The Weekly

Economic & Market Recap

Peapack-Gladstone Bank, Private Wealth Management

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As of 01/12/2018

STOCKS	Close	Wk Net Change	Wk % Change	Div Yield	YTD % Change	12 Mos % Change
DJIA	25,803.19	507.32	2.01	2.35	4.39	29.72
S&P 500	2,786.24	43.09	1.57	2.01	4.20	22.70
NASDAQ 100	6,758.54	105.25	1.58	1.11	5.66	34.06
S&P MidCap 400	1,965.97	29.70	1.53	1.64	3.44	17.14
Russell 2000	1,591.97	31.96	2.05	1.44	3.68	16.97

TREASURIES	Yield	FOREX	Price	Wk %Change
2-Year	2.00	Euro/Dollar	1.22	1.35
5-Year	2.34	Dollar/Yen	111.03	-1.83
10-Year	2.55	Sterling/Dollar	1.37	1.16
30-Year	2.85	Dollar/Cad	1.25	0.35

Source: Thomson Reuters & Bloomberg

What Caught Our Eye This Week

For the past five years, China has made a resolute effort to break into the nascent market for artificial intelligence (AI) semiconductors. “AI chips” do the processing for facial recognition, self-driving automobiles, virtual reality, speech translation and many other task-intensive applications. When hundreds or thousands of these processors run calculations simultaneously, the speeds can be 100x faster than the fastest computer chips on the market today. Chinese companies have attempted to purchase American, European and Asian semiconductor firms in order to hasten its effort. Although the Chinese companies bid for these competitors at what was sometimes considered outlandish prices, their attempts were largely thwarted. As a “plan B” the country is now trying to recruit top talent from chip companies worldwide and develop new technologies internally. The Chinese government, through one state-sponsored fund and through more than 30 municipal funds, has allocated about $150 billion toward financing this plan. Competitors outside of China fear that it will flood the globe with excess capacity driving down prices and driving competitors out of business. The country uses approximately 59% of the $380 billion in global semiconductors produced annually; and it currently buys 90% of its chips from foreign-owned companies. Over time, the government could orchestrate a shift toward purchasing chips that are produced domestically.

Economy

The most anticipated report this week was the retail sales report, which was released on Friday. Retail sales increased 0.4% in December and are now up 5.4% year-over-year. The all important control category, which excludes food service, autos, gas and building materials advanced by 0.3%. There also were positive revisions made to control group data for November and October. November online shopping for electronics surged by 3.9%. It now appears that real spending has increased by 3.8% in the fourth quarter. In other news this week, the consumer price index showed an increase of 0.1% in December and is now up 2.1% year-over-year. The core CPI (excludes food and energy) increased by 0.3% and is now up 1.8% year-over-year. On Tuesday, the JOLTS report (job openings and labor turnover survey) showed 5.879 million job openings in November. The quits rate was unchanged at 2.2%, and the layoffs and discharges rate was 1.1% in November. Overall, when reviewing the last 12 months, the net employment gain amounts to 2.1 million. The producer price index data was released on Thursday and showed a decline of 0.1% in December, which was below consensus. Producer prices are now up 2.6% year-over-year.

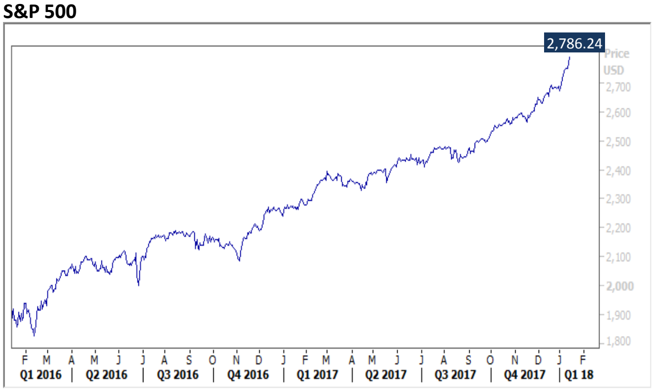
Fixed Income/Credit Market

Year-to-date (YTD), U.S. fixed income bond fund ETFs saw net inflows of approximately $5.1 billion, which increased the fixed income ETF market cap by 0.9%. Emerging markets experienced the greatest increase in market cap at 6.6% with inflows of approximately $1.7B YTD. From a duration perspective, ETF investors allocated most of their funds to the intermediate-term portion of the curve. More specifically, the market cap of intermediate-term fixed income ETFs increased by 2.3%. With the expectation that benchmark yields will continue increasing at a faster pace on the front-end of the curve in 2018, it is no surprise that investors are putting their money to work in intermediate-term assets to mitigate some of the interest rate risk of the front-end. YTD, interest rates across the active U.S. Treasury curve have increased anywhere from 4 basis points (bps) to 14.3 bps. The 2-year and 10-year U.S. Treasury yields close this week at 2.00% and 2.55%, respectively.

Equities

U.S. equities had their best start to the year in over a decade. Despite a decline on Wednesday, following news that China plans to halt their purchases of U.S. Treasuries, all major domestic indices rose more than 1% for the week. The Dow Jones Industrial Average Index (DJIA) was the best performing index week-to-date, driven by Boeing and Caterpillar rising 8.86% and 5.15%, respectively. Reflective of the DJIA’s strong performance this week, both the industrial and energy sectors were this week’s top performers. The energy sector was relatively flat early in the week but rapidly rose on Thursday morning as crude oil traded near $64 per barrel. The tilt sectors were this week’s worst performers as telecommunications and utilities declined 2.42% and 1.54%, respectively. According to Bloomberg, forward twelve month earnings expectations for the S&P 500 Blended Index have increased over the past several months and consensus is now at $151.45.

S&P 500



Our View

Investor optimism regarding economic growth has been lifted by the recently passed tax reform bill. As economists have adjusted their estimates for real GDP growth for 2018, expectations for Federal Reserve rate increases over the near-term have been rising. The two-year Treasury note is heavily influenced by Fed rate expectations and is a barometer of current economic health. This week the two-year Treasury broke the two percent level for the first time since the 2008 financial crisis. The fiscal stimulus generated by over a trillion dollar tax reduction should have a positive economic impact in 2018 and 2019, driving the U.S. economy to above-trend growth. Although wage growth has been a disappointment, labor markets with unemployment at 4.1% seem relatively tight. An accelerating economy, given the tightening labor conditions, has the potential to finally translate into higher wages. Perhaps in anticipation of this, a number of large companies (Target and Walmart) that typically employ people at the lower-end of the wage spectrum have announced increases in their starting pay. As the trend in wage growth picks up, inflation should drift towards the Federal Reserve’s two percent inflation target. We expect that the Fed will have good reason to justify three rate increases in 2018. In the meantime, better economic growth is lifting earnings expectations. The Bloomberg forward earnings estimate for the S&P 500 has risen from $146.56 at the end of 2017 to $151.45 today. According to Zacks Investment Research, index earnings are expected to be up 13.7% in 2018, notwithstanding the tax cut, this earnings growth expectation seems to us to be a high bar.

COMING UP NEXT WEEK		Est.
01/17 Industrial Production MM	(Dec)	0.5%
01/18 Housing Starts Number MM	(Dec)	1.275M
01/19 U Mich Sentiment Prelim	(Jan)	97.0

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