

# DOLL'S DELIBERATIONS

## WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	2.03%	-18.08%
S&P 500	1.56%	-22.68%
NASDAQ	0.75%	-31.49%
RUSSELL 2000	5.29%	-21.14%
RUSSELL 1000 GROWTH	1.20%	-29.83%
RUSSELL 1000 VALUE	2.20%	-15.94%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	1.70%	-38.00%
CONSUMER DISCRETIONARY	-1.11%	-30.67%
CONSUMER STAPLES	-0.36%	-12.15%
ENERGY	13.86%	53.64%
FINANCIALS	1.94%	-19.72%
HEALTHCARE	1.33%	-11.93%
INDUSTRIALS	2.87%	-18.44%
INFORMATION TECHNOLOGY	1.67%	-30.30%
MATERIALS	2.15%	-22.10%
REAL ESTATE	-4.06%	-31.73%
UTILITIES	-2.63%	-8.97%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	4.20%	-22.50%
MSCI ACWI EX U.S.	3.55%	-23.89%
MSCI EAFE	3.43%	-24.60%
MSCI EM	3.98%	-24.26%

### SUMMARY:

Equities closed higher (S&P 500 +1.6%) in a roller-coaster week, snapping a three-week losing streak. Stocks bounced early in the week on oversold conditions and negative sentiment. There was also a renewed pickup in policy pivot hopes. The week ended with a stronger than hoped for employment report selloff. Best sector was energy (+13.9%); worst sectors were REITS (-4.1%) and utilities (-2.6%).

### KEY TAKEAWAYS:

1. Nonfarm payrolls rose a solid +263,000 in September as the unemployment rate declined to 3.5%. This report does not support an easing in inflation, suggesting that the Fed will continue its restrictive stance.
2. The U.S. Composite PMI and the Leading Indicator Index point to early signs of economic weakness.
3. Despite COVID accumulated excess savings, falling net worth will likely result in consumer weakness in 2023.
4. The speed and magnitude of the backup in mortgage rates has upended the housing market. So far, it has resulted in a significant decline in activity, but little impact on prices.
5. OPEC agreed to lower its production cap by 2mm barrels per day starting in November, marking the largest cut since 2020. Crude oil prices have increased  $\approx 20\%$  in the last two weeks. The production cut threatens to aggravate supply risks and inflationary pressures.
6. We expect a number of multinational companies to cite the dollar as a reason for missing earnings in Q3.
7. Bringing inflation down to 2% may eventually require the Fed to push the policy rate to approximately 5%, but financial stability concerns could pre-empt the Fed's inflation mandate.
8. From the January 3 high to the September 30 low, the S&P 500 forward P/E fell from 21.5 to 15.1, the lowest since the pandemic.
9. The 5%+ rally in stocks in the first two days of October resulted from an oversold condition, negative sentiment, and a view (in light of U.K. developments) that the Fed has to give more weight to financial stability, meaning the current monetary tightening cycle might end sooner rather than later.
10. With an investment backdrop of falling earnings expectations, Fed tightening, inverted yield curve, a European energy crisis, and Russia discussing the use of nuclear weapons, it is hard to be constructive on equities despite reduced valuation levels and negative sentiment.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.19%	-14.45%
BLOOMBERG U.S. CORP HIGH YIELD	1.95%	-13.08%
BLOOMBERG U.S. GOV/ CREDIT	0.25%	-14.89%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.04%	0.67%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-1.30%	-29.17%
COMMODITIES (DJ)	5.13%	19.40%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	4.93%	-40.66%
CURRENCIES (DB G10 CURRENCY FUTURE)	0.92%	5.07%

## THE ROLLER COASTER RIDE IN BOTH DIRECTIONS CONTINUES

Risk assets attempted to rebound last week from deeply oversold levels on hopes that central banks will soon tone down their hawkish rhetoric. Equities started the fourth quarter on an upbeat note after one of the worst Septembers on record due to oversold technical conditions, negative sentiment, and the hope (probably misplaced) that the Fed may be closer to the end of rate hikes. A durable rally in equity prices is unlikely until reported inflation cools sufficiently to enable the Fed and other global central banks to tone down their hawkish rhetoric and move to a less aggressive pace of interest rate hikes, or even a pause in the rate-hiking cycle.

Although a U.S. recession has not been our base-case scenario, the odds of this outcome have been increasing and will ratchet higher if the uptrend in bond yields does not sustainably pause. Equity valuations have already discounted a mild economic downturn, but without central banks shifting to a less hawkish policy stance, there is no obvious catalyst to improve sentiment. As a result, stock prices could undershoot underlying fundamentals before finding their footing. Accordingly, investors should remain patient in deploying capital.

Capital markets are in payback mode after the huge price gains in 2020-2021 as the earlier liquidity boom unwinds. Global equities are barely above their immediate pre-pandemic level in one of the fastest ever round-trips, reflecting a massive de-rating in response to rising bond yields. The adjustment in the bond market has been even greater, evident in the surge in both yields and volatility. Commodities, cryptocurrencies, real estate and everything else inflated by pandemic-related fiscal and monetary policies, are coming back to earth.

The recent emergency measures by the BoE to stabilize the Gilt market and the surge in CDS spreads on Credit Suisse and some other European banks are reminders of the potential fallout as asset bubbles deflate, especially against a backdrop of slowing global economic growth. One clear danger is that the restrictive policy rate the Fed believes is necessary to calm U.S. inflation may be too high for leveraged borrowers in the rest of the world to bear, all the more so since rising U.S. interest rates have coincided with a very strong U.S. dollar. The risks of financial and economic accidents are rising.

Ultimately, the issue for capital markets is whether the Fed and other central banks can simultaneously tamp down inflation and fend off a pronounced economic downturn. The Fed, needs a moderation in month-to-month core inflation along with payroll increases to justify pausing or lowering the consensus rate path for 2023. Yet while recession risks are material and rising, we also continue to believe that the global economy is more resilient than many believe following a decade of deleveraging in the U.S. and Europe and a Chinese economy poised to rebound whenever COVID policy is eased. Our bearish outlook for G7 government bonds has been the foundation of our investment outlook this year and we continue to view the risk-reward as somewhat unfavorable on a 6-12 month horizon, despite the significant improvement in absolute and relative value in recent months. Global equities have already discounted a mild recession, making us comfortable with our current neutral stance.

## CONCLUSION:

Bond valuation has improved significantly this year, but only restoring it to fair value in a climate of significant inflation and monetary policy uncertainty. The macro and policy backdrops remain equity unfriendly, but stocks have already discounted a mild recession. De-rating pressures should diminish with interest rates having already risen sharply and the Fed near peak hawkishness. The big test will be earnings, which show tentative signs of rolling over from a high level.

Data from Bloomberg, as of 10/07/2022.

**Crossmark Global Investments, Inc. (Crossmark)** is an investment adviser registered with the Securities and Exchange Commission that provides discretionary investment management services to mutual funds, institutions, and individual clients. Investment advice can be provided only after the delivery of Crossmark's firm Brochure and Brochure Supplement Form ADV (Parts 2A and 2B) and Form CRS, and once a properly executed investment advisory agreement has been entered into by the client.

**All Investments are subject to risks, including the possible loss of principal. Past performance does not guarantee future results.**

Information and recommendations contained in market commentaries and writings are of a general nature and are not intended to be construed as investment, tax or legal advice. These materials reflect the opinion of Crossmark on the date of production and are subject to change at any time without notice. Where data is presented that was prepared by third parties, the source of the data will be cited, and we have determined these sources to be generally reliable. However, Crossmark does not warrant the accuracy of the information presented.