Daily Comment

Confluence INVESTMENT MANAGEMENT

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[Posted: January 17, 2025 — 9:30 AM ET] Global equity markets are higher 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 up 0.1%. Chinese markets were higher, with the Shanghai Composite up 0.2% 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*

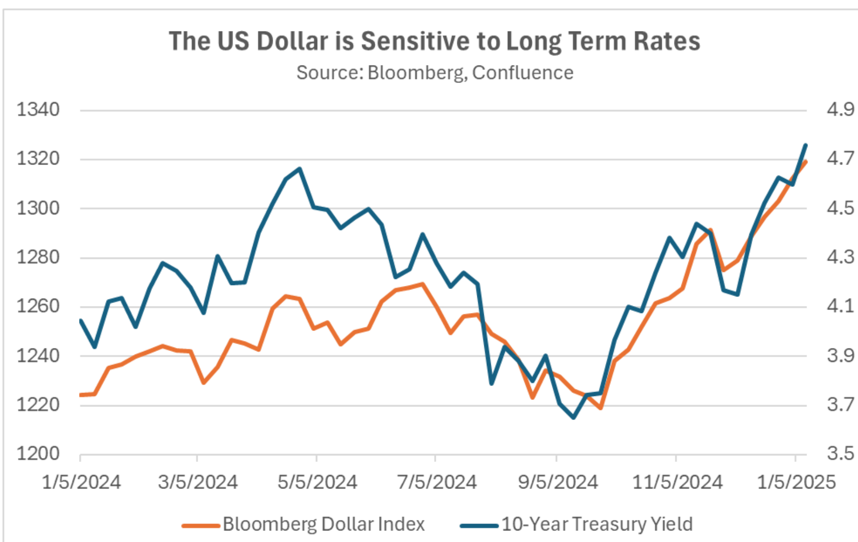
Note: Due to the holiday, the* Daily Comment *will not be published on Monday, January 20.

Good morning! The market is currently digesting the latest economic data. In sports news, Manchester City striker Erling Haaland has signed a 10-year contract to stay with his current club. Today's *Comment* will cover our key takeaways from the Senate confirmation hearing of Trump's Treasury secretary nominee, explore why Fed officials are divided on whether to proceed with rate cuts, and discuss other market-moving events. As usual, the report will also include a summary of both domestic and international data releases.

Bessent Speaks: Treasury Secretary nominee Scott Bessent successfully navigated his confirmation hearing, offering the first insights into the priorities of President-elect Donald

Trump's administration. During his testimony, he addressed key issues including the federal deficit, Federal Reserve independence, tariffs, and Russian sanctions.

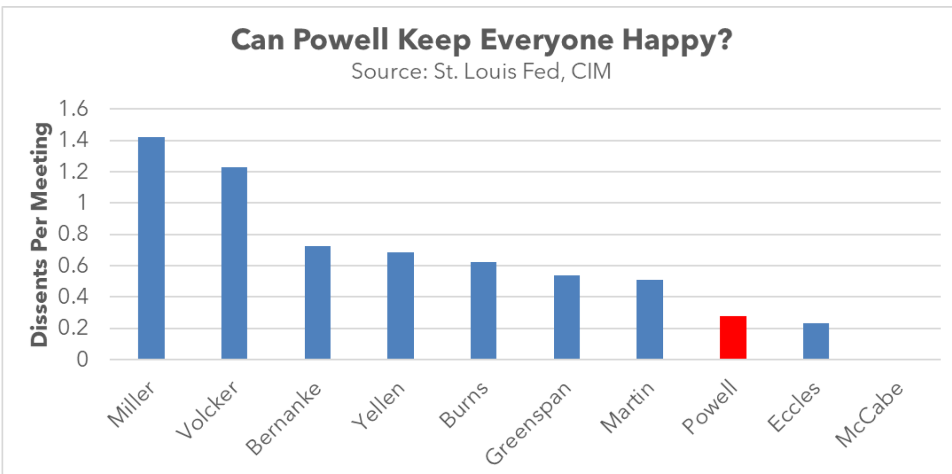
- *Government Spending*: Bessent stressed that extending the 2017 Trump tax cuts is essential to preventing another economic crisis. However, he also underscored the importance of tackling the growing deficit, suggesting that reductions in discretionary spending is a key area for budget cuts. Additionally, he expressed support for eliminating the US debt ceiling altogether.
- *Federal Reserve*: He also emphasized his respect for the central bank's independence in making monetary policy free from White House influence. Additionally, he expressed confidence that the Trump administration's tax policies could boost real wages without significantly driving up inflation.
- *US Trade Tariffs*: He has expressed support for the president-elect's ideas, which include utilizing import duties to increase government revenue. This support extends to both blanket tariffs and those specifically designed to address unfair trade practices from other countries, as well as to influence geopolitical matters. Furthermore, he indicated an openness to exploring the possibility of implementing carbon-based tariffs.
- *Russian Sanctions*: Bessent proposed that the US could implement stricter sanctions on Russian oil to hasten the end of the conflict in Ukraine. He also suggested that increasing domestic oil production to lower prices could undermine Russia's war efforts in Ukraine.



- Our key takeaway from the hearing is that Trump's policies should be bullish for the US dollar and supportive of US equities. However, the market's overall performance will largely depend on the incoming president's ability to address concerns about rising inflation and the increasing of US government bond yields.

Central Bank Discord: While the Federal Reserve demonstrated remarkable unanimity during the rate-hiking cycle, a lack of internal cohesion is now evident as they contemplate easing monetary policy. This disunity has contributed to the recent rise in 10-year Treasury yields over the last few weeks.

- On Thursday, Federal Reserve Governor Christopher Waller expressed optimism that the central bank could implement multiple interest rate cuts this year, potentially beginning in the first half, provided that inflation continues to demonstrate substantial progress. However, he emphasized that the Federal Reserve does not feel compelled to initiate rate cuts prematurely.
- In contrast, Cleveland Fed President Beth Hammack, a non-voting member this year, maintains that inflation is still a significant concern. She argues that not only are current price levels elevated, but the rate of price increases remains problematic and is a challenge the central bank must actively confront. These remarks follow her dissenting vote against the Federal Reserve's interest rate cut at the December FOMC meeting.



- The diverging views are likely to make it more challenging for Fed Chair Powell to align the Fed officials and maintain a unified stance as they work to manage market expectations through forward guidance. During his tenure in office, Powell has near-record low number of dissents per meeting, with only Marriner S. Eccles and Thomas Bayard McCabe having fewer.
- Additionally, President-elect Trump may be influencing the Federal Reserve's hesitancy to ease monetary policy. Some Fed officials appear to believe — justified or not — that his policies could contribute to inflationary pressures. A few weeks ago, Richmond Fed President Thomas Barkin and Fed Governor Adriana Kugler noted that the incoming administration's policies have complicated efforts to forecast the trajectory of inflation and the economy.
- Assuming continued progress in taming inflation towards the 2% target, we anticipate that the implementation of the incoming president's economic policies, which may prove

less radical than his campaign rhetoric, could embolden Federal Reserve officials to demonstrate greater openness to easing monetary policy.

German Elections Focus on Ukraine: Chancellor Scholz has faced criticism for his reluctance to provide additional military aid to Ukraine. German Foreign Minister Annalena Baerbock, a member of the Green Party, accused Scholz of withholding approval for 3 billion EUR ($3.08 billion) in support for Ukraine to secure "a few votes." This remark highlights the significant impact the war is expected to have on Germany's upcoming elections on February 23.

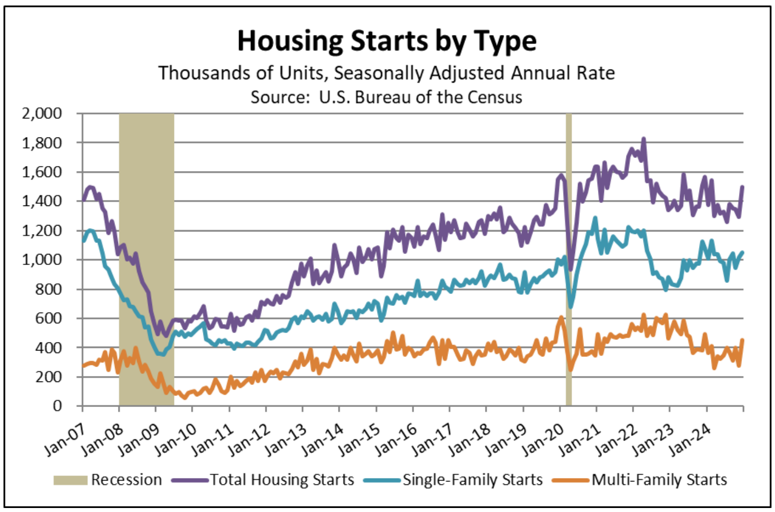
- Support for Ukraine is emerging as a significant point of contention within Germany, Europe's largest economy. Public opinion on the government's role in aiding Ukraine remains nuanced and somewhat contradictory. While a recent poll indicates that 57% of Germans favor continued financial and humanitarian assistance, another survey reveals that over 60% oppose the provision of more advanced military equipment to Ukraine, such as the Taurus cruise missile.
- A significant factor contributing to this divide is the prevalent fear that Germany could be drawn into a direct war with Russia. This anxiety is particularly acute among residents of former East Germany, with a poll indicating that 76% of respondents in that region fear a potential conflict, compared to only 44% in the western part of the country.
- The divide over support for the war has already sparked a pushback in local elections, with the populist parties Alternative for Germany (AfD) and the Sahra Wagenknecht Alliance (BSW) finding success by campaigning to end funding for Ukraine. The AfD, in particular, has seen its polling improve recently. The rise of populist parties within the German government could complicate efforts to sustain current levels of financial and military aid to Ukraine.
- The outcome of the German election will likely have significant repercussions for the continuation of support for Ukraine. Reduced funding from key Western allies, including Germany and the United States, would likely hinder Ukraine's ability to continue its war effort against Russia. Any potential resolution to the conflict, regardless of its terms, would likely exert downward pressure on global oil prices.

Crypto National Priority: President-elect Donald Trump is expected to issue an executive order to promote the increased adaptation of cryptocurrency. This order would facilitate collaboration between government agencies and industry stakeholders to develop a more comprehensive regulatory framework. Key provisions include the establishment of a dedicated crypto advisory board to provide guidance and insights on policy development.

TikTok Ban: The Supreme Court is expected to rule on whether the government has the authority to ban or force the sale of the social media platform later today. President Biden has stated that if the court moves forward with this decision, he will leave it to his successor to determine the next steps.

US Economic Releases

December ***housing starts*** rose to a seasonally adjusted, annualized rate of 1.499 million units, beating the expected rate of 1.327 million units and the revised November rate of 1.294 million units. The rate of housing starts in December was up 15.8% from the rate in the previous month, erasing the modest declines in each of the previous three months. December ***housing permits*** rose to a rate of 1.483 million units, beating their anticipated rate of 1.460 million units but down from their November rate of 1.493 million units. Permits issued for new housing units in December were down 0.7% from the previous month. Compared with the same month one year earlier, housing starts in December were down 2.7%, while permits were up 2.4%. The chart below shows the growth in new home starts by type of property 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						
ET	Indicator			Expected	Prior	Rating
16:00	Total Net TIC Flows	m/m	Mar		$203.6b	**
16:00	Net Long-Term TIC Flows	m/m	Mar		$152.3b	**
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	Japan Buying Foreign Bonds	w/w	10-Jan	¥756.7b	-¥332.3b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	10-Jan	¥589.1b	¥325.1b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	10-Jan	-¥501.2b	¥154.8b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	10-Jan	¥313.3b	-¥74.0b		*	Equity and bond neutral
New Zealand	BusinessNZ Manufacturing PMI	m/m	Dec	45.9	45.2		***	Equity and bond neutral
China	GDP	y/y	4Q	5.4%	4.6%	5.0%	**	Equity and bond neutral
	Industrial Production	y/y	Dec	6.2%	5.4%	5.4%	***	Equity bullish, bond bearish
	Retail Sales	y/y	Dec	3.7%	3.0%	3.6%	**	Equity and bond neutral
	Fixed Assets Ex Rural YTD	y/y	Dec	3.2%	3.3%	3.3%	**	Equity and bond neutral
EUROPE								
Eurozone	CPI	y/y	Dec F	2.4%	2.3%	2.4%	***	Equity and bond neutral
	Core CPI	y/y	Dec F	2.7%	2.7%	2.7%	**	Equity and bond neutral
Italy	Current Account Balance	m/m	Nov	-332m	5511m		*	Equity and bond neutral
UK	Retail Sales	y/y	Dec	3.6%	0.0%	4.9%	***	Equity bearish, bond bullish
	Retail Sales Ex-Auto Fuel	y/y	Dec	2.9%	-0.5%	4.0%	**	Equity bearish, bond bullish
Russia	Gold and Forex Reserves	m/m	10-Jan	$607.7b	$609.5b		***	Equity and bond neutral
	Money Supply, Narrow Definition	w/w	10-Jan	18.68t	18.95t		*	Equity and bond neutral
AMERICAS								
Canada	Housing Starts	m/m	Dec	231.5k	267.1k	250.0k	**	Equity and bond neutral
Brazil	FGV Inflation IGP-10	m/m	Jan	0.53%	1.14%	0.65%	**	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	420	-1	Down
U.S. Sibor/OIS spread (bps)	429	429	0	Down
U.S. Libor/OIS spread (bps)	432	432	0	Down
10-yr T-note (%)	4.58	4.61	-0.03	Down
Euribor/OIS spread (bps)	274	275	-1	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.

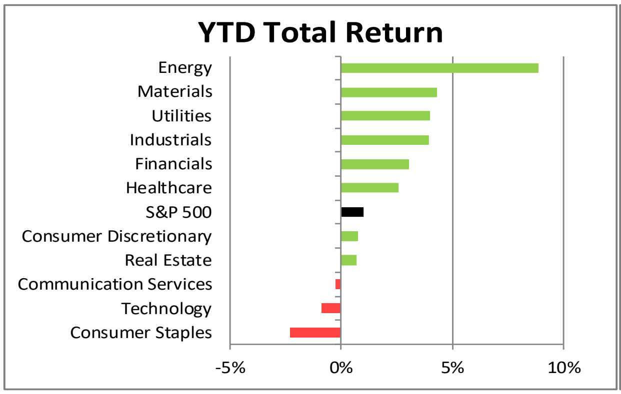
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$81.06	$81.29	-0.28%	
WTI	$78.60	$78.68	-0.10%	
Natural Gas	$4.09	$4.26	-4.02%	
Crack Spread	$17.20	$17.19	0.04%	
12-mo strip crack	$21.44	$21.41	0.14%	
Ethanol rack	$1.81	$1.80	0.39%	
Metals				
Gold	$2,711.40	$2,714.31	-0.11%	
Silver	$30.55	$30.81	-0.87%	
Copper contract	$442.05	$444.10	-0.46%	
Grains				
Corn contract	$476.00	$474.50	0.32%	
Wheat contract	$536.00	$537.50	-0.28%	
Soybeans contract	$1,022.25	$1,019.00	0.32%	
Shipping				
Baltic Dry Freight	1,023	1,063	-40	
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)	-258	-259	1	

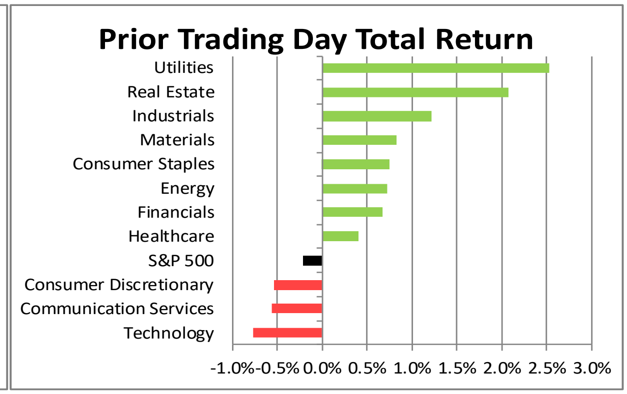
Weather

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 in California, Nevada, and the Dakotas. The forecasts call for wetter-than-normal conditions in the northern Rocky Mountains and the Southeast, with dry conditions in the Southwest.

Data Section

US Equity Markets – (as of 1/16/2025 close)

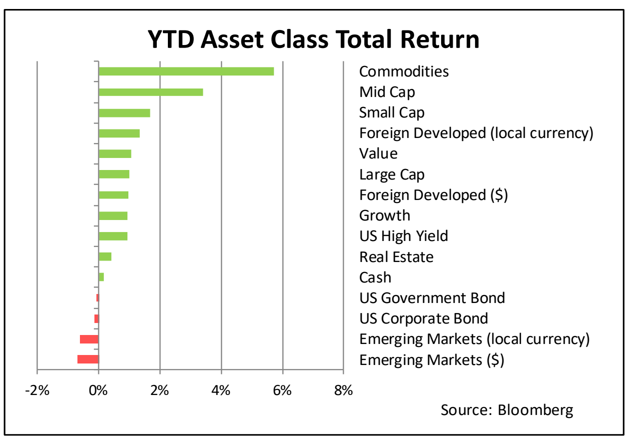




(Source: Bloomberg)

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 1/16/2025 close)

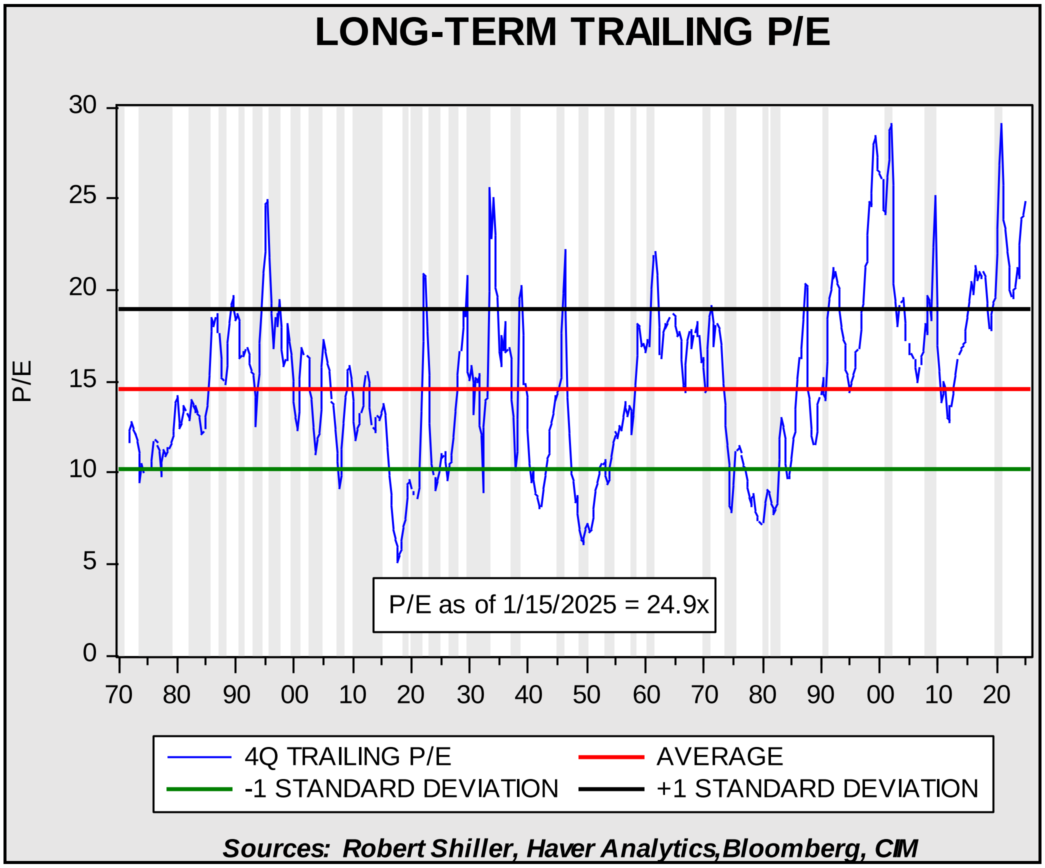


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.

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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.