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GLOBAL INVESTMENTS

Doll's Deliberations

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SUMMARY:

After reaching correction territory on Monday, stocks advanced each day with the S&P 500 (+5.9%) posting its best week in a year. Small stocks (Russell 2000 +7.6%) had their best week in two and a half years. Ten-year Treasury yields dropped 30bp for the week. Soft economic data and a dovish Fed meeting were among the supports. Best sectors were real estate (+8.6%), financials (+7.4%) and consumer discretionary (+7.2%). Laggards included energy (+2.3%), consumer staples (+3.3%), and healthcare (+3.5%).

KEY TAKEAWAYS:

1. As expected, the Fed maintained the target Fed funds rate at 5.25-5.50%. The minimal changes made to the Fed statement were to emphasize the strong pace of economic activity and to acknowledge that tighter financial conditions are a headwind for the economy.

2. We continue to believe that investors are overly optimistic about the likelihood that the FOMC will not hike again and that they will start cutting at the first sign of economic weakness.

3. The ISM Manufacturing PMI unexpectedly fell to 46.7 (vs. consensus estimates of 49.0).

4. Productivity jumped 5.9% during Q3. This is a big and important advance and should help bring inflation down.

5. U.S. labor leaders are vowing to take more aggressive stances as a decades-long era of union passivity comes to a close. Tentative agreements with the big three automakers call for a 25% increase in pay by April 2028. Sticky wage hikes may plague the Fed for years to come.

6. Company mentions of "inflation" have again increased as "recession" mentions have lessened.

7. Federal interest costs now exceed 14% of tax revenue which (according to Strategas) is the inflection point when bond market concerns build and stimulus transitions to austerity. At some point, the bond market may force DC to deal with hard choices.

8. It is not taking longer than normal for the economy to move into recession. On average, a recession begins ten quarters after Fed hikes begin. (As of Q4, it has only been seven quarters.)

9. While Q3 earnings are modestly exceeding expectations, 2024 estimates continue to get cut.

10. Last Monday, before last week's big rally, the S&P 500 entered correction territory (-10.3% from July high). The Russell 2000 fell below its 2022 low to November 2020 levels.

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	5.07%	4.53%
S&P 500	5.88%	15.05%
NASDAQ	6.62%	29.64%
RUSSELL 1000	4.87%	13.53%
RUSSELL 1000 GROWTH	6.25%	28.58%
RUSSELL 1000 VALUE	5.67%	1.79%
RUSSELL 2000	4.74%	-1.45%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	6.54%	43.65%
CONSUMER DISCRETIONARY	7.23%	27.21%
CONSUMER STAPLES	3.28%	-4.67%
ENERGY	2.35%	1.42%
FINANCIALS	7.45%	0.21%
HEALTHCARE	3.48%	-5.06%
INDUSTRIALS	5.31%	4.74%
INFORMATION TECHNOLOGY	6.85%	41.42%
MATERIALS	5.10%	2.92%
REAL ESTATE	8.57%	-2.52%
UTILITIES	5.30%	-10.16%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	4.08%	9.84%
MSCI ACWI EX U.S.	2.75%	3.78%
MSCI EAFE	3.14%	5.81%
MSCI EM	1.20%	-0.48%

THE PAUSE (IN THE DOWNTREND) THAT REFRESHES

The investment backdrop has improved for now as bonds, after a vicious sell-off, have calmed on hopes that easier monetary policy looms in 2024. We think this respite will last as long as investors believe economic weakness is good news (because it relieves the Fed of interest rate hikes and can ease inflation). However, we also believe the investment climate will eventually get more difficult as bond market relief proves temporary and the economic cycle edges closer to its final stages. We have consistently argued that long-term bond yields would rise until they triggered the end of the economic expansion. So far, no major cracks have developed that by themselves would upset the global economy or financial system, nor cause the Fed and other central banks to begin easing monetary policy.

Given the impressively resilient U.S. economy and expected sticky inflation, it is probably premature to declare the bond bear market over. However, from a short-term perspective, treasury bonds are still oversold such that last week's yield pullback is likely to persist in the near-term. This is providing some relief to equities which corrected meaningfully since their July peak. Absent a clear deterioration in the geopolitical climate, which we cannot rule out but do not expect, there are decent odds that both equities and bonds could post gains over the balance of the year. As we enter the late stages of the economic cycle, we recommend buying bonds on weakness and trimming equities on strength. For now, cash offers a compelling risk-reward profile.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	1.29%	-1.21%
BLOOMBERG U.S. CORP HIGH YIELD	1.86%	6.26%
BLOOMBERG U.S. GOV/ CREDIT	1.13%	-0.82%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.06%	4.22%

There have been many factors identified as drivers of the recent surge in bond yields, including the jump in the U.S. federal budget deficit and accompanying rise in U.S. Treasury issuance. The federal budget deficit widened significantly in the fiscal year ending in September. Treasury issuance has stepped up accordingly, both because of the expanded budget deficit, but also because of the need for the Treasury to replenish its general account at the Fed. While these factors have added to the bearish Treasury narrative, they hardly constitute new news and the prospect of large budget deficits in the future is also known.

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	6.64%	-4.75%
COMMODITIES (DJ)	-0.28%	-2.58%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	5.79%	9.90%
CURRENCIES (DB CURRENCY FUTURE HARVEST)	1.05%	8.77%

Geopolitics remains a potentially negative wildcard in the outlook given the tense conditions in the Middle East, ongoing stresses between the U.S. and China, and the Ukraine war. In the current circumstance, the modest rise in crude oil prices so far implies no material adverse economic consequences for the global economy. Signs that a widening of military action were developing in the Middle East, coinciding with a spike in oil prices, however, are still a potential threat to global growth.

CONCLUSION:

Stocks have scope to bounce more in the near-term if bond markets behave, and as de-rating pressure abates. That said, global equities have limited sustainable upside given the late stage of the economic cycle and elevated earnings and valuations.

Data from Bloomberg, as of 11/3/2023.