CROSSMARK
GLOBAL INVESTMENTS

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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	5.72%	-8.06%
S&P 500	3.97%	-17.09%
NASDAQ	2.25%	-28.59%
RUSSELL 2000	6.02%	-16.85%
RUSSELL 1000 GROWTH	3.01%	-25.93%
RUSSELL 1000 VALUE	5.04%	-8.86%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-2.86%	-37.92%
CONSUMER DISCRETIONARY	0.71%	-29.24%
CONSUMER STAPLES	6.12%	-3.26%
ENERGY	2.79%	67.57%
FINANCIALS	6.23%	-11.17%
HEALTHCARE	5.00%	-4.57%
INDUSTRIALS	6.74%	-9.38%
INFORMATION TECHNOLOGY	4.29%	-25.08%
MATERIALS	3.35%	-16.13%
REAL ESTATE	6.17%	-27.24%
UTILITIES	6.50%	-3.71%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	3.35%	-20.79%
MSCI ACWI EX U.S.	2.32%	-24.38%
MSCI EAFE	4.13%	-23.23%
MSCI EM	-2.24%	-29.64%

SUMMARY:

Equities were higher for the second straight week (S&P 500 +4.0%). Despite multiple megacap earnings disappointments, the market remained resilient. The market is embracing the idea that the Fed could soon begin to slow the pace of tightening. Best performers were industrials (+6.7%) and utilities (+6.5%); worst performers were communication services (-2.9%) and consumer discretionary (+0.7%).

KEY TAKEAWAYS:

1. Preliminary estimates indicate that U.S. GDP grew by 2.6% in Q3 beating expectations of 2.3%, following two consecutive quarters of negative growth. However, the details of the release are less upbeat than what the headline GDP number suggests. In particular, consumption's contribution to GDP growth decreased relative to Q1 and Q2.

2. It took over a year for inflation to peak this cycle, rising from 2% to 9% in June. This has started to reverse and should result in inflation falling to a 4-5% run rate by year-end.

3. The 10-year/3-month yield curve has inverted (a more reliable recession indicator than the 10-year/2-year. This has kept us away from a 2022 recession call.) Our view continues to be that a 2023 recession is more likely.

4. For the Fed to slow/stop its interest rate increases, we need to see some more slack in the U.S. labor market (there remain roughly 10 million job openings for 6 million unemployed).

5. The FOMC is likely to go ahead with a 75bp hike at its November 1-2 meeting, a 50bp hike at its mid-December meeting, and then pause rate-hiking early next year.

6. On average, the 10-year Treasury yield peaks 1-2 months prior to the last rate hike of the tightening cycle. If the Fed ends tightening around year-end (which implies a willingness to accept a 4-5% inflation rate), 10-year yields in the 4-4½% range may prove to be attractive. If, however, the Fed insists on a 2% inflation rate, interest rates will need to move higher.

7. We largely attribute the equity market upturn in recent weeks to hopes that the Fed will take a less harsh tightening path.

8. The terminal Fed Funds rate has always been higher than the CPI at the end of prior tightening cycles. (Current Fed funds is 3.25-3.50; current trailing CPI is 8%). In a tightening cycle, the stock market has never bottomed until Fed Funds exceeded inflation.

9. The largest tech stocks (GOOGL, MSFT, FB/META, AMZN, NFLX, TSLA and AAPL) have now lost more than $3 trillion in stock market capitalization over the last year (declining from $10.7 to $7.5 trillion).

10. Opinion polls are breaking in favor of Republicans in the final days of the midterm election campaign, indicating the Republicans will handily win the House and narrowly win the Senate.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	1.65%	-15.36%
BLOOMBERG U.S. CORP HIGH YIELD	2.44%	-12.16%
BLOOMBERG U.S. GOV/ CREDIT	1.46%	-15.90%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.06%	0.83%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	6.62%	-25.47%
COMMODITIES (DJ)	0.51%	14.16%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	8.81%	-38.19%
CURRENCIES (DB G10 CURRENCY FUTURE)	0.12%	6.49%

REPRIEVE IN BONDS ALLOWS STOCKS TO RISE

The conditions for another pause in the cyclical rise in global government bond yields are falling into place. Signs of weaker economic growth, a cresting in inflation pressures, and some hints of a slowing in the pace of central bank rate hikes all signal positively for government bonds. A pause in bond yields, even if caused by weaker economic growth, will provide some relief for stocks. Intense de-rating pressures have been the dominant factor causing the bear market this year, and this drag will ease as bond yields pause.

On their own, the current level of bond yields and policy rates is not likely to generate a recession. But inflation is not likely to fall to acceptably low levels in the next year. Some external shock could yet upset the economy, but we doubt that inflation will have a chance to get back to 2% without a noticeable and lasting economic downturn. Thus, although the cyclical bear market in bonds is becoming advanced, there are still good odds of another upleg in yields in 2023 to a new cyclical peak. Central banks are starting to respond to slowing growth and, undoubtedly, want to avoid another financial crisis. They are likely encouraged that the speculative froth in most asset markets has significantly receded and thus are less keen to further tighten financial conditions. A dip in bond yields, a slowdown in rate hikes, along with lower energy prices will all help to reduce the odds of a global recession. The key to a pause in the cyclical rise in bond yields will be for economic activity to be at least sluggish and for inflation, with a lag, to ease as well. We do not foresee a repeat of the quick drop in inflation to depressed levels that frequently occurred whenever economic growth weakened in the 1980s-2010s; rather we envision a further deceleration in goods inflation (already evident in the U.S.) and an eventual moderation in service sector inflation.

Our base-case scenario is for sluggish global growth or a mild recession next year, but not a full-on recession that cleans out the system and fully flushes inflationary pressures. A risk to this view is that one of the global "weak-link" economies snaps, which would cause us to downgrade our economic outlook. Global trade is struggling as two major sources of demand have been sluggish, namely China (for self-inflicted COVID reasons) and the euro area (the energy crisis). Even import growth in the prior booming U.S. economy is decelerating as consumers temper their pandemic-driven demand for goods and respond to much higher borrowing rates. While conditions are still reasonably healthy, the U.S. economy is cooling. The most important variable for U.S. demand is employment, and weakness there has always heralded weaker consumption and investment. Payroll gains should slow in the coming months.

So far, U.S. corporate profits have proven quite resilient overall, and thus hiring plans and layoffs have not deteriorated to any meaningful degree. Nevertheless, one must closely monitor U.S. employment market trends, as a breakdown in this key area would meaningfully impact the overall global economic outlook and, thus, inflation.

CONCLUSION:

The cyclical rise in global government bond yields is set to pause again, as economic activity is slowing, inflation pressures easing and there are good odds of a slowing in the rate-hiking cycle in many economies. However, even though the bear market in bonds is becoming advanced, we anticipate another upleg in yields in 2023 given the likelihood of resilient economic growth and sticky inflation in the U.S. and euro area. Equities are likely to enjoy another temporary reprieve as de-rating pressures ease. We see such a move as tactical in nature, and not the start of a durable bull phase.

Data from Bloomberg, as of 10/30/2022.

