

THOUGHTS ON THE MARKET

27th March 2020



SUMMARY

- It was bit of a strange night as risk markets rallied despite COVID-19 cases recording their largest daily increase and rising above half a million, the US surpassing China in total COVID-19 confirmed cases, and the US initial jobless claims (+3.28 million) being were four times higher than the previous record rise (in 1982) - which clearly demonstrates the severity and speed of the labour market dislocation underway in what is also a terrible sign for what's ahead for UAS June quarter growth.
- Recessions occur when shocks hit vulnerabilities, but this US contraction is very different to all before it as it normally takes up to six months for the impact of the shock to multiply enough to send the economy backwards, but in 2020 its happened in a few weeks. This makes the current US and global malaise unique on several fronts in that the contraction has occurred in the space of weeks, not many months, the size of the June quarter downturn will be the largest on record at around -35% q/qa, and US unemployment could to record its sharpest monthly increase in over nearly a century as 40% of the US population is under some form of voluntary or government mandated restriction.
- The stimulus response is underway, but we think it will prove inadequate as most of it is likely to be saved and hence will miss the target, and how firms handle these shutdowns is another key to the shape of the downturn and any recovery and next Friday's March non-farm payrolls will provide the next clue about impact of the industry shutdowns.
- The US Senate passed a USD2 trillion stimulus package yesterday and the plan should be passed by the House on Friday and signed by President Trump the following day. This is only thing that markets are focused on at present and confirmed that investors are once again hooked on their stimulus and are highly confident that governments and central banks will feed their addiction, irrespective of what happens, what is required, let alone the cost.
- Despite the double-consensus estimates rise in claims and another -5% decline in oil prices, both equity and credit markets rallied overnight in response to the stimulus action.

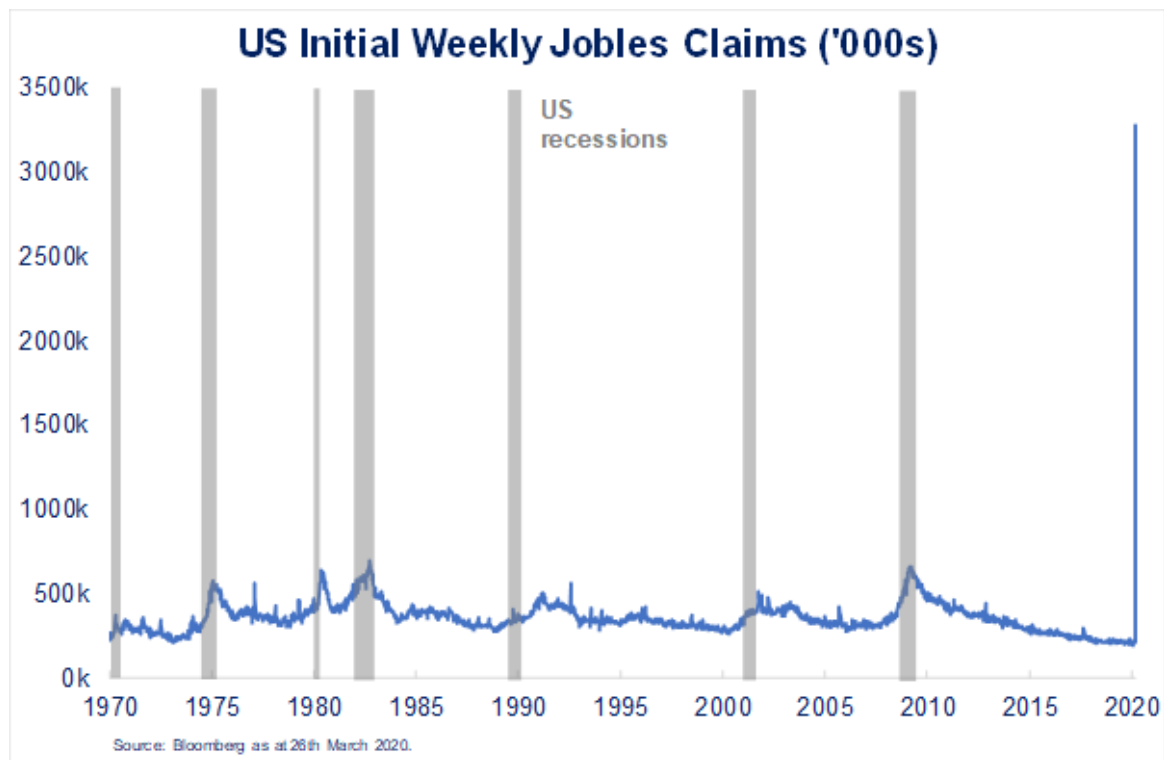
POLICY RESPONSES

- The US Senate passed a USD2 trillion stimulus package yesterday. Major parts include USD250 billion in direct payments to all adult US citizens of , 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.

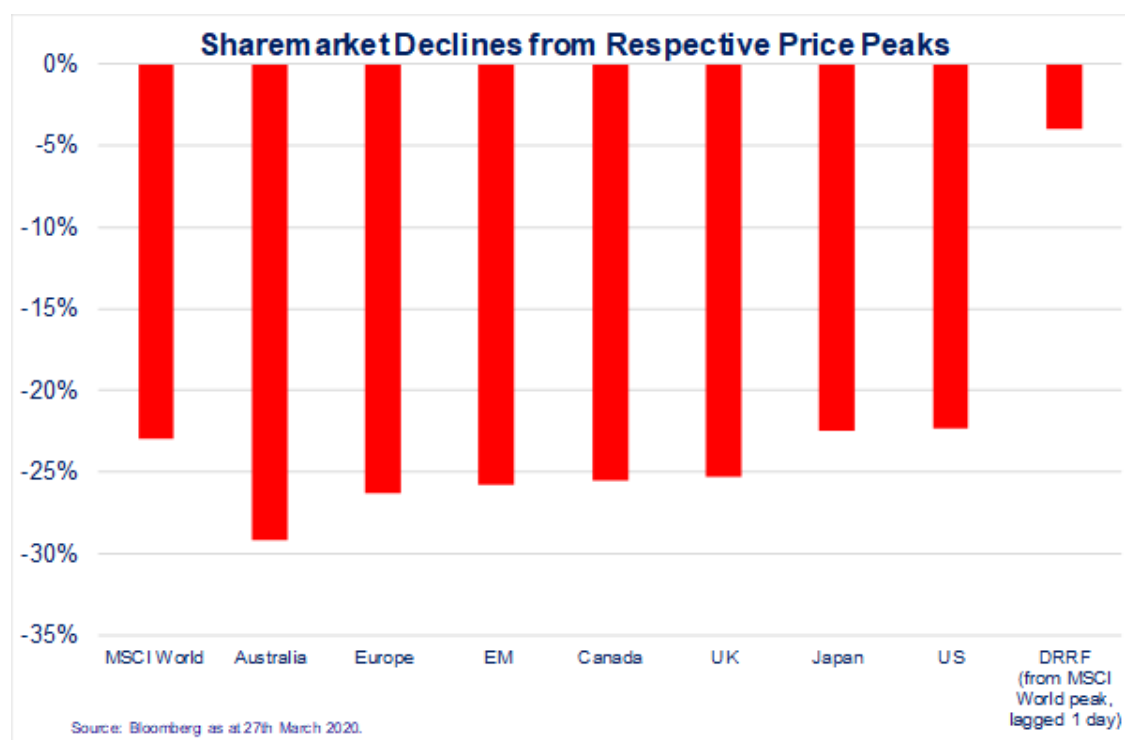
THE GLOBAL ECONOMY

- The magnitude of the economic devastation that is being unleashed on the US economy was laid bare overnight when the US government reported an unprecedented surge in the number of people seeking jobless benefits. US jobless claims increased +3.28 million in the week ending March 21, which was over four times the previous record peak in January 1982 and 2009, both of which were among the worst recessions in the past 90 years.

Claims increased in all 50 states and DC and nine of these states recorded increases of over 100k led by Pennsylvania (+379k), Ohio (+188k), California (187k) and Michigan (+129k) but in New York, where half of the US's Corona cases are known, claims 'only' rose by 80k. Claims this high in one week are indicative of US unemployment rising to +5.5% in March (from February's 50-year low of 3.5%) but it's hard to know how the labour market survey will be done and whether it accurately picks up the dislocation in the US labour market, and there is nothing to suggest that last week will be the peak.



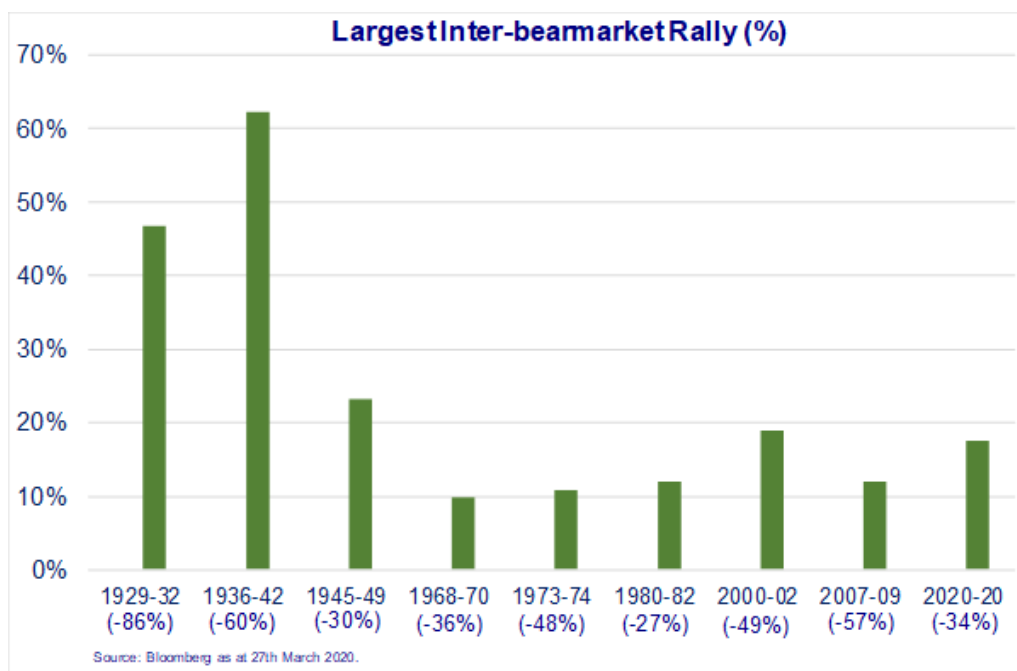
less buoyant with Japan -4.5% lower, Hong Kong and China (both -0.7%) also declined, but Australia posted a strong +2.3% gain. But it still has the largest regional decline (see Chart).



- We had a look at US bear markets in periods of economic recession. In the analysis, which uses daily data back to 1927, we have been very strict with definitions in that to be a bear market the S&P500 Index must have declined -20% or more, and the recession must be defined along the lines of the Bureau of Economic Analysis, rather than the traditional two negative quarters. This means:
 - A. the 1990 market decline is excluded as the index declined -19.9% peak to trough; and
 - B. the 2001 recession and associated bear market is included even though the US economy only contracted for one quarter during the period.

Some conclusions:

1. There have been 9 bear markets over the past 93 years that have occurred around a US recession and the current market decline is the 7th worst of those, so far;
2. Larger recessions are normally associated around policy mistakes causing financial crisis. For example, the -86% decline in 1929 saw a banking crisis met with higher rates from the Fed (in an effort to keep deposits elevated to maintain the stock of high powered money) and fiscal tightening (preserve government cashflows), and these two made what would have been a very bad recession into the Great Depression.
3. All bear markets associated with recession have recorded a bounce of +10% or more within it. This is normally early in the piece when the true nature of the downturn is unknown and policy is being unleashed. However, in the past 50 years governments and central banks have generally had to “do more” and this has produced highly similar inter-bear market rallies (i.e. they are getting less bang for the fiscal and interest rate/QE buck).
4. The current inter-bearmarket rally is the second largest since WW2, but most importantly, all these temporary bounces fade out and the market gives back the rally and lost even more.

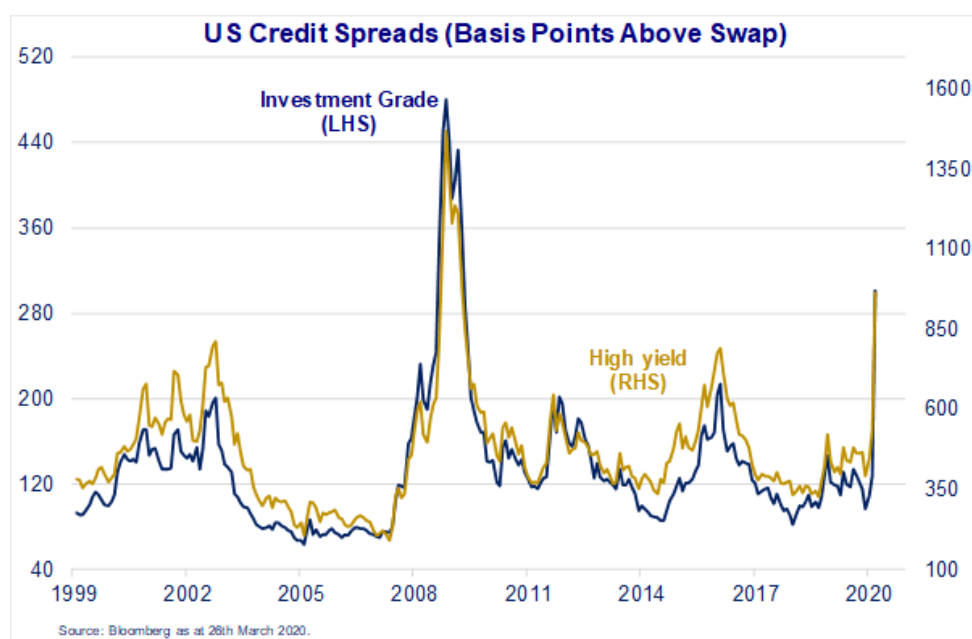


• CREDIT

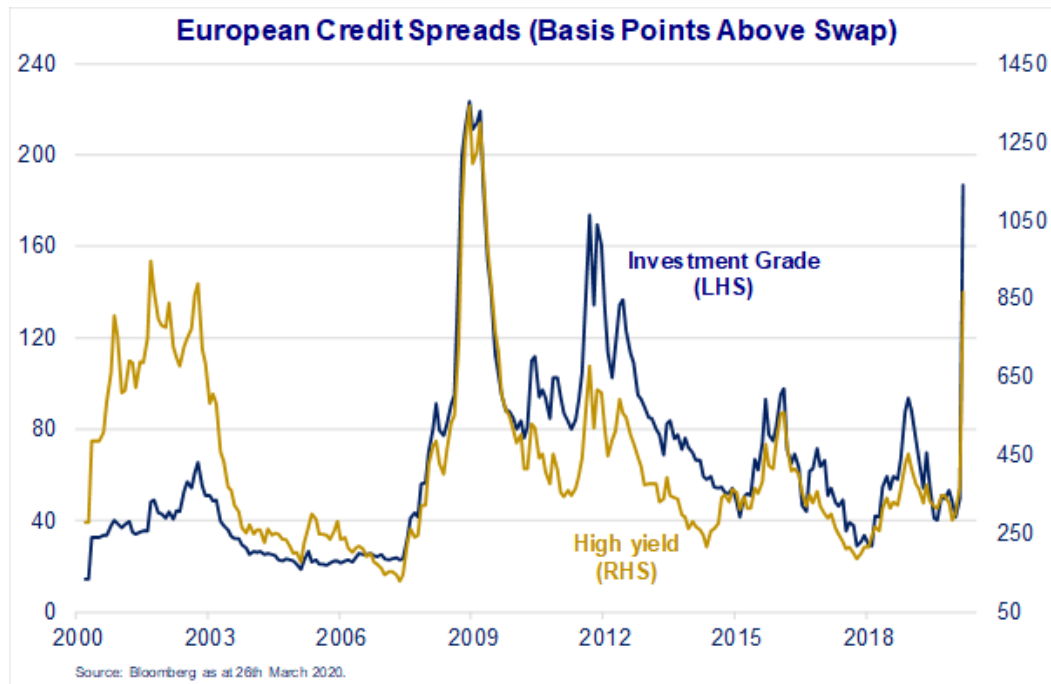
- Overnight US investment grade funds recorded a record USD38 billion of outflows for the week ended March 25th, exceeding last week's USD36 billion of outflows. In addition, and loans funds added another USD2.1 billion of capital withdrawals. Despite the outflow, US IG and HY credit spreads fell for a third straight day with IG down -13 to 301 bpts and HY fell -59 to 963 bpts. The sustained confirms 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 was no real pattern in the IG space with spread declines led by financial sub debt (-26 to 347 bpts), senior financials debt (-15 to 279 bpts) and energy (-9 to 566 bpts) brought up the tail of the field as oil prices fell another -5.7% to USD23.11 per barrel.

In the US HY markets spreads contraction was even larger at -59 (which was the largest since the aftermath of the GFC) to 962 bpts meaning that the market has recouped one-sixth of its 680 bpts blow out in the last two sessions. There were 70 bpts declines in both telcos and tech (-72 to 788 bpts and -70 to 759 bpts, respectively) and energy (-65 to 2192) performed strongly despite the crude price decline.

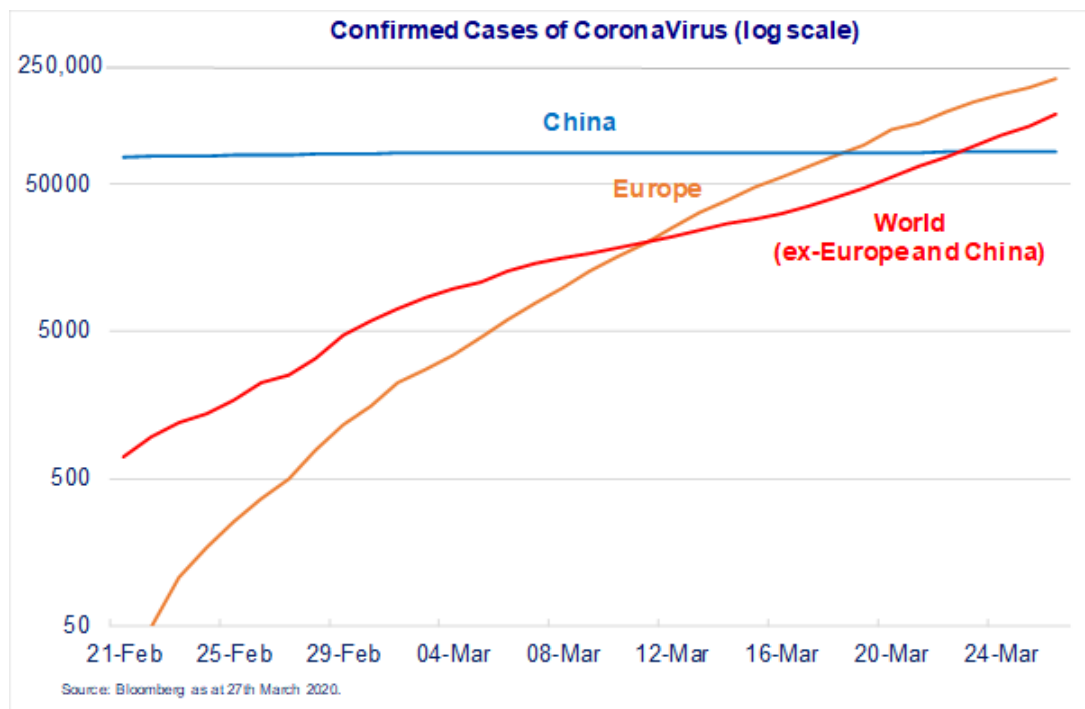


- In Europe, spreads declined across the board in both the IG space (-3 to 187 bpts) and HY (-42 to 773 bpts). In IG moves were minor with the largest decline in healthcare (-7 to 132 bpts) and consumer discretionary the least (-2 to 270 bpts). In HY consumer staples led the improvements (-83 to 747 bpts), followed by healthcare (-79 to 484 bpts) with energy (-59 to 1099 bpts) having its best day since the post-GFC normalisation.

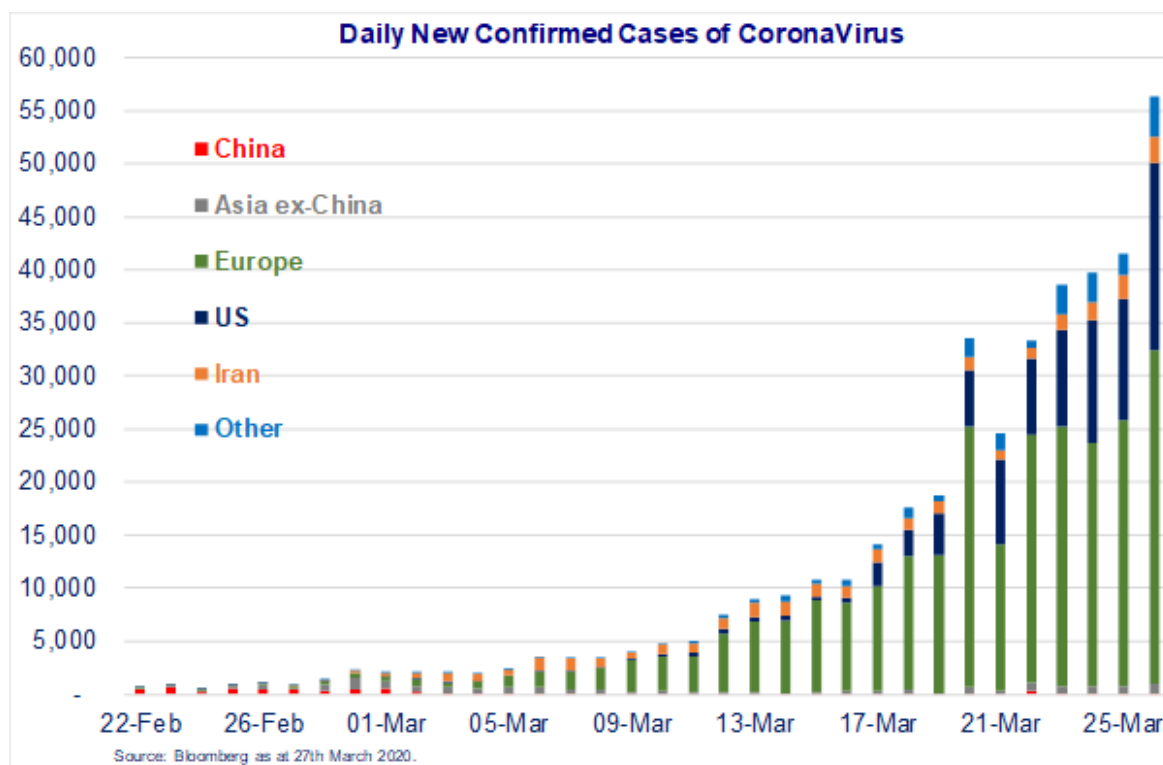


VIRUS UPDATE

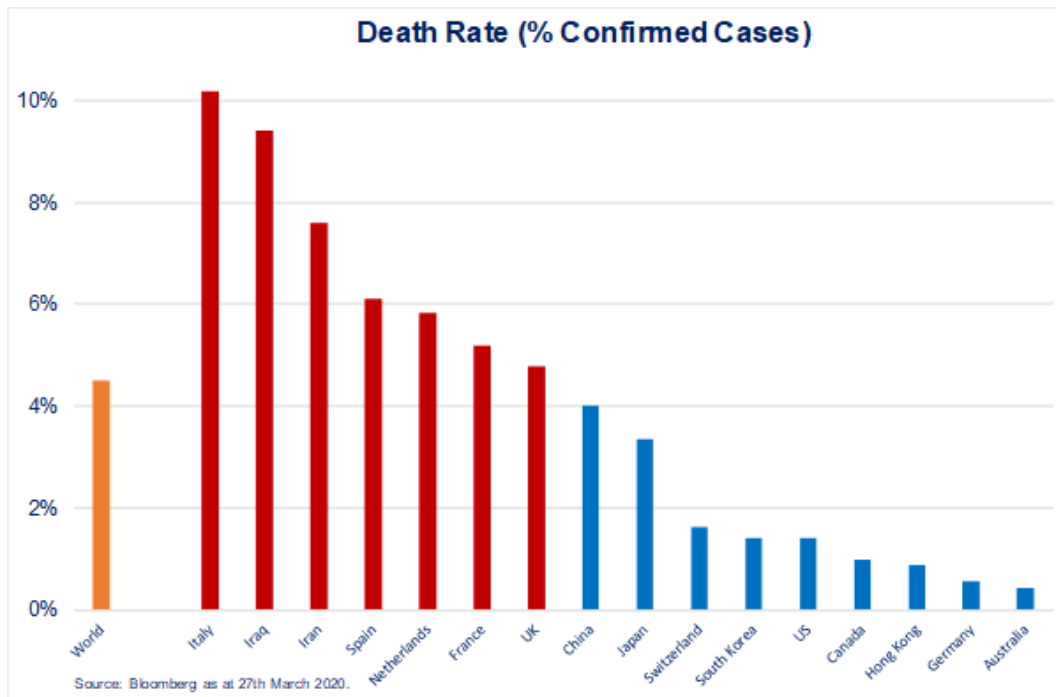
- Yesterday recorded a record +62k new confirmed cases of Cov-19 which took the global tally to 526k, deaths rose +2,721 to 23.7k and the death rate rose to 4.51% (14th rise in the past 19 days despite rising case numbers);



- Among regions, Europe (which recorded a fresh record high daily rise in new cases of +27,428 to 252k) and the US (up a record high of +17.2k to 82.4k) now have more cases than China (+121 to 81.8k), the US gains confirming that a third wave has broken out. Italy (+8,215) and Spain (4,145) now have four times more deaths than China (3,287).



- There are nine with over 10k cases, 7 with over 25k and 5 with over 40k. The most cases are in the US (largest increase of +17.6k to 82.4k), China (+121 to 81.8k), Italy (which recorded its fourth largest daily increase of +5,210 to 74,386), Spain (largest daily increase of +8587 to 56.2k), Germany (largest daily increase of +6,323 to 43.6k), Iran (largest daily increase of +2,389 to 29.4k) and France (highest daily increase of +3,946 to 29.5k). Australia confirmed cases remains low (+446) at 2.8k.
- The global death rate (deaths divided by confirmed cases) rose again (+0.01%) to 4.52% and total deaths in Spain (+711 to 4,145) overtook China (+6 to 3,287) which is now third highest. However, in terms of the death rate, the worst region continuing to be Italy (+0.1% to 10.2%), followed by Iraq (+1.0% to 9.4%), Iran (-0.1% to 7.6%), Spain (+0.2% to 7.4%), Netherlands (+0.3% to 5.8%), France (+0.5% to 5.7%) and the UK (+0.4% at 4.9%).
- Australia's death rate is very low and rose +0.1% to 0.4%. Australia remains in the earlier stages of its outbreak and appears to be 50 days and 14 days behind China and Italy, respectively. While Australia's growth rate is not as sharp as Italy's or the US's, the number of cases here is still doubling close to every five days, so the success of measures taken to tame the spread will be evident in around two weeks' time.



Yours sincerely,



MATT SHERWOOD
Head of Investment
Strategy, Multi Asset



MICHAEL O'DEA
Head of Multi Asset

This document has been prepared by Perpetual Investment Management Limited (PIML) ABN 18 000 866 535, AFSL 234426. It is general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider, with a financial adviser, whether the information is suitable for your circumstances. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information. The PDS for the Perpetual Diversified Real Return Fund, issued by PIML, should be considered before deciding whether to acquire or hold units in the fund.

The PDS can be obtained by calling 1800 022 033 or visiting our website www.perpetual.com.au. No company in the Perpetual Group (Perpetual Group means Perpetual Limited ABN 86 000 431 827 and its subsidiaries) guarantees the performance of any fund or the return of an investor's capital. Past performance is not indicative of future performance.

MORE INFORMATION

Perpetual Investments 1800 062 725

Email investments@perpetual.com.au

www.perpetual.com.au/investments