CROSSMARK
GLOBAL INVESTMENTS

INVESTMENT OUTLOOK
OCTOBER 2023

Robert C. Doll, CFA®
Chief Investment Officer

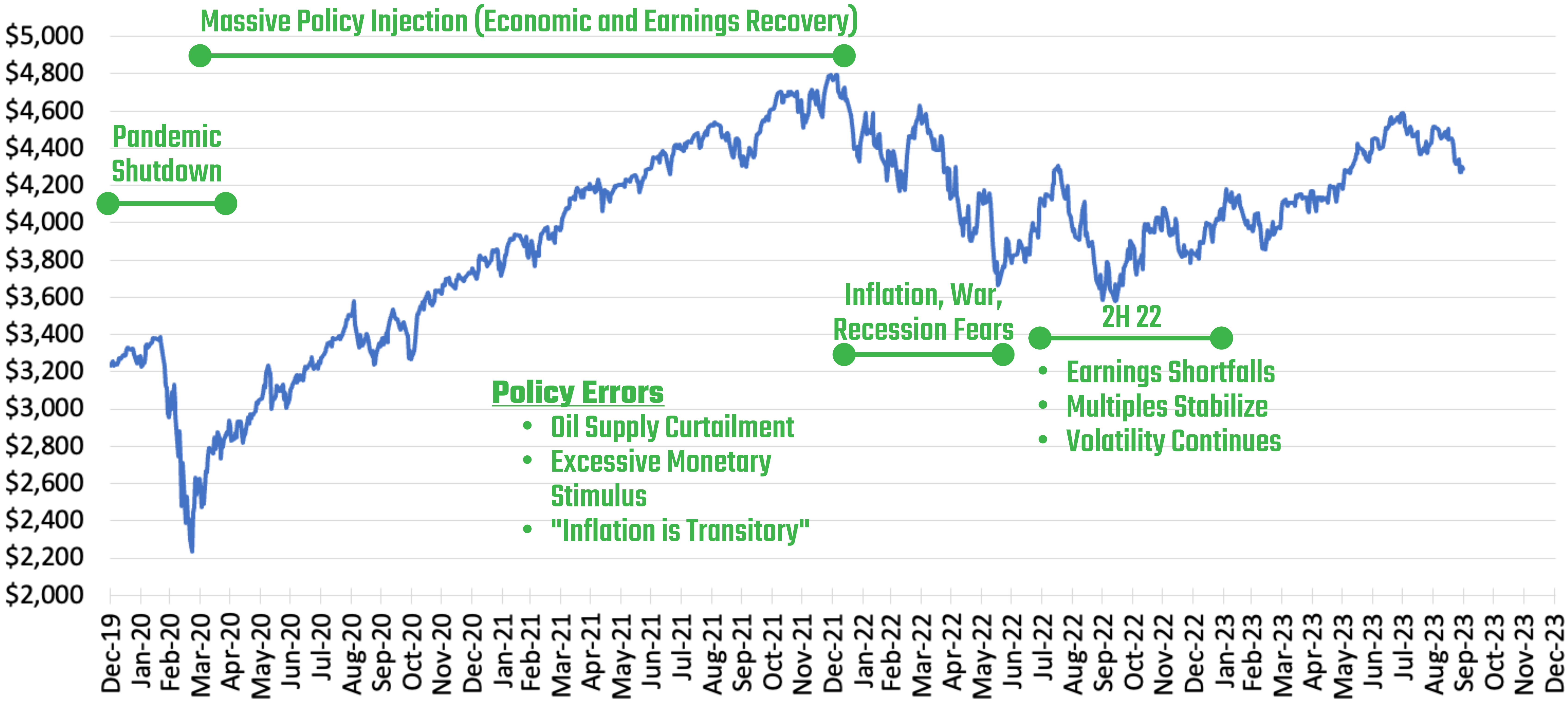
Financial services industry veteran, with over 40 years of experience. Experienced portfolio manager for large-cap equity strategies, as well as long and long-short equity strategies. Author of weekly, quarterly, and annual investment commentaries focusing on key themes and risks driving equity markets, monetary policy, and the global economy. Regular guest and contributor to multiple media outlets such as CNBC, Bloomberg TV, Moneywise, and Fox Business News.

Recent Returns

Index	Q3 2023	YTD 2023 (to Sept. 30)
90-Day Treasury Bills (Bloomberg U.S. Treasury Bill 1-3 Month TR)	1.3%	3.7%
10-Year U.S. Treasury (Bloomberg U.S. Treasury 10+ Yr TR)	-5.1%	-3.0%
U.S. Bonds (Bloomberg U.S. Agg Bond TR)	-3.2%	-1.2%
High-Yield Corporate Bonds (Bloomberg U.S. Corp High Yield TR)	0.5%	5.9%
S&P 500 TR Index	-3.3%	13.1%
S&P 500 Equal Weighted Index	-4.9%	1.8%
MSCI World Ex. U.S. (MSCI World Ex USA NR)	-4.1%	6.7%
MSCI Emerging Markets (MSCI EM NR)	-2.9%	1.8%
Commodities (DJ Commodity TR)	4.7%	-3.4%

Source: Bloomberg, as of Sept. 30, 2023

S&P 500 3 ¾ Year History



Source: Bloomberg, as of Sept. 30, 2023

Some Interesting Factoids

- Consensus calls for soft landing
- Consensus believes Fed is done or nearly done and will be lowering rates sometime in 2024
- Consensus calls for 4Q equity rally

S&P 500	+11%
Median S&P 500 Stock	+1%
Median R3000 Stock	-2%

41% of S&P 500 above 200-day moving average (worst since October 2022 – 11%)
10% of S&P 500 hit 52-week low (most since last fall above 30%)

2023 Theme: The Fed Calls the Shots

Question	Likely Consequence
Q: Will the Fed insist on 2% inflation?	Normal Recession
OR	
Q: Will the Fed blink, raise the inflation target to 3%, and possibly tolerate 4% inflation?	Soft Landing
OR	
Q: Will the Fed attempt to thread the needle?	Shallow Recession

10 Predictions for 2023

Theme: The Fed Calls the Shots

?	1	The U.S experiences a shallow recession as real GDP is in bottom ten of last 50 years.
✓	2	Inflation falls substantially, but remains above Fed's target.
✓	3	Fed funds reaches 5% and remains there for the balance of the year.
✓	4	Earnings fall short of expectations in 2023 due to cost pressures and revenue shortfalls.
?	5	No major asset class is up or down by a double-digit percentage for only the fourth time this century.
✗	6	Energy, Consumer Staples, and Financials outperform Utilities, Technology, and Communication Services as Value beats Growth.
?	7	The average active equity manager beats the index in 2023.
✗	8	International stocks outperform the U.S. for the second year in a row (first time since 2006-2007).
✓	9	India surpasses China as the world's largest population and is the fastest growing large economy.
✓	10	A double-digit number of candidates announce for President.

✓	5	Heading in Right Direction
?	3	Too Soon to Tell
✗	2	Likely Incorrect

Why Have Stocks Done So Well in 1H23?

1. Investors moved from expecting a recession to a soft landing.
2. Progress on inflation.
3. 1Q earnings less bad than feared.
4. AI hype/enthusiasm.
5. <u>Sentiment:</u> bearishness moved to bullishness (FOMO).

N.B. – while the S&P 500 was up 17%, the average stock was up only 7% (and was down at May 31.)

Reasons to be Concerned

- Sharply higher energy prices
- Higher interest rates
- Declining excess savings
- Tightening credit standards
- Student loan moratorium ending
- Europe and China weakening
- Stocks not cheap

Current Outlook

Bull Case		Bear Case
Cuts at First Signs of Weakness	The Fed	"Higher for Longer"
Sustained Decline Back to 2%	Inflation	Core Remains Sticky
"Soft Landing"	Growth Outlook	Recession in the Pipeline
Revisions Turning Up	Earnings	A Drop of 10% or More
Above Average, But Reasonable	Valuations	Increasingly Under Pressure

Source: Wolfe Research Portfolio Strategy

Investment Outlook – Positives

1. Inflation: Headline 9% → 3-4%
2. Labor market strength
3. Fed done or almost done
4. Federal spending contribution to nominal GDP last 12 months: +4%
5. Earnings bottoming

Investment Outlook – Negatives

1. Recession Indicators – lagged impact of Fed increases, yield curve, LEIs, money growth
2. Valuation P/E Top 10 26x (normal 20x); overall 18x (normal 14x)
3. Core Inflation: 5 ½ → 4%
4. Fed not done and unlikely to cut in 2024
5. Narrow breadth
6. Slowing in bank lending
7. Commercial Real Estate
8. Geopolitical: Russia, China, Iran
9. Federal Debt/Interest Expense
10. Federal spending contribution to nominal GDP next 12 months: -2% (swings of -6%)

Negatives

There are consequences to raising interest rates from 0 to 5¼% in just 18 months.

Main Risk to Economy and Earnings

Interest rate shock of last 18 months (Last 18 months increase 5X larger than 2002-2008 increase)

Why not bigger impact on economy yet?

- Consumer cash balances going into tightening higher than before
- Corporations locked in longer dated financing at low rates
- Mortgage refinancing occurred at low interest rates
- Warm winter, SPR release cushioned energy impact

Recession

Wall Street has had recession on the brain since early/mid 2022. We have been talking about it since the beginning of this year, still expecting one to commence between Labor Day and year-end.

Our Recession Concerns Remain

- “Lagged” impact of Fed action.
- Yield curve inverted
- Leading economic indicators down 17 months in a row (a record)
- Money growth remains negative
- PMIs weakish

Still Believe Recession Will Be Mild

- Consumer cash balances and balance sheets
- Healthy corporate sector
- Bank balance sheets in generally good shape

Inflation Down, But Still Far From Target

Review of Inflation

WAS	0-2%
PEAKED	8-9%
ENTERING 2023	6-7%
CURRENTLY	3-4%
FED GOAL	2%

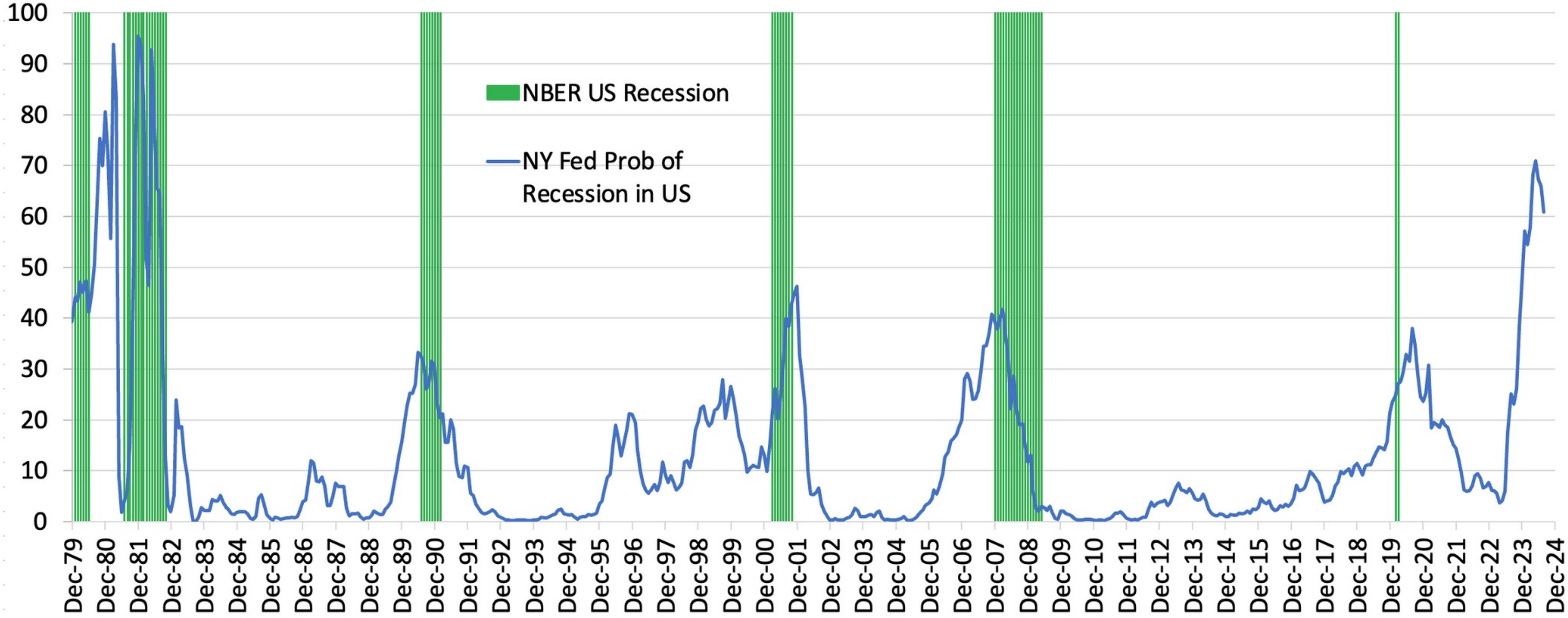
If Fed insists on 2% → Recession probability near 100%

- Stocks vulnerable (earnings cuts severe), bonds good

If Fed raises target to 3% and can tolerate 4% → Soft landing possible

- Stocks okay, earnings targets achieved, valuation questionable
- Bonds trading range

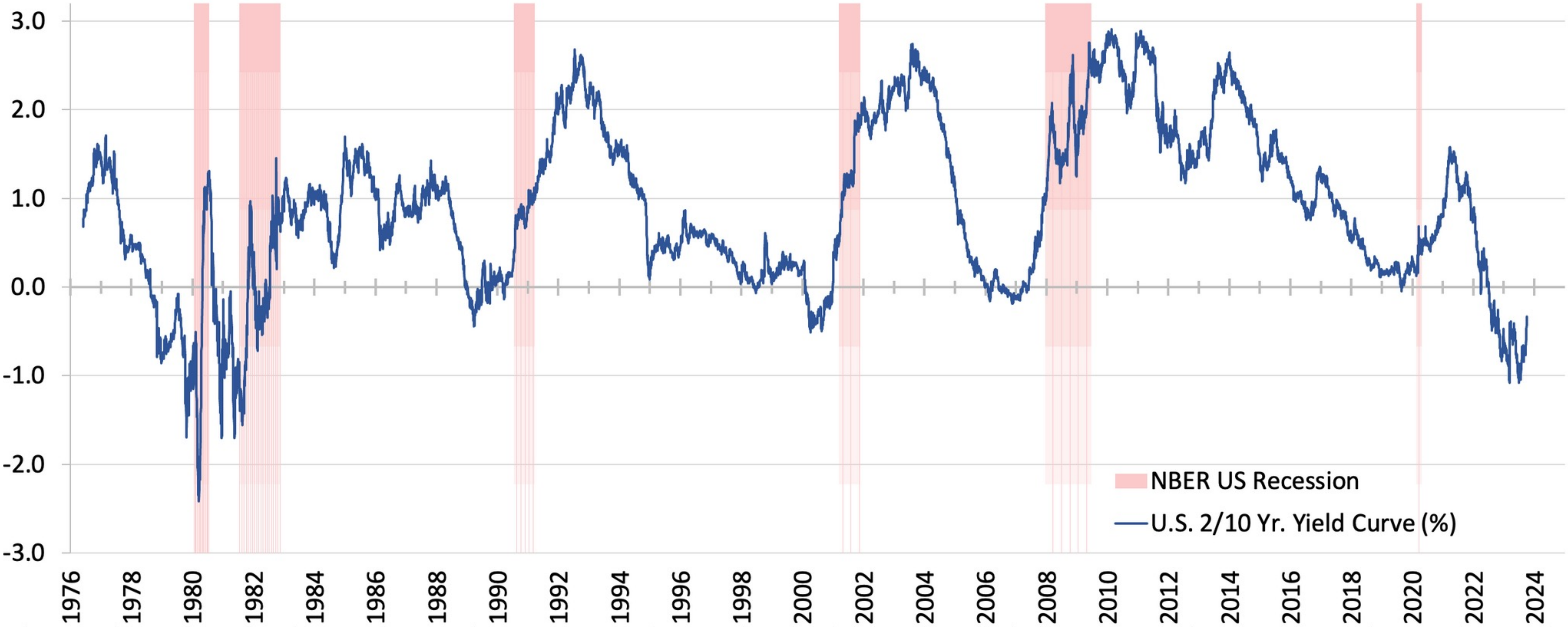
Probability of a Recession



Source: Bloomberg

Negative - Inverted Yield Curve

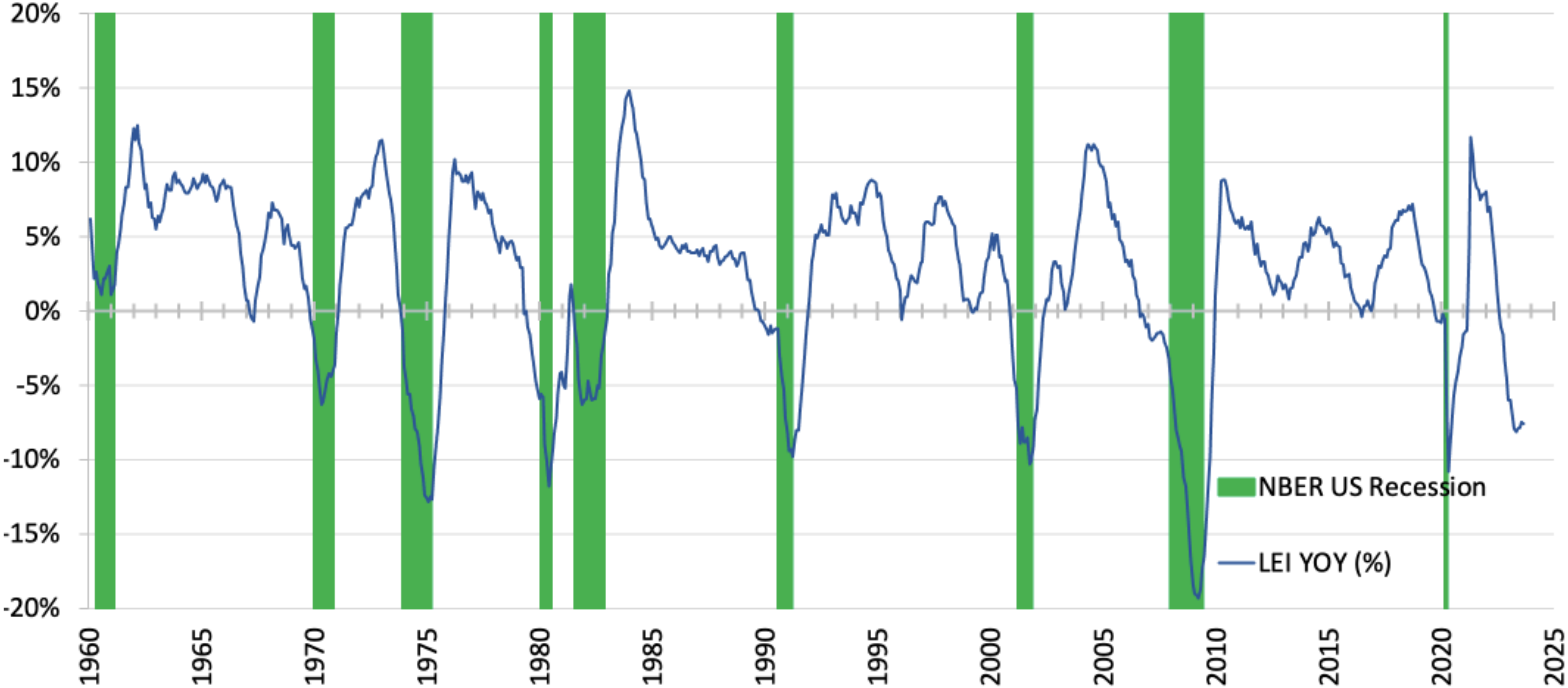
U.S. 2/10 Yield Curve



Source: Bloomberg

Negative - Leading Economic Indicators

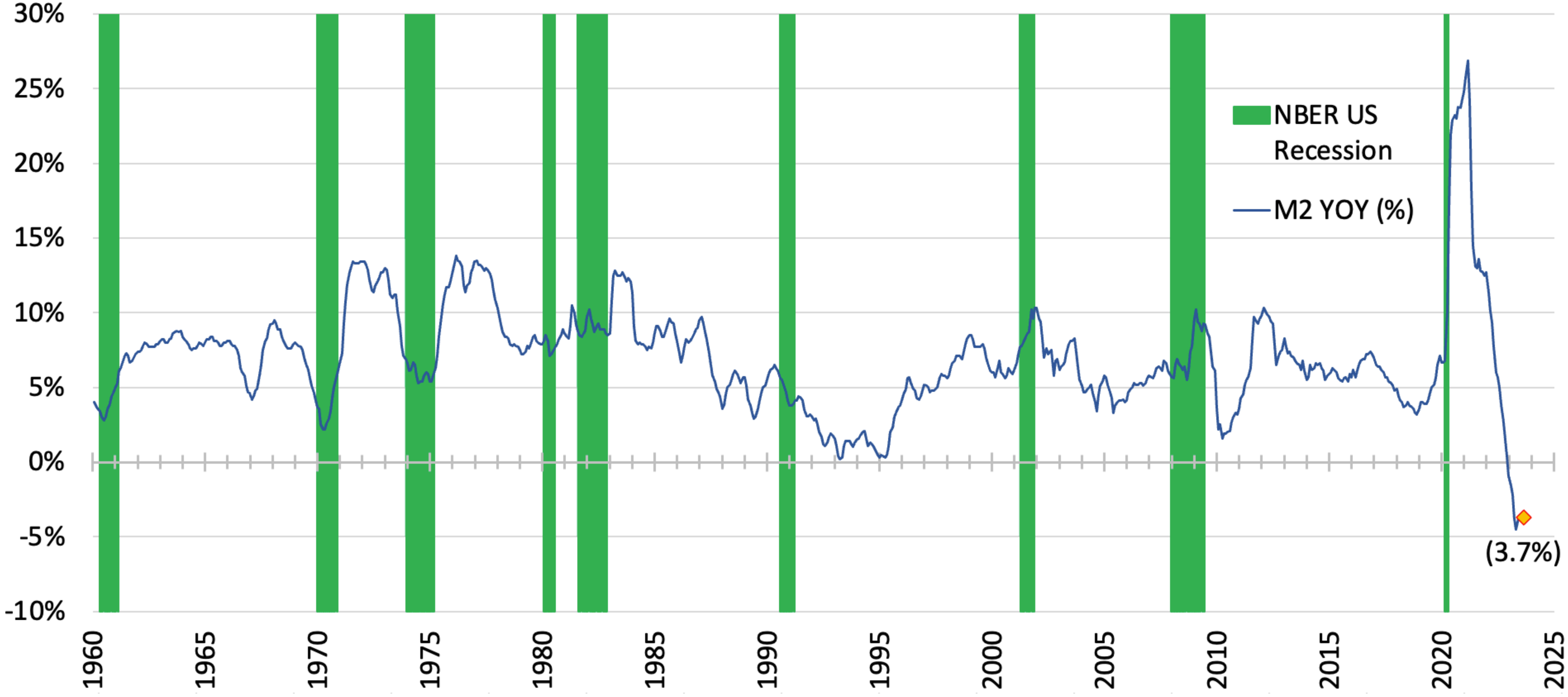
U.S. Leading Economic Indicators



Source: Bloomberg

Negative - Declining Money Growth

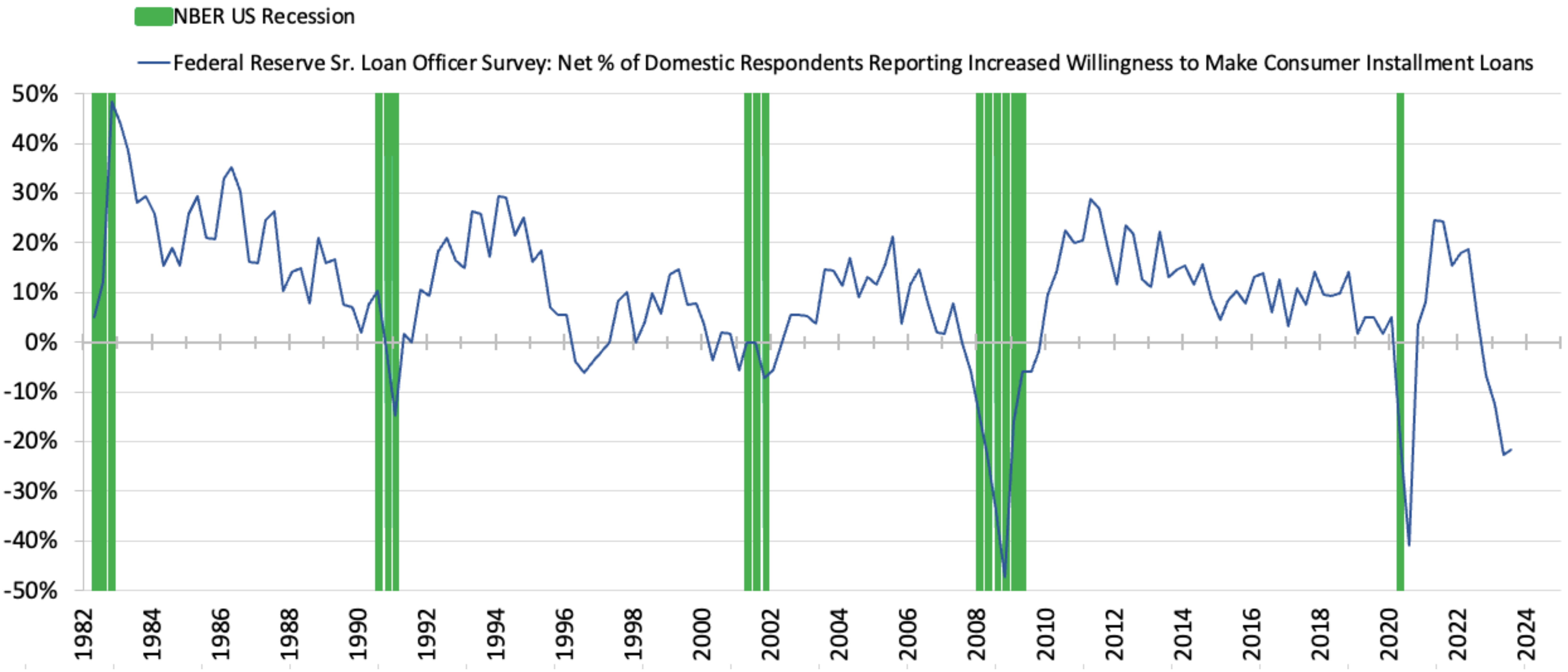
Year-Over-Year Percentage Change In M2 (%)



Source: Bloomberg

Negative - Banks Willingness to Lend

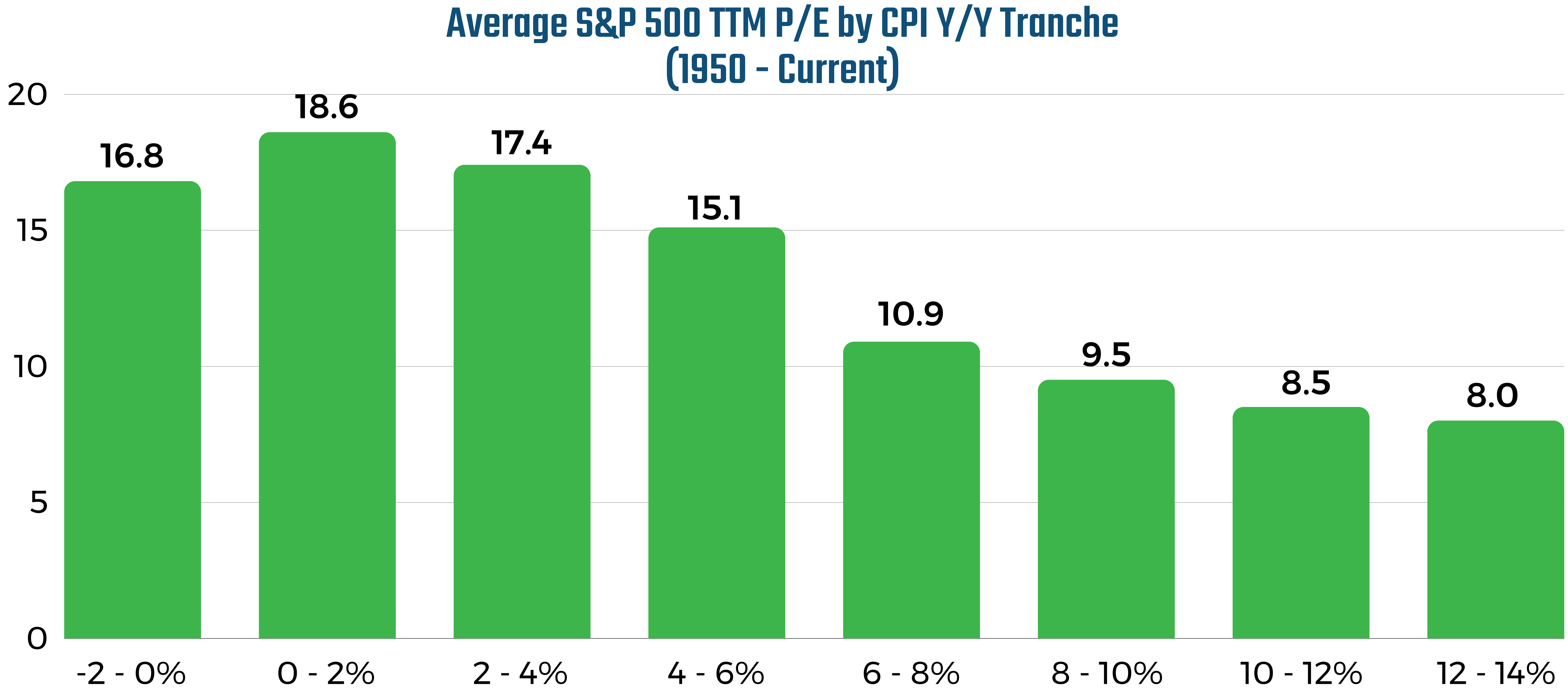
Net % Of Banks Easings



Source: Bloomberg

Stocks Expensive Relative To Inflation Rate

S&P 500 P/E vs. Inflation



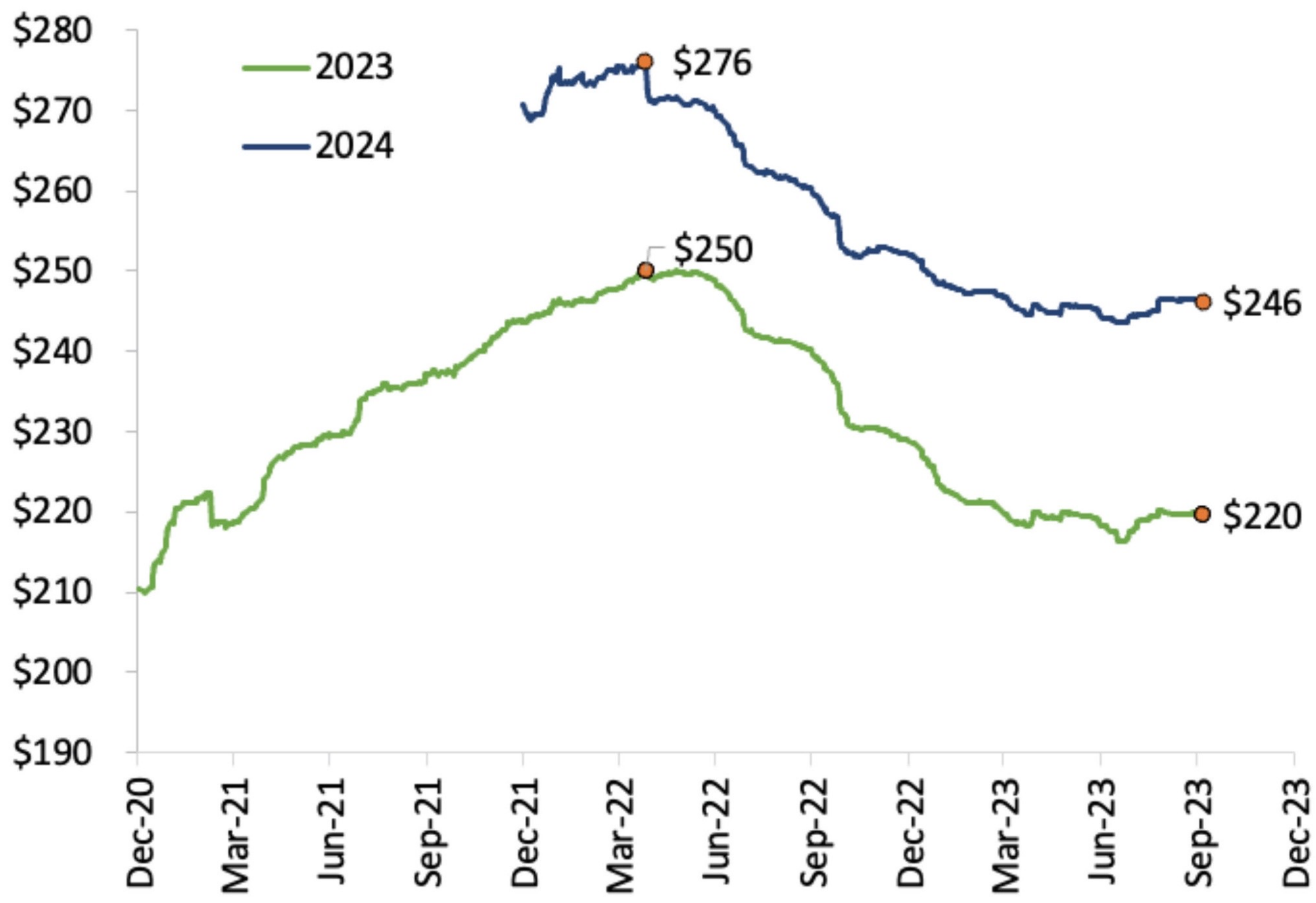
Source: Strategas

Earnings Estimates Too High

S&P Earnings	Consensus	Our Guess
2021	$204 (Actual)	$204 (Actual)
2022	$216 (Actual)	$216 (Actual)
2023	$222 +3%	$220 + 2%
2024	$247 +11%	$225 +2%

Source for "Consensus": FactSet

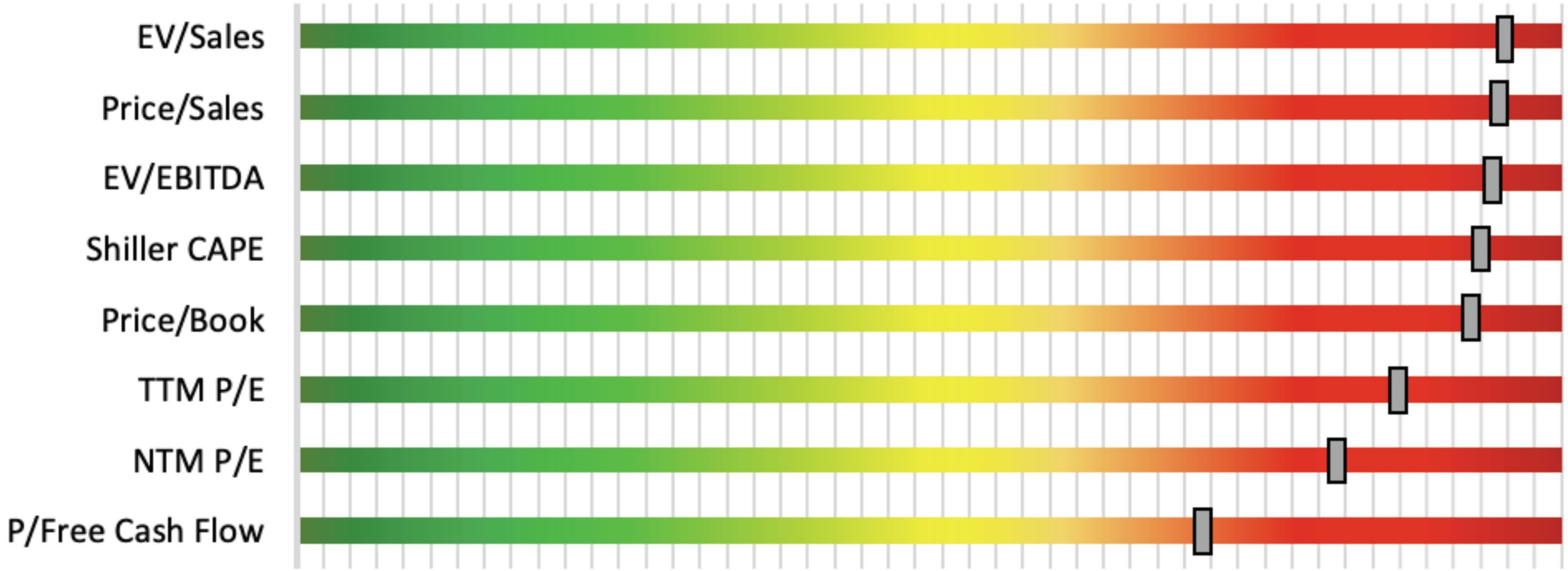
S&P 500 Operating EPS - Consensus



Source: FactSet

Equity Valuations Remain Historically Extreme

S&P 500 Valuation:
Current Percentile Ranking Relative to History



Source: Strategas

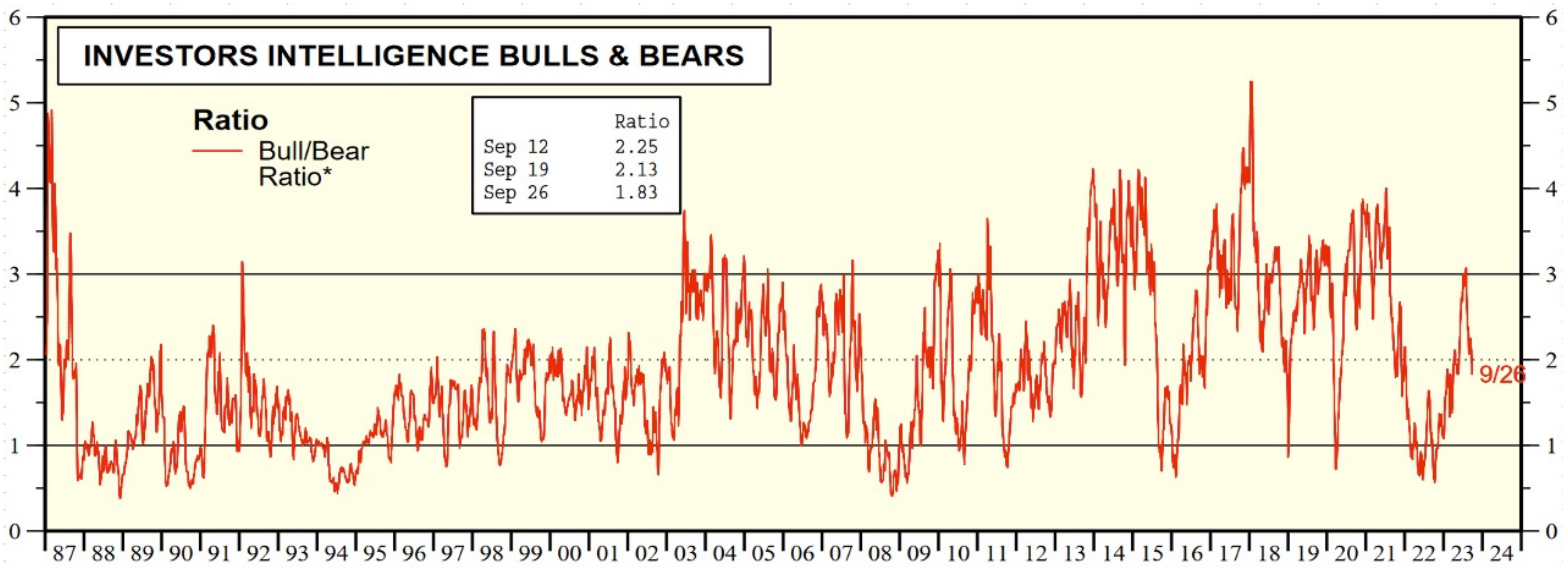
First Time Banks Have Been Down 12 Months Off S&P Low

S&P 500 & Bank Index Performance 12 Months Off Major Low

S&P Low Date	S&P 500	Bank Index
6/1/1932	147.5%	269.7%
3/14/1935	79.4%	25.7%
3/31/1938	32.5%	68.5%
4/28/1942	53.7%	82.4%
6/13/1949	40.1%	43.7%
10/22/1957	32.0%	46.5%
6/26/1962	34.2%	37.0%
10/7/1966	32.1%	49.4%
5/26/1970	46.2%	40.6%
10/3/1974	34.7%	25.7%
8/12/1982	55.4%	83.8%
12/4/1987	22.2%	32.7%
10/11/1990	28.8%	84.6%
8/31/1998	40.8%	28.5%
10/9/2002	33.8%	50.4%
3/9/2009	68.3%	148.0%
10/31/2011	31.1%	47.3%
12/24/2018	37.0%	40.1%
3/23/2020	74.9%	115.9%
10/12/2022	21.3%	-16.6%

Source: Strategas

Sentiment: Bearish to Bullish to Neutral



Source: Yardeni Research

2023 Market Targets (From Dec. 31, 2022)

S&P 500					
Probability	**Scenario**	**Close**	**%△**	**10-Year Yield**	**%△**
30%	Soft Landing	4200	+9.4%	4.25%	+38bp
50%	Mild Recession	3900	+1.6%	3.50%	-37bp
20%	Normal Recession	3600	-6.2%	2.75%	-112bp
Probability Weighted Average		3930		3.60%	

<u>Reminder:</u> Stocks have <u>never</u> bottomed before a recession started.

<u>Biggest Risk:</u> Without exception, <u>every</u> tightening cycle has been associated with a financial shock/crisis.

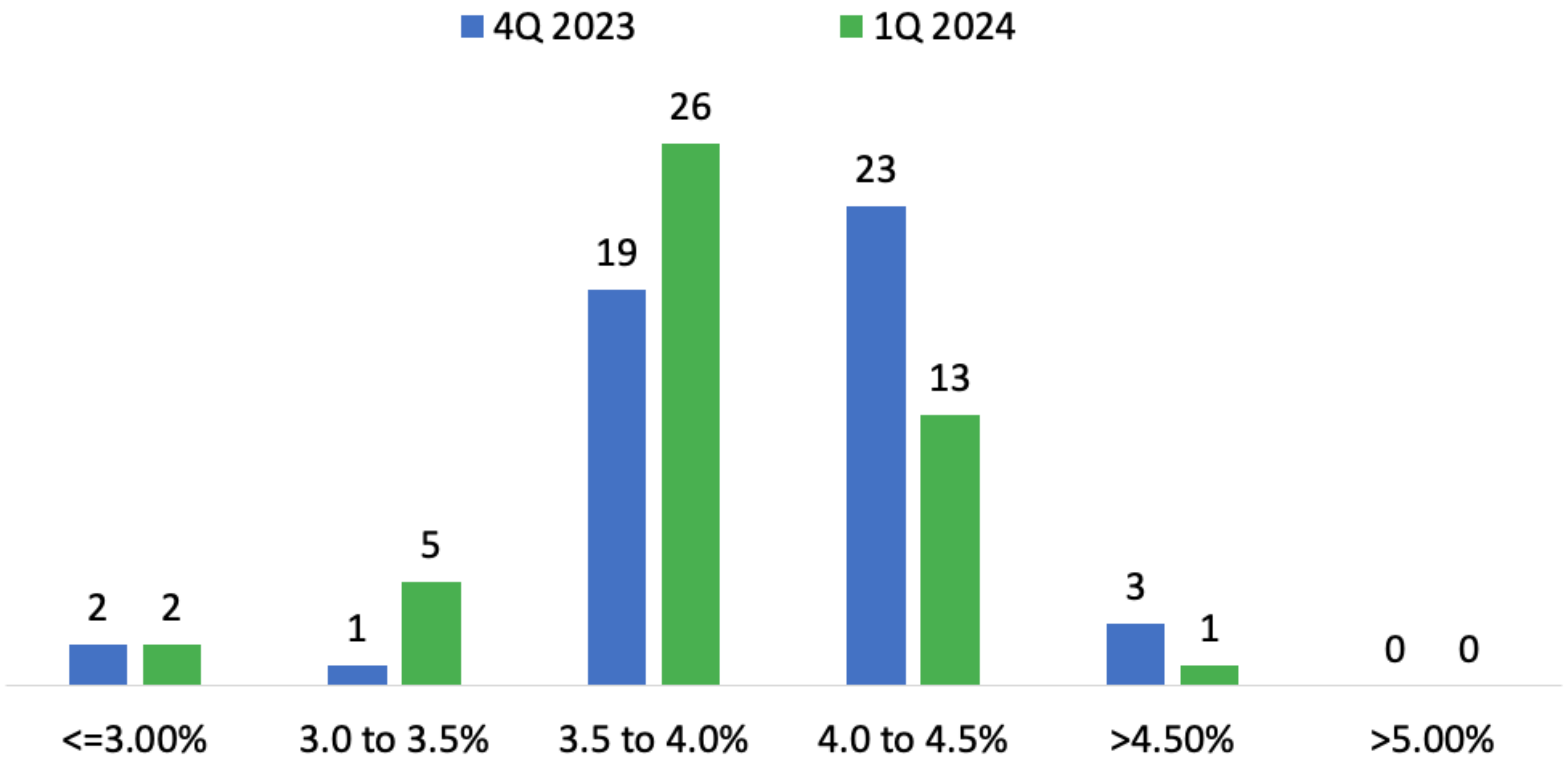
10-Year Treasury Returns (Since 1928)

Number of down years (Total Returns)	19/95	20%
Number of back to back down years	3/94	3%
Number of three down years in a row (In fact, never in the 250-year history of U.S. Treasuries)	0/94	0%

Note: Total return for 2021-2022 was worst in over 100 years.

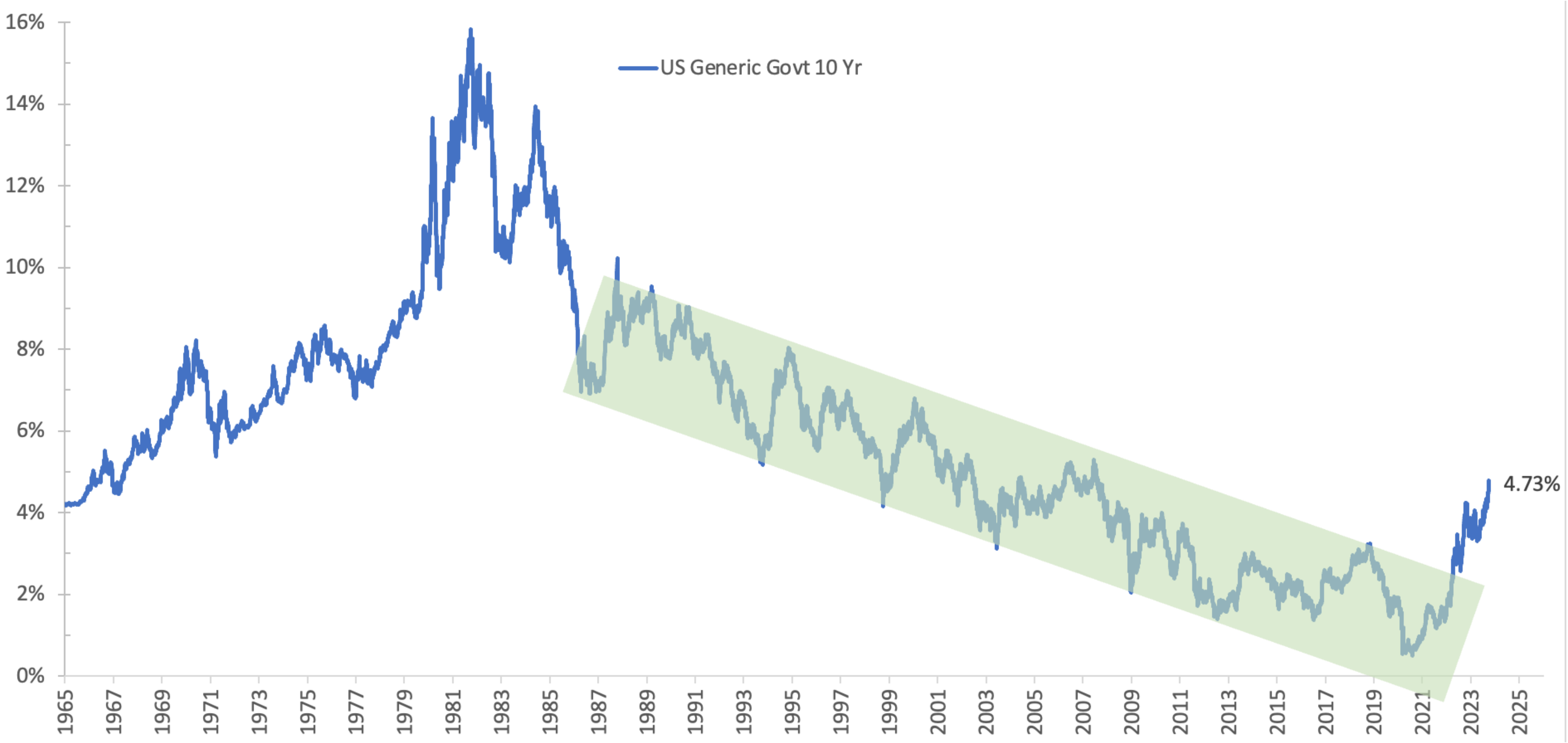
How is There Not Even One Sell Side Forecast > 5.00%?

Distribution of Sell Side 10-Year Yield Forecasts



Sources: Strategas Technical and Macro Research

30-Year Yields Hit Highest Since 2007



Source: Bloomberg

Sector Observations

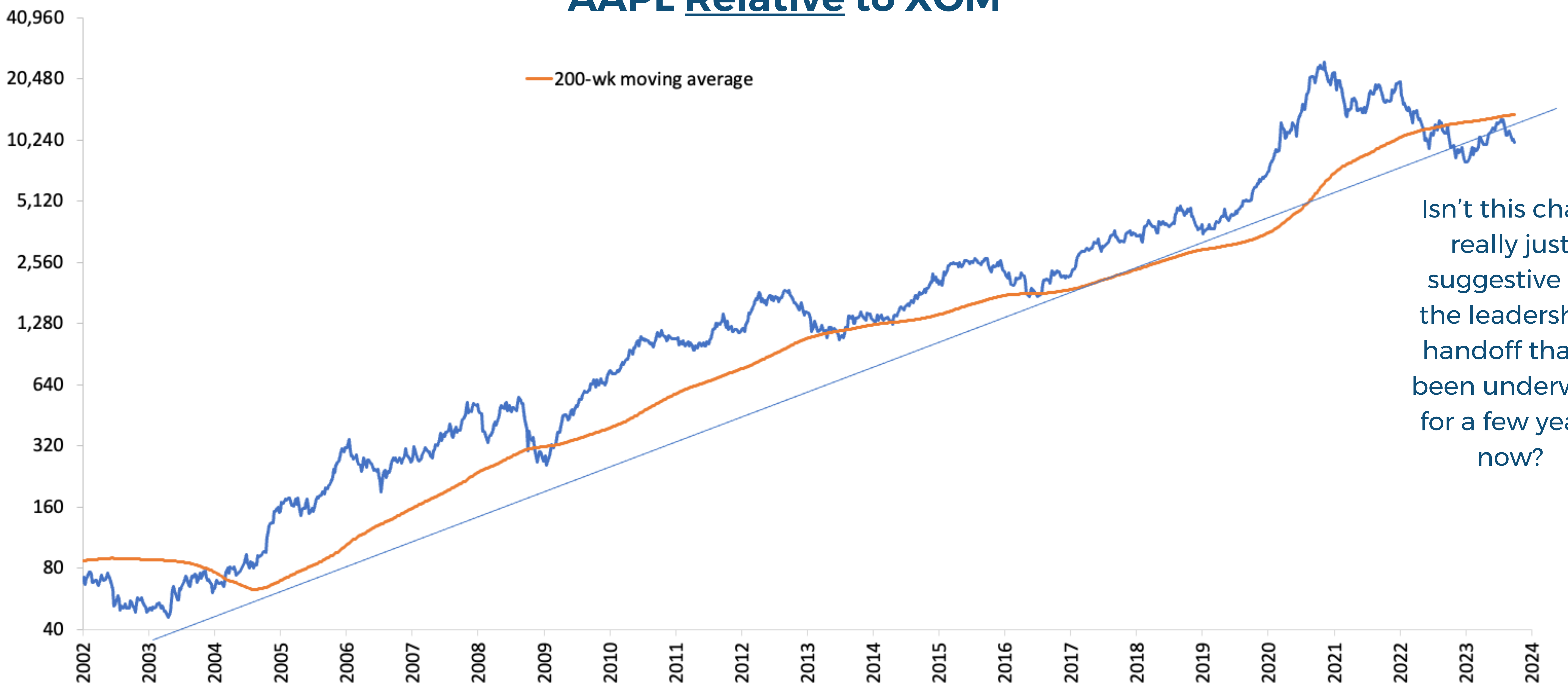
Picks	Sector Weight	Earnings Weight	Difference
Energy	4.7%	8.7%	+4.0%
Financials	12.8%	20.0%	+7.2%

Pans	Sector Weight	Earnings Weight	Difference
Technology	27.5%	18.3%	-9.2%
Utilities	2.4%	2.8%	+0.4%

Source: Strategas, as of Sept. 30, 2023

Interesting Chart...

AAPL Relative to XOM



Isn't this chart really just suggestive of the leadership handoff that's been underway for a few years now?

Sources: Strategas Technical and Macro Research

Bear Markets Are A Process

WE ARE HERE! →

(Will We Stop Here?)

Inflation Rises
↓
Fed Tightens
↓
Valuations Fall
↓
Economy Slows
↓
Earnings Estimates are cut
↓
"Bump in the Night" (Credit/Liquidity Problem)
↓
Recession Begins
↓
Stock Market Bottoms
↓
Fed Eases
↓
New Bull Market Begins

Geopolitical Threats Abound

Russia:

- “It is totally unclear what is really happening inside Russia … Russian instability will remain one of the greatest sources of geopolitical risk.” – BCA Research

China:

- A growing number of China experts warn that Xi Jinping has likely set a timeframe to annex Taiwan.
- 11% of EU companies have moved out of China. 7% more plan to. U.S. companies are following. “Western companies have finally begun to wake up to the fact that China steals all your intellectual property and then competes with you by underpricing you.” (On a positive note, watch India. It is a better place to invest and manufacture. They need to cut bureaucracy and develop more infrastructure.)

Iran:

- Is nuclear capability right around the corner?

Globalization Has Paused

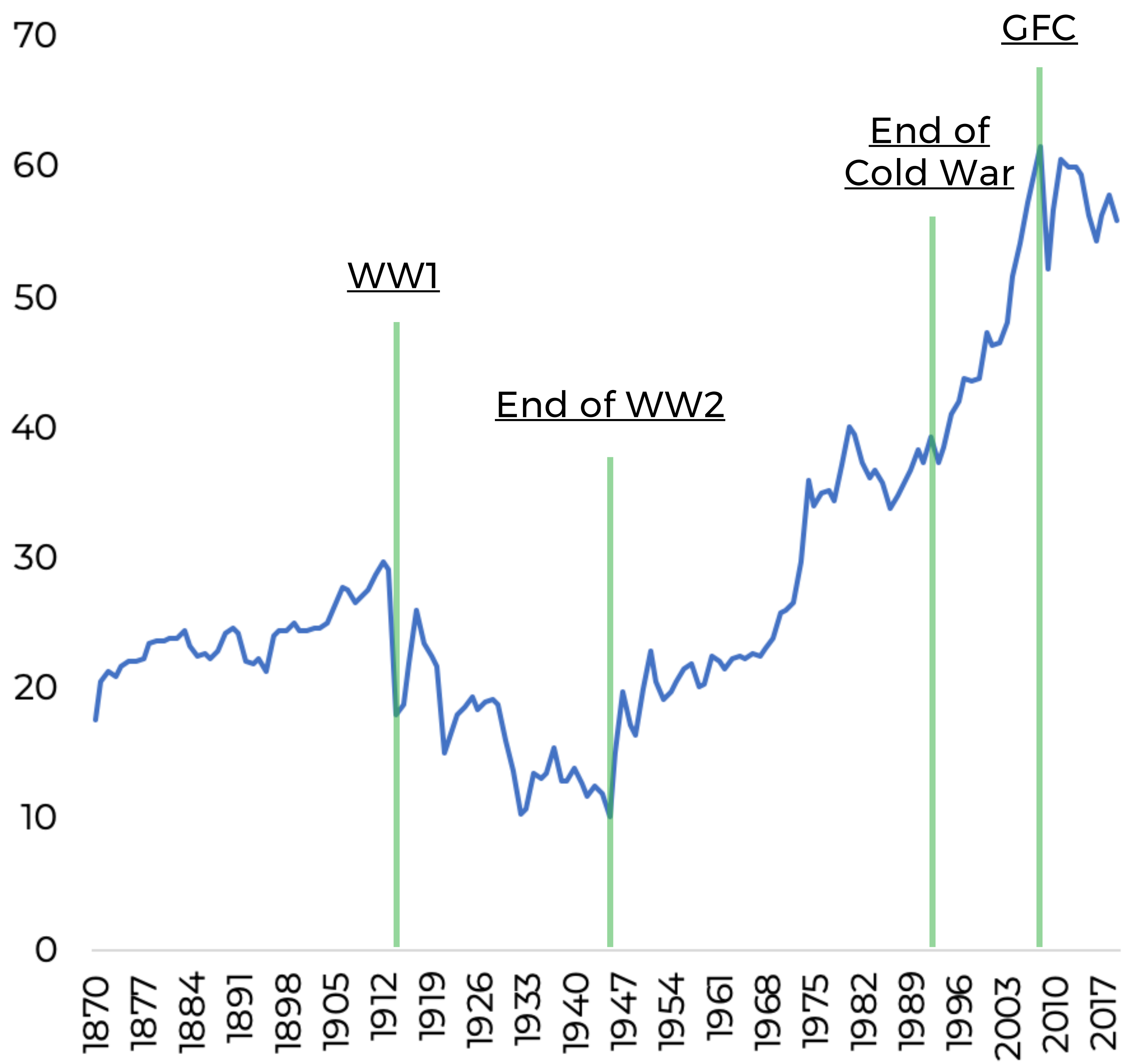
Consequences of Less Globalization

- Higher inflation
- Weaker profit margins
- Slower economic growth
- Greater levels of defense spending
- More political volatility
- Could be a positive for energy investments
- Many companies re-shoring production (despite higher labor costs

Source: Goldman Sachs

Total Trade As a Share of World GDP

(Our World in Data, Globalization over 5 Centuries)



Source: Strategas

Debt And Debt Service Explosion

Consequences

- Counter-cyclical fiscal policy less likely in a recession
- Tough to extend Trump tax cuts (2017)
- Additional social spending agenda stymied
- More economic and market volatility and potential crises
- Dollar pressure

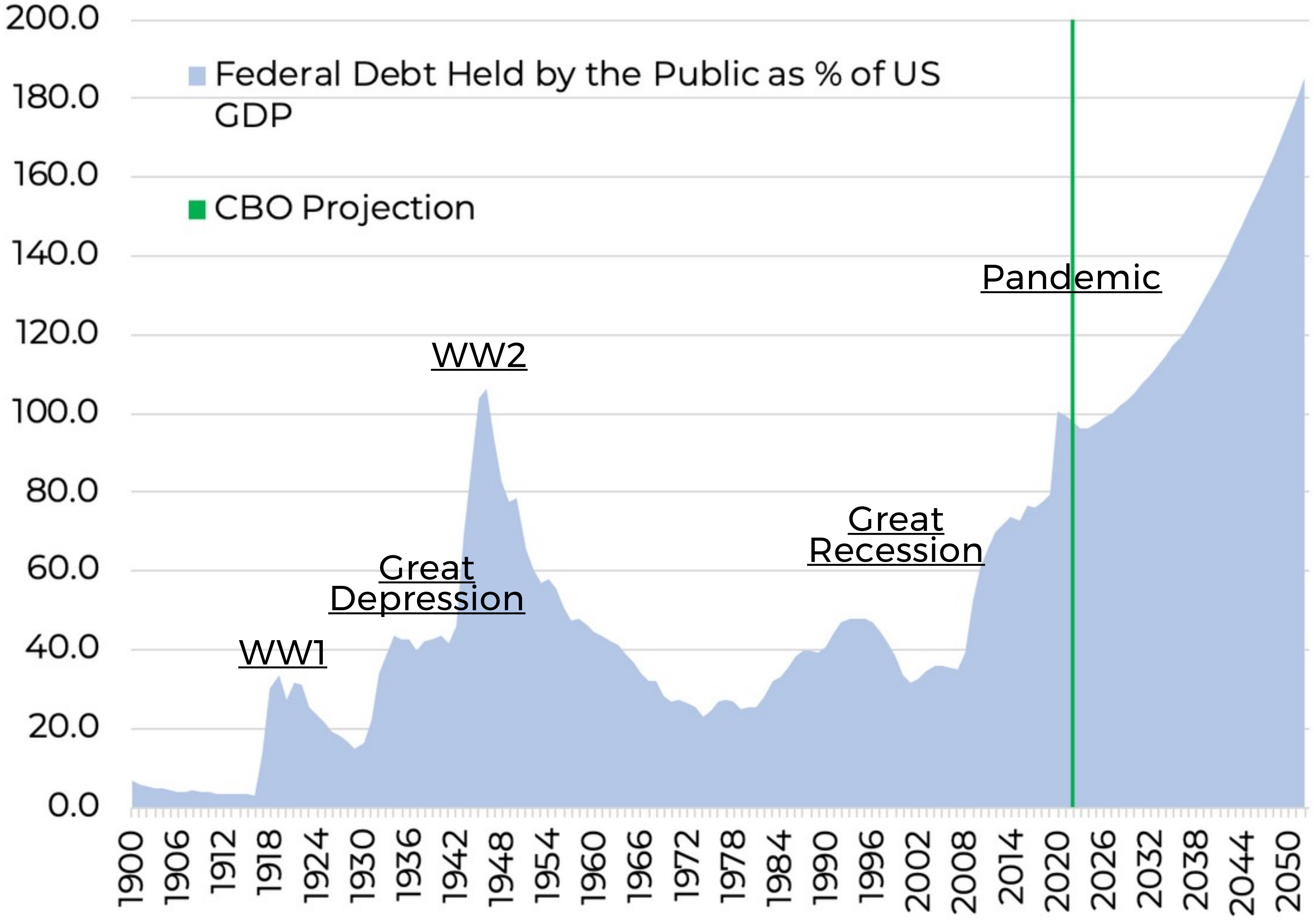
Consequences

- More debt issuance
- Higher inflation
- Financial repression
- Increased taxes
- Spending restraint (reduced benefits)

How will the debt be paid off?

- It won't be unless the U.S. runs budget surpluses which is highly unlikely.

Large Deficits Will Drive Federal Debt Held By The Public To Unprecedented Levels



Source: Congressional Budget Office

Economy Has Determined Whether Presidents Get Re-Elected

No Recession Two Years Before Re-Election

President	Recession?	Re-Elected?
Obama	No	Yes
Bush II	No	Yes
Clinton	No	Yes
Reagan	No	Yes
Nixon	No	Yes
LBJ	No	Yes
Eisenhower	No	Yes
Truman	No	Yes
FDR	No	Yes
FDR	No	Yes
FDR	No	Yes
Wilson	No	Yes

Recession Two Years Before Re-Election

President	Recession?	Re-Elected?
Trump	Yes	No
Bush I	Yes	No
Carter	Yes	No
Ford	Yes	No
Hoover	Yes	No
Taft	Yes	No

Source: Strategas

Equity Observations

1. "This is either the strongest bear market rally we have ever seen, or the weakest start to a bull market" - Strategas

2. At 4600, equity market was discounting a goldilocks scenario, good economy, declining inflation, Fed rate cuts (Fed rate cuts require economy growing below potential and visibility on 2% inflation)

3. Stocks have <u>never</u> bottomed before a recession started

4. - If the Fed requires a 2% inflation rate, probability of a recession ≈100%
   - If the Fed blinks and says 3% inflation is okay, we may have a soft landing

5. Most likely is a mild recession. Economic recessions have always been accompanied by earnings recessions

6. Consumer cash, corporate balance sheets, soundness of banking system should enable a soft landing or moderate recession, not a deep recession

7. Our year-end S&P 500 target was and remains 4200

Conclusions

1. We expect a mild recession to commence between Labor Day and year-end
2. The resilient labor market is beginning to show some cracks
3. Inflation remains a significant problem and isn't falling fast enough
4. Fed is likely to follow a higher-for-longer path
5. Bonds will face more upside yield pressure if economy stays okay and inflation stays stubborn... creating more valuation headwinds for stocks
6. Corporate profit estimates remain too high
7. Sentiment has moved from bearish to bullish to neutral
8. Valuation levels are high (given inflation and interest rates)
9. Stock risk/reward is unfavorable
10. Domestic and geopolitical risks are multiple

What To Do?

1. Expect choppy markets (buy dips/trim rallies)
2. Own some bonds
3. Diversify across asset classes and geographies (more non-U.S.)
4. Focus on free cash flow and high predictability and persistence in earnings
5. Own high quality value and less expensive growth
6. Consider an absolute return strategy to complement market exposures
7. Given uncertainty levels are higher than usual, avoid extreme positions

Important Information

Crossmark Global Investments, Inc. (Crossmark) is an investment adviser registered with the Securities and Exchange Commission that provides discretionary investment management services to mutual funds, institutions, and individual clients. Investment advice can be provided only after the delivery of Crossmark's firm Brochure and Brochure Supplement Form ADV (Parts 2A and 2B) and Form CRS, and once a properly executed investment advisory agreement has been entered into by the client.

All Investments are subject to risks, including the possible loss of principal. Past performance does not guarantee future results.

Equity investments generally involve two principal risks—market risk and selection risk. The value of equity securities will rise and fall in response to general market and/or economic conditions (equity market risk). The value of any individual equity security will rise and fall in response to the market's perception of the issuer's revenues, earnings, balance sheet, credit worthiness, business plan, and overall perception of the viability of the issuer's business (selection risk).

Fixed income investments generally involve three principal risks—interest rate risk, credit risk, and liquidity risk. Prices of fixed-income securities rise and fall in response to interest rate changes (interest rate risk). Generally, when interest rates rise, prices of fixed-income securities fall. The longer the duration of the security, the more sensitive the security is to this risk. There is also a risk that the issuer of a note or bond will be unable to pay agreed interest payments and may be unable to repay the principal upon maturity (credit risk). Lower-rated bonds, and bonds with longer final maturities, generally have higher credit risks. As interest rates rise and/or the credit risk associated with a particular issuer changes, bonds held within a portfolio may become difficult to liquidate without realizing a loss (liquidity risk).

Many municipal bonds also include call features that allow the issuer to call the bonds—repaying the principal before maturity—usually done in the context of a refinancing transaction if/when interest rates fall. When a bond is called, the holder does not incur a loss, but cash received from the call must be re-deployed, generally in a less favorable interest rate environment (call risk).

Information and recommendations contained in market commentaries and writings are of a general nature and are not intended to be construed as investment, tax, or legal advice. These materials reflect the opinion of Crossmark on the date of production and are subject to change at any time without notice. Where data is presented that was prepared by third parties, the source of the data will be cited, and we have determined these sources to be generally reliable. However, Crossmark does not warrant the accuracy of the information presented.

CROSSMARK
GLOBAL INVESTMENTS

Q&A

Crossmark Global Investments

888-845-6910

www.crossmarkglobal.com

advisorsolutions@crossmarkglobal.com

Thank You!