

DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-0.56%	19.79%
S&P 500	-0.27%	26.21%
NASDAQ	-0.68%	23.75%
RUSSELL 2000	-1.00%	23.11%
RUSSELL 1000 GROWTH	-0.53%	26.56%
RUSSELL 1000 VALUE	0.10%	23.86%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-0.49%	26.19%
CONSUMER DISCRETIONARY	-3.17%	24.38%
CONSUMER STAPLES	-0.20%	11.19%
ENERGY	-1.32%	58.09%
FINANCIALS	0.30%	38.13%
HEALTHCARE	0.63%	19.31%
INDUSTRIALS	0.46%	21.91%
INFORMATION TECHNOLOGY	0.18%	29.16%
MATERIALS	2.57%	25.86%
REAL ESTATE	-0.04%	34.84%
UTILITIES	-0.82%	8.75%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-0.01%	18.67%
MSCI ACWI EX U.S.	0.31%	10.01%
MSCI EAFE	-0.34%	12.45%
MSCI EM	1.71%	1.40%

SUMMARY:

U.S. equities snapped a 5-week winning streak with the S&P 500 down 0.3%. Inflation concerns dominated the headlines, with consumer prices rising at the fastest pace in more than 30 years. The path for a \$1.75 trillion social spending package remained complicated. Best sectors were materials (+2.5%) and healthcare (+0.6%); worst sectors were consumer discretionary (-3.2%) and energy (-1.3%).

KEY TAKEAWAYS:

- Headline CPI increased for the 17th consecutive month as CPI is now up +6.2% year-over-year (Y/Y), the highest level since November 1990. Core CPI (ex-food and energy) increased +4.6% Y/Y, the highest level since August 1991.
- The New York Fed Survey of Consumer expectations showed that inflation is expected to be 5.7% one year ahead, the highest reading on record.
- Consumer sentiment fell to 66.8 in November from 71.7 in October. Consumers are anticipating the least favorable economic conditions since 2011, citing rising prices as their primary concern.
- We continue to expect the Fed to increase the Fed funds rate in December 2022 and then boost rates 50-100bp in both 2023 and 2024.
- The pace of global growth and inflation will downshift from current elevated levels but ultimately level off at a higher run rate than last decade.
- The frustration around inflation has erupted in Washington DC such that the probability of a reconciliation \$1.75 billion bill has fallen somewhat. Perhaps a smaller bill will pass.
- The dollar's recent strength has come from (1) strong U.S. inflation reports, which raised market expectations of a rate hike in the U.S., and (2) relative economic data surprises favoring the U.S. over the Euro Area. We still expect dollar weakness over the next twelve months.
- In Q3, S&P 500 companies delivered stronger than expected results. Revenue growth was 16% vs. a 14% estimate, and net margin was 13.5% vs. pre-COVID at 12%.
- 3Q S&P 500 earnings reports showed costs up a double-digit percentage for the first time in a decade. In the past, double-digit cost growth has led to mediocre stock market returns.
- Stocks have been strong over the last few weeks due mainly to strong earnings reports. But the decline in the likely size of the reconciliation bill from \$3.5 billion to half that, thereby requiring few tax increases, is also one of the reasons.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.75%	-1.69%
BLOOMBERG U.S. CORP HIGH YIELD	-0.25%	4.73%
BLOOMBERG U.S. GOV/ CREDIT	-0.81%	-1.95%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.00%	0.03%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
FTSE NAREIT (REAL ESTATE)	-0.30%	31.39%
DJ COMMODITIES	1.28%	32.77%
RED ROCKS GLOBAL LISTED PRIVATE EQUITY	-0.15%	33.00%
DB G10 CURRENCY FUTURES	-0.34%	6.21%

HAVE THE FED AND THE BOND MARKET FALLEN BEHIND THE INFLATION CURVE?

Government bond yields have been relatively calm in the face of solid economic data and stronger than expected inflation. This calm has allowed equity markets to move to marginal new highs. The fact that the economic expansion is both vigorous and durable means that the bullish backdrop for risk-taking will persist until central banks and bond investors realize that the trend in underlying inflation is up and the need for emergency monetary policies has long since passed. We have been expecting bond yields to move up in waves, but the post-March pause has lasted longer than we would have anticipated, given the strength in the global economic and inflation data. Central banks, however, have continued to guide bond investors into staying sanguine about the outlook, in the belief that ongoing strength will not persist. Government bond markets are priced in anticipation that hyper-accommodative monetary and fiscal policies will not prove inflationary over the long haul.

Prior to the 2010s, dovish central bank developments during a time when growth and inflation were strong and rising likely would have triggered a bond market sell-off. Investors are sticking with what has worked in the more recent past and staying bond bullish, accepting central bank's forecasts that rising inflation will be transitory. The shutdowns caused by the pandemic and the subsequent abnormal economic recovery have significantly boosted uncertainty and caused investors to be wary of betting on a positive economic outcome.

Global economic data continue to confirm that the expansion is rolling on and quite robustly, despite ongoing COVID-19 waves. Most major countries are keeping their economies open during COVID-19 waves in hopes that high vaccination rates will prevent overloaded hospitals. Consumer behavior is still somewhat hesitant compared with the pre-

pandemic period, although international mobility is finally gaining momentum.

Yield curve movements continue to be unusual, with higher short rates tending to flatten the curve, despite mounting evidence that the Fed and other central banks have fallen further behind the inflation curve. We expect a period of bear steepening, but the bottom line is that long bond positions have considerable price downside, and the whole of the yield curve will eventually shift higher. Inflation in the major developed economies is not likely to return to the sub-2% world of the 2010s.

With no immediate economic roadblocks, we expect corporate earnings to continue to climb, albeit at a less rapid pace than in the past year, helping support stock markets. The cyclical risk for equities is that rather than modest periodic bouts of rising bond yields followed by pauses, a bond market panic will eventually erupt when investors realize that central banks are far behind the curve. Until then, however, the positive influence from rising corporate profits and ongoing hyper-accommodative policies will support equities.

CONCLUSION:

We remain economy-positive in our investment positioning. This is mostly the result of being maximum underweight in bonds rather than being aggressive towards stocks. The global economic backdrop is the brightest in years, but risk asset markets have already discounted a lot of good news and are ill-prepared for a durable bear market in bonds. Most likely, the rise in bond yields will occur gradually and in waves.

Data from Morningstar Direct, as of 11/15/2021.

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