CROSSMARK
GLOBAL INVESTMENTS

Doll's Deliberations

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SUMMARY:

U.S. equities were mixed last week, with the S&P 500 slightly higher (+0.3%) though NASDAQ posted its second straight week up at least 2.5%, largely driven by AI optimism. Analysts have continued to warn of narrow breadth. Best sectors were technology (+5.1%) and communication services (+1.2%); worst sectors were consumer staples (-3.2%) and materials (-3.1%).

KEY TAKEAWAYS:

1. Most reports suggest that a deal is close that will suspend the debt ceiling until after the 2024 election and include modest spending caps, claw backs of certain Covid spending, and some peripheral policy items (e.g., energy permitting reform).
2. The Fed is likely to pause at the June FOMC meeting. While further rate increases are possible later this year, we only see them occurring if core inflation starts to inflect higher. That said, the rate cuts priced into the curve for 2023 continue to look unlikely.
3. Recent consumer headwinds include a sharply lower consumer confidence reading, a stall in core retail sales and inventory levels that are still too high.
4. With banks increasingly tightening credit and the lagged effects of rate hikes fully taking hold, we expect the U.S. economy to slow over the coming months and perhaps experience a mild recession.
5. The burden of proof remains on those of us who are cautious. If economic activity holds up, the Federal Reserve pauses, and the debt limit is diffused, the path of least resistance may remain higher.
6. Year to date, while the S&P 500 is up 9% and the NASDAQ is up 24%, the average stock (equally weighted averages), the Russell 2000 (small stocks), the DJIA, and eight of eleven sectors are all down.
7. China is struggling with another Covid wave, a burst property bubble, and a rapidly aging population.
8. The A.I. phenomenon (which has been in development for about a decade) has reached the stock market. When it comes to revolutionary technologies (the mainframe computer, PCs, the internet, e-commerce), the market usually gets the direction right, but tends to overestimate both the rate of change and the number of winners.
9. The bullish narrative revolves around soft-landing expectations underpinned by a still strong labor market, somewhat better earnings/guidance/revision trends, easing regional banking stress, housing market recovery and depressed sentiment and positioning indicators.
10. Bears are focused on Fed pivot skepticism, sticky inflation pressures, lagged (and unknown) effects of aggressive Fed tightening cycle, recession signaling from inverted yield curve, collapsing money supply growth and tightening lending standards, very narrow market leadership, looming liquidity headwinds, and geopolitical tensions.

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-0.97%	0.70%
S&P 500	0.35%	10.29%
NASDAQ	2.52%	24.43%
RUSSELL 2000	-1.06%	0.20%
RUSSELL 1000 GROWTH	1.74%	21.25%
RUSSELL 1000 VALUE	-1.24%	-0.71%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	1.21%	32.98%
CONSUMER DISCRETIONARY	0.37%	18.85%
CONSUMER STAPLES	-3.21%	-0.91%
ENERGY	-1.06%	-8.90%
FINANCIALS	-1.52%	-5.72%
HEALTHCARE	-2.86%	-5.76%
INDUSTRIALS	-1.40%	0.58%
INFORMATION TECHNOLOGY	5.12%	34.57%
MATERIALS	-3.06%	-1.45%
REAL ESTATE	-1.36%	-2.63%
UTILITIES	-2.30%	-7.74%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-1.56%	7.58%
MSCI ACWI EX U.S.	-2.49%	5.87%
MSCI EAFE	-2.83%	8.19%
MSCI EM	-1.33%	1.58%

THE BEAT (NARROWER AND NARROWER) GOES ON!

Global financial markets continue to churn, swinging between optimism and pessimism. The environment in recent years has had so many unique features versus previous decades that most investors lack conviction in the outlook, and thus are wary of making large bets and/or are quick to make changes.

Most market participants are confused as to whether a recession is taking hold, or if growth will hold up. Because manufacturing indicators have been around for longer than service indexes (or non-manufacturing measures), and tend to have greater "cyclicality", manufacturing indexes more heavily influence overall economic perceptions (and investor behavior), even though service sectors are significantly larger in scale.

There is an unprecedented divergence between manufacturing and service sector activity in the major economies. The majority of bond investors generally accept the bearish message. (In our view, a recession is not reflected in equity and credit market pricing.) Those banking on a recession are persistently deferring the timing, but not abandoning the forecast. While most acknowledge that inflation has a 2% target, all major central banks seem wary of becoming too restrictive and risk triggering recession and renewed concerns about a debt deflation outcome.

Equity markets have been moving higher. However, breadth has been poor, as highlighted in the divergence between cap-weighted and equal-weighted benchmarks (i.e., a few stocks are generating most of the gains). Such behavior is typical of an unsustainable advance, rather than a durable bull market up move. As such, while we acknowledge that short term momentum could move stocks higher, intermediate term we are cautious.

We are continuing to focus on the rotation out of the U.S. (equities and currencies), but absolute returns may prove modest and temporary until the threat of higher rates and bond yields ends. Unfortunately, for equity bulls, the latter condition first awaits a downcycle in profits, i.e. a recession.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.63%	1.23%
BLOOMBERG U.S. CORP HIGH YIELD	-0.45%	3.25%
BLOOMBERG U.S. GOV/ CREDIT	-0.58%	1.43%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.08%	1.79%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-2.55%	-4.48%
COMMODITIES (DJ)	-0.88%	-9.52%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-1.97%	6.70%
CURRENCIES (DB CURRENCY FUTURE HARVEST)	-0.35%	3.27%

CONCLUSION:

We remain cyclically cautious, expecting at best an economic slowdown, and more likely, a mild recession. Valuation remains problematic.

Data from Bloomberg, as of 5/26/2023.

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