

# Doll's Deliberations®

## Weekly Investment Commentary



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### Summary

Stocks increased for the third straight week (S&P 500 +1.25%). All major averages (including Russell 2000) made new all-time highs. Most discussed was the Fed rate cut and speculation about what's next. Best sectors were communication services (+3.37%) and technology (+2.10%); worst sectors were consumer staples (-1.17%) and real estate (-1.12%).

### Key takeaways

1. The Fed lowered rates by 25 basis points (bps), as expected, and Chair Powell described the change as a "risk management" cut. The dot plot supports two more cuts this year.
2. With both inflation and unemployment (especially) seeing upward pressure, the Fed's job has gotten more difficult, and criticism will increase.
3. The Fed is divided. The "reflective" camp sees fewer cuts, as inflation remains above target, while the "proactive" camp is willing to look through tariff-driven inflation and focus on deteriorating growth.
4. Headline retail sales rose 0.6% in August, a strong result. Ultimately, consumption remains anchored by the labor market, which is showing signs of deceleration.
5. High-income Americans are still spending heavily [as the wealth effect from home-price appreciation and 401(k)s has been a big benefit], while low-income workers (who spent a lot during and post the pandemic) are curbing their spending.
6. The University of Michigan Consumer Sentiment Index dropped more than expected, with declines in both current conditions and expectations. Inflation expectations rebounded 0.4% to 3.9% for the five- to 10-year measure.
7. The median P/E of the largest five stocks is 34x, while the median P/E of the S&P 500 is 19x, and yet, the P/E for the top five has declined 0.8x since the start of the year, while the P/E of the S&P 500 has increased 0.7x.
8. After a great first quarter, the percentage of active managers outperforming their benchmarks has fallen to 40% as of the end of August.
9. Equities now represent more than 30% of household's total financial assets, a record high. (This compares with a peak of 25% in early 2000 at the end of the dot-com bull market.)
10. Economic imbalances (e.g., government debt) make the world economy vulnerable to future shocks. The more leverage in the system, the more painful the deflationary adjustment process if policymakers do not have the capacity to reflate.

Equity markets (Index total return %)	Last week	Year-to-date
DJIA	1.10	10.28
S&P 500	1.25	14.39
NASDAQ	2.22	17.76
Russell 1000	0.82	13.87
Russell 1000 Growth	1.92	17.24
Russell 1000 Value	0.52	11.16
Russell 2000	2.98	11.73

S&P equity sectors (Index total return %)	Last week	Year-to-date
Communication services	3.37	29.18
Consumer discretionary	1.45	6.60
Consumer staples	-1.17	4.60
Energy	-0.02	5.38
Financials	0.84	13.13
Healthcare	-0.61	0.72
Industrials	0.98	16.94
Information technology	2.10	20.28
Materials	-0.87	10.45
Real estate	-1.12	4.58
Utilities	-0.64	13.85

## Rate-cutting resumes but will likely be limited

Asset market trends might lead one to conclude that a disinflationary boom is underway. Bond markets are well bid, and policy rates have declined in the past year, while most risk-asset markets are still flying high despite rich valuations. However, economic growth is not booming. Although inflation has come down considerably since the reopening spike in 2022, most economies are still generating sticky, above-target inflation. In other words, market trends do not seem to reflect the macro backdrop: Both government bond markets and equity/credit markets appear to be overly optimistic.

Historically, current inflation trends would warrant restrictive monetary conditions rather than the easing cycle over the past year. Monetary conditions have not been restrictive in recent years, even in the U.S., where interest rates and bond yields were comparatively elevated. Although U.S. economic growth has cooled this year, primarily in terms of new hiring, the economy is far from recessionary, with continued solid demand growth. Moreover, the main drag on hiring has been trade policy rather than monetary conditions.

We believe that monetary conditions are still accommodative and becoming more so on the margin, and there is plentiful liquidity to sustain asset-price inflation. Valuations are mostly unappealing, as we are in a high-risk bull market. The next upleg in bond yields awaits greater confidence in the durability of the global economic expansion and a belated acknowledgment that policymakers and bond bulls are too optimistic on inflation.

There is some probability that corporate earnings will disappoint, but more likely that de-rating pressures from higher bond yields will be the catalyst for trouble down the road. Earnings are not likely to disappoint until after a meaningful economic roadblock develops. U.S. trade policy briefly had the potential to derail the economic expansion, but tensions have eased since the spring. U.S. tariff rates are well above pre-2025 levels and some uncertainty remains, but fresh fiscal stimulus is around the corner, monetary conditions are becoming even more supportive, and oil prices remain low and supportive of global growth.

Forward markets are far ahead of the Fed and discounting much lower rates ahead. The aggressive front-running of rate cuts is notable and undermines the Fed's argument that monetary conditions are restrictive. Financial conditions would likely be less easy if investors were not expecting significant Fed rate cuts.

## Conclusion

The Fed resumed cutting its policy rate last week. We expected a similar outcome to a year ago, i.e., the rate-cutting phase is not likely to persist as long as the futures curve suggests, and inflation is likely to remain sticky. We anticipate another upleg in bond yields that will threaten valuation levels. In the interim, monetary conditions are accommodative and becoming more so on the margin. This, in turn, will sustain risk-on for as long as the bond market stays calm.

Source: Bloomberg as of Sept. 19, 2025

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International equity markets (Index total return %)	Last week	Year-to-date
MSCI ACWI	0.75	17.69
MSCI ACWI EX U.S.	0.60	25.57
MSCI EAFE	0.06	24.59
MSCI EM	1.56	27.45

Fixed income markets (Index total return %)	Last week	Year-to-date
Bloomberg U.S. Aggregate Bond	-0.19	6.19
Bloomberg U.S. Corp High Yield	0.30	7.30
Bloomberg U.S. Gov/Credit	-0.17	5.99
Bloomberg U.S. T-Bill 1-3 Month	0.06	3.12

Alternatives (Index total return %)	Last week	Year-to-date
Real estate (FTSE NAREIT)	-0.88	3.94
Commodities (DJ)	-0.71	7.52
Global listed private equity (Red Rocks)	1.33	12.09
Currencies (DB Currency Future Harvest)	0.04	0.67