

DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-0.05%	14.58%
S&P 500	-0.54%	19.26%
NASDAQ	-0.46%	17.28%
RUSSELL 2000	0.45%	14.01%
RUSSELL 1000 GROWTH	-0.55%	19.27%
RUSSELL 1000 VALUE	-0.33%	17.79%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-1.23%	26.92%
CONSUMER DISCRETIONARY	0.55%	13.36%
CONSUMER STAPLES	-0.74%	8.01%
ENERGY	3.32%	33.57%
FINANCIALS	-0.06%	28.70%
HEALTHCARE	-0.17%	18.11%
INDUSTRIALS	-1.56%	14.05%
INFORMATION TECHNOLOGY	-0.68%	19.83%
MATERIALS	-3.19%	13.09%
REAL ESTATE	-0.03%	30.30%
UTILITIES	-3.04%	7.51%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-0.97%	14.23%
MSCI ACWI EX U.S.	-1.65%	8.45%
MSCI EAFE	-1.38%	11.34%
MSCI EM	-2.20%	0.67%

SUMMARY:

U.S. equities finished lower last week, with the S&P 500 down 0.6%. (Small stocks were +0.4%.) The macro discussion was somewhat confusing and unsettled: CPI, retail sales data, and regional manufacturing data were good, while supply chain and input price pressures along with economic normalization headwinds from the spread of the Delta variant were offsets. The path to additional fiscal stimulus remained complicated, and there were cautious comments related to China. It seems like the path of least resistance has moved to the downside. The only two sectors that advanced were energy (+3.3%) and consumer discretionary (+0.5%); the worst sectors were materials (-3.2%) and utilities (-3.1%).

KEY TAKEAWAYS:

1. We believe the recent economic slowdown is temporary and primarily driven by the Delta variant. Stronger growth should resume as businesses start to rebuild depleted inventories and ramp up CAPEX from historically depressed levels.
2. Retail sales for August were a positive surprise (+0.7%). This indicates a consumer willingness and ability to spend which is a positive signal for future consumption and overall economic growth.
3. Most equity averages, Treasury yields, and currency relationships have been flattish for weeks/months. Employment developments and Fed reactions are likely the key issues that will determine the direction of these markets.
4. Despite all the job growth openings and hiring, the U.S. still employs 5 million people below the pre-COVID levels.
5. The modest 0.1% increase in the CPI for August has convinced some that inflation is temporary. However, year-over-year core inflation eased only slightly to 4.0% (from 4.3%), while headline inflation edged down to 5.3% (from 5.4%). We see cyclical inflation pressure continuing to build.
6. Inflation is unlikely to impact Fed policy over the near term. Instead, the speed of the labor market recovery will dictate the Fed's liftoff date. Inflation will only become relevant to the Fed once the U.S. economy nears maximum employment.
7. According to the latest NFIB survey, more small businesses are planning to increase prices over the next three months than at any time since the 1970s.
8. We continue to expect a pullback of 5-10% in stocks before year-end due to the Delta variant, inflation concerns, Fed tapering anxiety, fiscal policy uncertainty, and less positive technical indicators.
9. An improving global economy into 2022 will ultimately become a headwind for the dollar.
10. The most likely fiscal policy outcome is that Congress will pass the initial \$1 trillion infrastructure bill and a slimmed-down (≈\$2 trillion, not \$3.5 trillion) second package of social spending and tax hikes.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.03%	-0.77%
BLOOMBERG U.S. CORP HIGH YIELD	0.14%	5.01%
BLOOMBERG U.S. GOV/ CREDIT	0.00%	-0.94%
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)	0.01%	26.11%
DJ COMMODITIES	0.23%	24.68%
RED ROCKS GLOBAL LISTED PRIVATE EQUITY	-0.59%	25.00%
DB G10 CURRENCY FUTURES	-0.01%	3.92%

FOR NOW, THE FED'S FOCUS IS ON JOBS, NOT INFLATION

The focus in the financial markets is on a perceived peaking in U.S. inflation following the recent spike and ongoing angst about the COVID-19 Delta variant. Will the "peak growth" narrative now shift to a similar "peak inflation" sentiment? Last week's U.S. CPI report showed a smaller monthly increase after considerable gains in prior months. This reinforced the narrative that this year's inflation surge will prove temporary, and a return to 2% or lower is inevitable. We disagree.

The key for investors is to identify the underlying trend in growth and inflation. We remain above consensus both for the U.S. and globally while acknowledging that clarity will take time since the re-opening process will likely remain choppy and globally de-synchronized. Headline inflation will be moderating from very elevated levels as the transitory and supply shortage-related inflation dissipates. But, core inflation (see wage rates) will likely remain stubborn. ([Click here for my new inflation whitepaper](#)) The short-lived decline in bond yields will likely turn around with the above-trend growth in employment and income. Ultimately, we expect bond yields to climb higher, although end-of-cycle monetary and bond market conditions seem far in the future. As this occurs, valuation will be a headwind for equity upside, despite the positive corporate earnings trends.

The business sector is anxious to hire but has struggled to fill open positions in a broad range of industries in many countries. This trend was evident before the pandemic, although it eased after the nationalistic/protectionist direction late last decade. The business sector as a whole is sufficiently positive on the profit outlook to want to lift headcounts significantly. The ongoing supply and shipping issues and rising input costs have not undermined upbeat business sentiment because profit margins are holding up

(which is another way of saying that price increases are being passed on to end-users).

Most major economies have high enough vaccination rates to stay fairly open even if international mobility remains constrained until a common global standard for health protocols is implemented.

CONCLUSION:

A moderation in U.S. growth and inflation momentum should only provide brief support for global bonds. A resilient global economic expansion and rise in underlying inflation mean that bond yields will trend higher over time.

Central banks will eventually become less accommodative, and real bond yields will climb out of negative territory. Therefore, we remain underweight bonds within a multi-asset portfolio. Our equity outlook is more mixed as good earnings growth will eventually be challenged by valuation compression. Resilience in global growth, especially trade, will allow investors to gradually venture beyond the U.S. in terms of currencies and equity preferences.

Data from Morningstar Direct, as of 9/20/2021.

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