CROSSMARK GLOBAL INVESTMENTS

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Doll's Deliberations

Weekly Investment Commentary

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Summary:

U.S. equities were lower with the S&P 500 (-1.5%) and the NASDAQ declining after nine straight weeks of gains. The Magnificent Seven were all lower with Apple down 5.9%. Treasuries were weaker with the ten-year yield moving above 4% for the first time since mid-December. Outperformers included healthcare (+2.1%) and utilities (+1.8%); underperformers included technology (-4.0%) and consumer discretionary (-3.5%).

Key Takeaways:

1. The employment report for December recorded an above expected 216,000 new jobs. Disturbingly, average hourly earnings were up 0.4 m/m and 4.1% y/y, not helpful to the Fed's cause. It is likely this report lowers the chances of the Fed lowering rates anytime soon.
2. The unemployment rate has recorded 25 months of below 4% unemployment, the longest streak in over 50 years.
3. Mid-East tensions are rising as seen with the rise in the price of oil and noticeable increases in Red Sea shipping (including insurance) costs. More than 10% of global trade passes through the Red Sea.
4. The equity market seems as convinced about a soft landing in 2024 as it was convinced of a recession in 2023.
5. The early in the year jitters for the stock market seem primarily related to investors having second thoughts about how much the Fed will cut rates in 2024. It is unlikely that the Fed will cut rates as much as the markets expect (six times). If accurate, that could put upward pressure on interest rates out the curve, and downward pressure on P/E ratios.
6. Even if the S&P 500 does continue to weaken over the remainder of January, it is neither a necessary nor sufficient condition for a selloff for the rest of 2024. Other forces will dictate the S&P 500's path over the coming 12-months. On this front, we expect the macroeconomic backdrop to weaken over the course of 2024, creating a headwind for stocks.
7. One of our ten predictions asserts that earnings growth in 2024 will likely fall short of the 11% consensus expectations. Over the past two weeks, full-year estimates have fallen by nearly $2.
8. Stock market rotation since the start of the year (and since last summer/fall) features equal-weighted averages beating cap-weighted averages (small outperforming big) and the Magnificent Seven lagging. There are more recent signs of improvement in defensive sectors plus financials and value outperforming growth.
9. The equity risk premium for stocks (earnings yield less ten-year treasury yield) is the least attractive since the Financial Crisis.
10. There is now support in both political parties that immigration reform is urgently needed. A bipartisan bill could pass in the next month or two.

EQUITY MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
DJIA	-0.56	-0.56
S&P 500	-1.50	-1.50
NASDAQ	-3.23	-3.23
RUSSELL 1000	-1.82	-1.82
RUSSELL 1000 GROWTH	-2.71	-2.71
RUSSELL 1000 VALUE	-0.34	-0.34
RUSSELL 2000	-3.41	-3.41

S&P EQUITY SECTORS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-1.12	-1.12
CONSUMER DISCRETIONARY	-3.45	-3.45
CONSUMER STAPLES	0.05	0.05
ENERGY	1.12	1.12
FINANCIALS	0.40	0.40
HEALTHCARE	2.10	2.10
INDUSTRIALS	-2.15	-2.15
INFORMATION TECHNOLOGY	-4.04	-4.04
MATERIALS	-1.42	-1.42
REAL ESTATE	-1.90	-1.90
UTILITIES	1.84	1.84

The High Wire Act Continues

After the big year-end run-up, capital markets are priced for a near-perfect economic and inflation outcome. While the macro backdrop of steady global economic growth, falling inflation and anticipated central bank rate cuts is positive for both stocks and bonds, it is already discounted in asset prices and some investors have taken profits as 2024 opened. Asset prices remain extraordinarily sensitive to interest rate expectations, (particularly from the Fed). The recent pivot by the Fed, with Chair Powell notably sanctioning investor expectations that rates will come down this year, has fueled the repricing of assets since late October, when global equities appeared to be on the verge of breaking down.

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN) (%)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-1.74	-1.74
MSCI ACWI EX U.S.	-1.61	-1.61
MSCI EAFE	-1.49	-1.49
MSCI EM	-1.88	-1.88

We remain of the view that economic growth will slow during the course of 2024, perhaps significantly. But at the moment, the U.S. economy continues to show resilience. The euro area economy disappointed in 2023, but easing inflation should bolster consumer confidence and spending the coming months. China's economy still faces structural headwinds, but growth has proven sturdier than many feared. We are less sanguine than the consensus that inflation can remain as calm as investors and central banks anticipate the Fed to validate the approximately 150 basis points of rate cuts expected this year. Moreover, with G7 10-year government bond yields down nearly 100 basis points since late October, corporate bond spreads at the low-end of their historical ranges, several equity bellwethers at or near highs, long-term inflation expectations already low and the U.S. equity market twelve-month forward P/E ratio at an elevated 20x, the path ahead for capital markets is likely to be much choppier than the macroeconomic outlook suggests.

FIXED INCOME MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.97	-0.97
BLOOMBERG U.S. CORP HIGH YIELD	-1.08	-1.08
BLOOMBERG U.S. GOV/ CREDIT	-0.93	-0.93
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.04	0.04

Investors have recently been focused on central bank rhetoric, but the political/geopolitical landscape will trigger periodic volatility, especially with the unpredictability of the conflict in the Middle East and the U.S. presidential election in November. Recent economic data has generally been mixed, with global manufacturing PMIs still lingering in mild contraction territory and services in mild expansion. G7 employment trends and global corporate earnings are still positive, and key measures of global trade are improving. The decline in G7 headline inflation continues because of the unwinding of the earlier pandemic-driven goods boom, supply-chain snags and the fall in energy prices.

ALTERNATIVES (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-1.45	-1.45
COMMODITIES (DJ)	0.09	0.09
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-3.18	-3.18
CURRENCIES (DB CURRENCY FUTURE HARVEST)	1.17	1.17

Stocks were short-term overbought and due for a breather at the start of the year. The big theme this year will be a rotation into laggards following the huge outperformance of mega-cap growth stocks last year. Global earnings will be supportive, but another upleg in bond yields sometime this year will impinge upon valuations. Rising forward earnings have been a positive contributor to global equity prices in the past year, but most of the market gains have come from a jump in the forward P/E ratio. There have been some encouraging signs that equity market breadth is improving.

Conclusion:

Equities will continue to have macro tailwinds in the near term, but valuations indicate lots of good news is already discounted. While earnings should trend higher in the year ahead, upside is constrained by already high profit margins. The big theme should be the catch-up of last year's laggards, which favors select non-U.S. markets, along with small caps, value stocks and equal-weighted indexes. The big risk to equities is another upleg in bond yields, since valuations are already full.

Data from Bloomberg, as of 1/5/2024.