Market and Economic Outlook

August 2017
Market/Economic Review and Outlook

After a strong first half to the year, positive economic growth continued into July. Risk assets were up across the board and volatility was notably muted. Second quarter earnings came in strong with both revenue and earnings surprises accelerating from already strong levels, helped by a weaker US dollar and depressed oil prices. On the political front, the Senate's failure to pass a healthcare bill cast a shadow on the "Trump trade", bringing forth concerns on whether meaningful tax and regulatory reform can be accomplished. However, this failure may serve as a catalyst for other pro-growth initiatives, such as tax reform, to be pushed through in the near future. Overall economic data leans positive and we expect markets will continue to trend upward over the near term.

The S&P 500 was up 2.1% in July and reached a record high mid-month, stemming from many large corporations reporting stronger than expected second quarter earnings. All sectors posted positive returns with the largest outperformers being telecom (+6.4%) and technology (+4.3%). Large cap stocks outperformed mid cap and small cap stocks and lead year to date. Growth outperformed value and leads by a large margin year to date.

Developed international equities outperformed domestic equities, returning 2.9% for the month. Improving fundamentals and increased investor sentiment in both the Eurozone and Japan helped spur continued positive economic growth. Both regions remain heavily reliant on central bank stimulus programs and speculation has begun on whether the European Central Bank or Bank of Japan will begin easing in the near future. Emerging markets rallied, gaining 6.0% for July, with all BRIC countries posting positive returns. Brazil was up over 11%, stemming from initial failed corruption allegations of the country's president, Michel Temer. Likewise India and China posted strong returns, fueled by strong economic growth and evidence of reform.

Fixed income markets were quiet during the month. The July Fed meeting was relatively uneventful with an expected announcement of no changes to interest rates. The Bloomberg Barclays US Aggregate Index returned 0.4% with all fixed income sectors posting positive returns. The 10 Year Treasury yield ended at 2.3%, relatively unchanged from the beginning of the month. High yield spreads contracted an additional 12 basis points. Municipals were up 0.8%, outperforming 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. 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: Despite a rocky start, we still expect fiscal policy expansion out of the Trump Administration, potentially including some combination of tax cuts, repatriation of foreign sourced profits, increased infrastructure and defense spending, and a more benign regulatory environment.

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Global growth improving: U.S. economic growth remains moderate and there is evidence growth outside of the U.S., in both developed and emerging markets, is improving. Earnings growth has improved across markets as well.

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

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

Administration unknowns: While the upcoming administration's policies are still being viewed favorably by investors, 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: While global growth has improved, it is important that central banks do not move to tighten too early. The Federal Reserve has begun to normalize monetary policy, but has room to be patient given muted levels of inflation. The tone of the ECB has begun to shift slightly more hawkish.

The technical backdrop of the market is favorable, credit conditions are supportive, and we have seen acceleration in economic growth. So far Trump's policies are being seen as pro-growth, and investor confidence is 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 opportunity we can take advantage of as active managers.

Brinker Capital Market Barometer

		Negative	Neutral	Positive
Short-Term Factors (<6 months)	Momentum			●
	Trend			●
	Investor Sentiment		●	
	Seasonality	●		
Intermediate-Term Factors (6-36 months)	Fiscal Policy			●
	Monetary Policy		●	
	Inflation			●
	Macroeconomic			●
	Business Sentiment			●
	Consumer Sentiment		●	
	Fundamentals			●
	Credit Environment			●
Long-Term Factors (36+ months)	Valuation		●	
	Business Cycle			●
	Demographics		●	

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