CROSSMARK GLOBAL INVESTMENTS

November 8, 2021
Issue 1.23

DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	1.43%	20.47%
S&P 500	2.03%	26.56%
NASDAQ	3.08%	24.59%
RUSSELL 2000	6.11%	24.35%
RUSSELL 1000 GROWTH	2.45%	27.24%
RUSSELL 1000 VALUE	1.39%	23.74%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	1.42%	26.81%
CONSUMER DISCRETIONARY	4.99%	28.45%
CONSUMER STAPLES	2.45%	11.42%
ENERGY	1.34%	60.19%
FINANCIALS	-0.61%	37.72%
HEALTHCARE	-0.63%	18.56%
INDUSTRIALS	1.85%	21.35%
INFORMATION TECHNOLOGY	3.39%	28.93%
MATERIALS	3.19%	22.71%
REAL ESTATE	0.85%	34.90%
UTILITIES	0.48%	9.65%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	1.62%	18.68%
MSCI ACWI EX U.S.	1.14%	9.67%
MSCI EAFE	1.64%	12.83%
MSCI EM	-0.04%	-0.31%

SUMMARY:

Equities were up again last week, with the S&P 500 +2.0% (small-cap stocks were up 6.1%). The path of least resistance remained higher, with the S&P up for a fifth straight week and a fourth consecutive week of more than a 1% gain. A highlight of the week was a strong October employment report. Best performers were consumer discretionary +5.0%, technology +3.3%, and materials +3.2%; the only sectors declining were healthcare -0.6% and financials -0.6%.

KEY TAKEAWAYS:

1. As was widely expected, the Fed ended its pandemic-era bond purchase program of $120 billion per month. They will reduce the pace of asset purchases by $15 billion per month, which means QE will conclude by mid-year 2022.
2. The Fed became less confident in the temporary nature of inflation by noting that elevated price levels reflect "factors that are expected to be transitory" instead of the more confident tone that inflation is the result of "transitory factors".
3. The bond market has priced in a 100% chance of two hikes in 2022 despite the fact that only 3 of 19 members expect two rate hikes next year and significant messaging from the Chairman that rate hikes may not be tied to the end of tapering.
4. Asset prices across the globe assume that real interest rates will remain low. If that expectation shifts (perhaps due to inflation remaining sticky), it could trigger a repricing. All of this leaves central banks walking an increasingly fine line.
5. Results from Tuesday's elections are a warning sign to Democrats and reinforce market expectations that the U.S. Congress will return to gridlock with the 2022 mid-term elections.
6. Democrats widely believe (and did before last Tuesday night) they will lose the House next year, which is why they are trying to pack as many policy wins as possible in the reconciliation bill. We still guess a 67% probability that a smaller deal gets done. Unless Senator Manchin folds, Democrats are probably weeks away from a deal.
7. Based on 75% of S&P 500 companies reporting 3Q earnings, upside surprises have averaged a very strong 11%. However, increases in forward earnings expectations are leveling off.
8. We expect capital expenditures to strengthen due to strong corporate profits, narrow credit spreads, and banks' willingness to lend.
9. Despite growing stagflation and supply chain concerns, stocks appear to be on solid footing technically. For example, the NYSE's cumulative advance/decline line broke out to a new high in late October.
10. 2021 has been a year of regulatory change in China. These initiatives are arguably positive for China's long-term growth prospects and represent structural reform. Nevertheless, they have exacerbated a cooling-off phase in economic momentum.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.64%	-0.95%
BLOOMBERG U.S. CORP HIGH YIELD	0.61%	5.00%
BLOOMBERG U.S. GOV/ CREDIT	0.74%	-1.15%
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)	1.52%	31.78%
DJ COMMODITIES	-0.99%	31.09%
RED ROCKS GLOBAL LISTED PRIVATE EQUITY	1.99%	33.19%
DB G10 CURRENCY FUTURES	-1.09%	6.58%

MONETARY ACCOMMODATION BEGINS TO UNWIND

The Fed announced it will begin tapering its asset purchase program immediately, marking an important shift in the global monetary landscape. Other central banks are also starting to unwind the emergency monetary policies enacted to combat the economic fallout from the COVID-19 pandemic. A gradual unwinding of monetary accommodation poses little threat to the global economic recovery but could prove more disruptive for capital markets, at least initially and periodically as it progresses. While real interest rates are set to rise, they will remain negative or very low and hence will continue to provide support for the economy. We expect consensus expectations for global growth to move higher in the coming months.

Even a gradual normalization of real interest rates will likely have an adverse impact on markets. Government bonds are priced for secular stagnation and low inflation, while risk assets are priced for sustained healthy economic growth, low inflation, and low interest rates. Prudence argues against basing investment strategy on the sustainability of this elevated starting point for valuation and duration. The shifting monetary landscape is part of the broader transition from the full-on pro-growth policies enacted to combat the COVID-19 pandemic toward a greater balance between the competing objectives of sustaining healthy growth and containing underlying inflationary risks. The combination of moderating, albeit still-above potential, economic growth, sticky/rising inflation, and gradually diminishing monetary/fiscal policy thrust translates into a more challenging investment outlook than has prevailed since the market low in March 2020.

The investment climate could become decidedly more difficult because investors are underestimating underlying inflation risks. Both bond yields and central banks would then need to quickly play catch up, with associated volatility reverberating across all asset classes and potential painful drawdowns. That said, our forecast warrants maintaining a moderately positive investment posture, including favoring equities over bonds and credit relative to government bonds. We continue to recommend some cash in portfolios to help shield performance against market volatility amidst the transitioning macro backdrop.

Equities continue to demonstrate resilience, with record highs reached again last week on the back of ongoing better-than-expected corporate earnings. Forward earnings estimates continue to rise, reflecting upgrades to this and next year's earnings expectations and the increasing weight of 2022 earnings in the rolling 12-month forward measure. Slowing but still solid earnings growth and rising interest rates point to moderate returns on a 6-12 month horizon, with greater volatility than over the past year.

CONCLUSION:

Rising interest rates and slowing earnings growth indicate moderate absolute returns for global equities on a 6-12 month horizon, with increasing potential for corrections. Recent U.S. outperformance on the back of mega-cap growth stocks is vulnerable to higher interest rates, although above-potential economic growth will provide solid overall earnings support. Our outlook suggests a gradual rotation away from the U.S., but clearer evidence is needed that non-U.S. relative earnings are poised to sustainably recover before positioning accordingly.

Data from Morningstar Direct, as of 11/8/2021.

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