Daily Comment

Confluence INVESTMENT MANAGEMENT

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Posted: May 20, 2025 — 9:30 AM ET] Global equity markets are mostly higher this morning. In Europe, the Euro Stoxx 50 closed up 0.5% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.4%. Chinese markets were higher, with the Shanghai Composite up 0.4% from its previous close and the Shenzhen Composite up 0.8%. Conversely, US equity index futures are signaling a lower open.

With 462 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 Military Balance of Power" (5/12/25) + podcast	"The Looming Battle for US Monetary Policy" (5/19/25) + **podcast**	Q2 2025 Report Q2 2025 Rebalance Presentation	Confluence of Ideas Podcast Value Equity Quarterly Update

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Our *Comment* today opens with a summary of President Trump's conversation with Russian President Putin yesterday. We next review several other international and US developments that could affect the financial markets today, including a warning by the Japanese government that it will take a tough stance in the next round of US-Japanese trade talks and interesting new US data suggesting Trump's immigration crackdown isn't weighing on employment levels yet.

United States-Russia-Ukraine: President Trump yesterday held a two-hour phone call with President Putin to discuss ending Russia's war against Ukraine. Trump later termed the call "excellent." However, he also said Russia and Ukraine would immediately start negotiations for a peace deal by themselves, hinting that he is preparing to pull the US out of the process and leave the situation for the Europeans to handle. In any case, Putin didn't commit to any interim ceasefire, suggesting he wants to keep fighting.

- Indeed, Putin has continued to insist that any peace deal would have to address the conflict's "root causes," which is basically codeword for Russia achieving its maximalist territorial and political goals in Ukraine.
- Western European leaders and Ukrainian President Zelensky have implored Trump not to withdraw from the peace efforts, arguing that it would play into Putin's hands. However, it isn't yet clear whether he can still be persuaded to remain engaged.

Japan-United States: Discussing Tokyo's approach to the next round of US-Japan trade talks, chief negotiator Ryosei Akazawa today clarified that he will insist that the US completely remove President Trump's new "reciprocal" tariffs and his product-specific duties on autos, auto parts, steel, and aluminum.

- The statement suggests that foreign leaders have interpreted the recent US trade deals with China and the UK to mean that it's better to take a tough stance against Washington. A tough stance like China's can get Trump to back down, while a relatively conciliatory stance like the UK's yields few concessions from the president.
- That suggests the remaining US trade talks with big, developed countries could be slower and more arduous than previously expected. In turn, that could push global stock markets lower again if investors lose the complacency that they took on after the China and UK deals.

Japan-China: The Japanese government has revealed that it is exploring the removal of a tariff exemption for small-value parcels from China. If implemented, the move would mirror the US's revocation of its exemption for "de minimis" Chinese packages with a value below $800. Indeed, the European Union and the United Kingdom are also reviewing their exemptions.

- The broad initiative probably reflects how the US is trying to get its traditional allies to present a unified wall against Chinese goods.
- The result would likely be negative for big Chinese purveyors of low-cost clothes, trinkets, and other goods, such as Shein and Temu.

Japan: Yields on long-duration Japanese government bonds are surging today after a poor auction revealed timid demand for the obligations. The yield on the 30-year bond rose as high as 3.14%, while the 40-year bond yield reached an all-time high of 3.61%. The weak demand likely reflects the Bank of Japan's continuing program to scale down its bond purchases and concerns about the impact of higher US import tariffs. Given that Moody's cut its US debt rating late Friday, the weak demand probably also reflects concern about Japan's high debt.

China: The People's Bank of China today cut its five-year bank prime loan interest rate by 10 basis points to 3.50%. The five-year prime rate is the main benchmark for home mortgage loans, so the move was probably designed to help spur new housing activity and residential purchases. The PBOC also cut its one-year prime loan rate by 10 basis points to 3.00%, in a likely effort to spur more corporate lending. All the same, the moves are likely too timid to provide much stimulus in the face of China's big, structural economic headwinds.

United Kingdom: The Bank of England's chief economist, Huw Pill, warned in an interview today that the central bank's policymakers are cutting interest rates too fast. Pill said he had advocated for a pause in rate cuts at the last policy meeting because of signs that the UK's disinflationary process is weakening. Indeed, Pill has warned that UK price inflation could remain elevated because of the knock-on effects of high energy prices and poor productivity growth.

US Tariff Policy: At JPMorgan's investor day yesterday, CEO Jamie Dimon warned that President Trump's tariff hikes have probably not fully worked themselves into the economy and that investors are underestimating the risk of an economic slowdown and stock market decline. Dimon warned that even though Trump has paused his maximum tariffs, the remaining levies are still "pretty extreme." The statement is a useful reminder that it's still much too early to be complacent about the new US tariff policy, economic growth, and corporate profits.

US Labor Market: An article in the *Wall Street Journal* yesterday noted that despite President Trump's heavy-handed effort to deport legions of illegal aliens, the economic data shows continued employment gains even in industries heavily reliant on immigrant labor. The article suggests most undocumented workers are continuing to work because of economic necessity. Despite being publicized heavily, the policies also may not have made much of a dent in the large total cohort of immigrant workers.

US Economic Releases

There were no domestic releases scheduled prior to the publication of this report. 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**
9:00	Raphael Bostic Opening Remarks	President of the Federal Reserve Bank of Atlanta
9:00	Thomas Barkin Gives Speech at Richmond Fed Conference	President of the Federal Reserve Bank of Richmond
9:30	Susan Collins Hosts Fed Listens Event in New Hampshire	President of the Federal Reserve Bank of Boston
13:00	Alberto Musalem Speaks on Economy, Policy	President of the Federal Reserve Bank of St. Louis
17:00	Adriana Kugler Gives Commencement Address	Member of the Board of Governors
19:00	Mary Daly and Beth Hammack Give Keynote and Raphael Bostic Moderates	Presidents of the Federal Reserve Banks of San Francisco, Cleveland, and Atlanta

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	Tokyo Condominiums for Sale	y/y	Apr	3.5%	-9.8%		*	Equity and bond neutral
EUROPE								
Eurozone	CPI	y/y	Apr F	2.2%	2.2%	2.2%	***	Equity and bond neutral
	Core CPI	y/y	Apr F	2.7%	2.7%	2.7%	**	Equity and bond neutral
	ECB Current Account SA	m/m	Mar	50.9b	40.6b		*	Equity and bond neutral
	Construction Output	y/y	Mar	-0.5%	-1.2%		*	Equity and bond neutral
Germany	PPI	y/y	Apr	-0.9%	-0.2%	-0.6%	**	Equity and bond neutral
Italy	Current Account Balance	m/m	Mar	1644m	1604m		*	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)	425	424	1	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 (%)	4.46	4.45	0.01	Down
Euribor/OIS spread (bps)	208	210	-2	Down
Currencies	**Direction**			
Dollar	Up			Down
Euro	Down			Up
Yen	Up			Up
Pound	Down			Up
Franc	Down			Up
Central Bank Action	**Current**	**Prior**	**Expected**	
RBA Cash Rate Target	3.85%	4.10%	3.85%	On Forecast
PBOC 1-Year Loan Prime Rate	3.00%	3.10%	3.00%	On Forecast
PBOC 5-Year Loan Prime Rate	3.50%	3.60%	3.50%	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.

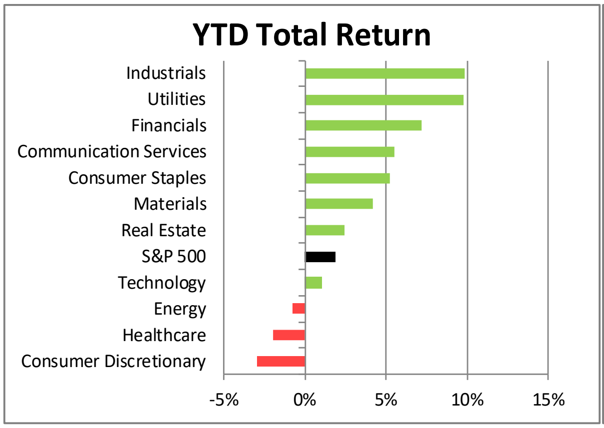
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$65.24	$65.54	-0.46%	
WTI	$62.39	$62.69	-0.48%	
Natural Gas	$3.17	$3.11	1.90%	
Crack Spread	$27.13	$26.98	0.53%	
12-mo strip crack	$22.39	$22.27	0.53%	
Ethanol rack	$1.86	$1.86	0.09%	
Metals				
Gold	$3,240.67	$3,229.56	0.34%	
Silver	$32.53	$32.36	0.51%	
Copper contract	$464.80	$467.05	-0.48%	
Grains				
Corn contract	$452.00	$447.50	1.01%	
Wheat contract	$538.00	$529.00	1.70%	
Soybeans contract	$1,050.50	$1,050.75	-0.02%	
Shipping				
Baltic Dry Freight	1,347	1,388	-41	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-1.17		
Gasoline (mb)		-0.94		
Distillates (mb)		-1.50		
Refinery run rates (%)		-85.0%		
Natural gas (bcf)		110		

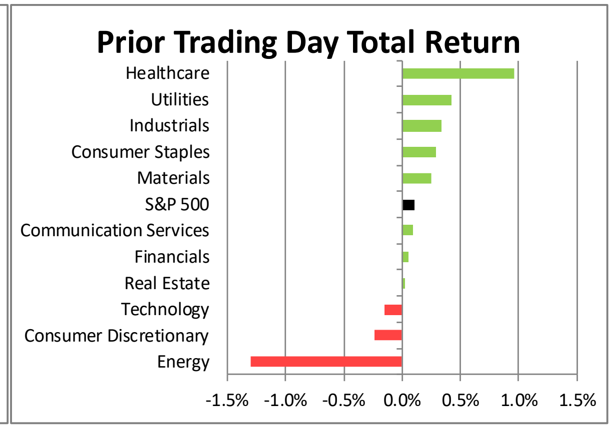
Weather

The 6-to-10 and 8-to-14-day forecasts currently call for warmer-than-normal temperatures for the Rocky Mountains and Gulf Coast, with cooler-than-normal temperatures in the Mississippi and Ohio Valleys. The forecasts call for wetter-than-normal conditions in the southern half of the country from the Four Corners region to the East Coast, the Northeast, and the Pacific Northwest, with drier-than-normal conditions in Michigan and Minnesota.

Data Section

US Equity Markets – (as of 5/19/2025 close)

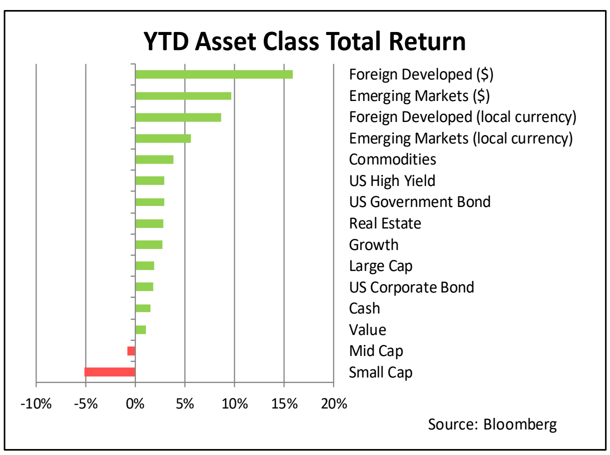




(Source: Bloomberg)

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 5/19/2025 close)

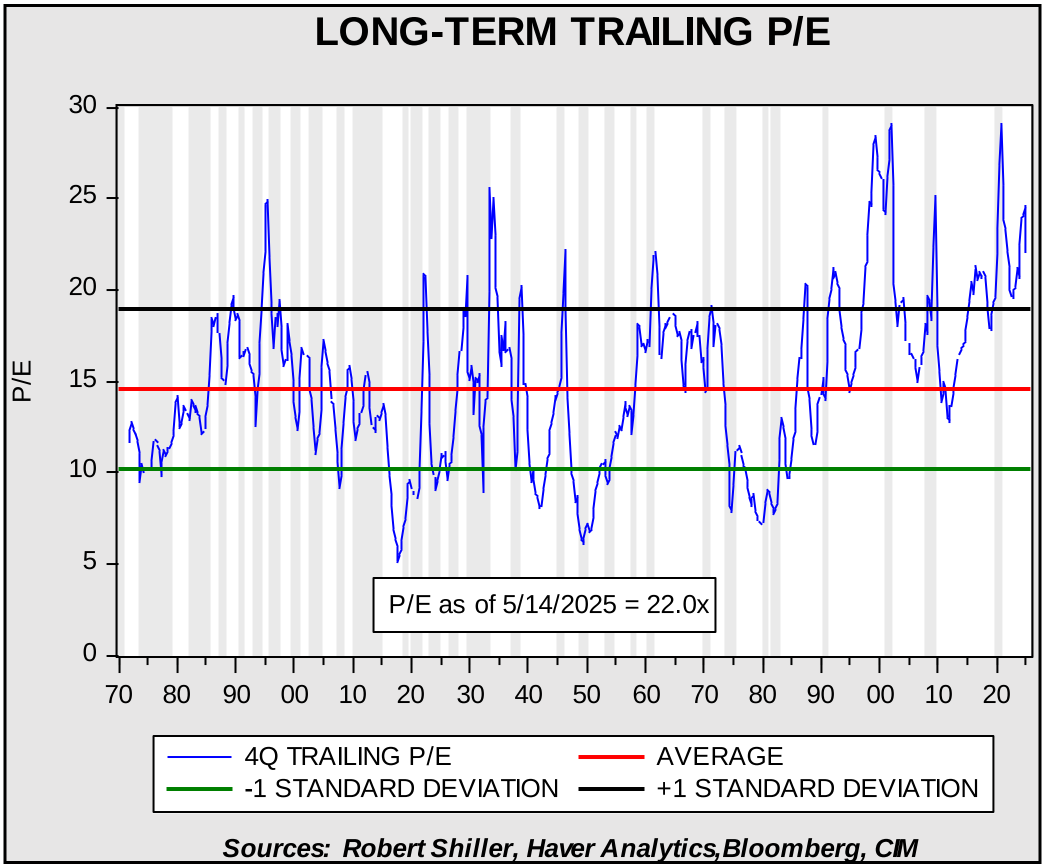


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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.