CROSSMARK GLOBAL INVESTMENTS

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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	1.27%	15.17%
S&P 500	0.83%	18.23%
NASDAQ	0.10%	13.70%
RUSSELL 2000	-0.37%	13.89%
RUSSELL 1000 GROWTH	0.33%	15.87%
RUSSELL 1000 VALUE	1.26%	19.07%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	0.05%	23.81%
CONSUMER DISCRETIONARY	0.90%	11.96%
CONSUMER STAPLES	1.42%	6.45%
ENERGY	5.02%	55.37%
FINANCIALS	2.35%	34.28%
HEALTHCARE	-0.33%	13.16%
INDUSTRIALS	1.78%	15.07%
INFORMATION TECHNOLOGY	0.29%	17.28%
MATERIALS	1.00%	13.37%
REAL ESTATE	-0.72%	24.80%
UTILITIES	1.45%	5.66%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	0.74%	12.40%
MSCI ACWI EX U.S.	0.68%	5.97%
MSCI EAFE	0.29%	7.84%
MSCI EM	0.85%	-0.92%

SUMMARY:

U.S. equities finished mostly higher last week, with the S&P 500 up +0.8%. Value and cyclicals outperformed growth and defensive stocks. Upside seemed to be a function of oversold conditions and a deal to raise the debt ceiling. Best sectors were energy (+5.0%) and financials (+2.3%); worst sectors were REITs (-0.7%) and healthcare (-0.3%).

KEY TAKEAWAYS:

1. The September employment report was a disappointment as non-farm payrolls rose just 194,000 in September. But average hourly earnings increased 0.6%, yet another sign of an inflationary environment.
2. A soft September will likely be followed by a better 4Q. COVID-19 cases are declining around the world, supply problems may be starting to fade, and consumer confidence may be bottoming.
3. Headwinds are mounting for corporate profits, including slowing revenue growth, accelerating wages, rising input costs, supply chain disruptions, and possible higher corporate taxes.
4. Corporate costs have increased 9.7% over the last year, marking the highest reading since early 2012.
5. According to FactSet, inflation was mentioned on 45% of earnings calls for Q2, well above the average of 28% over the last five years.
6. Inflationary pressures have prompted several central banks to initiate rate hikes. We suspect bond markets are underestimating the potential for tighter monetary policies over the next year or two.
7. The Fed is tentatively planning to end tapering by next summer permitting the possibility of a rate hike by the end of 2022.
8. The debt ceiling deal clears the path for Democrats to negotiate their "Build Back Better" spending agenda which will dominate headlines in October and November.
9. The weakness in the stock market of late has been enough to soften bullishness making sentiment more of a tailwind than headwind for the first time all year.
10. Financials are among the best performing equity sectors over the past three months and year to date. Financials will continue to benefit from rising bond yields, and low valuations are also a tailwind.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.78%	-2.05%
BLOOMBERG U.S. CORP HIGH YIELD	-0.33%	4.19%
BLOOMBERG U.S. GOV/ CREDIT	-0.92%	-2.52%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.00%	0.03%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-0.24%	22.71%
COMMODITIES (DJ)	1.87%	30.12%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	0.99%	21.29%
CURRENCIES (DB G10 CURRENCY FUTURE)	0.98%	5.81%

SIGNIFICANT CROSSCURRENTS PRIOR TO Q3 EARNINGS

Equity markets have been struggling with a number of short-term risk factors. None at this point (hopefully) seem to threaten the big-picture outlook of a solid global economic recovery. But when markets significantly front-run positive fundamentals (as they have), even modest risks can cause temporary setbacks. We remain short-term cautious, and expect the recent correction phase in equities to persist until investors regain confidence in the durability of the global economic expansion. We expect growth to remain robust in the coming months and for investors' concerns to gradually ease.

Notably, sentiment has pulled back meaningfully from the heights seen earlier this year. Such large declines can coincide with sizable risk-off phases if a recession or large growth scare develops, but we expect neither. The decline in sentiment reflects a combination of stretched valuations and an underlying nervousness about the durability of the economic recovery. In addition, some investors are starting to worry about stagflation, in view of the peaking in economic growth measures and the spike in inflation.

We share the concern about high valuations, as there is considerable downside in risk asset markets if the economic outcome turns negative. We neither expect such an outcome, nor a stagflationary environment. Growth prospects remain solid, as demonstrated by last week's robust PMI surveys in most of the major developed economies. We do, however, expect inflation to prove sticky and ultimately problematic. The inflation threat will not be a lasting issue for financial markets until bond market sentiment sours significantly, which central banks are doing their best to avoid. They have achieved notable success so far; bond yields remain far below nominal GDP growth and even below the rate of inflation. There are no meaningful roadblocks to solid global economic growth providing the pandemic continues to recede. We remain upbeat on corporate earnings (although third-quarter results may be mixed) and bearish on bonds, implying stocks will outperform bonds once near-run risk factors diminish. Nevertheless, valuations warrant greater caution toward equities than the earnings outlook and accommodative monetary conditions might suggest.

The near-nonstop advance phase since November 2020 has ended, and there has been notable churning and correcting in many stocks during recent months. There are short-term risk factors that are causing investor concerns such as prospects for a tapering from the Fed, negative economic and policy developments in China, peak U.S. economic and earnings growth, and political chaos. We would be much more concerned if central banks decided that the inflation upturn was indeed durable and they needed to restrain economic activity. That risk is not likely anytime soon.

Financial market valuations are stretched. To the extent that there is upward pressure on bond yields, long-duration equities are likely to face headwinds given their relatively high valuation multiples. These include the technology, communication services, and parts of the consumer discretionary sector. On the other hand, financials should fare better in an environment of rising bond yields. Should tapering produce an increase in equity market volatility, classic defensive sectors will likely be boosted, with healthcare better positioned to outperform than fixed-income proxies such as utilities, consumer staples, and REITs, given the sector's lower sensitivity to higher bond yields.

CONCLUSION:

Equity prices have moved ahead of improving underlying corporate earnings, such that stocks are still overbought at a point when some short-term threats have developed. None of these threats are cyclically threatening. Thus, while some near-term caution is warranted, our constructive cyclical view on the global economy points to continued upside for earnings and underlying support for stocks over bonds.

Data from Morningstar Direct, as of 10/11/2021.

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