CROSSMARK GLOBAL INVESTMENTS

Feb. 10, 2025 | Issue 5.07

Doll's Deliberations®

Weekly Investment Commentary

Bob Doll, CFA
CEO/CIO

Key takeaways

Stocks closed down for the second week in a row (S&P 500 -0.23%). Big tech stocks were mostly weaker with Google and Amazon dropping after earnings. Tariff/trade war headlines dominated a heavy week of relatively good earnings. Best sectors included consumer staples (1.58%) and real estate (1.29%); worst sectors were consumer discretionary (-3.58%) and communication services (-2.12%).

Equity markets (Index total return %)	Last week	Year-to-date
DJIA	-0.54	4.22
S&P 500	-0.23	2.55
NASDAQ	-0.53	1.13
Russell 1000	0.70	3.91
Russell 1000 Growth	-0.27	1.70
Russell 1000 Value	-0.18	4.44
Russell 2000	0.86	3.51

S&P equity sectors (Index total return %)	Last week	Year-to-date
Communication services	-2.12	6.80
Consumer discretionary	-3.58	0.68
Consumer staples	1.58	3.65
Energy	1.09	3.19
Financials	0.65	7.25
Heathcare	-0.31	6.46
Industrials	-0.78	4.22
Information technology	0.83	-2.10
Materials	-0.57	4.99
Real estate	1.29	3.15
Utilities	0.30	3.24

1. January payroll numbers fell short of expectations (143,000 new jobs vs. 175,000 consensus). The slow weakness in the labor market appears to be continuing (e.g., newly laid-off workers are having trouble finding work), which will eventually create some upside in the unemployment rate.
2. January's ISM Manufacturing PMI finally rose above 50.0 after 26 months in contraction, its longest spell below 50.0 on record.
3. December PCE inflation was in line with expectations, with headline inflation at 0.3% m/m (2.6% y/y) and core at 0.2% m/m (2.8% y/y).
4. According to Strategas, the median home price is up 31% in the last five years, but monthly mortgage payments are up 112%.
5. The Fed and the Treasury Department have a difficult balancing act as the U.S. economy is at a fragile equilibrium between inflation re-acceleration and a labor market slowdown.
6. Of late, Treasury yields have fallen, stocks have risen, and market breadth has improved. Consensus sentiment is (too) bullish on the dollar, (too) bearish on bonds, and neutral on equities.
7. Tariffs 2.0 will be used by the Trump Administration for policies beyond just trade (e.g., immigration, national security, foreign policies). As such, we expect sudden bouts of dovish volatility followed by recovery (similar to early last week).
8. Trump's tax priorities include no tax on tips, overtime pay, or Social Security benefits; a permanent extension of the expiring tax cuts, an adjusted SALT cap, taxing carried interest, ending tax breaks for "billionaire sports team owners," and tax cuts for products made in America.
9. The Trump administration is moving aggressively to freeze certain spending and fire government workers, testing the limits of executive branch authority.
10. The stock market has been priced for a favorable macro backdrop, whether measured by credit spreads, the equity risk premium, or by asset prices as a multiple of GDP. The market is not prepared for significant downside policy risks. Enthusiasm for the administration's pro-business/pro-growth/de-regulatory policy proposals has stirred animal spirits and pushed multiples to the upper end of their historical range. If history is a guide, the long-term profile for new money invested at prevailing valuation levels is not stellar.

Tariff risks dampen an otherwise decent economy and earnings

International equity markets (Index total return %)	Last week	Year-to-date
MSCI ACWI	0.73	4.11
MSCI ACWI EX U.S.	0.79	4.85
MSCI EAFE	0.75	6.04
MSCI EM	0.82	2.62

Fixed income markets (Index total return %)	Last week	Year-to-date
Bloomberg U.S. Aggregate Bond	0.69	1.22
Bloomberg U.S. Corp High Yield	0.18	1.54
Bloomberg U.S. Gov/Credit	0.68	1.22
Bloomberg U.S. T-Bill 1-3 Month	0.04	0.42

Alternatives (Index total return %)	Last week	Year-to-date
Real estate (FTSE NAREIT)	1.54	2.75
Commodities (DJ)	1.97	6.00
Global listed private equity (Red Rocks)	-0.87	6.20
Currencies (DB Currency Future Harvest)	-1.02	-0.78

U.S. tariff policy, if implemented, threatens to upend the pro-growth investment climate. Even tariff proponents acknowledge that the application of tariffs could cause short-term pain. Therefore, what investors had hoped would be the new Trump administration's pro-growth policies of further tax cuts and de-regulation could instead undermine the U.S. and global economic outlook over the next six to 12 months. As experienced the last couple of weeks, it is difficult to forecast how U.S. tariff policy might evolve, both in scope and timing. The one-month delay of the tariff on U.S. imports from Mexico and Canada, as well as China's tempered response to the U.S. tariffs, are consistent with our view that the prospect of tariffs is primarily a negotiating tool. Nevertheless, at best, uncertainty will prevail for some time and will be to the detriment of risk assets and investor sentiment.

Even absent the tariff threat, there were already reasons to be more cautious about investment strategy than global growth prospects would have implied. For starters, risk assets are already priced for solid growth but not sticky inflation. Some risks to U.S. Treasury yields are to the upside, since the U.S. economy is growing at an above-potential rate and headline and core inflation remain stubborn at well above the Fed's 2% target. Equally, U.S. stocks are historically expensive and growth expectations, particularly for tech/AI/Mag 7 stocks are very high. The potential for earnings disappointments is significant and elevated valuations will be increasingly vulnerable if Treasury yields rise. The flipside is that investor confidence outside the U.S. remains fragile and is exacerbated by the threats of tariffs. If U.S. tariffs are applied only moderately and selectively, as is still our base-case forecast, then the ongoing upturn in global trade and manufacturing should bode well for key non-U.S. equity markets.

Given expected ongoing U.S. policy uncertainty, we anticipate above-average capital market volatility and tepid overall returns for both stocks and bonds. January's PMI surveys provided support for a constructive economic outlook. Global manufacturing activity edged into expansionary territory, as did the U.S. ISM manufacturing measure (for the first time in more than two years). A sustained upswing in global manufacturing would be a signal of improving global growth momentum and breadth but will also be a flashpoint for any fallout from a trade war. Services activity continues to expand at a healthy clip.

Market expectations of two or more Fed rate cuts in the next year are misplaced unless the U.S. economy cools. Last year's combination of accelerating global and U.S. forward earnings alongside Fed rate cuts was historically anomalous and very positive for stock prices. However, it is unrealistic for this to persist over the next six to 12 months.

Conclusion

A decent economic outlook should coincide with a continuation of risk asset strength. The threat of a trade war is the main risk to our forecast, but for now, we expect the U.S. trade tariffs to be applied only selectively, such that the global trade cycle can continue to improve. However, persistent U.S. policy uncertainty implies that capital markets will be volatile with shakeouts likely.

Source: Bloomberg as of Feb. 7, 2025

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.

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.