Perpetual Investments

THOUGHTS ON THE MARKET

8th May 2020 – it's just another day...

SUMMARY

- A key question for investors is whether markets are correctly pricing the fundamentals. On a day in which oil fell, yield curves flattened, US consumer debt fell for the first time in a decade and initial jobless claims signalled that all of the US job gains this century could be in the process of being wiped out, equity traders sat down in their homes and saw energy companies, consumer stocks and banks all rally. So, as Paul McCartney sang, 'its just another day'... in the 2020 market where the yawning gap between investor sentiment and the economic data keeps getting wider underpinned by war time like fiscal deficits and highly unorthodox central bank policy.

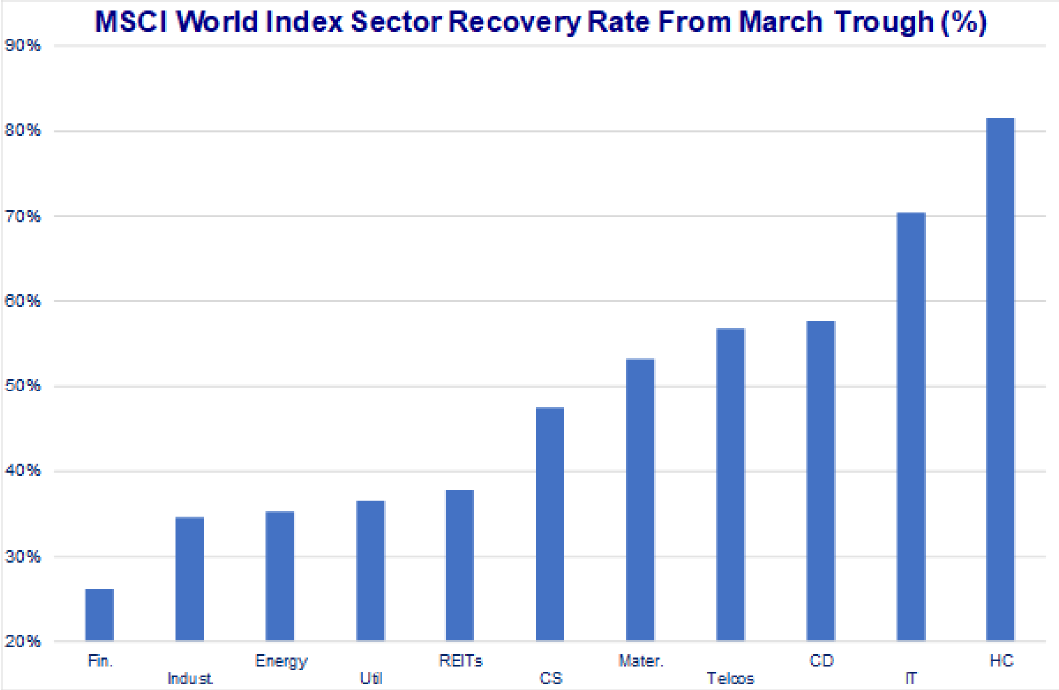
  However, while the policy support is unprecedented it won't fill the growth hole and overnight the Bank of England confirmed that the UK economy is likely to contract -14% in 2020, which will have a massive negative impact on the UK economy, unemployment, corporate earnings and dividends, but markets continue to believe that the business sector will survive the recession and re-open. Maybe the next McCartney song markets will hear is "here, there and everywhere" as there is no telling where all the stimulus, job losses and priced to perfection asset markets will go from here.
- Although it was risk-on overnight, the US market is really the only bourse which has made much headway in the past month to recover lost ground and even there outside Microsoft, Apple, Facebook, Amazon and Google, US stocks have gone literally nowhere in the past month, so it's a very narrow recovery. In other markets, credit spreads widened a touch adding to recent underperformance, US 10-year bond yields rallied strongly, with curve flattening, gold (+1.6% to USD1720.44 per troy ounce) posted its largest daily advance in three weeks, oil fell -2.5% to USD23.39 per barrel and the US dollar fell against all major currencies.
- Major economic data overnight was limited to the US where US initial weekly jobless claims came in above street estimates at +3,169 million which now threatens to wipe out all jobs created in the twenty first century, with tonight's April non-farm payrolls likely to see -24 million job losses and unemployment around 15%.
- In COVID-19 news the number of global cases rose +82.5k to 3.84 million with 4 countries having more than 200k cases, 10 countries having more than 100k cases, 27 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 10 days another 836k cases have been confirmed. Meanwhile, deaths rose +5.2k overnight to 269k, with the US now over 75k and the UK, Spain, Italy and France all over 25k, and the death rate sits at 7.0% (although final numbers are not yet in).

FINANCIAL MARKETS

- **EQUITIES**
  - The MSCI World Index close +0.9% higher overnight (recovery rate up to 48.7%) with gains in most sectors and regions. Overnight there was a clear rotation out of defensives and into cyclicals but in many cases the advances defied belief as energy (+1.9%) increased despite a lower oil price, consumer discretionary (+1.1%) rallied despite US consumer debt (i.e. credit card debt outstanding) declining for the first time in a decade and financials (+1.3%) lifted strongly despite flatter yield curves around the world.

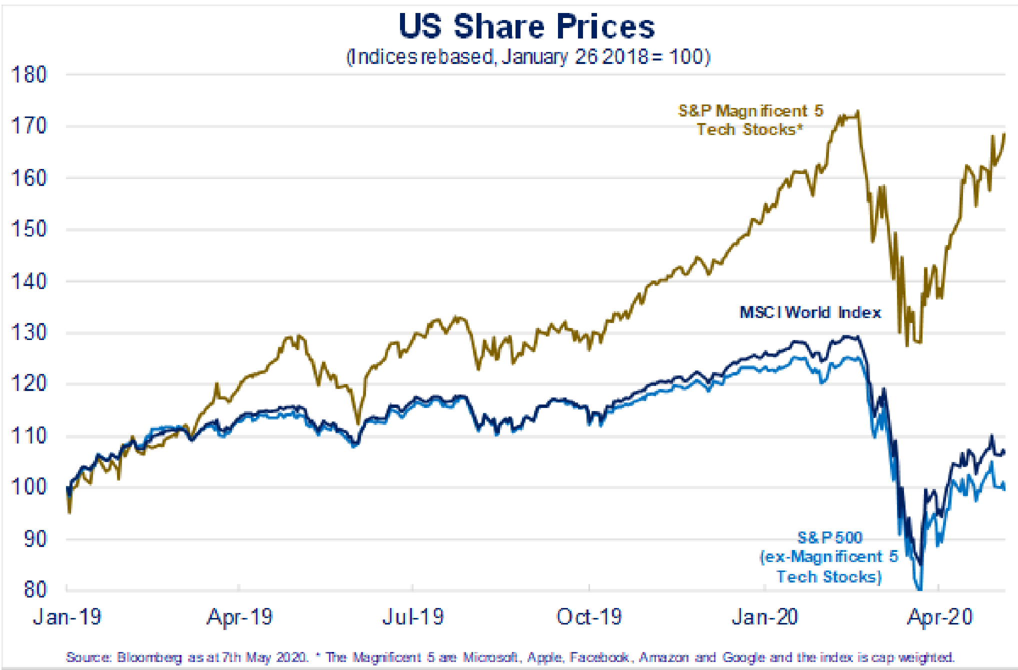
    The overnight gains mean that healthcare (at +81.5%) and IT (+70.4%) have now recovery the bulk of their March quarter decline, but the old economy type sectors such as utilities (36.5%), energy (35.3%), industrials (34.7%) and financials (26.3%) are lagging quite notably and markets with larger-than-average exposure to these sectors (such as Australia, Europe and EM) are also underperforming.

Perpetual



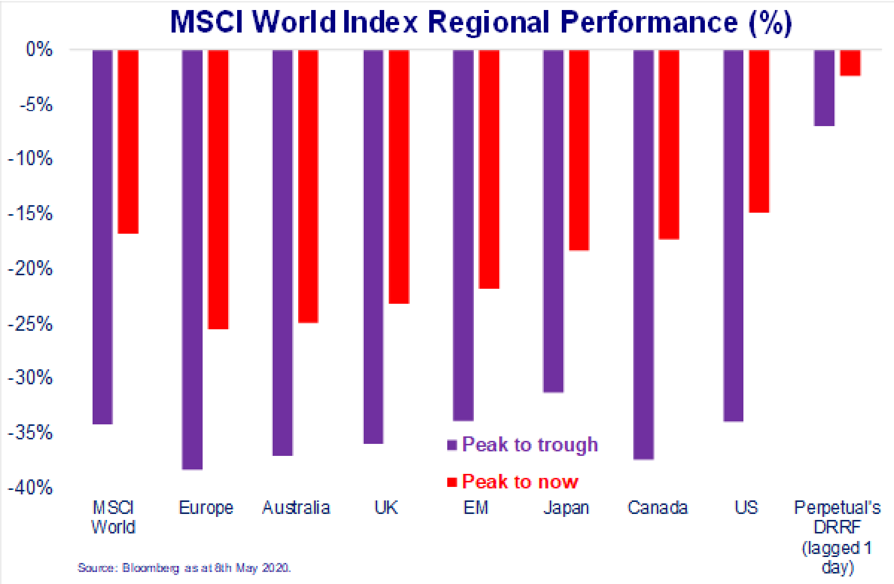
Among the regions and despite its heavy exposure to old economy sectors, Europe (+1.3%) led the pace of gains overnight although it was hard to pinpoint the catalyst other than lagging performance with France (+1.5%), the UK and Germany (both +1.4%) outperforming but the periphery markets where COVID-19 is most prevalent lagged with Spain (+0.9%) and Italy (+0.5%) at the tail of the regional field.

The positive sentiment flowed through to the US market with the S&P 500 rallying +1.2% on mounting speculation that the worst of the economic damage is passing as more states re-open activity and news broke that top US and China negotiators are set to speak next week on trade. The NASDAQ (+1.4%) enjoyed another good session which enabled the index to completely wipe out its -24% March quarter loss and turn positive for the year. However, the recovery is not particularly broad and has primarily been driven by five stocks namely Microsoft, Amazon, Facebook, Google and Netflix which have collectively, recovery 94% of their March quarter decline. Outside these five companies, the US market's recovery rate from its trough (46.6%) is less than the MSCI World (48.7% - see chart).



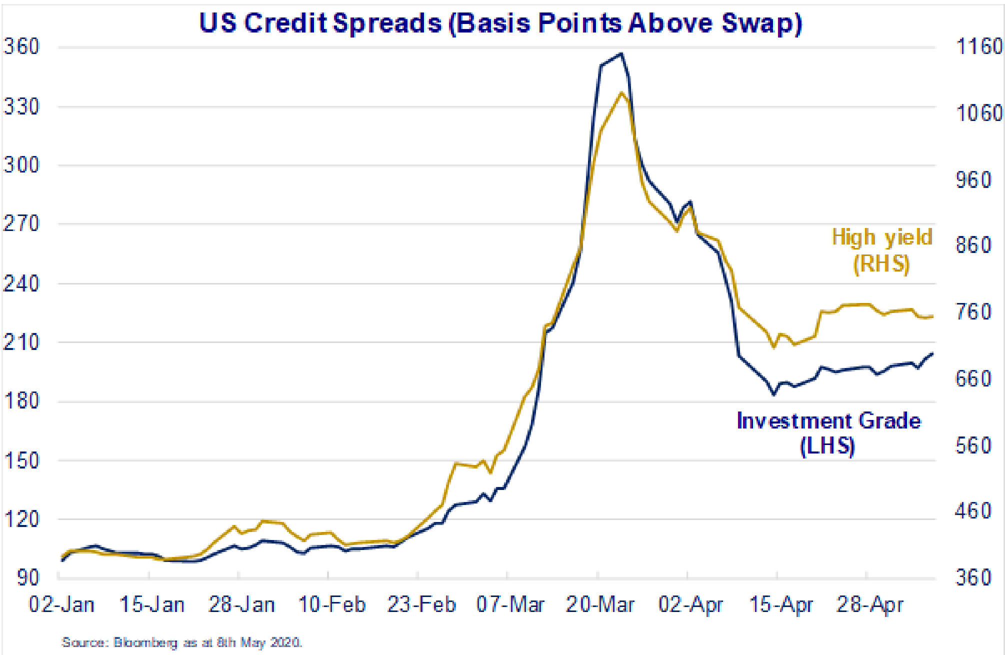
Earlier in Asian trade, things were less buoyant with Japan up (+0.3%) after returning from four days of national holidays, but China (-0.3%), Australia (-0.4%) and Hong Kong (-0.7%) all closed lower. Yesterday's performance still has Europe as the most dislocated market, closely followed by Australia, the UK and EM all of which are firmly in bear market territory (see chart below).

Futures markets indicate that the Australian market will open +0.1% higher at the bell, with Japan +0.3% higher when trading begins.

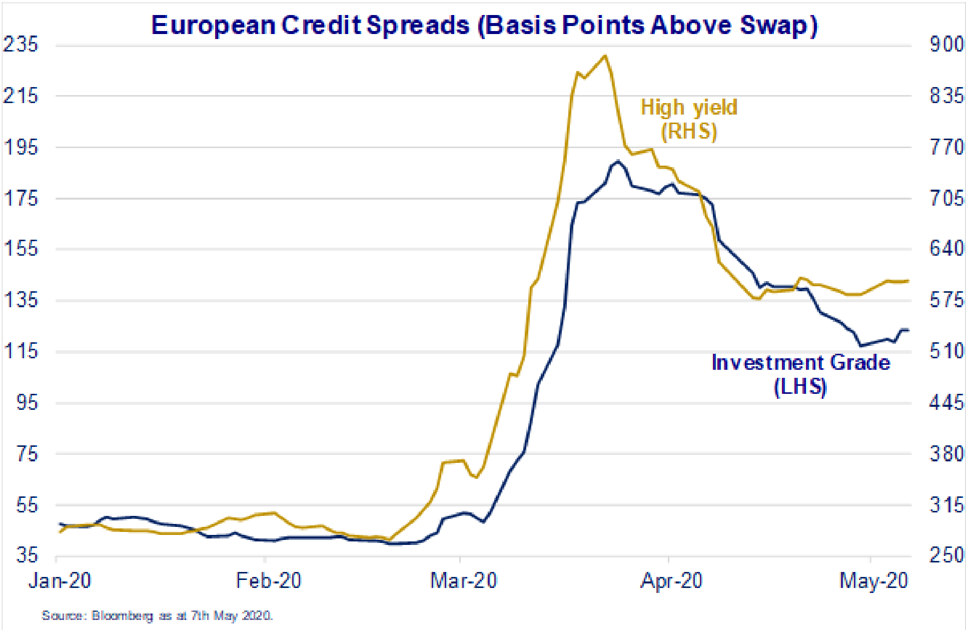


- **CREDIT**
    - Despite the positive lead from equity markets, US credit spreads widened overnight with investment grade spreads up +3 points to +204 bpts which is where they were one month ago and this pulled the recovery rate down to 60%. There were minor spread increases in all the sub-sectors led by cyclicals given the weak US labour market data released overnight which saw consumer discretionary spreads push out +4 points to +255 bpts and the recovery rate drop to 61%, with materials (+3 points to +259 bpts, 50%) also sold off.

      In the high-yield universe, spreads widened another +1.1 points to +754 bpts but the recovery rate remained at +50%. Both energy (-5 points, 1279 bpts, 67%) and tech (-5 points, +623 bpts, 46%) recorded lower spreads, but the impact here was outweighed by gains in healthcare (+6 points, +580 bpts, 64%) and senior financials +5 points, to 513 bps, 40%). But there wasn't much else.

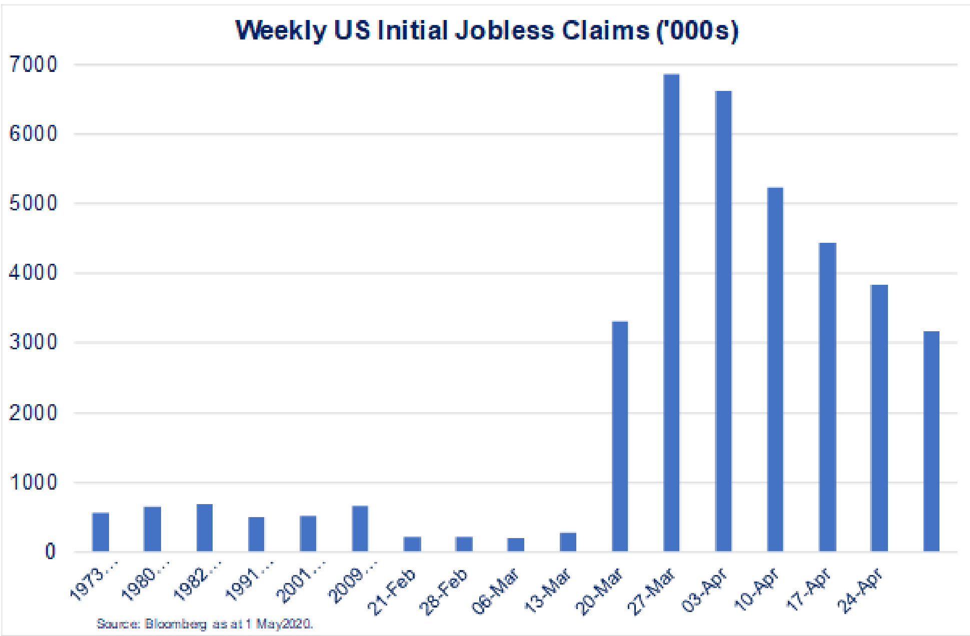


- European credit markets were quiet with the investment grade market steady at +125 bpts, 44%, as gains in subordinated financials (+3 points, 217 bpts, 51%) and consumer discretionary (+2 points, 188 bpts, 40%) were offset by declines in healthcare (-1 point, +65 bpts, 62%) and energy (-1 point, to 127 bpts, 28%). In the high-yield market, spreads increased +1 point to +600 bpts, but the recovery rate was steady at 47% with only consumer discretionary (+5 points +785 bpts, 45%) and industrials (-5 points, 705 bpts, 48%) recording any noteworthy movement, and even there is wasn't anything egregious.

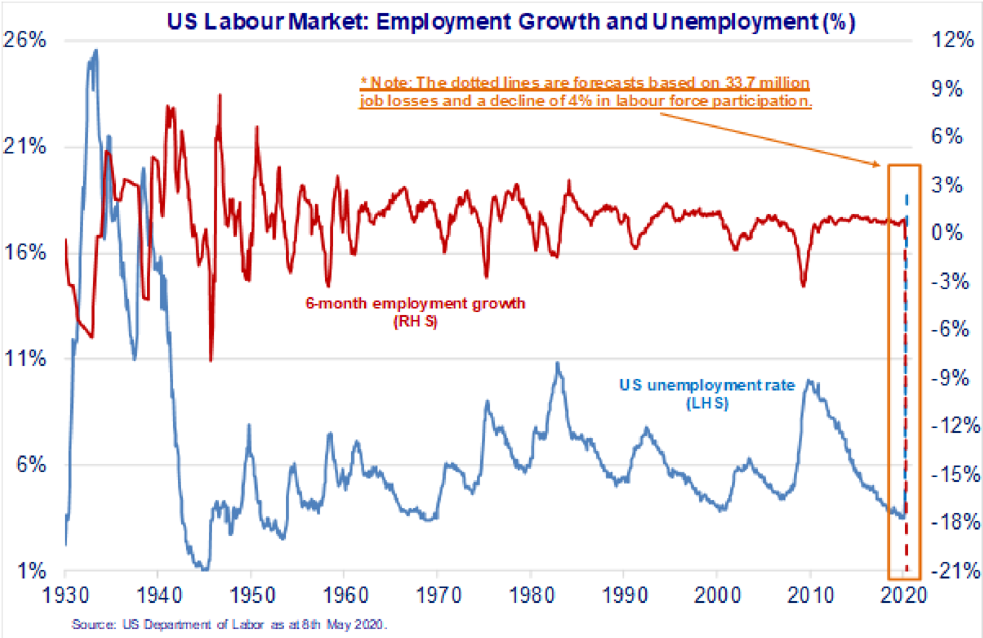


THE GLOBAL ECONOMY

- US initial jobless claims came down to 3.17 million for the week ended May 2nd which was above street estimates for a seventh consecutive week. While still at an elevated level they continue to moderate following the initial wave of layoffs in late March, but the collective number of layoffs is just staggering. That said, there was mixed news among the detail in that only 11 states recorded claims increases, which suggests that the dislocation is lessening, and some early-reopening states in the south such as Florida, Georgia and Tennessee not only saw initial claims fell significantly (-302k, -69k and -26k, respectively) but continuing claims dropped from the peak level in some states (including Florida at -60k and Ohio at -55k).



However, the overall continued strong weekly numbers indicate that the initial amount of job losses was much larger than expected as states have struggled to process the volume of applications. The April non-farm payrolls tonight is expected to decline around -24 million which by itself is enough to have unemployment up to 16% (see chart - although it could be less if the participation rate declines), the total dislocation is likely to reach just over -30 million which is enough to completely wipe out all the job gains recorded so far in the 21st century. Although the key unknown for the unemployment rate is the impact on the labour force size, the U-3 rate is likely to peak around 15%-20% and the rate of decline from there will depend on how successfully the US economy can reopen and how fast businesses want to rehire. Here, continuing claims (+4,636k to 22,647k) will be the most important number to watch.

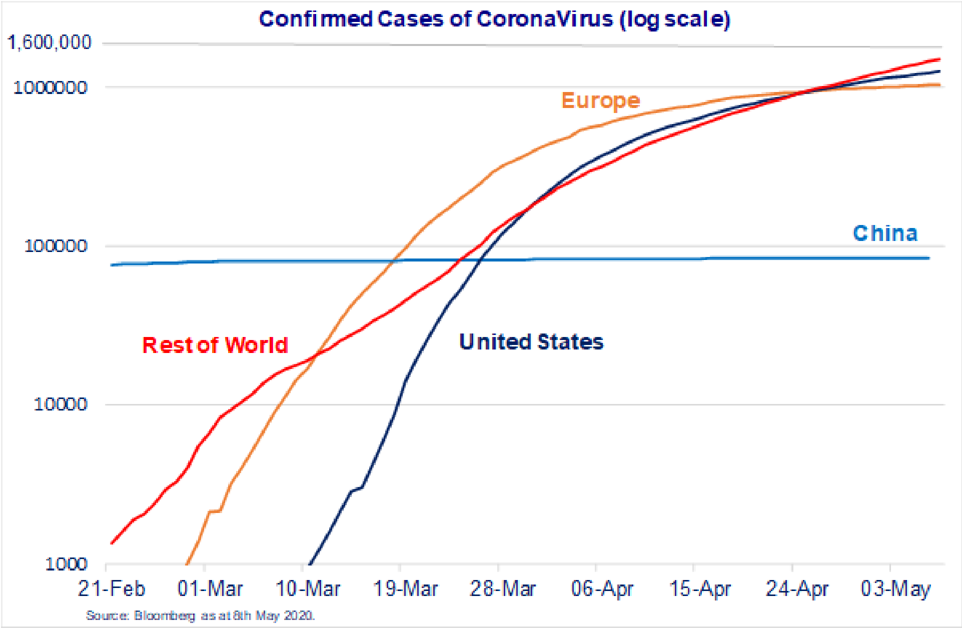


POLICY

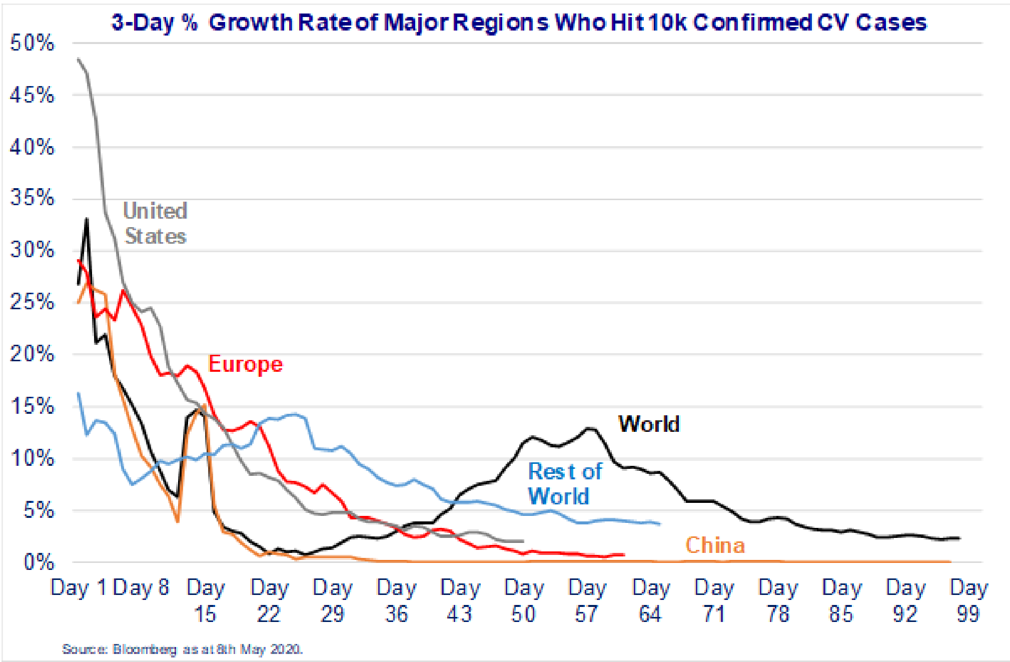
- The Bank of England kept its official policy rate unchanged at +0.1% and its QE target steady at £645 billion, although two members voted to increase QE by another £100 billion. The Bank stated that it expects 2020 economic output to decline -14% and this expected to rise +15% in 2021 and noted that it will take more action if market conditions deteriorated further, warning that risks to outlook were skewed to the downside as the effect of the lockdowns on demand will go on for a year with higher unemployment potentially persisting for longer than forecast. The Bank also noted that every additional two weeks of lockdown costs economy £28 billion in lost output and results in 0.75% increase in unemployment.

VIRUS UPDATE

- The number of global cases of COVID-19 stands at 3.84 million with another +82.5k cases overnight (that is the 37th day out of the past 38 where daily increases have topped 70k). The increase means 4 countries have more than 200k cases, 10 countries have more than 100k cases, 27 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 10 days another 836k cases have been confirmed. That said, the growth rate of daily confirmed cases has just started to increase (+2.3% since Monday) but is still coming down in a trend sense. Meanwhile, deaths rose +5.2k overnight to 269k, with the US now over 75k and the UK, Spain, Italy and France all over 25k, and the death rate sits at 7.0% (although final numbers are not yet in).

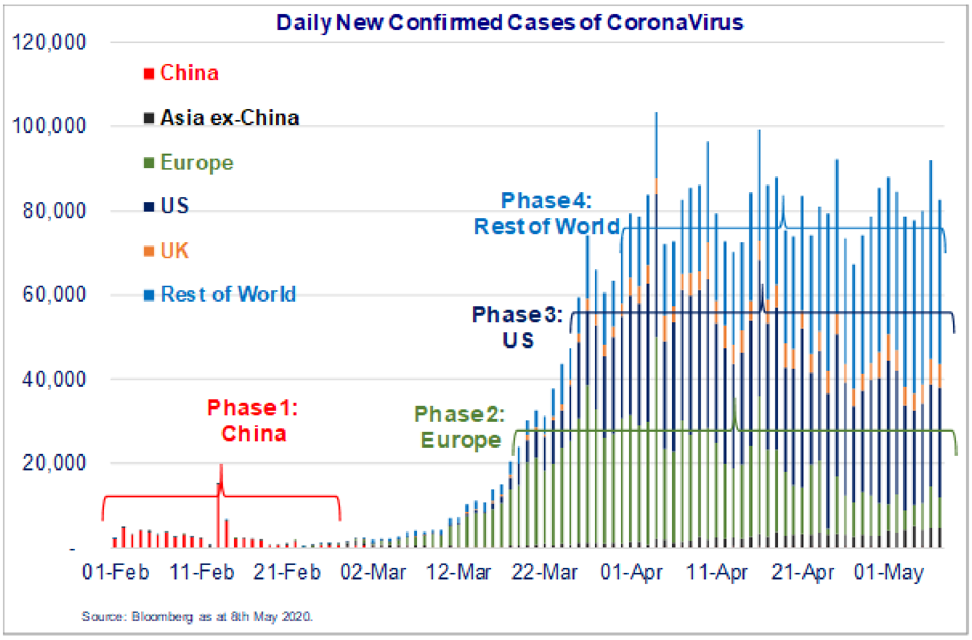


- We break the infections into four groups – the US, Europe, China and 'others' and the rest of the world outside the G3 economies (+38.8k (5-day low) to 1.5 million) now has the most total cases and highest daily new cases (and by a considerable margin) followed by the US (+26.1k (5-day high) to 1.25 million) and Europe (+7.2k to 1.03 million), with the latter two's daily increases, in terms of percentages, grinding 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 (+11.2k (record high) to 177.2k) and Brazil (+5.8k to 132.4k).

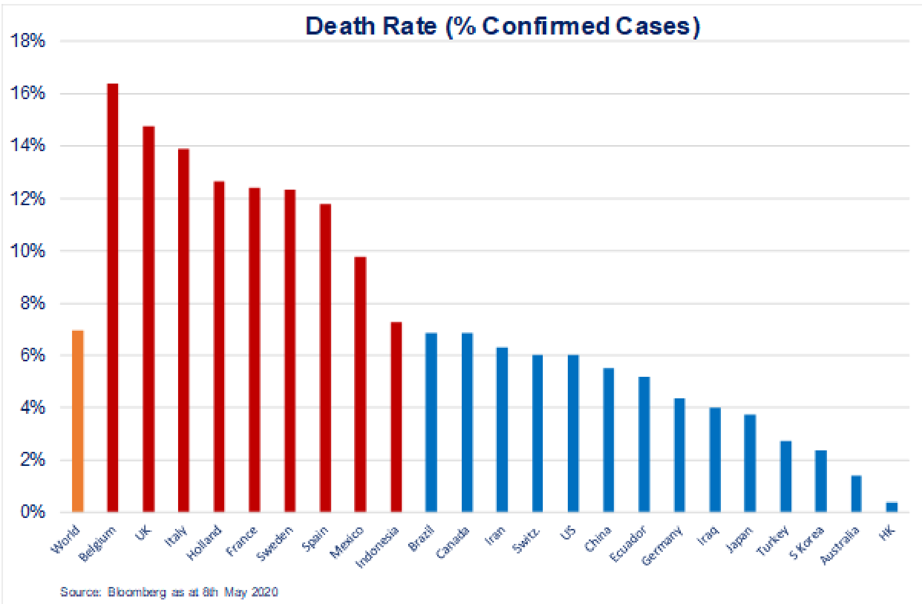


- Among countries, the most cases are in the US (+26.4k to 1.25 million), Spain (+1.1k to 221.4k), Italy (+1.4k to 215.9k), the United Kingdom (+5.6k to 208k), Russia (+11.2k to 177.2k), France (+0.7k to 174.9k), Germany (+1.3k to 169.4k), Turkey (+2.0k to 133.7k), Brazil (+5.8k to 132.4k), Iran (+1.5k to 103.1k) and China (+4 to 84.0k). Australia confirmed cases rose +6 to 6,900 yesterday which placed us 49th in terms of total infections.

  Elsewhere, Singapore recorded +741 new cases to 20.9k 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 (+338 to 12.8k) and the Philippines (+339 to 10.3k). Note, final numbers for yesterday at not in yet so these numbers can rise.



- The global death rate was steady at +7.0% with another +5.2k fatalities overnight bringing the global total to 269.0k. The US (+2.1k) has the most deaths at +75.5k, with Italy (+0.3k to 30.0k), the UK (+0.5k to 30.7k), Spain (+0.2k to 26.0k) and France (+0.2k to 26.0) all over +25k. The death rate is highest in European countries where the health systems have collapsed led by Belgium (steady at 16.4%), the UK (-0.1% to 14.8%), Italy (+0.1% to 13.9%), the Netherlands (steady at 12.6%), France (steady at 12.4%), Sweden (steady at 12.3%), and Spain (+0.1% to 11.8%). However, several emerging markets are now on the leader board including Mexico (steady at 9.8%), Indonesia (+0.1% to 7.3%) and Brazil (steady at 6.8%).



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Yours sincerely,

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MORE INFORMATION

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