CROSSMARK GLOBAL INVESTMENTS

February 7, 2022
Issue 2.5

DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	1.06%	-3.35%
S&P 500	1.57%	-5.47%
NASDAQ	2.41%	-9.84%
RUSSELL 2000	1.74%	-10.78%
RUSSELL 1000 GROWTH	1.86%	-9.60%
RUSSELL 1000 VALUE	1.61%	-1.89%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-0.25%	-8.64%
CONSUMER DISCRETIONARY	3.95%	-9.56%
CONSUMER STAPLES	0.42%	-1.44%
ENERGY	4.98%	24.49%
FINANCIALS	3.57%	2.70%
HEALTHCARE	1.34%	-6.13%
INDUSTRIALS	0.43%	-5.36%
INFORMATION TECHNOLOGY	1.11%	-8.31%
MATERIALS	-0.20%	-8.34%
REAL ESTATE	-0.21%	-9.84%
UTILITIES	0.81%	-4.29%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	1.95%	-4.72%
MSCI ACWI EX U.S.	2.27%	-2.66%
MSCI EAFE	2.10%	-3.75%
MSCI EM	2.53%	-0.84%

SUMMARY:

U.S. equities were higher for a second straight week (S&P 500 +1.6%). Despite the firmer tone, there were still expectations for a further shift in sentiment from buying the dip to selling the rally. The bulk of the focus continued to revolve around concerns that the hawkish global monetary policy repricing has more room to run. The best sectors were energy (+4.9%), consumer discretionary (+3.9%), and financials (+3.5%); three sectors were down fractionally – REITs, communication services, and materials.

KEY TAKEAWAYS:

1. U.S. non-farm payrolls surprised to the upside, rising 467,000. Average hourly earnings rose 0.7% M/M and 5.7% Y/Y. The U.S. looks close to a full-employment position.
2. After a solid inventory-led bounce in Q4 21 GDP, the Omicron variant, nasty weather, and consumer anxiety over inflation may suppress growth in Q1. We expect above-average growth for the remainder of the year.
3. Good economic and earnings growth will likely support equities. Strong demand from households and businesses will ultimately keep GDP expanding at an above-trend pace. That said, rising costs have been a key feature of the earnings season.
4. With the Fed continuing to purchase treasuries in the near term and not expected to raise rates for another six weeks, financial conditions remain easier than at any point before 2021. This suggests to us that they have a long way to go if they are going to tighten materially.
5. We are hopeful that once the FOMC starts to raise the federal funds rate and details the pace of running off the Fed's balance sheet, the financial markets will learn to live with tightening monetary policy as long as it doesn't risk causing a recession.
6. With nearly half of companies reporting, Q4 earnings surprises have fallen slightly below the long-term average.
7. Over the next 30-60 days, we expect some resolution in fiscal policy (watered down BBB), monetary policy (more clarity in Fed policy), geopolitics (Russia/ Ukraine), and judicial matters (Supreme Court).
8. Nearly all major financial assets posted negative returns in January. The main culprit was the rapid increase in U.S. Treasury yields as markets re-priced following the Fed's hawkish pivot. U.S. stocks (which are among the most expensive globally) have performed poorly vs. the rest of the world so far in 2022. We think that will be the case for the full year.
9. The stock market has enjoyed a reflex rally of more than half of the 11% it lost. We expect the reflex rally from the primary low to stall, and then the testing begins. While we don't think there is much more price risk, the market may need more time to heal. We expect more volatility with periodic short-term rallies and selloffs.
10. Uncertainty about the course of monetary policy tightening has unnerved stock investors. We maintain a S&P 500 4500 year-end target (20x $225 2022 EPS, 18x $250 2023 EPS).

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.95%	-3.05%
BLOOMBERG U.S. CORP HIGH YIELD	-0.30%	-3.10%
BLOOMBERG U.S. GOV/ CREDIT	-1.04%	-3.40%
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)	-0.17%	-9.05%
DJ COMMODITIES	2.88%	11.12%
RED ROCKS GLOBAL LISTED PRIVATE EQUITY	3.12%	-9.26%
DB G10 CURRENCY FUTURES	-0.92%	-0.25%

THE MONETARY SCREWS ARE SLOWLY TIGHTENING

Investors have ridden a wave of liquidity that is slowly beginning to turn over the past two years. On the margin, monetary policy is shifting from ultra-accommodative towards gradual normalization. The challenge for investors is that central banks have no clear framework for either the path from here to there or the final destination. For most of the past two decades, central bank policy has been guided by confidence that inflation would remain subdued regardless of how the economy performed.

Inflation in the developed market economies is increasingly problematic. It is well above central bank expectations, has lasted longer than they forecasted, is not limited to supply-chain driven constraints, has started to impact service sector prices and labor markets, will become more problematic as mobility improves, and has become a political liability for governments. At the same time, the global economic recovery seems poised to solidify in the months ahead, underpinned by a fading of the Omicron variant, buoyant household savings, a strong job market, and flush corporations anxious to expand their businesses. Against this macro backdrop, we expect the inflationary impulse to rotate and broaden from goods prices to service prices in the year ahead, keeping upward pressure on central bank policy rates and bond yields. We continue to expect global bond yields to climb further over the next 6-12 months, albeit in waves with periodic reprieves. Our underweight stance on bonds and short duration remain appropriate.

Equities will likely be vulnerable to de-rating pressure amidst monetary policy uncertainty and rising bond yields but will find support from the ongoing uptrend in corporate earnings. We expect equities will be bumpy with elevated volatility versus the last two years. Higher interest rates and solid global economic growth portend a change in equity market leadership toward select non-U.S. markets and value and small-cap stocks. We continue to recommend an overweight stance on cash, consistent with our short-duration stance on bonds, and to provide tactical flexibility during corrections in risk assets. Equities should outperform bonds but will likely generate only moderate returns such that a balanced multi-asset portfolio will struggle to produce gains on a 6-12 month horizon.

The recent equity market selloff could be repeated several times over the balance of this year, as monetary policy accommodation unwinds. Despite the expected volatility and a modest valuation de-rating as interest rates increase, an ongoing uptrend in corporate earnings implies that prices should rise moderately in a volatile, trendless U.S. market. Growth stocks suffered a harsher correction in response to the jump in bond yields, with global growth benchmark's late-January low 15% below its November high. Meanwhile, value stocks were down 5% over the same periods. The rise in bond yields has also triggered a shift in sector leadership. Technology stocks that are highly represented in the growth index underperformed sharply during the correction, while financials strongly outperformed and pushed to a nearly two-year relative high.

CONCLUSION:

Equities will continue to be volatile as the hyper-accommodative monetary backdrop turns less favorable. These headwinds should be countered by the tailwinds of a further rise in forward earnings expectations. Healthy global growth and rising interest rates suggest a shift in equity leadership toward value and small-cap stocks, along with select non-U.S. markets and financials among sectors.

Data from Morningstar Direct, as of 2/7/2022.

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