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weekly market update

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IN BRIEF

- In the US, the second quarter GDP number, measuring the growth in the US economy, was down 32.9%. Although slightly better than forecast, this is by far the largest retrenchment in US GDP in modern history.
- There were mixed fortunes in the credit markets (investment grade and high yield bonds). High yield had a good week in the US, as continued market support from the Federal Reserve bolstered the confidence of yield hungry investors.
- In China there were signals that the economic recovery is continuing, with improving business sentiment, as China's manufacturing activity rose for the third consecutive month.

OUR VIEW

Can you tell us about the latest US Q2 GDP (gross domestic product) figure?

It was the big event for the week, the US's GDP number that measures the size of the US's economy was down 32.9% in Q2. However, it did come in slightly better than forecast, but this is by far the largest retrenchment that we've had in US GDP in modern history. And if we couple this with what happened in Q1, when growth dropped 5%. It means that the US is in technical recession. If we look at what was hurting across the period, it was everything- because spending just stopped. The only area where we saw some growth was federal spending, when the government stepped in with lots of packages. This is an indication of how growth figures could look globally for Q2 2020.

How has this been affecting government bond markets?

What we saw last week was a lot of money flowing into US government bonds. As a result US government bond yields dropped (as bond prices increase, bond yields fall). And this was also reflected globally, and we also saw bonds yields dropping in the eurozone. The market doesn't believe that we are near any kind of normalisation of interest rate policy and central banks are going to keep the low levels of interest rates for the near future.

What about high yield bonds?

There were mixed fortunes in the credit markets (investment grade and high yield bonds). High yield had a good week in the US, as continued market support from the Federal Reserve bolstered yield-hungry investors' confidence. However, yields rose in the eurozone over the week. But when you look at the full month of July, it was a good month for high yield in general as an asset class. In the US high yield bonds returned about 4% and in the eurozone high yield bonds were up about 2%.

How is the US corporate earnings season progressing?

Up to Friday last week 63% of companies had reported their earnings, with 84% of those companies reporting earnings above estimates, which is positive. There was an expectation that company earnings were going to be down around 44% and as of

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last week, they had fallen 35%. Big tech companies have been a particular market focus so it's encouraging to see that those companies are still delivering strong earnings.

And in Asia?

In China there were signals that the economic recovery is continuing, with business sentiment improving, as China's manufacturing activity rose for the third consecutive month. This is mainly due to the ongoing policy support that we're seeing, but also because we've seen a rebound in exports. Consumer services are still the laggard in terms of recovery. What we're seeing is Chinese consumers adapting more to online services while the traditional areas of consumption that involve human interaction have been slower to return to normal. However, on the whole demand conditions do appear to be improving. Importantly, we have seen some further outbreaks of Covid-19 in Asia, particularly in China. We're seeing local outbreaks or clusters, really across some of the countries that initially dealt with the pandemic effectively, that is mainland China, Hong Kong, South Korea, and also Australia. China has seen the largest outbreak of the virus since Wuhan over the last couple of weeks, with over 500 cases in a Northwest region. Hong Kong has also seen a surge over the last couple of weeks, so there's a stop/start in these countries that initially dealt with the pandemic effectively. And this is something to monitor.

The big news this week will be the release of the US unemployment data.

We've got unemployment data coming out on Friday. Looking back to April, unemployment spiked to 14.7% and it's been coming down steadily ever since. This is important, because as people get back to work, this feeds into improvements in the economy and a pickup in GDP figures. There's a big correlation between unemployment levels and growth levels in the economy, so we hope that they continue to come down at a healthy pace.

WHAT IS NEXT FOR INVESTORS?

- Markets will look for signs of increasing Covid-19 infection rates in the US, which could upset stock markets.
- Elsewhere, gold and government bonds should continue to act as relative safe-haven assets.
- In the meantime, patience and a long-term view might be needed while waiting for a revival of economic activity and asset prices.