CROSSMARK
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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-4.55%	-5.63%
S&P 500	-5.67%	-7.66%
NASDAQ	-7.55%	-11.98%
RUSSELL 2000	-8.07%	-11.44%
RUSSELL 1000 GROWTH	-6.99%	-12.25%
RUSSELL 1000 VALUE	-4.57%	-3.64%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-7.05%	-8.90%
CONSUMER DISCRETIONARY	-8.48%	-12.16%
CONSUMER STAPLES	-1.42%	-1.43%
ENERGY	-3.08%	12.84%
FINANCIALS	-6.44%	-2.17%
HEALTHCARE	-3.41%	-8.08%
INDUSTRIALS	-4.40%	-4.36%
INFORMATION TECHNOLOGY	-6.94%	-11.34%
MATERIALS	-5.36%	-7.30%
REAL ESTATE	-2.85%	-9.46%
UTILITIES	-0.79%	-3.75%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-4.24%	-5.53%
MSCI ACWI EX U.S.	-1.88%	-1.23%
MSCI EAFE	-2.08%	-2.19%
MSCI EM	-1.04%	1.03%

SUMMARY:

U.S. equities finished sharply lower last week declining for a third consecutive week to start 2022. The S&P (-5.7%) and NASDAQ (-7.6%) saw their biggest weekly pullbacks since the start of the pandemic. Much of the blame remained focused on a market still coming to grips with the Fed's hawkish policy shift driven by concerns about more persistent inflation. Best sectors for the week were utilities (-0.8%) and consumer staples (-1.4%); worst sectors were consumer discretionary (-8.5%), communication services (-7.1%), and technology (-6.9%).

KEY TAKEAWAYS:

1. Rate hikes are just around the corner, as there is a growing consensus that it will be appropriate to deliver the first rate hike in March, as soon as net purchases reach zero. Our expectation is that the fed funds rate will rise to 2-2.5% over the next three years.
2. A strong U.S. economy, high inflation, monetary tightening, and rich valuation are a difficult mix for stocks to handle. Hence our ten predictions suggest a more difficult year for investors.
3. The NASDAQ has corrected more than 10% from its November high (S&P 500 is down nearly 9%) while global bond yields continue to move higher with German 10-year bunds turning positive for the first time since May 2019. Coming into the new year, our S&P 500 target for year-end 2022 is 4550 vs. a street consensus of 4950. The market has undercut that level. While we do not think the low is in, WE RECOMMEND BEGINNING TO PREPARE A SHOPPING LIST FOR A TACTICAL BOUNCE.
4. The average stock is down more than 15% from its 52-week high, while the average tech stock is down more than 20%.
5. The massive rotation out of growth and into value continued last week as the spike in longer-term yields hurt high P/E stocks relative to cheaper names. While a short-term reversal will undoubtedly occur, we believe this theme will continue in 2022.
6. U.S. labor costs are rising at the fastest pace in three decades, as companies compete for workers in a tight job market. Most companies have so far been able to absorb rising labor costs because of strong economic growth and decent productivity, but worries about the potential impact on profitability are increasing.
7. Inventories-to-sales ratios remain near all-time lows, creating the need to restore depleted inventories which will be among the forces supporting the U.S. economic expansion this year.
8. A late 2022/2023 economic slowdown is likely given the impacts of higher global bond yields and higher oil prices, not to mention central banks tightening policy.
9. Absent a concerted effort to raise production by OPEC and U.S. shale producers, oil prices could rise further as supply tightens and demand continues to rise.
10. We expect geopolitical risks, especially related to Russia and China, to rise in 2022.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.05%	-1.77%
BLOOMBERG U.S. CORP HIGH YIELD	-0.68%	-1.54%
BLOOMBERG U.S. GOV/ CREDIT	0.09%	-1.89%
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)	-3.82%	-8.80%
COMMODITIES (DJ)	1.88%	6.54%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-4.83%	-9.00%
CURRENCIES (DB G10 CURRENCY FUTURES)	-0.18%	-0.25%

BOND MARKET STABILIZATION NEEDED FOR EQUITIES TO REGAIN FOOTING

Led by the relentless rise at the short end of the yield curve in most developed markets, longer-term bond yields have recently started to catch up, with 10-year government bond yields hitting new cycle highs in many countries. Investors are looking beyond the Omicron wave to better economic conditions and a rate-hiking cycle. Meanwhile, inflation continues to generally exceed rising expectations, and is well above central banks' targets. The near-run risk to all financial markets is if bond yields continue to climb and bond investors start to panic. In other words, risk assets will remain vulnerable until bond markets stabilize. We have suggested that bond yields will move up in waves, and a pause should develop before too much damage occurs to portfolios given the still highly-supportive policy backdrop. However, market sentiment can change quickly, and mounting losses could undermine confidence in the bond markets. After a down year in 2021, bond investors could accelerate selling if losses start to look open-ended, triggering a disorderly rise in yields.

So far, the damage to risk assets has been modest (equities, credit, and commodities), especially relative to the sizable gains over the prior 20 months. However, the most speculative instruments have been hit hard, as it is clear that the liquidity boom is past its peak. On the positive side, credit spreads are staying tight which historically has coincided with no worse than modest drawdowns in the equity indexes. Importantly, although there has been a steady and broad rise in government bond yields, they are still well below the level of inflation and inflation expectations, and far below underlying nominal GDP growth rates. Thus, the rise in yields so far is not likely to create any economic headwinds.

The bond market consensus still seems to be that a modest rate-hiking cycle will be sufficient to return inflation to 2% without unduly impacting economic activity. In our opinion, this view is likely to be wrong, but it will take time before a more bearish outcome becomes evident. In the interim, risk asset markets will still be supported by rising corporate earnings. Central banks are under mounting pressure to end emergency policy settings, and some have started the long road back towards a less extreme stance. However, no policymaker is willing to take any economic risk yet. All seem to believe that the inflation threat is not serious enough to warrant bold action. We would characterize this phase of the cycle as central banks turning less dovish, rather than becoming hawkish. In bond market terms, the early phase of rising bond yields only reflects better growth and higher inflation risks, i.e., yields are not at levels that would be economically restrictive. The caveat for investors is that some high-flying risk asset markets had already been pushed to extreme valuations, such that even a rise in yields that does not undermine the economy can still be sufficient to cause significant profit taking, and trigger greater overall volatility.

We believe that central banks are behind the curve, but this view is not yet shared in the bond market. However, this will be a debate in 2023 and beyond, not this year. The pandemic has created huge economic uncertainty and there are widespread hopes that the current inflation spike will ultimately unwind once normal economic conditions return.

CONCLUSION:

Pressure on equity markets will persist until bond markets stabilize. Bonds are becoming oversold, so a short-term pause is possible, which would allow equity markets to regain their footing. However, a significant pause in the cyclical uptrend in bond yields may not develop until the current spike in U.S. inflation starts to moderate this summer. In the meantime, the corporate earnings picture seems to be (and needs to be) reasonably robust.

Data from Morningstar Direct, as of 1/24/2022.

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