CROSSMARK GLOBAL INVESTMENTS

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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-4.20%	-9.97%
S&P 500	-4.02%	-14.00%
NASDAQ	-4.43%	-21.99%
RUSSELL 2000	0.38%	-11.78%
RUSSELL 1000 GROWTH	-4.55%	-21.00%
RUSSELL 1000 VALUE	-3.16%	-7.80%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-4.82%	-29.52%
CONSUMER DISCRETIONARY	-4.74%	-21.72%
CONSUMER STAPLES	-3.32%	-2.54%
ENERGY	4.27%	53.02%
FINANCIALS	-3.55%	-12.87%
HEALTHCARE	-4.26%	-8.96%
INDUSTRIALS	-3.43%	-8.99%
INFORMATION TECHNOLOGY	-5.58%	-19.46%
MATERIALS	-1.29%	-12.83%
REAL ESTATE	-3.79%	-15.85%
UTILITIES	-2.60%	7.40%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-0.57%	-13.77%
MSCI ACWI EX U.S.	-0.54%	-16.15%
MSCI EAFE	-1.07%	-17.06%
MSCI EM	0.23%	-16.72%

SUMMARY:

Equities were sharply lower last week with the S&P -4.0%, its worst week in ten. Friday's Fed Chair Powell's Jackson Hole speech was the catalyst for the significant Friday decline as he signaled that the Fed is willing to risk recession to lower inflation. Best performers were energy (+4.3%), materials (-1.3%) and utilities (-2.6%). Worst sectors were technology (-5.6%), communication services (-4.8%) and consumer discretionary (-4.7%).

KEY TAKEAWAYS:

1. Fed Chair Powell, in a hawkish speech, reiterated that the Fed's job is to bring inflation down even if it weighs on economic growth and causes labor market weakness. He dispelled any thought of a pause in tightening.
2. Flash manufacturing, services and composite PMIs across the U.S., Eurozone, Japan, and the U.K. all decreased from July levels. Notably, U.S. services PMI and Eurozone manufacturing PMI fell deeper into contraction territory.
3. With further monetary tightening coming, the unemployment rate will eventually go up, job growth will turn negative, industrial production will fall, and so will corporate profits.
4. Europe appears to be falling into recession, aggravated by the energy situation, and tight monetary policy due to the inflation problem.
5. Peak U.S. inflation evidence should remove pressure on the Fed to continue with aggressive 75bp hikes. Rates still need to rise, and we look for the Fed funds rate to approach 4% by early 2023.
6. Rapidly rising natural gas prices could result in a shutdown of ammonia/ nitrogen fertilizer production which could create a global food shortage emergency.
7. Aging capital stock raises the need for investment in the new capacity (the average age of the capital stock is the highest since 1965). This should limit downside risk to capex even in a recession.
8. So far this earnings cycle, capex discipline in energy has been good. As long as that continues, it bodes well for energy earnings and stock prices.
9. A key catalyst behind the equity rally that started June 16 was consensus moving to a view that the Fed will be able to engineer a "soft landing" and avoid a recession. (History shows that many investors look for a soft landing in the early stages of a downturn.)
10. The strength of the summer rally caused some momentum-based indicators to suggest the worst of the bear market is over, but the macro backdrop of yield curve inversions, money supply growth decline, and further rate hikes argue for an unsettled period for equities, with some possibility of retesting the low.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.30%	-9.97%
BLOOMBERG U.S. CORP HIGH YIELD	-0.79%	-9.51%
BLOOMBERG U.S. GOV/ CREDIT	-0.22%	-10.76%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.03%	0.38%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-1.34%	-12.87%
COMMODITIES (DJ)	1.92%	26.55%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-0.39%	-30.50%
CURRENCIES (DB G10 CURRENCY FUTURE)	0.40%	5.86%

VOLATILE CHURN AND CHOPPINESS TO PERSIST

After a solid rebound over the summer, equity markets have started to churn. Sentiment has been hurt by ongoing recession fears and concerns that inflation might not recede quickly enough to prevent monetary policy overkill. Moreover, the recent slide in longer-term government bond yields has halted, reducing a tailwind for stocks. We anticipate that stocks will become choppier now that oversold conditions have been unwound. Inflation should recede slowly and irregularly which should allow central banks to tone down their hawkish rhetoric sometime this fall. The calming in government bond markets and correction in commodity prices should ensure that the economic expansion remains alive even with a tough winter in Europe and a muted COVID-restrained recovery in China. Economic growth rates will be modest and the path ahead will be more volatile following boom-like conditions associated with pandemic re-openings.

Investors will need to be more tactical and quicker to de-risk in the coming year because government bond yields are still in a cyclical bear market. As long as the pause in the bond yield uptrend persists, we expect underlying positive corporate earnings trends to provide support to equities. That said, the most profitable and lowest risk part of the investment cycle has ended and we do not expect the budding deceleration to return inflation to the desired 2% area. Rather, inflation is likely to prove sticky and level off well above 2% (say 4-5%) with a bias to drift higher should economic activity prove resilient. As a result, we think the upside in short-term rates over the near year or two is more than the bond market and central banks currently envision.

Critical to our investment strategy and outlook is whether a true recession develops in the coming months. We do not expect the sort of economic outcome that would warrant positioning one's portfolio for a traditional cycle-ending recession, barring some new non-monetary shock. Such an outcome may become inevitable based on our view that inflation will ultimately prove problematic but it may be premature to make that bet. Remember that central bankers spent the past two decades doing their best to avoid debt deflation and promote better growth, while persistently missing their inflation targets on the low side. The mindset is that inflation can be returned relatively easily to their target level. Thus, we expect the Fed (and other central banks) to be patient, and wait and see whether or not inflation recedes materially without taking significant economic risks.

European economic prospects are worrisome heading into the winter due to their energy crisis. Meanwhile, China's expansion will remain muted, albeit positive, due to its COVID-zero policy, but with drought-induced power shortages now adding additional concerns. Adding it up, the global economic picture is mixed and thus conducive to some central bank tightening and waiting to see how activity pans out over the coming quarters.

CONCLUSION:

We expect volatile choppiness in the months ahead as central bankers continue to tighten and a recession is avoided at least for the next few months. Ultimately, expect higher bond yields and more policy rate hikes than the forward markets are discounting. However, such an outcome awaits the realization that inflation is proving stickier and higher than is currently envisioned which may not be until 2023.

Data from Bloomberg, as of 08/26/2022.