The Weekly

Economic & Market Recap

Peapack-Gladstone Bank, Private Wealth Management

October 27, 2017

As of 10/27/2017		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	23,434.19	105.56	0.45	2.19	18.58	28.97
S&P 500	2,581.07	5.86	0.23	1.93	15.27	20.98
NASDAQ 100	6,213.47	104.65	1.71	1.06	27.75	28.47
S&P MidCap 400	1,839.12	4.83	0.26	1.54	10.75	22.52
Russell 2000	1,508.32	-0.93	-0.06	1.33	11.14	26.75

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	1.58	Euro/Dollar	1.16	-1.52
5-Year	2.02	Dollar/Yen	113.67	0.12
10-Year	2.41	Sterling/Dollar	1.31	-0.53
30-Year	2.92	Dollar/Cad	1.28	1.46

Source: Thomson Reuters & Bloomberg

What Caught Our Eye This Week

Morningstar is a research firm that rates the 10,800 mutual funds in the United States representing $16 trillion of investor assets. It is well known for its “star” rating system. The rating system takes into effect the performance of each fund after fees and the volatility of the fund’s returns (risk). Each month, Morningstar compares funds among its peers in each investment style and assigns a 1 to 5 rating – 5 stars for the top funds down to 1 star for the worst funds. The methodology is very sound and the star system is a good place to begin a fund selection process, but it is not strongly predictive of future fund performance. This Wednesday, the Wall Street Journal released its study of Morningstar’s rating system and found that, on average, 5-star rated funds become 3-star rated funds (average) for the subsequent 5-year period. The point of this study is that there are many managers that deliver excellent returns over the long term, but we should not expect managers who have delivered extraordinarily high relative returns for a brief period of time to be able to continue to place far ahead of the field for prolonged lengths of time. Performance consistency, reasonable costs, and tax efficiency are what really determine the best managers.

Economy

The economic headliner this week was Friday’s report on third quarter Real GDP. This was the first look at Q3 GDP and the figures came in better than consensus rising at a 3.0% annual rate. Real consumer spending increased by 2.4% and business spending on equipment advanced by 8.6%. This is the fourth straight quarter of positive business spending growth. Excluding inventory investment GDP growth was 2.3%. The Fed’s preferred inflation gauge, the personal consumption expenditures (PCE) price index excluding food and energy, increased at a 1.3 percent rate. In the second quarter, this metric only increased by 0.9%. There will be two more looks at third quarter GDP, first on November 3rd and then on December 21st. In other news this week, orders for durable goods increased by 2.2% in September and are now up 8.3% year-over-year. When examining “core” (non-defense, ex-aircraft) orders, these figures increased by 1.3% and shipments (non-defense, ex-aircraft) increased by 0.7%. Shipments have now increased for eight straight months. Finally, on Wednesday, we were pleased to see new home sales surge 18.9% in September to 667,000 units. This was the strongest month for sales going back to October 2007, but the recent hurricanes most likely inflated these figures.

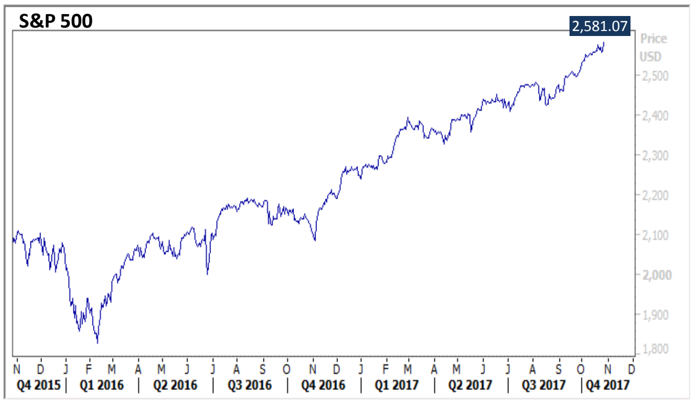
Fixed Income/Credit Market

Week-over-week the benchmark 2-year and 10-year Treasury yields widened 1.5 and 3.1 basis points, respectively. With the 10-year increase outpacing the 2-year increase, the 2-year and 10-year spread widened to approximately 82.5 bps. While not nearly as compressed as it had been on 10/17/17, when the spread hit its year-to-date low of 75.2 bps, the benchmark spread is still historically tight. This year alone, the spread hit a year-to-date high of roughly 128 bps on 1/26/17 only to compress back to the mid-seventies this month. Below is a chart depicting the 2-year and 10-year spread over a 5-year horizon.

U.S. TREASURY 2-YEAR AND 10-YEAR SPREAD (BPS)						
Year	2012	2013	2014	2015	2016	2017
High	154	265	261	178	136	128
Low	134	143	151	119	75	75

Equities

U.S. stock indices have increased for the past six consecutive weeks, with modest gains this week. Some of the major factors positively impacting domestic equity markets were better-than-expected earnings results, major economic releases surpassing consensus expectations, and the budget blueprint passing in the House of Representatives. Fifty-four percent of companies in the S&P 500 have announced their quarterly results beating earnings and revenue expectations by 74% and 67%, respectively. This week’s major economic release of 3% GDP growth implies the U.S. economy is strong. This week’s top performing sector was Information Technology, advancing 2.32%, following earnings releases from 23 technology companies. The Nasdaq 100 Composite Index added approximately $200 billion in market cap on Friday with the index increasing by 2.91% for the day as many of the largest technology companies released outstanding results for the quarter. This gain reversed a 4-day streak of declines and pushed the index back into the black for the week, increasing by 1.71%. The healthcare sector was this week’s worst performing sector, declining approximately 2.11% due to mixed earnings results and news of corporate actions.



Our View

Interest rates have been driven to historically low levels as global central banks have purposefully ballooned their balance sheets to create liquidity to reinvigorate economic growth. As an example, the European Central Bank has expanded their balance sheet by over 2 trillion euros over the last 18 months. The German 10-year bund trades at a yield around 0.38%. Low yields and cheap capital have certainly encouraged risk-taking and asset speculation. The efficacy of central bank efforts to lift economic production has been hotly debated, but clearly, there is an element of diminishing returns. Without a doubt, the incremental liquidity is also causing asset prices to rise and waning asset price volatility. Coincident with the flood of liquidity from central banks, and perhaps to some degree because of it, many more investors have embraced passive investing. Passive investors tend to be more insensitive to valuations, especially in low volatility environments. Price discovery is lacking. Value investors have had a very difficult time as equity market returns have become increasingly narrow and focused on a select number of growth names. The preference for growth stocks in a low-growth world made sense at some point, but now valuation differentials are so extreme between growth and value that we would expect money to shift to value-oriented sectors.

COMING UP NEXT WEEK		Est.
10/30 Personal Income MM	(Sep)	0.4%
10/31 Consumer Confidence	(Oct)	121.0
11/01 ISM Manufacturing PMI	(Oct)	59.5
11/03 Non-Farm Payrolls	(Oct)	310k
11/03 Factory Orders MM	(Sep)	1.3%

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