THOUGHTS ON THE MARKET

3rd September 2020 - More record sharemarket highs driven by defensive sectors

SUMMARY

- It was a very strong night on risk markets with solid gains in regional credit and share markets. The US market recorded is largest one-day rise in almost two months with the S&P 500 and NASDAQ 100 recording yet another record rise, but in contrast to recent days the US dollar rallied and tech shares underperformed with some of the traditional defensive sectors outperforming despite another decline in US treasury yields. While the leader of the peloton may have changed for one day, the underlying thematic of the market has not, with risk continuing to be supported by a flood of liquidity from central banks who remain highly accommodative with the resultant negative real interest rates almost forcing some investors into assets they would not hold without the monetary backstop.

  In other markets, US treasuries rallied for a fourth consecutive session with yields now down to 0.55% with curve flattening, commodities both declined with oil (-2.8% to USD41.58 per barrel) underperforming gold (-2.4% to USD1,943 per troy ounce, and G10 currencies all depreciated against a strong Greenback with losses led by the Euro (-1.1%), Sterling (-0.8%), AUD (-0.7% to USC73.36) and the Yen (-0.3%).

- It was quiet overnight on the macro and policy fronts with nothing of note out of Asia, Europe or the US, but in Australia our first recession in 29 years at -7.0% q/q in June, was confirmed to be twice as bad as that which followed the second oil shock in the early 1980s and four times as bad as the recession in the early 1990s, but it wasn't nearly as bad as those in other countries such as the UK (-21.7% q/q), Europe (-15.0% q/q) and the US (-9.1% q/q). Looking ahead, the Victorian lockdowns will mean a very weak growth bounce in the September quarter, but the total fiscal payments of around AUD40 billion during this period and accumulated household savings of AUD45 billion (from unused Q2 stimulus) could provide significant support, but given the mass uncertainty about the labour market recovery, households are unlikely to use the bulk of their surplus stimulus funds, as much as it could be tempting to assume they will.

  Overnight it was revealed that the US Centre for Disease Control and Protection has told public health officials to be prepared to distribute a coronavirus vaccine to certain groups by early November, which is eerily around the date of the US election and before Phase 3 trials are completed, let alone reviewed and refined. Nothing to see there.

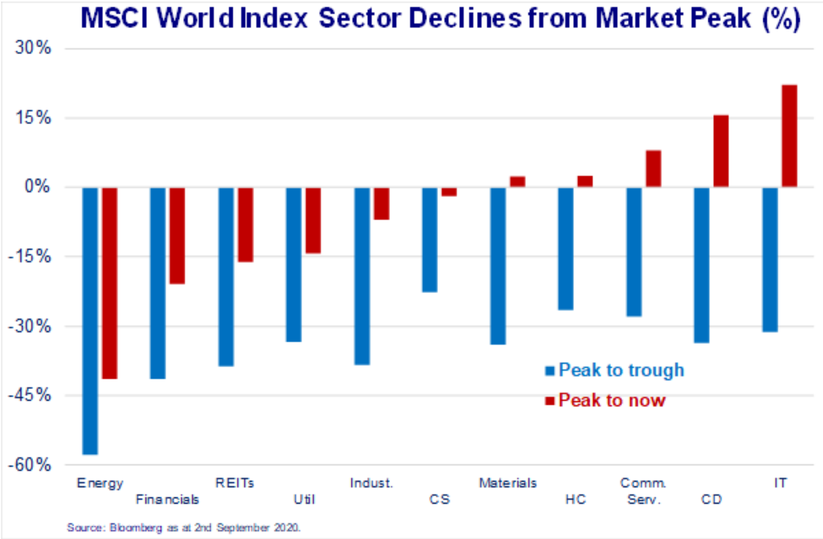
- The number of global cases of COVID-19 is 25.87 million with another +202.9k cases so far (but Brazil, Mexico and 5 US states have not reported their numbers) which means that Wednesday is set to be the 46th consecutive day where daily increases are greater than 200k. At present, 8 countries have more 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, 4 days, 4 days and 4 days. More importantly, the growth rate of daily confirmed cases (+0.8% since Sunday) is once again coming down. Meanwhile, deaths stand at 859.5k and the death rate has declined to 3.32% although the number of daily deaths remains elevated despite coming well off its peak.

FINANCIAL MARKETS

- **EQUITIES**
  - **The MSCI World Index recorded its strongest advance in three weeks (+1.1%)** underpinned by advances in traditional defensive sectors. Ten of the 11 sectors rallied with utilities (+2.5%) leading the capital gains after being the second worst performer in 2020, but it was hard to pinpoint the catalyst for

such a strong rally, considering this better growth dynamics which were cited as the over-arching thematic for the session, were unlikely to help much as this sector has the lowest correlation with activity. Meanwhile, communication services (+2.0%) was also upbeat boosted by internet and media stocks, with healthcare (+1.9%) also strongly supported amid gains in pharmaceuticals and distributors. Meanwhile cyclical stocks generally beat the market tape with materials (+1.6%) recording its largest daily advance in 11 weeks despite mixed commodity prices, industrials (+1.5%) also outperformed supported by airlines, but financials lagged (again) despite gains in banks and some insurers. Elsewhere oil (-0.2%) was the only sector to decline with the sector now having lost -9% in the past three weeks despite the oil price been relatively stable over that time.

By the close of trading, there was little change in our peak-to-now chart but energy is now -41.5% below its February peak with the recovery rate slipping to just 28%. Financials (-20.9%, 49.4%) are also lagging whereas five sectors have recorded a complete recovery (see chart).

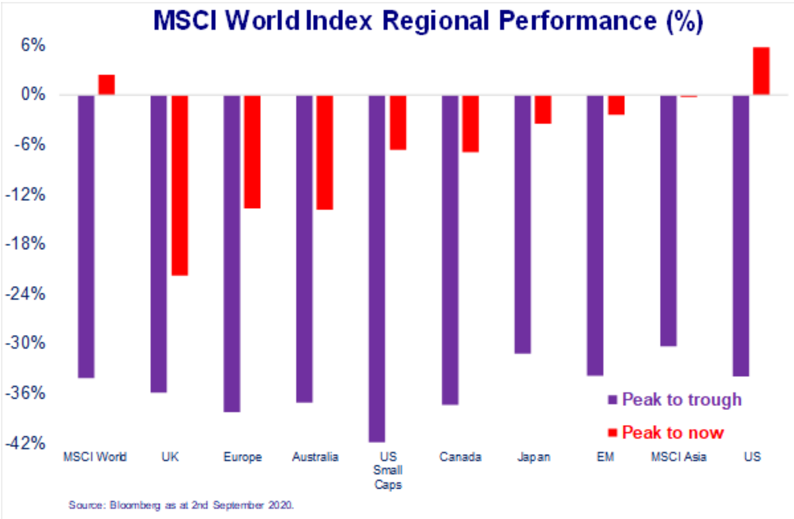


- **Among the regions**, the pace of gains was led by Europe (+1.8%) despite it being a quiet session in terms of newsflow. Recent comments by ECB chief economist Lane who said the euro-dollar rate matters linger in the ear of investors as the US Dollar's overnight rally sparked some reversal of the region's recent underperformance. On the macro front, German retail sales declined -0.9% m/m in July against the street at +0.5% m/m but this was dismissed by the market as likely to be recouped either by revisions or the August result. Meanwhile, the UK PM said his worker furlough scheme will end in October, and speculation is mounting that he will raise taxes at the next budget to improve the trajectory of his deficit. By the closing bell, there were large gains all round led by Germany (+2.1%), Switzerland (+1.9%), France (+1.9%), the UK (+1.4%), Italy (+1.3%), Sweden (+0.8%) and Spain (+0.6%).

The positive lead from Europe flowed through to US equities (+1.5%) which recorded their strongest daily advance in 8 weeks to yet another all-time high. The macro calendar was light overnight, so investors continued to ride the Fed liquidity train but it was the defensives which led the overnight advances with negative real rates and high tech sector valuations, potentially forcing traders into finding sectors that have any potential for a price gains over the near-term. Overnight it was revealed that the US CDC has told public health officials to be prepared to distribute a coronavirus vaccine to certain groups by early November, which is eerily around the date of the US election. Macro data was limited to the August ADP private payrolls which came in at only half street estimates (+428k vs +975k) but this has been a poor lead indicator for non-farm payrolls (out tomorrow) in 2020. Meanwhile, Fedspeak continued to echo Powell's recent framework shift that will allow the labour market and economy to run hotter. By the closing bell, at the NYSE, all major gauges recorded strong advances led by the Dow Jones (+1.6%, +455 points to 29,101), S&P 500 (+1.5%), NASDAQ 100 (+1.0%) and Russell 2000 (+0.9%).

Asian equities also finished higher (+0.3%) but there was no major catalyst despite an abundance of news flow. Media attention remained on Japan politics where the government confirmed a leadership ballot for 14-September in what looks to be a three-horse race (Suga, Kishida, Ishiba). Meanwhile, Australia's record GDP contraction was worse than expected, though headline did not go much beyond the confirmation of our first technical recession in 29 years. Elsewhere, RBNZ Governor Orr said central bank was thinking about how and when to use future monetary policy tools including negative interest rates in a potential sign of what may be ahead. By the closing bell, regional advances were led by Australia (+1.8% on iron ore strength), followed by South Korea (+0.6%), India (+0.5%) and Japan (+0.5%), with Mainland China (+0.04%) and Taiwan (-0.03%) both flattish, whereas Hong Kong (-0.3%) was the only major bourse to close lower.

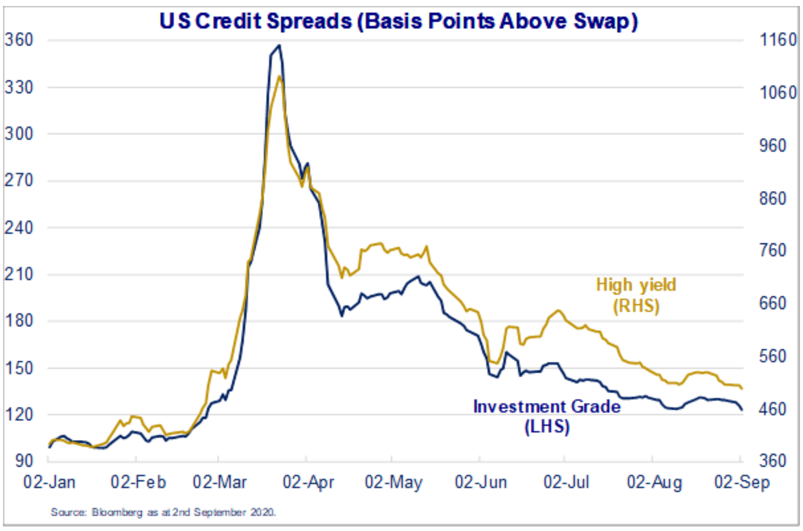
By the close of trading, there was little change in our peak-to-now chart with the UK still in bear market territory, the US having recorded a complete recovery which is pulling the MSCI World Index higher, but Asia and broader EM are also nearing that landmark (see chart).



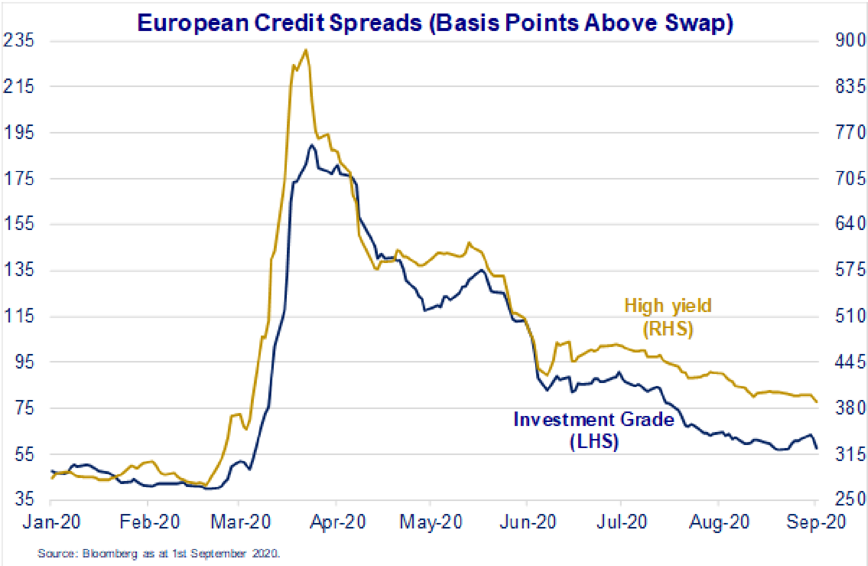
- **Futures markets suggest a strong opening in Asia** with Australia (+0.8%) and Japan (+0.9%) priced for large advances, but Hong Kong (-0.2%) appears slated for a modest decline.

CREDIT MARKETS

- **Regional credit indices were had their first strong day in about 4 weeks with spreads universally lower across regions.** Risk premiums in the US investment grade space declined -2.5 points (4-week high) to +123 bpts, which increased the recovery rate one notch to 92%. All 11 sub-sectors rallied in unison with the largest being subordinated financials (-3 points, +152 bpts, 91%) and communication services (-3 points, +148 pts, 92%) but everything else was around the market tape. In the high yield universe, spreads contracted -5 points (best in 6 sessions) to +500 bpts, which increased the recovery rate one notch to 87% (which is a COVID-19 high). This sector has had an 8-day win streak but for a sixth straight session no sub-sector recorded a double-digit decline. Nonetheless, the largest capital gains overnight were in consumer discretionary (-8 points, +486 bpts, 77%), healthcare (-6 points, +473 bpts, 81%) and industrials (-6 points, +627 bpts, 59%).



- **European credit markets were a bit stronger than the US peers** overnight with spreads in the investment grade universe declining -4 points (largest in 11 weeks) to +58 bpts, which increased the recovery rate three notches to 88%. There were declines in all 11 sub-sectors, with the most notable being subordinated financials (-9 points, +143 bpts, 84%) as investors embraced more risk and sought lagging sectors, but defensive sectors including healthcare (-4 points, +27 bpts, 94%) also experienced capital gains. In the high yield universe, spreads came in -6 points (largest in four weeks), to +388 bpts, which increased the recovery rate one notch to 81%. There were some large moves led by senior financials (-48 points, +311 bpts, 85%) which finally recoup its large losses from last week, whereas consumer staples (+25 points, +514 bpts, 91%) went the other way, perhaps reflecting some portfolio switching from defensives into cyclicals.

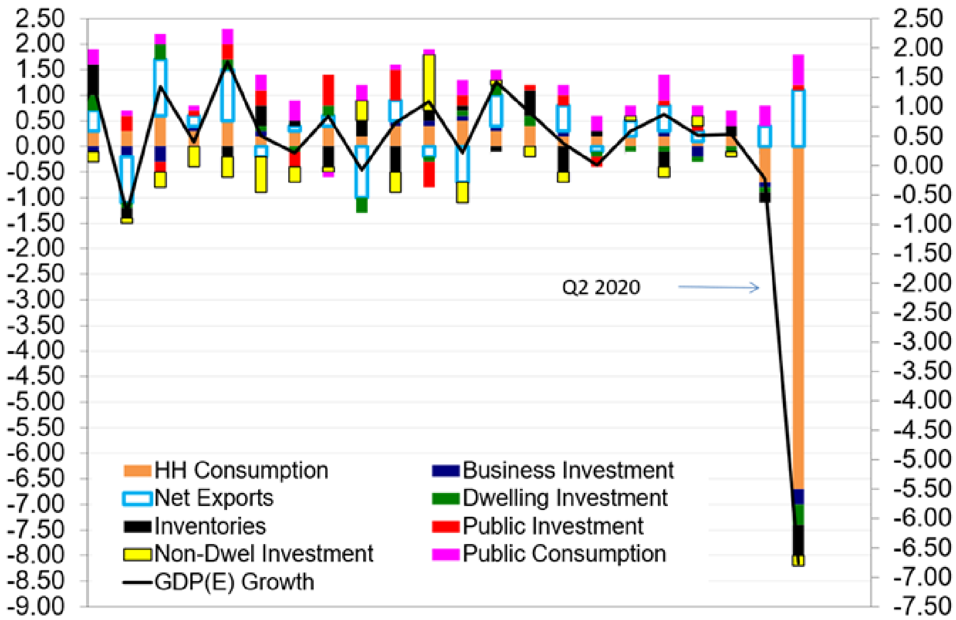


THE GLOBAL ECONOMY

- **The Australian economy contracted by -7% during the June quarter,** confirming our first recession in 29 years and the nation's worst quarter growth result since the end of World War II. By way of comparison, during the last recession at the start of the 1990s the economy recorded a total peak to trough contraction of -1.6% and in prior recession at the start of the 1980s, the total decline was -3.9% with six contractions 7 quarters. Accordingly, the 2020 recession so far has been nearly twice as bad as that, but it wasn't as bad as those in other countries such as the UK (-21.7% q/q), Europe (-15.0% q/q) and the US (-9.1% q/q).

  The June quarter decline was driven by the private sector where spending fell -7.9% q/q underpinned by a -12.1% q/q fall in consumption despite a +2.2% q/q rise in income (from AUD48 billion of fiscal supports) which pushed the savings rate up to a 46-year high of 19.8%. The decline in services (-17.6% q/q in areas such as transport, hotels and restaurants) made a much larger contribution to the decline than usual but this was known and has been evident in other countries. Meanwhile, private investment also contracted for both dwellings (-6.8% q/q) and businesses (-3.5% q/q) but the latter was much better than I thought, and inventories produced a much smaller drag (-0.6% off GDP growth).

  The private sector decline was offset by growth in other areas. As was highlighted in yesterday's current account report, net trade cushioned the impact and added +1 percentage points to GDP growth but this was the result of imports being more impacted than exports, with the former driven down by the large decline in consumption, whereas the latter was supported by higher iron ore volumes to China. Elsewhere, government spending (+2.6% q/q) added +0.6 percentage points to GDP underpinned by health-related spending by state and local governments, and given Government payments were skewed towards business corporate profits surged +14.9% q/q despite a -7.1% decline in production.



Looking ahead, it is clear that the Victorian lockdowns will mean a very weak growth bounce in the September quarter, but the total fiscal payments of around AUD40 billion and accumulated household savings of AUD45 billion of stimulus could provide some serious ballast in Q3, but given the mass uncertainty about the labour market recovery, households are unlikely to use a lot of their surplus funds, as much as it could be tempting to assume they will.

- **Fed's latest** Beige Book report noted that US economic activity had increased in most districts, but the improvements were generally modest and came in well below pre-COVID-19 levels. Manufacturing activity lifted in most districts and consumer spending continued its pick-up on strong vehicle sales and improvements in retail. The overall conclusion from the report was that the outlook was modestly optimistic and that there had been higher employment, but these were not universal. Overall, bank loan demand also increased at the margin, led was limited to the residential sector.

POLICY

- There were no major policy announcements overnight. However, the US CDC has notified public health officials that they should be prepared to distribute a COVID-19 vaccine to healthcare workers and other high-risk groups as soon as early November, which just happens to be when the US election occurs. However, this would be before Phase three trials are completed but three vaccine candidates are currently in Phase 3 trials and another is expected

VIRUS UPDATE

- The number of global cases of COVID-19 is 25.87 million with another +202.9k cases so far (but Brazil, Mexico and 5 US states have not reported their numbers) which means that Wednesday is set to be the 46th consecutive day 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.

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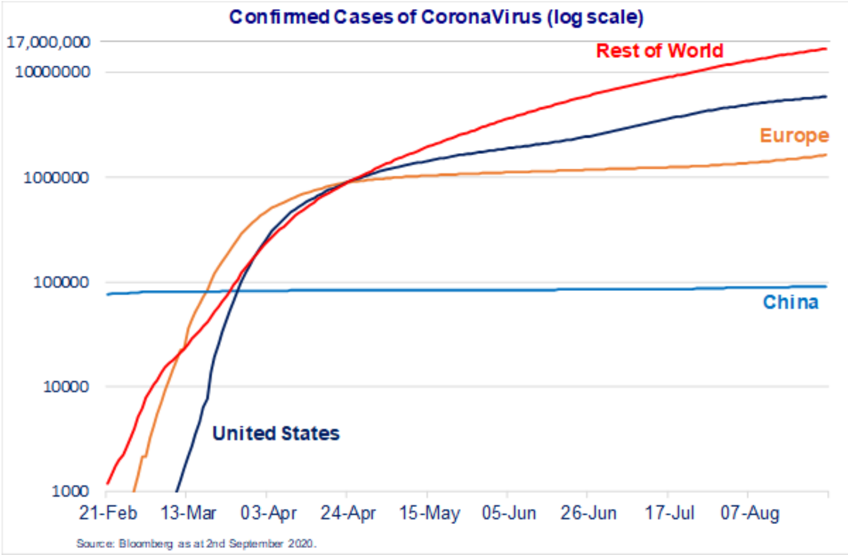
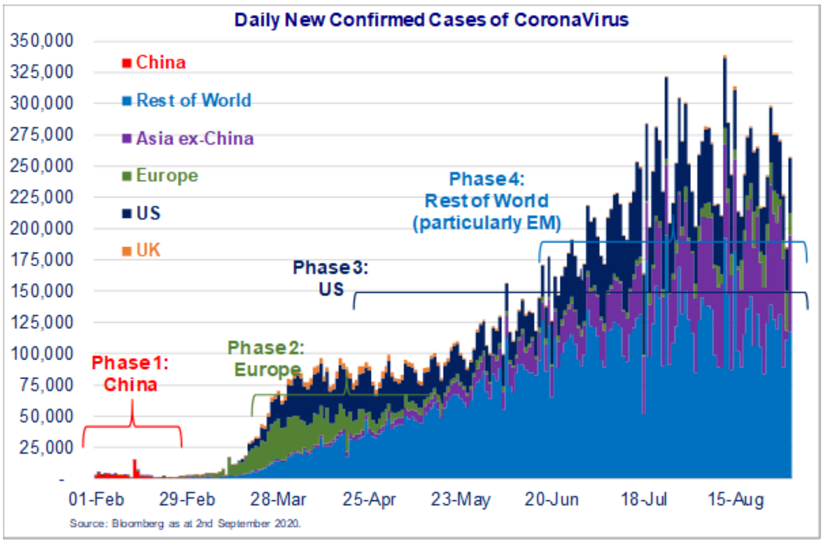
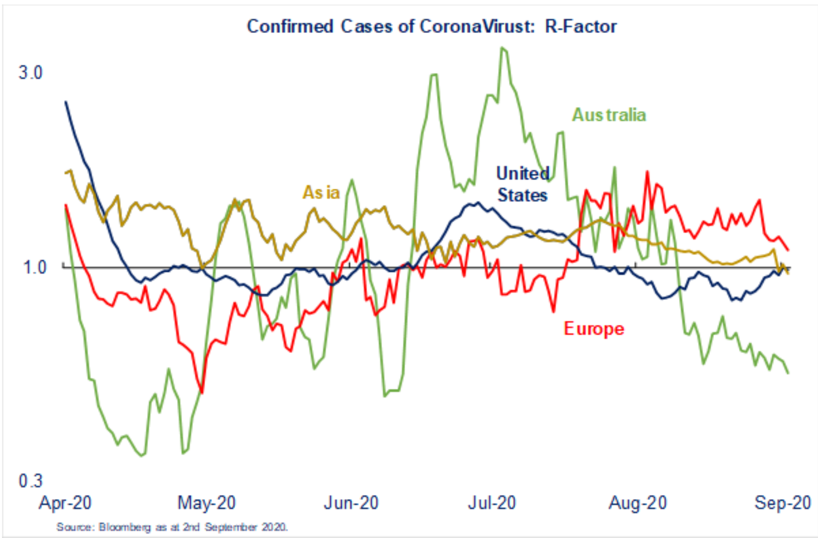


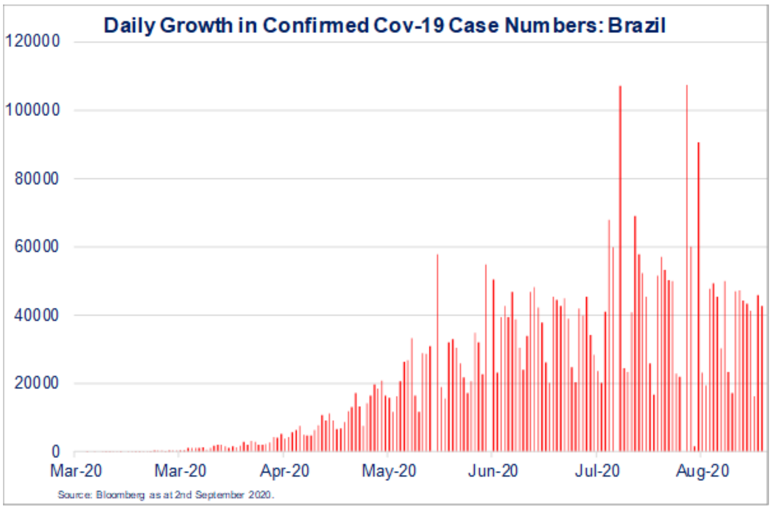
- We break the infections into four groups – the US, Europe, China and 'others' and the rest of the world outside the G3 economies now has the most total cases (+145.4k to 22.6 million) and highest daily new cases (and by a considerable margin) followed by the US (+36.7k to 6.11 million, although 5 states 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 (+20.7k to 1.75 million - see chart) which is the only region with an R-factor above 1.0 which indicates that the infection rate (1.10) is too high.

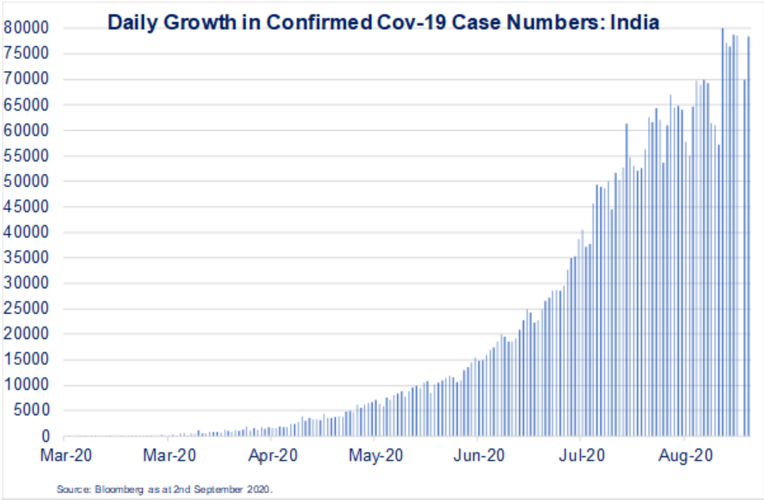


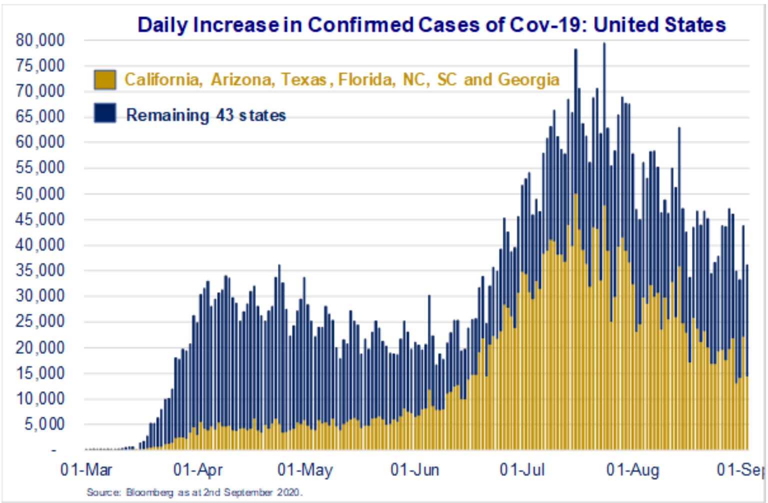


- Among countries, the most cases are in the US (+36.7k (so far) to 6.11 million, with 5 states yet to report), Brazil (not reported, 4.00 million), India (+78.4k to 3.77 million), Russia (+4.9k to 1.00 million), Peru (+5.1k to 657.1k), South Africa (+2.3k to 630.6k), Colombia (+8.9k to 624.1k), Mexico (not reported, +606.0k), Spain (+8.6k, 479.6k), Chile (+1.6k, 414.7k), Iran (+1.9k to 378.8k), United Kingdom (+1.5k to 340.9k), Saudi Arabia (+0.8k to 317.5k), Bangladesh (+2.6k to 317.5k) and Pakistan (+0.4k to +296.6k). Australia confirmed cases rose +104 to 25.9k yesterday which placed us 66th in terms of total infections.

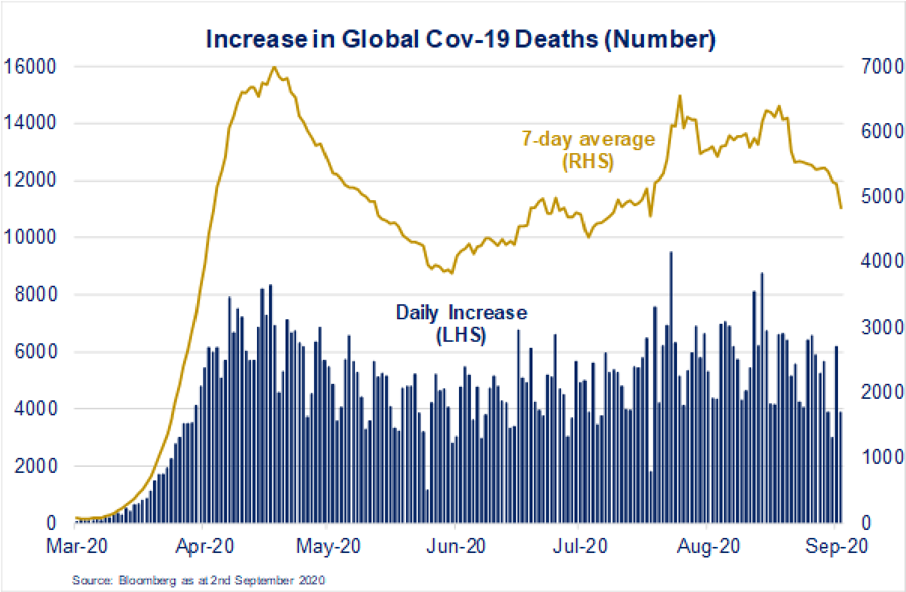
  Elsewhere, Singapore recorded +50 new cases to 56.9k most of which are linked to foreign workers who are forced to live in crowded dormitories, but Indonesia (+3.1k (second highest on record) to 180.6k) is now on the rise and has the second most cases in the region behind only the Philippines (+2.2k to 226.4k).

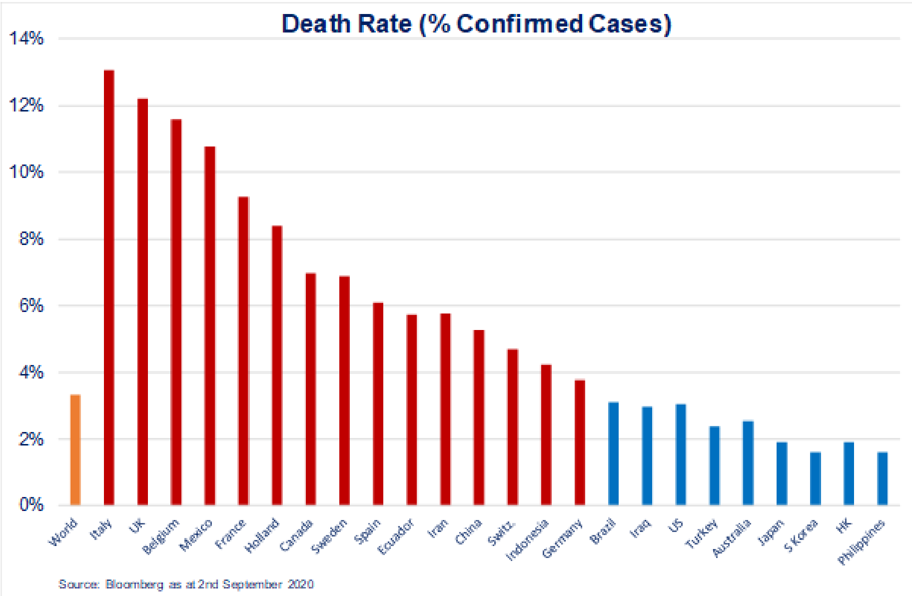






- Although final numbers are not in until 1pm AEST, the global death rate declined to 3.32% with the global total to 859.5k after another +3.9k deaths overnight, so far, which indicates the daily average deaths is stabilising again (see chart). The US (+1.0k so far) has the most deaths at +185.7k, with Brazil (not reported, 123.8k), India (+1.0k to 66.3k), Mexico (not reported, +65.2k), the UK (+10 to 41.6k), Italy (+6 to 35.5k) and France (+25 to 30.7k) all over +30k. The death rate is highest in European countries where the health systems had collapsed led by Italy (-0.1% to 13.1%), the UK (steady at 12.2%), Belgium (-0.1% to 11.6%), France (-0.2% to 9.3%), the Netherlands (-0.1% to 8.4%), Sweden (steady at 6.9%) and Spain (-0.1% to 6.1%). However, several emerging markets are now on the leader board including Mexico (+0.1% to 10.8%), Ecuador (-0.1% to 5.7%), Indonesia (steady at 4.2%) and Brazil (steady at 3.1%).





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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

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