Peapack Private Wealth Management

The Weekly
Economic & Market Recap

May 28, 2021

5/28/2021		Wk Net	Wk %	Div	YTD %	12 Mos %
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	34,529.45	321.61	0.94	1.74	12.82	35.94
S&P 500	4,204.11	48.25	1.16	1.37	11.93	38.76
NASDAQ	13,748.74	277.75	2.06	0.68	6.68	46.75
S&P MidCap 400	2,727.44	37.60	1.40	1.22	18.24	53.82

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	0.14	Euro/Dollar	1.22	-0.06
5-Year	0.79	Dollar/Yen	109.98	0.93
10-Year	1.58	GBP/Dollar	1.42	0.12
30-Year	2.26	Dollar/Cad	1.21	0.25

Source: Bloomberg/FactSet

What Caught Our Eye This Week

Through May 21st, 95% of the companies in the S&P 500 index have reported their earnings results for the first quarter. Earnings for the S&P 500 were robust, rising nearly 50% to $50.50 per share ($215 per share on an annualized basis). Operating leverage this quarter was particularly strong, as almost three-quarters of the index constituents saw their pre-tax margins expand. Each incremental dollar of revenue generated $0.50 in pre-tax profits, its best level since 2009. Most of the rise in earnings was converted into free cash flow, with increases in working capital and capital expenditures for most businesses flat or down. Investors remain wary of the impact of higher costs on margins, especially wage gains and soaring commodity prices. These cost pressures are the most pronounced in the last three decades. Some equity strategists still see analysts' earnings expectations, that have increased by 12% from $175 at the beginning of the year to $196 late last week, as too low. Should reported earnings improve further and long-term interest rates continue to rise, the global cyclical recovery may have room to run.

Economy

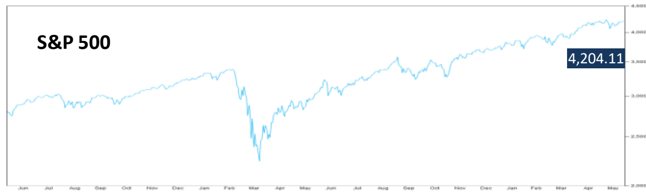
The economic headliner this week was the durable goods report, which was released on Thursday. Overall, new orders for durable goods declined 1.3% in April, which was below expectations. This is the first monthly decline in a year, but year-over-year these orders are up 52.1%. Excluding the volatile transportation sector, core capital goods orders increased 2.3% and core capital goods shipments rose 0.9%. On Tuesday, the Conference Board consumer confidence index posted a small decline to 117.2 in May, and its labor market differential improved to +34.6. New home sales data was also released on Tuesday and registered a 5.9% decline in April to 863,000 units at an annual rate. These figures were below expectations, but over the past twelve months new home sales have surged 48.3%. On Thursday, the second look at first quarter real GDP came in unrevised at 6.4%. Consumer spending was revised up to an annual rate of 11.3% in the first three months of the year. Finally, on Friday, personal income dropped 13.1% in April and real consumer spending fell 0.1%.

Fixed Income/Credit Market

On Friday, the Fed's preferred measure of inflation, Personal Consumption Expenditures (PCE), came in at roughly 3.6% – its highest print since the spike in oil prices after Iraq invaded Kuwait in the early 1990s. However, fixed income markets continue to reflect that the higher inflation number has already been priced in and/or continues to believe the numbers are transitory. This week, yields across the U.S. Treasury curve were mixed, ranging from -3.6 basis points (bps) to +1.3 bps. The 10-year tenor dropped 2.6 bps to 1.60% and has traded within a narrow range of 1.56% to 1.70% over a three-month horizon. Despite nominal Treasury yields being historically low, the slope of the curve is steep. Currently at 145.4 bps, the 2-year and 10-year spread (2/10 spread) is trading well above the pre-2008 crisis period when the slope had a mean spread of 79.9 bps. As the Fed continues to hold interest rates at the zero-lower bound and debate about inflation expectations remains, there is uncertainty surrounding the future shape of the Treasury curve.

Equities

It was a strong week for U.S. domestic equities as the S&P 500 finished up 1.16% on the week, snapping its two-week losing streak. Similarly, the Nasdaq rose 2.06% on the week, its second straight week of gains. The ongoing Congressional infrastructure negotiations remain a key focus for investors. On Thursday, Republicans unveiled their $928 billion version of the proposal and expressed cautious optimism that a bipartisan agreement can be reached. Democrats, however, balked at the proposal deeming it too small, and are expected to push their $1.7 trillion proposal via reconciliation. Moreover, President Biden unveiled his $6 trillion budget on Friday. This, coupled with the Fed's stance that the current inflation fears are transitory, buoyed equities and reinforced positive sentiment. Growth outperformed its value counterpart 1.62% to 0.93% this week due to strength in the internet, media, and tech spaces. The communication services and tech sectors climbed 2.47% and 1.58%, respectively. The consumer discretionary space also had a strong performance on the week, rising 2.23%, as a result of increased auto and retail sales.



Our View

When the White House and Congress need to announce information, but want to minimize the public scrutiny, the perfect time to do so is on a Friday in front of a long weekend. Today, President Biden unveiled his detailed budget proposal that would spend $6 trillion next year and run a deficit of $1.8 trillion. The budget incorporates the administration's multi-year initiatives such as $1.8 trillion for the American Families Plan and $2.3 trillion for infrastructure. The budget proposal, which covers not just the coming year but the ten years that follow, would have total spending hit $8.3 trillion by the end of the decade, despite a bevy of new tax increases on corporations and high-income individuals, annual deficits would consistently run around $1.3 trillion. Presidential budget proposals are essentially a wishlist of programs the administration wants to implement. Both the spending programs and the tax increases needed to pay for them will be hotly negotiated and it is highly unlikely that they will remain in their current form. The Biden budget proposal should not be taken literally, but it does provide an indication of the directional bias of future federal spending. After the federal government has amassed $28 trillion in debt, some investors are concerned with the prospect of the federal government running annual trillion-dollar deficits consistently over the next decade. Debt service has not been an issue so far because interest rates are so low. In a way, the Federal Reserve has been an enabler in Washington's spending and debt binge. By maintaining an ultra-low interest rate policy and soaking up government debt through their quantitative easing program, the Federal Reserve has created the conditions that have allowed virtually unfettered spending by both Republican and Democrat administrations. On top of other distortions, such as the misallocation of capital to economic projects that would not otherwise be viable, and encouraging financial market risk-taking, the accumulation of debt is another reason for the Fed to begin to normalize policy. Ultimately, as the debt burden continues to grow to become a more sizable portion of GDP through deficit spending, it will increasingly have an economic impact that could result in higher interest rates, higher taxes or greater inflation.

COMING UP NEXT WEEK		Consensus	Prior
06/01 ISM Manufacturing SA	(May)	60.5	60.7
06/03 ISM Non-Manufacturing SA	(May)	63.0	62.7
06/04 Nonfarm Payrolls SA	(May)	700.0K	266.0K
06/04 Unemployment Rate	(May)	5.9%	6.1%
06/04 Durable Orders SA M/M (Final)	(Apr)	-	-1.3%
06/04 Factory Orders SA M/M	(Apr)	0.50%	1.1%

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