Market and Economic Outlook

December 2017
Market/Economic Review and Outlook

After a short pause in the beginning of the month, it was more of the same for equity markets as the investment themes that have been apparent for most of the year were again evident throughout November. Synchronized global growth continued, fueled by positive earnings growth, improving labor markets and benign inflation. Politics dominated headlines with the announcement of the new Fed Chair, Jerome “Jay” Powell, with expectations for Powell to take the same gradualist approach as his predecessor Janet Yellon. Legislative progress was also made on a potential tax reform package, although the specifics have yet to be finalized. Overall, with seasonality in favor and a December interest rate hike already priced into markets, we believe the positive market momentum we have seen year-to-date will likely carry through to year-end.

The S&P 500 Index was up 3.1% in November with all sectors posting positive returns. Both telecom (+6.0%) and consumer staples (+5.7%) experienced significant rebounds from the lows reached earlier in the month. Consumer discretionary (+5.1%) also posted strong returns, helped by strong seasonality associated with holiday shopping. Information technology (+1.2%) posted relatively muted returns resulting from a broad sell-off within the sector at the end of the month. From a style perspective, growth outperformed value and leads year to date. Mid cap equities surpassed both large and small cap equities for the month.

Developed international equities were up 1.1%, underperforming domestic equities for the second month in a row. Macroeconomic data continued to lean positive indicating the European region is well on its way to recovery. However, as the European Central Bank begins tapering its quantitative easing purchases early next year, there are risks that the transition may disrupt its path to recovery.

Emerging markets were up 0.2% for November. The more tempered returns were due primarily to stalled growth within China as the Central Bank made further steps to reduce its debt by announcing new regulations that will likely impede its shadow banking system.

Fixed income was down in November with most sectors posting negative returns. Ten-year Treasury yields oscillated between 2.3% and 2.4% but broke through the upper bound at the end of the month, creating headwinds for treasuries and government bonds. Likewise, corporate and high yield bonds were negatively affected by the slight widening of credit spreads. Municipals were down -0.5%, underperforming 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 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 the administration'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)

Source: Brinker Capital. Views expressed are for informational purposes only. Holdings subject to change. Not all asset classes referenced in this material may be represented in your portfolio. Indices are unmanaged and an investor cannot invest directly in an index. All investments involve risk including loss of principal. Fixed income investments are subject to interest rate and credit risk. Foreign securities involve additional risks, including foreign currency changes, political risks, foreign taxes, and different methods of accounting and financial reporting. S&P 500: An index consisting of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large-cap universe. Companies included in the Index are selected by the S&P Index Committee, a team of analysts and economists at Standard & Poor's. Bloomberg Barclays U.S. Aggregate: A market capitalization-weighted index, maintained by Bloomberg Barclays, and is often used to represent investment grade bonds being traded in United States. Approved for use with investors.

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