CROSSMARK GLOBAL INVESTMENTS

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Doll's Deliberations

Weekly Investment Commentary

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Summary:
Equities fell last week (S&P 500 -0.2%) with notable weakness in mega-cap tech. The focus was on the February payroll report and Fed Chair Powell's congressional testimony. Best sectors were utilities (+3.3%) and materials (+1.6%); worst sectors were consumer discretionary (-2.5%) and technology (-1.1%).

Key takeaways:

1. February payrolls grew 275,000 (vs. 200,000 expected) BUT, the last two months were revised down 167,000 – so, not a great report . The unemployment rate rose from 3.7% to 3.9% (vs. a low of 3.5% last April). A 0.5% increase from the low (i.e., 4.0%) has always resulted in a recession.
2. Fed Chair Jerome Powell was very reassuring during his congressional testimony. He said the economy is fine, inflation is moderating, interest rates have probably peaked, and the Fed is likely to lower interest rates but won't rush to do so.
3. According to Piper Sandler, consumers have spent all of their Covid stimulus money, and are now into core savings to fuel consumption that exceeds incomes. That's simply not sustainable, and points to eventual economic weakness.
4. 4Q earnings came in at 9.8% (short of the October 1 estimate, but above the January 1 expectation). 2024 and 2025 consensus S&P 500 EPS estimates are $244 (up 11%) and $276 (+13%). For reference, 2022 and 2023 actuals were +5% and +0.5%, respectively.
5. Stocks are likely to push higher until either economic data signals a significant slowdown ahead or inflation looks sticky enough to keep the Fed from cutting much.
6. Reminder: The S&P 500 has increased in every presidential election year since 1944.
7. Deglobalization is costly – higher cost of doing business, potential supply chain disruption, and greater defense spending.
8. The Japanese stock market hit an all-time high at the end of 1989. It then began to fall and it took until February 22nd (34 years later) to reach this level again. The period was accompanied by the collapse of a colossal property bubble and was followed by decades of economic stagnation, rising government debt and periodic deflation.
9. Federal Government largesse in this election year includes deficit spending to the tune of 7% of GDP (along with some debt cancellation, reduced supply of Treasury issuance, and multi decade low in the Strategic Petroleum Reserve).
10. Now that the two parties have essentially chosen their nominees, we expect a highly partisan, nasty and negative campaign from both sides. Neither candidate will address the emerging U.S. fiscal crisis.

EQUITY MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
DJIA	-0.85	3.21
S&P 500	-0.23	7.73
NASDAQ	-1.15	7.31
RUSSELL 1000	0.43	8.15
RUSSELL 1000 GROWTH	-1.27	9.23
RUSSELL 1000 VALUE	1.12	5.40
RUSSELL 2000	0.44	3.07

S&P EQUITY SECTORS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-0.65	10.86
CONSUMER DISCRETIONARY	-2.53	2.63
CONSUMER STAPLES	0.95	4.84
ENERGY	1.25	5.34
FINANCIALS	0.84	8.01
HEALTHCARE	0.08	7.45
INDUSTRIALS	0.66	7.37
INFORMATION TECHNOLOGY	-1.07	11.27
MATERIALS	1.63	4.41
REAL ESTATE	1.55	0.31
UTILITIES	3.30	0.63

Priced for Perfection?

Equities have benefitted from investors upgrading their economic and earnings growth estimates after the consensus was too cautious at the start of the year. This upward revision to growth expectations is positive and has supported "risk-on" sentiment. However, if firmer economic activity continues, it will eventually threaten stocks via higher bond yields, thereby creating pressure on valuation.

While the Fed may be intent on lowering policy rates, the U.S. economy does not require easier policy at the moment. Broad-based strength in nearly all risk asset markets (including equities, fixed income spread products and cryptocurrencies) is signaling that the world is flush with liquidity. Bond investors will need to further unwind rate cut expectations. Inflation is likely to bottom well above the Fed's 2% target. (There is even some, albeit small, discussion emerging that the Fed may be forced to consider rate hikes later this year or in 2025, rather than the widely anticipated cuts.)

The U.S. economy continues to experience above-trend GDP growth, the trade cycle is firming (and boosting non-U.S. economies), labor markets remain historically tight, there is limited spare capacity, and inflation compensation increases are surprisingly low. In addition, fiscal deficits are elevated. So, the aggregate cost of capital is not high enough to undermine economic growth, corporate profits, or risk asset prices. It will likely have to go higher before economic expansion ends. Thus, either the Fed or bond investors respond to robust economic growth conditions or higher consumer price inflation will eventually force interest rates and/or bond yields upward. The U.S. economy will likely moderate some after two quarters of robust growth, and inflation is likely to ease modestly further as shelter inflation comes down. This comes at a point when the bond market has now priced out three Fed rate cuts for this year.

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN) (%)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	0.83	6.58
MSCI ACWI EX U.S.	1.52	3.76
MSCI EAFE	1.90	5.19
MSCI EM	0.57	0.84

FIXED INCOME MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.68	-0.63
BLOOMBERG U.S. CORP HIGH YIELD	0.43	0.90
BLOOMBERG U.S. GOV/ CREDIT	0.63	-0.59
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.06	0.96

ALTERNATIVES (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	0.51	-1.64
COMMODITIES (DJ)	0.91	0.37
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	0.80	4.60
CURRENCIES (DB CURRENCY FUTURE HARVEST)	-0.10	4.34

The dramatic rally in U.S. mega-cap technology-related stocks has significantly concentrated risks for investors. The magnificent seven alone now account for 28% of total capitalization of the U.S. equity market, while the broader information technology sector accounts for 30% which is the highest since the dot-com bubble of the late 1990s. In addition, the U.S. now accounts for 64% of total global equity market capitalization, which surpasses its peak in the early 2000s as well as that of Japan in 1989. In short, the equity market has become increasingly reliant on the performance of a small number of stocks, which some argue have been priced for perfection.

Conclusion:

Increased selectivity is warranted when putting fresh money to work. We do not recommend chasing U.S. mega-cap growth stocks. Instead, seek diversification in other parts of the market that have better valuation support and lower earnings bars to climb.

Data from Bloomberg, as of 3/8/2024.