Daily Comment

Confluence Investment Management

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[Posted: March 7, 2025 — 9:30 AM ET] Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 closed down 1.1% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.5%. Chinese markets were lower, with the Shanghai Composite down 0.3% from its previous close and the Shenzhen Composite down 0.5%. US equity index futures are signaling a slightly 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
"Sanctions as an Investment Risk" (2/24/25) + podcast	"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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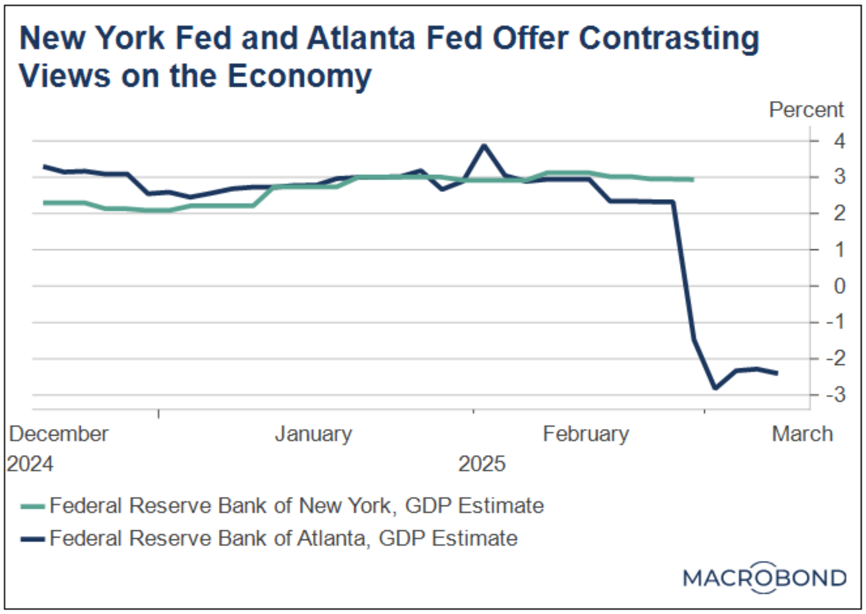
Good morning! The market is currently digesting the latest jobs data. In sports news, Dave Roberts and the Los Angeles Dodgers are nearing a long-term contract agreement. Today's *Comment* will cover the latest developments in the trade war, the reasons behind the differing views on the path of monetary policy by Fed officials, and other market-related news. As usual, the report will conclude with a summary of domestic and international data releases.

Trade War on Pause? For the second time this week, President Trump has delayed tariffs on goods. However, uncertainty remains widespread as businesses grapple with understanding the impact of trade policies on the economy.

- On Thursday, the Trump administration announced that goods covered under the 2020 North American trade agreement would be exempt from tariffs. This move comes a day after the president exempted auto goods from tariffs. The reversal appears to be a response to domestic backlash, as many US firms expressed concerns that the tariffs could severely disrupt their supply chains.

- Newly released data showed the US advanced trade deficit in goods deepened in January as imports surged. This increase was attributed to businesses stockpiling goods ahead of expected tariffs, a strategy likely aimed at mitigating the impact of the ongoing trade dispute. The significant rise in imports was a key factor in the Atlanta Fed's GDPNow forecast, which currently indicates a potential contraction in the US economy.
- While tariffs targeting Canadian and Mexican goods have been put on hold, the aluminum and steel tariffs are expected to take effect on March 12. Additionally, reciprocal tariffs, designed to pressure countries into reducing their trade barriers, are set to be implemented on April 2. As a result, the recent U-turn on tariffs has created even greater uncertainty about what could unfold in the coming weeks.

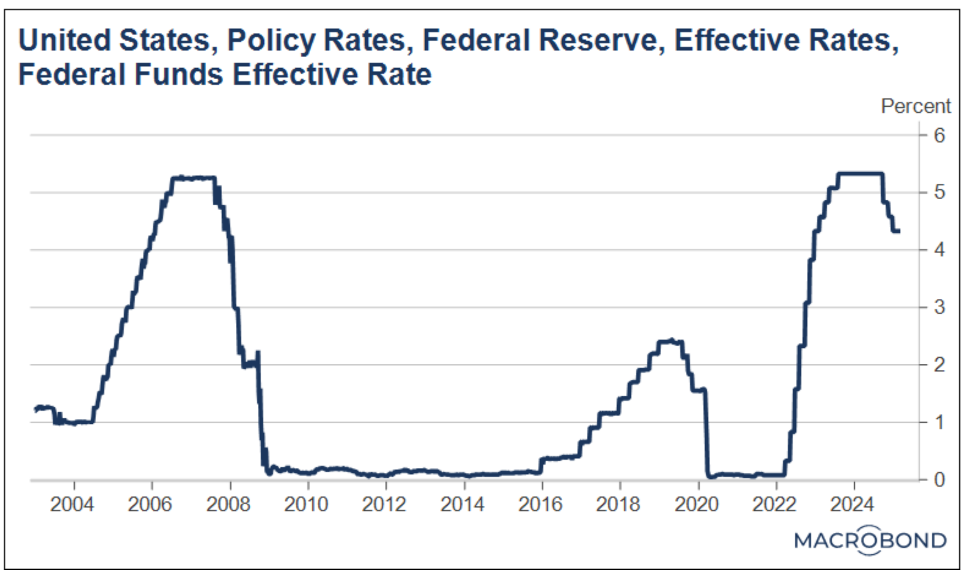


- While the US has reduced some tariffs, other countries have maintained theirs, and Canada has increased certain measures. Ontario Premier Doug Ford announced plans to raise electricity tariffs on Michigan, Minnesota, and New York. Additionally, Canadian provinces have pushed to remove US-made alcohol from shelves, demonstrating that trade hostilities persist despite the brief reprieve.
- While the tariff reversal is likely to reduce some disruptions in the coming weeks, it will still have a major impact on economic data, particularly for those attempting to front-run the tariffs. As a result, this could weigh on US GDP growth in the future. That said, the possibility of a recession remains 50/50, as it is unclear whether consumers will absorb some of the tariff costs. In short, the trade war is far from over.

Monetary Policy Uncertainty: Less than a week before Federal Reserve officials are set to meet, there is still no clear direction on where they might set policy for the rest of the year.

While several members have expressed concerns that tariffs could exacerbate inflation, others have remained optimistic.

- Fed Governor Christopher Waller suggested the possibility of two or three interest rate cuts this year. While he dismissed the likelihood of cutting rates at the upcoming meeting, Waller left the possibility open for a rate reduction in May. He emphasized that any decision to lower rates would be driven by sustained progress on inflation, rather than a reaction to economic weakness. Furthermore, he downplayed concerns about tariffs significantly impacting inflation, suggesting their effect would likely be limited.
- Waller's comments appeared to diverge from the more cautious stance of many of his colleagues regarding the possibility of rate cuts. Later that day, Atlanta Fed President Raphael Bostic noted that uncertainty surrounding future policy makes it unlikely the Fed will move on interest rates before late spring or early summer. Earlier in the week, New York Fed President John Williams had also struck a more cautious tone, specifically highlighting tariffs as a potential risk to inflation.
- The divergence between Waller's views and those of many of his colleagues comes at a time when market expectations for monetary policy have undergone a complete reversal. Before last Friday, markets had priced in no rate cuts for the year. However, sentiment shifted sharply following the release of the PCE price index, which showed a deceleration in price inflation, alongside weaker-than-expected economic data. Now the market is pricing in three or maybe four rate cuts this year.



- As highlighted in our previous reports, the Fed is likely to have the most success at the start of the year as opposed to the end of the year in bringing inflation down closer to target. This is supported by the latest Cleveland Fed Nowcast for Inflation, which projects the April PCE price index report will show overall inflation falling below 2.1%. That said, we continue to believe that, barring a recession, the Fed is likely to cut rates no more than twice this year.

Ukraine Update: Officials in the European Union, along with Congressional Republicans, are working to help repair relations between Ukrainian President Volodymyr Zelensky and US President Donald Trump.

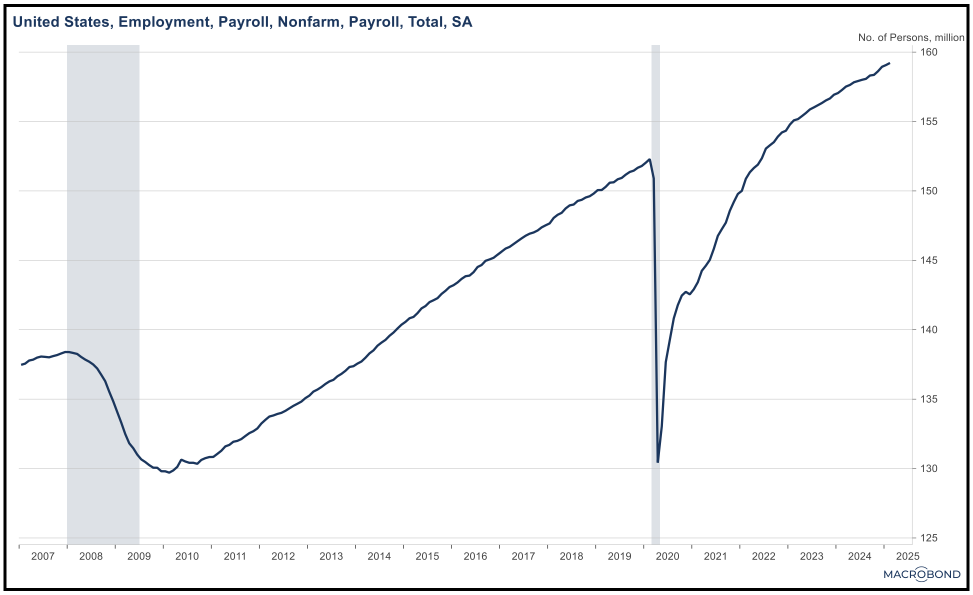
- Despite their differences, it is widely anticipated that the two leaders will reach a minerals agreement, which could help pave the way for a potential peace deal with Russia. In a gesture of goodwill ahead of his meeting with US officials, Zelensky has called for an enforced "silence in the sky." Meanwhile, US officials are scheduled to meet with their Ukrainian counterparts to facilitate peace negotiations.
- While President Trump has shown no signs of softening his stance, members within his own party are actively pushing for a change in approach. Several GOP senators have urged the president to resume intelligence sharing and provide renewed aid to Ukraine. Their insistence stems from concerns among many Republicans that Ukraine may be losing leverage in negotiations with Russia to end the war.
- Since the controversial meeting between Zelensky and Trump last week, Russia has seized the opportunity to intensify its attacks, aiming to strengthen its position in future negotiations. Putin has made it clear that he has no intention of retreating from territorial gains unless he secures guarantees for Russia's long-term security.
- While tensions between the US and Ukraine persist, there appears to be a potential pathway toward ending the Russian invasion. A resolution to the conflict could ease pressure on oil prices and provide a boost to European equities.

China's Annoyance: While President Trump offered some tariff concessions to North American counterparts, the levies on Chinese goods remained unchanged. Compounding the situation are indications that the Trump administration may be exploring the formation of a North American trade bloc.

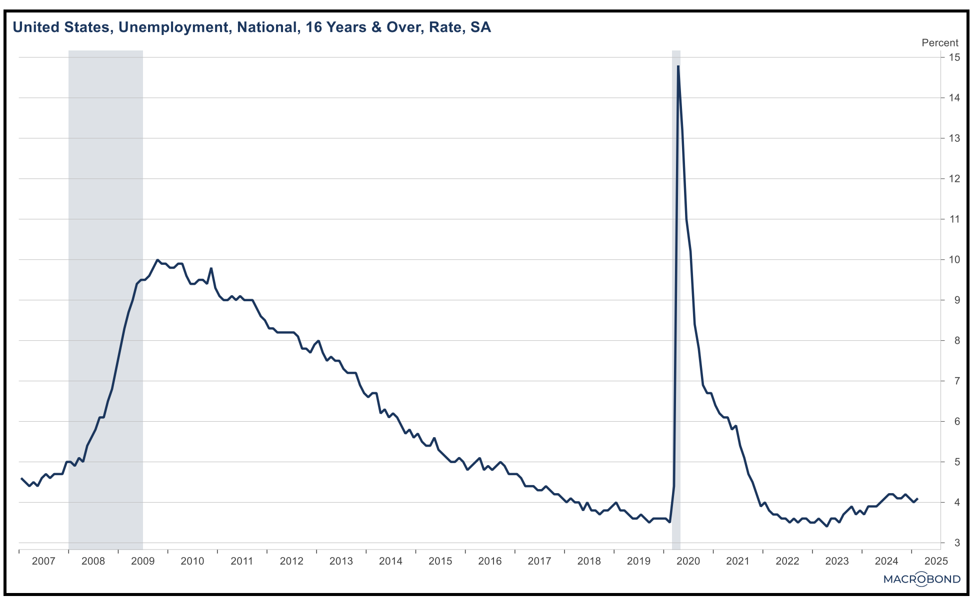
- China's foreign minister criticized the US for what he characterized as a "two-faced" approach to bilateral relations, pointing to perceived inconsistencies. He highlighted President Trump's complimentary remarks toward President Xi contrasted with the implementation of trade tariffs as examples of these mixed signals.
- His remarks follow new trade measures by Mexico to also review tariffs on Chinese imports. The move was seen as a way to curry favor with the incoming administration as they look to prevent a broader trade war with Mexico.
- The United States' ability to persuade more allies to impose tariffs on China is likely to fuel Beijing's concerns about being isolated from the global community. However, this outcome hinges on Washington's capacity to maintain unity among its allies — a challenging task, given apprehensions about potential US tariffs. That said, a unified front against China could serve as a strategic off-ramp for US allies seeking to preserve their relationships with Washington while addressing shared economic concerns.

US Economic Releases

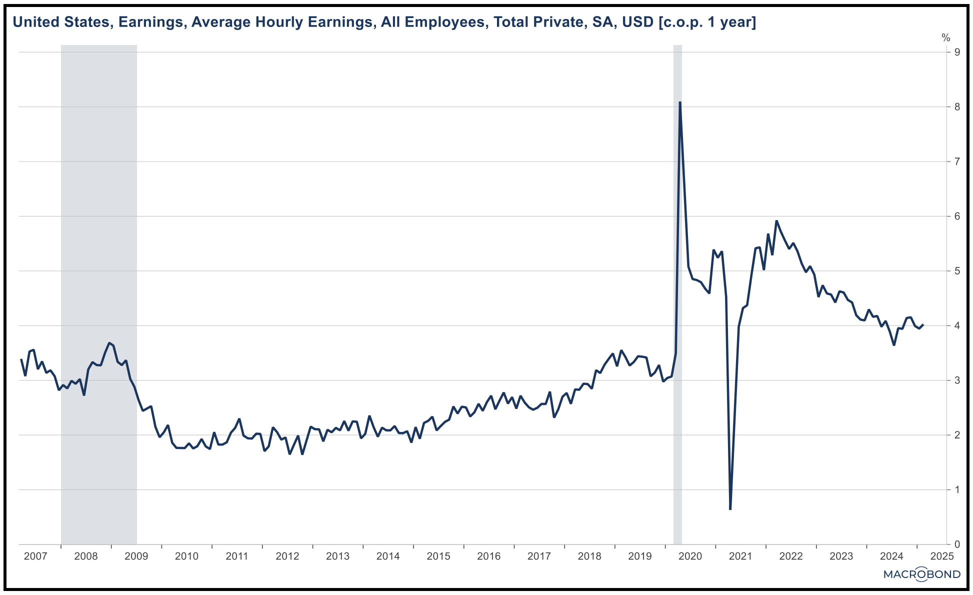
February ***nonfarm payrolls*** rose by a seasonally adjusted 151,000, slightly short of the expected gain of 160,000 but well above the revised January increase of 125,000. As usual, the large majority of the job gains in February were in the private sector. Job gains in the government sector slowed sharply to just 11,000, versus 44,000 in the previous month, possibly reflecting some of the Trump administration's effort to reduce the federal workforce. The chart below shows the change in total nonfarm payrolls since shortly before the Great Financial Crisis.



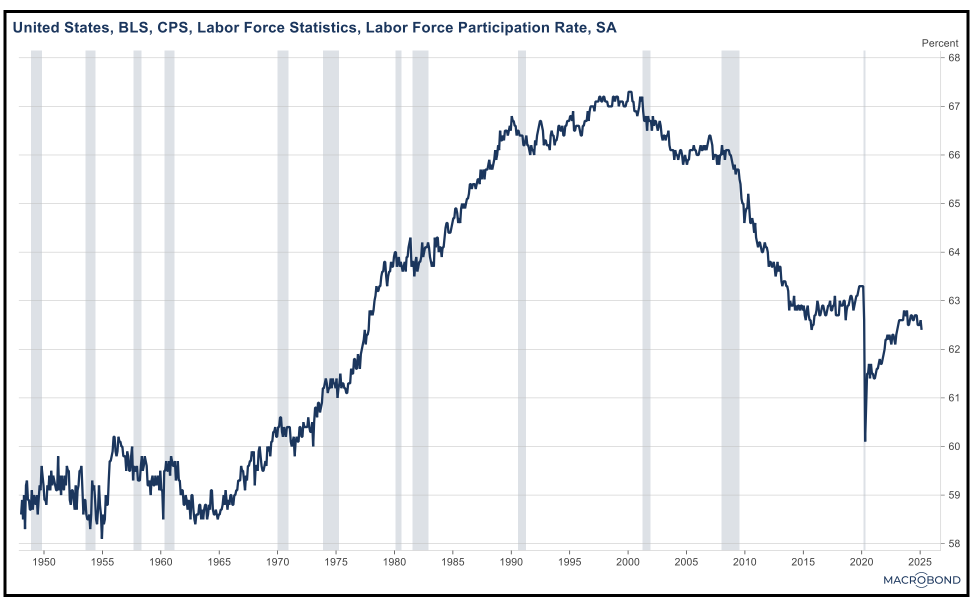
The February ***unemployment rate*** edged up to 4.1%, versus expectations that it would be unchanged at 4.0%. The chart below shows how the unemployment rate has evolved since just before the GFC.



According to the report, ***average hourly earnings*** in February rose to a seasonally adjusted $35.93, up 4.0% from the same month one year earlier. That was a bit softer than the expected rise of 4.1%, but it marked a small acceleration from the revised gain of 3.9% in the year to January. The chart below shows the year-over-year growth in average hourly earnings since just before the GFC.



A final key indicator in the monthly employment report focuses on the share of the adult, civilian, noninstitutionalized population that is either working or looking for work. The February ***labor force participation rate (LFPR)*** fell to a seasonally adjusted 62.4%, short of expectations that it would remain unchanged at 62.6%. The chart below shows how the LFPR has changed over the last several decades.



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

Economic Releases						
EST	Indicator			Expected	Prior	Rating
15:00	Consumer Credit	m/m	Jan	$15.000b	$40.847b	*
Federal Reserve						
EST	Speaker or Event	District or Position				
10:15	Michelle Bowman Speaks on Policy Transmission	Member of the Board of Governors				
10:45	John Williams Speaks on Panel on Policy Transmission	President of the Federal Reserve Bank of New York				
12:20	Adriana Kugler Speaks on Rebalancing Labor Markets	Member of the Board of Governors				
12:30	Jerome Powell Speaks on the Economic Outlook	Chairman of the Board of Governors				
13:00	Adriana KuglerAppears on Panel Discussion	Member of the Board of Governors				

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	Foreign Reserves	m/m	Feb	A$104.8b	A$104.1b	--	*	Equity and bond neutral
South Korea	BoP Current Account Balance	m/m	Jan	$2940.1m	$12367.5m	--	**	Equity and bond neutral
	BoP Goods Balance	m/m	Jan	$2500.4m	$10433.5m	--	*	Equity and bond neutral
China	Foreign Reserves	m/m	Feb	$3227.22b	$3209.04b	$3229.0b	**	Equity and bond neutral
EUROPE								
Eurozone	GDP	y/y	4Q F	1.2%	0.9%	0.9%	***	Equity and bond neutral
Germany	Factory Orders WDA	y/y	Jan	-2.6%	-6.9%	2.6%	***	Equity bearish, bond bullish
France	Trade Balance	m/m	Jan	-6540m	-3481m		*	Equity and bond neutral
	Current Account Balance	m/m	Jan	-2.2b	2.6b		*	Equity and bond neutral
Switzerland	Foreign Currency Reserves	m/m	Feb	735.4b	736.4b		***	Equity and bond neutral
Russia	Gold and Forex Reserves	m/m	28-Feb	$632.4b	$634.6b		***	Equity and bond neutral
	Money Supply, Narrow Definition	w/w	28-Feb	18.07t	18.23t		*	Equity and bond neutral
	Official Reserve Assets	m/m	Feb	632.4b	620.8B		*	Equity and bond neutral
AMERICAS								
Canada	International Merchandise Trade	m/m	Jan	3.97b	166b	1.30b	*	Equity and bond neutral
Mexico	CPI	y/y	Feb	3.77%	3.59%	3.75%	***	Equity and bond neutral
	Core CPI	y/y	Feb	3.65%	3.66%	3.63%	**	Equity and bond neutral
	Vehicle Production	y/y	Feb	317178	312257		*	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	Down
U.S. Sibor/OIS spread (bps)	429	429	0	Down
U.S. Libor/OIS spread (bps)	429	429	0	Down
10-yr T-note (%)	4.26	4.28	-0.02	Up
Euribor/OIS spread (bps)	251	250	1	Down
Currencies	**Direction**			
Dollar	Up	US		Down
Euro	Down	Euro		Up
Yen	Up	Japan		Up
Pound	Down	UK		Up
Franc	Down	Switzerland		Flat

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.

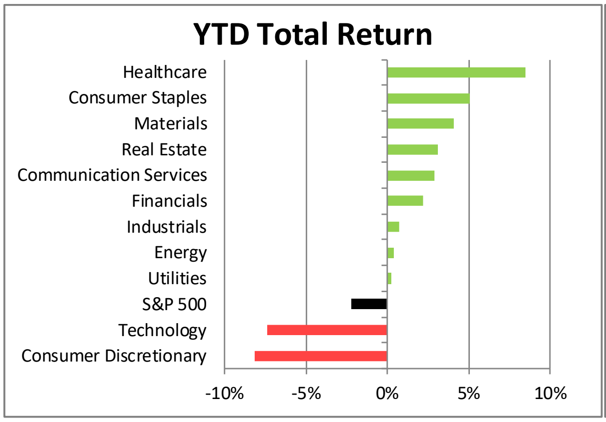
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$70.43	$69.46	1.40%	
WTI	$67.30	$66.36	1.42%	
Natural Gas	$4.20	$4.30	-2.49%	
Crack Spread	$23.63	$23.60	0.16%	
12-mo strip crack	$20.43	$20.38	0.26%	
Ethanol rack	$1.75	$1.75	0.06%	
Metals				
Gold	$2,921.97	$2,911.80	0.35%	
Silver	$32.47	$32.65	-0.53%	
Copper contract	$475.15	$480.75	-1.16%	
Grains				
Corn contract	$463.50	$464.00	-0.11%	
Wheat contract	$546.50	$554.00	-1.35%	
Soybeans contract	$1,026.50	$1,027.25	-0.07%	
Shipping				
Baltic Dry Freight	1,286	1,228	58	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	3.61	0.80	2.81	
Gasoline (mb)	-1.43	-0.75	-0.68	
Distillates (mb)	-1.32	1.50	-2.82	
Refinery run rates (%)	-0.6%	0.45%	-1.1%	
Natural gas (bcf)	-80	-94	14	

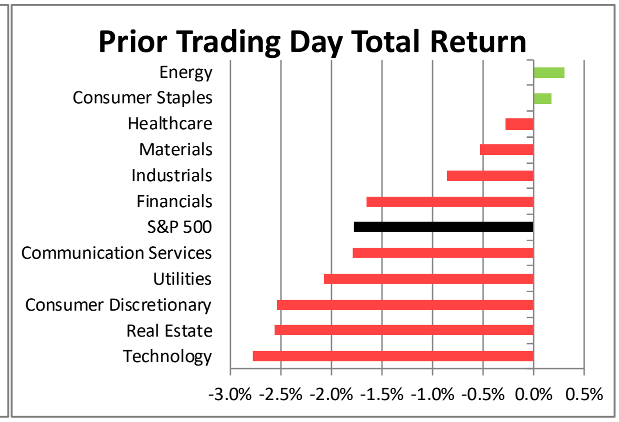
Weather

The 6-to-10 and 8-to-14-day forecasts call for cooler-than-normal temperatures from the Rocky Mountains westward, with warmer-than-normal temperatures from the Great Plains eastward. The forecasts call for wetter-than-normal conditions in all areas except for Texas and Florida. Conditions in Texas are expected to be drier than normal, while Florida's conditions will be near normal.

Data Section

US Equity Markets – (as of 3/6/2025 close)

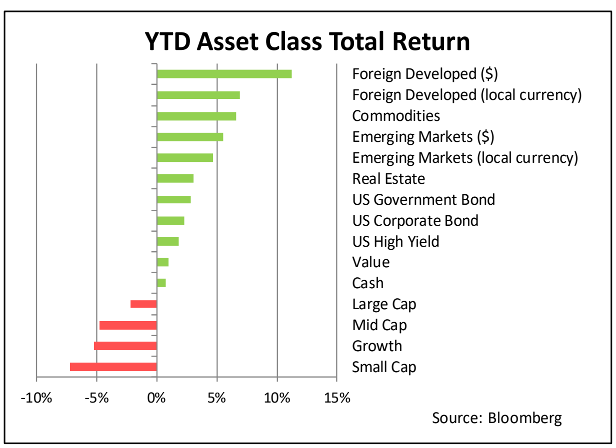




(Source: Bloomberg)

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 3/6/2025 close)

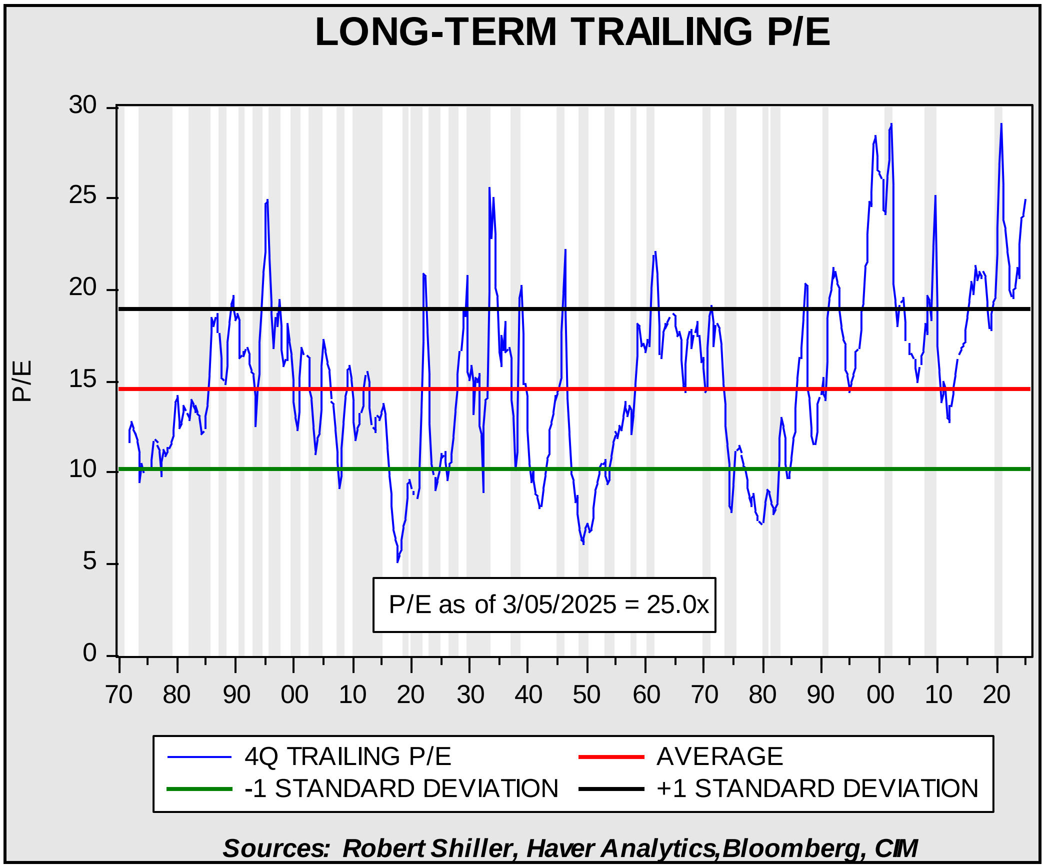


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

March 6, 2025



Based on our methodology,[1] the current P/E is 25.0x, down 0.1 from our last report. The drop in multiple was driven 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.