Brinker Capital

MAY 2019

# Market review and outlook

In April, risk assets posted positive returns for the fourth consecutive month. Global equity markets experienced tailwinds stemming from the shift to more accommodative central bank policies and anticipation of a resolution between the US and China trade negotiations. Within the US, economic growth was solid, with real GDP estimates up +3.2% quarter-over-quarter. The earnings season is also off to a good start with many companies posting positive surprises after earnings expectations were revised lower at the start of the year. Overall, we remain constructive on risk assets over the near term as data leans positive, inflation remains muted, and the Federal Reserve (Fed) has backed off its aggressive stance.

The S&P 500 Index was up 4.1% for the month and 18.3% for the year-to-date period. Financials (+9.0%) experienced a sharp rebound from the low reached last month. Communications services (+6.5%) and information technology (+6.4%) also posted strong returns. Consumer discretionary (+5.7%) was helped by accelerating wage growth and improving consumer sentiment. Healthcare (-2.6%) suffered headwinds from the uncertainty of the upcoming 2020 campaign season. Real estate (-0.6%) and energy (+0.1%) were flat for the month. From a style perspective, large cap equities outpaced mid and small cap equities, but year-to-date, mid cap equities maintain leadership. Growth outpaced value for the month and year-to-date.

International developed equities, as measured by the MSCI EAFE Index, were up 2.9% in April and have gained 13.3% year-to-date. Improving data from Europe suggested that the economy may be poised to accelerate in the second half of the year, but ongoing trade tensions and pockets of populism may continue to negatively impact the region. The European Union granted the UK another Brexit extension with the deadline extended until October 31, postponing the threat of a no-deal exit. The MSCI Emerging Markets Index gained 2.1% for the month. China, a key driver of index performance, posted muted returns based off concerns on whether the government may begin to dial back its stimulus.

The Bloomberg Barclays US Aggregate Index finished flat for the month. The 10-year Treasury yield continues to be range-bound but has declined 18 basis points from the start of the year. Neutral rhetoric from the Fed coupled with improvements in economic data led to a slight steepening of the yield curve, but the front-end of the curve remains inverted. High-yield spreads contracted 33 basis points, generating strong returns for the sector. Municipals outperformed taxable counterparts for the month.

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

**The following factors should provide support to 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 opportunity for upside surprises.
- **Fed pause:** The Fed has backed off their tightening stance with recent dovish statements. There is no expectation for a rate hike in 2019 as they forecast lower growth and view inflation as below their target level.

**However, risks facing the economy and markets include:**

- **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/yield curve:** There appears to be some ceiling on long-term Treasury yields due to concerns over economic growth and the relative value offered compared to yields on other developed market sovereign debt. We saw a brief inversion of the 10-year/3-month measure of the yield curve, but the 10-year/2-year measure remains positively sloped. We will continue to watch for a sustained inversion of the curve, as this has been a reliable recession warning in the past.
- **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 back to a more aggressive tightening stance.

We continue to believe the weight of the evidence leans positive. US economic growth, while moderating, is still positive helped by a strong labor market, elevated consumer confidence, solid corporate earnings growth, and muted levels of inflation. 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. With investor sentiment climbing into excessive optimism territory, we would not be surprised to see a return of volatility should the data deviate from expectations; however, over the intermediate term the fundamentals remain supportive for risk assets.

## Brinker Capital Market Barometer

The weight of the evidence still leans positive which argues for a modest overweight to risk across portfolios

**SHORT-TERM FACTORS** (< 6 months)

| | CHANGE | NEGATIVE | NEUTRAL | POSITIVE | |
|---|---|---|---|---|---|
| Momentum | | | | ● | Market momentum still strong |
| Trend | | | | ● | Global equity market indices above 200-day moving averages |
| Investor sentiment | ← | ● | | | Survey data remains in excessive optimism territory |
| Seasonality | | | | ● | Seasonality more supportive in second quarter |

**INTERMEDIATE-TERM FACTORS** (6-36 months)

| | CHANGE | NEGATIVE | NEUTRAL | POSITIVE | |
|---|---|---|---|---|---|
| Fiscal policy | | | | ● | Fiscal stimulus continues in 2019; watching trade |
| Monetary policy | | | | ● | Fed on an extended pause and will end balance sheet reduction |
| Inflation | | | ● | | Fed sees inflation as running below target |
| Interest rate environment | | | ● | | Longer-term rates range-bound; yield curve inversion at short end |
| Macroeconomic | | | | ● | Global growth still positive; strong US labor market |
| Business sentiment | | | ● | | Small biz confidence off record high; CEO confidence little improved |
| Consumer sentiment | | | | ● | Measures improved in March; levels still supportive |
| Corporate earnings | | | | ● | US earnings growth still solid; softer outside US |
| Credit environment | | | | ● | Credit spreads tighter; few signs of credit market stress |

**LONG-TERM FACTORS** (36+ months)

| | CHANGE | NEGATIVE | NEUTRAL | POSITIVE | |
|---|---|---|---|---|---|
| Valuation | | | ● | | US equity valuations at long-term averages; more attractive ex-US |
| Business cycle | | | | ● | Long recovery but has been muted; few signs point to recession |
| Demographics | | | ● | | Mixed (US and emerging markets positive; developed intl negative) |

Information as of May 3, 2019.



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