CROSSMARK GLOBAL INVESTMENTS

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Doll's Deliberations

Weekly Investment Commentary

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Summary:
Equities rose (S&P 500 +1.2%) last week with the S&P 500 setting a new all-time high. The equally-weighted S&P 500 declined, meaning leadership was narrow and driven by technology. Importantly, Fed rate cut expectations have begun to decline.

Key takeaways:

EQUITY MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
DJIA	0.76	0.55
S&P 500	1.19	1.54
NASDAQ	2.26	2.01
RUSSELL 1000	-0.11	0.05
RUSSELL 1000 GROWTH	2.21	3.07
RUSSELL 1000 VALUE	-0.20	-0.83
RUSSELL 2000	-1.39	-5.07

S&P EQUITY SECTORS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	1.95	4.42
CONSUMER DISCRETIONARY	0.52	-1.47
CONSUMER STAPLES	-0.93	0.29
ENERGY	-3.04	-4.29
FINANCIALS	0.96	0.84
HEALTHCARE	-0.70	2.36
INDUSTRIALS	0.31	-1.28
INFORMATION TECHNOLOGY	4.32	4.98
MATERIALS	-1.49	-3.88
REAL ESTATE	-2.13	-3.36
UTILITIES	-3.70	-3.77

1. The Fed's latest Beige Book delivered a lukewarm message on the U.S. economy. Any economic downturn has been delayed due to the mountain of excess savings arising from the extraordinary fiscal stimulus during the pandemic which is winding down.
2. The New York Fed's Empire State Survey delivered a negative signal about U.S. manufacturing conditions. The headline general business conditions index plunged from -14.5 to -43.7 in December (its lowest level since May 2020).
3. Recent data suggest that the U.S. housing market is resilient. This improvement in sentiment comes with lower mortgage rates and an undersupply of inventory.
4. Globally, inflation has been dropping, with China's economic woes effectively working to export deflation to the rest of the world. But war in the Middle East could jeopardize that scenario if it disrupts oil supplies.
5. Earnings growth for 4Q is expected to be 4.4% which is down slightly from the January 1 estimate of 4.7% and well below the October 1 estimate of 11%.
6. Although it is early in earnings reporting season, companies are reporting lackluster 4Q23 results and forward guidance. We see stocks facing a high bar during this earnings season. Anything short of strong corporate guidance re-affirming current high growth expectations is likely to be penalized.
7. In recent months, interest rates have been the most important determinant of equity performance, which is likely to continue in the near term.
8. In election years (17/23 times since 1932), value stocks usually outperform growth stocks (on average by 7½%).
9. Will supply chain problems re-emerge caused by increased instability in the shipping industry due to a broadening of conflict in the Middle East, and will that lead to new inflation?
10. In 2020, the net interest expense of the U.S. government was $330 billion. In the past twelve months, it has totaled $730 billion. The Congressional Budget Office expects net interest expenses to rise to above $1 trillion per year by 2028.

Magnitude of Rate Cuts in Question

Excitement over the possibility of an imminent and significant rate-cutting cycle is fraying in the face of a resilient economy. Investors have started to reduce the magnitude of expected rate cuts in 2024. Meanwhile, the much-anticipated return to a low inflation world has hit a few bumps, with indications that our view of sticky underlying inflation might well be panning out. Leading inflation gauges warn that inflation has not been tamed.

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN) (%)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-1.06	-1.33
MSCI ACWI EX U.S.	-2.74	-3.82
MSCI EAFE	-2.50	-2.88
MSCI EM	-3.51	-6.07

Massive monetary and fiscal stimulus this decade has led to a dearth of economic slack. This, in turn, means that inflation will be sticky if economic growth remains firm. Expectations of lower policy rates ahead, somewhat "endorsed" by Fed Chair Powell, provided fresh economic stimulus. The impact will be to prolong the economic expansion and help to further entrench inflation, reinforcing that monetary conditions are not very restrictive. While we are concerned about future inflation, we do not expect a return to the high rates recorded in 2022, which reflected a number of one-off distortions and price changes.

FIXED INCOME MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-1.12	-1.41
BLOOMBERG U.S. CORP HIGH YIELD	-0.58	-0.73
BLOOMBERG U.S. GOV/ CREDIT	-1.04	-1.37
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.04	0.24

We do not expect the recent Goldilocks investment backdrop to persist for much longer, and indeed 2024 has had a mixed start. We anticipate downgrading our equity outlook if bond yields resume their cyclical advance and aggressive policy rate cut expectations unwind. The backdrop of acceptable corporate profits will remain supportive for stocks although we think 2024 earnings estimates have to be reduced. The one outcome that would significantly change the investment landscape and prolong the Goldilocks backdrop would be if the consensus is correct and inflation and elevated wage growth fell.

ALTERNATIVES (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-3.19	-4.03
COMMODITIES (DJ)	-1.08	-1.57
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-0.92	-4.21
CURRENCIES (DB CURRENCY FUTURE HARVEST)	0.89	2.44

U.S. consumers still have some (but rapidly declining) leftover excess savings accumulated during the pandemic era. More importantly, U.S. consumers have sufficient income growth to sustain historically elevated consumption growth. China may modestly add to global growth this year, despite widespread angst amongst investors that the economy faces serious economic trouble. In the Euro area, structural headwinds related to geopolitical and domestic issues are intact, but the conditions for better growth exist.

Conclusion:

The aggressive front-running of policy rate cuts has sustained, if not boosted the global economic expansion. This will eventually spark another upleg in government bond yields which will threaten equity valuations.

Data from Bloomberg, as of 1/19/2024.