CROSSMARK
GLOBAL INVESTMENTS

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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS. (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-3.40%	9.79%
S&P 500	-1.87%	11.71%
NASDAQ	-0.26%	9.21%
RUSSELL 2000	-4.17%	13.78%
RUSSELL 1000 GROWTH	0.47%	9.15%
RUSSELL 1000 VALUE	-4.09%	13.86%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-1.09%	16.82%
CONSUMER DISCRETIONARY	-0.06%	6.87%
CONSUMER STAPLES	-2.77%	2.66%
ENERGY	-5.21%	40.10%
FINANCIALS	-6.17%	20.17%
HEALTHCARE	-0.68%	9.40%
INDUSTRIALS	-3.75%	12.85%
INFORMATION TECHNOLOGY	0.10%	9.24%
MATERIALS	-6.28%	11.86%
REAL ESTATE	-2.43%	22.57%
UTILITIES	-3.12%	2.96%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-1.86%	10.06%
MSCI ACWI EX US	-2.14%	8.73%
MSCI EAFE	-2.40%	8.92%
MSCI EM	-1.45%	6.25%

SUMMARY:
U.S. equities fell last week, with the S&P 500 down 1.9%, its worst week since February. Growth was a big outperformer vs. value after an unexpectedly hawkish Fed meeting was seen undermining the reflation trade. Bonds and the dollar rallied, while gold fell nearly 6%. The best sectors were technology and consumer discretionary (both sectors roughly flat), while materials and financials fell more than 6%.

KEY TAKEAWAYS:

1. The U.S. economy seems to be entering a slowdown phase but remains strong. For example, the Empire Manufacturing Survey suggests that while U.S. economic growth is moderating, it will continue at an elevated level.

2. Retail sales fell short of estimates, declining 1.3%, but the prior month was revised up. However, the report's details suggest that consumer spending remains robust.

3. As expected, the Fed left policy unchanged at its meeting last week. However, revised economic projections and the subsequent press conference reflect an ongoing shift away from the need for an ultra-accommodative approach.

4. The Fed meeting was a hawkish surprise for markets. The 10-year Treasury yield increased eight bps, the dollar advanced, and gold fell.

5. Fed Chair Powell said that the meeting was about "talking about talking about" tapering, implying the timeline of an announcement around Jackson Hole or the September meeting followed by the start of a long and gradual tapering early next year. The risks, however, are that the market may front-run the Fed even more and shift expectations for rate hikes even higher.

6. The resiliency of U.S. stocks has been remarkable in recent weeks with rising inflation, weaker than expected unemployment, fiscal stimulus deceleration, geopolitical tensions rising, and new fiscal policy negotiations in disarray.

7. The technical condition of the stock market is weakening somewhat. As Strategas put it, "market leaking momentum under the surface."

8. An investment policy response to an inflation threat should consider cyclical and value equities, real assets, low fixed income duration, and gold.

9. President Biden originally asked for more than $4 trillion in incremental spending for the next ten years. He might have to settle for as little as $1 trillion depending on Congressional negotiations.

10. May economic data confirms that China's domestic demand recovery has passed its peak strength. Chinese growth is likely to continue to decelerate.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG BARCLAYS U.S. AGGREGATE BOND	0.11%	-1.60%
BLOOMBERG BARCLAYS U.S. CORP HIGH YIELD	-0.07%	2.96%
BLOOMBERG BARCLAYS U.S. GOV/CREDIT	0.30%	-1.88%
BLOOMBERG BARCLAYS U.S. T-BILL 1-3 MONTH	0.00%	0.02%

FED SUPPORT PASSES MOST BULLISH PHASE OF THE CYCLE

Last week's first hint of an eventual change in Fed policy was a reminder that emergency monetary conditions and the free-money era will ultimately end. The FOMC maintained its upbeat economic forecast but remained stubborn on its call for little change in inflation (although it acknowledged more uncertainty about the outlook), a position it has maintained despite massive fiscal stimulus and a substantial economic rebound in the past year. Its only change was to shift from being adamant that the current rise in inflation was completely transitory to saying: "Inflation has risen, largely reflecting transitory factors."

We expect a series of incremental retreats from the Fed's benign inflation outlook in the coming months. This will be followed by a gradual tapering in bond purchases and, next year, a discussion about the conditions that would cause it to lift the fed funds rate eventually. By being so dovish, the Fed has encouraged bond investors to stay bullish on Treasuries, despite negative real yields and policy settings that would only be appropriate if the economy was mired in a downturn and inflation was falling. It had a window to become less hyper-accommodative when it became clear that fiscal stimulus was massively ramping up, but it did nothing. We expect that this inaction will likely haunt the Fed down the road.

Prior to last week, the pause in the cyclical uptrend in government bond yields had given a renewed boost to stocks. However, the impact was only modest, with most equity indexes only managing to hit marginal new highs. The big-picture view is one of an accelerating global economy that is delivering historically robust growth against a backdrop of gradually mounting price pressures. Still, some investors have nagging concerns about the sustainability of the economic expansion after the last decade's repeated disappointments and whether the pandemic will truly recede. These issues, in turn, are causing many investors to stay content with government bond positions and refrain from bidding up equity prices more aggressively.

The outlook for consumer spending is strong. U.S. consumers are experiencing a dramatic improvement in employment prospects at a time when there are massive sidelined savings and pent-up demand for some services. Household balance sheets are in great shape, reflecting last decade's deleveraging and the current huge tailwind from asset appreciation. Inequality remains a significant economic and political challenge, but the Fed is targeting maximum employment, implying that no policy roadblocks will be created in the foreseeable future.

We remain modestly positive on risk assets but selective, while cyclically negative on government bonds. We also would consider slowly rotating toward international markets and are cautious on the U.S. dollar. Stretched valuations and our more bearish view than the consensus on inflation (and thus government bonds) leads us to be less optimistic on risk asset markets than the economic and policy backdrop might warrant.

CONCLUSION:

Fed policy is slowly turning from a massive tailwind for U.S. equities to a less positive force. Over the next year or two, the Fed is likely to become a headwind for stocks. Investors will eventually focus on when and by how much the Fed will taper and eventually raise rates. However, a strong economy and rapidly rising earnings are an important positive offset for the time being.

Data from Morningstar Direct, as of 6/21/2021.

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