

# THOUGHTS ON THE MARKET

17<sup>th</sup> June 2020 - May US retail sales surge and outweigh rising COVID-19 case numbers

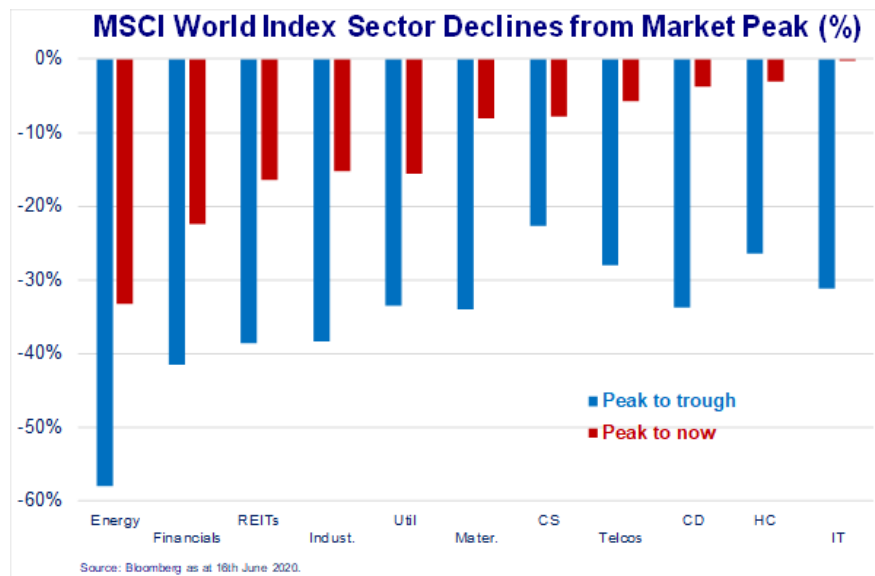
## SUMMARY

- This is a market which has more cross currents than we can ever remember, with investor's focus changing every 24 hours from concerns about US-China relations, rising COVID-19 case numbers, to Fed backstops and all of this is in a complete vacuum of earnings visibility and very high valuations. Despite this global risk markets rallied strongly overnight as equity and credit markets rose for a third consecutive day on optimism that a recovering US consumer will override rising COVID-19 case numbers in China, parts of the US, throughout Latin America and parts of Asia. In other markets, 10-year US treasuries rallied +3 points to 0.75% with curve steepening, commodities were higher with gold up +0.9% to USD1725 per troy ounce and oil rallied +5.8% to USD38.38 per barrel, and the most G10 currencies depreciated against a stronger Greenback including the Euro (-0.1%), Sterling (-0.5%) and AUD (-1.3% to 68.83).
- The economic calendar was light but US retail sales soared a record +17.7% m/m in May which suggests that US households spent in the mindset that there is unlikely to be any lasting damage from either income loss or labour market dislocation. In many ways the May report echoed the May non-farm payrolls with a much faster recovery than expected, but driver of the rebound overnight was relatively straight forward - it was from all the pent up demand from consumers who had been locked down and the income support from the government given its enormous fiscal stimulus. This, in unison, makes for a very powerful dynamic especially in a world of high savings and some re-openings which are likely to continue in the meantime. Meanwhile, the bi-weekly Australia payrolls report was disappointing as it detailed a deeper labour market downturn in April and May, and a double dip fall in wages growth which could impinge consumer spending in the months ahead, but it won't by itself force a policy re-think.
- On policy, rumours are circulating that the Trump administration is preparing an almost USD1 trillion spending spree on infrastructure for traditional work such as roads and bridges and also new technology including 5G wireless, and chances are this could be part of a push for a broader support package.
- In COVID-19 news, Florida reported that new cases rose to the highest level since the pandemic began, Texas saw hospitalisations surge and Beijing shut schools on concerns of new infections. Although final numbers are not in for another 5.5 hours, the number of global cases of COVID-19 topped 8.14 million with another +121.4k cases so far overnight (before Mexico, Chile and some US states report their numbers) which means that Tuesday was the 19th occasion in the past 21 days where daily increases have topped 100k (the other two were over +99k!). This means 3 countries have more than 500k cases, 8 countries have more than 200k cases and 17 countries have more than 100k cases. More importantly, the growth rate of daily confirmed cases (+1.7% since Saturday) is starting to rise (albeit modestly). Meanwhile, deaths stand at 440.3k and the death rate dropped for a forty first straight day to 5.41%.

## FINANCIAL MARKETS

- **EQUITIES**
  - The MSCI World Index rallied +2.2% overnight (5-week high) with century gains in all sectors. **Traditional value/cyclical sectors outperformed** led by energy (+2.8%), industrials (+2.7%) and materials (+2.4%) which pushed the market up as investors figure that central banks will do whatever it takes to keep markets stable. The overnight movements kept energy (-33.3%) and financials (-22.4%) in bear market territory, but other traditional value/cyclical sectors such as industrials (-15.2%) and REITs (-16.5%) moved

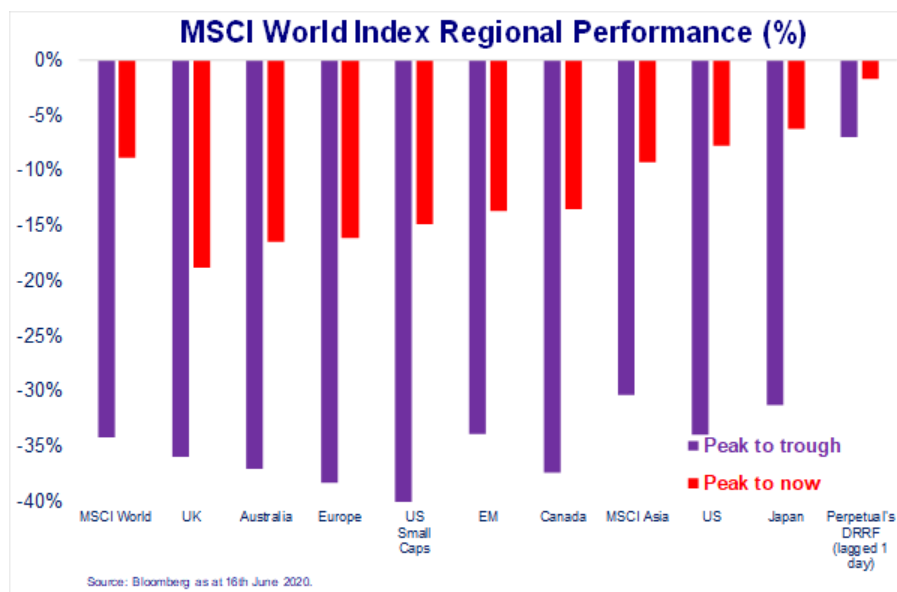
further away. Elsewhere tech, consumer discretionary and healthcare have nearly recovered all their Cov-19 losses (see chart).



- **Among the regions**, there were large advances across the board, The MSCI Asia Pacific index (+3.3%) rallied strongly as it caught up with recent Wall Street strength with Japan (+4.9% and -6.2% from its February peak) now overtaking the US in terms of recovery rate (see chart). Meanwhile, Australia (+3.9%) posted its strongest advance in 10-weeks despite some underwhelming labour market news and Hong Kong (+2.4%) and China (+1.5%) closed out a strong day of gains.

The momentum of Asia flowed through to European markets (+3.4%) which recorded a 7-day high surge in prices with broad-based gains. There was no universal trend to the extent of price gains, but it was a good day if strong rises in France (+2.8%) and the UK (+2.9%) were at the tail-end of the field. Periphery markets slightly outperformed led by Italy (+3.5%) and Spain (+3.3%) and Germany (+3.4%) spilt the difference. The strong performance in Asian and European markets led to a positive session on Wall Street where small caps (+2.3% for a third consecutive session) outperformed, closely followed by the Dow Jones (+2.0%, +527 points to 26,289) which outperformed the S&P 500 (+1.9%) and NASDAQ (+1.8%) given its highest exposure to traditional cyclical stocks.

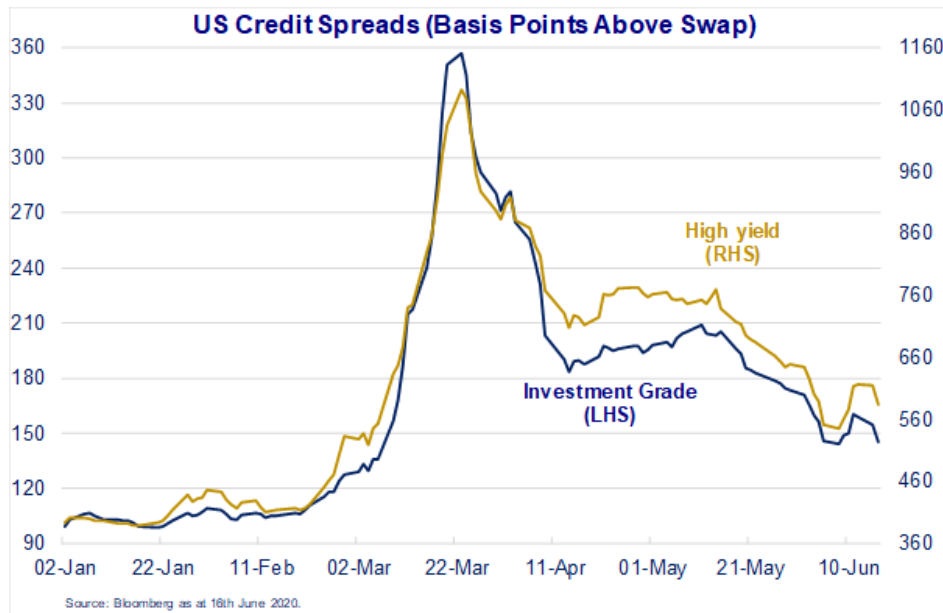
Overnight moves saw the UK market exit bear market territory and US and Japan exit 'correction' territory (see chart below).



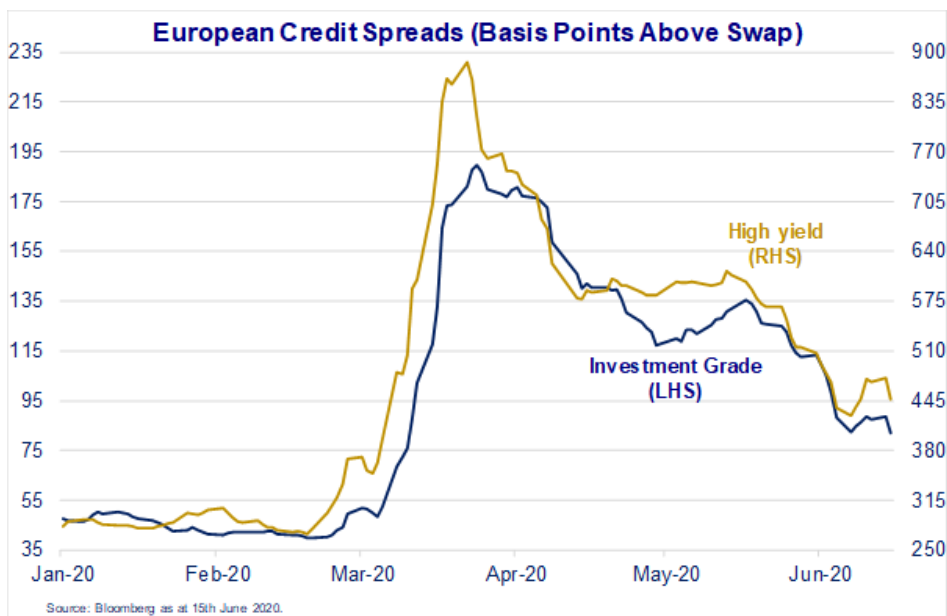
- Futures markets suggest a mixed opening in Asia with advance expected in China (+1.5%) and Australia (+0.5%) and losses in Hong Kong (-0.3%) and Japan (-0.2%).

## • CREDIT MARKETS

- Regional credit indices rallied strongly overnight with investors buoyed by equity performance and a solid rebound in US retail sales. Yields in the **US investment grade universe** contracted -10 points (7-day high) to +145 bpts, which increased the recovery rate to 83%. Among the sub-sectors, spreads declined across the board led by cyclicals including subordinated financials (-14 points, +177 bpts, 83%), consumer discretionary (-12 points, +174 bpts, 83%) which was supported by a strong recovery in US retail sales, and energy (-12 points, +197 bpts, 89%) which was supported by higher energy prices. In the high yield space, risk premiums declined -31 points to +584 bpts which boosted the recovery rate four notches to 75%. All sub-sectors rallied led by cyclicals where energy (-44 points, +916 bpts, 91%), industrials (-37 points, +694 bpts, 49%) and subordinated financials (-33 points, +628 bpts, 57%) outperformed.

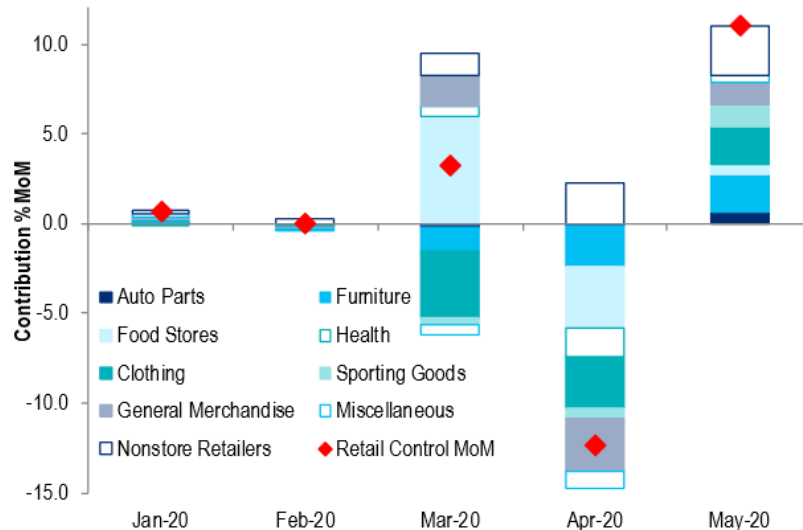


- European credit markets** also rallied strongly as investors embraced more risk in portfolios. Yields in the investment grade universe rallied -6.6 points to +82 bpts, which increased the recovery rate to 72% (13-week high – see chart)). Like the US, gains were led by the cyclical sectors including subordinated financials (-13 pints, +172 bpts, 71%), consumer discretionary (-11 points, +109 bpts, 74%) and energy (-6 points, +72 bpts, 68%). In the high yield space, spreads contracted -27 points to +447 bpts which saw the recovery rate lift four notches to 71%). There were gains in all sub-sectors and double-digit gains in 10/11 led by consumer discretionary (-43 points, +545 bpts 73%), energy (-38 points, +556bpts, 71%) and senior financials (-28 points, +404 bpts, 67%).



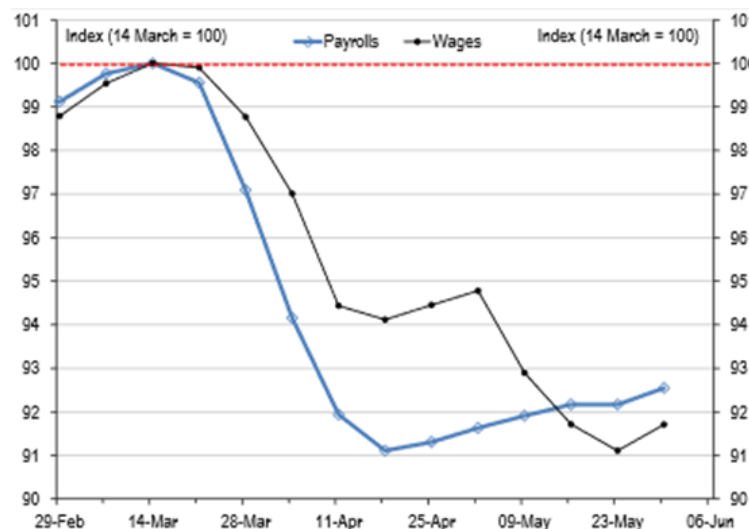
## THE GLOBAL ECONOMY

- US retail sales soared +17.7% m/m in May which suggests that US households went out and spent with the mindset that there is unlikely to be any lasting damage from either income loss or labour market dislocation. The May result saw the annual rate contract a smaller -6.1% y/y (-20% y/y in April) and the control group which feeds into GDP bounced +11.0% m/m (see chart). The driver of the rebound was relatively straight forward in that it was from all the pent up demand from consumers who had been locked down and the income support from the government with its enormous fiscal stimulus, which in unison make a very powerful dynamic especially in a world of high savings.



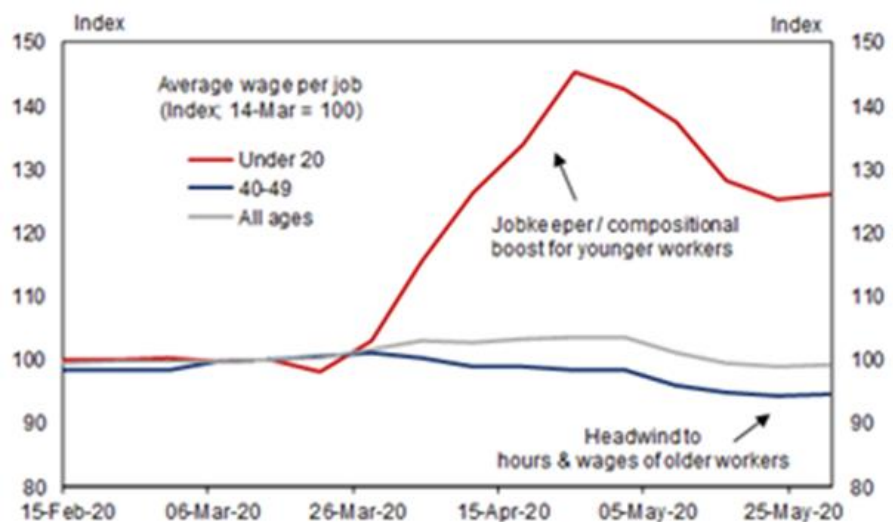
The spending increase was double consensus and in that way it echoed the May Non-farm payrolls result which highlighted the recovery had come about three weeks earlier than expected. To put some scale on the rise in sales: in May, total retail and food service sales by themselves were 92% of the February level despite many stores remaining shut. That said, the spending rebound was not uniform with those related to “nesting” such as building materials (+9% m/m) and food (+13% m/m) are booming, but things like furniture, electronics, and gasoline stations remain -20% to -30% below February levels, and the strong rise in restaurants (+29% m/m) still has it -60% below normal levels, and areas which involve close personal contact are likely to remain depressed for a while yet.

- There was mixed news from the ABS's bi-weekly Australian payrolls data in that payrolls bounced +1.0% in the 4 weeks to 30th May (see chart), but the prior peak-to-trough decline was revised sharply lower (-1.6% to -8.9%). While a recent employment gain signals an initial recovery, the net of the numbers implies a net loss of circa -131k for the May Labour Force Survey (taken in the two weeks to 16th May) and total peak-to-end-May job losses of around -900k which is much larger than the official labour force stats (-594k), with only some of the disparity explained by definitional differences about what constitutes a person being unemployed.



More worryingly, there was also signs in the release of second round effects with reductions in total hours worked and total wages growth despite the on-going ramp up in the JobKeeper allowance. It sounds strange but payrolls growth was associated with a -3.2% losses in total wages in the four weeks to 30th May which combined with the prior 6 weeks culminates in an aggregate wage decline of -8.3% since mid-March. The difference is explained by lower average hours (see chart below) in a broad set of services industries including construction, professional, finance IT and media suffering. However, at this stage it is hard to draw conclusions for Thursday's Labour Force Survey as the former in raw data and the latter is seasonally adjusted.

Overall, the report was disappointing as it detailed a deeper labour market downturn especially in wages with a faster economic re-opening preceding only a modest level of re-hiring by late-May, but it won't alone force a policy re-think. At the moment the clear re-think needs to be on the upcoming household income cliff where changes to JobKeeper, JobSeeker, superannuation withdrawals, government cash payments, debt payment deferrals and so on with produce a potential AUD90 billion income hole. At best, this funding issue will only 'slow' the recovery, but there is a risk, albeit a tail risk, that it may generate something more severe.

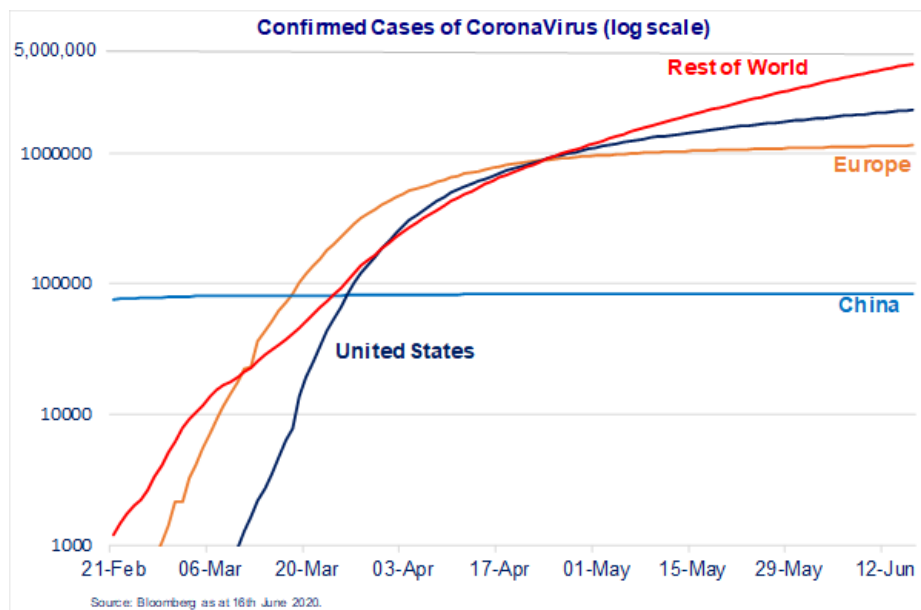


## POLICY

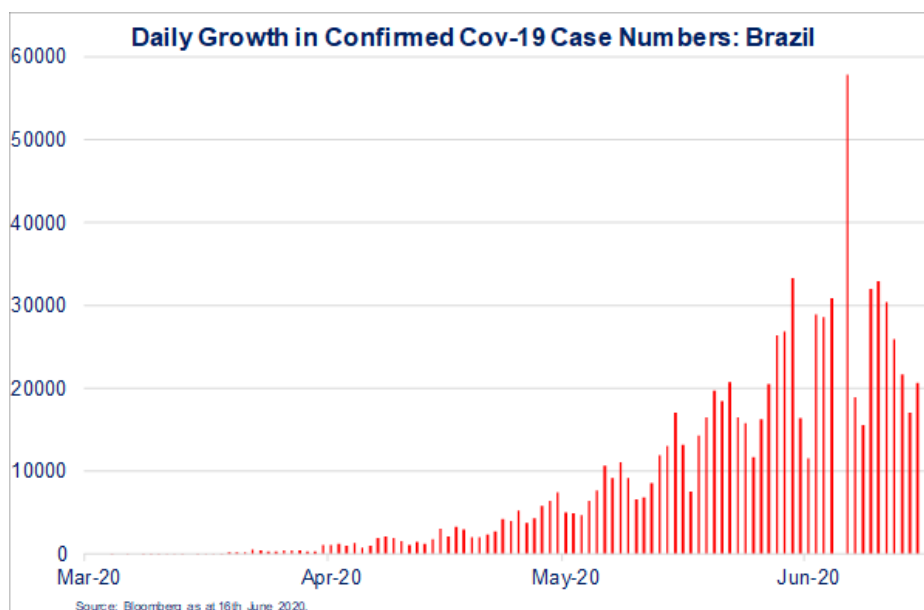
- Bloomberg reported that the Trump administration preparing an almost \$1T infrastructure proposal on traditional areas such as roads and bridges and also for new-age 5G wireless infrastructure. This could be part of a broader support package with more spending of offset by effect of COVID-19 even though Senate Republicans have been somewhat cool on the idea.
- In the minutes from its June meeting, the RBA continued to paint a somewhat bleak picture of the macro backdrop even though the domestic downturn has been shallower than expected, and we would note several key points made:
  - The RBA noted that the 1-year and 2-year yields were above the 3-year target rate and stated that if this persists, they will consider purchasing additional securities to get rates to target levels;
  - The take-up of the Term Funding Facility (TFF) had been modest, due to a surge of deposits and slow credit growth, but more recently the amount of drawdowns had accelerated and there is little to suggest that this funding channel will not be fully utilised in coming months which will see a major rise in exchange settlement balances to around AUD175 billion by end-2020; and
  - The appreciation of the AUD back to levels evident pre-COVID-19 presents a clear risk to the outlook as the May Quarterly Statement on Monetary Policy had assumed 0.64 rather than 0.70 and the latter will shave -0.5% off GDP growth and -0.3% off core inflation in FY21 which could see the bank downgrade their inflation forecast, which can feed into wages decision and delay any tightening and warrant more policy support which the RBA would have to term out yield curve control.

## VIRUS UPDATE

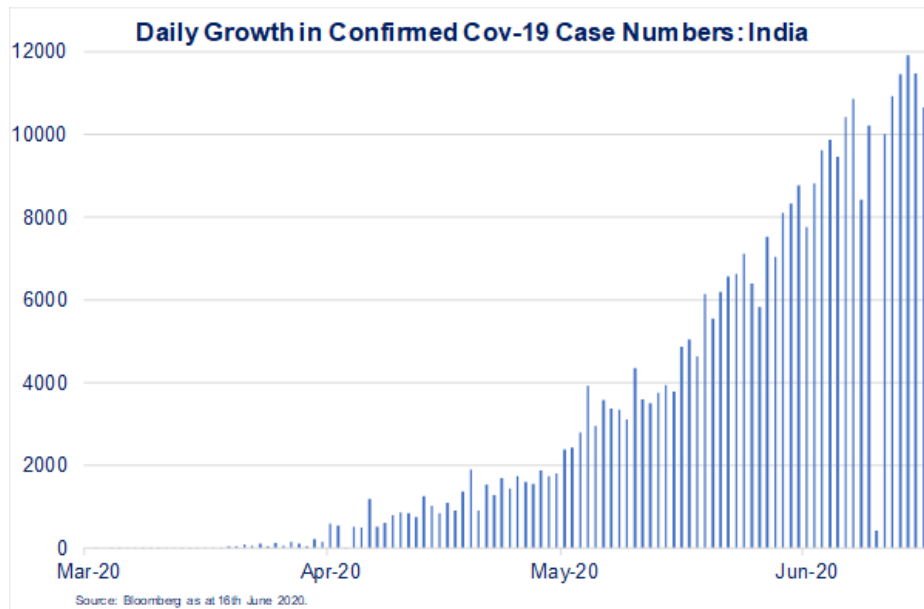
- Although final numbers are not in for another 5.5 hours, the number of global cases of COVID-19 topped 8.14 million with another +120.2k cases so far overnight (before Mexico, Chile and some US states report their numbers) which means that Tuesday was the 19th occasion in the past 21 days where daily increases have topped 100k (the other two were over +99k!). 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, and in the past 30 hours another 140k cases have been confirmed. More importantly, the growth rate of daily confirmed cases (+1.7% since Saturday) is starting to rise (albeit modestly). Meanwhile, deaths stand at 440.3k, with the US now over 115k (26.6% 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 forty first 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 (+87.0k to 4.78 million) and highest daily new cases (and by a considerable margin) followed by the US (+16.7k to 2.13 million) and Europe (+3.2k to 1.15 million). Within the rest of the world, the three concerns here are Brazil (+34.9k (second highest) to +923.2k, which is the second highest in the world), Russia (+8.2k to 544.7k, third highest) and India (+10.7k to 343.1k, fourth highest).

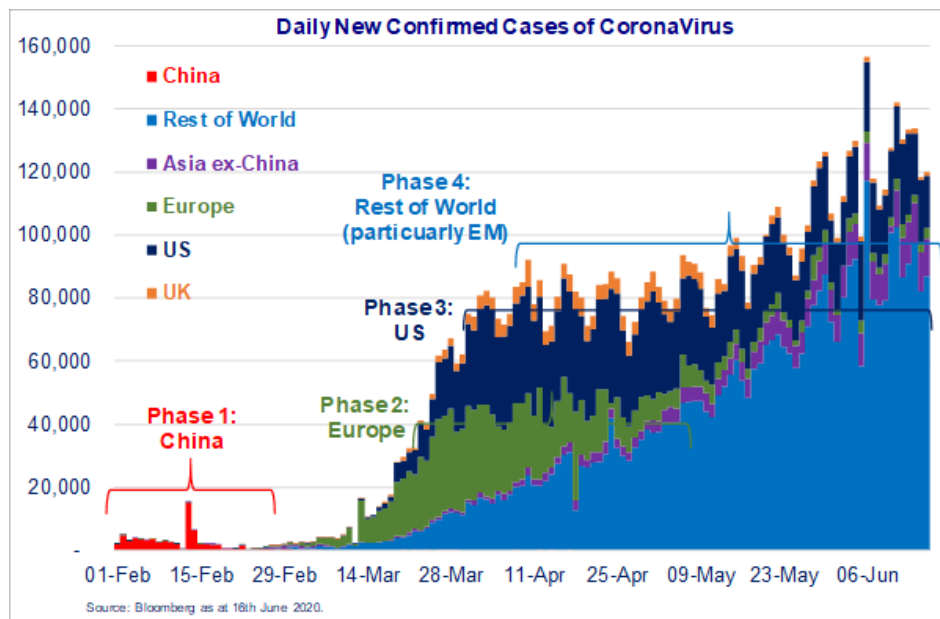




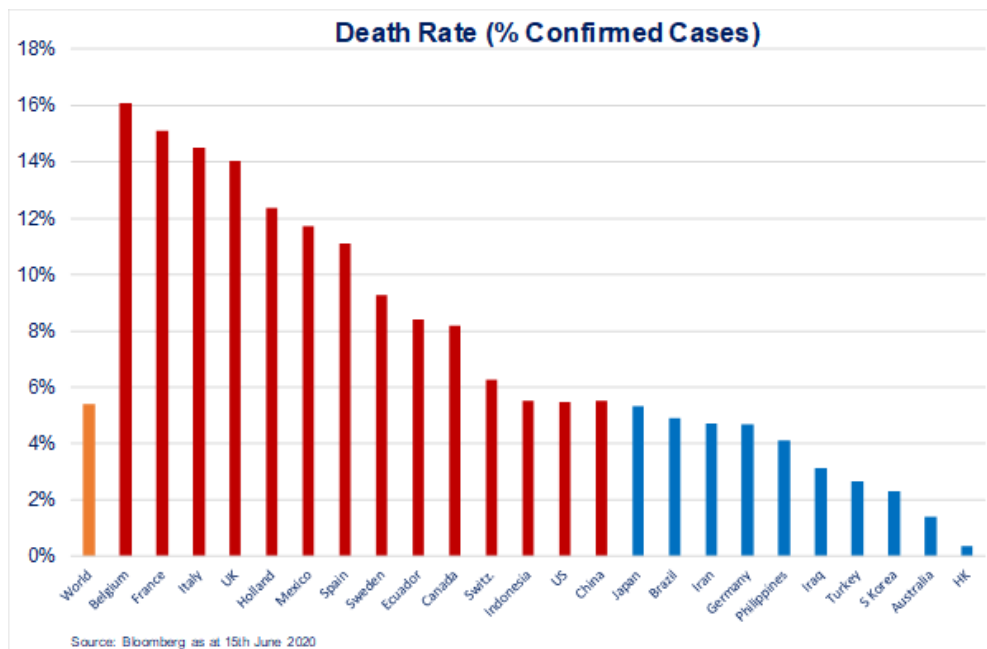


- Among countries, the most cases are in the US (+16.7k (so far) to 2.13 million), Brazil (+34.9k to 923.2k), Russia (+8.2k to 544.7k), India (+10.7k to 343.1k), the United Kingdom (+1.3k to 299.6k), Spain (+0.2k to 244.3k), Italy (+0.2k to 237.5k), Peru (not reported, +233.0k), France (+0.6k to 194.3k), Germany (+0.6k to 188.3k), Iran (+2.6k to 192.4k) and Turkey (+1.5k to 181.03k). Australia confirmed cases were unchanged at 7,347 yesterday which placed us 69th in terms of total infections.

Elsewhere, Singapore recorded +0.2k new cases to 41.0k 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 (+1.1k (third highest) to 40.4k) and the Philippines (+0.4k to 26.8k). Note final numbers for yesterday at not in yet so these numbers can rise.



- Although final numbers are not in until 12 noon AEST, the global death rate declined for a forty first straight day to 5.39% with the global total to 440.3k. The US (+0.6k so far) has the most deaths at +116.7k, with Brazil (+1.3k to 45.2k), the UK (+0.2k to 42.1k), Italy (+0.03k to 34.4k), France (+0.1k to 29.6k) 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 (+0.1% to 8.4%), Indonesia (-0.1% to 5.5%) and Brazil (-0.1% to 4.9%).



Yours sincerely,



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