Perpetual Investments

THOUGHTS ON THE MARKET

24th September 2020

Risk markets decline further, and the US Dollar extends its advance

SUMMARY

- Global risk markets closed lower overnight with the MSCI World Index at an 8-week low and US high yield spreads rising to a 9-week high as investors seemed to recalibrate market prices and growth expectations. US Fed Chair Powell pleaded with the US House of Representatives Financial Services committee on the need for more stimulus to lift the world's largest economy and noted that the recovery will be low and prolonged. This view contrasts with a lot of investors who had wagered that a combination of stimulus, virus control and economic reopening would spark a large recovery. There is no doubt that September quarter growth numbers for the US will be incredibly high at around +28% q/qa, but it's the follow through in subsequent quarters that really matters and at present March quarter 2021 US growth is looking to be back to a sub-trend pace at around +2% q/qa, with risks to the downside if a fiscal deal is not struck after the US election.

  At present, markets are concerned that the growth numbers they had assumed won't materialise and that as the fiscal impulse lessens, that the foundations for the recovery, in both economic activity and market prices, will become less stable. The trouble now for investors is that traditional portfolio diversifiers are providing much less protection from the risk sell-off given the extreme pricing in government bonds for example, but investors with a comprehensive set of protection strategies including options, safe haven currencies, gold, spread trades and value/quality within equity and credit (as insolvencies are set to increase) as well as lower allocation to market beta, are much better placed.

- In other markets, 10-year Treasuries did not move with yields at 0.67% for a third consecutive session with the slope also unchanged, commodities were mixed with a steady oil price (USD39.59 per barrel) outperforming a weakness in gold (-2.3% to USD1,863 per troy ounce) which reflected the impact of a stronger US Dollar which rallied against all G10 currencies where losses were recorded in Yen (-0.9% to 105.39), the Euro (-0.9% to 116.6), Sterling (-1.0% to 127.3) and AUD (-2.1% to 70.73).

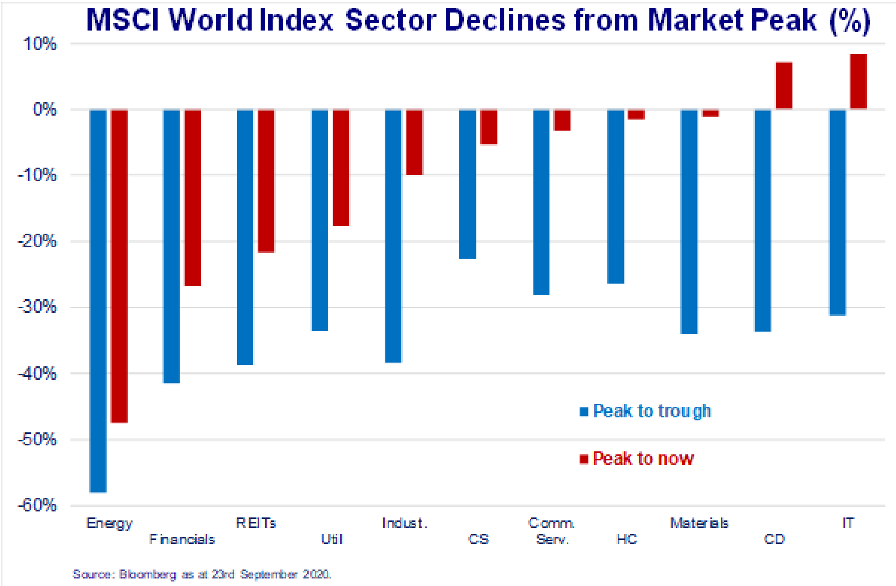
- There was not much economic data out overnight, but the Markit G4 composite PMIs for September indicated the growth surge in the US is flattening out and has already stagnated in Europe (led by services which returned to contraction territory after just two months of growth). Meanwhile, there was plenty of Fedspeak but nothing incremental as the Chair and Vice-Chair stuck to the recent script – a slow and prolonged recovery, the need for more stimulus especially on the fiscal side, tolerance for an inflation overshoot (although no specifications of how much and for how long) and that the virus needs to be contained for the recovery to be sustainable.

- The number of global cases of COVID-19 is 31.76 million with another +276.2k cases so far (but Mexico and Pakistan and 4 US states have not reported their numbers) which means that Tuesday was the 66th consecutive day where daily increases have been greater than 200k. At present, 11 countries have more than 500k cases, 22 countries have more than 200k cases and 36 countries have more than 100k cases. Meanwhile, deaths stand at 973.9k and the death rate was steady at 3.07% although the number of daily deaths remains elevated.

FINANCIAL MARKETS

- ### EQUITIES

  - **The MSCI World Index declined -1.6%, which took the gauge to an 8-week low with all 11 sectors closing lower for the third time in the past two weeks.** Losses were led by energy (-3.0%) which fell for the 24th day on the past six weeks despite the stable oil price overnight, with materials (-1.4%) weighed down by lower base and precious metals prices, whereas Tesla's battery updated dragged on lithium stocks. Meanwhile, IT (-2.7%) and communication services (-2.2%) were also underperformers with FAANG and other large-cap tech names reversing yesterday's gains. Elsewhere, there was a bowler's double century in REITs (-2.0%) which took the sector deeper into bear market territory, whereas financials (-1.2%) was a relative outperformer despite some large declines in banks, who added to their steep weekly losses. By the close of trading, three sectors are now in bear market territory with energy the worst at -47.4%, and materials (-1.1%) fell back below its February peak level (see chart) and tech's recovery rate is now down to a six-week low.

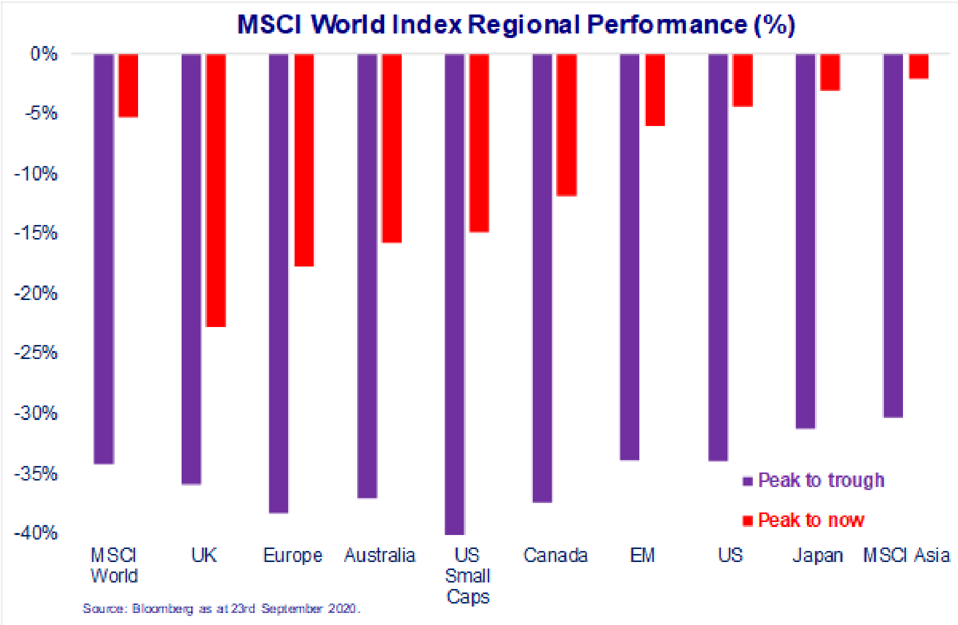


  - **Among the regions, the pace of price declines was led by the US where the market fell -2.4%, which is its fifth decline in the past 6 sessions.** There was nothing incremental from a data perspective to add to the market angst with the Markit US composite PMI declining -0.2% to 54.4, but this may be a sign that the inability of the Congress to enact the Cares 2 program is already impinging on the recovery – albeit at the margin. Concerns also remain that the market is still over-bought despite the near-10% sell off. The sell off was led by tech (-3.0%), but there was no offset from the cyclical sectors which also dropped sharply as fiscal stimulus hopes further eroded given the end of bipartisanship in relation to the Supreme Court nominee, but a deal was reach to prevent a shutdown of the government until mid-December. Meanwhile, Powell's testimony to the US Congress didn't help the mood when he spoke about the need for more stimulus and a generally slow recovery. By the closing bell, all major indices closed lower led by the NASDAQ Composite and Russell 2000 indices (both -3.0%), the S&P 500 (-2.4%) and the Dow Jones Industrial Average (-1.9%, -525 points, 26,763).

    The Asian sharemarket closed marginally lower yesterday with the MSCI Asia Pacific Index off -0.1%. Several prolonged thematics remained in play yesterday with Chair Powell's testimony continuing his recent themes, but not building on them, or solutions. Meanwhile, US-Sino tensions were raised after President Trump used a UN speech to accuse China of unleashing a coronavirus "plague", and the US House of Representatives passed legislation to restrict imports of goods made using forced labour from China. Elsewhere the macro calendar was light for a third consecutive day with only a sharp decline in Australian retail sales and a modest rise in Japan's manufacturing PMI of note. By the closing bell, the Australia rally (+2.4%) was the standout, with moderate gains also recorded in Mainland China (+0.4%) and Hong Kong (+0.1%), whereas South Korea was flat and Japan (-0.1%), India (-0.2%) and Taiwan (-0.5%) recorded modest declines.

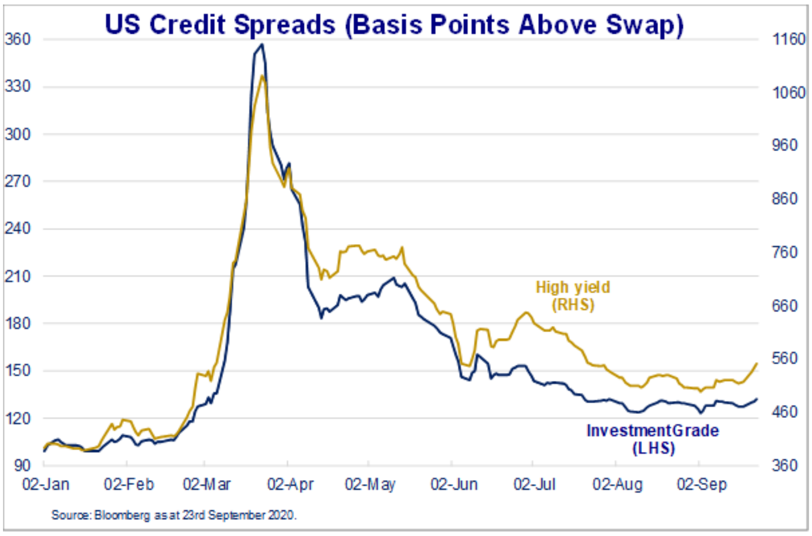
    In contrast, to the US and Asia, Europe was the one bright spot in regional markets closing +0.5%, although this was well below its intraday high and was primarily due to its larger losses from earlier this week. The market shook off more negative COVID-19 headlines where case numbers continue to mount which sparked fresh mobility measures in the UK with Belgium announcing restrictions on "close individual contact" to curb spread of virus. On a more positive front, comments from ECB officials highlighted their views that the growth and inflation outlook has not deteriorated since the ECB left policy unchanged earlier this month, although the regional Markit PMI clean bowled that notion with a loss of momentum in the services sector pulling it back into contraction territory after just two months of expansion. By the regional close, the pace of gains was led by the UK (+1.2%), Sweden (+0.8%), France (+0.6%), Germany (+0.4%), Italy (+0.2%) and Spain (+0.1%) whereas Switzerland (-0.3%) defied the regional trend and closed lower.

By the closing bell at the NYSE, there was not much change in our February peak-to-now chart with the UK still in bear market territory and the Asia region doing the best (see chart) given the resilient Chinese economy.

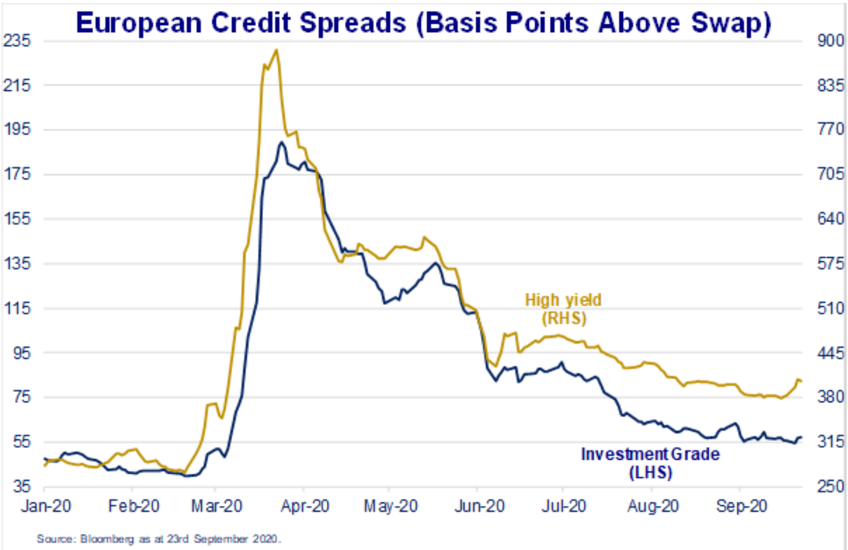


- **Futures markets suggest a weak opening in Asia this morning** with Australia (-1.0%), Hong Kong (-1.0%) and Japan (-0.5%) all set to open lower at the bell.

- **CREDIT MARKETS**
  - **Regional credit indices were mostly lower overnight as investors marked-to-market perceptions of slowing growth.** Spreads in the investment grade universe rose +2 points to +132 bpts, but the recovery rate was steady at 89%. All 11 subsectors recorded capital losses with the largest being energy (+3 points to +190 bpts, 91%) despite the steady oil price, but there wasn't much movement elsewhere. In the high yield universe, spreads rose +8 points which made it five consecutive days of losses which took spreads to +551 bpts (9-week high) and lowered the recovery rate to 79%. All 11 sub-sectors saw price declines but only three saw a double digit increase in spreads, namely, healthcare (+11 points, +533 bpts, 72%), subordinated financials (+11 points, +586 bpts (9 week high), 64%) and energy (+17 points, +863 bpts, 94%).

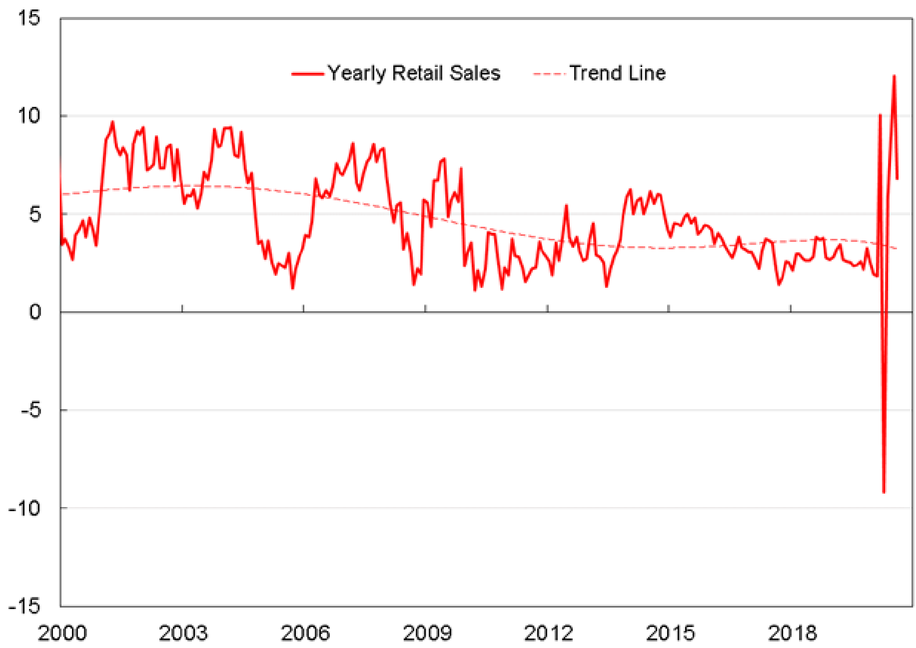


- **European credit markets were mixed** with spreads and the recovery rate in the investment grade universe steady at +57 bpts and 88%, respectively but no sector moved by more than a basis point. In the high yield space, spreads declined -2 points to +404 bpts but the recovery rate was steady at 78%. The decline was underpinned by a decline in consumer staples (-12 points, +525 bpts, 89%) which simply recovered some of its losses from earlier in the week. Outside this sector, moves were capped at three basis points, as eight sectors recorded capital gains, albeit quite modest ones.

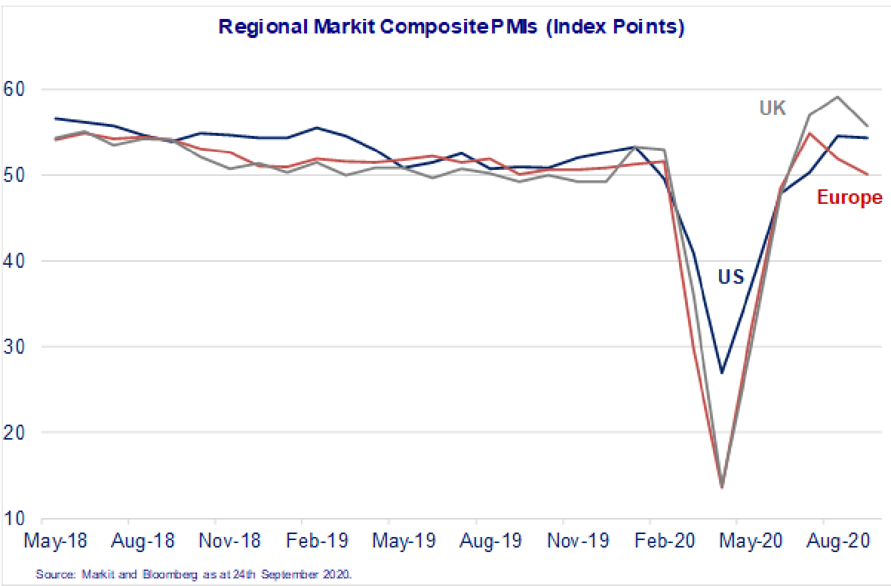


THE GLOBAL ECONOMY

- **Australian retail sales fell -4.2% m/m in August which pulled the annual rate down to a still impressive +6.9% y/y (see chart).** The primary drag emanated from the Victorian lockdowns where retail activity plunged -12.6% m/m (-10.3% y/y), but the rest of Australia collectively declined -1.5%. However, the ABS provided only limited information at the category level noting that household goods dropped back -6.8% m/m after booming +4.0% m/m in July but the annual pace was still a massive +20% y/y. This suggests that goods spending in Australia has been very strong so far in Q3 and even if spending was flat in September, Q3 growth would remain an impressive +7% q/q, but services spending has been much harder hit with the lockdowns. The recent 'confirmation' of material weakness in both the payrolls and retail sales reports points to a much weaker economy than was suggested in the August Labour Force Survey.



- **The G4 Markit PMIs for September came in and all confirmed a loss of momentum although there was a large range in that moderation:**
  - The European composite PMI fell -1.8 points to 50.1 in September with all of the slowing in activity driven by the service sector where the primary gauge dropped –3.1 to 47.6 with weaker than expected outcomes in both Germany (49.1 vs the street at 52.9) and France (47.5, 51.8) indicating that after just two months of growth, that sector activity is already back in contraction territory. In contrast, European manufacturing activity lifted (+2.0 to 53.7) with similar sized improvements in the two major economies buoyed by rising demand from export market and the reopening of retail in many countries.
  - In the US, the composite gauge for September declined a more sedate -0.2 points to 54.4 (see chart) with improvements in manufacturing (+0.4 to 53.5) offsetting a decline in services (-0.4 to 54.6). In manufacturing rising new orders and output underpinned the lift in the index but in both surveys, employment and order backlog grew less strongly, while input costs and selling prices increased. This is a sign that the September quarter rebound



POLICY

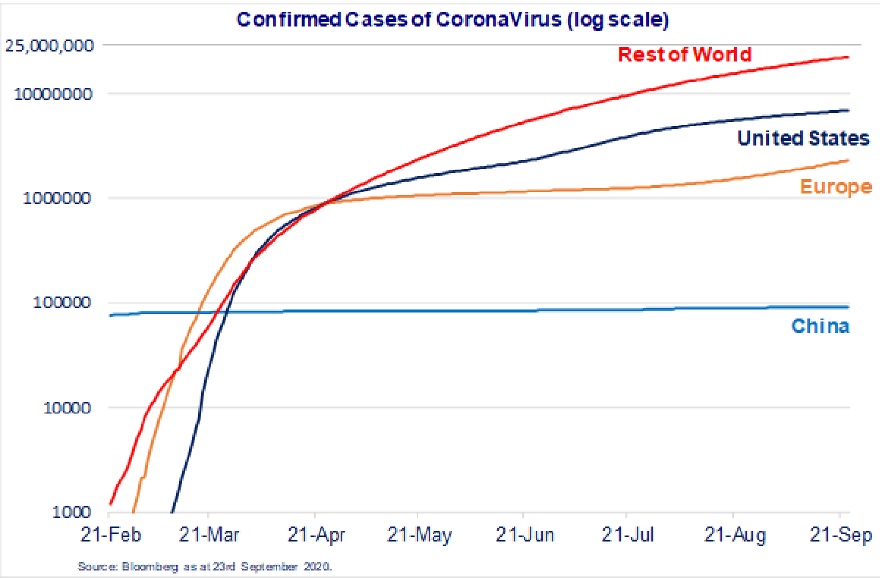
- On the policy front, there was considerable Fedspeak with Chair Powell's appearance before a House subcommittee like yesterday, in which he defended the Main Street program but talked up possible benefits of more PPP-style assistance. Meanwhile, Vice Chair Clarida reiterated inflation needs to be on track to moderately exceed 2% for some time to lift rates and voter Quarles said that minor inflationary overshoots are not a first-order concern for him.

- The White House and Democrats voted overwhelmingly to extent federal funding through to 11-December to avoid a pre-election government shutdown which could impact the US election result.

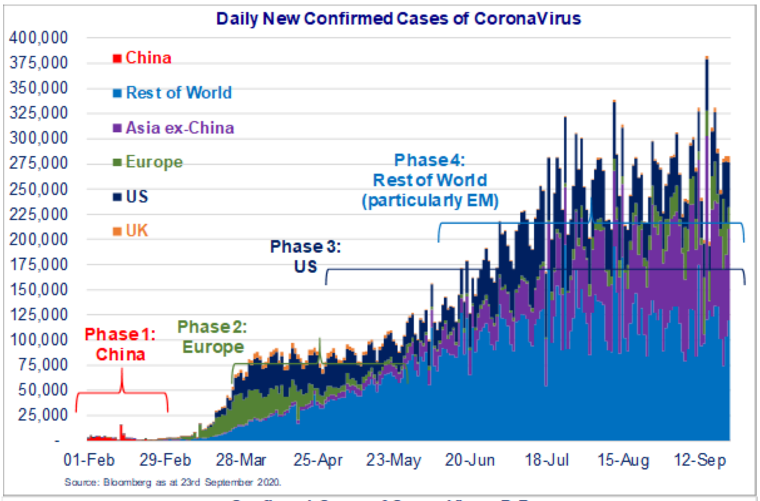
VIRUS UPDATE

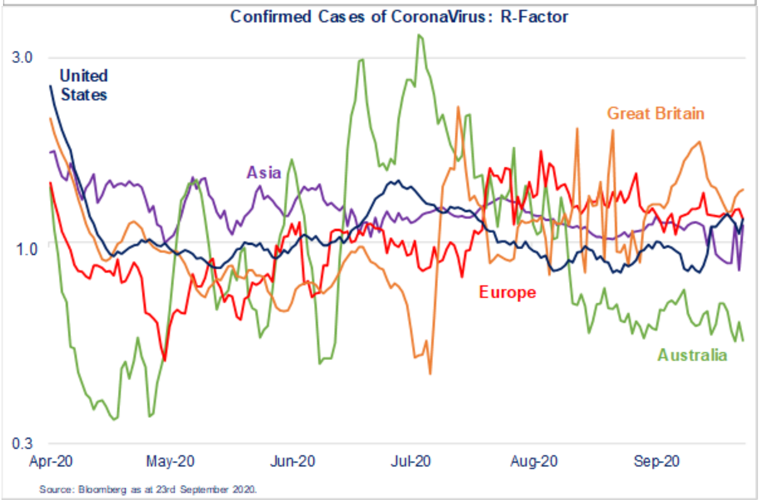
- The number of global cases of COVID-19 is 31.76 million with another +276.2k cases so far (but Mexico and Pakistan and 4 US states have not reported their numbers) which means that Tuesday was the 66th consecutive day where daily increases have been greater than 200k. At present, 11 countries have more than 500k cases, 22 countries have more than 200k cases and 36 countries have more than 100k cases.

  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 Sunday) is steady. Meanwhile, deaths stand at 973.9k and the death rate was steady at 3.07% although the number of daily deaths remains elevated.



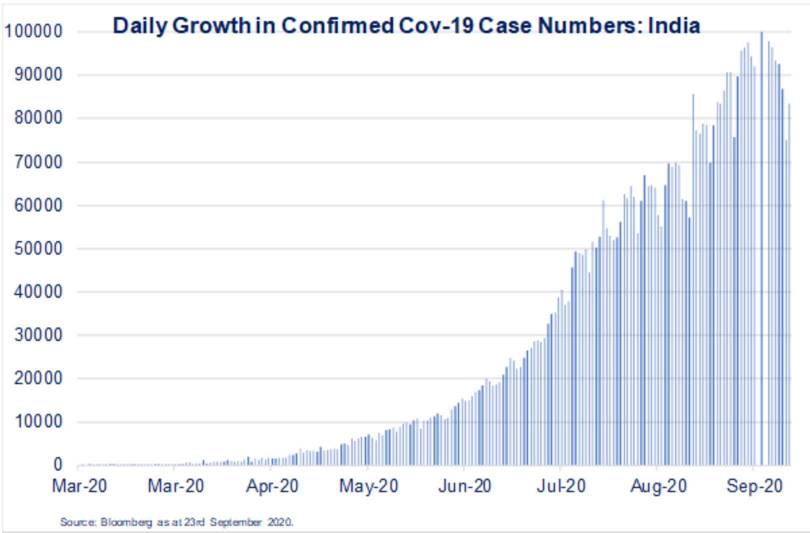
- We break the infections into four groups – the US, Europe, China and 'others' and the rest of the world outside the G3 economies now has the most total cases (+210.7k to 29.1 million) and highest daily new cases (and by a considerable margin) followed by the US (+44.0k to 6.94 million, although 4 states 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 (+21.5k to 2.31 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 (1.15 is too high, especially in Britain (1.37).

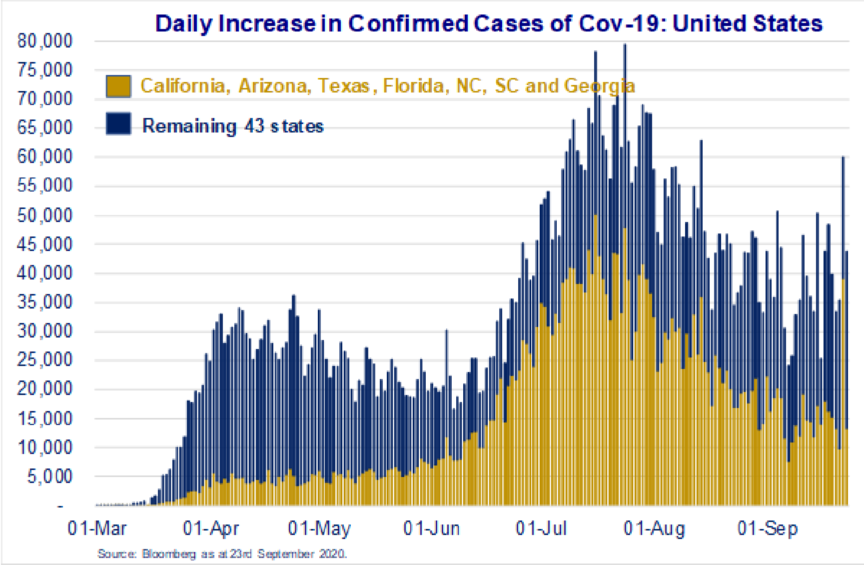




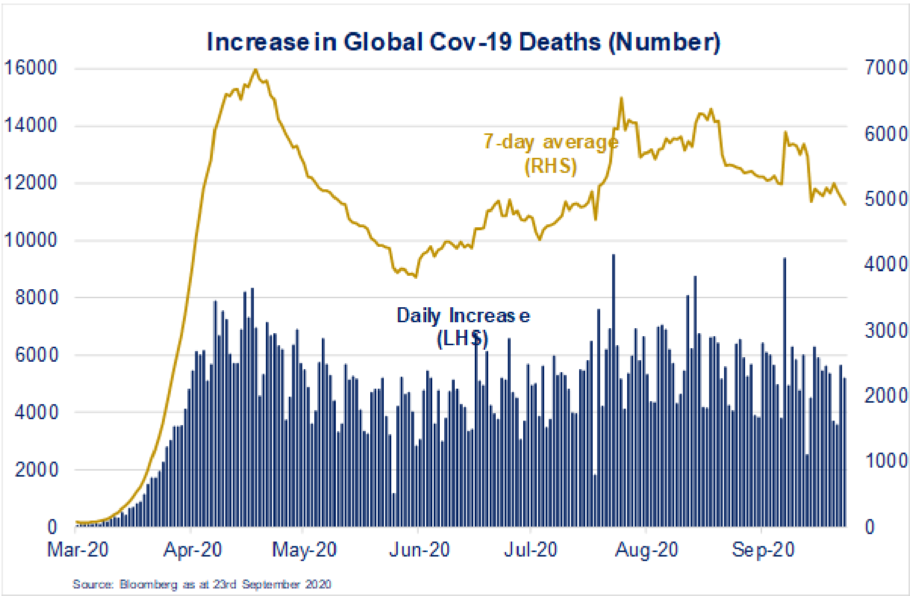
- Among countries, the most cases are in the US (+44.0k (so far) to 6.94 million, with 4 states yet to report), India (+83.3k to 5.65 million), Brazil (+33.3k to 4.59 million), Russia (+6.3k to 1.11 million), Peru (+7.7k to 776.5k), Colombia (+6.7k to 784.3k), Mexico (not reported, +705.3k), South Africa (+1.9k to 665.2k), Spain (+11.3k to 693.6k) and Argentina (+12.1k to 652.2k). Australia confirmed cases rose +2 (7-week low) to 26.9k yesterday which placed us 71st in terms of total infections.

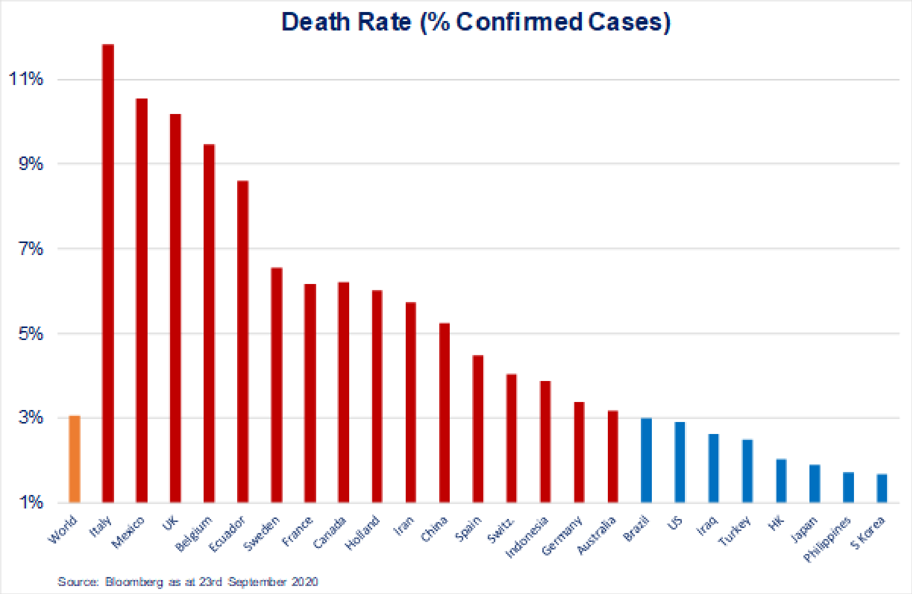
  Elsewhere, Singapore recorded +12 new cases to 57.6k most of which are linked to foreign workers who are forced to live in crowded dormitories, but Indonesia (+4.5k (record high) to 257.4k) is now on the rise and has the second most cases in the region behind only the Philippines (+2.8k to 294.6k).





- Although final numbers are not in until 1pm AEST, the global death rate declined to 3.07% with the global total to 973.9k after another +5.2k deaths overnight, so far, which indicates the daily average deaths is stabilising again (see chart). The US (+1.1k so far) has the most deaths at +201.9k, with Brazil (+0.8k to 138.1k), India (+1.1k to 90.1k), Mexico (not reported, 74.3k), the UK (0 to 42.0k), Italy (+20 to 35.8k) and France (+18 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 11.8%), the UK (-0.1% to 10.2%), Belgium (-0.1% to 9.5%), France (-0.1% to 6.2%), Sweden (steady at 6.6%), the Netherlands (-0.1% to 6.0%) and Spain (-0.1% to 4.5%). However, several emerging markets are now on the leader board including Mexico (+0.1% to 10.5%), Ecuador (-0.1% to 8.6%), Indonesia (steady at 3.9%) and Brazil (steady at 3.0%).





Yours sincerely,

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MORE INFORMATION

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