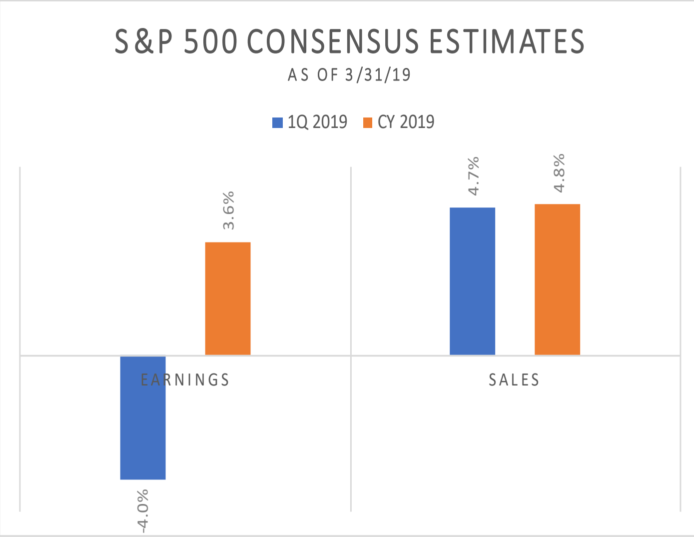

Chart of the Week: Though only six S&P 500 companies are expected to report earnings this week, this marks the start of 1Q earnings season. The financial sector kicks off the earnings season with JPM, PNC and WFC scheduled on Friday. S&P 500 earnings are expected to post a -4% year-over-year (Y/Y) decline for the quarter (see chart). This would be the first quarterly Y/Y decline in earnings since 2Q 2016. While Avalon doesn't expect as large of a Y/Y decline as the consensus, it would still not surprise us to see a small decline. Three sectors are actually expected to report double-digit earnings declines in 1Q: technology, materials and energy. The good news is that we don't expect a real earnings recession with the earnings picture brightening as the year progresses. Consensus expects a 3.6% Y/Y earnings increase for calendar year (CY) 2019 and Avalon retains our forecast of 5% Y/Y gains. For CY 2019, the consensus forecast calls for only two sectors to post earnings declines: materials and energy. A rebound in U.S. job growth and March China PMI data, posting its biggest jump since 2012, reduced worries about global economic growth last week. S&P 500 earnings estimates for CY 2019 have been trending lower all year but moved higher last week as growth prospects seemed to improve globally. Avalon still sees very little threat of recession in the U.S. over the next twelve months and there are now signs that a Chinese stimulus has started to make an economic impact.

Source: FactSet, Avalon Advisors, LLC as of April 8, 2019

WEEK IN PREVIEW

- Geopolitical: The European Union (EU) is holding an emergency Brexit summit to consider U.K. PM May's request for another extension to June 30 with the current extension expiring on April 12. Recent headlines have been optimistic, but markets will continue to monitor the progress of the trade negotiations between the U.S. and China closely. Israel and India hold general elections. The International Monetary Fund releases its updated world economic outlook on Tuesday.
- U.S.: March inflation data is on tap with both consumer (CPI) and producer (PPI) inflation expected to firm slightly but remain well-contained. Michigan sentiment for April is expected to moderate slightly but remain at a high level. 1Q GDP estimates from the Atlanta and NY Fed stand at 2.07% and 1.40%. Fedspeak on the calendar with minutes from the FOMC meeting expected to give more details about the Federal Reserve's dovish shift and six scheduled speeches add to the mosaic of monetary policy information.
- Europe: The European Central Bank (ECB) meets with no change in monetary policy rates as a foregone conclusion. An additional long-term bank loan program was approved at the last ECB meeting but is not slated to begin operating until September. The Eurozone reports February industrial production which is expected to decline. German February trade data are due to be released. Brexit negotiations are likely to get most of the attention with PM May hoping to secure an extension and Brexit by May 22 before the EU holds parliamentary elections. The U.K. reports February industrial and manufacturing production.
- Asia: Japan reports March PPI along with money supply and machine tool orders. China reported a small increase in March foreign currency reserves. March inflation data, both PPI and CPI, along with trade data are expected from China as well.
- Central Banks: In addition to the ECB, the central banks of Sri Lanka, Israel, Serbia, Namibia and Peru meet with no expected changes to monetary policy rates.

WEEK IN REVIEW

- The S&P 500 posted a gain of almost 2.1% to continue the momentum after a very strong 1Q. Fewer worries about global growth due to the combination of last week's better U.S. employment data and signs of Chinese economic acceleration helped boost stocks. Materials, financials and consumer discretionary were leading sectors while consumer staples and utilities were laggards. WTI and Brent oil prices were higher with energy stocks outperforming the S&P 500 and MLPs rising almost 1.3%. Small cap stocks outperformed with the Russell 2000 up almost 2.8%. The 10-year U.S. Treasury yield rose to almost 2.5% and high yield credit spreads reflecting increased risk tolerance by narrowing.
- Developed international stock indexes underperformed the S&P 500 in U.S. dollar terms due to an appreciating dollar. On a hedged-currency basis, developed market stocks were up 2.3%. The U.S. dollar was weaker against emerging market currencies though. The non-hedged stock returns were 1.9% for MSCI EAFE and 2.6% for MSCI Emerging Markets.
- The 10-2 yield curve widened and ended at 15.2 basis points. Another curve measure of three-month yield six quarters forward – three-month yield continues to be inverted at -14.1 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 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