

DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DOW JONES	-0.14%	17.10%
S&P 500	0.62%	21.95%
NASDAQ	1.57%	19.75%
RUSSELL 2000	0.68%	16.77%
RUSSELL 1000 GROWTH	1.30%	21.76%
RUSSELL 1000 VALUE	-0.07%	20.64%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	0.96%	30.07%
CONSUMER DISCRETIONARY	1.27%	13.12%
CONSUMER STAPLES	1.63%	10.18%
ENERGY	-1.38%	31.51%
FINANCIALS	-2.36%	30.44%
HEALTHCARE	1.70%	21.57%
INDUSTRIALS	-0.33%	18.85%
INFORMATION TECHNOLOGY	0.89%	22.81%
MATERIALS	-0.74%	18.70%
REAL ESTATE	4.02%	35.54%
UTILITIES	1.44%	12.57%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	1.30%	16.76%
MSCI ACWI EX U.S.	2.26%	10.78%
MSCI EAFE	1.80%	13.24%
MSCI EM	3.42%	3.42%

SUMMARY:

Stocks traded mostly higher again last week with the S&P 500 +0.6%. The path of least resistance for stocks has been higher. Monetary policy remains a key area of focus with thoughts that central banks globally will have a difficult time meaningfully dialing back extraordinary policy accommodation. Earnings, buybacks, and inflows continue to be flagged as tailwinds. Delta variant spread, persistent inflation pressures, supply constraints, and margin headwinds are among the higher-profile areas of concern. Best performers for the week were REITs (+4.0%) and healthcare (+1.7%); worst performers were financials (-2.4%) and energy (-1.4%).

KEY TAKEAWAYS:

1. The well-below consensus 235,000 gain in non-farm payrolls in August suggests that the Delta variant is beginning to weigh on the economy. This hopefully will not delay the start of Fed tapering.
2. The Fed has seemingly abandoned its long-standing dual mandate of full employment and price stability, opting instead for full employment and transitory inflation.
3. An indication that the Fed is not sure if the inflation increase is all temporary, Fed Chair Powell stated that "central banks cannot take for granted that inflation due to transitory factors will fade."
4. Upside surprises to European consumer and producer prices show that inflationary pressures are now broadening beyond the U.S.
5. Most analysts argue that President Biden's handling of Afghanistan will negatively impact U.S. relationships with allies and adversaries alike, thereby making U.S. businesses negotiations with trading partners more difficult.
6. Congress is about to begin debate on the largest tax increase in 50 years and the largest spending package since the Great Depression.
7. The tax increase portion of the all-Democratic reconciliation bill could take the form of a hike in the top individual income tax rate from 37 to 39.6%, the corporate rate from 21 to 25%, and the tax rate on capital gains from 20 to 28%.
8. When fears of the pandemic fade, confidence in above-trend economic growth will make the path of least resistance for bond yields higher.
9. While the stock market has been strong this summer and continues to make new highs, most measures show it is not overbought, suggesting it could go higher.
10. Multiples are likely to fall back somewhat in 2022, as typically happens when the Fed starts to tighten policy, but earnings growth is likely to be strong enough to provide an offset.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.06%	-0.76%
BLOOMBERG U.S. CORP HIGH YIELD	0.41%	4.74%
BLOOMBERG U.S. GOV/ CREDIT	-0.09%	-0.97%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.00%	0.03%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
FTSE NAREIT (REAL ESTATE)	3.49%	31.37%
DJ COMMODITIES	0.32%	24.42%
RED ROCKS GLOBAL LISTED PRIVATE EQUITY	1.41%	27.98%
DB G10 CURRENCY FUTURES	1.03%	4.07%

THE STOCK MARKET UPTURN WILL EVENTUALLY SHIFT TO A BUMPIER RIDE

Shifts in the macro climate over the next 6-12 months point to lower investment returns and more painful corrections. First, while remaining stronger than many fear, global growth will continue to moderate in the year ahead after the very robust initial pace of recovery. PMIs, consumer sentiment, trade and money supply growth have already peaked and will ease further. Judging by past economic expansions, investor confidence could periodically falter as growth moderates. Second, the Fed is signaling that it could begin tapering its asset purchases before year-end if employment growth remains strong and inflation sticky, as we expect will be the case, despite Friday's soft jobs report. Notwithstanding Fed Chair Powell's emphasis that tapering will not portend the start of a rate-hiking cycle, many market participants are primed to interpret a reduction in net new monetary stimulus as monetary tightening.

Inflation, particularly in the U.S., poses the biggest threat to capital market stability in the year ahead. Much of the recent surge in U.S. inflation will gradually ease as it reflects supply-chain disruptions and re-opening issues. However, underlying inflationary pressures are now above pre-pandemic levels and will be stickier than the Fed or market consensus believes, given trends prior to the onset of the pandemic, an output gap soon pushing into positive territory, and an American consumer flush with cash against a backdrop of an improving job market.

The recovery in corporate earnings is extraordinary by any standards. Global twelve-month forward earnings rose for a fourteenth consecutive month in August and are some 15% above their immediate pre-pandemic level. U.S. forward earnings have

risen even more strongly, but the rebound in global ex-U.S. earnings also has been robust. At the same time, the earnings acceleration phase is peaking. The pace of earnings growth will moderate in the year ahead, but the level should continue to rise as long as the economic recovery remains on track, as we expect. Consensus earnings estimates continue to rise for both 2022 and 2023, which will provide a tailwind for stocks, barring a negative growth shock.

Rising relative earnings continue to underpin U.S. relative outperformance, despite the strong rebound of global ex-U.S. earnings. We expect some earnings catch-up for global ex-U.S. markets on a 6-12 month horizon as U.S. growth cools, and Europe, Japan and much of the EM more fully recover from the pandemic, but an immediate catalyst is not evident.

Looking beyond the near-term, our macro outlook favors a modestly positive position supported by a still-improving global economy, but tempered by the likelihood higher real bond yields and building inflation pressures. We continue to recommend a maximum underweight stance on government bonds, where downside risks overwhelm expected returns. We remain broadly constructive on global equities, but elevated U.S. valuations justify only a neutral overall weighting in a multi-asset portfolio. We also expect the U.S. dollar to drift lower as the global economic recovery progresses.

CONCLUSION:

An ongoing earnings uptrend should enable stock prices to climb further in the year ahead, but returns will be more muted than they have been year-to-date, and there is risk of some short-term turbulence. Rich valuations remain a key vulnerability if bond yields rise as we expect over the next 6-12 months. Earnings continue to be a relative tailwind for U.S. stocks but is somewhat offset by valuation levels.

Data from Morningstar Direct, as of 9/7/2021.

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