The Weekly

Economic & Market Recap

Peapack-Gladstone Bank, Private Wealth Management

August 24, 2018

As of 08/24/2018		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	25,790.35	121.03	0.47	2.13	4.33	18.39
S&P 500	2,874.69	24.56	0.86	1.82	7.52	17.87
NASDAQ 100	7,485.40	107.86	1.46	0.97	17.02	28.30
S&P MidCap 400	2,035.10	24.91	1.24	1.50	7.08	19.61
Russell 2000	1,725.67	32.72	1.93	1.31	12.38	25.61

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	2.62	Euro/Dollar	1.16	1.57
5-Year	2.71	Dollar/Yen	111.22	0.63
10-Year	2.81	Sterling/Dollar	1.28	0.71
30-Year	2.96	Dollar/Cad	1.30	-0.21

Source: Thomson Reuters & Bloomberg

What Caught Our Eye This Week

Leveraged loans are debt from companies with below investment grade credit ratings. They are typically secured with a lien on the company's assets and are senior to the company's other debt. While the U.S. bond market has been hurt by rising interest rates, leveraged loans have been thriving. They provide protection against rising interest rates because they offer a floating rate that is pegged to the three-month LIBOR. Investors have added billions of dollars to this sector doubling its size since 2010 to $1.4 trillion. Unregulated by the SEC, leveraged loans are governed by covenants that stipulate provisions the borrowers must follow to preserve the interest of lenders. This usually involves maintaining interest rate coverage and leverage ratios, as well as preserving the position of lenders in the company's capital structure. Moody's Investor Service said this week that they have never seen weaker loan covenants. Demand has been so strong for these loans that the terms have been softening. Moody's characterizes more than 80% of the new loans in the market as "covenant-lite" loans. They have no financial maintenance restrictions and they give borrowers the flexibility to issue more debt and even pull collateral out from under lenders. Given the strength of the economy, the current default rates for high yield debt have been low.

Economy

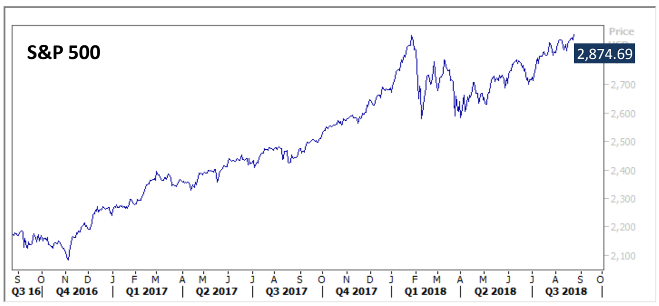
The most anticipated report this week was the durable goods report, which was released on Friday. Overall orders for durable goods decreased by 1.7% in July, led by a 35.4% decline in aircraft orders. The best news was centered in the "core" data, which exclude aircraft and defense. Core capital goods orders increased by 1.4% and core capital goods shipments advanced by 0.9%. Core capital goods orders are one of the best leading indicators for the U.S. economy, and core capital goods shipments are used by the government to calculate business investment for GDP purposes. In other news this week, existing home sales figures for July declined by 0.7% to 5.34 million units at an annual rate. This is the fourth straight month of declines for this data set, and over the past 12 months, existing home sales are down 1.5%. The median price of an existing home is now at $269,600 which is an increase of 4.5% year-over-year. On Thursday, new home sales were reported and also declined, dropping by 1.7% in July to 627,000 at an annual rate. These figures came in below the consensus expectations, but on a 12-month basis these sales have increased by 12.8%.

Fixed Income/Credit Market

The FOMC meeting minutes from August 1st were released on Wednesday and signaled the Fed intends on maintaining its pace of monetary policy tightening. Since the Fed began hiking the Fed funds rate in December 2015, the spread on the 2-year and 10-year Treasuries has narrowed 13 basis points (bps) on average after each increase. The 2-year and 10-year spread is currently trading at roughly 19 bps which indicates we are just two 25 basis point increases away from a potential yield curve inversion at the 2Y and 10Y tenors. According to Bloomberg, the current implied probability of a 25 basis point rate hike in September is 92%.

Equities

Ninety-seven percent of the S&P 500 index has now reported earnings through Friday's close with just a few names due to report, primarily constituents of the consumer sectors. Year-over-year, revenue increased 9.6%, a 1.5% surprise, and earnings jumped 24.8%, a 5.3% surprise. The rate of growth the market reported for this past quarter is the highest level in approximately eight years, surpassing this year's first quarter growth rates. Only two sectors reported single digit earnings growth, Utilities and Real Estate, compared to higher rates of growth from the Energy, Materials, Financials, and Information Technology sectors, reporting 123%, 40%, 27%, and 27%, respectively. Despite ongoing trade tensions and political concerns, the market advanced for the week due to strong financial results and economic data. The market has advanced for 113 months, an appreciation of 320% since March 9, 2009 marking one of the longest bull markets in history. The market rose further following Fed Chairman Jerome Powell's dovish comments at Jackson Hole today. This week's best performing sector was Energy, up 2.7%, as the price of oil increased throughout the week nearing a $70 level. The worst performing sectors were Utilities and Consumer Staples declining 1.68% and 1.65%, respectively.



Our View

Emerging markets made a comeback this week with the MSCI Emerging Market Index up roughly 2.5% through Thursday. Domestically, record corporate revenue, earnings and margins coupled with solid economic fundamentals (low unemployment along with strong consumer demand and confidence) pushed the S&P 500 to a record intraday high on Friday of this week. Bloomberg indicates the probability of the U.S. entering a recession over the next 12-month is only 15%. However, one of the major risks that could slow the current economic expansion is an escalating trade war with China. The two governments met this week and little progress was made after both countries enforced an additional $16 billion of tariffs on one another. Furthermore, an additional $200 billion of tariffs could be imposed after the comment period ends September 6th. It is our view that the trade war between the U.S. and China will take time to work out and could become tenuous along the way. Another risk we are closely monitoring is inflation and the potential for inflation to overshoot the FOMC's forecast, given its gradual pace of tightening. At this juncture, the market is not overly worried about runaway inflation as the TIPs market indicates the forward 5-year inflation rate to be close to 2.0%. But, if the current pace of Fed tightening is not fast enough to contain wage growth, then inflation expectations will rise and cause the Fed to adjust their current pace of tightening, which could weigh on future economic growth.

COMING UP NEXT WEEK		Est.
08/28 Consumer Confidence	(Aug)	126.5
08/29 GDP 2nd Estimate	(Q2)	4.0%
08/30 Consumption, Adjusted MM	(Jul)	0.4%
08/31 Chicago PMI	(Aug)	62.2