CROSSMARK GLOBAL INVESTMENTS

May 9, 2022
Issue 2.18

DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-0.21%	-8.92%
S&P 500	-0.18%	-13.07%
NASDAQ	-1.50%	-22.19%
RUSSELL 2000	-1.29%	-17.77%
RUSSELL 1000 GROWTH	-1.63%	-21.33%
RUSSELL 1000 VALUE	0.65%	-5.73%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	1.06%	-24.89%
CONSUMER DISCRETIONARY	-3.37%	-23.52%
CONSUMER STAPLES	-1.30%	0.21%
ENERGY	10.17%	50.81%
FINANCIALS	0.61%	-10.67%
HEALTHCARE	-0.45%	-7.58%
INDUSTRIALS	0.36%	-9.38%
INFORMATION TECHNOLOGY	-0.60%	-19.19%
MATERIALS	-0.56%	-6.31%
REAL ESTATE	-3.75%	-12.95%
UTILITIES	1.30%	1.62%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-1.47%	-14.22%
MSCI ACWI EX U.S.	-3.06%	-14.09%
MSCI EAFE	-2.83%	-14.49%
MSCI EM	-4.12%	-15.77%

SUMMARY:

Equities fell last week, with the S&P 500 down 0.2%, masking a huge rally on Wednesday and a big decline on Thursday. This was the fifth straight week of equity market decline. Equities fell due to headwinds from a continued back-up in yields (10-year yields were up 24 basis points). Best sectors were energy (+10.2%) and utilities (+1.3%); worst sectors were REITs (-3.8%) and consumer discretionary (-3.4%).

KEY TAKEAWAYS:

1. As expected, the Fed hiked interest rates by 50 basis points on Wednesday and released details of its balance sheet reduction plan. Chair Powell noted that a 75 basis point hike is not being actively considered, a revelation that eased investor concerns and caused a big rally on Wednesday.
2. Contributing to the stock market selloff on Thursday was the productivity drop of 7.5% during Q1. It was a setback for the technology-led productivity growth boom, potentially offsetting the chronic shortage of labor.
3. Payroll jobs grew at a strong clip (428,000) while wage growth moderated to 0.3% month-over-month. The release will not likely change the Fed's near-term path but could be the beginning of signs that inflation is peaking.
4. The U.S. labor market is undeniably tight and points to future wage growth pressures. There are nearly twice as many vacancies as Americans are looking for a job.
5. We continue to expect inflation to moderate in the second half of the year due to base effects and some decline in supply problems.
6. For now, the worst of the bond selloff may be behind us. Bonds are technically oversold, inflation will likely peak this quarter, there is evidence of economic slowing, and some anecdotal evidence of easing wage pressures. Bonds may rally at some point and take some pressure off equities.
7. Since year-end, our equity market caution has not been due to earnings concerns but due to caution related to valuations. The multiple for the S&P 500 has fallen from 21.5x at year-end to 17.0x currently. Current valuations are close to fair levels in our eyes.
8. The Investor Intelligence Bull/Bear Ratio fell below 1.00 again (as it did in early March). Such low readings often lead to equity rallies (as happened in mid-March).
9. China, the world's second-largest economy, may be falling into a recession due to the imposition of severe lockdowns to stop the latest COVID-19 outbreak.
10. The fiscal policy debate in Washington is likely to shift dramatically over the next couple of years. The national debt has soared, and deficits are projected to be high. Democrats will find it harder to increase spending, Republicans will find it harder to cut taxes, and counter-cyclical fiscal policy will also face more resistance.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-1.11%	-10.51%
BLOOMBERG U.S. CORP HIGH YIELD	-1.19%	-9.31%
BLOOMBERG U.S. GOV/ CREDIT	-1.21%	-11.13%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.01%	0.06%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
FTSE NAREIT (REAL ESTATE)	-3.47%	-12.09%
DJ COMMODITIES	0.08%	30.12%
RED ROCKS GLOBAL LISTED PRIVATE EQUITY	-3.80%	-28.65%
DB G10 CURRENCY FUTURES	-0.53%	5.14%

FED STRUGGLES TO THREAD THE NEEDLE

Capital market conditions will remain challenging in the months ahead as the pandemic-driven liquidity boom continues to unwind, inflation proves sticky, and growth momentum moderates further. These have been our main themes in recent months and remain so. Both stocks and bonds face hurdles as central banks step up efforts to combat the biggest outbreak of inflation in four decades. Meanwhile, the war in Ukraine and Covid-driven lockdowns in China are adding fresh strains to supply-chain pressures and, therefore, to inflation and undermining confidence in the global growth outlook.

Cash has decisively outpaced stocks and bonds year-to-date. Both stocks and bonds have suffered sizable losses as interest rates have risen. Over the past two decades, multi-asset portfolios that have benefited from the negative correlation between equity and bond prices during equity corrections have lost this fundamental support.

Ultimately, relief for capital markets awaits evidence that inflation can be brought under control without central banks overshooting and triggering a recession. The Fed stressed at last week's FOMC meeting that it hopes to do so by raising the policy rate to neutral or modestly above, which, combined with its shrinking balance sheet, it believes should bring U.S. demand into line with supply. It will be a very difficult needle to thread, and investors are rightly skeptical of the Fed's ability to do so. We believe the Fed may be underestimating how high-interest rates will need to rise to effectively tame inflation, implying that bond yields will eventually head higher.

At the same time, it is important to stress that the global economy had significant tailwinds coming into this year. Those tailwinds imply that both consumers and businesses will be more resilient than many growth bears believe once the Chinese lockdowns end, especially if signs of a potential de-escalation of the Ukraine war begin to emerge. We still see low odds of a U.S. recession in the next 12 months, although it is less clear that markets will find much comfort anytime soon in such a conclusion. However, while we do not expect a recession in the year ahead, there are material risks of an eventual growth scare.

One positive for investors is that both stocks and bonds are oversold, and valuations are much less stretched than at anytime since the peak of the last cycle. Bonds are overdue for at least a near-term relief rally that could provide support for stocks. Investors are in mini-panic mode, but there is not yet a case for getting decisively more constructive about either stocks or bonds. The core of our asset allocation strategy remains to stay underweight fixed income on a 6-12 month horizon, overweight cash, and be neutral on equities.

CONCLUSION:

In the near term, there is scope for both stocks and bonds to rebound from an oversold starting point, during which expected ongoing growth worries may favor bonds over stocks. However, on a 6-12 month horizon, our constructive economic outlook and sticky inflation imply another upleg for global bond yields and, therefore, that equities will resume outperforming bonds. Barring a sharper decline in inflation than we anticipate, multi-asset portfolios will struggle to generate positive real returns in the year ahead.

Data from Bloomberg, as of 05/06/2022.

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