

THOUGHTS ON THE MARKET

19th March 2020



OVERNIGHT DEVELOPMENTS

OVERALL VIEW

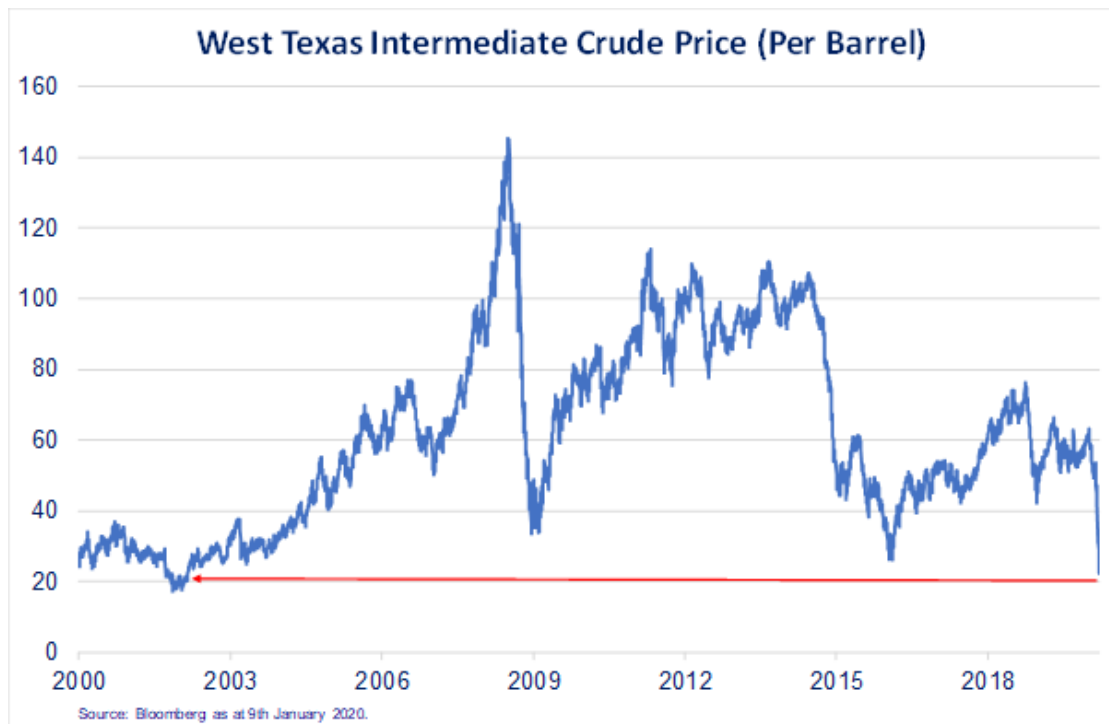
- The Coronavirus is growing, and sharemarkets plunging, at a faster rate than governments and central banks can release their policy responses. So the markets around the world are telling us that central bank and government policy announcements have been unable, so far, to quell concerns about the damage that social isolation and industry closure is doing to the global economy. I believe there is a three-stage process to easing market strains:
 1. Slow the pace of virus growth through social distancing and economic closures;
 2. Central banks and governments need to use their balance sheets and other tools to provide a massive balance sheet back stop to a vast bulk of the economy, especially small and medium businesses; and
 3. Society and markets will then have to stomach a huge economic dislocation that will see the largest economic growth contraction rate since the end of the WW2.
- I believe that while confirmed cases of Coronavirus continue to increase sharply around the world, 'isolation' should begin to become evident by the end of March/early April. Governments and central banks need to use this time to support what activity there is, but also to use all their policy armoury, both old and new, to keep small and medium businesses solvent during stage three. The Coronavirus is now a solvency crisis and massive government bailouts are now needed.
- Once the three stages are completed there will be an economic light at the end of the tunnel and as activity eventually picks up, unemployment falls and growth will accelerate. I expect this occur late in the December quarter 2020.

1. MARKET MOVEMENTS

- It was another bad night in markets with regional stock markets recording heavy losses (between -5% and -10%), oil prices plunging (-17%) and credit spreads further blowing out.

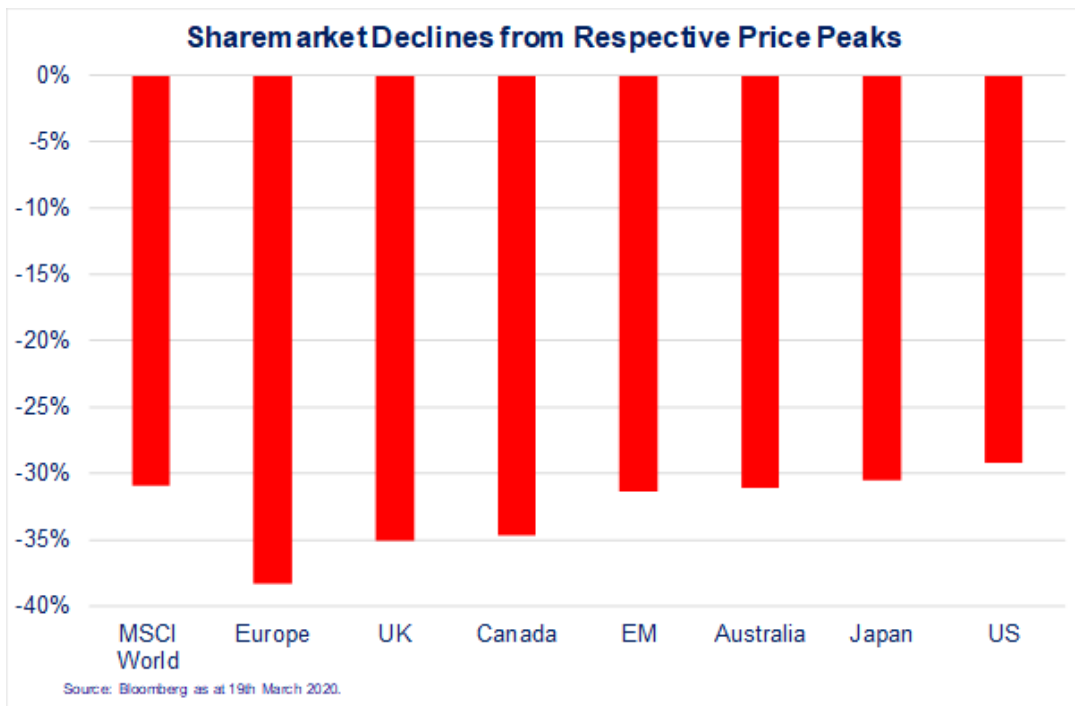
OIL MARKETS

- Oil recorded its largest daily decline in 29 years overnight (-17% to USD 22.39 per barrel). The last time oil was this low was in 2003 just after the US had invaded Iraq.
- The market is being hit from the growth destruction from the Coronavirus on the demand side, and a production war between Russia and OPEC on the other. Unfortunately, the resultant decline in crude prices is unlikely to produce the economic dividend that most economist are forwarding, firstly, as households are more likely to save it during the Coronavirus malaise, than go to the shop and spend it, and secondly, oil investment is likely to plunge with current rates of return so low.



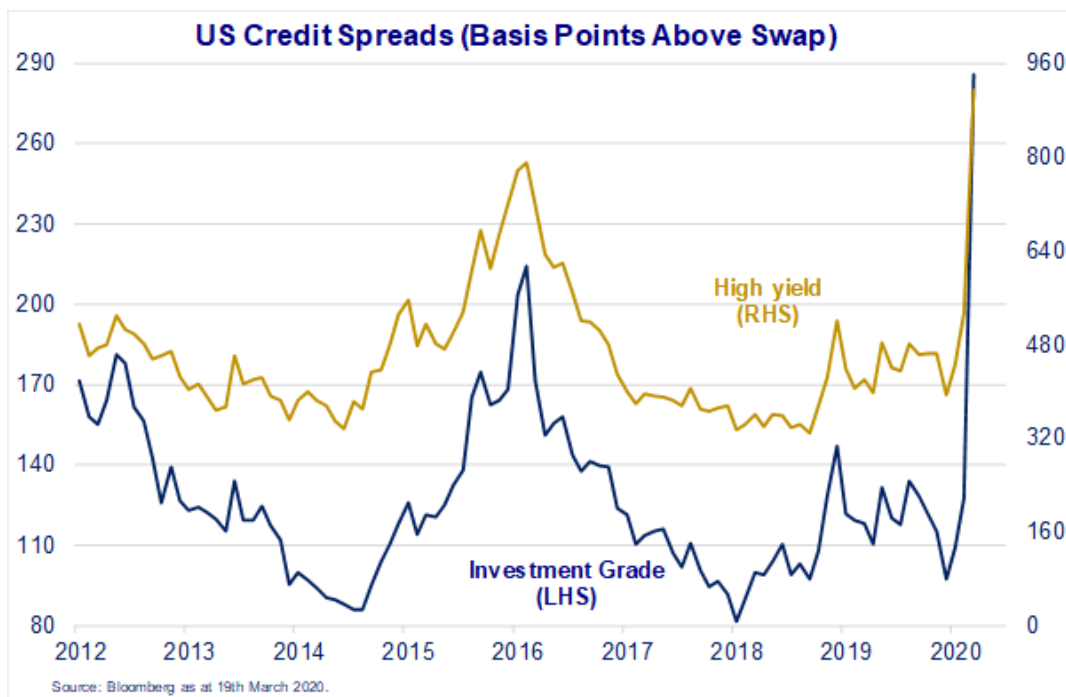
SHAREMARKETS

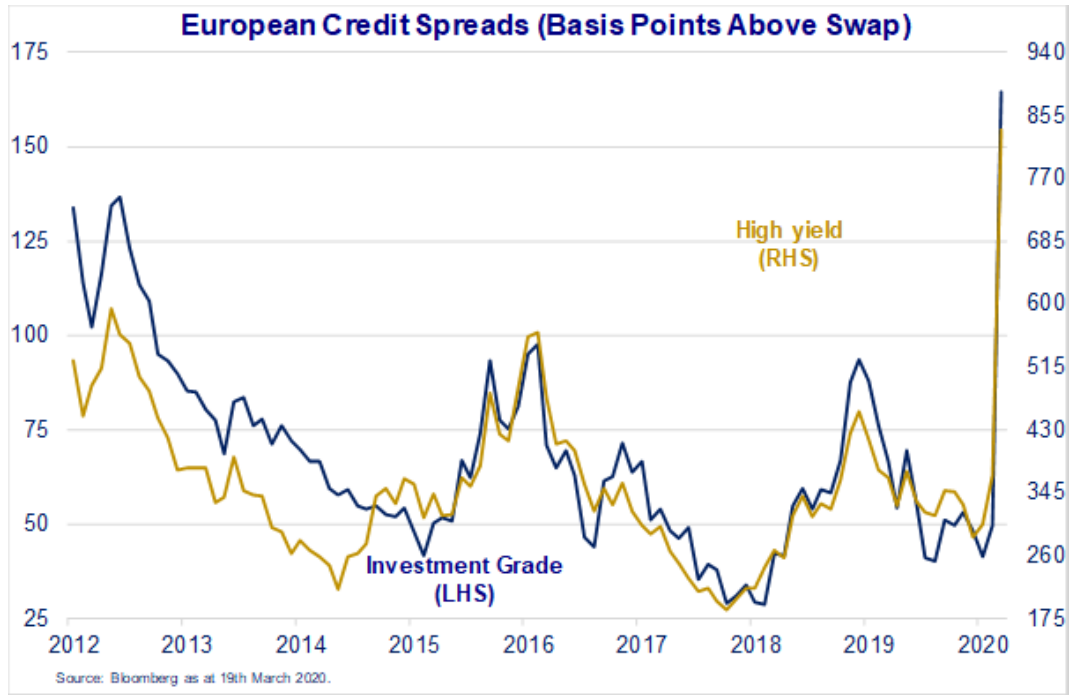
- There were large losses in the regional sharemarkets overnight as investors continued to remove the valuation premium that has built up over several years, and have begun to price in an economic and earnings dislocation that is underway, but is nowhere near complete.
- The largest overnight decline was recorded in Europe (-5.7% which took the regional bourse to a total decline of -38.3% since its mid-February peak, making the current malaise one of the fastest market descents in history) which is at the epicentre of CV case rises and also where policy ammunition and the policy response has been the most underwhelming. Cyclical sectors led the pace of declines overnight led by industrials (-13.1% d/d), energy (-11.1% d/d), IT (-7.4% d/d) and financials (-7.2% d/d) and not one stock in these four subsectors recorded a rise, in across the board selling.
- The US market (-2.5%, -29.5%) continued its whipsawing and was -5.2% lower after the circuit breaker was deployed at 1pm NYT, but the market closed well off its low for the day (-8.9% d/d) when bargain hunters and algorithmic traders came in in the last hour. The pace of decline was led by energy (-14.3% with the sector now down -61% from its 2020 peak) with financials (-8.9%) and REITs (-7.5%) also in the firing line.
- In other markets Australia declined -6.4%, Hong Kong (-4.2%), UK (-4.1%), China (-2.0%) and Japan (-1.7%). While Europe has led the pace of declines, most other markets are down around -30%, which is the same level as a week ago.



CREDIT MARKETS

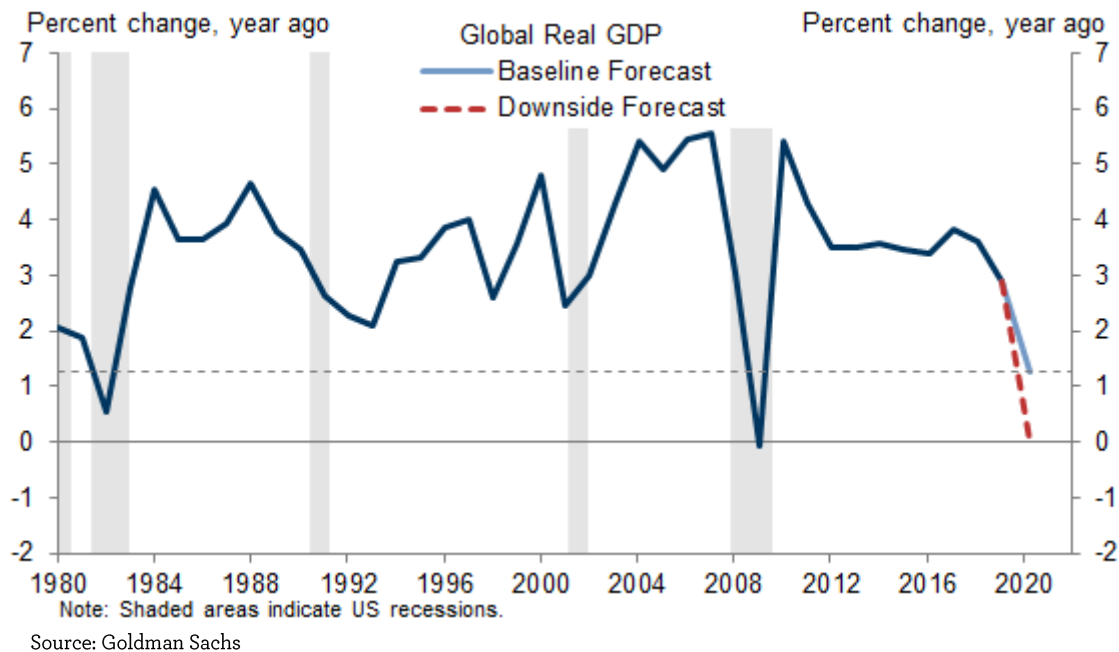
- Lower oil prices and weakening growth underpinned another blow out in credit spreads (the 31st in the past 35 days), with US IG (+28 to 284 bpts) hitting yet another post-GFC high, as did US HY (+56 to 913 bpts). There were gains in all sectors but cyclical IGs such as consumer discretionary (+39 to 337 bpts), IT (+31 to 249 bpts) and subordinated financials (+34 to 361) recorded larger increases. Conversely, it was more mixed in the HY space with gains led by industrials (+66 to 829 bpts), consumer discretionary (+62 to 862 bpts), telcos (+56 to 807 bpts) and healthcare (+54 to 800), but energy (+90 to 2055 bpts) continues to be cremated.
- European credit markets also were subjected to large downside pressures, even though the ECB is continuing to buy IG securities.



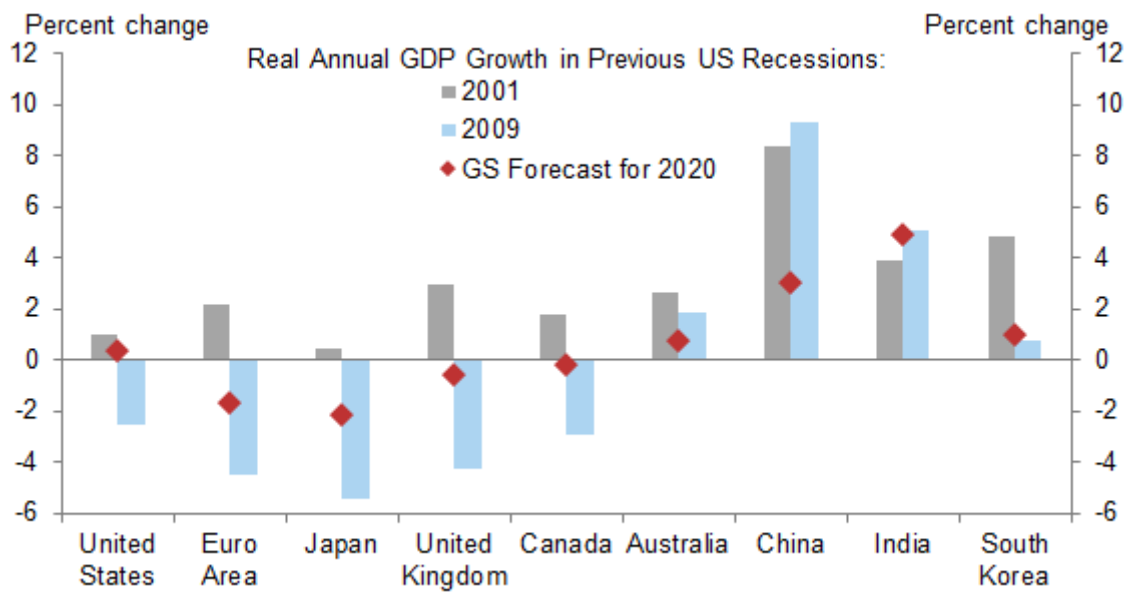


2. POLICY RESPONSE AND GROWTH OUTLOOK

- In recent days, the armoury of governments has been mobilised and income support to households is coming. While programs sized -4% to -6% of GDP sound impressive, the actual support is much less, as a large portion of this is providing income support to companies which is not a 'GDP' effect.
- Goldman Sachs updated their 2020 global GDP growth forecast which has declined to just 1¼% (on PPP basis which is about +0.6% y/y on an exchange rate basis, which I use). This would make 2020 better than the downturns in 1981/82 and 2008/09 but worse than the mild recessions of 1991 and 2001. The recession will clearly be front-loaded (largest in Q2), but its duration and its impact on the labour market are determinants as to how deep the contraction goes, and how large downside risks to this base case are.



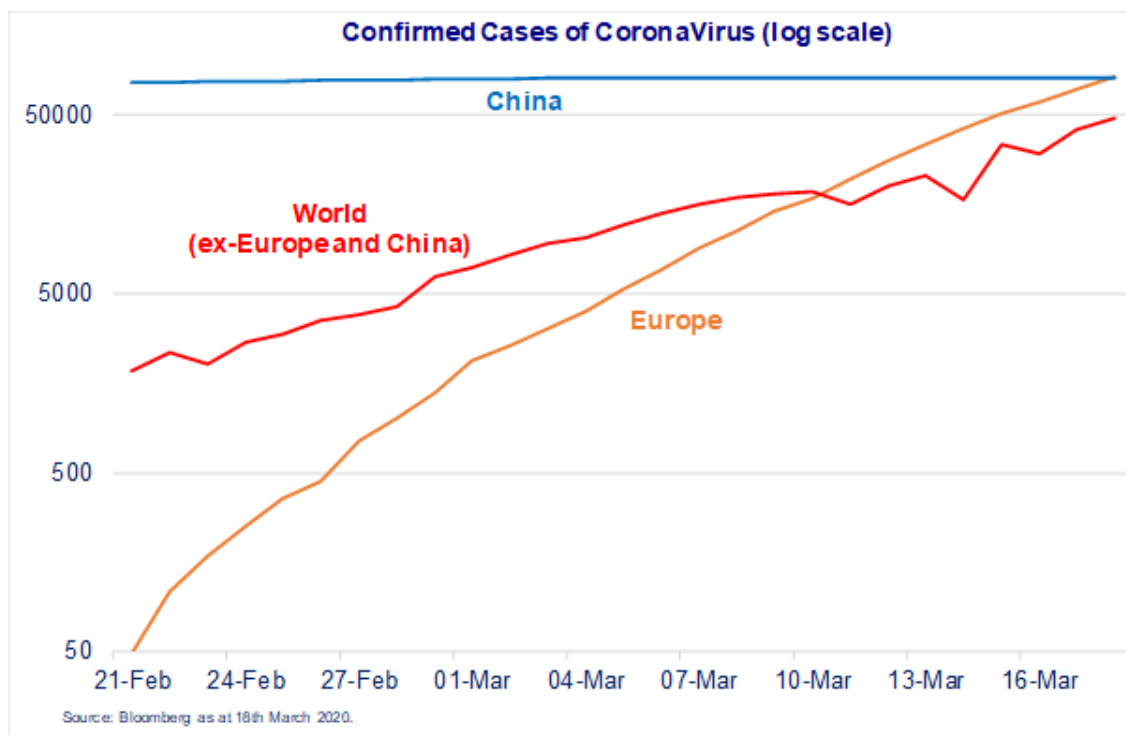
- Goldman Sachs have also adjusted their country forecasts and I think most of the numbers look accurate from what I can see, other than Australia (-1.5%) and the UK (-1.0%).



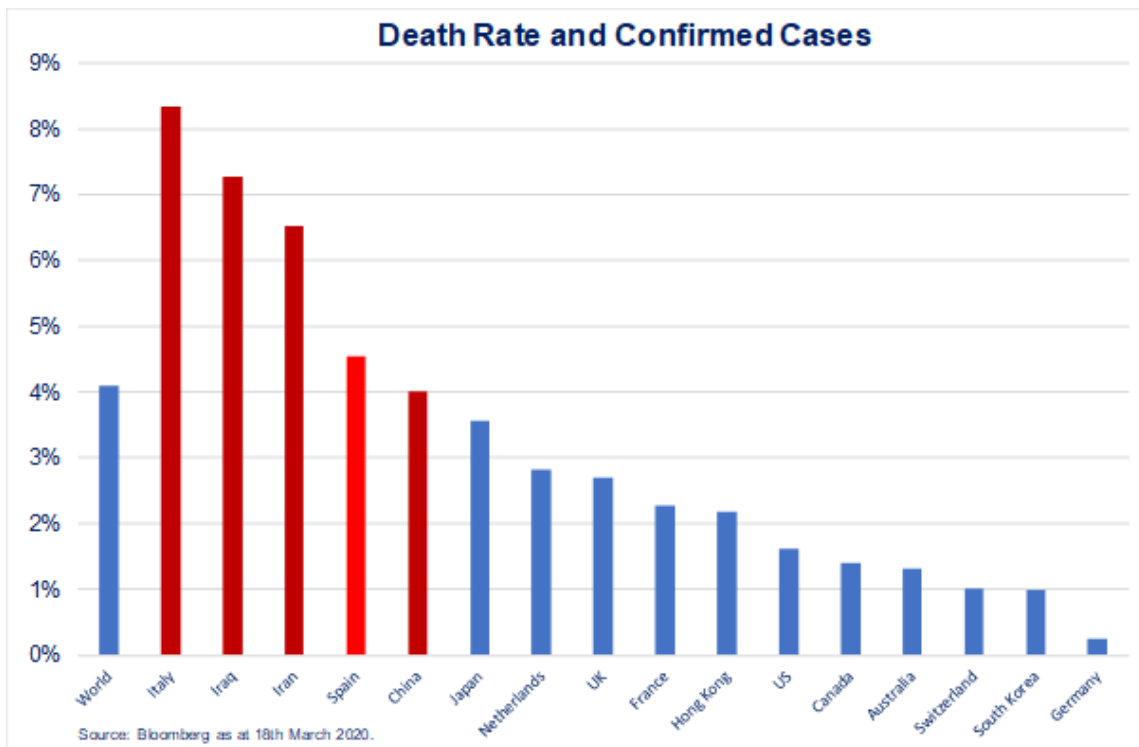
Source: Goldman Sachs

3. CORONAVIRUS UPDATE

- Coronavirus cases rose +23.1k overnight to 215k, deaths rose 711 to 8732 and the death rate rose to 4.1% (6th rise in the past 10 days despite surging case numbers);
- Europe (+13.4k to 82.9k) is now the most infected region led by large gains in Italy (+4,207 to 35,713), Germany (+3,272 to 11,333) and Spain (+2,732 to 13910). Other badly infected regions are China (+13 to 81,102) although new cases have flattened out), Iran (+1,192 to 17,361), the US (+1,386 to 7,866) and Korea (flat at 8,413).



Source: Bloomberg as at 18th March 2020.



Yours sincerely,



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