

THOUGHTS ON THE MARKET

15th April 2020

SUMMARY

- Global risk markets rallied again overnight amid signs that the COVID-19 outbreak is levelling off or easing in nearly all major regions. The risk market thrust pushed the NASDAQ 100 through its 100-day moving average, but we are not convinced that the price recovery won't roll over. The market is rallying behind economic closures containing the virus, but there is a massive growth hole ahead and the yield curve slope (currently 50 basis points) is not signalling to us that a recovery is taking hold like it did in 2009, when the slope was nearly 400 basis points despite the Fed doing QE at the time.
- Overnight the IMF's projected the global economy to contract by -3% y/y in 2020, which is much worse than the -0.1% y/y contraction during 2008-09 financial crisis, but they have a strong +5.8% y/y recovery in 2021, assuming lockdowns are progressively unwound. Among key economies, the US was downgraded to -5.9% y/y this year (+4.7% rebound in 2021) and Europe is forecast to contract -7.5% y/y (also +4.7% y/y).
- Oil markets declined sharply overnight with crude down -7.1% to 20.82 in the first full trading session since circa 15 million barrels per day of supply cuts were announced by OPEC+ and the price reaction confirms that not enough production has been removed to align supply with demand. With the oil price now within a whisker of its recent 18-year low of USD20.09, cuts may need to double from the announced level to have prices above key breakeven levels for producers, but we believe there is little chance of producers agreeing to that.

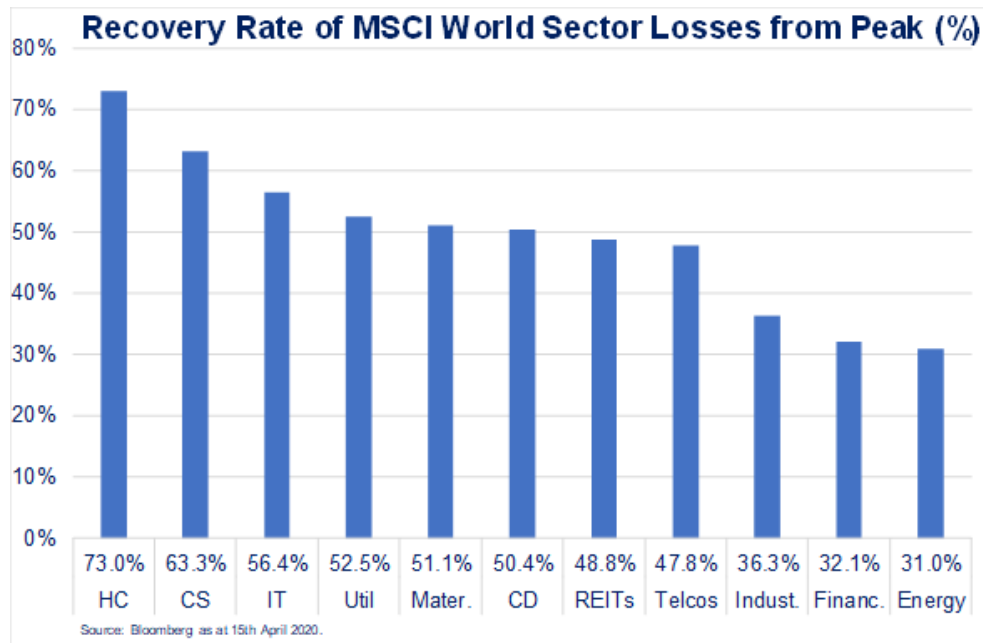
FINANCIAL MARKETS

• EQUITIES

- Regional equity markets rose strongly overnight although it was hard to pinpoint the catalysts other than confirmation around flattening out COVID-19 case numbers. Among regions, the US market rose to a 1-month high with the S&P 500 up +3.1% with gains led by consumer stocks (staples +4.2% d/d, discretionary +4.2% d/d) and IT (+4.2% d/d), but as usual financials (+0.3% d/d) and energy (-0.5% d/d) lagged. The US reporting season began with a strong result from Johnson & Johnson (+4.5%) which outperformed the market after posting stronger sales and increasing its quarterly dividend. In contrast, JPMorgan (-2.7%) and Wells Fargo (-4.0%) were not so fortunate and their profits were hit by major provisions in credit cards and selected industries including oil and gas and consumer discretionary, and these results weighed on financials as a whole.

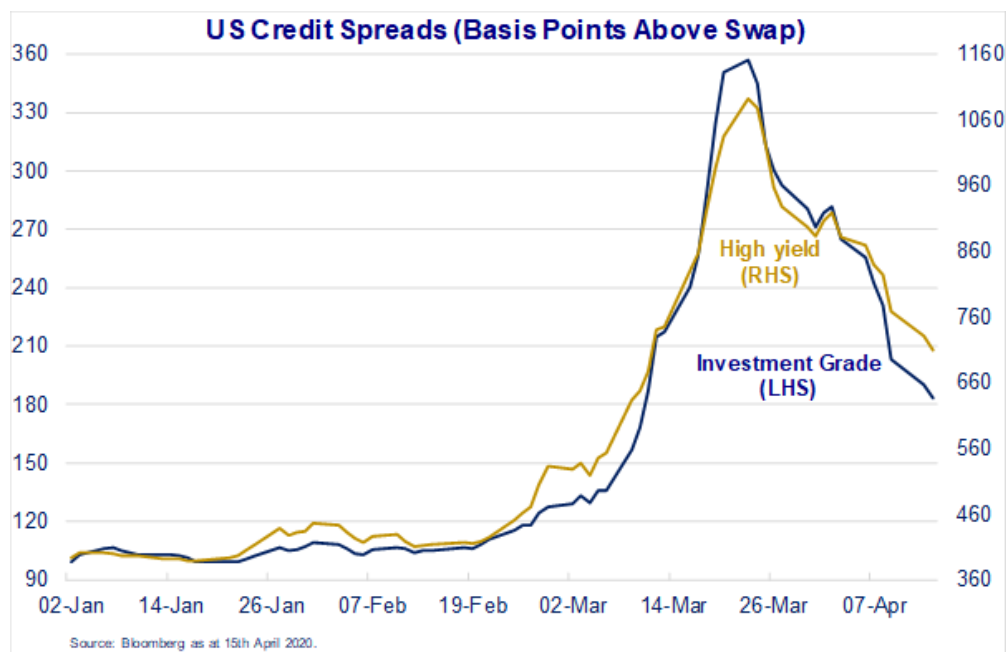
The rise in consumer staples and healthcare globally saw their recovery rates rise to an impressive 63% and 73%, respectively and the chart below shows what sectors investors are deploying their risk capital, and also where the stresses and risks remain with energy (31%) and financials (32%) recording the lowest recovery rates.

In other markets Europe lifted +0.9% led by gains in IT (+2.5%) and consumer staples (+1.9%), whereas utilities (-0.4%), financials (-0.8%) and energy (-2.6%) declined. Earlier in Asia, markets recorded upbeat returns led by Japan (+3.1%), China (+1.9%), Australia (+1.9%) and Hong Kong (+0.6%).



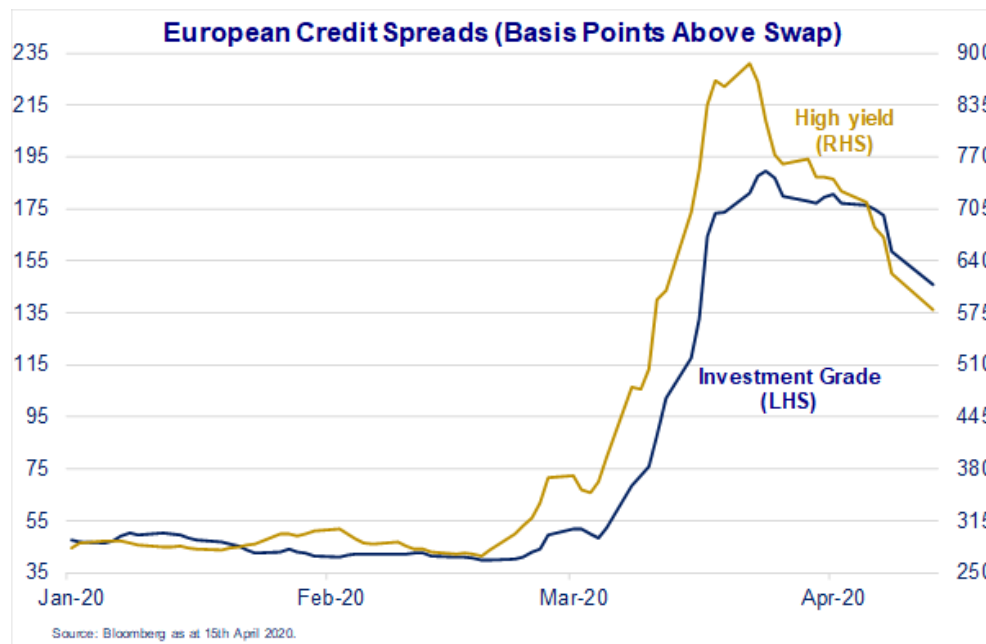
• CREDIT

- Credit markets recorded another modest contraction in spreads despite a large decline in the West Texas Intermediate Crude price (-7.1% to USD20.82). US IG spread contracted another -7 to 184 bpts, making a total of -174 bpts of spread contraction in the past 14 trading days, culminating in a 68% recovery rate for the sector. Overnight the spread contraction was uniform in all sectors led by energy (-21 to 324 bpts) and consumer discretionary (-10 to 230 bpts), but everything else was just a handful of points lower. Meanwhile, US HY spreads came in -23 to 709 bpts (see chart) which meant the 14-trading day recovery has been -383 bpts culminating in a 56% recovery rate. Overnight HY gains were led by energy (-46 to 1382 bpts with a recovery rate of 61%), healthcare (-48 to 5238 bpts, 72%) and senior financials (-46 to 691 bpts, 48%).



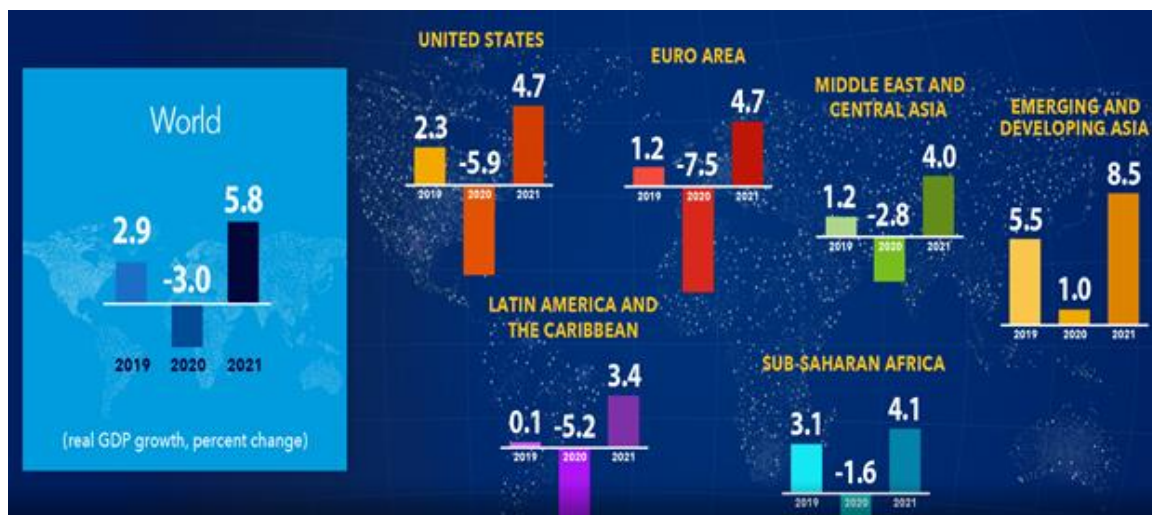
- European credit markets had another positive session catching up with the US trends over the past two days. European IG spreads came in a further -13 to 146 bpts, culminating in a recovery rate of 29% from the March peak, with fairly consistent moves between sectors led by consumer discretionary (-22 to 216 bpts,

recovery rate of 27%) whereas senior financials recorded the smallest decline (-8 to 147 bpts, 36%). In the HY universe, spreads came in -46 bpts to 578 bpts (see chart) in what again was consistent moves across the sub-sectors with the sector recovery rate now at 50%. Consumer discretionary (-68 to 763 bpts, 48%) led the spread contractions with strong support from senior financials (-63 to 641 bpts, 45%).



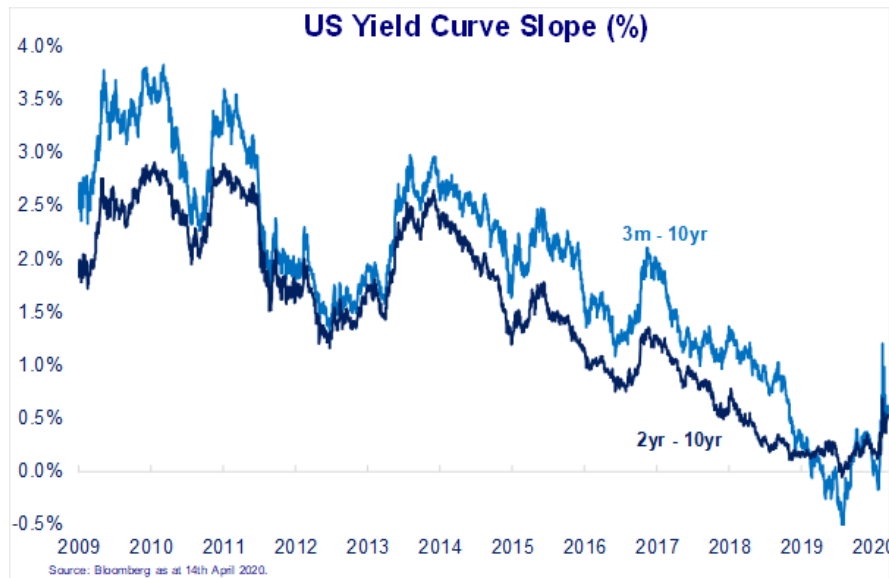
THE GLOBAL ECONOMY

- The IMF's provided its latest regional growth forecasts after releasing the April edition of its World Economic Outlook in which it projected the global economy to contract by -3% y/y in 2020. This would represent the largest global activity decline in 90 years and is much worse than -0.1% y/y contraction during 2008-09 financial crisis, but they have a strong +5.8% y/y recovery in 2021, assuming the pandemic fades and lockdowns are gradually unwound. However, the Fund flagged several risks cases including the pandemic proving more persistent than assumed which would have a larger and longer impact on economic activity and financial markets. Among key economics, the US was downgraded to -5.9% y/y (+4.7% rebound in 2021) and Europe contracts -7.5% y/y (+4.7% y/y – see chart below).



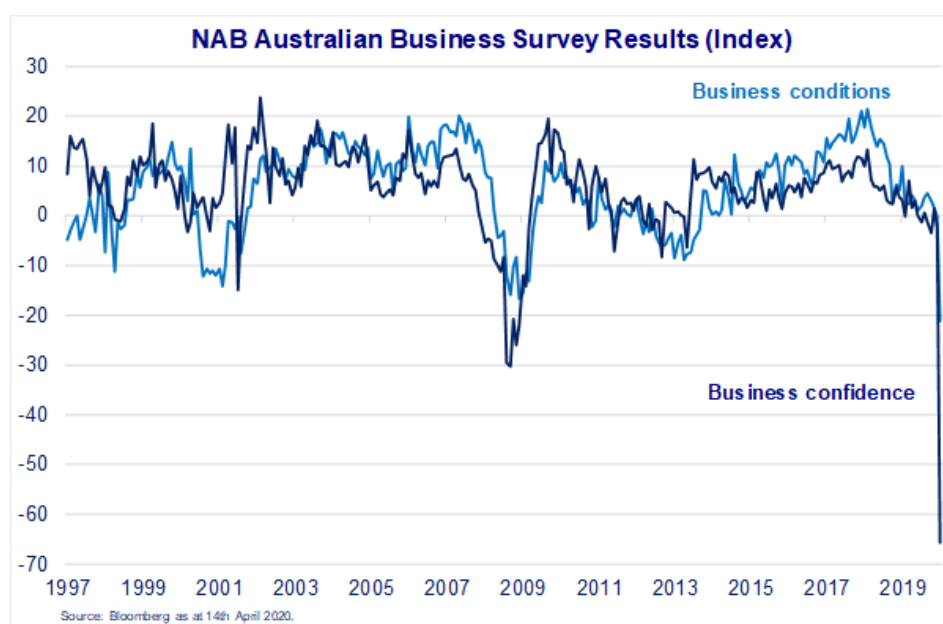
- Many are asking us if is this a short recession and a quick recovery. As we said yesterday, we have no line of sight yet on the rate of decline in global economic activity, but it's clear that it's massive, given across the world industry shutdowns. That, and leading indicators for the labour market, give an indication of the growth hole ahead which is

the largest since 1930, however, the yield curve slope, to ud, is not indicative of a robust recovery brewing. Some may say that Fed QE is holding long rates lower and while that is true, the US central bank was doing QE in early 2009, yet the curve slope rose to nearly 4% (see chart below). To us, the current 0.5% slope is indicative of a weak economic outlook which convinces us that the odds are high that the risk market rally could roll over when unemployment goes double-digit in the first week of May.



- The NAB Australian business survey for March made for fairly bleak reading. Business conditions (-21 points to -21) recorded its largest ever monthly decline to its lowest level since the early 1990s, and confidence fell by three times more (-64 to -66 points) to its lowest score on record. The survey predated the Morrison Government's Phase 3 fiscal package, so it may overstate the state of company expectations now, but that could be offset by ongoing strict conditions. Interestingly, all key components fell around the same level including trading conditions (-25pts to -19), forward orders (-25pts to -29), profitability (-22pts to -27) and employment (-21pts to -20) and all of this combined with capacity utilisation dropping to 75% supports a sharp deterioration of the Australian labour market in the next two months.

Most measures of price pressures also fell sharply, confirming that COVID-19 will have a disinflationary impact in the near-term. Growth in purchase costs (-40bp to +0.5% qoq) and final product prices (-50bp to -0.2% qoq) both fell, while labour costs fell -170bp to -0.9% qoq. That said, retail prices were resilient and remained unchanged at +0.6% qoq.

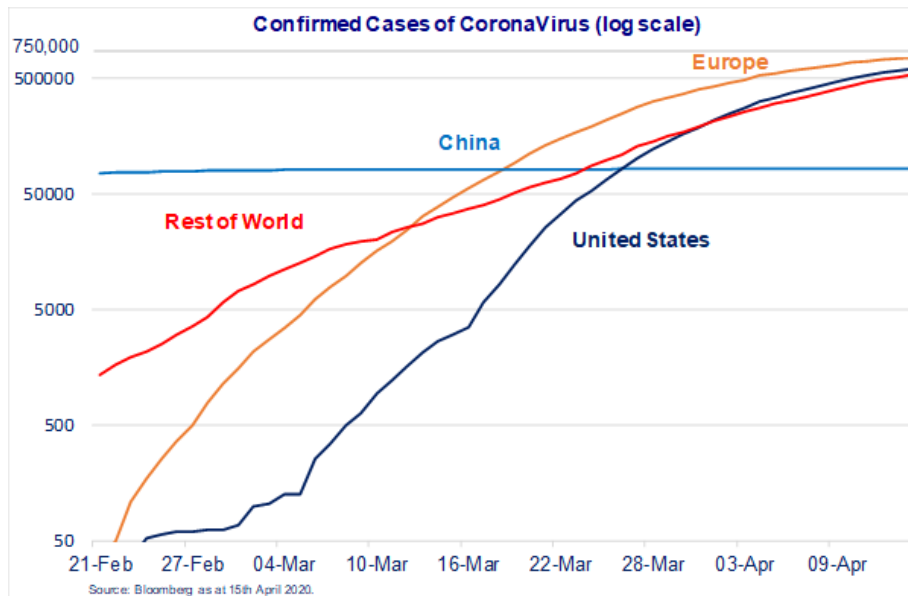


POLICY

- There were no policy announcements overnight.

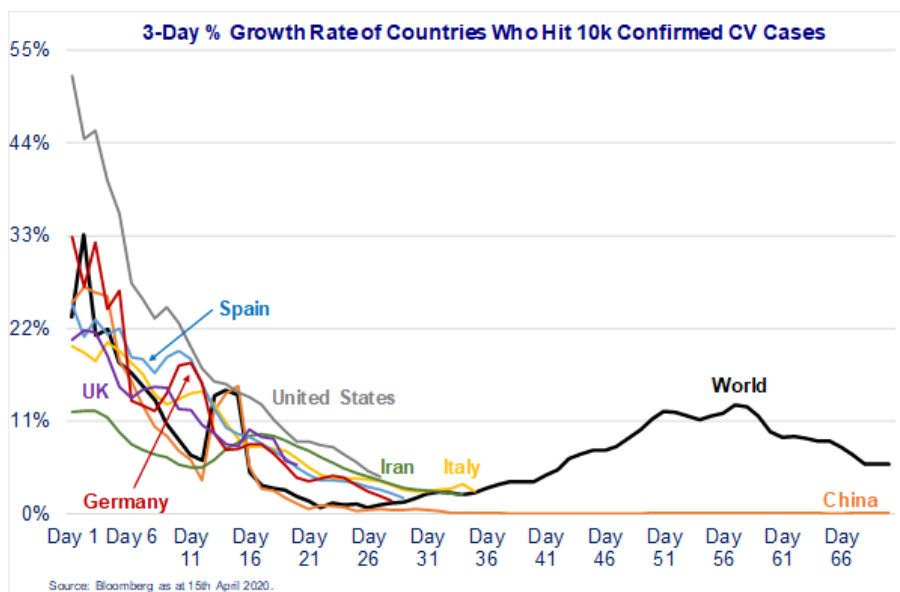
VIRUS UPDATE

- The world recorded another +63k of COVID-19 which is the lowest number in the past 18 days and the 3-day global growth rate slowed further to 3.7% which is the lowest in five weeks. The total confirmed cases increased to 1.98 million and deaths rose to 125.7k which brings the global death rate up to 6.35%.

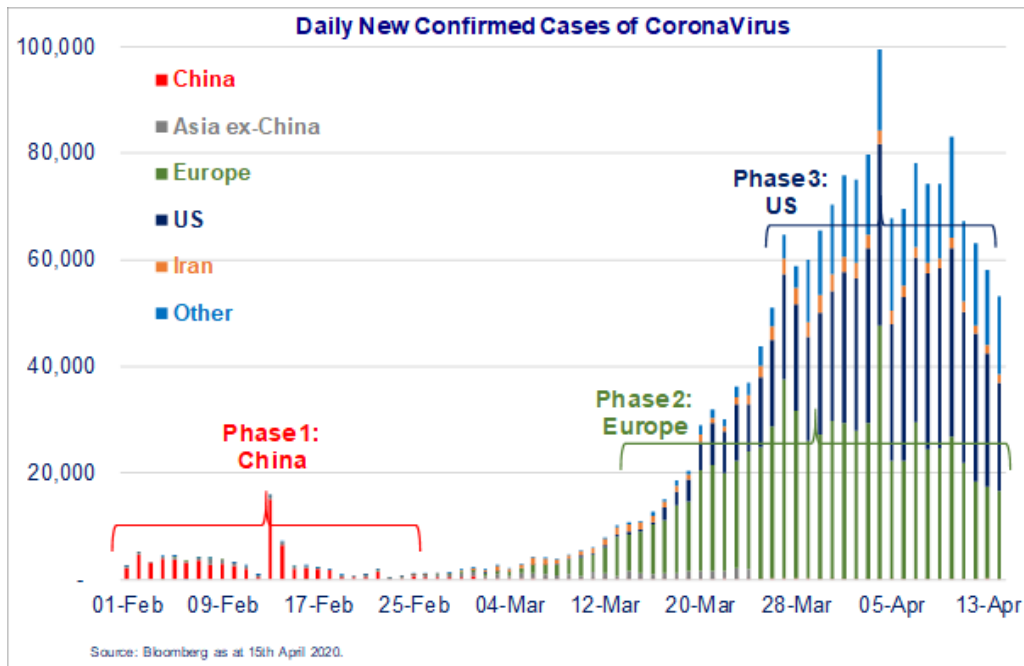


- Europe (+13.4k to 754k) continues to lead the world in terms of total cases, but the daily number of cases was the lowest in 26 days confirming not only has the curve flattened in the world's largest economic region, but it is heading lower like China's did in March. This confirms that social isolation works to reduce the spread of the virus, even though it comes at an enormous economic cost.

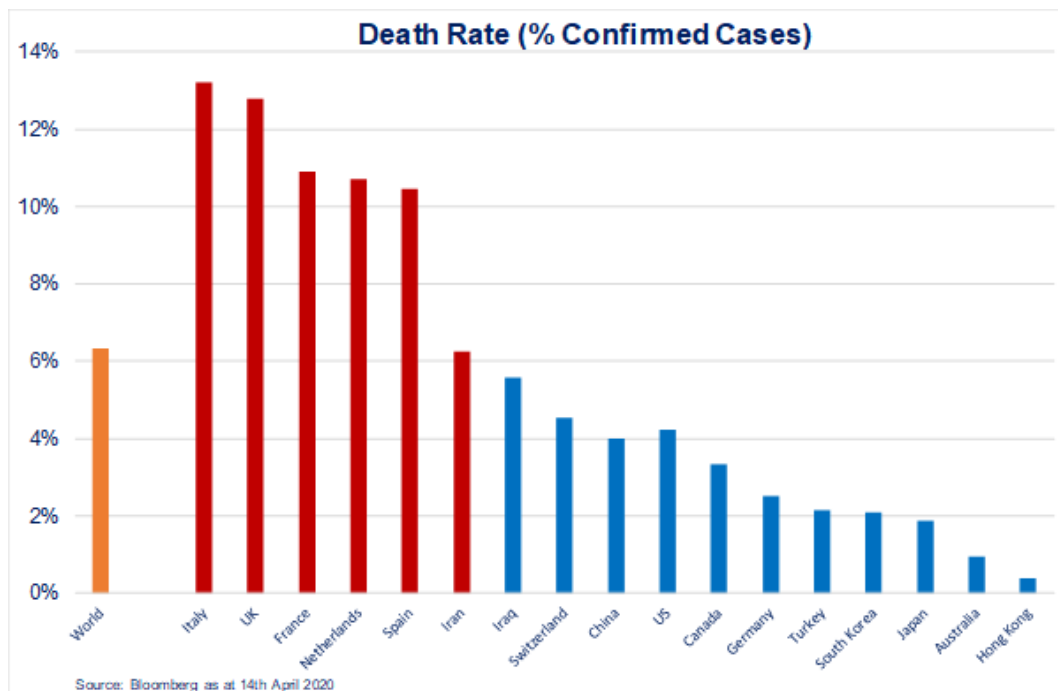
Similarly, the US had its best result in the past 16 days (+20.3k to 603k, although final numbers are not in) and its 3-day compound growth rate has declined to 4.4% which is equivalent to those seen in other countries four weeks after they reached 10k cases. New York new confirmed cases (+6.5k to 203k) were the second lowest in the past 16 days and while the 3-day growth rate has declined to 7.8% deaths recorded their fifth largest increase in the past three weeks which is indicative of the human toll in the city which never sleeps.



- Among countries we can see the number of daily cases is really starting to flatten out. The most infected country is the US (+20.4k to 603k), Spain (+2.4k (4-week low) to 172.5k), Italy (+3.1k to 162.5k), France (+6.5k to 144.4k), Germany (+1.2k (26 day low) to 131.4k), United Kingdom (+5.2k to 94.8k), China (+4 to 83.3k), Iran (+1.6k to 74.9k) and Turkey (+4.1k to 65.1k). Australia confirmed cases has increased (+143) to 6.5k which keeps us at 31st in terms of total infections.



- The global death rate has risen to +6.33% (having doubled in the past 7 weeks) with another +6.2k fatalities (fifth highest daily increase) overnight bringing the global total to 125.7k. The US had its second worst day of increases (+1.95k to 25.5k), but the death rate is highest in European countries where the health systems have collapsed led by Italy (+0.1% to 13.2%), the UK (+0.1% to 12.8%), France (flat at 10.9%), the Netherlands (+0.1% to 10.7%), Spain (+0.1% to 10.5%).



Yours sincerely,



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