CROSSMARK GLOBAL INVESTMENTS

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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-0.11%	-8.71%
S&P 500	0.39%	-12.24%
NASDAQ	2.18%	-18.73%
RUSSELL 2000	1.14%	-14.47%
RUSSELL 1000 GROWTH	1.52%	-18.22%
RUSSELL 1000 VALUE	-0.23%	-7.29%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	1.16%	-26.73%
CONSUMER DISCRETIONARY	1.17%	-19.17%
CONSUMER STAPLES	0.11%	-2.36%
ENERGY	-6.80%	34.82%
FINANCIALS	-0.01%	-12.87%
HEALTHCARE	-0.70%	-5.95%
INDUSTRIALS	0.58%	-8.36%
INFORMATION TECHNOLOGY	2.00%	-15.35%
MATERIALS	-1.29%	-13.97%
REAL ESTATE	-1.32%	-14.35%
UTILITIES	0.41%	5.35%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	0.52%	-14.16%
MSCI ACWI EX U.S.	0.13%	-15.52%
MSCI EAFE	0.26%	-15.34%
MSCI EM	0.12%	-17.73%

SUMMARY:

Stocks were mixed last week (S&P 500 +0.4%). The most notable event for the week was the hot jobs report on Friday as the Fed continued to push back talk of a Fed pivot post the turn of the year. Best sectors were technology (+2.0%), consumer discretionary (+1.2%) and communication services (+1.2%); worst sectors were energy (-6.8%), real estate (-1.3%) and materials (-1.3%).

KEY TAKEAWAYS:

1. The employment report for July was much stronger than expected and undermines the argument that the U.S. economy is in recession or will be so imminently. It also increases the odds of another 75bp Fed rate hike next month.
2. Expectations that weakening economic conditions will cause central banks to pivot from hiking to cutting interest rates dominated the behavior of financial markets in the last couple of weeks. (We think cutting rates anytime over the next six months is very unlikely.)
3. The Bank of England hiked interest rates by 50bps, expects inflation to peak at just over 13% in Q4, and expects the U.K. economy to enter recession in the fourth quarter.
4. Inflation probability has a relatively easy path back to 4-5% but a move to 2% will require a higher unemployment rate and point to a higher fed funds rate in 2023 than is currently discounted in the market.
5. Over 80% of S&P 500 companies have reported Q2 earnings. 77% have beaten expectations, better than the long-term average of 66%.
6. Senator Sinema has provided her backing for the Senate's reconciliation package with tweaks to the minimum corporate tax, removal of the carried interest charge, and addition of a stock buyback tax, putting Democrats a key step closer to passing the bill.
7. Federal tax revenues as a percentage of GDP are at 20%, their highest post-WWII level.
8. The stock market rally has been led entirely by valuation multiples, with the forward P/E of the S&P 500 jumping from 15.3 at June's low to 17.2 (December 31 P/E was 21.5). Fair value is likely in the 15-17 zone.
9. We believe the equity market rally is counter trend and is nearing its peak, it remains premature to look past the Fed, the economy is decelerating and fears of expectations for corporate profits are too high.
10. We are still of the view that THE equity market bottom has not yet been reached (two-thirds probability; one-third probability that June 16 was THE low.)

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.03%	-8.13%
BLOOMBERG U.S. CORP HIGH YIELD	0.87%	-8.33%
BLOOMBERG U.S. GOV/ CREDIT	0.21%	-8.93%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.03%	0.27%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-1.95%	-13.82%
COMMODITIES (DJ)	-3.22%	19.51%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-0.07%	-28.08%
CURRENCIES (DB G10 CURRENCY FUTURE)	0.35%	5.04%

HOT PAYROLLS REPORT CONTINUES TO PUSH BACK FED PIVOT TALK

Stocks and bonds rebounded since mid-June on hints that inflation may be in the process of peaking, and central banks will not need to hike interest rates as much as previously expected. Both stocks and bonds were deeply oversold in mid-June and overdue for a bounce. The global economy faces several challenges, but we reiterate that an economic recession is neither imminent nor inevitable (further evidence this past week was the July employment report) although growth will likely continue to slow. If a recession were to develop, it is likely to be short and shallow. Self-correcting forces in the forms of lower oil prices and bond yields are already at work and will eventually provide support for the U.S. economy where household, corporate and banking sector underpinnings are healthy.

Our base-case scenario is that the U.S. economy will avoid recession. Even so, underlying domestic demand growth will be muted over the balance of the year as employment gains eventually moderate from their unsustainably high year-to-date level. The outlook for the rest of the world is more problematic, albeit as a result of exogenous forces rather than underlying domestic conditions. Europe's and particularly Germany's economic outlook is clouded by the threat of further cuts in natural gas supplies from Russia and a regional recession cannot be ruled out. Our earlier hopes for a revival of China's growth have been delayed by renewed COVID restrictions, the duration of which is difficult to predict.

Overall, we remain mildly constructive on the global economic, especially compared with the consensus, but it is too soon to anticipate a positive inflection point. The Fed must balance competing objectives – it will be determined to prevent a recession, but it is anxious not to allow financial conditions to ease significantly. This view coincides with remaining neutral on global equities, although the significant de-rating of equities this year already discounts moderate earnings downgrades and improves their valuation case. We continue to recommend an overweight stance on cash, whose yield in many markets is only slightly below that of longer-term government bonds, but which provides flexibility amidst elevated economic uncertainty and bond market volatility. We also continue to recommend an underweight stance on bonds, which offer low or negative real yields and are discounting interest rate cuts next year and an unduly optimistic view on medium- and longer-term inflation.

Stocks have rebounded substantially since their mid-June low from an extreme oversold level and on optimism that central banks will throttle back their rate hiking path. However, they have recouped only a fraction of the first-half losses and remain well below their declining 200-day moving average. Forward earnings estimates have been resilient to slowing global growth, although they show signs of plateauing. The strong U.S. dollar has weighed on global earnings, which continue to show a solid uptrend.

CONCLUSION:

We expect equity market conditions to remain choppy in the near term given elevated uncertainty about global economic growth. Our mildly constructive economic outlook, however, implies that equity prices should be higher on a 6-12 month horizon. G7 government bonds are somewhat oversold, and yields have room to retreat further in the near term, but we expect yields to be higher 12 months from now.

Data from Bloomberg, as of 08/05/2022.

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