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Doll's Deliberations®

Weekly Investment Commentary

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Summary

Last week, stocks rose – S&P 500 (1.06%). The week featured a tug of war between earnings enthusiasm and rising geopolitical tensions. Best sectors were consumer discretionary (+8.30%) and communication services (+5.37%); worst sectors were utilities (-4.21%) and real estate (-2.20%).

Equity markets (Index total return %)	Last week	Year-to-date
DJIA	1.04	10.17
S&P 500	1.06	10.14
NASDAQ	1.60	9.53
Russell 1000	0.39	9.25
Russell 1000 Growth	0.57	0.32
Russell 1000 Value	1.41	20.67
Russell 2000	0.55	19.45

S&P equity sectors (Index total return %)	Last week	Year-to-date
Communication services	5.37	1.39
Consumer discretionary	8.30	0.04
Consumer staples	1.15	10.31
Energy	-0.16	34.74
Financials	1.07	4.91
Health care	-0.01	5.96
Industrials	-1.58	16.54
Information technology	-0.11	15.65
Materials	-1.72	10.12
Real estate	-2.20	14.33
Utilities	-4.21	5.29

Key takeaways

1. Despite market jitters, the Fed held rates at 3.5-3.75%, with three dissents in favor of a hike.
2. From the day after the June Fed meeting to the day after this one, two-year yields are up 8-basis points (bps) with 30-year yields up 33 bps. (Does this signal that the Fed "should have" raised rates 25 bps?)
3. Inflation is poised to remain elevated amid sticky services inflation, an AI capex boom that is spilling into higher consumer prices, and, of course, high oil prices.
4. It looks increasingly likely that the Fed will have to raise rates (talking hawkish but not acting so reduces the Fed's credibility).
5. Recent economic data suggests that the U.S. economy remains in good shape [e.g., final domestic sales (excludes trades and inventory) rose nearly 4% in the latest GDP report].
6. The rate of upward EPS estimate revisions is still trending lower (tech revisions remain strong but consumer industries have seen some weakness).
7. To highlight the continued volatility and divergence inside the market, last Wednesday was the worst breadth (more than 100 net decliners) for a day when the S&P 500 gained 1.5% ever.
8. De- and re-escalation of the Gulf War continues. One analyst says: "getting yin-yanged by the Gulf War."
9. We are likely in an environment of less-correlated returns across industries, countries, and assets, which means greater scope for diversification and more alpha opportunities.
10. Factoid: In every mid-term election since World War II, the S&P 500 was higher nine months later.

More Flies in the Ointment, but Earnings Remain Strong

International equity markets (Index total return %)	Last week	Year-to-date
MSCI ACWI	0.15	9.99
MSCI ACWI EX U.S.	-0.22	11.62
MSCI EAFE	1.64	11.17
MSCI EM	-3.96	12.62

Fixed income markets (Index total return %)	Last week	Year-to-date
Bloomberg U.S. Aggregate Bond	0.16	-0.41
Bloomberg U.S. Corp. High Yield	0.18	1.71
Bloomberg U.S. Gov/Credit	0.13	-0.59
Bloomberg U.S. T-Bill 1-3 Month	0.05	2.12

Alternatives (Index total return %)	Last week	Year-to-date
Real estate (FTSE NAREIT)	-1.71	17.59
Commodities (DJ)	-2.07	22.98
Global listed private equity (Red Rocks)	1.64	-9.26
Currencies (DB Currency Future Harvest)	-1.29	8.11

Global financial markets have hit another rough spot, which has been especially painful for high-flying AI/tech stocks. Investors face three issues: 1) yet another spike in oil prices and fears of supply shortfalls, 2) a souring in sentiment toward select tech and related niches, and 3) the relentless rise in government bond yields (recently spurred on by higher oil prices and fears of more tariff increases). The macro backdrop in terms of corporate profitability, economic momentum, and current accommodative monetary conditions remain supportive. Central banks remain cautious and pro-growth.

Two threats (the Middle East and tariffs) are self-inflicted and could be diffused by political decisions, although such an outcome has become more difficult in the Middle East. In terms of U.S. tariffs, past behavior suggests that tariff policy will not escalate to the point where it jeopardizes the global economic expansion. A similar view holds for the Middle East, although the odds of a misjudgment have increased. We have no insights on how events in the region will ultimately pan out but anticipate that the U.S. will seek an off-ramp rather than full-blown escalation. A return to normal trade flows in the region has become more difficult and it will take a significant change in the combatants' objectives, especially in the U.S.

Overbought AI, semiconductor, and related tech stocks have become volatile and will weigh on equity indexes in the near term. We anticipate something similar to the equity rotation outcome seen in the early-2000s, where tech stocks fell from favor and investors rotated into select lagging market niches for a time, rather than souring on equities in general.

In the end, rising bond yields will likely be the greatest threat to risk-asset markets. The timing of an overshoot in yields could be delayed if a period of risk-off occurs or perhaps a bout of softer economic growth develops, both of which would cap bond yields for a time. However, the lesson of recent years is that inflation is not going away, and most likely will not fade as a threat until the next recession develops. To this end, central banks are still fundamentally dovish in terms of their actions, even if some sound increasingly hawkish. Thus, the next recession, if not caused by deliberate (or accidental) political decisions, awaits the return of bond vigilantes.

The lowest-quality U.S. corporate bonds (CCC-rated) are providing a potential early warning for credit and equity markets, as spreads here have widened steadily. However, U.S. and euro area investment-grade and high-yield credit spreads remain near their historical lows, reflecting the ongoing positive trend in corporate profits.

In terms of the Fed and its recent meeting, new Chair Warsh provided little insight about the rationale behind the decision to stand pat and no insight into what comes next. He did suggest that the Fed may well change the specific inflation measure that it will target, albeit not until 2027. This will likely not be comforting to the Treasury market, especially with government agencies set to revise lower several inputs to the PCE deflator.

Conclusion

The war in the Middle East is not over and oil prices remain a wild card. As with tariffs, we are still betting on a de-escalation in the Middle East before the global economic expansion derails, but the risk of a miscue has risen. Central banks remain accommodative and overly cautious, especially in the U.S., which has the greatest inflationary pressures. Consequently, the odds of an overshoot in bond yields continue to slowly rise. Adding it up, we are not yet willing to de-risk our portfolio, although we recommend a close monitoring of market developments.

Source: Bloomberg as of 07/31/26