CROSSMARK
GLOBAL INVESTMENTS

Doll's Deliberations

Weekly Investment Commentary | August 28, 2023 | Issue 3.34

SUMMARY:

Stocks rose last week S&P 500 (+0.8%) as both the NASDAQ and S&P 500 broke three weeks of declines. Some mixed economic data and muted pricing pressures were tailwinds, while the backup in yields remains the biggest near-term headwind. Best sectors were technology (+2.6%) and consumer discretionary (+1.1%); worst sectors were energy (-1.4%) and consumer staples (-0.8%).

KEY TAKEAWAYS:

1. Against a backdrop of mixed US data, Fed Chair Powell remained somewhat hawkish in his Jackson Hole speech and reiterated "data dependency." The Fed realizes that inflation is being stubborn and reasonable economic growth and tight labor markets may hinder further progress.

2. We expect the Fed to remain on hold in September. But, contrary to the consensus, we expect they will raise rates another 25 basis points before year-end citing stubborn inflation.

3. August flash manufacturing and services PMIs both missed expectations and saw contractions in new orders.

4. Continued stronger growth and persistent inflation are a recipe for the Fed to either move higher than the market now expects or stay at a higher level longer than the market expects, or possibly both.

5. Labor – the biggest cost center in the economy – is hot. Unemployment is just a tenth of a percent off its all-time low, and 40%-over-4-years wage contracts are more and more common.

6. The monetary aggregate (M2) showed a continued shrinkage, now down 3.7% from a year ago. But at the same time, nominal GDP is up 6.3%. That means the larger size of the economy is having to get by with less money. This is generally not good news for risk assets, and eventually the economy.

7. China continues to face a list of challenges, including a deflating property bubble, falling consumer confidence and a shrinking population.

8. Blowout results and upward guidance from widely watched Nvidia were not enough to revive the broader AI tailwind for big tech.

9. Looking ahead to the 3rd quarter, S&P 500 earnings growth is expected to be +1.3% and would make the first y/y quarterly earnings increase in a year.

10. Overextended valuations and overbought conditions made the stock market particularly vulnerable to disappointment. At the July 31 peak, the S&P 500 was trading at 20x forward earnings. Valuation may be a terrible timing tool, but it always works over a longer timeframe.

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-0.42%	5.08%
S&P 500	0.84%	15.99%
NASDAQ	2.27%	30.59%
RUSSELL 1000	0.13%	14.95%
RUSSELL 1000 GROWTH	1.81%	27.92%
RUSSELL 1000 VALUE	-0.16%	4.43%
RUSSELL 2000	-0.69%	5.85%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	0.98%	39.54%
CONSUMER DISCRETIONARY	1.14%	29.94%
CONSUMER STAPLES	-0.73%	-0.85%
ENERGY	-1.37%	1.59%
FINANCIALS	0.08%	0.27%
HEALTHCARE	-0.08%	-0.99%
INDUSTRIALS	0.30%	9.41%
INFORMATION TECHNOLOGY	2.58%	38.83%
MATERIALS	-0.01%	5.02%
REAL ESTATE	0.76%	0.39%
UTILITIES	0.27%	-8.34%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	0.48%	12.03%
MSCI ACWI EX U.S.	1.03%	7.36%
MSCI EAFE	0.81%	8.93%
MSCI EM	1.90%	4.75%

THE CHOP IS LIKELY TO CONTINUE

After reaching the peak in yields achieved last October, bond yields have backed off due to some weaker economic data (e.g., PMIs) and renewed recession concerns. While we still expect a recession, for now the economy (lead by the consumer and labor market) is performing better than expected. Most economies excluding Japan have recorded significant policy rate hikes over the past 12-18 months and angst about monetary overkill has increased. However, it is possible that monetary conditions are still not restrictive, reflecting the depressed starting point for policy rates and the powerful forces that have helped to sustain economic activity. For example, ongoing wage gains have allowed companies to pass on higher costs, especially in service sectors.

Although price gains driven by 2020-2021's one-off supply restraints are subsiding, underlying inflation should prove sticky and is unlikely to fall anywhere close to 2% absent a recession. Central banks are still hopeful they can lower inflation without a recession. A pause in rate hikes is anticipated in most economies. While many bond bulls now believe that coupon income is attractive after many years of near-zero coupons, the reality is that it still only takes a small increase in bond yields to fully offset the gain from income and real bond yields are still low. The dip in bond yields last week provided relief to equity and credit markets, which had softened in the face of the earlier rise in yields. However, corporate high-yield bond spreads remain historically fairly narrow, and are not consistent with a recessionary outcome.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.27%	0.40%
BLOOMBERG U.S. CORP HIGH YIELD	0.32%	6.03%
BLOOMBERG U.S. GOV/CREDIT	0.32%	0.61%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.09%	3.14%

The US dollar has bounced because the US economic outlook continues to improve relative to most other economies. We expect this firming trend to reverse as other economies improve and eventually the US weakens.

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	0.60%	-0.09%
COMMODITIES (DJ)	1.29%	-3.36%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-0.54%	12.62%
CURRENCIES (DB CURRENCY FUTURE HARVEST)	0.24%	5.74%

The outperformance of stocks over bonds is inconsistent with an imminent economic downturn. It could take many months for central banks to be convinced whether policy is, or isn't, restrictive. Consequently, a decisive upside breakout in government bond yields may take longer to develop. Until better economic signals develop, lingering recession angst and the ongoing deceleration in annual inflation rates could very well prolong the period of range-bound bond yields and a choppy risk-on environment.

CONCLUSION:

Global financial markets are at critical junctures with bond yields testing their prior cyclical highs. However, a reprieve is still possible and bond markets may calm for a period because central banks are keen to pause and inflation will continue to decelerate. If so, then the choppy risk-on phase will persist.

Data from Bloomberg, as of 8/25/2023.

 DD-WKLY-COMM-3.34 08/23