CROSSMARK GLOBAL INVESTMENTS

June 21, 2022
Issue 2.24

DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-4.73%	-16.91%
S&P 500	-5.75%	-22.33%
NASDAQ	-4.76%	-30.72%
RUSSELL 2000	-8.31%	-26.09%
RUSSELL 1000 GROWTH	-5.05%	-30.31%
RUSSELL 1000 VALUE	-6.60%	-15.21%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-4.57%	-31.16%
CONSUMER DISCRETIONARY	-5.53%	-33.61%
CONSUMER STAPLES	-4.24%	-10.51%
ENERGY	-17.10%	34.03%
FINANCIALS	-4.84%	-20.47%
HEALTHCARE	-4.42%	-14.58%
INDUSTRIALS	-5.80%	-18.81%
INFORMATION TECHNOLOGY	-4.89%	-28.52%
MATERIALS	-8.24%	-16.97%
REAL ESTATE	-5.08%	-24.10%
UTILITIES	-9.11%	-8.72%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-5.53%	-21.72%
MSCI ACWI EX U.S.	-4.66%	-18.34%
MSCI EAFE	-4.50%	-19.59%
MSCI EM	-4.34%	-17.33%

SUMMARY:

Stocks were once again sharply lower last week as the S&P 500 had its worst weekly performance since March 2020 (-5.8%). (All sectors were down by at least 4%.) Risk-off sentiment was driven by factors including the Fed-led global monetary policy shift, concerns about policy mistakes, and rising skepticism of a soft landing. "Best" sectors included consumer staples (-4.2%), healthcare (-4.4%), and telecom (-4.6%); worst sectors were energy (-17.1%), utilities (-9.1%), and materials (-8.2%).

KEY TAKEAWAYS:

1. The Federal Reserve raised the Fed Funds rate by 75bps and indicated that it would push rates higher by another 50-75bps at its July meeting. The Fed remains way behind the inflation rate. The rapid adjustment in the expected path for Fed policy brought on by inflation implies that U.S. recession risks have increased.
2. U.S. consumers' short-term and long-term inflation expectations are rising. The risk is that price increases prompt employees to demand higher wages, leading to a wage-price spiral that would cause inflationary pressures to become entrenched.
3. Two policy errors have contributed to our inflation problem: (1) fiscal policy – $2 trillion of fiscal aid in 1Q21 and (2) the Fed failing to recognize that inflation was not transitory. We are concerned that (3) a trillion-dollar tax increase could be passed by the Democrats this summer. (We still think (and hope) the probability of passage is less than 50%.)
4. U.S. retail sales contracted 0.3% in May, which was a modest disappointment. After this release, the Atlanta Fed's Q2 GDP forecast was downgraded to zero from 0.9%.
5. S&P 500 profit estimates have risen 7% so far this year. Our expectation is that profit growth will recede for the balance of this year due to the impact of the slowing economy, a strong dollar, rising rates, and high oil prices.
6. Since the January 3 stock market peak, the S&P 500 forward P/E plunged from 21 ½ to 15 ½ even as forward earnings estimates continued rising to new record highs.
7. We continue to believe that THE bottom in stocks may be some time away, given the likely economic impact from higher rates and tighter financial conditions. That said, evidence of bearishness turning to capitulation has been growing. However, the conditions for A bottom occurred last week, raising the probability of a near-term bounce.
8. With the 10-year Treasury yield rising to 3.5% last week, the percentage of S&P 500 stocks with dividend yields greater than the 10-year fell to 11%, after peaking at 65% in 2020.
9. Energy stocks have finally cracked. This is another good sign in the bottoming process. (The strongest stocks are usually the last ones to decline.)
10. The evidence is mounting that the 2022 midterm election could be a rout for the Democrats. Americans are not pleased with the direction of the country and, of course, are concerned about the economy and inflation.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.94%	-11.50%
BLOOMBERG U.S. CORP HIGH YIELD	-3.09%	-13.27%
BLOOMBERG U.S. GOV/ CREDIT	-0.81%	-12.01%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.00%	0.10%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
FTSE NAREIT (REAL ESTATE)	-6.22%	-23.36%
DJ COMMODITIES	-6.37%	28.20%
RED ROCKS GLOBAL LISTED PRIVATE EQUITY	-8.88%	-35.74%
DB G10 CURRENCY FUTURES	-1.30%	4.09%

THE FED TURNS UP THE HEAT

The Fed validated market expectations last week by hiking its policy rate by 75 bps and reinforcing a more hawkish rhetoric as it seeks to combat inflation. The question is whether or not the Fed's expected policy path will be sufficient to calm inflation in a reasonable timeframe and at what economic cost. We remain broadly constructive about the global economic outlook, but the risk of a recession is rising, and investors should expect capital markets to remain volatile in the near term.

The recent gyrations in global bond markets reflect the ongoing dramatic shift in central bank policy expectations. U.S. government bond yields have spiked higher as the Fed has accelerated its expected rate hikes, and the surge in German and other European yields has been even more pronounced. As we have repeatedly argued, central banks have long been behind the curve. After the upside May CPI surprise, less-hawkish Fed rhetoric will only be credible if supported by core inflation rates. The Fed and other central banks will likely need to be closer to the end of their tightening cycles before bond volatility reverts to historical norms.

Investor anxiety about the economic growth outlook has accompanied the surge in central bank rate expectations. However, in our view, forecasts of recession are still premature at this point, at least in the U.S. While U.S. growth is slowing and inflation is high, the job market is still strong, household and business finances are in good shape, and there are few fundamental excesses that point to a major unwinding over the next year. Housing will be a weak spot but, on its own, will not derail the economic expansion.

China remains an important wildcard. Major economic regions in the country were effectively closed in the second quarter to combat COVID, which dampened global growth and aggravated already elevated global supply bottlenecks. After a brief re-opening, Shanghai and Beijing are under fresh restrictions of unknown duration, thereby delaying/muting an economic rebound. However, we remain hopeful that the economy will shift onto an expansion path over the balance of the year, reflecting sustained re-opening and fresh policy stimulus.

Equities are oversold after slipping into bear market territory last week. Prices will remain highly sensitive to interest rates, with the global forward P/E ratio having declined materially with the rise in global bond yields year-to-date. While equities, in general, will remain sensitive to bond yields, we expect earnings to be the key driver for equity prices in the year ahead. So far, global earnings expectations have held firm, although growth momentum is slowing rapidly, and some warning signs are emerging. Some cautious corporate messaging is consistent with some downgrades in the near term. A further slowdown in earnings growth could trigger an earnings recession scare, as occurred on multiple occasions in the last cycle.

CONCLUSION:

Capital markets remain under duress, with investors uncertain about whether central banks will be able to contain inflation without upending the economic expansion. The challenge for the Fed and other central banks remains formidable, and capital market conditions will likely remain volatile for some time. There is scope for bond yields to calm in the near term; equities are more likely to churn over the next few months (although a near-term oversold rally could develop) and will remain vulnerable until bond markets calm. We continue to recommend a neutral stance on equities, an underweight in bonds, and overweight in cash.

Data from Bloomberg, as of 06/17/2022.

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