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Weekly Investment Commentary

Bob Doll, CFA
PM/CIO/CEO

Summary

U.S. equity averages were mostly higher last week (S&P 500 +0.50%). However, the equal-weighted S&P lagged and finished lower for the second straight week. Best sectors were technology (+1.80%), communication services (+1.57%) and financials (+1.07%); worst sectors were energy (-1.96%), health care (-1.95%) and real estate (-1.28%).

Equity markets (Index total return %)	Last week	Year-to-date
DJIA	0.55	12.58
S&P 500	0.50	13.51
NASDAQ	0.85	14.03
Russell 1000	0.68	13.76
Russell 1000 Growth	0.31	4.09
Russell 1000 Value	0.40	23.83
Russell 2000	-0.11	22.34

S&P equity sectors (Index total return %)	Last week	Year-to-date
Communication services	1.57	1.80
Consumer discretionary	0.06	0.72
Consumer staples	-0.49	9.91
Energy	-1.96	41.23
Financials	1.07	7.07
Health care	-1.95	11.61
Industrials	-1.72	14.85
Information technology	1.80	22.52
Materials	-0.37	17.66
Real estate	-1.28	13.04
Utilities	-0.09	1.47

Key takeaways

1. July core PCE inflation came in at 0.25% m/m, above the 0.20% consensus. (This has been the Fed's favorite inflation indicator.)
2. The U.S. economy continues to show resilience and remains a tailwind for earnings. The labor market is not creating demand-side inflation yet, and the capex boom remains structural rather than cyclical, making it robust.
3. Housing remains weak. Consumer confidence remains weak with sluggish services activity. However, manufacturing remains relatively buoyant, likely helped in large part by the AI capex boom.
4. Since the beginning of the war, China is a key linchpin in the Iran strategy. The blockade and secondary sanctions are hurting Iran, but China remains its economic lifeline.
5. Iran does not need to close the Strait of Hormuz to exert control over it. Keeping the Strait dangerous enough that insurers and commercial shippers restrict traffic may accomplish much of the same objective without a formal closure.
6. The price for defending the Treasury market might be to sacrifice the dollar. However, the only permanent solution for the bond market is fiscal improvement, which is unlikely anytime soon.
7. As of mid-August, the S&P 500's forward earnings was up 24.9% YTD versus a 12.1% gain in the index, which has pushed the forward P/E down 9.9%. Forward earnings have risen almost uninterrupted this year.
8. A key concern is likely to be the slowdown in earnings growth into 2027, given the elevated growth rates this year. (The deceleration from more than 30% growth to the low teens is beginning to attract attention.)
9. Nvidia's earnings suggest that the AI spending boom is broadening. AI-related investments should remain a significant tailwind for economic and earnings growth.
10. Here's an interesting trio – U.S. public debt is more than 100% of GDP, the U.S. dollar is near a 25-year high, and profit margins are three standard deviations above normal.

Rising Interest Rates Risks Remain

The U.S. administration has not pivoted from taking short-term economic risks to pursuing pro-growth policies ahead of the mid-term elections, as expected. The result is that the still-healthy U.S. economy now faces some mildly stagflationary forces. Further increases in tariffs and a still-unresolved stand-off in the Middle East are directionally inflationary and negative for growth. Globally, the impacts vary. Energy-importing economies are facing higher energy prices and less certain supplies than was the case at the start of the year. Meanwhile, those countries most impacted by higher U.S. tariffs face economic headwinds.

The risks are not yet significant enough to undermine the U.S. and global economic expansion, as confirmed by recent generally positive data in most economies. The dilemma is that both the war and tariffs will reinforce the already existing upward pressure on global bond yields. The earliest warnings of a deteriorating economic outlook are usually found in the credit market, soon followed by weaker equity markets. However, even as absolute yields have risen modestly, investment-grade and high-yield corporate bond spreads remain historically low, although there is an early warning sign from the rising spread for the lowest-quality U.S. corporate paper.

A flood of new corporate borrowing is a new and growing concern, especially since it is occurring at a time of ever-rising public sector debt issuance. The latter is a major longer-term concern since it is not occurring during a recession, but rather at a time when most economies are near full employment. As a result, the path of least resistance for global bond yields appears to be upward. Economic growth remains solid, inflation is sticky, and the demand for capital via debt markets will continue to grow rapidly. In addition, a misguided attempt to lower long-term U.S. government bond yields by Treasury Secretary Bessent has only intensified the upward pressure at the long end of the yield curve.

International equity markets (Index total return %)	**Last week**	**Year-to-date**
MSCI ACWI	0.44	14.84
MSCI ACWI EX U.S.	-0.11	17.28
MSCI EAFE	-0.21	13.91
MSCI EM	0.08	24.32

Fixed income markets (Index total return %)	**Last week**	**Year-to-date**
Bloomberg U.S. Aggregate Bond	0.46	0.11
Bloomberg U.S. Corp. High Yield	0.36	2.81
Bloomberg U.S. Gov/Credit	0.45	-0.08
Bloomberg U.S. T-Bill 1-3 Month	0.04	2.41

Alternatives (Index total return %)	**Last week**	**Year-to-date**
Real estate (FTSE NAREIT)	-0.69	15.33
Commodities (DJ)	-0.14	30.93
Global listed private equity (Red Rocks)	0.61	-2.15
Currencies (DB Currency Future Harvest)	0.51	10.93

Offsetting the drag from higher government bond yields, credit and equity markets continue to benefit from still accommodative monetary and fiscal conditions, and the support of rising corporate profits. Strong earnings growth is unusual outside of periods following recessions. But there is now a high hurdle to continue outperforming elevated earnings expectations in the U.S. Profit growth is destined to decelerate in 2027.

U.S. economic and policy conditions are not conducive to bringing inflation down to pre-2020 levels, i.e., down to the Fed's target of 2%. While not related to higher tariffs, an additional source of U.S. and global inflationary pressures is coming from a previous and long-lasting source of disinflation, namely China.

Conclusion

The risk-on backdrop continues, despite ongoing tensions in the energy market and U.S. tariff policies. These headwinds are stagflationary but have not been sufficient to slow the global economic expansion. Despite an early warning sign from rising spreads on the CCC-rated debt, the overall credit market is still historically calm and supportive of equity markets. The main risk for investors is the relentless rise in long-term bond yields. Rising credit demand, now including the corporate sector, increases the odds of an overshoot in bond yields.

Source: Bloomberg as of 08/28/26