CROSSMARK
GLOBAL INVESTMENTS

Doll's Deliberations

Weekly Investment Commentary | June 20, 2023 | Issue 3.25

SUMMARY:

Stocks rose for the fifth consecutive week (the longest streak in over 18 months) with the S&P 500 +2.6%. As expected, the Fed paused its rate hikes but indicated the likelihood of future hikes down the line. Best sectors were technology (+4.4%) and materials (+3.3%); worst sectors were energy (-0.7%) and financials (+1.2%).

KEY TAKEAWAYS:

1. The Fed kept its policy rate unchanged at 5.00-5.25%, but indicated that it would raise rates before year-end an additional 50 basis points according to the median participant.

2. The European Central Bank (ECB) delivered a 25 basis point rate hike, raising the policy rate to 3.5% - the highest since August 2001 and signaled that further rate hikes are likely in July and potentially September.

3. Sharply lower energy prices helped hold down May headline inflation (+0.1% m/m). That said, core is still running hot (up 0.4% m/m), and 4.5% - 5.0% annualized – a pace certain to keep the Fed on edge.

4. U.S. initial jobless claims were flat at 262,000 equaling the higher level seen last week. This points to somewhat continued slowing in labor markets.

5. Near-term recession risks have faded as seen in credit conditions and the housing market in particular.

6. We still believe the lagged impact of the Fed's aggressive tightening campaign will eventually weigh on the labor market, consumer spending, and corporate profits leading to a mild recession commencing before year-end.

7. The Fed needs to push the policy rate well above its latest estimate of terminal rate if it wants to bring inflation to its 2% goal and in our minds that almost definitely means a recession. Time will tell.

8. U.S. debt service costs increased in May and now stand at 13% of tax revenues, the highest level since July 1999.

9. Information technology, communication services, and consumer discretionary are the only sectors that have risen in the first five months of the year with all three of them posting double-digit returns. (The other eight sectors had negative returns.)

10. Last week, bulls surged and outnumbered the bears in sentiment surveys for the first time since February. The shift in the data was striking and moved up to more than a 20% differential but was still shy of the 30% level that often signals trouble.

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	1.31%	4.60%
S&P 500	2.62%	15.78%
NASDAQ	3.26%	31.35%
RUSSELL 2000	1.32%	8.04%
RUSSELL 1000 GROWTH	3.22%	27.62%
RUSSELL 1000 VALUE	1.98%	4.29%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	2.13%	36.77%
CONSUMER DISCRETIONARY	3.16%	29.87%
CONSUMER STAPLES	2.11%	1.06%
ENERGY	-0.67%	-6.64%
FINANCIALS	1.23%	-1.39%
HEALTHCARE	1.50%	-2.30%
INDUSTRIALS	2.96%	7.82%
INFORMATION TECHNOLOGY	4.45%	41.57%
MATERIALS	3.36%	5.61%
REAL ESTATE	1.60%	2.79%
UTILITIES	1.35%	-3.85%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	2.77%	14.26%
MSCI ACWI EX U.S.	2.32%	11.28%
MSCI EAFE	2.44%	13.15%
MSCI EM	2.26%	8.16%

MAGNITUDE OF THE EQUITY RALLY HAS SURPRISED US (AND MOST OTHERS)

Capital markets are becoming more positive about the economic outlook. The choppy and narrow uptrend in equities has recently solidified and credit spreads have been tightening even as twelve-month fed funds rate expectations have climbed by roughly 100 basis points in the past month. Judging by recent actions, the market thinks the “long and variable lags” from monetary policy tightening to the real economy have already come and gone with the party’s punch bowl still in place.

The macro backdrop should remain relatively benign in the near term, reflecting resilient economic growth, easing headline inflation, and a somewhat less threatening Fed. While a recession seems elusive despite a plethora of leading indicators pointing in that direction, the economic expansion and investment climate are late-cycle, implying that risk exposures should be kept on a shorter-than-normal leash. Another bout of bond market turbulence represents a key risk to the benign near-term investment backdrop, and is inevitable down the road if our macroeconomic and inflation outlook pans out.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.41%	2.43%
BLOOMBERG U.S. CORP HIGH YIELD	0.43%	5.30%
BLOOMBERG U.S. GOV/ CREDIT	0.38%	2.43%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.09%	2.13%

The Fed validated market expectations that it would not hike last week, but the “dot plot” included a 50 basis point increase in the expected fed funds rate by year-end. Chair Powell highlighted that the FOMC is not finished, implying that the markets are overly complacent about the path ahead for U.S. interest rates. The feared “credit crunch” after the mini-banking sector panic in March has also disappeared from the headlines. We reject the notion that another 25 basis point rate hike will occur next month only to be followed by a series of interest rate cuts which is implied by the Fed Funds futures curve. Due to still stubborn inflation (even though it continues to fall), we expect that markets will further unwind the rate cuts discounted for next year. Neither the ECB nor the PBoC followed the Fed’s lead, instead hiking its policy rates by 25 basis points as it grapples with stubborn core inflation.

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	1.72%	2.70%
COMMODITIES (DJ)	4.25%	-4.65%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	1.76%	16.23%
CURRENCIES (DB CURRENCY FUTURE HARVEST)	0.86%	5.23%

While monetary policy remains front and center, equities have captured the limelight over the past few weeks. At the aggregate level, global equities are in an uptrend, and well above a now-rising 200-day moving average, which reinforces the underlying positive momentum. The latest runup has been powered primarily by huge rallies in mega-cap U.S. stocks floating on AI dreams. U.S. mega-caps have been on an incredible tear. The seven largest stocks, which account for some 28% of the S&P 500 market cap, are up approximately 59% year-to-date, compared with a much more pedestrian 4% for the rest of the market. The valuation divergence is equally stark, with the top seven stocks trading at a very rich 5.8x 2024 projected consensus revenues and 28x 2024 projected consensus net income, compared with 1.9x and 16x, respectively, for the rest of the market. Beneath the surface, however, the equity picture is less positive, which complicates investment strategy. The global equal-weighted index has bounced over the past two weeks, but has yet to establish a clear uptrend.

CONCLUSION:

Capital market conditions are likely to remain benign in the near term. Market expectations of central bank rate cuts in the year ahead are likely to continue to get unwound, creating valuation challenges for both stocks and bonds, not to mention profit margin pressures and therefore, earnings estimate risks.

Data from Bloomberg, as of 6/16/2023.

Crossmark Global Investments, Inc. (Crossmark) is an investment adviser registered with the Securities and Exchange Commission that provides discretionary investment management services to mutual funds, institutions, and individual clients. Investment advice can be provided only after the delivery of Crossmark’s firm Brochure and Brochure Supplement Form ADV (Parts 2A and 2B) and Form CRS, and once a properly executed investment advisory agreement has been entered into by the client.

All Investments are subject to risks, including the possible loss of principal. Past performance does not guarantee future results.

Information and recommendations contained in market commentaries and writings are of a general nature and are not intended to be construed as investment, tax or legal advice. These materials reflect the opinion of Crossmark on the date of production and are subject to change at any time without notice. Where data is presented that was prepared by third parties, the source of the data will be cited, and we have determined these sources to be generally reliable. However, Crossmark does not warrant the accuracy of the information presented.

This content may not be reproduced, copied or made available to others without the express written consent of Crossmark.

DD-WKLY-COMM-3.25 06/23