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Doll's Deliberations®

Weekly Investment Commentary

Bob Doll, CFA
PM/CIO/CEO

Summary

Thanks to a strong rally on Friday, stocks finished mostly higher for the week (S&P 500 0.30%). The Friday rally occurred in light of a shifting balance of risks from the Fed, noting downside risks to employment are increasing. Best sectors for the week were energy (3.14%), real estate (2.48%), and financials (2.15%); declining sectors were technology (-1.56%) and communication services (-0.88%).

Equity markets (Index total return %)	Last week	Year-to-date
DJIA	1.59	8.42
S&P 500	0.30	10.88
NASDAQ	-0.55	11.80
Russell 1000	-1.18	9.04
Russell 1000 Growth	-0.91	11.20
Russell 1000 Value	1.69	10.03
Russell 2000	-0.52	2.85

S&P equity sectors (Index total return %)	Last week	Year-to-date
Communication services	-0.88	17.08
Consumer discretionary	1.28	2.56
Consumer staples	0.33	7.33
Energy	3.14	4.92
Financials	2.15	11.73
Heathcare	1.47	1.38
Industrials	1.82	17.01
Information technology	-1.56	14.12
Materials	2.12	11.56
Real estate	2.48	5.80
Utilities	0.53	15.30

Key takeaways

1. In his last Jackson Hole speech, Fed Chair Powell leaned more dovish than expected, indicating the risks associated with unemployment are now higher than the risk of inflation. The September rate cut probability moved from 70% to over 90%. (Curiously, according to Goldman Sachs, since 1990, the Fed has cut rates nine times when the S&P 500 was within 1% of a record high. The median change in the S&P the day of the cut, one week, and one month later was zero.)
2. Retail sales and consumer sentiment data point to slowing underlying momentum. (Retail sales rose 0.5% m/m in July, below estimates and decelerating from 0.9% in June.)
3. U.S. housing data remain weak. Elevated mortgage rates are a headwind, and with consumer spending slowing, residential investment remains a drag on GDP growth.
4. The Philly Fed's index fell to -0.3 from 15.9 in July, with shipments, employment, and new orders all declining.
5. Wage growth has slowed to 2.4% in July, the weakest in five years.
6. The Fed minutes showed that the doves want to ease preemptively to cushion labor market weakness and discount persistent tariff-driven inflation, while hawks prefer to wait and assess realized inflation and its effects on expectations.
7. Despite questions about economic strength, inflation, and tariffs, earnings growth has been outstanding.
8. The smooth S&P 500 rally has dampened volatility. (The VIX has dropped from the 40s at peak, to around 20 for much of the summer, to 15 now.)
9. The top 10 S&P 500 contributors account for two-thirds of the 10% total return YTD.
10. The middle three days last week witnessed a noticeable decline in the top decile of stocks with the best YTD performance. Meanwhile, the majority of the other 90% rose – a weird and unusual divergence.

Threading the needle gets tougher

Mega cap growth stocks fell back last week (until Friday) following yet another climb to new highs. Valuations for these companies have become extended, similar to previous episodes when investment stampedes developed, because new technologies led to open-ended expectations at a time of plentiful liquidity. Equities are in favor because of the unusual and highly favorable combination of rising corporate earnings and increasing hopes for lower policy rates.

The starting point for the post-April run-up in all risk-asset markets was accommodative monetary conditions and favorable liquidity. The growth scare that month was not caused by signs of economic stress, but rather fears of a potentially destructive change in U.S. trade policy. The expectation of Fed rate cuts at a time of easing fiscal policies and already exuberant market sentiment has been extremely beneficial for risk asset markets once trade fears moderated. This positive investment backdrop seems destined to persist until either corporate earnings falter, reflecting a weakening economy, or the cost of money rises; i.e., bond yields break out to the upside. As valuations have climbed, threading the needle between these two potential problems has gotten increasingly precarious.

The U.S. 10-year Treasury yield has tracked sideways for months as intensifying political pressure on the Fed to slash rates has, for now, offset sticky and slightly rising inflation, decent ongoing economic momentum, and ever-rising government debt. A continuation of a relatively flat trend in yields means that the risk-on environment, while occasionally choppy, is likely to persist. The plentiful liquidity backdrop has not only boosted equity markets to new highs, but also has spurred ever-narrower credit spreads.

International equity markets (Index total return %)	Last week	Year-to-date
MSCI ACWI	-0.97	13.20
MSCI ACWI EX U.S.	-0.49	21.63
MSCI EAFE	-0.40	23.06
MSCI EM	-0.80	19.45

Fixed income markets (Index total return %)	Last week	Year-to-date
Bloomberg U.S. Aggregate Bond	-0.03	4.35
Bloomberg U.S. Corp High Yield	-0.11	5.48
Bloomberg U.S. Gov/Credit	-0.05	4.24
Bloomberg U.S. T-Bill 1-3 Month	0.04	2.76

Alternatives (Index total return %)	Last week	Year-to-date
Real estate (FTSE NAREIT)	0.99	2.42
Commodities (DJ)	1.33	5.78
Global listed private equity (Red Rocks)	-1.63	8.57
Currencies (DB Currency Future Harvest)	0.50	-0.15

While the political and policy noise is loud, investors have become somewhat immune and remain focused on easy/easier monetary and fiscal conditions and still-decent economic prospects, despite much higher U.S. tariffs. The tariffs present a larger headwind for the U.S. rather than non-U.S. economies, assuming that a good portion of the increased costs are absorbed locally, as surveys have suggested. The U.S. now has greater trade friction/costs with most countries, whereas most other countries only have it with the U.S. However, 30-year yields have not only risen but are near or even above their cycle highs, in marked contrast with 10-year yields, despite steadily lower policy rates. This is a warning that something is causing investors to pull back from taking very long duration risk. The divergence is an early warning that bond investors might be rethinking their multi-decade “lower inflation forever and government debt levels do not matter” bias.

Conclusion

Rising corporate earnings and lower policy rates from a starting point of already accommodative monetary conditions are positive for risk-asset markets. Asset-market valuations are not appealing, but risk-on is likely to persist until earnings are challenged by a weakening economy, or government bond yields break out to the upside due to sticky inflation and ever-increasing structural deficits.

Source: Bloomberg as of Aug. 22, 2025