Daily Comment

Confluence Investment Management

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[Posted: March 17, 2025 — 9:30 AM ET] Global equity markets are generally higher this morning. In Europe, the Euro Stoxx 50 closed up 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.0%. Chinese markets were higher, with the Shanghai Composite up 0.2% from its previous close and the Shenzhen Composite up 0.1%. Conversely, US equity index futures are signaling a lower 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
"United Arab Emirates: An Overview" (3/10/25) + podcast	**"Equities as an Inflation Hedge?" (3/17/25) + podcast**	Q1 2025 Report Q1 2025 Rebalance Presentation	The Confluence of Ideas podcast Business Cycle Report

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Our *Comment* today opens with a note on the Russia-Ukraine war, where Kyiv's forces appear to be on the brink of losing their toehold in the Russian territory of Kursk ahead of planned peace talks. We next review several other international and US developments with the potential to affect the financial markets today, including new details on China's latest economic stimulus plan and several new Trump administration initiatives in the realms of national security and foreign policy.

Russia-Ukraine War: Continuing their accelerated push over the last week, Russian forces this weekend nearly succeeded in reclaiming the Kursk region that the Ukrainians seized last summer to gain leverage in peace negotiations. It appears that Ukrainian forces could be pushed totally out of the Russian region at any moment. In addition, the Russians are reportedly threatening to surround an unknown number of Ukrainian troops remaining in Kursk, which would put Kyiv at a disadvantage during any talks.

South Korea: Shortly before the end of his term in January, President Biden reportedly put South Korea on a special list of countries that the US deems at risk of acquiring nuclear weapons. The Department of Energy confirmed the designation on Friday, suggesting that the

Trump administration has endorsed the move. The news comes one month after South Korean Foreign Minister Cho Tae-yul said that Seoul has not taken nukes "off the table," but that it has no specific plans to develop them right now.

- As we've noted before, rising geopolitical tensions and the US's growing reluctance to meet its mutual defense promises under various treaties have begun to prompt a range of countries to consider developing their own nuclear weapons.
- In recent polls, some 70% of South Koreans have said they want their own nukes. To block such a move, the Biden Administration in 2023 struck a deal under which Seoul would put any such effort on ice in return for stronger US security guarantees.
- Biden's designation of South Korea as a proliferation-sensitive state suggests that some political or military leaders in Seoul are still tempted by the possibility, which in turn would likely destabilize the Asia-Pacific region.

China: The State Council today provided a few more details on how the government will implement General Secretary Xi's vow to "vigorously boost consumption" and "expand domestic demand in all directions." According to State Council officials, the government will focus on raising incomes, stabilizing the real estate and stock markets, and improving medical and pension services. However, the officials gave few details on the actual planned spending, suggesting the latest stimulus program will again be too modest to truly boost growth.

- Separately, the state statistics agency said retail sales in January and February were up 4.0% from the same period one year earlier, accelerating from the 3.7% increase in the year to December.
- In response to the stimulus program and retail sales data, Hong Kong stocks today have posted a modest rise, while stocks in mainland China declined slightly.

United States-Yemen: The Trump administration on Saturday launched a series of strong airstrikes against the Iran-backed Houthi rebels in Yemen. According to military officials, the strikes are an escalation from those of the Biden administration and are expected to last up to several weeks to degrade the rebels' ability to attack shipping in the Red Sea. Along with the strikes, President Trump also warned Iran that it must cease providing aid to the rebels.

- The US strikes came after the Houthis last Tuesday said that they would resume attacks on Israeli ships in the Red Sea, the Arabian Sea, the Bab el-Mandeb Strait, and the Gulf of Aden, ending a period of relative calm that began in January with the Gaza ceasefire.
- The strikes also came just days after Iran's supreme leader, Ayatollah Ali Khamenei, rejected a Trump suggestion of talks aimed at stopping the country's nuclear program.

US Military: Late last week, Defense Secretary Hegseth directed that the Pentagon's storied Office of Net Assessments be dismantled. Under the order, military personnel working in ONA will return to their service and be reassigned, civilians will be moved to "mission critical" offices, and ONA contracts will be cancelled. The deputy secretary will then be tasked with developing a plan to rebuild ONA in a manner consistent with Hegseth's priorities.

- Since being established in 1973, the ONA has operated as a kind of Pentagon think tank to identify and analyze long-term national security trends and lay the groundwork for strategies to respond to them.
- Hegseth's dismantling of the ONA seems to adopt a "burn it down, then rebuild" approach to reforming the office. While the move is likely to produce near-term cost savings, it is also being panned for potentially creating a period when military planners won't have an authoritative, deeply researched perspective to rely on.
- Coupled with other recent moves, such as directing large cuts in the defense budget and ordering massive job cuts at the Pentagon and CIA, pulling the plug on the ONA adds to the evidence that fiscal consolidation and bureaucratic reforms are President Trump's highest priorities — perhaps much higher than even near-to-medium term national security.

US Foreign Policy: Over the weekend, President Trump announced that he has signed an executive order to slash funding and essentially shut down the US Agency for Global Media, which runs the Voice of America, Radio Free Europe/Radio Liberty, and Radio Free Asia. Those Cold War-era organizations were designed to beam uncensored information to closed societies, such as China and Russia, and to promote US values globally.

- According to Trump, the move to close down USAGM was necessary to save US taxpayers from supporting "radical propaganda."
- In the latest federal fiscal year, USAGM's budget was about $890 million.

US Trade Policy: The American Chamber of Commerce to the European Union today warned that the Trump administration's draconian tariffs could hamper up to $9.5 trillion in US-European transactions. According to the Chamber, the developing trade war threatens not only the $1.3 trillion or so in trans-Atlantic goods trade, but also the $750 billion in trans-Atlantic services trade and some $7.5 trillion in sales by US and European cross-border affiliates.

- For example, the Chamber warns that either the US or the Europeans could retaliate for the other side's goods tariffs by slapping tariffs on the other side's services.
- Potentially more problematic, US companies with affiliates in Europe could find their European operations hindered by any tariffs on imported US inputs, and vice versa. That could discourage further foreign direct investment by the US firms in Europe or by European firms in the US.

US Visa Policy: The *New York Times* over the weekend said that the Trump administration is considering a list of 43 countries whose citizens would be barred or restricted from visiting the US. The long list includes countries such as Cuba, North Korea, Afghanistan, Belarus, and Somalia. The extensive list is even broader than the list of countries that Trump used to bar foreigners in his first term.

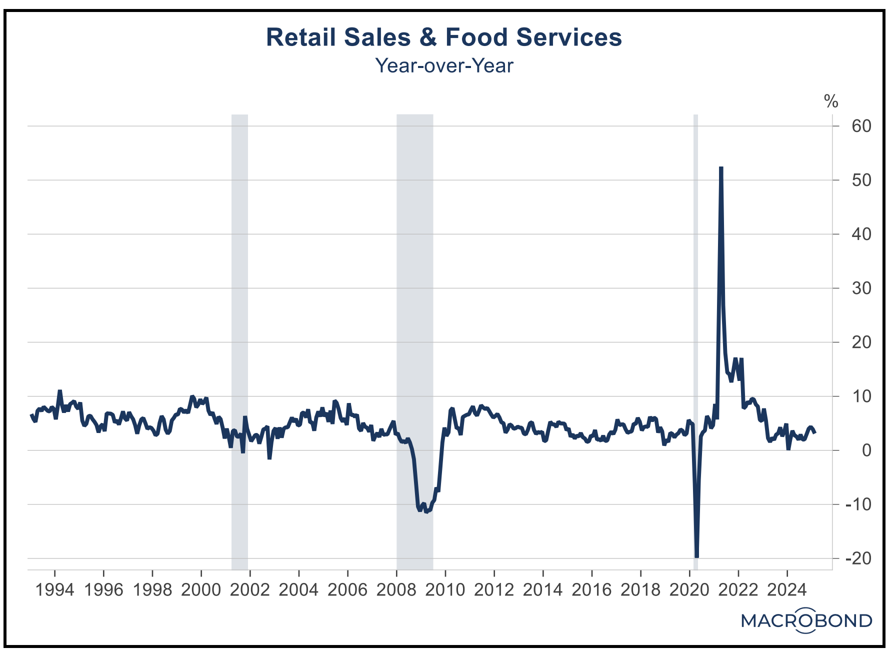
US Monetary Policy: Tomorrow, the Federal Reserve starts its latest two-day policy meeting, with its decision scheduled to be released on Wednesday at 2:00 PM ET. The policymakers are widely expected to hold their benchmark fed funds interest rate unchanged at its current range of 4.25% to 4.50%. Futures trading suggests that investors are now expecting two or three rate cuts of 25 basis points each this year, but the policymakers may hold their fire until consumer price inflation cools further, economic growth slows sharply, or both.

US Stock Market: In an interview yesterday, Treasury Secretary Bessent downplayed the significance of the US stock market slipping into a correction last week, saying simply that, “corrections are healthy . . . They’re normal.” The nonchalant tone of Bessent’s statement adds to the evidence that President Trump isn’t nearly as concerned now about market downturns as he appeared to be in his first term.

- Rather, it increasingly looks like the administration is willing to tolerate even steep declines in stock prices for what it sees as long-term economic benefits.
- Reflecting that realization, stock futures as of this writing are pointing to another day of falling prices.

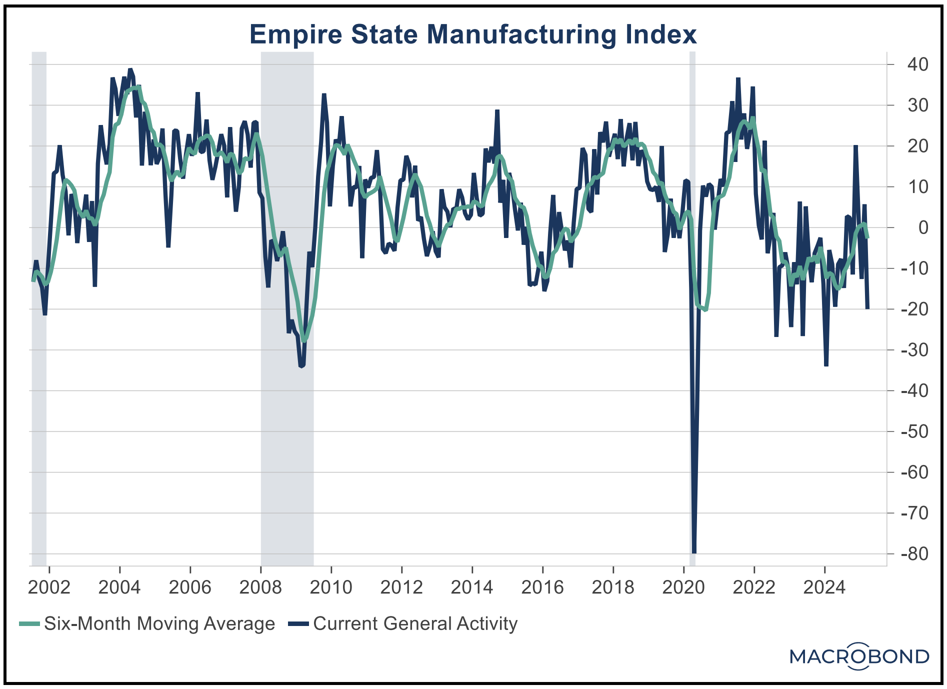
US Economic Releases

US retail sales showed signs of recovery in February, reflecting continued economic momentum despite lingering doubts. According to the Commerce Department, ***retail sales*** rebounded from a 0.9% decline in January to a modest 0.2% increase in February. ***Excluding autos***, sales rose by 0.3%, while ***core sales***, which also exclude gasoline, saw a stronger gain of 0.5% during the same period. Notably, the ***retail sales control group*** — which excludes autos, gasoline, and building materials — posted a solid 1.0% increase from the previous month.



The chart above illustrates the annual change in retail sales, which grew by 3.1% compared to the previous year. While this marks a slowdown from January's 4.2% year-over-year increase, the February rebound suggests resilience in consumer spending. The uptick in sales is likely to bolster market confidence, reinforcing the view that the economy remains on an expansionary path despite January's weak performance.

Manufacturing activity in the New York region contracted sharply in March, according to the latest survey by the Federal Reserve Bank of New York. The ***NY Empire State Manufacturing Index*** plummeted from +5.7 in February to -20.0 in March, signaling a significant slowdown in the sector.



The chart above illustrates the Empire State Manufacturing Index alongside its six-month moving average. The moving average declined from +1.1 to -2.7, indicating a shift from modest expansion to contraction in regional manufacturing activity.

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

Economic Releases						
EST	**Indicator**			**Expected**	**Prior**	**Rating**
10:00	Business Inventories	m/m	Jan	0.3%	-0.2%	*
10:00	NAHB Housing Market Index	m/m	Mar	42.0	42.0	*
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								
China	Industrial Production	y/y	Feb	5.9%	5.3%		***	Equity and bond neutral
	Retail Sales YTD	y/y	Feb	4.0%	3.8%		**	Equity and bond neutral
	Fixed Assets Ex Rural YTD	y/y	Feb	4.1%	3.2%		**	Equity and bond neutral
India	Trade Balance	m/m	Feb	-$14050m	-$22990m	-$21350m	**	Equity and bond neutral
	Exports	y/y	Feb	-10.9%	-2.4%		**	Equity and bond neutral
	Imports	y/y	Feb	-16.3%	10.3%		**	Equity and bond neutral
	Wholesale Prices	m/m	Feb	2.38%	2.31%	2.27%	*	Equity and bond neutral
EUROPE								
Italy	CPI, EU Harmonized	y/y	Feb F	1.7%	1.7%	1.7%	***	Equity and bond neutral
UK	Rightmove House Prices	y/y	Mar	1.00%	1.40%		**	Equity and bond neutral
Switzerland	Domestic Sight Deposits CHF	w/w	14-Mar	440.7b	435.9b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	14-Mar	448.5b	444.1b		*	Equity and bond neutral
Russia	Trade Balance	m/m	Jan	7.2b	5.6b	10.1b	**	Equity and bond neutral
	Exports	m/m	Jan	29.2b	31..b	39.4b	*	Equity and bond neutral
	Imports	m/m	Jan	22.1b	25.7b	29.3	*	Equity and bond neutral
AMERICAS								
Canada	Manufacturing Sales	m/m	Jan	1.7%	0.5%	2.0%	**	Equity and bond neutral
	Wholesale Sales ex Petroleum	m/m	Jan	1.2%	0.3%	1.80	**	Equity bearish, bond bullish
Brazil	Economic Activity Index	y/y	Jan	3.58%	2.60%	2.35%	**	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	419	0	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 (%)	4.29	4.31	-0.02	Up
Euribor/OIS spread (bps)	248	250	-2	Down
Currencies	**Direction**			
Dollar	Up	US		Down
Euro	Down	Euro		Up
Yen	Up	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.

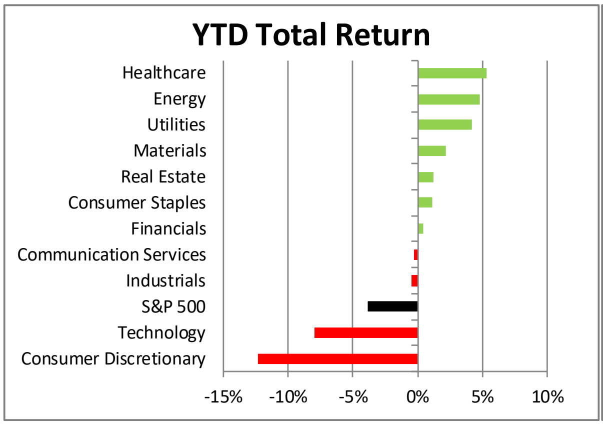
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$71.54	$70.58	1.36%	
WTI	$68.14	$67.18	1.43%	
Natural Gas	$4.18	$4.10	1.85%	
Crack Spread	$23.78	$23.31	2.00%	
12-mo strip crack	$20.49	$20.19	1.52%	
Ethanol rack	$1.83	$1.83	-0.18%	
Metals				
Gold	$3,000.08	$2,984.16	0.53%	
Silver	$33.80	$33.80	0.02%	
Copper contract	$492.35	$489.60	0.56%	
Grains				
Corn contract	$464.25	$458.50	1.25%	
Wheat contract	$568.50	$557.00	2.06%	
Soybeans contract	$1,016.75	$1,016.00	0.07%	
Shipping				
Baltic Dry Freight	1,669	1,650	19	

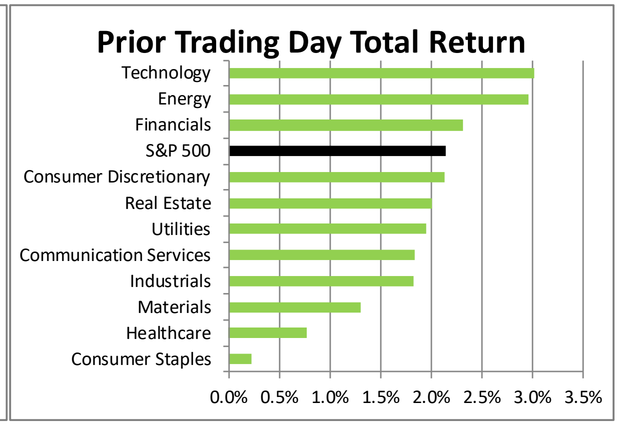
Weather

The 6-to-10 and 8-to-14-day forecasts predict warmer-than-normal temperatures for most of the country, with cooler temperatures expected in the Great Lakes region. The forecasts also indicate wetter-than-normal conditions in the Northern Rocky Mountain region and along the East Coast, while dry conditions are expected in the Southwest and most of the Midwest.

Data Section

US Equity Markets – (as of 3/14/2025 close)

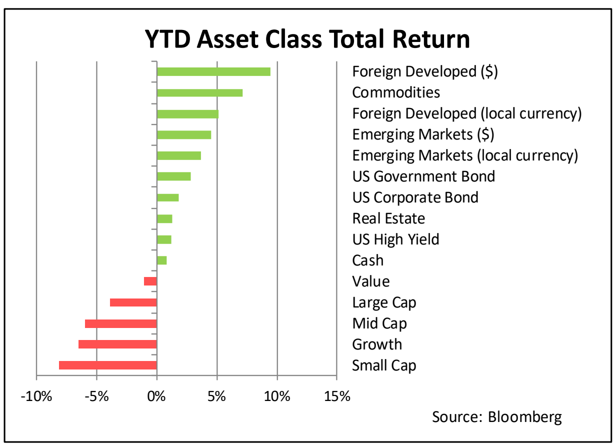




(Source: Bloomberg)

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 3/14/2025 close)

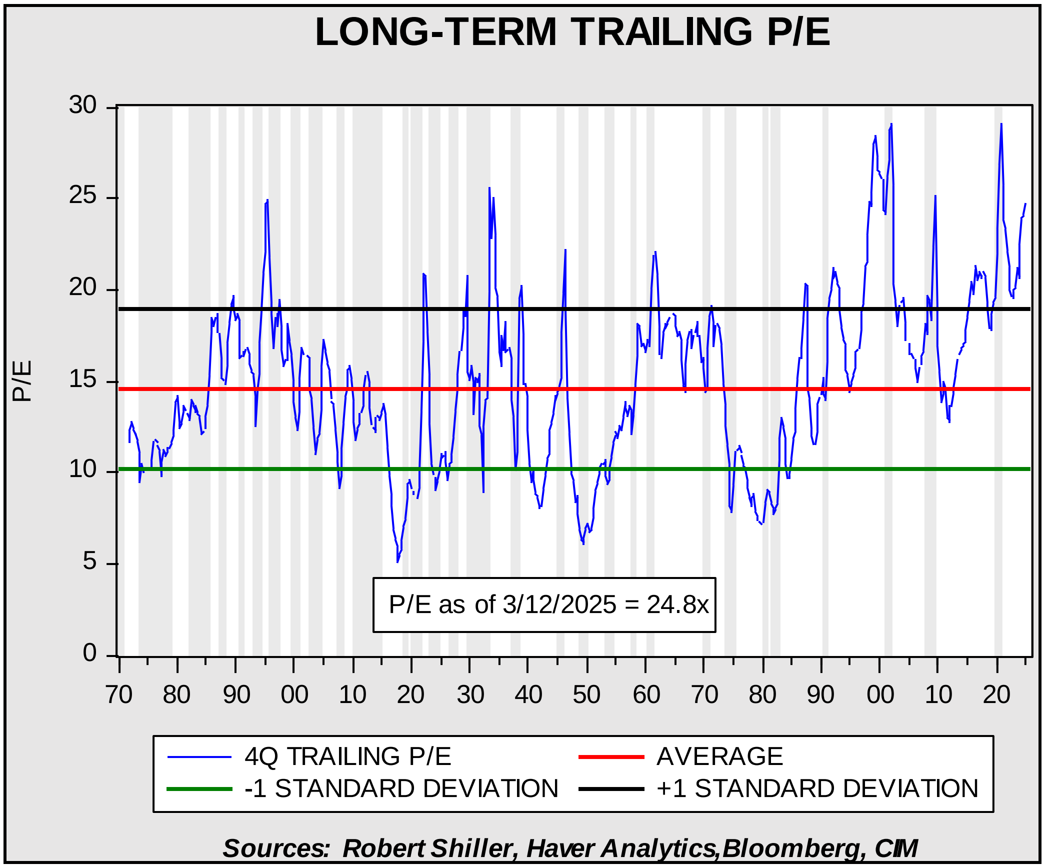


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.

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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 (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.