The Weekly

Economic & Market Recap

Peapack-Gladstone Bank, Private Wealth Management

July 20, 2018

As of 07/20/2018

STOCKS	Close	Wk Net Change	Wk % Change	Div Yield	YTD % Change	12 Mos % Change
DJIA	25,058.12	38.71	0.15	2.18	1.37	15.95
S&P 500	2,801.83	0.52	0.02	1.85	4.81	13.29
NASDAQ 100	7,350.23	-25.59	-0.35	0.93	14.91	24.13
S&P MidCap 400	1,998.36	2.01	0.10	1.51	5.15	12.36
Russell 2000	1,696.81	9.73	0.58	1.32	10.50	17.64

TREASURIES	Yield	FOREX	Price	Wk %Change
2-Year	2.60	Euro/Dollar	1.17	0.32
5-Year	2.76	Dollar/Yen	111.47	-0.82
10-Year	2.89	Sterling/Dollar	1.31	-0.77
30-Year	3.03	Dollar/Cad	1.31	-0.30

Source: Thomson Reuters & Bloomberg

What Caught Our Eye This Week

Since hitting lows in mid-April, the U.S. Dollar has risen steadily. The U.S. Dollar Index (DXY), which measures our currency against foreign currencies, has gained more than 5%. While the dollar has been whipsawed by trade disputes over the last several weeks, it hit a one-year peak. The dollar has gained strength in part because the Federal Reserve has been increasing interest rates as the economy is on solid footing. A stronger economy should lead to rising inflation supporting the prospect for higher interest rates. At the same time, Europe and Japan are holding their rates low which weakens their currency. Therefore, it is not surprising that some experts think the dollar will continue to strengthen. A strong dollar is a headwind for U.S. multinational companies. Companies with a higher percentage of sales from overseas could see an impact to their bottom line. Eighty-seven companies of the S&P 500 have reported 2nd quarter earnings and about a dozen have mentioned currency impact on their earnings calls. Interestingly, the three sectors of the S&P 500 that are expected to report the highest earnings and revenue growth also rank 1st (technology), 2nd (materials) and 4th (energy) for highest international revenue exposure, according to FactSet.

Economy

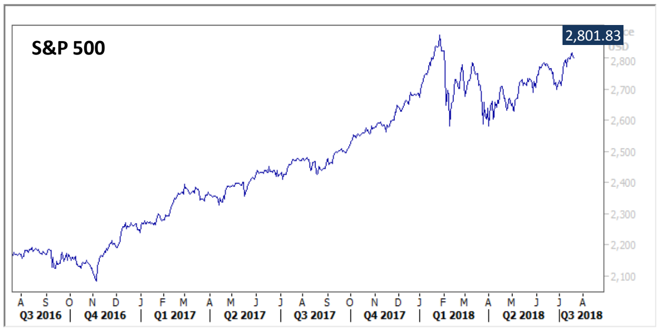
The most anticipated report this week was the release of retail sales data on Monday. Retail sales increased 0.5% in June and are now up 6.6% year-over-year. Retail sales have now grown for five consecutive months and there were positive revisions made to the May figures. The gains in June were led by restaurants and bars, autos and nonstore retailers. Overall in the second quarter, retail sales advanced by 5.9% and it appears real consumer spending increased by 3.0%. In other news this week industrial production figures came in above consensus expectations with a gain of 0.6% in June. The manufacturing sector, which excludes mining/utilities, rose 0.8% in June. Auto production increased by 7.7% and capacity utilization rose to 78.0%. On Wednesday, housing starts were reported and showed a decline of 12.3% in June to 1.173 units at an annual rate. This figure was well below consensus estimates, and there were broad-based declines across every major region. The only positive component of this report was single family home permits which increased by 4.6% in June.

Fixed Income/Credit Market

Ten-year municipal debt backed by the state of New Jersey is currently trading at approximately 73.1 basis points (bps) above the Bloomberg 10-year AAA municipal index, roughly 13.6 bps below the one-year average. Over the same one-year period, yields have fluctuated from a low of 2.67% on December 14, 2017 to a high of 3.48% on May 14, 2018. The current 73.1 spread is one standard deviation below the one-year average. New Jersey's visible 30-day supply is $115.4MM while the amount of debt expected to retire is $831MM, equating to net supply of negative $715.6MM. As supply and demand dynamics have pushed municipal bond prices higher, selective high-quality NJ municipal bond issuers remain attractive. This week a AA rated NJ issuer sold 10-year bonds at a yield of 2.70%, which has a taxable equivalent yield of 5.01% for NJ residents in the highest tax bracket. Compared to Bloomberg composite AA corporate bonds which are trading at 3.65%, NJ muni investors pick up approximately 136 bps of incremental yield.

Equities

Quarterly financial results were a point of focus for investors this week as they digested results from 60 companies in the S&P 500 index, officially kicking off 2Q'18 earnings season. Forty percent of the financial sector has reported earnings with 78% beating analysts' earnings estimates and 67% beating revenue estimates. Despite a rise in rates, the flattening of the yield curve has increased pressure on the sector. At the close of this week, 17% of companies in the S&P have reported results with 74% beating revenue estimates and 84% surpassing earnings estimates. Strong earnings were offset by further rate hikes and trade concerns. Oil was also a focal point as the price fell approximately 3% on Monday but rallied back by Friday, closing nearly flat week-over-week. This week's worst performing sectors were telecommunications and energy declining 2.8% and 1.8%, respectively. The top sectors were financials and industrials climbing 2.2% and 0.9%, respectively.



Our View

Investors were heavily focused midweek on Fed Chairman Powell's testimony before Congress. According to the most recent FOMC statement, "economic activity has been rising at a solid rate" with the consumer showing renewed signs of strength and business fixed investment increasing strongly. With inflation (annualized Core PCE index) running at 2%, there was concern that Chairman Powell would indicate a more hawkish monetary policy tone. The domestic markets reacted well after digesting Chairman Powell's comments and his continued commitment to gradual rate increases moving forward. Even though the current unemployment rate is running 50 basis points (bps) below the Fed's longer run projection, there still appears to be some slack in the overall labor market as average hourly earnings are up only 2.7% on a yearly basis. Possible reasons for the muted overall wage growth given the low unemployment rate may be due to the deflationary impact of evolving technology and new entrants to the labor force who were not previously counted as unemployed. However, given that monetary policy is still considered accommodative, we do expect the labor market to tighten further and it will prompt the Fed to raise interest rates. At this juncture, the Fed funds futures market shows the December of 2018 contract trading at 2.21%, which indicates the Fed will increase rates 25 bps roughly 1 to 2 more times this year. One of the major risks to the previous prediction is if the trade war with China escalates and the Chinese economy decelerates more rapidly than expected. Right now the default cycle in China is ramping up and the Shanghai Composite is in a bear market, but China is beginning to loosen monetary policy to combat its current headwinds.

COMING UP NEXT WEEK		Est.
07/23 Existing Homes Sales	(Jun)	5.40M
07/26 Durable Goods	(Jun)	2.8%
07/27 GDP Advance	(Q2)	4.1%
07/27 U Mich Sentiment Final	(Jul)	97.1

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