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Doll's Deliberations®

Weekly Investment Commentary

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Summary

Stocks were mixed last week (S&P 500 +0.13%). Focus continued to be on the rise in interest rates and higher oil prices. Best sectors were energy (+2.28%) and technology (+1.10%); worst sectors were consumer discretionary (-2.05%) and materials (-1.42%).

Equity markets (Index total return %)	**Last week**	**Year-to-date**
DJIA	-0.16	12.39
S&P 500	0.13	13.65
NASDAQ	0.42	14.51
Russell 1000	0.48	13.94
Russell 1000 Growth	0.56	4.68
Russell 1000 Value	-0.27	23.50
Russell 2000	-0.11	20.52

S&P equity sectors (Index total return %)	**Last week**	**Year-to-date**
Communication services	-0.42	1.37
Consumer discretionary	-2.05	-1.34
Consumer staples	-0.79	9.04
Energy	2.28	44.45
Financials	0.02	7.09
Health care	0.17	11.80
Industrials	-1.04	13.66
Information technology	1.10	23.86
Materials	-1.42	15.99
Real estate	-1.21	11.68
Utilities	0.82	2.29

Key takeaways

1. The August payroll report meaningfully beat expectations (167k vs. 55k expected), just the opposite of last month. Unemployment was unchanged at 4.1% and average hourly earnings increased 0.3%. (The inflation reports this week will be key to the Fed's rate decision later this month.)

2. U.S. manufacturing expanded for an eighth straight month in August. Factories continue to lean on resilient consumer demand and solid business investment, but tariffs and the war-driven spike in energy prices are increasingly visible in the details.

3. Underlying U.S. inflation remains sticky, holding at least 0.5 percentage points above the level consistent with the Fed's 2.0% target.

4. Fed Governor Waller said he's willing to hold the policy rate steady if progress toward the Fed's 2% inflation target continues. He also stressed that it would not take much evidence of persistent inflation pressures to support a hike. The burden of proof is now on the inflation data to justify a hike.

5. The current unemployment rate, at 4.1%, is the lowest it's been in 18 months and is also lower than it has been 88% of the time over the past 50 years.

6. The 30-year mortgage rate has climbed to 6.66%, up from 5.98% in early March. High mortgage rates have left new buyers scrambling to afford a home and existing homeowners trapped in homes with low mortgage rates.

7. Strong capital spending, in part reflecting the AI buildout, has contributed significantly to U.S. economic growth in recent quarters, but the capex cycle is maturing. The elevated level of capex also signals further upside pressure on corporate borrowing, interest rates, and inflation.

8. Economic expansions rarely die of old age. They get "murdered" by a central bank that raises rates significantly to fight inflation.

9. The torrid pace of earnings growth is unlikely to last beyond the next couple of quarters, as companies will face tough y/y comparisons in 1H27. This could leave the equity market vulnerable to more volatility in the months ahead as equity supply increases and bond yields face additional upward pressure due to the growing demand for capital and sticky inflation.

10. When the S&P 500 is up 10% plus through August, a negative September-December has occurred only once (out of 28 times since 1950).

How Long Can a Bull Market in Stocks and a Bear Market in Bonds Co-Exist?

Rising global bond yields are threatening to derail the liquidity-driven risk-on climate that has boosted equities, corporate credit, and other growth assets since late 2023. In Jackson Hole, Fed Chair Warsh underscored that a higher policy rate may be necessary to reduce broad-based inflation pressures and bolster Fed credibility. There are signs of increasing angst about AI with CDS spreads on several major plays continuing to rise. Recent renewed military action by the U.S. and Iran add to near-term upside risk for oil prices, inflation expectations, and bond yields.

The challenge for policymakers and investors is that bond market fundamentals are poor, with large government budget deficits adding to already elevated debt levels and bumping up against high/rising private sector borrowing. Absent an economic downturn, the path of least resistance for bond yields is up. There is no specific level at which government bond yields would trigger a downturn in the global economy and equity markets, but investor concerns will likely mount if the U.S. 10-year Treasury yield looks poised to breach the 5% level last reached in October 2023. The less-widely traded 30-year Treasury yield has already risen above its October 2023 peak and constitutes a warning sign. We expect the U.S. 10-year yield to rise above 5% at some point in the year ahead. As always, the speed at which it rises may be as important for capital markets as the level that it reaches.

These warning signs coincide with, and are partly driven by, the ongoing resilience of the global economy. The latest batch of PMI surveys highlighted that global economic momentum is improving, despite notable headwinds including the Middle East war. Corporate profits are booming and support corporate equities and credit.

International equity markets (Index total return %)	**Last week**	**Year-to-date**
MSCI ACWI	0.16	14.88
MSCI ACWI EX U.S.	-0.36	16.99
MSCI EAFE	-0.17	14.07
MSCI EM	-1.07	22.95

Fixed income markets (Index total return %)	**Last week**	**Year-to-date**
Bloomberg U.S. Aggregate Bond	-0.16	-0.37
Bloomberg U.S. Corp. High Yield	-0.10	2.62
Bloomberg U.S. Gov/Credit	-0.18	-0.56
Bloomberg U.S. T-Bill 1-3 Month	0.05	2.48

Alternatives (Index total return %)	**Last week**	**Year-to-date**
Real estate (FTSE NAREIT)	-0.47	14.18
Commodities (DJ)	1.98	33.52
Global listed private equity (Red Rocks)	-1.82	-3.95
Currencies (DB Currency Future Harvest)	-0.32	10.57

We continue our recommended tilt toward international markets. While all equity markets will be sensitive to the AI trade, the U.S. market is most vulnerable given its high technology concentration risk and elevated valuations and earnings growth expectations. Equity investors have been rewarded for being underweight the U.S. over the past two years, a trend we expect to persist. Our forecast of a weaker U.S. dollar will further boost non-U.S. equity relative performance.

The upcoming U.S. mid-term elections have the potential to inject volatility into markets in the near term, with Democrats favored to win control of the House of Representatives and possibly even the Senate. We doubt major legislative changes are likely if the Democrats win either or both houses of Congress, but such an outcome could add to longer-term policy uncertainty ahead of the presidential election in 2028.

Conclusion

The macro backdrop and rising corporate earnings point to further upside for stocks vs. bonds on a six- to 12-month horizon. Yet with the Fed and other major central banks expected to be hiking interest rates in the year ahead, and bond yields still biased to the upside, the path ahead is likely to be increasingly challenging, with lower returns than over the past few years. Equities would be increasingly vulnerable if earnings momentum rolls over beginning next year and/or bond yields continue to rise.

Source: Bloomberg as of 09/04/26