The Weekly

Economic & Market Recap

Peapack-Gladstone Bank, Private Wealth Management

August 17, 2018

As of 08/17/2018		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	25,669.32	356.18	1.41	2.13	3.84	18.02
S&P 500	2,850.13	16.85	0.59	1.83	6.59	17.27
NASDAQ 100	7,377.54	-30.76	-0.42	0.98	15.34	27.28
S&P MidCap 400	2,010.19	14.17	0.71	1.52	5.77	18.52
Russell 2000	1,692.95	6.14	0.36	1.33	10.25	24.58

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	2.61	Euro/Dollar	1.14	0.24
5-Year	2.74	Dollar/Yen	110.57	-0.35
10-Year	2.86	Sterling/Dollar	1.27	-0.17
30-Year	3.02	Dollar/Cad	1.31	-0.66

Source: Thomson Reuters & Bloomberg

What Caught Our Eye This Week

At around $860 billion, Turkey's economy is not terribly huge, but it is four times larger than Greece and approximately 6.5% of the total Eurozone GDP. It is a key NATO ally because of its geographical location. In Turkey, unlike the U.S. and the European Union, the central bank is controlled by the government. As a result, control over interest rates and inflation is in the hands of the President, Recep Tayyip Erdogan. He has been criticized for keeping interest rates low even though inflation (almost 16%) is more than three times the central bank's policy. Since January, the value of the Lira has fallen more than 34% vs the U.S. dollar and has lost half of its value over the last year. Turkey cannot support the Lira because it does not have the requisite amount of U.S. dollars to defend the decline. The country holds virtually no U.S. dollars. In addition, Turkey has the largest current account deficit among the emerging markets. The IMF forecasts its deficit to reach $49 billion this year or 5.4% of its GDP. To finance the deficit, Turkey borrowed in foreign currencies which become difficult to service as the Lira falls. Since Turkey's economic woes are unique to themselves, risks of contagion should be short term.

Economy

The most anticipated report this week was the retail sales report, which was released on Wednesday. Retail sales increased 0.5% in July and are now up 6.4% year-over-year. Retail sales have now grown for six consecutive months, and the gains in July were broad based with nine of thirteen major categories showing rising sales. The all important control category, which excludes food service, autos, gas and building materials advanced by 0.5%. Sales at food and drinking establishments increased 1.3% and are now up 9.7% year-over-year. Also on Wednesday industrial production figures rose 0.1%, which was below expectations. Manufacturing increased by 0.3% and capacity utilization was unchanged at 78.1%. The best news was the production of high-tech equipment advanced by 0.8% and is now up 12.1% versus a year ago. On Thursday, monthly housing starts were reported and showed an increase of 0.9% in July to 1.168 million units at an annual rate. Over the past 12 months, housing starts are down 1.4%. Single family starts increased 0.9% in July and single family permits advanced by 1.9%. Single family homes contribute significantly more to GDP data than does multifamily.

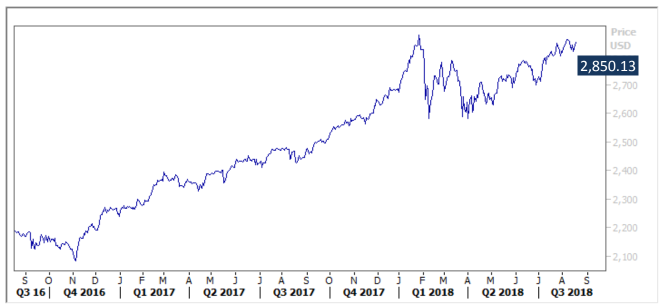
Fixed Income/Credit Market

After a three-day pause, the Turkish Lira resumed its weakening on Friday – one week after the currency lost 20% of its value in a 24-hour period. Concerns of contagion remain in the global financial markets but despite the headline risks, U.S. Treasury yields remained within a narrow trading range. On the week, the 2Y tenor increased 1.2 basis points (bps) to approximately 2.62% while the 10Y Treasury was lower just 0.5 bps to roughly 2.87%. The MOVE Index (Merrill Lynch Option Volatility Estimate), which is a yield curve weighted index of volatility on 1-month Treasury options, remained subdued. Week-over-week, the index remained unchanged closing at 50.6, 1.9 points below its one-year average of 52.5 and 21.2 points lower than its one-year high of 71.8 which occurred in February during the equity market sell-off. Furthermore, the 10-year U.S. Treasury Note Volatility Index (TYVIX) closed that week 1.8% lower at 3.87.

Equities

Equity markets endured a tumultuous week. Trade war concerns and Turkey's worsening currency crisis drove investor sentiment and weighed on bank stocks early in the week, but reversed course on Wednesday afternoon. The promise of future talks between the U.S. and China regarding tariffs and a handful of positive earnings reports drove stocks higher for the week. Quarterly earnings season is winding down and robust corporate earnings so far have boosted investors' confidence. For the second quarter, 467 of the S&P 500 members have reported with 79% of the companies beating EPS estimates and 72% surpassing revenue estimates. Results this week were mixed with positive reports, forward guidance, and stock performance from Cisco Systems (CSCO) and Walmart (WMT) offsetting select challenges within retail/consumer discretionary and technology sectors. The worst performing sector of the week was Energy (-3.53%) and the best performing was Consumer Staples (+3.34%).

S&P 500



Our View

The primary election cycle ends in a few weeks. There are only a handful of state primaries remaining with Florida being the most notable. Mid-term elections produce a high level of uncertainty and corresponding heightened volatility. According to recent academic research by Terry March from the University of California, the Dow Jones Industrial Average has produced an annualized return of just 1.4% in the six months preceding a midterm election in contrast to 21.8% annualized in the six months afterward. Domestic equity markets have produced acceptable returns compared to the muted returns that historically precede midterm elections. The returns are especially notable given the uncertainty created by trade tariff concerns. Equity prices in the third quarter have been very good, the DJIA up over 5%, driven by robust corporate earnings and a lessening of trade tensions. According to Thomson Reuters, second-quarter earnings growth for the S&P 500 will be a healthy 24.4%. Roughly ten percent of this earnings growth is related to the tax law change. Nonetheless, double-digit earnings growth and a solidly expanding economy have been very reassuring to domestic investors. A strong dollar and trade tensions, however, have created divergences in global equity markets. Emerging market equities are well into correction territory with the MSCI EM Index down over 14% in the last six months. Financial stress from currency and interest rate differentials are likely to expose economic problems such as Turkey. If the underlying fundamentals remain favorable, the ultimate path will be upward for equity prices.

COMING UP NEXT WEEK		**Est.**
08/22 Existing Home Sales	(Jul)	5.40M
08/23 New Home Sales – Units	(Jul)	0.650M
08/24 Durable Goods	(Jul)	0.8%
08/24 Durable Ex-Transport	(Jul)	0.3%

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