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Doll's Deliberations®

Weekly Investment Commentary

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Summary

The S&P 500 (-2.55%) broke a nine-week streak of gains. The Mag 7 and larger cap tech were among the key weak spots, and the equal weight S&P 500 was only down 0.5%. Best sectors were energy (+2.49%) and health care (+2.31%); worst sectors were consumer discretionary (-6.11%), technology (-5.39%), and communication services (-3.91%).

Equity markets (Index total return %)	Last week	Year-to-date
DJIA	-0.21	6.63
S&P 500	-2.55	8.43
NASDAQ	-4.65	10.92
Russell 1000	0.19	11.10
Russell 1000 Growth	-3.85	4.06
Russell 1000 Value	-0.53	13.07
Russell 2000	0.57	18.82

S&P equity sectors (Index total return %)	Last week	Year-to-date
Communication services	-3.91	5.04
Consumer discretionary	-6.11	-2.25
Consumer staples	1.05	8.62
Energy	2.49	29.18
Financials	1.39	-4.00
Health care	2.32	-0.71
Industrials	0.62	12.68
Information technology	-5.39	17.15
Materials	-1.14	10.67
Real estate	1.55	12.30
Utilities	-0.19	4.65

Key takeaways

1. Driven by an epic AI buildout (contributing more than 40% to GDP growth), the wealth effect, and OBBB tax stimulus, the U.S. economy remains reasonably strong, as indicators point to ≈3% real growth.
2. Consumer spending has remained reasonably good in the face of higher gas prices and inflation generally, thanks to a respectable job market.
3. May's U.S. ISM Manufacturing report (54, above the 53 estimate, and the highest reading since May 2022) reinforces improving activity alongside persistent price pressure, highlighting continued inflationary trends and hawkish risks to U.S. monetary policy.
4. Severe U.S. drought conditions combined with rising pressure on fertilizer availability will likely lead to higher food inflation.
5. Historically, whenever the U.S. two-year yield moved above the Fed funds rate, the Fed's next step was a hike.
6. So far, stellar earnings are outweighing elevated oil prices, rising yields, and increased probability that the Fed may have to hike rates.
7. In Q1, AI plays sourced almost two-thirds of the earnings gains and produced 50+% earnings growth. The 10% profit growth of the rest of the market, an above-trend result, paled in comparison.
8. From the March 30 low, the S&P 500 rose 19% while the tech sector rose 44% (including a 62% rise in the semiconductor industry).
9. Policymakers have indicated that a U.S.-Iran deal has been imminent for nearly four weeks and yet no deal has been reached. Investors continue to focus on when the Strait will open.
10. Since the start of the Middle East war, the U.S. has outperformed international averages. That trend could reverse with falling oil prices, a benefit to the rest of the world more than the U.S.

Expectations Remain High

Investors remain upbeat about the capital market outlook, assuming that the Strait of Hormuz will soon reopen and the global economic expansion will continue. Strong corporate earnings and optimism about AI are underpinning global equities and credit and supporting the overall risk-on climate.

While we, too, expect shipping through the Strait to soon begin to normalize and that the global economic expansion will continue to solidify, current investor exuberance may be overdone. Earnings and profitability are cyclical and already elevated by historical standards. Credit spreads are already very tight. The Fed may believe that U.S. monetary policy is neutral or even mildly restrictive, but elevated prices across many assets indicate that liquidity is still abundant. With inflation well above target in the U.S. and sticky elsewhere in the world, and global growth momentum likely to firm once the Strait opens, there is a clear danger that global liquidity will begin to dry up down the road, with adverse consequences for asset prices.

We have maintained a moderate pro-growth bias for the past several years, favoring stocks over bonds, and continue to do so. Nonetheless, we are becoming increasingly concerned that investors are underestimating the potential fallout for risk assets should liquidity gradually dry up in the year ahead, whether through higher central bank policy rates or bond yields. Market behavior suggests investors are primarily focused on potential returns and less concerned about the possible risks, not the least of which is the possibility of crippling supply shortages if the Strait does not open soon.

The Fed is in no mood to turn the liquidity taps off anytime soon, but the pressure to combat inflation will intensify in the months ahead. Timing a turn in the cycle is very difficult, but it defies economic logic to believe that the extrapolated high earnings expectations for AI companies and earnings estimates in general would not be a casualty in such circumstances.

International equity markets (Index total return %)	**Last week**	**Year-to-date**
MSCI ACWI	0.09	12.25
MSCI ACWI EX U.S.	-0.11	14.24
MSCI EAFE	-0.53	8.79
MSCI EM	0.44	26.16

Fixed income markets (Index total return %)	**Last week**	**Year-to-date**
Bloomberg U.S. Aggregate Bond	-0.11	0.26
Bloomberg U.S. Corp. High Yield	-0.11	1.57
Bloomberg U.S. Gov/Credit	-0.10	0.15
Bloomberg U.S. T-Bill 1-3 Month	0.04	1.54

Alternatives (Index total return %)	**Last week**	**Year-to-date**
Real estate (FTSE NAREIT)	0.26	12.91
Commodities (DJ)	-1.77	22.82
Global listed private equity (Red Rocks)	-2.88	-11.36
Currencies (DB Currency Future Harvest)	0.05	6.65

We continue to favor non-U.S. markets, including emerging markets expecting their economies to be the biggest beneficiaries of an opening of the Strait and the strengthening rebounds in global manufacturing and trade. We expect the U.S. dollar to experience another downleg as economic growth conditions outside the U.S. gradually firm.

The U.S. 30-year Treasury yield broke to a cyclical high last month and another upleg is likely to test investors' nerves and weigh on current equity valuations. A clear signpost that trouble looms would be a rise in the benchmark U.S. 10-year Treasury yield toward the 5% threshold hit in October 2023, or about 50 basis points (bps) above the current level.

Conclusion

We continue to recommend a balanced portfolio tilt in favor of stocks versus bonds on a six to 12-month horizon, but the overall investment risk-reward climate is less comforting than the top-down economic and policy outlook would imply. This is especially the case given the mature stage of the economic expansion and stickiness of inflation. An upside breakout of bond yields, which we view as increasingly likely over the next year, represents a key risk to current investor optimism.

Sources: Bloomberg as of 06/05/26