Market Review and Outlook

3Q2021

Market Review

After a strong first half to the year, risk assets experienced a pullback in performance and ended the third quarter with mixed results. The Delta variant weighed on the economic recovery as spikes in COVID-19 cases occurred across various regions. Concerns over rising inflation and slowing economic growth also served as headwinds. The Core PCE Index, the Federal Reserve's preferred measure of inflation, moved meaningfully higher during the quarter, as supply chain disruptions continued to persist. The Federal Reserve maintained its accommodative stance during its September meeting but appears likely to begin tapering asset purchases in November, with expectations of the first rate hike at the end of 2022. Fiscal stimulus measures also remained supportive but are nearing an inflection point with increasing odds of higher taxes and increased uncertainty surrounding the debt ceiling and government spending. As we move toward the end of the year, we expect economic growth to remain positive but at a more moderate pace.

The S&P 500 Index finished the third quarter slightly positive, gaining +0.6%, despite falling -4.7% in September. Year-to-date the Index gained +15.9%. Sector performance was mixed for the quarter. Financials (+2.7%) led returns, as rising interest rates at the end of the quarter served as tailwinds for the sector. Utilities (+1.8%), communications services (+1.6%), healthcare (+1.4%), and information technology (+1.3%) were also positive. Industrials (-4.2%) and materials (-3.5%) finished in negative territory as the sectors were hindered by weaker overseas growth and supply chain bottlenecks. Energy (-1.7%) was also negative during the quarter but favorable supply/demand dynamics has led the sector to gain +43.2% year-to-date. Growth outperformed value for the quarter but lags year-to-date. From a market capitalization perspective, large cap outperformed small and mid-cap equities.

Developed international equities, as measured by the MSCI EAFE Index, fell -0.4% during the third quarter but has gained +8.8% year-to-date. Similar to the US, central banks delivered a more hawkish tone. The Bank of England suggested UK rates could rise before year-end and the European Central Bank announced a reduction in the pace of its asset purchases under its pandemic emergency purchase program. Emerging markets, as measured by the MSCI Emerging Markets Index fell -8.0% in the third quarter. Delayed reopening and slower progress with vaccines hurt many countries within the region. China, a main driver of returns, declined -18.1% as the country faced meaningful challenges surrounding tighter regulatory policies and fears of contagion after the announcement of the potential default of a large Chinese property developer.

The Bloomberg US Aggregate Index, a proxy for investment grade fixed income, was flat for the third quarter and is down -1.6% year-to-date. After staying range-bound for the first two months, the 10-Year Treasury Yield moved higher in September, to end the quarter at 1.5%. High-yield credit spreads remained at historically low levels and outperformed the broad fixed income market, helped by record levels of issuance year-to-date. TIPS experienced the largest outperformance for the quarter as a rise in inflation expectations served as a tailwind. Municipals lagged taxable bonds for the quarter but lead year-to-date.

Market Outlook

The US economy is on track to experience growth in the second half of the year but concerns surrounding COVID-19 variants and less supportive fiscal and monetary policies may lead to higher volatility over the shorter-term. Inflation looks more persistent than transitory but could moderate if supply chain disruptions start to ease. Intermediate and long-term Treasury yields have recently moved higher but remain at historically low levels.

Consumer and business sentiment continue to improve, and earnings growth has reflected the strength in nominal GDP. The technical backdrop has also improved, with investor sentiment receding from recent high levels and seasonality becoming more favorable. Given the weight of the evidence, our overall outlook tilts positive over the near-term, which argues for a continued bias toward risk assets.

Brinker Capital Market Barometer

SHORT-TERM FACTORS (< 6 months)	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Momentum				●	Momentum remains positive although the rate of change is slowing
Trend				●	S&P 500 index dropped below 50-day moving average, but still in an uptrend
Investor sentiment	→		●		Bearish sentiment has increased; outflows from equity funds/ETFs
Seasonality		●			Seasonally weak period until end of October

INTERMEDIATE-TERM FACTORS (6-36 months)	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Fiscal policy				●	Remains supportive but watching for level of tax increases in final bill
Monetary policy				●	Fed has clearly communicated plan for tapering ('21) and potential rate hikes ('22)
Inflation			●		Inflation appears more persistent than transitory; supply chain issues remain
Interest rate environment				●	Treasury yields have risen modestly since August but remain at low levels
Macroeconomic				●	Economic strength on many fronts - employment, capex, personal income, housing
Business sentiment				●	Small business confidence remains at elevated level; labor shortage a concern
Consumer sentiment				●	Improved slightly in September; higher inflation weighing on purchases
Corporate earnings				●	Earnings picture remains strong; pace of growth may decelerate in 2H21
Credit environment				●	High yield spreads have remained relatively stable; credit conditions constructive

LONG-TERM FACTORS (36+ months)	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Valuation		●			Equity valuations above long-term averages but not a near-term driver
Business cycle				●	In an economic expansion period with positive GDP growth since 3Q20
Demographics			●		Mixed - US and emerging markets positive but developed international negative

Source: Brinker Capital. Information accurate as of October 4, 2021.

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