

Market & Economic Outlook

May 2017

Market/Economic Review and Outlook

After drifting lower for most of the month, risk assets rallied at the end of April and finished in positive territory. The French election spurred a rebound in markets when both Republican and Socialist candidates were edged out in favor of centralist candidate, Emmanuel Macron. The election has yet to go into the second round but political uncertainty has decreased as the French voting population appears to be favoring a more moderate political vision. On the domestic side, markets were relatively quiet. Data continued to lean positive with stabilizing inflation expectations, continued growth in home prices and elevated consumer sentiment. Business confidence continued to surge as expectations remain high on the Trump administration's economic plan but much uncertainty still remains on the administration's ability to deliver on its promised fiscal growth policies.

The S&P 500 Index was up 1.0%. Cyclical sectors outperformed more defensive sectors. Technology (+2.5%) posted the largest gain and leads year to date by a wide margin. Consumer discretionary (+2.4%) and industrials (1.8%) also posted strong returns for the month. Energy continued to lag and is down -9.4% year to date. Both telecom (-3.3%) and financials (-0.8%) were negative for the month. Growth outperformed value for the fourth consecutive month and small cap led both large and mid cap, a reversal from last month.

Developed international equity was up 2.6% for the month, outperforming domestic equities. Positive news surrounding the French election boosted markets but problems remained in other areas within the European Union. UK economic data exhibited signs of weakening as Brexit continues to loom over the economy and debt levels of both Italy and Greece remain problematic. Economic data in Japan showed signs of improvement during the month but growth continues to move at a slow pace. Emerging markets performed in line with developed markets. The region posted positive returns of 2.2%, fueled by strong growth in China and dissipating fears of US protectionism.

The Bloomberg Barclays US Aggregate Index was up 0.8% for the month with all sectors posting positive returns. The 10 year Treasury yield contracted 10 basis points, ending the month at 2.3%. After slightly widening last month, high yield spreads narrowed 12 basis points. Municipal bonds performed in line with taxable bonds, up 0.7%. Increased demand and limited supply served as tailwinds for the asset class.

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 our macro outlook is biased in favor of the positives and recession is not our base case, especially considering the potential of reflationary policies from the new administration, the risks must not be ignored.

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

Reflationary fiscal policies: With the new administration and an all-Republican government, we expect fiscal policy expansion in 2017, including tax cuts, repatriation of foreign sourced profits, increased infrastructure and defense spending, and a more benign regulatory environment.

Global growth improving: U.S. economic growth remains moderate and there are signs that growth outside of the U.S., in both developed and emerging markets, is improving.

Business confidence has increased: Measures like CEO Confidence and NFIB Small Business Optimism have spiked since the election. This typically leads to additional project spending and hiring, which should boost growth.

Global monetary policy remains accommodative: The Federal Reserve is taking a careful approach to monetary policy normalization. ECB and Bank of Japan balance sheets expanded in 2016 and central banks remain supportive of growth.

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.

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

Administration unknowns: While the upcoming administration's policies are currently being viewed favorably, uncertainties remain. The market may be too optimistic that all of the pro-growth policies anticipated will come to fruition. The Administration has quickly shifted from healthcare to tax reform legislation. We are unsure how Trump's trade policies will develop, and there is the possibility for geopolitical missteps.

Risk of policy mistake: The Federal Reserve has begun to slowly normalize monetary policy, but the future path of rates is still unclear. Should inflation move significantly higher, there is also the risk that the Fed falls behind the curve. The ECB and the Bank of Japan could also disappoint market participants by tapering policy accommodation too early.

The technical backdrop of the market is favorable, credit conditions are supportive, and we have started to see some acceleration in global economic growth. So far Trump's policies are being seen as pro-growth, and investor and business confidence has improved. We expect higher volatility to continue as we digest the onset of new policies under the Trump administration and the actions of central banks, but our view on risk assets remains positive over the intermediate term. Higher volatility can lead to attractive pockets of opportunity we can take advantage of as active managers.

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