Perpetual Investments

THOUGHTS ON THE MARKET

21st July 2020

Markets record a narrow rally amid speculation around vaccines and stimulus

SUMMARY

- Global risk markets rallied overnight amid speculation around several promising trial results for COVID-19 treatments, and the next round of stimulus in Europe and the US. While the US market's rise was very narrow with eight subsectors declining, large gains in IT and consumer discretionary names enabled the S&P 500 index to turn positive for 2020 and the NASDAQ Index to close at another record high. So, markets remain in the void where some investors believe negative real rates can justify any market valuation, whereas other see that the economic dislocation from COVID-19 has created an environment of sustained low growth which will struggle to improve until a vaccine arrives.

  In other markets, **10-year US Treasuries declined** -1.5 points to 0.61% which the curve slope back to just 0.50%, **commodities rallied** with gold up +0.4% to USD1,818 per troy once and oil rose +0.2% to USD40.69 per barrel, and the US dollar was mostly lower with **advances in G10 currencies** led by Sterling (+0.7%), AUD (+0.3% to USC70.2) and the Euro (+0.1%), but the Yen defied the regional trend and closed lower (-0.2%).

- The macro calendar was quiet on Monday with only the Japanese trade balance of note, with a smaller deficit recorded in June despite the bounce in export activity being completely lacklustre overall and underwhelming relative to China's, for example, who seems more favourably exposed to increase purchases of IT goods. There was very little corporate news either, but 20% of S&P500 companies report earnings this week, so things will ramp up tonight. Meanwhile, a new US COVID-19 relief bill being is being crafted by Senate Republicans and the White House which is likely to include some payroll tax reduction (more likely to be deferrals than cuts) which have been heavily pushed by President Trump, but it is likely to exclude the entire USD1 trillion of new aid for cities and states which House Democrats have pushed for.

- The number of global cases of COVID-19 is 14.62 million with another +141k cases so far overnight (but Mexico, Chile, Brazil, Peru and 9 US states have not reported their numbers) which means that Monday is certain to be the 28h occasion in the past 28 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 3 days another +632.1k cases have been confirmed. More importantly, the growth rate of daily confirmed cases (+1.6% since Thursday) is once again stabilising. Meanwhile, deaths stand at 608.6k and the death rate dropped for a seventieth fifth straight day to 4.16%.

FINANCIAL MARKETS

- **EQUITIES**
  - **The MSCI World Index closed +0.8% higher** to start the new week but it was a very mixed session across industries with FANG outperforming and cyclicals all universally lower. Advances for the session were very strong in IT (+2.6%) and consumer discretionary (+2.4%) with the latter supported by a surge in Amazon (+7.3%) on higher same store sales, but restaurants and apparel lagged notably. Similarly, Tech was broadly higher with internet and software stocks rising strongly led by Microsoft (+4.3%) and Fortinet (+4.4%), but healthcare lagged the market tape despite several solid COVID-19 drug trail results, with hospitals and managed care weaker. Meanwhile, traditional cyclicals struggled to find a foothold and

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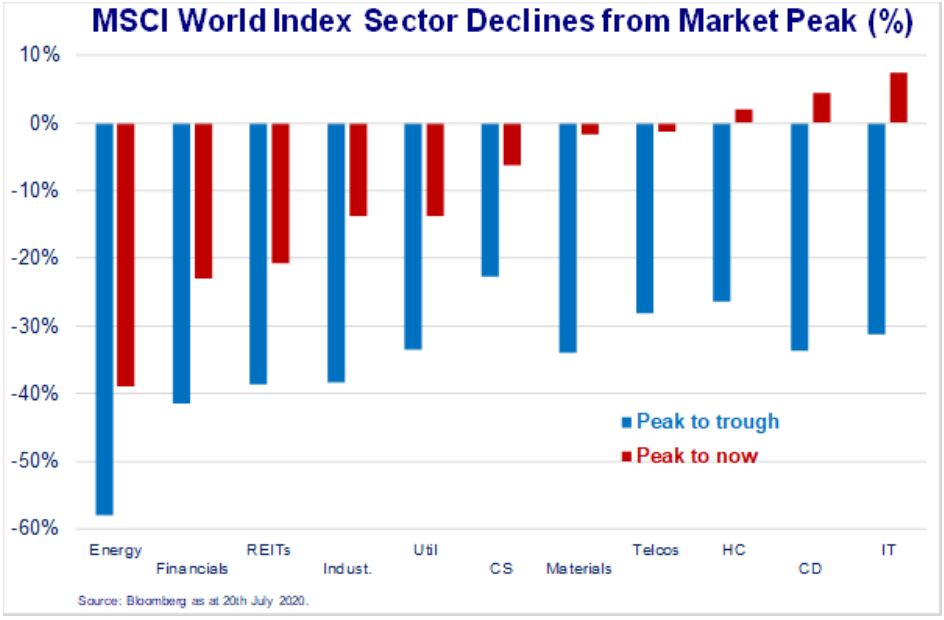
closed broadly lower with declines in financials (-0.2%), industrials (-0.3%), REITS (-0.8%) and energy (-1.7%). The decline in REITs saw the sector re-enter bear market territory, whereas IT continues to make new highs (see chart).

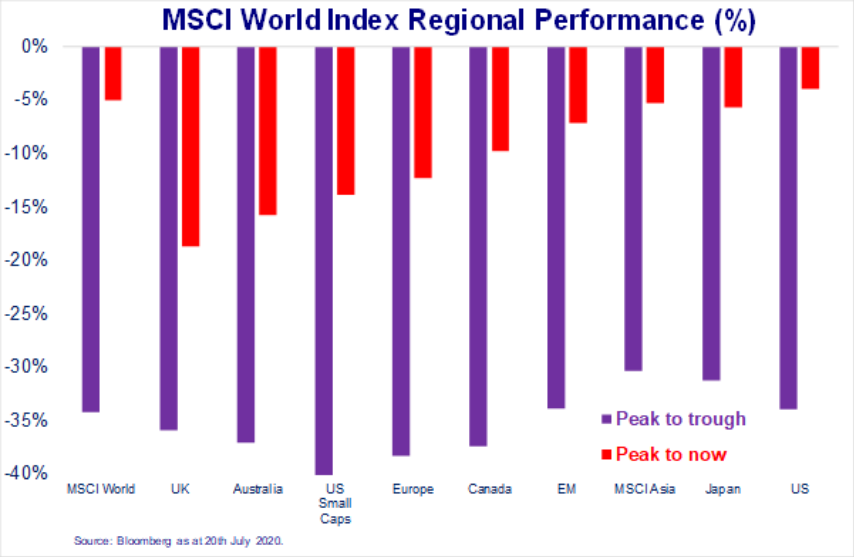


- **Among the regions**, gains were led by the US (+0.8%) but it was a very unusual session in that only three sub-sectors advanced led by consumer discretionary (+3.2%) and IT (+2.6%) where the prices of Amazon (+7.3%) and Zoom technology (+8.9%) surged on positive updates and also investors looking for companies that benefit from diminished economic activity. It was an otherwise quiet session with few corporate updates and even fewer macro releases which meant investors extrapolated returns from Friday into the new week. By the closing bell at the NYSE, the tech exposure of the NASDAQ 100 Index (+2.5%) saw it post its largest daily rise since April with yet another record close, but advances in the S&P 500 (+0.8%) and Dow Jones (+8 points, +0.03% to 26,681) and decline in the Russell 2000 Index (-0.4%) seemed more indicative of the broader market trend.

  In Europe, stocks advanced +0.7% in a day which also lacked directional drivers which meant markets just extended Friday's gains at the start of the new week. There was plenty of discussion about the region's €750 billion Recovery Fund which stretched into a fourth day of negotiations, but there wasn't much else and by the bell country advances were led by Germany (+1.0%), Italy (+1.0%), Sweden (+0.8%), France (+0.5%) and Spain (+0.5%), but the UK declined (-0.5%) although it was hard to pinpoint the catalyst.

  Earlier, **Asian equities** were mixed to start the new week but the MSCI Asia Pacific Index rose +0.5% overall. Mainland China rallied as a State Council decision last week to lift caps on insurance companies' equity investments prompted large price gains, and a modestly lower Yen supported Nippon price action (+0.1%) despite a weak June trade report which suggested that external demand is set to be a major drag in Q2. In contrast, prices were weaker in Hong Kong (-0.1%), Korea (-0.1%) and Australia (-0.5%) as negative COVID-19 developments remained in the spotlight amid no top tier macro data or policy announcements.

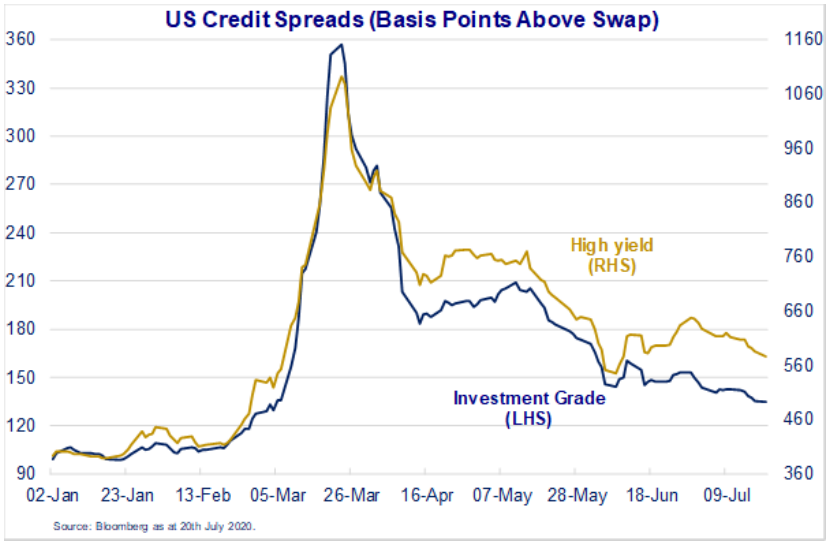
  The Monday movements saw no change in our bear-market list with the UK market the worst performer since its February peak, whereas the US market's megatech exposure has seen it push to within 4% of its all-time high (see chart).



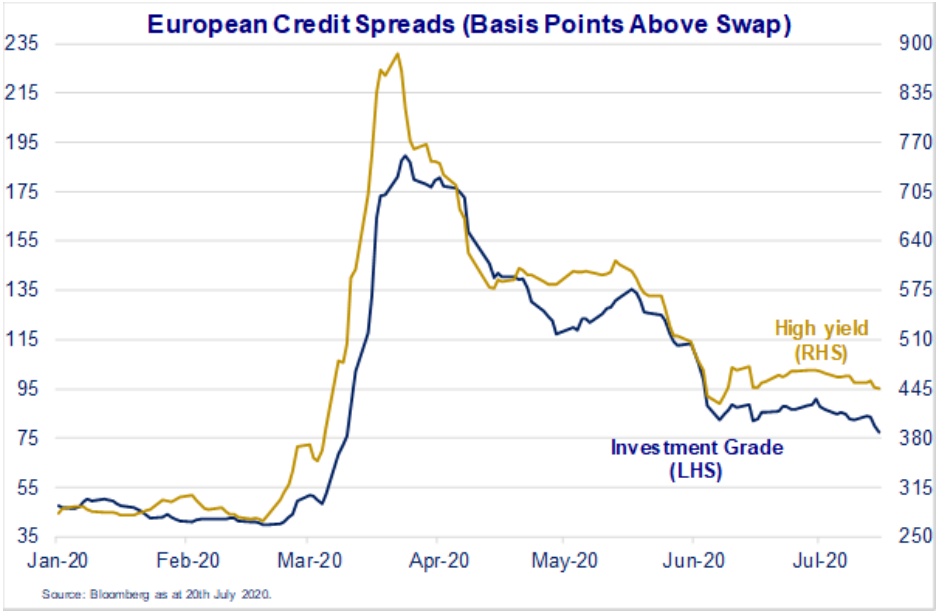
- Futures markets are pointing to solid advances on Asian markets this morning with gains priced in for Australia (+0.7%), Japan (+0.7%) and Hong Kong (+0.9%).

• CREDIT MARKETS

- Regional credit indices were solid overnight with gains in all regions. **Spreads in the US investment grade universe declined** -1 point to +135 bpts, but the recovery rate was unchanged at 88% with minute improvements in all 11 subsectors where the largest was in energy (-2 points, +188 bpts, 91%) given the slightly higher crude price, but that was about it. In the high yield universe, spreads came in for a seventh consecutive session, this time by -9 points to +577 bpts, which increased the recovery rate one notch to 76%. There was a little bit more action at the sub-sector level where three market areas recorded double digit spread declines including IT (-16 points to +490 bpts, 71%) with internet and software leading, healthcare (-12.5 points, +532 bpts, 72%) given promising drug trial results and materials (-11 points, +470 bpts, 77%) given higher commodity prices.

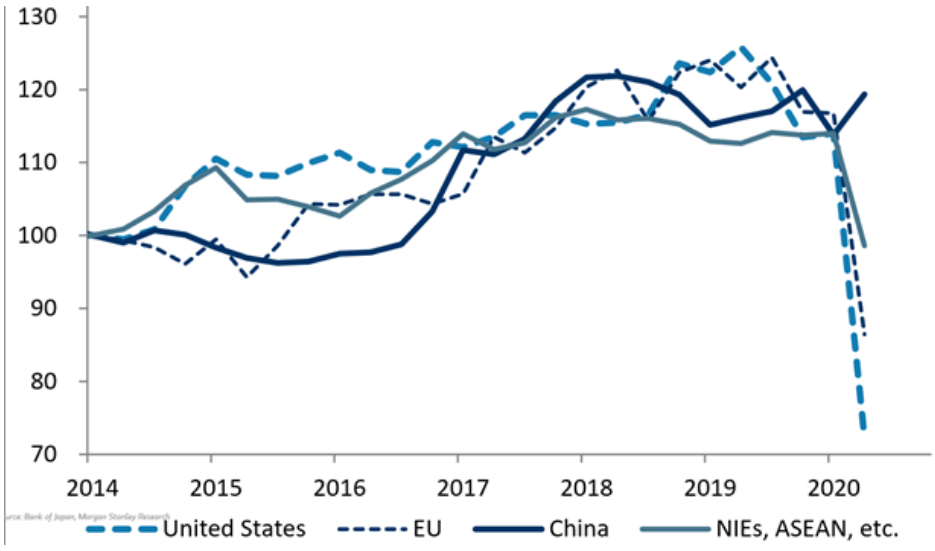


- **European credit markets also recorded solid gains** with spreads in their investment grade universe contracting -2.5 points to +74 points (14-week low), which increased the recovery rate to 77%. Lower risk premiums were recorded in all sectors led by consumer discretionary (-4 points, +100 bpts, 78%) on stimulus hopes, which flowed through to its consumer staples cousin (-3 points, +58 bpts, 100%) which have now staged a complete recovery, and materials (-3 points, +64 bpts, 77%) in response to higher commodity prices with Dr Copper now sitting above its February peak. In the high yield universe, spreads came in another -4 points to +439 bpts, which increased the recovery rate on notch to 73%. There were modest gains in all 11 sub-sectors led by senior financials (-7 points, +346 bpts, 78%) and consumer discretionary (-7 points, +535 bpts, 74%).



THE GLOBAL ECONOMY

- **Japan's trade balance** for June recorded a smaller deficit of ¥-0.2 trillion. Among the components, exports fell -26.2% y/y in June which marked a very minor improvement from the record -28.3% annual decline in May with the primary drags being autos, parts and generators. In contrast, imports fell -14.4% y/y, which was well below the May reading (-26.2% y/y) underpinned by a large rise in energy demand as the economy got back on its feet and the overall result suggests that external demand will be a major drag on June quarter growth which consensus has at -20% q/qa, however signs are that the trade weakness is set to continue into the September quarter and weigh further on the recovery.



POLICY

- There were no material policy announcements on Friday.

VIRUS UPDATE

- The number of global cases of COVID-19 is 14.62 million with another +141k cases so far overnight (but Mexico, Chile, Brazil, Peru and 9 US states have not reported their numbers) which means that Monday is certain to be the 28h occasion in the past 28 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.

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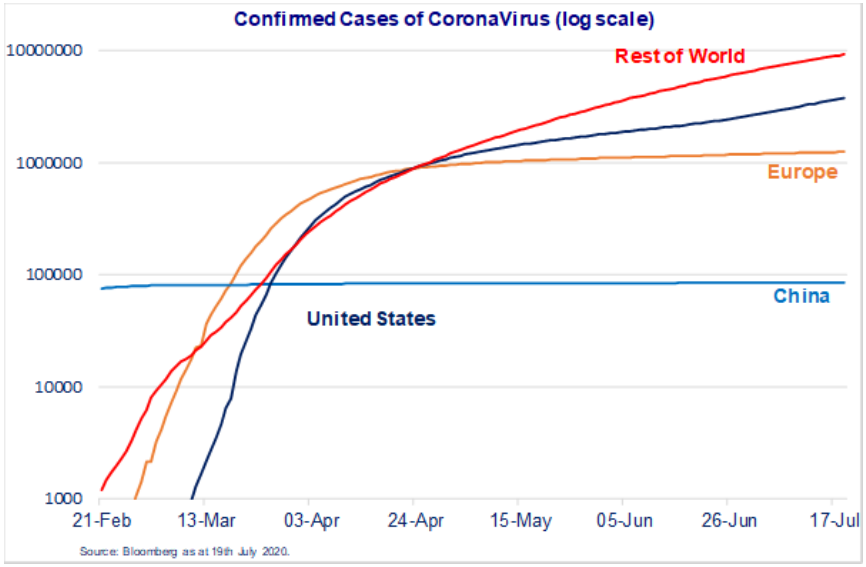
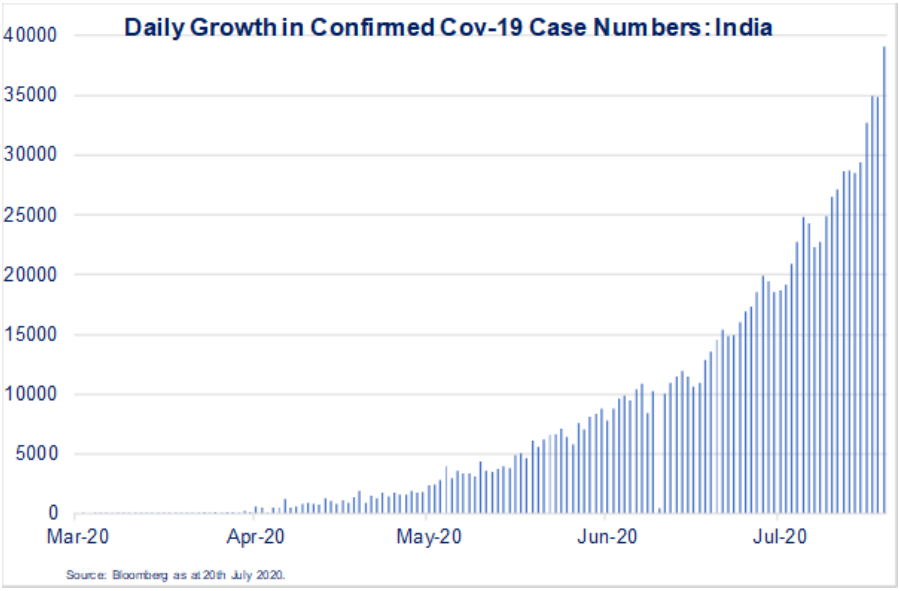


- We break the infections into four groups – the US, Europe, China and 'others' and the rest of the world outside the G3 economies now has the most total cases (+59.0k to 9.3 million) and US cases overnight increased +43.2k to 3.82 million (although 9 states are yet to report with 2 already reporting record numbers (Louisiana and Minnesota) but the R-factor here continues to decline, and Europe (+8.9k (11-week high) to 1.26 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, 2.12 million, which is the second highest in the world), India (+40.2k (record high) to 1.12k) and Russia (+5.9k to 776.2k, fourth highest) (see charts below).



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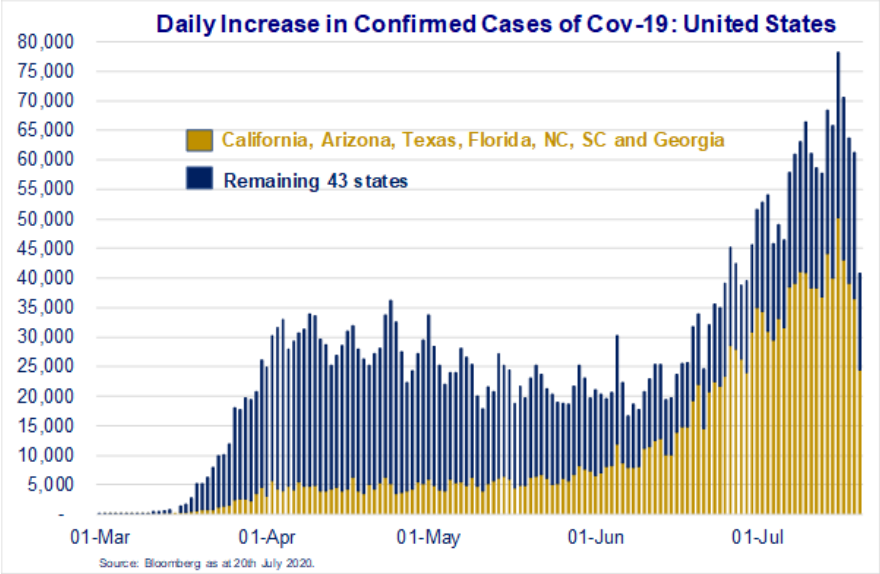
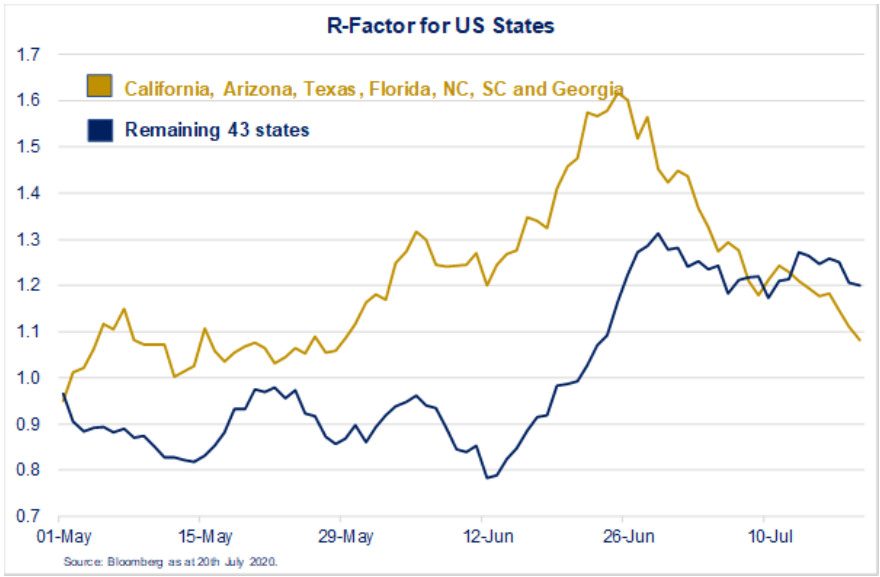
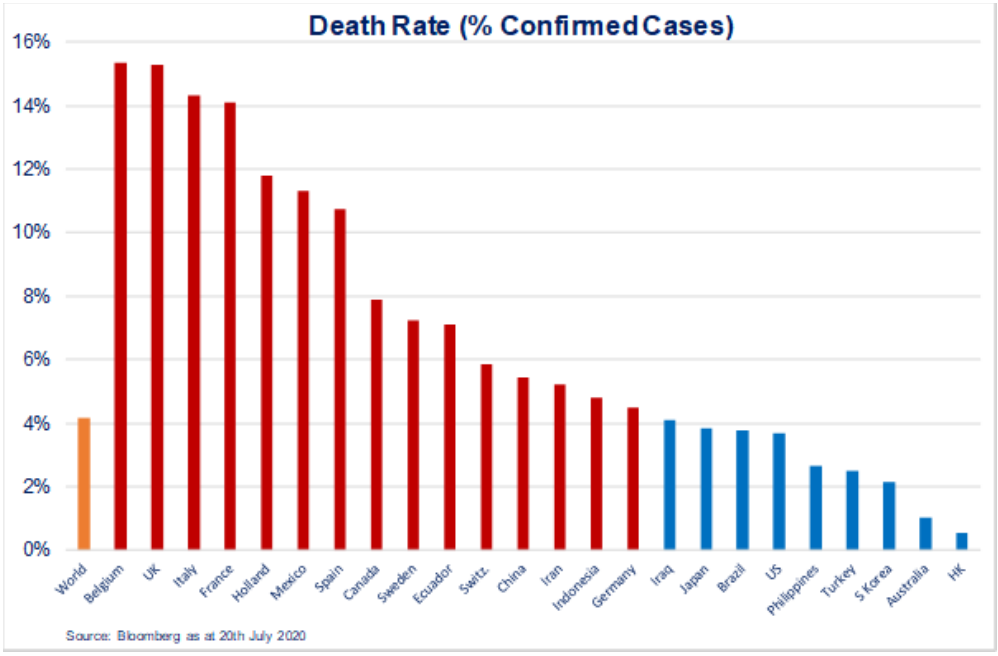




- Among countries, the most cases are in the US (+43.2k (so far) to 3.82 million, with 9 states yet to report and 2 already reporting record increases), Brazil (not reported, 2.12 million, India (+40.4k (record high) to 1.12k), Russia (+5.9k to 776.2k), South Africa (+9.3k to 373.6k), Peru (not reported, +353.6k), Mexico (not reported, +349.4k), the Chile (not reported, 330.9k), United Kingdom (+0.6k to 296.9k), Iran (+2.4k to 276.2k), Pakistan (+1.6k to +265.1k), Spain (+4.5k (11 week high) to 264.8k), Saudi Arabia (+2.4k to 253.3k), Italy (+0.2k to 244.6k), Turkey (+0.9k to 220.6k), France (+2.1k to 214.0k), Bangladesh (+207.5k) and Germany (+0.6k to 203.3k). Australia confirmed cases rose +267 to 12,070 yesterday which placed us 70th in terms of total infections.

  Elsewhere, Singapore recorded +0.1k new cases to 48.0k 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 (+1.7k to 88.2k) is now on the rise and has the most cases in the region, and the Philippines (+1.4k to 68.9k) is also on an upward trend.

- Although final numbers are not in until 1pm AEST, the global death rate declined for a seventieth fifth straight day to 4.16% with the global total to 608.6k after another 3.4k deaths overnight, so far. The US (+0.3k so far) has the most deaths at +140.9k, with Brazil (not reported, 80.1k), the UK (+0.01k to 45.4k), Mexico (not reported, +39.5k), Italy (+0.01k to 35.1k) and France (+0.03k 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 11.5k), 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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