Daily Comment

Confluence INVESTMENT MANAGEMENT

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[Posted: March 20, 2025 — 9:30 AM ET] Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 closed down 1.0% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.3%. Chinese markets were lower, with the Shanghai Composite down 0.5% from its previous close and the Shenzhen Composite down 0.6%. 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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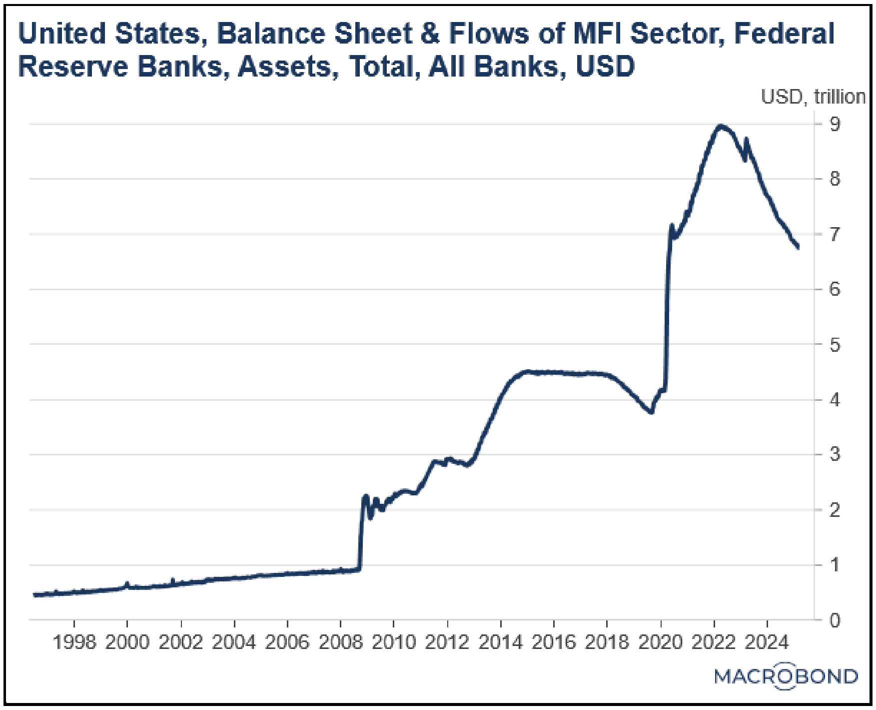
Good morning! The market is currently processing the latest decision from the Federal Reserve. In sports news, Duke University is bound to let college basketball fans down again in the NCAA Men's Basketball Tournament this year — whether they win or lose. In today's *Comment*, we'll delve into the Fed's latest rate decision, explore the growing pressures on chipmakers to establish operations in the US, and cover other key market developments. As always, we'll also provide a comprehensive roundup of the latest international and domestic data releases.

Team Transitory Is Back! While Federal Reserve officials have revised their inflation forecasts upward, they have kept the possibility of rate cuts on the table, maintaining their view that tariffs will only have a limited impact on inflation.

- The FOMC unanimously voted to maintain the federal funds rate target range at 4.00%-4.25%. However, Christopher Waller dissented regarding the Quantitative Tightening (QT) policy (specifically the reduction of the Fed's balance sheet runoff from $25 billion to $5 billion monthly), preferring to continue with the original pace.
- Fed officials cited increased uncertainty in the economic outlook, which led them to revise their year-end projections. Core PCE inflation was revised upward to 2.8% from

2.5%, the unemployment rate forecast was raised to 4.4% from 4.3%, and the GDP growth projection was lowered to 1.7% from 2.1%.

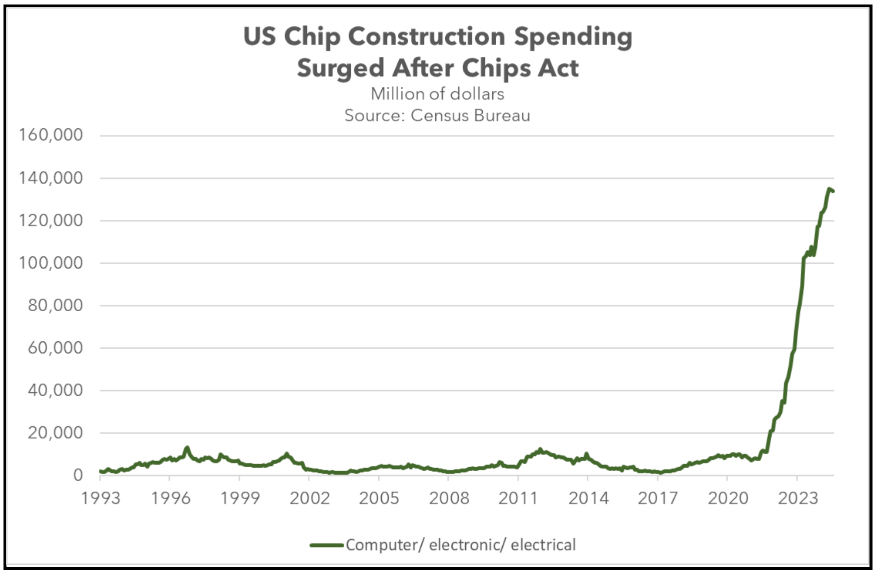
- During the press conference, Fed Chair Jerome Powell acknowledged that the central bank viewed tariffs as a potential driver of higher inflation throughout the year, which could hinder the Fed's progress toward its inflation target. When questioned about whether the Fed would raise interest rates in response to tariff-induced inflation, Powell emphasized that if the inflationary pressure is temporary and expected to dissipate on its own, tightening monetary policy would not be an appropriate response.



- Regarding quantitative tightening, Powell stated that the Fed intends to slow the pace of its balance sheet runoff to prolong the reduction process. However, he emphasized that this adjustment in pace does not signal any broader implications for future monetary policy decisions. He reiterated that the central bank would continue to shrink the balance sheet until reserves decline from their current abundant levels to what the Fed considers an ample level.
- The latest Federal Reserve meeting suggests that the central bank is poised to take a cautious, wait-and-see approach to monetary policy. While we still anticipate no more than two rate cuts this year, the likelihood of no cuts at all has risen as the economic impact of tariffs begins to materialize in key data. In response, the Fed may explore alternative measures, such as an earlier-than-expected halt to its balance sheet reduction program, in order to alleviate long-term rates.

Nvidia Invests: The chipmaker announced a multi-billion-dollar plan to build US manufacturing facilities for chips and electronics over the next four years, reflecting a broader shift among tech firms to relocate production domestically amid efforts to strengthen US supply chains.

- The [AI semiconductor leader plans to manufacture a significant portion of its systems in the US,] partnering with key suppliers such as Taiwan Semiconductor Manufacturing Company (TSMC) and Foxconn. This strategic shift reflects the company's response to escalating geopolitical risks, particularly growing threats from China. During the announcement, CEO Jensen Huang emphasized that the move would strengthen US supply chain resilience and reduce dependency on foreign manufacturing.
- The shift toward US manufacturing comes amid growing concerns about tech companies' reliance on production facilities in Taiwan. Rising tensions between China and Taiwan, including Beijing's increasingly assertive stance toward the self-governing island, have sparked fears of a potential invasion. Such a move could severely disrupt global supply chains, leaving companies dependent on Taiwanese factories exposed to significant risks.



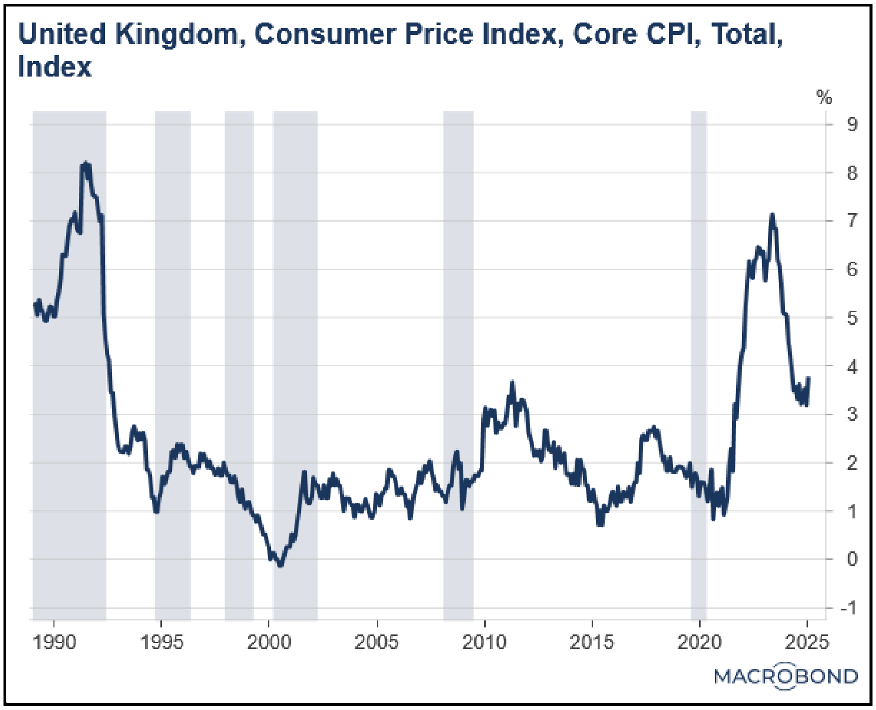
- To mitigate these concerns, construction spending in the US for computer, electronic, and electrical manufacturing has surged since 2022, fueled primarily by the CHIPS Act. The legislation has offered companies tax incentives and subsidies to accelerate the relocation of manufacturing facilities to the US. A significant portion of these investments has been directed toward states like Arizona, New York, and Ohio, where new factories are being built.
- While the current administration has aimed to build on this trend, it seeks to do so more cost-effectively by leveraging tariffs. President Trump argues that the government should not rely on financial incentives to encourage domestic manufacturing. Instead, companies should be motivated to build domestically to avoid tariffs.
- Despite President Trump's opposition to the CHIPS Act, there has been no significant policy reversal, indicating that the law is likely to remain in place. As a result, tariffs are expected to serve as the "stick" to complement the CHIPS Act's "carrot," as the US aims to expand its domestic chipmaking capabilities, reduce reliance on Taiwan, and better compete with China.

Election Date Set? Canadian Prime Minister Mark Carney is expected to announce this week that elections will be held on April 28. The campaign is likely to center on how best to address an increasingly assertive US without jeopardizing the economy or triggering a recession.

- Carney's decision to call for an election appears to be strategically motivated, as his Liberal Party has surged ahead of the opposition Conservative Party in recent polls. According to the latest data from Mainstreet Research Canada, the Liberals have a 61.4% chance of securing an outright majority in the upcoming election. They are projected to win approximately 179 out of 338 seats, while the Conservative Party is expected to trail behind with 127 seats, placing them in the minority.
- The reason for this shift has been driven by Canadians' dislike of President Trump following comments that Canada should become a US state. Current polls show that the number of Canadians with very/somewhat positive views of the US has dipped from 52% in June 2024 to 33% as of March of this year. In comparison, people with positive views of China improved from 29% to 30%, within the same time frame.
- A recent poll indicates Mark Carney is seen by many Canadians as best equipped to handle the nation's challenges, edging out Pierre Poilievre 36% to 34%. Carney's strong name recognition, despite limited public understanding of his detailed policies, appears to be a key asset. Conversely, Poilievre's populist rhetoric has led to comparisons with Trump, potentially hindering his appeal.
- Ironically, it is Poilievre who has emerged as the most vocal critic of Trump, pledging to lessen Canada's economic dependence on trade with the US. In stark contrast, Carney has taken a more pragmatic approach, openly conceding that Canada cannot sustainably engage in or escalate a tit-for-tat trade war with its powerful neighbor. This nuanced stance has seemingly resonated with Trump, who has publicly expressed a preference for working with Carney over Poilievre.
- The upcoming election is likely to intensify ongoing trade tensions between the US and Canada. While recent momentum has favored Carney, we anticipate that his support will begin to wane as the vote approaches. Consequently, we would not be surprised if Poilievre pulls off an upset or if neither party secures an outright victory. That said, a majority government in Canada would be viewed favorably by financial markets, as it would likely streamline the legislative process.

BOE Cautious: The Bank of England voted to keep its benchmark policy rates unchanged and signaled a greater willingness to pause future rate cuts.

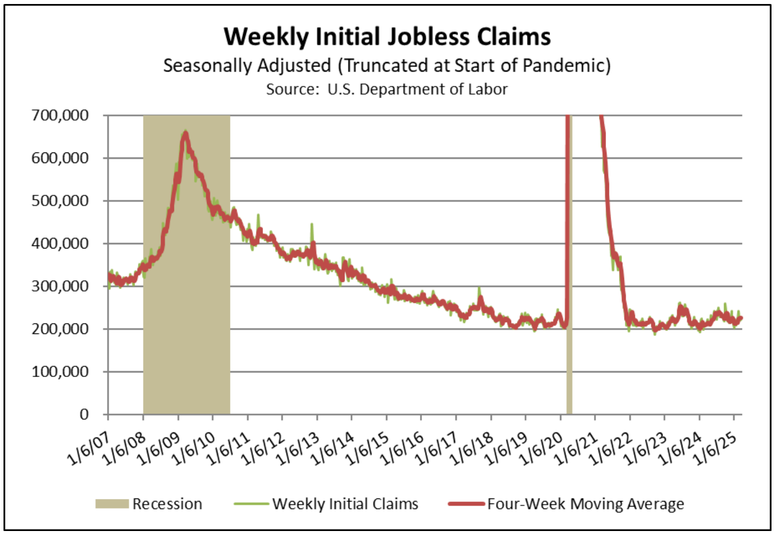
- While the decision was widely anticipated by the market, investors observed a more hawkish shift in tone. The Monetary Policy Committee voted 8-1 in favor of holding rates, indicating that one of the two rate-setters who had previously supported lower borrowing costs in the last three meetings switched their vote. The shift has led traders to pare back bets of a rate cut in May.



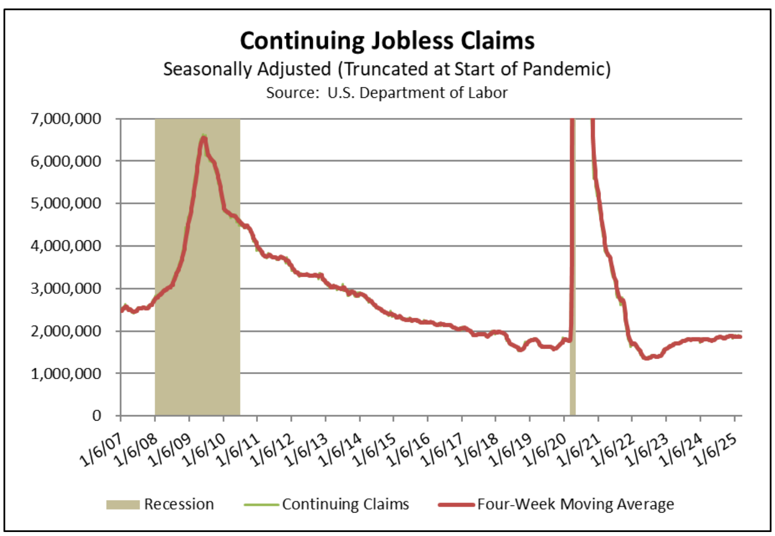
- The shift in policy may be linked to a pickup in inflation, as well as concerns over escalating trade tensions with the US. In January, core inflation surged from 3.2% the previous month to 3.8%. This rise has sparked concerns that US tariffs could further worsen the inflation outlook in the coming months.

US Economic Releases

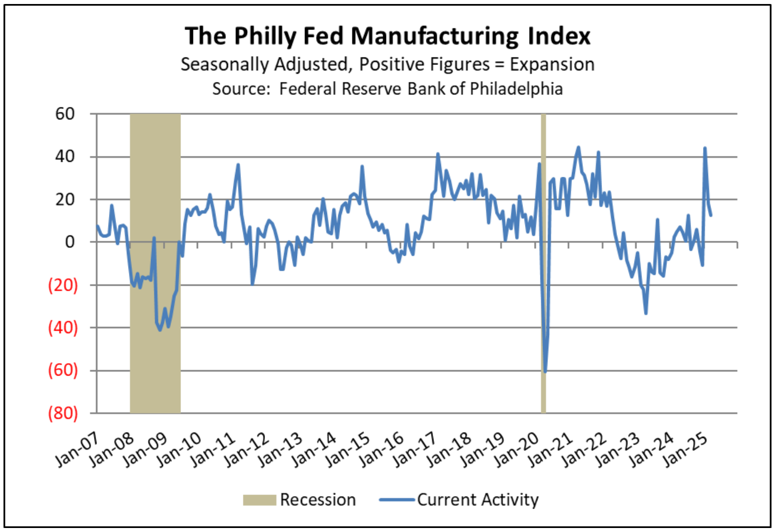
In the week ended March 15, ***initial claims for unemployment benefits*** rose to a seasonally adjusted 223,000, slightly short of the expected level of 224,000 but above the previous week's revised level of 221,000. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, rose to a nearly five-month high of 227,000. While the moving average still suggests labor demand is healthy, its recent rise could indicate that it is starting to soften a bit. 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.



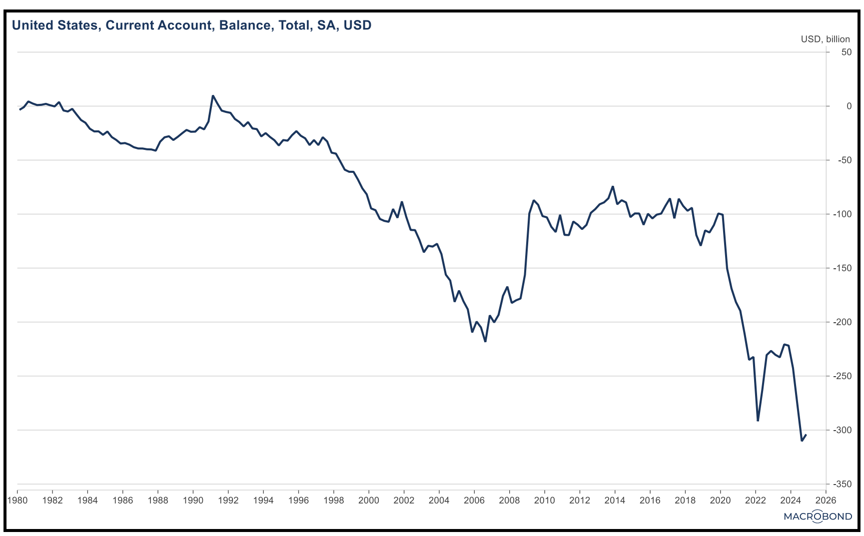
In the week ended March 8, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) rose to a seasonally adjusted 1.892 million, above both the anticipated reading of 1.887 million and the prior week's revised reading of 1.859 million. The four-week moving average of continuing claims rose to 1,875,750, keeping it above the levels seen just before the coronavirus pandemic and suggesting that those who do lose their job are having a harder time landing a new gig. 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 Philadelphia FRB said its March ***Philly Fed Index*** fell to a seasonally adjusted 12.5. That was better than the expected level of 9.0, but it was nevertheless below the February reading of 18.1. The index, officially designated as the Philadelphia FRB Manufacturing Activity Index, is designed so that positive readings point to expanding factory activity in the mid-Atlantic region. At its current level, the index suggests mid-Atlantic manufacturing is now growing again after generally contracting over the last couple of years. The chart below shows how the index has fluctuated since just before the GFC.



A final report so far today focused on the country's overall balance of international current transactions. The fourth-quarter ***current account balance*** showed a deficit of $303.9 billion, narrower than the anticipated shortfall of $330.0 billion and the revised third-quarter shortfall of $310.3 billion. The overall current account balance has been in deficit almost constantly since globalization really began to take hold at the beginning of the 1980s, mostly reflecting the US trade deficit. The chart below shows the overall current account balance since 1980.



The following table lists the additional releases and Fed events scheduled for the rest of the day.

Economic Releases						
EST	Indicator			Expected	Prior	Rating
10:00	Leading Index	m/m	Feb	-0.2%	-0.3%	***
10:00	Existing Home Sales	m/m	Feb	3.95m	4.08m	**
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								
Australia	Employment Change	m/m	Feb	-52.8k	30.5k	30.0k	***	Equity and bond neutral
	Unemployment Rate	m/m	Feb	4.1%	4.1%	4.1%	***	Equity and bond neutral
	Participation Rate	m/m	Feb	66.8%	67.2%	67.3%	**	Equity and bond neutral
New Zealand	GDP	y/y	4Q	-1.1%	-1.6%	-1.4%	***	Equity and bond neutral
EUROPE								
Eurozone	Construction output	y/y	Jan	0.0%	0.8%	-0.1%	*	Equity and bond neutral
Germany	PPI	y/y	Feb	0.7%	0.5%	1.0%	**	Equity and bond neutral
UK	Average Weekly Earnings 3M/YoY	m/m	Jan	5.80%	6.10%	5.80%	**	Equity and bond neutral
	ILO Unemployment Rate 3Mths	m/m	Jan	4.40%	4.40%	4.40%	**	Equity and bond neutral
	Claimant Count Rate	m/m	Feb	4.70%	4.60%		**	Equity and bond neutral
	Jobless Claims Change	m/m	Feb	44.2k	2.8k		**	Equity and bond neutral
Switzerland	Real Exports	m/m	Feb	4.2%	-3.9%		*	Equity and bond neutral
	Real Imports	m/m	Feb	3.3%	-1.4%		*	Equity and bond neutral
Russia	PPI	y/y	Feb	9.8%	9.7%		***	Equity and bond neutral
AMERICAS								
Mexico	International Reserves Weekly	w/w	14-Mar	$236288m	$235940m		*	Equity and bond neutral
	Aggregate Supply and Demand	y/y	4Q	1.9%	1.9%		*	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 (%)	4.21	4.24	-0.03	Down
Euribor/OIS spread (bps)	241	243	-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**	
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
Bank of England Bank Rate	4.50%	4.50%	4.50%	On Forecast
Swiss National Bank Policy Rate	0.25%	0.50%	0.25%	On Forecast
PBOC 1-Year Loan Prime Rate	3.10%	3.10%	3.10%	On Forecast
PBOC 5-Year Loan Prime Rate	3.60%	3.60%	3.60%	On Forecast
Brazil Selic Rate	14.25%	13.25%	14.25%	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.

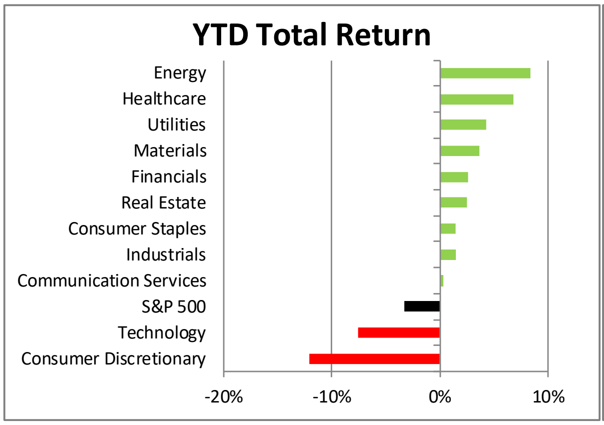
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$70.83	$70.78	0.07%	
WTI	$67.16	$67.16	0.00%	
Natural Gas	$4.18	$4.25	-1.65%	
Crack Spread	$24.74	$24.84	-0.39%	
12-mo strip crack	$21.02	$21.06	-0.17%	
Ethanol rack	$1.89	$1.88	0.74%	
Metals				
Gold	$3,032.10	$3,047.79	-0.51%	
Silver	$33.30	$33.80	-1.46%	
Copper contract	$510.95	$510.00	0.19%	
Grains				
Corn contract	$462.50	$462.00	0.11%	
Wheat contract	$559.25	$563.50	-0.75%	
Soybeans contract	$1,004.25	$1,008.25	-0.40%	
Shipping				
Baltic Dry Freight	1,637	1,650	-13	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	1.75	1.00	0.75	
Gasoline (mb)	-0.53	-3.00	2.47	
Distillates (mb)	-2.81	-0.50	-2.31	
Refinery run rates (%)	0.4%	0.0%	0.4%	
Natural gas (bcf)		4		

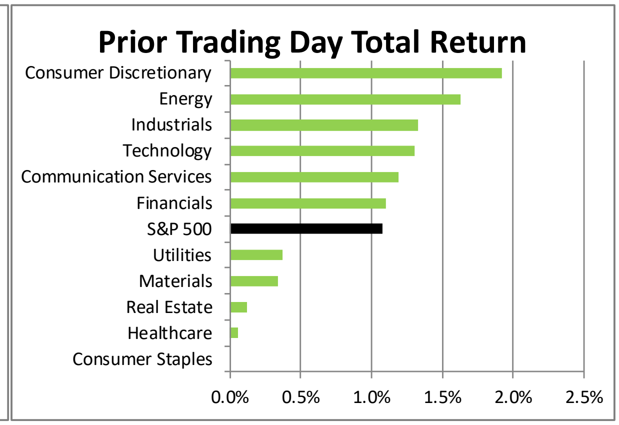
Weather

The 6-to-10 and 8-to-14-day forecasts currently call for cooler-than-normal temperatures in the Midwest, the mid-Atlantic states, and the Northeast, with warmer-than-normal temperatures from the Great Plains westward. The forecasts call for wetter-than-normal conditions in the northern half of the country and south Texas, with dry conditions in Arizona and New Mexico.

Data Section

US Equity Markets – (as of 3/19/2025 close)

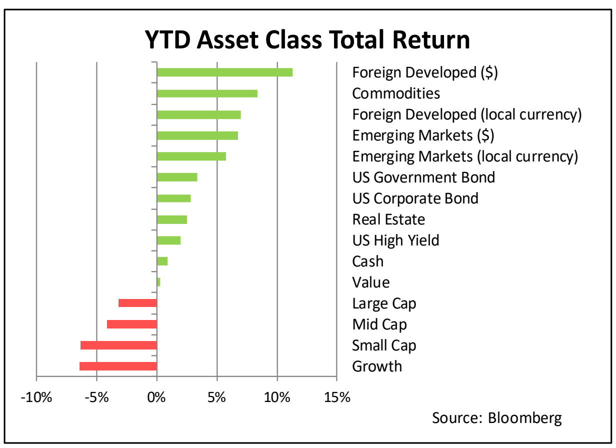




(Source: Bloomberg)

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 3/19/2025 close)

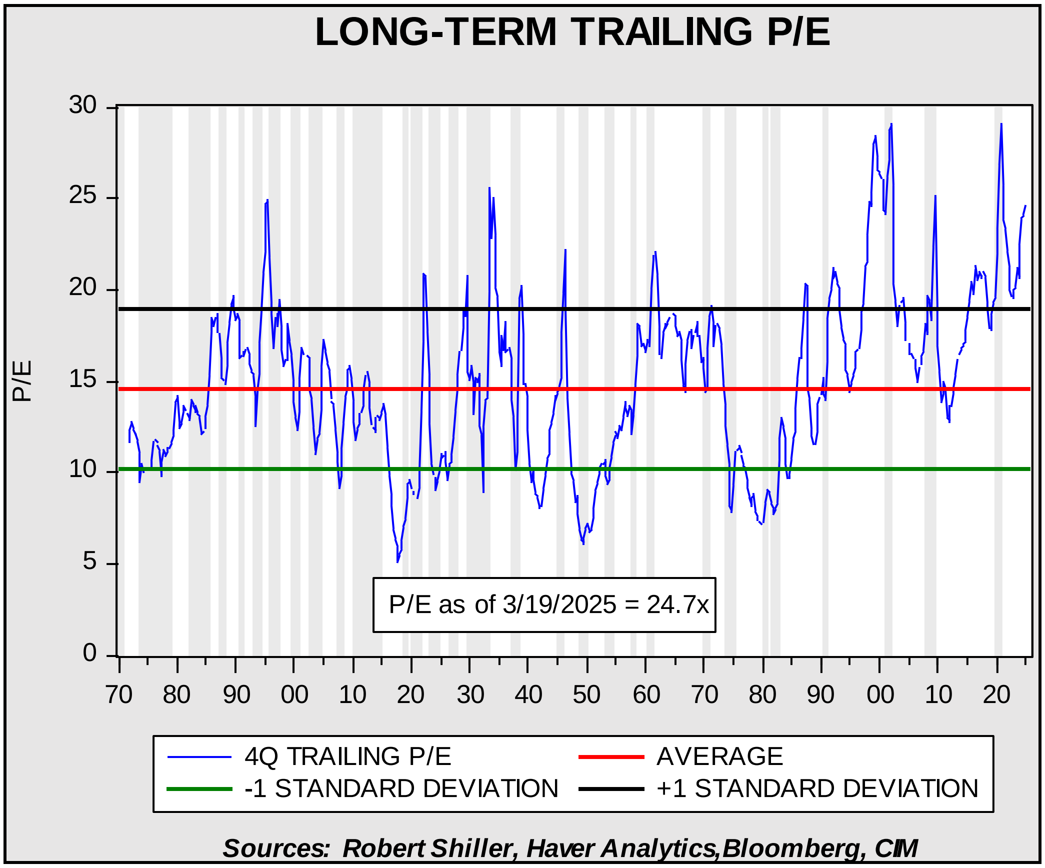


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 20, 2025



Based on our methodology,[1] the current P/E is 24.7x, down 0.1 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.