AVALON
INVESTMENT & ADVISORY

Avalon's Weekly Market Guide
Week of May 6, 2019

Source: Bloomberg, Avalon Investment & Advisory as of May 4, 2019

Chart of the Week: Bill Stone, Avalon's Chief Investment Officer, joined the roughly 42,000 people in his annual pilgrimage to the Berkshire Hathaway annual meeting in Omaha. The written summary of his major take-aways can be found **here**. Berkshire recently disclosed a purchase of Amazon (AMZN) shares and their largest publicly traded stock holding is currently Apple (AAPL). While AMZN was bought by one of his lieutenants and not Buffett himself, it does show the larger impact of technology even on Berkshire which has historically eschewed purchases of tech shares. Bloomberg recently noted that M-FAANG (Microsoft, Facebook, Amazon, Apple, Netflix and Google) now together account for almost one-fifth of the market capitalization of the S&P 500 (see chart). Buffett defended the AMZN purchase as still being consistent with their value philosophy. He went on to note that "all investing is value investing" and that the considerations are identical when you buy a technology stock or a bank stock. Munger added in strong language that he made a mistake in not purchasing Google (GOOG) despite being very familiar with their products. He noted that perhaps the Apple purchase was "atonement" for the Google miss. Buffett and Munger had long stated that technology stocks were outside their expertise. But the addition of the two additional investment managers, Todd Combs and Ted Weschler, has increased the circle of competence for the firm.

WEEK IN PREVIEW

- Geopolitical: Markets continue to monitor the progress of the trade negotiations between the U.S. and China especially with President Trump threatening to significantly increase tariffs on Friday if there is not enough progress. Chinese Vice Premier Liu He is in D.C. for trade talks this week.
- U.S.: Much quieter week of economic data with April consumer (CPI) and producer (PPI) inflation readings as the primary focus. Headline and core readings for both CPI and PPI are expected to increase slightly year-over-year (Y/Y) but remain well under control. Lots of Fedspeak with 10 speeches on the docket including Philadelphia Fed President Harker speaking at the Global Interdependence Center's Annual Monetary and Trade Conference with Avalon's CIO, Bill Stone, presenting as well. 2Q GDP estimates from the NY and Atlanta Fed stand at 2.15% and 1.67%. Uber is expected to make its post-IPO trading debut on Friday.
- 1Q S&P 500 Earnings: 78% of companies have now reported and 76% and 60% have beaten earnings and sales expectations respectively. Earnings are expected to decline -0.8% Y/Y versus -2.3% last week, while sales expectations improved to 5.2% growth from 5.1%. The improvements were driven primarily by the healthcare sector, PFE, MRK and HCA specifically. This week has 59 S&P 500 companies reporting including BRK/A, AIG, DIS and LYFT.
- Europe: The Eurozone reports March retail sales. In addition, the European Union Commission releases updated economic forecasts. March industrial production will be reported for both the U.K. and Germany. U.K. 1Q GDP is expected to improve to 1.8% Y/Y versus 1.4%.
- Asia: Japan has both April services and composite PMI. China's April Caixin composite and services PMI data continued to confirm the rebound in economic growth there which has calmed concerns about global growth. Chinese trade data, including FX reserves, are expected later in the week.
- Central Banks: The central banks of Australia, Malaysia, New Zealand, Thailand, Brazil, Norway, Philippines, Serbia, Chile and Peru meet with Australia, Malaysia, New Zealand and the Philippines expected to change their monetary policy rates with a -0.25% cut.

WEEK IN REVIEW

- The S&P 500 posted a gain of 0.2%. Sector returns were again very bifurcated with healthcare, financials and industrials posting nice gains, but energy was down over -3% and communications services declined almost -2%. WTI and Brent oil prices were down about -2% on the week. Small cap stocks outperformed with the Russell 2000 up 1.4%. While it was not perfect, the U.S. payrolls report showed continued strong job growth. The 10-year U.S. Treasury yield rose to 2.53% and high yield credit spreads reflecting increased risk tolerance by tightening.
- Developed international stock indexes underperformed the S&P 500 in U.S. dollar terms. On a hedged-currency basis, developed market stocks were down -0.06%. The U.S. dollar was weaker against developed and stronger against emerging market currencies. The non-hedged stock returns were 0.16% for MSCI EAFE and 0.44% for MSCI Emerging Markets.
- The 10-2 yield curve narrowed and ended at 19.0 basis points. Another curve measure of three-month yield six quarters forward – three-month yield continues to be inverted at -13.0 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 gives some probability to a cut 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 Avalon expects no rate hikes from the Federal Reserve 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