

THOUGHTS ON THE MARKET

1st May 2020

SUMMARY

- It was risk off overnight as poor data in the US and Europe weighed on sentiment and had investors questioning the 2020 EPS outlook. Among the key data sets, US initial jobless claims rose another +3.8 million which brought the six-week total to 30.2 million which suggests US unemployment should rise to around 15% in April with further increases expected in subsequent months which will weigh heavily on President Trump's re-election chances in November. Meanwhile, European GDP growth was -15.2% q/qa in March which was the worst result since records began in 1995, but things will materially decline in the June quarter with ECB Lagarde's bear case of -12% y/y for 2020 suggesting an EPS downside of around -70% (although that's a bear case, not a base case).
- On a more upbeat tone, global oil prices lifted for a second day to USD19.31 per barrel although there was nothing of note to pin the rise to and energy sector share prices led the pace of overnight declines, but its credit market counterpart saw lower spreads.
- The US Fed and ECB added to their previous policy announcements in moves designed to give more access to liquidity and funding operations. This were nothing materially new and the announcements were more a case of fine tuning.

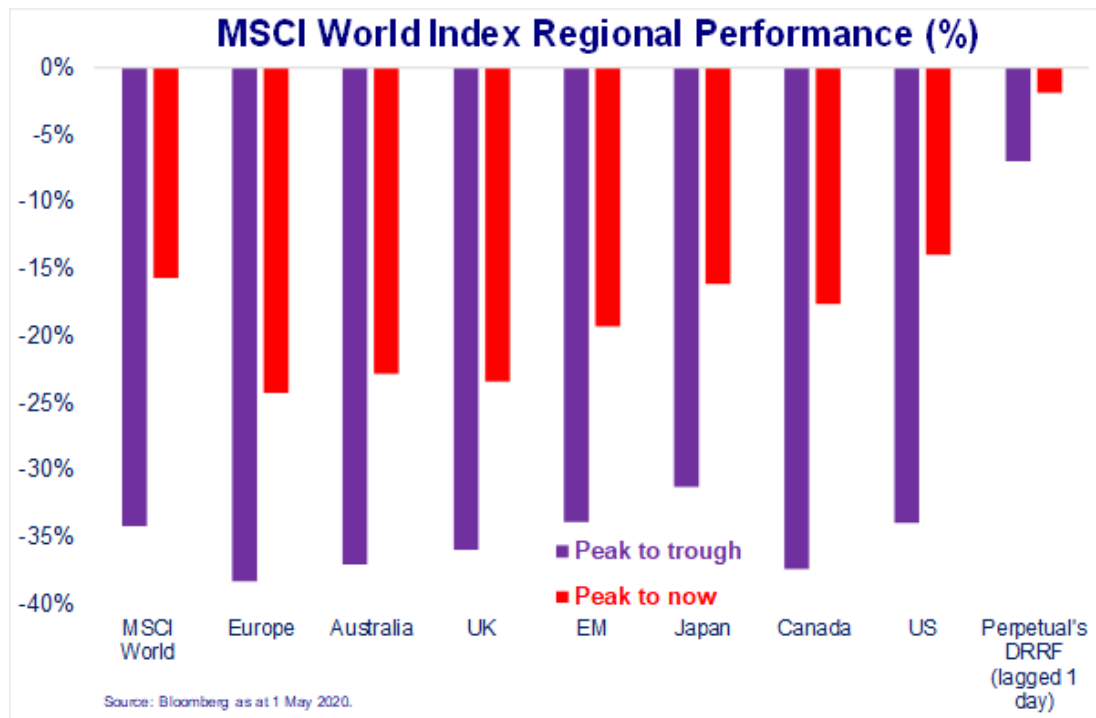
FINANCIAL MARKETS

EQUITIES

- The MSCI World Index declined -0.9% overnight with losses in all Northern Hemisphere markets and all sectors. Among the latter, the declines were led by energy (-3.1% with the recovery rate declining to 37%) despite a 28% rise in crude prices to USD19.31 per barrel, financials (-2.5%, 33%) despite fresh central bank support announcements and utilities (-2.0%, 43%). The overnight moves places four sectors in bear market territory (see chart), whereas healthcare has almost recovered all of its March losses.



Among the regions, the pace of declines was led by Europe (-2.3%) where investors not only took profits on the rally earlier this week, but seemed worried by the March quarter GDP growth numbers all of which came in well below street estimates which suggests downside risks to 2020 EPS estimates. Energy (-4.4%) and financials (-4.0%) and industrials (-2.6%) led the declines. The negative lead from the world's largest trading region followed through to the US market (-0.9%) where stocks declined in the wake of another poor weekly jobless claims which saw financials (-2.7%) and industrials (-2.0%) drop sharply, but strong tech earnings limited the damage on the NASDAQ (-0.3%).

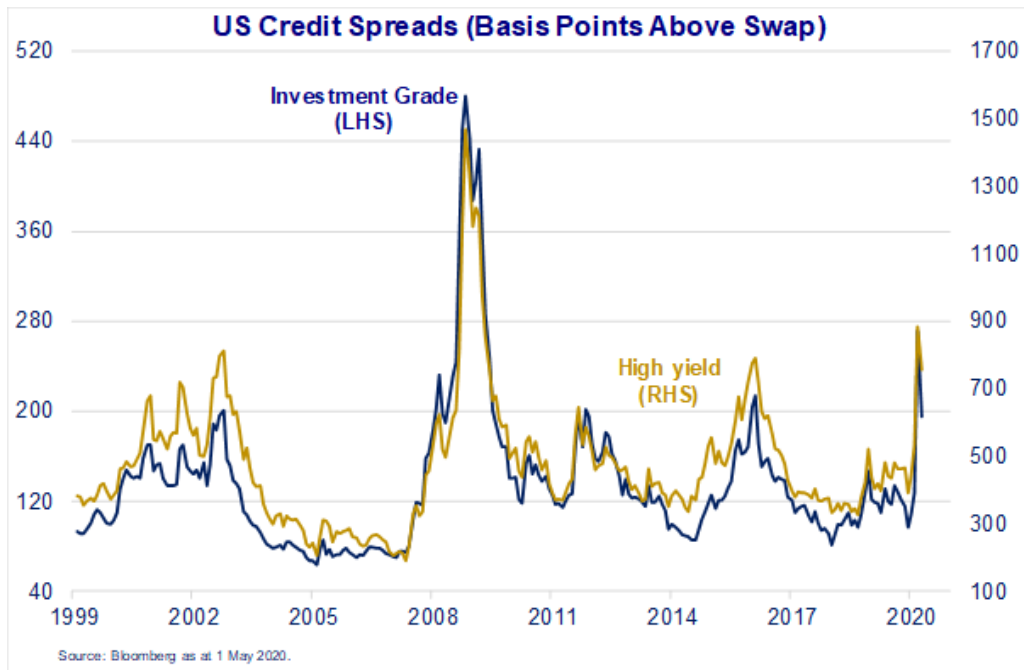


Earlier, Asian markets rallied strong led by Australia (+2.4%) and Japan (+2.1%), China (+1.2%), Korea (+0.7%) and Hong Kong (+0.3%). Futures markets suggest losses at the opening bell in Sydney (-2.4%) and Japan (-0.5%).

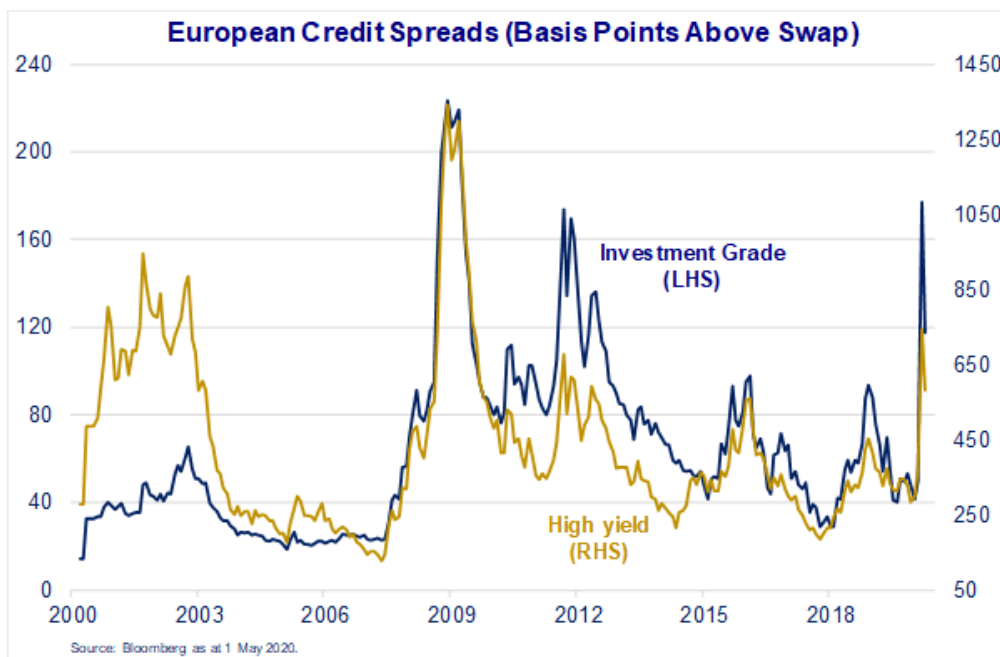
• CREDIT

- Credit markets were subdued and mixed overnight. The US investment grade universe recorded a 1-point rise in risk premiums to +195 bpts which was the 8th increase in the past 12 trading days and this has progressively lowered the sector's recovery rate to 63.7%. Energy was the standout performer as a 28% rise in crude prices buoyed sentiment, however this vibe was not widespread with all other sectors either flat or wider on a spreads basis, but increases were (again) measured in inches and feet not miles, with the largest being consumer discretionary after a -7.5 m/m decline in consumer spending sent spreads up +3 points to +243 bpts which lowered the recovery rate to 64%.

In contrast, the yield universe fell -6 points which was a third consecutive session of declines which took the index to +757 bpts (see chart) and the recovery rate up to 49%. The only major moves though were energy (-50 bpts to +1366 bpts, 62%) and subordinated financials (-14 to 494 bpts, 44%) with the remainder recordings contractions of less than -5 points.

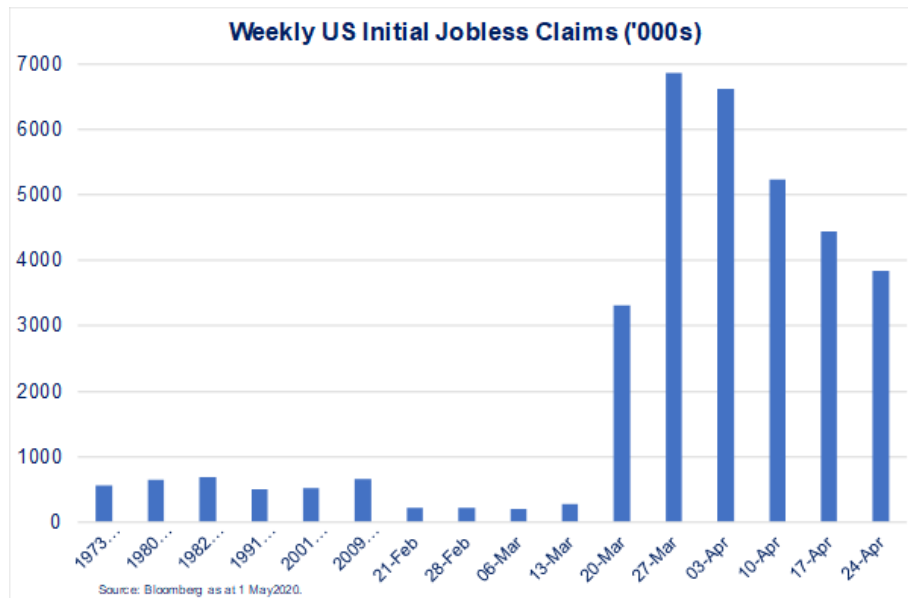


- European credit markets were also mixed with investment grade spreads contracting -5 points to +117 bps, which raised the recovery rate to 48%. Spreads contracted in all sectors, but the moves were not egregious with healthcare (-8 points to 58 bpts, 68%) the largest. In the high yield space, spreads increased +1 point to 583 bpts (see chart), which kept the recovery rate to 49%. Five sub-sectors recorded higher risk premiums led by financials (+7 points to 718 bpts, which kept the recovery rate at a universe low of 34%) and premiums fell in industrials (-13 points to +695 bpts, 50) which defied a large decline in its equities equivalent.



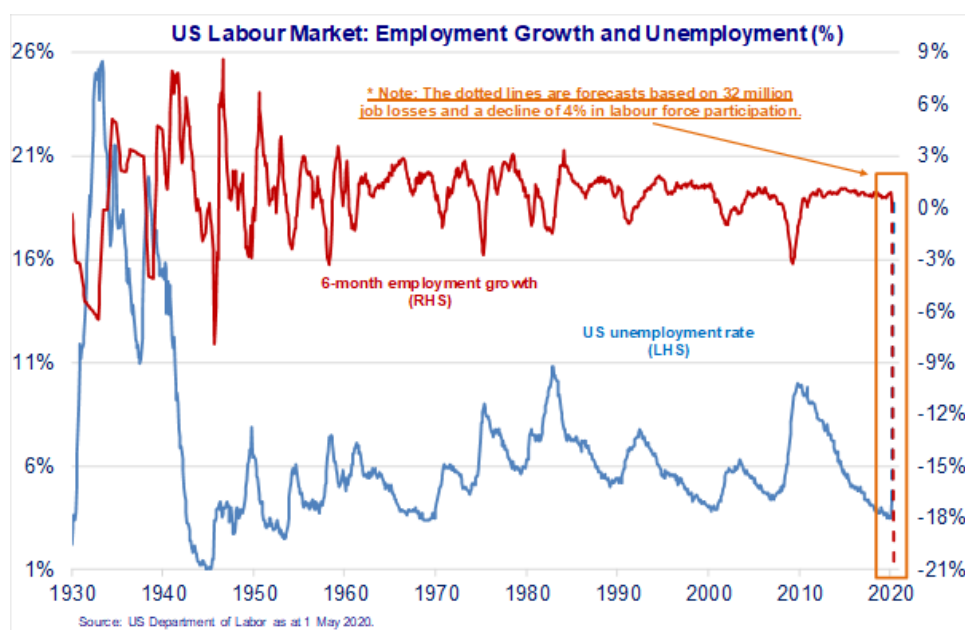
THE GLOBAL ECONOMY

- **US initial jobless claims declined** to 3.84 million for week ending 25th April. For the equity bulls this is the fourth week of declines and states are still reporting issues with processing, which suggests that recent claims reflect earlier dislocation of the labour markets, but for the bears, the total number of claims over the past six weeks is now 30.3 million (see chart), which is 19% of the US labour market.



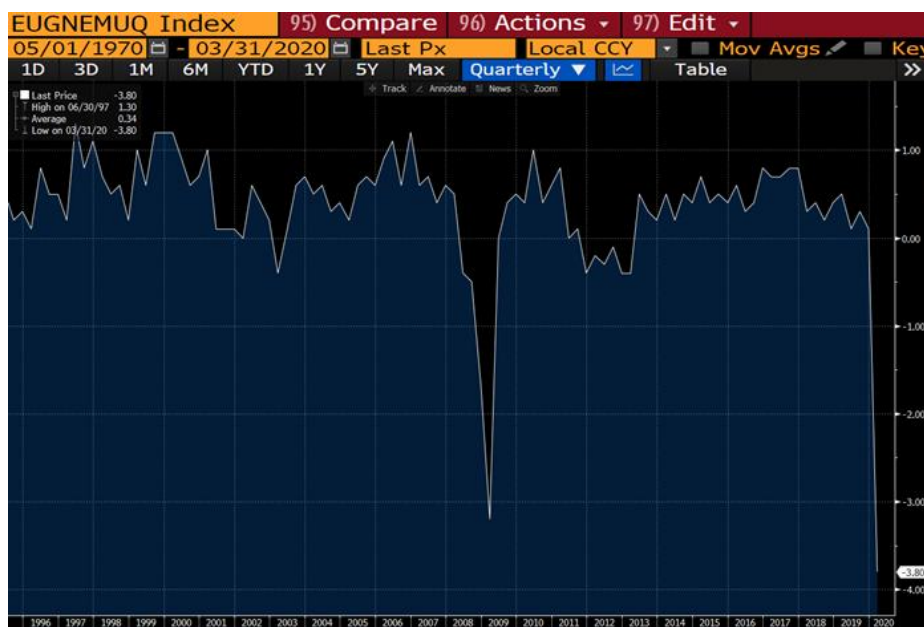
Importantly, there were 17.9 million continuing claims (not seasonally adjusted) filed during the week of April 18, which combined with last week's 4.4 million initial claims, culminates in a total of 22.2 million job losses that will be captured during the survey week of the April US non-farm payroll report (due out 8th May). At face value, this implies a 14-percentage point increase in the US unemployment rate, which would take the rate up to 19%. However, there will inevitably be technical issues around the US labour force's size which means the U-3 rate is likely to be around 15% (see chart), which is still a post-WW2 record. Despite some likely rehiring, continued elevated initial jobless claims suggest the unemployment rate will rise higher in May (to 18%) with another month of net job loss.

- In other US data overnight:
 - March monthly personal consumption expenditures declined -7.5% m/m which was not surprising given how weak consumer spending was in yesterday's Q1 US National Accounts, with personal income -2.0% m/m lower.
 - On an annual basis, the core PCE deflator declined -0.1% m/m to 1.7% and the March quarter employment cost index was +0.8% q/q and 2.8% y/y.
 - The April Chicago PMI fell -12.4 points to 35.4 which is the lowest since March 2009. Among the components, new orders declined most on record, production was the lowest since 1980 and the employment and backlogs fell, and inventories rose sharply.



- The European economy contracted -3.8% q/q (-15.2% q/qa) in the first three months of the year which is the largest contraction since records began in 1995 (see chart). Expenditure details are not yet available for the region, but among countries:
 - France suffered its worst post-WW2 contraction after nosediving -5.8% q/q (-23.2% q/qa) even though its lockdown didn't begin until March as domestic demand fell sharply with consumption at -6.1% q/q and fixed investment -11.8% q/q, whereas net exports were more subdued taking -0.2% off growth, as export and import activity declines primarily offset each other, and inventories added +0.9% to growth.
 - Spain's GDP plunged -5.2% q/q (-20.8% q/qa) driven by lower private demand as consumption (-7.5% q/q) and fixed investment (-5.8% q/q) both contracted, but government consumption rose +1.8% q/q and trade had little impact with exports and imports both down by -8.4% q/q.
 - Italy's contraction was -4.7% q/q (-18.8% q/qa) but the release only notes large negative contributions from both domestic demand and net exports; and
 - Germany's numbers have not been released yet, but partial indicators suggest it have fared relatively better than its peers in the March quarter.

Importantly, all of the numbers released overnight were worse than expected which suggests downside risks to 2020 growth estimates which ECB chair Lagarde overnight indicated could be as bad as -12% y/y (that's a bear case, not a base case). Although June is certain to record the largest contraction at -10% q/q (-39.6% q/qa), a double-digit annual decline for calendar year GDP is indicative of an EPS decline around -70%.



- China's official manufacturing PMI remained in expansion territory in April at 50.8, but this represented a month-on-month decline of -1.2 as aggregate new orders stalled following prior increases (see table below) with a material decline in export orders (-12.9 to 33.5) as the closed global economy caught up with China filling its order backlogs.

Among other major components, employment declined to a neutral level and production fell a touch but remains firmly in expansion territory. By corporate size the PMIs for large (-1.5 to 51.1) and medium sized firms (-1.3 to 50.2) fell back but remained just in expansion territory, whereas small firms edged fractionally higher (+0.1 to 51.0). Meanwhile, the non-manufacturing PMI edged higher (+0.9 to 53.2) in April driven primarily by acceleration in construction (+4.6 to 59.7), which translated to a mild improvement in the composite index (+0.4 to 53.4).

	Weight	Apr-20	Mar-20	Feb-20	Jan-20	Dec-19	Nov-19
New orders	30%	50.2	52.0	29.3	51.4	51.2	51.3
Production	25%	53.7	54.1	27.8	51.3	53.2	52.6
Employment	20%	50.2	50.9	31.8	47.5	47.3	47.3
Supplier delivery times†	15%	50.1	48.2	32.1	49.9	51.1	50.5
Raw material inventory	10%	48.2	49.0	33.9	47.1	47.2	47.8
Manufacturing PMI		50.8	52.0	35.7	50.0	50.2	50.2

Source: BofA Global Research, NBS

POLICY

- The US Fed announced it would expand the scope and eligibility for its upcoming USD600 billion “Main Street Lending Program” although no start date has been set. The Bank noted it will consider eligible businesses with up to 15k employees or USD5 billion in annual revenue (from the original metrics of 10k employees and USD2.5 billion in revenue) and the minimum loan size has been halved to USD500k. The Bank also noted it will create a new loan option for firms with larger debt loads, with lenders having to maintain a 15% stake in the debt sold to the Fed relative to 5% on other loan options and these funds will enable qualifying firms to pay off prior loans, which may open door for more oil and gas producers to obtain relief, which is one of the desires of the Trump administration.
- The ECB left its official interest rate and asset purchase programs unchanged at their April meeting, but announced a new refinancing operation to support liquidity conditions with 7 new operations stages from May 2020 and maturing in a staggered sequence between July and September 2021 with rates -25 bps below average rate on main refinancing operations. The Bank also eased the interest rate on targeted lending program, which is now 50 bps below average rate on main operations. Both decisions are designed to address tightening financial conditions among the region.

VIRUS UPDATE

- The number of global cases of COVID-19 stands at 3.25 million with another +60k cases overnight which means 3 countries have over 200k cases, 8 countries now have more than 100k cases, 23 over 20k cases and 39 over 10k. It took 73 days to record 1 million cases, 13 days for the next million, 11 days for the last million with another 350k added in the last three days. That said, the growth rate of daily confirmed cases continues to decline (+2.4% since Monday). Meanwhile, deaths rose +4.7k overnight to 232.9k, with the US now over 60k and the UK, Spain and Italy all around 25k, and the death rate sits at 7.2% (although final numbers are not yet in).
- Sadly, we can't provide our usual analysis of COVID-19 cases and deaths, as the data source has all kinds of data issues this morning and we don't feel confident that the numbers being represented are accurate (other than those above). The analysis and chart will be updated when these issues are resolved.

Yours sincerely,



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