The Weekly

Economic & Market Recap

Peapack-Gladstone Bank, Private Wealth Management

August 3, 2018

As of 08/03/2018		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	25,462.58	11.52	0.05	2.13	3.01	15.60
S&P 500	2,840.35	21.53	0.76	1.82	6.23	14.88
NASDAQ 100	7,395.49	98.71	1.35	0.96	15.62	25.53
S&P MidCap 400	2,000.04	24.82	1.26	1.52	5.23	14.47
Russell 2000	1,673.37	10.03	0.60	1.34	8.98	19.08

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	2.65	Euro/Dollar	1.16	-0.79
5-Year	2.81	Dollar/Yen	111.25	0.17
10-Year	2.95	Sterling/Dollar	1.30	-0.77
30-Year	3.09	Dollar/Cad	1.30	-0.51

Source: Thomson Reuters & Bloomberg

What Caught Our Eye This Week

The budget deficit (gap between revenue and spending) has been widening because of the $1.5 trillion in tax cuts together with the roughly $300 billion in spending approved by Congress. The deficit totaled $607 billion through the first nine months of the fiscal year compared with $523 billion the same time a year ago. The Congressional Budget Office (CBO) estimates that in this fiscal year the deficit will be $833 billion and will reach $1 trillion in 2020. The Treasury Department announced this week that it will increase its borrowing to pay for the rising budget deficit. In the July-September quarter, the Treasury expects to borrow $329 billion, $56 billion more than previously estimated and well above the $189 billion it borrowed in the same quarter a year ago. The Treasury borrows by issuing new marketable debt securities such as Treasury bills, notes and bonds through public auctions on a regular set schedule. The auction size of the debt securities will be increased by an additional $30 billion over the next three months. The increase in supply is coming at a time when the Fed has been raising short term rates; at the same time, shrinking its balance sheet, which puts more pressure on the bond market and ultimately increases the borrowing cost for the U.S. Treasury.

Economy

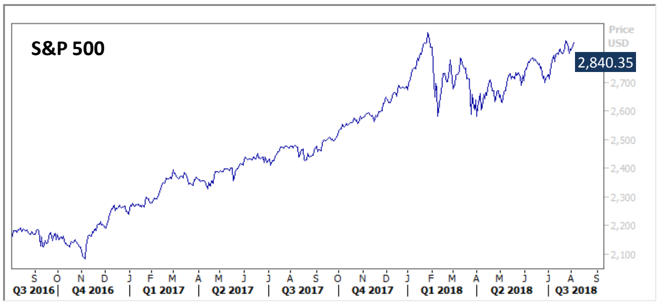
The most anticipated report this week was the nonfarm payroll report, which was released on Friday. This report showed payrolls increasing by 157,000 in July, which was below the consensus forecast of 190,000. The unemployment rate decreased to 3.9% and the U-6 measure of unemployment declined to 7.5%. Average hourly earnings increased by 0.3% (7 cents) and are now up 2.7% year-over-year. The labor force participation rate was unchanged at 62.9%. Examining the different employment sectors, manufacturing added 37,000 jobs, construction added 19,000 and health care and social assistance gained 34,000. In other news this week, the ISM manufacturing index decreased to 58.1 in July, which was below the consensus forecast of 59.4. The new orders index decreased to 60.2, but has now been above 60 for 15 consecutive months. On Tuesday, personal income and consumption posted impressive gains. Personal income and consumption advanced by 0.4% in June, and are now up 4.9% and 5.1%, respectively on a 12-month basis. Disposable personal income has increased by 5.4% over the past 12 months.

Fixed Income/Credit Market

Limited supply in the U.S. investment grade (IG) bond market is weighing on IG credit spreads. According to Bloomberg, only $7.8 billion of a projected $20 billion priced on the week which hampered new issue concessions for corporate bond investors. Furthermore, concessions for investors were negative, implying that issuers priced new bond deals at more attractive funding costs than their current outstanding debt on the secondary market. Since June 30th, IG 5-year AA, A and BBB – rated composites are 11.6 basis points (bps), 9 bps, and 9.2 bps lower, respectively. With new issue supply likely light for the rest of the summer, market participants expect corporate credit spreads to grind lower. Using the 5-yr A-rated composite as a proxy, a one standard deviation move puts the spread at 53.3 bps which is roughly 10 bps higher than where 5-yr AA composite bonds currently trade and 14.7 bps lower than the 5-yr A composite average. It can be argued that investors are not being adequately compensated for credit risk.

Equities

Equity investors were again this week caught between trade concerns and optimism regarding a constructive domestic economic outlook. Generally, stocks in Asia and Europe fell after the White House said it will consider even higher tariffs on Chinese imports exacerbating trade worries. Domestic equity indexes were mixed and directionless until solid earnings reports from several bellweather companies lifted investor confidence. Quarterly earnings results have been very good by most measures. Early in the week technology stocks had been under pressure due to profit-taking, but the technology sector turned due to the strong earnings report from Apple. Apple's shares surged allowing it to become the first U.S. company to surpass $1 trillion in market value. Real Estate, which has been a laggard in 2018, was the best performing sector lifted by also strong earnings. Healthcare rallied 2.1% after the Trump administration loosened restrictions on insurance plans, allowing consumers to enroll for short-term coverage up to 36 months. Energy and materials dropped as the price of oil drifted a bit lower on over supply concerns and tariffs possibly curtailing consumption.



Our View

Three major central banks met this past week with the U.S. Fed and Bank of Japan (BOJ) holding rates steady and the Bank of England (BOE) increasing rates 25 basis points (bps). The BOJ was more dovish than market participants expected, as the main adjustment made was to increase the yield curve control band around the 10-year JGB to 20 bps from 10 bps. It was also mentioned that rates would remain low "for an extended period". Of all the countries that have utilized quantitative easing to fight off deflation, Japan has been the most aggressive. According to Haver Analytics, the BOJ's assets are 96.5% of the local currency GDP, which compares to 21.1% for the U.S. Fed. Furthermore, the Japanese unemployment rate is only 2.4% as of June of 2018. Given the previously mentioned statistics, one might assume that inflation would be an issue in Japan; however, headline CPI was only 0.7% as of June of 2018 and the BOJ cut its inflation forecasts out to 2020. It is our belief that accommodative monetary policy will be utilized in Japan for the foreseeable future. On a different note, trade tensions with China escalated this week as the Trump administration threatened to increase the potential tax on $200 billion of Chinese goods up to 25% from 10%. China responded on Friday with a list of $60 billion worth of U.S. products that would be taxed up to 25% if the previously mentioned tariffs are put into place. It is our belief that both the U.S. and China will eventually sit down and work out a trade agreement, but it will take time and volatility will be high as the confrontational headlines persist.

COMING UP NEXT WEEK		**Est.**
08/07 Consumer Credit	(Jun)	17.95B
08/09 PPI Final Demand YY	(Jul)	3.4%
08/09 PPI exFood/Energy YY	(Jul)	2.8%
08/10 Core CPI YY, NSA	(Jul)	2.3%
08/10 CPI MM, SA	(Jul)	0.2%

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