Perpetual Investments

THOUGHTS ON THE MARKET

26th August 2020 - US market hits another all-time high, but the FY21 earnings outlook looks weak

SUMMARY

- The global sharemarket closed higher on US strength, and credit markets were mixed and little moved, with the markets continuing their usual intra-day pattern. When poor economic data is released, COVID-19 cases soar or policy makers suggest some form of tapering, markets buy tech shares and bonds, but on days when data is more upbeat or there is talk of vaccine developments, investors purchase the cyclicals sectors such as energy, financials or industrials, which have lagged the recovery.

  In other markets, 10-year US Treasuries rose +3 points to 0.68% with modest curve steepening, commodities were mixed with oil up (+1.7% to USD43.43 per barrel – which is a 5½ month high) but gold declined (-1.1% to USD1,928 per troy ounce), and G10 currencies were mixed against the Greenback with the Yen (+0.6%) and Sterling advancing (+0.2%), but the Euro and AUD were both steady (the latter at USC71.94).

- In macro land, there wasn't a lot of new information, but the latest Australian payrolls report showed a -0.8% decline in the 2 weeks to 8th August which combined with the previous report implies that the Australian labour market recovery has lost the gains since June 6th, with the August Labour Force Survey likely to detail job losses of around -100k jobs when it is released in September. The associated decline in nominal wages is worrying as this is before the JobKeeper supplement is set to be tapered in the December quarter. In other reports, July US new home sales were upbeat, the August Richmond Fed manufacturing index beat street estimates but the US Conference Board's consumer confidence gauge declined to a six-year low in August and this is part of our US earnings model which is still pointing to very weak US EPS growth in mid-2021.

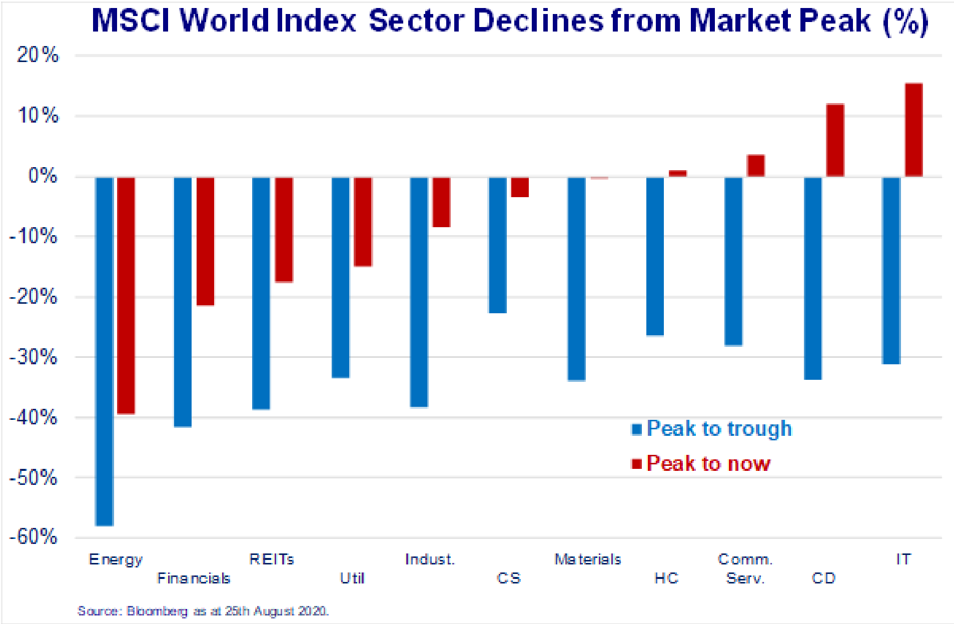
- The number of global cases of COVID-19 is 23.75 million with another +114k cases so far (but Brazil, India, Mexico and 7 US states have not reported their numbers) which means that Tuesday is set to be the 37th day in the past 38 where daily increases are greater than 200k. At present, 8 countries have more than 500k cases, 20 countries have more than 200k cases and 29 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 and 4 days. More importantly, the growth rate of daily confirmed cases (+1.0% since Saturday) is once again coming down. Meanwhile, deaths stand at 815.7k and the death rate has declined to 3.44% although the number of daily deaths is on the rise.

FINANCIAL MARKETS

- **EQUITIES**
  - **The MSCI World Index closed +0.2% higher** with advances in 7 of the 11 GICS sectors. Defensive sectors tended to outperform cyclical and growth sectors with the pace of gains led by communications services (+0.7%) after Facebook (+3.5%) unveiled a series of tools designed to expand demand on its social media platforms. Meanwhile healthcare (+0.4%) was among the better performers on biotech gains which were supported by a redesign of the Dow Jones Industrial Average which will include firm Amgen (+5.4%). Elsewhere, IT (+0.4%) beat the market tape on advances in both software and semiconductors which were partially offset by declines in hardware. Financials (+0.3%) rallied for a second straight session and performed in line with the broad index, whereas materials (-0.5%) and energy (-1.4%) were at the tail-end of the field despite higher commodity prices. The overnight moves had little impact on sectors peak-to-now

Perpetual

dynamics other than materials (-0.3) falling slightly below its February peak meaning only four sectors now sit above their respective levels of February 20th (see chart).

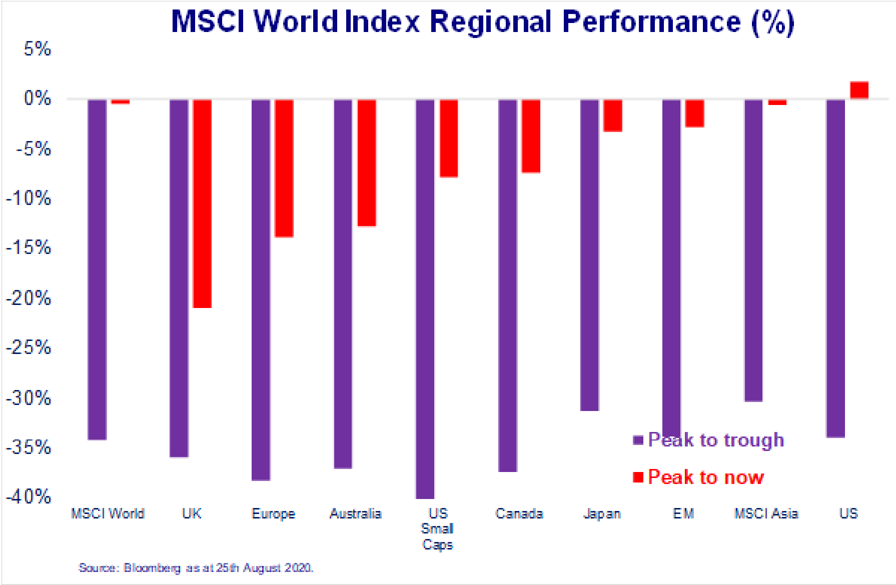


- **Among the regions**, Asian led the pace of gains (+0.6%) with optimism from the prior US and European sessions boosting regional sentiment on a day which lacked directional drivers. The first confirmed case of COVID-19 reinfection (in Hong Kong) raised questions about how much protection antibodies provide, but markets were not impacted as overall cases fell in Hong Kong. Japan, South Korea and Australia. The main news headline during the session was the US Treasury announcement that the US-China Phase 1 trade talks had resumed with both sides reaffirming commitment to the deal. Meanwhile, TikTok launched a lawsuit Monday in bid to challenge US government restrictions. By the regional bell, South Korea (+1.6%), and Japan (+1.4%) recorded large gains, followed by Taiwan (+0.9%), Australia (+0.5%) and Greater China (+0.1%), with Hong Kong (-0.3%) the only major regional market to close lower.

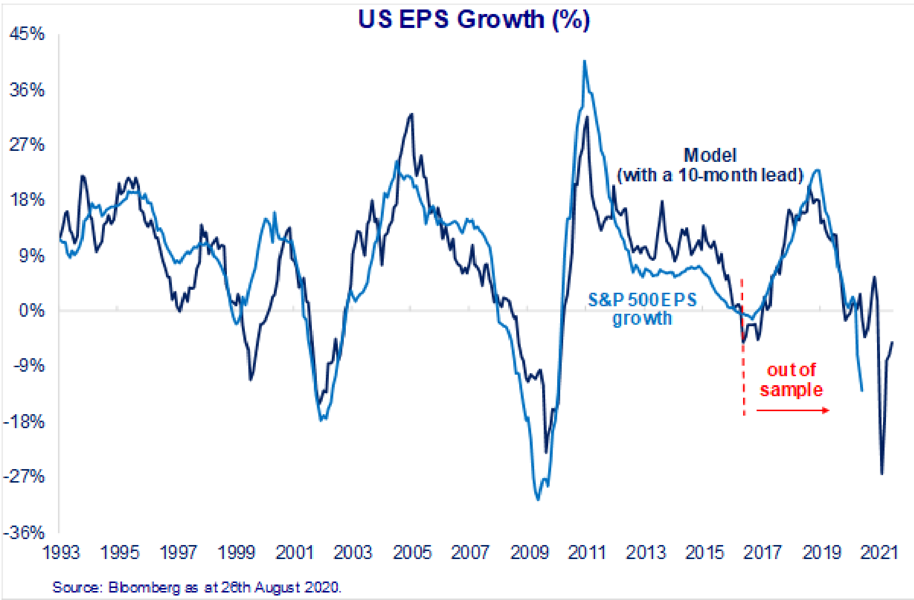
- **While US equities (+0.4%) closed at an all-time high** for a third consecutive day, it was a quiet session. The day lacked market moving catalysts, but the path of least resistance seems to be higher on back of general COVID-19 optimism supported by falling case numbers and also vaccines/treatment headlines although it is hard to decipher fact from corporate spin. The mood was also boosted by expectations that the US Fed Chair will detail or preview this week the Bank's expected shift toward an average-inflation targeting regime which will lead to lower-for-longer rates. In addition, there were positive headlines about the resumption of the US-China trade talks as both sides reiterated their support for the deal. However, these supports were tempered by mixed economic headlines with the August Richmond Fed manufacturing surprising to the upside (+8 to +18), but the August Conference Board consumer confidence measure missed consensus (84.8 vs 93.0) and fell to a six-year low. By the bell at the NYSE, the NASDAQ100 (+0.8%) and S&P 500 (+0.4%) both closed at all-time highs, the Russell 2000 (+0.2%) advanced, but the Dow Jones (-0.2%, -60 points, 28,248) fell for the first time in four sessions.

- **European equities (-0.1%) was the only region to close lower,** despite an upbeat opening. It was a day which was light on updates, with the primary macro news being the German Ifo survey where the current assessment (+87.9 vs consensus of 85.3) was better than expected, and the final measure of German GDP which also beat the street (-9.7% q/q, -10.1% q/q) but the latter is always a non-event for the sharemarket. There wasn't much on the COVID-19 front even though regional case numbers (+14.1k) were half of the previous day's record high which kept the region's R-factor at an elevated 1.3 which indicates that the virus is still spreading, and there were reports of two people in Europe also being re-infected. In corporate news, Credit Suisse (-0.7%) said it plans to close 35 Swiss branches and merge other subsidiaries as part of a CHF100 million cost savings plan and by the regional bell, most bourses were in negative territory led by the UK (-1.1%), Switzerland (-0.8%), Italy (-0.4%), Sweden (-0.1%), Germany (-0.04%), Spain (-0.01%) and France (steady).

The overall, market moves overnight saw the UK (-20.9%) slip back into bear market territory, but there wasn't much else in terms of movements (see chart).



- **The latest update on our US earnings model** suggests that annual US EPS growth will remain in negative territory by mid-2021, although there is a clear improvement underway. The growth rate suggests the US corporate sector needs more than just re-opening to rebuild opening models back to pre-COVID-19 levels and it highlights the need for continued policy support, particularly on the fiscal side which is a worry considering the protracted debates currently underway in the US Congress about stimulus payments. Once the US election is out of the way, the debate may become even more unfriendly if each side wins one house in the US Congress as is currently expected, thereby bringing more downside risks to the corporate outlook.

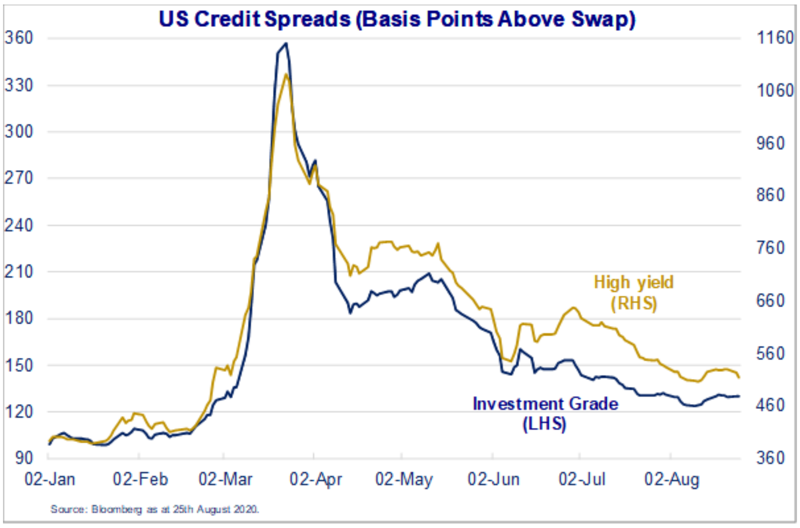


- **S&P Dow Jones Indices said it would add Salesforce.com, Amgen and Honeywell to the 30-member Dow Jones Industrial Average and remove Exxon, Pfizer and Raytheon.** Alternations to the index occur periodically and the change in 2020 is primarily underpinned by Apple's 4-for-1 stock split, which would significantly reduce the index's exposure to tech. The index designer said the shakeup will remove the overlap between companies of similar scope and add new types of business that better reflect the US economy. It has to be remembered that the S&P 500 is a market capitalisation-based index, but the Dow Jones Industrial Average is price-weighted which means that stocks with higher share prices have a larger weighting and more influence on index moves.

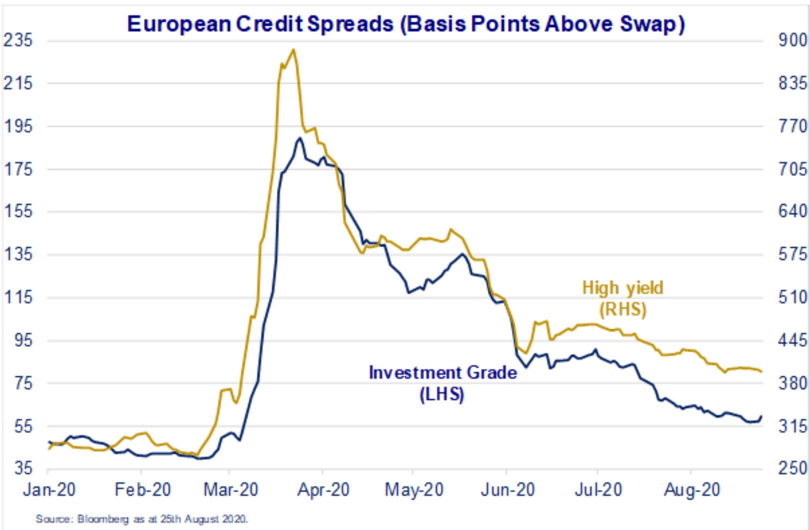
- **Futures markets suggest a weak opening in Asia** with Australia (-0.5%) and Japan (-0.3%) slated for opening bell losses, whereas Hong Kong (+0.1%) is priced for a modest advance after yesterday's decline.

CREDIT MARKETS

- Regional credit indices were mixed and little moved, with spreads in the US investment grade universe unchanged as has been the case for four of the past five trading sessions, at +130 bpts, which kept the recovery rate at 89%. Eight of the 11 sub-sectors recorded lower spreads, but none of them were more a half a basis point for a second consecutive session (see chart). There was a bit more action in the high yield space where spreads contracted -9 points (the most in 3 weeks) to +514 bpts, which lifted the recovery rate two notches to 85%. All 11 subsectors recorded lower risk premiums with three recording a double-digit decline led by industrials (-16 points, +644 bpts, 56%) which has been the worst performer since February, healthcare (-13 points, +490 bpts, 78%) which caught a tailwind from all the positive geomedical headlines about treatments, and communication services (-11 points, +402 bpts, 97%) which rallied in line with its equity peer.



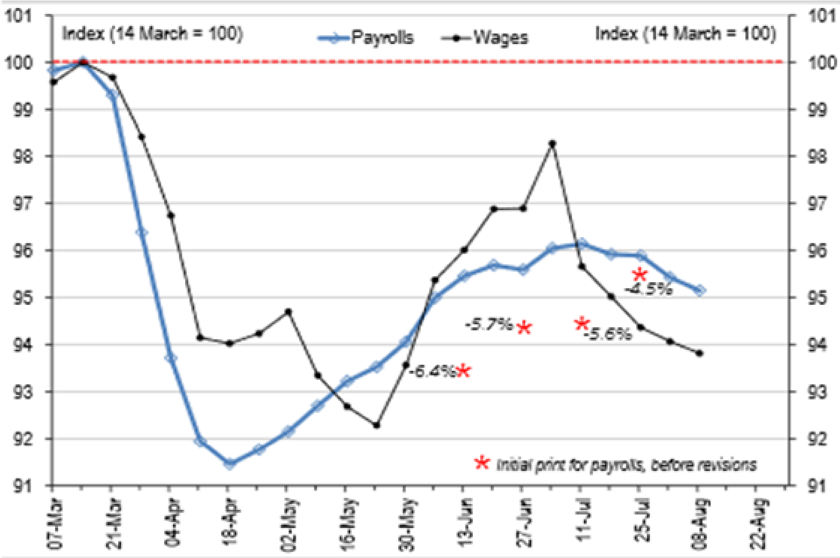
- **European credit markets were mixed** with spreads in the investment grade universe increasing +3 points (largest rise in 9 weeks) to +60 bpts, which lowered the recovery rate one notch to 87%. There were spread increases in ten of the 11 subsectors led by healthcare (+4 points, +31 bpts, +31 bpts, 91%), consumer staples (+3 points, +45 bpts, 88%) and communication services (+3 points, +58 bpts, 85%). In the high yield space, spreads declined by -2 points (third consecutive fall) to +397 bpts (see chart), but the recovery rate was unchanged at 79%. There were lower risk premiums in ten of the 11 sub-sectors but moves were modest led by energy (-5 points, +495 bps, 77%) given the solid rise in crude prices, materials (-5 points, +353 bpts, 80%) which responded well to higher base metals prices such as copper and aluminium, and tech (-3 points, +335 bpts, 66%).



THE GLOBAL ECONOMY

- **The Victorian lockdowns have underpinned a -0.8% decline in Australian payrolls** in the 2 weeks to 8th August and this came after -0.3% in the prior two weeks. This implies that the Australian labour market recovery has rolled over with all the gains since June 6th and this suggests that the August ABS Labour Force Survey could detail job losses of around 100k. Moreover, since the employment peak in mid-March, total Australian employment is down by -4.8% (see chart).

  Obviously, declines in Victorian payrolls (-1.6% in the past two weeks and -3.1% over the past four weeks) were the largest contributor to the payrolls weakness, but other states collectively lost a surprisingly large number also (-0.5% in the past two weeks and -0.2% over the past 4 weeks). Importantly, yesterday's data only captures the beginning of stage 4 lockdowns (which were implemented on August 2nd), so it's hard to imagine these numbers improving by end August with the recent closure of some state borders, and the implementation of other mobility restrictions, bringing further downside risks in the next month. Meanwhile, wages have slumped a worrying -4.5% in the past 8 weeks suggesting a net -6.2% decline in wages since the pandemic began. More importantly, the decline in wages is far in excess of payrolls (-4.8% - see chart) which implies that nominal wages are falling, and this is before the JobKeeper supplement is tapered in the December quarter.



Source: ABS, UBS

- **There were also other third tier data releases:**
  - **The US Conference Board's consumer confidence gauge declined -6.9 points m/m in August to 84.8 (six-year low).** The result was well below consensus (93.2) and the recent April trough (85.7). Among the components, the "present situation" index fell -11.7 points to 84.2 and expectations dropped -3.7 points to 85.2. The report noted that business and employment conditions deteriorated in the past month and that spending is expected to cool.

  - Elsewhere**, July US new home sales** came in at a 901k which represents a rise of +13.9% m/m (+36.3% y/y), was well ahead of consensus (782k) and had upgrades for June (+15k to 791k). Among the regions, the largest gains were in the mid-west (+58.8% m/m).

  - The **August Richmond Fed manufacturing index** came in at 18 which was well ahead of consensus (10) which was the opposite of the Philly Fed report last week, with both new orders (+6 to 15) and employment (+20 to +17) improving.

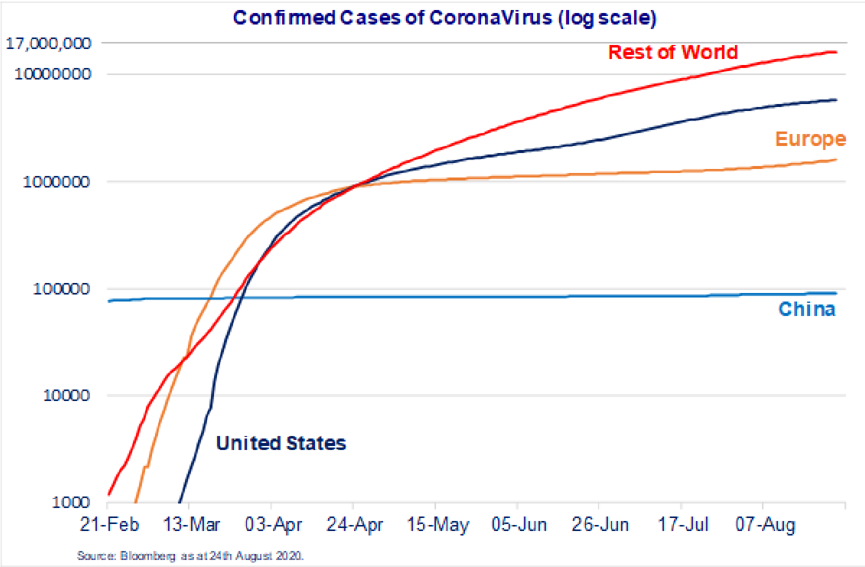
POLICY

- There were no material policy changes.

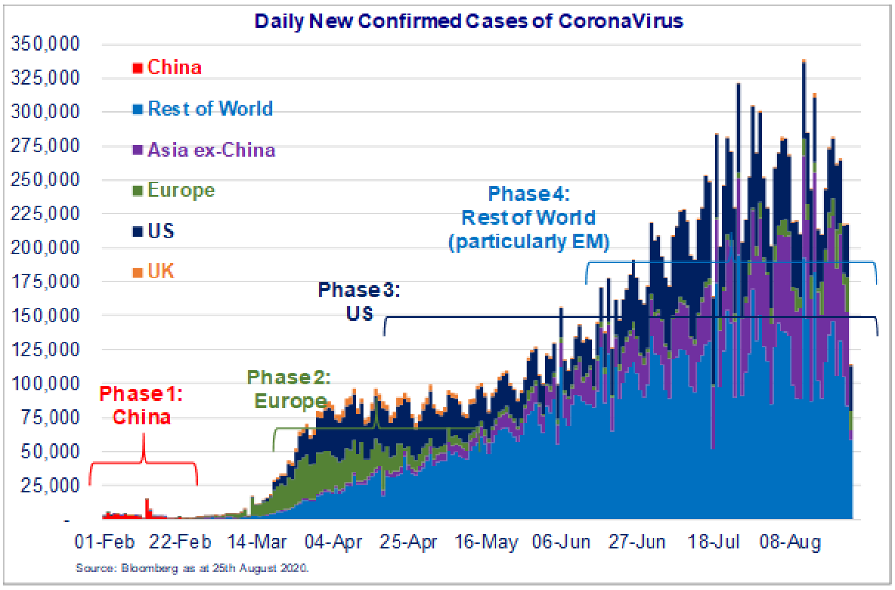
VIRUS UPDATE

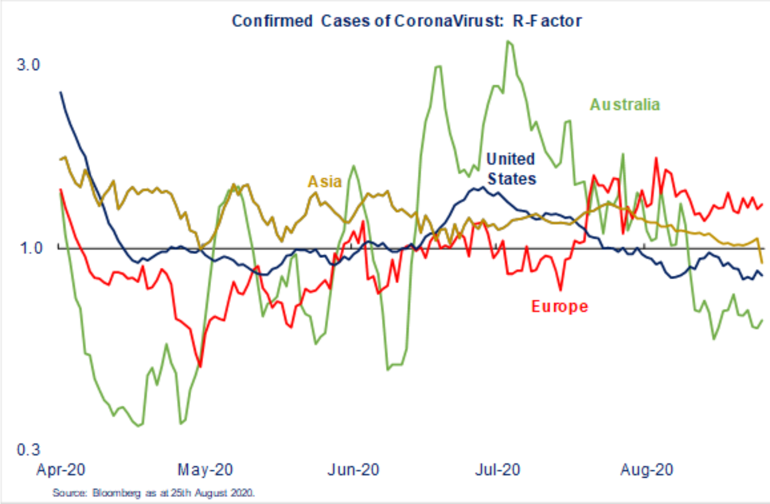
- The number of global cases of COVID-19 is 23.75 million with another +114k cases so far (but Brazil, India, Mexico and 7 US states have not reported their numbers) which means that Tuesday is set to be the 37th day in the past 38 where daily increases are greater than 200k. At present, 8 countries have more than 500k cases, 20 countries have more than 200k cases and 29 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 and 4 days. More importantly, the growth rate of daily confirmed cases (+1.0% since Saturday) is once again coming down. Meanwhile, deaths stand at 815.7k and the death rate has declined to 3.44% although the number of daily deaths is on the rise.



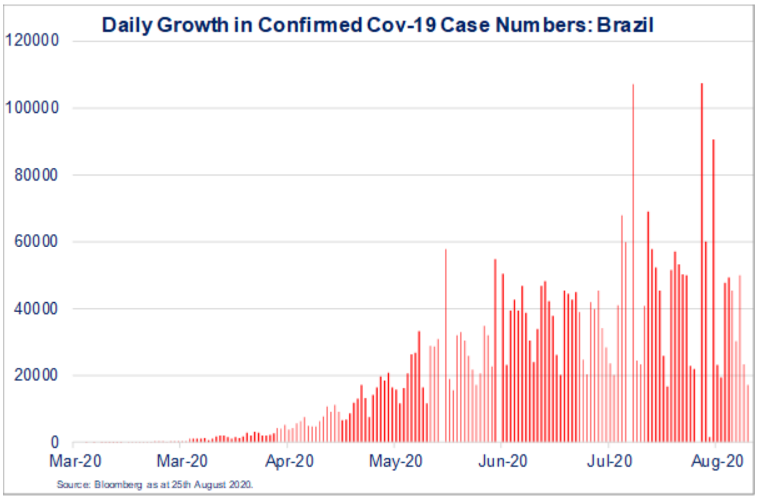
- We break the infections into four groups – the US, Europe, China and 'others' and the rest of the world outside the G3 economies now has the most total cases (+59k to 20.2 million) and highest daily new cases (and by a considerable margin) followed by the US (+33.7k to 5.77 million, although 7 states 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 (+14.5k to 1.60 million - see chart) which is the only region with an R-factor above 1.0.

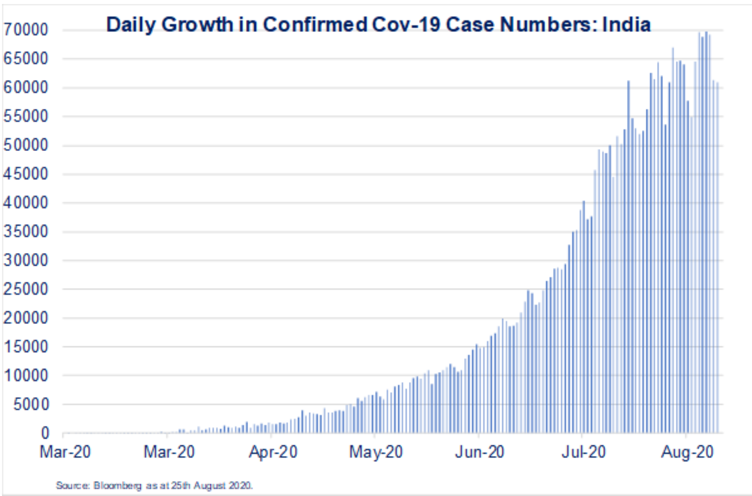


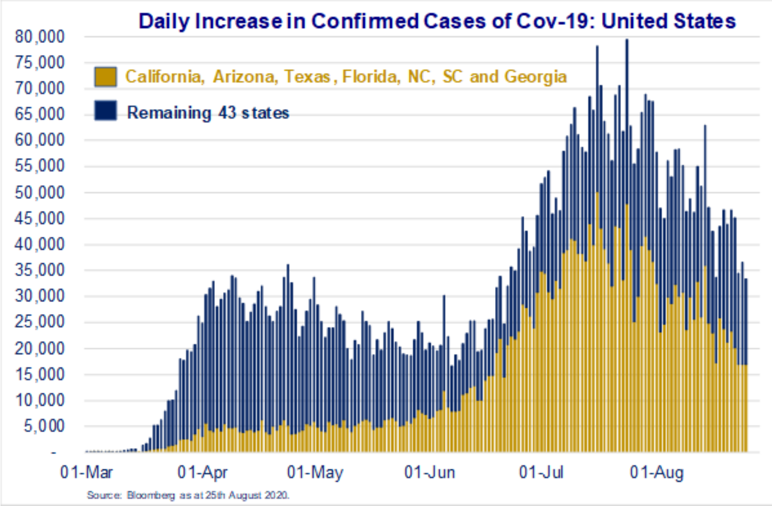


- Among countries, the most cases are in the US (+33.7k (so far) to 5.77 million, with 7 states yet to report), Brazil (not reported, 3.62 million), India (not reported, 3.17 million), Russia (+4.6k to 963.7k), South Africa (+1.6k to 613.0k), Peru (+6.1k to 600.4k), Mexico (not reported, +563.7k), Colombia (+10.5k to 551.7k), Spain (+7.1k to 412.6k), Chile (+1.4k, 401.0k), Iran (+2.2k to 363.4k), United Kingdom (+1.2k to 329.8k), Saudi Arabia (+1.1k to 309.8k), Pakistan (+0.5k to +293.8k), Bangladesh (+2.5k to 299.6k) and Italy (+0.9k to 261.2k). Australia confirmed cases rose +149 to 25.2k yesterday which placed us 65th in terms of total infections.

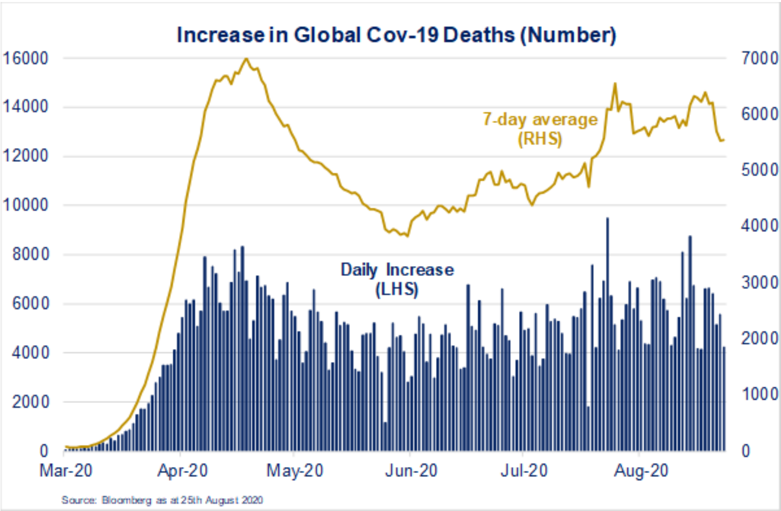
  Elsewhere, Singapore recorded +31 new cases to 56.4k most of which are linked to foreign workers who are forced to live in crowded dormitories, but Indonesia (+2.5k (third highest) to 157.9k) is now on the rise and has the second most cases in the region behind only the Philippines (+2.9k to 197.2k).

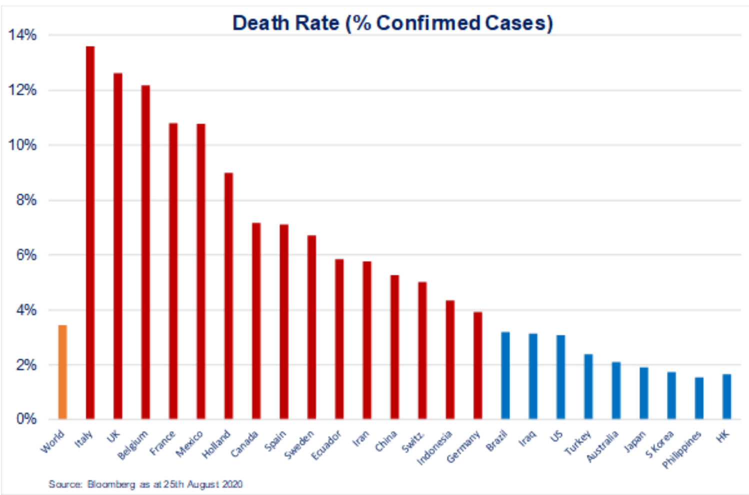






- Although final numbers are not in until 1pm AEST, the global death rate declined to 3.44% with the global total to 815.8k after another +3.0k deaths overnight, so far, which indicates the daily average deaths is stabilising again (see chart). The US (+0.45k so far) has the most deaths at +178.3k, with Brazil (not reported, 115.3k), Mexico (not reported, +60.8k), India (not reported, 58.4k), the UK (+16 to 41.5k), Italy (+4 to 35.4k) and France (+16 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 13.6%), the UK (steady at 12.6%), Belgium (-0.1% to 12.2%), France (steady at 10.8%), the Netherlands (-0.1% to 9.0%), Spain (-0.4% to 7.1%) and Sweden (steady at 6.7%). However, several emerging markets are now on the leader board including Mexico (-0.1% to 10.8%), Ecuador (-0.1% to 5.8%), Indonesia (steady at 4.4%) and Brazil (steady at 3.2%).





Perpetual

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