PEAPACK PRIVATE
Wealth Management

The Weekly
Economic & Market Recap

February 18, 2022

2/18/2022		Wk Net Change	Wk % Change	Div Yield	YTD % Change	12 Mos % Change
STOCKS	Close					
DJIA	34,079.18	-658.88	-1.90	1.86	-6.22	8.21
S&P 500	4,348.87	-69.77	-1.58	1.41	-8.76	11.10
NASDAQ	13,548.07	-243.09	-1.76	0.72	-13.40	-2.29
S&P MidCap 400	2,632.49	-14.97	-0.57	1.49	-7.37	5.44

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	1.47	Euro/Dollar	1.13	-0.54
5-Year	1.81	Dollar/Yen	115.15	-0.63
10-Year	1.92	GBP/Dollar	1.36	-0.14
30-Year	2.24	Dollar/Cad	1.27	0.41

Source: Bloomberg/FactSet

What Caught Our Eye This Week

The last three decades have witnessed the diminishment of Russia as a global superpower. Russia's president, Vladimir Putin, has vociferously stated that the collapse of the former Soviet Union was "the greatest geopolitical catastrophe of the century." Putin aspires to regain Russia's former hegemonic position in the world. The North Atlantic Treaty Organization, which was comprised of 16 countries during the Cold War, has steadily grown to 30 member countries today – mostly from former Warsaw Pact and ex-Soviet republics. Putin is threatened by this continual "encroachment," and he does not want to lose influence over his very valuable Ukrainian neighbor. Its population of 44 million people produce an annual gross domestic product over $180 billion. Additionally, Ukraine's history and identity are inextricably linked with Russia's. Ukraine's capital, Kiev, was ancient Russia's capital 12 centuries ago. Both countries share a common religion and language. As one of the most important wheat-producing countries in the world, Ukraine is considered Europe's breadbasket. It is also rich in mineral resources and has a robust manufacturing industry. Russia generates 25% of the global trade in natural gas, and 85% of it goes to Europe (source: Cowen, Inc.). Russia is vulnerable because about half its federal budget is funded from its oil and gas revenues and Ukraine contains major pipelines which link the oil and gas fields in central and eastern Russia with Europe.

Economy

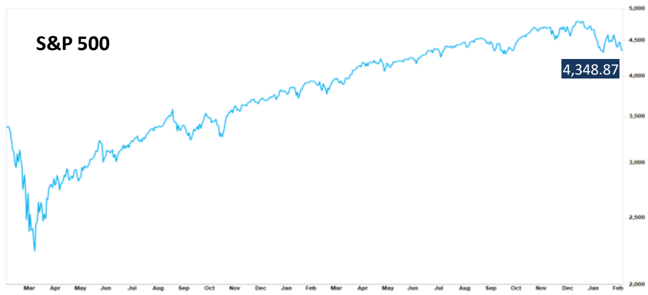
The most anticipated report this week was the retail sales report, which was released on Wednesday. Retail sales increased 3.8% in January, which was much stronger than anticipated. Over the past 12 months, retail sales were up 13%. Non-store retailers led the way, surging 14.5%, department stores gained 9.2% and vehicle dealers and parts increased 5.7%. The "control" category, which excludes food service, autos, gas and building materials rose 4.8%. In other news this week, the producer price index (PPI) surprised to the upside, rising 1.0% in January, the sharpest increase since May 2021. The "core" PPI rose 0.8% and is now up 8.3% year-over-year. On Wednesday, industrial production figures posted a 1.4% increase in January, easily exceeding expectations. Manufacturing output gained 0.2% and capacity utilization rose to 77.6%. Thursday brought us housing starts data, which disappointed, declining 4.1% to 1.638 million units at an annual rate. The bright spot was single family permits surging 6.8%, a fourth straight monthly gain.

Fixed Income/Credit Market

The seemingly insatiable demand for tax-exempt income that took place last year has reversed course putting upward pressure on tax-exempt municipal bond versus U.S. Treasury yield ratios. Moreover, the 10-year AAA municipal bond to U.S. Treasury yield ratio is currently 85% and is well above 70%, where it started the year. As of Thursday's close, the 10-year AAA Bloomberg Barclays Municipal Index yield as a percentage of Treasuries is close to its trailing 5-year average of 89%, according to Bloomberg. Recent supply and demand dynamics have driven municipal bond prices lower, evidenced by the negative 3.44% year-to-date (YTD) total return for the Municipal Bond Index versus a negative 2.73% YTD total return for the U.S. Treasury Index. Nationally, the visible 30-day supply is $9.7B while the amount of debt expected to be retired due to calls and maturities is $17.7B for a net issuance of negative $8.0B, which could add some near-term support to the market. A 10-year municipal debt backed by the state of New Jersey is currently trading at approximately 45 basis points (bps) above the Bloomberg 10-year AAA Muni Index, which is roughly 11 bps above the three-month average.

Equities

Major U.S. indices had a mixed start to the week, impacted by continuing geopolitical tension in Ukraine as well as inflation concerns. On Tuesday, the Producer Price Index (PPI), which measures the average change of selling prices received by domestic producers over time, came in higher than expected at 1.0% (vs 0.5%) for January and up 9.7% year over year. This heightened investors' focus on the FOMC minutes, released on Wednesday, which did not add color on the timing of the Fed's balance sheet contraction nor specifics surrounding the much-anticipated rate increase in March. Equity market volatility continued throughout the week as Ukraine dominated headlines with conflicting news regarding the movement of Russian troops along the Ukraine border. All major equity indices fell over 1% for the week. Notably, consumer staple sector was the only sector in positive territory.



Our View

When we exited 2019, the 10-year U.S. Treasury bond yield was at 1.91%, which is slightly below where it stands today. Mortgage rates approached 4% this week and are only 17 basis points above where they were two years ago. Additionally, the term structure of interest rates (2 through 10-year tenors) is very much the same, with the yield curve being only slightly steeper today than it was in December of 2019. Despite interest rates having returned to pre-pandemic levels, inflation has made the interest rate environment feel dramatically different than it did just two years ago. Interest rates declined throughout 2019 after the Federal Reserve abruptly ended its rate-tightening cycle at the end of 2018. There was a significant amount of concern that the Fed had moved rates too quickly and had driven the fed funds rate above the neutral rate, which would cause the economy to decelerate. By the fall of that year, the Fed was again *cutting* rates. Today, the situation stands in stark contrast because interest rates have been *rising* since early August due to an overstimulated economy and accelerating inflation. The Fed has not even started to raise rates. Fed fund futures suggest that Wall Street expects the Fed's policy rate to climb to at least 1.75% by the end of the year to fight inflation. The financial markets are always more volatile when monetary policy shifts due to heightened uncertainty. The markets are now faced with the added complication of a potential major geopolitical crisis with Russia threatening to invade Ukraine. The annexation of Crimea in 2014 can offer insight into the likely reaction of the markets. There was a temporary spike in bond yields due to concerns regarding energy prices and an equally short-lived drop in equity prices due to uncertainty. The broader impact will be largely dependent on the response by the U.S. and NATO, but inflationary pressures will almost certainly get worse, causing a bigger headache for the Fed. One key factor the markets are weighing is that today's inflationary conditions and the Fed's current flatfooted position, with fed funds at the zero-bound, the Fed will have a more limited ability to respond.

COMING UP NEXT WEEK		Consensus	Prior
02/22 Markit PMI Manufacturing SA (Preliminary)	(Feb)	56.0	55.5
02/22 Markit PMI Services SA (Preliminary)	(Feb)	52.2	51.2
02/24 GDP SAAR Q/Q (Second Preliminary)	(Q4)	5.8%	6.9%
02/24 New Home Sales SAAR	(Jan)	790.0K	811.0K
02/25 Durable Orders SA M/M (Preliminary)	(Jan)	0.60%	-0.69%
02/25 Personal Income SA M/M	(Jan)	-0.50%	0.30%
02/25 Michigan Sentiment NSA (Final)	(Feb)	61.7	61.7

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