Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: January 23, 2025 — 9:30 AM ET] Global equity markets are mostly lower 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 down 0.2%. Chinese markets were mixed, with the Shanghai Composite up 0.5% from its previous close and the Shenzhen Composite down 0.4%. US equity index futures are signaling a lower open.

With 65 companies having reported so far, S&P 500 earnings for Q4 are running at $62.40 per share, compared to estimates of $64.79, which is up 11.7% from Q4 2023. Of the companies that have reported thus far, 83.1% have exceeded expectations while 13.8% 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:

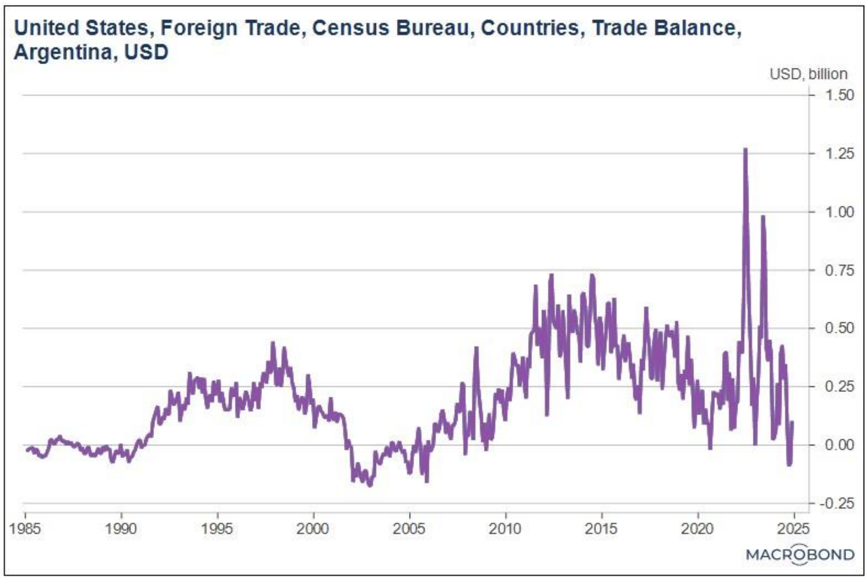
Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
Syrian Surprise: Implications of a Sudden Regime Change (1/13/25) + podcast	*Magnificent 7 to the Rescue!* (1/21/25) + podcast	Q4 2024 Report Q4 2024 Rebalance Presentation	*The 2025 Outlook: A Year of Political and Policy Change*

Good morning! The market is currently awaiting President Trump's remarks at Davos. In sports news, Aryna Sabalenka is one step closer to becoming the first woman since 1999 to win three consecutive Australian Opens. Today's *Comment* will discuss Argentina's unwillingness to take sides in the US-China rivalry, explain why tariffs are forcing firms to consider relocating, and provide the latest developments in the war in Ukraine. As usual the report will conclude with a summary of domestic and international data releases.

Argentina Has Options: Argentine President Javier Milei has explored the possibility of establishing trade deals with both the United States and China. This decision reflects his broader strategy to revitalize the economy during a challenging period.

- During an interview at the World Economic Forum in Davos, Milei hinted that his administration might be exploring a bilateral trade agreement with the United States. He even suggested a potential willingness to withdraw from the South American trade bloc, Mercosur, in order to secure a favorable deal with the US, if needed. However, he expressed confidence that existing mechanisms within the Mercosur trade arrangement would enable his country to maintain relationships with both trading partners.

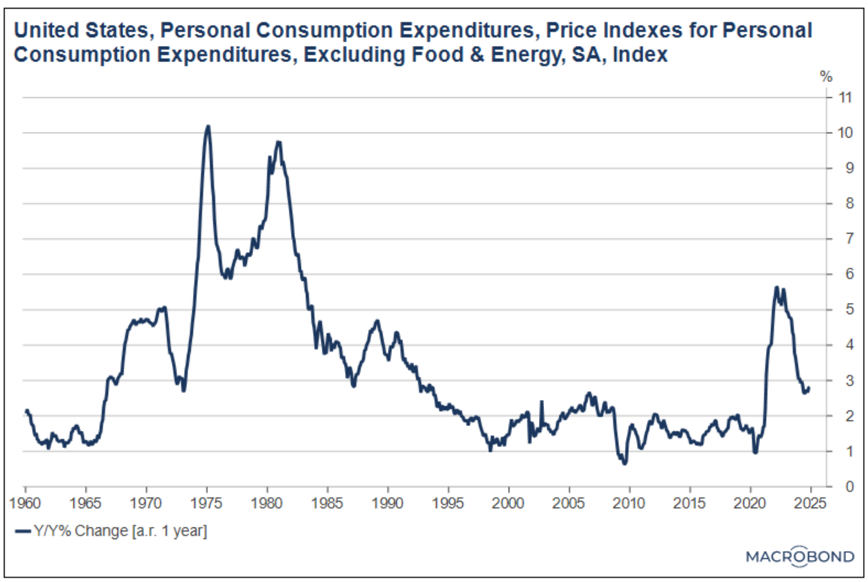
- Furthermore, he appears to have significantly altered his stance on engaging with China. After previously characterizing Beijing as a group of assassins, he now believes that China is a valuable trading partner, and he has expressed a desire to cultivate a deeper relationship with the world's second-largest economy. Milei and his team are expected to travel to China soon to discuss improving commercial ties.



- The Argentinian president's willingness to engage with both China and the United States likely reflects a desire to maintain strategic autonomy, despite shared interests with the latter. This reluctance to fully align with the US may stem from concerns about potential economic disruptions caused by proposed flat tariffs, as well as the perception of the US as an exporting rival.
- Since taking office, Milei has focused on expanding Argentine exports, particularly in grains, oil, and gas — sectors where the country directly competes with the United States — as a strategy for economic growth. Last year saw the nation achieve a record trade surplus, largely attributed to strong energy exports, while simultaneously reducing its trade deficit with the US.
- Millie's decision to engage with China signals how US trade threats may be driving other nations toward closer ties with Beijing, potentially creating a counterweight to American influence. This could compel the US to moderate its approach towards less security-dependent nations, potentially making these countries more attractive as investment destinations for those seeking to mitigate trade war risks.

Tariffs Headaches: Confronted with the looming threat of new tariffs, US companies in China are scrambling to explore all viable alternatives. A key concern is the relocation of operations with many reluctant to reshore to the US, raising the specter of renewed supply chain difficulties and potentially reigniting inflationary pressures.

- Nearly 30% of companies are considering relocation, according to a survey conducted by the American Chamber of Commerce in China. While the overall majority of firms plan on keeping their operations at their current location, the trend is showing that firms have started to take steps to hedge against rising trade tensions.
- That said, for most firms, the preferred destination for relocating operations appears to be other countries in Asia, rather than the US or its Northern American partners. Among respondents who plan to move operations, 38% indicated Asia as their preferred destination, with many companies specifically considering countries like Vietnam and the Philippines.
- The reluctance of firms to relocate from Asia to the US, despite policy incentives to do so, stems primarily from concerns about higher labor costs and difficulties in retaining skilled workers. This is particularly pronounced for labor-intensive industries such as wiring and optical fiber cable manufacturing, which often require specialized expertise.

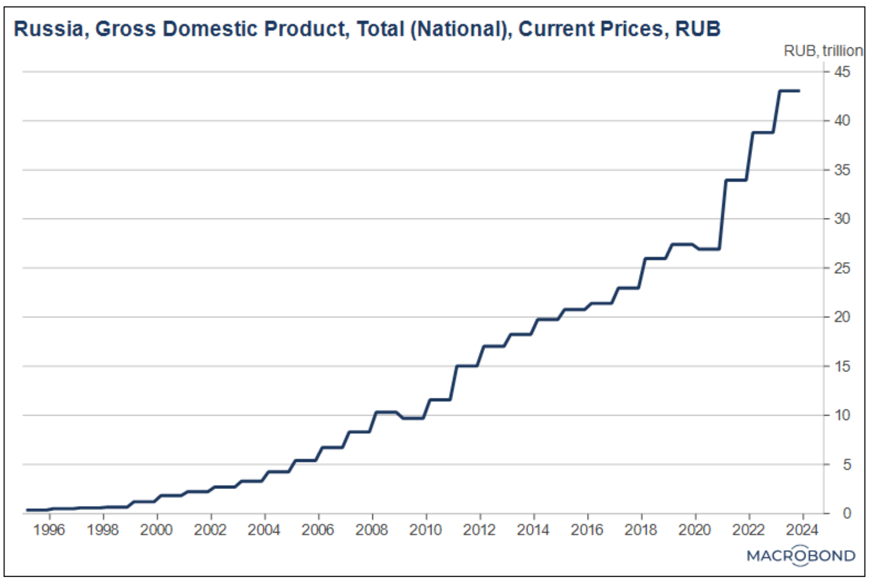


- As a result, proposed tariffs on goods from Mexico and Canada pose a significant threat to the US economy by disrupting supply chains and dampening consumer demand. Deutsche Bank research estimates that the 25% tariffs implemented on February 1 could increase the core PCE price index by 80 basis points, assuming a 50% cost pass-through to consumers. This figure rises to 110 basis points if 75% of costs are passed through.
- If Deutsche Bank's research proves accurate, it could hinder the Federal Reserve's efforts to lower interest rates further this year, potentially keeping rates elevated. However, the

inflationary impact of these tariffs may be transitory, which could mean the pause could be somewhat limited.

Ukraine-Russia Deal: The US president has demanded that Vladimir Putin quickly agree to a deal to end the war in Ukraine or face tariffs, taxes, or more sanctions. Trump's threat comes as he is expected to talk to the Russian president later this week to discuss the war.

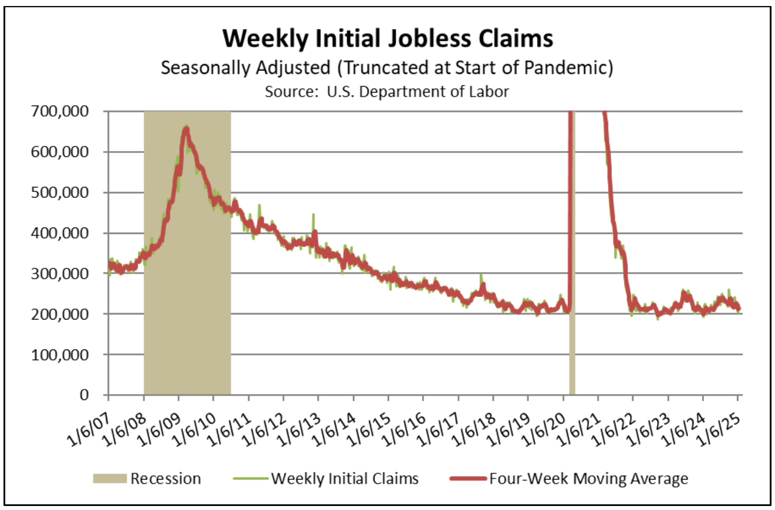
- Trump remains confident that Zelensky is open to negotiations but questions whether Putin is genuinely committed to ending the conflict. Earlier this week, he uncharacteristically criticized Putin, accusing him of destroying Russia by refusing to make a deal. His remarks come amid growing concerns that Russia has prolonged the conflict with support from North Korean troops.
- Moscow responded to Trump's remarks by expressing interest in meeting with the US for discussions while downplaying the president's threats as nothing new. Although some within the Kremlin reportedly support continuing the war, sources suggest that Putin believes the war's objectives have been achieved, indicating that Moscow may be open to a deal.



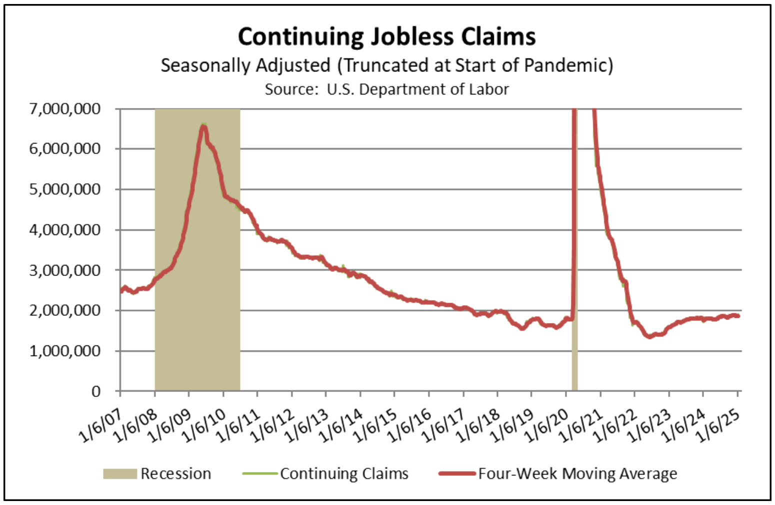
- The possible end of the war comes at a time when the Russian economy is facing increasing distress, with concerns that the war effort may be leading to some distortion. To mitigate fears of a possibly worsening economic outlook, Russian officials have suggested the rest of the world is also facing some form of economic difficulties.
- A potential peace agreement ending the war would likely be met with enthusiasm by financial markets, as a ceasefire could significantly reduce geopolitical tensions. Commodity prices, particularly energy, are expected to be the most immediate beneficiaries. The prospect of lifting sanctions on Russian oil and gas exports would likely exert downward pressure on energy prices.

US Economic Releases

In the week ended January 18, ***initial claims for unemployment benefits*** rose to a seasonally adjusted 223,000, above both the expected level of 220,000 and the prior week's level of 217,000. However, the four-week moving average of initial claims, which helps smooth out some of the volatility in the series, rose only slightly to 213,500. The four-week moving average remains close to the low floor that has been in place since 2022, suggesting the demand for labor is again very high and layoffs are rare. 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 11, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) rose to a seasonally adjusted 1.899 million, above both the anticipated reading of 1.866 million and the previous week's revised reading of 1.853 million. The four-week moving average of continuing claims rose to 1,865,750, but it remains near its lowest level in the last three months. 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.



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

Economic Releases						
ET	Indicator			Expected	Prior	Rating
11:00	Kansas City Fed Manfacturing Index	m/m	Jan	0	-4	*
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	Trade Balance	y/y	Dec	¥130.9b	-¥110.3b	-¥68.5b	**	Equity and bond neutral
	Exports	y/y	Dec	2.80%	3.80%	2.40%	*	Equity and bond neutral
	Imports	y/y	Dec	1.80%	-3.80%	3.20%	*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	17-Jan	¥819.3b	¥758.7b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	17-Jan	¥489.8b	¥588.9b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	17-Jan	¥876.1b	-¥502.5b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	17-Jan	-¥66.1b	¥259.1b		*	Equity and bond neutral
South Korea	GDP	q/q	4Q A	1.2%	1.5%	1.4%	**	Equity and bond neutral
EUROPE								
France	Business Confidence	m/m	Jan	95	94	94	**	Equity and bond neutral
	Manufacturing Confidence	m/m	Jan	95	97	96	*	Equity and bond neutral
Russia	Gold and Forex Reserves	m/m	17-Jan	$609.7b	$607.7b		***	Equity and bond neutral
AMERICAS								
Canada	Industrial Product Price	m/m	Dec	0.2%	0.6%	0.6%	**	Equity and bond neutral
	Raw Material Prices	m/m	Dec	1.3%	-0.1%	0.5%	*	Equity bearish, bond bullish

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	422	-1	Down
U.S. Sibor/OIS spread (bps)	431	430	1	Down
U.S. Libor/OIS spread (bps)	432	433	-1	Down
10-yr T-note (%)	4.64	4.61	0.03	Up
Euribor/OIS spread (bps)	267	268	-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.

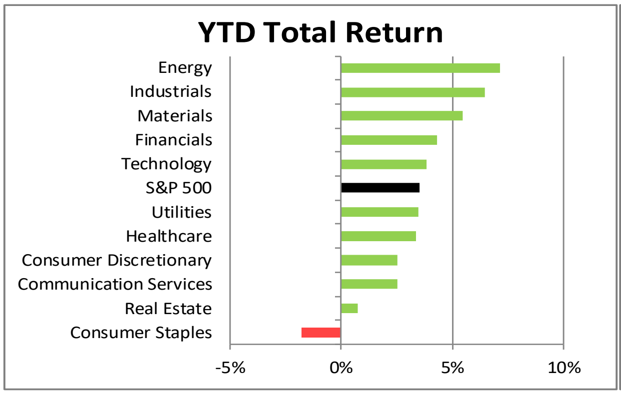
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$79.22	$79.00	0.28%	
WTI	$75.64	$75.44	0.27%	
Natural Gas	$3.97	$3.96	0.33%	
Crack Spread	$17.39	$16.87	3.08%	
12-mo strip crack	$21.00	$20.75	1.19%	
Ethanol rack	$1.81	$1.81	0.05%	
Metals				
Gold	$2,742.58	$2,756.48	-0.50%	
Silver	$30.26	$30.83	-1.86%	
Copper contract	$428.85	$430.10	-0.29%	
Grains				
Corn contract	$485.75	$484.25	0.31%	
Wheat contract	$553.25	$554.00	-0.14%	
Soybeans contract	$1,059.25	$1,056.00	0.31%	
Shipping				
Baltic Dry Freight	893	928	-35	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-0.40		
Gasoline (mb)		2.19		
Distillates (mb)		0.79		
Refinery run rates (%)		-0.9%		
Natural gas (bcf)		-247		

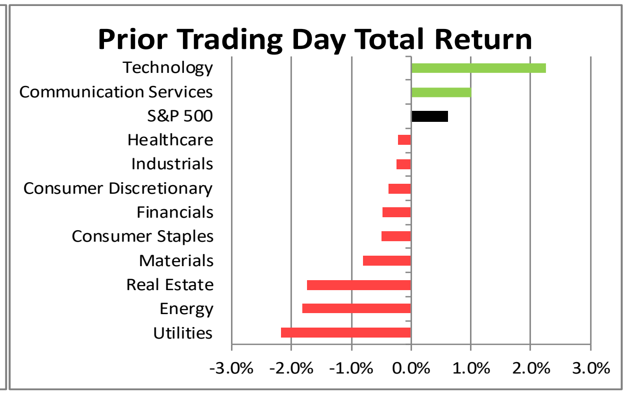
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for cooler-than-normal temperatures in the Pacific Northwest, the Southwest, and the Northeast, with warmer-than-normal temperatures in the central Great Plains and along the Gulf Coast. The forecasts call for wetter-than-normal conditions along the entire northern border with Canada, with dry conditions in the Southwest.

Data Section

US Equity Markets – (as of 1/22/2025 close)

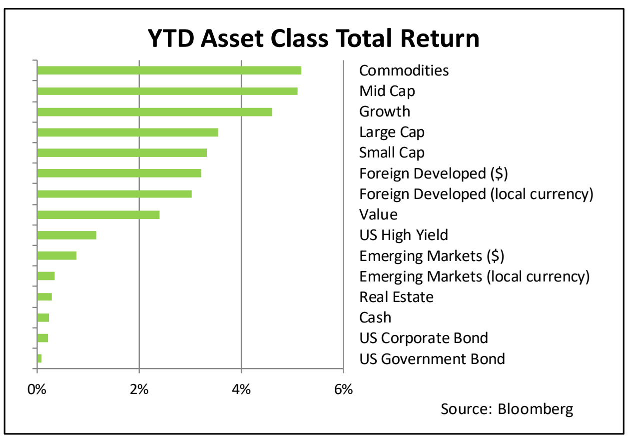




(Source: Bloomberg)

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 1/22/2025 close)

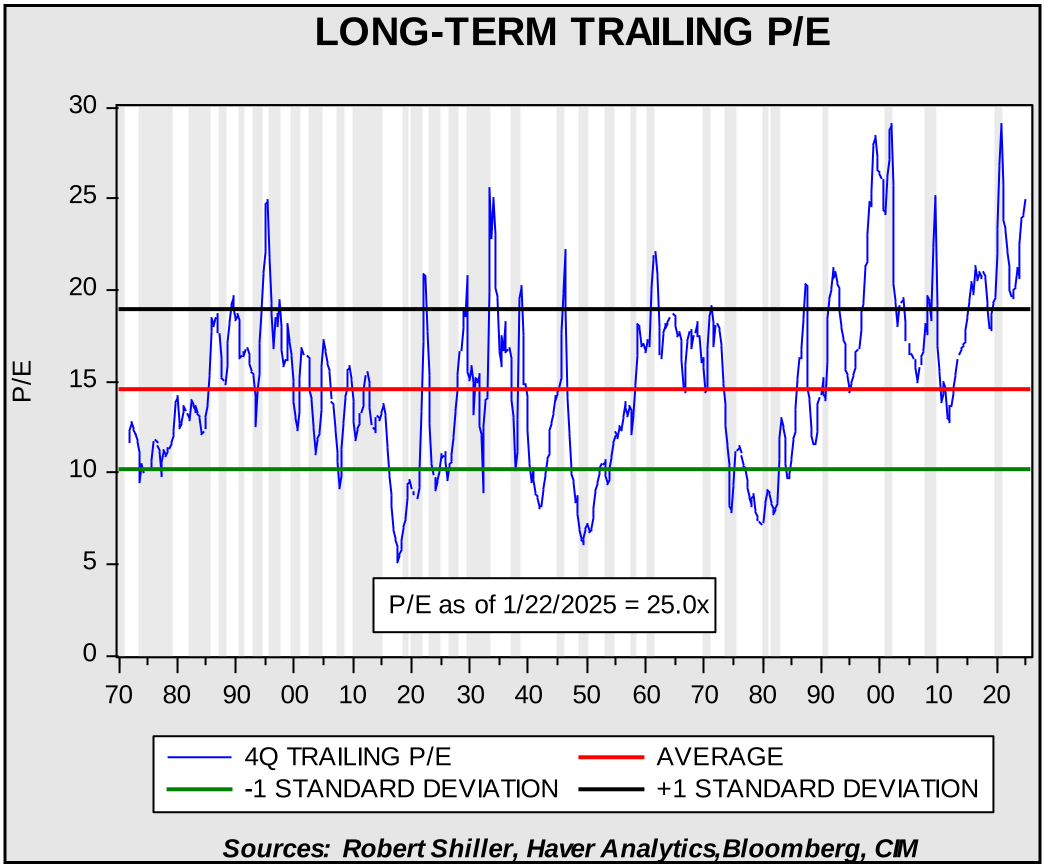


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 23, 2025



Based on our methodology,[1] the current P/E is 25.0x, 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.