

THOUGHTS ON THE MARKET

23rd April 2020



SUMMARY

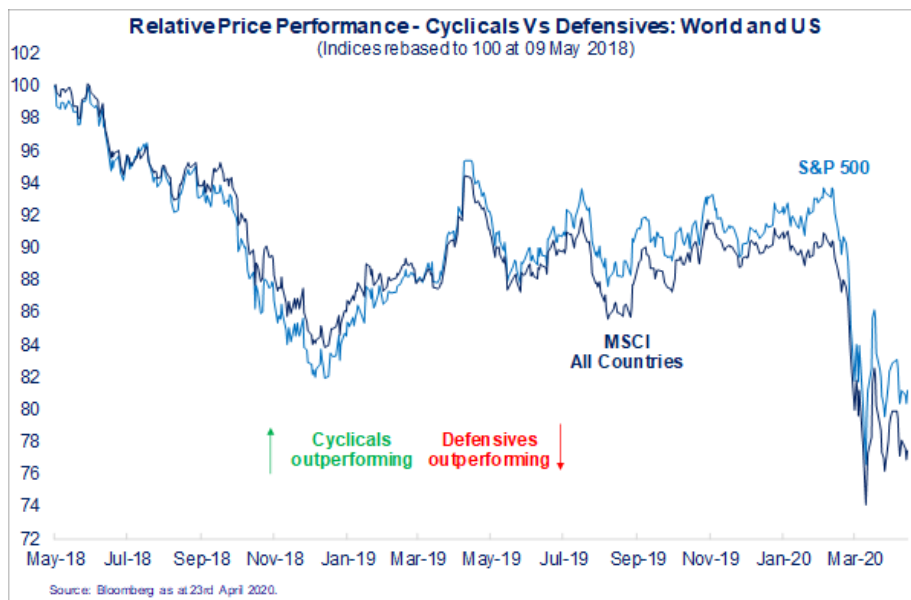
- In markets overnight, global stocks halted their two-day slide (MSCI World Index +1.9%), Treasuries saw 10-year yield increase 5 bpts to 0.61% with curve steepening (+5 bpts to 0.53%), gold rose +0.5% to USD1714 per ounce, and the US dollar was firmer against the Euro but little changed against the Yen.
- The main news overnight was oil prices (+41% to USD14.28 per barrel) rising off the canvas which combined with optimism about economic re-opening to facilitate investors pushing risk prices higher. However, at a time when various countries are taking some steps to end closures, one needs to be realistic that many sectors will either remain shut or will have to operate at activity levels far below any semblance of normality. Accordingly, the loss of output is likely to continue to accumulate through 2020 and it's not like reopening means returning to pre-2020 growth dynamics as a lot will change in household and corporate behaviour.
- There wasn't much of note on the data or policy front overnight, but the US Treasury Secretary stated overnight that he anticipates that most of the US economy will restart by August and we would argue that until we see the re-opening and its shape, volatility will remain the name of the game, which suggests risk management needs to remain at the forefront of investors' minds. To us, the trends in oil prices are endemic of a global economy with a deeper downturn ahead than is suggested by a 28% rise in the S&P 500 in the past three weeks. While there will be light at the end of the tunnel the global economy is not returning to the same growth dynamics as before especially in the absence of a COVID-19 vaccine.
- The number of global cases of COVID-19 stands at 2.629 million with another 69.4k cases overnight. It took 73 days to record 1 million confirmed cases, 12 days for the next million and in the past 8 days it has grown another 630k. That said, the growth rate of daily confirmed cases continues to decline (+3.0% since Monday). Meanwhile, deaths rose +5,191 to 183.0k and the death rate rose to 6.90% (final numbers are not yet in).

FINANCIAL MARKETS

• EQUITIES

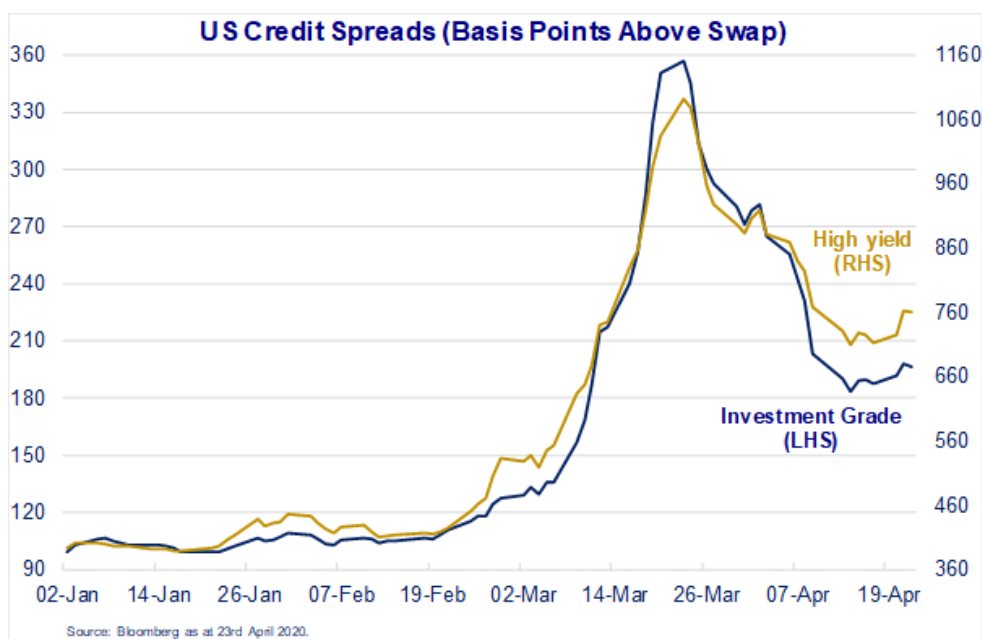
- The MSCI World Index rose +1.9% overnight. Among the regions, index rises were led by the US (+2.3% which lifted the recovery rate to 49%) with gains led by IT (+3.9%), energy (+3.6%), utilities (+3.0%) and telcos (+2.4%). This continued the trend of defensive sectors outperforming in the sell-off and holding onto most of their relative outperformance in the recovery (see chart below) – a trend also evident in the MSCI World Index. Meanwhile, European shares rose +1.6% (recovery rate of 30.4%) underpinned by a surge in energy stocks (+5.3%) with IT (+2.4%) and materials (+2.2%) also performing strongly. Earlier in Asian trade indices defied the weak US lead with Japan (-0.7%) closing well off its daily trough, Australia flat with gains in both Hong Kong (+0.4%) and China (+0.8%).

Futures markets are pointing to a solid gain at the opening bell for both Australia (+0.9%) and Tokyo (+1.3%).

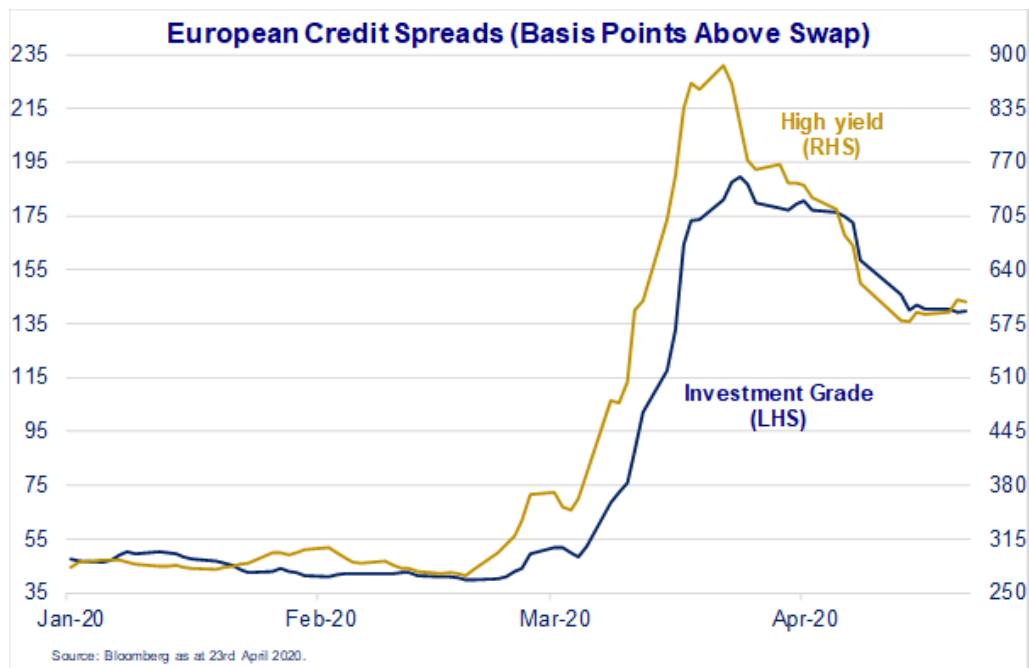


• CREDIT

- US credit spreads changed little overnight despite the rally in equity markets with spreads fairly flat after two days of widening. In the investment grade universe spreads came in 1 point to +197 bpts which kept the recovery rate at 63% from the March peak. Spreads fell in all sectors, but the movements were limited to one or two basis points with energy flat despite a rise in the price of crude (+41% to USD14.40 per barrel). The US high yield universe was also subdued with spreads coming in -2 points to +761 bpts, which lifted the recovery rate one notch to 49% (see chart). Among the sectors, energy came in (-19 points to +1516 bpts, 52%) but remains well above its recent trough and spreads in subordinated financials also widened (+7 points to 522 bps, 39%) as did industrials (+11 points to 805 bpts, 33%).

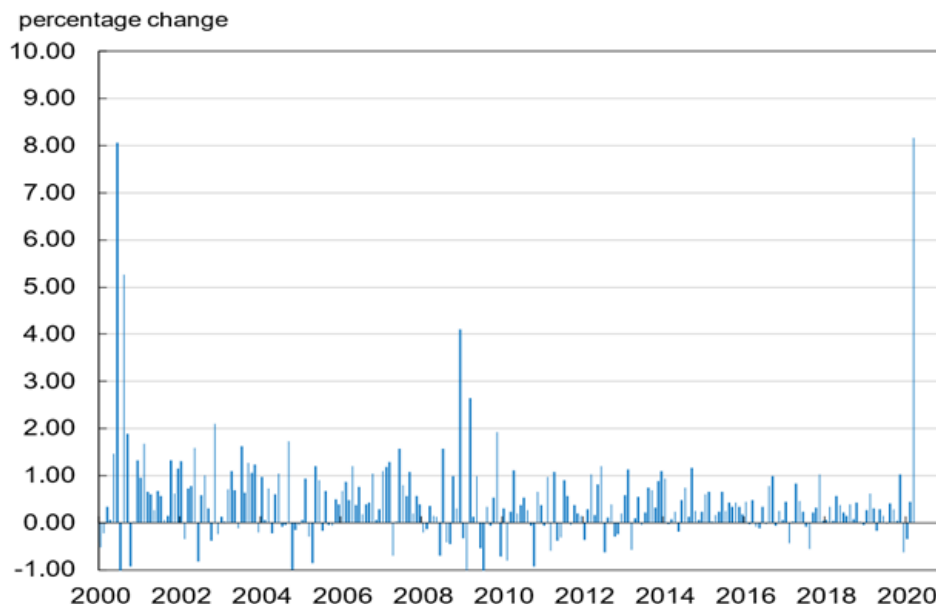


- European credit markets were also quiet with spreads little moved. In the investment grade universe spreads were flat (+0.3 points to +140 bpts, 33%) with increases in seven of the sub-sectors although the largest was +2 points (in healthcare) with energy (+0.6 points to +138 bpts, 19%) also widening. In the high-yield universe action was just as scant with spreads coming in -2 points (to +602 bpts, 46%) led by energy (-15 points to +773 bpts, 49%) but there wasn't much else as three sectors recorded wider spreads but even there the increases were a couple of basis points at most.



THE GLOBAL ECONOMY

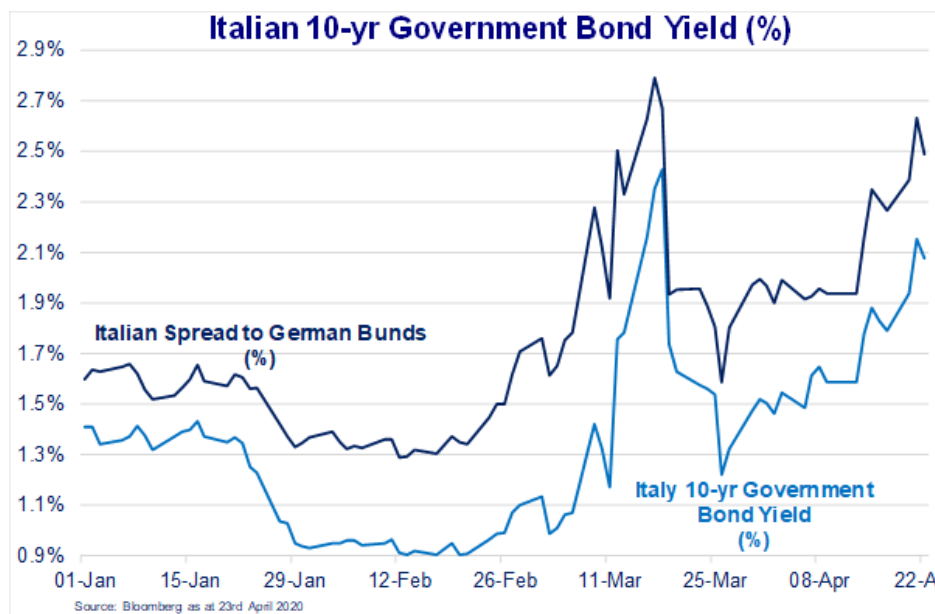
- There was no major economic release overnight. However, Australia retail sales rose +8.2% m/m in March, which is the largest monthly on record (see chart) which was underpinned by widespread 'panic buying' at supermarkets and this helped the annual rate rise to +9.8% y/y (32-year high). The ABS did not provide a sector-level breakdown of the data, but noted that spending across supermarkets, liquor retailing and other specialised food underpinned the rise and outweighed "strong falls" in cafes, restaurants, takeaway food services and clothing. While a strong number, the retail sales survey only covers around 30% of total household consumption and is skewed to food sales to the detriment of components which are likely to be severely impacted by closure such as hotels, recreation, transport, private health and motor vehicle sales. Although the March data implies a smaller decline to Q1 GDP, a circa -20% decline in aggregate hours worked, will see wages and real consumer spending decline around -14%, thereby dragging -7.5 percentage points from Q2 GDP growth.



POLICY

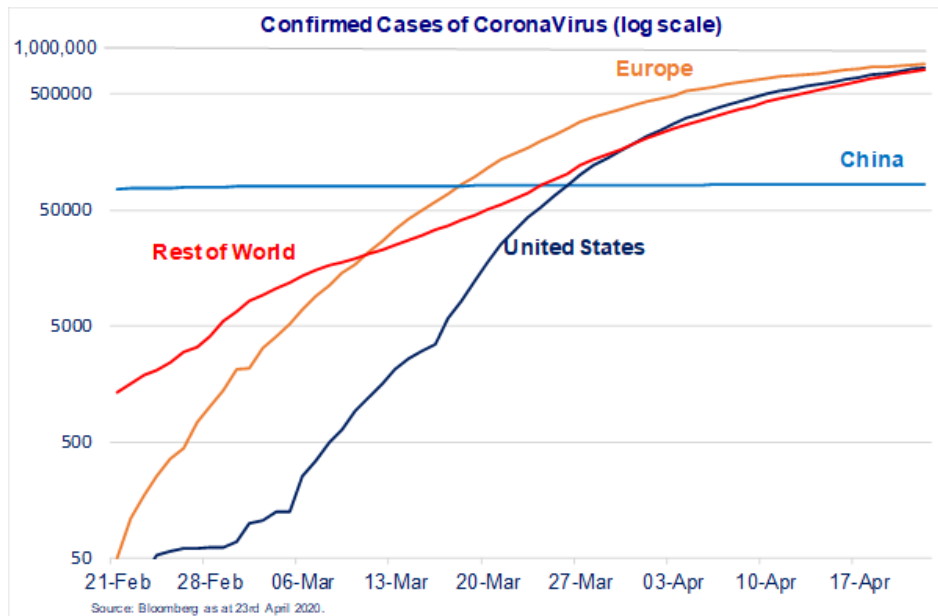
- There was no major policy announcement overnight. Nevertheless, rising borrowing costs for Italy (and other periphery economies) indicate that the ECB may be challenged to prevent a new debt crisis despite a €750 billion bond-buying plan implemented in March. This saw a quick unwinding of the rise in Italian yields and their discount to German bonds, but this has now been mostly wiped out (see chart). Italy is an economy which is being hit on all fronts – it is a very weak economy, with poor demographics, a fractious political system, a high debt load and the third highest number of COVID-19 cases in the world.

Some Eurozone politicians have discussed the issuance of jointly-backed “corona bonds” to share the financial burden of tackling the virus, but little progress has been achieved and this is seeing investors very quickly lose faith about Italian risk premiums. The ECB asset purchase program is small relative to other central banks and may have to double or triple in size to prevent a sharp tightening in financial conditions. This risk is timely as firstly, Germany, France, Italy, Spain and the Netherlands are expected to issue more than €1 trillion of bonds in 2020 (which leaves less room to support larger issuance of Italian and other periphery debt) and secondly, Italy’s credit rating which is two notches above ‘junk’ is set to be reviewed by Standard and Poor’s on Friday.



VIRUS UPDATE

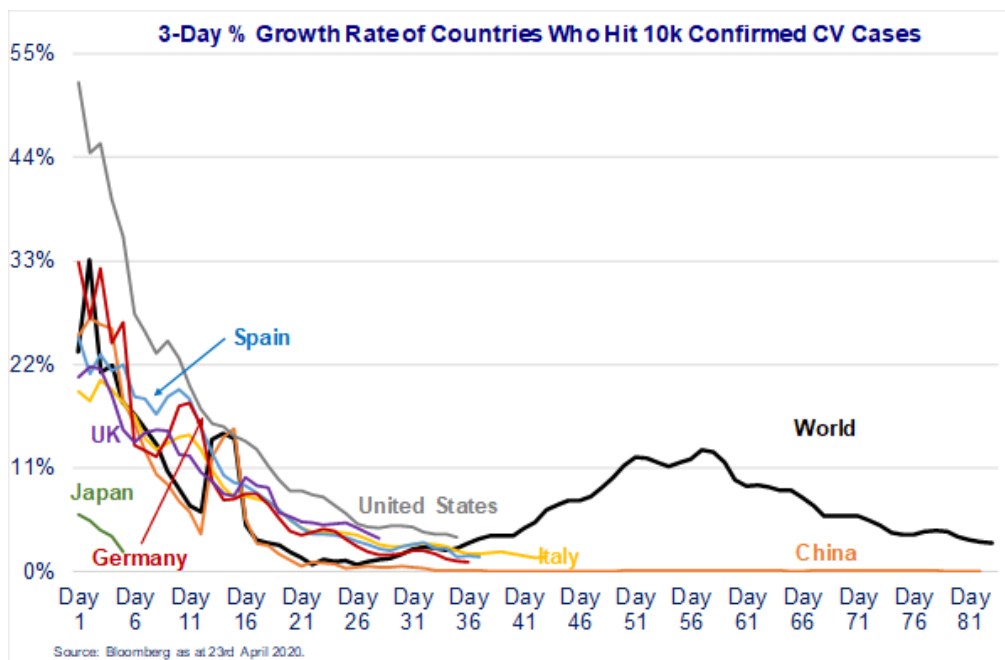
- The number of global cases of COVID-19 stands at 2.623 million with another 63.8k cases overnight with smaller rises in both the US (+21.9k) and Europe (+15.4k), suggesting moderation in large advanced economies, but EMs such as Turkey, Brazil and Mexico are still rising notably. The overnight increase means 6 countries now have more than 100k cases, 18 over 20k cases and 30 over 10k. It took 73 days to record 1 million cases, 12 days for the next million and in the past 8 days it has grown another 630k. That said, the growth rate of daily confirmed cases continues to decline (+3.0% since Monday). Meanwhile, deaths rose +5,191 to 182.9k but the death rate rose to 6.90% (although final numbers are not yet in).



- Europe (+15.4k to 903.8k) continues to lead the world in terms of total cases but its daily increase (number, not percentage) is trending lower (third lowest in the past 36 days) which shows that social isolation works to reduce the spread of the virus, even though it comes at an enormous economic cost.

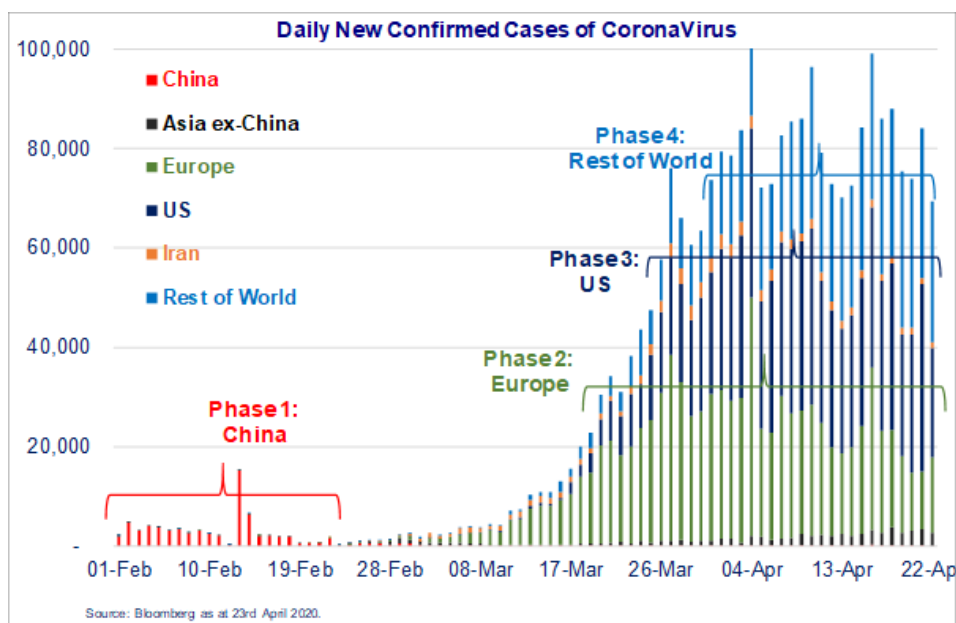
Similarly, the US had its lowest daily increase of new confirmed cases in 27 days (+21.9k to 847.0k) and its 3-day compound growth rate has declined to +3.7% 35 days after they reached 10,000 cases. That said, New York cases rose +4.8k (+2.0% over the past three days) but it continues to underperform the national average for new cases, although the death rate is much higher (7.4% against 3.4%) with another +299 deaths in the city that never sleeps (20-day low) to 19.4k.

Elsewhere, Singapore recorded a sharp increase in cases (+1,016 to 10.7k) 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 (+283 to 7.4k) and the Philippines (+110 to 6.7k).

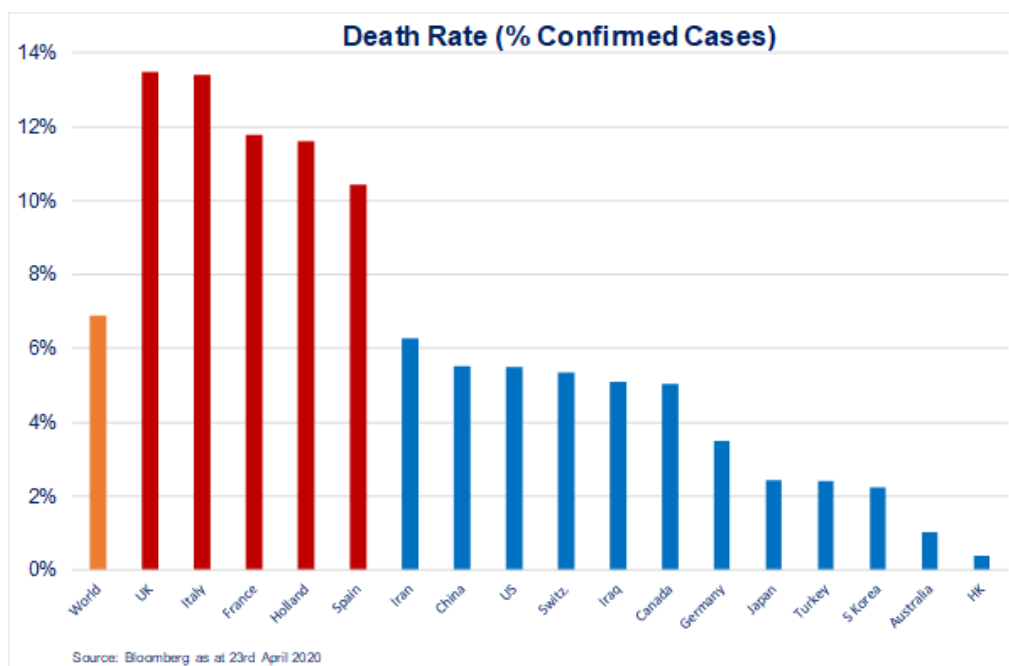


- Among countries, the most cases are in the US (+21.9k (27-day low) to 847.0k), Spain (+4.2k (4-day high) to 208.4k), Italy (+3.4k (4-day high) to 187.3k), France (+2.6k (4-day high) to 157.1k), Germany (+1.6k (3-day high) to 150.1k), the

United Kingdom (+4.5k to 134.6k), Turkey (+3.1k (18-day low) to 98.7k), Iran (+1.2k (31-day low) to 86.0k) and China (+4 to 83.9k). Australia confirmed cases rose to 6,619 which placed us 43rd in terms of total infections.



- The global death rate rose to +6.90% (its 39th rise in the past 40 days) with another +5.4k fatalities overnight bringing the global total to 183.0k. The death rate is highest in European countries where the health systems have collapsed led by Italy (+0.1% at 13.4%), the UK (+0.4% to 13.5%), France (+0.4% to 11.8%), the Netherlands (+0.4% to 11.6%), and Spain (steady at 10.4%).



Yours sincerely,



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