The Weekly

Economic & Market Recap

Peapack-Gladstone Bank, Private Wealth Management

November 17, 2017

As of 11/17/2017		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	23,358.24	-63.97	-0.27	2.22	18.19	23.56
S&P 500	2,578.85	-3.45	-0.13	1.94	15.19	17.91
NASDAQ 100	6,314.51	5.44	0.09	1.06	29.83	30.83
S&P MidCap 400	1,840.74	14.99	0.82	1.55	10.85	14.67
Russell 2000	1,492.82	17.55	1.19	1.34	10.00	14.00

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	1.72	Euro/Dollar	1.18	1.08
5-Year	2.05	Dollar/Yen	112.07	-1.29
10-Year	2.34	Sterling/Dollar	1.32	0.16
30-Year	2.78	Dollar/Cad	1.28	0.64

Source: Thomson Reuters & Bloomberg

What Caught Our Eye This Week

The yield curve, also known as the “term structure of interest rates”, shows the various yields across treasury maturities from the shortest to the longest. It provides investors with a quick glance of the comparison of the yields offered by short-term and long-term bonds. Typically, the yield curve is upward sloping as investors require additional yield for taking on longer-term risks. This week, we saw the difference between the widely watched two-year and ten-year treasury yields contract to 63 basis points, the flattest (narrowest) since November 2007. Since the short end of the curve is directly impacted by Federal Reserve interest rate policies, the bond market is pricing in future interest rate increases. Conversely, yields on longer-term bonds are impacted by inflation and macro-economic forces. Along with persistently weak inflation, foreign central banks’ quantitative easing (QE) programs are suppressing yields. In addition, the Treasury recently announced that it wants to focus issuance on shorter-term maturities creating a scarcity at the longer end of the curve. The shape of the yield curve is worrisome if it inverts. This occurs when short-term rates are higher than long-term rates. An inverted curve has preceded each of the nine recessions since 1955. While the economy seems to be strengthening, the shape of the yield curve will need to be closely monitored.

Economy

The most anticipated report this week was the retail sales report, which was released on Wednesday. Retail sales increased 0.2% in October and are now up 4.6% year-over-year. The all important control category, which excludes food service, autos, gas and building materials advanced by 0.3%. The best performing sectors were motor vehicles and parts (+0.7%) and food services (+0.8%). It now appears that real consumption growth will increase close to 3.0% in the fourth quarter. Also, on Wednesday, the October consumer price index displayed an advance of 0.1%, which was very close to expectations. The core CPI (excludes food and energy) increased by 0.2% and is now up 1.8% year-over-year. In other news this week industrial production figures came in better than expected rising by 0.9% in October, while manufacturing output advanced by 1.3%. On Friday, we were pleased to see monthly housing starts increase by 13.7% to 1.290 million, easily beating consensus estimates. The best news from this report was single family starts increasing by 5.3% and single family permits increasing by 1.9%. Finally weekly jobless claims increased by 10,000 to 249,000 during the week ending November 11th. The four-week average is now at 238,000.

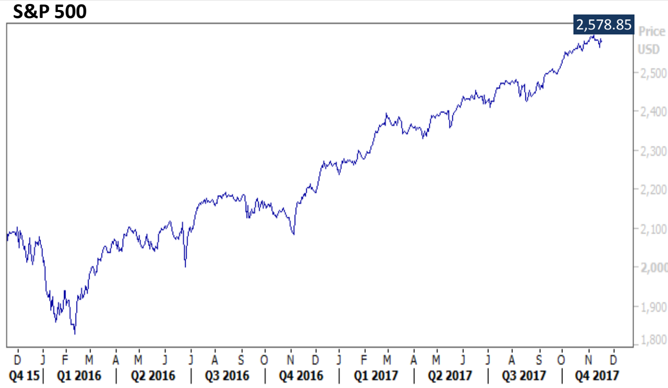
Fixed Income/Credit Market

It has been a volatile year for municipal bond ratios versus like duration U.S. Treasuries. Immediately following the 2016 U.S. Presidential election, ratios began trending upwards on President Trump’s proposed policy changes, particularly infrastructure spending. On December 2, 2016, the 10-year municipal bond ratio peaked at 107% of the 10-year U.S. Treasury. President Trump’s proposed policies have been slow to materialize putting downward pressure on municipal bond ratios. By the end of July, the 10-year muni bond ratio dipped to its 5-year low at approximately 81% of the 10-year Treasury. Over the past week, ratios have begun to rebound as tax reform gains traction and begins to progress through Congress. Moreover, the 10-year municipal bond ratio increased by 4 basis points on the week to close at 87% of the U.S. Treasury.

Equities

Domestic large cap equities remain close to all-time highs driven by positive 3Q earnings, the GOP tax plan, and historically low bond yields. The market largely reversed its decline for the week on Thursday, following positive economic data and better than expected earnings releases. Eight of the eleven sectors that make up the S&P 500 index advanced for the week. Telecommunications and consumer discretionary sectors led the index increasing 3.2% and 1.3%, respectively. Following the decline in oil prices this week, the energy sector declined 3.2%. Expectations for the full year 2017 earnings and revenues advanced to 7.6% and 4.9%, respectively. Mid and small cap equities also had a positive week increasing 0.8% and 1.2%, respectively. Small cap equities are on pace to turn positive for the third quarter with analysts anticipating earnings and revenue to grow 5.5% and 5.7%, respectively.

S&P 500



Our View

The Trump Administration’s goal is to pass a tax reform bill by year-end. It strikes us that this could be too ambitious unless House and Senate Republicans are considerably more willing to compromise than they have been on other major legislative initiatives. The House of Representatives on Thursday passed a sweeping reform bill that will be the largest change the tax coded in 31 years. The Senate’s recent version is broadly similar to the House bill, but there are several fundamental differences that need to be reconciled. One of the major stumbling blocks will be the deduction for state and local taxes (SALT deduction). The House version allows the deduction with a cap, but the Senate version scraps the SALT deduction altogether. Eliminating the SALT deduction is a significant problem for House Republicans from high-tax states such as New Jersey. The Senate bill repeals the individual mandate that forces healthy people to buy insurance. This is very unpopular for some moderate Republican Senators because it would result in higher premiums and a drop in insurance coverage. Another major problem is that ultimately the reconciled bill will have to comply with the budget resolution that has already capped the deficit increase at $1.5 trillion over the next ten years. If the tax bill does not meet this test, it would require a full 60 votes in the Senate, which the Republicans do not have. The Republicans are very motivated to pass a tax reform bill, but their narrow majority in the Senate and their need to appeal to competing interests will make for delicate negotiations. We think they will pass a tax reform bill, but it will likely slip to next year and will be a somewhat watered down version.

COMING UP NEXT WEEK		Est.
11/21 Existing Homes Sales	(Oct)	5.43M
11/22 Durable Goods	(Oct)	0.4%
11/22 U Mich Sentiment Final	(Nov)	98.0
11/24 Markit Mfg PMI Flash	(Nov)	55.0

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