Market and economic outlook

Brinker Capital

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Volatility continued into the second quarter with risk asset performance mixed. Geopolitical risk created uncertainty within markets as the threat of US tariffs along with planned retaliation amongst global trading partners escalated throughout the quarter. The Federal Reserve (Fed) implemented a 25 basis point (bps) rate hike in June and revised its forecast from three to four rate hikes for 2018. Concern over a more hawkish Fed coupled with increasing trade tensions will likely cause volatility to persist, but we expect fiscal stimulus and strong fundamentals will lead to positive economic growth over the intermediate term.

The S&P 500 Index was up 0.6% for the month and finished the quarter up 3.4%. Sector performance was mixed. Energy (+13.5%) was the top performer for the quarter as energy companies rallied in response to rising commodity prices. Consumer discretionary (+8.2%) was also positive, helped by elevated consumer confidence. Industrials (-3.2%) had a challenging quarter as the threat of protectionist trade policies created headwinds for many companies within the sector. Financials (-3.2%) were also negative for the quarter. From a style perspective, small caps outperformed large and mid caps by a large margin and growth outpaced value.

Developed international equities as measured by the MSCI EAFE Index were down -1.2% for the month and -1.0% for the second quarter. Rising populism led to political turmoil within Europe and weaker economic growth created additional headwinds. The European Central Bank presented more hawkish rhetoric in its June meeting, setting the stage to wind down its quantitative easing purchases later this year. Emerging markets experienced a significant correction during the second quarter, falling -7.9%. A surging US dollar and trade tensions, particularly between the US and China, negatively impacted the region.

The Bloomberg Barclays US Aggregate Index performance was flat for both the month and quarter. After reaching a high of 3.1%, the 10-year Treasury yield finished at 2.85%, 11 bps from the start of the quarter. The yield curve continued to flatten as long-term rates remained range-bound, raising concerns of an inverted yield curve if the Fed continues on its tightening path. High yield was the best performing fixed income sector and investment grade corporates were largely negative. Municipal bonds outperformed taxable counterparts, helped by an increase 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, supporting 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.

- **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:** The yield curve has meaningfully flattened as long-term rates have not kept pace with tightening monetary policy. 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 recent volatility, 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 7/02/18)

Factors		Change	Negative	Neutral	Positive	Commentary
Short-term factors (<6 months)	Momentum			●		US indices above moving averages; International indices below
	Trend			●		Mixed
	Investor sentiment			●		Remains in neutral territory
	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				●	Inflation measures approaching Fed's target
	Interest rate environment			●		Longer-term rates range-bound; further yield 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 US 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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