

THOUGHTS ON THE MARKET

7th May 2020



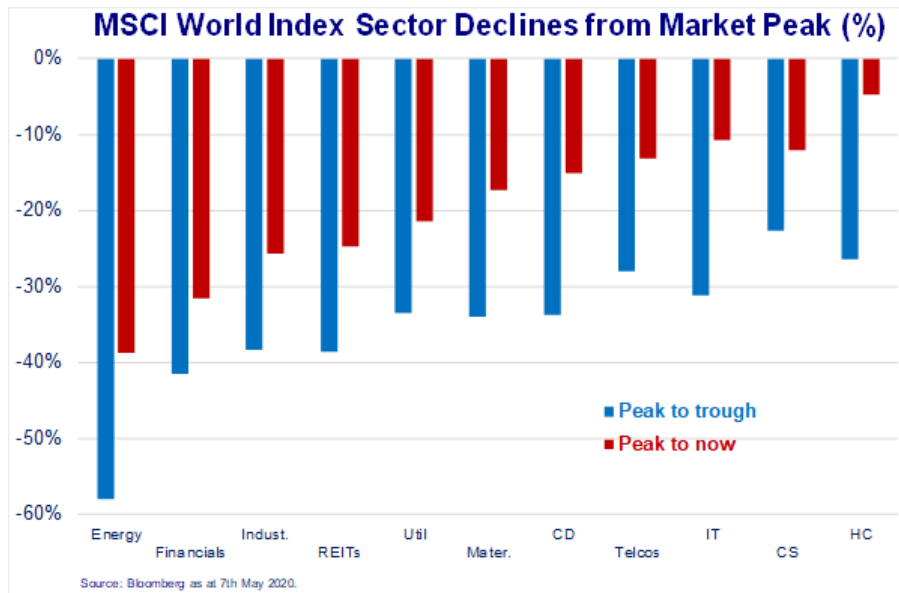
SUMMARY

- Global risk markets sold off for the first time in three days as investors digested mixed corporate earnings results, another bout of woeful economic data and rising geopolitical tensions between Washington and Beijing. This combination had investors questioning the rally given the earnings decline is likely larger than markets have factored in and valuations are aligned to a strong recovery in the second half of the year, which could be jeopardised by the lingering effects of COVID-19 and renewed trade tensions. Interestingly, growth concerns saw oil prices drop -1.4% to USD24.09 per barrel which is its first decline in five sessions.
- Despite the risk-off mood, defensive assets were mixed with gold down -1.1% to USD1688 per troy ounce, the US dollar rallied against the Euro (+0.1%) and AUD (+0.5% to 63.9) but depreciated against the Yen (-0.2%) and Sterling (-0.2%), and US 10-year Treasuries (+4 points to 0.70%) recorded their largest rise in yields in three weeks, with curve steepening, after the US announced plans to increase the amount of debt it plans to issue.
- On the data front, the ADP private payrolls dropped -20.2 million which is the largest on record (which if indicative of the April non-farm payrolls (out on Friday night) could see US unemployment rise to 16%), the global PMI came in at 26.5 (which is equivalent to an earnings decline of around -65%) and European retail sales declined -11.2% in April – all of these were slightly below street estimates.
- In COVID-19 news, the number of global cases of COVID-19 rose to 3.74 million with another +81.2k cases overnight (4-day high) with 4 countries now having more than 200k cases, 10 countries have more than 100k cases, 26 over 20k cases and 40 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 8 days another 744k cases have been confirmed. That said, the growth rate of daily confirmed cases continues to decline (+2.2% since Saturday). Meanwhile, deaths rose +5.8k overnight (7-day high) to 263.1k, with the death rate steady at 7.0%.

FINANCIAL MARKETS

• EQUITIES

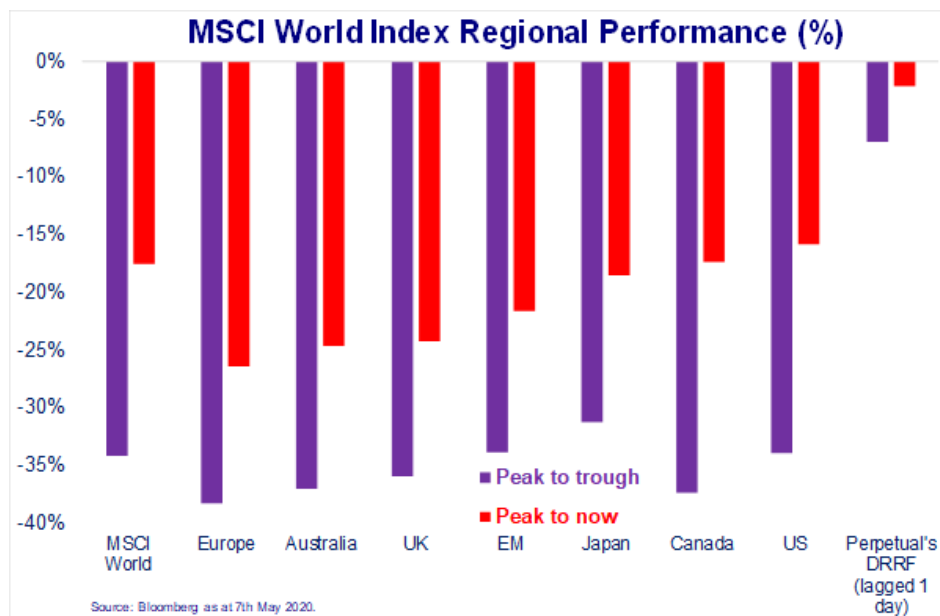
- The MSCI World Index declined -0.5% overnight with losses in all major regions and nearly all sectors. Declines were led by cyclical sectors as another round of weak composite PMI results for April confirmed we are in the midst of a large growth hole which policy can only partially fill. This saw energy (-2.3%) lead the pace of the declines as oil prices dropped -2% which wiped out most of the sectors advances from earlier this week and these flowed through to financials (-1.4%) and materials (-1.1%). In contrast, some cyclical sectors lifted led by IT (+0.7%) with the FANG stocks mostly higher (only Google declined, albeit only -0.2%). The movements kept five of the 11 GICS sectors in bear market territory (see chart), but healthcare (-4.8% from its February peak) is grinding towards a complete recovery



Among the regions, losses were led by Europe whose regional PMI (which fell -38 points to just 13.6) was really grim which sent regional indices lower in a fairly uniform selloff. The largest regional decline was Italy (-1.3%, who's regional PMI fell -40 points to just 10.9), but France, Germany, Spain and Sweden were all -1.1% lower, whereas the UK (+0.1%) eked out a small gain.

The negative sentiment from Europe didn't flow through initially to the US which opened in the green but renewed threats of China tariffs by Trump and an increase in US debt issuance saw the rally fade out in the last hour of trade with the S&P 500 (-0.7%) and Dow Jones (-0.9%) indices closing lower, but a solid performance by IT and consumer discretionary stocks kept the NASDAQ (+0.5%) in positive territory as investors continue to believe that stocks like Netflix, Apple and Microsoft will do well in the stay-at-home world.

In Asian trade yesterday performance was mixed with Australia down (-0.4%) but both China (+0.6%) and Hong Kong (+1.1%) posted gains. These results mean now that Europe has recorded the largest peak-to-now decline (-26%), with Australia (-24.7%), the UK (-24.3%) and EM (-21.6%) still firmly in bear market territory. Futures markets are suggesting a -0.9% in Australia at the opening bell this morning.

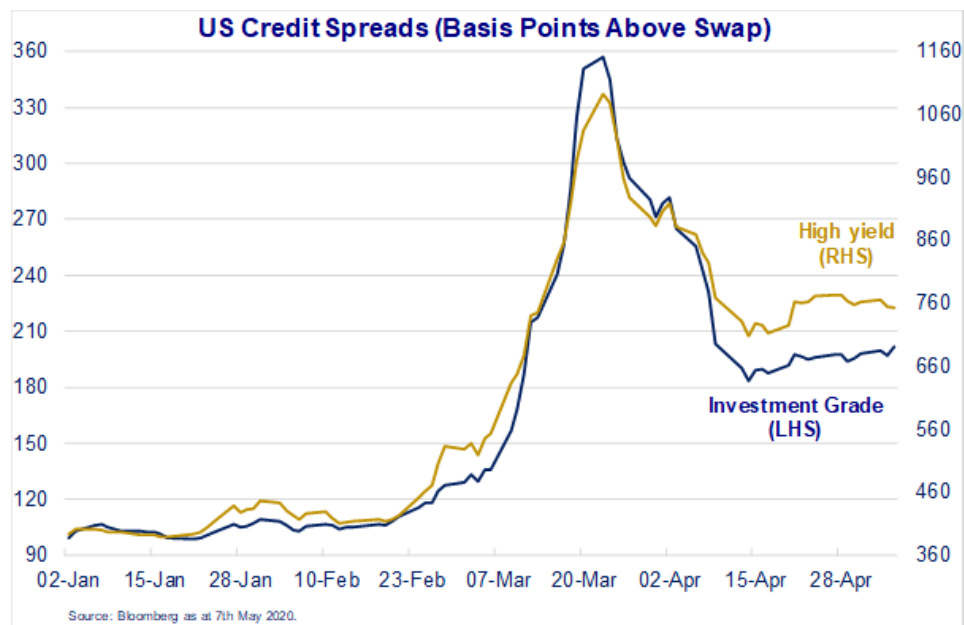


• CREDIT

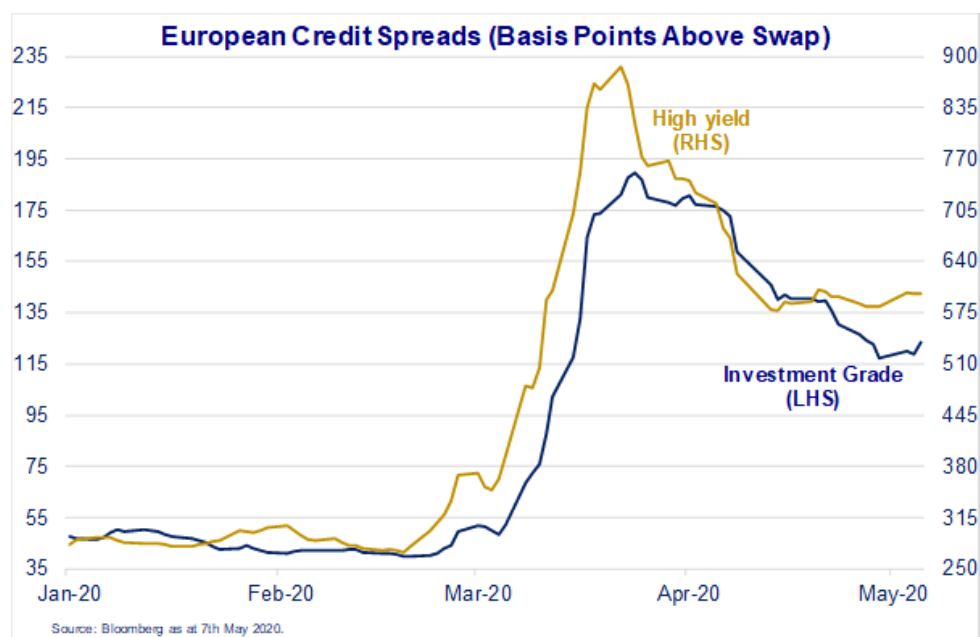
- US credit spreads widened as investors fretted over more mixed data and rising geopolitical risks, although the increase was not uniform. In the US investment grade space spreads widened +4 points to

+202 bpts which is an 18-day high with the recovery rate down two notches to 61%. Among the sub-sectors there were wider risk premiums across the board led by telcos (+6 points to +222 bpts, 62%), tech (+5 points to +159 bpts, 64%) and subordinated financials (+4 points to +246 bpts, 61%). Energy (+1 point to +325 bpts, 60%) recorded the lowest spread increase even though global oil prices recorded their first decline in a week (-1.9% to USD24.09 per barrel).

In the high yield space, spreads came in -2 points to +753 bpts (see chart), which kept the recovery rate at 50%. There was mixed performances around with spreads coming in -9 points in both energy (to +1284 bpts, 67%) and healthcare (to +574 bpts, 65%) which were partially offset by higher risk premiums in senior financials (+5 points, to 508 bpts, 41%) and their subordinated peers (+5 points to 801 bpts, 32%).



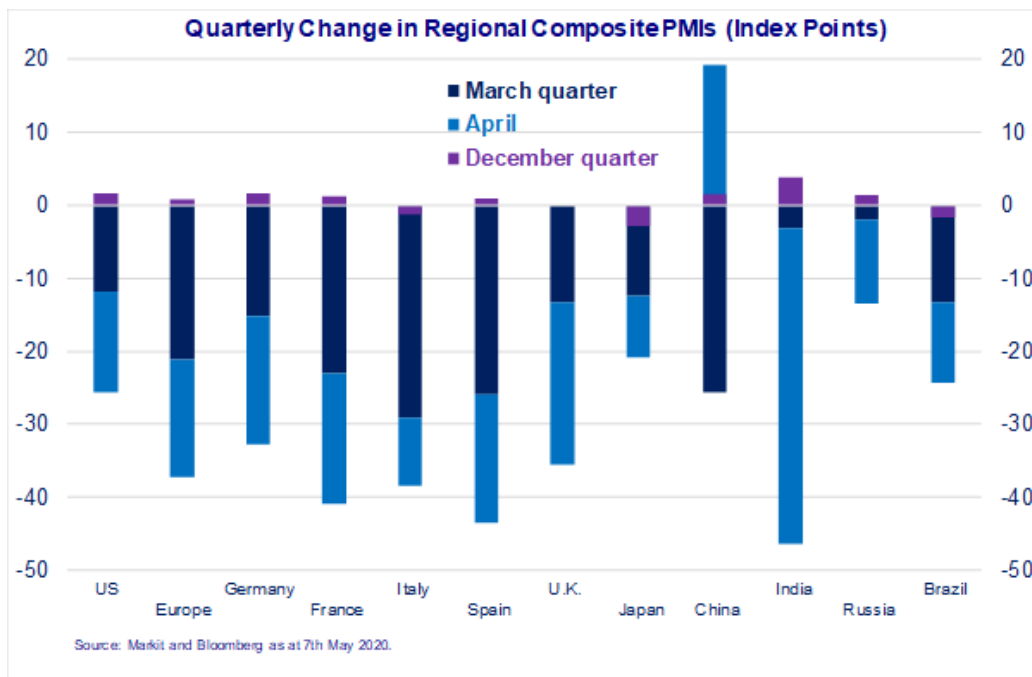
- European credit markets followed a similar trend to the US with investment grade spreads widening +5 points to +124 bpts, which lowered the recovery rate three notches to 44%. There were losses across all cyclical sectors given the poor regional PMI result for April which confirmed a deep downturn in H1 2020, led by consumer discretionary (+7 points which was the largest daily increase in four weeks, to +186 bpts, 41%) and Tech (+6.2 points, +61 bpts, 50%). Like in the US, spreads in the high yield universe were little changed at +599 bpts (see chart) which kept the recovery rate at 47%. Among the sub-sectors, spreads in senior financials rallied in strongly (-17 points, to 732 bpts, 31.9%) although it was hard to pinpoint the catalyst, and these declines were offset by minor moves elsewhere.



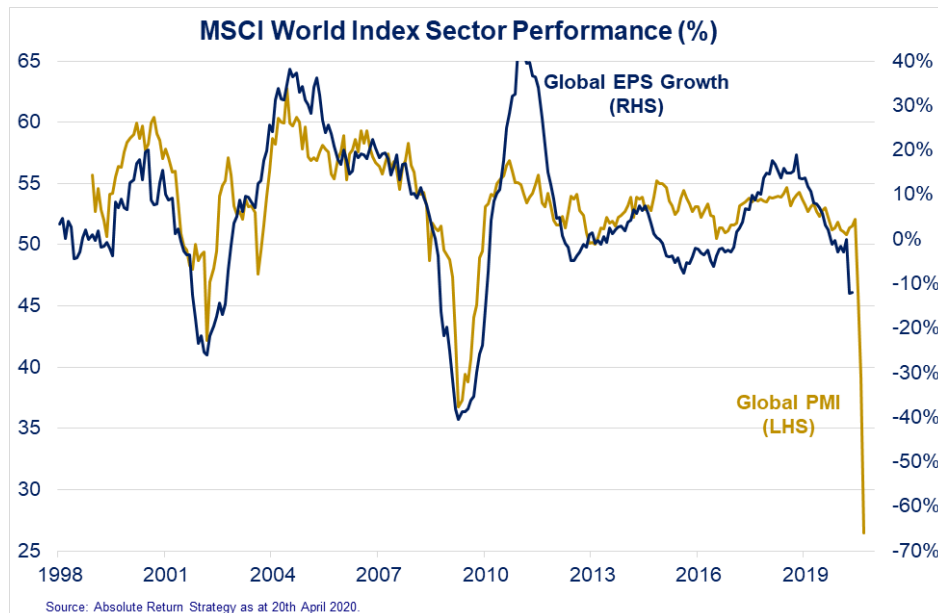
THE GLOBAL ECONOMY

- **US private sector employment** declined by a record -20.24 million in April according to the ADP report which was in line with street estimates. Among the sectors, employment in the services sector declined by 16.0 million led by a decrease in leisure and hospitality (-8.6 million), with the remainder decline in goods producing industries (-4.2 million) led by a fall in construction employment (-2.05 million). There were minor revisions to the March data (-122k to -149k) which are barely worth mentioning, but ADP noted that its report “*does not reflect the full impact of COVID-19 on the overall employment situation*” and given the historic differences between ADP and the Bureau of Labor’s non-farm payrolls, Friday’s release should come in at around -22 million, which will see the unemployment rate increase to around 16%.
- **Regional PMIs** plunged in April to levels never seen before. The chart below shows the damage done to PMI gauges in the March quarter (but really March) and April. The worst result is in India which fell by -50.4 points from its five-year high in February of 57.6 to single digit territory. India is a services based economy whose service PMI fell from 57.5 in February to 5.4 now which is the lowest individual PMI score in the history of the world and this suggests an economic contraction of -25% in the June quarter with around 120 million left destitute as they receive daily wages.

In Europe, composite PMI gauges dropped 30 to 40 points, to levels which are three times worse than the GFC lows in Spain (now at 9.2), Italy (10.9) and France (11.2) and two times the trough in Germany (17.4), with every country almost at a standstill. With lockdowns being eased across most jurisdictions it is highly likely April will represent the historic trough, but with optimism about the outlook 12 months ahead at fresh record lows given “*long-term impacts from the pandemic on demand, activity and the health of companies and consumers*”, the labour market recovery could be extremely slow.



The global composite PMI gauge came in at 26.5 which may suggest a larger plunge in global EPS than we were initially expecting (50% for us and 65% based on the April 2020 global PMI). Although technically the global PMI should bear no relationship with corporate performance as it measures the breath of a decline, rather than its depth, the relationship and signalling is remarkably consistent and given that markets are now factoring in a -17% decline in global EPS in 2020, and a fast rebound, there is likely to be either a large downgrade cycle, or major earnings disappointments ahead. Neither of these are good considering that markets are trading at elevated valuations, especially in the US (20x on a 12MF basis) where COVID-19 is still spreading quite widely with a complete recovery in earnings expected by investors in 2021 – we are really doubtful of that and this suggest that the risk-reward for US shares are unattractive at present levels.

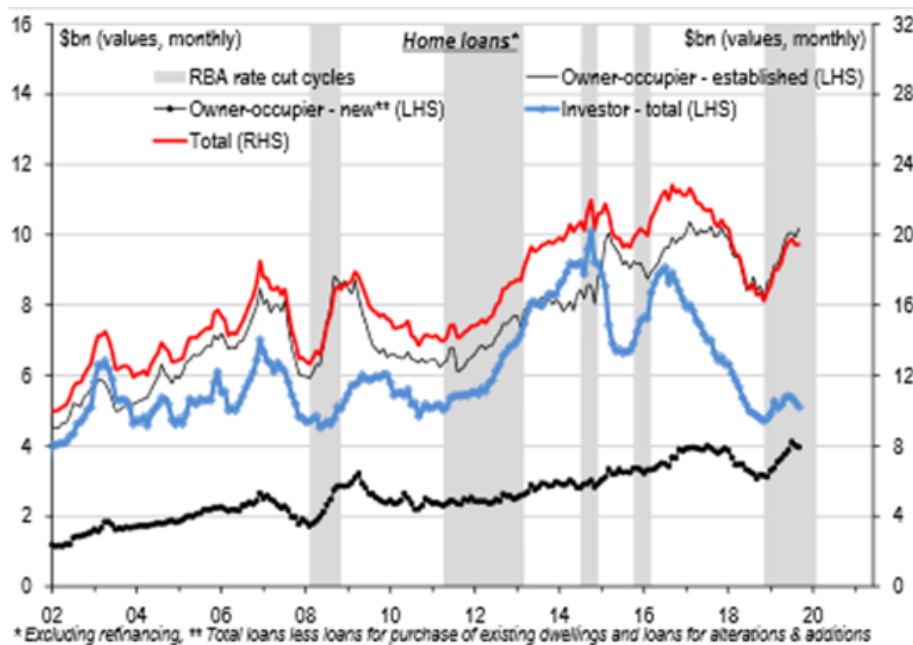


- German factory orders** fell -15.6% m/m in March to their lowest level since records began in 1991. The decline was more than double street estimates (-7% m/m) and pulled the annual rate down to -16% y/y (see chart below) with all sectors engulfed led by investment goods. The extent of the decline highlights impact of lockdown measures not only in Germany but also overseas amid massive supply chain disruptions.



- Australian housing approvals** (ex-refinancing) was surprisingly positive in March rising +0.2% m/m (+17.5% y/y) as the rise in owner occupier lending (+1.2% m/m and +22.5% y/y) slightly outweighed the decline in loans for investors (-2.5% m/m, +5.3y/y). Interestingly, demand for first home buyers remained robust at +2.5% m/m which pulled the annual rate up +39.4% y/y which is the highest level in a decade which represents 29% of total owner-occupied loans.

While lending volume has risen since end-2018 to just under AUD20 billion in March, the ABS noted, these numbers reflect largely reflect loan applications submitted in February and the first half of March which was before mobility and auction restrictions impacted Australian housing, jobs and broader confidence. This combination is likely to see precipitous declines in April and beyond, which could have monthly loan values halve to AUD10 billion (see chart) and this is a key lead indicator of home prices and hence wealth effects and consumer confidence.

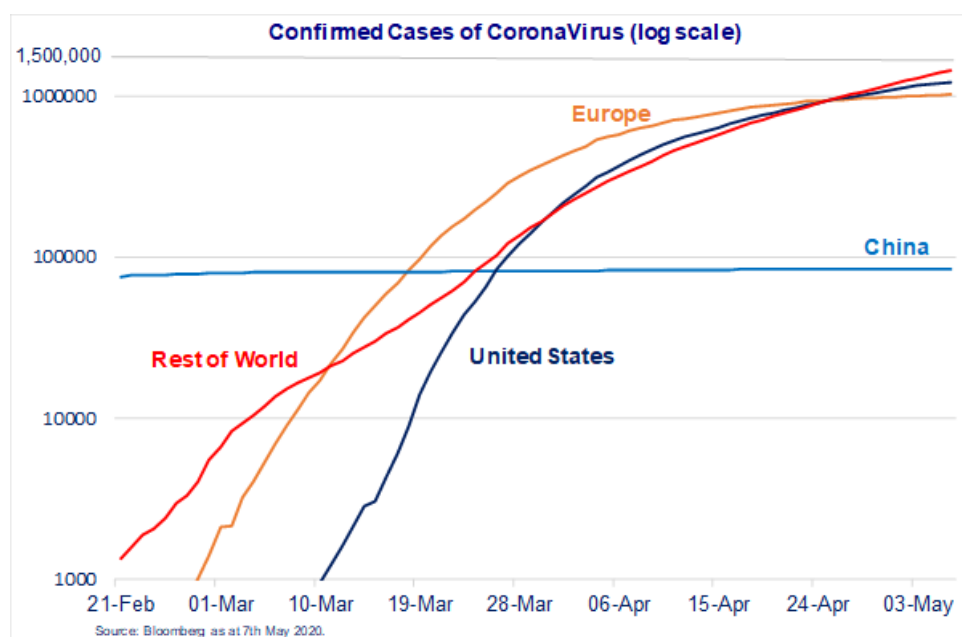


POLICY

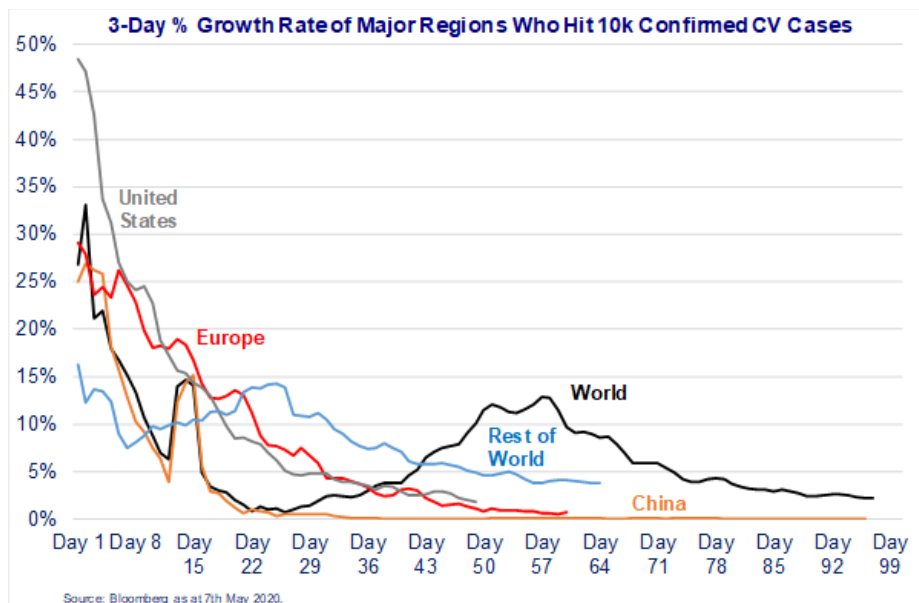
- There were no material policy announcements yesterday, but President Trump said that his Coronavirus taskforce will remain in place indefinitely, but there will be a renewed focus on reopening the economy and developing a vaccine. He conceded that more deaths are likely as economy reopens and that twenty states which have lifted lockdown restrictions have not met White House guidelines for reopening.

VIRUS UPDATE

- The number of global cases of COVID-19 stands at 3.74 million with another +81.2k cases overnight (4-day high). That increase means 4 countries have more than 200k cases, 10 countries have more than 100k cases, 26 over 20k cases and 40 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 8 days another 744k cases have been confirmed. That said, the growth rate of daily confirmed cases continues to decline (+2.2% since Saturday). Meanwhile, deaths rose +5.8k overnight (7-day high) to 263.1k, with the US now over 70k and the UK (30.2), Spain (25.9), Italy (29.7) and France (25.8) all over 25k, and the death rate sits at 7.0% (although final numbers are not yet in).

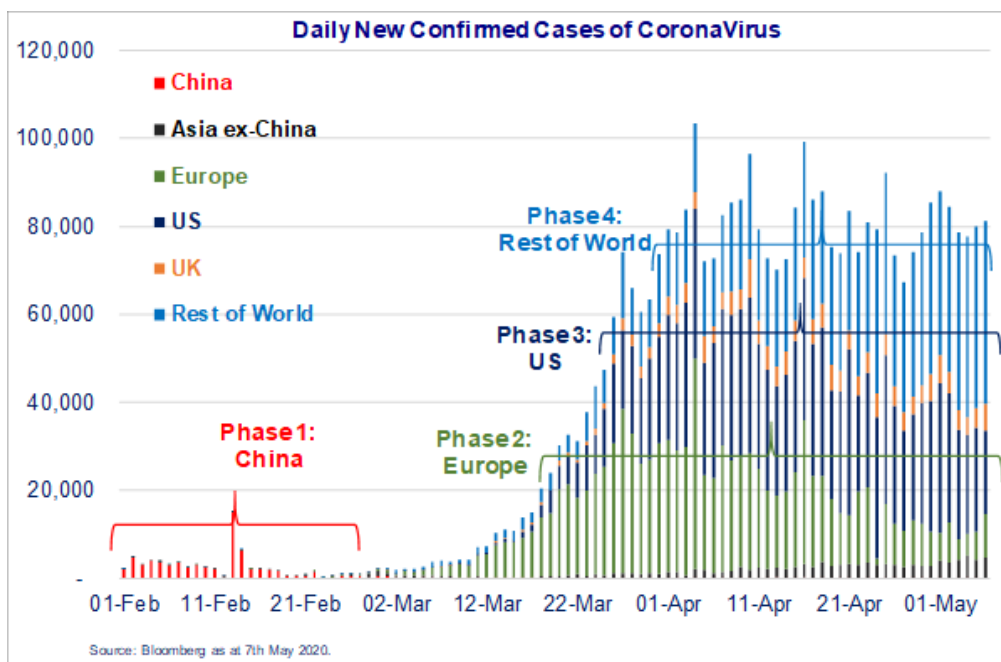


- We break the infections into four groups – the US, Europe, China and ‘others’ and the rest of the world outside the G3 economies (+41.7k to 1.44 million) now has the most total cases and highest daily new cases followed by the US (+19.0k to 1.22 million) and Europe (+9.7k to 1.03 million), with the 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 to 166.0k) and Brazil (+9.3k (fresh daily record high to 125.2k).

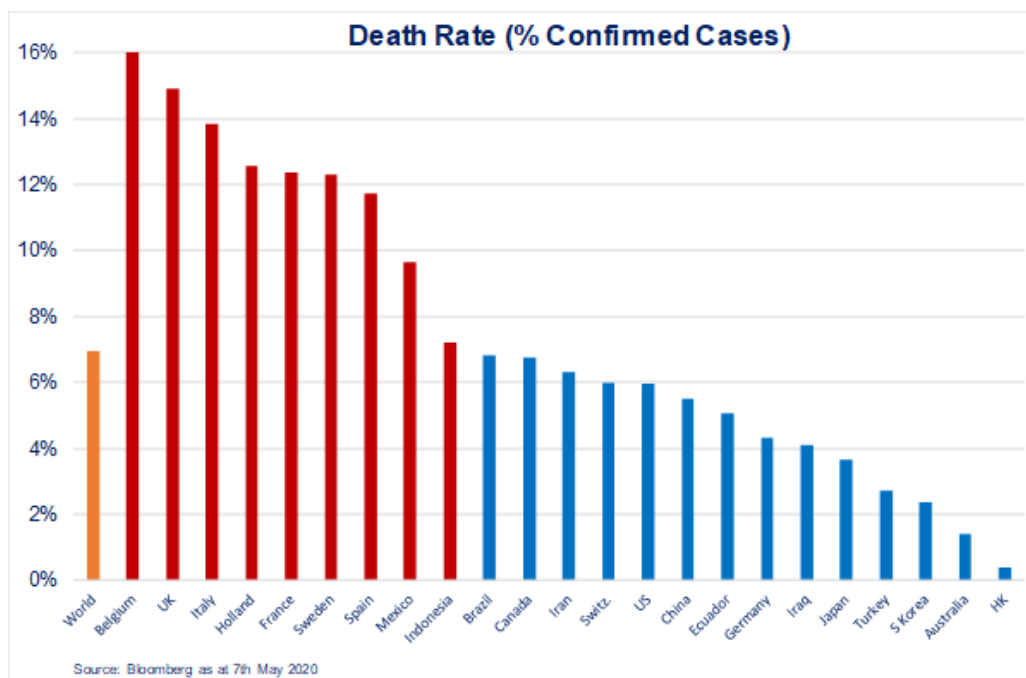


- Among countries, the most cases are in the US (+19.0k to 1.22 million), Spain (+1.0k to 220.3k), Italy (+1.4k to 214.5k), the United Kingdom (+6.1k (5-day high) to 202.4k), France (+4.0k (18-day high) to 174.2k), Germany (+1.2k (7-day high) to 168.2k), Russia (+10.6k to 165.9k), Turkey (+2.3k to 131.7k), Brazil (+9.2k *(record daily increase) to 125.2k), Iran (+1.2k (25-day high) to 101.7k) and China (+1 to 84.0k). Australia confirmed cases rose +3 to 6,858 yesterday which placed us 49th in terms of total infections.

Elsewhere, Singapore recorded +788 new cases to 20.2k 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 (+367 to 12.4k) and the Philippines (+320 to 10.0k). Note final numbers for yesterday at not in yet so these numbers can rise.



- The global death rate was steady at +7.0% (having risen in 51 of the past 60 days) with another +5.8k fatalities overnight (7-day high) bringing the global total to 263.1k. The US has the most deaths with +1.97k to +73.0k, with the UK (+650 to 30.2k), Italy (+0.4 to 29.7k) and Spain (+244 to 25.8k) and France (+275 to 25.8k) all over +25k. The death rate is highest in European countries where the health systems have collapsed led by Belgium (+0.5% to 16.4%), the UK (-0.1% to 14.9%), Italy (steady at 13.8%), the Netherlands (steady at 12.6%), France (-0.1% to 12.4%), Sweden (steady at 12.3%) and Spain (steady at 11.7%). However, several emerging markets are now on the leader board including Mexico (steady at 9.6%), Indonesia (steady at 7.2%) and Brazil (-0.1% to 6.8%).



Yours sincerely,



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