CROSSMARK GLOBAL INVESTMENTS

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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-0.88%	-1.13%
S&P 500	-0.29%	-2.11%
NASDAQ	-0.28%	-4.79%
RUSSELL 2000	-0.79%	-3.67%
RUSSELL 1000 GROWTH	-0.88%	-5.65%
RUSSELL 1000 VALUE	0.15%	0.97%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	0.52%	-1.99%
CONSUMER DISCRETIONARY	-1.47%	-4.02%
CONSUMER STAPLES	-0.42%	-0.01%
ENERGY	5.26%	16.42%
FINANCIALS	-0.83%	4.57%
HEALTHCARE	-0.22%	-4.83%
INDUSTRIALS	-0.61%	0.04%
INFORMATION TECHNOLOGY	-0.06%	-4.73%
MATERIALS	-0.57%	-2.04%
REAL ESTATE	-1.97%	-6.81%
UTILITIES	-1.40%	-2.99%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	0.18%	-1.35%
MSCI ACWI EX U.S.	1.04%	0.67%
MSCI EAFE	0.18%	-0.11%
MSCI EM	2.57%	2.09%

SUMMARY:

U.S. equities fell a small amount last week (S&P 500 -0.3%) with volatility higher. Value beat growth again and the ten-year Treasury yield moved up to 1.78%. The probability that the Fed begins raising rates in March and does so four times this year went higher. Outperformers included energy (+5.2%) and communication services (+0.5%); underperformers included REITs (-2.0%) and consumer discretionary (-1.5%).

KEY TAKEAWAYS:

1. The December U.S. CPI report indicates that price pressures remain extreme. U.S. consumer inflation rose to 7.0% y/y in December, up from 6.8% y/y in the prior month, the highest level in 40 years.
2. The FOMC meeting was just a month ago and already the guidance is changing again. Four weeks ago, there were only two 2022 dots at the 4 hikes level in the dot plot. Now, there are six FOMC members eager to start hiking in March, which makes it look like almost half the committee is open to the idea of four hikes. Even if current market expectations play out, the fed funds rate will still end the year below its level immediately prior to the pandemic.
3. Expansions don't die of old age, they are murdered by the Fed. – Rudi Dornbusch
4. President Biden has nominated three new appointees to the Fed. All three will likely lean dovish, but probably not impact the Fed's thinking regarding a first rate hike, as they have to go through the long confirmation process.
5. The retail trade report for December was weaker than expected. This report, along with the Omicron variant, will likely create weakness in Q1 GDP, but probably not impact the Fed's tapering plan or plans for the first rate increase.
6. The Q4 earnings season has started. We are expecting another strong season, with actual results once again beating expectations. The expected y/y growth rate for Q4 has been hovering around 20% since mid-2021.
7. The U.S. has hit full employment which will lead to unprecedented labor shortages. The gap between the number of people that are unemployed and job openings makes us think that wage growth will remain strong.
8. The market no longer has any confidence that Congress will pass President Biden's "Build Back Better" plan. We still think a reconciliation bill will pass, albeit in a watered down form.
9. Equity market breadth has been deteriorating since early last year which indicates that fewer and fewer stocks are participating in the rally.
10. While we continue to believe interest rates out the Treasury curve will move higher and that value will beat growth and that cyclicals will outperform defensives, the magnitude of the move already this calendar year suggests a pause and partial reversal at some point is inevitable.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.29%	-1.82%
BLOOMBERG U.S. CORP HIGH YIELD	0.07%	-0.87%
BLOOMBERG U.S. GOV/ CREDIT	-0.27%	-1.97%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.00%	0.00%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-1.43%	-5.18%
COMMODITIES (DJ)	2.28%	4.58%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-1.04%	-4.38%
CURRENCIES (DB G10 CURRENCY FUTURE)	0.00%	-0.08%

THE FED HAS "ANNOUNCED" THE REMOVAL OF THE PUNCH BOWL

Financial markets have hit a bumpy patch, not because of growing economic angst or concerns about weaker corporate earnings. Instead, the mounting concern is that central banks will pull away the proverbial punch bowl. Over-inflated liquidity plays have been crunched despite only a minor rise in bond yields and central banks confirming that they will remain strongly pro-growth even though monetary conditions will become less accommodative. The sizable market response in some markets to what is and will be a slow moving process to normalize monetary policies could very well become the norm in the coming year(s). Almost all asset prices are stretched at a time when emergency monetary conditions have long since passed. Central banks will move cautiously if they can, and so far the longer end of yield curves are not overreacting, but the path ahead is becoming clearer.

Investors should be prepared for greater volatility and much more muted returns, even though the global economy will record its best period of growth in over a decade. The supportive economic backdrop, however, has a downside as it also means that the below 2% inflation era is over. Consequently, monetary conditions will progressively become less positive for asset markets. The U.S. has been the traditional global leader in terms of the business cycle, and financial market and policy trends. The pandemic de-synchronized conditions given widely divergent responses in each country to rising caseloads and hospitalizations, and now the U.S. is leading financial market trends, although the Fed has not been the first central bank to hike rates. U.S. 10-year Treasury yields are close to hitting new cycle highs, with other countries following. The rebound in global bond yields still leaves yields deeply in negative territory in real terms, and far from creating any economic headwinds. A sustained move by Bund yields into positive territory likely awaits a rolling over in the Omicron wave, and a recovery in mobility and service sector activity. We expect such an outcome heading into the critical summer tourist season.

While the U.S. will still lead global trends, Europe should be more in-sync with the U.S. after diverging last decade. The euro has shown recent signs of resilience against the dollar, likely reflecting bets that the regional economy will perform better beyond the near run. The U.S. dollar, in fact, has turned soggy against most cross rates, and should trade on the soft side as the global economic expansion proves resilient this year.

Broad equity indexes are only off modestly and corporate high-yield bond spreads remain historically narrow, and are not signaling any stress. The initial phase of Fed rate hiking cycles has tended to trigger corrections in global equities of 10% or so, but not bear markets. The resilience of most stocks so far might seem encouraging, but it likely only means that bond yields have further to climb. The recent upshift in U.S. rate expectations has been sufficient to snap one of the most vulnerable market areas, namely speculative growth stocks.

CONCLUSION:

We recommend investors be positioned for higher bond yields and a choppier equity and credit market backdrop. Global economic growth will be more resilient and stronger than last decade, in view of the much more accommodative policy backdrop and fewer structural drags. Monetary conditions will gradually become less positive. The era of low (below 2%) inflation has ended, although this is not yet discounted in financial asset valuations. These factors underscore that the coming years will witness more muted market returns.

Data from Morningstar Direct, as of 01/18/2022.

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