

THOUGHTS ON THE MARKET

26th March 2020

SUMMARY

- It was another positive night on global sharemarkets with all regions posting consecutive gains for the first time since mid-February. However, the rally was unconvincing with the US market, in particular closing well off its peak and with little momentum. As the environment is governed by massive uncertainty, large price declines and very high economic risk, elevated two-way volatility should be expected, as we saw in mid-November 2008 in the wake of several Congressional stimulus packages when the US markets rallied +24.2% over the six weeks to end-2008 and then gave it all back (and more) by falling -29% to its March low of 666 in 2009.
- In a positive sign credit spreads in the US fell for a second consecutive day and this suggests that central banks may have convinced markets that the Fed is getting ahead of funding market stresses and have fixed the plumbing in the global financial system, particularly the shortage of US dollars. However, the impending record contraction in US (and global) GDP that is ahead for Q1 and Q2 may produce an avalanche of ratings downgrades from Investment grade to junk, which could test market liquidity, so caveat emptor!
- What we believe is needed for investors to have high confidence that risk markets have found a sustained bottom is:
 1. A stabilisation of growth rate COVID-19 cases in the world's three largest economies – China (cases here have stabilised and declined for a month), Europe (things may be in the process of stabilising but they are not declining) and the US (daily new cases are still growing);
 2. Declining credit spreads – which may have started in the IG space after central banks put their balance sheets on the line to support the market, but downgrades could test this;
 3. The financial sector has capacity to undertake intermediation again; and
 4. A restoration in private sector balance sheets – so this part of the economy can invest in capital and labour to enhance the recovery when public stimulus has faded.

This combination will provide a steadfast foundation to bring unemployment down and to create positive reinforcing feedback loops in terms of activity, profits, labour market gains and investment. Risk markets will not have to see all four to begin their recovery, but investors need to remain cautious as major downside risks in markets are still prevalent and may spark when the economic damage from sector closures reveals itself.

POLICY RESPONSES

- Republicans and Democrats and the White House came to an arrangement on the USD2 trillion stimulus package, but the bill remains contained in US Senate procedural issues as its final details are debated. The dispute is around unemployment benefits and if it should be outlawed for a worker to receive more unemployment benefit than they receive in wages. As such, Senate Leader Mitch McConnell (R) has not yet set a time for the vote, but it is expected today.

Major parts of the package include USD250 billion in direct payments to all adult US citizens, USD367 billion in small business loans that will be forgiven if employees are retained, a USD500 billion loan guarantee program for industries, cities and states, USD150 billion for state and local stimulus funds and USD130 billion for hospitals and expanded unemployment benefits.

THE GLOBAL ECONOMY

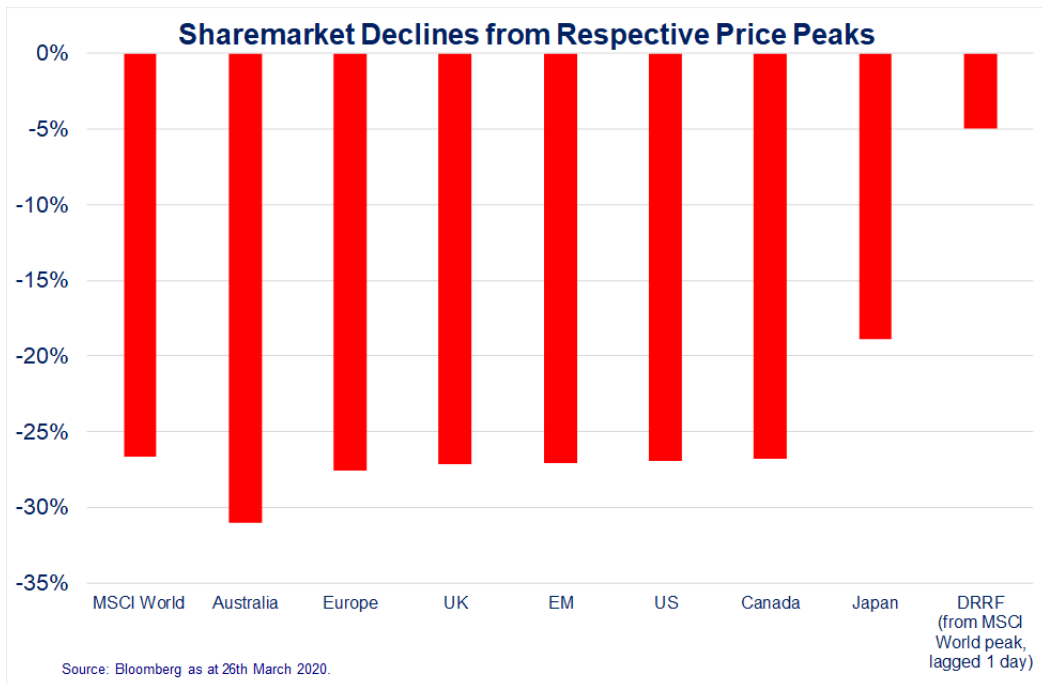
- US new orders for February rose +1.2% m/m, but the increase reflected a large 26% m/m boost for defense equipment and some increase for motor vehicles (+1.8% m/m), which saw goods ex-transport decline -0.6% m/m and there was broad weakness, with declines in fabricated metals (-1.2% m/m), machinery (-0.5% m/m), and computers (-0.8% m/m). There was also downgrades to the January number, which culminated in stalling business investment so far in Q1.
- The big data out tonight in US jobless claims for last week and this could be +3 million which would be a record.



FINANCIAL MARKETS

• EQUITIES

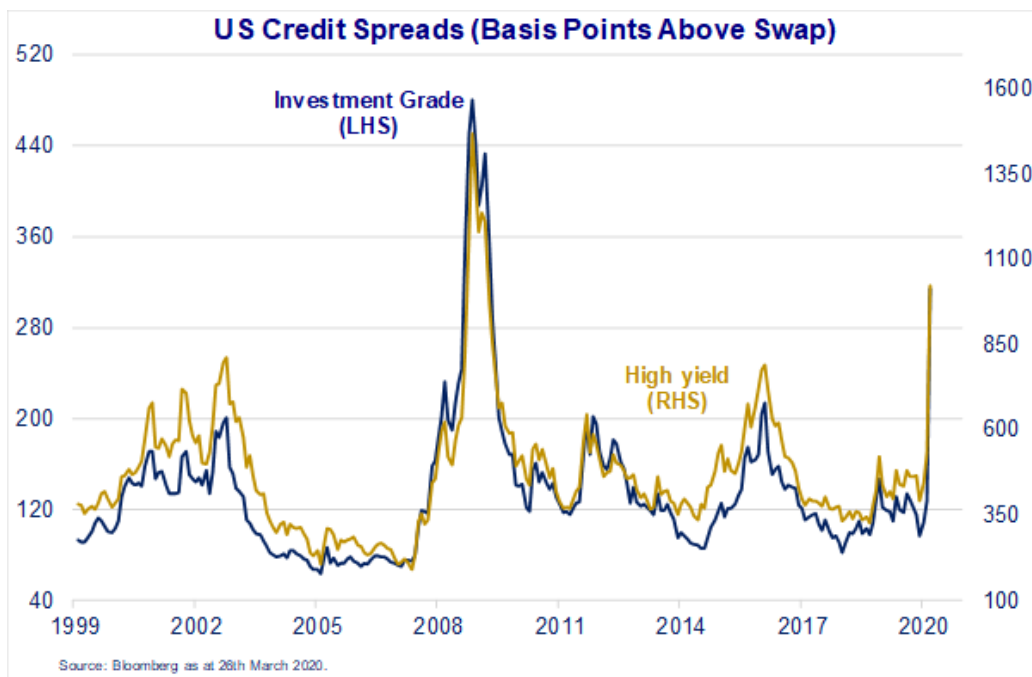
- Overnight regional equity markets all posted gains with rises led by Europe (+3.1%) driven by gains in energy (+7.0%), industrials (+5.6%) and consumer discretionary (+4.9%), whereas defensives such as utilities (+1.8%), healthcare (+1.8%) and telcos (-1.0%) tended to lag. The overnight increase took the regions peak-to-trough decline down to -27.6%.
- US markets also increased overnight but the increase was tempered in the final hour of trading by the continued delay of the US Senate in passing the USD2 trillion stimulus program. The overnight rise followed on from Tuesday's large bounce when Dow posted its biggest one-day gain since the Great Depression, and S&P500 rose the most since October 2008. Among the leading indices, the Dow Jones Industrial Average increased +2.4%, S&P 500 +1.2%, but the NASDAQ declined -0.5%. Among S&P sectors gains were led by cyclicals with industrials (+5.3%), energy (+4.5%), whereas defensives such as consumer staples (-0.2%) and telcos (-1.6%) fell as well as IT (-0.3%).
- In Asian markets yesterday, gains were very large led by Japan (+8.0%), Australia (+5.5%), Hong Kong (+3.8%) and China (+2.7%). Despite another large rise in the domestic index, Australia now has the largest decline in regional markets, although futures markets suggest a further +2% gain this morning at opening.



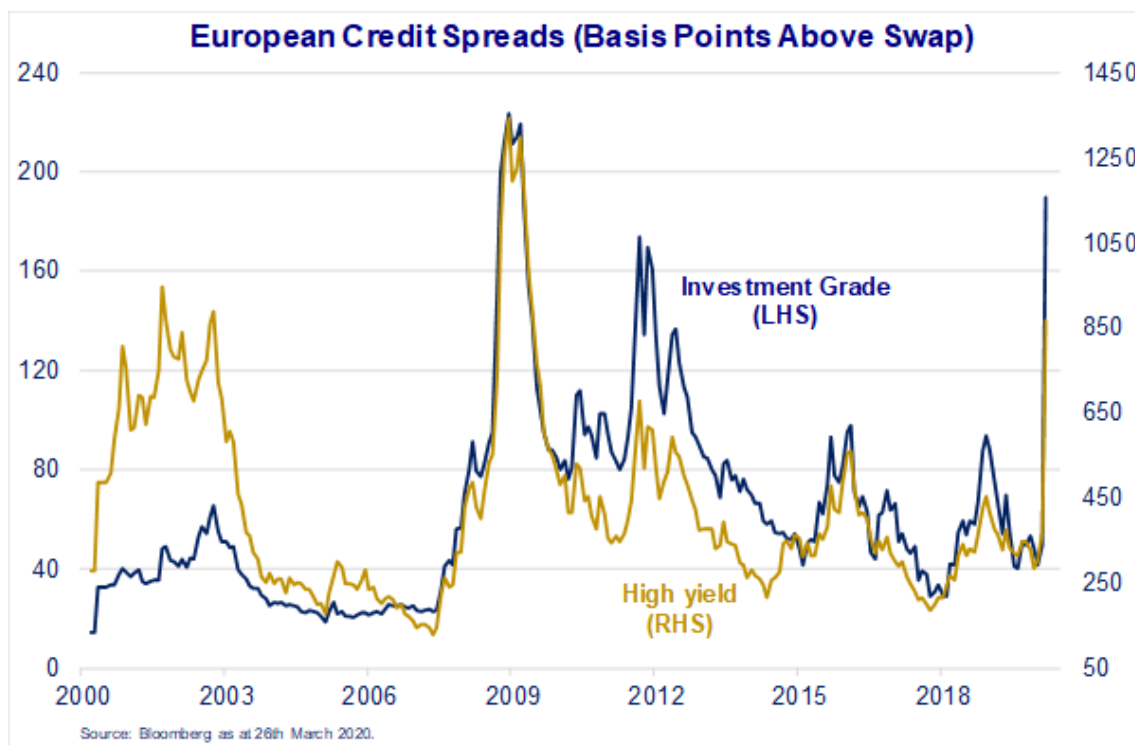
• **CREDIT**

- Overnight US automobile manufacturer Ford was downgraded to Junk by Standard and Poor's (downgraded to BB+ from BBB-) in what may be the first in an avalanche of downgrades in the USD2.5 trillion BBB space which may test the credit market's liquidity.
- In a more positive sign US credit spreads declined for a second consecutive day. IG spreads fell -31 bpts in its largest single day gain since 2009. This decline may demonstrate the market's confidence that the policy announcements from the US Fed, including putting its balance sheet on the line to backstop this market sector, has eased the stresses in funding markets.

There were across-the-board double-digit declines in spreads with gains led by telcos (-44 to 299 bpts), financials (sub -41 to 373 bpts) and energy (-11 points to 575 bpts). In the HY markets spreads contraction was even larger at -55 to 1,022 bpts with rallies of over 25 basis points in all sectors including energy (-56 to 2257 bpts) and telcos (-75 to 860 bpts).

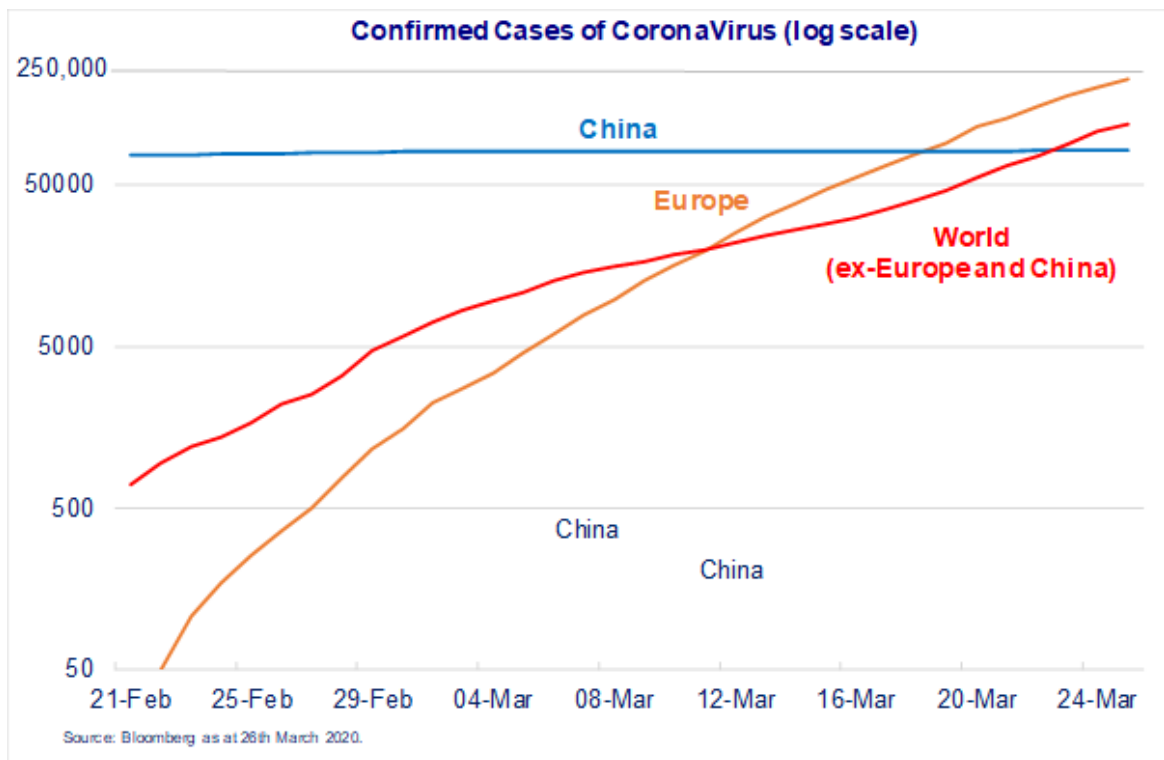


- In Europe, spreads were mixed with increases in IG space (+2 to 190 bpts) and HY -50 to 815 bpts. In the IG space moves were minor with sub-financials (-6 to 328 bpts) the only sector of note and in HY only utilities rose (+4 bpts) but all others recorded contractions in excess of 20 bpts with energy (-41 to 1158 bpts) recording its first set of back-to-back declines since mid-February.

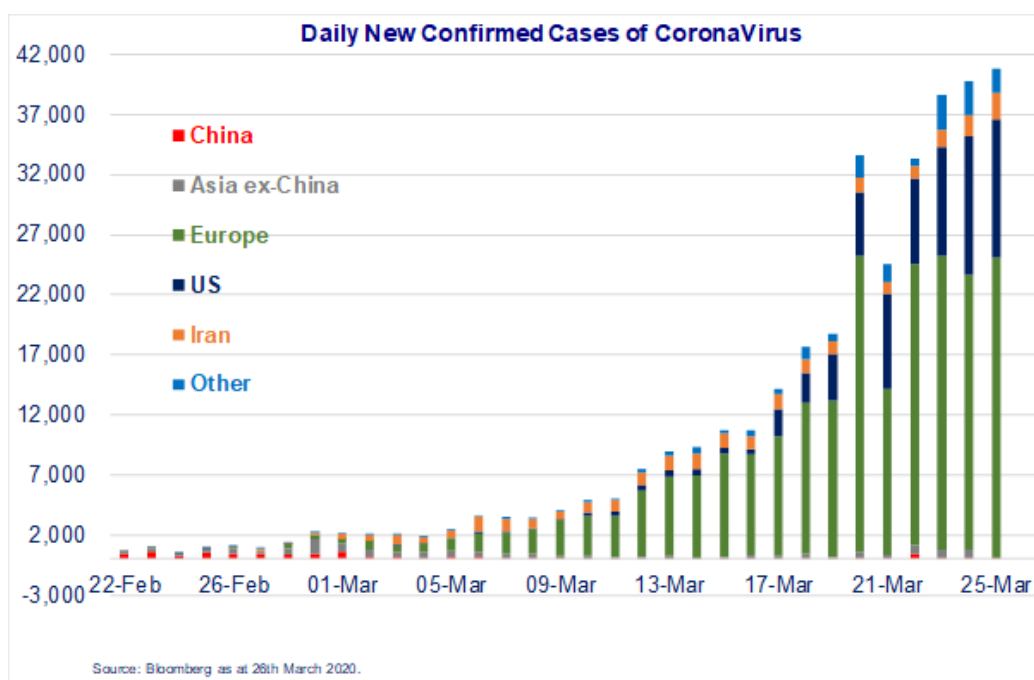


VIRUS UPDATE

- Yesterday recorded +46,328 new confirmed cases of Cov-19 which took the global tally to 464k, deaths rose +2,250 to 20.9k and the death rate rose to 4.5% (13th rise in the past 18 days despite rising case numbers);



- Among regions, Europe (which recorded a record high daily rise in new cases of +25,016 to 225k) continues to lead the world in total cases and daily new cases, and now Italy (7,503) and Spain (3,434) have more deaths than China (3,277). Interestingly, confirmed cases in the US (+11,496 to 64,726) continue to rise sharply, which suggests a third (and final) phase has opened.



- There are eight with over 10k cases, 7 with over 25k and 4 with over 45k. The most cases are in China (+70 to 81,661), Italy (which recorded its fourth largest daily increase of +5,210 to 74,386), the US (second largest increase of +11,496 to 64,726), Spain (largest daily increase of +7,934 to 39,676), Germany (third largest daily increase of +4,542 to 37,323), Iran (largest daily increase of +2,206 to 27,017) and France (second highest daily increase of +2,961 to 25,583). Australia confirmed cases remains low (+605) at 2,364.

- The global death rate (deaths divided by confirmed cases) rose again (+0.1%) to 4.5% and Spain overtook China with the second most deaths at 3,434. However, in terms of the death rate, the worst region continuing to be Italy (+0.2% to 10.1%), followed by Iraq (steady at 8.4%), Iran (-0.1% to 7.7%), Spain (+0.1% to 7.2%), Netherlands (+0.6% to 5.5%), France (+1.4% to 5.2%) and the UK (steady at 5.2%). Australia's death rate is very low and fell -0.1% to 0.3%.

Yours sincerely,



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