CROSSMARK
GLOBAL INVESTMENTS

November 1, 2021
Issue 1.22

DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	0.40%	18.77%
S&P 500	1.35%	24.04%
NASDAQ	2.72%	20.88%
RUSSELL 2000	0.27%	17.19%
RUSSELL 1000 GROWTH	2.60%	24.20%
RUSSELL 1000 VALUE	-0.44%	22.03%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	2.04%	25.02%
CONSUMER DISCRETIONARY	3.98%	22.34%
CONSUMER STAPLES	0.08%	8.76%
ENERGY	-0.63%	58.07%
FINANCIALS	-0.84%	38.56%
HEALTHCARE	1.63%	19.31%
INDUSTRIALS	-0.26%	19.15%
INFORMATION TECHNOLOGY	1.98%	24.70%
MATERIALS	0.33%	18.91%
REAL ESTATE	0.30%	33.77%
UTILITIES	-0.50%	9.13%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	0.42%	16.79%
MSCI ACWI EX U.S.	-0.80%	8.43%
MSCI EAFE	-0.11%	11.01%
MSCI EM	-2.18%	-0.27%

SUMMARY:

U.S. equities finished higher last week with the S&P 500 +1.3%, up for a fourth straight week. Growth meaningfully outperformed value. Additional positive developments included generally strong Q3 earnings results and some hint that supply chain pressures may be peaking. Best sectors were consumer discretionary (+4.0%), communication services (+2.0%), and technology (+2.0%). Worst sectors were financials (-0.8%), energy (-0.6%) and utilities (-0.5%).

KEY TAKEAWAYS:

1. 3Q real GDP rose at a less than expected 2.0% (after rising 6.7% in 2Q.) The slowdown reflects the delta wave of infections and supply chain disruptions. We expect supply chain challenges will linger but that consumption will benefit from receding infection rates. We expect economic growth to remain above trend.
2. The GDP deflator for Q3 was 5.7%, the highest in many years and another reminder of inflationary problems.
3. Economic growth estimates have been falling over the last few months, while inflation estimates have been rising. Stagflation concerns are creeping in – we think erroneously. Growth is likely to pick up starting this quarter.
4. Nearly half the companies in the S&P 500 have reported earnings, and nearly 80% have beaten estimates, with the biggest surprises coming in cyclical areas such as consumer discretionary and financials.
5. While companies are substantially beating analyst 3Q expectations (by a double-digit percentage for a record sixth consecutive quarter), beats are only being modestly rewarded in stock prices, but misses are being punished.
6. Corporate profit margins going forward are likely to be challenged by rising wages, increasing material costs, a slowdown in productivity growth, and higher interest and depreciation expenses.
7. White House officials announced a deal on a $1.75 trillion social-spending framework, but it is still unclear whether enough lawmakers will sign on.
8. We think there is a 67% probability that a roughly $1.75 trillion reconciliation bill will pass by Thanksgiving, but there are still many tax and spending issues that haven't been resolved. Passage of new, unvetted, and complicated policies, particularly at the last minute, rarely happens.
9. The Bank of Canada delivered a hawkish surprise announcing the end of its quantitative easing program.
10. With a 7% run-up in just two weeks, the stock market is overbought and may need a break.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.52%	-1.58%
BLOOMBERG U.S. CORP HIGH YIELD	0.09%	4.36%
BLOOMBERG U.S. GOV/ CREDIT	0.62%	-1.88%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.00%	0.03%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
FTSE NAREIT (REAL ESTATE)	-0.02%	29.80%
DJ COMMODITIES	-0.23%	32.40%
RED ROCKS GLOBAL LISTED PRIVATE EQUITY	0.68%	30.59%
DB G10 CURRENCY FUTURES	0.06%	7.76%

YIELD CURVE PERTURBATIONS CONFUSING, BUT UNLIKELY TO IMPACT STOCKS

The diverging pattern between the short and long ends of the U.S. yield curve is significant. The short-end yield moved up because of higher expectations of early Fed tightening, and the long-end yield dropped because of expectations of a lower Fed terminal rate. This pattern suggests that investors believe there is underlying fragility in the U.S. and global economy, a view we do not share. Rather, we anticipate ongoing resilience and strength and an overall bear steepening trend in the run-up to the first Fed rate hike. Recent bond market gyrations have had no impact on economic prospects, with policy still hyper-accommodative and a long time away from becoming restrictive based on current central bank intentions and goals. Not surprisingly, risk asset markets have stayed well bid. Equities have been reasonably strong, and we continue to expect stocks to outperform bonds over the next 6-12 months.

The rise in short-term bond yields has progressed as expected, given solid economic activity and central banks' belated acknowledgment that inflation is both higher and less transitory than they had envisioned. The yield curve tends to steepen until a rate hiking cycle takes hold. Therefore, yield curve flattening seems odd; this is likely a legacy of last decade's chronically disappointing global growth profile and dominant secular stagnation narrative. The level of yields is ultimately the most important variable for the economy, rather than the steepness of the curve. Bond yields and policy rates are still far below the underlying level of inflation and nominal GDP growth. Most likely, the cycle will eventually follow its normal pattern. The long end of the yield curve should rise faster than the short end when it becomes clear that underlying inflation is not easing much after the unwinding of the base effects from this year's spike.

The key misread by both the Fed and government bond investors, in our view, is that the rise in inflation is not solely, or even mostly, driven by temporary supply woes. The bigger issue for inflation is that demand is solid and economic slack is unwinding. Final demand is solid in most of the world and, in the case of the U.S. and euro areas, is being augmented by a record amount of sidelined savings related to pent-up demand and unprecedented government transfers. Household balance sheets have been boosted by asset inflation, further supporting the demand outlook. The economic emergency is over, and emergency monetary conditions should no longer exist.

In terms of corporate earnings, the overall global outlook is upbeat, even though peak growth rates have passed. Corporate profits, employment, income, and balance sheet trends ultimately drive final demand, and here the picture is still upbeat. Massive policy stimulus worked, and the outlook for growth in most developed economies, and to a lesser extent in the emerging markets (EM) world, is brighter than last decade. Lasting equity bear phases occur when earnings contract (usually coinciding with recessions), and we do not foresee such an outcome in 2022. If valuations were reasonable, this would paint a very positive equity story, but that is not the case as prices have significantly front-run positive earnings trends, especially in the U.S.

CONCLUSION:

The shift from hyper-accommodative monetary conditions to a restrictive stance will play out over a long period (likely in waves) rather than be short-lived and end abruptly. We remain mildly positive in our investment stance, albeit this is more a reflection of an underweight in bonds rather than a large overweight in equities. Growth prospects are upbeat, but most equities have front-run positive corporate profit news.

Data from Morningstar Direct, as of 11/1/2021.

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