PEAPACK PRIVATE
Wealth Management

The Weekly
Economic & Market Recap

Peapack Private Wealth Management

SPECIAL EDITION: EXPECTATIONS FOR 2021

 January 8, 2021

1/8/2021		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	31,097.97	491.49	1.61	1.94	1.61	8.80
S&P 500	3,824.68	68.61	1.83	1.54	1.83	18.15
NASDAQ	13,201.98	313.70	2.43	0.74	2.43	45.58
S&P MidCap 400	2,416.37	109.75	4.76	1.42	4.76	17.91

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	0.14	Euro/Dollar	1.23	0.17
5-Year	0.48	Dollar/Yen	103.80	0.53
10-Year	1.12	GBP/Dollar	1.36	-0.56
30-Year	1.87	Dollar/Cad	1.27	-0.40

Source: Bloomberg/FactSet

Equities

The commitment of equity investors to remain focused on their long-term investment goals was severely tested last year due to the unprecedented impact of the coronavirus on both the economy and financial markets. Since the emergence of the pandemic in early March, the coronavirus has been at the forefront of investors' thoughts and has so radically shifted the market's fundamental underpinnings that the initial expectations going into 2020 were meaningless. As the virus spread, consumers stayed at home, held on to their disposable income, and refocused their buying toward grocery and home related products. Enabling technologies that allowed corporations and knowledge workers to continue to function were in high demand. These select areas of the market were rewarded, pushing valuations of many companies to levels we have not seen in 20 years. Conversely, the share prices of hospitality, restaurant, personal service and energy segments, which were severely impaired by government lockdowns and travel restrictions, were punished harshly in the market. The challenge for equity investors was not only the dramatic swings in spending and economic fundamentals, but also it was often difficult to square the market's reaction with the rapidly changing economic facts.

Driven by the fall out of the pandemic, the equity market experienced the fastest bear market in history, as the S&P 500 declined 34% in just 33 days. Market volatility during the sell-off was extreme with 19 days of over 3% moves in the index in just 26 trading days. The stunning level of volatility tried the resolve of many investors.

Global central banks responded with breathtaking speed to intervene with additional accommodative monetary policy. The Fed dropped the fed funds target rate to 0 – 0.25% and aggressively reinstituted its quantitative easing program (currently purchasing $120 billion a month). The Federal government also responded in a massive way by ramping up fiscal spending to support small businesses and the over 20 million Americans who lost jobs as the recession began. After a series of spending programs, the 2020 projected U.S. fiscal deficit has reached 16% of GDP, which is the largest in percentage terms since 1945. The intervention, coupled with the diminution of the virus over the summer, allowed the economy to stabilize and turned the psychology of the market. A robust equity market recovery began during the second quarter. With the news of viable vaccines and the conclusion of the election in the fourth quarter, two major issues overhanging the market seemed to fade, and the recovery turned into new market highs by year end. It needs to be noted that effectively zero interest rates have had a pervasive impact on the entire investing landscape, especially on the valuation of risk assets such as equities. By year-end, equity market valuations rose to over 22 times forward earnings expectations, which is two standard deviations above the long-term average multiple.

As we look ahead, the economy should pick up substantially after the economic drag of renewed lockdowns over the winter begin to recede. Consumer demand should be ebullient in the second half of the year due to pent-up demand that has been stifled for the last twelve months. Demand will have plenty of fuel with record levels of personal savings and an improving labor market. Strong economic growth should drive a solid earnings recovery in 2021. Consensus estimates suggest earnings growth of over 20%, which should support higher equity levels. The high equity valuations caused by the equity market melt-up in the fourth quarter, and the possibility of some multiple contraction over the course of 2021, could allow us to see more muted returns and occasional periods of profit-taking. The reflation trade that has begun will take multiple years to unfold and should benefit equity investors.

Economy

The U.S. economy continues to recover from the massive dislocation brought on by the Covid-19 pandemic. With a stunning degree of fiscal policy support, consensus expectations of economists for the U.S. economy is to grow approximately 4.0% in 2021. We are forecasting the second and third quarters to be the strongest periods for all of 2021. The unemployment rate should continue moving down from 6.7% today to approximately 5.50% at year-end. Investors will have close scrutiny on the 10-year Treasury yield. Recent strength in the 10-year Treasury yield and an accelerating economy will allow the yield to finish the year higher within a range of roughly 1.25% to 1.75%. Housing finished the year strong with existing home sales advancing 25.8% year-over-year through November. The median price of an existing home increased 14.6% and now sits at $310,800. Single family construction hit its highest level since 2007 and contributes significant multiplier effects to the overall economy. Politically, with the Democrats in control of the White House and holding slim majorities in both chambers of congress, we are expecting a continued high level of federal spending and fiscal transfers to households. Another spending package of $900 billion is expected in the next few months with the possibility of $2,000 checks for consumers sometime around inauguration day. In total it appears that $464 billion will eventually be injected into consumers' pocketbooks, which should allow for an above-average consumer spending year. With respect to the Federal Reserve, they appear to be on the sidelines with an interest rate increase on hold until inflation and employment goals are satisfied.

COMING UP NEXT WEEK		Consensus	Prior
1/12 JOLTS Job Openings	(Nov)	-	6,652K
1/13 CPI ex-Food & Energy SA M/M	(Dec)	0.20%	0.20%
1/13 CPI NSA Y/Y	(Dec)	1.1%	1.2%
1/15 PPI ex-Food & Energy SA M/M	(Dec)	0.10%	0.10%
1/15 PPI NSA Y/Y	(Dec)	0.50%	0.76%
1/15 Retail Sales ex-Auto SA M/M	(Dec)	0.40%	-0.90%
1/15 Retail Sales SA M/M	(Dec)	0.20%	-1.1%
1/15 Industrial Production SA M/M	(Dec)	0.0%	0.40%
1/15 Michigan Sentiment NSA (Preliminary)	(Jan)	81.4	80.7

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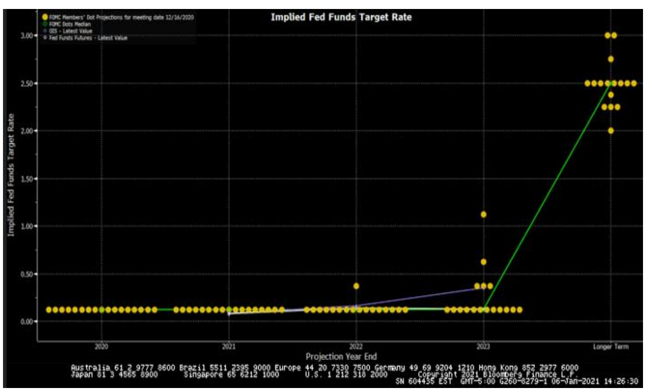
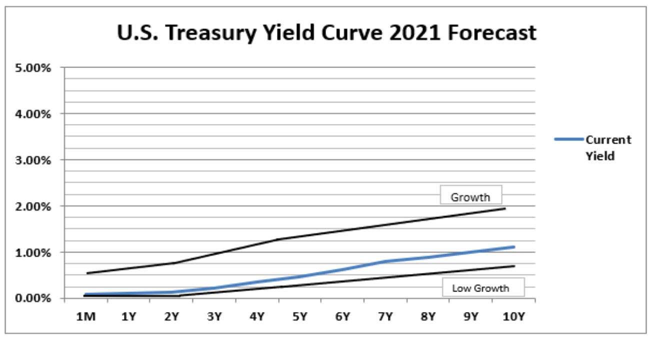
Fixed Income

Lifestyles were dramatically altered over the course of 2020 as Covid-19 spread around the globe and perpetuated a tremendous amount of human hardship. The fed funds rate, which was reduced 0.75% in 2019, began the year at a target range between 1.50% to 1.75%. Financial conditions deteriorated as the virus spread and the FOMC wasted no time easing monetary policy. Moreover, during the month of March the Fed cut the fed funds rate by 1.5%, began purchasing an unprecedented amount of fixed income securities and pledged to backstop numerous markets through liquidity facilities. The Bloomberg Financial Conditions Index bottomed on March 24th at negative 6.34 and then began to rapidly improve as market dislocations subsided and confidence in the financial system was restored. However, the economic damage that followed was horrific as over 20 million people lost their jobs during the month of April and a vast majority of the nation's population experienced lockdown conditions. Given the severity of the pandemic coupled with structural deflationary forces, the FOMC is committed to highly accommodative monetary policy until the labor market is restored and inflation returns to the 2% level with the expectation to modestly exceed 2% for a period of time.

If the U.S. economy progresses according to the FOMC's most recent projections, the fed funds rate should end 2021 at 0.125%, which implies no rate hikes over the course of the year. The fed funds futures market is in close agreement and projects the fed funds rate to end the year at 0.08%. The FOMC forecasts their preferred inflation metric (Core PCE) to rise 40 basis points (bps) over the course of 2021 to 1.8%, which will still be below their flexible average inflation target of 2.0%. With highly accommodative monetary and fiscal policy working their way through the economy, it is our belief that inflation could surprise to the upside over the course of the year as long as Covid-19 is contained over the next 6 months. However, with the FOMC committed to buttressing the economic recovery we do not expect the fed funds rate to move from its current level over the course of 2021.



Interest rates along the U.S. Treasury (UST) curve have surged in 2021 resulting in the 10-year Treasury breaching 1% for the first time since March 4th. The move higher in yields was precipitated by the expectation that Georgia's Senate runoff would result in the Democratic Party winning control of the Senate. The market reaction played right into the narrative during election season of a steeper yield curve if a "blue wave" occurred. While 1% on the 10-year Treasury is more of a psychological level, the curve steepening does have a material impact on the spread between the 2-year and 10-year Treasury yields (2/10 spread). Currently 95.5 bps, the 2/10 spread is at its steepest slope in almost four years. However, many are left wondering if this could be an eventual path towards interest rate normalization or will the Fed use their policy influence to keep a lid on long-term Treasury yields. With global rates at historically low levels, it is hard to envision the Fed allowing U.S. interest rates to dislocate too far from the rest of the world. According to Bloomberg's forward curve matrix, over a 1-year horizon, the 2/10 spread is forecasted to steepen slightly to 103.6 bps, a result of relatively inconsequential 2-year and 10-year yield increases of 15.6 bps and 20.2 bps, respectively.



While U.S. investment grade (IG) and high yield (HY) corporate bonds did not perform nearly as well as they did in 2019, they did in fact provide investors with palatable year-end returns in 2020 of 9.89% and 7.11%, respectively. Both sectors rebounded sharply after a dismal first quarter that provided investors with total returns of -3.63% (IG) and -12.68% (HY). Investment grade and high yield bond prices were buoyed by unprecedented Fed accommodation (in the form of the Primary and Secondary Corporate Credit Lending Facilities) which drove credit spreads tighter following March's blowout. Additionally, yield hungry investors flocked toward higher yielding securities, particularly in the primary market which saw record bond issuance. Investment grade and high yield option adjusted spreads (OAS) ended 2020 slightly higher at 96 bps and 360 bps, respectively. IG and HY OAS spreads had respective peaks on March 23rd of 373 bps and 1,100 bps. With Democrats controlling the House and Senate, it is perceived that corporate balance sheets could come under pressure in the future – primarily through tax reform. If such an event materializes and causes credit spreads to widen back to their 5-year averages of 146 bps (IG) and 441 bps (HY), principal losses could be a potential concern for corporate bond investors.