CROSSMARK GLOBAL INVESTMENTS

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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	2.99%	-5.98%
S&P 500	3.31%	-9.34%
NASDAQ	3.10%	-16.21%
RUSSELL 2000	2.80%	-11.36%
RUSSELL 1000 GROWTH	2.89%	-15.86%
RUSSELL 1000 VALUE	3.92%	-3.65%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	4.48%	-23.45%
CONSUMER DISCRETIONARY	3.28%	-16.52%
CONSUMER STAPLES	1.25%	-1.14%
ENERGY	7.45%	44.87%
FINANCIALS	5.49%	-8.09%
HEALTHCARE	1.66%	-4.39%
INDUSTRIALS	3.84%	-4.84%
INFORMATION TECHNOLOGY	2.47%	-13.26%
MATERIALS	5.21%	-9.49%
REAL ESTATE	4.10%	-10.83%
UTILITIES	3.33%	8.86%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	1.79%	-12.81%
MSCI ACWI EX U.S.	2.16%	-14.01%
MSCI EAFE	2.47%	-14.03%
MSCI EM	1.18%	-16.06%

SUMMARY:

U.S. equities posted strong gains last week, with the S&P 500 (+3.3%) up for a fourth straight week. The peak-inflation narrative was the key focus gaining more traction after a batch of data showing softening price pressures, despite Fed officials saying more work on inflation needs to be done. Best sectors were energy (+7.5%), financials (+5.5%), and materials (+5.2%); worst sectors were consumer staples (+1.3%), healthcare (+1.7%), and technology (+2.5%).

KEY TAKEAWAYS:

1. The CPI was flat in July (better than expected), slowing to 8.5% y/y (down from 9.1%). Core CPI (ex food and energy) rose +0.3%, keeping the y/y number at 5.9%. While inflation is still too high, and monetary policy needs to continue to tighten, our prediction that inflation would peak in Q2 may have been accurate.
2. Current Fed policy and some improvement in supply chain problems should bring inflation down to 4-5% by the end of the year, but a decline back to 2% will take much more work and perhaps a recession.
3. M2 was growing at nearly 25% at the start of 2021 and at 12% at the start of this year. It's growth has fallen to 5.9% y/y and looks to fall further.
4. The Atlanta Fed's GDPNow tracking model estimates a 2.5% real GDP in Q3. There are also signs that Q1 and/or Q2 GDP may be revised up. This is shaping up to be a year of slow growth but not of recession.
5. The consumer savings rate has declined supporting the view that households need to and are likely to reach into their savings to maintain trend consumption.
6. Productivity fell for the second consecutive quarter as U.S. output continued to contract while hours worked increased. Nonfarm productivity declined 4.6% after falling 7.4% in the previous quarter, the weakest back-to-back readings since 1947, indicating that wage pressures will likely continue.
7. Oil prices have weakened cyclically, but structurally (longer term) are still likely headed higher.
8. Ironically, earnings estimates moved up in the first half of this year as the stock market fell, but earnings are being cut now as the stock market has moved higher.
9. During the rally since June 16, the P/E ratio on the S&P 500 has moved from 16 to 18.5. During that timeframe, the 50 most shorted stocks have risen nearly 40%.
10. Democrat prospects are becoming less bad for the mid-term election in light of peak inflation, declining gasoline prices, and Roe vs. Wade. We still expect the Republicans to take over the House, but the Senate has become too close to call.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.12%	-9.22%
BLOOMBERG U.S. CORP HIGH YIELD	0.84%	-7.76%
BLOOMBERG U.S. GOV/ CREDIT	-0.21%	-10.12%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.03%	0.30%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	2.68%	-11.31%
COMMODITIES (DJ)	4.59%	25.00%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	3.75%	-26.25%
CURRENCIES (DB G10 CURRENCY FUTURE)	0.20%	5.25%

THE INFLATION PEAK UNLEASHES A RISK-ON SURGE

A risk-on backdrop has taken hold, as global government bond yields have eased materially since the spring, and the expected deceleration in U.S. inflation is becoming more evident. We have not been in the recession camp, and thus are comfortable betting against such an outcome. It is unlikely that there will be one key piece of information which will spark renewed economic confidence, but rather a cumulation of positive data and less bad news.

The conditions consistent with a U.S. recession are not in place, even though growth has cooled after the post-pandemic boom and the global backdrop has deteriorated especially in Europe and China. The perception of high economic vulnerability and concerns about extreme monetary policy still exist, as manifested in an inverted U.S. yield curve. The period of maximum economic risk in the U.S. was in the spring of this year, when the rise in bond yields and increase in policy rate expectations threatened to become open-ended. Bond market conditions have calmed considerably since then, and the Fed has hinted that it might slow the pace of rate hikes.

There has been an easing in U.S. and global inflation expectations triggered by lower crude oil and commodity prices. Commodity price weakness also decreases the odds of a recession, by lowering inflation worries that have undermined economic sentiment and by reducing prior economic headwinds. Recession fears have shown up in the record-breaking gaps between current economic conditions (generally still good) and expectations (which have plunged to levels last seen at the depths of early-2020 or even 2008), in the U.S. and Europe. The huge uncertainty associated with the unique events in recent years has caused consumers and businesses to voice great concern about the future, even though current profits, employment and income trends are healthy. The inflation surge starting last year, the belated and abrupt hawkish pivot by central banks this year, and the war in Ukraine have combined to fuel recession fears.

Last week's U.S. CPI report confirmed that the high-water mark for the past year's surge in inflation likely has been seen, which should buoy business (and consumer) sentiment for a period of time. Clarity on where inflation is ultimately headed will not become apparent over the next six months. Instead, the trend in headline, but also to some degree in core, inflation should be down. Investors and central banks are strongly biased to expecting a return to the low-inflation environment of the last decade. Thus, hopes for replay of the generally positive investment market environment of the 2010s could revive for a time, as investors welcome (and extrapolate) the deceleration in inflation. We disagree with the low-inflation view, believing inflation will eventually fall only to the 4-5% level. Eventually, another bond upleg will take hold, but not until after recession fears meaningfully diminish, and investors and central banks realize that the deceleration in inflation will stall well short of the 2% central bank target.

CONCLUSION:

A peak in inflation, a calm bond market, and ongoing good corporate profitability have led to the best equity rally of this bear market so far. A choppy investment environment is probable as investors anticipate an eventual slowing in the pace of rate hikes and less hawkish central bank rhetoric. Once recession fears recede significantly and it becomes apparent that underlying inflation is not headed to the 2% area, then the investing environment may become more difficult again.

Data from Bloomberg, as of 08/12/2022.

