Brinker Capital

FEBRUARY 2019

Market review and outlook

January market review

After a challenging end to 2018, risk assets rebounded in January to finish the month in strong positive territory. Helping market returns were more dovish signals from the Federal Reserve (Fed), indicating they may be more patient with future interest rate hikes for 2019. Oil bounced off its lows and we saw improving rhetoric between the US and China on trade as we approach the March 1 deadline. However, geopolitical issues continued with a partial US government shutdown for the majority of the month, ongoing political issues in the European Union, and uncertainty surrounding Brexit. The list of concerns is extensive but overall fundamentals remain supportive.

The S&P 500 Index was up 8.0% for January. Sector performance was positive across the board. Leading returns was industrials (+11.4%), helped by the temporary trade war truce between the US and China. Energy (+11.1%) was positively impacted by the rebound in oil prices. Low unemployment and rising wages led to strong growth in consumer discretionary (+10.3%). From a style perspective, growth outperformed value. Small cap equities outpaced large and mid cap equities for the month.

The MSCI EAFE Index finished up 6.6% for the month. Developed international equities rebounded from December lows but concerns remained over slower economic growth within the eurozone, brought forth by the European Central Bank ending its quantitative easing program. Political turmoil escalated in France from the yellow vest protest movement and Brexit negotiations remained in gridlock. The MSCI Emerging Markets Index was up 8.8%, helped by a stabilizing US dollar. Trade tensions have been a recent headwind for the region but increased fiscal stimulus within China, a key driver for emerging market indices, may help offset any negative impact.

The Bloomberg Barclays US Aggregate Index was up 1.1% for the month. The 10-year Treasury yield was range-bound for the month and finished at 2.6%, roughly the same level as the start of the year. The short-end of the yield curve remained inverted and inflation expectations muted, setting the stage for a likely Fed rate hike pause at the beginning of the year. Credit spreads meaningfully contracted from December highs during the month, generating positive returns for high-yield and investment-grade credit sectors.

Market outlook

As we continue moving through the business cycle, we still find a number of factors supportive of the economy and markets; however, we remain cognizant of the risks. In the short term, a number of factors are adding to global uncertainty and increasing the potential for additional volatility.

The following factors should support the economy and markets over the near term:

- **US economic growth:** We may see a moderation of US economic growth as the benefits of tax reform begin to fade in 2019. However, fundamentals remain solid and we see continued strength in the labor market.
- **Solid US earnings growth continues:** The outlook for corporate earnings growth remains favorable. Earnings estimates have declined, providing an opportunity for upside surprises.
- **Fed pause:** The Fed has backed off their more aggressive tightening stance with recent dovish rhetoric. Expectations are for the Fed to take a pause to assess the impact of their rate hikes so far this cycle.

However, risks facing the economy and markets include:

- **Global policy uncertainty:** Global monetary policy has become directionally tighter with central bank balance sheets declining year-over-year and developed market central banks beginning to remove accommodative policies. A too aggressive policy could impede global growth and lead to 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, but the curve has not yet inverted between longer- and shorter-dated maturities, which would be cause for further concern.
- **Potential for higher inflation:** Inflation is manageable at current levels and inflation expectations remain muted. Should inflation move meaningfully higher, the Fed may be forced to shift to a more aggressive tightening stance.

Despite the recent heightened volatility, we believe the positives outweigh the negatives. US economic growth, while moderating, is still positively helped by a strong labor market, consumer confidence remains elevated, corporate earnings growth is solid, and inflation remains muted. Credit conditions are still supportive. Global policies and actions of governments and central banks may lead to higher volatility, but our view on risk assets remains positive over the intermediate term. The higher volatility should result in a wider dispersion of returns across and within asset classes, an attractive environment for our diversified, active investment approach.

Brinker Capital Market Barometer (as of 1/28/19)

Factors		Change		Neutral	Positive	Commentary
Short-term factors (<6 months)	Momentum	→		●		Market momentum building following 12/24/18 bottom
	Trend		●			Major market indices below 200-day moving averages
	Investor sentiment			●		Shifted back to neutral after reaching extreme pessimism in early Jan.
	Seasonality	←		●		Seasonality less of a tailwind in the first quarter
	Fiscal policy				●	Continued to benefit from tax cuts and deregulation; watching trade
	Monetary policy			●		Global monetary policy directionally tighter; Fed to pause rate hikes
	Inflation			●		Wage growth has ticked higher; few signs of broader inflation
	Interest rate environment			●		Rates biased higher but choppy; flat yield curve a concern
	Macroeconomic				●	Global growth moderating but still positive; strong US labor market
	Business sentiment	←		●		Decline in CEO confidence; small business confidence off record high
	Consumer sentiment				●	Measures declined in January, but levels still supportive
	Corporate earnings				●	US earnings growth still solid; softer outside US
	Credit environment				●	Credit spreads still behaved; few signs of credit market stress
Long-term factors (36+ months)	Valuation	→			●	More attractive following sell-off; forward P/E below LT average
	Business cycle				●	Long recovery but has been muted; few signs point to recession
	Demographics			●		Mixed (US and emerging markets positive; developed int'l negative)

Brinker Capital

BrinkerCapital.com
800.333.4573

1055 Westlakes Drive, Suite 250
Berwyn, PA 19312

Connect with us: BLOG in f