PEAPACK PRIVATE

Wealth Management

The Weekly

Economic & Market Recap

July 17, 2020

7/17/2020		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	26,671.95	596.65	2.29	2.44	-6.54	-2.43
S&P 500	3,224.73	39.69	1.25	1.87	-0.19	7.35
NASDAQ	10,503.19	-114.25	-1.08	0.82	17.06	27.73
S&P MidCap 400	1,836.55	63.57	3.59	1.94	-10.98	-5.91

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	0.14	Euro/Dollar	1.14	0.91
5-Year	0.27	Dollar/Yen	107.15	0.37
10-Year	0.62	GBP/Dollar	1.25	-1.00
30-Year	1.33	Dollar/Cad	1.36	-0.03

Source: Bloomberg/FactSet

What Caught Our Eye This Week

Having enjoyed a tremendous surge since mid-May and reaching an eight-month high just a week ago, the Baltic Dry Index, a gauge of shipping rates for unpackaged ("dry") bulk cargo such as metal ores, cement, steel, tin, coal, and grains, turned down late last week. Observers wonder whether the increase spurred by a revival of consumer and industrial demand amidst loosening coronavirus restrictions was fleeting or if it will have staying power. As a leading indicator of global economic strength and weakness, does the recent decline of the index foreshadow continued difficulty for the global economy? The pandemic and trade policy have resulted in the worst cargo volume levels since the Great Recession, a point from which it took almost an entire decade to recover. In addition, a forecast released earlier this month by the National Retail Federation (NRF) and Hackett Associates suggests the nation's ports will have the lowest peak season volume since 2014. Retailers are faced with elevated levels of unsold inventory, opaque consumer demand, and a volatile freight market as states work to reopen stores and restaurants safely. News of surging coronavirus cases continues and could easily lead to renewed restrictions, which would cause demand to weaken again.

Economy

The economic headliner this week was the retail sales report, which was released on Thursday. Retail sales increased 7.5% in June, which was better than analyst's expectations. Total sales were $524.3 billion and were led by a pickup in sales of autos, furniture, clothing and electronics. Gas station sales increased by 15.3% and sales at sporting goods stores (guns) surged by 26.5%. The "control" category, which excludes food service, autos, gas and building materials advanced by 5.6%. Overall 10/13 retail sales categories reported gains and with the June increase retail sales are only 0.6% below the February mark. In other news this week, the consumer price index data showed the CPI increasing 0.6% in June and the "core" CPI gaining 0.24%. These positive numbers are the first advances in four months. Energy prices turned higher (+5.1%) for the first time in five months. The "core" CPI is now up 1.2% over the past 12 months. On Wednesday, we were pleased to see industrial production figures increase by 5.4% in June, while manufacturing output surged 7.2%. Auto production led the way with an increase of 105% and overall capacity utilization climbed to 68.6%.

Fixed Income/Credit Market

U.S. Treasury yields in the month of July have decreased as much as 8.8 basis points which has driven positive total returns month-to-date (MTD) for most of the fixed income funds that we follow. The reach for yield in longer-dated securities acting as haven assets coupled with global central bank accommodation putting downward pressure on corporate credit spreads has contributed to the outperformance of long-term bonds and riskier asset classes. The top performing funds thus far in July have been high quality long-term bonds, preferred equity, and 0-5 year high yield bonds which have returned 3.02%, 2.02%, and 1.62%, respectively. The bottom performers have been mortgage-backed securities, short-term Treasuries, and high quality short-term bonds which have turned in respective returns of -0.03%, 0.04%, and 0.13%. Additionally, the Bloomberg Barclays U.S. Aggregate Index has returned 0.83% MTD lead by U.S. corporate bonds (+2.03%) which have been driven by utilities (+3.17%) long thought to be another safe haven bond sector.

Equities

Equity investors had a plethora of information to digest throughout the week, and the S&P 500 managed to post a third consecutive week of gains. Over the weekend and into Monday, most of the news centered around the continued acceleration in U.S. coronavirus cases and the roll-back of reopening measures. The following day kicked off 2nd quarter earnings season with most of the major U.S. banks reporting throughout the week. The key themes revolved around strong trading and underwriting revenues coupled with large increases in cash reserves in anticipation of loan losses over the coming quarters. On Wednesday, stocks rallied on news that Moderna's coronavirus vaccine produced antibodies in all patients tested in an initial safety trial. Another notable development this week was the rotation out of growth and momentum stocks into value and cyclical stocks. The Russell 1000 Value posted a 3.40% gain while the Russell 1000 Growth declined 0.85%. Furthermore, small and mid-cap indexes outperformed large-cap indexes. Investors will continue to focus on earnings in the coming weeks, and expectations are for a dismal quarter – according to FactSet, S&P 500 earnings are expected to decline 44% in the 2nd quarter.

Our View

The Federal Reserve has taken unprecedented steps, most notably expanding its balance sheet by over $3 trillion, to stave off an economic crisis in the wake of the Covid-19 pandemic. The Fed has vowed to maintain short-term interest rates at the zero-bound through 2021 and to purchase securities as required to provide liquidity to the capital markets. As with any liberally administered prescriptive measure, there are unintended side effects. Long term, the impact may be a secular deterioration of the dollar and higher inflation, but this risk seems to be too far in the future to worry investors today. The more immediate concern has been the dramatic impact of the Fed on asset prices. Although most of the Fed's bond buying has been in U.S. Treasuries and mortgage-backed securities, the Fed's pledge to intervene in the market for corporate debt has given financial markets confidence to bid up risk assets. It seems to us that in some cases prices have become unmoored from the near-term fundamentals and risks are not being properly priced. Although there has been significant issuance of new debt offerings, the premiums demanded on corporate bonds relative to Treasuries has narrowed sharply. Credit spreads in the high-yield segment of the bond market have been cut in half since March, and the investment grade spreads are almost back to pre-pandemic levels. Distortions and risk-taking can be found in the equity side as well. The forward price-to-earnings multiple on Growth stocks (Russell 1000 Growth Index) is 31.2x and over 13 multiple points higher than Value stocks. Companies that are perceived to be beneficiaries of current pandemic have seen their stocks rally sharply. Netflix is a case in point. After soaring 60% this year on the realization of a blowout first quarter, the stock sold off today as investors realized that despite a great first quarter earnings, subscriber and revenue growth were simply pulled forward. With abundant liquidity and highly accommodative monetary policy, investors need to stay focused on long-term investment opportunities and be mindful of the valuation distortions present in the current market environment.

COMING UP NEXT WEEK		Consensus	Prior
07/21 Chicago Fed National Activity Index	(Jun)	5.0	2.6
07/22 Exiting Home Sales SAAR	(Jun)	4,900K	3,910K
07/23 Leading Indicators SA M/M	(Jun)	2.1%	2.8%
07/24 Markit PMI Manufacturing SA (Prelim)	(Jul)	52.0	49.8
07/24 Markit PMI Services SA (Preliminary)	(Jul)	51.0	47.9

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