Daily Comment

Confluence Investment Management

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: January 30, 2025 — 9:30 AM ET] Global equity markets are mostly 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 down 0.2% Chinese markets were closed for the Chinese Lunar New Year. US equity index futures are signaling a higher open.

With 112 companies having reported so far, S&P 500 earnings for Q4 are running at $62.50 per share, compared to estimates of $64.79, which is up 11.7% from Q4 2023. Of the companies that have reported thus far, 79.5% have exceeded expectations while 15.2% 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:

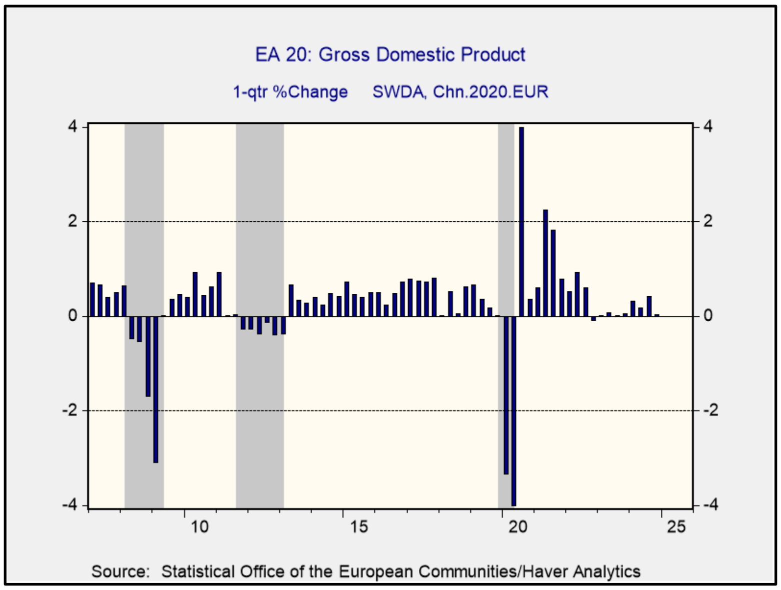
Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
Trump and the Political Economy of Alliances (1/27/25) + podcast	*Magnificent 7 to the Rescue!* (1/21/25) + podcast	**Q1 2025 Report**	*The 2025 Outlook: A Year of Political and Policy Change* *Keller Quarterly* January 2025

Our *Comment* today opens with several notes on the weak economic situation in Europe, which helped spur the European Central Bank to cut interest rates again today. We next review several other international and US developments with the potential to affect the financial markets today, including a new reform of the pension system in Chile and a review of the Federal Reserve's decision yesterday to hold US interest rates steady.

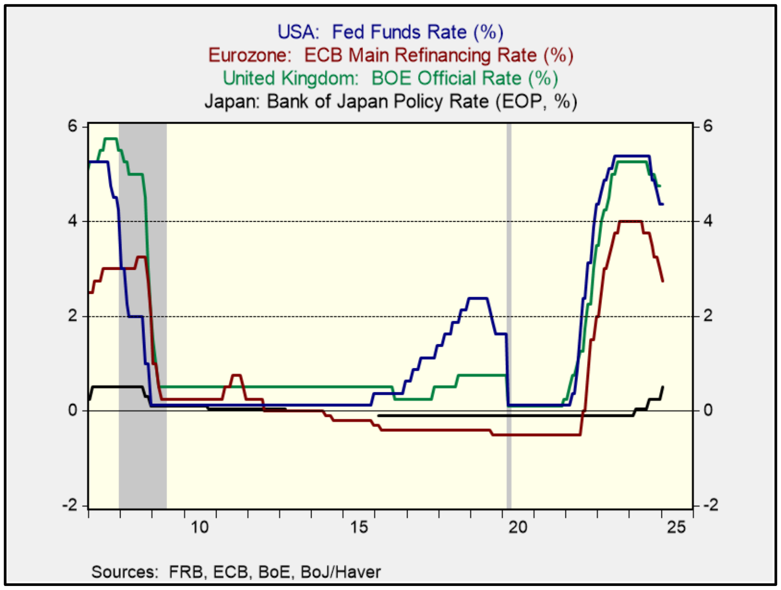
European Union: European Commission President von der Leyen yesterday unveiled the bloc's new "Competitiveness Compass" program, which is aimed at reducing regulations and spurring increased innovation, investment, and economic growth. The plan is geared toward improving the EU's competitiveness in comparison to the booming but increasingly protectionist US economy and the threatening Chinese economy. The plan particularly aims to boost EU activity in cloud computing and artificial intelligence.

- The plan would also reportedly include "Buy European" provisions for public procurement, much the same as the rules that the US and China have implemented favoring domestic producers.
- That would risk running afoul of World Trade Organization rules. However, given Europe's need to compete with the US and China, the EU is prepared to take the chance.

Eurozone Economic Growth: Highlighting the broader EU's economic stagnation, new data shows that the eurozone's fourth-quarter gross domestic product was flat with the third quarter, short of the expected rise of 0.1% and much weaker than the 0.4% gain in the previous period. Compared with the fourth quarter of 2023, the region's GDP was up just 0.9%. The weak growth largely stems from tepid corporate investment and a deteriorating trade balance.



Eurozone Monetary Policy: Consistent with eurozone's stagnant economic growth, the European Central Bank today cut its benchmark short-term interest rate to 2.75% from its previous level of 3.00%, as widely expected. That marked the ECB's fifth rate cut in its last six policy meetings. In addition, since the Fed held its benchmark fed funds rate steady yesterday (see below), the ECB's move increased the rate differential between the eurozone and the US. The euro is nevertheless roughly flat on the day, trading at $1.0410.



Chile: Both houses of the legislature have now approved a major reform of the country's pensions system, whose meager payouts helped prompt mass demonstrations six years ago. The reform will boost employer contributions to the system and promote competition between private-sector pension fund managers. The increase in the system's funds may also help boost activity in the Chilean financial markets.

US Monetary Policy: The Fed yesterday decided to hold its benchmark fed funds short-term interest rate steady at 4.25% to 4.50%. The policymakers also decided to keep reducing the central bank's holdings of Treasury securities, agency debt, and mortgage-backed obligations. Both decisions were widely expected. Importantly, Fed Chair Powell said in his post-decision press conference that the Fed would need to see "real progress on inflation" or unexpected weakness in the labor market before considering further rate reductions.

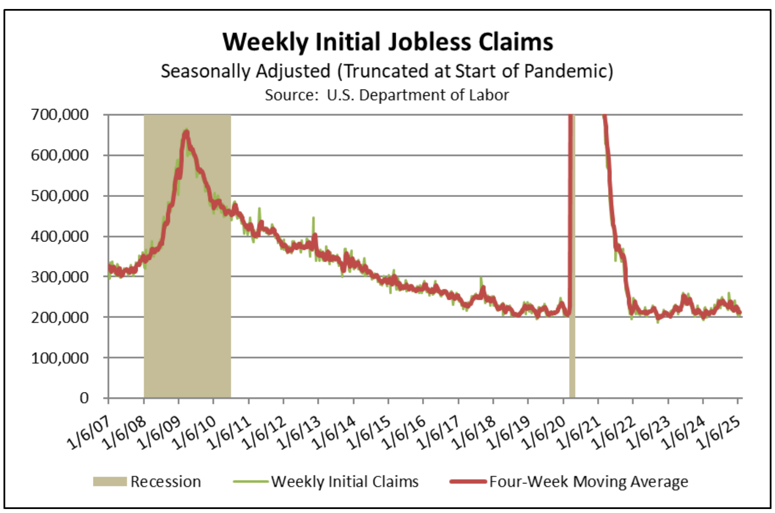
- The policy statement and Powell's press-conference remarks support our view that the monetary policymakers will probably implement only a limited number of rate cuts in 2025. They may even hold rates steady or potentially raise them if inflation pressures rebound.
- In response to the Fed's action, President Trump castigated the policymakers for keeping interest rates too high, suggesting that he will continue to pressure the Fed for more rate cuts in the coming months, even if they would risk a rebound in inflation pressures.

US Fiscal Policy: The federal government's Office of Personnel Management has reportedly been surprised that its anti-diversity directive last week has turned up so few employees to discharge. The directive had required agencies to identify all employees working full-time on diversity, equity, inclusion, and accessibility and prepare to fire them. The Department of Veteran Affairs has identified only 60 such employees, and other agencies have identified far fewer. OPM is now expanding its definition of employees subject to the directive.

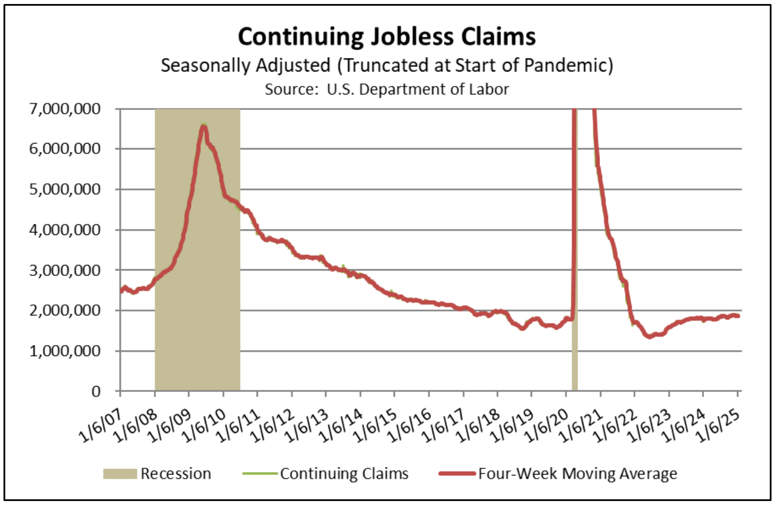
- The failure to identify legions of DEI workers could mean that officials in the new administration had a false understanding of how many such workers were on the federal payroll. It could also reflect some lower-level officials trying to protect their employees. Perhaps more likely, it could be a combination of such factors.
- In any case, the situation suggests that the new administration may find it harder to purge large numbers of federal workers than it expected, especially given the political and legal issues such an effort could entail.

US Economic Releases

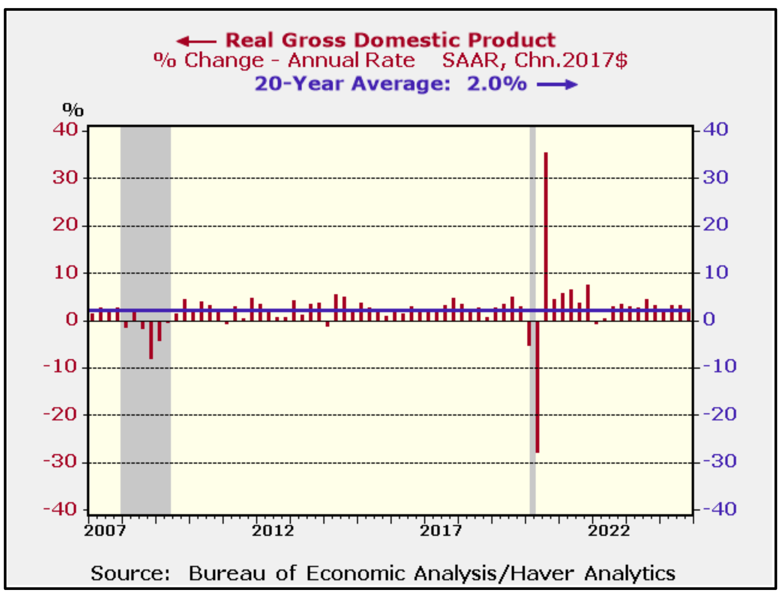
In the week ended January 25, ***initial claims for unemployment benefits*** fell to a seasonally adjusted 207,000, down from the previous week's 223,000 and well short of the expected 225,000. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, fell to a very low 212,500 from 213,500. 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.



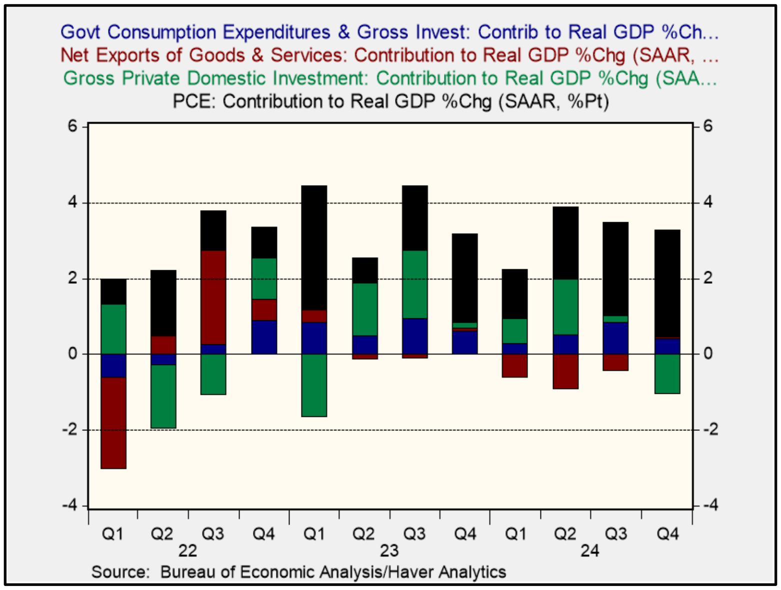
In the week ended January 18, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) fell to 1.858 million, from the previous week's 1.9 million and less than the expected 1.902 million. The four-week average of continuing claims rose to 1.872 million. The 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.



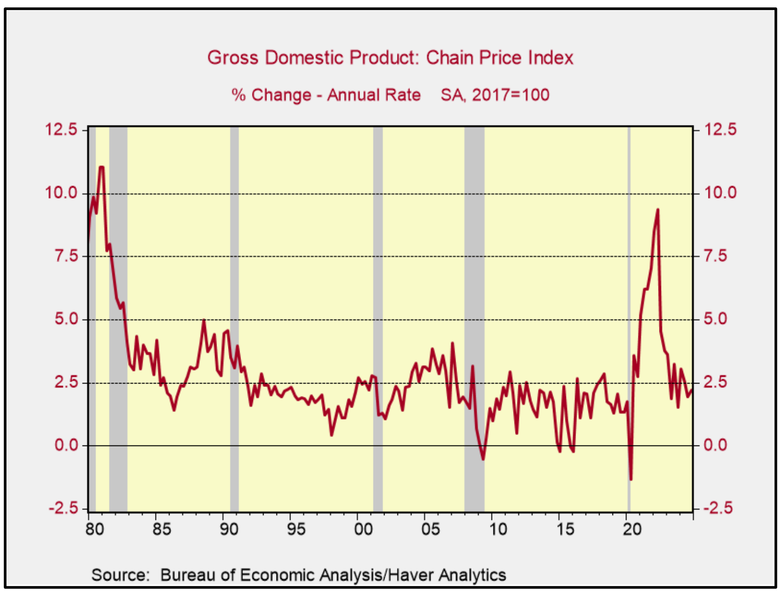
Separately, the Commerce Department released its advance estimate of economic activity in the fourth quarter of 2024. After stripping out seasonal factors and price changes, fourth-quarter ***gross domestic product (GDP)*** rose at an annualized rate of 2.3%, short of the expected 2.6% and marking a deceleration from the third quarter's 3.1%. The chart below shows the annualized growth rate of US GDP since just before the GFC.



A close look at the details in the report shows that personal consumption drove the growth in the fourth quarter, while a shrinkage in the rate of private investment weighed on the result. The chart below shows the contributions to the annualized growth rate in the fourth quarter.



The GDP report also includes the broadest measure of US inflation. The fourth-quarter ***GDP Price Index*** came in at 2.2%, an acceleration from the previous quarter's 1.9% but less than the expected 2.5%. The chart below shows the year-over-year change in the GDP Price Index over the last several decades.



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	Pending Home Sales	m/m	Dec	0.0%	2.2%	**
10:00	Pending Home Sales NSA	y/y	Dec	4.2%	5.6%	*
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	Japan Buying Foreign Bonds	w/w	24-Jan	¥178.0b	¥818.4b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	24-Jan	¥217.2b	¥489.8b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	24-Jan	¥127.2b	¥875.2b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	24-Jan	¥753.0b	-¥69.0b		*	Equity and bond neutral
New Zealand	Exports NZD	m/m	Dec	6.84b	6.42b		**	Equity and bond neutral
	Trade Balance NZD	m/m	Dec	219b	-435m		**	Equity and bond neutral
	Imports NZD	m/m	Dec	6.62b	6.85b		**	Equity and bond neutral
	ANZ Activity Outlook	m/m	Jan	45.8	50.3		*	Equity and bond neutral
	ANZ Business Confidence	m/m	Jan	54.4	62.3		**	Equity and bond neutral
EUROPE								
Eurozone	GDP SA	y/y	4Q A	0.9%	0.9%	1.0%	***	Equity and bond neutral
	Consumer Confidence	m/m	Jan F	-14.2	-14.2		**	Equity and bond neutral
	Economic Confidence	m/m	Jan	95.2	93.7	94.1	***	Equity and bond neutral
	Industrial Confidence	m/m	Jan	-12.9	-14.1	-13.8	***	Equity bullish, bond bearish
	Services Confidence	m/m	Jan	6.6	5.7	6.1	**	Equity bullish, bond bearish
	Unemployment Rate	m/m	Dec	6.3%	6.2%	6.3%	**	Equity and bond neutral
Germany	GDP NSA	y/y	Q4 P	-0.4%	0.1%	-0.3%	**	Equity and bond neutral
	GDP WDA	y/y	Q4 P	-0.2%	-0.3%	0.0%	**	Equity and bond neutral
France	GDP	y/y	Q4 P	0.7%	1.2%	0.8%	**	Equity and bond neutral
Italy	GDP WDA	y/y	Q4 P	0.5%	0.5%	0.6%	**	Equity and bond neutral
	Unemployment Rate	m/m	Dec	6.2%	5.9%	5.7%	**	Equity bearish, bond bullish
	Industrial Sales WDA	y/y	Nov	-2.6%	-5.1%		*	Equity and bond neutral
UK	Net Lending Sec. on Dwellings	m/m	Dec	3.6b	2.5b	2.6b	*	Equity and bond neutral
	Mortgage Approvals	m/m	Dec	66.5k	66.1k	65.0k	***	Equity and bond neutral
	M4 Money Supply	y/y	Dec	2.5%	3.0%		*	Equity and bond neutral
Switzerland	Real Exports	m/m	Dec	5.1%	-7.7%		*	Equity and bond neutral
	Real Imports	m/m	Dec	4.5%	-2.5%		*	Equity and bond neutral
	KOF Leading Indicator	m/m	Jan	101.6	99.6	100.2	**	Equity and bond neutral
Russia	PPI	y/y	Dec	7.9%	3.9%		***	Equity and bond neutral
	Gold and Forex Reserves	m/m	24-Jan	$619.7b	$609.7b		***	Equity and bond neutral
AMERICAS								
Mexico	GDP NSA	y/y	Q4 P	0.6%	1.6%	1.0%	***	Equity and bond neutral
Brazil	FGV Inflation IGPM	y/y	Jan	6.75%	6.54%	6.67%	***	Equity and bond neutral
	Formal Job Creation	m/m	Dec	-535547	106860	-402500	**	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)	418	419	-1	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 (%)	4.50	4.53	-0.03	Down
Euribor/OIS spread (bps)	261	262	-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**	
FOMC Rate Decision (Upper Bound)	4.50%	4.50%	4.50%	On Forecast
FOMC Rate Decision (Lower Bound)	4.25%	4.25%	4.25%	On Forecast
FOMC Rate on Reserve Balances	4.40%	4.40%	4.40%	On Forecast
ECB Deposit Facility Rate	2.75%	3.00%	2.75%	On Forecast
ECB Main Refinancing Rate	2.90%	3.15%	2.90%	On Forecast
ECB Marginal Lending Facility	3.15%	3.40%	3.15%	On Forecast
Bank of Canada Rate Decision	3.00%	3.25%	3.00%	On Forecast
Brazil Selic Rate	13.25%	12.25%	13.25%	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.

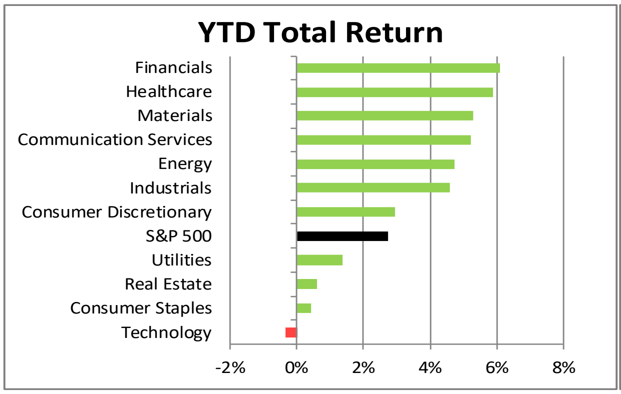
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$76.73	$76.58	0.20%	
WTI	$72.70	$72.62	0.11%	
Natural Gas	$3.19	$3.17	0.57%	
Crack Spread	$18.41	$18.34	0.38%	
12-mo strip crack	$21.20	$21.28	-0.38%	
Ethanol rack	$1.82	$1.81	0.28%	
Metals				
Gold	$2,781.76	$2,759.36	0.81%	
Silver	$31.14	$30.85	0.94%	
Copper contract	$430.55	$428.30	0.53%	
Grains				
Corn contract	$494.25	$497.00	-0.55%	
Wheat contract	$562.25	$562.50	-0.04%	
Soybeans contract	$1,050.75	$1,060.50	-0.92%	
Shipping				
Baltic Dry Freight	726	746	-20	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	3.46	2.19	1.28	
Gasoline (mb)	2.96	0.25	2.71	
Distillates (mb)	-4.99	-2.30	-2.69	
Refinery run rates (%)	-2.4%	-0.8%	-1.6%	
Natural gas (bcf)		-314		

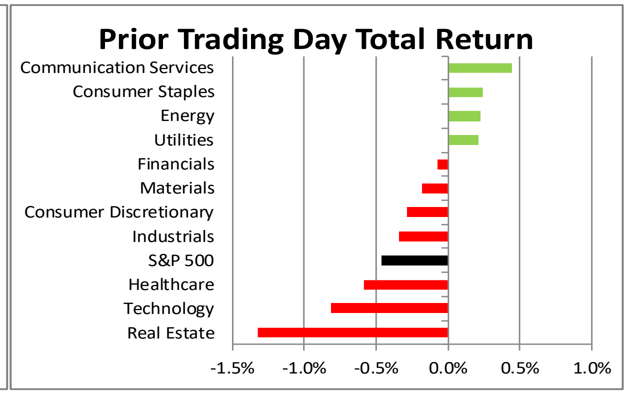
Weather

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 along the entire East Coast and in the southern half of the country to the Four Corners region, 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 across most of the country, with dry conditions in the Desert Southwest and the Gulf Coast.

Data Section

US Equity Markets – (as of 1/29/2025 close)

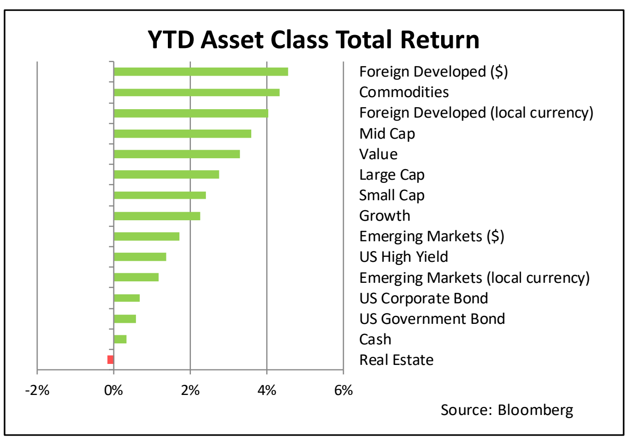




(Source: Bloomberg)

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 1/29/2025 close)

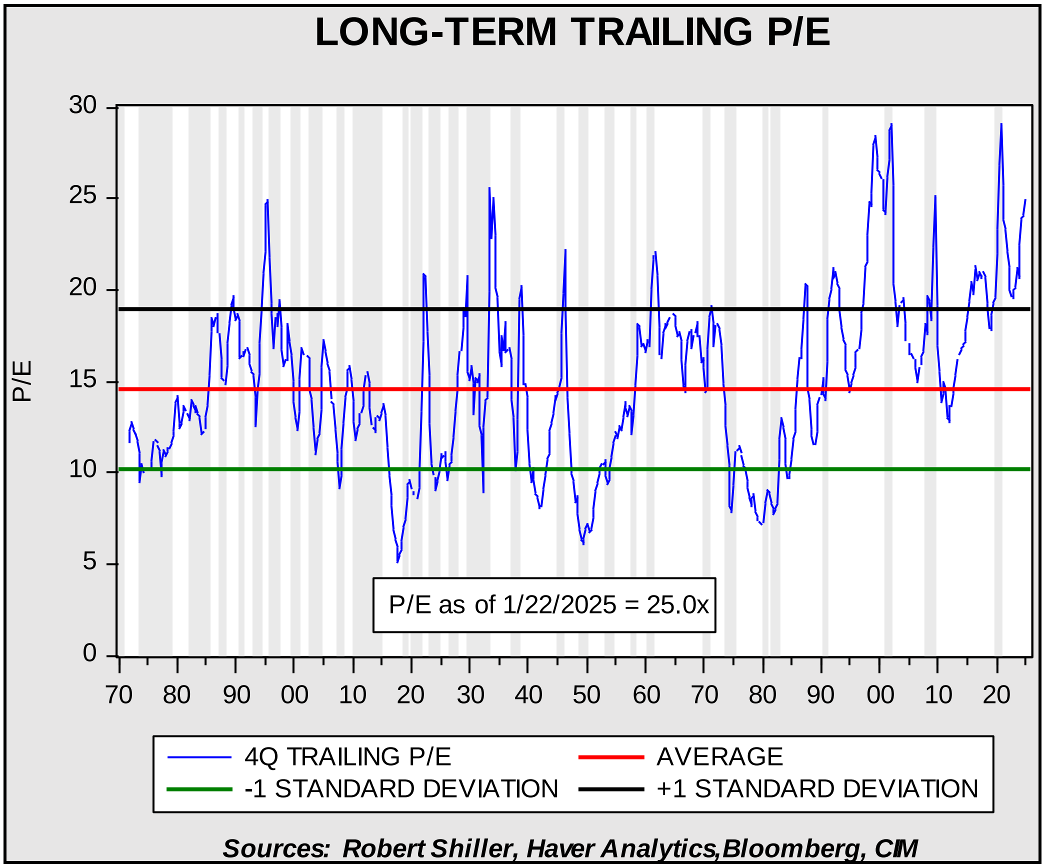


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.

---

[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.