

ECONOMIC HIGHLIGHTS

U.S. Existing Home Sales came in at 4.99mm units in December, a drop of 10.3% year-over-year. Weakness was felt generally across the country. The Index of Leading Economic Indicators was down 0.1% for December, the first decline in recent memory. With the government shutdown, that is all which was reported this week.

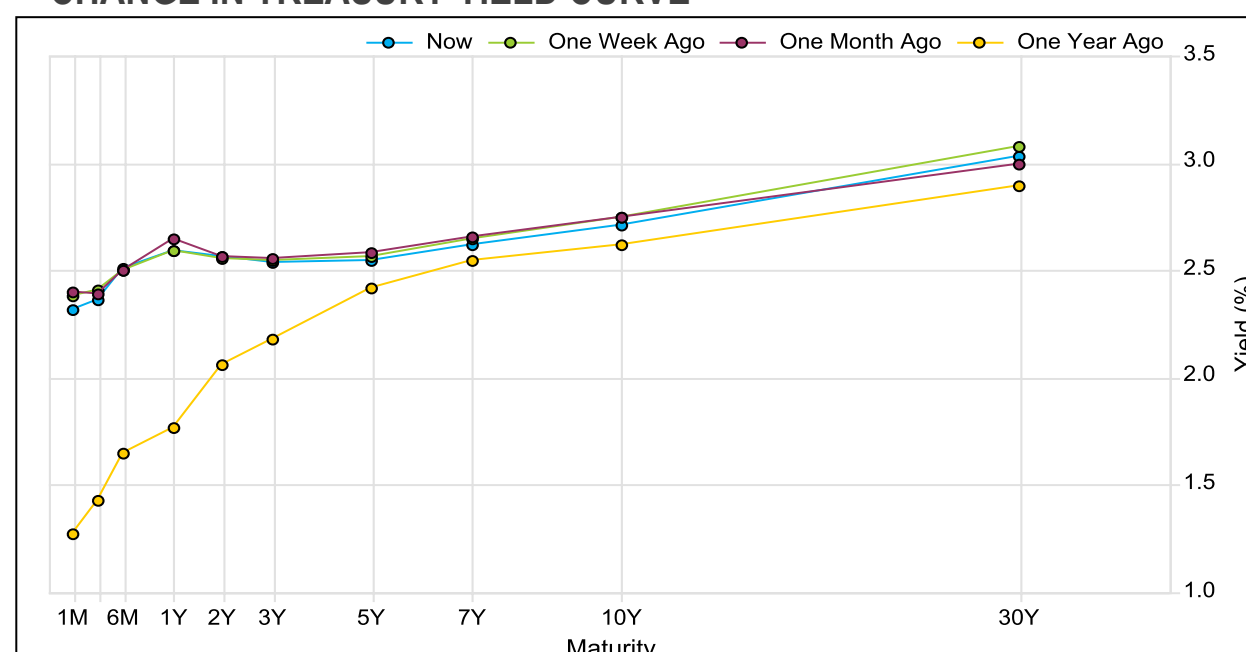
FIXED INCOME

Treasury traders are bracing for heightened volatility this week as Federal Reserve Chairman Jerome Powell ushers in a new era of press conferences after every meeting, while the U.S. and China meet again for trade talks. Officials are expected to keep interest rates unchanged following nine hikes since late 2015. But investors see scope for the Fed's statement to tilt dovish, or for Powell to signal as much in his comments, a shift that could help drive yields lower. The market will also be looking for any hints that the central bank is closer to ending its balance-sheet runoff, which combined with the deal to reopen the government, could bolster risk sentiment at the expense of Treasuries. But there's more on the calendar: Progress on the trade front may lift yields as it's seen as easing global economic headwinds. And the Treasury is slated to detail issuance plans for the coming three months, with sales projected to be at a record level. January labor data will round out the week, with the effects of furloughed government workers potentially boosting the jobless rate. "It's going to be a busy week," said Chris Ahrens, chief market strategist at First Empire Securities. "People want to know what Powell has to say about the balance sheet, with many wondering if they'll adjust what they are doing now." At 2.76%, the benchmark ten-year Treasury yield has been stuck in a 14 basis point range the past two weeks. It has rebounded from this month's low yield of 2.54% amid improved investor confidence after the Fed officials indicated they would be patient in adjusting rates further. Bond-market volatility as gauged by options volume has dropped from a ten-month high reached in December. Powell will take center stage as his counterparts at other major central banks appear to be stalling in efforts to normalize monetary policy. Last week, European Central Bank President Mario Draghi said risks to growth "have moved to the downside," while Bank of Japan cut its inflation outlook. Before the Fed meeting this week and their decision on rates Wednesday, traders will also get details on the supply they will have to absorb in the months ahead. The majority of the street expects the Treasury to say at its quarterly refunding announcement that sales of Treasury securities will remain elevated.

CURRENT GENERIC BONDS YIELDS

TREASURIES		AGENCIES		CORPORATES		MUNICIPALS	
3 mo	2.37%	3 mo	2.42%	3 mo	2.57%	3 mo	1.61%
6 mo	2.50%	6 mo	2.42%	6 mo	2.65%	6 mo	1.65%
1 yr	2.58%	1 yr	2.41%	1 yr	2.70%	1 yr	1.71%
2 yr	2.61%	2 yr	2.65%	2 yr	2.83%	2 yr	1.73%
5 yr	2.60%	5 yr	2.66%	5 yr	3.09%	5 yr	1.91%
10 yr	2.76%	10 yr	3.19%	10 yr	3.52%	10 yr	2.39%
30 yr	3.07%	30 yr		30 yr	4.07%	30 yr	3.34%

CHANGE IN TREASURY YIELD CURVE



EQUITY

INDEX RETURNS	LAST WEEK	YTD
Dow Jones Industrials	0.12%	6.16%
S&P 500 (Large Cap)	-0.31%	6.31%
S&P 400 (Mid Cap)	0.08%	9.45%
Russell 2000 (Small Cap)	0.02%	10.05%
NASDAQ Composite	0.11%	8.01%
MSCI EAFE (International)	0.10%	5.69%
iShares Real Estate	1.10%	7.49%

U.S. stocks were marginally lower last week – as measured by the S&P 500. Sector returns were mixed as five groups posted gains and seven groups fell. Advancing sectors were led by Real Estate and Technology – while Energy and Consumer Staples had the steepest declines. Nearly one month into the new year and all 12 groups show year-to-date gains, reversing the difficult 2018.

A report from SentimenTrader last week noted the giant miss on the latest reading of Consumer Confidence. The latest consumer confidence report showed a big drop from the prior month, and a massive miss from what economists had been expecting. Since at least 2000, no month has seen a larger miss between what economists expected and what consumers actually felt. The firm's research shows that when the survey misses by at least 2 points or more (this case was 6) – historically it has been a bit of a headwind for stocks and future returns.

Bespoke issues a report last week which made note of the fact that 2019 is the 6th best start to any year for the S&P 500 – through last week the index is up over 6%. The study is a bit of a wet blanket though for the bulls – as in the 8 prior years where the index gained 5%+ through 13 trading days, the S&P fell for the rest of the year five times, and the average rest-of-year change has been -3.2%.

The breadth of the rally so far this year has been a positive factor according to data from Bespoke. The number of stocks in the S&P 500 above their 50-day moving averages is at a very healthy 67%. The firm notes that level indicates a rising tide rally where the majority of stocks are participating. At the sector level, Financials have the strongest breadth reading with 85% of the stocks in the group above their 50-day moving average – that is followed by Materials at 80% and Energy at 73%.

One indicator showing positive momentum for the S&P was written about last week by SentimenTrader. Since the S&P hit its 52-week low, the index has managed to put together four consecutive weeks with gains greater than 1% - that streak ended last week. Bulls have managed to push the index like this only three other times since 1928 and the forward returns in the small sample size was decisively positive, with the average gain 12 months later of 41%.

Stocks rallied on Friday after President Trump agreed to reopen the government until mid-February to allow border negotiations to continue. The agreement came after two competing bills to end the shutdown failed in the Senate on Thursday, though the government could be shut down again on February 15 is an agreement contains no border wall funds.

Data from FactSet shows that for Q4 earnings, with 22% of companies in the S&P 500 reporting results, 71% have reported positive earnings per share surprise and 59% have reported a positive revenue surprise. So far the blended growth rate is 10.9% - if that mark proves to be the actual growth rate for the quarter, it will mark the fifth straight quarter of double-digit earnings growth for the index.

For the week ahead, Q4 earnings will continue to dominate the corporate news cycle this week with notable reporters including Caterpillar, General Electric, Lockheed Martin, Verizon, Boeing, Facebook, AT&T, Amazon, and MasterCard. The economic calendar will focus on Fed Funds Rate decision on Wednesday, with Case Shiller data out Tuesday and Employment numbers out Friday.

The flat equity markets last week did not materially change the support and resistance levels we continue to watch. First support for the S&P 500 lies at 2630 and below that at 2600. Keep the Christmas Eve low of 2351 penciled in as an important level for this cyclical bear market. Resistance for the S&P stands at 2675 and then above that at 2740 – which is the index's currently flat 200-day moving average.

ASSET ALLOCATION

CURRENT SENTIMENT

Cash	Neutral
Short Fixed Income	Neutral
Intermediate Fixed Income	Neutral
Inflation-Adjusted Fixed Income	Unfavorable
High Yield Fixed Income	Neutral
International Fixed Income	Unfavorable
Equity Income	Favorable
Large Cap Equity	Favorable
Mid Cap Equity	Favorable
Small Cap Equity	Neutral
International Equity	Neutral
Emerging Markets Equity	Neutral
Real Estate	Neutral
Commodities	Unfavorable

Below is a summary of our current stance on most asset classes:

- Cash** - Neutral weighting now that Fed Funds rate is above 2%. Any exposure is for defensive positioning or liquidity needs.
- Short Term Bonds** - Relative to Intermediate Bonds, the reduced duration is preferable given the outlook for higher interest rates.
- Intermediate Term Bonds** - The current trading range of intermediate bonds warrants a neutral position with limited upside potential. Some opportunities still remain present in floating rate securities.
- Inflation-Adjusted Bonds** - Low inflation expected in near-term providing zero real return.
- High Yield Bonds** - Spreads have tightened considerably and do not warrant exposure to unnecessary credit risk when compared to Treasuries.
- International Bonds** - Foreign bonds offer good diversification qualities and higher yield opportunities, however, risks have been elevated recently and investment should be made cautiously.
- Equity Income** - High quality and higher-dividend-paying companies remain attractive for long-term investors given their favorable risk-adjusted profile and current yield curves.
- Large Cap Stocks** - A favorable weighting is recommended. Growth continues to be a more favorable style and should be overweighed versus Value.
- Mid Cap Stocks** - Mid cap exposure remains an attractive market capitalization. Mid cap stocks continue to provide the "sweet spot" of market capitalization - large enough to provide stability, but small enough to be more nimble.
- Small Cap Stocks** - In broad market corrections, small cap stocks will suffer most with increased volatility. However, a recent divergence of relative strength between small caps and large caps warrants a neutral exposure.
- International Stocks** - Given most foreign investment is in developed markets and European countries, until sovereign debt concerns are alleviated, an underweight to neutral weight is recommended.
- Emerging Market Stocks** - Stronger balance sheets, less debt, and better growth potential make emerging markets more fundamentally attractive than developed countries longer-term. However, trade uncertainty and dollar strength provides a headwind for EM in the near term.
- Real Estate** - Pricing has stabilized and long-term valuations appear attractive. Real Estate has performed well of late and should continue to be a strong alternative to other asset classes.
- Commodities** - Global demand should support higher prices if the global recovery remains on track. Volatility will be higher and commodities will be susceptible to short-term price shocks, however, if used in conjunction with other asset classes, risk can be reduced substantially within a diversified portfolio. Used alone though is not recommended as the short-term outlook is not favorable.

Sources of statistical information are Bloomberg and Ned Davis Research.

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