CROSSMARK GLOBAL INVESTMENTS

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Doll's Deliberations®

Weekly Investment Commentary

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Key takeaways

Stocks posted solid gains last week with the S&P 500, returning 2.93% after two weekly declines. Washington remained in the headlines, but little clarity remains on upcoming Trump policies. Bank earnings were quite strong. Best sectors were energy (6.17%) and financials (6.11%); worst sectors were healthcare (0.38%) and consumer staples (1.26%).

Equity markets (Index total return %)	Last week	Year-to-date
DJIA	3.69	2.26
S&P 500	2.93	2.01
NASDAQ	2.45	1.67
Russell 1000	2.12	1.33
Russell 1000 Growth	2.16	1.36
Russell 1000 Value	4.26	3.46
Russell 2000	3.55	1.67

S&P equity sectors (Index total return %)	Last week	Year-to-date
Communication services	1.31	2.18
Consumer discretionary	3.99	2.71
Consumer staples	1.26	-0.97
Energy	6.17	9.21
Financials	6.11	3.95
Heathcare	0.38	1.94
Industrials	4.83	4.54
Information technology	1.58	-0.16
Materials	6.03	5.05
Real estate	4.86	0.98
Utilities	4.27	4.16

1. December CPI came in slightly better than expected. While headline CPI met estimates of 0.4% m/m (2.9% y/y), core surprised to the downside at 0.2% m/m, decelerating to 3.2% y/y from 3.3%.
2. December U.S. retail sales missed estimates and coincided with a downtick in consumer confidence fitting within a trend of slowing consumption growth
3. The 4Q EPS is estimated to be +9.5%. This is down from 12% at the start of the quarter. The 2025 EPS growth is expected to be +13%. Consensus for 2025 is $273 (our estimate is $265).
4. Our theme for this year – more headwinds/fewer tailwinds—suggests the tails of the distribution have gotten wider and fatter. That should imply shrinking equity multiples and widening credit spreads to reflect the rise in uncertainty.
5. The Magnificent 7 are 34% of the S&P 500's capitalization, but represent only 24% of its earnings. (By context, the financial sector is 14% of capitalization, but 18% of earnings.)
6. Small cap stocks are relatively inexpensive and should benefit from the "America First" policies of the incoming Trump Administration. However, ongoing weakness in underlying relative earnings and the prospects for a less dovish Fed cause us to advise against making aggressive bets on small cap stocks.
7. We expect this year to be better for active management with a broadening opportunity set, given the higher-for-longer interest rate view is now increasingly consensus.
8. The Atlanta Fed's GDPNow tracking model is now showing Q4 2024 real GDP growth of 3.0%. We see President Trump's economic plan resulting in 1) rising business and consumer confidence, 2) extension of tax cuts, and 3) deregulation and potential government efficiency. (We still see financials as the biggest sectoral winner.)
9. Proposed Treasury Secretary Scott Bessent will propose a "3-3-3" goal for the economy: boosting growth to 3% annually, cutting the deficit to 3% (from 6.9%) of GDP, and increasing oil production by 3 mm barrels per day. Bessent forcefully noted he supported Fed independence and asserted that the deficit problem is a spending problem, not a tax problem.
10. We expect to see tariffs put in place, but they will not be anywhere near the levels talked about previously. (Some tariffs will be threatened to force Canda and Mexico to deal with the fentanyl and immigration issues, and China will face some tariffs.)

A calmer bond market—for now

International equity markets (Index total return %)	Last week	Year-to-date
MSCI ACWI	1.78	0.91
MSCI ACWI EX U.S.	1.38	0.42
MSCI EAFE	1.70	0.96
MSCI EM	0.92	-0.72

Fixed income markets (Index total return %)	Last week	Year-to-date
Bloomberg U.S. Aggregate Bond	1.01	0.00
Bloomberg U.S. Corp High Yield	0.62	0.66
Bloomberg U.S. Gov/Credit	0.92	-0.02
Bloomberg U.S. T-Bill 1-3 Month	0.05	0.17

Alternatives (Index total return %)	**Last week**	**Year-to-date**
Real estate (FTSE NAREIT)	4.49	0.50
Commodities (DJ)	1.26	5.21
Global listed private equity (Red Rocks)	4.16	2.37
Currencies (DB Currency Future Harvest)	-0.38	-0.33

A core CPI data print that was a bit less than expected provided a reprieve to the beleaguered bond market (after several months of higher yields) and spurred a surge in equity prices. The U.S. continues to grow at a solid rate at a time when the economy has been operating above its long-run potential. In our view, U.S. inflation is not under control, and the risks remain to the upside even if the Fed stops cutting its policy rate. After a sluggish 2024, global growth prospects are gradually improving: Global trade is firming, lower policy rates are easing debt-servicing burdens, and a strong U.S. dollar is beneficial to the rest of the world.

Despite the excitement last week about a slightly better-than-expected core CPI report, the trend in core inflation is worrisome and at odds with Fed (and bond market) expectations. After a deceleration in the middle of last year, core CPI popped in recent months and is holding above 3%. There are likely to be periodic risk-off phases whenever bond yields rise too rapidly. An economic knock-out blow from either protectionism or an overshoot in Treasury yields is unlikely anytime soon, but significant forward equity market progress is also unlikely.

Correctly gauging the inflation outlook will likely be the most important investment issue of the year, as it will determine whether bond yields rise sufficiently to threaten economic activity and possibly end the uptrend in corporate earnings or remain supportive of growth. Rising corporate earnings are the key driver of equity bull markets and have underpinned the persistent outperformance of equities over bonds in recent years.

With the incoming Trump Administration, we could see select tariffs and deportation measures. At a minimum, we expect considerable noise this year from Trump and periodic bouts of heightened angst. In the end, we are guessing that tariffs will not derail the global economic expansion. However, this view is already imbedded in asset pricing, leaving downside risk if it proves too optimistic.

Conclusion

U.S. economic growth is still running above the economy's long-run potential, and inflation will stay above the Fed's target over the course of 2025. The global economy should gradually improve, although investors will remain wary until some clarity develops about the new U.S. administration's trade policies. Government bond markets are due for a reprieve, although any consolidation in yields should prove temporary. In the interim, a calmer bond market will benefit most risk asset markets. The U.S. is the most expensive global equity market and ultimately will face the greatest inflation and bond market risks.

Source: Bloomberg as of Jan. 17, 2025

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