The Weekly

Economic & Market Recap

Peapack-Gladstone Bank, Private Wealth Management

November 2, 2018

As of 11/02/2018		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	25,270.83	582.52	2.36	2.20	2.23	7.46
S&P 500	2,723.06	64.37	2.42	1.94	1.76	5.45
NASDAQ 100	6,965.29	112.89	1.65	1.06	8.89	11.69
S&P MidCap 400	1,862.40	67.30	3.75	1.69	-2.01	1.70
Russell 2000	1,547.98	64.16	4.32	1.47	0.81	3.44

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	2.91	Euro/Dollar	1.14	-0.11
5-Year	3.04	Dollar/Yen	113.18	1.13
10-Year	3.22	Sterling/Dollar	1.30	1.04
30-Year	3.46	Dollar/Cad	1.31	-0.05

Source: Thomson Reuters & Bloomberg

What Caught Our Eye This Week

As the third quarter earnings season progresses, one corporate mantra has remained constant, "We are raising our prices." From transportation companies to household products producers to manufacturers and industrial suppliers, prices have begun to rise, and these same companies expect further increases into next year. Driving these decisions is the fact that fuel, metal, food, transportation and other input costs are rising. Additionally, since the end of September, President Trump has levied a 10% tariff on $200 billion worth of goods imported from China. Depending how trade talks progress this month, he plans to raise the tariffs to 25%. Since 2008, companies have been reluctant to raise prices and lose business. Things are different today. Unemployment is the lowest in 49 years (3.7%), consumer confidence is at its highest in 18 years, worker compensation growth is at its strongest in 10 years, and taxes have been lowered for many. The average buyer is now more willing and able to shoulder higher costs. Given the trajectory of prices, it would not be surprising to see inflation in the U.S. accelerate over the next several quarters. This in turn could encourage the Federal Reserve to continue to increase interest rates. Inflation outside the U.S. is following suit. European inflation now stands at 2.2%, and inflation in much of the emerging markets has risen to 2.8% on average.

Economy

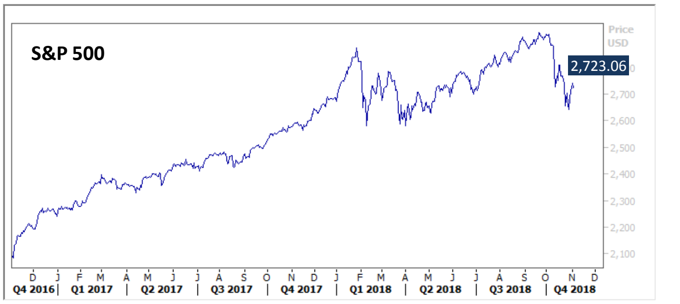
The most anticipated report this week was the nonfarm payroll report, which was released on Friday. This report showed payrolls increasing by 250,000 in October, which was above the consensus forecast of 190,000. The unemployment rate was unchanged at 3.7% (49-year low), and the U-6 measure of unemployment dropped to 7.4%. Average hourly earnings increased by 0.2% (5 cents) and are now up 3.1% year-over-year. The labor force participation rate increased to 62.9%. Examining the different employment sectors, manufacturing added 32,000 jobs, construction added 30,000 and leisure and hospitality gained 42,000. In other news this week, personal income and consumption continued to move in the right direction. Personal income increased by 0.2% and personal consumption advanced by 0.4%. Over the past 12 months, personal income is up 4.4% and personal consumption is up 5.0%. Finally on Thursday the ISM manufacturing index declined to 57.7 in October, which was a larger drop than expected. The new orders index also fell, settling at 57.4.

Fixed Income/Credit Market

Ten-year municipal debt backed by the state of New Jersey is currently trading at approximately 46.5 basis points (bps) above the Bloomberg 10-year AAA municipal index, roughly 26.4 bps below the one-year average. However, the yield for 10-year NJ municipal debt trades at approximately 3.24% which is 101.25% of the 10-year U.S. Treasury. New Jersey's visible 30-day supply is $607.3MM while the amount of debt expected to retire is $1,453.8MM, equating to net supply of negative $846.5MM. As supply and demand dynamics have pushed municipal bond prices higher, October's Buy/Sell Ratio in NJ showed purchases were down on the month. This week, a AA-rated NJ issuer sold 10-year bonds at a yield of 3.15%, which has a taxable equivalent yield of 5.84% for NJ residents in the highest tax bracket. Compared to Bloomberg composite AA corporate bonds which are trading at 3.95%, NJ muni investors pick up approximately 189 bps of incremental yield.

Equities

After a tumultuous start to October (the market unwound nine months of gains in three weeks), stocks began the week with an attempted rally before earnings guidance from a few technology stocks led the S&P 500 Index to decline 2.1% Monday afternoon. Stocks reversed course on Tuesday and despite a wage growth-related pullback after Friday's employment report still advanced 2.33% for the week, buoyed by strong earnings and hopes of progress on trade talks with China. Notably, corporate insiders acquired shares at a rate greater than that at which they sold them this week. Economic fundamentals remain positive and point to continuing growth. With over half of S&P 500 companies reporting third-quarter results, earnings season is ahead of expectations with average EPS growth of 24% (5-6 points above consensus). FactSet reports almost 75% are outpacing earnings estimates but only 60% are exceeding revenue estimates (below the past year's 73% average). The best performing sector for the week was Materials advance of +6.46%, while the worst was Utilities decline of -.05%.



Our View

The Federal Reserve operates under a statutory mandate, which "seeks to foster maximum employment and price stability." With the recent escalation in market volatility and tightening financial conditions, some have begun to question whether the Fed's forward guidance regarding rate hikes is too aggressive. Looking at the employment figures, there is no question the Fed should be raising rates. Moreover, the unemployment rate resides at 3.7%, which is the lowest level since 1969 and well below the Fed's long run projection of 4.5%. Tightness in the labor market is also starting to impact the cost of labor with average hourly earnings up 3.1% on a yearly basis. Looking at the latter portion of the Fed's dual mandate shows that inflation is running at the Fed's 2.0% target according to core personal consumption expenditures (core PCE) and has been at this level for the past five months. The previous statistic also indicates that the Fed should be raising rates at the current juncture. Furthermore, the implied probability of a rate hike at the December 19th meeting currently stands at 74.6% and we strongly believe that the Fed will raise rates for a fourth time in 2018. Looking out into 2019, the Fed has indicated it will hike rates 3 times, but with elevated trade tensions and slowing global growth the market is only projecting 2 rate hikes. Looking at market based inflation expectations moving forward, the 5-year breakeven rate is 1.90% and implies that inflation will actually moderate as time progresses. Also, U.S. GDP forecasts for 2019 show growth decelerating to the 2.5% range due to the fading benefits of tax reform. With that being said, the Fed should be more vigilant with rate increases in 2019 and beyond.

COMING UP NEXT WEEK		Est.
11/05 ISM N-Mfg PMI	(Oct)	59.5
11/07 Consumer Credit	(Sep)	17.25B
11/08 Fed Funds Target Rate	(8 Nov)	
11/09 PMI Final Demand MM	(Oct)	0.2%
11/09 U Mich Sentiment Prelim	(Nov)	98.0