Peapack Private Wealth Management

January 31, 2020

| 1/31/2020 | | Wk Net | Wk % | Div | YTD % | 12 Mos % |
|---|---|---|---|---|---|---|
| **STOCKS** | Close | Change | Change | Yield | Change | Change |
| DJIA | 28,256.03 | -733.70 | -2.53 | 2.26 | -0.99 | 12.96 |
| S&P 500 | 3,225.52 | -69.95 | -2.12 | 1.83 | -0.16 | 20.31 |
| NASDAQ | 9,150.94 | -163.97 | -1.76 | 0.95 | 1.99 | 27.40 |
| S&P MidCap 400 | 2,007.22 | -57.93 | -2.81 | 1.79 | -2.70 | 9.85 |

| **TREASURIES** | Yield | **FOREX** | Price | Wk %Change |
|---|---|---|---|---|
| 2-Year | 1.32 | Euro/Dollar | 1.11 | 0.52 |
| 5-Year | 1.32 | Dollar/Yen | 108.39 | -0.96 |
| 10-Year | 1.52 | GBP/Dollar | 1.32 | 0.87 |
| 30-Year | 2.01 | Dollar/Cad | 1.32 | 0.65 |

Source: Bloomberg/FactSet

**What Caught Our Eye This Week**

2019 Novel Coronavirus (2019-nCoV) is a virus identified as the cause of an outbreak of respiratory illness first detected in early December in Wuhan, Hubei Province, China, about 700 miles south of Beijing. In addition to the primary public health concerns related to the person-to-person spread of the virus, there are implications for significant portions of the world economy including travel, tourism, trade, and manufacturing as entire Chinese cities grind to a halt. Store closures and travel limitations put in place to limit further contagion are a blow to consumer confidence and will weaken demand. Furthermore, companies must adjust for the potential lack of previously thriving Chinese consumers in the tourism, travel, and services industries where they normally spend $258 billion per year. An impoverished country just 40 years earlier, China has developed into an integral component of the modern global industrial machine. It recently accounted for approximately one-sixth of global economic output and is the world's largest manufacturer. To the extent that they have not done so already, businesses worldwide will need to plan around potential disruptions to an interwoven global supply chain powered by its vast factories and extensive transportation network. The degree of the hit to the broader business world remains unclear. It is worth noting that in 2003 SARS knocked 2% off of China's gross domestic product growth at a time when the country represented only 4% of the world's economic output.

**Economy**

The economic headliner this week was the Q4 Gross Domestic Product (GDP) report which was released on Thursday. Real GDP grew at a 2.1% annual rate in the fourth quarter which slightly beat consensus estimates of +2.0%. As a result, 2019 real GDP grew 2.3%. The largest contributors to the fourth quarter growth rate were net exports and personal consumption. The weakest component was inventories. Earlier in the week, December new single-family home sales posted a decline of 0.4% to a 694,000 annual rate. This came in below expectations for 730,000, but sales are up 23% year-over-year. In 2019, sales hit an annualized pace of 682,000 units which is a post-recession high. On Tuesday, December durable goods showed new orders for durable goods rose 2.4% which beat the consensus estimate of +0.3%. The strength was mostly due to the volatile defense aircraft sector. Shipments of "core" non-defense capital goods ex-aircraft, an input for business investment in the calculation of GDP growth, declined 0.4% in December. This metric is down in five of the last six months.

**Fixed Income/Credit Market**

The potential economic impact of the coronavirus pushed investors into safe haven assets this week putting further downward pressure on U.S. Treasury yields, particularly the long-end of the curve. The 10-year Treasury decreased 18.1 basis points (bps) week-over-week and closed Friday at 1.50%. At a rate of 1.50%, the 10-year is trading roughly 27 bps below its 100-day moving average. Furthermore, over a one-year horizon, the 10-year is now more than one standard deviation below its one-year mean of 2.06%. Since the beginning of 2020, the 10-year Treasury has dipped 41.5 bps while the 2-year Treasury has dropped 25.3 bps decreasing the spread between the two tenors 16.2 bps. The 2-year and 10-year spread closed Friday at 18.6 bps. On Wednesday, the FOMC left the Fed funds rate unchanged in a target range of 1.50% to 1.75%, however, they increased the Interest Rate on Excess Reserves (IOER) 5 bps to 1.60%. The increase in the IOER was a technical move to bring the Fed funds rate closer to the middle of its target range.

**Equities**

Equities were highly volatile for the week as the coronavirus continues to create concern and uncertainty across global markets. Monday marked the first instance since mid-October that the S&P 500 moved more than 1%. Closing down 1.57%, it was the largest pullback for the index since August and erased gains for the month of January. Despite no clear catalysts, equities rebounded on Tuesday as all sectors finished on high notes. Wednesday saw mixed results for stocks as the coronavirus again dominated headlines. The S&P 500 was down 0.09% while the Dow and Nasdaq were up 0.04% and 0.06%, respectively, for the day. The World Health Organization (WHO) declared the coronavirus a "public health emergency of international concern" on Thursday, sparking an afternoon rally that resulted in all major indices posting gains and reversing Wednesday's losses. As of Friday, there have been 10,000 confirmed cases of the coronavirus with every Chinese province reporting instances of infected patients. The United Kingdom and Russia also confirmed their first cases of the virus. With a multitude of countries issuing travel restrictions to China, apprehensions about the disease do not seem to be dissipating. Friday's close showed all major indices down for the day. Utilities was the top performer (+0.85%), while energy was the week's laggard (-5.59%).


**Our View**

Equity markets were under pressure last week as investors try to assess the effect of the coronavirus on the global economy. The growing global contagion has created uncertainty and will likely cause earnings expectations to be reduced. Although fourth quarter earnings reports have generally been in line with forecasts, investors are concerned about forward earnings. Historically, the economic and market related impact for global contagions have tended to be relatively contained and short lived. From a longer perspective, the bipartisan Congressional Budget Office (CBO) released their latest baseline budget projections. The CBO forecast federal deficits will exceed $1 trillion each year over the next ten years. Over the period from 2021 to 2030, the U.S. will amass another $13 trillion in debt, adding to the $23 trillion that we currently owe. More worrisome is that the forecasts expect that the annual deficits will be accelerating over time. Net debt-to-GDP at the end of 2019 was 79% and is projected to be 98% by the end of the forecast period. The only other time the debt/GDP ratio was this high was due to WWII. The U.S. is producing a large debt burden during a time of economic stability. The deficit issue is being driven by rapid growth in spending caused by an aging population, rising healthcare costs, and interest costs. In fact, the fastest growing portion of the budget over the forecast period is net interest costs that will grow from $383 billion per year in 2019 to an estimated $819 billion in 2030. As the debt burden increases, it could lead to less public and private investment, reduced fiscal flexibility and slower overall economic growth. Financial markets are not concerned about debt levels at this point. The sooner the legislators in Washington address the nation's fiscal situation, the easier the solution will be and the more acceptable the societal cost.

| COMING UP NEXT WEEK | | Est. |
|---|---|---|
| 02/03 Markit PMI Manufacturing SA (Final) | (Jan) | 51.7 |
| 02/03 ISM Manufacturing SA | (Jan) | 48.3 |
| 02/04 Durable Orders SA M/M (Final) | (Dec) | 2.4% |
| 02/07 Nonfarm Payrolls SA | (Jan) | 160.0K |
| 02/07 Unemployment Rate | (Jan) | 3.5% |

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