

# THOUGHTS ON THE MARKET

24<sup>th</sup> June 2020 - What would Shakespeare say about the current state of markets?

## SUMMARY

- Global risk markets were mixed overnight with another rise in global shares whereas global credit markets recorded a minute increase in spreads. However, examining trends below broad index lines shows that growth stocks which were being dumped a few weeks ago by investors to buy cheaper value stocks which outperform in the early stages of a recovery, are now back in favour. It's not that value stocks aren't rising, but growth stocks are surging again with investors paying absolutely no attention to valuations. Needless to add, higher stock prices overnight were supported by the US tech sector which helped push the NASDAQ 100 index to a fresh all-time high with investors encouraged by talk of another stimulus round. On the whole, investors are betting trillions of dollars of assets that the trillions of dollars of stimulus can outweigh the potential impact of trillion of dollars of economic disruption from a second wave of COVID-19 infections. While rising stock indices can be alluring, Shakespeare reminds us all that "expectations are the root of all heartache".

In other markets, US 10-year Treasuries were flat at 0.71% with the curve slope increasing to 0.58% given a drop at the short end, commodities were mixed with gold up +1.2% to USD1,768 per troy ounce and oil fell -1.2% to USD40.02 per barrel (on higher US inventories) and the Greenback continued its slide against Sterling (+1.1%), Euro (+0.9%), AUD (-0.8% to 69.27) and Yen (-0.4%).

- The economic calendar was light again, but we got the preliminary round of G4 flash PMIs for June which pleased the bulls as large gains were made, but nearly all manufacturing and services gauges remained below 50. This indicates that while output, demand and employment are still falling, they are no longer collapsing which is an improvement although a long multi-year road is ahead to rebuild capacity, labour markets and demand.
- On the virus front, the US's top infectious disease doctor warned that COVID-19 is not taking a summer vacation. Indeed, the number of global cases of COVID-19 was 9.18 million with another +100k cases so far overnight (before Brazil, Mexico, Pakistan and some US states report their numbers) which means that Monday was the 26th occasion in the past 28 days where daily increases have topped 100k (and the other two were over 99k!). It took 73 days to record 1 million cases, but one million cases after that were recorded in 13 days, then 11, 12, 10, 11, 8, 8 and 7 days, and in the past 24 hours another +178k cases have been confirmed. The growth rate of daily confirmed cases (+1.8% since Saturday) is starting to gradually rise. Meanwhile, deaths stand at 474.6k and the death rate dropped for a forty eighth straight day to 5.14%.

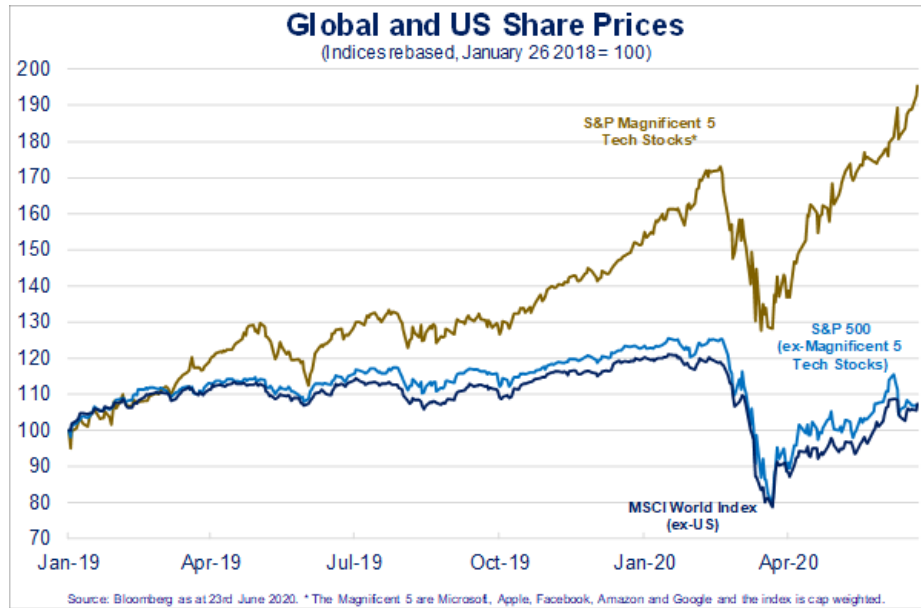
## FINANCIAL MARKETS

### EQUITIES

- The MSCI World Index closed +0.8% higher overnight with gains in all regions and most sectors. Among the latter, nine of the 11 sub-sectors recorded gains led by consumer discretionary (+1.2%), financials (+0.8%) and IT (+0.7%), with only REITs (-0.2%) and utilities (-0.3%) closing in the red. The overnight moves inched the latter two sectors towards bear market territory in what has been a strong recovery in recent weeks, with IT continuing to surge to record highs almost on a daily basis with investors not seeming to care that Amazon, for example, is trading at a forward PE ratio of 132x which is probably closest to its highest level since the aftermath of the dotcom boom.

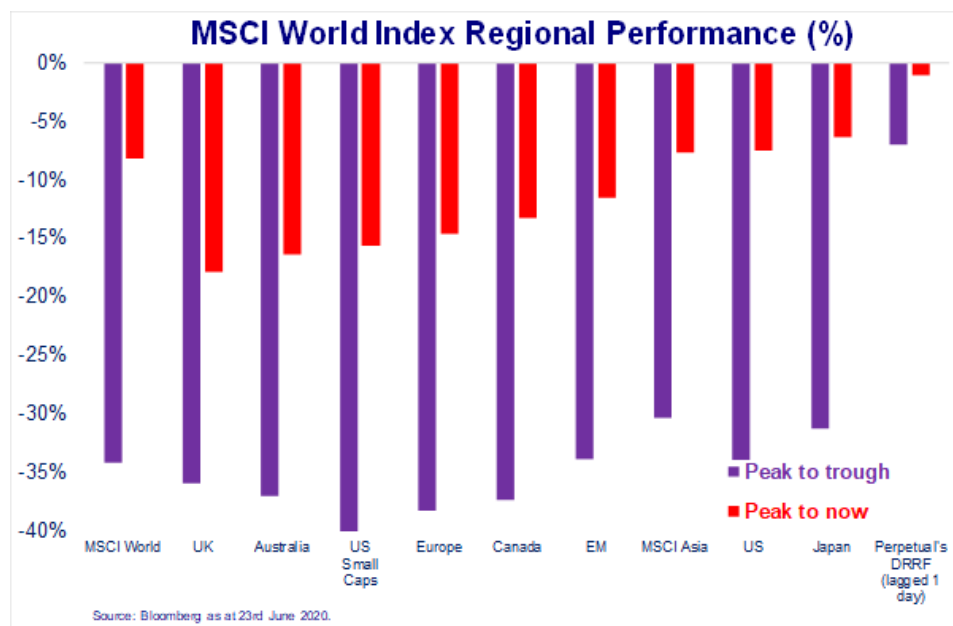
Interestingly, since the end of May, the US sharemarket has risen +2.9% but that has been entirely driven by its tech sector which itself has increased +11.6%. However, outside this, the remaining US sharemarket's

ex-tech return has been -0.8%, relative to a return for the MSCI World ex-US of +6.1% in June so far (see chart).



- Among the regions, there were gains aplenty led by Europe (+1.8%) where investors were buoyed with a solid rebound in the June regional composite PMI which still showed activity is still contracting but is not collapsing. Among countries, Germany (+2.1%) outperformed all as investors believed that improving activity and trillions of Euro's worth of stimulus will be good for corporate bottom lines even if COVID-19 spikes higher. In other markets, advances were widespread with gains in Italy (+1.9%), Sweden (+1.6%), France (+1.4%), Spain (+1.3%) and the UK (+1.2%). Earlier in the Asia session the MSCI Asia Pacific Index closed +1.3% higher with Hong Kong (+1.6%), Korea (+0.6%), China (+0.5%), Japan (+0.5%) and Australia (+0.2%) all posting positive performances.

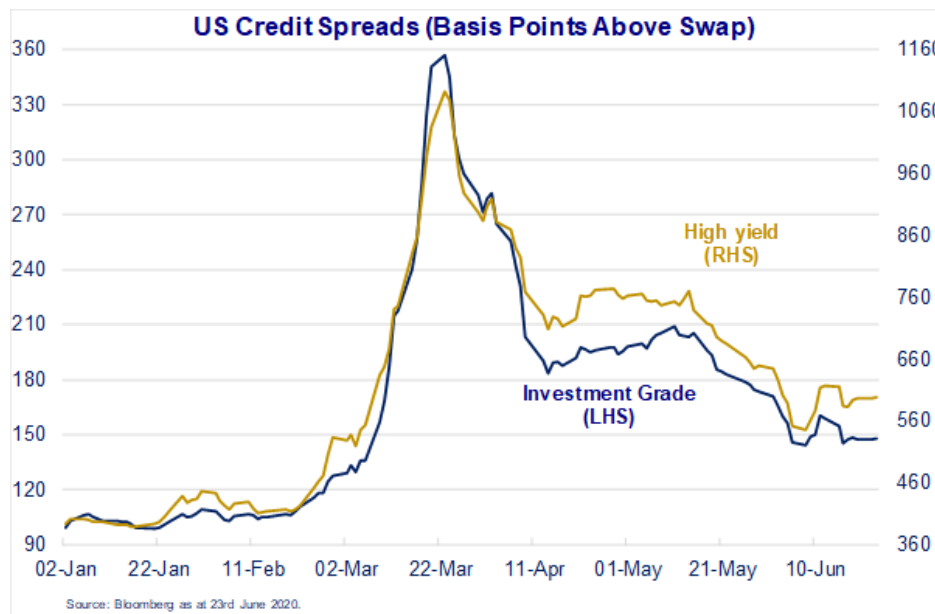
In the US, stocks finished higher powered by consumer discretionary (+1.0%) and tech (+0.7%) which enabled the NASDAQ 100 and its Composite twin to record an eighth straight session of gains which is a 2020 high. During the session, investors overall continued to look beyond another sharp rise in COVID-19 case numbers, betting that any economic impact will be offset by stimulus. At the bell, the NASDAQ (+0.7%) outperformed the Dow Jones (+0.5%, +131 points to 26,156) and the S&P 500 and Russell 2000 (both +0.4%).



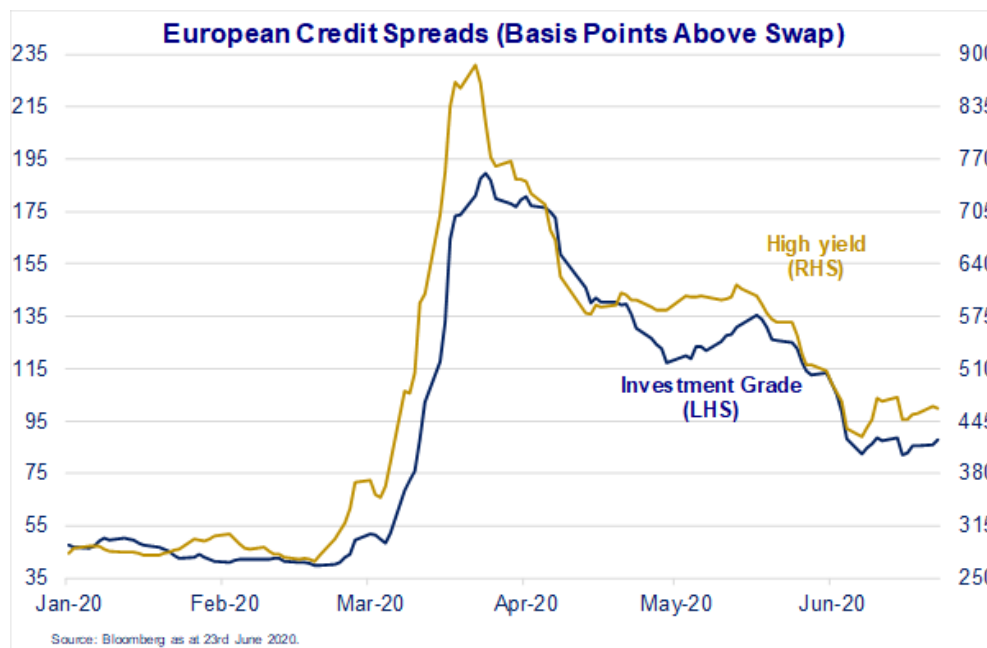
Futures markets suggest a mixed opening in Asia with gains expected in China (+0.5%) and Australia (+0.2%), but declines are likely in Japan (-0.2%).

## • CREDIT MARKETS

- Regional credit markets marked time overnight with very modest movements in spreads for a fifth consecutive session. In the US investment grade universe, spreads increased +0.2 of a point to +144 bpts, which kept the recovery rate at 82%. Seven of the 11 sub-sectors recorded higher risk premiums led by telcos (+1 point, +170 bpts, 83%) and energy (+1 point to +202 bpts, 88%), which wore a lower crude price, but the remainder of the sectors had even smaller movements. In the high yield space, the spread also increased +0.2 of a point to +597 bpts, which had the recovery rate stable at 73%. Four sectors recorded higher spreads led by industrials (+5 points, +715 bpts, 46%) which did not find favour despite some solid bounces in regional PMI indices, with utilities (+2 points, +505 bpts, 59%) also higher, four sectors were unchanged and three declined including subordinated financials (-3 points, +639 bpts, 56%) and energy (+4 points, +921 bpts, 91%).

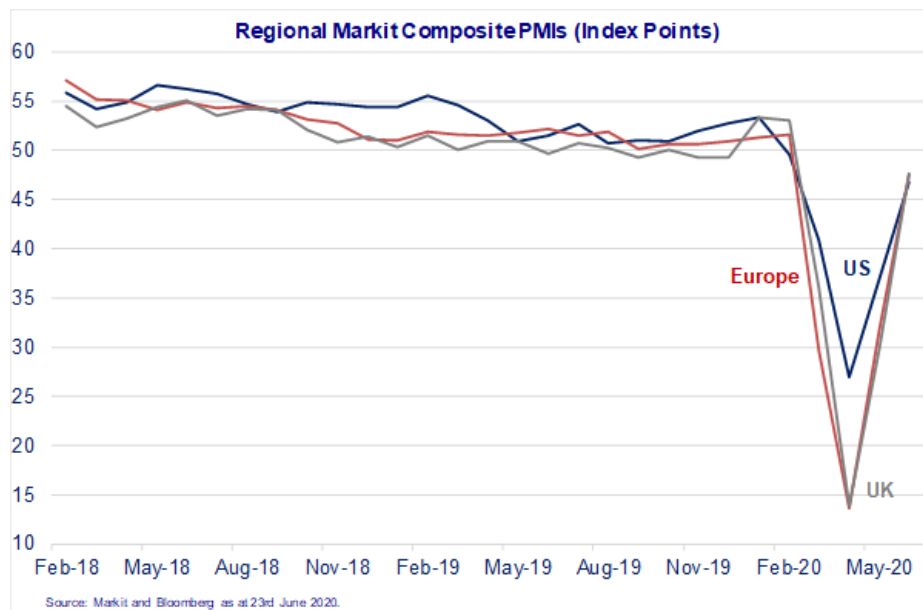


- European credit markets were also subdued with risk premiums in the investment grade universe increasing +2 points, which represented its fourth rise in the past five days. The increases in spreads was fairly consistent across sectors with a rise in healthcare (+3 points, +49 bpts, 76%) and a decline in subordinated financials (-1 point +176 bpts, 69%). In the high yield space, spreads contracted -3 points with ten sectors recording declines led by consumer discretionary (-5 points, +560 bpts, 71%), consumer staples (-4 points, +478 bpts, 98%) and industrials (-4 points, +573 bpts, 67%).



## THE GLOBAL ECONOMY

- Global recovery hopes were boosted by the latest round of G4 flash PMIs:
  - In the US, the HIS Markit flash manufacturing PMI rose +9.8 points to 49.6 which is a four-month high, but it simply reflects state economies reopening and provides no indication on the shape of the recovery. Among the components, output rose +13.4 to 47.8 which is not far away from expansion territory, employment losses also moderated, and backlogs of work continued to fall. Meanwhile, services rose +9.2 points to 46.7 as new orders contracted much less on a pickup in domestic and foreign client demand.



- The Eurozone composite PMI improved +15.6 to 47.5 in June which was considerably higher than the street estimates (42.4), with the rise in manufacturing (+7.5 points to 46.9) modest relative to services (+16.8 to 47.3) but this reflects the extent of the March/April downturn. This indicates that while output, demand and employment are still falling, they are no longer collapsing.
- In the UK the composite PMI increased +17.6 to 47.6 in June with manufacturing (+9.4 to 50.1) back in expansion territory and services also lifted strongly (+18 to 47.0) beating expectations.
- Finally, Japan's composite PMI pushed up +10.1 to 37.9, with services (+15.8 to 42.3) much stronger than manufacturing (-0.6 to 37.8) which surprisingly fell back.

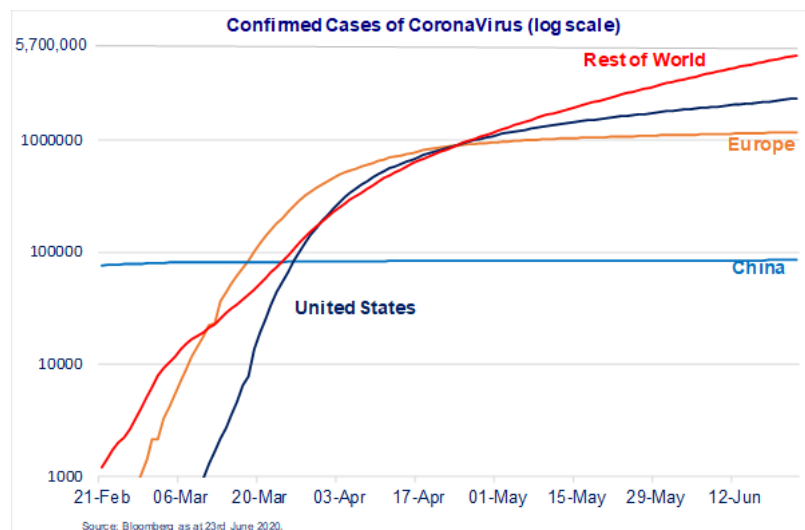
## POLICY

- There was no major policy announcement overnight. However, the big news story was White House trade advisor Peter Navarro saying that the Phase 1 US-China trade deal was over, but President Trump later said that the trade deal is fully intact.

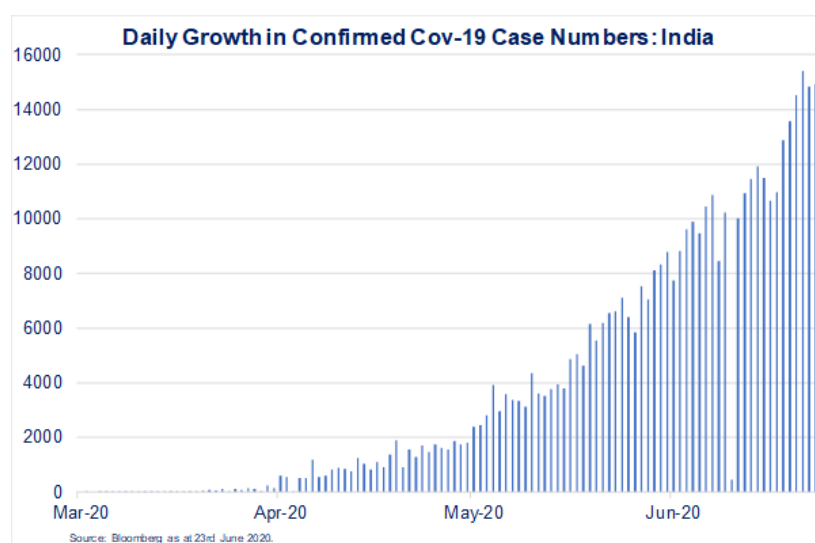
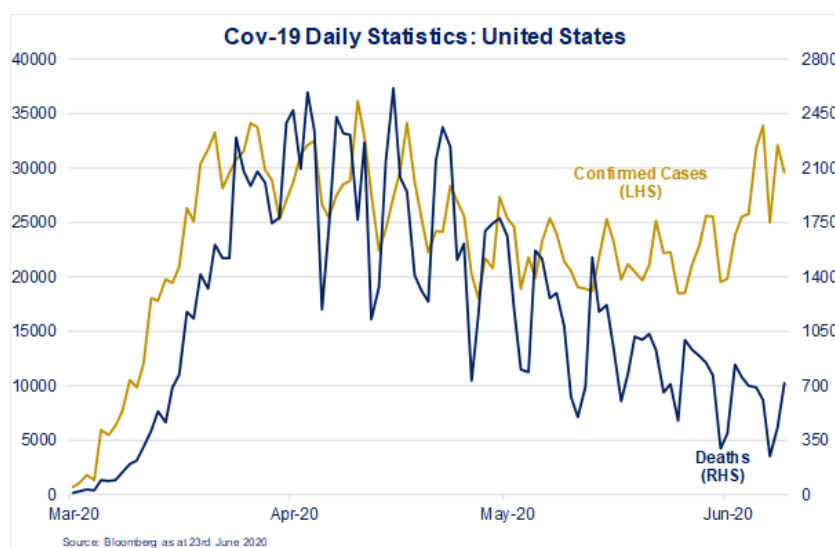
## VIRUS UPDATE

- Although final numbers are not in for another 5.5 hours, the number of global cases of COVID-19 was 9.18 million with another +106k cases so far overnight (before Brazil, Mexico, Pakistan and some US states report their numbers) which means that Monday was the 26th occasion in the past 28 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 and 19 countries have more than 100k cases.

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 sixth million and 8 days for the seventh and eighth million, a record low 7 days for the ninth million. In the past 24 hours another +183k cases have been confirmed but more importantly, the growth rate of daily confirmed cases (+1.8% since Saturday) is starting to rise. Meanwhile, deaths stand at 474.6k, 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 eighth straight day to 5.14%.

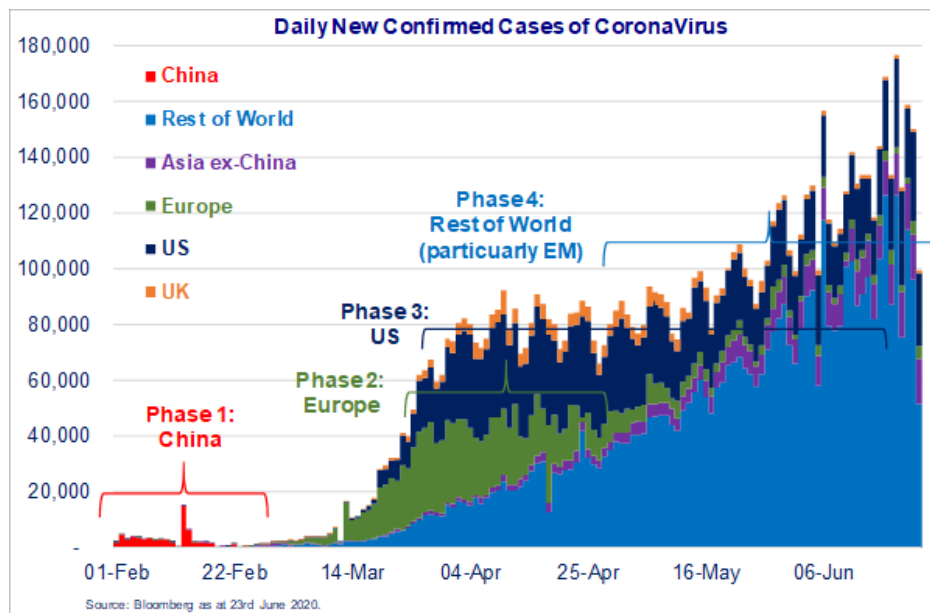


- We break the infections into four groups – the US, Europe, China and ‘others’ and the rest of the world outside the G3 economies now has the most total cases (+51.7k to 5.6 million) and highest daily new cases (and by a considerable margin) followed by the US (+29.6k to 2.34 million) and Europe (+4.4k to 1.17 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 (not reported, 1.11 million, which is the second highest in the world), Russia (+7.4k to 598.9k, third highest) and India (+14.9k (second highest) to 440.2k, fourth highest – see charts below).

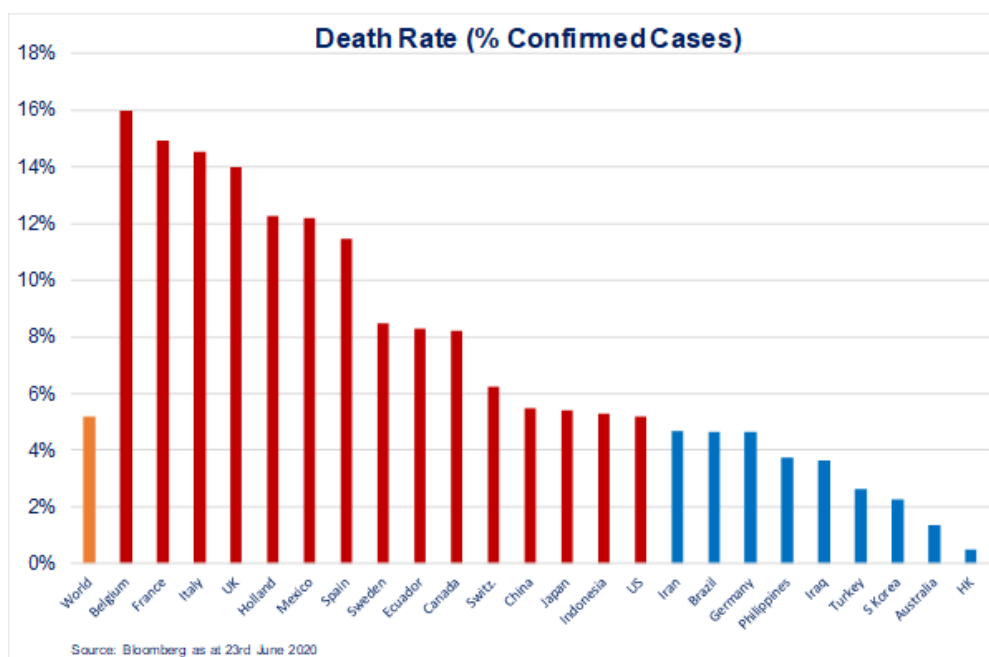


- Among countries, the most cases are in the US (+29.6k (so far) to 2.34 million), Brazil (not reported, 1.11 million), Russia (+7.4k to 598.9k), India (+14.k (second highest) to 440.2k), the United Kingdom (+0.9k to 307.7k), Peru (+3.3k to +260.8k), Chile (+3.8k to 250.7k), Spain (+0.2k to 246.8k), Italy (+0.1k to 238.8k), Iran (+2.4k to 210.0k), France (+0.6k to 197.8k), Germany (+0.7k to 192.5k) and Turkey (+1.3k to 190.2k). Australia confirmed cases rose +20 to 7,492 yesterday which placed us 71st in terms of total infections.

Elsewhere, Singapore recorded +0.1k new cases to 42.4k 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, but Indonesia (+1.1k to 47.9k) is now on the rise and has the most cases in the region, and the Philippines (+1.1k (record high) to 31.8k) is also on an upward trend.



- Although final numbers are not in until 1pm AEST, the global death rate declined for a forty eighth straight day to 5.14% with the global total to 474.6k. The US (+0.7k so far) has the most deaths at +121.1k, with Brazil (not reported, 51.3k), the UK (+280 (two week high) to 43.0k), Italy (+0.02k to 34.7k), France (+0.06k 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 (-0.1% to 14.9%), Italy (steady at 14.5%), the UK (+0.1% to 14.0%), the Netherlands (steady at 12.3%), Spain (steady at 11.5%) and Sweden (-0.2% to 8.5%). However, several emerging markets are now on the leader board including Mexico (+0.1% to 12.2%), Ecuador (steady at 8.3%), Indonesia (steady at 5.3%) and Brazil (-0.1% to 4.6%).





Yours sincerely,



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