WEEK IN PREVIEW

• **Geopolitical**: Markets continue to monitor the progress of the trade negotiations between the U.S. and China. China holds its annual National People’s Congress with Premier Li Keqiang expected to announce their economic growth target. The OECD releases its interim economic outlook.

• **U.S.**: The February payrolls report should continue to reflect a strong jobs reports with gains of 185k and unemployment falling to 3.9%. February ISM Non-manufacturing PMI is expected to improve to 57.3, well above the 50.0 line of demarcation between signaling growth or contraction. 4Q GDP came in better than expected at 2.6% with the latest 1Q GDP estimates from the Atlanta and NY Fed at 0.34% and 0.88%. Six speeches by Federal Reserve members are scheduled with Chair Powell on Friday and the Beige Book released on Wednesday.

• **4Q S&P 500 Earnings**: 96% have reported with 69% and 61% beating earnings and sales estimates respectively. Blended earnings estimates held steady at 13.1% year-over-year (Y/Y). Sales fell to 5.8% Y/Y due to a miss in sales estimates for Berkshire Hathaway; sales would be 7% Y/Y without Berkshire Hathaway included. 10 S&P 500 companies report earnings including quite a few retailers.

• **Europe**: The European Central Bank (ECB) meets with monetary policy almost certainly unchanged but will be monitored for new economic forecasts along with a possible long-term loan program for banks. U.K. February Markit Construction, Services and Composite PMI readings are expected to decline slightly. While the probability of a no deal Brexit on March 29 has fallen which has been reflected in the British pound strengthening against the euro, headlines regarding any progress will continue to be monitored closely by the markets.

• **Asia**: The Caixin China Services PMI is forecast to fall to 53.5. China also reports February trade data. Japan reports the January leading and coincident index along with a revision to 4Q GDP.

• **Central Banks**: In addition to the ECB, the central banks of Kazakhstan, Australia, Malaysia, Turkey, Canada, Poland, Serbia and Peru meet with no expected changes in monetary policy rates.

**Chart of the Week**: The S&P 500 has notched five straight weeks of advances taking the year-to-date return to 11.8%. Our chart looks at how this rally off the low on December 24 stacks up against the average of other post-World War II rebounds after declines of roughly 20% or more. In addition, the chart shows the average price recovery off the bottom separated by those accompanied and not accompanied by recession. Through Friday, the S&P 500 has risen 19.3% off the low which places it ahead of the average rebound of 15.2% over the same period and even further ahead of rebounds from non-recession lows which averaged 13.3%. In fact, this rebound ranks as the strongest non-recession rebound at this point with the closest being the 16% return in 1998. We’ll repeat our thought from last week that stocks may be a bit ahead of themselves and the data would certainly argue that one should be prepared for some consolidation. But investors should not overreact to any weakness since the average returns one year out of almost 36% or 28% for non-recession periods from previous similar lows still offer an attractive upside for stocks. There was historically only one occurrence in the 1978 rebound where stocks returned less one year out from the bottom than returns now. Avalon remains constructive on stocks due to their relative valuation versus bonds and would expect to take advantage of a breather from the market’s torrid pace.
WEEK IN REVIEW

- The S&P 500 posted a 0.4% gain for the week. Energy, technology and financials were leading sectors. Both WTI and Brent oil prices fell but energy stocks rose while MLPs fell. Small cap stocks underperformed with the Russell 2000 down -0.03%. The 10-year U.S. Treasury yield rose to 2.75% and high yield credit spreads continued to improve.

- 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 +0.43%. The U.S. dollar was weaker against developed currencies and stronger against emerging market currencies. The non-hedged stock returns were 0.5% for MSCI EAFE and -0.7% for MSCI Emerging Markets. Chinese stocks were again very strong with the mainland A-shares rising 4.3% and MSCI announcing that more A-shares would be added to their international indexes over the next nine months. This change will take the percentage of A-shares in the MSCI Emerging Markets index to 3.3% when complete.

- The 10-2 yield curve widened and ended at 19.8 basis points. Another curve measure of three-month yield six quarters forward – three-month yield widened to 12.6 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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