Daily Comment

Confluence Investment Management

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Posted: May 12, 2025 — 9:30 AM ET] Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 closed up 1.6% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 2.5%. Chinese markets were higher, with the Shanghai Composite up 0.8% from its previous close and the Shenzhen Composite up 1.7%. US equity index futures are signaling a higher open.

With 452 companies having reported so far, S&P 500 earnings for Q1 are running at $63.80 per share compared to estimates of $60.75, which is up 7.3% from Q1 2024. Of the companies that have reported thus far, 77.0% have exceeded expectations, while 19.0% 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
"Export Controls" (4/28/25) + podcast	"US Capital Flight and the Implications for Investors" (5/5/25) + podcast	Q2 2025 Report **Q2 2025 Rebalance Presentation**	Keller Quarterly Business Cycle Report

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Our *Comment* today opens with an overview of the interim US-China trade deal announced earlier today. News of the deal has been reflected in surging values for all manner of risk assets around the world, but we also note a few words of caution for the longer term. We next review several other international and US developments with the potential to affect the financial markets today, including the latest on the India-Pakistan military tensions and a new proposal from President Trump to cut US drug prices.

United States-China: According to Trump administration officials, the US-China trade talks in Switzerland over the weekend yielded an interim agreement under which both sides would slash their tariffs on each other and dismantle other trade-war measures for 90 days. The three-month deal is designed to give the two sides time to negotiate a new permanent trade structure. In response, global risk markets are surging so far this morning, with futures linked to the S&P 500 price index up more than 3% as of this writing. US bond yields and the dollar are also rising.

- Under the deal, the US will slash its "reciprocal" tariffs on Chinese imports to 10% from the current 125% for the interim period, while China will slash its retaliatory tariffs to 10% from 125%. However, the US will maintain its 20% punitive tariff linked to fentanyl trafficking, which means most Chinese imports will face a tariff of 30%. The US's product-specific tariffs on steel, aluminum, autos, and some other goods will also remain.
- Under the deal, China will also suspend or cancel some of its non-tariff retaliatory measures against the US, potentially including its clampdown on exporting critical minerals.
- However, despite the market euphoria today, we think it's unlikely that the administration would allow the US tariffs and trade barriers against China to ultimately settle anywhere near as low as they were before Trump's second term. If the US's trade barriers against China were going to revert to their previous low levels, there would have been no reason for the disruptive tariff announcements of the last four months.
- More generally, we think the US is likely to maintain much higher barriers to foreign imports than in the past, sparking major changes in economic dynamics and international capital flows over the long term, including a possible intensification of the capital flight out of the US that has become apparent over the last month or more.
- Indeed, the director of the non-partisan Congressional Budget Office recently warned that the US's tariff war could discourage foreigners from buying US financial assets going forward, potentially weighing on US economic performance.

India-Pakistan: After four days of cross-border airstrikes and drone attacks, a ceasefire struck by New Delhi and Islamabad early Saturday appears to be holding, despite initial violations by both sides. Even though global investors had taken a surprisingly sanguine view of the conflict between the two nuclear-armed nations, we think the situation bears continued watching and could potentially still upend financial markets if the fighting flares again.

Russia-Ukraine: After publicly expressing his support for the Ukrainian people on Sunday, newly installed Pope Leo XIV today reportedly held a phone call with Ukrainian President Zelensky. According to Zelensky, the conversation was "very warm and truly substantive." The news shows that Leo XIV may continue to throw his moral weight behind the Ukrainians after his predecessor, Pope Francis, struck a much more neutral tone and sometimes seemed to suggest that Kyiv should capitulate to the Russian invasion.

Turkey: The leadership of the Kurdistan Workers' Party, or PKK, which has been fighting Ankara for independence and greater Kurdish rights since the 1980s, today said it will give up its military struggle and disarm. While it still isn't clear that all PKK militants will stop their attacks on the government, the announcement is a breakthrough that could increase political stability in Turkey and help ease US-Turkish tensions. It is therefore likely to provide a boost to Turkish stocks going forward.

South Korea: Illustrating the chaos in the conservative People's Power Party ahead of the June presidential election, the group on Saturday canceled its decision one week earlier to nominate Kim Moon-soo as its presidential candidate. Party leaders said the move was needed after former Prime Minister Han Duck-soo expressed an interest in the role, upending the consensus for Kim. The PPP's disarray reinforces expectation that the liberal Democratic Party's Lee Jae-myung is in the driver's seat to take over as president.

United Kingdom: Prime Minister Starmer today announced a sweeping reform of the British immigration system that marks a sharp clampdown on inward migration. The dramatic changes appear in part to be a response to surging support for Nigel Farage and his anti-immigration Reform UK party. In any case, the reform shows how even center-left politicians throughout the West, such as Starmer and his Labour Party, are now trying to respond to the rise of populist nationalism in their societies, despite the potential negative impact on labor supply.

- Among other measures, Starmer's reform ends automatic "settlement," or permanent legal residency, for immigrants after five years. Instead, immigrants will only get settlement after living legally in the UK for 10 years, unless they can show "a real and lasting contribution to the economy and society."
- The reform will also tighten work visa rules.

US Drug Industry: Over the weekend, President Trump indicated he will sign an executive order today requiring the federal government to pay "most favored nation" prices for prescription drugs. In other words, rather than pay today's ultra-high prices for many key drugs, the policy would require cutting the US prices to the same low levels paid by many foreign governments. If fully implemented, the policy might help some medical providers and healthcare consumers, but it would likely cut into the revenues of major pharmaceutical firms.

US Beef Industry: Recent price data and food firms' earnings reports show US beef prices are surging as ranchers reduce their herds in response to drought, lost grazing land, and higher input costs. For example, the latest consumer price index shows the price of ground beef is now up 12.8% year-over-year, standing at a record $5.79 per pound. The rise in beef prices will likely spur consumers to shift more toward cheaper types of protein and potentially undermine President Trump's political support.

US Economic Releases

No major US economic reports have been released so far today. The table below lists the economic releases and Fed events scheduled for the rest of the day.

Economic Releases						
EST	Indicator			Expected	Prior	Rating
14:00	Federal Budget Balance	m/m	Mar	256.0b%	-$160.5b	**
Federal Reserve						
EST	Speaker or Event	District or Position				
10:45	Adriana Kugler Speaks on Economic Outlook	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								
Japan	BoP Current Account Balance	m/m	Mar	¥3678.1b	¥4060.7b	¥3790.8b	***	Equity and bond neutral
	BoP Trade Balance	m/m	Mar	¥516.5b	¥712.9b	¥547.7b	**	Equity and bond neutral
China	PPI	y/y	Apr	-2.7%	-2.5%	-2.8%	**	Equity and bond neutral
	CPI	y/y	Apr	-0.1%	-0.1%	-0.1%	**	Equity and bond neutral
EUROPE								
Switzerland	Domestic Sight Deposits CHF	w/w	9-May	444.8b	443.1b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	9-May	453.2b	454.1b		*	Equity and bond neutral
AMERICAS								
Canada	Net Change in Employment	m/m	Apr	7.4k	-32.6k	5.0k	***	Equity and bond neutral
	Unemployment Rate	m/m	Apr	6.9%	6.7%	6.8%	***	Equity and bond neutral
	Participation Rate	m/m	Apr	65.3%	65.2%	65.3%	*	Equity and bond neutral
Mexico	Industrial Production	y/y	Mar	1.9%	-1.3%	1.5%	***	Equity and bond neutral
	Manufacturing Production	y/y	Mar	3.1%	-0.3%	3.5%	*	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)	421	423	-2	Up
U.S. Sibor/OIS spread (bps)	431	431	0	Flat
U.S. Libor/OIS spread (bps)	430	431	-1	Down
10-yr T-note (%)	4.39	4.38	0.01	Up
Euribor/OIS spread (bps)	214	215	-1	Down
Currencies	**Direction**			
Dollar	Up			Down
Euro	Down			Up
Yen	Up			Up
Pound	Down			Up
Franc	Down			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.

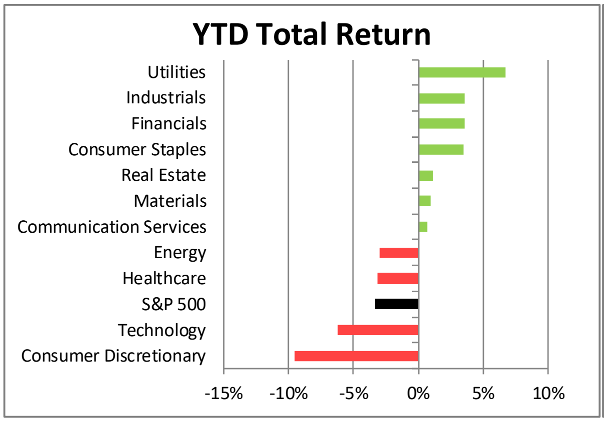
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$66.31	$63.91	3.76%	
WTI	$63.49	$61.02	4.05%	
Natural Gas	$3.73	$3.80	-1.82%	
Crack Spread	$26.93	$27.05	-0.46%	
12-mo strip crack	$22.48	$22.47	0.04%	
Ethanol rack	$1.84	$1.84	0.02%	
Metals				
Gold	$3,223.36	$3,324.98	-3.06%	
Silver	$32.30	$32.72	-1.29%	
Copper contract	$469.00	$465.30	0.80%	
Grains				
Corn contract	$453.75	$449.75	0.89%	
Wheat contract	$521.50	$521.75	-0.05%	
Soybeans contract	$1,071.50	$1,051.75	1.88%	
Shipping				
Baltic Dry Freight	1,299	1,316	-17	

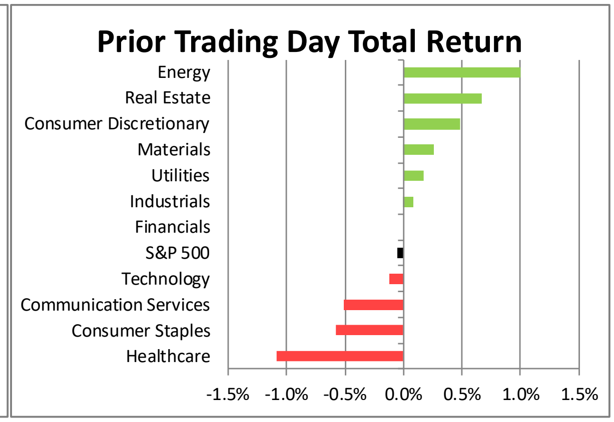
Weather

The 6-to-10 and 8-to-14-day forecasts currently call for warmer-than-normal temperatures throughout most southern states, with cooler-than-normal temperatures for the rest of the country. The precipitation outlook calls for wetter-than-normal conditions in most states west of the Rocky Mountain, with dry conditions expected in the Pacific region and Florida.

Data Section

US Equity Markets – (as of 5/9/2025 close)

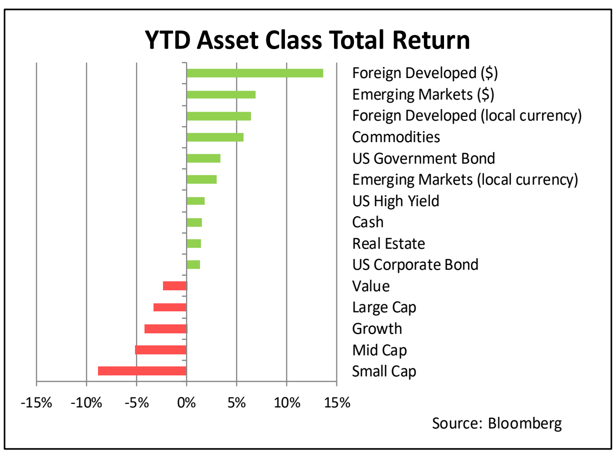




(Source: Bloomberg)

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 5/9/2025 close)

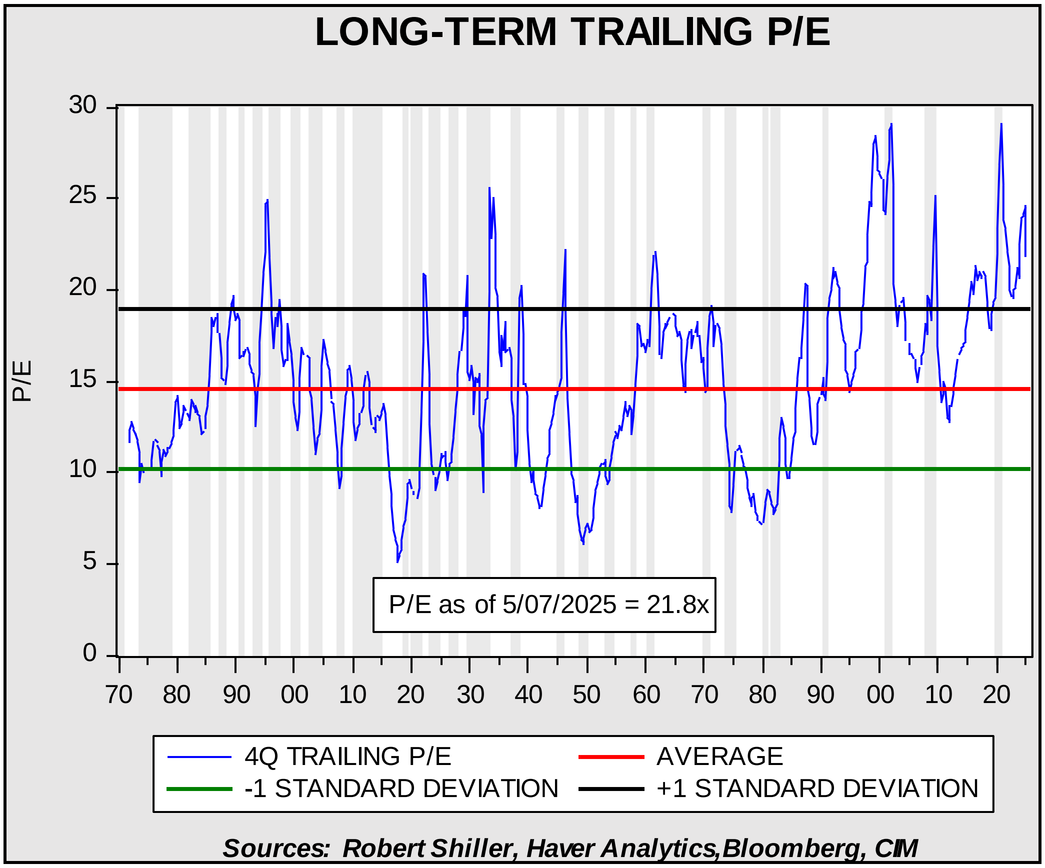


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

May 8, 2025



Based on our methodology,[1] the current P/E is 21.8x, up 0.2 from our last report. The rise in the stock price index outweighed the increase in earnings.

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.