Market and Economic Outlook

November 2017
Market/Economic Review and Outlook

Risk assets were up in October. Many of the global growth themes that were evident in the third quarter carried into the start of the fourth quarter. Macroeconomic data remained positive and earnings announcements generally came in above analyst forecasts. Expectations surrounding potential tax reform increased when the Senate narrowly approved the budget for fiscal year 2018, the first step in paving the way for tax reform/cuts. Our base case remains that the positive market momentum we have seen year-to-date will likely continue through year-end. However, we are cognizant that with equity markets at record highs and volatility at record lows, this may indicate investor sentiment is reaching excessive levels. These signs of complacency may lead to any potential bad news having a larger negative impact on equity markets.

The S&P 500 Index was up 2.3% in October, marking it the twelfth consecutive month the index has posted positive returns. Information technology (+7.8%) led returns but all cyclical sectors were positive. More defensive sectors lagged with consumer staples (-1.4%) and telecom (-7.6%) both posting negative returns. Growth outpaced value and continues to lead year-to-date. Large cap equities outpaced both small and mid cap equities.

Developed international equities were up 1.5% for the month, underperforming domestic equities. Positive momentum within the European region continued with macroeconomic data confirming signs of stronger economic growth. Acknowledging the region's improved outlook but leaving a margin of safety, the European Central Bank announced it will taper the pace of its quantitative easing purchases but will extend its program for an additional nine months. Emerging markets posted solid returns of 3.5% for the month. Further signs of stabilization and positive economic growth within China helped drive returns.

Fixed income was flat for October. Treasuries and government bonds were negative, adversely impacted by rising 10-year Treasury yields during the month. On the positive side, TIPS benefited from an increase in inflation expectations and corporate and high yield bonds generated positive returns. Credit spreads continued to slightly contract and remain at very tight levels. Municipals were up 0.2% helped by limited supply and strong demand.

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 growth has accelerated outside of the US, 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.

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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.

Investor Sentiment: Equity markets are beginning to show signs of excessive investor sentiment and complacency which can often precede a market sell-off.

The technical backdrop of the market is favorable, credit conditions remain supportive, and we have seen acceleration in global economic growth. So far Trump's policies are being seen as pro-growth, and business 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			•	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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