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Avalon Advisors' Weekly Market Guide
Week of December 24, 2018

Recession Years	S&P 500 Peak	Peak Date	S&P 500 Trough	Trough Date	Decline Duration	S&P 500 Decline
1948-1949	17	6/15/1948	14	6/13/1949	363	-20.6%
1953-1954	27	1/5/1953	23	9/14/1953	252	-14.8%
1957-1958	50	8/2/1956	39	10/22/1957	446	-21.6%
1960-1961	61	8/3/1959	52	10/25/1960	449	-13.9%
1969-1970	108	11/29/1968	69	5/26/1970	543	-36.1%
1974-1975	111	10/12/1973	62	10/3/1974	356	-44.1%
1980	118	2/13/1980	98	3/27/1980	43	-17.1%
1981-1982	141	11/28/1980	102	8/9/1982	619	-27.1%
1990-1991	369	7/16/1990	295	10/11/1990	87	-19.9%
2001	1527	3/24/2000	777	10/9/2002	929	-49.1%
2007-2009	1565	10/9/2007	677	3/9/2009	517	-56.8%
Mean					**419**	**-29.2%**
Median					**446**	**-21.6%**

Source: Bloomberg, NBER, Avalon Advisors, LLC

Chart of the Week: The S&P 500 has declined 17.5% from its September 20 peak and is nearing in on the 20% decline that many define as a bear market. Historically, the S&P 500 has seen declines of 20% on average about every three years since 1928 but has gone more than nine years without one in the current cycle. This current respite was well earned after the almost 60% decline in stocks during the Great Recession. While there doesn't need to be a recession for stocks to decline 20%, the vast majority of the worst declines in U.S. stock market history are associated with a recession. Our chart looks at the S&P 500 declines associated with recession since World War II. Interestingly, the typical decline is a bit over 20% with the larger declines associated with severe economic distress like inflation, the tech bubble and financial crisis. While it is a fool's errand to try to time the market, it does seem likely that this market correction is closer to its end than beginning if our view on the economy is correct. Avalon still believes the risk of recession remains low over the next twelve months, though U.S. growth is certainly slowing from its torrid second quarter pace. U.S. stock valuations (see below) are not cheap by absolute standards but have become significantly undervalued relative to corporate bond yields. With return to a more normal monetary policy along with a slowing global economy, it seems likely that volatility will persist for some time.

WEEK IN PREVIEW

Wishing you and yours a Merry Christmas and a prosperous New Year!

- Geopolitical: The partial shutdown of the U.S. government may continue, but these situations typically do not have a serious negative impact on stocks. Markets will also be focused on any additional news impacting the trade negotiations between the U.S. and China.
- U.S.: November new and pending home sales are expected to improve. The Conference Board reports December consumer confidence which should decline slightly but remain at elevated levels. 4Q GDP estimates from the Atlanta and NY Fed are 2.71% and 2.48%.
- Stock Valuation: While valuation is a poor timing tool, valuations on stocks are the most attractive in years. The estimated 2018 S&P 500 price-to-earnings ratio is the lowest in over five years, and it is a similar story for most markets shown below.

Name	Est P/E	Est P/B	Est P/CF	Est Dvd Yld	Est P/S
S&P 500 INDEX	14.83	2.78	10.76	2.25	1.79
MSCI ACWI	13.55	1.93	9.23	2.88	1.37
MSCI EUROPE	12.82	1.55	7.95	4.18	1.08
MSCI EAFE	12.63	1.41	8.13	3.84	1.04
MSCI ACWI xUSA	12.23	1.43	7.86	3.63	1.08
MSCI UK	11.88	1.55	8.00	5.10	1.02
MSCI JAPAN	11.35	1.11	7.32	2.65	0.74
MSCI EM	11.24	1.45	7.17	3.11	1.13
MSCI CHINA	11.22	1.45	7.49	2.65	1.25

- Europe: The European Central Bank releases an economic bulletin which provides analysis of economic data and monetary policy.
- Asia: Japan's November releases include employment data along with retail sales and industrial production. China reports November industrial profits.
- Central Banks: The central banks of Sri Lanka and Egypt meet.

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WEEK IN REVIEW

- Ugly decline in stocks with the S&P 500 falling over 7%. Worries about global economic growth along with fears of a Federal Reserve policy error weighed heavily on stocks. Please see our **Avalon Perspectives** publication, *The Federal Reserve Raises Rates*, from December 19, 2018 for more on the Fed's miscommunication with the markets last week. Energy stocks were hit very hard with WTI and Brent oil prices both lower by over 10%. Small cap stocks underperformed with the Russell 2000 down 8.4%. The 10-year U.S. Treasury yield fell to 2.79% and credit spreads widened reflecting the flight to safety.
- Both developed international and emerging market stock indexes were lower but significantly outperformed the S&P 500 on both a hedged and unhedged-currency basis. The U.S. dollar was weaker against both developed and emerging market currencies which increased their non-hedged stock returns.
- The 10-2 yield curve narrowed slightly and ended at 14.7 basis points. Another curve measure of three-month yield six quarters forward – three-month yield narrowed to 28.8 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 any economic recession. While a future inversion came closer last week, it still hasn't started the countdown clock. In addition, stocks have historically had significant advances post-inversion. Please see our **Avalon Perspectives** publication, *The Yield Curve and Equity Returns*, from April 26, 2018 for more details.

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DISCLOSURES