Market and economic outlook

Brinker Capital

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Higher market volatility persisted throughout April with risk asset performance mixed. US fundamentals remained strong with first quarter annualized real GDP growth up 2.3% and the economy at full employment. Earnings season was also off to a good start with upward earnings revisions exceeding expectations. Inflation continued to rise with core PCE, the Federal Reserve's (Fed) preferred inflation measure, reaching 2% year-over-year, meeting the Fed's target in the first time in a year. Although inflation remains low relative to historical levels, current levels began to put pressure on bond prices. Concerns over the implementation of tariffs also escalated during the month but the tax reform bill passed last year will likely offset negative effects triggered from any additional US protectionist trade policies.

The S&P 500 Index was up 0.4% for the month and down -0.4% year-to-date. Sector performance was mixed for the month. After a period of extended lackluster performance, energy (+9.4%) was the largest outperformer as energy companies began to catch up to rising commodity prices. Likewise, utilities (+2.1%) was helped by a sharp rally at the end of the month but breadth within the sector remained weak. Consumer staples (-4.3%) and industrials (-2.8%) both exhibited negative returns and technology (0.1%) was flat for the month. Small cap equities outperformed large and mid cap equities in April and continue to lead year-to-date. Value outperformed growth by a large margin in small and mid cap equities but there was not a clear leader in large cap equities.

Developed international equities as measured by the MSCI EAFE Index was up 2.4% in April and is outperforming domestic equities year-to-date. A decline in unemployment and strengthening labor market helped support consumer confidence within the eurozone. Likewise, accommodative monetary policies in both eurozone and Japan also continued to serve as a tailwind. Emerging markets was down -0.4% for the month but remain positive year-to-date. The recent surge in the US dollar coupled with fears of more protectionist US trade policies negatively impacted many countries within the region.

The Bloomberg Barclays US Aggregate Index was down -0.7% as fears of inflation and rising interest rates created headwinds for traditional fixed income securities. The 10-year Treasury yield hit 3% for the first time since 2014, increasing expectations of additional Fed rate hikes this year. High-yield credit was the only sector to generate a positive return as spreads slightly tightened throughout the month. Municipal bonds exhibited negative returns but outperformed 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, supported by the extended recovery period. 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.

- **Pro-growth policies:** The Trump administration has delivered a new tax plan and a more benign regulatory environment which could help boost GDP growth in 2018.
- **Synchronized global economic growth:** Growth in the US has started to accelerate, and growth in both developed international and emerging economies has meaningfully improved supported by positive fundamentals.

- **Improvement in earnings growth:** Corporate earnings growth has accelerated, and global and corporate tax reform should further benefit US-based companies.
- **Elevated business sentiment:** Measures like CEO Confidence and NFIB Small Business Optimism are at elevated levels. This typically leads to additional project spending and hiring, which should boost growth. The corporate tax cut should also benefit business confidence and lead to an increase in capital spending.

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

- **Policy uncertainty:** Administration actions, including the development of tariffs and other protectionist trade policies, remain uncertain. Tensions may increase between the US and other countries and there is the possibility for geopolitical missteps.
- **Fed tightening:** The Fed will continue to tighten monetary policy, with at least three interest rate hikes priced in for 2018. We may see an incremental shift to less accommodative monetary policy from other central banks as well.
- **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, even more so as some of the complacency has been removed. Credit conditions are still supportive, global economic growth is accelerating, and business and consumer confidence are 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 opportunities for active managers.

Brinker Capital Market Barometer (as of 3/31/18)

Factors		Change	Negative	Neutral	Positive	Commentary
Short-term factors (<6 months)	Momentum	←		●		Momentum neutral; consolidation period
	Trend	←		●		US and EM between 200 and 50 DMA; EAFE below 200 DMA
	Investor sentiment	→		●		Investor sentiment has retreated to neutral/pessimism
	Seasonality				●	First half of second quarter historically positive for equities
Intermediate-term factors (6-36 months)	Fiscal policy				●	Fiscal stimulus (tax cuts, deregulation); uncertainty over tariffs
	Monetary policy			●		Fed tightening; ECB and BOJ still modestly accommodative
	Inflation				●	Some evidence of global reflation but below central bank targets
	Interest rate environment				●	Long-term rates moved higher then paused; curve flattening
	Macroeconomic				●	GDP growth accelerating and should benefit from tax cuts
	Business sentiment				●	CEO and small business confidence at high levels
	Consumer sentiment				●	Highest level since 2004
	Corporate earnings				●	Global earnings advancing
	Credit environment				●	Credit spreads behaved but watching for signs of stress
Long-term factors (36+ months)	Valuation			●		Forward looking S&P 500 P/E has come down to LT average
	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: 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 US 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. VIX Index: An options-based barometer that reflects implied volatility in equities. It can be purchased in the form of an ETF by investors who want to bet for/against future volatility. In 2017 it reached an all-time low (meaning volatility was extremely low), but has since spiked to start 2018.

Brinker Capital
BrinkerCapital.com
1055 Westlakes Drive, Suite 250
Berwyn, PA 19312
800.333.4573