Perpetual Investments

THOUGHTS ON THE MARKET

15th July 2020 - Stalemate

SUMMARY

- Global risk markets posted solid gains overnight but when the bonnet was lifted the increase was generated in the last hour of the US session as investors decided that bad news on the virus front was good news on the stimulus front. In the end, markets have trade sideways for over a month as bulls and bears move their bishops and horses out on the chess board and then hoard them back in when the other side makes a move. The net result has been a prolonged stalemate as forward-looking assumptions about COVID-19 treatments and a vaccine offset what is happening today in terms of rising case numbers and an unwinding or stalling of reopening plans. From here case numbers need to get worse for the bears to have things their way as the bulls have another Congressional stimulus plan and the Fed in their corner.

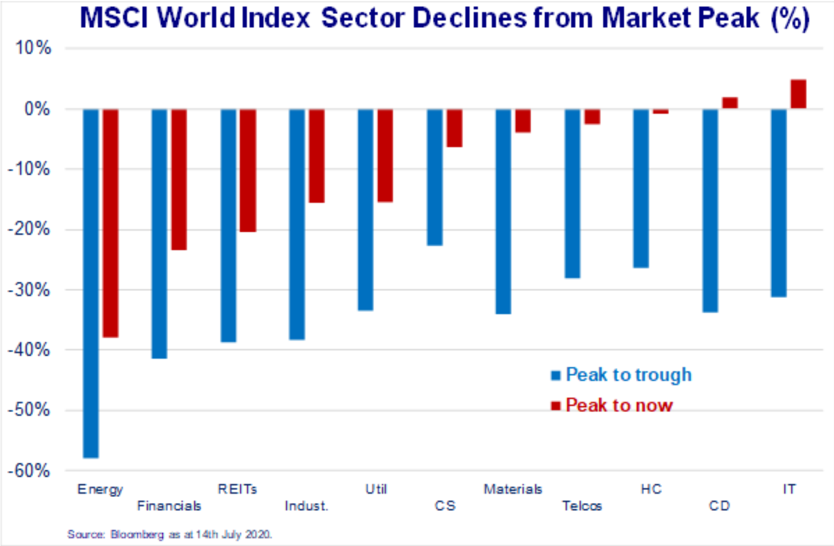
  In other markets, 10-year Treasuries were steady at 0.62% with curve slope staying under 0.5% for a second session, commodities were mixed with oil up +1.1% to USD40.75 per barrel whereas the gold price was steady at USD1809 per troy ounce, and G10 currencies were mixed with Sterling (-0.3%) and the Yen (-0.2%) depreciating against the Greenback, whereas the AUD (+0.2% to USC69.87) and Euro (+0.7%) both rallied.

- The economic calendar overnight had more volume than all of last week put together but there was no change in the underlying narrative. US inflation came in ahead of street estimates as several sectors recorded price gains from the depressed levels of recent months as the US economy reopened, and this is likely to continue in coming months, before the price gauge settles down well below the Fed's 2% target. Meanwhile, Australia's bi-weekly payrolls surprisingly declined -0.8% before the surge in Victoria's case numbers, but it's hard to draw any conclusion here as its only one month of weak data, and the time series has been subjected to large revisions.

- The number of global cases of COVID-19 is now 13.26 million overnight with another +187.4k cases so far (Mexico, Ecuador and 7 US states have not reported their numbers) which means that Tuesday was the 47th occasion in the past 49 days where daily increases have topped 100k. This means 4 countries have more than 700k cases, 17 countries have more than 200k cases 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 36 hours days another +258.3k cases have been confirmed. More importantly, the growth rate of daily confirmed cases (+1.6% since Saturday) is once again stabilising. Meanwhile, deaths stand at 573.3k and the death rate dropped for a sixty ninth straight day to 4.35%.

FINANCIAL MARKETS

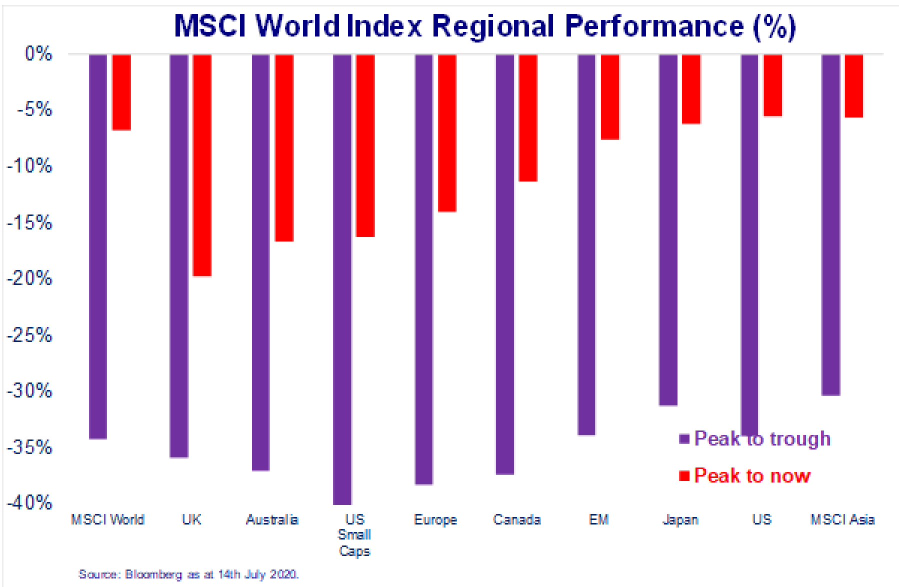
- **EQUITIES**
  - **The MSCI World Index closed +0.8% higher with all sectors advancing for the first time in the past eight trading sessions. The price increases were led by the two resource sectors** with energy (+2.9% continuing its recent price run of +5.2% in the past three sessions) and materials (+1.3%, +3.0%) which responded to higher commodity prices, with IT (+0.8%), industrials (+0.8%) and financials (+0.5%) also performing solidly. The overnight movements did not change the sectors in bear market and correction territory, but materials (-3.9%), telcos (--2.5%) and healthcare (-0.8%) are inching towards a complete recovery (see chart).



- **Among the regions, the US (+1.3%) led the pace of gains** with a strong last hour pushing the market to a century-plus advance. Banks were mixed after JPMorgan Chase and Co (+0.6%) reported strong trading results which was tapered by a larger than expected $10.5 billion provision as well as a bigger NIM contraction, it was a similar story for Citigroup (-3.9%) whereas Wells Fargo (-4.6%) tumbled after cutting its dividend and reporting its first quarterly loss since 2008. So, the earnings season has got off to a mixed start and the volume of results really ramps up next week and this will show how corporates have performed during closure, but guidance is the key for the markets. That said, by the bell at the NYSE the Dow Jones (+2.1%, +557 points, 26,642) outperformed its sector peers given a strong advance by Caterpillar (+4.8%), with the Russell 2000 (+1.8%) and the S&P 500 (+1.3%) both scoring centuries increases to offset yesterday's declines, and NASDAQ (+0.9%) also advanced.

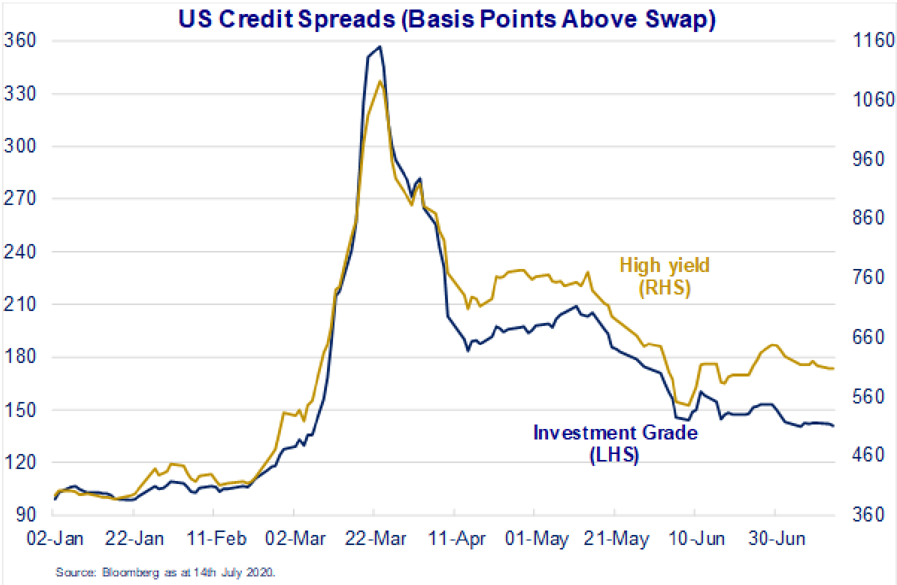
  In contrast to the US, **European markets (-0.9%) dropped** for the third time in the past five sessions. However, there was little incremental newsflow to underpin the move, so it was put down to concerns over potential economic lockdowns taking hold in the region despite very good performance on that front, so I put it down to simple profit taking after the region had risen +14.0% in the prior six weeks. The overnight decline was led by Spain (-1.0%), France (-1.0%), Germany (-0.8%), Italy (-0.6%) and Switzerland (-0.4%), but the UK (+0.1%) defied the regional trend and closed higher despite its monthly June GDP result (+1.8% m/m) coming in well below street estimates (+5.0% m/m).

  Earlier the MSCI Asia Pacific Index also declined by -0.9% yesterday following a weak lead from Wall Street to start the week with the late sell-off in US tech weighing heavily on the regional tech heavy weights, but a strong trade result for China in June as the economy reopened, which cushioned yesterday's regional downside. When the regional bell rang there were losses in Korea (-0.1%), Australia (-0.6%), Japan (-0.9%), China (-1.0%) and Hong Kong (-1.1%).

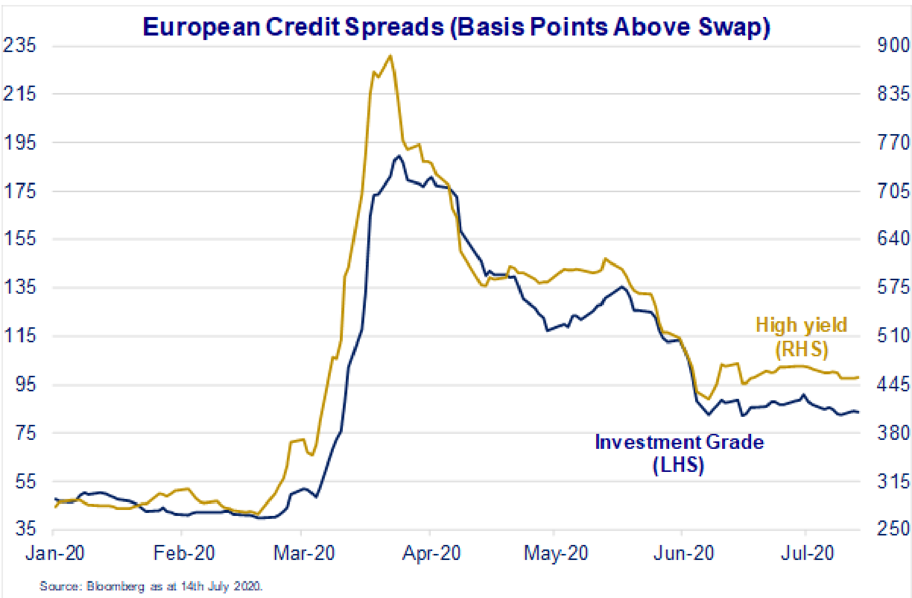


- Futures markets suggest a positive opening in Asia with Australia (+0.5%), Hong Kong (+0.6%) and Japan (+0.7%) all set to open in the green.

- **CREDIT MARKETS**
  - Regional credit indices were little moved as has been the case for most of the past month. In the US investment grade space, spreads came in -0.7 of a point to +141 bpts, which kept the recovery rate at 85%. There were lower risk premiums in 9 of the 11 sectors but only materials (-2 points, +180 bpts, 83%) beat the market average. In the high yield universe, the price action was even more subdued with the market index declining -0.4 of a point to +607 bpts, which kept the recovery rate at 71%. There was a little bit more action at the sector level where 7 sectors recorded lower spreads led by utilities (-6 points to +461 bpts, 69%) and this was about it. Hmmmmm.



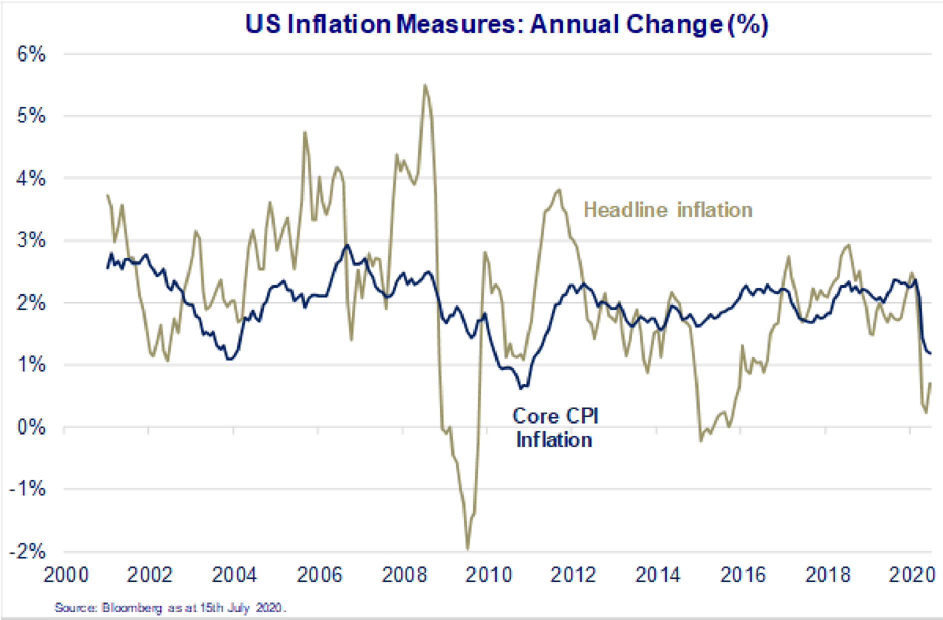
  - **European credit markets** were also very quiet with spreads in the investment grade universe down -0.6 of a point to +84bpts, which kept the recovery rate at 71% with 10 of the 11 sub-sectors recording spread declines. The decline was led by consumer discretionary (-3 points, +117 bpts, 71%) and tech (-2 points, +48 bps, 62%) and these price gains were offset by a rise subordinated financials (+3 points, +171 bpts, 71%) which continued to drift wider. In the high yield universe, spreads increased +2 points to +455 bpts, which kept the recovery rate at 70% with risk premiums rising in 8 of the 11 sectors led by healthcare (+12 points, +342 bpts, 66%) as investors continued to rebalance their portfolios and sell previously outperforming sectors and rotating into cheaper cyclicals including subordinated financials (-2 points, +430 bpts, 75%).



Perpetual

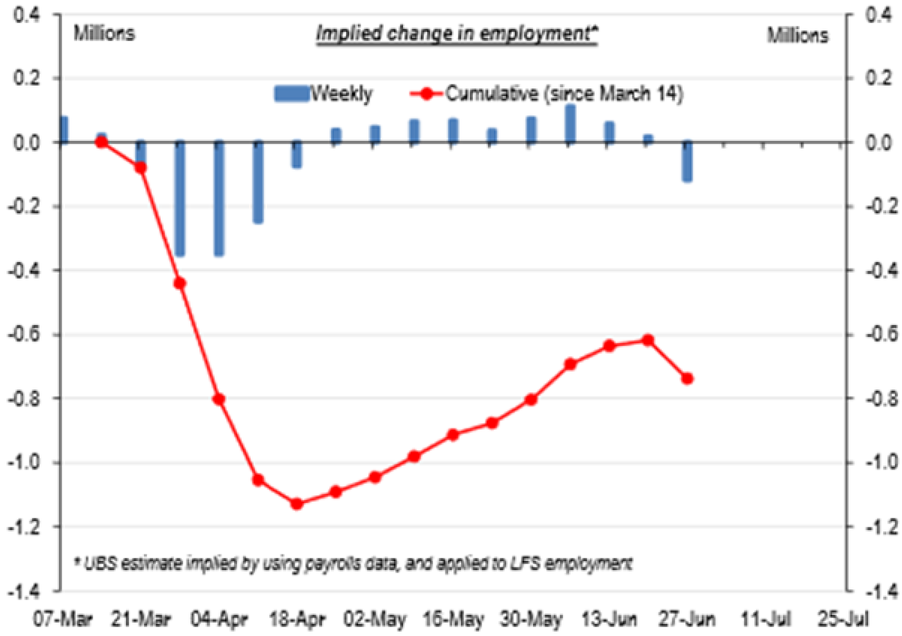
THE GLOBAL ECONOMY

- The **US CPI for June** rose +0.5% m/m which took the annual rate up to +0.6% y/y. The monthly reading was the first positive monthly result since February and this was underpinned by a +5.1% m/m rise in energy and +0.6% m/m for food and when these two volatile series were excluded the remaining core reading came in at 0.23% m/m (5-month high) which kept the annual rate at 1.2% y/y given large base effects. The strength in the core reading was unsurprisingly led by apparel (+1.7% m/m), airfares (+2.6% m/m), car and truck rental (+17.5% m/m) and lodging away from home (+1.2% m/m), all of which had declined precipitously in the prior four months. Interestingly, auto prices which had also fell sharply during Cov-19 lockdowns defied reopenings and continued to decline (-1.2% m/m). Aside from the bounce in hotel prices, services were supported by another solid 0.48% m/m increase in medical services, whereas owner's equivalent rent (which is 24.4% and the largest component in the CPI basket) and direct rents both slowed substantially to +0.09% m/m and +0.12% m/m, respectively.

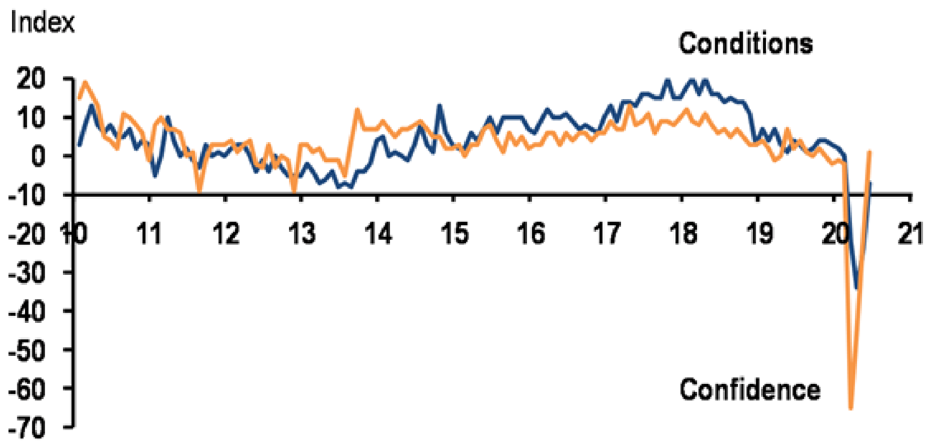


  Incorporating the CPI inputs, together with firm PPI details on health care and financial services prices released last week, we forecast core PCE inflation to rise 0.24% m/m in June, which would raise the year-over-year rate to 1.1% y/y from 1.0% y/y. US inflation is going to bounce around in the near term as there is potential for a further bounce in depressed categories like hotel, apparel prices and autos where demand has rapidly rebounded and favourable seasonality should support travel and tourism in the next two months. Once that is over, slowing shelter prices create risk of more persistently weak inflation and keep the annual rate well below the Fed's 2% target and policy on full throttle.

- The Bi-weekly **Australia payrolls report** suggest that labour market conditions had weakened in the two weeks to June 27, which is before the very recent tightening of mobility restrictions in Victoria, but after the survey period for the June Labour Force Survey. Indeed, the total payrolls dropped -0.8% in the second half of June which is a worrying sign as it's the first decline since lockdowns eased in late April and if it persists it would raise questions about the durability of Australia's recovery as a large labour market rebound is needed to offset the impact of reduced fiscal support in H2 2020.. That said, there are two caveats to the weak number – firstly, it's only a preliminary estimate and a flat number a fortnight ago was revised up to +1.4% yesterday, and secondly, the vast bulk of the decline was delivered by losses in healthcare which seems almost unbelievable as we are in a midst of a health crisis. Even so, the total jobs lost to the mid-April trough was +8.7%, of which +3.3% so far has been recovered (which implies a net loss of -737k jobs), but with the upcoming LFS undertaken in the first two weeks of June, the result (out 16th July) is likely to see jobs growth of around +200k (see chart), but the reintroduction of the JobSeeker 'mutual obligation' test (from June 9) should also result in a rebound of the participation rate and the unemployment rate.



- The **NAB survey of Australian business conditions** rebounded strongly in June (+17 bpts to -7) and is now back above the GFC trough. Interestingly, surveyed **business confidence** was stronger still (rising +21 pts to +1 – see chart), but the survey was conducted in the last week of June, which captured most of the mobility easings, but predated the surge in Victorian cases which is now spreading into NSW, so it may not be surprising to see business sentiment come off these levels in the next few months. That said, it was a strong report in that the June rebound was broad based with strong improvements in employment (+20pts to -11), trading conditions (+12pts to -7) and profitability (+11pts to -8), even though all three of these remained in negative territory as did forward orders (+20pts to -9).



Source: NAB, J.P. Morgan.

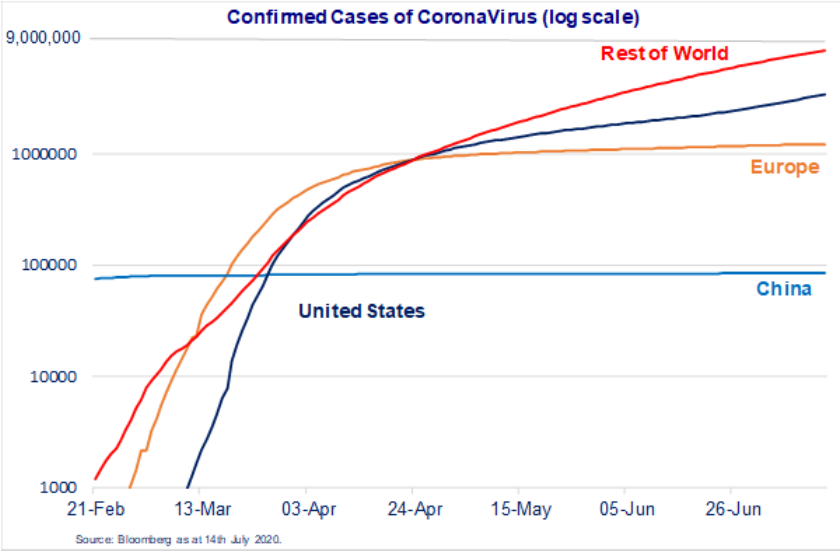
POLICY

- Senate Majority Leader McConnell said Republicans will finish their own plan for a fifth coronavirus bill sometime next week and then open up negotiations with the House Democrats. The sides are miles apart and there is not a lot of time given the widely discussed looming fiscal cliff and signs that the nascent recovery is levelling off with a wave of infections in the South and the West. Stimulus checks, enhanced unemployment benefits, state and local government aid, liability protections and tax cuts pushed by the White House are expected to be some of the more contentious issues.

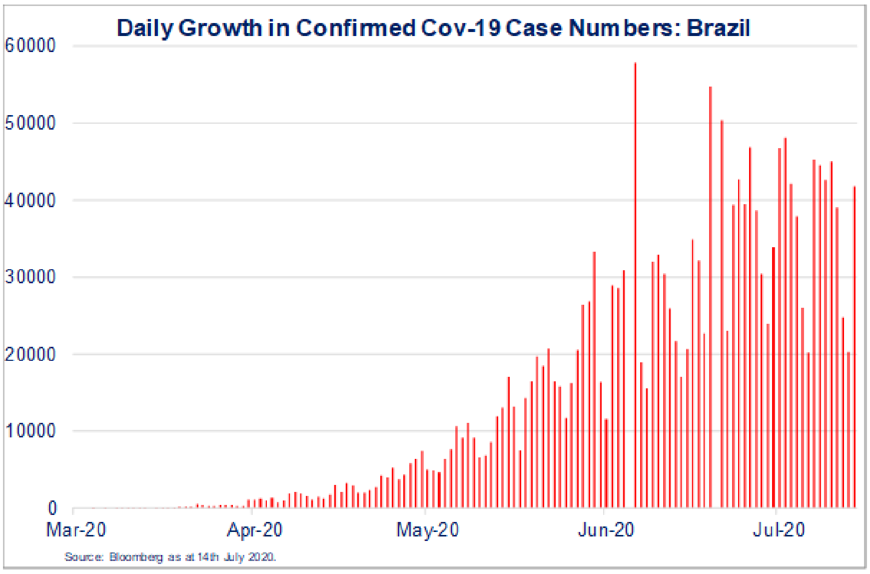
VIRUS UPDATE

- The number of global cases of COVID-19 is now 13.26 million overnight with another +187.4k cases so far (Mexico, Ecuador and 7 US states have not reported their numbers) which means that Tuesday was the 47th occasion in the past 49 days where daily increases have topped 100k. This means 4 countries have more than 700k cases, 17 countries have more than 200k cases and 22 countries have more than 100k cases.

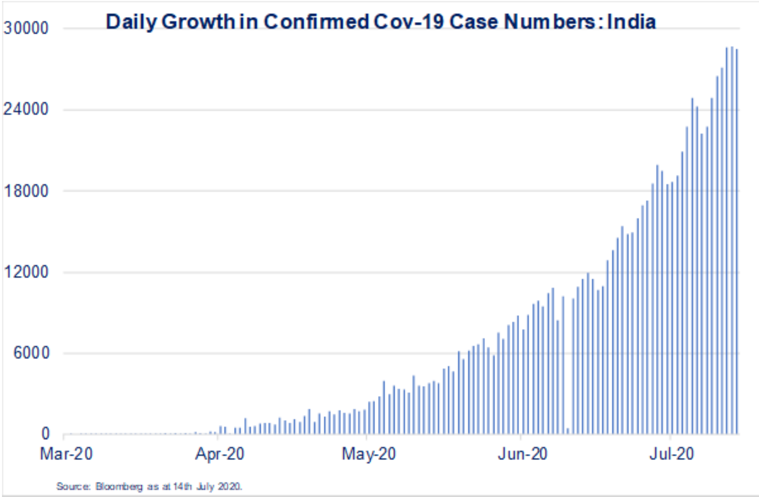
  It took 73 days to record 1 million cases, and after this each subsequent million has taken 13 days, 11 days, 12 days, 10 days, 11 days, 8 days, 8 days, 7 days, 6 days, 5 days, 5 days and 5 days, and in the past 36 hours days another +258.3k cases have been confirmed. More importantly, the growth rate of daily confirmed cases (+1.6% since Saturday) is once again stabilising. Meanwhile, deaths stand at 573.3k and the death rate dropped for a sixty ninth straight day to 4.35%.

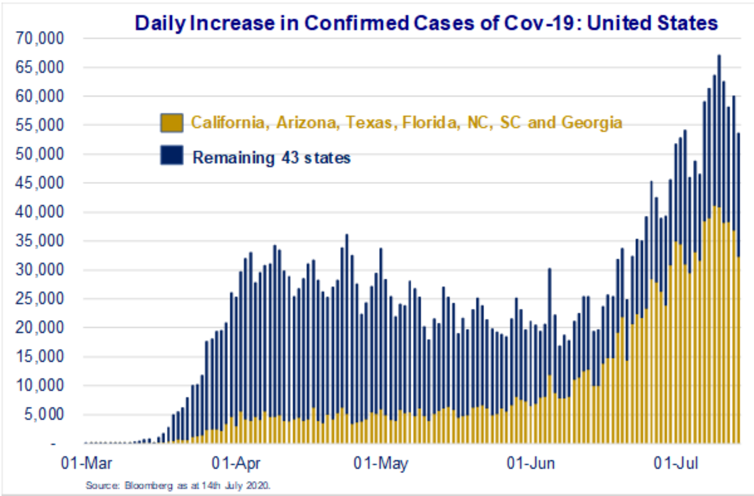


- We break the infections into four groups – the US, Europe, China and 'others' and the rest of the world outside the G3 economies now has the most total cases (+97.9k to 8.52 million) and highest daily new cases (and by a considerable margin) followed by the US (+53.2k to 3.42 million, although 7 states are yet to report) and Europe (+1.8k 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 (+41.9k to 1.93 million, which is the second highest in the world), India (+28.5k to 906.8k) and Russia (+6.2k to 738.8k, fourth highest) (see charts below).



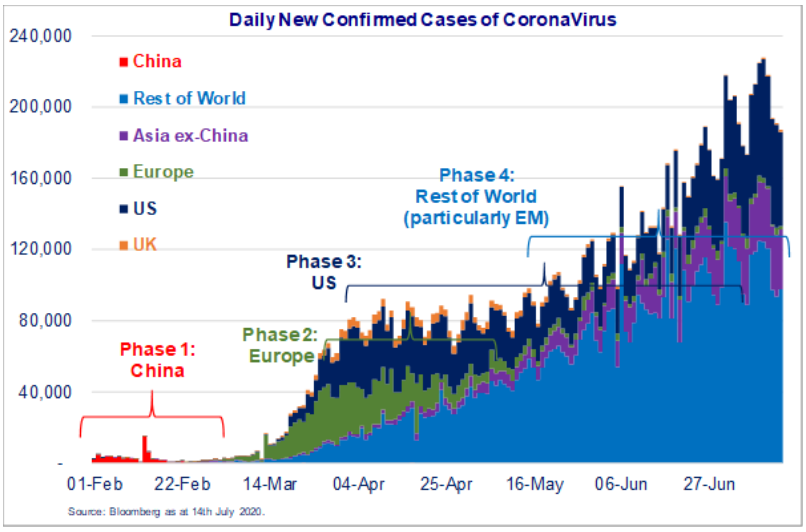
Perpetual



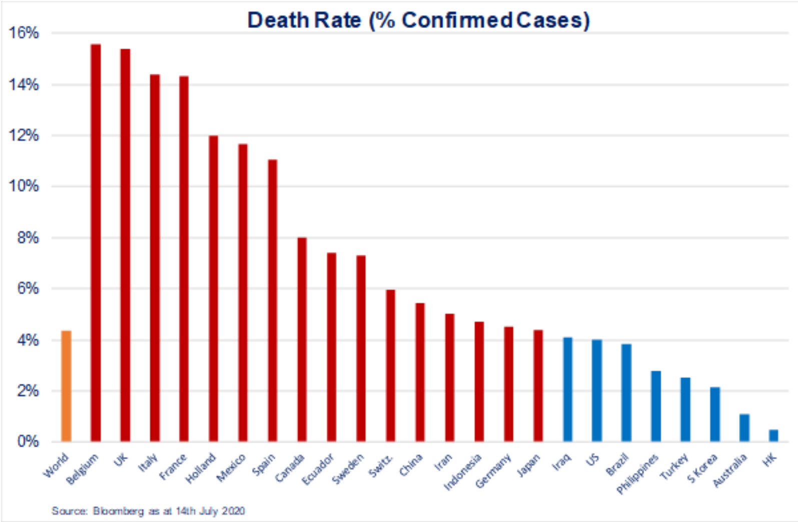


- Among countries, the most cases are in the US (+53.2k (so far) to 3.42 million, with 7 states yet to report), Brazil (+41.9k to 1.93 million), India (+28.5k (second highest on record) to 906.8k), Russia (+6.2k to 738.8k), Peru (+3.7k to +333.9k), Chile (+1.8k to 319.5k), Mexico (not reported, +304.4k), South Africa (+10.5k to 298.3k), the United Kingdom (+1.2k (6-week high) to 291.7k), Iran (+2.5k to 262.2k),Spain (+0.7k to 256.6k), Pakistan (+2.0k to +253.6k), Italy (+0.1k to 243.3k), Saudi Arabia (+2.7k to 237.8k), Turkey (+1.0k to 215.0k) and France (not reported, 209.6k). Australia confirmed cases rose +271 to 10,251 yesterday which placed us 70th in terms of total infections.

  Elsewhere, Singapore recorded +0.3k new cases to 46.6k 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 (+1.6k to 78.6k) is now on the rise and has the most cases in the region, and the Philippines (+0.5k to 57.5k) is also on an upward trend.



- Although final numbers are not in until 1pm AEST, the global death rate declined for a sixty ninth straight day to 4.35% with the global total to 573.3k after another 4.3k deaths overnight, so far. The US (+0.7k so far) has the most deaths at +136.3k, with Brazil (+1.3k to 74.1k), the UK (+0.1k to 45.1k), Italy (+0.01k to 35.0k), Mexico (not reported, +35.5k) and France (not reported, 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 4.7%) and Brazil (-0.1% to 3.9%).



Yours sincerely,

MATT SHERWOOD
Head of Investment Strategy, Multi Asset

MICHAEL O'DEA
Head of Multi Asset

This document has been prepared by Perpetual Investment Management Limited (PIML) ABN 18 000 866 535, AFSL 234426. It is general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider, with a financial adviser, whether the information is suitable for your circumstances. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information. The PDS for the Perpetual Diversified Real Return Fund, issued by PIML, should be considered before deciding whether to acquire or hold units in the fund.

The PDS can be obtained by calling 1800 022 033 or visiting our website www.perpetual.com.au. No company in the Perpetual Group (Perpetual Group means Perpetual Limited ABN 86 000 431 827 and its subsidiaries) guarantees the performance of any fund or the return of an investor's capital. Past performance is not indicative of future performance.

MORE INFORMATION

Perpetual Investments 1800 062 725
Email investments@perpetual.com.au
www.perpetual.com.au/investments