

Doll's Deliberations[®]

Weekly Investment Commentary



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Summary:

Equities advanced last week (S&P 500 +0.63%), but once again the capitalization-weighted averages handily beat equal-weighted averages. More evidence of a weakening economy occurred. Best sectors were consumer discretionary (+2.50%), energy (+1.86%), and financials (+1.70%); worst sectors were utilities (-0.75%) and technology (-0.66%).

Key takeaways:

- The Citigroup U.S. Economic Surprise Index fell to its lowest level since August 2022.
- May retail sales grew 0.1% m/m (versus consensus of 0.3%), a further sign that the U.S. economy is losing momentum.
- Payrolls have not yet deteriorated, BUT, many labor metrics are weakening—e.g., unemployment, temporary employment, the work week, household employment, and job openings.
- All of the Eurozone's flash PMIs unexpectedly weakened in June, a sign of economic slowdown.
- The University of Michigan gauge of consumer sentiment unexpectedly dropped in June to 65.6 from 69.1 against expectations of improvement (one-year inflation expectations held steady at 3.3%, while 5- to 10-year inflation expectations ticked higher to 3.1%).
- Could it be that the "long and variable lags" from the first Fed rate cut to the onset of recession are causing many—and increasing—signs of economic weakness?
- In the last month, only 19% of stocks have outperformed the S&P 500—the worst in 20 years. YTD, the largest quartile of the S&P 1500 is up 8%; quartile 2: +2%, quartile 3: -2%; smallest quartile: -11%.
- YTD, the S&P 500 (cap-weighted) has outperformed the equal-weighted S&P 500 by more than 10%. Should that hold for the balance of the year, it will be the first time ever that this occurred in back-to-back years. **MARKET BREADTH IS VERY NARROW!**
- Some NVIDIA factoids: Its market cap is larger than the GDP of all but seven countries, larger than the net worth of the world's 12 richest people, and larger than the oil and gas industry.
- The CBO (Congressional Budget Office) raised its forecast for the current year's federal budget deficit by a whopping \$400 billion (to \$2.0 trillion), with nearly three-fourths of the revision coming from overspending.

EQUITY MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
DJIA	1.50	4.87
S&P 500	0.63	15.36
NASDAQ	0.01	18.26
RUSSELL 1000	0.77	14.35
RUSSELL 1000 GROWTH	0.25	20.49
RUSSELL 1000 VALUE	1.21	6.85
RUSSELL 2000	0.57	0.17

S&P EQUITY SECTORS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	0.77	25.10
CONSUMER DISCRETIONARY	2.50	5.18
CONSUMER STAPLES	0.97	9.67
ENERGY	1.86	8.04
FINANCIALS	1.70	10.38
HEALTHCARE	0.65	8.16
INDUSTRIALS	1.56	8.36
INFORMATION TECHNOLOGY	-0.66	28.79
MATERIALS	0.80	5.19
REAL ESTATE	-0.16	-3.23
UTILITIES	-0.75	10.57

Is economic weakness for real?

Asset markets continue to face multiple crosscurrents. The robust U.S. economy has slowed somewhat after a strong three quarters starting in mid-2023. GDP estimates for the current quarter are mixed. Although the outlook is still positive, recent worries about a deteriorating U.S. consumer sector have surfaced. Non-U.S. developed economies remain mixed. Central banks are embracing further easing in inflation. The notable exception is the U.S., where inflation has firmed slightly this year and remains well above the Fed's 2% target. Stocks (and bonds) remain reasonably well bid given a good corporate earnings outlook and the prospect of Fed rate cuts somewhere in the future.

Equity leadership remains uncomfortably narrow and focused on secular growth plays. Investors remain uncertain about the durability of the economic cycle, and thus lack the conviction to bet on lagging equity markets and sectors, especially outside the U.S. The key equity theme of late is to chase perceived secular growth plays regardless of valuations, rather than position for a rotation into better-valued laggards. Sluggish non-U.S. economic growth over the past one to two years has undermined confidence in the global economic backdrop.

Thus, a rotation out of the U.S. mega-cap "tech" shares awaits investors gaining conviction that the global economic expansion is both broadening and rolling on at a healthy growth rate. Alternatively, a weakening economy would likely cause earnings estimate cuts across the board, creating general risk asset weakness.

This decade's economic performance has been historically unique, in that the pandemic-hit global economy initially shut down and then re-opened in stages. There was a boom in goods demand in 2020-22 and parallel collapse in most service sectors. This unprecedented pattern has been unwinding over the past 18 to 24 months, leaving a legacy of elevated uncertainty and low confidence in the durability of the economic and profit cycle, especially outside the U.S.

Periodic jolts to economic sentiment are inevitable, more so since the political and geopolitical backdrop has become more turbulent since the late-2010s. To this end, the recently announced snap election in France has generated considerable angst about the outlook for France, and even for the future of the euro. Regional equities have weakened markedly from global trends, and the spread on French bond yields has risen significantly versus German yields.

This decade's unprecedented economic and inflation gyrations have caused investors and central banks to become "data-dependent." Consequently, the Fed et al. have been of the view that a return to more "normal" interest rate levels is inevitable, with normal being far lower than at present. This sentiment has spurred investors to chronically front-run the next rate-cutting cycle, almost since central banks began hiking rates. The Fed slashed its long run expected nominal policy rate to 2.5% as inflation stagnated during the deleveraging, weak growth backdrop of the 2010s. It has belatedly started to change its view: The FOMC raised its median estimate of the longer-run policy rate for the second consecutive meeting, from 2.6% to 2.8%.

Conclusion

Risk-on will likely persist until after developed market bond yields resume rising, which still does not appear to be an imminent threat. Longer term, the lifting of the Fed's estimate of the long-run neutral rate is bond-bearish. Counter to that, in the near/intermediate term is further evidence of economic slowdown in the U.S.—not yet far enough or long enough for earnings estimates to be cut—stay tuned.

Data from Bloomberg as of June 21, 2024

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INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN) (%)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	0.91	11.58
MSCI ACWI EX U.S.	1.14	6.15
MSCI EAFE	0.96	5.90
MSCI EM	1.80	8.29

FIXED INCOME MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.17	-0.08
BLOOMBERG U.S. CORP HIGH YIELD	0.18	2.51
BLOOMBERG U.S. GOV/ CREDIT	-0.22	-0.11
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.06	2.53

ALTERNATIVES (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-0.30	-3.50
COMMODITIES (DJ)	-0.59	5.80
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	1.51	5.64
CURRENCIES (DB CURRENCY FUTURE HARVEST)	0.58	10.37