Market and economic outlook

Brinker Capital

June 2018

In a continuum from previous months, volatility persisted throughout May. Political risk dominated headlines with uncertainty escalating around the Trump administration's trade policy, increasing tensions between the US and its trading partners. We continue to believe the positive effects of the tax reform bill will likely outweigh any negative effects of restrictive trade policies. Macroeconomic data remained supportive with first quarter corporate earnings and profit margins stronger than expected and unemployment at an 18-year low. This increases the likelihood for four Federal Reserve (Fed) rate hikes in 2018, with the next potential hike occurring in June.

The S&P 500 Index was up 2.4% for the month and up 2.0% year-to-date. Sector performance was mixed with information technology (+7.4%) leading performance. Energy (+3.0%) was also a positive, as energy companies began to catch up to rising commodity prices. Utilities (-1.1%) and consumer staples (-1.5%) were negative as more defensive sectors faced headwinds during the month. Likewise, telecom (-2.3%) was hurt by rising interest rates. Growth outperformed value for both the month and year-to-date. Small cap outperformed large and mid cap by a large margin and leads year-to-date.

Developed international equities, as measured by the MSCI EAFE Index, was down -2.1% in May and is lagging domestic equities year-to-date. Negative returns were largely driven by political turmoil within Italy, the third largest economy in the European Union, as anti-euro rhetoric gained traction from Italian populist parties. Although it remains unlikely Italy will retreat from the European Union, tensions with its European Union partners may further increase. Emerging markets was down -3.5% for the month and is down -2.5% year-to-date. Concerns over trade and the surge in the US dollar hindered performance over the short term. Over the long term, the outlook for the region remains positive due to measures of reform and favorable political shifts across many of the countries in the region.

The Bloomberg Barclays US Aggregate Index was up 0.7% for the month but is down -1.5% year-to-date. Ten-year Treasury yields reached a high of 3.1% mid-month before falling to 2.8%, down 10 basis points from the start of the month. High yield generated flat returns as spreads widened 24 basis points but remain at low levels relative to historical values. Performance across remaining fixed income sectors was positive for the month. Municipal bonds outperformed taxable counterparts but lag year-to-date.

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 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 increase 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. 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 5/16/18)

Factors		Change	Negative	Neutral	Positive	Commentary
Short-term factors (<6 months)	Momentum			●		Improving more recently but still neutral backdrop
	Trend			●		Slight improvements; all asset classes above 50 & 200 day moving averages
	Investor sentiment			●		Receded to neutral after starting the year with excessive optimism
	Seasonality	←	●			3Q and 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			●		Fed tightening; ECB and BOJ still modestly accommodative
	Inflation				●	Some evidence of pickup in inflation; wage growth restrained
	Interest rate environment	←		●		Longer-term rates moved higher higher to key levels; curve flattening
	Macroeconomic				●	GDP growth accelerating and should benefit from tax cuts
	Business sentiment				●	CEO and small business confidence at high levels
	Consumer sentiment				●	Remains elevated
	Corporate earnings				●	Global earnings growth at a high level
	Credit environment				●	Credit spreads behaved but watching for signs of stress
Long-term factors (36+ months)	Valuation			●		Global equity valuations have come down closer to LT averages
	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: 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 U.S. Aggregate: 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.

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