

THOUGHTS ON THE MARKET

16th June 2020 - A Fed policy re-announcement ignites risk-on sentiment

SUMMARY

- Global shares were mixed overnight with losses in Asia and Europe offset by gains in the US. However, the US market opened sharply lower, but when the US Fed followed through on their March pledge to buy corporate bonds, stocks rallied and edged higher. In other markets, 10-year Treasuries index two points to +0.72% with curve steepening, commodity prices were mixed with gold -0.3% lower at USD1725.15 per troy ounce and rose +2.0% higher at USD37.07 per barrel, and G10 currencies were mostly high against a weaker Greenback led by the AUD (+0.7% to USC69.11), the Euro (+0.6%) and Sterling (+0.5%), with the Yen steady.
- There was no top tier economic data out overnight, but the regular old economy monthly data set from China showed continued growth which were softer than expected and mixed relative to April. The message here is clear that the supply side is doing better than demand, manufacturing is outperforming services and that cars are outperforming catering.
- The Fed announcement overnight was the material price news and it suggests markets remain confident that the Fed wants to keep credit spreads under control and the institution added a twist that they would follow an internally derived diversified market index of US corporate bonds, but this has not been released.

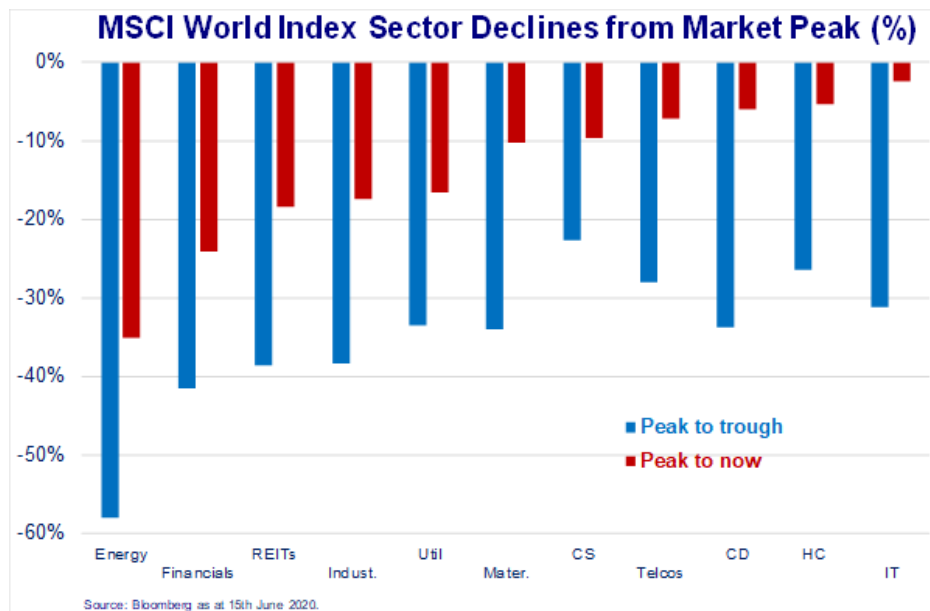
The market backstop is needed as while economic growth has begun lifting around the world after a record plunge, data in recent weeks indicates the global economy is still very weak and rising COVID-19 cases numbers in numerous areas in the US, China and broader EM has poured cold water on expectations of a more rapid re-opening and a V-shaped recovery. That risk is now not only off the table, its back in the fridge as a slower re-opening will make it very difficult for the reality of business to keep up with bullish expectations.

- The number of global cases of COVID-19 topped 8.0 million this morning with another +100.8k cases so far overnight (before Mexico, Chile and some US states report their numbers) which means that Sunday was the 18th occasion in the past 20 days where daily increases have topped 100k. This means 3 countries have more than 500k cases, 8 countries have more than 200k cases and 17 countries have more than 100k cases. It took 73 days to record 1 million cases, 13 days for the next million, 11 days for the third million, 12 days for the fourth million, ten for the fifth million, 11 for the six million and 8 days for the seventh and eighth million. More importantly, the growth rate of daily confirmed cases (+1.7% since Friday) is starting to rise (albeit modestly). Meanwhile, deaths stand at 435.6k and the death rate dropped for a fortieth straight day to 5.44%.

FINANCIAL MARKETS

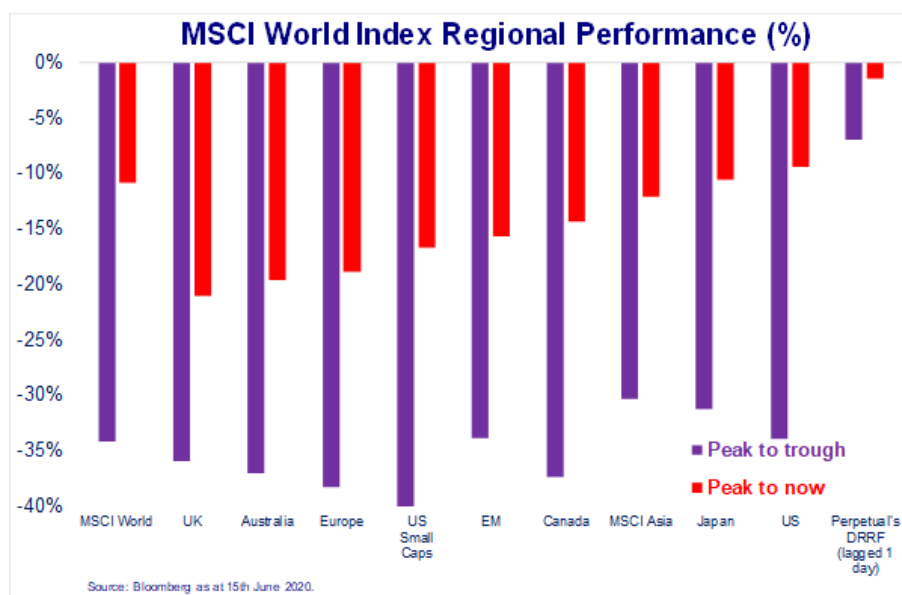
• EQUITIES

- The MSCI World Index closed +0.3% higher in choppy and mixed trading. Seven of the 11 GICS sectors closed higher led by tech (+0.8%) and telcos (+0.6%) but there was little else in a quiet news day, with energy (-0.4%) the only decliner worth mentioning as their losses took the sector deeper into bear market territory (see chart). In the regions, the US (+0.8%) was the strongest performer as equity investors like the sound of the Fed actually opening its credit market and main street lending programs which were announced two months ago and have underpinned the ensuing rally. This announcement was supportive for financials which overnight US sector performance, with the Russell 2000 (+2.3%) outperforming the NASDAQ (+1.4%) and Dow Jones (+158 points, +0.6% to 25,763).



In Europe, stocks dropped -0.6% but this was well off its lows (-2.8%) but there was little news so stressed markets continued to underperform led by Portugal (-0.9%), the UK (-0.7%), Spain (-0.5%) and France (-0.5%). Germany outperformed but was still lower (-0.3%), and Italy (+0.4%) bucked the regional trend and closed in the black, although could not claim that this reflected investors de-risking their portfolio!

Earlier, the MSCI Asia Pacific index closed -2.3% lower (12-week low) with investors fretting over rising COVID-19 case numbers in the US, China and broader EM which underpinned large losses in Japan (-3.5%), Australia (-2.2%), Hong Kong (-2.2%) and China (-1.2%). This saw Japan re-enter correction territory and Australia and Europe inch towards bear market territory (see chart), but the US is now out of correction territory, but who knows for how long?

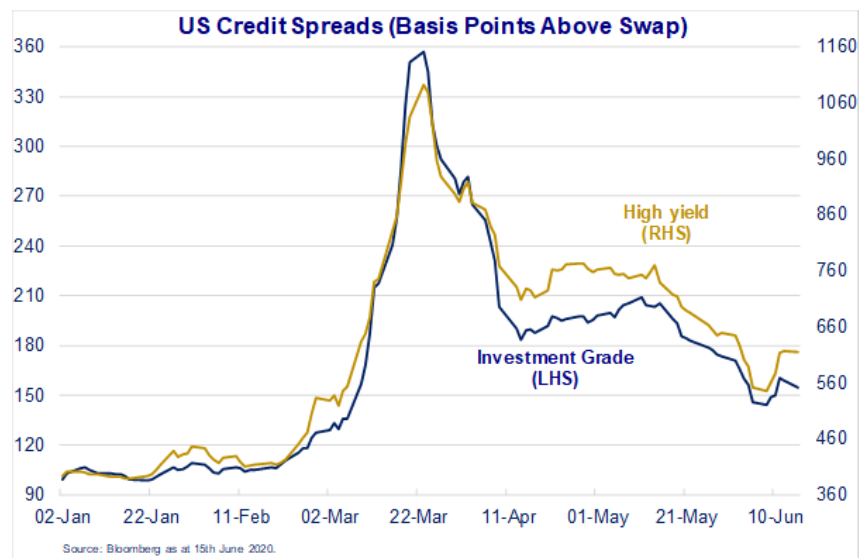


Futures markets suggest a very strong opening at the bell with gains expected in Australia (+2.6%) Japan (+2.5%), Hong Kong (+1.5%), but China is expected to open in the red (-1.2%).

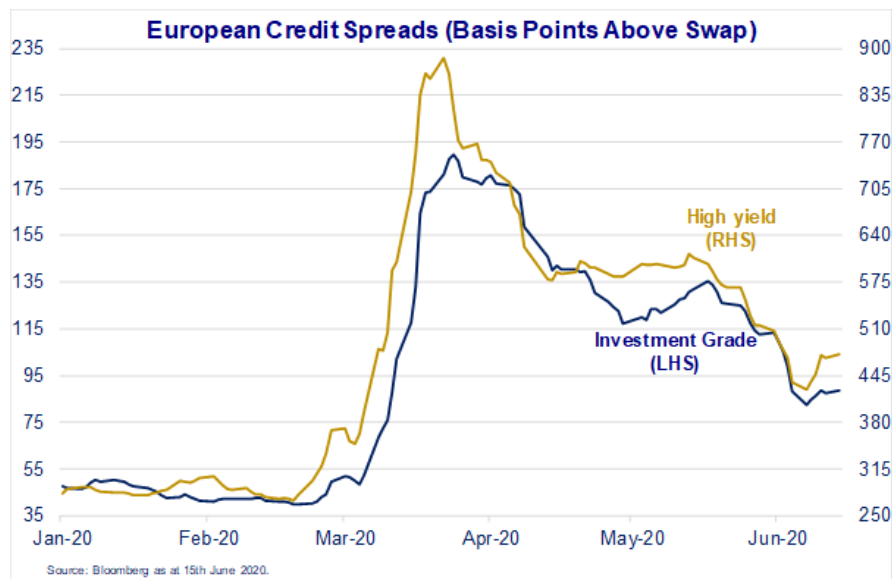
• CREDIT MARKETS

- While the US equity market rallied strongly on the Fed announcement of buying credit securities, the credit market themselves were unmoved. Spreads in the US investment grade universe declined for a second consecutive day this time by -3.8 points, to +144 bpts, which increased the recovery rate up to 80%. There were declines across the 11 sub-sectors led by energy (-5 points, +209 bpts, 87%) which was also supported by a rise in crude prices, tech (-5 points, +127 bpts, 79%) and utilities (-5 points, +150 bpts, 77%).

In the high yield universe, spreads fell -1 point to +615 bpts, which kept the recovery rate at 70%. Spreads contracted in 7 of the sub-sectors, led by senior financials (-7 points, +422 bpts, 58%), their subordinated peers (-5 points, +661 bpts, 53%) and tech (-4 points, +524 bpts, 64%), with energy (+1 point, +960 bpts, 88%) recording the largest spread widening.



- European credit markets lower to start the new week with spreads widening for the fourth time in the past five sessions. Spreads in the investment grade universe increased +1 point to +89 points, which lowered the recovery rate to 67% with risk premiums increasing in all sub-sectors led by subordinated financials (+4 points, +185 bpts, 65%), energy (+3 points, +78 bpts, 64%) and telcos (+2 points, +88 bpts, 59%). In the high yield universe spreads widened +5 points, to +474 bps, which lowered the recovery rate one notch to 67%. Nine of the 11 subsectors recorded higher spreads led by energy (+13 points, +594 bpts, 67%), subordinated financials (+7 points, +504 points, 65%) and tech (+5 points, +397 bpts, 54%), as investors seemingly de-risked portfolios which saw senior financials (-5 points, +432 bpts, 62%) as the only noteworthy sector to advance.



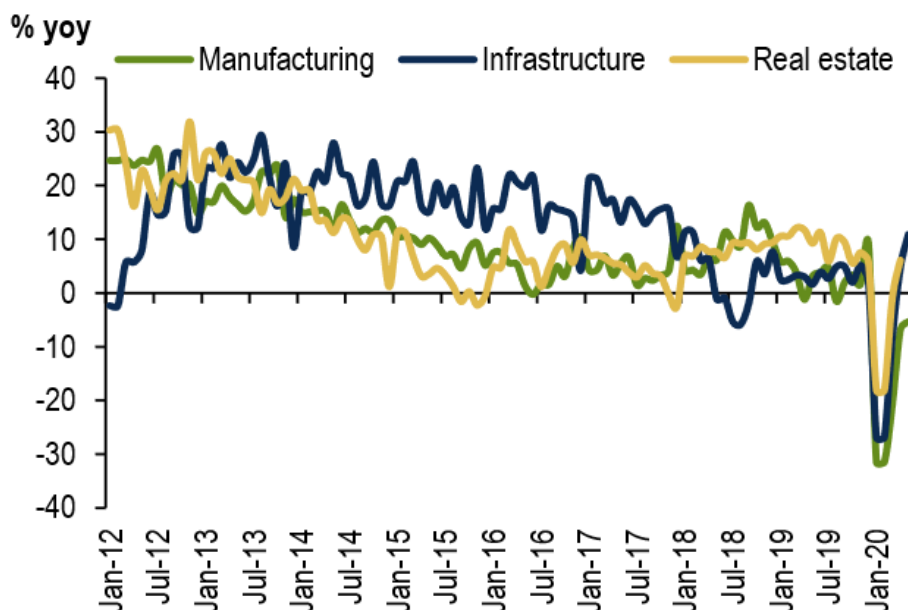
THE GLOBAL ECONOMY

- Yesterday China released its usual monthly activity set for the old economy sectors: Overall, activity growth data suggested continued growth in May, but the lift was below expectations and mixed relative to April, so the takeaways remain on the cautious side given the patchy and below-street estimate recovery:
 - The annual rate of **industrial production** rose +0.5% to +4.4% y/y in May but the rise was quite tepid relative to expectations (+5.0%) and on a monthly basis growth actually slowed relative to April (-0.7% to

+1.5% m/m) Among the sectors, growth picked up the most in utilities (+3.4% to +3.6% y/y) and mining (+0.8% to +1.1% y/y) whereas manufacturing marked time (+0.2% to 5.2% y/y) despite improvements in sectors including auto (+19% vs 5.1% in April) and smartphone (+8.4%, -2.0%).

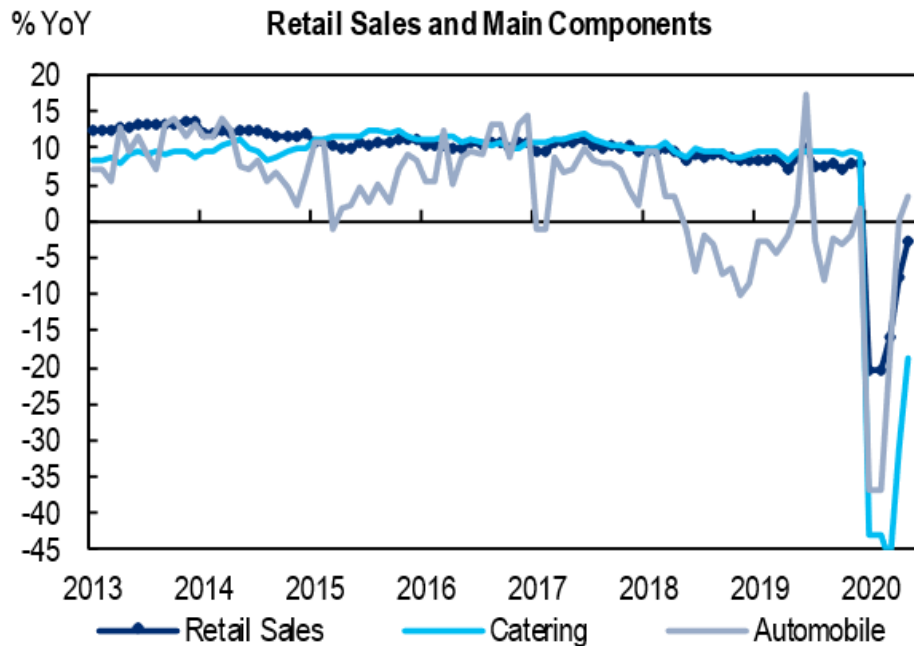


- The year-to-date contraction in **fixed asset investment** continued to narrow in May as the gauge rose +4% to -6.3% YTD but this was below street estimates (-6.0%). Smaller contractions were recorded across the board led by infrastructure investment (+5.5% to -6.3% y/y) which has been supported by relaxed rules for local governments but momentum overall in the sector moderated a touch, and manufacturing investment (+4.0% to -14.8% y/y) also lifted but the monthly rate barely positive despite lock downs being over for over two months. Meanwhile, the private sector (-9.6% YTD) remains in a deep decline given elevated uncertainty and weak profit outlook which is impinging firm's desire to deploy capital as demand can be met through existing structures. Elsewhere, real estate investment lifted +1.1% to +8.1% y/y with improvements in commercial sales even though it remains in double digit negative territory.



- The **retail sales** recovery continued to be 'gradual' despite the annual rate rising +4.7% to -2.8% y/y. On a positive note, online sales (24.3% of total nominal sales) lifted +2.9% to +11.5% y/y and discretionary items improved including cosmetics (+9.4% to +12.4% y/y) and autos which turned positive at +3.5% y/y for only the second time in 22 months (see chart). However, on the negative side the retail sales recovery rate is nothing special on a monthly basis - after the -10.4% m/m decline in January, the monthly sales numbers have been +0.4% m/m, +0.65% m/m, +0.75% m/m and +0.79% m/m against a monthly average 2019 growth rate of +0.70% which suggests that monthly consumer spending has not normalised despite several

months of re-opening. This suggests that V-shaped recoveries expected by markets has not yet eventuated in a world governed by high risk and uncertainty.



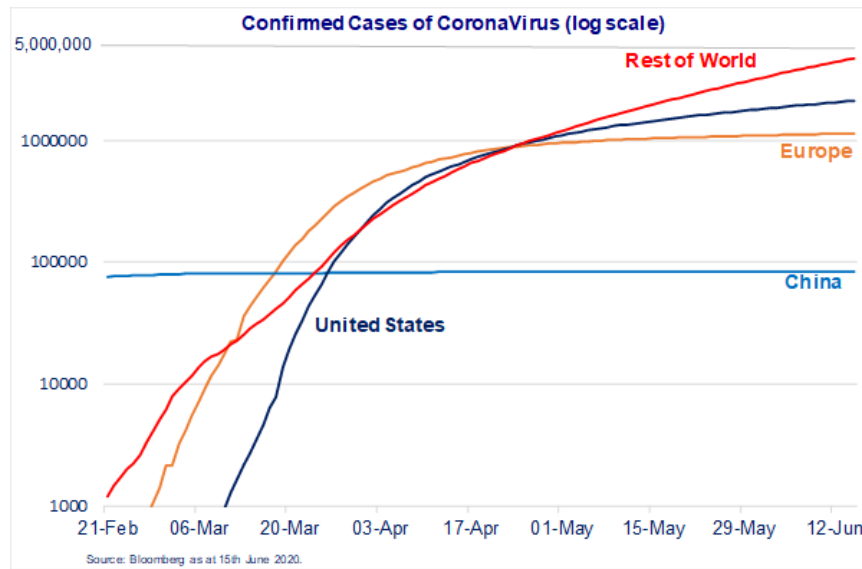
POLICY

- The Fed announced overnight that its USD250 billion Secondary Market Corporate Credit Facility will begin buying individual credit securities tonight in a diversified portfolio to complement its USD 5.5 billion of ETF purchases so far. The Fed spelled out how they plan to implement the program saying it would follow a diversified market index of US corporate bonds issued in the secondary market by US companies which satisfy the facility's minimum credit rating and maximum maturity criterion. This will fast-track support in that the Fed has verified company compliance, rather than corporations having to certify it themselves. The index was built internally, but the Fed spokesman did not know if the details would be made public.

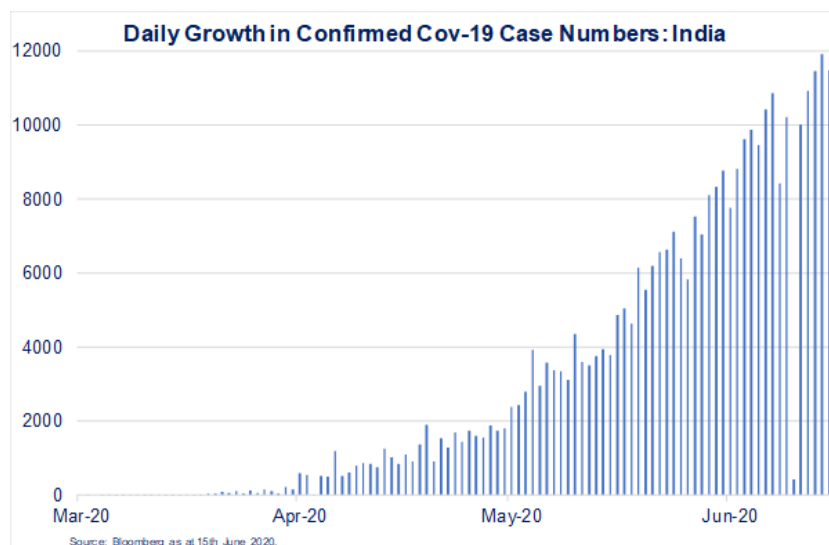
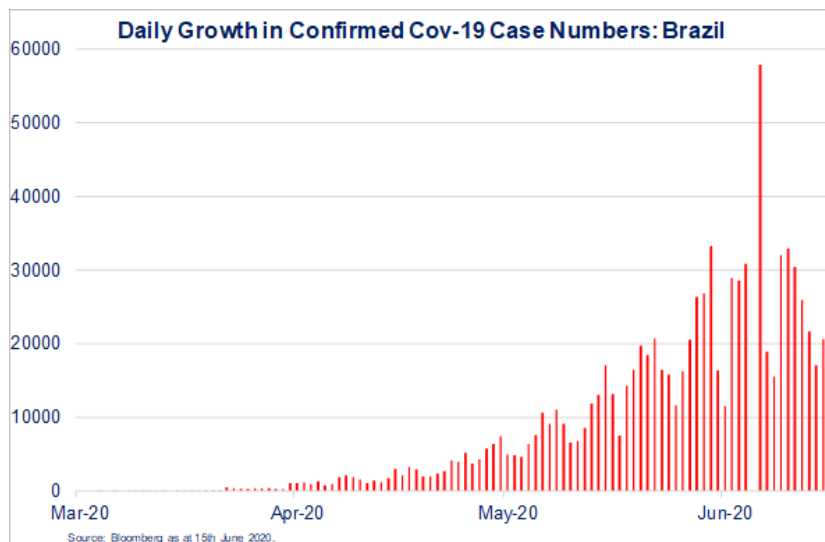
Elsewhere, the Fed announced that its Main Street Lending Program was open for lender registration. The USD600 billion program targets companies that were in good shape before the pandemic but now need financing to retain workers and fund operations, with loans offered through participating financial institutions to US businesses with up to 15,000 employees or with revenues up to USD5 billion. The program has already faced criticism due to high rates, curbs on corporate behaviour and sluggish rollout.

VIRUS UPDATE

- Although final numbers are not in for another 5.5 hours, the number of global cases of COVID-19 topped 8.0 million with another +100.8k cases so far overnight (before Mexico, Chile and some US states report their numbers) which means that Sunday was the 18th occasion in the past 20 days where daily increases have topped 100k. This means 3 countries have more than 500k cases, 8 countries have more than 200k cases and 17 countries have more than 100k cases. It took 73 days to record 1 million cases, 13 days for the next million, 11 days for the third million, 12 days for the fourth million, ten for the fifth million, 11 for the sixth million and 8 days for the seventh and eighth million. More importantly, the growth rate of daily confirmed cases (+1.7% since Friday) is starting to rise (albeit modestly). Meanwhile, deaths stand at 435.6k, with the US now over 115k (26.7% of global deaths even though they have only 4% of the global population), the UK, Italy and Brazil over 30k, with Spain and France over 25k, and the death rate dropped for a fortieth straight day to 5.44%.

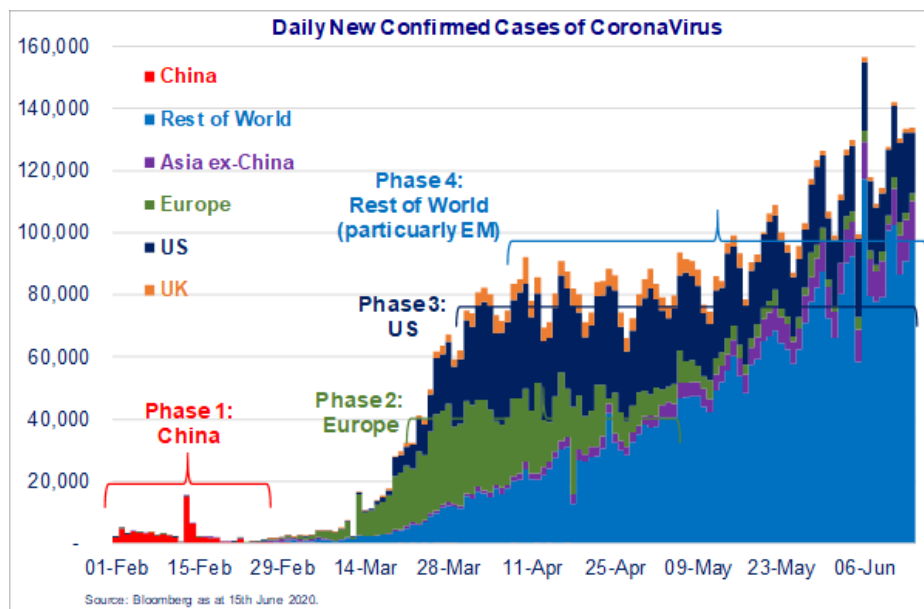


- We break the infections into four groups – the US, Europe, China and ‘others’ and the rest of the world outside the G3 economies now has the most total cases (+67.5k to 4.66 million) and highest daily new cases (and by a considerable margin) followed by the US (+16.7k to 2.11 million) and Europe (+2.9k to 1.14 million). Within the rest of the world, the three concerns here are Brazil (+20.6k, +888.3k, which is the second highest in the world), Russia (+8.2k to 536.5k, third highest) and India (+11.5k to 332.4k, fourth highest).

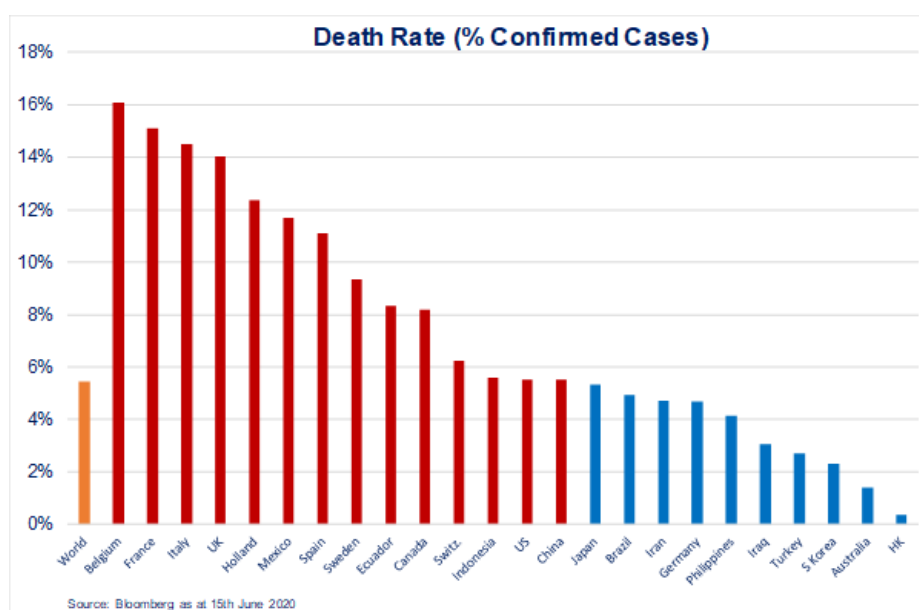


- Among countries, the most cases are in the US (+16.7k (so far) to 2.11 million), Brazil (+20.6k to 888.3k), Russia (+8.2k to 536.5k), India (+11.5k to 332.4k), the United Kingdom (+1.0k to 298.3k), Spain (+0.2k to 244.1k), Italy (+0.3k to 237.3k), Peru (not reported, +229.7k), France (+0.8k (16-day high) to 194.3k), Germany (+0.2k to 187.7k), Iran (+2.4k to 189.9k) and Turkey (+1.6k (4-week high) to 179.8k). Australia confirmed cases rose +12 to 7,347 yesterday which placed us 69th in terms of total infections.

Elsewhere, Singapore recorded +0.2k new cases to 40.8k 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 after overtaking Indonesia (+1.0k to 39.3k) and the Philippines (+0.5k to 26.4k). However, the apparent increase in China case numbers in Beijing has not appeared in China's national tally. Note final numbers for yesterday at not in yet so these numbers can rise.



- Although final numbers are not in until 11am AEST, the global death rate declined for a fortieth straight day to 5.44% with the global total to 435.6k. The US (+0.4k so far) has the most deaths at +116.1k, with Brazil (+0.6k to 44.0k), the UK (+0.04k to 41.8k), Italy (+0.03k to 34.4k), France (+0.09k to 29.4k) and Spain (steady at 27.1k) all over +25k. The death rate is highest in European countries where the health systems have collapsed led by Belgium (steady at 16.1%, France (steady at 15.1%), Italy (steady at 14.5%), the UK (-*0.1% to 14.0%), the Netherlands (steady at 12.4%), Spain (steady at 11.1%) and Sweden (-0.1% to 9.3%). However, several emerging markets are now on the leader board including Mexico (-0.1% to 11.7%), Ecuador (steady at 8.3%), Indonesia (steady at 5.6%) and Brazil (steady at 5.0%).



Yours sincerely,



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