Perpetual Investments

THOUGHTS ON THE MARKET

28th July 2020 - Fed speculation sparks a tech rally, but is it sustainable?

SUMMARY

- It was risk on overnight with global markets spurred by speculation that the US Federal Reserve will reinforce a dovish message at its Wednesday policy meeting, which sparked a large rally in tech shares. The Fed speculation is well founded as the recent surge in COVID-19 cases has already flattened out the US recovery, but the US central bank was on hold for years anyway with an ultra-dovish stance to be maintained for as far as the eye can see. That said, policy will remain in place as the dislocation from COVID-19 has been larger and longer than expected, and with fiscal policy set to be less supportive, one wonders how much longer markets and analysts will cling to their expectations of a robust earnings recovery.

  In other markets, 10-year US Treasuries saw a modest increase in yields to 0.62% with curve steepening rising to +0.52% (6 day high), commodities were upbeat with gold (+2.2% to USD1,944 per troy ounce) rising to an all-time high and oil increased +0.8% to USD41.64 per barrel, whereas G10 currencies all rose against a pressured US Dollar, led by the Euro (+0.9%), Yen (+0.8%), Sterling (+0.7%) and AUD (+0.6% to USC71.51).

- Economic data was constructive in that the June durable goods report detailed another solid rise in spending, but this was expected and told us very little. Meanwhile, the White House and Senate Republicans have agreed on a fifth stimulus package totalling around USD1 trillion, but the upcoming debate with House Democrats will be quite contentious as concerns about the US fiscal cliff and the plateauing of the US recovery get more attention.

- The number of global cases of COVID-19 is 16.37 million with another +165.2k cases so far (but Brazil, France, Spain, South Korea and 5 US states have not reported their numbers) which means that Monday was 35th occasion in the past 35 days where daily increases have topped 150k. This means 4 countries have more than 800k cases, 19 countries have more than 200k cases and 24 countries have more than 100k cases (Indonesia joined this group in the past 24 hours). 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 and 3 days. More importantly, the growth rate of daily confirmed cases (+1.7% since Friday) is once again starting to rise. Meanwhile, deaths stand at 651.4k and the death rate dropped for an eighty first straight day to 4.0% although the number of daily deaths is on the rise.

FINANCIAL MARKETS

- **EQUITIES**
  - **The MSCI World Index closed +0.9% higher** on broad-based tech strength (+1.5%) with Apple (+2.4%) making the largest individual contribution to the broad index rise, ably supported by platforms which saw communications services (+0.6%) outperform the tape given gains in Netflix (+3.2%), Google (+1.4%) and Facebook (+1.2%). Other cyclical sectors were mixed with materials (+1.3%) outperforming supported by the higher gold and silver prices, consumer discretionary (+1.1%) got a boost from Amazon (+1.5%), homebuilders and the auto complex, but financials (-0.6%) declined for a fourth consecutive session. Similarly, defensive sectors lagged the market tape with consumer staples (+0.4%) and utilities (-0.9%) at the back of the field. The overnight movements saw no major change in our peak-to-now chart but tech has dominated since the end of May (+16%), whereas the remainder of the US market is up slightly (+2.5%) with the MSCI World ex-US (+7%) splitting the difference (see chart).

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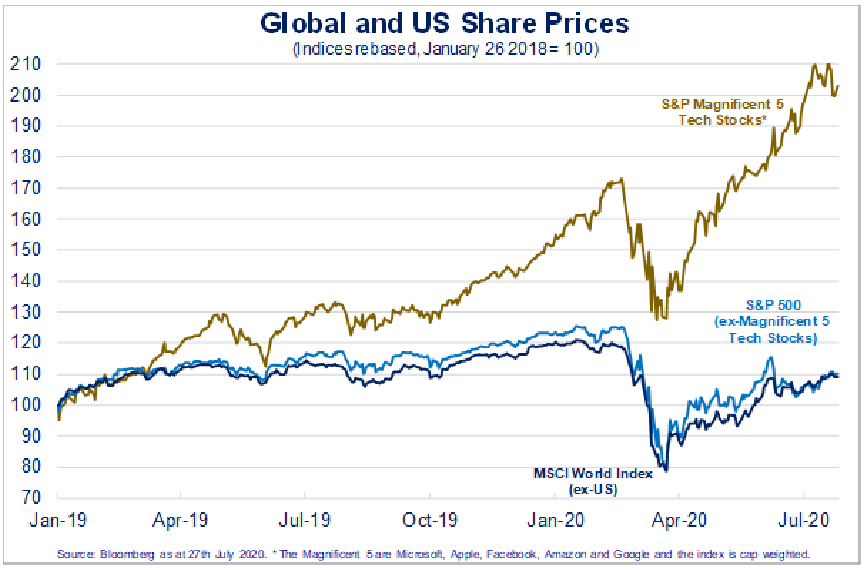
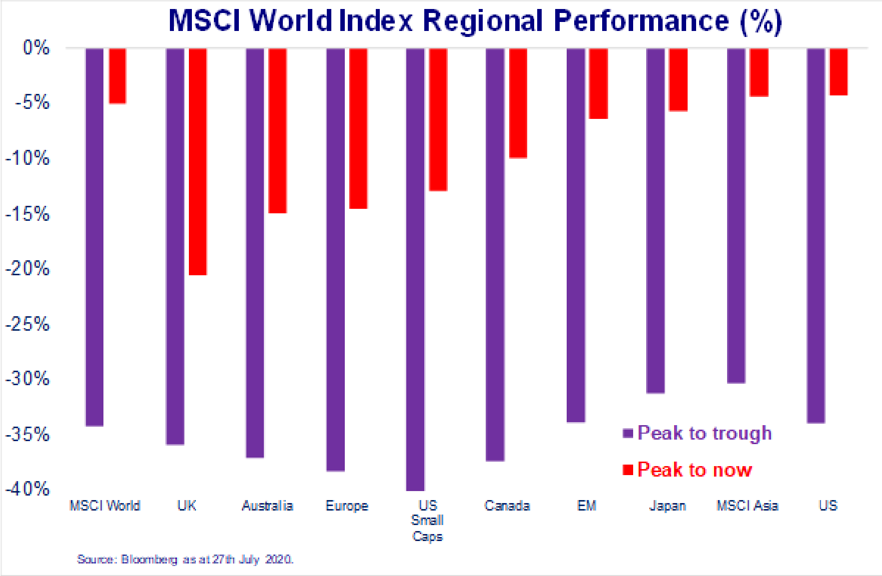


- **Among the regions, advances were led by Asia where the MSCI Asia Pacific Index closed +0.8% higher** in a quiet session which lacked a major catalyst. Rising US-China tensions received more attention, but there was no new development, so investors debated upcoming earnings reports and the FOMC meeting. Regional COVID-19 concerns remain elevated even though cases in Japan declined to below 200 for the first time in a week, but the recent acceleration has prompted fears that the medical system may be under strain. In Australia, record new cases in Victoria raised the likelihood that the six-week lockdown of Melbourne will be extended. By the bell, the regional index closed higher with advances in Taiwan (+2.3%), Korea (+0.8%), China (+0.5%), Australia (+0.3%) offset by losses in India (-0.2%), Japan (-0.2%) and Hong Kong (-0.4%).

  Meanwhile, **the US sharemarket (+0.7%) rallied** and reversed last week's losses underpinned by a rebound in tech which outweighed a slide in banks. Economic data was constructive with an as-expected increase in duration goods orders, as was COVID-19 case numbers as several recent hot spots have eased their R-factor, but the North-East and Mid-West remains concerns. Meanwhile, the White House and Senate Republicans have reached an agreement and will detail their USD1 trillion (fifth) stimulus bill which will comprise USD1,200 stimulus checks to the same recipients as last time, but higher unemployment benefits will be curtailed (-66% to $200 extra) which still leaves a gaping fiscal cliff in H2 2020 which will weigh heavily on growth if it's not addressed. By the bell, the gains were led by the NASDAQ 100 Index (+1.7%) which outperformed the Russell 2000 (+1.2%), S&P 500 (+0.7%) and the Dow Jones (+115 points, +0.4%, 26,585).

  In contrast, **Europe was the only major region to close lower (-0.2%)** with sentiment soured by increased concerns about a second wave of COVID-19 infections across the region which prompted the UK, France and Norway to impose a quarantine on travellers returning. Confidence was also weighed down by worsening tensions between the US and China, and there wasn't much on the earnings front to offset that with a handful of corporate updates and none of note, but on the macro-data front Eurozone M3 money supply saw a lower-than-expected growth in June, but the Ifo Business Climate Index showed German businesses are growing increasingly optimistic that government support at home, and an unprecedented euro-area fiscal plan, will drive an economic recovery later this year. By the regional bell, most indices were lower led by Spain (-1.7%), France (-0.3%), the UK (-0.3%), Italy (-0.3%), Germany was flat, and Sweden and Switzerland (both +0.6%) were the only large markets to close higher.

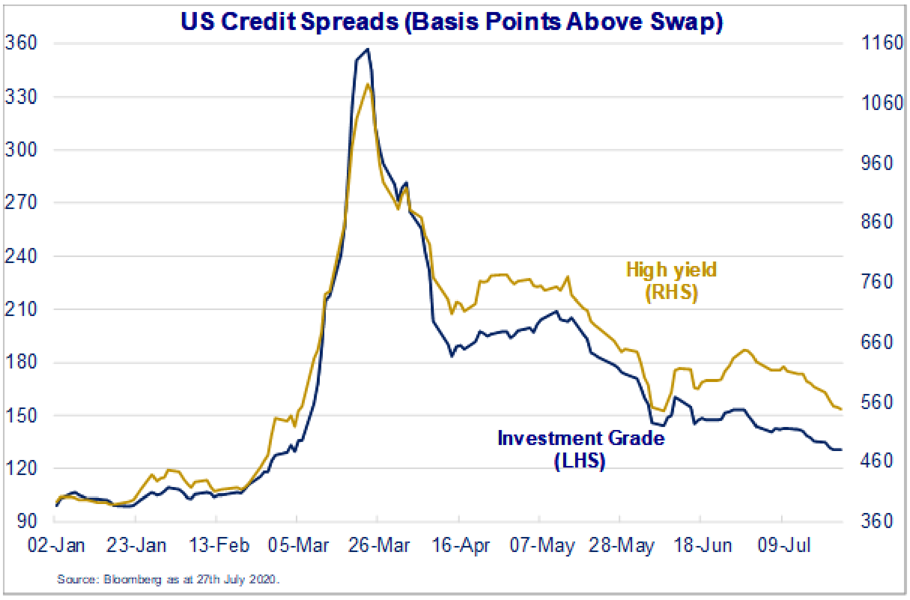
  At the close of regional trading, there was no real change in market performance with the UK (-20.6%) the only market in bear market territory, with the overnight move in Canada (+1.0%) seeing them leave correction territory given their resource-based market composition.



- **Asian stocks look set for a muted start today, with futures markets pointing to modest gains** in Australia (+0.4%) and Hong Kong (+0.5%) and little change in Japan (-0.1%).

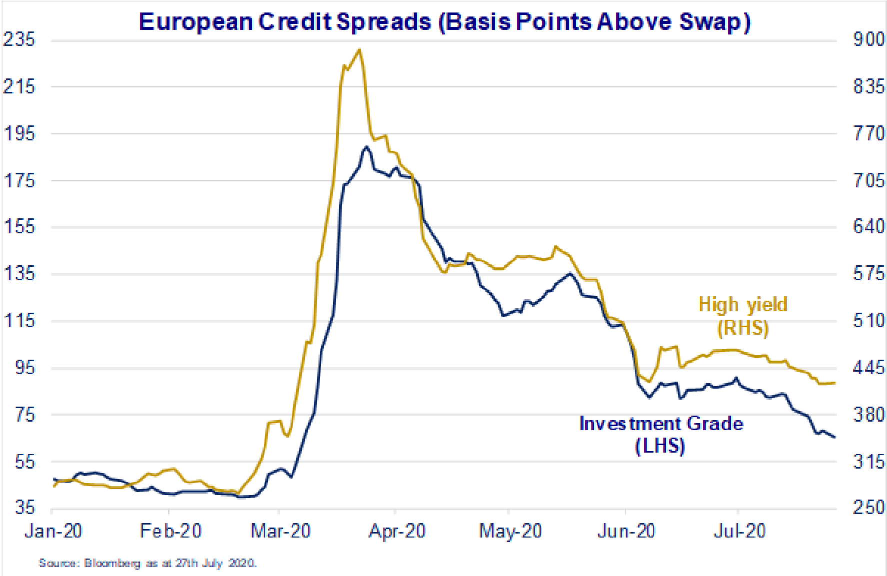
CREDIT MARKETS

- Regional credit indices were mixed, and little changed overall. In the US investment grade space, spreads were widened +0.2 of a point to +131 bpts, which kept the recovery rate at 89%, with 7 of the 11 sub-sectors recording higher risk premiums. There was little of note in movements with the largest being communication services (+1 point, +158 bpts, 88%) and materials (-1 point, +164 bpts, 89%) and everything else was in between in a very quiet night. In the high yield universe, spreads declined -3 points to +546 bpts, which kept the recovery rate at 80%. Ten of the 11 sub-sectors recorded lower spreads led by defensive sectors such as consumer staples (-9 points, +395 bpts, 100%), healthcare (-7 points, +491 bpts, 78%) and utilities (-6 points, +405 bpts, 81%) with the remaining sectors limited to movements of only a couple of basis points.



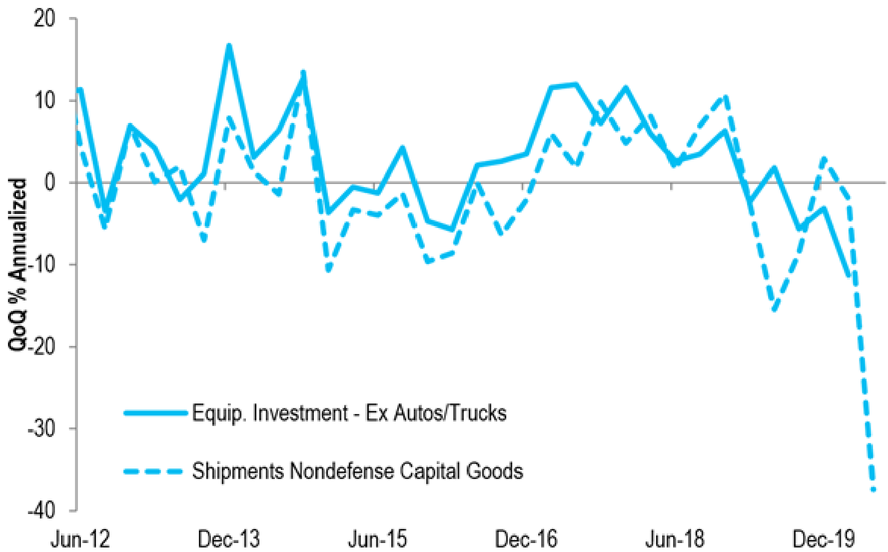
- **European credit markets** were also quiet and mixed, with spreads in the investment grade universe contracting -2 points to +66 bpts, which lifted the recovery rate two notches to 83%. All 11 subsectors recorded lower spreads led by the moves were very modest with the largest being healthcare (-4 points (+35 bpts, 87%) and materials (-3 points, +56 bpts, 82%) which benefited from higher commodity prices. In the high yield universe, spreads widened by +1 point to +424 bpts, which lowered the recovery rate to 75%.

Six sectors recorded higher risk premiums, but it was the rise in consumer staples (+11 points, +498 bps, 94%) which underpinned the increase supported by subordinated financials (+4 points +400 bpts, 80%).



THE GLOBAL ECONOMY

- **US durable goods orders rose +7.3% m/m in June** underpinned by orders for autos and parts which rebounded strongly in June, given high savings rate, employment gains which meant plenty of pent-up demand, and this is likely to persist for at least one more month. Orders ex-transport and core capital goods orders both rose +3.3% m/m, and shipments +3.4% m/m, in a report which held few surprises as business investment clawed back some of its COVID-19 decline. That said, average shipments of non-defense capital goods declined -37.4% q/qa in the June quarter (see chart) which culminates in an expected -3.75% decline in business equipment investment in the June quarter national accounts (released Thursday) where economic activity is expected to decline -33% q/qa. Looking ahead, the re-emergence of COVID-19 cases and weak profits are likely to limit the size and delay the timing of any major recovery in investment into 2021.



- **China's industrial profits grew +11.5% y/y in June,** which was nearly double the May result (+6.0% y/y) but the increase was entirely delivered by favourable base effects with the monthly decrease in June being around -1.3% m/m. Meanwhile, industrial revenue growth accelerated to 4.0% y/y in June, from +1.6% y/y in May which suggest real revenue growth of +7.2% y/y which is higher than industrial production for June (+6.1%), implying some modest margin expansion. Looking forward trends in industrial profits will be boosted by likely reductions in PPI

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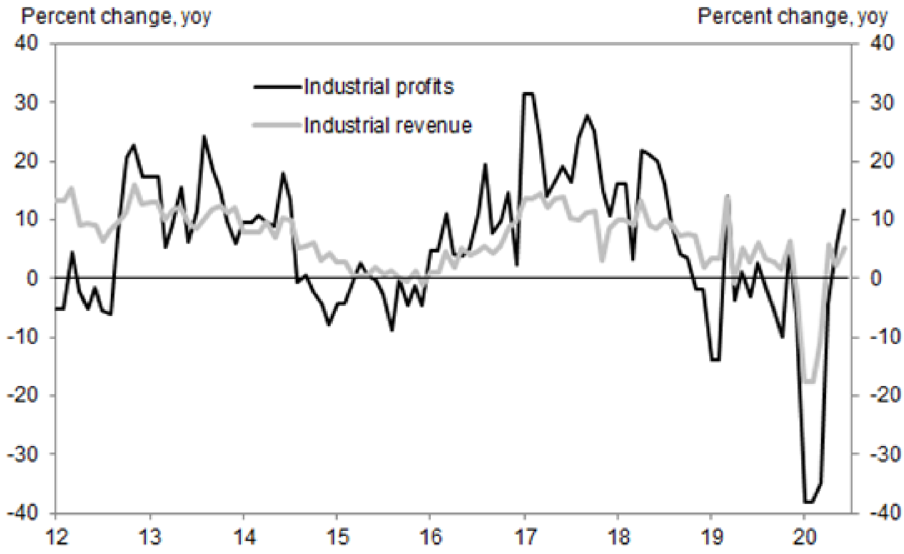
deflation, but this will be offset by slowing activity growth as lost production has been recouped and the global recovery remains subdued.



Source: NBS, Goldman Sachs Global Investment Research

POLICY

- **The White House and Senate Republicans are expected to release their proposal for a fifth coronavirus relief bill later this morning** with an anticipated USD1 trillion in support including another round of $1,200 stimulus cheques to the same group of Americans which qualified for payments in the June quarter. However, the USD600-per-week of additional unemployment benefits will be lowered to $200-per-week for at least two months before transitioning to 70% of prior wages. Importantly, the proposal does not include additional funding for state and local governments but provides them with flexibility on how to spend earlier aid. Meanwhile, there will be an extension of the federal moratorium on protecting millions of renters from eviction. However, upcoming negotiations with Democrats are expected to be contentious as concerns about the US fiscal cliff and a plateauing of the US recovery get more attention.

VIRUS UPDATE

- The number of global cases of COVID-19 is 16.37 million with another +165.2k cases so far (but Brazil, France, Spain, South Korea and 5 US states have not reported their numbers) which means that Monday was 35th occasion in the past 35 days where daily increases have topped 150k. This means 4 countries have more than 800k cases, 19 countries have more than 200k cases and 24 countries have more than 100k cases (Indonesia joined this group in the past 24 hours).

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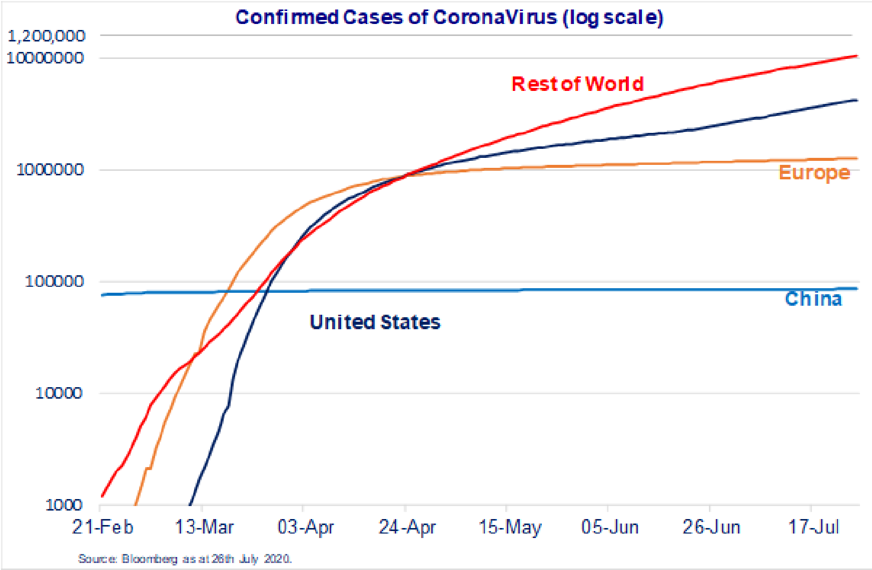
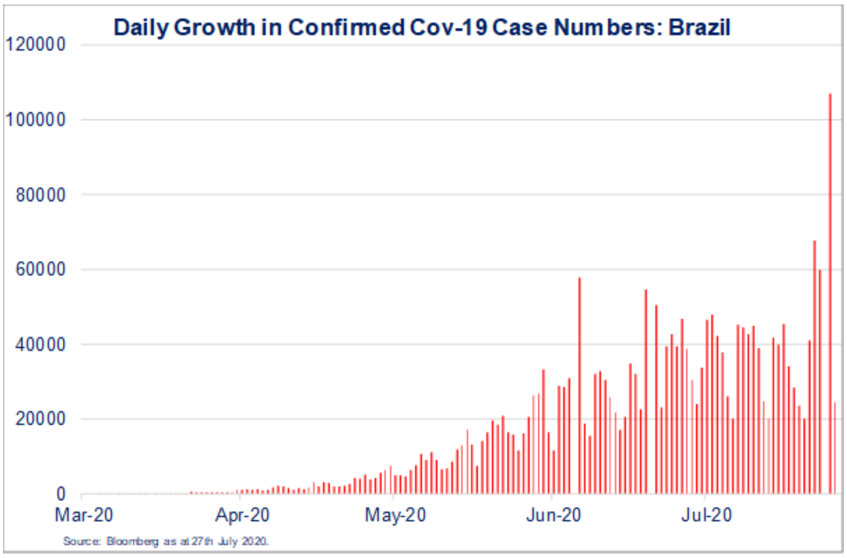


- We break the infections into four groups – the US, Europe, China and 'others' and the rest of the world outside the G3 economies now has the most total cases (+58.0k to 10.72 million) and highest daily new cases (and by a considerable margin) followed by the US (+48.2k to 4.28 million, although 5 states are yet to report). More worryingly, the COVID-19 reproduction rate is rising in the North East, not the South West (which is now declining on the whole, see chart) which is a sign that things are spreading quickly. 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 (+2.1k to 1.28 million - see chart).



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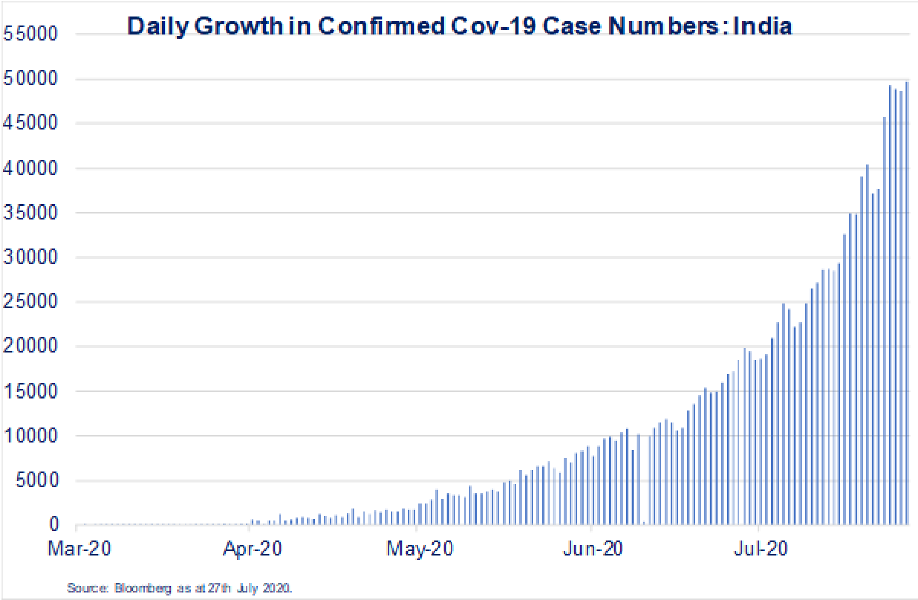
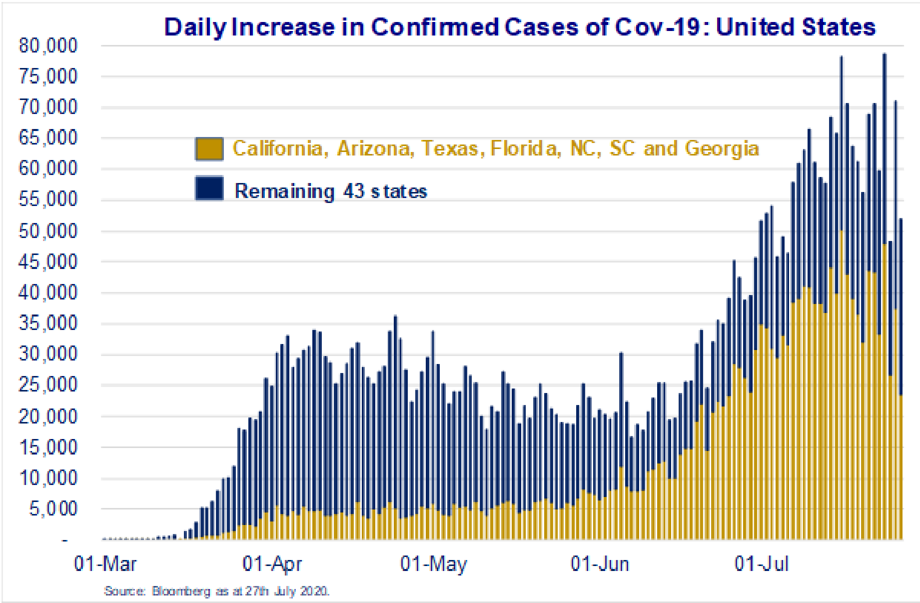
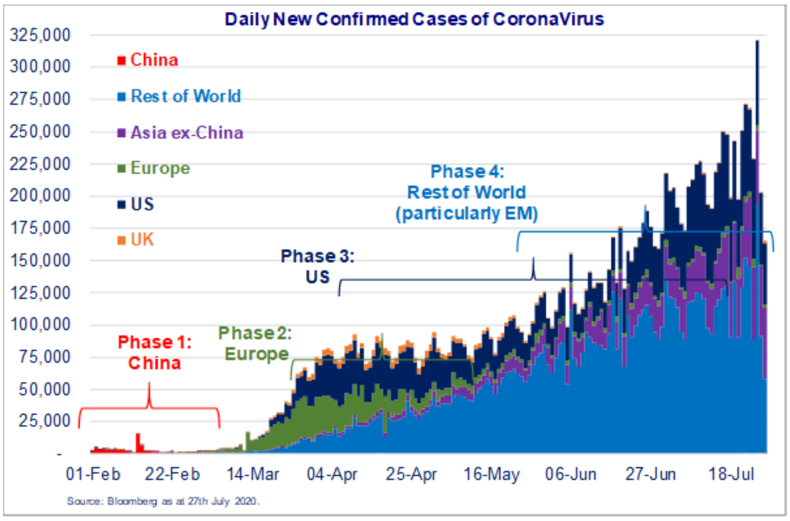


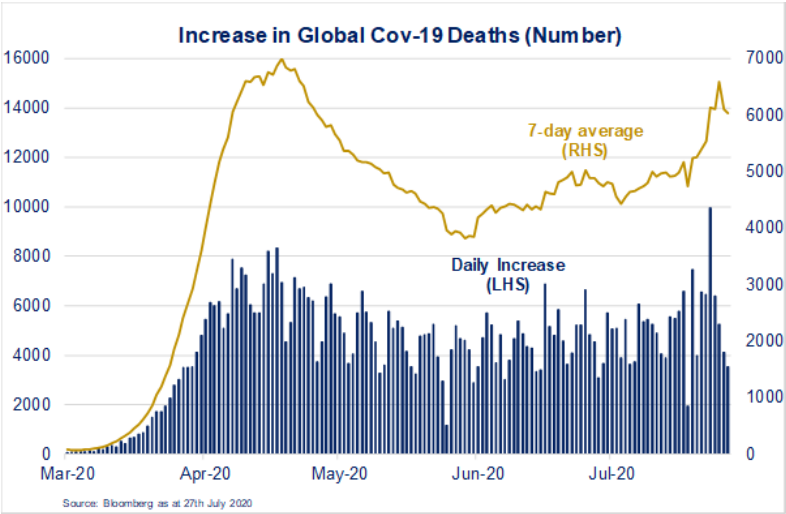


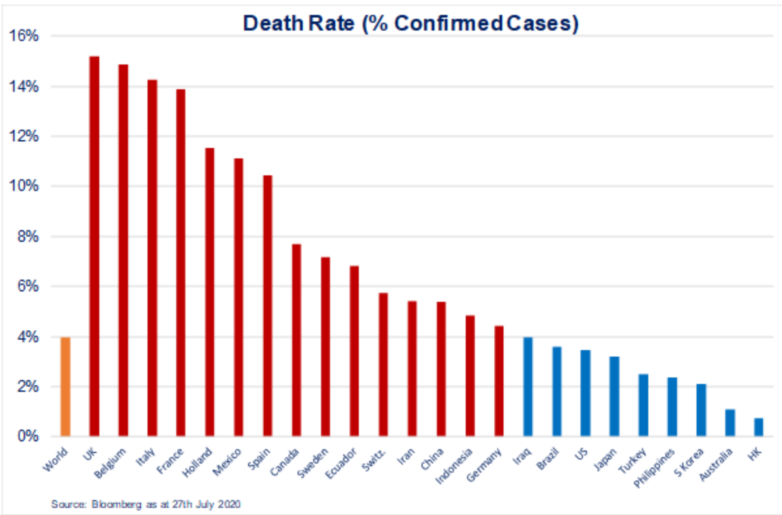
- Among countries, the most cases are in the US (+48.2k (so far) to 4.28 million, with 5 states yet to report), Brazil (not reported to 2.42 million), India (+49.7k (record high) to 1.44k), Russia (+5.6k to 816.7k), South Africa (+7.1k to 452.5k), Mexico (+4.9k to +395.5k), Peru (not reported, 376.0k), Chile (+2.1k, 347.9k), United Kingdom (+1.4k (8-week high) to 301.7k), Iran (+2.4k to 293.6k), Pakistan (+1.2k to +274.3k), Spain (not reported, 272.4k), Saudi Arabia (+2.0k to 268.9k), Italy (+0.4k to 246.3k), Turkey (+0.9k to 227.0k), Bangladesh (+1.9k to 226.2k), France (not reported, 217.8k), and Germany (+0.4k to 207.01k). Australia confirmed cases rose +534 to 14.9k yesterday which placed us 71st in terms of total infections.

  Elsewhere, Singapore recorded +0.5k new cases to 50.8k 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 (+1.5k to 101.3k) is now on the rise and has the most cases in the region, and the Philippines (+1.6k to 82.0k) is also on an upward trend.



- Although final numbers are not in until 1pm AEST, the global death rate declined for a eighty first straight day to 4.0% with the global total to 651.4k after another 6.0k deaths overnight, so far, which indicates the daily average deaths is increasing again (see chart). The US (+0.9k so far) has the most deaths at +147.8k, with Brazil (not reported, 87.0k), the UK (+0.02k to 45.8k), Mexico (+0.23, +44.0k), Italy (+10 to 35.1k), India (+0.7k to 32.8k) and France (not reported, 30.2k) all over +30k. The death rate is highest in European countries where the health systems had collapsed led by the UK (-0.1% to 15.2%), Belgium (-0.1% to 14.9%), Italy (steady at 14.3%), France (-0.1% 13.9%), the Netherlands (-0.1% to 11.5%), Spain (-0.1% to 10.4%) and Sweden (-0.1% to 7.2%). However, several emerging markets are now on the leader board including Mexico (-0.1% to 11.1k), Ecuador (-0.1% to 6.8%), Indonesia (-0.1% to 4.8%) and Brazil (-0.1% to 3.6%).





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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