The Weekly

Economic & Market Recap

Peapack-Gladstone Bank, Private Wealth Management

September 29, 2017

As of 09/29/2017		Wk	Wk		YTD	12 Mos
STOCKS	Close	Net Change	% Change	Div Yield	% Change	% Change
DJIA	22,405.09	55.50	0.25	2.29	13.37	23.49
S&P 500	2,519.36	17.14	0.68	1.97	12.53	17.11
NASDAQ 100	5,979.30	46.98	0.79	1.11	22.94	23.58
S&P MidCap 400	1,795.94	27.29	1.54	1.57	8.15	16.65
Russell 2000	1,490.86	40.08	2.76	1.35	9.85	20.45

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	1.49	Euro/Dollar	1.18	-1.20
5-Year	1.93	Dollar/Yen	112.47	0.42
10-Year	2.33	Sterling/Dollar	1.34	-0.73
30-Year	2.86	Dollar/Cad	1.25	1.05

Source: Thomson Reuters & Bloomberg

What Caught Our Eye This Week

There are many different styles of hedge funds (merger arbitrage, distressed asset, equity neutral, global macro, etc.) and making comparisons among these funds can be difficult. Generally speaking, hedge funds offer the hope of higher risk adjusted returns. The $2.5 trillion hedge fund industry has been struggling for many years because it has been unable to deliver compelling results. According to Crandall Pierce, over the past ten years through August, hedge funds have returned on average 1.3% annually. This compares with 7.7% for large cap U.S. stocks. Over the past five years, the performance has been even worse. Hedge funds have returned 4.0% annually compared to 14.4% for large cap U.S. stocks. Hedge funds can offer lower volatility compared to a typical 60/40 stock/bond blend and are only moderately correlated with stocks. Thus, hedge funds offer some diversification, but the question remains whether this is worth the cost. The typical hedge fund charges a fee of 2% of assets annually and another 20% on the profits over a certain threshold. There are over 29 thousand hedge funds today. Hedge funds have experienced continued investment outflow or have shut down.

Economy

The most anticipated report this week was Thursday's final look at second quarter GDP. Second quarter GDP advanced by 3.1%, which was the quickest pace in two years. Consumer spending increased by 3.3%, exports were up 3.5%, and nonresidential fixed investment advanced by 6.7%. Overall, the first six months of the year have produced growth of 2.1%. On Wednesday, we were pleased to see orders for durable goods increase by 1.7% in August, which beat expectations, and were led by orders for computers and electronic products (+1.3%). Core non-defense capital goods orders excluding aircraft were up 0.9%, and core shipments increased by 0.7%. Core shipments have now increased for seven straight months, and it is this metric that the government uses to calculate business investment for GDP purposes. New home sales were reported on Tuesday and displayed a drop of 3.4% to 560,000 in August. These figures were below expectations and over the last 12 months, new home sales are down 1.2%. The median price of a new home sold is now at $300,200. On Friday personal income figures showed an increase of 0.2% in August, while personal consumption advanced by 0.1%. Personal income is now up 2.8% in the past year, and personal consumption is up 3.9%.

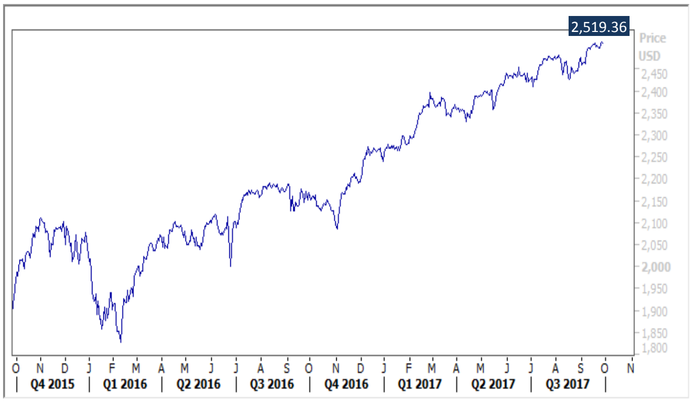
Fixed Income/Credit Market

Hawkish rhetoric by members of the FOMC and details surrounding the framework of tax reform both contributed to higher interest rates this week. The 10-year U.S. Treasury closed this week at approximately 2.34%, an 8 basis point (bp) increase week-over-week. The 1-year forward U.S. Treasury curve, according to Bloomberg, indicates that interest rates are expected to increase an additional 31 bps at the 2-year tenor and 21 bps at the 10-year tenor. On a total return basis over a 1-year horizon, the highest expected return occurs in the 30-year tenor at 141 bps. However, if the forward curve proves to be wrong and rates were to rise 100 basis points, the resulting total return on the 30-year Treasury becomes negative 15.18%. The next best performing tenor is the 2-year Treasury, which returns 133 bps using the forward curve projections and a positive total return of 0.68% with a 100 bp rate increase. Thus, duration risk should be taken with caution.

Equities

Stocks continued climbing higher this week as the S&P 500 once again reached a new high on Friday. The technology heavy Nasdaq 100, after a few weeks of profit-taking, was the best performing major large cap index. As the third quarter came to a close, just about all major averages have attained record levels at one time or another. Economic strength in the United States and overseas has kept corporate profits growing. Positive economic releases and renewed discussion of tax reform boosted investor confidence. As interest rates moved higher across the entire curve due to the Federal Reserve suggesting normalizing rates, the financial sector was a standout performer. Energy also moved higher as the price of West Texas Intermediate oil stayed above the $50 level on expectations of improved supply and demand balance. Third quarter earnings will be reported in the coming weeks.

S&P 500



Our View

The Trump Administration released their framework for tax reform on Wednesday. Unlike the many failed Republican attempts at repealing and replacing Obamacare, there seems to be a strong coordination between Republican leadership in Congress and the Administration regarding tax reform. Passing tax reform requires a high willingness to compromise because the margins for success are so thin. If the Democrats vote as a block, the Republican Party can only afford to have two senators or 22 congressmen defect. There are several controversial aspects that make tax reform a heavy lift. The impact on the deficit will be dependent on how much economic growth is generated from tax reform and the revenue offsets that are selected to reduce the budgetary impact of lower rates. Estimates of the effect on GDP growth of lower corporate and personal tax rates vary widely and will be vociferously debated on both sides of the aisle. The Freedom Caucus contains 36 Republican members in the House that are budget hawks and are unlikely to go along with a significant expansion of the deficit. Additionally, eliminating or limiting deductions for state and local taxes will pit high tax states versus low tax states. Given the complexity and the myriad of constituencies, we expect a lengthy process before a potentially workable bill can be produced.

COMING UP NEXT WEEK		Est.
10/02 ISM Manufacturing PMI	(Sep)	58.0
10/03 Total Vehicle Sales	(Sep)	16.23M
10/04 ISM N-Mfg PMI	(Sep)	55.4
10/05 Factory Orders MM	(Aug)	1.0%
10/06 Non-Farm Payrolls	(Sep)	98k
10/06 Unemployment Rate	(Sep)	4.4%

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