

THOUGHTS ON THE MARKET

9th July 2020 - So what's next?

SUMMARY

- It was a quiet night on markets with a light economic and policy calendar leaving COVID-19 case numbers the only market-altering news, but investors decided today that the declining death rate and vaccine optimism, were more important than rising infection rates which enabled the US markets to push higher. In contrast, other equity and credit markets were mixed, but gold (+1.8% to USD1,809) rallied beyond USD1,800 per troy ounce having recently been given everything they desired from the Fed - a commitment to zero rates, lower treasury yields without yield curve control, continued asset purchases and a depreciating US Dollar. This is a formidable line up, which combined with rising COVID-19 case numbers, helps create plenty of demand for the income-less asset.

In other markets, US Treasuries rose +2 points to 0.66% with curve steepening, oil rose +0.6% to USD40.88 per barrel, and most G10 currencies rallied against a weaker US dollar led by Sterling (+0.9%), AUD (-0.7% to USC69.81) and the Euro (-0.5%), but the Yen (+0.4%) bucked the trend.

- After a surge in April and May, regional sharemarkets have grinded higher since and a key question is what comes next. It is clear from data over the past week (including a record rise in the US non-manufacturing ISM for June (+11.7 to 57.1)) that a solid global economic rebound started in May and continued in June as economies re-opened, but now more of the US, Australia and the world remain stuck at home which is constructive for tech shares, but raises numerous questions about ex-tech earnings, and whether market valuations are remotely sustainable.

For the market to advance further from here we need either more stimulus, or a hand-over from valuation expansion to earnings delivery, and given valuations, for that we need a perfect hand over from fading government stimulus to a robust labour market recovery. On those fronts, there are plenty of conflicting impulses from the private sector, policy support and the pandemic, and as such at present it's hard to get a precise reading on how developments are likely to evolve. At present, the market is giving the government and corporate sectors the benefit of the doubt that further stimulus (both fiscal and monetary) will be provided, and that the corporate sector will begin to recover its surplus cashflow in the September quarter (when the global fiscal impulse begins to turn negative).

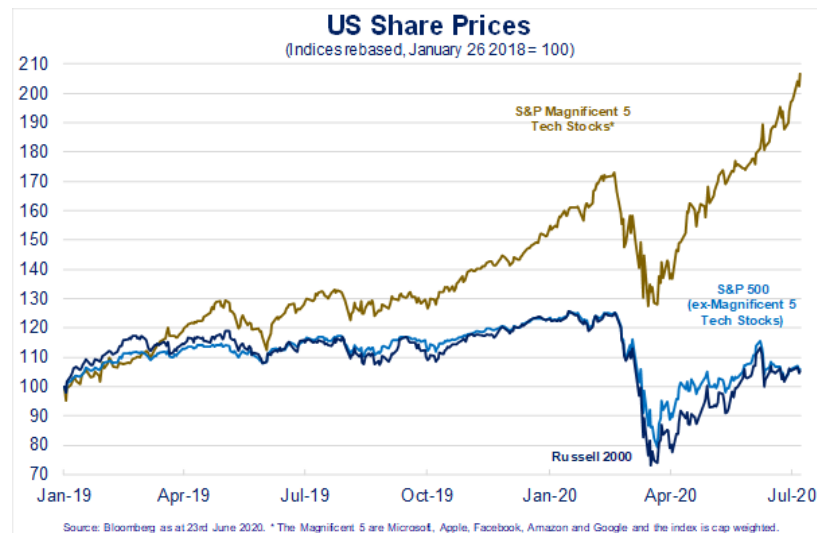
In terms of the global economic recovery, we still believe it will be strongest in North Asia (driven by China and increase IT manufacturing), Europe (from a deeper hole, better virus containment and therefore more sustainable reopenings), Australia (provided the Morrison Government provides additional support and Victorian case increases are contained and reversed), but its likely to underwhelm in the US (as lockdown and the absence of a vaccine weighs on their large consumer sector, and where 60% of June job gains were in hospitality, retail and leisure which are threatened by rising case numbers) and other economies including LATAM and Japan.

- Although final numbers are not in for another couple of hours, the number of global cases of COVID-19 was 12.0 million with another +183.4k cases so far overnight (before Mexico, Ecuador, and some US states report their numbers) which means that Wednesday was the 41st occasion in the past 43 days where daily increases have topped 100k (and the other two were over 99k!). This means 4 countries have more than 700k cases, 16 countries have more than 200k cases and 21 countries have more than 100k cases. It took 73 days to record 1 million cases, and after this each subsequent million has taken 13 days, 11 days, 12 days, 10 days, 11 days, 8 days, 8 days, 7 days, 6 days, 5 days and 5 days. More importantly, the growth rate of daily confirmed cases (+1.6% since Sunday) is once again stabilising. Meanwhile, deaths stand at 547.9k and the death rate dropped for a sixty third straight day to 4.6%.

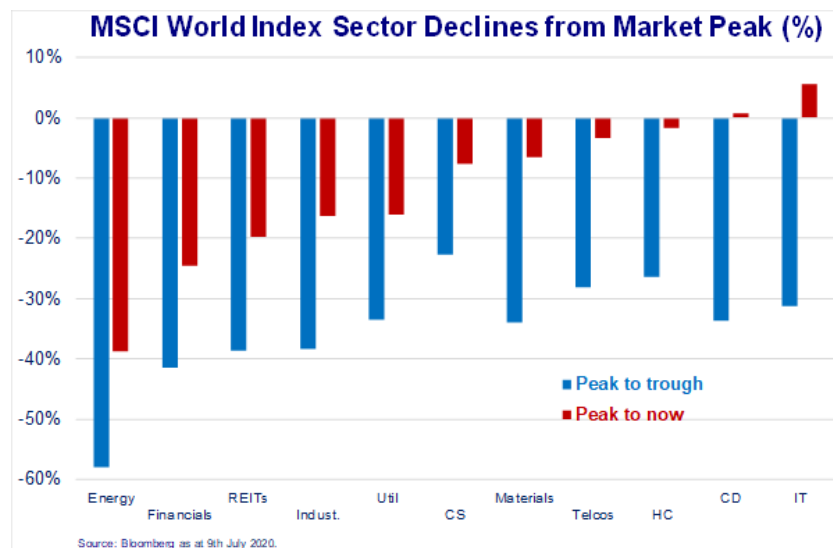
FINANCIAL MARKETS

• EQUITIES

- The MSCI World Index rose +0.4% overnight but there were only gains in 4 sub-sectors as a large rally in tech (+1.4%) offset losses in the traditional cyclical parts of the market. It was the Megacap tech stocks including Apple (+2.3%), Amazon (+2.7%) and Twitter (+7.3%) which outweighed losses elsewhere with investors betting that increased Cov-19 case numbers should be constructive for earnings as more of the US and global population buy on-line. Looking under the bonnet, the global rebound has been very narrow since end-May with US tech firms up +18.1%, whereas the remainder of the US market is down -1.6% (see chart) and the Russell 2000 index splits the difference being up only +2.4%.

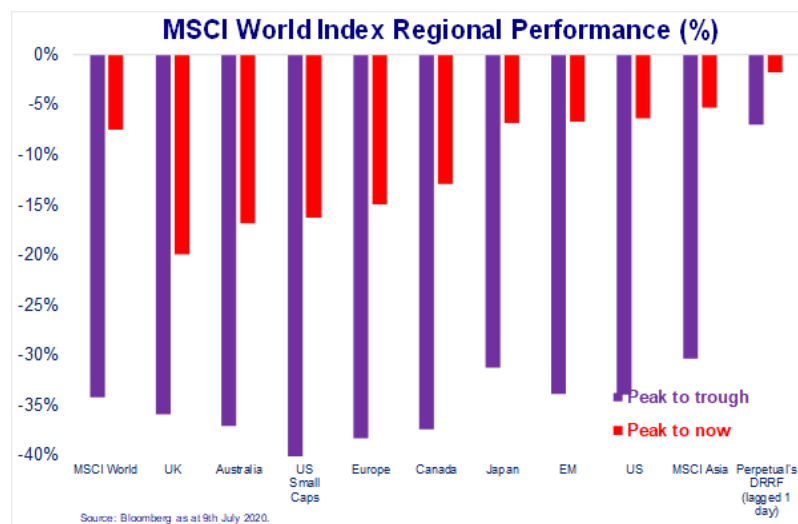


Outside, tech the only other sectors to record positive performance overnight were the defensive sectors including telcos (+0.6%) and utilities (+0.8%). In contrast, the typically cyclicals declined led by energy (-0.6%), consumer discretionary (-0.5%) and industrials (-0.3%). The overnight movements saw energy (-38.8%) and financials (-24.6%) remain in bear market territory with REITs (-19.8%) knocking on the door, whereas consumer discretionary (+0.8%) and IT (+5.5%) has staged a complete recovery (see chart).



- In terms of regions, the US led the pace of gains overnight given its large tech stocks which continue to benefit from the increased tendency of households and workers to remain at home, with the NASDAQ (+1.4%) rising to yet another fresh record high. The tech-heavy index outperformed the S&P 500 (+0.8%), Russell 2000 (+0.8%) and the Dow Jones (+177 points, +0.7%, to 26,067) in a day which lacked incremental drivers. Similarly, the MSCI Asia Pacific index closed +0.5% higher with China (+1.6%) continuing to surge in the wake of its economic recovery which pulled up Hong Kong (+0.6%) despite rising risks from President Trump threatening to pull support for its pegged currency, but these advances were partially offset by losses in Korea (-0.2%), Japan (-0.8%) and Australia (-1.5%).

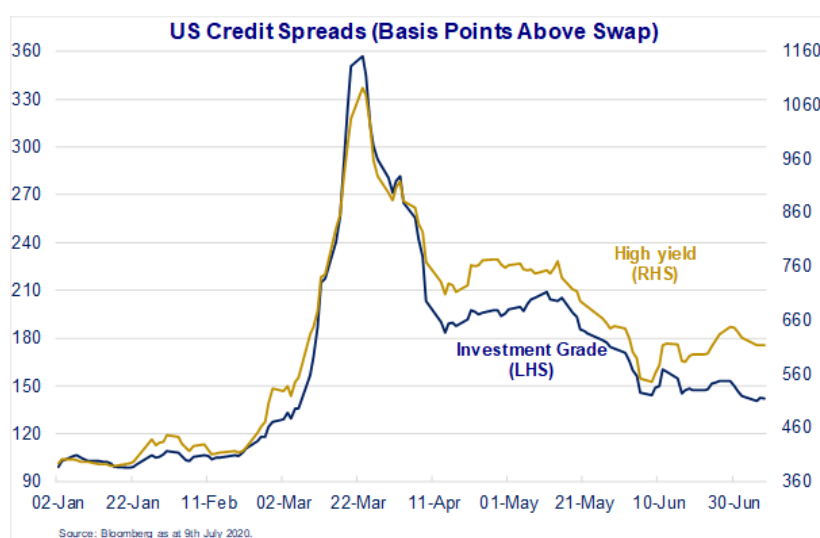
Meanwhile, European markets dropped sharply (-1.1%) for a second consecutive session despite a modest number of daily new COVID-19 numbers and a lack of macro directional drivers. That said, since the end of May, the European market (+7.7%) has outperformed all its advanced economy peers and therefore there could be some profit taking with investors worried that US case surges may be a bellwether for Europe. Among regional markets losses were led by Spain (+1.6%), France (-1.2%) and Germany (-1.0%) all of whom recorded bowler's centuries, with Italy and the UK (both -0.6%), Sweden (-0.5%) and Switzerland (-0.3%) outperforming but still falling. The overnight moves meant that UK (-20.0%) is back in bear market territory and Australia (-16.8%) is not far away either (see chart), with MSCI Asia now the best performed market having recovered 83% of the March quarter losses, which is more than the US (81%) and Japan (78%).



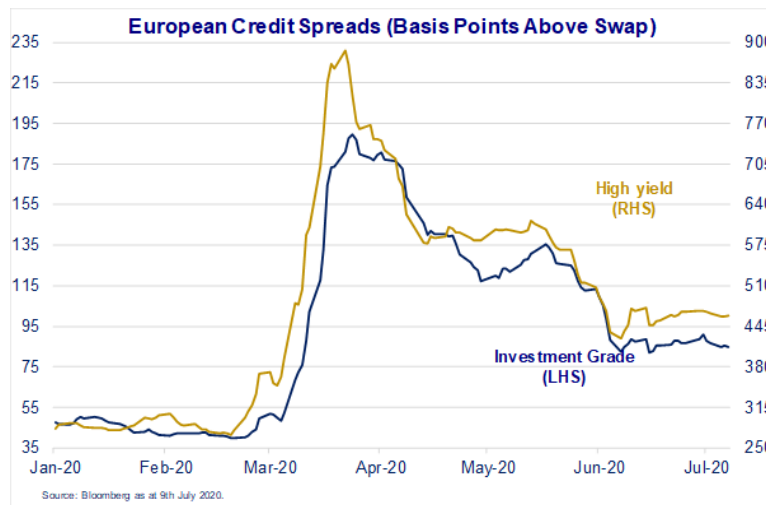
- Futures markets suggest a positive opening in Asia with gains expected at the bell in Hong Kong (+0.8%), Sydney (+0.8%) and Tokyo (+0.5%).

• CREDIT MARKETS

- Regional credit indices were little changed overnight with spreads in the **US investment grade space** declining -0.5 of a point to +142 bpts, which increased the recovery rate to 85%, with lower risk premiums in 9 of the 11 sub-sectors. Overall, the movements were modest led by materials (-2 points, +182 bpts, 82%) as commodity prices continue to improve on rising China demand, and utilities (-1 point to +139 bpts, 83%) although it was hard to pinpoint the catalyst here. In the high yield space, spreads rose +0.2 of a point to +614 bpts, which kept the recovery rate from the March peak at 70%. Among the sub-sectors 7 of the 11 market areas recorded higher risk premiums given the absence of a direct Fed backstop, with higher spreads led by energy (+4 points, +967 bpts, 88%) despite a higher crude price, industrials (+3 points, +728 bpts, 44%) which continues to lag given the impending incomplete recovery by end-2021 which will weigh in industrial production outside IT, and healthcare (+2 points, +549 bpts, 69%).

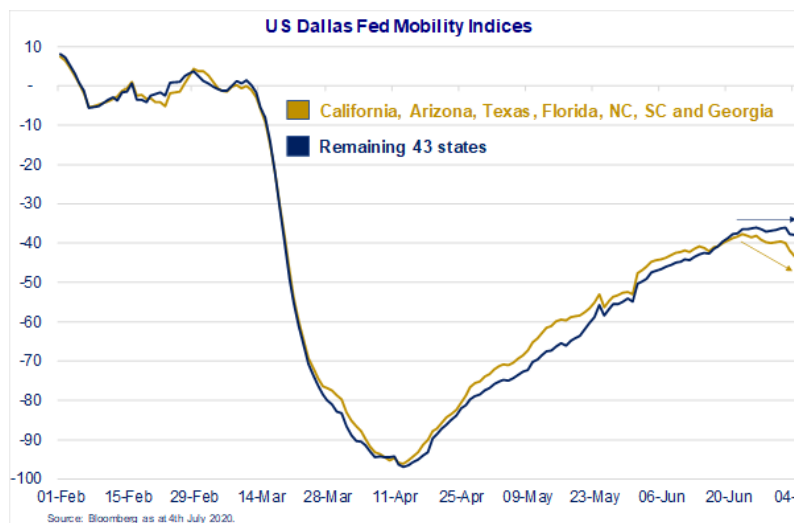


- **European credit markets** were also mixed with spreads in the investment grade universe declining -0.6 of a point to +85 bpts, which saw the recovery rate steady at 70%. There were spread decreases in 10 of the 11 subsectors, but only one was more than a basis point (telcos +1 point, +84 bpts, 63%). In the high yield space, it was equally quiet with spreads increasing only +1 point to +462 bpts which kept the recovery rate at 69%. Eight of the 11 sub-sectors recorded higher spreads led by energy (+5 points, +574 bpts, 69%), healthcare (+3 points, +321 bpts, 70%) and materials (+2 points, +406 bpts, 71%) and these capital losses were partially offset by senior financials (-2 points, +360 bpts, 76%).



THE GLOBAL ECONOMY

- There were no material data releases overnight, but there does appear to be an impact of rising COVID-19 case numbers in the southern and South-West United States, which has seemingly sapped the energy for re-opening with the recent activity improvement starting to level off. If this continues, the seemingly rapid rebounds in jobs, retail sales and some other measures of activity in May and June are unlikely to persist and could weigh on market trends if policy support is not forwarded. Interestingly, the latest quarterly survey of more than 500 company chief financial officers, conducted jointly by the Atlanta and Richmond Fed offices and Duke University, showed that the finance chiefs were, on average, worried about continued weak demand and expected the job recovery to stall for the rest of the year.
- Meanwhile, the US Fed's economic mobility index showed that the US economic recovery has started to decline in the states with surging case numbers which has led to the re-introduction of restrictions (California, Arizona, Texas, Florida, North and South Carolina and Georgia - see chart), but states outside of these have also flattened and the question here is whether the break in the upward trend from April is just temporary or something more sustained. Of concern here may be small businesses, many of which are being left out of relief efforts because they lack banking relationships which were central to the offering of recent relief measures. If mobility is stalled, the Fed is not the right body to undertake a response and Congress is split about on-going support.



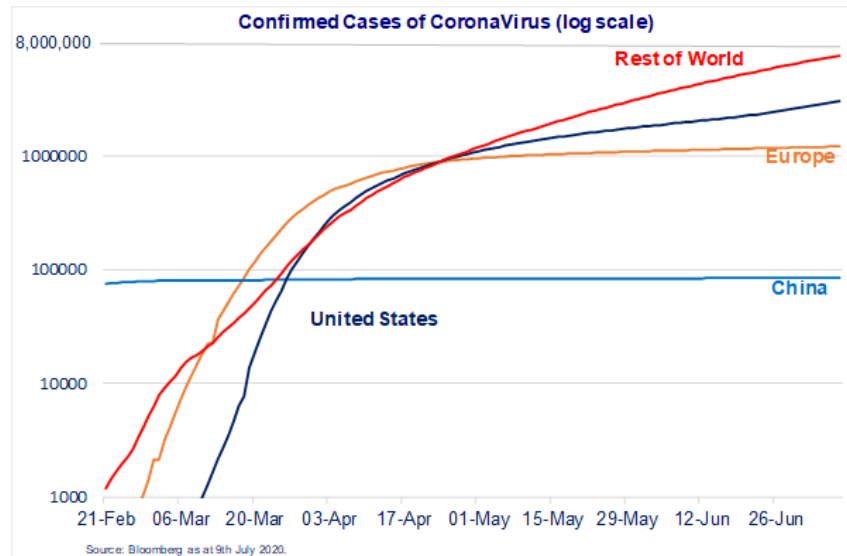
POLICY

- There were no material policy announcements overnight.

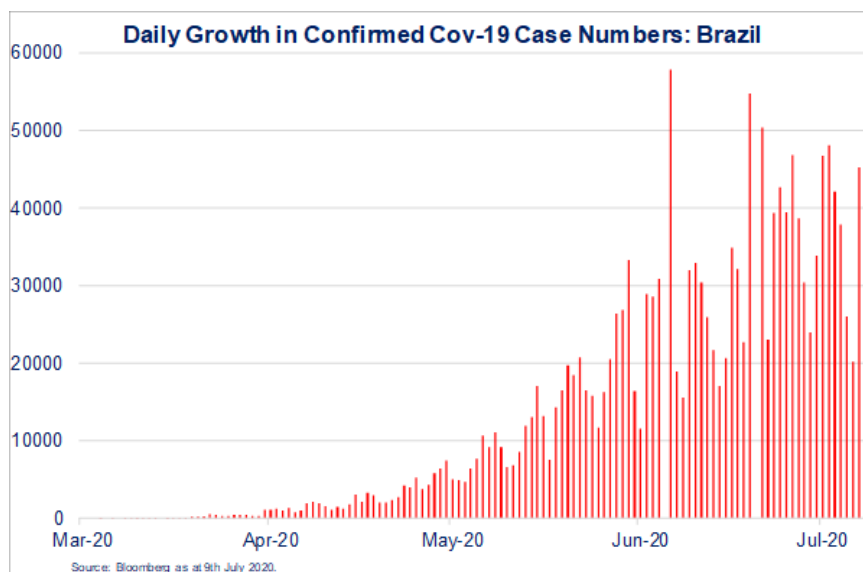
VIRUS UPDATE

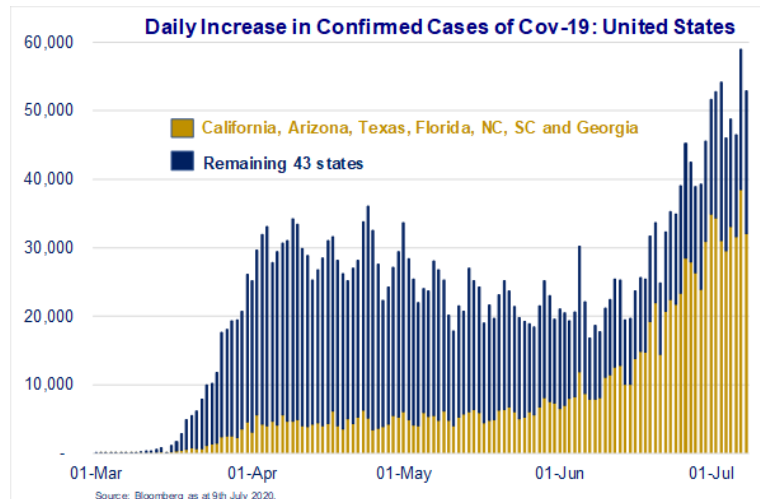
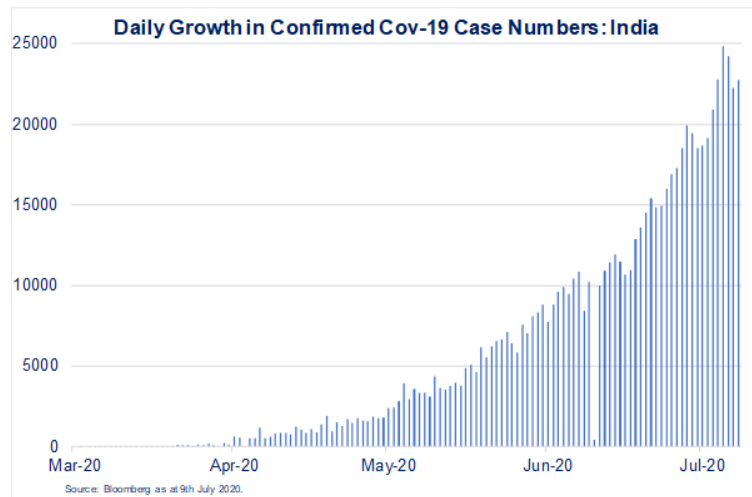
- Although final numbers are not in for another couple of hours, the number of global cases of COVID-19 was 12.0 million with another +183.4k cases so far overnight (before Mexico, Ecuador, and some US states report their numbers) which means that Wednesday was the 41st occasion in the past 43 days where daily increases have topped 100k (and the other two were over 99k!). This means 4 countries have more than 700k cases, 16 countries have more than 200k cases and 21 countries have more than 100k cases.

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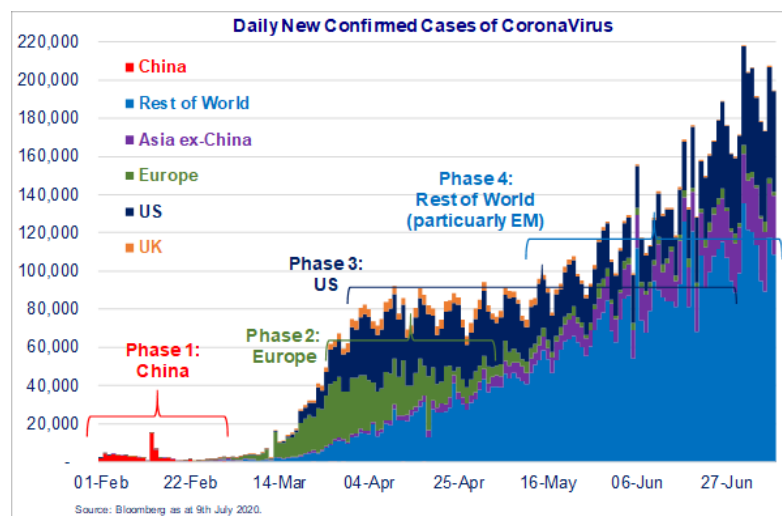
- We break the infections into four groups – the US, Europe, China and ‘others’ and the rest of the world outside the G3 economies now has the most total cases (+102k to 7.6 million) and highest daily new cases (and by a considerable margin) followed by the US (+47.2k to 3.04 million) and Europe (+2.3k to 1.22 million - see chart). The issue for the US is that they never flattened their curve which means economic opening has not been associated with lower case numbers. Within the rest of the world, the three concerns here are Brazil (+44.5k to 1.71 million, which is the second highest in the world), India (+22.8k (third highest) to 742.4k) and Russia (+6.5k to 700.0k, fourth highest) (see charts below).



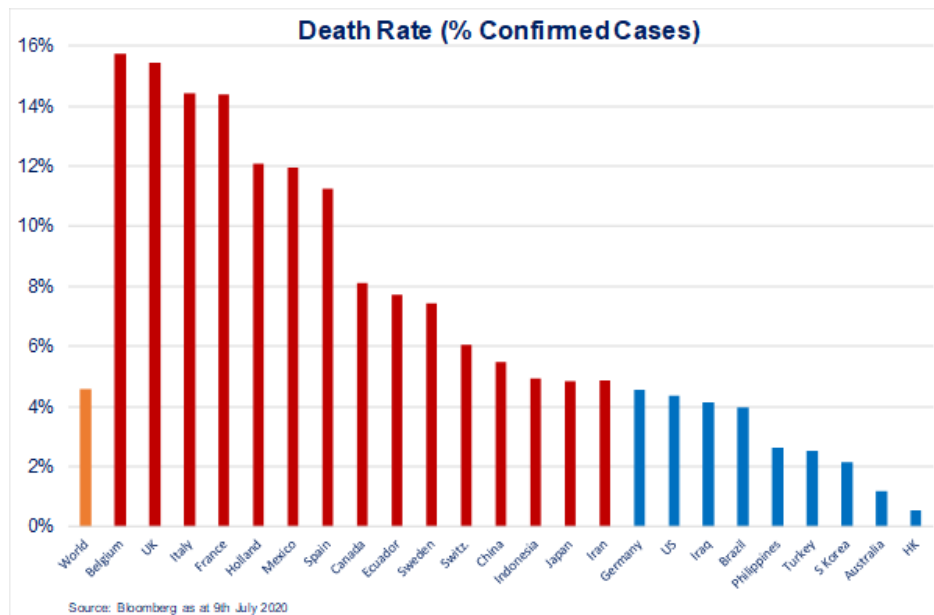


- Among countries, the most cases are in the US (+52.6k (so far) to 3.05 million), Brazil (+44.6k to 1.71 million), India (+22.8k to 742.4k), Russia (+6.5k to 700.0k), Peru (+3.6k to +312.9k), Chile (+2.1k to 303.1k), the United Kingdom (+0.6k to 288.5k), Mexico (not reported, +268.0k), Spain (+0.4k to 252.5k), Iran (+2.7k to 248.4k), Italy (+0.2k to 242.4k), Pakistan (+3.0k to +237.5k), South Africa (not reported, +224.7k), Saudi Arabia (+3.0k to 220.1k), Turkey (+1.0k to 208.9k) and France (not reported, 206.1k). Australia confirmed cases rose +148 to 8,886 yesterday which placed us 69th in terms of total infections.

Elsewhere, Singapore recorded +0.2k new cases to 45.3k 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, but Indonesia (+1.9k to 68.1k) is now on the rise and has the most cases in the region, and the Philippines (+2.5k to 50.4k) is also on an upward trend.



- Although final numbers are not in until 1pm AEST, the global death rate declined for a sixty third straight day to 4.6% with the global total to 547.9k after another 4.3k deaths overnight. The US (+0.74k so far) has the most deaths at +132.2k, with Brazil (+1.2k to 68.0k), the UK (+0.1k to 44.6k), Italy (+0.02k to 34.9k), Mexico (not reported, +32.0k), France (+3 to 29.9k) and Spain (+4 to 28.4k) all over +25k. The death rate is highest in European countries where the health systems have collapsed led by Belgium (steady at 15.7%), the UK (steady at 15.5%), Italy (steady at 14.4%), France (steady at 14.4%), the Netherlands (-0.1% to 12.1%), Spain (-0.1% to 11.3%) and Sweden (-0.1% to 7.4%). However, several emerging markets are now on the leader board including Mexico (steady at 11.9k), Ecuador (-0.2% to 7.7%), Indonesia (-0.1% to 4.9%) and Brazil (-0.1% to 4.0%).



Yours sincerely,



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