PEAPACK PRIVATE

Wealth Management

The Weekly

Economic & Market Recap

June 4, 2021

6/4/2021		Wk Net	Wk %	Div	YTD %	12 Mos %
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	34,756.39	226.94	0.66	1.73	13.56	32.24
S&P 500	4,229.89	25.78	0.61	1.37	12.61	35.91
NASDAQ	13,814.49	65.75	0.48	0.68	7.19	43.66
S&P MidCap 400	2,728.67	1.23	0.05	1.22	18.30	47.32

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	0.15	Euro/Dollar	1.22	-0.15
5-Year	0.79	Dollar/Yen	109.52	-0.42
10-Year	1.55	GBP/Dollar	1.42	-0.05
30-Year	2.24	Dollar/Cad	1.21	0.07

Source: Bloomberg/FactSet

What Caught Our Eye This Week

One way a corporation looks to increase shareholder value is by separating noncore businesses, that could be valued differently by the market, into a separate entity. The new entity goes from being a segment of a large company, to a new company with its own management team, board, and corporate strategy. When a company spins off a unit to investors, it is a tax-free transaction. Spinoffs usually occur because a parent company wants to narrow its focus and believes the new entity can generate greater profits as a standalone company. Merck spun off their women's health and biosimilars division into a new company, Organon. Merck will now focus on pharmaceuticals for oncology, vaccines, and animal health while Organon will look to grow their women's health and biosimilars medicines. AT&T announced they will spin off their WarnerMedia unit which will allow AT&T to focus on its core telecom businesses. According to Refinitiv data, the global value of spinning off a business to investors averaged just $94 billion in 2019 and 2020, far below the value of corporate mergers and acquisitions. Growth through acquisitions has seen a spike in transactions, but when it comes to creating value bigger may not always be better.

Economy

The economic headliner this week was the nonfarm payroll report, which was released on Friday. This report showed payrolls increasing by 559,000 in May and the unemployment rate dropping to 5.8%. There were also positive revisions for March and April totaling 27,000. Nonfarm payrolls are still down 7.6 million from the pre-pandemic levels of February 2020. The broad U-6 measure of unemployment dropped from 10.4% to 10.2% and the labor force participation rate was little changed at 61.6%. Examining the different employment sectors, leisure & hospitality added 292,000 jobs, manufacturing gained 23,000 jobs and healthcare & social assistance secured 46,000 jobs. In other news this week, the ISM manufacturing survey increased from 60.7 to 61.2 in May. The new orders index rose to 67.0 and 16 out of 18 industries reported growth. Finally, on Thursday, the ISM services survey increased from 62.7 to 64 in May, an all-time record high. The new orders index rose to 63.9 and 18/18 services industries reported growth.

Fixed Income/Credit Market

Fixed income performance during May was positive for most of sectors that we follow. However, returns were modest as U.S. Treasury yields remain in a holding pattern and concerns about runaway inflation have abated. The top performers were Treasury Inflation-Protected Securities (TIPS), international Treasuries, and emerging market debt (non-currency hedged) which returned 1.02%, 0.98%, and 0.96%, respectively. The laggards during May were mortgage-backed securities (MBS), high-quality international bonds, and short-term Treasuries which had respective returns of -0.31%, 0%, and 0.08%. U.S. Treasury rates closed the month anywhere from -4.7 basis points (bps) to +1.8 bps. The benchmark 10-year yield dropped 3.2 to close May at approximately 1.6%. The 10-year breakeven rate which measures inflation expectations went from 2.41 to 2.45 which is a 1.7% increase, however, the gauge dropped from an intra-month high of 2.57 on May 17th equating to a 4.7% decrease in the second half of May. The Fed's monthly purchases of MBS continue to weigh heavily on the sector which is suffering from both yield and spread compression.

Equities

Domestic equities posted modest gains during a relatively quiet holiday-shortened trading week. Most of the discussion centered around employment data and the prospect of the Federal Reserve tapering asset purchases. Thursday's ADP private payrolls report beat expectations handily, while Friday's nonfarm payrolls report came in below consensus estimates. Given the mixed results, many chalked up the numbers as not weak enough to raise red flags on the economy but also not overly strong where the Fed would have to consider pulling back on its easy monetary policies. The results were well received as the S&P 500 rallied 0.88% on Friday. In other news, President Biden has offered to create a new corporate tax floor of 15% rather than raising the tax rate to 28%. This is largely in effort to target dozens of profitable U.S. companies that pay little to no federal taxes. Energy stocks outperformed the broader market gaining 6.68% this week, while healthcare lagged posting a decline of 1.15%.

Our View

What a difference a year can make as twelve months ago the economy was largely shut down to mitigate the spread of Covid-19, and now the reopening process is well underway. Moreover, the second quarter of 2020 experienced a 31.4% contraction in GDP (quarter-over-quarter annualized rate) while the second quarter of 2021 is projected to show a 9.2% increase, according to the median economist tracked by Bloomberg. Extraordinarily innovative and accommodative monetary policy support was the first line of defense in combating the market dislocations and economic hardships caused by the pandemic. On March 23rd of 2020, the Fed announced a host of support measures, which included a new facility to purchase corporate debt on the secondary market along with ETFs backed by corporate debt. With the Fed playing a key support role in the corporate debt markets and acting as a backstop, credit spreads quickly contracted, liquidity returned, and the corporate default cycle was truncated. Since then, U.S. corporations have issued more than $2 trillion in new debt and credit spreads have contracted to historically low levels. With the corporate credit market clearly functioning at an efficient level, the Fed announced this week it would gradually unwind the Secondary Market Corporate Credit Facility (SMCCF). The SMCCF only grew to a small fraction of its stated capacity, but the notion of its presence went a long way in restoring investor confidence. Financial markets have healed nicely since the early stages of the pandemic and the Fed has now embarked on pulling back some of its emergency measures. The Fed is still purchasing $120 billion in U.S. Treasuries and Agency MBS and the discussion of a plan to taper the purchases is being discussed by Fed members, although nothing has been formally announced. In order for the Fed to begin to taper the previously-mentioned bond purchases, significant progress must be made towards achieving maximum employment and price stability. Given the robust expansion the economy is currently experiencing, we would not be surprised if the decision to start tapering is announced in the near future. However, the tapering of bond purchases will be a drawn-out process and the Fed will most likely give itself the ability to make adjustments along the way.

COMING UP NEXT WEEK		Consensus	Prior
06/07 Consumer Credit SA	(Apr)	$19.0B	$25.8B
06/09 Wholesale Inventories SA M/M (Final)	(Apr)	0.80%	0.80%
06/10 CPI ex-Food & Energy SA M/M	(May)	0.40%	0.90%
06/10 CPI SA M/M	(May)	0.40%	0.80%
06/10 CPI NSA Y/Y	(May)	-	4.2%

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