CROSSMARK GLOBAL INVESTMENTS

Sept. 30, 2024 | Issue 4.39

Doll's Deliberations®

Weekly Investment Commentary

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Summary:

Stocks advanced again last week (S&P 500 +0.64%) as the equal-weighted index continued to outperform the cap-weighted index. The big stories last week included China stimulus and a respectable core PCE report. Best sectors were materials (+3.39%) and consumer discretionary (+1.75%); worst sectors included healthcare (-1.11%) and energy (-0.82%).

Key takeaways:

1. The U.S. economy is beginning to struggle due to high price levels, high and rising consumer debt, and in many industries, high inventories.

2. The path to a U.S. soft landing remains getting previously impaired sectors of the economy to turn up before labor weakness causes spending to struggle.

3. The vast majority is focused on the Fed's easing cycle, perhaps forgetting we are still feeling the effects of Powell's massive tightening cycle. We are just 10 quarters after the end of tightening, a typical time frame for the start of a recession.

4. The Fed's favorite inflation gauge (PCE) rose 0.1% in August vs. 0.2%, as expected. Trailing 12 months rose 2.2% with core inflation (excluding food and energy) +2.7%.

5. While earnings estimates for 2025 remain +15%, 3Q24 estimates continue to fall and are now +3.7%, down from +7.3% on July 1.

6. The path of least resistance for stocks has been higher on the new Fed easing cycle and soft-landing narrative. However, valuation is being noted as increasingly demanding.

7. Chinese stocks rose 4% last Monday, thanks to a collection of easing measures by their central bank (lowered reserve requirements, cut interest rates, etc.) designed to boost demand. Meanwhile, Europe shows mounting signs of weakness (especially Germany).

8. The U.S. continues to dominate global equity markets, now representing nearly 65% of global equity market capitalization (MSCI), an all-time high.

9. The number of S&P 500 stocks hitting a new high this quarter (339) is the highest in 22 years, indicating a market that has broadened beyond mega-cap growth stocks.

10. Gasoline prices are a big deal for election outcomes. The recent fall in oil prices (and therefore gasoline prices) is a tailwind for Kamala Harris.

EQUITY MARKETS (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
DJIA	0.59	13.89
S&P 500	0.64	21.55
NASDAQ	0.96	21.37
RUSSELL 1000	0.72	20.83
RUSSELL 1000 GROWTH	0.37	23.94
RUSSELL 1000 VALUE	0.88	16.34
RUSSELL 2000	-0.80	10.11

S&P EQUITY SECTORS (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	1.02	27.80
CONSUMER DISCRETIONARY	1.75	14.23
CONSUMER STAPLES	0.17	18.61
ENERGY	-0.82	7.47
FINANCIALS	-0.53	21.51
HEALTHCARE	-1.11	13.65
INDUSTRIALS	1.57	19.60
INFORMATION TECHNOLOGY	1.13	29.56
MATERIALS	3.39	14.81
REAL ESTATE	-0.18	13.34
UTILITIES	1.09	30.08

Will the desired soft landing materialize?

The global easing cycle is in full swing, with China adding to the impetus to boost asset prices and support economic growth following the Fed's sizable rate cut. Bond yields have already fallen, and rate-cutting expectations show that a significant decline is anticipated over the next 12-18 months. It may take a recession to meaningfully and sustainably lower rate expectations and bond yields from current levels.

The good news for bond investors is that yields should at least be capped for the next three to six months. The 2/10 yield curve inversion over the past two years has ended (cash and near-cash still offer higher rates, but these will decline). The jury is out as to whether the desired soft landing can be achieved, or whether a significant slowdown/recession is more likely.

The global easing cycle is underway, yet economic conditions are generally not weak outside the manufacturing sector, and there are still pockets of strength such as U.S. consumption. No financial accidents are yet evident.

We are not convinced that the inflation cycle is over, as policymakers are acting to extend the economic cycle. Long-term inflation expectations were slow to unwind during the 1980s and 1990s despite the success in driving down measured inflation. The long period of disinflation in those decades still occasionally witnessed bouts of sharp rate and bond yield upcycles, which helped to sustain low inflation. Now, there is an equally entrenched belief that inflation will not rise absent some major supply chain disruptions, such as occurred during the pandemic.

As long as central banks are focused on boosting economic growth and earnings are growing, risk assets will remain firm. It is unusual for a Fed rate-cutting cycle to coincide with good earnings growth. In past Fed rate-cutting cycles, forward earnings growth was either slowing markedly or negative; i.e., the Fed was cutting to combat deteriorating economic activity and a weakening earnings outlook.

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN %)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	1.60	18.45
MSCI ACWI EX U.S.	3.17	14.22
MSCI EAFE	2.47	13.32
MSCI EM	5.17	16.07

FIXED INCOME MARKETS (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.28	4.41
BLOOMBERG U.S. CORP HIGH YIELD	-0.04	7.80
BLOOMBERG U.S. GOV/ CREDIT	-0.29	4.32
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.05	4.03

ALTERNATIVES (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-0.50	12.86
COMMODITIES (DJ)	2.24	5.73
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	0.60	18.48
CURRENCIES (DB CURRENCY FUTURE HARVEST)	-0.06	8.27

Conclusion

Central banks are easing in the absence of the typical recessionary backdrop. Corporate profit expectations are weakening, but only marginally. The debate between the desired soft landing and a notable slowdown/recession will continue.

Data from Bloomberg as of Sept. 27, 2024