Avalon Advisors' Weekly Market Guide
Week of April 1, 2019

Asset	YTD performance	Best since
S&P 500	13.07% ▲	1998
WTI crude	32.44 ▲	2002
U.S. high-yield credit	7.04 ▲	2003
Emerging-market dollar bonds	5.28 ▲	2012
U.S. investment-grade credit	5.23 ▲	1995

Source: Bloomberg
Note: Compares percentage-point gains with previous first quarters
Bloomberg

Source: Bloomberg, Avalon Advisors, LLC as of April 1, 2019

Chart of the Week: The 1Q returns for both stocks and bonds were the best in quite a few years (see chart). International developed and emerging stocks trailed the U.S. in 1Q but still posted close to double-digit gains. The S&P 500 has rebounded by almost 21% since the Christmas Eve 2018 low. Our analysis of rebounds following large declines since World War II puts this rebound at the high end of the typical at this point. Average rebounds have been up almost 17% at this point and only 13% in situations like the current one when the decline was not related to a recession. Our analysis would indicate that investors should not be surprised by some consolidation and the pace of gains should slow, but our history of rebounds still supports further gains for the year. Interestingly, there still remains quite a bit of buying power available with money market assets now at $3.1 trillion, which is the highest level since 2010. While the U.S. 10-year falling below 3-month yields (inversion) spooked the markets for a short time recently, those yields were no longer inverted at the end of last week. This inversion has given false signals of a recession in the past and Avalon will look for both a sustained inversion and other confirming signals before becoming overly concerned. Avalon still sees very little threat on recession in the U.S. over the next twelve months and the Chinese PMI data from over the weekend give an early sign that their stimulus might be working.

WEEK IN PREVIEW

- Geopolitical: Brexit activity continues after an unsuccessful third vote on PM May's European Union Withdrawal Agreement last week. The U.K. Parliament is likely to begin a series of indicative votes in a search for the path to an agreement prior to the new April 12 deadline. Markets continue to monitor the progress of the trade negotiations between the U.S. and China with China's Vice Premier Liu He headed to D.C. this week.
- U.S.: February retail sales started the week with the headline reading lower, but the data has been very noisy since the government shutdown and there were large January upward revisions. March ISM Manufacturing PMI will give us another current read on the economy and is expected to improve to a robust 54.5. March jobs data is expected to rebound from the weather-impacted February reading. Nonfarm payrolls are expected to increase by 175,000 while the unemployment rate remains at 3.8%. 1Q GDP estimates from the Atlanta and NY Fed stand at 1.71% and 1.31%.
- Europe: The Eurozone reports March consumer inflation and February producer inflation with both holding roughly steady at 1.5% and 3.1% year-over-year respectively. German February factory orders and industrial production are due to be released. Brexit negotiations are likely to continue to get the majority of the attention, but the U.K. reports March manufacturing, construction, services and composite PMIs.
- Asia: Japan 1Q Tankan manufacturing reports were generally weaker than last quarter. March services and composite PMIs provide another nowcast of the current state of the economy. China reported March official PMI data over the weekend surprised to the upside with the manufacturing component rising sharply to 50.5 from 49.2 which was the biggest jump since 2012. The Caixin manufacturing PMI at 50.8 also confirmed the upside surprise.
- Central Banks: The central banks of Australia, Ghana, Uganda, Romania, Poland and India meet with only India expected to change their monetary policy rate with a cut of 0.25% to 6.00% for their repurchase rate.

WEEK IN REVIEW

- The S&P 500 posted a gain of almost 1.2% for the week to cap off a very strong 1Q. Please see our Chart of the Week for more details on the quarter. Industrials, materials and consumer discretionary were leading sectors while communications services and utilities were laggards. WTI and Brent oil prices were higher with energy stocks lagging the S&P 500 and MLPs down fractionally. Small cap stocks outperformed with the Russell 2000 up 2.25%. The 10-year U.S. Treasury yield fell to 2.41% and high yield credit spreads reflecting increased risk tolerance by narrowing.
- Developed international stock indexes underperformed the S&P 500 in both U.S. dollar and hedged-currency terms. On a hedged-currency basis, developed market stocks were up 0.5%. The U.S. dollar was stronger against developed and emerging market currencies. The non-hedged stock returns were -0.4% for MSCI EAFE and -0.1% for MSCI Emerging Markets.
- The 10-2 yield curve widened and ended at 13.9 basis points. Another curve measure of three-month yield six quarters forward – three-month yield continues to be inverted at -24.4 basis points. The yield curve has historically provided an accurate forecast of future recessions when the difference in these measures turns negative, also known as inversion. Yield curves are one of the major indicators that we monitor to judge recession risk, but these inversions typically happen a year or more in advance of an economic recession. In addition, stocks have historically had significant advances post-inversion. The three-month yield six quarters forward yield is now reflecting that the market expects perhaps one net cut in short-term rates over the next year and a half. Much of the decline in the forward-looking three-month yield came in response to the weak European economic data, so it might be an overreaction. Our view remains that the odds of a recession in 2019 remain low and Avalon expects no rate hikes from the Federal Reserve in 2019. Avalon continues to monitor the data closely. Please see our **Avalon Perspectives** publication, *The Yield Curve and Equity Returns*, from April 26, 2018, for more details.

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