CROSSMARK GLOBAL INVESTMENTS

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Doll's Deliberations

Weekly Investment Commentary

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Summary:
Stocks were mostly higher last week (S&P 500 +1.0%) with small stocks outperforming again. Oil rose 4.5%. A Treasury rally was a key tailwind. Profit growth risk remains. Best sectors were technology (+2.5%), real estate (+2.1%), and consumer discretionary (+2.1%); worst sectors were healthcare (-1.0%), utilities (-0.4%), and consumer staples (-0.5%).

Key takeaways:

1. Core PCE inflation (the Fed's favorite inflation measure) came in as expected, +0.4% m/m. The market reacted positively due to a sigh of relief after the disappointing CPI and PPI reads earlier in February.

2. The outlook for consumption is weakening. Softening labor demand will exert downward pressures on nominal wage growth and thus real disposable income. In addition, Covid excess savings are being depleted and credit has become less available due to tightened lending standards.

3. The global economy isn't in a recession mostly because the U.S. economy is growing at a solid pace. However, the U.K., Japan, Germany and China are either in recession or on the edge of one.

4. Fiscal stimulus (especially given that it is an election year) is the biggest risk to a significant slowdown/recession outlook.

5. Analysts have shaved their 2024 earnings forecast from $244 at the start of this year to $242 currently. That is up 9% from last year's results.

6. The S&P 500 has increased in 16 of the last 18 weeks. That has not happened in over 50 years (last time was 1971).

7. It's hard to be bullish based on valuation: the S&P 500 is trading at a 95th percentile price to trailing earnings ratio based on data back to 1900. Statistical valuation models matter in the long-term and suggest lower returns over the next decade. But factors like sentiment and surprise matter more for 3- to 12-months.

8. According to Strategas, S&P 500 average forward returns when the P/E is greater than 20x are 3.9%, 4.4%, 5.5%, and 3.0% over subsequent 1, 3, 5 and 10-year periods, respectively.

9. The market cap-weighted S&P 500 continues to advance ahead of the equal-weighted index, widening the gap between the two. This is corroborated by the upsurge in the momentum factor since the beginning of the year.

10. The U.S. dollar is perhaps the most overvalued currency. On a purchasing power priority (PPP) basis, it is 20% overvalued. While high valuation does not mean that a reversal is imminent, it probably limits significant further upside.

EQUITY MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
DJIA	0.00	4.09
S&P 500	0.99	7.97
NASDAQ	1.76	8.55
RUSSELL 1000	0.26	6.87
RUSSELL 1000 GROWTH	1.27	10.63
RUSSELL 1000 VALUE	0.72	4.24
RUSSELL 2000	1.93	1.54

S&P EQUITY SECTORS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-0.30	11.58
CONSUMER DISCRETIONARY	2.08	5.29
CONSUMER STAPLES	-0.45	3.85
ENERGY	1.33	4.03
FINANCIALS	0.00	7.11
HEALTHCARE	-1.04	7.36
INDUSTRIALS	1.08	6.66
INFORMATION TECHNOLOGY	2.52	12.47
MATERIALS	1.31	2.74
REAL ESTATE	2.17	-1.22
UTILITIES	-0.40	-2.59

Rate Cuts Continue to Be Pushed Back in Time

Capital markets have moved with expectations regarding the Fed swinging from undue fears of excessive tightening in 2022 and most of 2023 to over optimism about rate cuts going forward, although expectations have receded significantly since mid-January. It can often be difficult to interpret the message about interest rates from central banks suffering from excessive media exposure, committed to forward guidance in an uncertain world, and month-to-month inflation releases. The Fed appears determined to begin reducing interest rates this year on the assumption that monetary policy is tight, and inflation is headed inevitably toward the Fed's 2% target.

Capital markets are acting as if financial conditions are easy, or at least not restrictive. Moreover, investors believe a few rate cuts will fortify global growth and continue to support both risk assets. As evidence, most equity averages in the U.S. and many overseas are at highs. AI productivity expectations and narrow credit spreads all suggest that economic risks are low. It is a bit confusing that investors and central banks can reconcile the notion that easier monetary and financial conditions will coincide with quiescent inflation that is nevertheless still above target, alongside above-potential economic growth. While economic growth has remained stronger than expected, inflation has turned sticky and unlikely to reach the Fed's 2% target.

Geopolitics remains a potential wildcard although markets seemingly have become unworried about events in Ukraine and the Middle East. We caution against complacency about the upcoming U.S. elections, which will steadily heat up. Former President Trump already has floated some potential trade policy changes if he wins in November that would have very important consequences for the global economy.

Improving global growth momentum and decent earnings results have resulted in stocks outperforming bonds. We expect equity volatility to increase especially if bond yields continue to rise. We have witnessed huge outperformance of a limited number of large-cap stocks in the past year, primarily in the U.S. And yet cash has provided a better volatility-adjusted return than the average global stock over the past few years.

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN) (%)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	0.04	4.90
MSCI ACWI EX U.S.	-0.27	1.51
MSCI EAFE	-0.07	2.42
MSCI EM	-0.67	-0.11

FIXED INCOME MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.08	-1.68
BLOOMBERG U.S. CORP HIGH YIELD	0.02	0.29
BLOOMBERG U.S. GOV/ CREDIT	0.05	-1.59
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.05	0.86

ALTERNATIVES (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	0.84	-3.10
COMMODITIES (DJ)	2.00	-0.54
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	0.69	3.34
CURRENCIES (DB CURRENCY FUTURE HARVEST)	-0.39	4.45

We continue to believe that a recession is likely in the U.S. over the coming year. By conventional measures, monetary policy is tight, and the excess household savings that have supported spending over the past year are nearly gone. The recent pickup in economic sentiment is occurring in response to expectations of significant rate cuts. A mild recession would have significant implications for the stock market, given how low the U.S. equity risk premium has fallen (i.e., how high valuations are).

Conclusion:

Scenarios	Likely Market Reaction	
Probability	Stocks	Bonds
40% Mild Recession	Fall >10%	Rally toward 3.50 10-yr
30% Soft Landing	Rally Continues	Modest Rally
30% Strength Continues	Fall <10%	Sell off to 4.50-5.00 10-yr

Data from Bloomberg, as of 3/1/2024.