CROSSMARK
GLOBAL INVESTMENTS

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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	2.97%	-8.60%
S&P 500	4.28%	-12.58%
NASDAQ	4.72%	-20.47%
RUSSELL 2000	3.67%	-15.98%
RUSSELL 1000 GROWTH	4.99%	-19.44%
RUSSELL 1000 VALUE	3.39%	-7.08%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	2.49%	-27.57%
CONSUMER DISCRETIONARY	5.55%	-20.10%
CONSUMER STAPLES	1.65%	-2.47%
ENERGY	10.37%	44.66%
FINANCIALS	2.99%	-12.86%
HEALTHCARE	2.00%	-5.29%
INDUSTRIALS	5.71%	-8.88%
INFORMATION TECHNOLOGY	5.09%	-17.01%
MATERIALS	4.10%	-12.85%
REAL ESTATE	4.88%	-13.20%
UTILITIES	6.51%	4.92%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	2.07%	-15.59%
MSCI ACWI EX U.S.	1.01%	-16.25%
MSCI EAFE	0.96%	-16.52%
MSCI EM	0.78%	-17.52%

SUMMARY:

Stocks rallied again last week (S&P 500 +4.3%) for the third week in the past four helped by continued better than feared earnings (especially big technology companies), declines in bond yields, and valuation improvement. Best sectors were energy (+10.4%) and utilities (+6.5%); worst sectors were consumer staples (+1.6%) and healthcare (+2.0%).

KEY TAKEAWAYS:

1. U.S. real GDP declined for the second consecutive quarter in 2Q, falling 0-9% (housing -14.0%; inventories took GDP down 2.0%) after the -1.6% drop in 1Q. While recessions require broad-based weakness in data, two consecutive negative quarters of GDP outside of a recession are rare (the last time was 1947).
2. As expected, the Fed delivered another 75bp rate hike to combat persistent inflationary pressures. Chair Powell acknowledged that spending has softened and that the labor market remains robust.
3. Layoff announcements continue to increase, and jobless claims remain in an upward trend. Some rise in the unemployment rate is inevitable.
4. Fiscal and monetary tightening are finally getting money out of the system. M2 growth in 1H 2022 was only 1.6%.
5. While there are signs that inflation is peaking (e.g., commodity prices), the gap between 2.5% Fed Funds and 9% inflation (even if it falls) is still enormous. (The Fed Funds rate is nowhere near neutral.)
6. Given up for dead, a package of new environmental spending and modest tax hikes has been negotiated between Senators Joe Manchin and Chuck Schumer. The proposed bill raises taxes on large corporations that pay little or no taxes, and puts caps on prescription drug prices. Chance of passage seems to be more than 50%.
7. With over half of S&P 500 companies having reported, two-thirds are beating 2Q earnings estimates. Overall, earnings have surprised to the upside by 0.8%. Since July 1, 2Q22E EPS has been revised up 1.6%, but full-year 2022 EPS has been revised down -0.6%.
8. The Q2 earnings reporting season so far reflects a slowing economy, but not a recession. For now, the market seems to be siding with Powell's view that a soft landing is possible.
9. U.S. stocks have managed to climb higher despite recession fears. So far, the tailwind to multiples from lower bond yields is overwhelming the headwind to earnings from the deteriorating growth outlook.
10. With stocks up a double-digit percentage since the June 16 low, inflation still a problem, and earnings growth slowing, chasing the market here is a tough call. Expect some consolidation and pullback.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.56%	-8.23%
BLOOMBERG U.S. CORP HIGH YIELD	0.77%	-9.80%
BLOOMBERG U.S. GOV/ CREDIT	0.32%	-9.18%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.03%	0.22%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	4.39%	-12.54%
COMMODITIES (DJ)	4.60%	23.49%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	2.60%	-29.20%
CURRENCIES (DB G10 CURRENCY FUTURE)	-0.55%	4.67%

CONFUSING CROSS-CURRENTS CONTINUE TO CONFOUND

Last week's first estimate of Q2 GDP showed that the U.S. might already be flirting with a recession, with overall GDP contracting in the first half of the year. Final demand growth stayed positive, despite a cooling in goods spending, but was more than offset by the strength in imports in the first half (which subtracts from GDP). For the NBER to call an official recession, labor and consumption both need to weaken. Less hawkish Fed rhetoric, some relief from high inflation and a slowdown in the pace of rate hikes could buoy U.S. consumer and business confidence, and ease angst about the future.

The FOMC delivered the expected 75bps rate hike, acknowledging that inflation remains elevated, but noted that economic activity has softened. Chair Powell suggested that the Fed may be well advanced in its rate-hiking cycle. We expect that suggestion may come back to haunt the Fed, but only further down the road.

Financial markets have shifted from worrying about higher inflation and interest rates to fearing recession. The recent decline in government bond yields and inversion of the U.S. 2/10 yield curve, combined with weaker economic data and the large equity market drawdown in the first half of 2022, have triggered a rush to position for the next recession. There is no doubt that Europe has been meaningfully weakened by both soaring energy costs and the huge uncertainty about supplies. China continues its stop/start economic expansion due to its self-imposed COVID-zero policy. Even in the previously-booming U.S. economy, activity has slowed and angst about the outlook has intensified despite the strongest labor market in decades and resiliently high corporate profit margins.

Two consecutive quarters of negative U.S. GDP growth is a narrow and, in the current case, irrelevant definition of recession, because consumption continues to expand and job availability remains robust. Nevertheless, we envision an eventual recessionary outcome if global central banks become determined to meet their low inflation targets. At this juncture, such fears seem premature. Monetary conditions are far from being restrictive.

While not likely in the coming months, we anticipate that eventually another wave or two of higher bond yields will occur before the cycle ends. A key assumption we are making is that the cycle will not be aborted by additional black swan-type developments, such as the pandemic and this year's war in Ukraine and the resulting economically-destructive impact it has had on global energy supplies. For the near term, the Treasury market is likely to stay well bid until economic softness and uncertainty lifts. Although we remain cyclically bearish on bonds, the current pause in the uptrend in government bond yields is expected to persist until recession fears recede. Headline inflation rates are set to decelerate, given the recent downturn in most commodity prices and slowdown in economic activity.

Equity markets are trying to bottom but a durable and sustained rally likely awaits less hawkish rhetoric from central banks and an easing in recession fears. Such conditions should develop in the coming months. An easing in inflation pressures is needed to boost current depressed economic sentiment and, thus, help to sustain a better equity market backdrop.

CONCLUSION:

The cyclical bond yield uptrend has paused and reversed although further downside in yields from current levels should be limited. Equity markets are becoming overbought after a double-digit percentage rally since the June 16 low. A sustained equity rally needs recession concerns to fade which is not imminent but could develop if inflation fears ease.

Data from Bloomberg, as of 07/29/2022.