Perpetual Investments

THOUGHTS ON THE MARKET

14th August 2020 - Is good news now bad news?

SUMMARY

- Last night I was thinking how strange the world is, given that the GWS Giants were playing the Sydney Swans over in Perth, and Melbourne was playing in the NRL in Sydney. Go figure.

- Global risk markets were slightly lower overnight in a day which lacked fresh directional drivers. The US market pulled back from the cusp of fresh record highs as the political gridlock in Washington DC showed no sign of ending before September. This prompted investors to focus on what will outperform if the recovery begins to flatten out behind reduced government payments. Accordingly, tech rallied overnight, and traditional cyclical sectors underperformed even though initial jobless claims fell below 1 million for the first time since early March.

  Consequently, overnight moves may be a case of "good economic news is bad market news" as it casts more doubt about the need for aggressive stimulus, from a politician's point of view, as the economy and labour market are already improving. The issue here is that the stimulus is improving the economy, rather than a strong economy not needing as much income support. If this mindset continues, the US runs the risk of repeating one of the key mistakes of the last cycle when fiscal support was pulled away too early and the recovery stalled and slowed the labour market recovery.

  In other markets, US bonds recorded capital losses for a fifth consecutive session as the US Treasury sold a record amount of 30-year bonds, with 10-year yields ending +5 points higher at 0.72% with curve steepening. Elsewhere, commodities were mixed with gold (+1.1% to USD1954 per troy ounce) resuming its climb whereas oil (-1.0% to 42.24) came off its recent highs, and G10 currencies were marginally higher against the Greenback with advances in the Euro (+0.3%), Sterling (+0.1%), AUD (+0.1% to USC71.49), but the Yen (-0.1%) bucked the trend and closed slightly lower.

- Economic data was modest in volume but this week's jobless claims continued its downtrend and continuing claims suggest that the US economy has coped well so far with renewed mobility restrictions in several key states. Meanwhile, the Australian labour market recording a modest rise in unemployment, but the report was somewhat academic in that it preceded Victoria's stage 4 lockdowns which should push the jobless rate towards 10% in coming months.

FINANCIAL MARKETS

- **EQUITIES**
  - **The MSCI World Index declined for the third time in the past five session,** but the decline was minor (only -0.1%). Traditional value and cyclical stocks were the primary laggards overnight with energy (-2.0%) leading the pace of decline as the oil price came off its recent high, and investors worried about the impact of US political gridlock. Financials (-0.8%) fell despite the steeper yield curve as investors sought to reduce their cyclical exposures, and bond proxies also declined with utilities (-0.5%) and REITs (-0.9%) both lagging the market tape, as did non-tech defensive sector such as healthcare (-0.1%) and consumer staples (-0.1%). In contrast, communication services (+0.4%) and tech (+0.4%) both rallied, with the latter supported by Apple (+1.8%) who is readying a series of bundles that will see lower prices for people who use several of the company's products. The overnight movements saw REITs approach bear market territory again, but materials were the fifth sector to stage a complete recovery (see chart).

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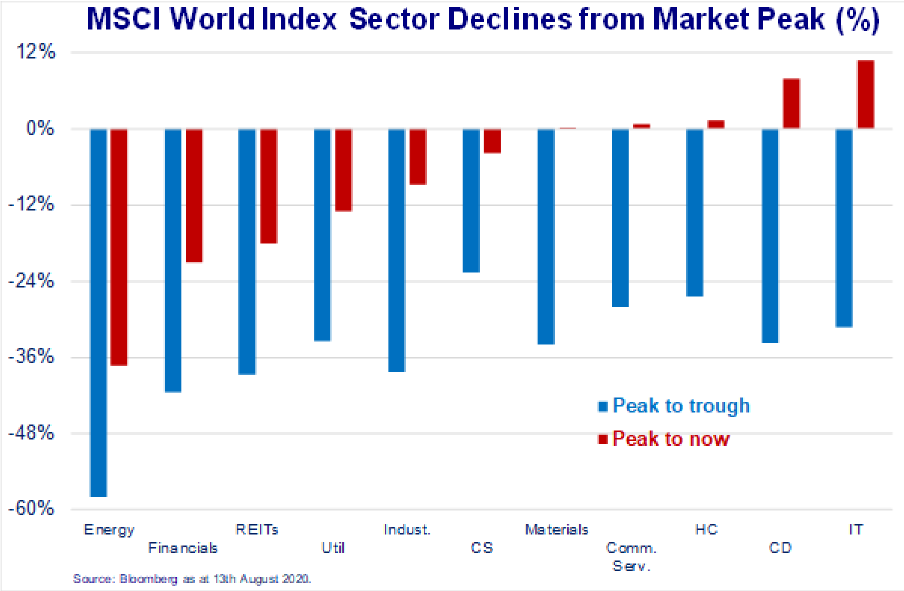
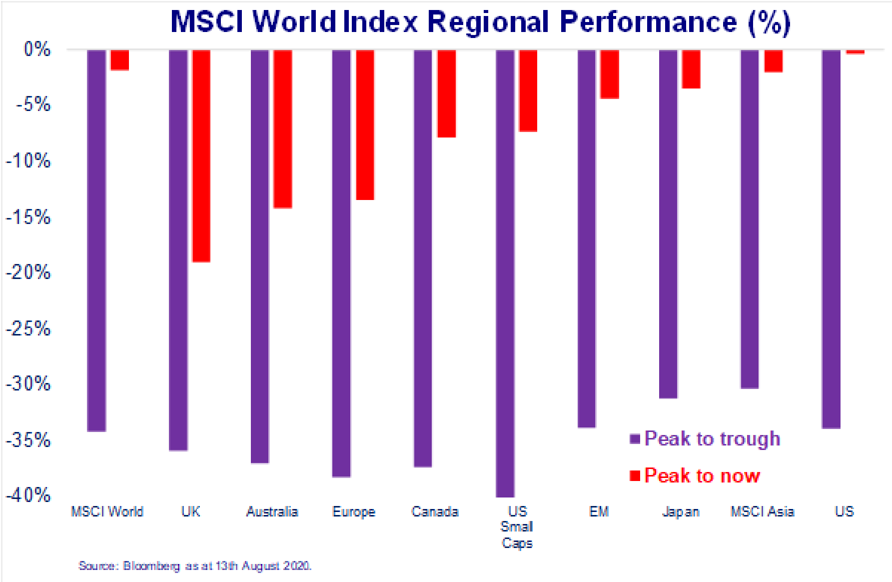


- **Among the regions, the pace of losses was led by Europe, where the EuroStoxx 600 declined -0.6%,** following solid gains in the previous session. It was a relatively quiet session overall from a macro headline perspective with no major drivers. Corporate news was also limited but Zurich Insurance (-2.6%) led the financial sector lower after a soft result. Market sentiment was also weighed down by reports that the US stimulus stalemate is likely to drag on into September with President Trump not hopeful a deal can be struck. In geopolitical news, the US treasury department said that it would leave its tariffs in place on European goods but modify the list of affected products to hit Germany and France, and investor sentiment was also impacted by data which showed that the region has a R-factor still at 1.2 although it has grinded lower in recent weeks. By the closing bell, the pace of losses was set by the UK (-1.5%), Italy (-0.9%), Spain (-0.6%), France (-0.6%), Germany (-0.5%), Switzerland (-0.2%) and Switzerland (-0.1%).

  This negative sentiment flowed through to **the US at opening and the broad market never recovered and closed -0.2% lower**, although it bounced off its worst level in the last hour of trade. It was a quiet session from a headline perspective but US COVID-19 cases fell, as did initial jobless claims, but the positive impact here was offset by press talk that the stimulus stalemate is likely to drag on into September with President Trump noting that a deal is "not going to happen". In stock news, Cisco Systems (-11.2%) detailed a -10% decline in orders and guided next quarter's earnings down, and investors followed suit on the stock price, whereas diversified tech company 3M (+1.0%) delivered upbeat sales data for July which buoyed investors. By the bell at the NYSE, it was mixed on the performance tables with the Dow Jones (-0.3%, -80 points to 27897), Russell 2000 (-0.2%) and S&P 500 (-0.2%) closing lower, but another good day for tech saw the NASDAQ 100 (+0.3%) close above the breakeven line.

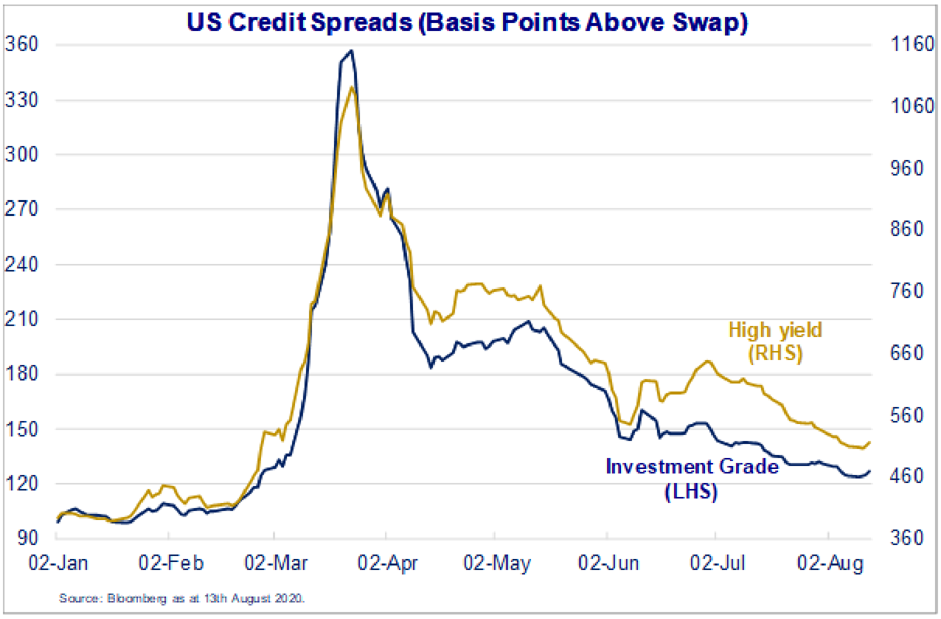
  Yesterday Asian equities finished higher in another session where investors continued their search for directional cues. There was the continual stalemate in the US Congress, continued trade tensions between the US and China, and continued daily releases of COVID-19 statistics which for the region have been improving with the R-factor now at a four-month low of 0.9. Again it was quiet on the macro front with few material releases across the region and by the regional bell in Mumbai, **the MSCI Asia Pacific Index closed +0.5% higher** with a strong advance in Japan (+1.8%), solid gains in both Taiwan (+0.7%) and Korea (+0.2%), and losses in Hong Kong (-0.1%), China (-0.3%) and Australia (-0.7%).

  Overnight returns saw the UK (-19.0%) once again approach bear market territory, whereas Asian markets are closing in on a complete recovery (see chart).

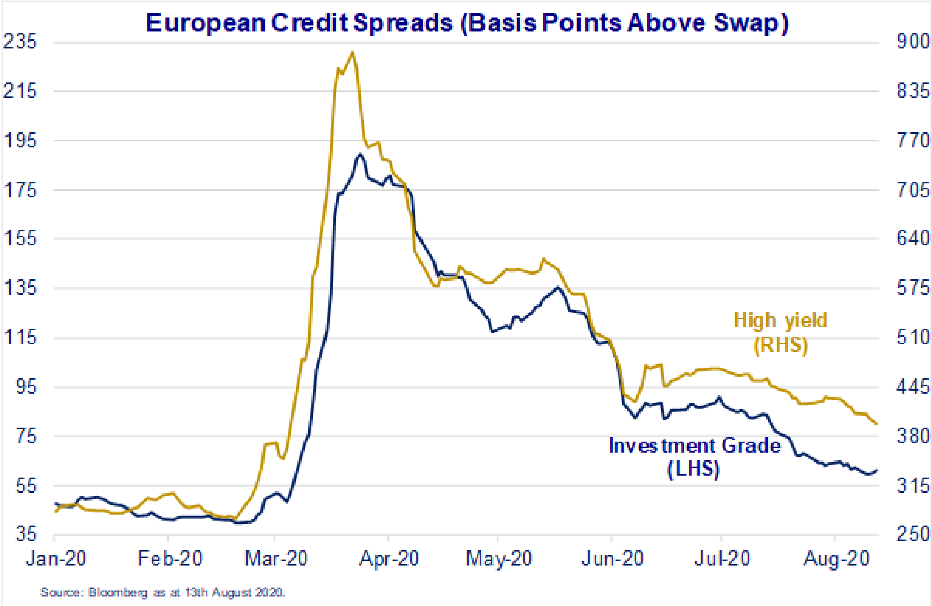


- Futures markets suggest a subdued opening in Asia with Australia (-0.1%), Hong Kong (-0.1%) and Japan (-0.1%) all set to open slightly lower at the bell.

- **CREDIT MARKETS**
  - **Regional credit indices were lower overnight** as political gridlock weighed in investor sentiment. In the US investment grade space, spreads rose for a second consecutive session by +2 points, to +127 bpts although the recovery rate was steady at 91%. Although all 11 sectors recorded a minor increase in spread premiums, movements were overall modest with the largest being in tech related sectors including communication services (+3 points, +152 bpts, 90%) and tech (+3 points, +106 bpts, 89%), which contradicted with the performance of their equity peer. In the high yield space, spreads increased +6 points (6-week high) to +516 bpts, but the recovery rate was steady at 85%. Spreads rose in 10 of 11 subsectors, with the largest being tech (+11 bpts, +426 bpts, 82%), consumer discretionary (+10 points, 514 bpts, 73%) and utilities (+7 points, +395 bpts, 84%), with senior financials (-1 point, +362 bpts, 69%) the only subsector to record capital gains.

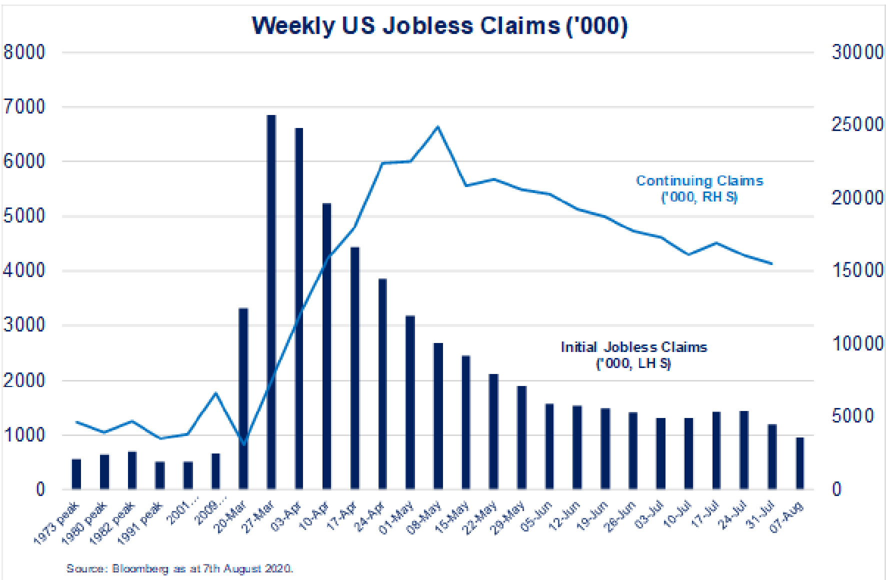


  - **European credit markets** were a bit more mixed than their US peer, but spreads in the investment grade universe rose +1 point to +61 bpts, which kept the recovery rate steady at 86%. There was spread increases in ten of the 11 subsectors but only healthcare (+2 point, +33 bpts, 89%) and utilities (+1 point, +39 bpts, 86%) lagged the market tape and these were partially offset by a rally in sub-ordinated financials (-3 points, +142 bpts, 84%). In the high yield universe, spreads contracted -3 points to +397 bpts (4-month low) which boosted the recovery rate one notch to 80%. There were spread declines in 8 of the 11 sub-sectors led by defensive sectors such as healthcare (-8 points, +292 bpts, 75%) and consumer staples (-5 points, +476 bpts, 98%) which has nearly closed out a complete recovery, with consumer discretionary (-6 points, +454 bpts, 84%) continuing to outperform its peers despite its cyclical cashflows.



THE GLOBAL ECONOMY

- **US initial jobless claims fell by -228k to +963k** which was well below street estimates (1.1 million), with the median state's seasonally adjusted claims down by -22% suggesting broad-based improvement despite renewed state mobility restrictions. While there were numerous reasons forwarded for the better than expected outcome, but it may simply reflect a more muted COVID-19-related effect this time around as businesses know that at some stage the virus spread will moderate and activity improve. Manufacturing states have notably lower new claims week-to-week providing more evidence that the goods sector has recovered quite strongly (and more strongly than was implied in the July non-farm payrolls which suggesting hiring had slowed considerably), whereas services are clearly lagging. That said, we should not be ignorant of the fact that claims are still very high relative to recessions outside of 2020 – they are still above the peak of the past six recession dating back to 1973 (see chart).



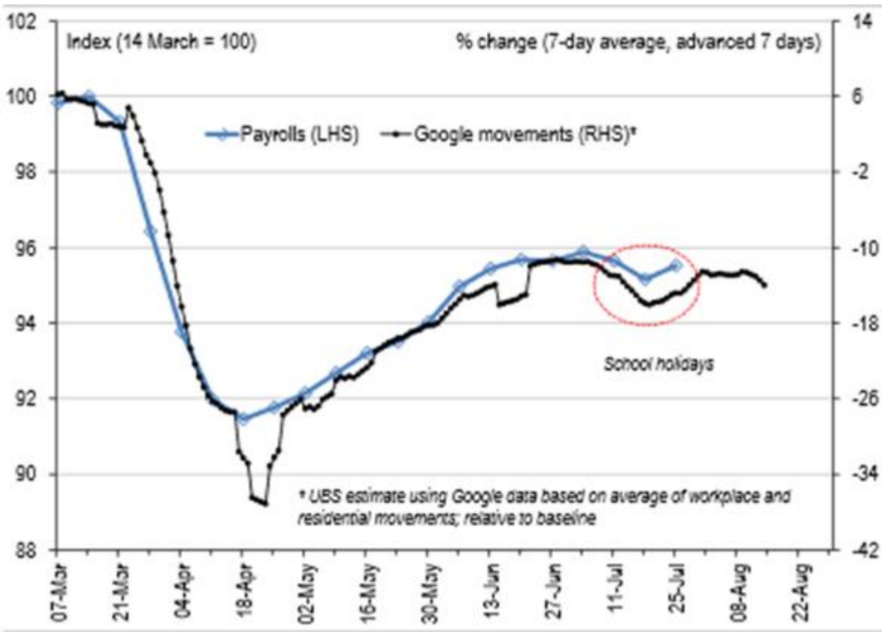
Meanwhile, the number of continuing claims also fell by -604k to 15.5 million with the median state's continuing claims down by -0.9% as a share of employment which suggests the US labour market has adjusted well to renewed social restrictions. That said, the largest contribution to continuing claims came from California (+123k), whereas New York (where daily case numbers have been anaemic) recorded the largest decline (-103k). On the whole, the implied outflows from claims (probably representing re-employment) were 2 million, which is similar to the prior month and the difference between initial claims (1 million on a 2-week moving average) and implied outflows (2 million) suggests further declines in continuing claims are likely in the coming weeks.

Overall, it was a good report and despite the expiration of additional welfare payments in the US at end-July there is no evidence, at least yet, that this has translated to a second round of layoffs through less spending. However, this could just be timing issues in that it may just materialise with a lag, or consumers have an elevated savings rate which is allowing them to maintain spending for the time being.

- **The Australian economy added a strong +115k jobs in July** which was well above street estimates (+30k) but the unemployment rate rose marginally to 7.5%, as the +0.6% rise in participation to 64.7% offset the jobs growth. Other indicators also showed marginal improvement including hours worked (+1.9% although this is still down -5% y/y) and under-utilisation (-0.4pts to 18.7%, although this is still +4.7 points higher than March and +0.5% higher than the prior recession peak of 1992).

  The +115k rise in yesterday's survey was considerably more than that implied by the payrolls report earlier this week, although the former survey's only 1/40th of the latter, but it nonetheless built on a record +228k in June, yet unemployment is just above one million people. More importantly, if the unemployment rate is adjusted from those who did not work at all, and we assume the participation rate was still at the level in March, then the 'real unemployment rate' would be 10% - which is well above the reported 7.5%, but well below the 14.8% peak in April.

  However, in many ways this report is academic as it predates Victoria's stage 4 lockdown (Victorian jobs rose +23k in July and the unemployment declined to +6.8% due to a lower participation) and this will be the acid test, but it is no surprise to say that there are more uncertainties than usual in forecasting labour market data. That said, recent Australian mobility data suggests that the recovery in payrolls is likely to stall moving forward (see chart). If the total job losses from social restrictions is -250k and the participation rate rises further, then unemployment is likely to hit around 9.5% by end-2020 but that is before the 15% of GDP fiscal cliff is addressed. This suggests it may be hard to lower the unemployment rate much in early-2021 unless more income support is provided.



Source: ABS, UBS Evidence Lab, Google (> Access Dataset)

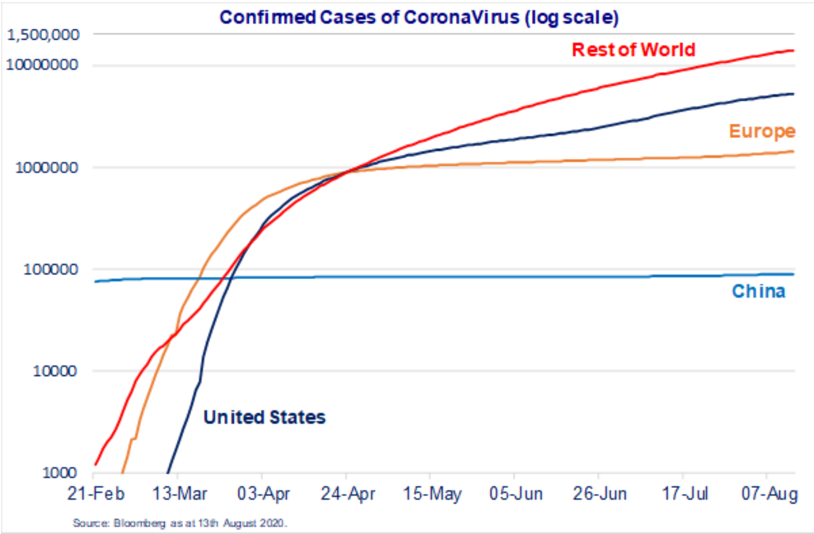
POLICY

- There were no material policy announcements overnight. Importantly, there was no progress on a fifth COVID-19 US relief bill following the breakdown in talks last Friday. Reports continue to suggest that the stalemate is likely to drag into September even though markets expect a package worth circa 1.5 trillion to help offset the US fiscal cliff. Two issues with President Trump's executive actions this week are that they do not include another round of $1,200 stimulus cheques, and the $600 per week of additional unemployment benefits was heavily reduced which will inevitably hit spending. Moreover, that money is likely to take a couple of weeks to reach workers and funding could be exhausted in six weeks.

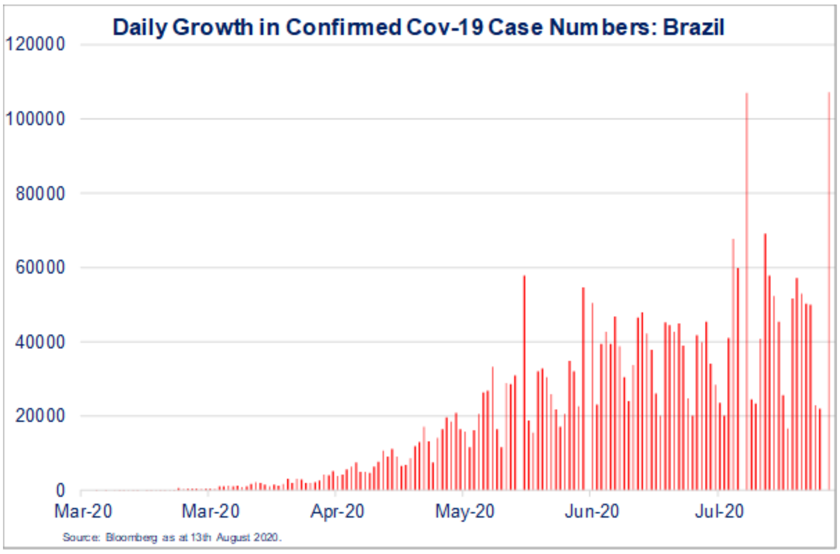
VIRUS UPDATE

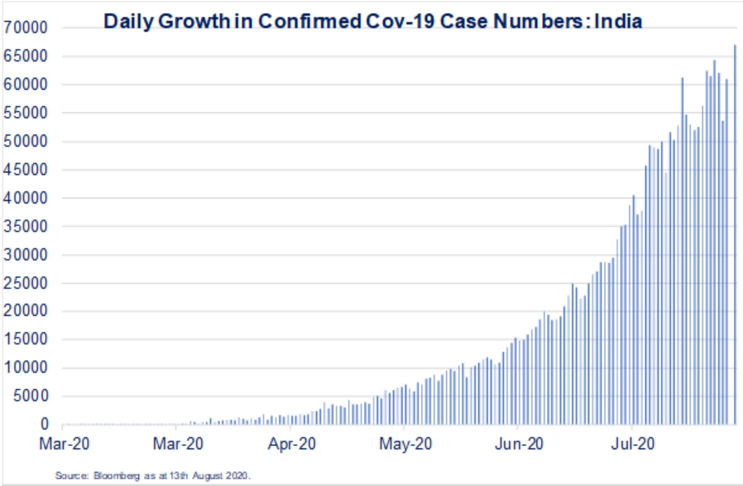
- The number of global cases of COVID-19 is 20.74 million with another +123k cases so far (but Brazil, India, Mexico, and 5 US states have not reported their numbers) which means that Thursday could be the 26th consecutive day where daily increases have topped 200k. This means 4 countries have more than 900k cases, 20 countries have more than 200k cases and 26 countries have more than 100k cases.

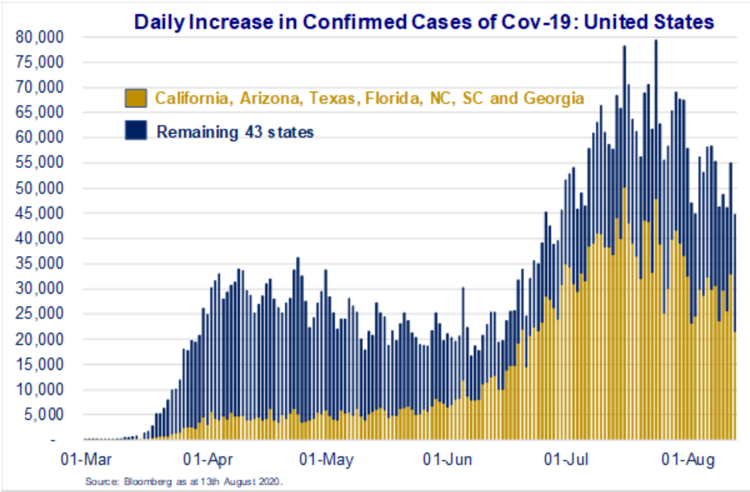
  It took 73 days to record 1 million cases, and after this each subsequent million has taken 13 days, 11 days, 12 days, 10 days, 11 days, 8 days, 8 days, 7 days, 6 days, 5 days, 5 days, 5 days, 4 days, 5 days, 3 days, 4 days, 4 days and 4 days. More importantly, the growth rate of daily confirmed cases (+1.1% since Monday) is once again coming down. Meanwhile, deaths stand at 752.1k and the death rate was steady at 3.63% although the number of daily deaths is on the rise.



- 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 (+61.8k to 17.1 million) and highest daily new cases (and by a considerable margin) followed by the US (+45.2k to 5.24 million, although 5 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 (+11.8k to 1.43 million - see chart).

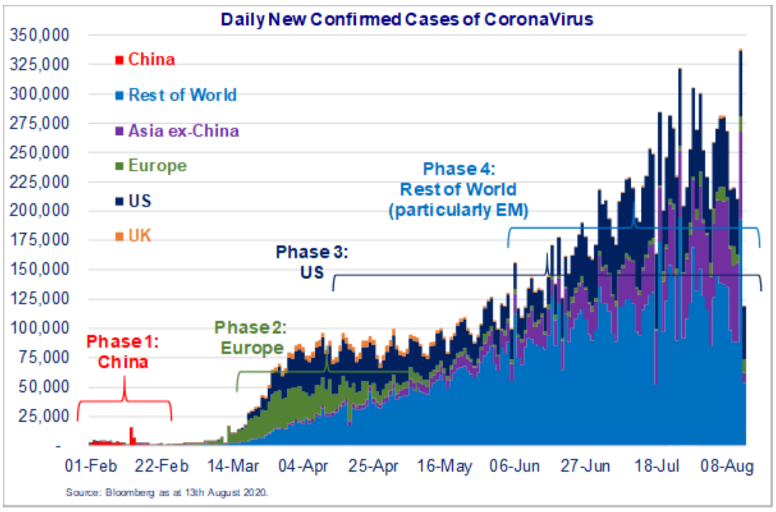






- Among countries, the most cases are in the US (+45.2k (so far) to 5.24 million, with 5 states yet to report), Brazil (not reported, 3.16 million), India (not reported, 2.40k), Russia (+5.0k to 905.8k), South Africa (+3.9k to 572.9k), Peru (+8.9k to 498.6k), Mexico (not reported, +498.4k), Chile (+1.9k, 380.0k), Spain (+7.6k to 337.3k), Iran (+2.6k to 336.3k), United Kingdom (+2 to 315.6k), Saudi Arabia (+1.5k to 294.5k), Pakistan (+0.8k to +286.7k), Bangladesh (+2.6k to 269.1k), Italy (+0.5k to 252.2k), Turkey (+1.2k to 245.6k), France (+0.1k to 244.1k), and Germany (+1.4k (15-week high) to 222.9k). Australia confirmed cases rose +231 to 22.4k yesterday which placed us 64th in terms of total infections.

  Elsewhere, Singapore recorded +0.1k new cases to 55.5k most of which are linked to foreign workers who are forced to live in crowded dormitories, but Indonesia (+2.1k to 132.8k) is now on the rise and has the second most cases in the region behind only the Philippines (+3.8k to 147.5k).



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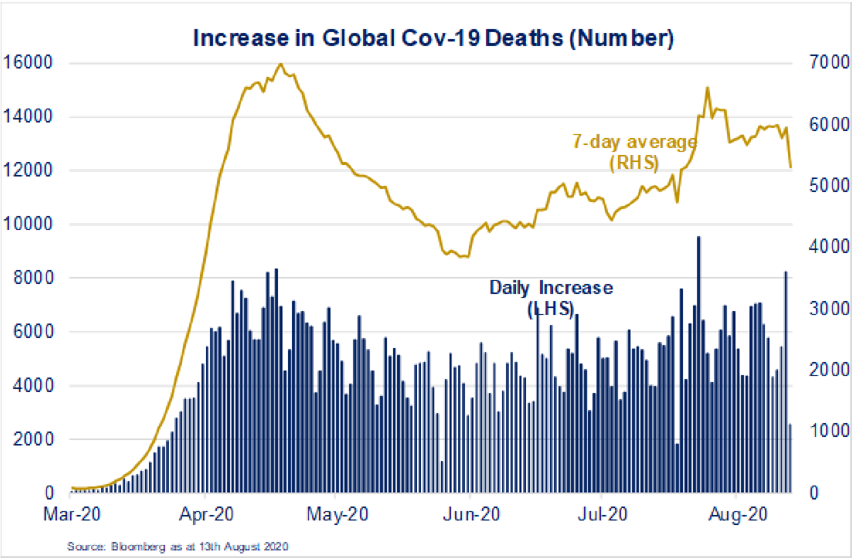
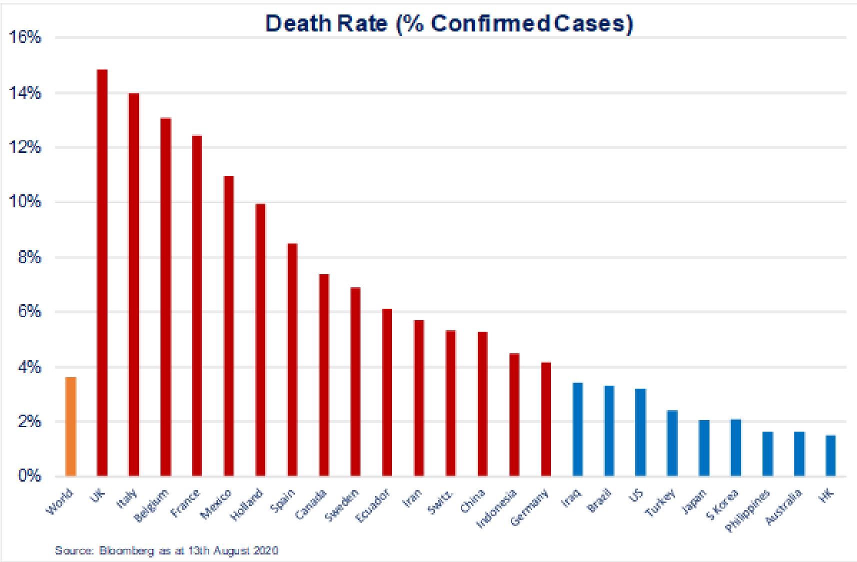
- Although final numbers are not in until 1pm AEST, the global death rate was steady at 3.63% with the global total to 752.1k after another +2.6k deaths overnight, so far, which indicates the daily average deaths is increasing again (see chart). The US (+0.9k so far) has the most deaths at +167.0k, with Brazil (not reported, 104.2k), Mexico (not reported, +54.7k), the UK (+0.0k to 46.9k), India (not reported, 47.0k), Italy (+6 to 35.2k) and France (+1 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 14.8%), Italy (steady at 14.0%), Belgium (steady at 13.1%), France (steady at 12.4%), the Netherlands (-0.2% to 9.9%), Spain (-0.3% to 8.5%) and Sweden (steady at 6.9%). However, several emerging markets are now on the leader board including Mexico (+0.1% to 11.0%), Ecuador (-0.1% to 6.1%), Indonesia (steady at 4.5%) and Brazil (steady at 3.3%).





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Yours sincerely,

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