Market and Economic Outlook

September 2017
Market/Economic Review and Outlook

In a historically seasonally weak month, risk assets exhibited weaker performance in August. Political risk dominated headlines with tensions rising between the US and North Korea, violent events erupting in Charlottesville, VA and a terrorist attack in Barcelona. Despite these conflicts, global economies continued to stay the course on the path to recovery with both consumer and business confidence and macroeconomic data remaining positive. As we move out of the summer months, a heightened focus will likely be on the agenda in Washington as legislators must deal with raising the debt ceiling and government funding to avoid a government shutdown as well as creating a new budget to pave the way for a much-anticipated tax reform next year. We expect these upcoming actions may serve as a catalyst for a pickup in volatility, which has been notably absent year to date. However, more volatile periods can often lead to attractive market opportunities.

The S&P 500 Index was up 0.3% in August. Sector performance was mixed with the largest outperformers being technology (+3.5%) and utilities (+3.3%). On the negative side, energy (-5.2%) and telecom (-3.0%) struggled. From a style perspective growth continued to lead value by a large margin. Small cap stocks posted negative returns for the month as policy uncertainty from the Trump administration weighed heavily on the asset class. Large cap equities continued to outpace both mid cap and small cap equities year to date.

Developed international equities were flat for the month, lagging domestic equities. Consumer confidence in the Eurozone increased and second quarter GDP came in at 2.2%, the highest level since 2011. However, an appreciating euro served as a headwind to returns and inflation ticked higher, but remained stubbornly below the European Central Bank target of 2%, casting a shadow on the central bank's ability to reduce quantitative easing in the near future. Emerging markets were up 2.3%, boosted by a weaker US dollar and strong economic growth from China.

Fixed income was marginally positive. Bloomberg Barclays US Aggregate Index was up 0.9% for the month. The yield curve flattened in August and 10 year Treasury yields reached a year to date low, ending the month at 2.1%. High yield spreads widened 26 basis points, generating flat returns for the sector. Municipals were up 0.8% but lagged taxable counterparts.

We remain positive on risk assets over the intermediate-term, although we acknowledge we are in the later innings of the bull market and the second half of the business cycle. While this cycle has been longer in duration compared to history, the recovery we have experienced has been muted. While our macro outlook is biased in favor of the positives, the risks must not be ignored.

We find a number of factors supportive of the economy and markets over the near term.

Reflationary fiscal policies: Despite a rocky start, we still expect fiscal policy expansion out of the Trump Administration, potentially including some combination of tax cuts, repatriation of foreign sourced profits, increased infrastructure and defense spending, and a more benign regulatory environment.

Global growth improving: US economic growth remains moderate and there is evidence growth outside of the US, in both developed and emerging markets, is improving. Earnings growth has improved across markets as well.

Market and Economic Outlook

Business confidence has increased: Measures like CEO Confidence and NFIB Small Business Optimism have improved since the election. This typically leads to additional project spending and hiring, which should boost growth.

However, risks facing the economy and markets remain, including:

Administration unknowns: While the upcoming administration's policies are still being viewed favorably by investors, uncertainties remain. The market may be too optimistic that all of the pro-growth policies anticipated will come to fruition. The Administration has quickly shifted from healthcare to tax reform legislation. We are unsure how Trump's trade policies will develop, and there is the possibility for geopolitical missteps.

Risk of policy mistake: While global growth has improved, it is important that central banks do not move to tighten too early. The Federal Reserve has begun to normalize monetary policy but has room to be patient given muted levels of inflation. The tone of the ECB has begun to shift slightly more hawkish.

The technical backdrop of the market is favorable, credit conditions remain supportive, and we have seen an acceleration in global economic growth. So far Trump's policies are being seen as pro-growth, and investor confidence is elevated. The onset of new policies under the Trump administration and actions of central banks may lead to higher volatility, but our view on risk assets remains positive over the intermediate term. Higher volatility can lead to attractive pockets of opportunity we can take advantage of as active managers.

Brinker Capital Market Barometer

		Negative	Neutral	Positive
Short-Term Factors (<6 months)	Momentum			●
	Trend			●
	Investor Sentiment		●	
	Seasonality	●		
Intermediate-Term Factors (6-36 months)	Fiscal Policy			●
	Monetary Policy		●	
	Inflation			●
	Macroeconomic			●
	Business Sentiment			●
	Consumer Sentiment		●	
	Fundamentals			●
	Credit Environment			●
Long-Term Factors (36+ months)	Valuation		●	
	Business Cycle			●
	Demographics		●	

Brinker Capital