Daily Comment

Confluence Investment Management

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

Posted: May 7, 2025 — 9:30 AM ET] Global equity markets are mixed 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 higher, with the Shanghai Composite up 0.8% from its previous close and the Shenzhen Composite up 0.5%. US equity index futures are signaling a higher open.

With 404 companies having reported so far, S&P 500 earnings for Q1 are running at $63.60 per share compared to estimates of $60.75, which is up 7.3% from Q1 2024. Of the companies that have reported thus far, 76.0% have exceeded expectations, while 20.0% 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	Keller Quarterly Business Cycle Report

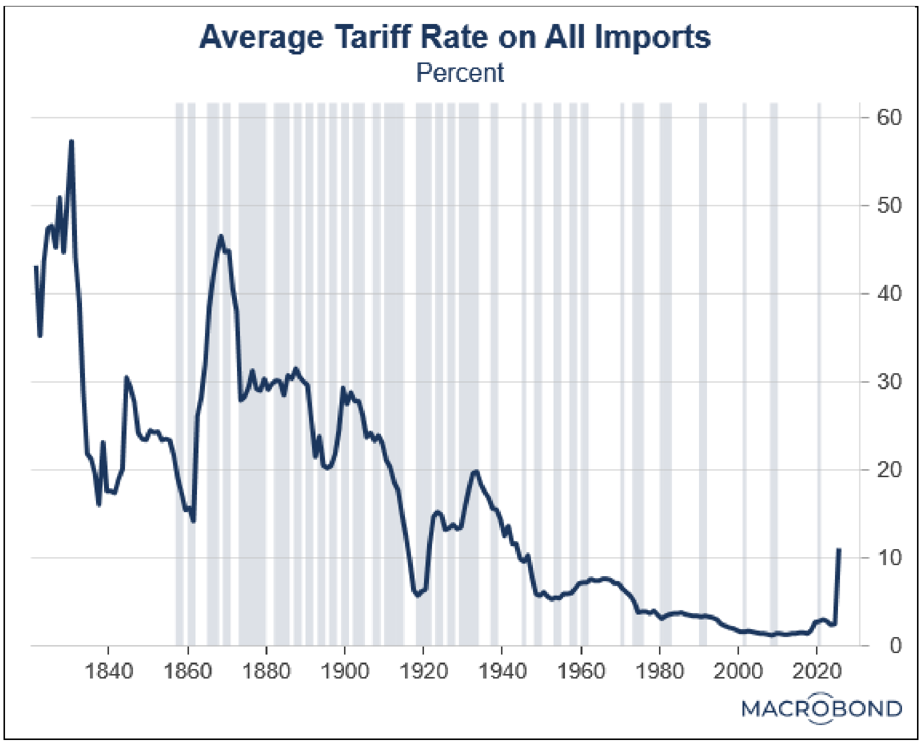
---

Good morning! The market is digesting the latest trade updates. In sports news, Inter Milan has knocked FC Barcelona out of the Champions League semifinals. Today's *Comment* will focus on positive trade developments, ongoing conflicts in the Indo-Pacific and the Middle East, and other key market-moving stories. As always, we'll also provide a roundup of today's international and domestic data releases to keep you informed.

Positive Trade News: The White House has announced progress in ongoing trade negotiations, a move intended to mitigate concerns regarding potential supply chain disruptions.

- The US and China are set to hold their first face-to-face talks next week, marking the first high-level discussion between the two powers since tariffs were imposed in April. Treasury Secretary Bessent acknowledged the talks as a positive step but cautioned that the meeting would likely focus on preventing further escalation rather than resolving existing disputes. Meanwhile, Chinese officials have mentioned that they are engaging in talks due to the possibility of tariff relief.

- The ongoing dispute between the two nations comes amid growing evidence that tariffs are weighing heavily on both economies. China has attempted to circumvent the measures by rerouting exports through third countries or undervaluing shipments to reduce duties. Meanwhile, concerns are mounting over potential shortages as reduced Chinese imports mean fewer goods being shipped to the US, leading to speculation that some firms may be hurt due to their hidden exposure to Chinese suppliers.
- The decision by China and the US to hold talks suggests that other nations may soon follow suit. Treasury Secretary Bessent noted that, aside from China, all 18 of America's other major trading partners have already engaged in discussions in hopes of securing tariff relief before the July deadline. While several countries have submitted proposals, President Trump has made clear that he does not intend to lift all tariffs.



- The UK is poised to become the first country to secure a trade deal with the US under the Trump administration. On Tuesday, officials announced a plan that will exempt certain UK exports from full tariffs under a quota system. In return, Britain has committed to scaling back its digital services tax, which has disproportionately affected major US tech firms.
- So far, trade negotiations appear to be progressing, with the US leveraging tariffs not only to reduce trade barriers but also to secure regulatory concessions that currently disadvantage American firms. While hopes of a trade deal may provide some relief to equities hit hard by tariffs, we believe a sustained market boost would require clear

evidence that tariffs have had minimal demand-side impact or, better yet, moderated significantly from their current level.

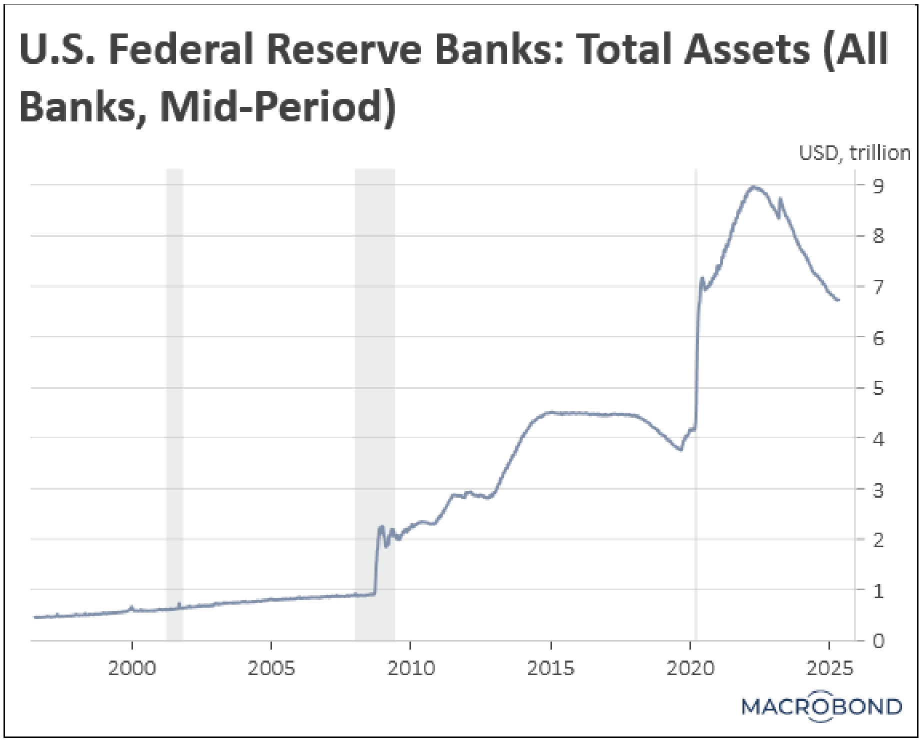
India's Response: India and Pakistan appear to be on the brink of war as tensions escalate following an April terrorist attack.

- India executed targeted military strikes against nine locations inside Pakistan, identified as "terrorist infrastructure." The action was perceived as measured due to its avoidance of Pakistani military facilities. Prior to the attack, Pakistan's defense minister had warned that the country was prepared to retaliate against any Indian aggression. While the Pakistani government has confirmed plans for a response, it has not disclosed the timing or nature of its countermeasures.
- So far, it remains unclear how far either side is willing to escalate the conflict. The last full-scale war between India and Pakistan erupted in 2019 after a suicide bomber targeted Indian security forces. Both nations now claim to be acting in self-defense, yet their increasingly aggressive posturing risks triggering a dangerous cycle of retaliation that could push the confrontation to a perilous new level.
- The US and China are expected to monitor the conflict closely, given their strategic interests in the region. Washington has sought to maintain strong ties with both India and Pakistan as key partners in its geopolitical orbit. Meanwhile, Beijing has a vested interest in preventing a destabilizing war near its borders, particularly given its close alliance with Pakistan and complex rivalry with India.
- The critical issue to watch now is how both nations handle the Indus River Basin dispute. Following recent hostilities, India suspended a key water-sharing treaty that regulates the flow of river water into Pakistan. This decision has already begun threatening Pakistan's agricultural output, particularly its vital cotton and rice crops, potentially exacerbating regional tensions.
- While US financial markets have yet to meaningfully price in geopolitical risks, escalating tensions may soon prompt investors to reassess their risk appetite. This uncertainty emerges during an already fragile period for markets, with lingering trade tariff concerns continuing to pressure sentiment. In this environment, we believe quality defensive plays, particularly established companies with consistent earnings track records, may offer investors prudent hedges against potential volatility.

Powell Is on the Clock: While interest rates dominate market focus ahead of the central bank's decision, its balance sheet is another key element to watch.

- The Federal Reserve is widely expected to leave its benchmark interest rates unchanged at today's meeting. This decision follows weeks of policymakers voicing concerns about the uncertain inflationary impact of tariffs, even amidst indications of easing price pressures. While some market participants had anticipated that softening economic data might compel Fed action, unexpectedly strong employment figures and resilient consumer spending have tempered dovish expectations.
- If the Fed doesn't cut rates, it might instead change how it handles its bond holdings. At the last meeting, Fed officials decided to slow down how quickly they were shrinking the

bond portfolio because of the debt ceiling fight in Congress. There was even some talk of stopping the reduction indefinitely, and with the economy now sending mixed signals, that idea may be revived.



- The potential conclusion of quantitative tightening should help relieve pressure in the Treasury market. Ending this policy would mean the Fed reinvests proceeds from maturing securities rather than continuing to reduce its balance sheet. This move would boost market liquidity and support bond prices. The policy's significance was underscored Wednesday when the Fed made its largest participation in a 10-year Treasury auction in over three years, contributing to the auction's strong performance.
- If the Fed agrees to hold rates steady this month, its policy statement and economic projections will offer critical clues about a potential June cut. Policymakers have adopted a cautious stance, seeking clearer evidence of how tariffs will impact the economy — especially inflation and employment — in the coming months. While resurgent price pressures would likely delay any easing, a sharp deterioration in labor market conditions could force the Fed's hand toward more substantial rate cuts this summer.

Weak Dollar Problem? There are growing concerns that the strength of the US currency is starting to have an impact abroad.

- Across Asia, there have been signs that central banks are intervening in markets to support their currencies. The Hong Kong Monetary Authority was forced to offload dollar holdings to defend its peg. Meanwhile, Taiwan's typically stable exchange rate has experienced sharp fluctuations amid rumors of potential intervention to secure a trade deal with the US. Lastly, [China has cut its key interest rate and reduced reserve requirements] in an effort to prevent further appreciation of the yuan against the dollar.

- While a weaker dollar generally reduces the price of imported goods for foreign consumers, its impact on the wider economy presents a trade-off. It may diminish profits for foreign companies exporting goods to the US, and a declining greenback could incentivize foreign investors to rebalance their portfolios away from US assets. This trend, while not currently critical, deserves careful monitoring.

US Economic Releases

The Mortgage Bankers Association today said ***mortgage applications*** for the week ended May 2 rose 11%. Applications had declined for three consecutive weeks, including a 4.2% drop the previous week. Applications for both home purchase mortgages and refinancing mortgages rose 11.1%, in both cases mirroring the headline number by stopping what had been three consecutive weeks of decline. Meanwhile, the average interest rate on a 30-year mortgage fell 5 basis points to 6.84%.

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	FOMC Rate Decision (Lower Bound)	w/w	7-May	4.25%	4.25%	***
13:00	FOMC Rate Decision (Upper Bound)	w/w	7-May	4.50%	4.50%	***
14:00	Interest on Reserve Balances Rate	w/w	8-May	4.40%	4.40%	**
15:00	Consumer Credit	m/m	Mar	$9.387b	-$0.810	*
Federal Reserve						
No Fed speakers or events for the rest of today						

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	Jibun bank Composite PMI	m/m	Apr F	51.2	51.1		*	Equity and bond neutral
	Jibun Bank Services PMI	m/m	Apr F	52.4	52.2		**	Equity and bond neutral
New Zealand	Unemployment Rate	q/q	1Q	5.1%	5.1%	5.3%	***	Equity and bond neutral
	Employment Change	q/q	1Q	-0.7%	-1.2%	-0.5%	**	Equity and bond neutral
China	Foreign Reserves	m/m	Apr	$3281.66b	$3240.67b	$3277.50b	**	Equity and bond neutral
EUROPE								
Eurozone	Retail Sales	y/y	Mar	1.5%	1.9%	1.6%	*	Equity and bond neutral
Germany	Factory Orders WDA	y/y	Mar	3.8%	-0.2%	1.1%	***	Equity bullish, bond bearish
	HCOB Germany Construction PMI	m/m	Apr	45.1	40.3		*	Equity and bond neutral
France	Trade Balance	m/m	Mar	-6248m	-7700m		*	Equity and bond neutral
	Current Account Balance	m/m	Mar	1.4b	-1.6b		*	Equity and bond neutral
Italy	Retail Sales	y/y	Mar	-2.8%	-1.4%		**	Equity and bond neutral
UK	S&P Global UK Construction PMI	m/m	Apr F	46.6	46.4	46.0	**	Equity and bond neutral
Switzerland	Foreign Currency Reserves	m/m	May	702.9b	725.6b		*	Equity and bond neutral
Russia	S&P Global Russia Composite PMI	m/m	Apr	49.8	49.1		**	Equity and bond neutral
	S&P Global Russia Services PMI	m/m	Apr	50.1	50.1		**	Equity and bond neutral
	Money Supply, Narrow Definition	w/w	30-Apr	18.13t	18.04t		*	Equity and bond neutral
AMERICAS								
Canada	International Merchandise Trade	m/m	Mar	-0.51b	-1.41b	-1.60b	*	Equity and bond neutral
Mexico	International Reserves Weekly	w/w	2-May	$239319m	$239138m		**	Equity and bond neutral
Brazil	Industrial Production	y/y	Mar	3.1%	1.5%	1.5%	***	Equity bullish, bond bearish

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	421	0	Up
U.S. Sibor/OIS spread (bps)	430	430	0	Down
U.S. Libor/OIS spread (bps)	429	429	0	Down
10-yr T-note (%)	4.33	4.31	0.02	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.

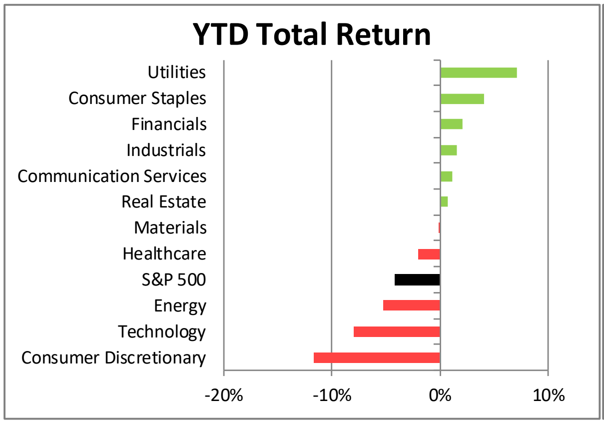
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$62.53	$62.15	0.61%	
WTI	$59.57	$59.09	0.81%	
Natural Gas	$3.56	$3.46	2.77%	
Crack Spread	$26.31	$26.93	-2.30%	
12-mo strip crack	$21.97	$22.36	-1.71%	
Ethanol rack	$1.88	$1.88	-0.09%	
Metals				
Gold	$3,386.21	$3,431.77	-1.33%	
Silver	$32.89	$33.22	-0.99%	
Copper contract	$468.20	$477.80	-2.01%	
Grains				
Corn contract	$462.00	$455.50	1.43%	
Wheat contract	$541.50	$536.00	1.03%	
Soybeans contract	$1,053.75	$1,041.25	1.20%	
Shipping				
Baltic Dry Freight	1,406	1,421	-15	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-1.86		
Gasoline (mb)		-1.20		
Distillates (mb)		-0.12		
Refinery run rates (%)		0.6%		
Natural gas (bcf)		103		

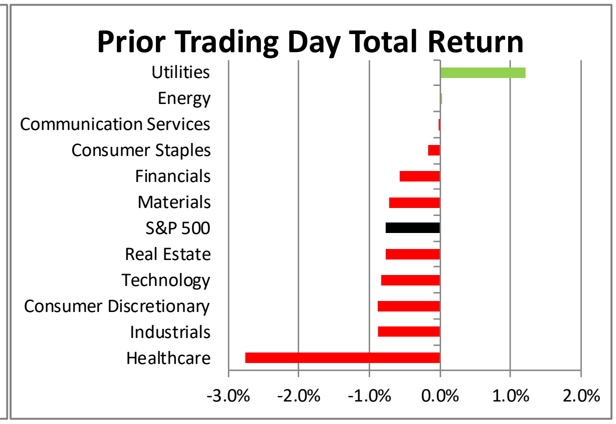
Weather

The 6-to-10 and 8-to-14-day forecasts currently call for warmer-than-normal temperatures for most of the country from the Rocky Mountains eastward, with cooler-than-normal temperatures on the West Coast. The forecasts predict wetter-than-normal conditions in the northern quadrant of the country and the East Coast from Chesapeake to Florida, with drier-than-normal conditions in Texas and New England.

Data Section

US Equity Markets – (as of 5/6/2025 close)

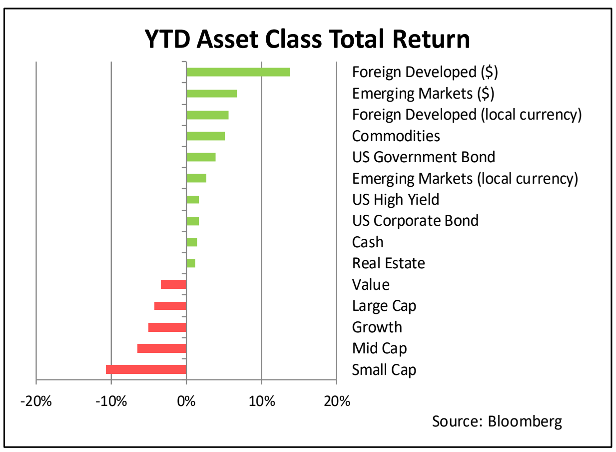




(Source: Bloomberg)

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 5/6/2025 close)

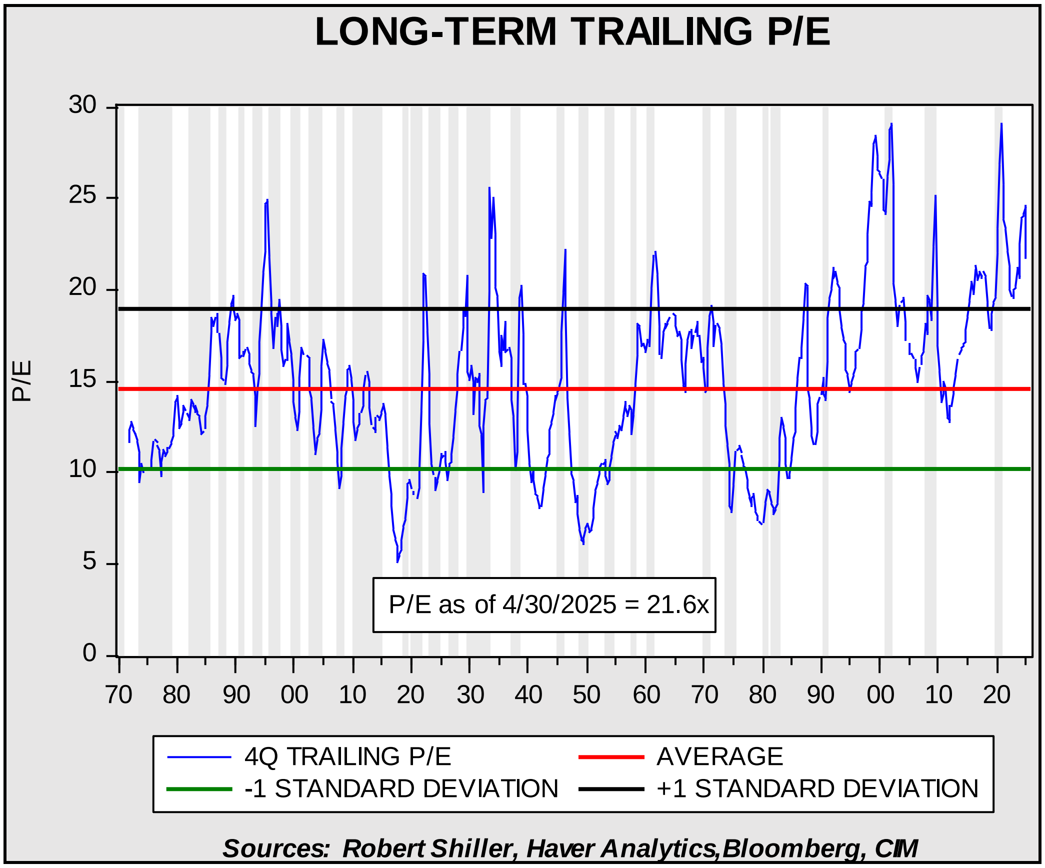


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 1, 2025



Based on our methodology,[1] the current P/E is 21.6x, unchanged from our last report. The rise in the stock price index was 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.

---

[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.