PEAPACK PRIVATE
Wealth Management

The Weekly
Economic & Market Recap

Peapack Private Wealth Management

SPECIAL EDITION: EXPECTATIONS FOR 2020
 January 10, 2020

updated as of:
1/10/2020

STOCKS	Close	Wk Net Change	Wk % Change	Div Yield	YTD % Change	12 Mos % Change
DJIA	28,823.77	188.89	0.66	2.21	1.00	20.71
S&P 500	3,265.35	30.50	0.94	1.81	1.07	26.32
NASDAQ	9,178.86	158.09	1.75	0.98	2.30	31.94
S&P MidCap 400	2,051.39	-4.28	-0.21	1.74	-0.56	17.39

TREASURIES	Yield	FOREX	Price	Wk %Change
2-Year	1.56	Euro/Dollar	1.11	-0.46
5-Year	1.63	Dollar/Yen	109.56	1.42
10-Year	1.82	GBP/Dollar	1.31	-0.08
30-Year	2.28	Dollar/Cad	1.31	0.54

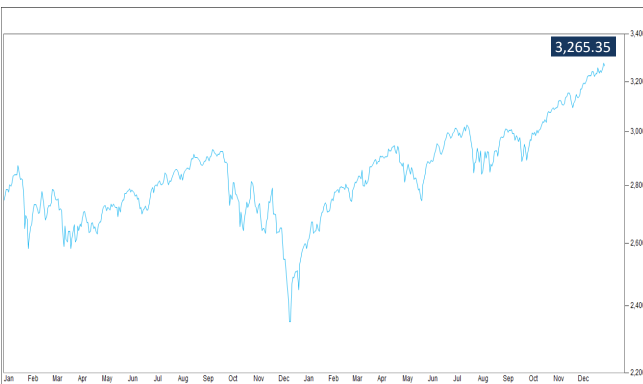
Source: Bloomberg/FactSet

Equities

December closed out the decade in historic fashion as the S&P 500 realized its 129th consecutive bull market month – its longest run in American history – and ultimately rewarded investors with double digit returns across all sectors for the year. The S&P 500 returned a thundering 31.5% for the year, its best calendar performance since 2013, despite headlined events such as the Federal Reserve cutting rates three times, an inverted yield curve, the threat of North Korea, the U.S.-China trade war, civil unrest in Hong Kong, Brexit, and the impeachment of President Trump. While some of these risks have resolved or eased in severity, many remain relevant as the market enters 2020. These events, coupled with the escalating tensions in the Middle East, the forthcoming Phase One agreement with China, and November's Presidential election, pose the question: What can investors expect for 2020?

Global economic growth continues to stabilize and, correspondingly, we expect U.S. real GDP expansion to settle somewhere between 1.75% and 2.25%. We do not expect a recession to hit the economy in 2020. With the trade environment still a complicated issue, fiscal and monetary policy will remain accommodative as low interest rates will help provide stimulus to the economy. Moreover, moderate inflation, steady wage growth, and healthy employment figures serve as positive harbingers for continued consumer confidence and strength. The flip side to this however is that the increased wages and input costs associated with these factors have a negative impact on corporate margins. These conditions, coupled with low capital expenditure levels, weak corporate confidence, and elevated corporate debt, point to what we expect will be a muted year for corporate earnings growth.

S&P 500



Equities (cont.)

Attractive valuations on a price-to-earnings basis coupled with low interest rates served as a catalyst for the rally in 2019. For the majority of the decade's equity market expansion however, returns were fueled mostly by earnings growth. Considering that current expectations are for 1.3% earnings growth in 2019 (Q4 2019 earnings have yet to be reported), it is clear that the recent runup is attributable to increased multiples. According to FactSet, the S&P 500 is trading at 18.2x forward twelve month earnings compared to its 10-year median of 15.4x. We do not expect significant multiple expansion with stocks trading at the upper end of their valuation range. It will require increased corporate earnings for stocks to continue to rally.

As the market rolls into 2020, investors should be cognizant of the potential risk factors mentioned above. The market will also be closely focused on corporate earnings and any signs of future Federal Reserve rate adjustments. Earnings shortfalls can put downward pressure on equities, and a decision by the Federal Reserve to raise interest rates can combat inflation while simultaneously compressing valuation multiples. Despite these jeopardies, we believe that investors should be able to anticipate equity market returns that are ultimately consistent with overall corporate earnings growth.

Economy

Despite the disconnect in 2019 between lackluster economic growth and robust stock market returns, we expect risk assets will outperform in 2020 while economic/GDP growth will continue in the moderate 1.75% - 2.25% range. We are expecting GDP growth to be slightly better in the second half of 2020, as the global economy transitions back into synchronized growth mode. Global risks are fading, supportive macroeconomic policies remain in place, and global liquidity conditions have improved. Regarding the U.S. economy, we are expecting job growth to continue at a pace of 120,000 – 140,000 jobs per month. The consumer enters 2020 on strong footing with the underemployment rate at 6.7%. The labor force participation rate is at 63.2%, just off the cycle high which was achieved in October 2019. The housing market has posted better numbers recently with existing home sales increasing by 2.7% year-over-year, and the median price of an existing home ($271,300) advancing by 5.4%. Inflation figures in 2020 will most likely resemble 2019 numbers. On the negative side it still appears that businesses will spend cautiously, and non-residential construction reports will display no growth at all. These components will once again lead to subdued productivity numbers which have been materially absent during this 11 year expansion.

COMING UP NEXT WEEK		Est.
01/14 CPI ex-Food & Energy SA M/M	(Dec)	0.20%
01/14 CPI SA M/M	(Dec)	0.25%
01/15 Empire State Index SA	(Jan)	5.0
01/15 PPI ex-Food & Energy SA M/M	(Dec)	0.25%
01/15 PPI SA M/M	(Dec)	0.30%
01/16 Retail Sales ex-Auto SA M/M	(Dec)	0.55%
01/16 Retail Sales SA M/M	(Dec)	0.45%
01/17 Housing Starts SAAR	(Dec)	1,368K
01/17 Industrial Production SA M/M	(Dec)	0.25%

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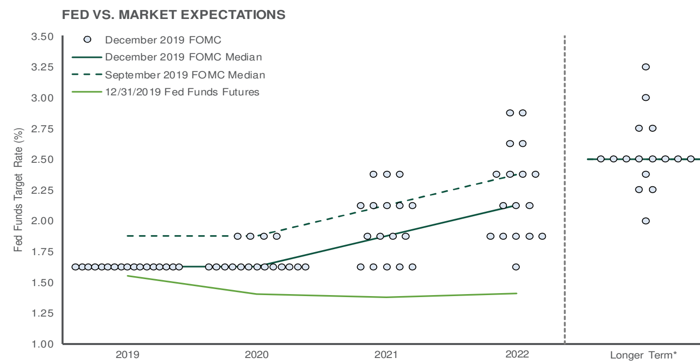
Fixed Income

The FOMC embarked on a three-year tightening cycle which lasted from December of 2015 to December of 2018. Over the previously mentioned timeframe, the FOMC increased interest rates by 25 basis points (bps) nine times and began decreasing the size of its massive balance sheet in hopes that the U.S. economy finally had enough forward momentum to expand on its own. Unfortunately, with the waning benefits from the 2017 tax reform, escalating global trade tensions, rising populism, mounting geopolitical risks and lack of business optimism, U.S. growth began to decelerate over the course of 2019 which forced the FOMC to pivot from keeping rates on hold to eventually cutting. Moreover, the FOMC decreased the Fed funds rate 0.75% cumulatively in 2019 to a target range of 1.50% to 1.75%. It is our belief that U.S. growth will stabilize and reside in the 1.75% to 2.25% range in 2020 thanks to easier financial conditions, decreased trade tensions and expansionary fiscal policy.

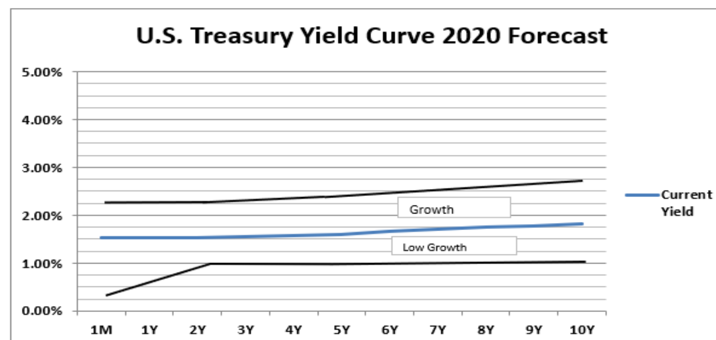
If the U.S. economy progresses according to the FOMC's most recent projections, the Fed funds rate should end 2020 at 1.625%, which implies no rate hikes over the course of the year. The Fed funds futures market is not quite as optimistic and projects the Fed funds rate to end the year at 1.35%, which implies approximately one rate cut over the next twelve months. The FOMC forecasts their preferred inflation metric (Core PCE) to rise 30 basis points over the course of 2020 to 1.9%, which will still be below their symmetric 2% inflation goal, but not by much. With the unemployment rate at a 50-year low and the beneficial impacts of the FOMC's three rate cuts in 2019 permeating through the economy, it is our belief that inflation will rebound to a modest degree this year and we expect the FOMC to hold rates at their current level over the course of 2020.



Source: Northern Trust Investment Strategy, Bloomberg, Federal Open Market Committee (FOMC) Summary of Economic Projections. Most recent FOMC projections as of the 12/11/2019 committee meeting. *Longer term represents FOMC expectations for w here the rate is expected to converge over time. Fed funds futures data as of 12/31/2019.

As it tends to be the case during periods of monetary easing, the U.S. Treasury curve steepened between the 2-year and 10-year tenors in addition to the 3-month and 10-year tenors over the course of 2019. However, the spread increases were not as pronounced as some market participants expected given the lack of a fourth rate cut. The 2-year and 10-year spread closed 15.3 bps higher at 34.8 bps while the 3-month and 10-year spread increased just 4.7 bps to 37 bps. Since the beginning of 2020 the 2-year and 10-year and the 3-month and 10-year spreads have compressed 7.4 bps and 8.5 bps, respectively. Utilizing Bloomberg's forward curve matrix, both spreads are forecasted to increase over a one-year horizon a respective 7.6 bps and 9.1 bps. With the full scope of the U.S.-China trade deal undetermined and geopolitical hostilities flaring up, projecting the path of interest rates across the U.S. Treasury curve remains a difficult task. However, we do expect interest rates to stay relatively range bound unless inflation surprises to the upside or economic growth deteriorates.

Low funding costs and compressed credit spreads drove corporate bond issuance in 2019 as investors continued the global chase for yield. The demand for investment grade (IG) and high yield (HY) bonds drove outsized total returns for investors. IG bonds returned 14.54% on the year, besting HY bonds by 22 basis points. The supply surge has not abated thus far in 2020 as issuers have already brought over $60B of IG bonds to market in the first full week of the year while costs remain low and before any potential protracted conflict between the U.S. and Iran drives spreads higher. Investment-grade 5-year AA, A and BBB – rated composite spreads decreased 41.9 bps, 45.7 bps, and 62.8 bps, respectively. The high-yield (HY) sector was more pronounced as 5-year BB and B – rated composite spreads decreased 184.1 bps and 248.6 bps, respectively. Furthermore, the Bloomberg IG OAS and HY OAS indices are trading 31 bps and 106 bps below their 5-year averages. If a tense geopolitical landscape causes a widening in credit spreads and investor appetite for credit investments dissipates, current holders of both IG and HY bonds could face principal losses. We caution investors from taking on undue credit risk in 2020.



Source: Bloomberg

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