

# THOUGHTS ON THE MARKET

18<sup>th</sup> September 2020

Investors fret that there is not enough stimulus to sustain economic growth

## SUMMARY

- Global risk markets were lower overnight, and Treasuries rallied, as investors seemingly had a hangover from yesterday's FOMC meeting which had them questioning if enough stimulus was being unleashed to the global economy. Given concerns about a fiscal pullback from wartime-like deficits, all eyes remain on central banks with the Bank of England overnight noting it was exploring negative rates to counter the ongoing risks to the labour market from both a harder Brexit and increase COVID-19 case numbers.

While investors were disappointed with the Fed overnight given the lack of details on its new inflationary averaging regime, and are worried more broadly about peak monetary policy, we would argue that the policy quiver from these institutions is empty and what they are doing with asset purchases is just creating market distortions which are causing more problems than they are solving. Accordingly, fiscal policy needs to really step up as consumer sentiment data and the employment picture still reflect a fragile recovery which needs to be bolstered by higher incomes, and Chair Powell did not mention this several times in his press conference to fill in time.

In other markets, 10-year US Treasuries rallied with yields down to 0.69% but the curve slope was steady at 60 points, commodities markets were mixed with oil (+2.0% to USD40.94 per barrel) continuing its three day win streak whereas gold (-1.1% to USD1945 per troy ounce) was down for a second consecutive day, and G10 currencies were mixed against a stronger Greenback with declines in the AUD (-0.3% to USC73.15) and the Euro (-0.1%), whereas Sterling was steady and the Yen (+0.3%) increased.

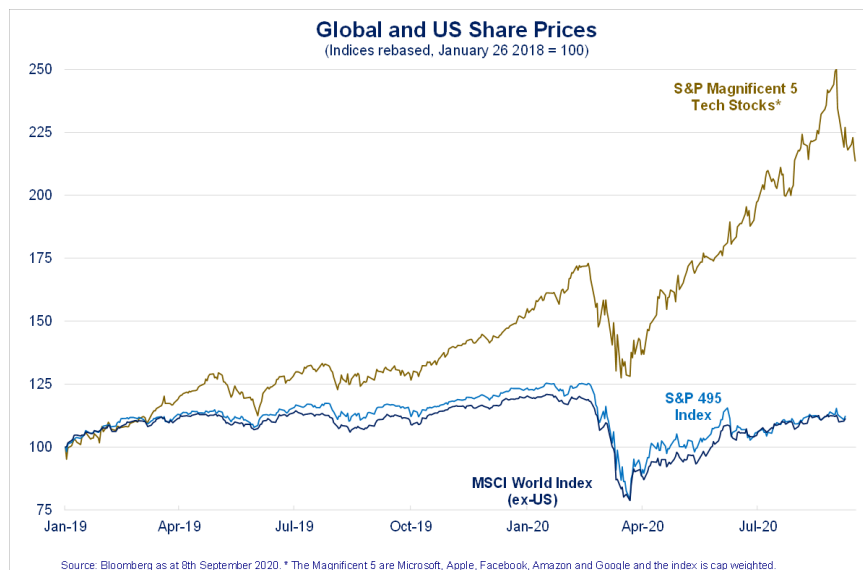
- **Economic data overnight was mixed.** The Australian labour market shocked everyone by producing +111k jobs in August and a decline in the unemployment rate to 6.8%. While 99% of the payroll's improvement was generated by 'sole traders' who have returned to normal employment definitions given changes to Jobkeeper and JobSeeker programs, growth for traditional employees was flat which itself is a very good result (given the Victorian lockdowns). Meanwhile, weekly US jobless claims were mixed with only a modest decline in initial claims to 860k, whereas continuing claims saw an improvement of -916k, and the business outlook measure within the Philadelphia Fed index declined for a third consecutive month, but indices of new orders, production and employees rose.
- **The number of global cases of COVID-19 is 30.02 million** with another +239k cases so far (but Brazil, Mexico, Colombia and Pakistan and 7 US states have not reported their numbers) which means that Thursday is the 60th consecutive day where daily increases are greater than 200k. At present, 10 countries have more than 500k cases, 22 countries have more than 200k cases and 33 countries have more than 100k cases. More importantly, the growth rate of daily confirmed cases (+0.9% since Sunday) is steady. Meanwhile, deaths stand at 943.5k and the death rate was steady at 3.14% although the number of daily deaths remains elevated.

## FINANCIAL MARKETS

### • EQUITIES

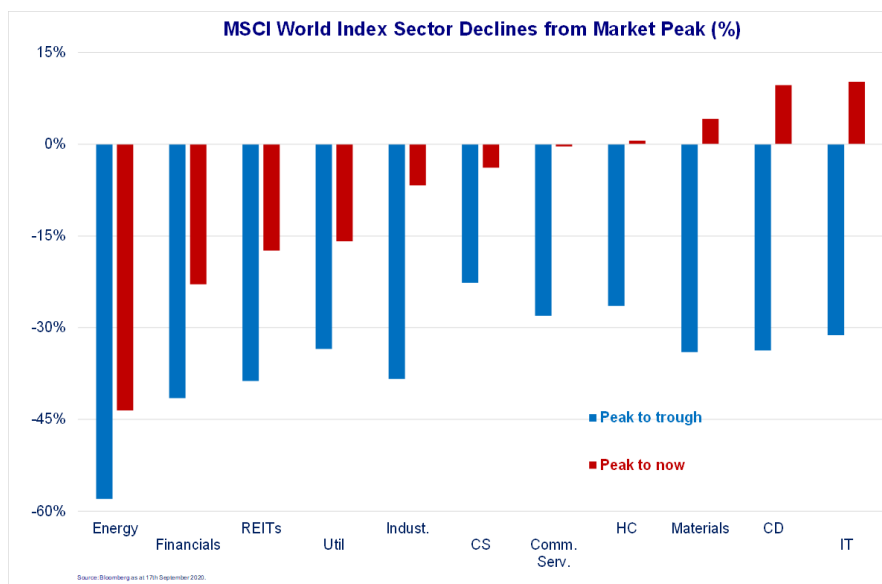
- **The MSCI World Index closed -0.8% lower with losses in all regions and sectors.** Communication services (-1.6%) was the worst performer given the decline of the entire FAANG complex led by Facebook (-3.3%)

which is now down -15.8% from its peak two weeks ago, with a similar performance with Apple (-1.6%, -16.0%) weighing on IT (-0.8%). The decline in tech stocks has seen our Magnificent 5 Tech Index decline -14.6% from its peak which has brought the index back to where it was at end-July but it's still up +68% from its March low and +23.5% from its February peak (see chart).



Meanwhile, REITs (-1.5%) were also at the tail end of the field as investors decided to trim positions after a three-day win streak, and consumer discretionary (-1.5%) declined due to weakness in Amazon (-2.3%), restaurants, homebuilders and entertainment. Among the cyclicals, financials lagged (-0.9%) with declines in money centre banks and investment banks, but energy (-0.4%), materials (-0.3%) and industrials (-0.1%) all beat the market tape for a second straight day.

By the closing of trading, communication services (with a peak to now decline of -0.4%) slipped below its February peak, IT (+10.2%) became the best performing sector, whereas financials (-22.9%) and energy (-43.5%) remained firmly entrenched in bear market territory (see chart).



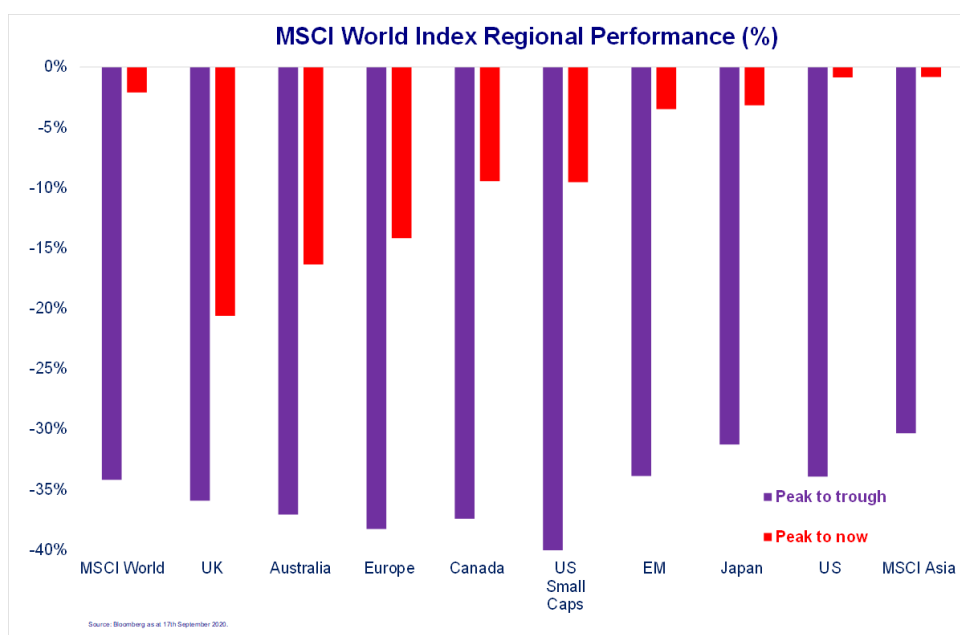
- Among the regions, the pace of losses was led by Asia which closed -0.9% lower. Sentiment was dragged lower by analysis of the Fed September policy meeting which committed to keep rates at zero until at least 2024, but investors thought the takeaways were somewhat bearish after Powell's remarked that the US recovery was showing signs of slowing. In Asia, the BOJ's September meeting was a non-event with policy unchanged as expected while the economic assessment was upgraded although not to the extent that would underpin a recalibration of consensus, and there was nothing from Governor Kuroda's press conference. Meanwhile, the surge in Australia employment confounded expectations for decline due to Victoria's lockdown, although data quirks explained much of the jobs growth, but outside this the labour market

remained quite resilient. By the closing bell, Hong Kong (-1.6%), Australia (-1.2%) and South Korea (1.2%) logged sharp losses, followed by moderate declines in India (-0.8%), Taiwan (-0.8%) Japan (-0.6%) and Mainland China (-0.5%).

**US equities followed the negative leads from other regions and closed -0.8% lower with growth and momentum names underperforming with the entire FAANG complex lower.** The sentiment drag from the September FOMC policy outcome continued for a second day with investors underwhelmed by the lack of details in the updated guidance and the fact that the QE program was not bolstered, which sparked growing fears of peak monetary policy. Meanwhile, the fiscal stimulus stalemate continued and was sighted as a market drag, but this has been building for a while, so economists may soon be forced to re-do Q4 growth numbers. Meanwhile, economic data was mixed with initial claims just above expectations and continuing claims just below, housing starts missed street estimates as did the Philly Fed manufacturing index, but the details were quite solid. By the closing bell at the NYSE, all indices declined but closed off their daily lows with losses led by the NASDAQ Composite Index (-1.3%), S&P 500 (-0.8%), Russell 2000 (-0.6%) and the Dow Jones Industrial Average (-0.5%, -130 points, +27,902).

**The weak Asian lead saw European shares open lower and while the region closed well off its daily lows it still closed down -0.7%.** There was nothing on the data front other than the final August Eurozone CPI which was in line with the flash estimate. In central banks news the BoE's voted unanimously to leave key policy on hold but the outlook for economy was 'highly uncertain' given a potential for a harder Brexit and increase COVID-19 cases, which sparked increased discussion about negative interest rates. On the virus front, rising infections in Spain, France and the UK continue to keep these markets on the back foot as mobility restrictions are enforced and broadened. Other headlines included the ECB offering banks more capital relief to cope with the pandemic. By the regional close all bourses were in the red, led by Italy (-1.1%), France (-0.7%), the UK (-0.5%), Germany and Spain (both -0.4%) and Switzerland and Sweden (both -0.3%).

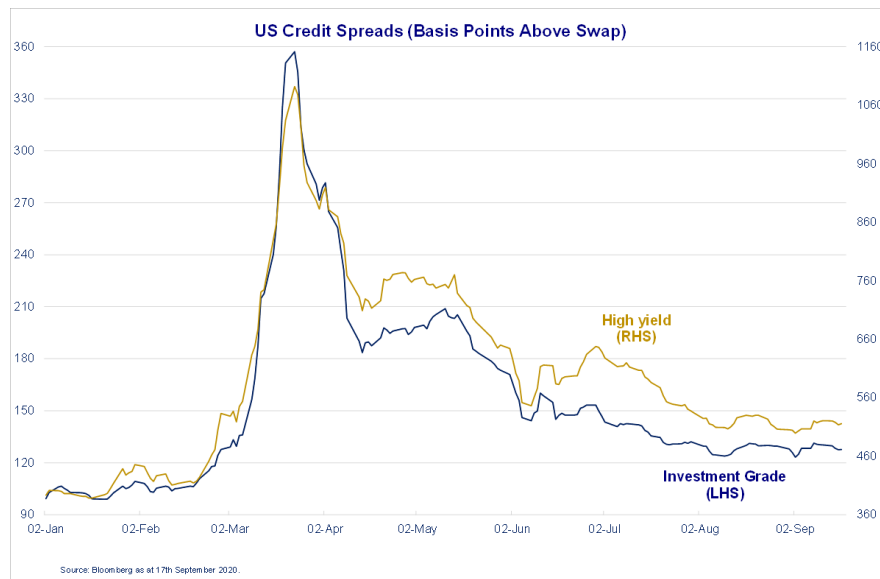
By the closing bell at the NYSE, our regional peak-to-now chart saw the UK (-20.6%) move deeper into bear market territory, with the US (-0.9%) and Asia (-0.8%) now back below their respective February peaks (see chart) and not much change elsewhere.



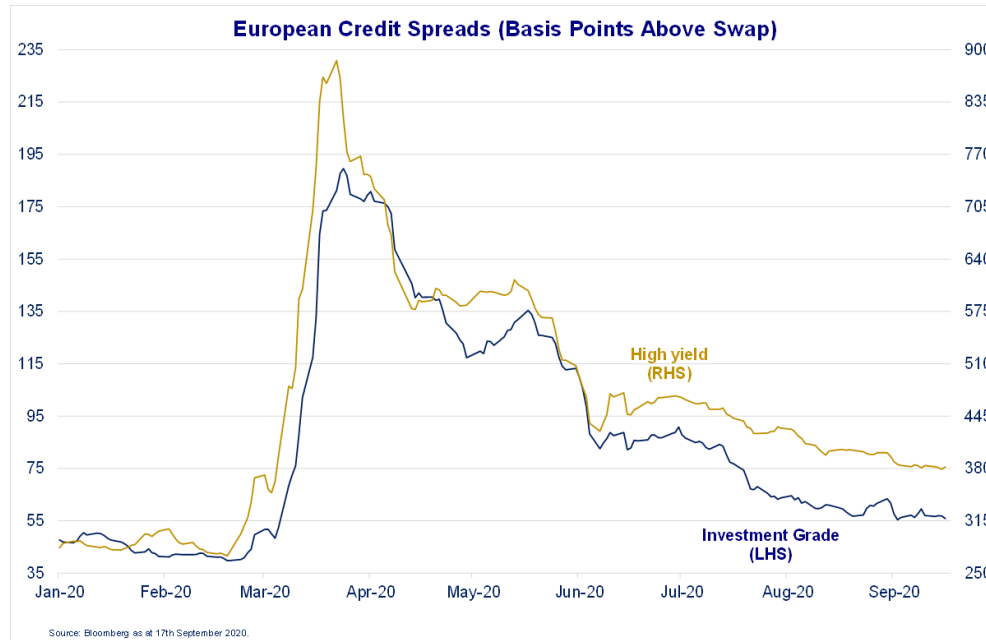
- **Futures markets suggest a positive opening in Asia** with Australia (+0.3%), Hong Kong (+0.3%) and Japan (+0.5%) priced to open higher at the bell.

## • CREDIT MARKETS

- **Regional credit indices were little changed yet again, with spreads in the US investment grade universe unchanged at +128 bpts, which left the recovery rate at 90%.** Eight of the 11 subsectors recorded capital losses by none was by more than half a basis point. In the high yield space, spreads increased +2 points to +516 bpts, which snapped a three-day win streak, but the recovery rate was steady at 85%. Nine of the 11 subsectors had capital losses but, again, these were minor and capped at four basis points.



- **European credit markets were also subdued with spreads in the investment grade universe declining one point to +56 bpts, but the recovery rate was steady at 89%.** All 11 sub-sectors recorded capital gains but there were no real noteworthy changes in risk premiums at the tier two level. Conversely, spreads in the high yield space increased +3 points which snapped a three-day win streak and culminated in the recovery rate dropping one notch to 82%. Ten of the 11 sub-sectors experienced capital losses but they were not egregious with the largest being consumer staples (+5 points, +499 bpts, 94%) and energy (+5 points, +481 bpts, 79%).



## THE GLOBAL ECONOMY

- **The Australian labour market produced +111k jobs in August which among other things saw the unemployment rate decline to 6.8%.** The results were way better than consensus (-40k, 7.7%) and on the surface these were incredible numbers, especially in light of the Victorian lockdowns and also the ABS's own

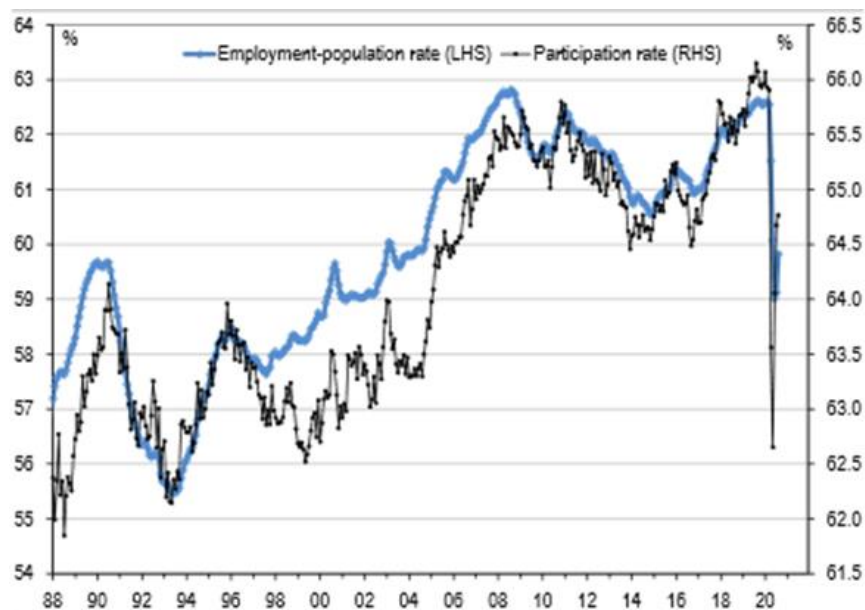
payrolls survey which suggested a -100k of job losses in the time when the labour force survey was undertaken. Forecast errors this large are normally explained by data quirks and August 2020 was no exception. While employment in Victoria declined -42k, the rest of Australia lifted but +153k with annual employment growth now moderating to -2.6% y/y which is split evenly between part-time (+75k m/m, -2.5% y/y) and full-time (+36k, -2.7% y/y).

So, what drove the gains? Well 99% of the payroll's improvement was generated by the group labelled 'owner managers without employees' which are pretty much sole traders. Accordingly, the reintroduction of mutual obligation around JobSeeker and the upcoming wind back of JobKeeper program prompted these workers to return to 'normal' employment definitions. Growth outside this group for traditional employees was flat which itself is a very good result (given Victoria) and is consistent with hours worked (+0.1% m/m, -5.4% y/y – see chart). While this may raise questions about the true strength of the result, we still think on the surface zero jobs losses is much better than what was expected.

### Australia: Total hours worked

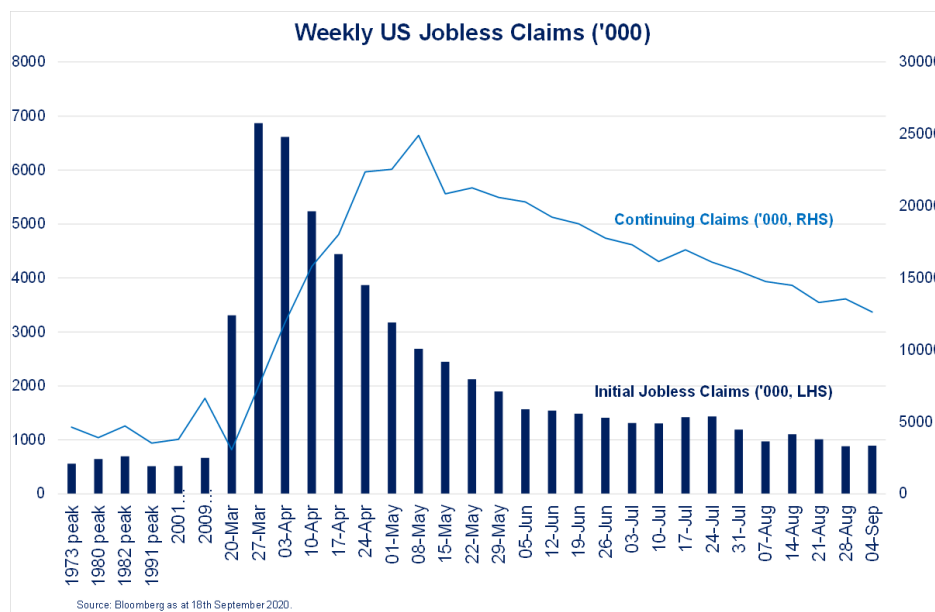


Meanwhile, the participation rate rose slightly (+0.1% to 64.8%), but remains well below the March peak of 65.9%, and should continue to rise amid the reinstatement of mutual obligation, and the broader underutilisation rate (including underemployment) declined -0.7% to 18.0% (which is around the 1992 recession peak of 18.2%) which is equivalent to around 1 million workers (8% of total employment). If we adjust the unemployment rate to include those 'not working at all', and also assume the participation rate was unchanged since March, then the 'real unemployment rate' would be 9.5%.



We would argue that the monthly result, which was driven more by part time is aligned to the challenge faced by the economy even though the official unemployment rate is below well below what the Government and RBA estimate it will be by end-Q4 (9.5%). So overall, despite the data quirks, the result was constructive and much better than anyone would have expected, even if the definitional alterations from sole traders are put to one side. This suggests that if the labour market resilience can be sustained, there are upside biases to growth projections as data has on mass been coming in better than expected lately, which suggests a shallower growth hole from the pandemic. However, the incomplete recovery thesis is still intact as the easy re-employment is occurring now, but the heavily impacted services sector will see a tougher and much more prolonged process to re-hire some workers, whereas a vast bulk of others will be permanently dislocated.

- **US data overnight was mixed with initial jobless claims declining less than forecast and by a modest -33k to +860k in the week ending 12th September.** While they have declined for three of the past four weeks, initial claims are not too far away from where they were at the start of August, suggesting that the labour market momentum is slowing. However, continuing claims were somewhat more encouraging having declined by -916k to 12.6 million, catching up on the trends in the recent payrolls report, and with businesses and schools continuing to reopen after the Labour Day holiday, these claims should decline further in coming weeks. That said, the recovery rate is gradual and grinding and nothing more.



#### In other data:

- The September Philadelphia Fed index of 15 declined for a fourth consecutive month, but among the components there were improvements in new orders, production, input prices, num of employees rose, whereas the average workweek was not as strong; and
- US housing starts declined -5.1% m/m in August to 1.416 million which was below street estimates (1.48 million) and July's reading (1.49 million). This pulled the annual result down to +2.8% y/y.

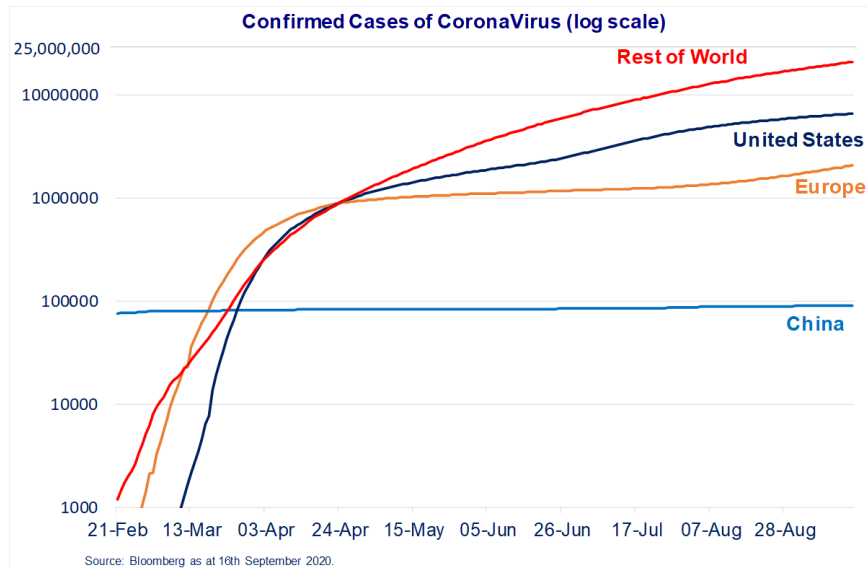
## POLICY

- **The Bank of England committee voted unanimously to leave the overnight cash rate at 0.1%, as expected, and noted that the economic outlook for the world's sixth largest economy remained 'unusually uncertain'.** They noted that the UK economy was performing in line with their expectation and that the outlook was conditioned on direct impact of COVID-19 on economy gradually dissipating and UK moving to a comprehensive free trade agreement with EU. Both assumptions are characterised by rising uncertainty at this stage. The committee said they are ready to adjust policy as required with increased discussion of the use of negative rates to buttress the labour market should it be warranted.

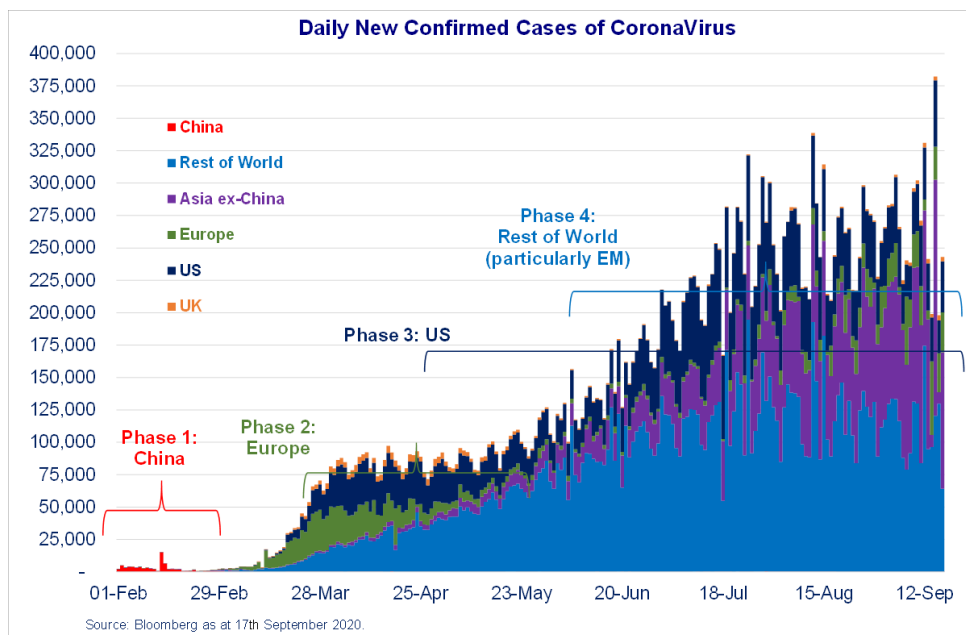
## VIRUS UPDATE

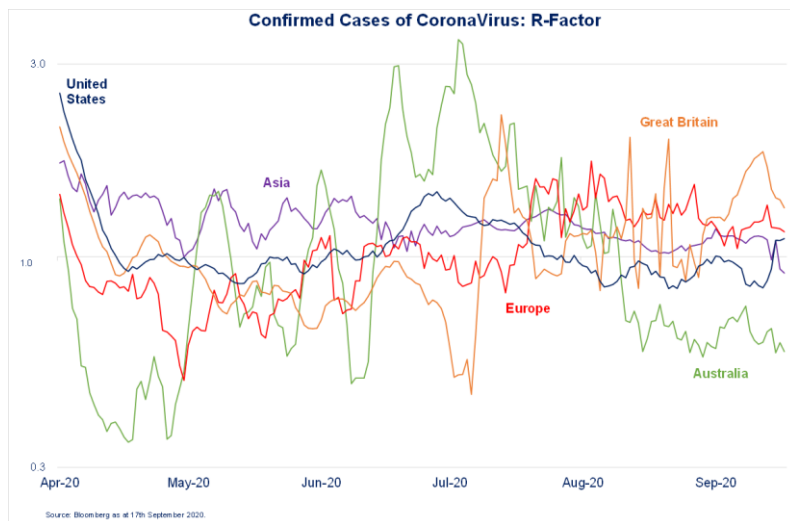
- The number of global cases of COVID-19 is 30.02 million with another +239k cases so far (but Brazil, Mexico, Colombia and Pakistan and 7 US states have not reported their numbers) which means that Thursday is the 60th consecutive day where daily increases are greater than 200k. At present, 10 countries have more than 500k cases, 22 countries have more than 200k cases and 33 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, 5 days, 4 days, 5 days, 3 days, 4 days, 4 days, 4 days, 4 days, 4 days, 4 days, 4 days and 4 days. More importantly, the growth rate of daily confirmed cases (+0.9% since Sunday) is steady. Meanwhile, deaths stand at 943.5k and the death rate was steady at 3.14% although the number of daily deaths remains elevated.



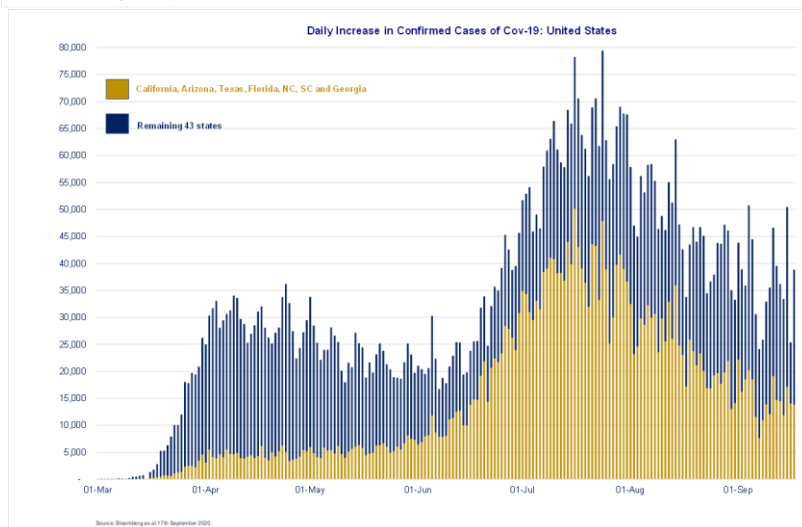
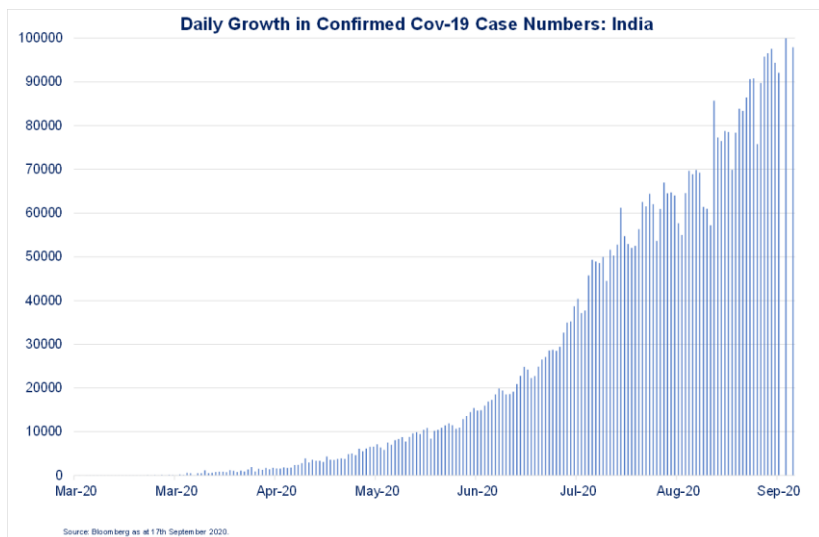
- We break the infections into four groups – the US, Europe, China and ‘others’ and the rest of the world outside the G3 economies now has the most total cases (+169.4k to 27.2 million) and highest daily new cases (and by a considerable margin) followed by the US (+39.4k to 6.67 million, although 5 states are yet to report). The issue for the US is that they never flattened their curve which means economic opening has not been associated with lower case numbers, and rising case numbers are also evident in Europe (+30.7k to 2.13 million - see chart) which is the only region with an R-factor above 1.0 which indicates that the infection rate (1.15 is too high, especially in Britain (1.32)).



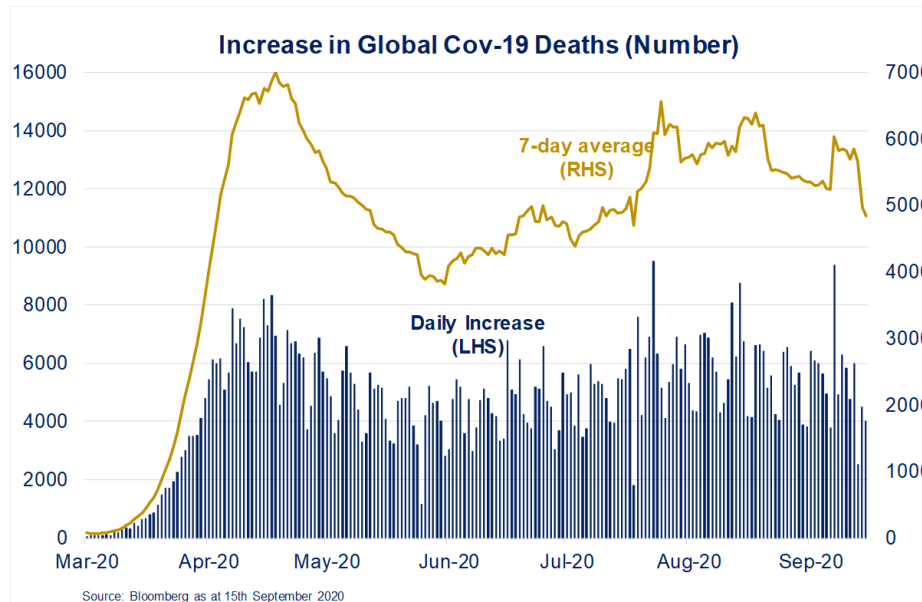


- Among countries, the most cases are in the US (+39.4k (so far) to 6.69 million, with 7 states yet to report), India (+97.9k to 5.12 million), Brazil (not reported, 4.42 million), Russia (+5.7k to 1.08k), Peru (+6.3k to 744.4k), Colombia (not reported, 736.7k), Mexico (not reported, +680.9k), South Africa (+2.1k to 655.6k), Spain (+11.3k to 625.7k) and Argentina (+23.1k to 601.7k). Australia confirmed cases rose +35 (6-week low) to 26.9k yesterday which placed us 70th in terms of total infections.

Elsewhere, Singapore recorded +18 new cases to 57.5k most of which are linked to foreign workers who are forced to live in crowded dormitories, but Indonesia (+3.6k to 232.6k) is now on the rise and has the second most cases in the region behind only the Philippines (+3.4k to 276.3k).



- Although final numbers are not in until 1pm AEST, the global death rate declined to 3.14% with the global total to 943.5k after another +3.7k deaths overnight, so far, which indicates the daily average deaths is declining again (see chart). The US (+0.8k so far) has the most deaths at +197.6k, with Brazil (not reported, 134.1k), India (+1.1k to 83.2k), Mexico (not reported, 72.0k), the UK (+21 to 41.8k), Italy (+13 to 35.6k) and France (+47 to 31.1k) all over +30k. The death rate is highest in European countries where the health systems had collapsed led by Italy (-0.1% to 12.2%), the UK (steady at 10.9%), Belgium (-0.1% to 10.4%), France (-0.2% to 6.9%), the Netherlands (-0.1% to 6.8%), Sweden (steady at 6.7%) and Spain (-0.1% to 4.9%). However, several emerging markets are now on the leader board including Mexico (+0.1% to 10.6%), Ecuador (-0.2% to 9.0%), Indonesia (steady at 4.0%) and Brazil (steady at 3.0%).



Yours sincerely,



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