

# Doll's Deliberations®

## Weekly Investment Commentary



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### Summary

After reaching new record highs, stocks fell last week (S&P 500 -2.34%). Breadth was notably negative as equal-weighted averages underperformed cap-weighted averages. The pullback related to growth concerns following a disappointing July non-farm payrolls report and sharp downward revisions to prior months. Advancing sectors were utilities (1.56%) and communication services (0.01%); biggest decliners were materials (-5.40%) and consumer discretionary (-4.54%).

### Key takeaways

1. U.S. nonfarm payrolls rose a disappointing 73,000 in July, and there were sharp downward revisions of 258,000 to May/June. (May/June/July job growth was the lowest three-month period in five years.) In light of these results, the probability of a Fed cut in September has increased.
2. In his presser, Fed Chair Powell noted several times that the unemployment rate has been steady, yet inflation is above target, implying the Fed is focused on the risk of higher inflation more than the risk of weaker growth.
3. Year-over-year readings of inflation (2.3%) and the unemployment rate of 4.2% seem good. However, FOMC participants expected both of these numbers to worsen in the months ahead, with unemployment averaging 4.5% in the fourth quarter and year-over-year inflation rising to 3.0%.
4. 2Q GDP flash was 3.0%, but real final sales were up a more paltry 1.2%. (Net trade as a result of tariffs boosted growth by 5.0%.)
5. So far, the impact of tariffs on overall earnings has been less severe than initially anticipated. The effective tariff rate seems to be shifting from around 10% to around 15%. This remains a manageable number for most corporations.
6. While trade deals may give the initial impression of emerging stability, risks remain: Will the details to be negotiated cause some deals to fall apart? Will each (the U.S. and the relevant trading partner) stick with the details? And what economic headwinds (e.g., inventory builds, margin hits) will the deals create?
7. With half the S&P 500 having reported 2Q25 earnings, more than 80% have exceeded expected earnings and more than 60% have exceeded expected revenues. The average earnings beat has been about 6%, a strong result.
8. July was the third straight month of equity market increases and the first month in a year where no day saw the S&P 500 up or down 1% or more.
9. Through July 31, the path of least resistance for stocks has been higher on the resilient macro backdrop, the steady removal of tariff uncertainties, elevated buying by retail and quants, earnings beats, the AI growth theme, expected Fed rate cuts, and a pickup in deal activity.
10. While we don't believe we are in a full-blown bubble, asset prices are at or near all-time highs in many areas. Stocks are priced for perfection and the market's failure to power higher in the face of strong 2Q EPS results leaves us wanting to take some profits over the near-term into weaker seasonality.

Equity markets (Index total return %)	Last week	Year-to-date
DJIA	-2.92	3.43
S&P 500	-2.34	6.85
NASDAQ	-2.16	7.33
Russell 1000	-0.80	8.48
Russell 1000 Growth	-1.75	7.97
Russell 1000 Value	-3.12	5.24
Russell 2000	-2.18	-0.08

S&P equity sectors (Index total return %)	Last week	Year-to-date
Communication services	0.01	11.95
Consumer discretionary	-4.54	-4.87
Consumer staples	-1.10	4.45
Energy	-1.53	1.92
Financials	-3.73	7.27
Healthcare	-3.86	-3.77
Industrials	-3.33	14.42
Information technology	-1.40	11.30
Materials	-5.40	4.76
Real estate	-3.45	3.18
Utilities	1.56	14.97

## Risk-reward turning unfavorable

Investors have thrown caution to the wind and embraced pro-growth monetary and fiscal policies, while discounting any of the upside inflation or other policy risks, such as several higher U.S. tariff rates. U.S. equities, corporate credit, private credit, gold, and cryptocurrencies have been among the beneficiaries of buoyant liquidity conditions and boast historically rich valuations. An unquenchable thirst for AI plays, high hopes of significant Fed rate cuts in the year ahead, and confidence that U.S. tariffs will not jeopardize global economic growth or corporate profits have spurred a risk-on climate.

Last week's announcement of the U.S. tariffs, including higher rates on Canada and Brazil than previously expected, for example, are a reminder of U.S. policy uncertainty. Whether some of the announced rates will be modified in the coming days is unclear, let alone whether the tariffs will be upheld by U.S. courts. Regardless, tariff uncertainty complicates forecasting the U.S. and global economic outlook.

Tariffs aside, AI is viewed as the ultimate outcome, expected to boost growth, productivity and corporate profits, while simultaneously dampening inflation and allowing central banks to drive nominal and real interest rates to low levels. Whether AI can deliver on those outcomes remains to be seen, but history is replete with bull markets driven into bubble territory on the combination of easy money and the extrapolation of a sure-fire investment thesis. And it is almost always "different this time," or so investors proclaim during the bull run.

Lacking a crystal ball, we can only rely on economic and capital market fundamentals and frameworks that argue for considerably greater caution than investors are demonstrating. The longevity of the current cycle is unknowable, as is how high the prices of risk assets could climb in the meantime. At the same time, we also know that the rich valuations for many assets weaken their risk-reward outlook and indicate the potential for significant losses should today's optimistic assumptions prove erroneous – or at least overstated. Prudent investment strategy is neither about running with the pack nor being a contrarian, but rather is about aligning the macro and policy outlook with the risk and return assessments of the major asset classes.

Our biggest concerns are that investors are underestimating inflation risks as well as evident economic slowing. The forward P/E ratio is now nearly 10% higher than immediately prior to the April 2 announcement of U.S. tariffs and is very elevated by historical standards. The economic expansion will likely continue but at a slower pace than would have been the case without the tariffs. Moreover, earnings growth momentum is slowing. The huge 65% U.S. share of global equity market capitalization combined with high valuations and earnings expectations, most notably for technology and technology-related stocks, tempers our enthusiasm for stocks.

## Conclusion

Positive prospects are already discounted in equity and credit prices. Investors are complacent about inflation and weakening growth. And therefore, risk assets are fully valued.

International equity markets (Index total return %)	Last week	Year-to-date
MSCI ACWI	-1.23	11.54
MSCI ACWI EX U.S.	-2.18	17.56
MSCI EAFE	-2.76	17.77
MSCI EM	-1.12	17.51

Fixed income markets (Index total return %)	Last week	Year-to-date
Bloomberg U.S. Aggregate Bond	0.14	3.75
Bloomberg U.S. Corp High Yield	-0.03	5.04
Bloomberg U.S. Gov/Credit	0.17	3.72
Bloomberg U.S. T-Bill 1-3 Month	0.05	2.50

Alternatives (Index total return %)	Last week	Year-to-date
Real estate (FTSE NAREIT)	-3.35	0.93
Commodities (DJ)	-2.67	4.48
Global listed private equity (Red Rocks)	-3.17	7.63
Currencies (DB Currency Future Harvest)	1.43	-0.36

Source: Bloomberg as of Aug. 1, 2025

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