Daily Comment

Confluence INVESTMENT MANAGEMENT

By Patrick Fearon-Hernandez, CFA, and Thomas Wash

Posted: May 8, 2025 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed up 1.3% 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 0.3% from its previous close and the Shenzhen Composite up 1.0%. US equity index futures are signaling a higher open.

With 430 companies having reported so far, S&P 500 earnings for Q1 are running at $63.80 per share compared to estimates of $60.75, which is up 7.3% from Q1 2024. Of the companies that have reported thus far, 77.0% have exceeded expectations, while 19.1% 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

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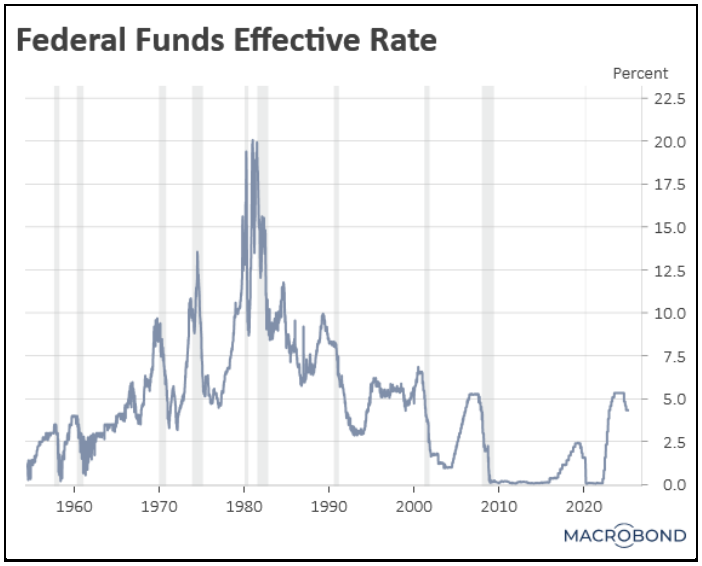
Good morning! Markets are digesting yesterday's pivotal Fed rate decision, while also keeping an eye on an exciting NBA playoff series where the New York Knicks have surged to a 2-0 lead against the Boston Celtics. In today's *Comment*, we'll analyze the implications of the Fed's latest move, examine the Trump administration's evolving foreign policy vision, and cover other key market developments. As always, we'll also provide our signature roundup of critical domestic and international economic data releases to keep you fully informed.

Fed Patience: The Federal Reserve vowed that it will not cut rates without solid evidence that the economy is in trouble.

- As expected, following its two-day meeting the central bank kept its federal funds target range steady at 4.25%-4.50% and maintained the current pace of balance sheet reduction. The decision to delay policy easing underscores officials' beliefs that, despite economic uncertainty, growth remains resilient. They also noted that uncertainty surrounding the scope and scale of potential tariffs could prolong the pause until there is greater clarity on their economic impact.

- During the press conference, Fed Chair Powell reaffirmed the central bank's commitment to a patient policy stance. He underscored that future policy actions would be primarily determined by the extent to which tariffs affect employment and inflation. While preserving optionality, Powell appeared to dismiss the possibility of rate increases, signaling that the Fed's subsequent move would likely be either a continuation of the current rate or a reduction.

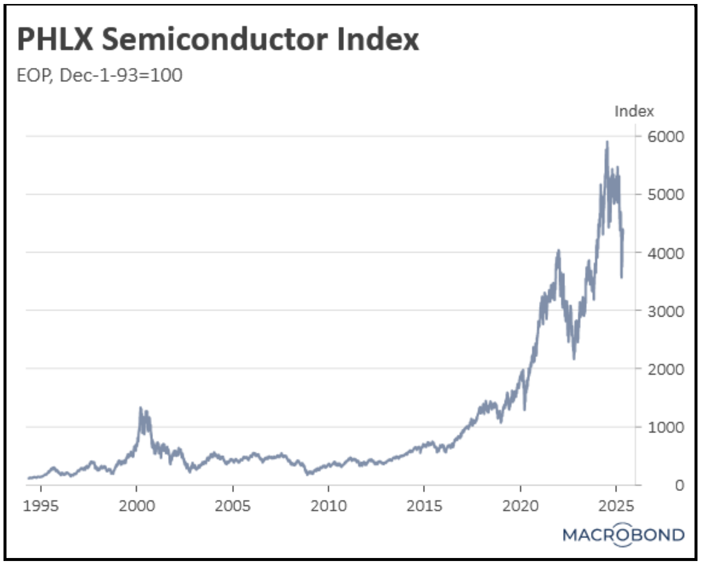


- Despite Powell's moderately hawkish tone, the 10-year Treasury yield fell following the policy announcement — a sign that markets remain confident in the Fed's commitment to its inflation target, even amid growing political pressure for rate cuts. In recent weeks, the president has repeatedly urged the Fed to lower rates, though he has explicitly denied any intention to dismiss Powell should the central bank maintain its current stance.
- While the Fed has maintained its stance that it will not raise rates unless necessary, the market still anticipates at least three rate cuts this year, with the first potentially arriving in July. This optimism stems partly from expectations that an economic slowdown could force the Fed to act. However, we maintain that without substantial evidence of a weakening economy, aggressive rate cuts this year remain unlikely.

New AI Standards: In a policy shift from the previous administration, the White House aims to make its AI restrictions more inclusive of nations interested in investing in the United States.

- Just one week before their scheduled May 15 implementation, the Trump administration has rescinded Biden-era regulations on AI-related semiconductor exports. This move addresses criticisms from both international allies and technology companies. The timing is notable as US officials are poised to engage in high-level discussions with the United Arab Emirates and Saudi Arabia, focusing on American AI infrastructure investments and bilateral trade.

- The "AI Diffusion Rule," a late-term Biden administration regulation, restricts the sale of high-performance chip technology to certain nations. This framework compels countries to comply with US standards or face losing access to critical technology. It further segments the global market into three tiers: top priority is given to US allies, who receive unfettered access to advanced semiconductors, while Russia and China — effectively barred from importing key technologies — are relegated to the lowest tier.
- The rule has drawn significant criticism from foreign governments dependent on US technology to achieve their strategic ambitions. This is particularly true for Middle Eastern nations placed in the second tier, despite their growing AI aspirations. Saudi Arabia, for instance, has made AI investment a cornerstone of its Vision 2030 initiative to reduce oil dependence. Similarly, the UAE aims to establish itself as a global AI leader by 2031.



- The semiconductor industry stands to benefit from the AI regulation rollback, though the Trump administration has already signaled plans for revised rules, suggesting any relief may be temporary. Officials aim to craft a lighter-touch framework, while still preserving US AI leadership. The policy shift could accelerate investment in domestic AI infrastructure, which appears central to the administration's tech strategy.

UK Trade Deal: As noted in yesterday's report, the US and UK are poised to announce a trade deal that could serve as a blueprint for other nations willing to align with Washington's trade priorities.

- The White House is expected to announce the deal this morning as the president seeks to demonstrate progress in his push for trade agreement negotiations. While details of the arrangement remain undisclosed, sources indicate it will likely include reduced tariffs on US automobiles and agricultural products, along with the elimination of British taxes targeting American tech firms. However, the agreement is expected to serve as a framework for future talks rather than a finalized deal.

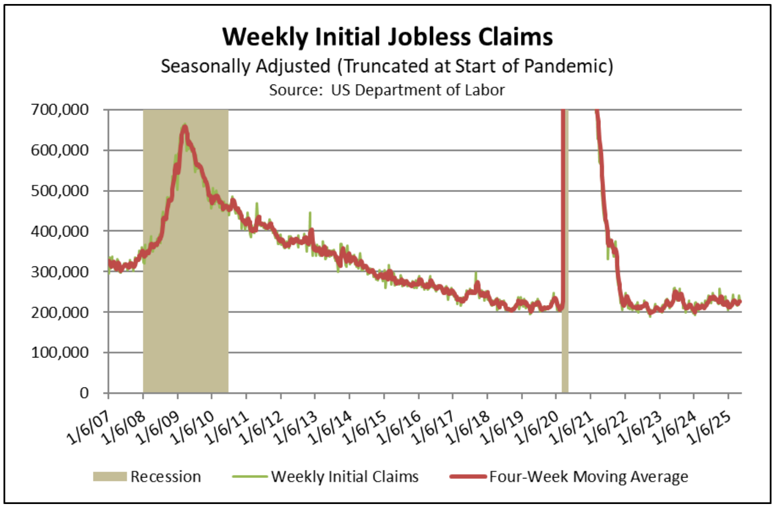
- The agreement to begin formal talks is significant as it may reveal what concessions the US is prepared to make in negotiations with its trading partners. Unlike most other nations, the UK already faced minimal tariff rates before their temporary suspension and maintains a trade deficit with the US, making widespread tariff reductions unlikely. Consequently, the focus of US-UK negotiations is expected to shift toward addressing tariffs on specific products rather than pursuing broad, economy-wide cuts.
- Facing the dual headwinds of weak global demand and steep 25% US steel tariffs, the UK is aggressively pursuing relief. The impact of these tariffs is clear: British steel exports to the US plummeted by nearly 30% in 2023, falling from 235,000 to just 165,000 metric tons. As a potential point of negotiation, the Trump administration has indicated it will push for stricter monitoring of transatlantic steel shipments to address concerns about the distortion of Chinese overproduction on global markets.
- Automobiles represent another critical sector affected by product-specific tariffs. As the US serves as the largest export market for British vehicles, these tariffs pose a significant threat to the UK automotive industry. This substantial economic vulnerability explains why securing tariff relief has become a key priority in negotiations.
- However, certain red lines remain firmly in place — most notably, the UK's refusal to accept US agricultural standards. A key sticking point is chlorine-washed chicken, which Britain has explicitly rejected due to concerns it could jeopardize ongoing efforts to secure a trade deal with the EU.
- Progress in US trade negotiations is expected to bolster risk assets as markets focus on potential easing of trade restrictions. While this development may provide near-term support for equities, sustained gains will ultimately depend on the economy's ability to demonstrate resilience amid ongoing trade changes.

Growing EU-US Friction: The EU is prepared to impose its own tariffs on the US if a mutually agreeable trade solution cannot be reached.

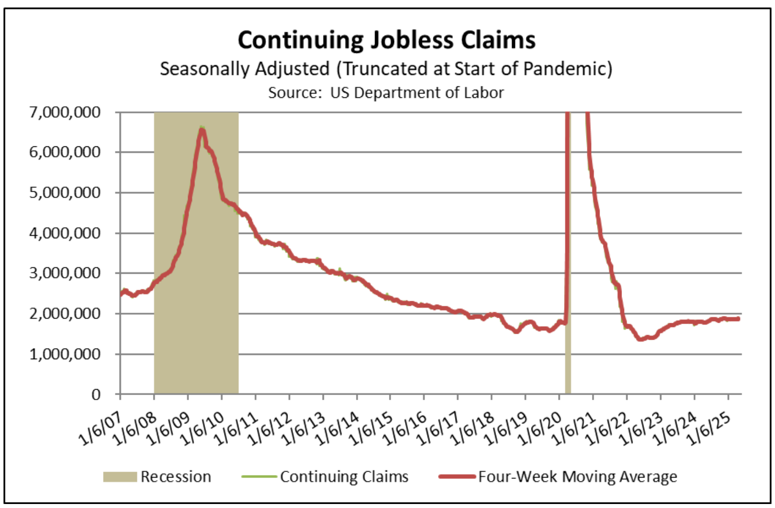
- The EU plans to impose $108 billion in tariffs on US goods, including cars, planes, and bourbon, starting Thursday. This retaliatory measure follows previously administered US tariffs and comes as both sides prepare for upcoming talks.
- This announcement likely represents strategic posturing by the EU to strengthen its negotiating position. Key areas the US administration seeks to address include reform of the EU's VAT system and an end to the bloc's scrutiny of digital services, which predominantly affects large US tech companies.

US Economic Releases

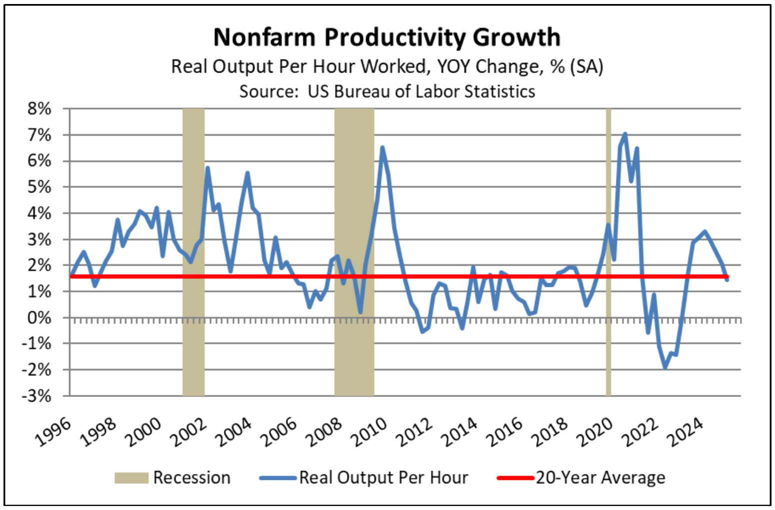
In the week ended May 3, ***initial claims for unemployment benefits*** fell to a seasonally adjusted 228,000, below both the expected level of 230,000 and the previous week's level of 241,000. The four-week moving average of initial claims, which helps smooth out some of the volatility in the series, rose to a still-modest 227,000. The chart below shows how initial jobless claims have fluctuated since just before the Great Financial Crisis (GFC). The chart is truncated through much of the pandemic period because of the extremely high level of claims at that time.



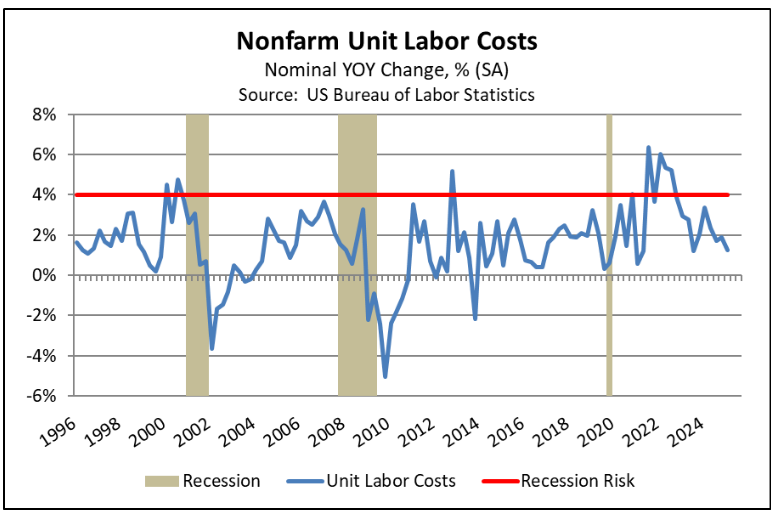
In the week ended April 26, the number of ***continuing claims for unemployment benefits*** (people continuing to draw benefits) fell to a seasonally adjusted 1.879 million, below both the anticipated reading of 1.895 million and the prior week's revised reading of 1.908 million. The four-week moving average of continuing claims rose to 1,874,500. The four-week moving average of continuing claims is now at its highest level since early December, suggesting that those workers who are laid off are finding it more difficult to find a new job. 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.



Another report today focused on the productivity of US workers, defined as the average value of output per hour worked. Excluding price changes and normal seasonal fluctuations, first quarter ***nonfarm productivity*** declined at an annualized rate of 0.8%, matching expectations and reversing about half of the fourth quarter's revised growth rate of 1.7%. Taking into account the changes in each of the last four quarters, productivity in the first quarter was up a weak 1.4% from the same period one year earlier. The chart below shows the year-over-year growth in real productivity over the last quarter-century or so.



Reflecting the decline in productivity early in the year, first quarter ***unit labor costs*** jumped at an annualized rate of 5.7%, exceeding the expected growth rate of 5.1% and accelerating from the revised growth rate of 2.0% in the fourth quarter. Nevertheless, unit labor costs in the first quarter were up just 1.3% year-over-year, far below the 4.0% or so that has sometimes been associated with recessions in the past. The chart below shows the year-over-year growth in unit labor costs since 1996.



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

Economic Releases						
EST	**Indicator**			**Expected**	**Prior**	**Rating**
10:00	Wholesale Inventories	m/m	Mar F	0.5%	0.5%	**
10:00	Wholesale Trade Sales	m/m	Mar	0.9%	2.4%	*
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								
Australia	Foreign Reserves	m/m	Apr	A$102.4b	A$105.2b		**	Equity and bond neutral
South Korea	Foreign Reserves	m/m	Apr	$404.67b	$409.66b		**	Equity and bond neutral
EUROPE								
Germany	Industrial Production WDA	y/y	Mar	-0.2%	-4.1%	-2.7%	**	Equity bullish, bond bearish
	Trade Balance	m/m	Mar	21.1b	18.0b	19.1b	*	Equity and bond neutral
	Exports	m/m	Mar	1.1%	1.9%	1.0%	*	Equity and bond neutral
	Imports	m/m	Mar	-1.4%	0.5%	0.4%	*	Equity and bond neutral
UK	RICS House Price Balance	y/y	Apr	-3%	2%	-4%	**	Equity bullish, bond bearish
AMERICAS								
Mexico	CPI	y/y	Apr	3.93%	3.80%	3.90%	***	Equity and bond neutral
	Core CPI	y/y	Apr	3.93%	3.64%	3.92%	**	Equity and bond neutral
Brazil	Trade Balance	m/m	Apr	$8153m	$7757m	$8300m	**	Equity and bond neutral
	Exports	m/m	Apr	$30409m	$28786m	$30500m	*	Equity and bond neutral
	Imports	m/m	Apr	$22256m	$21029m	$22235m	*	Equity and bond neutral
	FGV Inflation IGP-DI	y/y	Apr	8.11%	8.57%	8.17%	**	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)	421	422	-1	Up
U.S. Sibor/OIS spread (bps)	431	431	0	Down
U.S. Libor/OIS spread (bps)	430	430	0	Down
10-yr T-note (%)	4.31	4.27	0.04	UP
Euribor/OIS spread (bps)	215	214	1	Down
Currencies	**Direction**			
Dollar	Up			Down
Euro	Down			Up
Yen	Up			Up
Pound	Down			Up
Franc	Down			Up
Central Bank Action	**Current**	**Prior**	**Expected**	
FOMC Rate Decision (Upper Bound)	4.50%	4.50%	4.50%	On Forecast
FOMC Rate Decision (Lower Bound)	4.25%	4.25%	4.25%	On Forecast
Bank of England Bank Rate	4.25%	4.50%	4.25%	On Forecast
Brazil Selic Rate	14.75%	14.25%	14.75%	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.

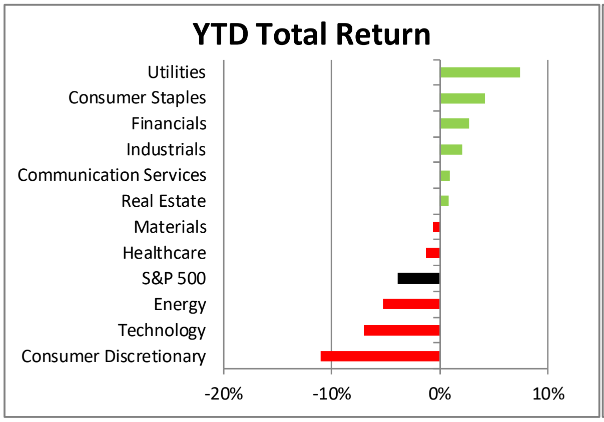
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$62.06	$61.12	1.54%	
WTI	$59.11	$58.07	1.79%	
Natural Gas	$3.65	$3.62	0.80%	
Crack Spread	$26.22	$26.40	-0.68%	
12-mo strip crack	$21.84	$21.94	-0.45%	
Ethanol rack	$1.86	$1.87	-0.54%	
Metals				
Gold	$3,343.25	$3,364.50	-0.63%	
Silver	$32.39	$32.46	-0.20%	
Copper contract	$459.60	$465.95	-1.36%	
Grains				
Corn contract	$450.75	$449.25	0.33%	
Wheat contract	$538.50	$534.25	0.80%	
Soybeans contract	$1,046.25	$1,039.25	0.67%	
Shipping				
Baltic Dry Freight	1,374	1,406	-32	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)	-2.03	-1.86	-0.17	
Gasoline (mb)	0.19	-1.20	1.39	
Distillates (mb)	-1.11	-0.12	-0.99	
Refinery run rates (%)	0.4%	0.6%	-0.2%	
Natural gas (bcf)		100		

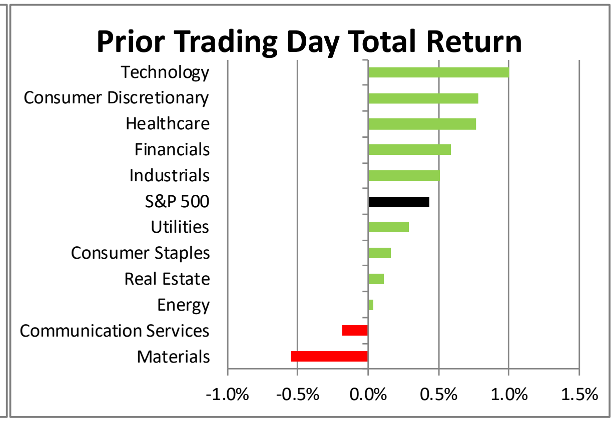
Weather

The 6-to-10 and 8-to-14-day forecasts currently call for warmer-than-normal temperatures across the entire area from the Great Plains eastward, with cooler-than-normal temperatures in the Rocky Mountains. The forecasts call for wetter-than-normal conditions in the northern Rocky Mountains, the northern Great Plains, and the Upper Midwest, with dry conditions in the Southeast.

Data Section

US Equity Markets – (as of 5/7/2025 close)

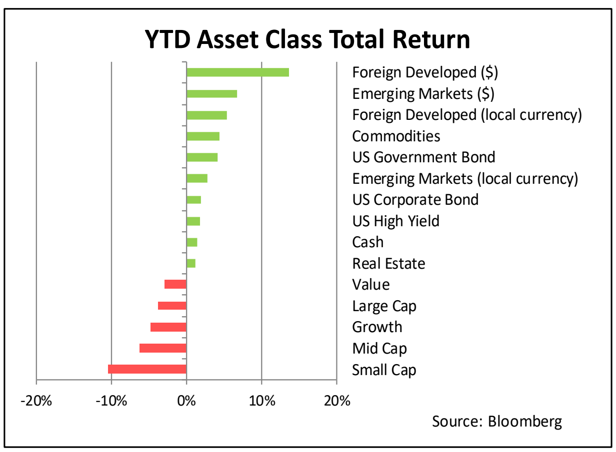




(Source: Bloomberg)

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 5/7/2025 close)

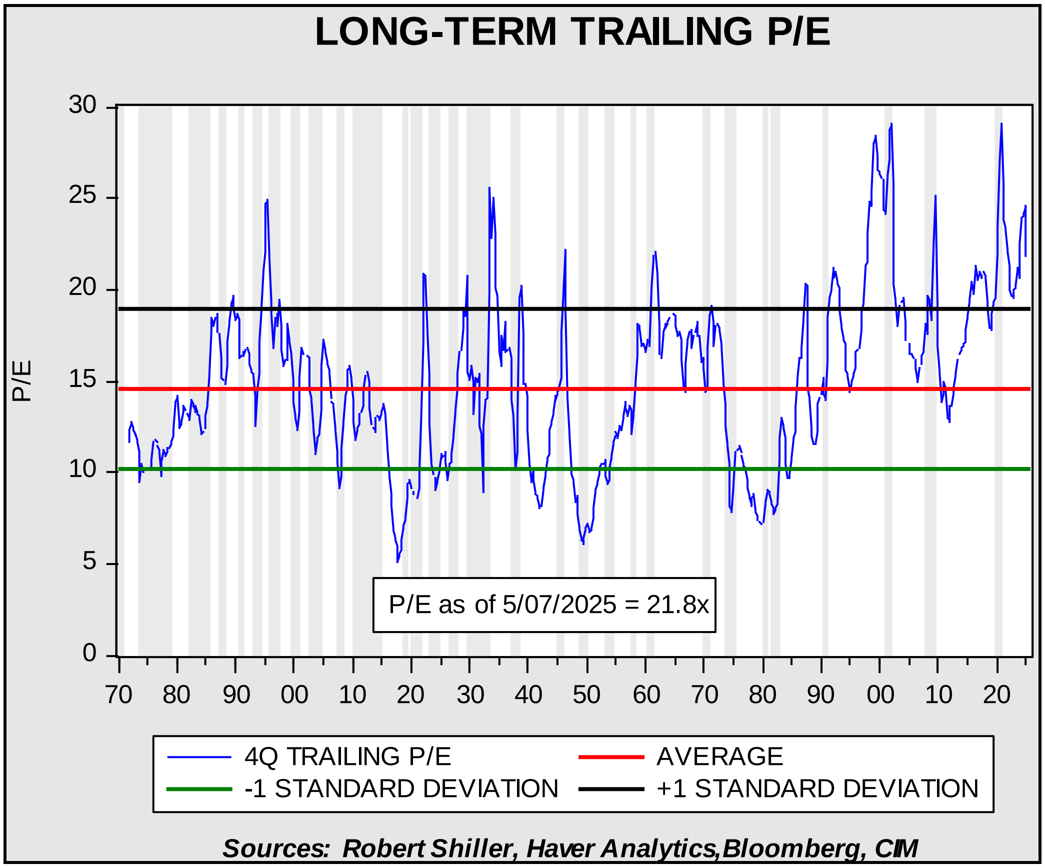


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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 8, 2025



Based on our methodology,[1] the current P/E is 21.8x, 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.