



# Doll's Deliberations

Weekly Investment Commentary | February 6, 2023 | Issue 3.6

## SUMMARY:

Stocks were higher last week (S&P 500 +1.6%) as the path of least resistance remained to the upside with a resilient labor market and expectations that the Fed is nearing the end of its rate hikes. Best sectors were communication services (+5.3%) and technology (+3.8%); worst sectors were energy (-5.9%) and utilities (-1.5%).

## AS CONFUSING AS IT GETS...SO MANY CROSS-CURRENTS

1. U.S. payroll employment surged +517,000 m/m in January with upward revisions to prior months. The unemployment rate declined to 3.4% (a 53-year low!) A tight labor situation will continue to threaten future wage pressure.
2. The Fed delivered on a 25 basis point rate increase but Chair Powell struck a far less hawkish tone than expected. He said he wasn't worried about easing financial conditions.
3. While investors were listening carefully at last week's Fed press conference, Powell's repeated insistences that restoring price stability will "require maintaining a restrictive stance for some time" and that "we will need substantially more evidence to be confident that inflation is on a sustained downward path" were seemingly ignored. (Bond yields fell sharply at both the short and long ends of the Treasury curve as Powell spoke, and risk assets rallied.) In other words, financial conditions eased significantly even as the Fed Chair did his best to communicate that the Fed's policy stance retains its hawkish bias.
4. The January ISM Manufacturing PMI declined to 47.4, a fresh low and the third month in a row below 50 (after 30 months of expansion).
5. Consumer delinquency rates are rising, and will climb further, as we enter a negative credit cycle. Banks are already tightening lending standards, and raising loan loss provisions.
6. Although we expect that an agreement to raise the federal debt ceiling will ultimately be passed, we do not rule out that markets may get spooked about a default as the deadline approaches.
7. Thus far, only 68% of companies are beating analyst estimates, the worst quarter in nearly a decade (except for one quarter during the pandemic).
8. 2023 S&P 500 earnings have fallen from \$252 last summer to \$225. Our projection is they will continue to fall to \$200.
9. When will bad macro data lead to bad markets? The answer is simply when bad macro data translates into bad earnings and higher credit risks. We have not seen that yet.
10. Since the peak in the USD (end of September) companies with high foreign revenues are up +30% versus those with zero foreign revenue up just 10%.

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-0.15%	2.44%
S&P 500	1.64%	7.86%
NASDAQ	3.33%	14.77%
RUSSELL 2000	4.71%	13.69%
RUSSELL 1000 GROWTH	2.74%	11.30%
RUSSELL 1000 VALUE	0.83%	5.63%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	5.28%	21.11%
CONSUMER DISCRETIONARY	2.25%	17.06%
CONSUMER STAPLES	0.64%	-1.39%
ENERGY	-5.90%	-1.89%
FINANCIALS	1.01%	7.04%
HEALTHCARE	-0.10%	-2.32%
INDUSTRIALS	1.72%	4.74%
INFORMATION TECHNOLOGY	3.76%	14.02%
MATERIALS	0.03%	7.39%
REAL ESTATE	1.52%	10.87%
UTILITIES	-1.45%	-3.71%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	1.92%	9.48%
MSCI ACWI EX U.S.	0.62%	9.65%
MSCI EAFE	1.17%	9.82%
MSCI EM	-0.53%	9.37%



11. In January, the equity market experienced a mini melt-up due to growing expectations for the U.S. economy to have a “soft landing” while the Fed embarks on a prolonged cutting cycle at the same time.
12. It always looks like a soft landing when the Fed is close to wrapping up their tightening cycle. We think the market has priced out too much risk for an economic backdrop that remains in a precarious state, as the digestion of the global tightening cycle is beginning to show up.
13. The market appears not concerned about inflation. While inflation may continue to decelerate (and take earnings with it), we have high conviction that PMIs and EPS estimates will too. In other words, growth will continue to become cooler along with inflation.
14. In January, 2022’s worst performing quintile of stocks appreciated 21% while 2022’s best performers were up only 2%. This is one of, if not the most, extreme January reversals in history (and appears overdone!)
15. Nearly 60% of Russell 3000 names made 20-day highs Thursday. Historically, this would suggest a high probability that equities have entered a new bull market phase.
16. U.S. equities have been underperforming international equities due to an improvement in the economic outlook. A warmer-than-anticipated winter prevented a European energy crisis from unfolding and China’s reopening has boosted expectations of an economic recovery.
17. Stocks always rally near the end of a Fed tightening cycle. The duration of that rally is a function of whether employment deteriorates. In soft landings, a new bull market is born (e.g., 2019, 1995, 1985). In hard landings, rallies abruptly end when employment deteriorates. These rallies can be powerful in magnitude but ultimately end in a bear market.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.84%	3.85%
BLOOMBERG U.S. CORP HIGH YIELD	1.51%	5.48%
BLOOMBERG U.S. GOV/ CREDIT	0.89%	3.74%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.08%	0.37%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	3.62%	13.38%
COMMODITIES (DJ)	-3.98%	-4.66%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	3.71%	18.81%
CURRENCIES (DB G10 CURRENCY FUTURE)	-0.32%	0.42%

**CONCLUSIONS:**

1. The upward move in stocks year-to-date has come on the back of investors increasingly believing in a soft landing in the U.S., the end of Fed rate hikes, Fed cuts by year-end, no European energy crisis and China reopening.
2. In our view, the bulls are dismissing negatives for the equity market including a very negative yield curve, negative money growth, declining leading economic indicators, PMIs below 50, and the lagged economic impact of the second fastest Fed funds increase in history.
3. We believe investors should fade the year-to-date rally as recession risks are merely postponed rather than diminished. We believe market upside is limited short-term. Growth and earnings are still slowing while wage growth might not fall enough. It is time for a break and we lean negative on equities in the short-term.

Data from Bloomberg, as of 2/3/2023.

**Crossmark Global Investments, Inc. (Crossmark)** is an investment adviser registered with the Securities and Exchange Commission that provides discretionary investment management services to mutual funds, institutions, and individual clients. Investment advice can be provided only after the delivery of Crossmark’s firm Brochure and Brochure Supplement Form ADV (Parts 2A and 2B) and Form CRS, and once a properly executed investment advisory agreement has been entered into by the client.

**All Investments are subject to risks, including the possible loss of principal. Past performance does not guarantee future results.**

Information and recommendations contained in market commentaries and writings are of a general nature and are not intended to be construed as investment, tax or legal advice. These materials reflect the opinion of Crossmark on the date of production and are subject to change at any time without notice. Where data is presented that was prepared by third parties, the source of the data will be cited, and we have determined these sources to be generally reliable. However, Crossmark does not warrant the accuracy of the information presented.