Market review and outlook

The third quarter was marked by a high level of volatility in what is historically the most challenging period of the year from a seasonality perspective. Risk assets were mixed for both September and the third quarter, with weaker global economic data and declining confidence levels contributing to fears of a global growth slowdown. In an attempt to prolong the economic expansion, the Federal Reserve (Fed) cut interest rates by 25 basis points in both July and September, and the expectation remains for additional cuts before year-end. The House announced a formal impeachment inquiry of President Trump in late September, adding to geopolitical uncertainty. An impeachment proceeding does not necessarily have a direct negative effect on risk assets, but it increases policy uncertainty. As we move toward the end of the year, the global economy faces many risks, the largest of which the trade war with China and the US political environment, including the 2020 election and impeachment proceedings, and global growth has already showed signs of slowing. However, with inflation still at low levels, central banks maintain the flexibility to continue with easing monetary policy to help promote growth.

The S&P 500 Index (S&P 500) was up 1.7% for the third quarter and has returned 20.6% year-to-date. Sector performance was mixed with yield-oriented sectors like utilities (9.3%) and real estate (7.8%) leading returns for the quarter. Consumer staples (6.1%) benefited from investors seeking more defensive areas of the market amidst an increase in market volatility. Energy had strong performance in September as oil prices spiked following the attack on Saudi Arabia's oil infrastructure, but the sector was the worst performing for the quarter (-6.3%). Healthcare (-2.3%) continued to face headwinds based off concerns the impeachment inquiry may reduce the probability of any meaningful healthcare legislation being passed. From a style perspective, we saw a sharp reversal in leadership in September, with value outperforming growth by a large margin; however, this shift did not persist into October. Large cap equities continued to outpace mid- and small cap stocks.

International developed equities, as measured by the MSCI EAFE Index, fell -1.0% for the quarter but have returned 13.4% year-to-date. Weakening economic data within the Eurozone led to the European Central Bank decision to cut interest rates further into negative territory and restart quantitative easing during its September meeting. Brexit continued to drag on with uncertainty increasing on whether a deal can be reached with the European Union by the October 31 deadline. Emerging markets, as measured by the MSCI Emerging Markets Index, were down -4.1% for the quarter and up 6.2% year-to-date. China, a key driver of index performance, continued to be weighed down by the trade war, a headwind we expect to persist.

The Bloomberg Barclays US Aggregate Index gained 2.3% in the third quarter and 8.5% year-to-date. In September, the 10-year Treasury yield surged 44 basis points based off diminishing concerns of an economic downturn. However, the yield on the 10-year Treasury note ended the quarter at 1.68%, 32 basis points lower than it began. The interest rate cuts implemented by the Fed during the quarter led to a slight steepening of the yield curve, with the 10-year/2-year measure no longer inverted. Corporate credit spreads widened modestly with the volatility in equities, but still remain at historically tight levels.

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, a number of 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:

- **Global monetary policy easing:** After an extended pause, the Fed implemented two rate cuts with a high probability for additional future rate cuts to help mitigate the possibility of an economic downturn. The ECB also announced to ease more aggressively.

- **Low inflation:** Inflation globally is low and slowing and inflation expectations have fallen recently. Lower inflation in the US provides the Fed greater flexibility to ease monetary policy.
- **US relative economic growth:** US economic growth has moderated but is attractive relative to the rest of the world.

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:** Portions of the yield curve remain inverted, which has been a reliable recession warning over each of the past seven recessions. In addition, the impact of the growing pool of negative-yielding debt is a concern.

We continue to believe the weight of the evidence leans positive and fundamentals are supportive for risk assets over the near-term. US economic growth, while moderating, is still positive and the Fed is likely to continue to support growth in the absence of inflation. However, we expect continued volatility due to global policy uncertainty and actions of governments and central banks.

Brinker Capital Market Barometer

The weight of the evidence remains moderately positive, in line with our neutral to slight overweight overall risk positioning in portfolios.

SHORT-TERM FACTORS (< 6 months)	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Momentum			●		Momentum has continued to improve
Trend			●		S&P 500 Index remains in an uptrend
Investor sentiment	←		●		Sentiment survey data shifted more neutral; equity flows still negative
Seasonality	→ →			●	4Q tends to be the most constructive for equities

INTERMEDIATE-TERM FACTORS (6-36 months)	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Fiscal policy			●		Fiscal stimulus potentially dwarfed by tariffs in 2020
Monetary policy				●	Expect additional Fed rate cuts; global easing cycle continues
Inflation				●	Global inflation low; US wage growth has increased modestly
Interest rate environment			●		Significant amounts of debt trading at negative rates; curve inversion
Macroeconomic			●		Global growth slowdown but still positive; US/China trade war concerns
Business sentiment			●		Small business confidence still elevated; CEO confidence more pessimistic
Consumer sentiment				●	Measures have ticked down but remain at elevated levels
Corporate earnings			●		US earnings growth slowing but positive; weaker ex-US
Credit environment				●	Credit spreads have remained in check; Fed aware of repo market issues

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; increasing fears of US recession
Demographics			●		Mixed (US and emerging markets positive; developed int'l negative)

Information as of October 4, 2019.

Brinker Capital

BrinkerCapital.com
800.333.4573

1055 Westlakes Drive, Suite 250
Berwyn, PA 19312

Connect with us: BLOG in f