Market and economic outlook

Brinker Capital

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It was a rough start to the fourth quarter as increasing concerns over the "wall of worry" led to risk assets suffering a sharp drawdown in October. An over-reaction to hawkish rhetoric from Federal Reserve Chair Jay Powell about his commitment to additional monetary policy tightening served as an initial catalyst for an increase in market volatility. Uncertainty over global trade, China growth deceleration, and Italy's fiscal situation further weighed on markets. Despite these negatives, US fundamentals remained solid with third quarter US real GDP growth coming in at 3.5% and unemployment at a record low. During periods of heightened volatility, it's important to remember that large market drawdowns are not necessarily precursors to a recession. As we progress through the fourth quarter, seasonality is supportive, and we expect the conclusion of mid-term elections will remove some uncertainty within markets.

The S&P 500 Index was down -6.8% for the month, bringing the year-to-date gain down to 3.0 %. Defensive sectors were the clear leader for the month; consumer staples (+2.3%) and utilities (+2.0%) were the only sectors to generate positive returns. Industrials (-10.8%), financials (-4.7%), and energy (-11.3%) were the deepest oversold sectors with fewer than 20% of issues trading above their 200-day moving averages. Consumer discretionary (-11.3%) also suffered a large drawdown but remains positive (+7.0%) year-to-date. Large cap outperformed mid and small cap for the month and leads year-to-date. Value outperformed growth for the month but lags year-to-date.

Developed international equities, as measured by the MSCI EAFE Index, were down -8.0% for the month and -8.9% year-to-date. Weaker economic momentum and political concerns continued to serve as challenges for the Eurozone. The region lacks a clear catalyst to propel outperformance and plans from the European Central Bank to stop quantitative easing purchases at the end of the year may create additional challenges. Emerging markets as a group were down -8.7% for the month, but performance was mixed with Brazil gaining more than 17%. The asset class is down -15.5% year-to-date. Trade tensions with the US led to a broader slowdown in China, negatively impacting growth. The strength in the US dollar has also been a headwind for emerging markets.

The Bloomberg Barclays US Aggregate Index was down -0.8% for the month and is down -2.4% year-to-date. The 10-yield Treasury yield rose to 3.2% early in the month based off expectations that strong economic fundamentals and a robust labor market could lead to upward pressure on wages. However, with the decline in equity markets, the 10-year yield fell 10 basis points to end the month at 3.1%. Credit spreads widened, generating negative returns for both high-yield and investment-grade credit bonds, but remain at low levels relative to historical values. Municipals were down for the month but outpaced taxable bonds.

Despite the recent sell-off in equity markets, we remain positive on risk assets over the intermediate term. The technical backdrop is weaker and investor sentiment has moved more negative, but not yet reached extreme pessimism territory. However, the fundamentals have not changed. In determining our macro outlook, we continue to believe the weight of the evidence leans positive; however, we remain cognizant of the potential risks to that outlook.

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 has further benefited US-based companies.
- **Elevated business and consumer sentiment:** Measures like CEO confidence, NFIB Small Busi-

ness 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 among consumers, all of which should support economic growth.

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

- **Global policy uncertainty:** The Federal Reserve (Fed) continues on its normalization path, but there is concern it will be too aggressive, pushing the economy into a recession. On the fiscal policy side, 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/yield curve:** The yield curve has flattened meaningfully this year, but the recent move higher in long-term rates has caused this spread to widen slightly. The curve has not yet inverted, which would be cause for concern.
- **Higher inflation:** Current levels of inflation are muted but inflation expectations have ticked higher. Should inflation move higher, the Fed may be forced to shift to a more aggressive tightening stance.

Despite the volatility experienced recently, economic fundamentals remain solid. 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 9/12/18)

Factors		Change	Negative	Neutral	Positive	Commentary
Short-term factors (<6 months)	Momentum			●		Positive for US; weaker for international markets
	Trend			●		Positive for US; weaker for international markets
	Investor sentiment			●		Remains neutral; neither excessive optimisim nor pessimism
	Seasonality		●			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			●		Global monetary policy directionally tighter
	Inflation				●	Inflation ticking higher but still low; inflation expectations stable
	Interest rate environment			●		Longer-term rates range-bound; flatter yield curve a concern
	Macroeconomic				●	GDP growth accelerating and should benefit from tax cuts
	Business sentiment				●	CEO and small business confidence at high levels
	Consumer sentiment				●	Remains elevated; driven by income and employment conditions
	Corporate earnings				●	US earnings growth has accelerated; softened outside US
	Credit environment				●	Credit spreads still behaved; EM spread widening contained
Long-term factors (36+ months)	Valuation			●		US equity valuations elevated; international equity moved lower
	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 Index: Widely regarded as the best single gauge of large cap US equities. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization. Bloomberg Barclays US Aggregate Index: AA broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS (agency and non-agency). MSCI EAFE Index: A stock market index that is designed to measure the equity market performance of developed markets outside of the US and Canada.

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