PEAPACK PRIVATE
Wealth Management

The Weekly
Economic & Market Recap

Peapack Private Wealth Management

October 11, 2019

10/11/2019		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	26,816.59	242.87	0.91	2.29	14.96	4.76
S&P 500	2,970.27	18.26	0.62	1.93	18.49	6.63
NASDAQ	8,057.04	74.57	0.93	1.03	21.43	8.56
S&P MidCap 400	1,916.57	12.78	0.67	1.79	15.24	0.58

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	1.59	Euro/Dollar	1.10	0.51
5-Year	1.55	Dollar/Yen	108.59	1.59
10-Year	1.73	GBP/Dollar	1.27	3.17
30-Year	2.19	Dollar/Cad	1.32	-0.89

Source: FactSet

What Caught Our Eye This Week

The Michigan Consumer Sentiment Index (MCSI) conducted monthly by the University of Michigan was released Friday morning. The index came in at 96.0, which was a three-month high, and stronger than consensus expectations of 92.0. Despite a strike at General Motors and a formal impeachment inquiry against the President, the current figure suggests households foresee stronger real income growth ahead. Lower inflation expectations and a tight labor market, where jobs are plentiful, are the likely cause for the anticipated pick up in real income growth. Regardless of the reason, higher real incomes are favorable for the consumption outlook. The survey reported that buying conditions for big-ticket durable goods improved to a four-month high, which is a good indication that consumers are feeling confident. U.S. trade policy and the trade war with China has certainly had a negative impact on the manufacturing side of the economy, as indicated by last weeks ISM numbers, but the consumer has not been materially impacted. These data points seem to suggest that consumer spending will be strong enough to extend the longest expansion in U.S. history.

Economy

This week the economic data centered around inflation statistics with the release of the producer price index and the consumer price index. On Tuesday, the PPI came in much weaker than anticipated, posting a decline of 0.3% in September. The "core" PPI also dropped by 0.3% and is now up 2.0% over the past 12 months. Energy prices were down 2.5% and gasoline prices collapsed by 7.2%. The consumer price index was reported on Thursday; the headline figure was unchanged and the "core" CPI increased by 0.13%. Overall, the CPI has advanced by 1.7% year-over-year and the "core" CPI has increased by 2.4%. Once again, energy prices had a significant effect on these metrics with a drop of 1.4% in September. Finally, on Wednesday, the JOLTS report (job openings and labor turnover survey) showed 7.051 million job openings on the last business day of August. The "quits" rate was unchanged at 2.3% and the net employment gain over the last year is a respectable 2.4 million.

Fixed Income/Credit Market

The 10-year U.S. Treasury, which started the week at approximately 1.53% increased roughly 20 basis points (bps) to end the week at 1.73%. Positive progress pertaining to the trade talks between the U.S. and China coupled with optimism regarding Brexit negotiations culminated into a flight from high quality assets. With the 10-year Treasury yield moving so rapidly in such a short time frame, one might ponder how high the 10-year Treasury yield could go? The answer is hard to predict, but according to the forward Treasury curve matrix, the 10-year Treasury is only projected to hit 2.22% five years from now and the median analysts' forecast according to Bloomberg shows the 10-year Treasury yielding around 2.00% by the end of the fourth quarter of 2020. It should come as no surprise that with the risk-on sentiment in full swing, high yield credit spreads compressed. For example, the 5-year BB-rated corporate bond spread above the 5-year Treasury is 239 bps and is down 18 bps on the week through Thursday according to Bloomberg.

Equities

U.S. equities sold off on both Monday and Tuesday as volatile headlines concerning the U.S.-China trade talks pushed markets into distress. Sentiment turned Wednesday, however, as news purporting that Chinese diplomats were still open to negotiating a potential deal bolstered confidence. According to reports – despite President Trump's desire to secure a wide-sweeping deal, China's adamancy on keeping intellectual property policy untouched, and the blacklisting of various Chinese officials and companies – China expressed openness to de-escalation by purchasing additional agricultural goods as long as no further tariffs are implemented. Equities responded positively Thursday in accordance with the start of the meetings, and carried the momentum into Friday morning on the notion that a second day of meetings is indicative of constructive progress. At Friday's end, the S&P 500 closed up 1.09%, ending three consecutive weeks of losses, with President Trump stating "we are very close to ending the trade war" in light of a phase 1 deal being reached. The week's top performing sector was materials (+1.85%), with the laggard being utilities (-1.41%).

Our View

The core CPI, which excludes the volatile food and energy component, rose 0.1% in September, and year-over-year is running at up 2.4%. The September headline CPI increase was slightly less than expected as energy prices declined, and a lower than anticipated increase in used car prices helped keep overall price pressures in check. On the surface, it does not appear that tariffs are having a significant impact on consumer prices even after the introduction of an additional $150 billion of tariffs on Chinese imports. Slowing demand due to a weakening global economy is weighing on prices in several major categories. Despite the unemployment rate dropping to 3.5%, its lowest rate since 1969, wage growth has leveled off at 2.9%. This is well below the 4% rate where the Federal Reserve becomes concerned. The Fed cut the fed funds rate 25 basis-points in both July and September, but it has not lifted inflation expectations. There is a stark disconnect between market expectations for rates and the Fed's expectations as indicated by its "dot plot". The fed funds rate remains above the entire Treasury curve except for the 30-year Treasury. Many analysts believe that current conditions will lead to another rate decrease by the Fed at its next meeting later this month. U.S. GDP growth is likely to slow to well-below 2.0% in 2020 due to the reduction in business investment spending. Businesses are hesitant to make capital commitments due to the uncertainty created by the trade war and weak global growth. Export volumes have deteriorated, and earnings growth has slowed dramatically. Trade and global economic activity are intertwined and can be partially resolved by a U.S./China trade deal. The probability of a comprehensive trade deal that includes an acceptable solution on intellectual property issues before the election seems remote, given how far apart the U.S. and China are at this point in the negotiations. A limited trade deal will ease mounting economic pressure on both countries and will be a major boost to market psychology.

COMING UP NEXT WEEK		Est.
10/16 Retail Sales SA M/M	(Sep)	0.30%
10/17 Housing Starts SAAR	(Sep)	1,303K
10/17 Industrial Production SA M/M	(Sep)	-0.20%

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