Perpetual Investments

THOUGHTS ON THE MARKET

14th July 2020

Global COVID-19 cases top 13 million and 70% of the US is now seeing reopening plans either stall or reverse

SUMMARY

- Global risk markets declined overnight as concerns mounted that rising COVID-19 cases were throttling the reopening plans of several large US states including California (which alone is the eighth largest economy in the world), Texas and Florida. The former announced overnight that indoor dining and bars will be closed, and its two largest school districts will offer only remote learning, which will negatively impact the labour market. Accordingly, around 70% of the US economy is now been subjected to re-opening plans which are either being stalled or reversed and this is likely to weigh on the trajectory of the recovery and particularly the employment recovery which is central to offset the upcoming fiscal contraction.

  It is amazing how much confidence markets have considering given the long list of uncertainties including the economic impact of US daily case numbers having almost doubled from the levels in March, and the market impact of the Fed's balance sheet now going into reverse and a complete lack of guidance from companies. The last thing investors could think now is that the danger has passed, and that things are back to normal with the blue skies backed by cheap valuations and rising corporate performance. None of that is the case.

  In other markets, 10-year US Treasuries dropped -3 points to 0.62% with curve flattening, commodity prices were soft with oil down -1.1% to USD 40.10 per barrel and gold rallied +0.2% to USD1,803 per troy ounce, and G10 currencies were mostly weaker against a stronger Greenback led by with declines in Sterling (-0.5%), Yen (-0.3%) and AUD (-0.1% to USC69.42), with the Euro (+0.4%) bucking the global trend and closing higher.

- It was a very quiet night on the macro calendar with no material releases, but the event list will ramp up tonight as the Q2 US earnings seasons begins with banks reporting, and overall expectations are very low with the market projecting a -45% q/qa decline in earnings per share which would represent the largest contraction since December 2008. On the positive side, the pace of earnings downgrades has declined significantly in recent weeks. Meanwhile, the US overnight formally rejected China's expansive claims in the South China Sea with Secretary Pompeo saying the US will not allow Beijing to treat the region as its maritime empire.

- The number of global cases COVID-19 topped 13 million overnight with another +169k cases so far (Mexico and 5 US states have not yet reported their numbers) which means that Monday was the 46th occasion in the past 48 days where daily increases have topped 100k. This means 4 countries have more than 700k cases, 17 countries have more than 200k cases (Germany joined this group overnight) and 22 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 and 5 days, and in the past 12 hours days another +48.2k cases have been confirmed. More importantly, the growth rate of daily confirmed cases (+1.7% since Friday) is once again stabilising. Meanwhile, deaths stand at 571.7k and the death rate dropped for a sixty eighth straight day to 4.38%.

FINANCIAL MARKETS

- **EQUITIES**
  - The MSCI World Index closed -0.3% lower in a very mixed day across regions and sectors. The primary drag on the global index was tech (-1.9%) which fell for a second consecutive day with across-the-board weakness in FANG which spread into consumer discretionary (-0.6%) as investors seemingly took profit

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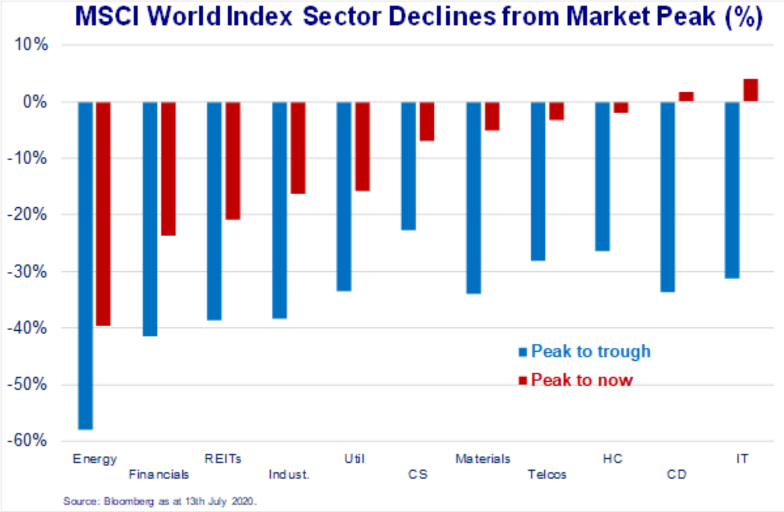
on sectors which have recorded a complete recovery of March quarter losses. That said, REITs (-0.7%) also fell as investors fretted about the earnings impact of any economic re-closures and telcos (-1.4%) also closed int the red.

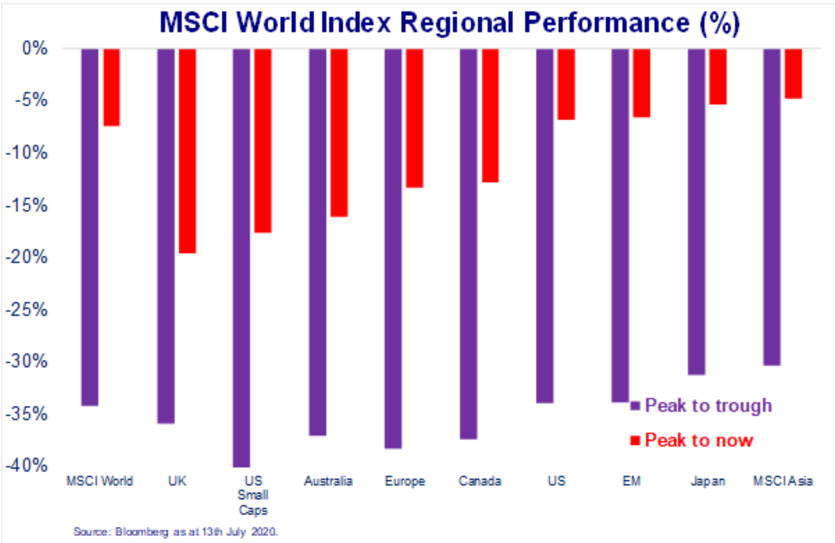
In contract, traditional cyclical sectors added to their advances from Friday night including energy (+0.5%) despite the lower crude, financials (+0.7%) despite a flatter yield curve and industrials (+0.9%) despite the lack of any material data. The overnight movements saw energy (with a peak-to-now decline of -39.7%), financials (-23.7%) and REITs (-20.9%) entrenched in bear market territory, whereas consumer discretionary (+1.7%) and IT (+4.0%) hang onto their complete recovery narrative (see chart).



- **Among the regions**, advances were led by Europe (+1.6%) as the lack of economic data meant the market focus was on political developments as well as COVID-19 related headlines where case number rose to a seven day high (+4.2k to 1.23 million) but the rise was mostly due to one country (Spain which recorded a 63-day high of +2.05k to 256k). By the bell, all major regional markets posted century advances led by Sweden (+1.8%), France (+1.7%), Spain (+1.5%), the UK (+1.3%), Germany (+1.3%) and Italy (+1.2%).

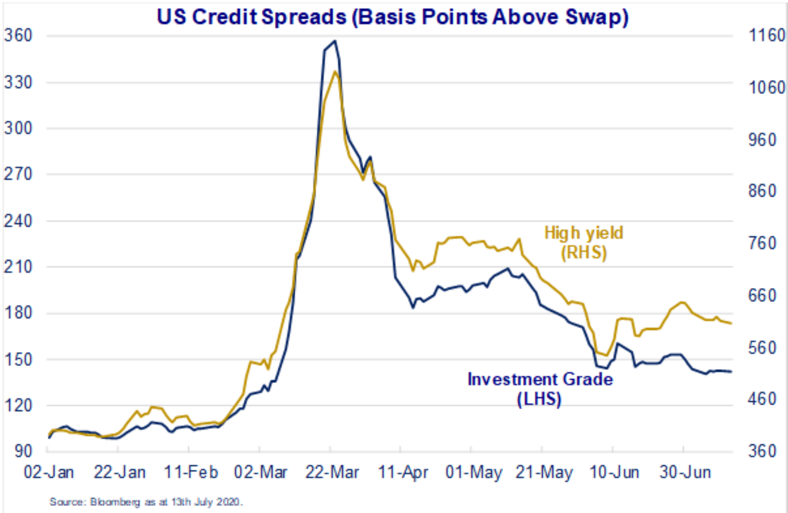
  The US had a truly mixed session. All indices opened higher following the European lead, but COVID-19 news skewed down in the afternoon after California announced all inside bars and restaurant would close and schools in LA and San Diego went virtual for this semester which placed some doubts over the extent of the regional recovery. By the bell all major indices were at their respective lows for the day with losses led by the NASDAQ 100 (-2.1%), Russell 2000 (-1.3%) and the S&P 500 (-0.9%), but the Dow Jones (+11 points, +0.04%, 26,086) closed fractionally higher.

  Earlier, the MSCI Asia Pacific index closed +0.9% higher as a lack on news meant the regions followed the positive lead from Wall Street on Friday. Advances were uniform, led by Japan (+2.2%), China (+2.1%), Australia (+1.0%) and Hong Kong (+0.2%). The overnight moves meant that the UK (-19.6%) left bear market territory and Japan (-5.4%) has the best recovery rate (see chart).



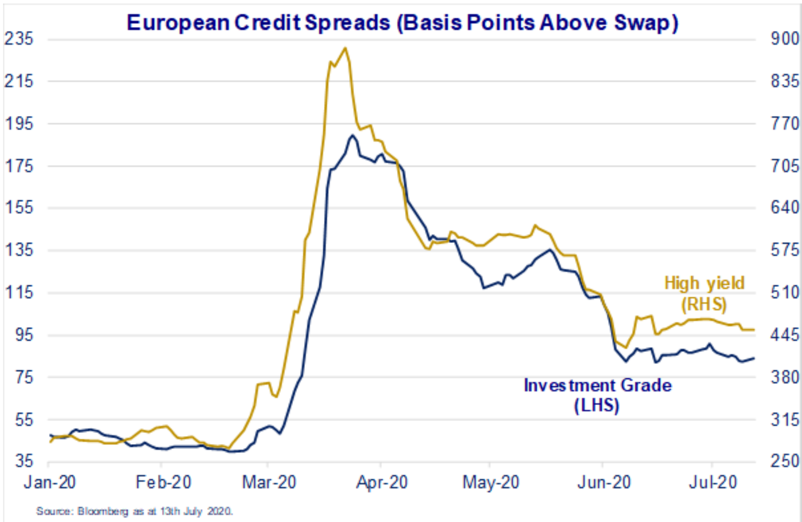
- Futures markets suggest a mixed opening in Asia with Australia (-0.8%) and Japan (-0.7%) set to open lower, but Hong Kong (+0.4%) is slated for a positive opening.

- **CREDIT MARKETS**
  - Regional credit indices were flattish overnight with spreads in the **US investment grade universe** steady at +142 bpts, which kept the recovery rate at 85%. There were spread contractions in 9 of the 11 sub-sectors but only consumer staples (-1 point, +127 bpts, 89%) recorded an overall move in excess of one basis point in what was a very quiet session. In the high space, spreads contracted -5 points to +546 bps, which increased the recovery rate one notch to 71%. There were spreads contractions in 10 of the 11 sub-sectors led by healthcare (-15 points, +564 bpts, 67%) which recovered some of last week's blowout as did IT (-13 p0oints, +533 bpts, 63%) and industrials (-11 points, +701 bpts, 48%) although it was hard to pinpoint the catalyst for the change in sentiment given the weak lead from the US equity market.



  - **European credit markets** were quiet all night with spreads in the investment grade universe rising +2 points to +84 bpts, which lowered the recovery rate one notch to 70%. Overall, there were higher risk premiums in 10 of the 11 GICS sectors led by industrials (+3 points, +91 bpts, 57%) which continues to lag its peers despite a likely strong pick up in industrial production for May and June. Meanwhile, tech (+2 points, +50 bpts, 60%) and biotech (+3 points, +51 bpts, 74%) were also sold down as investors became seemingly more concerned about the outlook and valuations.

    In the high yield universe, spreads were steady at +426 bpts, which saw the recovery rate unchanged at 70%. Risk premiums declined in 8 of the 11 sub-sectors led by energy (-6 points, +584 bpts, 68%) despite the lower overnight crude price, and telcos (-3 points, +368 bpts, 67%) which continued to recover its spread blow out from late June. However, these modest gains were offset by a large rise in industrials (+17 points, +584 bpts, 66%) although one could not identify why this sector defied the broad market trend.



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THE GLOBAL ECONOMY

- There was no material economic data overnight. However, Bloomberg detailed five indicators which suggest the recovery has flattened out – the decline in hours worked in Texas-Florida-Arizona, a levelling off in the percentage of Americans who are working, a decline in restaurant reservations on Open Table (particularly in areas with rising infections), a slowdown in the New York Fed's real-time economic index (after a large rebound in May and early June), and an apparent rise in housing market stress.

- Elsewhere, the Washington Post discussed concerns the recovery may be fizzling out in that Goldman Sachs highlighted that more than 70% of the country has either paused or reversed reopening plans, which will eventually spread to the labour market as companies adjust to lower levels of demand and the coronavirus provides an excuse to "right-size". They noted that layoffs have spread beyond companies that provide services requiring direct human contact.

POLICY

- There were no material policy announcements. However, Australia is not the only country that has an issue with a fiscal cliff with US Senate Republican resisting to extension to the USD600-per-week of additional unemployment benefits, which have pumped USD18 billion per week into the economy since the crisis began. The impact here on household income will be amplified for the non-renewal of the USD1,200 stimulus cheques which went to individuals earning less than USD75k last year and this is amplified by austerity measures at the state and local government level. This adds to the worry that Congress and the White House can't agree on the next round of Cov-19 relief with Republicans wanting a $1 trillion, whereas House Democrats are demanding the passing of their $3 trillion-plus bill.

- Overnight, the US State Department officially rejected China's expansive territorial claims in the South China Sea in a letter from Secretary Pompeo which said China's claims to offshore resources "*are completely unlawful, as is its campaign of bullying to control them.*" The document asserted China has no legal grounds for its claims given a unanimous 2016 decision by a UN tribunal tasked with settling the debate, and the US said it will not allow Beijing to treat the South China Sea as its maritime empire. While the US had never accepted China's territorial claims, the letter represents an increase in emphasis and potential for higher tensions.

VIRUS UPDATE

- The number of global cases of COVID-19 topped 13 million overnight with another +169k cases so far (Mexico and 5 US states have not reported their numbers) which means that Monday was the 46th occasion in the past 48 days where daily increases have topped 100k. This means 4 countries have more than 700k cases, 17 countries have more than 200k cases (Germany joined this group overnight) and 22 countries have more than 100k cases.

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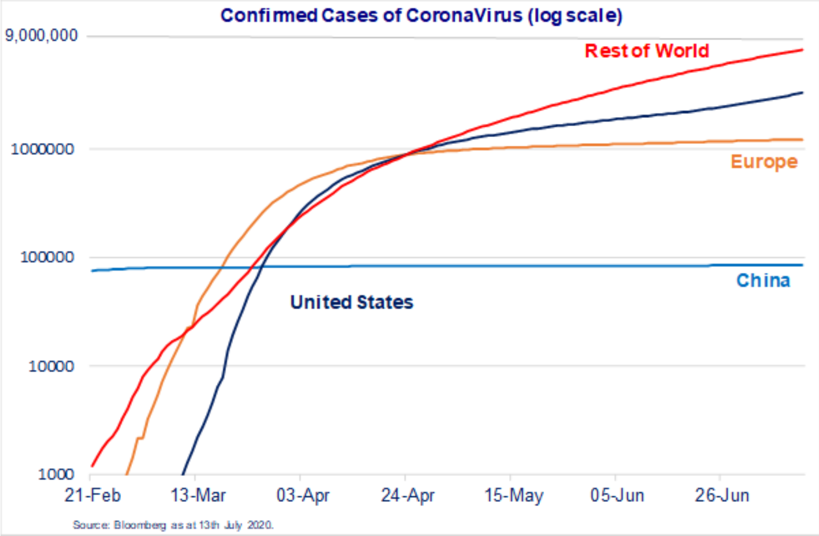
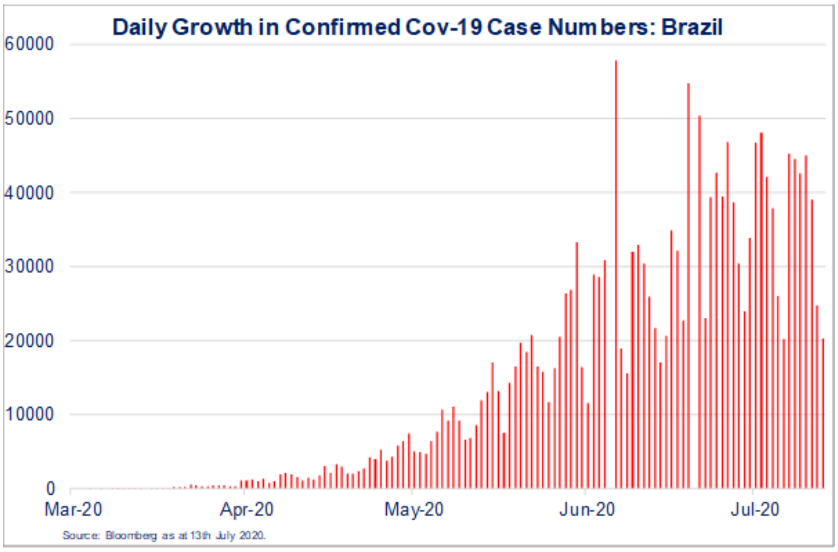
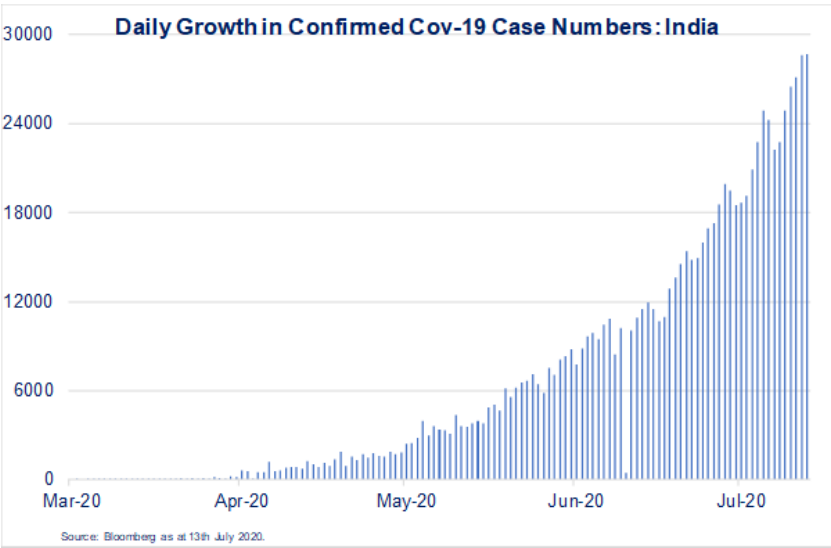
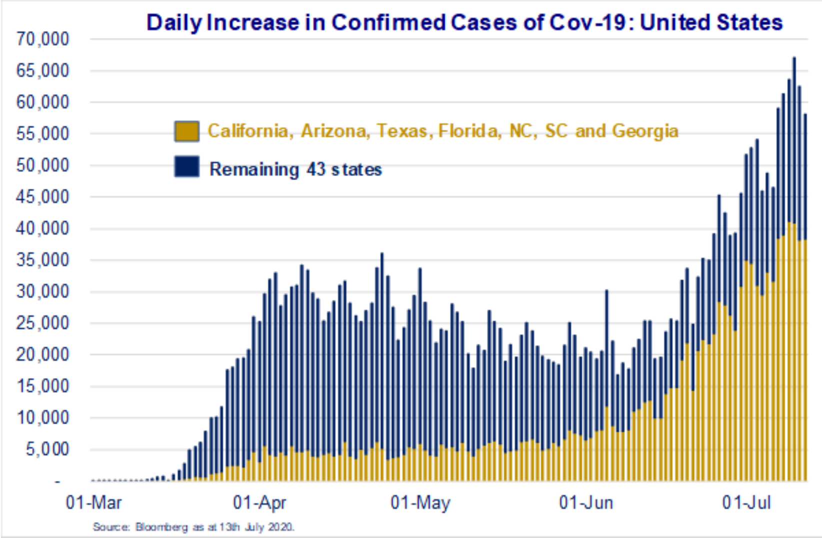


- We break the infections into four groups – the US, Europe, China and 'others' and the rest of the world outside the G3 economies now has the most total cases (+81.2k to 8.38 million) and highest daily new cases (and by a considerable margin) followed by the US (+48.5k to 3.35 million, although 5 states are yet to report) and Europe (+4.3k (7-day high) to 1.23 million - see chart). The issue for the US is that they never flattened their curve which means economic opening has not been associated with lower case numbers. Within the rest of the world, the three concerns here are Brazil (+20.3 to not reported, 1.88 million, which is the second highest in the world), India (+28.7k (record high) to 878.3k) and Russia (+6.5k to 732.5k, fourth highest) (see charts below).

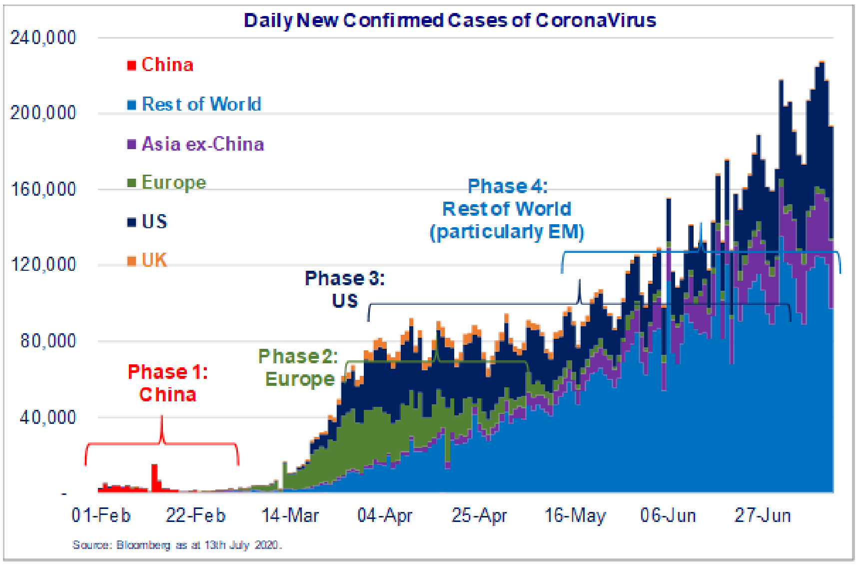




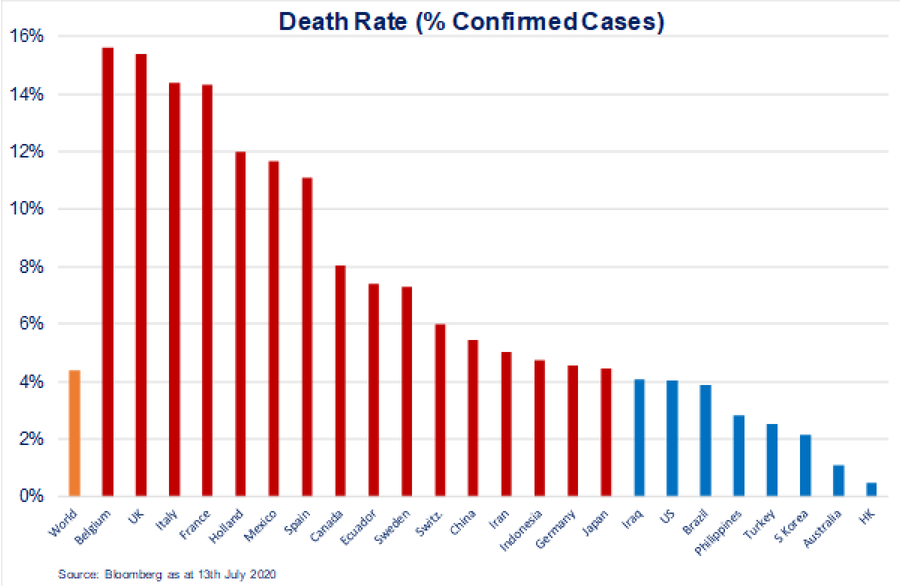


- Among countries, the most cases are in the US (+48.5k (so far) to 3.35 million, with 5 states yet to report), Brazil (+20.3k to 1.88 million), India (+28.7k (record high) to 878.3k), Russia (+6.5k to 732.5k), Peru (+3.8k to +330.1k), Chile (+2.6k to 317.7k), Mexico (not reported, +299.8k), the United Kingdom (+0.5k to 291.7k), South Africa (+11.6k to 287.8k), Iran (+2.3k to 259.7k),Spain (+2.05k (63-day high) to 256.0k), Pakistan (+2.8k to +251.6k), Italy (+0.2k to 243.2k), Saudi Arabia (+2.9k to 235.1k), Turkey (+1.0k to 214.0k) and France (+0.3k to 209.6k). Australia confirmed cases rose +184 to 9,980 yesterday which placed us 71st in terms of total infections.

  Elsewhere, Singapore recorded +0.3k new cases to 46.3k 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, but Indonesia (+1.3k to 77.0k) is now on the rise and has the most cases in the region, and the Philippines (+0.7k to 57.0k) is also on an upward trend.



- Although final numbers are not in until 1pm AEST, the global death rate declined for a sixty eighth straight day to 4.38% with the global total to 571.7k after another 3.1k deaths overnight, so far. The US (+0.3k so far) has the most deaths at +135.5k, with Brazil (+0.7k to 72.8k), the UK (+0.04k to 44.9k), Italy (+0.01k to 35.0k), Mexico (not reported, +35.0k) and France (+0.02k to 30.0k) all over +30k. The death rate is highest in European countries where the health systems had collapsed led by Belgium (-0.1% to 15.6%), the UK (-0.1% to 15.4%), Italy (steady at 14.4%), France (steady at 14.3%), the Netherlands (-0.1% to 12.0%), Spain (-0.1% to 11.1%) and Sweden (-0.1% to 7.3%). However, several emerging markets are now on the leader board including Mexico (-0.1% to 11.7k), Ecuador (-0.1% to 7.4%), Indonesia (-0.1% to 4.8%) and Brazil (-0.1% to 3.9%).



Yours sincerely,

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