CROSSMARK GLOBAL INVESTMENTS

Doll's Deliberations

Weekly Investment Commentary | April 17, 2023 | Issue 3.16

SUMMARY:

Stocks were higher last week for the fourth week of the last five (S&P 500 +0.8%). The week featured somewhat better inflation news, weaker retail sales, and continued concerns of an economic slowdown/recession. Best performers were financials (+2.9%) and energy (+2.5%); worst performers were REITs (-1.5%) and utilities (-1.3%).

KEY TAKEAWAYS:

1. The headline CPI inflation rate fell from 6.0% y/y in February to 5.0% in March. However, core inflation edged up from 5.5% to 5.6%. The good news – inflation continues to fall; the bad news – it is still too high.

2. According to minutes from the March FOMC meeting, for the first time the Fed now expects a "mild" recession.

3. The Fed is likely to hike by another 25bps at its next meeting but not make the cuts later in the year implied by the Fed futures curve.

4. Most data points suggest narrower margins and lower profits over the next few quarters (the global slowdown, higher interest rates, tighter credit, still tight labor, and weak productivity).

5. Strategas reports that California's corporate tax revenues fell by 80% in March and 38% in Q1. This is notably higher than the rest of the country and perhaps the leading edge of a profit recession.

6. The greatest threat for the dollar near term is the debt ceiling impasse. We do not foresee any significant change in the dollar's role in global trade as the dollar is by far the most generally accepted currency in the world.

7. Geopolitics will be a major wildcard for the foreseeable future as policy friction increases between Washington and traditional allies.

8. Several big banks reported better than expected earnings. Bank deposit migration has slowed considerably, but credit availability continues to weaken.

9. The stock market continues to experience a stalemate in the war between the bulls and the bears. Neither side has gained much ground. The S&P 500 has been trading about 5% either side of 4,000 for 11 months.

10. In Q1, Apple, Nvidia, and Microsoft contributed over half of the gains of the S&P 500. The top ten stocks accounted for more than 95% of the gain. This concentration is a huge headwind for active managers.

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	1.20%	2.84%
S&P 500	0.82%	8.31%
NASDAQ	0.30%	16.13%
RUSSELL 2000	2.42%	2.44%
RUSSELL 1000 GROWTH	0.54%	14.26%
RUSSELL 1000 VALUE	1.21%	2.30%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	0.60%	24.31%
CONSUMER DISCRETIONARY	1.31%	14.19%
CONSUMER STAPLES	-0.24%	1.52%
ENERGY	2.50%	0.68%
FINANCIALS	2.86%	-3.40%
HEALTHCARE	0.78%	-0.56%
INDUSTRIALS	2.10%	2.09%
INFORMATION TECHNOLOGY	-0.35%	20.02%
MATERIALS	1.65%	4.67%
REAL ESTATE	-1.35%	-0.19%
UTILITIES	-1.34%	-1.57%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	1.37%	8.75%
MSCI ACWI EX U.S.	1.85%	9.18%
MSCI EAFE	2.13%	11.30%
MSCI EM	1.03%	4.74%

IS THE CLOUD LIFTING OR IS THIS THE CALM BEFORE THE STORM?

Last month's banking crisis appears to be fading into the background. Despite the panic and anxiety that it generated, it may ultimately have only a minor negative impact on the U.S. lending conditions. In addition, the "bump in the night" has helped lower interest rate expectations, which is positive for economic prospects. So far, the crisis has had little effect on equity markets, with some euro area markets hitting new highs last week. Central banks were on track to slow or even pause their rate-hiking cycle before the banking crisis as a product of a growing belief that significant economic headwinds had been created as a (lagged) consequence of policy tightening, and in anticipation that the ongoing deceleration in headline inflation would also translate into meaningfully lower core CPI over time.

The message from the Silicon Valley Bank failure is that there were a lot of distortions created during the free money era, and thus a lot of potential dominoes to fall before the cycle ends. Commercial real estate is a much larger domino than SVB with much greater potential contagion, and an obvious candidate given higher interest rates and structurally lower demand. The key investment question is whether enough problems will surface to set in motion a recession. With the inverted yield curve, negative money growth, and eleven months of declining LEI's, we continue to expect a mild recession. Elevated and sticky core CPI will remain the main cyclical threat to asset markets, and is likely to unwind current expectations for lower policy rates later this year. This could set the stage for another risk-off period.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.02%	3.44%
BLOOMBERG U.S. CORP HIGH YIELD	0.84%	4.53%
BLOOMBERG U.S. GOV/ CREDIT	-0.10%	3.59%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.10%	1.29%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-0.03%	0.81%
COMMODITIES (DJ)	1.60%	-3.10%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	3.32%	9.00%
CURRENCIES (DB CURRENCY FUTURE HARVEST)	0.08%	0.81%

We anticipate another upleg in U.S. bond yields before the cycle ends, likely when investors realize that current expectations for a sizable decline in policy rates is not going to occur. Earnings results and the setting of expectations for the remainder of the year could create problems for equities, especially now that stocks are nearly 20x earnings. Therefore, cyclically we are leaning a bit more cautious.

The minutes from the last FOMC meeting noted that the Fed is forecasting a mild U.S. recession by year-end, albeit with plenty of hedging should the banking crisis abate. The latest small business sector survey from the NFIB also had some cautions comments. We expect U.S. employment growth to continue to gradually slow this year, as heralded by the increase in layoff announcements and reduced hiring plans is some sectors that had previously boomed.

The U.S. core inflation should ease somewhat next year, but we expect it to level off well above pre-pandemic levels (and well above the Fed's 2% inflation target.) There is no slack in many economic sectors and, especially, in the broad labor market. While wage growth is cresting, it also is likely to prove sticky without a sustained rise in unemployment.

CONCLUSION:

Last month's mini-panic is unwinding, and, therefore, is benefitting risk assets. Policy rate expectations have declined and long-term government bond markets have calmed. However, the economic and policy cycle has not ended but is showing signs of fraying at the edges. The cyclical outlook is still not bullish and thus investors should have some caution.

Data from Bloomberg, as of 4/14/2023.