Market and Economic Outlook

October 2017
Market/Economic Review and Outlook

Synchronized global growth, which began earlier this year, carried into the third quarter. Despite the devastating effects of hurricanes Harvey and Irma, the U.S. economy remained near full employment and earnings growth was positive. In September, more clarity surrounding anticipated tax reform policies helped boost consumer and business sentiment and there is now a higher probability that corporate tax cuts and/or move to a territorial tax system will be enacted in the beginning of 2018. The "Amazon effect" and stubborn wage growth continued to put downward pressure on inflation, reducing the likelihood for the Fed to implement an additional interest rate hike in the fourth quarter. Overall, macroeconomic data leans positive and we expect the positive market momentum we've seen so far in 2017 to carry through the end of the year.

The S&P 500 Index was up 4.5% for the quarter. All sectors ex-consumer staples posted positive returns. Energy, which has notably struggled for most of the year, rallied in September (+9.9%) as global demand increased and OPEC production constraints improved supply conditions. From a style perspective, growth outperformed value for the quarter. Small caps outperformed both large and mid cap equities. Small cap equities rallied in September as the implementation of any corporate tax reform will have the largest positive impact on the asset class.

Developed international equities outperformed domestic equities for both the month and quarter. Europe made significant strides in its path to recovery with macroeconomic data and sentiment, both positives for the quarter. In response to the region's improved outlook, the European Central Bank is expected to announce additional tapering in the pace of its quantitative easing purchases as early as next year. The outlook for the U.K. remains far less uncertain as Brexit negotiations and a strong pound continued to weigh heavy on the economy. Emerging markets experienced weaker performance in September, down -0.4%, but the region was up 8% for the quarter, supported by solid fundamentals and a weaker dollar.

Fixed income finished the quarter in positive territory, but was largely negative for the month. Treasury yields reached a year-to-date bottom on September 8th but quickly surged in response to the mid-month announcement that the Fed will soon begin rolling assets off its balance sheet. The 10 year Treasury yield ended the month at 2.3%. High yield spreads contracted 31 basis points in September and generated positive returns for the month and quarter. Municipals performed in line with taxable counterparts for the month and slightly outperformed for the quarter.

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.

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Global growth improving: U.S. economic growth remains moderate and growth has accelerated outside of the U.S., in both developed and emerging markets. Earnings growth has improved across markets as well.

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 President 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 President Trump's policies are being seen as pro-growth, and investor confidence is elevated. The onset of new policies under the current 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 that we can take advantage of as active managers.

Brinker Capital Market Barometer

		Negative	Neutral	Positive	
Short-Term Factors (<6 months)	Momentum			●	Momentum still strong as we enter final months of 2017
	Trend			●	Markets above 50-day and 200-day moving averages
	Investor Sentiment	●			Excessive optimism territory; signs of complacency
	Seasonality			●	Fourth quarter typically highest quarterly return for equities
Intermediate-Term Factors (6-36 months)	Fiscal Policy			●	Anticipate new Administration policies to be pro-growth
	Monetary Policy		●		Fed tightening; ECB and BOJ still modestly accommodative
	Inflation			●	Below Fed's target; inflation expectations still muted
	Interest Rate Environment			●	Long-term rates low; yield curve is positively sloped
	Macroeconomic			●	GDP growth improvement; labor, housing, PMIs positive
	Business Sentiment			●	CEO and small business confidence at high levels
	Consumer Sentiment		●		Elevated, but historically returns muted from current levels
	Corporate Earnings			●	Global earnings growth positive
	Credit Environment			●	Favorable; credit spreads continue to tighten
Long-Term Factors (36+ months)	Valuation		●		Valuations at long-term averages but could remain elevated
	Business Cycle			●	Second half of cycle; Long but muted recovery
	Demographics		●		Mixed (US and EM positive; DM negative)

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