ECONOMIC HIGHLIGHTS

U.S. Consumer Prices were flat for January, after having been up 1.6% year-over-year. Core Consumer Inflation for January was up 0.2% and up 2.2% for the 12 months ended January 2019. U.S. Producer Prices were down 0.1% for January, while Core Producer Inflation was up 0.3%. U.S. Retail sales were down 1.2% for December 2018, with the weakness fairly widespread. Business Inventories were down 0.1% for November 2018, with the downtrend in Business Inventories to Sales from early 2016 still intact as of the November data. Industrial Production was down 0.6% for January with Capacity Utilization at 78.2%.

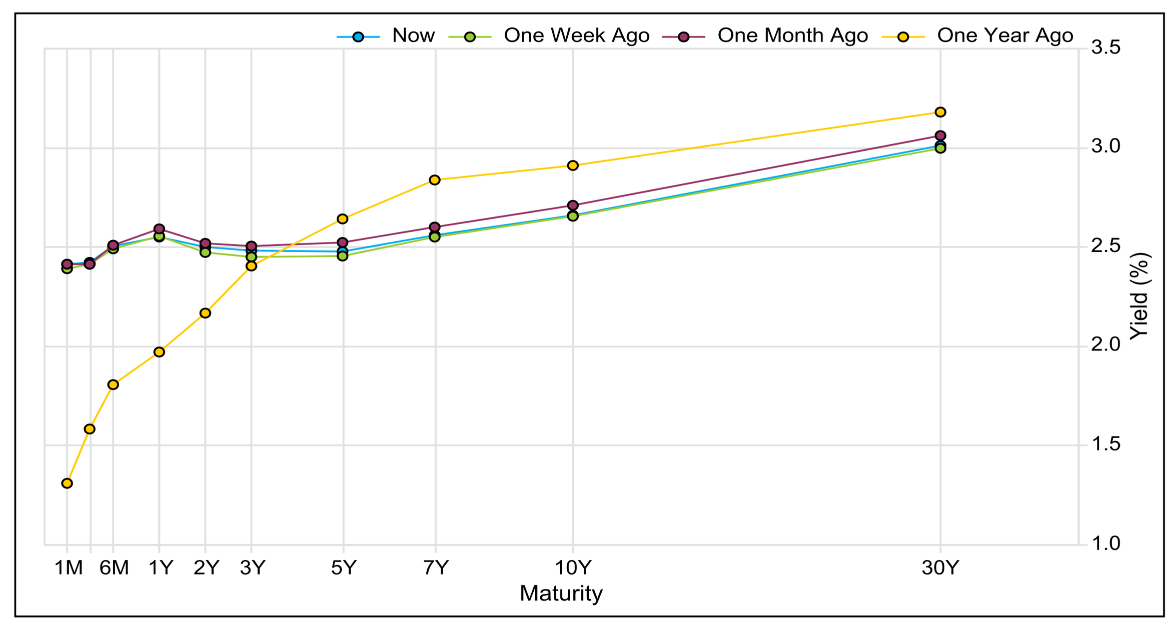
FIXED INCOME

In the wake of last month's Federal Reserve meeting, traders have been left with as many questions as answers when it comes to the fate of the central bank's balance sheet. This week may finally provide some clues on where the runoff goes from here. The holiday-shortened week will be light on economic data but heavy on Fed signals. Investors will get to dive into the January meeting minutes, while also hearing from at least three policymakers who will address the $4 trillion portfolio specifically. Key for investors will be any insights into the ultimate end date of the unwind, the eventual size of the balance sheet and the final asset mix. These decisions have implications for a broad swath of the fixed-income world, touching on everything from mortgages to repos to Treasuries. "Most of the focus will be on the balance sheet, given how, at this point, the Fed has largely capitulated to the market on rate hikes," said Jonathan Cohn, the head of interest-rate trading strategy at Credit Suisse in New York. "The real surprise in January was how quickly they pivoted toward balance-sheet flexibility, so most of the attention will be on that front." At last month's meeting, the FOMC said that it's prepared to adjust its program to steadily reduce holdings of U.S. government bonds and mortgage-backed securities, seeking to maintain a monetary-policy regime with an "ample supply" of bank reserves while allowing for changes to the normalization process "in light of economic and financial developments." The central bank's crisis-era bond investments created vast excess bank reserves. Post-crisis rules enacted to curb risk-taking have prompted banks to use much of those reserves to meet the more stringent regulatory requirements. As the balance-sheet unwind slowly drains liquidity from the financial system, some in the market are suggesting bank reserves are once again poised to become scarce. Fed Governor Lael Brainard last week said in an interview on CNBC that the balance-sheet unwind should probably come to an end later this year as financial markets signal significant demand for those reserves. Her timeline is roughly in line with a recent Bloomberg survey of economist, who expect the central bank to begin slowing the pace of the rundown in the third quarter. With St. Louis Fed President James Bullard, Philadelphia Fed President Patrick Harker and Fed Governor Randal Quarles speaking about the outlook for the balance sheet on Friday, investors are likely to get an even better look at thinking inside the central bank on the timetable for ending the rundown.

CURRENT GENERIC BONDS YIELDS

TREASURIES		AGENCIES		CORPORATES		MUNICIPALS	
3 mo	2.42%	3 mo	2.26%	3 mo	2.57%	3 mo	1.61%
6 mo	2.50%	6 mo	2.31%	6 mo	2.61%	6 mo	1.63%
1 yr	2.53%	1 yr	2.36%	1 yr	2.66%	1 yr	1.66%
2 yr	2.51%	2 yr	2.55%	2 yr	2.74%	2 yr	1.69%
5 yr	2.49%	5 yr	2.56%	5 yr	2.95%	5 yr	1.82%
10 yr	2.66%	10 yr	3.07%	10 yr	3.40%	10 yr	2.33%
30 yr	2.99%	30 yr		30 yr	3.98%	30 yr	3.36%

CHANGE IN TREASURY YIELD CURVE



EQUITY

INDEX RETURNS	LAST WEEK	YTD
Dow Jones Industrials	3.43%	11.37%
S&P 500 (Large Cap)	2.43%	10.97%
S&P 400 (Mid Cap)	2.60%	15.20%
Russell 2000 (Small Cap)	3.25%	16.41%
NASDAQ Composite	2.27%	12.75%
MSCI EAFE (International)	2.60%	8.15%
iShares Real Estate	0.55%	13.21%

U.S. stocks rallied last week ending higher for the third straight week and 6 of the last 7 weeks going back to the December 24 lows. All 12 major sector groups rose led by Energy (+5%), Telecom (+4.8%), and Industrials (+3.6%). Last week's strong rally also pushed year-to-date gains for 8 sectors further into double-digit territory. Industrials leads on a year-to-date timeframe, up +17.5% followed by Energy which is up a little over +15%.

Helping to fuel the recent equity rally has been the Fed's dovish pivot. That argument gained some additional traction last week with the focus on balance sheet normalization. Fed Governor Brainard told CNBC that she is in favor of bringing runoff to an end later this year. The Wall Street Journal also reported that Fed officials are closing in on a plan to end the wind-down of the central bank's $4 trillion asset portfolio as soon as this year.

Several reports last week noted that despite the recent strong equity rally, U.S. equity funds have seen near record level of outflows. According to EPFR Global, U.S. equity funds saw an eleventh straight week of outflows in the week-ended February 13. In a separate report, Bank of America Merrill Lynch noted that equity allocations are the lowest since September 2016, and cash is the most over weighted since January 2009. Institutional positioning reports such as these are widely viewed as contrarian indicators lending credence to the argument the recent rally could have more room to run higher.

While Institutional Investors are paring back equity exposure, a report from SentimenTrader noted that the last survey results from AAII showed that individual investors piled back in during January's large rebound. They upped the allocation to stocks to over 71% of their portfolio, at the expense of their cash allocation which plunged to just over 13%. The spread between their stock and cash allocations is just under 60%, ranking near the top of their exposure over the past 30 years.

Breadth as measured by the percentage of stocks trading above their 50-day moving averages is now extremely strong, according to data from Bespoke. In a report the group released last week they noted that 88% of stocks in the S&P 500 are now above their 50-day moving averages, and five sectors have readings in the 90s. Industrials, Real Estate, and Energy all have 97% of stocks above their moving average – a very healthy reading indicating widespread participation among sectors in this recent rally.

Last Wednesday marked the 30th trading day of 2019 and with a gain of +9.68% year-to-date, 2019 has been the 8th best start to a year in the S&P 500's history, according to data from Bespoke. The last time the index has seen a start as strong as this was back in 1991 when it rose 10.68% in the first 30 days. Bespoke noted that in the top 10 best starts to a year for the S&P 500, the remainder of the year has averaged a meager -0.49% and shown positive returns 66% of the time. The correlation between how the index starts the year and how it finishes is very weak indicating the performance through the first month or so of trading is hardly indicative of where the index may finish a particular year.

For the holiday shortened week ahead Q4 earnings will largely dominate headlines with reports expected from Wal-Mart, Advance Auto Parts, Medtronic, CVS, and Domino's Pizza. The Economic calendar will be relatively slow in the U.S. with NAHB housing market index and FOMC meeting minutes along with latest PMI readings highlighting the scheduled releases.

The S&P 500 is fast approaching the resistance level marked by the upper bound of the October and November trading range – which stands at 2820. Last week the S&P 500 rose above its 200-day moving average which it had been trading under since early December. Support for the index stands at the 200-day moving average of 2743 then below that at 2630 and 2605. The index closed last week at 2775.

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.