CROSSMARK GLOBAL INVESTMENTS

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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	5.39%	-12.43%
S&P 500	6.46%	-17.31%
NASDAQ	7.51%	-25.52%
RUSSELL 2000	2.77%	-23.31%
RUSSELL 1000 GROWTH	7.94%	-24.78%
RUSSELL 1000 VALUE	5.31%	-10.71%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	7.00%	-26.35%
CONSUMER DISCRETIONARY	8.25%	-28.13%
CONSUMER STAPLES	6.57%	-4.62%
ENERGY	-1.55%	31.95%
FINANCIALS	5.14%	-16.38%
HEALTHCARE	8.17%	-7.60%
INDUSTRIALS	4.24%	-15.36%
INFORMATION TECHNOLOGY	7.30%	-23.30%
MATERIALS	2.70%	-14.72%
REAL ESTATE	7.79%	-18.19%
UTILITIES	7.24%	-2.12%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	2.16%	-20.20%
MSCI ACWI EX U.S.	0.24%	-18.97%
MSCI EAFE	0.81%	-19.99%
MSCI EM	-0.79%	-18.26%

SUMMARY:

Stocks advanced sharply last week (S&P 500 +6.5%), largely reversing the decline of the prior week. The rally stemmed from a technically oversold condition and some evidence that inflation might be peaking. Best performers were consumer discretionary (+8.3%) and healthcare (+8.2%); worst performers were energy (-1.6%) and materials (+2.7%).

KEY TAKEAWAYS:

1. Fed Chair Jerome Powell conceded that the Fed's recent moves to fight inflation could cause a recession.
2. The recent decline in the price of copper and oil suggests that inflationary pressures and expectations may be abating.
3. We expect core U.S. inflation to fall to 4-5% even in the absence of recession. However, a recession and associated labor market weakness are likely required to move inflation from 4% back to the Fed's 2% target.
4. Business confidence in the U.S. has collapsed this year. The war in Ukraine, lockdowns in China, inflationary pressures, prolonged supply chain disruptions, and tight labor market conditions are weighing on businesses.
5. It seems as though earnings estimates are too high even in the event a recession is avoided. 72 companies have issued negative guidance for Q3. This is the highest number since 4Q19.
6. A case can be made that lower multiples as a result of higher inflation are priced in, but it is far more difficult to make the same claim about earnings and earnings guidance. Earnings growth for the second quarter is estimated to be 5.6%, implying further profit margin compression.
7. The Bull/Bear Ratio of 0.60 is the lowest reading since March 2009, which was when the last bear market bottomed.
8. The aggressive sell-off in growth stocks vs. value stocks has brought relative valuations for growth and value stocks closer to neutral.
9. Small-cap stocks now trade at a 2 multiple-point discount vs. a 3-point historical premium.
10. The U.S. dollar has discounted both stronger relative growth and widening interest rate differentials and is now being propped up by safe-haven flows due to global recession fears and a severe risk-off phase. With the currency overvalued and overbought, vulnerability exists at some point in the second half of the year.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.85%	-10.73%
BLOOMBERG U.S. CORP HIGH YIELD	-0.02%	-13.11%
BLOOMBERG U.S. GOV/ CREDIT	0.78%	-11.28%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.03%	0.13%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	4.67%	-19.15%
COMMODITIES (DJ)	-4.28%	22.72%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	1.41%	-34.36%
CURRENCIES (DB G10 CURRENCY FUTURE)	-0.18%	3.90%

SLOWING ECONOMY FOR SURE – WILL IT BE A SOFT LANDING OR A RECESSION?

Investors and policymakers were far too complacent last year about the inflation outlook. The worst bond rout in many decades has been painful as central banks are now talking hawkishly about trying to return inflation to 2%. In turn, equities are now front-running a recession. They have not waited for the traditional signs of deteriorating growth or even a move in policy rates and bond yields to restrictive levels. The endpoint of policy actions is assumed to be a recession within a year. It will be extremely challenging for policymakers to significantly lower inflation without generating a meaningful economic slowdown. However, there should be some countertrend moves along the way as cracks in many commodity markets are developing, which could ease some of the inflation angst and reduce the economic headwind.

A recession could eventually develop if central banks do not moderate their bearish message after a few more rate hikes and/or bond market yields rise to economically-damaging levels. While the rise in nominal yields has been unprecedented, real yields remain historically low. We doubt central banks will risk pushing their economies over a cliff. Therefore, there is a good chance for a rebound in equities if central bank rhetoric becomes less hawkish. The recent pause in bond yields persists, as we still believe there is less than a 50% chance of a recession given the current interest rate expectations and healthy household and corporate finances in the U.S. and euro area.

Equity sentiment has swung from very positive to pessimistic in the past six months or so. Equity prices are already discounting at least a shallow recession, based on the magnitude of the decline. This underscores the potential for an equity rebound if the economy continues to grow, albeit at a much slower pace. It is also notable that forward corporate earnings expectations have held up, although there could be some downgrades in the near term. The entrenched nature of inflation in many economies makes us cautious on a longer-term basis. However, a signal from the Fed that they do not want to shift to outright restrictive territory and a sustained pause in the uptrend in bond yields should reduce current economic and equity market pessimism. This, in turn, should spur a furthering of the current bear market equity rally.

Global PMI surveys have historically provided useful coincident signals of resilience or recession. Last week's PMI flash updates for most countries confirmed that the spike in borrowing rates and energy price headwinds are having a negative impact but have not yet been terminal. Growth in the coming months will be less than otherwise if interest rates and energy prices had not soared, but the impact of both has been to moderate what was going to be quite strong growth this year.

CONCLUSION:

The outlook for the next few years is not supportive of significant financial asset returns, given the likelihood that inflation will prove sticky and hold well above central banks' targets. Nevertheless, there are good odds for a sustained pause in the uptrend in bond yields and rate expectations. Economic growth is moderating, and industrial commodity prices are correcting, which will help temporarily ease some inflation angst. Equity markets are oversold and are discounting at least a mild recession and thus should benefit from a pause in bond yields and the likelihood that economic conditions will prove resilient.

Data from Bloomberg, as of 06/24/2022.

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