

THOUGHTS ON THE MARKET

12th August 2020

Rotation out of expensive tech into traditional cyclicals continues for a third day

SUMMARY

- Risk markets were subdued overnight with minor declines in the global sharemarket and mixed performance in credit markets, but this masked a notable decline in assets which had recently outperformed including gold and tech stocks. The rationale provided for the latter was the Congressional stalemate around the US fifth stimulus deal, and COVID-19 caseloads impacting the recovery, but to me these lacked intellectual rigour as both drivers here are largely recycled news.

A more logical reason is some portfolio switching being underway given the constant flurry of concerns about crowded positioning and stretched valuations in growth sectors including tech and communication services, whereas value and cyclicals continue to be supported by positive economic surprise momentum. This trend could persist in the September quarter as the production side of the global economy increases activity, as the growth lift in May and June has so far been met by an inventory rundown – in the end deltas matter in a recovery even though its pace seems to be plateauing in several major regions.

In other markets, 10-year US treasuries recorded their largest loss in 10 weeks with yields up +6.6 points to 0.66% with curve steepening, commodities were lower with gold down -5.0% (to USD1,927 per troy ounce) and oil -0.7% lower (to USD41.66 per barrel), and the G10 currencies were little changed against the US Dollar with the Euro steady, slight appreciations in AUD (+0.1% to USC71.49) and Sterling (+0.3%), but the Yen (-0.03%) slipped a touch.

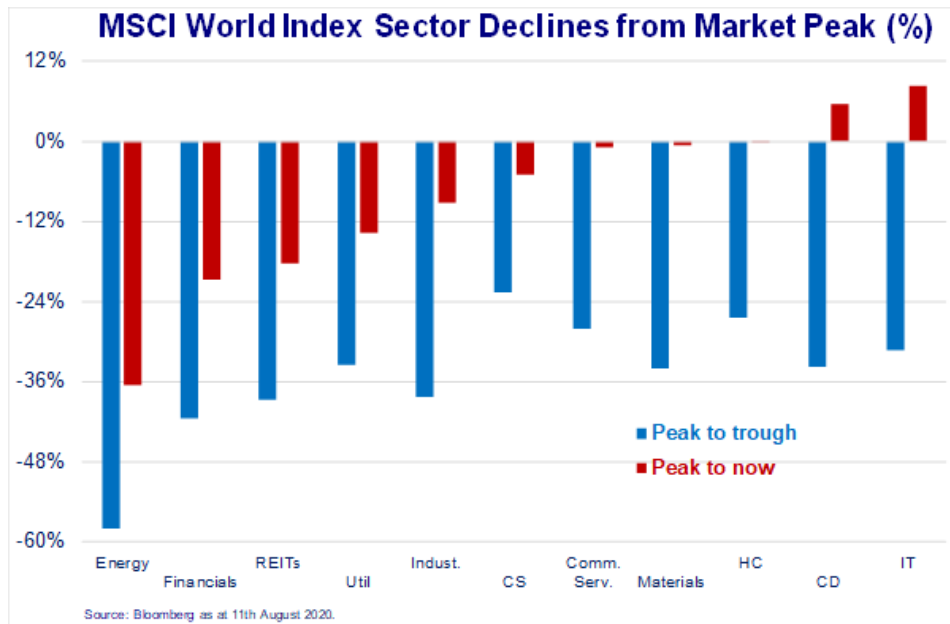
- The number of global cases of COVID-19 is 20.19 million with another +165k cases so far (but Brazil, Mexico, and 4 US states have not reported their numbers) which means that Tuesday is likely to be the 24th occasion in the past 24 days where daily increases have topped 200k. This means 4 countries have more than 800k cases, 19 countries have more than 200k cases and 25 countries have more than 100k cases (Kazakhstan joined this group overnight). It took 73 days to record 1 million cases, and after this each subsequent million has taken 13 days, 11 days, 12 days, 10 days, 11 days, 8 days, 8 days, 7 days, 6 days, 5 days, 5 days, 5 days, 4 days, 5 days, 3 days, 4 days, 4 days and 4 days. More importantly, the growth rate of daily confirmed cases (+1.2% since Saturday) is once again coming down. Meanwhile, deaths stand at 738.8k and the death rate dropped for the 97th straight day to 3.66% although the number of daily deaths remains elevated.

FINANCIAL MARKETS

• EQUITIES

- The MSCI World Index closed -0.1% lower as growth and momentum stocks and sectors lagged value and cyclicals for a third straight day. Once again FAAMG names were on the defensive given elevated valuations which underpinned the underperformance of tech (-1.4%) and communications services (-1.0%) and provided a broader market overhang despite their apparent resilience to the anticipated secular growth outlook. The selloff in 10-year Treasuries also propelled a decline in bond proxies including REITs (-0.5%) and utilities (-1.1%), but other defensive sectors such as healthcare (-0.1%) and consumer staples (-0.1%) at least beat the market tape. In contrast, cyclical sectors rallied strongly, with the steepening curve culminating in the best day for financials (+1.7%) in four weeks, with a strong rise in Chinese auto sales boosting industrials (+1.5%), and energy (+0.9%) rallied despite a modest drop in crude price. By the closing bell at the NYSE, the overnight movements meant there are now two sectors in bear market territory (energy and financials – see chart), two sectors in correction territory (REITs and utilities), two

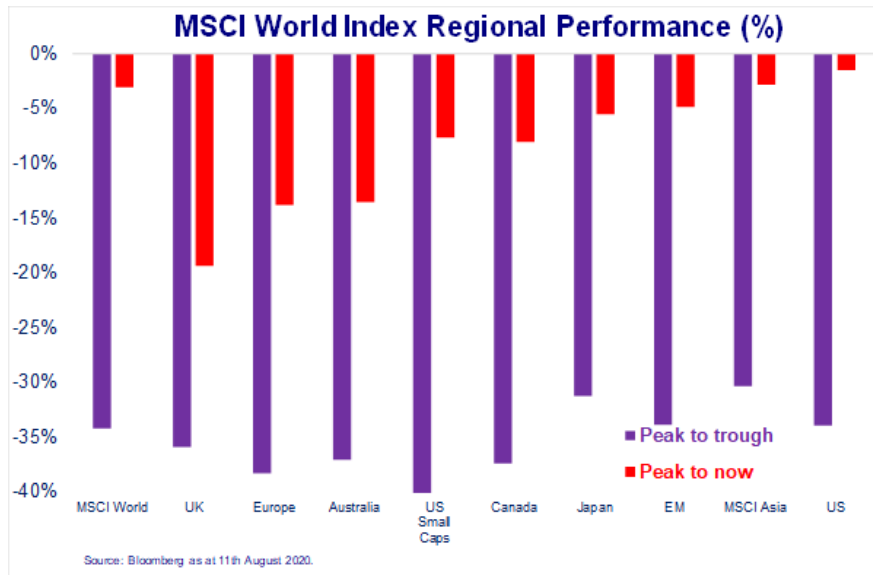
which have staged a complete recovery (tech and consumer discretionary) and five sectors with peak-to-now losses of between 0% and -10%.



- Among the regions, the US market (-0.8%) broke its 7-day win streak and closed lower this morning but there was not much to the decline as the cited reasons of the stimulus negotiation stalemate, and COVID-19 caseloads stalling the recovery, were largely recycled news. There wasn't much macro or corporate news available to provide investors with respite, or optimism about the recovery, which saw a continuation of recent performance trends, namely growth and momentum sectors lagging value and cyclicals for a third consecutive day, but bond proxies including utilities and REITS underperformed given the selloff in Treasuries. Meanwhile, tech and communications services also trailed as crowded positioning and elevated valuations finally caught up with the sector and by the closing bell all indices were lower led by the tech-rich NASDAQ 100 (-1.7%), S&P 500 (-0.8%), Russell 2000 (-0.6%) and the Dow Jones (-104 points, -0.4% to 27,687).
- In contrast, **European shares closed higher (+2.2%)** as positive China and German data outweighed rising COVID-19 case numbers. Italy and France were amongst the best performers of the session as auto stocks rallied after Chinese auto sales rose +16.4% m/m in July, which suggests the production side of the global economy is set to lift activity, with rising consumer spending so far being met by an inventory rundown. Meanwhile, the European Centre of Disease Prevention and Control recommended new virus restrictions amid a "true resurgence in cases" and Russian President Putin announced the first COVID-19 vaccine, though nearly everyone is sceptical over their testing approach. Elsewhere, BoE Deputy Governor Ramsden said the Bank will do more and faster QE if the economy slows and markets wobble again. Lastly, the German ZEW economic sentiment survey beat consensus which is indicative of rising expectations for a speedy recovery, but the assessment of the situation is that the growth improvement is proceeding slowly. By the time the bell was rang, the region has put on its second best day in the past six weeks with advances led by Spain (+3.0%), Italy (+2.8%), France (+2.4%), Sweden (+2.1%), Germany (+2.0%) and Switzerland (+0.6%).

Asia equities finished higher yesterday with the MSCI Asia Pacific Index up +1.0% in a quiet session which lack a material catalyst. The large rise in Japan who came back from a national holiday was a talking point with optimism about US stimulus cited as a support, although I suspect that was simply a case of retro-fitting an event to a market movement. That said COVID-19 headlines were supportive with lower hospitalisations rates in some US states, and Asia receiving some respite from its recent stretch of record infections. Meanwhile, geopolitical risks festered as China announced sanctions on US officials in retaliation for similar measures imposed by the US on Friday over the Hong Kong security legislation, but the move had no market impact. PBOC Governor Yi offered a conciliatory message on the Phase One trade deal but he did not address how China will catch-up with its lagging purchases of US farm goods. By the closing bell Hong Kong (+2.1%), Japan (+1.9%) and South Korea (+1.4%) posted sharp gains, Australia (+0.5%) rose moderately, while mainland China (-0.9%) and Taiwan declined (-0.9%).

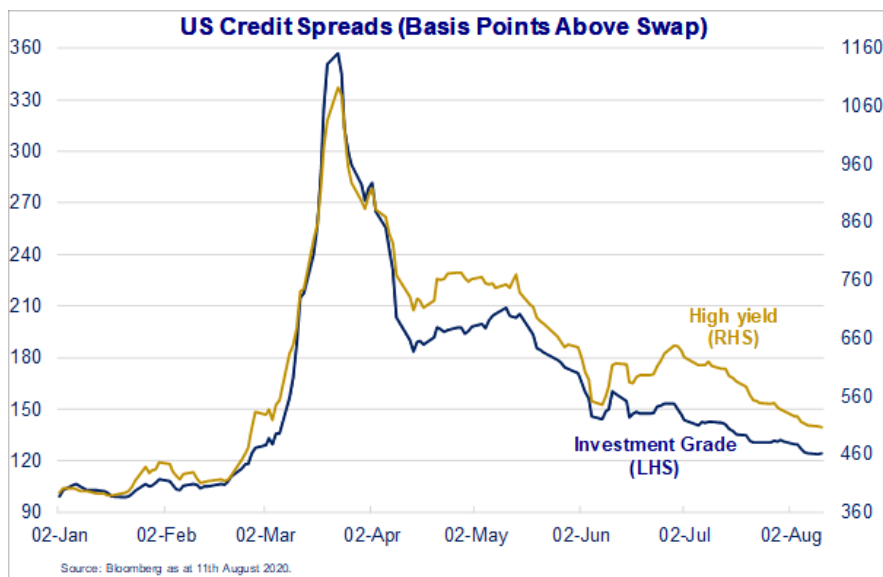
After yesterday's movements, the UK (-19.3% from its March quarter peak) has finally left bear market territory (see chart) and it is now back with Europe (-13.8%) and Australia (-13.5%) in correction territory, with the US (-1.5%) still within one day of staging a complete recovery.



- Futures markets are pointing to a modest opening in Asia with Australia (+0.1%) and Japan (-0.1%) and Hong Kong (+0.2%) all slated for minor moves.

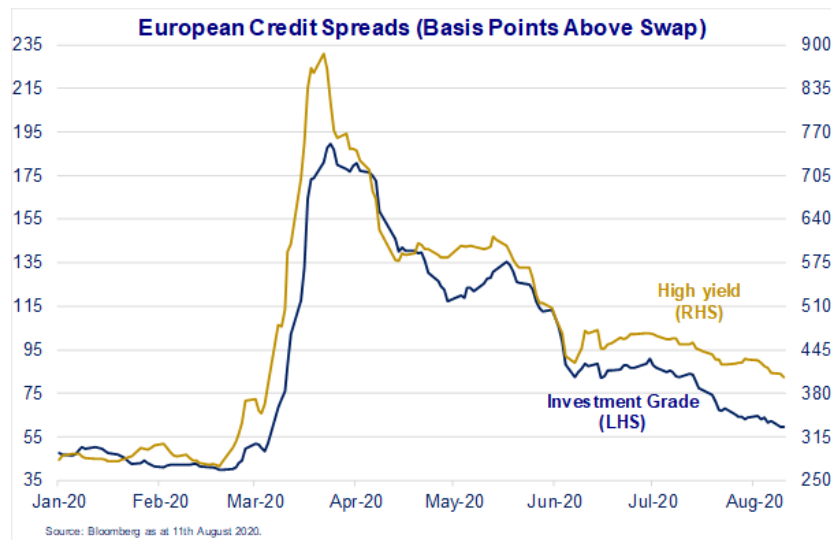
• CREDIT MARKETS

- Regional credit indices were little moved overnight as a combination of high recovery rates and highly leveraged balance sheets kept investors on the fence. The US investment grade universe broke its 7-day win streak overnight but moves were minimal and no cause for concern as spreads increased +0.3 of a point to +124 bpts, which kept the recovery rate at 92%. There were spread increases in 8 of the 11 sub-sectors, but only utilities (+1.4 points, +128 bpts, 90%) was more than one point higher. In the high yield space, the moves were also modest with spreads contracting -2 points to +507 bpts, which had the recovery rate unchanged at 86%. Nine of the 11 sub-sectors saw lower risk premiums relative to Monday with consumer discretionary (-7 points, +504 bpts, 75%) performing strongly although it was hard to pinpoint the reason for its outperformance, as was the case with energy (-4 points, +756 bpts, 100%) which rallied despite a lower crude price.



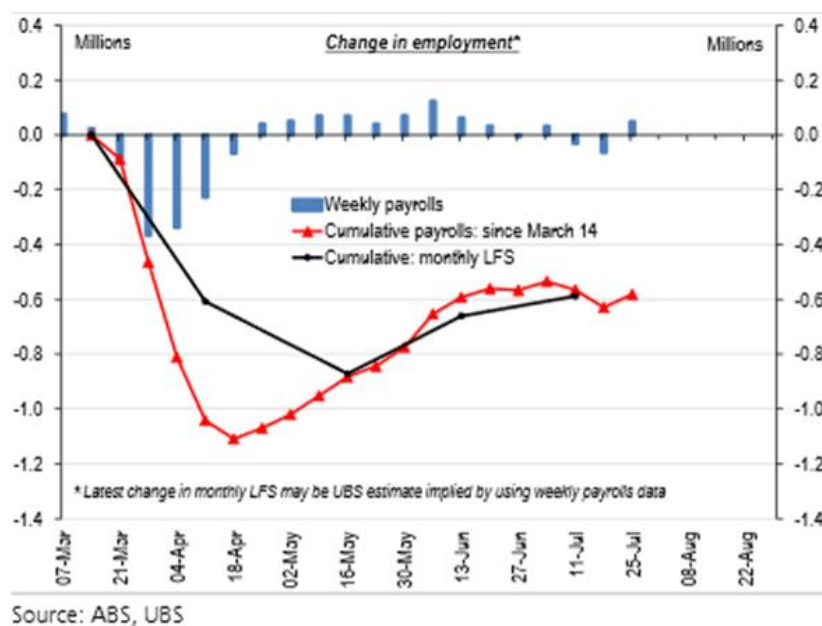
- **European credit markets** were also subdued with spreads in the investment grade space unchanged at +60 bpts, which saw the recovery rate stay at 87%. Seven of the 11 sub-sectors recorded higher spreads but

most moves were less than one basis points, but these were offset by a minor improvement in subordinated financials (-4 points, +146 bpts, 82%) and senior financials (-1 point, +69 bpts, 82%). In the high yield space, price action was also modest with spreads declining -5 points to +404 bpts, which had the recovery rate steady at 78%. Spreads declined in ten of the 11 subsectors, with consumer staples (-10 points, +485 bpts, 96%) continuing its positive price action and to near a complete recovery, with tech (-7 points, +350 bpts, 63%) also outperforming the market tape and materials (-6 points, +361 bpts, 78%) also rallied despite a decline in commodity prices.



THE GLOBAL ECONOMY

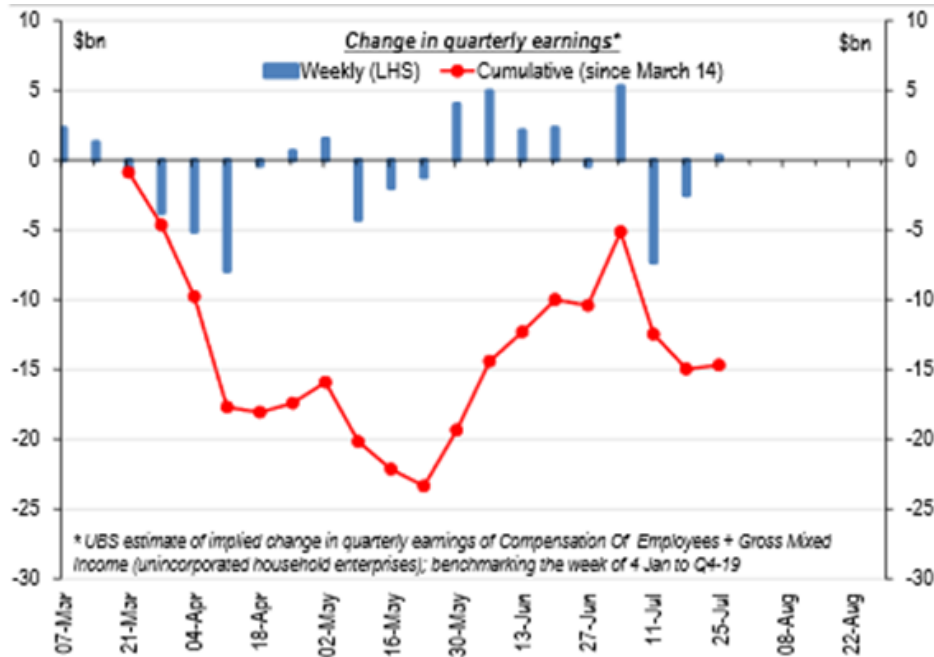
- The bi-weekly ABS Australian payrolls data indicated that the jobs recovery which had been evident since mid-April has now completely flattened out. That is, between February and the 18th April, total jobs declined -8.5%, and from the latter date total payrolls rose just under +5.0% to mid-June, but since then the total payrolls has declined -0.1% which points to a stalling in the labour market recovery. That said, there continues to be large upward revisions to history with the prior -1.2% decline in the fortnight to July 11th revised to be being flat. Interestingly, yesterday's data provides the first measure of the impact of Level 3 restrictions in Melbourne on July 8th with total payrolls down -1.2% in the two weeks to July 25th and down -1.9% since June 20th (just after the last monthly Australian Labour Force survey).



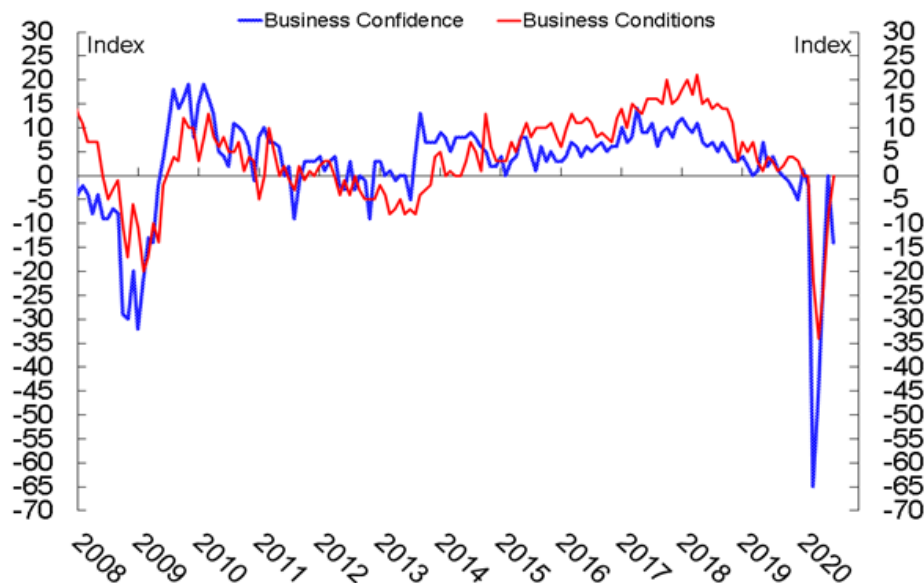
In contrast, the remainder of Australia was up +0.2% and +0.5%, respectively. The current levels in the payrolls report suggest that the July Labour Force Survey will detail gains of around +80k jobs but given the

reintroduction of the 'mutual obligation' which should raise participation and push unemployment towards 8%. More importantly, as the sample period is for June 28th to July 11th the August report is likely to record further dislocation centred around Victorian stage 4 lockdowns.

Another concern from the payrolls data in that wage growth is now really starting to decline with a -3.2% moderation since July 4th. This brings the total wage decline since the March peak to -5%, implying that average wages (when adjusted for labour force size) is about zero and this is likely to weigh on retail sales and also real spending volumes which will limit any GDP recovery.



- The latest NAB business survey was undertaken on July 22-31st which captures the impact of Stage 3 lockdowns, but was before Stage 4, and it demonstrated that business conditions has now completely recovered the COVID-19 losses and are back to levels at the start of 2020. Interestingly, business confidence had achieved this feat a month earlier, but has since deteriorated in July (-14.4 to -13.9). Importantly, the employment intentions measure (+7.3 to -4.6) were less negative than in June which implies some jobs growth ahead, but the large excess capacity still evident in the utilisation measure (76.9%) points to extended higher unemployment and likely falls in business investment. In addition, selling prices turned negative again suggesting a very weak September inflation report, and some further headwinds for earnings growth.



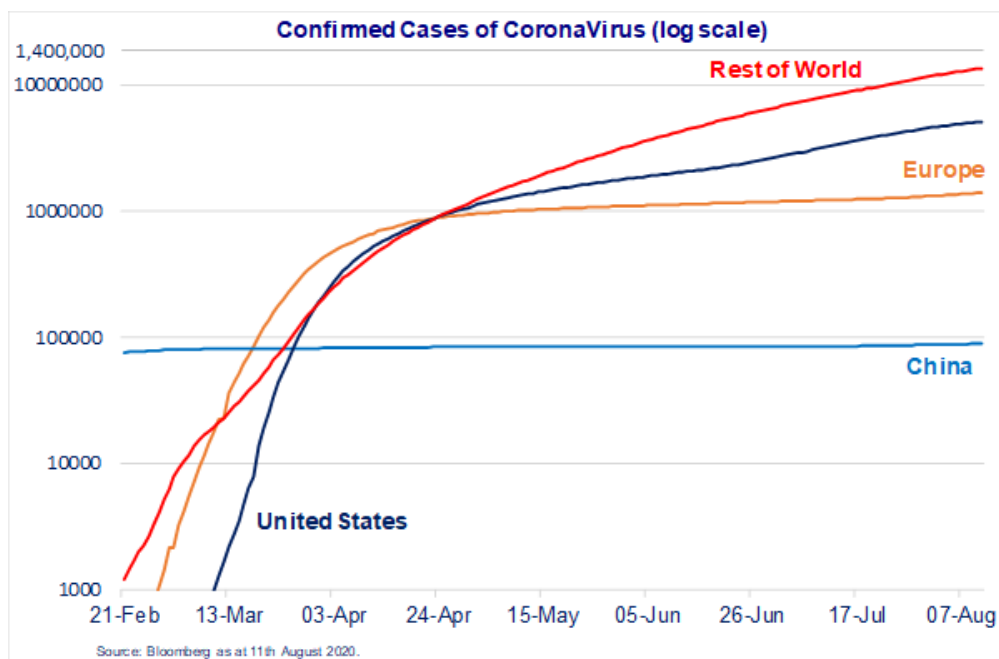
POLICY

- Senate Majority Leader McConnell said that the negotiations around the fifth coronavirus stimulus bill are at a stalemate with reports that there are no additional talks scheduled between the White House and House Democrats. This would be a worry as the markets still expects a USD1.5 trillion deal to avoid the December quarter fiscal cliff. Meanwhile, President Trump talked about more tax relief through alternations to capital gains tax through inflation adjustments, but reports flagged logistical challenges of recent executive actions.
- Democrat Presidential candidate Joe Biden has made his Vice President pick in the form of Senator Kamala Harris betting that her criminal justice background and ties to the African American community will help propel him to the White House. Harris, who is 55, ran a modest campaign against Biden to win the Democrat nomination but dropped out in December. That said, the latest national poll has Biden ten points ahead of Trump while swing states tightening.

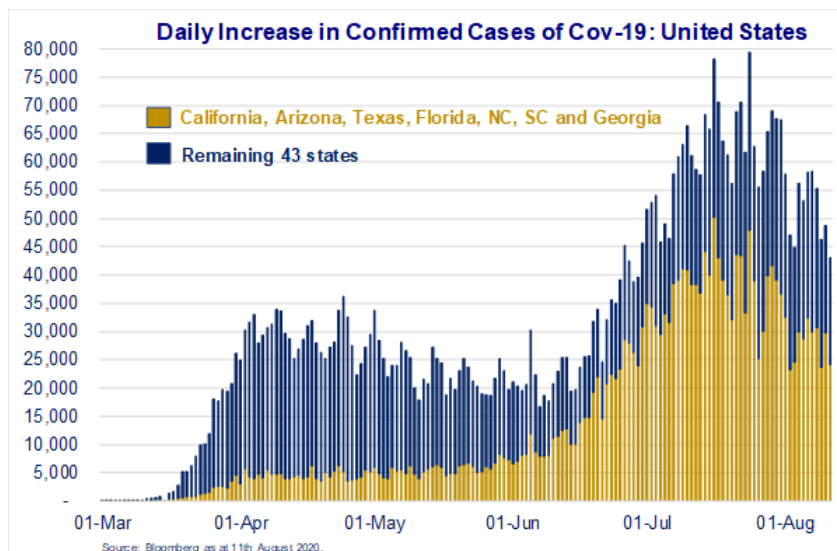
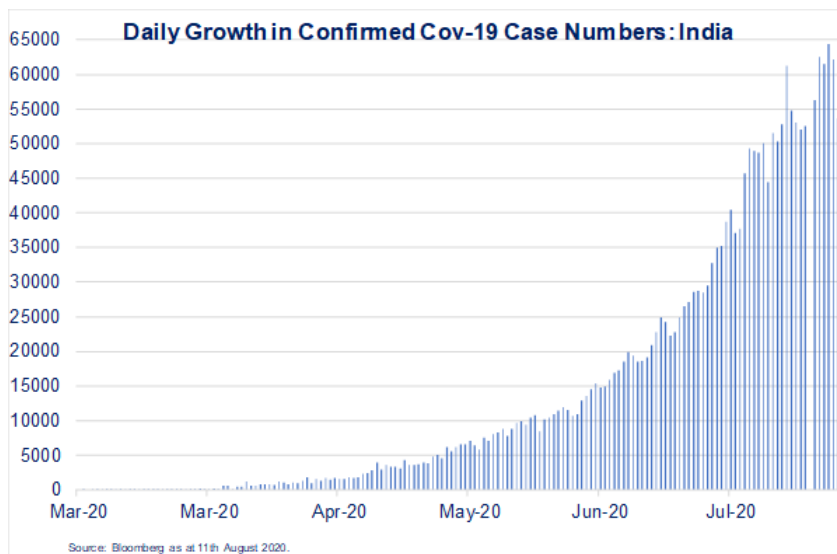
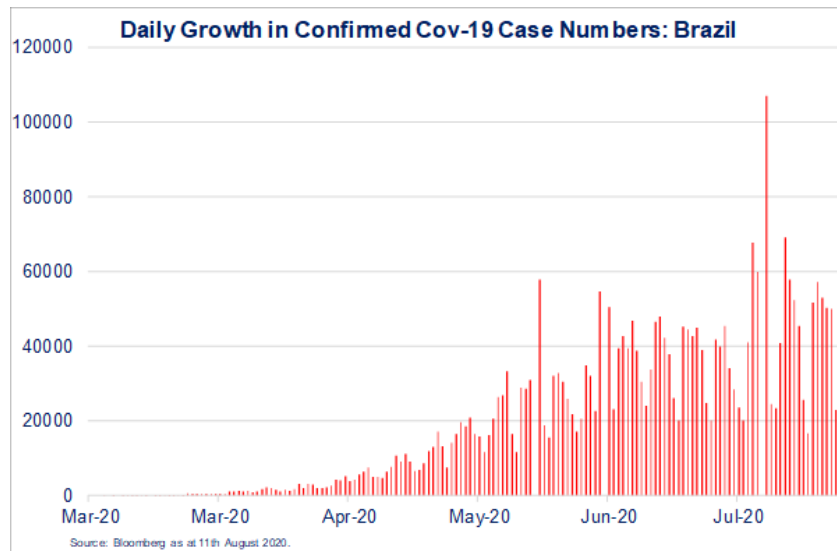
VIRUS UPDATE

- The number of global cases of COVID-19 is 20.19 million with another +165k cases so far (but Brazil, Mexico, and 4 US states have not reported their numbers) which means that Tuesday is likely to be the 24th occasion in the past 24 days where daily increases have topped 200k. This means 4 countries have more than 800k cases, 19 countries have more than 200k cases and 25 countries have more than 100k cases (Kazakhstan joined this group overnight).

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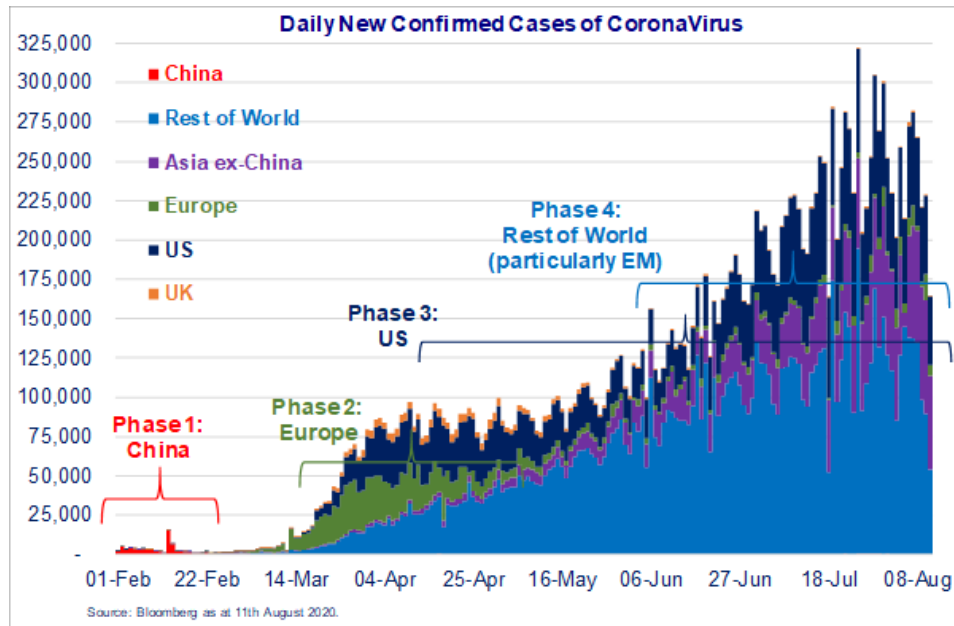


- We break the infections into four groups – the US, Europe, China and ‘others’ and the rest of the world outside the G3 economies now has the most total cases (+113k to 16.5 million) and highest daily new cases (and by a considerable margin) followed by the US (+43.7k to 5.14 million, although 4 states are yet to report). The issue for the US is that they never flattened their curve which means economic opening has not been associated with lower case numbers, and rising case numbers are also evident in Europe (+7.0k to 1.41 million - see chart).

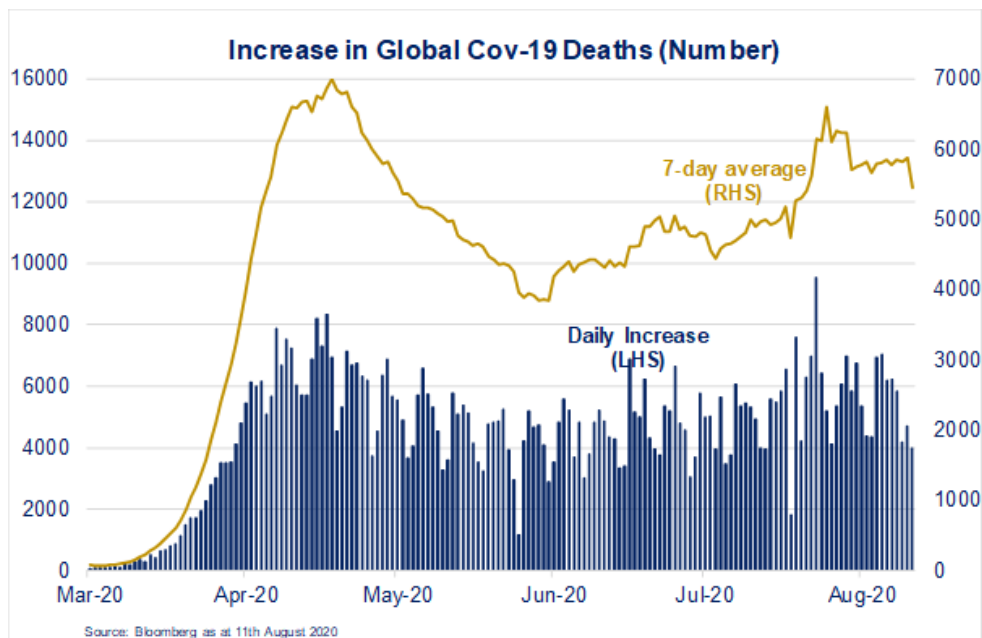


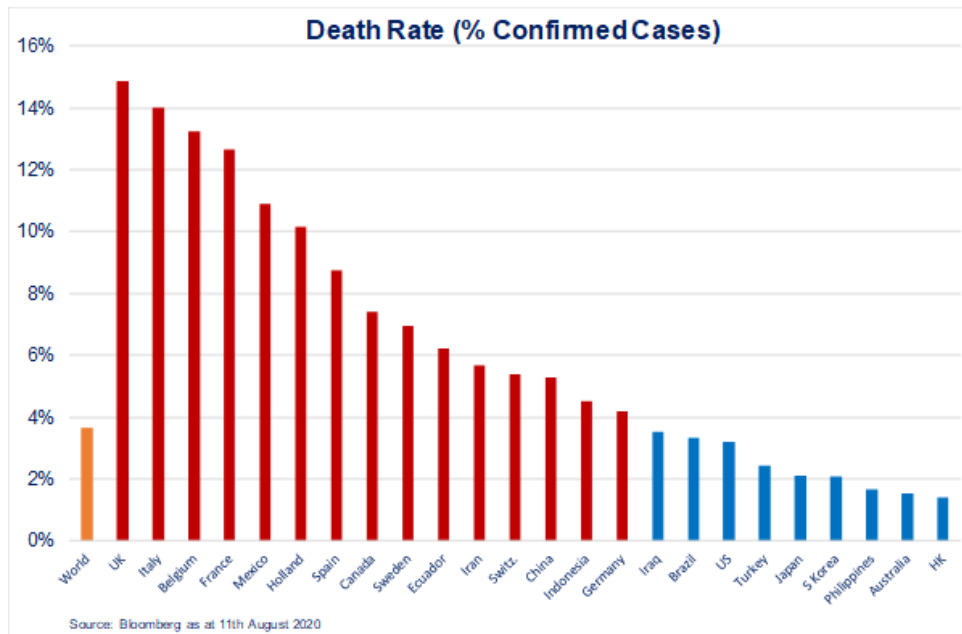
- Among countries, the most cases are in the US (+43.7k (so far) to 5.14 million, with 4 states yet to report), Brazil (not reported to 3.06 million), India (+53.6k to 2.27k), Russia (+4.9k to 896.0k), South Africa (+2.5k to 566.1k), Mexico (not reported, +485.8k), Peru (+5.1k to 483.1k), Chile (+1.6k, 376.6k), Iran (+2.3k to 331.2k), Spain (+3.6k to 326.6k), United Kingdom (+2 to 313.4k), Saudi Arabia (+1.5k to 291.5k), Pakistan (+0.5k to +285.2k), Bangladesh (+2.9k to 263.5k), Italy (+0.4k to 251.2k), Turkey (+1.2k to 243.2k), France (+6 to 239.3k), and Germany (+1.0k to 219.5k). Australia confirmed cases rose +316 to 21.7k yesterday which placed us 65th in terms of total infections.

Elsewhere, Singapore recorded +0.1k new cases to 55.4k most of which are linked to foreign workers who are forced to live in crowded dormitories, but Indonesia (+1.7k to 128.8k) is now on the rise and has the second most cases in the region behind only the Philippines (+2.9k to 139.5k).



- Although final numbers are not in until 1pm AEST, the global death rate declined for a 97th straight day to 3.66% with the global total to 738.8k after another 4.0k deaths overnight, so far, which indicates the daily average deaths is increasing again (see chart). The US (+1.2k so far) has the most deaths at +164.7k, with Brazil (not reported, 101.8k), Mexico (not reported, +53.0k), the UK (+0 to 46.7k), India (+0.8k to 45.3k), Italy (+6 to 35.2k) and France (+0 to 30.3k) all over +30k. The death rate is highest in European countries where the health systems had collapsed led by the UK (steady at 14.9%), Italy (steady at 14.0%), Belgium (-0.1% to 13.2%), France (steady at 12.7%), the Netherlands (-0.2% to 10.1%), Spain (-0.1% to 8.8%) and Sweden (steady at 6.9%). However, several emerging markets are now on the leader board including Mexico (steady at 10.9%), Ecuador (-0.1% to 6.2%), Indonesia (steady at 4.5%) and Brazil (steady at 3.3%).





Yours sincerely,



MATT SHERWOOD
Head of Investment
Strategy, Multi Asset



MICHAEL O'DEA
Head of Multi Asset

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Perpetual Investments 1800 062 725

Email investments@perpetual.com.au

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