



10/18/2019		Wk	Wk		YTD	12 Mos
	Close	Net Change	% Change	Div Yield	% Change	% Change
<b>STOCKS</b>						
DJIA	26,770.20	-46.39	-0.17	2.30	14.76	4.14
S&P 500	2,986.20	15.93	0.54	1.93	19.12	6.30
NASDAQ	8,089.54	32.50	0.40	1.03	21.92	5.85
S&P MidCap 400	1,936.76	20.19	1.05	1.78	16.46	1.22

<b>TREASURIES</b>	Yield	<b>FOREX</b>	Price	Wk %Change
2-Year	1.57	Euro/Dollar	1.11	0.94
5-Year	1.57	Dollar/Yen	108.52	-0.06
10-Year	1.75	GBP/Dollar	1.29	1.70
30-Year	2.25	Dollar/Cad	1.31	-0.48

Source: FactSet & Bloomberg

### What Caught Our Eye This Week

With the frenetic back and forth of Chinese tariff negotiations, a review of the trade war is warranted. The first tariff increase by the Trump administration was instituted in January of 2018, and the level has increased over time. Today, the United States imposes tariffs on \$360 billion worth of Chinese imports. Last week, the administration announced that the planned October 15 tariff increase from 25% to 30% on \$250 billion of Chinese goods would be halted. In response to this freeze, the Chinese government has agreed to increase its purchases of U.S. farm products over the next two years. The Trump administration has stated that the Chinese have agreed to buying up to \$50 billion of beef, pork, soybeans, and other agricultural products from the U.S. China has refrained from committing to this number which many believe to be unrealistic. In the year before the trade wars began, the Chinese imported only \$24 billion in U.S. farm products. In a follow-on phase of the negotiations, the U.S. aspires to resolve three issues that are at the heart of the trade dispute: protecting U.S. intellectual property, allowing U.S. corporations more access to the Chinese market with the ability to compete fairly, and limiting the Chinese government's subsidies to its state firms. If little is accomplished in the upcoming negotiations, on December 15, the U.S. administration plans to impose a 15% tariff on \$156 billion worth of Chinese goods above and beyond the \$360 billion that is currently in place.

### Economy

Data released on Wednesday showed that retail sales declined 0.3% for the month of September, missing the expected consensus gain of 0.3%. The decline in sales – the first one in the last seven months – was driven by autos, building materials, and gas stations. "Core" sales however, which exclude autos, building materials, and gas stations due to their volatility, were up 0.1% for the month. Clothing and accessory stores had the largest gains at 1.3%. Housing starts posted a 9.4% decline for September as all major regions weakened. The annual rate fell to 1.256 million, well below expectations of 1.32 million. The decline is attributed to a 28.2% drop in multi-family starts, the biggest monthly drop since 2016. Single-family starts on the other hand increased 0.3% for the month. Starts overall are now up 1.6% versus a year ago. On Thursday, industrial production data reported a monthly decline of 0.4%, missing the consensus of -0.2%. Manufacturing, which excludes mining/utilities fell 0.5% in September, while non-auto manufacturing dropped 0.1% as well. The GM strike weighed heavily in the auto production pull back; however, nearly every major category showed declines, indicating the slowdown was broadly based.

### Fixed Income/Credit Market

The yield curve steepened this week with the spread between the 2-year and 10-year U.S. Treasury widening from 14 basis points (bps) to 18 bps. The 10-year yield hit its highest level, 1.80%, since September 19<sup>th</sup>. The expectation for a cut in the Fed Funds rate at this month's Federal Reserve meeting on October 30<sup>th</sup> is currently 84.2%. The market will be watching for signals of a possible rate cut at the December meeting as well. There continues to be disagreement among the Federal Reserve members on whether current economic conditions warrant further rate cuts. Corporate bond fund inflows were strong this week with additions to investment grade funds of \$2.89 billion and high yield funds of \$1.7 billion as of Friday morning, according to Refinitiv's Lipper. The U.S. Treasury announced issuance of \$40 billion 2-year, \$41 billion 5-year, \$32 billion 7-year and \$20 billion 2-year floating rate notes for next week.

### Equities

Stocks continued to move higher this week as a few of investors' concerns were at least somewhat alleviated. Firstly, optimism over a de-escalation in U.S.-China trade talks due to the announcement of a "phase one" trade deal last Friday has provided a nice tailwind for equities. Investors were also focused on the unofficial start to Q3 corporate earnings season this week, and it has had a pretty good start thus far. Most of the big banks beat both top and bottom line estimates, industrial companies have been getting credit for good execution, and two major healthcare stocks, Johnson & Johnson and UnitedHealth, released numbers that beat expectations while also raising their full year earnings guidance. Lastly, on Thursday, British and European Union leaders came to a tentative Brexit deal that would result in an orderly split between the U.K. and EU. The British Parliament is scheduled to vote on the deal Saturday. The S&P 500 gained more than 0.5% on the week with healthcare (+2.0%) as the top performing sector and energy (-1.7%) the worst performing sector.



### Our View

The repurchase (repo) market is a short-term financing venue where more than \$3 trillion of cash and collateral are swapped each day and is a critical element which allows the U.S. financial system to function properly. On September 17<sup>th</sup>, the overnight repo rate spiked briefly to 10%, which was roughly 8% higher than its one-year average. There were three main causes that came together to drain enough liquidity out of the system to shock overnight rates. First, a vast sum of Treasuries settled on dealer's balance sheets, which had to be paid for. Second, corporations withdrew cash from money-market funds and banks to make quarterly tax payments. Lastly, banks were holding onto cash to satisfy quarter-end reporting requirements. The lack of cash that caused the drastic increase in the overnight repo rate sent alarm bells off throughout the financial system and prompted the Fed to inject emergency liquidity into the system for the first time since the financial crisis. It is interesting to note that the repo market meltdown in September of 2008 significantly contributed to the financial panic at the time and it begs one to question whether the recent spike in the overnight repo rate is a telling sign of more ominous things to come. We do not think the recent dislocation in the overnight repo market is a harbinger of funding pressure ahead as the Fed has numerous tools to restore reserve levels and create the necessary buffers that are needed during times of stress. Just recently the Fed announced that it will be purchasing \$60 billion of Treasury bills per month through the second quarter of 2020. The expansion of the Fed's balance sheet will not be similar to quantitative easing since the Fed is only purchasing short duration Treasuries to enhance market liquidity and not drive down rates further out on the yield curve. Also, the Fed will continue to engage in term repo operations until at least January of 2020. The Fed's recent actions have pacified the overnight repo market as the average rate since September 17<sup>th</sup> has been just under 2%.

COMING UP NEXT WEEK			Est.
10/24	Durable Orders SA M/M (Prelim)	(Sep)	0.0%
10/24	Markit PMI Manufacturing SA	(Oct)	50.0
10/24	Markit PMI Services SA	(Oct)	52.0
10/25	Michigan Sentiment NSA (Final)	(Oct)	96.0

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