Perpetual Investments

THOUGHTS ON THE MARKET

21st May 2020

Stocks rise to 10-week highs, but when will the payback for the stimulus come?

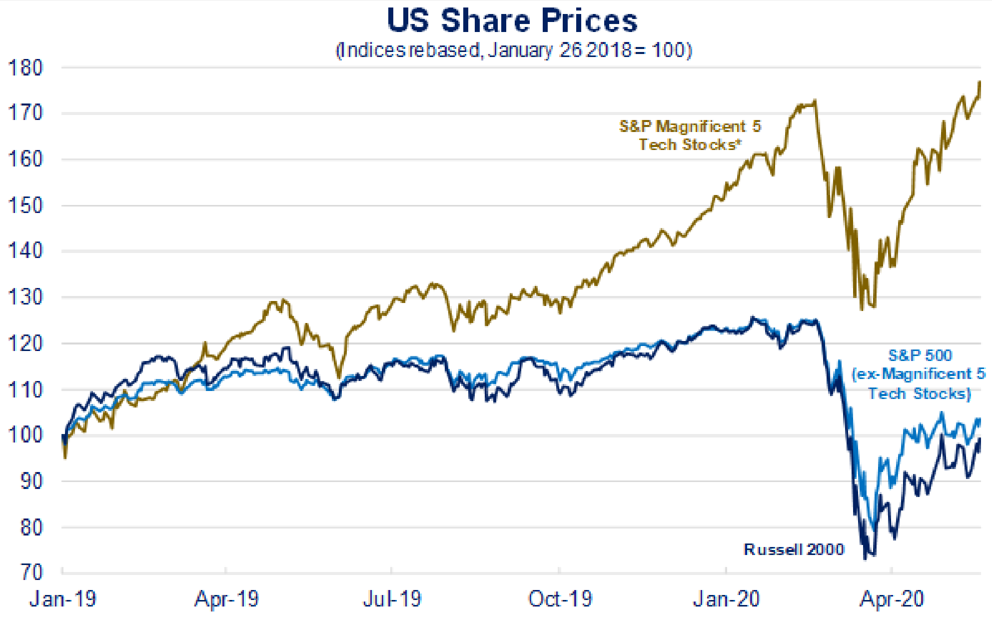
SUMMARY

- Global stocks rallied to 10-week highs on optimism that the global economy will continue to re-open with investors unperturbed overnight about downstream effects such as changes to consumer and business behaviour. In other markets, 10-year Treasuries were fractionally lower across the curve with no change in slope, the US Dollar declined against the Euro (-0.2%), Yen (-0.1%), Sterling (-0.3%) and AUD (-0.3%), gold firmed +0.9% to USD1750.8 per troy ounce and oil rallied for a fifth day, +3.1% to USD33.52 per barrel.
- The minutes of the April FOMC meeting were released overnight and told us what we knew – the US economy looks terrible, the bulk of the committee can't see a V-shaped recovery, there are risks everywhere and policy support will be maintained until the US economy is on track to achieve their full employment and inflation goals. However, members noted very high risk of a further COVID-19 outbreak in near- to medium-term and the FOMC are committed to using full-range of tools to support the economy, with some participants saying forward guidance should be used to anchor short- to medium-term Treasuries at specific levels. The committee is also worried about small businesses ability to endure an extended shock, and that some economic models may no longer be viable if consumer behaviour changes.
- The economic calendar was light with no top-tier data overnight, which meant the investors continue to be whipsawed by optimism around COVID-19 vaccines and an easing of lockdowns against concerns that they must by consequences for the extraordinary monetary and fiscal stimulus which could come through any number of channels – higher bond yields due to massive government debt issuance, higher inflation once the economy revives, sovereign downgrades and defaults given rollover risks, lower long term growth due to higher private sector savings and lower investment, currency downgrades due to high government debt and low interest rates. Most of these concerns were around at the start of the post-GFC cycle in 2009, but we start this one with de-globalisation already well advanced, long bond yields close to zero, government balance sheets much more highly leveraged and the political populism movement engulfed in both sides in many key countries. The June quarter should mark the end of the economic contraction as restrictions are eased, but it's the shape of the recovery that matters.
- Although final numbers are not in for another 3 hours, the number of global cases of COVID-19 stands at 4.97 million with another +60.0k cases overnight. The recent daily case increases have been very high, and this means 6 countries have more than 200k cases, 12 countries have more than 100k cases (with Peru joining this group overnight), 32 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 11 days another 969k cases have been confirmed, but the growth rate of daily confirmed cases is trending lower (+1.7%). Meanwhile, deaths rose +2.7k overnight to 326.5k and the death rate dropped for a fourteenth straight day to 6.51%.

FINANCIAL MARKETS

- **EQUITIES**
    - The MSCI World Index closed +1.5% higher which lifted its recovery rate to 59% with advances in all sectors. The global share increase was led by energy (+2.8%) which benefitted from a fifth consecutive day of rising crude prices (which saw the index price very close to a 10-week high and the recovery rate up to 39%), tech (+2.1%, 83%) with another surge in the Magnificent 5 which are now +9% above their February peak and +17% from end-2019 (see chart) and financials (+1.5%, 28%).

Perpetual

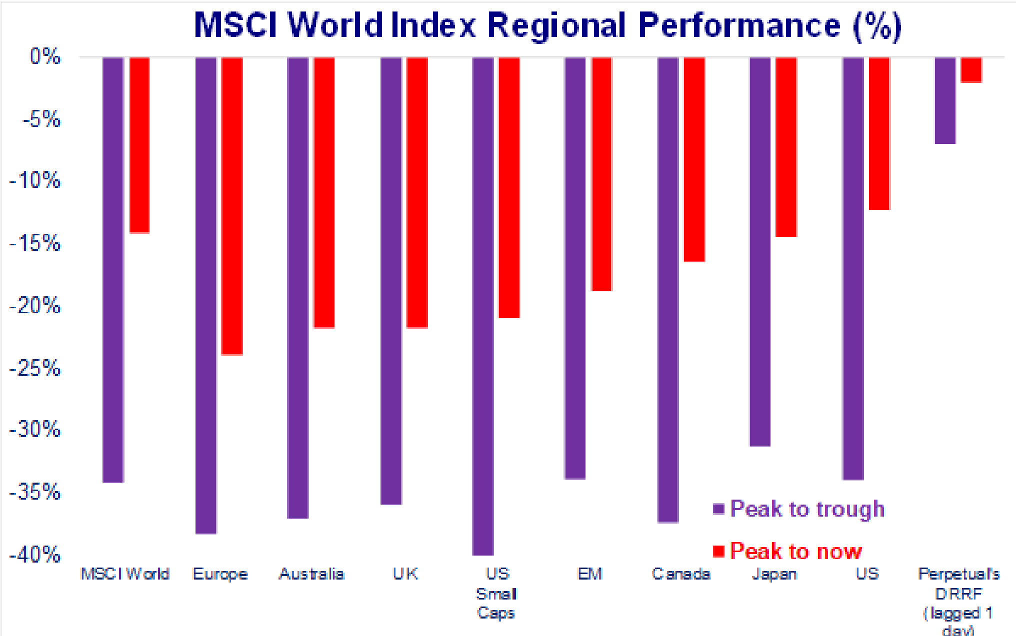


Source: Bloomberg as at 20th May 2020. * The Magnificent 5 are Microsoft, Apple, Facebook, Amazon and Google and the index is cap weighted.

- Among the regions, the US (+1.7%) led the performance table given its high exposure to tech and bio tech stocks which erased all of Tuesday's losses and drove the market's recovery rate up to 64%, but the index closed off its best levels after the US Senate passed a bill that could bar some Chinese companies from listing on US exchanges. This followed a recovery the Europe (+1.3%) from an early decline with the Euro recording its fourth consecutive day of appreciation against the US dollar as expectations grew that a €500 billion region-wide stimulus plan will be approved.

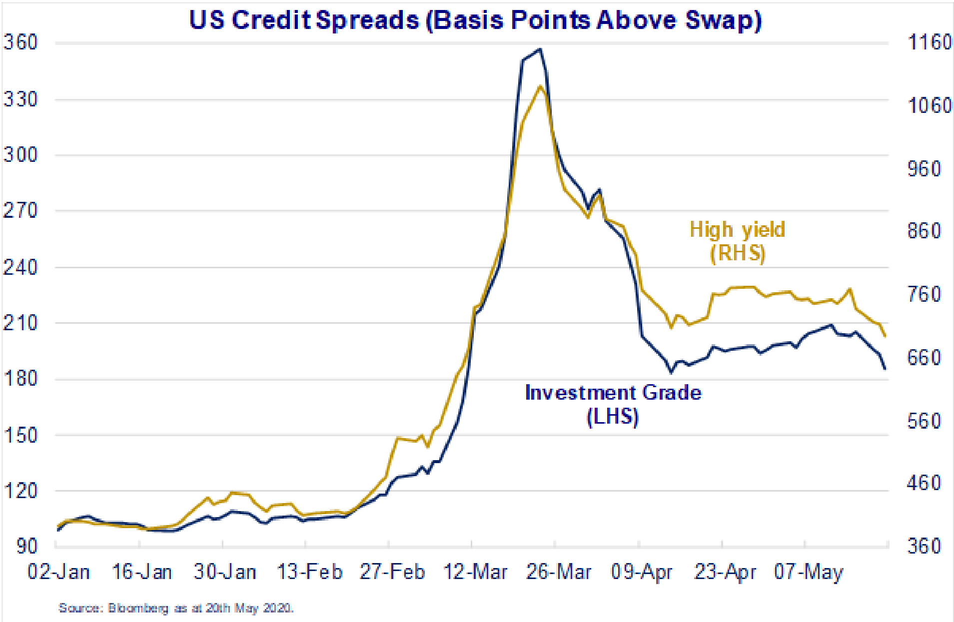
  Earlier, the MSCI Asia Pacific index closed +0.6% higher with gains in Japan (+0.8%), Korea (+0.5%), Australia (+0.2%) and Hong Kong (+0.1%) offset by losses in China (-0.5%). Gains yesterday saw EM come out of bear market territory (see chart), although US small cap s (-21.0%), the UK (-21.7%), Australia (-21.7%) and Erope (-23.9%) remain entrenched.

  Futures markets suggest a positive opening in Asia with gains expected at the bell in both Australia (+0.6%) and Japan (+0.8%).

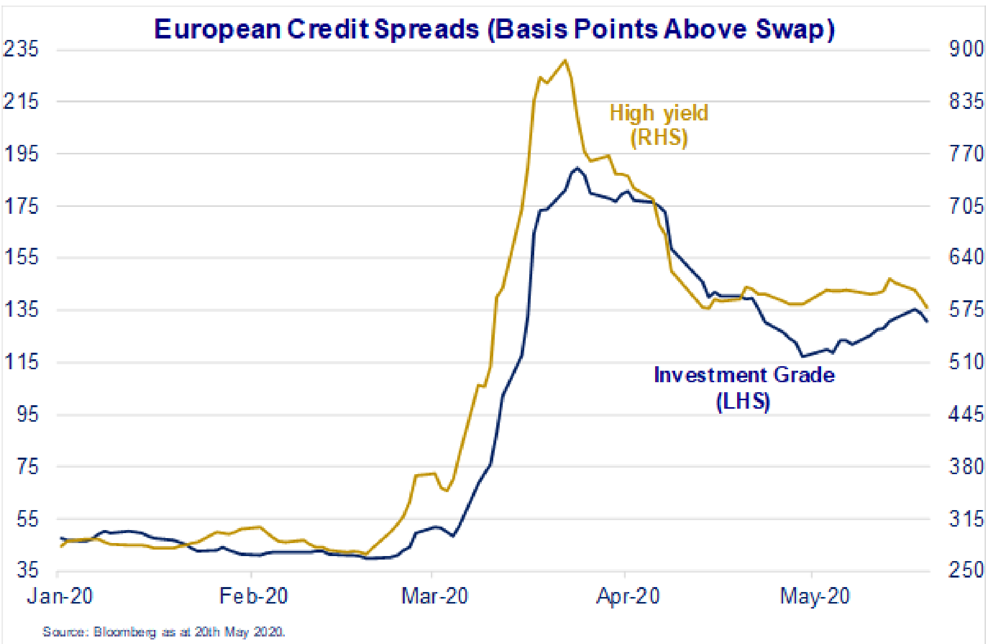


Source: Bloomberg as at 20th May 2020.

- **CREDIT MARKETS**
    - Regional credit indices rallied with spreads in the US investment grade sector down -8 points to +186 bpts, which increased the recovery rate to 67%. There were declines across all sub-sectors led once again by energy (-16 points to +270 bpts, 72%), consumer discretionary (-10 points, +228 bpts, 68%) and materials (-8 points, +236 bpts, 60%). Meanwhile high yield spreads came in for a fourth consecutive session by -18 points to +696 bpts, which increased the recovery rate to 58%. There were double digit declines across all sub-sectors led by energy (-44 points to +1089 bpts, 80%), subordinated financials (-21 points to +765 bpts, 36%) and consumer discretionary (-19 points, +730 bpts, 44%).



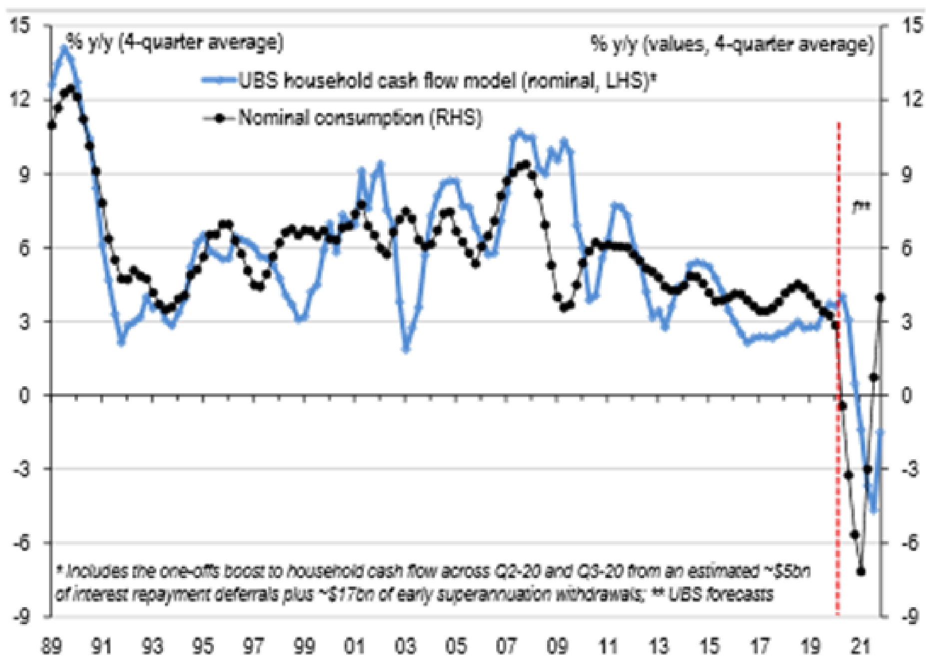
    - European credit markets also rallied with investment grade spreads contracting for a second consecutive session +3 points to +131 bpts, which increased the recovery rate to 39%. There were modest gains across all sectors led by consumer discretionary (-6 points to +191 bpts, 38%) and energy (+6 points, +130 bpts, 26%) but movements elsewhere were limited to less than -2 points. In the high yield space, spreads came in for a fourth consecutive session by -12 points, to +579 bpts, which increased the recovery rate to 50%. Lower spreads were universal, led by tech (-18 points, +488 bpts, which increased the recovery rate to 35%), subordinated financials (-17 points, +695 bpts, 37%) and consumer discretionary (-16 points, +762 points, 48%).



THE GLOBAL ECONOMY

- Australian retail sales slumped a record -17.9% m/m in April which was double market expectations, but it came after a +8.5% m/m increase in March as lockdowns spurred panic buying. This saw the annual rate drop to a record low of -9.4% y/y and among the components, food fell by -17.1% m/m (after +24.1% m/m in March, and remains up by +5.5% y/y) and UBS estimates that non-food dropped back even more to -18.6% m/m (-19.9% y/y). Importantly, the ABS estimated that the online share of total retail jumped in April to a record high of 10% (6% in February) and this is likely to continue.

  Interestingly, UBS used industry and transactions data to suggest that in April shopping centre foot traffic collapsed -90% amid restrictions, but this has lifted in May but the annual rate is still -50% y/y suggesting that there is still a very long way to go on that front. The worry is that in the December quarter some government stimulus is likely to be closed or wound back (JobKeeper and JobSeeker which are now paid to 8 million households) and this is likely to present a cashflow cliff (see chart below from UBS) which will weigh on household spending and hence the Australian economy if the labour market has not snapped back.



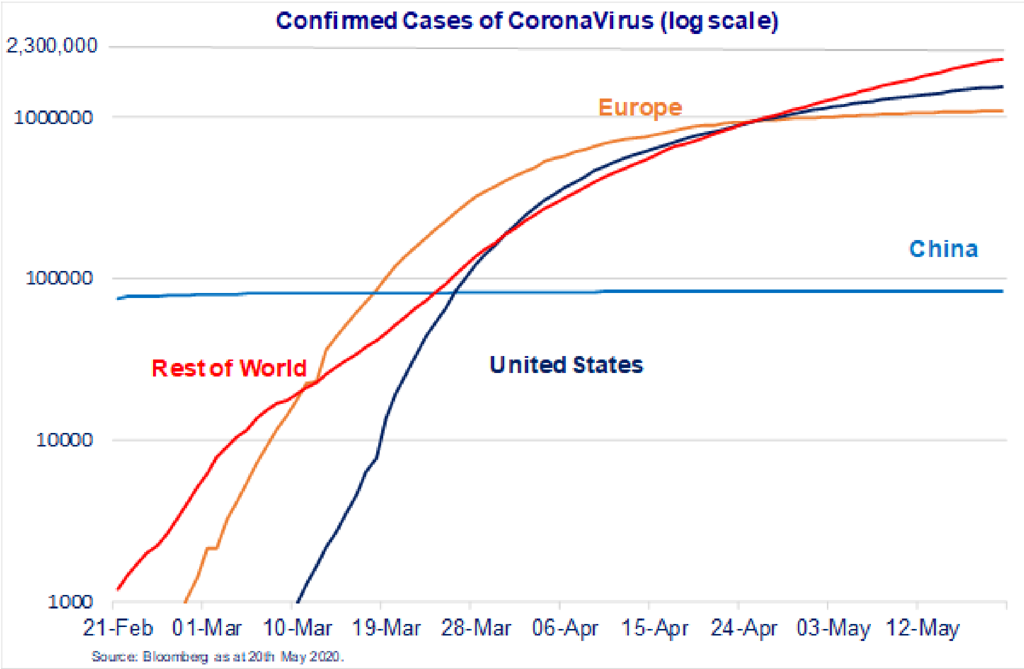
POLICY

- There were no major policy announcements overnight, but the minutes of the April FOMC meeting were released overnight and told us what we knew – the US economy looks terrible, the bulk of the committee can't see a V-shaped recovery, there are risks everywhere and policy support will be maintained until the US economy is on track to achieve their full employment and 2% inflation goals. However, members noted very high risk of a further COVID-19 outbreak in near- to medium-term and the FOMC are committed to using full-range of tools to support the economy, with some participants saying forward guidance should be adopted to anchor short- to medium-term treasury yields at specific levels. The committee is also worried about small businesses ability to endure an extended shock, and that some economic models may no longer be viable if consumer behaviour changes.

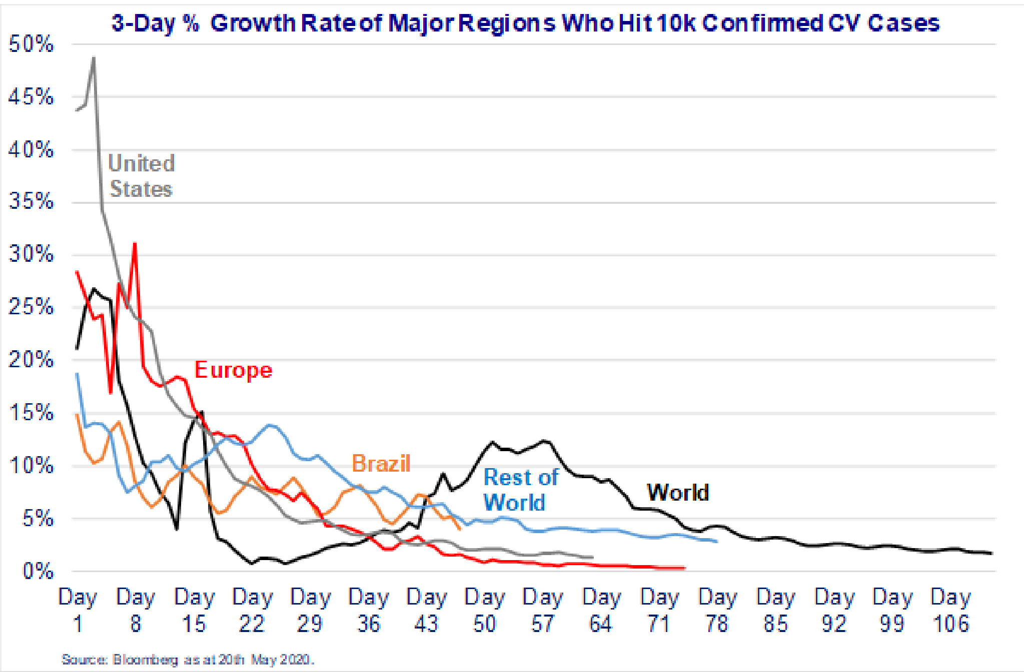
VIRUS UPDATE

- Although final numbers are not in for another 3 hours, the number of global cases of COVID-19 stands at 4.97 million with another +60.0k cases overnight (which means Wednesday is likely to be the 51st occasion in the past 52 days where daily increases have topped 70k). The recent daily case increases have been very high and this means 6 countries have more than 200k cases, 12 countries have more than 100k cases (with Peru joining this group overnight), 32 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 11 days another 968k cases have been confirmed. That said, the growth rate of daily confirmed cases is trending lower (+1.7% since Sunday).

Meanwhile, deaths rose +2.7k overnight to 326.5k, with the US now over 90k (28.6% 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 fourteenth straight day to 6.52%.



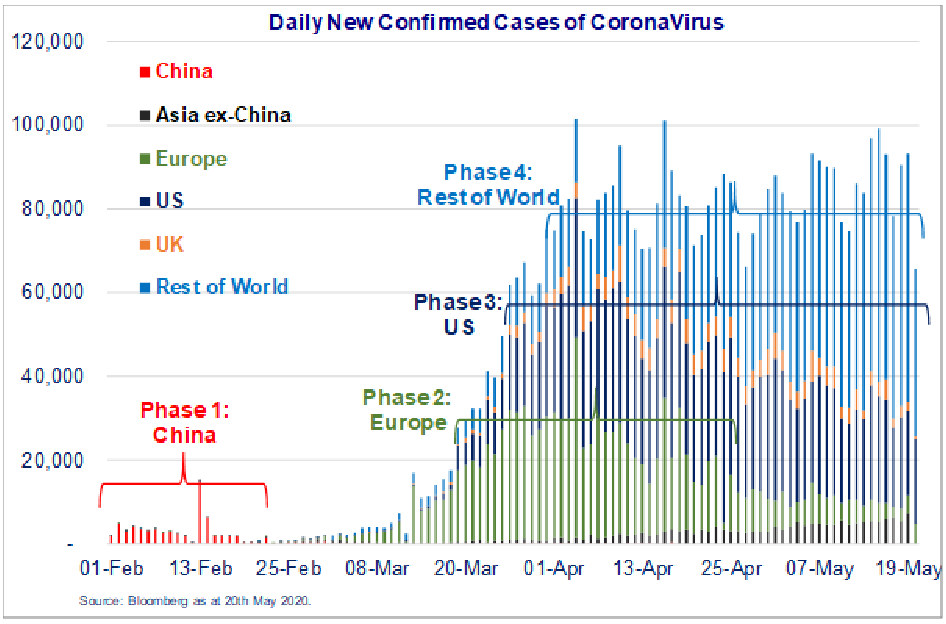
- We break the infections into four groups – the US, Europe, China and 'others' and the rest of the world outside the G3 economies now has the most total cases (+30.1k to 2.27 million) and highest daily new cases (and by a considerable margin) followed by the US (+18.8k (7-week low) to 1.55 million) and Europe (+4.4k (5-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 (+8.8k to 308.7k) which is the second most infected nation after the US, and Brazil (271.6k) which is now the third most infected nation.



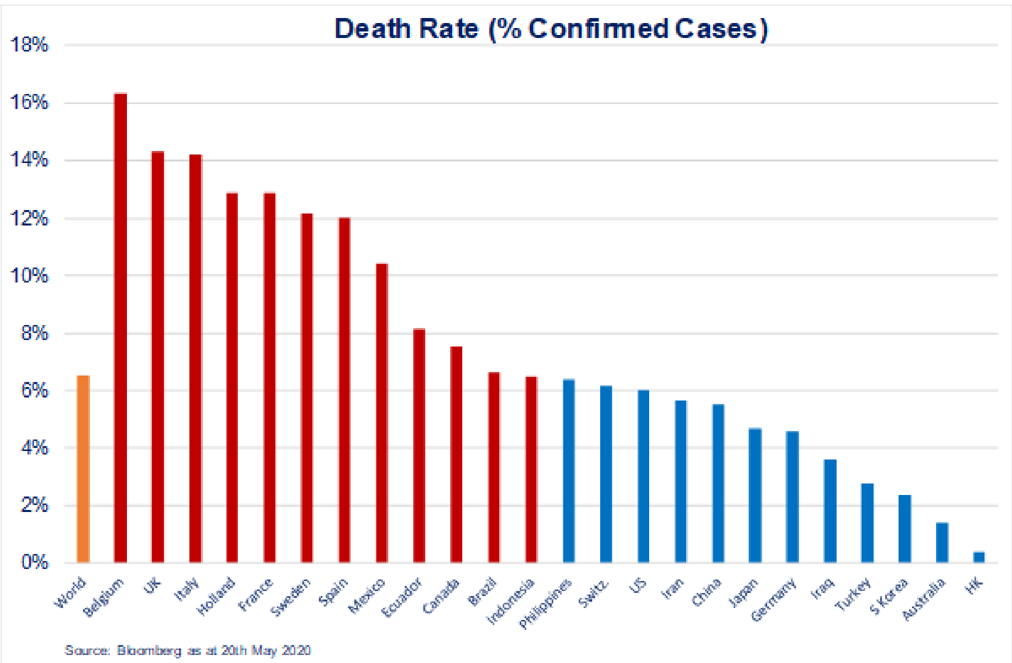
- Among countries, the most cases are in the US (+18.8k (7-week low) to 1.55 million), Russia (+8.8 to 308.7k), Brazil (271.6k), the United Kingdom (+0.8k (8-week low to 249.6k), Spain (+0.5k to 232.6k), Italy (+0.7k to 227.4k), France (+1.0k (1-week high) to 181.7k), Germany (+0.7k to 178.5k), Turkey (+1.0k to 152.6k), Iran (+2.3k (6 week high) to

126.9k), India (+5.6k (second highest ever) to 112.3) and China (steady at 84.0k). Australia confirmed cases were steady at 7,079 yesterday which placed us 57th in terms of total infections.

Elsewhere, Singapore recorded +570 new cases to 29.4k 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 (+693 to 19.2k) and the Philippines (+279 to 13.2). 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 a fourteenth straight day to 6.51% with another +2.7k fatalities overnight bringing the global total to 326.5k. The US (+1.2k) has the most deaths at +93.1k, with the UK (+0.4k to 35.7k), Italy (+0.2k to 32.3k), France (+0.1k to 28.1) and Spain (+0.1k to 27.9k) 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 14.3%), Italy (steady at 14.2%), France (steady at 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 (-0.1% to 10.4%), Ecuador (-0.1% at 8.2%), Brazil (-0.1% to 6.6%) and Indonesia (-0.1% to 6.5%).



Yours sincerely,

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MORE INFORMATION

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