

THOUGHTS ON THE MARKET

5th May 2020



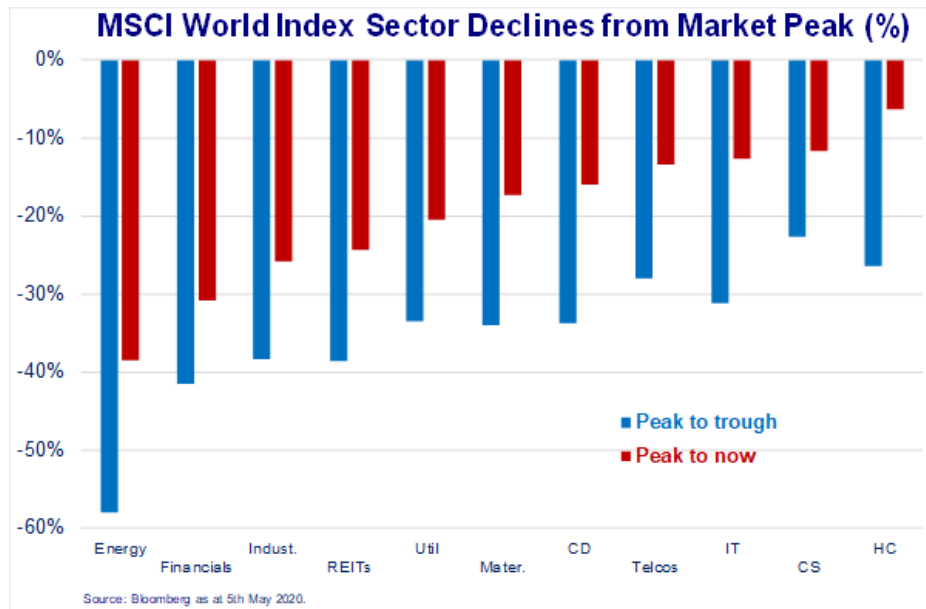
SUMMARY

- Global risk markets were lower overnight with stocks and credit indices down for a third straight session, which is a streak not seen for almost two months. In other markets, defensive asset generally declined with gold off -0.2% to USD1702 per ounce, US 10-year bonds rose a couple of basis points to 0.63% with curve steepening, and the US dollar declined against the Yen (-0.2%) and Australian dollar (-0.3%), but rose against the Euro (+0.3%) and Sterling (+0.3%).
- One negative thematic which is gaining traction is deteriorating relations between the US and China, with the former overnight continuing to highlight evidence that the COVID-19 virus began in a Wuhan laboratory and was concealed by the Chinese government to stock up on medical supplies. Given its an election year and 51% of voters in key swing states blame the US economic downturn on China, it is hard to imagine the US Administration letting go of this mantra and this risks being a flash point for markets. The key risk here is that the US walks away from the Phase 1 trade agreement which it can do as China imports of US goods in February and March were not remotely close to what was promised.
- The economic calendar was light overnight and was limited to final numbers for several US releases which did not alter the narrative from the flash estimates, as well as a couple Australian data points which provided no guide on the April growth decline given timing issues. When the global economy gets back to any semblance of normalcy is highly uncertain, but the remainder of the week is quite important with final April PMIs and US service sector PMI released Wednesday, US initial jobless claims on Thursday and April US non-farm payrolls on Friday night.
- In COVID-19 news, the number of global cases stands at 3.61 million with another +71.8k cases overnight. That increase means 3 countries have more than 200k cases, 9 countries have more than 100k cases, 25 over 20k cases and 39 over 10k. It took 73 days to record 1 million cases, 13 days for the next million, 11 days for the last million, and in the past 7 days another 578k cases have been confirmed. That said, the growth rate of daily confirmed cases continues to decline (+2.3% since Friday) but deaths rose +3.6k overnight (36-day low) to 251.1k, with the death rate steady at 7.0% (although final numbers are not yet in).

FINANCIAL MARKETS

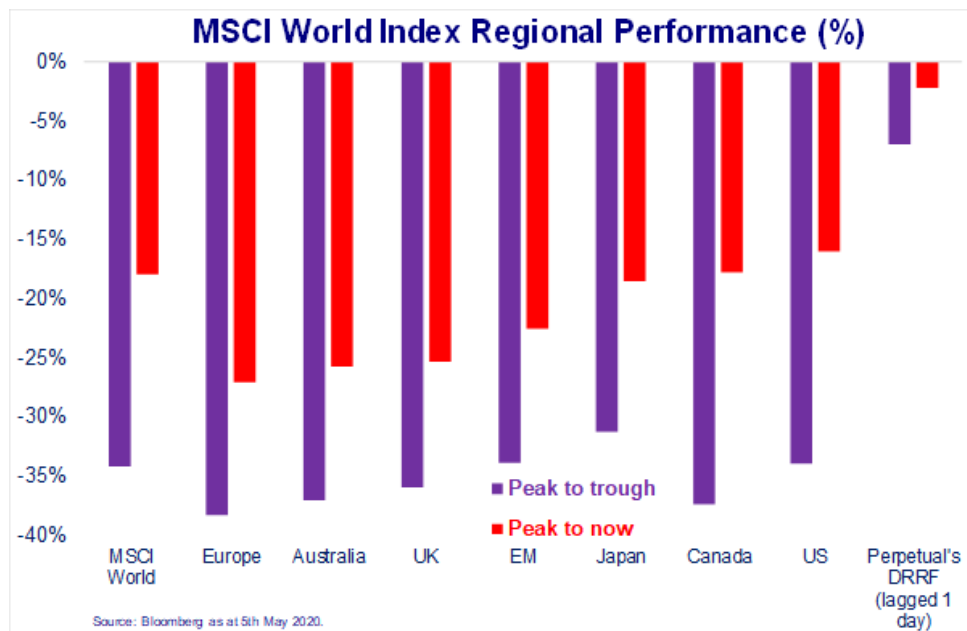
• EQUITIES

- The MSCI World Index closed -0.4% lower overnight but performance was mixed with 4 sectors closing higher. Although the worsening US-China dialogue was a constant undercurrent throughout the session with US Secretary of State Pompeo citing “enormous evidence that COVID-19 began in a Wuhan laboratory and was concealed by the Chinese government to stock up on medical supplies”, this was angrily denied by Beijing. Among sectors, declines were led by industrials (-1.6%, with the recovery rate now down to 32.7%) which fell for a third consecutive session, as did financials (-1.4%, 25.7%). In contrast, IT (+1.0%, 59%) advanced in response to renewed appetite for the FANGS, as did energy (+1.6%, 33.6%, see chart below) given rising crude prices which closed up +7.1% at USD21.40 per barrel.



Although the headline index fell for a third consecutive session which is something not seen since early March, regional disparity was broader than the prior two sessions. Europe (-3.8%) led the pace of declines as investors returned from labour day holidays and indices caught up with US events on Friday night. Among countries, Belgium (-4.7%), Sweden (-4.6%) and France (-4.2%) were disproportionately hit, but performances in other major markets such as Italy (-3.7%), Germany (-3.6%), and Spain (-3.6%) were quite bunched. The negative regional performance flowed through to the US which dropped early but increase demand for tech names and the rise in energy prices saw investors claw back the losses and the market closed higher by the bell, with the NASDAQ (+1.2%) outperforming the S&P 500 (+0.4%) and Dow Jones (+0.1%).

Earlier in Asian trade, performance was mixed with Hong Kong (-4.2%) and South Korea (-2.5%) dropping sharply, but Australia bounced +1.2% after Friday's outsized decline brought out bargain hunters. Yesterday's performances left Europe (-27.1% with the recovery rate at 29.1%, see chart) with the largest peak-to-now decline closely followed by Australia (-25.7%, 31%) and the UK (-25.3%, 29.5%).

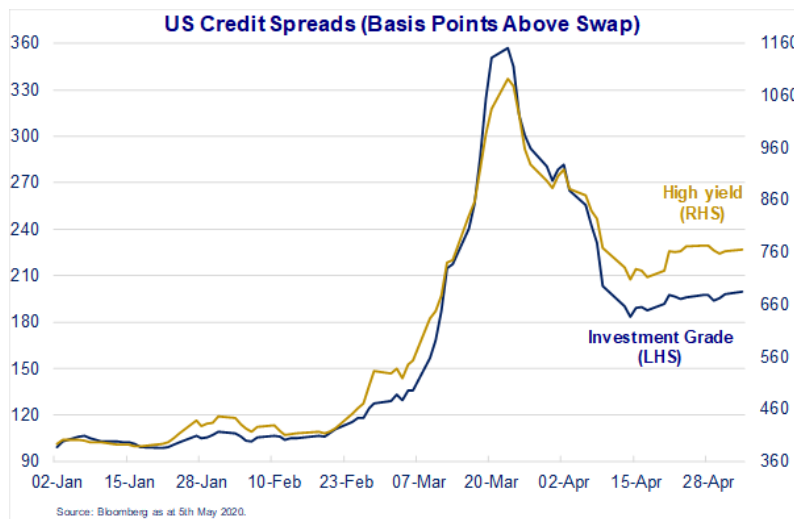


Futures markets have the Australian market opening up +0.3% at the bell, with Japan still closed for national holidays.

• CREDIT

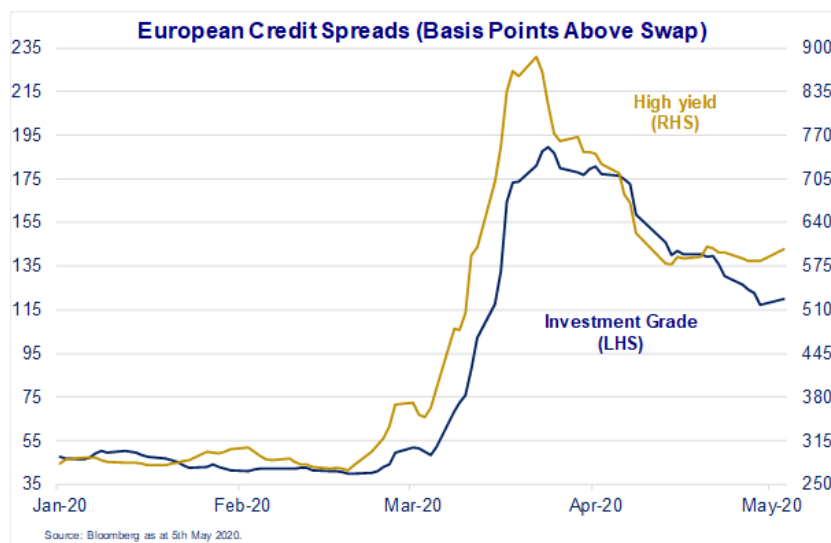
- US credit spreads widened for a third consecutive session but again the increase was modest, with investment grade spreads up +1.3 points to +199 bpts, which lowered the sector's recovery rate to 62% from the March peak. There were modest gains in all sectors other than energy (-1 point to +332 bpts, 58%) where spreads rose in early trading, but this reversed as crude prices gradually recovered and closed higher for a fourth consecutive session (+7.1%) at USD21.18 per barrel. Given the renewed concerns about the shape and nature of the recovery, cyclical sectors underperformed with consumer discretionary (+4 points to +250 bpts, 62%) and tech (+3 points, +155 bpts, 65%) leading the way.

It was a similar story in the high yield space where the universe rose +4 points to +766 bpts (see chart), but the recovery rate stayed at 48%. Among sub-sectors the more cyclical sectors such as industrials (+10 points to +847 bpts, 26%) and consumer discretionary (+7 points to +776, 38%) recorded higher risk premiums, but several defensive sectors also recorded saw higher spreads including healthcare (+6 points to +598 pts, 61%) and telcos (+3 points to +626 bpts, 58%).

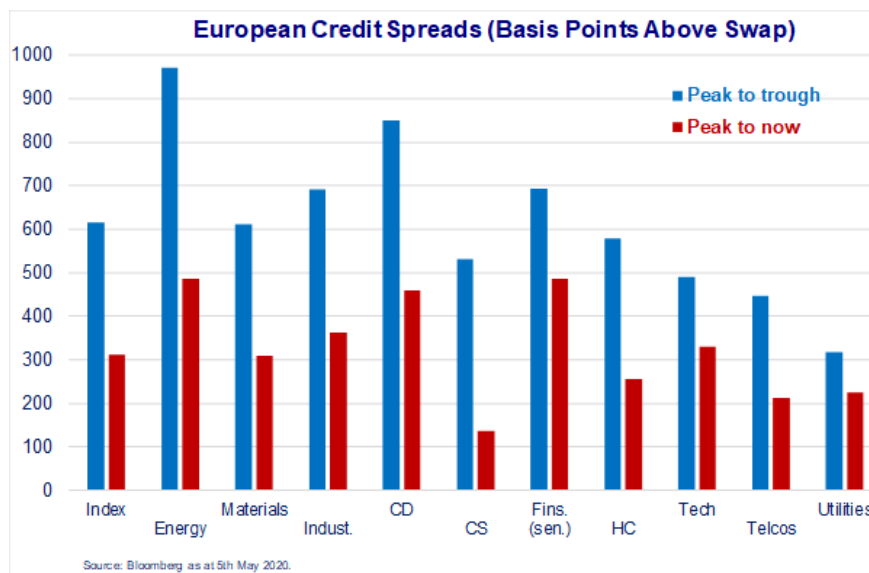


- European credit markets underperformed their US peers as investors caught up with events on Friday when regional markets were closed. European investment grade spreads rose +3 points to +120 bpts which lowered the recovery rate one notch to 47%. While all sub-sectors recorded wider spreads the main spikes were limited to subordinated financials (+7 points to +210 bpts, 54%) and consumer discretionary (+5 points to +180 bpts, 43%).

In the high yield universe risk premiums increased +17 points (largest widening and nearly three weeks) to +600 bpts, which lowered the recovery rate two notches to 47%. Among the sub-sectors, there were large increases in cyclicals including materials (+30 points to +537 bpts, 50%), financials (-28 points, to +745 bpts, 30%) and consumer discretionary (+20 points to +777 bpts, 46%), but all sectors were up.

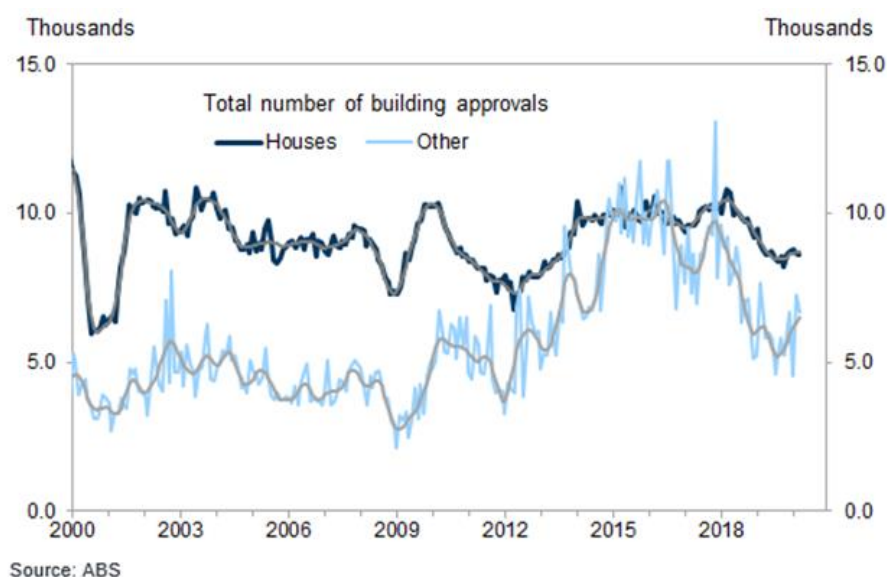


- It is interesting to examine the inter-sector spreads as these can reveal where potential stress points are, and while energy recorded the largest initial spread blow-out (see blue bars in the chart below) as oil prices plummeted below break-even lines, those spreads have recovery half their initial loss and are now priced reasonably similarly to senior financials (which has now recovered only 29.9% of its losses) and consumer discretionary (at 46%). This signals that investors are worried that banks, which are nothing more than a leveraged play on regional GDP (which is set to decelerate at an unprecedented rate in 2020 and take several years to recoup the lost production) and regional banks here are also characterised by massive excess capacity, questionable loan quality, increased default rates and weak margins. This to us is a large stress point waiting for a catalyst.



THE GLOBAL ECONOMY

- Australian residential building approvals declined -4.0% m/m in March to an annualised pace of +182k, with little indication of a negative reaction to COVID-19. That is not surprising as the ABS noted "*takes some time to approve an application for building construction work, there will be a lag between any change in the number of applications, and [building approvals].*" Nonetheless, among the components, detached dwellings declined -0.6% m/m which dragged the annual rate to -2.2% y/y, and the more volatile higher density dwelling (i.e. units) dropped (-8.0% m/m with the annual rate now at +3.4% y/y). We remain of view that increased household caution is likely to see a large -35% decline in approvals to around +115k in coming months as declines in employment, confidence, disposable income and population growth weigh on housing activity.



- The ANZ job ads also fell -53.1%mom in April (which pulled the annual rate down to -62.2% y/y) which is the largest decline since 1975. Based on the historic relationship, the attached chart from UBS suggests that the April decline would be enough to push employment growth down from +2% to -1.6% would be equivalent to employment slipping -406 m/m with unemployment mechanically rising to just over 8.2%.



However, there are several blind assumptions in this approach and in the current crisis, perhaps a better approach is to realise that an additional +900k people have registered for the Jobseeker allowance in the last 6 weeks, which by itself would be enough to have unemployment at 11%+ (see table below). However, some individuals receiving JobKeeper will not be measured as 'unemployed' in the labour force survey, even if they are currently doing zero hours, providing they are perceived as having jobs to go back to. However, when the JobKeeper allowance ends on 30th September 2020, unemployment would increase further if those jobs have not re-materialised.

Change in jobs	-500k	-600k	-700k	-800k	-900k	-1000k	-1100k	-1200k	-1300k	-1400k	-1500k	-1600k
550	9.1%	9.9%	10.6%	11.4%	12.1%	12.9%	13.7%	14.4%	15.2%	15.9%	16.7%	17.5%
500	9.1%	9.8%	10.6%	11.3%	12.1%	12.9%	13.6%	14.4%	15.1%	15.9%	16.6%	17.4%
450	9.0%	9.8%	10.5%	11.3%	12.1%	12.8%	13.6%	14.3%	15.1%	15.8%	16.6%	17.3%
400	9.0%	9.8%	10.5%	11.3%	12.0%	12.8%	13.5%	14.3%	15.0%	15.8%	16.5%	17.3%
350	9.0%	9.7%	10.5%	11.2%	12.0%	12.7%	13.5%	14.2%	15.0%	15.7%	16.5%	17.2%
300	8.9%	9.7%	10.4%	11.2%	11.9%	12.7%	13.4%	14.2%	14.9%	15.6%	16.4%	17.1%
250	8.9%	9.6%	10.4%	11.1%	11.9%	12.6%	13.4%	14.1%	14.8%	15.6%	16.3%	17.1%
200	8.9%	9.6%	10.4%	11.1%	11.8%	12.6%	13.3%	14.1%	14.8%	15.5%	16.3%	17.0%
150	8.8%	9.6%	10.3%	11.0%	11.8%	12.5%	13.3%	14.0%	14.7%	15.5%	16.2%	16.9%
100	8.8%	9.5%	10.3%	11.0%	11.7%	12.5%	13.2%	13.9%	14.7%	15.4%	16.2%	16.9%
50	8.8%	9.5%	10.2%	11.0%	11.7%	12.4%	13.2%	13.9%	14.6%	15.4%	16.1%	16.8%
0	8.7%	9.5%	10.2%	10.9%	11.7%	12.4%	13.1%	13.8%	14.6%	15.3%	16.0%	16.8%
-50	8.7%	9.4%	10.2%	10.9%	11.6%	12.3%	13.1%	13.8%	14.5%	15.2%	16.0%	16.7%
-100	8.7%	9.4%	10.1%	10.8%	11.6%	12.3%	13.0%	13.7%	14.5%	15.2%	15.9%	16.6%
-150	8.6%	9.4%	10.1%	10.8%	11.5%	12.3%	13.0%	13.7%	14.4%	15.1%	15.9%	16.6%
-200	8.6%	9.3%	10.1%	10.8%	11.5%	12.2%	12.9%	13.6%	14.4%	15.1%	15.8%	16.5%
-250	8.6%	9.3%	10.0%	10.7%	11.4%	12.2%	12.9%	13.6%	14.3%	15.0%	15.7%	16.5%
-300	8.6%	9.3%	10.0%	10.7%	11.4%	12.1%	12.8%	13.5%	14.3%	15.0%	15.7%	16.4%
-350	8.5%	9.2%	9.9%	10.7%	11.4%	12.1%	12.8%	13.5%	14.2%	14.9%	15.6%	16.3%
Labourforce												

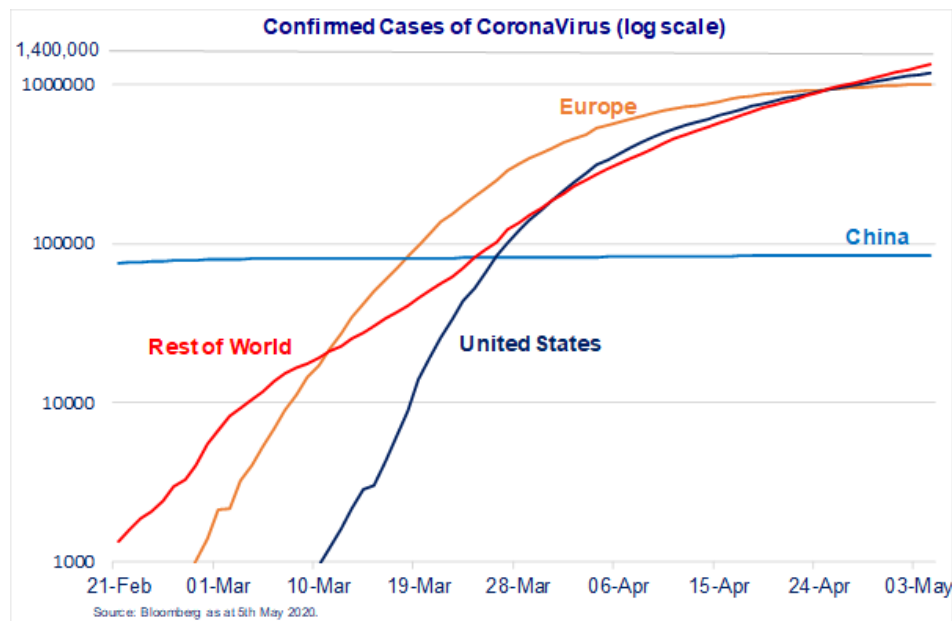
POLICY

- There were no major policy announcements on Monday.

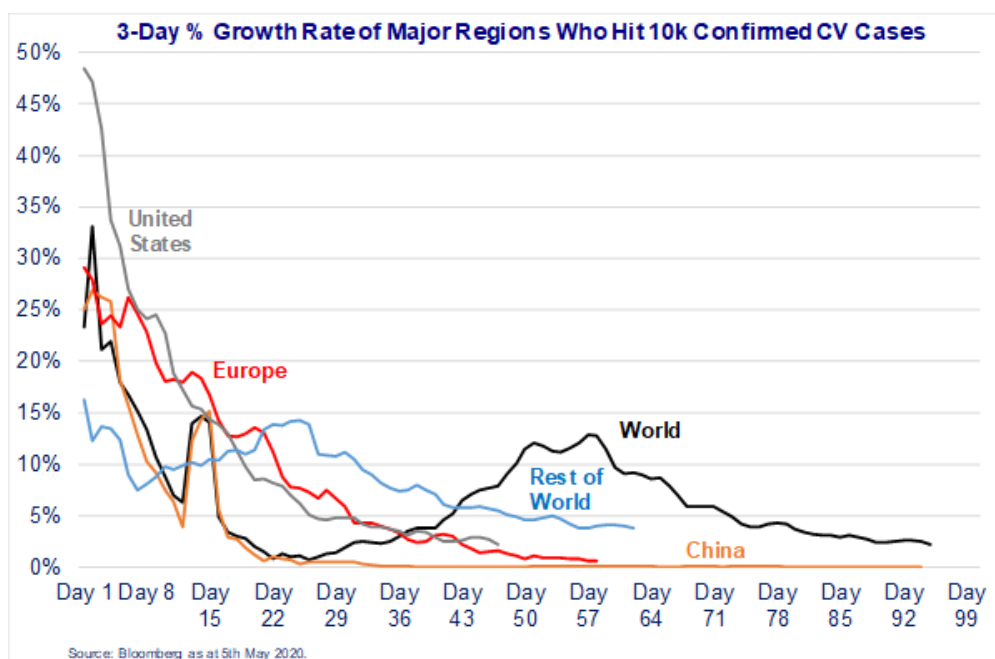
VIRUS UPDATE

- The number of global cases of COVID-19 stands at 3.61 million with another +71.8k cases overnight. That increase means 3 countries have more than 200k cases, 9 countries have more than 100k cases, 25 over 20k cases and 39 over 10k. It took 73 days to record 1 million cases, 13 days for the next million, 11 days for the last million, and in the past 7 days another 578k cases have been confirmed. That said, the growth rate of daily confirmed cases continues to decline (+2.3% since Friday). Meanwhile, deaths rose +3.6k overnight (36-day low) to 251.1k, with the US now over

60k and the UK, Spain, Italy and France all over 20k, and the death rate sits at 7.0% (although final numbers are not yet in).



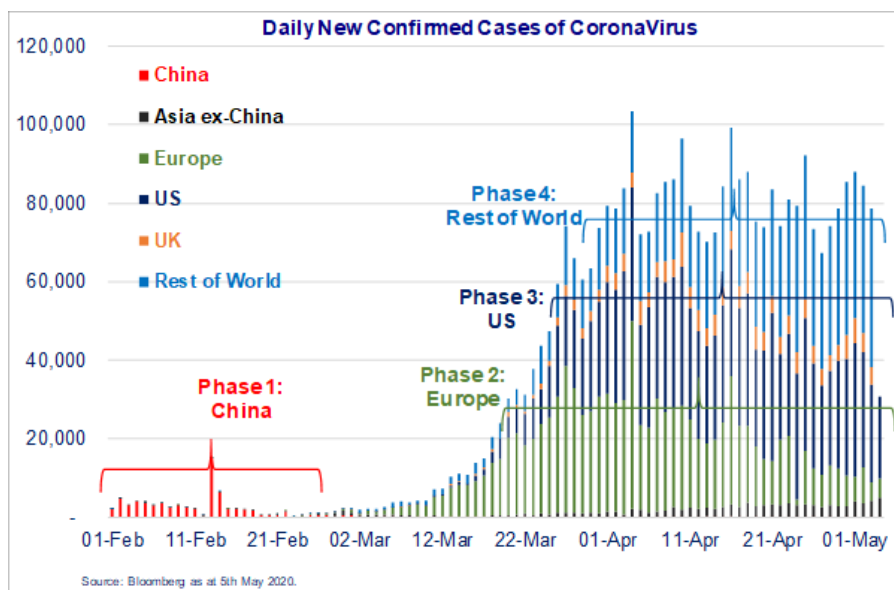
- We break the infections into four groups – the US, Europe, China and ‘others’ and the rest of the world outside the G3 economies (+46.0k to 1.33 million) now has the most total cases and highest daily new cases followed by the US (+20.8k to 1.178 million) and Europe (+4.9k to 1.01 million), with the latter two’s daily increases, both number and percentages, trending lower which shows that social isolation works to reduce the spread of the virus, even though it comes at an enormous economic cost. In the rest of the world, the two concerns here are Russia (+10.6k which is its fifth consecutive record high, to 145.3k) and Brazil (+6.0k to 107.8k).



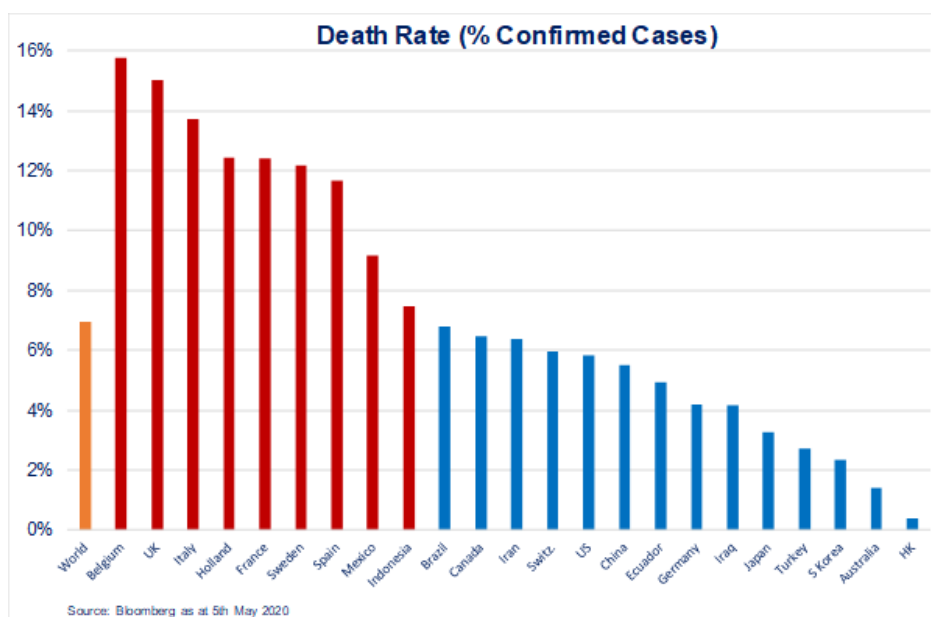
- Among countries, the most cases are in the US (+20.8k to 1.18 million), Spain (+545 to 218k), Italy (+1.2k to 211.9k), the United Kingdom (+4.0k to 181.8k), France (+102k to 169.6k), Germany (+473 to 166.1k), Russia (+10.6k (record daily increase) to 145.3k), Turkey (+1.6k to 127.7k), Brazil (+6.0k to 107.8k), Iran (+1.2k to 98.6k) and China (+1 to 84.0k). Australia confirmed cases rose to 6,825 yesterday which placed us 49th in terms of total infections.

Elsewhere, Singapore recorded +573 new cases to 18.8k 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 after

overtaking Indonesia (+395 to 11.6k) and the Philippines (+262 to 9.5k). Note final numbers for yesterday at not in yet so these numbers can rise.



- The global death rate declined to +7.0% (fifth consecutive decline) with another +3.6k fatalities overnight (36-day low) bringing the global total to 251.1k. The US has the most deaths at +68.7k, with Italy (+0.2 to 29.1k), the UK (+280 to 28.8k) and Spain (+160 to 25.4k) all over +25k. The death rate is highest in European countries where the health systems have collapsed led by Belgium (+0.1% to 15.8%), the UK (-0.2% to 15.0%), Italy (steady at 13.7%), the Netherlands (steady at 12.4%), France (-0.1% to 12.4%), Sweden (+0.2% to 12.2%), and Spain (+0.1% to 11.7%). However, several emerging markets are now on the leader board including Mexico (-0.1% to 9.2%), Indonesia (-0.1% to 7.5%) and Brazil (-0.1% to 6.8%).



Yours sincerely,



MATT SHERWOOD
Head of Investment
Strategy, Multi Asset



MICHAEL O'DEA
Head of Multi Asset

This document has been prepared by Perpetual Investment Management Limited (PIML) ABN 18 000 866 535, AFSL 234426. It is general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider, with a financial adviser, whether the information is suitable for your circumstances. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information. The PDS for the Perpetual Diversified Real Return Fund, issued by PIML, should be considered before deciding whether to acquire or hold units in the fund.

The PDS can be obtained by calling 1800 022 033 or visiting our website www.perpetual.com.au. No company in the Perpetual Group (Perpetual Group means Perpetual Limited ABN 86 000 431 827 and its subsidiaries) guarantees the performance of any fund or the return of an investor's capital. Past performance is not indicative of future performance.

MORE INFORMATION

Perpetual Investments 1800 062 725

Email investments@perpetual.com.au

www.perpetual.com.au/investments