Market and economic outlook

Brinker Capital

October 2018

Risk assets were mixed for the third quarter with domestic equities outperforming international equities by a large margin. Despite what historically is a challenging quarter from a seasonality perspective, a strong macroeconomic backdrop triggered robust growth within US equities. During the quarter, US consumer confidence and small business confidence both reached market cycle highs. Wage growth rose to the highest level since 2009 and initial jobless claims fell to the lowest level since 1979. As we head into the fourth quarter, we expect the upcoming midterm elections and ongoing trade negotiations may create heightened volatility within global markets.

The S&P 500 Index was up 7.2% for the quarter with all sectors posting positive returns and year-to-date is up 10.6%. Healthcare (+14.5%) led third quarter performance as easing concerns over political and regulatory risks served as a tailwind for many companies within the sector. Industrials (+10.0%) also had strong returns, helped by a pickup in CapEx Energy (+0.6%) was flat for the quarter, negatively impacted by the widening gap between oil prices and energy stocks. Large cap outperformed mid cap and small cap equities for the quarter and leads year-to-date. Growth outperformed value.

Developed international equities, as measured by the MSCI EAFE Index, were up 1.4% for the quarter and down -1.0% year-to-date. During the quarter, global protectionist trade policies led to a decline in Eurozone exports and political uncertainty within Italy also negatively impacted the region. Emerging markets were down -1.0% for the quarter and -7.4% year-to-date. A stronger US dollar and global trade tensions continued to create headwinds for the region but despite these short-term challenges, our outlook for the region remains favorable. Many countries within the region are trading at attractive valuations with strong growth prospects over the longer term.

The Bloomberg Barclays US Aggregate Index was flat for the quarter and down -1.6% year-to-date. Ten-year Treasury yields surged to a high of 3.1% in September, after being range-bound for the first two months of the quarter. As markets anticipated, the Federal Reserve (Fed) implemented a 25 basis point interest rate hike in September and expectations are leaning for an additional interest rate hike in December. Credit spreads grinded tighter, generating positive returns for high-yield and investment-grade credit bonds. Municipals underperformed taxable counterparts for the quarter due to a decrease in supply.

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, likely supporting the extended recovery period. In determining our macro outlook, we continue to believe the weight of the evidence leans positive; however, we remain cognizant of the potential risks to that outlook.

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

- **US economic growth:** Sound fundamentals and pro-growth fiscal policies such as tax reform and deregulation have led to solid economic growth within the US.
- **Continuation of strong earnings growth:** Strong corporate earnings growth is evident across global markets and corporate tax reform should further benefit US-based companies.
- **Elevated business and consumer sentiment:** Measures like CEO Confidence, NFIB Small Business Optimism, and Consumer Confidence are

at elevated levels. This typically leads to an increase in capital spending and hiring within corporations and an increase in spending amongst consumers, all of which should boost economic growth.

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

- **Global policy uncertainty:** The development of tariffs and other restrictive trade policies have led to tensions between the US and its global trading partners. Rising populism and political turmoil have increased the possibility for global geopolitical missteps.
- **Interest rate environment/yield curve:** The yield curve has meaningfully flattened as long-term rates have not moved higher with Fed tightening. There is a risk that the Fed could tighten too far too fast causing an inverted yield curve, historically a bearish signal for the economy.
- **Higher inflation:** Current levels of inflation are muted but inflation expectations have ticked higher and the reflationary policies of the administration could further boost levels. Should inflation move higher, the Fed may be forced to shift to a more aggressive tightening stance.

Despite the volatility experienced recently, the technical backdrop of the market remains favorable. Credit conditions are still supportive, US economic growth is positive, and business and consumer confidence are elevated. Global policies and actions of central banks may lead to higher volatility, but our view on risk assets remains positive over the intermediate term. The higher volatility has resulted in wider dispersion of returns across and within asset classes, an attractive environment for our diversified, active investment approach.

Brinker Capital Market Barometer (as of 9/12/18)

Factors		Change	Negative	Neutral	Positive	Commentary
Short-term factors (<6 months)	Momentum			●		Positive for US; weaker for international markets
	Trend			●		Positive for US; weaker for international markets
	Investor sentiment			●		Remains neutral; neither excessive optimisim nor pessimism
	Seasonality		●			Period preceding mid-term elections historically weaker
Intermediate-term factors (6-36 months)	Fiscal policy				●	Fiscal stimulus (tax cuts, deregulation); uncertainty over tariffs
	Monetary policy			●		Global monetary policy directionally tighter
	Inflation				●	Inflation ticking higher but still low; inflation expectations stable
	Interest rate environment			●		Longer-term rates range-bound; flatter yield curve a concern
	Macroeconomic				●	GDP growth accelerating and should benefit from tax cuts
	Business sentiment				●	CEO and small business confidence at high levels
	Consumer sentiment				●	Remains elevated; driven by income and employment conditions
	Corporate earnings				●	US earnings growth has accelerated; softened outside US
	Credit environment				●	Credit spreads still behaved; EM spread widening contained
Long-term factors (36+ months)	Valuation			●		US equity valuations elevated; international equity moved lower
	Business cycle				●	Second half of cycle; long recovery but has been muted
	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 Index: Widely regarded as the best single gauge of large cap US equities. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization. Bloomberg Barclays US Aggregate Index: AA broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS (agency and non-agency). MSCI EAFE Index: A stock market index that is designed to measure the equity market performance of developed markets outside of the US and Canada.

Brinker Capital

BrinkerCapital.com
800.333.4573

1055 Westlakes Drive, Suite 250
Berwyn, PA 19312

Connect with us: BLOG