

THOUGHTS ON THE MARKET

24th August 2020 - It's a stalling market recovery outside of tech

SUMMARY

- Global risk markets were mixed on Friday with modest rises and falls, as regional composition and sector tilts continued to drive absolute and relative performance. While newswire headlines continue to talk about fresh record highs, it is really just a tech story, which is supporting tech-heavy indices such as the NASDAQ, S&P500 and Taiwan indices. In contrast, other regional indices have been trading sideways for the past 50-60 sessions (circa three months) given an array of concerns about global growth, challenged index composition and renewed social mobility restrictions. In addition, governments around the world are still walking a very thin line between easing coronavirus lockdowns to revive growth and controlling any resurgence of COVID-19.

In other markets, 10-year Treasuries rallied with yields declining two points to 0.63% with curve flattening, commodities were mixed with gold bouncing (+0.5% to USD1,940 per troy ounce) but oil declined for a second straight session (-0.6% to USD42.34 per barrel), and G10 currencies were mostly lower against the Greenback led by the Euro (-0.4%), Sterling (-0.3%) and AUD (-0.1% to USC71.61), but the Yen (+0.1%) bucked the trend with its post-April appreciation trend now firmly entrenched.

- There was limited data for Friday, but what there was reinforced our recent view that the May-June rebound has continued in July and August, but at a considerably slower pace. In addition, the growth driver is changing from stimulus and pent up demand in May and June, to increased industrial production and trade growth in July and August as firms replace depleted inventories. In contrast, the services rebound is sluggish amid resurgent case numbers and mobility restrictions.

There also continue to be signs of clouds on the growth horizon, with high frequency data suggesting the US and European rebounds have flattened out in August. The latter was confirmed with the August European PMI coming off -3.4 points to 51.6 with the decline led economically by the services sector which was barely in expansion territory, and geographically by France and periphery where the virus pickup has been most severe. If sustained this could challenge our view that Europe will outperform the US in FY21. In the US, increases in the Chase Cards data are pointing to modest household spending growth in August with no sign of weakness yet from the July expiration of benefits. I would hypothesise that households are using their stimulus savings to hold spending at recent levels, but this support will be exhausted within a few months.

- The number of global cases of COVID-19 is 23.3 million with another +175k cases so far (but Brazil, Mexico, Spain and 10 US states have not reported their numbers) which means that Sunday is set to be the 36th consecutive day where daily increases are greater than 200k. At present, 9 countries have more than 500k cases, 20 countries have more than 200k cases and 29 countries have more than 100k cases (the Ukraine 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 and 4 days. More importantly, the growth rate of daily confirmed cases (+1.2% since Thursday) is once again coming down. Meanwhile, deaths stand at 806.6k and the death rate has declined to 3.46% although the number of daily deaths is on the rise.

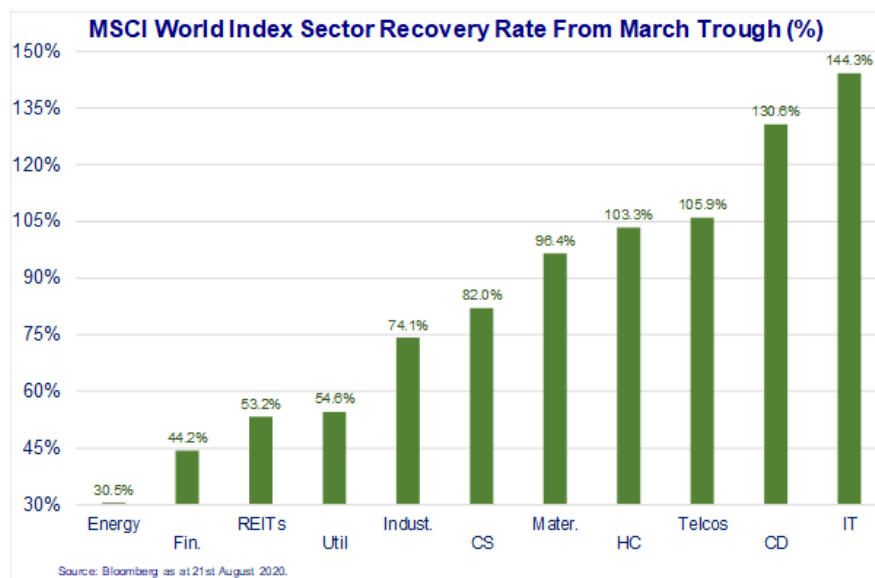
FINANCIAL MARKETS

• EQUITIES

- The MSCI World Index advanced +0.1% on Friday to close out its fourth consecutive weekly advance (+0.3% w/w). It was a very quiet session in terms of price movements within which growth and

momentum plays continued to standout while value and cyclicals came under more pressure as some signs suggested the recovery is slowing, although not to any alarming rate. Among the sectors, five advanced led by another strong performance in tech (+1.0%) as Apple rallied (+5.5%) ahead of the record date for its 4-for-1 stock split stock-split (effective tonight). Consumer discretionary (+0.5%) was also one of the better performers on the back of strong performances from home builders as US existing home sales hit a 16-year high but this was partially offset by declines in Amazon (-0.4%), department stores and autos. Meanwhile, consumer staples (+0.2%) performed in line with the market tape as discounters rallied and outweighed declines in beverages and food. In contrast, traditional cycle sectors lagged including financials (-0.2%) which recorded its sixth loss in the past seven sessions, which is a return trend matched by materials (-0.4%) despite generally higher commodity prices whereas energy (-0.6%) went one worse and declined for a seventh straight session given the lower crude price.

Accordingly, it seems fair to conclude that price movements on Friday simply continued the recent trend with sectors positively impacted by COVID-19 and stimulus continuing to outperform (see chart), whereas traditional cyclical sectors such as energy (which a peak-to-now decline of -40.3% and a recovery rate of just +30.5%) and financials (-23.2%, 44.2%) fell deeper into bear market territory, with REITs (-18.2%, +53.2%) and utilities (-15.2%, 54.6%) not too far away from that mark.



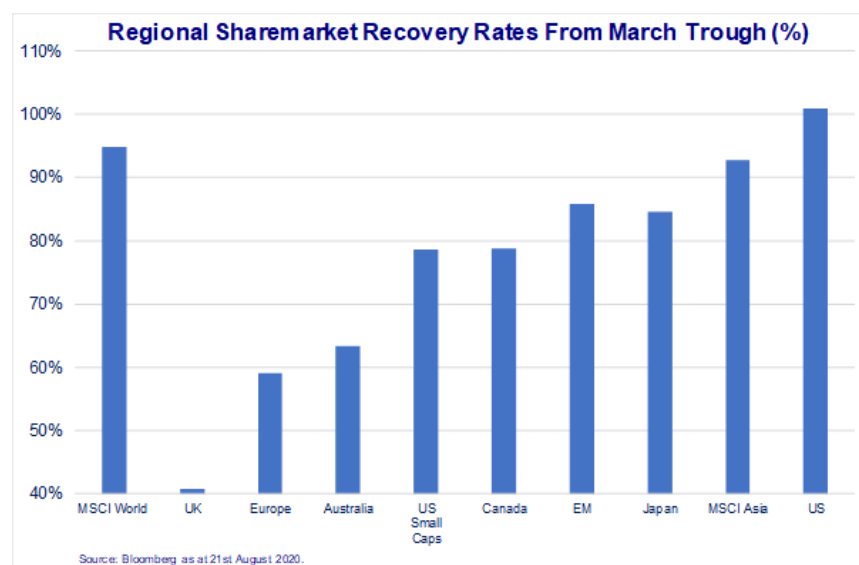
- **Among the regions. Asia (+0.8%) led the pace of gains on Friday** with the advance put down a strong tech-driven rise on Wall Street on Thursday. Markets also took heart from China noting it will soon meet with the US re the Phase 1 trade agreement and economic data was also supportive in Japan and Australia in that there was no downside surprise, even though the actual results are not suggestive of a sharp economic rebound. Meanwhile, COVID-19 cases also made headlines with a sharp increase in South Korea and Japan, but the decline seems entrenched in Australia. By the regional close Taiwan (+2.0%), South Korea (+1.3%) and Hong Kong (%) posted sharp gains, followed by moderate advances in mainland China (+0.9%) and Japan (+0.2%), with Australia (-0.1%) the only major region to decline, albeit not by much.

The US sharemarket closed out its fourth consecutive weekly advance on Friday with a modest price gain of +0.3%. There was no top tier economic data, but the second and third tier information was constructive with a better-than-expected rise in the Conference Board's Leading Economic Indicator and existing home sales posted their largest rise in 16 years, but its flow through to GDP is minimal as housing is now just 2% of US output, rather than 5% in 2007. Meanwhile, the August HIS Markit flash PMIs were solid (54.7 on the composite score which is a 6-month high) suggesting the rebound is continuing. By the closing bell, the Dow Jones (+191 points, +0.7% to +27930) led the gains, with the NASDAQ 100 (+0.4% to a fresh record high) and S&P 500 (+0.3% to a fresh record high) also posting modest gains, but the Russell 2000 (-0.8%) closed lower for a second straight day, highlighting the tech-cyclical and mega-cap-small cap differentials.

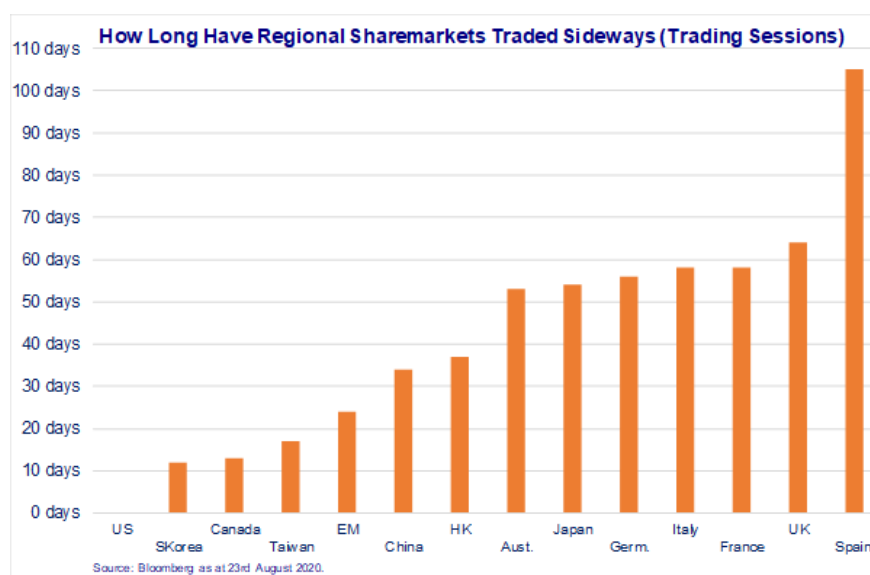
In contrast to Asia and the US, European shares closed lower (-0.4%) for the fifth occasion in the past seven sessions. The region continues to be weighed down by its index composition and its high exposure to financials and energy stocks which are lagging the gains in other sectors. Economic data was weak with

the Markit regional PMI showed the recovery losing considerable momentum with the gauge well below the street (51.6 vs 55.3 expected), driven by the services sector which barely remained in expansion territory (50.1 vs 54.5) amid increased mobility restrictions. COVID-19 also weighed on sentiment as the region recorded its largest single day increase (+29.1k) since 3rd April and its sixth worst day on record.

The overnight moves on Friday, saw the UK move deeper into bear market territory (-21.3% on a peak to trough basis, which had the market's recovery rate anaemic at just 40.5% relative to its European peers at 59.1%, and the US at 101% (see chart).

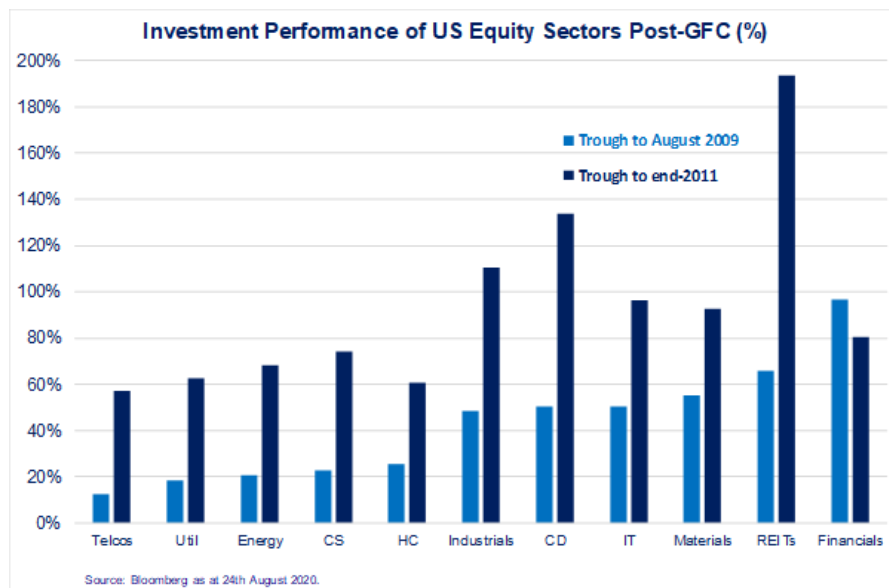


- It is clear that the tech sector, and regions which are tech-heavy in their composition – such as the S&P500, Nasdaq, Taiwan and South Korean markets, have notably outperformed their peers as the tech sector is a strong free-cashflow generator, whose output supports household and corporate adjustment and resilience to COVID-19, and which does not require foot traffic to underpin earnings recovery. These factors have seen all of these markets recover their pre-COVID-19 peaks, whereas other markets which are top-heavy in traditional cyclical sectors including energy, industrials and financials had early bounces on the back of stimulus, but have trended sideways for the past 50 to 60 trading sessions (i.e. nearly three months – see chart) and longer in the case of the UK and Spain.



The recovery in these old economy markets (and sectors) have stalled given an array of low-intensity concerns including weaker-than-expected activity data (Euro PMIs, initial jobless claims and the Philly Fed, for example), a rising virus count, talk of reduction in fiscal stimulus, and subdued central bank commentary. Interestingly, the underperformance of the cyclical sectors in the earlier stage of the expansion was also evident in the 2009-2020 cycle and it took several years for this trend to reverse

during which time the US experienced record cross-border equity inflows just like it is today. Clearly when COVID-19 fades as an economic headwind through either better treatment, a vaccine or better contact tracing, the tech and US outperformance will likely reverse but this could take a considerable period to occur.

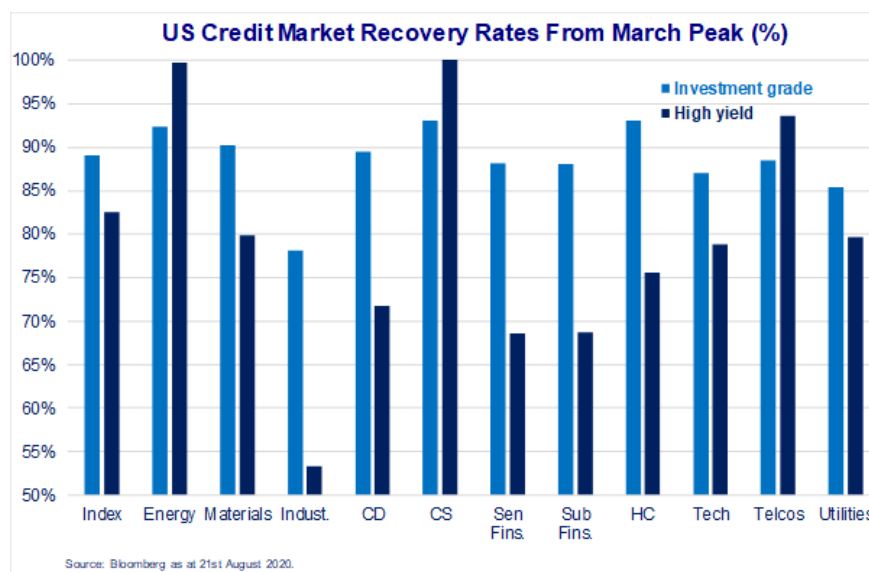


- Futures markets are pointing to a mixed opening in Asia this morning with Australia slated for losses (-0.2%), Japan flat and Hong Kong potentially rising (+0.3%).

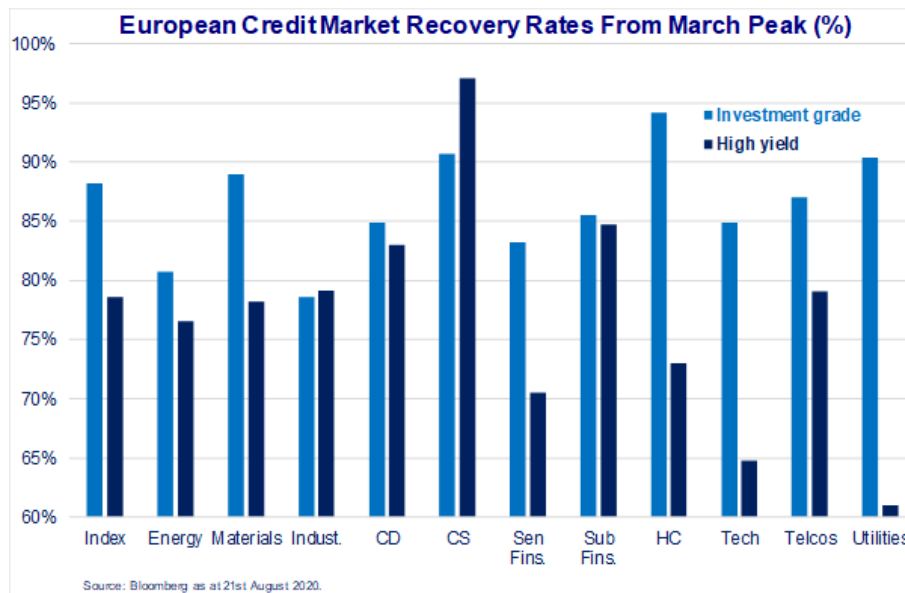
• CREDIT MARKETS

- Regional credit indices were little changed with investors seemingly not wanting to push risk premiums any lower until economic and balance sheet risks are resolved. **Spreads in the US investment grade universe were unchanged at +131 bpts which kept the recovery rate at 89% with lower spreads in eight of the 11 sub-sectors**, but no sector moved more than one basis point in what was a subdued session.

Similarly, spreads in the high yield sector increase just +2 points to +530 bpts, but the recovery rate was unchanged at 83%. There were higher spreads in 9 of the 11 sub-sectors, but again the changes in spreads were capped at +3 points in energy (+779 bpts, 100%) and communication services (+420 bpts, 94%) in a session where there was really nothing of note. Although spread movements now are very minor, some analysis indicates that whether it is in the investment grade or high yield universe, traditional cyclical sub-sectors such as industrials, financials, and consumer discretionary, and highly indebted sectors such as utilities, continue to lag market performance (see chart).



- **European credit markets were also quiet** with spreads in the investment grade universe contracting -1 point to +57 bpts, but the recovery rate was idle at 88%. Spreads declined in all 11 sub-sectors but the largest movement was healthcare (-2 points, +27 bpts, 94%) but everything else was a basis point or less. In contrast, spreads in the high-yield universe increased +1 points to +403 bpts but recovery rate was steady at 79%. There was spread increases in 8 of the 11 sub-sectors but, again, the moves were no more than a basis point. Broader analysis indicates that the underperformance of cyclical sectors which has been prevalent in the US, is less so in Europe as the regional recovery seems stronger than the US, but there are now more questions around this given increased social mobility restrictions and falling PMIs but the price reaction, so far, has been limited to equities.

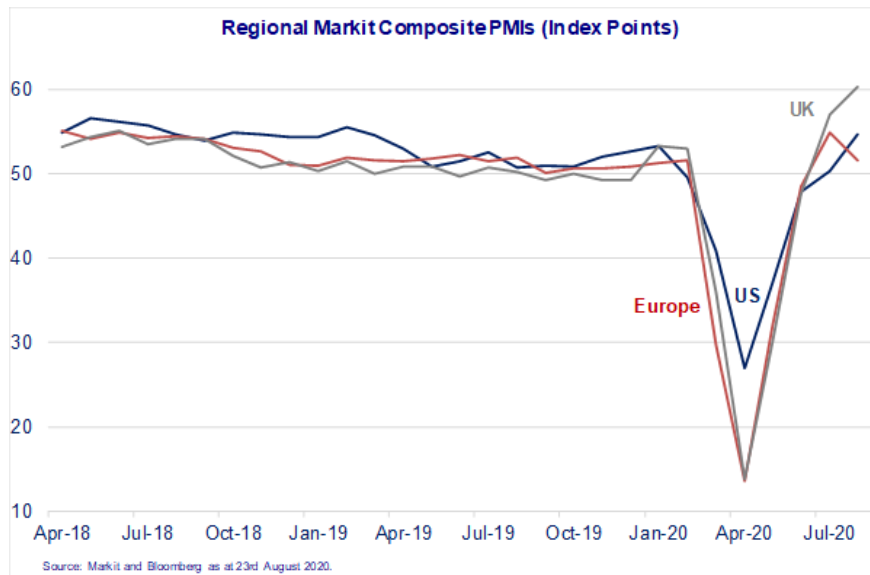


THE GLOBAL ECONOMY

- **The IHS Markit US flash PMIs for August came in above street estimates** which contrasted with declines in the Philly Fed earlier last week. The manufacturing gauge increased +2.7 points to 53.6 (the street was at 52) with improvements in new orders, output and employment, and services rose +4.8 points to 54.8 (consensus at 51.0) which is a 17-month high with higher sales, employment and international orders.

In contrast, the IHS Markit Eurozone flash August PMIs detailed a clear loss of momentum in the private sector, with manufacturing down -0.1 to 51.7 which was well below the street (at 52.9), and services were barely in expansion territory having declined -4.6 to 50.1 (consensus was 54.5) with renewed social mobility perhaps weighing on activity with softness in both Germany (-4.8 to 50.8) and France (-5.4 to 51.9) which saw the composite gauge decline -3.3 to 51.6 which is a two-month low. The report suggests that the regional recovery has been undermined by rising virus cases which bears watching, but the weakness was not evident in the UK (see chart).

This report reinforces our view of a fast recovery in the goods sector which is set to continue in the September quarter. However, the growth driver is changing from stimulus and pent up demand in May and June to higher industrial production and trade in August and September, as firms replace depleted inventories. In contrast, the services rebound is sluggish amid resurgent case numbers and mobility restrictions. This was initially evident in the US and EM, but the impact on the economy may be more felt in Europe, but this may be a delayed effect as the September quarter rebound there looks very strong (albeit reflecting the low activity base).



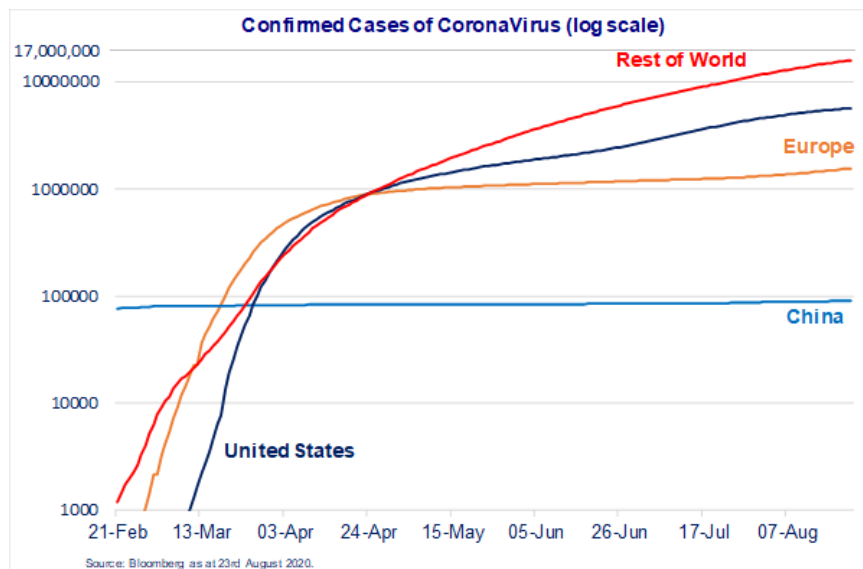
POLICY

- There were no major policy announcements on Friday or over the weekend.

VIRUS UPDATE

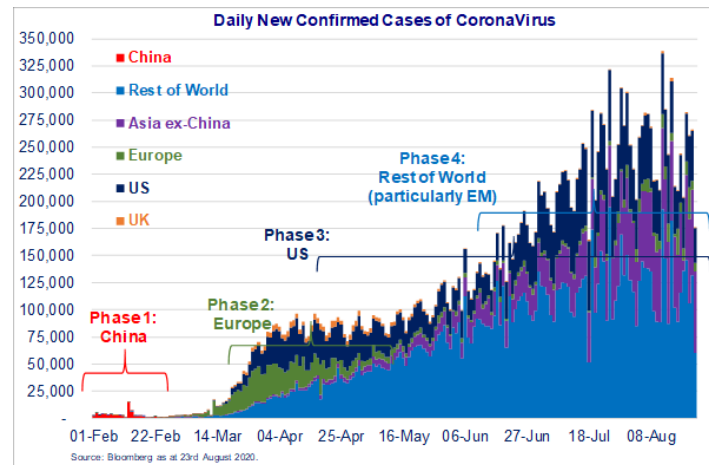
- The number of global cases of COVID-19 is 23.3 million with another +175k cases so far (but Brazil, Mexico, Spain and 10 US states have not reported their numbers) which means that Sunday is set to be the 36th consecutive day where daily increases are greater than 200k. At present, 9 countries have more than 500k cases, 20 countries have more than 200k cases and 29 countries have more than 100k cases (the Ukraine joined this group overnight).

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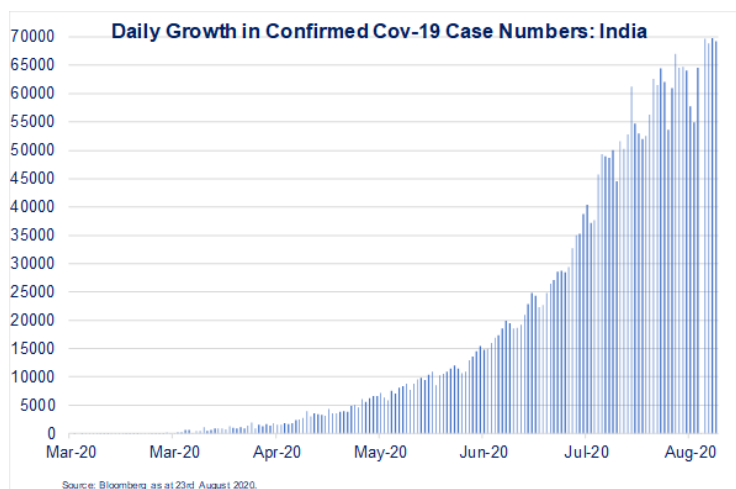
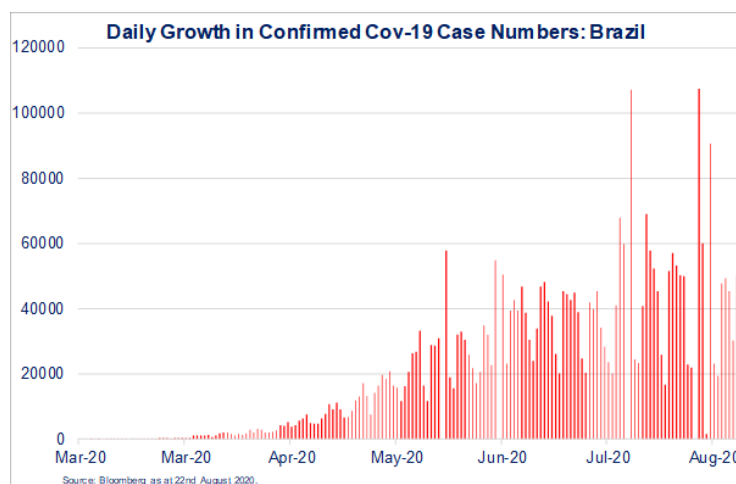
- We break the infections into four groups – the US, Europe, China and ‘others’ and the rest of the world outside the G3 economies now has the most total cases (+135k to 19.8 million) and highest daily new cases (and by a considerable margin) followed by the US (+31.7k to 5.7 million, although 10 states are yet to report). The issue for

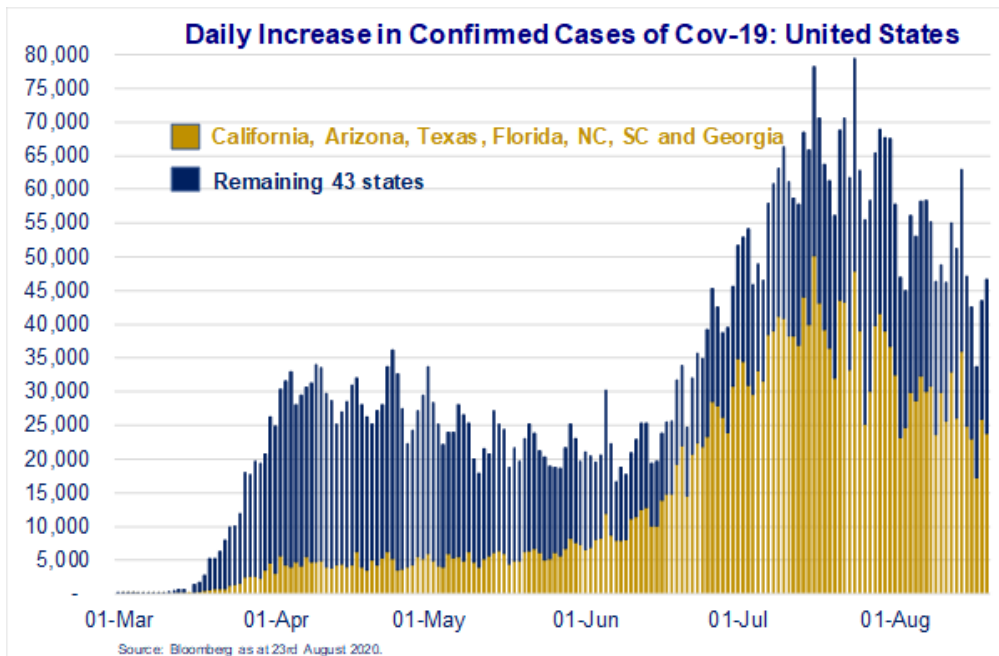
the US is that they never flattened their curve which means economic opening has not been associated with lower case numbers, and rising case numbers are also evident in Europe (+8.2k to 1.56 million - see chart).



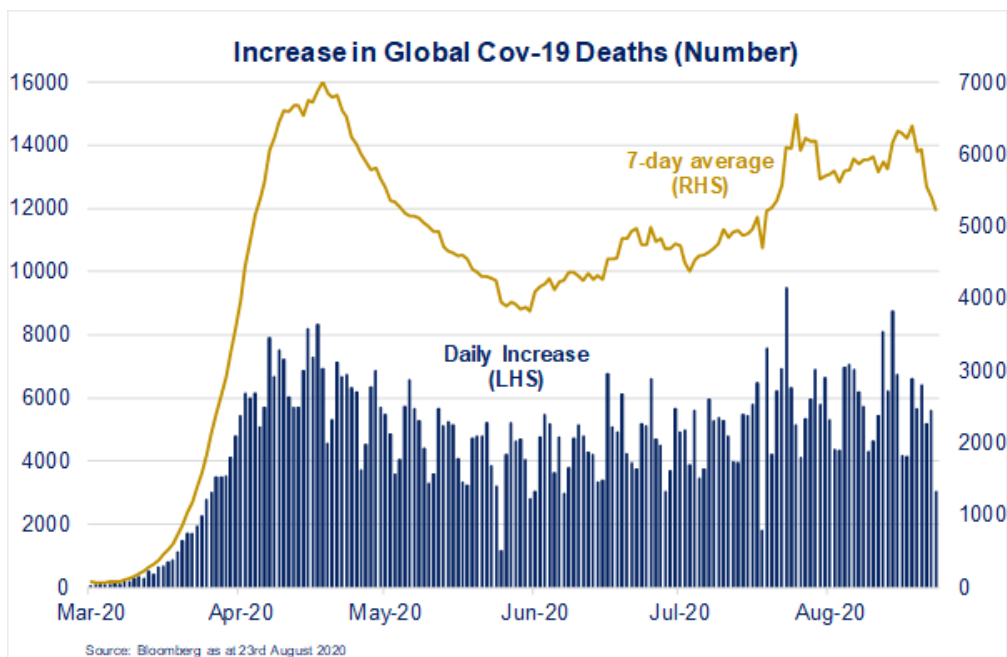
- Among countries, the most cases are in the US (+31.7k (so far) to 5.7 million, with 10 states yet to report), Brazil (not reported, 3.58 million), India (+69.2k (third highest on record) to 3.04 million), Russia (+4.8k to 954.3k), South Africa (+2.7k to 610.0k), Peru (+9.1k to 585.2k), Mexico (not reported, +556.2k), Colombia (+10.9k to 533.1k), Chile (+2.0k, 397.7k), Spain (not reported, 386.1k), Iran (+2.1k to 358.9k), United Kingdom (+1.0k to 327.6k), Saudi Arabia (+1.1k to 307.5k), Pakistan (+0.6k to +292.8k), Bangladesh (+2.9k to 294.6k) and Italy (+1.2k to 259.3k). Australia confirmed cases rose +209 to 24.9k yesterday which placed us 68th in terms of total infections.

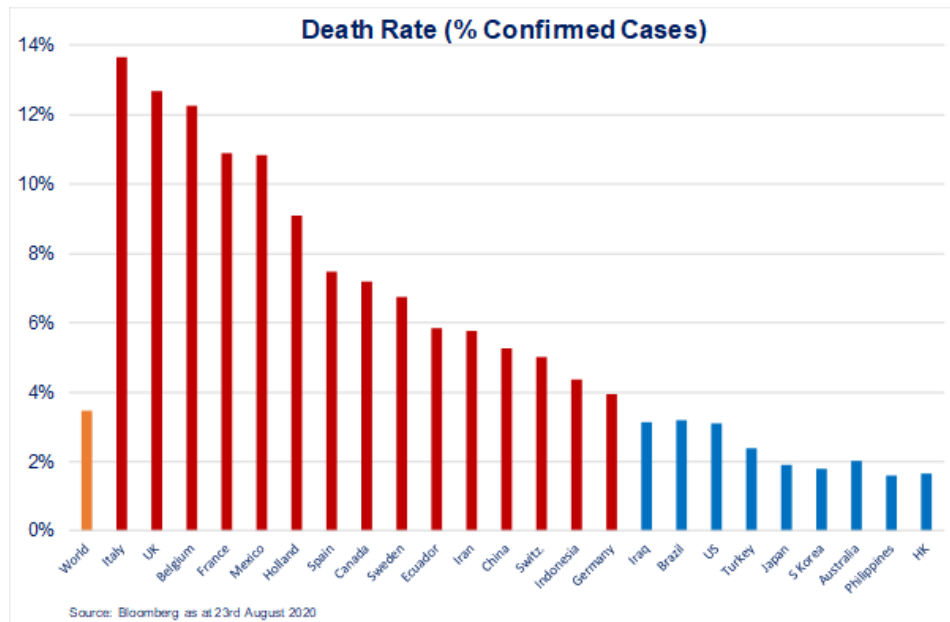
Elsewhere, Singapore recorded +87 new cases to 56.4k most of which are linked to foreign workers who are forced to live in crowded dormitories, but Indonesia (+2.0k to 153.5k) is now on the rise and has the second most cases in the region behind only the Philippines (+2.4k to 189.6k).





- Although final numbers are not in until 1pm AEST, the global death rate declined to 3.46% with the global total to 806.6k after another +3.0k deaths overnight, so far, which indicates the daily average deaths is stabilising again (see chart). The US (+0.4k so far) has the most deaths at +176.8k, with Brazil (not reported, 114.3k), Mexico (not reported, +60.3k), India (+1.1k to 56.7k), the UK (+6 to 41.5k), Italy (+7 to 35.4k) and France (+1 to 30.5k) all over +30k. The death rate is highest in European countries where the health systems had collapsed led by Italy (-0.1% to 13.7%), the UK (steady at 12.7%), Belgium (-0.2% to 12.3%), France (steady at 10.9%), the Netherlands (-0.2% to 9.1%), Spain (-0.1% to 7.5%) and Sweden (steady at 6.8%). However, several emerging markets are now on the leader board including Mexico (-0.1% to 10.8%), Ecuador (-0.1% to 5.9%), Indonesia (steady at 4.4%) and Brazil (steady at 3.2%).





Yours sincerely,



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