Market and economic outlook

August 2018

The third quarter was off to a good start with risk assets positive for July. Global trade tensions continued to escalate throughout the month, but geopolitical uncertainty was offset by positive economic growth. Corporate earnings came in strong with roughly 90% of US companies reporting earnings above expectations in July. Second quarter real US GDP increased 4.1%, helped by elevated consumer and business spending as well as a surge in exports ahead of retaliatory tariffs from China. Core PCE inflation rose to 1.9% year-over-year and is now roughly in line with the Federal Reserve's (Fed) target, helping to set the stage for the Fed to continue its monetary policy normalization path.

The S&P 500 Index was up 3.7% for the month with sector performance positive across the board. After a challenging second quarter, industrials (+7.3%) posted strong returns in response to increased clarity surrounding NAFTA and European Union tariff negotiations. Healthcare (+6.6%) notably improved and financials (+5.3%) benefited from banks reaccelerating off their May lows. Information technology (+2.1%) produced notably weaker performance hindered in part by the sharp sell-off in Facebook. From a style perspective, we saw a shift in leadership with value outperforming growth. Large cap equities outperformed both mid and small cap equities.

Developed international equities as measured by the MSCI EAFE Index was up 2.5% for the month and flat year to date. Trade tensions between the US and European Union de-escalated as the two administrations agreed to work together toward a mutually beneficial solution surrounding tariffs and restrictive trade policies. Within the UK, Brexit continued to create uncertainty as the country begins its formal negotiations on the future relationship with the European Union. Emerging markets was up 0.5% for the month and down -4.4% year to date. Trade tensions between China and the US escalated as both countries threatened retaliation of additional tariffs on imported goods. Currently, no resolution is in sight as China is likely waiting until after US midterm elections to begin further negotiations.

The Bloomberg Barclays US Aggregate Index was flat for the month and down -1.6% year to date. The 10-year Treasury yield rose 12 basis points, ending the month at 2.97%. Credit spreads contracted during the month, generating positive returns for both investment grade and high-yield credit sectors. Municipal bonds outperformed taxable counterparts and lead year to date.

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, 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 kept pace with tightening monetary policy. 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)

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