

# THOUGHTS ON THE MARKET

19<sup>th</sup> May 2020 – Are markets now willing to overlook all risks?

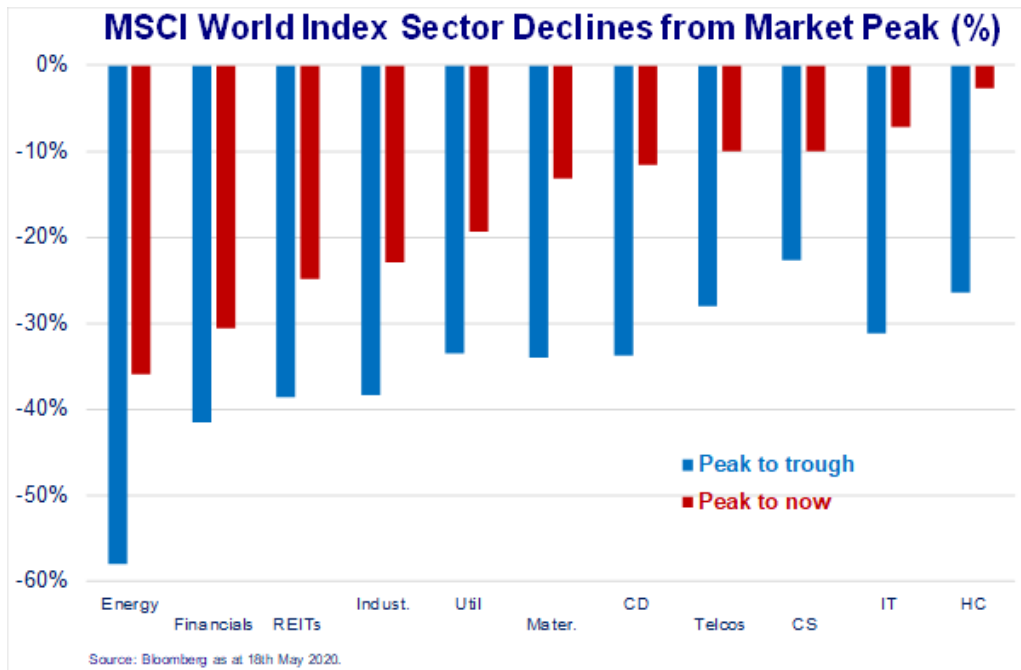
## SUMMARY

- Markets overnight were in a mood that everything was going to improve – COVID-19 cases have not spiked despite economic reopening, September quarter growth will be better than June, and 2021 GDP and EPS growth will be better than 2020. So, it may be the case that central bank liquidity is chloroforming markets to overlook risks such as overleveraged corporate and government balance sheets, growing COVID-19 case numbers, growth holes and a slow recovery path. It remains to be seen how sustainable this situation is, but this mindset overnight saw stocks jump the most in 6 weeks and stocks and sectors which would benefit the most from a normalisation of economic conditions led the rally in the absence of major economic data or policy announcements. The rally came as Fed Chair Powell stated that he has more ammunition to combat any weakness, but I would argue that his policy support can help markets, but not the economy.
- In other markets, 10-year Treasury yields were +0.08% higher with curve steepening up to 0.62%, the US dollar was weaker against the Euro (-1.0%), Sterling (-0.6%) and AUD (-1.0%) and steady against the Yen, gold finished down -1.7% to USD1732 per troy ounce and WTI crude rallied +11.2% to USD32.74 per barrel.
- Although final numbers are not in for another 3 hours, the number of global cases of Cov-19 stands at 4.79 million with another +69.0k cases overnight. This means 6 countries have more than 200k cases, 11 countries have more than 100k cases (with India joining this group overnight), 31 over 20k cases and 47 over 10k. 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, and in the past 9 days another 787k cases have been confirmed. That said, the growth rate of daily confirmed cases is trending lower (+1.7% since Friday). Meanwhile, deaths rose +2.3k overnight to 317.6k, with the death rate dropping for a twelfth straight day to 6.60%.

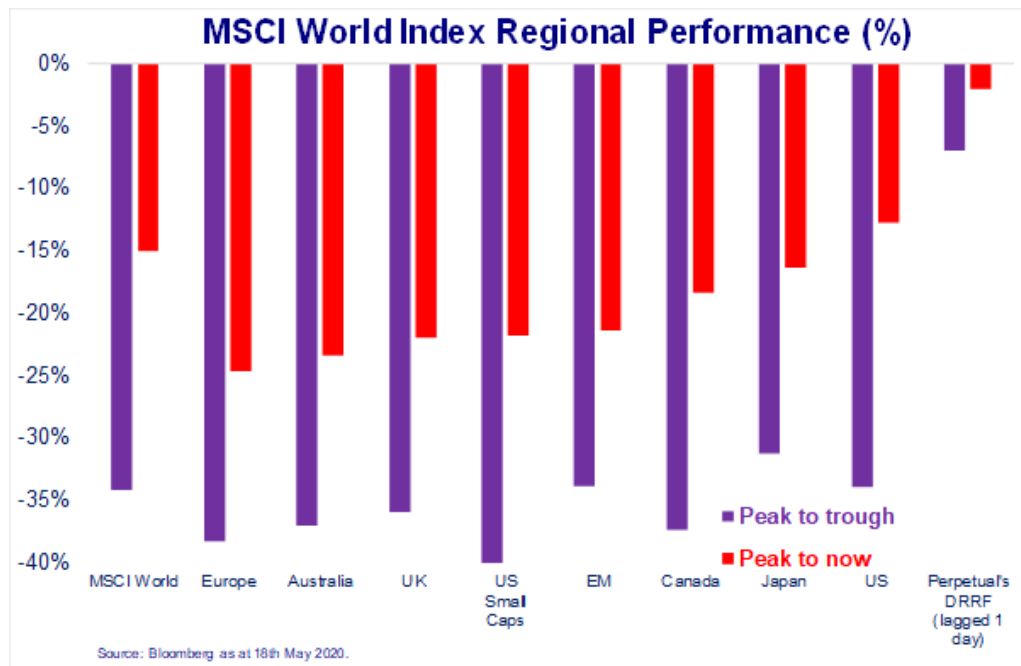
## FINANCIAL MARKETS

### • EQUITIES

- **The MSCI World Index rose +3.0%** (three-week high) which pushed the index up to a six-week high. Gains were widespread but led by energy (+6.1%) which responded positively to oil prices hitting a 9-week high of USD32.74 per barrel as investor appear increasingly confident that any growth improvement will help ease supply-demand imbalances. This sentiment flowed through to other cyclical components of the market such as industrials (+4.8%), financials (+4.0%) and REITs (+4.0%). Meanwhile, the rally in utilities (+3.5%) may have been less than that of its peers, but it enabled the sector to leave bear market territory for the first time in two weeks (see chart).



Among the countries, those which had lagged the recovery were 'bid' overnight and recorded outsized gains. The charge higher was led by Europe (+5.1%) and UK (+4.1%) where stocks benefited from a German-French plan to construct a €500 billion recovery fund which will support the hardest hit economies such as Italy (+3.3%) and Spain (+4.7%) who lagged the performance of other markets such as Germany (+5.7%) and France (+5.2%) who benefit the most by keeping the world's largest trading block together.

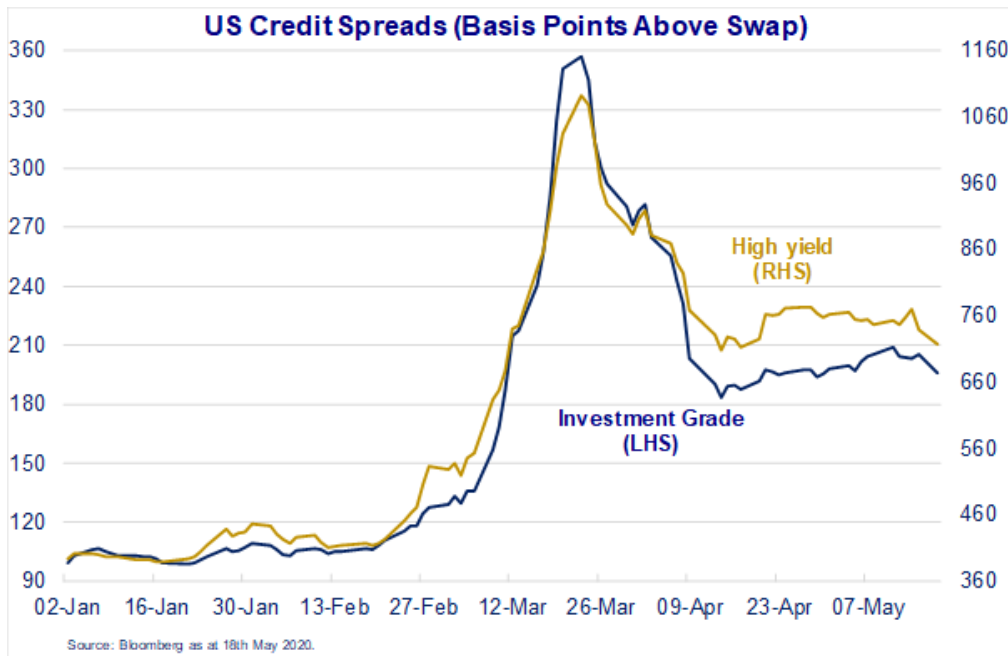


This positive sentiment flowed through to the US, where the Dow Jones (+3.9%) and S&P500 (+3.2%) outperformed the NASDAQ (+2.4%) given the outperformance of traditional value sectors. Earlier, the MSCI Asia Pacific Index rallied +0.5% with across the board gains in Australia (+1.0%), Hong Kong (+0.6%), Korea (+0.5%), Japan (+0.5%) and China (+0.3%). The rally in stock prices saw recovery rates lift across the board but the EM, US small caps, UK, Australia and Europe remain anchored in bear market territory.

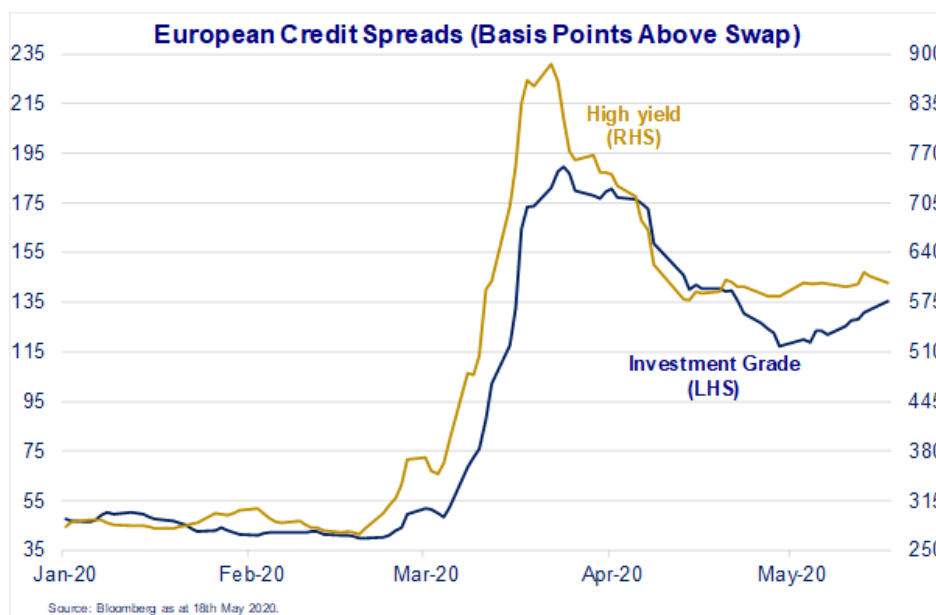
Futures markets suggest a strong opening on Tuesday morning in both Australia (+1.9%) and Japan (+1.9%).

## • CREDIT MARKETS

- Regional credit indices were mostly high with spreads in US investment grade coming in -9 points to +196 bpts which lifted the recovery rate to 63% (2-week high). All sectors recorded lower spreads led by energy (-13 points, to +294 bpts, 67%), subordinated financials (-11 points to +242 bpts, 62%) and consumer discretionary (-10 points to +343 bpts, 64%). Meanwhile, high yield spreads were wound in even more, contracting -21 points, to +718 bpts (five-week low – see chart) with the recovery rate lifting to 55%. There were double digit gains in nearly every sub-sector led by energy (-54 points to +1137 bpts, 76%), utilities (-29 bpts, +522 bpts, 56%) and consumer discretionary (-26 points to +758 bpts, 40%).

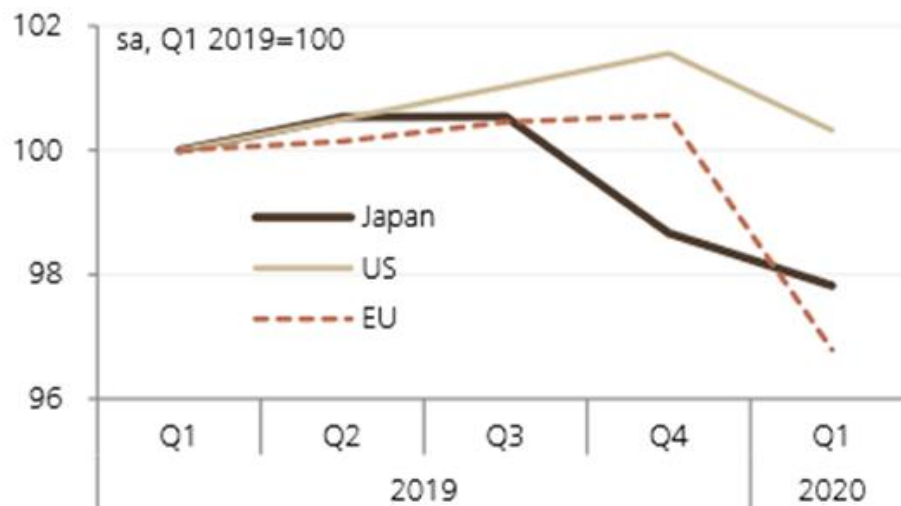


- European credit markets were mixed with spreads in the investment grade universe rising +4 points to +135 bpts which lowered the recovery rate three notches to 36%. Among the sub-sectors, the risk premium rise was universal and led by tech (+5 points, +79 bpts, 52%), healthcare (+5 points, +77 bpts, 32%) and consumer staples (+4 points to +108 bpts, 37%). In contrast, the high yield space saw spreads tighten -8 points to +601 bpts (see chart) which lowered the recovery rate one notch to 46%. Spreads came in in every sub-sector but only a few were more than a handful of basis points, with only energy (-17 points to +721 bpts, 54%) and materials (-21 points to 563, 45%) outperforming.



## THE GLOBAL ECONOMY

- Not a lot of data yesterday, but **Japanese March quarter GDP** contracted -3.4% q/q annualised which followed a -7.3% q/qa decline in the December drop in prior quarter to culminate in yet another official recession. Japan is highly vulnerable to repercussions from COVID-19 given its dependence on trade with both China (the country where the pandemic began) and the US (the country hardest hit) and this culminated in a large contraction in net exports (-0.8% q/qa) as exports plunged more than imports. However, the largest growth hit was in domestic demand (-2.8% q/qa) where the contractions in consumption (-2.8% q/qa) and residential investment (-22% q/qa) were sharper than that of business investment (-2.0% q/qa) with government the only area lift (+0.4% q/qa). The Q1 decline in Japan was larger than that of Europe (-14.2% q/qa) and the US (-4.8% q/qa – see chart below), but the first estimate of Japanese GDP is notoriously unreliable and is normally subjected to large revisions. March quarter 2020 will be no exception.

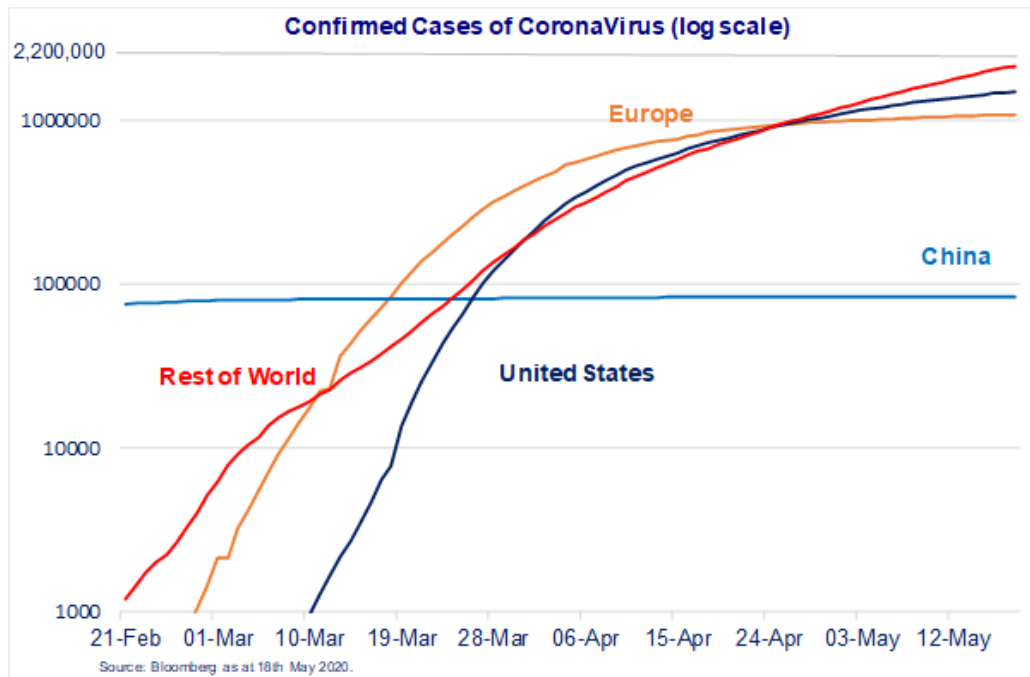


## POLICY

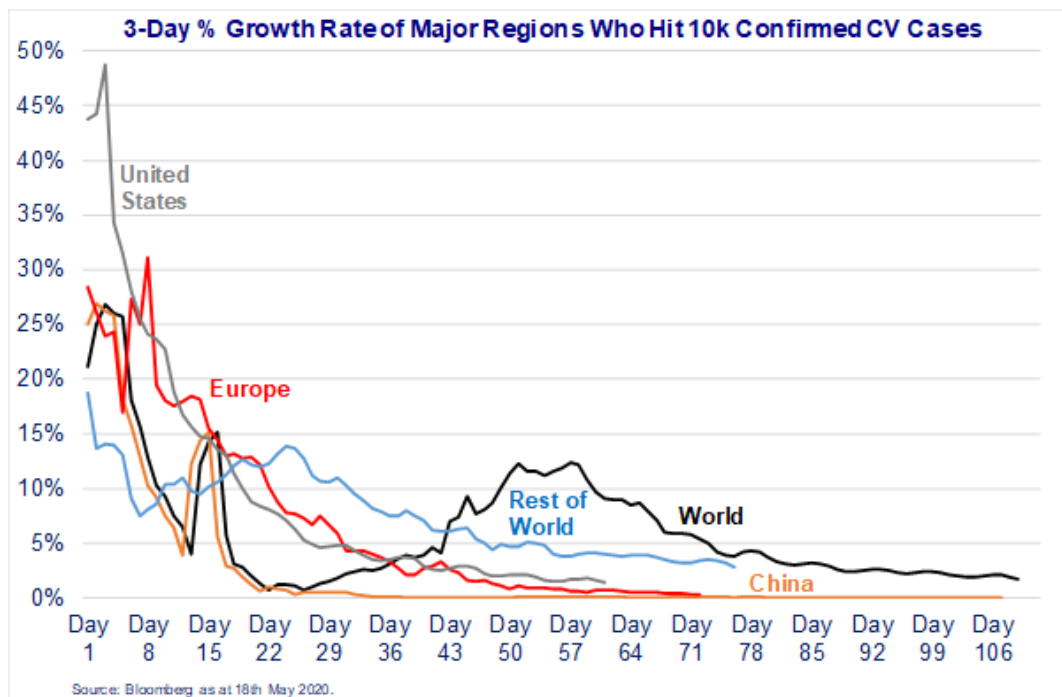
- Yesterday industrial metals climbed strongly after China announced some simple guidelines to revive infrastructure projects on the nation's western region. This saw ore and crude prices strengthen and took the currencies of these regions up with them including the Australian dollar. The guidelines primarily targeted improving basic public services, infrastructure and people's living standard to levels equivalent to those in the eastern region by 2035. Measures included:
  - Supports qualified companies in the western region to finance via initial public offerings and bond sales;
  - Constructs a batch of oil and gas production bases and speed up exploration and utilization of coalbed methane;
  - Speeds up planning and construction of major railway projects; and
  - Encourages establishment of technology and innovation firms.

## VIRUS UPDATE

- Although final numbers are not in for another 3 hours, the number of global cases of COVID-19 stands at 4.78 million with another +69.0k cases overnight (which means Monday is likely to be the 48th occasion in the past 49 days where daily increases have topped 70k). The recent daily case increases have been very high and this means 6 countries have more than 200k cases, 11 countries have more than 100k cases (with India joining this group overnight), 31 over 20k cases and 47 over 10k. 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, and in the past 9 days another 782k cases have been confirmed. That said, the growth rate of daily confirmed cases is trending lower (+1.7% since Friday). Meanwhile, deaths rose +2.3k overnight to 317.6k, with the US now over 90k (28.4% of global deaths even though they have only 4% of the global population), the UK and Italy over 30k, with Spain and France over 25k, and the death rate dropped for a twelfth straight day to 6.60%.

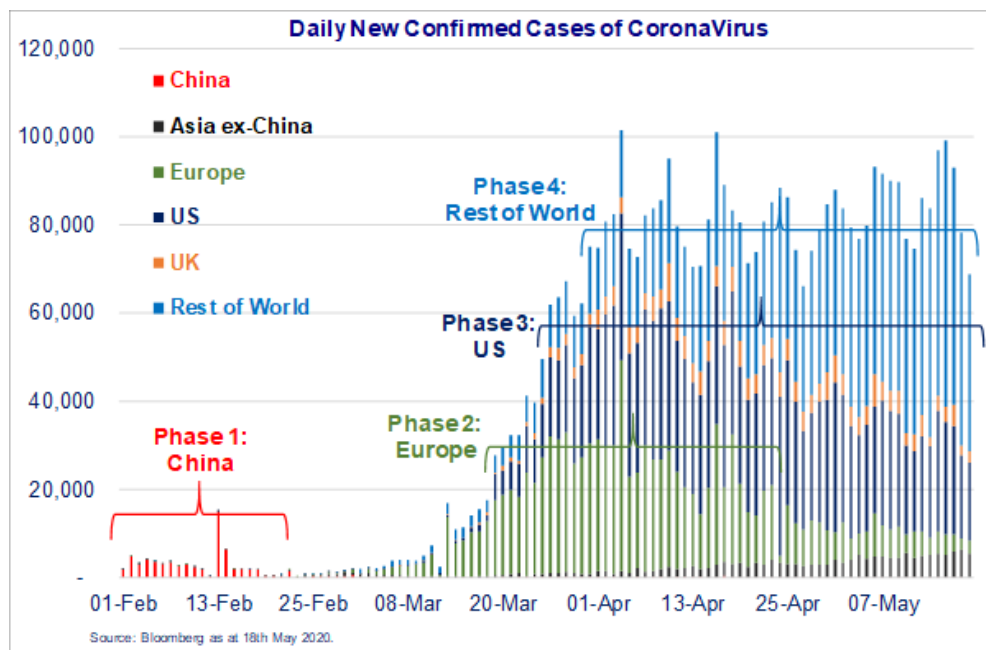


- We break the infections into four groups – the US, Europe, China and ‘others’ and the rest of the world outside the G3 economies now has the most total cases (+40.1k to 2.14 million) and highest daily new cases (and by a considerable margin) followed by the US (+17.6k (7-week low) to 1.5 million) and Europe (+3.0k to 1.09 million), with the latter two’s daily increases, in terms of percentages, grinding lower which shows that social isolation works to reduce the spread of the virus, even though it comes at an enormous economic cost. In the rest of the world, the two concerns here are Russia (+8.9k to 290.7k) which has now overtaken Spain to be the second most infected nation after the US, and Brazil (+4.5k to 245.6k) which is now the fourth most infected nation.

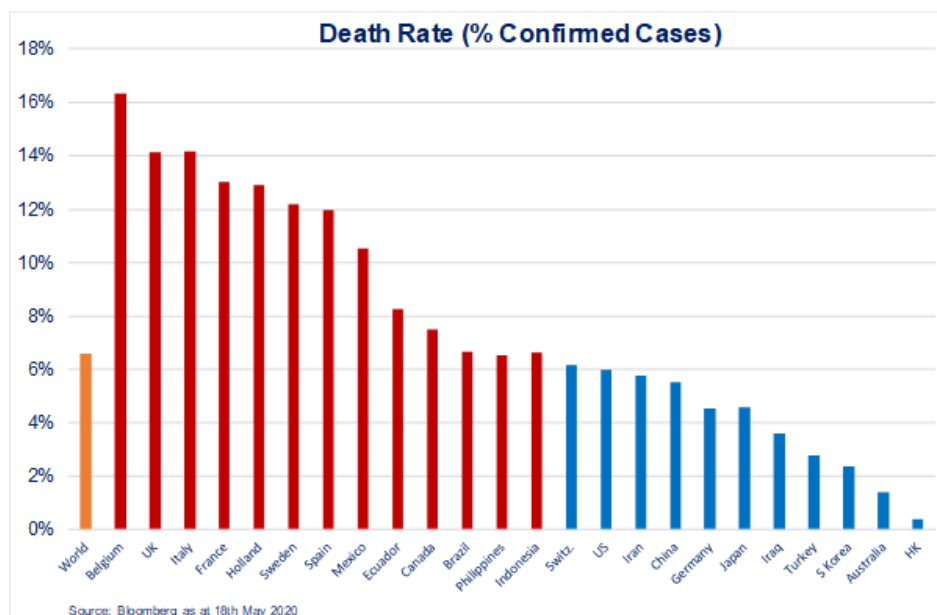


- Among countries, the most cases are in the US (+17.6k to 1.50 million), Russia (+8.9k to 290.7k), the United Kingdom (+2.7k to 247.7k), Brazil (+4.5k to 245.6k), Spain (+0.9k to 2231.6k), Italy (+0.5k to 225.9k), France (+0.5k to 180.1k), Germany (+0.2k to 176.5k), Turkey (+1.1k to 150.6k), Iran (+2.3k to 122.5k), India (+4.6k to 100.3) and China (steady at 84.0k). Australia confirmed cases rose +6 to 7,060 yesterday which placed us 53rd in terms of total infections.

Elsewhere, Singapore recorded +305 new cases to 28.3k 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 (+496 to 18.0k) and the Philippines (+205 to 12.7). 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 an eleventh straight day to 6.60% with another +2.3k fatalities overnight bringing the global total to 317.7k. The US (+0.6k) has the most deaths at +91.2k, with the UK (+0.1k to 34.8k), Italy (+0.1k to 32.0k), Spain (+0.15k to 27.7k) and France (+0.1k to 28.2) all over +25k. The death rate is highest in European countries where the health systems have collapsed led by Belgium (-0.1% to 16.3%), the UK (-0.1% to 14.1%), Italy (steady at 14.2%), France (steady at 13.0%), the Netherlands (steady at 12.9%), Sweden (steady at 12.2%), and Spain (steady at 12.0%). However, several emerging markets are now on the leader board including Mexico (-0.2% to 10.5%), Ecuador (steady at 8.3%), Canada (steady at 7.5%), Brazil (steady at 6.7%), Philippines (steady at 6.6%), and Indonesia (steady at 6.6%).



Yours sincerely,



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