PEAPACK PRIVATE

Wealth Management

The Weekly

Economic & Market Recap

Peapack Private Wealth Management

July 12, 2019

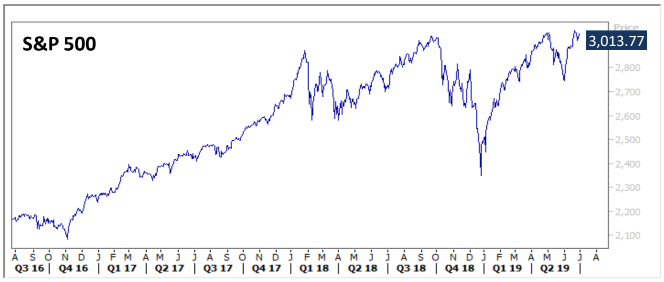
07/12/2019		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	27,088.08	165.96	0.62	2.17	16.12	9.67
S&P 500	3,013.77	23.36	0.78	1.87	20.22	8.64
NASDAQ	8,244.15	82.36	1.01	1.00	24.25	6.84
S&P MidCap 400	1,960.49	-5.46	-0.28	1.70	17.89	-1.56
Russell 2000	1,566.99	-5.62	-0.36	1.56	16.42	-7.12

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	1.85	Euro/Dollar	1.13	0.27
5-Year	1.87	Dollar/Yen	108.02	-0.41
10-Year	2.12	GBP/Dollar	1.26	0.42
30-Year	2.64	Dollar/Cad	1.31	-0.14

Source: FactSet

Equities

Domestic equities gained for a second consecutive week, and all three major indexes closed at all-time highs on Friday. The advance was primarily attributed to a continued expectation of an interest rate cut from the Federal Reserve later this month. On Wednesday, Fed Chairman Jerome Powell essentially confirmed that the rate cut was coming as he pointed to muted inflation and economic weakness abroad and its potential to impact U.S. growth. Generally, a lower interest rate backdrop is viewed as a positive for stocks. Rising oil prices helped boost the energy sector to the top of the S&P 500, while uncertainty surrounding drug pricing weighed on the healthcare sector this week. With the market pricing in a rate cut, investors will be looking for Q2 earnings season to push equities higher. Major banks such as Bank of America, Wells Fargo and JP Morgan will report next week.



What Caught Our Eye This Week

President Trump has made it clear that he intends to continue to work toward his goal of reducing prescription drug prices in the United States. Given that there is unusual bipartisan support and broad campaign focus on addressing the problem of escalating drug costs, some kind of change is most likely inevitable. On Monday, a federal judge ruled that the administration overstepped its authority while trying to require pharmaceutical companies to disclose the list prices of drugs in their television ads. Furthermore, on Thursday, a White House spokesman announced that the administration was dropping its plan to curb the drug rebates present in the drug supply chain for Medicare and Medicaid. Many doubted the efficacy of this plan from the start. (The problem with drug rebates is that a material portion of the money ultimately does not find its way to patients looking to buy their prescription drugs at more affordable prices.) Some believe that the administration's next effort to reduce drug costs may be its attempt to implement the International Pricing Model. This proposal would require the Medicare and Medicaid programs to pay no more for its drugs than what is charged for these same medications outside of the U.S. The prices that patients pay for drugs overseas is typically far lower than what patients pay in the U.S. The uncertainty surrounding each attempt to fix the problem of high drug prices is causing the stock prices of pharmaceutical companies, drug distributors, pharmacy benefit managers and insurance companies to fluctuate wildly.

Economy

This week the economic data centered around inflation statistics with the release of the producer price index and the consumer price index. On Thursday, the CPI exceeded expectations with a gain of 0.1% in June. Over the past 12 months, this metric has increased by 1.6%. The "core" CPI which excludes food and energy prices increased by 0.3% and is now up 2.1% year-over-year. The producer price index was reported on Friday and showed an increase of 0.1% in June, which was slightly above expectations. The "core" PPI advanced by 0.3% and is now up 2.3% year-over-year. Energy prices dropped by 3.1% and food prices increased by 0.6%. The "core" goods PPI was unchanged for the third straight month. On Tuesday, the JOLTS report (job openings and labor turnover survey) showed 7.3 million job openings on the last business day of May. Despite a drop of 300,000 openings going back to the January report, the net employment gain over the last year is a respectable 2.6 million.

Fixed Income/Credit Market

Fixed income performance in the second quarter was strong thanks to global central banks shifting to a more dovish stance due to slowing global growth and muted inflation. The sectors that we follow all had positive quarterly returns with the top performers being long duration high quality bonds, emerging markets debt (non-currency hedged) and international Treasuries (non-currency hedged) which returned 6.32%, 4.22%, and 4.04%, respectively. Over the course of the second quarter, U.S. Treasury yields plummeted anywhere from 28.5 basis points (bps) at the 30-year tenor to an astonishing 50.7 bps at the two-year tenor. The dramatic compression of bond yields was not confined to the U.S. as an additional $2.5 trillion of global debt slipped below the zero percent yield boundary. At the end of June close to $13 trillion of debt had negative yields. The worst performing sectors for second quarter were senior loans, short-term U.S. Treasuries and short duration high yield bonds, which returned 1.35%, 1.46%, and 1.48%, respectively.

Our View

During this week's semiannual monetary policy testimony, Fed Chair Powell strongly suggested that the Federal Reserve was ready to pull the trigger on a rate cut at their July 30-31 meeting unless economic data showed improvement. The fixed income market is fully pricing in a rate cut. Equity markets responded with a rally to new highs, and the S&P 500 broke through the 3000 level for the first time. Assuming the Fed does cut rates, it will mark the most significant and rapid shift in central bank policy without the impact of a major exogenous event (i.e., war). In December, the Fed was guiding markets expectations toward two rate hikes in 2019, which created a drawdown in equity prices. The trailing price-to-earnings multiple on the S&P 500 bottomed at 15.5 times. After the roughly 19% rally in equities, the trailing multiple on the market today is over 19 times. At some point, multiple expansion due to the prospect of lower interest rates and central bank accommodation will no longer provide a lift to equity prices. Earnings growth will ultimately need to drive valuations higher. Companies will begin to report second-quarter earnings in the next couple of weeks. According to FactSet, 114 companies have issued earnings forecasts, and 77% of them have issued negative earnings guidance. The primary reasons being cited are lingering trade uncertainty and slowing global economic growth. Analysts have revised estimates lower for the second quarter. Heading into earnings reports, analysts now expect earnings to decline by 2.9%. By comparison, when the year began estimates for the second quarter were for earnings growth of 5%. The equity market has so far been able to look past the earnings slowdown because of the shift in Fed policy. News regarding the trade situation has been very light since the end of the G20 Summit, but the potential harmful impact on profit margins caused by trade tariffs will get investors' attention. For the equity market to maintain momentum given current valuations, companies' earnings guidance for the second half will be crucial.

COMING UP NEXT WEEK		**Est.**
07/15 Empire State Index SA	(Jul)	2.3
07/16 Retail Sales SA M/M	(Jun)	0.20%
07/17 Housing Starts SAAR	(Jun)	1,265k
07/18 Philadelphia Fed Index SA	(Jul)	5.0
07/19 Michigan Sentiment NSA (Prelim)	(Jul)	98.2

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