CROSSMARK GLOBAL INVESTMENTS

March 21, 2022
Issue 2.11

DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	5.53%	-3.89%
S&P 500	6.19%	-6.05%
NASDAQ	8.20%	-11.05%
RUSSELL 2000	5.43%	-6.86%
RUSSELL 1000 GROWTH	8.36%	-11.03%
RUSSELL 1000 VALUE	4.39%	-1.41%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	5.80%	-12.96%
CONSUMER DISCRETIONARY	9.28%	-10.60%
CONSUMER STAPLES	3.94%	-3.50%
ENERGY	-3.58%	33.70%
FINANCIALS	7.18%	-0.06%
HEALTHCARE	6.30%	-2.71%
INDUSTRIALS	5.04%	-2.72%
INFORMATION TECHNOLOGY	7.88%	-10.72%
MATERIALS	5.23%	-4.98%
REAL ESTATE	2.95%	-8.81%
UTILITIES	0.56%	-0.99%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	5.76%	-6.80%
MSCI ACWI EX U.S.	4.73%	-6.88%
MSCI EAFE	5.60%	-7.26%
MSCI EM	3.50%	-8.59%

SUMMARY:

U.S. stocks had their best week since November 2020, with the S&P 500 +6.2%. Oil fell for the second week in a row. The themes cited included oversold conditions, depressed sentiment, cooling commodities, overstated recession fears, and China's statements about market support. The best sectors were consumer discretionary (+9.3%), technology (+7.9%), and financials (+7.1%); the only sector closing down was energy (-3.6%).

KEY TAKEAWAYS:

1. The FOMC voted to raise Fed Funds to 25bp and signaled additional rate hikes in 2022. The default path would be 25bp at each of the remaining six meetings.
2. According to Strategas' analysis, S&P 500 performance since 1994 following a first rate hike is -3.3% three months later and +3.8% six months later.
3. U.S. consumer one-year ahead inflation expectations increased from 5.8% to 6.0%. The rate three years ahead increased to 3.8%.
4. Russia's military campaign is experiencing setbacks as it is starting to lose the economic war launched by the West in retaliation.
5. A proposed deal between Russia and Ukraine would likely include a cease-fire, the Ukrainian government declaring neutrality, Ukraine accepting limits on its armed forces, eastern provinces annexed to Russia, and Putin's forces withdrawing from the rest of the country.
6. China's top economic official assured policymakers to implement measures to stimulate the Chinese economy and support capital markets. This was a big positive for markets last week.
7. A new world order is emerging that is negative for globalization and economic growth. As a cold economic war develops, China and Russia are emerging vs. the West.
8. We believe near-term recession risk remains low, which means an equity recovery is likely to post the war and before a recession.
9. A tumultuous market makes rapid moves in both directions without ultimately going anywhere. That has been our view since the beginning of the year and remains our view.
10. One of the unintended consequences of the quantitative easing era (which has ended) has been a plethora of companies that consistently fail to produce profits. This has therefore been a difficult time for active managers. In a "normal" business cycle, higher interest rates and an increasing cost of capital for marginal companies would lead to either failure or consolidation.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.39%	-5.16%
BLOOMBERG U.S. CORP HIGH YIELD	0.51%	-5.06%
BLOOMBERG U.S. GOV/ CREDIT	-0.32%	-5.65%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.00%	0.02%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
FTSE NAREIT (REAL ESTATE)	2.49%	-7.59%
DJ COMMODITIES	-2.10%	25.46%
RED ROCKS GLOBAL LISTED PRIVATE EQUITY	6.74%	-15.33%
DB G10 CURRENCY FUTURES	1.86%	5.89%

RUMORS OF WAR NEGOTIATIONS, LOWER OIL PRICES, AND PREDICTABLE FED LIFT STOCKS

News from the Russia-Ukraine war continues to cause wild swings in the global financial markets, with a few hopeful signs finally appearing last week despite a still worrisome backdrop. We are expecting no worse than a temporary economic fallout from the war. If correct, the conditions for a rebound in oversold equity markets will develop since many risk assets are priced for a significant growth slowdown. It is notable that even though the euro area is extremely vulnerable to economic fallout from the war, regional government bond yields have rebounded solidly after a brief dip and are at new highs for the cycle. That said, the level of yields is still depressed and inconsistent with even a muted economic recovery. While the immediate impact of the war has been a hit to economic sentiment, it will also boost reported inflation through various channels. If war tensions ease in the next month or two, as we expect, regional economic prospects will stay upbeat, and the cyclical outlook for inflation will become progressively more problematic for the ECB.

The stampede into perceived safe havens has also shown signs of cresting. Oil prices are off their highs, gold prices have declined, and the U.S. dollar has churned in the past week. The FOMC delivered its first rate hike for the cycle, and expectations are for six more hikes this year, which will provide some support to the dollar. However, if the non-U.S. economic outlook improves down the road as we expect, then we would anticipate that the dollar will eventually retreat, opening the door for other currencies and equity markets to outperform the U.S.

We expect the focus of investors (and policymakers) will soon return to the primary pre-war cyclical risk factor that was driving global financial markets, namely the inflation outlook. Inflation holds the key as to whether a long business cycle will unfold, as occurred in the past four decades with occasional bumps along the way, or if conditions will warrant monetary policy becoming restrictive in the coming two years, resulting in a short expansion. U.S. inflation is at its highest level in several decades. While much of the focus has been on the surge in goods prices and ongoing supply shortages, this misses the more important uptrend in service sector inflation. For policymakers, the sluggish pace of wage gains in recent decades had provided a strong headwind to inflation and inflation expectations. The recent uptrend in wages has gained a powerful head of steam in the past year or so. The risk is that a self-reinforcing cycle of price increases and higher inflation expectations and wages becomes entrenched, to the point where it will necessitate a recession to bring them under control.

We expect the debate to increasingly shift to whether companies can continue to pass on higher input costs (including labor) to support profit margins, which will act to boost inflation (and is bearish for bonds, while putting downward pressure on risk asset valuations), or whether the business sector suffers an erosion in profit margins to the detriment of equities, and eventually, the business cycle. Margins are historically high, so it would probably take a long time before profits are squeezed to the point where a recession occurs.

CONCLUSION:

We remain modestly constructive on equities, especially into weakness, expecting that the economic fallout of the Russia-Ukraine war will prove temporary, including in the most vulnerable euro area economy. If so, we anticipate a further correction in recent favored "safe havens" and rebound in equities given oversold conditions and the sudden shift towards economic pessimism. Meanwhile, the poor inflation outlook warrants maintaining an underweight in bonds.

Data from Morningstar Direct, as of 03/21/2022.

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