The Weekly

Economic & Market Recap

Peapack-Gladstone Bank, Peapack Private Wealth Management

February 15, 2019

As of 02/15/2019		Wk	Wk		YTD	12 Mos
STOCKS	Close	Net Change	% Change	Div Yield	% Change	% Change
DJIA	25,883.25	776.92	3.09	2.22	10.96	2.71
S&P 500	2,775.60	67.72	2.50	1.97	10.72	1.63
NASDAQ 100	7,055.18	142.05	2.05	1.09	11.46	3.83
S&P MidCap 400	1,914.01	61.56	3.32	1.69	15.09	0.89
Russell 2000	1,569.25	62.85	4.17	1.45	16.36	2.09

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	2.52	Euro/Dollar	1.13	-0.38
5-Year	2.49	Dollar/Yen	110.42	0.61
10-Year	2.66	Sterling/Dollar	1.29	-0.47
30-Year	2.99	Dollar/Cad	1.33	-0.23

Source: Thomson Reuters & Bloomberg

What Caught Our Eye This Week

Alphabet's Waymo division recently became the first company to launch a commercial driverless taxi business – now operating in four suburbs of Phoenix, Arizona. Autonomous Vehicles (AVs) use cameras, laser sensors, and very sophisticated software to replace a human behind the wheel of a car. Currently, each taxi is staffed with a driver behind the wheel to take over only in the event of an unforeseen situation, and another observer is seated in the front passenger seat. Presently, the vehicles drive "timidly" and only in clear weather and over well-mapped and well-defined geographies. Some state regulations require AV companies to disclose the number of incidents when the computers require an override by the human observers. The commercial success of this nascent industry will be predicated on near-perfect operational performance, the ability to function without the cost of employees sitting in the vehicles for safety, and the decline in cost of the sensors. This could be many years (or a couple decades) away from reality. Many other companies are testing AVs for delivering groceries, consumer packages or meals. With a much lower risk hurdle, it is quite likely that these applications may be the first to go completely driverless.

Economy

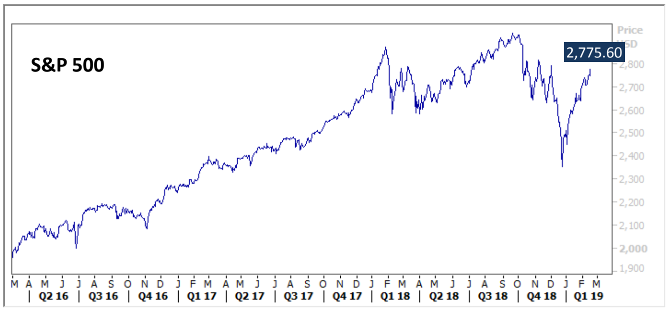
The most anticipated report this week was the retail sales report, which was released on Thursday. Retail sales decreased by 1.2% in December (the most in 9 years), and are now up 2.3% year-over-year. Overall, 11 of 13 major categories declined during the month. The all important control category, which excludes food service, autos, gas and building materials decreased by 1.7%. The headline figure was heavily influenced by gas station sales (↓5.1%) and online sales (↓3.9%). This report suggests the economy entered 2019 with much less momentum than previously anticipated. Earlier in the week, the Consumer Price Index posted a flat reading for January, which was below consensus expectations. The "core" reading increased by .24%, which was higher than expected and is now up 2.2% year-over-year. Housing and medical care prices led the rise in the "core" CPI. Overall, consumer prices were unchanged for a third consecutive month. Finally on Friday industrial production figures disappointed, dropping by 0.6% in January. Manufacturing output also declined, decreasing by 0.9%.

Fixed Income/Credit Market

On Valentine's Day, we looked back over a 5-year horizon to see what type of love the financial markets have shown the 10-year U.S. Treasury (UST) yield to magnify the current flatness of the yield curve. On February 14, 2014, the 2-year U.S. Treasury was trading at just 0.31% while the 10-year Treasury yield was roughly 2.74% –- a spread of 243 basis points (bps). At the close of February 14, 2019, the respective yields of the 2-year and 10-year Treasuries were approximately 2.50% and 2.66%, narrowing the spread between the two benchmarks 227 bps over a 5-year period. The yield on the 2-year UST has increased 706.5% while the yield on the 10-year UST has decreased 2.9%. The FOMC set out on a path towards normalization in December of 2015 with nine 25 bp hikes through December of 2018. The flatness of the UST curve has been further exacerbated by the Fed's balance sheet run-off and an increase in Treasury supply, particularly on the front-end of the curve.

Equities

Equities put in another strong week, marking the eighth consecutive week of positive returns despite poor economic news. Contributing to the positive risk on sentiment were news of progress in trade talks with China, a border security compromise that averts a second government shutdown, and investors' belief that the Federal Reserve likely ends the reduction of its balance sheet this year. With 79% of S&P 500 companies having reported results for the fourth quarter of 2018, the blended earnings growth for the Index is 13.1% year-over-year (above expectations of 12.1% at year end) and 70% have beaten analysts' estimates (just below the 5-year average of 71%). The best sector was Energy, +3.12% thanks to the bounce in oil prices while the worst sector was Utilities, (0.53%) driven by an earnings disappointment from a significant constituent.



Our View

Global growth deceleration was one of the triggers that caused risk assets to correct in the 4th quarter of 2018. China, the world's second largest economy, recently released its 2018 GDP growth figure, which slowed to 6.4% on a yearly basis and was the slowest pace of growth since 2009. There are numerous headwinds facing China and one of which is the deleveraging campaign that is shrinking the shadow lending sector and making it more difficult for certain companies to refinance their debt. Moreover, the liquidity crunch that is taking place precipitated a record 119.6 billion yuan (approximately $17.7 billion) of defaults in 2018. Chinese officials are attempting to halt the credit cycle from deteriorating further by adding cash to the financial system by lowering banks' required reserve ratios and introducing a new bank-perpetual-debt swap program. Although credit availability is still limited for certain borrowers, we feel that the steps taken thus far should help boost credit growth. Another headwind impacting China has to do with its demographic profile. There have been numerous studies about the relationship between age and productivity and the results have found that people aged 40 to 49 tend to add the most to productivity growth. China's aging population will require increasing amounts of support and will weigh on longer-term economic growth. A final headwind for China pertains to the trade war with the United States. Both sides have been working feverishly to come to terms and progress is being made, however differences still remain. The current deadline of March 1st could be pushed back for 60 days, but if it is not then tariffs on $200 billion of Chinese goods will increase from 10% to 25% and it could negatively impact Chinese GDP by roughly 30 basis points. Due to the willingness of both sides to reach an agreement, we believe the trade war will be resolved, but given the complexity of certain issues a full resolution will take some more time.

COMING UP NEXT WEEK		Est.
02/21 Durable Goods	(Dec)	1.7%
02/21 Philly Fed Business Index	(Feb)	15.0
02/21 Markit Mfg PMI Flash	(Feb)	54.7
02/21 Existing Home Sales	(Jan)	5.03M

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