

THOUGHTS ON THE MARKET

12th June 2020 - The global risk market rally comes to an abrupt halt

SUMMARY

- Global risk markets tumbled overnight as their 12 weeks surge came to an abrupt halt amid rising economic concerns and COVID-19 case numbers. No space was spared with the only thing stopping larger losses being the closing bell at 4pm New York time by which time, the S&P 500 had dropped -5.9% (12-week low) with only one stock recording a rise in the index. Overall, stocks and sectors which had outperformed in the past six weeks bore the brunt of the selling pressure with value/cyclical hardest hit which culminated in material stocks and US shares re-entering 'correction' territory, and the UK sharemarket and REITs officially back in bear market territory, with many of their peers knocking on the door to join them.

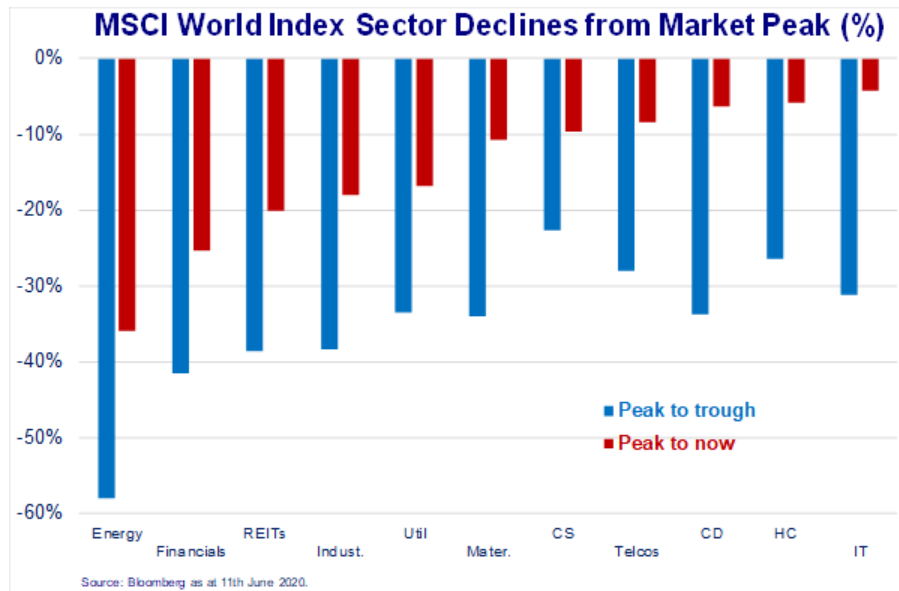
In other markets, 10-year treasuries rallied -6 points to 0.67% with the curve slope flattening back to 0.51% (7-week low). Elsewhere, gold rallied +0.6% to USD1,730 per troy ounce, oil plunged -6.7% to USD36.25 per barrel and G-10 currencies ceased their rise the US dollar with declines in the Euro (-0.7%), Sterling (-1.5%) and AUD (-2.5% to 0.6823), but the Yen (+0.6%) bucked the trend.

- While much of the sell-down owed to the frantic pace of the recent rally, the US Fed reminded investors yesterday of the long and winding road ahead as economies attempt to rebuild themselves from record growth and employment plunges. The economic calendar was light overnight but US weekly jobless claims remained high (+1.52 million) underscoring the longer-term challenges ahead caused by the pandemic with over 2 million US citizens infected so far. If cases continue to rise, state re-openings may have to at least pause, thereby throwing more doubt on the labour market and activity recovery, which could create much larger longer-term issues which can't be solved through central bank liquidity.
- Although final numbers are not in for another 6.5 hours, the number of global cases of COVID-19 stands at 7.45 million with another +81.8k cases so far overnight (before Mexico, Peru and many US states report their numbers) which means that Sunday was the 73rd occasion in the past 74 days where daily increases have topped 70k). This means 3 countries have more than 500k cases, 8 countries have more than 200k cases, 16 countries have more than 100k cases, and 59 over 10k. It took 73 days to record 1 million cases, 13 days for the next million, 11 days for the third million, 12 days for the fourth million, 10 for the fifth million, 11 for the six million and 8 days for the seventh million, and in the past four days another 449.5k cases have been confirmed. More importantly, the growth rate of daily confirmed cases (+1.5% since Friday) has ceased declining having been around this figure for the past 20 days. Meanwhile, deaths stand at 418.8k and the death rate dropped for a thirty sixth straight day to 5.63%.

FINANCIAL MARKETS

• EQUITIES

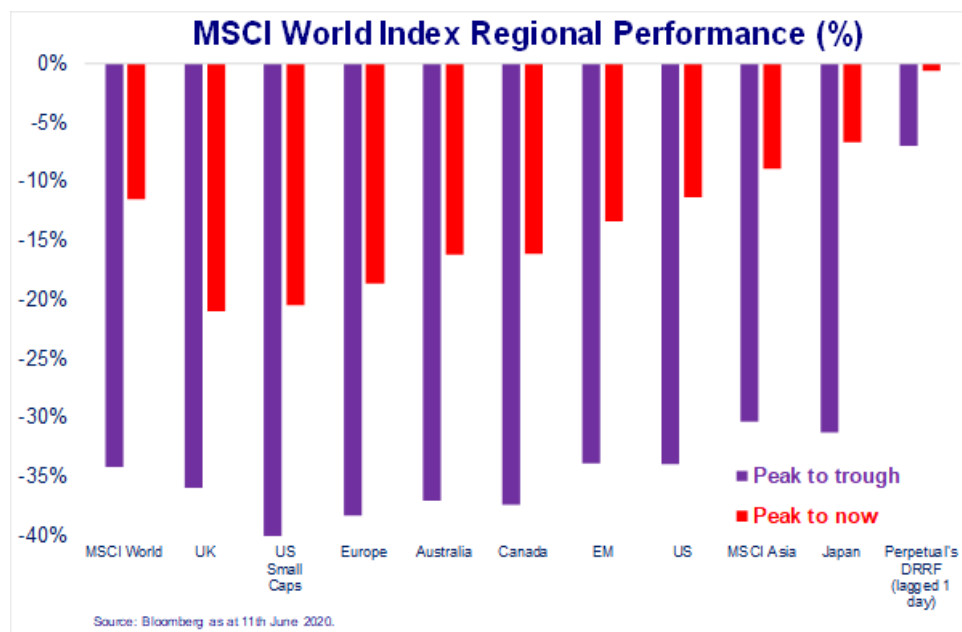
- The MSCI World Index closed -5.0% lower (12-week low) with large losses across the board. Much of the sell down owed to the frantic pace of the rally in May and early June which culminated in larger losses overnight in traditional cyclical/value sectors which had performed very strongly in the past six weeks. The overnight declines were led by energy (-7.7%) which was a part of a broad-based rout in oil, and financials (-6.5%) weren't far behind as yield curves flattened. Meanwhile, industrials (-5.4%), tech (-5.3%), REITs (-5.1%) and consumer discretionary (-4.6%) were all heavily scarred as investors lightened risk and sought the protection of safe havens. The overnight declines saw materials (-10.2%) re-enter correction territory and REITs was again below the -20% bear market line (see chart), with industrials (18.0%) and utilities (-16.9%) not far away.



- Among the regions, losses were led by Wall Street who had recorded among the largest price bounces since the late-March trough. The Dow Jones led the market lower dropping -1862 points (-6.9%) to 25,128, the S&P 500 (-5.9%) did only slightly better and was not far away from the first circuit breaker level with only 1 stock in the index closing higher (Kroger Co.) and tech was not spared with the NASDAQ 100 (-5.3%) also off sharply.

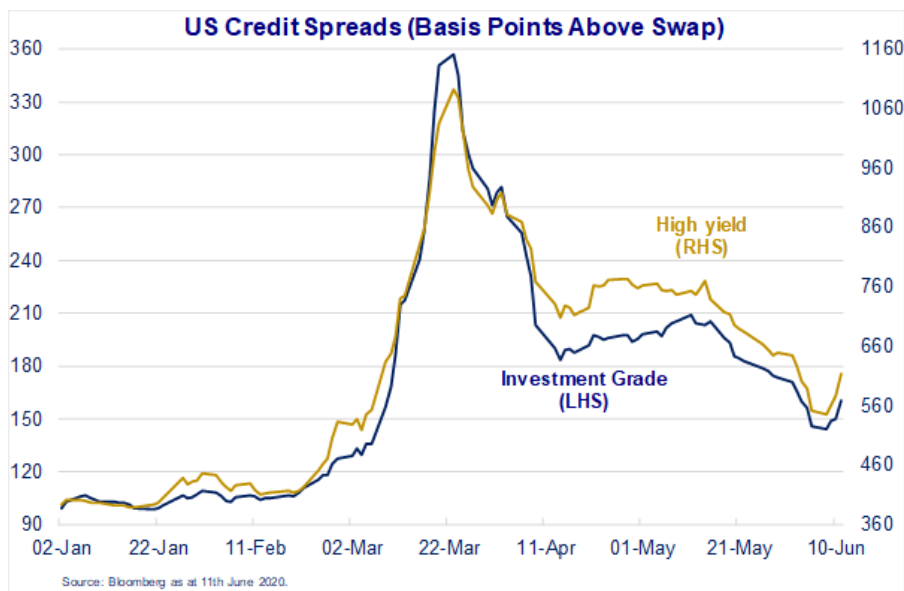
Earlier, European markets dropped -4.5% with larger declines in markets which had outperformed recently including Spain (-5.0%), Sweden (-4.9%), Italy (-4.8%) France (-4.7%) and Germany (-4.5%). However, the UK (-4.0%) did slightly better with its constituents better protected given the larger depreciation in Sterling, and periphery markets such as Greece (-2.7%) and Portugal (-2.0%) were at the top of a sad and sorry leader board. Meanwhile, the MSCI Asia Pacific index closed -2.1% yesterday with Australia (-3.1%), Hong Kong (-2.8%) and Japan (-2.8%) leading with way down, but China (-1.1%) and Korea (-0.9%) provided some ballast to the region.

The movements overnight saw the US re-enter correction territory and the UK is back in bear market territory (see chart), but several markets may join them in coming days as futures markets are signalling a weak opening this morning in Asia with losses slated in Japan (-3.1%), Australia (-3.0%), Hong Kong (-2.4%) and China (-1.3%).

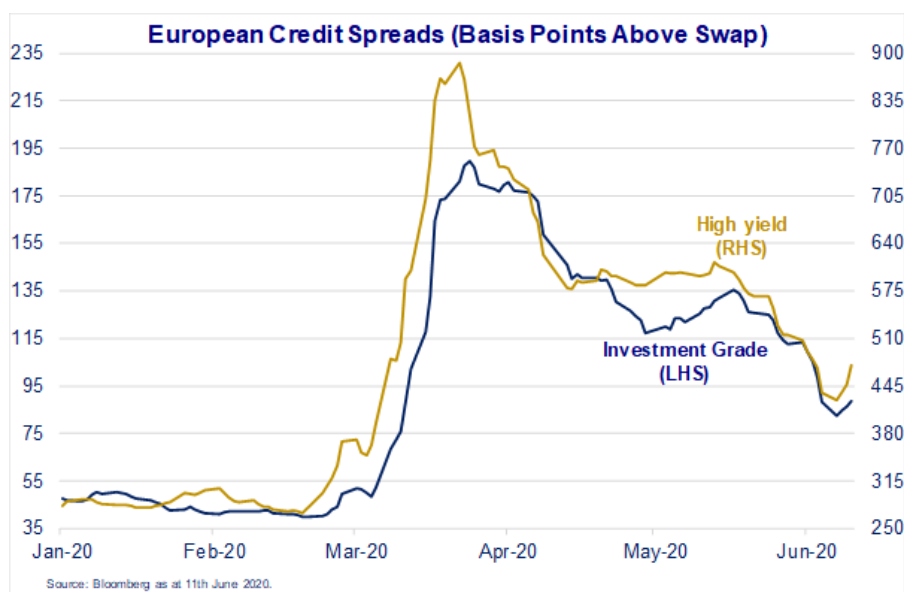


• CREDIT MARKETS

- Regional credit indices dropped overnight but the sell-off was not nearly as abrupt as was seen in early March. Spreads in the **US investment grade space** widened +10 points (10-week high) to +160 bpts which lowered the recovery rate to 77%. Risk premiums in all sub-sectors rose and 7 recorded double-digit increases and this was led by areas which had outperformed in recent weeks including energy (+16 points, +215 bpts, 85%), telcos (+13 points, +183 bpts, 78%), subordinated financials (+12 points, +195 bpts, 77%) and consumer discretionary (+12 points, +192 bpts, 78%). In the **US high yield space**, spreads increased +37 points to +613 bpts (see chart) which lowered the recovery rate 6 notches to 70%. Among the sub-sectors, energy (+52 points, +950 bpts, 89%) suffered given the overnight drop in crude prices, with healthcare (+46 points, +552 bpts, 68%) and industrials (+43 points, +718 bpts, 45%) not far behind.

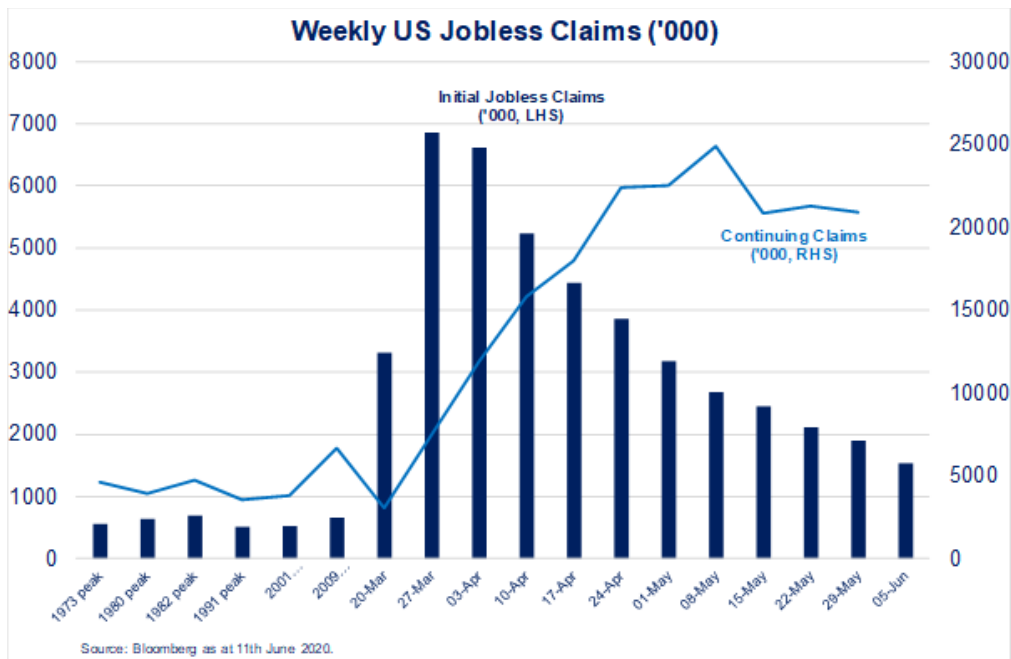


- European** credit markets fared better than their US counterpart as they had rallied less in the past three months, but they traded lower nonetheless. That said the contours of the selloff were similar in terms of sector performance. Spreads in the **investment grade** universe rose only +2 points to +89 bpts, which lowered the recovery rate one notch to 67%. Nine of the 11 sub-sectors recorded higher risk premiums led by subordinated financials (+11 points, +186 bpts, 65%), consumer discretionary (+8 points, +117 bpts, 70%) and energy (+4 points, +75 bpts, 66%). In the high yield universe, spreads widened +26 points to +473 bpts (see chart), which lowered the recovery rate 4 notches to 67%. There were double-digit increases in 10 of the 11 sub-sectors, led by consumer discretionary (+40 points, +585 bpts, 68%), energy (+36 bpts, +584 bps, 68%), telcos (+28 points, +370 bpts, 66%).

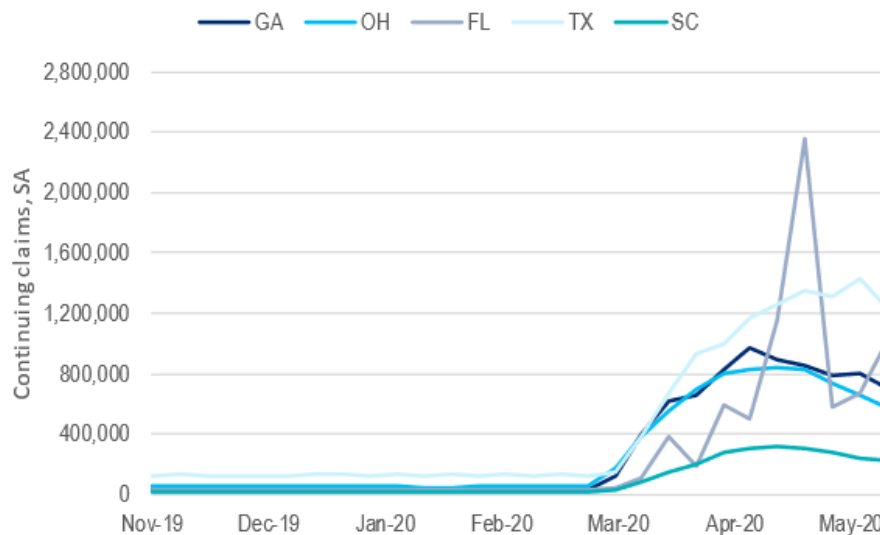


THE GLOBAL ECONOMY

- **US initial jobless claims** fell -355k to 1.54 million in the week ending June 6th, which is still two and a half times higher than the peak recorded in the GFC, but on a brighter note, continuing claims (the number of persons receiving benefits through standard programs) fell -339k to 20.9 million (see chart). The improvement in both measures was broad-based with lower initial claims and continuing claims in 35 and 36 states, respectively, but the former down nearly 80% from the peak in late March.



That said, with more states reopening and rehiring having already begun, the declines in continuing claims are a more useful indicator for the state of the labour market and US unemployment. These claims have fallen by -4 million from the peak three weeks ago (-16%) and this implies re-employment flows of +2.5 million over the past week, which is slightly below the six-week average of +2.7 million. However, the improvement is patchy with continuing claims increasing in Florida (+306k), Oregon (+201k) and California (+102k) but declining in Texas (-160k) and Pennsylvania (-167k). That confirms to me that businesses remain cautious and the labour market recovery will continue to slow especially as risks are rising of a second wave of COVID-19.

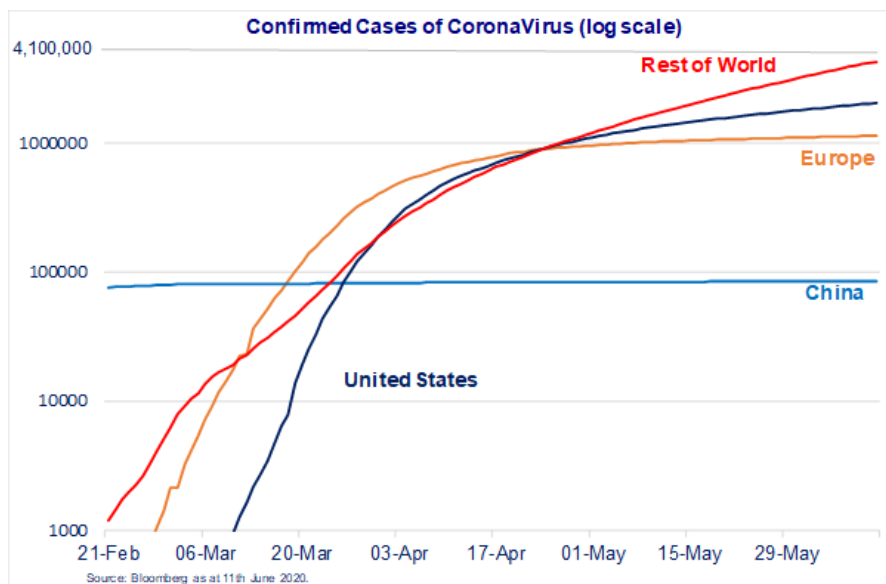


POLICY

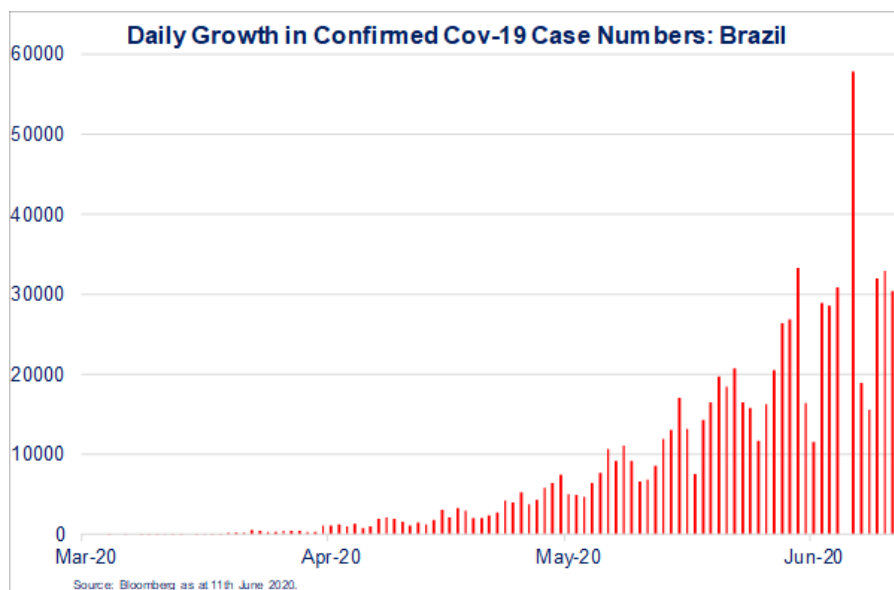
- There were no major policy announcements overnight.

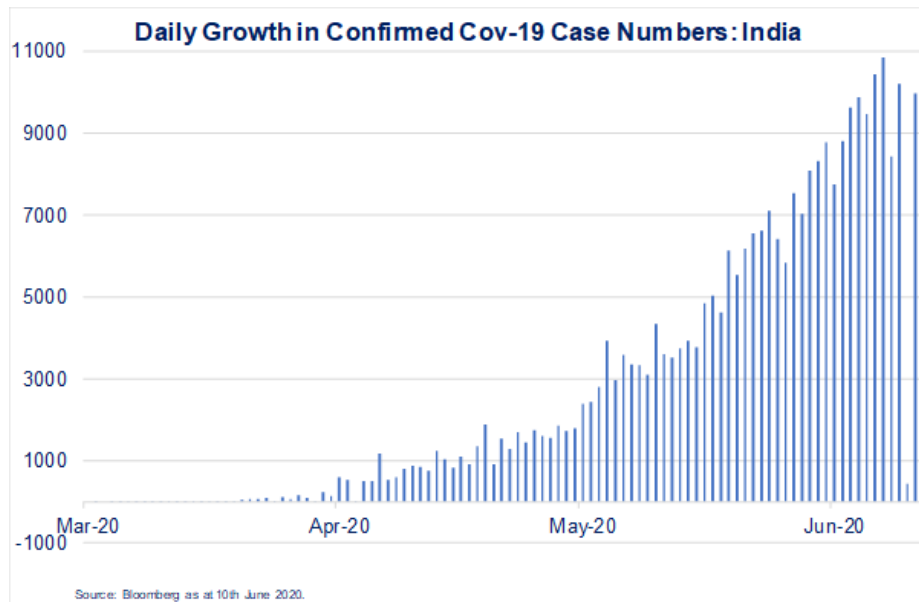
VIRUS UPDATE

- Although final numbers are not in for another 6.5 hours, the number of global cases of COVID-19 stands at 7.45 million with another +81.8k cases so far overnight (before Mexico, Peru and many US states report their numbers) which means that Sunday was the 73rd occasion in the past 74 days where daily increases have topped 70k). This means 3 countries have more than 500k cases, 8 countries have more than 200k cases, 16 countries have more than 100k cases, and 59 over 10k. It took 73 days to record 1 million cases, 13 days for the next million, 11 days for the third million, 12 days for the fourth million, ten for the fifth million, 11 for the sixth million and 8 days for the seventh million, and in the past four days another 449.5k cases have been confirmed. More importantly, the growth rate of daily confirmed cases (+1.5% since Friday) has ceased declining having been around this figure for the past 20 days. Meanwhile, deaths stand at 418.8k, with the US now over 110k (27.2% of global deaths even though they have only 4% of the global population), the UK, Italy and Brazil over 30k, with Spain and France over 25k, and the death rate dropped for a thirty sixth straight day to 5.63%.



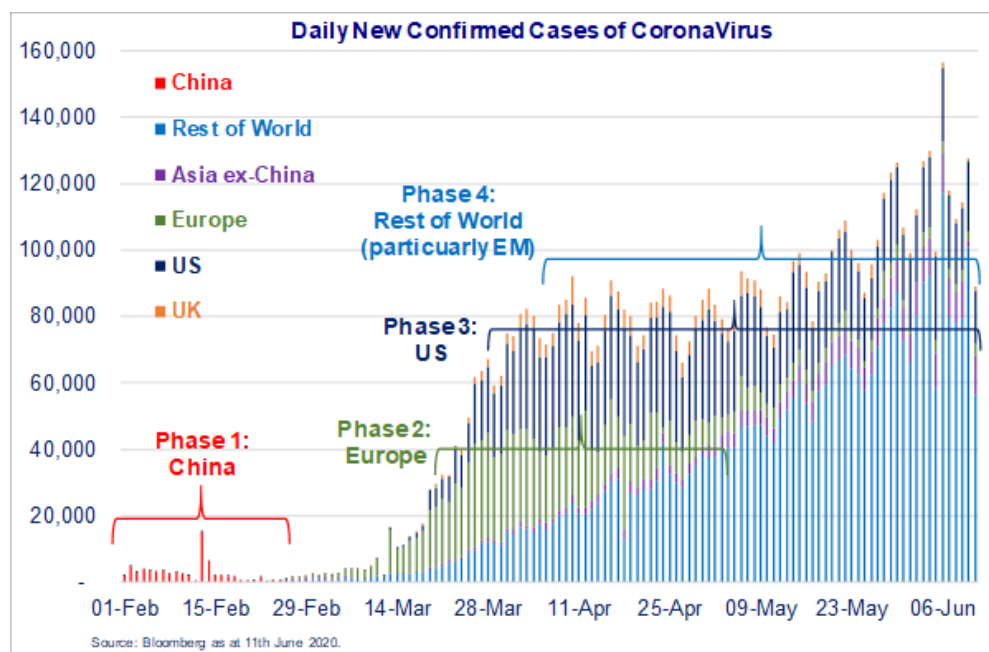
- We break the infections into four groups – the US, Europe, China and ‘others’ and the rest of the world outside the G3 economies now has the most total cases (+50.7k to 4.21 million) and highest daily new cases (and by a considerable margin) followed by the US (+114.8k to 2.01 million) and Europe (+3.6k (6 day high) to 1.13 million), with the latter’s daily increases, in terms of percentages, grinding lower which shows that social isolation works to reduce the spread of the virus, even though it comes at an enormous economic cost. In the rest of the world, the three concerns here are Brazil (+30.4k to +802.8k, which is the second highest in the world), Russia (+8.8k to 501.8k, third highest) and India (+10.0k to 286.6k, fifth highest). Yesterday, there was record case growth in Saudi Arabia (+3.7k to 116.0k), the second highest in Pakistan (+5.8k to 119.5k) and third highest in Chile (+5.6k to 154.1k).



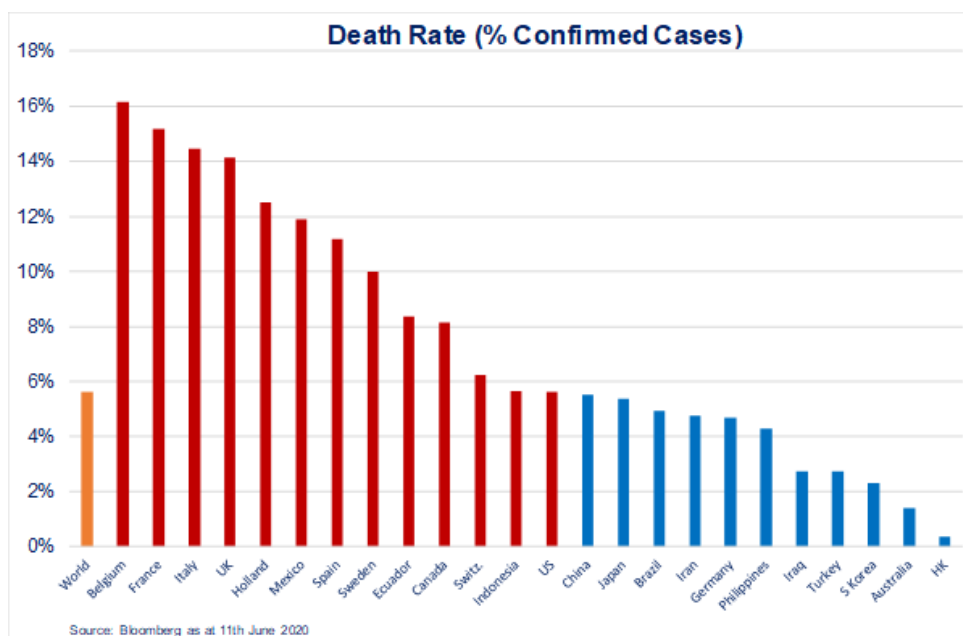


- Among countries, the most cases are in the US (+16.1k (so far) to 2.02 million), Brazil (+30.4k to 802.8k), Russia (+8.8k to 501.8k), the United Kingdom (+1.3k (19-day low) to 292.9k), India (+10.0k to 286.6k), Spain (+0.4k to 242.7k), Italy (+0.3k to 236.1k), Peru (+5.9k (second highest) to 214.8k), France (+0.4k to 192.5k), Germany (+0.2k to 186.7k), Iran (+2.2k to 180.2k), Turkey (+1.0k to 174.0k) and Chile (+5.6k to 154.1k). In Australia confirmed cases was steady at 7,285 yesterday which placed us 68th in terms of total infections.

Elsewhere, Singapore recorded +0.4k new cases to 39.4k most of which are linked to foreign workers who are forced to live in crowded dormitories, with the countries having the largest case numbers in South East Asia after overtaking Indonesia (+1.0k to 35.3k) and the Philippines (+0.4k to 24.2k). Note final numbers for yesterday at not in yet so these numbers can rise.



- Although final numbers are not in until 12 noon AEST, the global death rate declined for a thirty sixth straight day to 5.63% with the global total to 418.85k. The US (+0.7k) has the most deaths at +113.7k, with the UK (+0.2k to 41.4k), Brazil (not reported, 39.7k), Italy (+0.1k to 34.2k), Spain (steady at 27.1k) and France (+0.03k to 29.3k) all over +25k. The death rate is highest in European countries where the health systems have collapsed led by Belgium (-0.1% to 16.1%), France (steady at 15.2%), Italy (+0.1% to 14.5%), the UK (steady at 14.1%), the Netherlands (steady at 12.5%), Spain (-0.1% to 11.2%) and Sweden (-0.2% to 10.0%). However, several emerging markets are now on the leader board including Mexico (+0.2% to 11.9%), Ecuador (steady at 8.4%), Indonesia (steady at 5.7%) and Brazil (-0.2% to +4.9%).



Yours sincerely,



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