Perpetual Investments

THOUGHTS ON THE MARKET

Global cases top 10 million without a vaccine in sight

29th June 2020

SUMMARY

- Global risk markets retreated sharply on Friday night as a record surge in new Cov-19 infections in the United States and around the world impinged the market's pricing for a V-shaped recovery. The combination of economic reopening and rising infection rates suggests the road to overcoming the impact of Cov-19 is getting longer and steeper which rules out any "return to normal", let alone a V-shaped one. If there is one statistic that epitomises the economic challenge ahead, it is US consumer confidence which barely rose in June despite economic re-opening, a large household savings pool, a sharp rise in employment and record increases in spending.

  While Texas's bars and Miami beach's being closed just before July 4th holidays is a sign that things are not normal, it has to be remembered that US testing has ramped up, so higher case numbers likely do not signal that things are worse than in March or April, at least not yet. However, with the economy highly unlikely to be re-closed to combat the virus, the big unknown is how consumers respond, but it is unlikely to be constructive. Accordingly, unless a vaccine miraculously happens in the near-term, which is a development with a very low probability, the US and global economies are heading for very difficult 18-24 months.

  In other markets, 10-year US Treasuries fell to 0.64% (6-week low) with the curve slope down to 0.50% (9-week low), commodities were mixed with gold up +0.7% to USD1,771 per troy ounce (close to an 8-year high) and oil down -0.6% to USD38.49 per barrel, and the US dollar was mixed after appreciating against Sterling (+0.9%), the AUD (+0.1% to 68.65) and Yen (+0.1%), but declined against the Euro (-0.1%).

- There wasn't much on the data front other than US personal income holding up better than expected but this failed to translate to personal spending being above street estimates. There also wasn't much from central banks or fiscal authorities, but Texas Governor Greg Abbott rolled back the state's reopening plans and ordered that all bars to closed again and restaurants to reduce occupancy to 50% and Florida leadership subsequently suspended all on-premise alcohol consumption state-wide.

- The number of global cases of Cov-19 was 10.07 million with another +117.1k cases so far overnight (before Mexico, Ecuador, France, Pakistan and some US states report their numbers) which means that Sunday was the 31st occasion in the past 33 days where daily increases have topped 100k (and the other two were over 99k!). This means 3 countries have more than 600k cases, 12 countries have more than 200k cases (Mexico (212k) Pakistan (203k) joined this group over the weekend) and 19 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 and 6 days. In the past 12 hours another +72k cases have been confirmed but more importantly, the growth rate of daily confirmed cases (+1.9% since Wednesday) is rising despite the large base. Meanwhile, deaths stand at 500.3k and the death rate dropped for a fifty third straight day to 5.0%.

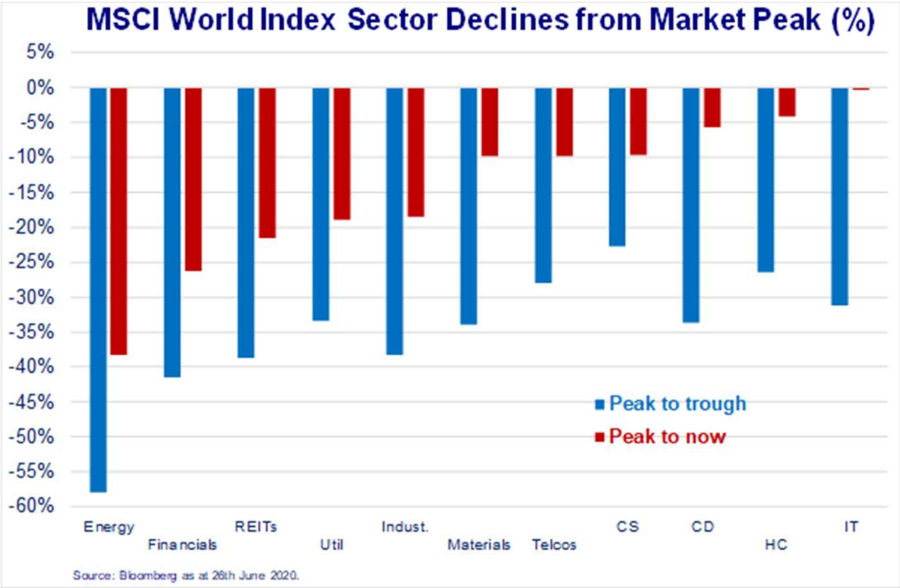
FINANCIAL MARKETS

EQUITIES

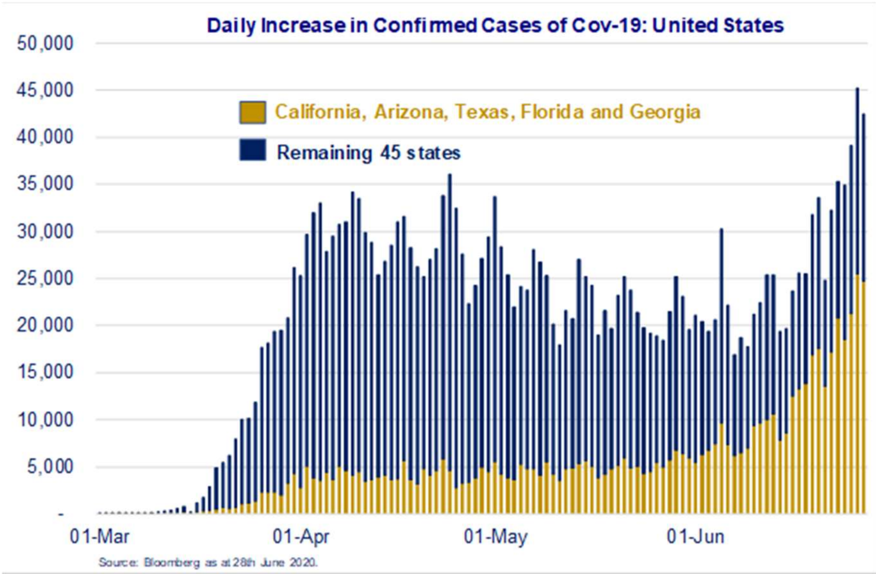
- The MSCI World Index closed -1.7% lower on Friday which culminated in a -2.3% drop for the week. There was across-the-board losses to close out the week led by communication services as Facebook (-8.3%) and Twitter (-7.4%) were boycotted by several large advertising clients given their refusal to monitor and remove hate-pieces. Meanwhile, declines were also prominent in the traditional value/cyclical sectors including financials (-2.6%) given the flattening yield curve and concerns about caps on bank dividends potentially beyond September, and energy (-2.4%) given the

Perpetual

lower crude prices and concerns about the sustainability of the economic recovery. The moves on Friday meant energy (with a peak to now decline of -38.3%), financials (-26.3%) and REITs (-21.6%) went deeper into bear market territory, with utilities (-19.0%) and industrials (-18.5%) not far away (see chart).

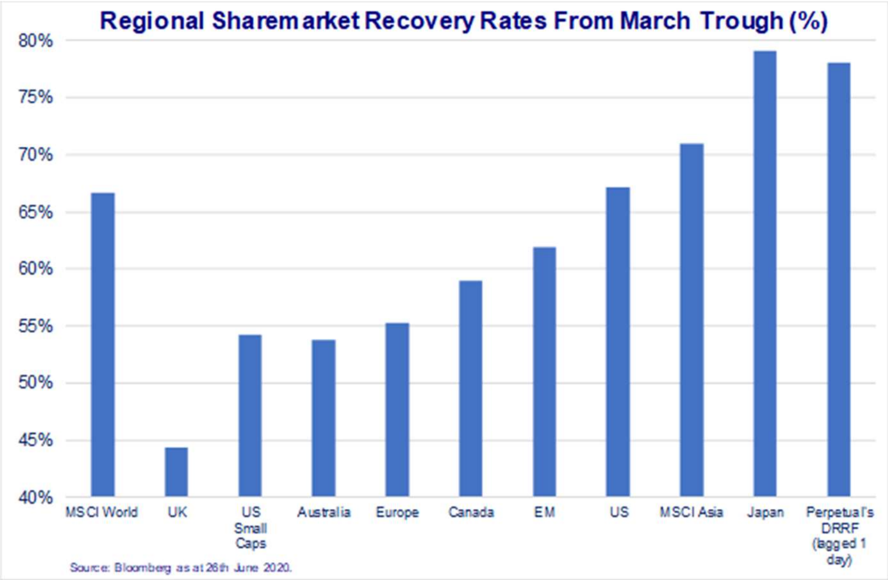


- Across the regions, losses were steepest in the US as investors decided that another set of poor Cov-19 cases threatened the sustainability of the recovery with several large states halting plans to expand economic activity. The case numbers are surging primarily in the South (Florida, Georgia, Texas), and Southwest (Arizona and California) where five states accounted for 58% of total new cases, relative to 14% in March and April (see chart). This weighed heavily on cyclical sectors such as financials (-2.5%) which were also weighed down by the Fed's decision to cap dividends, and the boycotting of several major advertisers of firms in the communication services sector (-3.1%) as platforms have stalled on dealing with hate-speech and mis-information. By the bell at the NYSE, the Dow Jones Industrial Average (-730 points, -2.8% to 25,016) led the declines followed by the NASDAQ 100 Index (-2.6%) and S&P 500 and Russell 2000 (both -2.4%).



Earlier in Europe (-0.5%) stocks declined moderately in a session which struggled for directional drivers, with ECB Chair Lagarde saying the worst of the crisis was likely over and that a "modest" was underway. But other that piece of ambiguity there was scant new information to trade on given the lack of top tier economic data or policy announcements. By the close Spain (-1.3%), Germany (-0.7%) and Italy (-0.6%) underperformed the regional index, whereas France (-0.2%) and the UK (+0.2%) were little changed.

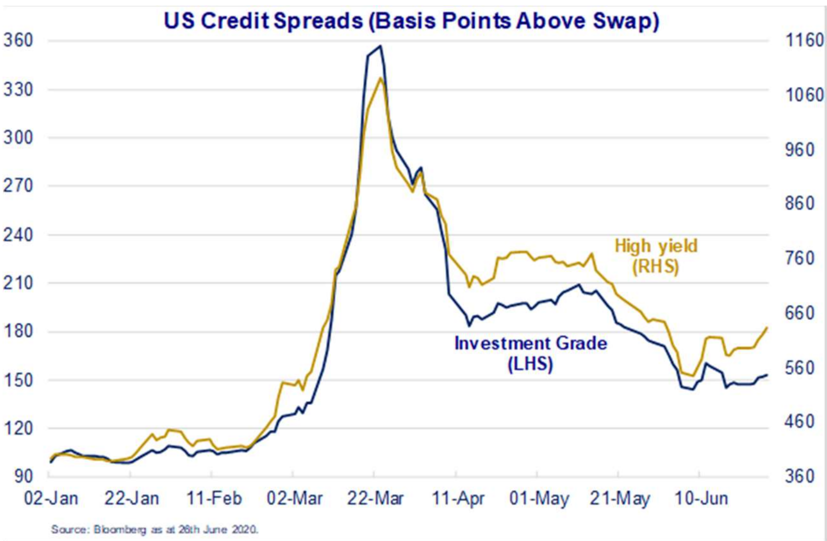
Before that, Asia markets closed out a positive session (+0.3%) and a week of gains (+0.1%) with strong advances in Australia (+1.5%) and Japan (+1.1%), but Hong Kong (-0.9%) came back from national holidays and caught up with the weekly downtrend in global share prices, and China was closed. By the close of trading for the week, the UK (with a decline of -20.0% on a peak-to-now basis) was the only bourse in bear market territory, but US small caps (-19.1%) and Australia and Europe (both -17.1%) are not far away, and the US (-11.1%) re-entered 'correction' territory for the first time in several weeks as its recovery rate slipped below 70% (see chart).



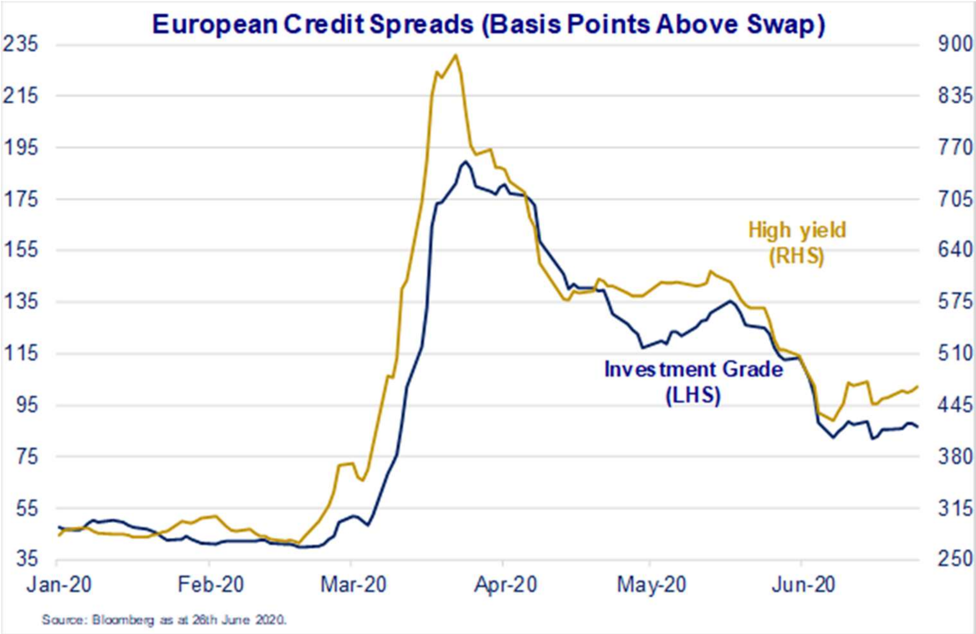
- Futures markets suggest sharp losses on the opening bell in Asia to start the week with Hong Kong (-0.4%), Japan (-0.9%) and Australia (-1.5%) all priced to open lower.

CREDIT MARKETS

- Regional credit indices were mostly lower to close the week. Spreads in the US investment grade universe increased for +1 point, which was the fifth consecutive rise with all sectors witnessing higher risk premiums. Yet again the spread increase in this market sector was contained with investors seemingly unwilling to let go of assets which have both a positive yield premium over treasuries, and balance sheet backing from the Fed. Indeed, the only noteworthy increases were in energy (+ 2 points to ++212 bpts, 86%) and subordinated financials (+2 points, +187 bpts, 80%). However, in the high yield space, the lack of a direct Fed backstop saw spreads increase another +13 points (seventh consecutive increase) to +634bpts (4-week high), which lowered the recovery rate to 67%. All sectors recorded higher spreads and 8 of the 11 sub-sectors recorded double-digit increases led by energy (+21 points, +973 bpts, 87%), healthcare (+17 points, +581 bpts, 64%) and subordinated financials (+14 points, +675 bpts, 50%).



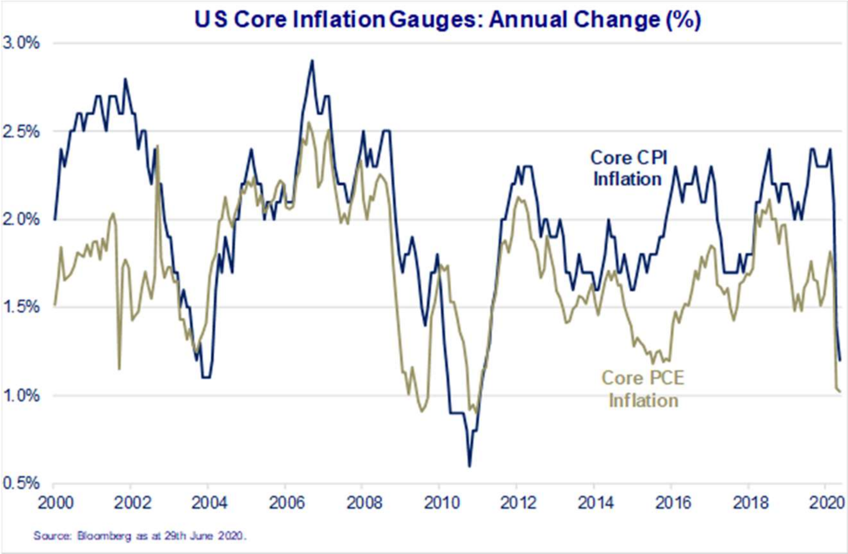
- European credit markets were mostly unchanged with investment grade spreads steady at 82 basis points, which kept the recovery rate at 69%. Only 4 of the 11 sub-sectors recorded higher spreads and only consumer discretionary (+1 point, +123 bps, 68%) and energy (+0.6 of a point to +82 bpts, 61%) of note. Spreads were also steady in the high yield space (+0.2 pf a point to +468 bpts, 68%) with noting of note among the sub-sectors.



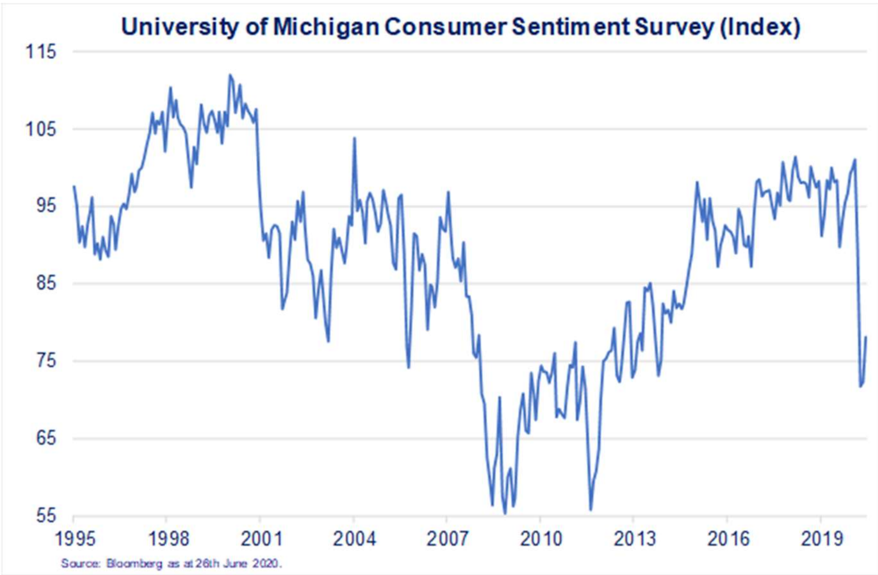
THE GLOBAL ECONOMY

- The decline in May US personal incomes (-4.2% m/m) and the increase in May personal spending (+8.2% m/m which was the highest monthly increase since the Commerce Department began tracking this in 1959) were both below street estimates, but the latter suggests that a strong rebound in consumer spending is underway and the high personal savings rate suggests that this should continue in the months ahead even though household income is likely to decline as policy supports are withdrawn. Accordingly, it will be a struggle to maintain spending unless there is a strong and sustained upswing in the labour market. That said, whilst spending in certain areas such as health care should continue given strong pent up demand, others such as recreation are likely to remain lower for longer. Among the income sources, government transfer payments declined -17.2% m/m (after spiking +90.1% in April), wages and salaries rose +2.8% m/m and the savings rate declined -9% to 23.2% (see chart).

- The US May core PCE inflation rose 0.10% m/m which pulled the annual rate down to 1.0% y/y which is a 9-year low. (see chart). Interestingly, the May core PCE rose (unlike the core CPI which declined -0.1% m/m), but this was primarily based on stronger elements from price components from the PPI. Over the long-term, it is hard for prices especially on a core basis to keep heading lower as, for example, components related to travel and tourism that saw significant price declines in April and May are likely to stabilise or even rebound slightly as the economy re-opens and firms cease sacrificing margins for volume. Notwithstanding some possible transitory strength in some areas, core PCE will likely remain well below the 2% target for much of the next year and into 2022.



- University of Michigan consumer sentiment slipped in the second half of June to 78.1 (the preliminary reading was 78.9) in sync with a resurgence of Cov-19 cases, with current conditions (down -0.7 to 87.1) and expectations (--0.8 to 72.3) both down from the initial print. While the decline from mid-June to end-June was not much and it was not far below consensus (79.2), it highlights consumers' lingering anxiety as the early reopening of the economy has restored jobs and incomes, but it has come at the cost of an uptick in the spread of the virus, which could weigh on the timing and sustainability of the recovery. The resurgence of the virus will be accompanied by weaker consumer demand among residents of the Southern and Western regions of the US, and could also temper the reactions of consumers in the Northeast.



POLICY

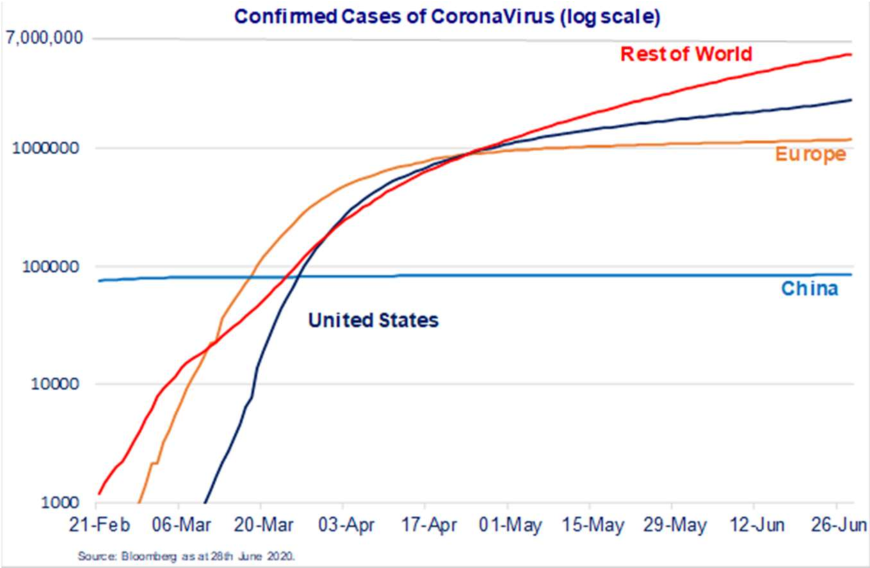
- There were no policy announcements from authorities. However, the Fed's balance sheet contracted for a second straight week (even though it remained above USD7 trillion) underpinned by a continued decline in demand for the Fed's dollar swap lines which was partially offset by increases in holdings of both US Treasuries and MBS. One interesting note is the limited use of the Fed's emergency facilities with only 4% (USD103 billion) of the initial USD2.6 trillion being accessed since March, which shows the power of 'signalling' has effectively done the job for them. However, there could be a concern that these programs may not be able to remedy the problems facing some small and medium-sized businesses and state and local governments. Time will tell.

Perpetual

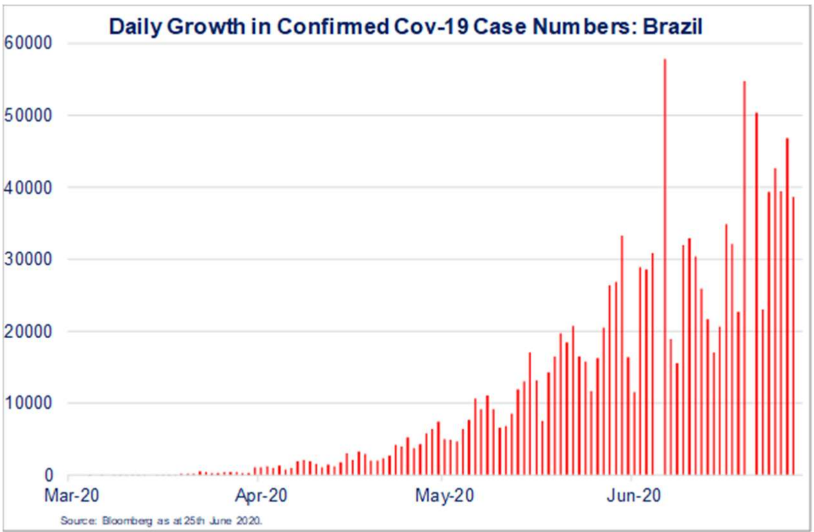
VIRUS UPDATE

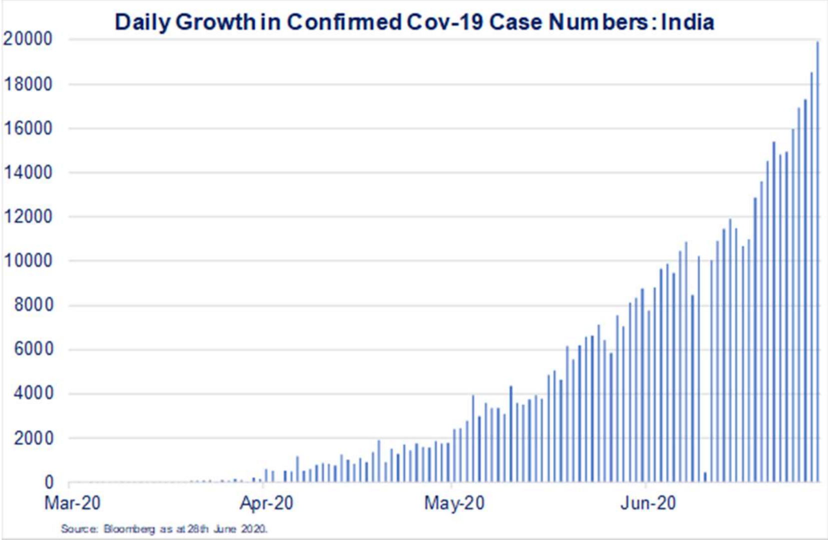
- Although final numbers are not in for another 5.5 hours, the number of global cases of Cov-19 was 10.07 million with another +117.1k cases so far overnight (before Mexico, Ecuador, France, Pakistan and some US states report their numbers) which means that Sunday was the 31st occasion in the past 33 days where daily increases have topped 100k (and the other two were over 99k!). This means 3 countries have more than 600k cases, 12 countries have more than 200k cases (Mexico (212k) Pakistan (203k) joined this group over the weekend) and 19 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 and 6 days. In the past 12 hours another +72k cases have been confirmed but more importantly, the growth rate of daily confirmed cases (+1.9% since Wednesday) is rising despite the large base. Meanwhile, deaths stand at 500.3k, with the US now over 120k (25.1% of global deaths even though they have only 4% of the global population), Brazil (57.1k), the UK (43.6k) and Italy (34.7k) all over 30k, with France (29.8k) and Spain (28.3k) over 25k, and the death rate dropped for a fifty third straight day to 5.0%.



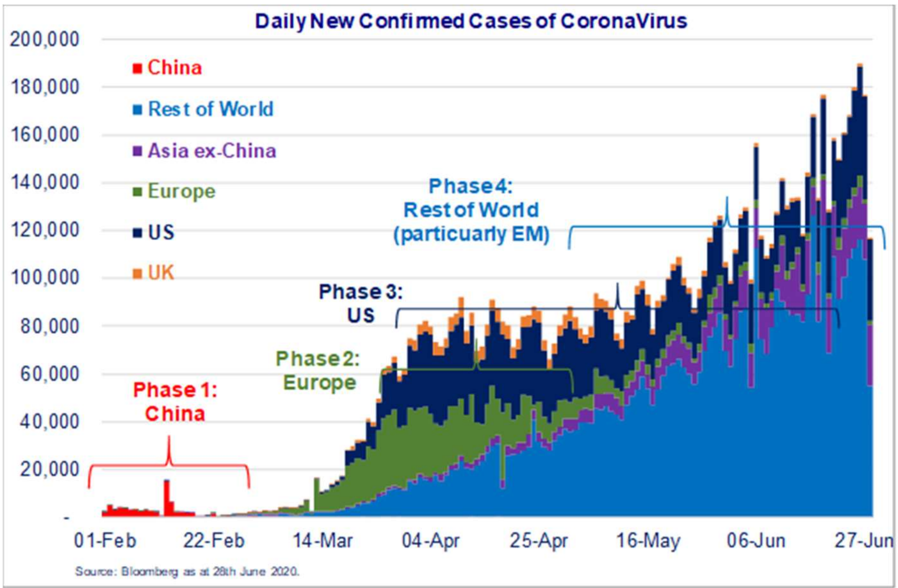
- We break the infections into four groups – the US, Europe, China and 'others' and the rest of the world outside the G3 economies now has the most total cases (+54.3k to 6.25 million) and highest daily new cases (and by a considerable margin) followed by the US (+32.6k to 2.54 million) and Europe (+1.4k to 1.18 million - see chart). The issue for the US is that they never flattened their curve which means economic opening has not been associated with lower case numbers (see chart). Within the rest of the world, the three concerns here are Brazil (not reported, +1.31 million, which is the second highest in the world), Russia (+6.8k to 633.6k, third highest) and India (+19.9k (record high) to 528.9k, fourth highest – see charts below).



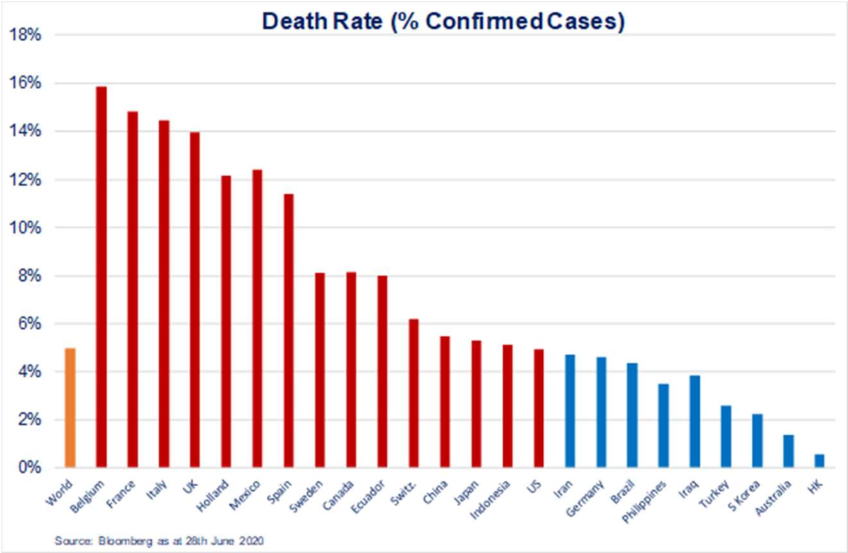


- Among countries, the most cases are in the US (+34.1k (so far) to 2.54 million), Brazil (not reported, 1.31 million), Russia (+6.8k to 633.6k), India (+19.9k (record high) to 528.9k), the United Kingdom (+0.9k to 312.6k), Peru (+3.4k to +279.4k), Chile (+4.2k to 272.0k), Spain (+0.3k to 248.8k), Italy (+0.2k to 240.3k), Iran (+2.5k to 222.7k), Mexico (not reported, +212.8k), Pakistan (not reported, +203.0k), France (not reported, 199.5k), Germany (+0.4k to 192.9k) and Turkey (+1.4k to 197.2k). Australia confirmed cases rose +85 to 7,686 yesterday which placed us 71st in terms of total infections.

  Elsewhere, Singapore recorded +0.2k new cases to 43.5k 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 (+1.2k to 54.0k) is now on the rise and has the most cases in the region, and the Philippines (+0.7k to 35.5k) is also on an upward trend.



- Although final numbers are not in until 1pm AEST, the global death rate declined for a fifty third straight day to 5.0% with the global total to 500.3k after another 2.1k deaths overnight. The US (+0.23k so far) has the most deaths at +125.8k, with Brazil (not reported, 57.1k), the UK (+0.04k to 43.6k), Italy (+0.02k to 34.7k), France (not reported, 29.8k) and Spain (+2 to 28.3k) all over +25k. The death rate is highest in European countries where the health systems have collapsed led by Belgium (steady at 15.9%), France (steady at 14.8%), Italy (steady at 14.5%), the UK (steady at 14.0%), the Netherlands (-0.1% to 12.2%), Spain (-0.1% to 11.4%) and Sweden (-0.1% to 8.1%). However, several emerging markets are now on the leader board including Mexico (steady at 12.4%), Ecuador (-0.2% to 8.0%), Indonesia (steady at 5.1%) and Brazil (-0.1% to 4.3%).



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

Perpetual