Peapack Private Wealth Management

November 22, 2019

11/22/2019		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	27,875.62	-129.27	-0.46	2.23	19.50	13.94
S&P 500	3,110.29	-10.17	-0.33	1.87	24.07	17.37
NASDAQ	8,519.89	-20.94	-0.25	1.01	28.40	22.20
S&P MidCap 400	1,985.87	-14.74	-0.74	1.75	19.41	8.64

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	1.63	Euro/Dollar	1.10	-0.17
5-Year	1.62	Dollar/Yen	108.66	-0.07
10-Year	1.77	GBP/Dollar	1.28	-0.57
30-Year	2.22	Dollar/Cad	1.33	0.51

Source: FactSet

What Caught Our Eye This Week

Investor appetite has surged for private equity. Private equity is an alternative asset class typically in the form of a partnership. Private equity firms purchase both private and public companies to restructure operations and expand their cash flow. Ultimately, after the company has grown, the private equity firm liquates its position by selling the acquired firm to another company or into the public market. Valuations for private-equity acquisitions exceed those of the global stock markets for only the third time in history. Also, stakes in existing private equity investments that have historically traded at a small discount to their net asset value (NAV) are being sold between institutional investors on the secondary market at par (equal to NAV). Investment partnerships managed by the best-known firms are trading at 5% to 7% premiums to NAV. Declining interest rates have continued to fuel investors' appetite for yield, and have driven 100+% growth in the United States' leveraged loan market. This market has supported private equity deals of approximately $1.2 trillion over the past 12 years. With the large sum of money available to the private equity industry, investors can expect additional mergers and acquisitions at higher prices and potentially lower standards of credit quality.

Economy

It was an uneventful week for economic data, and the main focus was on existing home sales, which were released on Thursday. These figures rose by 1.9% to 5.46 million units at an annual rate in October. Over the past 12 months, these sales have advanced by 4.6% and more importantly, over the most recent three months, these sales have increased by 3.0% on an annual basis. The median price of an existing home is now at $270,900. The only negative component of this report is that for homes priced at $250,000 or less, sales growth remains negative. On Tuesday, monthly housing starts were reported and posted a 3.8% advance to 1.314 million at an annual rate in October. Permits rose by 5.0% to 1.461 million, and overall housing starts have increased by 8.5% over the past 12 months. The single family data were particularly impressive with starts increasing by 2.0% and permits advancing by 3.2%. Finally, on Thursday, weekly jobless claims were reported and these claims were unchanged at 227,000 for the week ending November 16th. The four-week moving average is now at 221,000.

Fixed Income/Credit Market

Apart from weekly cash management in the form of U.S. Treasury Bill issuance, supply in the U.S. Treasury market was muted this week except for the sale of $12B 10-Year TIPS (Treasury Inflation Protected Securities). The auction statistics indicate that demand was strong as bonds were awarded at a high yield of 0.149% compared to a pre-auction yield forecast of 0.155%. Given the inverse relationship between bond prices and bond yields, we can deduce that stronger than expected demand drove prices higher at the auction. The 0.149% was the lowest 10-year TIPS auction stop since September 2016 when bonds were awarded at a high yield of 0.052%. While real yields (10-year Treasury yield less 10-year TIPS inflation break-evens) remain historically low, the Fed has put investors on watch. The recent 75 bps of monetary easing together with the expansion of the Fed's balance sheet through repo operations and T-Bill purchases are likely to cause a moderate uptick in inflation, which would encourage fixed income investors to limit the duration risk in their portfolios.

Equities

After six consecutive weeks of gains for the S&P 500, the index posted yet another all-time record on Monday. The recent runup in stocks is largely attributable to optimism around a U.S. and China phase one trade deal, an accommodative Federal Reserve and better-than-expected corporate earnings. Equities traded lower throughout the middle of the week on concerns about the timing of the trade deal. A Reuters report on Wednesday claimed that the deal may not get completed this year, and the passing of a bill by the U.S. Senate in support of Hong Kong protestors further supported that notion. Stocks ended the week on a positive note driven by better-than-expected manufacturing and services flash PMI numbers. This week's best performing sector was healthcare (+0.8%) primarily due to strength in biotechnology stocks, and the worst performing sector was materials (-1.7%).

Our View

The two primary drivers of the financial markets over the last two years have been trade tensions and monetary policy. Risk assets, such as equities and high yield bonds, have had an exceptional year because global central banks have eased, and trade tensions have not continued to escalate as many investors feared. The monetary response was triggered by sluggish global growth. The U.S. economy has slowed from 4.1% growth in 1Q '18 to an estimated 1.9% in Q4 '19. The recent rally in stocks suggests that equity investors are pricing in a stabilization and reacceleration of growth in 2020. The case for continued growth next year credibly rests on the support of three fed rate cuts in 2019 and the transitory nature of the causes for economic softness this year. Much of the slow-down has been related to inventory deaccumulation and manufacturing that has been impacted by the GM strike and Boeing's 737 Max problem. These issues could prove to be temporary, but none the less, there are worrying signs that should be noted. The inverted yield curve is a classic warning that signals a potential recession could be ahead. Leading economic indicators are another important data point that have been deteriorating, but are not yet in recession territory. We believe the U.S. economy will continue to generate modest growth next year, which is consistent with the market's expectation. However, a major caveat is that a trade deal needs to be done relatively quickly. Corporate America does not seem to have much conviction regarding a soft-landing for the economy as reflected in declining fixed investment spending and CEO confidence. CEO confidence has fallen since the trade war began and is at levels that have occurred during earnings recessions. The lack of clarity and the mixed signals lead us to suggest clients maintain a neutral allocation to equities within their strategic range. With equity multiples toward the top of the historic range and forward earnings growth likely to be modest, return expectations for 2020 should be below the long-term average.

COMING UP NEXT WEEK		**Est.**
11/26 Consumer Confidence	(Nov)	126.1
11/27 Durable Orders SA M/M (Prelim)	(Oct)	-0.50%
11/27 Personal Consumption Expenditure	(Oct)	0.30%
11/27 Pending Home Sales M/M	(Oct)	0.30%

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