CROSSMARK GLOBAL INVESTMENTS

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# DOLL'S DELIBERATIONS

## WEEKLY INVESTMENT COMMENTARY

| EQUITY MARKETS (INDEX TOTAL RETURN) | LAST WEEK | YEAR-TO-DATE |
|---|---|---|
| DJIA | -4.11% | -13.85% |
| S&P 500 | -4.73% | -17.80% |
| NASDAQ | -5.46% | -26.40% |
| RUSSELL 2000 | -3.02% | -17.95% |
| RUSSELL 1000 GROWTH | -5.36% | -25.21% |
| RUSSELL 1000 VALUE | -4.21% | -10.96% |

| S&P EQUITY SECTORS (INDEX TOTAL RETURN) | LAST WEEK | YEAR-TO-DATE |
|---|---|---|
| COMMUNICATION SERVICES | -6.42% | -33.76% |
| CONSUMER DISCRETIONARY | -4.15% | -22.77% |
| CONSUMER STAPLES | -3.48% | -6.30% |
| ENERGY | -2.54% | 45.43% |
| FINANCIALS | -3.77% | -14.56% |
| HEALTHCARE | -2.32% | -8.82% |
| INDUSTRIALS | -6.37% | -14.97% |
| INFORMATION TECHNOLOGY | -6.11% | -25.80% |
| MATERIALS | -6.64% | -18.67% |
| REAL ESTATE | -6.23% | -21.00% |
| UTILITIES | -3.78% | 5.66% |

| INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN) | LAST WEEK | YEAR-TO-DATE |
|---|---|---|
| MSCI ACWI | -3.12% | -18.99% |
| MSCI ACWI EX U.S. | -1.62% | -20.01% |
| MSCI EAFE | -1.77% | -20.95% |
| MSCI EM | -1.15% | -20.34% |

### SUMMARY:

Stocks fell for the fourth time in the last five weeks and are down nearly 10% since the August 12 peak. The main event of the week that sparked the sell-off was the hotter than expected August CPI report on Tuesday (see details below). Best sectors were healthcare (-2.3%) and energy (-2.5%); worst sectors were materials (-6.7%), REITS (-6.2%) and communication services (-6.4%).

### KEY TAKEAWAYS:

1. U.S. inflation was hotter than expected in August. Headline CPI increased by 0.1% m/m (consensus was a 0.1% decline). Annual inflation fell from 8.5% to 8.3% (expectations were 8.1%).
2. We still see a reasonable path for inflation to moderate to an annualized 4-5% range by year-end. However, bringing inflation down to the 2% target will most likely require the Fed to cause a recession.
3. During previous tightening cycles, the Fed only stopped tightening after the Fed rates exceeded the rate of inflation. (Fed funds is currently 2 3/8% and inflation is 8.3%.)
4. August industrial production and retail sales reports show that the U.S. economy continues to grow, but at a slow pace.
5. Corporate operating margins will decline in the coming months. That will add volatility to equity prices, but some of that bad news is reflected in current valuations.
6. The main concern facing most businesses is a chronic shortage of labor. Businesses are responding by spending more on capital equipment and technology to boost productivity.
7. The dollar has been supported by favorable interest rate differentials and global economic pessimism, favoring the more defensive U.S. currency. This increase has left the dollar stretched and overbought, and vulnerable to corrections.
8. The Eurozone is likely headed for recession due to high inflation, energy supply shortages, and an ECB on a tightening path.
9. Ukraine has made substantial and surprising progress over recent weeks in the war with Russia.
10. We expect U.S. stocks to remain in a trendless, volatile tug of war between the bears and the bulls for the balance of 2022. At some point, a test of the June lows is likely.

| FIXED INCOME MARKETS (INDEX TOTAL RETURN) | LAST WEEK | YEAR-TO-DATE |
|---|---|---|
| BLOOMBERG U.S. AGGREGATE BOND | -0.86% | -12.32% |
| BLOOMBERG U.S. CORP HIGH YIELD | -1.50% | -11.56% |
| BLOOMBERG U.S. GOV/ CREDIT | -0.74% | -12.88% |
| BLOOMBERG U.S. T-BILL 1-3 MONTH | 0.04% | 0.53% |

| ALTERNATIVES (INDEX TOTAL RETURN) | LAST WEEK | YEAR-TO-DATE |
|---|---|---|
| REAL ESTATE (FTSE NAREIT) | -5.72% | -19.82% |
| COMMODITIES (DJ) | -1.44% | 18.78% |
| GLOBAL LISTED PRIVATE EQUITY (RED ROCKS) | -3.97% | -35.71% |
| CURRENCIES (DB G10 CURRENCY FUTURE) | -0.86% | 5.67% |

## THE NOOSE ON THE FED TIGHTENS A NOTCH

Both inflation and economic growth have too much momentum for investors and central bankers, especially in the U.S. Good economic momentum has generally been a positive for risk asset markets, but not recently given the return of inflation. So far, earnings resilience exists because companies have been able to pass on higher input costs to end-users and they, in turn, are being forced to boost wages to attract and retain labor.

One possible scenario is for economic growth to cool further or stay moderate, coinciding with some decline in inflation due to the efforts of the Fed and some supply chain problem resolution. This scenario could allow central banks to continue to lower inflation and possibly avoid a recession. Central banks may have room to slow their rate-hiking cycle by year-end. Nevertheless, we believe that the interest rate and bond yield upcycles will last longer and peak at higher levels than most investors, as 2-3% inflation levels will prove elusive.

While the cyclical bond bear market is now moderately advanced, the finish line is not in sight and additional bond losses loom. In turn, there is a risk of yet another downleg in risk asset prices, despite the still-positive backdrop for corporate earnings. As noted in the recent inflation report, the ultimate end point is that "it most likely will take a recession in order for inflation to return to close to the Fed's target of 2%." The cyclical path upward in rates and yields should still entail pauses and/or brief countertrend moves. The heightened sensitivity of risk asset prices to higher bond yields will be one periodic brake on higher yields, and the normal ebbs and flows in economy activity will also occasionally generate temporary bond buying. Already, some investors are touting current yields as offering "good value", even though yields are far below the level of actual inflation.

Energy prices have recently declined meaningfully, which is positive for both growth and inflation in the coming months, yet this economic plus is being offset by ever-higher borrowing rates.

It is unusual for companies to still want to add headcount in the face of sluggish economic growth and widespread forecasts of recession. The resilient and generally elevated underlying profitability of the business sector remains a feature of the post-pandemic period. Any number of factors (including input costs and wages, domestic and geopolitical uncertainties, a war, high energy prices, etc.) should have caused companies to retreat, but this is not yet evident.

## CONCLUSION:

The revival of inflation has ended the era of ever-higher financial asset prices and valuations. As a result, capital preservation has become a key objective for investors. Tactical long opportunities will occasionally develop, and a slowdown in the rate-hiking cycle is still more likely over the next 6-12 months than a straight-line tightening in policy that ultimately drives the global economy over a cliff. Equity markets are becoming oversold again and could rally if government bond markets calm and central bank rhetoric turns less hawkish.

Data from Bloomberg, as of 09/16/2022.