CROSSMARK
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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-0.96%	-4.28%
S&P 500	-1.79%	-7.16%
NASDAQ	-2.17%	-11.80%
RUSSELL 2000	1.42%	-9.51%
RUSSELL 1000 GROWTH	-2.62%	-11.97%
RUSSELL 1000 VALUE	-0.45%	-2.33%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-3.86%	-12.16%
CONSUMER DISCRETIONARY	-2.23%	-11.58%
CONSUMER STAPLES	-0.87%	-2.30%
ENERGY	2.09%	27.10%
FINANCIALS	0.02%	2.73%
HEALTHCARE	-1.45%	-7.49%
INDUSTRIALS	-0.73%	-6.05%
INFORMATION TECHNOLOGY	-2.89%	-10.96%
MATERIALS	1.15%	-7.29%
REAL ESTATE	-2.74%	-12.31%
UTILITIES	-2.14%	-6.33%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-0.44%	-5.13%
MSCI ACWI EX U.S.	1.51%	-1.18%
MSCI EAFE	1.42%	-2.38%
MSCI EM	1.60%	0.75%

SUMMARY:

After posting back-to-back weekly gains following the big January sell-off, equities were lower last week (S&P 500 - 1.8%). Value and small-cap beat growth and large-cap. Oil was higher for an eighth-straight week. The big story was the January CPI inflation surprise and hawkish Fed commentary. Best sectors were energy (+2.1%) and materials (+1.1%); worst sectors were communication services (-3.9%) and technology (-2.9%).

KEY TAKEAWAYS:

1. Inflation has broken out to 40-plus year highs in the U.S. and has become a pressing issue for major central banks worldwide.
2. For the trailing twelve months, U.S. CPI inflation has increased to 7.5% (headline) and 6.0% (core), the highest readings in 40 years. We continue to think inflation will peak this spring and decline, but nowhere close to the Fed's 2% goal (more like 3-4%).
3. The Fed is providing nearly the same liquidity today as it was at the height of the pandemic (still purchasing bonds (QE) and pegging Fed Funds at zero), despite the economy being reopened. The Fed is behind the curve in both time and level.
4. Since late December, the global dollar value of negative-yielding debt has been down 75%.
5. The Omicron wave is fading rapidly. The world economy could be setting up for a resurgence in service sector activity and tourism, giving us another year of above-average growth.
6. 1Q has started out on a choppy note. Labor markets are tight; wage gains have continued. Companies are starting to feel the pressure on costs.
7. U.S. Markit and ISM manufacturing PMIs indicate a general improvement in supply chains in January, despite Omicron. That's good for the economy, but it implies the Fed will have to push harder to slow economic activity.
8. The valuation spread between growth and value equities (while somewhat reduced) remains large by historical standards. It leaves growth stocks vulnerable to relative and absolute de-rating pressures as the interest rate structure moves higher.
9. State tax revenues are booming, causing an increasing number of governors to call for tax cuts.
10. If President Biden follows the path of his predecessors, his approval rating will move modestly higher as the mid-term elections approach. That will not prevent a Republican victory in the House but could impact the Senate races and the size of the House Republican majority. The degree of unity within the Republican party is hugely important as well.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.41%	-3.45%
BLOOMBERG U.S. CORP HIGH YIELD	-0.96%	-4.03%
BLOOMBERG U.S. GOV/ CREDIT	-0.35%	-3.74%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.00%	0.00%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
FTSE NAREIT (REAL ESTATE)	-1.76%	-10.65%
DJ COMMODITIES	0.69%	11.89%
RED ROCKS GLOBAL LISTED PRIVATE EQUITY	-0.83%	-10.01%
DB G10 CURRENCY FUTURES	0.80%	0.55%

MARKETS ADJUSTING TO END OF AN ERA

The end of easy money and very low-interest rates is upon us, and investors will be the losers after what has been a fantastic bull run. Historians will look back at this era and marvel that towards its end, investors remained willing to own fixed income instruments with negative interest rates in a world that was not suffering deflation. The end of the liquidity boom will take time to unwind, as policymakers are in no mood to take risks with economic growth. The early February ECB pivot was inevitable yet still seems to have caught many investors off guard. However, we doubt that the ECB (or any of the major central banks) is on track to pursue a rapid rate-hiking cycle or aggressive shrinking of their balance sheet. Nevertheless, the unwinding of a key factor that had been propelling many risk asset markets into very expensive territory will be problematic. As bond market losses accumulate, we expect significantly lower net returns and higher volatility in the coming years.

The macro outlook is for economic growth to stay robust over the next twelve-plus months with ebbs and flows as the pandemic's economic toll hopefully continues to recede. Inflation will be higher and stickier than at any point in several decades and well above levels that are currently being discounted in government bond markets. There is a strong basis for expecting higher bond yields, but it will not be a straight line. We foresee a tug of war between higher bond yields and equity and credit markets. As bond yields surge, equities will eventually get hit, which in turn causes the rise in bond yields to calm and partially unwind. A calmer bond market soon rekindles fund flows back into riskier assets, as investors realize there has been little economic damage and monetary conditions are still far from being restrictive. This process may well repeat until the cycle eventually matures, depending on how long the bond market is willing to believe that inflation will ultimately return to lower levels.

Equity market valuations are still too stretched to weather rising bond yields for very long and will be prone to correct when yields gain a head of steam, as has occurred this year. In terms of cyclical warning signs for equities, credit spreads are not yet worrisome for the broad equity market, although spreads have widened a bit. The outlook for corporate earnings is still positive even though last year's growth boom will not be repeated. Economic momentum has slowed some under the drag from Omicron. Higher output prices point to continued gains in corporate earnings but also mounting de-rating pressures from higher inflation and interest rates. The tug-of-war between earnings tailwinds and valuation headwinds will likely dominate the investment landscape until the next recession approaches.

While inflation is moving at a stronger pace in the U.S. than in other large developed economies, the general picture is one of diminishing economic slack and rising underlying inflation. This represents a very different backdrop to the 2010s, something the bond market and central bankers have not yet fully realized. There remains considerable hope that inflation will cool significantly once the post-pandemic dust settles. However, once rising prices impact wage demands and longer-term inflation expectations, which is gradually taking hold, policymakers' task becomes considerably more difficult. And soft landings become much more difficult to achieve.

CONCLUSION:

Our key assumptions are that (1) the economy will grow above trend in 2022, allowing (2) earnings to be good, but that (3) inflation will fall during the course of the year but remain higher than comfortable, and that (4) stocks will be volatile in both directions without much net change, frustrating both the bulls and the bears.

Data from Morningstar Direct, as of 2/14/2022.

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