CROSSMARK
GLOBAL INVESTMENTS

Doll's Deliberations

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SUMMARY:

Stocks were higher (S&P 500 +1.8%) for a third straight week (NASDAQ was up six weeks in a row). Equities advanced on the passage of the debt ceiling bill and further support for a soft landing. Best sectors were consumer discretionary (+3.3%) and real estate (+3.1%); worst sectors were consumer staples (+0.3%) and utilities (+0.8%).

KEY TAKEAWAYS:

1. The May non-farm payroll report was, on balance, strong. Payrolls increased by 339,000, but the unemployment rate increased from 3.4% to 3.7%.

2. Fed funds futures are now pricing in another rate HIKE at one of the next couple of Fed meetings as the job market and inflation remain stubbornly strong.

3. The fiscal drag from the debt ceiling bill is likely to reduce FY 24 growth by 0.25% and up to 0.40% in FY 25.

4. With the debt ceiling issue now behind us, the hard work of the budget is still ahead of us and the longer the work is postponed, the harder a fix becomes. At some point, social security, Medicare and Medicaid will have to be reformed.

5. There have been nine recessions since 1960. All have been preceded by yield curve inversions. The median lead time has been eleven months (which is where we are now), in a range of 7-21 months. We continue to believe a mild recession is likely.

6. Even though the S&P 500 has been grinding higher, the equal-weighted index is down year-to-date. Poor breadth rallies are generally not sustainable.

7. The liquidity backdrop changed with the debt ceiling deal completed which usually means equities struggle, the S&P 500 outperforms the NASDAQ, and value beats growth (obviously the opposite of year-to-date action).

8. Copper prices and most other commodities have fallen, extending the downtrend that started in late January, a signal for investors that cyclical stocks are likely to underperform defensives.

9. The bull arguments are that we have had a rolling recession, the Fed is done, earnings are better than expected, and AI will provide productivity gains.

10. The bear arguments include stretched valuations, a coming recession, an uncertain banking system, a not-finished Fed, and narrow breadth.

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	2.17%	2.89%
S&P 500	1.88%	12.37%
NASDAQ	2.07%	27.01%
RUSSELL 2000	-0.24%	1.02%
RUSSELL 1000 GROWTH	2.08%	23.78%
RUSSELL 1000 VALUE	1.95%	1.22%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	1.12%	34.47%
CONSUMER DISCRETIONARY	3.39%	22.88%
CONSUMER STAPLES	0.38%	-0.54%
ENERGY	1.37%	-7.66%
FINANCIALS	2.20%	-3.64%
HEALTHCARE	2.19%	-3.69%
INDUSTRIALS	2.66%	3.26%
INFORMATION TECHNOLOGY	1.39%	36.44%
MATERIALS	3.10%	1.61%
REAL ESTATE	3.10%	0.39%
UTILITIES	0.85%	-6.96%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	0.04%	8.80%
MSCI ACWI EX U.S.	-0.62%	5.91%
MSCI EAFE	-0.45%	8.31%
MSCI EM	-1.09%	1.40%

MIXED SIGNALS = UNCERTAINTY AND CONFUSION

There are decidedly mixed signals regarding the economic outlook highlighting investor uncertainty, while the reverberations from the pandemic, associated policy responses, and subsequent recovery continue to reverberate across the global economy and capital markets and complicate investment strategy. Having benefitted during the pandemic, manufacturing and trade are now weak, while services are strong. Equity benchmarks are in uptrends, and speculation about AI-related stocks has reached a fevered pitch, but the average stock is lagging badly. Credit spreads are well behaved, while oil prices and many industrial materials have weakened.

Core inflation is likely to remain sticky and, therefore, market expectations of significant interest rate cuts by the Fed in the year ahead are unlikely to be validated. There are few signs of recession, although many indicators continue to point in that direction. Either way, overall macro conditions are late-cycle given already tight labor markets and low unemployment, elevated corporate profits, and in the case of the U.S., richly-priced equities. Late-cycle conditions warrant a comparatively short-leash on risk and an overweight on cash, which we continue to recommend, especially given current high cash yields. Late cycle conditions are typically difficult to navigate, even more so in current circumstances given the distortions associated with/caused by the pandemic and the Ukraine war. Such conditions put a premium on tactical flexibility.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	1.47%	2.69%
BLOOMBERG U.S. CORP HIGH YIELD	0.61%	3.96%
BLOOMBERG U.S. GOV/ CREDIT	1.34%	2.78%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.09%	1.90%

Core inflation will be stubborn and bond yields may eventually move higher as the market unwinds expected Fed rate cuts in the year ahead. Higher bond yields, in turn, would likely dampen equity valuations, especially for growth stocks. Global trade growth reflects the unique character of the pandemic and re-opening. Trade growth has slowed sharply over the past year, albeit from an unsustainably high rate, as final demand has shifted from trade-oriented goods to domestic-oriented services.

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	1.06%	-2.28%
COMMODITIES (DJ)	-0.15%	-9.66%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	0.92%	8.95%
CURRENCIES (DB CURRENCY FUTURE HARVEST)	0.77%	4.07%

Global equities remain in the mild uptrend that began last October, but momentum in key markets has recently stalled and relative performance has shifted back to the U.S. over the past month as investors have plowed into beneficiaries of accelerating AI potential. We expect these shifts to prove temporary, but overall and regional relative equity market performance will likely be choppy in the coming months. The shift in performance of small caps has been pronounced after outperforming their large-cap counterparts for most of 2022, but they have given back all those gains and more. Excluding 2020, small caps are at a 13-year relative low. Value stocks, which decisively outperformed growth stocks in 2022 have markedly underperformed so far this year. Underscoring the narrowness of the equity uptrend, only about one-half of all stocks in the Bloomberg World Index are up year-to-date and only about one-third are up in the past month.

CONCLUSION:

Until a notable slowing in economic and employment surfaces, stocks are likely to remain firm. Eventually a slowing economy, disappointing earnings, and high valuations will threaten the equity uptrend.

Data from Bloomberg, as of 6/2/2023.

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