



Chart of the Week: The December retail sales released last Thursday were shockingly weak with an annualized decline of more than 4% for the control group which is used for consumer spending data in the GDP calculations. Avalon expected some deceleration in retail sales due to various factors including the government shutdown and the early Thanksgiving holiday but certainly not to the extent reported. Stocks reacted to the numbers by selling off at the open and the Atlanta Fed's estimate of 4Q GDP fell to 1.53% from 2.73% due primarily to the poor retail sales numbers. Avalon's chief economist, Sam Rines, wrote about the issue on Thursday and Friday morning. There are many reasons to look at the very weak retail sales with a jaundiced eye including the strong Johnson Redbook index and 4Q Walmart sales which were the best in more than a decade. Our analysis indicates that the December retail sales data are likely to be revised higher. There is also good reason to believe that even if it is not revised away, the December retail sales will turn out to be an outlier. Multiple other indicators (chart) point to the U.S. consumer continuing to be a strong part of economic growth when the January data is released toward the end of February. On Friday, February consumer sentiment rebounded even further which helped stocks continue to shrug off the grim December retail sales data and supported our case that you should do the same.

Source: Goldman Sachs, Avalon Advisors, LLC, as of February 19, 2019

WEEK IN PREVIEW

- **Geopolitical:** Markets were helped last week as the talks seemed to make some progress with further trade negotiations between China and the U.S. continuing this week in D.C. ahead of the March 1 tariff deadline. European Union ambassadors meet to discuss Brexit status.
- **U.S.:** December durable goods orders are expected to accelerate to 1.8%. January existing home sales should grow slightly. February Markit Manufacturing PMI should give us a glimpse at the current state of the economy with the consensus expecting an improvement to 55.0, well above the 50.0 line of demarcation between signaling growth or contraction. The latest 4Q GDP estimates from the Atlanta and NY Fed are 1.53% and 2.23%. Eleven speeches by Federal Reserve members are scheduled and the minutes of the last FOMC meeting are released.
- **4Q S&P 500 Earnings:** 79% have reported so far with 70% and 62% beating earnings and sales estimates respectively. Blended earnings estimates declined slightly to 13.1% year-over-year (Y/Y) primarily due to some worse than expected earnings from AIG and Loews Corp. Sales held steady at 7.0% Y/Y. Forty-nine S&P 500 companies report earnings including BRK/A, WMT and CVS.
- **Europe:** Eurozone January consumer inflation (CPI) is expected to decelerate to 1.4% Y/Y. February Eurozone manufacturing PMI is forecast to decline to 50.3 from 50.5. Germany reports February ZEW expectation improved slightly and IFO will also be watched for some sign of an economic bounce. U.K. December unemployment held steady at 4%. Brexit is likely to continue to dominate with the official Brexit date of March 29. U.K. parliament is expecting a February 27 vote on Brexit legislation with Avalon not expecting a no deal Brexit despite the lack of a deal to date.
- **Asia:** China has no significant releases. Japan reports January trade data with exports and imports expected to fall Y/Y. January CPI from Japan should continue to reflect no significant pressure at 0.2% Y/Y. Japan manufacturing PMI for February will be released with January last at 50.3.
- **Central Banks:** The central banks of Zambia, Guatemala, Indonesia, Sri Lanka and Mauritius meet with no expected changes in monetary policy rates.

WEEK IN REVIEW

- The S&P 500 continued to surprise with its strength and a 2.5% gain for the week. Energy, industrials and materials were leading sectors. Both WTI and Brent oil prices were high which sent energy stocks and MLPs sharply higher. Small cap stocks outperformed with the Russell 2000 up 4.2%. The 10-year U.S. Treasury yield rose to 2.66% and high yield credit spreads narrowed.
- Developed and emerging international stocks indexes underperformed the S&P 500 in U.S. dollar terms. On a hedged-currency basis, developed market stocks were +2.6% due to strength from Europe and Japan. The U.S. dollar was stronger against both developed and emerging market currencies which decreased their non-hedged stock returns to 2% for MSCI EAFE and -0.5% for MSCI Emerging Markets.
- The 10-2 yield curve narrowed and ended at 14.2 basis points. Another curve measure of three-month yield six quarters forward – three-month yield widened to 7.8 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 an 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 a 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.

Henry J. Lartigue, CFA
Managing Partner

Samuel E. Rines
Chief Economist

Bill Stone, CFA, CMT
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. ©2019 Avalon Advisors, LLC. All rights reserved.