Chart of the Week: Is the global economic slowdown over? It seems likely in our view even though it hasn't shown up widely in the hard data yet. While the April manufacturing PMIs for the Eurozone and Japan remain below the contraction level of 50 (see chart), there is reason for optimism under the surface. Both measures did improve month-over-month after eight straight monthly declines for the Eurozone measure and Japan peaking in January 2018. In addition, the forward-looking expectations component of the recent ZEW survey reported last week bodes well for our Eurozone view. The German IFO expectations rose last month and April readings should continue to improve this week. China is the major force in our forecast since it accounts for the majority of GDP growth and has an outsized impact on Europe and Japan. China continued its string of better than expected economic data with improvements in March industrial production and retail sales plus better 1Q GDP last week. The U.S. posted very robust March retail sales growth and initial jobless claims fell to a fresh 49-year low at 192,000. U.S. 1Q GDP growth should be around 2% which would be a good start to the year in what is typically a seasonally-weak quarter. The S&P 500 1Q earnings season is still in its early stages, but earnings expectations have been improving week-over-week and forecasts for 2019 growth have stabilized after declining since the year began.

Source: Bloomberg, Avalon Investment & Advisory as of April 22, 2019

WEEK IN PREVIEW

- Geopolitical: Holiday shortened trading week in some parts of the world with markets closed on Easter Monday. Markets continue to monitor the progress of the trade negotiations between the U.S. and China, the next meetings are scheduled the week of April 29 in Beijing.
- U.S.: March housing data: existing home sales and new home sales are expected to reflect some softness. March durable goods orders are expected to rebound for both the headline and excluding transportation. First look at 1Q GDP which consensus expects at 2.2% growth. 1Q GDP estimates from the Atlanta and NY Fed stand at 2.77% and 1.37%, respectively.
- 1Q S&P 500 Earnings: 15% of companies have now reported and 78% and 53% have beaten earnings and sales expectations, respectively. Earnings are expected to decline -3.9% year-over-year versus -4.3% last week, while sales expectations improved to 5.0% growth from 4.8%. The improvements were again driven by the financials. The pace of earnings reports really picks up this week with a broad range of industries reporting. One hundred and fifty S&P 500 companies report including AMZN, FB, MSFT, CAT, BA, CVX, XOM, PG, BMY, KO and SBUX.
- Europe: The European Central Bank releases their economic bulletin with their economic views. Eurozone reports April consumer confidence and Germany has the IFO sentiment data on tap. Despite the October 31 Brexit deadline, the path to an agreement remains unclear. Brexit without an agreement remains a low probability in our view; even the U.K. remaining in the European Union has a higher likelihood.
- Asia: Japan reports March labor market data. In addition, March readings on industrial production and retail sales are expected. Bank of Japan meets with no change to their policy rate or 10-year yield target expected. China calendar is very light with only March industrial profits.
- Central Banks: In addition to the Bank of Japan, the central banks of Canada, Botswana, Guatemala, Indonesia, Sweden, Ukraine, Turkey, Mozambique, Russia and Colombia meet with only Ukraine expected to change to monetary policy rate with a cut.

WEEK IN REVIEW

- The S&P 500 posted a small decline with losses of almost 0.1%. Sector returns were very bifurcated with industrials, technology and consumer staples posting nice gains. Healthcare and yield-oriented sectors like real estate, utilities and MLPs were punished last week. WTI and Brent oil prices were higher with energy stocks lower on the week. Small cap stocks underperformed with the Russell 2000 down -1.20%. The 10-year U.S. Treasury yield fell slightly to 2.56% and high yield credit spreads reflecting decreased risk tolerance by widening.
- Developed international stock indexes outperformed the S&P 500 in U.S. dollar terms. On a hedged-currency basis, developed market stocks were up 0.80%. The U.S. dollar was stronger against developed and emerging market currencies. The non-hedged stock returns were 0.27% for MSCI EAFE and 0.32% for MSCI Emerging Markets.
- The 10-2 yield curve widened and ended at 17.7 basis points. Another curve measure of three-month yield six quarters forward – three-month yield continues to be inverted at -7.3 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 little net change 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 and it has been retracing much of the decline as better U.S. and Chinese data are reported. 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.

Henry J. Lartigue, CFA
Managing Partner

Samuel E. Rines
Chief Economist

Bill Stone, CFA, CMT
Chief Investment Officer

DISCLOSURES