The Weekly

Economic & Market Recap

Peapack-Gladstone Bank, Private Wealth Management

January 27, 2017

As of 01/27/2017		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	20,093.78	266.53	1.34	2.38	1.67	26.02
S&P 500	2,294.69	23.38	1.03	2.04	2.40	21.75
NASDAQ 100	5,168.06	104.86	2.07	1.17	6.26	25.17
S&P MidCap 400	1,696.67	20.99	1.25	1.66	2.09	32.80
Russell 2000	1,370.70	18.86	1.39	1.40	0.96	36.64

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	1.22	Euro/Dollar	1.07	-0.12
5-Year	1.95	Dollar/Yen	115.04	0.34
10-Year	2.48	Sterling/Dollar	1.25	1.39
30-Year	3.06	Dollar/Cad	1.31	-1.32

Source: Thomson Reuters

What Caught Our Eye This Week

Debt in China has grown to approximately $27 trillion, or approximately 260% of the country's annual gross domestic product. This does not include "shadow banking," an $8.5 trillion sector of the financial market that denotes bank-like activity that is not regulated by the government. This often takes the form of "disguised" loans (shown on bank balance sheets as investment receivables) and high yielding investments (also known as wealth management products - WMPs). Bank "investment receivable" loans are often made to risky entities, and because they are not technically loans, they avoid the government's legal limits on lending and reserve requirements. These kinds of "loans" have helped banks make additional investments into entities that are having cash flow problems, and it has also served to increase banks' profitability. WMPs are investments offered by banks, trust companies, brokers, micro-lenders and other financial services companies. Investor money is solicited, and the proceeds are invested in high yield bonds, loans, stocks, real estate, and other investments with high returns and implied guarantees. These types of shadow banking activities have radically increased leverage and risk to the Chinese financial system, and they will likely lead to destabilization at some point in the future.

Economy

The most significant report this week was Friday's GDP Advance number. Real GDP grew at 1.9% annual rate in Q4 of 2016, coming in below consensus estimates of 2.2%. The trade deficit reduced the headline number by 1.7% as net exports drop significantly due to strong consumer goods imports. Fourth quarter core PCE was another economic release coming up short of expectations reporting 1.3% versus expectations of 1.6%. Personal consumption, making up roughly 70% of GDP, declined by 25% versus its prior report. Earlier in the week, Markit PMI was reported at 55.1 advancing past expectations by 1.3%. Existing home sales came in weaker than expected missing expectations by 0.9% reporting 5.54 million. New home sales reported a weak 536,000 units, falling short of consensus by 8.2%. Durable goods came in below expectations falling by 0.4% versus consensus of 2.6% growth for December. Durable goods, excluding transportation, however was in line with consensus. Lastly, University of Michigan sentiment came in with a strong beat reporting 98.5 versus consensus of 98.1 for the month of January.

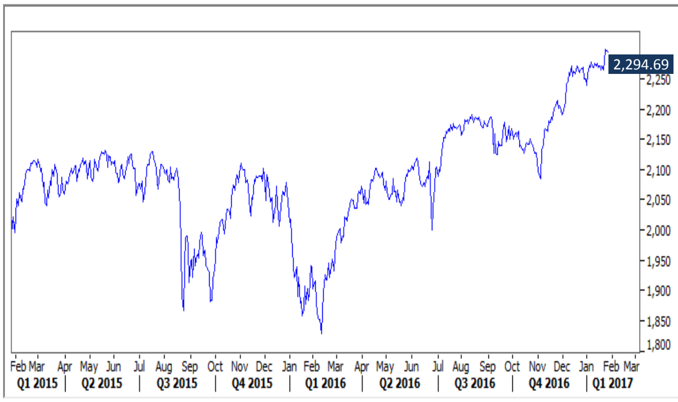
Fixed Income/Credit Market

Week-over-week, the benchmark 2-year and 10-year Treasury yields widened 2.8 and 1.7 basis points, respectively. This yield compression left the 2-year and 10-year spread roughly unchanged week-over-week at approximately 127 bps, its widest spread year-to-date in 2017, but below the 2016 high of 136 basis points which was reached on 12/22/16. The 2-5-10 butterfly spread has compressed back to approximately 19 bps from 2016's high of 32 bps on 12/27/16, indicating that the 5-year part of the UST curve is getting more expensive. Focusing on the front end of the yield curve, all eyes will be on the FOMC this upcoming week when they announce the Fed funds rate decision on Wednesday. The implied probability of a rate increase is very low at 12.4%. At this point, Fed funds futures indicate that the Fed will be able to increase rates twice in 2017, which will leave the Fed funds rate at 1.12% in December of this year.

Equities

The equity market had a good week as the Dow Jones Index finally broke through 20,000 points as a majority of the DJIA components contributed to the gain. The market was boosted by renewed hope that President Trump would unleash pro-growth policies and generally positive earnings reports. So far, 170 companies have reported their earnings for Q4 with 65% exceeding consensus expectations. Earnings revisions have been negative with companies that have reported their Q4 earnings, lowering expectations by 1.4% on average for Q1 2017. President Trump grabbed attention in regard to trade and foreign relations with his meeting with British Prime Minister Teresa May, as they discussed a number of issues of mutual interest between the two countries. On Thursday, the market shrugged off the concern over rising trade tensions between Mr. Trump and Mexico. The materials sector continued to display positive returns for the week, along with financials and technology stocks. Interest-rate sensitive and defensive areas (telecommunications and utilities) were laggards.

S&P 500



Our View

The U.S. Bureau of Economic Analysis released GDP statistics for the fourth quarter of 2016 on Friday. GDP growth was modestly below expectations growing at an annualized rate of 1.9 percent despite solid consumer and investment spending. The disappointment stemmed from a 4.3 percent annualized decline in exports that reversed a 10 percent increase in the third quarter. Net exports is a relatively small contributor to the overall domestic economy, but the GDP release does highlight the importance of the trade environment. Obviously, the global trade system is complex with many influences. Generally, goods should be produced to provide the product at the lowest possible cost. It raises everyone's standard of living. The Trump administration's desire to forge mutually beneficial bilateral trade agreements would be very helpful in constructing a healthy trade environment. Punitive border-adjusted tax levies have the potential to be incendiary and could lead to retaliatory trade action. The result of a trade war would be higher-priced products for everyone and a lower standard of living. The real driver of secular growth would be a more competitive corporate (and personal) tax structure. It will be a much more demanding lift given the various fractions in Washington and the current animosity. We would prefer the new administration to focus their efforts on tax reform.

COMING UP NEXT WEEK		Est.
01/30 Personal Income MM	(Dec)	0.4%
01/30 Consumption, Adjusted MM	(Dec)	0.5%
01/31 Consumer Confidence	(Jan)	112.5
02/01 ISM Manufacturing PMI	(Jan)	55
02/03 Unemployment Rate	(Jan)	4.7%
02/03 Factory Orders MM	(Dec)	1.4%

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