The Weekly

Economic & Market Recap

Peapack-Gladstone Bank, Private Wealth Management

February 17, 2017

As of 02/17/2017		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	20,624.05	354.68	1.75	2.34	4.36	25.34
S&P 500	2,351.16	35.06	1.51	2.00	4.93	21.92
NASDAQ 100	5,324.72	98.04	1.88	1.16	9.48	26.81
S&P MidCap 400	1,734.76	13.92	0.81	1.63	4.39	32.41
Russell 2000	1,399.86	11.02	0.79	1.39	3.07	38.34

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	1.19	Euro/Dollar	1.06	-0.31
5-Year	1.90	Dollar/Yen	112.85	-0.34
10-Year	2.42	Sterling/Dollar	1.24	-0.62
30-Year	3.03	Dollar/Cad	1.31	0.09

Source: Thomson Reuters, Bloomberg

What Caught Our Eye This Week

Gold traditionally trades inversely to stocks and the U.S. dollar. When investors flock to stocks and riskier financial assets, gold usually comes under pressure. Further, a strong U.S. dollar hurts gold because gold is priced in dollars and it becomes more expensive to foreign buyers. Some experts say assets have become much more correlated in recent years because of the increasing link of the global markets as well as the impact of easy monetary policy. Interestingly, between February 1 and February 15 of this year, gold, stocks and the U.S. dollar have all risen. This has only occurred two times in the past 10 years (March 2013 and February 2010). This is a rare environment in which all three seem to have the same catalyst – rising inflation. Annual CPI inflation rose to a five-year high of 2.5% over the past year. Rising inflation indicates a stronger economic environment, which is good for stocks, but also opens the door for the Fed to raise rates more quickly. Higher rates give the dollar a boost as long as inflation expectations remain moderate. Meanwhile, rising inflation drives investor interest in gold which usually maintains its buying power.

Economy

The most anticipated economic report this week was the retail sales report, which was released on Wednesday. Retail sales increased 0.4% in January and are now up 5.6% year-over-year. The all important control category, which excludes food service, autos, gas and building materials, also advanced by 0.4%. Retail sales figures were revised higher for December by approximately 1%. The January figures were broad based with nine of thirteen categories showing growth. We expect further gains in retail sales as job growth continues and wage growth accelerates. Industrial production figures were also released on Wednesday and posted a 0.3% decline in January. This decline was led by a drop off in utilities and a 2.9% decrease in auto production. Manufacturing advanced by 0.3%, and oil and gas well drilling posted its 8th consecutive gain in January. The consumer price index continues to increase displaying a 0.6% gain in January, and is now up 2.5% year-over-year. When excluding food and energy prices, the "core" CPI is now up 2.3% over the last 12 months. The worst news in this report was that real average hourly earnings declined by 0.5% in January. Finally on Thursday, monthly housing starts decreased by 2.6% to 1.246 million. The good news was housing permits increased by 4.6%.

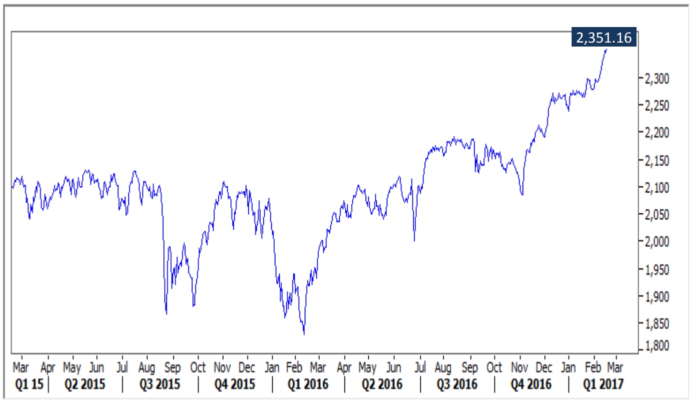
Fixed Income/Credit Market

The 1-year forward U.S. Treasury curve, according to Bloomberg, indicates that interest rates are expected to increase 80 basis points at the 1-year tenor and 12 basis points at the 30-year tenor. On a total return basis using the 1-year forward Treasury curve over a 1-year horizon, the highest expected return occurs in the 30-year tenor at 107 basis points. With the forward curve projecting Treasury curve flattening with the front-end rising quicker than the long-end, it may encourage investors to take duration risk. However, if the forward curve is wrong and rates were to rise 100 basis points, the resulting total return on the 30-year Treasury becomes negative 14.65%. The next best performing tenor, the 7-year Treasury, returns 99 basis points using the forward curve projections and a total return of only negative 2.37% with a 100 basis point rate increase. Duration risk should be taken with caution.

Equities

The major stock indexes posted record closing highs during the week. Corporate earnings, solid economic data and the expectation of President Trump presenting a "phenomenal" tax reduction plan were catalysts lifting benchmarks. The stock market's strength reflects optimistic expectations of growth. Fed Chair Yellen spoke to both houses of Congress this week and continued to express willingness by the Fed to raise the federal funds target during the year. Financials continued to be market leaders as they are the primary beneficiaries of higher rates. Technology also had solid gains as corporate earnings and analyst upgrades moved the sector higher. Energy lagged despite compliance on OPEC output cuts as U.S. rig counts are up 200 or so from their bottom. The price of a barrel of West Texas Intermediate Crude oil at $53.15 is the same price it was two years ago.

S&P 500



Our View

Corporate share buybacks have been an important component to equity market performance over the last five years. Since 2011, companies in the S&P 500 have repurchased more than $2.7 trillion of their own stock. During that same time period, both individual and institutional investors have been net sellers. The share repurchase programs, in many cases, have used borrowed money for the repurchases. The end result is a modestly higher per share earnings at the cost of a risky capital structure. Operational performance, as measured by aggregate operating earnings, has not been good over the last five years; operating earnings on an annualized basis are only marginally higher. At current equity valuations, it is harder for corporate boards to justify continuing to purchase stock. Back in 2011, the S&P 500 was trading around 1100 and was trading at a price-to-earnings multiple of roughly 13x trailing earnings. Today, the S&P 500 is trading at 2,340 with a trailing P/E of 23.9. Over the next few weeks, we expect to hear some details emerging regarding tax reform. We would hope to see an investment tax credit to incentivize companies to invest capital in their businesses rather than using excess cash flow to repurchase shares. In the long run, by making investments that enhance their productivity, companies will be strengthening their growth potential – which is a far more productive use of capital.

COMING UP NEXT WEEK		**Est.**
02/21 Markit Mfg PMI Flash	(Feb)	55.2
02/22 Existing Home Sales	(Jan)	5.53mln
02/23 Initial Jobless Claims	w/e	241k
02/24 New Home Sales – Units	(Jan)	0.57mln
02/24 U Mich Sentiment Final	(Feb)	96

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