The Weekly

Economic & Market Recap

Peapack-Gladstone Bank, Private Wealth Management

April 27, 2018

As of 04/27/2018		Wk Net	Wk %	Div	YTD %	12 Mos %
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	24,311.19	-151.75	-0.62	2.19	-1.65	15.87
S&P 500	2,669.91	-0.23	-0.01	1.93	-0.14	11.77
NASDAQ 100	6,656.35	-11.40	-0.17	1.03	4.06	19.48
S&P MidCap 400	1,892.23	-8.27	-0.44	1.59	-0.44	8.16
Russell 2000	1,556.24	-7.89	-0.50	1.30	1.37	9.84

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	2.48	Euro/Dollar	1.21	-1.31
5-Year	2.80	Dollar/Yen	109.08	1.30
10-Year	2.96	Sterling/Dollar	1.38	-1.62
30-Year	3.13	Dollar/Cad	1.28	0.59

Source: Thomson Reuters & Bloomberg

What Caught Our Eye This Week

Since the global economy is inextricably linked, it is important that we keep abreast of interest rates and growth trends around the world. The U.S. Federal Reserve has increased interest rates six times since 2015, and it is expected to increase rates another two times this year and more in 2019. The Bank of England raised rates for the first time last year, and investors expect it to do so again possibly in November of this year. It is expected that the European Central Bank (ECB) will begin to phase out its $36 billion/month quantitative easing program in September of this year. The $17 trillion European economy has increased for 20 straight quarters, and 2017 was a particularly strong year. Over the past several months, consumer prices and industrial production have moderated, and the rate of growth in the manufacturing and services sectors has declined. This slowdown has led analysts to wonder if the ECB would be able to end its accommodative policy anytime soon. Consensus estimates indicate that the ECB could begin to increase interest rates in the latter half of next year assuming that Europe's rate of growth does not decline further. Finally, the Bank of Japan continues with its 5-year, $730 billion annual bond-buying effort to stimulate its economy. The timing of ending this program and subsequently raising interest rates in Japan has been relegated to the distant future.

Economy

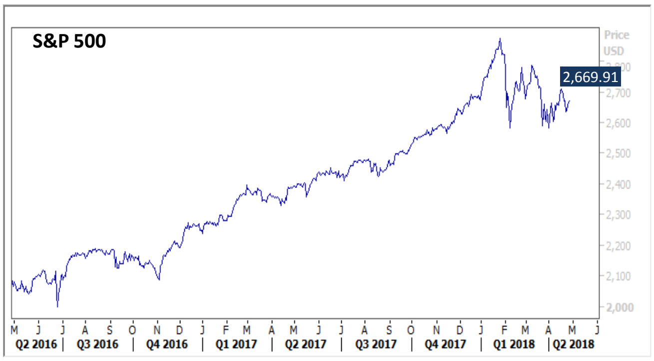
It was a week filled with economic reports, starting on Monday with existing home sales data. Existing home sales increased 1.1% in March to a 5.60 million annual rate beating the consensus figure of 5.55 million. Over the past 12 months, existing home sales are down 1.2%. The median price of an existing home increased to $250,400 and has now risen 5.8% year-over-year. On Tuesday, new home sales figures surprised to the upside advancing by 4.0% in March to 694,000 units at an annual rate. New home sales are up 8.8% over the past year and the median price has increased to $337,200. Transactions for homes above $250,000 grew robustly, while homes priced below $250,000 declined in March. Thursday brought us durable goods numbers and the headline figure advanced by 2.6%. The "core" data which excludes aircraft and defense were not as impressive. Core capital goods orders declined by 0.1% and core capital goods shipments fell by 0.7%. Finally on Friday we received the first look at first quarter real GDP, and these metrics were better than expected. First quarter growth came in at 2.3% versus expected growth of 2.0%. The weakest component of the report was consumer spending, which grew at its weakest pace in nearly five years.

Fixed Income/Credit Market

On Wednesday of this week, the 10-year U.S. Treasury finally broke through the 3.00% level and reached an intraday high of 3.03%. Over the past 5 years, the 10-yr Treasury has only broken the 3.00% level twice and quickly receded thereafter. According to the forward Treasury curve, a year from now the 10-yr yield is expected to be approximately 3.07%, and the median analysts forecast according to Bloomberg shows the 10-yr Treasury yielding around 3.25% by the end of the first quarter of 2019. It is interesting to note that investment grade credit spreads are on the rise as well. For example, the 5-yr A-rated corporate bond spread above the 5-yr Treasury is 62 basis points (bps) right now and is up 14 bps thus far in 2018 according to Bloomberg. Borrowers, who have had access to historically low funding rates since the financial crisis, may need to revisit their liquidity needs moving forward given the new interest rate environment.

Equities

This week, 185 companies in the S&P 500 Index reported quarterly earnings resulting in continued volatility for the equity markets. The three major indexes started off the week relatively unchanged, as mostly positive earnings reports were offset by rising bond yields. Tuesday opened in positive territory, but quickly sold off after the benchmark 10-year U.S. Treasury yield briefly surpassed the 3.0% mark and a few industrial bellwether earnings releases sparked concerns over the sustainability of earnings growth. Perhaps the most noteworthy trigger for the decline was comments made by Caterpillar's CEO, Bradley Halverson, who called first-quarter earnings the "high-water mark" for 2018. All three major indexes closed down over 1.3% on the day. Stocks rebounded later in the week as rate fears subsided and robust corporate earnings were reported by some of the biggest U.S. companies. The rally was led by the technology sector with Microsoft, Intel and Facebook all posting positive earnings reports. The S&P 500 index ended slightly lower on the week with utilities being the best performing sector and industrials being the worst performer. Next week, equity investors will continue to gauge whether corporate earnings are strong enough to drive equity prices higher despite the recent runup in bond yields.



Our View

Equity investors and bond traders were closely tracking the 10-year Treasury this week as the yield breached the 3% level for the first time since 2011. A strengthening domestic economy, which features a tightening labor market, is not only pushing longer interest rates higher but is also partially responsible for the exceptional earnings reports equity investors have experienced recently. The countervailing factors of rising rates and strong earnings have caused the choppy trading pattern in equities. This week exemplified these forces. As rates increased, investors become concerned with the potential for a higher discount factor. When rates flatten out, earnings surprises improve equity market sentiment. Although we have a constructive view on the economy over the next 12 to 18 months, it is unlikely that the economy will accelerate enough to let inflation fears cause a dramatic backup in the 10-yr Treasury. Earnings should have the predominant influence over equities for the time being as earnings reports should continue to be favorable through the balance of the year. Perhaps the more significant drag for equities will be at the short end of the curve. The 2-yr Treasury currently yields approximately 2.5% which has become a viable capital allocation option for investors that were forced into equities because of low rates.

COMING UP NEXT WEEK		Est.
04/30 Consumption, Adjusted MM	(Mar)	0.40%
05/01 ISM Manufacturing PMI	(Apr)	58.6
05/03 Factory Orders MM	(Mar)	0.9%
05/03 ISM N-Manufacturing PMI	(Apr)	58.1
05/04 Non-Farm Payrolls	(Apr)	195k
05/04 Unemployment Rate	(Apr)	4.0%

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