Peapack Private Wealth Management

September 20, 2019

09/20/2019		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	26,935.07	-284.45	-1.05	2.28	15.47	2.00
S&P 500	2,992.07	-15.32	-0.51	1.91	19.36	2.89
NASDAQ	8,117.67	-59.04	-0.72	1.03	22.34	2.11
S&P MidCap 400	1,944.64	-18.52	-0.94	1.78	16.93	-4.22

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	1.71	Euro/Dollar	1.10	-0.65
5-Year	1.63	Dollar/Yen	107.89	-0.16
10-Year	1.75	GBP/Dollar	1.25	0.35
30-Year	2.21	Dollar/Cad	1.33	0.21

Source: FactSet

What Caught Our Eye This Week

Walmart became the latest retailer to weigh in on the controversial subject of vaporizers and electronic cigarettes (e-cigarettes) this week, when it decided to stop selling the devices. Since their introduction in the early 2000s, the popular alternative to traditional cigarettes has seen exponential growth. Instead of inhaling cigarette smoke, users inhale an aerosol ("vapor") generated by heating a liquid solution called an e-liquid. E-liquids are comprised of propylene glycol, glycerin, nicotine, flavorings, additives, and differing amounts of contaminants. While the benefits and health risks are not entirely known, both e-cigarettes and vaporizers have been thrust into the public consciousness after a mysterious increase in severe breathing illnesses related to their use. The spike in lung illnesses is most likely attributed to illicit devices or new chemicals on the market. Various authorities including the U.S. government, India, and the states of New York and Michigan have reacted to this crisis by proposing or enacting bans on the flavored e-liquids. Critics of the bans suggest a better approach might be informed regulation of the market rather than a blanket ban. Beyond concerns about public health, the various legislation to ban or restrict sales of electronic cigarettes and vaporizers may spur consolidation in the tobacco industry.

Economy

On Tuesday, August industrial production data showed an increase of 0.6% which beat expectations of +0.2% and is its largest monthly increase in a year. The only major category that posted a decline in August was auto manufacturing which fell 1.0%. Housing starts were also strong, increasing 12.3% month-over-month which easily surpassed expectations of +5.0%. The increase was primarily driven by a 32.8% increase in multi-family starts while single-family starts showed a gain of 4.4%. Starts are now up 6.6% versus a year ago. In other news, the Conference Board Leading Economic Index (LEI) for the U.S. was unchanged in August, remaining at 112.1, following a 0.4% increase in July. Expectations were for a decline of 0.1%. According to the Conference Board's Senior Director of Economic Research, "The recent trends in the LEI are consistent with a slow but still expanding economy, which has been primarily driven by strong consumer spending and robust job growth." Finally, initial jobless claims rose to 208,000 for the week ended September 14. This came in below expectations of 213,000, and the four-week moving average is now 212,250.

Fixed Income/Credit Market

On Wednesday, the FOMC voted to lower the Fed funds rate by 25 basis points (bps) for the second time this year to a range of 1.75% to 2.00%. The decision was far from unanimous as three members voted against the rate cut with Esther George and Eric Rosengren calling for no rate change and James Bullard voting for a 50 bp rate cut. The FOMC's updated median economic projections showed GDP growing 2.2% in 2019, which was up 10 bps from its June projection. The FOMC statement indicated the economy was growing at a moderate pace with strength in the labor market being offset by weakening fixed business investment, exports and overseas growth. The FOMC's median projected Fed funds rate at the end of 2019 indicates no further rate cuts. The market on the other hand indicates a 67.3% probability of a rate cut by December of 2019, according to effective Fed funds futures. For the week, U.S. Treasury yields were down across the curve anywhere from 0.9 bp at the 6-month tenor to 21.0 bps at the 30-year tenor.

Equities

Last weekend's attack on Saudi Arabia's oil facilities triggered a 3.29% surge for the energy sector on Monday, as fears of disrupted supply rippled through the market. However, reassurances that crude production should return to normal capacity by month's end calmed investors the next day and led energy stocks to underperform for the majority of the week. Markets were mixed mid-week as the 25bp rate cut on Wednesday sparked debate as to whether the divided Federal Reserve will accommodate future rate cuts. Furthermore, prospects surfaced Thursday in regard to a potential deal slated for next month that would see increased Chinese purchases of U.S. agricultural products, the postponement of future tariff spikes, and assuaged restrictions on Huawei. Sentiments reversed, however, on Friday after the deal was nixed. The top performing sector for the week was utilities, up 2.25%, while the worst performing sector was consumer discretionary, trailing -2.14%. The S&P closed at 2,992 on Friday while the Dow closed at 26,935.

Our View

Datadog, the developer of an IT analytics platform, came public this week selling 24 million shares at $27 that valued the firm at $7.83 billion. With fewer companies today electing to come public due to burdensome listing requirements, increased regulatory scrutiny, and to avoid investor's short-term mentality, it was encouraging to see the company opt for a public listing. It was especially encouraging since immediately before its IPO, Datadog had a $7 billion acquisition offer from Cisco. Large, deep-pocketed companies, especially in the IT space, have been acquiring non-public companies in attractive growth niches to augment their growth prospects or to defend their products from rival offerings. A lower number of corporate IPOs and acquisitions are just a couple of factors contributing to the broader concern of the shrinking U.S. equity market. Today, there are 3,600 publicly-listed companies in the U.S. compared to 8,000 in 1996. Another primary reason for the decline in the number of public companies is the availability of capital from private equity sources. Every single year since 2011, U.S. companies have bought more shares than they have issued. The aggregate share count in 2018 shrunk by roughly 3% due to the significant shift in the relative cost of debt versus equity. Even before the recent compression of rates over the last three months, Citigroup calculated that the cost of debt in the U.S. is 4.1% while the cost of equity is 6.7%. The shrinking of the U.S. public equity market has several disturbing consequences. First, companies today are much larger, and profits are increasingly becoming more concentrated. A study by the University of Arizona highlights this issue. In 2015, the top 200 companies by earnings accounted for all the profits in the stock market and the remaining 3,281 publicly-traded companies, in aggregate, lost money. The second issue is that as the equity opportunities shift toward private equity, where the average investor does not have access, retail and smaller investors are losing the ability to participate in early-stage growth companies. Regulators will eventually need to address this structural issue.

COMING UP NEXT WEEK		Est.
09/26 GDP SA Y/Y (Final)	(Q2)	2.3%
09/27 Durable Orders SA M/M (Preliminary)	(Aug)	-1.3%
09/27 Michigan Sentiment NSA (Final)	(Sep)	92.0

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