Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: January 16, 2025 — 9:30 AM ET] Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 closed up 1.4% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.9%. Chinese markets were higher, with the Shanghai Composite up 0.3% from its previous close and the Shenzhen Composite up 0.4%. US equity index futures are signaling a higher open.

With 28 companies having reported so far, S&P 500 earnings for Q4 are running at $62.30 per share, compared to estimates of $64.79, which is up 11.7% from Q4 2023. Of the companies that have reported thus far, 82.1% have exceeded expectations while 17.9% have fallen short of expectations.

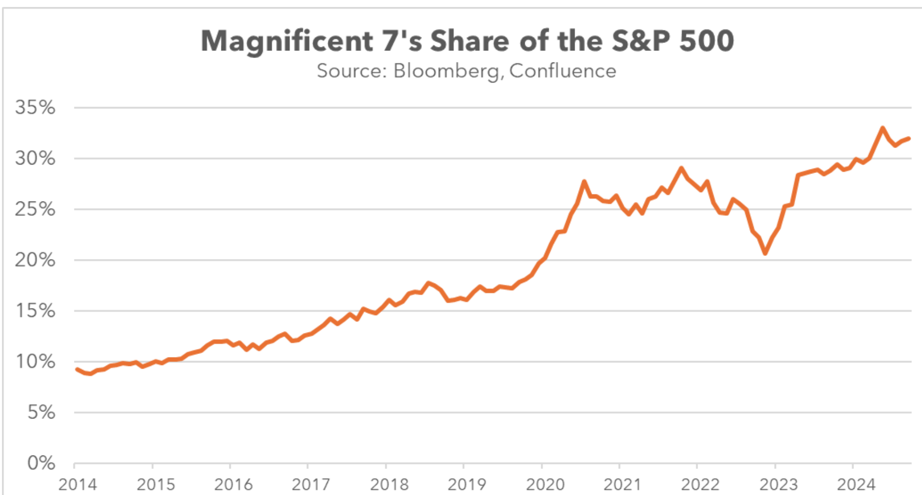
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below with new items of the day in bold:

Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
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! The market is processing the latest development in the Israel-Hamas conflict. In sports news, three MLS teams are reportedly in discussions to sign Brazilian football star Neymar. Today's *Comment* will share our thoughts on President Biden's farewell address to the nation, analyze the latest inflation data, and discuss other market-moving stories. As always, our report will include a summary of international and domestic data releases.

Biden's Parting Shots: The outgoing president took aim at the rising power of Silicon Valley in his final address to the nation. During his speech, he warned that the "tech industrial complex" has become increasingly powerful and has used misinformation and lies to enable the abuse of power. He also expressed concern about the rise of AI. His comments are a reminder of the growing wariness the public is experiencing with large tech companies.

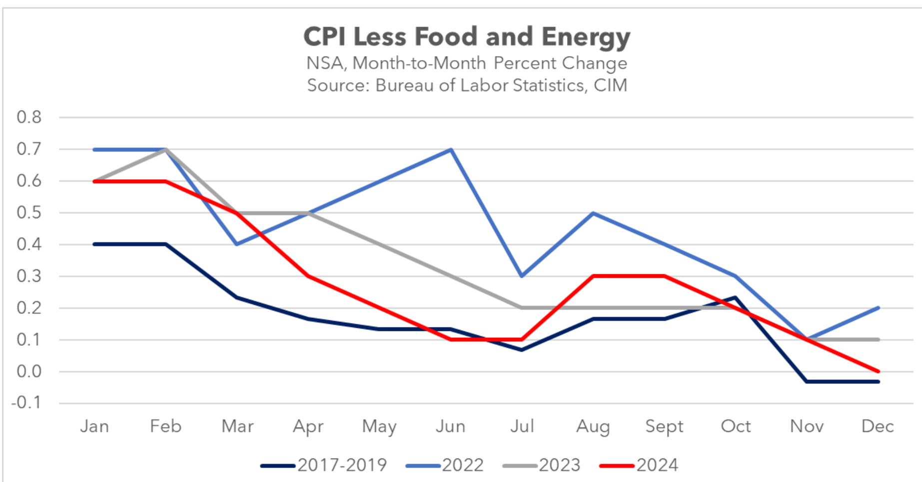
- Both during Biden's term and Trump's first term, assertive approaches were adopted to curb Big Tech's power. However, this time feels different, as tech firms appear to have widely embraced Trump's return to the White House with open arms and seem to have turned their backs on the Democratic Party.
- Most of the Magnificent 7 companies donated to President-elect Trump's inauguration, probably in an effort to curry favor with the incoming administration. These companies likely hope that staying in the president's good graces will lead to leniency, as several are under investigation for antitrust violations and many rely on a disproportionate share of the revenue from countries that are likely to be targets of tariffs.
- However, it remains unclear how the tech industry's newfound MAGA stance will resonate with the populist wing of Trump's coalition. For instance, there have already been murmurs of discontent regarding the industry's heavy reliance on H-1B visas, which some see as a means to sidestep domestic hiring. Additionally, concerns are growing over Elon Musk's increasing influence, as many within the coalition view him as lacking genuine alignment with Trump's vision for the country.



- President-elect Trump has, thus far, managed to navigate between the two sides, striving to keep both camps satisfied. While he has acknowledged that the program may negatively impact American workers, he has also concluded that it serves a purpose. We expect that this balancing act will continue throughout his term in office as he looks to ensure that Republicans maintain a fundraising advantage over Democrats going into future election cycles.
- Biden's speech highlights how the tech industry is increasingly viewed as an adversary by the Democratic Party, making it a likely target for political attacks. Meanwhile, right-wing populists' distrust of the industry adds another challenge. This suggests that the regulatory environment for Big Tech companies may not improve significantly as Trump may be reluctant to invest the political capital needed to shield them from backlash. However, an alliance with him could prevent potential breakups of the firms.

Rate Cut Hopes Get a Boost: The latest December inflation report has boosted investor confidence that the central bank will proceed with planned interest rate cuts this year. Investors now expect the bank to lower rates twice, up from last week's prediction of just once, according to the CME FedWatch Tool. Following the report, the S&P 500 stock market index rose nearly 2%.

- Headline inflation increased 0.4% month-over-month on a seasonally adjusted basis, marginally exceeding market forecasts of 0.3%. Core inflation, excluding volatile food and energy prices, rose 0.2% month-over-month, falling short of the anticipated 0.3% increase.
- The optimism in the CPI was due to signs that underlying price pressures are finally beginning to stabilize. Shelter price inflation held steady at 0.3%, medical services eased from 0.4% to 0.2%, and recreation services eased from 0.3% to 0.1%.



- December's inflation data provides further evidence that the Federal Reserve is making consistent progress in curbing price pressures. Notably, the CPI increased above the previous year's pace in only two out of the 12 months of the year, strongly reinforcing the central bank's progress towards its 2% inflation target.
- It's also important to remember that inflation usually reaches its highest point in the first three months of the year. This is normal. However, the central bank will be watching closely to see if the month-to-month increase in prices slows down to its usual level. If it does, the bank might be more willing to lower interest rates significantly this year, if other factors remain the same.

Gaza Ceasefire: Israel and Hamas have agreed to pause the conflict after 15 months of fighting, despite ongoing tensions. The deal, announced on Wednesday, has received approval from both President-elect Trump and outgoing President Biden. While the agreement has been widely welcomed, concerns about its stability exist. Following the agreement, the Tel Aviv Stock Exchange rose to a record high.

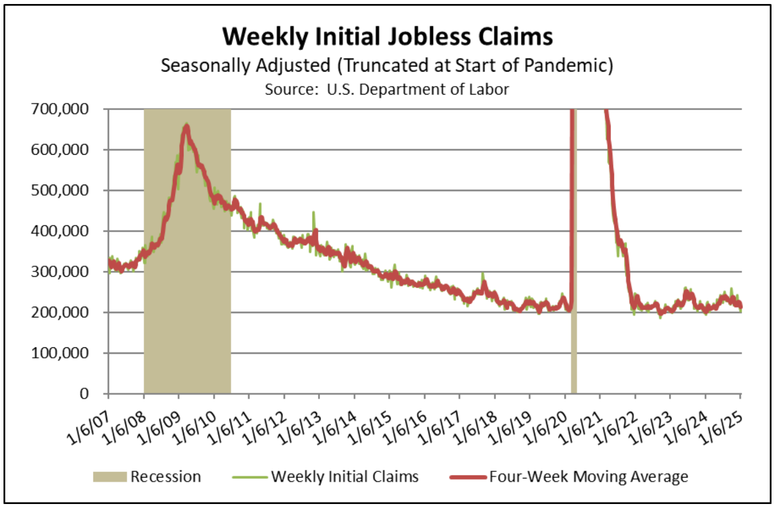
- Hours after the agreement was announced, Israeli Prime Minister Benjamin Netanyahu accused Hamas of violating the deal. He criticized Hamas for opposing Israel's veto over which Palestinian prisoners would be released in exchange for hostages following the 2023 attacks. Netanyahu warned that his cabinet would not approve the deal unless Hamas agreed to all of the terms outlined in the agreement.
- So far, the deal appears to be holding. The arrangement begins on Sunday with a 42-day ceasefire, which will lead to the Israeli military's withdrawing from several regions in Gaza, as well as the delivery of aid to the Gaza Strip. The goal of the agreement is to secure the release of all hostages and effect a complete withdrawal of Israel from the region.

Canada Tit-for-Tat: Although Canada has stated its intention to comply with the US decision to shore up border security to mitigate rising trade tensions, it has also warned of potential retaliatory measures, such as tariffs, if its interests are significantly impacted.

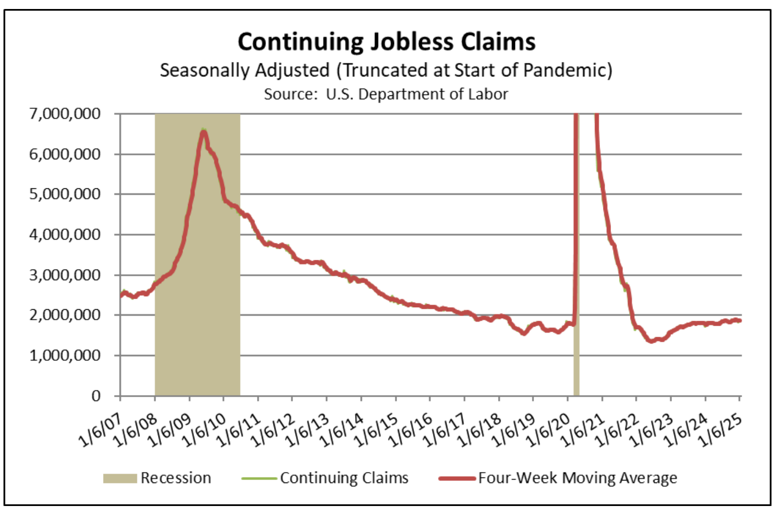
- Ottawa announced potential retaliatory measures, including tariffs on steel and orange juice, if the US imposes tariffs on Canadian goods. While these measures are unlikely to impact the US economy significantly, they would directly target states like Michigan and Florida, with the former being a key swing state in national elections.
- The warning comes as the country braces for federal elections, set to take place before October 20, 2025. Lawmakers are working to strengthen their populist credentials, aiming to demonstrate to citizens that they will prioritize their needs.
- While we do not expect the US and Canada to engage in a trade war, tensions between the allies are elevated.

US Economic Releases

In the week ended January 11, ***initial claims for unemployment benefits*** rose to a seasonally adjusted 217,000, above both the expected level of 210,000 and the previous week's revised level of 203,000. However, the four-week moving average of initial claims, which helps smooth out some of the volatility in the series, fell back to a modest 212,750. At that level, the four-week moving average is low enough to confirm that the demand for labor remains strong. 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.

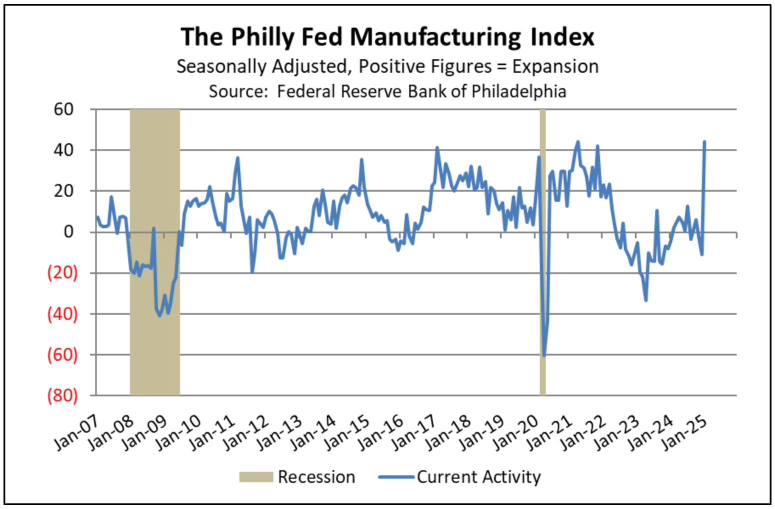


In the week ended January 4, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) fell to a seasonally adjusted 1.859 million, below both the anticipated reading of 1.870 million and the prior week's revised reading of 1.877 million. The four-week moving average of continuing claims fell to a moderate 1,866,750. 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.

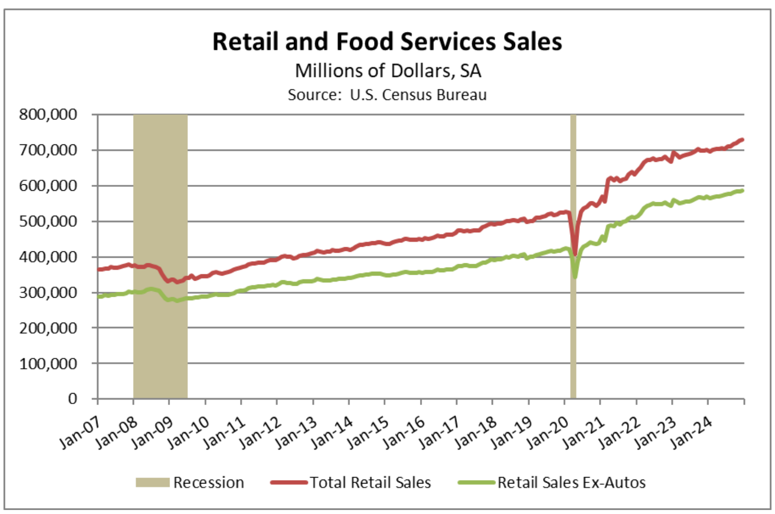


Separately, the Philadelphia FRB said its January ***Philly Fed Index*** jumped to a seasonally adjusted 44.3, far better than the expected -5.0 and up from -10.9 in December. This indicator, officially designated as the Philadelphia FRB Manufacturing Activity Index, is designed so that positive readings point to expanding factory activity in the mid-Atlantic region. At its current level, the index suggests mid-Atlantic manufacturing has suddenly surged, although it isn't clear whether such a strong level of activity can be sustained. The chart below shows how the index has fluctuated since just before the GFC.

Confluence INVESTMENT MANAGEMENT

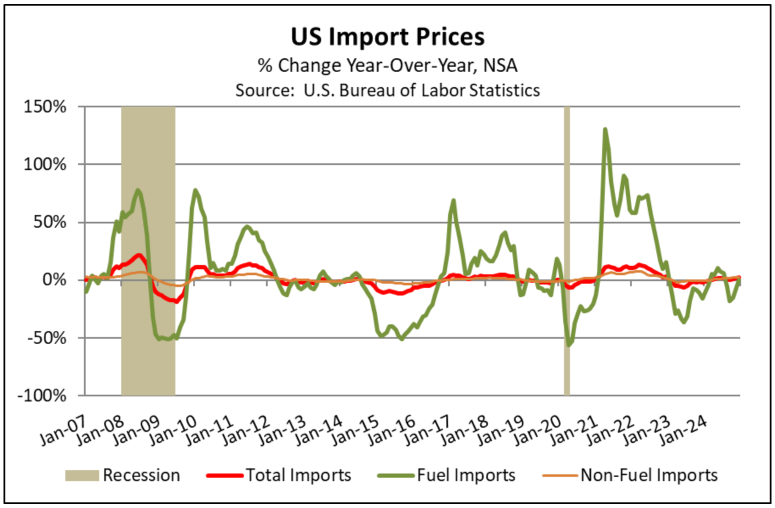


In another report today, December ***retail sales*** rose by a seasonally adjusted 0.4%, short of the anticipated rise of 0.6% and only half as strong as the revised 0.8% increase in November. Overall retail sales are often driven by the volatile auto and auto parts sector, which makes up almost one-fifth of the total. However, that wasn't necessarily the case this time around. December ***retail sales excluding autos and auto parts*** were up also up 0.4%, short of their expected rise of 0.5% but enough to mark an acceleration from their November rise of 0.2%. Overall retail sales in December were up 3.8% from the same month one year earlier, while sales excluding autos and auto parts were up 3.0%. The chart below shows how retail sales have changed since just before the GFC.

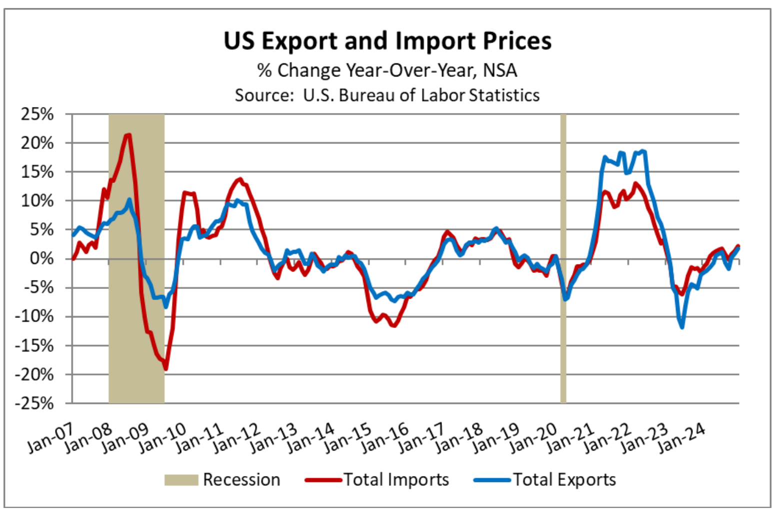


Finally, December ***import prices*** were up 0.1% for a second straight month, compared with an expected decline of 0.1%. Of course, import prices are often driven by volatility in the petroleum fuels category. December ***import prices excluding fuels*** were up 0.2% for a second straight month, compared with their expected fall of 0.1%. Overall import prices in December were up

2.2% year-over-year, while import prices excluding fuels were up 2.4%. The chart below shows the year-over-year change in import prices since just before the GFC.



According to the report, ***export prices*** in December were up 2.2% from one year earlier, in large part because of the key agriculture category. Comparing the annual change in export prices versus import prices provides a sense of the US "terms of trade," or the relative advantage or disadvantage the country is facing because of trends in international trade prices. The chart below compares the year-over-year change in US export and import prices since just before the GFC.



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

Economic Releases						
ET	Indicator			Expected	Prior	Rating
10:00	Business Inventories	m/m	Nov	0.10%	0.10%	*
10:00	NAHB Housing Market Index	m/m	Jan	45.0	46.0	*
Federal Reserve						
No Fed speakers or events for the rest of today						

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	PPI	y/y	Dec	3.8%	3.8%	3.8%	***	Equity and bond neutral
Australia	Employment Change	m/m	Dec	56.3k	28.2k	15.0k	***	Equity and bond neutral
	Unemployment Rate	m/m	Dec	4.0%	3.9%	4.0%	***	Equity and bond neutral
	Participation Rate	m/m	Dec	67.1%	67.0%	67.0%	**	Equity and bond neutral
New Zealand	Food Prices	m/m	Dec	0.1%	-0.1%		***	Equity and bond neutral
EUROPE								
Germany	CPI	y/y	Dec F	2.6%	2.6%	2.6%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Dec F	2.8%	2.8%	2.8%	**	Equity and bond neutral
Italy	CPI, EU Harmonized	y/y	Dec F	1.4%	1.4%	1.4%	***	Equity and bond neutral
UK	Industrial Production	y/y	Nov	-1.8%	-1.1%	-0.9%	***	Equity bearish, bond bullish
	Manufacturing Production	y/y	Nov	-1.2%	-0.4%	-0.5%	**	Equity bearish, bond bullish
	Index of Services 3M/3M	m/m	Nov	0.00%	0.00%	0.10%	**	Equity and bond neutral
	Visible Trade Balance	m/m	Nov	-£19311m	-£19327m	-£18000m	**	Equity and bond neutral
	Trade Balance	m/m	Nov	-£4757m	-£5014mm	-£3600m	**	Equity and bond neutral
	RICS House Price Balance	y/y	Dec	28%	24%	28%	**	Equity and bond neutral
Russia	CPI	y/y	Dec	9.5%	8.9%	9.8%	***	Equity and bond neutral
	Core CPI	y/y	Dec	8.9%	8.3%		**	Equity and bond neutral
AMERICAS								
Canada	Manufacturing Sales	m/m	Nov	0.8%	2.1%	0.5%	**	Equity and bond neutral
	Wholesale Sales ex Petroleum	m/m	Nov	-0.2%	1.3%	-0.70	**	Equity and bond neutral
Brazil	Econimic Activity	y/y	Nov	4.11%	7.23%	4.35%	*	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)	420	420	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 (%)	4.68	4.65	0.03	Down
Euribor/OIS spread (bps)	275	276	-1	Down
Currencies	**Direction**			
Dollar	Up	US		Down
Euro	Down	Euro		Up
Yen	Down	Japan		Up
Pound	Down	UK		Up
Franc	Down	Switzerland		Up
Central Bank Action	**Current**	**Prior**	**Expected**	
Bank of Korea Base Rate	3.000%	3.000%	2.750%	Above Forecast

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.

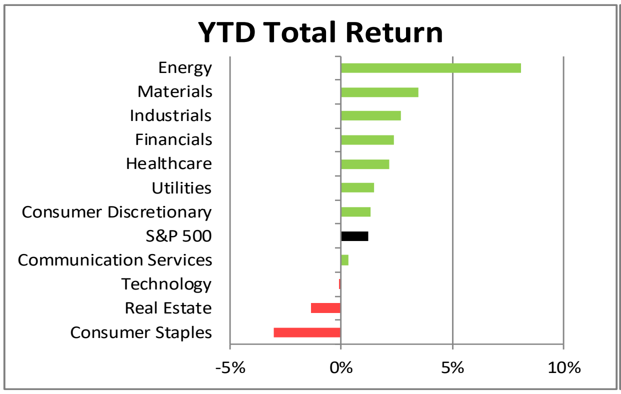
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$81.29	$82.03	-0.90%	
WTI	$79.31	$80.04	-0.91%	
Natural Gas	$4.13	$4.08	1.22%	
Crack Spread	$17.25	$17.21	0.21%	
12-mo strip crack	$21.53	$21.74	-0.97%	
Ethanol rack	$1.79	$1.80	-0.04%	
Metals				
Gold	$2,702.95	$2,696.32	0.25%	
Silver	$30.62	$30.65	-0.10%	
Copper contract	$440.25	$438.90	0.31%	
Grains				
Corn contract	$475.00	$478.75	-0.78%	
Wheat contract	$539.25	$547.00	-1.42%	
Soybeans contract	$1,027.75	$1,042.75	-1.44%	
Shipping				
Baltic Dry Freight	1,063	1,080	-17	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-1.96	-0.85	-1.11	
Gasoline (mb)	5.85	2.60	3.25	
Distillates (mb)	3.08	1.34	1.74	
Refinery run rates (%)	-1.6%	-0.9%	-0.7%	
Natural gas (bcf)		-259		

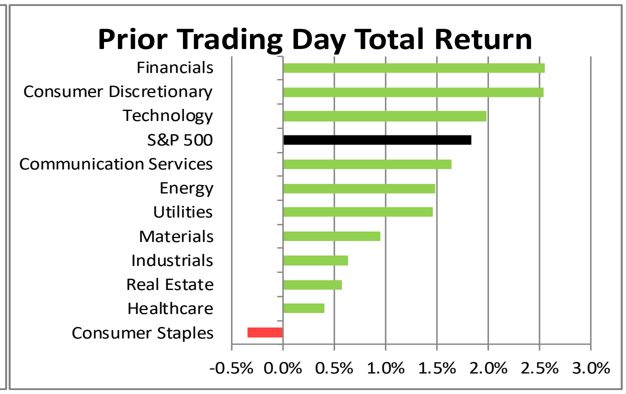
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for cooler-than-normal temperatures in the Pacific Northwest, the Rocky Mountains, the southern Great Plains, and virtually all areas east of the Mississippi River, with warmer-than-normal temperatures only in northern and central California. The forecasts call for wetter-than-normal conditions in Montana, North Dakota, and northern Minnesota, with dry conditions in California and the Great Lakes region.

Data Section

US Equity Markets – (as of 1/15/2025 close)

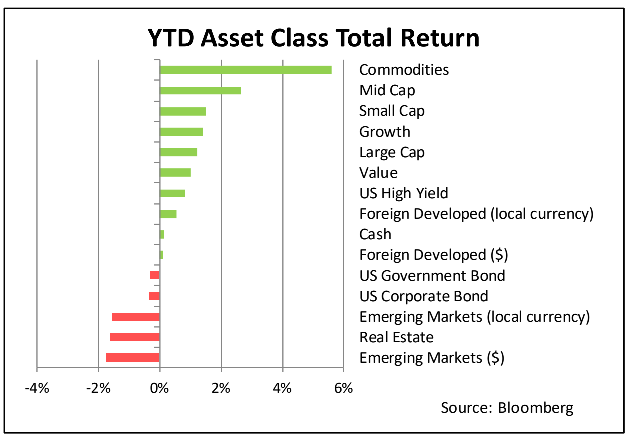




(Source: Bloomberg)

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 1/15/2025 close)

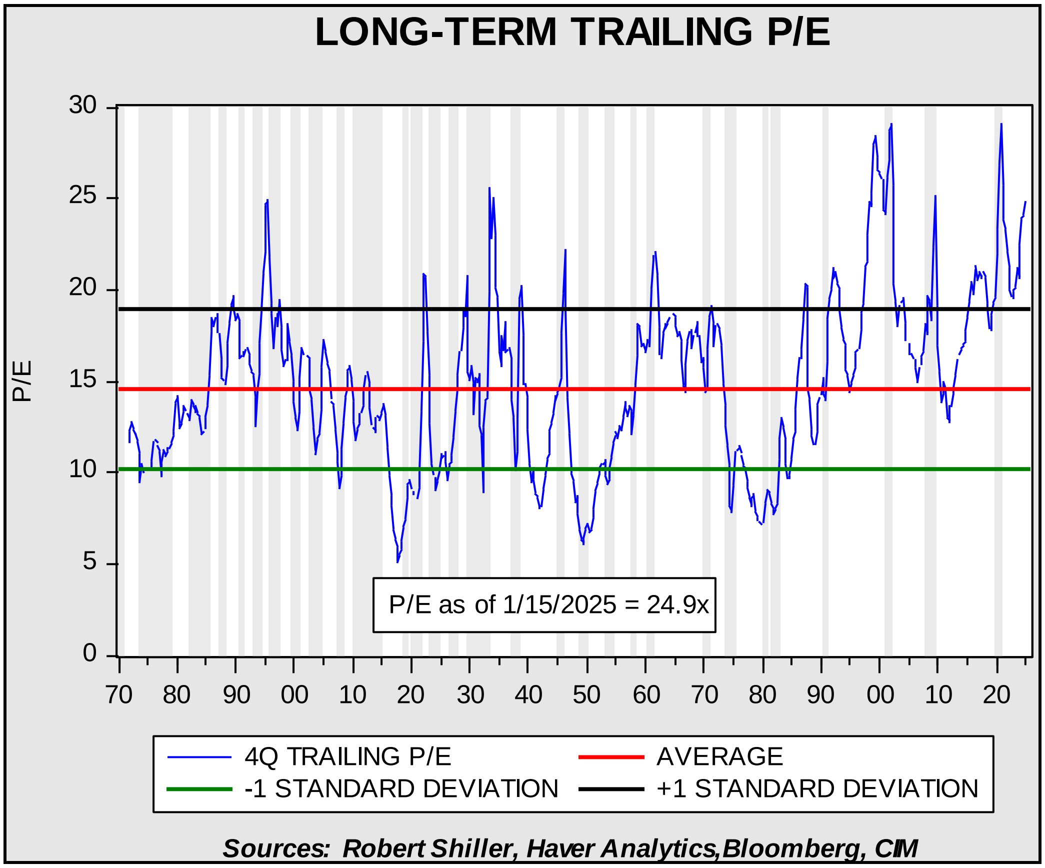


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 16, 2025



Based on our methodology,[1] the current P/E is 24.9x, 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.