Peapack Private Wealth Management

August 16, 2019

08/16/2019		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	25,886.01	-492.18	-1.87	2.32	10.97	2.88
S&P 500	2,888.68	-29.97	-1.03	1.97	15.23	2.49
NASDAQ	7,895.99	-63.15	-0.79	1.05	19.00	1.57
S&P MidCap 400	1,873.22	-28.11	-1.48	1.79	12.64	-5.60

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	1.49	Euro/Dollar	1.11	-0.87
5-Year	1.43	Dollar/Yen	106.39	0.69
10-Year	1.56	GBP/Dollar	1.21	0.53
30-Year	2.04	Dollar/Cad	1.33	0.68

Source: FactSet

What Caught Our Eye This Week

Recent concerns of slowing global growth and the subsequent 23% drop (from 2.02% on July 31st to 1.56% today) in U.S. Treasury 10-year yields have brought volatility back to the equity market with a vengeance. Investor attention and appetite remains focused on defensive stocks (consumer staples, utilities, real estate investment trusts and certain portions of the healthcare sector), those companies with strong balance sheets, consistent earnings, and stable dividend yields. Sometimes referred to as "bond proxies", these stocks with high and consistent yields have soared to historic-ally high valuations when measured in terms of their price-to-earnings (P/E) ratios. A Bloomberg article this week highlights that the P/E for the quintile of stocks whose price performance was most positively correlated with bond prices trades at an almost 57% premium to the quintile whose prices were most negatively correlated with bond prices. The price-earnings ratio for both the Consumer Staples and Utilities sectors trade above their 10-year median levels by 14% and 22%, respectively. As the market continues to forecast the likelihood of a recession for the U.S. economy, these are elevated levels for industries whose earnings are not entirely immune to an economic slowdown.

Economy

The economic headliner this week was the retail sales report, which was released on Thursday. Retail sales increased 0.7% in July easily exceeding expectations. Retail sales have now increased for five consecutive months and are up 3.4% over the past 12 months. The all-important control category, which excludes food service, autos, gas and building materials, advanced by 1.0%. There were also positive revisions made to the May "control" figures with these numbers now showing 0.8% growth. Overall, 10 of 13 major retail categories posted higher sales. Once again, nonstore retailers were the top performers with an advance of 2.8%. This group now makes up 12.8% of overall retail sales. In other news this week, the consumer price index showed a 0.3% increase in July matching consensus expectations. The "core" CPI which excludes food and energy prices also increased by 0.3% and is now up 2.2% year-over-year. Industrial production figures were released on Thursday posting a drop of 0.2% in July, which was below consensus. Finally, on Friday, monthly housing starts fell 4% in July to a five-month low and were heavily influenced by the volatile multi-family category.

Fixed Income/Credit Market

The demand for high quality assets has driven U.S. Treasury (UST) yields to multi-year lows. On Wednesday the 30-year UST dropped below 2% for the first time in history, then on Thursday, the 10-year UST dipped below 1.5% for the first time since August 2016. According to Bloomberg, the rally in the 30-year UST yield is more than just a flight-to-quality, it could be a sign that bond traders are not fearful of a pickup in global growth, rising interest rates, nor a rebound in inflation in the foreseeable future. The risk of buying longer dated bonds such as the 30-year Treasury is that losses would be much more pronounced if interest rates reversed course. An instantaneous rate shock of 100 basis points would result in a loss of 8.8% on the 10-year versus 19.8% on the 30-year. Investors should take a balanced approach to taking duration risk. The 10-year and 30-year USTs closed Friday at roughly 1.56% and 2.04%, respectively.

Equities

Volatility was elevated in equity markets this week, and the S&P 500 index posted a third consecutive weekly decline. A reduction in investors' appetite for riskier assets resulted from an escalation of the protests in Hong Kong, global economic growth concerns, and a recent pickup in fears of a prolonged U.S.-China trade war. After substantial declines across all three major indexes on Monday, stocks rallied on Tuesday after the U.S. announced that they would delay a 10% tariff on certain items such as cell phones, laptop computers and video game consoles until December 15th. Risk on sentiment quickly reversed the following day causing the S&P 500 to finish with the second-biggest percentage decline of the year. The primary trigger for the selloff was the inversion of the 2-year and 10-year U.S. Treasury yields for the first time in over ten years. On a positive note, stocks were able to regain their footing following such an ugly day, and the S&P 500 posted back-to-back gains finishing Friday up over 1.4%. The only three sectors that managed to post a positive week were consumer staples, real estate and utilities.

Our View

There is no question the global economy is decelerating and the main culprit is the escalation of trade tensions between the U.S. and China. Moreover, the JPMorgan Global Manufacturing Purchasing Managers' Index resided at 49.3 in July (any figure below 50 signifies contraction) and has been falling consistently since April of 2018. Just this week German second quarter flash GDP declined by 10 basis points on a quarterly basis and China reported the weakest growth rate in industrial production on an annual basis in 17 years. Rising concerns of weak inflation coupled with slowing global economic growth has caused investors to flock toward safe haven assets and high quality bond yields have plummeted particularly on the long end of the yield curve. Early on Wednesday morning, the yield on the 2-year U.S. Treasury briefly elevated above the 10-year U.S. Treasury yield for the first time since 2007. Yield curve inversions have historically been a fairly accurate indicator of a looming recession. Moreover, the last five 2-10 inversions have ultimately resulted in recessions and the recessions have on average arrived 22 months after the initial inversion. However, after the onset of yield curve inversion, equity markets have historically performed quite well. Dow Jones Market Data shows that one year after initial inversion the S&P 500 has returned on average roughly 13.5% according to the past five instances of inversion. Also, outside of the manufacturing sector, the U.S. economy is on stable ground. Initial jobless claims are close to a 50-year low, household balance sheets are healthy, corporate default rates are extremely low, the banking sector is well capitalized and financial excesses appear to be contained. With that being said, trend GDP growth of roughly 2% in the U.S. is expected in the short run, but global risks are certainly mounting and warrant close monitoring.

COMING UP NEXT WEEK		Est.
08/21 Existing Home Sales SAAR	(Jul)	5,405K
08/22 Leading Indicators SA M/M	(Jul)	0.20%
08/23 New Home Sales SAAR	(Jul)	640.0K

For more information about our solutions: http://peapackprivate.com