Perpetual Investments

THOUGHTS ON THE MARKET

23rd June 2020 - Equity markets rise as COVID-19 surges through 9 million cases

SUMMARY

- Global risk markets were mixed overnight with a modest US-driven gain in equities and a minor selloff in credit. There was a distinct absence of fresh data with the economic calendar empty and central banks and other policy makers very quiet as all participants waited around to see the latest numbers of COVID-19 case numbers.

  In other markets, 10-year Treasuries rose +2 points to 0.71% with curve steepening (German 30-year yields traded below 0% for the first time since May) and commodity prices rose with gold up +0.6% to USD1,754 per troy ounce (closing in on a fresh 8-year high) and oil rallied +1.8% to USD40.46 per barrel (4-month high). Meanwhile, G10 currencies were mostly higher against a weaker Greenback led by AUD (+1.1%), Sterling (+0.9%) and Euro (+0.8%) but the Yen was unchanged.

- At present, the market thematic are well established with the bulls saying there is a solid floor under the market underpinned by economic reopening, continued policy support for markets and the economy, a belief that politicians won't re-introduce draconian lockdowns even of COVID-19 cases continue to rise, and that positive economic growth will help corporates recover lost earnings. In contrast, the bears say that the market upside is capped by valuations being at a near-two decade high, the V-shaped recovery being undeliverable with all the uncertainty, a second wave of COVID-19 may not lead to lockdowns but it will notably lessen the private sector recovery which is needed as governments become net drags on growth in FY21, and corporates have not dealt with the balance sheet issues.

  The US sharemarket recovery from its 23rd March trough has been highly similar to that seen in 2009 with a 40% rally recorded in the first three months on both occasions. The challenge for investors is that returns have been pulled forward through valuation expansion given central bank asset purchase programs - today the S&P 500 is trading at a 12-month forward multiple of 22.2x in 2020 which is a 19-year high, against +13.9x in 2009 which was close to a 15-year low. Elsewhere, interest rates are at zero and large central bank balance sheets are already in place. Add to that the recovery in 2020 after the September 2020 growth surge that is coming, is looking weaker than it did in 2009.

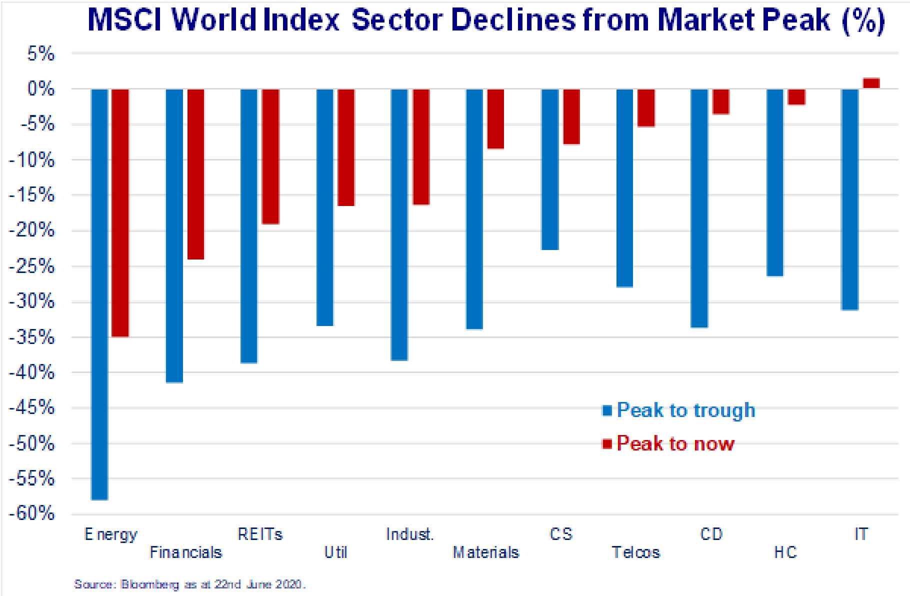
- The number of global cases of COVID-19 was 9.1 million with another +127.8k cases so far overnight (before Mexico, France, Pakistan and some US states report their numbers) which means that Monday was the 25th occasion in the past 27 days where daily increases have topped 100k (and the other two were over 99k!). This means 3 countries have more than 500k cases, 10 countries have more than 200k cases Iran joined this list on Sunday) and 19 countries have more than 100k cases (South Africa joined this joined overnight). 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, ten for the fifth million, 11 for the six million and 8 days for the seventh and eighth million, and a record low of seven days for the ninth million. More importantly, the growth rate of daily confirmed cases (+1.7% since Friday) is starting to rise (albeit modestly). Meanwhile, deaths stand at 470.7k and the death rate dropped for a forty seventh straight day to 5.20%.

FINANCIAL MARKETS

- **EQUITIES**
  - The MSCI World Index snapped a three-day losing streak and closed +0.4% overnight, but more sectors declined than rose. The advance was underpinned by tech which continued to benefit from investors angst about the state of the recovery which meant cyclical stocks lagged, whereas those exposed to the

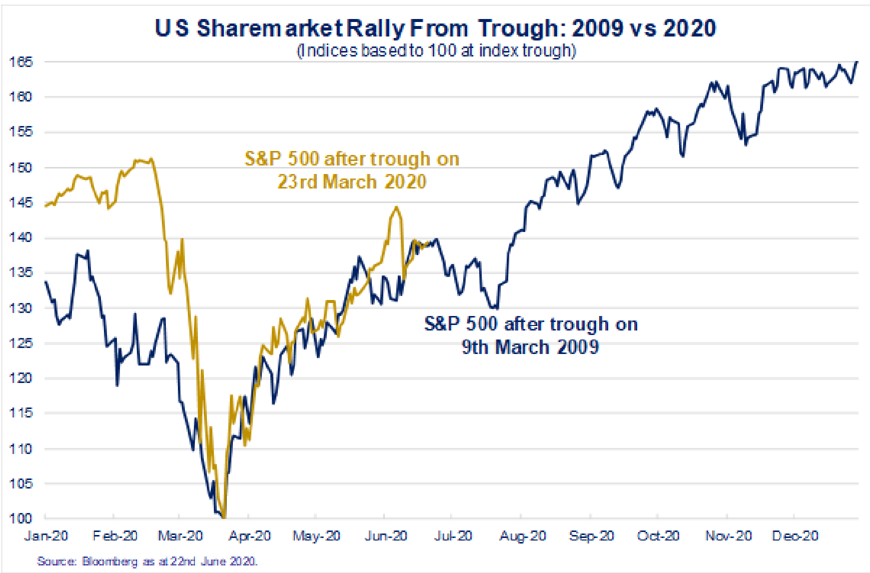
growing stay-at-home expectations led the market higher. Indeed, only five of the 11 sectors rallied and tech (+1.6%) was the standout with Amazon, Adobe and Square all ending at all-time highs. Elsewhere gains were minor and led by some of the defensives sectors including utilities (+0.5%) and consumer staples (+0.3%), but others in this universe declined including healthcare (-0.4%) and consumer staples (-0.6%) and were joined by cyclicals including industrials (-0.1%), REITs (-0.3%) and financials (-0.5%).

The overnight movements took energy (with a peak-to-now decline of -35.0%), financials (-24.0%) deeper into bear market territory, with REITs (-19.0%) and utilities (-16.5%) and industrials (-16.4%) knocking on the door (see chart). In contrast, tech has now recovered all its February/March losses.



- Among the regions, advances were limited to the US (+0.7%) and Canada (+0.3%). In the US the rises were led by the Russell 2000 (+1.1%) and NASDAQ (+1.1%) the latter of which rallied for a seventh straight session which is its longest win streak for 2020. Conversely, the S&P 500 (+0.7%) and Dow Jones (+154 points, +0.6% to 26,025) lagged given their smaller tech exposure. However, overall, there were few directional drivers overnight and no material change to the market narrative.

  That said, the US sharemarket recovery from its 23rd March trough appears highly similar to that seen after the trough in 2009 with a 40% rally recorded in the first three months on both occasions (see chart). The challenge here for investors is what can underpinned a further market leg up from here as governments will become large net drags on the economy in FY21 (-2.8% of GDP), returns have been pulled forward through valuation expansion given central bank asset purchase programs (22.2x in 2020 which is a 19-year high, against +13.9x in 2009 which was close to a 15-year low), interest rates are at zero and large central bank balance sheets are already in place.

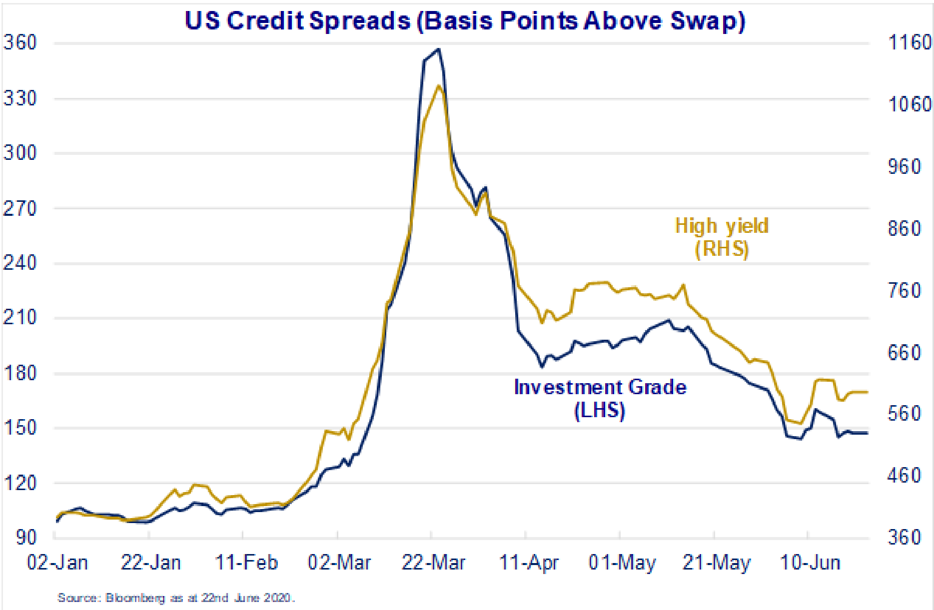


- Meanwhile, Europe slumped -0.7% with German payment processor and financial services provider Wirecard AG plunging -44% after more than €2 billion of assets went missing. Notwithstanding this lead weight, Germany (-0.5%) recorded a smaller decline than its peers including France (-0.6%), Italy (-0.7%), UK (-0.8%), Spain (-0.9%) Portugal (-1.0%) and Switzerland (-1.1%). Earlier, the MSCI Asia Pacific index closed -0.1% lower but most markets seemingly marked time given the lack of top tier economic data and despite a negative lead from Wall Street on Friday night. Among the countries, China (+0.1%) outperformed, Australia (+0.0%) broke even, Japan eased back (-0.2%) and Hong Kong (-0.5%) and Korea (-0.8%) recorded losses in line with the US on Friday night.

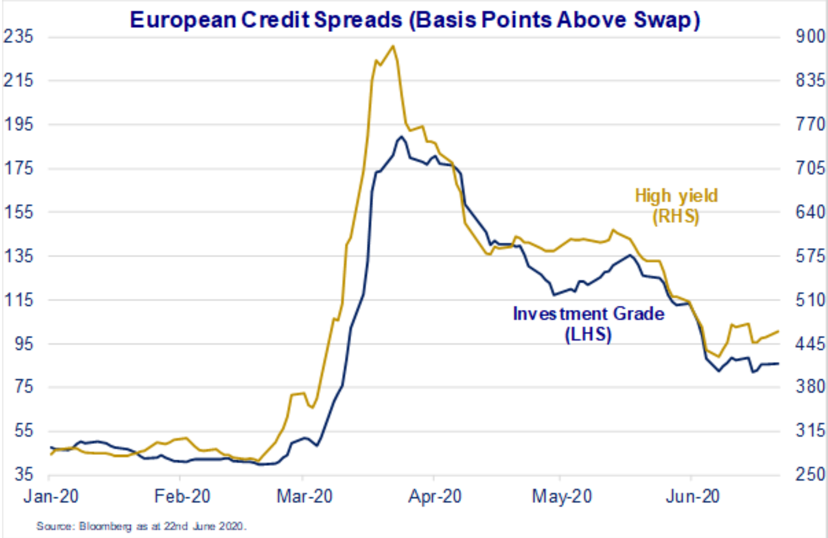
  The overnight movements meant that UK (-18.1%), Australia (-16.5%) and Europe (-15.4%) remain close to bear market territory, whereas the US (-8.5%) and UK (-6.7%) are grinding back towards their February peaks. Futures markets suggest a positive opening in Asian trade today with gains expected at the bell in Australia (+0.6%), Hong Kong (+0.8%) and Japan (+1.1%).

• CREDIT MARKETS

- Regional credit indices were slightly lower overnight. In the US investment grade universe, spreads were unchanged (+0.1 point) at 148 bpts with the recovery rate at 82%. Seven of the 11 sub-sectors recorded spread widening, but the largest were consumer staples (+0.7 of a point, +136 bpts, 86%) and tech (+0.6 points, +121 bpts, 82%) in a fairly uneventful day for investors. Similarly, the high yield universe was quiet with spreads increasing only +1 point to +597 bpts, which kept he recovery rate at 73%. There was slightly more action at the sub-sector level where 8 sectors recorded higher spreads led by utilities (+7 points, +503 bpts, 60%) industrials (+6 points, +710 bpts, 47%) and healthcare (+5 points, +537 bps, 71%), with only consumer staples (-4 points, +458 bpts, 100%) recording a noteworthy spread contraction which meant it has now completely recovered its February/March losses.



- European credit markets were also fairly quiet with spreads in the investment grade universe unchanged at +86 bpts with the recovery rate idle at 69%. Eight of the 11 sub-sectors recorded increases in their respective risk premia, but the movements were low with only consumer discretionary (+3 points, +118 bpts, 70%) of note. In the high yield universe, spreads increased for a third consecutive session, this time by +8 points to +463 bpts which lowered the recovery rate one notch to 69%. Nine of the 11 subsectors recorded wider spreads led by industrials (+13 points, +577 bpts, 67%), telcos (+12 points, +367 bpts, 67%) and consumer discretionary (+10 points, +564 bpts, 71%). In contrast, senior financials (-10 points, +400 bpts, 68%) rallied in a day when its subordinated peer (+8 points, +495 bpts, 66%) was sold down as investors seemingly sought to de-risked their portfolio.



THE GLOBAL ECONOMY

- There were no economic data releases overnight.

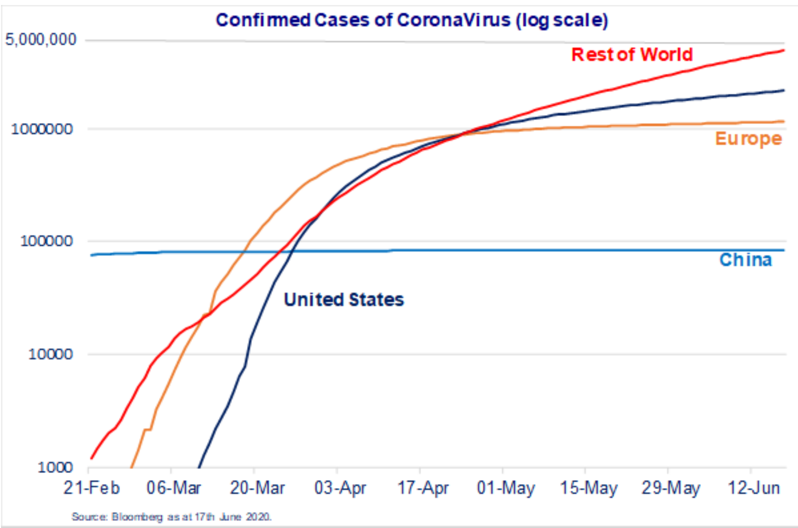
POLICY

- There was no major policy announcement overnight.

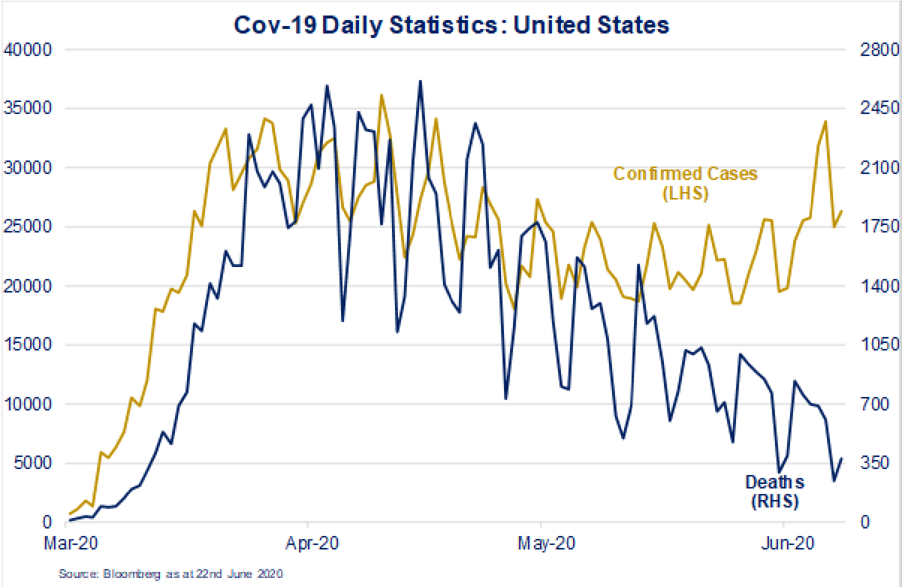
VIRUS UPDATE

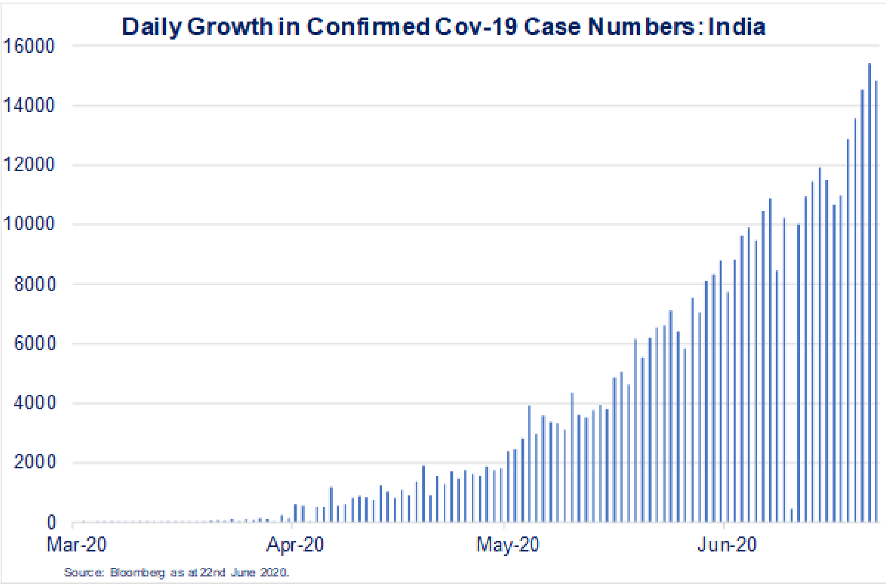
- Although final numbers are not in for another 5.5 hours, the number of global cases of COVID-19 was 9.1 million with another +127.8k cases so far overnight (before Mexico, France, Pakistan and some US states report their numbers) which means that Monday was the 25th occasion in the past 27 days where daily increases have topped 100k (and the other two were over 99k!). This means 3 countries have more than 500k cases, 10 countries have more than 200k cases Iran joined this list on Sunday) and 19 countries have more than 100k cases (South Africa joined this group overnight).

  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, ten for the fifth million, 11 for the six million and 8 days for the seventh and eighth million, and a record low 7 days for the ninth million. More importantly, the growth rate of daily confirmed cases (+1.7% since Friday) is starting to rise (albeit modestly). Meanwhile, deaths stand at 470.7k, with the US now over 120k (25.6% of global deaths even though they have only 4% of the global population), Brazil, the UK and Italy and over 30k, with Spain and France over 25k, and the death rate dropped for a forty seventh straight day to 5.20%.



- 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 (+80k to 5.5 million) and highest daily new cases (and by a considerable margin) followed by the US (+26.4k to 2.31million) and Europe (+4.4k to 1.16 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 (see chart). Within the rest of the world, the three concerns here are Brazil (+21.2k, +1.10 million, which is the second highest in the world), Russia (+7.6k to 591.5k, third highest) and India (+14.8k to 425.3k, fourth highest – see charts below).

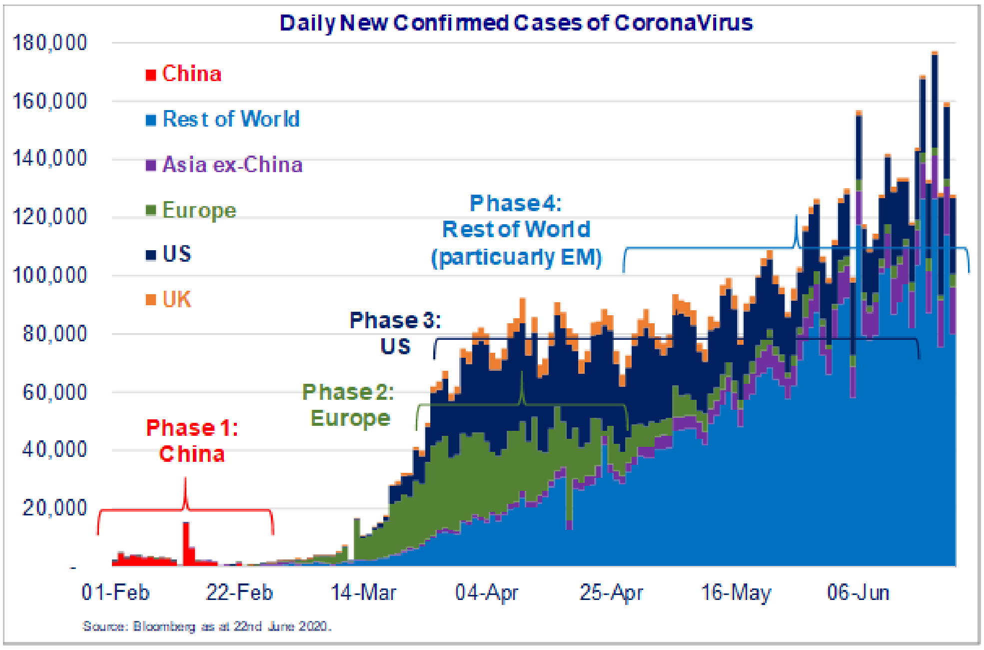




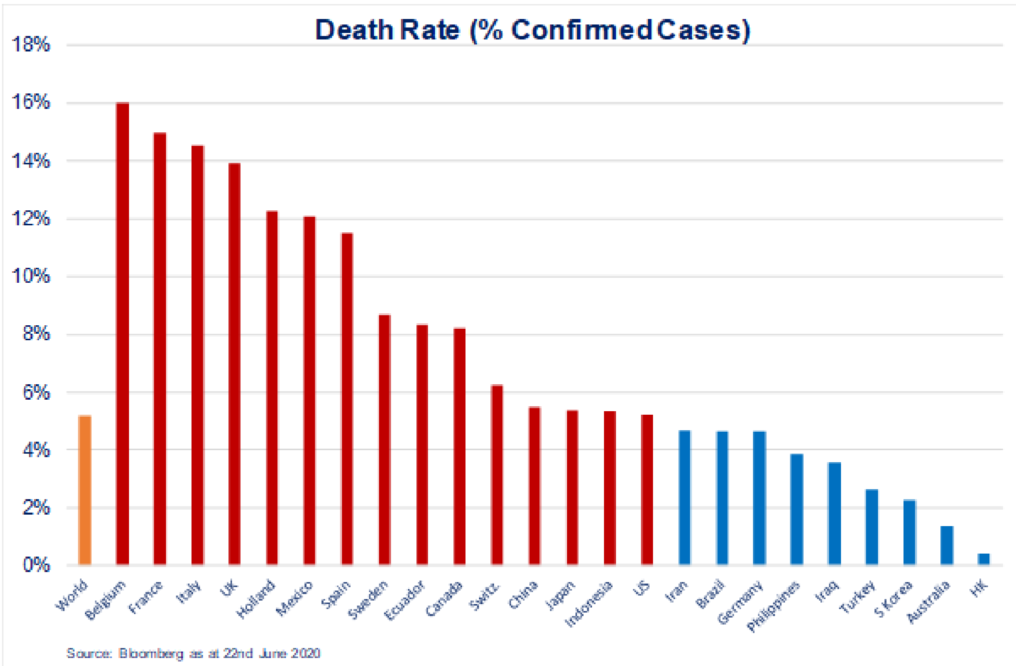
- Among countries, the most cases are in the US (+26.4k (so far) to 2.31 million), Brazil (+21.2k to 1.10 million), Russia (+7.6k to 591.5k), India (+14.8k to 425.3k), the United Kingdom (+1.0k to 306.8k), Peru (+6.1k (second highest) to +257.4k), Chile (+4.6k to 247.0k), Spain (+0.2k to 246.5k), Italy (+0.2k to 238.7k), Iran (+2.6k to 207.5k), France (not reported, 197.4k), Germany (+0.5k to 191.8k) and Turkey (+1.2k to 188.9k). Australia confirmed cases rose +13 to 7,474 yesterday which placed us 71st in terms of total infections.

  Elsewhere, Singapore recorded +0.2k new cases to 42.3k 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 (+1.0k to 46.8k) and the Philippines (+0.6k to 30.7k).

Perpetual



- Although final numbers are not in until 11am AEST, the global death rate declined for a forty seventh straight day to 5.20% with the global total to 470.7k. The US (+0.4k so far) has the most deaths at +120.4k, with Brazil (+0.6k to 51.2k), the UK (+14 to 42.7k), Italy (+0.02k to 34.7k), France (+0.02k to 29.7k) and Spain (+1 to 28.3k) all over +25k. The death rate is highest in European countries where the health systems have collapsed led by Belgium (steady at 16.0%), France (steady at 15.0%), Italy (steady at 14.5%), the UK (-0.1% to 13.9%), the Netherlands (steady at 12.3%), Spain (steady at 11.5%) and Sweden (-0.3% to 8.7%). However, several emerging markets are now on the leader board including Mexico (+0.1% to 12.1%), Ecuador (steady at 8.3%), Indonesia (-0.1% to 5.3%) and Brazil (-0.1% to 4.6%).



Yours sincerely,

MATT SHERWOOD
Head of Investment
Strategy, Multi Asset

MICHAEL O'DEA
Head of Multi Asset

MORE INFORMATION

Perpetual Investments 1800 062 725
Email investments@perpetual.com.au
www.perpetual.com.au/investments

Perpetual