

# DOLL'S DELIBERATIONS

## WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-1.77%	-5.97%
S&P 500	-1.52%	-8.57%
NASDAQ	-1.73%	-13.32%
RUSSELL 2000	-1.00%	-10.42%
RUSSELL 1000 GROWTH	-1.82%	-13.57%
RUSSELL 1000 VALUE	-1.51%	-3.80%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-2.47%	-14.33%
CONSUMER DISCRETIONARY	-0.39%	-11.92%
CONSUMER STAPLES	1.14%	-1.18%
ENERGY	-3.45%	22.71%
FINANCIALS	-2.26%	0.40%
HEALTHCARE	-2.14%	-9.47%
INDUSTRIALS	-1.08%	-7.07%
INFORMATION TECHNOLOGY	-1.66%	-12.45%
MATERIALS	-0.21%	-7.48%
REAL ESTATE	-1.68%	-13.79%
UTILITIES	-1.22%	-7.47%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-1.66%	-6.71%
MSCI ACWI EX U.S.	-1.61%	-2.77%
MSCI EAFE	-1.86%	-4.20%
MSCI EM	-0.67%	0.07%

### SUMMARY:

Equities fell again last week (S&P 500 -1.5%) as the path of least resistance continues to be on the downside, with the Russia-Ukraine situation joining inflation/higher interest rate fears as catalysts. The only sector up on the week was consumer staples (+1.1%); the worst sectors were energy (-3.5%) (on a 4% decline in the price of oil) and communication services (-2.5%).

### KEY TAKEAWAYS:

1. U.S. retail sales surged in January, with the headline number up +3.8%. We continue to be more concerned about supply shocks vs. demand in the current environment.
2. We expect a normalization of economic activity to cause consumer spending to shift from goods to services and, in turn, ease demand-side pressures on inflation. Fed uncertainty is likely to plague markets until inflation shows definitive signs of decelerating, and it appears that consumer spending will hold up into rising prices.
3. The University of Michigan consumer sentiment index fell 8.2 points in February to a decade low. The survey attributes weaker consumer sentiment to rising inflation, lower confidence in economic policies, and poor economic outlook. Some offset includes the mammoth \$2-2 ½ trillion of excess savings in the hands of U.S. consumers.
4. According to the New York Fed's Survey of Consumer Expectations, the median three-year ahead expected inflation rate stands at 4.0 percent. One-year expected inflation is 6.0%.
5. We expect \$10-20 per barrel of oil price decline if (1) Russia-Ukraine simmers down, (2) Iran increases production in a nuclear deal with the West, and/or (3) OPEC increases production.
6. The effective rate on a 30-year fixed-rate mortgage is approaching 4%, which would be the highest in two years.
7. Since early December, the 60+ basis point increase in the 10-year yield has pushed Treasuries into oversold territory. It is becoming increasingly likely that the climb up in Treasury yields could pause and that a counter trend rally is possible.
8. We expect the ECB to follow the Fed's pivot later in 2022 and begin the path to normalize policy after that. This is a somewhat non-consensus view, although the bond market is moving in that direction.
9. A scaled-back Build Back Better bill is possible, especially if accompanied by some tax increases (e.g., higher corporate tax rate, higher top capital gains rate).
10. Global M&A activity exceeded the \$5 trillion mark in 2021 for the first time ever. It was fueled by corporate access to unprecedented levels of cash and cheap capital during the pandemic.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.24%	-3.68%
BLOOMBERG U.S. CORP HIGH YIELD	-0.25%	-4.27%
BLOOMBERG U.S. GOV/ CREDIT	-0.29%	-4.02%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.01%	0.01%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-1.30%	-11.81%
COMMODITIES (DJ)	1.04%	13.05%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-3.93%	-13.54%
CURRENCIES (DB G10 CURRENCY FUTURE)	-0.06%	0.49%

## WAR PROSPECTS TEMPORARILY REPLACE INFLATION AS THE MAIN CONCERN

Global financial markets remain on edge as concerns about a rapid rate-hiking cycle have been temporarily displaced by fears of war in Ukraine and soaring oil prices. Such tensions have slowed the advance in government bond yields but have not been able to reverse the uptrend. Bond markets are moderately stretched, and yields could well pause for a time, but the cyclical fundamentals are still bond-bearish. We are assuming that the economic cycle will not be hurt by events in Ukraine. Instead, the cyclical picture is one of a fading in the pandemic drag on an already robust economic expansion and rising inflation in the developed world, which has triggered the beginning of a gradual normalizing in monetary policies. Although bond yields and forward interest rates have risen noticeably of late, the starting point was absurdly depressed interest rates, which are not close to economically-restrictive territory. The offset for equities is that corporate fundamentals are solid, and earnings are still climbing, even if the growth rate will slow in 2022.

The revival of inflation represents a major longer-term turning point, having been a non-issue for several decades. Bond markets are complacently priced for only a temporary and modest rate cycle. We think inflation will prove durable, and policy rates will ultimately rise by more than the forward markets are discounting. After being in such high demand for almost 40 years, we expect a long bond duration to be shunned before this cycle ends.

U.S. inflation data may soon show signs of cooling on a rate-of-change basis, purely due to base effects from the spikes seen over the past year. While this

might be seen as a favorable development for government bonds, it will likely be offset by a broader and stronger revival in service sector activity this summer, especially in the lagging euro area. Real yields remain extraordinarily depressed and somewhat out-of-sync with the economic cycle. One new area of concern is that energy prices may rise to the point where they could choke economic activity since part of the recent advance has been geopolitically driven rather than just due to stronger demand.

A pause in the uptrend in bond yields is likely necessary for equities to advance in view of still-stretched valuations. The sweet spot of the cycle when buying and holding is rewarded has ended, and equity and credit markets have transitioned to a period of reduced net returns with higher volatility. The good news is that the bear market stage characterized by restrictive money conditions and deteriorating earnings prospects is not yet on the horizon.

## CONCLUSION:

We remain cyclically bearish on bonds. Yields could soon pause given that conditions are becoming technically stretched and U.S. rate expectations have already ratcheted higher. This phase, like the pause last year, will not mark the end of the cyclical rise in yields: economic growth will be too robust and underlying inflation too high to warrant only a short and modest rate-hiking cycle. Equities will likely be skittish until bond yields calm and Ukraine tensions ease or are digested. However, a powerful short-term bounce could occur at any point, given markets are oversold. The conditions for a bear market in both are still not on the horizon, but the cycle has transitioned to the phase where net returns are limited, and volatility is more elevated.

Data from Morningstar Direct, as of 02/23/2022.

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