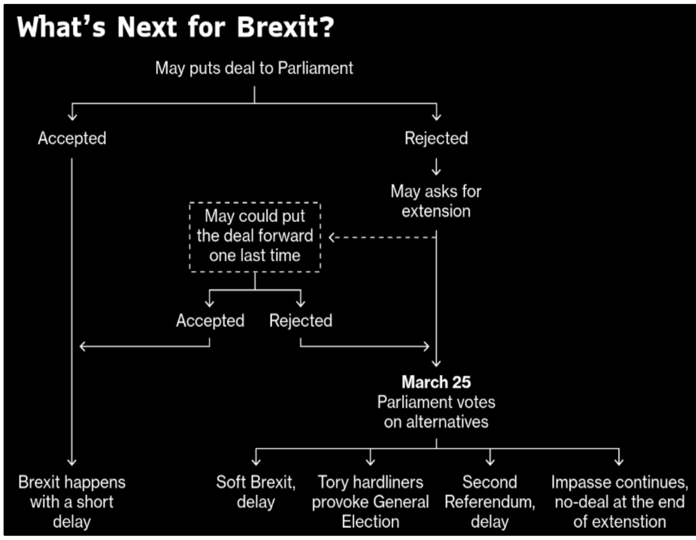

Source: Bloomberg as of March 18, 2019

Chart of the Week: Brexit continues 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 another flow chart from Bloomberg to map out a likely series of events. The U.K. may vote again Tuesday on PM May's revised Brexit deal. Will the third (or even a fourth) time be the charm? It seems unlikely that the current versions of the Brexit agreement will pass, so the E.U. would need to approve an extension to the Brexit deadline at the March 21-22 summit. Assuming a delay is granted, it is unclear how long to delay but a short extension perhaps to the end of June seems a likely answer. The U.K. parliament should then look to vote on several possible Brexit alternatives in late March or early April, including a second referendum on leaving the E.U. 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 view remains that a no deal Brexit remains a low but not zero probability. The British pound strengthened last week and is well off its lows, indicating the financial markets agree with this view. Avalon continues to monitor the situation closely as a no deal Brexit would add to global risks. The U.K. is approximately 3.5% of world GDP, which is about the same size as France and provides about 2.3% of sales for the S&P 500 and 9.7% for European stocks.

WEEK IN PREVIEW

- Geopolitical: Markets continue to monitor the progress of the trade negotiations between the U.S. and China. Brexit activity continues, please see our Chart of the Week for more details.
- U.S.: Housing is expected to show some improvement with the March NAHB Housing Price Index and February existing home sales expected to show gains. March Markit PMI data gives a look at current economic conditions. Manufacturing and services PMIs are expected to remain well above the 50 line of demarcation signaling growth versus contraction at 53.6 and 55.8 respectively. 1Q GDP estimates from the Atlanta and NY Fed stand at 0.38% and 1.37%.
- U.S. Federal Reserve: The Fed meets on Wednesday with the monetary policy rates all but certain to be left unchanged. The Fed also releases new economic forecasts. Markets will be monitoring the new "dot plot" very closely to gauge how many more hikes are expected with one more hike most likely. In addition, further evidence of a more pliant Fed could come from a discussion of or a plan to reduce the pace of the Fed's balance sheet shrinkage.
- Europe: Markets will be looking for any sign from March PMI data that Eurozone economies, especially Germany, might be starting to find some positive momentum with both the Eurozone and German manufacturing PMIs sinking below 50 already in early 2019. The U.K. reports January consumer and producer inflation plus retail sales. The Bank of England (BoE) meets and will almost certainly hold policy steady with Brexit looming.
- Asia: Japan reported February trade activity with exports -1.2% and imports -6.7% year-over-year. Japan's March manufacturing PMI will also be watched for some improvement from the 48.9 level reported in February.
- Central Banks: In addition to the Fed and BoE, the central banks of Thailand, Iceland, Brazil, Guatemala, Indonesia, Taiwan, Philippines, Switzerland, Norway, Russia and Colombia meet with only Norway expected to change their monetary policy rate with an increase of 0.25% to 1.00%.

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WEEK IN REVIEW

- The S&P 500 posted a gain of almost 2.9% for the week. Technology, healthcare and energy were leading sectors. Both WTI and Brent oil prices rose with energy stocks rallying strongly and MLPs up less than 1%. Small cap stocks underperformed with the Russell 2000 up almost 2.1%. The 10-year U.S. Treasury yield fell to 2.59% and high yield credit spreads reflected increased risk tolerance by tightening.
- Developed international stock indexes underperformed the S&P 500 in both U.S. dollar and hedged-currency terms. On a hedged-currency basis, developed market stocks were up almost 2.1%. The U.S. dollar was weaker against developed and emerging market currencies. The non-hedged stock returns were 2.8% for MSCI EAFE and 2.6% for MSCI Emerging Markets. Chinese stocks were higher last week and very strong performers year-to-date.
- The 10-2 yield curve narrowed and ended at 14.7 basis points. Another curve measure of three-month yield six quarters forward – three-month yield inverted to -7.2 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 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 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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