve Assets	m/m	Dec	609.1b	616.5b		*	Equity and bond neutral
AMERICAS								
Mexico	Gross Fixed Investment	y/y	Oct	-2.6%	-2.9%	-2.8%	**	Equity and bond neutral
	International Reserves Weekly	w/w	10-Jan	$228921m	$229017m		*	Equity and bond neutral
Brazil	IBGE Services Volume	y/y	Nov	2.9%	6.4%	3.3%	*	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)	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 (%)	4.76	4.79	-0.03	Up
Euribor/OIS spread (bps)	276	279	-3	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.

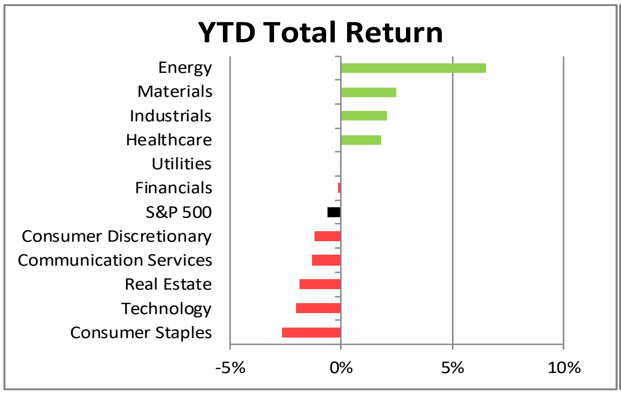
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$80.05	$79.92	0.16%	
WTI	$77.70	$77.50	0.26%	
Natural Gas	$3.94	$3.97	-0.83%	
Crack Spread	$17.37	$16.82	3.27%	
12-mo strip crack	$21.39	$21.38	0.04%	
Ethanol rack	$1.79	$1.79	0.03%	
Metals				
Gold	$2,684.41	$2,677.46	0.26%	
Silver	$29.94	$29.90	0.12%	
Copper contract	$436.10	$434.25	0.43%	
Grains				
Corn contract	$476.25	$474.50	0.37%	
Wheat contract	$543.75	$546.25	-0.46%	
Soybeans contract	$1,047.75	$1,047.50	0.02%	
Shipping				
Baltic Dry Freight	1,080	1,093	-13	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-0.85		
Gasoline (mb)		2.60		
Distillates (mb)		1.34		
Refinery run rates (%)		-0.9%		
Natural gas (bcf)		-261		

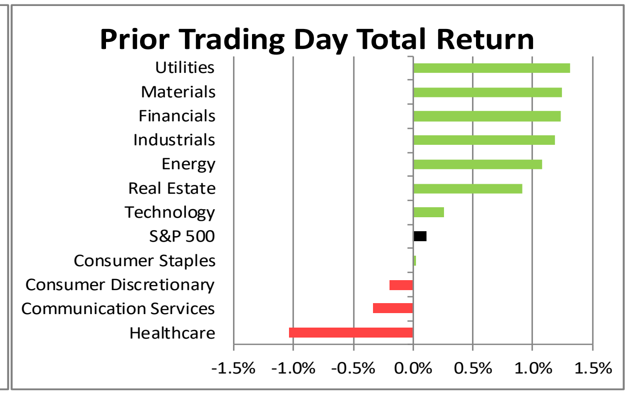
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for cooler-than-normal temperatures for most of the country, with a small area in California expecting warm temperatures. The precipitation outlook calls for wetter-than-normal conditions along the Gulf Coast and lower East Coast, with dry conditions expected in the West, Midwest, and New England.

Data Section

US Equity Markets – (as of 1/14/2025 close)

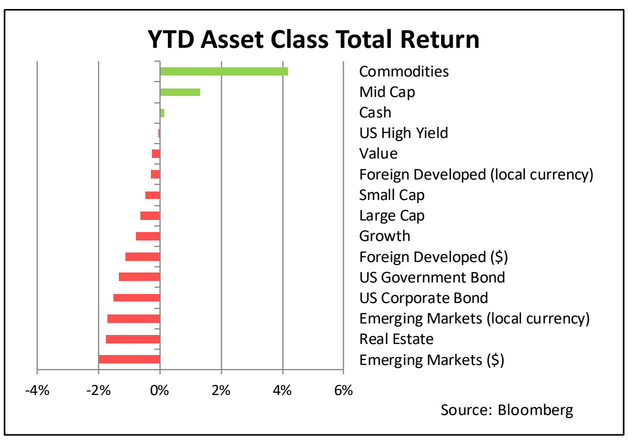




(Source: Bloomberg)

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 1/14/2025 close)

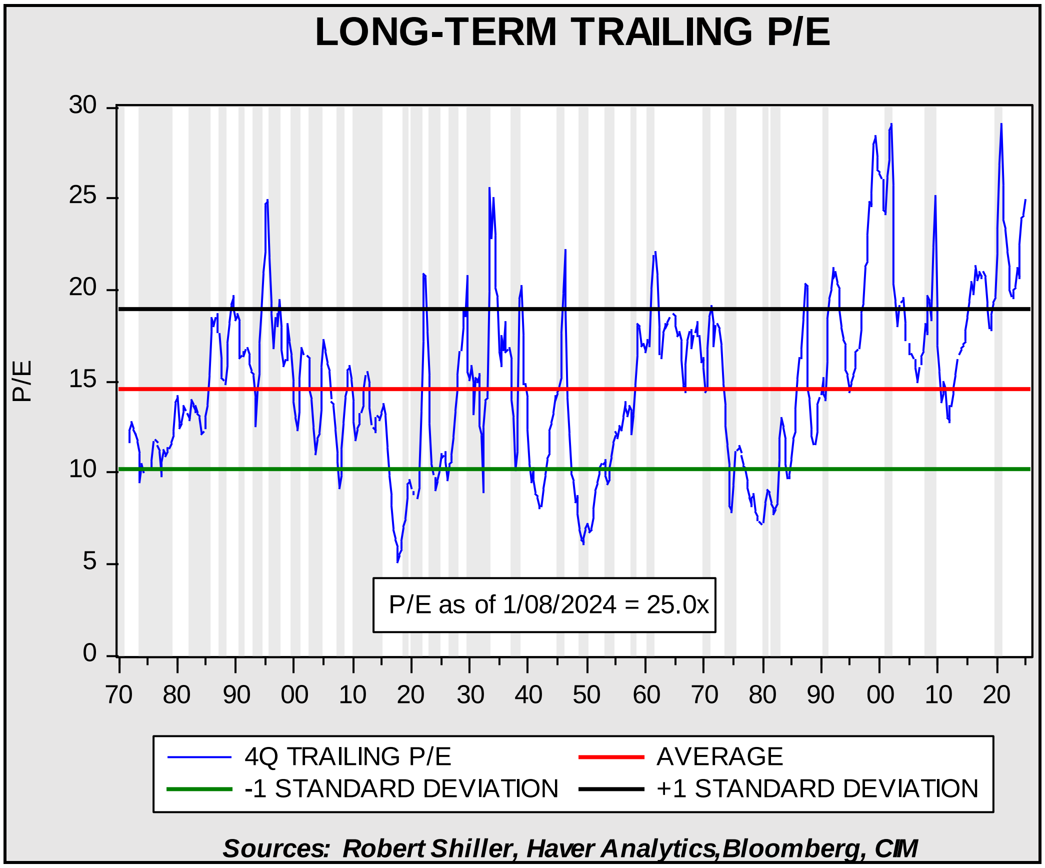


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.

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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.