Destinations IDX

JULY 2017

Executive summary

As we march through the second half of the business cycle, we still find a number of factors supportive of the economy and the markets, but recognize that risks remain.

Tailwinds	Headwinds
Potential for reflationary fiscal policies	Administration unknowns
Improvement in global growth	Risk of policy mistake
Earnings growth improving	
Elevated levels of business sentiment	

Since we reaffirmed our market outlook in March, portfolios have drifted to a more aggressive posture as global equity markets continued to experience substantial economic growth following the election. Valuations are elevated and central banks are either in the process of, or beginning to contemplate, reducing their easy monetary policies. While we remain positive on equity markets over the intermediate term, we feel it is prudent to take profits at these levels and reduce our overweight to risk. We trimmed our equity overweight across all portfolios. Portfolios will maintain a modest overweight to risk, with moderate to aggressive portfolios possessing a larger overweight than more conservative portfolios.

Strategy	Overall risk positioning*
Conservative (30/70)	+1.00%
Moderately Conservative (40/60)	+1.50%
Moderate (60/40)	+2.50%
Moderately Aggressive (70/30)	+2.75%
Aggressive (80/20)	+2.75%

*Over/underweight to equity-oriented strategies versus neutral weighting

Our key investment themes remain unchanged. Our "focus on income" theme is still in place but has declined in prominence with the implementation of the Fed rate hike cycle.

Changes were implemented in client portfolios the week of July 10.

Later in the business cycle, still positive on risk assets

- 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, which argues for a more extended recovery. Our macro outlook is biased in favor of the positives and recession is not our base case;

however, the risks must not be ignored.

- We find a number of factors supportive of the economy and markets over the near term, including the potential for reflationary fiscal policies, along with tax reform and more benign regulation, an acceleration in global economic growth and earnings growth, and elevated levels of business sentiment. However, risks remain, including the negative impact from the administration not making any progress on policy, and the potential for a policy mistake by central banks.
- We have maintained an overweight to risk in our portfolios since mid-2013. A more sizeable overweight has been expressed in moderate to aggressive strategies as we place a greater emphasis on the risks for more conservative portfolios. We increased our overweight to risk in our November 2016 reallocation as we anticipated the outcome of the presidential election would serve as a positive catalyst for markets. We maintained our risk exposure during our March 2017 reallocation meeting, based on the improving fundamentals of global equity markets.

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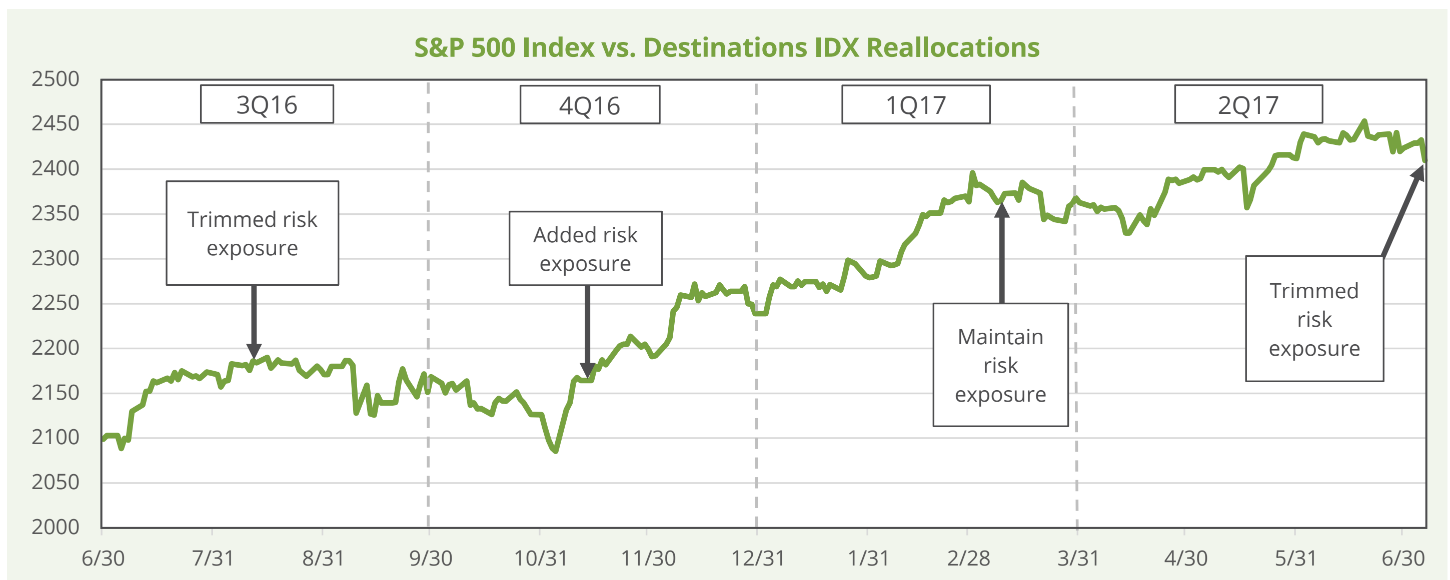
Portfolio changes

Global equity

From a global equity perspective, we increased our allocation to international equity at the expense of domestic equity. While we will remain slightly underweight to international equity following this shift, we believe it is an appropriate time to narrow the gap. Fundamentals in developed international markets have steadily improved with evidence of stable economic growth and improvement in both earnings growth and labor markets. The threat of populism, which previously loomed heavily on markets, has lessened. Uncertainty continues to surround the UK as the country begins Brexit negotiations, and the future policy actions of the ECB and BOJ may become a headwind as they transition toward tighter monetary policy, but we believe the recovery we have seen so far in the



Source: Brinker Capital

region merits a larger weight within portfolios. International equity markets, both developed and emerging, have also underperformed domestic equity markets for some time and exhibit more attractive relative valuations.

Within international equity, we increased exposure to our active international equity stragey in moderately aggressive to aggressive equity portfolios. We also increased exposure to emerging markets across all portfolios, maintaining an overweight to emerging markets. Valuations in emerging markets remain attractive relative to developed equity markets. Higher relative growth, as well as currency stabilization and evidence of reform in many of the emerging economies are also a positive for the asset class. However, depressed oil prices may create additional headwinds for oil exporting countries and an increased probability of higher interest rates as the Fed moves further along the road to interest rate normalization could create challenges for debt-heavy emerging countries, risk factors we are watching carefully.

As a result of our decision to incrementally decrease overall risk, we decreased exposure to both our passive international and domestic equity strategies. However, as a result of our decision to reduce our domestic equity overweight, exposure to our passive domestic equity strategy was decreased by a larger degree.

Fixed income

Our fixed income allocation continues to be positioned with shorter duration and a yield premium versus the broad fixed income market as represented by the Bloomberg Barclays US Aggregate Index. The Fed has remained committed to interest rate normalization, implementing two rate hikes year-to-date with market expectations for a third. However, we expect the path to interest rate normalization will not be linear and likely characterized by fits and starts. Factors such as macro risks, geopolitical noise and the relative attractiveness of U.S. sovereign debt given the amount of debt globally trading at low to negative interest rates, may keep a ceiling on interest rates over the near term.

As a result of our decision to incrementally decrease overall risk, we added exposure to our active core fixed income strategy and active high yield credit strategy.

Real assets and absolute return

We incrementally added to our passive REIT strategy in real assets and active event driven strategy in absolute return in order to bring these allocations back to a 1% weight within portfolios.

Key investment themes

Our key investment themes remain unchanged. Our “focus on income” theme is still in place but has declined in prominence with the implementation of the Fed rate hike cycle.

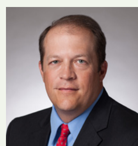
Theme	Primary implementation	Rationale
Reflationary policies	■ Overweight equity ■ Real assets	■ Expect fiscal policy expansion from the Trump administration (tax cuts, repatriation, infrastructure spending, more benign regulation), which will serve to boost growth and inflation
The road to interest rate normalization	■ Shorter duration ■ Yield cushion ■ Lower volatility absolute return	■ Long-term bias is rates to move higher; road to rate normalization will be choppy and protracted ■ Favor credit risk over interest rate risk
Inefficient and/or undiscovered markets	■ Micro cap ■ Event driven	■ Active management can add significant value in inefficient asset classes
Focus on income	■ High yield credit ■ High dividend equity	■ Investors will place a premium on yield producing assets in a low nominal yield environment

Portfolio positioning summary

Allocation decision	Current bias
Overall risk	Overweight in all portfolios
Global equity	Slight underweight to international equity
US equity	Emphasis micro cap, dividend growth
Int'l equity	Emphasis emerging markets
Fixed income	Shorter duration with a yield advantage, emphasize MBS, U.S. high yield credit
Absolute return	Global macro, event driven
Real assets	Global natural resource equities, REITs

If you have any questions regarding changes in our program, please call a member of your Brinker Capital Client Service Team at 800-333-4573. Thank you for your continued confidence in Brinker Capital.

Destinations portfolio management team



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