# The Weekly
## Economic & Market Recap

October 22, 2021

| 10/22/2021 | | Wk | Wk | | YTD | 12 Mos |
|---|---|---|---|---|---|---|
| | | Net | % | Div | % | % |
| **STOCKS** | Close | Change | Change | Yield | Change | Change |
| DJIA | 35,677.02 | 382.26 | 1.08 | 1.73 | 16.57 | 25.78 |
| S&P 500 | 4,544.90 | 73.53 | 1.64 | 1.31 | 21.00 | 31.60 |
| NASDAQ | 15,090.20 | 192.86 | 1.29 | 0.64 | 17.08 | 31.15 |
| S&P MidCap 400 | 2,796.84 | 48.56 | 1.77 | 1.33 | 21.25 | 39.64 |

| **TREASURIES** | Yield | **FOREX** | Price | Wk %Change |
|---|---|---|---|---|
| 2-Year | 0.45 | Euro/Dollar | 1.16 | 0.35 |
| 5-Year | 1.20 | Dollar/Yen | 113.59 | -0.41 |
| 10-Year | 1.64 | GBP/Dollar | 1.38 | 0.03 |
| 30-Year | 2.07 | Dollar/Cad | 1.24 | -0.03 |

Source: Bloomberg/FactSet

**What Caught Our Eye This Week**

2021 is shaping up to be a record-breaking year for merger and acquisition (M&A) activity. Just this week, PayPal Holdings was rumored to pursue the social media company Pinterest Inc. Investors flush with cash and access to low-interest-rate debt have completed almost 44,000 deal transactions with a combined value of $4.3 trillion during the first nine months of the year. This shatters the previous high watermark set 14 years earlier (2007), when corporations and private equity firms completed 35,000 M&A deals with an aggregate value in excess of $3.2 trillion in the comparable period. This is a noteworthy recovery from the first nine months of 2020, when the Covid-19 pandemic pushed deal value down to a 7-year low of $2.2 trillion. Investor optimism has been fueled by historically low interest rates as well as private equity firms looking for investment opportunities with a vast amount of dry powder on the sidelines. Whether companies are seeking acquisitions in areas where they need to grow or add capabilities to help shape their post-Covid future, the M&A environment suggests that both investment bankers and acquirers are confident in the intermediate-term prospects for the global economy.

**Economy**

On Monday, industrial production showed a decline of 1.3% in September which came in well below the consensus expectation for a gain of 0.1%. Overall, the Federal Reserve estimates that roughly half of the decline in industrial production can be attributed to Hurricane Ida. Furthermore, overall capacity utilization declined to 75.2% in September from 76.2% in the prior month. In other news, housing starts declined 1.6% in September to a 1.555 million annual rate which was below the consensus expectation for 1.615 million. This drop was entirely due to a 5.0% decline in the multi-family sector while the single-family sector was unchanged. However, in the past year, multi-family starts are up 38.5% while single-family starts have fallen 2.3%. On Thursday, existing home sales increased 7.0% in September to a 6.29 million annual rate which easily beat expectations of 6.10 million. Although sales rose in all major regions month-over-month, sales are down 2.3% versus a year ago. The median price of an existing home fell to $352,800 in September but is up 13.3% year-over-year.

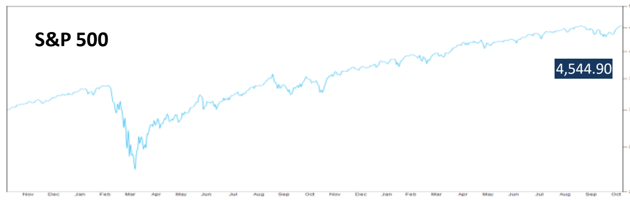
**Fixed Income/Credit Market**

Inflation expectations have created a major shift along the U.S. Treasury yield curve year-to-date (YTD), particularly in Note yields from the 2-year tenor out to the 7-year tenor. While low base rates exacerbate the percentage change in yields, the move higher in rates cannot be overlooked. The increases highlighted below indicate the market's expectation that Fed rate hikes will be pulled forward with at least one 25 basis point increase in the Fed funds rate in 2022.

| Tenor | 10/22/2021 | 12/31/2020 | YTD change in bps | % change |
|---|---|---|---|---|
| 2Y | 0.458 | 0.122 | 33.6 | 275% |
| 3Y | 0.778 | 0.166 | 61.2 | 369% |
| 5Y | 1.204 | 0.362 | 84.2 | 233% |
| 7Y | 1.483 | 0.646 | 83.8 | 130% |
| 10Y | 1.642 | 0.916 | 72.6 | 79% |
| 20Y | 2.054 | 1.442 | 61.2 | 42% |
| 30Y | 2.074 | 1.646 | 42.8 | 26% |

**Equities**

All major indexes finished with weekly gains as strong earnings continue to bolster U.S. domestic equities. Lately, companies have been experiencing rising costs as a result of inflation and bottlenecks across global supply chains, and they have been insulating themselves by increasing the prices of their products to maintain margins. Strong consumer demand has allowed companies to pass along some of the increased costs. According to FactSet, of the 23% of S&P 500 companies that have reported, 84% have seen actual earnings above consensus estimates. If these numbers hold, it will be the third highest percentage of positive beats since 2008. Although still early, communication services, healthcare, real estate and utilities have yet to report a single miss on the earnings front. For the week, the S&P 500 rose 1.64%, the Dow 1.08%, and the Nasdaq 1.29%.




**Our View**

Investors are digesting a deluge of third-quarter corporate earnings reports. Earnings have been quite strong and have helped lift equity indexes back toward early September highs. Since the beginning of 2021, earnings have powered the stock market forward despite lofty valuations. Looking ahead, we expect earnings growth will remain the key driver of the direction of equity prices. Many factors that have allowed multiple expansion over the last few years will be detrimental to higher valuations. On balance, with current inflationary pressures and a solidly growing economy, we expect the bias is for higher interest rates and equity discount factors. Low rates have driven multiples for many growth stocks to levels we have not seen in twenty years. Additionally, the liquidity provided by a $4 trillion expansion of the Federal Reserve's balance sheet, since the start of the pandemic, has bled into asset prices. It now seems to be finding its way into the real economy via higher inflation. Inflation is also being generated through demand stimulated by $5 trillion in federal government deficit spending over the last two years. Over the next few years, the Fed is likely to be draining excess liquidity from the system, and deficit spending should shrink dramatically. With the dual headwinds of less liquidity and higher discount factors working against higher price levels, earnings will be the main driver of equities. Since companies are having difficulty filling job openings, corporate surveys indicate that the number of companies planning to raise worker compensation is at an all-time high. Higher compensation costs (and supply disruptions) will ultimately lead to pressure on corporate profit margins. Margins and revenue growth are the primary aspects we focus on when reviewing corporate earnings reports. During this reporting period, we are more interested in company guidance than the actual earnings reports. As the economic cycle advances and economic growth inevitably slows, we believe investors should focus on quality companies with sustainable competitive advantages and superior pricing power. The list of potential concerns, such as inflation, margin erosion, and the fading impact of monetary and fiscal stimulus, will create uncertainty and occasionally bouts of volatility. Investors should be focused on upgrading the quality of their portfolios and maintaining well-diversified portfolios.

| COMING UP NEXT WEEK | | Consensus | Prior |
|---|---|---|---|
| 10/26 Consumer Confidence | (Oct) | 110.5 | 109.3 |
| 10/27 Durable Orders SA M/M (Preliminary) | (Sep) | 0.20% | 1.8% |
| 10/28 GDP SAAR Q/Q (First Preliminary) | (Q3) | 4.0% | 6.7% |
| 10/29 Personal Income SA M/M | (Sep) | 0.40% | 0.20% |
| 10/29 Michigan Sentiment NSA (Final) | (Oct) | 71.4 | 71.4 |

For more information about our solutions: http://peapackprivate.com