Confluence INVESTMENT MANAGEMENT

Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

[Posted: March 27, 2025 — 9:30 AM ET] Global equity markets are mostly down this morning. In Europe, the Euro Stoxx 50 closed down 0.6% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.6%. Chinese markets were mixed, with the Shanghai Composite up 0.2% from its previous close and the Shenzhen Composite down 0.1%. 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
"The Bessent Gambit" (3/24/25)	"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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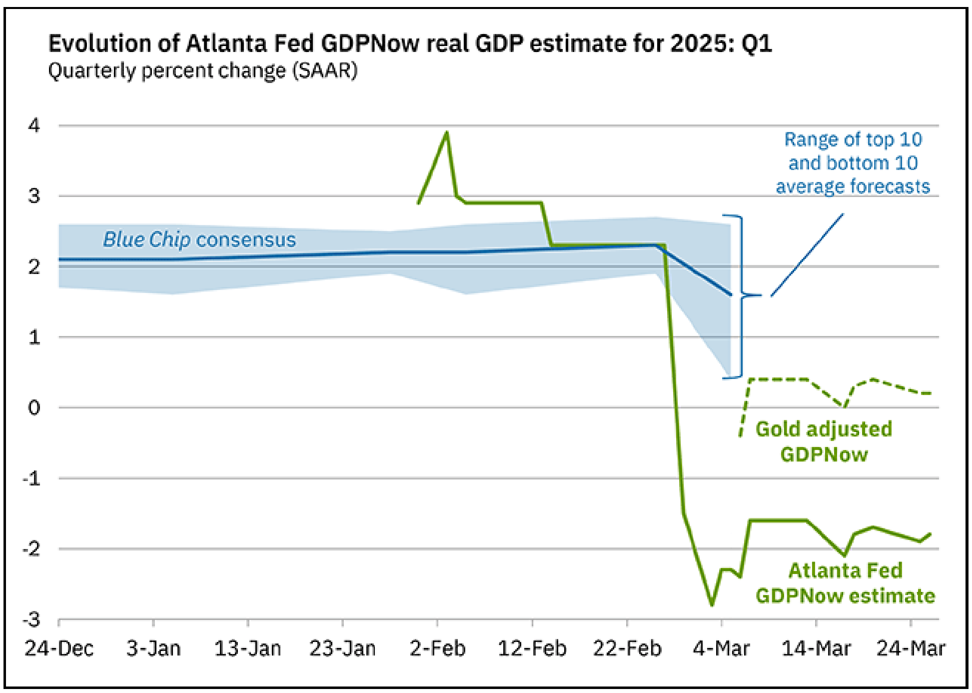
Good morning! The market is currently digesting the latest news regarding tariffs. In sports, the St. Louis Cardinals begin their season today, embarking on what promises to be a historic run for the World Series title this year. Today's *Comment* will delve into the latest developments on auto tariffs, an update on the TikTok deal, and other pertinent market news. As usual, this report will also include a summary of key international and domestic data releases.

More Tariffs, More Problems: Wednesday's tariff announcement marks the administration's latest move to reshape trade policy, even as Federal Reserve officials and business leaders voice growing apprehension about its potential economic impacts.

- President Trump will impose sweeping new 25% tariffs on automotive imports, set to take effect next week, as part of his administration's efforts to reshore vehicle manufacturing. The tariffs will comprehensively cover finished vehicles and critical components, including engines, powertrains, transmissions, and electrical systems. Notably, these tariffs will be implemented as permanent measures without exemptions.
- The president has consistently maintained that these protectionist measures are essential to safeguard America's industrial base and national security. This justification originates from his administration's 2019 Section 232 investigation into automotive imports under

the Trade Expansion Act, which authorizes executive action when imports are deemed to threaten national security interests.

- New tariffs will disproportionately affect foreign automakers by reducing the price competitiveness of their vehicles in the US market. Mexico and South Korea appear particularly vulnerable, having significantly expanded their automotive exports to the United States in 2024. With imports accounting for nearly half of all vehicles sold domestically last year, American consumers may also face higher prices and reduced choice in the marketplace.
- Fed officials have warned that new tariffs may constrain their ability to implement further rate cuts this year. Atlanta Fed President Raphael Bostic recently challenged Chair Powell's assessment of tariffs as transitory, revising his projected rate cuts for 2025 from two down to one. Meanwhile, St. Louis Fed President Alberto Musalem warned that hawkish trade policy could generate secondary inflationary effects, potentially prolonging the economic impact of tariffs beyond just a one-time effect.

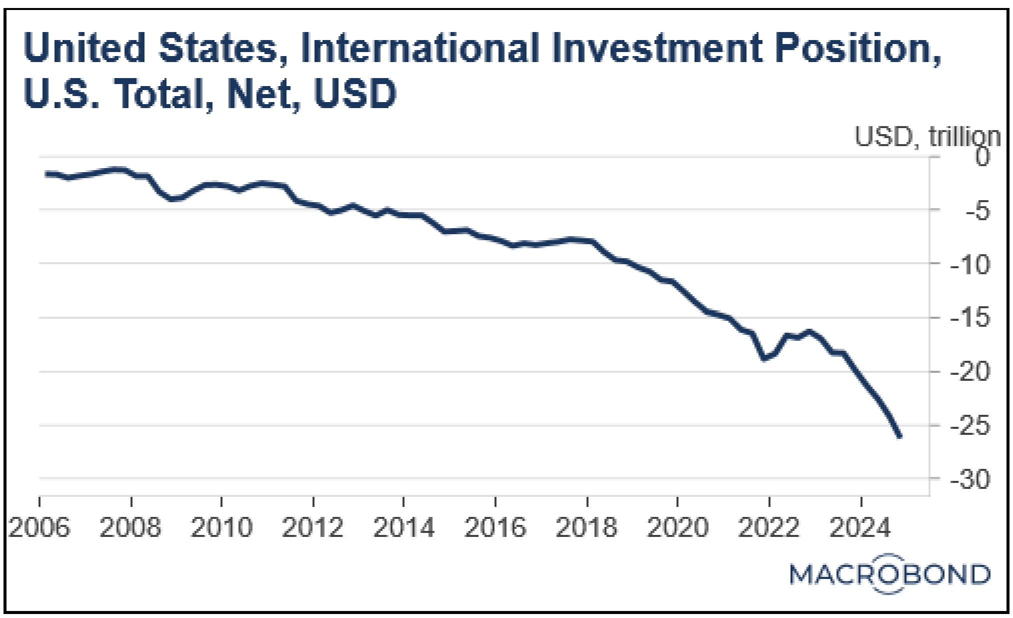


- Furthermore, business leaders are increasingly concerned about a potential economic recession. A recent survey of CFOs revealed that almost 60% anticipate an economic downturn within the next six months, with an additional 15% expecting it in 2026. These fears are seemingly supported by the highly anticipated update in the Atlanta GDPNow forecast, which projects a severe economic slowdown in the US economy during the first quarter, when adjusted for gold imports.
- A key focus for us has been observing the market's reaction to the latest trade developments. Although the market closed lower yesterday, it's noteworthy that the VIX remained below the critical level of 20. This suggests that the immediate impact of the tariff actions on equities may be diminishing. Looking ahead, the market's primary focus

will shift to economic indicators. Continued GDP growth could provide some upside for the market; conversely, a contraction could lead to an increase in market pessimism.

Hardball Tactics: While often discussed as a tool for reindustrialization, the administration has highlighted tariffs' broader strategic uses, including pressuring foreign regulatory reforms and securing critical acquisitions.

- President Trump has signaled a potential reduction of certain Chinese tariffs as leverage in negotiations to transfer TikTok to US ownership. This conciliatory gesture follows his administration's recent imposition of 20% tariffs on targeted Chinese imports, while broader product-specific duties remain in effect. Although Beijing would welcome tariff relief, the Chinese government — whose approval is required for any sale — remains adamant that ByteDance retains control of TikTok's core algorithm.
- China may not be the only target of such measures. The Trump administration has repeatedly stated its willingness to impose tariffs on European allies unless they amend legislation perceived as discriminatory toward US technology firms. Furthermore, officials have pushed for the elimination of the EU's value-added tax system, despite its non-discriminatory application across all companies.
- The administration's tariff strategy appears to be driven by a wider geopolitical vision, and a desire to position the United States as the central hub of global commerce. This approach is not solely focused on domestic re-industrialization but also involves actively supporting US corporations in acquiring strategic foreign competitors and in influencing international regulations deemed detrimental to American business interests.



- A crucial metric to monitor is the US net international investment position (NIIP), which measures the difference between US-owned assets abroad and foreign-owned assets within the US. This gap has recently widened to its largest recorded level, indicating a growing foreign ownership of US assets. The administration may be considering policies to reduce this imbalance as part of its broader objective to reshape the global economic landscape. If successful, large-cap US corporations would likely be primary beneficiaries.

Enough about Tariffs, Now NATO: Amid growing European doubts about America's NATO commitments, the transatlantic military alliance has reaffirmed its readiness to defend itself and its allies should the need arise.

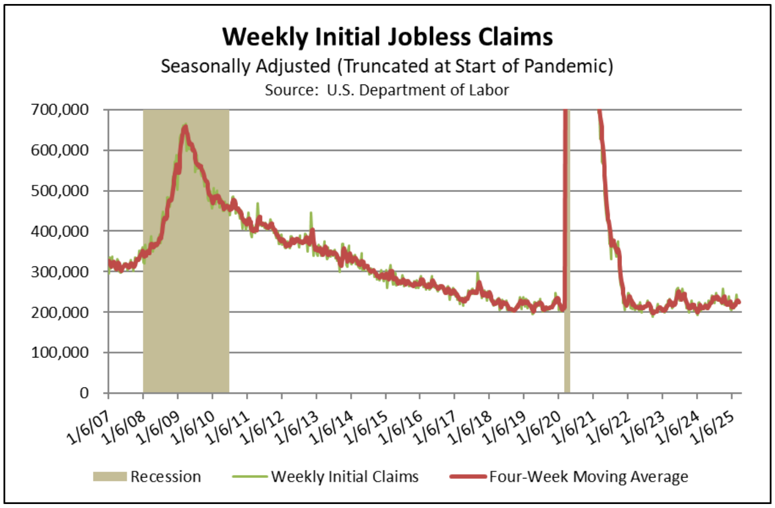
- The NATO Secretary General has unequivocally declared the alliance's readiness to deploy its full military capabilities in response to any Russian aggression against Poland or other member states. These remarks come as Moscow nears a potential agreement with the US to end its invasion of Ukraine — a development that has heightened concerns about possible Russian expansion of hostilities to other European targets.
- The escalating Russian threat has prompted European nations to significantly boost defense expenditures, aiming to ensure self-sufficiency amid concerns about potential US disengagement from NATO. Poland has emerged as the vanguard of this strategic realignment, committing to spend 4% of GDP on defense — the highest percentage among NATO members — while actively pursuing nuclear-sharing arrangements to enhance its deterrent capabilities.
- Europe's drive for greater military autonomy is expected to benefit defense sector equities across the bloc. However, the substantial borrowing required to fund this expansion may exert upward pressure on interest rates. One potential mitigation strategy would be the introduction of EU-backed guarantees for joint defense bonds. While discussions about such mechanisms are ongoing, concrete progress toward implementation remains limited.

BOJ Pause: The Bank of Japan's hawkish stance faces headwinds from trade uncertainty, pushing back the timeline for any potential rate policy normalization.

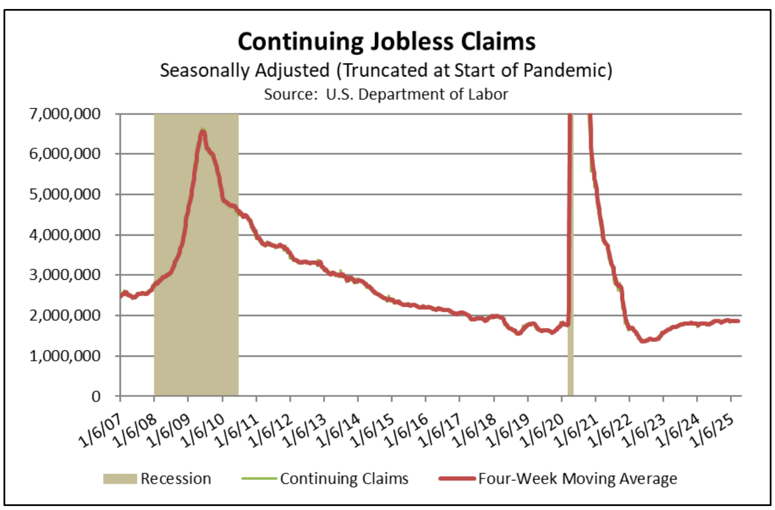
- BOJ Governor Kazuo Ueda has emphasized maintaining policy flexibility ahead of the central bank's May 1 meeting. His cautious approach to rate hikes stems from concerns that tightening monetary policy amid escalating trade tensions could potentially harm Japan's economic recovery.
- Japan has seen an increase in its inflation over the last few months, with the inflation reading hitting 3% in February. The lack of action to ensure that inflation falls to target is likely to put further pressure on the Japanese yen (JPY) which recently surpassed 150 per dollar.

US Economic Releases

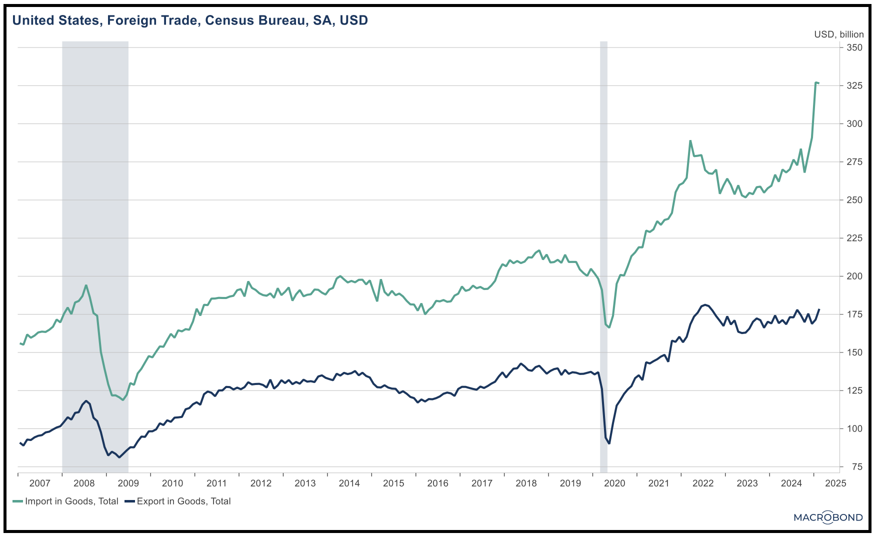
In the week ended March 22, ***initial claims for unemployment benefits*** edged down to a seasonally adjusted 224,000, versus expectations that they would be unchanged from the prior week's revised level of 225,000. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, also fell to 224,000. 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.



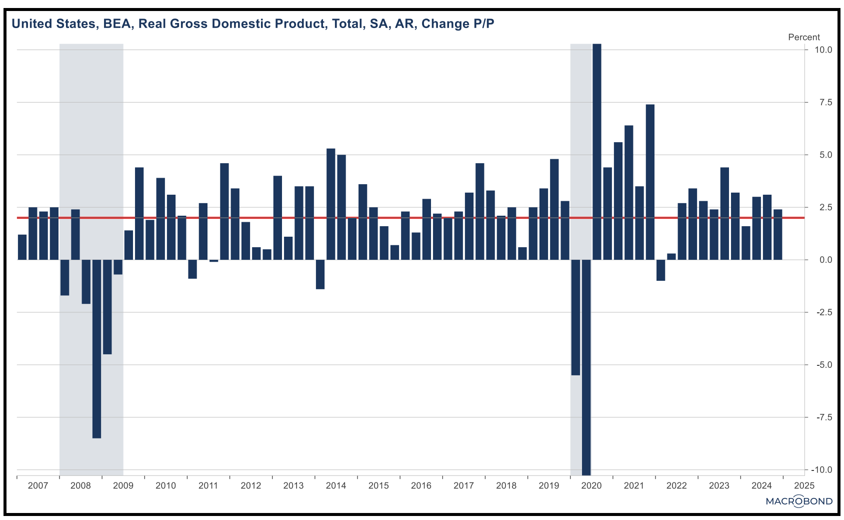
In the week ended March 15, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) fell to a seasonally adjusted 1.856 million, below both the anticipated reading of 1.886 million and the previous week's revised reading of 1.881 million. The four-week moving average of continuing claims rose to a 13-week high of 1,870,000. 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.



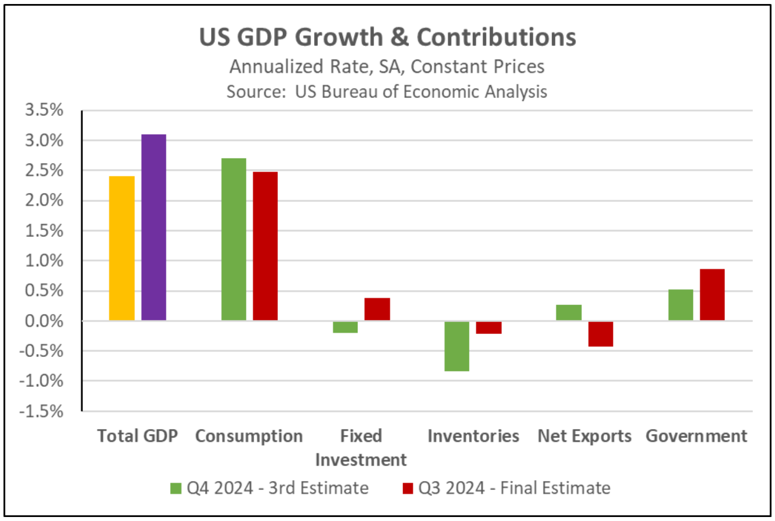
Separately, a preliminary estimate today showed the US ***merchandise trade balance*** in February came in at a seasonally adjusted deficit of $147.9 billion, exceeding the expected shortfall of $139.0 billion but narrowing from the revised January shortfall of $155.6 billion. According to the data, total merchandise exports jumped 4.1%, while imports fell 0.2%. Compared with the same month one year earlier, exports in February were up 2.5%, while imports were up 22.5%. The chart below shows the monthly value of US exports and imports since just before the GFC.



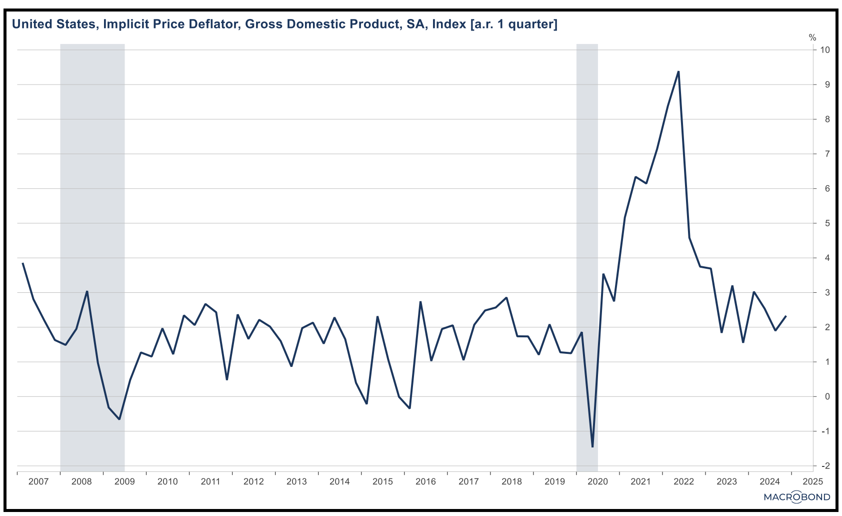
Finally, the Commerce Department released its third and final regular estimate of economic activity in the fourth quarter of 2024. After stripping out seasonal factors and price changes, fourth-quarter ***gross domestic product (GDP)*** rose at an annualized rate of 2.4%, beating expectations that the growth rate would be unchanged from the previous estimate of 2.3%. The chart below shows the annualized growth rate of US GDP since just before the GFC.



A close look at the report shows that the main source of growth in the fourth quarter was consumer spending, probably reflecting the continuing strong demand for labor, low unemployment, and rising wage rates. Government spending and net exports also made small contributions to the expansion. The chart below shows the contributions to the annualized growth rate in the fourth quarter.



The GDP report also includes the broadest measure of US price inflation. The fourth-quarter ***GDP Price Index*** rose at an annualized rate of 2.3%, better than expectations that the rate of increase would be unchanged from the prior estimate of 2.4%. The chart below shows the year-over-year change in the GDP Price Index since just before the GFC.



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

Economic Releases						
EST	**Indicator**			**Expected**	**Prior**	**Rating**
10:00	Pending Home Sales	m/m	Feb	1.0%	-4.6%	**
10:00	Pending Home Sales NSA	y/y	Feb	-3.5%	-5.2%	*
11:00	Kansas City Fed Manufacturing Activity	m/m	Mar	-5.0	-5.0	*
Federal Reserve						
EST	**Speaker or Event**	**District or Position**				
16:30	Thomas Barkin Gives Speech, Q&A	President of the Federal Reserve Bank of Richmond				
16:30	Susan Collins Speaks in Fireside Chat on Ecomony	President of the Federal Reserve Bank of Boston				

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	21-Mar	-¥207.1b	-¥83.5b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	21-Mar	¥272.1b	-¥752.5b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	21-Mar	-¥1797.4b	¥3395.3b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	21-Mar	-¥1206.0b	-¥1805.6b		*	Equity and bond neutral
China	Industrial Profits	y/y	Feb	-0.3%	-3.3%		*	Equity and bond neutral
EUROPE								
Eurozone	M3 Money Supply	y/y	Feb	4.0%	3.8%	3.8%	***	Equity and bond neutral
Russia	Industrial Production	y/y	Feb	0.2%	2.2%	1.2%	***	Equity bullish, bond bearish
AMERICAS								
Mexico	Trade Balance	m/m	Feb	2212.4m	-4558.0m	-527.5m	**	Equity and bond neutral
	Exports	m/m	Feb	49280m	44446m		*	Equity and bond neutral
	Imports	m/m	Feb	47067m	49004m		*	Equity and bond neutral
Brazil	IBGE Inflation IPCA-15	m/m	Mar	5.26%	4.96%	5.30%	***	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)	431	431	0	Down
10-yr T-note (%)	4.39	4.35	0.04	Up
Euribor/OIS spread (bps)	237	237	0	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.

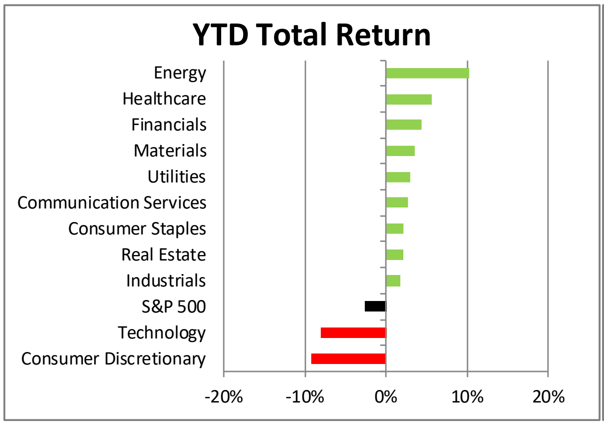
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$73.54	$73.79	-0.34%	
WTI	$69.45	$69.65	-0.29%	
Natural Gas	$3.78	$3.86	-2.10%	
Crack Spread	$24.52	$24.43	0.38%	
12-mo strip crack	$21.26	$21.23	0.16%	
Ethanol rack	$1.87	$1.87	-0.19%	
Metals				
Gold	$3,050.85	$3,019.38	1.04%	
Silver	$34.01	$33.63	1.13%	
Copper contract	$523.20	$524.30	-0.21%	
Grains				
Corn contract	$452.25	$451.25	0.22%	
Wheat contract	$536.00	$535.25	0.14%	
Soybeans contract	$1,004.50	$1,001.00	0.35%	
Shipping				
Baltic Dry Freight	1,634	1,642	-8	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-3.34	1.98	-5.32	
Gasoline (mb)	-1.45	-1.50	0.05	
Distillates (mb)	-2.81	-1.00	-1.81	
Refinery run rates (%)	0.1%	-0.5%	0.6%	
Natural gas (bcf)		33		

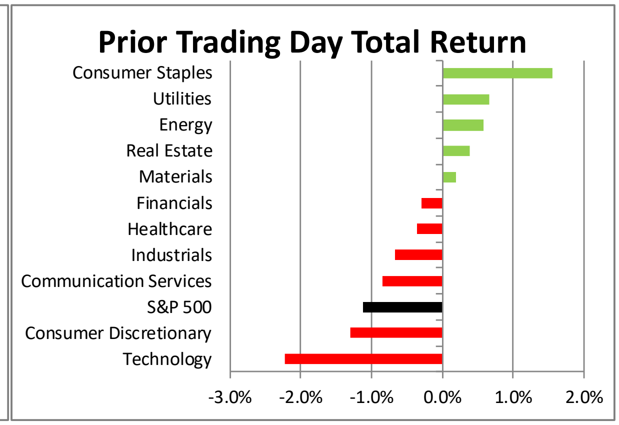
Weather

The 6-to-10 and 8-to-14-day forecasts currently call for warmer-than-normal temperatures in virtually all areas from the Great Plains eastward, with cooler-than-normal temperatures in the Far West. The forecasts call for wetter-than-normal conditions everywhere but Texas, where conditions will be dry.

Data Section

US Equity Markets – (as of 3/26/2025 close)

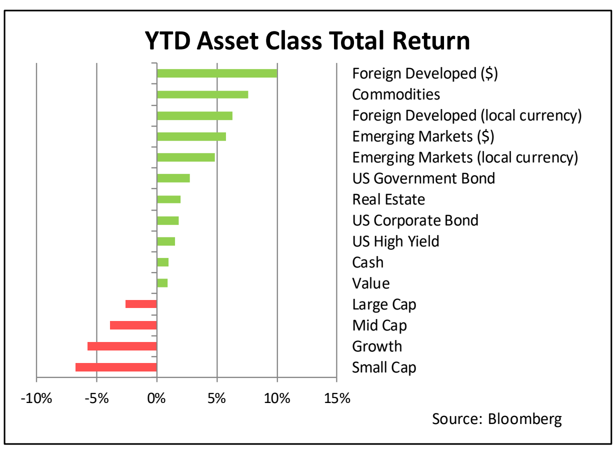




(Source: Bloomberg)

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 3/26/2025 close)

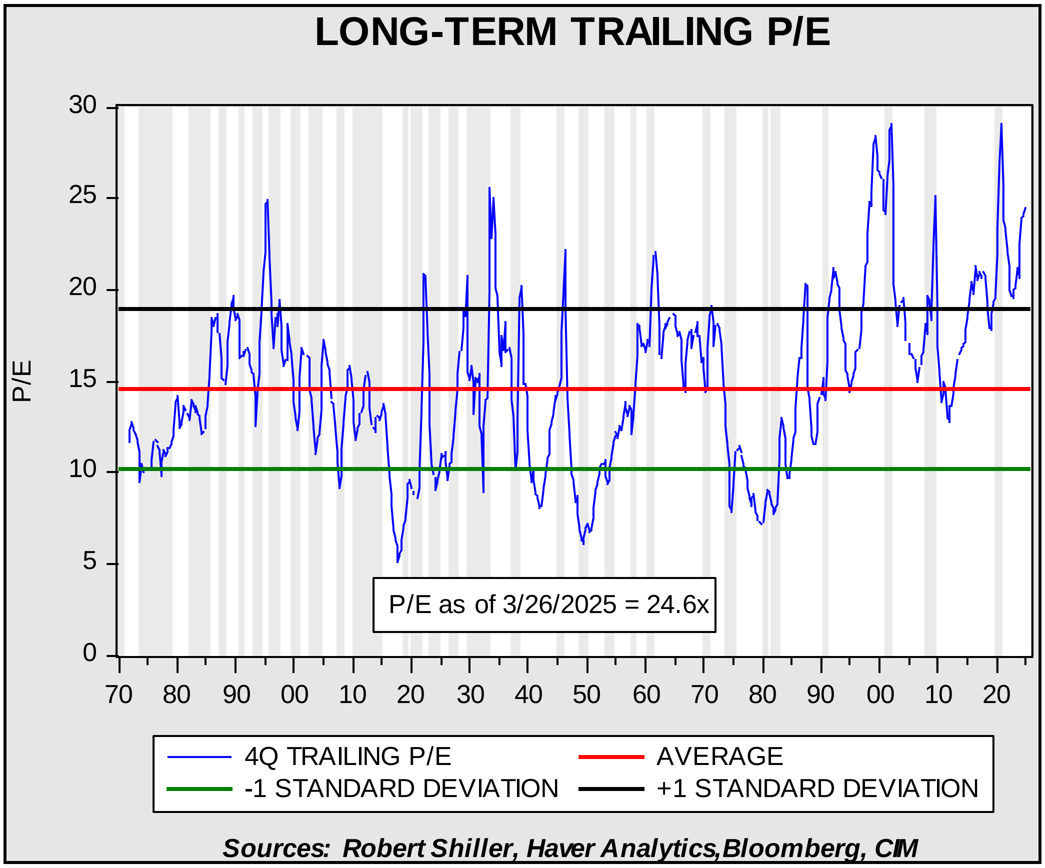


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 27, 2025



Based on our methodology,[1] the current P/E is 24.6x, 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.