

THOUGHTS ON THE MARKET

19th June 2020 - Markets pause as better manufacturing data is offset by rising Cov-19 case numbers disappointing labour market statistics.

SUMMARY

- Global risk markets closed marginally lower overnight as investors continued to weigh up some virus hotspots which threaten to derail the economy against record amount of stimulus. The net result was another fairly flat night although global credit and equity closed slightly lower. The challenge for markets is that we have major amounts of uncertainty, company management don't want to provide any guidance and policy makers have a large income chasm in September which may be difficult to completely fill. Such a murky and unprecedented environment means that analysts don't have a great sense for what earnings are going to be like in H2 2020 and 2021.

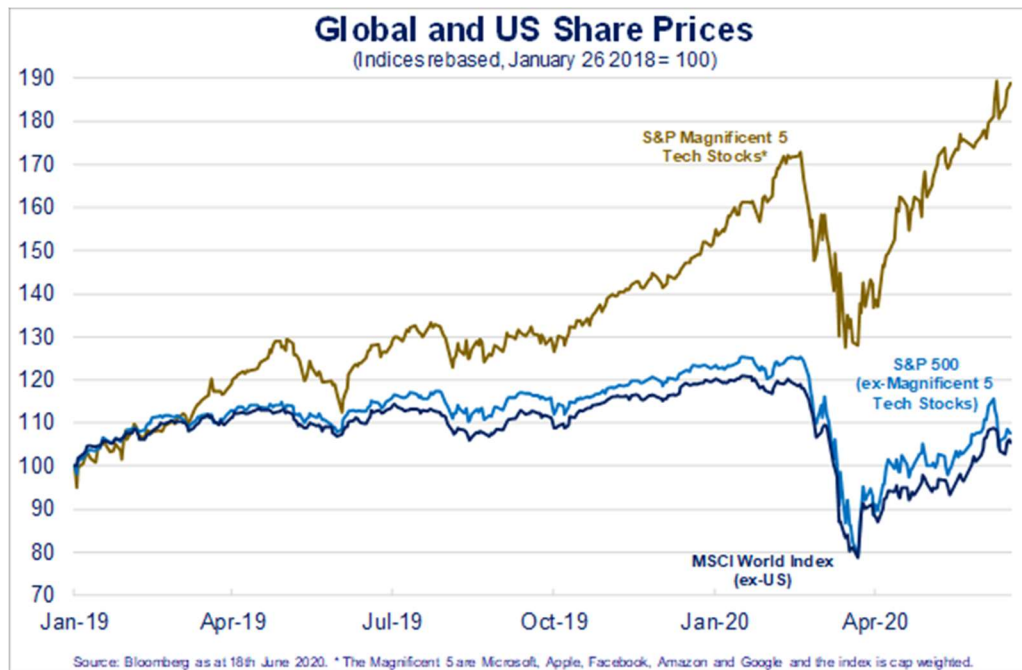
In other markets, 10-year Treasury yields closed three points lower at 0.71% with curve flattening, commodity prices were higher with gold up +0.2% (USD1723 per troy ounce) and oil erased early losses to close +1.2% higher (at USD38.84), and most G10 currencies depreciated against a stronger Greenback led by Sterling (-1.2%), AUD (-0.6% to USC68.54), the Euro (-0.03%), but the Yen (+0.4%) buck the trend for a second consecutive day.

- The economic calendar was light on volume but sent some strong signals in that Australian unemployment surged to a 19-year high (7.1% both the true measure is about 14.5%), and the US initial and continuing jobless claims showed little overall improvement but states with large manufacturing hubs and which were early to re-open outperformed. It was also quiet on the policy front although the Bank of England voted 8-1 to increase its bond buying program by £100 billion which sent Sterling sharply lower.
- Although final numbers are not in for another 5.5 hours, the number of global cases of Cov-19 was 8.45 million with another +118.4k cases so far overnight (before Mexico, Pakistan and some US states report their numbers) which means that Thursday was the 23rd occasion in the past 25 days where daily increases have topped 100k (and the other two were over 99k!). This means 3 countries have more than 500k cases, 9 countries have more than 200k cases and 18 countries have more than 100k cases (Canada joined this list overnight at 101.9k). 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 and in the past three days a further +449k cases have been recorded. More importantly, the growth rate of daily confirmed cases (+1.8% since Monday) is starting to rise (albeit modestly). Meanwhile, deaths stand at 452.5k and the death rate dropped for a forty third straight day to 5.33%.

FINANCIAL MARKETS

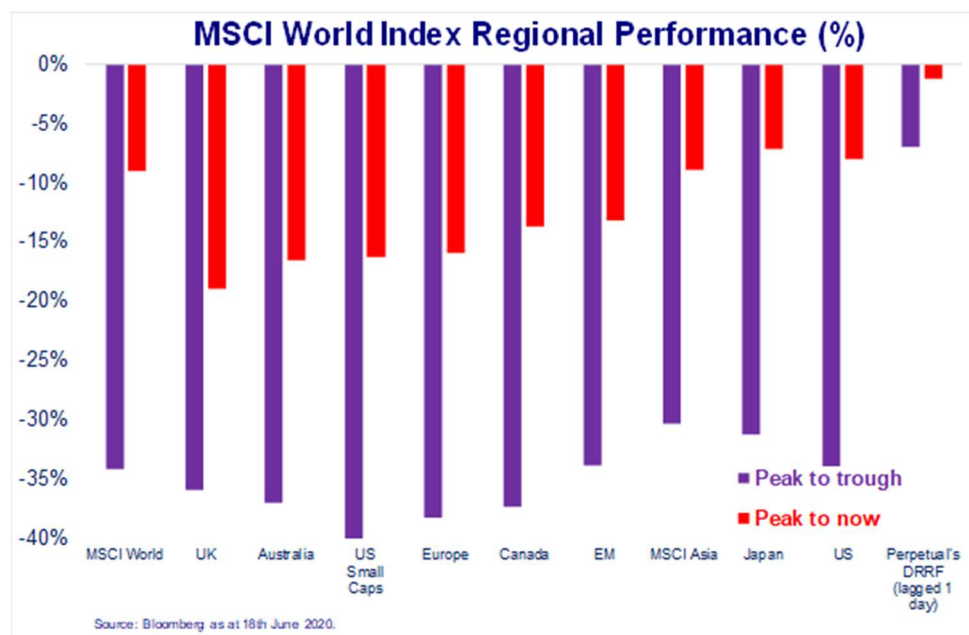
EQUITIES

- The MSCI World Index closed -0.1% lower for a second day with losses in 6 of the 11 GICS sectors. Leading the advances was energy (+0.6%) which responded positively to another rise in the oil price and IT outperformed after another set of solid gains for Microsoft (+1.1%) and Amazon (+0.5%). This helped the Magnificent 5 tech stocks to rise +48% since their March trough, whereas the remainder of the US sharemarket (+35.9%) and MSCI World ex-US (34.0%) has underperformed (see chart). Meanwhile, value/cyclical stocks underperformed again with losses in financials (-0.2%), consumer discretionary (-0.3%) and industrials (-0.3%).



- Among the regions, the MSCI Asia Pacific index was steady as losses in Australia (-0.9%), Japan (-0.5%), Korea (-0.4%) and Hong Kong (-0.1%) were offset by a rise in China (+0.7%) in what turned out to be a fairly quiet sessions. In Europe, markets (-0.5%) opened lower and stay there all day but lifted into to close as investors curbed losses although it was hard to identify the catalysts as the economic calendar and policy space were void of content. Nevertheless, all indices closed in the red with no sense of trends driving relative performance with losses in Greece (-1.5%), Spain (-1.2%), Germany (-0.8%), France (-0.8%), Italy (-0.5%), the UK (-0.5%), Portugal (-0.4%) and Switzerland (-0.2%).

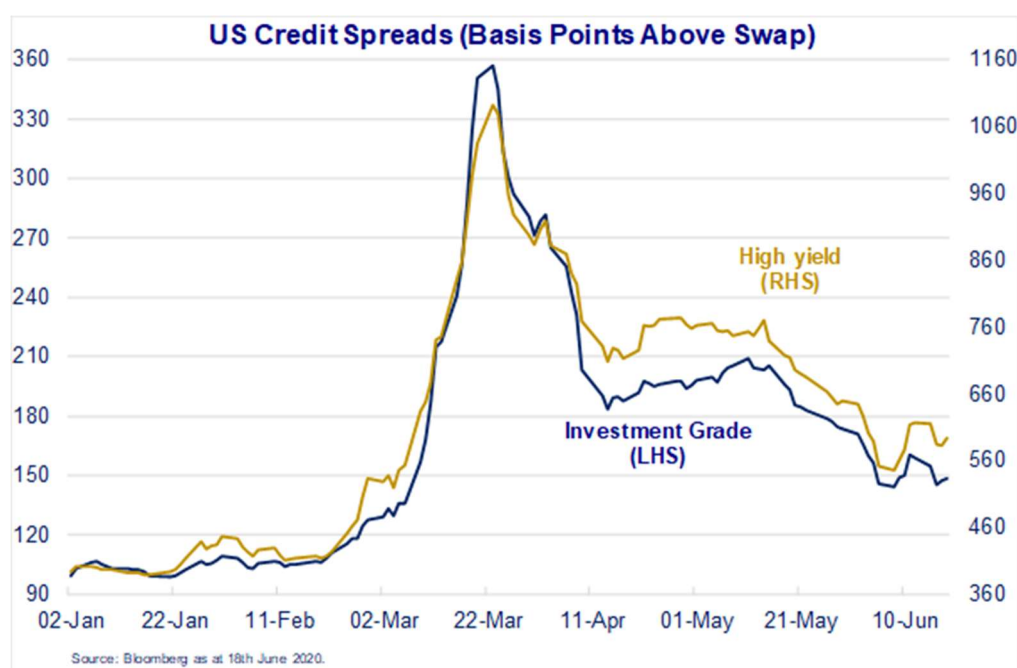
The US market (+0.1%) was little changed as investors juggled multiple themes without finding a clear sense of direction. The index oscillated between gains and losses all day within a tight trading band as a disappointing set of jobless claims and rising Cov-19 case numbers were offset by an improvement in the Philly Fed Index. By the bell the NASDAQ (+0.3%) led the pace of advances given its tech exposure and the S&P 500 (+0.1%) outperformed the Russell 2000 (+0.04%) and the Dow Jones (-0.2%, -40 points to 26,080). Yesterday's performances sent the UK (-19.0%), Australia (-16.6%) and Europe (-15.9%) closer to bear market territory (see chart).



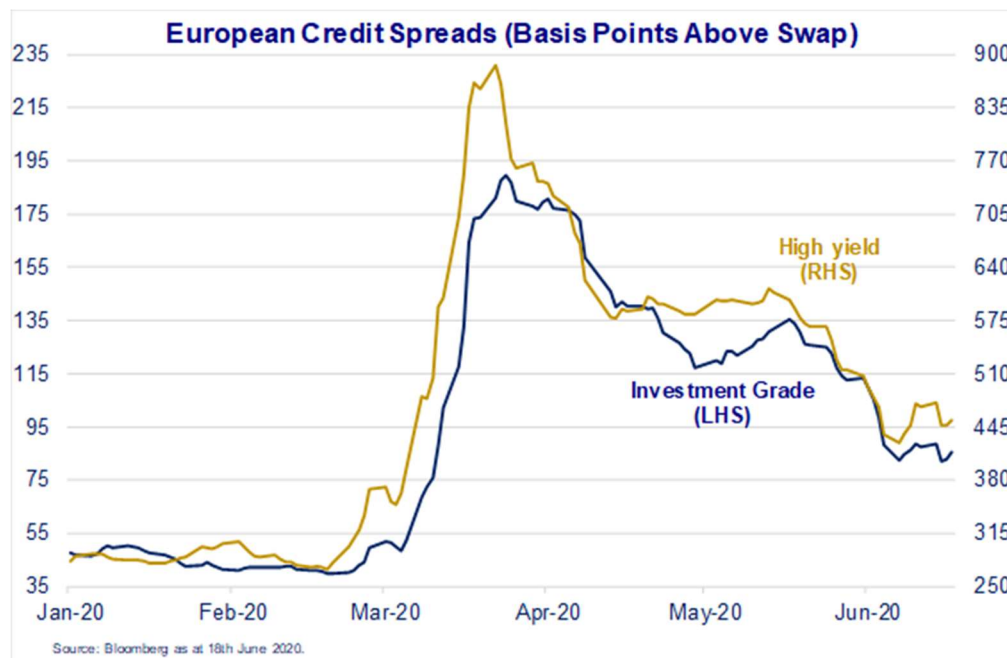
Asian stocks seem poised for a mixed start to end the week with futures markets suggesting losses on the bell for Korea (-0.2%) and Australia (-0.1%), and advances in Japan (+0.7%) and China (+1.3%).

CREDIT

- Regional credit indices sold off for a second day but not by much. Spreads in the US investment grade universe widened +1 point to +149 bpts (+4 four point above its June low – see chart), which lowered the recovery rate one notch to 82%. Ten of the 11 sub-sectors recorded higher risk premiums led by energy (+3 points +201 bpts, 88%) which defied a higher oil price, subordinated financials (+2 points, +181 bpts, 82%) and tech (+2 points, +121 bpts, 82%) which defied their equity peers. In the high yield space, spreads widened +11 points to +593 bpts, (46 bpts above its June low) which lowered the recovery rate two notches to 73%. All 11 sub-sectors recorded wider spreads and five recorded double-digit increases led by healthcare (+16 points, +524 bpts, 73%), energy (+13 points, +924 bpts, 90%) and tech (+11 points +513 bpts, 66%).

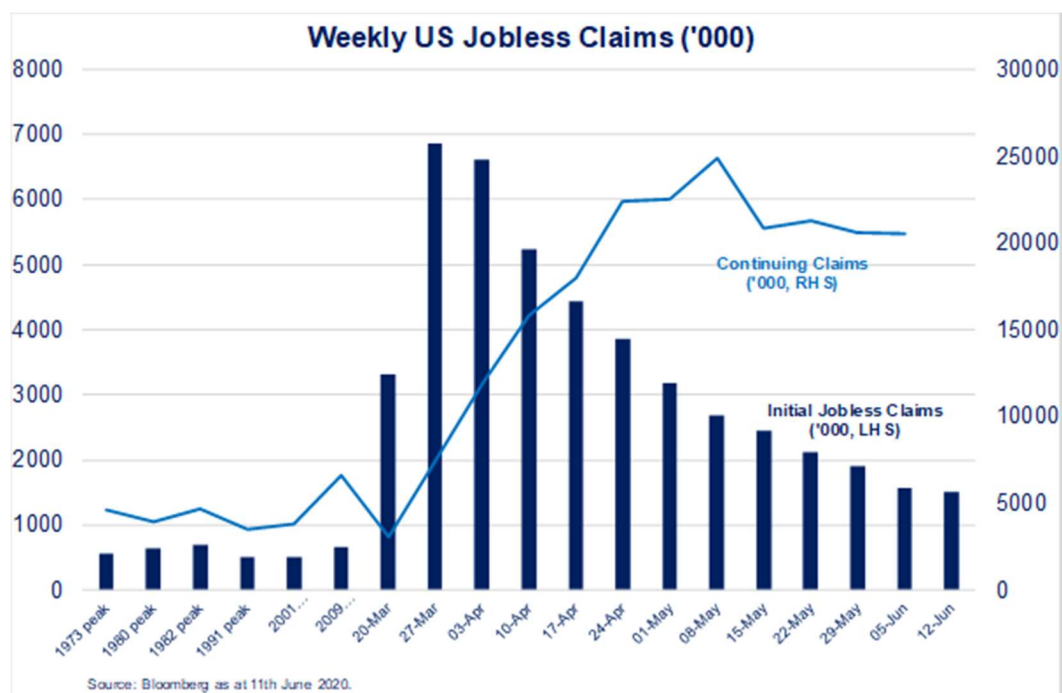


- European credit markets recorded back-to-back spread increases with risk premiums in the investment grade space up +3 points to +85.7 bpts, which lowered the recovery rate two notches to 69%. All sub-sectors increased their spreads led by cyclical sectors including consumer discretionary (+4 points, +115 bpts, 71%), energy (+4 points, +77 bpts, 65%) and senior financials (+96 points, +96 bpts, 67%). In the high yields space, spreads widened another +6 points, +453 bpts, which lowered the recovery rate to 70%. Ten of the 11 sub-sectors recorded wider risk premiums led by senior financials (+9 points, +414 bpts, 65%), consumer discretionary (+7 points, +554 bpts, 72%) and consumer staples (+7 points, +475 bpts, 98%).

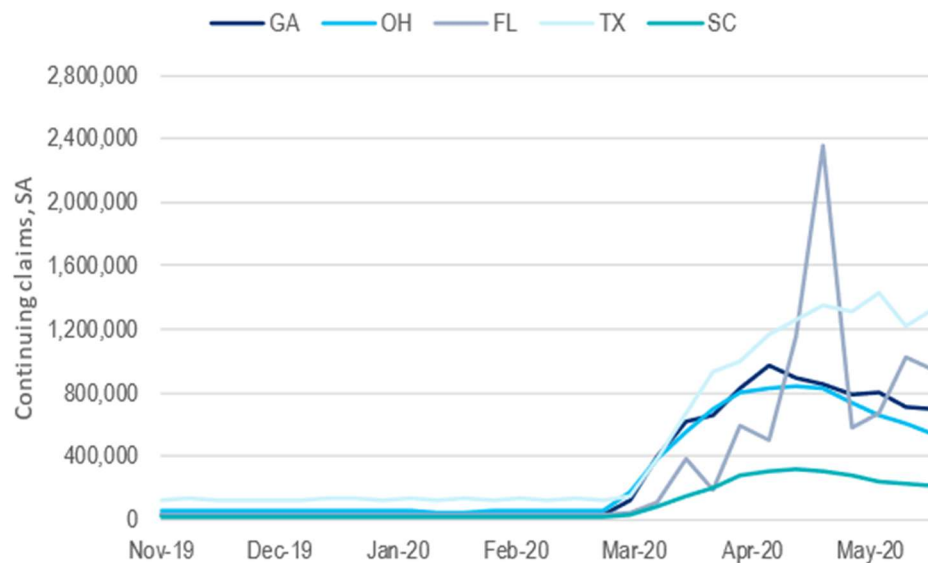


THE GLOBAL ECONOMY

- For the economic and market bulls, this week's US jobless claims for the week ending June 13th were disappointing in that initial claims dropped only -58k to 1.51 million and continuing claims (which is a measure of labour market slack) for the week ending June 6th fell only -62k to 20.5 million (see chart). Initial claims continue to be high at 1% of covered employment, but the fact that claims rose in 31 states is astounding and there were, for example, large increases in Oregon's continuing claims totalling +173k which around 9% of employment which appear extreme and are well away from the national trend. This highlights the risk of measurement errors, data quirks or something else which is not 'economic'. Both claims numbers were considerably worse than street estimates and they seem at odd with constant headlines about economic re-opening. However, if the decline in both claim numbers continue to stall, economists will have to downgrade their estimates for both the June non-farm payrolls and June quarter economic growth.



We remain focused on the changes in continuing claims (CC) as the best indicator of unemployment trends, and re-employment needs to remain elevated to adsorb the still high initial claims flows. On a more positive note, early re-opening states showed a decline in CC over the past week including Georgia, Ohio and South Carolina (see chart), but Florida's decrease (+76k to 890k) still has it above the levels of prior weeks. Meanwhile, there were sizable contributions from California (+289K to 3.03 million which is its fourth consecutive weekly increase) and Texas (+94k to 1.33 million).

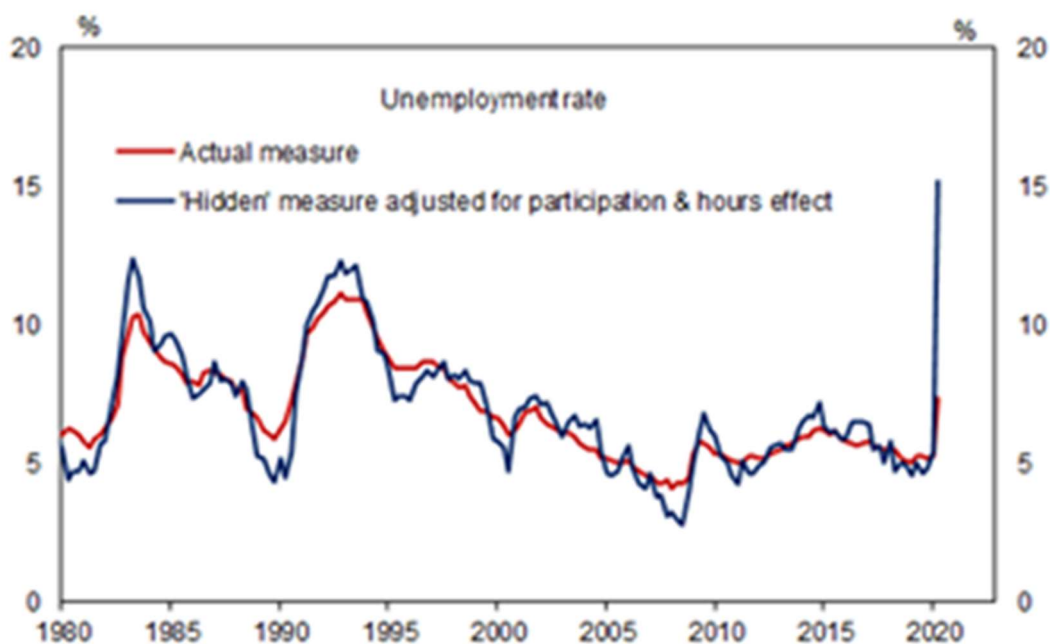


- Another notion for the US labour market is that states with a lot of manufacturing are seeing claims broadly decline as it is much easier for these types of firms to turn their processes back on than perhaps services firms which rely on volumes of people to run their businesses. On that front, the Philadelphia Fed manufacturing survey rose to 27.5 in early June from -43.1 in May, but that is not a sign of a strong factory rebound, it merely means that early June was slightly better than early May—which was a very grim reading. Most manufacturing states have reopened to some degree and this suggests that they should have positive diffusion indices other than NY which had the worst Cov-19 caseload. The improvement in activity from a low base, suggests that the June US ISM manufacturing index should be above 50 but investors need to be cautious about reading too much into such a result.



- Total Australian employment in May declined -228k, total hours worked declined -0.7% m/m, the participation rate fell -0.7% to 62.9% (as many workers who didn't qualify for the JobKeeper payment left the labour force) and unemployment increased to 7.1% which is a 19-year high which could be considerably higher later this year as people receiving Jobseeker currently don't have to look for work. The latest payroll decline means the cumulative job losses across April and May are -835k (or -6.4%), which is aligned to the -900k implied by the bi-weekly report and brings the annual rate down to -5.4% which is worse than the July-1991 recession trough of -3.4% y/y but not as bad as the all-time low of -7.3% y/y during the Great Depression. Compositionally, part-time led the decline (-139k m/m, -11.2% y/y) with full-time also lower (-89k, -2.7% y/y).

The broad sweep of data suggest Australian labour market conditions are proving somewhat more resilient than initially feared, but when the distortions of JobKeeper and workers falling out of the survey are adjusted for the truer unemployment rate is around 14.5% which is much higher than in recent decades (see chart). Moreover, the total hours worked has declined a total -10.2% in two months which is a bad sign for June quarter economic growth, but it is better than recent upgraded RBA estimate of -15% and with re-opening it is hard to see how this could decline more.



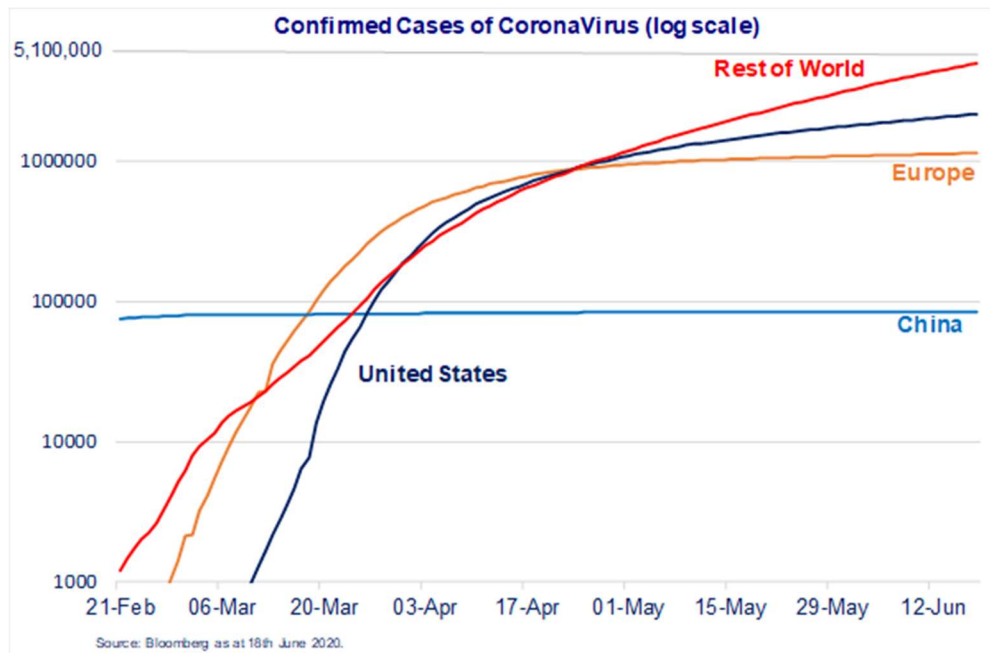
POLICY

- The Bank of England left its key Bank Rate at 0.1% but voted 8-1 to increase its asset purchase program by £100 billion which was in line with expectations. The attached statement said asset purchases can now be conducted at a slower pace and expects to be completed by end-2020. The Bank also noted that there is some emerging evidence which suggests the fall in June quarter GDP is less severe than was suggested in its May report, though the outlook is highly uncertain. It added that the economy will take time to recover to its previous path.

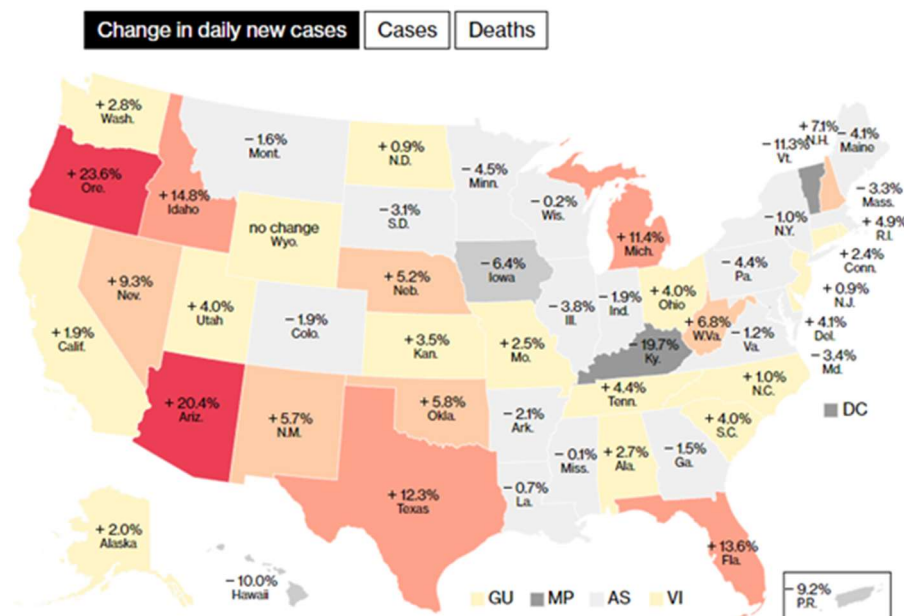
VIRUS UPDATE

- Although final numbers are not in for another 5.5 hours, the number of global cases of Cov-19 was 8.45 million with another +118.4k cases so far overnight (before Mexico, Pakistan and some US states report their numbers) which means that Thursday was the 23rd occasion in the past 25 days where daily increases have topped 100k (and the other two were over 99k!). This means 3 countries have more than 500k cases, 9 countries have more than 200k cases and 18 countries have more than 100k cases (Canada joined this list overnight at 101.9k). 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 three days a further +449k cases have been recorded. More importantly, the growth rate of daily confirmed cases (+1.8% since Monday) is starting to rise (albeit modestly). Meanwhile, deaths stand at 452.5k, with the US now over 118.3k (26.2% 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 third straight day to 5.33%.

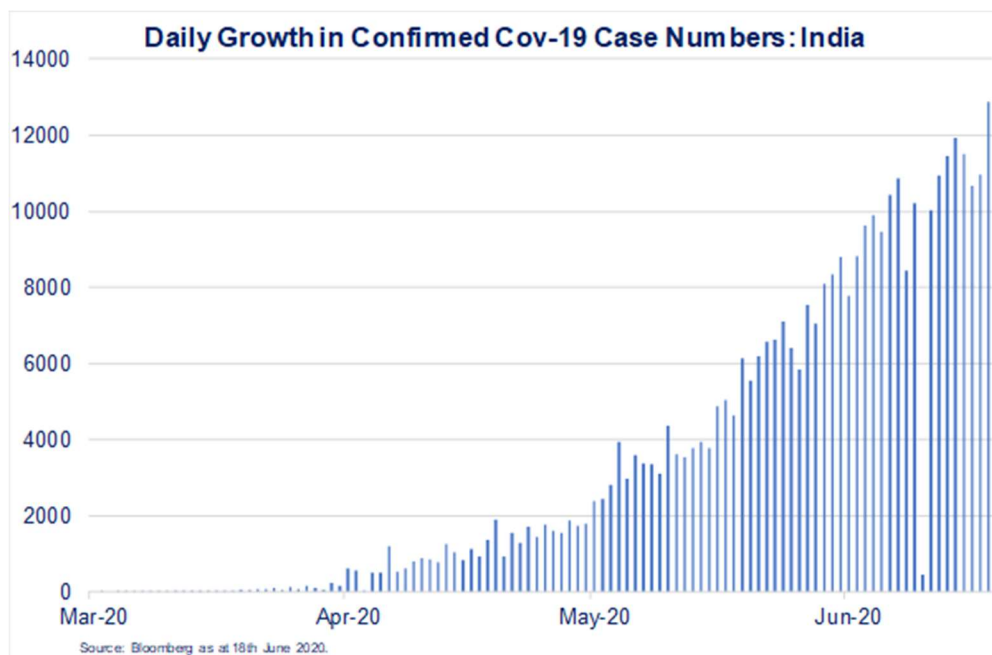
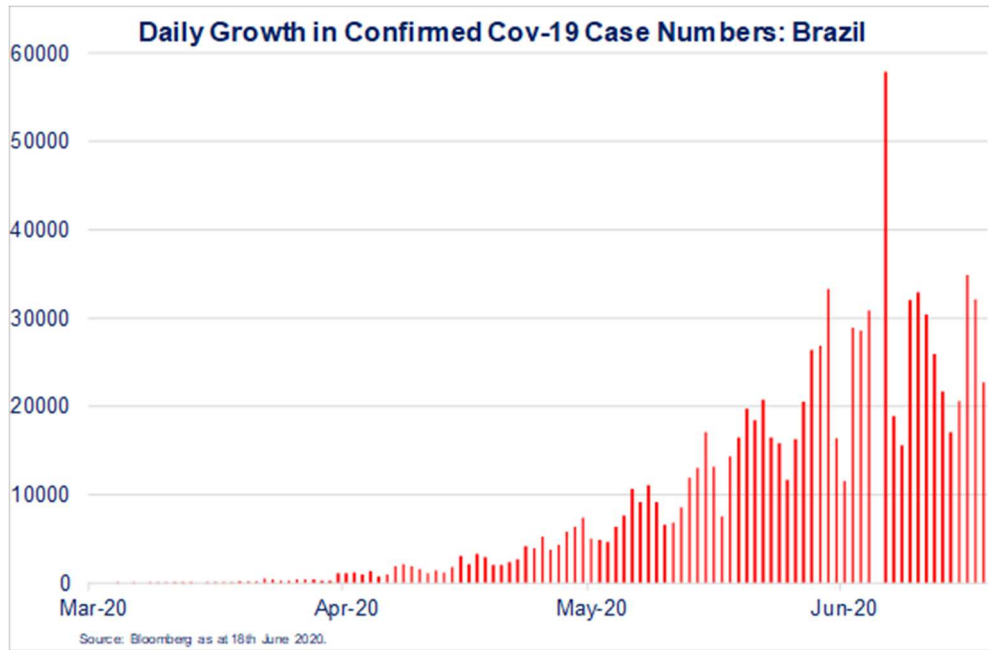


- We break the infections into four groups – the US, Europe, China and ‘others’ and the rest of the world outside the G3 economies now has the most total cases (+75.7k to 5.03 million) and highest daily new cases (and by a considerable margin) followed by the US (+22.6k to 2.19 million) and Europe (+4.3k (three week high) to 1.15 million). In the US nine states reporting record daily cases overnight including California (+4.1k to 161.1k), Texas (+3.5k to 99.85k) and Florida (+3.2k to 85.9k) with the former mandating the use of masks outside.



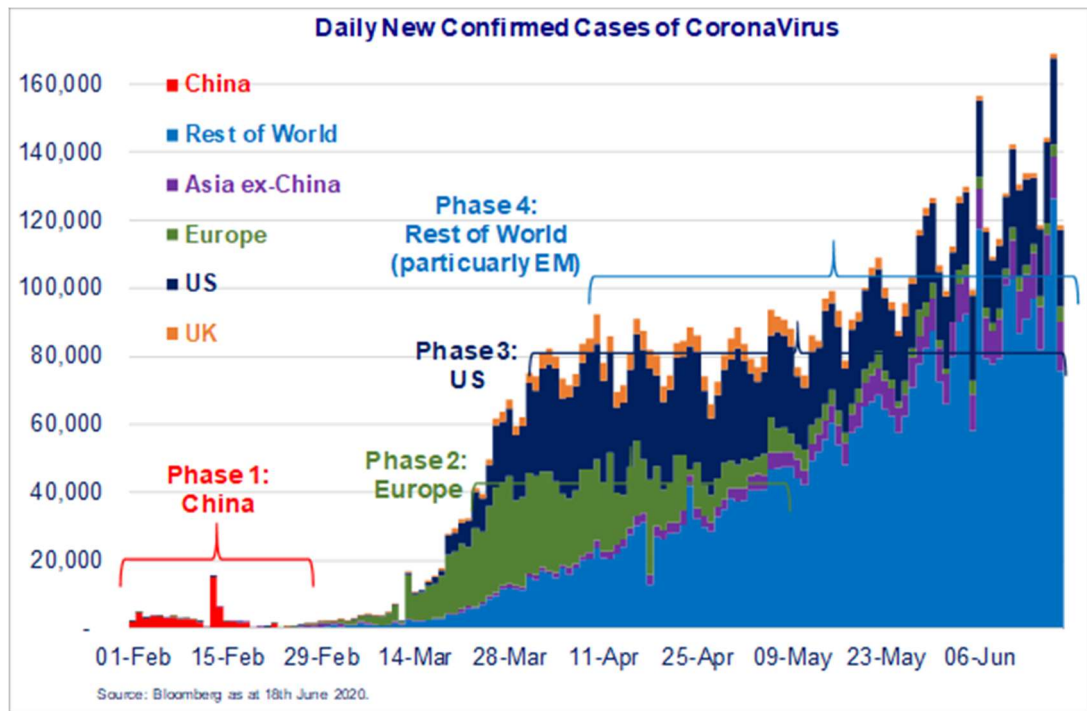
Notes: Change in daily news cases is calculated with a seven-day rolling average (data as of June 16). State figures may not reflect repatriated patients from the Diamond Princess cruise ship or those evacuated from Wuhan, China.

Within the rest of the world, the four concerns here are Brazil (+22.7k, +978.1k, which is the second highest in the world), Russia (+7.8k to 560.3k, third highest), India (+12.9k (record high) to 366.39k, fourth highest) and Saudi Arabia (+4.7k to 146.0k) 16th highest – see charts below).

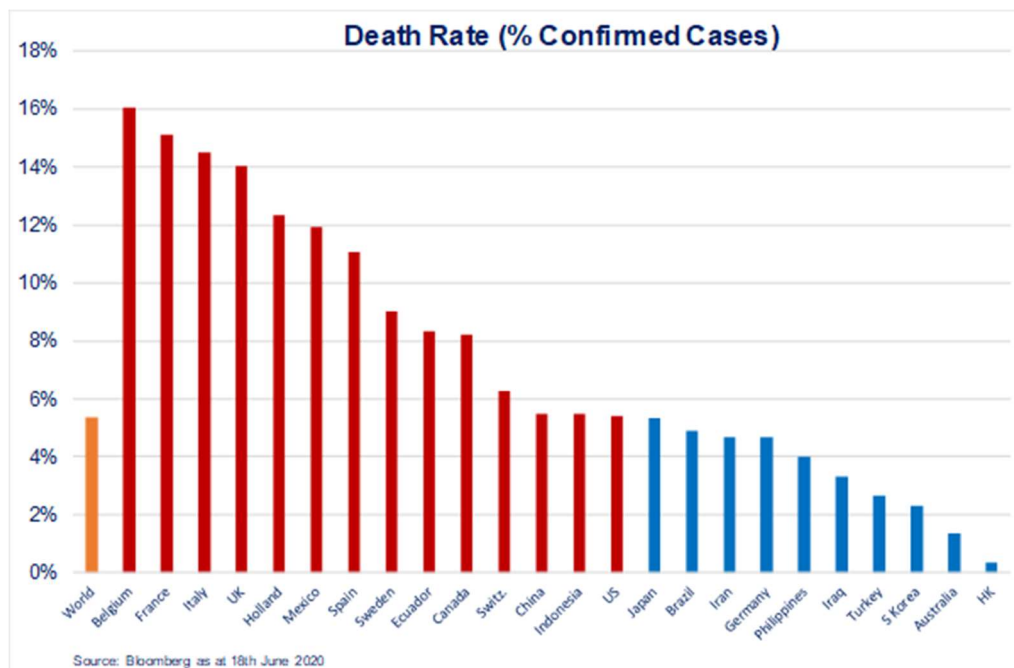


- Among countries, the most cases are in the US (+22.6k (so far) to 2.19 million), Brazil (+22.8k to 978.1k), Russia (+7.8k to 560.3k), India (+12.9k to 366.9k), the United Kingdom (+1.2k to 301.9k), Spain (+0.6k to 245.2k), Peru (not reported, 240.9k), Italy (+0.3k 238.2k), Chile (+4.4k to 225.1k), Iran (+2.6k to 197.6k), France (not reported +0.5k to 195.2k), Germany (+1.2k (8-week high) to 189.8k) and Turkey (+1.3k to 184.0k). Australia confirmed cases rose +1 to 7,391 yesterday which placed us 69th in terms of total infections.

Elsewhere, Singapore recorded +0.3k new cases to 41.5k 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 (+1.3k to 42.8k) and the Philippines (+0.6k to 27.8k). Note final numbers for yesterday at not in yet so these numbers can rise.



- The global death rate declined for a forty third straight day to 5.33% with the global total rising +4.0k to 452.5k. The US (+0.6k so far) has the most deaths at +118.3k, with Brazil (+1.2k to 47.7k), the UK (+0.1k to 42.2k), Italy (+0.1k to 34.5k), France (+0.03k 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 (-0.1% to 16.0%), France (steady at 15.1%), Italy (steady at 14.5%), the UK (-0.1% to 14.0%), the Netherlands (steady at 12.3%), Spain (steady at 11.1%) and Sweden (-0.1% to 9.1%). However, several emerging markets are now on the leader board including Mexico (+0.1% to 11.9%), Ecuador (steady at 8.3%), Indonesia (steady at 5.5%) and Brazil (-0.1% to 4.9%).



Yours sincerely,



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