CROSSMARK GLOBAL INVESTMENTS

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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-0.16%	-12.97%
S&P 500	-0.91%	-18.27%
NASDAQ	-1.57%	-26.50%
RUSSELL 2000	-3.48%	-23.42%
RUSSELL 1000 GROWTH	-1.29%	-25.60%
RUSSELL 1000 VALUE	-0.83%	-12.17%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-3.26%	-28.50%
CONSUMER DISCRETIONARY	-1.04%	-29.13%
CONSUMER STAPLES	0.11%	-4.54%
ENERGY	-3.04%	26.58%
FINANCIALS	-0.89%	-17.79%
HEALTHCARE	-0.39%	-6.84%
INDUSTRIALS	-1.21%	-17.23%
INFORMATION TECHNOLOGY	-0.32%	-23.78%
MATERIALS	-1.29%	-19.62%
REAL ESTATE	-0.43%	-19.66%
UTILITIES	-0.10%	-1.05%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-3.19%	-21.15%
MSCI ACWI EX U.S.	-3.61%	-21.19%
MSCI EAFE	-3.49%	-22.22%
MSCI EM	-3.34%	-20.26%

SUMMARY:

Stocks finished the week modestly lower (S&P 500 -0.9%) though off the worst mid-week levels that followed the higher than expected June CPI. The decline reflected a steeper expected Fed rate path, persistent inflation fears, growing recession odds, and thoughts that earnings estimates still need to come down. Best performers were consumer staples (+0.1%) and utilities (-0.1%); worst performers were communication services (-3.3%) and energy (-3.0%).

KEY TAKEAWAYS:

1. U.S. headline CPI rose by a stronger-than-expected 9.1% y/y in June, the highest reading in 41 years. Gasoline, shelter and food continues to drive headline inflation. These price pressures call for another 75bp hike at the July 26-27 FOMC meeting.
2. The June inflation reading disturbed markets so much that the odds of a 100-basis point hike in July went from 8% to 79% in a few hours. That likely overstates those odds but illustrates how far behind the curve the Fed fell after moving far too slowly to tighten.
3. While U.S. economic growth is clearly slowing, we don't see the unemployment rate rising enough for the Fed to abandon its tightening cycle any time soon. The Fed is prioritizing relieving consumers' inflation angst over sustaining robust economic growth.
4. Recent signals from shipping costs, commodity prices, and the PMI's supplier deliveries index all point to easing price pressures, confirming easing in supply chain pressures.
5. Many think two consecutive quarters of negative real GDP growth qualifies as a recession. In reality, the National Bureau of Economic Research considers a broader range of measures when defining the business cycle such as employment, income, consumption, and industrial production. These do not point to underlying weakness in the U.S. economy.
6. Most company managements are likely to report that they are concerned about a recession but aren't seeing it in their businesses and that inflation is boosting their revenues and the Fed's tighter monetary policies aren't depressing their unit sales so far.
7. The U.S. Dollar Index (DXY) hit its highest level in 20 years, which is negative for earnings, but positive for inflation.
8. Current forward P/E multiples already discount the recent surge in interest rates, so the direction of stock prices going forward is likely to hinge more on the outlook for earnings.
9. Dividend paying stocks have outperformed non-dividend paying stocks by 20% so far this year.
10. Growth has recently outperformed value due to views that (1) inflationary pressures will ease, (2) economic growth is slowing, and (3) value stock earnings are more at risk than growth stock earnings.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.56%	-10.09%
BLOOMBERG U.S. CORP HIGH YIELD	-0.28%	-13.14%
BLOOMBERG U.S. GOV/ CREDIT	0.55%	-10.85%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.00%	0.16%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-1.94%	-19.94%
COMMODITIES (DJ)	-2.07%	14.91%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-4.69%	-37.00%
CURRENCIES (DB G10 CURRENCY FUTURE)	0.58%	5.95%

UNCERTAINTY PREVAILS LEADING TO VOLATILITY IN BOTH DIRECTIONS

Financial markets see all roads leading to recession, because inflation has gotten out of control. An easing in measured inflation in the second half of the year and, thereafter, less hawkish central bank rhetoric should provide a reprieve. Longer-term, however, we anticipate that inflation will prove sticky unless meaningful economic slack develops. Recession fears are overstated, as employment conditions and corporate profitability remain in good shape in most developed market economies.

While the Fed has recently sounded very hawkish, we suspect that it will back off if inflation eases in the coming months and the recent dip in inflation expectations persists. The central bank still has an entrenched view that inflation will eventually revert to much lower levels once various temporary, non-business cycle forces fade, i.e. supply problems are resolved and the impact from the war in Ukraine diminishes. This bias supports a less hawkish Fed should inflation ease.

We have become concerned that inflation was becoming entrenched to the point where monetary conditions will eventually have to become restrictive, causing meaningful economic pain. By all measures, such conditions do not currently exist with nominal and real bond yields and even interest rate expectations for the next year still fairly low. However, other factors have conspired to undermine economic expectations, including: (1) the increase in the cost of living, (2) the war in Ukraine and its impact on energy prices and supplies, (3) ongoing Covid restrictions (especially in China), (4) a sense that underlying economic conditions are fragile, and (5) mounting losses in financial markets and the wealth effect on consumption. None of these issues individually are cycle enders, but the collective impact has caused recession fears to gather steam. That risk asset markets were overvalued heading into 2022 has magnified the angst among investors, who were ill-prepared for the surge in inflation and bond yields, and the unwinding of the prior liquidity boom.

The powerful rise in government bond yields has paused in the past month. The pause has a dark side to it as it mostly reflects increased recession fears, rather than an easing in inflation and inflation expectations. To this end, global equities have slid further reflecting mounting economic worries. Bond yields should be calm until recession fears ease, but the latter may not develop until after central banks dial back their hawkishness. However, current bond yields still offer poor longer term value. The recent decline in oil and industrial commodity prices will help ease some inflation angst. However, even though the near-run backdrop will be supportive for government bonds, it is unlikely to mark the end of the cyclical threat to fixed-income markets.

For equities, the backdrop is also difficult, with near-term earnings concerns likely to keep prices under pressure, despite deeply oversold conditions and pessimistic sentiment. We remain more upbeat than the consensus on economic prospects, creating a bias to look for a buying opportunity in stocks. This year's de-rating of equities mostly reflects higher bond yields, along with an expectation of earnings downgrades. More reasonable valuations combined with our expectation of respectable corporate earnings over the next year would normally lead us to buy equities. However, it could take some time before sentiment starts to recover given the vague but widespread fear of the future and, thus, we are neutral on stocks.

CONCLUSION:

Recession fears are overstated, as employment conditions and corporate profitability remain in reasonably good shape in most developed market economies. Government bond yields will continue to consolidate until recession fears ease. The latter hinges on some cooling in measured inflation and less hawkish rhetoric from the major central banks. Such an outcome has high odds of occurring late this summer and fall but global financial markets will remain volatile and prone to risk-off in the interim, despite deeply oversold conditions.

Data from Bloomberg, as of 07/15/2022.