CROSSMARK
GLOBAL INVESTMENTS

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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-1.45%	15.05%
S&P 500	-1.17%	22.45%
NASDAQ	-2.60%	17.77%
RUSSELL 2000	-3.66%	10.27%
RUSSELL 1000 GROWTH	-3.93%	21.97%
RUSSELL 1000 VALUE	-1.54%	10.27%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-2.75%	17.54%
CONSUMER DISCRETIONARY	-2.29%	21.63%
CONSUMER STAPLES	-0.31%	9.57%
ENERGY	-0.75%	51.70%
FINANCIALS	-1.90%	30.94%
HEALTHCARE	-1.07%	16.31%
INDUSTRIALS	-0.93%	16.57%
INFORMATION TECHNOLOGY	-0.43%	27.45%
MATERIALS	-1.24%	19.14%
REAL ESTATE	0.09%	33.80%
UTILITIES	1.03%	9.97%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-1.24%	13.64%
MSCI ACWI EX U.S.	-0.70%	4.25%
MSCI EAFE	-0.94%	6.40%
MSCI EM	0.19%	-3.31%

SUMMARY:

U.S. equities fell last week (S&P 500 -1.2%, NASDAQ -2.6%, Russell 2000 -3.9%) with the market concerned about the potential impact of the new Omicron variant despite the absence of much hard data. The Treasury curve continued to flatten, with the ten-year yield dropping briefly to 1.35%. Oil dropped 2.8%, its sixth consecutive weekly decline. Best sectors were utilities (+1.0%) and REITs (+0.1%); worst sectors were communication services (-2.8%) and consumer discretionary (-2.3%).

KEY TAKEAWAYS:

1. The November employment report was short of expectations at +210,000. On the positive side were positive prior month revisions, a rise in the participation rate, a fall in the unemployment rate, and a rise in average hourly earnings.
2. The University of Michigan Survey of Consumer Sentiment fell to the lowest since November 2011. The decline was driven by weakness in both current conditions and the inflation expectations component.
3. Financial markets have experienced greater volatility as the Omicron variant increases economic uncertainty, and the Fed has hinted at an increased pace of unwinding monetary accommodation.
4. The conversation has shifted from downside risks to employment to upside risks to inflation for the Fed. (Thankfully!) We expect the asset purchase program to be concluded by March, with a rate hike possible next summer.
5. Fed funds futures are now pricing in six hikes by January 2024 (to 1.5%). That, of course, is a significant change from just a couple of weeks ago.
6. Corporate pricing power has deteriorated somewhat while both input costs and labor costs are rising. This could put some pressure on Q4 profit margins (and earnings).
7. Washington D.C. deadlines are approaching on funding the government (deal just completed), raising the debt ceiling (likely by year-end), passing the defense authorization legislation (likely by year-end), and the reconciliation bill that is at the heart of the Biden social and economic agenda (tough to handicap, but likely to drag into 2022).
8. Last month, the virtual meeting between President Biden and President Xi produced no tangible results because there is virtually no common ground between the two nations.
9. High yield bond spreads jumped 30bps on Friday, November 26, to the widest level since February 2021. Further widening out would be of some concern.
10. Since 1950, there have been 20 times where January-November returns were above 20%. In those years, December has been up 75% of the time with an average gain of 2.2%. Similarly, there have been 22 negative Novembers (like last month) since 1950. December was positive 86% of the time, with an average return of 2.7%.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.09%	-1.60%
BLOOMBERG U.S. CORP HIGH YIELD	-0.38%	4.33%
BLOOMBERG U.S. GOV/ CREDIT	0.10%	-1.86%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.00%	0.03%

THE EASY MONEY HAS BEEN MADE

2022 is likely to be more challenging for investors as central banks progressively unwind monetary accommodation in response to the ongoing economic recovery/expansion and elevated inflation readings. While solid economic growth is typically positive for risk assets, a combination of sticky inflation and rising real interest rates portend less positive and more turbulent trading conditions than have prevailed over the past 18 months. The Omicron variant of the coronavirus represents a risk to global economic growth in the near term. Still, we do not expect it to disrupt the underlying pace of the economic expansion. Our base-case scenario is that global growth will be reasonably strong but more moderate than 2021, with U.S. and euro area consumers flush with cash and bolstered by an improving job market. China is likely to avoid any major pitfalls and continue to contribute positively to the global economy.

Our capital market views are more muted. Risk asset prices have run ahead of the global economic recovery and have discounted an above-consensus growth view for next year. Real interest rates will rise relative to real GDP growth, which will likely impact the valuations of risk assets. If so, this would mark a reversal of the past 18 months, when real GDP growth was accelerating while real interest rates were falling to deeply negative levels. Inflation and interest rate uncertainty will trigger more frequent and intense bouts of risk-off, albeit with bonds providing only limited protection when equities and other risk assets are correcting.

Our base-case scenario for 2022 is for modest and volatile returns for balanced portfolios. We expect equities to outperform bonds as bonds belatedly adjust to the shifting monetary policy landscape, while equities ultimately find support from the ongoing rise in corporate earnings. We continue to advocate overweight exposure to inflation-protected bonds and credit product within fixed-income portfolios, and look to gradually reduce equity exposure to the U.S. market as relative earnings improve in select non-U.S. markets, including the euro area.

Inflation remains the big risk factor for capital markets in 2022. Some transitory supply-driven pressures will fade while demand-side pressures may intensify. We expect inflation to fall in 2022, but be higher and stickier than is currently discounted with risks to the upside as the economic recovery progresses. The corresponding fallout for bonds could prove more disruptive than is embedded in our base-case scenario.

The downside valuation risk for stocks should be offset by an ongoing rise in corporate earnings. Global earnings have been extraordinarily strong over the past 18 months, led by the U.S., but most other major markets have also registered solid profit gains. Earnings momentum has been slowing in recent months from unsustainably high levels and investor worries about earnings could increase in the near term. However, barring a severe COVID or other economic shock, there is little risk that the level of earnings could decline anytime in the year ahead, as it did on multiple occasions in the last economic expansion.

CONCLUSION:

Continue to tilt multi-asset portfolios in favor of stocks versus bonds, but prepare for increased volatility and the likelihood of periodic simultaneous drawdowns in both stocks and bonds as global bond yields rise. The ongoing healthy economic recovery should enable corporate earnings expectations to rise, thereby providing underlying support for stocks during periods of heightened investor anxiety.

Data from Morningstar Direct, as of 12/6/2021.

Crossmark Global Investments, Inc.
15375 Memorial Drive, Suite 200, Houston, TX 77079
888.845.6910 advisorsolutions@crossmarkglobal.com
crossmarkglobal.com