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GLOBAL INVESTMENTS

Doll's Deliberations

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SUMMARY:

U.S. equities fell last week (S&P 500 -1.4%) as the S&P 500 broke a five-week streak and the NASDAQ an eight-week streak of gains. Higher-for-longer Fed policy remains a key piece of the bearish narrative. Best sectors were healthcare (+0.2%) and consumer discretionary (-0.0%); worst sectors were real estate (-4.0%) and energy (-3.5%).

KEY TAKEAWAYS:

1. The Conference Board's Leading Economic Indicator (LEI) is now down 14 months in a row, clearly pointing to a recession. While we are not yet in a recession, this indicator is concerning.

2. Housing starts rose a whopping 22% in May, the highest since April 2022.

3. U.S. initial jobless claims rose to 264,000. With profits under some pressure, the labor market remains key to economic activity.

4. Manufacturing data have been weak since 4Q 2022 but services have provided a cushion. There are now cracks forming in the service sector.

5. The fiscal support to the economy was approximately 4% nominal over the last 12 months. That is likely to turn to a 2% drag over the next 12 months, or a 6% swing.

6. For a variety of reasons (including TGA, treasury issuance, and QT), a liquidity drain has begun and is strengthening.

7. The equity rally until last week included AI hype, hope that the Fed will pause, and renewed optimism about the economy.

8. The S&P 500 is trading at 19x estimated earnings vs. 14x on average for the past 20 years. The ten largest are trading at 29x vs. 20x on average.

9. So far in 2023, dividend stocks have had their worst relative performance since 1999.

10. A growing number of China experts warn that Xi Jinping has likely set a timeframe to annex Taiwan.

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-1.67%	2.86%
S&P 500	-1.37%	14.19%
NASDAQ	-1.43%	29.47%
RUSSELL 2000	-1.45%	5.70%
RUSSELL 1000 GROWTH	-1.06%	26.27%
RUSSELL 1000 VALUE	-2.02%	2.18%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-0.76%	35.74%
CONSUMER DISCRETIONARY	-0.02%	29.85%
CONSUMER STAPLES	-0.37%	0.69%
ENERGY	-3.45%	-9.86%
FINANCIALS	-2.02%	-3.38%
HEALTHCARE	0.26%	-2.05%
INDUSTRIALS	-1.64%	6.05%
INFORMATION TECHNOLOGY	-2.02%	38.71%
MATERIALS	-1.94%	3.56%
REAL ESTATE	-3.96%	-1.28%
UTILITIES	-2.59%	-6.34%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-1.25%	12.78%
MSCI ACWI EX U.S.	-2.16%	9.39%
MSCI EAFE	-1.98%	11.40%
MSCI EM	-2.71%	5.90%

THE HIGH WIRE ACT CONTINUES

The rate-hiking cycle has been aggressive versus recent decades, and the massively inverted U.S. yield curve has been signaling recession for some time. The broad and deep bear market in global risk assets in 2022, the downshift in global PMI manufacturing indexes to below their boom/bust lines this year, and signs of a possible U.S. banking crisis in March seemed to cement the case for recession. The recession view plus the rolling over in inflation was widely seen as pointing to an end to rate hikes, with subsequent rate cuts to follow.

Instead, the global economy has stayed resilient and risk asset markets have rallied in 2023, and in fact have even gained some upside momentum in the past month or so. Moreover, core and underlying measures of inflation, along with wage growth, have not followed the disinflation script and have stayed sticky. As a result, the FOMC, despite pausing earlier this month, lifted its terminal rate for the fourth time this year, signaling that more hikes loom. The new dot plot showed that a majority of participants now expect the policy rate to rise by another 50 basis points by year-end.

There is now increasing evidence that central banks have not yet pushed monetary conditions into restrictive territory. The persistence of strong labor demand in the face of considerably higher rates in developed economies reflects solid underlying corporate profitability, and refutes sentiment polls that indicate significant pessimism about the future. The implication is that monetary conditions will ultimately have to tighten by more and for longer than the consensus has been expecting.

Inflation will ultimately drive the policy and business cycles. The U.S. inflation and wage outlook is already deviating from the FOMC's projection by proving more resilient. While U.S. policy rates and bond yields are up considerably from their prior low levels, it is possible they still not restrictive. The implication is that any policy pause will prove temporary, and monetary conditions will need to tighten until hiring plans weaken and there are greater odds for sustainably lower core inflation.

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FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.21%	2.00%
BLOOMBERG U.S. CORP HIGH YIELD	-0.52%	4.76%
BLOOMBERG U.S. GOV/ CREDIT	-0.13%	2.09%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.09%	2.22%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-3.24%	-0.66%
COMMODITIES (DJ)	-2.56%	-7.09%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-3.51%	11.61%
CURRENCIES (DB CURRENCY FUTURE HARVEST)	0.09%	5.32%

CONCLUSION:

Investors should maintain tactical risk-on positions but with tight stops. The choppy risk-on backdrop should persist until a bond market sell-off returns. The economic backdrop, particularly the strength in hiring intentions warns that inflation is going to remain well above pre-pandemic levels for the foreseeable future.

Data from Bloomberg, as of 6/23/2023.