Perpetual Investments

THOUGHTS ON THE MARKET

8th April 2020

SUMMARY

- Stocks were mixed in volatile trading overnight as oil sank, investors debated whether than moderation in the spread of COVID-19 cases was sustainable or data noise, and bonds, gold and the US dollar all retreated. The big news overnight was the rolling over of a +3.5% early advance by the S&P 500 and a -9% slide in crude prices as investors worried about both whether any deal can be struck by OPEC+ and if enough supply can be removed. This meant that the black gold resource has lost half of its 42% recent rally in the space of a few days.
- Volatility has risen and it's no big claim to suggest it is likely to stay that way as we have a classic battle between the bulls and the bears. The bulls see an attractive trifecta of peaking COVID-19 cases, unprecedented stimulus and what they see as attractive valuations. In contrast, the market bears are engrossed by the economic reality that is ahead including a growth contraction larger than the worst recorded during the Great Depression, 1970s oil shocks and the GFC in the US, China, the UK, Australia and Europe, in addition to plunging consumer confidence, major funding issues for companies, a potential halving of global EPS growth, a rapid shredding of corporate dividends and a host of credit downgrades and defaults.

  Given how early we are in the economic contraction and the funding stresses already evident, we don't see much out there at present to be optimistic about, but the thing we worry about most are the unforeseen economic and financial aftershocks that will come when the recession reveals itself.

FINANCIAL MARKETS

- **EQUITIES**
  - Regional equity markets were mixed overnight with the US market losing a +3.5% early rally, but Europe and Asia both lifted. In the absence of major economic data, it seemed that US investors overnight weighed up signs of a slowing of the COVID-19 infection rate against the worst day of fatalities and they perhaps came to a realisation that the stimulus released so far is about keeping the patient alive, rather than something that will see a much higher growth rate as 2020 ends.

    In the US market, the S&P500 had declined -0.2% at the bell as gains in materials (+2.4%) and energy (+2.0%) were slightly outweighed by losses in IT (-1.1%) and consumer staples and utilities (both -1.2%). In Europe, bourses rallied led by Sweden (+3.4%) and Germany (+2.8%), as they saw the early stage of the US rally with sector gains led by materials (+3.7%), IT (+3.0%) and consumer discretionary (+2.6%), whereas energy (+1.3%) brought up the tail of the field. Yesterday, Asian markets recorded solid gains led by China (+2.3%), Hong Kong (+2.1%) and Japan (+2.0%), with Australia (-0.7%) one of the few markets to close lower. Yesterday's decline has seen Australia with the largest peak-to-now loss (-27% - see chart) closely followed by the UK (-26.2%) and Europe (-26.1%).

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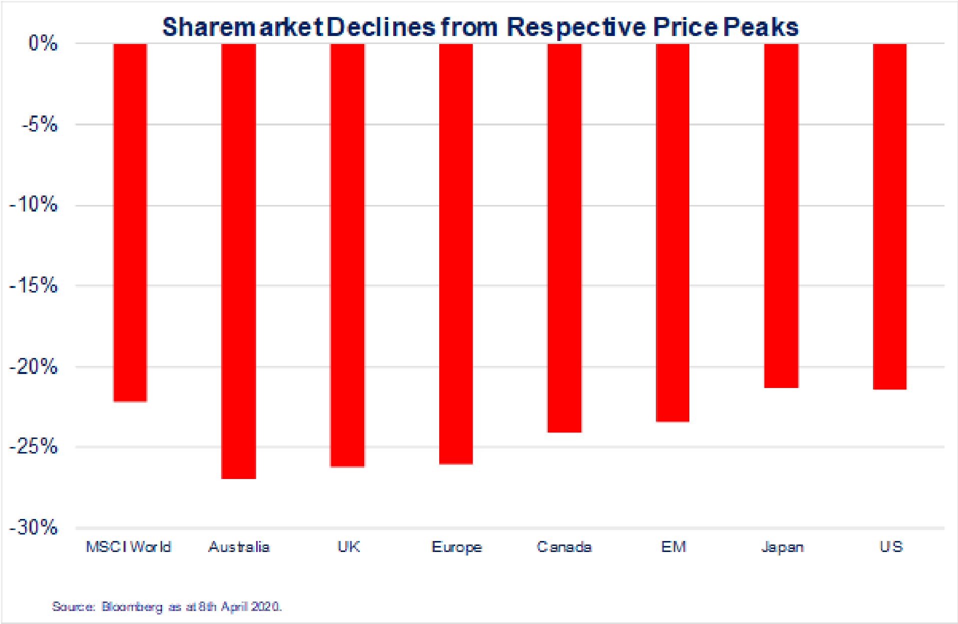
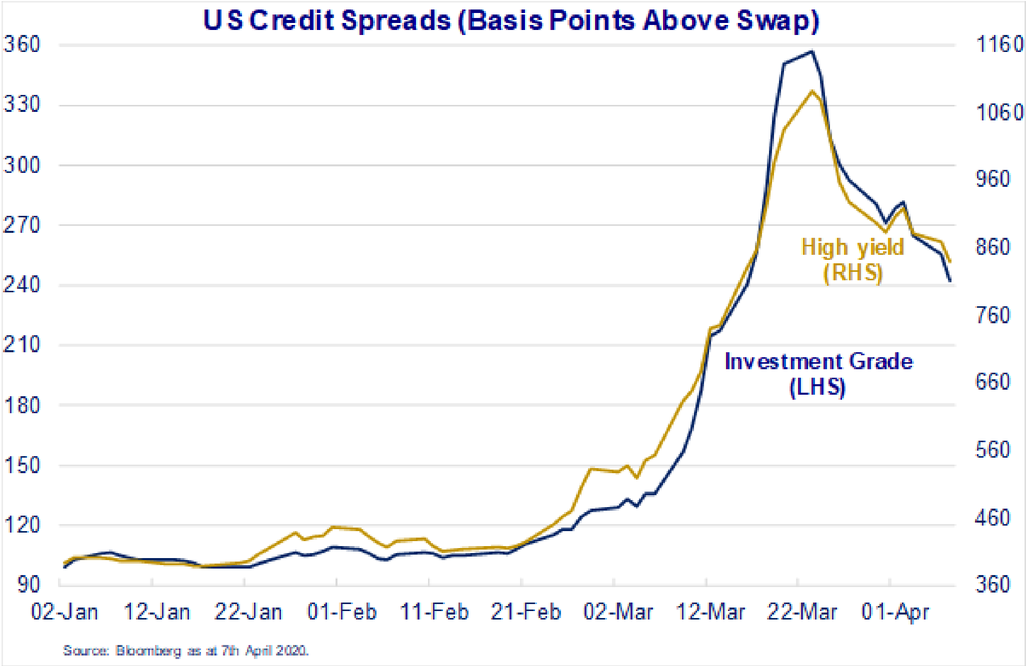


Meanwhile, sector performance from their respective peaks is a conga line of stressed sectors with largest losses in energy (-40.5%), banks (-31%) and industrials (-26.6%) and those three sectors have the lowest recovery rates from their respective troughs (29.5%, 25.6% and 30.3%, respectively).

Futures markets are all pointing to declines in Australia, Hong Kong and Tokyo.

- **CREDIT**
    - Despite another plunge in global oil prices, credit spreads tightened for a third consecutive night. Spreads in US IG declined -13 to 243 meaning that the sector has recovered 45% of its losses from mid-February, with all sectors recording a double-digit spread contraction. The largest decline was recorded in energy (-18 to 415 pts, 39%) despite a -9% fall in crude prices, with the rally in Tech (-16 to 185, 51) culminating in the sector becoming the third to recover half its losses (after telcos and healthcare yesterday).

In the US HY space, spreads rallied -29 to 840 bpts which is a 16-day low which has seen the sector recover 37% of its spread blow out since mid-February. Energy (-105 to 1720 bpts) once again led the gains but gains elsewhere weren't exactly egregious with IT (-344 to 696 bpts) the largest and consumer staples (-18 to 618 bpts) the smallest.



- European credit also had a good night with IG spreads coming in another point to +175 bpts and HY declining a more impressive -32 to +682 bpts, which meant the sectors have recovered 10% and 33% of their respective losses. In the IG space spreads expanded in 8 of the 11 subsectors, but the overall gauge came in as bank subordinated debt retracted another -20 points to 269 bpts which is a 16-day low (with a recovery rate of 29% which is well beyond its any of its sector peers). In HY the action was more impressive, but it was also concentrated in energy (-107 to +855, 40%) and consumer discretionary (-41 to 923 bpts, 29%).

THE GLOBAL ECONOMY

- There were no major economic data point released yesterday.

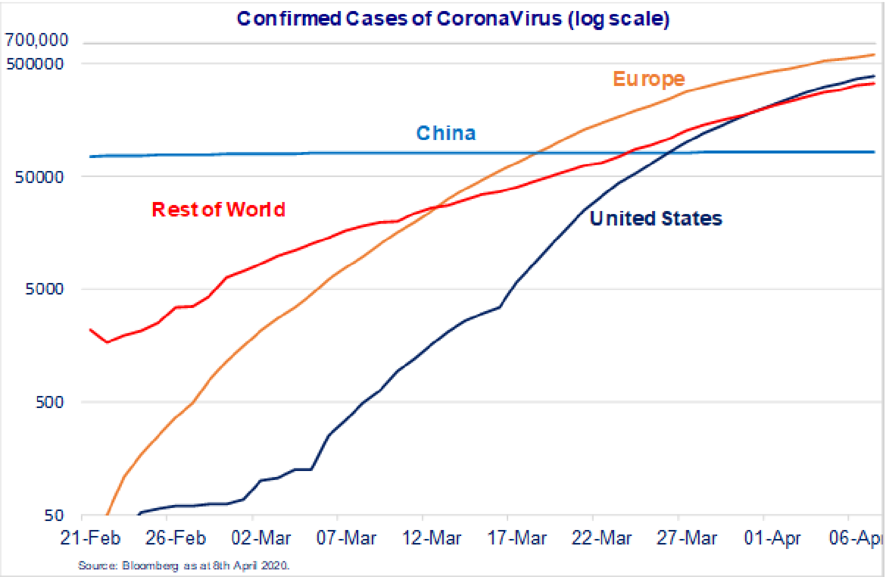
POLICY

- Japan's Prime Minister Abe declared a state of emergency to fight new COVID-19 infections (44% of the population are now 'asked' to stay at home) and unveiled a Y108 trillion (USD990 billion – or 20% of GDP) stimulus package to soften the economic blow. However, only one-third of the plan (Y39.5 trillion or 7% of GDP) is direct stimulus.
- The RBA held their regular monthly policy discussion yesterday and given previous guidance from the Governor that 0.25% is the effective lower bound, and with the March minutes stated there was "no appetite for negative rates", it was no surprise that the cash rate stayed at +0.25%. In the minutes the RBA confirmed their emphasis on Yield Curve Control (YCC) to keep the 3-year bond at the target cash rate of 0.25% until progress is made towards the goals for full employment and inflation. The Bank also noted they had been busy soaked up government debt to the tune of AUD36 billion (4% of the stock of Australian Government debt on issue) and this will continue to ensure smooth functioning funding markets, but they noted some thoughts of tapering asset purchases if things continue to improve. Interestingly, if things precede at the recent pace (around AUD2 billion of purchases per day), the RBA Australian government bond holdings could be AUD500 billion by end-2020, which is close to the announced spending program for FY20 and FY21. This combined with ongoing YCC should help anchor yields low. Even if they halved the current pace, they would absorb all the new stock by 30th June 2021.

The bank also noted their expectation that a "very large economic contraction ... in the June quarter and the unemployment rate ... to increase to its highest level for many years." We think a record -8.5% q/q contraction is ahead in June (-6% in 2020) and that unemployment will rise to around 12% but the latter is subjected to how the ABS treats people with no work, but who are still technically attached to an employer.

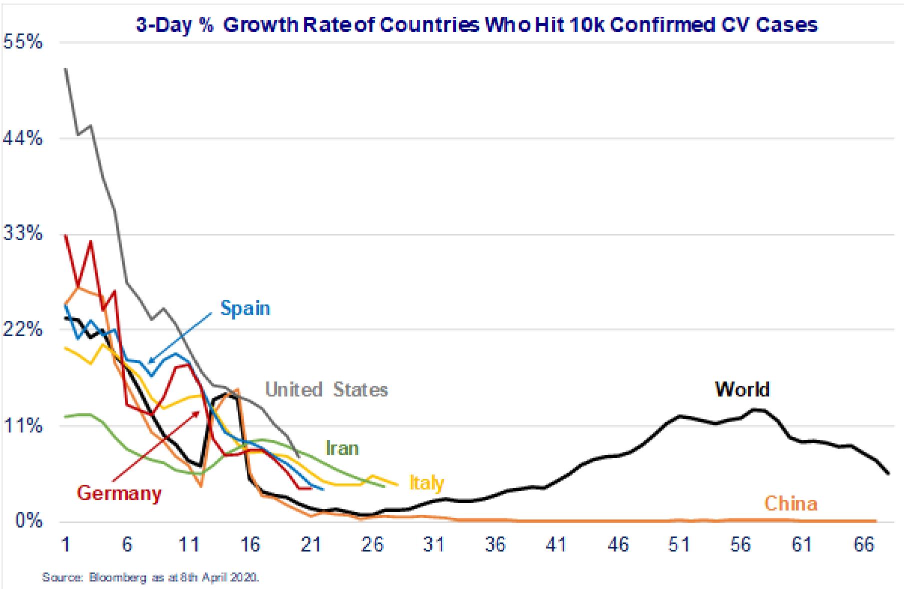
VIRUS UPDATE

- It was a mixed day for the spread of COVID-19 with the world recording its smallest daily increase in the past 9 days. New confirmed cases rose +66.9k to 1,415k, but deaths rose a record +6.4k to 81.2k and the death rate rose to 5.75% (28th rise in the past 31 days despite surging case numbers).

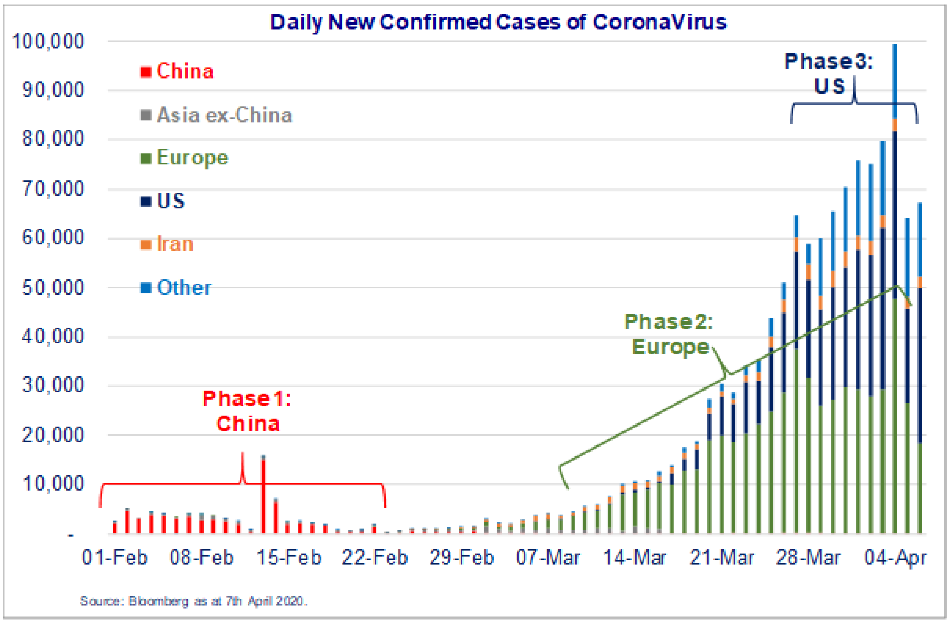


- Europe (+30.4k to 605k) continues to lead the world in terms of total cases and it had its fourth worst day in terms of daily number increases, but in trend terms new case numbers continues to decline – confirming that social isolation works to reduce the spread of the virus, even though it comes at an enormous economic cost.

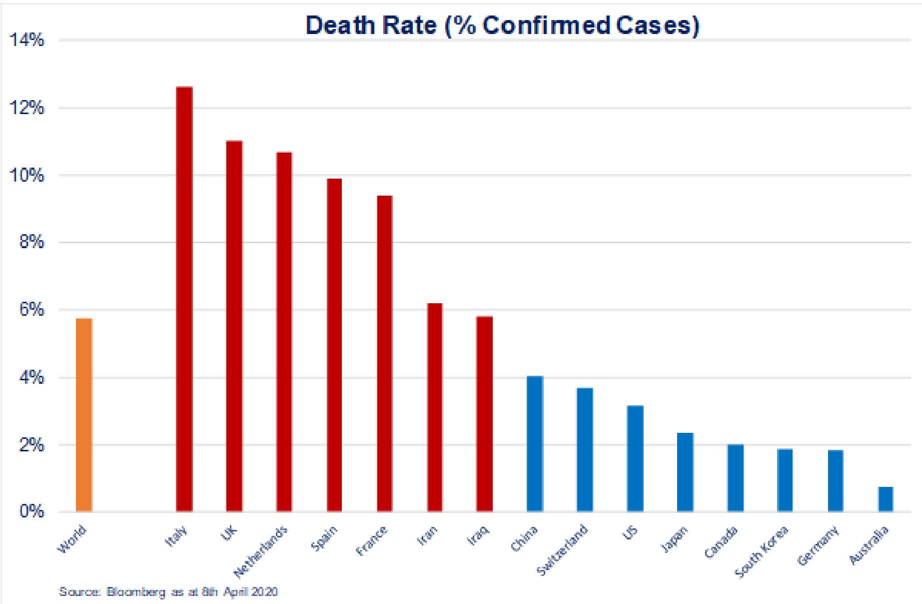
  In contrast, the US had its best day in 12 (although final numbers are not in) at +18.6k to 386.8k, but its 3-day compound growth rate is declining towards the levels seen in other countries that reached 10k cases, with New York new confirmed cases (+7.0k to 138.9k) grinding lower in both numbers and percentages (+6.7% which is a record low since the first case was detected on 14th March). Another positive development was Italy recording their lowest daily increase in 24 days (+3.0k to 135.6k).



- Among countries, case numbers dropped sharply in Italy (lowest daily increase since the 14th March) and the US (26th March), but France had its second worst day of increases. The most cases are in the US (+18.6k to 386.8k), Spain (+5.5k to 140.6k), Italy (+3.0k to 135.6), China (+53 to 82.7k), Germany (+5.6k to 107.5k), France (+11.1k to 110.0k) and Iran (+2.0k to 62.5k). Australia confirmed cases has increased (+98 – 10 day low) to 5.9k which placed us 23rd in terms of total infections.



- The global death rate has risen to +5.75% (having doubled in the past 7 weeks) with another +6.3k fatalities overnight which is a record high bringing the global total to 81.2k. The US had its third worst day of increases (+1.3k to 12.3k), but the death rate is highest in European countries where the health systems have collapsed led by Italy (+0.1% to 12.6%), the UK (+0.7% to 11.0%), the Netherlands (+0.8% to 10.7%), Spain (steady at 9.9%) and France (+0.4% to 9.4%).



Yours sincerely,

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MORE INFORMATION

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