CROSSMARK GLOBAL INVESTMENTS

Doll's Deliberations

Weekly Investment Commentary | March 6, 2023 | Issue 3.10

SUMMARY:

U.S. equities were higher last week (S&P 500 +1.9%) after three weeks of declines. Markets continued to reprice upward Fed rate expectations. Best sectors were materials (+4.0%), communication services (+3.3%) and industrials (+3.3%); worst performers were utilities (-0.5%) and consumer staples (-0.3%).

KEY TAKEAWAYS:

1. There is clearly not yet enough progress on inflation to satisfy the Fed which means higher risk of ongoing hikes. This factor coupled with declining money supply and the inverted yield curve creates headwinds for GDP growth as the year progresses.

2. Despite an increasing number of job cut announcements (especially in technology), there is still little evidence of a deterioration in the very strong labor market.

3. The Conference Board's quarterly survey shows an improvement in CEO confidence, while consumer confidence continues to fall.

4. We believe that the Fed will execute a "higher for longer" policy in order to set inflation on a sustainable path downward, but will still fail in getting down to the Fed's 2% target.

5. Businesses are likely to continue to cut production due to falling demand and elevated inventories. The cost of capital has increased at the fastest pace in over 40 years.

6. Home prices are weakening, but not enough to offset the deterioration in affordability due to rising mortgage rates.

7. 2024 consensus earnings estimates were $270 last summer, but have fallen to $250, where 2023 estimates were last summer. (2023 estimates have fallen to $220 and are still too high.)

8. Equity valuation is higher than at year-end as stocks are up and earnings estimates have been revised downward. Stocks are more than 18x falling consensus estimates and are, at best, fully valued.

9. Commodities may be in a secular uptrend (despite recent weakness) especially as countries focus on shifting towards renewable energy, putting upward pressure on non-energy commodities.

10. China's reopening is providing a near-term lift to global growth, making the job of central bankers more difficult.

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	1.85%	1.15%
S&P 500	1.96%	5.69%
NASDAQ	2.61%	11.87%
RUSSELL 2000	0.69%	8.23%
RUSSELL 1000 GROWTH	2.48%	9.25%
RUSSELL 1000 VALUE	1.53%	3.36%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	3.28%	11.98%
CONSUMER DISCRETIONARY	1.67%	13.19%
CONSUMER STAPLES	-0.32%	-2.69%
ENERGY	3.07%	-0.46%
FINANCIALS	0.88%	5.20%
HEALTHCARE	0.52%	-4.93%
INDUSTRIALS	3.34%	5.55%
INFORMATION TECHNOLOGY	2.94%	12.66%
MATERIALS	4.20%	8.94%
REAL ESTATE	1.62%	4.90%
UTILITIES	-0.51%	-6.01%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	0.55%	4.48%
MSCI ACWI EX U.S.	0.88%	4.82%
MSCI EAFE	0.88%	5.80%
MSCI EM	0.85%	2.58%

THE CHOPPINESS CONTINUES

Global economic growth continues to outperform consensus expectations. Inflation will continue to moderate given last year's base effects and easing supply constraints. Most developed market central banks are in the later stages of their policy tightening cycles, although they still have more work to do. However, good economic data may not be good news for risk assets. As we witnessed in February, January's market optimism was overdone. The downside of a constructive economic view is a belief that resilient economic growth means that inflation will prove sticker than markets were discounting, and that market expectations of central bank rate cuts by the second half of 2023 are misplaced. While economies can cope with moderately higher real interest rates, risk assets may be more vulnerable. At the same time, the global economy is still in a late-cycle expansion.

Since mid-fourth quarter, markets have raised year-end rate expectations for the Fed by 90 basis points. The market is expecting a fed funds peak rate of 5.3% in Q3. The fate of equities likely lies with bonds in the coming months. The U.S. 2-year yield has broken to new cyclical highs and the U.S. 10-year is threatening to breach its October peak. Markets are overly optimistic about inflation and prematurely still pricing in rate cuts by year end and in 2024, reinforcing the upward bias to bond yields in the near term. As was the case last year, if bond yields continue to rise, they will exert continuing de-rating pressure on equity, credit and other asset valuations. A breakout of the U.S. 10-year Treasury yield above its October high looms as a significant near-term threat to risk assets.

U.S. corporate earnings are still vulnerable to downgrades after being inflated during the pandemic. We recommend an underweight in the U.S. relative to international markets. Worrisome for stocks is the fact that the earnings yield is at the low-end of its range over the past year, while the G7 10-year government bond yield is significantly higher. Overall, we continue to expect market conditions to be choppy in the months ahead and do not advocate aggressive positioning.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.63%	-0.47%
BLOOMBERG U.S. CORP HIGH YIELD	0.13%	2.13%
BLOOMBERG U.S. GOV/ CREDIT	-0.52%	-0.43%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.08%	0.72%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-0.25%	3.49%
COMMODITIES (DJ)	2.71%	-3.21%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	1.31%	11.62%
CURRENCIES (DB G10 CURRENCY FUTURE)	-0.14%	1.78%

CONCLUSION:

As bonds approach new highs in yields, we would add to positions. We continue to believe equities will remain in a choppy sidewise pattern, alternating between frustrating the bulls and frustrating the bears. Equities face the crosscurrents of a better-than-expected economic growth backdrop and rising interest rates, as well as the divergence in earnings prospects for the U.S. and global ex-U.S. benchmarks.

Data from Bloomberg, as of 3/3/2023.

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.

This content may not be reproduced, copied or made available to others without the express written consent of Crossmark.