Brinker Capital

Economic Headwinds Tailwinds

We continue to approach our macro view as a balance between cyclical tailwinds and more structural headwinds. While we have seen some improvement in the economy and strong global equity markets, helped by easy monetary policy, we continue to face global macro risks and uncertainties. The unresolved risks could result in bouts of market volatility. As a result, portfolios have a modest defensive bias, and are focused on high conviction opportunities within asset classes.

A review of current market conditions and the headwinds and tailwinds driving the economic cycle.

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Tailwinds

Accommodative monetary policy: The Fed continues with their Quantitative Easing Program and will keep short-term rates on hold until they see a sustained pickup in employment. The European Central Bank has also pledged support to defend the Euro and has committed to sovereign bond purchases of countries who apply for aid. Now the Bank of Japan is embracing more monetary easing in an attempt to boost growth and inflation. The markets remain awash in liquidity.

U.S. companies remain in solid shape: U.S. companies have solid balance sheets that are flush with cash that could be put to work through M&A, capital expenditures or hiring, or returned to shareholders in the form of dividends or share buybacks. While estimates are coming down, profits are still at high levels.

Housing market improvement: There is evidence that the housing market has bottomed and could soon be in a position to contribute to economic growth. Prices have stabilized and sales have increased over last year. Homebuilder confidence is at levels last seen in 2007. Housing inventories have fallen. Low mortgage rates and rising rents have driven affordability to record levels; however, credit remains tight.

Headwinds

U.S. policy uncertainty continues: While the fiscal cliff deal resolved some of the uncertainty on the tax side, it sets up more fiscal policy uncertainty and drama in Washington in the first quarter. We are gearing up for a heated debate on the debt ceiling and sequester which need to be addressed by the end of February. The deal does little to address our long term unsustainable fiscal path, and a lack of a credible plan of action this year to stabilize our debt to GDP ratio may trigger another downgrade of our sovereign debt.

Fiscal drag: While the fiscal cliff deal did reduce the projected fiscal drag for 2013, there remains a drag of between 1.0-1.5% of GDP, primarily due to the expiration of the 2% payroll tax cut. All workers will feel this tax hit in their paychecks, reducing disposable income and in an economy growing at a sluggish pace, it will likely be felt.

European sovereign debt crisis and recession: The promise of bond purchases by the ECB has driven down borrowing costs for problem countries and bought policymakers time, but it cannot solve the underlying problems in Europe. Austerity measures are serving only to weaken growth further and cause higher unemployment and social unrest.

Sluggish global growth: There was evidence of slower global economic growth in the second half of 2012. The U.S. continues to muddle through at sub-3% growth, and even a reduced fiscal drag of 1.0-1.5% of GDP, primarily driven by the elimination of the payroll tax cut, will negatively impact growth in the first quarter of 2013. Europe is in recession territory. Evidence of a soft landing in China is mounting after growth weakened meaningfully last year. Weaker economic growth will flow through to weaker top line growth and weaker earnings.