Perpetual Investments

THOUGHTS ON THE MARKET

25th March 2020

POLICY RESPONSES

- There were no major policy announcements overnight, but financial markets were buoyed with the lowering of US political uncertainty as both sides stepped closer to passing a US2 trillion stimulus package. An agreement is expected to be announced today after twice failing to clear a procedural hurdle in the US Senate with heated partisan rhetoric. The stimulus will be required as the US now appears to be the third epicentre, and potentially the last, of the growth of the Coronavirus.
- While it's too early to be blindly optimistic about the investment outlook given the massive growth hole ahead, many investors are now being tempted by attractive share valuations and wide credit spreads, but we would highlight to all that cheap markets can become a hell of a lot cheaper as investors found out the hard way in 1931/32 and 2008/09.

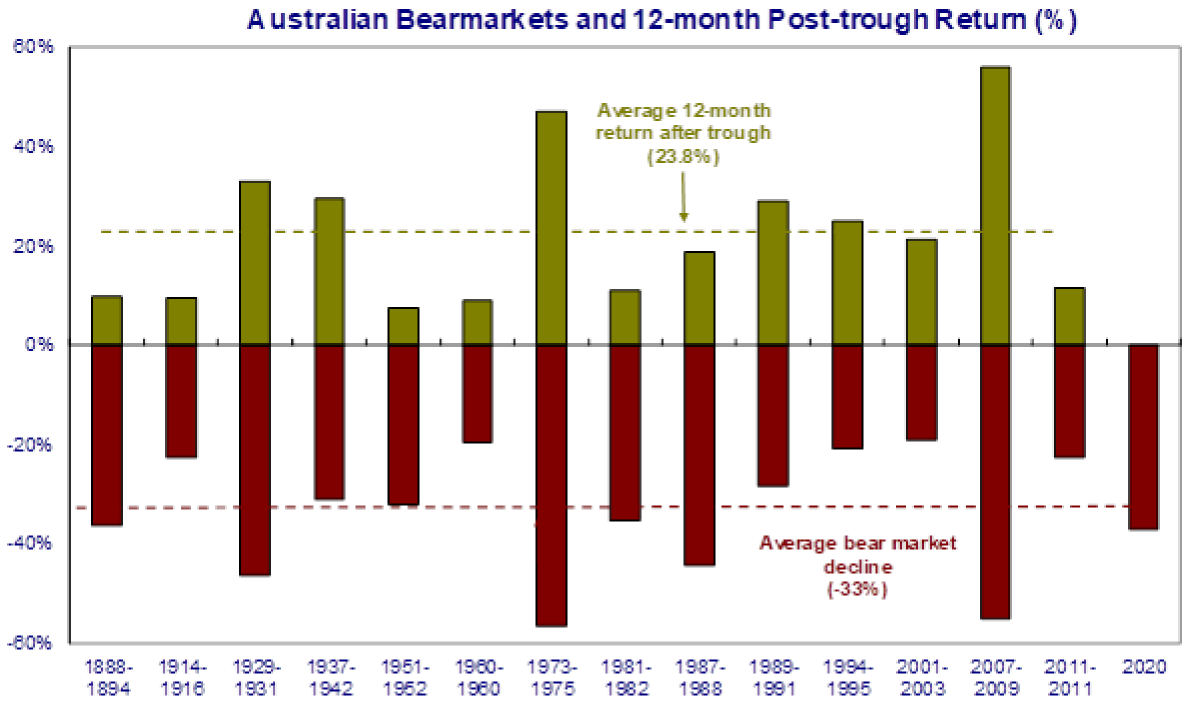
THE GLOBAL ECONOMY

- Preliminary PMIs confirmed that business activity has crashed to record lows in the US and Europe as the Coronavirus pandemic fuels an economic growth crisis, and raises questions about whether the large amount of stimulus to date will provide a backstop. We suspect it won't, as little of the stimulus will be spent as governments and central banks cannot stimulate what they are literally closing. Overall, we suspect China's GDP will contract at a record low of -40% q/qa pace in the March quarter and Europe by -20% q/qa, and risks are that the US and Europe will both be around -40% q/qa in the June quarter, raising questions about whether the market is priced for, and able to digest, such a huge earnings retracement.

The composite PMI gauge for Europe declined -20.2 to 31.4 which represents an all-time low and this was taken in the past few weeks when lockdowns were not strictly enforced which suggests the index is likely to decline further. Among the sectors, the largest decline was recorded in the usually less-cyclical services sectors (-24.2 to 28.4) which employs the vast bulk of workers in every major economy. Likewise the US service measure declined to an all-time lower of 39.1 (again before closures broadened and were truly enforced, and the series here is not overtly long). Meanwhile, manufacturing in both regions contracted at a slower pace (Europe -4.4 to 44.8 and US at 49.2 (which took the composite gauge down to 40.5)) but they are both at levels not seen for a decade.

THE FINANCIAL MARKETS

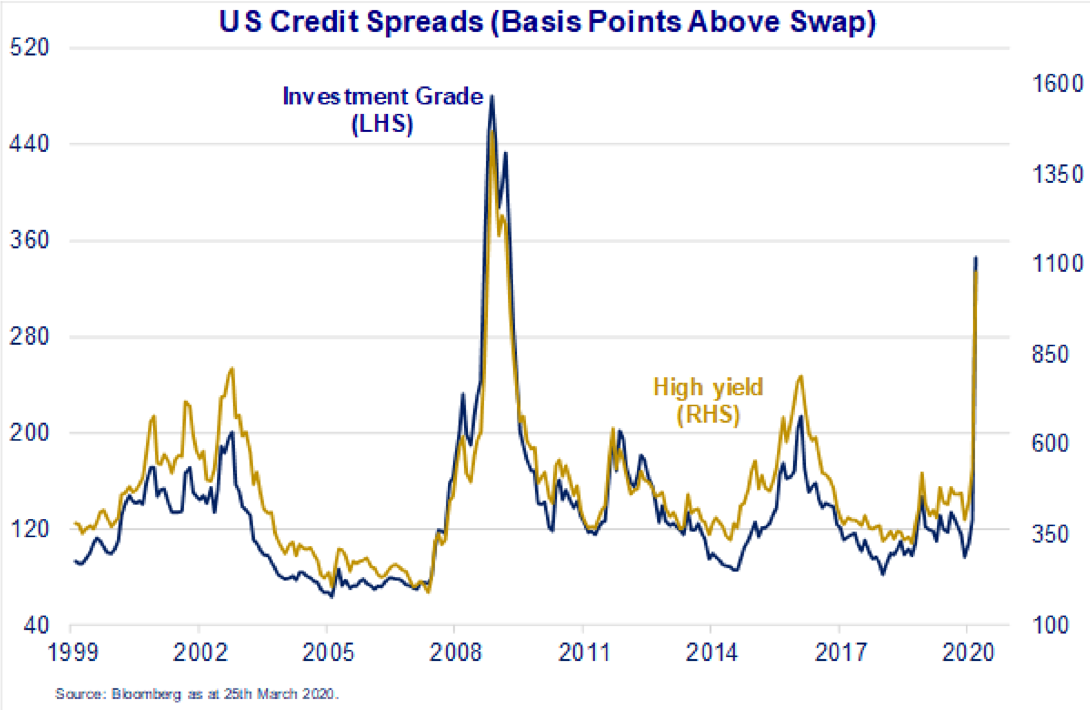
- **EQUITIES**
    - Markets overnight ignored the growth outlook and instead were buoyed around the likely passing of a USD2 trillion stimulus package by the US Congress. This sent the US (+9.4%) and European (+9.2%) sharemarkets sharply higher from multi-year lows, with the Dow Jones Index recording its largest daily gain (+11.4%) in 87 years. Among US sectors, gains were led by beaten up sectors including energy (+16.3%), industrials (+12.8%) and financials (+12.8%) as investors sought to deploy risk in areas with much more attractive valuations relative to a few weeks ago.
    - It was a similar story in Europe with gains led by energy (+15.0%), financials (+14.2%), consumer discretionary (+11.9%) and industrials (+10.0%) all of whom post double digit gains.
    - In Asian markets yesterday, there were strong gains all around led by Japan (+7.1%), Hong Kong (+4.5%) and China (+2.7%). In Australia gains were also solid (+4.2%), albeit after the market had recorded the sharpest 1 month drop ever, and posted its fifth largest bear market loss since 1875 – the only larger declines on the ASX were in 1987/88 (-44%), 1929/31 (-46%), 2007/09 (-55%) and 1973/75 (-57%). Interestingly, after the 14 bear markets shown in the chart below, gains in the 12 months following the trough averaged 24%.



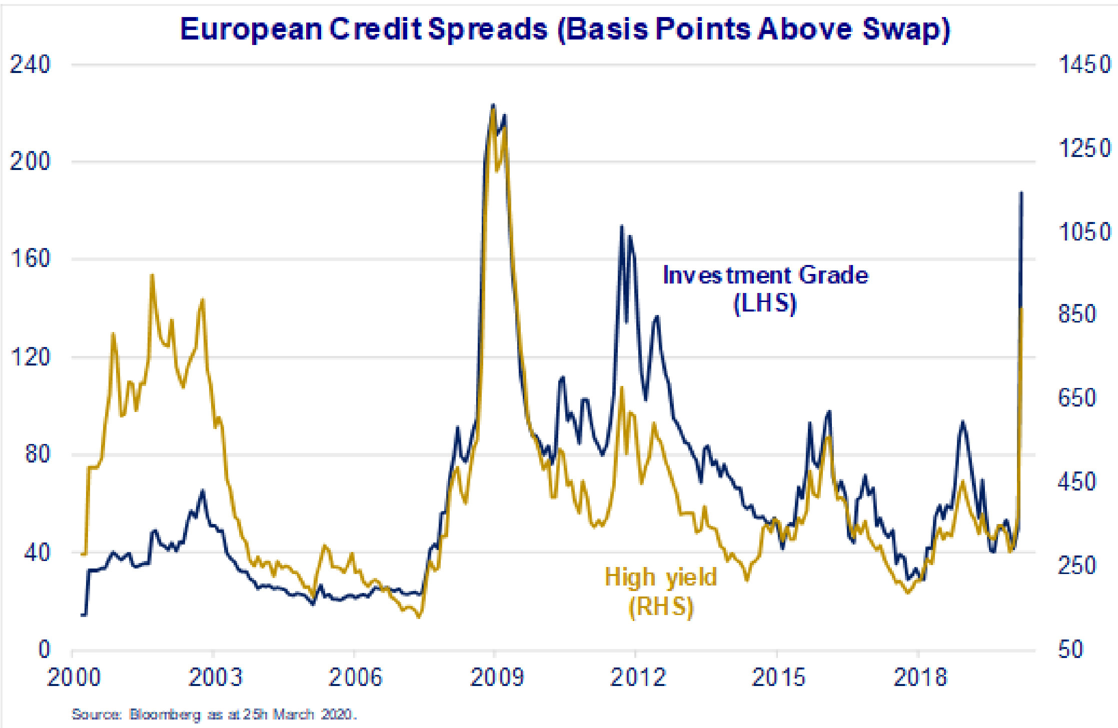
Source: Australian Stock Exchange as at 24th March 2020.

- **CREDIT**
    - While market liquidity remains very tight, US credit spreads followed the positive lead of equities and posted their first decline in two and a half weeks with investment grade spreads down -12 to 345 bpts and high yields fell to -13 to 1079 bpts. It is possible that the US Fed's recent policy adjustment including undertaking asset purchases in the IG space, has put a floor under spreads, but there is still a huge

economic contraction to contend with which is likely to see defaults rise sharply. Having said that, spreads declined in 8 of 11 subsectors, with -20 bpts declines in IT (to 268), telcos (345 bpts) and subordinated financials (415 bpts). Sadly, energy (+3 to 586 bpts) widened further despite a second consecutive day of higher crude prices (+3.9% to USD24.26 per barrel).

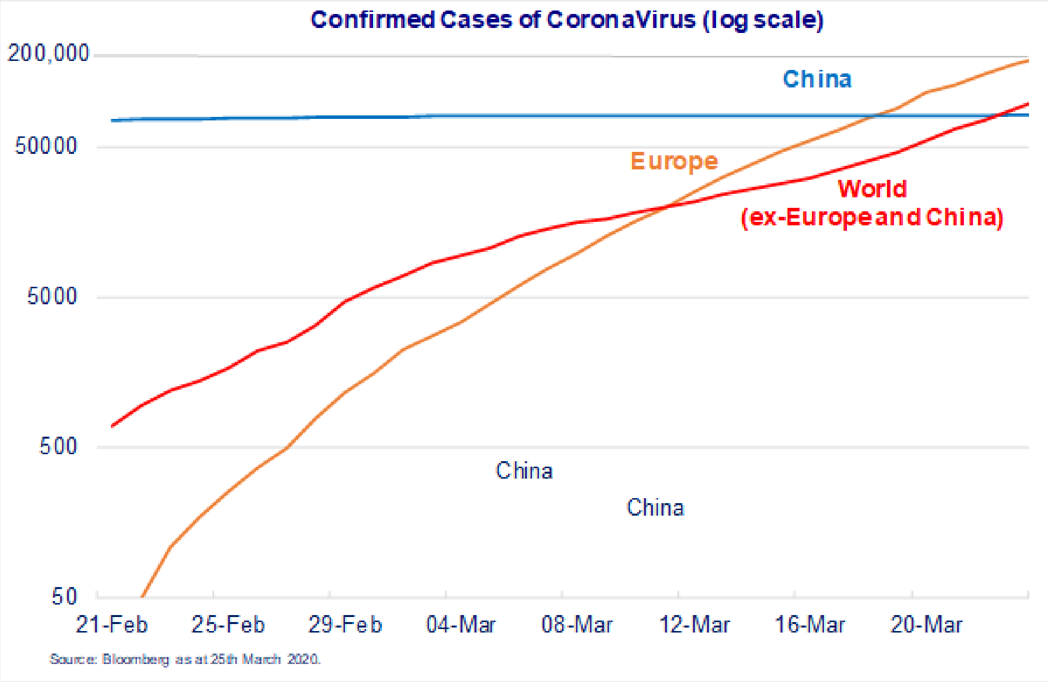


- European spreads were a bit mixed with IG higher for a 13th consecutive session (+6 to 188 bpts) to yet another post-GFC high, but HY was lower (-22 to 864 basis points) with declines in all subsectors other than utilities. It may be the case that central bank policy support may be giving investors more confidence (clearly from a low base) to deploy more risk, but it would be foolhardy not to acknowledge that any sentiment rebound, at this stage, would be highly fragile.

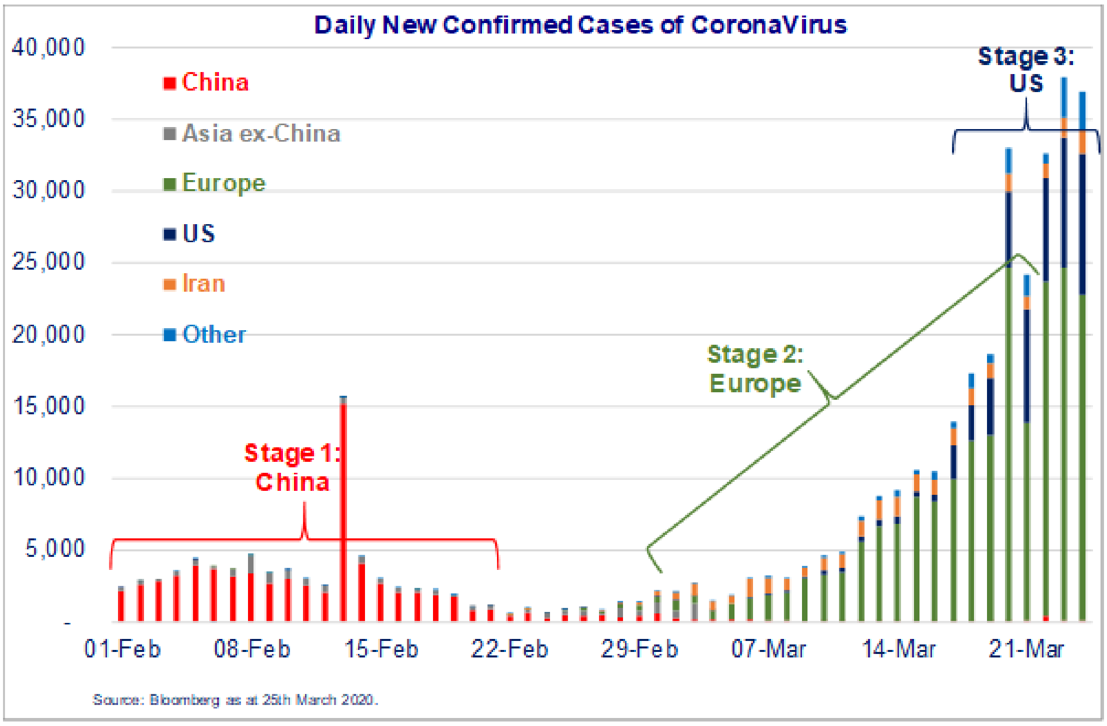


VIRUS UPDATE

- Yesterday recorded +41,714 new confirmed cases of Coronavirus which took the global tally to 414k, deaths rose +2,176 to 18.6k and the death rate rose to 4.5% (12th rise in the past 17 days despite rising case numbers);



- Most importantly, the number of daily new cases, whilst high, may be showing the early signs of topping out – even though there have been an additional +121k in the past 3 days. Among regions, Europe (+22,673 to 200k) continues to lead the world in total cases and daily new cases, and now Italy has had more deaths (6,820) than China (3277) and Spain (2800) put together. Interestingly, confirmed cases in the US (+9,834 to 51,542) are starting to rise sharply, which suggests a third phase may have opened.



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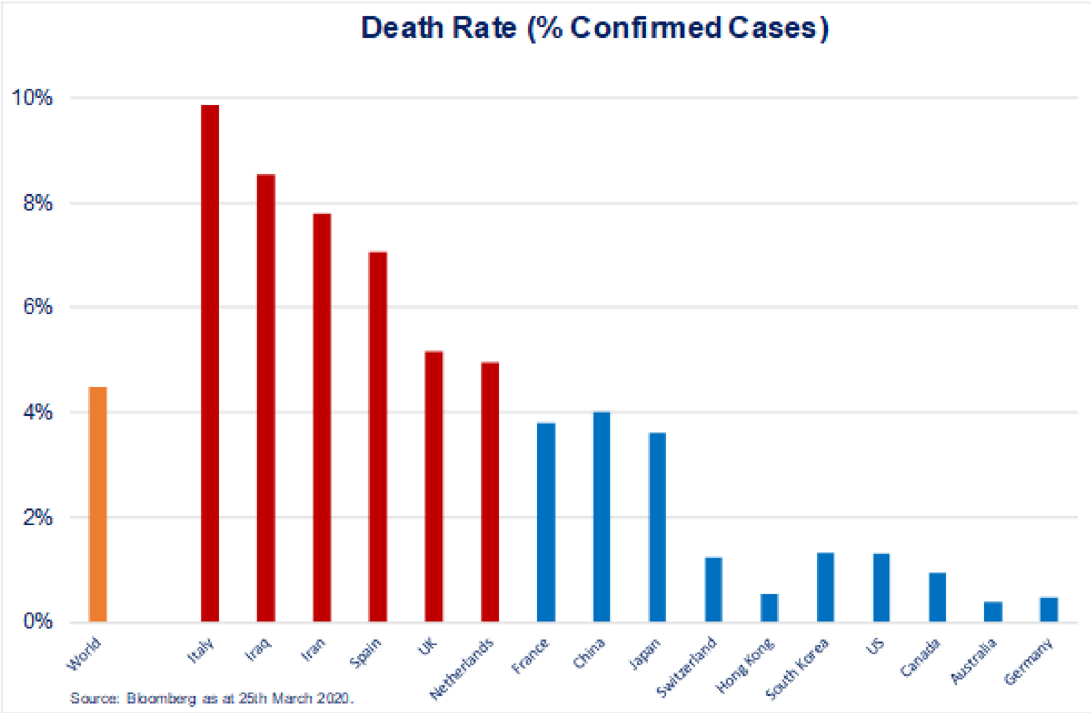
- Among countries, the most cases are in China (+95 to 81,591), Italy (+5,249 to 69,176), the US (which had its largest daily increase of +9,834 to 51,542), Spain (+6,587 to 39,676), Germany (+3,725 to 32,781), Iran (1,762 to 24,811) and France (+2,501 to 22,605). Australia confirmed cases remains low (+402) at 2,044.
- The global death rate (deaths divided by confirmed cases) rose again (+0.1%) to 4.5% with the worst region continuing to be Italy (+0.4% to 9.9%), followed by Iraq (-0.1% to 8.4%), Iran (-0.1% to 7.8%), Spain (+0.4% to 7.1%), the UK (+0.2% to 5.2%) and Netherlands (+0.4% to 4.9%).



Yours sincerely,

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MORE INFORMATION

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