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GLOBAL INVESTMENTS

Doll's Deliberations

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SUMMARY:

Stocks fell last week (S&P 500 -1.3%) as the S&P 500 and NASDAQ fell below their 50-day moving averages. The market's mood was primarily defensive with investors focused on the renewed back up in interest rates, dollar strength, and the spike in oil prices. Positive sectors included energy (+1.4%) and utilities (+0.9%); underperformers included industrials (-2.9%) and materials (-2.5%).

KEY TAKEAWAYS:

1. EPS revision trends are improving somewhat as both energy and financials have moved into positive territory.

2. Payroll gains have shifted down from an average of 300k in 2022 to 150k over the past three months, we think due to the lagged impact of Fed tightening.

3. Brent crude closed above $90/bbl last Tuesday for the first time since last November after key OPEC+ members extended production curbs until the end of the year. Absent a notable economic slowdown, oil prices could reach $100.

4. Narrower profit margins and low profit growth are likely due to the global slowdown, rising rates, tighter credit, still-tight labor, and weakening productivity.

5. We have witnessed a substantial decline in the mentioning of "recession" and "inflation" in corporate transcripts from their peaks in the middle of 2022.

6. Corporate bankruptcies in August increased more than 50% from last August. This is likely a direct result of the Fed raising rates more than 500 basis points in eighteen months.

7. The Fed can win the war against inflation, but not without much higher unemployment/recession. Or, the Fed can prevent much higher unemployment/recession but not without losing the war against inflation. Faced with this choice, the Fed will likely choose to win the war against inflation.

8. Covid, the Russian-Ukraine war, China's economic issues, and less global leadership from the U.S. have all rendered a noticeable pause, and perhaps, end, to globalization. Consequences include higher inflation, slower growth, weaker profitability, greater defense spending, and more political volatility.

9. Equity market sentiment/positioning has retreated from high bullishness at the end of July. It is approximately at the mid-point between the bullish and bearish extremes at the end of July and December, respectively.

10. In a study going back to 1962, Strategas showed that in rising interest rate environments, stocks outperformed bonds by 1200 basis points per annum. (In falling interest rate environments, bonds outperformed stocks by 100 basis points per annum.)

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-0.70%	5.99%
S&P 500	-1.26%	17.45%
NASDAQ	-1.92%	32.27%
RUSSELL 1000	-1.44%	17.16%
RUSSELL 1000 GROWTH	-1.24%	30.56%
RUSSELL 1000 VALUE	-1.38%	4.94%
RUSSELL 2000	-3.37%	6.46%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-0.04%	44.32%
CONSUMER DISCRETIONARY	-0.52%	33.32%
CONSUMER STAPLES	-0.52%	-1.58%
ENERGY	1.48%	6.99%
FINANCIALS	-1.05%	1.28%
HEALTHCARE	-1.07%	-1.99%
INDUSTRIALS	-2.88%	8.49%
INFORMATION TECHNOLOGY	-2.34%	41.60%
MATERIALS	-2.38%	6.34%
REAL ESTATE	-1.02%	0.83%
UTILITIES	0.91%	-8.95%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-1.37%	13.41%
MSCI ACWI EX U.S.	-1.32%	7.41%
MSCI EAFE	-1.23%	9.24%
MSCI EM	-1.20%	3.87%

BONDS HOLD THE KEY TO THE DIRECTION OF STOCKS IN THE NEAR TERM

Many investors are tempted to buy bonds on the prospect of central banks nearing the end of the monetary tightening cycle and cutting interest rates down the road. The implication of such a view is that long-duration government bonds should enjoy capital gains that will more than compensate investors for the current yield advantage on short-duration bonds or cash. Inherent in the bond bull case is the belief that monetary policy and the level of interest rates is restrictive. That is, they believe that the current levels of short and long-term interest rates will crimp growth to below underlying potential, not only bringing down inflation toward or below central bank targets, but also causing an unnecessary rise in unemployment since inflation will fall toward 2% on its own. In short, that monetary policy will needlessly jeopardize the economic expansion. We disagree.

A US 10-year Treasury yield of 4.25% is hardly restrictive against 5% nominal GDP growth. The key issue for the next 6-12 months is whether the economic expansion will continue, or recessionary forces will take hold. While rates may have to work their way higher to stymie growth, the long and unpredictable lead time from Fed raises to economic weakness may still strike before year-end. Market expectations of Fed rate cuts in the next year will unwind and push up G7 10-year government bond yields. Given late-cycle economic conditions, combined with lingering investor uncertainty about central bank policy rates and bond yields, we expect capital markets to be choppy over the balance of the year with a downside bias.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.40%	0.49%
BLOOMBERG U.S. CORP HIGH YIELD	-0.37%	6.75%
BLOOMBERG U.S. GOV/ CREDIT	-0.37%	0.67%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.09%	3.36%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-0.70%	1.18%
COMMODITIES (DJ)	-0.50%	-2.60%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-0.50%	15.79%
CURRENCIES (DB CURRENCY FUTURE HARVEST)	0.38%	6.58%

While recent global economic data has been mixed, the US has exhibited reasonable strength in most sectors. Pessimism about China is widespread, with a disappointing economic re-opening adding to the negative narrative about the already long-underway structural growth slowdown. China's property sector and high leverage will remain drags.

While the Fed et al may soon go on hold, which equity investors are anxiously awaiting, equities face a lingering threat from higher interest rates. The latter is especially the case for the US growth stocks that have dramatically outperformed this year and are expensive by historical standards. With the US representing approximately 60% of global market capitalization and the seven largest US growth stocks by themselves some 18% of the global total, the risk/reward is not positive. Valuations reinforce this cautious tone. The gap between the earnings yield on stocks and the G7 10-year government bond yield (i.e., the equity risk premium) is at its narrowest level since before the Great Recession. The ERP could decline further, but the diminishing valuation cushion for equities versus bonds argues against an overweight on equities within a multi-asset portfolio.

CONCLUSION:

1. If we experience an ongoing economic expansion, we will likely see a further, albeit modest and choppy rise in the global stock-to-bond ratio (i.e., stocks will outperform bonds) translating into unimpressive returns.
2. Higher bond yields pose a particular risk to US growth stocks.
3. We expect government bond yields to move higher against a backdrop of decent global economic growth and an unwinding of central bank rate cut expectations.
4. Equities are likely to be choppy and rangebound.
5. We remain neutral on commodity prices with the notable exception of a constructive outlook on oil.

Data from Bloomberg, as of 9/8/2023.

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