Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: January 28, 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 down 0.1% Chinese markets were closed for the Chinese Lunar New Year. US equity index futures are signaling a higher open.

With 83 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, 80.7% have exceeded expectations while 12.0% 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
Trump and the Political Economy of Alliances **(1/27/25)** + **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 a few observations on yesterday's rout in Western technology stocks related to artificial intelligence. We next review several other international and US developments with the potential to affect the financial markets today, including signs that China's property slump is starting to weaken even its strongest developers and a White House order last night that could potentially disrupt federal payments to a wide range of businesses and nonprofits.

Global Technology Stock Sell-Off: Yesterday's sell-off in Western artificial-intelligence stocks erased some $589 billion of Nvidia's market value alone. The previously high-flying stock closed down about 17% for the day, and other AI-related firms closed down almost as much. As a reminder, the sell-off was sparked by a realization that Chinese AI firm DeepSeek was able to produce a top AI model without expensive Nvidia chips and far more cheaply than Western firms have been able to create competing models.

- Since AI stocks had gotten so richly valued, they were probably susceptible to a correction at the sign of any bad news. As we've written recently, investors had even begun looking at the Magnificent 7 as a sort of safe haven. The reality is that stock prices can be volatile, and while it can be tempting to chase the momentum plays, keeping diversified can be a safer approach.
- Looking forward, it's probably too early to gauge exactly how DeepSeek or other Chinese AI models could affect the US firms. As the US-China "AI race" heats up, there is a chance that the US government will limit access to Chinese tools for national security purposes. That could leave America's AI-related firms in pole position to serve the US geopolitical bloc and maybe even beyond, while keeping them out of the China bloc.
- At the same time, even if the US and Chinese AI markets are walled off from each other, investors should remember that increased competition within the US bloc's market could weigh on profits as the market develops. There are also positive trends in other sectors of the US economy. That's a key reason why we think investors shouldn't forget the importance of diversification and the potential for better future performance from smaller cap stocks and value stocks.

United States-China: After years of saying it didn't have enough data to say whether the COVID pandemic occurred naturally or from a lab leak in China, the Central Intelligence Agency has released an updated assessment saying it now favors the lab-leak theory, although with only a low level of confidence. The reassessment, ordered by former President Biden last year and released by the new CIA director last week, will likely exacerbate US-China tensions and encourage further economic decoupling between the US and Chinese economies.

China: Yesterday, major property developer Vanke, until now considered the most stable of China's major housing firms, reported a massive fourth-quarter loss of approximately $6.2 billion and announced the resignation of several top officials. Company figures showed the firm suffered a massive drop in new residential sales and falling margins — data that suggests China's housing crisis has now spread to even its strongest developers. A key question going forward is whether the government will step in to help Vanke stay in business.

United States-India: According to the White House, President Trump has told Indian Prime Minister Modi that he wants New Delhi to buy more US weapons to help rebalance trade between the two countries. The request comes as India, the world's biggest arms importer, is trying to diversify its buying away from Russia. That creates a potential opportunity for US defense contractors. However, it's important to note that New Delhi is also trying to expand its own defense industrial base so that it is less reliant on foreign suppliers.

- As we've noted previously, President Trump has reportedly told newly confirmed Defense Secretary Hegseth to prepare for smaller defense budgets, potentially presenting a risk for US defense firms.
- However, Trump's conversation with Modi suggests he may be looking to offset lower US arms orders with increased orders from abroad. That is likely also a reason why

Trump is pushing other US allies to spend more for their own defense, since a lot of that new spending could well be channeled to US suppliers.

- We note, however, that many US allies are still resisting increased defense budgets and/or purchases from the US. In Germany, for example, the namesake leader of the radical left-wing Sahra Wagenknecht Alliance has vowed to block any increase in military spending if her party gains representation in the Bundestag in next month's election. According to opinion polls, the party currently has about 5% support, just enough to enter parliament.

US Monetary Policy: The Fed begins its latest policy meeting today, with the decision due out tomorrow at 2:00 PM ET. The policymakers are widely expected to hold the benchmark fed funds interest rate unchanged at its current range of 4.25% to 4.50%, but surprises are possible given that the annual rotation of committee members will bring new officials to the panel. Chair Powell's post-meeting news conference will be especially important, as investors will be looking for more guidance on the future path of rates.

US Fiscal Policy: The White House's Office of Management and Budget last night ordered executive departments and agencies to pause federal grants, loans and other financial-aid programs pending a review by the new administration. Because of the broad nature of the order, departments and agencies are reportedly confused about what disbursements must be stopped and how long they will be frozen.

- Footnotes to the memo exempted Social Security, Medicare, and other payments made directly to individuals.
- However, that would still leave a vast array of federal payments that could potentially be frozen, from small-business loans to highway funding. A disbursement freeze of that magnitude could be disruptive to the economy and undermine business confidence.

US Trade Policy: According to a *Financial Times* article yesterday, Treasury Secretary Bessent is pushing the Trump administration to back a gradual increase in US import tariffs. Under Bessent's plan, the universal tariffs would rise 2.5% per month until they reach 20.0%, giving firms more time to adjust and creating the opportunity for the US to strike trade deals with foreign countries. Our latest *Bi-Weekly Geopolitical Report* discusses how Bessent's trade policies fit into the overall Trump program of shifting security and prosperity costs to US allies.

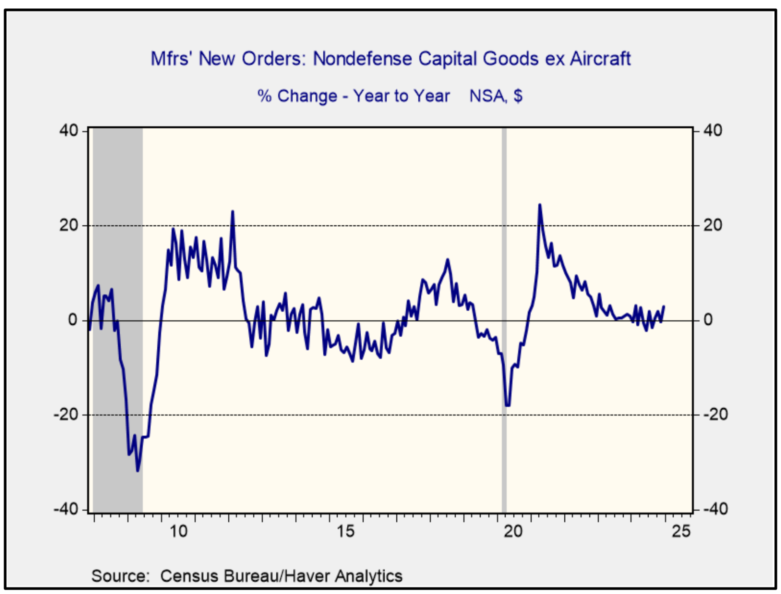
US Health Policy: New reports say Robert Kennedy Jr. is struggling to convince senators to confirm him as Secretary of Health and Human Services because of his controversial stand against vaccines and his support for abortion rights. If Kennedy fails to win confirmation in a vote later this week, healthcare stocks would likely rally, at least until a new nominee is named.

US Commercial Real Estate Industry: According to data providers such as MSCI, sales of US office buildings jumped approximately 20% in 2024 to a total of $63.6 billion. Sales are still much weaker than the annual average of $142.9 billion from 2015 to 2019, but the rebound last year provides further evidence that investors have started trying to take advantage of the distressed industry.

- As we've noted over the last few months, we are seeing increased evidence that buyers are scooping up properties burdened by excessive debt, high interest rates, and low occupancy rates.
- As companies impose more back-to-the-office policies, the new sales could bode well for office-sector real estate investment trusts (REITs) going forward.

US Economic Releases

December ***durable goods*** orders fell by a seasonally adjusted 2.2%, meaningfully less than the expected 0.6% rise and extending the previous month's 2.0% decline. Durable goods orders are often driven by transportation equipment, where just a few airliner orders can have a big impact. December ***durable goods orders excluding transportation*** rose 0.3%, matching the expectation. Finally, the durable goods report also includes a key proxy for corporate capital investment. In December, ***nondefense capital goods orders ex-aircraft*** rose 0.5%, slightly ahead of the expected 0.3% but decelerating from the prior month's 0.9% rise. Compared with the same month one year earlier, overall durable goods orders in December fell 3.8%, while durable orders ex-transport rose 2.5%. Nondefense capital goods orders ex-aircraft rose 3.0%. The following chart shows the progression of nondefense capital goods orders ex-aircraft since just before the Global 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
10:00	Conference Board Consumer Confidence	m/m	Jan	105.9	104.7	***
10:00	Conference Board Present Situation	m/m	Jan		140.2	*
10:00	Conference Board Expectations	m/m	Jan		81.1	*
10:00	Richmond Fed Manufact. Index	m/m	Jan	-10	-10	**
10:00	Richmond Fed Business Conditions	m/m	Jan		14	**
10:30	Dallas Fed Manufacturing Activity	m/m	Jan		9.6	**
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	2.9%	3.0%	3.2%	***	Equity and bond neutral
	Machine tool orders	y/y	Dec F	12.6%	11.2%		**	Equity and bond neutral
Australia	NAB Business Confidence	m/m	Apr	-2	-3		***	Equity and bond neutral
	NAB Business Conditions	m/m	Apr	6	3		***	Equity and bond neutral
EUROPE								
France	Consumer Confidence	m/m	Jan	92.0	89	90	***	Equity and bond neutral
AMERICAS								
Brazil	FGV Construction Costs	m/m	Jan	0.71%	0.51%	0.89%	*	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)	430	429	1	Down
U.S. Libor/OIS spread (bps)	432	431	1	Down
10-yr T-note (%)	4.56	4.54	0.02	Down
Euribor/OIS spread (bps)	264	264	0	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.

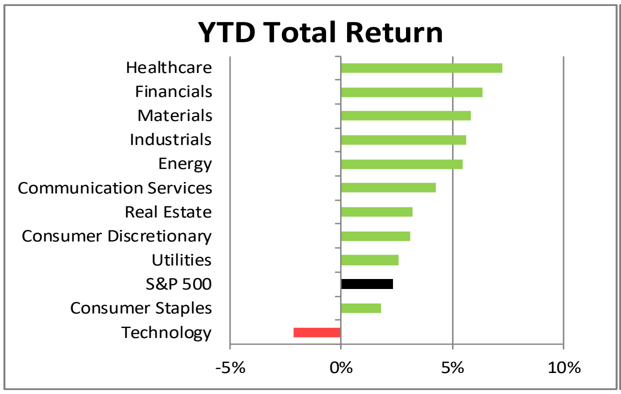
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$77.66	$77.08	0.75%	
WTI	$73.72	$73.17	0.75%	
Natural Gas	$3.59	$3.70	-3.00%	
Crack Spread	$18.04	$17.96	0.45%	
12-mo strip crack	$21.26	$21.04	1.08%	
Ethanol rack	$1.80	$1.80	-0.06%	
Metals				
Gold	$2,745.01	$2,740.81	0.15%	
Silver	$30.17	$30.22	-0.16%	
Copper contract	$426.05	$423.15	0.69%	
Grains				
Corn contract	$484.25	$482.00	0.47%	
Wheat contract	$539.75	$535.50	0.79%	
Soybeans contract	$1,048.25	$1,045.00	0.31%	
Shipping				
Baltic Dry Freight	761	778	-17	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		2.69		
Gasoline (mb)		-0.96		
Distillates (mb)		-3.00		
Refinery run rates (%)		-0.9%		
Natural gas (bcf)		-248		

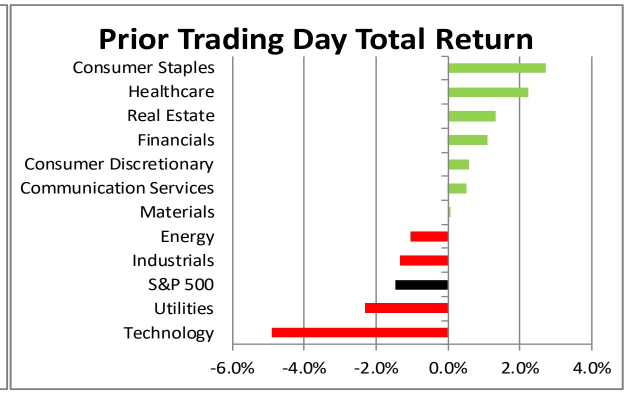
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures in the southern half of the country from the Four Corners region to the East Coast, with cooler-than-normal temperatures on the West Coast and along the northern tier as far east as the Great Lakes. The forecasts call for wetter-than-normal conditions in the entire northern two-thirds of the country, with dry conditions in the Southwest, Florida, Georgia, and the Carolinas.

Data Section

US Equity Markets – (as of 1/27/2025 close)

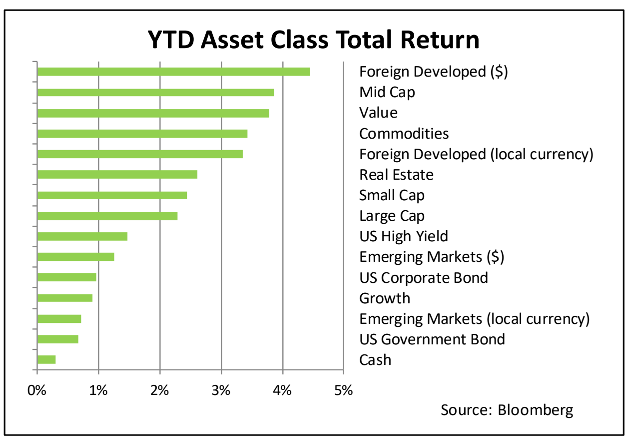




(Source: Bloomberg)

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 1/27/2025 close)

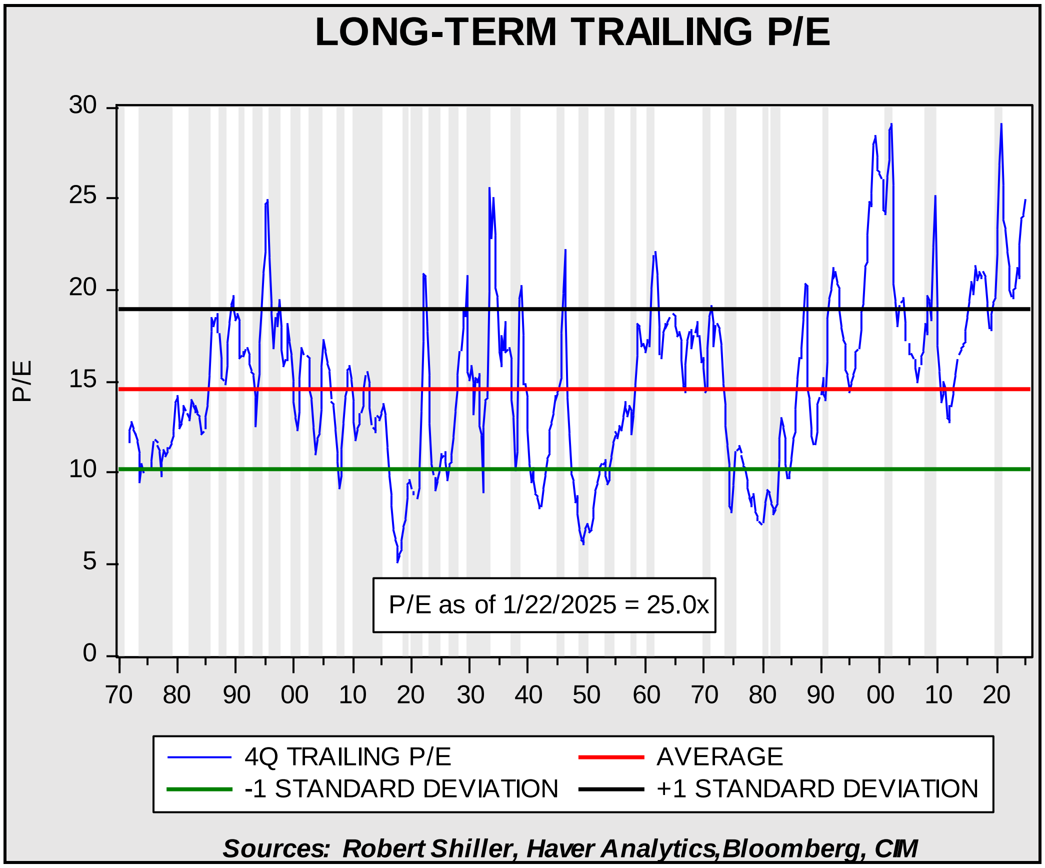


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.