Brinker Capital

Market and economic outlook

September 2018

Risk assets generated mixed returns for August. Despite a historically difficult month for markets, US equities finished in strong positive territory and a new record was set for the longest bull market in history. Positive corporate earnings and elevated business sentiment led to a boost in capital expenditure (capex), and we also saw a rise in productivity. Retail spending rose more than expected, helped by a strong labor market and tax reform. International equities sold off during the month, negatively affected by the events in Turkey, US protectionist trade policies, and geopolitical tensions.

The S&P 500 Index was up 3.3% for the month and gained 9.9% year-to-date. Sectors leading performance were those that benefited the most from tax reform, including: information technology (+6.9%), consumer discretionary (+5.1%), and healthcare (+4.4%). Repatriation helped technology and healthcare sectors as companies within these sectors typically hold large amounts of overseas cash. Likewise, tax cuts led to an increase in consumption, benefiting companies within the consumer discretionary sector. Energy (-3.3%) and materials (-0.5%) were negative for the month. From a style perspective growth outperformed value and small cap outpaced large cap and mid cap equities.

Developed international equities as measured by the MSCI EAFE Index were down -1.9% for the month and -1.9% year-to-date. Uncertainty within Italy escalated over the new government's budget plan, due to be released next month, and whether it will deliver on the objectives of the European Union Stability and Growth Pact. Concerns sparked a sell-off in Italian bonds with the 10-year Italian bond yield surging to 3.2%, the widest spread over Germany since 2013. The MSCI Emerging Markets Index was down -2.7% for the month and -6.9% year-to-date. Trade tensions and a stronger US dollar continued to negatively impact the region.

The Turkey lira crisis dominated headlines with the US decision to increase tariffs on Turkish steel and aluminum imports leading to further deterioration of the lira and sparking fears of contagion across other emerging markets.

The Bloomberg Barclays US Aggregate Index was up 0.6% for the month with all sectors posting positive returns. Demand for US government securities put upward pressure on prices as investors retreated to safety amidst geopolitical turmoil and fears of contagion. The 10-year Treasury yield declined 12 basis points, ending the month at 2.85%, leading to further flattening of the yield curve. Although there remains a risk of the yield curve inverting, historically, it is very rare when corporate profits are positive such as we have seen in this current market environment.

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 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 moved higher with the Federal Reserve (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 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 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.

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