The Weekly

Economic & Market Recap

Peapack-Gladstone Bank, Private Wealth Management

July 13, 2018

As of 07/13/2018		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	25,019.41	562.93	2.30	2.18	1.21	16.08
S&P 500	2,801.31	41.49	1.50	1.85	4.79	14.46
NASDAQ 100	7,375.82	168.48	2.34	0.93	15.31	27.32
S&P MidCap 400	1,996.35	6.86	0.34	1.52	5.04	13.47
Russell 2000	1,687.08	-6.98	-0.41	1.33	9.87	18.34

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	2.58	Euro/Dollar	1.17	-0.54
5-Year	2.72	Dollar/Yen	112.33	1.68
10-Year	2.83	Sterling/Dollar	1.32	-0.39
30-Year	2.93	Dollar/Cad	1.32	0.51

Source: Thomson Reuters & Bloomberg

What Caught Our Eye This Week

Earnings growth for the S&P 500 exceeded 20% in the first quarter and will approach that level in the second quarter. Equity investors have not been fully rewarded by this rapid earnings growth because a meaningful portion of incremental growth in earnings has been the result of the 2017 Tax Cuts and Jobs Act. Statutory corporate tax rates have been cut to 21% from 35%. Many economists expect some of the tax related earnings increase to erode over time as competitive factors impact corporate profit margins. The bump in earnings is a cash transfer to corporations from the federal government. The Treasury Department is seeing a noticeable reduction in receipts. Federal receipts were down 7% in June year-over-year with gross corporate taxes paid falling by roughly a third. Predictably the budget gap, the difference between federal revenues and federal spending, is beginning to swell. Over the first nine months of the current fiscal year the budget gap grew 16%, with federal spending growing 4% versus federal revenue growing only 1%. The impact of the tax law will likely make the budget gap even worse.

Economy

This week, the economic data was centered around inflation statistics with the release of the producer price index and the consumer price index. On Thursday, the CPI figures came in below expectations with an increase of 0.1% in June. Over the past 12 months, this metric has increased by 2.9%. The "core" CPI which excludes food and energy prices advanced by 0.2% and is now up 2.3% year-over-year. The biggest influence on the headline figure was food prices, which increased by 0.2%. The producer price index was reported on Wednesday and displayed an increase of 0.3% in June, which was above the consensus forecast. Over the past year, this index has increased by 3.4%. The "core" PPI increased by 0.3% and is now up 2.8% year-over-year. Energy prices had the largest influence on the headline figure rising by 0.8%. On Tuesday, the JOLTS report (job openings and labor turnover survey) showed 6.6 million job openings in May. The jobs opening rate came in at 4.3%, and the quits rate edged up to 2.4%. This report also showed a net employment gain over the past 12 months of 2.5 million.

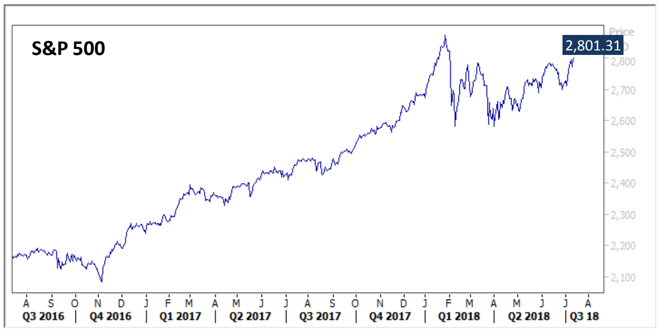
Fixed Income/Credit Market

The geopolitical landscape continues to put downward pressure on yields across the U.S. Treasury curve as investors continue flocking to safe-haven assets. Despite trading at historically low levels, U.S. Treasury bond yields remain attractive compared to other global bonds. The front-end of the U.S Treasury curve especially stands out, while other developed nations maintain zero interest-rate policies (ZIRP). In fact, five of the seven countries we include in our global yield outlook continue to have negative interest rates at their 2-year tenors. At 2.58%, the 2-year U.S. Treasury looks attractive versus the peer group.

Country	Rate	Basis point spread vs U.S.	Country	Rate	Basis point spread vs U.S.
U.S.	2.578		Italy	0.669	-190.9
U.K.	0.734	-184.4	Spain	-0.314	-289.2
France	-0.474	-305.2	Switzerland	-0.807	-338.5
Germany	-0.649	-322.7	Japan	-0.142	-272

Equities

The equity market posted a second consecutive week of gains as investor optimism for a robust Q2 earnings season outweighed global trade war concerns. All three major indexes continued their positive momentum in the beginning of the week, but on Wednesday stocks ended a four-day rally after the U.S. government announced a list of $200 billion of Chinese imports on which it plans to impose an additional 10% tariff. The sell-off was led by a 2.1% decline in energy shares as Brent crude oil had its biggest one-day drop in two years. The risk-off trade quickly reversed as concerns over an escalating U.S. trade battle with China subsided and earnings optimism materialized, resulting in equities posting positive returns the following two days. The NASDAQ ended the week at an all-time high on the back of the best performing sector, technology. In other news, on Thursday, the DOJ announced it would appeal the approval of AT&T's $85.4 billion acquisition of Time Warner. This could prove to be a major shakeup for other mega mergers such as the current bidding war between Disney and Comcast for Twenty-First Century Fox. Next week, 60 companies from the S&P 500 are expected to report second quarter earnings.



Our View

The unofficial beginning of the second quarter earnings reporting season kicked off on Friday as several major banks reported second-quarter earnings with mixed results. Trading revenue and loan growth were generally solid, but interest expenses are growing faster than interest income due to the flattening yield curve. The yield differential between the two-year Treasury and the ten-year Treasury continued to compress this week to roughly 25 basis points. This is the tightest spread level since July of 2007, which was just before the Great Recession. Although not an infallible indicator, an inverted Treasury curve has been a solid predictor of a recessionary environment ahead and typically offers investors at least a six-month lead. The persistent decline of the treasury spread over the last 18 months has been disconcerting. In our view, the flattening yield curve is probably not as meaningful a signal as in the past. Due to the distortive effects of quantitative easing across the entire yield curve, but especially regarding intermediate maturities, the flatness of the yield curve is not providing investors with historically correct information. We feel that we are in a typical cycle that has been elongated due to the depths of the last economic recession and impact of central bank action. As the economic cycle continues, we expect the typical pattern of inflation followed by higher long rates, and ultimately overtightening by the Federal Reserve to play out.

COMING UP NEXT WEEK		Est.
07/16 Retail Sales Ex-Autos MM	(Jun)	0.4%
07/16 Retail Sales MM	(Jun)	0.5%
07/17 Industrial Production MM	(Jun)	0.5%
07/18 Housing Starts Number	(Jun)	1.320M

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