Daily Comment

Confluence INVESTMENT MANAGEMENT

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

Posted: May 15, 2025 — 9:30 AM ET] Global equity markets are lower this morning. In Europe, the Euro Stoxx 50 closed down 0.3% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.1%. Chinese markets were lower, with the Shanghai Composite down 0.7% from its previous close and the Shenzhen Composite down 1.4%. US equity index futures are signaling a lower open.

With 458 companies having reported so far, S&P 500 earnings for Q1 are running at $63.90 per share compared to estimates of $60.75, which is up 7.3% from Q1 2024. Of the companies that have reported thus far, 77.1% 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
"Update on the US-China Balance of Power" (5/12/25)	"US Capital Flight and the Implications for Investors" (5/5/25) + podcast	Q2 2025 Report Q2 2025 Rebalance Presentation	Confluence of Ideas Podcast Value Equity Quarterly Update

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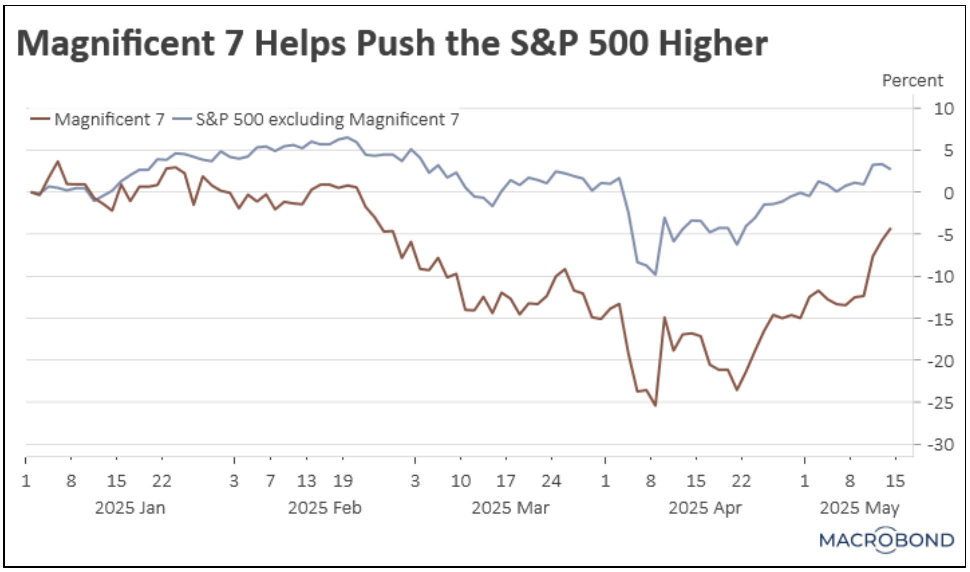
Good morning! The market is currently focused on analyzing the latest slew of economic data. In sports news, fans are celebrating as the Minnesota Timberwolves secured their spot in the NBA Western Conference Finals. In today's *Comment*, we'll examine the sources of the market's growing optimism, the underappreciated strategic depth behind Trump's negotiation tactics, and other notable market developments. We'll conclude with our regular roundup of international and domestic data releases.

Market Optimism: The initial shock from the tariffs appears to be fading, with the market increasingly reflecting a risk-on sentiment.

- Since the president's controversial Liberation Day announcement, which imposed steep tariffs on key trading partners, the S&P 500 has not only fully recovered its initial losses but has now climbed above its 200-day moving average. This rebound reflects improving market sentiment, as investors grow increasingly confident that the administration may adopt a more flexible approach than initially feared when the tariffs were introduced.

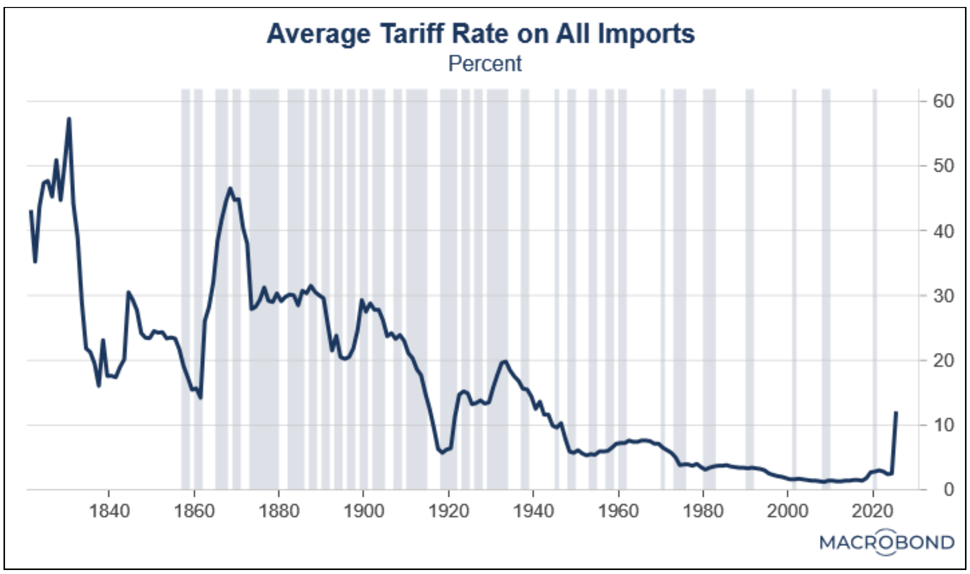
- Following progress in trade negotiations with the UK and China, the US announced on Thursday that additional countries have shown willingness to engage on some of the president's key trade concerns. On Thursday, he revealed that India is considering eliminating all tariffs on US goods. Meanwhile, there have also been discussions suggesting that EU officials are increasingly confident about reaching a deal with the Trump administration.



- Following progress in trade talks, we have seen investors return to the momentum trade that drove the S&P 500 higher in 2023 and 2024. Notably, investors have rushed back into AI-related firms amid optimism that demand for new technology will fuel strong earnings growth over the coming years. The most significant gainers have been Tesla and Nvidia, which both have surged roughly 23% since April 2.
- Investors increasingly believe the president will adopt a more pragmatic approach to tariffs moving forward — a shift many interpret as a sign that the worst may be over. As a result, markets have begun pricing in the prospect of future trade progress, which could significantly benefit US firms. While it is still too early to confirm whether this optimism is justified, sentiment is likely to hold as long as the administration signals no further escalation in tariffs beyond current levels.
- Consequently, we believe it may be prudent to begin cautiously testing the market, particularly by targeting companies with minimal supply chain risks and strong earnings potential. These firms are likely to show the most upside risk as long as the economy continues to grow. That said, there are still risks that are hard to quantify; therefore, a wait and see approach is still the safest.

Trump's Strategy: While the president's trade policies may appear volatile, there may be more strategy at play than many realize.

- His decision to impose steep tariffs on fentanyl-related imports from allies and China caught markets by surprise. At the time, many had underestimated his willingness to escalate a trade war due to the impact it would have on equities. As a result, the tariff led to an immediate market sell-off. This move put other countries on notice that he meant business but also forced companies to stockpile goods and brace for further disruptions.
- Next, he imposed sky-high tariffs on nearly all major trade partners, redefining a "trade cheat" not as a country exploiting the system, but simply as any nation running a surplus with the US. By pushing tariffs to extreme levels, he reshaped market expectations of how high tariffs could go, while reinforcing his broader goal of fundamentally restructuring US trade relationships.
- Then, in a tactical pivot, he slashed tariffs to a flat 10% — still triple pre-trade war levels but significantly below his initial demands. This triggered another round of inventory hoarding while boosting government tariff revenues and showcasing their viability as a fiscal tool. More importantly, it delivered an unambiguous warning to trade partners that access to the US market now comes with strings attached.



- Meanwhile, China's tariffs were maintained at effectively prohibitive levels, compelling Chinese exporters to divert goods to alternative markets. This deliberate oversupply strategy served a dual purpose as it demonstrated the disruptive consequences of Chinese export dominance while creating economic incentives for other countries to align with US efforts to restrain China's trade practices.
- The US strategically reduced Chinese tariffs to triple the standard rate applied to other nations in a calibrated move that maintained China's status as the primary trade-policy target. This triggered two key effects: (1) an immediate surge in imports as companies raced to rebuild inventories, boosting tariff revenues; and (2) sustained pressure on US firms to accelerate supply chain diversification away from Chinese manufacturing hubs.
- While this breakdown omits many nuances and certain events, the key takeaway is clear: The president's tactics, though unorthodox, serve deliberate goals. The trade war is

unlikely to end soon, but the volatility itself has secondary benefits such as generating revenue through inventory surges, which could sustain growth longer than many realize. While the ultimate outcome of these policy shifts remains uncertain, there are strong indications of a broader, calculated strategy at work.

Tax Bill Gets Uncomfortable: Republican lawmakers are expected to have a tax bill by July; however, there still seems to be a lot of disagreement over the details.

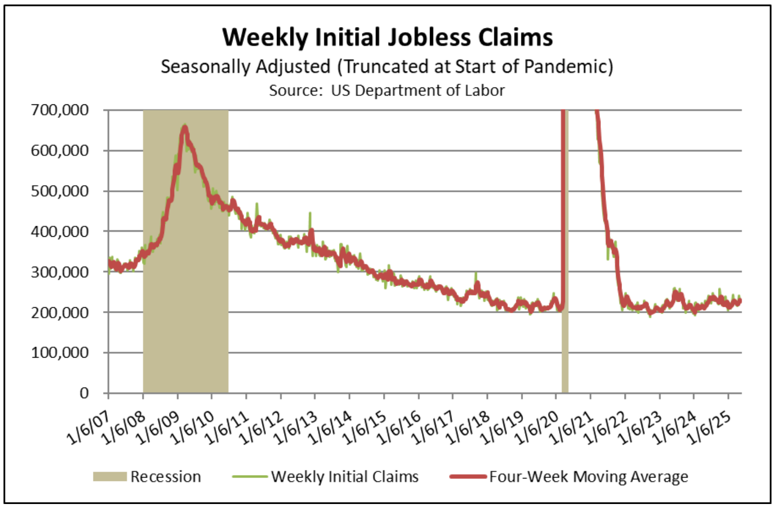
- Republican lawmakers from high-tax states are set to gain a significant tax concession, with a proposed bill raising the State and Local Tax (SALT) deduction cap to $80,000. This compromise follows threats from several Republicans to block extensions of Trump-era tax cuts unless the deduction — capped at $10,000 since 2017 — was increased. The negotiated change, if enacted, would represent a notable win for moderates in high tax states.
- The House has advanced a bill that would impose steep cuts to Medicaid. Key provisions include imposing work requirements (with specific exemptions) for childless adults aged 19 to 64, eliminating states' ability to tax healthcare providers for Medicaid funding, and penalizing states offering Medicare access to individuals without legal status. While some conservative lawmakers have expressed concerns about these changes to social programs, it remains unclear whether they have sufficient votes to block the bill.
- The proposed increase in the SALT deduction cap, combined with spending restrictions on Medicaid, will likely result in a narrow passage in the House but spark a more contentious debate in the Senate. While the legislation is still expected to pass, further amendments may be introduced to mitigate its political fallout. That said, the bill's enactment would likely be supportive for equities.

Trump Deregulation Push: The White House is set to start rolling back bank rules in a win for the financial industry.

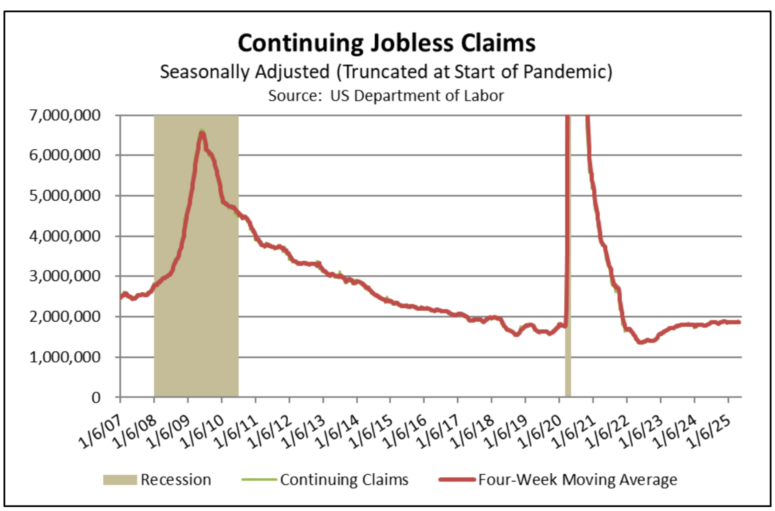
- Regulators are expected to lower capital requirements for banks in a move that could affect their lending capacity. Specifically, they plan to reduce the supplementary leverage ratio (SLR), a rule mandating that large banks maintain a minimum level of high-quality capital relative to their leverage. This ratio acts as a buffer against liquidity shortages during periods of financial stress.
- The financial industry has consistently opposed the rule, arguing that its capital requirements not only constrain lending to households but also discourage banks from acting as stabilizers in the Treasury market. By including Treasury securities in the leverage ratio calculation, the rule limits banks' ability to absorb shocks during periods of bond market stress — a weakness starkly exposed during last month's volatility.
- The easing of financial regulations is expected to provide a meaningful boost to economic activity. By reducing capital constraints on banks, the policy shift should expand credit availability, enabling households to secure financing more easily and supporting a rebound in consumer spending. This rule change should help support the broader economy.

US Economic Releases

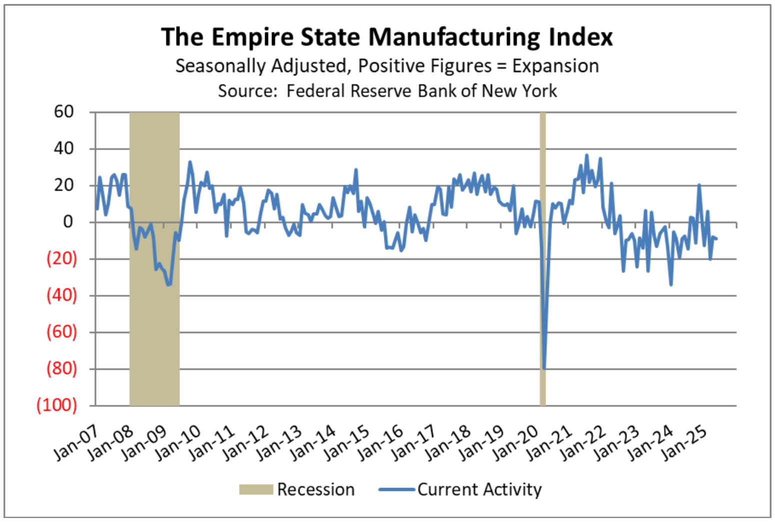
In the week ended May 10, ***initial claims for unemployment benefits*** held steady at a seasonally adjusted 229,000, matching the previous week's revised level and only slightly above the expected level of 228,000. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, rose to 230,500. 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.



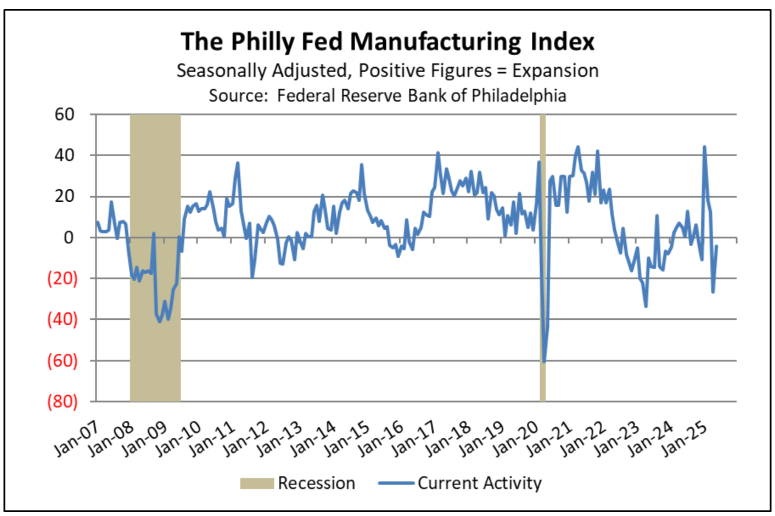
In the week ended May 3, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) rose to a seasonally adjusted 1.881 million, below the anticipated reading of 1.890 million but still above the prior week's revised reading of 1.872 million. The four-week moving average of continuing claims rose to a five-month high of 1,873,500. 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.



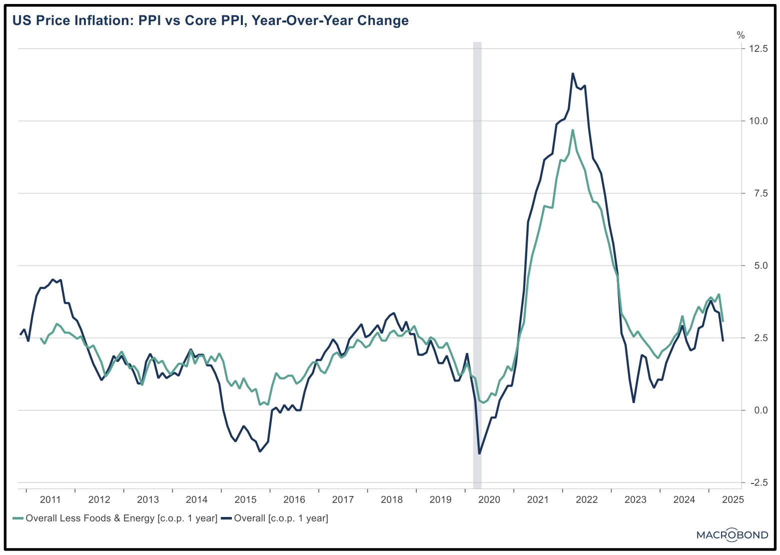
Separately, the New York FRB said its May ***Empire State Manufacturing Index*** fell to a seasonally adjusted -9.2, worse than both the expected level of -8.0 and the April level of -8.1. This index is designed so that positive readings point to expanding factory activity in New York state. At its current level, the index suggests New York manufacturing has now contracted for three straight months. The chart below shows how the index has fluctuated since before the GFC.



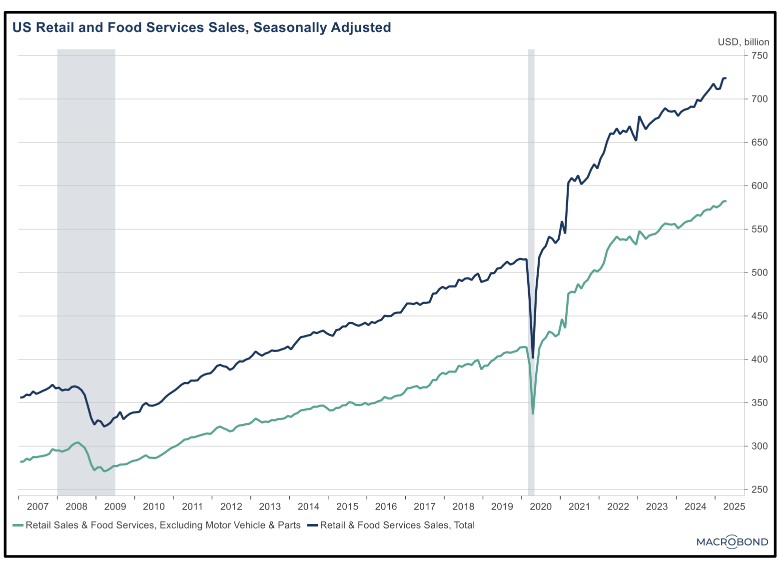
In contrast to the New York data, the Philadelphia FRB said its May ***Philly Fed Index*** rose to a seasonally adjusted -4.0, much better than both the anticipated reading of -11.0 and the April reading of -26.4. The index, officially designated as the Philadelphia FRB Manufacturing Activity Index, 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 has now contracted for two straight months. The chart below shows how the index has fluctuated since just before the GFC.



In data on business pricing, the April ***producer price index (PPI)*** unexpectedly fell by a seasonally adjusted 0.5%, in contrast with the expected rise of 0.2% and the revised flat reading for March. Excluding the volatile food and energy components, the April ***"core" PPI*** declined 0.4%, in contrast with its anticipated rise of 0.3% and the revised 0.4% increase in March. The overall PPI in April was up 2.4% from the same month one year earlier, while the core PPI was up 3.1%. The chart below shows the year-over-year change in the PPI and the core PPI over the last decade or so.



Finally, in data on the consumer sector, April ***retail sales*** rose by a seasonally adjusted 0.1%, slightly beating expectations for a flat reading but still a huge slowdown from the revised gain of 1.7% in March. Of course, overall retail sales are often driven by the volatile auto and auto parts sector, which makes up almost one-fifth of the total, but that wasn't the case this time around. April ***retail sales excluding autos and auto parts*** were also up 0.1%, short of their expected rise of 0.3% and much slower than their 0.8% gain in the previous month. Overall retail sales in April were up 5.2% from the same month one year earlier, while sales excluding autos and auto parts were up 4.2%. The chart below shows how retail sales have changed since just before the GFC.



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

Economic Releases						
EST	Indicator			Expected	Prior	Rating
10:00	Business Inventories	m/m	Mar	0.2%	0.2%	*
10:00	NAHB Housing Market Index	m/m	May	40	40	*
Federal Reserve						
EST	Speaker or Event	District or Position				
8:40	Jerome PowellSpeaks on Framework Review	Chairman of the Board of Governors				
14:05	Michael Barr Gives Opening Remarks	U.S. Federal Reserve Vice Chairman for Supervision				
	Second Thomas Laubach Research Conference	Live Broadcast at federalreserve.gov				

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	Expected
ASIA-PACIFIC								
Japan	Japan Buying Foreign Bonds	w/w	9-May	¥1923.2b	-¥541.2b		*	Equity and bond neutral
	Japan Buying Foreign Stocks	w/w	9-May	¥250.8b	¥2545.4b		*	Equity and bond neutral
	Foreign Buying Japan Bonds	w/w	9-May	-¥141.1b	-¥912.7b		*	Equity and bond neutral
	Foreign Buying Japan Stocks	w/w	9-May	¥439.0b	¥968.0b		*	Equity and bond neutral
	Machine tool orders	y/y	Apr P	7.7%	11.4%		**	Equity and bond neutral
Australia	Consumer Inflation Expectation	m/m	May	4.10%	4.20%		***	Equity and bond neutral
	Employment Change	m/m	Apr	89.0k	36.4k	22.5k	***	Equity bullish, bond bearish
	Unemployment Rate	m/m	Apr	4.1%	4.1%	4.1%	***	Equity and bond neutral
	Participation Rate	m/m	Apr	67.1%	66.8%	66.8%	**	Equity bullish, bond bearish
New Zealand	Food Prices	m/m	Apr	0.8%	0.5%		***	Equity and bond neutral
EUROPE								
Eurozone	GDP	y/y	1Q S	1.2%	1.2%	1.2%	***	Equity and bond neutral
	Industrial Production WDA	y/y	Mar	3.6	1.0	2.2	***	Equity bullish, bond bearish
France	CPI	y/y	Apr F	0.8%	0.8%	0.8%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	Apr F	0.9%	0.8%	0.8%	**	Equity and bond neutral
	CPI Ex-Tobacco Index	q/q	Apr	119.93	119.24	119.87	*	Equity and bond neutral
UK	GDP	y/y	1Q P	1.3%	1.5%	1.2%	***	Equity and bond neutral
	Total Business Investment	y/y	1Q P	8.1%	1.8%	2.3%	*	Equity and bond neutral
	Industrial Production	y/y	Mar	-0.7%	0.4%	-0.8%	***	Equity and bond neutral
	Manufacturing Production	y/y	Mar	-0.8%	0.5%	-0.5%	**	Equity and bond neutral
	Index of Services 3M/3M	m/m	Mar	0.7%	0.6%	0.7%	**	Equity and bond neutral
	Construction Output	m/m	Mar	1.4%	1.4%	1.3%	**	Equity and bond neutral
	Visible Trade Balance GBP	m/m	Mar	-£19869m	-£20964m	-£19000m	**	Equity and bond neutral
	Trade Balance GBP	y/y	Mar	-£3696m	-£4856m	-£1956m	**	Equity and bond neutral
Switzerland	Producer & Import Prices	y/y	Apr	-0.5%	-0.1%		**	Equity and bond neutral
AMERICAS								
Canada	Building Permits	m/m	Mar	-4.1%	4.9%	-1.20	**	Equity bearish, bond bullish
Brazil	Retail Sales	y/y	Mar	-1.0%	1.6%	-0.7%	***	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)	428	428	0	Up
U.S. Sibor/OIS spread (bps)	432	433	-1	Flat
U.S. Libor/OIS spread (bps)	432	432	0	Down
10-yr T-note (%)	4.51	4.54	-0.03	Up
Euribor/OIS spread (bps)	214	214	0	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.

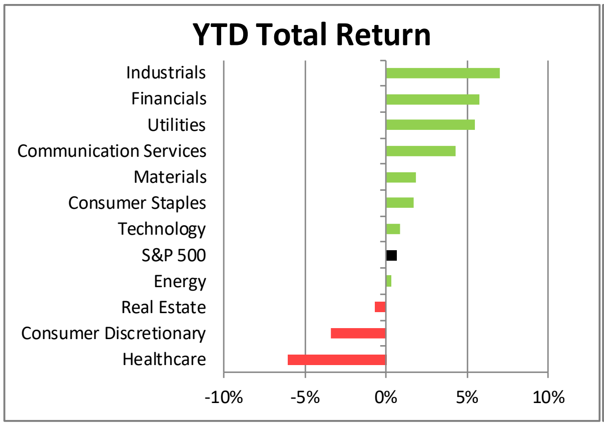
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$64.06	$66.09	-3.07%	
WTI	$61.10	$63.15	-3.25%	
Natural Gas	$3.46	$3.49	-1.06%	
Crack Spread	$27.90	$28.34	-1.53%	
12-mo strip crack	$22.64	$23.14	-2.17%	
Ethanol rack	$1.83	$1.83	-0.11%	
Metals				
Gold	$3,182.01	$3,177.25	0.15%	
Silver	$32.16	$32.23	-0.22%	
Copper contract	$464.10	$465.05	-0.20%	
Grains				
Corn contract	$445.00	$445.50	-0.11%	
Wheat contract	$524.00	$524.75	-0.14%	
Soybeans contract	$1,062.50	$1,077.75	-1.41%	
Shipping				
Baltic Dry Freight	1,267	1,280	-13	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	3.45	-2.21	5.66	
Gasoline (mb)	-1.02	-0.94	-0.08	
Distillates (mb)	-3.16	0.12	-3.28	
Refinery run rates (%)	1.2%	0.7%	0.5%	
Natural gas (bcf)		110		

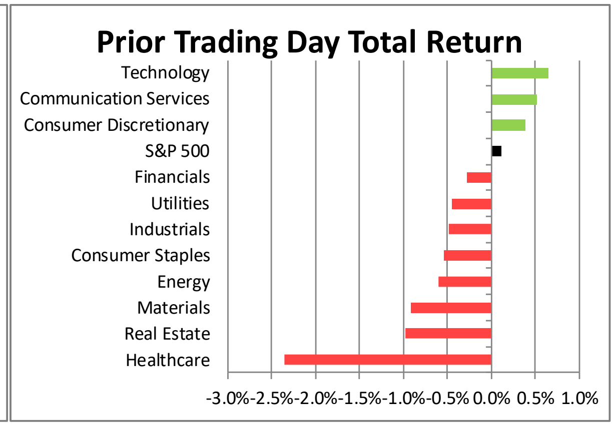
Weather

The 6-to-10 and 8-to-14-day forecasts currently call for warmer-than-normal temperatures across the southern half of the country, with cooler-than-normal temps in the northern Great Plains, the Midwest, and the Northeast. The forecasts call for wetter-than-normal conditions in Texas and the Northeast, with dry conditions in California, Oregon, Nevada, and Florida.

Data Section

US Equity Markets – (as of 5/14/2025 close)

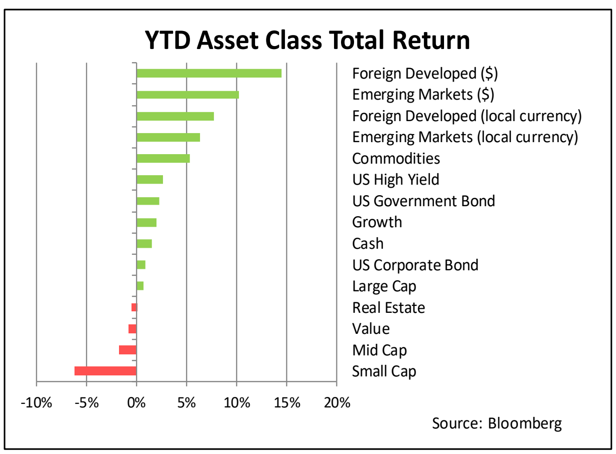




(Source: Bloomberg)

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 5/14/2025 close)

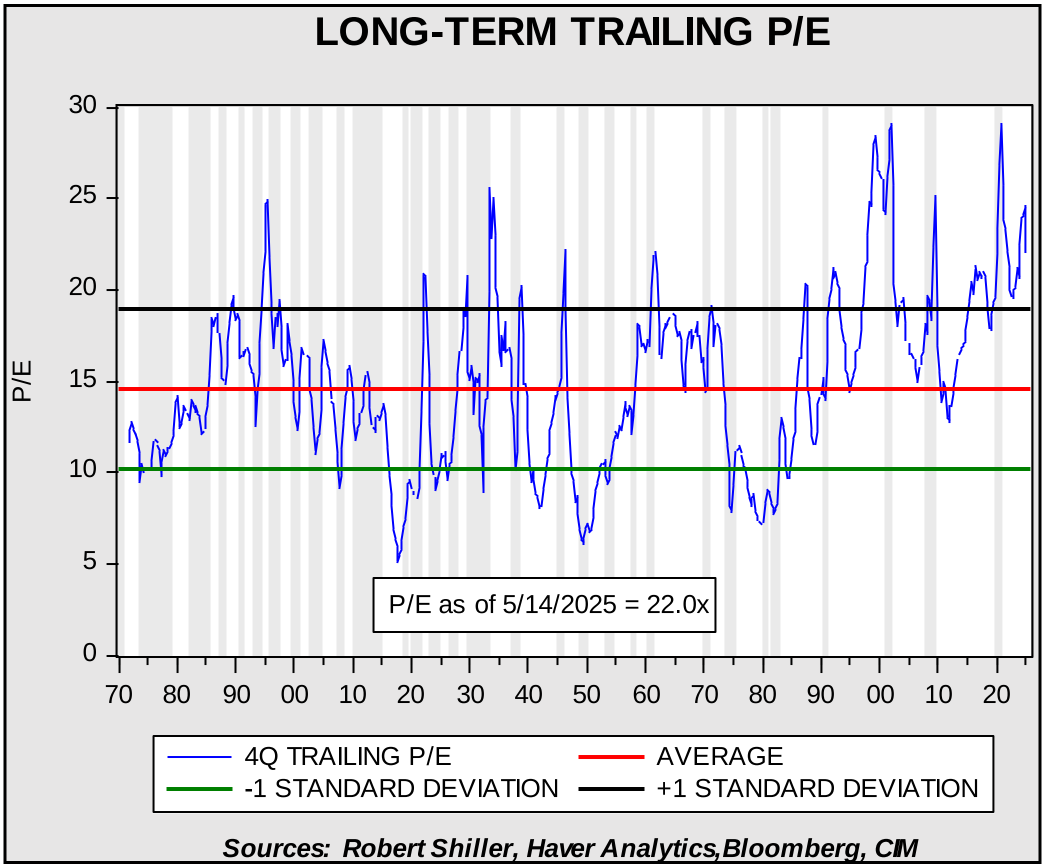


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 15, 2025



Based on our methodology,[1] the current P/E is 22.0x, 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.