CROSSMARK GLOBAL INVESTMENTS

May 28, 2024 | Issue 4.22

# Doll's Deliberations

## Weekly Investment Commentary

**Robert C. Doll, CFA®**
Chief Executive Officer,
Chief Investment Officer

**Summary:**
Stocks were mixed last week (S&P 500 +0.05%), while the NASDAQ recorded a fifth straight weekly gain powered by Nvidia's strong earnings release. Some signs of consumer weakness were in evidence. Rising sectors included technology (+3.44%) and communication services (+0.25%); worst sectors were energy (-3.82%) and real estate (-3.65%).

### Key takeaways:

1. Released Fed minutes suggest a more hawkish tone than Chair Powell's press conference following the meeting. While the release of the minutes was part of the blame for the Thursday sell-off, some weaker data (real growth and inflation) since that meeting are consistent with Powell's comments.
2. Banks' consumer lending standards remain tight and we expect lower labor demand ahead to exert downward pressure on nominal wage growth.
3. One-third of CEOs in the Conference Board's CEO survey now anticipate a recession over the next 12 months, down from three-quarters in Q423.
4. We expect continuation of softening trends in economic data to eventually lead to an economic slowdown, and perhaps a recession. This is a conflict with the double-digit percentage earnings gains projected by the consensus.
5. The death of the Iranian president underscores the instability of Iran and the Middle East. It is likely that Middle East instability will eventually impact global oil supply.
6. While large cap stocks are expensive relative to small cap stocks, small cap stocks are more negatively impacted by higher interest rates and slowing economic growth.
7. Widely watched Nvidia reported another earnings beat and a 10-for-1 stock split continuing the AI excitement.
8. The BBR (bull/bear ratio) continues its volatility. After reaching a seven-year high before the April pullback, and then falling to below average, it has now catapulted higher as equities have advanced.
9. Our election probabilities: Trump wins Presidency – 55% (although it is a long way to November), Republicans capture the Senate – 75% (Republicans probably pick up 2-4 seats), and Democrats win the House – 51% (tough call).
10. Geopolitical experts are openly speculating about the terms of a truce in the Gaza war. Israel will be very reluctant, Hamas will continue to be a huge threat, and hostages will have to be released. What is new is that Saudi Arabia will play a significant role.

| EQUITY MARKETS (INDEX TOTAL RETURN) (%) | LAST WEEK | YEAR-TO-DATE |
|---|---|---|
| DJIA | -2.30 | 4.44 |
| S&P 500 | 0.05 | 11.85 |
| NASDAQ | 1.42 | 13.05 |
| RUSSELL 1000 | -0.80 | 10.43 |
| RUSSELL 1000 GROWTH | 0.96 | 14.43 |
| RUSSELL 1000 VALUE | -1.40 | 7.42 |
| RUSSELL 2000 | -2.23 | 1.58 |

| S&P EQUITY SECTORS (INDEX TOTAL RETURN) (%) | LAST WEEK | YEAR-TO-DATE |
|---|---|---|
| COMMUNICATION SERVICES | 0.25 | 21.60 |
| CONSUMER DISCRETIONARY | -1.84 | 1.00 |
| CONSUMER STAPLES | -1.31 | 9.06 |
| ENERGY | -3.82 | 10.14 |
| FINANCIALS | -1.96 | 11.07 |
| HEALTHCARE | -1.25 | 6.40 |
| INDUSTRIALS | -0.65 | 9.66 |
| INFORMATION TECHNOLOGY | 3.44 | 19.04 |
| MATERIALS | -0.82 | 7.14 |
| REAL ESTATE | -3.65 | -6.08 |
| UTILITIES | -1.15 | 13.90 |

## The beat (profits feeding self-reinforcing expansion) goes on ...

Risk asset markets remain well bid as investors have patiently waited for the promised rate cuts from the Fed. The U.S. economy is in no need of lower borrowing rates, as monetary conditions remain accommodative, asset inflation is flourishing, and there are still few signs of broad-based economic stresses, yet plenty of signs of robust or improving growth. Corporate profits continue to drive a self-reinforcing expansion. Meanwhile, the global economy and trade are steadily firming, following a sluggish 18-24 months. Too many investors expect inflation to just naturally fade away, allowing policy rates to return to “normal” levels without a recession. Indeed, from time to time, such a Goldilocks outcome does appear likely.

The dearth of economic slack warns that disappointment looms once investors realize that interest rates are not likely to return to low levels. Therefore, we recommend positioning for risk on, albeit with tight stops. It is possible that we will see higher bond yields because inflation will prove sticky and stay above central bank targets, in which case equities would be vulnerable.

Globally, the economic gloom of last year is slowly lifting, with some notable signs of life in China and the euro area. Although U.S. economic data is no longer outperforming expectations, it must be noted that such expectations have risen considerably in recent quarters as recession angst has receded. We disagree with Fed Chair Powell’s assertion that monetary conditions are restrictive. We have described the Goldilocks backdrop as one that combines rising corporate earnings with flat-to-lower bond yields. Eventually, one condition will change and Goldilocks will end. In the near term, upcoming inflation data, especially in the relatively hot U.S. economy, will determine how long such conditions persist.

Economic expansions end when meaningful roadblocks develop and the business sector’s profit expectations sour, causing hiring to turn into layoffs. The latter generates a self-reinforcing economic downturn as households reduce spending. So far, such conditions have not developed. Since 2021, the global business sector has impressively managed to lift profit margins even in the face of the largest increase in input costs in over 40 years as well as the substantial rise in interest rates. However, this impressive corporate performance has a significant downside associated with it, namely higher consumer price inflation. Global companies (especially in the U.S.) are enjoying rising profits and expect such conditions to continue, which means they will continue adding to payrolls and pay higher wages. This, in turn, bodes positively for consumption. Borrowing rates will eventually be sufficiently onerous to slow economic activity and cause some weak links to snap. Until then, the cycle will roll on.

| INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN) (%) | LAST WEEK | YEAR-TO-DATE |
|---|---|---|
| MSCI ACWI | -0.73 | 9.31 |
| MSCI ACWI EX U.S. | -0.74 | 7.08 |
| MSCI EAFE | -0.64 | 7.37 |
| MSCI EM | -0.74 | 7.52 |

| FIXED INCOME MARKETS (INDEX TOTAL RETURN) (%) | LAST WEEK | YEAR-TO-DATE |
|---|---|---|
| BLOOMBERG U.S. AGGREGATE BOND | -0.28 | -1.68 |
| BLOOMBERG U.S. CORP HIGH YIELD | -0.21 | 1.64 |
| BLOOMBERG U.S. GOV/ CREDIT | -0.23 | -1.58 |
| BLOOMBERG U.S. T-BILL 1-3 MONTH | 0.11 | 2.16 |

| ALTERNATIVES (INDEX TOTAL RETURN) (%) | LAST WEEK | YEAR-TO-DATE |
|---|---|---|
| REAL ESTATE (FTSE NAREIT) | -3.63 | -6.22 |
| COMMODITIES (DJ) | -0.58 | 8.79 |
| GLOBAL LISTED PRIVATE EQUITY (RED ROCKS) | -0.42 | 6.27 |
| CURRENCIES (DB CURRENCY FUTURE HARVEST) | 0.70 | 9.60 |

## Conclusion

Investors have returned to a Goldilocks mindset, as calmer government bond markets have spurred more risk taking. As in the recent past, this phase will likely prove temporary. While bond markets will remain hostage to the ebbs and flows in the monthly inflation data, sticky inflation will eventually spark another upleg in government bond yields. Equities will likely remain in a volatile, broad trading range.

Data from Bloomberg as of 5/24/2024