Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: January 31, 2025 — 9:30 AM ET] Global equity markets are mostly higher this morning. In Europe, the Euro Stoxx 50 closed up 0.4% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.5% Chinese markets were closed for the Chinese Lunar New Year. US equity index futures are signaling a higher open.

With 164 companies having reported so far, S&P 500 earnings for Q4 are running at $63.30 per share, compared to estimates of $64.79, which is up 11.7% from Q4 2023. Of the companies that have reported thus far, 79.9% have exceeded expectations while 15.9% 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
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

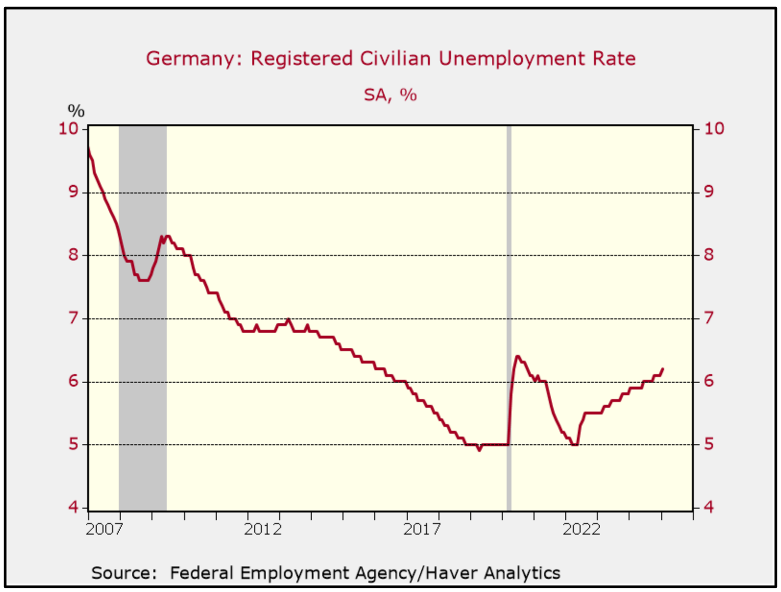
Our *Comment* today opens with news of a massive new command complex being built for the Chinese military — a move the portends further US-Chinese geopolitical and economic tensions over time. We next review several other international and US developments with the potential to affect the financial markets today, including more signs of political and economic change in Germany and a warning from a major hedge fund that the US cryptocurrency market is in a dangerous bubble.

China: According to the *Financial Times*, the Chinese military is building a massive command center and bunker complex on the outskirts of Beijing. The complex will apparently be some 10 times bigger than the Pentagon and should facilitate China's effort to better integrate the various branches of its armed forces. The deep bunkers also underline China's intention to become a more credible nuclear power. In sum, the new facility reflects China's rapid, on-going military expansion and the likelihood of continuing US-China geopolitical tensions.

German Politics: Ahead of next month's elections, the center-right Christian Democratic Union this week won parliamentary approval for a nonbinding resolution to drastically restrict immigration, but only with the support of the far-right Alternative for Germany (AfD) party. The move broke Germany's longstanding taboo against cooperating with the AfD and sets the stage for a possible right-wing coalition after the February 23 elections.

German Economy: German defense contractor Hensoldt, which makes air defense radars, is reportedly negotiating with auto suppliers Bosch and Continental to hire almost 200 of their workers facing layoffs. The talks reflect the changing dynamics in Germany's industrial sector, where defense firms are booming amid today's geopolitical tensions and increased defense budgets, while automotive firms are struggling amid stagnating exports and foreign competition. The talks also help affirm our positive view on European defense stocks.

- On a related note, data today showed Germany's registered unemployment rate rose to a seasonally adjusted 6.2% in January, up from 6.1% in December.
- Excluding the pandemic period, the registered unemployment rate is now at its highest since 2016.



Sweden-Iran: After an anti-Islam campaigner famous for public burnings of the Koran was shot and killed near Stockholm on Wednesday, the Swedish government has indicated it is probing whether the murder was instigated by a foreign power. The most likely government that might attempt such an assassination is probably Iran.

- In any case, if such a connection is confirmed, it would underline the increased aggressiveness of the top authoritarian countries in the China-led geopolitical bloc, including China, Russia, Iran, and North Korea.

- If the murder is linked to a foreign power such as Iran, it would worsen the current geopolitical tensions between Western countries and countries in the China bloc.

Israel-Hamas: While the ceasefire between Israel and Hamas in Gaza continues, Hamas is increasingly making the daily release of Israeli hostages a humiliating, televised spectacle. For example, the militant group is releasing hostages into angry mobs in front of the demolished homes of Hamas leaders killed in the fighting. The tactic creates a risk that Tel Aviv will bring the ceasefire to an end and rekindle fighting around the region.

United States-Canada-Mexico: Even though President Trump yesterday reiterated his intention to slap broad tariffs on imports from Canada and Mexico by Saturday, administration officials are reportedly still talking with Ottawa and Mexico City and may impose only targeted levies. Whether the tariffs are universal or targeted, they could include a grace period before they are formally imposed, and they may rely on existing authorities rather than the novel approaches that officials have floated.

- According to the report, the Mexican government has already agreed to set up a joint task force with the US to tackle cross-border migration and fentanyl trafficking.
- The Canadian government is reportedly still in negotiations with the US to set up a similar task force.

US Fiscal Policy: In the wake of the fatal collision between an American Airlines plane and an Army helicopter in Washington on Wednesday, President Trump yesterday implied that the cause was lax standards and diversity, equity, and inclusion policies under Presidents Biden and Obama. According to Trump, the Federal Aviation Administration under Biden was "actively recruiting workers who suffer severe intellectual disabilities and psychiatric problems and other mental and physical conditions" under DEI initiatives.

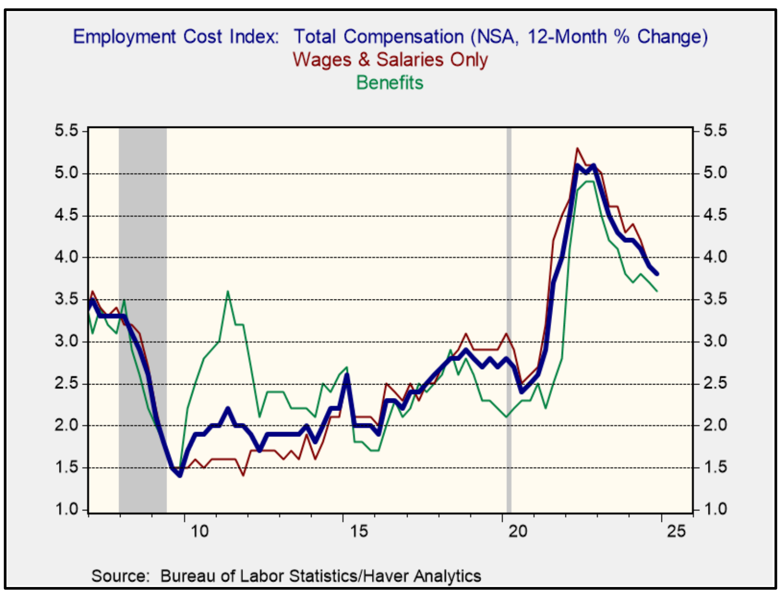
- When asked to provide evidence for his assertion, Trump merely replied, "Because I have common sense."
- Coupled with the new administration's many executive orders against DEI programs and firings of personnel related to DEI initiatives, the statement suggests that DEI has become an all-purpose epithet to justify personnel or program cuts across government.
- We mention this strictly because it could have implications for investors: It now appears that political rhetoric focusing on DEI complaints could well be a useful signal of where the hammer may next fall in terms of top officials about to be fired, program reductions, or broad layoffs under the new administration.

US Cryptocurrency Policy: In an investor letter, hedge fund Elliott Capital Management warns that cryptocurrencies have become the most dangerous asset bubble in today's investment frenzy, not only because of the size that the crypto market has attained, but also because of the Trump administration's support of it. Elliott criticizes crypt assets as having "no substance" and warns that the "inevitable collapse" of the crypto bubble "could wreak havoc in ways we cannot yet anticipate."

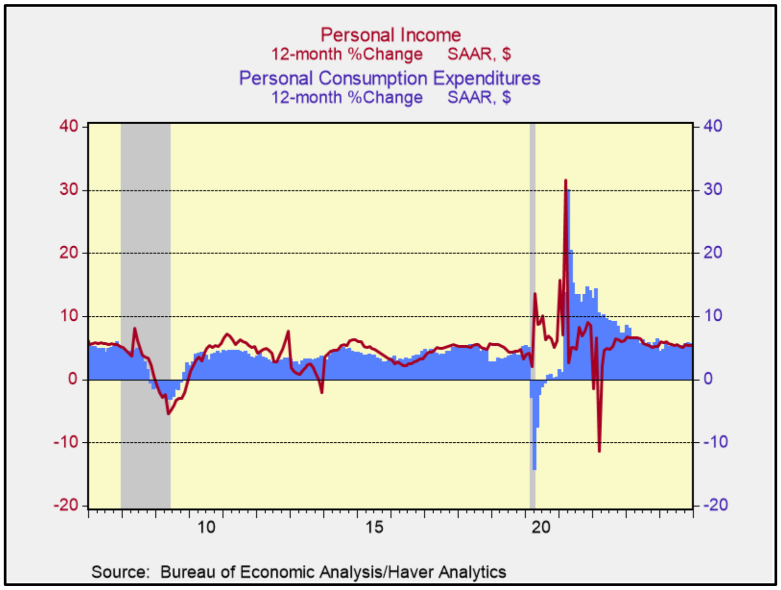
- While it's true that many assets have extremely high valuations today, it's notoriously difficult to identify which assets are in a true bubble, and when any such bubble might burst.
- A key issue is whether a retrenchment in the crypto market would spread to other areas of the financial system. A particular risk would be if banks or other traditional parts of the system have provided leverage to crypto buyers. The crypto winter a couple of years ago revealed only limited problems, but we continue to monitor the markets for any sign that such risky linkages have become more significant now.

US Economic Releases

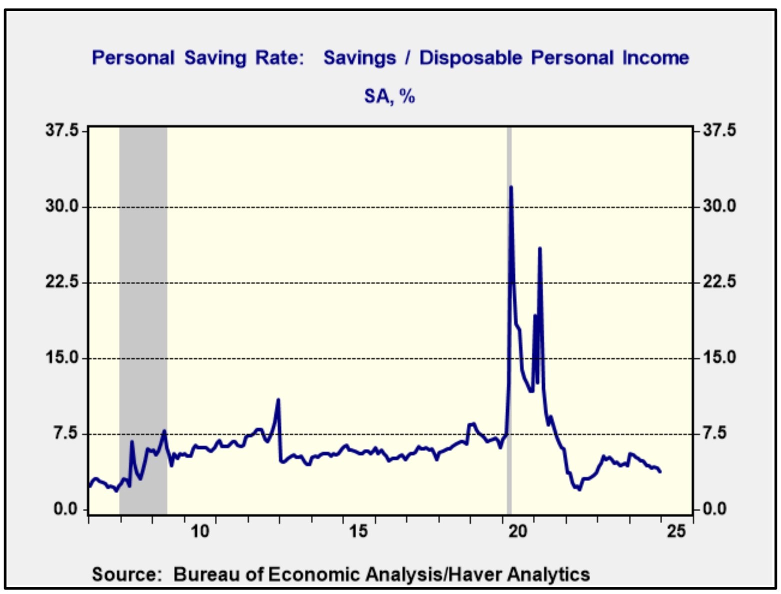
The fourth-quarter ***Employment Cost Index (ECI)*** rose by a seasonally adjusted 0.9%, matching the expectation and slightly exceeding the previous quarter's 0.8%. The subindex on wages and salaries rose 0.9%, while the subindex on benefits rose 0.8%. Compared with the same period one year earlier, the overall ECI in the fourth quarter rose 3.8%. The subindex on wages and salaries rose 3.8% year-over-year, while the subindex on benefits rose 3.6%. The chart below shows the year-over-year change in the ECI since just before the Global Financial Crisis.



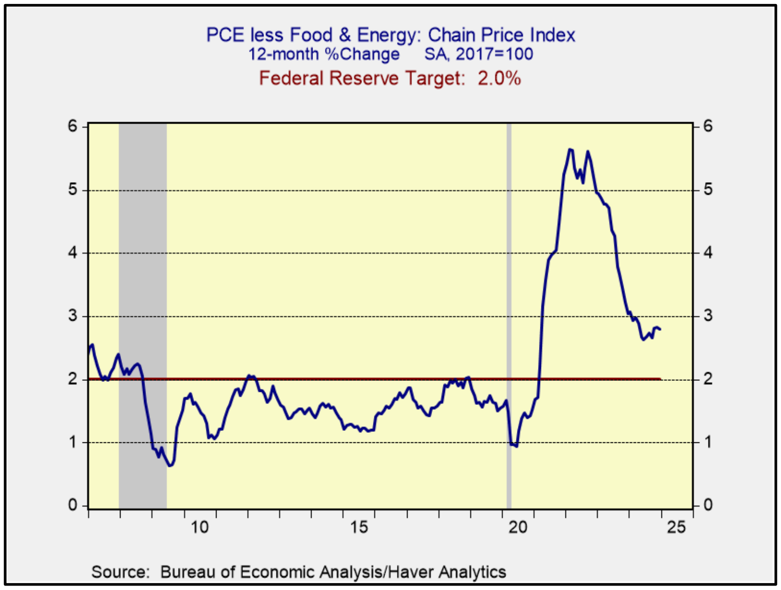
December ***personal income*** rose by a seasonally adjusted 0.4%, matching expectations and slightly exceeding November's 0.3% rise. Meanwhile, December ***personal consumption expenditures (PCE)*** rose 0.7%, exceeding both the expected 0.5% and November's 0.6%. Personal income in December rose 5.3% from the same month one year earlier, while PCE rose 5.7%. The chart below shows the year-over-year change in personal income and PCE since just before the Global Financial Crisis.



The personal income and spending report also includes a measure of personal saving, defined as disposable (after tax) income less consumption spending on goods and services. The December ***personal savings rate*** fell to a seasonally adjusted 3.8% from the prior month's 4.1%. The chart below shows how the personal savings rate has fluctuated since just before the GFC.



Finally, the income and spending report includes the Fed's preferred measure of consumer price inflation. After stripping out the volatile food and energy components, the ***Core PCE Deflator*** for December rose 2.8% from the same month one year earlier, matching expectations and the November result. The chart below shows the year-over-year change in the Core PCE Deflator since just before the GFC.



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

Economic Releases						
ET	**Indicator**			**Expected**	**Prior**	**Rating**
9:45	MNI Chicago PMI	m/m	Jan	40.0	36.9	***
Federal Reserve						
ET	**Speaker or Event**	**District or Position**				
8:30	Michelle Bowman Speaks on Economy and Banks	Member of the Board of Governors				

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	Jobless Rate	m/m	Dec	2.4%	2.5%	2.5%	***	Equity and bond neutral
	Job-To-Applicant Ratio	m/m	Dec	1.3%	1.3%	1.3%	***	Equity and bond neutral
	Tokyo CPI	y/y	Jan	3.4%	3.1%	3.0%	**	Equity and bond neutral
	Tokyo CPI Ex-Fresh Food	y/y	Jan	2.5%	2.4%	2.5%	***	Equity and bond neutral
	Tokyo CPI Ex-Fresh Food & Energy	y/y	Jan	1.9%	1.8%	1.9%	*	Equity and bond neutral
	Industrial Production	y/y	Dec P	-1.1%	-2.7%	-2.2%	***	Equity bullish, bond bearish
	Retail Sales	y/y	Dec	3.7%	2.8%	3.2%	**	Equity and bond neutral
	Depart. Store & Supermarket Sales	y/y	Dec	2.9%	3.5%		*	Equity and bond neutral
	Housing Starts	y/y	Dec	-2.5%	-1.8%	-3.9%	**	Equity and bond neutral
	Annualized Housing Starts	y/y	Dec	0.787m	0.775m	0.777m	*	Equity and bond neutral
Australia	PPI	y/y	4Q	3.7%	3.9%		**	Equity and bond neutral
	Private Sector Credit	y/y	Dec	6.5%	3.3%		**	Equity and bond neutral
New Zealand	ANZ Consumer Confidence Index	m/m	Jan	96.0	100.2		*	Equity and bond neutral
EUROPE								
Germany	Retail Sales	y/y	Dec	1.1%	3.1%	2.6%	*	Equity and bond neutral
	Unemployment Change	m/m	Jan	11.0k	10.0k	15.0k	***	Equity and bond neutral
	Unemployment Claims Rate	m/m	Jan	6.2%	6.1%	6.1%	**	Equity and bond neutral
	CPI	y/y	Jan P	2.3%	2.6%	26.0%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Jan P	2.8%	2.8%	2.8%	**	Equity and bond neutral
France	CPI	y/y	Jan P	1.4%	1.3%	1.5%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Jan P	1.8%	1.8%	1.9%	**	Equity and bond neutral
	PPI	y/y	Dec	-3.8%	-4.7%		*	Equity and bond neutral
Italy	PPI	y/y	Dec	1.3%	-0.7%		**	Equity and bond neutral
UK	Nationwide House Price NSA	y/y	Jan	4.1%	4.7%	4.3%	***	Equity and bond neutral
Switzerland	Real Retail Sales	y/y	Dec	2.6%	1.4%		**	Equity and bond neutral
Russia	Money Supply, Narrow Definition	w/w	24-Jan	18.39t	18.56t		*	Equity and bond neutral
AMERICAS								
Brazil	Primary Budget Balance	y/y	Dec	15.7b	-6.6b	10.4b	*	Equity and bond neutral
	Net Debt % GDP	m/m	Dec	61.1%	61.2%	61.0%	**	Equity and bond neutral
	National Unemployment Rate	m/m	Dec	6.2%	6.1%	6.1%	*	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 (%)	4.53	4.52	0.01	Down
Euribor/OIS spread (bps)	261	261	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.

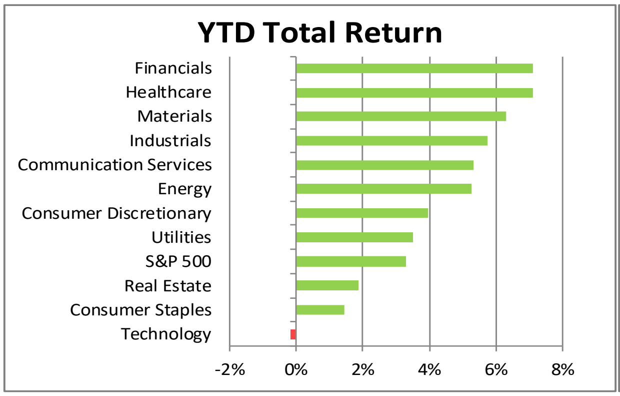
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$76.78	$76.87	-0.12%	
WTI	$72.70	$72.73	-0.04%	
Natural Gas	$3.02	$3.05	-0.75%	
Crack Spread	$19.18	$18.88	1.59%	
12-mo strip crack	$21.61	$21.52	0.41%	
Ethanol rack	$1.82	$1.82	0.05%	
Metals				
Gold	$2,806.79	$2,794.59	0.44%	
Silver	$31.67	$31.60	0.23%	
Copper contract	$428.45	$430.75	-0.53%	
Grains				
Corn contract	$482.00	$490.25	-1.68%	
Wheat contract	$555.50	$566.50	-1.94%	
Soybeans contract	$1,037.25	$1,044.00	-0.65%	
Shipping				
Baltic Dry Freight	715	726	-11	
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)	-321	-313	-8	

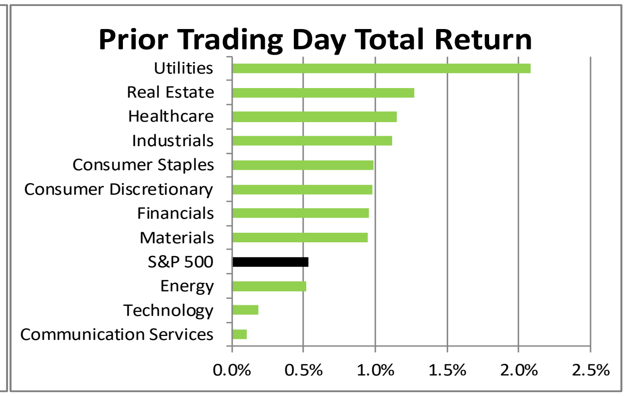
Weather

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 1/30/2025 close)

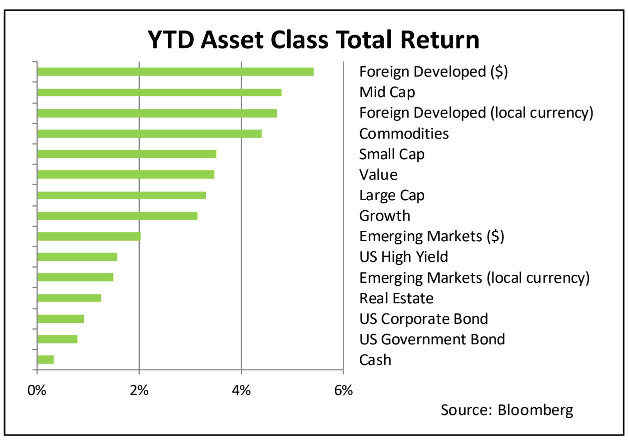




(Source: Bloomberg)

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 1/30/2025 close)

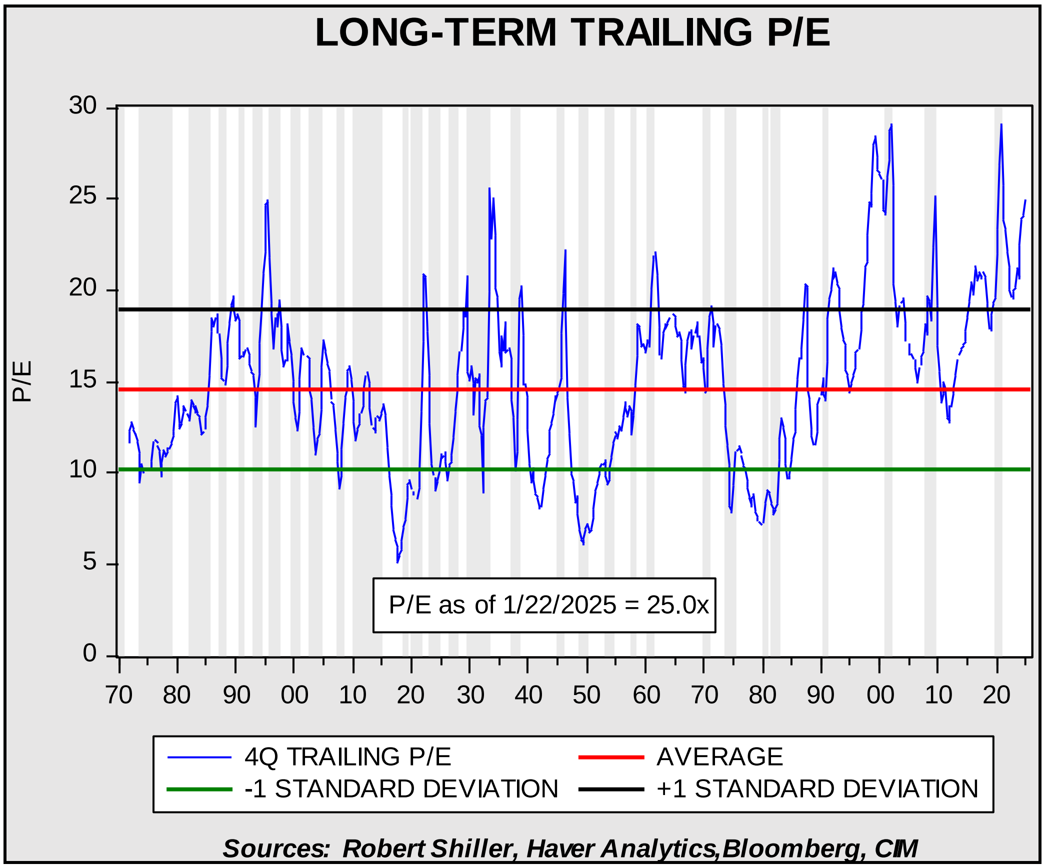


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.