Market and economic outlook

Brinker Capital

April 2018

After a tumultuous quarter, most asset classes ended slightly negative. The notably low volatility we experienced last year came to an abrupt halt at the end of January when fears of inflation sparked a sell-off in equities and higher volatility continued throughout the rest of the quarter. Markets continued to tighten; the Fed implemented an additional 25 basis point interest rate hike in March and the three-month LIBOR rate, a measure of the cost of intra-bank borrowing, reached a cycle high. Trade dominated headlines with the announcement that the Trump administration will begin to impose tariffs, heightening tensions between the US and its trading partners. However, details have yet to come forth and we expect the final outcome will be more modest than headlines suggest.

The S&P 500 Index finished the month down -2.5% and is down -0.8% for the quarter. Sector performance was largely negative for both the quarter and month. The Facebook data scandal created challenges for the information technology sector in March, but the sector ended the quarter up 3.5%. Consumer discretionary was also positive for the quarter, up 3.1%. Despite choppier markets, consumer staples, a more defensive sector, did not offer a safe haven for investors and was down -7.1%. Likewise, higher yields negatively impacted the telecom sector, down -7.5%. Small cap equities outperformed large and mid-cap equities for both the month and quarter. Growth continues to outpace value.

Developed international equities, as measured by the MSCI EAFE Index, were down -1.7% for the month and -1.4% for the quarter. Concerns over a potential trade war escalated, after the announcement of the implementation of US protectionist trade policies. A strengthening euro and yen, created additional headwinds for developed international markets. Emerging markets, as measured by the MSCI Emerging Markets Index, were down -1.8% for the month but finished the quarter up 1.5%. A heightened focus remains on China as they begin negotiations with the US regarding trade imbalances between the two countries.

Rising interest rates and fears of inflation led to volatile conditions for fixed income markets during the first quarter. The Bloomberg Barclays US Aggregate Index was up 0.6% for the month but down -1.5% for the quarter. 10-year Treasury yields surged during the first two months of the year, reaching a high of 2.9% in February, before leveling out and ending the quarter at 2.7%. Credit spreads widened, negatively impacting returns for both high yield and investment grade credit sectors, but remain at low levels relative to historical values. Municipals outperformed taxable counterparts but were also negative for the quarter.

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, supported by 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.

- **Pro-growth policies:** The Administration has delivered a new tax plan and a more benign regulatory environment which could help boost GDP growth in 2018.
- **Synchronized global economic growth:** Growth in the US has started to accelerate, and growth in both developed international and emerging economies has meaningfully improved supported by positive fundamentals.

- **Improvement in earnings growth:** Corporate earnings growth has accelerated and global and corporate tax reform should further benefit U.S.-based companies.
- **Elevated business sentiment:** Measures like CEO Confidence and NFIB Small Business Optimism are at elevated levels. This typically leads to additional project spending and hiring, which should boost growth. The corporate tax cut should also benefit business confidence and lead to increased capital spending.

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

- **Policy uncertainty:**
  Administration actions, including the development of tariffs and other protectionist trade policies, remain uncertain. Tensions may increase between the US and other countries and there is the possibility for geopolitical missteps.
- **Fed tightening:**
  The Federal Reserve will continue to tighten monetary policy, with at least three interest rate hikes priced in for 2018. We may see an incremental shift to less accommodative monetary policy from other central banks as well.
- **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, even more so as some of the complacency has been removed. Credit conditions are still supportive, global economic growth is accelerating, and business and consumer confidence are 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 opportunities for active managers.

Brinker Capital Market Barometer (as of 3/31/18)

Factors		Change	Negative	Neutral	Positive	Commentary
Short-term factors (<6 months)	Momentum	←		●		Momentum neutral; consolidation period
	Trend	←		●		US and EM between 200 and 50 DMA; EAFE below 200 DMA
	Investor sentiment	→		●		Investor sentiment has retreated to neutral/pessimism
	Seasonality				●	First half of second quarter historically positive for equities
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				●	Some evidence of global reflation but below central bank targets
	Interest rate environment				●	Long-term rates moved higher then paused; curve flattening
	Macroeconomic				●	GDP growth accelerating and should benefit from tax cuts
	Business sentiment				●	CEO and small business confidence at high levels
	Consumer sentiment				●	Highest level since 2004
	Corporate earnings				●	Global earnings advancing
	Credit environment				●	Credit spreads behaved but watching for signs of stress
Long-term factors (36+ months)	Valuation			●		Forward looking S&P 500 P/E has come down to LT average
	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: An index consisting of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large-cap universe. Companies included in the Index are selected by the S&P Index Committee, a team of analysts and economists at Standard & Poor's. Bloomberg Barclays U.S. Aggregate: A market capitalization-weighted index, maintained by Bloomberg Barclays, and is often used to represent investment grade bonds being traded in United States. VIX Index: An options-based barometer that reflects implied volatility in equities. It can be purchased in the form of an ETF by investors who want to bet for/against future volatility. In 2017 it reached an all-time low (meaning volatility was extremely low), but has since spiked to start 2018.

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