Peapack Private Wealth Management

February 14, 2020

2/14/2020		Wk Net	Wk %	Div	YTD %	12 Mos %
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	29,398.08	295.57	1.02	2.17	3.01	15.09
S&P 500	3,380.16	52.45	1.58	1.78	4.62	22.78
NASDAQ	9,731.18	210.66	2.21	0.89	8.45	31.14
S&P MidCap 400	2,096.61	47.31	2.31	1.71	1.63	10.74

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	1.42	Euro/Dollar	1.08	-1.08
5-Year	1.41	Dollar/Yen	109.76	-0.01
10-Year	1.59	GBP/Dollar	1.30	0.59
30-Year	2.04	Dollar/Cad	1.33	-0.36

Source: Bloomberg/FactSet

What Caught Our Eye This Week

This week the Federal Trade Commission (FTC) ordered several large technology companies (Amazon.com Inc., Apple Inc., Facebook Inc., Microsoft Corp. and Alphabet Inc.) to turn over detailed information pertaining to hundreds of acquisitions of smaller companies completed over the last ten years. The FTC is looking specifically at whether deals which were beneath the commission's dollar-value threshold for antitrust review (currently $94 million) were anti-competitive/monopolistic. This action meaningfully expands the federal government's already extensive scrutiny of anti-trust concerns within digital markets. Many observers feel that large technology companies are using catch-and-kill tactics which stifle innovation from which consumers would benefit and are gaining unchecked market dominance in the process. Further evidence of the heightened scrutiny came this week when Edgewell Personal Care abandoned its purchase of the startup Harry's Inc., a manufacturer of shaving equipment and men's personal care products. Edgewell had sought to acquire Harry's for $1.37 billion, but the FTC sued to block the transaction, citing antitrust concerns. These are both noteworthy developments at a point in the business cycle where many larger companies see a benefit in pursuing smaller, "bolt-on" acquisitions rather than large transformational deals during a period when organic growth has been challenging.

Economy

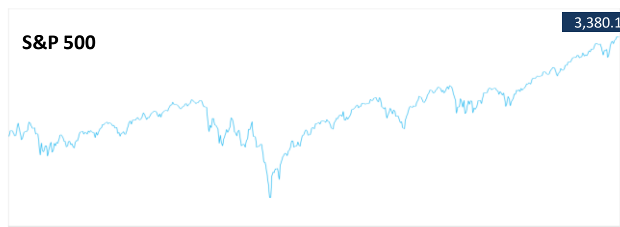
The economic headliner this week was the retail sales report, which was released on Friday. Retail sales increased 0.3% in January, which was about in line with expectations. Building materials sales increased by 2.1% following a 1.3% advance in December. These positive figures were most likely supported by warmer-than-usual weather the past two months. On the negative side, this weather assistance significantly affected clothing sales which declined by 3.1%. The all-important control category, which excludes food service, autos, gas and building materials was unchanged in January, and there were downward revisions made to the November and December figures. Clearly, over the past 6 months, consumer spending has entered a soft patch. On Tuesday, the JOLTS report (job openings and labor turnover survey) showed 6.4 million job openings as of 12/31/2019. The "quits" rate held steady at 2.3%, and the net employment gain over the past 12 months is a respectable 2.2 million. The consumer price index data was released on Thursday and showed a modest increase of 0.14% in January. The "core "CPI advanced by 0.14% and is now up 2.3% year-over-year.

Fixed Income/Credit Market

The 30-year U.S. Treasury (UST) auction statistics from Thursday indicated that some investors are bracing themselves for the economic impact of the coronavirus. In order to obtain incremental yield, some market participants prefer to shift away from higher yielding credit assets and into longer-dated high quality assets such as U.S. Treasuries. From a yield perspective, the 30-year auction sold at its lowest on record at 2.06% and had a bid-to-cover ratio of 2.43 times, meaning that for every $2.43 worth of bids the Treasury only sold $1 worth of bonds. Its evident long-bond investors are opting for higher interest rates by adding duration risk as opposed to assuming credit risk in other fixed income sectors. Currently, over a one-year horizon, if U.S. Treasury yields increased 100 basis points (bps) the value of the 30-year UST would decrease 18.33%. However, according to Bloomberg's forward curve matrix, the 30-year UST yield is forecasted to increase just 4 bps over a one-year horizon which would provide investors with a total return of 1.65%.

Equities

Domestic equities posted a gain for the week despite concerns of the coronavirus's impact on economic growth. Markets traded higher through mid-week on new earnings reports, positive comments from Fed Chair Jerome Powell, and eased fears as the rate of reported coronavirus declined. Investors focused on the congressional testimony from Fed Chair Jerome Powell who highlighted the continued strength of the U.S. economy leading markets higher on Tuesday and Wednesday. Markets opened lower Thursday morning as a spike in coronavirus cases in China was reported escalating fears once again. The market recouped most of the losses but still posted a negative return on Thursday and was relatively flat on Friday. Oil gained over 3% for the week as supply estimates declined and oil traded back above $50 a barrel. The best performing sector was real estate gaining 4.9%. The worst performing sector was materials posting a 0.7% gain. 78% of the S&P 500 Index constituents have reported fourth quarter earnings, posting sales growth of 3.58% and earnings growth of 1.3%. Sales and earnings have beat analysts' estimates by 1.2% and 5.4%, respectively.



Our View

Growth stocks have dramatically outperformed value stocks in 2020. Year-to-date, the Russell 1000 Growth index has risen 8.4% versus only 1.1% for the Russell 1000 Value index. That is a stunning divergence in a relatively short period. The top five companies in the growth index also happen to be the top five in the S&P 500. From a market cap weight perspective, these stocks account for roughly 29.7% of the Russell 1000 Growth index and 16.8% of the S&P 500. The performance of these top five companies has contributed almost 60% of the year-to-date return for both indexes. The top five companies are Apple, Microsoft, Alphabet, Amazon, and Facebook. The weighted average return of these companies is over 12% in 2020 and has driven the S&P 500 index up 4.6%. In contrast, the equally weighted S&P 500 index is up only 2.5%. The concentrated nature of this equity market has been a concern for many investors. There have been several reasons that have resulted in investment dollars flowing disproportionately into relatively few names. Better organic revenue growth is a major reason but share buybacks have also been a significant driver of outperformance for these top companies. The tax reform initiated in 2018 unlocked foreign cash holdings with the hopes that the repatriated dollars would go into capital investment, but far more money has gone into enhancing shareholder returns through share repurchases and dividend increases. Share repurchases have been a huge source of liquidity for the equity market, with repurchases totaling $700 billion in 2019. The buybacks have also been highly concentrated, with just 25 companies accounting for over half of the total. According to DataStream, Apple, Microsoft, and Alphabet collectively repurchased $116.7 billion worth of stock. Share buybacks are likely to slow and be less supportive of equities over the next few years. First, for at least two-thirds of top 25 companies, the amount of the buybacks are greater than net cash flow after capital expenditures and dividend payments and therefore are not sustainable. Second, it becomes harder to make a compelling case that share repurchases are an effective use of capital as PE multiples rise.

COMING UP NEXT WEEK		Est.
02/19 PPI SA M/M	(Jan)	0.20%
02/20 Philadelphia Fed Index SA	(Feb)	10.0
02/20 Leading Indicators SA M/M	(Jan)	0.20%
02/20 Existing Home Sales SAAR	(Jan)	5,380K

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