

DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	0.41%	-3.30%
S&P 500	1.19%	-13.26%
NASDAQ	2.12%	-26.17%
RUSSELL 2000	0.73%	-15.12%
RUSSELL 1000 GROWTH	1.76%	-23.36%
RUSSELL 1000 VALUE	0.77%	-3.78%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	3.31%	-34.55%
CONSUMER DISCRETIONARY	2.22%	-29.24%
CONSUMER STAPLES	1.26%	2.30%
ENERGY	-1.89%	69.00%
FINANCIALS	-0.55%	-6.63%
HEALTHCARE	1.96%	0.46%
INDUSTRIALS	1.05%	-1.97%
INFORMATION TECHNOLOGY	1.32%	-22.00%
MATERIALS	1.70%	-6.05%
REAL ESTATE	0.46%	-22.93%
UTILITIES	0.12%	1.49%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	1.69%	-14.39%
MSCI ACWI EX U.S.	2.21%	-13.69%
MSCI EAFE	1.70%	-12.23%
MSCI EM	3.98%	-18.45%

SUMMARY:

U.S. equities were higher last week with the S&P 500 (+1.2%) rising above the 200-day moving average for the first time since April. Treasuries were firmer across the curve with the 10-year yield ending below 3.50%. The dollar fell to the lowest level since June. Powell's mid-week speech sparked a big equity and Treasury rally. Strongest sectors were communication services (+3.3%) and consumer discretionary (+2.2%); weakest sectors were energy (-1.9%) and financials (-0.6%).

KEY TAKEAWAYS:

- Fed Chair Powell indicated the Fed would proceed on its tightening course with "moderation," to avoid setting off a recession. The FOMC is on track to raise the federal funds rate by 50bps at the December 13-14 meeting.
- Global equities have benefitted from preliminary signs that inflationary pressures are easing. While the Fed will slow the pace of rate hikes at its next meeting, Chair Powell's comments on Wednesday underscore that labor market conditions are still too tight for the central bank to start thinking about ending rate hikes.
- The labor market remains too tight. The November payrolls report showed 263,000 increases, well above the consensus 200,000. The unemployment rate at 3.7% is still too low to have the sustained slowdown in wage inflation that Fed Chair Powell wants to see.
- The Fed's challenge going forward is to continue raising rates to 5% and keeping them there for an extended period while reducing the balance sheet, and not creating a recession.
- U.S. Q3 GDP was revised higher to 2.9% from the initial 2.6% on the strength of upwardly revised consumer spending. The consensus real GDP estimate for Q4 is 0.5%, which is probably too low by at least a percentage point.
- The ISM Manufacturing PMI contracted in November for the first time since mid-2020. Details of the report underscore deteriorating demand conditions both domestically and globally.
- According to the Senior Loan Officer survey, the bank's willingness to lend shows that the net percentage turned negative. In 8 of the last 9 instances when this happened previously, a recession occurred.
- The Personal Savings Rate is near an all-time low (3.1%). Consumers, particularly on the low end, are being squeezed. Therefore, credit card debt will likely continue to rise.
- As the Federal Reserve has lifted short rates, the entire yield curve has risen, and higher interest rates have been a big drag on stocks. It now looks like stocks will also have to grapple with declining earnings expectations.
- The recent rally can continue if the U.S. somehow avoids a recession. But with monetary tightening (highlighted by a significant slowdown in M2), avoiding a recession is unlikely.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	1.20%	-11.74%
BLOOMBERG U.S. CORP HIGH YIELD	0.88%	-9.86%
BLOOMBERG U.S. GOV/ CREDIT	1.28%	-12.26%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.07%	1.18%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	0.77%	-21.29%
COMMODITIES (DJ)	-0.31%	17.41%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	0.17%	-31.78%
CURRENCIES (DB G10 CURRENCY FUTURE)	-1.10%	3.26%

SO MANY CROSS-CURRENTS

The key drivers of global capital markets in the first-half of 2023 will likely be slow/ slowing economic growth, easing inflation and at least a temporary halt to central bank interest rate hikes. On the margin, that compares favorably with the past year, which has been characterized by weakening growth and sharply rising inflation and interest rates. Both stocks and bonds will start 2023 with more attractive valuations than at this time a year ago.

But the macro landscape still poses several challenges for investors given the desynchronized character of the economic, policy and capital markets cycles since the pandemic recovery. While recession fears are widespread, they are not yet conclusive. Inflation will steadily ease in the coming months because of favorable base effects, lower energy prices and the lagged response to slower growth. But inflation will ultimately prove stickier than is discounted later next year and the Fed will have little scope for fulfilling market expectations of rate cuts.

Such a scenario is consistent with stop-start conditions in capital markets favoring periodic tactical asset allocation shifts rather than a decidedly pro-growth or defensive investment posture. While cheaper than a year ago, neither stocks nor bonds are particularly attractive. There is ample scope for surprises to either the upside or downside in 2023. On the upside, easing inflation, pausing central banks and a stronger than expected recovery in euro area and Chinese economic

growth could enable equities to outperform expectations, while catalyzing an overdue rotation away from the U.S. Among the downside scenarios, politics/geopolitics could continue to weigh on economic activity in China and the euro area, adding to growth risks in the U.S. Government bonds would fare well in such a scenario, but significant downgrades to corporate earnings would drag down equity and credit prices. Conversely, if bond yields were to climb materially in 2023, then the overleveraged global economic “weak links” could snap, triggering economic and financial market contagion.

The fundamental outlook for both stocks and bonds in the next year is uninspiring and returns will likely be subdued by historical standards. Bonds will remain well bid in the near-term as inflation moderates, but we retain a cyclically bearish view, expecting yields to have another leg up. Equities may continue to periodically enjoy risk-on rallies in 2023, but the combination of limited upside for valuations and looming cuts to earnings expectations point to subdued returns. Given the inevitable deceleration in U.S. corporate revenue growth in the year ahead and the fact that margins and return on equity remain historically high, we expect 2023 earnings to be below this year's level, implying earnings downgrades in the months ahead.

CONCLUSION:

We expect bonds to do better in 2023 than in 2021 or 2022, but still have mediocre results. Likewise, equities will produce mediocre returns in the year ahead, with at best neutral valuations and earnings constraints even assuming the global economy is acceptable.

Data from Bloomberg, as of 12/2/2022.

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