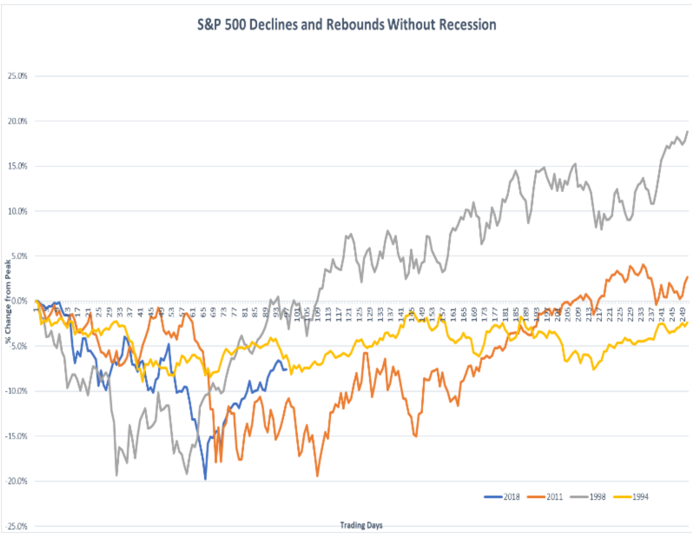

Source: Bloomberg, Avalon Advisors, LLC

Chart of the Week: In our Chart of the Week on December 31, 2018 we wrote about historical stock returns after a roughly 20% or more decline from the peak. Our analysis showed that on average, investor returns were positive over the next ninety days, one-year and three-years if one purchased after these roughly 20% declines even if the decline ended up continuing further. The recession-related scenarios were more challenging in the short-run but ended up at a similar three-year positive return. At the time our opinion was that no recession was imminent in the U.S., so the non-recession scenario was more likely. With this analysis in mind and the economic data continuing to support our no recession case as we noted again last week, this chart looks at the returns following the non-recession peaks of 1998 and 2011 along with 2018. If history is any guide, the sharp rebound we have experienced since the late 2018 bottom is not out of place. The chart of 1994 was added since that year shared some of the same issues as 2018 around trade disputes and Federal Reserve hikes. The decline off peak was not nearly as severe in 1994 at -9% and the S&P 500 meandered around for the remainder of the year before ramping in 1995 with a calendar year gain of over 34%. In any case it would not be a surprise based on past experiences to see more stock volatility even if the market ends 2019 with a positive return as we expect is the most likely outcome.

WEEK IN PREVIEW

- Geopolitical: Markets should continue to respond to additional news from trade negotiations with U.S. Trade Representative Lighthizer and Treasury Secretary Mnuchin headed to Beijing this week ahead of the March 1 tariff deadline. The next partial U.S. government shutdown starts at midnight on February 15 unless another spending bill is passed. U.K. parliament is expected to vote on alternate Brexit legislation with Avalon not expecting a no deal Brexit despite the lack of deal to date.
- U.S.: Delayed economic data continues to trickle in due to the residual impact of the partial government shutdown. January consumer (CPI) and producer (PPI) inflation are expected to slow to 1.5% and 2.1% year-over-year (Y/Y). December headline retail sales are only expected to grow by 0.1% for the month but lower gasoline prices likely disguise the underlying strength. The latest 4Q GDP estimates from the Atlanta and NY Fed are 2.73% and 2.41%. Nine speeches by Federal Reserve members are scheduled.
- 4Q S&P 500 Earnings: 66% have reported so far with 71% and 62% beating earnings and sales estimates respectively. Blended earnings and sales estimates rose to 13.3% and 7.0% year-over-year (Y/Y) primarily due to some better than expected energy and communications services earnings. 65 S&P 500 companies report earnings including NVDA, CSCO, KO, AIG and DUK.
- Europe: U.K. 4Q GDP came in below estimates at 1.3% Y/Y, down from 1.5%. The Eurozone and Germany report 4Q GDP expected at 1.2% and 0.8% Y/Y. The U.K. reports January CPI, PPI and retail sales, but Brexit is likely to continue to dominate with the official Brexit date of March 29.
- Asia: Japan 4Q GDP should move back into the positive at 1.4% Y/Y. China reports January loan data along with currency reserves and trade data. Trade data will be watched due to the negotiations with the U.S. along with trying to judge the extent of China's economic slowdown.
- Central Banks: The central banks of New Zealand, Sweden, Namibia and Egypt meet with no expected changes in monetary policy rates.

WEEK IN REVIEW

- The S&P 500 continued its winning ways for 2019 thanks to a Friday afternoon ramp squeaking out a 0.1% gain for the week. Utilities, industrials and real estate were leading sectors. Both WTI and Brent oil prices were lower which sent energy stocks sharply lower despite strong 4Q earnings. Small cap stocks outperformed with the Russell 2000 up 0.3%. The 10-year U.S. Treasury yield fell to 2.63% and high yield credit spreads were little changed.
- Developed and emerging international stocks indexes underperformed the S&P 500 in U.S. dollar terms and on a hedged-currency basis. The U.S. dollar was stronger against both developed and emerging market currencies which decreased their non-hedged stock returns to -1.4% for MSCI EAFE and -1.4% for MSCI Emerging Markets.
- The 10-2 yield curve narrowed and ended at 16.5 basis points. Another curve measure of three-month yield six quarters forward – three-month yield narrowed to 0.2 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. 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 at most one net hike in short-term rates over the next year and a half. Our view remains that the odds of recession in 2019 remain low and expect perhaps only one hike from the Federal Reserve later 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.

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