Daily Comment

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

Posted: May 23, 2025 — 9:30 AM ET] Global equity markets are mostly lower this morning. In Europe, the Euro Stoxx 50 closed down 0.4% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.3%. Chinese markets were lower, with the Shanghai Composite down 0.9% from its previous close and the Shenzhen Composite also down 0.9%. US equity index futures are signaling a lower open.

With 478 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, 77.4% have exceeded expectations, while 18.8% 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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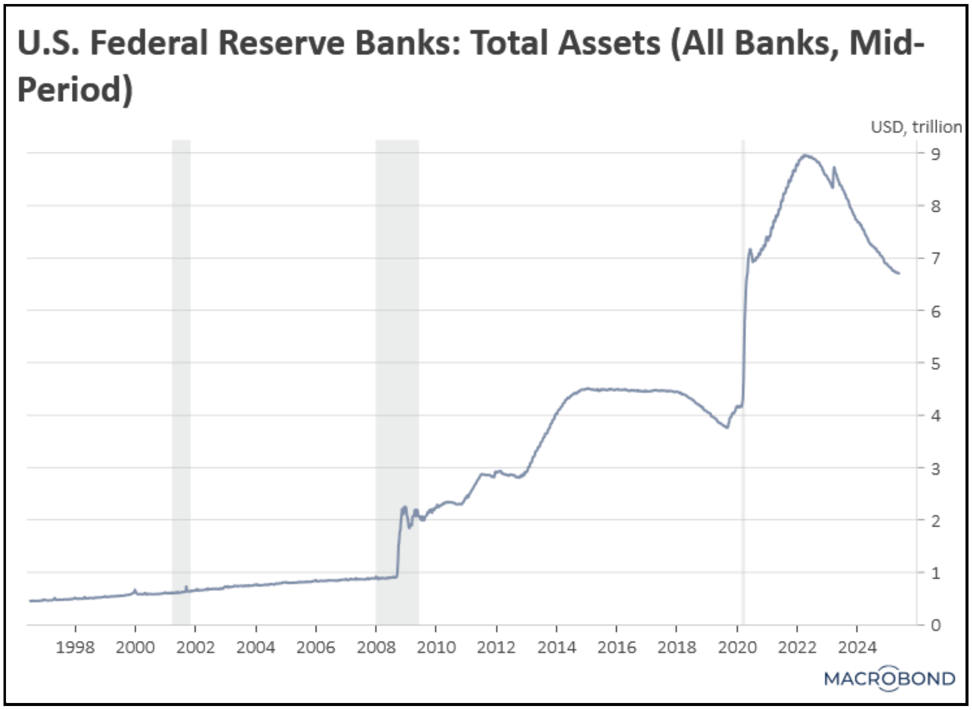
Good morning! Financial markets are digesting the president's latest comments on potential new tariffs. In sports, the Oklahoma City Thunder secured a 2-0 advantage in the Western Conference Finals against the Timberwolves. Today's *Comment* focuses on the Federal Reserve's recent court victory, important details emerging from the Republican tax bill proposal, and other market-moving news. We'll conclude with our regular roundup of economic data releases from both domestic and international sources.

Fed Independence Win: The Supreme Court's ruling is expected to reinforce market confidence in the central bank, potentially easing recent bond market jitters.

- The Supreme Court ruled that the president has the authority to dismiss the heads of independent agencies while a court case is pending. However, the decision explicitly excluded the Federal Reserve's board, describing the central bank as a "uniquely structured, quasi-private entity" and thus outside the scope of the ruling. This outcome reinforces the view that the president lacks the power to remove the Federal Reserve's chair, Jerome Powell.

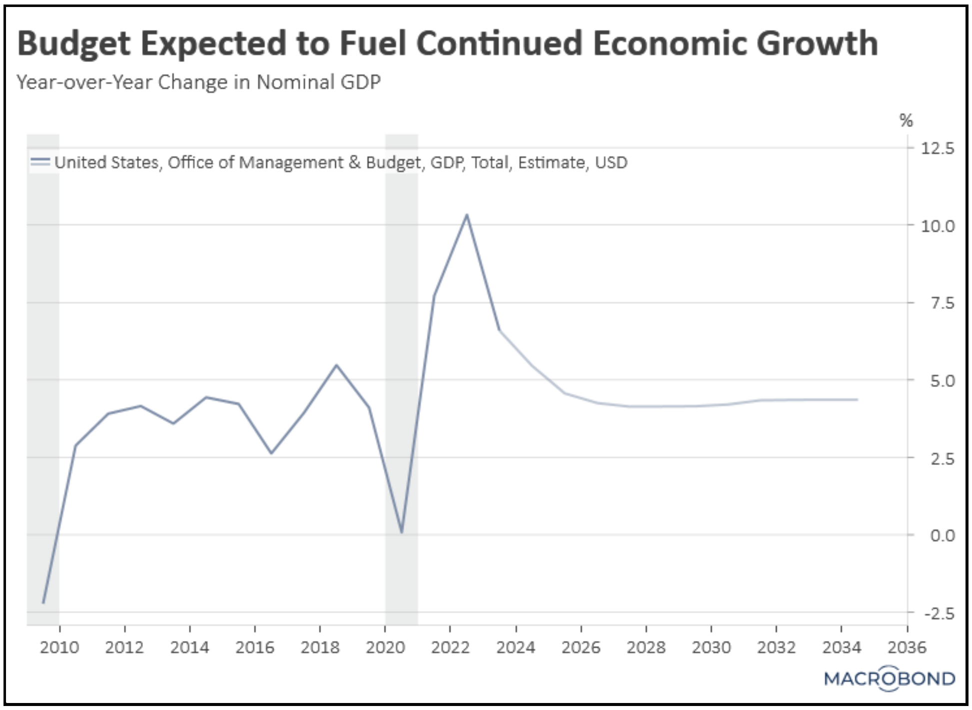
- The ruling should reassure bond markets that the president cannot single-handedly control the Fed. Concerns had grown after the president repeatedly threatened to oust Fed Chair Powell for refusing to align interest rate decisions with White House demands. These threats spurred a bond sell-off as investors feared political interference in monetary policy, particularly the president's push to lower rates simply to follow moves by other countries.



- The ruling further solidifies the central bank's ability to sustain its moderately restrictive policy stance. Fed officials have repeatedly expressed hesitancy about cutting interest rates, warning that inflation could rebound by mid or late summer, keeping short-term rates elevated. Meanwhile, Federal Reserve Governor Chris Waller has dismissed speculation about expanding the Fed's balance sheet to stabilize bond markets, instead maintaining its strategy of shrinking holdings to transition reserves from *abundant* to *ample* levels.
- In summary, the court's decision to shield the Fed from presidential dismissal authority is ultimately market-positive but presents short-term uncertainties. While the ruling strengthens the central bank's long-term credibility by cementing its political independence, it may paradoxically make the Fed more cautious about near-term market interventions. Policymakers could now require clearer signs of financial stress before acting after becoming wary of appearing politically influenced even when staying on the sidelines.

Republican Tax Bill: The GOP succeeded in passing its tax bill through the House, but there is still a strong chance the final legislation will differ from the current version.

- The bill passed by the narrowest possible margin, with a 215-214 vote. The legislation now heads to the Senate where bipartisan calls for changes are growing, particularly over proposed Medicaid cuts and the rollback of renewable energy tax incentives. At the same time, there does seem to be some concerns among moderate Republicans that the bill could hurt them in the mid-term election.
- That said, the House bill fulfills several of President Trump's major campaign promises, including an extension of the corporate and individual tax cuts initially passed under his 2017 tax reform. The legislation also embraces more populist proposals, such as tax exemptions for tipped wages, overtime income, and auto loan interest. Additionally, the bill increases funding for immigration enforcement and border security while raising the SALT deduction cap from $10,000 to $40,000 for households earning $500,000 or less.



- The bill introduces significant changes to Medicaid, including stricter work requirements for able-bodied recipients, more frequent eligibility checks, and verification provisions to confirm beneficiaries' legal status. It also reduces Medicaid funding for states that provide coverage to undocumented workers. Additionally, the bill imposes stricter work requirements on food programs like SNAP. It also eliminates energy tax breaks for consumers and phases out tax credits supporting green energy investments.
- While the final legislation may differ, we expect many of the tax benefits to remain largely intact. However, spending cuts could gain more attention as the Senate works to reduce the bill's overall cost. As previously noted, we believe the tax package will be a

net positive for equities. The proposed changes should help offset the impact of tariffs while encouraging greater private investment.

Trade Flows to Capital Flows: There are signs that some countries have started to take aim at foreign investments as they look to prevent market distortion.

- In response to Spain's worsening housing crisis, the Socialist Party of Prime Minister Pedro Sánchez has introduced legislation that would impose a 100% tax on property purchases by non-EU buyers. While the proposal includes exemptions for foreign workers legally residing in Spain, its passage remains uncertain given the government's slim parliamentary majority. If approved, the measure would take effect in January 2026.
- Spain's focus on restricting foreign real estate investment may signal a shift in how governments view capital flows. While countries typically welcome beneficial investments like foreign direct investment for job creation and infrastructure, portfolio investments are increasingly scrutinized due to their links with asset bubbles and widening wealth gaps.
- While these measures for the Spain housing market specifically target the distortive effects of foreign capital inflows, they also underscore a fundamental tension in global economic governance. The challenge is particularly acute in trade relations with China, where the systematic recycling of export revenues into importing nations serves as an implicit currency stabilization mechanism. These permissive capital flow regimes have exacerbated structural imbalances in global trade.
- We do not anticipate that Spain's measures will trigger widespread EU restrictions on foreign investment in financial assets, nor do we expect significant spillover into equity markets. However, these actions may signal an emerging trend as governments increasingly seek to shield domestic markets from distortive foreign capital flows. Over the long term, we expect countries will focus on developing domestic industrial capacity — a shift that could ultimately enhance the appeal of international investment opportunities.

Trade Hardline: While the market believes trade tensions are easing, Trump's actions suggest that they could heat up again.

- President Trump has threatened to impose 25% tariffs on iPhones unless Apple shifts production back to the US. This comes as the tech giant plans to move much of its iPhone manufacturing from China to India. The escalation reflects the administration's broader push to force companies to relocate supply chains to the US.
- The Trump administration has rejected the EU's proposal for a mutual tariff reduction, warning that negotiations will stall unless the EU accepts stricter reciprocal duties. The remarks underscore how far apart the two sides remain in trade talks.
- We've noted the president's strategic pattern of creating high expectations before negotiations, only to later secure a more favorable compromise. A prime example was his initial proposal of an 80% tariff floor rate ahead of China talks, which was subsequently reduced to 30% following discussions. Given this precedent, the current EU tariff threats

likely serve as a tactical opening position rather than a definitive policy. We therefore recommend maintaining perspective and avoiding an overreaction to these developments.

- That said, the president's recent remarks underscore how quickly the administration's stance can shift from easing tensions to sudden cooling. As a result, we maintain that a "wait-and-see" approach remains prudent for conservative investors. However, those willing to take on risk may find opportunities by focusing on key factors such as strong earnings growth and minimal overseas supply chain exposure.

US Economic Releases

No major US economic reports have been released prior to publication of this article. 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	New Home Sales	m/m	Apr	695k	724k%	***
10:00	New Home Sales MoM	m/m	Apr	-4.0%	7.4%	**
	Building Permits	m/m	April F	1412k	1412K	**
Federal Reserve						
EST	**Speaker or Event**	**District or Position**				
9:35	Alberto Musalem, Jeff Schmid Speak in Fireside Chat	Presidents of the Federal Reserve Banks of St. Louis & Kansas City				
12:00	Lisa Cook Gives Speech on Financial Stability	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	National CPI	y/y	Apr	3.6%	3.6%	3.5%	***	Equity and bond neutral
	National CPI Ex-Fresh Food	y/y	Apr	3.5%	3.2%	3.4%	**	Equity and bond neutral
	National CPI Ex-Fresh Food & Energy	y/y	Apr	3.0%	3.9%	3.0%	*	Equity and bond neutral
	Nationwide Dept Sales	y/y	Apr	-4.50%	-2.8%		***	Equity and bond neutral
New Zealand	Retail Sales Ex Inflation	q/q	1Q	0.80%	1.00%	0.00%	***	Equity and bond neutral
South Korea	PPI	y/y	Apr	0.9%	1.3%		**	Equity and bond neutral
EUROPE								
Germany	GDP NSA	y/y	Q1 F	-0.2%	-0.4%	-0.4%	**	Equity and bond neutral
	GDP WDA	y/y	Q1 F	0.0%	-0.2%	-0.2%	**	Equity and bond neutral
France	Consumer Confidence	m/m	May	88	91	93	***	Equity and bond neutral
UK	GfK Consumer Confidence	m/m	May	-20	-23	-22	***	Equity and bond neutral
	Retail Sales	y/y	Apr	5.0%	1.9%	4.5%	***	Equity and bond neutral
	Retail Sales Ex-Auto Fuel	y/y	Apr	5.3%	2.6%	4.4%	**	Equity bullish, bond bearish
Russia	Gold and Forex Reserves	m/m	16-May	667.5b	687.3b		***	Equity and bond neutral
	Money Supply, Narrow Definition	w/w	16-May	18.17t	18.15t		*	Equity and bond neutral
AMERICAS								
Canada	Industrial Product Price	m/m	Apr	-0.8%	0.3%	-0.5%	**	Equity and bond neutral
	Raw Material Prices	m/m	Apr	-3.0%	-0.7%	-2.3%	*	Equity bearish, bond bullish
Mexico	Exports	m/m	Apr	$54.33b	$55.53b		*	Equity and bond neutral
	Imports	m/m	Apr	$54.38b	$52.09b		*	Equity and bond neutral
	Trade Balance	m/m	Apr	-$88.1m	$3.44b	$115.5m	**	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)	423	424	-1	Up
U.S. Sibor/OIS spread (bps)	432	433	-1	Up
U.S. Libor/OIS spread (bps)	432	433	-1	Down
10-yr T-note (%)	4.47	4.53	-0.06	Down
Euribor/OIS spread (bps)	205	205	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.

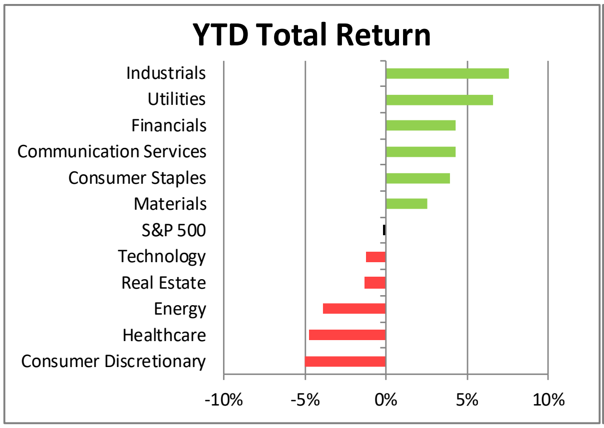
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$64.56	$64.44	0.19%	
WTI	$61.29	$61.20	0.15%	
Natural Gas	$3.28	$3.25	0.89%	
Crack Spread	$26.67	$26.92	-0.92%	
12-mo strip crack	$22.51	$22.75	-1.08%	
Ethanol rack	$1.91	$1.91	0.14%	
Metals				
Gold	$3,339.48	$3,294.52	1.36%	
Silver	$33.03	$33.06	-0.06%	
Copper contract	$471.40	$467.95	0.74%	
Grains				
Corn contract	$463.25	$463.00	0.05%	
Wheat contract	$544.00	$544.50	-0.09%	
Soybeans contract	$1,067.25	$1,067.50	-0.02%	
Shipping				
Baltic Dry Freight	1,341	1,337	4	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	1.33	-1.10	2.43	
Gasoline (mb)	-1.02	-2.00	0.98	
Distillates (mb)	0.58	-1.40	1.98	
Refinery run rates (%)	0.5%	0.7%	-0.2%	
Natural gas (bcf)	120	119	1	

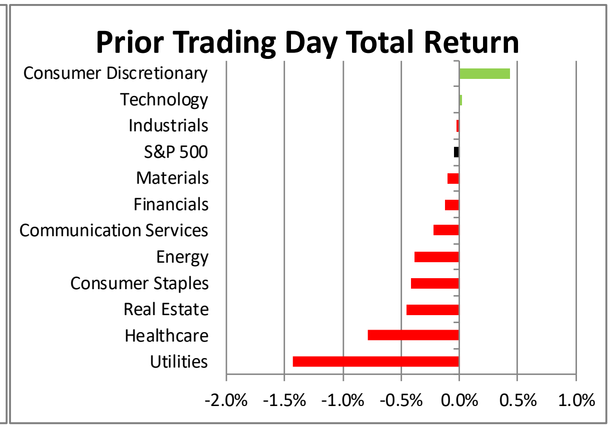
Weather

The 6-to-10 and 8-to-14-day forecasts currently call for warmer-than-normal temperatures in the Far West, the northern Great Plains, and Florida, with cooler-than-normal temperatures in the southern Great Plains, the Midwest, and the Deep South. The forecasts call for wetter-than-normal conditions in the southern Rocky Mountains and Great Plains and along the Gulf Coast, with dry conditions in the northern Great Plains and Midwest.

Data Section

US Equity Markets – (as of 5/22/2025 close)

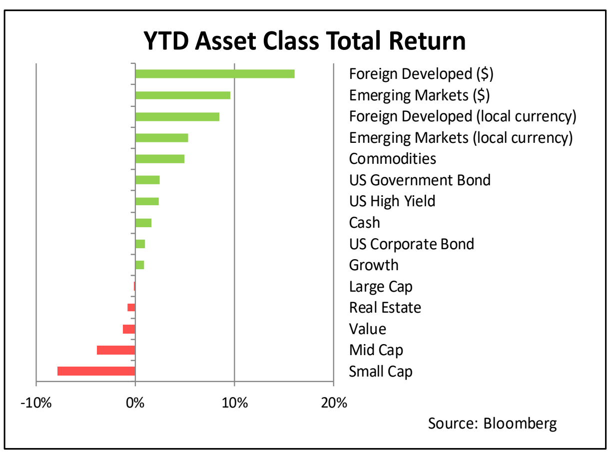




(Source: Bloomberg)

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 5/22/2025 close)

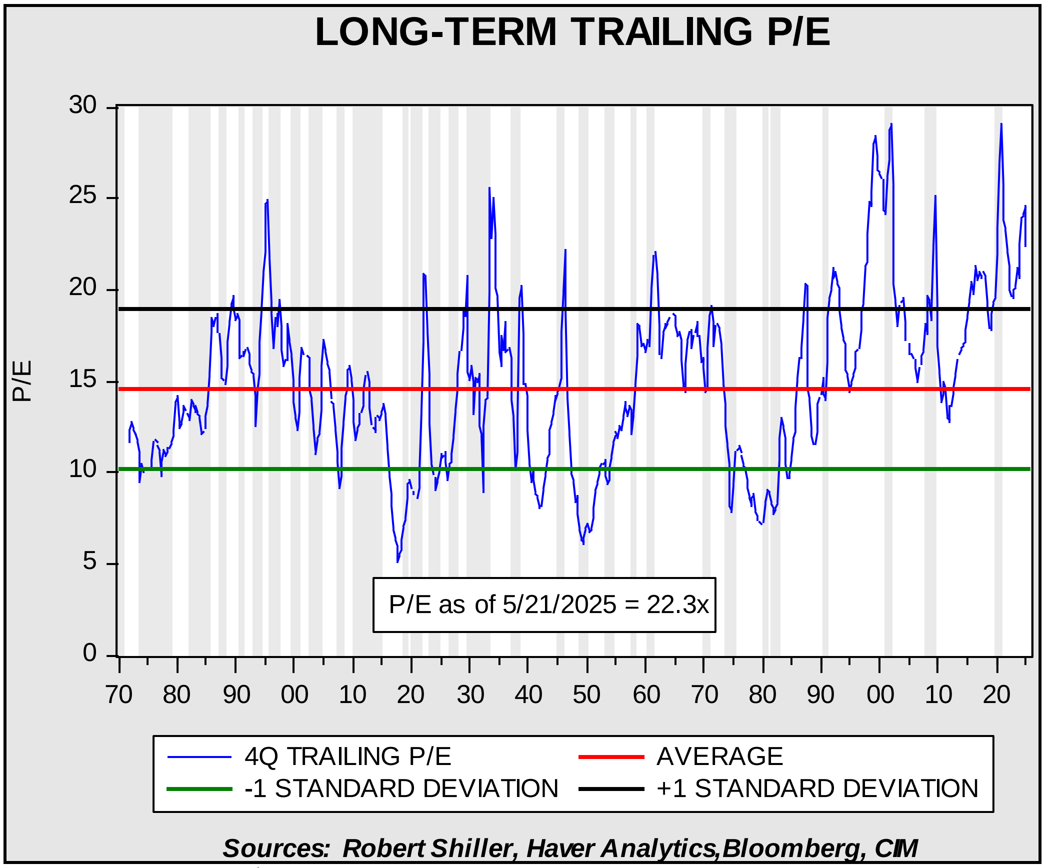


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 22, 2025



Based on our methodology,[1] the current P/E is 22.3x, up 0.3 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.