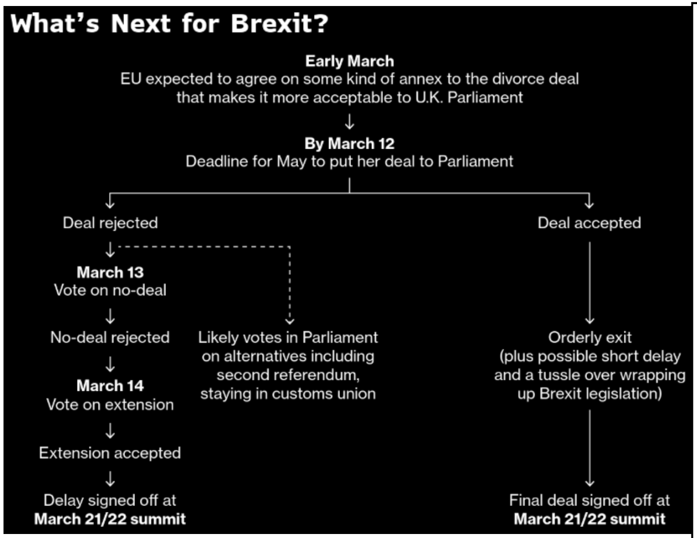

Chart of the Week: Brexit action heats up this week as the current deadline for a U.K. exit from the European Union (E.U.) is March 29. Our chart of the week uses a flow chart from Bloomberg to map out the likely series of events. The U.K. is expected to vote Tuesday on PM May's revised Brexit deal. It seems unlikely that the Brexit agreement will pass, so on Wednesday the British Parliament should vote on whether to exit the E.U. with no agreement in place, A.K.A. hard Brexit. It is almost certain that a hard Brexit will be defeated which leads to a vote on Thursday to delay the Brexit deadline which was set as part of the U.K. invoking Article 50 to begin the process to leave the E.U. This request to extend the deadline for Brexit would need to be approved by the E.U. which would likely happen at the March 21-22 summit. Even if the E.U. rejects the extension, which seems unlikely given some statements from the E.U. already; the U.K. could unilaterally revoke Article 50 and stop Brexit. Our summary is that a no deal Brexit remains a low but not zero probability. The British pound though weaker last week is still off the lows and indicating the financial markets agreement with this view. Why do you care? A no deal Brexit could add to global risks. The U.K. is approximately 3.5% of world GDP which is about the same size as France. In terms of possible corporate impact, the U.K. provides 2.3% of sales for the S&P 500 and 9.7% for Europe.

Source: Bloomberg, as of March 11, 2019

WEEK IN PREVIEW

- Geopolitical: Markets continue to monitor the progress of the trade negotiations between the U.S. and China. China wraps up its annual National People's Congress on Friday. Brexit activity heats up with a complicated series of votes likely, please see our Chart of the Week for more details.
- U.S.: January retail sales this morning reflected a good bounce from the dismal (and in our view incorrect) December readings. Speaking of dismal, February payroll growth was reported at a much below estimates 20k gain. Evidence points to this weakness being primarily related to weather disruptions and some give-back for the outsized gains of the last couple of months, so no need to panic about the labor market yet. February consumer (CPI) and producer (PPI) inflation is expected to remain tame with CPI staying steady at 1.6% year-over-year (Y/Y). Consensus expects January new home sales to rise modestly. At the end of the week, consumer sentiment for March is expected to rebound from the declines driven by the government shutdown and trade war. The weak 1Q GDP estimates from the Atlanta and NY Fed stand at 0.48% and 1.40%.
- Europe: The Eurozone reports January industrial production which should improve for the month but still reflect declines Y/Y. The European Central Bank (ECB) met last week and their actions reflected the weakened economy. The ECB gave guidance that rates would not rise until at least the end of the year; provided a new lending program for banks to add liquidity, and revised the GDP forecast lower to 1.1% growth in 2019.
- Asia: Among the items announced at China's National People's Congress were the 2019 real GDP target of 6.0-6.5% down from "about 6.5%" in 2018 and a large cut in the value-added tax. The meeting of the Bank of Japan (BoJ) concludes on Friday with no change in policy expected given the better 4Q GDP reported last week. Given the global and regional slowdown impacts on Japan, Governor Kuroda's comments will be watched for future policy clues.
- Central Banks: In addition to the BoJ, the central banks of Georgia and Ukraine meet with no expected changes in monetary policy rates.

WEEK IN REVIEW

- The S&P 500 posted a loss of almost -2.2% for the week. Utilities, real estate and communications services were leading sectors. Both WTI and Brent oil prices rose slightly but energy stocks fell over -3.8% and MLPs held steady. Small cap stocks underperformed with the Russell 2000 down almost -4.3%. The 10-year U.S. Treasury yield fell to 2.63% and high yield credit spreads reflecting the flight to safety by widening.
- Developed international stock indexes outperformed the S&P 500 in both U.S. dollar and hedged-currency terms. On a hedged-currency basis, developed market stocks were -1.2%. The U.S. dollar was stronger against developed and emerging market currencies. The non-hedged stock returns were -2.1% for MSCI EAFE and -2.0% for MSCI Emerging Markets. Chinese stocks were lower last week though still very strong performers year-to-date.
- The 10-2 yield curve narrowed and ended at 16.1 basis points. Another curve measure of three-month yield six quarters forward – three-month yield inverted to -4.1 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. The inversion occurred on Thursday and reflects worries about the global economy emanating from the actions of the ECB. Our view remains that the odds of a recession in 2019 remain low and expect perhaps only one hike from the Federal Reserve late 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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