PEAPACK PRIVATE
Wealth Management

The Weekly
Economic & Market Recap

August 28, 2020

8/28/2020		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	28,653.87	723.54	2.59	2.28	0.40	11.16
S&P 500	3,508.01	110.85	3.26	1.72	8.58	22.27
NASDAQ	11,695.63	383.83	3.39	0.81	30.35	49.43
S&P MidCap 400	1,946.51	36.26	1.90	1.80	-5.65	6.21

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	0.15	Euro/Dollar	1.19	1.01
5-Year	0.26	Dollar/Yen	105.31	-0.61
10-Year	0.72	GBP/Dollar	1.33	1.98
30-Year	1.50	Dollar/Cad	1.31	-0.72

Source: Bloomberg/FactSet

What Caught Our Eye This Week

On Wednesday, durable goods orders for July rose 11.2% (total new orders of $230.7 billion) compared with expectations for an increase of 4.3% and on top of 7.6% growth in June. Durable goods orders are defined as procurements placed with domestic manufacturers for delivery of factory hard goods (typically expensive items that last three years or more and are purchased infrequently). Since businesses and consumers are likely to place orders as their confidence grows, the statistic is a key indicator investors use to gauge the health of the economy. Though they can be volatile and are often subject to revision, durable goods orders provide valuable insight into the supply chain. Increases in the data point can help investors assess the long-term potential for sales and earnings growth in industries such as machinery, technology manufacturing, and transportation. With the value of new orders just below February levels, the U.S. economic recovery looks strong. Amidst these otherwise robust numbers, however, the inventory levels at American manufacturers are declining. This ongoing drawdown suggests they may have some caution that the recent improvement in demand may not continue.

Economy

The economic headliner this week was the durable goods report, which was released on Wednesday. Overall, new orders for durable goods surged 11.2% in July marking a third straight month of advances. The volatile transportation sector led the way (+ 35.6%), but there were also impressive gains with core capital goods orders (+ 1.9%) and core capital goods shipments (+2.4%). At this juncture, durable goods orders are just 6.7% below the February pre-pandemic high. In other news this week new home sales posted a 13.9% increase in July easily surpassing consensus estimates. This is also the third consecutive monthly gain for new home sales and these figures are now up 36.3% year-over-year and surpassed the January high. On Thursday the 2nd look at Q2 real GDP revealed a decline of -31.7%, which was slightly better than the previously reported -32.9%. Finally, on Friday personal income showed a 0.4% advance in July and personal consumption posted an increase of 1.9%. Personal income is now up 8.2% year-over-year while personal consumption is down 2.8%.

Fixed Income/Credit Market

Week-over-week benchmark interest rates across the U.S. Treasury curve bear steepened as Fed Chairman Powell formally announced the Fed will implement "average inflation targeting" moving forward. Moreover, the front end of the Treasury curve compressed roughly 1.2 basis points (bps) at the 2-year tenor while the 10-year tenor increased by 9.4 bps, which caused the 2-year to 10-year spread to expand approximately 10.6 bps over the course of the week and finish at 59.2 bps. With inflation expectations now on the rise, the US 10-year breakeven inflation rate is approximately 1.78%, which is the highest level since late January of this year and is up 23 bps in August thus far. Given the arduous task of maintaining inflation expectations in the face of ever improving technology, aging demographics and excessive labor market slack, the FOMC will have to keep the Fed funds rate positioned near zero for the foreseeable future. But, even with extremely accommodative monetary policy today and well into the future, the forward Treasury curve predicts that the 10-year Treasury yield will have trouble rising above 2% over the next decade.

Equities

Domestic equities posted very strong gains this week with the S&P 500 up for a fifth consecutive week. Furthermore, the index managed to post gains on every day and finished Friday at a new all-time high. The big news this week centered on the Fed policy framework shift. Fed Chair Jerome Powell highlighted that the central bank will now seek to achieve a 2% average inflation target which can be viewed as a more flexible framework than it has been historically. Investor's risk-on sentiment was further bolstered by coronavirus vaccine optimism and positive developments on Covid-19 testing. Abbott Labs was granted FDA emergency use authorization for its $5 rapid Covid-19 antigen test which returns results in roughly 15 minutes. In other news, the stalemate over additional fiscal stimulus persisted but appeared to do little to dampen market expectations for a bipartisan agreement on a fifth coronavirus relief bill in late September. The only sector to post a loss on the week was utilities while the top performing sector was communication services which gained 4.79%.

Our View

The Federal Reserve Bank of Kansas City sponsors a symposium on important economic and policy issues facing the global economy every August in Jackson Hole, Wyoming. The symposium is closely watched because it attracts prominent central bankers, government finance ministers, and notable academics. This year the Jackson Hole symposium's title is "Navigating the Decade Ahead: Implications for Monetary Policy". Fed Chair Jerome Powell's address at Jackson Hole on Thursday spoke directly to the theme of the conference. Mr. Powell announced a major policy shift to "average inflation targeting," which essentially means that the Fed will allow inflation to run modestly above its 2% goal for a period after being below its target. The Federal Reserve will actively pursue monetary policy that will lift inflation above its target to offset periods of inflation persistently below its goal. The reasoning is that inflation will occasionally be driven below the target by recessions. Therefore, it needs to be above target during periods of expanding economic environments to average the Fed's long-term target. The central bank does not want inflation expectations to be embedded persistently below target due to all the attending problems that arise from weak inflation expectations. The practical implication of the Fed's policy shift, given the long period of inflation undershoot, is that the Fed is likely to keep short rates pinned to zero for many years. Despite the prospect of additional stimulus from Washington and the possibility of a short-term rekindling of inflation as prices firm with the service side of the economy reopening, the Fed is paving the way for potentially more monetary stimulus regardless of the short-term direction of the consumer price index. The Fed may feel the need to ramp up its current quantitative easing program from the current $20 billion per week rate. Also, the new policy seems sufficiently vague to provide for significant latitude before the Fed is compelled to normalize policy.

COMING UP NEXT WEEK		Consensus	Prior
09/01 ISM Manufacturing SA	(Aug)	54.7	54.2
09/02 Durable Orders SA M/M (Final)	(Jul)	11.2%	11.2%
09/02 Factory Orders M/M	(Jul)	5.8%	6.2%
09/03 ISM Non-Manufacturing SA	(Aug)	57.5	58.1
09/04 Nonfarm Payrolls SA	(Aug)	1,500K	1,763K
09/04 Unemployment Rate	(Aug)	9.8%	10.2%

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