Peapack Private Wealth Management

The Weekly
Economic & Market Recap

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December 6, 2019

12/6/2019		Wk Net Change	Wk % Change	Div Yield	YTD % Change	12 Mos % Change
STOCKS	Close					
DJIA	28,015.06	-36.35	-0.13	2.26	20.09	11.94
S&P 500	3,145.91	4.93	0.16	1.85	25.49	16.51
NASDAQ	8,656.53	-8.94	-0.10	1.00	30.46	20.93
S&P MidCap 400	2,021.98	11.83	0.59	1.71	21.58	10.70

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	1.63	Euro/Dollar	1.10	0.21
5-Year	1.66	Dollar/Yen	108.66	-0.78
10-Year	1.84	GBP/Dollar	1.31	1.33
30-Year	2.28	Dollar/Cad	1.33	-0.12

Source: Bloomberg/FactSet

What Caught Our Eye This Week

Each month, two firms release data compiled from surveys sent to manufacturing executives in the United States: IHS Markit and the Institute for Supply Management (ISM). Earlier this week, these organizations released November survey data which told different stories. Markit released a headline number of 52.6 compared to ISM's 48.1 reading. Both companies use diffusion indices which range from 1 (lowest) to 100 (highest) and indicate whether manufacturing in the US is generally contracting (lower than 50) or expanding (higher than 50). Both indices hit a high in mid-2018 and a low between August and September of this year. Both have also trended up since then, though Markit has shown continued manufacturing expansion while ISM has shown its fourth month in a row of continued contraction. The difference lies in the methodology underlying the construction of each company's index. Markit polls companies of different sizes somewhat proportional to the composition of total manufacturing output in the country, and it uses data only from factories located in the US. Alternatively, ISM focuses on larger multinational companies and it uses some data from manufacturers with factories located outside of the country. Current weakness in Europe and Asia may be accounting for some of the negative skew in the ISM numbers. Markit measures five primary types of variables that are weighted based on each variable's forward-looking properties. ISM weights its five variables equally. Finally, Markit compiles surveys from approximately 800 firms each month while ISM uses a sample set of about half this size.

Economy

The most anticipated report this week was the nonfarm payroll report, which was released on Friday. This report showed payrolls increasing by 266,000 in November, which was significantly more than consensus estimates (184,000). The unemployment rate dropped to 3.5% and the U-6 measure of unemployment decreased to 6.9%. The labor force participation rate was unchanged at 63.2%, and there were positive revisions of 41,000 jobs for the September and October reports. Average hourly earnings rose by 7 cents to $28.29 and the year-over-year gain is now at 3.1%. Examining the different employment sectors, healthcare added 45,000 jobs, manufacturing gained 54,000 and professional and technical services added 31,000. The ISM manufacturing survey declined to 48.1 in November and the new orders index dropped to 47.2 from 49.1. The survey showed 13/18 industries contracting in November. On Wednesday, the ISM non-manufacturing survey posted a decline, eroding to 53.9 in November. In total, 12/17 industries reported growth.

Fixed Income/Credit Market

On Thursday, Twitter (Ba2/BB+) sold a $700MM tranche of eight-year senior unsecured bonds with a 3.875% coupon at par. The spread versus like duration US Treasury bonds was 213 basis points (bps). According to Bloomberg, initial price talk was in the 4% area for a $600MM sale; however, investor demand allowed Twitter to upsize the deal an additional $100MM while lowering the cost of debt 0.125%. For investors that participated in the offering, the yield they received is substantially lower than the overall market. To put it into context, 8-year composite BB bonds are currently yielding roughly 4.42%. The yield concession that Twitter received on its debt issuance is not all that surprising given the compression in both high yield (HY) and investment grade (IG) credit spreads year-to-date (YTD). HY and IG option adjusted spreads (OAS) have narrowed 154 bps and 50 bps, respectively, in 2019 as investors continue to clamor for yield.

Equities

Investors' concerns about a phase-one trade deal between the US and China continued to weigh on markets. Weak US economic data and renewed tariffs with Latin America and European countries also negatively impacted the major indices. Momentum shifted on Thursday after news that the U.S. and China phase-one trade deal was again close. Citing sources familiar with these developments, Bloomberg News reported the deal will likely be signed before the U.S. imposes fresh tariffs on China effective December 15th. The conflicting news that a deal is or is not close was overshadowed by positive economic releases Friday driving equity markets higher and posting gains for the week. With less than four weeks until year end, investors have a close eye on what will take place on or before December 15th. The best performing sector was Energy up 1.4% after OPEC announced a cut to production and Saudi Aramco's IPO set a record due to its size. The worst performing sector was Industrials (-1.1%).

Our View

Back in late August of this year, the aggregate amount of negative yielding debt across the globe surpassed $17 trillion, which represented a quarter of all investment grade debt. Prior to the financial crisis, negative yielding debt was just a theory as it was believed that no rational investor would pay a borrower to utilize their funds and guarantee a loss. However, Europe's struggle to recover from its double dip recession prompted the ECB to push deposit rates below zero. The idea behind negative rates was to encourage investment by disincentivizing banks from parking their funds at the ECB. Banks would instead lend the funds which would facilitate economic expansion and ward off the threat of deflation. However, negative rates drove down returns on loans and many banks elected not to pass negative rates along to their depositors for fear of deposit runoff, which compressed net interest margins and weighed on bank profitability and their ability to extend credit. Negative rates have also adversely impacted pensions and bond funds who, regardless of yield, are chartered to hold risk free assets. Asset bubbles also become a potential issue when rates are negative as it pushes investors to take on additional risk just to obtain a positive return and has the ability to distort financial stability. The subzero interest rate experiment has few proponents at this point and the near-term solution to negative rates appears to be expansionary fiscal policy. Just this week Japan's Prime Minister Shinzo Abe announced a multiyear fiscal stimulus package worth approximately $120 billion to help revive growth. Europe is another area of the globe that could use a boost from increased fiscal policy. Right now, Brussels is reluctant to unleash expansionary fiscal policy in the European Union, but as the limits of monetary policy become increasingly clear it is our belief that government spending will be utilized to rekindle growth and alleviate the damage that has been caused by negative rates.

COMING UP NEXT WEEK		Est.
12/11 CPI ex-Food & Energy	(Nov)	0.20%
12/11 CPI SA M/M	(Nov)	0.20%
12/12 PPI SA M/M	(Nov)	0.20%
12/13 Retail Sales SA M/M	(Nov)	0.50%