Peapack Private

Wealth Management

The Weekly

Economic & Market Recap

October 15, 2021

10/15/2021		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	35,294.76	548.51	1.58	1.75	15.32	23.87
S&P 500	4,471.37	80.03	1.82	1.33	19.04	28.36
NASDAQ	14,897.34	317.80	2.18	0.64	15.59	27.18
S&P MidCap 400	2,748.28	58.06	2.16	1.35	19.15	37.22

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	0.39	Euro/Dollar	1.16	0.27
5-Year	1.12	Dollar/Yen	114.07	1.81
10-Year	1.57	GBP/Dollar	1.38	0.96
30-Year	2.05	Dollar/Cad	1.24	-0.81

Source: Bloomberg/FactSet

What Caught Our Eye This Week

Americans pay considerably higher prices for brand drugs than do consumers in other industrialized nations. Most Americans consider U.S. prescription drug prices unreasonable, with almost 3 in 10 reporting they go without prescribed medications due to cost. A recent Kaiser Family Foundation (KFF) poll found that 83% of the public favored the federal government negotiating lower drug prices for both Medicare and private insurance. While the federal government lowering drug prices directly (either by negotiating with manufacturers or unilaterally setting prices) would save money for governments, employers, and consumers, it would constitute a major policy initiative to veer away from reliance on market forces. The U.S. is the largest pharmaceutical market in the world, representing at least 60% (possibly as high as 78%) of the industry's global profits. The pharmaceutical industry warns that price controls would ultimately hurt patients by depressing innovation and leading to fewer new medications. According to the Congressional Budget Office, U.S. pharmaceutical companies spend about 25.8% of annual revenue on R&D, meaningfully higher than innovative industries such as software (16.2%) and semiconductors (15.7%). The long-term implications of sudden government price controls on the U.S. prescription drug market are uncertain, but past research by RAND Corporation suggests that reduced revenue for the pharmaceutical industry would inevitably lead to less spending on R&D and less innovation.

Economy

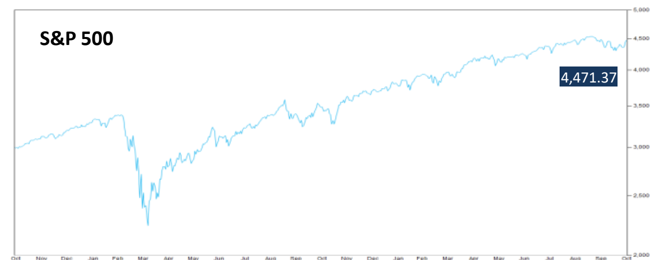
This week the economic data centered around inflation statistics with the release of the consumer price index (CPI) and the producer price index (PPI). On Wednesday, the CPI came in a tick above expectations, posting a 0.4% increase in September. Year-over-year, this metric has surged 5.4%, which is the largest annual increase since 2008. The "core" CPI posted a 0.2% gain and is now up 4.0% over the past 12 months. Rent measures were very strong with the owners equivalent rent advancing 0.4%. New vehicle prices increased 1.3% and are now up 8.7% year-over-year. The PPI was released on Thursday and came in softer than expected, gaining 0.5% in September. This index is now up 8.6% year-over-year. The "core" PPI advanced 0.2% and is now up 6.8% over the past 12 months. Supply chain issues continue to exert significant upward pressure on prices. Finally, on Friday, retail sales exceeded expectations increasing 0.7% in September. The "control" category, which excludes food service, autos, gas and building materials, also surpassed expectations, rising 0.8%.

Fixed Income/Credit Market

Thus far in October, U.S. ETF fund flows have taken shape as expected due to the combination of the looming Fed taper and a global rise in interest rates. Month-to-date yields across the U.S. Treasury curve have increased as much as 18.5 basis points (bps) which alerted investors that it might be time to sell out of sectors potentially impacted by higher interest rates. Fund flows by asset class have seen emerging market (EM) debt and corporate bond funds decrease their market caps 2.6% and 0.3%, respectively. That equates to outflows of $752.6MM (EM) and $963.7MM (corporate). Meanwhile, inflation protected and bank loan funds had market cap increases of 3% and 1.7%, respectively. In dollar figures, that amounted to inflows of $2.7B (inflation protected) and $1.4B (bank loans). By rating class, fund flows for investment grade bonds increased its market cap 1.5% while high yield funds saw an exodus of 1.1% which equates to +$4.9B and -$1.1B, respectively. Additionally, long-term bond funds decreased their market cap by 0.6% (-$290.5MM) while short-term funds had net inflows of $2.6B, a market cap increase of 1%.

Equities

U.S. domestic equities surged this week as strong earnings reports and better than expected economic data delivered the market's best weekly performance since July. Catapulted by a late-week rally on Thursday and Friday, the S&P 500's had its best single-day session since March. Stocks appeared to finally shrug off some of the inflation concerns that have plagued them for most of the fall. Although it is still early in earnings season (only 8% of the companies in the S&P have reported) and most of the lift has come from banks, investors are encouraged. Positive earnings surprises, combined with the good retail sales data and cooling of inflation fears, allowed equity investors to focus on an optimistic view of the broader economic recovery. On the week, the S&P 500 rose 1.82%, the Dow jumped 1.58%, and the Nasdaq sprung 2.18%. Sector-wise, all except for communication services finished the week with gains. Growth outperformed value by 0.61%.



Our View

Economic growth in China is being negatively impacted from many different angles, which is making the outlook challenging. Third quarter Chinese GDP figures are set to be released on October 17th and projections indicate that growth should slow to 5.0% year-over-year versus the prior period's growth rate of 7.9%. One of the major headwinds facing the Chinese economy is the real estate slump that has been precipitated by the liquidity crisis at China Evergrande Group; an enormous developer with approximately $300 billion in liabilities. In order to satisfy Evergrande's heavy debt load, it has been selling assets but some fear that it may have to resort to discounting its current inventory of properties, which would weigh heavily on the Chinese property sector. Moreover, according to Goldman Sachs Group Inc., China's property sector along with other housing related industries make up approximately 25% of Chinese GDP. Chinese authorities are acutely aware of the situation and the People's Bank of China has asked lenders to keep credit flowing to the real estate sector in order to help alleviate systemic stress. However, policy makers know that real estate prices have been increasing dramatically over the last decade and a half and they are fearful of continuing to support a fully valued sector. Therefore, they have develop-ed three red lines that developers must meet in order to refinance debt. The goal is that growth can continue on a more durable path and that financially weak developers can eventually be dismantled in an orderly fashion. Some initially feared that the Evergrande situation would trigger another Lehman Brothers systemic risk-off event, but the Chinese government seems to have the ability to deal with above-mentioned financial stresses for now. Although Chinese sovereign credit default swaps have increased 17 basis points (bps) since early September to reside at 49 bps currently, they are still far from the 124 bp level hit in late 2016. Chinese officials have sacrificed short-term growth prospects through the recent wave of regulatory reforms in order to prioritize long-term financial stability. The situation is extremely fluid and we will continue to monitor it closely.

COMING UP NEXT WEEK		Consensus	Prior
10/18 Capacity Utilization NSA	(Sep)	76.5%	76.4%
10/18 Industrial Production SA M/M	(Sep)	0.20%	0.40%
10/19 Housing Starts SAAR	(Sep)	1,620K	1,615K
10/21 Existing Home Sales SAAR	(Sep)	6,090K	5,880K
10/21 Leading Indicators SA M/M	(Sep)	0.50%	0.90%
10/22 Markit PMI Manufacturing SA (Preliminary)	(Oct)	60.3	60.7
10/22 Markit PMI Services SA (Preliminary)	(Oct)	54.7	54.9

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