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GLOBAL INVESTMENTS

Doll's Deliberations

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SUMMARY:

U.S. equities were higher for the third week in a row (S&P 500 +3.5%). Headlines were sparse, with lower volatility around banks. Flows to money market accounts eased from the prior two weeks. Best sectors were energy (+6.2%) and consumer discretionary (+5.6%); worst sectors were communication services (+1.5%) and healthcare (+1.8%).

KEY TAKEAWAYS:

1. The U.S. labor market still looks tight, but cracks are forming (e.g., noticeable rise in U.S. jobless claims) and leading indicators suggest risks still skew to the downside.

2. The improvement in the U.S. manufacturing and service PMIs continues an uptrend that started in January, corroborating the recent stronger-than-anticipated inflation and employment gains.

3. Money supply (M2) has declined 2.4% year over year, the first decline in our lifetime. The Fed has begun to partially reverse that in the wake of the banking crisis.

4. We expect that banks will have to raise their deposit rates which will squeeze their profit margins, especially small community and regional banks.

5. The commercial real estate market appears to be next in line in the wall of worry. It is particularly concerning that small and mid-sized banks, already vulnerable to deposit flight, hold more than $2 trillion of commercial real estate debt, or nearly 80% of all commercial mortgages held by banks.

6. The excesses from zero interest rates and pandemic-era spending permeated the economy, and the hangover, which is just beginning, is likely to show up in both expected and unexpected places in the coming months.

7. It has been almost four weeks since we have seen the failure of Silicon Valley Bank and despite the increasing chances of a recession, there has been no movement in both 2023 and 2024 EPS estimates. We continue to think estimates are too high.

8. The NASDAQ-100 has produced a total return of +16% year-to-date (compared to +4% for the S&P 500 and -1% for the economically-sensitive Russell 2000). The "long-duration" trade has been partially re-inflated by 1) the Fed's recent balance sheet expansion to support banks, 2) growing expectations for the Fed to start cutting this summer, and 3) policymakers apparent willingness to "do whatever it takes" to ensure financial stability.

9. Stock market action over the past three weeks suggests that stock investors expect the economy to weaken, but that a Fed cutting cycle will allow the economy to glide into a soft landing. Our view is that it is like "threading a needle" (i.e., very difficult to achieve).

10. The most likely outcome for the debt ceiling is Democrats will give Republicans modest spending cut concessions to break loose the votes to raise the debt ceiling, but it could be a very bumpy process.

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	3.22%	0.93%
S&P 500	3.50%	7.50%
NASDAQ	3.38%	17.05%
RUSSELL 2000	1.99%	0.79%
RUSSELL 1000 GROWTH	3.28%	14.37%
RUSSELL 1000 VALUE	4.09%	1.01%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	1.46%	20.50%
CONSUMER DISCRETIONARY	5.58%	16.13%
CONSUMER STAPLES	2.53%	0.83%
ENERGY	6.22%	-4.67%
FINANCIALS	3.77%	-5.56%
HEALTHCARE	1.77%	-4.31%
INDUSTRIALS	4.43%	3.47%
INFORMATION TECHNOLOGY	3.41%	21.82%
MATERIALS	5.01%	4.29%
REAL ESTATE	5.31%	1.95%
UTILITIES	3.08%	-3.24%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	2.46%	6.16%
MSCI ACWI EX U.S.	3.05%	6.40%
MSCI EAFE	3.61%	8.04%
MSCI EM	1.48%	3.48%

ARE WE IN THE EYE OF A HURRICANE?

Global financial markets have moved past the shock from the abrupt failure of Silicon Valley Bank and a few other banks as well as the forced takeover of Credit Suisse. There will be lingering fears of additional fallout, since many financial institutions are sitting on portfolio losses arising from the cyclical rise in bond yields, not to mention worries about economic contagion. We anticipate a modest impact on the U.S. and global economic expansion from the banking woes of the past month. Mortgage rates are now lower and the risk of Fed overkill has eased for the time being. Interest rate and potential central bank pauses are lifting risk asset prices as sentiment recovers. Nevertheless, we remain in a maturing economic cycle with still-elevated cyclical investment risks including falling but unacceptable inflation.

The Silicon Valley Bank bust confirms that policy rates and bond yields cannot go much higher without breaking something major and triggering a recession. If there are no further banking issues and no real change in the economic and inflation trends, we expect global bond markets will reverse the recent decline in bond yields and rate expectations. Prolonging the economic expansion will further cement a floor under inflation, i.e., the current deceleration in inflation will level off well above pre-pandemic levels. The banking crisis is a reminder that the financial market landscape will remain risky for as along as the cost of money is rising. Policymakers' have indicated they will do whatever is needed to support the financial system and hopefully prevent a recession. In our view, they will ultimately fail, but have bought themselves more time.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.92%	2.48%
BLOOMBERG U.S. CORP HIGH YIELD	0.90%	2.71%
BLOOMBERG U.S. GOV/ CREDIT	-0.84%	2.59%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.04%	1.09%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	3.22%	-0.65%
COMMODITIES (DJ)	2.50%	-5.36%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	3.18%	5.77%
CURRENCIES (DB CURRENCY FUTURE HARVEST)	0.84%	1.14%

The Conference Board's U.S. consumer survey showed solid current conditions and high employment demand, even as expectations languished at depressed levels. While the survey closed just as Silicon Valley Bank went bust, we envision some hit to confidence and consumer spending. Business investment might slow if credit conditions tighten at the margin, but this will be partially offset by lower bond yields and rate expectations, at least for a while. The other two major sources of global demand growth, China and the euro area, are rebounding after being quite weak for much of 2022. In China's case, it was simply a matter of re-opening. In the euro area's case, it was the unwinding of high energy prices and the fears about future energy supplies that have now allowed the economy to regain its footing, particularly the service sector.

CONCLUSION:

The recent easing in bond yields and rate expectations, if they persist, will provide support to the global economic expansion and further solidify the floor under inflation. Barring further banking woes, the near-term outlook has brightened a bit. But, this phase will prove tactical in nature, because the cyclical investment outlook is negative: the economic cycle is maturing and monetary conditions will need to become restrictive if the goal of returning to a 2% inflation world is to be met.

Data from Bloomberg, as of 3/31/2023.

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