CROSSMARK GLOBAL INVESTMENTS

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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	1.03%	13.76%
S&P 500	1.20%	12.62%
NASDAQ	2.08%	6.98%
RUSSELL 2000	2.45%	15.30%
RUSSELL 1000 GROWTH	1.63%	6.32%
RUSSELL 1000 VALUE	0.98%	18.41%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	2.47%	16.49%
CONSUMER DISCRETIONARY	2.27%	6.22%
CONSUMER STAPLES	-0.35%	5.22%
ENERGY	-0.01%	39.22%
FINANCIALS	1.09%	29.53%
HEALTHCARE	-0.61%	9.29%
INDUSTRIALS	2.00%	19.03%
INFORMATION TECHNOLOGY	1.59%	6.36%
MATERIALS	0.72%	20.91%
REAL ESTATE	2.10%	19.48%
UTILITIES	-1.57%	4.65%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	1.41%	10.79%
MSCI ACWI EX US	1.59%	9.75%
MSCI EAFE	1.22%	10.42%
MSCI EM	2.39%	6.03%

SUMMARY:

U.S. equities closed higher last week, with the S&P 500 up +1.2%. There was an absence of catalysts, with Q1 earnings season effectively over, fiscal stimulus progress coming slowly, economic reopening and domestic COVID trends improving as expected, and concerns about the Fed tapering its asset-purchase program focused on the June 16 FOMC meeting. The best sectors were communication services, consumer discretionary, and REITs (all up 2+%); the worst sectors were utilities and healthcare.

KEY TAKEAWAYS:

1. The economy is reopening, but consumer confidence is stalling, even with more and more people vaccinated, strong PMIs, and falling unemployment claims. A likely cause is rising prices for all sorts of items like gasoline, used cars, food, and houses.
2. Economies are recovering in a staggered fashion. The U.S. and U.K. are leading (aided by successful vaccination campaigns), followed by the Eurozone. Japan will pick up later this year.
3. Productivity will be critical for this expansion. Profit margins will eventually come under pressure (e.g., wages, taxes, interest rates, and regulations). Therefore, accelerating productivity growth is needed to contain inflation and support profit margins.
4. The Fed is moving closer to scaling back the pace of asset purchases, but the timeline looks pretty uncertain.
5. Bond yields fell back below 1.6%, well off the early-April peak of 1.73%. We believe investors have largely priced in a rapid economic recovery, and that is consistent with rangebound bond yields in the short-term (next move in rates remains higher).
6. The S&P 500 has failed to break above its May 7 all-time high. This stagnation is consistent with indications that the rally was vulnerable to some profit-taking. Such signals include higher than anticipated inflation numbers and a noticeable reduction in the number of positive earnings surprises.
7. The easy money has been made since the March 2020 trough as the S&P 500 has risen nearly 90%. However, we expect a choppy, directionless, next several months and therefore are willing to take some profits on rallies and add on dips.
8. The predominant market narrative has shifted from economic normalization amid solid earnings growth to concerns about rising inflation and the potential for a policy mistake. As a result, defensive sectors have retaken leadership from cyclicals and factor returns have taken on a more defensive/risk-off flavor.
9. After a poor start to the year, gold is up about 10% so far in Q2. The rise has come from increases in inflation expectations, the decline in the U.S. dollar, and the collapse of bitcoin.
10. Beyond Biden's infrastructure plan, his additional initiatives are in jeopardy. The higher tax plans are encountering resistance from every Republican in the Senate, the business community, and a handful of moderate Democrats.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG BARCLAYS U.S. AGGREGATE BOND	0.35%	-2.29%
BLOOMBERG BARCLAYS U.S. CORP HIGH YIELD	0.36%	2.25%
BLOOMBERG BARCLAYS U.S. GOV/CREDIT	0.43%	-2.95%
BLOOMBERG BARCLAYS U.S. T-BILL 1-3 MONTH	0.00%	0.02%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
FTSE NAREIT (REAL ESTATE)	2.00%	18.04%
DJ COMMODITIES	2.15%	21.43%
RED ROCKS GLOBAL LISTED PRIVATE EQUITY	2.08%	18.93%
DB G10 CURRENCY FUTURES	0.82%	5.36%

The Tug of War Continues Between a Great Economy and Earnings versus the Threat of Higher Inflation and Interest Rates

The calming in government bonds starting in April has provided a boost to equities. There is an entrenched belief that policymakers are a long way from slowing the liquidity boom, encouraged by the most dovish central banks in decades. We expect another move higher in yields to develop once investors gain more conviction regarding the recovery in the lagging economies, especially the euro area and, eventually, Japan. At that point, talk of tapering bond purchases will gain steam, all in the context of central banks still targeting both a robust and durable economic expansion and higher inflation.

However, for now, a pause in the uptrend in bond yields is underway, and asset inflation continues to flourish. Beyond the short-term, we remain bearish on Treasury bonds and modestly constructive on equities. We continue to be cautious on the dollar and increasingly constructive on international equities. We also expect the shift from growth to value stocks to resume after a period of digestion.

All good things eventually come to an end, and so will the era of free money and ever-rising asset prices. Many assets have become inflated because of easy money and plentiful credit, so any tightening conditions will be problematic. However, the good news for many is that the end is not yet in sight, even if the pre-conditions are building. The U.S. economy is flying high but will inevitably moderate on a sequential basis, and we expect investors will gravitate to better valued, catch-up plays, such as assets in the euro area and E.M.

The U.S. consumer sector is in solid shape regarding income, savings, and balance sheet. Actual personal consumption expenditures have already rebounded sharply, and growth prospects are the best in many decades. Some of the rebound will reflect previously deferred spending on services, but the underlying consumption trend will remain robust. A boom in financial wealth reinforces the positive consumer backdrop. Also, existing home prices are rising more rapidly than they did during the mid-2000s housing mania.

The U.S. economy will continue expanding at an above-trend pace, which will be problematic for keeping a lid on inflation. As a result, we expect the U.S. core inflation rate to have an upward tilt over the next few years. However, the underlying trend may not be apparent until 2022 since there will be a lot of noise in the coming months as temporary, post-pandemic price changes occur (as has already been seen in recent inflation data.) So, for now, the Fed is sticking with its view, embraced by bond bulls, that any uptick in core inflation will be transitory.

CONCLUSION:

The cyclical risks are tilted towards higher bond yields and a bumpier path ahead for risk assets. Still, end-of-cycle conditions are a good way off, and thus we remain mildly pro-growth in our portfolio stance. We continue to favor a gradual rotation out of U.S. assets towards non-US currencies and assets.

Data from Morningstar Direct, as of 5/28/2021.

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