CROSSMARK
GLOBAL INVESTMENTS

Doll's Deliberations

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SUMMARY:

Stocks were mostly higher last week (S&P 500 +1.3%), with small stocks falling yet again (Russell 2000 -4.2%). Stocks rose despite hawkish Fed commentary and a weak 30-year treasury auction. Outperforming sectors included technology (+4.8%) and communication services (+2.2%); biggest laggards included energy (-3.8%) and utilities (-2.6%).

KEY TAKEAWAYS:

1. Payroll growth slowed significantly in October, rising 150,000. The unemployment rate rose to 3.9% up from a low of 3.4% in April (a 0.5% increase historically is a recession signal).

2. The economy is generating growth, albeit decelerating, and still needs to digest some of the massive policy tightening of the last 18+ months.

3. Running budget deficits of 5% of GDP at full employment makes the Fed's job difficult. It also signals that reaching the Fed's 2% inflation target is nearly impossible without economic pain (recession) or a significant jump in productivity.

4. Net interest expense for the U.S. government is now 15% of GDP, the highest since the 1980's. The bond market will eventually force the government into some austerity measures.

5. A further deterioration in the labor market is needed for bond yields to decline meaningfully. Although employment conditions are softening, the unemployment rate remains low. Therefore, there is limited scope for yields to continue to provide a tailwind for stocks. If yields decline substantially next year, it will likely be in the context of a recession.

6. With 90% of the S&P 500 reporting Q3 earnings, results have exceeded expectations by a significant 7%. However, concerns about economic weakness have caused analysts to continue to ratchet back Q4 and 2024 expectations.

7. The consensus expects the Fed to cut rates in enough time to allow the economy to have a soft landing with 2024 earnings up a double-digit percentage. We do not expect that rosy of an environment with particular concern for 2024 earnings.

8. The Magnificent Seven (Microsoft, Apple, Amazon, Google, Meta, Nvidia and Tesla) continue to perform well, largely due to quality balance sheets including large cash balances and good cash flow profiles, characteristics important in a high uncertainty environment.

9. Investors should prepare for potential oil price volatility and supply disruptions stemming from the Middle East.

10. As no cohesive plan seems to be in the making and time is running short, the probability of a government shutdown appears to be greater than 50%.

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	0.72%	5.29%
S&P 500	1.35%	16.60%
NASDAQ	2.40%	32.76%
RUSSELL 1000	-0.37%	14.30%
RUSSELL 1000 GROWTH	3.02%	32.46%
RUSSELL 1000 VALUE	-0.99%	0.78%
RUSSELL 2000	-4.15%	-2.97%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	2.21%	46.82%
CONSUMER DISCRETIONARY	0.95%	28.42%
CONSUMER STAPLES	0.23%	-4.45%
ENERGY	-3.82%	-2.45%
FINANCIALS	0.34%	0.55%
HEALTHCARE	-0.90%	-5.92%
INDUSTRIALS	0.93%	5.72%
INFORMATION TECHNOLOGY	4.81%	48.23%
MATERIALS	-1.80%	1.07%
REAL ESTATE	-2.10%	-4.56%
UTILITIES	-2.52%	-12.43%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-0.04%	11.10%
MSCI ACWI EX U.S.	0.31%	5.64%
MSCI EAFE	0.29%	7.44%
MSCI EM	0.86%	2.28%

LOWER BOND YIELDS CONTINUE TO ENCOURAGE EQUITY ADVANCES

We remain somewhat constructive on the near-term economic outlook but still believe a recession is on the horizon. Therefore, the consensus double-digit percentage earnings growth estimates for 2024 is unlikely to materialize. A potential economic threat that has developed is the possibility of higher oil prices should the Middle East war widen. U.S. GDP growth will slow meaningfully in Q4 after a strong Q3. By many measures, the U.S. labor market has not been this tight in decades, and it has manifested itself in rising strike action and ongoing historically elevated wage demands.

There have been several countertrend declines in government bond yields during the past two years. So far, all have proved temporary. While bond bullish sentiment quickly surged, the yield declines were false signals of a possible bond bull market. The forward markets are now expecting much lower policy rates in 2024 and many investors are anticipating a sizable bond bull market ahead. Our view remains unchanged; that is, the cyclical bond bear market is nearing its end, but won't be a straight line and will likely have notable setbacks. Bond valuations have improved considerably over the past two years and now there are some cracks developing in the economic growth picture. Believe it or not, cash has beaten 10-year treasuries over the past decade.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.41%	-0.93%
BLOOMBERG U.S. CORP HIGH YIELD	-0.36%	6.81%
BLOOMBERG U.S. GOV/ CREDIT	-0.37%	-0.62%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.06%	4.33%

Whenever countertrend bond yield declines developed during 2022-2023, lower yields provided some economic insurance against a recession and, ironically, further complicated the work of the Fed. The Fed has acknowledged that higher bond yields were helping its goal of slowing growth and hopefully reducing inflation risks. Therefore, absent a significant downgrading in the growth outlook, the Fed should be less dovish on the margin in view of the sharp drop in bond yields in recent weeks.

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-3.46%	-6.05%
COMMODITIES (DJ)	-3.34%	-5.83%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	0.71%	13.66%
CURRENCIES (DB CURRENCY FUTURE HARVEST)	-0.03%	8.94%

The investment and policy cycles are now sufficiently advanced to warrant buying bonds on weakness and selling equities on strength. However, a clear cyclical turning point is still not yet on the horizon.

CONCLUSION:

We suggest adding to bonds on weakness and trimming equities on strength. The investment cycle is into the late stages, yet the endpoint of a meaningful global economic downturn and, thus, a sustained bond bull market is still not on the horizon. Earnings disappointments going forward will, at a minimum, cap the upside for stocks and may eventually cause more weakness.

Data from Bloomberg, as of 11/10/2023.