Perpetual Investments

THOUGHTS ON THE MARKET

21st August 2020

Lower bond yields and increased recovery uncertainty sees tech rally

SUMMARY

- Global risk markets were mixed overnight with sizable selldowns in European and Asian equity markets and modest increases in high yield credit spreads, whereas investment grade credit was steady and US equities lifted, although not by a lot. Investor sentiment deteriorated after the release of yesterday's FOMC meeting minutes from July which detailed a weak recovery and provided no guidance on interest rate guidance. The latter was ultimately good news as it suggests 'lower for longer' interest rates, but cyclical sectors didn't like the uncertainty given the weak growth backdrop. In contrast, lower bond yields and Wall Street's obsession with fortress-like profits from a group of IT firms which are benefitting from social distancing, lifted the NASDAQ 100 Index up to a fresh record high overnight, in a trade which has characterised to post-March recovery. The tech rally offset another slide in traditional cyclical sectors such as energy (-1.9%) and financials (-1.1%).

  In other markets, 10-year Treasuries recoded their largest price gain in three weeks with yields down -3 points to +0.65% with curve flattening, commodities declined with gold (-2.0% to USD1947 per troy ounce) down more than oil (-0.8% to USD42.58 per barrel), and G10 currencies were mostly lower against a stronger Greenback with declines in the Sterling (-0.1%), Yen (-0.5%), Euro (-0.6%) and AUD (-1.0% to USC71.92).

- Economic data was scant in supply, but markets were initially worried about a solid rise in US jobless claims with the weekly gauge rising to 1.1 million which signals a pause in labour market activity and confirms our view that the labour market in the recovery will come in fits and starts, culminating in a long path back for many workers. However, continuing claims declined in a constructive sign for the August non-farm payrolls which are out in two weeks' time. Meanwhile, the Philly Fed index fell a bit more than expected with a poor composition as shipments, employment and new orders all fell.

- The number of global cases of COVID-19 is 22.54 million with another +198k cases so far (but Brazil, France, Mexico and 5 US states have not reported their numbers) which means that Thursday is set to be the 33th consecutive day where daily increases are greater than 200k. At present, 7 countries have more than 500k cases, 20 countries have more than 200k cases and 29 countries have more than 100k cases (the Ukraine joined this group overnight). 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, 4 days, 5 days, 3 days, 4 days, 4 days. 4 days, 4 days, 4 days and 4 days. More importantly, the growth rate of daily confirmed cases (+1.0% since Monday) is once again coming down. Meanwhile, deaths stand at 790.5k and the death rate has declined to 3.51% although the number of daily deaths is on the rise.

FINANCIAL MARKETS

- **EQUITIES**
  - **The MSCI World Index closed -0.2% lower for a second consecutive day** with declines in seven of the 11 GICS sectors. Declines were led by the traditional cyclicals such as energy (-1.9%) which is now on a 6-day losing streak during which time the sector has lost -6.3%. Financials (-1.1%) followed suit as lower long-end rates and a flattening curve weighed on sentiment, materials declined (-0.9%) despite higher base metals prices, and industrials (-0.7%) recorded their largest decline in 3 weeks as investors bid down airlines and machinery. Defensives were a bit mixed with falls in both consumer staples (-0.5%) and healthcare (-0.4%) given scattered losses in pharmaceuticals, but communication services (+0.8%) were supported by

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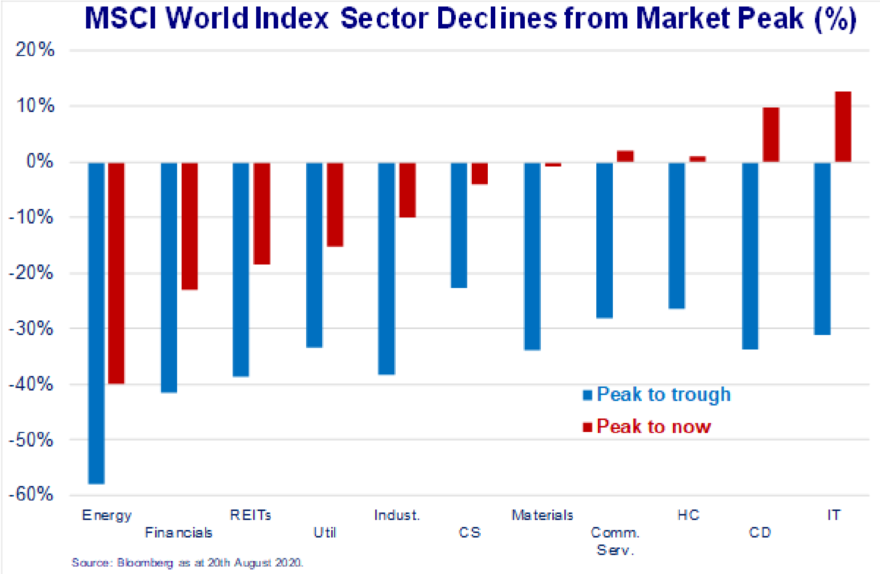
platforms such as Netflix (+2.8%), Facebook (+2.4%) and Google (+2.1%) and IT (+1.1%) led the charge higher with large gains in megacap and software. The overnight moves saw energy and financials move deeper into bear market territory, whereas tech is growing as everyone's favourite go-to pandemic play with investors here clearly not worried about valuation extremes and their ability to deliver of lofty earnings expectations year-in year-out.

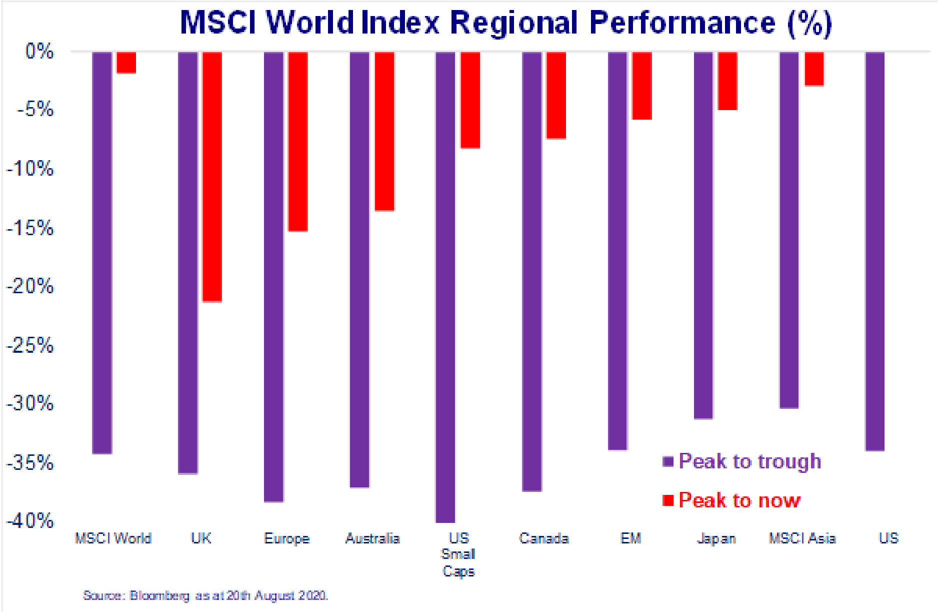


- **Among the regions, Asian equities (-1.6%) led the pace of declines,** as investors reacted negatively to the July FOMC minutes which detailed a downbeat economic assessment, which had investors questioning current high valuations. Other investors were disappointed that about the lack of clarity on policy guidance as the Fed backed off from setting their time frame for laying out the path for interest rates, even though the implications of the uncertainty are ultimately dovish. Meanwhile, there wasn't anything of note on the regional macro calendar to change the market direction, and geopolitical developments between the US and China were a case of all bark and no bite. By the closing bell in Mumbai, the MSCI Asia Pacific Index closed -1.6% lower (5-week low), with very large declines in both South Korea (-3.7%) and Taiwan (-3.3%) given their tech overhangs, with markets also lower in Hong Kong (-1.5%), Mainland China (-1.3%), Japan (-1.0%), India (-0.9%) and Australia (-0.8%).

  Shares in Europe (-1.3% - a 3-week low) followed the weak Asian lead, as investors worried about a weak global recovery and rising regional case numbers. Spain looks to be at the epicenter of surge in European cases and was among the largest decliners, but cases are also up notably in France and Germany. There was nothing on note on the macro calendar, and in central bank meetings the Norges Bank kept key rates unchanged at 0% and ECB minutes from its July meeting emphasised available policy space and an ability to act further, but this was already known. The lack of data and policy moves which meant politics dominated the regional headlines with a Reuters poll highlighting expectations that the UK economy won't reach pre-pandemic size for at least two years. By the regional closing bell there was red on all screens with losses led by the UK (-1.6%), Spain (-1.4%), Italy (-1.4%), France (-1.3%), Sweden (-1.3%), Germany (-1.1%) and Switzerland (-0.8%).

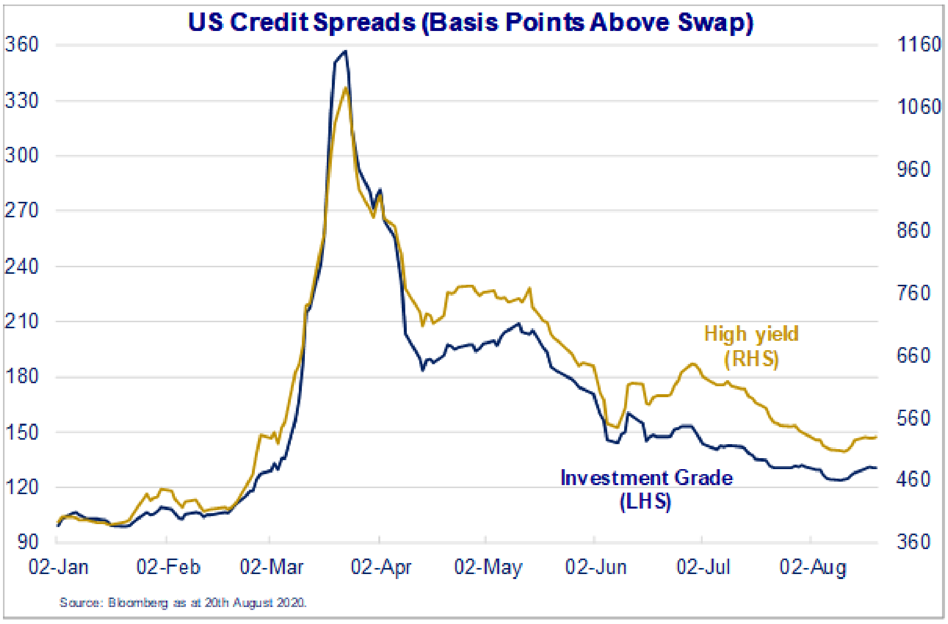
  Similar to other markets, the US opened in the red, but the combination of lower bond yields and Wall Street's obsession with fortress-like profits from firms which are benefitting from social distancing, saw tech stocks rally and put a floor under the market. The movement was enhanced by Intel, with the world's largest chipmaker saying it will buy-back USD10 billion of its shares, with FAANG also up strongly despite already rich valuations. These price gains helped offset softness in traditional cyclical sectors in a day with limited macro newsflow where investors initially worried about a solid rise in initial weekly jobless claims to +1.1 million although this was tempered by a nice decline in continuous claims. There wasn't much else around other than China saying that will soon review the Phase 1 agreement with the US and by the closing bell at the NYSE the NASDAQ 100 (+1.1%) rose to a fresh all-time high, with gains also in the S&P 500 (+0.3%) and Dow Jones (+0.2%, +47 points, 27740), but the low tech weighting of the Russell 2000 Index (-0.5%) saw it close lower.

The movements overnight saw the UK with a February peak-to-now decline of -21.6% re-enter bear market territory, with Europe (-15.3%) also approach this mark, whereas the US (with a recovery rate of 99.9% - see chart) is within a whisker of its February level (even though it passed this earlier in the week).

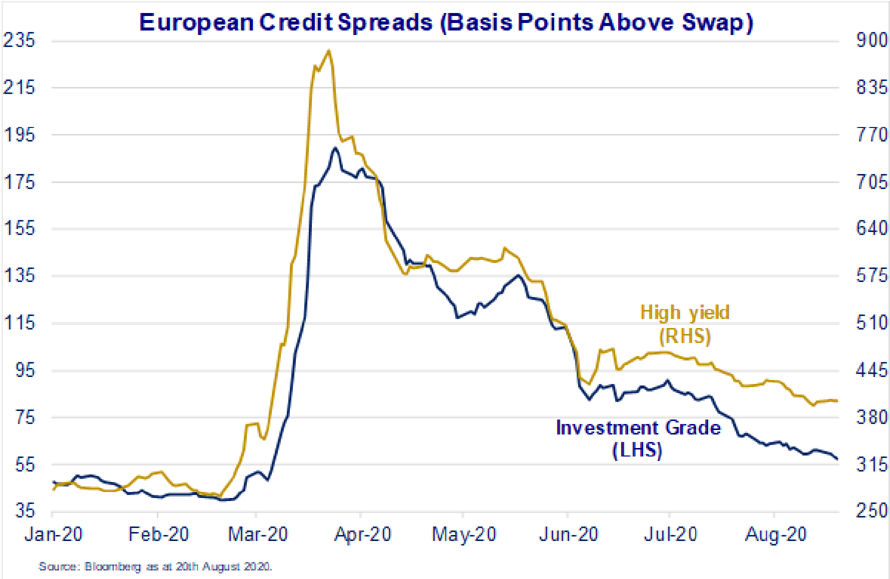


- Futures markets are pointing to a positive opening at the bell in Asia with advances priced in for Australia (+0.2%), Japan (+0.5%) and Hong Kong (+0.7%).

- **CREDIT MARKETS**
  - **Regional credit indices were little changed with spreads in the US investment grade space steady for a second straight day** at +131 bpts which kept the recovery rate at 89%. Although 8 of the 11 subsectors recorded lower spreads, not one sector recorded a movement of more than a basis point, which suggests that the weak economic outlook and high leverage in corporate balance sheets has investors not wanting to push risk premiums any lower until signs emerge of more policy support or a more positive growth impulse. In the high yield space, things were almost as quiet with spreads increasing +2 points to +530 bpts, but the recovery rate was unchanged at 83%. Nine of the 11 sub-sectors recorded higher spreads but not one of them has moved by a double-digit amount over any of the last three sessions, with overnight changes led by energy (+3 points, +779 bpts, 100%) which has had a six-day lose streak like its equity peer, and telcos (+3 points, +420 bpts, 94%).

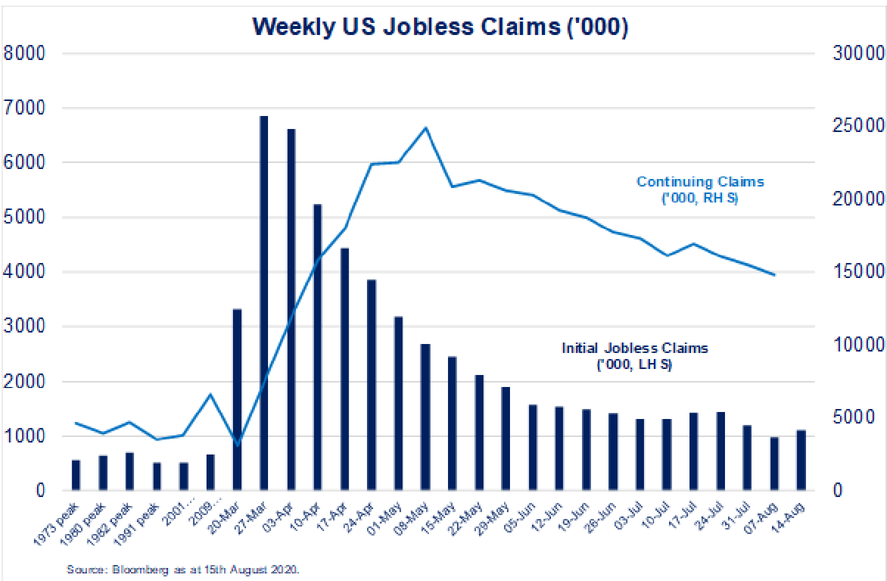


- **European credit markets were also quiet** with investment grade spreads declining one point to +57 bpts, but the recovery rate was steady at 88%. Although all 11 sub-sectors recorded lower spreads, it was hard to pinpoint the rationale given the equity market weakness but only healthcare (-2 points, +27 bpts, 94%) and materials (+1 point, 45 bpts, 89%) were of note. Conversely, spreads in the high yield space increases half pf a point to +397 bpts (see chart) which kept the recovery rate at 79% with 8 of the 11 subsectors recorded higher risk premiums. However, no sector recoded a move of more than one basis point overnight and no sectors has recorded a double-digit increase in the past six trading sessions suggesting that investors aren't wanting to push valuations any more.



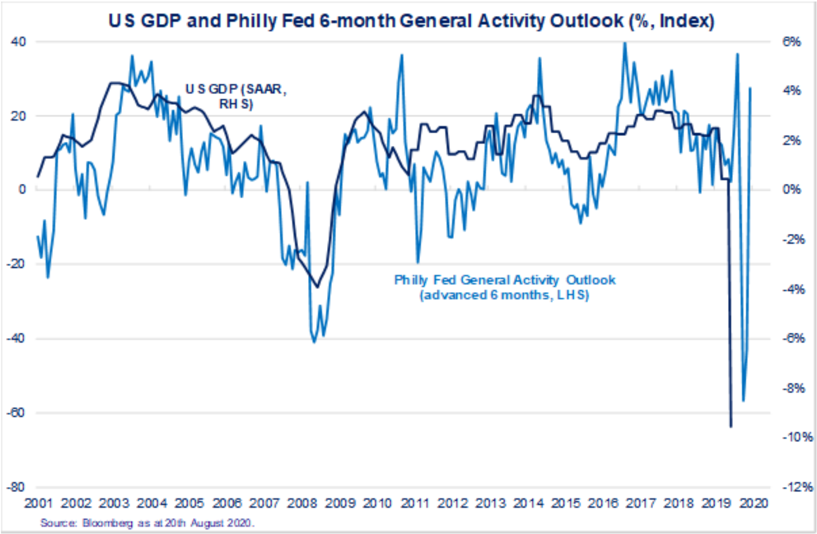
THE GLOBAL ECONOMY

- This week's jobless claims was a mixed bag with initial claims increasing by +135k to 1.1 million for the week ended August 15th which was higher than street estimates (+930k), This was the third increase in claims in the past 5 weeks which points to the notion that re-hiring and firings in a COVID-19 world will be in fits and starts rather than one prolonged trend as was the case in 2009-19. Among key states, initial claims increased by +18k in New York, +16k in California, and +15k in Texas and decreased by -5k in Michigan.



Meanwhile, nationwide continuing claims (which is the number of persons receiving benefits through standard programs) decreased by -636k to 14.8 million in the week ended August 8th, but after adjusting for biweekly filing schedules in Florida and California, the level of continuing claims is most likely higher (14.9 million), although not by a lot. We take more heart from falling continuous claims than we are worried about rising initial claims, but the data does suggest that the labour market recovery is moderating, but it is certainly not reversing at this stage.

- **The Philadelphia Fed manufacturing index fell by -6.9pt to +17.2** in August which was a bit more than the street (21.0). Importantly, the underlying composition of the index was quite weak with declines in shipments (-5.9pt to +9.4), new orders (-4.0pt to +19.0) and employment (-11.1pt to +9.0) although all remained in expansion territory. The manufacturing activity decline was as surprise as the economic recovery in May and June was associated with lower inventories which will need to be replenished by corporations, but it appears to have been modest so far. In other components, the prices paid measures edged down by 0.4pt to +15.3, and the 6 months-ahead business conditions index increased by 2.8pt to +38.8 but this series has been very noisy of late, which means translating it to a GDP forecast is much harder than usual (see chart).



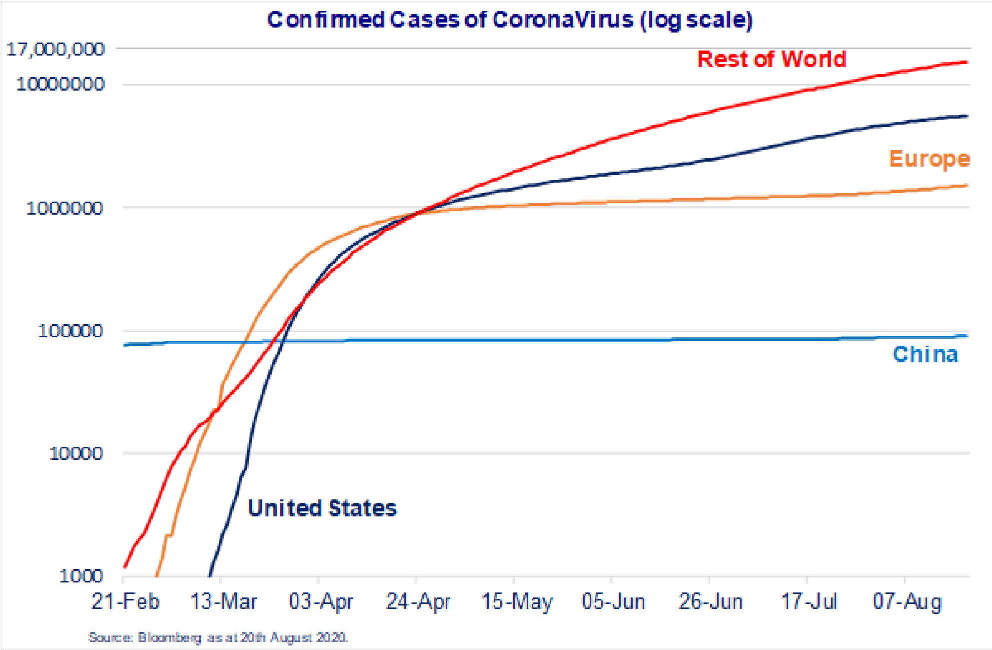
POLICY

- There were no major policy announcements overnight.

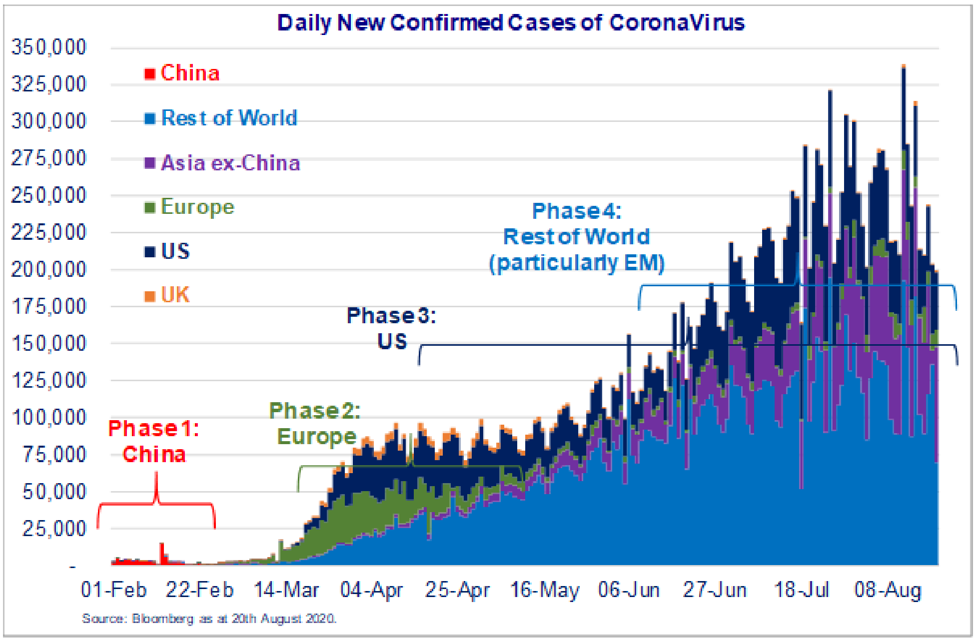
VIRUS UPDATE

- The number of global cases of COVID-19 is 22.54 million with another +198k cases so far (but Brazil, France, Mexico and 5 US states have not reported their numbers) which means that Thursday is set to be the 33th consecutive day where daily increases are greater than 200k. At present, 7 countries have more than 500k cases, 20 countries have more than 200k cases and 29 countries have more than 100k cases (the Ukraine joined this group overnight).

  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, 4 days, 5 days, 3 days, 4 days, 4 days. 4 days, 4 days, 4 days and 4 days. More importantly, the growth rate of daily confirmed cases (+1.0% since Monday) is once again coming down. Meanwhile, deaths stand at 790.5k and the death rate has declined to 3.51% although the number of daily deaths is on the rise.

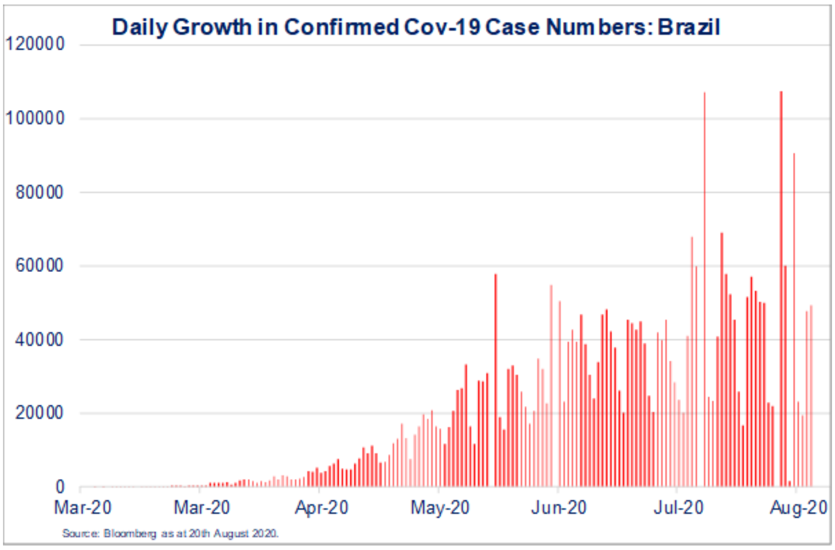


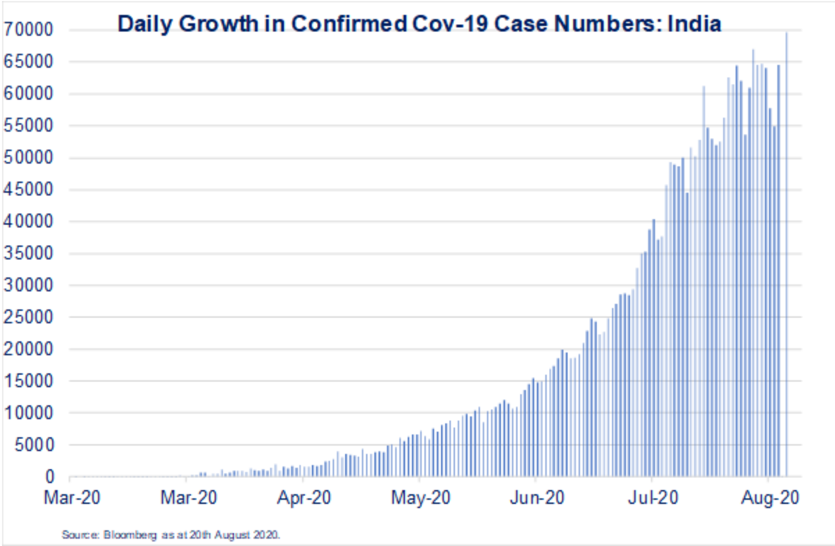
- We break the infections into four groups – the US, Europe, China and 'others' and the rest of the world outside the G3 economies now has the most total cases (+225k to 18.97 million) and highest daily new cases (and by a considerable margin) followed by the US (+38.6k to 5.57 million, although 5 states are yet to report). The issue for the US is that they never flattened their curve which means economic opening has not been associated with lower case numbers, and rising case numbers are also evident in Europe (+11.8k to 1.51 million - see chart).

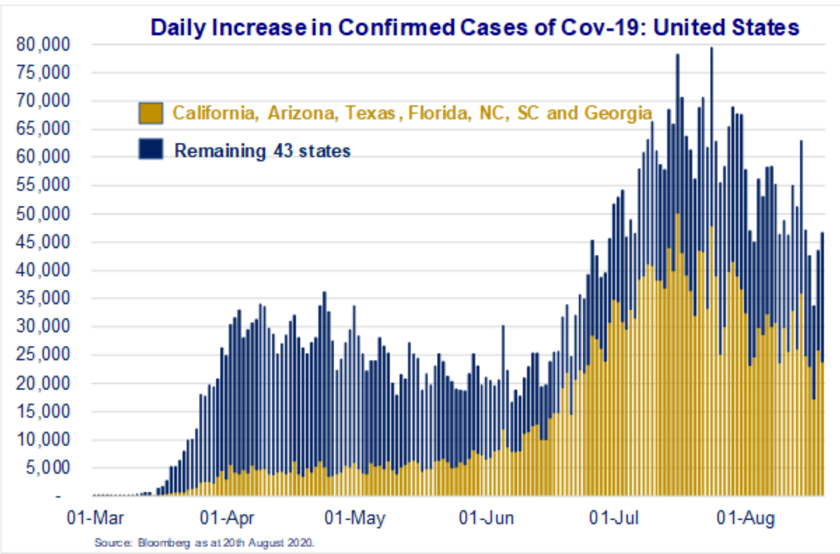


- Among countries, the most cases are in the US (+38.6k (so far) to 5.51 million, with 5 states yet to report), Brazil (not reported, 3.46 million), India (+69.7k to 2.84k), Russia (+4.8k to 939.8k), South Africa (+3.9k to 599.9k), Peru (+9.1k to 558.4k), Mexico (not reported, +537.0k), Chile (+1.8k, 391.8k), Iran (+2.3k to 352.6k),Spain (+7.0k to 377.9k), United Kingdom (+1.2k to 324.2k), Saudi Arabia (+1.3k to 304.0k), Pakistan (+0.5k to +291.0k), Bangladesh (+2.9k to 288.0k), Italy (+0.8k to 256.1k), France (not reported, 256.3k), Turkey (+1.4k to 254.5k), and Germany (+1.6k to 231.3k). Australia confirmed cases rose +247 to 24.2k yesterday which placed us 69th in terms of total infections.

  Elsewhere, Singapore recorded +68 new cases to 56.1k most of which are linked to foreign workers who are forced to live in crowded dormitories, but Indonesia (+2.23k to 147.2k) is now on the rise and has the second most cases in the region behind only the Philippines (+4.2k to 178.0k).

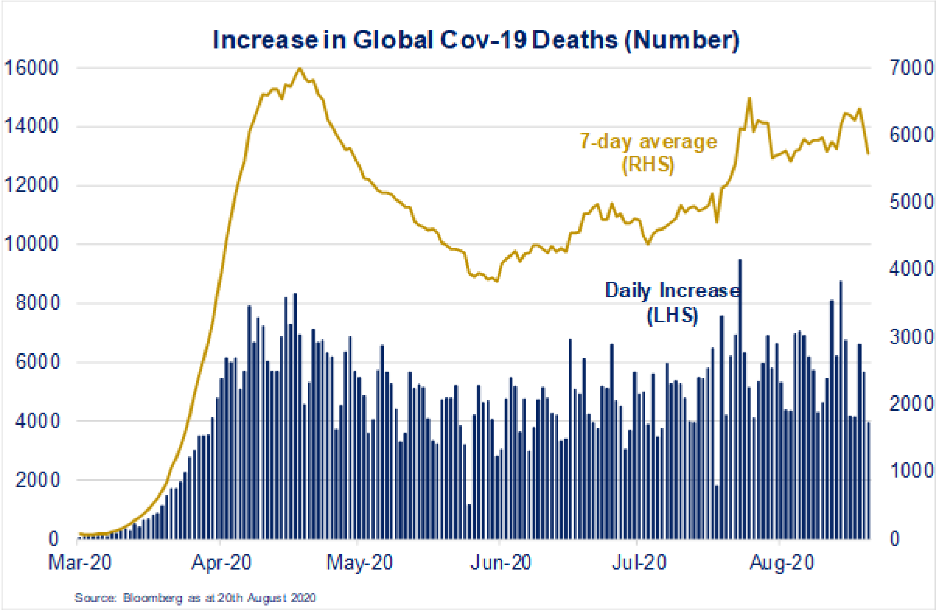


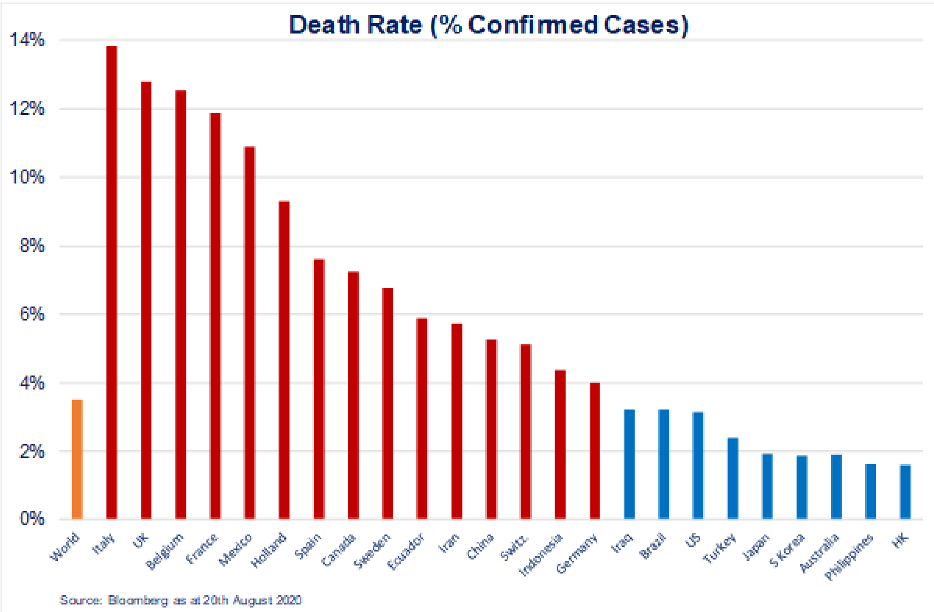




- Although final numbers are not in until 1pm AEST, the global death rate declined to 3.51% with the global total to 790.05k after another +4.0k deaths overnight, so far, which indicates the daily average deaths is increasing again (see chart). The US (+1.0k so far) has the most deaths at +174.1k, with Brazil (not reported, 111.1k), Mexico (not reported, +58.5k), India (+1.9k to 53.9k), the UK (+6 to 41.5k), Italy (+6 to 35.4k) and France (not reported, 30.4k) all over +30k. The death rate is highest in European countries where the health systems had collapsed led by Italy (-0.1% to 13.8%), the UK (steady at 12.8%), Belgium (-0.1% to 12.6%), France (steady at 11.9%), the Netherlands

(-0.1% to 9.3%), Spain (-0.2% to 7.6%) and Sweden (steady at 6.8%). However, several emerging markets are now on the leader board including Mexico (+0.1% to 10.9%), Ecuador (-0.1% to 5.9%), Indonesia (steady at 4.4%) and Brazil (steady at 3.2%).





Yours sincerely,

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MORE INFORMATION

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