Before the Bell

Morning Market Brief

February 11, 2019

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MONDAY MORNING MARKET STRATEGY: *David M. Joy, Chief Market Strategist*

With little domestic news on either the policy or economic front, U.S. equities were virtually unchanged last week. The S&P 500 did close fractionally higher, but failed to push above its 200 day moving average. Not helping matters were reminders from the White House that trade talks with China were far from any agreement, and from Europe concerning its ongoing economic slowdown and the challenges for monetary policy of Brexit uncertainty. While investors await further developments on all of these issues, the dearth of market moving news resulted in the VIX index ending the week at 15.7, well down from the 36.1 reading of Christmas Eve.

Bond investors focused on the sluggish economic data coming from Europe, where industrial production in December fell for the fourth straight month in both Germany and Italy, and the European Commission lowered its 2019 EU growth forecast from 1.9 to 1.5 percent. The yield on the ten-year German Bund fell to seven basis points to 0.09 percent, its lowest level since October 2016. Bond yields in the U.S. followed suit, as the ten-year treasury note fell five basis points to 2.63 percent, while the two-year slipped four basis points to 2.47 percent. Credit spreads were little changed on the week, but as with other asset categories, did weaken later in the week following the softer data out of Europe.

The March 29th Brexit deadline is now less than fifty days away, and the possibility of a no deal crash out of the European Union remains a distinct possibility. The IMF has warned of the longer-term negative economic implications of such an outcome, but UK markets have been relatively calm of late. The pound sits right in the middle of its six-month trading range against the dollar at 1.29. The FTSE 100 stock index is basically unchanged in four months, and higher by 5 percent so far this year. The broader FTSE All-Share index is ahead by a similar amount. But the uncertainty surrounding Brexit was captured by BOE governor Carney on Thursday when he referred to the "fog of Brexit" while announcing a sharply lower growth forecast for the UK economy in 2019, from 1.7 to 1.2 percent, while also keeping rates on hold.

Trade talks between the U.S. and China are scheduled to resume this week in Beijing. And while both sides are saying that the talks have been constructive, the U.S. side has warned that serious issues remain and that the two sides are far from an agreement. The March 1st negotiating deadline is just three weeks away. Back home, the congressional committee charged with hammering out an immigration bill, and keep the government open past Friday, has reported some progress. Republican Senator Shelby said an agreement could be reached as early as Monday of this week, although subsequent reports said that negotiations broke down over the weekend. Although the president has been briefed on the bi-partisan negotiations, it remains to be seen whether he will sign whatever bill the committee might produce.

The economic calendar ramps back up somewhat this week, with scheduled reports that include December retail sales, January CPI, industrial production and small business sentiment, and February consumer sentiment. Earnings season in the U.S. is two-thirds complete and are growing at a projected rate of 13.3 percent according to FactSet. First quarter estimates have now dropped to -1.7 percent, with full-year growth expectations at 5 percent. Domestic Chinese markets resumed trading on Monday following their week-long closure for the Lunar New Year and were broadly higher. Stocks

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- For further information on any of the topics mentioned, please contact your Financial Advisor.
- Unless specifically stated otherwise, comments contained in this document should not be construed as an investment opinion or recommendation of any securities mentioned. Charts depicted are from FactSet unless otherwise noted.

in Hong Kong traded on Friday, and were fractionally lower, but joined to move higher on Monday.

MORNING MARKET COMMENTARY: *Anthony M. Saglimbene, Global Market Strategist*

- ***Quick Take***: U.S. futures are pointing to a stronger open; Europe is trading higher; Asia ended mixed overnight; West Texas Intermediate (WTI) oil trading at $52.30; 10-year U.S. Treasury yield at 2.66%.

- ***The State Of The Market:*** In our view, asset prices currently reflect the opportunity and risk facing investors today. That is to say, we believe stocks are fairly priced based on the current macro environment. Although the lows of December and subsequent rebound in 2019 showed the market was too pessimistic at the end of last year, risk assets will need more positive catalysts to push higher from here. Those positives could take shape in the form of trade, earnings, and economic growth. However, we believe developments on each of these fronts could act to pressure markets if they deteriorate. Importantly, all three are interwoven into directing market sentiment and somewhat dependent on one another. Developments on trade, earnings, and economic growth are unlikely to operate in vacuums this year, and we anticipate investors will react to changes in each with an eye towards their effect on the other two. **As we enter the new week, below is a brief rundown of the current macro environment and a *State of the Market* to get your Monday started on the right foot:**
  - **The Dow Jones Industrial Average eked out its seventh straight week of gains, while on Friday, the S&P 500 Index marked the seventh straight trading day it was able to rally into the close. As we have highlighted previously, this is a bullish market signal supporting the theory that longer-term investors and 'smart money' traders are willing to step in and buy stocks late in the trading day**. This is a very different environment compared to December, where those same market participants were selling into the close. Investor confidence has improved this year, and we believe it's showing up in how the market is trading at critical points during the trading day.
  - Nevertheless, **the S&P 500 Index was unable to breach its 200-day moving average last week,** and the level may provide near-term resistance for stocks in the absence of major positive catalysts.
  - The 50 smallest stocks in the S&P 500 Index are higher by +14.2% year-to-date, the best performing decile by market-capitalization weight. **According to *Bespoke Investment Group*, both low and high valuation stocks are performing well this year, while stocks with high dividends and stocks that do not pay a dividend are outperforming the 'middle of the pack.'** Stocks with substantial revenue exposure to overseas markets are also outperforming more domestically focused companies in 2019.
  - **First quarter earnings for S&P 500 companies are expected to decline by 1.7%–a large contrast to the +3.3% growth analysts forecast at the end of December**. If companies do ultimately deliver a negative earnings print for the current quarter, it will mark the first profit decline in roughly three years, according to *FactSet*. Thus far, 82% of S&P 500 companies providing Q1 guidance have guided below analyst forecasts.
  - **Although U.S. stocks are still attractively priced on a forward and trailing earnings basis compared to their five-year averages, equities are still modestly expensive on a longer-term basis**. Slowing earnings growth trends this year could keep longer-term investors cautious on pushing stock prices higher, particularly if we are headed for an earnings recession. A negative earnings growth print in Q1 and Q2 would technically trigger an earnings recession. However, companies notoriously outperform earnings expectations, so it is by no means certain earnings growth will come in negative for Q1.
  - Global growth is slowing, particularly in Europe and China. We believe decelerating economic growth and earnings trends in areas outside of the U.S. could dampen the U.S. growth trajectory this year. **Although the American economy is largely closed and highly dependent on the U.S. consumer and services-related industries, we believe a global slowdown in manufacturing is a key item to watch over the coming months**.
  - Because of a weakening outlook for growth outside the U.S., international stocks are 24% cheaper compared to domestic equities. Although a stronger outlook for U.S. growth likely justifies some of the valuation discrepancies, sentiment towards ex-U.S. stocks is now extremely negative.

- ***Asia-Pacific:*** Asian equities finished mixed on Monday. Per *Axios*, President Trump and China President Xi Jinping could meet in Mar-a-Largo in mid-March. While administration officials said the location of the meeting could also take place in Beijing, it remains uncertain where and 'if' a trade meeting between the two leaders will even take place. Given a second summit with North Korea, and still lacking progress on a trade agreement between the world's two largest economies, a meeting between the two leaders before the March 1st trade deadline now seems unlikely.

- U.S./China trade talks resume this week in Beijing. Lower level discussions will take place early in the week, while higher-level discussions that include U.S. Trade Representative Robert Lighthizer and U.S. Treasury Secretary Steven Mnuchin are scheduled for Thursday and Friday. According to *Reuters*, structural issues, including forced technology transfers are on the docket for discussion. Enforcement procedures are also expected to be highlighted this week. Importantly, we believe the hard deadline of March 1st could be pushed back if the U.S. believes trade discussions are progressing. This would avoid escalating tariff rates on Chinese imports and potentially roiling global markets.
- Retail sales, as well as food-and-drink sales in China during the Lunar New Year holiday, grew +8.5%, down 1.7% from 2018. The slower sales during the holiday mark the lowest growth rate since 2005, according to *Nikkei*. On the brighter side, a record 7 million people traveled overseas during the Lunar New Year. Spending outside of China's borders and where China's Commerce Ministry cannot account for spending likely weighed on some of the domestic holiday spending data.
- ***Europe:*** Markets across the region are trading higher at midday. According to *FactSet*, UK Prime Minister Theresa May is looking for Parliament to give her another two weeks to win concessions for her Brexit plan. As a compromise, Mrs. May has offered MPs a series of non-binding votes on possible Brexit alternatives by February 27th.
- UK economic data mostly disappointed expectations, with preliminary Q4 GDP up +1.3% y/y versus the +1.4% expected. Industrial production and manufacturing output for December also disappointed versus consensus estimates.
- ***U.S.:*** Equity futures are pointing to a stronger open this morning. After the longest U.S. government shutdown in history ended in January, the three-week reprieve is set to expire on Friday. According to multiple reports over the weekend, border security talks have collapsed between Republicans and Democrats. In our view, the weekend breakdown reduces the chances that both sides can work out an agreement on border security, vote on a bill that would pass through Congress, and get legislation on President Trump's desk by Friday. Although Congress has proven they can work under fire in the past, there are significant philosophical differences on border security that make it very difficult for both sides to find common ground. According to *FactSet*, lawmakers were attempting to salvage a deal that would provide some funding for Trump's border wall but fall short of the $5.7 billion originally requested. To avoid a government shutdown, Trump could call a national emergency on the southern border. However, this move could ultimately be challenged by Democrats in court.
- According to weekly statistics from the Internal Revenue Service (IRS), the average tax refund is down 8.4% y/y to $1,865. Additionally, the number of people receiving refunds this year is down nearly 25%. The IRS noted, however, not to read too much into the early numbers, due to an impact from the government shutdown. Also, many Americans received larger weekly and bi-weekly checks throughout the year following the tax law overhaul. Meaning, the smaller refunds are partly a function of paying fewer taxes during 2018.

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WORLD CAPITAL MARKETS *(all data as of approximately 8:00 AM ET)*

Americas	% chg.	% YTD	Value
S&P 500	0.07%	8.24%	2,707.9
Dow Jones	-0.25%	7.91%	25,106.3
NASDAQ	0.14%	10.10%	7,298.2
Russell 2000	0.05%	11.80%	1,506.4
Brazil Bovespa	-0.61%	7.82%	94,762.5
S&P/TSX Comp. (Canada)	-0.45%	9.39%	15,633.3
Mexico IPC	-1.02%	3.71%	43,180.5

Europe (Intra-day)	% chg.	%YTD	Value
DJSTOXX 50 (Europe)	1.05%	5.88%	3,168.4
FTSE 100 (U.K.)	0.72%	5.92%	7,122.4
DAX Index (Germany)	1.03%	4.36%	11,019.6
CAC 40 (France)	1.14%	6.13%	5,018.2
FTSE MIB (Italy)	1.48%	7.17%	19,638.6
IBEX 35 (Spain)	0.90%	5.22%	8,936.5
Russia TI	0.61%	7.78%	4,512.7

Asia/Pacific (Last Night)	% chg.	%YTD	Value
Nikkei 225 (Japan)	Closed	1.60%	20,333.2
HK Hang Seng (H. Kong)	0.71%	8.92%	28,143.8
Korea Kospi 100	0.17%	6.84%	2,180.7
Singapore STI	0.13%	4.59%	3,206.3
Shanghai Comp. (China)	1.36%	6.42%	2,653.9
Bombay Sensex (India)	-0.41%	0.97%	36,395.0
S&P/ASX 200 (Australia)	-0.17%	7.34%	6,060.8

Global	% chg.	% YTD	Value
MSCI All-Country World Idx	-0.35%	7.44%	488.7

Developed International	% chg.	%YTD	Value
MSCI EAFE	-0.98%	5.08%	1,804.7

Emerging International	% chg.	%YTD	Value
MSCI Emerging Mkts	-0.57%	7.34%	1,036.0

*Note: International market returns shown on a local currency basis. **Equity index data is total return, inclusive of dividends.***

S&P 500 Sectors	% chg.	% YTD	Value
Consumer Discretionary	-0.51%	8.03%	843.5
Consumer Staples	0.54%	6.11%	552.6
Energy	-0.72%	9.83%	463.8
Financials	-0.55%	7.85%	425.5
Real Estate	0.10%	11.57%	214.5
Health Care	0.18%	4.10%	1,040.4
Industrials	0.12%	13.42%	614.2
Materials	-0.05%	4.33%	330.3
Technology	0.49%	9.66%	1,190.8
Communication Services	0.35%	9.63%	151.7
Utilities	0.49%	5.28%	282.4

Equity Income Indices	% chg.	% YTD	Value
JPM Alerian MLP Index	0.00%	9.79%	24.4
FTSE NAREIT Comp.	0.02%	12.59%	18,684.5
DJ US Select Dividend	0.15%	7.17%	1,993.8
DJ Global Select Dividend	0.08%	6.10%	219.4
S&P Div. Aristocrats	0.10%	6.44%	2,551.4

Bond Indices	% chg.	% YTD	Value
Barclays US Agg. Bond	0.10%	1.20%	2,071.1
Barclays HY Bond	-0.10%	4.83%	2,001.5

Commodities Futures & Spot (Intra-day)	% chg.	% YTD	Value
CRB Raw Industrials	-0.12%	0.03%	480.6
NYMEX WTI Crude (p/bbl.)	-0.51%	15.50%	52.5
ICE Brent Crude (p/bbl.)	0.00%	15.43%	62.1
NYMEX Nat Gas (mmBtu)	4.76%	-7.96%	2.7
Spot Gold (troy oz.)	-0.72%	1.75%	1,304.9
Spot Silver (troy oz.)	-0.83%	1.28%	15.7
LME Copper (per ton)	-0.60%	4.06%	6,190.8
LME Aluminum (per ton)	-0.75%	-0.28%	1,857.5
CBOT Corn (cents p/bushel)	-0.27%	-0.47%	373.3
CBOT Wheat (cents p/bushel)	-0.68%	2.09%	513.8

Foreign Exchange (Intra-day)	% chg.	% YTD	Value
Euro (€/$)	-0.1%	-1.4%	1.13
British Pound (£/$)	-0.3%	1.1%	1.29
Japanese Yen ($/¥)	-0.58%	-0.62%	110.37
Australian Dollar (A$/$)	-0.23%	0.33%	0.71
Canadian Dollar ($/C$)	0.0%	2.7%	1.33
Swiss Franc ($/CHF)	-0.3%	-2.2%	1.00

Data/Price Source: Bloomberg; Equity Index data is total return, inclusive of dividends where applicable.

Ameriprise Global Asset Allocation Committee

U.S. Equity Sector - Tactical View

Sector	S&P 500 Index Weight	GAAC Tactical View	GAAC Tactical Overlay	GAAC Recommended Weight
1) **Communication Services**	10.2%	Underweight	- 2.0%	8.2%
2) **Consumer Discretionary**	9.8%	Equalweight	-	9.8%
3) **Consumer Staples**	7.5%	Underweight	- 2.0%	5.5%
4) **Energy**	5.3%	Overweight	+2.0%	7.3%
5) **Financials**	13.3%	Equalweight	-	13.3%
6) **Health Care**	15.5%	Overweight	+2.0%	17.5%
7) **Industrials**	9.2%	Equalweight	-	9.2%
8) **Information Technology**	20.2%	Equalweight	-	20.2%
9) **Materials**	2.6%	Equalweight	-	2.6%
10) **Real Estate**	3.0%	Overweight	+1.0%	4.0%
11) **Utilities**	3.4%	Underweight	- 1.0%	2.4%

Index weighting represents relative weightings based on the regional market capitalization balance of the MSCI All-Country World Index; may not add due to rounding. The GAAC Tactical Overlay, as well as Recommended Tactical Weights, is derived from the Ameriprise Global Asset Allocation Committee (GAAC).Views are expressed relative to the Index and are provided to represent investment conviction in each region. Tactical Allocations are designed to augment Index returns over a 6-12 month time horizon. Index weights as of 12/20/18. Numbers may not add due to rounding.

Ameriprise Global Asset Allocation Committee

Global Equity Region - Tactical View

Region	MSCI All-Country World Index Weight	GAAC Tactical View	GAAC Tactical Overlay	GAAC Recommended Weight
1) **United States**	54.1%	Overweight	+3.1%	57.2%
2) **Canada**	3.0%	Equalweight	-	3.0%
3) **United Kingdom**	5.4%	Underweight	- 1.0%	4.4%
4) **Europe ex U.K.**	14.9%	Underweight	- 1.0%	13.9%
5) **Latin America**	1.4%	Equalweight	-	1.4%
6) **Asia-Pacific ex Japan**	12.5%	Equalweight	-	12.5%
7) **Japan**	7.6%	Equalweight	-	7.6%
8) **Middle East / Africa**	1.1%	Underweight	- 1.1%	-

Index weighting represents relative weightings based on the regional market capitalization balance of the MSCI All-Country World Index; may not add due to rounding. The GAAC Tactical Overlay, as well as Recommended Tactical Weights, is derived from the Ameriprise Global Asset Allocation Committee (GAAC).Views are expressed relative to the Index and are provided to represent investment conviction in each region. Tactical Allocations are designed to augment Index returns over a 6-12 month time horizon. Index weights as of 12/20/18. Numbers may not add due to rounding.

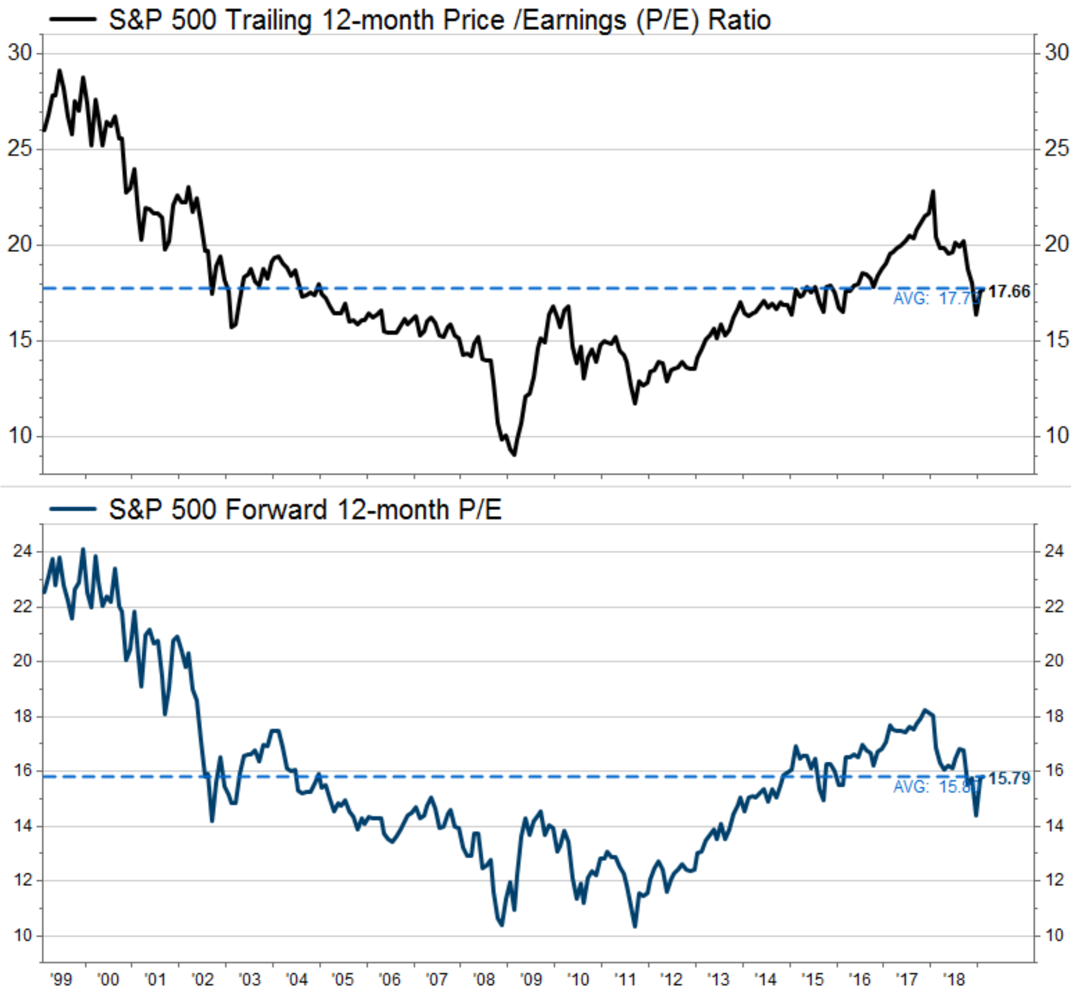
THE WEEK AHEAD: *Russell T. Price, CFA*

- **The Q4 earnings release season goes on.** Through last Friday, 335, or about 66% of S&P 500 companies had reported their financial results for Q4. Consensus estimates for the period as compiled by FactSet now see S&P 500 earnings per share (EPS) for the period of $41.32 (versus $41.01 last week), which represents a year-over-year growth rate of 13.3% (+13.0% last week). At the start of the fourth quarter (October 1st, 2018), consensus estimates were looking for EPS of $42.55, representing yr./yr. growth of +17.2%, but by the end of the period estimates had fallen to +12.8% due to falling energy commodity prices and slower technology sales in China. Current estimates for Q4 would leave 2018 full-year EPS growth at 22.8%, if achieved.
- The downshift in Q4 EPS estimates has been fundamental, in other words, it has come with downward adjustments in sales growth as well. However, sales growth has also been better than expected by a material margin thus far. Sales per share are currently forecast to have been 6.9% higher in Q4 (+6.4% estimated last week) versus the 4.0% yr/yr gain forecast a month-ago. Estimates were for a +6.8% gain at the start of the quarter but would still be well below the +9.4% rate achieved in Q3.
- Higher results for Q4 however, have combined with falling estimates for the next few quarters to result in lower near-term earnings growth rates for S&P 500 companies. In fact, year-over-year S&P 500 EPS are now expected to be down yr/yr by abot 2%. Recent downshifts have largely come as a result of the ongoing trade dispute between the U.S. and China. A further escalation of the trade rift could yet have a greater impact on corporate financial results, but a general resolution could also have a strong beneficial influence as well.
- **The economic calendar is starting to get back in order this week.** Most notably, we could get two retail sales reports this week. There appear to be conflicting reports as to whether Friday's report for January will occur as scheduled but the delayed report for December has been scheduled for Thursday. Retail sales for December are expected to have been fairly flat. This may come as somewhat of a surprise to some after widespread reports of it having been a strong holiday shopping season. However, headline results for the period are expected to see a sizable drag from sharply lower gasoline prices (of 0.6 to 0.7 percent, in our view). Excluding autos and gasoline, Bloomberg consensus estimates look for a healthy month-over-month gain of about 0.4% for a year-over-year increase of about 5%. Should results for January be released on Friday as some are saying, we expect sales to again be fairly flat month-over/month due to the exceptional cold that hit late in the month and the government shutdown.
- Investors will also be looking for evidence of a bounce back in sentiment this week. Business and consumer sentiment have both dropped over the last few months amid heavy stock market pressure in Q4, followed by the lengthy government shutdown through January. We'll likely have to wait for signs of an improvement in business sentiment, however. This week's Small Business Optimism Index from the National Federation of Independent Businesses covers the month of January and is thus expected to reflect ongoing dysfunction concerns related to the shutdown. Friday's Consumer Sentiment Index from the University of Michigan, however, covers the first half of February. As a result, forecasters expect the Index to show a modest recovery in light of the temporary appropriation bill that got government workers back on the job. The 93.5 Index reading forecast via the Bloomberg consensus (versus the 91.2 final reading for January) would represent a modest improvement, but it would still below the Index's recent month-end high of 100.1 as achieved in September.
- Inflation is also in focus this week. On Monday, the Labor Department will release its annual revisions to the Consumer Prices Index (CPI) which could result in some minor changes to estimates, but overall headline CPI inflation is expected to drop due to this year's much lower gasoline prices, while the much more important core inflation metrics are forecast to ease slight to 2.1% year-over-year from the 2.2% rate reported for December (pre and revisions) .

February 11	12	13	14	15
GDP - U.K.	**NFIB Small Bus. Index**	**Consumer Price Index**	**Initial Jobless Claims**	**Retail Sales - January**
Trade - China	**Job Openings Report**	*Industrial Production - Euro Zone*	**Empire Mfg. Index**	**Import Price Index**
	Industrial Production - India	*GDP - Japan*	**Producer Price Index**	**Empire Mfg. Index**
	Inflation - India	*Inflation - U.K.*	**Retail Sales - December**	**Industrial Production**
	Employment - S. Korea	*Retail Sales - Brazil*	*Inflation - China*	**U. of M. Consumer Conf.**
			Manufacturing Activity - Canada	**Business Inventories**
			Home Prices - Canada	*Trade - Euro Zone*
				Retail Sales - U.K.

Where Market Fundamentals Stand Heading into The Week:

S&P 500 Trailing and Forward P/E valuations: *Source: FactSet*
Please note: Although we try to maintain consistency as much as possible, Price to Earnings (P/E) ratios may differ modestly from once source to another. Most notably, P/E numbers can often show their most notable differences _during_ *an earnings release season as some sources may still use the last full 'actual' earnings number (for instance, currently Q3 trailing 12-month earnings per share) while others use earnings per share that are updated for Q4 using a combination of actual and estimated earnings per share. The calculation of earnings (operating earnings versus 'as reported' or GAAP) also often differs modestly from one data source to another due to the proprietary use of calculation methodologies. The "average" shown in the charts below represent averages for the period shown.*



Consensus Earnings Estimates: *Source: FactSet*

S&P 500 Earnings Estimates	2014	2015	2016	2017				2018				2019				2020
2/11/2019	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Est.	Est.	Est.	Est.	Est.	Est.
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
Quarterly $$ amount				$30.87	$32.80	$33.54	$36.29	$38.71	$41.03	$42.85	$41.32	$37.95	$41.77	$43.94	$44.97	
change over last week											$0.31	-$0.34	-$0.05	$0.03	$0.02	
yr/yr				13.9%	10.7%	6.7%	15.9%	25.4%	25.1%	27.8%	13.9%	-2.0%	1.8%	2.5%	8.8%	
qtr/qtr				-1%	6%	2%	8%	7%	6%	4%	-4%	-8%	10%	5%	2%	
Trailing 4 quarters $$	$119.02	$118.67	$119.64	$123.25	$126.42	$128.53	$133.50	$141.34	$149.57	$158.88	$163.91	$163.15	$163.89	$164.98	$168.63	$188.89
yr/yr	6.8%	-0.3%	0.8%				11.6%				22.8%				2.9%	12.0%
Implied P/E based on a S&P 500 level of: **2708**											16.5	16.6	16.5	16.4	16.1	14.3

ECONOMIC NEWS OUT TODAY:

Economic Releases for Monday, February 11, 2019. All times Eastern. Consensus estimates via Bloomberg.

None Scheduled

Economic Perspective: ***Russell T. Price, CFA – Chief Economist***

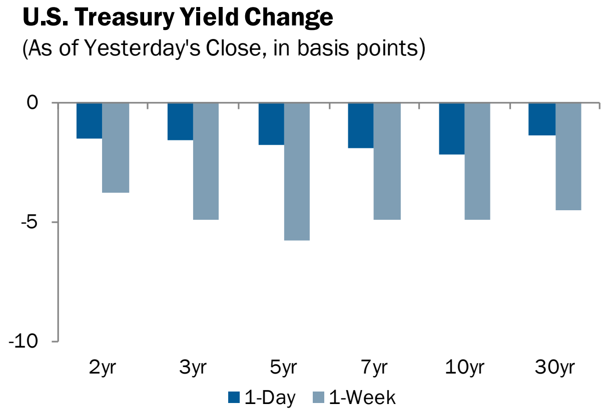
- **US /China trade negotiations – another important week.** "The market climbs a wall of worry." Let's hope this old Wall Street adage rings true as several key issues approach respective deadlines. Aside from the high-level U.S. /China trade talks that we discuss below, there is also an important Brexit vote in the U.K. on Thursday, and here in the U.S., government funding talks appear to have stalled ahead of Friday's deadline.
- This week, Treasury Secretary Mnuchin and Trade Representative Lighthizer head to China for trade talks with China's Vice Premier Liu. Lower level officials on both sides are scheduled to meet early in the week with the high-level officials scheduled to meet on Thursday and Friday. Reuters is reporting that officials are expected to focus on the issue of forced technology transfers and how to structure enforcement, after the fact, should a deal be reached. In our view, the idea that China resists giving up its technology transfer policies so strenuously is disconcerting as to their intentions to abide by such changes in the future.
- Negotiators have until March 1st to reach an agreement before U.S. tariffs on about $200 billion in Chinese made goods (mostly consumer goods) jumps to 25% from the 10% level instituted in September on March 2nd. Markets reacted quite negatively last Thursday to news that President Trump would not have time to meet with China's President Xi before the deadline. This announcement came just days after the President said no deal would be forthcoming until he could talk it over with Xi directly. However, President Trump has also indicated that the deadline could be pushed back again if "sufficient" progress was being made.
- So what's the most likely path? Although we are skeptical as to China's true commitment to changing its policies, we believe market fears related to the approaching deadline may be overdone. So long as tangible progress is being made, we believe President Trump would be inclined to extend the current "truce" beyond the March 2nd date. From an economic prospective, we believe this is the most likely path. However, we also would not rule out a negative statement to follow this week's meeting as to possibly put added pressure on China to make concession as the deadline approaches.
- As we've noted previously, despite the material threat to near-term economic activity should negotiations fail, we believe it would be much more dangerous to U.S. and western world economic prospects over the long-term if the President were to settle for small gains or a simple narrowing of the trade deficit.

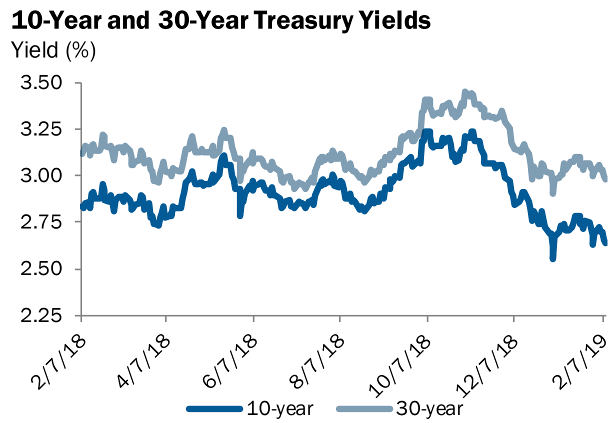
FIXED INCOME NEWS & VIEWS: *Brian M. Erickson, CFA, Fixed Income Research & Strategy*

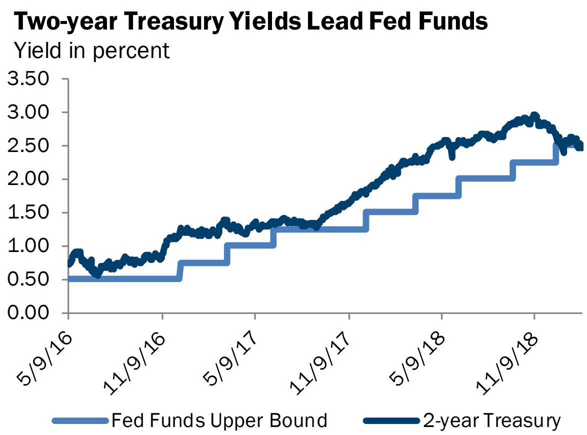
Decelerating Growth Becomes the Greatest Risk for 10s/2s Inversion

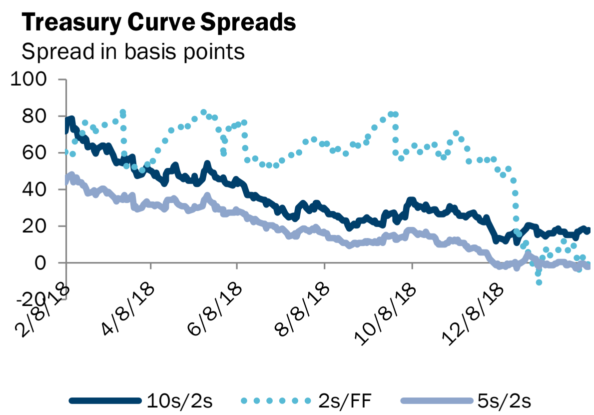
- Treasury yields ended last week lower, led by the belly of the curve. Five-year Treasury yields ended the week yielding 2.44%, down six basis points on the week (see chart below left), and just nine basis points above the one year low of 2.35% set on January 3, 2019. Treasury yields are modestly higher this morning ahead of the open to U.S. equity markets, with 5-year yields up three basis points to 2.47%.
- The "patient" Fed lowers the risk that aggressive Fed hikes invert the 10s/2s Treasury yield spread, shifting risk around an inversion to decelerating growth that depresses long-term inflation prospects and Treasury yields (see Treasury curve spread chart bottom right)**. While many economic expansions have been ended by Fed policy designed to slow inflation, this time may be different. Fed futures markets carry a modest bias toward a cut in 2020 as the next move for the Fed. We remain oriented more toward a hike as the next move, given our expectation for continued U.S. economic growth this year. This also supports our forecast that Treasury yields likely move higher from current levels that have been mired in a flight to quality from slowing global growth.** Chair Powell is scheduled to give his semi-annual policy update to the Senate Banking Committee on Feb 26 offering yet another venue to frame-up the current Fed policy approach.
- <u>The week ahead</u>: This week contains data on inflation in the form of January Producer Price Index and Consumer Price Index on Wednesday and Thursday, respectively. Treasury issuance this week is relegated to bills inside a year.
- Inflation as a catalyst for higher Treasury yields has faded as slowing global growth dynamics see demand ease pressure on tight markets, leaving our 2019 10-year Treasury yield target a bit high as geopolitical overhangs continue to weigh on the global economy. Interim resolutions to Brexit, another partial federal government shutdown,

and U.S./China trade relations may remove some of the flight to quality dynamic that led Treasury yields lower and sustain business and consumer spending at levels that bring inflation back as a concern in our view and prompt a move higher in Treasury yields beyond the near-term.









Source: Bloomberg

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Beta: A measure of the risk arising from exposure to general market movements as opposed to company-specific factors. Betas in this report, unless otherwise noted, use the S&P 500 as the market benchmark and result from calculations over historic periods. A beta below 1.0, for example, can suggest the equity has tended to move with lower volatility than the broader market or, due to company-specific factors, has had higher volatility but generally low correlations with the overall market.

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