The Weekly

Economic & Market Recap

Peapack-Gladstone Bank, Private Wealth Management

September 21, 2018

As of 09/21/2018		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	26,743.50	588.83	2.25	2.07	8.19	19.61
S&P 500	2,929.67	24.69	0.85	1.79	9.55	17.13
NASDAQ 100	7,531.07	-14.42	-0.19	0.97	17.74	26.89
S&P MidCap 400	2,041.36	-5.20	-0.25	1.52	7.41	15.80
Russell 2000	1,712.32	-9.40	-0.55	1.32	11.51	18.57

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	2.80	Euro/Dollar	1.18	1.01
5-Year	2.95	Dollar/Yen	112.53	0.41
10-Year	3.06	Sterling/Dollar	1.31	0.05
30-Year	3.20	Dollar/Cad	1.29	-0.92

Source: Thomson Reuters & Bloomberg

What Caught Our Eye This Week

Last week, the U.S. House and Senate agreed on a short-term spending package to fund the departments of Energy, Veterans Affairs and the legislative branch of the government. This past Tuesday, the Senate passed a bill that aims to fund the departments of Defense, Labor, Education, and Health and Human Services. The House will begin deliberations on this second bill next week. A third bill which will fund the departments of Agriculture, Treasury, Interior, HUD, and Transportation is still in negotiations in both legislative chambers. These congressional efforts are an attempt to fund the U.S. government from the October 1st beginning of the new fiscal year through the midterm elections on November 6th. A common theme in all three bills is the bipartisan nature of the legislation and the fact that they continue an unbridled increase in government spending. According to this week's Barron's, "Debt held by the public, a conservative tally of what America owes, will swell from $15.7 trillion at the end of September, or 78% of gross domestic product, to $28.7 trillion in a decade, or 96% of GDP." In order for the debt to simply remain at 78% of GDP, $400 billion would have to be cut from the budget this coming year and more in subsequent years – a fiscal orientation that is not evident in the three recent bills. Most economists from either political party will concede that ballooning government debt in a higher interest rate environment is pernicious.

Economy

It was an uneventful week for economic data, and the main focus was on existing home sales data which was released on Thursday. These figures came in below expectations unchanged at a 5.34 million annual rate in August. Overall sales have declined 1.5% year-over-year and the median price of an existing home now sits at $264,800. It appears that real residential investment will decline in the third quarter. On Wednesday, housing starts showed a 9.2% increase to 1.282 million units at annual rate in August. These figures were driven by the multi-family category which jumped by 29.3%. The bad news was total permits declined by 5.7% to their lowest level since May 2017. Single family permits decreased by 6.1%, to a level last seen 12 months ago. Rising rates, rising material costs and labor shortages are posing significant challenges for builders. Finally, weekly jobless claims decrease by 3,000 to 201,000 during the week ending September 15th to a 40-year low.

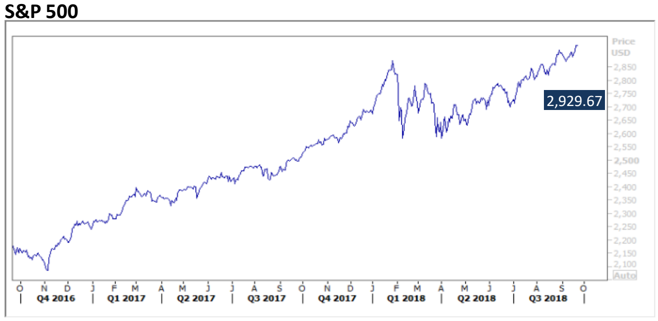
Fixed Income/Credit Market

Week-over-week, yields across the U.S. Treasury curve increased as much as 7.1 basis points (bps) at the 30-year tenor. The 2-year and 10-year yields increased 2.2 bps and 6.7 bps, steepening the spread between the two benchmarks roughly 4.5 bps to 26.2 basis points. On September 26th, the FOMC is expected to hike the Federal funds rate for the third time in 2018 with an implied probability of a 25 bp increase currently at 97.9%, according to the Effective Fed Funds Futures. Since the Fed began its tightening cycle in December 2015, the spread between the 2-year and 10-year Treasury has decreased on average 13 bps per rate increase. Furthermore, after the FOMC increased the Fed funds rate 25 bps on June 13th, the benchmark spread has decreased 13.6 bps. It will be interesting to see if that trend continues next week, if so, we would be just one additional rate increase away from an inverted yield curve at the 2-year and 10-year tenors.

Equities

Major equity indexes had a strong week with the Dow Jones Industrial Average closing at new all-time high on Friday. The only significant decline this week was on Monday as investors' hopes of easing trade tensions subsided after President Trump threatened another round of tariffs against China. On Monday night, the president made it official by imposing $200 billion worth of tariffs on Chinese imports which will go into effect on September 24th. China retaliated with tariffs on $60 billion of US goods with rates in the range of 5 to 10 percent compared to a previously stated 20 to 25 percent. The softer-than-expected retaliation combined with strong US economic fundamentals and a robust labor market helped equities rally for three consecutive days resulting in the S&P 500 gaining 0.85% this week. Investors' appetite for riskier assets sent bond yields higher which helped the financial sector gain 2.26%. The worst performing sector was utilities which continued trading inversely with bond yields.

S&P 500



Our View

Despite trade concerns and softening economies in Europe and China, domestic equity markets have rallied strongly in the third quarter. The DJIA has lifted from 24,271 to over 26,700 since the end of June. The prospect of a 5% to 10% pullback in stocks as we approach the November election cannot be dismissed and some would argue that consolidating recent gains would be healthy from a market standpoint. However, the equity market is not showing any sign of stress from a technical or volatility perspective. In fact, the VIX (a measure of the market's expectation of 30-day volatility) has been in a trading range between 11 and 15 for the entire third quarter and has been trending lower since the January/February market correction. The capital markets overall are not indicating concern. The spread between high yield bonds and comparably dated U.S. Treasuries remain extremely tight. Typically, ahead of market turbulence we see these spreads widen noticeably. Equities have been very resilient as investors have focused on the strength of the underlying U.S. economy and the lack of a substantial pickup in inflation. The Labor Department reported that initial unemployment claims fell to the lowest level since 1969, which is remarkable considering the size of the civilian labor force has increased by more than 60 million people. The Federal Reserve will appropriately raise rates next week. Barring a change in the Fed's gradualist approach to normalization, or a geopolitical blowup, it is difficult to foresee a reason for a major shift in investor sentiment. To be clear, there are challenges on the horizon such as Brexit and slower economic growth in 2019, but for now investors are not focusing on these future potential concerns.

COMING UP NEXT WEEK		Est.
09/25 Consumer Confidence	(Sep)	131.3
09/26 Fed Funds Target Rate	(Sep)	2-2.25%
09/27 Durable Goods	(Aug)	1.7%
09/27 GDP Final	(Q2)	4.2%

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