

THOUGHTS ON THE MARKET

20th May 2020 – Are markets jumping at shadows?

SUMMARY

- Global stocks fell for the first time in four sessions after reports circulated that Moderna Inc's vaccine study, which on Monday night underpinned the largest price surge in global shares for six weeks, was characterised by a lacked critical data to judge its success. There is no doubt that a COVID-19 vaccine would be a game changer, but with excess liquidity abound, investors are jumping at shadows and then asking questions later. Accordingly, it is likely that markets are going to continue to be characterised by elevated volatility, rumours presented as facts, and continued questions about the recovery path in the absence of a vaccine. However, investors need to be wary of valuations, as the US market is now trading around 21x 2021 EPS which is its highest valuations since the unwinding of the tech boom in 2002, so a lot of good news has been priced in and a lot of bad news being overlooked. Valuations this high have historically been associated with anaemic investment returns in the next five years.

In other assets, 10-year Treasuries rallied with yields down -4 points to 0.69% with curve flattening, gold rose +0.5% to USD 1744 per troy ounce and the US rallied against the Euro (+0.4%), Yen (+0.2%) and AUD (+0.2%) and was flat against Sterling. Meanwhile, WTI crude settled up +2.1% to USD32.51 per barrel but has already lost this increase in early Wednesday trading.

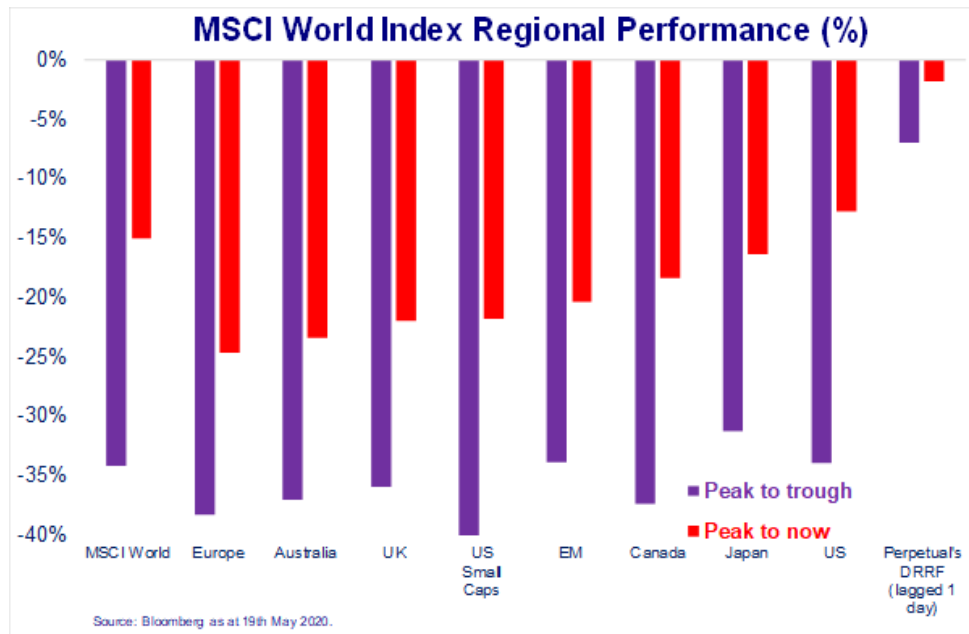
- There was little macro data or policy announcements overnight with US housing starts coming in slightly above street estimates and German investor confidence surprising to the upside. Meanwhile, US Fed Chair Powell reaffirmed his statement on 60 Minutes over the weekend, that the Fed will use all its policy arsenal to combat the economic consequences of COVID-19 and he dismissed concerns about surging government debt and said Congress may need to do more to offset the long-term economic damage from the virus.
- The number of global cases of COVID-19 stands at 4.89 million with another +77.3k cases overnight with 6 countries having more than 200k cases, 11 countries with more than 100k cases, 31 over 20k cases and 48 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 10 days another 890k cases have been confirmed, but the growth rate of daily confirmed cases is trending lower (+1.7% since Saturday). Meanwhile, deaths rose +3.9k overnight to 322.7k and the death rate dropped for a twelfth straight day to 6.55%.

FINANCIAL MARKETS

• EQUITIES

- The MSCI World Index closed -0.4% lower. There was mixed performance with MSCI Asia Pacific Index up around +1.3% as the region caught up with the strong US rally on Monday night with gains led by Hong Kong (+1.9%), Australia (+1.8%), Japan (+1.5%) and China (+0.9%). This positive lead did not flow through to Europe (-0.3%) where investors showed little reaction to news of a proposed €500 billion regional rescue package, with large losses in the periphery markets such as Spain (-2.5%), Italy (-2.1%) and Greece (-1.4%). Meanwhile, major markets in the north such as France (-0.8%) and UK (-0.3%) also declined, but Germany (+0.3%) rallied in response to a surprise jump in German investor confidence, albeit off a very low base.

The negative lead in Europe spread to the other side of the Atlantic where US stocks fell for the first time in four sessions after reports circulated about Moderna Inc's research which stated the firm did not produce enough critical data to accurately assess its COVID-19 drug's success. This sparked a flat market to turn negative in the last hour of trading with the NASDAQ off -0.5% as the Magnificent 5 outperformed, the S&P 500 down -1.1%, whereas the Dow Jones dropped -391 points (-1.65%) to 24,207.

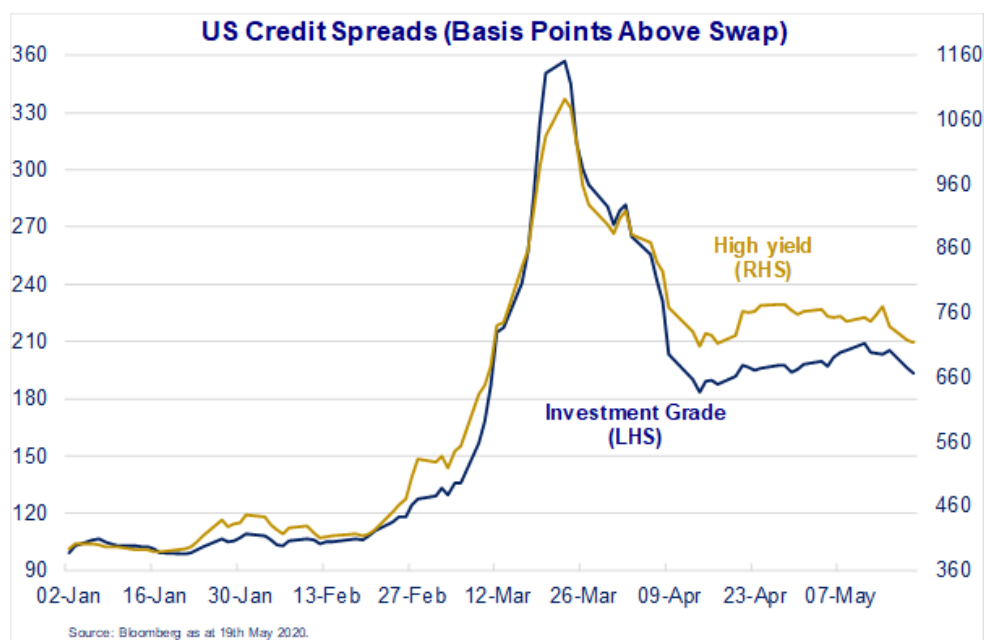


Futures markets suggest a negative opening in Asia this morning with Australia (-1.6%) and Japan (-0.7%) set to open in the red.

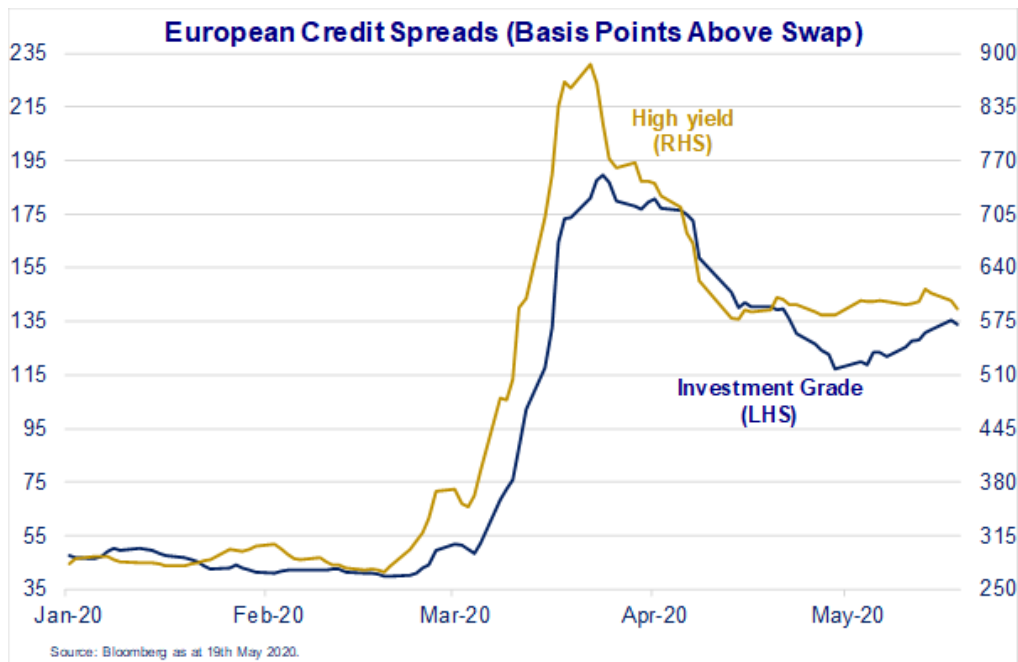
• CREDIT MARKETS

- Regional credit indices rallied with contracting spreads in all regions and sectors. Risk premiums in the US investment grade space came in -3 points to +193 bpts, which boosted the recovery rate to 64%. This means the sector has now recovered half of its spread increase in the first two weeks of May and ten of the 11 sub-sectors recording lower risk premiums overnight led by energy (-7 points, +287 bpts, 69%) given another rise in the price of crude and this flowed through to consumer discretionary (-5 points to +238 bpts, 65%), but there were only modest improvements elsewhere.

In the high yield space, spreads contracted another -4 points to 714 bpts, but the recovery rate was steady at 55%. There were lower spreads in 9 of the 11 sectors led by tech (-9 points, +596 bpts, 51%), consumer discretionary (-9 points, +749 bpts, 41%) and senior financials (-9 points, +515 bpts, 40%), but increased questions about Moderna's Inc's research saw risk premiums in healthcare expand (+3 points, +614 bpts, 59%).

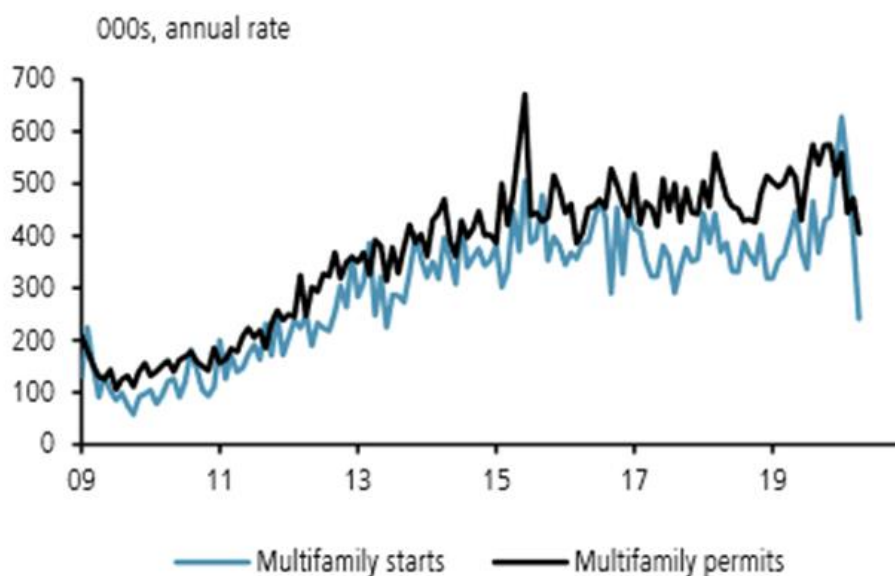


- European credit markets rallied for the first time in 7 sessions with spreads in the investment grade space contracting -2 points to +134 bpts, which boosted the recovery rate to 37%. Sub-sector declines were modest but universal led by consumer discretionary (-5 points to +197 bpts, 36%), subordinated financials (-3 points to +224 bpts, 48%) and energy (-3 points to +135 bpts, 21%) which responded positively to crude price trends. In the high yield space, spreads came in -10 points to +591 bpts, which increased the recovery rate to 48% with lower risk premiums in all subsectors other than banks (+50 points, +516 bpts, 45%), led by energy (-29 points to +692 bpts, 57%), materials (+22 points to +541 points, 49%) and consumer discretionary (-20 bpts, +778 bpts, 46%) as confidence in the state of the regional recovery improved, albeit from a low base.



THE GLOBAL ECONOMY

- There were no top-tier economic releases overnight. However, US housing activity slowed again in April with the construction of single family dwellings down to +650k (was +1034k in February), but multi-family starts showed more weakness declining to +240k (533k – see chart) as these are bigger projects which involve more workers and which are more exposed to mobility restrictions. Interestingly, the trends in housing starts is different from that in retail sales where the downtrend accelerated in April in response to both mobility restrictions and job losses, but the same trend was not evident in housing starts.

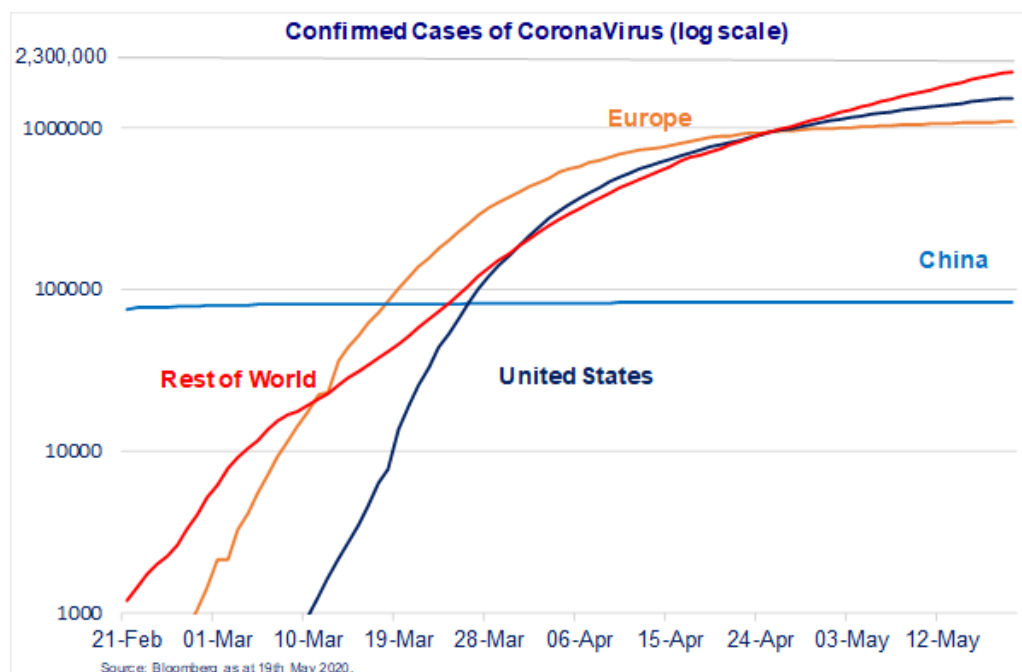


POLICY

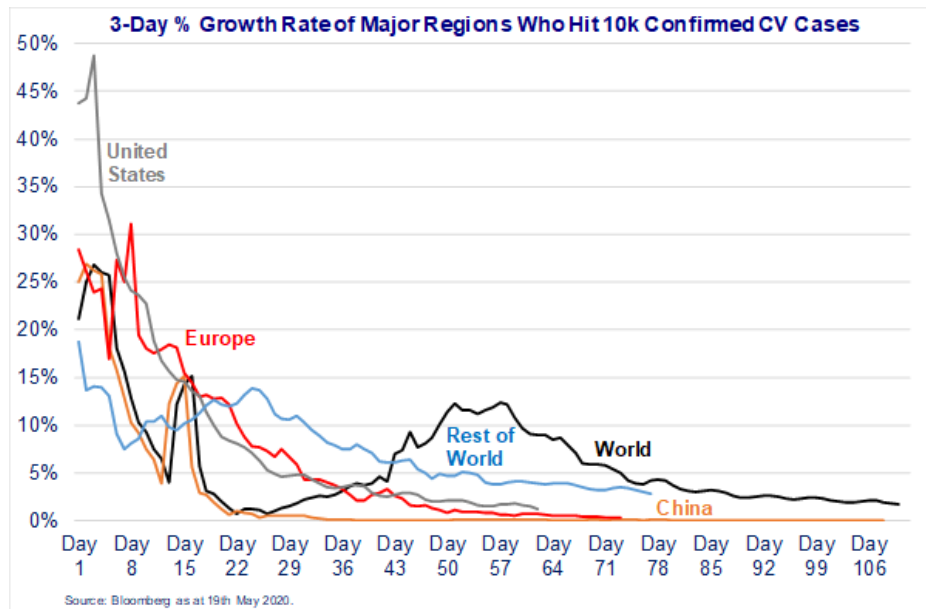
- There were no material policy announcements overnight, however, Germany ended its long-held opposition to share debt with other EU members in an overdue sign of unity in the face of the worst economic downturn the bloc has seen in its brief existence. Under a French-led proposal, €500 billion in loans and grants will be available to help poorer member countries through the recession and this will also help deal with populist forces in Hungary and Poland who want to loosen its' ties with the trading bloc. This deal would add to the €540 billion package agreed among finance ministers from the 19 EU countries that use the Euro, but the program is limited in scale and duration and its yet to be approved, although a lack of German opposition is a strong sign of strengthening momentum for closer fiscal ties.
- Reuters circulated a story that Nasdaq Inc is set to unveil new restrictions on IPOs, which will make it more difficult for some Chinese companies to trade on its stock exchange. While Nasdaq will not cite Chinese companies specifically, the move is driven by concerns about accounting transparency in some of China's IPO hopefuls.

VIRUS UPDATE

- Although final numbers are not in for another 3 hours, the number of global cases of COVID-19 stands at 4.89 million with another +77.3k cases overnight (49th rise of over +70k in the past 50 days). 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, 31 over 20k cases and 48 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 10 days another 890k cases have been confirmed. That said, the growth rate of daily confirmed cases is trending lower (+1.7% since Saturday). Meanwhile, deaths rose +3.9k overnight to 322.7k, 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 6.55%.

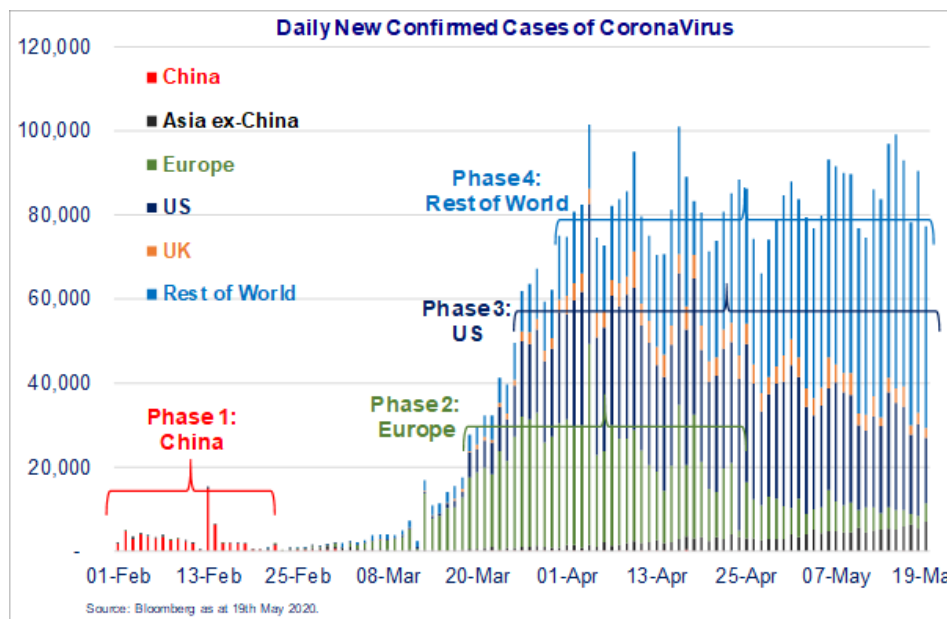


- We break the infections into four groups – the US, Europe, China and ‘others’ and the rest of the world outside the G3 economies now has the most total cases (+47.9k to 2.22 million) and highest daily new cases (and by a considerable margin) followed by the US (+15.5k (7-week low) to 1.52 million) and Europe (+4.4k (4-day high) 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 (+9.2k to 300.0k) which has now overtaken Spain to be the second most infected nation after the US, and Brazil (+10.5k to 265.9k) which is now the third most infected nation.

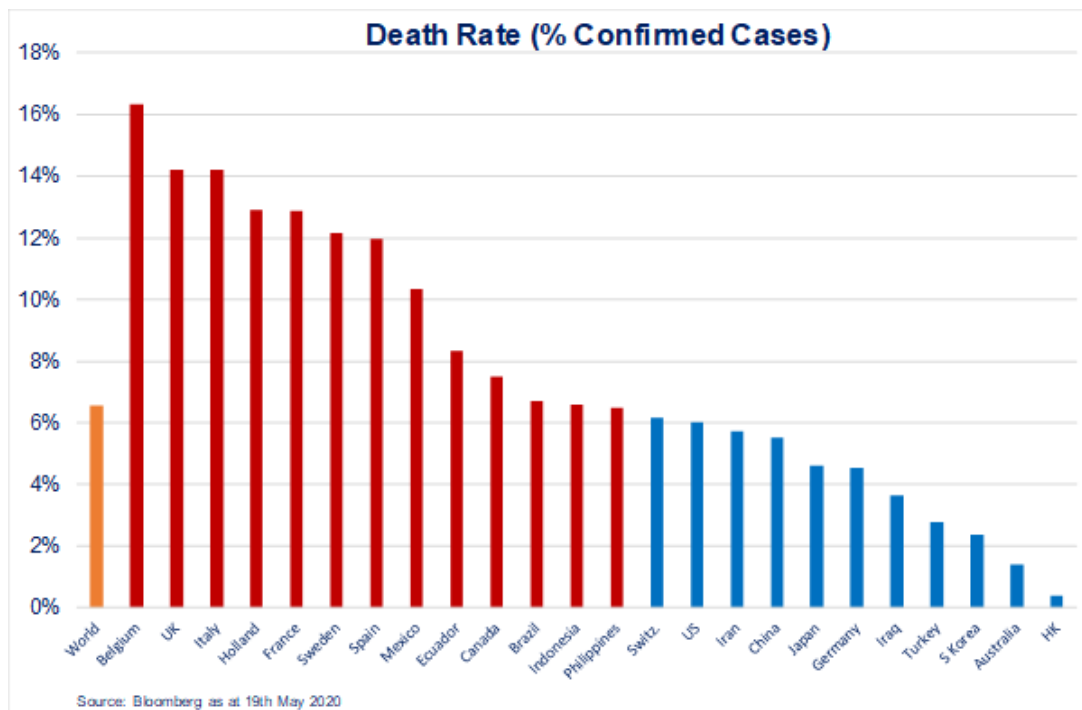


- Among countries, the most cases are in the US (+15.5k (7-week low) to 1.52 million), Russia (+9.2k to 300.0k), Brazil (+10.5k to 265.9k), the United Kingdom (+2.4k to 250.1k), Spain (+0.4k to 230.0k), Italy (+0.8k to 226.7k), France (+0.8k to 180.9k), Germany (+1.2k (12-day high) to 177.8k), Turkey (+1.0k to 151.6k), Iran (+2.1k (second highest in 8 weeks) to 124.6k), India (+6.1k (record high) to 106.5k) and China (steady at 84.0k). Australia confirmed cases rose +8 to 7,068 yesterday which placed us 57th in terms of total infections.

Elsewhere, Singapore recorded +451 new cases to 28.8k 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 (+486 to 18.5k) and the Philippines (+224 to 12.9k). 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 thirteenth straight day to 6.56% with another +3.9k fatalities overnight bringing the global total to 322.7k. The US (+1.3k) has the most deaths at +91.6k, with the UK (+0.5k to 35.3k), Italy (+0.1k to 32.2k), France (steady at 28.0) and Spain (+0.1k to 27.8k) all over +25k. The death rate is highest in European countries where the health systems have collapsed led by Belgium (steady at 16.3%), the UK (+0.1% to 14.2%), Italy (steady at 14.2%), France (-0.1% to 12.9%), 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 10.3%), Ecuador (steady at 8.3%), Brazil (steady at 6.7%) and Indonesia (steady at 6.6%).



Yours sincerely,



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