CROSSMARK
GLOBAL INVESTMENTS

CROSSMARK OUTLOOK

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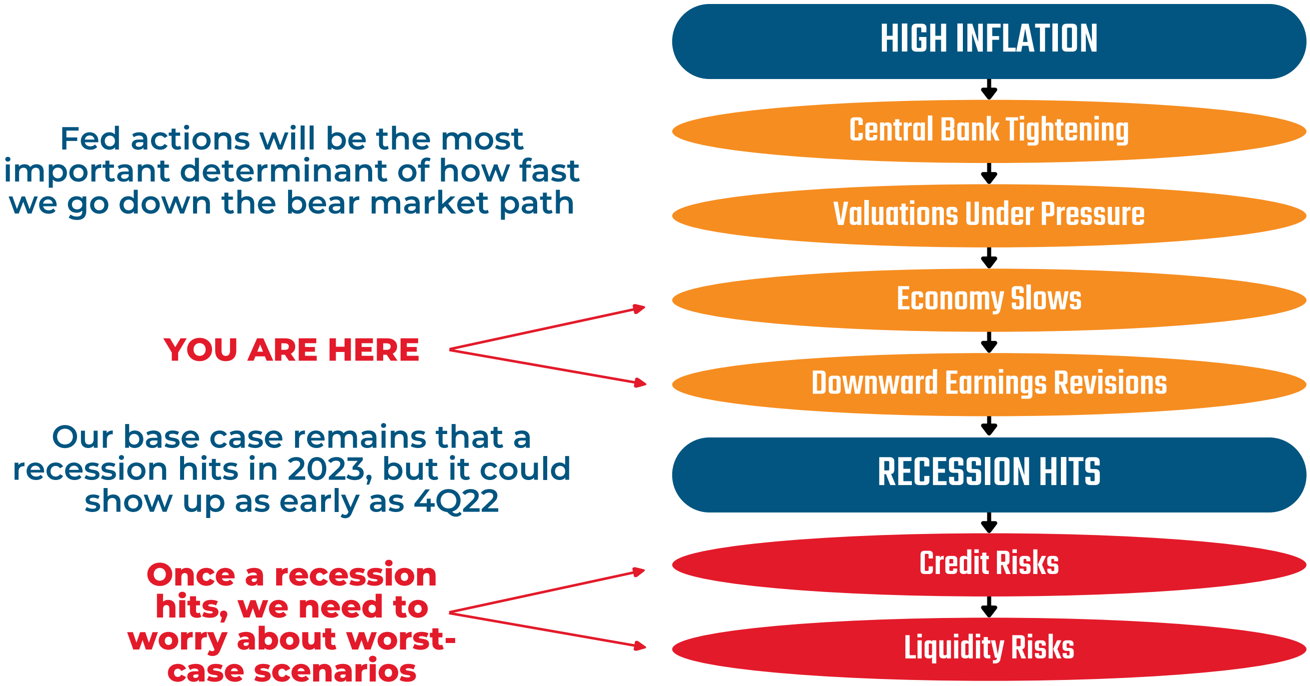
CROSSMARK GLOBAL INVESTMENTS

Q3 and YTD Returns

Index	2022 - Q3	2022 - Thru 9/30
90-Day Treasury Bills (Bloomberg U.S. Treasury Bill 1-3 Month TR)	0.5%	0.6%
10-Year U.S. Treasury (Bloomberg U.S. Treasury 10+ Yr TR)	-9.6%	-28.8%
U.S. Bonds (Bloomberg U.S. Agg Bond TR)	-4.8%	-14.6%
High-Yield Corporate Bonds (Bloomberg U.S. Corp High Yield TR)	-0.7%	-14.8%
S&P 500 TR Index	-4.9%	-23.9%
MSCI World Ex. U.S. (MSCI ACWI Ex USA NR)	-9.9%	-26.5%
MSCI Emerging Markets (MSCI EM NR)	-11.6%	-27.2%
Commodities (DJ Commodity TR)	-4.1%	13.6%

Source: Morningstar Direct. As of September 30, 2022.

Bear Markets Are A Process



Source: Wolfe Research.

Conclusions - Economy

1. Economic growth is slowing globally, but not collapsing.
2. The U.S. economic foundation is solid (consumer, corporate, jobs).
3. Inflation peaked in Q2 and will fall irregularly to 4-5% by year-end.
4. The neutral policy rate for the U.S. is roughly 4-5%.
5. The Fed will likely move rates into restrictive territory by year-end.
6. A recession will likely require rates to be restrictive (i.e., over 4%,perhaps 5-6%).
7. The probability of a recession in 2023 has increased.
8. Earnings expectations are too high.
9. European energy shortages/price spikes are a real risk.
10. China has debt problems primarily related to real estate.

Important Information

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10 PREDICTIONS

10 Predictions for 2022 Q3 2022 Update

Year Ahead View (December 31, 2022)
Our view is that the equity market is in a tug of war between a good earnings tailwind and a modest valuation headwind. Despite a positive earnings picture, the overall macro backdrop has become less favorable for the equity market in 2022. The combination of elevated market valuations, revenue and earnings growth losing steam, a war and higher oil prices, and rising bond yields point to a more difficult year with more frequent pullbacks and higher volatility. Valuation will be of paramount importance in positioning equity portfolios. We believe that it makes sense to lean modestly in favor of value/cyclicals.

Key: √ Heading in right direction X Heading in wrong direction ? Too soon or too close to call

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1 ?

U.S. real growth and inflation remain above-trend but decline from 2021 levels.

The jury is out on this prediction. At mid-year, it is clear inflation will be above-trend and real growth will slow from last year. But will inflation decline and will real growth remain above-trend? (Looking unlikely)

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2 ?

Inflation falls, but core inflation remains stuck at around 3%.

We continue to argue that inflation peaked in Q2. We won't know until further into Q3. But we also believe inflation will retreat to a still unacceptable level. The trajectory of inflation this year and beyond is perhaps the most significant variable in determining the direction of capital markets.

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3 √

For the first time since 1958/1959, 10-year Treasuries provide a second consecutive year of negative returns.

10-year Treasuries crossed above 4% briefly toward the end of the quarter, increasing losses in bonds this year. The two-year decline in returns will surpass that of the last back to back decline in the 1950's.

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4 √

Stocks experience their first 10% correction since the pandemic and fail to make the gains widely expected.

Strategists were predicting the S&P 500 would end the year above 5000. Even our pessimistic 4500 is looking optimistic. It is likely that the U.S. stock market is shifting from multiple compression to focus on earnings disappointments.

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5 ?

Cyclical, value, and small stocks outperform defensive, growth, and large stocks.

Thanks to energy, cyclicals have outperformed defensive stocks ... but that race is close. Small stocks have lagged behind big stocks and are now about as cheap as ever on a relative basis. The big winner here has been value trouncing growth by record amounts.

As of October 1, 2022

10 PREDICTIONS

Key: ✓ Heading in right direction ✗ Heading in wrong direction ? Too soon or too close to call

10 Predictions for 2022 Update (Cont'd)

6 ✓ **Financials and energy outperform utilities and communication services.**

Thanks to the energy sector's massive outperformance and significant underperformance on the part of communication services, this prediction is currently solidly in the money. Financials and utilities are more middle of the pack so far this year.

7 ? **International stocks outperform the U.S. for only the second year in the last decade.**

International stocks led U.S. stocks through mid-year. A strengthening dollar reversed that in Q3. A win for this prediction probably requires dollar weakness, so far elusive.

8 ? **Values-based investing continues to gain share.**

Anecdotal evidence clearly points in our favor on this prediction, but statistics are not yet available. We are witnessing more and more individuals and institutions desiring to line up their portfolios with their values.

9 ✓ **After a 60+ year low in 2021, federal interest expense as a percentage of revenue begins a long-term move higher.**

Sadly, with both federal debt and interest rates rising, this prediction had a tailwind coming into the year. Notably, Federal revenue is rising as well on the back of a reasonably good economy. The impact of borrowing from the future will eventually have onerous consequences.

10 ? **Republicans gain at least 20-25 House seats and barely win the Senate.**

Current polls give the House prediction reasonable likelihood. The Senate is too close to call and could be 50-50 again. Some races may not be called until days after November 8.

Final Tally: ✓ - 4 ✗ - 0 ? - 6

In Summary

In sum, 2022 is shaping up to be more challenging for investors, as central banks progressively unwind unprecedented monetary accommodation in response to ongoing economic recovery and expansion and elevated inflation pressures. While decent economic and earnings growth will be a tailwind for equities, rising interest rates and stubborn inflation will be headwinds. This is likely to create volatility and, at times, turbulent churning. This is why I proposed the theme of "Tug of War Between Earnings Tailwinds and Valuation Headwinds" for 2022..

As of October 1, 2022

Central Banks Seem Determined to Slay Inflation (and Likely Cause a Recession)
Stocks and bonds both declined for the third consecutive quarter, the longest streak in almost 50 years. The S&P 500 fell 5.3%, ten-year Treasury yields rose 85bps and two-year yields rose 130bps resulting in the most inverted yield curve in several decades. The dollar rose for the fifth straight quarter, increasing 7%, the largest quarterly gain in nearly 8 years. The big story for the quarter was the tightening of financial conditions driven by expectations of a more aggressive global rate hike cycle leading to increased fears of recession. A second overhang that will be watched in Q4 is the risk that earnings expectations may fall. By the end of the quarter, worries surfaced that tighter financial conditions could lead to liquidity or credit problems and a “break” in the system. Crude oil fell more than 20% and gold dropped nearly 8%. Best sectors were consumer discretionary (+4.4%) and energy (+2.4%); worst sectors were communication services (-12.7%) and REITS (-11.0%).

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The world has entered a high-risk zone as a consequence of the largest rise in inflation in 40 years, rising policy rates, several developed market countries having excessive debt levels, some poorly-timed fiscal actions and the awakening of the bond vigilantes. The key driver of global demand (the U.S.) deleveraged last decade and is still on reasonably solid footing, and thus can absorb much of the current and expected increase in borrowing rates. However, that is not true for all parts of the world. Global markets (especially fixed income in the U.K.) have experienced borderline disorder in recent days. That, in turn, is reducing confidence that a recession can be avoided. This activity has pushed the dollar yet higher, causing potentially higher inflation outside the U.S.

Over the coming year, we see two possible economic scenarios playing out in the U.S. The first is that the Fed moves forward with raising rates in line with its new projections, and that the U.S. economy succumbs to a recession. We think this scenario will occur if supply-side and pandemic-related disinflation does not emerge relatively soon. The other outcome is a non-recessionary scenario in which inflation decelerates meaningfully. Unfortunately, the historical “soft landing” record is not on the Fed’s side. The odds of a U.S. recession occurring next year have increased. While a tight labor market and robust consumer cash levels have kept a recession from happening, it seems increasingly likely that in 2023 a hard landing will be a result of higher inflation and in turn higher interest rates.

The negative economic growth that occurred in the U.S. in the first half of the year was driven by an export shock in Q1 and a substantially negative contribution to growth from inventories in Q2. During that period, job growth remained quite strong, and consumer spending was growing at a modestly sub-trend pace – patterns that are not consistent with a recession. The U.S. economy has so far managed to absorb higher borrowing costs. Indeed, housing activity has steadily cooled, but consumer confidence is still historically high, propped up by a strong labor market, healthy income gains and still manageable debt servicing. So far, credit spreads are not blowing out as typically occurs heading into a recession, which reflects solid underlying corporate fundamentals. The positive news for investors is that it is too soon to conclude that the U.S. economy is about to enter a recession as a result of a contraction in consumer spending.

Our view coming into the year was that inflation would peak in Q2. We continue to expect inflation to decline from the 8-9% level at that peak to 4-5% on an annualized basis by year-end. Contributors to the decline include the Fed’s tightening process intended to slow growth, the significant slowing in money growth, the strength in the dollar, lower commodity prices, and some improvement in supply chain disruptions. Money (M2) growth has fallen from over 25% (y/y) in late 2020 to less than 5% currently. The slowdown in money growth is likely a necessary precursor to getting inflation under control (as its huge growth was a contribution to the inflation problem that now haunts us.)

Fed pivot talk during the summer resulted in a significantly rally in bonds, a 15% rise in the S&P 500, and a 20% rise in the NASDAQ. This has been the most powerful rally so far in this bear market. The pivot talk turned out to be mistaken resulting in a give back (and more) in recent weeks. Financial conditions, have, and will likely continue to remain tight as the Fed has subsequently emphasized a hawkish stance to fight inflation even at the cost of the economic cycle. So far, analysts have only modestly cut earnings expectations for 2022 and 2023. As more and more companies are providing profit warnings due to macroeconomic trends, it is inevitable that expectations will deteriorate, likely causing a broad-based earnings decline.

Fixed Income
The Fed will deliver on its projected rate hikes in the next two meetings but could pause by Q1 of next year to assess the impact on the economy. This would open a window for bond yields to consolidate from oversold levels. The government bond bear market is now becoming more advanced, but cyclical risks will remain to the upside for yields until there is evidence that underlying inflation pressures are abating and/or the global economy is weakening further in response to higher interest rates. Government bond valuations have improved materially, but bonds are still far from being cheap. Near-term, bonds are oversold and therefore, increasing duration modestly (but remaining below benchmark) may be in order.

Equities
Stocks have retraced their late-summer gains as investors came to the realization that they jumped the gun on the disinflationary narrative in reaction to the July CPI release. The recent revisions to the FOMC's expected path of interest rates at its September meeting prompted an acceleration of the selloff. Equity investors have been justified in selling stocks in reaction to the Fed's projected rate path. Based on the Fed's "new normal" view of the neutral rate of interest, which is also shared by many investors, the new projected path for the Fed funds rate will move monetary policy into the most restrictive territory of the past three decades.

Equities will likely continue to face headwinds as economic and earnings expectations decline even as the Fed pushes interest rates into restrictive territory. That said, equities have been de-rated aggressively this year. It is possible, if not likely, that absent a liquidity or credit accident, equities have limited downside risk, but in the near-term, probably not much upside potential. While there has been a lot of volatility, equity downside in Q3 has been less than in Q1 and Q2. We may be entering a period of a broad trading range, frustrating both the bulls and the bears.

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Commodities and Currencies
Commodity prices have sold off significantly over the past several months, with energy, precious metals, and industrial metals prices all below their 200-day moving averages. The selloff in commodities now represents the largest decline since the early days of the pandemic. The recent weakness in energy prices, in the face of obvious risks to supply, reflects mounting concerns over demand. We expect the supply risk will eventually lead to higher prices again. We expect that cyclically-sensitive commodity prices will remain under pressure while the odds of a U.S./global recession remain elevated.

The U.S. dollar has appreciated by over 25% since the beginning of 2021, a concerning development for U.S. equity investors. S&P 500 companies derive roughly 40% of sales from abroad and the strong dollar is a headwind. Not only does an appreciating domestic currency diminish foreign earnings through a currency translation effect, but it also makes U.S. goods and services more expensive and less competitive in a global marketplace. As the U.S. continues to tighten monetary conditions, it will sustain the strong dollar and maintain pressure on other central banks to tighten. Over the past few months, a number of U.S. multinationals have cited the adverse effect of the strong greenback on their sales and earnings.

Conclusions:
1. Economic growth is slowing globally, but not collapsing.
2. The U.S. economic foundation is solid (consumer, corporate, jobs).
3. The Fed will likely move rates into restrictive territory by year-end.
4. The probability of recession in 2023 has increased.
5. Inflation peaked in Q2 and will fall irregularly to 4-5% by year-end.
6. Earnings expectations are too high.
7. Bond and stock valuations have improved significantly but are still not cheap.
8. TINA for equities is no longer valid.
9. Equities likely have limited further downside, but not much upside potential either.
10. A true equity market bottom ("THE" bottom) likely requires signs of capitulation

Source: BCA Research, MRB Partners, FactSet As of October 1, 2022

