CROSSMARK GLOBAL INVESTMENTS

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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-4.00%	-17.30%
S&P 500	-4.63%	-21.61%
NASDAQ	-5.06%	-30.13%
RUSSELL 2000	-4.21%	-22.57%
RUSSELL 1000 GROWTH	-4.57%	-28.63%
RUSSELL 1000 VALUE	-5.20%	-15.59%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-5.09%	-37.14%
CONSUMER DISCRETIONARY	-7.01%	-28.19%
CONSUMER STAPLES	-2.15%	-8.31%
ENERGY	-9.00%	32.34%
FINANCIALS	-5.58%	-19.32%
HEALTHCARE	-3.36%	-11.88%
INDUSTRIALS	-4.54%	-18.83%
INFORMATION TECHNOLOGY	-3.57%	-28.45%
MATERIALS	-5.63%	-23.25%
REAL ESTATE	-6.37%	-26.03%
UTILITIES	-2.99%	2.50%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-3.00%	-22.16%
MSCI ACWI EX U.S.	-2.83%	-23.18%
MSCI EAFE	-3.03%	-24.08%
MSCI EM	-2.25%	-23.31%

SUMMARY:

Stocks fell significantly again last week (S&P 500 -4.6%), with the major averages experiencing the fifth decline in the last six weeks. The selloff was driven by the Fed's unilateral "fight inflation" rhetoric, a back-up in yields, and rising recessionary fears. Best performers were consumer staples (-2.2%) and utilities (-2.9%); worst performers were energy (-9.0%) and consumer discretionary (-7.0%).

KEY TAKEAWAYS:

1. As expected, the Fed delivered a 75bp rate hike, bringing the Fed funds rate to a range of 3.00-3.25%. The Fed also made downward revisions to economic growth estimates and upward revisions to the unemployment rate and inflation forecasts (not a good combination). Chair Powell reiterated that bringing inflation back down to the 2% target remains the Fed's overarching goal which, if achieved, almost guarantees a recession.

2. The University of Michigan Consumer Survey shows that inflation expectations continue to decline. This is good news for the Fed, as it reduces the risk that inflation becomes entrenched.

3. Our view is that the peak in the Fed funds rate will occur during 1H 2023 and that, while a pause in the Fed's tightening cycle is likely at that point, inflation will be strong enough to preclude rate cuts.

4. The Atlanta Fed's GDP model reduced 3Q GDP estimates from 2.5% to 0.5%. This creates a highly uncertain and turbulent environment for financial markets.

5. Commodity prices are falling, the dollar is soaring, and real GDP estimates are clustering around zero. It may be that the Fed (and the markets) are concluding that the only way to bring inflation down is via a recession.

6. Given the activity inside the stock market of late (outperformance of defensive stocks and underperformance of cyclical stocks), it is possible that the stock market has become more concerned with recession than inflation.

7. Fedex, Alcoa, Nucor, and a few other economically-sensitive companies have highlighted how quickly the economy has downshifted and their stocks have paid the price, which means a recession was not priced in.

8. Given the recent activity in the stock market, it is not surprising to see that the Bull/Bear Ratio dropped below 1.00 again to 0.96 (readings of 1.00 or less have proven to be good times to buy for long-term investors).

9. A market bottom has never occurred with a negative real earnings yield. Currently, the real earnings yield is -2%.

10. While the stock market has experienced significant downside and it as the lower end of the trading range and therefore could bounce at any time, sadly the downside risk is probably still larger than the upside potential in the intermediate term (especially if there is a liquidity or credit accident.)

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-1.32%	-13.54%
BLOOMBERG U.S. CORP HIGH YIELD	-0.81%	-12.74%
BLOOMBERG U.S. GOV/ CREDIT	-1.22%	-14.05%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.04%	0.58%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-5.22%	-23.89%
COMMODITIES (DJ)	-3.66%	14.43%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-6.65%	-40.98%
CURRENCIES (DB G10 CURRENCY FUTURE)	-0.35%	5.30%

RECESSION RISKS INCREASE AND WEIGH ON STOCKS

The biggest issue facing investors and central banks is whether inflation pressures can recede significantly before a full-blown recession takes hold. We had been hopeful that at least a modest short-term easing in the U.S. inflation would develop and allow the Fed to ease back a notch from its newfound hawkishness. However, such a pause has not yet developed, and the Fed has stayed on its hawkish path. In turn, expectations of a looming recession are rising.

U.S. interest rate expectations are finally getting to levels necessary to meaningfully cool growth and generate some economic slack. Last week's Fed meeting saw policy rate forecasts from the FOMC ratchet higher yet again, along with a further sharp rise in market expectations. Nevertheless, the Fed is still anticipating a softish economic landing and benign glide-path towards 2% core inflation. Such a goldilocks outcome is no longer likely. The odds of an earlier U.S. recession have increased due to higher global inflation and the persistence of strong labor demand in the U.S. It likely will take a meaningful economic downturn and sizable rise in unemployment to fully reverse rising wage pressures and sustainably reduce inflation and inflation expectations It is likely the Fed and other central bankers are still too optimistic on how difficult it will be to return inflation to low levels for an extended period.

For investors, the main takeaway is that conditions are progressively becoming riskier on a cyclical basis. The decline in government bonds has intensified to the detriment of risk asset markets. Last week, liquidity and some credit concerns surfaced especially outside the U.S. For example, European bond yields have surged further in the absence of positive economic news reinforcing the seriousness of the inflation threat and absurdly low starting point for policy rates this cycle.

Recessions typically take hold when the most interest rate-sensitive and vulnerable economic sectors succumb to the forces slowing economic activity, typically tightening monetary conditions and the rising cost of capital. Indeed, even the U.S. housing market is slowing notably in the face of rising borrowing costs and still sky-high home prices despite a shortage of inventory and the strongest labor market in decades.

CONCLUSION:

Although a recession over the next 6-12 months has not been inevitable in our view, the odds of this outcome are increasing and will continue to climb if the rise in interest rate expectations persists. The rise in long-term government bond yields may periodically be slowed by weak risk asset markets, but cyclical risks of higher yields will persist until a recession takes hold. This latter point is ultimately bearish for stocks. Sadly, the room to avoid a recession has narrowed.

Data from Bloomberg, as of 09/23/2022.

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