Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: March 13, 2025 — 9:30 AM ET] Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 closed down 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.1%. Chinese markets were lower, with the Shanghai Composite down 0.4% from its previous close and the Shenzhen Composite down 1.1%. US equity index futures are signaling a lower open.

With 495 companies having reported so far, S&P 500 earnings for Q4 are running at $65.60 per share compared to estimates of $64.79, which is up 11.7% from Q4 2023. Of the companies that have reported thus far, 74.4% have exceeded expectations, while 19.1% 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
"United Arab Emirates: An Overview" (3/10/25)	"Tackling Long-Term Interest Rates" (3/3/25) + podcast	Q1 2025 Report Q1 2025 Rebalance Presentation	The Confluence of Ideas podcast Business Cycle Report

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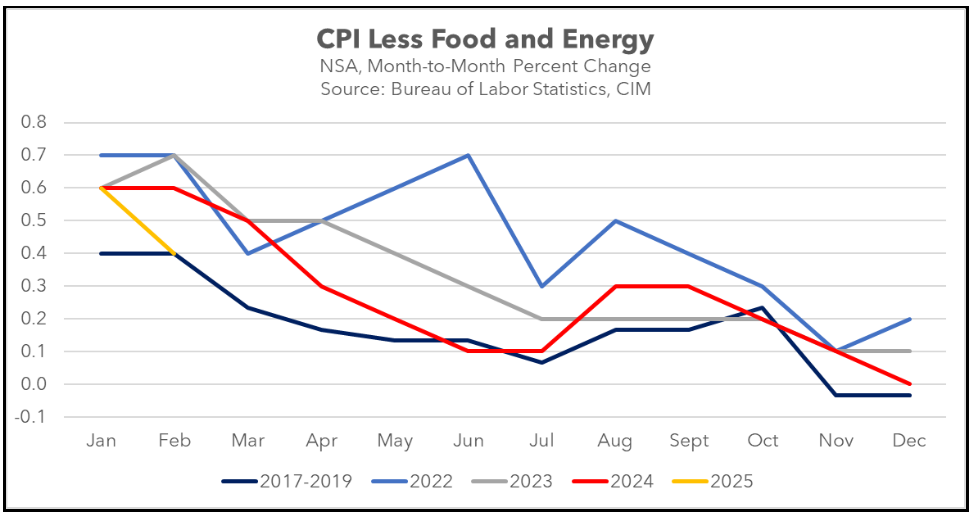
Good morning! The market is currently weighing the possibility of a government shutdown. In sports news, Real Madrid secured a victory over cross-town rivals Atlético Madrid and advanced to the quarterfinals of the Champions League. Today's *Comment* will delve into the bond market's subdued reaction to the latest CPI report, explore why Senate Democrats are engaging in a high-stakes standoff over the stopgap funding bill, and cover other key market-related news. As always, the report includes a summary of domestic and international economic data releases.

CPI Down, Market Shrugs: While the Bureau of Labor Statistics Consumer Price Index (CPI) indicated a better-than-expected inflation reading for February, the bond market's muted response is signaling ongoing investor apprehension regarding tariffs.

- Annual inflation in February surprised to the downside, declining from 3.0% to 2.8%, while core inflation also slowed, dropping from 3.3% to 3.1%. Both figures came in below expectations, as headline inflation was forecast to fall to 2.9% and core inflation was projected to ease to 3.2%. The moderation was driven by cooling shelter costs and declines in the prices of airfare and gasoline. Although egg prices surged 58% year-over-year, they had a negligible overall impact on the index.

- Despite the positive inflation news, concerns over tariffs took center stage. On Wednesday, the US imposed tariffs on steel and aluminum products, a move expected to significantly impact automakers and homebuilders. Furthermore, the prospect of additional tariffs, set to take effect on April 2, raises the risk of renewed price pressures in the near future.
- Despite inflation posting its strongest two-month start since the pandemic, the potential disruption from tariffs has led many investors to refrain from concluding that the fight against inflation will end anytime soon. The 10-year Treasury yield ended the day roughly 3 basis points higher, reflecting growing skepticism that inflation will reach the 2% target this year.

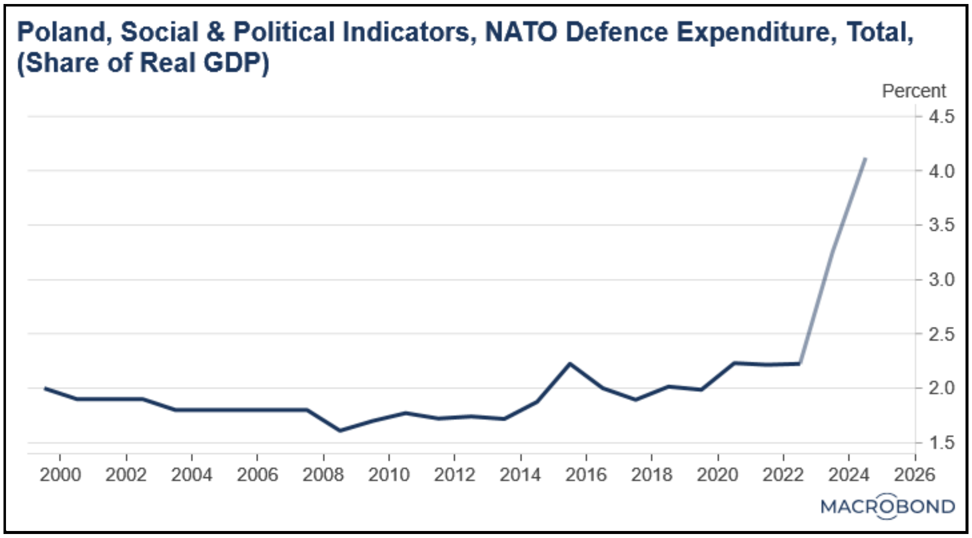


- One area we will be closely monitoring during the trade war is the labor market. We anticipate that firms may attempt to offset profit losses caused by tariffs by reducing their workforce. Such a move could help exert downward pressure on inflation. However, if the labor market remains tight or tightens further due to tariffs, inflation is likely to stay stubbornly elevated.

Polish Nuclear Power? Polish President Andrzej Duda has proposed that the US station nuclear warheads in Poland, reflecting growing global interest in nuclear arsenals amid perceived US reluctance to provide security guarantees.

- Duda believes that President Trump should consider relocating US nuclear warheads currently stored in Western Europe or the United States to Poland as a strategic deterrent against Russian aggression. His proposal aims to revive discussions around nuclear sharing, a dialogue initiated during the previous administration. This initiative comes at a critical juncture, as Eastern European nations seek enhanced security measures to counter potential threats from Russia.

- While it is unclear whether Trump will entertain such a proposal, the idea highlights the deepening anxieties among Eastern European nations regarding the potential fallout from the ongoing Russia-Ukraine conflict. Duda's remarks align with his recent push to increase Poland's military spending to a minimum of 4% of GDP, reflecting a broader effort to strengthen regional security and deterrence capabilities in response to heightened geopolitical tensions.

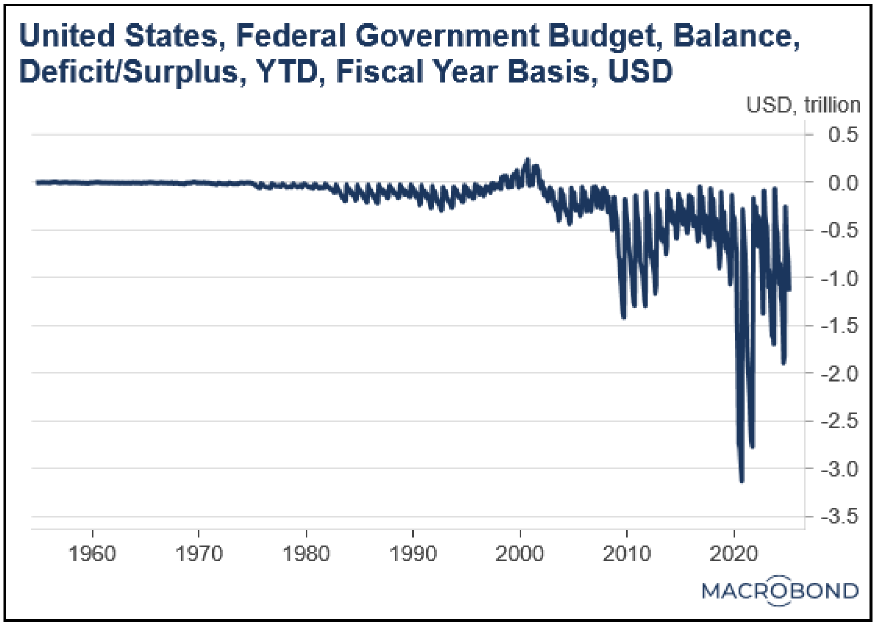


- Poland's proposal to request nuclear weapons from the US highlights a growing trend among nations seeking to fill the security void left by America's apparent reduction in global military engagement. While such a move would be politically untenable in most countries, it reflects a broader strategy for self-preservation, as possessing nuclear capabilities could deter potential invasions and eliminate the prospect of unconditional surrender in the face of aggression.
- This trend may extend beyond Europe, as regions like the Middle East also seek nuclear capabilities for security. A US military pullback could spur nuclear proliferation, risking a global arms race. For investors, this instability could boost commodities, as demand for safe-haven assets like gold and raw materials often rises amid geopolitical uncertainty.

On Second Thought: While it was widely anticipated that Senate Democrats would approve the stopgap measure to fund the government for the next six months, the group ultimately failed to support the legislation. This unexpected setback has significantly increased the likelihood of a government shutdown over the weekend.

- Senate Democrats are advocating for a short-term 30-day stopgap bill, prioritizing their push for specific legislative measures over the longer-term funding proposal put forward by their counterparts. Their refusal to support the extended bill heightens the risk of a government shutdown, which could be averted only if they reconsider their stance before the critical Friday deadline.
- The ongoing standoff between Democrats and Republicans underscores the deepening partisan divide, as both sides struggle to find common ground on reducing the

government deficit. In the first five months of fiscal year 2025, government spending soared to a record $1.147 trillion, including $307 billion from President Trump's first month in office.



- This mounting fiscal challenge underscores the pressing need for bipartisan cooperation, yet the persistent deadlock casts doubt on the government's ability to effectively address its escalating financial obligations. While Democrats currently oppose the measure, there remains a possibility that they could ultimately support it in order to avert the political fallout and economic disruption that would accompany a government shutdown.

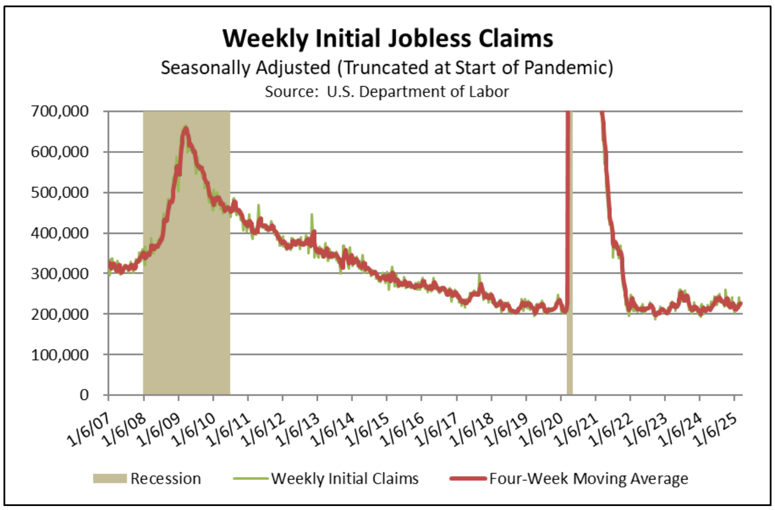
Europe's Borrowing Costs: As EU countries move to significantly increase military spending, the resulting pressure on government budgets is driving up bond yields, compelling the bloc to explore drastic measures to prevent debt from escalating into a long-term economic challenge.

- The potential downgrade by Fitch Ratings has pushed France's 30-year government bond yields to their highest levels in 14 years, as investors react to heightened fiscal concerns. Last month, the ratings agency warned that France might scale back its planned fiscal consolidation following the passage of its budget. These concerns have only intensified since the government pledged to increase defense spending, further straining its financial outlook and raising questions about its long-term debt sustainability.
- France is not alone in facing fiscal pressures, as Germany is also experiencing a sharp rise in long-term bond yields amid plans to significantly increase spending. The yield on Germany's 10-year bund has surged the most in a single week since 1990, following efforts to revise the country's budget rules to accommodate higher defense expenditures.
- One of the key developments to monitor as these countries aim to strengthen their defense capabilities is the potential shift toward a more integrated fiscal union. Recently, Italy has proposed the creation of a European guarantee mechanism, which would

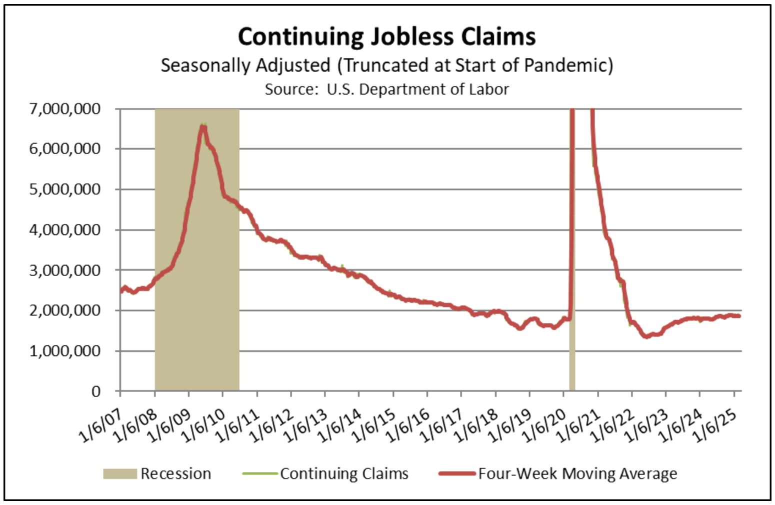
enhance the marketability of bonds issued by countries seeking to increase debt to fund defense initiatives. This implicit backing could make European bonds more attractive to foreign bondholders.

US Economic Releases

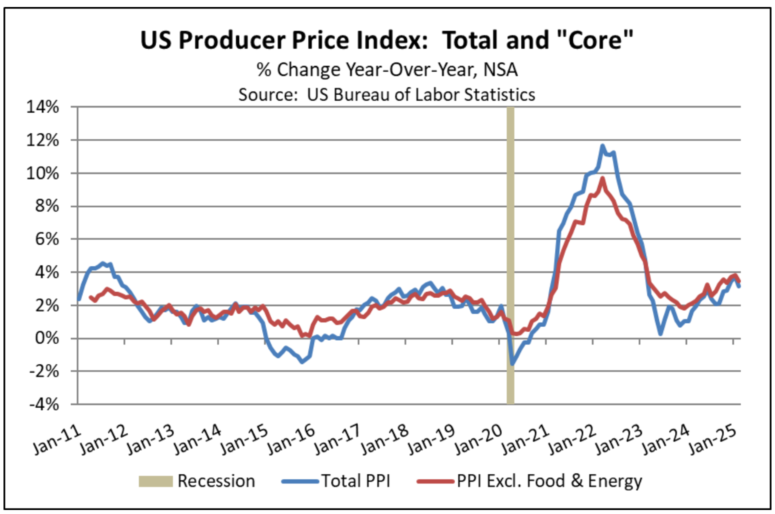
In the week ended March 8, ***initial claims for unemployment benefits*** fell to a seasonally adjusted 220,000, below both the expected level of 225,000 and the previous week's revised level of 222,000. Nevertheless, the four-week moving average of initial claims, which helps smooth out some of the volatility in the series, rose to an 11-week high of 226,000. 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 March 1, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) fell to a seasonally adjusted 1.870 million, lower than both the anticipated reading of 1.888 million and the prior week's reading of 1.897 million. The four-week moving average of continuing claims rose to 1,872,250. 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 February ***producer price index (PPI)*** was unchanged on a seasonally adjusted basis, versus expectations for a 0.3% increase. However, the January PPI was revised upward to show an increase of 0.6% instead of the originally estimated 0.4%. Excluding the volatile food and energy components, the February ***"core" PPI*** declined 0.1%, versus an expected gain of 0.3% and a revised January rise of 0.5%. The overall PPI in February was up 3.2% from the same month one year earlier, while the core PPI was up 3.4%. The chart below shows the annual change in the PPI and core PPI over the last decade or so.



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

Economic Releases						
EST	Indicator			Expected	Prior	Rating
12:00	Household Change in Net Worth	q/q	4Q		$4766b	*
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	7-Mar	-¥355.9b	¥1514.2b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	7-Mar	¥1257.4b	¥626.9b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	7-Mar	¥686.4b	¥776.5b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	7-Mar	-¥220.5b	-¥708.3b		*	Equity and bond neutral
EUROPE								
Eurozone	Industrial Production WDA	y/y	Jan	0.0%	-1.5%	-0.8%	**	Equity bullish, bond bearish
Italy	Unemployment Rate Quarterly	q/q	4Q	6.1	6.3	6.2	*	Equity and bond neutral
UK	RICS House Price Balance	y/y	Feb	11%	21%	20%	**	Equity bullish, bond bearish
Switzerland	Producer & Import Prices	y/y	Feb	-0.1%	-0.3%		**	Equity and bond neutral
Russia	CPI	y/y	Feb	10.1%	9.9%	10.0%	***	Equity and bond neutral
	Core CPI	y/y	Feb	9.6%	9.3%		**	Equity and bond neutral
AMERICAS								
Mexico	Industrial Production	y/y	Jan	-2.9%	-2.7%	-1.7%	***	Equity bearish, bond bullish
	Manufacturing Production	y/y	Jan	-0.8%	-0.6%	0.2%	*	Equity bearish, bond bullish
Brazil	Total Outstanding Loans	m/m	Feb	6462b	4671b	4700b	**	Equity and bond neutral
	IBGE Services Volume	y/y	Jan	1.6%	2.4%	1.5%	*	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	Up
U.S. Sibor/OIS spread (bps)	430	430	0	Down
U.S. Libor/OIS spread (bps)	432	432	0	Down
10-yr T-note (%)	4.34	4.31	0.03	Up
Euribor/OIS spread (bps)	253	255	-2	Down
Currencies	**Direction**			
Dollar	Up	US		Down
Euro	Down	Euro		Up
Yen	Up	Japan		Up
Pound	Down	UK		Up
Franc	Down	Switzerland		Up
Central Bank Action	**Current**	**Prior**	**Expected**	
Bank of Canada Rate Decision	2.75%	3.00%	2.75%	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.

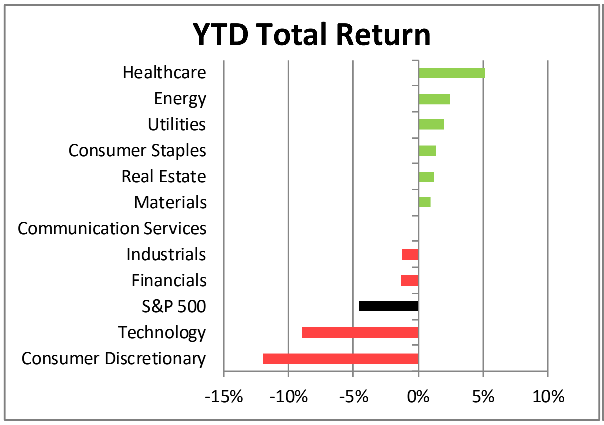
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$70.79	$70.95	-0.23%	
WTI	$67.47	$67.68	-0.31%	
Natural Gas	$4.11	$4.08	0.54%	
Crack Spread	$23.66	$23.43	0.97%	
12-mo strip crack	$20.50	$20.39	0.55%	
Ethanol rack	$1.82	$1.81	0.19%	
Metals				
Gold	$2,945.77	$2,934.77	0.37%	
Silver	$33.18	$33.25	-0.20%	
Copper contract	$483.50	$484.95	-0.30%	
Grains				
Corn contract	$465.00	$460.75	0.92%	
Wheat contract	$559.00	$554.00	0.90%	
Soybeans contract	$1,009.50	$1,000.50	0.90%	
Shipping				
Baltic Dry Freight	1,559	1,436	123	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	1.45	2.00	-0.55	
Gasoline (mb)	-5.74	-1.61	-4.12	
Distillates (mb)	-1.56	0.00	-1.56	
Refinery run rates (%)	0.6%	0.45%	0.2%	
Natural gas (bcf)		-49		

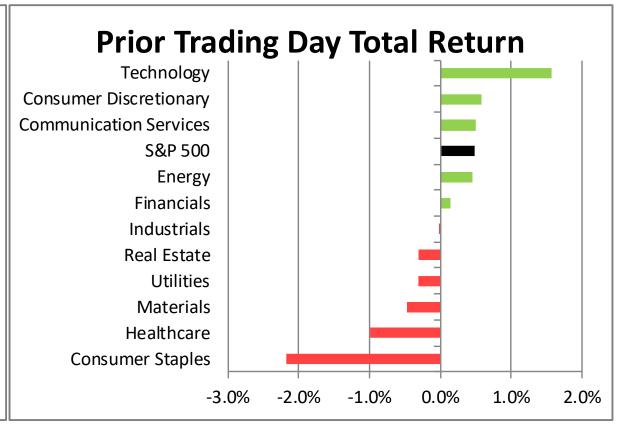
Weather

The 6-to-10 and 8-to-14-day forecasts call for cooler-than-normal temperatures in the Far West, with warmer-than-normal temperatures in the Great Plains, the Midwest, and the Northeast. The forecasts call for wetter-than-normal conditions in the Pacific Northwest, the northern Rocky Mountains, and from the Great Plains eastward, with dry conditions in Texas.

Data Section

US Equity Markets – (as of 3/12/2025 close)

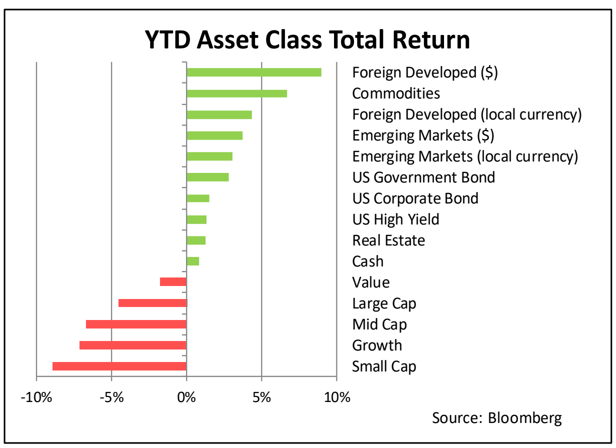




(Source: Bloomberg)

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 3/12/2025 close)

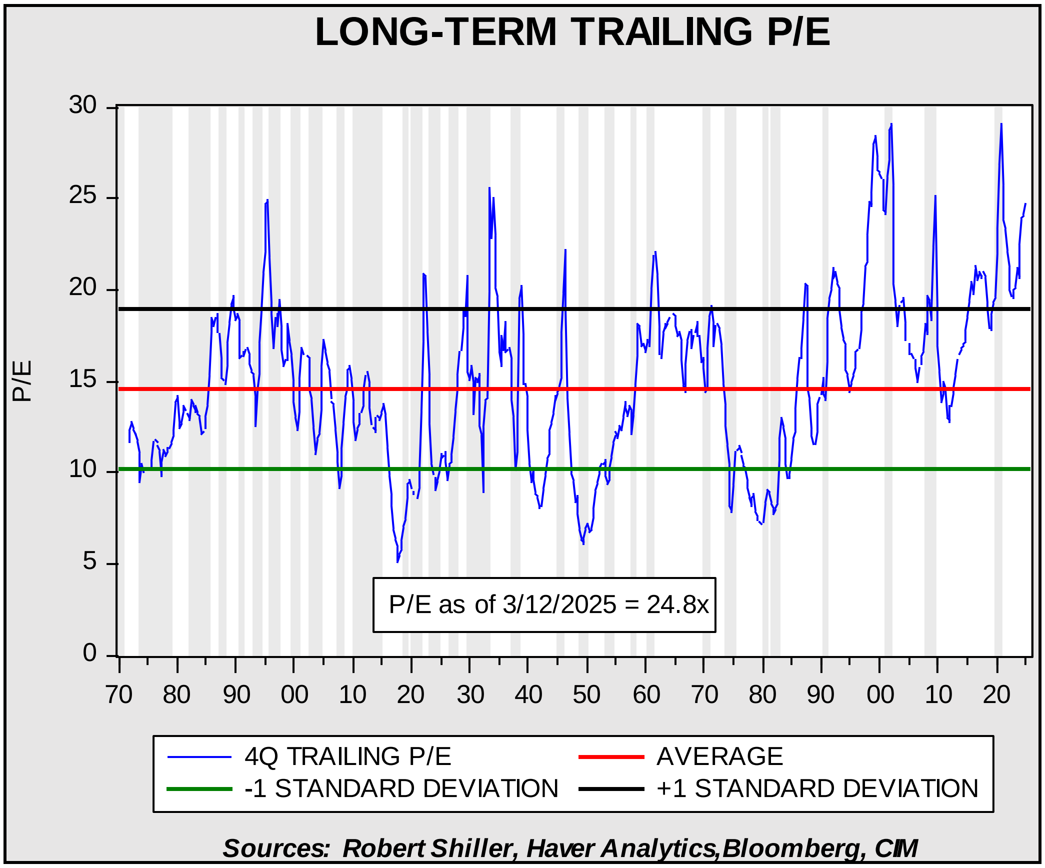


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

March 13, 2025



Based on our methodology,[1] the current P/E is 24.8x, down 0.2 from our last report. The drop in multiple was driven primarily by a decline 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 (Q4). 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.