Daily Comment

Confluence INVESTMENT MANAGEMENT

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Posted: September 9, 2025 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is relatively unchanged from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 1.9%. 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 higher open.

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
"Tariff Trilemma: The Three Rs Driving US Trade Policy" (8/25/25) + podcast	"The Cap-Weighted and Equal-Weighted S&P 500" (9/8/25) + podcast	Q3 2025 Report Q3 2025 Rebalance Presentation	The Confluence Mailbag Podcast Business Cycle Report

Have a question on the economy, markets, geopolitics, or other important topics? You can submit your queries to our new monthly podcast, *Confluence Mailbag*! Submit your question to mailbag@confluenceim.com.

Our *Comment* today opens with news of a potentially fundamental change in US defense strategy that could have large implications for the country's foreign relations, economy, and financial markets. We next review several other international and US developments with the potential to affect the financial markets today, including the latest on the search for new prime ministers in Japan and France and a sobering report on how long it may take US firms to see a positive return on their current investments in artificial intelligence.

US Defense Strategy: New reporting says the Pentagon's draft defense strategy would prioritize domestic missions, homeland defense, and protection of the Americas region over preparing to fight major foreign rivals such as China and Russia. Although the strategy could still be revised, it appears that the current version is calling for the US to end its traditional role as the global hegemon and instead focus on being a regional hegemon, probably relying on the Pacific and Atlantic Oceans and the US nuclear arsenal to deter longer-range threats.

- The apparent strategy change is surprising because the document is being developed by Under Secretary of Defense for Policy Elbridge Colby, who has long advocated for the US to focus its military on the potential threat from China. Like other Republican China hawks, Colby has argued for shifting military resources from Europe and the Middle East to the Asia-Pacific, not to the Americas.
- If the strategy shift is finalized, a key question is what it means for future US defense spending and the economic and financial prospects of the defense industry. As we've noted before, isolationist sentiment in parts of the administration's political base could force eventual defense spending cuts, even as new military technologies lead to smaller orders for major, expensive weapon systems such as aircraft carriers and bombers.
- At the same time, we think that the prospect of the US pulling back from its foreign defense commitments will continue to prompt foreign nations to hike their own spending. Some of those new orders will likely go to major US defense contractors, but the bulk will likely go to foreign defense firms.
- That validates our longstanding expectation that European and Asian defense firms could be especially well placed to enjoy increased sales, bigger profits, and higher stock prices than their US counterparts.

Japan: Yesterday, Toshimitsu Motegi, the former secretary-general of the ruling Liberal Democratic Party, became the first Japanese politician to say he will contend to replace Prime Minister Ishiba as head of the LDP and the government following his resignation on Sunday. Several other top politicians are also expected to throw their hats into the ring in the coming days, including the investor favorite, free-market advocate and former Economic Security Minister Sanae Takaichi.

China: On the sidelines of the Munich Auto Show yesterday, the executive vice-president of Chinese electric-vehicle giant BYD said about 100 of the country's carmakers would have to be pushed out of business for the industry to stabilize. The statement comes as Beijing starts taking top-down steps to rein in the country's growing problem with excessive industrial capacity and debilitating price wars in many industries. However, some observers believe that even putting 100 carmakers out of business would leave China with too many auto firms.

Indonesia: Following last month's widespread protests against government corruption and lawmaker privileges, President Prabowo Subianto yesterday fired longtime Finance Minister Sri Mulyani Indrawati. The firing of the respected finance official suggests the president may be considering looser fiscal spending to curry favor with voters. Reflecting the threat to financial discipline, Indonesia's benchmark stock index fell approximately 1.8% today, while the rupiah has weakened about 1.0% against the US dollar.

European Union: ASML, the Dutch maker of semiconductor manufacturing equipment, has announced that it will invest 1.3 billion EUR ($1.5 billion) in the French artificial intelligence start-up Mistral to help foster its "strategic technology." As the US and China battle for the lead in AI technology and development, leaving other major countries in their dust, the ASML-

Mistral deal illustrates how European countries are scrambling to catch up, or at least avoid falling into irrelevance.

France: As previewed in our *Comment* yesterday, Prime Minister Bayrou did lose yesterday's no-confidence vote in parliament, with 364 of the 577 lawmakers voting against him. President Macron today will accept Bayrou's resignation and may announce a nominee to replace him. Even so, whoever accepts the poisoned chalice to try to become the next prime minister will face the same challenges of a fractured parliament and strong resistance to economic reform, which will likely weigh on French asset values and push bond yields higher.

US Labor Force: According to the Department of Education, high schoolers' average math and reading scores in the National Assessment of Educational Progress for 2024 fell to their lowest levels on record. The share of 12th graders rated as "proficient" or above also declined, to just 22% in math and 35% in reading. Such abysmally low levels of proficiency have long been seen as an Achilles heel for the US that will leave companies without the educated workers they need to reindustrialize and compete globally in high technology and the sciences.

US Artificial Intelligence: Julie Sweet, CEO of consulting giant Accenture, said in an interview with Axios that it will probably take several years for US companies to really see a positive return on their AI investments. According to Sweet, that's because it will take time for firms to retrain their workforces and revamp their operations to make full use of the technology. The statement is consistent with other recent studies and commentaries that have warned that the payoff from AI may be further in the future, creating some risk of a pullback in AI-related stocks.

US Economic Releases

There are no economic releases or Fed events scheduled for the rest of the day.

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	Money Stock M2	y/y	Aug	1.3%	1.0%		**	Equity and bond neutral
	Money Stock M3	y/y	Aug	0.8%	0.6%		**	Equity and bond neutral
	Machine tool orders	y/y	Aug P	8.1%	3.6%		**	Equity and bond neutral
Australia	Westpac Consumer Conf SA	m/m	Sep	-3.1%	5.7%		**	Equity and bond neutral
	Westpac Consumer Conf Index	m/m	Sep	95.4	98.5		**	Equity and bond neutral
	NAB Business Confidence	m/m	Aug	4	8		***	Equity and bond neutral
	NAB Business Conditions	m/m	Aug	7	5		***	Equity and bond neutral
New Zealand	Mfg Activity SA	q/q	2Q	-3.0%	4.8%		*	Equity and bond neutral
	Mfg Activity Volume	q/q	2Q	-2.9%	2.4%		**	Equity and bond neutral
EUROPE								
France	Industrial Production	y/y	Jul	1.3%	2.2%	0.7%	***	Equity bullish, bond bearish
	Manufacturing Production	y/y	Jul	1.5%	2.6%		**	Equity and bond neutral
AMERICAS								
Mexico	CPI	y/y	Aug	3.57%	3.51%	3.56%	***	Equity and bond neutral
	Core CPI	y/y	Aug	4.23%	4.23%	4.20%	**	Equity and bond neutral
	Vehicle Production	y/y	Aug	349856	309453		*	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)	391	390	1	Down
U.S. Sibor/OIS spread (bps)	406	406	0	Down
U.S. Libor/OIS spread (bps)	401	400	1	Down
10-yr T-note (%)	4.07	4.04	0.03	Down
Euribor/OIS spread (bps)	203	205	-2	Up
Currencies	**Direction**			
Dollar	Up			Down
Euro	Down			Up
Yen	Up			Down
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	$66.57	$66.02	0.83%	
WTI	$62.81	$62.26	0.88%	
Natural Gas	$3.15	$3.09	1.81%	
Crack Spread	$25.17	$24.99	0.71%	
12-mo strip crack	$24.21	$24.14	0.29%	
Ethanol rack	$2.16	$2.16	-0.26%	
Metals				
Gold	$3,653.43	$3,635.98	0.48%	
Silver	$41.30	$41.35	-0.14%	
Copper contract	$456.05	$455.95	0.02%	
Grains				
Corn contract	$421.00	$421.75	-0.18%	
Wheat contract	$523.00	$523.75	-0.14%	
Soybeans contract	$1,033.00	$1,033.75	-0.07%	
Shipping				
Baltic Dry Freight	2,019	1,979	40	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		-1.87		
Gasoline (mb)		0.85		
Distillates (mb)		0.51		
Refinery run rates (%)		-0.7%		
Natural gas (bcf)		55		

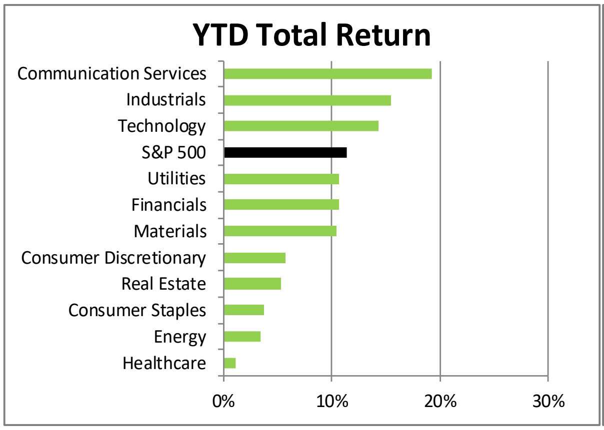
Weather

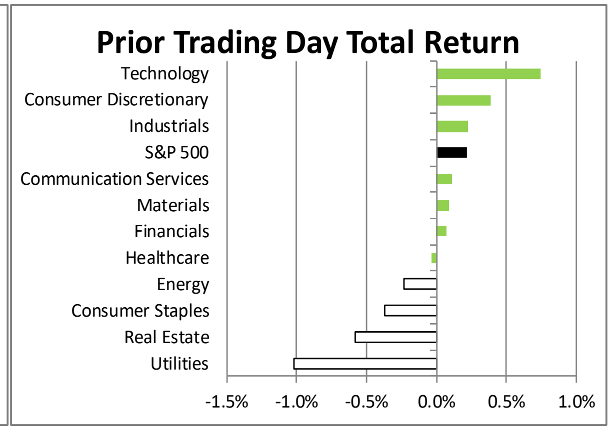
The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures for most of the country, with cooler temperatures expected on the East Coast. The precipitation outlook calls for wetter-than-normal conditions in the Rocky Mountain, Southwest, and lower East Coast regions, with dry conditions expected in the Midwest and New England.

There is no tropical cyclone activity expected within the next week.

Data Section

US Equity Markets – (as of 9/8/2025 close)

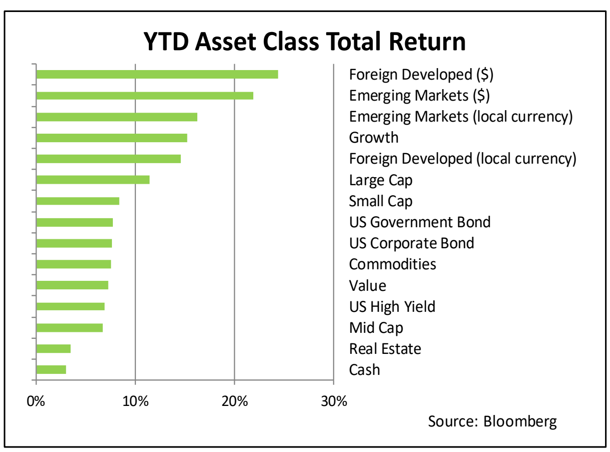




(Source: Bloomberg)

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 9/8/2025 close)

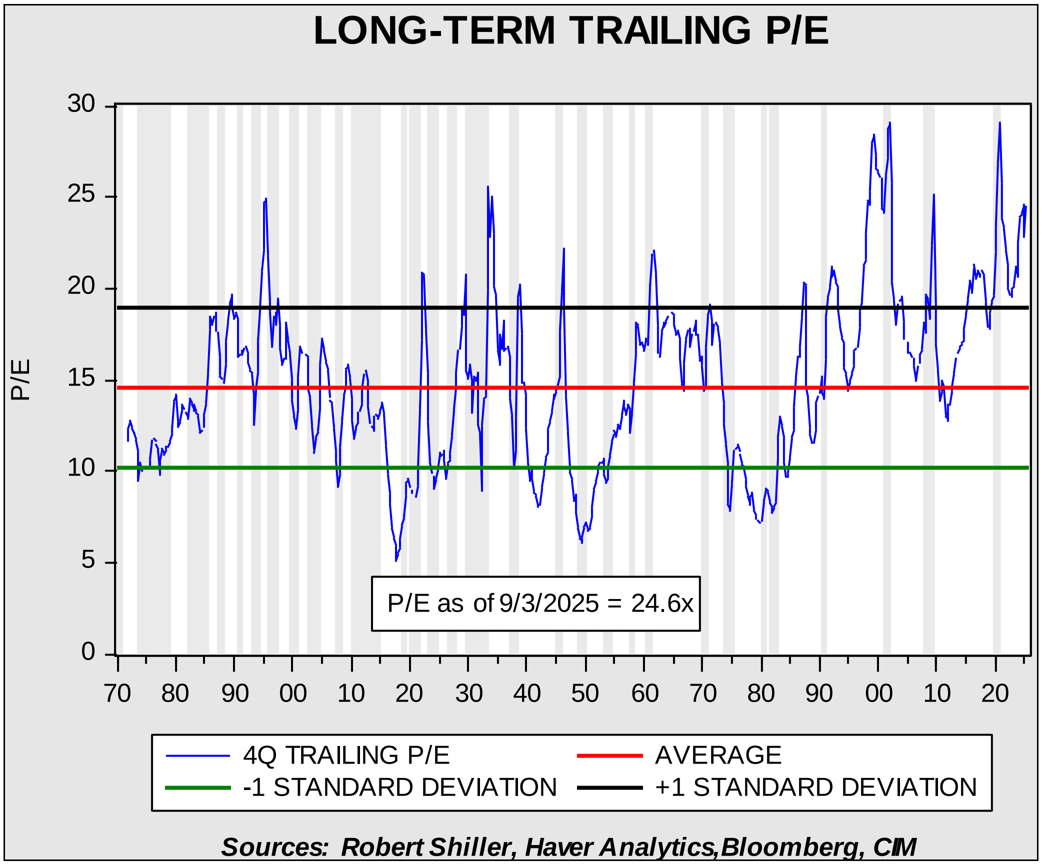


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

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

September 4, 2025



Based on our methodology,[1] the current P/E is 24.6x, which is unchanged from the previous report. The increase 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.

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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 (Q1, Q3, Q4) and one estimate (Q2). 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.