Perpetual Investments

THOUGHTS ON THE MARKET

7th April 2020

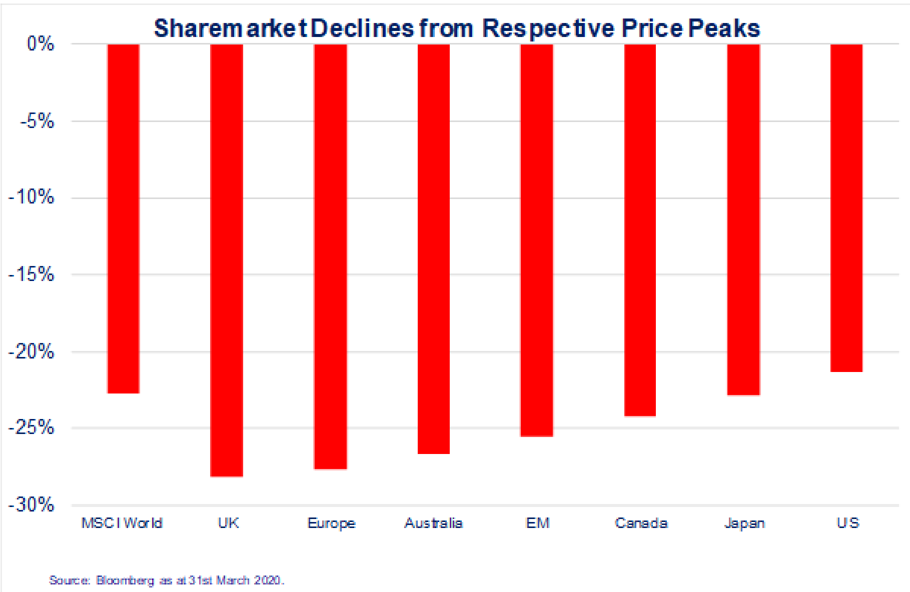
SUMMARY

- It was a quite night in terms of newsflow, macro data and policy announcements. Accordingly, global risk markets focused on COVID-19 case data where falling new daily cases in Europe overshadowed a rise in US deaths above 10k, with the former sending regional risk markets higher. The rally was led by US equities, but the recent improvements in regional bourses has been underpinned by defensive sectors in terms of loss recovery rates.
- Accordingly, it may be a fair conclusion that despite the solid bounce in regional bourses in recent weeks, investors are not factoring in an economic recovery, instead they are embracing a combination of cheap valuations and lower earnings risk and are finding this in sectors which have low sensitivity to the massive economic growth hole that is in front of us.

FINANCIAL MARKETS

- **EQUITIES**
    - Equities performed strongly overnight with the absence of macro data meaning that investors focused on COVID-19 case rates. Regional gains were recorded in all sectors led by the US (+7.0%) where advances were led by IT (+8.8%), utilities (+7.8%) and consumer discretionary (+7.7%). In Europe, the regional index was up +5% with advances led by Germany (+5.8%) and France (+4.6%), but the UK (+3.1%) was near the tail end of the field as British PM Johnson was admitted to intensive care. All European sectors advanced led by industrials (+8.1%) and financials (+6.7%), and in Asian markets yesterday gains were led again by Australia (+4.3%), with Japan (+4.2%) and Hong Kong (+2.2%) not far behind. China declined (-0.6%).

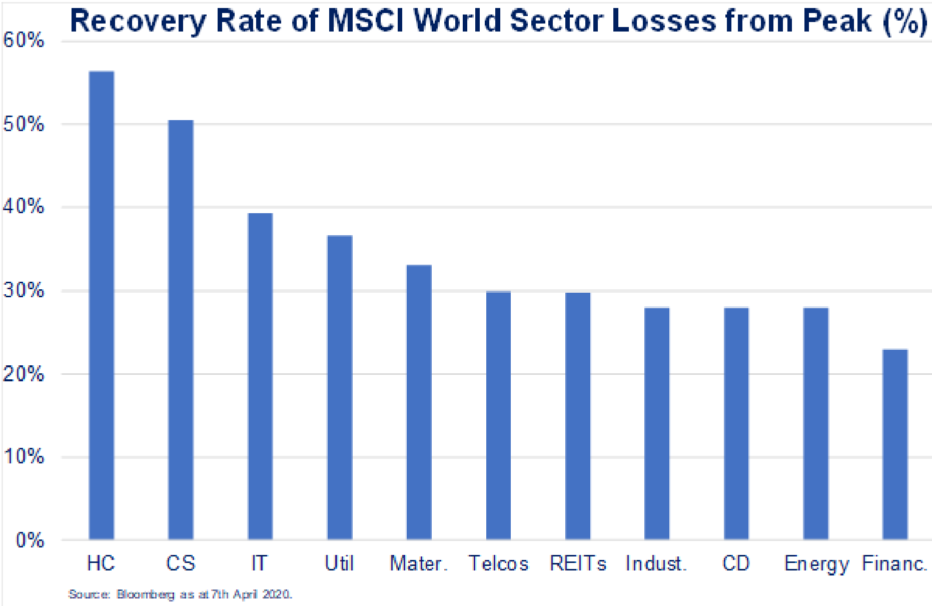
      Overnight moves now mean the UK (-28%) is the most sold market on a peak-to-now metric, with Europe (-27.7%) and Australia (-27.0%) also lagging (see chart).



- Among global sectors, overnight gains were led by IT (+8.3%), with consumer discretionary (+7.3%) and telcos (+6.2%) also outperforming. It is interesting examining the recovery rate of losses by sector as it reveals investor's mindset about where they still see stresses and enough valuation discount relative to earnings risk, to deploy capital.

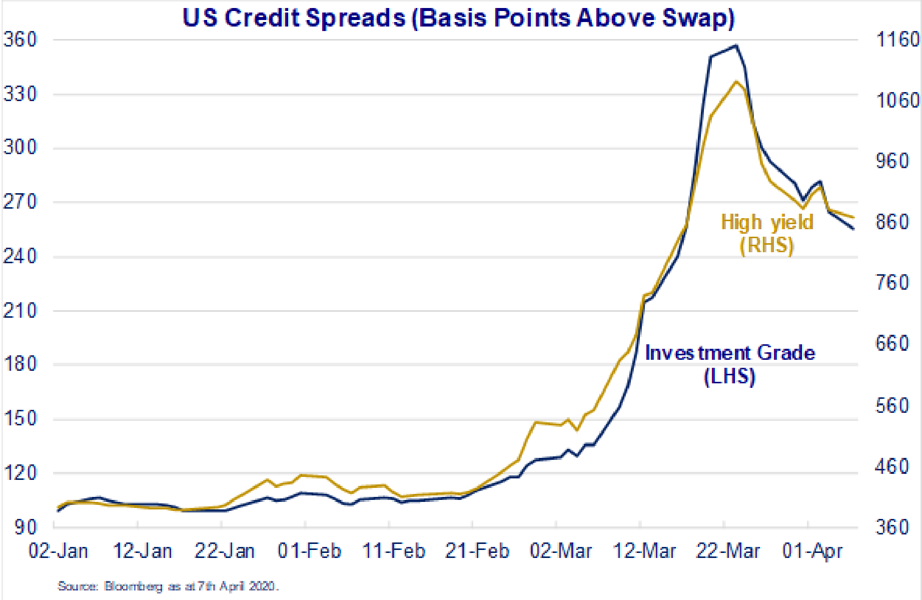
  In the end, if investors thought things were returning to normal one might expect sectors with the largest losses to see the largest gains - in this case it would be energy (-58% peak to trough loss), REITs (-38%) and industrials (-38%), and sectors with small peak-to-trough declines such as healthcare (-26%) and consumer staples (-22%) would lag, but this is not the case.

  In fact, defensive sectors have led the recovery rate with healthcare (+56%) and consumer staples (51% - see chart below) the only sectors so far to recover more than half their its losses, but other outperformers on this front include utilities (37%) and telcos (30%) all of which are defensive sectors with less sensitivity to the economic cycle. Accordingly, it may be a fair conclusion that despite the solid bounce in regional bourses in recent weeks, investors are not bracing an economic recovery, instead they are embracing a combination of cheap valuations and low earnings risk.



- **CREDIT**
  - US credit spreads contracted for a second consecutive session and for the eighth session since the market spread peaked ten trading days ago. The constructive thing in credit is not only lower spreads, but also that the contraction is contained each day, suggesting that investors are gradually becoming more confident that the Fed action two weeks ago is holding risk premiums and allowing capital allocation at attractive valuations.

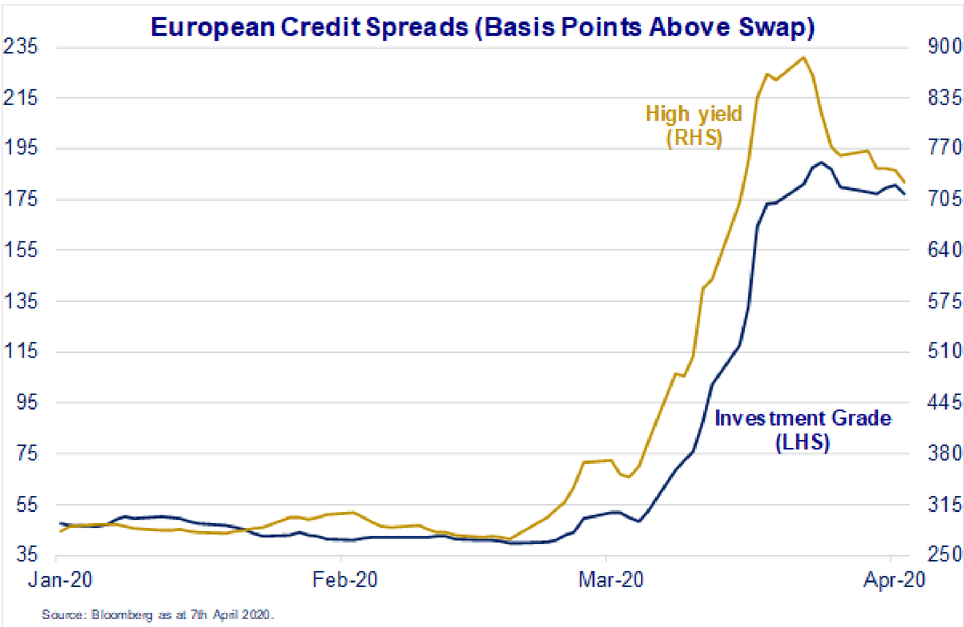
    In the investment grade universe, spreads came in -9 points to 256 points (see chart), which is a 15-day low with energy (-12 points to 433 bpts) leading the way even though crude prices fell -7.2% d/d as early optimism began to fade around OPEC+'s ability to take out enough supply to meet crashing demand. There wasn't much else in other sectors with spreads down around -10 points and this has now meant that the overall IG universe has recovered 40% of the spread blow out since mid-February.



In US high-yield credit is was a similar story with spreads contracting for the eighth session of the past 10 days and declines being led by energy (-39 points to 1825 bpts), with modest movements elsewhere. However, the absence of a Fed backstop in HY has meant the sector has recovered only 33% of its mid-February losses which is a bit less than the IG space.

- European markets were quieter relative to the US, with IG spreads only coming in 1 point to 176 bpts, with movements of less than 2 points in all sectors other than bank subordinated debt (-+14 to 289 bpts). However, the recovery rate of the IG spreads blowout in Europe has been lackluster at only 9%.

  Interestingly, spreads in energy (164 bpts), materials (168 bpts) and industrials (168 bpts) are still sitting at post GFC highs, with only financial senior debt (14%) and subordinated debt (20%) seeing any material recovery in response to ECB policy. In the high yield space, European spreads declined for a second session (-14 to 714 bpts) with energy (-39 to 962 bpts) dominating with little movement elsewhere. The HY universe has recovered 28% of its mid-February losses (see chart).



THE GLOBAL ECONOMY

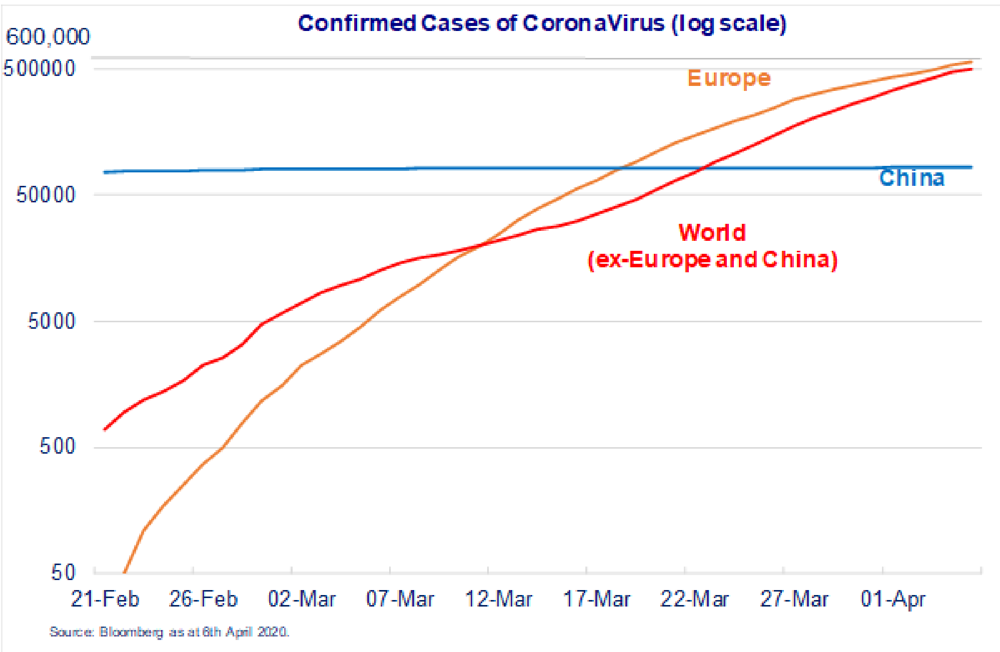
- There were no material economic releases overnight.

POLICY

- There were no material policy announcements overnight either. Despite a USD350 billion rescue package, there have been some reported issues surrounding small-business owners struggling in their ability to get approved for loans they needed to keep their doors open, with others saying they have been denied altogether. In addition, recently passed provisions to bolster unemployment benefits has been complicated by dated and overwhelmed state bureaucracies.

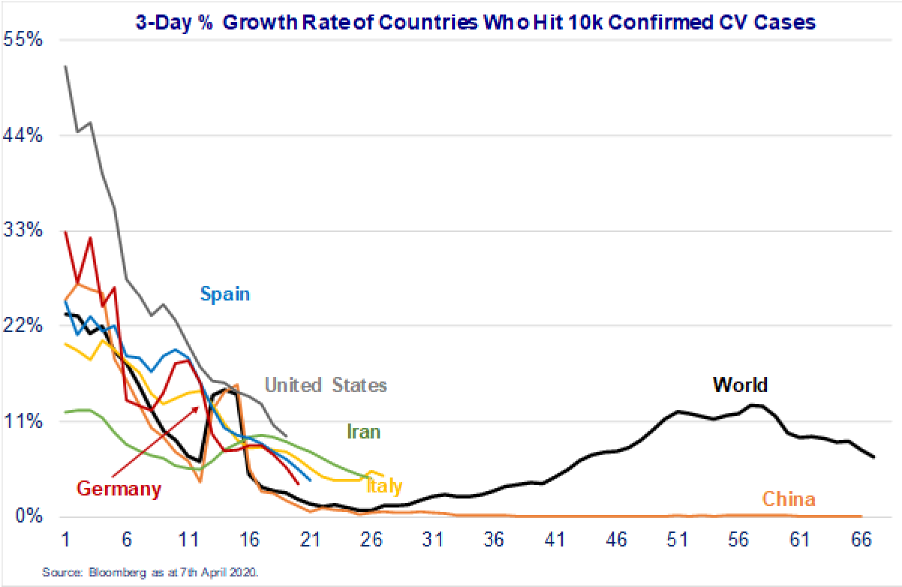
VIRUS UPDATE

- It was a good day for the spread of COVID-19 with the world recording its small daily increase in the past week. New confirmed cases rose +71.8k to 1,341.9k but only Indonesia (+218 to 2,491) reported a fresh daily high of new cases, but total cases there remain low. Meanwhile, deaths rose a record +4.7k to 74.1k and the death rate rose to 5.53% (27th rise in the past 30 days despite surging case numbers).

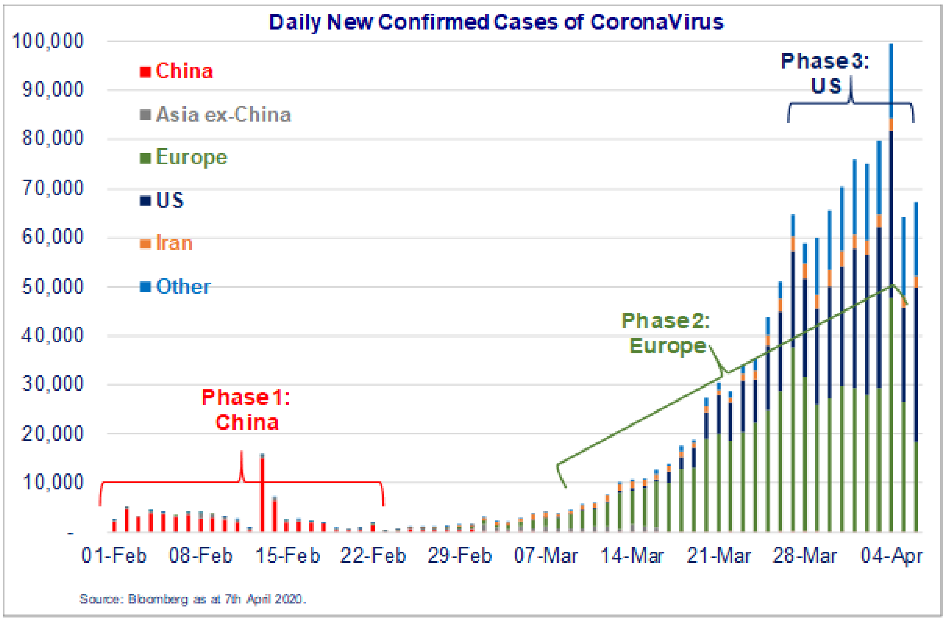


- Europe (+18.3k to 575k) continues to lead the world in terms of total cases but its daily increase (both numbers and percentages) is flattening out with the daily increase the best in the past 18 days – confirming that social isolation works to reduce the spread of the virus, even though it comes at an enormous economic cost.

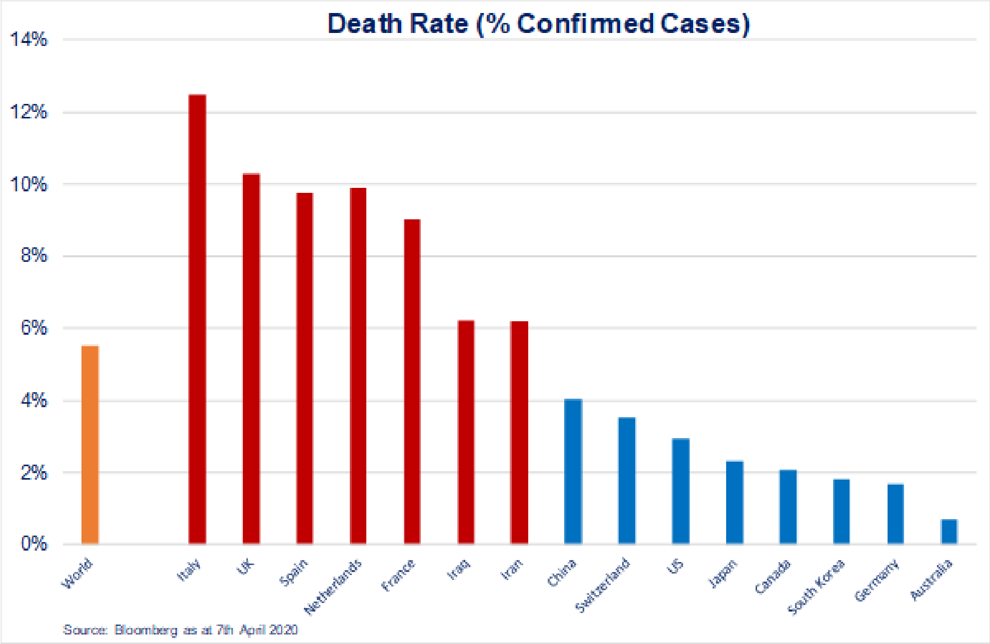
  In contrast, the US had its third worst day of new confirmed cases (+31.5k to 362.7k) but its 3-day US compound growth rate is declining and fell below 10% for the first time since reaching 10k cases 19 days ago, with New York new confirmed cases (+8.4k to 131.6k) grinding lower. Another positive development was Italy who recorded their lowest daily increase in three weeks (+3,599 to 132.5k).



- Among countries, the most cases are in the US (+31.5k to 362.7k), Spain (+3.3k which is its lowest increase in 17 days) to 135k), Italy (+3,599 to 132.5k), China (+63 to 82.7k), Germany (+1.7k (lowest increase in 18 days) to 101.8k), France (+5.2k (fourth largest) to 99.0k) and Iran (+2.2k to 60.5k). Australia confirmed cases has increased (+110) to 5,797 which placed us 21st in terms of total infections.



- The global death rate has risen to +5.53% (having doubled in the past 6 weeks) with another +4.7k fatalities overnight bringing the global total to 74.2k. The US became the third country overnight to record more than 10k deaths, but the death rate is highest in European countries where the health systems have collapsed led by Italy (+0.2% to 12.5%), the UK (+0.1% to 10.3%), the Netherlands (steady at 9.9%), Spain (+0.2% to 9.8%) and France (+0.4% to 9.0%).



Yours sincerely,

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MORE INFORMATION

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