Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

Posted: June 5, 2025 — 9:30 AM ET] Global equity markets are mostly higher this morning. In Europe, the Euro Stoxx 50 closed up 0.4% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.1%. Chinese markets were higher, with the Shanghai Composite up 0.2% from its previous close and the Shenzhen Composite up 0.5%. 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
"Why Greenland Matters" (5/27/25) + podcast	"The Japan Problem" (6/2/25) + podcast	Q2 2025 Report Q2 2025 Rebalance Presentation	Confluence of Ideas Podcast Value Equity Quarterly Update Business Cycle Report

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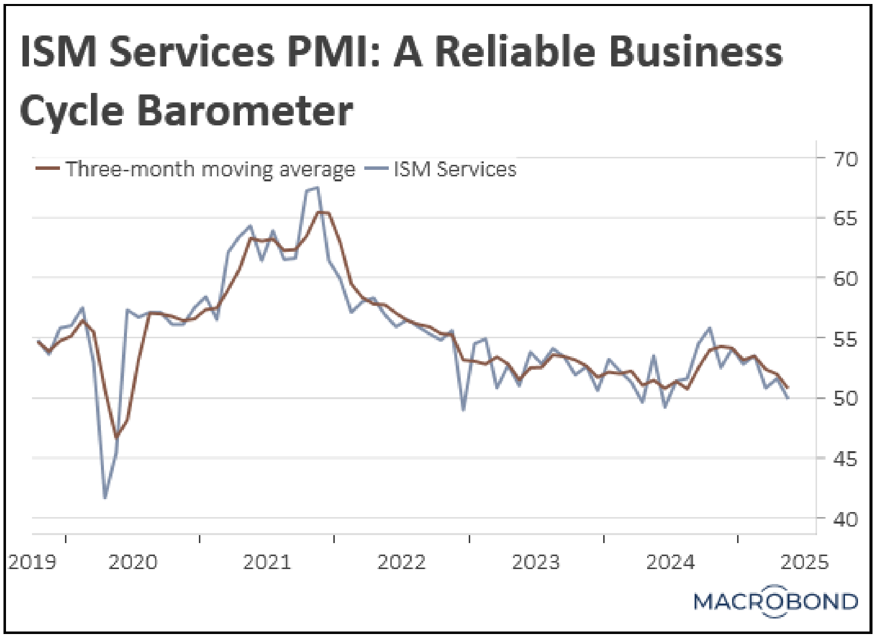
Good morning! The market remains focused on the latest developments in the tax bill. Today's *Comment* examines why the weak PMI reading may not be as significant as some fear, breaks down how the CBO scoring offered both positive and negative implications for the White House, and covers other key market updates. As usual, the report will also include a summary of today's domestic and international data releases.

Economic Jitters: Just a day after markets breathed a sigh of relief over surprisingly strong job numbers, fresh data casts doubt on that optimism.

- The ISM Services PMI unexpectedly fell from 51.6 to 49.9 in June. While a reading below 50 indicates potential contraction in the services sector, which represents nearly two-thirds of US economic activity, it appears that the decline more likely reflects statistical noise rather than fundamental weakness. The deterioration was concentrated in inventory and new orders components, which were particularly vulnerable to normalization effects following tariff front-running by firms.
- While much attention has been paid to the weak June figure, we believe the moving average is a more reliable indicator. Notably, the index has dipped below 50 three times since the pandemic without triggering a downturn, suggesting that a single weak month

may not be significant. However, if the three-month moving average falls below 50, that would be more consistent with an impending downturn.



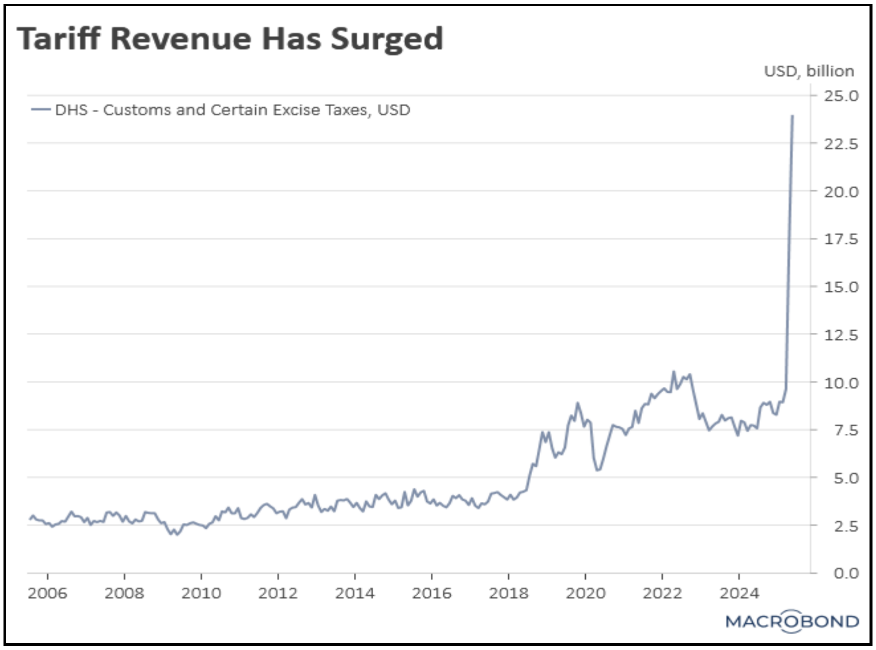
- While the indicator may not yet signal a downturn, it does suggest inflationary pressures are building. The key component to watch is prices paid. Not only is that hovering well above 60 (indicating strong expansion), but it also appears to be gaining momentum. If this trend continues, firms may be able to absorb higher costs through squeezed margins, reduced employment, or an increase in consumer prices.
- The economy is sending mixed signals — some good, some not so good — and inflation is still a worry. Because of this, the Fed is unlikely to cut interest rates at this time. Even if Friday's jobs report is weaker than expected, we don't think that will be enough to sway their decision. Right now, fed fund futures suggest that the central bank will cut rates 2-3 times this year, with the first being in September.

Budget in Better Balance: Despite criticism of the president's sweeping bill, the White House received favorable budget news.

- The Congressional Budget Office (CBO), a nonpartisan group, projects that the recently passed House budget will increase the national deficit by $2.42 trillion over the next decade. The bill shows expected increases in spending of $3.67 trillion along with a decline in spending of $1.25 billion. This estimate, however, does not factor in potential economic growth, which could partially offset the increase in the deficit.
- There was some good news. The CBO's analysis suggests that the tariffs imposed as of May 13, could offset a significant portion of the new spending, potentially even pushing the federal budget into surplus. According to the agency's estimates, these tariffs could generate up to $2.8 trillion in offsets, which may substantially reduce the deficit.

Additionally, the CBO projects that the policy would lower interest expenses, further improving the fiscal outlook.

- However, the head of the CBO included several caveats in the agency's analysis. The CBO warned that tariffs could reduce overall GDP by 0.6% over the forecast period and might increase inflation by 0.9% by 2026, before stabilizing afterward. Additionally, the agency cautioned that the estimates were subject to significant uncertainty, given the lack of historical precedent for tariffs of this size and scope. That said, we have already seen that tariffs are a strong revenue generator.



- The latest CBO estimates are likely to fuel arguments both for and against the president's new tax bill. Republican senators will likely need near-unanimous support to ensure passage — a feasible goal given their 53-seat majority and control of the White House, which provides a three-vote cushion. Given the high stakes, we anticipate the bill could be signed into law as early as next month, though passage by the end of summer appears more likely.

US-NATO Rift: While NATO members are boosting military expenditures, US strategic priorities appear to be rebalancing from the Russian threat to the Chinese challenge.

- The Pentagon has informed Congress of its intent to reallocate advanced anti-drone technology originally destined for Ukraine to US forces. This decision follows Russia's vow to retaliate against Ukraine after a successful drone strike deep inside Russian territory destroyed more than 40 aircraft. While the US president, who was not briefed on the operation beforehand, privately praised the attack, some reports suggest he also expressed concern that it might undermine his diplomatic peace efforts.
- Additionally, the US has declined to support a European proposal for an American security guarantee following any potential ceasefire agreement. Despite pressure from the

UK and France, who have urged Washington to provide air defense systems to support a coalition of European forces that would deter Moscow from any future reinvasion, the US remains unwilling to commit to enforcing the terms of a future Russia-Ukraine peace deal.

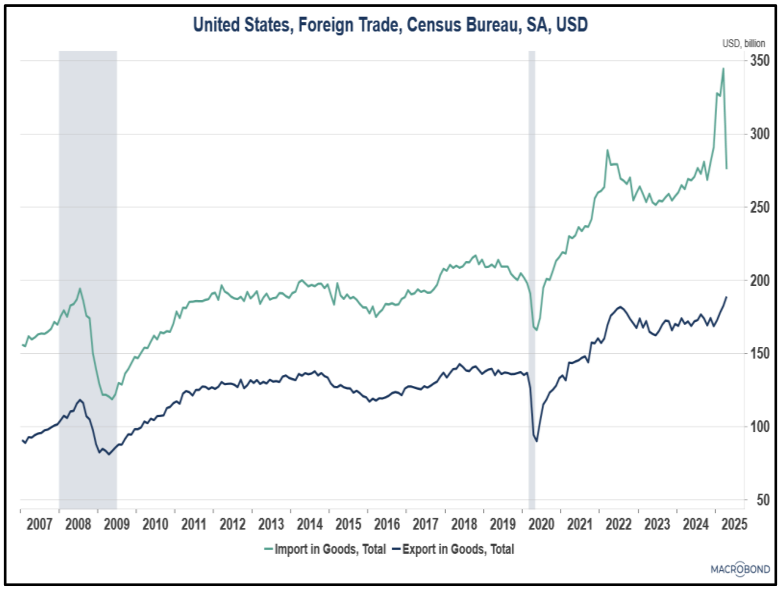
- These developments are likely to raise concerns among European leaders about the need to increase defense spending as the US shifts its strategic focus toward the Indo-Pacific. According to Secretary of Defense Pete Hegseth, NATO members appear poised to raise their defense spending target to 5% of GDP. Germany, Europe's largest economy, is positioned to take the lead, planning a significant military expansion that would add 60,000 active-duty personnel to its armed forces.
- The US strategic pivot away from NATO is expected to pressure European nations to increase defense spending. While this could lead to higher debt issuance among member states, potentially pushing up sovereign bond yields, the accompanying fiscal stimulus may provide support for equity markets.

Data Credibility: Growing concerns are emerging that budget cuts may compromise the reliability of official government statistics.

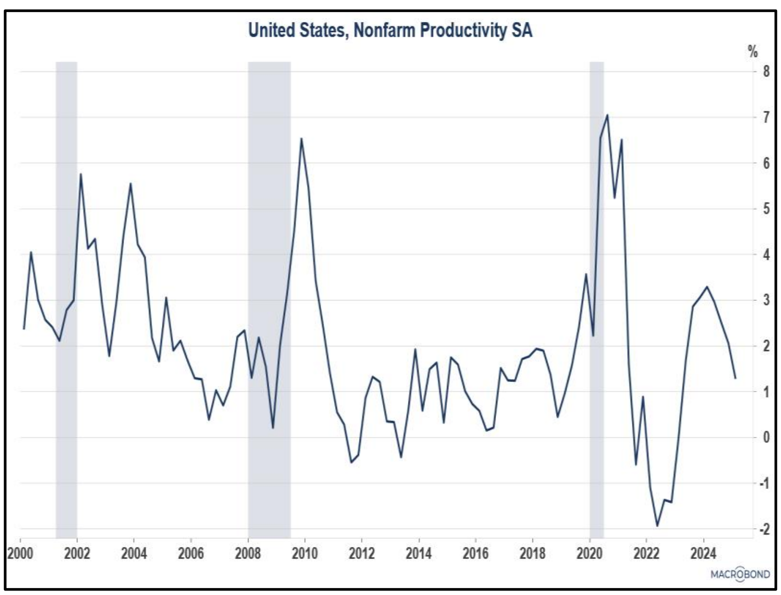
- The Trump administration has proposed cutting the Bureau of Labor Statistics' (BLS) budget by 8%, along with an equivalent reduction in staff. This comes as the agency — responsible for critical price and employment data — has faced years of underfunding that have compromised its data collection capabilities. These constraints have drawn particular criticism following significant downward revisions to last year's payroll figures, which undermined confidence in the agency's reporting.
- Budget cuts could lead to an increased reliance on private-sector data for economic assessment. However, these alternative sources may prove less reliable and more limited in scope than official government statistics, potentially distorting economic analysis and undermining informed policy decisions. Moreover, the reduced transparency could fuel market uncertainty, driving up risk premiums as investors grapple with diminished data quality and consistency.

US Economic Releases

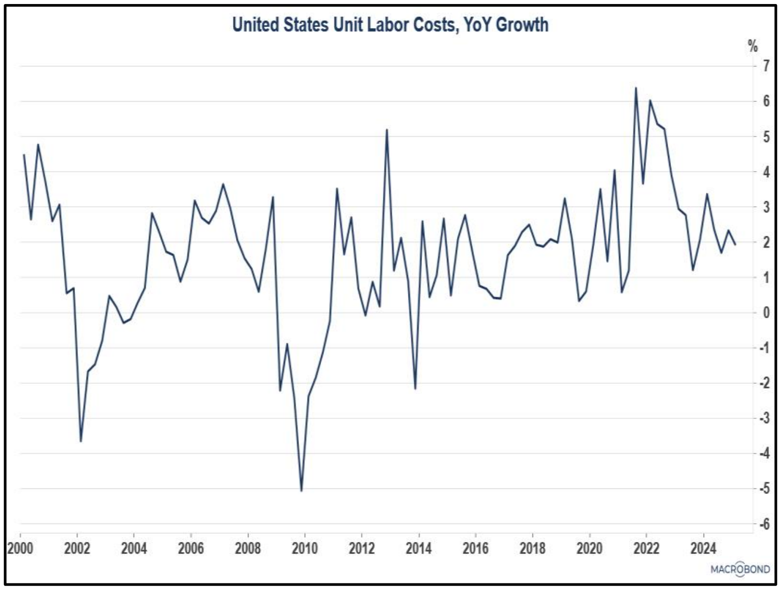
The April ***trade balance*** showed a seasonally adjusted deficit of $61.6 billion, compared to an expectation of $66.0 billion. This is significantly less than the previous month’s deficit of $138.3 billion, which reflected reactions to tariff news. According to the data, total ***exports*** rose 3.0%, while ***imports*** fell an extraordinary 16.3%, again in reaction to tariffs. Compared with the same month one year earlier, exports in April rose 9.9%, while imports rose 2.5%. The chart below shows the monthly value of U.S. exports and imports since just before the Global Financial Crisis.



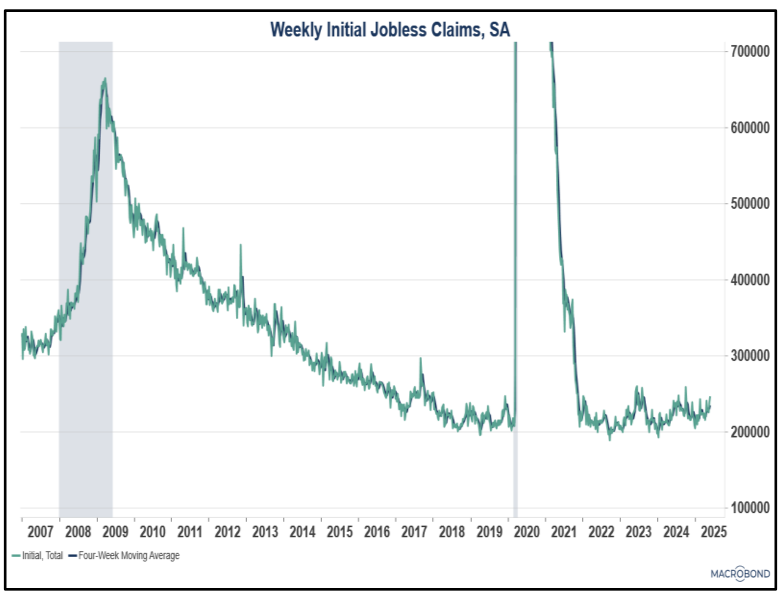
Another report today focused on the productivity of US workers, defined as the average value of output per hour worked. After stripping out price changes and normal seasonal fluctuations, first-quarter ***nonfarm productivity*** fell at an annualized rate of 1.5%, exceeding the expected value and that of the previous quarter, both of which had dropped 0.8%. Taking into account the fluctuations in each of the last four quarters, productivity in the first quarter rose 1.3% from the same period one year earlier. The chart below shows the year-over-year growth in real productivity since the turn of the century.



First-quarter ***unit labor costs*** rose at an annualized rate of 6.6%, exceeding both the expected value and that of the previous quarter, both of which were 5.7%. Unit labor costs in the first quarter rose 1.9% year-over-year. The chart below shows the year-over-year growth in unit labor costs since the turn of the century.



In the week ended May 31, ***initial claims for unemployment benefits*** rose to a seasonally adjusted 247,000 from 239,000 the previous week and exceeding the expected 235,000. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, rose to 235,000 from the previous 230,500. Meanwhile, in the week ended May 24, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) fell slightly to 1.904 million from the previous 1.907 million but fell short of the expected 1.91 million. 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.



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

Economic Releases		
	No economic releases for the rest of today	
Federal Reserve		
EST	**Speaker or Event**	**District or Position**
12:00	Adriana Kugler Speaks on Economic Outlook, Policy	Members of the Board of Governors
13:30	Patrick Harker Speaks on Economic Outlook	President of the Federal Reserve Bank of Philadelphia
13:30	Jeffrey Schmid Speaks on Banking Policy	President of the Federal Reserve Bank of Kansas City

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	Labor Cash Earnings	y/y	Apr	2.3%	2.3%	2.6%	**	Equity and bond neutral
	Real Cash Earnings	m/m	Apr	-1.8%	-1.8%	-1.6%	*	Equity and bond neutral
	Japan Buying Foreign Bonds	w/w	30-May	-¥118.0b	¥100.4b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	30-May	-¥1144.1b	-¥524.7b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	30-May	¥1165.4b	-¥332.8b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	30-May	¥336.1b	¥309.1b		*	Equity and bond neutral
Australia	Trade Balance	m/m	Apr	A$65413m	A$6892m	A$6000m	***	Equity and bond neutral
	Exports	m/m	Apr	-2.4%	7.2%		*	Equity and bond neutral
	Imports	m/m	Apr	1.1%	-2.4%		*	Equity and bond neutral
New Zealand	ANZ Commodity Price	m/m	May	1.9%	0.0%		**	Equity and bond neutral
South Korea	GDP	q/q	1Q P	0.0%	-0.1%	-0.1%	**	Equity and bond neutral
China	Official Composite PMI	m/m	May	49.6	51.1		*	Equity and bond neutral
	Official Services PMI	m/m	May	51.1	50.7	51.0	**	Equity and bond neutral
EUROPE								
Eurozone	PPI	y/y	Apr	0.7%	1.9%	1.1%	**	Equity and bond neutral
Germany	Factory Orders WDA	y/y	Apr	4.8%	3.7%	3.9%	***	Equity bullish, bond bearish
	HCOB Germany Construction PMI	m/m	May	44.4	45.1		*	Equity and bond neutral
Italy	Retail Sales	y/y	Apr	3.7%	-2.7%		**	Equity and bond neutral
UK	S&P Global UK Construction PMI	m/m	May	47.9	46.6	47.3	**	Equity bullish, bond bearish
	New Car Registrations	y/y	May	1.6%	-10.4%		*	Equity and bond neutral
Switzerland	Unemployment Rate	m/m	May	2.8%	2.8%	2.8%	**	Equity and bond neutral
Russia	Retail Sales	m/m	Apr	1.9%	2.3%	2.9%	***	Equity bearish, bond bullish
	Unemployment Rate	m/m	Apr	2.3%	2.3%	2.3%	***	Equity and bond neutral
AMERICAS								
Canada	S&P Global Canada Services PMI	m/m	May F	45.6	41.5		*	Equity and bond neutral
	S&P Global Canada Composite PMI	m/m	May	45.5	41.7		*	Equity and bond neutral
Brazil	S&P Global Brazil Composite PMI	m/m	May F	49.1	49.4		***	Equity and bond neutral
	S&P Global Brazil Services PMI	m/m	May	49.6	48.9		***	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)	422	424	-2	Up
U.S. Sibor/OIS spread (bps)	431	431	0	Up
U.S. Libor/OIS spread (bps)	432	432	0	Up
10-yr T-note (%)	4.35	4.36	-0.01	Down
Euribor/OIS spread (bps)	196	197	-1	Down
Currencies	**Direction**			
Dollar	Up			Down
Euro	Down			Up
Yen	Up			Up
Pound	Down			Up
Franc	Down			Up
Central Bank Action	**Current**	**Prior**	**Expected**	
Bank of Canada Rate Decision	2.75%	2.75%	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.

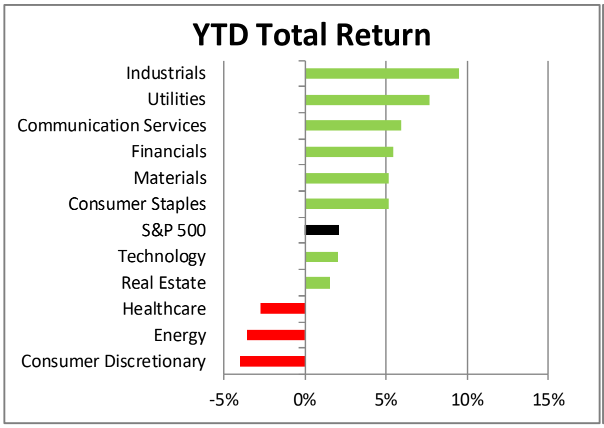
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$65.09	$64.86	0.35%	
WTI	$63.05	$62.85	0.32%	
Natural Gas	$3.69	$3.72	-0.65%	
Crack Spread	$23.47	$23.19	1.22%	
12-mo strip crack	$21.12	$20.97	0.71%	
Ethanol rack	$1.85	$1.85	-0.37%	
Metals				
Gold	$3,392.16	$3,372.72	0.58%	
Silver	$35.60	$34.50	3.17%	
Copper contract	$500.00	$488.65	2.32%	
Grains				
Corn contract	$441.25	$438.75	0.57%	
Wheat contract	$546.25	$543.25	0.55%	
Soybeans contract	$1,042.25	$1,045.00	-0.26%	
Shipping				
Baltic Dry Freight	1,489	1,430	59	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-4.30	-3.13	-1.18	
Gasoline (mb)	5.22	-0.50	5.72	
Distillates (mb)	4.23	0.17	4.06	
Refinery run rates (%)	3.2%	1.0%	2.2%	
Natural gas (bcf)		112		

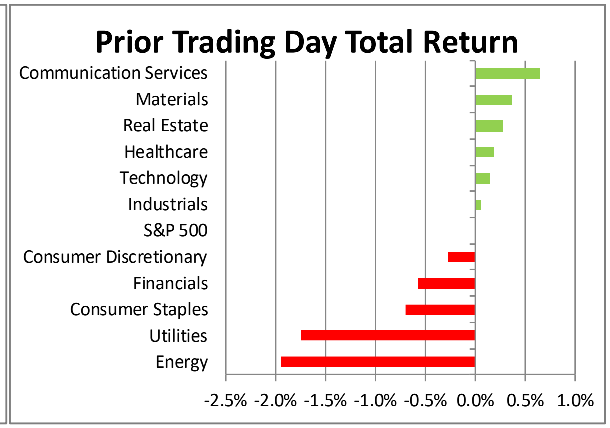
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures in the northern Great Plains and Rocky Mountains and the East and Gulf Coasts, with normal temperatures elsewhere. The outlook calls for wetter-than-normal conditions in the Southeast, Great Plains, and Rocky Mountains, with normal conditions elsewhere.

Data Section

US Equity Markets – (as of 6/4/2025 close)

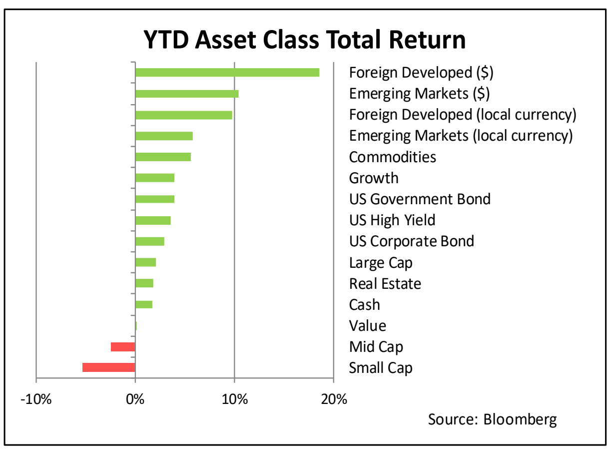




(Source: Bloomberg)

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 6/4/2025 close)

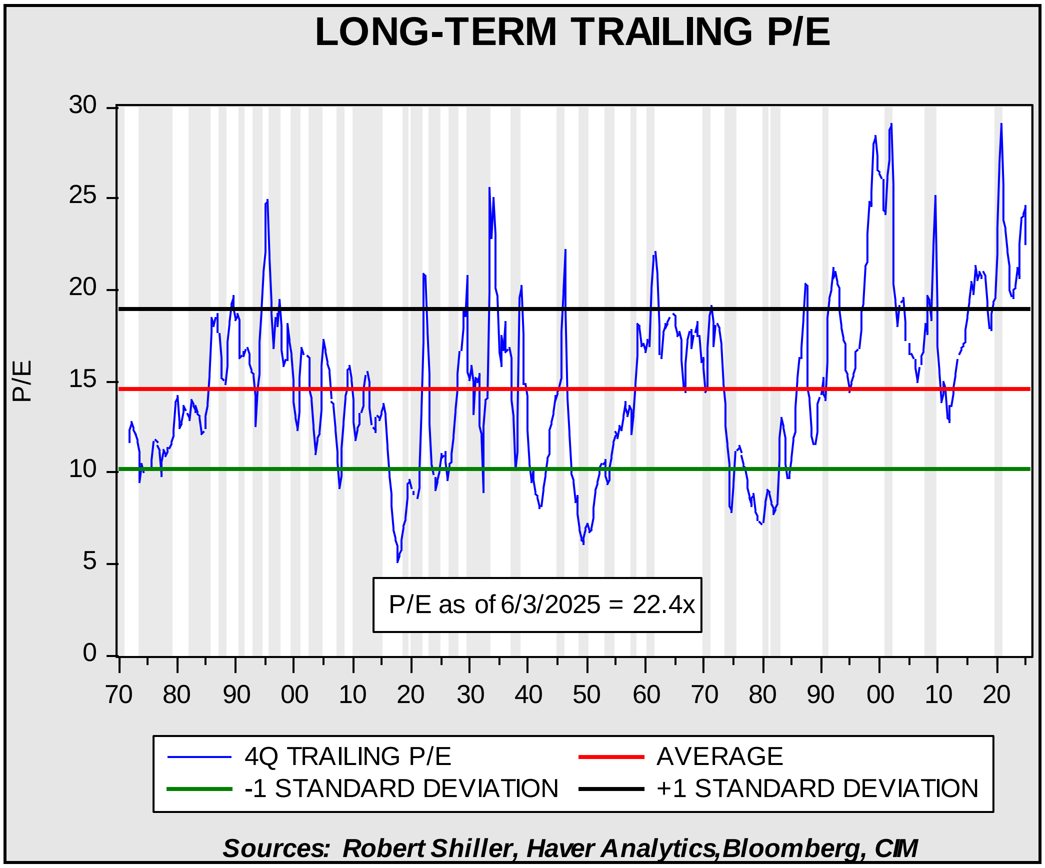


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

June 4, 2025



Based on our methodology,[1] the current P/E is 22.4x, up 0.1 from our last report. The increase in the multiple was due to a rise 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 (Q2, Q3, and Q4) and one estimate (Q1). 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.