CROSSMARK GLOBAL INVESTMENTS

July 29, 2024 | Issue 4.30

Doll's Deliberations®

Weekly Investment Commentary

Robert C. Doll, CFA®
CEO/CIO

Summary:
U.S. equities were mixed again last week with the S&P 500 (-0.82%) and NASDAQ lower (-2.08%) and the small cap Russell 2000 up (+1.77%). Big tech/momentum were the biggest decliners. Best sectors were utilities (+1.47%), healthcare (+1.41%), and materials (+1.37%); underperformers included communication services (-3.76%), technology (-2.44%), and consumer discretionary (-2.31%).

Key takeaways:

1. The preliminary release of Q2 2024 U.S. GDP surprised to the upside (+2.8%) with the two largest drivers of the improvement consumption and inventories.

2. Housing shows no signs of recovery. Existing home sales came in weaker than expected in June – back to cycle lows. Affordability remains a major issue.

3. A rise in consumer credit is noteworthy in an environment of a softening labor market and dwindling excess savings.

4. We have been saying for some time that the U.S. economy is slowing. Clearly, it is small cracks, not big cracks. Therefore, the jury is still out on whether this will be a soft or bumpy landing.

5. The Fed is getting closer to beginning the process of recalibrating monetary policy. Recent commentaries strongly point to a September rate cut, with July's meeting being used to prep the markets that a series of cuts are on the horizon.

6. The U.S. yield curve is its least inverted in two years. That generally happens on the eve of a recession.

7. AI is making/will make a difference over time, but—productivity gains from the rollout of a new technology can take time; a broad-based expansion in earnings driven by a new technology almost always takes more time to materialize; and the early beneficiaries of a new technology may not end up being the final winners.

8. Earnings estimates for the second half of 2024 (2H24) are seeing revisions lower, with 3Q coming down 1.4% since July 1 and 4Q coming down 0.2%. A bigger concern is the decline in multiples for big tech due to AI concerns.

9. The Russell 2000 has outperformed the S&P 500 by 10% since July 9. Small caps typically outperform in the early stages of economic expansions when growth is accelerating, inflation is rising, and lending standards are easing. As a result, we caution against chasing these gains at such a late stage of the cycle, even though cheap valuations may offer some cushion.

10. Investors have been pricing in a Trump victory. The race is now changing and will no longer be about Biden's competence. We expect some of the recent momentum in the Trump trade to cool off temporarily. Still, Republicans remain the slight favorite to win the election.

EQUITY MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
DJIA	0.77	8.84
S&P 500	-0.82	15.35
NASDAQ	-2.08	16.08
RUSSELL 1000	-1.79	13.31
RUSSELL 1000 GROWTH	-2.37	16.94
RUSSELL 1000 VALUE	1.23	11.22
RUSSELL 2000	1.77	10.49

S&P EQUITY SECTORS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-3.76	18.83
CONSUMER DISCRETIONARY	-2.31	4.63
CONSUMER STAPLES	0.56	11.96
ENERGY	-0.24	12.02
FINANCIALS	1.29	16.34
HEALTHCARE	1.41	10.88
INDUSTRIALS	1.16	11.63
INFORMATION TECHNOLOGY	-2.44	23.91
MATERIALS	1.37	7.68
REAL ESTATE	0.54	3.47
UTILITIES	1.47	14.26

Uncertainty levels have increased

Uncertainties in the form of recent selling pressure among technology/AI stock and the withdrawal of President Biden from the election this November have clouded the picture somewhat. Those reversals could have profound implications for capital markets and asset allocation in the year ahead.

The one constant in global equities for the past 18 months has been the incredible strength of technology stocks associated with the unbridled optimism surrounding AI. Suddenly, however, some cracks in the narrative have developed, with tech stocks experiencing major turbulence over the past few weeks after hitting a substantial air pocket. A high earnings-expectations bar and rich valuations suggest there is further downside potential. More fundamentally, if the global economic expansion continues, then a gradual weakening of the tech narrative could help fortify a rotation into other sectors and markets that would be healthy for global equities overall.

It is still early days, but the U.S. political landscape has changed dramatically in the past week with Biden's withdrawal and the Democrats' immediate pivot to Vice President Harris. Betting odds that have been decisively in favor of Trump have diminished significantly, and the first polls this week show the presidential race has tightened. The next few weeks could indicate whether the current Harris bump can be sustained or fades, but at least for now, investors will be examining their assumptions about the next administration's fiscal and other economic policies.

On the economic front, the moderation of U.S. economic growth (notwithstanding the solid Q2 GDP report) and the latest soft inflation readings have reinforced investor confidence that the Fed will soon begin cutting interest rates. Global manufacturing is still in the early days of a recovery after two years of downshifting, and global trade is gradually improving. Rate cuts are not needed to shore things up, but even modest cuts will bolster investor confidence in the economic outlook.

The market is discounting five, 25-basis-point rate cuts by the Fed in the next year, taking the Fed funds rate to between 4% and 4.25%. The Fed rate cut expectations are predicated on three assumptions, namely, that monetary policy is currently restrictive; inflation will continue to move to 2%; and U.S. real economic growth also will broadly flat-line at around 2% over the balance of this year and next. We think Fed and market confidence in each of those assumptions is misplaced, or at best premature. Any enthusiasm for stocks has to be tempered by the elevated earnings and rich valuations of the U.S. market.

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN) (%)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-1.73	10.67
MSCI ACWI EX U.S.	-1.41	6.00
MSCI EAFE	-1.47	5.87
MSCI EM	-1.42	6.70

FIXED INCOME MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.09	0.39
BLOOMBERG U.S. CORP HIGH YIELD	0.16	4.18
BLOOMBERG U.S. GOV/ CREDIT	-0.10	0.35
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.06	3.05

ALTERNATIVES (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-1.38	2.09
COMMODITIES (DJ)	-1.46	0.32
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-0.41	9.38
CURRENCIES (DB CURRENCY FUTURE HARVEST)	-1.18	9.84

Conclusion

Investors should move toward a conservative positioning. Fixed income investors should be lengthening portfolio duration. Stocks remain fully valued and are subject to downside action if economic and earnings weakness manifest themselves as we expect.

Data from Bloomberg as of July 26, 2024

DD-WKLY-COMM-4.30 07/24