CROSSMARK GLOBAL INVESTMENTS

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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	0.31%	-3.60%
S&P 500	1.81%	-4.35%
NASDAQ	1.99%	-9.28%
RUSSELL 2000	-0.38%	-7.22%
RUSSELL 1000 GROWTH	1.71%	-9.50%
RUSSELL 1000 VALUE	1.59%	0.15%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	2.15%	-11.09%
CONSUMER DISCRETIONARY	1.07%	-9.64%
CONSUMER STAPLES	1.47%	-2.08%
ENERGY	7.42%	43.63%
FINANCIALS	1.67%	1.61%
HEALTHCARE	-0.21%	-2.91%
INDUSTRIALS	1.15%	-1.60%
INFORMATION TECHNOLOGY	2.35%	-8.62%
MATERIALS	4.12%	-1.06%
REAL ESTATE	0.37%	-8.47%
UTILITIES	3.49%	2.47%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	1.19%	-5.69%
MSCI ACWI EX U.S.	0.34%	-6.56%
MSCI EAFE	0.19%	-7.09%
MSCI EM	0.22%	-8.39%

SUMMARY:

Stocks finished higher again last week (S&P 500 +1.8%). The biggest story discussed was the hawkish Fed policy shift (lots of discussion around 50bp Fed hikes), pushing bonds lower and stocks higher. Earnings discussions were generally upbeat. Best sectors were energy (+7.4%) and materials (+4.1%); worst sectors were healthcare (-0.2%) and REITs (+0.4%).

KEY TAKEAWAYS:

1. Preliminary PMI releases for March indicate that economic activity remains resilient while the Ukraine crisis is a headwind (particularly for the Eurozone). Robust private sector demand supports the outlook for earnings this year.
2. Economic growth forecasts and earnings growth estimates are likely to be downgraded, which could act as a cap to equity progress.
3. We do not think the probability of a recession in 2022 is very high due to (1) the Fed is nowhere near punitive, (2) consumers are flush with cash, (3) business inventory levels are not problematic, and (4) U.S. oil producers benefit as much as oil consumers are hurt from higher oil prices.
4. The surge in yields across the Treasury curve reflects Fed Chair Powell's increasing acknowledgment that inflation will be persistent and his implicit admission that the FOMC is woefully behind the curve.
5. Fed Chair Powell indicated a 50bp rate hike is on the table for May, that he is willing to deal with a not-so-soft landing to slow inflation, and that he is done with waiting for the supply side to right itself.
6. The S&P 500 is up 10% from its February 24 beginning of war trough reducing year-to-date losses to 6%. As we suggested in our late February/early March commentaries, there is a chance that February 24 4115 S&P 500 could be the low for 2022.
7. The strong rally we have seen in equities has been driven by (1) hopes for a Russia/Ukraine resolution, (2) the China State Council's pledge to support growth, and (3) an asset allocation rotation out of fixed income and into equities as interest rates spiked.
8. Equity buybacks in 2021 set a record at $882 billion and continue strong in 2022.
9. While there is no deal yet, Russian forces have stalled and are nearly out of food, water, and fuel, and missile failures are widespread.
10. Globalization is becoming unglued due to various recent developments, including Trump's trade wars, the COVID-19 pandemic, the Cold War between the U.S. and China, the hot war between Ukraine and Russia, and the resulting sanctions imposed on Russia by the West.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-1.82%	-6.89%
BLOOMBERG U.S. CORP HIGH YIELD	-0.64%	-5.68%
BLOOMBERG U.S. GOV/ CREDIT	-1.76%	-7.32%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.01%	0.03%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
FTSE NAREIT (REAL ESTATE)	0.45%	-7.17%
DJ COMMODITIES	4.92%	31.63%
RED ROCKS GLOBAL LISTED PRIVATE EQUITY	-2.26%	-17.24%
DB G10 CURRENCY FUTURES	1.75%	7.74%

FED RATCHETS DIALOGUE UP A NOTCH; WILL ACTIONS FOLLOW?

Last week, Fed Chair Powell pivoted again by sounding considerably less dovish. Perhaps he concluded that the Fed had still not grasped how entrenched rising inflation had become and the significant amount of policy steps it faces in trying to return to a 2% inflation world. It is hard to reconcile his words with the fact that the fed funds rate is still only 25bps, and the FOMC continues to expect the policy rate to peak only in the 2.5% area this cycle. The Fed and perhaps bond investors may not comprehend that monetary conditions and the Treasury market are far from becoming restrictive. The forward markets are priced for a considerable number of rate hikes in the next year, but such increases will still leave nominal rates far below nominal GDP growth, and real rates will remain negative. The longer the lag before the Fed catches up, the higher policy rates will ultimately climb and the harsher the eventual economic fallout. We remain cyclically bearish on bonds but acknowledge that conditions are becoming technically quite stretched. A pause in the yield uptrend or even a temporary countertrend decline is possible, if not likely. This would be consistent with our view that the cycle will play out in a series of waves, with higher peaks and troughs in yields along the way.

The positive offset for equities has been strong earnings and resilient profit margins despite surging input costs. After the big equity rally off the war breakout low a month ago, we are somewhat cautious even though we expect the Russia-Ukraine war to soon shift away from escalation towards a negotiated stalemate and that related sanctions will not undermine the euro area economic expansion. The path to a restrictive policy stance has begun and will, ultimately, end poorly for all markets. Outright restrictive monetary conditions are not likely this year. The overall cyclical investment backdrop will become progressively more difficult, although the transition from a bearish bond environment to a bearish equity and credit environment will take time. Euro area equities will suffer some earnings downgrades in the near term, but the underlying cyclical earnings uptrend should persist, and relative valuations are compelling.

A risk in the U.S. is that a durable self-reinforcing inflation cycle develops, as tightening labor markets, ample income and savings, and high corporate profit margins generate rising inflation expectations and higher measured inflation. The Fed and bond bulls have been wary of embracing this outcome. The pandemic and resulting in unprecedented policy response have boosted economic uncertainty, but the underlying assumption has been that economic strength and the spikes in prices would prove temporary. We have disagreed with this view and expect a very different inflation outcome than during the past four decades. Higher inflation has not just been in goods prices related to temporary strong demand and supply woes. Rather, service sector inflation has also increased despite the sector still operating well below normal levels. Wage gains also are spreading. Central bank words will ultimately have to be matched by actions, and the outcome will not be positive for global financial markets.

CONCLUSION:

The near-run outlook is uncertain given the ongoing Russia-Ukraine war. Before March, the world economy, particularly the euro area, was accelerating, and this head of steam should remain intact. An easing in geopolitical tensions would reduce anxiety about the economic outlook, although it will also open the door to central bank rate hikes given the worsening inflation picture. The positive corporate earnings outlook should allow many equity markets and sectors to grind ahead but against a backdrop of downward pressure on P/E ratios. A rotation out of the U.S. dollar and stocks in favor of select non-U.S. plays awaits clarity on the global growth outlook.

Data from Morningstar Direct, as of 03/28/2022.

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