

THOUGHTS ON THE MARKET

16th July 2020 - Markets continue to speculate over a COVID-19 vaccine

SUMMARY

- Global stocks climbed to a six-week high overnight as investors remained optimistic about the chances of developing a vaccine for COVID-19 after Moderna Inc reporting promising trial results where patients develop antibodies. However, as a person with 4 auto-immune conditions, I can assure you that the existence of antibodies may do nothing to prevent the development of COVID-19, so the market rally is pure speculation underpinned by central bank liquidity - forget valuation, forget earnings, forget a stalling recovery, forget the fiscal cliff and forget about upcoming deleveraging.

In other markets, 10-year US Treasuries were steady at 0.63% with curve slope unchanged, commodities rallied with oil up +1.7% to a 4-month high of USD40.99 per barrel and gold rose +0.9% to a fresh 9-year high of USD1,810 per troy ounce, and G10 currencies lifted against a weaker Greenback led by the AUD (+0.7% to USC70.07), Sterling (+0.5%), Yen (+0.4%) and the Euro (+0.4%).

- In macro news, US industrial production for June rose +5.4% m/m which beat the street and is a constructive sign for tonight's June US retail sales result, but the overnight report was not strong with activity still depressed and -11% below the level recorded in February. Meanwhile, the NY Fed's Empire manufacturing index reported increased activity (+17.4 to 17.2) and a larger work week, but the employment index (+3.9 to 0.4) showed workers have stopped being fired rather are being rehired, and expectations moving forward fell sharply after the June surge.

These two reports are more signs that the goods sector has risen solidly from the ashes of COVID-19, whereas the services sector is lagging notably. Indeed, the 12-month trailing profit margin for the Russell 3000 restaurant index is down to a 5-year low with foot traffic down 50% over the period and with USD120 billion lost in March and April. More worryingly, the National Restaurant Association reported that 85% of restaurants could permanently close by end-2020. By way of comparison, European sales are down -20% with traffic -40% lower, and in Asia both numbers are down -30%.

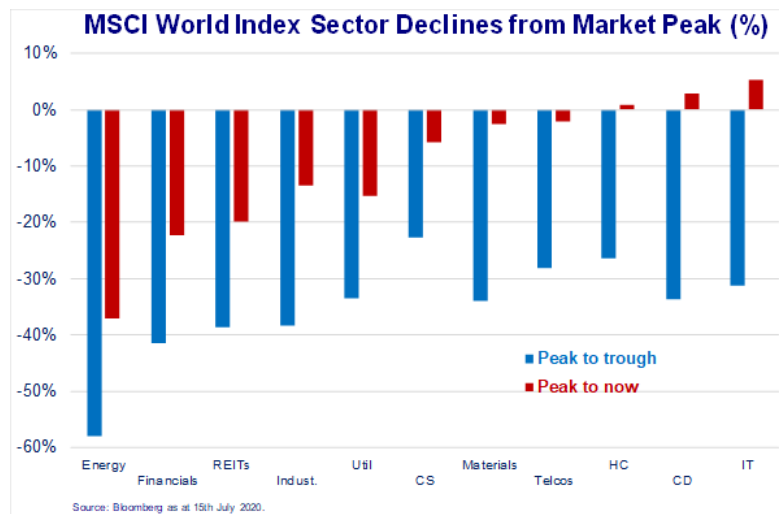
- The number of global cases of COVID-19 is now 13.5 million with another +205k cases so far (Mexico and 5 US states have not reported their numbers) which means that Wednesday was the 48th occasion in the past 50 days where daily increases have topped 100k. This means 4 countries have more than 700k 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 2 days another +494.8k cases have been confirmed. More importantly, the growth rate of daily confirmed cases (+1.6% since Sunday) is once again stabilising. Meanwhile, deaths stand at 581.1k and the death rate dropped for a seventieth straight day to 4.32%.

FINANCIAL MARKETS

EQUITIES

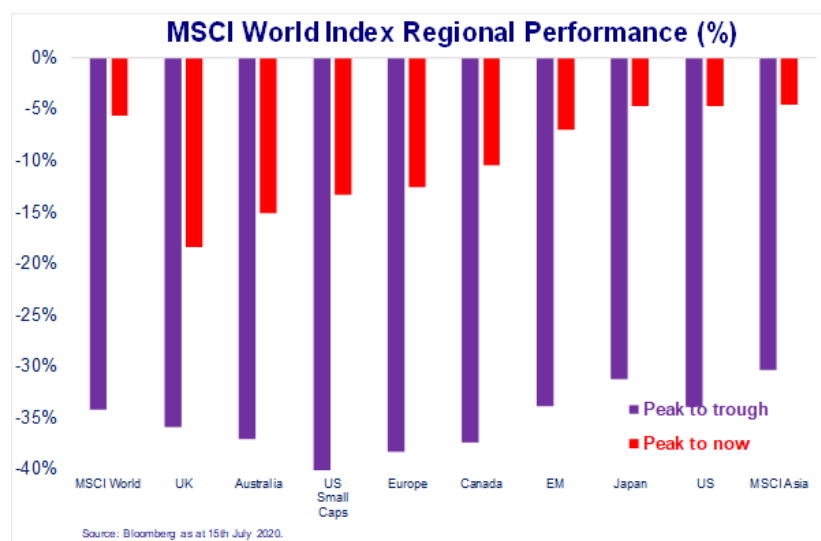
- The MSCI World Index closed +1.2% higher with advances all sectors and countries for the first time in the past two weeks. For a fourth consecutive session the cyclicals led the rally with advances in industrials (+2.5%), financials (+1.5%), energy (+1.5%) and consumer discretionary (+1.0%), with tech (+0.5%) lagging on likely portfolio switching, and defensives mostly up between +0.2% and +0.5% for the session. Sentiment was buoyed by Moderna Inc's COVID-19 vaccine trial where all patients produced antibodies, however a

number of participants also experienced side effects, some of which were severe and the findings from the Phase I trial were largely in line with results published in a report the company issued back in May. Nevertheless, the overnight moves, saw REITs (with a peak-to now loss of -19.9%) leave bear market territory and financials (-22.2%) are closing in on that achievement, whereas healthcare (+0.9%) joined consumer discretionary (+2.9%) and tech (+5.4%) in recording a complete recovery.



- **All major regions** recorded price gains overnight for only the second time in the past 3 weeks with advances led by Europe (+1.7%) despite the absence of accretive macro news. Regional sentiment was buoyed by positive coronavirus vaccine developments with speculation mounting that there will be positive news on initial trials from a trail backed by AstraZeneca (+5.2%) which has been supported by UK government funding. This speculation underpinned double century advances for France (+2.0%) and Italy (+2.0%), with strong price support also evident in Switzerland (+1.9%), Germany (+1.8%), Spain (+1.8%) and the UK (+1.8%). This positive sentiment flowed through to the US, where the lingering news from Moderna Inc. trial supported sentiment for a second day as did better than expected industrial production for June, and a very strong result from Goldman Sachs (+1.4%) and upbeat mortgage performance by US Bancorp (+3.8%). By the close, the US market advances were led by the Russell 2000 (+3.5%), S&P 500 (+0.9%) and the Dow Jones (+227 points, +0.8%, to 26870), whereas the NASDAQ 100 index (+0.6%) lagged for a third consecutive session.

Earlier, the MSCI Asia Index rose +1.1% with advances in Australia (+1.9%) and Japan (+1.6%) offset by a flat result in Hong Kong (+0.01%) and a decline in China (-1.3%) in a session which lacked incremental data which left the region to follow the Wall Street lead. The overnight moves saw the UK (-18.4% from its February peak) move further away from bear market territory (see chart).

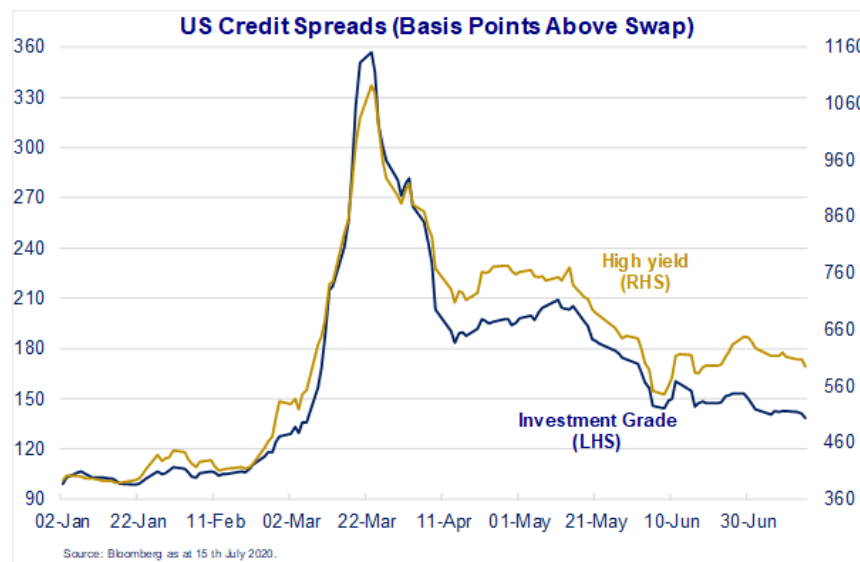


- Futures markets suggest a mixed opening in Asia with Australia (+0.4%) set to advance along with Hong Kong (+0.4%), whereas the rally in the Yen is expected to weigh on the opening in Japan (-0.3%).

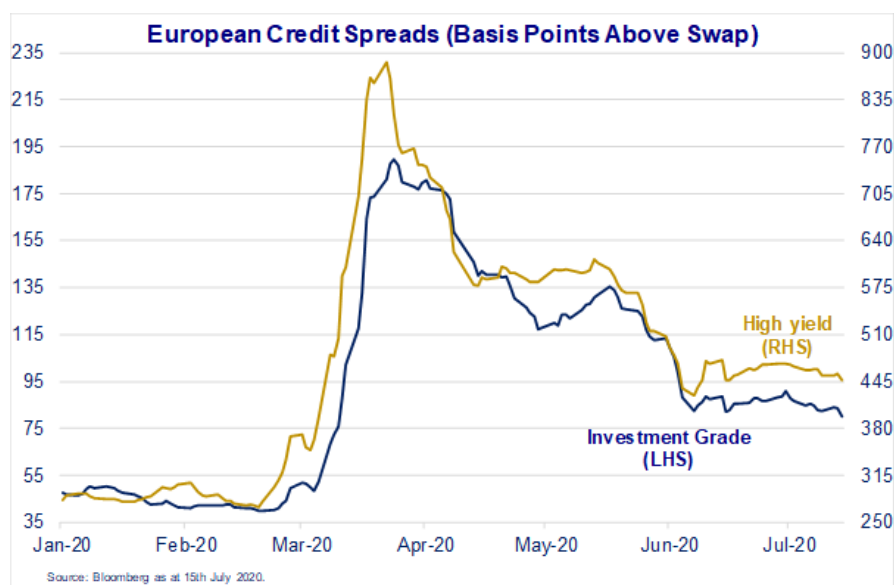
• CREDIT MARKETS

- **Regional credit indices** rallied overnight with the positive sentiment from equities finally flowing through to corporate debt markets. In the US investment grade space, spreads contracted -3 points (an 8-session peak) to +139 bpts (4-month low) which increased the recovery rate to 86%. Risk premiums declined in all sectors, with the cyclicals outperforming led by energy (-4 points, +194 bpts, 90%) which liked the sound of a 4-month high for oil prices, industrials (-3 points, +152 bpts, 74%) where sentiment improved given a solid NY Fed manufacturing index report, and materials (-4 points, +177 bpts, 84%) despite a mixed performance in base metal prices.

In the high-yield universe, spreads came in -12 points to +595 bpts which increased the recovery rate two notches to 73%. All sectors recorded lower risk premiums and nine saw double digit declines led by the cyclicals including tech (-17 bpts, +516 bpts, 66%) although the supporting macro currents here were weak, energy (-14 points, +894 bpts, 92%) and consumer discretionary (-13 points, +599 bpts, 62%).



- **European credit markets** were also upbeat overnight with spreads in the investment grade universe coming in -3 points to +80 bpts, which increased the recovery rate two notches to 73%. All 11 sub-sectors rallied, and like the US, the advances were led by the cyclical sectors including consumer discretionary (-5 points, +111 bpts, 73%), subordinated financials (-5 points, +166 bpts, 73%), and industrials (-5 points, +84 bpts, 61%). In the high yield space, spreads came in -8 points to +426 bpts which increased the recovery rate one notch to 71%. All sectors rallied, but industrials (-37 points, +550, 71%) was the star of the day as investors sought the most lagging cyclical sector as regional economic prospects have brightened with economic reopening and sustained low COVID-19 case numbers. Other leading sectors were senior financials (-9 points, +355 bpts, 76%) and energy (-5 points, +580 bpts, 69%).



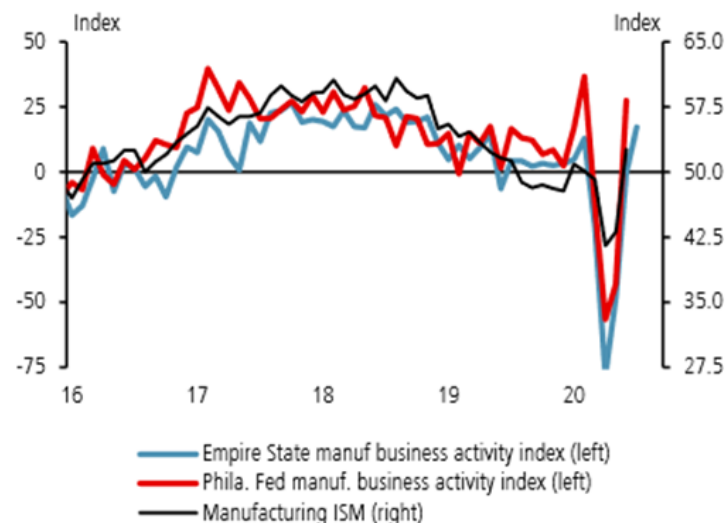
THE GLOBAL ECONOMY

- **US industrial production** rose +5.4% m/m in June which beat the street (+4.3% m/m) and the May result (+1.4% m/m), with the increase underpinned by a large +7.2% m/m bounce in manufacturing activity, which outweighed weakness in utilities and mining given the still faltering energy sector. This may represent a second month of increased activity, but it is still not a strong report as the fastest recovering sector (manufacturing) is still -11% below its February level—but it does corroborates the restart of activity that's been shown in payrolls and factory surveys. A large portion of the manufacturing bounce is autos with the remaining sectors up only +3.9% m/m (see table) with as supply chain strains potentially impacting activity, with several Ford plants, for example, potentially closing next week because of shortages of engines built in Mexico.

	Mar	Apr	May	Jun
Total IP (%m/m)	-4.4	-12.7	1.4	5.4
Manufacturing	-5.1	-15.9	3.8	7.2
High-tech	0.2	-2.8	-0.4	1.8
Ex high-tech	-5.2	-16.2	3.9	7.4
Manuf ex autos	-3.2	-12.3	1.9	3.9
Total IP (%y/y)	-4.7	-16.3	-15.3	-10.8
Manufacturing	-5.3	-19.7	-16.7	-11.1
High-tech	3.0	1.3	1.3	1.8
Ex high-tech	-5.6	-20.2	-17.2	-11.5
Capacity util (%)	73.5	64.2	65.1	68.6
Manufacturing	71.3	60.0	62.3	66.9

Source: Federal Reserve Board, UBS

- **The Empire State manufacturing index** rose from -0.2 in early June to 17.2 in early July, as state activity caught up with the rest of the country as businesses slowly re-opened. The chart below shows that New York went down harder given its large COVID-19 infection rate and the economy has been slower to recover in terms of speed and size, but that is just a case of timing with New York seemingly one month behind other states. Within the survey, the indexes of new orders (+14.5 to 13.9) and the average work week showed similar improvement to the headline number, but the employment index (+3.9 to 0.4) was very soft as it inched into growth territory which suggests firms are no longer firing workers, rather than aggressively rehiring them. Meanwhile, the 6-month ahead gauge declined (-18.1 to 38.4) after last month's surge.



Source: Federal Reserve System, ISM, UBS

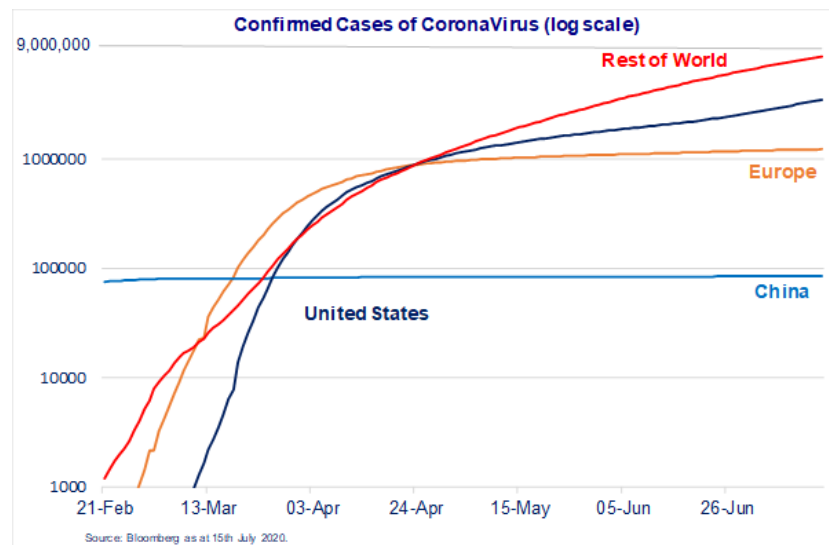
POLICY

- There were no major policy announcements overnight.

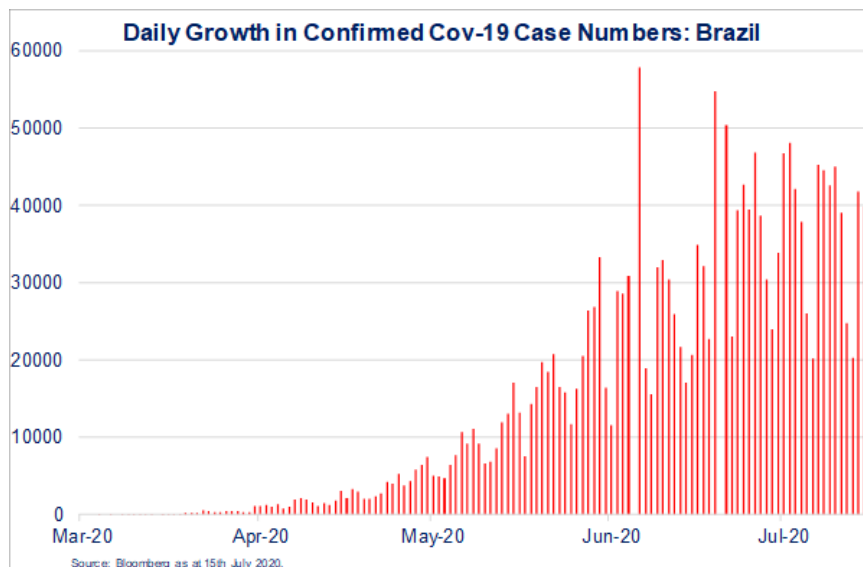
VIRUS UPDATE

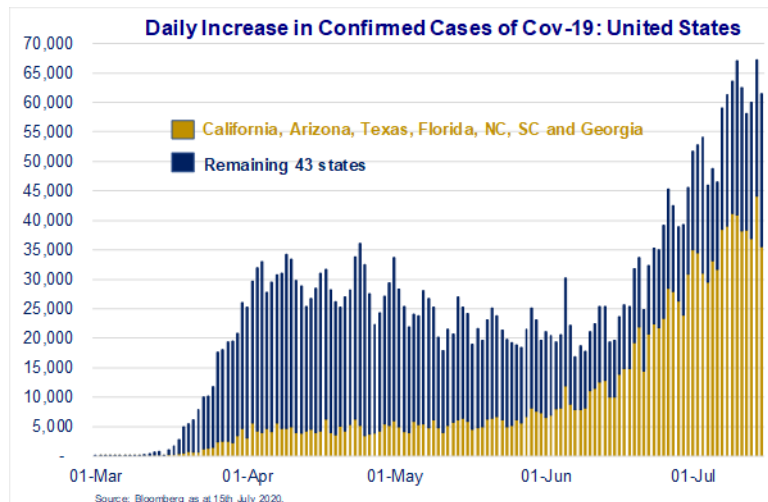
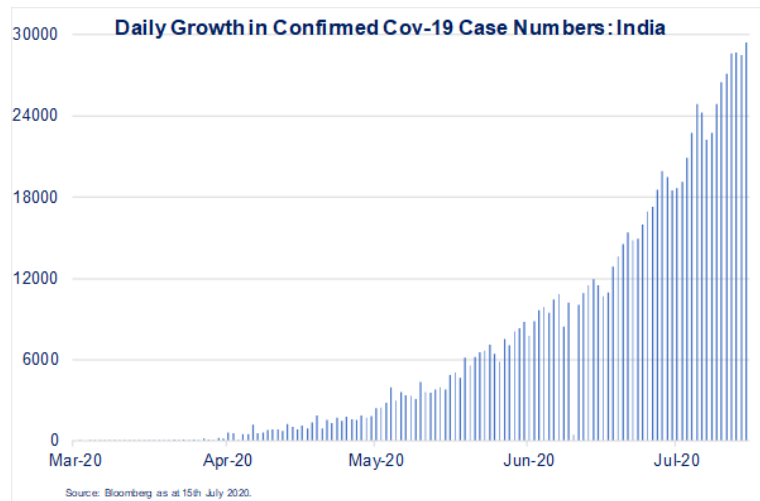
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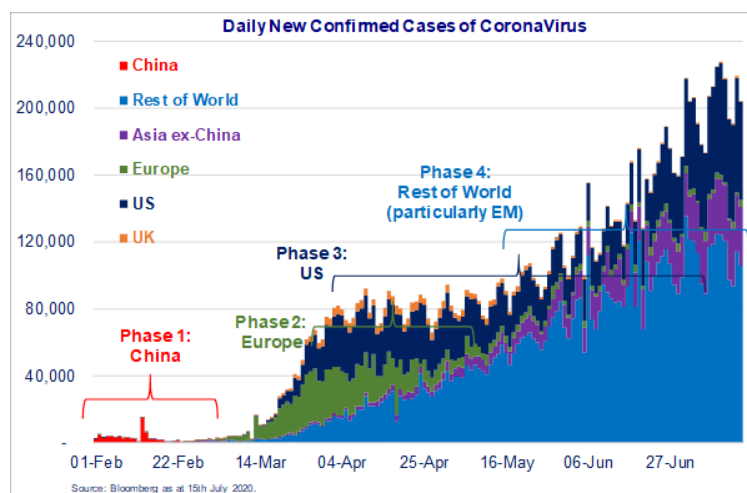
- We break the infections into four groups – the US, Europe, China and ‘others’ and the rest of the world outside the G3 economies now has the most total cases (+106.0k to 8.7 million) and highest daily new cases (and by a considerable margin) followed by the US (+61.4k to 3.35 million, although 4 states are yet to report with 5 already reporting record numbers) and Europe (+3.8k to 1.24 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 (+40.0 to 1.97 million, which is the second highest in the world), India (+29.4k (record high) to 936.2k) and Russia (+6.4k to 745.2k, fourth highest) (see charts below).



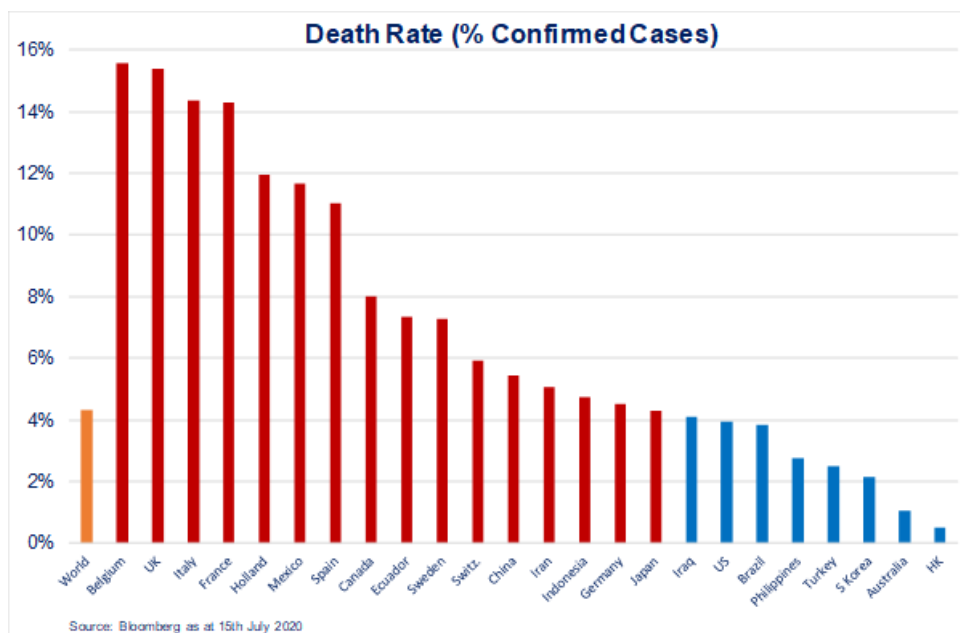


- Among countries, the most cases are in the US (+61.4k (so far) to 3.49 million, with 4 states yet to report and 5 already reporting record increases), Brazil (+40.0k to 1.97 million), India (+29.4k (record high) to 936.2k), Russia (+6.4k to 745.2k), Peru (+3.9k to +337.8k), Chile (+1.7k to 321.2k), Mexico (not reported, +311.5k), South Africa (+12.7k to 311.0k), the United Kingdom (+0.5k to 293.5k), Iran (+2.4k to 264.6k), Spain (+0.9k to 257.5k), Pakistan (+2.2k to +255.8k), Italy (+0.2k to 243.5k), Saudi Arabia (+2.7k to 240.5k), Turkey (+0.9k to 215.9k) and France (+0.9k to 210.6k). Australia confirmed cases rose +236 to 10,495 yesterday which placed us 72nd in terms of total infections.

Elsewhere, Singapore recorded +0.2k new cases to 46.9k 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 (+1.5k to 80.1k) is now on the rise and has the most cases in the region, and the Philippines (+1.3k to 58.9k) is also on an upward trend.



- Although final numbers are not in until 1pm AEST, the global death rate declined for a seventieth straight day to 4.33% with the global total to 581.1k after another 4.5k deaths overnight, so far. The US (+0.8k so far) has the most deaths at +137.2k, with Brazil (+1.2k to 75.4k), the UK (+0.1k to 45.1k), Mexico (not reported, +36.3k), Italy (+0.01k to 35.0k) and France (+0.1k to 30.1k) 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 11.0%) 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 7.3%), Indonesia (-0.1% to 4.7%) and Brazil (-0.1% to 3.3%).



Yours sincerely,



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