The Weekly

Economic & Market Recap

Peapack-Gladstone Bank, Private Wealth Management

February 16, 2018

As of 02/16/2018		Wk Net	Wk %		YTD %	12 Mos %
STOCKS	Close	Change	Change	Div Yield	Change	Change
DJIA	25,219.38	1028.48	4.25	2.10	2.02	22.31
S&P 500	2,732.22	112.67	4.30	1.87	2.20	16.41
NASDAQ 100	6,770.66	357.98	5.58	1.00	5.85	27.73
S&P MidCap 400	1,901.19	80.26	4.41	1.52	0.03	9.70
Russell 2000	1,543.55	65.71	4.45	1.32	0.52	10.32

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	2.19	Euro/Dollar	1.24	1.37
5-Year	2.63	Dollar/Yen	106.30	-2.31
10-Year	2.87	Sterling/Dollar	1.40	1.34
30-Year	3.13	Dollar/Cad	1.25	-0.25

Source: Thomson Reuters & Bloomberg

What Caught Our Eye This Week

According to the World Economic Forum, the United States' overall infra-structure places 12th behind Japan, Germany, the Netherlands, and France. This is evident in the congested highways, which costs the U.S. $160 billion annually in lost productivity, and the deteriorating water systems which experience 240,000 water main breaks annually. The infrastructure plan released earlier this week expects $200 billion in federal expenditures to generate $1.5 trillion in new investment for "rebuilding infrastructure in America". Half of the federal money would be for "incentive programs" for states and localities that can show they pay 80% of their projects' costs. Currently, federally funded road projects are 80/20 federal-local matched while transit projects are 50/50. This is at a time when state and local budgets are already being squeezed by other rising costs. The other half is earmarked for $50 billion in rural infra-structure, $20 billion for projects of national significance, $20 billion to expand credit programs and $10 billion to finance real-estate acquisition for the federal government. To partially pay for the plan, the president has endorsed an increase of 25-cents to the federal gas tax.

Economy

This week there was an abundance of economic reports with the focus heavily skewed to inflation data. On Wednesday, the Consumer Price Index showed a 0.5% increase in January, which was above expectations. The "core" CPI (excludes food and energy) advanced by 0.349% and is now up 1.8% year-over-year. This was a significant monthly increase and was the largest monthly gain going back to March 2005. Overall, the headline CPI figure was heavily influenced by energy prices (↑3%) and gasoline prices (↑5.7%). Thursday brought us the producer price index data and these figures were in line with expectations (↑0.4%), but the year-over-year increase is now +2.7%. Core PPI also advanced (↑0.4%) and is now up 2.2% over the past 12 months. Retail sales figures were reported on Wednesday and displayed a decline of 0.3% in January. The "control" category, which excludes food service, autos, gas and building materials was unchanged in January and there were negative revisions made to both November and December figures. Overall, retail sales numbers are up 3.6% year-over-year. The best news of the week came on Friday with the release of monthly housing starts, which increased by 9.7% to 1.326 million units in January.

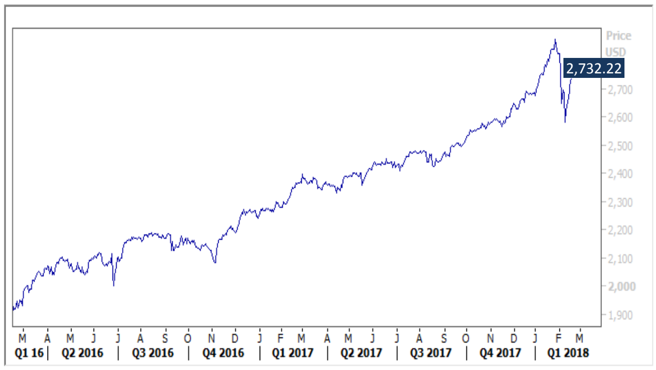
Fixed Income/Credit Market

Thus far in February, interest rates across the active U.S. Treasury curve are up anywhere from 4.9 basis points (bps) at the 2-year tenor to 20 bps at the 30-year tenor. An increase in growth and inflation expectations have been the primary drivers of the upward pressure on interest rates so far in 2018. At roughly 2.19%, the 2-year Treasury is currently trading at its 5-year high which is 141 bps above the 5-year average of approximately 0.78%. The 10-year Treasury closes Friday at approximately 2.88% which is 63 bps above its 5-year average of 2.25%. The 1-year forward curve is currently forecasting the 2-year and 10-year Treasuries to be trading at 2.59% and 3.02%, respectively. Investment grade and high yield bond spreads have also increased in February. The 5-year AA, A, BBB-rated composites increased 5.8 bps, 3.5 bps, and 5.1 bps, respectively. The widening in high yield has been more pronounced with 5-year BB and B-rated composites increasing 26.4 bps and 35.6 bps, respectively.

Equities

Equity markets made a remarkable reversal after last week's sell-off, with equity markets producing the best weekly return in five years. Each of the five trading sessions closed higher and the S&P 500 returned to positive territory for the year. Concerns of inflation were trumped by rising earnings expectations, which raised the appeal of equity prices. Despite market volatility over the last few weeks, earnings estimates continue to rise and 2018 estimates are about 7% higher than the beginning of the year. All of the industry sectors experienced positive returns during the week, with growth momentum continuing to outpace value style. Global market strength, coupled with the weakening U.S. dollar, pushed foreign developed and emerging markets into positive territory. Although the market volatility index VIX is still elevated compared to the calm levels of 2017, it has dropped considerably from the anxiety of last week.

S&P 500



Our View

The equity market melt-up in December and January was caused by optimism over economic expectations and earnings for 2018 as investors assessed the positive economic impact of corporate tax reform. The S&P 500 index rose 8.7% from Thanksgiving to New Year's Day. The increase was uncomfortably fast for many traders and technicians. Some fundamental analysts cautioned that valuations were extended and ahead of the fundamentals. Rising real bond yields and modestly higher inflation expectations created a brief market dislocation in February as market participants considered the appropriate discount rate for equity earnings. Equities were ripe for a drawdown. Investors have been speculating that the equity market was "due for a correction" for many months. Often the collective psychology of investors creates the very condition that is feared. Fundamentals ultimately emerge and drive markets in the appropriate direction. Despite higher rates, equities recovered this week as investors became more comfortable with valuations after robust earnings releases. According to Zacks Research, total earnings for the S&P 500 for the fourth quarter are expected to be up 13.9% from the same period last year. The days of extremely low inflation and interest rates are over, for now, so we can expect high volatility and very limited multiple expansion for equities. For the near-term, fundamentals remain solid.

COMING UP NEXT WEEK		Est.
02/21 Markit Mfg PMI Flash	(Feb)	55.3
02/21 Markit Svcs PMI Flash	(Feb)	54.0
02/21 Existing Home Sales	(Jan)	5.60M

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