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.

- **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.
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.

Henry J. Lartigue, CFA
Co-Chief Investment Officer

Samuel E. Rines
Chief Economist

Bill Stone, CFA, CMT
Co-Chief Investment Officer

DISCLOSURES

This report is furnished for the use of Avalon Advisors, LLC and its clients and does not constitute the provision of investment or economic advice to any person. Persons reading this report should consult with their investment advisor regarding the appropriateness of investing in any securities or adopting any investment strategies discussed or recommended in this report. Statements regarding future prospects may not be realized. The information contained in this report was obtained from sources deemed reliable. Such information is not guaranteed as to its accuracy, timeliness, or completeness by Avalon Advisors, LLC. The information contained in this report and the opinions expressed herein are subject to change without notice. Past performance is no guarantee of future results. Neither the information in this report nor any opinion expressed herein constitutes an offer to buy or sell, nor a recommendation to buy or sell, any security or financial instrument. Avalon Advisors, LLC does not provide legal, tax, or accounting advice. ©2018 Avalon Advisors, LLC. All rights reserved.