Daily Comment

Confluence INVESTMENT MANAGEMENT

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

Posted: May 30, 2025 — 9:30 AM ET] Global equity markets are mostly lower 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 down 1.0%. Chinese markets were lower, with the Shanghai Composite down 0.5% from its previous close and the Shenzhen Composite down 1.1%. US equity index futures are signaling a lower open.

With 490 companies having reported so far, S&P 500 earnings for Q1 are running at $64.20 per share compared to estimates of $60.75, which is up 7.3% from Q1 2024. Of the companies that have reported thus far, 77.6% 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.

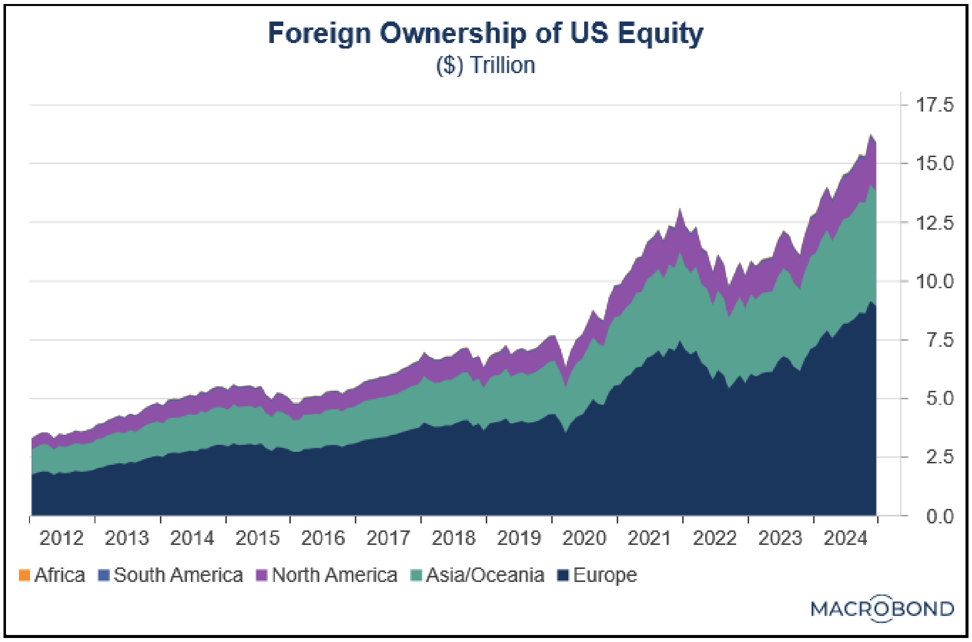
Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
"Why Greenland Matters" (5/27/25) + podcast	"The Looming Battle for US Monetary Policy" (5/19/25) + podcast	Q2 2025 Report Q2 2025 Rebalance Presentation	Confluence of Ideas Podcast Value Equity Quarterly Update **Business Cycle Report**

Good morning! The White House is once again using Friday to remind markets about its trade concerns. Today's *Comment* will discuss how a provision in the tax bill could discourage foreign investment in the US, explain why the administration is crafting a backup plan for tariffs, and report on other latest market-moving developments. As always, we'll also include a roundup of key domestic and international economic data.

Taxing Foreigners: A little-known provision within the tax bill has caused a stir on Wall Street due to its potential to hurt the US's safe-haven status.

- Section 899 of the recently passed House legislation authorizes the US government to implement reciprocal tax measures against investors and corporations from countries found to maintain discriminatory tax practices targeting American entities. The provision's broad scope could significantly affect both: (1) US-domiciled firms with substantial foreign ownership, and (2) multinational corporations maintaining operations or investment ties in the US.

- The measure appears primarily targeted at the European Union, which US officials have accused of maintaining discriminatory policies against American companies. The White House has repeatedly urged the EU to reform its Value-Added Tax (VAT) system, arguing it creates unfair trade advantages for member states. This tension has escalated as several EU countries (most recently Germany) have moved forward with proposed digital taxes that would disproportionately affect US tech giants like Meta and Google.

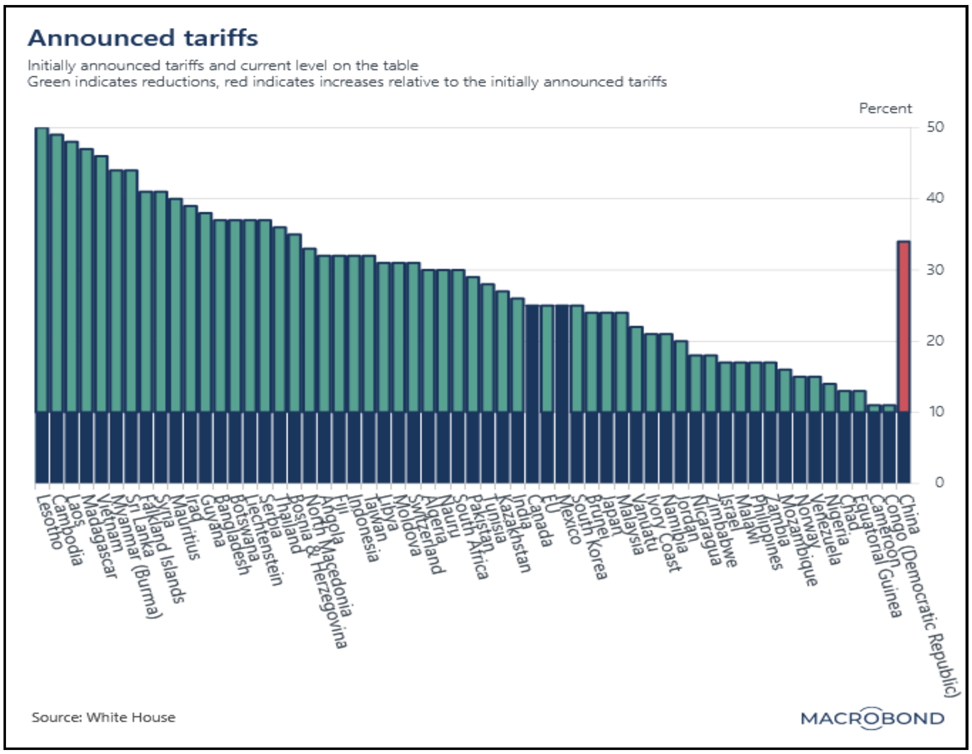


- However, the provision contains significant ambiguity regarding its application to US Treasury securities. While the legislation clearly subjects foreign holders of equities and corporate bonds to potential levies, it fails to clarify whether purchases of government debt — traditionally exempt from such taxation — would also become taxable. The lack of clarity could create an incentive for foreign investors to purchase even more US government bonds.
- This law essentially functions as a form of capital control. Its underlying rationale likely stems from a desire to pressure foreign elites into advocating for US interests, particularly regarding regulatory restrictions. By targeting influential individuals who comply with laws that disadvantage American companies, the US is effectively leveraging financial coercion. The potential impact is twofold: It could drive increased investment into US Treasurys, or it trigger capital outflows from equities.

Trade Developments: The Trump administration has received a reprieve from the courts on its tariffs but is already searching for a backup as it looks to regain leverage in trade talks.

- A [US federal appeals court has lifted the hold on global tariffs](), clearing the way for the White House to escalate the issue to the Supreme Court. This decision is expected to reinstate the president's import tariffs, reinforcing his push to reshape US trade policy. However, the long-term viability of these levies remains uncertain. The reprieve came after two separate rulings deemed the administration's approach as unlawful.

- As noted in yesterday's comment, the president has options should the tariffs be deemed unconstitutional. The administration is exploring the use of the Trade Act of 1974, which permits temporary tariffs of up to 15% for 150 days to rectify trade imbalances. Additionally, the White House is preparing to leverage Section 301, which grants the US authority to investigate and retaliate against unfair trade practices. There have also been discussions about invoking the Smoot-Hawley Tariff Act of 1930 as a potential fallback.



- That said, the ruling has significantly impacted perceptions of the US's capacity to negotiate effectively with its trading partners. While the US and the European Union have committed to ongoing dialogue in an effort to resolve their trade differences, discussions between the US and China have, by contrast, reportedly reached an impasse. Following the court's decision, President Trump sharply criticized China for failing to meet its trade agreement commitments.

- The ongoing tariff dispute is likely to fuel further market uncertainty regarding future trade policy. Investors now face a dual challenge where they must not only assess whether new tariffs will be implemented, but also whether existing ones will remain in place. This persistent ambiguity will disproportionately pressure firms with significant trade exposure. Given these conditions, we maintain that the most compelling opportunities lie in companies with resilient earnings power and fortified supply chains.

Monetary Policy Dilemma: President Trump and Fed Chair Powell met this week for the first time since November 2019 to discuss the economy.

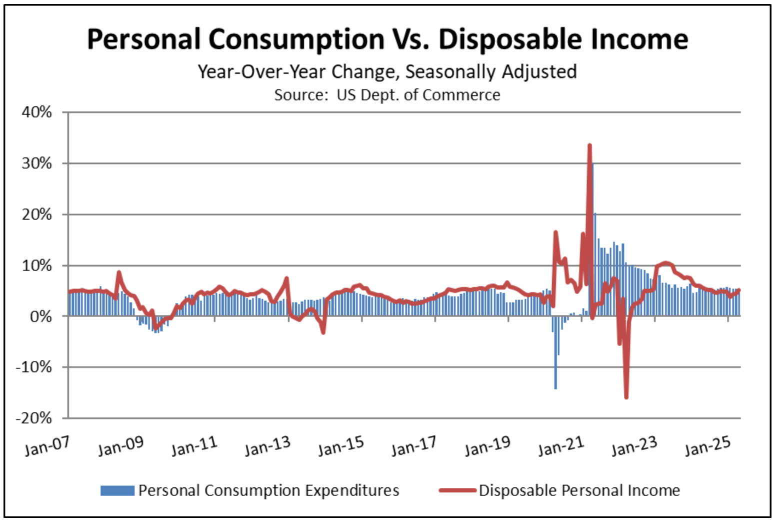
- During the meeting, President Trump pressed Chair Powell to cut interest rates at the upcoming FOMC meeting, arguing that the US should align with other central banks' policies. However, the Fed chair avoided signaling any commitment to the president's demands, instead emphasizing that the Fed's decisions would remain data-dependent and based on economic developments.
- The challenge confronting the president and Federal Reserve officials is the impact of US tariffs on both the domestic and global economies. Tariffs, or import taxes, serve two main purposes: revenue generation and import restriction. The latter is arguably the more complex aspect. While US tariffs have the potential to inflate domestic prices by increasing the cost of imported goods or limiting supply, they can simultaneously lead to excess foreign capacity, thereby driving down prices abroad.
- This dynamic is likely to place the Federal Reserve at a disadvantage relative to its international peers. Assuming all other factors are constant, foreign central banks possess greater latitude to implement rate cuts because the decline in exports due to US tariffs has created a surplus of domestic supply, prompting them to stimulate demand. Conversely, the reduction in foreign imports means the Fed may need to maintain higher rates to prevent increased demand from exacerbating domestic supply chain constraints.
- The key uncertainty lies in how US businesses will adapt to tariffs. Some firms may attempt to pass through higher costs, which would reinforce the Fed's current policy stance. Others may resort to workforce reductions to mitigate the financial impact. This divergence in responses makes unemployment the potential swing factor in the tariff policy calculus.
- We acknowledge the possibility of both higher inflation and higher unemployment, but we're not convinced they'll trend upward simultaneously. This phenomenon, known as stagflation, typically occurs during sharp increases in energy prices, which are currently trending downward. Given the hiring trends and the limited purchasing power of households since the pandemic, we believe a cooling labor market is the most likely scenario. Consequently, we think the Fed could still cut rates this year.

Demand Optimism: Despite recession concerns, there are still signs that households may not be changing their spending habits by much.

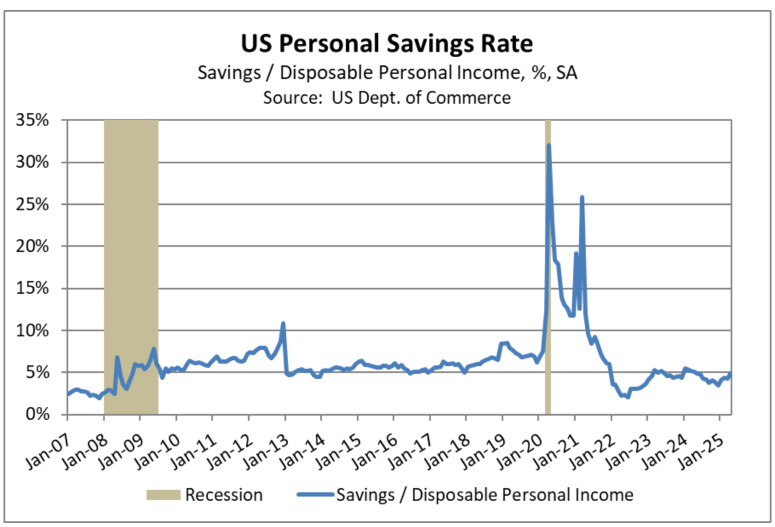
- Recent driving data indicates that Americans hit the road in greater numbers this holiday weekend. According to GasBuddy, gasoline consumption has increased by 2% compared to the previous year. This uptick suggests households may be shifting spending away from goods and toward services — a potential strategy to mitigate the impact of rising tariffs.
- The shift toward service-oriented spending is expected to bolster the economy amid ongoing uncertainty. This trend will likely persist, provided that businesses keep prices in check. As a result, an immediate recession seems unlikely.

US Economic Releases

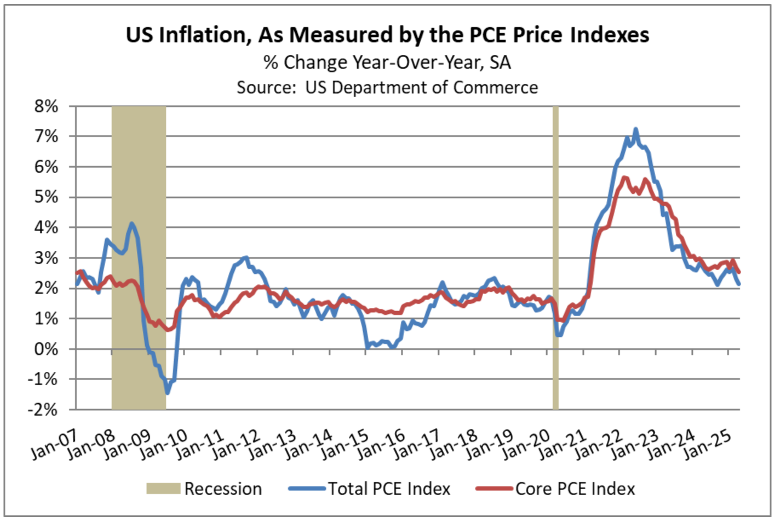
April ***personal income*** jumped by a seasonally adjusted 0.8%, obliterating the expected increase of 0.3% and accelerating from the upwardly revised gain of 0.7% in March. In contrast, April ***personal consumption expenditures (PCE)*** rose a modest 0.2%, matching expectations and decelerating from the previous month's increase of 0.7%. Personal income in April was up 5.5% from the same month one year earlier, while PCE was up 5.4%. The chart below shows the annual change in personal income and PCE since just before the Great Financial Crisis.



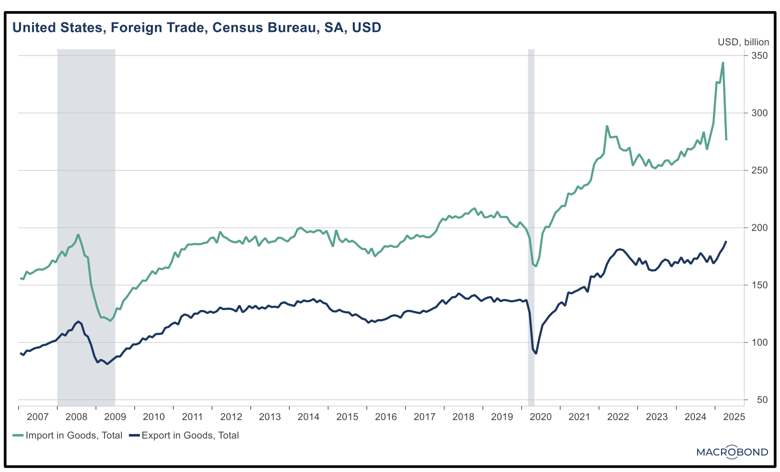
The personal income and spending report also includes a measure of personal saving, defined as disposable (after tax) income less consumption spending on goods and services. The April ***personal savings rate*** rose to a seasonally adjusted 4.9%. The chart below shows how the personal savings rate has fluctuated since just before the GFC.



Finally, the income and spending report includes the Federal Reserve's preferred measure of consumer price inflation. After stripping out the volatile food and energy components, April's ***Core PCE Deflator*** was up 2.5% from the same month one year earlier. That matched the expected gain, and it marked a further modest slowing in inflation after its revised 2.7% rise in the year to March. In fact, Core PCE inflation in April was at its lowest level since early 2021. The chart below shows the year-over-year change in the Core PCE Deflator since just before the GFC.



In a separate report today, a preliminary estimate showed the US ***merchandise trade balance*** in April came in at a seasonally adjusted deficit of $87.6 billion, far narrower than the anticipated shortfall of $143.0 billion and the revised March shortfall of $162.3 billion. According to the data, total merchandise exports rose 3.4% in April, while imports plummeted 19.8%, almost certainly because importers pulled back on foreign purchases after the Trump administration announced its big tariffs. Compared with the same month one year earlier, exports in April were up 9.6%, while imports were up 1.8%. The chart below shows the monthly value of US exports and imports 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
9:45	MNI Chicago PMI	m/m	May	45.0	44.6	***
10:00	U. of Michigan Consumer Sentiment	m/m	May F	51.5	50.8	***
10:00	U. of Michigan Current Conditions	m/m	May F	58.0	57.6	**
10:00	U. of Michigan Future Expectations	m/m	May F	47.7	46.5	**
10:00	U. of Michigan 1-Year Inflation Expectation	m/m	May F	7.1%	7.3%	*
10:00	U. of Michigan 5-10 Year Inflation Expectation	m/m	May F	4.6%	4.6%	*
Federal Reserve						
EST	Speaker or Event	District or Position				
16:45	Mary Daly Speaks in Panel Conversation	President of the Federal Reserve Bank of San Francisco				
19:30	Austan Goolsbee On the Interview Show	President of the Federal Reserve Bank of Chicago				
	Austan Goolsbee Appears on Freakonomics Radio Podcast	President of the Federal Reserve Bank of Chicago				

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	Jobless Rate	m/m	Apr	2.5%	2.5%	2.5%	***	Equity and bond neutral
	Job-To-Applicant Ratio	m/m	Apr	1.3%	126.0%	126.0%	***	Equity and bond neutral
	Tokyo CPI	y/y	May	3.4%	3.4%	3.4%	**	Equity and bond neutral
	Tokyo CPI Ex-Fresh Food	y/y	May	3.6%	3.4%	3.5%	***	Equity and bond neutral
	Tokyo CPI Ex-Fresh Food & Energy	y/y	May	3.3%	3.1%	3.2%	*	Equity and bond neutral
	Industrial Production	y/y	Apr P	0.7%	1.0%	0.1%	***	Equity and bond neutral
	Retail Sales	y/y	Apr	3.3%	3.1%	3.0%	**	Equity and bond neutral
	Depart. Store & Supermarket Sales	y/y	Apr	1.5%	1.7%		*	Equity and bond neutral
	Housing Starts	y/y	Apr	-26.6%	39.1%	-18.1%	**	Equity bearish, bond bullish
	Annualized Housing Starts	y/y	Apr	0.626m	1.080m	0.700m	*	Equity and bond neutral
Australia	Building Approvals	m/m	Apr	-5.7%	-7.1%	3.0%	***	Equity bearish, bond bullish
	Retail Sales	m/m	Apr	-0.1%	0.3%	0.3%	***	Equity bearish, bond bullish
	Private Sector Credit	y/y	Apr	6.7%	6.5%		**	Equity and bond neutral
New Zealand	Building Permits	m/m	Apr	-15.6%	10.7%		**	Equity and bond neutral
	ANZ Consumer Confidence Index	m/m	May	92.9	98.3		*	Equity and bond neutral
South Korea	Industrial Production	y/y	Apr	4.9%	4.4%	4.0%	***	Equity bullish, bond bearish
India	GDP	y/y	1Q	7.4%	6.4%	6.8%	*	Equity bullish, bond bearish
EUROPE								
Eurozone	M3 Money Supply	y/y	Apr	3.9%	3.7%	3.7%	***	Equity and bond neutral
Germany	Retail Sales NSA	y/y	Apr	4.0%	1.3%	-1.8%	*	Equity bullish, bond bearish
	CPI	y/y	May P	2.1%	2.1%	2.1%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	May P	2.1%	2.2%	2.0%	**	Equity and bond neutral
Italy	GDP WDA	y/y	Q1 F	0.7%	0.6%		**	Equity and bond neutral
	CPI, EU Harmonized	y/y	May P	1.9%	2.0%	1.9%	***	Equity and bond neutral
	CPI NIC Including Tobacco	y/y	May P	1.7%	1.9%	1.7%	**	Equity and bond neutral
	PPI	y/y	May P	3.8%	5.4%		**	Equity and bond neutral
Switzerland	KOF Leading Indicator	y/y	May	98.5	97.1	98.4	**	Equity and bond neutral
Russia	Gold and Forex Reserves	m/m	23-May	$678.5b	$667.5b		***	Equity and bond neutral
	Money Supply, Narrow Definition	w/w	23-May	18.09t	18.17t		*	Equity and bond neutral
AMERICAS								
Canada	Current Account Balance	q/q	1Q	-$2.13b	-$3.56b	-$3.24b	**	Equity and bond neutral
Mexico	Unemployment Rate NSA	m/m	Apr	2.54%	2.20%		***	Equity and bond neutral
Brazil	Primary Budget Balance	y/y	Apr	14.2b	3.6b	18.8b	*	Equity and bond neutral
	Central Govt Budget Balance	m/m	Apr	17.8b	1.1b	18.0b	*	Equity and bond neutral
	Net Debt % GDP	m/m	Apr	61.7%	61.6%	61.7%	**	Equity and bond neutral
	GDP	q/q	1Q	2.9%	3.6%	3.1%	***	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)	432	432	0	Up
U.S. Libor/OIS spread (bps)	433	433	0	Up
10-yr T-note (%)	4.42	4.42	0.00	Down
Euribor/OIS spread (bps)	200	201	-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.

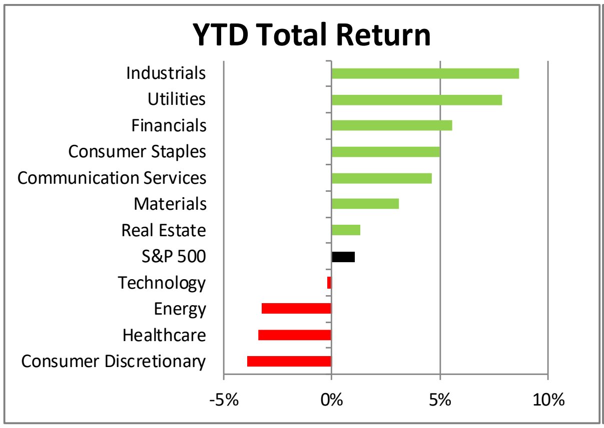
world	Price	Prior	Change	Explanation
Energy Markets				
Brent	$64.53	$64.15	0.59%	
WTI	$61.59	$60.94	1.07%	
Natural Gas	$3.48	$3.52	-1.14%	
Crack Spread	$24.55	$24.49	0.23%	
12-mo strip crack	$21.45	$21.41	0.19%	
Ethanol rack	$1.88	$1.89	-0.35%	
Metals				
Gold	$3,290.37	$3,317.94	-0.83%	
Silver	$33.08	$33.32	-0.71%	
Copper contract	$469.15	$467.55	0.34%	
Grains				
Corn contract	$447.50	$447.00	0.11%	
Wheat contract	$534.25	$534.00	0.05%	
Soybeans contract	$1,049.25	$1,051.75	-0.24%	
Shipping				
Baltic Dry Freight	1,353	1,303	50	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-2.80	-1.80	-1.00	
Gasoline (mb)	-2.44	0.90	-3.34	
Distillates (mb)	-0.72	0.64	-1.37	
Refinery run rates (%)	-0.5%	0.6%	-1.1%	
Natural gas (bcf)	101	101	0	

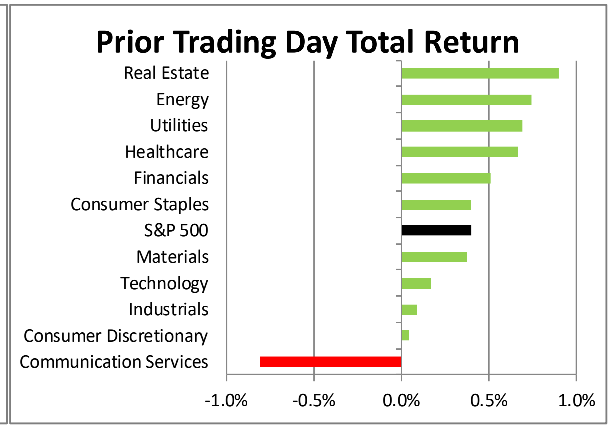
Weather

The 6-to-10 and 8-to-14-day forecasts currently call for warmer-than-normal temperatures across the entire eastern half of the country, with cooler-than-normal temperatures on the West Coast. The forecasts call for wetter-than-normal conditions in the Great Plains and Florida, with dry conditions in the Desert Southwest.

Data Section

US Equity Markets – (as of 5/29/2025 close)

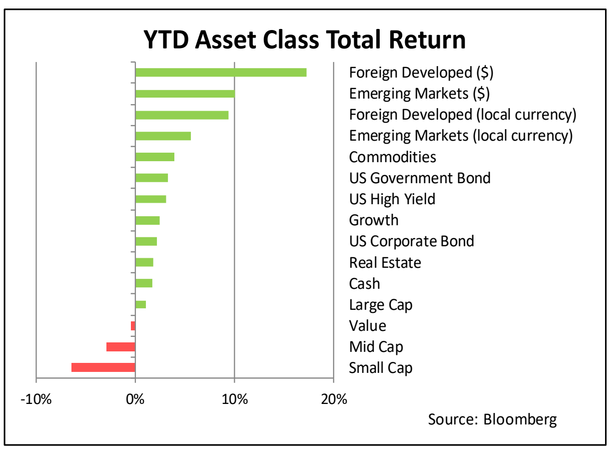




(Source: Bloomberg)

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 5/29/2025 close)

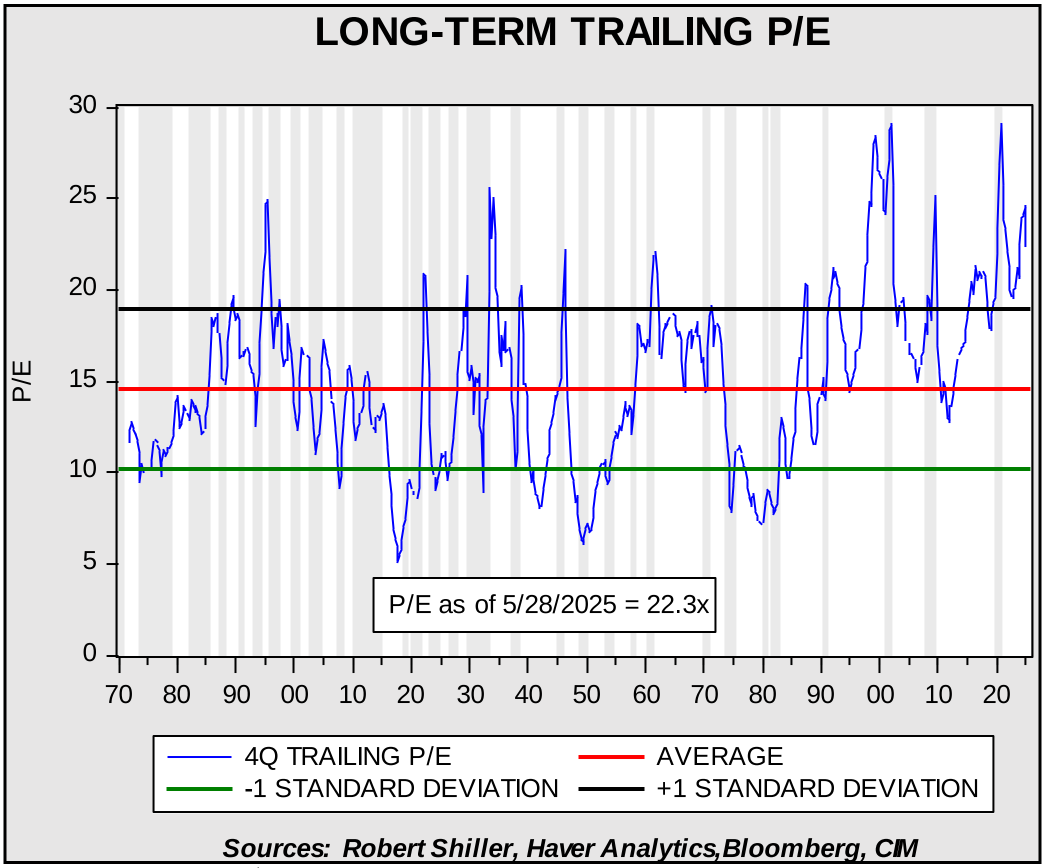


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 29, 2025



Based on our methodology,[1] the current P/E is 22.3x, unchanged from our last report. The rise in the stock price index offset by an 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.