Brinker Capital

JULY 2019

Market review and outlook

The second quarter was characterized by a high level of volatility but both equities and fixed income finished firmly in positive territory. Risk assets rallied off the May lows and led to the best June for the S&P 500 Index (S&P 500) since 1955. Expectations for easier monetary policy and renewed hopes for a trade deal between the US and China helped propel markets, with the outcome of the G20 Summit at the end of the month leading to a temporary trade truce. Weaker economic data led to accommodative central bank rhetoric from both the European Central Bank and the Federal Reserve (Fed), increasing the probability of rate cuts in the second half of the year. Any easing monetary policies would be supportive of risk assets and help prolong the economic expansion.

The S&P 500 was up 7.1% in June and 4.3% for the quarter. Cyclicals outperformed more defensive sectors with financials (+8.0%) leading sector returns for the quarter. Information technology (6.1%), materials (+6.3%), and industrials (3.6%) benefited from receding trade issues at the end of the month. Likewise, consumer discretionary (+5.3%) was helped by elevated consumer confidence. Energy (-2.8%) was the only sector to post a negative return as declining oil prices created headwinds for the sector. From a style perspective, large cap equities outperformed mid cap and small cap equities for the quarter. Growth continued to outperform value.

International developed equities, as measured by the MSCI EAFE Index, were up 6.0% for the month and 4.0% for the second quarter. Similar to the US, the euro region responded favorably to comments from European Central Bank president, Mario Draghi, that they could move back toward monetary stimulus if needed to prevent the current slowdown from turning into an economic downturn. The MSCI Emerging Markets Index was up 6.3% for the month and 0.7% for the quarter. A temporary halt to tariff escalations between the US and China led to strong returns in June, but much uncertainty remains and a breakdown in negotiations could serve as further headwinds for the region.

The Bloomberg Barclays US Aggregate Index was up 1.3% for the month and 3.1% for the second quarter. The 10-year Treasury yield steadily fell throughout the second quarter and ended at 2.0%. Inflation expectations as measured by the University of Michigan fell to a record low and the PCE Index, the Fed's preferred inflation measure, remained below target. Low inflation helps set the stage for the Fed to cut interest rates this year. Credit spreads slightly contracted during the month after widening in May in response to heightened volatility. Municipals lagged taxable counterparts for the quarter.

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:

- **Fed pausing/easing:** The Fed is on an extended pause. Expectations are for the Fed to implement easing monetary stimulus with at least one rate cut in 2019 to help mitigate the possibility of an economic downturn.
- **Low inflation:** Inflation globally is low and slowing and inflation expectations remain muted. Lower inflation in the US provides the Fed with an opportunity to ease monetary policy.
- **US relative economic growth:** US economic growth has moderated but is attractive relative to the rest of the world. US fundamentals have declined from their peak but remain solid and we see continued strength in the labor market.
- **Continued solid US earnings growth:** The outlook for corporate earnings growth remains favorable. Net earnings revisions are moving higher.

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:** The 10-year/3-month measure of the yield curve is inverted, 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.

We continue to believe the weight of the evidence leans positive and fundamentals are supportive for risk assets over the intermediate term. US economic growth, while moderate, 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. On balance, market technicals have improved after the strong rebound in global equities experienced in June. 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.

Brinker Capital Market Barometer

The weight of the evidence still leans positive which is in line with our slight overweight to risk in moderate to aggressive portfolios.

SHORT-TERM FACTORS (< 6 months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Momentum	→			●	Market momentum strengthened
Trend	→		●		Global equity indices moved above ST and LT moving averages
Investor sentiment			●		Investor sentiment surveys more optimistic but fund flows muted
Seasonality	←←	●			Third quarter historically weakest for equities

INTERMEDIATE-TERM FACTORS (6-36 months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Fiscal policy				●	Fiscal stimulus expected to increase leading up to 2020 election
Monetary policy				●	Expectations for a Fed rate cut; global central banks more accommodative
Inflation	→			●	Global inflation low and slowing; inflation expectations muted
Interest rate environment			●		Longer-term rates range-bound; yield curve inversion at short end
Macroeconomic			●		US growth solid but ex-US growth weaker; global trade war concerns
Business sentiment			●		Small business confidence off record high; CEO confidence little improved
Consumer sentiment				●	Remains at elevated levels; still supportive
Corporate earnings				●	US earnings growth still solid; softer outside US
Credit environment				●	Credit spreads have tightened

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 July 2, 2019.

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