Peapack Private Wealth Management

December 20, 2019

12/20/2019		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	28,455.09	319.71	1.14	2.23	21.98	22.00
S&P 500	3,221.22	52.42	1.65	1.82	28.50	28.49
NASDAQ	8,924.96	190.08	2.18	0.97	34.51	34.48
S&P MidCap 400	2,065.61	40.89	2.02	1.69	24.21	24.01

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	1.63	Euro/Dollar	1.11	-0.46
5-Year	1.73	Dollar/Yen	109.46	0.17
10-Year	1.91	GBP/Dollar	1.30	-2.22
30-Year	2.34	Dollar/Cad	1.32	-0.23

Source: Bloomberg/FactSet

What Caught Our Eye This Week

Earlier this week, a three-year-old private company that builds robots for safety and infrastructure monitoring received $40 million in financing from a handful of venture capital investors, including Mark Cuban. Once the subject of science fiction and comic books, robots are poised to revolutionize several industries that rely heavily on process-driven or manual work. Robotics has seen a massive increase in interest in almost every industry but is becoming ever more important in areas such as automated assembly lines and warehouses, and the safety and compliance functions of chemical plants, refineries and construction. In addition, they have the ability to help employers reduce labor costs and address a skills shortage facing certain industries like construction. For instance, 91% of U.S. builders have difficulty attracting or retaining skilled laborers and as construction begins to transition away from ineffective manual processes towards a more data-driven approach, robots can be used to automate a variety of dangerous, repetitive, and unpleasant tasks. While a surveyor might only be able to check 5-10% of the elements on a jobsite, robots can do a more comprehensive assessment and eliminate errors between blueprints and final construction.

Economy

On Tuesday, the November Industrial Production/Capacity Utilization report showed a 1.1% increase in industrial production, surpassing the expected gain of 0.9%. This is the largest monthly gain for industrial production since 2017 and is largely due to the termination of the GM strike. Correspondingly, auto production surged 12.4% while non-auto manufacturing rose 0.2% for the month. Year-over-year however, both these metrics are down 0.5% and 0.9%, respectively. Manufacturing, which excludes mining and utilities, was also up 1.1% for November. Thursday's November Housing Starts report showed a healthy 3.2% increase, bringing the yearly change to 13.6%. The annual rate, now at 1.365 million starts, beat the consensus of 1.345 million. The upsurge in November starts is attributed to both single-family and multi-family starts. The November Existing Home Sales report exhibited a decline of 1.7%, missing the consensus expectation of 5.440 million by 90,000. Despite increases in the Northeast and Midwest, the drag came from the respective 3.9% and 3.5% drops in the South and West. The decline is due to single-family homes and condos/coops.

Fixed Income/Credit Market

U.S. investment grade (IG) and high yield (HY) credit spreads have compressed year-to-date (YTD) which has led to robust returns for investors. Since the beginning of the year, IG 5-year AA, A, BBB-rated composite spreads above the 5-year Treasury have decreased 41.3, 44.6 and 62.1 basis points (bps), respectively. Even more pronounced is the decrease in HY credit spreads which have declined 193.8 and 247.8 bps at the 5-year BB and B-rated composites. The Bloomberg Barclay's IG corporate bond index has returned 14.35% YTD, while the high yield index has provided investors with a total return of 14.06%. The risk-on sentiment in corporate credit has been buoyed by increased clarity regarding the trade negotiations between the U.S. and China, looser financial conditions thanks to central bank easing around the globe and a modest uptick in global manufacturing. High yield credit has become so expensive that the spread between BBB and BB-rated bonds is only 38 bps, which is the narrowest spread since records began back in 1994. With such rich valuations in corporate bonds, now is not an opportune time to be taking credit risk.

Equities

It was yet another strong week for all three major domestic equity indexes, with the S&P 500 posting its 32nd record close of 2019 on Friday. The risk-on trade continues to be driven by optimism about the U.S./China Phase One trade agreement, the Federal Reserve's balance sheet expansion, U.S. economic resilience and an earnings growth inflection. Not even the House of Representatives voting to impeach President Trump was able to disrupt the stock market's upward trajectory. It appears the markets are confident that Trump will be acquitted by the Senate given that Republicans hold the majority. The S&P 500 has now achieved a total return of over 30% year-to-date, and, according to FactSet, the index is expected to earn $177.65 per share in 2020 which represents growth of 9.6% year-over-year. Based on that, the index is trading at roughly 18.1x on a price-to-earnings basis compared to a 10-year median of 15.4x. Investors will be paying close attention to corporate earnings over the next year to get a better sense of whether the earnings estimate is achievable.

Our View

The Wall Street Journal published its December economic survey this week. The consensus expectation of economists who participated was generally constructive, with solid 1.8% growth projected for next year. Although growth is expected to slow modestly from the 2.2% forecasted for 2019, the rising recession concerns that gripped investors over the summer have started to dissipate. Economists assessed the probability of a recession beginning in the next 12 months as 25.9%, which is down from 34.2% only two months ago. In 2019, the economy was bolstered by the strength of the U.S. consumer, and consumer spending is likely to continue to be a strength next year as the labor market remains strong. Economists expect the U.S. economy to produce on average an additional 130,000 jobs per month, which should be sufficient to allow for wage growth above the 3.0% level and for additional entrants to be absorbed into the labor force. Barring an exogenous shock, there is more of a potential upside surprise for the economy than a further deceleration. Business investment has been poor due to trade tensions, slowing global growth, policy uncertainty, and concerns over future profitability. The Fed's pivot to lowering rates in 2019 will help lower hurdle rates for capital projects. More importantly, a certain trade environment created by the trade deals should partially restore confidence to invest. The interim U.S./China Phase One trade deal will have more of a psychological impact, but the USMCA deal will have a meaningful economic effect. Global PMIs have improved slightly due to monetary stimulus, and generally, global growth prospects are showing signs of stabilizing. The lifting of recession fears has been a contributing factor for the fourth quarter equity rally. The S&P 500 has moved from 3000 to above 3200 since the middle of October. The ten-year treasury yield has also lifted and is now approaching the psychologically important 2% barrier. Financial markets are a good leading indicator for the economy but it seems that markets may be ahead of the fundamentals.

COMING UP NEXT WEEK		Est.
12/23 Chicago Fed National Activity Index	(Nov)	-0.08
12/23 Durable Orders SA M/M (Preliminary)	(Nov)	1.9%R
12/23 New Home Sales SAAR	(Nov)	730.0K

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