Peapack Private
Wealth Management

The Weekly
Economic & Market Recap

December 10, 2021

12/10/2021		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	35,970.99	1390.91	4.02	1.75	17.53	19.91
S&P 500	4,712.02	173.59	3.82	1.28	25.45	28.46
NASDAQ	15,630.60	545.13	3.61	0.61	21.28	25.99
S&P MidCap 400	2,779.84	77.70	2.88	1.36	20.52	23.76

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	0.66	Euro/Dollar	1.13	0.22
5-Year	1.25	Dollar/Yen	113.42	0.18
10-Year	1.48	GBP/Dollar	1.32	0.07
30-Year	1.88	Dollar/Cad	1.27	-0.61

Source: Bloomberg/FactSet

What Caught Our Eye This Week

Public retirement funds face a potential cash crunch stemming from prospective investment allocations, inflation fears, and a burgeoning number of retirees to whom these pension programs must provide income. The funds that manage more than $4.5 trillion in retirement savings for America's teachers, police, and firefighters have reduced cash allocations to a seven-year low – according to data from the Boston College Center for Retirement Research. Their cash targets are equal to approximately 0.8% of their holdings. With long-term expected annual return targets for state and local government retirement funds of 7% on average, several pensions have reduced their allocation to investment grade fixed income and global equities to pursue higher potential returns in private equity, real estate, infrastructure, and illiquid credit investments. One, the California Public Employees Retirement System (Calpers), even recently announced plans to borrow up to 5% of the plan's assets to increase its allocation to private market investments. What appears optimal on paper may in fact present some challenges in less steady markets. Without a stable source of cash from their bond allocations, these institutions and other non-profit entities may face losses from having to liquidate risk assets or redeem private investments prior to their maturity to meet their obligations.

Economy

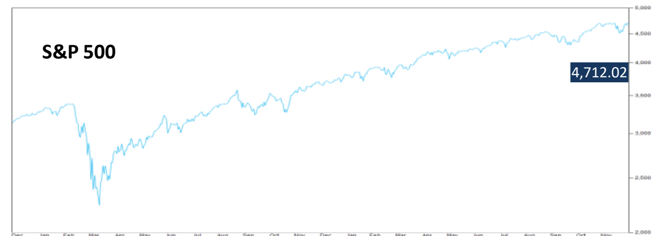
The economic headliner this week was once again the consumer price index (CPI), which was released on Friday. The CPI in November advanced 0.8%, which was above expectations. Over the past twelve months, the CPI has increased 6.8%. The "core" CPI also increased, rising 0.535% and is now up 4.9% year-over-year. Airfares surged 4.7%, energy prices rose 3.5% and used-vehicle prices gained 2.5%. On Wednesday, the JOLTS report (job openings & labor turnover survey) showed 11.033 million job openings on the last day of October. The "quits" rate declined to 2.8% and over the past twelve months there is a net employment gain of 5.7 million. Initial jobless claims were posted on Thursday and dropped from 227,000 to 184,000 during the week ended December 4th. This level of claims is the lowest since 1969, and the four-week moving average is now at 219,000. Finally, on Tuesday, there was a modest downward revision to Q3 nonfarm productivity, disappointing expectations. Productivity declined 5.2% in the third quarter and unit labor costs are up 6.3% year-over-year.

Fixed Income/Credit Market

In anticipation of accelerated Fed tapering and a potential interest rate hike in the first quarter of 2022, market sentiment has precipitated a material flattening of the U.S. Treasury yield curve. The closest watched yield curve spread between the 2-year tenor and the 10-year tenor (2/10 spread) is now trading at approximately 83.0 basis points (bps). The year-to-date (YTD) average is 119.7 bps and peaked at 158 bps on March 31st. At the current spread, the benchmark yield curve gauge is roughly 2 standard deviations below the YTD mean. The YTD low occurred one week ago when the 2/10 spread hit 75.5 bps. Another related measure of yield curve steepness, or lack thereof, is the spread between the 5-year and 30-year tenors (5/30 spread). The 5/30 spread now at just 63.5 bps is trading close to 2¼ standard deviations below its YTD mean of 123.1 bps. For longer-dated investors wanting to be compensated for term risk, the future is not much brighter. According to Bloomberg's forward curve matrix, the 2/10 spread and 5/30 spread are forecasted to be just 21.5 bps and 26.5 bps five years forward.

Equities

It was a strong week for the stock market beginning with a three-day rally causing the S&P 500 to gain approximately 3.6% and ultimately closing at a new all-time high on Friday. Domestic equities rose substantially after data suggested that the Omicron variant may be less severe with milder symptoms. Pfizer and BioNTech further encouraged investors on Wednesday after revealing that three doses of their vaccine can neutralize the new variant. The positive findings resulted in big weekly gains across the board. This week the S&P 500, Nasdaq, and Dow rose 3.82%, 3.61%, and 4.02%, respectively. Growth stocks outperformed value by roughly 1.50%, and large-cap stocks easily outperformed small-cap stocks. The information technology sector was the top performer with gains of 5.98%, supported by solid earnings from Oracle and Broadcom Inc. The consumer discretionary sector trailed with gains of 2.52%. All sectors ended in the green this week.



Our View

Inflation continues to run uncomfortably hot. November's consumer price index (CPI) indicated that consumer prices are growing at the fastest pace in 39 years. Many economists believe that the headline inflation number will soon peak, but that core inflation, which strips out food and energy prices, will remain high well into next year. Supply-side issues remain a problem, and both wage and housing costs will likely continue to run at a higher pace. Wage and shelter costs take a while to feed into inflation data making a return to the Federal Reserve's target level of two percent well off in the future. Although pricing pressures are unlikely to subside in the near term significantly, we are confident that headline and core inflation will meaningfully decelerate next year. Eventually, the Federal Reserve's policy response and easing supply constraints will allow price pressures to abate. The primary question is whether inflation will slow to an acceptable rate according to the Fed or will inflation remain at a level that will compel the Fed to continue to raise interest rates, once they begin to raise rates, at a pace faster than the financial markets expect. The economy, for the foreseeable future, will be exerting pressure on inflation due to growth rates. The fastest economic growth rates are behind us, with the recovery well underway. Still, domestic GDP growth will probably grow at least an entire percentage point faster than the five-year average growth rate and at a level that is above the economy's potential growth rate. Due to inventory rebuilding and pent-up consumption spending, economic growth in the first half of 2022 will be solid. Inflation is a broader issue than energy prices or supply chain dislocations. Real demand is a significant element causing higher inflation. The Fed can do little about the supply-side causes of inflation, but they can certainly impact the demand side with higher interest rates. The critical question for investors is how patient the Fed will be if inflation rates remain persistently high. The market is pricing in two/three Fed Funds rate increases next year. We will closely monitor comments and statements this upcoming week following the Fed's December meeting to see if they express increased concern after November's CPI data.

COMING UP NEXT WEEK		Consensus	Prior
12/14 PPI NSA Y/Y	(Nov)	9.1%	8.6%
12/15 Retail Sales ex-Auto SA M/M	(Nov)	0.80%	1.7%
12/15 Retail Sales SA M/M	(Nov)	0.70%	1.7%
12/16 Housing Starts SAAR	(Nov)	1,563K	1,520K
12/16 Capacity Utilization NSA	(Nov)	76.8%	76.4%
12/16 Industrial Production SA M/M	(Nov)	0.60%	1.6%

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