CROSSMARK
GLOBAL INVESTMENTS

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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-2.74%	-5.95%
S&P 500	-3.35%	-16.17%
NASDAQ	-3.98%	-29.10%
RUSSELL 2000	-3.92%	-17.96%
RUSSELL 1000 GROWTH	-3.62%	-26.14%
RUSSELL 1000 VALUE	-3.35%	-7.00%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-5.39%	-38.07%
CONSUMER DISCRETIONARY	-4.47%	-32.40%
CONSUMER STAPLES	-1.78%	0.48%
ENERGY	-8.30%	54.98%
FINANCIALS	-3.86%	-10.23%
HEALTHCARE	-1.28%	-0.83%
INDUSTRIALS	-3.19%	-5.10%
INFORMATION TECHNOLOGY	-3.33%	-24.60%
MATERIALS	-3.28%	-9.13%
REAL ESTATE	-1.77%	-24.30%
UTILITIES	-0.27%	1.22%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-2.08%	-16.43%
MSCI ACWI EX U.S.	-1.06%	-15.11%
MSCI EAFE	-1.07%	-13.72%
MSCI EM	-0.46%	-19.19%

SUMMARY:

U.S. Equities were lower last week (S&P 500 -3.4%), having declined in six of the last seven sessions. While the Fed is expected to reduce its hiking pace to 50bp from its recent 75bp pattern, there seems to be anxiety about the terminal rate and a "higher for longer" message.

KEY TAKEAWAYS:

1. The Fed is preparing to downshift the pace of rate hikes at its upcoming December 14-15 meeting (50bp instead of 75), but it is unlikely to start cutting rates anytime soon.
2. Several labor market indicators are showing softness, (but overall conditions remain fairly tight). Continuing unemployment claims surprised to the upside and were higher for the eighth consecutive week. The number of job openings has rolled over from its spring high.
3. The year over year change in the Fed Funds rate leads net income growth by about two years, suggesting a larger earnings decline is ahead.
4. Earnings growth is key to 2023 equity performance. With economic growth deteriorating, it is reasonable to expect the earnings outlook to deteriorate as well. Current estimates are for 2023 earnings to be up 5%. Even in a mild recession, earnings typically fall by 20-25%.
5. Risk off has been the theme thus far for December despite favorable seasonality. Economic growth fears and a concern that the Fed is focused on lagging indicators have surfaced.
6. Falling interest rates led to good gains in the recent bear market rally which has been significant. The risk-reward of expecting more upside is no longer favorable. We expect the market to settle back into a trading range.
7. Perhaps the single biggest change to the financial markets in 2022 was the transition from quantitative easing to quantitative tightening. The era of free money is over. Interest expense will inevitably consume a greater share of corporate cash. Companies with an ability to generate enough cash to self-fund should have a significant advantage in this environment.
8. High P/E stocks struggled mightily as interest rates went up during the last twelve months. The dollar strengthened and economic growth was respectable. Curiously, the opposite set of fundamentals has occurred in the last month or two, and high P/E growth stocks have not led the market. Those stocks appear broken.
9. Protests around the world are pressuring policymakers to change their policy direction to more leniency (e.g., China).
10. This week we get November CPI and the Fed meeting. Bearish narrative revolves around sticky inflation, upside risk to terminal rate, higher for longer Fed, heightened recession risk and negative earnings revisions. Bullish narrative revolves around slowdown in Fed-led global tightening cycle, pickup in disinflationary trends, and China reopening.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.17%	-11.29%
BLOOMBERG U.S. CORP HIGH YIELD	-0.36%	-10.13%
BLOOMBERG U.S. GOV/ CREDIT	0.28%	-11.75%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.09%	1.29%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-1.72%	-22.85%
COMMODITIES (DJ)	-2.31%	14.70%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-2.87%	-34.60%
CURRENCIES (DB G10 CURRENCY FUTURE)	0.09%	3.36%

BOND BULLISHNESS AND EQUITY BEARISHNESS REFLECT ECONOMIC WEAKNESS CONCERNS

The pause in the cyclical rise in government bond yields is looking a lot like the one earlier this year, in that the decline has been rapid. The odds of it being short-lived increased last week given the change in China’s Covid policy, which has boosted the country’s economic outlook. For now, government bonds should be supported by the deceleration in headline inflation and entrenched economic pessimism, as seen in the near-record inversion of various government yield curves.

Cyclically, however, we remain more upbeat than the consensus on global economic prospects (and a later rather than earlier recession). The rebound in China’s prospects is a powerful stabilizer for global economic momentum in 2023.

Bond bulls have embraced the recent decline in yields, massively front-running lower policy rates. This, in turn, has pushed the U.S. yield curve to near-record invertedness, creating a self-reinforcing dynamic of an ever-more inverted yield curve and rising expectations of a pending recession. There have been some indicators that the euro area economy is weathering the regional energy and geopolitical crisis far better than was feared. Economic activity will still struggle over the winter, but thereafter we envision a pick up in euro area growth, especially in the lagging service sector.

The only way for bond yields to sustainably decline would be if a recession developed, which is not reflected in corporate earnings expectations and would be equity-bearish. Conversely, if a recession is not in the cards, then the downside in bond yields will be limited in both scope and duration, so the odds would favor another yield upleg in 2023. Risk-on phases should prove temporary for as long as inflation remains “too high” and liquidity conditions, over time, will become steadily tighter.

At the moment, credit spreads are not consistent with a looming recession. The narrowing in EM and euro area high-yield spreads has been quite impressive in the face of widespread gloom in their economic and equity markets. PMI surveys have dropped below the boom/bust line of 50, and global trade is decelerating markedly. Actual industrial production and final demand measures are not as negative. While a recession may materialize in 2023, it is premature to forecast a recession as long as Americans have high job security and good income growth.

CONCLUSION:

The risk-on phase may persist in the near run, aided by a decline in headline inflation and the pause in the cyclical uptrend in government bond yields. A resilient global economy, which will be boosted by a durable re-opening in China, means that underlying inflation will also prove stickier than is discounted. This, in turn, means that central banks will not fulfill expectations for rate cuts later next year.

Data from Bloomberg, as of 12/9/2022.

