The Weekly
Special Edition: 2017 in Review
Peapack-Gladstone Bank, Private Wealth Management

December 29, 2017

As of 12/29/2017		Wk Net	Wk %	Div	YTD %
STOCKS	Close	Change	Change	Yield	Change
DJIA	24,719.22	97.57	0.40	2.10	25.08
S&P 500	2,673.61	928.00	0.34	1.88	19.42
NASDAQ 100	6,396.42	6.70	0.11	1.04	31.52
S&P MidCap 400	1,900.57	-3.72	-0.20	1.51	14.45
Russell 2000	1,535.51	-15.30	-1.00	1.34	13.14

TREASURIES	Yield	FOREX	Price	Wk %Change
2-Year	1.88	Euro/Dollar	1.19	-1.03
5-Year	2.20	Dollar/Yen	112.67	1.17
10-Year	2.40	Sterling/Dollar	1.35	-0.65
30-Year	2.74	Dollar/Cad	1.26	1.28

Source: Thomson Reuters & Bloomberg

Equities

Equity markets around the world experienced robust growth due to a synchronized global economic recovery. Favorable economic growth was driven by improving consumer and business confidence, stronger employment and controlled inflation. The solid economic backdrop and a weaker dollar drove corporate earnings to exceed most expectations.

Global equity markets were remarkably resilient in 2017. Despite geopolitical concerns over North Korea, dysfunction in Washington, unresolved Brexit concerns, election uncertainty in several key global countries, and Fed Funds rate increases, equity markets consistently made new record highs. Additionally, there has been a notable lack of volatility in equity markets. The largest drawdown in the S&P 500 this year has been 2.8% which is the smallest intra-year drawdown since 1995. Since 1950, the average intra-year drawdown has been 13.6%, and in 91% of the years, the S&P 500 has at least one 5% correction. The CBOE Volatility Index (VIX), a commonly used measure of implied volatility of S&P 500 index options, averaged only 11 versus a long-term average of 20. Furthermore, monthly declines were virtually nonexistent during 2017, which has not happened in over twenty years.

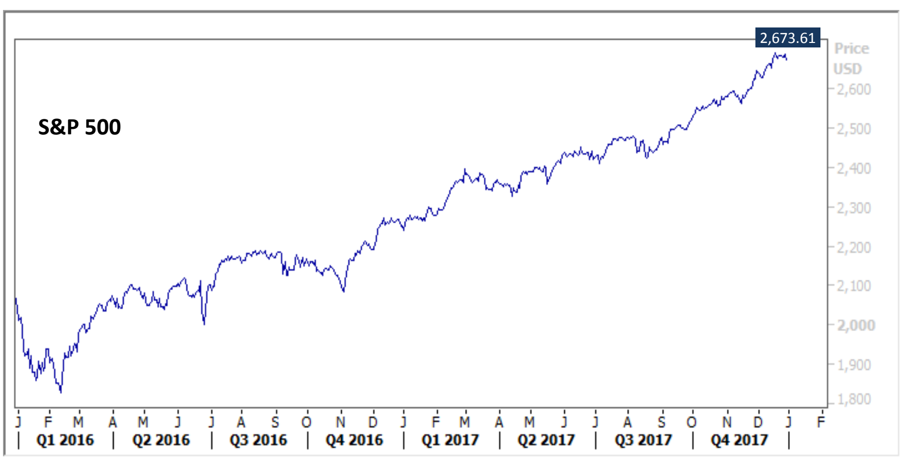
In addition to the broad market growth, the underlying crosscurrents were noteworthy. Sector dispersion (the spread between the best and worst performing groups in the index) was the greatest since 2009. Financials, healthcare, consumer discretion, industrials and materials all generated solid returns. Technology produced returns which significantly outpaced the broader markets. Energy and telecommunication industries were the laggards for the year posting negative returns. There was an unusually large disparity between the performance of growth stocks and value stocks.

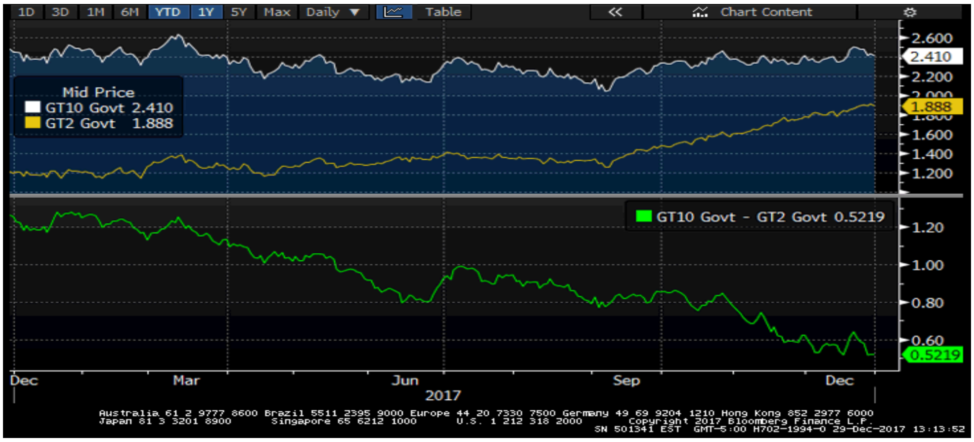
The long term driver of stock prices is earnings. Earnings growth resumed in 2017 after profits stalled the previous two years. Full-year total earnings for the S&P 500 index is expected to be up 7.5%, and revenues are expected to grow 5%. Although corporate share buybacks have contributed to an increase in earnings per share, the dollar amount of total earnings is on track to reach a new all-time quarterly record of over $310 billion. Based on current estimates, the growth rates are expected to accelerate in 2018, helped by tax law changes.

Small and Mid-Cap companies produced solid returns as they benefited from favorable financing due to low interest rates, accelerating domestic growth, and expectations of the positive impact of tax reforms. International markets outperformed most domestic markets in 2017 reversing the underperformance of the prior years. Although the weaker dollar lifted international investments, foreign markets also benefited from improving economies in Europe and Japan. The developed overseas economies were reinforced by global central banks which provided ample monetary stimulus. Extremely low foreign yields, some still negative, continue to encourage investment.

Cross border mergers and acquisitions in 2017 exceeded $3 trillion for the fourth year according to Bloomberg. Low financing rates, healthy balance sheets and favorable stock prices created a favorable environment for deals. Strategic integration opportunities provided a backdrop for several "megadeals" in various industries such as technology, healthcare and media. Cross-border mergers during the year illustrate the perceived opportunities for global strategy. The expectation is that mergers and acquisition momentum will continue in 2018.

Tax legislation during the second half of the year contributed to the market rally. Despite healthcare legislation that failed and consumed much of Washington's focus in the first half of the year, tax legislation was passed at the end of the year. The centerpiece of the tax plan is a significant cut in the corporate tax rate from 35% to 21%, which is more equitable with international competition. Despite political disagreement in the overall tax plan, the impact on corporate profits will be favorable. Furthermore, changes in depreciation provisions have the potential to improve capital deployment. Finally, the tax plan is structured to incentivize companies to repatriate overseas cash which potentially could result in more efficient utilization of corporate resources.





Fixed Income

In January, Fed Chair Janet Yellen indicated that the U.S. economy was stable enough to withstand gradual rate increases in 2017. Throughout the year, the Fed continued to monitor global economic conditions and remained data dependent. According to the latest Fed statement, economic activity has been on the rise – the labor market has continued to strengthen, job gains have increased, and unemployment continues to decline. Furthermore, household spending is expanding at a moderate pace while business fixed investment has increased the past few quarters. Despite the positive economic data, annual inflation, according to core personal consumption expenditures decreased 40 basis points (bps) from 1.9% to 1.5% over the course of 2017.

Incoming Fed Chair, Jerome Powell, is expected to continue the Fed's path to interest rate normalization. The Fed is confident that inflation will stabilize around 2% for the medium-term and maintains that 2017's low inflation readings have been transitory. 10-year implied inflation according to the TIPs market increased considerably from the June low of 1.67% to close the year at roughly 1.98%. When the FOMC met in December 2016 it had projected that by the end of 2017 the Fed funds rate would be 1.375% according to the central tendency median. A year ago the market projected that the Fed funds rate would be 1.17%, according to the Fed funds futures contract for December of 2017. With the Fed funds effective rate closing the year at approximately 1.42%, the FOMC proved to be a better forecaster than the market in 2017.

U.S. Treasury (UST) yield curve flattening was a major theme in 2017. The benchmark 2-year and 10-year UST spread began the year at 126 bps. On March 15th, the FOMC voted to raise the Fed funds rate 25 bps. The tone of the announcement was slightly dovish and the 2-year and 10-year Treasury spread ended the first quarter at 113 bps. Economic data in the second quarter was softer, but on June 14th the Fed increased the Fed funds rate another 25 bps to a target range of 1.00% to 1.25%. That same day, the 2-year and 10-year Treasury spread closed at its year-to-date low of 79 bps due to the uncertainty of the Fed's plan to reduce its $4.3 trillion balance sheet and its impact on the UST yield curve.

In the second half of 2017, low inflation continued. At the July FOMC meeting, Fed Chair Yellen stated that the Fed would consider changing the course of monetary policy if inflation remains below the targeted 2% for a prolonged period. At the September Fed meeting, the FOMC left the Fed funds rate unchanged to monitor the impact of $10B of monthly balance sheet amortization beginning in October. The 2-year and 10-year Treasury spread ended 3Q 2017 at 85 bps. On December 13th, the FOMC increased the Fed funds rate an additional 25 bps on stronger economic data despite persistently low inflation. The 2-year and 10-year Treasury spread closes 2017 at roughly 53 bps, 97 bps below its 5-year average of approximately 150 bps. The 2-year Treasury closes 2017 up 70 bps to 1.89% while the 10-year Treasury is down 2.6 bps to 2.42%.

Fixed income asset classes that performed the best over the course of 2017 included long-term high-quality U.S. bonds, emerging market bonds (currency hedged), and international treasury bonds (non-currency hedged) with year-to-date total returns of 10.38%, 10.14%, and 9.55%, respectively. On the other hand, short-term U.S. Treasuries, short-term high-quality bonds, and senior loans performed poorly with total returns of -0.03%, 1.16%, and 2.03%, respectively.

As the appetite for investment grade and high yield debt continued in 2017, credit spreads reached multi-year lows. The 5-year A-rated corporate bond spread above Treasuries narrowed 22 bps to end the year at approximately 47 bps. The move was even more dramatic in the high yield sector with the 5-year B-rated corporate bond spread decreasing 51 bps to end the year at 299 bps.

Top 10 Financial Stories in 2017

Factors that influenced the financial markets:

10) Geopolitical Risks – Geopolitical events never impacted the financial markets in a meaningful way despite pundit's predictions.
9) Washington Dysfunction – Washington faced a tough year with lawmakers struggling to come to an agreement over many significant policy initiatives.
8) Rise of the Cryptocurrencies – Cryptocurrencies saw large inflows from speculators looking to make astronomical returns in a short period of time.
7) New Fed Chair – Jerome Powell was elected to take the place of former Fed Chair Janet Yellen. Fed Chairman Jerome Powell is expected to continue the Fed's path to interest rate normalization.
6) U.S. Treasury Curve – The flattening of the yield curve has continued throughout the year. The yield spread between the 2-year and 10-year treasury yield is at its lowest level since 2008.
5) Inflation Remains – Using the Consumer Price Index (CPI) to measure inflation, the U.S. inflation rate was above 2.1%. This is the highest rate of inflation since 2012.
4) Fed Normalization – The Federal Reserve is normalizing rates and reducing their security holdings.
3) Dollar Weakness – The dollar declined approximately 9.8% this year, the first annual decline in five years and worst performance since 2005.
2) Earnings – The S&P 500 Index is estimated to have earnings of $131.50 for 2017 compared to $106.26 in 2016, an increase of approximately 24%.
1) Tax Reform Drives Equities – The restructured tax bill will make America more competitive by reducing the corporate tax rate from 35% to 21%. Individuals are expected to benefit from the tax reform as well.