CROSSMARK
GLOBAL INVESTMENTS

October 18, 2021
Issue 1.20

DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	1.58%	16.98%
S&P 500	1.84%	20.40%
NASDAQ	2.18%	16.18%
RUSSELL 2000	1.47%	15.57%
RUSSELL 1000 GROWTH	2.62%	18.90%
RUSSELL 1000 VALUE	1.35%	20.68%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-0.43%	23.28%
CONSUMER DISCRETIONARY	3.55%	15.93%
CONSUMER STAPLES	1.17%	7.70%
ENERGY	1.18%	57.21%
FINANCIALS	1.24%	35.95%
HEALTHCARE	0.84%	14.11%
INDUSTRIALS	1.94%	17.31%
INFORMATION TECHNOLOGY	2.61%	20.34%
MATERIALS	3.65%	17.51%
REAL ESTATE	3.53%	29.21%
UTILITIES	1.42%	7.16%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	2.16%	14.83%
MSCI ACWI EX U.S.	2.41%	8.52%
MSCI EAFE	2.42%	10.44%
MSCI EM	2.13%	1.19%

SUMMARY:

U.S. equities were higher last week, with the S&P 500 (+1.8%) and Nasdaq posting the best weeks since August. Growth broke four straight weeks of underperformance versus value. A strong start to earnings season was a big driver of the week's upside. Economic data was also a tailwind this week despite a mixed outlook on inflation trends. Best sectors were materials (+3.6%) and consumer discretionary (+3.5%); worst sectors were telecommunications (-0.4%) and healthcare (+0.8%).

KEY TAKEAWAYS:

1. The 0.7% month-over-month (m/m) rise in retail sales in September suggests goods spending held up well. We are constructive on consumer spending in 2022 and therefore think consumer discretionary stocks will outperform consumer staples.
2. Growth may be slowing from the recent high, but the combination of low interest rates, higher incomes, and ample liquidity should keep most of the economy vibrant.
3. Robust demand, supply shortages, and rising input costs, especially surging energy prices, point to the potential for a sustained period of above-desired inflation, and thus building pressure on central banks.
4. The minutes of the Fed's September meeting suggested a Quantitative Easing (QE) taper announcement in early November, with the purchases likely to be completed by mid-2022.
5. U.S rent inflation made a notable move in September (+0.5% m/m). Once a turn happens in rent, the data typically continues in that direction. Momentum is developing to the upside.
6. The U.S. labor market has probably never been so confusing. Part of the problem is that the labor market is so tight that a record 4.3 million workers quit their jobs during August. Job openings are taking longer to fill as workers have become pickier about job type and pay.
7. Corporate guidance post Q3 earnings reports will likely be more cautious due to cautionary comments about higher labor and materials costs, as well as shortages of workers and parts.
8. Congressional Democrats need to shrink a $3.5 trillion package to a $2 trillion package, likely by largely reducing the time span of the bill.
9. A COVID-hit weak Q3 in China will likely be followed by somewhat stronger growth over the next several quarters, barring a major credit problem.
10. U.S. corporate bond spreads have been widening a bit recently. While a reduction in spread product exposure is not yet warranted, this is an early warning sign for corporate bond spreads.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.33%	-1.72%
BLOOMBERG U.S. CORP HIGH YIELD	0.15%	4.35%
BLOOMBERG U.S. GOV/ CREDIT	0.45%	-2.09%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.00%	0.03%

THE EQUITY MARKET SEE-SAW CONTINUES

After a quiet summer of falling bond yields and generally positive trends in risk asset markets, the past few weeks have turned bumpier. Growth expectations have been moderating, but nagging inflation and warnings of central bank bond tapering have unnerved investors. The first yield upwave ended in spring and was a reaction to the arrival of vaccines starting last November and hopes for economic re-opening. Inflation concerns were generally still not evident. Risk assets celebrated the positive economic developments and easily weathered the modest rise in bond yields from record low levels, because corporate earnings expectations soared and central banks continued to promise to leave hyper-accommodative policies in place for a long time.

The second bond yield upwave is not proving to be as positive for risk assets as was the case during the first wave. The current upleg is coinciding with a change in central bank rhetoric and decelerating growth in economic indicators, all at a time when risk asset market valuations are more stretched than last November. To the extent that longer-term economic and earnings expectations still have more upside, this will be bullish for equities. While too early to conclude, initial third quarter earnings reports are supportive. Even so, this positive will be partly offset by the likelihood that higher longer-term economic expectations will coincide with rising real bond yields, creating a drag on valuations. In other words, the super-easy money phase for financial markets is over, which is negative for government bonds and implies that other markets will face gradually increasing headwinds. Stocks will likely be more volatile with less upside than during the past 18 months.

One early warning sign of a fundamental change in the monetary backdrop has been the upward creep at the short end of the yield curve. Although the Fed will move before the ECB and the BoJ, it is still a long way from hiking rates and will be very wary of shifting to a restrictive stance; its bias is strongly on the side of promoting higher inflation. It is premature to suggest a bearish backdrop for risk assets. Monetary conditions may have peaked in terms of maximum stimulus, but will remain supportive for some time. Still, change occurs on the margin, and equity markets have recently been soft, as it is becoming apparent that the maximum positive conditions of sharply rising earnings expectations and open-ended monetary stimulus is ending. Corrections should be temporary in nature, as end-of-cycle conditions are not on the horizon. However, achieving capital gains will become progressively more challenging.

U.S. businesses are dealing with supply shortages and lingering mobility issues related to the pandemic that have slowed the service sector. The availability and quality of labor remain a drag and inflation is now seen as a problem. So far, profit margins are holding up because input costs are generally being passed on to end-users.

CONCLUSION:

Signs that global inflation will prove sticky continue to accumulate. Thus, we are maintaining a maximum underweight position on bonds, and expect another upleg in yields as investors gain greater conviction in the durability of the global economic expansion. Higher bond yields and less accommodative monetary conditions will eventually create a headwind for equity valuations. For now, stocks are likely to outperform bonds, but with greater volatility than in the past 18 months.

Data from Morningstar Direct, as of 10/18/2021.

Crossmark Global Investments, Inc.
15375 Memorial Drive, Suite 200, Houston, TX 77079
888.845.6910 advisorsolutions@crossmarkglobal.com
crossmarkglobal.com