

THOUGHTS ON THE MARKET

31st August 2020 - US consumer spending will remain upbeat in the September quarter, but Q4 at this stage looks problematic

SUMMARY

- Global equity markets closed higher on Friday and closed out their strongest weekly advance (+2.7% w/w) in eight weeks as the US Fed's new inflation framework rippled through markets. This sparked fresh record highs for the MSCI World, the S&P 500 and NASDAQ100 indices and the Dow Jones turned positive for the year, but the joy was not uniform with a second consecutive decline in European, UK, Japanese and Canadian markets. At present tech-heavy equity markets are seeing the best of all worlds in that the economy is now rebounding, the stimulus impulse, and some investors are continuing to reduce underweight risk positions. However, this is not March 2009 when valuations 10x, policy was a one-way bet and a multi-year period of above-trend growth beckoned. In fact, it's almost the complete opposite in FY21 as the recovery is set to decelerate in the December quarter, valuations are at tech-boom highs, and the fiscal cliff is large. So, at present, caveat emptor!

In other markets, 10-year US Treasuries declined -3 points to 0.725% with curve flattening, commodities were mixed with gold up strongly (+1.3% to USD 1965 per troy ounce) whereas oil drifted lower (-0.2% to USD42.97 per barrel), and G10 currencies all rallied against a weaker Greenback with gains led by the AUD (+1.6% to USC73.65), Sterling (+1.3% to 133.53 which is a 9-month high), the Euro (+0.8% to 119.0 which is a 27-month high) and the Yen (+0.7% to 105.37).

- Economic data was constructive on Friday with the July US personal spending continuing to bounce (+1.9% m/m) from the April low but the rise was one-third of the June increase and less than one-quarter of May's. Meanwhile, US personal income rose only +0.4% m/m in July meaning that households are still using their large savings reserves to lift spending levels, but they have already depleted 63% of this pool. It is neither surprising nor concerning to see spending growth rates slow, but a large savings pool suggests that consumer demand will remain upbeat in the September quarter. Looking further ahead, we still contend that US household savings rates will remain well above its February level (8.3%) given the prolonged labour market dislocation. This combined with fiscal delays/austerity will see incomes dip by about a sizable USD75 billion per month (USD900 billion annualised) and implies that the December quarter could be subjected to sizable downside risks.
- The number of global cases of COVID-19 is 25.11 million with another +182.1k cases so far (but Brazil, Colombia, Mexico, Spain and Sweden and 8 US states have not reported their numbers) which means that Sunday is set to be the 42nd day in the past 43 where daily increases are greater than 200k. At present, 8 countries have more than 500k cases, 21 countries have more than 200k cases and 29 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, 3 days, 4 days, 4 days, 4 days, 4 days, 4 days, 4 days and 4 days. More importantly, the growth rate of daily confirmed cases (+1.1% since Thursday) is once again coming down. Meanwhile, deaths stand at 844.2k and the death rate has declined to 3.36% although the number of daily deaths remains elevated.

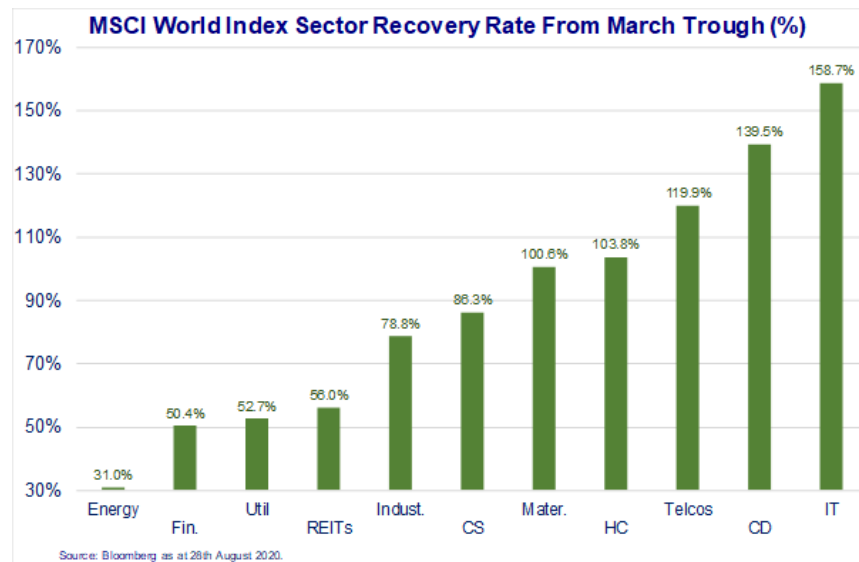
FINANCIAL MARKETS

• EQUITIES

- The MSCI World Index closed +0.6% higher on Friday which put a seal on its strongest weekly advance (+2.7%) in eight weeks with nine of the 11 sectors closing higher. Energy (+0.8%) led the pace of advances on Friday with investors once again sending the sector in the opposite direction of underlying crude prices, but in doing so they snapped a 3-day losing streak with gains among refiners and oil-services

names. Tech (+0.7%) also beat the market tape with solid gains in both hardware and semis, and REITs rose for a second straight session amid signs that US retail spending has not yet been negatively impacted by delays in stimulus cheques.

In contrast, materials underperformed its peers and despite further gains in base metals and precious metals, as did industrials (+0.2%) despite strength in airlines which remain supported by the reopening thematic, whereas consumer staples (-0.04%) and healthcare (-0.2%) were the only sectors to close in the red. The overnight advances had little impact on the recovery rate for sectors with energy (with a recovery rate of 31%) and financials (50.4%) both remaining in bear market territory, although at least the latter is inching towards the key -20% line, whereas five sectors have now completed a complete recovery (see chart).

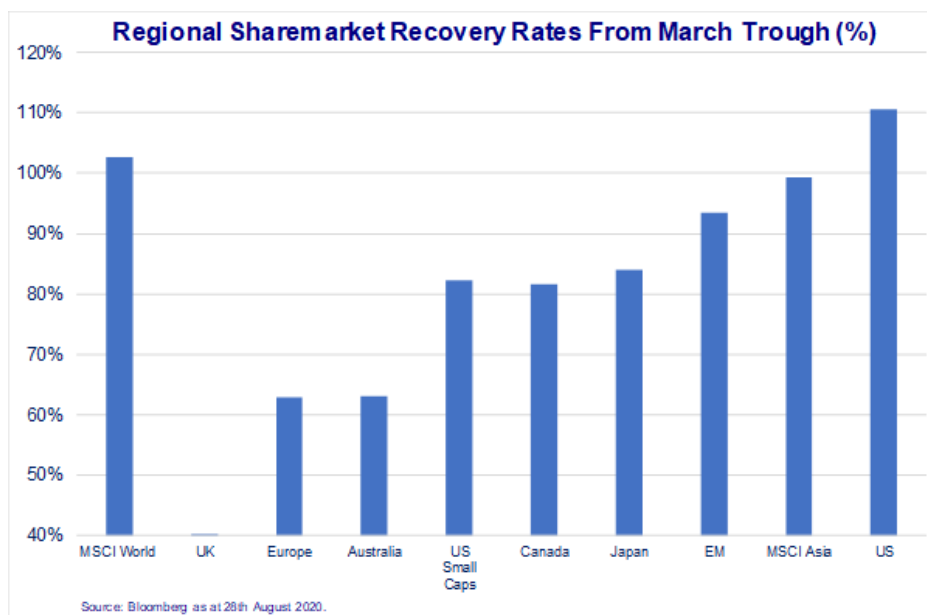


- **Among the regions, the pace of advances was led by the US (+0.7%) market for a third straight session** in what was a uneventful day which ended with the S&P 500 and NASDAQ indices each logging their fifth consecutive weekly advance, whereas the Dow closed in positive territory for 2020. Economic data for the session was upbeat with personal income and spending both beating the street and remaining firmly in expansion territory, whereas the Fed's preferred inflation gauge (the core PCE) came in well below consensus. Elsewhere, expectations around fiscal stimulus and a COVID-19 vaccine remained firm and outweighed Friday's daily case numbers which hit a 2-week high (of 46.7k). Accordingly, all indices closed in positive territory led by the Russell 2000 (+0.9%), S&P500 (+0.7%), NASDAQ 100 (+0.6%) and Dow Jones (+0.6%, +162 points to 28,654).

Asia stocks (+0.4%) also advanced but put in a very mixed performance among its constituent regions. Price movements were uneventful for most of the session as markets digested the Fed's change to an inflation averaging regime which will result in no real change in policy for several years but the late-breaking headline that Japan PM Abe resigned due to health reasons weighed on sentiment and sparked late declines in Nippon share prices amid Yen strength, although both were short lived. There wasn't anything else of note and by the closing bell in Mumbai, solid gains in Mainland China (+2.4%) and advances in India (+0.9%), Hong Kong (+0.6%) and South Korea (+0.4%), contrasted with declines in Taiwan (-0.5%), Australia (-0.9%) and a late sell off in Japan (-1.4%).

In contrast to gains in the US and Asia, Europe declined (-0.5%) for a second straight session as investors fretted over rising COVID-19 case numbers which hit +18.1k on Friday night. While this was not remotely close to a one month high, consumer data in France (+0.5% m/m after +10.3% in June) weakened in a similar vain to Spain's showing the potential impact of the second wave, but broader Eurozone confidence was a bit firmer, albeit still at low levels. Elsewhere, a senior European Union source told the London Times that UK PM Johnson has less than two weeks to save post-Brexit trade talks. By the closing bell, the region was lower with losses led by Sweden (-1.0%), Switzerland (-0.7%), the UK (-0.6%), Germany (-0.5%), France (-0.3%) and Italy (-0.03%), whereas Spain (+0.6%) defied the regional trend and closed higher although it was hard to pinpoint the rationale here.

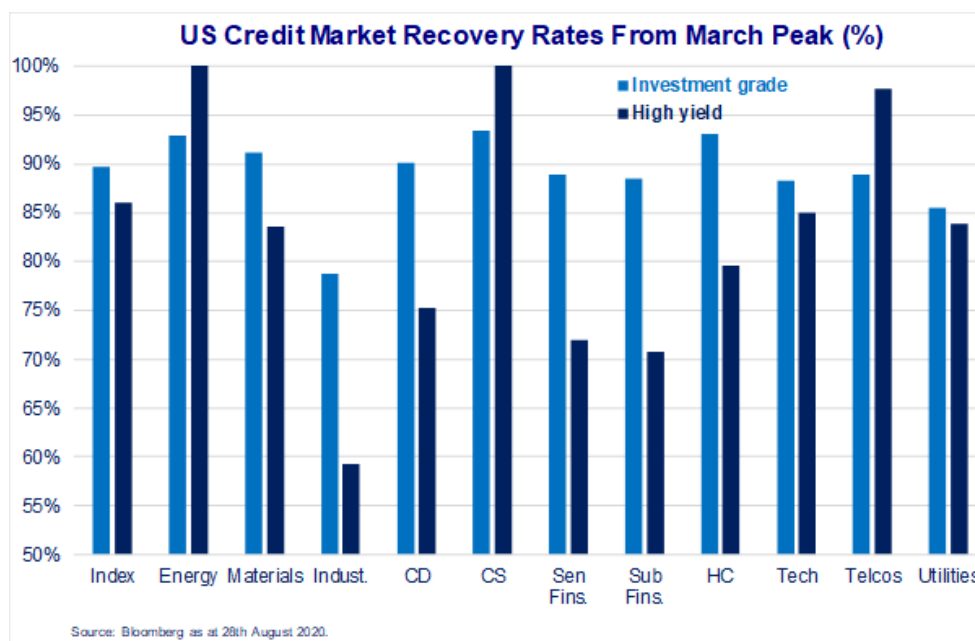
Movements for the week, saw no change in our regional peak-to-now chart and the respective recovery rates implied by the movements (see chart) with the UK (+40%) the weakest, and the US and MSCI World (111% and 103%, respectively) the only markets to experience a complete recovery, but Asia (99%) is probably one session away.



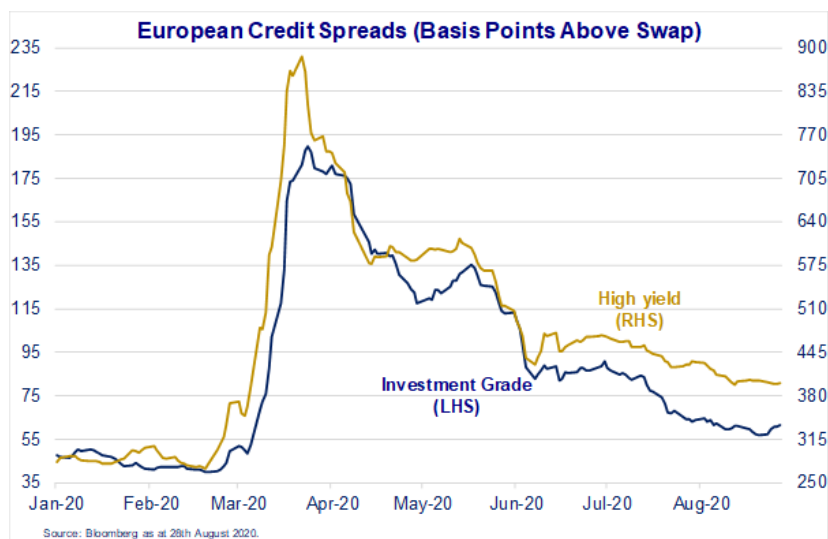
- **Futures markets suggest a subdued opening in Asia this morning**, with Australia (-0.7%) priced for an opening bell decline, whereas prices are pointing to advances in both Hong Kong (+0.2%) and Japan (+0.3%).

• CREDIT MARKETS

- **Regional credit indices were little changed as has been the case now for two weeks. US investment grade spreads were idle for a fifth straight session at +129 bpts**, which left the recovery rate at 90%. Eight of the 11 sub-sectors recorded lower risk premiums but for the eighth straight session not one sector moved by more than a basis point. In the high yield universe, spreads were also flat at +506 bpts, which kept the recovery rate at 86% (see chart) with six sectors recording higher risk premiums, but again no move was more than four basis points in a very quiet session. Accordingly, the sub-sector recovery rates did not change at all over the past week with market prices eerily quiet as investors await the next policy impulse from the US Fed, and the next growth impulse from the economy.

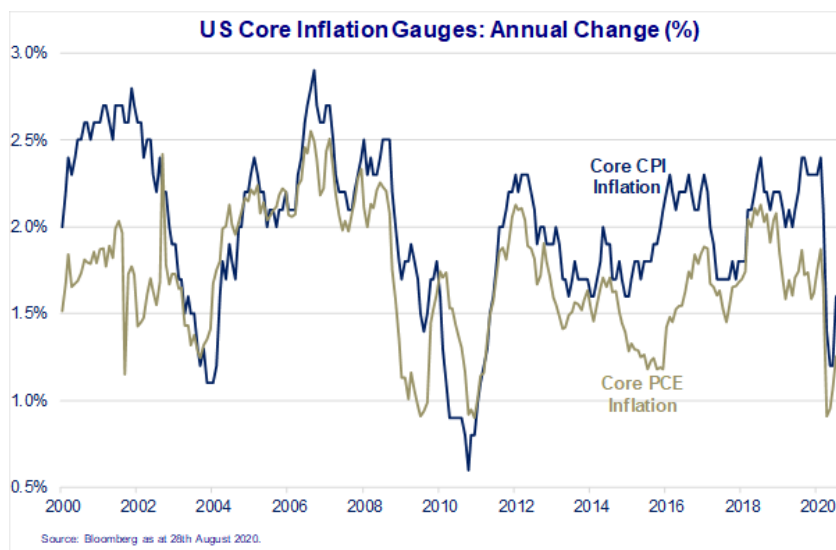


- **European credit markets were also very quiet to end the week** with spreads in the investment grade universe rising +1 point to +62 bpts, which lowered the recovery rate one notch to 85%. Ten of the 11 sub-sectors recorded lower spreads, all of which were by a basis point or less, but they were outweighed by a large rise in subordinated financials (+11 points, +149 bpts, 81%) whose prices fell to a 3-week low. Similarly, in the high yield universe, spreads increased +2 points to +399 bpts, which lowered the recovery rate one notch to 79%. Again, 9 of the 11 subsector recorded capital gains, but there were offset by a major rise in subordinated financials (+46 points, to +359 bpts, 76%) which recoded its largest daily capital loss in 14 weeks, and wiped out the last seven weeks of capital gains. The last time this sector recorded a large price declines (on the 2nd July where spreads rose +35 points) it was recovered in the next session, so it will be interesting to see if this occurs tonight.

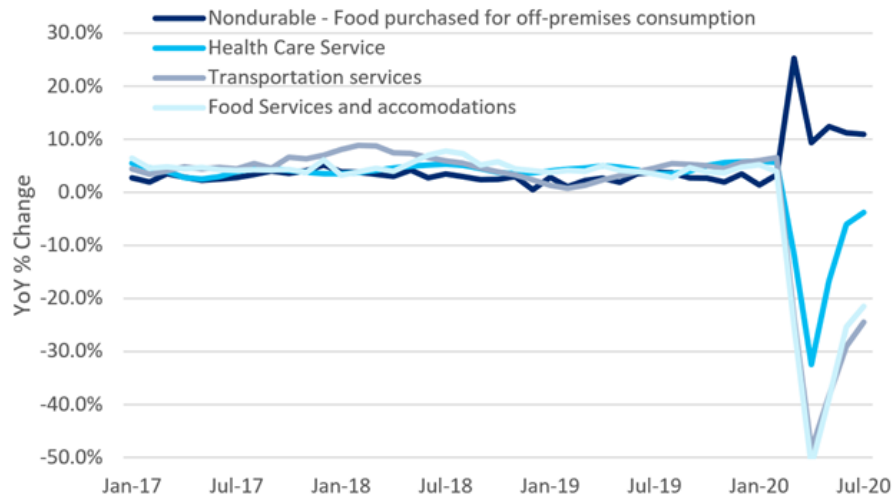


THE GLOBAL ECONOMY

- **US PCE prices increased +0.32% m/m in July and core prices rose +0.35% m/m underpinned by above-average increases for both apparel, and prices such as hotels as the US economy reopened.** These monthly results culminated in the annual rates rising to 1.0% y/y and +1.25% y/y respectively (see chart) and while the monthly increases seems large relative to their 20-year average (of +0.16% m/m and +0.14% m/m, respectively), they were below consensus expectations of +0.45% m/m and +0.44% m/m rises, respectively. There was also a 11bp upward revision to June largely stemming from updated estimates of used vehicle margins, which have increased strongly from the near 30-year low in April. While both gauges are well below the Fed's 2% inflation target, I expect them to rise further in coming months as prices in closed sectors of the economy normalise amid reopening, but after that they are likely to ease back and remain well below 2% for the next few years as excess capacity and low wages growth impinge price increases.



- **US personal spending continued its bounce from the April low and was up +1.9% m/m in July with modest upward revisions to the June data.** This confirmed that goods spending (+2.0% m/m and +6.5% y/y) has materially lifted with reopening, but services spending (+5.8% m/m in May and June) is now starting to moderate (+1.9% m/m in July) and remains deeply in negative territory on an annual basis (-7.0% y/y). Within services, healthcare spending is rebounding strongly and is now down only -3.8% y/y after being down -32.5% y/y in April (see chart), whereas the rebound in restaurant spending is more modest (down -14.2% y/y after a trough of -46% y/y in April). It is neither surprising nor concerning to see monthly growth rates slow, particularly with goods spending already well above pre-COVID-19 levels, but stronger-than-expected spending growth in June and July, together with almost USD1 trillion in excess saving, suggests that the rebound in consumption will continue in the September quarter.



- **US personal income rose +0.4% m/m in July which beat the street (-0.2% m/m) as employee compensation rose +1.4% m/m amid rehiring and more than offset the -7.0% m/m decline in unemployment benefits** (USD-105 billion annualised) This meant that the US savings rate declined to 17.8% which means that 63% of the excess savings have been used to fund spending in the past three months (see chart).
- Looking forward, we still contend that household savings rates will remain well in excess of their February level (8.3%) as households remain concerned about the displaced labour market. USD600 per week of enhanced unemployment benefits expired at end-July, and only a handful of states have paid the USD300 per week provided by executive action, which means that incomes will dip by about a sizable USD75 billion in August (USD900 billion annualised). However, this is less than 10% of the excess savings that households built up over the last five months (see chart), implying that the US consumer spending rebound can continue in the September quarter despite the rapid drop in income. However, the lack of progress on a fiscal package presents downside risk to spending in Q4 and beyond.



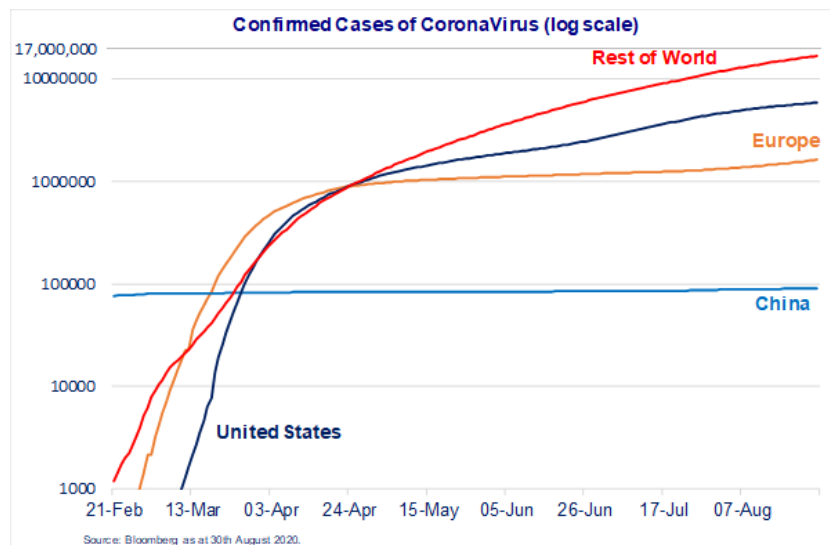
POLICY

- There were no material policy announcements on Friday.

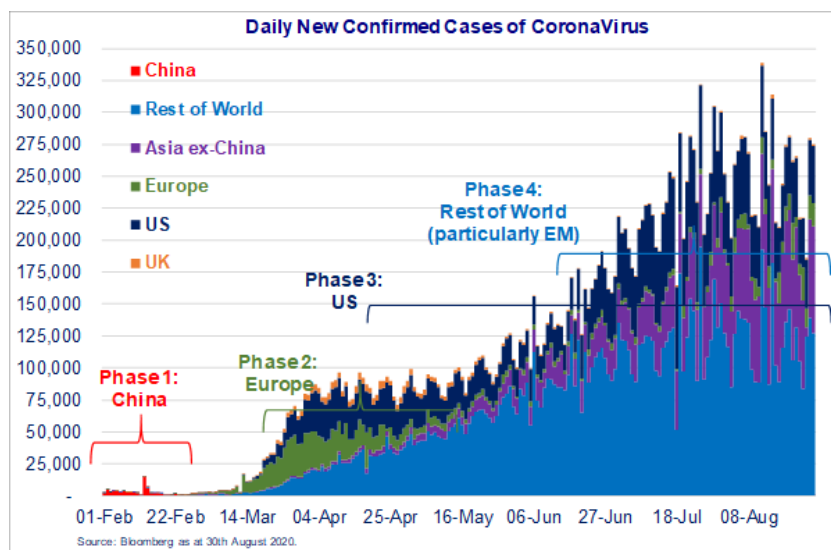
VIRUS UPDATE

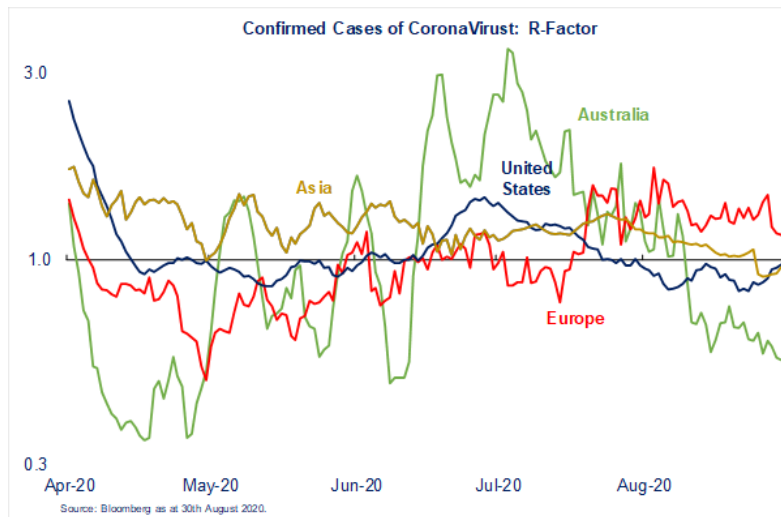
- The number of global cases of COVID-19 is 25.11 million with another +182.1k cases so far (but Brazil, Colombia, Mexico, Spain and Sweden and 8 US states have not reported their numbers) which means that Sunday is set to be the 42nd day in the past 43 where daily increases are greater than 200k. At present, 8 countries have more than 500k cases, 21 countries have more than 200k cases and 29 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, 3 days, 4 days, 4 days, 4 days, 4 days, 4 days, 4 days and 4 days. More importantly, the growth rate of daily confirmed cases (+1.1% since Thursday) is once again coming down. Meanwhile, deaths stand at 844.2k and the death rate has declined to 3.36% although the number of daily deaths remains elevated.



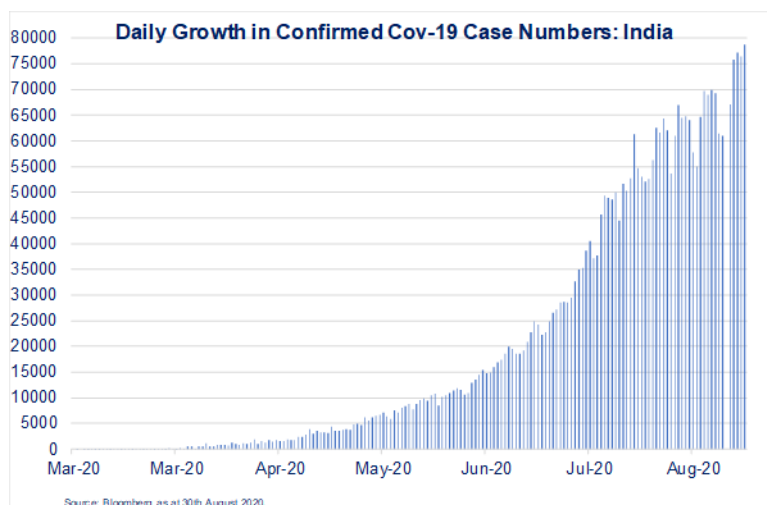
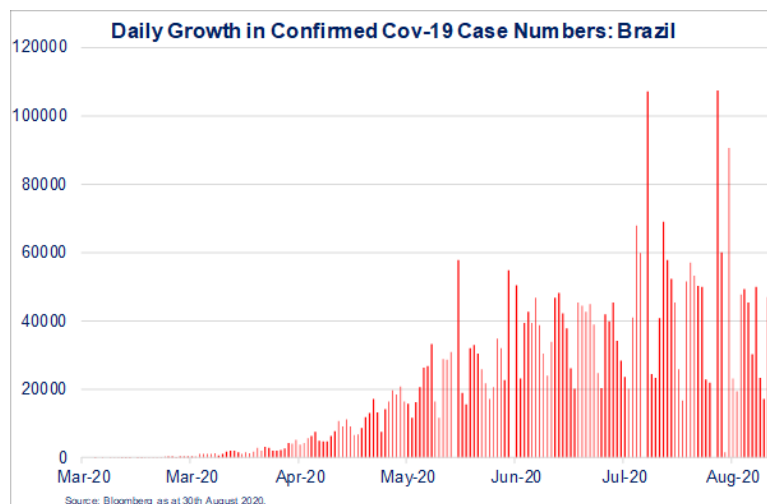
- We break the infections into four groups – the US, Europe, China and ‘others’ and the rest of the world outside the G3 economies now has the most total cases (+136.0k to 21.74 million) and highest daily new cases (and by a considerable margin) followed by the US (+31.7k to 5.99 million, although 8 states are yet to report). 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 (+14.4k to 1.68 million - see chart) which is the only region with an R-factor above 1.0 which indicates that the infection rate (1.16) is too high.

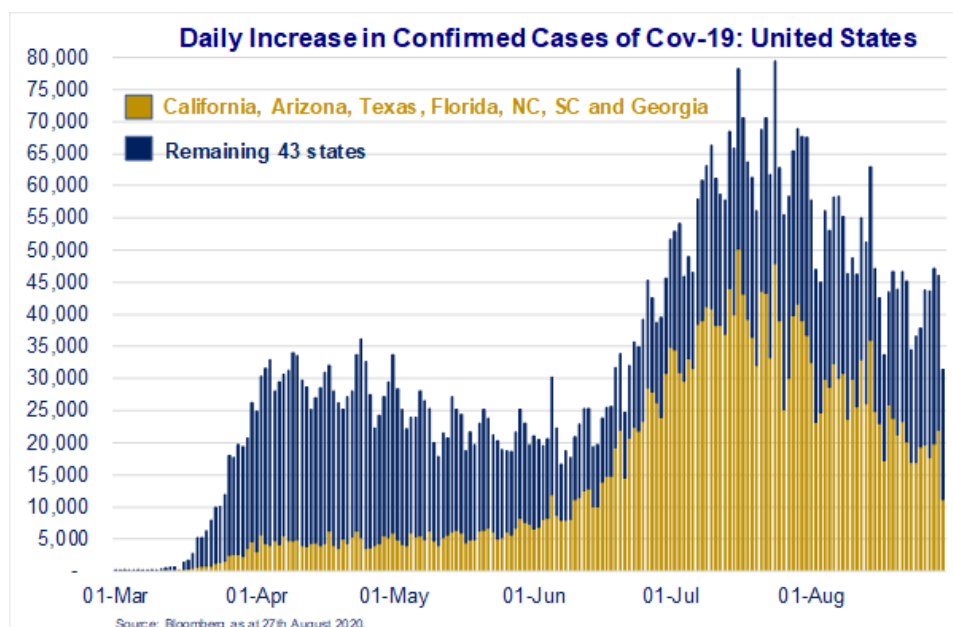




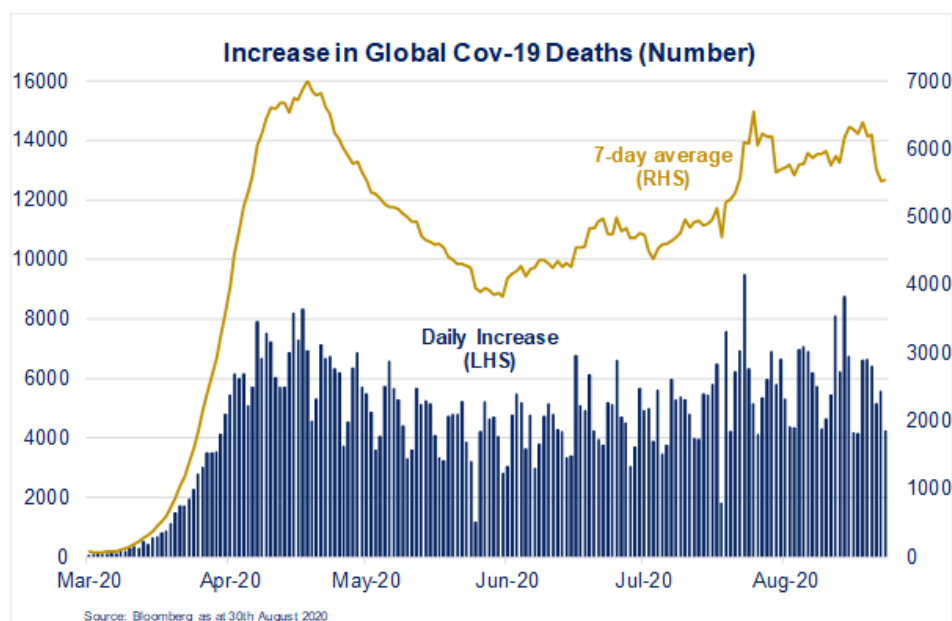
- Among countries, the most cases are in the US (+31.7k (so far) to 5.99 million, with 8 states yet to report), Brazil (not reported, 3.85 million), India (+78.8k (record high) to 3.54 million), Russia (+4.9k to 987.5k), South Africa (+2.5k to 625.1k), Peru (+9.5k to 639.4k), Colombia (not reported, to 599.9k), Mexico (not reported, +591.7k), Spain (not reported, 439.3k), Chile (+2.0k, 410.0k), Iran (+1.8k to 373.6k), United Kingdom (+1.7k to 336.6k), Saudi Arabia (+0.9k to 314.8k), Pakistan (+0.3k to +295.6k) and Bangladesh (+2.5k to 310.8k). Australia confirmed cases rose +123 to 25.67k yesterday which placed us 66th in terms of total infections.

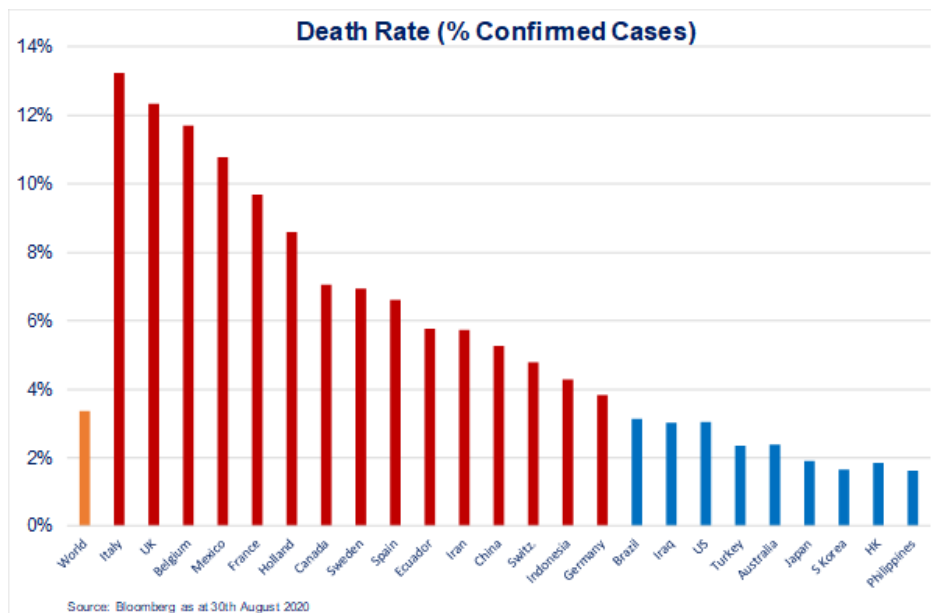
Elsewhere, Singapore recorded +54 new cases to 56.8k most of which are linked to foreign workers who are forced to live in crowded dormitories, but Indonesia (+2.9k to 172.1k) is now on the rise and has the second most cases in the region behind only the Philippines (+4.3k to 217.4k).





- Although final numbers are not in until 1pm AEST, the global death rate declined to 3.36% with the global total to 844.2k after another +2.6k deaths overnight, so far, which indicates the daily average deaths is stabilising again (see chart). The US (+0.3k so far) has the most deaths at +183.0k, with Brazil (+0.2k to 120.5k), Mexico (not reported, +63.8k), India (+0.9k to 63.5k), the UK (+1 to 41.6k), Italy (+4 to 35.5k) and France (+10 to 30.6k) all over +30k. The death rate is highest in European countries where the health systems had collapsed led by Italy (-0.1% to 13.2%), the UK (steady at 12.4%), Belgium (-0.1% to 11.7%), France (-0.2% to 9.7%), the Netherlands (-0.1% to 8.6%), Sweden (steady at 6.9%) and Spain (-0.1% to 6.6%). However, several emerging markets are now on the leader board including Mexico (-0.1% to 10.8%), Ecuador (-0.1% to 5.8%), Indonesia (steady at 4.3%) and Brazil (steady at 3.1%).





Yours sincerely,



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