PEAPACK PRIVATE
Wealth Management

The Weekly
Economic & Market Recap

August 7, 2020

8/7/2020		Wk Net	Wk %	Div	YTD %	12 Mos %
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	27,433.48	1005.16	3.80	2.37	-3.87	5.39
S&P 500	3,351.28	80.16	2.45	1.80	3.73	16.29
NASDAQ	11,010.98	265.71	2.47	0.78	22.72	40.57
S&P MidCap 400	1,938.53	74.62	4.00	1.81	-6.03	2.92

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	0.13	Euro/Dollar	1.18	-0.31
5-Year	0.23	Dollar/Yen	105.89	0.15
10-Year	0.57	GBP/Dollar	1.31	-0.56
30-Year	1.24	Dollar/Cad	1.34	-0.10

Source: Bloomberg/FactSet

What Caught Our Eye This Week

As a result of its significant investment in biomedical research, the United States has become a world leader in drug discovery and development, but is no longer at the forefront of drug manufacturing. In recent decades, drug manufacturing has gradually moved out of the United States. This is especially true for manufacturers of active pharmaceutical ingredients (APIs), the actual drug compounds which are then formulated into tablets, capsules, injections, etc. According to the FDA, which only tracks the number of manufacturing facilities and not their total production amount, 72% of the facilities that supply the U.S. are located outside of the U.S. The pandemic caused many drugs to be in short supply and has thereby caused concern over the supply chain for medicines. The $765 million government loan to Eastman Kodak (EK) under the Defense Production Act is intended to help expedite the domestic production of drugs and reduce the U.S. reliance on foreign sources. EK will form a new division, Kodak Pharmaceuticals, with the goal of producing 25% of APIs for medicines.

Economy

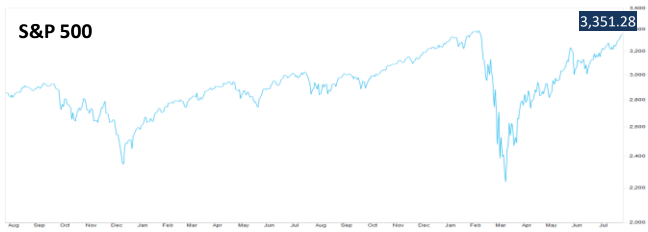
The economic headliner this week was the nonfarm payroll report, which was released on Friday. This report showed payrolls increasing by 1.763 million in July, and the unemployment rate declining from 11.2% in June to 10.2% in July. The U-6 measure of broad labor market utilization dropped from 18.0% to 16.5%. The labor force participation rate decreased from 61.5% to 61.4%. Examining the different employment sectors, leisure & hospitality gained 592,000 jobs, construction added 20,000 jobs, and manufacturing secured 26,000 jobs. The payroll diffusion index, which measures the number of industries that increased employment last month, dropped from 75.0% in June to 61.4% in July. In other news this week, the ISM manufacturing survey increased from 52.6 in June to 54.2 in July. The new orders index increased from 56.4 to 61.5 and the production figures moved up to 62.1. Overall 13/18 industries reported growth. Finally, we were pleased to see the ISM non-manufacturing survey improve from 57.1 in June to 58.1 in July. The new orders index increased from 61.6 to 67.7 and the business activity index moved up to 67.2.

Fixed Income/Credit Market

The benchmark 10-year AAA Bloomberg Callable Curve is currently trading at 0.54%, a historic low dating back to the benchmark's inception in January 2010. For context, the historic average is approximately 2.09% and prior to this year has never touched below 1.23% (8/16/19). However, strong demand for the asset class picked up 2020 where it left off in 2019 as investors clamored for incremental yield as U.S. Treasury yields dropped precipitously forcing the AAA curve to hit a new low on March 9, 2020 of roughly 0.80%. Between March 9th and March 23rd, the 10-year AAA benchmark skyrocketed about 207 basis points (bps) to 2.87% as the potential impact on state and local governments resulting from the coronavirus was unknown. The Fed's Main Street Lending Facility quickly allayed municipal bond investors' fears of possible defaults and market illiquidity. By the end of March, 10-year AAA muni bonds were trading at 1.35% – a 152 bps decrease over an eight-day period. A strong appetite for safe-haven assets and tax shielded investments continues to put downward pressure on municipal yields.

Equities

U.S. domestic equities performed strongly this week as solid earnings reports and anticipation of Congress' new coronavirus bill pushed stocks into what is now eight straight days of gains. Sentiment reversed course on Friday, however, with markets initially on pace to close in negative territory, stocks rebounded and finished with slight gains. Friday's initial slip came as news broke late Thursday night that lawmakers balked on reaching an agreement for the new stimulus package. Despite the positive unemployment numbers released that morning, because fiscal stimulus has acted as such a key driver in the market's comeback, the inability to breakthrough before President Trump's Friday deadline ultimately cloaked the nation's recovery efforts with uncertainty. Furthermore, the U.S. and China tensions escalated Thursday night, as President Trump implemented executive orders to ban the Chinese technology apps TikTok and WeChat within the United States. The Chinese will undoubtedly view President Trump's actions as an attempt stifle their technological progression, so news of the signings weighed on market sentiment. Notwithstanding all of Friday's negative news, the S&P 500 finished +0.06% for the day and +2.45% for the week. All sectors posted weekly gains as well, with industrials leading the charge up +4.76%.



Our View

2020 has thus far been a year filled with economic, social and emotional turbulence and hardship. Fear and uncertainty regarding the forward path of Covid-19 has left numerous corporate income statements devoid of much needed revenue after a decade of indulging on cheap debt, which altered the financial health of many companies. Moreover, bankruptcy filings of companies with liabilities of at least $50 million are on pace to be the most since the recession that followed the financial crisis back in 2008. But the situation would have been much worse had the Fed not instituted an enormous open-ended bond purchasing program, along with numerous liquidity facilities targeted at corporate bonds among other asset classes. Moreover, short-term funding costs as measured by the spread between 90-day commercial paper and Treasury bills has compressed to an extremely low 7 basis points (bps) after spiking on March 24th to over 205 bps. Also, credit spreads have dropped precipitously since their March highs. Furthermore, U.S. high yield bonds experienced tremendous demand during the month of July as yields fell the most during any single month on record. Historically, when bankruptcy filings and defaults pick up, credit spreads tend to widen in order to compensate investors for the increased probability of potential losses. Right now, the high yield market is being distorted to a degree as many troubled companies work to outlast the downturn by deferring rent payments, obtaining temporary reprieves from suppliers, furloughing workers and applying for government aid. The previously mentioned tactics along with extremely accommodative monetary policy has undoubtedly kept companies in business longer than what would have been imaginable. However, the pace of the economic recovery will ultimately decide the severity of the credit cycle and given the current unknowns and the diminished upside potential in the high yield market, we feel this asset class should be approached with caution.

COMING UP NEXT WEEK		Consensus	Prior
08/12 CPI ex-Food & Energy SA M/M	(Jul)	0.20%	0.20%
08/14 Retail Sales SA M/M	(Jul)	2.0%	7.5%
08/14 Industrial Production SA M/M	(Jul)	3.2%	5.4%
08/14 Michigan Sentiment NSA (Preliminary)	(Aug)	72.4	72.5

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