Avalon's Weekly Market Guide
Week of February 24, 2020

Source: Avalon Investment & Advisory, Bloomberg as of February 22, 2020

Chart of the Week: Warren Buffett, Chairman of Berkshire Hathaway, released his much-anticipated annual letter this weekend along with their earnings report. Berkshire repurchased $2.2 billion of stock in Q4, a record quarter for Berkshire, which brings the 2019 total to $5 billion or 1% of the company. Despite the repurchases, Berkshire ended the year with a near record cash hoard of $128 billion (see chart). While the cash reflects the company's cash generation, it also underscored Berkshire's difficulty in making large acquisitions in the current environment. Buffett did comment on stocks by making a "rosy prediction" that stocks are "almost certain" to outperform long-term bonds over time if yields and corporate tax rates remain close to current levels. He did, however, warn that there will be major declines in stocks at some point. Avalon will report more from the upcoming annual meeting in Omaha.

WEEK IN REVIEW

- Geopolitical: China considers a delay of the annual National People's Congress, currently scheduled for March 5, due to the coronavirus outbreak. G-20 finance ministers and central bank governors met in Riyadh to discuss the impact of the outbreak on the global economy. Developments regarding the coronavirus and its potential impacts on the global economy and earnings will be monitored with markets reacting negatively to start the week.
- U.S.: More housing data should paint a supportive picture for the economy with January new and pending home sales expected to grow 3.0% and 2.0% month-over-month (M/M) respectively. February Conference Board consumer confidence should remain resilient at elevated levels. January personal income expected to improve to 0.4% M/M while spending holds steady at 0.3% M/M. The Atlanta and NY Fed currently estimate Q1 2020 GDP growth at 2.57% and 2.01%.
- Q4 S&P 500 Earnings: 87% of S&P 500 companies have reported with 70% and 66% beating earnings and sales respectively. The blended earnings growth rate for the S&P 500 for Q4 held steady at 0.9% year-over-year (Y/Y), well above the expectation of -1.7% Y/Y decline expected at year-end. The impact of the coronavirus has continued to depress Q1 earnings expectations which are now at 1.5% Y/Y, down from 4.6% Y/Y at year-end. The earnings season is winding down with 43 companies scheduled to report including several important retailers.
- Europe: German IFO business climate and expectation for February surprised by improving slightly. February U.K. GfK consumer confidence should improve slightly.
- Asia: Japan unemployment rate for January forecast steady at 2.2%. Japan retail sales for January to decline -0.2% M/M and -1.0% Y/Y. China February manufacturing PMI likely to fall well into the contraction zone at 47.4, impacted by the shutdown due to the coronavirus outbreak. China non-manufacturing PMI expected to fall to 50.0.
- Central Banks: The central banks of Israel, Hungary, Botswana, South Korea, Mozambique and Bulgaria meet with no change in monetary policy rates expected.

WEEK IN REVIEW

- Stocks posted a decline of -1.3% for the week amid renewed concern about the coronavirus outbreak. Real estate (+0.0%), consumer staples (-0.1%) and utilities (-0.2%) outperformed the S&P 500, while information technology (-2.5%), financials (-1.3%) and communication services (-1.2%) were the biggest laggards. WTI (+2.6%) and Brent (+2.1%) crude oil prices were up for the week, but the energy sector (-1.0%) and MLPs (-2.4%) were lower with the equity market. Small cap stocks outperformed the S&P 500 with the Russell 2000 down only -0.5%. The 10-year U.S. Treasury yield fell to 1.47%. High yield credit spreads widened, reflecting decreased risk appetite.
- The U.S. dollar was stronger against both developed and emerging market currencies. Developed international stocks as measured by MSCI EAFE paced with the S&P 500 returns in U.S. dollar terms (-1.3%) and outperformed on a hedged-currency basis (-0.7%). Emerging market stocks underperformed the S&P 500 with the non-hedged return of -2.0% for MSCI EM.
- The 10-2 yield curve flattened to +11 basis points. Another curve measure of three-month yield six quarters forward – three-month yield inverted more and closed the week at -27 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 more than a year 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 reflecting that the market has begun to price in a possible insurance rate cut in the coming months in response to the economic dislocation from the coronavirus. Our view remains that the Federal Reserve is likely on hold for the time being and the odds of a recession over the next twelve months remain well below 50%. 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.

Phan Phan Duong
Senior Analyst

Henry J. Lartigue, CFA
Managing Partner

Samuel E. Rines
Chief Economist

Bill Stone, CFA, CMT
Chief Investment Officer

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