Perpetual Investments

THOUGHTS ON THE MARKET

22nd September 2020 -
The sharemarket rout continues but the market concern is now centred on the growth outlook

SUMMARY

- Global sharemarkets went further south overnight, but a late rally in US tech shares saw the US index close well off its worst levels for the session and cushion the blow for the broader global sharemarket. While much of the September share price slide has been attributed to crowded positioning and unsustainable tech sector valuations, the market down leg seems to have entered a new stage with cyclical sectors underperforming as investor's growth focus changes from a robust September quarter to a slowing December quarter. Growth was always going to slow from its Q3 pace, but the worry here is that policy is being pulled at a time when the recovery is embryonic, highly fragile and needs sustained support.

  Diminishing prospects for more economic stimulus has been underpinned by governments wanting to pull back on income support and central banks not having any tools left to boost growth and inflation – a fact confirmed last week by the US Fed. While extremely high GDP growth in the September quarter will come as some relief to governments and create the impression that the private sector can now drive the recovery, there are still large gaps between February and end-2020 for inflation, profits and employment and more support is required.

  Accordingly, after six months of strong co-ordination it appears that we may be repeating the mistakes of the last cycle with fiscal policy being pulled too early which is reducing the policy impulse and leaving growth and inflation at the mercy of the 3 D's – debt, demographics and disruptive technology. If this occurs the risks are that the average growth and inflation in the current cycle will be even weaker than the record low record recorded in the post-GFC cycle, which will have flow-on effects to returns.

- In other markets, 10-year US Treasuries rallied with yield down -3 points to 0.67% amid curve flattening, commodities prices declined with oil (-3.6% to USD39.65 per barrel) underperforming gold (-2.0% to USD1912 per troy ounce) and G10 currencies depreciated against a stronger Greenback with declines led by AUD (-0.9% to USC72.25), Sterling (-0.8% to USC128.2), Euro (-0.6% to USC117.7) and Yen (-0.1% to 104.69).

- There were no major policy announcements or macro data in a session overnight which lacked any material news.

- The number of global cases of COVID-19 is 31.2 million with another +252.6k cases so far (but Brazil, Mexico, Colombia, Pakistan and 5 US states have not reported their numbers) which means that Monday was the 65th consecutive day where daily increases are greater than 200k. At present, 10 countries have more than 500k cases, 22 countries have more than 200k cases and 35 countries have more than 100k cases (the Netherlands joined this group overnight). More importantly, the growth rate of daily confirmed cases (+0.9% since Friday) is steady. Meanwhile, deaths stand at 962.3k and the death rate was steady at 3.09% although the number of daily deaths remains elevated.

FINANCIAL MARKETS

- **EQUITIES**
  - **The MSCI World Index closed -1.6% lower overnight which was its fourth consecutive decline and the longest loss streak since end-February**, but it could have been a lot worst had it not been for a strong rally

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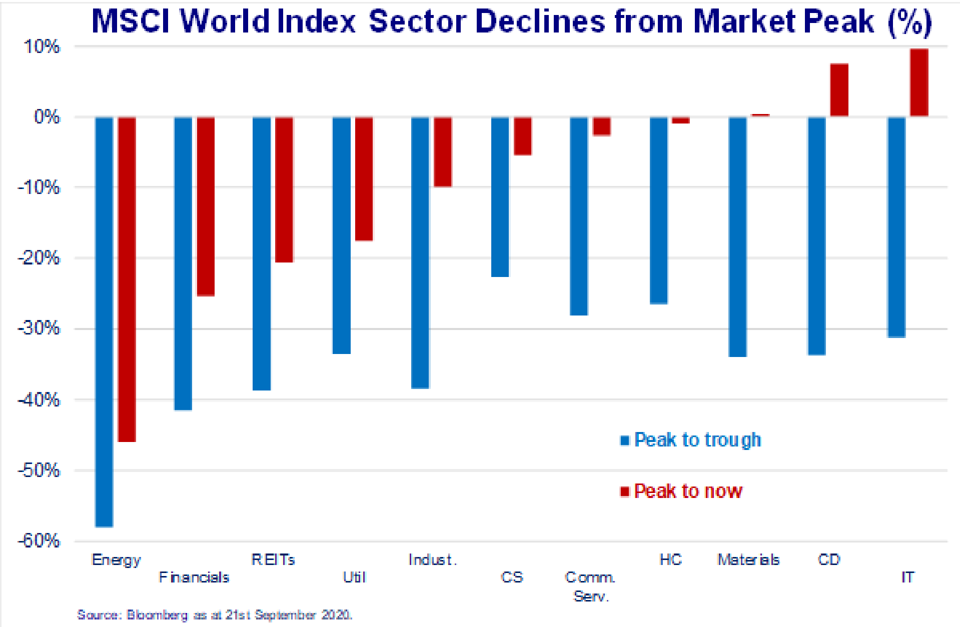
in tech shares in the last hour of trading in New York. While most market analysts have attributed the market's September decline to crowded positioning and unsustainable tech valuations, it was the cyclical sectors overnight which led all bourses lower with large losses recorded in materials and energy (both -3.0%) given lower prices in oil, base metals and precious metals. After those, industrials (-2.7%) and financials (-2.7%) lagged the market tap with the latter led down by cards, life insurers and banks which declined sharply, with REITs (-2.3%) not far behind.

Defensive sectors outperformed their cyclical peers and, on the whole, beat the market tape with more moderate losses in communication services (-1.2%), utilities (-0.9%) and consumer staples (-0.9%). In contrast, IT (+0.6%) was the only sector to rally with strength in hardware (such as Apple (+3.0%)), internet (Netflix (+3.7%)) and software (Oracle (+1.8%)). By the close of trading, energy (down -45.9% from its February peak) and financials (-25.3%) went deeper into bear market territory, REITs (-20.6%) fell back into bear market territory, industrials (-10.0%) re-entered correction territory (see chart) and healthcare (-1.0%) saw its recovery rate drop back below 100%.

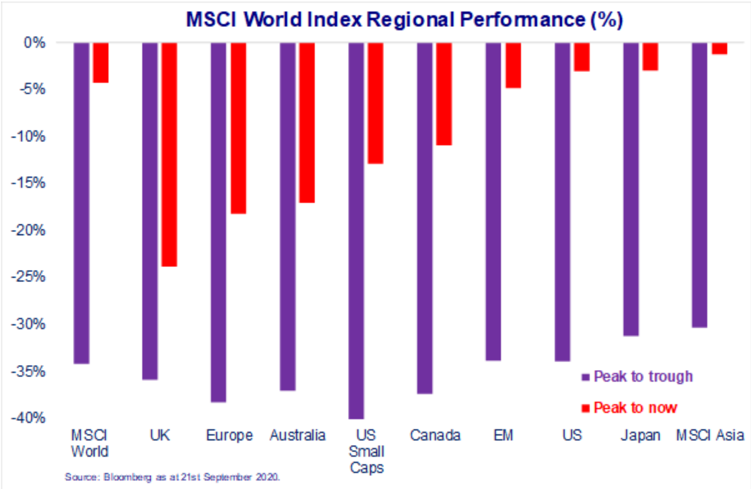


- **Among the regions, losses were led by Europe (-3.7% - 14 week low) given its high economic beta composition.** Resurging COVID-19 case numbers across Europe and the fear of further mobility restrictions weighed on broader sentiment, and especially on impacted sectors such as airlines, hotels, tourism and restaurant names. However, banks (-5.5%) led the declines amid reports of money laundering accusations where banks apparently profited from moving trillions of dollars around the world for terrorists, kleptocrats and drug lords over the objections of bank employees, but protect themselves by filing a suspicious activity report with the US Treasury Department. Other than this is was a quiet session with no macro data of note and in central bank news, the FT reported that the ECB will review its Pandemic Emergency Purchase Program and whether enhanced flexibility could be used for other asset purchase schemes. By the closing bell, there were deep losses all round led by Germany (-4.4%), Italy (-3.8%), France (-3.7%), Sweden (-3.5%), Spain and the UK (both -3.4%) and Switzerland (-2.0%).

  The US sharemarket (-1.2%) followed the negative leads from Asia and Europe and was under pressure after the S&P 500 finished at six-week lows last week and suffered its third straight weekly decline. The cyclical sectors led the losses overnight but the US market's low weighing to financials (-2.5%), REITs (-2.7%), Energy (-3.3%) and industrials (-3.4%) provided investors with some ballast. There was no macro data of note, the Fed was also quiet after last week's disappointment, and President Trump said that he would announce his nomination for the US Supreme Court on Friday or Saturday. By the closing bell, it was red numbers on the screens, but all indices closed well off their daily lows given a late rally in tech which saw the NASDAQ Composite (-0.1%) outperform other indices including the S&P 500 (-1.2%), Dow Jones (-1.8%, -510 points, 27,148) and Russell 2000 (-3.4%).

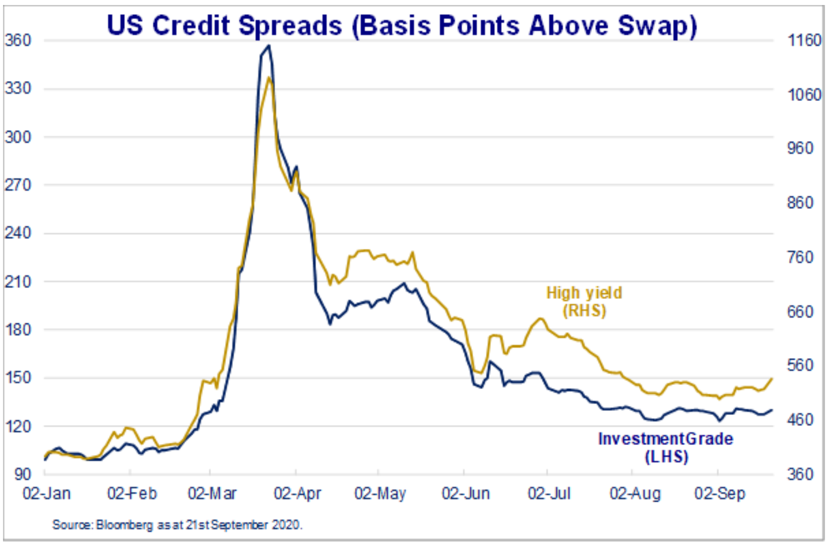
  Asia equities finished lower with the MSCI Asia Pacific Index off -0.9% following a negative lead from Wall Street on Friday night. It was a very quiet session in terms of trading volume and newsflow with no macro releases which meant markets mostly followed US futures prices. A few themes came into play during trading including an exposé on money laundering in the banking sector which helped send HSBC (-5.3%) down to its lowest level since 1995 and weighed heavily on the Hang Seng. There were also considerable reports on the purchase of Oracle's bid for TikTok, but the market impact was minor. Meanwhile, increased COVID-19 cases declined in Victoria and South Korea. By the regional close, Hang Seng (-2.1%) led the pace of declines, followed by moderate losses in Mainland China (-1.0%), Korea (-1.0%), India (-0.8%), Australia (-0.7%) and Taiwan (-0.6%), with Japan was closed for national holidays.

By the close of trading, the UK market (with a peak-to-now decline of -23.9%) went deeper into bear market territory, US small caps (-12.9%) and Canada (-10.9%) went back into correction territory, and all other regions are now back below their February peak (see chart).

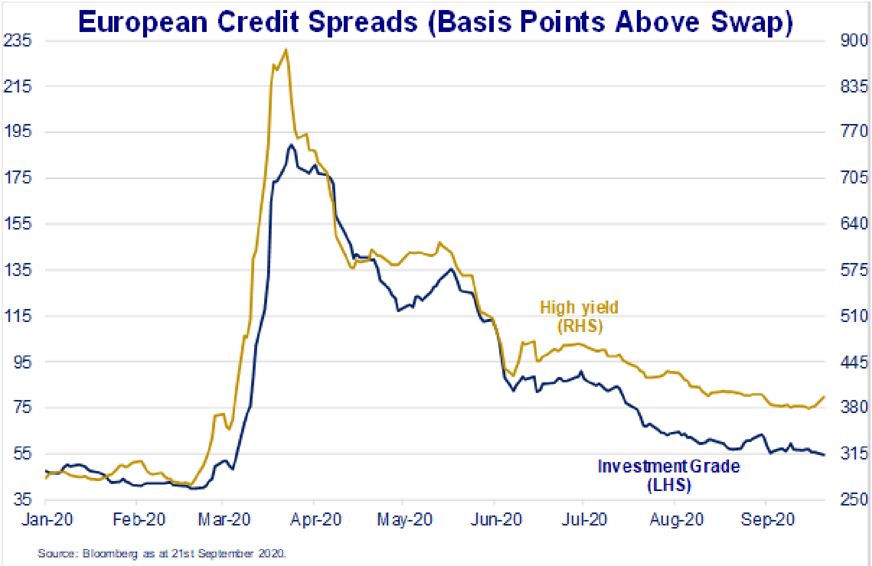


- **Futures markets suggest a subdued opening in Asia** with Australia (-1.0%), Japan (-0.4%) and Hong Kong (-0.3%) all set to open lower at the bell.

- **CREDIT MARKETS**
  - **Regional credit indices were lower overnight, with spreads in the US investment grade universe increasing +3 points (two-week high) to +130 bpts,** which lowered the recovery rate one notch to 89%. Overnight, there were capital losses in all 11 sub-sectors for the first time in the past 9 session, but they weren't particularly egregious with the largest being in subordinated financials (+5 points, +165 bpts, 87%), and energy (+4 points, +187 bpts, 92%) which responded poorly to a lower crude price. In the high yield space, spreads increased +19 points to +536 bpts (highest since end-July), which lowered the recovery rate two notches to 84%. There were higher risk premiums in all sub-sectors and double-digit spread declines in ten of the 11, with losses led by healthcare (+27 points, +514 bpts, 75%) and cyclical sectors including energy (+22 points, +830 bpts, 96%) and consumer discretionary (+22 points, +508 bpts, 74%).



- **European credit markets were mixed** with spreads in the investment grade universe declining -1 point to +55 bpts, which increased the recovery rate one notch to 89%. Ten of the 11 subsectors recorded capital gains, but these were all minor with none was more than -2.5 basis points. In contrast, spreads in the high yield space, increased by +13 points (14-week high) to +396 bpts (highest since end-August) which lowered the recovery rate two notches to 80%. There were spread increases in all 11 sub-sectors and double digit increases in seven led by consumer staples (+28 points, +528 bpts, 88%) and a raft of cyclical sectors such as IT (+17 points, +353 bpts, 63%) and consumer discretionary (+17 points, +436 bpts, 86%).



THE GLOBAL ECONOMY

- There were no releases, major or minor, overnight.

POLICY

- There were no major policy announcements overnight.

VIRUS UPDATE

- The number of global cases of COVID-19 is 31.2 million with another +252.6k cases so far (but Brazil, Mexico, Colombia, Pakistan and 5 US states have not reported their numbers) which means that Monday was the 65th consecutive day where daily increases are greater than 200k. At present, 10 countries have more than 500k cases, 22 countries have more than 200k cases and 35 countries have more than 100k cases (the Netherlands 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, 4 days, 4 days, 4 days, 4 days, 4 days, 4 days, 4 days, 4 days, 3 days and 4 days. More importantly, the growth rate of daily confirmed cases (+0.9% since Friday) is steady. Meanwhile, deaths stand at 962.3k and the death rate was steady at 3.09% although the number of daily deaths remains elevated.

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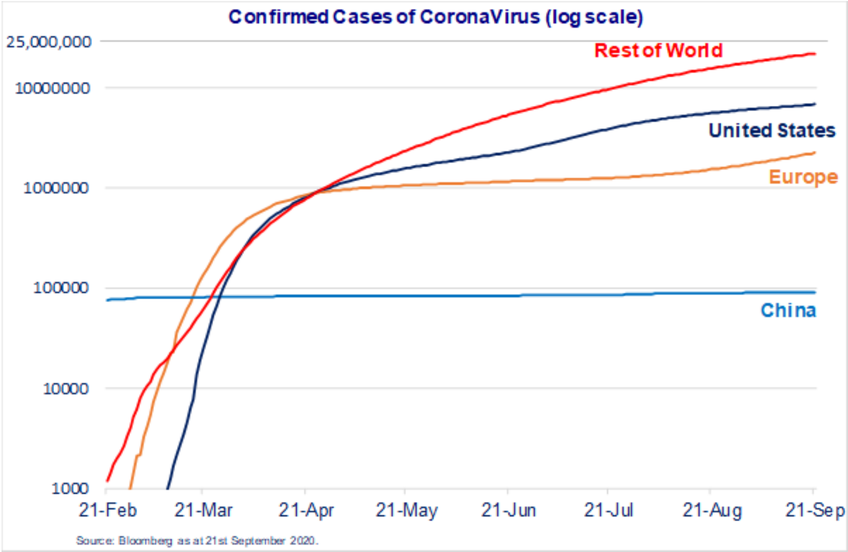
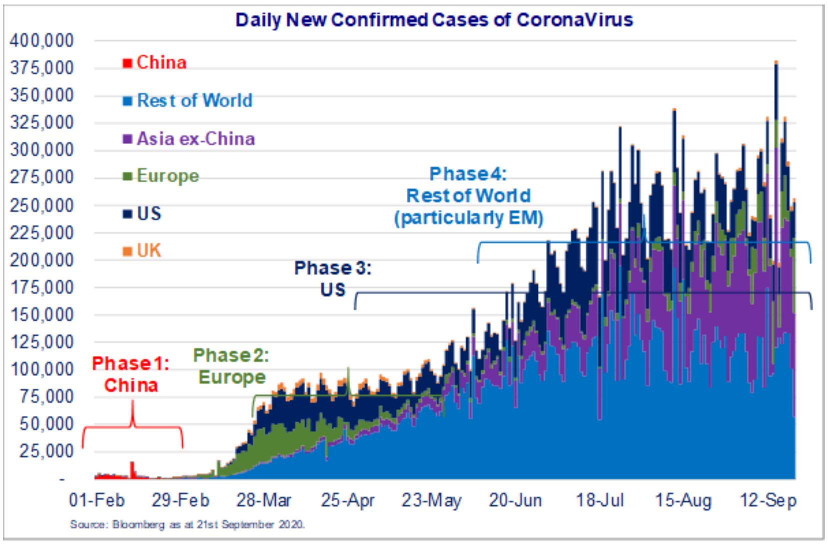
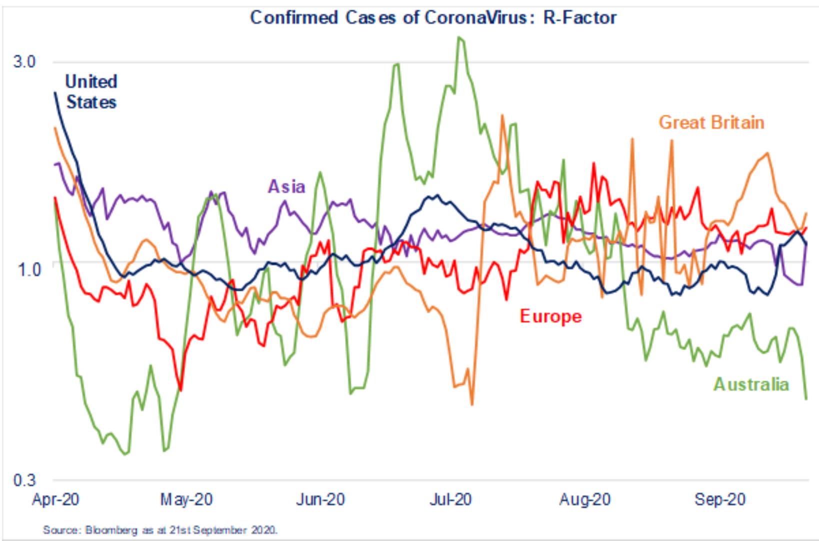


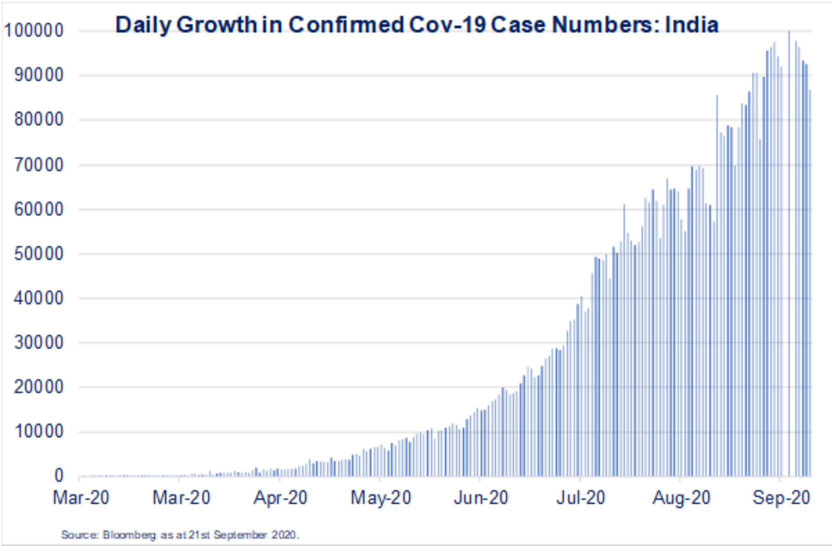
- We break the infections into four groups – the US, Europe, China and 'others' and the rest of the world outside the G3 economies now has the most total cases (+151.5k to 28.5 million) and highest daily new cases (and by a considerable margin) followed by the US (+32.0k to 6.83 million, although 5 states 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 (+69.2k to 2.25 million - see chart) which is the only region other than the US, with an R-factor above 1.0 which indicates that the infection rate (1.21 is too high, especially in Britain (1.31).

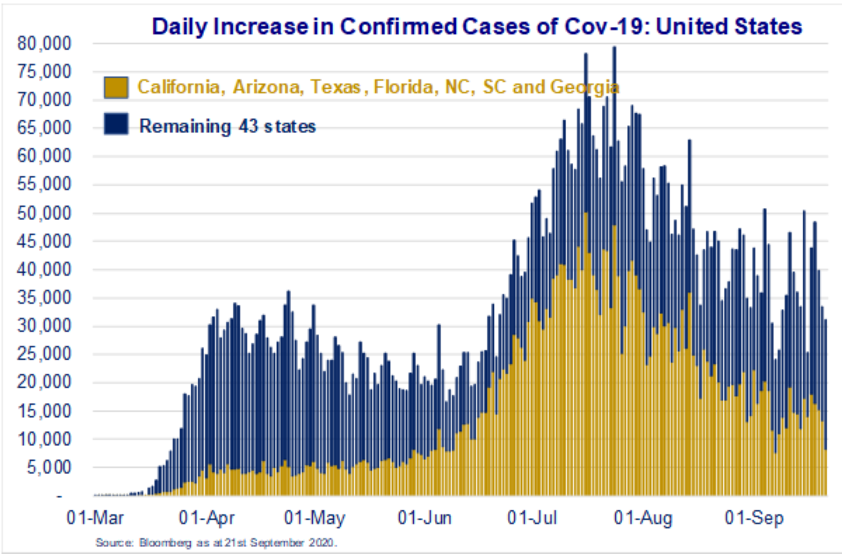




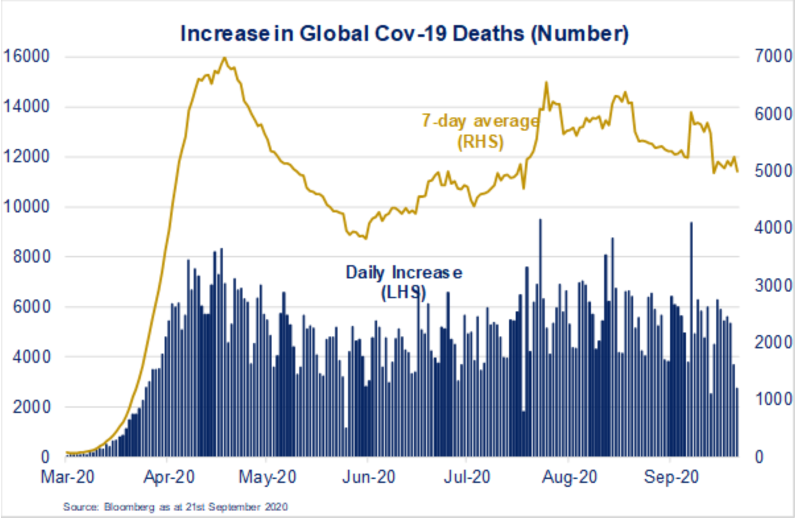
- Among countries, the most cases are in the US (+32.0k (so far) to 6.83 million, with 5 states yet to report), India (+87.0k to 5.49 million), Brazil (not reported, 4.54 million), Russia (+6.1k to 1.11 million), Peru (+6.0k to 768.9k), Colombia (not reported, 765.1k), Mexico (not reported, +697.7k), South Africa (+0.7k to 661.9k), Spain (+31.4k to 671.5k) and Argentina (not reported, 631.4k). Australia confirmed cases rose +14 (7-week low) to 26.9k yesterday which placed us 71st in terms of total infections.

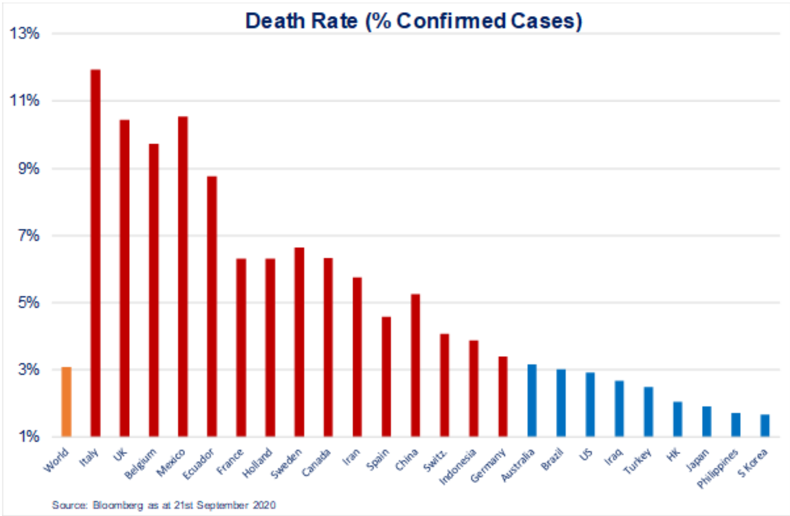
  Elsewhere, Singapore recorded +30 new cases to 57.6k most of which are linked to foreign workers who are forced to live in crowded dormitories, but Indonesia (+4.2k (record high) to 248.9k) is now on the rise and has the second most cases in the region behind only the Philippines (+3.4k to 290.2k).





- Although final numbers are not in until 1pm AEST, the global death rate declined to 3.09% with the global total to 962.3k after another +2.7k deaths overnight, so far, which indicates the daily average deaths is stabilising again (see chart). The US (+0.3k so far) has the most deaths at +199.8k, with Brazil (not reported, 136.9k), India (+1.1k to 87.9k), Mexico (not reported, 73.5k), the UK (+11 to 41.9k), Italy (+17 to 35.7k) and France (89 to 31.4k) all over +30k. The death rate is highest in European countries where the health systems had collapsed led by Italy (-0.1% to 11.9%), the UK (-0.5% to 10.4%), Belgium (-0.1% to 9.7%), France (-0.6% to 6.3%), the Netherlands (-0.1% to 6.3%), Sweden (steady at 6.7%) and Spain (-0.2% to 4.6%). However, several emerging markets are now on the leader board including Mexico (+0.1% to 10.5%), Ecuador (-0.2% to 8.8%), Indonesia (steady at 3.9%) and Brazil (steady at 3.0%).





Yours sincerely,

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MORE INFORMATION

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