CROSSMARK GLOBAL INVESTMENTS

June 10, 2024 | Issue 4.24

Doll's Deliberations®

Weekly Investment Commentary

Robert C. Doll, CFA®
Chief Executive Officer,
Chief Investment Officer

Summary:
Equities advanced last week (S&P 500 +1.36%) as the S&P 500 and NASDAQ hit new all-time highs. Breadth was narrow as the equal weight S&P fell for the week. Best-performing sectors were technology (+3.83%) and healthcare (+1.96%); laggards included utilities (-3.81%) and energy (-3.41%).

Key takeaways:

1. May non-farm payrolls increased 272,000, well above consensus. The unemployment rate rose to 4.0%, the highest level in over two years. Disappointing for potential Fed rate cuts, average hourly earnings increased 0.4% (4.1% y/y).

2. The ISM Manufacturing PMI showed weakness; the ISM Services PMI showed strength … a continuation of mixed signals for the U.S. economy.

3. Tight monetary policy typically takes a long time to impact the economy. According to BCA Research, the average lag between the first Fed rate hike and recession has been 29 months … that would place the beginning of a recession in August.

4. It is more likely that the Fed will find itself behind the curve in easing monetary policy (i.e., not cutting enough to prevent a recession), than cutting too much and reigniting inflation.

5. Corporate and high yield bonds are the fixed income sectors that are most exposed to an economic slowdown. Markets continue to price in a Goldilocks scenario, with spreads narrowing. Already tight spreads give them little room to compress further and could widen as the economy slows.

6. NVIDIA's YTD return has accounted for one-third of the S&P 500's 12% return YTD.

7. The median P/E of the largest five companies is 32x. The median return of the next 495 is 18x.

8. While the S&P 500 achieved a new all-time high last week, only 71% of the S&P 500 is above their 200-day moving average, down from 85% at the last high in March … while minor, a negative divergence, nonetheless.

9. Despite all-time highs for equity averages, with technicals stretched, little fear baked in, and sentiment optimistic, we continue to expect volatility to pick up over the summer.

10. Real incomes are flat over the past year and well below their 2021 peak. After-tax, after-inflation income has been highly correlated with the percentage of the two-party vote that an incumbent receives in a re-election bid.

EQUITY MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
DJIA	0.33	3.86
S&P 500	1.36	12.81
NASDAQ	2.40	14.51
RUSSELL 1000	1.29	12.00
RUSSELL 1000 GROWTH	2.72	16.15
RUSSELL 1000 VALUE	-0.82	6.76
RUSSELL 2000	-0.98	1.68

S&P EQUITY SECTORS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	1.73	22.97
CONSUMER DISCRETIONARY	1.59	2.33
CONSUMER STAPLES	0.57	9.79
ENERGY	-3.41	8.55
FINANCIALS	-0.40	10.71
HEALTHCARE	1.96	7.85
INDUSTRIALS	-0.93	7.76
INFORMATION TECHNOLOGY	3.83	21.81
MATERIALS	-1.87	5.29
REAL ESTATE	-0.12	-4.49
UTILITIES	-3.81	11.41

Crosscurrents continue to be confusing

Growth anxieties have begun to creep into the market following some mildly disappointing U.S. economic data in the past few weeks. Economy-concerned investors argue that the drag from earlier monetary tightening will become increasingly evident in coming months (despite having made the same claim in both 2022 and 2023). It is likely that interest rates have not reached a sufficiently restrictive level to end the economic expansion. The U.S. consumer and corporate sector still have reasonable income growth and healthy balance sheets that should ensure continued resilience, absent some exogenous shock.

Markets should applaud slower U.S. economic growth as a necessary condition to prevent the Fed from hiking interest rates in the near term given a positive output gap and the recent rising trend in core inflation. Meanwhile, there are encouraging indications from the euro area and parts of the emerging world that global growth momentum is improving, including solidifying upturns in manufacturing and trade. Our base-case scenario is that economic growth in the U.S. will weaken, but will improve overseas. Inflation in major economies will remain sticky at well-above central bank target levels, and most central banks (including the ECB) will only trim interest rates, rather than embark on a significant easing cycle.

The investment landscape is likely to be choppy, as investors fear a moderation of U.S. economic growth and uncertainty about the Fed outlook. Bonds may stay well bid in the near term, but we continue to expect another upleg as growth outside the U.S. gains traction, but central banks will likely cut less than markets are discounting. Rich valuations and elevated earnings expectations temper our enthusiasm for U.S. stocks.

Commodities are a mixed bag. Sturdy global growth will be a positive for base metals and energy demand, but while oil prices have upside, previously overheated copper prices are vulnerable to further near-term downside. The backdrop is supportive for gold in the near term, but prices are elevated in real terms. The election will almost certainly be acrimonious, and given the sharply different objectives of the two main parties, policy uncertainty is likely to intensify.

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN) (%)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	1.42	10.43
MSCI ACWI EX U.S.	1.46	7.33
MSCI EAFE	1.34	8.50
MSCI EM	2.35	5.83

FIXED INCOME MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	1.27	-0.40
BLOOMBERG U.S. CORP HIGH YIELD	0.62	2.26
BLOOMBERG U.S. GOV/ CREDIT	1.19	-0.36
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.06	2.32

ALTERNATIVES (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	0.73	-3.57
COMMODITIES (DJ)	-1.04	5.68
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-0.32	5.81
CURRENCIES (DB CURRENCY FUTURE HARVEST)	-0.25	9.24

Conclusion

Improving global growth momentum and sticky inflation imply fewer central bank rate cuts over the next six to 12 months than currently discounted. An improving global economy (especially in the U.S.) should allow the current uptrend in forward earnings expectations to persist, thereby underpinning global equity prices. We expect the broadening of global economic growth momentum from the U.S. to the rest of the world over the next six to 12 months to boost the relative earnings and performance of select non-U.S. markets.

Data from Bloomberg as of June 7, 2024