Wishing everyone a happy and prosperous New Year in 2019!

- Geopolitical: Most of the world markets will be closed early in the week to celebrate the beginning of 2019. The partial shutdown of the U.S. government continues, but these shutdowns typically do not have a serious negative impact on stocks. The new U.S. Congress begins on January 3. Markets will also be focused on any additional news impacting the trade negotiations between the U.S. and China after some optimistic news on that front over the weekend.

- U.S.: December ISM manufacturing readings are expected to moderate to around 58.0, but still well above the line of demarcation at 50.0 for economic contraction in interpreting PMI readings. The ISM reading should continue to reinforce Avalon’s “slowing but growing” view regarding the U.S. and global economy. Some U.S. economic data is delayed due to the partial government shutdown, but the important December employment report is not impacted. Payrolls are expected to grow by 180,000 while the unemployment rate stays steady at 3.7%. The latest 4Q GDP estimates from the Atlanta and NY Fed are 2.71% and 2.48%.

- Fedspreak: Federal Reserve Chairman Powell along with ex-Chairs Bernanke and Yellen speak on Friday. Markets will be particularly listening to Powell for confirmation of a pause in rate hikes to start 2019.

- Europe: Eurozone December consumer inflation (CPI) should slow to 1.8% year-over-year. U.K December manufacturing PMI should moderate to 52.5 while services improves slightly to 50.7.

- Asia: December official manufacturing and non-manufacturing PMI readings were 49.4 and 53.8 versus 50.0 and 53.2 in November as China continues to struggle to keep the economic growth engine going. The Caixin version of the December PMI readings are released this week.

- Central Banks: The central banks of Bulgaria and Dominican Republic meet.
WEEK IN REVIEW

• Roller coaster ride for the S&P 500 during the Christmas holiday-shortened week but ended up gaining 2.9%. Consumer discretionary, technology and communications services were the leading sectors. Energy stocks were laggards with WTI and Brent oil prices both lower. Small cap stocks outperformed with the Russell 2000 up 3.6%. The 10-year U.S. Treasury yield fell to 2.72% and credit spreads widened slightly.

• Both developed international and emerging market stock indexes were higher but significantly underperformed 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 widened and ended at 19.8 basis points. Another curve measure of three-month yield six quarters forward – three-month yield narrowed to 10.5 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 by one of our measures 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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