

# Doll's Deliberations®

## Weekly Investment Commentary



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### Summary

Most equity averages fell last week (S&P 500 -0.08%). Detractors included concerns over Fed independence, ongoing labor market issues, and mixed takeaways from Nvidia earnings. Best sectors were energy (2.45%), financials (0.77%), and communication services (0.71%); worst sectors were utilities (-2.00%), consumer staples (-1.67%), and industrials (-0.76%).

### Key takeaways

1. The second estimate of Q2 real GDP was revised higher to an annualized rate of 3.3% from an initial estimate of 3.0%. This stronger performance was primarily driven by upward revisions to key domestic sectors (e.g., consumer spending).
2. The August Conference Board Consumer Confidence Index beat expectations but fell. Confidence remains near cycle lows, with expectations only timidly recovering from peak trade tensions while current conditions stay sluggish.
3. Regional Fed surveys point to low GDP growth, not an outright recession, which tactically supports low growth plays such as duration and tech.
4. For the first time in months, the year-over-year change in next 12 months earnings is starting to trend higher, now reaching 9.0%. This provides some reassurance that underlying market fundamentals remain relatively sound.
5. With the S&P 500 up 4% in August, the best decile of YTD performance stocks are actually down; one of many signs of rotation.
6. President Trump's firing of Federal Reserve Governor Lisa Cook marks an unprecedented moment for central bank independence, signaling the White House's escalating campaign to exert direct influence over monetary policy decisions.
7. If Trump is successful in removing Lisa Cook as Fed Governor, he will have appointed a majority of Federal Reserve Board Governors, which likely tilts the scale to a more aggressive financial deregulation plan.
8. The persistent uncertainty created by our President, initially centered on trade and now shifting to attacks on the Federal Reserve, continues to put pressure on the dollar.
9. Volatility has fallen to 2025 lows, as equities have climbed back to all-time highs with minimal pullbacks, steadily compressing realized volatility.
10. We see some room for small caps to continue to lead as long as Fed dovishness is maintained.

Equity markets (Index total return %)	Last week	Year-to-date
DJIA	-0.11	8.30
S&P 500	-0.08	10.79
NASDAQ	-0.18	11.60
Russell 1000	0.61	11.46
Russell 1000 Growth	0.04	11.33
Russell 1000 Value	-0.11	10.01
Russell 2000	0.71	7.58

S&P equity sectors (Index total return %)	Last week	Year-to-date
Communication services	0.71	17.91
Consumer discretionary	-0.52	2.02
Consumer staples	-1.67	5.54
Energy	2.45	7.49
Financials	0.77	12.59
Healthcare	-0.56	0.81
Industrials	-0.76	16.12
Information technology	-0.07	14.04
Materials	0.07	11.64
Real estate	-0.12	5.67
Utilities	-2.00	13.00

## Valuation concerns are never a timing tool

Tensions between the Federal Reserve and President Trump have steadily increased this year, even though Chair Powell acquiesced to pressures by signaling an imminent rate cut in his Jackson Hole speech. However, the President wants much lower rates, not just the occasional 25-basis-point reduction. So far, investors have shrugged their shoulders and not reacted to the potential loss of Fed independence.

Perhaps investors are more focused on the prospects for much lower short-term rates, rather than being bothered by the potential for higher long-term Treasury yields, especially as the benchmark 10-year Treasury yield has not risen. The financial markets appear to be discounting higher odds of better economic growth and corporate earnings and have ignored any inflation risks. Such optimism flies in the face of recent firming inflation data and a significantly positive U.S. output gap. The legacy of decades of first disinflation and then flat inflation means that there is a deeply entrenched belief among investors and the Fed that all roads lead to 2% inflation, without the necessity of a recession. We do not expect such a benign outcome.

For now, risk-on will continue since investors are staying focused mostly on the short-term outlook, which is still positive. The short-term nature of investors' investment horizon is not surprising since they, and the Fed, have struggled to find an accurate framework for the economic cycle, and have benefitted from persistently positive corporate earnings in recent years. To this end, the just-completed U.S. earnings report season showed no signs of stress. This, in turn, underscores that the downshift in hiring growth this year has not been driven by deteriorating profits, but rather by heightened policy uncertainty related to tariff policy and by the sharp drop in immigration.

Until an economic roadblock develops, investors will remain content to ride the liquidity wave, especially with the promise of more liquidity ahead via lower Fed rates. Tariff increases created an economic headwind, but they have not been sufficient to offset other positive influences on growth, including upcoming fiscal stimulus. Equity markets are at highs, and credit spreads remain historically very tight. This generally positive backdrop will continue, despite ever more elevated valuations, until a new policy threat to economic growth develops and/or the bond market riots. It appears that investors are not going to react to the threat of a loss of Fed independence until such an outcome actually appears imminent, and the potential consequences hit home.

At this juncture, we are suggesting a bear-steepening, given our inflation forecast, i.e., even if short-term rates decline, long-term yields should climb because of higher inflation; eventually, this outcome will put downward pressure on long-duration asset valuations and flip the environment to risk-off. For now, the Fed wants to ease reflecting its entrenched dovish bias, which is pro-growth, benefits risk assets, and is bearish for the U.S. dollar.

The Fed has claimed that monetary policy is restrictive because of some weak economic sectors, such as housing. This claim is not consistent with solid risk-asset markets and overall economic performance, as well as the uptrend in inflation. If the Fed were to ease policy for the weakest economic links, it would overstimulate healthy sectors and sustain asset-price inflation.

## Conclusion

The advisability of Fed easing is questionable based on economic/inflation trends, but will occur regardless. The liquidity boom will roll on, helping to sustain the already-stretched risk-on environment. Investors appear unfazed by the potential loss of Fed independence. For now, the U.S. and global economy are weathering the tariff war, and the expansion will roll on.

Source: Bloomberg as of Aug. 29, 2025

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International equity markets (Index total return %)	Last week	Year-to-date
MSCI ACWI	0.11	14.86
MSCI ACWI EX U.S.	-0.79	21.88
MSCI EAFE	-1.14	23.16
MSCI EM	-0.54	19.28

Fixed income markets (Index total return %)	Last week	Year-to-date
Bloomberg U.S. Aggregate Bond	0.28	5.12
Bloomberg U.S. Corp High Yield	0.45	6.35
Bloomberg U.S. Gov/Credit	0.23	4.95
Bloomberg U.S. T-Bill 1-3 Month	0.05	2.85

Alternatives (Index total return %)	Last week	Year-to-date
Real estate (FTSE NAREIT)	-0.42	3.73
Commodities (DJ)	1.22	7.07
Global listed private equity (Red Rocks)	-0.77	10.21
Currencies (DB Currency Future Harvest)	0.19	-0.24