

THOUGHTS ON THE MARKET

29th July 2020 - More evidence of a cooling in the global recovery

SUMMARY

- It was risk off overnight as a combination of some weak earnings results in high profile cyclical companies, rising COVID-19 case numbers in Europe and Asia, and a yawning gap between Senate Republicans and House Democrats regarding the fifth relief bill's size, culminated in investors taking some risk off the table. The sell down wasn't large, but several sectors, such as energy and consumer discretionary, have declined for most of the past week as investors worry that too much of an earnings recovery has been priced in, given the plateauing of the economic rebound which was confirmed overnight by US consumer confidence rolling over in July.

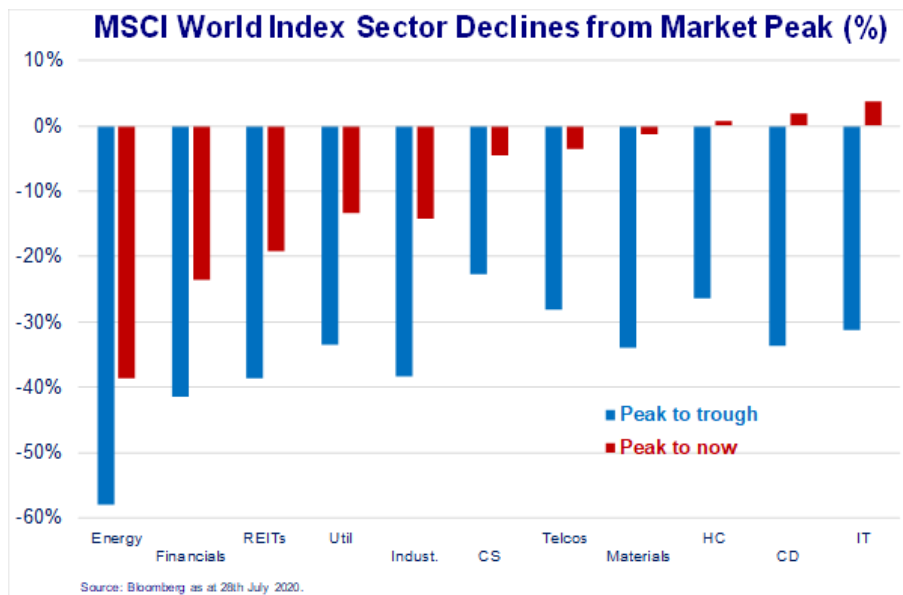
In other markets, **10-year Treasuries** recouped all of yesterday's losses and **closed at 0.48% (which is a 14-week low)** with curve flattening, commodities were in a risk-off mode with gold up +0.7% to a fresh record high of USD1,958 per troy ounce and oil declined -1.3% to USD41.08 per barrel, **and the US dollar was mixed** against its G10 peers with advances in Sterling (+0.5%) and the AUD (+0.2%), but there were minor depreciations in both the Euro and Yen (both -0.1%).

- Economic data overnight was thin in volume but detailed a decline in US consumer confidence, and a -1.2% decline in Australian payrolls in early July which sets the scene for a sizable decline in local jobs when the July Labour Force survey is released in two weeks' time. Although there has not been a large volume of data recently, what has been released has added to the evidence that the pace of the global economic rebound ex-China is cooling as a resurgent virus interrupts re-openings and puts households in a more cautious mood. This has come at a time where governments are looking to reduce income support to halt the ballooning of their deficits.
- The number of global cases of COVID-19 is 16.61 million with another +180.3k cases so far (but Brazil, France, Peru, South Korea and 10 US states have not reported their numbers) which means that Tuesday was 36th occasion in the past 36 days where daily increases have topped 150k. This means 4 countries have more than 800k cases, 19 countries have more than 200k cases and 25 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 and 3 days. More importantly, the growth rate of daily confirmed cases (+1.7% since Saturday) is once again starting to rise. Meanwhile, deaths stand at 657.7k and the death rate dropped for a eighty second day to 3.96% although the number of daily deaths is on the rise.

FINANCIAL MARKETS

• EQUITIES

- **The MSCI World Index closed -0.5% lower** with defensive sectors outperforming both growth and cyclicals as investors worried about rising COVID-19 cases in both Europe and Asia and waning economic momentum in the US. Losses were steepest in consumer discretionary (-1.2%) with a drop in the July US consumer confidence adding to evidence that the pace of the rebound is waning which sent sector prices down for the seventh occasion in the past 9 sessions. Meanwhile, energy (-1.1%) declined for a fifth consecutive session as crude prices came off, IT declined for the third time in the past four sessions as FANG reversed yesterday's gains, and financials declined for the eighth time in the last nine sessions. In contrast, Utilities (+1.1%) ended its three-day losing streak and REITs rose for a second consecutive session, which is its equal highest win streak for July. By the close of trading, REITs left bear market territory, albeit just, whereas energy (-38.6%) is approaching double-bear market losses (see chart).

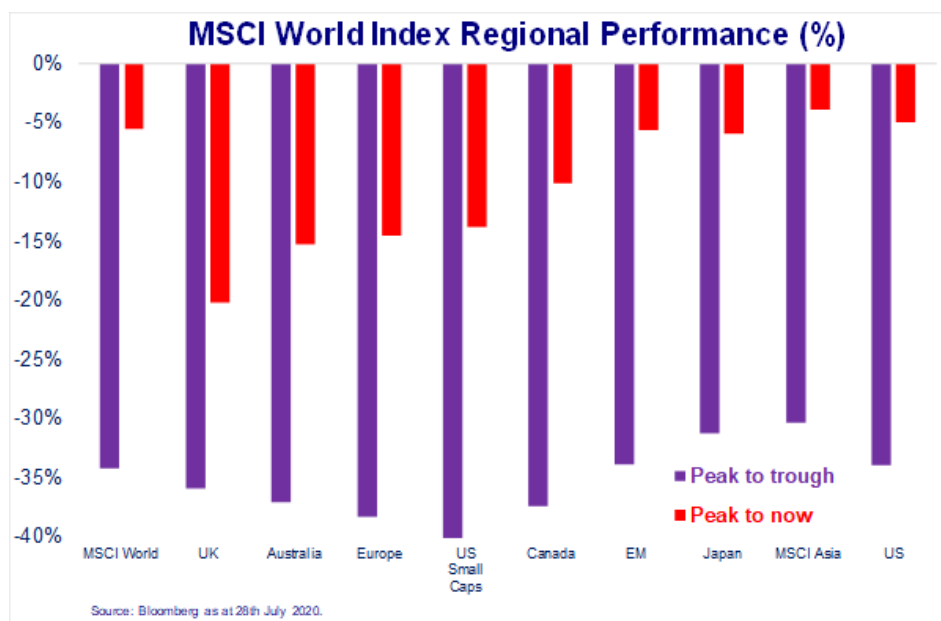


- **Among the regions, US equities (-0.7%) led the pace of declines** and closed at their worst levels for the day as concerns about the gulf between Senate Republicans and House Democrats festered, in an otherwise quiet trading session. There wasn't much of note on the macro calendar other than a decline in July consumer confidence, which was entirely driven by lower expectations (-14.6 to 91.5), but the Richmond Fed index rose from 0 last month to 10 in July. Corporate results were mixed with Pfizer rallying (+3.9%) after beating street estimates despite sizable COVID-19 disruptions, whereas 3M (-4.8%), McDonalds (-2.5%) and Harley Davidson (-0.8%) underwhelmed expectations and were sold down accordingly. By the bell, the daily results were the opposite of yesterday with NASDAQ 100 (-1.3%) leading the declines, with the Russell 2000 (-1.0%). Dow Jones (-205 points, -0.8%, 26,379) and S&P500 (-0.7%) also lower.

In Europe stocks were flat in a cautious session given rising COVID-19 infection rates in several key economies (notably Spain, but also France, Belgium, the UK and Germany). There was nothing of note on the macro calendar to improve the mood, and there was a couple of reports from high-end brands including Louis Vuitton Moët Hennessy (-4.1%) which came in below street estimates. By the regional bell performance was mixed with advances in Spain (+1.1%) after yesterday's outsized loss, and the UK (+0.4%), a steady result in Germany (-0.03%) and declines in France (-0.2%), Sweden (-0.3%) and Italy (-0.6%).

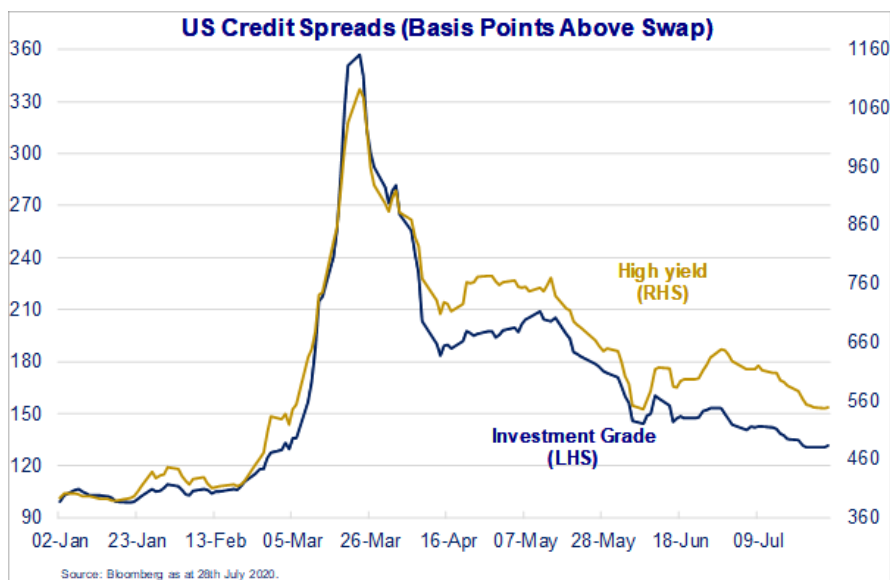
Asian markets were mixed on Wednesday but the MSCI Asia Pacific Index closed +0.5% higher, in another quiet session which lacked economic data and where regional thematic did not break any new ground. The echoes from the previous US session came though at opening, but then gauges went their respective ways and by the bell there were gains in Korea (+1.8% given the previous US tech rally), China (+0.9%) and Hong Kong (+0.7%), a flat result in Taiwan (-0.01%) and losses in Australia (-0.4%) and Japan (-0.5%).

Overnight moves had little impact on the peak-to-now chart with the UK still the only market to recover less than half its March quarter decline (see below), and futures markets are pointing to losses in Australia (-0.5%), Japan (-0.5%) and Hong Kong (-0.1%).



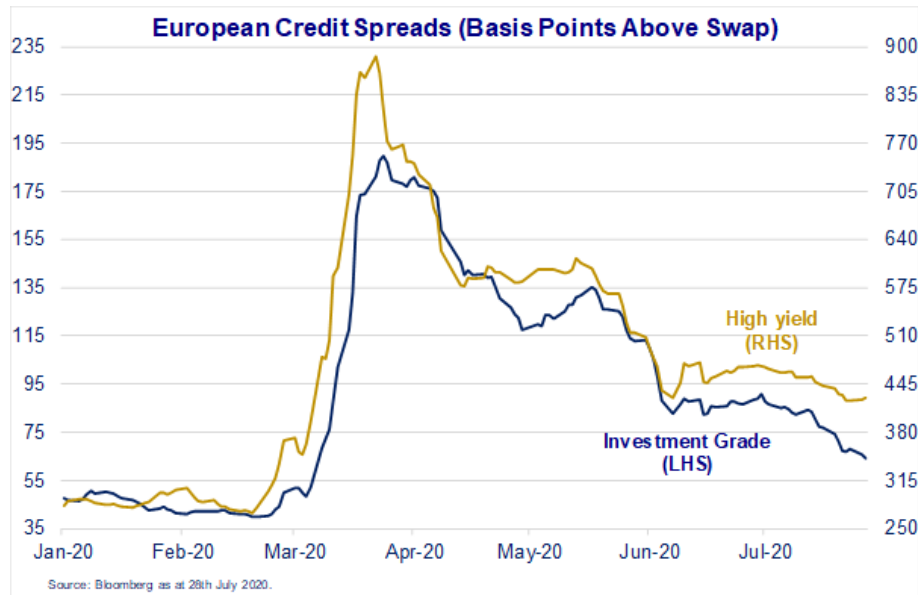
• CREDIT MARKETS

- Regional credit indices were mostly lower overnight. Spreads in the US investment grade space increased (for a third consecutive session) +1 point overnight to +132 bpts, which kept the recovery rate at 89%. There were lower risk premiums in all 11 subsectors, but the movements were modest led by communication services (+2 points, +160 bpts, 87%) but all other sectors had movements of +1 point or less. Meanwhile, spreads in the high yield universe increased for the first time in three weeks, but only +2 points overnight, to +548 bpts, but the recovery rate was steady at 80%. Sector action was also fairly quiet even though 9 of the 11 subsectors recorded higher risk premiums, with notable increases limited to energy (+4 points, +862 bpts, 94%) which did not like the sound of lower crude prices, with healthcare (+4 points to +496 bpts, 77%) also lower in defiance of its equity sector peer.



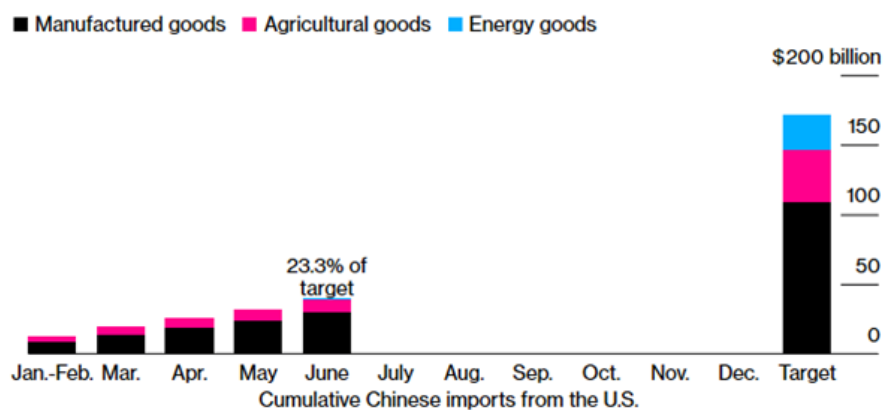
- European credit markets were mixed overnight with spreads in the investment grade space **contracting** another point to +64 bpts, which saw the recovery rate rise one notch to 84%. Spreads were lower in every sector, but the movements were modest led by healthcare (-2 points, +33 bpts, 89%) as several companies made announcements about COVID-19 drug trials, and materials (-2 points, +55 bpts, 83%) which rose in line with copper prices. In contrast, spreads in the high yield universe rose +2 points (second consecutive rise) to +426 bpts, but the recovery rate was unchanged at 75%. Among the sectors spread increases were led by consumer discretionary (+9 points, +526 bpts, 75%) which had outperformed

recently and may have sparked some profit taking, and this was also evident in subordinated financials (+5 points, +405 bpts, 79%). These capital losses were partially offset by another constructive session for tech (-4 points, +374 bpts, 58%).



THE GLOBAL ECONOMY

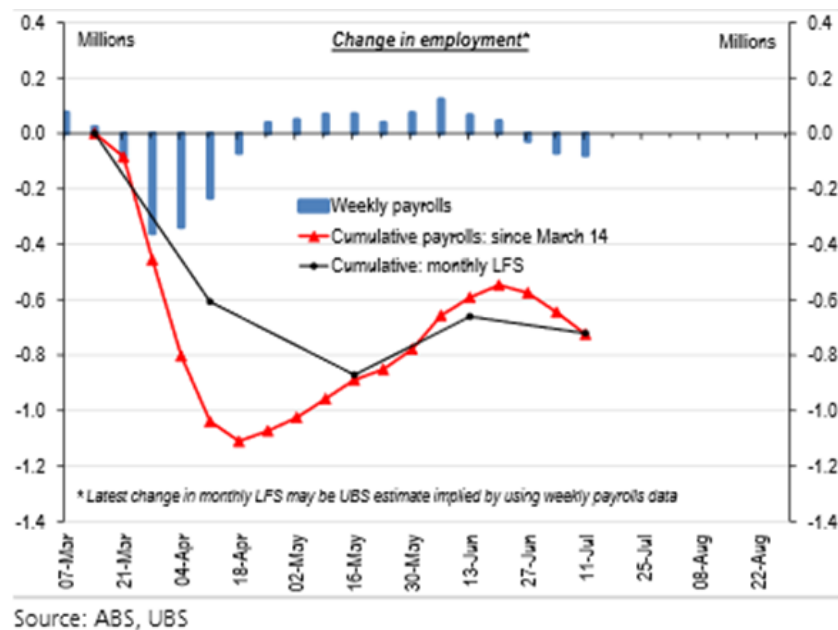
- The July Conference Board measure of **US consumer confidence declined -5.7 points to 92.6, which was below street estimates** (95.0). Among the components, the present situation index improved +7.5 to 94.2, but was outweighed by a large decline in the expectation's component (-14.6 to 91.5). Meanwhile, the labour-market differential moved back into positive territory after three months negative, with respondents currently seeing jobs as "plentiful" rose while proportion seeing as "hard to get" declined, however, this is a lagging indicator and may not yet be capturing any dislocation from the second round of COVID-19 infections, with the report noting increasingly pessimistic outlook for job market in the months ahead.
- The Phase 1 trade agreement between the US and China** is halfway through its first year and China is lagging badly behind its commitment to purchase USD170 billion of manufacturing, agricultural and energy goods from the US. After six months, China has imported just 23% (around USD40 billion) of the annual total, which means its required level of US imports would have to triple by end-2020 to meet the annual target (see chart). There is little doubt that the COVID-19 crisis and China's March quarter contraction have hindered the process, and China is still increasing overall imports (including autos, pharmaceutical, optical, medical instruments, agricultural and energy which all saw sizable increases in June), but the arrangement can be terminated by either side for any reason, which could be a concern as geopolitical tensions between the two nations intensify.



Source: Bloomberg calculations based on official Chinese data

- The bi-weekly Australian payrolls series report indicated that total Australian payrolls declined by -1.2% in the two weeks to July 11th, which is the third consecutive weekly decline (-1.4% over that time). This is a worrying sign as the report only captures the early stages of the Melbourne lockdown (July 8th) which suggests there will be more downside risks in upcoming reports, and if payrolls fail to rebound after this it will be a large growth risk as Australia's AUD70 billion fiscal cliff in December quarter could cause large-scale dislocation to the recovery in both activity and the labour market. That said, it is important to remember this is just once piece of data which has a record so far of being revised higher, and a large portion of the decline in this report reflected a decline in the health sector, which beggars belief considering we are in a health crisis.

Given the timing of the report, we now have a solid lead on the July Labour Force Survey (released on August 13, with the survey undertaken in the first two weeks of July 11) which is likely to detail a circa -60k m/m decline in employment (see chart), after June's +211k rebound). Importantly, the reintroduction of the JobSeeker 'mutual obligation' test, should also see a further rebound of the participation rate which mathematically will send the unemployment rise to around 8%. Meanwhile, wages also decline -0.8% in the last 2 weeks and -4.8% since the peak (in mid-March) which could be an issue as income support from Government payments will be reduced in coming months, which will be a time when the labour market is going backwards.



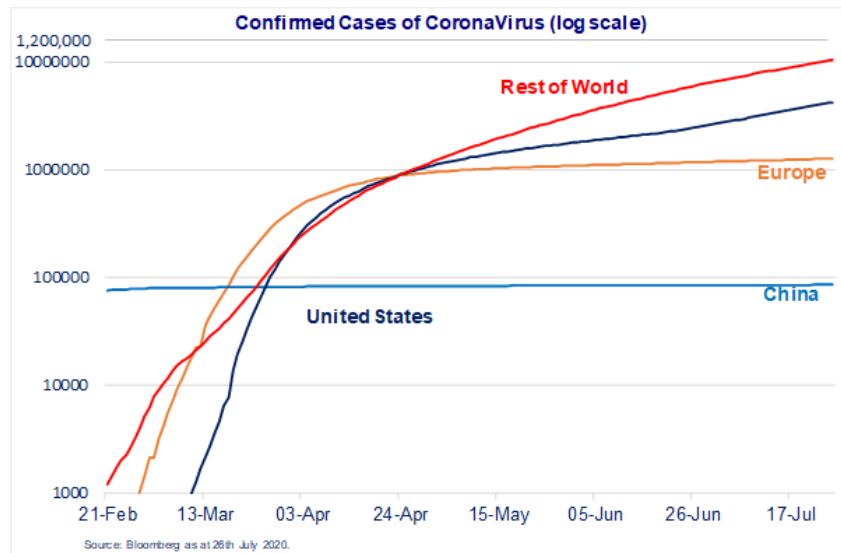
POLICY

- There were no major policy announcements overnight, but the Fed is due to report this morning.

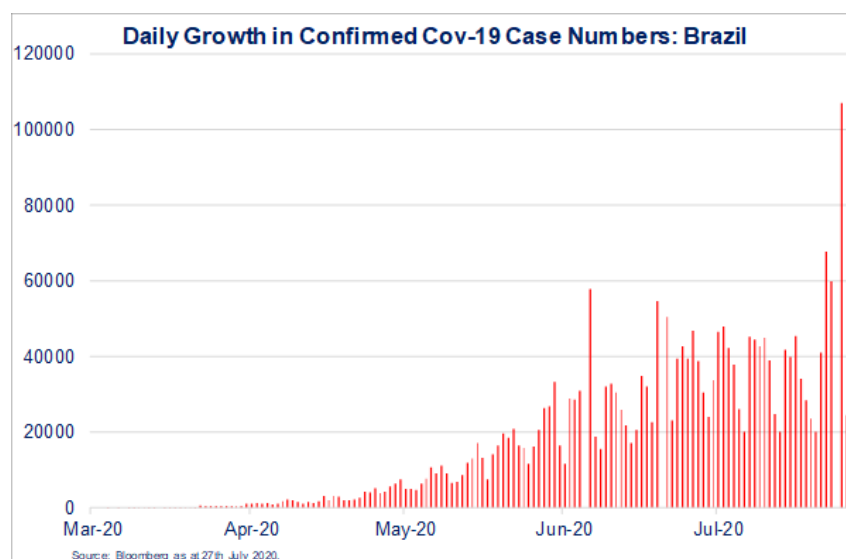
VIRUS UPDATE

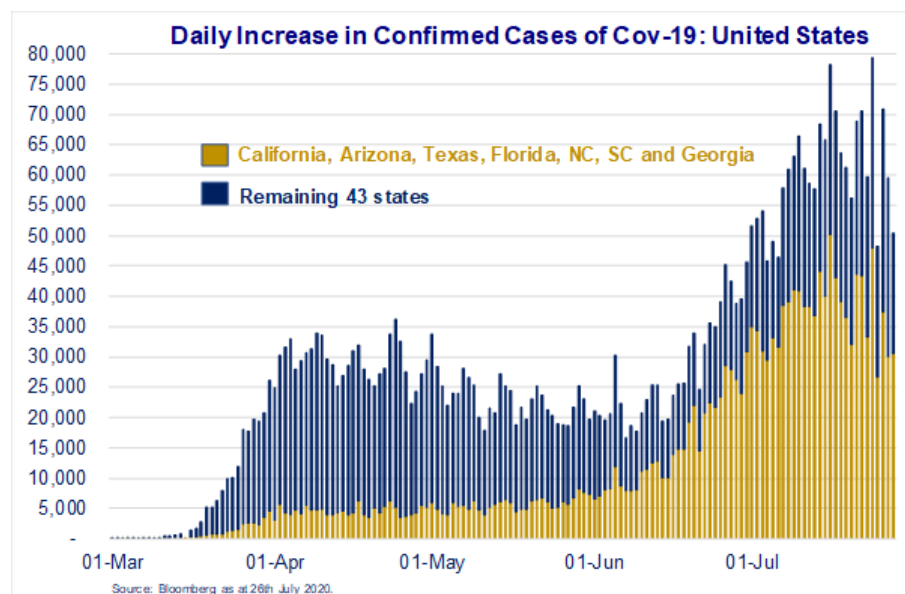
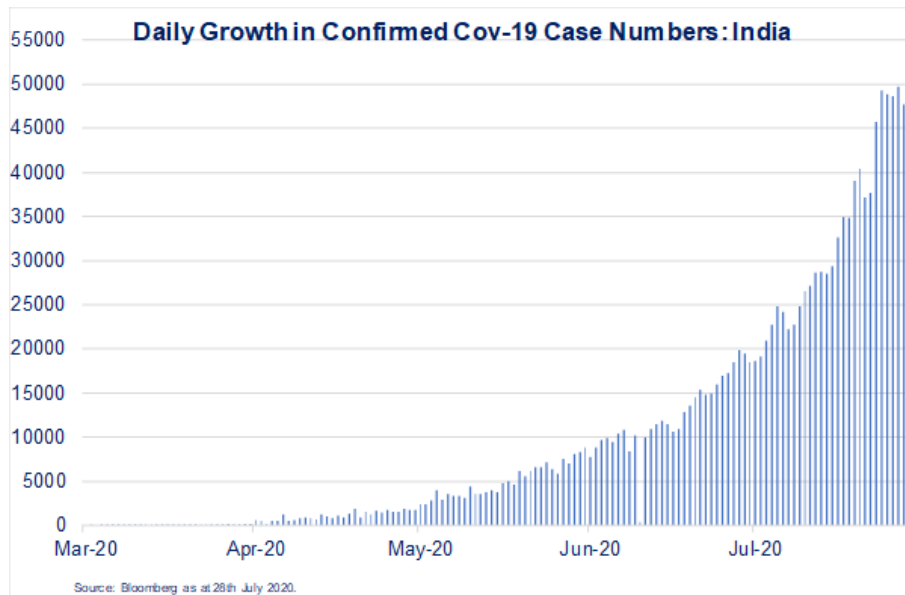
- The number of global cases of COVID-19 is 16.37 million with another +180.3k cases so far (but Brazil, France, Peru, South Korea and 10 US states have not reported their numbers) which means that Tuesday was 36th occasion in the past 36 days where daily increases have topped 150k. This means 4 countries have more than 800k cases, 19 countries have more than 200k cases and 25 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 and 3 days. More importantly, the growth rate of daily confirmed cases (+1.7% since Saturday) is once again starting to rise. Meanwhile, deaths stand at 657.7k and the death rate dropped for a eighty second day to 3.96% although the number of daily deaths is on the rise.



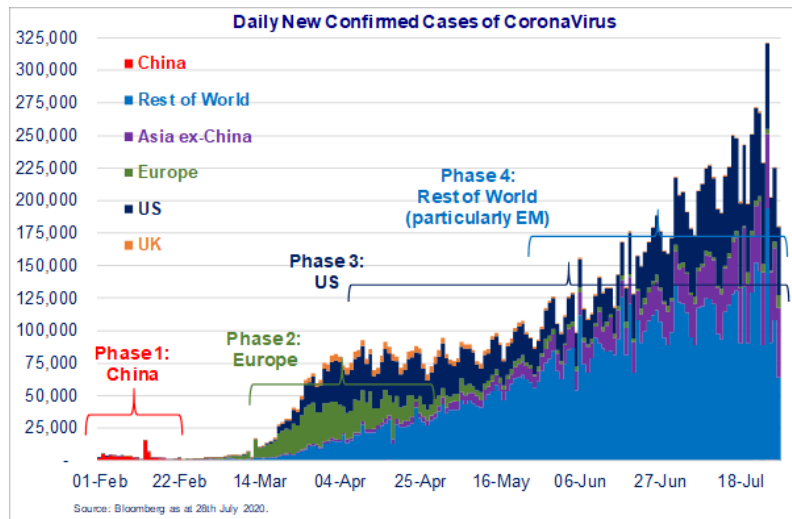
- We break the infections into four groups – the US, Europe, China and ‘others’ and the rest of the world outside the G3 economies now has the most total cases (+64.0k to 10.88 million) and highest daily new cases (and by a considerable margin) followed by the US (+52.3k to 4.34 million, although 10 states are yet to report). More worryingly, the Cov-19 reproduction rate is rising in the North East, not the South West (which is now declining overall, see chart) which is a sign that things are spreading quickly, albeit in smaller states. 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 (+9.8k (12-week high) to 1.295 million - see chart).



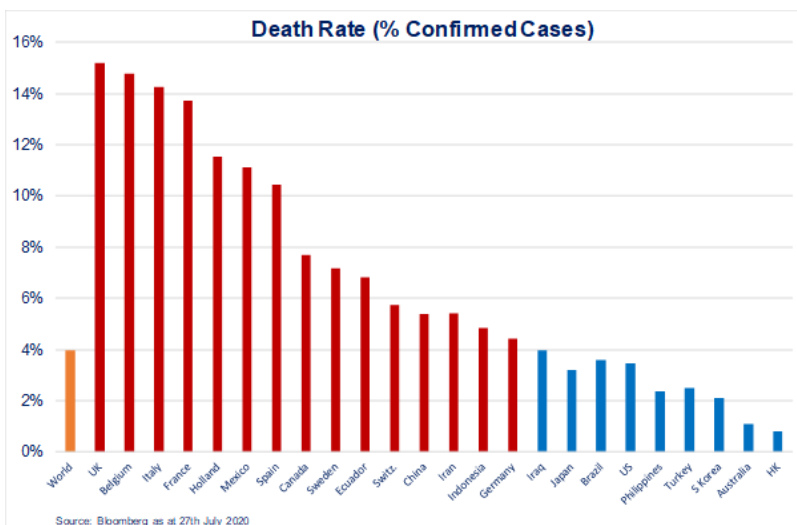
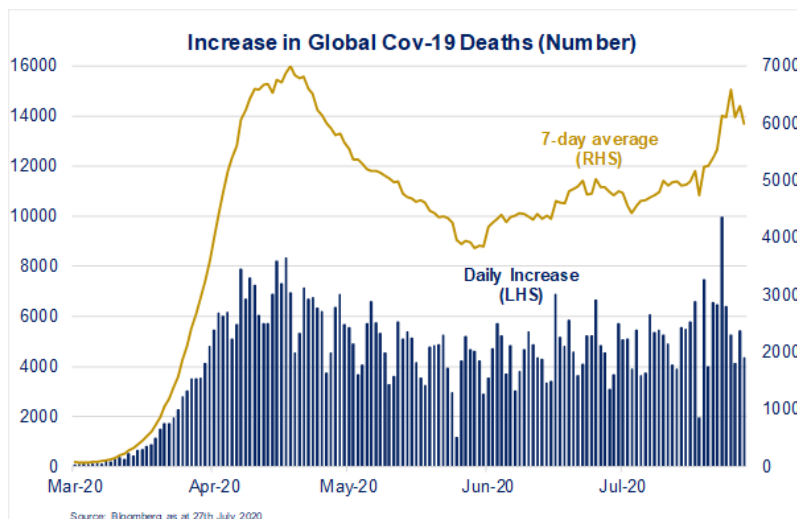


- Among countries, the most cases are in the US (+52.3k (so far) to 4.34 million, with 10 states yet to report and 4 states already reporting record increases (Alabama, Mississippi, New Mexico and South Carolina), Brazil (not reported to 2.44 million), India (+47.9k to 1.48k), Russia (+5.4k to 822.1k), South Africa (+7.2k to 459.8k), Mexico (+7.2k to +402.7k), Peru (not reported, 389.7k), Chile (+1.9k, 349.8k), United Kingdom (+0.6k to 302.3k), Iran (+2.7k (3-week high) to 296.3k), Spain (+8.2k to 280.6k), Pakistan (+0.9k to +275.2k), Saudi Arabia (+1.9k to 270.8k), Italy (+0.2k to 246.5k), Bangladesh (+3.0k to 229.2k), Turkey (+1.0k to 228.0k), France (not reported, 220.4k) and Germany (+0.6k to 207.7k). Australia confirmed cases rose +367 to 15.3k yesterday which placed us 71st in terms of total infections.

Elsewhere, Singapore recorded +0.4k new cases to 51.2k 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 (+1.7k to 102.1k) is now on the rise and has the most cases in the region, and the Philippines (+1.6k to 83.6k) is also on an upward trend.



- Although final numbers are not in until 1pm AEST, the global death rate declined for a eighty second straight day to 3.96% with the global total to 657.7k after another 4.3k 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 +149.1k, with Brazil (not reported, 87.6k), the UK (+0.1k to 46.0k), Mexico (+0.9k to +44.9k), Italy (+11 to 35.1k), India (+0.6k to 33.4k) 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 14.8%), Italy (steady at 14.3%), France (-0.2% to 13.7%), 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%).



Yours sincerely,



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