

THOUGHTS ON THE MARKET

20th July 2020

Is Friday's sector rotation a sign that the market recovery is flattening out?

SUMMARY

- There were modest gains in risk markets on Friday night as both credit and equity markets closed out a third consecutive week of gains. There was no directional drivers for the rise as investors on the whole ignored another poor set of COVID-19 statistics for the US and around the world, but there was a hint of more caution at a more granular level with defensive share sectors outperforming and countries (ex-US) with rising COVID-19 case numbers tending to witness some modest underperformance.

In other markets, 10-year US Treasuries were little moved at 0.63% with the curve steepening one point to 0.52%, commodities were in a risk-off frame of mind with gold up +0.2% to USD1,810 per troy ounce and oil down -0.4% to USD40.59 per barrel, and G10 currencies all appreciated against a weaker Greenback with advances in the Yen of +0.1%, and +0.3% appreciation in Sterling, the Euro and AUD (to USC69.96)

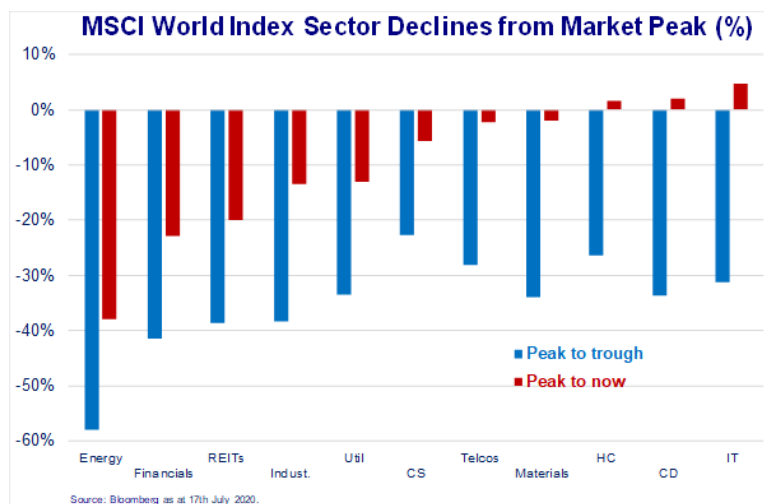
- Global data over the last week has not changed the recent narrative. The main releases were strong retail spending numbers in the US (+7.5% m/m, after +18.2% m/m in May) which is part of a strong bounce globally (+10% in volume terms (underpinned by pent up demand and large savings rates from the combination of lockdowns and government stimulus)) which has flowed through the production side of the global economy with industrial productions bouncing strongly (+6.5% m/m in both May and June). However, the goods sector rebound is not indicative of services activity which outside China has been quite limited and this sector is likely to be more hampered by renewed restrictions on social mobility. Despite the strong recovery in China and large bounce in retail sales, it still won't prevent the largest annual contraction in the global economy since 1946 (of -4.25%) but the decline is slightly lower than what was initially thought (-4.75%).
- The number of global cases of COVID-19 is 14.39 million with another +148k cases so far (Mexico, Chile, Ecuador, Brazil, Peru, Spain, Sweden and 17 US states have not reported their numbers) which means that Sunday is certain to be the 27th occasion in the past 27 days where daily increases have topped 150k. This means 4 countries have more than 750k cases, 18 countries have more than 200k cases (Bangladesh joined this group overnight) and 22 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 and 4 days, and in the past 2 days another +385.2k cases have been confirmed. More importantly, the growth rate of daily confirmed cases (+1.6% since Sunday) is once again stabilising. Meanwhile, deaths stand at 603.6k and the death rate dropped for a seventieth fourth straight day to 4.20%.

FINANCIAL MARKETS

• EQUITIES

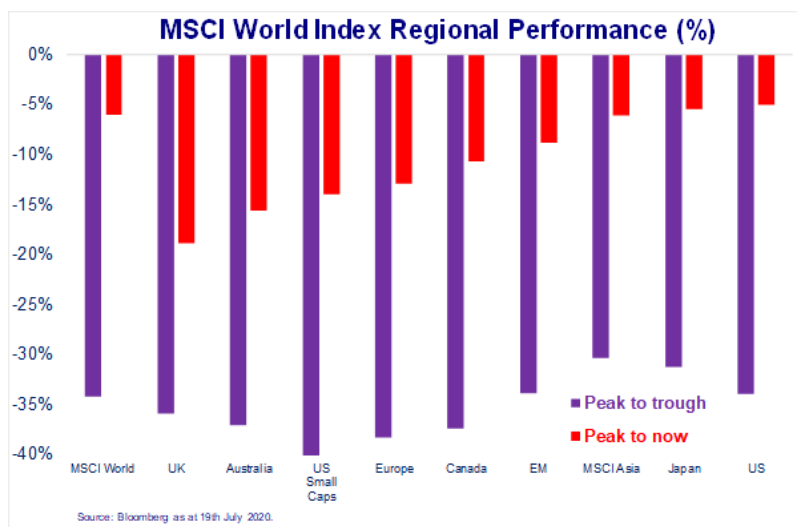
- The MSCI World Index closed +0.2% higher on Friday night but it had a very unusual day in that the index's overall price increase was underpinned by previously unloved defensives stocks. Indeed, rising COVID-19 numbers around the world were enough to drive some sector rotation with utilities (+1.6%), healthcare (+1.2%) and consumer staples (+0.3%) outperforming, but it was not enough to spark a market decline as the first expansion in the Fed's balance sheet in a month saw liquidity drive up the bellwether index despite losses in consumer discretionary (-0.4%), financials (-0.7%) and energy (-1.2%). Interestingly, tech rallied on Friday night (+0.6%) but this was not enough to prevent its first negative week in the past 3 with growth/momentum stocks underperformed value/cyclicals for the first time in the past six weeks.

The price moves on Friday night did not alter sector location in bear market territory with energy (with a peak to now decline of -37.9%), financials (-22.8%) and REITs (-20.0%) in the lagging group, whereas healthcare (+1.6%), consumer discretionary (+2.0%) and tech (+4.7%) have all recovered their losses in the March quarter (see chart).



- **Among the regions,** Asia outperformed with the MSCI Asia Pacific Index (+0.4%) leading the pace of gains with the price increase just enough to pull the region into positive territory for the week. Overall regional advances were fairly tame led by China (+0.6%) as investors went bargain hunting after the near -5% loss earlier in the week and this fed some support for Hong Kong (+0.5%) and Australia (+0.4%) in a session which lacked directional drivers given the empty macro calendar, whereas Japan (-0.3%) responded negatively to a stronger Yen. The positive Asian lead was wasted in the European session where stocks were flat overall, with flareup in COVID-19 cases sparking losses in Spain (1.4k after 1.4k cases which was the second highest in the past 7 weeks) and France (-0.3%, +0.8k which was the second highest in the past week) and Switzerland (-0.2%), whereas better health numbers sparked price gains in Italy (+0.3%), Germany (+0.4%) and the UK (+0.6%).

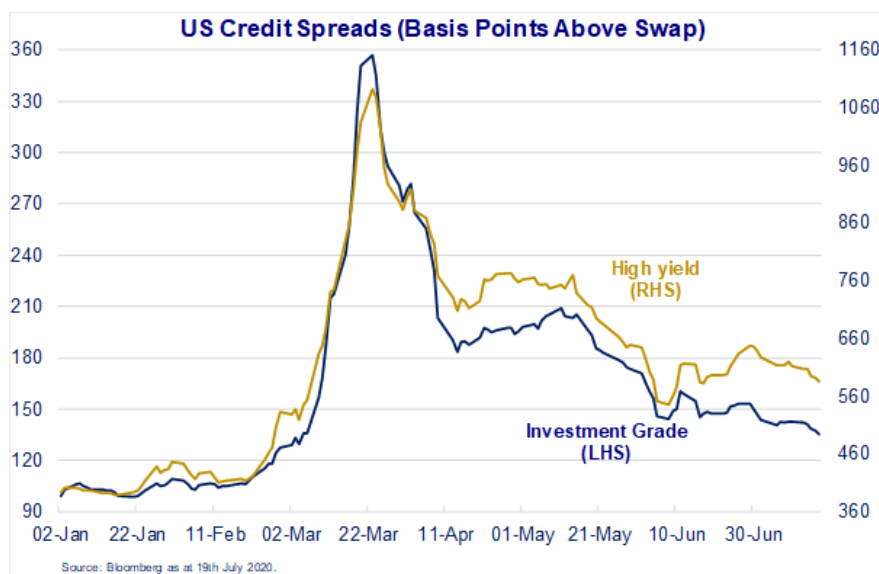
In the US, stocks (+0.4%) closed in positive territory and near their session highs in a session which lacked material data and market-moving headlines. The earnings season continues to dominate headlines and so far, results have been in line with pre-season expectations of a -44.1% decline in the June quarter with financials, energy and industrials hardest hit. Despite this prices continue to be held up by Fed asset purchases (which turned positive last week for the first time in a month) and speculation that a deal between House Democrats and Senate Republicans is nearing (although the two sides seem quite a way apart). By the bell to end the trading week, advances were largest in the Russell 2000 index (+0.4%), the NASDAQ and S&P 500 (both +0.3%), but the Dow Jones closed lower (-63 points, -0.2% to 26,672). The Friday moves did not change positions in our peak-to-now chart with the UK lagging (-18.9%) given its longer lockdown and later reopening, whereas the US has outperformed (see chart) despite ballooning case numbers in recent weeks.



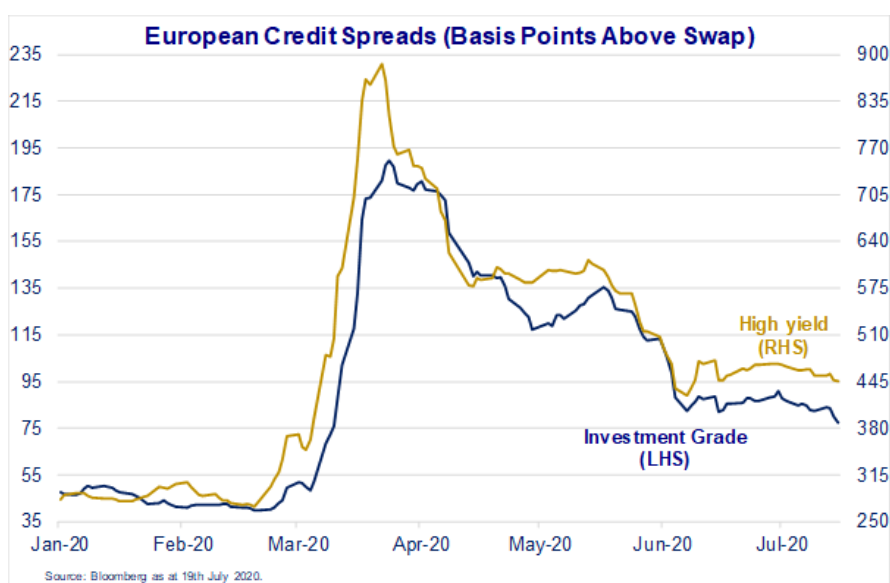
- Futures markets suggest a flat opening in Asia with Australia (unchanged) and Japan (+0.1%) set to slightly higher.

• CREDIT MARKETS

- All regional credit indices recorded modest gains on Friday. In the US investment grade space, spreads came in a further -2 points to +136 basis point which lifted the recovery rate one notch to 87%. All 11 sub-sectors recorded lower risk premiums, but movements in all were limited to no more than -3 points which were recorded in both materials (-3 points, +172 bpts, 86%) and telcos (-3 points, +159 bpts, 87%). In the high yield space, spreads came in for a sixth session with a -6-point decline to +596 bpts (see chart), which also increased the recovery rate one notch to 74% with all sub-sectors seeing lower risk premiums. The pace of decline was led by consumer staples (-10 points, +433 bpts) which has now recorded a complete recovery of the March quarter blow out in spreads with higher commodity prices in recent weeks helping materials (-7 points, to +480 bpts, 75%) to continue to outperform its peers.



- **European credit markets** were constructive from a return perspective, with spreads coming in -1 point to +77 bpts, which the recovery rate unchanged at 75%. All 11 sub-sectors recording lower spreads, but only consumer discretionary (-2 points, +104 bpts, 76%) beat the market average in a fairly quiet session. In the high yield space, spreads were also little moved declining by -3 points to +443 bpts, which kept the recovery rate at 72%. Nine of the 11 sub-sectors recorded lower spreads with the largest being telcos (5 points to +355 bpts with the recovery rate down one notch to 70% with materials (-4 points, +401 bpts, 72%) also outperforming the market index.



THE GLOBAL ECONOMY

- There was very little in the macro calendar and nothing in the top-tier space, but the July University of Michigan consumer sentiment survey recorded its first decline (-4.9 points to 73.2) since March with the current conditions index down -2.9 to 84, and consumer expectations off -6.1 to 66.2 and risks are that this gauge will decline further in line with the rise in the COVID-19 infection rate and upcoming fiscal cliff. The report suggests that the spending lift in May and June has not been associated with a commensurate confidence lift.



- Meanwhile, US housing starts for June rose +17.3% m/m to a 1.19 million units which represented the largest percentage increase since October 2016, with May revised up +37k to 1.01 million. Elsewhere building permits rose +2.1% to a 1.24 million units, but May was revised fractionally lower to 1.22 million.

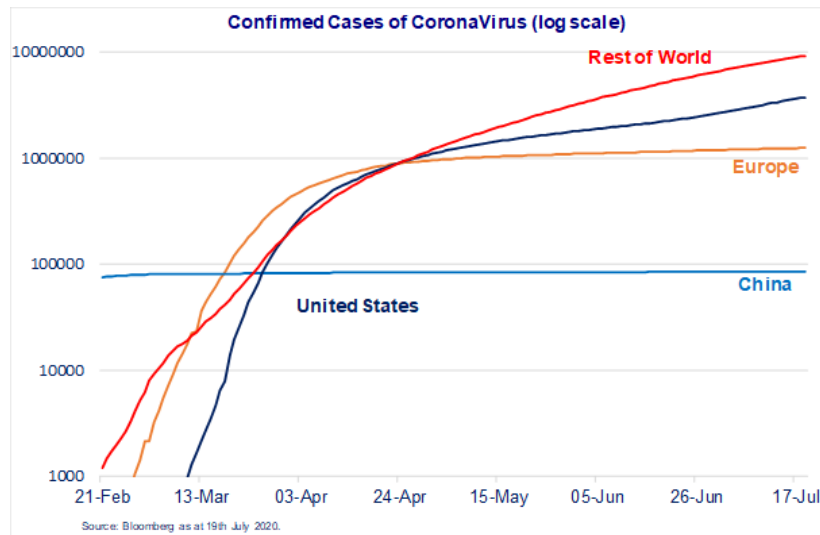
POLICY

- There were no material policy announcements on Friday.

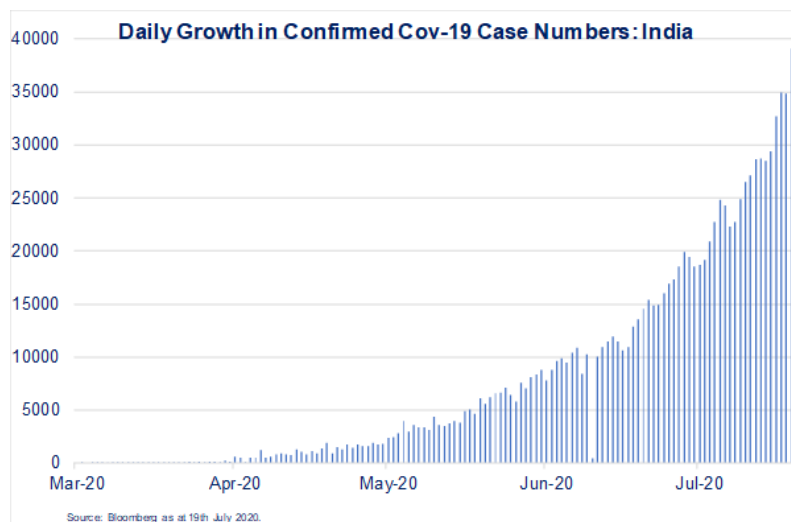
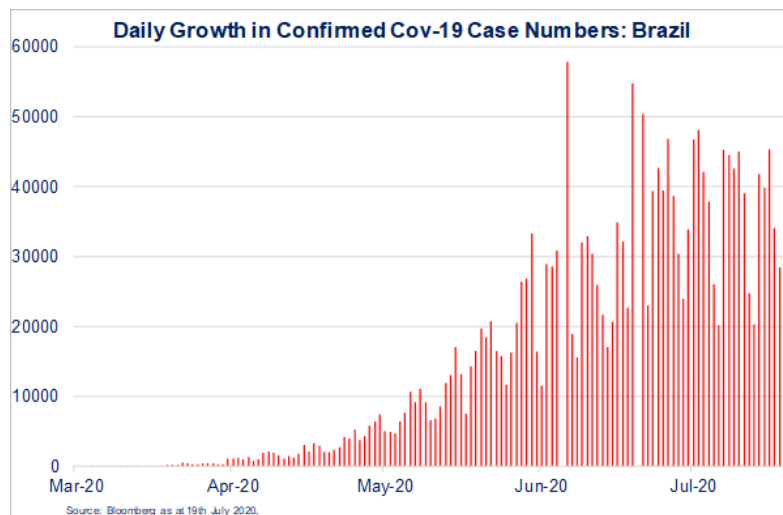
VIRUS UPDATE

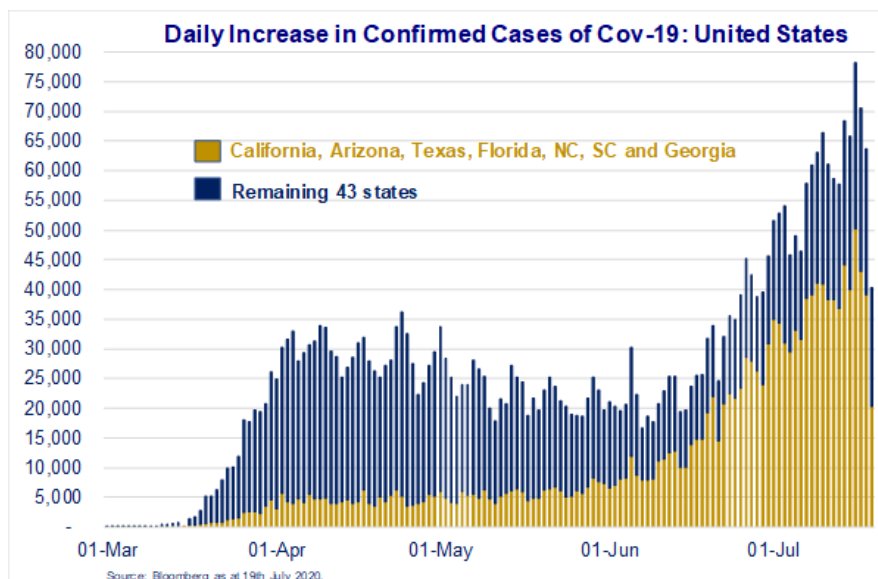
- The number of global cases of COVID-19 is 14.39 million with another +148k cases so far (Mexico, Chile, Ecuador, Brazil, Peru, Spain, Sweden and 17 US states have not reported their numbers) which means that Sunday is certain to be the 27th occasion in the past 27 days where daily increases have topped 150k. This means 4 countries have more than 750k cases, 18 countries have more than 200k cases (Bangladesh joined this group overnight) and 22 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 and 4 days, and in the past 2 days another +385.2k cases have been confirmed. More importantly, the growth rate of daily confirmed cases (+1.6% since Sunday) is once again stabilising. Meanwhile, deaths stand at 603.6k and the death rate dropped for a seventieth fourth straight day to 4.20%.



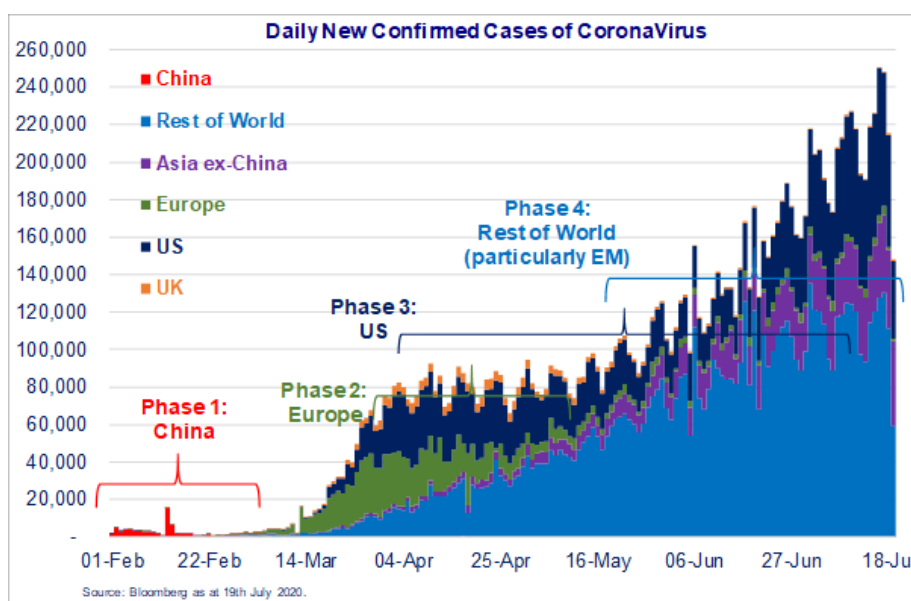
- We break the infections into four groups – the US, Europe, China and ‘others’ and the rest of the world outside the G3 economies now has the most total cases (+59.0k to 9.3 million) and highest daily new cases (and by a considerable margin) followed by the US (+41.7k to 3.75 million, although 17 states are yet to report with 2 already reporting record numbers (Louisiana and South Carolina) and Europe (+1.2k (19 week low) to 1.25 million - see chart). The issue for the US is that they never flattened their curve which means economic opening has not been associated with lower case numbers. Within the rest of the world, the three concerns here are Brazil (not reported, 2.07 million, which is the second highest in the world), India (+39.1k (record high) to 1.08k) and Russia (+6.1k to 770.3k, fourth highest) (see charts below).



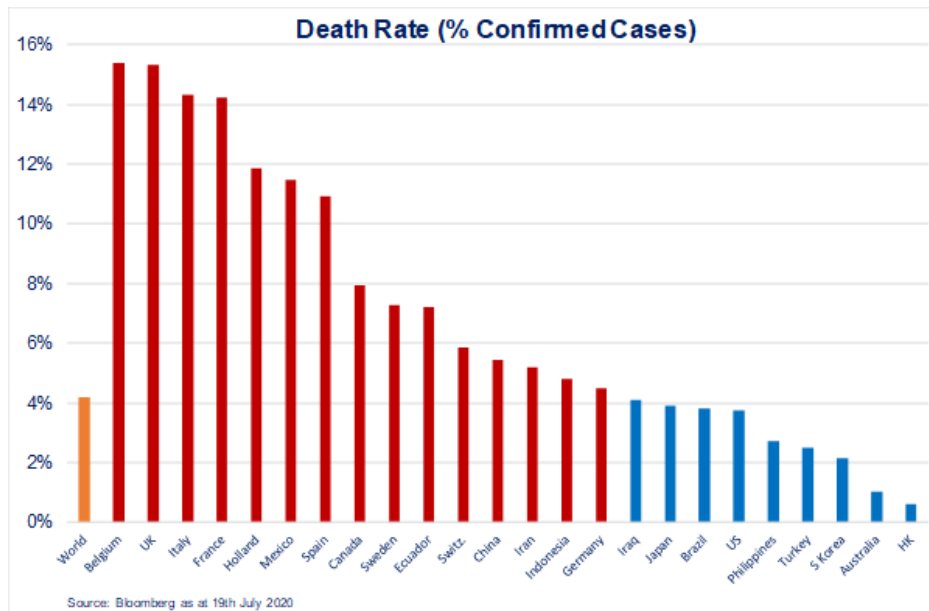


- Among countries, the most cases are in the US (+41.7k (so far) to 3.75 million, with 17 states yet to report and 2 already reporting record increases), Brazil (not reported, 2.07 million, India (+39.1k (record high) to 1.08k), Russia (+6.1k to 770.3k), South Africa (+13.4k to 364.3k), Peru (not reported, +349.5k), Mexico (not reported, +338.9k), the Chile (+2.0k to 330.9k), United Kingdom (+0.7k to 296.4k), Iran (+2.2k to 273.8k), Pakistan (+1.6k to +263.5k), Spain (not reported, 260.3k), Saudi Arabia (+2.5k to 250.9k), Italy (+0.2k to 244.4k), Turkey (+0.9k to 219.6k), France (not reported, 211.9k), Bangladesh (+204.5k) and Germany (+0.2k to 202.6k). Australia confirmed cases rose +361 to 11,802 yesterday which placed us 70th in terms of total infections.

Elsewhere, Singapore recorded +0.3k new cases to 47.9k 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, but Indonesia (+1.6k to 86.5k) is now on the rise and has the most cases in the region, and the Philippines (+2.2k to 67.5k) is also on an upward trend.



- Although final numbers are not in until 1pm AEST, the global death rate declined for a seventieth straight day to 4.20% with the global total to 603.6k after another 2.3k deaths overnight, so far. The US (+0.3k so far) has the most deaths at +140.4k, with Brazil (not reported, 78.8k), the UK (+0.03k to 45.4k), Mexico (not reported, +38.9k), Italy (+0.003k to 35.0k) and France (+0.1k to 30.2k) all over +30k. The death rate is highest in European countries where the health systems had collapsed led by Belgium (-0.1% to 15.4%), the UK (-0.1% to 15.3%), Italy (steady at 14.3%), France (steady at 14.2%), the Netherlands (-0.1% to 11.9%), Spain (-0.1% to 10.9%) and Sweden (-0.1% to 7.3%). However, several emerging markets are now on the leader board including Mexico (-0.1% to 11.5%), Ecuador (-0.1% to 7.2%), Indonesia (-0.1% to 4.8%) and Brazil (-0.1% to 3.8%).



Yours sincerely,



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