The Weekly

Economic & Market Recap

Peapack-Gladstone Bank, Peapack Private Wealth Management

January 25, 2019

As of 01/25/2019		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	24,737.20	30.85	0.12	2.30	6.04	-6.27
S&P 500	2,664.76	-5.95	-0.22	2.03	6.29	-6.15
NASDAQ 100	6,787.37	2.76	0.04	1.12	7.23	-1.86
S&P MidCap 400	1,818.57	1.32	0.07	1.76	9.35	-8.49
Russell 2000	1,482.85	0.35	0.02	1.52	9.96	-7.42

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	2.61	Euro/Dollar	1.14	0.41
5-Year	2.60	Dollar/Yen	109.53	-0.24
10-Year	2.76	Sterling/Dollar	1.32	2.50
30-Year	3.07	Dollar/Cad	1.32	-0.41

Source: Thomson Reuters & Bloomberg

What Caught Our Eye This Week

During the financial crisis, the U.S. Federal Reserve instituted a massive bond purchasing program (quantitative easing) with the aim of flooding the financial system with cash, driving down long-term interest rates and encouraging more risk-taking. This program increased the Fed's balance sheet (bond holdings) from $870 billion in 2007 to $4.5 trillion in 2015. Since then, the Fed maintained a steady level of holdings by simply replacing maturing bonds. Not until October, 2017 did it begin to allow bonds to mature and "runoff" its balance sheet, thus reducing its holdings. The Fed now has a balance sheet of $4 trillion, and it is reducing its assets by about $50 billion each month. Historically, the size of the Fed's balance sheet grew in concert with the growth of the economy. In 2017, it was assumed that the balance sheet would eventually be reduced to a target of $1.5-$3.0 trillion and that it would take about 5 years of runoff for this to ensue. This thinking has changed dramatically. The Fed has found that its assumptions regarding the efficacy of balance sheet reduction and expansion have come into question. Expectations are that the Fed will normalize its balance sheet to a level of $3.0-$3.5 trillion bonds by mid-2020. Investors are hoping that the Fed's statement after its policy committee next Thursday may give some insight into its plans.

Economy

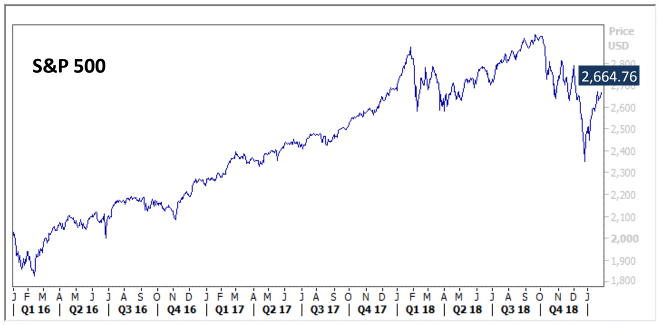
It was another unusual week for economic data, as the partial government shutdown has delayed the release of key economic data from the Commerce Department. The Department of Labor has already been funded, so we continue to receive weekly jobless claims reports. Initial jobless claims declined by 13,000 to 199,000 in the week ending January 19th. The four-week moving average is now at 215,000 and overall claims have been below 300,000 for 204 consecutive weeks. The claims data – which excludes federal workers – is at its lowest level since November 1969. The other pertinent economic report came on Tuesday with the release of monthly existing home sales, which were a big disappointment relative to consensus expectations. These sales fell 6.4% to 4.99 million units at an annual rate in December. This reading was the weakest monthly sales pace since November of 2015, and year-over-year existing home sales are down 10.3%. The median sale price of an existing home increased by 2.9% over the past 12 months, but this is the smallest increase since March of 2012.

Fixed Income/Credit Market

After interest rates rose last week as much as 10 basis points (bps) at the 7-year tenor, U.S. Treasury Notes pared some of their losses this week when yields decreased as much as 4.1 bps at the 5-year and 7-year tenors. The 10-year U.S. Treasury Note Volatility Index (TYVIX) closed last week 4.5% lower at 3.84. After Monday's market holiday, the TYVIX surged this Tuesday to 4.25, a 10.7% increase. Throughout the remainder of the week volatility subsided as financial markets simmered down and the FOMC entered their blackout period. The TYVIX closed this week at 3.82, a 10.1% decrease from this week's high of 4.25. On the week, the benchmark 2-year and 10-year U.S. Treasuries decreased 1.5 bps and 3.7 bps, respectively, which narrowed the spread between the two benchmarks 2.1 bps to 14.8 bps. On Wednesday January 30th, the Fed is not expected to hike interest rates. The implied probability of a hike is currently at 0.5%.

Equities

Domestic equity markets' positive momentum since the December 24th bottom reversed during the first trading day of the holiday shortened week. The International Monetary Fund (IMF) reduced its global growth expectations for 2019 to 3.5% from 3.7%, sparking growth worries again. Secondly, weak housing sales figures concerned investors. Stocks rallied on Friday driven by positive earnings and guidance from several bellwethers which helped lift the market as well as optimism around a government shutdown deal. Also, late on Friday, President Trump announced a temporary reopening of the government for three weeks. This week's top sectors were Real Estate and Information Technology returning 1.47% and 0.92%, respectively. This week's worst performance came from the Energy and Health Care sectors declining 1.49% and 1.33%, respectively.



Our View

Since consumer consumption makes up almost 70% of the domestic economy, it is a major macro driver. Consumer spending is a function of the ability to spend and the willingness to spend. Factors that impact the consumer's ability are things like disposable income growth and consumer debt levels. Whereas, confidence in job prospects and the wealth effect have a significant influence over the consumers' willingness to spend. Our analysis indicates that these factors are in good shape at this point in the economic cycle. We focus intently on wages since it is such a critical element for the health of consumer spending. Wage growth has accelerated sharply over the last year with wage increases of 3.2% year-over-year in December. This is the fastest rate of growth in wages since the recovery began and growth has been over 3.0% for three consecutive months. The Federal Reserve watches these trends closely as well. The Fed gets concerned when wage growth becomes too robust and threatens to impact inflation expectations. Typically, wage growth would have to reach and be sustained at 4% before the Fed takes more aggressive action to blunt inflation pressures. Technology has created the opportunity for greater globalization and automation that has elongated the process of low unemployment leading to higher wages. Several factors have shifted bargaining power from the employee to the employer, thus reducing the sensitivity of wage rates to job growth. It is difficult to predict when wage growth will be high enough to threaten economic growth, but currently it appears to be in the sweet spot. Wage growth is sufficient to matter to the consumer, but not too rapid to create pressure on the Fed to raise rates.

COMING UP NEXT WEEK		Est.
01/28 Durable Goods	(Dec)	1.8%
01/28 Factory Orders MM	(Nov)	0.2%
01/30 GDP Advance	(Q4)	2.5%
01/31 Personal Income MM	(Dec)	0.4%
02/01 Non-Farm Payrolls	(Jan)	168k
02/01 ISM Manufacturing PMI	(Jan)	54.3

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