Daily Comment

Confluence INVESTMENT MANAGEMENT

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[Posted: January 24, 2025 — 9:30 AM ET] Global equity markets are mostly higher this morning. In Europe, the Euro Stoxx 50 closed up 0.5% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.9%. Chinese markets were higher, with the Shanghai Composite up 0.7% from its previous close and the Shenzhen Composite up 1.2%. Conversely, US equity index futures are signaling a lower open.

With 71 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 12.7% 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	Outlook	Of Note
Syrian Surprise: Implications of a Sudden Regime Change (1/13/25) + podcast	*Magnificent 7 to the Rescue!* (1/21/25) + podcast	*The 2025 Outlook: A Year of Political and Policy Change*	***Keller Quarterly January 2025***

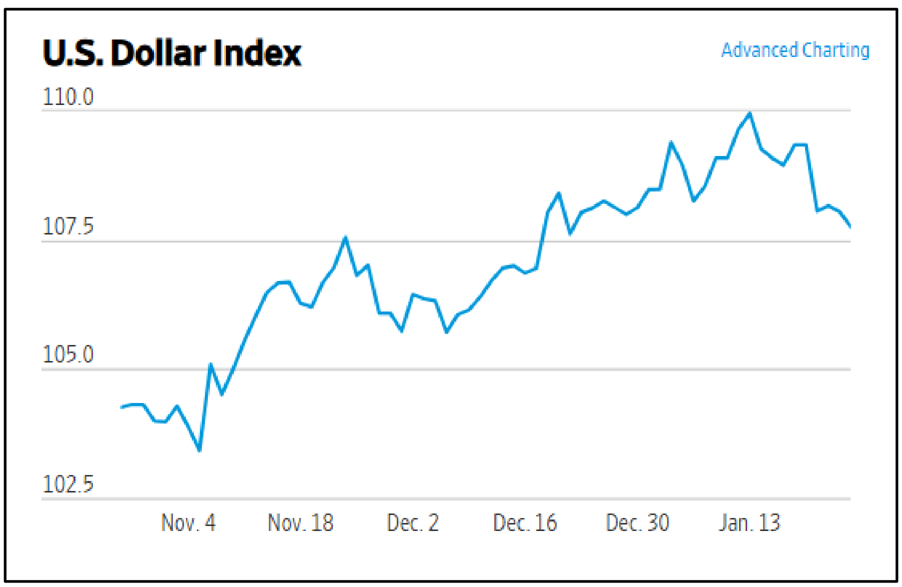
Our *Comment* today opens with new, market-driving statements by President Trump regarding global energy supplies and US tariff policy. We next review several other international and US developments with the potential to affect the financial markets today, including new signs that Europe is taking steps to protect itself from China's predatory economic policy and new pressure on the Federal Reserve from Trump to cut US interest rates.

United States-World Economic Forum: Yesterday, in his video speech to the WEF in Davos, Switzerland, President Trump urged Saudi Arabia and the other members of the Organization of the Oil Exporting Countries to boost oil production and bring down prices, claiming the price cuts would reduce consumer price inflation and allow interest rates to fall. He also reiterated his invitation for foreign firms to invest in the US and take advantage of its low tax rates, but he warned that foreign manufacturers would be subject to import tariffs.

- Taken together, Trump's statements on oil prices, inflation, and import tariffs help confirm that he is looking for lower energy prices to offset some of the inflationary impact of some of his other policies, such as higher tariffs.
- Even if that is Trump's strategy, however, it's important to remember that the plan may not work. Given that so many of Trump's policies run the risk of higher price pressures, any lowering of energy prices may merely slow the resulting price inflation, rather than bringing overall prices down.

United States-China: Despite reiterating his willingness to hike tariffs in his WEF speech, President Trump said in an interview released last night that he would "rather not" have to impose them against China. Coupled with the lack of any specific new tariffs imposed since Trump was inaugurated on Monday, the statement has increased the market's uncertainty regarding tariff policy, pushing the dollar lower against most major currencies today and giving a boost to some foreign stock markets.

- As of this writing, the US Dollar Index is down approximately 0.3% to 107.71.
- The index is now down 2.1% from mid-January.



(Source: Wall Street Journal*)*

European Union-China: Teresa Ribera, executive vice president of the European Commission, has revealed to the *Financial Times* that Brussels is considering an EU-wide subsidy for consumers to buy electric vehicles. The subsidy would aim to help EU automakers survive the onslaught of super-cheap EV imports from China. If it is ultimately approved and implemented, the subsidy program would be yet another sign of the protectionism and industrial policy being implemented around the world.

Germany-China: Friedrich Merz, chief of the center-right Christian Democratic Union and leading candidate for chancellor in February's elections, warned that German firms investing in China shouldn't expect government help if those investments go sour. The warning comes as German manufacturers desperate for growth are increasingly building factories in China, even though China's predatory industrial policies are essentially aimed at putting them out of business on their home turf.

- The statement by Merz suggests that he would support further economic decoupling from China if he becomes chancellor as expected.
- The statement therefore signals that the potential policies of Europe's rising right-wing leaders will likely lead to more global fracturing going forward, which we think will tend to boost consumer price inflation and interest rates in the future.

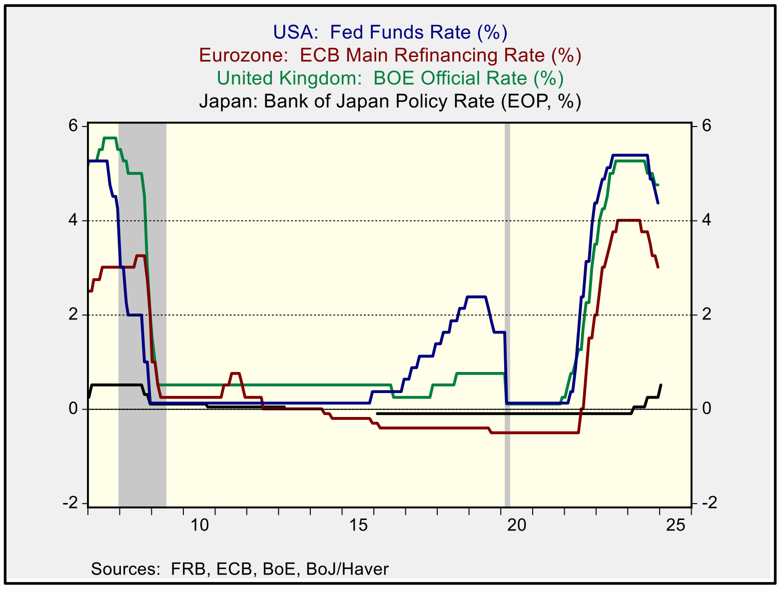
Eurozone: On a panel during the last day of the WEF in Davos, European Central Bank Chief Lagarde said Europeans are too pessimistic and should be more confident about their economic prospects. According to Lagarde, one thing that would help boost the European economy would be to keep more of its highly skilled workers and capital from going abroad. On the same panel, BlackRock CEO Larry Fink said there is not only too much pessimism in Europe, but that it was also probably time to be investing back into the Continent.

- In our view, Lagarde and Fink probably have a point regarding the extreme pessimism that many investors feel toward Europe these days. The Continent retains an enormous amount of wealth, income, human capital, and economic potential. The question is whether the European economy is finally turning the corner to a new round of strong growth, which may be a necessary catalyst for renewed investor optimism.
- In any case, even though Europe continues to face challenges ranging from disrupted energy supplies and high energy prices to a fractured financial system, high regulation, and poor demographics, we think opportunistic investors can still find attractive opportunities in certain sectors and among the Continent's many well-run, innovative firms with strong world market shares.

Italy: Monte dei Paschi di Siena, widely recognized as the world's oldest bank, has announced an unsolicited bid worth nearly $14 billion for fellow Italian lender Mediobanca. The combined firms would make up Italy's third-largest bank by assets. Along with recent takeover bids by Italian lender UniCredit, the proposed takeover has once again raised investor hopes for a consolidation of the fractured banking system in Italy, and in the broader European Union.

Japan: The Bank of Japan today hiked its benchmark short-term interest rate to 0.50%, boosting it from 0.25% previously and marking the third rate hike in less than a year. In a post-decision press conference, BOJ Governor Ueda said his policymakers had become more confident that a rate hike would help them keep consumer price inflation to their target of 2.0% over the medium term, while they saw no unexpected developments from the new Trump administration that would make them change their tightening course.

- Despite the rate hike and the dollar's pullback against many other currencies so far today, the yen (JPY) has weakened about 0.2% to 156.32 per dollar ($0.0064).
- Even though the BOJ's recent hikes have helped close the rate gap with other central banks, the yen today remains near its weakest level since 1990.



US Monetary Policy: With the Fed widely expected to hold its benchmark interest rate at a relatively high 4.25% to 4.50% next week, President Trump yesterday claimed he understands interest rates "much better" than the central bankers and would pressure them to cut interest rates "a lot." The statement confirms that Trump is ready to strongarm Fed Chair Powell into cutting rates and trample on the Fed's traditional independence, even if the policymakers think Trump's policies will push up consumer price inflation.

- Trump's rhetoric illustrates why many investors have been wary of the increasingly powerful right-wing populist politicians in the US and Europe.
- Some investors worry that right-wing populist politicians will cut taxes and hike outlays on workers, expanding national budget deficits. However, they are also concerned that these politicians will push for excessively loose monetary policy, which will raise the risk of resurgent inflation.

US Fires: Even as firefighters were finally making progress on the major blazes elsewhere in Los Angeles County, new fires have broken out in the northern part of the jurisdiction and are now being fanned by strong winds. The Hughes fire near Santa Clarita has exploded to almost 10,400 acres, sparking thousands more evacuation orders. The new Sepulveda fire has broken out just two miles from the perimeter of the Palisades fire that has already destroyed some 23,000 acres and thousands of structures.

US Economic Releases

No major US reports have been released so far today. 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	U. of Michigan Consumer Sentiment	m/m	Jan F	73.2	73.2	***
10:00	U. of Michigan Current Conditions	m/m	Jan F		77.9	**
10:00	U. of Michigan Future Expectations	m/m	Jan F		70.2	**
10:00	U. of Michigan 1-Year Inflation Expectation	m/m	Jan F	3.2%	3.3%	*
10:00	U. of Michigan 5-10 Year Inflation Expectation	m/m	Jan F	3.2%	3.3%	*
10:00	Existing Home Sales	m/m	Dec	1.20%	4.80%	**
11:00	Kansas City Fed Servics Activity	m/m	Jan		2	*
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	Tokyo Condominiums for Sale	y/y	Dec	-2.4%	-18.7%		*	Equity and bond neutral
	National CPI	y/y	Dec	3.6%	2.9%	3.4%	***	Equity and bond neutral
	National CPI Ex-Fresh Food	y/y	Dec	3.0%	2.7%	3.0%	**	Equity and bond neutral
	National CPI Ex-Fresh Food & Energy	y/y	Dec	2.4%	2.4%	2.4%	*	Equity and bond neutral
	Jibun bank Composite PMI	m/m	Jan P	51.1	50.5		*	Equity and bond neutral
	Jibun Bank Manufacturing PMI	m/m	Jan P	48.8	49.6		***	Equity and bond neutral
	Jibun Bank Services PMI	m/m	Jan P	52.7	50.9		**	Equity and bond neutral
	Nationwide Dept Sales	y/y	Dec	2.80%	3.40%		***	Equity and bond neutral
Australia	S&P Global Australia Composite PMI	m/m	Jan P	50.3	50.2		*	Equity and bond neutral
	S&P Global Australia Manufacturing PMI	m/m	Jan P	49.8	47.8		***	Equity and bond neutral
	S&P Global Australia Services PMI	m/m	Jan P	50.4	50.8		**	Equity and bond neutral
India	HSBC India PMI Composite	m/m	Jan P	57.9	59.2		**	Equity and bond neutral
	HSBC India PMI Composite	m/m	Jan P	58.0	56.4		**	Equity and bond neutral
	HSBC India PMI Composite	m/m	Jan P	56.8	59.3		**	Equity and bond neutral
EUROPE								
Eurozone	Consumer Confidence	m/m	Jan P	-14.2	-14.5	-14.1	**	Equity and bond neutral
	HCOB Eurozone Composite PMI	m/m	Jan P	50.2	49.6	49.7	*	Equity and bond neutral
	HCOB Eurozone Manufacturing PMI	m/m	Jan P	46.1	45.1	45.4	***	Equity and bond neutral
	HCOB Eurozone Services PMI	m/m	Jan P	51.4	51.6	51.5	**	Equity and bond neutral
Germany	HCOB Germany Manufacturing PMI	m/m	Jan P	44.1	42.5	42.7	***	Equity and bond neutral
	HCOB Germany Services PMI	m/m	Jan P	52.5	51.2	51.0	**	Equity and bond neutral
	HCOB Germany Composite PMI	m/m	Jan P	50.1	48.0	48.3	**	Equity and bond neutral
France	HCOB France Manufacturing PMI	m/m	Jan P	45.3	41.9	42.5	***	Equity and bond neutral
	HCOB France Services PMI	m/m	Jan P	48.9	49.3	49.4	**	Equity and bond neutral
	HCOB France Composite PMI	m/m	Jan P	48.3	47.5	47.7	**	Equity and bond neutral
UK	GfK Consumer Confidence	m/m	Jan	-22	-17	-18	***	Equity bearish, bond bullish
	S&P Global UK Manufacturing PMI	m/m	Jan P	48.2	47.0	47.0	***	Equity and bond neutral
	S&P Global UK Services PMI	m/m	Jan P	51.2	51.1	50.8	**	Equity and bond neutral
	S&P Global UK Composite PMI	m/m	Jan P	50.9	50.4	50.1	**	Equity and bond neutral
Russia	Money Supply, Narrow Definition	w/w	17-Jan	18.56t	18.68t		*	Equity and bond neutral
AMERICAS								
Canada	Retail Sales	m/m	Nov	0.0%	0.6%	0.2%	**	Equity and bond neutral
	Retail Sales Ex-Autos	m/m	Nov	-0.7%	-0.1%	0.1%	**	Equity bearish, bond bullish
Mexico	Economic Activity IGAE	y/y	Nov	0.53%	0.77%	0.70%	**	Equity and bond neutral
Brazil	Current Account Balance	m/m	Dec	-$9033m	-$32140m	-$12800m	**	Equity and bond neutral
	Foreign Direct Investment	m/m	Dec	$27665m	$6956m	-$2000m	**	Equity and bond neutral
	IBGE Inflation IPCA-15	m/m	Jan	4.50%	4.71%	4.36%	***	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)	421	421	0	Down
U.S. Sibor/OIS spread (bps)	430	430	0	Down
U.S. Libor/OIS spread (bps)	432	432	0	Down
10-yr T-note (%)	4.63	4.64	-0.01	Flat
Euribor/OIS spread (bps)	267	267	0	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**	
BOJ Target Rate	0.500%	0.250%	0.500%	On Forecast
PBOC 1-Year Med-Term Lending Volume	200.0b	300.0b	300.0b	Below Forecast
PBOC 1-Year Med-Term Lending Facility	2.00%	2.00%	2.00%	On 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.

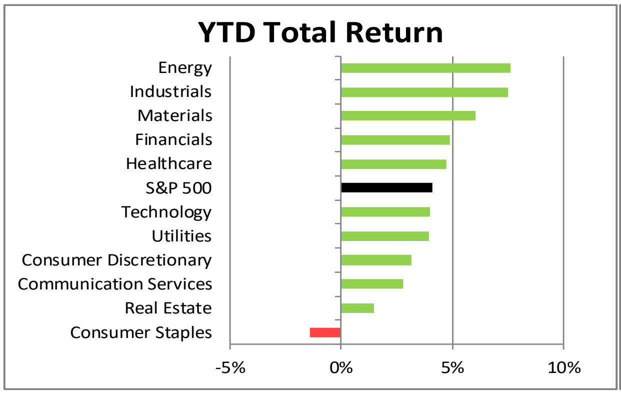
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$78.79	$78.29	0.64%	
WTI	$75.09	$74.62	0.63%	
Natural Gas	$3.83	$3.95	-2.84%	
Crack Spread	$17.83	$18.04	-1.14%	
12-mo strip crack	$21.09	$21.11	-0.10%	
Ethanol rack	$1.81	$1.81	-0.15%	
Metals				
Gold	$2,778.56	$2,754.87	0.86%	
Silver	$30.92	$30.45	1.53%	
Copper contract	$436.90	$432.85	0.94%	
Grains				
Corn contract	$484.50	$489.75	-1.07%	
Wheat contract	$547.75	$554.00	-1.13%	
Soybeans contract	$1,051.50	$1,065.50	-1.31%	
Shipping				
Baltic Dry Freight	824	893	-69	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-1.02	-0.40	-0.62	
Gasoline (mb)	2.33	2.19	0.15	
Distillates (mb)	-3.07	0.79	-3.86	
Refinery run rates (%)	-5.8%	-0.9%	-4.9%	
Natural gas (bcf)	-223	-248	25	

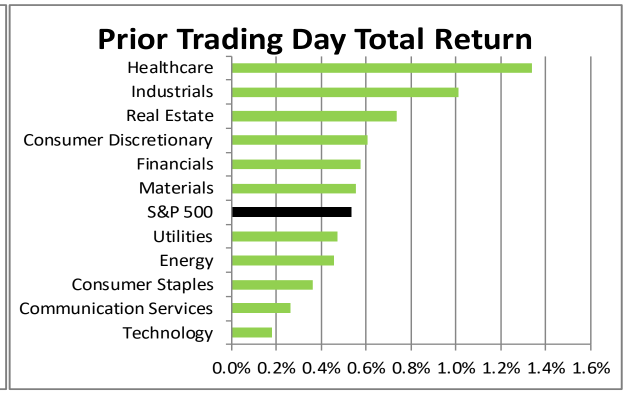
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for cooler-than-normal temperatures in the Pacific Northwest and the Northeast, with warmer-than-normal temperatures in the central Rocky Mountain region, the southern Great Plains, and the Southeast. The forecasts call for wetter-than-normal conditions in the Pacific Northwest and Mississippi Valley, with dry conditions in the Southwest.

Data Section

US Equity Markets – (as of 1/23/2025 close)

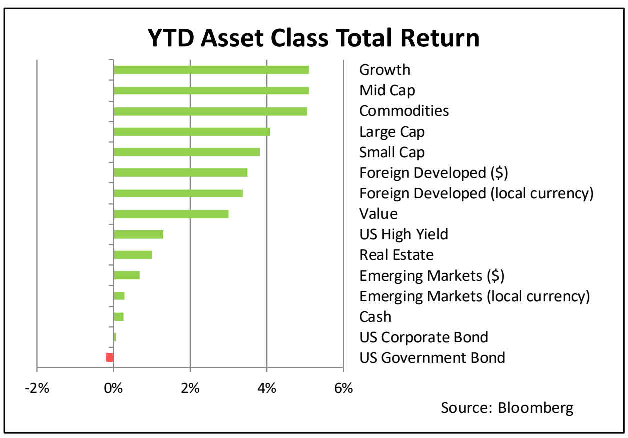




(Source: Bloomberg)

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 1/23/2025 close)

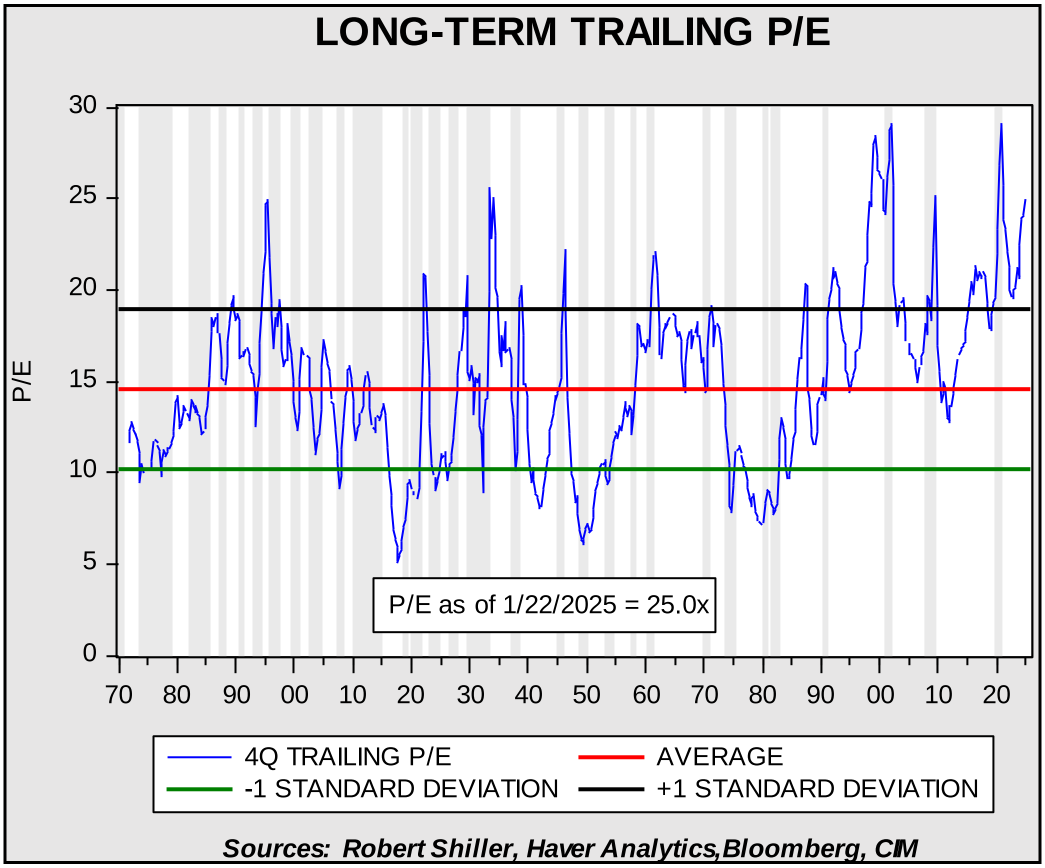


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.