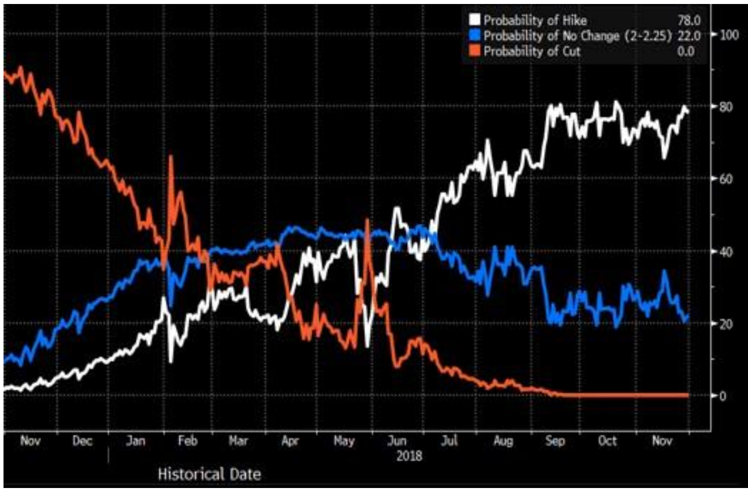

Source: Bloomberg, Avalon Advisors, LLC

Chart of the Week: As we noted last week, fears of a policy error by the Federal Reserve (Fed) and the impact of trade policies have caused worries about the future path of the global economy. In addition, the sharp decline in the price of oil since the start of October has added to those concerns about the global economy. While data last week continues to point to a U.S. and global economy losing some momentum, markets were cheered by the change in tone from Fed Chairman Powell. His comments noted that interest rates are "just below" neutral rather than his previous view of a "long way from neutral." This implies less rate hikes than previously thought and reduces the probability of a policy error, so stocks rallied strongly as a result. Avalon expects the Fed to still hike by 0.25% in December and the market is pricing in a high probability of hike (see chart). In addition, Avalon forecasts two more rate hikes in 2019.

WEEK IN PREVIEW

- Geopolitical: President Trump and Chinese president Xi agreed to a 90 day pause in the trade war at the G-20 Leaders' Summit. Markets will cheer the delay in the move to 25% from 10% tariffs and the possibility of a deal coming from this negotiating period. If a stopgap deal isn't reached or appropriation bills approved by the end of the week, the U.S. government faces a partial shutdown. OPEC meets on Thursday and Friday with oil markets monitoring the implications for production.
- U.S.: November ISM reports should indicate a U.S. economy losing some momentum but remaining at robust readings. November vehicle sales are released. The main event for data is on Friday with the November job report. Nonfarm payroll growth should slow from the October level, but still expected to grow by 199,000. Wages are expected to hold steady at a 3.1% year-over-year (Y/Y) rate. 4Q GDP estimates from the Atlanta and NY Fed are 2.62% and 2.50%. U.S. markets are closed on Wednesday in memory of the passing of President George H.W. Bush.
- Fedspeak: There are several Fed speaking events. The most closely monitored will be Chair Powell's testimony to Congress on Wednesday. Powell is not likely to deviate from the more dovish views noted in the **Chart of the Week** and reiterate that "there is no preset policy path". The Fed releases the Beige Book on Wednesday as well.
- Europe: Eurozone October retail sales should improve to 2.0% Y/Y. Germany has the October industrial production which should accelerate to 2.1% Y/Y. The U.K. releases their November PMI readings with manufacturing, services and the composite expected to improve.
- Asia: Japan's October leading and coincident indexes should both improve and indicate a recovery from the GDP decline in 3Q. November services and composite PMI are released. November China (Caixin) manufacturing PMI held steady at 50.1, just above the growth/contraction level of 50. Caixin services and composite PMI are also expected to remain steady.
- The central banks of Australia, Kazakhstan, Chile, Botswana, India, Canada, Namibia, Poland and Serbia meet with all expected to hold their policy rates steady.

Avalon Advisors, LLC
2929 Allen Parkway Suite 3000, Houston, TX 77019 | 713.238.2050
755 Mulberry Avenue Suite 105, San Antonio, TX 78212 | 210.694.4329
www.avalonadvisors.com

Publication Date: 12/3/18

WEEK IN REVIEW

- Sharp recovery in stocks with the S&P 500 rising almost 4.9%. As noted in the **Chart of the Week**, Fed Chair Powell's comments helped ignite the rally. Healthcare, technology and consumer discretionary stocks were the strongest sectors. Price momentum stocks were also particularly strong. Small cap stocks underperformed with the Russell 2000 up almost 3%. WTI oil was modestly higher but still below $51 per barrel. The 10-year U.S. Treasury yield fell to 2.99%.
- Both developed international and emerging market stock indexes were higher but underperformed the S&P 500. The U.S. dollar was stronger against developed currencies which hurt non-hedged returns from developed international stocks, but emerging market currencies were stronger which benefitted their stock returns. Japanese stocks remained a standout within developed markets last week.
- The 10-2 yield curve flattened and ended at 19.9 basis points, but our other curve measure of three-month yield six quarters forward – three-month yield widened to 57.7 basis points. The yield curve has historically provided an accurate forecast of future recessions when the difference in these measures turns negative. Yield curves are one of the major indicators that we monitor to judge recession risk.

Henry J. Lartigue, CFA
Co-Chief Investment Officer

Samuel E. Rines
Chief Economist

Bill Stone, CFA, CMT
Co-Chief Investment Officer

DISCLOSURES