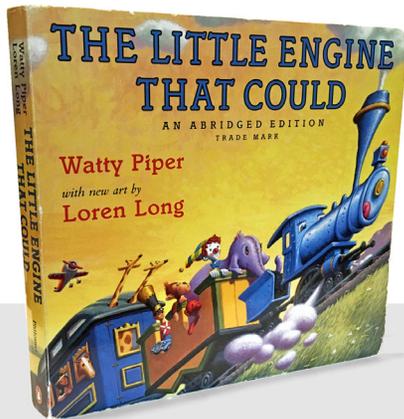


# What small caps might be telling us about the economy and the market



For a big country, we sure have an affinity for little things. Think TV shows: “Tiny House Nation”; sayings: “Big things come in small packages”; and children’s books: “The Little Engine That Could” as being among the more obvious examples of our love of things little or small. It is a love of small things which brings us to the focus of this week’s Weekly Wire, US small cap stocks, and what the asset class might be telling us about the US economy and the US stock market as we approach the second half of 2020.

At the risk of oversimplifying things, US small cap stocks – relative to large cap stocks – are typically more domestic facing, economically sensitive, riskier, volatile, in greater need of capital, and less profitable. As such, they tend to do well on a relative and absolute basis when the economy is

strengthening, capital markets are supportive of growth, and investors are more optimistic than not. Considering what the US economy has endured in 2020 you are likely not surprised to read that the Russell 2000 – the benchmark for US small cap stocks – was off approximately 16% year-to-date and 3% on a trailing 12-month basis through May 31, compared to a loss of 5% and a gain of 13% for the S&P 500 Index (S&P 500). During periods of great uncertainty, we should expect big to do better than small. What is more interesting to us are the relevant return streams for the Russell 2000 and the S&P 500 during the second quarter through May 31 – up 21% and up 18%, respectively. While two months don’t necessarily a trend make, we find it encouraging small is gaining on big, which reflects a growing – and we think reasonable – consensus that corporate borrowing conditions have improved dramatically and the US economy has bottomed out. As it concerns small cap stocks and the outlook for – well, small cap stocks – research firm Strategas notes that when small cap stocks have done as well as they have of late (based on return, the percentage of small cap stocks trading above their respective 50-day moving average and the percentage of small cap stocks trading at a 20-day high), returns for the asset class looking out six to 12 months tend to be well above average.

Russell 2000 forward performance following momentum extremes

Metric	Recent Extreme Reading	+20-Days	+65-Days	+125-Days	+250-Days
50-Day % Change	39.3%	0.4%	3.3%	10.5%	16.8%
% of Stocks >50-Day Average	91.6%	1.4%	7.0%	13.0%	19.2%
% of Stocks at 20-Day High	46.1%	0.1%	2.3%	4.9%	13.6%
Historical Average	-	0.8%	2.6%	5.2%	10.3%

Three different momentum indicators recently hit the 99th percentile of all historical observations. Momentum can be short-term climatic, but in the long run these surges are often found coming off major market lows.

Stocks, bonds, and commodities (6/5/2020)

Security name	Last	QTD chg	YTD chg	12mo chg
S&P 500	3193.93	23.58%	-1.14%	12.32%
MSCI AC World ex USA	272.60	18.68%	-9.64%	-0.51%
MSCI EAFE	1846.51	18.40%	-9.35%	-0.41%
MSCI EM	1002.65	18.16%	-10.05%	-0.01%
Bloomberg Barclays US Agg	109.59	1.28%	3.76%	5.62%
Crude Oil WTI	38.97	90.28%	-36.18%	-25.90%
Natural Gas	1.80	9.76%	-17.77%	-22.55%

Treasury rates (6/5/2020)

	Price	Yield
2Y	99.26 / 99.2	0.208
3Y	99.16 / 99.1	0.286
5Y	98.28 / 98.2	0.474
7Y	98.18 / 98.1	0.709
10Y	97.12 / 97.1	0.900
30Y	90.02 / 90.0	1.671

Weekly reports

This week
• NFIB Small Business Index
• U of Michigan Sentiment
Last week
• Nonfarm Payrolls 2.509K
• Unemployment Rate 13.3%

# Brinker Capital Market Barometer

JUNE 2020

The COVID-19 pandemic remains the key driver for the economy, financial markets, and confidence. A powerful monetary and fiscal policy response has helped bridge the gap, and we are now seeing the economic data bottom as areas of the economy begin the slow process of reopening. We expect the equity market to remain range-bound in the near term as we wait for continued improvement in the COVID-19 data and as we assess the gradual reopening of the economy.

## SHORT-TERM FACTORS (< 6 months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Momentum	→			●	Momentum has been broad and impressive
Trend			●		Expect continued trading range until more clarity on economy reopening
Investor sentiment			●		Sentiment still leans bearish but not at extreme pessimism levels
Seasonality			●		Seasonality relatively neutral

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

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Fiscal policy				●	Very strong fiscal response; more debate expected on next round
Monetary policy				●	Fed all in to support markets and economy; Global central banks taking action
Inflation				●	Global inflation low and inflation expectations continue to fall
Interest rate environment				●	Treasury yields remain at low levels but stable; yield curve has normalized
Macroeconomic		●			Significant decline in 2Q due to lockdowns; starting to show signs of improvement
Business sentiment		●			CEO confidence likely to remain weak due to virus and election uncertainty
Consumer sentiment		●			Consumer confidence dropped to levels last seen in 2011
Corporate earnings		●			Global revenues and earnings will be negatively impacted by COVID-19 in 2020
Credit environment	→			●	Credit environment continues to improve and Fed remains supportive

## LONG-TERM FACTORS (36+ months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Valuation	←	●			Equity valuations above long-term averages but not a near-term driver
Business cycle		●			US recession expected given disruptions caused by COVID-19
Demographics			●		Mixed - US and emerging markets positive but developed international negative

Source: Brinker Capital. Information is accurate as of June 2, 2020. Themes and specific funds utilized to implement themes are discussed within the context of Brinker Capital's managed asset allocations and are based on current market conditions and constitute Brinker Capital's judgment and opinions, which are subject to change without notice. Past performance does not guarantee future results. Statements referring to future actions or events, such as the future financial performance of certain asset classes or market segments, are based on the current expectations and projections about future events provided by various sources, including Brinker Capital's Investment Management Group. These statements are not guarantees of future performance and actual events may differ materially from those discussed. Brinker Capital Inc., a registered investment advisor. MSCI AC World ex US Growth: An index made up of approximately the top 50% of the MSCI AC World ex US Index as composite ranked by five growth rates. This is a common proxy used to represent the growth segment of the developed international market. MSCI EAFE Index: A market-capitalized weighted index representing developed international equity markets located in Europe, Australia, Asia and Far East (EAFE). S&P 500 Index: An index consisting of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large-cap universe. Companies included in the Index are selected by the S&P Index Committee, a team of analysts and economists at Standard & Poor's. Barclays US Aggregate Index: A market capitalization-weighted index, maintained by Barclays Capital, and is often used to represent investment grade bonds being traded in the US. MSCI Emerging Markets: a float-adjusted market capitalization index representing 13% of global market capitalization. Captures mid and large cap across more than two dozen emerging market countries.