

Doll's Deliberations[®]

Weekly Investment Commentary



Robert C. Doll, CFA
CEO/CIO

Summary:

Stocks put in a mixed performance last week as the S&P 500 increased (0.27%) but the NASDAQ fell (-0.91%). Treasuries were weaker with the yield curve steepening. Discussion revolved around AI (especially Nvidia's earnings) and the Fed's attempt at a soft landing. Best sectors were financials (+2.95%) and industrials (+1.71%); worst sectors were technology (-1.47%) and communication services (-0.69%).

Key takeaways:

- U.S. Q2 GDP growth was unexpectedly revised up to 3.0% from 2.8%.
- All the focus regarding monetary policy is on the Fed. Not to be ignored is the rate of growth of M2 (the Fed's estimate of the total liquid money supply) and TGA (Treasury General Account).
- It would be a first—a significant Fed rate-cutting cycle at the same time earnings are growing 15% (the consensus expectation).
- Over the last 12 months, more than 80% of net new jobs have been in government, healthcare, and education.
- We expect labor demand to continue slowing with negative feedback loops, pushing the unemployment rate higher and culminating in a mild recession.
- We are skeptical that the upcoming easing cycle will produce a soft landing. Economic conditions are currently responding to the previous tightening cycle and this new easing cycle is likely to be too little, too late.
- While money market assets are at record levels, they represent only 13% of S&P 500 market cap, down from a peak of 64% in 2010.
- According to BCA Research, the S&P 500's current valuation stands at the third percentile of historic distribution (i.e., valuations are exceptionally stretched).
- Nvidia's much anticipated earnings were better than expected, along with a \$50 billion buyback announcement. The initial reaction was to sell the stock, as technology leadership continues to wane. (Financials picking up the leadership baton.)
- Berkshire Hathaway (Warren Buffett's company) became the first non-tech stock to reach \$1 trillion in market value.

EQUITY MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO- DATE
DJIA	1.07	11.75
S&P 500	0.27	19.53
NASDAQ	-0.91	18.57
RUSSELL 1000	-0.73	17.46
RUSSELL 1000 GROWTH	-0.68	21.12
RUSSELL 1000 VALUE	1.32	15.08
RUSSELL 2000	-0.70	9.64

S&P EQUITY SECTORS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO- DATE
COMMUNICATION SERVICES	-0.69	23.11
CONSUMER DISCRETIONARY	-0.17	6.37
CONSUMER STAPLES	0.82	17.68
ENERGY	1.02	11.35
FINANCIALS	2.95	22.58
HEALTHCARE	1.11	16.31
INDUSTRIALS	1.71	16.26
INFORMATION TECHNOLOGY	-1.47	27.14
MATERIALS	1.67	11.21
REAL ESTATE	0.36	10.64
UTILITIES	1.17	22.55

The economy and markets keep on trucking

The global economic expansion continues, slightly decelerating in the U.S. and slightly improving elsewhere. Most of the improvement is in service sector activity, rather than in manufacturing. In the case of the U.S., the modest deceleration in most economic gauges is occurring from unprecedented heights reached earlier this decade. Corporate profits are expected to continue trending higher.

Bond yields have declined significantly in recent months, with policy rates likely to follow. Monetary conditions have eased over the summer. The economic and financial market environment that has typically existed at the start of a U.S. rate-cutting cycle does not exist. The implication is that both the business cycle and ongoing asset inflation will persist. Although conditions that typically are present when the Fed starts to lower its policy rate do not exist, Fed Chair Powell is determined to proceed. There is a strong belief among central banks (and bond bulls) that policy is restrictive and the inflation threat is now resolved.

After a brief stumble at the start of the month, equity and credit markets have rallied solidly. Many global equity indexes have fully recovered and hit new highs. Meanwhile, the U.S. and euro area high-yield corporate bond markets are witnessing new multi-year lows in yields, which is supportive of growth and overall risk taking. We doubt that the uptrend in equity markets will be smooth since conditions are not oversold, valuations are not compelling, and investors are already generally well-positioned in stocks.

Select areas that have lagged the big-cap U.S. equity index until recently will likely perform better, especially since the U.S. dollar has lost some luster and we anticipate gradual weakness ahead. The attraction of high-growth, tech-related U.S. stocks seems to be past its peak, which should continue to spur a rotation into select laggard areas as investors realize the global economy is performing better than expected.

There are many unusual economic features of recent years, some related to the pandemic and its aftermath, and others resulting from longer-term forces. In the end, the trend in corporate profits is critical to the business cycle, as those profits determine whether companies will expand and hire, or do the opposite.

Conclusion

Equity and credit markets are well-supported, with central banks promising to lower rates and corporate earnings continuing to trend higher. However, the forward markets have already discounted an aggressive rate-cutting cycle without the necessary bearish economic and financial market backdrop that would be conducive to much lower rates and yields. The implication is that rate cut expectations for 2025 will likely be scaled back.

Data from Bloomberg as of Aug. 30, 2024

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INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN) (%)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-0.47	15.08
MSCI ACWI EX U.S.	0.12	10.86
MSCI EAFE	0.37	11.70
MSCI EM	-0.50	9.05

FIXED INCOME MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.27	3.32
BLOOMBERG U.S. CORP HIGH YIELD	0.18	6.26
BLOOMBERG U.S. GOV/ CREDIT	-0.27	3.22
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.06	3.58

ALTERNATIVES (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-0.40	9.42
COMMODITIES (DJ)	-0.29	0.95
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-0.73	11.76
CURRENCIES (DB CURRENCY FUTURE HARVEST)	0.93	8.39