What Caught Our Eye This Week

The number of Chinese companies looking to go public in the U.S. in 2018 is expected to surge. In 2017, 16 companies went public on U.S. exchanges, up from seven in 2016. Except for 2012, China has been the top lister of IPOs among all non-U.S. companies every year since 2007. In the last decade, China’s tech sector has matured which has led to many companies looking for better international exposure through a broader investor base. In the first quarter of 2018, eight Chinese companies raised $3.3 billion in the U.S. market, the most in three years. The U.S. offers faster IPO approval than mainland China and Hong Kong where there are much stricter rules. Chinese companies looking to list in their country must show a profit for three consecutive years leading up to the application year. The U.S. has less stringent rules about profitability. Ever since the Hong Kong Exchange (HKEX) lost Alibaba to a U.S. listing in 2014, the HKEX has been planning an overhaul. Beginning this week, Hong Kong will allow companies with dual-class share structures and biotech firms with no revenue to be able to apply for listing on the HKEX. It will be interesting to see where these Chinese companies choose to list their stock.

Economy

The most anticipated report this week was the nonfarm payroll report, which was released on Friday. This report showed payrolls increasing by 164,000 in April, which was below the consensus forecast of 192,000. The unemployment rate dropped to 3.9% and the U-6 measure of unemployment declined to 7.8%. The U-6 measure has not been this low since July 2001. Average hourly earnings increased by 0.1% and are now up 2.6% year-over-year. The labor force participation rate decreased from 62.9% to 62.8%. Examining the different employment sectors, manufacturing added 24,000 jobs and construction added 17,000. In other news this week, the ISM manufacturing survey dropped to 57.3 in April which was below expectations. The new orders index also fell, decreasing to 61.2, but overall 17 of 18 industries reported growth. The ISM nonmanufacturing survey was released on Thursday and also declined, dropping to 56.8 in April. The business activity index also declined, but all 18 service sector industries reported growth. Finally, personal income/consumption data was reported on Monday and both metrics posted impressive gains. Personal income advanced by 0.3% in March and personal consumption increased by 0.4%.

Fixed Income/Credit Market

On Wednesday, the Fed released a statement from their most recent FOMC meeting that reaffirmed what market participants already seemed to expect; two more rate hikes this year but possibly three. The Fed funds futures implied rate is currently forecasting a Fed funds rate of 2.19% for December 2018 which is slightly more than two 25 basis point (bp) rate hikes. The Fed’s tightening cycle has contributed to a very flat U.S. Treasury yield curve. Furthermore, while the Fed can control the front-end of the curve, the back-end of the curve is controlled by supply and demand fundamentals in the marketplace. Given the flatness of the U.S. Treasury curve, investors may be cautious going out on the yield curve as the 3-year tenor yields approximately 89% of the 10-year tenor with much less duration risk and potential price volatility. The U.S. Treasury 2-year and 10-year spread is currently 44.6 bps which is 28.5 bps below its one-year average and 61.2 bps below its one-year high of 105.8 bps.

Equities

This week, investors weighed more 1Q’18 earnings results, renewed trade and tariff concerns, as well as mixed economic data. Following today’s close, 81% of the S&P 500 companies have reported their first quarter’s earnings. Approximately 79% beat analysts’ expectations with an average upward surprise of 6.8%. Year-over-year earnings have grown by 26.6% which is reflective of healthy business operations and a reduced corporate tax rate. A fifth of the index is still yet to report, but investors have a large enough sample size to digest these releases and conclude that earnings season has been strong. The market’s reaction to earnings has been mixed with some companies not receiving the market’s approval after reporting strong numbers. This reaction is partially due to the skeptical outlook from investors that growth will persist in the future. Trade remains a key concern as tariffs and trade wars historically result in negative global growth. Friday’s nonfarm payroll report showed an increase month-over-month, but was below estimates. Soft wage rate data reduced inflation concerns leading to a strong rally on Friday. The top performing sectors were information technology and real estate up 2.6% and 1.3%, respectively. The worst performing sector was health care down 2.9%.

Our View

The U.S. and China held two days of trade talks this week in Beijing. The U.S. trade delegation included senior-level representatives from the Trump administration, headed by Treasury Secretary Steven Mnuchin, Commerce Secretary Wilbur Ross, and National Economic Council Director Larry Kudlow. These are important trade discussions being conducted at the highest levels. Although some analysts had suggested the potential of a short-term deal being reached in a specific area, such as in the automotive industry, it was unrealistic to expect a comprehensive resolution of complex trade issues after one set of meetings. The differences regarding trade policies and practices have evolved over many decades and will take a while to resolve, especially given the national political realities both Chinese and American officials face at home. The U.S. and China are the two largest economies representing over 30% of global GDP, so the trade issues themselves are complex. But the U.S. concerns extend well beyond tariffs into thorny areas like intellectual property rights and cyber theft. Further compounding the negotiations, each country operates on a competing political ideology and differing national aspirations. The stakes are high. It is extremely likely that trade tensions will be a market factor well into 2019. Ultimately, we expect a negotiated solution, perhaps a series of small deals which will settle the issue. In the meantime, investors will have to accept some volatility related to the mercurial nature of a complex trade deal being negotiated in a social media-oriented world.

The weekly market recap distributed to Private Wealth Management clients of Peapack-Gladstone Bank. Securities and mutual funds are not FDIC insured, are not obligations of or guaranteed by Peapack-Gladstone Bank, and may involve investment risk, including possible loss of principal. Information provided for educational purposes only. This should not be relied upon as tax and/or investment advice. We encourage you to consult your personal legal, tax or financial advisor for information specific to your situation. Peapack-Gladstone Bank and its logo are registered trademarks.