CROSSMARK
GLOBAL INVESTMENTS

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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY - EXTENDED VERSION

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-2.78%	-13.29%
S&P 500	-3.00%	-17.67%
NASDAQ	-3.77%	-27.20%
RUSSELL 2000	-0.88%	-20.54%
RUSSELL 1000 GROWTH	-4.13%	-26.77%
RUSSELL 1000 VALUE	-1.82%	-9.14%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-3.01%	-27.27%
CONSUMER DISCRETIONARY	-7.43%	-31.60%
CONSUMER STAPLES	-8.60%	-8.13%
ENERGY	1.36%	48.87%
FINANCIALS	-1.75%	-15.34%
HEALTHCARE	0.93%	-7.54%
INDUSTRIALS	-3.62%	-14.85%
INFORMATION TECHNOLOGY	-3.71%	-24.89%
MATERIALS	-0.11%	-8.70%
REAL ESTATE	-1.72%	-17.75%
UTILITIES	0.44%	0.98%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-1.48%	-17.33%
MSCI ACWI EX U.S.	1.02%	-14.85%
MSCI EAFE	0.95%	-14.90%
MSCI EM	1.08%	-17.08%

SUMMARY:

U.S. equities fell (-3.0% for the S&P 500) for the seventh straight week. The DJIA fell for the eighth week in a row, the longest losing streak since 1923. The S&P 500 briefly dipped into 20+% decline territory, the traditional definition of a bear market. Multiple bearish themes dominated the dialogue. Three sectors were up for the week: energy (+1.4%), healthcare (+0.9%), and utilities (+0.4%); worst sectors were consumer staples (-8.6%) and consumer discretionary (-7.4%).

KEY TAKEAWAYS:

1. U.S. retail sales rose 0.9% month-over-month (m/m) in April. The consumer continues to be a solid contributor to growth, but this invites a more aggressive Fed.
2. The University of Michigan Consumer Sentiment Index fell to 59.1 in May, significantly below expectations. While the U.S. consumer is in relatively good shape, real wage growth has turned negative with the increase in inflation.
3. Several retailers forecast a difficult outlook. While revenue is still growing nicely, profitability concerns have emerged due to both cost increases and some buyer resistance to paying higher prices.
4. Even though economists continue to lower GDP forecasts, analysts are generally still raising earnings estimates. This apparent dichotomy is likely to be resolved before long – likely in the downward direction for earnings estimates.
5. We continue to see some initial improvement in inflation indicators, most notably some easing in wage pressure.
6. The Investors Intelligence Bull/Bear Ratio dropped further last week, increasing the probability of an oversold rally.
7. In the recent stock market decline, the forward P/E ratio of the S&P 500 fell to 16x, below the 10-year average of 16.9x and the 25-year average of 16.3x.
8. It is unlikely we have seen "THE" bottom in stocks until we get some more capitulation (elevated VIX, a spike in put/call buying, and several high TRIM readings).
9. Active managers are having their best year vs. benchmarks since 2007, with 58% of large-cap core managers outperforming. This is consistent with our view of a better environment for stock prices.
10. State tax revenues have surged over the past year by about 25%. States are likely to initiate tax rebates, gasoline and grocery tax cuts, more government spending, and income tax rate reductions

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.26%	-9.48%
BLOOMBERG U.S. CORP HIGH YIELD	-0.79%	-11.11%
BLOOMBERG U.S. GOV/ CREDIT	0.24%	-10.22%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.01%	0.08%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-2.77%	-17.28%
COMMODITIES (DJ)	1.76%	31.89%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-1.31%	-30.11%
CURRENCIES (DB G10 CURRENCY FUTURE)	-0.39%	3.26%

EARNINGS CONCERNS KEEP MARKET HEAVY, BUT A RALLY LIKELY SOON

The surge in bond yields in recent months and an increasingly hawkish tone from central banks have increased worries about the economic outlook. We expect such worries to subside, assuming bond markets calm. The economic foundation remains reasonably good, and even the bleak current data from locked down China will give way to a meaningful rebound as restrictions are eased. However, the surge in energy and food prices and higher borrowing costs will be drags. But, the global economy has considerable momentum, and we expect the expansion to continue given the improvement in balance sheets in recent years and still very positive incomes and cash flows in both the consumer and corporate sectors. With equity sentiment having soured considerably, it could take some time before risk-taking revives and may first need some tangible good economic news.

The main risk to our still somewhat upbeat economic outlook would be if bond yields do not calm. Central banks have unnerved bond markets with the abrupt shift from being hyper-accommodative to doing whatever it takes to lower inflation. Our uncertainty, however, relates to how central bankers and bond investors will react as the inflation data cools. Will they be relieved and back off a notch, or stay the course and proceed to outright restrictive monetary conditions and, therefore, much higher odds of a recession? The good news is that U.S. inflation will sequentially decelerate this summer as goods demand should cool, and base effects following last year's huge price surge will be favorable.

Momentum and sentiment gauges are signaling that equity markets have hit short-term extremes. The likelihood and magnitude of any rebound rests with the bond market, as the latter needs to calm for a period of time to reduce both the intense de-rating pressure on equities and recent angst that monetary policy will overshoot and undermine the economic expansion. We are anticipating a sigh of relief over the summer as U.S. inflation cools. For an equity rally to begin, three conditions likely will be needed: (1) inflation needs to roll over for a period of time, (2) the relentless downward pressure on risk asset valuations needs to diminish, which is conditional on an easing in bond yields, and an end to the escalating hawkish central bank rhetoric, and (3) corporate earnings need to continue to climb. While there have been a few high-profile earnings disappointments as of late, these have been either isolated situations or pandemic beneficiaries that are now witnessing some payback after demand had been pulled forward. Most companies are reporting no worse than slowing growth rates in earnings, as demand growth has been healthy, especially in nominal terms. Nevertheless, worries about the economic outlook have increased noticeably of late.

The window of opportunity for a calming in bond markets and a relief rally in equities could be short as the cyclical inflation outlook is still worrisome. A rolling over in core and headline CPI is highly likely in the U.S. over the next six months. However, the picture is expected to be less market-friendly thereafter. Upside wage pressures will result in a sticky inflation picture, dashing hopes that temporary pandemic-related distortions and the Ukrainian war were mostly the cause of the surge in inflation.

CONCLUSION:

It is premature to worry about an approaching recession until the bond market and central banks push monetary conditions into restrictive territory, which is unlikely anytime soon. Meanwhile, we expect a window of opportunity for equity markets to rebound as global growth conditions prove resilient and assuming interest rate expectations and bond yields calm. Such a calming is probable given that U.S. inflation will decelerate over the summer. After that, the cyclical outlook is likely to become progressively less friendly, assuming our forecast for sticky inflation pans out.

ADDITIONAL MARKET THOUGHTS:

1. As you will recall from our Ten Predictions released in December, we forecasted the order of finish in 2022 to be (1) cash, (2) stocks, and (3) bonds. In other words, cash is king, and stocks and bonds will have a down year. We were in a distinct minority calling for a down stock market – our problem was (and remains) valuations. Having said that, with the 20% decline (and some stock stocks down 40-50% or more), prices are getting far more interesting now.

2. Perhaps the most positive element for the stock market at the moment is sentiment (record low bullishness and record-high bearishness). This doesn't guarantee a bottom but argues for a significant bounce at some point.

3. The P/E ratios of the S&P 500 were 21.5x at the start of the year (top decile of historical readings). Today it is 16x (approximately the long-term average). More than 100% of the stock market decline has been multiple compression – this has been caused by rising inflation and interest rates. During the same time frame, earnings expectations have been rising, buttressed by stronger than expected 1Q earnings.

4. This week, earnings concerns have surfaced, especially in the consumer space (e.g., Walmart, Target, and Kohl's). It is likely that a slowing economy (caused by less generous monetary and fiscal policy) will result in some downgrade in earnings expectations.

5. Equities probably have a limited downside (another 5%ish) if we don't have a recession (which is our mainline scenario). If a recession occurs in 2022, more downside is likely.

6. Both stocks and bonds are oversold, meaning a bounce could come at any point (remember, in March, we had a 10% increase in the S&P 500 in 3 weeks; NASDAQ increased 16% during the same period).

7. Technical conditions have not yet shown a "give-up" phase, which is normally necessary to bring about a more durable bottom.

8. The Fed is between a rock and a hard place – they have the unenviable task of attempting to curb inflation without causing a recession – a so-called soft landing.

9. Reasons we think a recession is likely to be avoided in 2022 are (1) health of the U.S. consumer (lots of cash on balance sheets), (2) health of corporate America (cash, cash flow, strong balance sheets), and (3) the strength of the labor market (the U.S. has never entered a recession with the labor market this strong).

10. In our fixed income portfolios, we have extended duration a bit (having been correct in anticipating higher rates) but still maintaining below benchmark duration. In equities, we are focused on quality – quality of earnings, balance sheet, and management.

Data from Bloomberg as of 05/23/2022.

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