Daily Comment

Confluence Investment Management

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[Posted: January 7, 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 0.5%. Chinese markets were higher, with the Shanghai Composite up 0.7% from its previous close and the Shenzhen Composite up 1.6%. US equity index futures are signaling a higher open.

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
The 2025 Geopolitical Outlook (12/16/24) + podcast	*Household Cash Levels and the S&P 500* (12/9/24) + podcast	Q4 2024 Report Q4 2024 Rebalance Presentation	*The 2025 Outlook: A Year of Political and Policy Change*

Our *Comment* today opens with new US moves to constrain the Chinese economy and military buildup. We next review several other international and US developments with the potential to affect the financial markets today, including some notes on yesterday's resignation of Canadian Prime Minister Trudeau and a positive new outlook for artificial-intelligence darling Nvidia.

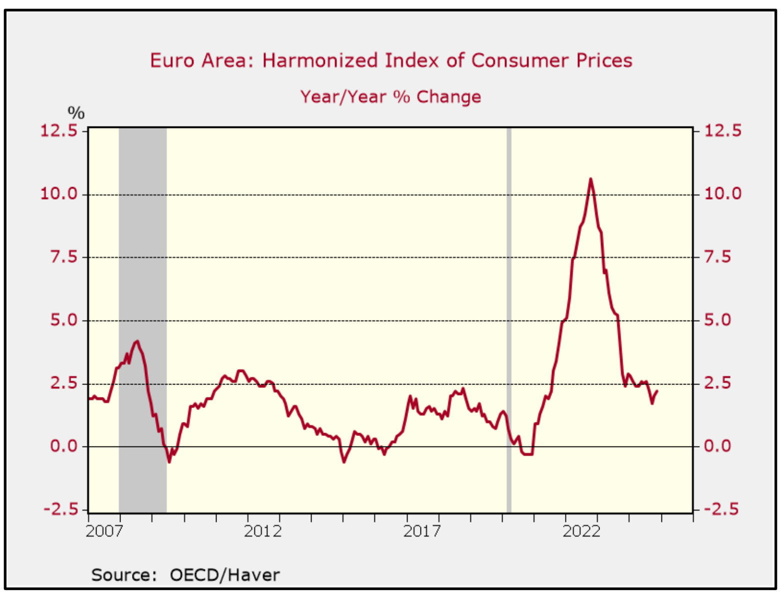
United States-China: The Department of Defense yesterday put a slew of additional high-profile Chinese companies on its list of firms that support the People's Liberation Army. Firms added to the list include social media giant Tencent, electric-vehicle battery maker CATL, and shipping firm COSCO. Companies on the list aren't automatically sanctioned, but Western firms and investors typically become skittish about doing business with them or investing in them.

- The action appears to mark yet another of the Biden administration's parting shots at Beijing and its military.
- Biden's outgoing China hawks may fear that President-elect Trump will be convinced by the Chinese and/or the internationalist business interests in his administration to go soft on Beijing. Indeed, Trump's recent moves on immigration and tariffs suggest he will favor his corporate supporters over the populist nationalists in his coalition.

- As we outlined in our recent *Outlook 2025* report, "Technology Sector Supporters" are a key part of Trump's coalition. This constituency includes many tech leaders who hadn't been close to Trump in the past but are investing heavily to curry favor with him to protect their business interests both domestically and internationally.
- In the latest example of this today, Meta CEO Mark Zuckerberg said Facebook and Instagram will stop fact-checking and end speech restrictions, aligning the platforms with Trump and his incoming administration.

North Atlantic Treaty Organization: In an interview with the *Financial Times* today, the chief of the NATO's military committee said Western rating agencies, banks, and investors are being "stupid" for not investing more in defense companies. Consistent with our own analysis here at Confluence, Adm. Rob Bauer pointed to the huge amounts of new money European governments are pouring into defense rebuilding. We continue to believe that European and Asian defense stocks are especially well positioned to benefit from this new spending.

Eurozone: The December consumer price index was up 2.4% from the same month one year earlier, accelerating from a rise of 2.2% in the year to November and 2.0% in the year to October. Eurozone price inflation has now accelerated for three straight months and remains above the European Central Bank's target of 2.0%. Because of the eurozone's sluggish economic growth, the ECB is still expected to cut interest rates at its January 30 policy meeting, but sticky inflation will complicate the outlook for further rate cuts.



Canada: Prime Minister Trudeau announced his resignation yesterday, finally bowing to his many critics both within his Liberal Party and outside of it. The deeply unpopular Trudeau said he will stay on as prime minister until the party picks his successor, which could take several months. To forestall a no-confidence vote in the meantime, he also suspended parliament.

- Trudeau is the latest of the world's progressive national leaders to lose power over issues such as weak economic growth, high price inflation, burgeoning debt, burdensome new climate regulations, and rising immigration.
- Going forward, Trudeau's resignation leaves Pierre Poilievre and his right-wing Conservative Party in pole position to win Canada's next parliamentary election. If Poilievre were to become prime minister, he would likely push pro-growth policies such as tax cuts and deregulation.

US Monetary Policy: Fed Vice Chair for Supervision Michael Barr yesterday said he will resign his regulatory role in February but will remain on the central bank's board of governors. Barr has pushed for tough bank regulations, raising the prospect of conflicts with the incoming Trump administration and its plan to push for deregulation. Now, that prospect of conflict is much reduced, as Trump will be able to nominate his own vice chair from the other remaining Fed governors.

US International Trade Policy: Yesterday, President-elect Trump denied the *Washington Post's* early morning report that his proposed big import tariffs would be limited to critical goods. True to character, he described the report as "fake news." In response, the US dollar regained much of the value it had lost early in the day, with the US Dollar Index closing down only slightly.

US Economy: According to S&P Global, at least 686 companies in the US filed for bankruptcy in 2024, up about 8% from 2023 and the most since 2010, when filings associated with the Great Financial Crisis peaked at 828 filings. The report is a reminder that despite the US economy's continued strong growth and moderating price inflation, it still has pockets of weakness. High interest rates have probably been one key reason for the rise in business failures.

US Technology Sector: Nvidia CEO Jensen Huang yesterday laid out a future vision for the firm that encompasses not only more growth in its current business of producing chips for developing artificial-intelligence systems, but also "trillions of dollars" of opportunities in areas such as robotics and self-driving vehicles. Given that Nvidia has been such a key driver of the US stock market over the last couple of years, a credible outlook for continued strong growth that can keep the stock's price moving upward is important to the overall US market.

US Financial Services Industry: According to the *Financial Times*, the US private-equity industry is preparing to lobby the incoming Trump administration to broaden the types of investors that can invest in its funds. For example, one deregulation goal would be to allow defined contribution retirement plans, such as 401(k)s, to invest in private-equity funds.

US Economic Releases

The November trade balance showed a seasonally adjusted deficit of $78.2 billion, almost exactly in line with the expected $78.3 billion, but a notable 6.2% expansion from October's $73.6 billion deficit. According to the data, total exports rose 2.6%, while imports rose 3.4%. Compared with the same month one year earlier, exports in November rose 6.6%, while imports rose 9.4%. The chart below shows the monthly change in US exports and imports 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	JOLTS Job Openings	m/m	Nov	7740k	7744k	**
10:00	ISM Services Index	m/m	Dec	53.5	52.1	***
Federal Reserve						
ET	Speaker or Event	District or Position				
8:00	Thomas Barkin Speaks to Raleigh Chamber	President of the Federal Reserve Bank of Richmond				

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	Monetary Base, End of Period	m/m	Dec	¥660.3t	¥667.9t		*	Equity and bond neutral
	Monetary Base	y/y	Dec	-1.0%	-0.3%		**	Equity and bond neutral
Australia	Building Approvals	m/m	Nov	-3.6%	5.2%	-1.0%	***	Equity bearish, bond bullish
China	Foreign Reserves	m/m	Dec	$3202.36b	$3265.86b	$3248.00b	**	Equity and bond neutral
EUROPE								
Eurozone	CPI	y/y	Dec P	2.4%	2.2%	2.4%	***	Equity and bond neutral
	Core CPI	y/y	Dec P	2.7%	2.7%	2.7%	**	Equity and bond neutral
	Unemployment Rate	m/m	Nov	6.3%	6.3%	6.3%	**	Equity and bond neutral
Germany	HCOB Germany Construction PMI	m/m	Dec	37.8	38.0		*	Equity and bond neutral
France	CPI	y/y	Dec P	1.3%	1.3%	1.5%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Dec P	1.8%	1.7%	1.9%	**	Equity and bond neutral
Italy	Unemployment Rate	m/m	Nov	5.7%	5.8%	5.8%	**	Equity and bond neutral
	CPI, EU Harmonized	y/y	Dec P	1.4%	1.5%	1.6%	***	Equity and bond neutral
	CPI NIC Including Tobacco	y/y	Dec P	1.3%	1.4%	1.5%	**	Equity and bond neutral
UK	S&P Global UK Construction PMI	m/m	Dec	53.3	55.2	54.4	**	Equity and bond neutral
Switzerland	CPI	y/y	Dec	0.6%	0.7%	0.6%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Dec	0.4%	0.7%	0.6%	*	Equity and bond neutral
	Core CPI	y/y	Dec	0.7%	0.9%	0.8%	*	Equity and bond neutral
AMERICAS								
Canada	S&P Global Canada Composite PMI	m/m	Dec	49.0	51.5		*	Equity and bond neutral
	S&P Global Canada Services PMI	m/m	Dec	48.2	51.2		*	Equity and bond neutral
Brazil	FGV Inflation IGP-DI	y/y	Dec	6.86%	6.62%	6.75%	**	Equity and bond neutral
	Trade Balance	m/m	Dec	$4803m	$6873m	$3345m	**	Equity and bond neutral
	Exports	m/m	Dec	$24905m	$27842m	$23900m	*	Equity and bond neutral
	Imports	m/m	Dec	$20101m	$20968m	$20913m	*	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 Libor yield (bps)	485	485	0	Down
3-mo T-bill yield (bps)	419	419	0	Down
U.S. Sibor/OIS spread (bps)	429	429	0	Down
U.S. Libor/OIS spread (bps)	432	432	0	Down
10-yr T-note (%)	4.64	4.63	0.01	Up
Euribor/OIS spread (bps)	276	273	3	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.

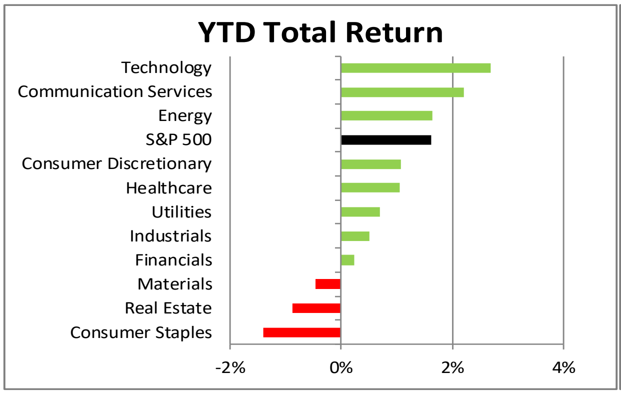
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$77.02	$76.30	0.94%	
WTI	$74.13	$73.56	0.77%	
Natural Gas	$3.63	$3.67	-1.23%	
Crack Spread	$16.31	$16.46	-0.90%	
12-mo strip crack	$19.53	$19.56	-0.12%	
Ethanol rack	$1.77	$1.77	0.12%	
Metals				
Gold	$2,650.00	$2,636.47	0.51%	
Silver	$30.25	$29.96	0.98%	
Copper contract	$418.35	$416.15	0.53%	
Grains				
Corn contract	$455.75	$457.75	-0.44%	
Wheat contract	$540.25	$540.50	-0.05%	
Soybeans contract	$990.00	$997.75	-0.78%	
Shipping				
Baltic Dry Freight	1,043	1,072	-29	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-0.50		
Gasoline (mb)		0.00		
Distillates (mb)		0.00		
Refinery run rates (%)		-0.3%		
Natural gas (bcf)		-128		

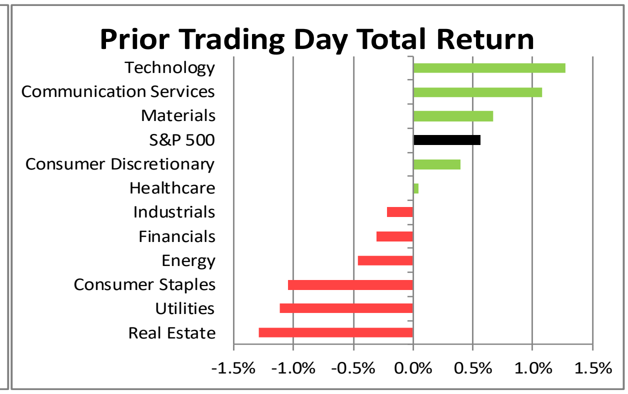
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for cooler-than-normal temperatures to prevail across most of the country from the Rocky Mountains eastward, with normal temperatures elsewhere. The precipitation outlook calls for wetter-than-normal conditions in the northern Great Plains and the Permian Basin, with dry conditions expected in a bubble surrounding Nevada and the northern half of the East Coast.

Data Section

US Equity Markets – (as of 1/6/2025 close)

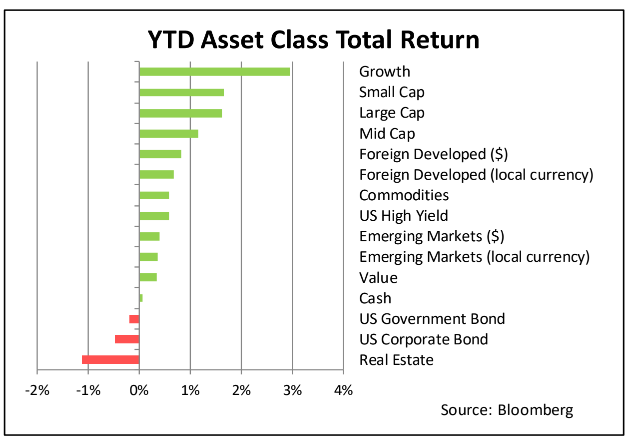




(Source: Bloomberg)

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 1/6/2025 close)

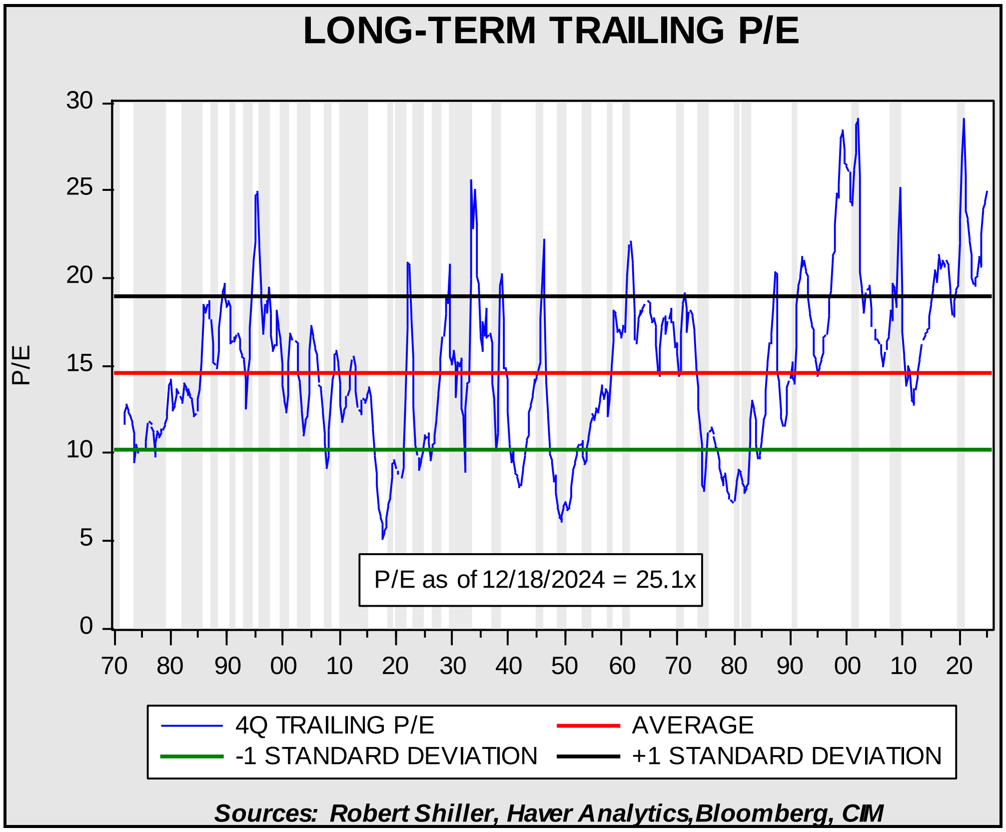


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

December 19, 2024



Based on our methodology,[1] the current P/E is 25.1x, up 0.3 from our last report. The increase in the multiple was due to downward revisions to Q3 earnings and 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.