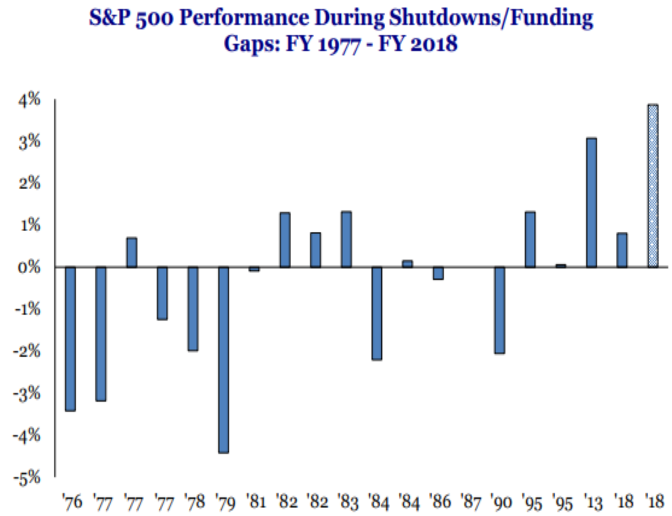

Source: Strategas Research Partners

Chart of the Week: With the partial government shutdown entering its third week, the history of market performance during these shutdowns becomes more interesting. Strategas Research Partners notes that the average government shutdown since 1976 has lasted almost seven days, so we are well past that now. The length of the shutdown does not seem to be correlated with S&P 500 losses or gains, however. In fact, the S&P 500 actually rose in two of the three longest shutdowns (1978, 1995 & 2013) in our history presented in this chart. So far, the S&P 500 has gained 4.8% since the current partial government shutdown began on December 22. While news surrounding the shutdown may add to market volatility on the margin, the markets are more broadly likely to be driven in the short-term by views regarding the strength of the global economy and trade negotiations along with future U.S. Federal Reserve expected policy path. Long-term stocks tend to move with corporate earnings which are likely to grow by more than 11% and 20% year-over-year for the fourth quarter and 2018 respectively. Looking forward, Avalon estimates 5% S&P 500 earnings growth in 2019 but we'll be monitoring company guidance and economic data closely. Three S&P 500 companies are scheduled to report fourth quarter earnings this week, but the season begins in earnest next week with many of the large financials releasing their earnings.

WEEK IN PREVIEW

- Geopolitical: Markets will be focused on any news from the U.S. and China trade negotiations. The U.S. trade delegation begins negotiations with Chinese officials in Beijing beginning today. The World Bank releases updated global economic forecasts on Tuesday.
- U.S.: Some U.S. economic data is delayed due to the partial government shutdown. December ISM non-manufacturing readings are expected to moderate to around 59.0, 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. Consumer inflation (CPI) in December should reflect the impact of falling energy prices, declining to 1.9% year-over-year from 2.2%. The latest 4Q GDP estimates from the Atlanta and NY Fed are 2.59% and 2.49%.
- Fedspeak: The FOMC minutes from the last rate hike are released but will be of less interest than normal after Federal Reserve Chairman Powell's comments last week stressing "patience and flexibility" around future rate increases. Powell speaks again on Thursday and will likely stick to the script that gave markets comfort in expecting a significant pause in rate hikes.
- Europe: Eurozone unemployment rate for November should hold steady at 8.1%. Minutes from the European Central Bank meeting, where it phased out additional asset purchases, will be released. News regarding the upcoming Brexit vote on or about January 15 in the House of Commons will continue to impact markets.
- Asia: December Japan composite and services PMI declined to 52.0 and 51.0 versus 52.4 and 52.3 in November. China reported December foreign currency reserves that grew slightly with CPI and producer inflation expected midweek.
- Central Banks: The central banks of Israel, Romania, Canada, Poland, Serbia and Peru meet with none expected to change monetary policy rates.

WEEK IN REVIEW

- Another roller coaster ride for the S&P 500 during the New Year's holiday-shortened week but it ended up gaining 1.9%. Weak ISM manufacturing and Apple's revenue warning weighed on stocks before Federal Reserve Chairman Powell's comments and a strong U.S. jobs report sent stocks soaring on Friday. Energy, communications services and consumer discretionary were the leading sectors. Both WTI and Brent oil prices were both significantly higher. Small cap stocks outperformed with the Russell 2000 up 3.2%. The 10-year U.S. Treasury yield fell to 2.67% and high yield credit spreads narrowed.
- Both developed international and emerging market stock indexes were higher in U.S. dollar terms but 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. Emerging market stocks declined last week on a local currency (currency-hedged) basis. The People's Bank of China increased economic stimulus and liquidity by announcing a one percentage point cut in the bank reserve requirement.
- The 10-2 yield curve narrowed and ended at 17.2 basis points. Another curve measure of three-month yield six quarters forward – three-month yield narrowed to 1.4 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 no rate hikes over the next year and a half and is beginning to price in the possibility of a cut at some point during that period. Our view remains that the odds of recession in 2019 remain low but 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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