CROSSMARK
GLOBAL INVESTMENTS

April 18, 2022
Issue 2.15

DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-0.78%	-4.68%
S&P 500	-2.11%	-7.45%
NASDAQ	-2.62%	-14.50%
RUSSELL 2000	0.53%	-10.41%
RUSSELL 1000 GROWTH	-2.82%	-14.11%
RUSSELL 1000 VALUE	-0.99%	-1.10%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-2.93%	-16.00%
CONSUMER DISCRETIONARY	-0.81%	-12.53%
CONSUMER STAPLES	0.15%	3.15%
ENERGY	0.35%	45.21%
FINANCIALS	-2.63%	-5.13%
HEALTHCARE	-2.87%	-1.23%
INDUSTRIALS	0.43%	-5.16%
INFORMATION TECHNOLOGY	-3.81%	-15.52%
MATERIALS	0.71%	-1.33%
REAL ESTATE	-1.79%	-5.32%
UTILITIES	-1.14%	7.09%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-1.66%	-8.13%
MSCI ACWI EX U.S.	-1.03%	-7.91%
MSCI EAFE	-1.05%	-8.62%
MSCI EM	-1.23%	-9.20%

SUMMARY:

U.S. equities were lower last week, with the S&P 500 down 2.1%. (Small-cap stocks were modestly higher.) Some bullish talking points didn't get much market traction, including peak inflation, better supply chain trends, and consumer resilience. These positions were overshadowed by fear around inflation, supply chains, and geopolitics. Best performing sectors (and the only ones positive) were materials (+0.7%), industrials (+0.4%), energy (+0.3%), and consumer staples (+0.2%); worst performers were technology (-3.8%), communication services (-2.9%) and healthcare (-2.9%).

KEY TAKEAWAYS:

1. In March, U.S. headline CPI inflation surged to a 40-year high of 8.5% year-over-year (y/y). Meanwhile, core inflation decelerated to 0.3% month-over-month (m/m) – the lowest since last September. Inflation will likely peak by mid-year. But, we expect inflation to be 4% by year-end.
2. Compensation growth appears to be trending at 6%. With productivity at around 2%, it suggests trend inflation of about 4%.
3. Retail sales were in-line with estimates, but revisions totaled +0.7% earlier month. Consumer spending remains reasonably robust.
4. Recession speculation remains rampant. Our view – trying to analyze and process all the cross-currents – is that a recession in 2022 is unlikely but is possible in 2023.
5. Earlier signs of the Russia-Ukraine war easing have faded, pointing to a longer slog.
6. Consensus expects 1Q EPS growth will decelerate sharply to just 5% y/y. (To put the slowdown in context, EPS growth was 27% last quarter.)
7. Analysts remain amazingly bullish on the outlook for earnings despite the war, soaring raw material costs, increasing supply chain disruptions, and China's COVID lockdown.
8. Since its brief inversion in March, the 2yr/10yr Treasury spread has moved up nearly 40bps. (Taking recession risk lower.)
9. Sentiment on bonds is about as one-sided as it gets. While we have not seen the high in interest rates for this cycle, a bond rally could develop at any time.
10. How has the stock market held up reasonably well in the face of a big increase in inflation, a more hawkish Fed, rising interest rates, and a war? (1) plenty of excess liquidity from the Fed and on consumer balance sheets, (2) relative safe-haven status of the U.S., (3) still decent revenue growth and profit margins, (4) negative sentiment, and (5) TINA, even though not as strong a case as it was.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.70%	-8.54%
BLOOMBERG U.S. CORP HIGH YIELD	-0.32%	-6.55%
BLOOMBERG U.S. GOV/ CREDIT	-0.81%	-9.05%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.00%	0.03%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
FTSE NAREIT (REAL ESTATE)	-0.92%	-4.72%
DJ COMMODITIES	4.20%	32.50%
RED ROCKS GLOBAL LISTED PRIVATE EQUITY	-0.87%	-18.21%
DB G10 CURRENCY FUTURES	0.41%	7.99%

WILL RISING RATES CAUSE STOCKS (AND THE ECONOMY) TO STUMBLE?

The bond market is in danger of deteriorating from an orderly rise in yields to a full-blown riot. Neither the war in Ukraine nor a sluggish equity market have slowed the rise in government bond yields. Investors now (finally) realize that central banks are far behind the inflation curve. Our view that bond yields would move higher in waves, with periodic pause phases, is in jeopardy of giving way to a relentless one-way move higher that could ultimately undermine economic activity.

The first ray of hope that bond markets could stabilize arrived with last week's CPI report, as goods price inflation ticked down. There may only be a small window for bond tensions to ease if service sector activity ratchets higher. In other words, the spike in goods price inflation is likely to cool going forward, but this relief may be offset by higher service sector inflation. A brief calm due to base effects and easing auto price inflation is likely, but underlying core inflation will still settle well above the Fed's 2% target (probably closer to 4%). We will likely witness very confusing inflation reports in the next six months, something for bond bulls and bears. We remain cyclically bearish on bonds but recognize that an oversold rally can come at any time.

For equities, prospects for a durable rally will remain on hold for as long as bond yields are rising. There are concerns that central banks may be forced to engineer a significant economic slowdown or recession. While we expect another solid corporate earnings season for the first quarter, equity valuations will remain under pressure if bond yields keep moving higher. For warning signs of bigger trouble ahead for stocks, continue to monitor credit spreads, which so far have stayed fairly calm despite the bearish bond market backdrop and a war. The foundations under the U.S. economic expansion are solid and durable, and the same is true to a lesser extent for the overall global economy. We expect the expansion to be able to weather higher bond yields and policy rates for the foreseeable future, providing the rise is orderly and/or there are periodic pauses. U.S. income, corporate profit, and balance sheet trends are still positive and should ensure solid growth persists. Equity markets, meanwhile, will continue to struggle until bond markets and the escalation in hawkish central banks rhetoric calm.

The surge in U.S. rate expectations and huge shift in Fed policy and rhetoric have provided a lift to the U.S. dollar. It is likely that pro-dollar forces are at or near their best readings, given the more vigorous economic expansion in the U.S. than elsewhere, a sharp hawkish shift in Fed thinking, much larger fiscal stimulus than in other economies, and relatively low economic and financial exposure to the Ukraine war. We doubt there will be a sudden unwinding of these positives for the dollar, but they are not likely to get better in relative terms, assuming the war does not spill beyond Ukraine's borders.

CONCLUSION:

We remain positive on economic prospects, which means that the rise in inflation will persist. However, the spike in goods price inflation will cool this year, easing core inflation rates. Nevertheless, core inflation will settle well above central banks' targets. We remain bearish on bonds with the potential for an oversold bounce at any time. Real and nominal yields are still historically low and not yet a headwind for economic activity. Equity and credit markets will continue to struggle in absolute terms until bond yields calm but should continue to outperform government debt.

Data from Morningstar Direct, as of 04/18/2022.

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