CROSSMARK
GLOBAL INVESTMENTS

November 22, 2021
Issue 1.25

DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-1.29%	18.25%
S&P 500	0.36%	26.67%
NASDAQ	1.27%	25.32%
RUSSELL 2000	-2.83%	19.63%
RUSSELL 1000 GROWTH	1.81%	28.85%
RUSSELL 1000 VALUE	-1.84%	21.58%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-1.00%	24.93%
CONSUMER DISCRETIONARY	3.83%	29.14%
CONSUMER STAPLES	-0.94%	10.14%
ENERGY	-4.90%	50.35%
FINANCIALS	-2.81%	34.25%
HEALTHCARE	-0.66%	18.52%
INDUSTRIALS	-1.11%	20.56%
INFORMATION TECHNOLOGY	2.41%	32.28%
MATERIALS	-1.98%	23.37%
REAL ESTATE	0.01%	34.86%
UTILITIES	0.99%	9.82%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-0.23%	18.39%
MSCI ACWI EX U.S.	-0.97%	8.94%
MSCI EAFE	-0.78%	11.56%
MSCI EM	-1.25%	0.12%

SUMMARY:

Last week, stocks were mixed: the S&P 500 rose 0.3%, but the unweighted S&P was down 1.2%. Growth beat value by nearly 400 basis points. The House passed Build Back Better though the Senate is not expected to deal with the social spending package until December. Best sectors were consumer discretionary (+3.8%) and technology (+2.4%); worst sectors were energy (-4.9%) and financials (-2.8%).

KEY TAKEAWAYS:

1. The November Philadelphia Fed Business Outlook survey and the Empire State survey point to stronger manufacturing conditions in the U.S. This outcome is consistent with the likely outperformance of cyclical equities.
2. Consumer spending should remain strong as U.S. households have accumulated more than $2 trillion in excess savings during the pandemic.
3. Monetary and fiscal policy intentions were to run the economy "hot" to offset damage from COVID and pandemic lockdowns. But this has backfired as inflation has accelerated rapidly.
4. The evidence is now pretty clear that inflation will be more persistent than the FOMC wants to admit. Near term, the Fed's dovishness is a clear positive for equity markets. However, risks are rising.
5. We believe that the Fed should taper quickly and start hiking rates in the first half of 2022. However, this appears very unlikely.
6. President Biden will be appointing at least three new Fed board members before long. New members are likely to be dovish and more tolerant of higher inflation.
7. The odds of a technical default on U.S. debt, while still low in absolute terms, appear higher than ever before because the lack of flexibility and the presence of strong competing political interests in Congress make finding a solution hard.
8. Corporate profit margins may have reached a peak. A slowdown in revenue growth coupled with weaker corporate pricing power and rising wage and raw material costs are likely to weigh on corporate margins in 2022.
9. With 2021 earnings continuing to surprise to the upside, it appears to be borrowing from 2022 earnings. The 7.7% growth rate that is currently estimated for 2022 is the lowest since the 2022 estimate was first reported back in April of 2020.
10. The Chinese Communist Party appears to be setting President Xi on a path to becoming Chairman for life despite turmoil in its real estate market, resurgent COVID-19 cases, and slowing economic growth.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.09%	-1.60%
BLOOMBERG U.S. CORP HIGH YIELD	-0.38%	4.33%
BLOOMBERG U.S. GOV/ CREDIT	0.10%	-1.86%
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)	-0.05%	31.32%
DJ COMMODITIES	-0.96%	31.50%
RED ROCKS GLOBAL LISTED PRIVATE EQUITY	-1.21%	31.39%
DB G10 CURRENCY FUTURES	-0.56%	5.62%

THE EQUITY MARKET HIGH WIRE ACT CONTINUES

The equity market outlook remains reasonably positive (although we expect greater volatility than in the past year) until bond markets decide that central banks are both behind the inflation curve and resolved to catch up. However, the longer-term return outlook is much less positive for most assets. The next decade should see a notable break with the past 40 years, given the end of the secular decline in bond yields and the inevitable headwinds that this will create for valuations. Bonds will generate poor performance, and a buy-and-hold strategies for equities and credit will be far less profitable. A more selective and tactical investment strategy will be critical to generating decent real returns. Time will no longer favor long-only positions, as has been the case for most markets in recent decades.

The U.S. is undergoing a solid, broad-based rise in consumer price inflation. The rise in inflation is mostly demand driven and not transitory in nature, although there are temporary impacts from supply shortages that should diminish next year. The notion that record-breaking retail sales are being mostly driven by consumers front-running higher prices and/or fearing supply shortages ignores that the historical drivers of consumption are extremely positive. The outlook for U.S. consumer spending is still quite positive given strengthening income growth due to an unprecedented mountain of sidelined savings thanks to record government transfers, pent-up demand for services, and the largest-ever wealth gains. Total retail sales have boomed, but services spending has lagged significantly. However, retail sales have been quite volatile, partly due to the choppiness of re-opening, as well as ongoing supply problems. Overall consumption has been strong, and prospects are still bright with the spending boom on goods set to fade but services spending will gain momentum.

Today's hyper-accommodative monetary policies will gradually unwind, although the road to outright restrictive settings should be long. Most likely, the uptrend in yields will occur in waves followed by pauses, as central banks will persistently remain biased towards supporting economic activity and trying to avoid harsh asset market setbacks. The implication is that progress towards positive real bond yields and rates will be slow, which will be positive for investors and economic risk-taking in the interim. While some argue that the long end of the government yield curve is signaling long-term economic problems ahead, risk asset markets currently do not agree. In fact, our view has been that if bond yields remain well below levels consistent with the trend in nominal economic growth, then the asset boom will persist, or at least not deflate. Nevertheless, the rate of change of liquidity will slow, heralding lower market returns, diminishing breadth, and greater volatility.

The peculiar action in the Treasury yield curve has persisted. The short end of the U.S. yield curve has steadily marched higher in recent months, consistent with the announcement that QE will end by mid-2022, with the start of the rate-hiking cycle expected thereafter. However, the long end of the curve has seen yields hold below the levels reached earlier this year despite strong economic activity and multi-decade highs in inflation. Not surprisingly, the decline in real bond yields to very depressed levels has benefitted a wide range of asset markets, including gold, commodities, credit, and equities. The economic expansion will roll on until bond yields and policy rates threaten to become restrictive. The business sector's overall profit margins are generally holding up at high levels despite accelerating input costs (based on Q3 results) because higher costs are being passed on to end-users. Thus, corporate earnings continue to climb providing support to economic-sensitive asset markets, even in the face of elevated valuations. As with the economic expansion, valuations will stay elevated until bond yields move higher.

CONCLUSION:

We recommend maximum underweight bonds and duration within a fixed-income portfolio, as the risk-reward balance is decisively negative given the upbeat economic outlook and underlying uptrend in inflation. Despite high valuations, equities tend to generate positive returns until the outlook for corporate profits weakens which is unlikely in the next year.

Data from Morningstar Direct, as of 11/22/2021.

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