CROSSMARK
GLOBAL INVESTMENTS

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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-2.47%	-8.73%
S&P 500	-3.26%	-12.92%
NASDAQ	-3.92%	-21.00%
RUSSELL 2000	-3.94%	-16.69%
RUSSELL 1000 GROWTH	-3.25%	-20.03%
RUSSELL 1000 VALUE	-3.33%	-6.34%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-4.09%	-25.68%
CONSUMER DISCRETIONARY	-7.88%	-20.85%
CONSUMER STAPLES	-2.05%	1.53%
ENERGY	-1.23%	36.89%
FINANCIALS	-4.53%	-11.21%
HEALTHCARE	-2.51%	-7.16%
INDUSTRIALS	-3.31%	-9.71%
INFORMATION TECHNOLOGY	-1.26%	-18.70%
MATERIALS	-0.82%	-5.78%
REAL ESTATE	-5.65%	-9.56%
UTILITIES	-4.05%	0.32%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-2.63%	-12.94%
MSCI ACWI EX U.S.	-1.57%	-11.38%
MSCI EAFE	-2.20%	-12.00%
MSCI EM	0.08%	-12.15%

SUMMARY:

Equities were sharply lower last week (S&P 500 -3.3%) as stocks made their lowest close of the year. The week was capped off by a big Friday selloff. Some suggest risks are skewed toward a near-term rally given factors, including weak sentiment, low positioning, and oversold conditions. Treasuries were little changed, pausing after the big backup in yields over recent weeks. Best sectors were materials (-0.8%) and technology (-1.3%); worst sectors were consumer discretionary (-7.9%) and REITs (-5.7%).

KEY TAKEAWAYS:

1. The 1Q real GDP report in the U.S. of -1.4% was weaker than expected. There should be a bounce-back in 2Q as trade and inventories normalize.
2. It's virtually a given that the FOMC will raise the funds rate by 50bps on Wednesday, something that has not happened in 22 years. Powell's tone at the press conference is likely to remain fairly hawkish – the FOMC is determined to see a decline in inflation.
3. The transition away from quantitative easing to quantitative tightening may be the most significant change to the financial markets in a generation. While we think a likely resolution of some supply chain issues and a slowdown in global growth should ease inflationary pressures starting soon, there are specific secular forces – wages, rents, and a structural shortage of oil, gas, and industrial metals – that we believe will be stubborn keeping inflation above 4% this year.
4. The ability of the Fed to lower inflation to 2% without increasing the unemployment rate is low. In past cycles, bad things have happened when they have increased the unemployment rate. It is almost impossible to get inflation to 2% without a recession.
5. Without the job market weakening, a recession in the U.S. would be a first, and the U.S. labor situation still looks strong (jobless claims, payrolls, unemployment).
6. Half the S&P 500 has reported earnings with 75% beating 1Q expectations. Earnings have surprised to the upside by 5.0%, another excellent result.
7. The 10-year Treasury yield rose from 1.51% at the start of the year to peak at 2.94% on April 19, while the S&P 500's forward P/E fell from about 21.0x at the beginning of this year to less than 18x, the lowest since April 2020.
8. The percentage of stocks in the S&P 500 with a yield higher than the 10-year Treasury yield peaked at the pandemic low at 82%. Today it is 21%, the lowest in over a decade.
9. Nearly 100% of utilities had a yield higher than the 10-year Treasury in the middle of 2021. Today it is barely half that, the lowest level since 2009.
10. The percentage of days this year that the S&P 500 has had a range of more than 1% is nearly 90%., the highest since the financial crisis more than a decade ago.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.01%	-9.50%
BLOOMBERG U.S. CORP HIGH YIELD	-0.91%	-8.22%
BLOOMBERG U.S. GOV/ CREDIT	-0.18%	-10.04%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.01%	0.05%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
FTSE NAREIT (REAL ESTATE)	-5.34%	-8.93%
DJ COMMODITIES	0.26%	30.02%
RED ROCKS GLOBAL LISTED PRIVATE EQUITY	-5.91%	-25.83%
DB G10 CURRENCY FUTURES	-1.30%	5.70%

A PAUSE THAT REFRESHES...?

A pause in the cyclical upwave in bond yields may be developing as growth concerns have increased and less alarming inflation data may be on the horizon. Bond yields are extremely stretched technically, although it took heightened recession fears and broad-based losses in risk asset markets before the rise in yields halted in the past week. No significant asset market has shown gains, underscoring that everyone loses after asset prices become overinflated. Then inflation rises, as inflation has brought about the end to the free money era. The backdrop has become more threatening for all markets because central banks made a big mistake by providing too much stimulus for too long.

The key unknown is whether central banks can tighten sufficiently to reverse the rise in inflation without triggering a recession. The good near-term news is that inflation should cool in the U.S. economy due to base effects and supply constraints gradually. The bad news is that any cooling should prove temporary. Our view is that even if the Fed funds rate is lifted in line with current forward rate expectations, it will be insufficient to materially dampen U.S. domestic demand, let alone trigger a recession, and thus not halt the cyclical advance in inflation.

Equity markets are likely to continue to struggle until it is clear that the ratcheting up in interest rate expectations has paused and central banks stop escalating their belated hawkish rhetoric. Such a shift is necessary to calm recession fears by reducing forecasts for an overshoot in policy rates. An easing in sequential inflation data should soon help calm bond markets. Most central bankers still seem wedded to the view that eventually, inflation will return to the 2% area, and thus they will likely embrace less worrisome inflation data. In addition, the geopolitical and pandemic backdrops offer an excuse for central banks to back off if given any opening.

The rate-of-change in policy rate expectations had become extremely rapid, so a pause or modest countertrend decline in yields and rate expectations would be consistent with our view that the rise in yields will unfold in waves. It is easy to lose sight of the absurd starting point for yields this cycle, including the fact that a large part of the global bond universe had negative yields. After many years of providing no return, U.S. cash holdings now provide some yield (albeit negative in real terms).

In the short-term, the Chinese economy will be weak, but we expect it to return to decent growth once the Covid infection waves ease. The euro area will be less robust than if the war had not happened but will still expand reasonably and provide support to the global economic expansion. And the U.S. will remain historically strong. This positive economic backdrop comes with a dark cloud in that it also means that inflation pressures will continue to intensify over time.

CONCLUSION:

We expect a pause in the cyclical rise in bond yields, as growth concerns have increased, and there should be less alarming inflation data ahead, at a point when government bond markets are extremely oversold. A pause, in turn, should allow the recent risk-off phase to diminish once investors realize that the economic progress remains positive. The foundations under the global economic expansion are still solid. Still, the liquidity boom is unwinding, and financial market returns will be far less than in recent years, as bond yields will move higher over time.

Data from Bloomberg, as of 04/29/2022.

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